

Research report no 91

Social policy series



Enhancing policy implementation:

Lessons from the Growth, Employment,
and Redistribution strategy

Zondie Masiza and Thami Ngqungwana

Researchers, CPS



Centre for Policy Studies

Johannesburg

October 2001

This report forms part of a study entitled 'Closing the gap between policy and implementation in South Africa', funded by the European Union.

The Centre for Policy Studies is an independent research institution, incorporated as an association not for gain under Section 21 of the Companies Act.

Centre for Policy Studies
Construction House
130 Sivewright Ave
New Doornfontein 2094
Johannesburg, South Africa

P O Box 16488
Doornfontein 2028
Johannesburg, South Africa

Tel (011) 402-4308
Fax (011) 402-7755
e-mail: admin@cps.org.za

www.cps.org.za

ISBN 1-919708-46-4

CONTENTS

THE POLICY FORMULATION PROCESS: MOVING INTO GEAR	2
Introduction	2
Research method	3
Background to GEAR	4
<i>Do policy; I'll do politics</i>	6
A neo-classical economic strategy?	10
Outward orientation: a solution in search of the problem?	13
The aftermath: implementation	14
FOREIGN DIRECT INVESTMENT: REALITY OR MIRAGE?	17
Trends in FDI, 1994-9	19
The view from within	20
Views from without	24
CONCLUSION	29

THE POLICY FORMULATION PROCESS: MOVING INTO GEAR

Introduction

It is nearly five years since the African National Congress-led government announced its macroeconomic Growth, Employment, and Redistribution (GEAR) strategy. Among other things, the strategy seeks to address the country's socio-economic problems such as the sluggish growth rates, high unemployment levels, and poverty, to mention just a few. To reverse this trend, the government projected in GEAR an annual (average) growth rate of 6 per cent and employment rates of 400 000 by the year 2000. There was an expectation that the private sector would be the primary driver of this process.

Although the strategy has succeeded in achieving macroeconomic stabilisation, thus far the realisation of the projections mentioned above has proven elusive. For instance, the economic growth rate for 2000 was around 3,2 per cent, and formal employment is continuing to decline – in fact, the past four years are generally regarded as a period of jobless growth. The critics and proponents of GEAR have advanced a number of explanations for this economic performance. On the one hand, the critics say the strategy has failed because it is based on World Bank/International Monetary Fund-inspired structural adjustment programmes (SAPs) that have had little success in developing countries; and envisages a leading role for the private sector. On the other, organised business says the policy is too ambitious and has unrealistic time frames for achieving its stated objectives. Others complain that GEAR has not been fully implemented.

Since its launch in June 1996, GEAR has provoked much controversy and public debate. The labour movement, one of the economy's chief stakeholders, received GEAR with a mixture of surprise and circumspection. Over the years labour's rejection of GEAR has intensified, thus ruling out -- at least for now -- a possible consensus on the strategy. According to private sector economists, the absence of this consensus is one of the important factors deterring both domestic and foreign direct investment (FDI) in the South African economy.

Some of GEAR's critics monitor the results of the strategy's outputs on a yearly basis, to highlight its shortcomings.¹ It is indisputable that GEAR has not shown the positive results the government have expected. To many critics, GEAR is synonymous with the often disastrous SAPs advocated by the IMF in developing countries, so to them its failure to 'deliver' was expected. The I-told-you-so attitude of these critics has not in the least persuaded the government to pursue an alternative macroeconomic policy. In this debate, it is the government that has tended to have the political initiative, and that dictates the terrain of engagement.

The controversy surrounding GEAR is essentially what the eminent political scientist Robert Dahl describes as the politics of deciding who gets what, how, and when.² In this

¹ Among them are Asghar Adelzadeh, research director of the National Institute of Economic Policy (NIEP).

² See Robert Dahl, *Modern political analysis* (Englewood Cliffs, Prentice-Hall, 1976).

view, economic policy-making is not simply about technical matters, because it affects people's interests. Therefore it is likely to prompt conflict, whatever its technical merits.

It does not (always) automatically follow from this that all stakeholders must or will be consulted. Policy-makers could decide that there is no point in consulting a particular interest group. But, if a given stakeholder is crucial to implementation, then policy-makers need a strategy to deal with it, or the policy in question will face implementation problems. There is evidence to suggest that top government officials thought this through. Apparently, they thought the government's social partners (ie business and labour) would 'join [government] in the combined efforts needed to achieve this goal [ie GEAR].'³

The co-operation among the social partners entails a large degree of political skill on the part of all the important players in the economy. Among other things, the political skill of policy-makers means the government has to constantly engage with different stakeholders (eg organised business and labour) to get their acquiescence on critical economic matters. This, however, is not the only variable that will determine the success or failure of GEAR. In essence, policy-makers will also need strategies to deal with such variables as the highly unpredictable economic environment – eg international financial crises and oil prices, (negative) foreign investor perceptions or sentiments, and poor policy co-ordination by government departments and institutions. Therefore, any explanatory account of the discrepancies between the intentions and outcomes of GEAR would have to examine some if not all of these variables.

Although it is generally known that the GEAR projections have not materialised, little is publicly known about the strategy's formulation and implementation processes. This paper sketches these processes in order to put GEAR and its consequent impact in a proper context.

Research method

This report is based on a number of in-depth interviews held with both the formulators and implementers of GEAR and some important players in the economy. Top government officials considered to be driving the GEAR implementation process were targeted. They were mainly from the national treasury, the department of trade and industry (DTI), the Industrial Development Corporation (IDC), and Trade and Investment of South Africa (TISA). Outside the public sector, interviews were conducted with representatives of financial institutions, organised business and related institutions; academics; and labour-aligned economists.

This is an interim report on ongoing research, and focuses mainly on the formulation of GEAR and the government's implementation of its FDI policy. In the next phase, this study will look at privatisation and job creation. For that segment, the intention is to interview actors in big business and the labour movement, eg in the motor and components industries.

³ See department of finance, *Growth, employment and redistribution: a macroeconomic strategy* (Pretoria, 1996), p 2.

As mentioned earlier, little has been written on GEAR's formulation and implementation. The dominant feature of the public discourse regarding this strategy is its unintended outcomes – ie, mostly its failings. Hence it was regarded as important to interview the authors⁴ of GEAR about its origins and how they see the policy unfolding.

Readers are reminded that this is an interim report describing the history of GEAR's formulation and implementation, and examining the assumptions that informed these processes.

Background to GEAR

Common knowledge has it that GEAR was developed as a response to the currency devaluation crisis that hit South Africa on 14 February 1996. It turns out, however, that the makings of this crisis had been on the government's radar screen for some months before. One of the co-ordinators of the GEAR team, Iraj Abedian, says he identified this threat as early as September 1995.⁵ At the time, Abedian was serving as a consultant to Alec Erwin, then deputy minister of finance and now minister of trade and industry. In the mid-1990s it was quite common to have academics or analysts advising various government ministers on policy issues, and, more often than not, helping government formulate its policies.

According to Abedian, signs of an imminent financial crisis included the fact that:

- the rand exchange rate was high while trade tariffs were coming down, thus hurting domestic manufacturing;
- macroeconomic trends showed that the balance of payments were in a critical state; and
- the South African Reserve Bank was doing nothing to lower interest rates.⁶

Abedian's chief concern was that the economy had no self-correcting mechanism for dealing with these problems. He attributed this to a lack of consensus among economic players on macroeconomic issues. For instance, the banking sector was generally happy with the high interest rates, because its institutions were earning good returns. The then governor of the South African Reserve Bank, Chris Stals, preferred higher interest rates for a different reason, namely to maintain a strong rand.

As hinted above, and as discussed below, the question of the overvalued rand had been in the minds of policy-makers and their advisers, for they were planning a devaluation strategy to pre-empt a market-driven devaluation.⁷ The market, however, beat them to the post, and thereafter the policy-makers focused their attention on formulating a

⁴ The GEAR authors interviewed are Prof Iraj Abedian, co-ordinator and then professor in economics at the University of Cape Town; Andrew Donaldson, department of finance; Brian Kahn, then an economics lecturer at the University of Cape Town; Prof Guy Mhone, then with the department of labour; and Prof Ben Smit of the Bureau of Economic Research, University of Stellenbosch. For a complete list of the participants in the GEAR formulation process, see the GEAR document.

⁵ Interview with Abedian, 18 July 2000.

⁶ *ibid.*

⁷ John Matisonn, The problem of how to deliver (*Mail & Guardian*, electronic edition, 18 November 1998), <http://www.mg.co.za/mg/news/98nov2/18nov-anc.html>

macroeconomic strategy, namely GEAR. A cursory reading of the GEAR document reveals that the government was motivated by the desire to formulate 'economic fundamentals' in order to stimulate the economy through, among other things, attracting FDI and making South Africa internationally competitive.

In 1994 and 1995 the economy grew by 3,1 per cent, which was higher than the population growth rate but not high enough to generate jobs. Apart from that, the country's domestic savings and investment rates were too low to stimulate and sustain higher growth rates.

