

THE TRANSITION TO DEMOCRACY: A FRAMEWORK FOR MACROECONOMIC POLICY

Extracted from the ANC Macroeconomic Research Group (MERG) Report entitled 'Making Democracy Work: A Framework for Macroeconomic Policy in South Africa', December 1993

1 WHAT CAN BE ACHIEVED

The political transformation of South Africa will make it possible to achieve economic growth and to set realistic goals for improved living standards and economic security for all South Africans, especially the most disadvantaged. Without a new growth path to put these goals within reach, political transformation itself will be put in jeopardy.

Despite difficult conditions globally and domestically, this new economy can be achieved. Other countries have made transitions which are similar in scale, although their specific problems differed from those of South Africa. What is required is effective state intervention, a vigorous private sector, the active involvement of women and men in all spheres of society, and a carefully designed, implementable, and well-supported macroeconomic strategy for transition.

MERG has formulated a feasible and affordable programme to achieve major gains during the next decade. These gains correspond to the published objectives of the democratic movement.

'The central goal of ANC economic policy is to create a strong, dynamic and balanced economy that will be directed towards:

- Eliminating the poverty and the extreme inequalities generated by the apartheid system;
- Democratizing the economy and empowering the historically oppressed;
- Creating productive employment opportunities at a living wage for all South Africans;
- Initiating growth and development to improve the quality of life for all South Africans, but especially for the poor;
- Developing a prosperous and balanced regional economy in Southern Africa based on the principles of equity and mutual benefit.

In 1992 the economic policy conference of COSATU set out a growth path which emphasized the following elements:

- An industrial policy designed to widen the income base through job creation and new economic activity, and deepen that base by developing human resources and technological capability that increases productivity, wages and incomes and lowers the cost of production;

- A strong, decisive and democratic state intervening strategically within the framework of the growth path in support of economic reconstruction.

- The building of workers' power;

- Mutually beneficial agreements and cooperation to secure growth and development in the Southern African region.

The four pillars of the COSATU reconstruction programme are:

- Job creation;

- Human resource development to extend the skill base of the working population;

- A social wage, including the effective delivery of social services (housing, electricity, health, education and wages), and security provisions (unemployment benefits, pensions);

- The empowerment of civil society, including the improvement in the economic and political rights and circumstances of workers, women, rural people etc.

MERG took these objectives of the democratic movement as its starting point. The aim of the MERG framework is to secure a rapid improvement in the quality of life of the poorest, most oppressed and disadvantaged people in South Africa. The policy recommendations stress projects to initiate job creation and training programmes for the unemployed; to improve the status of the poorest women in rural areas; to improve the availability and quality of education and health and housing and electrification; to raise the minimum level of wages of low-income earners; and to improve the skills of employed workers.

Some key data provided by the MERG macro-economic model illustrate the way in which these objectives will be achieved over the next few years.

- The MERG growth objective is for GDP growth to rise steadily through the 1990s to reach just under 5 per cent per year in the early years of the 21st century. Such growth should create about 300,000 jobs a year. The total number of jobs created between 1992 and 2004 would then be 2.5 million, compared to the zero net jobs created between 1982 and 1992. The growth projections are feasible; they involve an increase in GDP by only 1.1 per cent in 1994, rising to an average of 3.8 per cent between 1995 and the year 2000.

- In education, MERG proposes a minimum of R5 billion (in 1992 prices) in annual recurrent and teacher training expenditures and a lifting of annual education capital expenditures from the current R0.5 billion to R1 billion. This level of expenditure will provide the infrastructure (teachers, classrooms and incidentals) to offer universal access to a minimum of ten years of education.

- In adult basic education, MERG proposes a four year programme for persons already in the workforce at the rate of 50,000 new trainees per year; and a programme for unemployed persons to be engaged on physical infrastructural projects, who will receive training similar to that for employed workers, at a rate of 100,000 new programme entrants per year. The combined effect of the proposals for education and training will be a radical change in the characteristics and productivity of the labour force.

- In health, MERG sets out a programme to provide 2,000 clinics at a capital cost of R300 million (in 1992 prices) and a recurrent cost of R1.5 billion per year; and a basic health care and nutrition programme to be implemented at a cost of R1 billion per year.

