

## SPECIAL FOCUS

**TIPS/DPRU Forum 2003:  
The Challenge of Growth  
and Poverty:  
The SA Economy Since Democracy**

Sustainable Solutions Needed for  
Economic Growth and Development –  
*Trevor Manuel* 1

The Next Decade in SA:  
Challenges for Ensuring  
Welfare-Enhancing Growth –  
*Alan Hirsch and Neva Makgetla* 4

## FEATURES

The Economic Rationale for  
SMME Promotion in SA –  
*TIPS* 6

WTO Watch –  
*Kennedy Mbekeani* 10

Tanzania's Privatisation  
Programme Outpaces SA –  
*Reg Rumney* 11

## FOCUS ON FACTS

SA's GDFI and Capital Stock  
Show Modest Growth –  
*Donald Onyango* 14

*TIPS Executive Director: Stephen Hanival  
Editor: Lucille Gavera*

While copyright in the journal as a whole is vested in TIPS, copyright in the articles rests with individual authors. Opinions expressed are the responsibility of the authors and not of TIPS.

ISBN: 1-919982-08-6

# Sustainable Solutions Needed for Economic Growth and Development – Trevor Manuel



**Minister of Finance Trevor Manuel** delivered the keynote address at the gala dinner of the joint TIPS/DPRU Annual Forum held from 8-10 September 2003. The forum focused on SA's progress in addressing growth and poverty since democracy and the challenges it still faces in these areas.

1994 marked the end of one struggle and the embracing of a new one. Our struggle for political freedom had ended. We were a nation filled with hope and expectation. At the same time, we realised that we were not even half way on our long walk to freedom. Political freedom is paramount. But that democracy must provide the vehicle for the realisation of our dreams and aspirations.

On the economic front, we have every reason to be proud. We have successfully turned around a virtually bankrupt economy into one capable of delivering 19 quarters of uninterrupted

growth. But as this conference recognises, our community remains scarred by the experience of intense poverty and social exclusion.

Between 1994 and 2002, economic growth averaged almost 3%. In the 10 years preceding democracy, the economy spluttered along at less than 1% a year. Similarly, over the past years, we have restored health to the public finances. The budget deficit has fallen to 1.2% of gross domestic product (GDP) last year from over 7% in 1994.

These are remarkable achievements. Particularly so if one considers the international turbulence that has buffeted our economy over the past decade. From emerging market crises in Mexico in 1995 to Asia in 1997 and Argentina a year or so ago, emerging markets have faced considerable volatility.

Despite this, we cannot pretend that we are divorced from events in the global economy. The world is at a level of inter-connectedness that ties our development path with our sister nations in Africa, the rest of the developing world and of course the rich nations of the north.

The past year has been especially challenging for the global economy. Geopolitical uncertainty compounded weaknesses in the major economies. The eternal optimists were forecasting a strong rebound in the global economy during 2002. But growth forecasts were consistently revised downward over the course of last year, as the reality of weak global demand weighed on global production, compounded by rising unemployment and worsening fiscal positions.

*continued from page 1*

While the rate of growth is slowly increasing in some major world economies, serious misalignments will continue to make the recovery fragile. These include the development of interest rate differentials between the US, Europe and Japan, and result in inappropriate monetary stances for some, particularly Europe.

As interest rates diverge in the near term, the possibility of significant shifts in capital could result in greater exchange rate volatility until new equilibria (including growth, employment, interest and exchange rates) are reached.

At the same time, stronger growth in the US carries with it the possibility that structural balance of payments misalignment between the US, Europe and Japan will continue. Stronger growth in private consumption, investment and employment in the US will lead to significant further deterioration in the US current account deficit in the short term, and will probably add to the long-term misalignment – especially if the US dollar strengthens.

European economies need to shed the fiscal constraints on growth at the same time as they pursue structural reforms. Germany's efforts to reform the labour market are a positive sign. It is very unlikely that the US current account deficit will be unwound in a positive way if Europe does not raise its growth rates significantly.

Of equal concern in the short run are the exchange rate policies being practised by China and other Asian economies, which are pegging to the US dollar and so maintaining highly competitive export orientations.

In addition to undermining European growth, this policy adds to deflationary pressures on their own domestic prices because the real depreciation requires tight monetary policy and hence reduced domestic consumption.

The development of interest rate differentials in the North carries further risks for the South. In particular, rising interest rates in the US will put upward pressure on monetary policy in developing countries that borrow on international markets. The impact on growth will be negative, even if the interest rate rise is restricted to long-term rates. Exchange rate policies in most developing countries still tend to peg against major currencies, so they are unlikely to provide much of a buffer for domestic interest rates and growth.

Finally, it is worth noting that the fragility of growth in Europe will weigh heavily against

any serious reform of the Common Agricultural Policy via the World Trade Organisation (WTO) and the Doha negotiations.

Despite weakening production in the face of global adversity, it is clear that strength remains in the domestic economy. This bodes well for our future development path.

It is particularly notable that we continue to build for a prosperous future. Capital formation over the first half of the year was a healthy 8%, continuing the momentum from the 9% in the second half of last year.

Sustaining this growth is the challenge, not least because growth creates employment, and employment is the single most important factor in reducing poverty. How we get growth and employment is the central challenge.

Trade, fiscal and industrial policy are critical components of a growth strategy. The economic history of most developed and developing countries – including our own – is littered with the debris of failed strategies, inefficient and subsidised parastatals and private companies, costly services and unsustainable fiscal commitments and debts. For SA, industrial policy needs to focus on labour-intensive capital accumulation.

Through trade policy we can lower the costs of imports to both the manufacturing sector, which needs capital imports, and to the consumer. Reduced costs to both consumers and producers free resources for other consumption and investment, contributing to growth.

*A developmental state should be one where poverty is reduced in the long term through providing people with the capabilities to engage in productive employment in an economy that is expanding with opportunities.*

With the gradual real depreciation of our exchange rate over the past nine years, the effective protection of our industries has risen after the initial deep liberalisation. Tariffs have fallen faster on inputs than on output, leading to increases in effective protection. More than 50% of the economy has seen an increase in effective protection over the 1990s, with just 15% of the economy experiencing a reduction in effective protection.

