

IMPROVING MANUFACTURING PERFORMANCE IN SOUTH AFRICA: A CONTRARY VIEW

Trevor Bell

1. Introduction

That the growth performance of South African manufacturing industry has deteriorated markedly since the mid-1970s, and that a major improvement in the performance of this sector is essential for sustained recovery of the economy as a whole, is generally acknowledged. The question of the causes of the deterioration in the performance of manufacturing industry in South Africa, and the requirements for a substantial improvement, however, is much more debatable.

The recently published *Report of the Industrial Strategy Project (1995)* (written by four academics, Avril Joffe, David Kaplan, Raphael Kaplinsky and David Lewis), represents a major attempt to address this important question. In terms of the sheer scale of the research underlying the *Report*, for a single project on the problems of South African manufacturing, it may well be unprecedented. The *Report*, however, is also significant because of the close association of the ISP with Cosatu and the ANC during the course of the research, and the fact that several members of the research team are now in key policy-making positions. It is likely, therefore, that the *Report* will have, indeed probably is already having, a significant influence on policy. Its findings thus call for careful consideration.

In view of this, the present review article is devoted entirely to consideration of the analytical and policy issues raised by the ISP report.

Central to the *Report* are its views on the productivity growth performance of South African manufacturing industry, which largely determine the ISP's perspective on the causes of the problems of the sector, and how they should be overcome. The crucial questions of South Africa's productivity growth record, and the determinants of manufacturing productivity growth, are discussed in Section 2. As an extension of this, in Section 3, some other sources of the problems of manufacturing industry, suggested by the ISP report, are considered, and an alternative perspective on the deterioration in the performance of South

African manufacturing industry is proposed. In the light of this alternative, Section 4 essentially redefines the nature of the obstacles to industrial revival, shifting away from the emphasis on micro-level factors found in the ISP report, to the broader task of economic restructuring, and considers the outlook for export expansion. Given the distinct possibility which emerges in Section 4 that export expansion and capital inflows will not be enough to give external balance at some reasonable, sustained rate of GDP growth, Section 5 considers the importance of the import side of the balance of trade. Section 6 contains some further comments on some aspects of the ISP's supply-side industrial policy proposals, and Section 7 concluding remarks.

2. Productivity Growth

Central to the *Report* is the notion that slow productivity growth has been a major reason for South Africa's poor manufacturing growth performance since the mid-1970s. The *Report* states (1995:11-12) that South Africa's productivity growth rate has been low for a sustained period; that it has been lower than in almost all the OECD countries; that it has been declining and has latterly been negative; and that sustained declines in productivity are highly unusual. So far as policy is concerned, they say (1995:21): 'Raising productivity is the heart of any industrial strategy'; and (1995:25): 'Raising productivity is the centre-piece of our industrial strategy'.

Given this emphasis, a striking feature of the *Report* is the absence of any detailed, systematic discussion of the productivity growth record of South African manufacturing industry or of its determinants. These issues, crucial to the ISP's policy proposals, are considered in the following two sub-sections.

□ The Productivity Growth Record

The evidence presented by the ISP report consists solely of a table (Table 1, 1995:13) showing the economy-wide (as distinct from manufacturing) Total Factor Productivity (TFP) growth rates of OECD countries in the periods 1960-73, 1973-79, and 1979-90, and of South Africa in the last two of these periods.

As their table shows, South Africa's economywide TFP growth rates in both 1973-79 and 1979-90 are indeed worse than those of nearly all the OECD countries. The appropriateness of comparing South Africa with OECD countries, however, is questionable. In general, economically more advanced countries tend to have higher TFP growth rates than developing countries.¹ Even so, it should be noted, the TFP growth rates of the OECD countries listed in the ISP's table were not invariably higher than South Africa's.

As to their contention that 'sustained declines in productivity are highly unusual', no attempt is made to justify this empirically, or to consider the matter in a serious fashion. In the economy-wide evidence, on which the ISP relies, three of the 18 OECD countries, had negative TFP growth rates in 1973-79 and two in 1979-90. This evidence may perhaps make such negative TFP growth rates seem 'unusual', if not highly so (though it should be noted that the US was one of the countries with which South Africa shared this distinction, in 1973-9). The picture, however, is very different when non-OECD countries are included in the comparison. Young's (1994:970) estimates for the 118 countries included in the Summers and Heston (1991) data set, indicate that some 53 countries had economy-wide TFP growth rates in 1970-85 of zero or less. According to Syrquin (1994:48), on average, low, lower middle and upper middle-income developing countries all had negative economy-wide TFP growth rates in 1980-89, with only the industrial countries on average having a positive rate in this period. Furthermore, in the case of each and every one of the OECD countries in the ISP's table, the economy-wide TFP growth rate was lower in both 1973-9 and 1979-90 than in 1960-73. It seems, therefore, that South Africa is by no means alone in having experienced low and declining economy-wide TFP growth rates; and, indeed, that negative economy-wide TFP growth rates are not 'highly unusual'.

Surprisingly, considering the subject of the *Report*, no comparative data are provided for manufacturing industry separately. Such comparative data are indeed hard to come by. However, Page (1990:113, Figure 1) provides estimates for industry in the aggregate for 17 countries (of which 13 are developing countries), to which Wright (1993:25) has added the figures for South Africa. The estimation period varies somewhat from country to country, but in each case falls within the years 1956-82. This evidence on South Africa's TFP growth performance turns out to be mixed. As Wright (1993:26) reports it, South Africa's TFP growth, total factor input (TFI) growth, and total output growth are not significantly different from the those of Mexico, Japan, Yugoslavia or India. Korea, Indonesia, Thailand and Turkey record much better growth in all three (TFP, TFI and total output), while Argentina, Chile, Hungary and Egypt record better TFP growth, but worse TFI and total output growth.

South Africa outperforms the Philippines and Zambia in TFP growth, but records lower TFI and total output growth.

South Africa's manufacturing TFP growth rate thus was clearly exceeded by eight of the other 14 countries mentioned in the preceding paragraph. One of these eight was Korea, an outlier in the sample, a special case, whose manufacturing TFP growth rate was not approached by any other country.

Excluding Korea, South Africa's manufacturing TFP growth was about equal to the median in the sample, and thus not exceptionally poor compared to these other countries.²

Furthermore, as these data make clear, TFP growth is not everything, when it comes to the performance of manufacturing industry, as measured by the growth of total value-added. As noted above, several countries with higher TFP growth rates than South Africa, had lower total output growth. And, apart from Korea, in the cases of all those countries which had both faster TFP and faster total output growth than South Africa (Turkey, Thailand and Indonesia) it was faster TFI growth, as much as faster TFP growth, which accounted for the difference in total output growth. The ISP's emphasis on TFP growth as a major cause of the poor performance of South African manufacturing industry is therefore questionable on these grounds alone.

Data permitting international comparisons in individual manufacturing sectors are exceedingly scarce. Nishimizu and Robinson, however, provide estimates for individual sectors (at a 2-digit ISIC level) for five countries, for various time periods: India (1960-80), Korea (1960-80), Turkey (1963-76), Yugoslavia (1965-78), and Japan (1955-73). Wright (1993:26) compares the performance of South African industries with these countries in the period applicable to each. He finds that in comparison to India, South Africa recorded positive and significantly superior TFP growth performance in every industry. Although South Africa's TFP growth performance for manufacturing as a whole is slightly worse than Yugoslavia's, in most individual sectors for which comparable data is available, South Africa performed substantially better than Yugoslavia (the exceptions being base metals and rubber). Compared to Korea, South Africa's TFP growth performance is very poor for manufacturing as a whole, as well as for virtually all individual industries. Compared to Turkey and Japan, the TFP growth performance of South African manufacturing as a whole is relatively poor, though some individual South African sectors did not compare too badly.

As noted above, however, Korea is a special case; and Japan is clearly not a country at a comparable stage of development. Based on this small sample of five countries, thus, any claim to the effect that South Africa's TFP growth rate has been exceptionally poor compared to other developing countries would have to be based on the comparison with Turkey. This clearly is a completely inadequate basis for such a claim.

Admittedly, the evidence above does not include the 1980s, the decade in which South Africa's manufacturing TFP growth rate was at its lowest, indeed, according to the ISP report, negative. Comparative data on manufacturing TFP growth for the whole or most of the 1980s is also scarce. The evidence considered

above (from Page, 1990; Nishimizu and Robinson, 1984; Wright, 1993) did not in the case of any country include a year beyond 1982. Even in a recently published study (Helleiner, 1994), which includes manufacturing TFP growth estimates for about eight countries, only in a couple of cases (Colombia and Korea) do the estimation periods include most of the 1980s.

Based on the evidence for these eight countries, up to the end of the periods for which data was available for each, however, it appears that there was a general tendency for manufacturing TFP growth rates to decline (Helleiner, 1994). Exemplifying this, is the particularly noteworthy case of Korea, the brightest star in the Newly Industrialising Country firmament, and one of the two countries for which, in the Helleiner volume, estimates are available for relatively recent years. According to Kim (1994:349-50), Korea experienced a sharp decline in its average annual manufacturing TFP growth rate, from 4.2 percent in 1967-73, to 1.9 percent in 1973-9 and 0.5 percent in 1979-88. So far as the decline in its manufacturing TFP growth rate is concerned, therefore, South Africa was in exceedingly good company. Furthermore, in the light of this evidence, as will be suggested below, it is questionable whether South Africa's manufacturing TFP growth rate in 1981-90 was significantly smaller than Korea's in 1979-88.