- In housing, MERG proposes that the government triples the number of housing sites from the current 100,000 to 300,000 per year. The number of formal houses completed should rise step by step from current levels of around 38,000 (per year) to 350,000 by the early part of the next century.

- For rural development, MERG proposes that the state intervenes to redistribute land within a short period of time to the benefit of adult female members of landless households in the rural homelands. A policy capable of ensuring stable and affordable prices of basic foods is also recommended.

- MERG proposes the establishment of a realistic statutory minimum wage, set initially at two-thirds of the Minimum Living Level (MLL). Such a policy will have positive macroeconomic and microeconomic consequences.

- The industrialization and trade strategy proposed by MERG is based on increasing export revenues by

extending existing natural resource advantages, but it avoids the danger of getting stuck in a new rut and falling prey to fluctuating prices for primary commodities. Production of manufactured goods for both the local and export market is emphasized. Trade policy stresses institutional reform and carefully phased tariff reductions, together with newly designed and more cost effective export support programmes focused on the potentially most dynamic exporters of manufactures, and re-negotiated trade preference arrangements. Industrial policy emphasizes technological capacity building to develop productive skills and competition policy aimed at eliminating monopolistic inefficiencies. The competition policy advocated should improve the links between big and small firms. It would also involve setting up market-related programmes for smaller Black-owned businesses. The macroeconomic policies critical for industrial growth are described; these include the maintenance of the real effective exchange rate at an appropriate level.

- The MERG proposals for other sectors of the economy support its overall economic programme. Detailed and practical proposals have been developed to restructure the banking and finance sector. Such proposals include extending facilities to the majority of the population by creating a cheap, widely available system of money transfer, and improving the availability and terms of finance for investment in targeted growth sectors. To complement these proposals, MERG recommends changes in the structure of company tax in order to widen its base and strengthen incentives for investment.

The MERG strategy contrasts sharply with the approach of the Normative Economic Model (NEM) of the government (CEAS 1993). The NEM favours the advantaged sections of society and assumes that the trickle down effects will distribute the benefits to the disadvantaged. The MERG approach targets the disadvantaged directly.

The proposed strategies will immediately contribute to growth, but have also been designed to achieve sustained growth and macroeconomic balance. Government consumption expenditure will be contained at roughly its present level in real terms until the end of the 1990s. A moderate growth in tax revenue is to be achieved by some changes in the composition of total tax revenue. Such changes have been designed to be sustainable. It will be shown that the MERG strategy is consistent with required macroeconomic balances. The realization of MERG objectives will be

impossible unless policy is characterized by prudent and risk-averse fiscal, monetary and balance of payments management. Sound macroeconomic policies should ensure sustainability and increased capacity to deliver social goods and will facilitate, rather than constrain, the development strategy of the democratic movement. Success will also depend upon the absence of any major deterioration in the ability to gain from trade in world markets.

2 THE BUILDING BLOCKS FOR OUR FUTURE

It is hoped that the policy agenda set out below will constitute the first building blocks for constructing a solid future for the South African economy. The economic issues are complex and challenging; the policy solutions cannot be simplistic nor, unfortunately, can they conveniently be presented in the form of snappy phrases useful for journalists.

Each of the policy initiatives provide an analysis of past policy failure in each of the critical areas of economic management: fiscal, monetary and exchange rate policies; investment in social and physical infrastructure; the labour market; rural development and food policies; industrial, corporate and trade policies; the banking and financial system; and the management of the public sector. The purpose of providing these accounts of failure is to lay a sound basis for the formulation of new economic thinking and new policies capable of addressing the severe problem faced by all South Africans.

3 FISCAL POLICY

The starting point for the design of fiscal policy is the principle that the relative size of public sector investment needs to be increased. If the targeted rate of growth in non-interest government expenditure is to be sustained, the proposed increases in public expenditure must be directed into investment in infrastructure and human resource development, not into low productivity employment in the public sector, not into consumption oriented social welfare.

On the revenue side, a democratic government should commit itself not to increase the share of personal income tax in GDP while, within these totals, it should restructure the personal tax system. Part of the restructuring will involve the removal of features that discriminate against women and low income tax payers. A democratic government should not increase the nominal rate of company tax, although the

structure of the tax will have to be changed, in order to widen its base and strengthen incentives for investment.