The Industrial Development Corporation (IDC) confirms these results. Of the 29 sectors evaluated by the IDC in 1998, 14 show effective protection rates of greater than 10% of which 10 are higher than 20%. Most of these sectors produce manufactured goods and the average effective protection rate for the

manufacturing sector as a whole, at 23.7%, is almost twice that of the total economy.

Even where effective protection has fallen, so too have export subsidies, and anti-export bias remains prevalent in almost all economic sectors. The price-raising effect of import protection therefore remains a disincentive to export. It also imposes a significant welfare cost on the consumer. Van Seventer and Edwards (TIPS, May 2001) show that the total welfare cost of tariff protection in SA is "considerable" and has increased between 1998 and 2000.

Regional and bilateral trade agreements can help to open new markets but they do entail a number of costs. Preferential tariffs seldom generate new trade, but are more likely to divert trade from suppliers favoured by importers to less favoured ones.

This in itself imposes welfare costs on domestic consumers of goods imported from outside of the preferential trade area. Either they continue to purchase from favoured suppliers but at a higher relative cost, or switch to imports from within the region, which may be of inferior quality or type.

The results of these studies are confirmed by the National Treasury's own analysis of prospective trade agreements with Brazil and India (TIPS Working Paper 10 - 2000). The trade and welfare benefits arising out of a number of alternative scenarios, including autonomous liberalisation, are higher than those involving the Mercosur trade bloc and South Asia.

Almost all increased trade resulting from bilateral liberalisation with Mercosur or South Asia arises from the artificial diversion of demand away from favoured to less-favoured suppliers (at the expense in the case of the Southern African Customs Union, or SACU, of imports of SA consumers, including producers using imported inputs).

In terms of fiscal policy, we have not gone far enough down the road of creating an activist developmental state, equipped with the newer tools of market intervention to minimise negative externalities and maximise the positive externalities.

A developmental state should be one where poverty is reduced in the long term through providing people with the capabilities to engage in productive employment in an economy that is expanding with opportunities. At the same time, the social safety net plays a crucial role in preventing the worst effects of poverty and malnutrition.

This requires government to perform a balance act. From a macroeconomic perspective, one consideration is whether or not social insurance policies facilitate or impede the adjustment of individuals and communities to new forms of economic activity. The microeconomics of the problem is how and to what extent the precise social insurance policies or instruments incentivise individuals to choose between remunerative and non-remunerative activities.

But what has become increasingly clear to many policy-makers is that even where social insurance is geared toward incentivising remunerative activity, many impediments exist and have become more debilitating over time, especially for the poor who usually have neither the social nor physical capital to overcome them.

The concept of a social wage is one way in which these impediments can be reduced, through the public provision of services, such as inexpensive transport, better education, re-skilling, communications facilities and credit.

Better education or inexpensive public transport, for example, serve to both reduce economic insecurity and create economic opportunity by making it less costly for even the poor to engage in economic activity. That said, it is also important for our social policies to address those that need welfare, that is, those who cannot engage in economic activity. Only a balanced agenda of this sort is likely to meet our objectives of growing our economy and reducing poverty and inequality.

Healthy fiscal balance over the past few years have allowed us to concentrate our energies on important areas of social transformation. In particular, we have expanded infrastructure support in recent years, improved the capacity of the health system to deal with HIV/Aids, invested in quality enhancement in the education system, and widened and deepened the social security systems. Overall access to key services, such as electricity, sanitation and health and welfare has increased.

But equally we are reminded that this is not good enough. Too many people do not have jobs, adequate accommodation or food. We must ensure that in the debate on trade policy, industrial strategy and welfare policy the discourse must be fresh, it must probe, it must provoke. But above all, it must challenge, it must drive us from our place of comfort – because the poor know no comfort. And we carry a burden of responsibility to develop sustainable solutions to economic growth and development.

## **NINTH ANNUAL CONFERENCE ON ECONOMETRIC MODELLING FOR AFRICA**

**30 June  
to  
2 July 2004**



**ANNOUNCEMENT AND  
CALL FOR PAPERS**

Scientists and all individuals interested in research and teaching in Econometrics, Econometric Modelling and Mathematical Economic Theory are invited to the **9th Annual Conference on Econometric Modelling in Africa.**

The Conference is hosted by the **School of Economics (University of Cape Town)** and **The African Econometric Society**

The goal of the conference is to improve the capacity for econometric modelling on the African continent. Previous international contributors included the editors of Economic Modelling, Stephen Hall from Imperial College, London (UK), and Peter Pauly of the University of Toronto (Canada); former president of the Royal Econometric Society, David Hendry, Oxford University (UK); Hashem Pesaran, University of Cambridge (UK); Pravin Trivedi, Indiana University (USA); Angus Deaton and Marianne Bertrand, Princeton University (USA); Marc Nerlove, Maryland (USA); Esther Duflo, MIT (USA); Adrian Pagan, Australian National University (Australia) and John Muellbauer, Oxford University (UK).

**Conference Address:**  
The Conference Organiser  
School of Economics  
University of Cape Town  
Rondebosch, 7701  
South Africa  
Tel: +27-21-650 2733  
Fax: +27-21-650 2854

E-mail:  
[aesinfo@commerce.uct.ac.za](mailto:aesinfo@commerce.uct.ac.za) (administrative issues)  
[aespaper@commerce.uct.ac.za](mailto:aespaper@commerce.uct.ac.za) (academic issues)

**Conference Venue: University of Cape Town**



# The Next Decade in SA: Challenges for Ensuring Welfare-Enhancing Growth

At the recent TIPS/DPRU Annual Forum, a panel including Cosatu co-ordinator of fiscal, monetary and public sector policy, Neva Makgetla, and Alan Hirsch, chief director: policy co-ordination and advisory services at the Presidency, debated possible solutions to the growth and poverty challenges facing South Africa in the next decade. This is an edited excerpt of their contributions.

**Hirsch**, in his discussion, highlighted some of the achievements made in SA over the past nine years, before addressing the challenges the country still faces in terms of economic growth and development.

"Some level of macroeconomic security has been achieved, perhaps best illustrated in the way SA dealt with the currency shock without massive outflows of capital.

"In addition we have seen a steady decline in bond rates, as well as slow but steady growth, with SA enjoying the longest period of consecutive quarters of economic growth since the recording of GDP.

