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The Growth of Banking and Financial Institutions

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The Rhodesian Economic Society was founded in 1949 to promote interest in economic matters with an emphasis on Rhodesian problems. The Society has a wide membership of business men, financiers, civil servants and academic economists and its deliberations have accordingly been general and of wide interest.

It was only in 1959 that the Society brought together the various papers delivered to the Society meetings in a volume of Proceedings. Eleven volumes have since been published though the circulation of these Proceedings has been largely confined to Society members.

In keeping with its original objectives the Society has felt the time has now come to replace the Proceedings with a Journal which should become a quarterly with wider circulation. The Journal is not intended to appeal only to the specialist reader but to all interested in the Rhodesian economy. In addition to technical studies, it will publish articles of general economic interest. For this reason extracts from speeches and addresses that reflect and record development within Rhodesia will also be included.

Although the main body of the Journal will reproduce papers read to the Society, written contributions on economic topics are welcome.

The Rhodesian Economic Society is grateful for the financial support provided by a number of firms and other organisations without which the Journal could not be published.

EDWARD OSBORN,
President,
Rhodesian Economic Society.
THE DETERMINANTS OF ECONOMIC GROWTH IN SOUTH AFRICA SINCE 1960¹

J. L. SADIE

The growth of the South African economy during 1960-66 is reflected by the increase in the gross domestic product from 5,335 million Rand to 8,756 million Rand at current prices. Converted to constant prices these figures represent an annual average real growth of 6.2 per cent in the G.D.P., which is appreciably higher than the target rate of 5½ per cent set by the Economic Development Programme for 1966-71. The individual annual rates vary, however, describing a curve which begins at 2.8% and ends at 5.6% and attains a peak of 9.4% in 1963. In terms of the net national income per capita, the volume of goods and services at the disposal of the average South African increased by approximately 3.3% per annum. This rate appears to be unsurpassed in the economic history of South Africa, and implies that its continuation could double the average level of living within 21 years.

The long-term change in the composition of the domestic product, which has been in progress for many years in South Africa, was continued during the initial years of the Republican era, but at an accelerated rate. Although the absolute volume of agricultural production showed a reasonable increase, the share of agriculture declined sharply, owing partly to exceptional drought conditions which also resulted in considerable losses in foreign earnings—some R150 to R200 million. The gold mining industry set up new records every year until 1965 when the value of its production amounted to R775 million. In spite of rises in the prices of labour and material, a 40 per cent increase in the yield was realised, through the exploitation of the higher grade ore found in the new mines, the substitution of capital for labour and rationalisation, with a consequent increase in the productivity per worker, since the index of employment fell from a maximum of 114.3 in 1961 to 106.0 in 1965 (1958 = 100). Of all the minerals only uranium oxide is experiencing an absolute decline in sales. As in the case of agriculture, the relative importance of mining as a co-generator of the domestic product nevertheless decreased, namely from 13.7% in 1960 to an estimated 11.4% in 1966.

¹ Paper read to the Society in January 1967.
Growing Importance of Manufacturing

The place of honour for the largest absolute increase in its contribution to the domestic product must be accorded to the manufacturing industry whose share rose from 18.6% in 1960 to an estimated 23% in 1966. Its gross product at current prices increased by 90% between these two years, and it was thus responsible for more than 30% of the expansion of the G.D.P. of the Republic. The manufacturing industry's index of the physical volume of production increased from 114.4 in 1961 to 171.8 in 1965, i.e. by 50.2%. The corresponding percentages for various sub-sectors were as follows: transport equipment, 127.3%; basic metals and metal products, 63.0%; machinery (including electrical), 58.7%; non-metallic mineral products, 48.3%; chemicals and chemical products, 38.3%; textiles, clothing and footwear, 37.2%; and foodstuffs, 15.2%. These figures would indicate that industrialisation in South Africa has now reached the advanced stage where the emphasis falls on the heavy, mostly capital-intensive industries. They also represent import-replacement industries in so far as the economy used to be dependent upon other countries for the supply of the products concerned. Together with the greater differentiation, the industrial structure has also become more integrated in the sense that the degree of domestic interdependence, as shown by the inter-industry provision of intermediate products in the input-output table, has increased.