The next government should commit itself to a multiple-rate VAT system to ensure that VAT has a progressive effect, imposing lower average rates on the expenditure of the poor and higher average rates on the expenditure of the rich. There are detailed discussions of capital gains taxation, capital transfer taxation, customs and excise duties, wealth taxes and taxes on property. Advice on the design of these and other taxes will be delivered by an independent Fiscal Commission. Recommendations concerning the role and functions of such a commission are provided.

The share of government revenue in GDP is projected to rise moderately between 1993 and 2003. However, this moderate increase will, under reasonable assumptions concerning the rate of growth of GDP, make a huge difference to state revenue. Attention is given to measures to improve the efficiency and management of public spending. Recommendations include the introduction of a system of multi-year expenditure planning and rolling budgets, as well as institutionalized performance auditing.

4 MACROECONOMIC BALANCE, MONETARY POLICY AND EXCHANGE RATE POLICY

Because of low debt ratios there is some scope for higher levels of foreign borrowing. Capital inflows in the years ahead should reverse the current situation of outflows of between two and three per cent of GDP. The MERG also proposes that the Reserve Bank should attempt to maintain a fairly stable real effective exchange rate. The real rate should be compatible with both a decline in unemployment and increases in non-traditional exports.

It is not proposed that exchange controls on foreign investors will be tightened in any way, nor that restrictions will be placed on profit remittances. The focus of exchange controls will continue to be on domestic residents. Moves towards capital account liberalization are not envisaged in the short-term, and a number of conditions are spelled out, all of which would have to be met before any such moves were contemplated.

Monetary policy since 1989 has been too narrowly focused on inflation, resulting in a policy stance

which has been excessively tight in the face of severe recession and falling employment. While lower inflation is preferable to higher inflation, the costs of reducing a moderate level of inflation to a low level must be examined closely. The real interest rate target recommended is positive, but low.

5 SOCIAL AND PHYSICAL INFRASTRUCTURE

Proposals for investment in social and physical infrastructure are divided into four sectors, covering housing, schooling, basic health services and electrification. The key issue in these areas is not simply the macroeconomic question of how much to spend and how to finance this spending; a series of microeconomic questions about the capacity to deliver must also be addressed. Cost and financing will not necessarily be the binding constraint on infrastructural provision. If the current inequalities and inefficiencies in infrastructural provision are addressed in terms of financial constraints, an undue and simplistic emphasis will be placed on the role of user charges, access to credit and funding.

In addition to proposals for a building programme rising to at least 350,000 units per year, the housing section contains proposals for a water supply programme and an access and feeder road construction programme. The needs of the rural population are emphasized in these programmes, which require the establishment of a unitary national housing authority with wide ranging responsibilities and powers. It will be necessary to regulate both for housing and building supplies markets. Particular attention is paid to the need for a variety of forms of housing tenure, delivery, upgrading and products to reflect the full range of housing needs. Instead of focusing attention on the building of owner-occupied houses through indirect financial mechanisms, it makes more sense to use the finance available to the state to fund a housing programme directly, so that the poor can rent subsidized housing.

The MERG Report estimates the costs of the priority programme for ten years of universal education in terms of its annual salary component, the teacher training requirements, the school building programme and the necessary supplies of consumables to schools. Proposals are made for the training of teachers by means of distance learning methods and through an enhanced commitment to supplying teachers by all institutions of higher learning.

Arguments for the regulation and monitoring of private sector education are presented, and the role of user charges in the financing of education is placed in perspective, by querying the rationale for using the schooling system as a fiscal unit. The provision of extra funding to make up for missing schools, shortages of qualified teachers, etc. will succeed only if accompanied by programmes that provide for employment, housing and transport, and nutritional support. This is because economic and social deprivation undermine learning, and because subsequent job prospects are an important component in raising the incentive to learn, as well as in utilising what has been learned.

The main thrust of the proposed public sector health programme is a growing provision of primary and preventive care, which can provide a basis for an expanded public provision of higher levels of curative treatment at a later stage. Primary health services in rural areas are a priority, with emphasis on the low-cost preventative and curative measures that serve the majority of the population and will achieve very high social rates of return. The costs of providing vaccinations, essential drugs, oral rehydration and supplements to address nutrient deficiencies are estimated. Estimates are provided for the costs of a nutrition intervention programme covering two million infants and pre-school children. Expenditures to meet the capital and recurrent costs of constructing 2,000 rural clinics are proposed.