Hirsch said significant improvements have also been recorded in value added.

"Growth in exports has been relatively good. The shift to the services sector has boosted value added and even manufacturing has shown some growth.

"There has also been a shift from medium-tech to high-tech exports, for instance a shift from metals to motor vehicles. This has translated into a 2% growth in the employment rate over an eight-year period. Growing unemployment is, however, undeniable."

Another achievement of the SA economy, Hirsch noted, was the rapid growth in the economically active population of 4% or more over the eight-year period.

"People are redefining their position in the labour market. For example, the rate of economically active African women has grown by 2.8% over the period. This has obvious implications for more rapid growth.

"Further there have been successes in the delivery of housing, electricity and other social services. A larger proportion of households are receiving basic services, the scope and reach of government transfers have improved and there have been some improvements in health and education."

On a negative note, Hirsch said, SA saw the emergence of two, or possibly three, distinct economies.

"The modern economy has shown steady growth and an improvement in the standards of living of those participating in this economy. There is a positive difference of 1.2% between GDP and population growth, reflected mainly in the modern industrial economy."

But Hirsch said that the problem for the poorest 40% to 45% of the population is that nothing much has changed.

"While improvements in social transfers may provide some relief, the levels of poverty, inequality and unemployment have not improved. In some households up to three generations have never been employed, pointing to a sinister form of unemployment that goes beyond structural unemployment. In spite of social programmes, many households escape effective incorporation."

Importantly, Hirsch proposed that this implies the need for a greater range of policy approaches to strengthen the modern first economy to develop growth, create wealth and generate jobs.

"But the marginal economy must also be strengthened, which is probably more separate today than it was under *apartheid* when there was a small measure of interaction.

Hirsch also referred to DPRU director Haroon Borat's definition of a third economy: the unemployable.

"There are people on the periphery of urban and rural areas who are relatively old, uneducated and unskilled, and therefore not a target for reincorporation into the industrial economy. Their children, however, may be well-placed to be drawn into the modern economy.

"The need is to target strategies carefully to deal with those who will never be integrated and those who have the potential to contribute."

Hirsch also remarked that the first economy is growing too slowly, with the following constraints to growth:

- **Monetary policy**  
"One of the growth, employment and re-distribution policy's (GEAR's) aims was a stable competitive exchange rate, which has never been achieved. This volatility has not helped the investment climate."

- **Infrastructure services**  
"Initially these were viewed as an advantage, but nine years later they have shown a long period of low investment and poor management. Parastatals have been placed in a bind, as they were expected to make profits and investments while their results were externalised."



- *Skills and education*

"Although there is the need for greater focus on sectoral strategies, the growth in some sectors has demonstrated that a concerted industrial policy can work. The tourism industry has been successfully stimulated and similarly the high-tech, labour-intensive outsourcing sector."

With regard to the marginalised economy, Hirsch observed that although the National Spatial Development Framework aims to create jobs, they tend to be in areas where it is cheap and efficient to do so and not necessarily in areas where the majority of the poor live.

"The focus should be placed on the strengthening of social services to provide access to information, health and social grants but this alone is not enough.

"The extended public works programme with its three prongs – labour-intensive construction initiatives, conservation-related initiatives, and social services for the poor, especially in the health sector – will have positive effects on social capital and employment."

Hirsch finally highlighted government's significance in increasing investment.

"Government's capital expenditure for public corporations has declined as a percentage of GDP, highlighting the need for alternative paths to raise the investment rate. Government and the Treasury have acknowledged their role in increasing investment. The question is how quickly and efficiently they can do this, creating more jobs at the same time."

**Makgetla** observed that the conference's focus on growth and poverty, and growth and redistribution represents an ongoing question.

"The relationship between growth and poverty is mediated by the employment structure and the structure of ownership, so that even when growth goes up, so do unemployment and inequality.

"The question is what do we do if we cannot get rapid growth? Growth of 7% or 8% would probably solve poverty and unemployment, but it may be more difficult to achieve growth than to tackle poverty and unemployment.

"Many of the countries cited by Al Berry in his keynote address – *Accelerating Growth with Poverty Reduction* – to the Forum already had substantial equity programmes in place before they achieved accelerated growth. It is a bit depressing to think that many of them had policies that looked very similar to the Reconstruction and Development Programme (RDP).

"Furthermore, the basis for greater investment and greater saving is often the basis for greater skills, which are long term and cannot be accelerated."

Makgetla found three major, interrelated issues to have emerged from the TIPS/DPRU Forum, or three ways of looking at the structure of the economy and society to address poverty and growth. They are:

- *The vicious cycle of poverty*

"Because people are extremely poor and cannot contribute to growth as it is difficult to obtain skills or employment, they remain poor. The argument is that government should intervene because this is the basis for growth."

- *The dualism of the economy*

"This dualism, aggravated by *apartheid*, refers to the exclusion of a major part of the population from engagement with the formal

sector, except as cheap labour. To address growth, we have to find ways to engage these people by ensuring their access to assets, skills, formal institutions such as marketing networks and financial institutions, and the delivery of basic services."

- *The role of the formal sector in creating jobs*

"The restructuring of the formal sector is a hard point for business and government to acknowledge. The question is why the formal sector is not creating enough jobs and what can be done to remedy this. The more labour-intensive sectors tend not to produce high-tech, globally tradeable goods. They include the production of goods and services to the poor as well as downstream industry – mining, petrochemicals, agriculture and textiles – some of which could be exported. The problem with producing for the poor is limited demand, since the poor cannot purchase a lot."

Makgetla added that basic government sectors should start to be seen as industries in themselves and as potential sources of income for the poor.

"There is also a tendency to avoid the issue of macroeconomic policy, because it is so controversial. While it is not the only problem, a restrictive macroeconomic policy makes it difficult to address structural problems.

"Budget cuts have a very negative influence on investment. For instance, general investment in construction is lower as a percentage of GDP than it has been since 1946. In addition it has a direct impact on unemployment.

Makgetla advised a more integrated approach to poverty and growth, which raises some institutional issues, including who is responsible for an integrated approach.

"The problem is that institutions are not well defined. For example, the Department of Housing builds houses in the middle of nowhere, thinking this is acceptable because its mandate is to deliver four walls and a roof, regardless as to whether people can get jobs living so far away, or whether its procurement policy stimulates investment along the production chain.