Balance of Payments

The above mentioned developments lie at the root of the disequilibrium experienced in the current account of the balance of payments from 1964 onwards. The large net earners of foreign exchange generated a shrinking proportion of the national product, while the large net consumer of such currency (manufacturing) expanded its share in the economic activities of the country. As a permissive medium for the promotion of economic development through its earnings of international currencies, the gold mining industry continued to maintain its dominant position. In a certain sense the importance of its net contribution, which rose from R543 million in 1960 to R701 million in 1964, increased in this connection since almost the total increment was used for the purchase of capital and intermediate goods in foreign markets, while marginal earnings were formerly also partly spent on consumer goods. Although the positive contributions to the current account of the balance of payments by other mining industries and agriculture were appreciably lower than in the case of gold mines, they nevertheless increased at a considerably faster rate than that of gold, and, in the case of agriculture, even doubled. Despite this fact, they were unable, towards the end of the period to continue filling the gap caused by the net foreign currency consumption of the manufacturing industry. This condition is a function of the high import content of
capital formation in the manufacturing industry: for each R100 of fixed investment, roughly 65 Rands' worth of imports are required and an increasing concentration on capital-intensive industries prevents a lowering of the coefficient. This investment also indirectly increases the demand for imports through its multiplier and accelerator effect, thereby adding to the consumption of foreign currency by the other sectors who are net consumers, except of course, in so far as this is prevented by *force majeure* in the form of control.

Experience during the last few years has once again illustrated the operation—in South Africa at least—of what may be called the law of import-replacement under protection, and which can be formulated as follows: each effort to save foreign currency by replacing imports with domestic production increases the net consumption of such currency. With respect to policy this does not imply that import-replacement should be relinquished, but that, when conditions of full or over-employment prevail, it should take place on a competitive basis, unless the subjugation of the market mechanism is to be accepted as normal procedure. However, the importance of competitive ability in this connexion is progressively reduced as the degree of under-and unemployment increases.

It is interesting to note that there has been one exception to the rule that exports have always been making a statistically larger contribution to the total annual supply of goods and services in South Africa than total gross domestic investment (fixed capital formation plus inventories). It occurred in 1965, when probably for the only time in the history of South Africa, the latter exceeded the former in the ratio of 112:100, after rising from 66:100 in 1962. Exports only barely reasserted their quantitative superiority in 1966, when the ratio came to 99:100. In view of the fact that aggregate domestic capital formation has an import content of roughly 40 per cent, the above data provide further evidence of the balance-of-payments effect of rapid economic growth brought about by import-substitution.

**Aftermath of Sharpeville**

Basically, the economic development depicted above, must be related to the intangible and unquantifiable factor: the spirit of enterprise. In this respect the sixties started off in a rather inauspicious manner. The Sharpeville riots, the flight of foreign capital, the drain on the gold and foreign exchange reserves, the rumours of a possible devaluation of the Rand, the forced withdrawal of the Republic from the Commonwealth and the communication of foreign distrust to South African businessmen, created a state of uncertainty about the future in which economic activity was unable to thrive. Plans for expansion and investment are related to expectations about the future, and the pessimism in regard to the latter reduced the marginal efficiency of capital
in the classical Keynesian sense, and accordingly dampened the willingness of entrepreneurs to invest. The decline in the level of capital formation by the private sector, which was not compensated for by the public sector, together with an increase in the savings coefficient, restricted the total demand for production factors to a level which was insufficient to absorb the total increase in the labour force, with the result that unemployment increased. The economy was in a state of recession.

During the three years after the riots, not only did the recollection of those events fade and the pessimistic atmosphere created by them diminish in intensity, but entrepreneurs also became conditioned to the fact that we live in a dangerous world and that the time might probably never, or not soon, arrive when foreign criticism and pressure on South Africa, which were fraught with potential dangers, would cease. In a certain sense they became immunised to incidents which formerly would have had the effect of severely shaking their confidence. It was not so much a confidence in the future, as a neutral attitude towards the uncertainty caused by political conditions, that increased the marginal efficiency of capital. It was the strength of the irrepressible spirit of enterprise which lifted investment from its stagnant level of 1961 and 1962, and placed the economy upon the upward phase of the cyclical wave. Although this factor, as a determinant of change, must not necessarily be accorded priority in terms of historical sequence, it nevertheless deserves a place of honour because of its impact. The increase in employment during 1962, especially by the Central Government, and by the manufacturing sector to utilise the idle productive capacity, admittedly did provide new income for workers but it lacked impetus as a stimulant. There was no lack of entrepreneurial material willing to make use of the opportunities offered. Entrepreneurs also created their own opportunities and increased their gross investment at current prices from the low level of R680 million in 1962 to the record peak of R1,411 million in 1965, after it had decreased between 1960 and 1962. The ambitious thinking and vitality on the part of the members of this leading group of human production factors was remarkable. In this connexion special mention may perhaps be made of the rôle played by the first and second generations of Afrikaans-speaking entrepreneurs, since they were only, a short while ago, still a largely underdeveloped community in the non-agricultural sectors. In their case the development can almost be described as the second phase of an economic resurgence which first manifested itself in the forties.