Given the availability of only fragmentary evidence, there seems to be no way of telling whether South Africa's (possibly) negative manufacturing TFP growth rate in the 1980s was 'highly unusual', as the ISP report asserts. It is noteworthy, however, that Brago and Rossi (as reported in Fritsch and Franco, 1994), though not covering most of the 1980s, find a negative manufacturing TFP growth rate of 0.59 percent for Brazil in 1970-83.³ Other studies in the same volume indicate negative manufacturing TFP growth rates for Bangladesh in 1975-76 to 1983-4 (Rahman, 1994:285) and Colombia in 1974-82 (Ocampo, 1994:160); and some estimate negative rates for Turkey in various periods (Celâsun, 1994:477). Even for periods not including most of the 1980s, a decade of economic decline in many developing countries, thus, it seems that negative TFP growth rates were not all that unusual.

□ The Determinants of Manufacturing TFP Growth

No systematic consideration is given to the determinants of manufacturing TFP growth in the ISP report. This is remarkable seeing that 'raising productivity' is the avowed aim of their policy proposals. In so far as the *Report* takes a view on this matter, it can be inferred only from these policy proposals themselves. For the authors of the ISP, it seems, improving productivity is largely a matter of improvements in allocative and technical efficiency, to be achieved by removal of the anti-export bias due to protection; by reducing the ill-effects of economic

concentration; by reforming outmoded systems of industrial relations and work organisation; and by adopting an effective technology policy to enhance technological capabilities. All of these proposals are concerned essentially with micro-level reforms, aimed at raising productivity.

Virtually no account is taken of the impact of macro-economic factors on the TFP growth rate. Helleiner (1994:29), in reviewing the evidence from a number of developing countries, states: 'Over the short to medium-term periods analysed in these studies one finds the principal concomitant of manufacturing productivity growth to be the growth of output itself'. The implicit view of the ISP is that in this statistical association the direction of causation runs mainly from productivity growth to output growth. The output growth performance of manufacturing industry, thus, is to be increased through improvements in allocative and technical efficiency, by means of micro-level reforms.

To a large extent, however, at least in the short to medium-term, the direction of causation runs the other way. Helleiner (1994:29), for instance, states: 'Much of this association between productivity growth and output growth is attributable to the impact of variation in capacity utilisation'. This evidently applies also to South Africa. Wright (1993:55) finds for virtually every one of the five sub-periods in his analysis (spanning the years 1945-90) a highly significant positive relation between the variation in value-added growth and the variation in TFP growth rates, across individual manufacturing industries. Furthermore, the strength of this relationship is greatest in recent periods, especially in 1981-90, when variations in capacity utilisation have been much greater than in earlier sub-periods. For manufacturing industry as a whole, adjusting for capacity utilisation reduces the *positive* TFP growth rate in 1974-81 (a period of relatively high capacity utilisation) from 0.32 to 0.28 percent, and the *negative* TFP growth rate in 1981-90 (a period of much excess capacity) from 0.50 to 0.06 percent. Excess capacity thus accounts for virtually all the measured decline in TFP in 1981-90 (Wright, 1993:58-59). The measured, unadjusted decline in TFP thus cannot be interpreted simply as a decline in efficiency. Indeed, since the adjusted *negative* TFP growth rate of 0.06 percent is insignificantly different from zero, it cannot be said with any confidence that South Africa's manufacturing TFP declined at all in the 1980s.

In addition to the effects of capacity utilisation, through its effects on output growth, the low levels of investment during the 1980s, might also have tended to reduce the measured TFP growth rate, due to the generally acknowledged 'embodiment' effect of investment on productivity growth, stated by Helleiner (1992:51-52) as follows: 'High investment rates are likely to generate technical advances through the embodiment of new technologies in freshly installed capital

equipment and the reduced average age of the capital stock'. Wright considers this factor in some detail for South Africa, but in the end his analysis is inconclusive because, as he says (1993:60), it is difficult to separate out the relationship between investment and TFP growth, given the dominance of the direct influence of capacity utilisation.

There is, thus, no justification whatsoever on either *a priori* or empirical grounds for the ISP's statement (1995:12) that sustained declines in productivity are highly unusual '*particularly where they are accompanied by declines in investment and employment*' (emphasis added). On the contrary, because of the capacity utilisation and embodiment effects, it is precisely in conditions of investment and employment decline, generally associated also with rising excess capacity, that declines in productivity are *most* likely to occur.

Improvements in TFP growth, thus, at least in the short to medium-term, depend to a large extent on improved macro-economic performance. As the author of a study of Colombia (Ocampo, 1994:162) aptly puts it, 'TFP is largely a dependent rather than an independent variable, with demand variables ... playing the dominant role ...' This implies that micro-level efforts to increase efficiency may have relatively little effect on productivity growth in the absence of a significant improvement in macro-economic conditions; and that trade and supply side industrial policy reforms, aimed at raising productivity, will have a positive effect only if they have a significant expansionary effect on domestic output, and hence on macro-economic performance.

In the longer-term, causation may perhaps run to a greater extent from TFP growth to output growth. However, even over long time periods, it is clear that TFP growth as such is not the major part of the explanation of why growth rates differ internationally. As noted earlier, the data in Page (1990:113, Figure 1) show *inter alia* that compared to those countries which had both faster TFP and faster total output growth than South Africa, it was faster TFI growth, as much as faster TFP growth, which accounted for the difference in output growth. More recently, contrary to popular opinion, Young (1994) has shown that what has distinguished the East Asian NICs from other developing countries, and enabled them to achieve higher per capita income growth than any other country in 1960-85 (except Botswana!), has not been exceptionally high TFP growth rates, but huge increases in capital and labour inputs. In particular, he notes (1994:968) that between 1960 and 1980, the investment / GDP ratio doubled in Taiwan, trebled in Korea, and quadrupled in Singapore. As Krugman (1994:70) says, noting that massive resource mobilisation, rather than increases in efficiency have been the key to their high output growth rates, the East Asian miracle 'turns out to have been based on perspiration rather than inspiration'.

This is not to say that improved manufacturing and macro-economic performance in South Africa depends on a similarly massive mobilisation of resources, or that this is economically and politically possible in our case. The evidence cited in the preceding paragraph is simply one illustration of the fact that productivity growth is not the only, or indeed even the major, determinant of output growth performance, which depends heavily on a host of other factors. The dramatic deterioration in the growth performance of the Japanese economy in recent years provides another example. It is clearly not due to the Japanese having suddenly become less efficient in their factories. It suggests what some writers have long suspected, that the key to the success of Japanese industry, has not simply been Japanese production systems, but also to a major extent certain other features of the Japanese macro-economy.

Thus, if both manufacturing TFP and total output growth in South Africa are to be improved significantly, attention must be given to the causes of the deterioration in macro-economic performance, and to the requirements for successful macro-economic restructuring.

3. Causes of the Slower Growth of Manufacturing Industry

By contrast with the ISP's view, it has been suggested that the productivity growth slowdown has largely been a consequence rather than a cause of the slower growth of manufacturing value-added, and of the deterioration in the growth performance of the economy as a whole.

The ISP report does not in fact consider systematically the causes of the slower growth of manufacturing industry. Instead, they make categorical, unargued statements which together, however, do not represent a coherent view of the problem. At one point (1995:xi) they list as the causes of the 'malaise' of the manufacturing sector, and as 'the most obvious sources of the crisis in manufacturing', a number of essentially supply-side factors -

the skills profile of the workforce, repressive and outmoded industrial relations systems and work organisation, technological backwardness, a highly concentrated industrial structure coupled with a concomitantly weak and repressed SME and micro-enterprise sector, and a poorly structured system of protection ...

At another, income inequality and import-substituting industrialisation (ISI) together are seen as the source of the difficulties. South Africa's manufacturing problems are likened to those of Latin America, which are described (1995:4-5) as follows:

ISI was designed to overcome balance of payments constraints.

However, high income inequality limited the growth in demand and soon resulted in saturation and excess capacity in industry. As ISI was then extended to more import-intensive products, the share of imports in GDP rose and shortages of foreign exchange became the primary constraint on further industrialisation.

This last statement has the attraction of seeming to account at one stroke for the onset of domestic recession and a foreign exchange constraint. However, the simple underconsumptionist model underlying it implies the completely untenable notion that recession in the 1980s was due to inadequate aggregate demand. It also conflicts with their supply-side explanation of the 'malaise' of South African manufacturing, which in fact dominates the view of the *Report* as a whole and its policy prescriptions.

Neither the supply-side factors listed by the ISP, nor the combination of income inequality and ISI, are in fact among the 'obvious sources of the crisis in manufacturing'. Whatever their income distribution and trade orientation, many developing countries in the 1970s, but especially in the 1980s, experienced severe macro-economic instability. Helleiner (1994:10), for instance, in emphasising the importance of macro-economic factors as causes of the problems of manufacturing industry in developing countries, states that:

during the 1970s and 1980s, much more than in the previous two decades, the macro-economic environment ... was highly unstable. Two major oil price shocks, major global recessions, large international interest rate variations and the debt crisis all created severe external pressures ... [B]alance of payments "crises", large fiscal deficits, high rates of price inflation and, periodically, sharp currency devaluations and severe austerity programmes to deal with the latter problems, were characteristic of the period.

Though one would not expect this description to apply in every detail to the South African case, it is in such terms that the crisis here in manufacturing, as in the economy as a whole, must be understood. Such factors, not any of those listed in the ISP report, are the obvious sources of the crisis. The debt crisis, perhaps the most obvious source of all, seems to get not one word of mention in the entire ISP report.