Importantly, Makgetla suggested that the work presented and debated at conferences such as the TIPS/DPRU Annual Forum is not consistently feeding into government policy negotiations.

"At the same time that this Forum is held, negotiations are taking place at the National Economic Development and Labour Council (Nedlac), at parliament and at sectoral summits. If we want to move from a discourse based on power to one based on reason we need to ensure that this work feeds into those engagements rather than just representing an academic conference with conference papers which leak indirectly into that more direct kind of policy forum."



# The Economic Rationale for SMME Promotion in SA

This article is an excerpt from the TIPS publication – The Economics of SMMEs in SA – authored by Al Berry (University of Toronto), Magali von Blottnitz (University of Cape Town), Rashad Cassim (TIPS), Anna Kesper (University of the Witwatersrand), Bala Rajaratnam (The World Bank) and Dirk Ernst van Seventer (TIPS). This is the first in a series of discussions in the TIPS Trade & Industry Monitor on SMMEs in SA.

Since 1994, SA has been faced with the challenges of reintegration into world markets as a global economy, while at the same time positioning itself to realise the high expectations of its populace regarding a successful transition towards a more democratic order. To achieve the objectives of economic growth through competitiveness on the one hand, and employment generation and income redistribution as a result of this growth on the other, SA's small-, micro- and medium-sized enterprise (SMME) economy has been actively promoted since 1995. Despite voluminous research, however, there is still little clarity about the extent to which SA's SMMEs contribute to poverty alleviation, economic growth or international competitiveness.

SMMEs encompass a very broad range of firms, from established traditional family businesses employing over a hundred people (medium-sized enterprises) to the survivalist self-employed from the poorest layers of the population (informal micro enterprises). While the upper end of the range is comparable to the small- and medium-sized enterprise (SME<sup>1</sup>) population of developed countries, statistics reveal that an immense majority of SMMEs are concentrated at the very lowest end. These are primarily black survivalist firms.

While there is a general consensus on the importance of SMMEs in SA, their economic rationale to date has been neither well argued nor rigorously investigated. In particular, there is a lack of clarity on how SMMEs fit within the industrial policy framework and other objectives of government.

## Main Functions of SMMEs

SMMEs as enterprises fulfil an economic role by contributing to a country's national product by either manufacturing goods of value or through the provision of services to both consumers and/or other enterprises. This encompasses the provision of products,

and to a lesser extent, services to foreign clients, thereby contributing to overall export performance.

From an economic perspective, however, enterprises are not just suppliers, but also consumers, with an important role if they are able to position themselves in a market with purchasing power. Their demand for industrial or consumer goods will stimulate the activity of their suppliers, just as their own activity is stimulated by the demands of their clients. Demand in the form of investment plays a dual role, both from a demand side (with regard to the suppliers of industrial goods) and on the supply side (through the potential for new production arising from upgraded equipment). In addition, demand is important to SMMEs' income-generation potential and their ability to stimulate the demand for both consumption and capital goods.

*While the importance of SMMEs in SA is indisputable, their economic rationale has not been well argued or rigorously investigated. In particular, it is unclear how SMMEs fit within the industrial policy framework.*

Most importantly, and in a SA context, SMMEs have the potential to generate employment and upgrade human capital. SA's current economic situation is comparable to the period of Europe's industrialisation and the subsequent development of other emerging economies. As technological progress in agriculture liberated the agrarian labour force, this unskilled excess labour force was absorbed into small manufacturing industries and exposed to business experience, which encouraged a 'learning-by-doing' effect. In SA, the excess labour force is 'released', not so much from the agricultural sector but from large enterprises in the secondary and tertiary sectors. These enterprises are not necessarily facing economic recession, but are growing and transforming in such a way that their demand for unskilled

labour is decreasing, resulting in an abundant pool of unskilled labour, which SMMEs can possibly employ and upgrade.

It has also been suggested that, in cases of low growth and a mismatch between the demand for and supply of unskilled labour, a shift in both the sectoral composition of the economy and the occurrence of growth in different categories of firms may be an important avenue for the generation of employment opportunities and growth. The question here is whether a more robust SMME growth strategy in SA will bring about such changes. This in turn depends on whether SMMEs are more labour intensive and therefore likely to employ unskilled labour, and whether they can provide a 'skills upgrading process'.

## Structural Features of the SA Economy and its Implications for SMME Growth

### The apartheid legacy

Compared to many other developing countries, the contribution of SA's SMMEs to employment and economic growth is low. This relatively poor performance is often associated with the racial distortions in education, income and economic empowerment inherited from the previous regime. Nevertheless, there is a danger in ascribing all the responsibility for the underdevelopment of SMMEs to political disenfranchisement, since the corollary to this argument is that the new economic order provides a sufficient condition for the revitalisation of the SMME economy. The removal of *apartheid* has been insufficient to unleash the full potential of the SMME economy because the inherited structures contribute to:

- A highly dualistic economy characterised by a high productivity (modern) and a low productivity (informal) sector with little interaction, and a division along racial lines;
- A transition phase marked by political uncertainty and considerable crime and violence, both impacting negatively on local and foreign direct investment in the modern sector;
- A shift in industrial policy to liberalisation of trade and finance and a rapid technological change, reflecting a comparable process at the global level; and
- Low levels of education and training among the participants in the traditional sector who have, in addition, suffered from the suppression of entrepreneurial activities

<sup>1</sup> There is a distinction between SMMEs and SMEs. This is intentional, as medium-sized enterprises are often very different from micro enterprises.

(continued on page 8)



#### Secretariat:

Namibian Economic Policy Research Unit (NEPRU)  
*Postal:* P.O. Box 40710, Ausspannplatz, Windhoek, Namibia  
*Street:* 59 Bahnhof Street, Windhoek, Namibia  
*Tel.:* +264 – 61 - 277500      *Fax:* +264 – 61 – 277 501  
SEAPREN Co-ordinator: Dirk Hansohm (DirkH@nepru.org.na)  
Assistant Co-ordinator: Rosa Endjala (RosaE@nepru.org.na)  
*Website:* www.seapren.kabissa.org

#### The Southern and Eastern Africa Policy Research Network (SEAPREN)

SEAPREN is a network of seven economic policy research institutions, founded in 1999. The aim of the Network is to advance sound economic policy among Southern and Eastern African countries through informed collaboration by regional research establishments by way of adopting best practices in research development, implementation and administration.

