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the oxford companion to the
ECONOMICS



of **SOUTH
AFRICA**

Edited by

Haroon Borat, Alan Hirsch,
Ravi Kanbur, and Mthuli Ncube

The Oxford Companion to the Economics of South Africa

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■ PREFACE

In 1994 South Africa saw the end of apartheid. The new era of political freedom was seen as the foundation for economic prosperity and inclusion. The last two decades have seen mixed results. Economic growth has been volatile. While inequalities in public services have been reduced, income inequality has increased, and poverty has remained stagnant. Throughout this period, there has been vigorous debate on economic strategy, with the appearance of programmes with acronyms like RDP, GEAR and, most recently, NGP. Behind the acronyms lie basic and unresolved differences on an appropriate strategy for an economy like South Africa, with a strong natural resource base but with deeply entrenched inherited inequalities, especially across race.

As the twentieth anniversary of the transition to democracy approaches in 2014, the economic policy debates in South Africa are in full flow. They combine a stock-taking of the various programmes of the last two decades with a forward-looking discussion of strategy in the face of an ever open but volatile global economy. This volume contributes to the policy and analytical debate by pulling together perspectives on a range of issues—micro, macro, sectoral, country-wide and global—from leading economists working on South Africa.

The economists invited are from within South Africa and from outside; from academia and the policy world; from international and national level economic policy agencies; and from the private sector. The contributors include recognized world leaders in South African economic analysis, as well as the very best of the younger crop of economists who are working on South Africa—the next generation of leaders in thought and policy. Other than the requirement that it be analytical and not polemical, the contributors were given freedom to put forward their particular perspective on their topic.

We hope that this *Companion* will contribute to analysis and to the policy discourse as South Africa looks ahead in the next 20 years to meeting the economic promise of 1994—rapid and inclusive development which will raise the well-being of all South Africans.

H.B.

A.H.

R.K.

M.N.

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Economic policy in South Africa—past, present and future

HAROON BHORAT, ALAN HIRSCH, RAVI KANBUR
AND MTHULI NCUBE

1 Introduction

In 1994 South Africa saw the end of apartheid. The new era of political freedom was viewed as the foundation for economic prosperity and inclusion. The last two decades have seen mixed results. Economic growth has been volatile. Whilst inequalities in public services have been reduced, income inequality has increased and poverty levels have remained stagnant. Throughout this period, there has been vigorous debate on economic strategy, with the appearance of programmes with acronyms like RDP, GEAR and, most recently, the NGP. Behind the acronyms lie basic and unresolved differences on an appropriate strategy for an economy like South Africa, with a strong natural resource base but with deeply entrenched inherited inequalities, in particular across race.

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The economists invited are from within South Africa and from outside; from academia and the policy world; from international and national level economic policy agencies; and from the private sector. The contributors include recognized world leaders in South African economic analysis, as well as the very best of the younger crop of economists who are working on South Africa—the next generation of leaders in thought and policy. Other than the requirement that it be analytical and not polemical, the contributors were given freedom to put forward their particular perspective on their topic.

This overview is not and should not be a mere summary of the 50 or more entries in the volume. Rather, it represents the editors' own perspectives on South Africa's economic trajectory and the ongoing debates on economic policy. It draws on but goes beyond the entries in this volume. Section 2 begins with a broad account of the evolution of the economy since 1994. Section 3 focuses on macroeconomic policy, including fiscal, monetary and exchange rate policy. Section 4 turns to the question of structural transformation and the range of sectoral issues to which it gives rise. Section 5 takes up perhaps the most important element in the current debates—how to address the problems of unemployment, inequality and poverty. Section 6 concludes the overview.

2 Economic development in South Africa since 1994

Since the onset of democratic rule, through to the end of 2012, the South African economy recorded an average annualized growth rate in real GDP of 3.28 per cent. Specifically, the period under review will show that 73 of the 76 quarters in the period 1994–2012 recorded positive economic growth. The three-year period 2005–07 represented the economy's most successful growth spurt, as annualized real GDP growth rates exceeded 5 per cent in each consecutive year. It was only in the 2008–09 period that the economy suffered from the consequences of the global financial crisis, as growth was negative on average for 2009. The recession, despite being short-lived, has had—as we show in detail later in this section—significant labour market consequences which the South African economy is still trying to recover from. Importantly, however, the period prior to the recession represents probably the longest period of uninterrupted positive economic growth in South Africa's modern history.

This growth, however, belies the key set of structural changes that the economy has undergone in the post-1994 period. These structural shifts are manifest in four key outcomes: first, the share of mining in GDP stood at 11 per cent in 1994, but has steadily declined over an 18-year period to its current 5 per cent in 2012. In short, the share of mining in national output has more than halved in the post-apartheid period. Second, the manufacturing sector has remained stagnant. From constituting 19 per cent of total output in 1994, it was marginally below this, at 17 per cent of real GDP in 2012. Third, the key sectoral growth engine in this period has been the financial and business services sector, as the latter witnessed a rise in its share of national output, from 17 per cent in 1994 to 24 per cent in 2012—a 7 percentage point increase. Finally, one other subtle increase in the share of GDP emanated from the transport and telecommunications sector, driven in large part by the revolution in the mobile phone industry in South Africa and the rest of Africa.

In essence, then, the South African economy has moved from its dependence on the non-renewable sector—historically a key contributor to employment and growth

generation—to an economy now very much defined by a globally competitive and highly sophisticated financial and business services sector. Indeed, the Global Competitiveness Index of the World Economic Forum ranks South Africa 3rd of the 144 economies in the world in terms of financial market development (World Economic Forum, 2013). In contrast, the economies of Brazil, Russia, India and China—rank 46th, 130th, 21st and 54th respectively. Despite this high level of financial sophistication, South African manufacturing remains an inadequate contributor to both employment and GDP. Whilst the average middle-income country yielded a manufacturing share of GDP at 21.2 per cent, and the estimate for upper middle-income economies was 22.5 per cent (World Bank, 2013), the figure for South Africa as noted above is 17 per cent, having declined from its contribution in 1994. The lack of a dynamic, job-generating and competitive manufacturing sector must therefore remain one of the key growth challenges in the South African economy.

The period since 1994 was marked most notably by South Africa's full re-entry into the global economy. This re-entry also saw South Africa embark on a rapid process of trade liberalization, which yielded a sharp increase in export and import volumes. Data for the 1994–2012 period show that on the basis of the index of real export volumes, non-gold exports more than doubled over these years. It remains true, however, that even outside of South Africa's high share of commodity exports, manufactured exports from South Africa readily contain a high share of primary commodities as inputs. In essence, South Africa's export profile continues to be natural resource and capital-intensive in nature. An export strategy and trajectory based on labour-intensive, job-creating products, is certainly not a feature of the South African economy. Import demand continues to be procyclical with investment and GDP, as imported inputs finance South Africa's growth cycle.