In part the success of entrepreneurs must be ascribed, of course, to the usual process of self-realisation of expectations or hopes when the latter are acted upon over a broad front. The endogenous process of the cumulative causation manifesting itself during the cyclical upswing played a significant rôle, and no less so when the inflationary pressures began to exert themselves, and prices started to increase.
The spirit of enterprise was, however, fostered by conditions and policy measures which created an atmosphere favourable to economic expansion. The sixties have, in fact, been dominated so far by what could be described as a growth mentality or philosophy.

**Rôle of Liquidity**

In the monetary sphere favourable conditions were created as a result of foreign exchange control which was forced upon South Africa by the efflux of foreign capital during 1960-1961, and which reduced gold and foreign exchange reserves by R173 million within 18 months' time. By means of various currency measures the export of capital was controlled in such a way, and the current account improved to such an extent, that the gold and currency reserves began to rise, culminating in a peak of R580 million in 1963. As a result, the banks were inundated with liquidity without, however, being able to utilise the consequent credit-creating capacity owing to the absence of a corresponding demand for credit for investment purposes. Opportunities for investment were assiduously sought by the banks and the public was in fact urged to make use of loan facilities. Credit for, *inter alia*, speculation was granted fairly easily, and it would appear that the impact of this liquidity was in the first place directed at the stock exchange and private share transactions. Persons who previously showed no interest in equities started to participate in speculation, and funds which would formerly have flowed only to safe deposits in a bank or building society, now gave signs of a readiness to assume the risk-bearing function. To a large extent the speculation fed on itself; the turnover index of the Johannesburg Stock Exchange soared from an average of 113 in 1961 to 449 in April, 1964, and the index of industrial and commercial share prices rose from 94 to 273 (1958 = 100). The average yield on the latter decreased during the same period from 7.52% to 4.09%.

And, so far as is known, for the first time in the history of South Africa the returns on risk-bearing securities were exceeded by those on Government stock. At this stage the hedging-against-inflation motive on the part of the non-institutional investor or speculator was not yet the predominant cause of this reverse yield gap. It was largely the expectation of further rises in share prices that set a self-realising action in motion. The absence of foreign competition, which limited the supply of scrip, contributed to this. Meanwhile the investment policy of life-insurance companies underwent a radical change. In 1960, 58.5% of the net addition to the assets of the four largest institutions took the form of ordinary shares, and during the following three years the percentage fluctuated between 36.9 and 42.1%. Expressed as a fraction of their total assets this form of investment increased from 4.9% in 1959 to 15.9% in 1963. The corresponding ratio in the case of pension funds rose from 9.2% in 1961 to 16.9% in 1965.
Demand for Equities

This unprecedented interest in shares on the part of institutions and the public as a whole contributed to the economic upsurge towards the end of 1962. As a result of rising prices and decreasing returns, investment in new issues became attractive, and from the point of view of the entrepreneur real investment became a possible alternative to financial investment. Capital for new enterprises could be obtained fairly easily, at least by existing firms, and new issues were regularly oversubscribed during these years, in one case as much as twentyfold. In so far as this interest in equities represented a sustained new approach and therefore a structural change, it introduced a growth-promoting element in the private sector. While the relative shortage of risk-bearing funds for the private sector used to be a chronic bottleneck, it would appear that from now on it may be the Public Sector which is going to experience difficulty in obtaining sufficient savings for its capital expenditure.

The government’s rôle in the fostering of economic growth during the past few years was of more than mere incidental significance. The restoration and maintenance of law and order has provided a political framework which condu­ced to confidence in the future and created a more favourable business climate. The private sector also benefited by government action in the economic sphere.