It was estimated that, for the South African economy to achieve high growth rates, it would need a savings rate equalling 25 per cent of GDP – ie about 10 per cent higher than the savings rates obtaining in 1996. The value of the rand was declining in relation to other foreign currencies. Although South Africa's fiscal deficit was not very high compared to those of other developing countries, the government felt it had to introduce fiscal discipline as a way of managing its resources. The manufacturing sector needed to adjust to the international market to become more competitive. Lastly, South Africa needed to shift from exporting primary to secondary goods.

In its analysis of the country's economic problems, the government realised that the economy's dependence on an import substitution industrial strategy was distorting the economy and was, in the long run, unsustainable. To address these problems, it opted for an outward-oriented strategy that entailed encouraging the growth of non-gold (manufactured) exports and the flow of FDI into the country. Regarding the latter, the government felt it was imperative to attract FDI by lowering company tax, offering tax holidays, and pursuing labour flexibility. There is an assumption internationally that countries that have pursued similar measures have tended to perform well; the example always mentioned is that of the Asian tigers.

In December 1995, at the suggestion of Abedian, the ministry of finance decided to do something about the 'impending' crisis. Abedian had the idea of assembling a macroeconomic think-tank to find policy alternatives.⁸ The first meeting took place in Cape Town in January of that year; only a few South African economists were invited to discuss policy options. The organisers initially wanted this to be a first step towards establishing a regular forum consisting of about 40 macroeconomists.⁹ This idea, however, was abandoned when it became clear that these experts had widely differing views.

The second meeting took place at the South African Reserve Bank in Pretoria just two days before the currency crisis that struck on 14 February. The group of experts consisted of government officials¹⁰ and non-governmental economists such as Terrence Moll of Old Mutual, David Lewis of the labour market commission, and Azghar Adelzadeh, a senior economist at the National Institute for Economic Policy. From the labour movement, Abedian extended an invitation to Jeremy Baskin – then director of COSATU's think-tank, the National Labour Economic Development Institute (NALEDI) -- but he could not attend the meeting due to other commitments.

⁸ Interview with Brian Kahn, Reserve Bank, 19 July 2000.

⁹ *ibid.*

¹⁰ Mainly from the departments of finance, labour, and trade and industry.

Although at the time the RDP office was leading the national growth and development strategy (NGDS) process, it was not invited to the workshop.¹¹ Abedian says the RDP office was excluded because it had no economists. The journalist John Matheson agrees that the Jay Naidoo, minister without portfolio responsible for the RDP, had no control over fiscal policy, and his department's projects were 'financed by savings in the existing line budgets of departments [which] considered [Naidoo] at minimum an intrusion, at most a threat'.¹² Guy Mhone, who represented the department of labour in the GEAR process, offers a different account. Mhone says the RDP office was excluded because its developmental thinking 'did not tally well with the IMF/World Bank philosophy',¹³ of restrictive fiscal policy. In fact, the office did have a few economists, among them Neva Makgetla. So it appears as if the decision not to involve it was based on ideological considerations –ie it was seen as not fully endorsing market-friendly economic policies aimed at reducing the budget deficit, among others.

Mhone confirms that this team of experts had been in existence as far back as December 1995.¹⁴ He adds that its status was unclear at the time.¹⁵ The team included a few people from the World Bank and the IMF who were on secondment to the department of finance. The team worked to produce a macroeconomic document based on various econometric models. Mhone notes that the work of the team was running parallel with the discussions on the national growth and development strategy (NGDS) and the labour market commission.¹⁶ According to Abedian, the NGDS was not enough to stem the looming crisis because its focus was more on public works development projects. By contrast, the concerns of the GEAR team were: a) how to get the economy growing as a whole; b) boosting the credibility of the ANC-led government in international markets; and c) establishing a good track record of fiscal discipline that would help the government withstand future economic shocks.¹⁷

Do policy; I'll do politics

On 14 February 1996 the planned meeting took place at the South African Reserve Bank – just two days before the currency crisis struck. Some of the participants in this meeting say there was an air of uncertainty about it, since its thrust was not clear to everyone. To complicate matters further, the motley team of economists gathered there had fundamentally different and conflicting opinions on how to continue with structural economic re-

¹¹ The NGDS was an attempt by the RDP office to elaborate on the economic development aspects of the RDP base document. Its details have never been made public.

¹² Matheson, The problem of how to deliver.

¹³ Interview with Dr Guy Mhone, Public and Development Management, University of Witswatersrand, 12 July 2000.

¹⁴ *ibid.*

¹⁵ *ibid.*

¹⁶ The work on the NGDS was led by the RDP office. The aim of the strategy was to kick-start the economy. It had six components, including capacity-building, crime prevention, a development programme, and the role of the state.

¹⁷ Interview with Abedian, 18 July 2000.

forms. This persuaded Abedian of the need to have a small group of like-minded economists and to exclude the dissenters¹⁸ from further involvement in the process.

The GEAR team consisted of representatives of the departments of finance, labour, and trade and industry, as well as non-governmental economic experts, who were coordinated by Abedian and André Roux. At the time, Roux worked in the macroeconomic policy unit of the Development Bank of Southern Africa (DBSA), and later joined the department of finance as deputy director-general. Erwin is said to have handpicked the non-governmental experts – most of whom were deemed to be unfriendly to labour.¹⁹ Although indirectly involved, Erwin provided general leadership to those engaged in the GEAR process.

Some of the participants saw the crafting of this framework strictly as a technocratic exercise that warranted the involvement of a small group of experts. Others thought this was a naïve view of the process, because the real world was far more complex than technocratic thinking assumed.²⁰ When the currency crisis hit the country two days later, the group seemed trapped in a state-of-emergency mode of thinking, and this provided an impetus to the process of formulating the GEAR framework.²¹ In the end, time pressure presented by the crisis justified confining the task at hand to a small group of ‘like-minded’ experts and not consulting a number of stakeholders. International decision-making experience shows that in moments of crisis it is normal to have high-level decisions ‘made in a setting of a small group’.²²

One of the earliest casualties of the new process was the RDP office, whose work on the NGDS was superseded by that on GEAR. Although there are (passing) references to the NGDS in government policy documents (eg the National Crime Prevention Strategy), it never saw the light of day.

The exclusion of the labour-aligned and development-oriented economists, however, has had serious consequences for the implementation of GEAR. It has, for instance, forced the government to adopt an incremental approach in implementing some of the GEAR objectives.²³ Some observers say this approach scuppers the GEAR deal that was intended to be implemented as a package.²⁴

¹⁸ One of these was Adelzadeh.

¹⁹ Interview with Adelzadeh, National Institute of Economic Policy, 4/07/2000.

²⁰ Interview with Kahn.

²¹ *ibid.*

²² Alexander L George, *Presidential decision-making in foreign policy: the effective use of information and advice* (Boulder: Westview Press, 1980), p 81.

²³ Owing to staunch opposition from the trade unions, the government has had to delay its plans to privatise or restructure the state-owned enterprises for nearly four years. Labour’s opposition is motivated by a fear of job losses, which it argues almost inevitably come with privatisation. In the face of this opposition, the government has pushed the issue with great circumspection.

²⁴ Interview with Bill Lacey, an economist at the South African Chamber of Business, August 2000. Obviously, this is an outsider’s interpretation of how GEAR was supposed to be implemented. In reality, the drafters of the strategy had advised that the policy be implemented in sequences, taking into account policy trade-offs.

In fact, the question of consultation posed a dilemma for the participants. One informant noted that consultations would not have worked because Abedian had a technocratic view of the process. For Abedian, formulating a macroeconomic policy is not and should not be an open consultative process, because such exercises are money-making or money-losing endeavours. Today, he says, one could not go to NEDLAC and say the government was considering a 10 per cent devaluation. He adds that no government can ever afford to make macroeconomic policy openly.²⁵ Many participants were convinced that consultations would be a long process. In sum, the authors of GEAR held no consultations with crucial stakeholders – ie organised business and labour - outside their group. Since the technical view dominated the process, the technocrats involved seemed less concerned about non-economic issues such as the reaction of excluded stakeholders, especially labour's. As discussed below, this task was left to the political principals who provided political backing and leadership to the process.

It is this high-level backing that gave an academic economist (ie Abedian) with no political credentials the authority to influence a major decision on the country's macroeconomic direction. In a way, he was able to do so because the political principals were already leaning towards a market-led growth strategy.

Two World Bank employees, Louis da Silva and Richard Ketley, who were on secondment to the department of finance were involved in the project in their personal capacity. Da Silva had been analysing the South African economy for some time.²⁶ The team is said to have benefited a lot from Da Silva's expertise. In general, Abedian liked the involvement of the two because internationally the outcome of the exercise would be seen to have the World Bank's approval. He thought this would boost the credibility of the process in the eyes of the international markets. Domestically, however, this was a bad idea.²⁷ It is commonplace to hear most critics of the government's macroeconomic strategy charging that GEAR is the brainchild of the World Bank or Bank or IMF – two institutions that had dictated the unpopular SAPs. One critic of GEAR thinks it made little sense for the government to embrace such a programme when these international financial institutions had no leverage over South African policy-makers.²⁸

The political principals close to this process were seemingly uneasy about appearing to be following a SAP script to the letter. One participant in the process says the principals changed the GEAR draft several times -- for instance, references to such issues as privatisation and transport reforms were taken out at the last hour.²⁹ The earlier versions of the draft were strong on privatisation – ie, its drafters were advocating the need to move fast on this front.³⁰ The moderation on privatisation was largely due to the intervention of the

²⁵ Interview with Abedian.

