

THE POST-SANCTIONS ECONOMY

A BETTER FRAME OF MIND

BENEFITS WILL DEPEND LARGELY ON SUSTAINING AN OPEN ECONOMY



As sanctions recede, hopes for substantial, sustained economic growth are reviving. But they are tentative at best. So many structural problems — some created by apartheid and sanctions, others inherent

in a developing economy — will remain that any forecasts on growth must be heavily qualified.

The cost of economic sanctions, imposed since the Sixties and intensified after 1985, can never be accurately quantified. Not least because much of the cost was in opportunities forgone when the economy turned inward — focusing, for instance, on import replacement for more than two decades.

Washington-based Investor Responsibility Research Centre has estimated that growth sacrificed in the Seventies and Eighties — as a result of economic policies designed to counter sanctions — was equivalent to 20%-35% of GDP. Though it didn't make the further calculation, this would equate to about a 1%-1,5% reduction in the annual growth rate. Research by the centre established that the long period over which the full-scale application of sanctions was threatened allowed the economy to minimise its vulnerability when they arrived.

Ironically, this was perhaps the most damaging aspect of trade sanctions. Over more than 20 years, as policy-makers built protective devices into the fabric of the economy, they systematically reduced it to a state of technological near-stagnation, constrained its flexibility and consequently eroded exporters' ability to compete on international markets. Domestic suppliers were subject to the same constraints as import tariffs and surcharges pushed up the cost of crucial capital inputs.

In the light of the changes in the political policies of the ruling NP, this legacy is now as helpful as a stegosaurus's armour plating. And there will be costs involved in dismantling it. Nor is it only the cost of sanctions that must be counted — but also the purely economic cost of apartheid. Aside from the wasted potential of generations of blacks subjected to job reservation and Bantu education, there are areas where the waste can actually be calculated.

Says Econometrix's Azar Jammie: "Government spending has been rising as a percentage of GDP for the past two decades, as funds were poured into the duplication of functions and the creation of a multiplicity of bureaucracies both in central government and in the newly created homelands. This

drove taxes ever higher, eroding disposable income, leaving ever less savings for investment and growth. A reversal of this trend is the primary prerequisite for the generation of internally based growth."

Nedbank chief economist Edward Osborn points out another consequence of disinvestment: "The severance from parent company R&D and ready access to technology — factors for which local subsidiaries rarely have the financial resources." Nor were foreigners the only ones to leave. The loss of South Africans, their skills and ideas may have been even more damaging.

While these developments systematically eroded our ability to grow, the most dramatic constraint came from financial sanctions over the past five years.

Some indication came in a document, presented in 1988 by the Reserve Bank's late governor, Gerhard de Kock, on a "growth-orientated balance-of-payments adjustment." He estimated a capital outflow between 1985-1988 of US\$11bn — equal to 4% of GDP that year.

To provide for this, it became imperative to eliminate the deficit on the current account (R2,6bn in 1984) and build and maintain a surplus. The adjustment was "effected mainly via exchange rate depreciation and price inflation."

In other words, the authorities let the rand absorb the impact of capital outflows. Its value tumbled from US50c in July 1985 to US36c-38c only a few months later. Despite a temporary recovery in 1987, it is little higher today. Inflation accelerated sharply

on the back of a falling rand (a move sustained by negative real interest rates) from 11,7% in 1984 to 18,6% in 1986. The adjustment could have been made with less exchange rate depreciation and therefore lower price increases, said De Kock. But that would have required "Draconian deflationary fiscal and monetary measures."

Given the path chosen, the costs of the transformation from capital importer to capital exporter were high and rising inflation, to rates approaching 20% in 1986, and a consequent decline in the standard of living as real income was eroded. Though remedial monetary and fiscal policy later reduced the rate of inflation, the legacy of inflationary expectations remains — and double-digit inflation is still firmly entrenched.

The perceived need to preserve a current account surplus and counter inflation ensured that no economic recovery could be sustained (see graph). The authorities were obliged — as in 1989 — to abort it.

A particularly debilitating aspect of depreciation was that it further deterred already reluctant investors from initiating much-needed capital expenditure. The result was to reinforce a declining trend in real domestic fixed investment, which started early in the Eighties. Fixed investment in constant 1985 prices fell from R30,9bn in 1984 to R22,9bn in 1987. After recovering in 1988 and 1989, it fell once again in 1990 to just under R26bn.