A brief interpretation of the onset of the South African economic crisis is provided elsewhere (Bell, 1993:91-5), and will not be repeated here. Essential to it, however, is that a series of adverse foreign exchange shocks, culminating in the debt crisis, created a severe foreign exchange constraint which produced a sharp contraction of the economy. Contrary to the suggestion of the ISP, noted above, this foreign exchange constraint did not stem primarily, if at all, from an

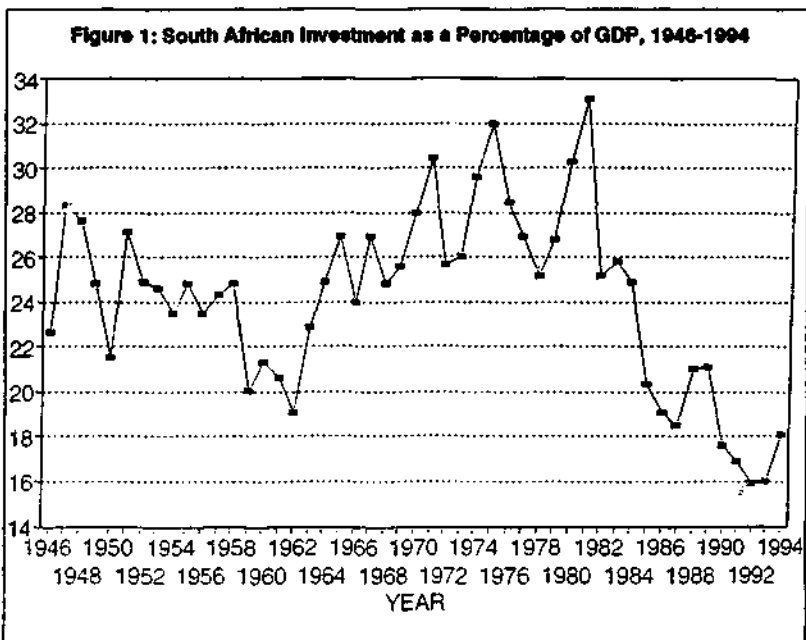
increase in the share of imports in the GDP. For instance, variations in the ratio of imports of goods and non-factor services to the GDP (excluding the boom years of 1980-81, when the ratio rose because of a strong Rand, and high levels of investment) are insignificant beside the huge 6.7 percent of GDP swing in the capital amount, from a net inflow of 1.6 percent in 1984 to a net outflow of 5.1 percent in 1985. Furthermore, given the powerful macro-economic forces which were at work, ISI (somehow combined by the ISP with income inequality), rather than being a cause of the problems of the economy, can much more plausibly be seen as having been de-railed by the crisis. Of Latin America, Fanelli et al. (1992:5) state: 'The biggest difference between the sub-periods before and after 1973 is not the dominance or gradual weakening of ISI doctrines but rather the impact of two international earthquakes: the oil shock and the debt crisis'. A broadly similar perspective on ISI applies in the case of South Africa.

The ISP report (1995:9) describes low investment as one of the two outstanding factors which have 'contributed to poor manufacturing performance' in South Africa (the other being low productivity growth). As evidence of this they point to the decline in the investment/GDP ratio. No attention is given, however, to the reasons for this decline. As we saw above, in considering the sources of the East Asian miracle, a country's long term I/GDP ratio and changes in it can be a significant determinant of its long term growth rate. However, in the short to medium-term it largely reflects shorter-term macro-economic and political forces.

The decline in the I/GDP ratio in South Africa in the past ten years or so, rather than being a cause, is a symptom of the same macro-economic problems, described above, which produced the deterioration in the growth performance of manufacturing industry. That this is so, is evident in Figure 1⁴ which shows South Africa's I/GDP ratio in the period 1946-93.⁵

Up to 1984 there was no persistent tendency for the I/GDP ratio to decline. The I/GDP ratio of 24.9 percent in 1984 was about as high or higher than it was in all but three years from 1949 to 1968. It was exceeded significantly only in certain exceptional periods, especially during and immediately following sharp increases in the gold price, such as 1973-75 and 1979-81. These gold booms resulted in major increases in the capital stock, and hence in production capacity, which could not be sustained when the booms ended.

The first year in which it fell significantly below the long-term levels, excluding those exceptional periods, was 1985 when it fell by nearly one-fifth to 20.3 percent (a level not recorded since 1958-61, a period of severe recession, which also saw considerable capital flight). The watershed year for South Africa, thus, was 1984, which is readily explicable in terms of the foreign exchange



shocks, which culminated in the debt crisis of 1985. This conforms to the experience of Latin America, following its debt crises. In Brazil, for instance, the I/GDP ratio fell from 21.0 percent in 1982, to 16.7 percent in 1983 and 15.7 percent in 1984 (International Monetary Fund, *International Financial Statistics*).

These reasons for the decline in South Africa's I/GDP ratio are clearly at least as important as the fact of the decline, to which the ISP restricts itself for understanding the ills of South African manufacturing, and for formulating strategies to remedy them.⁶

While the decline in the three years after 1984 seems to be readily explicable in the terms suggested above, it is striking that, rather than the partial recovery of the I/GDP ratio in 1988-89 being sustained, in the early-1990s it goes into further decline, to reach an all-time low of about 16 percent in 1992-93, and apparently falls significantly relative to several other developing countries.⁷ The reasons for this probably include continuing unfavourable macro-economic conditions (such as the poor performance of exports, noted below, due largely to external conditions), and the great political uncertainty associated with the

1990-93 period. In 1994 the ratio increases to 18.1 percent, and during the first two quarters of 1995 to just over 20 percent, with signs of a continuing upward trend (probably largely due to the substantial capital inflows since early-1994) which have alleviated the foreign exchange constraint.

The essential point of the above is that, contrary to the impression given by the ISP report, South African business does not suffer from an inherently low propensity to invest, which has been an autonomous cause of the poor performance of manufacturing industry. Movements in the I/GDP ratio since 1984 largely reflect changes in macro-economic conditions, including in particular developments in the balance of payments.⁶

4. Economic Restructuring and Export Expansion

Since macro-economic factors have been mainly responsible for the relatively poor performance of manufacturing industry, a macro-economic perspective on the adjustments necessary for revival of South African manufacturing is essential to the formulation of industrial policy.

The ISP report (1995:15) speaks of the need for 'industrial restructuring', but without defining it. Implicit in their view, however, is that it primarily involves changes aimed directly at making domestic producers more efficient, and hence more competitive internationally.⁹

The task which has faced the South African economy, in the past ten years or more, is a broader one, that we shall call 'economic restructuring'. This may be defined for present purposes as a process which, following events that have adversely affected a country's growth trajectory, involves changes in the structure or composition of output in the economy as a whole, which once again make the attainment of some desired, higher economic growth rate compatible with balance of payments equilibrium.

Immediately following the adverse shocks of the first half of the 1980s, which resulted in a severe foreign exchange constraint, the most urgent requirement for recovery was a substantial increase in the availability of foreign exchange, to pay for essential intermediate and capital goods imports. In the absence of significant renewed capital inflows, this required a dramatic increase in the rate of growth of exports, in particular (in view of the persistently poor performance of the mining industry) of manufactured exports. Essentially, the task faced was the formidable one of what is sometimes called 'export substitution', that is, substantially faster growth of non-traditional manufactured exports, to compensate for the poor performance of traditional primary commodity exports.

Since the crisis of the mid-1980s the South African economy has adjusted in various ways. As a result, the nature of the balance of payments constraint has

changed somewhat. In 1994 the capital account went into surplus for the first time since 1984. This indicates that South Africa now has easier access to foreign borrowing. This greater flexibility on the capital account does not however reduce the importance of foreign exchange. Between 1993 and 1994 there was a current account turnaround (from surplus to deficit) of almost R8 billion. As investment expenditure increases the scale of the deficits could increase. With persistent deficits on the current account, the foreign debt/GDP ratio could rise quickly. Furthermore, the great bulk of the capital inflow has been short-term, and cannot be relied upon indefinitely. The importance of a strong current account therefore remains.

The ISP recognises the problem of a balance of payments constraint. It states (1995:49):

We should emphasise that our trade performance is cause for considerable concern. The growth of the South African economy is subject to a powerful balance of payments constraint that effectively aborts the growth process before it is able to deliver rising per capita incomes.

However, they provide no analysis of this constraint, and it seems to have no influence on their view of the efficacy of their policy proposals.

The ISP report also sees the necessity of strengthening the trade account to alleviate the balance of payments constraint. However, for this they seem to rely exclusively on export expansion.¹⁰ This is so despite their claim (1995:49) that they are 'not fixated on export performance'. They say (1995:49) that there are 'important opportunities to save foreign exchange by substituting for imports', and (1995:50) that even 'within GATT constraints, there remains a certain capacity to bolster import substitution utilising the traditional instruments of trade policy'. However, they envisage that their trade policy proposals 'will certainly lead to an increase in imports across a wide front', and that unless 'accompanied by an immediate improvement in export performance', this will result in 'tighter constraints through the balance of payments ...'. The burden of adjustment in the trade account, and indeed apparently in the balance of payments as a whole, thus, falls entirely on export expansion.