Compounding this truncated export profile is a growth cycle in South Africa, built on running regular current account deficits, financed through short-term capital flows. Short-term capital flows, in turn, have often aided the appreciation of the rand, which has hurt exporters. The presence of such Dutch Disease effects in the South African economy, together with an often highly volatile currency, serve as important externally driven constraints on the economy's growth trajectory.

Ultimately, then, despite an apparently impressive growth record in the post-1994 period, South Africa continues to suffer from significant real economy constraints. The changing structure of the economy, wherein the manufacturing industry is essentially employment-dormant; a homogenous export profile; and an unstable currency are only some of the growth dynamics which have beleaguered this economy.

The upshot of the above growth pattern though has been to generate very particular employment, poverty and inequality outcomes for the economy. We turn first to some of the data on employment in the post-1994 period. Over the period 2000–08, for example, the data show that the simple output employment elasticity stood at about 0.69, meaning that for every 1 per cent increase in GDP, employment increased by 0.69 per cent. This stands

in sharp contrast to the post-crisis period (2008–12), where a 1 per cent increase in growth led to a 0.16 per cent decline in employment. Put differently, the data show that—for the post-crisis period—whilst average annual GDP growth stood at 1.9 per cent, employment in this period declined by 0.3 per cent. In absolute terms the data show that the period 2001–12 has seen considerable growth in total employment, from 11.2 million in 2001 to 13.7 million in 2012. The impact of the recession on the labour market though was profound: from a peak in employment of almost 14.1 million in 2008Q4, the economy lost more than 1 million jobs, and by 2010Q3 employment had plummeted to levels last seen in 2006. Thus, the global crisis of 2008/09 resulted in the expansion of employment in the South African economy over the 2006–08 period being completely nullified by the end of 2010.

Employment growth trends in South Africa thus broadly followed GDP growth trends in the post-2000 period, though employment growth was generally lower than GDP growth. Furthermore, it appears that during harsh economic times such as the 2008/09 recession, the negative growth response of employment is much more pronounced than the shrinkage in GDP. The results above imply that GDP growth rates would have to accelerate to much higher levels in order to deal adequately with South Africa's poverty and unemployment problems, and that global economic difficulties appear to have a sharp and relatively long-lasting impact on South Africa's labour market.¹

Despite this labour market churn, South Africa's key labour market constraint—that of the economy's inordinately high unemployment rates—remains. Unemployment rates in 2001 thus stood at almost 30 per cent of narrowly defined labour market participants and 41 per cent of broadly defined labour market participants. Importantly, though, both narrow and broad unemployment rates declined between 2001 and 2007 when the economy was growing relatively quickly. By 2007, the narrow rate of unemployment stood six percentage points lower at 23 per cent whilst the broad rate of unemployment stood five percentage points lower at 36 per cent. In turn, in the period between 2008 and 2012, when the economy was severely hit by the global recession, both the narrow and broad rate of unemployment rose from 23 to 25 per cent and 27 to 33 per cent respectively. Put differently, by 2012, a third of those who were willing and able to work but not necessarily actively searching for work could not find jobs in the South African economy.

Employment estimates over the period 2001–12 suggest five broad trends. First, that workers in the primary sectors were losers in the period: the agriculture and mining sectors were the only two sectors which experienced declines in employment in the period as more than half a million jobs were lost in agriculture in the period between 2001 and 2012, whilst more than 200,000 jobs were lost in mining. Job losses in agriculture were driven in the main by the promulgation of the minimum wage in this sector (Bhorat, Kanbur and Stanwix, 2013). Second, this period (and indeed that for the post-1994 period

¹ There is also a view that the rapid growth of domestic household credit may have also contributed to the real economy effects of the recession.

as a whole) is characterized by a lacklustre performance in the manufacturing sector. Manufacturing employment grew by just over 100,000 jobs in the 11-year period, and as a consequence the sector's share of employment dropped from 14.5 per cent to 12.7 per cent in the period. Third, the real driver of relative and absolute employment growth in this period has been within the tertiary sector. Hence, the financial services and community services sectors created 782,000 and 1 million jobs respectively in the period. The community services sector must be singled out here: this sector employed almost 18 per cent of the workforce in 2001, and its relative growth performance resulted in the sector accounting for more than 40 per cent of the increase in employment in the period. The results for the tertiary sector give way to a fourth important sub-trend since 2000, namely that public sector employment (which is dominant in community services) has grown very rapidly, at the expense of private sector employment. Fifth, and finally, financial services employment growth reveals, upon more detailed statistical analysis, the growth of temporary employment service providers as a source of 'alternative contract' employment amongst firms wanting to bypass the labour regulatory regime.

These sectoral employment shifts in turn were matched by employment shifts at the occupational level, which remained biased towards highly skilled workers. Data for the period 2001–12 thus indicate that the employment growth rate for high-skilled occupations was double the overall employment growth rate, whilst the growth rates for medium and unskilled jobs were at 0.6 and 0.8 of the overall growth rate respectively. The absolute numbers show that 1.1 million high-skilled jobs were created in the economy between 2001 and 2012, whilst the number of medium and unskilled jobs grew by 768,000 and 613,000 respectively. Thus, although workers across the skills spectrum shared in employment growth in the period, skilled workers in particular benefited most, in both absolute and relative terms. In turn, medium-skilled workers were the relative losers in the period.

Given the above sectoral and skills-biased employment shifts (in many senses a continuation of a long-run trend for the South African economy) and the pattern of economic growth noted above, it is important to assess the impact of this growth and employment dynamic on poverty and inequality outcomes in the society. Utilizing income and expenditure survey data based on two national poverty lines, the derived estimates suggest that at the aggregate level, as well as for individuals living in African- and coloured-headed households, poverty as measured by the headcount index declined significantly (yet modestly) between 2005 and 2010.² Specifically, at the upper bound poverty line, the

² All poverty measures have been calculated using individual per capita household consumption expenditure, and the indicators are based on the standard Foster, Greer and Thorbecke (FGT) class of poverty measures. Two national poverty lines have been utilized, an upper-bound line of R577 (in March 2009 prices) per person per month and a lower bound line of R416 (again in March 2009 prices) per person per month.

aggregate headcount rate declined by close to 7 percentage points from 52.7 per cent to 45.9 per cent. At the lower line the decline was slightly smaller at just more than 6 percentage points, from 39.6 per cent to 33.4 per cent.

Relative poverty, as measured by the poverty gap ratio also declined over the five-year period. At the R577 line, the poverty gap at the national level declined by 4 percentage points to 20.4 per cent in 2010, whilst the poverty gap according to the lower bound line declined by 3 percentage points to 12.7 per cent. Overall, these results suggest that the average poor person's position relative to the poverty line improved irrespective of the choice of poverty line. The slightly magnified decline in both poverty measures at the higher line, however, suggests that the poorest of the poor did not experience the largest relative improvement in their levels of consumption expenditure, but rather those who were considered poor at a higher poverty line.

