CDE ROUND TABLE

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CDE Round Table is an occasional publication reflecting discussions held on key contemporary topics

Getting into gear

The assumptions and implications of the macro-economic strategy

On 22 January 1997 20 people met at the invitation of the Centre for Development and Enterprise for a round-table discussion on the government's macro-economic strategy as set out in the document Growth, Employment and Redistribution, popularly known as GEAR.

This an edited version of the day's discussion. A number of experts had been asked to prepare short lead-in papers on various aspects of GEAR, and extracts from these are summarised in the main text.

Key points which emerged are presented as the executive summary overleaf.

Participants in the round table

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Views expressed by the participants are not necessarily those of CDE.

Summary of key points

Investment and jobs

- GEAR is the most viable strategy available to government. The major challenges are to develop and implement consistent public policies, build business confidence, gain the assent of organised labour, and keep on track.
- GEAR trades off short-term social and political costs against longer term delivery. Over a five-year period it aims to get the economic fundamentals right in order to encourage private sector investment leading to job creation.
- GEAR's hypothetical projections of 400 000 new jobs per annum, and a growth rate of 6%, are probably over-optimistic. Such projections are not predictions; but if politicians don't recognise this distinction, they might over-react when the projections are not achieved. A government oscillating uncertainly between GEAR and a greater populism will create an unattractive environment for investment.
- GEAR faces critical challenges in its economic and political environment. Economic activity is in a period of cyclical decline, which is unfortunate for GEAR's objective of attracting investment. Meanwhile, in the political arena, the 1999 elections and matters relating to the presidential succession are already exercising minds within the ANC, and some politicians might find the attractions of populism irresistible.

GEAR and government

- GEAR is incompatible with the full realisation of many of the policy objectives set out by line ministries in White Papers during the past two-and-a-half years, at least as these were originally envisaged. If GEAR is to work, line ministries must be brought on board.
- Currently, links between GEAR and the ministries are weak. This must be remedied. Programmes must find points of connection with GEAR, and ministries will have to revisit delivery mechanisms, especially by exploring private sector partnerships.
- GEAR will also disrupt objectives previously set out by provincial governments.
- GEAR needs to be driven by a strong 'champion' in central government. The Deputy President's Office and the Department of Finance are obvious candidates to take on this role in close collaboration with each other.

Seeking consensus

- GEAR broke away from patterns of highly consultative but time-consuming 'direct democracy'. A team of technicians put GEAR together with impressive speed. The downside is that the necessary political consensus was not negotiated.
- For GEAR to succeed, processes are needed to build greater consensus within the ANC and among its partners in the alliance – but to do so without changing course. As a distinct move away from the ANC's egalitarian political background, GEAR's perceived political insensitivity also complicates matters.
- GEAR makes heavy demands on the trade unions. Wage restraint and labour market flexibility are necessary conditions for its success – even though at present labour market flexibility seems to be little more than a buzzword, and elaborate dispute resolution mechanisms could hinder increased flexibility.
- In the wider society, government cannot dictate policy. It has to manage the processes to gain acceptance for its policies – a challenge magnified by the size of South Africa's marginal class, and because bodies in civil society are now weaker and less numerous than they were.
- Processes to build consensus are hampered too by weaknesses in the state – manifested for example in the slow pace of delivery, and in the apparent inability to deal with crime – which also have a negative impact on business confidence and investment.

Investor confidence

- Investor confidence is a key variable. The success of GEAR hinges on increased private sector investment, both domestic and foreign. However, surveys show that perceptions among businessmen are currently very negative. Government must not only create an environment conducive to investment, but convince business that this will be maintained for 10 to 20 years.

- Effective public relations is essential to building confidence. This needs urgent attention. The government has not been effective in publicising its economic successes such as tariff cuts, some exchange control liberalisation, and deregulation in agriculture.
- South African business people attempting to send positive messages to the international business community are frustrated by an unreceptive environment. Enhancing receptiveness is the task of government, not the private sector. The positive symbolic value of well-managed events to demonstrate government's commitment to investment-friendly policies – a large scale privatisation, for instance – cannot be over-estimated.
- Investor confidence is only one element in a wider process of confidence-building. This requires consistent policies and appropriate government actions. A key target group should be skilled younger people who are currently inclined to emigrate, rationalising this in terms of crime, declining education and health facilities, and affirmative action which discriminates against whites.
- Government spokespersons must also be far more consistent in the signals they send.

GEAR and redistribution

- GEAR has been severely criticised in certain quarters as a decisive move away from the government's proclaimed commitment to redistributing incomes, wealth and opportunities. The counter argument is that GEAR is a necessary precondition for redistribution through economic growth – inevitably a long term strategy, with a 20-year horizon – whereas fiscal redistribution through government spending would be bound to fail, not least because resources are limited.
- Policy must ensure that in as many households as possible there should be people who are employed. There is strong evidence that a steady job of almost any sort is the decisive factor which enables families to escape from deep poverty.
- Nevertheless, there is also an urgent need for policies to soften the impact of unemployment over the medium term, and to ensure an improvement in social services for those people who most need them, through cost-effective delivery mechanisms including contracting to the private sector.

