Word count: 3740 without reference list

The Challenge of growth: South African economic development in the face of a a difficult global economic climate.

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1. Introduction

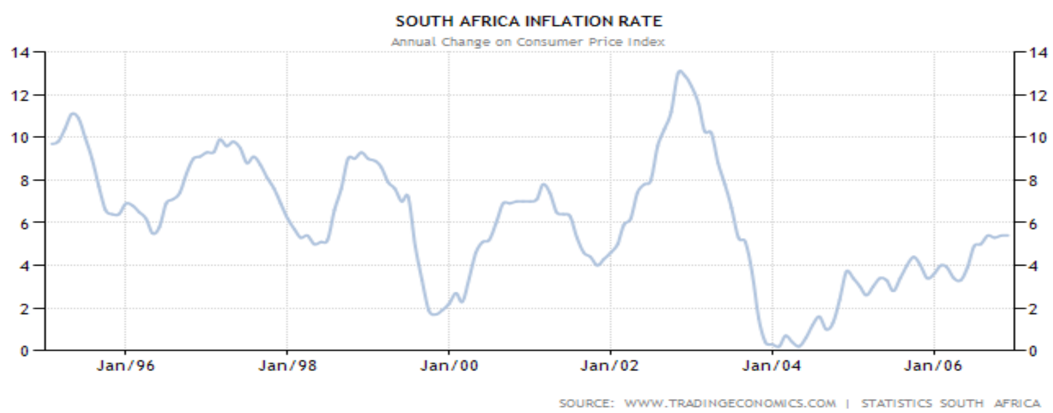
The South African economy is one that has over the years faced a number of challenges that are not necessarily unique in the face of the global economic climate but one cannot deny that the history of the country has played and continued to play an important part in creating the dynamics that we see in the economy today (Segatti and Pons-Vigonn, 2013: 538). The balance between aspiring to become a developed economy juxtaposed against the backdrop of the realities of being a welfare state has meant that more often than not the policies that have been created have been pulling in opposite directions. This is further fuelled by the challenge of having an economy that is extremely sensitive to developments occurring in the global economy a position that has been created by the economy's dependence on the foreign sector cemented by our role as a large exporter of minerals. (Segatti and Pons-Vigonn, 2013: 540). Economic growth is vital if the objective of socio-economic transformation is to become a reality. Often social reform policies in the country are viewed as contrary to economic policy and although this may very well be true at times, the following essay will argue that the two do not always have to be mutually exclusive, in fact a symbiotic relationship between economic and social policy is what is needed to move the economy forward, in a meaningful way. The essay will attempt to answer the question by exploring the progress of South African Economic policy since 1994, identifying what are often contradictions between the needs of the economy and the policies. This will be followed by a look at how the missing link has been and continues to be a strong focus on creating a strong industrial sector and how developing a strong industrial base will be key in moving the economy closer to the goal of being less vulnerable to developments in the global economy. The essay will also show that another obstacle to SA's growth is the lack of the middle or small business sector in the economy. With this the essay will finally make policy recommendations based on the conclusions drawn.

2. The Development of South African Economic Policy post-1994. Mistakes made, lessons learnt?

At the dawn of democracy the newly elected government inherited an economy that was in tatters. State systems had collapsed, the country was facing what seemed to be insurmountable debt, low levels of savings and fixed investment and appalling socio-economic conditions for the majority of the population (Hirsch, 2005: 1). In 1994, South Africa was a society plagued by inequality with a gini-coefficient higher than 0.60 coming second only to Brazil (Woolard, 2002: 6). While the black population constituted 78% of the population they accounted for 95% of those living in poverty, with only 5% of white people being classified as poor (Woodard, 2002: 3). Although the South African economy has made commendable progress in its first 20 years of democracy, the challenges described above are still challenges that the economy faces currently and citizens are becoming increasingly impatient. Furthermore, current statistics indicate that the promise that came with the dream of a democratically elected government have not completely come to fruition particularly with regards to economic transformation. Recent statistics show that inequality has in fact worsened since the democratically elected state took over, with the most recent gini-coefficient standing at 0.7 with intra-racial inequality increasing steadily over the years (StatsSA, 2013). This requires us to ask whether or not the policy decisions made over the course of what has been termed the 'first-transition', contributed to the challenges that the currently faces 20 years into democracy being strikingly similar to those witnessed at the dawn of democracy.