Whilst individuals living in African households experienced an improvement in their levels of poverty relative to the other three race groups, African individuals still account for the majority of the poor in the country, irrespective of the choice of poverty line. For example, in 2010, almost 55 per cent of this population group were considered poor according to the upper bound line, whilst 28 per cent of coloureds were considered poor at that line. In addition, the data show that in 2010, of the just more than 23 million South Africans who were poor according to the R577 a month poverty line, more than 94 per cent, or almost 22 million individuals, resided in African-headed households. The results according to the gender of the household head confirm that those living in female-headed households remain relatively poorer than individuals living in households headed by males. In fact, by 2010, the headcount rate for households headed by females was at both lines almost 15 percentage points higher than the corresponding rate for male-headed households.

The trends in income inequality based on post-2000 data for South Africa have consistently pointed to a sharp rise in the Gini coefficient, using various measures of income and expenditure across a series of nationally representative surveys. Specifically, Bhorat and Van der Westhuizen (2012) found that the Gini coefficient, calculated using per capita expenditure estimates from the 1995 and 2005/06 IES, increased from 0.64 in 1995 to 0.69 in 2005. Using alternative datasets³ and per capita income, Leibbrandt, et al. (2009) found that the Gini coefficient increased from 0.66 in 1993 to 0.70 in 2008. Whilst the estimates were slightly different, the trends were similar.

The results, however, based on the IES data for 2005–10, very tentatively suggest a possible reversal of the post-apartheid trends in inequality. Based on per capita expenditure, the data suggests that South Africa experienced a decline in inequality between 2005

³ The 1993 South African Integrated Household Survey from the Project for Statistics on Living Standards and Development (PSLSD), conducted by the Southern African Labour and Development Research Unit (SALDRU) and the 2008 National Income Dynamics Survey, also conducted by SALDRU.

and 2010. Specifically, the Gini coefficient decreased from 0.696 in 2005 to 0.66 in 2010. The data by race, however, show no statistically significant changes between 2005 and 2010, implying that the inequality within the four population groups did not change over the period. In 2010, the difference in the Gini coefficients for Africans and coloureds is not statistically significant, suggesting that the levels of inequality within these two race groups were relatively similar. The values of the Gini coefficients are 0.581 for Africans and 0.542 for coloureds. Both these cohorts display significantly higher levels of inequality than Asians and whites, with the Gini coefficients for the white population the lowest at 0.450.

In line with the result at the national level, all individuals irrespective of the gender of the household head experienced a decline in their levels of inequality between 2005 and 2010. The Gini coefficient for male-headed households declined from 0.689 to 0.647, whilst the estimate for female-headed households declined from 0.653 to 0.619. In both years the difference between the two Gini coefficients was not statistically significant, suggesting that the distribution of expenditure was relatively similar in male- and female-headed households.

3 Macroeconomic policy

Following Section 2, which presents the overall economic development of South Africa since 1994, it is pertinent to outline the macroeconomic policies that created the macro-environment for implementation of development objectives. In this regard we outline the fiscal, monetary, inflation, exchange rate and balance of payments aspects of macroeconomic policy.

Fiscal policy in South Africa is anchored on the principles of being countercyclical and ensuring long-term sustainability in an environment of weakening economic growth. The budgeting framework is typically based on a three-year horizon in the quest to balance these two principles. The budget framework, as pronounced in the *Medium Term Budget Policy Statement 2013*, seeks to support programmes that enhance the social wage, cap spending, limit the growth of the wage bill of government, improve efficiency, and shift borrowing to capital and investment expenditure. The impact of this would be to reduce the budget deficit over the medium term.

South Africa's debt profile remains sustainable due to an effective debt management strategy. The net debt is expected to stabilize at 44 per cent of GDP in 2017/18. However, the fiscal deficit needs to be monitored closely. In the fiscal year 2012/13 the budget deficit was 4.2 per cent of GDP and expected to be 4.2 per cent again for the fiscal year 2013/14. Total government revenue was 28.3 per cent of GDP in the 2012/13 fiscal year, compared to 27.9 per cent in 2011d12. Government expenditure was 32.5 per cent of GDP in

2012–13, up from 29.9 per cent in the previous fiscal year. It seems the increased deficit has to do with the implementation of countercyclical measures designed to support economic growth and employment creation.

The single most important source of government revenue is tax revenue, which amounted to 89.6 per cent of total revenue in the fiscal year 2012/13, for example. In monetary terms, tax revenue collected through the South Africa Revenue Services (SARS) was R 813 billion in the fiscal year 2012/13. Within tax revenue, the three largest contributors are personal income tax, company income tax and value added tax, which contributed 33.9 per cent, 19.5 per cent and 26.5 per cent, respectively, in the fiscal year of 2012/13. Personal income tax remains strong due to high wage settlements. Reduced consumer demand due to slower economic growth and weaker tax collection has capped domestic VAT and excise duties. At the local government level, local government revenues come largely from grants from central government and municipal utilities, and other charges.

The largest component of current expenditure remains the wage bill which the government aims to cap, going forward with the three-year public sector wage agreement suggestive of this intention. The wage bill for both national and provincial government employees was 35 per cent of total expenditure in 2012/13. In the planned implementation of the National Development Plan (NDP), expenditure will supposedly focus on investment in infrastructure, spatial development, rural development and enhancing competitiveness. Expenditure on infrastructure is expected to rise over time to R 3.2 trillion over the next 10 years. The Presidential Infrastructure Commission will oversee the delivery of the various projects.

Prior to 1981, South African monetary policy consisted mainly of direct controls, which ranged from credit ceilings, cash reserve requirement and interest rate controls. Between 1960 and 1981, the liquidity asset ratio-based system was used with quantitative restrictions on interest rates and credit. The aim of these direct controls was to deal with inflation by curbing the growth of monetary aggregates (see Aziakpono and Wilson (2010) and Ncube and Ndou (2013)). In the year 1977, the De-Kock Commission was formed, which resulted in the shift to market oriented monetary policies. The De-Kock Commission's recommendations included the use of an accommodation monetary policy, which was complemented by open market operations, and variable cash reserve requirements.⁴ There was, therefore, a mixed system during this transition period of 1981–85 (Leape and Ncube (2009)).

From 1986 to 1998 a pre-announced M3 monetary target was used, with the use of the discount rate in influencing the market interest rate. From 1998, the Reserve Bank

⁴ The accommodation policy included variations in terms and conditions taking the form of changes in quantities of liquidity provided to market and the interest rates costs of accommodation. This included using discount policy known as accommodation policy, which was complemented by open market operations and variable cash reserve requirements.

shifted to using daily tenders of liquidity through repurchase transactions. Monetary growth guidelines and target ranges, or core inflation,⁵ were announced every three years. It became more difficult to target money supply due to financial liberalization and the increasing openness of the capital account since 1995 (Aziakpono and Wilson (2010) and Ncube and Ndou (2013)).