²⁶ Interview with Ben Smit, one of the GEAR drafters and head of the Bureau of Economic Research, University of Stellenbosch, 19 June 2000.

²⁷ Interview with Kahn.

²⁸ Asghar Adelazadeh, *From the RDP to GEAR: the gradual embracing of neo-liberalism in economic policy*, NIEP occasional paper series no 3, August 1996, p 4.

²⁹ Interview with Kahn.

³⁰ Interview with Smit.

then vice-president, Thabo Mbeki. Mbeki was not directly involved in the process, but was kept informed of the team's progress. So a great deal was written on a number of issues, but the text was eventually whittled down dramatically.³¹ The final document was presented to and endorsed by the cabinet without much discussion. Even the (political) principals of the departments involved in formulating GEAR had hardly discussed the document among themselves.³²

This deliberate excision of sensitive items such as privatisation is evidence that the decision-makers did consider politics. Also, it suggests the salience of political factors in implementing GEAR. In a sense, the principals who provided political authority to the GEAR process had gone to some length to anticipate the reaction of the stakeholders. A few months before the release of GEAR in June, the business-aligned South Africa Foundation and COSATU had released their macroeconomic visions, and they had worked on these without involving the government.³³ The two documents received a good deal of publicity and analytical comment. It may well be that the GEAR drafters were sufficiently familiar with the thinking of business and labour to not bother about consulting with them on macroeconomic issues.

Certainly, the manner in which GEAR was formulated deviated from the new norm the ANC government was promoting, namely broad participation and consultation in public policy-making. According to the 1995 National Economic Development and Labour Council (NEDLAC) Act, all labour legislation and socio-economic policy which impact 'on the world of work need to be discussed in NEDLAC before being referred to parliament or implemented'.³⁴ One of the main criticisms of GEAR is that it was formulated in a non-transparent way. For instance, the deputy general secretary of the South African Communist Party (SACP), Jeremy Cronin, complains that the SACP and COSATU 'were given a general briefing on the broad orientation of GEAR' just 10 days before the policy was announced.³⁵ Not only was its formulation process closed; the details of the Reserve Bank macroeconomic model used to arrive at the GEAR projection have never been made public.

Regarding this non-transparency, Adelzadeh says the RDP drafting process was different in that it was people-driven and went through eight drafts, all of which had inputs from the important stakeholders.³⁶ Perhaps what galls the labour movement is that, when GEAR was announced in June 1996, it was declared to be 'non-negotiable'.³⁷ But, given

³¹ Interview with Kahn.

³² Interview with Mhone.

³³ These were the South African Foundation's *Growth for all: an economic strategy for South Africa*, March 1996, and COSATU's *Growth with equity*, April 1996, respectively.

³⁴ NEDLAC is a statutory negotiating forum for the tripartite social partners, namely business, government, and labour. It is the only South African institution involving all three these social actors.

³⁵ Jeremy Cronin, Why the communists Reject GEAR (*Mail & Guardian*, electronic edition, 5 July 1998), <http://www.mg.co.za/mg/news/98july1/15jul-gear.html>.

³⁶ Interview, Adelzadeh. These stakeholders were the South African National Civic Organisation (SANCO), COSATU, and the ANC's national executive committee.

³⁷ Cronin, Why the communists reject GEAR.

that COSATU has also declared GEAR to be ‘non-negotiable’ on ideological grounds, it is debatable whether consulting with it would have mattered in the end.

A neo-classical economic strategy?

GEAR’s critics have denounced the strategy for its neo-liberal economic leanings, which reflect what the economist John Williamson defines as the ‘Washington Consensus’: a set of informal rules and guidelines for instituting structural economic reforms. Williamson coined the term in the early 1990s following an international conference held to discuss and evaluate the economic reform experience of 13 countries.³⁸ The conference attracted mostly technocrats who had been involved in implementing economic reforms in their respective countries. The consensus referred to is widely thought to be about the acceptance of the economic SAP propounded by the IMF and encouraged by the World Bank. It seems, however, that what Williamson was referring to was the existence of a good deal of agreement on the content of successful economic reforms – ie macroeconomic discipline, trade liberalisation, and participation in the global economy – an economy needs to be globally competitive. Williamson admits that there is no consensus on the political conditions needed to sustain the momentum of meaningful economic reform,³⁹ but critics of the ‘Washington Consensus’ often overlook this fact. As far as they are concerned, the ‘Washington Consensus’ is about the endorsement of the IMF’s SAPs, which emphasise the neo-liberal brand of macroeconomic policy.

According to labour, the South African government was following the IMF prescriptions, which are: ‘overly restrictive, choking off investment, and limiting the effectiveness of other critical transformations’.⁴⁰ As proof of this association, labour representatives point to what they perceive to be a neo-liberal strain in GEAR, and to Da Silva’s involvement - albeit limited and in a consultative capacity – in the GEAR process.⁴¹ COSATU in particular criticises GEAR as an ‘inappropriate policy tool for addressing the socio-economic and political ills of South Africa’;⁴² hence it advocates the reversal of GEAR’s ‘restrictive monetary policies ... to stimulate economic activity’.⁴³ In this regard it has

³⁸ For a detailed discussion of this, see John Williamson (ed), *The political economy of policy reform* (Washington DC: Institute of International Economics, 1994). The countries examined at the conference were Australia, Brazil, Chile, Colombia, Indonesia, Mexico, New Zealand, Peru, Poland, Portugal, South Korea, Spain, and Turkey.

³⁹ *ibid.*

⁴⁰ COSATU, *Creating jobs in South Africa: key issues and strategies*, Input into presidential jobs summit, April 1998, <http://www.cosatu.org.za/docs>, p 5.

⁴¹ Abedian stresses that the World Bank econometrician Louis da Silva Pierera, who was involved in his personal capacity, merely served as a technician.

⁴² COSATU, *Defend, consolidate, and advance social transformation*, Inaugural central committee resolution, 1998, p 5.

⁴³ *IBID*, p 3.

proposed that legislation be passed empowering parliament to amend the budget to meet the socio-economic needs of the country's people.⁴⁴

Cronin says GEAR is a completely different economic policy from the RDP in that it embraces a neo-liberal doctrine that has as its 'core assumption ... that if [the government gets its] fundamentals right, private sector investors will drive a growth process'.⁴⁵ Similarly, Adelzadeh says the government's primary objective with respect to GEAR is to 'boost investor confidence by adopting the main tenets of neo-liberal strategy and policies. This unduly conservative macroeconomic framework, far from achieving the RDP objectives, will constrain growth, employment, and redistribution'.⁴⁶ Although much of the criticism has been directed at GEAR's neo-liberal strain, the authors of the strategy argue that the government had moved significantly towards neo-liberalism long before GEAR, among other things by:

- reducing the budget deficit, reforming the tax system, and reprioritising public expenditure;
- bringing down inflation and easing the balance of payments constraint;
- opening the economy to international competition, and securing international markets; and
- transforming public sector institutions.⁴⁷

Ben Smit, director of the Bureau of Economic Research at Stellenbosch University, acknowledges that GEAR is not a labour-friendly policy, and it eventually emerged as 'something akin to the 'Washington consensus''.⁴⁸ He admits, however, that GEAR was not an attempt to please everyone.

For its part, the government regards GEAR as an integrated 'strategy for rebuilding and restructuring the economy ... in keeping with the goals set in the Reconstruction and Development Programme'.⁴⁹ The government's main assumption informing this integrated strategy is that: 'Sustained growth on a higher plane requires a transformation towards a competitive outward-oriented economy'.⁵⁰ This integrated strategy has 13 central elements:

- Budget reform to strengthen the redistributive thrust of state expenditure;
- Fiscal deficit reduction to contain debt service obligations, counter inflation and free resources for investment;
- Competitive, stable, and real effective exchange rate policy;
- Consistent anti-inflationary monetary policy;
- Gradual relaxation of exchange rate;

⁴⁴ Hearing on the budgetary process, National Council of Provinces' select committee on finance (*The Star*, 24/08/00).

⁴⁵ Cronin, Why the communists reject GEAR.

⁴⁶ Asghar Adelzadeh, *From the RDP to GEAR: the gradual embracing of neo-liberalism in economic policy* (National Institute for Economic Policy [NIEP], Occasional paper series no 3, August 1996), p 27.

⁴⁷ Department of finance, *Growth, employment and redistribution: a macroeconomic strategy*, p 1.

⁴⁸ Interview with Smit.

⁴⁹ Department of finance, *Growth, employment and redistribution: a macroeconomic strategy*, p 2.

⁵⁰ Department of finance, *Growth, employment and redistribution: a macroeconomic strategy*.