What then is the outlook for export expansion? Despite their emphasis on export expansion, this question is not systematically addressed in the ISP report. However, the general impression created is of considerable pessimism about the prospects for spontaneous, market-driven export expansion. They state, (1995:7-9) for instance, that South Africa's 'primary products and semi-manufactures', which make up the bulk of total exports, are 'growing slowly', and that 'the increase in manufactured exports is still far from

satisfactory'; and refer (1995:48) to 'the weak performance of South African manufacturers in international markets', and to 'extremely poor export performance across the range of manufactured commodities'. Thus (1995:9): 'Poor export performance has been the major factor prohibiting the economy from growing at a high rate ...'. They do observe (1995:49) that recent years 'have seen a strengthening of our [manufactured] export performance, albeit from a low base', but this slightly more cheerful note is immediately negated by their contention that 'this is not a reliable guide to the future: a combination of domestic recession, an unsustainable export subsidy, and a depreciating currency, has created an unusually favourable climate for this export surge'.

These remarks clearly do not inspire confidence that a binding foreign exchange constraint, such as that which the ISP says exists in South Africa, can be overcome through a more or less exclusive reliance on export expansion, as they seem to imply. Can it be, though, that they believe that the trade policy reforms and supply-side industrial policies which they propose would greatly accelerate the rate of export growth?

It appears not. So far as trade policy is concerned, they state (1995:48) that 'the weak performance of South African manufacturers in international markets has inspired a re-examination of trade policy ...'. This seems to say that their proposed trade policy reforms will enhance the growth of manufactured exports. However, they go on to note (1995:60), quite rightly, that 'the assumption that tariff liberalisation correlated with export growth has not withstood empirical examination'.¹¹ Furthermore, the General Export Incentive Scheme (GEIS), South Africa's major direct export promotion programme, introduced in April 1990, is in the process of being phased out, and any future direct export promotion measures are likely to be much weaker than those of the past five years. The creation of a more effective free trade regime for exporters may partially compensate for this but, as they recognise (1995:58), any beneficial effect of this on the trade balance could be at least partially negated, if, as a result, 'potentially competitive domestic capacity ... [is] ... precipitously eliminated'. There would thus seem to be little in the ISP report to suggest that the trade policy reforms *per se* would produce a significant improvement in the export performance of manufacturing industry - except perhaps by intensifying the domestic recession.

There are tentative, unconvincing references (1995:59) to support for 'investment in capabilities - for example, schemes related to technology development and human-resource development - that underpin export activity', which they suggest should be explored further. A greater emphasis on the promotion of exports by SMEs, though described as 'an issue of first order importance', is apparently proposed only on the basis of the rather weak claim

that ISP researchers 'have encountered [SME] firms - in the furniture industry for example - who ... with a little focused support, might easily be induced (more easily than the dominant firms) to contest international markets'. Though this is clearly possible, one gets no sense from the *Report* that this would make a quantitatively significant difference to the rate of export expansion.'

Finally, in their quest for ways of stimulating exports, the ISP report resorts to exchange rate policy. Their discussion raises numerous serious difficulties but only one, particularly germane to the viewpoint of the ISP, will be touched on here. They seem to be aware that the devaluation which they propose (if it is a real rather than merely nominal one), will tend to reduce real incomes, at least in the short to medium-term. They seek to avoid these adverse effects by proposing that the devaluation should be accompanied by a lowering of tariffs so as to leave the domestic currency prices of importables unchanged, and by a tax on traditional, resource-based exports, to prevent the prices paid by domestic buyers for such exportables from rising. Two problems with this should be noted.

Firstly, if a real devaluation is to improve the trade balance there would seem to be no way a cut in real incomes, including real wages, can be avoided. It raises the price of tradables relative to non-tradables. Labour is the non-traded good *par excellence*. Hence, as Helleiner (1992:11) states 'real currency devaluation typically implies real wage reduction'. This, and the generally contractionary effects of a devaluation - especially in a South African-type economy (See Solimano, 1986) mean that the costs of a real devaluation must be carefully weighed against those of alternative means of improving, or preventing a deterioration in, the balance of trade.

Secondly, a real devaluation accompanied by a proportional decrease in tariffs, would mean no improvement in the ability of domestic producers to compete against imports. It would therefore not discourage imports, usually one of the aims of a devaluation. And a tax on traditional exports would negate the potentially positive effect of the real devaluation on the volume of such exports. The ISP's proposals thus would at least partly defeat the purpose of a real devaluation.

There is nothing in the ISP Report, therefore, which would make one expect the rate of growth of South Africa's total exports to be significantly higher in future than it has been in the recent past. The *ISP Report* does not provide any statistical analysis of past and likely future trends in the growth of South Africa's exports. However, preliminary analysis indicates that South Africa's total exports have been growing slowly and that there are significant obstacles to accelerated export growth.

The main piece of evidence presented by the ISP (1995:23) to show that

manufactured exports have performed poorly is that, by contrast with various other developing countries, the share of manufactures in total exports did not increase between 1970 and 1990. Their data source is not indicated. According to data provided recently by the IDC for 1972-93, however, the share of manufactures did increase somewhat, from 33.2 percent in 1972 to 37.1 percent in 1990. Such changes in percentage shares, though, reflect a multitude of influences and are not particularly illuminating. For instance, according to these data, the share of manufactures in total exports in 1980 was only 25 percent, but this was clearly due to the high gold price at that time.

Rates of growth of exports are perhaps more revealing. As noted above, South Africa faces the task of 'export substitution', that is, accelerated growth of non-traditional, manufactured exports, to compensate for the poor performance of traditional primary commodity exports. The nature of this problem may be illustrated as follows: Measured in constant US dollars¹² (current Rand values, converted to current US dollars at the average exchange rate, and deflated by the US producer price index), manufactured exports in the period 1988-93 grew at an average annual rate of 5.4 percent. However, gold exports (which in 1988 still comprised a significant proportion of our total exports) fell at 6.8 percent and agricultural exports at about 2.0 percent a year. The result was a meagre increase in total exports, measured in these terms, of only 1.1 percent per annum. Furthermore, there was a tendency for the performance of total exports to worsen. In the sub-period 1990-93, manufactured exports grew only slightly slower than in 1988-93 as a whole, and the rate of decline of gold exports decelerated significantly. However, apparently owing mainly to substantial declines in the two other traditional primary commodity exporting sectors, agriculture and 'other mining', total exports fell at an average annual rate of about 0.7 percent.¹³

Based on the trends in operation in 1988-93, thus, and with gold output continuing to decline, the outlook for export expansion seems bleak. If, as the ISP report seems to say, there is a binding foreign exchange constraint, at higher, sustained rates of growth, therefore, it may well be that this cannot be overcome through a strategy which focuses more or less exclusively on export expansion.

In the light of this, there are two crucial questions, not raised in the ISP report, which need to be addressed: (1) What is the realistically attainable, maximum average annual rate of growth of South Africa's exports over, say, the next five to ten years? (2) What rate of growth of South Africa's exports is necessary to achieve some desired, higher, average annual GDP growth rate (of say 3.5 percent) over the next five to ten years (given likely import/GDP ratios at such a growth rate, and the *sustainable* ratio of net capital inflows to GDP)?

More definitive answers to these questions require further work, and no attempt

is made to provide them here. It seems, however, that there is the distinct possibility that the required export growth rate, as defined above, will exceed the maximum feasible rate. Despite their implicitly rather un-reassuring view of the prospects for export expansion, the ISP does not consider this possibility. It is in effect simply assumed that exports will be sufficient for a significant sustained increase in the rate of growth of manufacturing output. If this turns out not to be the case, their micro-level measures aimed directly at increasing productivity, however well-conceived, will contribute little towards improving manufacturing performance in South Africa.

5. Economic Restructuring and the Import Side of the Trade Account

Given the limits to export expansion, the import side of the trade account, and its contribution to successful economic restructuring in South Africa, call for careful attention. We consider this question under two headings: import liberalisation, and import substitution.

□ Import Liberalisation

As shown earlier, the ISP sees South Africa's traditional strategy of import-substituting industrialisation as a major source of the recent troubles of manufacturing and, indeed, of the economy as a whole. This, it was argued above, is an untenable position. This, however, still leaves open the question of the desirability now of reducing levels of protection through import liberalisation.

The issue, it should be noted, is not whether South Africa should in future pursue a strategy of ISI or one of export-oriented industrialisation (EOI). As argued elsewhere (Bell, 1993), South Africa was forced by the macro-economic shocks of the early- to mid-1980s to shift abruptly from ISI to EOI, and there can be no going back on that.

Such a shift, however, is generally characterised simply as entailing the removal of a significant anti-export bias, and the creation of a system of incentives much more neutral as between production for domestic and export markets. In South Africa, in the mid-1980s, having already largely removed quantitative restrictions (QRs) in the period 1983-85, a further major change in the incentive structure in that direction resulted from a substantial real depreciation of the Rand. This was reinforced later by direct export promotion measures, including subsidies provided in terms of the General Export Incentive Scheme (GEIS), introduced in April 1990.

The shift from ISI to EOI in this sense is *in principle* not incompatible with

retention of some measure of protection in the domestic market. Helleiner (1994:15) says of the fourteen developing countries included in his study:

Import liberalisation, except for imports destined directly or indirectly for use in manufactured exports, was *not* generally ... an important means of reducing anti-export bias in the 1970s (or, in most cases, the 1980s). Typically, import substitution policies were built upon, through the provision of new export incentives, rather than dismantled.

He goes on (1994:15-16):

It was not until the late-1980s and early-1990s, in such cases as Mexico, Peru and Colombia, and to a lesser extent, India and Korea, that import liberalisations themselves could be said to be 'leading' in the efforts to reduce anti-export bias in the manufacturing sector.