Economic Planning

In the economic history of the nineteen sixties the programme of positive government action has probably been of predominant importance. The Economic Development Programme (E.D.P.) reflects and confirms the emphasis laid on economic development and itself constitutes an instrument for the promotion of this object, which, according to the Economic Adviser to the Prime Minister, Dr. Riekert, in the introduction to the 1965-70 programme, is "to increase as rapidly as possible the standard of living, from a long-term point of view, of all South Africans". The E.D.P. determines the quantitative implications of various growth rates, identifies the specific sectors considered to be of strategic importance, indicates which growth rates fall within the realms of probability, and forms the basis for a target aimed at by the Government. As is known, this target was set at 5.5% p.a. for the period 1964-69, and retained in the latest 1966-71 programme. Although the document constitutes the framework for the formulation of economic and financial policy by the Government, its publication "is also intended to serve as an aid . . . for private businessmen who wish to make use of the development possibilities indicated in it". (E.D.P. 1965-70, p.3). Among entrepreneurs it creates the presumption that the target will indeed be realised, and in the same document it is also stated that "an increasing number of businessmen are taking account of the sectoral estimates of the E.D.P. in connection with their investments.
and future planning of their own firms”. Through the medium of the Economic Advisory Board and regular liaison with executives in the private sector in drawing up the E.D.P., the necessary contact is maintained and co-operation thus secured.

Importance of Public Expenditure

The expenditure programme of the various authorities—central, provincial and local—has made a considerable direct contribution to the increase in the G.D.P. The current expenditure on goods and services—i.e. excluding transfer payments—doubled between 1960 and 1966, in comparison with a 63% increase in the total gross domestic expenditure. This was largely influenced by the need for reinforcing national security, for which the sum of R300 million was budgeted in 1965-66, after the figure had amounted to R91 million in 1960-61. In addition, the wage and salary increases awarded to civil servants, postal workers and railway workers in 1965 placed larger monetary incomes in the hands of the public and, to a certain extent, served as an example for workers in the private sector to justify their demands for higher remuneration.

The total expenditure of public authorities and public corporations on capital formation also doubled between 1960 and 1966, and the share of the corporations in the combined total rose from one sixth to a quarter. Among other things the development of Iscor helped to increase strategic steel production from 1.7 million tons to approximately 3 million. The provision by the State of satisfactory housing for the lower-income groups took place at an accelerated rate during this period. The first phases of the Orange River project, which will ultimately cost R450 million, were embarked upon, partly to reduce the present vulnerability of industry in regard to water supplies. Border area development, which is a key element in the Bantustan policy, and which has already led to the establishment of the first self-governing Bantu area—the Transkei—has been tackled with vigour and determination.

Fiscal Policy

The country’s fiscal policy, which was intended to stimulate consumption and investment during the 1961-62 recession, was maintained over the entire period without any changes worth mentioning, that is, even when activities had already reached inflationary proportions. Taxation of firms during their initial years was effectively reduced by granting (for the calculation of taxable income)—in addition to the normal write-offs—an initial allowance of 15% (originally 20%) in respect of factory equipment and machinery and an investment allowance of 20% (at first 15%). The investment allowance for industrial and hotel buildings amounted to 10%. These concessions were set even higher in the case of “economic development areas” (originally “border areas”). New gold mines would begin paying tax only after their capital expenditure and
capitalised interest had been written off against profit. Exploration costs were treated on a similar basis; old mines also obtained relief and a measure of financial assistance; and mines other than gold mines were allowed an immediate write-off of 25% of their capital expenditure, with the possibility of higher percentages where they processed an appreciable portion of their products themselves or had this done.

These measures to a large extent eliminated the "heads-I-win, tails-you-lose" feature of the taxation system and promoted a greater willingness to invest. The 5% reduction on income tax and the tax-free period of eight months brought about by the introduction of the P.A.Y.E. system in March, 1963, undoubtedly contributed to the increase of R301 million in consumption between 1962 and 1963, as compared with an increase of only R244 million in personal income.

With regard to the financing of the difference between current receipts and total government expenditure on Revenue and Loan Account, the State also promoted investment in the private sector by refraining from large-scale active competition in the capital market, even during the most recent years when disinflationary absorption of money would have been the indicated policy. The control of rates of interest payable on deposits probably had a similar effect.

Import Control

The strongest weapon in the arsenal of policy measures, however, was the foreign exchange and trade policy. This enabled the Government to determine to a large extent the rate as well as the composition of economic growth. The consequences of the insulation of the capital market against disruptive influences from abroad have already been mentioned above. Import control is a much more powerful protective measure than tariff walls could ever be, with due regard to South Africa’s existing international obligations in respect of the latter. Through the progressive reduction of that portion of the foreign exchange available for commodity imports which may be spent on consumer goods from abroad, domestic producers were assured of an expanding market without being hampered by the competition which tariff protection over the whole market would have permitted. The policy adopted in respect of the latter at the same time underwent a metamorphosis in the sense that tariff protection is now being regarded as a right rather than a privilege, and that profits of, for example, 20% in an industry are, from the point of view of granting protection, not regarded as disqualifyingly high earnings.