In February 2000, the South Africa Reserve Bank (SARB) adopted a new framework based on inflation targeting. Initially, the inflation target was consumer price inflation, excluding mortgage rates, and the use of a repo system. The target was changed to headline-inflation in January 2009. The South African government sets and adjusts the inflation target, meaning that the central bank does not have goal independence but has operational independence in monetary policy. Thus the central bank can use any available monetary policy instrument in the pursuit of the inflation target. At the time of adopting inflation targeting, the central bank also changed its exchange rate policy and moved away from intervening in the foreign exchange market, except in continuing to buy foreign exchange to supplement the foreign exchange reserves.

On recent developments, the slight improvement in real economic activity, in the second quarter of 2013, led to an acceleration on money supply growth to 12.5 per cent annualized compared to 7.7 per cent in the first quarter. Over a 12-month period, broad money growth (M3) accelerated to 10 per cent in April 2013 compared to 5.2 per cent in December 2012, but then moderated to a level of 7.4 per cent in July 2013. This general growth in M3 deposits was due to growth in deposits by households and the corporate sector, in an environment of financial market volatility, where cash holdings were preferred to risky securities holdings. Growth in deposit holdings grew negatively in the fourth quarter of 2012, but then grew positively by 14 per cent and 15.8 per cent in first and second quarters of 2013 respectively.

In the first and second quarters of 2013, banks' total loans and advances to the private sector saw moderate quarter-to-quarter growth rates of 8.5 per cent and 8.7 per cent respectively.⁶ This was a slowdown in credit extension growth from what has been experienced in the last four years. The household sector accounted for 53 per cent of the overall increase in total loans and advances in the second quarter of 2013, and the corporate sector for 47 per cent. The general slowdown in credit extension was due to the high level of personal debt, uncertain global and domestic growth prospects, and weak labour market conditions.

On interest rates, the Monetary Policy Committee (MPC), by July 2013, had kept interest rates to a three-decade low level of 5 per cent per annum. The objective of the MPC, in

⁵ The repo system involves regular repurchase transactions between SARB and the bank's clients and caters for shortfalls in bank liquidity using a borrowing window for the Reserve Bank related to various securities which are tendered to the bank on daily or intraday basis.

⁶ See South African Reserve Bank Quarterly Bulletin, September 2013.

this tough economic period, has been to balance the need to support the weak economic recovery against the risk of rising inflation in the face of a weaker and volatile domestic currency. Short-term money-market rates remained fairly constant during the first eight months of 2013. On the other hand, longer-term and forward-looking money-market rates rose sharply, in May 2013, due a deteriorating inflation outlook, and domestic currency depreciation. The yield curve slope thus steepened.

Coming to the prime lending rate and the predominant rate on mortgage loans, this has remained at 8.50 per cent since July 2012. The announcement of possible QE tapering in the United States saw the South African government bond yield rise to 8.05 per cent (R208 maturing in 2021) from an all-time low of 5.78 per cent in mid-May 2013. Going forward, the risk of QE tapering in the United States may put upward pressure on yields of long-term government bonds.

Prior to 1979, South Africa followed a fixed exchange rate regime with the rand pegged either to the US dollar or British pound sterling. From 1979, a more flexible exchange rate and dual exchange rate system was adopted. The process was based on the announcement of the official exchange rate daily, as determined by market forces, whilst the financial exchange rate was applied to non-resident portfolio and direct investment transactions. The introduction of the dual exchange rate system was meant to break the direct link between domestic and foreign interest rates, and insulate the capital account from unmanageable outflows. Subsequently, the dual exchange rates were unified, following De-Kock Commission recommendations. In 1983–85, South Africa experienced a debt standstill crisis, which resulted in the reintroduction of the dual exchange rate system and reintroduction of the financial rand and the tightening of capital controls for residents. The dual currency lasted until March 1995.

The South African Reserve Bank had a policy of intervention in the foreign exchange market. It intervened in both the spot and forward foreign exchange markets. On some occasions, it made use of an oversold foreign exchange position (NOFP) as an intervention tool, which has since been abandoned. During the period 1979–88, the SARB intervened, partly to maintain profitability and stability in the gold mining industry. However, after August 1989, the objectives of SARB changed as it actively sought to stabilize the real effective exchange rate to support the international export competitiveness of the country. The effectiveness of the intervention was tested in 1994 when the country experienced huge capital outflows.

With the introduction of the inflation-targeting framework in February 2000, exchange rate management ceased to become a priority. The exchange rate is market determined, with volatility being influenced by terms of trade and capital flow shocks due to quantitative easing globally, and also domestic factors such as political and economic shocks (see de Jager and Kahn in this volume). The rand seems prone to overshooting its fair value. Short-term portfolio flows have funded a persistent current account deficit. For example,

the investment by foreigners in domestic government bonds increased from 13 per cent in 2008 to about 36 per cent in September 2013.

Looking at the valuation of the rand, de Jager and Kahn (this volume) show that the currency, relative to the equilibrium exchange rate, was undervalued at the beginning of the financial crises in 2008, and has depreciated since, to an undervalued position of 10 per cent in the second quarter of 2013. The degree of undervaluation seems to have inflationary consequences. The currency is expected to remain volatile and face depreciation risk as the United States institutes QE tapering. Risks of lower growth, credit-rating downgrades, and domestic political issues and labour unrest, all put pressure on currency volatility going forward.

After the Soweto 1976 uprisings, import surcharges were applied above the normal tariffs on imports in order to alleviate pressure on the current account. The surcharges were removed in 1980 when the gold price increased substantially, bolstering the current account. The import surcharges were reintroduced in February 1982 to November 1983, which did not alleviate pressure enough on the current account, as it remained in deficit. The current account deficit led to sharp depreciation on the rand. The import surcharges were only phased out after 1995 during a much broader trade liberalization programme following the Uruguay Round of the GATT.

After the elections of 1994, which ushered in a new South Africa and the removal of international trade sanctions, capital inflows increased, and this was accelerated by the removal of exchange controls for non-residents in March 1995. The adoption of a new growth plan in around 2010, suggests that net trade balance could be the main driver of economic growth. The plan identified the exchange rate as being important, with monetary policy playing a much bigger role in driving growth.

On recent developments, the trade deficit over the first half of 2013 was 2.6 per cent of GDP and the terms of trade declined. The value of imports increased by 15.8 per cent over the first half of 2013, whilst the value of exports only increased by 14.2 per cent. The main contributors to import growth are mineral products (fuel), chemicals, plastics, rubber, machinery and transport equipment. On exports, exports to China have been increasing and now match exports to the Southern Africa Development Community (SADC) at about 12 per cent of total exports, in the first half of 2013. SADC accounted for 22.4 per cent of manufactured exports in the first half of 2013. Exports to the European Union are still the largest share at about 20 per cent of total exports, as of the first half of 2013, having declined from over 30 per cent in 2000.

The current account deficit stands at about 6.5 per cent of GDP and is expected to remain above 5 per cent into the medium term due to investment growth staying above growth in domestic savings. Over the medium term, transfers to the South African Customs Union (SACU) members, namely Botswana, Lesotho, Namibia and Swaziland, will amount to about 1 per cent of GDP.