The desirability of *further* import liberalisation in South Africa, through comprehensive tariff reductions, is considered at some length in Bell (1993). Essentially, the argument there was that in the midst of macro-economic instability, the likely adverse macro-economic effects of import liberalisation (on the balance of payments and domestic output and employment) could prove much more damaging to the economy than the price distortions which such liberalisation supposedly seeks to correct. This seems as true today as it was two years ago, the substantial foreign capital inflows since early-1994 notwithstanding.¹⁴

As the findings of Helleiner (1994:5), quoted above, suggest, middle-income countries, such as Brazil and Korea, whose circumstances permitted, or compelled, them to switch from ISI to EOI some decades ago, were able for a considerable period of time thereafter, to combine continued protection with the promotion of manufactured exports. South Africa's transition from ISI to EOI occurred much later, largely during the period of the Uruguay Round of trade negotiations. Consequently only a matter of a few years after this transition, South Africa is now under pressure to liberalise its import trade substantially.

The commitments entered into by South Africa in terms of the Uruguay Round, thus, limit the freedom of policymakers to continue to protect producers in the domestic market. The ISP report states (1995:52) that 'GATT has effectively imposed a global trade regime as the parameter to which national trade and industrial policies have to conform'; and (1995:53) that one of the elements of their 'new trade policy' is: 'A tariff policy, the terms of which are effectively set by our adherence to GATT'. However, there seems to be much more to their advocacy of import liberalisation, and their neglect of the import side of the

balance of trade, than this.

In justifying their emphasis on improved export performance, apparently as against maintaining existing protection or the promotion of further import substitution, they contend (1995:50) that there are 'persuasive micro-economic arguments for it', and that 'import success correlates with rapid industrial development'; and refer to the positive 'effects of exporting on productivity growth'. They assert (1995:54), too, that 'the dismantling of trade barriers ... is a precondition for strengthening our manufacturing base'; and (1995:25) that import liberalisation 'will lead to more competitive pressures ... [which] will further facilitate productivity gains'. Their emphasis on export expansion thus seems to rest on their belief in the positive virtues of import liberalisation rather than simply on the constraints imposed by GATT. For none of these claims, made in support of import liberalisation, however, is there any conclusive theoretical or empirical support, either in the ISP report itself or in the general literature.¹⁵

By contrast with their exaggeration of the efficiency benefits of import liberalisation, they seem to completely discount the damaging effects on the balance of trade and domestic production, which, by their own admission (see remarks from 1995:50 quoted above, for instance), could result from the tariff policy reforms which they support. It may well be that the hands of South African policymakers are largely tied by the commitments entered into in the Uruguay Round, and that these effects on the trade account of the balance of payments are therefore unavoidable. In that case, however, we should face the likely consequences squarely. Import liberalisation, rather than helping to strengthen the trade account, and so contributing to successful economic restructuring, will increase the already heavy burden falling on export expansion.

□ **Import Substitution**

Whereas import liberalisation will tend to increase the import/GDP ratio, successful economic restructuring - given the limits to faster export expansion - may well require further effective import substitution.¹⁶ This too is not in principle incompatible with export-oriented industrialisation. The ISP's attitude on this issue is perhaps coloured by their view of the past ill-effects of ISI. That the ISP does not in fact attach any significance to import substitution, despite their token reference to 'important opportunities', is also apparent from their statement (1995:53) that they seek 'a system of export supports designed, in the first instance, to compensate for the anti-export bias arising from tariff protection, but, beyond that to underpin a net outward orientation in our overall trade regime'. This would seem to mean the creation of a bias in favour of exports, and hence against encouragement of the production of tradable goods for the

domestic market.

It is doubtless true, as the saying goes, that South Africa has come to 'the end of the easy stage of import substitution'. Indeed, South Africa probably reached that point some considerable time ago. However, as the discussion in the preceding section suggests, we have now also come to 'the end of the easy stage of export expansion'. This happened comparatively recently. Until the latter half of the 1960s, South Africa was by and large able to increase its exports relatively effortlessly, through growth in its gold output, and thereafter, though more erratically, was able to benefit from temporary gold booms, right through to the early-1980s. It was only then that export expansion became permanently more difficult.

In so far as we have the freedom to choose, thus, South Africa is now faced with the tough choice between difficult export expansion and difficult import substitution. For many, the idea of further import substitution is unthinkable. It is widely believed that the process of import replacement has gone much too far already, and that for various reasons (including in particular sanctions) there was in South Africa an exceptional drive for self-sufficiency, which has resulted in an unusually closed (and inefficient) economy. This belief, though strongly held, has to my knowledge never been supported by evidence, or proper argument (See Bell, 1993a on the treatment of import substitution in the sanctions literature).

In fact, neither in terms of its trade/GDP ratios, nor its levels of protection has the South African economy been exceptionally closed. As Figures 2(a) and 2(b) show¹⁷, for its economic size, South Africa's trade ratios have not been strikingly out of line with other developing countries. In terms of its levels of protection, too, the World Bank (Belli et al, 1992:7) found a few years ago that South Africa was not an overly-protected country.

Furthermore, these international comparisons show that there is nothing sacrosanct about our past import/GDP ratios. There is no reason in principle why South Africa's optimum trade ratios in future should not be significantly lower than the actual trade ratios of the past, which were the result of the relative ease with which we were able to expand exports.

In thinking about the future role of import substitution, it is instructive to note some features of the process in South Africa in the past. Figure 3 shows the values of an import-substitution index for consumer goods, intermediate goods, capital goods and manufacturing industry in the aggregate between 1917 and 1988. The index is defined as the ratio of imports to total supply, which is the sum of domestic gross output and imports.¹⁸

Figure 2a: Import/GDP Ratios of South Africa and Some Other Countries Related to the Size of their Economies

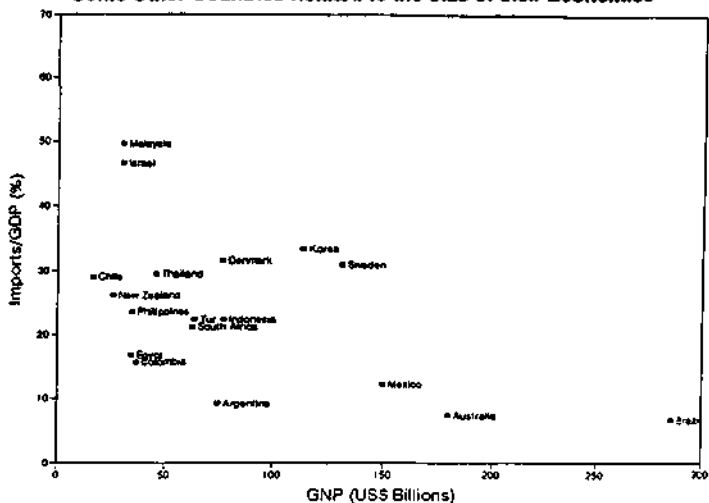
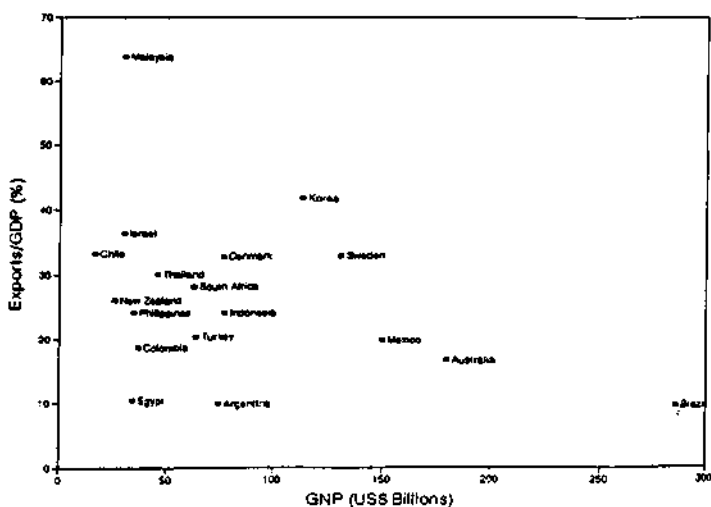
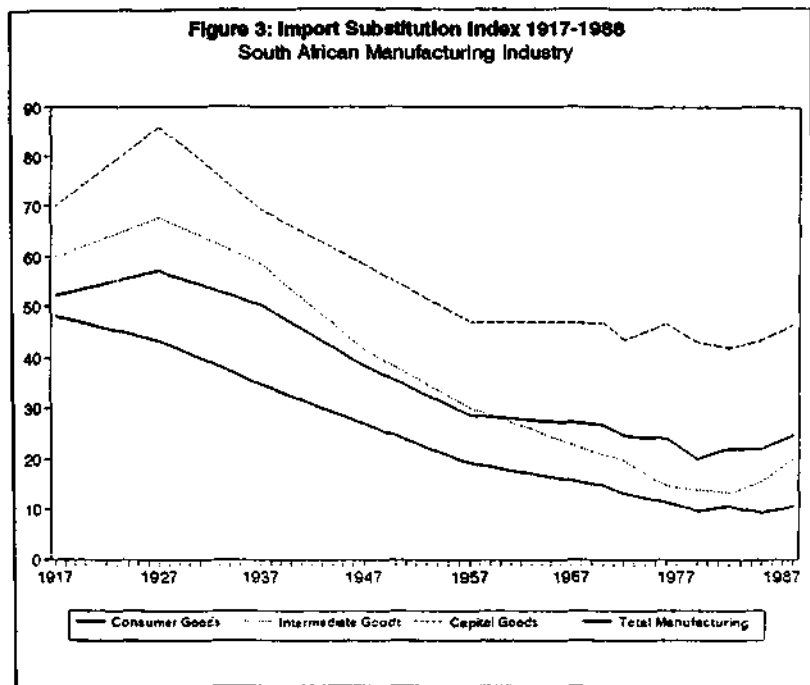
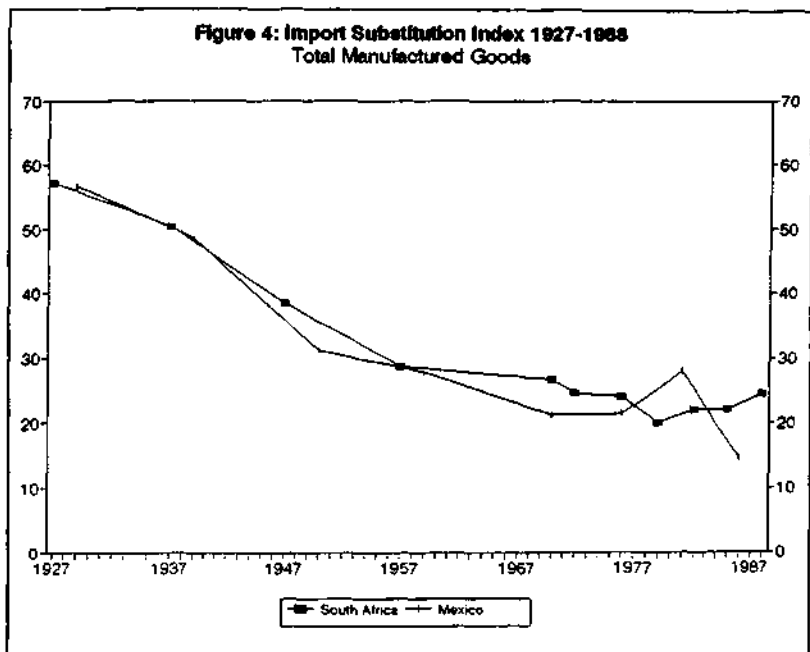