The use of the major portion of the foreign exchange for the granting of permits to import capital goods and intermediate inputs offered an opportunity for the promotion of import-replacement and strategic industries—in
the latter case especially with a view to a lessening of the economic and military vulnerability of South Africa, after former suppliers of military material had begun to apply sanctions against the Republic. The Republic’s first aeroplane factory was constructed, the tonnage of ships under South African control was rapidly increased, the principle of granting temporary subsidies to tractor manufacturers was accepted, and the metal industry supporting the manufacture of weapons was promoted. The motor industry received special encouragement to increase the South African content of motor vehicles to 55% by 1968, and thus to establish the country’s own motor manufacturing industry. In this process some of the advantages of international specialisation of labour were sacrificed.

Export Promotion

The Government’s measures to promote exports include the following: special rebates on income tax in respect of expenditure incurred in the development of foreign markets; financial support for the establishment of an organisation for the promotion of South African exports; and greater official commercial representation abroad.

Importance of Immigration

On the lower level of causality we find the supporting rôle of the expanding population and labour force. Between September, 1960, and June, 1966, the total population increased at an annual rate of 2.3%, this figure being higher than that recorded during any corresponding period since Union. The share of the White population in the total showed a slight decrease, namely from 19.1 to 18.9%. The decline would have been greater if the community had not been re-inforced by a sustained and unprecedented net influx of immigrants at the rate of about 30,000 p.a. since 1963, after the figures had amounted to 1,420 and 11,970 in 1961 and 1962, respectively. The average annual net immigration for the first five years of the Republican period, namely May, 1961 to May, 1966, was 23,700, which added exactly 50% to the natural increase and raised the growth rate to almost 2.3% p.a.

If the trend, manifested during 1951-60, of the participation rates of Whites in the labour force has continued since that period, then the male and the female labour force has been expanding by 10,000 and 7,800 p.a. respectively, as a result of natural increase. Immigration has strengthened the former by 88% p.a. and the total White labour force by 56% p.a. These magnitudes reflect the strategic rôle played by immigration in facilitating the economic development of the Republic. It is this reinforcement of the leading element in the hierarchy of the economically active population that has made the high growth rate possible. At the same time, immigrants served as a stimulus to greater investment and soon became an additional inflationary factor.
by adding to the demand for consumer goods, housing and other capital goods. The effect of an addition of about 50% to the demand for accommodation which was already being generated by the natural increase in the White population, was undoubtedly responsible for a large part of the phenomenal expansion of the construction industry.

The growth of the White working population was accompanied by increases of 2.2%, 3.0% and 4.0%, in the Bantu, Coloured and Asiatic labour forces respectively. Because of the relative scarcity of semi-skilled and skilled labour, non-Whites were promoted to higher and better-paid posts which, since their savings coefficient is minimal, resulted in the demand for consumer goods rising accordingly, this fact being partly responsible for the increase in 1963 and 1964 in the percentage of the disposable income spent on consumer goods. Of the three categories, i.e. durable goods, non-durable goods and services, the first-mentioned experienced the largest relative increase namely from 13.0% of consumer expenditure in 1960 to 14.6% in 1965, after the figure had reached a peak of 15.0% in 1964. In 1963 the annual sales of passenger motor cars also exceeded the 100,000 mark for the first time and rose to the record level of 141,588 in 1964.

In this way the rapid growth in the population, together with the greater purchasing power placed in its hands and the increased demand for consumer goods and housing, served as a determinant of gross economic growth and at the same time acted as a factor which made possible the realisation of the economies of scale. The rapid increase in labour, as factor of production, which resulted from this, in turn prevented the marginal productivity of capital from falling to such an extent that investment would be curbed.

Conclusion

The fundamental determinants of economic growth in the Republic, namely government policy (by which the restrictive element in the operation of the market mechanism is to an important extent eliminated), an unquenchable spirit of enterprise, demographic factors and the process of cumulative causation, therefore all contributed in raising economic activity to an inflationary level. This largely amounted to the creation of growth by means of a planned disequilibrium system. And in 1966, the policy-makers were faced with the difficult choice whether they should continue with this system and still stimulate growth, thereby accepting inflation, or effectively strive towards stability and thereby possibly restricting economic development in the short-term. But it is undoubtedly far better to have to fight inflation which results from the over-enthusiasm of businessmen, than to have stability resulting from stagnation.

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