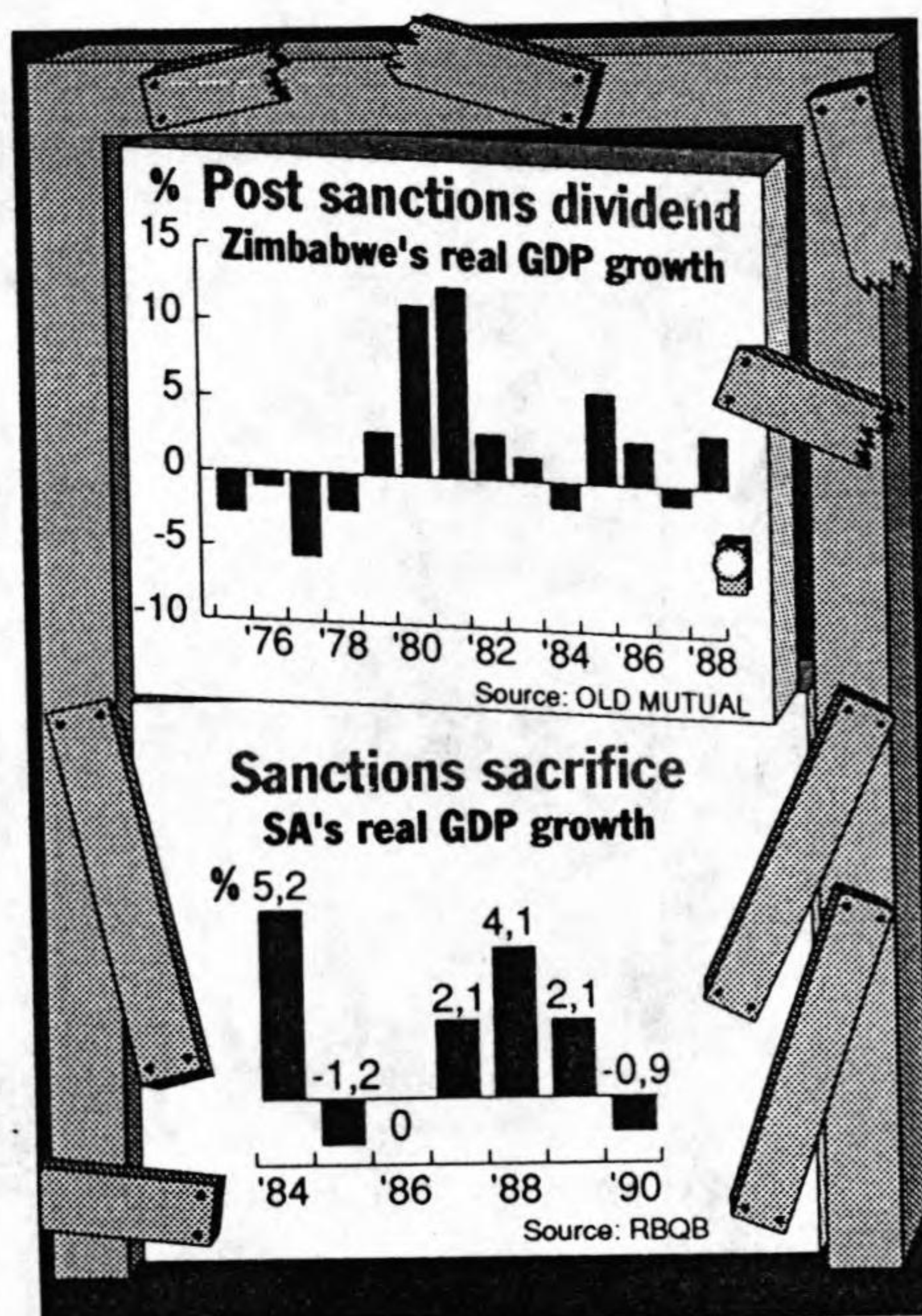
As SA moves into a post-apartheid, post-sanctions era, low capital stock, much of it ageing, is another barrier to growth. What can we then expect, in terms of immediate benefits, after sanctions?

Any assessment has to take into account the fact that trade sanctions had a comparatively muted impact. Unlike Rhodesia, which was almost isolated by international sanctions, SA was able to keep open important trade links.

The latest Reserve Bank *Quarterly Bulletin* records that: "In the seven-year period 1984-1990 the volume of merchandise exports grew impressively at an average annual rate of slightly more than 10%... This was well in excess of the average rate of growth in total world trade and also somewhat higher than the average annual rate of increase (of about 9%) in total imports by volume of SA's principal international trading partners."

No vast unexploited markets are waiting. In fact, Old Mutual economist Rian le Roux points out, SA's comparative cost advantage lies in markets which are growing more slowly than that for manufactured goods.

Moreover, the international economy is in recession, trade is falling and the prices of commodities, SA's main exports, peaked in



1988-1989 and have been in sharp decline since the fourth quarter of 1990. Not only will it take time and effort to recapture lost markets, they will be less profitable ones.