Figure 2b: Export/GDP Ratios of South Africa and Some Other Countries Related to the Size of their Economies





Though we cannot here go into the detail underlying these trends, certain features of the process should be noted. Historically, import substitution has largely been a logical, evolutionary process, explicable in terms of the establishment of a succession of leading industries and their backward and forward linkages. It is hard to see how South African industrialisation could have taken place in any other way. Most of the decline in the import/supply ratios had occurred by 1957. There is no support in Figure 3 for the contention that government in its efforts to withstand the threat of sanctions in the period 1967-85, had pursued a 'semi-autarkic' strategy (Becker and Pollard, 1990). The trends in South Africa and Mexico¹⁹ between the late-1920s and the 1980s have been remarkably similar in all three categories of goods and, as Figure 4 shows, in manufacturing in the aggregate. This also does not suggest that the process has, for peculiarly South African political reasons, been taken to excessive lengths, which make further import substitution exceptionally difficult.²⁰



Furthermore, it is arguable, contrary to current opinion, that far from being an impediment to faster growth, import replacement was a macro-economic imperative for the maintenance of external balance at the growth rates actually achieved into the 1970s. As suggested above, it may well be that successful economic restructuring requires it to play the same role in the future.

Whether import substitution can play this role in future is another matter. It is possible that it will not be able to do so, for two reasons.

First, GATT clearly does impose constraints in respect of continued protection, and the encouragement of further import substitution. However, as the ISP report says (1995:52), 'there is room for manoeuvre within the GATT parameters. The capacity for manoeuvre within GATT - and the prospects for extending it - is a key point of entry for national policymakers'. In their subsequent discussion, the emphasis is mainly on exploring the room for manoeuvre in relation to export promotion. More attention may have to be given to the room to manoeuvre for promoting new import-substitution. It is possible nevertheless that this will be insufficient for significant effective import substitution.

Second, domestic conditions are less favourable to import substitution, than they were in earlier decades. Whereas a sluggish domestic economy provides a strong incentive for export expansion, it is not conducive to substantial new investment in production for the domestic market to replace imports. Promotion of significant new import replacement thus may initially require considerable resources, and much resolve on the part of those responsible for promoting South African industrialisation.

If any of these conditions is lacking we may well, as the ISP report implies, have to rely more or less exclusively on export expansion. In that case, however, we shall probably have to lower our sights considerably so far as improvements in the growth performance of manufacturing industry and the economy as a whole are concerned.

6. Some Comments on the ISP's Supply-Side Industrial Policies

As argued above, the revival of manufacturing growth rates, at least in the short to medium-term, depends largely on a process of macro-economic stabilisation and restructuring, rather than on micro-level, supply-side measures aimed directly at raising productivity. Helleiner (1994:10) states:

The relative importance of micro-economic signals, reflecting trade, industrial and other policies, was bound to decline in such a macro-economically turbulent period. The significance of policy reforms directed at the rationalisation of micro-level incentives, and improved efficiency, was therefore almost certainly correspondingly less than it would have been, say, in the 1960s ...

Though doubtless less true than at the height of the macro-economic instability, in the mid-1980s, Helleiner's remarks regarding the lesser importance of micro-level factors, at least in the short to medium-term, probably still apply to South Africa today.

The ISP report nevertheless seems to see their supply-side industrial policies as having a major role to play even in the relatively short-term, and this, indeed, appears to be a significant part of their justification for these policies. They say (1995:52) for instance that:

GATT's circumscribing of national trade policy options does focus attention on supply-side interventions: where the hands of policymakers are tied by liberalised commodity and capital markets, supply-side measures take on added significance in the domestic policy armoury.

In short, these measures are required simply to counteract the likely ill-effects of trade reforms, which they themselves support, on export and import-competing industries. Without them, import liberalisation 'will inevitably result in a substantial increase in manufactured imports'; many local firms may respond ... by ceasing production altogether; it 'will certainly lead to an increase in imports across a wide front'; and 'we shall face even tighter constraints through the balance of payments and inevitable job loss'. It seems that all that stands between us and these dire consequences of import liberalisation are the 'productivity enhancing measures' represented by '[their] industrial policy', an 'important objective' of which, we are told, 'is to ensure that local manufacturers can compete more effectively with imports for the domestic market'. In view of this, the ISP's failure, anywhere in the report to consider properly whether their supply-side industrial policies can, not only raise the efficiency of manufacturing industry sufficiently, but do so quickly enough to stave off these potential disasters, makes their treatment of those vital matters seem extraordinarily cavalier.

It is highly unlikely that the ISP's supply-side policies will be able to play this role in dealing with these problems, which are likely to arise in the relatively short-term. This is so even if these supply-side proposals are well-conceived. Proper consideration of whether they are in fact well-conceived would require at least another whole paper. A few comments, however, on the issues raised by the ISP report, on the subject of market concentration, follow.

The ISP report asserts essentially that existing levels of market concentration in individual industries have been major obstacles to improvement in the performance of South African manufacturing. They claim (1995:63) for instance that: 'in several sectors, ISP research has identified a clear association between dominant firms and low levels of technological dynamism ... reflected in low levels of expenditure on R & D in dominant firms and a strong dependence on foreign technological licences'. They say too (1995:63-64) that they are 'persuaded that the structure of South African product markets constitutes a powerful entry barrier for SMEs'; and (1995:65) that 'there is a growing recognition that existing levels of market concentration and conglomeration constitute powerful obstacles to increased foreign investment'.

By the conventional rules of logic and evidence, none of these propositions can be said to have been properly established. The actual evidence produced by the 'ISP research' for the 'association' to which they refer, including the identity of the 'several sectors' to which it was found to apply, is apparently not presented anywhere in the report. The reader thus is unable to assess this claim, and is asked in effect to accept on faith that it is based on solid empirical evidence. This is

asking too much, especially given the inadequacy of the report's analysis of productivity, the causes of the slowdown of manufacturing output growth, and other matters, described above; and the following statement (Helleiner, 1994:30-31):

Scale and/or growth of own output were strongly positively related to productivity growth in Brazil, Colombia, India, Korea and Mexico, i.e., in every country for which there were data except Peru. Industrial concentration was associated positively with productivity growth in Brazil, Colombia and Korea.

There is also no theoretical basis for a negative relation between productivity growth and market concentration.

Similarly, no convincing evidence is given for their claim (1995:63) that concentrated markets constitute 'a powerful entry barrier for SMEs'. It is apparently based solely on their finding (1995:74) that 'South African SME operators identify circumscribed market access as the greatest obstacle...'. Such opinions, however, hardly provide a sufficient scientific basis for their strong conclusion (1995:73) that 'large, vertically integrated firms [are] the key obstacle confronting South African SMEs'; or for their claim (1995:140) that it 'provides a powerful argument for a vigorous competition policy directed at market power'; or for the notion that such a policy would significantly increase production efficiency and so enhance the growth performance of manufacturing industry (as distinct from merely redistributing rents). It is hard to avoid the impression that the ISP report has allowed itself to be too easily 'persuaded'.

Their discussion of the effects of market dominance also seems to involve some striking contradictions. For instance, against the view that, in the pulp and paper industry, SAPPI and Mondi are engaged in intense competition with one another, they note (1995:142-43) that, while this is so in certain market segments, others 'are clearly dominated by one firm or the other'; and say:

We are ... confident that both firms have the resources, technological and financial, to enter and compete in the full range of activities in the pulp and paper sector. That they choose not to is evidence, at the very least, of collusion.