When the African National Congress (ANC) was elected into power in 1994 many, particularly the corporate sector, were concerned about the strong communist voice within the movement. Socialism was a dominant thread in many of the documents that had been produced by the movement before coming into power, the most prominent of these being the Freedom Charter (Natrass, 1994: 344). In fact Natrass (1994: 345) highlights the statement made by the late President Mandela on the "inconceivable" idea of the ANC abandoning its policy of nationalisation of mines and banks. However, after some time it was evident that the idea of a lack of investment in the new economy was enough to lead the governing party to adopt more market-orientated economic policy. This led to the birth of the Reconstruction and Development Plan (RDP), which has since become synonymous with the low-income housing that dots the landscape of townships and rural parts of the country. The RDP was a policy that had a key focus on social welfare and economic transformation targeted at grass-root or bottom-up development which would be lead and spearheaded by the South African public. (Natrass, 1994: 357-358). The policy was formulated at a time when policy-makers had to make the choice between achieving redistribution through growth or growth through redistribution. The RDP failed to spend the money that had been assigned to the project and as a result the plan failed to take off. After the poor performance of the RDP the next policy to follow was the controversial Growth, Employment and Redistribution policy otherwise known as GEAR. GEAR took what seemed to be a clear path that focused on fiscal prudence, developing a more market orientated economy and boosting investor confidence by applying monetary policy easing by allowing interest rates to fall (Natrass, 1996: 26). Many of those who were opposed to the GEAR policy viewed it as an abandonment of the social-welfare needs of the South African public at the time. Hirsch (2005:101) brought to light the concerns of the labour-force that believed that the strong emphasis on reducing the budget deficit and creating an investor-friendly monetary policy was merely the ANC making too many concessions for the foreign investors with very little guarantee of the perceived benefits of these concessions, for the future of the economy. Needless to say GEAR was abandoned but Streak (2004: 277) states that although GEAR failed to achieve its primary development goals it did manage to achieve substantial macroeconomic improvements with inflation falling to levels below the targets set out by GEAR, real interest also fell during the period and the goal of achieving a reduced budget deficit was achieved. Figure 1 below shows how inflation rates were on a downward trend after the introduction of GEAR in 1996.

Figure 1



A lack of commitment to implementing policies effectively seems to be a challenge that will continue to plague the South African economy. The RDP and GEAR both have elements that are strong although, GEAR was arguably better for the fulfilment of sustained and targeted growth of the economy. Aside from poor implementation RDP failed largely due to the fact that the policy was too open to interpretation and although it may have been necessary to garner support from all stakeholders in the economy, it meant that clear objectives and plans were difficult to construct (Blumenfield, 1997: 8). GEAR seemed to cure policy-makers of this policy confusion, however, the constant pressure to promote redistribution and an absence of well-functioning measures to implement constructive redistribution programmes meant that the programme was deemed a failure and abandoned. The latest economic policy is also one that is not free of contestation. The National Development Plan has been dubbed the blueprint for the growth and development part that the economy will follow to achieve the vision of an improved South Africa by 2030 (National Development Plan, 2011:14). However, as much as the policy has many merits it follows the same poor pattern as previous South African policies. Firstly, the policy lacks clarity in terms of a stance that the economy will take with regards to, whether the focus will be on growth before redistribution or whether the economy will achieve growth through redistribution because it seems that prioritising both objectives has not produced the desired results. In order to achieve the objectives the NDP proposes the following: increasing exports, developing more efficient and more competitive infrastructure, reducing the cost to comply with regulation particularly for small businesses, creating a labour market that is more flexible in order to take advantage of economic opportunities in the market and finally the plan proposes that the country begins to take advantage of its competitive advantage of mineral wealth, strong and developed financial sector and being close to fast growing African economies (National Development Plan, 2011: 28-32). All of these points are valid points and the economy should be moving on implementing these targets. However, the focus on the maintaining the country's competitive advantage pertaining to resource wealth is a point of concern. The risk in this is that the economy will continue to be vulnerable to global market developments. Furthermore, Le Roux (2013) highlights the importance of getting an economy to move up the value chain by creating new competitive advantages that are not driven by resource exports. This essay proposes that the best way to do this would be to develop a strong industrial base.