SEAPREN undertakes presently two joint research projects, in co-operation with the Chr. Michelsen Institute (CMI) in Bergen, Norway, in the areas:

- Economic governance and budgetary processes in southern and eastern Africa
- Comparative analysis of poverty policies in southern and eastern Africa

In the same framework the institutes collaborate on projects to come closer to 'best practices' in the areas of:

- Network Communication
- SEAPREN promotion
- Institutional Efficiency

#### SEAPREN Member Institutes

Botswana Institute for Development Policy Analysis (BIDPA), **Botswana**, [www.bidpa.bw](http://www.bidpa.bw)

Development Policy Research Unit (DPRU), **South Africa**, [www.uct.ac.za/depts/dpru](http://www.uct.ac.za/depts/dpru)

Economic Policy Research Centre (EPRC), **Uganda**,

Economic and Social Research Foundation (ESRF), **Tanzania**, [www.earf.or.tz](http://www.earf.or.tz)

Institute of Economic and Social Research (INESOR), **Zambia**

Institute of Policy Analysis and Research (IPAR), **Kenya**, [www.ipar.or.ke](http://www.ipar.or.ke)

Namibian Economic Policy Research Unit (NEPRU), **Namibia**, [www.nepru.org.na](http://www.nepru.org.na)

For further information please contact:

Dirk Hansohm, SEAPREN Co-ordinator ([dirkh@nepru.org.na](mailto:dirkh@nepru.org.na)) or

Rosa Endjala, Assistant Co-ordinator ([rosae@nepru.org.na](mailto:rosae@nepru.org.na))

Website: [www.seapren.kabissa.org](http://www.seapren.kabissa.org)

Newsletter can be downloaded from the Website.



(continued from page 6)

### The way forward for SA

SA has adopted a regime of trade liberalisation and fiscal prudence that limit the use of protectionism and public sector employment. This may partly explain why unemployment levels and income inequality have increased. Taking into account the characteristic dual economy, adequately remunerative employment could originate from:

- The high productivity sector increasing its level of employment – absorbing people previously located in the low productivity sector (or unemployed); and
- The low productivity sector increasing its income generating capacity through investment, technological improvement and education and training.

However the success of these mechanisms is limited by the historical neglect of education and training for both employers and employees in the low productivity sector. So the key challenge is to identify the best policy levers available to government, given the problem of inequality and the overall thrust of an economic reform strategy comprising fiscal prudence, trade liberalisation and deregulation of various economic sectors.

### Can SMMEs Resolve the Unemployment Problem?

#### Capital, productivity and demand for labour

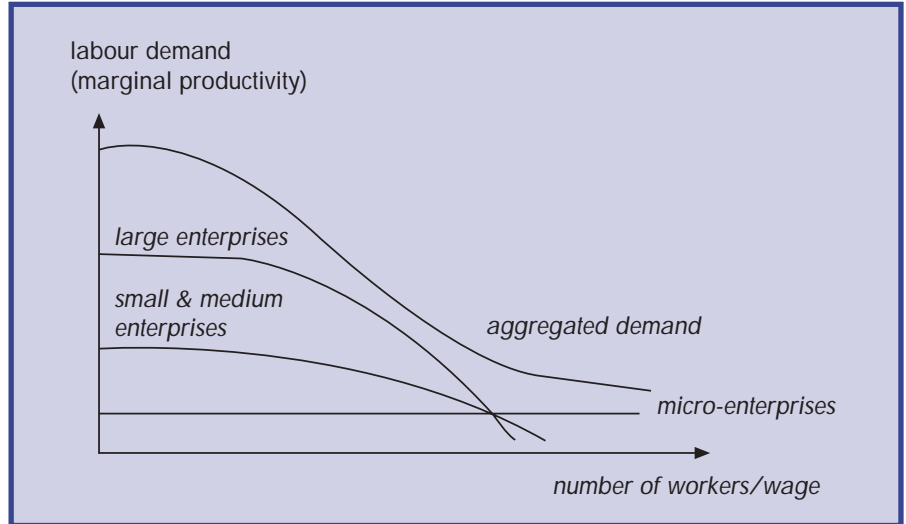
Countries with a broad capital base (typically developed countries) exhibit high labour productivity, and because their national product is high, will be able to employ the majority of their labour force. By contrast, developing countries – SA included – are characterised by lower capital endowments and an abundance of low-skilled labour. Overall productivity in developing economies cannot be high as long as only a limited number of workers are needed to operate the fixed amount of capital. This results in a dearth of employment opportunities for unskilled labour. A similar distinction can be made between the various sizes of enterprises. This is done on the assumption that the larger firms are more capital intensive and that the demand for labour is directly related to its marginal productivity.

In large capital-intensive firms, the first few workers are highly productive, but as workers are added their marginal productivity tapers off fast. Thus the demand curve for labour as a whole or for high-skilled labour starts high on the vertical axis of a typical demand/supply diagram for labour, but then falls sharply.

In contrast, the labour demand of the micro-enterprise sector does not achieve high levels at any point. To begin with, much of the demand is imputed since the workers are self-employed. In addition, the marginal product of the labour employed is low because of the limited capital and simple technologies employed. So the demand remains relatively flat (elastic), because of the low barriers to entry.

productivity sector, but flattens towards the bottom where it reflects the existence of the micro-enterprise sector. In other words, in a country with a large labour supply, the equilibrium wage for this category of relatively unskilled workers is defined by the marginal labour productivity in the micro sector.

Figure 1: Labour demand curve by size of enterprise



The labour demand of the SMME sector lies between these two extremes. The first workers are relatively more productive than those in micro enterprises, but less so than those in large firms. Productivity declines slower than in large firms as workers are added, but faster than in micro enterprises. This is illustrated in Figure 1.

#### The role of the high productivity sector on labour markets

A healthy high productivity sector directly contributes to employment creation. However, when capital is scarce, its main impact on employment is indirect by means of technology spin-offs, subcontracting and transfers to the lower productivity sectors. The combination of an increase in the demand for labour in the high productivity sector and the rest of the economy produces a rightward shift of the labour demand curve.