The first nine months of 2013 also saw a drop in net purchase of domestic bonds by foreign investors, dropping to R37 billion, compared to R76 billion over the same period in 2012. On the equity market, the same period saw a net inflow of R26 billion in 2013, compared to a net outflow of R5 billion in 2012. The general decline in inflows is due to the possibility of tapering of quantitative easing in the United States, which resulted in a rise in US bond yields and an outflow of capital out of emerging markets in general, coupled with a weaker domestic economy in South Africa. FDI into South Africa, in the first half of 2013 amounted to R16.9 billion, largely driven by long-term loan financing that international companies are extending to their domestic subsidiaries.

On February 23, 2000, South Africa adopted inflation targeting as a monetary policy framework. From 2003, the SARB adopted a continuous target to be achieved on a monthly basis. During this period, the bank targeted consumer price inflation excluding mortgage interest costs. In October 2008, the SARB announced that it would target changes in consumer price inflation, as from January 2009. An inflation band of 3–6 per cent is targeted, with variable success. A low of 1.4 per cent was recorded in 2004 and a high of 11.5 per cent in 2008. The inflation-targeting period has seen a period of prolonged economic growth, suggesting a negative relationship between the two variables.

On recent developments, in July 2013, consumer price inflation breached the 3–6 per cent target band for the first time since April 2012, reaching a level of 6.3 per cent. Major contributors to inflation included higher transport costs and food prices, amongst others. Whilst inflation is expected to decline going forward, the weaker domestic currency risks higher inflation.

Overall, South Africa's economic growth is expected to remain modest in 2013, and was 2.5 per cent in 2012, down from 3.5 per cent in 2011 (see *Africa Economic Outlook*, AfDB, 2009–13). The economy is still experiencing pressure from the global economic slowdown, and domestic structural bottlenecks, including labour unrest. The SARB has limited room to manoeuvre in stimulating economic growth through easier monetary policy. In the long run, success in the implementation of the National Development Plan could unlock the economy's potential within an inclusive growth agenda.

4 Structural transformation

It is widely agreed that the economic and social order which prevailed during the apartheid era of 1948–94, as well as the period of segregation which preceded it, favoured a cheap labour system for South Africa's mines and farms and blocked the structural transformation of the South African economy. It was hoped by many that the transition to democracy in 1994 would loosen the economic shackles of apartheid and herald an era of stronger economic growth, based on a transforming economy. However, transformation

achieved under democracy has been below expectations. Particularly since the onset of the global financial crisis, South Africa has returned to a familiar pattern of underperformance. This could be a result of poor policies leading up to and/or in response to the crisis, and it could also be a product of the fact that the structural transformation that many had hoped for has not yet happened.

What are we looking for in the structural transformation of South Africa? In the tradition of development economics, some of the key changes would be a shift from agriculture to industry, increasing scale of productive units and shifts in the structure of consumption. In South Africa these transitions are long completed—indeed many would argue that the increasing average size of enterprises and the shift in consumption patterns have gone further than they should have (Worgetter, this volume, on firm size). And yet, as noted in previous sections, South Africa remains a country where poverty is declining slowly, inequality is extremely high, and production and trade patterns have not shifted from the relative predominance of raw materials, exports, and the importation of high value added manufactures.

Probably the most important structural shift that symbolizes the movement of an economy from factor-driven to efficiency-driven to innovation-driven in the language of the world competitiveness index (Sala-i-Martin and Artadi, 2004), or from extractive to inclusive growth in the typology of Acemoglu and Robinson (2012), is the deepening of investment in capital, both in physical capital and human capital.

We will take up the issue of education in detail in the next section, pointing to the disappointing performance in education despite significant public expenditure. The very substantial racial and gender imbalances in skilled and managerial roles in the workplace in no small part result from the poor quality of supply of skills, though they certainly result from residual racial and gender prejudices (Posel, this volume). The role of women in the economy grew rapidly in the first decade after apartheid, but the poor representation of women in management and the large wage gap between men and women in similar roles point to the prevalence of prejudice (Posel, this volume). Equally pertinent is the concentration of women in more precarious forms of employment. For black men and women, and for women in general, South Africa is far from meeting the Spence Commission test of equality of opportunity (Commission on Growth and Development, 2008).

Investment in capital stock fell to astonishingly low levels in the late apartheid period, with gross fixed capital formation (GFCF) falling to a low level equilibrium of about 15 per cent of GDP. A significant part of the decline came from the withdrawal of the public sector from infrastructure investment, as rising current expenditure obligations and stagnating revenue squeezed the capital budget. It took a long time for this to turn around in the post-apartheid period, and GFCF only began to rise 10 years after the transition. This led to constraints on growth in several ways, including electricity shortages that emerged in 2008, which have held back investments in energy-intensive economic activities.

Investment rose to over 20 per cent of GDP briefly in 2009 and 2010, but has drifted down again, though still above late apartheid era levels. Huge backlogs remain, and even after building around 3 million low-income houses, housing conditions for the poor are inadequate and 2.1 million households do not have adequate homes (Savage, this volume). Poor spatial development plans, the cheap-outlay, high long-term social cost model of apartheid, and poor public transport facilities, have led to a high cost of reproducing labour.

Perhaps the clearest symptom of the lack of transformation of the South African economy is the mediocre performance of the manufacturing sector which has continued to decline as a proportion of GDP since 1993. Few high value added manufactures are produced or exported; the motor industry is an exception having received systematic industrial policy support from government.

Several of our authors argue or show that one of the main causes of the lack of competitiveness of the industrial sector is the highly concentrated oligopolistic structure of the South African economy (Manuel, Sharma, Worgotter, Fedderke, this volume). Fedderke points out that margins for the oligopolies have grown since 1994, along with the shrinking of margins for smaller businesses. Worgotter notes that the industrial structure has contributed to very poor levels of competition by OECD standards. Other contributors to the poor environment are the nature of the involvement of the state in network industries (also discussed by Levy), and heavy product market regulation.

Worgotter argues that in the rent distributing industries high margins are shared with unionized workers, a point that Fedderke makes too. In addition, Worgotter argues that South Africa raises much less revenue from non-renewable resource extraction, which adds to the other effects of 'Dutch Disease'. Unless the incentive structure of the economy shifts, competitive industrialization will elude South Africa. Competition law was strengthened and the Competition Commission is effective, but Worgotter suggests that its mandate is too limited and its tool-kit is too small.

Outside of the extractive sector, innovation is limited in its impact on economic growth and job creation. Though South Africa has a reasonable share of GDP devoted to research and development, both Kaplan and Fedderke point out that this has not had a significant impact on output. Government has not steered funds sufficiently effectively to encourage industrial innovation and the emergence of a significant number of innovation-based firms. This is in spite of a relatively high scientific output.