The EC decision to lift the ban on imports of SA iron ore, steel and Krugerrands, though an important step back into the international community, has more psychological than actual value. What is expected in concrete terms is a reduction in costs — goods will no longer have to be routed circuitously via countries such as Turkey, Israel and some in south-east Asia — to their former markets. It will also eliminate the political leverage which allowed buyers of SA goods to negotiate a discount.

This reduction in exporters' costs will mean an increase in what are now thin margins. This should apply particularly to steel, which is sold on an efficient and highly competitive market. But the gain will be cushioned by a variety of factors, including low demand. "Europe has a surplus of steel," says an analyst, "and the price, which peaked in 1988-1989, is weak."

The EC decision could make even less difference to iron ore exports. Demand for premium-quality ore remained high despite sanctions.

Trade in gold coins should improve. Unlike steel, which managed to circumvent sanctions, Krugerrands were readily identifiable and trade in them came to a standstill. But, says Simpson McKie research director Rodney Yaldwyn: "Krugerrands will have to re-establish themselves in a far more competitive and weaker market than when they were banned."

Osborn says sanctions on Krugerrands were irrelevant: "Their function as a means of promoting small investor involvement was picked up by other gold coins, like the Canadian Maple Leaf and American Eagle."

Though coal was not part of the EC package, these sanctions have also been falling away. Coal exports have been among those

that have been inhibited, but not halted, by sanctions. "So the immediate benefit," says Fergusson Bros' Derek Ritchie, "will be that we will no longer bear a US\$2/t discount."

Osborn, however, suggests the discount could already have been dissipated by now.

There will be no other immediate spin-off because SA has been exporting at maximum capacity. Says Ritchie: "What inhibited exports throughout was capacity at the Richards Bay coal terminal, not sanctions. "We can't push coal exports until capacity is increased from 44M Mt to 53 Mt a year. Though the terminal will reach this capacity by year-end, exports will be constrained for a further two years by rail limitations."

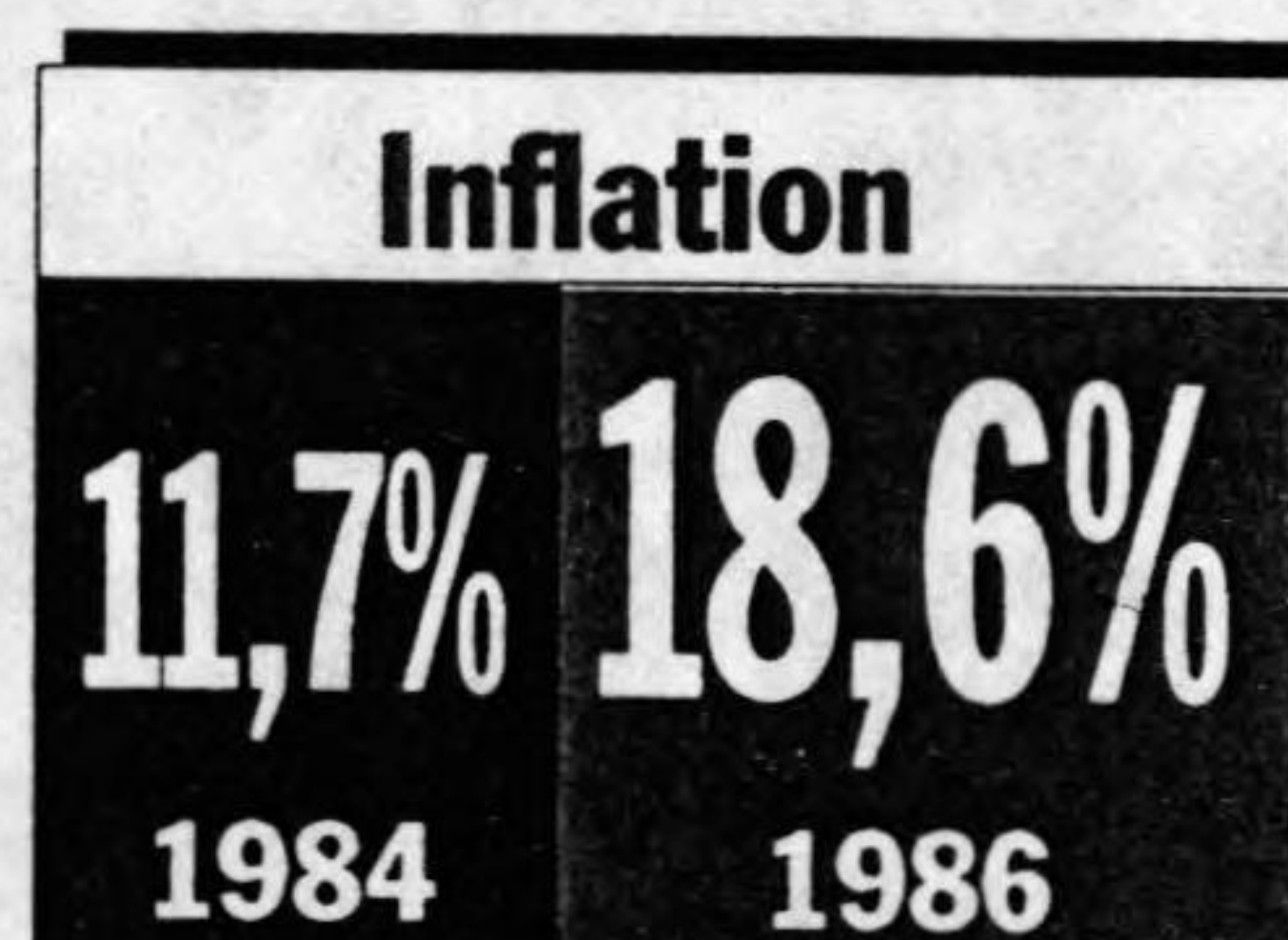
What is important, says Osborn, is "the accompanying lifting of the opprobrium" in dealing with SA. "Boycotts should fall away and open trading be restored. For example, the Cape agricultural and wine industries and clothing should benefit markedly."