- Reduction of tariffs to contain input prices and facilitate industrial restructuring;
- Tax incentive for investments in competitive and labour absorbing projects;
- Restructuring of state owned assets to attract investments;
- An expansionary infrastructure programme to tackle service deficiencies and backlogs;
- Flexible collective bargaining system;
- Strengthened levy system to fund training programmes;
- Increased investment and trade flows in South Africa; and
- Commitment to the implementation of stable and co-ordinated policies.⁵¹

From the above, it is clear that the government's intention was to assure international market players that it was committed to achieving a stable macroeconomic environment. In getting its economic fundamentals right, the framers of GEAR were, among other things, driven by the assumption that foreign investors would react positively to the investor-friendly climate they were creating. The selling points of this climate were mainly fiscal discipline, relaxed exchange rate, and tax incentives. However, the crafters of GEAR never went on to define a credible investment policy framework; they left this task to government officials.

Again, it is clear that the government was persuaded by the positive results of obtained by East Asian countries to opt for an outward strategy, spelt out in GEAR. This means trying to push exports up to more than 20 per cent of GDP, as well as encouraging trade liberalisation. The East Asian countries have achieved sustainable economic growth levels for more than three decades. Accompanying this are high levels of savings, low unemployment, a reduction of poverty, and income inequalities. Many developing countries in the world today, including South Africa, would like to emulate the success of these East Asian countries; South Africa, for instance, is still facing low economic growth rates, low savings, high levels of unemployment, high rates of poverty, and inequality.

In pursuing an outward strategy, the ANC-led government was attempting to reverse the consequences of an inward strategy that had been pursued by the previous National Party government. This involved protecting domestic markets through high tariffs and state subsidies for local industries. Many critics of the previous government, including the current ANC government, considered this strategy to be unsustainable and costly to the economy. For instance, for more than four decades, South Africa had relied on exporting primary goods in order to generate foreign exchange earnings. There is evidence to suggest that, during this period, the South African manufacturing industries had grown incompetent and less competitive compared to their international competitors. Historically, these industries have relied on a low-paid and less skilled labour force.

However, the demands of the global markets require that the government place more emphasis on the need for a skilled labour force if the country's competitiveness in the global markets is to be improved. Thus the government opted for an export-led growth strategy in order to put South Africa on a sound footing in the world economy.

⁵¹ *ibid.* For a detailed analysis of the GEAR strategy, see Adelzadeh, *From the RDP to GEAR.*; and Nicoli Natrass, *Macroeconomics: theory and policy in South Africa* (Cape Town: David Phillip, 1997), ch 14.

Alan Hirsch, a senior DTI official and one of the framers of GEAR, says the government's objective in trying to attract FDI was to secure access to international markets and increase the country's exports, particularly finished goods.⁵² Clearly, the intended consequences of this are that demand for South African manufactured goods would increase, this expanding investment, creating jobs, and improving the country's current account.

As mentioned earlier, before the launch of GEAR, the government had been implementing a number of initiatives to improve trade. These included:⁵³

- reducing quantitative tariff barriers;
- rationalising the tariff structure by almost halving the number of tariff lines;
- abolishing import surcharges, completed in October 1995;
- phasing out tariffs, begun in 1995, by an average of one third over five years; and
- phasing out the general exports incentive scheme by 1997.

Besides these measures, the government provided various incentives for investors, including the following:

- Reducing corporate taxes to enable companies to generate enough profits and savings for reinvestment purposes. This would enable companies to expand their operations, and create jobs.
- Tax holiday packages aimed at encouraging companies to invest in areas earmarked by the government.
- Speeding up trade liberalisation, with the aim of making South African companies competitive in world markets. Obviously, the intended impact was to increase the competitiveness of the country's economy, which would lead to higher demand for skilled workers and South African manufactured goods.

In terms of the impact of trade liberalisation, there has been mixed views about its consequences. For instance, COSATU's view has always been that trade liberalisation has had negative consequences in the form of job losses, particularly in manufacturing industries such as textiles and others. Riaan Coetzee, an economist at the Industrial Development Corporation (IDC), concurs with the view that trade liberalisation did have a negative impact on job losses but that this was inevitable in order for the country's economy to adjust to integration into international economy.⁵⁴ However, Hirsch disagrees with COSATU's view that job losses could be attributed to trade liberalisation.

Outward orientation: a solution in search of the problem?

Some commentators are questioning the government's outward strategy as a means of achieving its socio-economic policy objectives. For instance, Adelzadeh, who helped the labour movement to prepare its policy response to the introduction of GEAR, argues that trade should be used to help reconstruct and develop the economy.⁵⁵ He criticises the current strategy, which is based on the wholesale acceptance of the free trade dogma.

⁵² Interview with Alan Hirsch, November 2000

⁵³ Department of finance, *Growth, employment and redistribution: a macroeconomic strategy*, p 12.

⁵⁴ Interview with Riaan Coetzee, November 2000.

⁵⁵ Adelzadeh, *From the RDP to GEAR*.

Adelzadeh believes the state should protect or support those domestic sectors (eg clothing and textiles) that generate large positive externalities such as technological spill-overs. Tariffs may also have large positive effects through increasing domestic demand, thus stimulating the introduction of new products.

Adelzadeh also argues that the government's exports target of 8,4 per cent of non-gold goods a year is unrealistic and unattainable, because a high growth rate in exports would imply a 22,7 per cent increase in the export ratio of GDP within four years - from 20,9 per cent of GDP in 1995 to 25,64 per cent by the year 2000. He argues that such a high rate of growth in a short period has never been experienced by any European, American, or Asian countries. As an example, he notes that in the 25 years between 1970 and 1994 the average export ratio of the OECD countries increased by only 6 per cent. During the same period, the average export GDP ratios of Brazil, India, Indonesia and South Korea increased by 5 per cent, 1 per cent and 4 per cent respectively.

Kennedy Mbekeani, former senior economist at NIEP, argues that macroeconomic policies alone do not necessarily attract FDI. He believes there is a serious need for investment in the development of skills. In a study comparing Malaysia, South Africa and Mexico, he found that there was insufficient emphasis on skills development in South Africa when compared to Malaysia.⁵⁶

The aftermath: implementation

Of all the members of the GEAR team, only Andrew Donaldson and Alan Hirsch are still in government, working for the national treasury and the DTI respectively. While Gelb is still with the DBSA, he spends time in the presidency's economic co-ordination unit. Other authors have gone back to academic institutions and the South African Reserve Bank, or have joined financial institutions.

One wonders whether their not staying on had any negative impact on the implementation of GEAR. It is noteworthy that, after announcing GEAR in June 1996, the government 'forgot about' the strategy for nearly six months.⁵⁷ During this period, however, a) labour's criticism of GEAR grew louder; b) the Reserve Bank still kept interest rates high; and c) the department of labour went ahead with its work on the labour relations bill that undermined the policy objective of labour flexibility contained in GEAR.⁵⁸ It was at the end of November that the government realised that things were not happening as foreseen in the GEAR document - for instance, foreign investors had not come scrambling for the South African market.

Manuel advises that GEAR cannot be judged on a single indicator such as job creation;⁵⁹ it is concerned with many issues, including government expenditure as a tool for

⁵⁶ See Kennedy Mbekeani, *Foreign direct investment and economic growth* (NIEP occasional paper series no 11, September 1997).

⁵⁷ Interview with Kahn.

⁵⁸ *ibid.*

⁵⁹ See Does GEAR still exist? (CDE Debate no 9, Johannesburg: Centre for Development Enterprise, 26/02/98).

redistribution, South Africa's integration into the world economy, and improving the balance of payments. Therefore, in reviewing the history of GEAR implementation, one needs to take into account Helen Ingram's suggestion that: 'Success in implementation must be evaluated in the context of particular problems, and critical factors affecting implementation will vary with what is being implemented.'⁶⁰ In this case one is dealing with an economic policy that is premised on contentious ideological assumptions, which have polarised two of the economy's key stakeholders: ie government and labour. As far as implementing GEAR is concerned, the government hoped its 'social partners will join [it] in the combined efforts needed to ... break current constraints and catapult the economy to the higher levels of growth development and employment needed to provide a better life for all South Africans'.⁶¹

In practice, however, the government has tried to get labour to acquiesce to GEAR while at the same time declaring that the policy is 'non-negotiable' – ie, it cannot be changed. The government has found it difficult to deal with labour on these terms. The ministry of finance, for instance, has tried to engage labour on the meaning of 'labour market flexibility' without success.⁶²

GEAR is one of those policies whose realisation does not solely depend on the government's implementation capacity. It can be argued that a good degree of its success depends on the co-operation of the ANC government's alliance partners, namely COSATU, other trade unions, and the business community.

The implementation of GEAR has had mixed results. Success has been achieved in areas (eg reducing budget deficits and lowering tariffs) that require no interdepartmental co-ordination, and implementation has stalled in politically sensitive areas such as the privatisation of state-owned enterprises. Labour has tended to emphasise one aspect of the impact of privatisation: job losses. Some analysts blame the government's apparent inertia on privatisation when explaining the lack of fixed direct investment in the country. The minister of public enterprise, Jeff Radebe, released a privatisation framework in mid-August 2000. According to media reports, COSATU supports the framework thanks to minister Radebe's political deftness. For instance, initially he won COSATU's approval of the framework because he had: a) consulted the union federation extensively before releasing it; b) promised to adhere to the national framework agreement on privatisation; and c) talked of 'restructuring' and not of 'privatisation'.⁶³

Judging by Radebe's approach to the privatisation question, it seems the government is relying on deft political management of labour to push ahead with GEAR. It remains to be seen whether this tactic will advance the implementation of GEAR or not. Recently, however, labour has been renewing and intensifying its resistance to the privatisation of SOEs.