Even if this is adequate evidence of collusion, which is debatable, is the resulting specialisation by these firms economically undesirable? For, earlier in the report (1995:28), they complain of the lack of specialisation in the structure of individual firms, saying:

for example, South Africa's largest packaging firm manufactures virtually all forms of packaging ... whereas all of its major foreign competitors specialise in a narrow range of these materials'.

This seems to be a case, in their attack on 'dominant firms', of 'heads I win, tails you lose.

The statements (1995:65) that 'there is growing recognition that existing levels of market concentration and conglomeration constitute powerful obstacles to increased foreign investment', and (1995:75) that they are 'an oft-cited impediment to direct foreign investment', are not accompanied by any indication of the grounds for this 'growing recognition', or any serious consideration of whether, though 'oft-cited', these claims are true. Indeed, they add (1995:75) that there is 'evidence of foreign producers attempting to overcome these barriers by entering into joint ventures with South African companies dominant in the local market', so that it seems that the real problem for them is that such joint ventures 'between a dominant South African firm and a large international counterpart may further raise entry barriers into the domestic and regional markets'. From this viewpoint, it seems that dominant firms attract too much rather than too little foreign capital; and this seems to provide the justification for their recommendation (1995:75) that inward investment flows and competition should be regulated to facilitate 'joint venture arrangements between international producers and local SMEs', on the grounds that 'the structure of domestic markets would be positively influenced'. The question of the impact on the volume of foreign investment raised earlier (1995:65) seems in the end thus to be subordinated to this consideration.

The ISP states (1995:63): 'By any standard, South African product markets are highly concentrated'. It seems however that no evidence is provided for this in the report itself; and the evidence for the related claim (1995:40) that in 'South Africa ... small and medium enterprise is particularly weak', is completely unsatisfactory. It seems to depend entirely on an implicit comparison with Japan and Germany, two of the world's mightiest industrial powers, and thus verges on the absurd. Compared to such countries, or even to some other highly successful developing countries, a host of possible explanations of any relative lack of a significant SME sector in South Africa, other than 'the highly concentrated industrial structure', spring to mind.

Time and space do not permit detailed consideration of the ISP's treatment of the question of conglomeration. However, it suffers from the same sort of problems as the discussion of market concentration. The other two aspects of the ISP's supply-side industrial policy proposals, human resource development and work organisation, and technology policy, appear to be on a different footing from the question of market and ownership concentration. Intervention in these other two areas can to some, perhaps to a large, extent be justified on the grounds of market failures resulting from externalities associated, for instance, with

investment in the enhancement of skills and technological capabilities. Given the urgency of improving the growth performance of South African manufacturing, the questions which remain are how long it will take for interventions in these areas, however well-conceived, to yield benefits, and whether even in the long term they will make a significant difference to the performance of South African industry.

7. Concluding Remarks

The discussion above questions the ISP's assertions, central to its entire viewpoint, that the productivity growth performance of South African manufacturing industry has been exceptionally low by international standards, that this has been a major reason for the slower growth of manufacturing output, and that industrial revival depends principally on raising productivity through the micro-level trade and industrial policies proposed in the report of the ISP. TFP growth differences do not adequately explain why output growth rates differ among developing countries.

For these and other reasons, it has been argued that the ISP report mis-diagnoses the ills of South African manufacturing industry. Contrary to the view taken by the ISP, the worsened performance of manufacturing industry in South Africa, as in many other developing countries, has been due to a number of adverse macro-economic factors. In particular, it cannot be attributed to South Africa's traditional strategy of import-substituting industrialisation.

An improvement in the performance of South African manufacturing industry and of the economy as a whole, therefore, depends on a process of macro-economic stabilisation and restructuring; that is, essentially on changes in the structure of the economy which make possible internal and external balance at some desired, higher rate of economic growth.

Though the ISP report misinterprets its causes, and does not adequately consider its implications, it does recognise that the growth performance of the South African economy has been constrained by foreign exchange scarcity, and that overcoming it requires a substantial strengthening of the trade account of the balance of payments. However, its emphasis is more or less exclusively on export expansion, despite its own apparently pessimistic view of the outlook for a spontaneous acceleration of the rate of export growth, and the fact that there is little reason to believe that its proposed trade and industrial policies will make a significant difference in this respect. The report does not consider whether export expansion alone will be sufficient to achieve the improvements in the trade account required for a sustained, higher rate of GDP growth of, say, 3½ percent a year. There is the distinct possibility that it will not.

The ISP report, nevertheless, neglects the role of the import side of the trade account in the process of economic restructuring. It takes an apparently sanguine view of the substantial degree of import de-substitution which, by its own admission is likely to result from its proposed trade policy reforms, and which by worsening the balance of trade is likely to impede the required process of macro-economic restructuring. The ISP report does not confront itself with and address the real possibility that such adverse macro-economic effects of import liberalisation will considerably outweigh any possible efficiency benefits resulting from the removal of price distortions through import liberalisation. Contrary to the impression given by some of the ISP's remarks, it seems that their neglect of these problems rests, not simply on the constraints imposed by our commitments in terms of the Uruguay Round, but on their (groundless) belief in the positive virtues of free trade. A consequence of this is that the report says nothing to discourage the enthusiastic approach to unilateral import liberalisation, going beyond our unilateral commitments, which is now evident.

Also, on the question of the role of adjustments on the import side of the trade account, it is argued that further import substitution, reflected in some measure of compression of the import/GDP ratio, may well be necessary for successful economic restructuring. This does not imply a reversion to our traditional ISI strategy, but is in principle compatible with our current phase of EOI, which must continue. South Africa some time ago came to 'the end of the easy stage of import substitution', but it has also, more recently, come to 'the end of the easy stage of export expansion'. As measured by trade/GDP ratios and levels of protection, the South African economy has not been exceptionally closed by international standards, and there is nothing sacrosanct about past import/GDP ratios. Within manufacturing industry itself the time paths of the import/supply ratios for consumers, intermediate, and capital goods, in the period 1917-88 are largely explicable in terms of factors not peculiar to South Africa, and are remarkably similar to those of, for instance Mexico, where, in terms of this measure, import substitution had gone somewhat further in all three categories of goods by the later half of the 1980s than in South Africa. Furthermore, in the past, import substitution played a positive, indeed indispensable, role in the growth of manufacturing industry, and the economy as a whole, by helping to attain external balance, and may well be necessary for improved growth rates in future. Whether the room to manoeuvre within GATT, unfavourable domestic conditions, and the resolve of policymakers will permit it, is another matter. If not, however, given the limits to export expansion, we may well have to lower our sights, so far as the future growth trajectory of manufacturing industry and the economy are concerned.

The proper focus for policymakers, bent on improving manufacturing performance in South Africa, thus, is on the process of economic restructuring, as described above, at least in the medium-term. Import liberalisation will, if anything, impede this process. It is highly unlikely that the other, supply-side industrial policy measures, even if well-conceived, can work quickly or powerfully enough (as the report apparently envisages they should), to counteract the adverse macro-economic effects of import liberalisation, which are likely to be felt in the relatively short term. The question whether these supply-side measures are in fact well-conceived is not fully considered above. However, so far as 'market concentration' is concerned, the evidence presented in the ISP report itself, as distinct from any that the authors may have kept in reserve, does not seem to establish that it has been a significant cause of poor manufacturing performance, or that a vigorous policy to curb market power will significantly improve it.

In conclusion, the ISP's views on a number of crucial matters is coloured by their basic assumption that the problems of manufacturing industry are simply due to the inefficiency of South African business, which in turn, is the result, for instance, of excessive protection and insufficient competition among domestic producers. This is a dangerous assumption. It can, as we have seen, lead to a distorted perspective on the real causes of our problems, and hence to an inappropriate policy emphasis. It can also lead to attitudes towards business which are not conducive to the kind of cooperative relations necessary if we really are to improve manufacturing performance in South Africa.

NOTES

- 1 According to the estimates of Young (1994:970, Table 3), based on the Summers and Heston (1991) data set, in the period 1970-85, all of the OECD countries listed in the ISP's table, excepting the US, New Zealand and Switzerland, had economy-wide TFP growth rates that put them in the top half of the 118 countries included in Young's calculations.
- 2 That South Africa's TFP growth rate is not significantly different from that of Japan, the home of successful production systems, during the heyday of Japanese industrial expansion, is also noteworthy.
- 3 Fritsch and Franco (1994:83) say of the productivity slowdown reflected in this estimate, that 'although probably exaggerated, [it] seems to be confirmed by the ... low level of the recent estimates of Bonelli'. They point out that whereas Pinheiro (cited in Fritsch and Franco 1994) finds a manufacturing TFP growth rate of 2.6 percent in 1970-80, Bonelli estimates 0.8 percent in 1975-85, which together suggest negative TFP growth from the late 1970s.
- 4 I am indebted to Greg Farrell of Rhodes University for producing this figure and for calculating the export growth rates reported in Section 4 below. The ratios in Figure 1 are the sum of

Gross Domestic Fixed Investment and Inventory changes divided by Expenditure on Gross Domestic Product. The data for 1946-93 is from the Supplement to the South African Reserve Bank *Quarterly Bulletin* June 1994, p B-12; and for 1994 SARB *Quarterly Bulletin*, September 1995.