GEAR, the RDP and expectations

- According to one interpretation the two policies are not enemies and 'each is impossible without the other'. A counter argument maintains that GEAR has supplanted the RDP, leaving gaps which have to be filled.
- GEAR certainly does not obviate the need for a range of other policies to alleviate poverty and unemployment, and address low capacities.
- Because post-liberation euphoria still persists in the mass of the electorate, disappointments at the slow pace of socio-economic delivery are not yet affecting government support, and there is a window of opportunity here for reducing the deficit.
- Government must recognise that it cannot do everything it wants to do simultaneously. Priorities must be set. It must project a 'centre of gravity', which will increase predictability.

Updating and monitoring GEAR

- GEAR will have to be updated regularly, with the budgetary process providing the best opportunity for such adjustments – but the government must ensure that revisions are not perceived as backtracking.
- The 1997/8 budget is a major test of the government's determination and ability to implement GEAR.

The round-table discussion

The day began with a discussion of the socio-political context in which GEAR must operate. This was followed by an assessment of GEAR as an economic policy. The discussion then moved on to consider business perspectives on GEAR, before exploring some of its broader social implications.

The political context

Frederik van Zyl Slabbert introduced this discussion, placing GEAR in its socio-political context.

A structural tension or paradox is built into the transition in South Africa. Simply put: democracy promises equality; but the economy delivers inequality. In order to bring about greater equality, as promised by democracy, the state needs the wealth generated by a competitive market economy to meet the demands for a greater equality of services, for example in education, health and housing. However, in the short term, economic reforms necessary to improve the performance of the economy will increase inequalities before they lead to a greater distribution of wealth – an outcome which cannot be guaranteed.

A paradox is built into the transition in South Africa ... Democracy promises equality; but the economy delivers inequality ... Therefore, government is constantly confronted with the inevitable political consequences of necessary economic reforms.

The government faces a cruel choice. It has to intervene in the economy to create conditions for South Africa to become more competitive. However, such intervention incurs political costs. It could alienate interests, especially labour, whose support is necessary to keep it in power.

If government acts to placate its support base it risks undermining economic performance by alienating key interests in international and local business. Therefore, government is constantly confronted with the inevitable political consequences of necessary economic reforms.

The government consequently needs social, political and economic pacts to prevent the centrifugal tendencies of an emerging democracy, and the simultaneous tendency towards greater inequality in the economy, from causing a breakdown in the transition. It cannot afford *laissez faire* in politics or the economy if the ANC wishes to survive. Its only alternative is to make deals to bring interest groups on board its policy platform. Corporatism, as some analysts call this process, is already evident in the establishment of Nedlac, in attempts to co-opt other political parties (the Democratic Party and Pan Africanist Congress) into the Cabinet, and in the widespread de-politicisation of issues through the use of various commissions.

If successful, this approach will prevent democratic spaces from being exploited too vigorously, and avert greater instability and disorder. The downside is greater inflexibility, delayed decision-making and general governmental paralysis. There is a constant trade-off between political costs and economic decline.

This socio-political dilemma is aggravated by a number of complicating factors: a weak state, which means that increased demands for delivery are confronted by incapacity to perform; ethnic mobilisation in a context of competition for limited resources; the complexity of our diverse society, so that management, not control, is the only option – and this needs good information, not ideological blinkers; issues surrounding in-migration; the 1999 elections and the problem of succession, which consumes considerable managerial energy; and poorly developed subordinate tiers of government, especially at the local level, where delivery has to occur.

Discussion

- Crime is yet another complicating factor. This too is an aspect of the weak state – weak in its administration of the police service, courts, and prisons. Because of our large marginal class and high levels of socio-economic dependency, weaknesses in the state are particularly problematic in South Africa .
- The ANC, the government, and the state are different entities. The ANC, under pressure from elements in its own constituency, is searching for interaction with the private sector. The ANC is an 'omnibus' containing diverse and contradictory elements, and the process of pacting and corporatism is an attempt to bring order and stability to this complexity. It would therefore be foolish to expect too much too soon.
- A number of participants asked for international examples of cases where corporatism and pacting had been used to facilitate the success of a conservative macro-economic strategy. However, it is very difficult to draw comparisons because there are so many variables that go into making corporatism successful. Even Chile, an example frequently referred to, is of little use for purposes of comparison, because the sequence of events there was so different. In Chile, pacting preceded the transition to democracy, while in South Africa the reverse applies.
- Pacting failed in the case of the National Party, which would otherwise still be in the government of national unity. And it should be noted that there has been very little pacting over GEAR.
- Are pacts only a device to prevent increasing inequality from breaking the system? Must inequality grow inevitably? Can't pacts contribute to a programme of development and job creation? In response to these questions, however, it was emphasised that pacting is needed to allay the fears of 'threatened' groups. This is essentially a political issue.
- Although corporatism carries anti-democratic connotations for some, it is not necessarily a bad thing. It is in fact a tried and tested form of socio-political management. Every stable system of government in the modern world contains elements of corporatism.
- In the past the South African economy was over-regulated and under-competitive. Does this suggest that there is a case for less intervention now? Two kinds of intervention must be distinguished from each other. In one, the state becomes a player in the market place – a role we need to be cautious about in South Africa. In the other – which may be an unavoidable necessity for us – the state intervenes to allay the fears of threatened groups.

GEAR faces the danger that its dramatic projections - of 6% growth and 400 000 jobs a year - will be regarded by politicians as predictions, or even as promises. If these are not realised, recriminations and attempts to apportion blame are likely.

