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University of Massachusetts Amherst

10th floor Thompson Hall, University of Massachusetts, Amherst, MA 01003
(413) 545-6355, peri@econs.umass.edu, http://www.umass.edu/peri

Out of Gear? Economic policy and performance in post-apartheid South Africa

James Heintz*
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The South African elections of 1994 marked a fundamental turning point in the country's democratic transformation. As the ANC-led government of national unity took control, beleaguered apartheid institutions were dismantled and a new constitutional, legal, and policy environment emerged. The transformative agenda extended well beyond a new vision of basic human and political rights for all South Africans. There was also a pressing need to address the economic legacy of apartheid: staggering inequalities, widespread poverty, unequal access to social services and infrastructure, and an economy that had been in crisis for nearly two decades. Has economic policy in the democratic era been successful in reducing the social deficit left by the apartheid regime? This Policy Brief grapples with this question by analyzing some key socio-economic trends in South Africa since the '94 elections.

The key policy framework which has determined the trajectory of the post-apartheid economic transformation is the Growth, Employment, and Redistribution (GEAR) policy that the Department of Finance (now the National Treasury) introduced in June 1996. The GEAR policies were launched in an environment in which the rand was depreciating and foreign exchange reserves were at an extremely low level. The strategy proposed a set of medium-term policies aimed at the rapid liberalization of the South African economy. These policies included a relaxation of exchange controls, trade liberalization, "regulated" flexibility in labor markets, strict deficit reduction targets, and monetary policies aimed at stabilizing the rand through market interest rates. Another component of the strategy – the privatization of state assets – was being negotiated through an earlier agreement between government and labor, called the National Framework Agreement (NFA).

The GEAR document contained ambitious targets for the South African economy – by the year 2000 the economy was to generate a sustainable 6 percent average growth rate and 400,000 new jobs each year. A critical link in the logic of the GEAR strategy was a rapid

* Assistant Research Professor, Political Economy Research Institute, University of Massachusetts, Amherst.

expansion of new investment – in particular, foreign direct investment. High levels of new investment would support rapid rates of economic growth which, in turn, would create hundreds of thousands of jobs. The twin engines of high growth and rapid job creation would allow South Africa to overcome the vast inequalities that apartheid left behind. Growth would allow for the eventual expansion of social services and the provision of infrastructure, job creation would raise the incomes of ordinary South Africans.

The Post-Apartheid Economy: growth, inflation, and investment

Has the South African economy been able to deliver in the post-apartheid era? Table 1 shows the record on gross domestic product (GDP) growth, and its component expenditure categories, for two time periods – 1996-2002, corresponding to the introduction of the GEAR policies, and 1994-2002, corresponding to the entire democratic era. Between 1996 and 2002, economic growth never came close to the GEAR forecasts. Even if we restrict our attention to GDP in the final years of the period, 2000-2002, the economy grew at an average annualized rate of approximately 3 percent – about half of the target level. The most important contributors to economic growth were an expansion of consumer spending and increased exports. Investment – the linchpin of the GEAR strategy – increased at a lower rate than overall economic growth.

Table 1.
Growth of GDP and expenditure components, South Africa

	1996-2002*	**1994-2002***
	annualized % change over entire period	**annualized % change over entire period**
Real GDP	2.4%	2.8%
Household consumption	2.6%	3.3%
Investment	2.0%	3.9%
Government spending	1.6%	0.9%
Exports	2.8%	4.5%
Less: Imports	1.5%	4.2%

Source: South African Reserve Bank. Note: Estimates for 2002 were calculated by extrapolating the average real growth rates of the first three quarters. For example, GDP growth for 2002 was estimated to be 2.9%.

Comparing the growth record under the GEAR policies with that of the entire post-apartheid era reveals some interesting patterns. The overall annualized growth rates do not differ dramatically – 2.6 percent versus 2.8 percent. However, the expenditure components of GDP show more significant shifts. Spending on imports dropped off significantly in the years of the GEAR policy compared to the full time period. This could be good news, since slower growth of imports could raise demand for domestic goods and improve South Africa's trade balance with the rest of the world. Unfortunately, the drop in the rate of expansion of imports coincided with a drop in the growth rate of all other expenditure categories, with the notable exception of government spending. The slower growth of government expenditures in the years immediately following the '94 elections do not reflect a policy of fiscal constraint as much as they reflect high levels of spending and the rapid build-up of public debt during the final years of the apartheid regime.