The implementation of these proposals will require the creation of a single Department of Health. For this Department to fulfil its responsibility, it will require the resources to develop and strengthen the health information system so that valid data for policy evaluation is available.

To facilitate the major role that electrification and electricity will play in support of developmental goals it is recommended that Eskom remain in public ownership. The institutional restructuring of electricity distribution to eliminate rent seeking by local authorities and to tap economies of scale in distribution is proposed, together with the development of an electrification programme for the Southern African region.

Additional recommendations are made concerning the role of user charges and the requirement to meet the anticipated growth in the demand for electrical

consumer durables. The scale of the programme may be appreciated by the fact that, within a short period, 400,000 new connections per year will be completed.

6 LABOUR MARKET POLICIES

One of the main arguments of the MERG Report is that active labour market intervention will be required to achieve the objectives of the democratic movement. Some increase in the rate of growth of employment may be anticipated as a consequence of higher rates of output growth. However, the trickle-down effects on labour market conditions of a more favourable macroeconomic environment will not be sufficient to prevent an escalation of the social, political and human costs of labour under-utilization and poverty wages.

The required interventions in the labour market are discussed under three headings: investment in human resources; proposals for a living wage; and proposals for labour-based infrastructural investment. Simulations indicate that the wage earning capacity of the Black labour force will rise rather rapidly and that a shift in the proportion of the Black labour force confined to the lowest education/skill categories can be achieved. The net result is that Black workers' skills and wage profiles move considerably closer to those of white workers over the period of the investment programme.

The primary aim of the national minimum wage proposed by MERG is not to achieve a rapid general rise in wages, but to improve the wages and productivity of the lowest-paid members of the workforce, say the bottom ten per cent of earners. A conservative and cautious initial approach to setting the national minimum wage is proposed, which takes a fraction of the Minimum Living Level as its starting point. The consequences for the level of inflation, the growth of exports and the level of employment are considered.

The infrastructural investment programme will combine the objectives of delivering physical structures to selected sectors, increasing the employment opportunities available to women and the poorest people, and ensuring that all expenditures result in genuine investments with high rates of return. A phased programme of Public Works will be implemented over the years 1994 to 2004, such that the overall share of general government capital expenditure (i.e. excluding public enterprises) rises from the

current level of 1.3 per cent of GDP to three per cent by the end of the period. The number of new employment opportunities created will be significant.

7 RURAL DEVELOPMENT AND FOOD POLICY

The MERG Report lists the economic arguments for according the Agricultural and Agro-industrial sectors priority in the growth strategy. The characteristics of the poor in South Africa are provided. The largest numbers of the poor and the most acute forms of poverty are to be found in rural areas amongst Black females. Well over half the rural poor depend on agricultural wage employment for their survival and, therefore, the impact of rural development policy on the demand for agricultural wage labour is a crucial issue.

The policy recommendations include a land redistribution programme, which focuses on women living in landless households in the rural homelands; a programme of investment in rural social and physical infrastructure, also designed to benefit women; a range of incentives for the most dynamic capitalist farmers and agri-businesses, which will encourage them to employ a large amount of productive labour at a living wage and to make a significant contribution to export revenues. Institutional reforms, the most important of which are aimed at developing the organizational strength and political voice of landless rural females and rural wage labourers are recommended.

It is not proposed that there should be a rapid convergence to a rigid link between world and domestic staple grain prices. The more efficient domestic producers and all low-income consumers of staple grains should be cushioned from world market price fluctuations through state intervention using variable tariffs on maize and wheat to ensure price stability. The most vulnerable households would be targeted through nutritional programmes focused on specified rural clinics and their female and infant clients. The Report offers proposals to increase the purchasing power of the most food-insecure households by raising their incomes from employment. This will be achieved through the introduction of the national minimum wage and through the increase in the number of rural employment opportunities available as a result of the recommended Public Works programme and the programme of support for investment on the farms of efficient employers.

8 INDUSTRIAL, CORPORATE AND TRADE POLICY

The MERG Report presents an overview of the causes and consequences of manufacturing decline, and of industrial policy since the 1930s. The skewed composition of industry and the continuing absence of a broader range of manufacturing capability is highlighted. The central features of South African industry are analysed. Mining and mineral processing are identified as lying at the core of the South African industrial production structure. Some key strategy proposals are addressed. These relate to competition policy (including an assessment of market and ownership structures, as well as the role of small-, medium- and micro-enterprises); trade policy; and strategies aimed at strengthening the capacities required to revitalize manufacturing, particularly in the area of human resource development and technological capabilities.