So direct and tangible effects will be limited and an end to sanctions may not produce the sudden surge in growth seen in Zimbabwe in 1981 (see graph).

The most substantial short-term benefit will come if inflows on capital account allow consumer-driven recovery to be sustained for a much longer period. Firstly, because it will

be possible to contemplate a smaller surplus — even a deficit — on current account. And, secondly, because the value of the rand will be maintained by capital inflows. If such capital is productively used, the returns that flow will generate further growth.

"If," of course, is the pivotal word. There is the danger that, like the gold boom dividends of earlier years, the funds will simply flow into consumption rather than into improving supply, which means the economic recovery will self-de-



struct.

The swing factor will be whether investors in the real economy believe political and social stability are probable. Opening up the economy will be a painstaking business, involving a change in a once-cherished mindset, the reversal of the long

drawn-out process which created the siege economy, the absorption of people previously excluded from the mainstream of the economy — and a climate of political confidence. But a return to the world community will provide a window of opportunity of the sort we haven't seen since the gold price booms. However modest the initial effect of the phasing-out, it will be welcome. Certainly there is no scope left for import substitution, which ran its course by 1978.

Research by Wits economist Harry Zarenda shows that imports as a percentage of total supply fell from 12,1% in 1967 to 7,7% in 1978, 7,4% in 1985 and remained there in 1988. A Bank of Lisbon *Economic Focus* that year concluded: "Further (import substitution) would entail producing intermediate and capital goods." Factors which make this impracticable include the lack of economies of scale; high capital costs; and shortage of skilled labour.

If the end of sanctions is to have any real meaning, the government which comes to power after a negotiated settlement will have to create an environment that attracts investment capital.

Says Osborn: "The new SA must commit itself to a statutory investment code that guarantees the right of withdrawal of capital or disinvestment and does not prohibit nor encumber dividend and profit remittance, other than by normal, reasonable taxes."

Government must enhance the spontaneous opening of the economy by progressively removing tariffs, removing barriers to competition and trade, stabilising prices and encouraging exports. Only then will the benefits of the post-sanctions era be both tangible and sustainable.



NAMIBIA

EDGING INTO YEAR TWO

THE ECONOMIC BALANCING ACT IS WORKING WELL — SO FAR

Much of the fear that hovered over Namibia's independence a year ago has dissipated and, while life goes on as usual in some ways, in others it will never be the same.

The Swapo government, which has padded key posts in the public sector with the party faithful, is grappling with the problems and opportunities uncovered by independence. In the private sector this is reflected in commerce and industry's hope and guarded

optimism that government will follow through on its strong commitment to democracy, the country's constitution and a free-market economy.

This commitment has been welcome and concerns that government would adopt a socialist stance have so far proved unfounded.

The optimism stems from the hard pragmatism that most public-sector representa-

tives are demonstrating. Contrary to much of the political posturing before the elections, there seems to be a general recognition that adherence to Western democratic values is the only way the country will be able to realise its full potential and provide social upliftment.

Namibians are full of enthusiasm and praise for the way President Sam Nujoma is guiding the country's destiny. Nonetheless,