3. Industrialisation: A solution for South Africa?

So often in South African policy the industrial sector is mentioned and identified as a key component in the progression of the economy, however, even with the formulation of the industrial policy action plan by the Department of Trade and Industry there seems to be a misguided focus on creating an economy that is largely driven by the tertiary sector, when in fact the economy lacks the human and physical capital needed to be a tertiary sector driven economy. South Africa is a country that has potential to have a strong industrial base if it would play to the economy's strengths. The country is a country that needs to create industries that are labour intensive. Hausmann, Rodrik, and Sabel (2007, 6) suggest that the best strategy for establishing an industrial base in the South Africa would be one that focuses on existing advantages or industries and building on those. The automotive, steel, agro-processing, as well as mineral processing industries are areas that the economy has the greatest potential to grow. The automotive industry alone, accounts for 6% of the country's total GDP and accounting for approximately 12% of the country's exports. According to the Automotive Industry Export Council, (2010) the automotive production and component manufacturing sector employs a total of 271 000 people. South Africa's industrial production has not seen much improvement over the past 10 years.

Figure 2

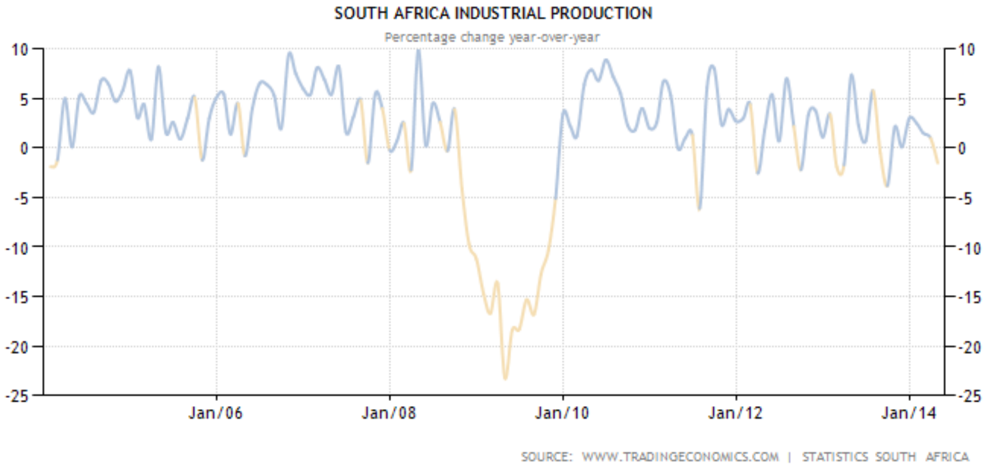


Figure 2 above shows that there has not been significant improvement in the development of South Africa's industrial production from 2004 to 2014. In fact the graph shows that industrial production in South Africa has been fluctuating between 0 and 10 per cent. Furthermore, the graph illustrates that industrial production in the country is not stable the fluctuations in the changes are frequent and this will inevitably not only impact upon the operation of existing producers but it will have a negative impact upon the perception that potential industrialists may have of the climate that the South African economy has for the industrial sector. The contraction of the industrial production in 2008 can be attributed to the financial crisis and although the sector seems to have recovered the production sector has simply returned to its previous band.

In order to promote a strong industrial base policy-makers need to create policies that are viewed as being friendly to business. In terms of overall global competitive index South Africa ranks relatively well, coming in at 53 out of 148 countries measured. There are a number of factors that have counted in the country's favour when it came to global competeveness one being the excellent management and regulation of the Johannesburg Stock Exchange and the country's auditing standards place it first in the world (Keeton, 2014). However, Keeton (2014) goes on to mention that in terms of sub-categories South Africa ranks poorly on businesses' perception of the government particularly with regards to the view government holds of business. Figure 3 below also shows that since the 2008 financial crisis South Africa received a knock with regards to business confidence in our economy and some may argue that the initial knock was of no fault of the South African economy but from the developments occurring in the global economy. This brings to light an important element of the position that South Africa finds itself in, in that global developments punish the economy very harshly. In addition to this many argue that the reason that the South African economy has not been able to recover has been due to unfriendly industrial domestic policy, that has not made it easier for the manufacturing sector to recover even with a weakening exchange rate (Manufacturing circle, 2012: 7).