Revenues earned from mineral exports have been considerably depressed as a result of transfer pricing and excessive levels of commissions paid for handling these exports. MERG recommends the creation of a public sector Minerals Marketing Board. Further cooperation between the private sector mining and minerals companies and the state is recommended to promote beneficiation more effectively, to maximize the possibility of developing efficient depletion and extraction programmes and to deal with chronic excess capacity.

The arguments in this chapter do not support a programme of dismantling the conglomerates. However, a much more vigorous competition policy is advocated and a strengthening of the resources and punitive power of the existing competition authorities. Proposals are made to promote greater cooperation between firms, including the development of industrial districts. Proposals are also made to expand the role of small and medium enterprises in the South African economy.

The conclusion concerning technological capabilities is that the combination of private initiative and an incoherent and weak state policy has resulted in highly deficient capability. Existing institutional arrangements for technology promotion are too weakly designed to complement and supplement the workings of the market. The MERG proposals include policies to strengthen incentives to firms to invest in the development of in-house technological capabilities; and proposals to restructure

the funding and other incentives that affect the operations of the system of statutory science councils.

The trade policy proposals are designed to lower costs to domestic industry by reforming protection, without jeopardizing development strategies, and to coordinate export support programmes with protection policy, while making them more cost-effective. Detailed policies for the reform of import protection and for changes in export support are recommended.

9 BANKING AND FINANCE

The MERG Report describes the crucial role that the financial system will play. It argues that the financial liberalization policies of the past decade have not created a financial system which provides a strong base for economic transformation. They were based on the philosophy that unrestricted, competitive financial markets would facilitate an improved allocation of finance which would underpin efficient economic growth and prompt improvements in banking and other financial intermediaries. By contrast, the policies MERG proposes do not rely only on competition to promote improvements in the financial system. They involve direct initiatives in building institutions oriented to the needs of the new South African economy.

The initiatives proposed include a People's Bank based on the post office network to give all South Africans access to a cheap and effective means of transferring money and receiving payments. MERG considers it is important to raise the personal saving ratio and proposes that a saving-related housing finance institution be established as well as an earnings-related, funded, contributory state pension scheme. In addition it is proposed that the portfolio of the Post Office Savings Bank be widened and its saving schemes be strengthened.

To strengthen the financing of productive investment, the Report proposes measures which increase the orientation of the capital market toward productive infrastructural ventures rather than financial speculation. These include changes in the tax structure, especially the creation of a capital gains tax, a change in the marketable securities tax, and prescribed asset ratios for pension funds and life assurance companies. With the same objective, measures are proposed which would improve the relations of the banking system with corporations.

The MERG Report proposes the strengthening of bank regulation and policies to safeguard the savings of depositors. It is also proposed that the Reserve Bank should be accountable, subordinate to the Ministry of Finance and subject to parliamentary scrutiny; and it should be fully state owned, ending its anomalous character as a formally private institution.

10 THE STATE AND THE ECONOMY

The MERG Report argues that the state will have to provide leadership and coordination for widely-based economic development and must intervene directly in key areas to facilitate this development. To achieve these objectives the state structures will need to be changed. The machinery of government, in addition to being democratic, with strong mechanisms of accountability and transparency, must serve the purposes of a developmental state. The perspective of MERG is that the developmental state should itself be efficient and should not absorb a high level of resources for its own functioning. Unlike the present South African state, it should be a slim state, disciplined by mechanisms which provide

incentives for efficiency and for monitoring performance. The structure of ministries and state agencies will have to be redesigned so that plans for investment and economic development are carefully coordinated.

The Report also proposes that the mechanism and criteria for operating state owned industries should be restructured to improve enterprise efficiency. A commission should be established to evaluate proposals for a change of ownership (from private to public ownership or vice versa) in selected enterprises. The investment programmes of state owned enterprises and other state agencies should be set within overall totals which enable public sector investment to raise the rate of gross domestic investment. These programmes should be designed so that private and public sector investment are mutually reinforcing.

The final section of the Report discusses the role of the state in the Southern African region. An active role for the state in the development of new regional structures is proposed.