⁶⁰ Helen Ingram, Implementation: a review and suggested framework, in Naomi B Lynn and Aaron Wildavsky (eds), *Public administration: the state of the discipline* (Chatham: Chatham House Publishers, 1990), p 470.

⁶¹ See department of finance, *Growth, employment and redistribution: a macroeconomic strategy*.

⁶² Interview with Elias Masilela, national treasury, 27/11/2000.

⁶³ *Financial Mail*, 18/08/00, p 50.

Manuel often sells GEAR as a necessary pain to be endured now if the country is to realise prosperity later. Such entreaties do not appeal to labour and the left-of-centre economists. All the same, the government has stood its ground. At the last NUMSA national congress Erwin told delegates that GEAR has proven to be an appropriate policy for stabilising prices, exchange rates, the balance of payments, and helping to restructure the economy to make it internationally competitive.⁶⁴ Erwin warned delegates that it would be 'suicidal to implement one policy and change it the next day'.⁶⁵

Although South Africa has formal tripartite institutions such as NEDLAC, what it seems to lack is something akin to the Japanese (social) networks of intermediate organisations linking government officials, captains of industries, labour, and academia which facilitate policy discussion, consultation, and implementation of policy decisions.⁶⁶ These networks are informal, and they are neither completely public nor entirely private - hence the term 'intermediate zone'. Besides engendering the idea of *wa* (harmony in Japanese) as an integrative principle of social organisation, the intermediate organisations perform a number of important functions in the Japanese political economy, including gathering and analysing information on international markets, facilitating overseas investments, etc.

The unity of purpose displayed by the government, the gold mining industry, and labour during the 1999 gold price crisis was a step towards forming such a network. As it turned out, this co-operation did not outlive the crisis that gave rise to it. However, the recent informal meeting of Mbeki, the president of the World Bank, James Wolfensohn, and representatives of international and local business at the Union Buildings can be regarded as an attempt to establish such a network. The major shortcoming of this (investment) initiative was the exclusion of the labour movement. If the integrative concept of *wa* were to be adopted in this country (with some modifications to suit South African conditions), the ongoing conflict over GEAR may be resolved or ameliorated.

To a great extent, the South African government has to contend with the fact that, 'in the wider society, government cannot dictate policy it has to manage the process to acceptance for its policy.'⁶⁷ This means, among other things, that the strategy cannot be advertised as 'non-negotiable'.

South Africa has the potential to attract FDI, but is receiving far less than it should. TISA has recognised this; hence it has conducted a study on improving promotional efforts and ways of attracting FDI to particular industries or projects. The IDC has also gone down this route by identifying projects and inviting overseas partners.

⁶⁴ *Sowetan*, 23/08/00.

⁶⁵ *ibid.*

⁶⁶ For an elaborate discussion of this institution, see Daniel I Okimoto, Political inclusivity: the domestic structure of trade, in Takashi Inoguchi and Daniel I Okimoto (eds), *The political economy of Japan: the changing international context* (vol 2) (Stanford: Stanford University Press, 1990).

⁶⁷ CDE Round Table no 1 (Johannesburg: Centre for Development and Enterprise, 1997).

FOREIGN DIRECT INVESTMENT: REALITY OR MIRAGE?

Notwithstanding GEAR, South Africa has managed to attract about R56 billion in FDI between 1996 and 1999 (second quarter).⁶⁸ Given South Africa's potential to attract FDI, and the size of its economy, the FDI attracted so far is generally regarded as pitifully little.⁶⁹ The government had expected FDI to be well above the annual average of 17,5 per cent of GDP during this period.⁷⁰

The central concern in this section is not to elaborate on various economic theories pertaining to FDI; this aspect of the debate has been treated to some extent in the literature review that informs this empirical study.⁷¹ What will be done here is to examine the reasons for the gap between the government's optimistic expectations in respect of FDI, and the poor record of FDI inflow into this country. The reasons for this phenomenon are many, and they differ depending on whether one talks to a government official or to an economist in an academic institution or in the private sector. Although some of these explanations are spurious and elusive (eg reputed investor fears about the crime rate and rigid labour market), they are essentially normative arguments about what the government needs to do to improve the situation. Importantly, most of the private sector interviewees were largely ignorant of what the government was doing to attract investments.

What underlies or informs the government's investment policy framework? One of the assumptions of the policy-makers was that South African economic growth was 'constrained by investment, not savings, and once investment rises, higher incomes will generate savings necessary to finance the investment rise'.⁷² Also, the policy-makers were encouraged by the fact that investment or capital flows were one of the significant 'hallmarks of the more rapidly growing developing economies world-wide'.⁷³ They too sought to attract these flows into South Africa because they saw FDI as playing a critical part in stimulating growth in the following ways:

- enhancing modern technology transfers;
- enhancing the skills, management expertise and high-level training that comes with productive or direct investment projects;
- enhancing access to international sources of finance; and

⁶⁸ The figure of R59 billion is taken from a 1999 BusinessMap report. It is important to note that BusinessMap only records FDI inflows of, or intentions to invest, R10 million or more. It is therefore reasonable to assume that the level of FDI in the period 1994 to the second quarter of 1999 might be higher than BusinessMap claims it to be.

⁶⁹ The investment potential is usually measured in terms of the presence of an advanced financial (banking) sector, a credible amount of law and order and respect for property rights, a fairly extensive infrastructure, etc.

⁷⁰ See department of finance, *Growth, employment and redistribution: a macroeconomic strategy*.

⁷¹ See Zondie Masiza and Xolela Mangcu, *Understanding implementation: an exploration of research surrounding the Growth, Employment and Redistribution (GEAR) strategy*, Research report no 78 (Johannesburg: Centre for Policy Studies, 2001).

⁷² Stephen Gelb, Economic growth, people, and the environment, in Gitanjali Maharaj (ed), *Between unity and diversity* (Cape Town: David Philip, 1999), p 156.

⁷³ Department of finance, *Growth, employment and redistribution: a macroeconomic strategy*, appendix 12, p 27.

- facilitating access to global markets.⁷⁴

Imbued with this optimism, therefore, GEAR's architects went on to identify the 'fundamental determinants of international investments decisions and the underlying macro-economic expectations which may be relevant'.⁷⁵ These fundamentals included some of the following:

- political and economic stability, including macroeconomic stability and clarity about economic policy;
- sustained high rates of economic growth;
- investment incentives;
- [reforming] the tariff regime;
- protection of property rights; and
- various determinants of expected investment returns.⁷⁶

In identifying the above, GEAR's architects thought they had discovered the interventions that would prompt investors to respond to investing. Two years later, this kind of optimism informed the DTI's decision to create Trade and Investment South Africa (TISA)⁷⁷ - a national agency for co-ordinating FDI policies and promote South African exports.

As already mentioned, one of the government's assumptions when it formulated GEAR was that having a policy document that states its macroeconomic fundamentals would result in increased volumes of domestic and foreign direct investment, and that this, in turn, would stimulate economic growth and job creation.

On this score, the academic economist Nicoli Nattrass criticises the authors of GEAR for gambling on a 'wild investment card'.⁷⁸ Nattrass's criticism stems from the fact that nobody knows exactly what motivates investors to invest. Thus far, poor levels of FDI seem to bear out her argument. All the same, the government continues to believe that its assumptions hold true, and has continued to implement GEAR despite of the discouraging results and the criticisms.

This shows that government officials have a different account of this lack-lustre performance. However, the officials responsible for attracting FDI now concede that just getting the macroeconomic 'fundamentals' right is not enough in itself to attract investment. Consequently, they believe that, in order to attract more FDI, South Africa has to aggressively marketed as an investment destination; administrative procedures have to be simplified; and South Africa has to learn from 'best practice' elsewhere. These three themes are evident in a conference paper presented by the chief executive officer of TISA, Rafiq

⁷⁴ *ibid.*

⁷⁵ *ibid.*

⁷⁶ *ibid.*

⁷⁷ See, for instance, a paper written by TISA's chief executive officer, Rafiq Bagus, An appropriate investment promotion framework for South Africa, TIPS 1999 annual forum, September 1999.

⁷⁸ Nicoli Nattrass, *Gambling on investment: competing economic strategies in South Africa*, in Maharaj, *Between unity and diversity*, p 85.

Bagus, to the TIPS Annual Forum 1999, and in the advice the United Nations Conference on Trade and Development gives to developing countries wishing to attract FDI.⁷⁹

Before probing the government's implementation of its FDI policy, this analysis will be contextualised by first examining trends in FDI, including identifying the sectors that attract productive investments. This will inform a judgement as to whether or not the types of investment the country is receiving are in line with the government's FDI strategy.

Trends in FDI, 1994-9

It is public knowledge that South Africa has not attracted the levels of FDI envisaged in GEAR. In this section the government's implementation of its FDI strategy will be examined in detail. The focus here will therefore be on uncovering the obstacles to FDI flows and to review the government's actions to deal with them.