One of the most overtly transformative policies of the democratic South African government was the Black Economic Empowerment (BEE) strategy. Initially the government focused on the promotion of black people into positions of greater responsibility in the economy, in the public and private sector. Later, more attention was given to the transfer of ownership of economic assets to black South Africans on the legitimate grounds that apartheid artificially blocked accumulation by black people, that broadening ownership

would underpin democracy, and that it could also give a new dynamism to the economy as Mandela had hoped as early as 1955:

... the breaking up and democratisation of these monopolies would open up fresh fields for the development of a prosperous, non-European bourgeois class. For the first time in the history of this country, the non-European bourgeoisie will have the opportunity to own in their own name and right mills and factories, and trade and private enterprise will boom as never before. (Mandela, 1956: 49)

Manning (this volume) shows in her entry that the BEE strategy has had very limited success because empowerment is far too narrow in scope and because it engenders a cluster of rent-seeking rather than entrepreneurship. Notably, BEE has failed to produce a significant number of successful entrepreneurs in the manufacturing sector. Sharma refers to South Africa as the 'cappuccino economy ... white cream over a large black mass, with some chocolate sprinkled on top'.

Small business development remains a stated objective of government, but the resources devoted to it have had little impact and the oligopolistic structure of the economy has not created an environment conducive to fast growing small and medium businesses. In addition to facing the power of oligopolies and cartels, small businesses have to contend with a regulatory environment that poses risks to employers of labour in regard to dismissal procedures. Red tape, corruption and crime provide further disincentives (Rankin, this volume), especially in poorer communities.

One of the chief strategies used by the democratic government to raise the competitive temperature in South Africa was to reduce tariffs in line with its commitment to the Uruguay Round of the GATT. Analysts looking at the outcomes of the reforms found links between tariff reform and greater dynamism in manufacturing (Jonsson and Subramanian, 2000 and Edwards, this volume), but the effects were limited. The limited impact on competition and dynamism might be because tariff reforms in the 1990s were not continued during the 2000s, and/or because other factors such as labour market constraints and/or the volatile exchange rate discouraged investment in export-oriented manufacturing. At the same time, trade reform in wage goods sectors motivated by the general welfare effects on living standards led to a sharp decline in employment in labour-intensive industries such as clothing, textiles and footwear. So whilst wage goods were cheaper to the extent permitted by oligopolistic markets, the positive dynamic effects were limited and the negative effects on employment were severe.

As a result, non-traditional exports are weak with the exception of the motor industry which operates under an unusually strong incentive regime. Commodities are still a large proportion of exports and trade is extremely pro-cyclical in relation to global growth trends. Overall, exports are relatively weak. The result is that growth which requires higher levels of investment is reliant on capital inflows, and as there is hardly any green-field

FDI (Black, this volume), most investment is portfolio investment in bonds and stocks. The dependence of the economy on short to medium-term capital inflows for growth tends to reproduce dependence on the resource sector and powerful, publicly quoted oligopolies in the services sector.

The result as Rankin, Fedderke and others point out is a low rate of improvement of productivity, low levels of competition and low levels of innovation. Except in periods of exceptional economic growth, employment creation is limited and the condition of structural unemployment inherited from the late apartheid period remains.

To draw on the language of Acemoglu and Robinson (2012), whilst it would appear that inclusive political institutions have emerged in South Africa, economic institutions remain extractive. The process of economic reform began in 1994 with the transition to democracy, but structural transformation still has a long way to go.

5 Poverty, inequality and unemployment

Human development indicators in South Africa show a contrasting picture when comparing income and non-income dimensions. Many non-income dimensions of welfare have improved. Access to basic services—housing, water, sanitation and electricity—has increased. Measures of poverty and inequality based on asset indices that incorporate these factors show an improvement in the post-apartheid period.⁷ However, the picture for income dimensions is somewhat different. As shown in Section 2, inequality has increased over most of the post-apartheid period, and the poverty reduction performance has been lacklustre. Further, racial imbalances in the income dimensions of well-being continue to be severe.

The inability to move poverty, inequality and unemployment, and continued racial imbalances in these, is a major feature of South Africa over the past 20 years and a central focus of debate on economic policy. The persistence of poverty and inequality has happened despite efforts by the state to address the issue through transfers. Several papers show that without state grants poverty and inequality, and inter-racial differences, would be even higher.⁸ Why is the market distribution of income in South Africa so unequal, and what policy interventions other than transfers could improve the situation?

A simple framework for understanding the distribution of income begins by thinking of income as a combination of assets and the returns to these assets. The major asset, in general and particularly for the poor, is their labour power. Labour income explains the bulk of household income. This is true around the world, and South Africa is no exception.

⁷ Bhorat et al. (2006), Leibbrandt et al. (2006) and Woolard and Woolard (2007).

⁸ Leibbrandt and Levinsohn (2011), Bhorat and van der Westhuizen (2012) and Leibbrandt, Finn and Woolard (2012).

In South Africa wage income (including self-employment income) accounts for 70 per cent of income. Decompositions of inequality by income source show that labour income accounts for 85 per cent of inequality.⁹ Thus the evolution of income inequality and poverty depends on a combination of trends in access to labour income, and inequality of the labour income itself. Access to labour income earning opportunities is of course related to unemployment and the role of the informal sector, whilst inequality of labour income itself depends on the distribution of skills and the distribution of returns to skills.

The structural reasons for persistence of income poverty and inequality in South Africa thus boil down to (i) inequality in skills, primarily education, (ii) inequalities in the returns to skills, (iii) unemployment and (iv) low productivity and low labour income in the self-employed informal sector. Correspondingly, the policy responses to address the issues can also be classified under the same headings. There are of course cross-linkages between these entry points—for example, levels of education are strongly correlated with unemployment.

Of the four explanations of the evolution of income distribution, perhaps the one over which the government has least control is the distribution of returns to education. South Africa is part of a global trend of growing inequality in these returns. Whilst there is a debate on the relative contribution of this phenomenon to growing income inequality in the United States and elsewhere, there is consensus that it is a significant explanatory factor in rising inequality. And whilst the phenomenon is not fully understood in detail, skills-biased technical progress has been identified around the world as the cause for sharply rising wage premiums for educated labour.¹⁰

Given the global trend in returns to education, a policy priority for the government must be to lift up the lower end of the distribution of educational attainment so that those currently at lower incomes can benefit from the rising returns. The government's record on this front is decidedly mixed. Whilst the government spends a relatively high share of GDP (4 per cent) on education, the outcomes are disappointing. Since the end of apartheid more Africans are moving from primary to secondary school, but the rates of graduation from secondary school have barely shifted since 1994. Test scores on average are low relative to other countries, but at the same time there are enormous inequalities between schools in rich and poor areas. In poor areas there is considerable grade repetition, which in turn leads to overcrowding.¹¹ Measured in standard school quality benchmark tests, South Africa's schools have very poor performance by global standards; measured in proportion to the cost of education, the result is particularly poor (Muller, 2013).

The structural inequalities across race and income groups are only further exacerbated in higher education. The post-school systems are also weak. Whilst there are some good

⁹ Leibbrandt, Woolard, Finn and Argent (2010).