Economic policy perspectives

Charles Simkins began with some comments on the role of macro-economic models in relation to policy making. The main use of simple sectoral models, he said, is to tell you what matters, and what doesn't. In complex macro models, the major influences may be much harder to identify. But in any case what you learn from studying models is their own logic; not necessarily how the world works. We must also remember that projections – which are all that a model like GEAR can produce – are not predictions. Projections depend entirely on the selected parameters. GEAR faces the danger that its dramatic projections – of 6% growth and 400 000 jobs per year – will be regarded by politicians as predictions, or even as promises. If these are not realised, recriminations and attempts to apportion blame are likely. It is worth noting that GEAR uses a mixture of models, and has chosen parameters which enhance the projected outcomes. Another problem is that GEAR contains no risk analysis.

Is GEAR a shift in the right direction? We can reject one of the rival models immediately. The Cosatu/ILO alternative ignores the reality of international capital mobility. The days of closed-economy Keynesianism are over. We live in a world of free trade and capital mobility. South Africa is making progress in moving towards free trade. However we still have a major capital mobility problem. Oddly, none of the macroeconomic policy analyses deals with the implications of South Africa making reasonably rapid progress in this area – possibly because labour is against it, and business is ambivalent. Chris Stals's implicit view (rightly) is that there is substantial repressed demand for foreign assets. Consequently Stals urges caution. The problem is that Stals's timetable can be extended indefinitely, thereby excluding us from certain capital flow/investment games. Certainly inflows will be balanced against portfolio diversification outflows until liberalisation is complete. Complete liberalisation may in turn induce inflows if its maintenance is credible. All this is tricky to quantify, which makes policy a gamble. The trouble is, we can't afford not to gamble.

GEAR is not an attack on the RDP, but is in fact a necessary precondition for the implementation of RDP objectives.

Is GEAR deflationary? Some people focus on the budget deficit cuts and conclude that it is. However one can't simply stop at that point. What about monetary policy, where there is room to ease, other things being equal? Of course other things aren't equal, so whether monetary policy can in fact be eased in the wake of deficit cuts remains an open question. Presumably lower but positive real interest rates stimulate investment (and consumption too for that matter). It is much more important to notice that the real effect of GEAR is to transfer some economic activity from the public to the private sector, especially if no tax increases are envisaged.

More analysis is needed – despite all the documents produced by business, labour, government, and assorted academics and analysts – in areas such as the comparison of models and accounting for differences; risk identification and sensitivity analysis; and modelling further and complete capital account liberalisation.

Asghar Adelzadeh noted that in assessing GEAR one of the problems is that the model it employs has never been publicised. He went on to argue that the National Institute for Economic Policy (NIEP) believes that GEAR will fail to deliver the development promises made by the government. The strategy is unduly conservative and will not increase the rate of growth, reduce unemployment or re-distribute income and wealth in a more equitable way.

GEAR treats redistribution as an outcome of growth, rather than a factor contributing to it. Linkages to the various departmental White Papers are also inadequate. And some of the policies are contradictory; the promotion of a fast-growing economy is accompanied by tight monetary policy which has the effect of constricting economic activity.

GEAR projects results as being sustainable for ever after. In GEAR increased public investment will only begin in later years, if the early period sees a significant increase in government revenue. If expected growth does not materialise in 1996-98, increased public investment to overcome the country's infrastructural deficiencies will fail to materialise.

What is GEAR?

Growth, Employment and Redistribution: A Macro-Economic Strategy was published by the Department of Finance on 16 June 1996.

GEAR is consistent with the present strong international consensus on the efficiency of the market system. Recognising the importance of a globalised world economy, it stresses the need for a market-oriented growth strategy, fiscal discipline and investor confidence. While not discounting an active redistributive role for the state, it sees job creation through greater labour market flexibility as the most effective and sustainable means of reducing inequality. The strategy proposes a reduction of the budget deficit from 6% to 3% of GDP; financial liberalisation; a programme of privatisation; and a 6% annual growth rate projected to generate 400 000 new jobs by the year 2000.

The executive deputy president, Thabo Mbeki, and the minister of finance, Trevor Manuel, declared the strategy to be 'non-negotiable' once it had been announced, with the backing of President Mandela.

GEAR claims that sustained growth requires an outward-oriented economy. This is based on the false perception that South Africa's economy has been relatively closed. Currently one-fourth of total output is exported, which is substantially more than in many OECD countries and the South East Asian tigers. Furthermore, the government has not developed industrial strategies geared to sub-sectors with potential for exports. Thus the export growth target of 8,4% a year is unrealistic.

GEAR asserts that the current fiscal situation is unsustainable. A key objective is to reduce fiscal deficit by cutting government expenditure. Since the 3% target has serious implications for the achievement of RDP objectives, the government must provide a stronger rationale for its target. The World Bank's 1993 scenarios for SA assumed that, in a growing economy, a deficit of 12% at the first phase of the transformation is sustainable even in the medium term.

GEAR advocates job creation based on 'wage moderation'. But this will increase poverty. On the basis of GEAR's preferred 'integrated scenario', income distribution will actually deteriorate. This is contrary to the RDP promise that 'our growth path must ensure more equitable distribution of income'. GEAR's projected 1,35 million new jobs in five years represents an employment growth rate of 2,9%. With a labour force growing at 2,5% this will have little impact.

Adelzadeh concluded by saying that GEAR's abandonment of the RDP is a panic response to the exchange rate instability and a lame surrender to ideological pressure from international financial institutions and domestic conglomerates. GEAR is analytically flawed, empirically insupportable, historically unsuitable and, if implemented, will lead to disappointment and failure to fundamentally transform inherited patterns of inequality.