What do the trends show? Cumulative FDI inflows (actual and promised) amount to about R59 billion for the period 1994-9.⁸⁰ When disaggregated by source country it becomes clear that the leading investors are, in order of importance, the United States (R17 billion), Malaysia (R10 billion), the United Kingdom (R7 billion), Switzerland (R4.3 billion), and Germany (R4 billion). One cannot say whether this was a reaction to GEAR or not. What is probable is that – excepting Malaysia - the American, British and German investors were investing or reinvesting in a market they know well. In a sense, it could be argued that these countries were responding to the lifting of economic sanctions against South Africa and to the partial sale of Telkom and South African Airways. The former was a function of the normalisation of South Africa's international financial relations. Both factors could explain the decline in FDI post 1998. There are, of course, other explanations, such as the cautious stance of investors towards emerging market economies.

Three regions dominate FDI in South Africa: the Americas, Europe, and Asia, in that order. As a region, Asia's investment in South Africa is very significant, particularly given that its presence here is relatively recent. However, this process was halted due to the Asian crisis of 1997--8. For instance, investment flows from the Asian region totalled R12bn, as against R20bn from the European region.⁸¹

Given the government's desire to see FDI in job creation projects, it is worth noting that most of the foreign investments have gone to sectors (eg information and technology and telecommunications) that generate little or no new jobs for semi-skilled and unskilled workers. The table below disaggregates FDI by sector.

⁷⁹ See Bagus, *An appropriate investment promotion framework for South Africa*; and United Nations Conference on Trade and Development, *Foreign direct investment in Africa: performance and potential* (New York: United Nations, 1999).

⁸⁰ As noted earlier, BusinessMap only captures FDI inflow equalling or exceeding R10 million. Although the South African government does not systematically capture FDI data, it is likely that FDI inflows are much higher than the R59 billion recorded by BusinessMap for the period 1996-9.

⁸¹ BusinessMap report, 1999. Although inadequate (see footnote 81), BusinessMap is the only South African source of systematic data on FDI inflows.

Table 1: FDI by sector (for all country investing in South Africa)

Sectors	Rm
Telecommunication and IT	8 768.0
Energy and oil	8 517.0
Food, beverages and tobacco	5 642.0
Motor and components	5 536.4
Transport and transport equipment	4 539.0
Mining and quarrying	3 958.5
Chemicals, plastics and rubber products	3 497.5
Hotel, leisure and gaming	2 936.0
Metal products and mineral beneficiation	2 704.0
Other manufacturing	2 608.0

Source: BusinessMap's on line SA FDI Database

The table shows clearly that investments go predominantly to the telecommunications and information technology (IT) sectors, followed by the energy, food, and transport sectors. Mergers and acquisitions accounted for most (about R35 billion) of FDI. These have gone mainly to the telecommunications and IT sectors. Therefore, FDI seems to be going to already established service sectors and new manufacturing sectors. Perhaps in this regard the government has misread international trends in FDI. It should be concerned if this trend continues, because foreign mergers and acquisition are characterised by the rationalisation of production and management, which almost always leads to the retrenchment of 'redundant' labour as one way of ensuring competitiveness.

In the main, the kinds of FDI South Africa has realised thus far have tended to be capital-intensive and directed to high-tech sectors,, which not only demand highly competent managers but also a highly skilled labour force. The government acknowledges that the shortage of skills is one of the main deficiencies of the local labour market -- hence the recent decision to lift restrictions on recruiting and employing skilled expatriates.

How does one explain this poor FDI record? There are many explanations for this lacklustre performance. Most are based on the perceptions of economic observers and players. If FDI policy is a gamble on a wild card, then the same criticism applies equally to explanations of the low level of FDI in South Africa. As hinted earlier, the explanations given by government officials are not congruent with those of private sector economists.

The view from within

Poor FDI in 1994-9 has not shaken the government's conviction that, in the present situation of low domestic savings, it will provide the much-needed elixir for the economy. Starting from this premise, the ANC government has ruled that facilitating FDI should be a

crucial part of the work of the DTI.⁸² However, GEAR's architects have cautioned the government against depending too much on FDI. They have also urged the government to show due consideration in selecting the type of FDI it wants to attract. But the government has pinned all its hopes on a positive response from foreign investors, without being too discriminating about different kinds of FDI.

The GEAR document only referred to the need for a number of developments to attract a 'substantial volume of FDI', such as:

- a macroeconomic policy framework conducive to growth and an expanding domestic and regional market;
- removal of exchange controls;
- improved domestic savings and steady reductions in the fiscal deficit;
- a tax regime favourable to foreign investment;
- privatisation of state-owned enterprises; and
- reducing crime and improved social stability.⁸³

Initially, GEAR's silence on practical plans for attracting FDI created the impression that the onus for doing so fell largely on the then president, Nelson Mandela, and the ministry of finance.

For about two years of GEAR's implementation the government seemed optimistic that foreign and local business would react positively by investing in the country's economy – ie purely on the strength of GEAR. Therefore, the government initially had no clearly defined and credible investment framework.⁸⁴ For instance, it did not really distinguish between portfolio and production (or direct) investment.

In effect, FDI was being pursued on an ad hoc basis. For instance, on his numerous official trips to western capitals, Mandela tended to stress that South Africa needed massive FDI inflows in order to bolster its fledging democracy. The ministry of finance was wont to highlight that the government was pursuing an investor-friendly macroeconomic policy. Consequently, the institutional framework for investment promotion in South Africa was diffused, involved a large number of players, and was poorly co-ordinated.⁸⁵

By 1998 the ad hoc nature of pursuing FDI and the unsatisfactory results it yielded convinced the DTI of the need to review the country's investment policy. Among other things, this entailed the following:

- a review of investment promotion in South Africa, which resulted in the establishment of Investment South Africa (now Trade and Investment South Africa, or TISA) as the DTI's marketing arm. The review also served to inform future policy development regarding investment;
- a detailed review of the erstwhile regional industrial development programme which led to its abolition and the establishment of tax holiday programmes and a small and medium manufacturing development programme;

⁸² Stephen Hanival and Alan Hirsch, *Industrial policy and programmes in South Africa: the perspective from government* (Pretoria: Department of Trade and Industry, April 1998), p 23.

⁸³ Department of finance, *Growth, employment and redistribution: a macroeconomic strategy*.

⁸⁴ Gelb, Economic growth, people, and the environment,

⁸⁵ Bagus, *An appropriate investment promotion framework for South Africa*, p 4.

- an examination of the programmes of the IDC, which resulted in a new government mandate to the IDC board stressing industrial entrepreneurs and midi rather than mega projects. Under this new mandate, the IDC had to meet the government's objectives in terms of industrial development; and
- prioritising the question of policy co-ordination among other institutions in the DTI 'family' (ie the IDC and TISA).⁸⁶

TISA's creation was an acknowledgement of the fact that South Africa was 'generating mediocre levels of FDI ... [and was] by no means near enough to the kind of investment targets [it] should be achieving'.⁸⁷ What the government seeks to do is raise its gross-domestic-fixed-investment-to-GDP ratio well above the country's average of 17,4 per cent.⁸⁸ With the creation of a centralised authority for investment promotion, DTI officials hoped to 'end the practice of conducting foreign missions and investment seminars at all levels of government in pursuit of foreign capital in the absence of clearly set out targets ...'.⁸⁹ According to TISA's chief executive officer, Rafiq Bagus, this unstructured approach to FDI was the main reason why South Africa was not able to realise the levels of FDI anticipated by GEAR's architects.

It was on the strength of this argument that TISA was established in 1998. This does not mean that its establishment was without controversy. It turns out that some officials in the DTI resisted the new agency. According to Bagus, the source of this resistance was the 'old guard' which was averse to the idea of establishing an investment agency 'outside of government, in Sandton of all places, run by some "hot shots" [as Bagus and his colleagues were described] ...'.⁹⁰ It is likely that the 'old guard' was increasingly being sidelined as a result of transformation within DTI. Perhaps what galled its members most was to see the new agency run by the 'new guard,' which, by Bagus's own admission, lacked an understanding of issues relating to investment promotion.⁹¹

The DTI's single-minded determination to establish TISA caused its top officials to underestimate the 'problem' the novices would present to the new agency. Even then, these officials had initially not followed through by giving direction to the agency, because they were preoccupied with transforming South Africa's 'economy from [an inward]-focused economy to an outward-focused global manufacturing economy ...'.⁹²

It appears, therefore, that in its first year TISA was only 'muddling through', and the unco-ordinated drive for FDI probably continued as before. President Thabo Mbeki introduced the cluster system in mid-1999, and it is still too early to say whether or not it has improved co-ordination among government departments.⁹³ The problem of co-ordination in government is a universal one, for government structures are not geared towards co-

⁸⁶ Hanival and Hirsch, *Industrial policy and programmes in South Africa*, p 24.

⁸⁷ For instance, see Bagus, *An appropriate investment promotion framework for South Africa* p 14.

⁸⁸ Industrial Development Corporation, *Accelerating foreign investment in productive assets*, June 2000.

⁸⁹ Bagus, *An appropriate investment promotion framework for South Africa*, p 4.

⁹⁰ Bagus, *An appropriate investment promotion framework for South Africa*, p 9.