*The key challenge is to identify the best policy levers available to government, given the problem of inequality and the overall thrust of an economic reform strategy comprising fiscal prudence, trade liberalisation and deregulation of various economic sectors.*

In SA's case, however, technological upgrading seems to work in the opposite direction. The high productivity or modern sector seems to grow 'vertically', with no transfer, technology spin-offs or other indirect benefits. As a result, wages in the high productivity sector rise, but fall in the other sectors. Such growth causes more income inequality, reinforced by the likely fall in wages of low-skilled micro-enterprise employees because this segment of the labour market gets flooded (see Figure 2).

#### Labour markets, wage rates and productivity

The summation of the three labour demand curves described above constitutes the total demand curve, which in turn is a function of the wage. Its intersection with the supply curve of labour represents the equilibrium wage, which is applicable to all low-skilled workers in the absence of labour legislation or other institutions which affect wages of various subgroups of workers found in this labour market segment.

International experience suggests that the direct (low) employment creation capacity of the high productivity sector does not vary much across developing countries, but that the extent of its positive impact on employment creation in the lower productivity sectors does. In the case of Latin America as a whole, for example, there has been virtually no net employment creation

As Figure 1 illustrates, the demand curve is steep at the beginning, where most of the demand for labour originates from the high

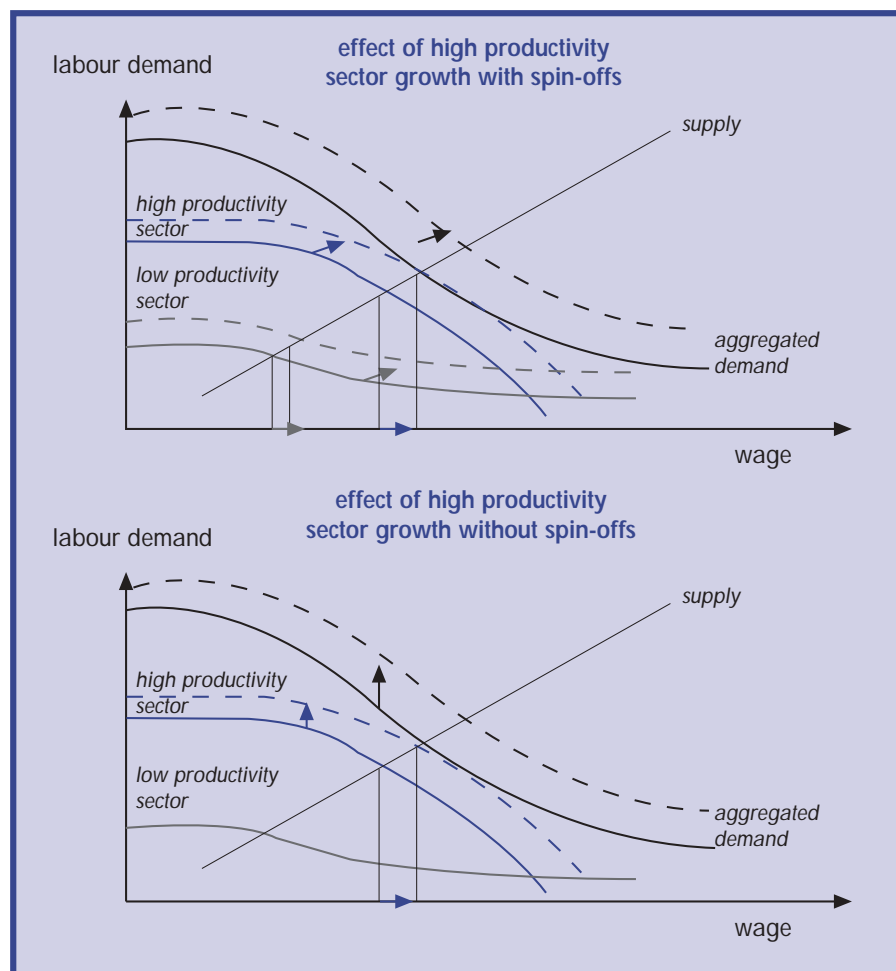


of this sort in the 1990s – even though a modest rate of overall economic growth was achieved. The Latin American experience suggests that the high productivity sector cannot be expected to provide the answer to a developing country's employment needs in a world of liberalisation, fiscal prudence and rapid technological change. Its employment growth is slow, and unless productivity is raised in the other sectors, the equilibrium wage would stay low for a discouragingly long time.

The marginal product of labour in the micro-enterprise sector determines the equilibrium wage for unskilled labour in the whole economy, although labour legislation and trade union power artificially push up wages in large-scale firms and part of the SME sector, so that the actual wages tend to lie above those paid in the non-unionised micro-enterprise sector. Nevertheless, the social and economic importance of having policies that raise productivity in this micro sector must be viewed

enterprises (or induce the formation of dynamic ones to replace less productive ones) so that the labour demand (labour productivity) curve of that sector will rise. Unfortunately, this cannot be the final resolution to the challenge of adequate employment, because the productivity levels of micro enterprises have a relatively low ceiling. So, while effective policies impact positively on micro-enterprise productivity, they achieve poverty alleviation at most, but not an expansion of the middle class.

**Figure 2: Effect of high productivity sector growth on labour demand**



**The role of the micro-enterprise and SME sectors**

It is important to distinguish between the micro-enterprise sector and the SME sector. The micro-enterprise economy increases the average productivity of labour in the economy as a whole by ‘pulling into production’ unemployed, low-skilled labour whose skill levels are not sufficient to qualify for employment in larger firms. Although this probably does not raise the average labour productivity of the employed labour force, it makes the most productive use of the unemployed, economically active population. This raises total output in the economy at little or no opportunity costs. By means of modest support measures, the average labour productivity of those so employed could be enhanced.

in light of the fact that its impact on earnings can go beyond the micro enterprise itself. The successful implementation of such policies raises not only the income of people employed here but of all other comparable workers in the economy whose incomes are not above the equilibrium due to ‘institutional distortions’.