Figure 3

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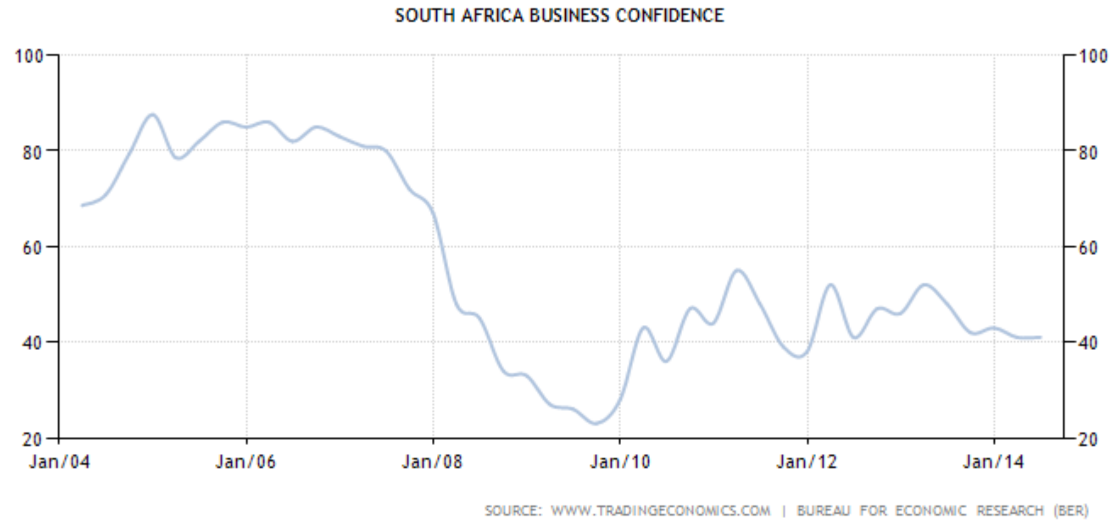

Poor infrastructure has also been repeatedly identified as a hindrance to the economy creating a successful industrial sector. Production mark-ups in South Africa are quite high when compared to other countries both developed and developing. These have been driven largely by the rocket in electricity prices in recent years. Aghion, Braun and Johannes Fedderke (2008:755) go on to state that levels of productivity and competitive levels would improve significantly if the production mark-ups were to be reduced. This is by in large attributed to the high costs associated with production and moving goods across the country. Attention must be paid to creating infrastructure that allows for cheap and efficient production and transportation. The National Infrastructure Plan (NIP) that was introduced in 2012 highlighted 18 Strategic Integrated Projects (SIPs). These SIPs will result in the approximately R827 billion of Government expenditure being spent over the 2013/2014 (National Industrial Plan, 2012). Of the 18 SIPs three are allocated to energy, one to water sanitation and five allocated to geographical infrastructure (Department of Trade and Industry, 2012).

- *Energy*

The three SIPs dedicated to energy attempt to match green energy and increase sustainable energy and the capacity that South Africa can accommodate a larger industrial grid (Department of Trade and industry, 2008). The increase in capacity will result in an increase in demand for labour, thus lowering unemployment. A more stable energy grid also increases the demand for direct foreign investment.

- *Geographical*

The Geographical additions/improvements will ports, pipeline and rail infrastructure. Transnet, at the beginning of 2013, increased their Capital Expenditure Programme (Department of Trade and industry, 2008). The improvement of ports and rail allows a greater capacity to import and export. The increased efficiency will result in South African exports being more affordable to the international market. The increase in exports will result in a reduction in the current account deficit.

The two focus areas concentrated on above a critical for the successful development of an industrialised economy.

4. Building 'the middle': The role of small business in South Africa's economy

Developing countries such as South Africa have low levels of capital endowment partnered with an abundance of low-skilled labour (Berry *et al*, 2000). Endogenous growth theory, suggests that for any economy to experience sustainable long term growth it must create an environment that stimulates technological innovation in order to improve the output-labour ratio as well as GDP per capita (Burda and Wyplosz, 2009). Small businesses have been hailed by Rothwell (1989) as having had the greatest impact on innovation across the globe because of their size they have often been forced to find innovative ways to do things. Enterprises are not just producers they are also consumers in an economy and the demand that they have for industrial or consumer goods will stimulate the demands for other suppliers. As a result the SMME sector has important implications for both the demand and supply side of an economy (Berry et al, 2000). Burda and Wyplosz (2009) suggested that the importance of small businesses lies in the theory that suggests that as businesses grow they transfer production inputs from labour intensive techniques to capital intensive production measures. As a result smaller businesses are often the greater source of employment both in developed and developing countries.

There have been a number of constraints that have been identified by researchers and small business owners as having been the greatest obstacles to the growth of the local SMME sector. Clover and Darroch (2005) identified 3 primary constraints the first being socio-economic constraints, secondly institutional constraints and finally firm level barriers such as owners who lack basic business skills. Beyond these three constraints Abor and Quartey (2010) identified restrictive legislature particularly with regards to labour, taxation and business licensing.