⁹¹ *ibid.*

⁹² *ibid.*

⁹³ Interview with Dracker.

operation since territorial departments or ministries are often locked in their respective silos.⁹⁴

TISA focuses exclusively on dealing with would-be foreign investors, and does not seem to realise the need for encouraging domestic investors to invest in the South African economy as well. It seems lost on the agency that foreign investors observe the behaviour of domestic investors. For instance, the decision by the minister of finance, Trevor Manuel to allow the South African Breweries, the Anglo American Corporation and Old Mutual - three of South Africa's largest companies - to relocate their listings to the London Stock Exchange has made most foreign investors circumspect about investing in South Africa. At the same time, it is conceivable that Manuel permitted this move in terms of the government's world trade treaty obligations. But a number of TISA documents and publications hardly mention the relocation of these giant companies and the implications of this for the South African economy. This seems to point to a lack of strategy to communicate to potential investors why the relocation was not a vote of no confidence in the South African economy.

When DTI officials decided to establish TISA, they assumed that substantial co-ordination within government could be achieved, thus creating an investor-friendly climate. In practice, this co-ordination seems to be more vertical than horizontal – ie, it is DTI-IDC and DTI-TISA. In substance, therefore, the different mandates pursued by the IDC (promoting government's industrial objectives) and TISA (marketing South Africa as an investment destination) tends to preclude co-ordination between the two institutions. On the one hand, IDC stresses the micro side of the operations and has a proactive investment approach that targets specific foreign investors.⁹⁵ In addition to incentives provided by the government to would-be foreign investors, the IDC identifies investment projects, puts money on the table, and then asks for partnerships with foreign investors on the selected projects.⁹⁶ In sum, IDC sees itself as the government's investment arm that strives to make government's industrial policy a reality.⁹⁷

On the other hand, TISA focuses strictly on promoting FDI inflows and, unlike the IDC, is not in the business of co-financing investment projects. So its role is general, but it also aspires to controlling and directing IDC promotional activities.⁹⁸ In recent months, TISA has increasingly adopted the IDC method of identifying projects for would-be investors. It has also sought to match the skills found in the IDC by recruiting personnel with sector-specific expertise or knowledge. Notwithstanding the government's emphasis on policy co-ordination, there seems to be a duplication of investment promotion capacity in the country. It may well be that, as a young organisation, TISA still needs to prove it can almost single-handedly turn the FDI situation around.

The department of foreign affairs (DFA) is another government department that seeks to exert some influence over FDI via its chairing of the international relations, peace and

⁹⁴ *ibid.*

⁹⁵ Interview with Loyiso Jiya, chief economist, Industrial Development Corporation, 15 June 2001.

⁹⁶ *ibid.*

⁹⁷ *ibid.*

⁹⁸ For instance, see Bagus, Bagus, *An appropriate investment promotion framework for South Africa*, p 11.

security cluster. This cluster consists of the following departments: foreign affairs, defence, trade and industry, intelligence, and home affairs. The economic subcommittee of this cluster deals with investment and other economic matters. It is chaired by Faizal Ismail, the DTI's deputy director-general and chairperson of the TISA board. According to a DTI official, the DFA regards the DTI and TISA as line function agencies, and sees its duty as that of determining policy directions on trade and FDI. Notwithstanding this rivalry, in terms of capacity the DFA is well placed to play a significant role in promoting FDI; for instance, DFA has more than 90 missions abroad. Thus its international reach is greater than that of the DTI and TISA combined. Besides this, the DFA is closer to the presidency, which is also increasing its role as an agency for attracting FDI – witness Mbeki's establishment of an international advisory team on economic policy and FDI.

Notwithstanding their different mandates, both the IDC and TISA do co-operate when going on promotional road-shows abroad. On these tours, their representatives find themselves having to constantly rebuff the negative perceptions foreign investors have of South Africa. Their common experience is that it is often overseas-based South Africans (not all but a majority of them) who discredit this country.⁹⁹

According to a senior DTI researcher, Peter Dracker, FDI will not be South Africa's saviour.¹⁰⁰ He says it is domestic investors who have to pull their weight and take the lead, but they seem reluctant to invest, for several reasons. These include the following:

- white business is cautious to invest due to perceived socio-political instability;
- business says South African labour laws discourage local investors;
- many whites complain about affirmative action; and
- there is a perception that southern Africa is unstable and that the South African government is not seen to be making the region stable – ie from an investment point of view.¹⁰¹

If local business investment is important to attracting FDI, should TISA not direct some of its energies towards addressing the concerns or misgivings of domestic investors? Dracker believes the agency was not established to do this, and that promotion of local investment cuts across several departments, namely labour, land and agricultural affairs, the DTI, etc.¹⁰² However, this should not prevent the agency from co-operating with local business on promoting both domestic and foreign investment in the South African economy.

Views from without

There are many competing explanations of poor FDI in South Africa. Most of these are based on theoretical assumptions about FDI determinants. It is usually on this basis that most observers judge whether the South African government's actions are encouraging or discouraging FDI inflow. Generally, these observers take into account the global eco-

⁹⁹ Interview with Jiya.

¹⁰⁰ Interview with Dracker.

¹⁰¹ Ibid.

¹⁰² Ibid.

conomic environment in which South Africa operates. This is an environment characterised by financial global crises, fickle investor sentiment, Afro-pessimism, and stiff competition for FDI. It is interesting that, in his paper referred to earlier, Rafiq hardly mentions these as factors that hinder FDI inflows. As noted then, his diagnosis of the lagging investment programme is a lack of co-ordinated action in attracting FDI.

Apart from poor co-ordination of efforts to attract FDI, there are several constraining factors that can be offered as explanations of the poor investor response. Many of the critical constraining factors are beyond the government's control; they include the international financial crisis of 1997--8; negative investor perceptions of emerging markets, of which South Africa is a part; the environmental crisis in Mozambique (ie the floods); the land crisis in Zimbabwe; and surging crude oil prices. However, this should not spare the government from criticism, because it can address the domestic sources of some constraints, namely the lack of institutional capacity and effective policy co-ordination, the lack of a national consensus on GEAR, and huge social backlogs.

According to the South Africa Foundation's chief economist, Philip Black, the investment targets set by the government were unrealistically ambitious.¹⁰³ Black says the government did not fully appreciate the structural adjustments a transitional economy has to undergo.¹⁰⁴ In addition, he acknowledges that GEAR is being implemented in a dramatically changed domestic and international environment. This environment is characterised by an increasing degree of volatility in the global economy, which can be detrimental to the economic health of developing and transition economies.

The 1997-9 East Asian economic crisis had a negative impact on the South African economy. In the wake of the crisis, the Asian Tigers devalued their currencies and thus constrained their demand for exports. In 1998, for instance, Malaysia cancelled its order of the South African attack helicopter, the Rooivalk. Since South Africa was an emerging market, investors were reluctant to invest in it. Its currency was an object of speculative attacks by international fund managers. Notwithstanding the South African Reserve Bank's efforts to bolster the rand, the currency depreciated. The Reserve Bank's preoccupation with the strength of the rand led to record interest rates of 25 per cent, which further constrained economic growth.

Therefore, South Africa's transformation is coinciding with globalisation and its effects.¹⁰⁵ And no one could have anticipated the Asian turmoil and speculative attacks on currencies. All of these could not have been foreseen, and the framers of GEAR could not have foreseen or allowed for them. The rand has also been susceptible to a stronger American dollar and a weakening Euro.¹⁰⁶

Other factors relate to the perceived political implications of political crisis in the region – particularly the Zimbabwean land crisis. Whether true or not, many economic observers suggest Zimbabwe's handling of this crisis has eroded investor confidence in South and southern Africa. The civil wars in Angola and the Democratic Republic of

¹⁰³ Interview with Phillip Black, senior economist, South African Foundation, 1 November 2000.

¹⁰⁴ *ibid.*

¹⁰⁵ Interview with Azhar P Jammie, chief economist, Econometrix, 12 December 2000.

¹⁰⁶ Interview with Black.

Congo and the floods in Mozambique are also thought to reflect negatively on this region. The international advisers appointed by Mbeki to advise his government on creating an investor-friendly climate hold the same views. In other words, they believe these crises have deterred FDI.

During the past five years the internal political dynamics may have differed from those the GEAR authors had anticipated. The power of the trade unions has not weakened. The authors of GEAR assumed that COSATU would go along with the strategy, and that there would be no friction. But the strong opposition from the trade unions may explain the missing of 'targets.'¹⁰⁷ The strength of trade unions, the fear of them going on strike, and the Basic Conditions of Employment Act have increased costs. This has resulted in employers pursuing capital-intensive production. This is reputed to have the government 'oscillating uncertainly between GEAR and greater populism', which creates an unattractive environment for investment.¹⁰⁸

According to Azhar Jammie, some of GEAR's objectives have been achieved.¹⁰⁹ One major area of non-implementation is related to the labour market, which is inflexible and therefore undermines GEAR. Education and skills training has also not taken off. The reason for this is that the business community and department of labour have not committed themselves to pursuing the matter. The absence of education and training is serious if one considers the fact that there is a mismatch between jobs available and the skills of job-seekers.

Jammie thinks it was a mistake for GEAR's authors to prescribe time frames for achieving the document's objectives. For instance, he says education takes a long time to improve. He criticises the government for hammering local business for not investing in the economy. In fact, figures show the private sector has invested much more than the public sector and state corporations; in short, the government has not led the way. GEAR says the government should reduce the public service and spend more on fixed investment. It has started doing the latter, but not much.