André Roux argued that GEAR is not an attack on the RDP, but is in fact a necessary precondition for the implementation of RDP objectives. Before the recent decline in the value of the rand, the Department of Finance did the calculations around RDP expenditure. The conclusion was that at a 3% growth rate, the fiscal constraints will prevent social and developmental delivery.

In fact the constraints are so tight that we have probably been helped by poor RDP delivery over the last two-and-a-half years. Thanks to roll-overs and underspending, the state never actually had to confront the potential fiscal constraints. However you have to see GEAR in light of the fact that this delivery is in the process of improving and that these fiscal constraints will begin to bite in the near future.

GEAR is not intended as a long term sustainable strategy and should not be viewed as such. It is a short term intervention, which simply begins to tackle our problems. Any long term strategy has to include a human resources development component – which GEAR of course does not. This component is where the RDP is relevant.

He argued that the role played by models has been exaggerated by GEAR's critics. Models are certainly useful as checking devices, and impose greater consistency than simple growth accounting. GEAR in fact had made use of the Reserve Bank's model, because this was available within government – and it must be understood that this model cannot be released in full since it has certain sensitive aspects. However, GEAR doesn't rest on a modelling exercise. It is essentially very simple. Aware of the fiscal constraints, the authors of GEAR asked a straightforward question. How can government stimulate growth in a modern, open economy? A number of variables are important. Firstly, this can't be done by stimulating government expenditure because this will cause capital flight. Secondly, the balance of payments is a fundamental constraint, as has been recognised for many years. The only solution is to boost exports. In this context, the recent depreciation of the currency is welcome. Finally, investment needs to be cranked up. Currently the private sector invest about R80 billion and government about R20 billion. The level

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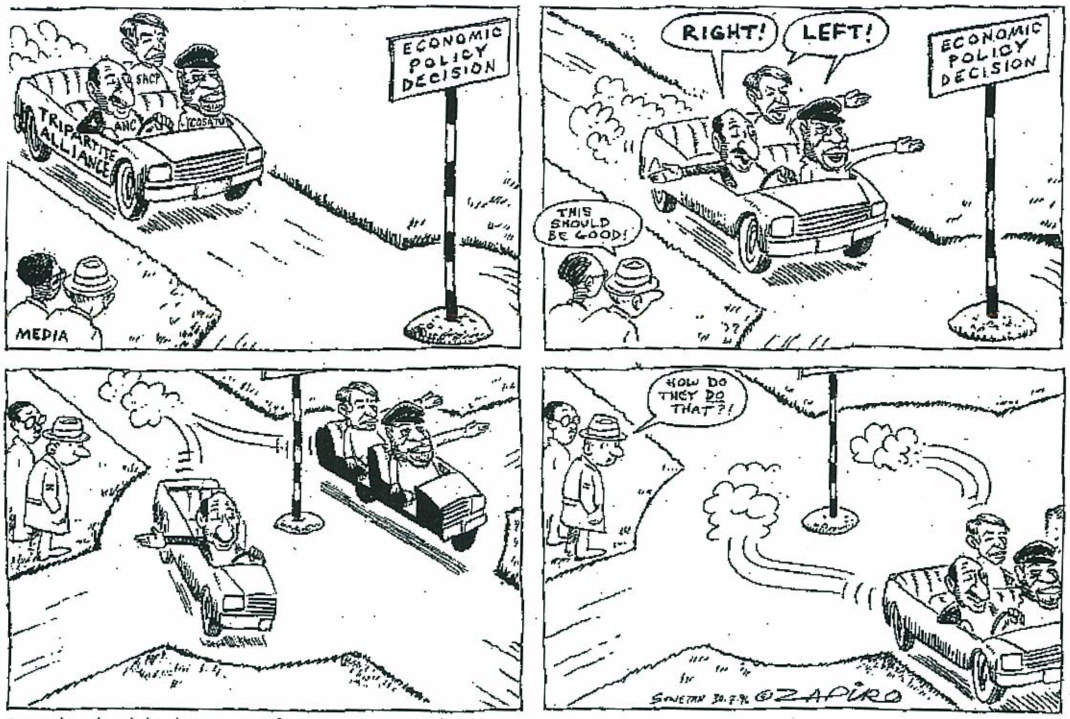

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of investment must be increased and to do so requires the building of a climate of confidence.

Therefore GEAR has a tight logic. It is designed to impact on areas where government is able to act. There are of course elements beyond government's control; its success hinges on the reaction of the private sector.

Contrary to some perceptions, GEAR never argued that the deficit crowds out investment. However we do need to reduce government dissavings in the medium term. It is also necessary to control inflation. The recent decline in the value of the rand presents an opportunity. Devaluation is a well established means of kick-starting the economy; it increases one's comparative advantage. However, some of the other countries that have tried to go this route have failed because of accelerating inflation. Inflation robs an economy of the benefits of devaluation.

We are currently achieving considerable success at containing inflationary pressures. This is being done through maintaining a steady monetary policy. The downside is of course the current high interest rates, which does not leave government much room to act in this area. The only alternative is tighter fiscal policy; in other words, to reduce government spending. Hence our need to get the deficit down to 4%.

Building credibility has turned out to be an extremely tough job which requires consistent measures. We need to talk up our successes. The situation is nowhere near as bad as many potential investors seem to think it is. They tend to focus on social issues, not on the economy. The economic picture is by no means as gloomy as they make out.