South Africa like the rest of the world has an economy where a large portion of those who are employed are employed in Small Medium and micro enterprises (SMME's)

A thriving SMME sector has been identified by Kesper (2004) as having played a key role in creating a prosperous private sector. The pressure to provide employment, promote economic growth and increase the international competitiveness of nations has led to an increase in the research concerning SMME's and their ability to make positive contributions (Berry *et al,* 2002). Kesper (2004) provided evidence that in both developed and developing economies SMME's are the drivers of economic growth, spearheaded by a strong private sector. Rogerson (2004) suggested that although the post-apartheid government stressed the importance of promoting SMME development the reality has been very different, particularly in rural areas, where the sector consists largely of survivalist micro-enterprises with very little potential for growth. The biggest hindrance to the desired progress on the part of the state has been the mismatch between the country's policy modelling and the unique realities faced by the sector. (Jeppesen, 2005). Although the SMME sector constitutes the greatest portion of the private sector in South Africa the contribution made, towards the output produced by the economy, is substantially lower than that made by large Multinational companies and parastatals (Ladzani and Netswera, 2009). Jeppesen (2005:471) suggested that the need to develop the SMME sector on the part of the government post-apartheid has been driven by two primary objectives of "fostering equitable development" and promoting the rapid industrialisation and international competitiveness of the economy. Jeppesen (2005) further claimed that although these two objectives can work symbiotically, it is difficult in the South African case where redistribution policies can work against economic objectives. It is therefore important to ask whether the South African SMME sector has failed due to poor policy or whether there are unique constraints faced by SMME's particularly in rural areas.

Policy suggestions

Basic economic theory suggests that in order for any economy to grow in the long run it should increase the rate of change in technological innovation, capital deepening while increasing the labour force or in the case of South Africa increasing the labour absorption rate in the economy (Burda and Wyplosz, 2013: 54-55).Currently South Africa faces high levels of unemployment, high income inequality and high levels of public debt.

South African policy post-1994 seems to have been attempting to juggle policy that is focused on either growth through redistribution or redistribution through growth. There is an urgent need for the government to create policies that are clear, in terms of the objectives that the policies would like to achieve. Once the objectives have been clarified the strategies on how the economy will get there must be formalised. (Adelzadeh, 1996: 68)

The South African government has acknowledged the importance of developing a strong industrial sector that is independent of the mining industry rather than being in existent because the mining sector exists.(DTI, 2013:10 -11). A big mistake that the South African economy has made has been to focus on becoming a tertiary sector driven economy and although that may be the goal eventually, following this approach has delayed the progress that could have been made by simply developing our primary and secondary industries. One of the primary reasons why this is a viable option for South Africa is because the vast majority of those who cannot find employment are those who are under-skilled or unskilled.(Hausman, Rodrick and Sabel, 2008:4-5). Aiming to increase our tertiary sector capacity is counter-productive if the aim is to achieve growth that creates jobs because generally the jobs that would be created would be for those who have some kind of skill training. Intensive investment into our industries means that the country could look forward to the prospect of moving up the value chain, globally, this is a very real reality if we could focus on developing the economy's competitive advantage in labour. Developing the skills of the work force would assist in improving the employability and the productivity of the workforce. (Edwards, 2001: 41-42). This means that the government needs to create an economy that is business-friendly to encourage the development and the establishment of businesses that are better able to absorb labour that South Africa has an abundance of while creating policies, beyond the current Sector Education and Training Authorities, that ensure that businesses are able to create skills development projects for their employees.

To encourage the promotion of the industrial or the production sector many suggestions have been considered, one at the fore includes the idea of special development zones. These zones would be areas within the country that are created for industry to establish plants but the labour laws in the areas would have less restrictive or rather more flexible labour laws. This would also apply to developing the agricultural sector in the country because it, much like the manufacturing sector, has large potential in terms of creating jobs while contributing to our output potential. A strong industry sector would mean that the economy is creating the kinds of jobs that our labour force would be able to fill while at the same time developing our country's capacity to grow. (Aron, Kahn and Kingdon, 2009:216).

Conclusion

The point is not to discourage the development of the tertiary sector or to dispute the progress that has been made thus far in terms of economic transformation however, it is important that South African policy makers begin to acknowledge the position that the South Africa finds itself in. In order to make a real impact on the socioeconomic landscape of the country perhaps it is time to look back at the decisions that were made in 1994 and whether those decisions were the right decisions.. It is clear that the question that policy-makers are faced with is whether to grow the cake and then divide it or to divide the cake now and hope that it will stimulate others to help to bake the cake. To make a real change in the structure of the economy policies must be integrated and aligned in order to bolster the overall growth efforts. The economy cannot achieve the required growth if policy makers are not willing to make the difficult decisions and follow through.

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