Table 2. Economic and social indicators, South Africa, 1994-2002

	1994	**1995**	**1996**	**1997**	**1998**	**1999**	**2000**	**2001**	**2002**
Economic growth	3.2%	3.1%	4.3%	2.6%	0.8%	2.0%	3.5%	2.8%	2.9%
Inflation rate	8.8%	8.7%	7.3%	8.6%	6.9%	5.2%	5.4%	5.7%	8.8%
Real prime lending rate	6.8%	9.2%	12.2%	11.4%	14.9%	12.8%	9.1%	8.1%	6.0%
Exchange rate (R/$US), year end	R3.54	R3.65	R4.68	R4.87	R5.86	R6.15	R7.57	R12.13	R8.51
Budget deficit/GDP	5.1%	4.5%	4.6%	3.8%	2.3%	2.0%	2.0%	1.4%	2.1%
Rate of accumulation of fixed capital	0.8%	1.3%	1.7%	1.9%	2.0%	1.0%	0.8%	0.9%	n/a
% pregnant women with HIV/AIDS, median urban	6.0	9.0	13.5	14.9	19.2	21.0	24.3	n/a	n/a
% pregnant women with HIV/AIDS, median non-urban	6.7	8.3	16.3	18.1	21.3	23.0	22.9	n/a	n/a
Growth rate: private sector employment	-0.9%	0.5%	-2.6%	-2.5%	-4.4%	-1.3%	-2.0%	-1.4%	n/a
Growth rate: total formal sector employment	-0.4%	-1.1%	-0.7%	-1.7%	-3.5%	-2.0%	-2.7%	-1.6%	n/a
National income per capita (R1995)	R13 586	R13 656	R13 961	R13 987	R13 759	R13 641	R13 789	R13 862	n/a

Sources: South African Reserve Bank; International Monetary Fund, *International Finance Statistics*, CD-ROM; South African Department of Finance, *Budget Review 2002*; UNAIDS "Epidemiological Fact Sheets on HIV/AIDS and Sexually Transmitted Diseases: South Africa", 2002 Update. Note: The growth rate for 2002 is based on the trend over the first three quarter; the inflation rate on the first 10 months; and the prime lending rate on the first 6 months.

The growth rate of the economy only tells us so much about the performance of the post-1994 South African economy. Table 2 provides a more detailed year-by-year socio-economic picture, illustrated by a number of key indicators. A central element of the GEAR policy is to keep inflation low while liberalizing financial markets. In general, inflation has come down over this period. However, the price paid for low inflation has been relatively higher real interest rates, which likely dragged down economic growth. Furthermore, an on-going erosion in the value of the rand contributed to the trade-off between interest rates and inflation. The rand never stabilized during this entire period. In particular, a dramatic fall in the rand during 2001/02 led to a re-emergence of inflationary pressures – including rapid increases in the prices of basic food items.

The National Treasury has managed to reduce the size of South Africa's budget deficit – outperforming the targets outlined in the original GEAR policy. However, low inflation and declining deficits have not revitalized private investment. The growth rate of fixed capital stock (that is, the rate of accumulation) has remained at historically low levels. Moreover, the success in meeting the deficit reduction targets should be seen in a broader context: specifically, the tragedy of HIV/AIDS in South Africa. The average prevalence rate of the disease among pregnant women has grown to between 22 and 25 percent in South Africa, raising serious questions as to whether expanding efforts to stop the disease and treat the dying should receive much more priority, even if it compromises future deficit reduction targets.

The South African employment crisis: jobless growth

If growth and investment have yet to measure up, how has the second element of the macroeconomic strategy – employment – fared during this period? Here the record is alarming. As Table 2 shows, jobs have been lost throughout this period, pushing South Africa's already high unemployment rate higher still. Although growth rates have fallen below the optimistic projections of the GEAR strategy, economic growth was generally positive throughout the post-apartheid period. However, growth in employment has been consistently negative. Such "jobless growth" raises serious concerns that current economic policies have failed to translate even modest levels of growth into real social benefits.