According to Black, the government has good policies, but these have little effect on the ground.¹¹⁰ Regarding social services, for example, he says the government has not delivered to the extent it should have. Delivery has taken longer than the government hoped.¹¹¹ The high rate of unemployment (about 26 per cent), together with widespread poverty create the potential for social instability, especially in a highly politicised country such as South Africa. Generally, therefore, investors perceive the current situation to be too unstable for fixed investment.

Government officials are convinced that progress is being made.¹¹² They admit that the current education drive will only pay off in the long run. A quarter of the national

¹⁰⁷ *ibid.*

¹⁰⁸ CDE Round Table no 1.

¹⁰⁹ Interview with Jammie.

¹¹⁰ Interview with Black.

¹¹¹ *ibid.*

¹¹² Interview with Dracker.

budget goes towards education. The second biggest expenditure is on servicing debt. This is what GEAR was all about.

For Jammine, there are several determinants of FDI. He says the most important of these is to show a commitment to push policies through. The international financial markets have been looking for a much more aggressive advancement of GEAR. However, he admits that if GEAR had been rapidly implemented there would have been a groundswell of opposition to it. According to Jammine, South Africa has a 'mediocre' situation where there is no popular uprising and, at the same time, you do not have much progress regarding policy implementation.¹¹³

On the debit side, he says there is now an aggressive push for affirmative action. Consequently, this has given rise to fears that this policy is pushing out skilled personnel and attracting enthusiastic but less qualified people. This policy is being implemented at a time when the white business sector is inclined to resist change, and blacks want to see transformation.¹¹⁴ This tension seems to be giving rise to the perception that there is an increased racial polarisation under the Mbeki presidency (a reference to Mbeki's 'two nations' speech). What the government needs to pursue are the politics of 'unity in diversity' rather than emphasising differences.¹¹⁵

One aspect that has not been emphasised enough is that South and southern Africa constitute a small market (about 100 million people) for investors. In addition, the region is characterised by uneven economic development and poor infrastructure. DTI officials admit that South Africa is in a difficult position and therefore has to be smart about how it competes for FDI with the likes of India and China. For instance, the cost of transport within South Africa is too high. So in November 2000 the DTI gazetted the establishment of industrial development zones (IDZs) to overcome the transport problem. These will be located adjacent to international ports to provide manufacturers with easier access to South Africa's trading partners. Production at these IDZs will be high-tech and is not aimed at semi-skilled or unskilled labour. Economists and policy-makers acknowledge that IDZs will attract only skilled labour, which is still in short supply.

There is evidence to suggest that FDI flows to those regions that are economically well integrated. Thus strengthening the southern Africa as a whole is critically important. The South African government has taken this seriously by encouraging private and state-owned enterprises to invest in the region. Various projects are being implemented which vary in their magnitude and location. Major among them is the Maputo Corridor a so-called spatial development initiative involving a transport corridor linking Maputo-Mpumalanga and Gauteng. The other projects are industrial initiatives in mining and electricity.

According to Black, strengthening trade relations and regional integration will have positive results for the region and the country.¹¹⁶ He says this can happen in a twofold manner. First, the region can help South Africa to test its ability to market value-added

¹¹³ Interview with Jammine.

¹¹⁴ Interview with Jammine.

¹¹⁵ *ibid.*

¹¹⁶ Interview with Black.

goods in an international market, and second, South Africa's strategic involvement in the region will help to create infrastructure at lower costs. Thus strengthening trade with SADC countries, especially by increasing exports, could benefit the region and South Africa economically and socially. Already certain SADC countries had far higher growth rates than other emerging markets, which was a good sign for investment. Finally, he believes the region could successfully attract FDI if it acts in a concerted manner. Already a lot of work is being done to address the question on FDI in the region.

Although the ministry of finance is doing a superb job with respect to maintaining fiscal discipline, South Africa is still muddling along on economic growth.¹¹⁷ The major problem here lies with microeconomic issues. As a first step in addressing this problem, Mbeki has just started talking to the business community – for instance, the Business Trust, which is chaired by the former chief executive officer of Transnet, Saki Macozoma. Greater progress is needed towards improving South Africa's skills base. On this front the government must lead the way, but with business and labour playing their respective roles.¹¹⁸

One other factor that is generally regarded as constraining FDI is South Africa's high interest rates – ie compared to those of its competitors. High interest rates (averaging 18 per cent in 1996-9) have had a negative impact on attracting FDI or stimulating domestic investment, for they make South Africa capital-expensive. Thus high interest rates can act as a brake on economic growth. Conversely, however, the high rates have been a boon to portfolio investors. The danger of portfolio investments is that they are short term and are quickly withdrawn at the first hint of trouble – witness the panic that resulted from the recent Asian crisis. The interest rate problem points towards a lack of co-ordination between the department of finance and the Reserve Bank during Stals's tenure as governor.

GEAR's architects assumed that there would be greater co-operation between the government and the Reserve Bank. In reality, these two institutions were pursuing different objectives in respect of the South African currency. The former wanted a stable exchange rate; the latter was committed to maintaining a stronger rand, which meant maintaining high interest rates – reaching 25 percent during the Asian contagion in 1998. Given the Reserve Bank's constitutionally entrenched independence, the government was wary of appearing to pressure the bank to toe its line. Consequently, it let Stals have his way on monetary policy.

The last constraint identified by economic observers was the lack of progress on privatisation.¹¹⁹ Before the department of public enterprise's release of the policy framework on accelerated privatisation in September 2000, the government's policy on this question was unclear. Even the GEAR document does not say much on this issue. The 2000 document makes it clear that the privatisation of SOEs would be a phased approach.

¹¹⁷ Interview with Jammine.

¹¹⁸ Interview with Jammine.

¹¹⁹ The question of privatisation or the lack thereof will be considered in the next phase of this study. It is mentioned here because several interviewees cited it as one of the problem areas in implementing GEAR.

This shows that the government is acutely aware that this is a politically sensitive area that needs to be negotiated with due consideration. The private sector feels the government is being unnecessarily tardy and too accommodative of labour. For its part, labour thinks privatisation is not linked to development of the country and would lead to job losses.

New studies show that fast-tracked privatisation – as carried out in Russia and some east European countries – often ends up in failure. In Russia it has resulted in rent-seeking behaviour by the wealthy elite. Thus privatisation benefits have not accrued to that country's economy.

CONCLUSION

It is argued here that, to turn the FDI situation around, South Africa needs to stimulate its domestic economic growth, because investors tend to flock to growing economies. As South Africa provides a small market for potential investments, it should intensify its efforts to develop the southern African region. Today investors tend to invest in regional economic blocs, which provide an expanded market.

There should be serious investment in human capital, as investors prefer investing in countries with high human resource levels. South Africa should aggressively market itself internationally. In this regard, government departments, the provinces, and government agencies should co-ordinate their efforts. The government should consult key stakeholders when formulating policy strategies in order to minimise conflicts over policy direction.

At another level, the successful implementation of GEAR depends to a significant degree on the workings of the unpredictable world economic environment. Owing to labour's exclusion from the GEAR process, the failure of the policy in certain instances has become a self-fulfilling prophecy. Labour does not seem to take much regard of the fact that some of these failures may have to do with international constraints beyond the control of government.

GEAR is a major cause of deep-seated discord between the government and organised labour. So intense are the disagreements that the media frequently speculate about an imminent 'divorce' in the tripartite alliance. This suggests that if GEAR, as some argue, had been intended for public consumption, the government would have long abandoned it due to its political costs.

Notwithstanding the foregoing analysis, the implementation of some of the GEAR objectives will depend on co-operation from labour. This has either been given grudgingly, or not been forthcoming, particularly in the areas of privatisation and labour market reform. Although labour is crucial, successful economic policy must secure the co-operation of a variety of actors. This speaks to the view that economics is about human behaviour. Therefore, economic policies will not work unless human beings behave in an expected way. This notion of 'required' behaviour presupposes the idea of power relations, which determines who gets what, when, and how.

But even beyond those obvious areas of blockage there are areas where GEAR -- even if it were logically correct -- would run into implementation problems, because of de-

pendence on other transformations, which are outside of its ambit. These are land reforms redistribution programmes, the privatisation of SOEs, and a skilled and disciplined labour force, particularly in export-oriented industries. These transformations are difficult to realise, not because of a lack of will but they are difficult to effect in the short to medium term. Apart from that, implementing such programmes entails co-operation or co-ordination among departments that are used to working independently.

While some of the GEAR objectives (eg reducing budget deficit and lowering trade tariffs) have been achieved, some have not - notably an annual economic growth of 4 per cent and job creation, to mention just two. Economic experts say these goals remain unrealisable because the targets were unrealistically ambitious.¹²⁰ The authors of GEAR are accused of not appreciating the extent of the problems generated by structural adjustments to a transitional economy.¹²¹ These are problems presented by the huge backlogs in service delivery.

It is against this background that economic policy observers regard the GEAR time frames as unrealistic. The lessons provided by the Asian Tigers and Chile is that a programme such as GEAR takes at least 20 years to bear fruit.

¹²⁰ Interview with Black.

¹²¹ *ibid.*