Discussion

- Are debates about the model an important issue? What is more important is that GEAR does not stress the real problem with the deficit; that almost all of it is absorbed in interest payments and recurrent costs. None goes into capital investment. South Africa's foreign reserves are among the worst in the world. Given this, the issue is how to increase investment without higher government debt. The problem therefore is how to attract capital. This suggests that it may be sensible to restructure our corporate tax rate. However, the effective rate of corporate tax is not particularly high in South Africa.

• The problem with a high-deficit scenario such as that mentioned in connection with the World Bank (1993) is that models of that kind are by and large based on closed economies. Given the reality of the global economy, capital markets, and an open economic environment, high deficits would simply lead to disastrous capital flight.

• While it is indeed true that about one-fourth of South Africa's total output is exported, this is not unusual in developing economies; and increasing the size of the export sector would still be quite modest in relation to what some other countries have done.

• The deficit is a problem which precedes GEAR, and it is consequently not a valid ground for attacking the strategy. A far greater negative effect has been created by the raising of public sector wages.

• Provincial government debt has recently been incorporated in the current debt figures, but local authority debt is still not included in national figures. Some kind of restriction or control on the borrowing of local authorities obviously has to be applied because if local government debts are unsustainable, this has implications for the national deficit. Local government tends to 'play chicken' with central government over debt. Local authorities incur unsustainable debts and then dare the central government to let them sink. In the past, local authorities have succeeded in forcing the centre to bail them out.

• GEAR is being implemented as two downswings get underway: one in the normal business cycle, and the other in political sentiment. The latter, it was argued, reflects disillusionment on the part of white businessmen as the realisation of the loss of white political power sinks in.

• Scepticism was expressed about the feasibility of the GEAR projections.The current 3% growth rate is determined almost entirely by agriculture, and the formal sector is not creating jobs at present. Only twice in South Africa's past has job generation managed to approach about 230 000 jobs a year – in the early 1970s and again in the early 1980s.

This puts GEAR's projected 400 000 jobs per annum 'into perspective'.

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Perceptions and expectations

GEAR hinges on the response of investors. With this in mind, the next two speakers had been asked to deal with issues of business confidence, and the implications for investment.

Lawrie Schlemmer reported that he and the SA Institute of Race Relations had recently surveyed 300 medium size companies. Business is generally pessimistic, except for GEAR and the new Constitution. On GEAR, opinions are evenly divided – 34% are optimistic while 32% are pessimistic. There is considerable disbelief in government's determination and implementation capacity. Against a range of issues, the vast majority of these companies are pessimistic and cynical: quality of government administration (80%); corruption (80%); capacity of local government (70%); delivery and the RDP (70%); local government (60%); tendering (60%).

Hence, there is gloom and a growing, bitter cynicism. Respondents single out crime as a concern, not simply because of the threat it poses to persons, but because crime is a barometer of the capacity to govern. The weak rand also worries business. While this increases our comparative advantage, the trade-off is the negative effect on business costs and investor confidence.

When it comes to labour relations, for medium-sized businesses, the 'hassle' factor is even more of a disincentive than elaborate

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dispute resolution procedures. These companies tend to feel that this has not been adequately considered.

Government is not given enough credit for its courage in going for GEAR. It is true that the timing is unfortunate – coming late in the business cycle. However, in terms of business confidence, the real problem is that GEAR is being swamped by other negative perceptions, such as the mess around matric examination results. Highlighting government's positive achievements needs attention.

The contradictions within the system are reflected within the ANC. The 'body language' of the party is ambiguous and confusing for observers, including business – for example, contradictory statements made by different Cabinet and ANC spokespersons. The perception is that the ANC lacks a predictable 'centre of gravity'.

Among the electorate, there is growing disillusionment over the rate of delivery. However the 'feel-good' factor in politics (post-liberation euphoria) is still there – an apparent contradiction. But the feel-good bubble could be burst precisely by the fiscal discipline and constraints on social programmes necessary to implement GEAR. In the short to medium term, however, this symbolic bubble allows the government some relief from pressures to deliver social benefits and therefore creates a window of opportunity for GEAR.

In his paper, **Terence Moll*** argued that investment is crucial to GEAR's success.If business invests strongly, GEAR will work; if it holds back it will probably fail. GEAR is gambling on investment – it reckons that if government follows conservative policies, cutting spending, reducing tariffs and encouraging market forces, investment will respond dramatically. Is this plausible?

If the budget deficit is cut, government demand will fall, harming investment. But this will be offset by a fall in interest rates, encouraging investment. In the short run, the former effect is likely to be stronger. Therefore GEAR's fiscal rectitude may undermine investment. But on the other hand, fiscal cutbacks could boost the government's credibility; it will be seen to be keeping promises and steering away from populism. If investors become convinced of the government's belief in market-oriented policies (regardless of whether these work!), then investment is likely to respond positively.

GEAR is appropriate for an open world economy. Investors world-wide are highly sophisticated and capital is very mobile – and worried about economic fundamentals. Investors want to see lower deficits and spending, and policies more aligned to business interests. This can work. In Malaysia, despite a huge fall in the budget deficit, market policies have paid off; in 10 years gross domestic fixed investment has soared from 23% of GDP in 1987 to an awesome 42% today. The economic logic behind GEAR makes a lot of sense. It entails government doing the things investors like.