¹⁰ See e.g. Kanbur and Zhuang (2012).

¹¹ Lam and Branson (this volume).

universities, the system as a whole is not producing sufficient graduates in key skill categories; this was undoubtedly a constraint on growth in the first decade of the twenty-first century. Even more serious is the relatively small number of suitable graduates emerging from vocational and technical training colleges.

Education has an effect on income only when the person with that education becomes employed. But high unemployment remains a scourge and, not surprisingly, is correlated with poverty and is a major contributor to inequality. Further, youth unemployment is a major driver of the overall level—the unemployment rate for 15- to 30-year-olds in 2010 was a staggering 42 per cent.¹² There is vigorous debate in South Africa on the causes of high levels of unemployment, with some emphasizing demand-side factors and others highlighting supply-side reasons.

One straightforward way of increasing demand for labour is through public sector employment. There is much discussion of, and support for, public works schemes as a temporary safety net. The different components of the Expanded Publics Works Programme, including the Community Works Programme that is being piloted, are being assessed. It is likely that they will be expanded along the lines of India's Mahatma Gandhi National Rural Employment Guarantee Act.¹³ However, it is also recognized that Public Works Programmes are a safety net and cannot be a permanent solution to absorbing the growing number of entrants to the workforce, where attention will have to focus on the private sector.

On the private sector demand side, the issue in South Africa is not just the relatively low economic growth rate over the post-apartheid period, but also its low employment intensity. It is a well-known argument in South Africa and elsewhere that various labour market rigidities, in particular high wages and constraints on dismissing workers once hired, lead to low employment elasticities and prevent growth from being translated into employment gains. A counter-argument is that the laws themselves are not unusually rigid relative to global benchmarks, but that the institutions of implementation are inefficient (Bhorat and Van Der Westhuizen, 2009). The political economy of South Africa means that this is a contentious issue, and policy attempts to address the high wages indirectly, for example through employment subsidies for youth employment, will be hotly debated. Amongst the technical arguments deployed are that a youth wage subsidy will not create new employment but will simply change the composition of unemployment by displacing adult workers by youth workers. However, measures to introduce such subsidies have recently been passed.

Attention has also naturally turned to more supply-side-oriented explanations and interventions. One such explanation is that of a skill mismatch. The idea here is that South African unemployment is higher than it should be because the skills demanded

¹² Mlatsheni and Leibbrandt (this volume).

¹³ Philip (this volume).

by employers are not those being produced by the schooling and training system. The poor functioning of the colleges of Further Education and Training is a major concern in this regard, and the contribution of the Sector Education and Training Authorities is much discussed in policy circles. If the demand-side route to reducing unemployment is blocked, then these supply-side interventions are bound to be the major focus of interest.

A key concept in supply-side explanation of unemployment is that of the reservation wage. Simply put, the wage being offered in employment is not high enough to attract the unemployed person to take up the job—unemployment is preferable. Thus it is not that the wage is too high to reduce unemployment by increasing demand for labour, but that it is too low to reduce unemployment by inducing the unemployed to move to employment. One study found that with appropriate controlling of other factors, more than three-quarters of males and more than half of females have stated desired wages that are above those they could get (with their skills and background) in a moderate-sized firm.¹⁴ But such findings are also disputed by technical researchers, and in general by the seeming absurdity of the notion that the unemployed would not be prepared to work for wages that paid them more than the next best alternative.

There is, however, a structural reason linked to the particular history of South Africa which makes the reservation wage hypothesis particularly relevant. As is well known, the residential and work patterns in South Africa owe a lot to apartheid period segregation policies. The African population was confined to certain areas, from where they undertook often long commutes to work. The transportation structure and patterns conformed to this basic design. This residential pattern has not changed much in the 20 years since the end of apartheid. Employment opportunities are mainly to be found outside the townships where most Africans in urban South Africa live. The high pecuniary and non-pecuniary costs of transportation require that the wage in employment be high enough to be compensated for these costs. Hence the seemingly peculiar outcome that despite there being/having only low-earning opportunities in the townships, the residents are not willing to take up jobs that pay high in gross terms, but not sufficiently high once the costs of transportation are subtracted.¹⁵

The answer to this structural problem is not easy, and not likely to be solved overnight, since it was created over several decades in deliberate fashion. Investing and job creation in the townships themselves is problematic, again because of the structural feature that little of the income spent in the townships stays there. An assessment of the impact of the Community Work Program in Diepsloot shows significant direct effects, but that the multiplier impacts are relatively small because of the leakages of demand to outside the township.¹⁶ There is hope, however, that these multipliers may increase over time through

¹⁴ Rankin and Roberts (2010).

¹⁵ World Bank (2012).

¹⁶ Davies and Van Seventer (2012).

these and other interventions such as the setting up of industrial parks nearby. In any event, reducing the distance to work is an important element in addressing the supply-side of South Africa unemployment.

The high levels of open unemployment in South Africa are a surprise to many working in other developing countries such as India, where the informal sector is much larger. In these countries, policies towards the informal sector and informal employment is a major component of the policy discourse, and this is increasingly so in South Africa.¹⁷ There is now a consensus that there are a whole range of barriers to setting up in the informal sector, with a particular focus on national and local regulations, many of them dating to the apartheid era. These discriminate against self-employed activities, activities which could provide income-earning opportunities for the unemployed.¹⁸ A number of specific policy interventions are possible, as exemplified in the transformation of the Warwick Junction area of Durban, but this must begin with a change in the policymaking mindset, which views informality as a 'problem' to be swept aside, rather than a sector to be engaged with to generate employment possibilities.

Addressing poverty, inequality and unemployment in South Africa will require many policy instruments and interventions. High rates of growth, and employment intensity of that growth, are central. Encouraging employment intensity requires demand-side and supply-side policy reforms and direct interventions. The supply-side encompasses efforts in skill matching as well as addressing the particular spatial pattern of work and residence in South Africa. The demand side includes a change in the mindset which restricts informal employment, as well as introducing temporary safety nets through public works programmes. Finally, redistribution of market incomes through state grants, and better deployment of public expenditure for access to services is also key. South Africa has had significant successes in some areas, but education remains a channel through which inequalities continue to be perpetuated and strengthened.

6 Conclusion: challenges and policies for the future

The end of apartheid in 1994 promised a new beginning for South Africa, with political freedom and inclusive development for all South Africans. The focus of this volume, and of this overview, is on the economic record and the economic prospects of post-apartheid South Africa. The record is a mixed one. A start has been made in addressing many of the basic inequalities in health, education and housing that were the hallmark of apartheid economics. Growth is stronger than before and poverty is lower, access to education and

¹⁷ Valodia (this volume).

¹⁸ Skinner (2008).

health care is much stronger, access to infrastructure services is hugely improved and a strong social safety net cushions poverty for the very poor. But unemployment remains high, especially amongst young Africans, and income inequality has increased. Economic growth has been volatile and lacklustre as South Africa has had to cope with the consequences of global crises.