*SMMEs emerge as the most promising section of SA's economy, from a productivity perspective and with an interest in income distribution.*

Promoting the micro-enterprise sector with a micro-finance programme, for example, may raise the productivity of enough micro

The SME sector, by contrast, is not just a desirable complement to growth in the high productivity sector and a multiplier of productivity increases in the micro sector, but holds the main key to whether the country will succeed or fail in confronting its employment challenge. Labour productivity is sufficiently high in most of this sector so that its workers earn above the poverty line. Further productivity improvements raise average wage levels of this sub-sector. Even more helpful, however, is the horizontal expansion of this sector through the entry of new firms and the growth in size of existing firms. This shift in the size distribution of firms can be explained by:

- The redeployment of former lower skilled micro-enterprise employees to SME firms (or the ‘maturation’ of micro enterprises into SMEs) until eventually only a few micro enterprises are left; and
- The redeployment of high-skilled and less-skilled workers from the high productivity sector, which tends to replace labour with capital.

SMMEs therefore emerge as the most promising section of SA's economy, not only from a productivity perspective but also with an interest in income distribution. The country could have raised its average labour productivity by allocating a high share of capital to large firms, which yield scale economies, and/or firms using modern technologies. In this case, only a few high-skilled and well-paid workers would be needed to operate this capital, while the majority of the labour force produces with little capital, and hence low levels of productivity and remuneration. In this scenario, labour (as the abundant factor of production) is sub-optimally used and income distribution worsened, especially with regards to unskilled workers and labour entrants.

Since SA has a large pool of low-skilled workers, maximising average labour productivity of those who are employed seems to be the wrong path to follow. Such a strategy would lead to a high rate of unemployment and inequality in income distribution. While the micro-enterprise segment usually absorbs some of the unemployed, slightly increasing the overall productivity of the economy, it is more desirable to have SMEs generate the bulk of employment, which is more productive, and hence able to pay higher wages.



## WTO WATCH

SATRAN co-ordinator Kennedy Mbekeani considers some of the central issues around Cancún.

The Fifth Session of the WTO Ministerial Conference in Cancún, Mexico, ended on 14 September without agreement on a Ministerial Text after chairperson Luis Ernesto Derbez concluded that members remained entrenched on the 'Singapore' issues.

The session's main task was to take stock of progress in negotiations and other work under the Doha Development Agenda. Two new members – Cambodia and Nepal – were also accepted. They are the first least-developed countries to accede to the WTO since its establishment.

The meeting collapsed over long-standing deep divisions among members, particularly over whether and how to launch negotiations on the 'Singapore issues' of investment, competition, trade facilitation and transparency in government procurement.

Most developing countries oppose the launch of new negotiations on the Singapore rules until more basic issues, such as measures to start phasing out rich countries' protectionist measures in agriculture, are resolved. Developed countries promote the Singapore issues as minimal rules governing each of these areas to harmonise trade procedures, while the developing world mainly sees them as ways for the richest countries to protect multinationals' interests in poor countries.

Observers are cautious over whether the group of developing countries that emerged as the G22 or G20+ at Cancún could stick together and effectively defend their common interests against the world's rich nations. However, the group did manage to hold its position successfully against the US and the EU on their protectionist stance over agricultural subsidies and tariffs. India and China led the new grouping, which includes SA as well as 13 Latin American countries.

Government officials of some of these nations have implied that they might leave the grouping to rather seek regional trade agreements and bilateral trade deals with the US. Significantly, Colombian

Trade Minister Jorge Botero said his country would remain in the G22 "only as long as the group does not become a factor of political confrontation with the US". Washington also hinted that those who form part of the bloc would not be considered for future bilateral trade negotiations. And it was speculated that SA's active involvement in the G20+ could possibly have a negative impact on the SACU/US free trade accord.

*The Cancún session is the first at which developing nations negotiated in a bloc to bring forth their common positions and made use of collective bargaining power.*

But the Cancún session is still the first at which developing nations negotiated in a bloc to bring forth their common positions and made use of collective bargaining power against the developed countries which hold the more powerful positions.

According to SA's Ambassador to the WTO, Faizel Ismail, some progress was even made in identifying the key areas of difference in terms of agriculture and indicating possible advances from both the EU and US side and that of the G20+.

Observers say the impasse in Cancún makes the possibility of meeting WTO timetables and targets more difficult. The end of 2004 is the deadline for the 146 WTO member countries to begin to implement a series of pending accords that would benefit developing nations. The establishment of the Free Trade Area of the Americas (FTAA) by January 2005 could also be more difficult to achieve.

In the end, Mexico's Derbez proposed a six-paragraph ministerial statement, which was approved in the closing session and instructs member governments' officials "to continue working on outstanding issues with a renewed sense of urgency and purpose and taking fully into account all the views we have expressed in this Conference".

The ministers asked the General Council Chairman and the WTO Director-General to co-ordinate the work and to convene a meeting of the General Council at senior officials' level no later than 15 December 2003 to take the necessary action.

*The Southern Africa Trade Research Network (SATRN) is designed to assist the Southern African Development Community (SADC) member countries to participate more effectively in the WTO process. It aims to mobilise the capacity for research and policy analysis across the region, and to strengthen the links between SADC researchers and SADC's policy community. For more information, visit <http://www.tips.org.za/satrn/>*

# SATRAN

# Tanzania's Privatisation Programme Outpaces SA

Reg Rumney, Executive Director at The BusinessMap Foundation, reviews Tanzania's privatisation process. This is the first in a series of articles that focus on SADC.

If there is any doubt that revenue should be the main aim of privatisation in African countries, the Tanzania experience will dispel this idea. Tanzanian revenue so far from an ambitious programme of privatisation – more advanced than SA's own restructuring programme – has been around US\$200-million since it began in 1992.

To put that into perspective, Tanzania's total debt, outstanding and disbursed, was \$7.238-billion in 2002.<sup>1</sup> The reason, the privatisation agency argues, is that the family silver was not merely tarnished, it was corroded, so that competitive bidding raised relatively little.

This was revealed at a recent privatisation seminar, arranged by the Netherlands Institute for Multiparty Democracy, in Dar es Salaam. The seminar included representatives of all significant opposition parties in Tanzania.