But there's a problem in this regard: credibility. Firms have investment horizons of 10 to 20 years. Before they invest, they want to feel confident that economic policies will be favourable for a long time ahead. Firms will wait until they are sure about government's commitment to GEAR before investing. But if they wait too long, GEAR's costs will be felt while its benefits lag. Then GEAR might fail. Political turbulence and a bout of anti-market policies could follow.

So how can government build up its policy credibility? How can it demonstrate to business that it is firmly committed to GEAR?

- Budget deficit targets are GEAR's most widely publicised component. The Finance Department should not only meet these, but exceed them. It should also meet its targets for cutting government consumption spending.
- Some major well-publicised steps implementing GEAR would also help – such as a large privatisation, a rise in VAT (to ease fiscal pressure), an irrevocable commitment not

* As Terrence Moll was unable to attend the round table, the paper he had prepared was read on his behalf.

to raise company taxes, a steady withdrawal of the SA Reserve Bank from the forward exchange market.

• Exchange control is an ongoing nightmare for investors. While government should not be rash, it needs to liberalise faster, and risk the consequences.

• Government must publicise its successes far better. Major achievements like tariff cuts, easing some exchange controls, restructuring government finances and deregulating agriculture should be broadcast far and wide.

• Business needs to interact with senior policy-makers to evaluate their personal commitment to GEAR. 'Economic' ministers and MECs should consider making quarterly presentations to business

• Finally, government must avoid actions and ill-considered statements that create unnecessary uncertainty for business and knock the confidence of businessmen.

GEAR can work. But as with an ailing marriage, it requires that the two crucial parties – government and business – trust each other. Government should demonstrate that it is committed to GEAR; business should understand government's political constraints and take GEAR far more seriously.

Discussion

• The most important thing about GEAR is also the most obvious: South Africa now has a coherent macro-economic strategy in place.

• The political challenge is to market a policy where returns are not immediate. Experience in Asia and Latin America suggests that a 20 to 30-year perspective may be appropriate.

• GEAR needs a 'champion' in government to ensure that policy is translated into plans by sectors, national departments, and provinces. Without falling into the trap of central planning, someone has to drive and co-ordinate the programme. Such a 'champion' needs both political authority and financial clout. Realistically, the possible candidates are the Department of Finance and the Deputy President's Office, preferably both, working together. However it was also observed that support in the cabinet is likely to be fickle. Politicians are likely to support GEAR only until they see that it is incurring political costs. This might well occur when it becomes apparent that GEAR is preventing delivery of promised infrastructure and services. There is therefore likely to be a pendulum effect in economic policy, swinging between populism and conservatism.

• Labour market flexibility is crucial because the main issue is jobs. Migration is also important in this context, as it is a key resource factor which builds economies – or undermines them. In South Africa the loss of skills is clearly problematic and must be addressed.

• It had been said that GEAR has been misunderstood. However there is a deeper problem than a mere 'misunderstanding'; there has been a failure to build consensus within the Alliance. GEAR's rhetoric is aimed mainly at business and focuses mainly on growth. To build the needed consensus, it is necessary to look beyond business.

• GEAR needs interpreters in civil society in general. Business could do more by way of communication. Part of this should involve greater interaction with the Department of Trade and Industry, especially over business's activities in the rest of Africa. Another aspect of communication could entail business initiatives to inform overseas businessmen. Foreign businesses do not listen to governments; they listen to other businessmen. The impact of a positive statement on the South African economy by Julian Ogilvie Thompson, for example, would be far greater than that of any government communiqué.

• In reply, it was stated that Anglo American had recently issued several positive statements which 'simply disappeared into a black hole'. Although there is a role for business to talk up the economy, the key constraint is that the wider environment is not receptive. Terence Moll's suggestions for a government strategy to demonstrate its commitment to GEAR had also been made by some

Government should demonstrate - with some dramatic actions - that it is committed to GEAR; business should understand government's political constraints and take GEAR far more seriously.

key actors in government; but unfortunately there had been a failure to follow through.

- Government spokespersons must develop a greater consistency. Perhaps the government needs a checklist of things that speakers can and cannot say!
- The March 1997 budget would be crucial in pointing the way towards the implementation of GEAR. In this regard, it is significant that the present government is stronger politically than any of its predecessors. It need not be driven by immediate interests, and this affords it the independence necessary to implement GEAR.
- Do perceptions differ between urban and rural areas? Delivery appears to have been concentrated in urban areas. One participant suggested that rural delivery is in fact not as bad as is frequently made out – for example, delivery of water and electricity is beginning to take place in the Ciskei, where his home village is located. These are the 'essentials' that concern most people.
- Evidence is contradictory on the urban-rural issue. However rural people say that things are improving. The significant factor is that there is no bubble to burst. In urban areas, one might have expected the opposite, but there too the mood is still upbeat. The explanation might be that urban residents have been most exposed to the excitement of transition and are still positive and optimistic as a result.
- Is there a significant difference in optimism between white and black medium size businesses? Business confidence indices might be misleading; and confidence might have improved enormously in townships like Soweto. The downbeat attitude of white businessmen might be largely a reflection of their being exposed to conditions – especially crime – which have long existed in the townships. In reply, Lawrie Schlemmer said that in his survey 40% of black businesses were cynical as opposed to 60% of white. However black business is concentrated in sectors which have benefited overwhelmingly from the expansion of consumer credit over the past few years. On the issue of crime, there was no difference between black and white business perceptions. In fact crime generally hits (small) black business worse than it hits white business.
- One should never underestimate the role of 'animal spirits' (a strong willingness to take risks in pursuit of profits) in the South African economy. Remember that the desire to make money out of diamonds and gold led firstly to a costly war and then to national unification. Domestic and foreign investors have many decades of experience in a risky environment. The resumption of growth following the international recession of the early 1990s and the South African political settlement is a demonstration that animal spirits remain and, indeed, have been strengthened by the entry of new players. The major policy challenge is to give them freer rein, and to restore the rate of investment to its 1960s levels and beyond.