In addition, a comparison of changes in private employment and total employment reveal some significant patterns. Before 2000, the rate of decline in private employment was almost always larger than the decline in total employment. This suggests that public employment helped to soften the blow of job losses in the private sector. However, beginning in 2000, total employment actually declined faster than private employment, suggesting that government employment policies are contributing to the unemployment crisis instead of moderating it. An increasing rate of unemployment has serious social consequences that extend beyond the loss of income of the newly jobless. Because of these social costs to unemployment, there is a clear role for public policy, including public employment, in addressing the problem

And Redistribution?

Average incomes in South Africa have not grown significantly during the democratic era. For example, real national income per capita was at approximately the same level in 2001 as it was in 1994 (Table 2). However, averages tell us little about how the current economic policies are coping with one of the largest challenges left behind by the apartheid system: the vast economic inequalities that exist in South Africa. To get a better sense of the final component of the GEAR strategy – redistribution – it is important to look at changes in the distribution of income.

Table 3 presents data on the distribution of income in South Africa based on recent (1995 and 2000) *Income and Expenditure* surveys conducted by Statistics South Africa. The extent of inequality in South Africa is dramatic: in 2000, the poorest 20 percent of households in South Africa received just 1.63 percent of all income, while the richest 20 percent of households received 35 percent of total income. Moreover, the extent of inequality has been increasing. In 1995, the poorest 20 percent of households received a larger share of total income – 1.87 percent. This increase in inequality is also reflected in South Africa's Gini coefficient – a measure of inequality ranging from 0 (perfect equality) to 1 (perfect inequality). The Gini coefficient for South Africa rose from 0.56 in 1995 to 0.57 in 2000. This change is relatively small, but it clearly reveals that South Africa is not moving in the direction of mitigating the inequalities left behind by the apartheid regime.

Table 3. Income inequality.

	2000	1995	% change
Income share of bottom 20% of households	1.63%	1.87%	-12.8%
Income share of top 20% of households	35.13%	35.05%	+0.2%
Gini coefficient	0.57	0.56	+1.8%
Income of African households (2000 Rand)	R26 000	R32 000	-18.8%
Income of White households (2000 Rand)	R158 000	R137 000	+15.3%

Source: Statistics South Africa (2002), *Earning and Spending in South Africa: selected findings and comparisons from the Income and Expenditure surveys of October 1995 and October 2000*, Pretoria.

Finally, given the importance of race in South Africa's history, it can be revealing to examine changes in incomes within the historical racial classifications of the apartheid government. Average incomes of African households, expressed as year 2000 rands, actually fell by over 18 percent from 1995 to 2000. Many factors contributed to this decline – from growing unemployment to the ravages of HIV/AIDS. In contrast, average real incomes of White households actually increased by over 15 percent during this same period. In terms of these figures, there is little evidence that the economic strategies implemented after the 1994 elections have been able to address the legacy of inequality and unemployment that the apartheid system left behind.

A way forward?

The market-friendly, liberalization policies pursued in recent years have not delivered the social benefits needed to transform the South African economy and eventually free it from the historical chains of apartheid. To be fair, there have been a number of successes that can be attributed to the economic management of the democratic era thus far. The economy has achieved modest levels of growth and has avoided any serious economic downturn during a period in which other countries around the world faced extremely serious economic crises. In addition, there have been some significant gains in access to basic services and infrastructure – piped water, community taps, electrical service, and housing. Nevertheless, in terms of the three components of the government's macroeconomic strategy – growth, employment, and redistribution – only growth shows any evidence of positive performance and even this falls well below the expectations of what the South African economy is truly capable of.

In order to realize the real potential for growth, employment, and redistribution, economic policies should move away from market-friendly, inflation-targeting strategies and towards a developmental, employment-targeting approach. The exact content of such a strategy is well beyond the scope of this short brief, but it would certainly involve direct controls on capital mobility, monetary policies conducive to job creating investment, sustainable public investment and employment, income transfers to address the most severe forms of poverty, free public treatment for HIV/AIDS, and efficient regulation rather than outright liberalization. Although a detailed plan for implementing these specific policy proposals would require additional research, such policies reflect viable alternatives for an economy like South Africa's in this era of global integration.