During the post-apartheid period a series of economic policy packages has been introduced, including the GEAR, ASGISA, the New Growth Path and the National Development Plan. Several others have been stillborn, including the thoughtful report prepared by the team assembled by Dani Rodrik and Ricardo Hausmann in 2006–07, the National Growth and Development Plan developed in the RDP office in 1995–96 and the report of the Labour Market Commission, also delivered in 1996. The GEAR was implemented over a period of time, but only in part.

Considering that South Africa is a young nation built on a complex and very challenging political economy, expectations that the new government would get everything right quickly were naïve. The rest of the packages which were actually launched have not been driven consistently by government. Whilst the National Development Plan appears to have the support of the ANC government and many in the broader community (though not those on the left of the trade union movement), its limitations are that it is not much more than a framework to guide policy to 2030, and that it is not yet evident that the government or the ANC have a systematic approach towards its implementation.

Regulatory uncertainty has affected investment levels in sectors such as mining and networked industries in particular. The shortfall in electricity generation since 2008 was the most dramatic outcome of this uncertainty. High telecommunications costs and limited broadband access have also been symptoms of weak regulation. Alongside this, in the rhetoric of government and the ruling party, the concept of a developmental state is often conflated with increasing state participation in the economy. The combination of the waning credibility of government's economic plans with regulatory uncertainty and confusion about the role of government in the economy has weakened the credibility of government plans and has reduced investors' confidence in the leadership of the South African economy. The challenge to roll back poverty, unemployment and inequality becomes all the more difficult in this context.

Perhaps the most important short-term challenge of government is to win back credibility in its economic policymaking and implementation. The easiest way to do this would be the same way as its credibility began to be won, at great cost, in the 1990s—though the firmer implementation of macroeconomic commitments, especially in the realm of fiscal policy. Budget deficit targets have been exceeded every year since 2009—this pattern needs to be broken. Monetary policy is now more credible—the system of inflation targeting has been consistently followed, though there was greater flexibility in the application of the policy after the global financial crisis began. However, a real commitment to

reserve accumulation and the introduction of some targeted macro-prudential measures could reduce the volatility of the price of the currency and lessen its impact on the domestic economy, especially for the non-traditional tradable sector.

It would also be valuable if it were clear that government was prioritizing capital expenditure and was firmly committed to limit the growth of current expenditures, especially on the government wage bill. But this needs to be taken further, towards greater coherence in economic policy as a whole. The appearance that economic policy is made sector by sector without any strong centre needs to be reversed. Strong leadership is needed on regulatory coherence in order to ensure that infrastructure services are good, cheap and reliable, and certainty should be established on what exactly the government means by a 'developmental state'. It should not necessarily mean more state ownership in the economy, which some in the ruling alliance say it should, but it should include effective measures to counteract the oligopolistic forces in the economy that restrict competition and innovation.

An appropriate definition of the developmental state would in South Africa necessarily include an overarching social pact and perhaps a series of sub-pacts between business, government and labour to support investment, innovation, and the emergence of dynamic small and medium enterprises. This could lead to a new, more meaningful form of economic empowerment. A well-designed and strongly led social pact could conceivably also remove some of the key obstacles to investment such as the antagonistic industrial relations environment in the private and public sectors.

Perhaps the biggest challenge is to fix the basic education system and, further, to expand post-school training opportunities in colleges and universities. Evidence increasingly suggests that not only do resources need to be allocated better, from salaries to learning materials, but also that the total envelope for education is not high in comparative terms—certainly when measured in expenditure per learner.¹⁹ So education commitments could increase. But the fundamental challenge is to improve the quality of management of schools and the provincial administration systems, which will allow for more rapid improvements in teacher performance.

The extraordinarily damaging legacy of the apartheid spatial framework is a further key challenge that has not yet been adequately addressed. Cities need to be made into more liveable places for the poor and more efficient economic activity hubs. The effective implementation of good housing and public transport policies within a reforming spatial development framework is absolutely critical, city by city.

As long as the gap between the demand and supply of labour remains so wide, special measures must be taken to reduce the negative social effects of widespread unemployment, especially amongst young people. Effective public employment programmes, public works programmes and community work programmes, which are able to build social

¹⁹ OECD (2013) *Economic Survey South Africa 2013* and Muller (2013).

capital, need to be strengthened and expanded. Other medium-term interventions such as special training and employment promotion schemes for young people should be well designed and well managed.

There has been vigorous debate on economic policies, for a country with a unique historical legacy of structural inequality having to navigate the often unforgiving forces of globalization and global markets. The entries in this volume reflect that debate and those uncertainties. Our task has not been to summarize those entries. Rather, we have provided our own perspective on the challenges faced by South Africa. Our conclusion is that clarity on goals combined with pragmatism in means is the best stance for South African policymakers. The basic economic goal is clear—it is to generate inclusive economic growth, which leads to broad-based development and addresses the inequalities which are the burden of apartheid. It means we do not think it serves South Africa well to be dogmatically ‘statist’ or ‘marketist’. The real issue is in what combination South Africa should choose, and this will vary across time, space and sectors. There are some areas, such as health and education, where state involvement is crucial, but efficient implementation, and learning through experimentation, is key. There are other areas, primarily in production, which are best left to market forces, but appropriate regulatory frameworks are essential.

Of course this broadly pragmatic stance leaves open ample room for debate, discussion and disagreement. This is bound to be the case, especially for a country with a history like that of South Africa. We hope that this volume will contribute to this lively discourse as South Africa enters its third decade of freedom.

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Part 1

The Economics of Post-Apartheid South Africa

1 **Twenty years of economic policymaking—putting people first**

TREVOR MANUEL

1 **Introduction**

The South African economy under apartheid, in many respects, displayed patterns similar to that of a typical colony but with some notable differences. The major driver of growth was the extraction of minerals. In many areas, industrial policy supported a transition into early stage manufacturing. The rents from the minerals sector funded a small but relatively sophisticated services sector dominated by financial services. The social policies under apartheid and its precedents consciously skewed the rents from the economy towards white South Africans and therein lies the differences with a typical colonial setting. The key beneficiaries of mineral extraction live inside South Africa.

In the late 1980s, as the apartheid government was in its death throes, the liberation movement under the leadership of President Tambo set about defining the principles upon which a new post-apartheid society would be built. There were several strands of this work focusing on international relations and legal, economic, social and political issues. The legal aspect of this work culminated in the constitutional principles which ultimately shaped South Africa's post-apartheid constitution. At the centre of these principles was the concept of a people-centred democracy, a thriving and open society premised on mutual respect, trust and human dignity.

It was these same principles that shaped economic policymaking in the African National Congress (ANC) and then in government over the past 20 years. The ANC sought to transform the economy into one that benefited all the people of South Africa. To achieve this objective, the economy would have to be fundamentally reshaped and restructured. But it also had to grow faster to generate the domestic and foreign resources to rebuild the post-apartheid society.