Perhaps the government needs a checklist of things that speakers can and cannot say!

GEAR and its social effects

Servaas van der Berg spoke on some of the major employment and distributional implications of GEAR, while **Andrew Donaldson** concentrated on the health and education sectors.

Servaas van der Berg argued that employment is the only solution to South Africa's distributional and poverty problems in the long term; but that GEAR is probably over-optimistic about employment prospects. Even its own figures confirm that solutions cannot be found in the medium term. A crucial requirement is for policies to soften the impact of unemployment over the medium term, and to ensure a continuing improvement in social services for those who most need them.

He began by noting that it is useful to distinguish three macroeconomic objectives according to time frames. In the short term, the objective is to maintain macroeconomic stability. This is not GEAR's main focus. In the medium term– which is GEAR's concern – the objective is to move the economy to levels of growth commensurate with employment and fiscal resource needs for addressing social backlogs. Long term objectives include sustainable growth and employment, which involves education and social policies among others. GEAR is essentially a medium term strategy which has long term implications.

We must remember that GEAR incorporate elements of the RDP. It is assumed that running parallel to GEAR, basic goals in the education, development and social spheres will be met. GEAR does not obviate the need to put adequate human development policies in place.

The problem is that the focus of GEAR is too short for redistribution to take place through economic growth. Comparative international experience shows us that redistribution through growth is a process which takes 20 to 30 years. This means that the only possible mechanism for re-distribution is the budget. However, there is little scope for increasing tax.

Shifts in the budget impact differently on black and white optimism or pessimism. There are currently problems in this regard. For instance, the impact on white education is perceived as negative – a perception widely used to rationalise emigration. – while the budget shift has as yet not made a positive impact on black education.

GEAR is designed to create jobs. In this sense GEAR is certainly a move in the right direction, because the problem of poverty is conditioned most importantly not by low wages but by the absence of employment. A job – virtually any form of steady employment – is crucial in making it possible for a family to escape from deep poverty. But how seriously can we take GEAR's projections, which seem unrealistically high?

If GEAR is too optimistic, what are the implications for policy? Overall growth will be lower than projected and the cost of labour will increase. Essentially, nothing is being put in place to look at the unemployment question because everything is assumed to hinge on growth. The same reservation applies to welfare.

To have room for manoeuvre, policy makers require progress on the redistributive front. The continuing inability to bring services to many of the poor is worrying, as it exacerbates the gap between achievements and expectations. The government must improve its delivery capacity, while direct measures aimed at alleviating unemployment are also imperative. These could include youth training programmes and low wage special public employment schemes.

On the fiscal front, the shift of resources to social spending categories has very nearly reached a limit. Further redistributive shifts within the budget can only come from re-targeting social expenditures. More importantly, improvements in the quality of social service delivery would amount to the equivalent of a massive injection of resources, greater even than under the most populist expenditure programme.

Andrew Donaldson pointed out that GEAR is potentially consistent with a wide range of social policy configurations. It does not undermine the RDP; nor does it diminish the policy-making processes most ministries have engaged in over the past three years.

However it is what GEAR cannot spell out that counts most in making for credible and effective government policy. Budgetary re-prioritisation and employment creation are the primary vehicles for redistribution. It has long been recognised that spending is where governments do most for redistribution; addressing poverty of opportunity associated with deeply embedded structural unemployment is where they can improve income distribution.

Employment is the only solution to South Afria's distributional and poverty problems in the long term; but GEAR is probably over-optimistic about employment prospects.

Budgetary policies and labour market regulations could of course have damaging effects. It is thus in the details of social policy that government must give effect to its re-distributive commitment.

In health and education, there have been far-reaching shifts in policy over the last two-and-a-half years. But there is another longer term re-distributive dimension to GEAR. Across the inter-generational dimension GEAR represents a commitment to opportunities in the labour market, greater aggregate household incomes and available fiscal resources in 10 and 20 years' time – when our children will be seeking places for themselves in a far more integrated world than we know now, on the strength of the industrial progress and institutional capacity we will have created on their behalf in the intervening years. This is a challenge from which we dare not shrink.

In the short term, some provincial departments and some education and health institutions will come under severe budgetary pressure. The opportunities for system change, for redesigning the way in which government goes about its business, will not remove these pressures. But appropriate reforms will create opportunities for providing citizens with better services within the limits to which the fiscus is unavoidably subject.

Improvements in the efficiency and quality of social service delivery would amount to the equivalent of a massive injection of resources, greater even than under the most populist expenditure programme.

In health and education, the mix of private and public sectors has been re-thought. Where certain costs cannot be afforded on a universal, equitable basis, it is important to recover these from beneficiaries. Acknowledgement of the diversity of service providers in education and health is on-going; properly nuanced policies do require greater differentiation in these sectors.

Perhaps most important of all is reforming the institutional character of public service providers, with new methods of accountability to clients, changing mechanisms for procurement of supplies and other aspects of governance and financing.