- 5 The ISP has two figures (1995:10-11) which respectively are said to show 'Gross fixed investment as a percentage of GDP', for South Africa, and 'Total investment as a percentage of GDP' for South Africa, NICs, 2nd Tier NICs, and DMECs. These ratios, however, are not defined, and data sources are not given (a problem with the ISP report in general). Nor are the countries included in 'NICs' etc specified.
- 6 It might also be noted that in 1984, prior to the debt crisis, South Africa's I/GDP ratio of 24.9 percent was apparently about equal to Europe's average, and exceeded the averages for Asia (excluding Hong Kong, Singapore, Taiwan and Korea) (about 22 percent), for the America's (about 15 percent), and for Africa as a whole (about 12.5 percent) (See Young, 1994:969). It seems, too, that between 1960 and 1984, South Africa's I/GDP ratio was consistently above Hong Kong's, and hardly ever lower than Taiwan's (which also had declined greatly since 1980). It did not approach Singapore's, but then no other country did either.
- 7 Even then, it is not true to say, as the ISP does (1995:10), that in the early 1990s South Africa's I/GDP ratio was less than half those of 'comparator countries', unless the latter include only the East Asian NICs. Also, though recent data for Brazil, from the same sources as above, are not available, it is stated in Hoge (1995:75) that Brazil's I/GDP ratio in the past couple of years has been below 15 percent.
- 8 It might be noted that this interpretation also implies that raising the I/GDP ratio does not require some *prior* increase in the savings/GDP ratio.
- 9 It is therefore similar to industrial restructuring as defined by Lieberman (1990:1).
- 10 They state (1995:49): 'The immediate balance of payments constraint could be significantly relaxed by more favourable movements on the capital account. However, in the medium and long term, we will only sustain the required level of importation by the export of goods and services'.
- 11 This is argued at greater length in Bell (1993).
- 12 A difficulty in calculating these growth rates at present is the writer's lack of a suitable series of export price deflators for all sectors of the economy for recent years. Given this, constant US dollars, a widely used measure, seems the least problematical. The basic data, in current Rands, has been provided by the IDC.
- 13 Rough estimates have also been made of rates of growth of exports, measured in constant Rands, by deflating the current Rand values by the GDP deflator. It is found that, in these terms, in the period 1988-93, manufactured exports increased at 2.5 percent a year, but that gold, 'other mining' and agricultural exports all declined, so that total exports fell at 3.7 percent per annum.
- 14 See Krugman (1995) for a recent view on the uncertain but probably small size of the efficiency and growth benefits of import liberalisation, stressed in Bell (1993), and on the transitory and 'distinctly disappointing' nature of the returns to the large short term capital inflows that have followed the adoption of a package of free trade and sound money (by contrast with 'the presumed generous payoff from free trade and sound money'). Indeed, the strengthening of the domestic currency which results from these capital inflows is part of the process which leads to 'deflated expectations'.

- 15 See, for instance, Helleiner (1994:26-31) on the connection between trade orientation and TFP growth; and Krugman (1995:32-33) on the claim that countries with liberal trade regimes systematically grow more rapidly than those with closed markets.
- 16 Effective import substitution refers to compression of the import/GDP ratio applicable at high levels of capacity utilisation and GDP growth, as distinct from 'recessive' import substitution, that is declines in this ratio associated with domestic recession.
- 17 Figures 2(a) and 2(b) respectively show the ratios of imports and exports of goods and non-factor services to GDP (from IMF, *International Financial Statistics Yearbook 1992*, pp 136-139) plotted against GNP in US dollars (calculated from population and GNP per capita data in *World Development Report 1989*).
- 18 In Figure 3, the indexes for 1916/17 - 1956/57, calculated from constant price data in T.A. du Plessis (1965); and for 1961 -88 from current price data in various issues of *South African Statistics*. The classification into the three categories of goods is in accordance with Villarreal (1990:302-3, Table 11.2).
- 19 The Mexican data is from Villarreal (1990:307, Table 11.4).
- 20 This sample of only one other country is clearly not adequate, but it might be noted that Mexico was in effect chosen at random because of the availability of the Mexican data. Comparison of import/gross output (as distinct from import/supply) ratios for the various categories of manufactured goods, suggests that we have a long way to go before reaching the levels of self-sufficiency in Brazil, or even Mexico in some cases. South Africa's self-sufficiency is especially low in capital goods.
- 21 Effective import substitution refers to compression of the import/GDP ratio applicable at high levels of capacity utilisation and GDP growth, as distinct from 'recessive' import substitution, that is declines in this ratio associated with domestic recession.
- 22 Figures 2(a) and 2(b) respectively show the ratios of imports and exports of goods and non-factor services to GDP (from IMF, *International Financial Statistics Yearbook 1992*, pp 136-139) plotted against GNP in US dollars (calculated from population and GNP per capita data in *World Development Report 1989*).
- 23 In Figure 3, the indexes for 1916/17 - 1956/57, calculated from constant price data in T A du Plessis (1965); and for 1961 -88 from current price data in various issues of *South African Statistics*. The classification into the three categories of goods is in accordance with Villarreal (1990:302-3, Table 11.2).
- 24 The Mexican data is from Villarreal (1990:307, Table 11.4).
- 25 This sample of only one other country is clearly not adequate, but it might be noted that Mexico was in effect chosen at random because of the availability of the Mexican data. Comparison of import/gross output (as distinct from import/supply) ratios for the various categories of manufactured goods, suggests that we have a long way to go before reaching the levels of self-sufficiency in Brazil, or even Mexico in some cases. South Africa's self-sufficiency is especially low in capital goods.

REFERENCES

- Becker, C and P Pollard (1990), 'The Vulnerability of the South African Economy to Economic Sanctions', in *The Impact of Sanctions on South Africa: Part 1, The Economy*, Investor Responsibility Research Center, Washington DC (project directors D Hauck and M Lipton).

- Bell, T (1993) 'Should South Africa Further Liberalise its Foreign Trade?', in M Lipton and C Simkins (eds), *State and Market in Post Apartheid South Africa*, Johannesburg: Witwatersrand University Press and Boulder, San Francisco and Oxford: Westview Press
- Bell, T (1993a) 'The Impact of Sanctions on South Africa', *Journal of Contemporary African Studies*, 12.
- Belli P, M Finger and A Ballivan (1993) *South Africa: A Review of Trade Policies*, The World Bank Southern Africa Department, Informal Discussion Paper on Aspects of the Economy of South Africa, Discussion Paper 4.
- Celâlan, M (1994) 'Trade and Industrialization in Turkey: Initial Conditions, Policy and Performance in the 1980s' in Helleiner (ed).
- Du Plessis, T A (1965) *The Industrial Growth Pattern and the Real Forces of Economic Expansion in South Africa 1916/17-1956/57* Unpublished DComm thesis, University of South Africa.
- Fanelli, J M, R Frenkel and L Taylor (1992) *The World Development Report 1991: A Critical Assessment*, Buenos Aires: CEDES.
- Fritsch, W and H B Franco (1994) 'Import Compression, Productivity Slowdown and Manufactured Export Dynamism, Brazil, 1975-90', in Helleiner, (ed).
- Helleiner, G K (ed) (1994) *Trade Policy and Industrialisation in Turbulent Times*, London and New York: Routledge.
- Hoge, J F Jr (1995) 'Fulfilling Brazil's Promise: A Conversation with President Cardoso', *Foreign Affairs*, 74,4.
- Joffe, A, D Kaplan, R Kaplinsky and D Lewis (1995) *Improving Manufacturing Performance in South Africa: Report of the Industrial Strategy Project*, University of Cape Town Press, for the Industrial Strategy Project and the International Development Research Centre.
- Kim, K S (1994) 'Trade and Industrialization Policies in Korea: An Overview', in Helleiner (ed), 1994.
- Krugman, P (1994) 'The Myth of Asia's Miracle', *Foreign Affairs*, 73,(6) November/December.
- Krugman, P (1995) 'Dutch Tulips and Emerging Markets', *Foreign Affairs*, 74(4).
- Lieberman, I (1990) *Industrial Restructuring: Policy and Practice*, The World Bank, Washington, DC; Policy and Research Series.
- Nishimizu, M and S Robinson (1984) 'Trade Policies and Productivity Changes in Semi-industrialized Countries', *Journal of Development Economics*, 16(1).
- Ocampo, J A (1994) 'Trade Policy and Industrialisation in Colombia, 1967-91', Helleiner, (ed).
- Page, J M Jr (1990) 'The Pursuit of Industrial Growth: Policy Initiatives and Economic Consequences', in M Scott and D Lai (eds), *Public Policy and Economic Development: Essays in Honour of Ian Little*, Oxford: Clarendon Press.
- Rahman, S H (1994) 'Trade and Industrialisation in Bangladesh: An Assessment', in Helleiner (ed).
- Solimano, A (1986) 'Contractionary Devaluation in the Southern Cone: The Case of Chile', *Journal of Development Economics*, 23.
- Summers, R, and A Heston (1991) 'The Penn World Table (Mark 5): An Expanded Set of International Comparisons, 1950-88', *Quarterly Journal of Economics*, 106, May.

- Syrquin, M (1994) 'Growth and Industrialisation since 1965: A Comparative Study of Fourteen Countries', in Helleiner (ed).
- Villarreal, R (1990) 'The Latin American Strategy of Import Substitution: Failure or Paradigm for the Region?', in G Gareffi and D L Wyman (eds), *Manufacturing Miracles: Paths of Industrialisation in Latin America and East Asia* Princeton: Princeton University Press.
- Wright, A (1993) 'Productivity Growth in the South African Manufacturing Sector: Deriving and Assessing Neoclassical TFP Measures' in K Krüger (ed), *Papers Submitted for the Competition to Promote Academic Research into Industrial Policy and Development in South Africa*, Industrial Development Corporation, Sandton.
- Young, A (1994) 'Lessons from the East-Asian NICs: a contrarian view', *European Economic Review*, 38.