There is also an employment focus to the strategy. The rapid growth of employment in the private services sector is a feature of our economy, as in other parts of the world, which is inadequately reflected in the official statistics.

Discussion

- Inter-generational transfers are politically an attractive concept but, in order to make economic sense, the channels of transfer need to be specified.
- Two trends have important redistributionary implications. Firstly, the rent and services boycott, by freeing up disposable income, has had a substantial impact on many black households. If Operation Masakhane succeeds, a lot of pain will result. Secondly, there is a considerable shift to self-employment among whites. The salary ratio between white and Indian self-employment and salaried employment is nearly 2,5:1. If we assume that public sector wages will start falling behind again, racial income differentials could widen once more as minorities turn to entrepreneurship.
- Government has subscribed to the theory that an efficient public service requires competitive wages, together with a significant reduction in posts. However international experience is that more often jobs are spread through the civil service, with a loss of efficiency. Zola Skweyiya has indeed stated that he is fighting a 'losing battle' in the effort to create a 'lean and mean' civil service. There is a real danger that we will end up with the worst of both worlds; a civil service that is well remunerated and ineffective at one and the same time.
- It was noted that while broadbanding will relieve the upward pressure on public service wages, these wages will probably still grow at between 5% and 6% next year, which will indeed put the budget under pressure. The Minister of Finance consequently needs to be involved in this issue.

Concluding remarks

• This discussion has shown how much more complicated it is to manage our society now than it was in the past. It would be wrong to see the ANC currently as harbouring a drive towards ideological hegemony. Their challenge is to manage, not dictate from above, and they are battling.

• There is a close relationship between economic and political reform. Expect a stop-go element in this process. Economic policy innovations lead to political complications which in turn lead to rethinking the economic policy. GEAR has been developed by technocrats insensitive to political fallout as the ANC moves away from its past.

• Developing a centre of gravity within the ANC, as a platform for GEAR, is obviously crucial. Its effects will make this an unpopular policy. Therefore the group at the top in the ANC will need to strengthen its back and stick to its guns. A much greater awareness of the political vulnerability of economic reform is required; but this must be balanced by the reality that the ANC has no significant political competitor now or anywhere in sight.

• GEAR allows a greater role for the private sector. The ANC is now not quite so believable as the representative of the most marginalised groups in society.

• With an appalling policy the NP spent millions on positive propaganda, at home and abroad. Why is the ANC so weak at selling its much more laudable achievements? What is needed is clear, honest information marketed effectively. The autonomy (almost autarchy) of individual cabinet ministers and senior ANC spokespersons is a problem.

• Some of the things that are delivered in future will increase a popular sense of grievance because they cost too much (for example, the well-intentioned desire to spread the use of telephones). The planners and prospective beneficiaries do not seem to understand the cost implications for the average household economy. It is probably a good thing that in housing policy the promises of massive delivery weren't carried through – only 25% of the envisaged recipients could have afforded them if they were!

• Labour market flexibility affects production decisions. Is this ever taken into account? Labour market flexibility is currently nothing more than a slogan and the commission's report is not helpful in getting beyond this situation. All in all there has been very little constructive debate on this issue – either in government, or in Nedlac.

• If we are to succeed a number of things must be confronted:

- Major corporations are unable to retain the best young trained people. Emigration fuelled by fears about crime, education, and health services is a major worry.
- Older professionals (50+) are fast disappearing out of the system. As a result vital experience is being lost.
- The productive sector is moving up the technology curve away from employment of the unskilled. There is a growing body of unskilled, unemployed people with only a few years' education at best. Growth stimulated by GEAR will not create employment in this category.
- Government has to address crime and, as importantly, make international and local audiences believe that it is committed to doing so.

• Business needs to develop a strategic response to GEAR. Up to now the thinking has been supportive but low key.

• The success of GEAR will be determined by factors outside of GEAR.

• The link between GEAR and the different Ministries and provinces is very weak. Ministries will challenge GEAR because it is going to make their White Paper objectives impossible.

• GEAR is not the RDP, it is a fiscal pro-

GEAR is a very positive strategy. It makes real choices. It is different from the RDP. However it also leaves gaps, especially in social policy, and these need to be filled, not least because of the negative impact such gaps could have on GEAR itself.

Labour market flexibility is currently little more than a slogan.

gramme. Although it sets limits on what government can do this does not obviate the need to get support from departments. GEAR does not remove the need to alleviate poverty and unemployment, which are likely to worsen over the next five years.

Rounding off the day's proceedings, **Ann Bernstein** stressed the need for both government and business to set their priorities in relation to GEAR.

The commitment to GEAR must be strengthened within government itself, and within the ANC. Business too must be clear about its objectives, the ways in which it is going to respond to GEAR and what support it can and will give within a complex political and socio-economic environment.

Critical choices must be made in the course of 1997. It is significant that GEAR did not emerge from Nedlac, but comes out of strong positions adopted by key players. By and large, policy capacity is poor in South Africa. This weakness must be confronted, especially in government, which must develop a clear and coherent vision, and then act consistently, courageously and with determination even at the risk of unpopularity.

GEAR is a very positive strategy. It makes real choices. In this regard it is different from the RDP. However it also leaves gaps, especially in social policy, and these need to be filled, not least because of the negative impact such gaps could have on GEAR itself.

Above all, leadership will be crucial to GEAR's success.

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