The pressure for privatisation as part of a Structural Adjustment Programme framed by the multilateral agencies was raised, but not discussed in any detail. None of the political parties appear to have taken a completely oppositional stance to privatisation, whether past, present or planned. Their quarrel seems to be over proceeds and procedures of particular privatisations, rather than the programme itself. The Chama Cha Mapinduzi (CCM) governing party has a grip on power that has provided political stability if not political stasis for decades.

Whether this represents consensus or an inability to tap popular resentment, and whether the lack of opposition will last as privatisation or part-privatisation of public utilities proceeds, and private sector involvement in provision of services takes hold, is open to question. Privatisation in Tanzania to date has been of the 'non-strategic' or 'non-core' State-owned assets rather than utilities – entities such as hotels that are now almost universally accepted to be more logically privately owned.

Some of the disquiet about particular past privatisation exercises related to the subsequent sale of assets, particularly residential property, which were acquired by the private sector investor at a profit, raising the spectre of asset stripping. And in the light of the relatively small sum received by the fiscus from the privatisations to date, questions were raised about whether State assets had been undersold relative to their net value.

The need for privatisation of inefficient State-owned enterprises seems to have general support, however, in the light of Tanzania's specific experience of nationalisation and State control. The Arusha Declaration of 1967 that sought State control of the commanding heights of the economy is well known. It can be argued

*Some of the disquiet about particular past privatisation exercises related to the subsequent sale of assets, particularly residential property, which were acquired by the private sector investor at a profit.*

that State-driven development in Tanzania was not that different from the programmes of other African countries which were not as explicitly socialist. But in Tanzania the use of State-Owned Entities (SOEs) to provide employment and spearhead economic growth through import-substitution tended to go farther than elsewhere, and was accompanied by the highly controversial policy of the collectivisation of agricultural production.

It could be expected that the reaction to this socialist approach would be a fervent embrace of 'capitalist', 'free-market' or 'neo-liberal' models, but the evidence is that the Tanzanian government's approach to privatisation is no more or less pragmatic than, say, the SA government's, whose privatisation exercise is carefully framed within a policy of 'restructuring' rather than merely 'privatising' SOEs.

Clearly practical reasons existed for the Tanzanian State to privatise at the beginning

of the last decade of the 20<sup>th</sup> century. On top of the nationalisation drive that began post-1967, the Tanzanian government established new parastatals, and by 1990 there were nearly 400 SOEs that had accumulated losses and were heavily indebted, according to the head of the Parastatal Sector Reform Commission (PSRC), John Rubambe.<sup>2</sup> They had little prospect of revitalisation, and a good number had developed substantial non-core investments, which were being directly financed by the core business.

"General performance of most of the parastatals dropped to an average of 20% of installed capacity and in the wake of trade liberalisation, which started in the mid-1980s, they failed to compete with imported goods and services, given the monopolistic and bureaucratic tendencies that characterised the SOEs then."<sup>3</sup>

The Tanzanian government's approach to privatisation is unequivocal, according to Rubambe, as part of a deliberate withdrawal of direct involvement in business to reserve its core responsibilities. Whereas privatisation is one option for SA's Department of Public Enterprises, which does not control privatisation of, say, the entities owned by the IDC or public land held by other departments, Tanzania has the Presidential PSRC, explicitly charged with co-ordinating the privatisation drive.

"These include education, health and other social services, good governance, maintenance of law and order, setting up appropriate legislative frameworks, improving the investment climate and provision of an arms-length regulatory framework geared to set up a level playing field at the market place and to restrict monopolistic firms from abusing their monopolistic positions."

Rubambe made it clear that revenue maximisation had never been the main aim of privatisation. Nor could it be, with in some instances enterprises using inefficient machinery imported some 30 years before from the communist Eastern bloc, and for which spare parts were in some cases unavailable.

Tanzania has privatised 266 out of 389 public enterprises marked for divestiture. Of these, 134 enterprises are now fully owned by Tanzanian citizens, 16 by foreign investors, and the remaining 116 are joint ventures between foreign investors, the Tanzanian government and Tanzanian investors.

<sup>1</sup> The World Bank Group, country profile.

<sup>2</sup> The Tanzanian Experience of Privatisation and the Role of the Presidential Parastatal Sector Reform Commission, PSRC Executive Chairman, John C Rubambe, September 4 2003.

<sup>3</sup> Ibid.

*(continued on page 12)*



(continued from page 11)

The government of Tanzania boasts that privatised and rejuvenated enterprises have provided better products at competitive prices. "The days of a permit to buy beer are gone," noted Rubambe. The privatised companies are also paying taxes.

Clearly, not everyone has benefited equally from privatisation, which everywhere probably has the potential to deepen national inequality. The spectre of economic inequality combining with xenophobia and racist thinking did rear its head at the seminar, with expressions of dissatisfaction about the race of the Tanzanian citizens who were seen to be benefiting from privatisation.

The resentment caused by the perceptions that Asian business people have profited from Tanzania's privatisation and liberalisation policy feeds into popular resentment about Asian dominance of the economy, though Asians form less than 1% of the entire population. Perceptions of 'losing out to foreigners' may in time lead to political crisis, though a much expanded and growing economy will provide more opportunities for indigenous business growth and a thought-out version of Black Economic Empowerment (BEE).

The need for domestic redistribution policies is outweighed for the moment by the desire to attract foreign investment. In time 'foreignisation' of the economy through privatisation may galvanise opposition. SA investment, by Absa, in the National Microfinance Bank, was treated with suspicion, especially when Absa subsequently sold a stake to the International Finance Corporation.

The Tanzanian government has no clearly articulated 'indigenisation' policy on the table, though it appears sensitive to the need to encourage local ownership. While the history of racial discrimination in the two countries differs, a case can be made for redressing racial imbalances left by colonisation. If a form of BEE were to be followed, it would have to be adapted very carefully to local conditions, because the racial history is not parallel to SA's, and poverty alleviation must be even more of a priority.

Notwithstanding high economic growth rates in recent years and a more efficient economy thanks to privatisation, Tanzania is one of the

poorest countries in the world, and among the poorest and least urbanised countries in Africa.

The government is aware of the sensitivity of the privatisation of utilities. Yet here too it is ahead of SA. The Tanzanian government decided in 1996 to include utility and infrastructure parastatals in the privatisation programme.

So far being sold are:

- All commercial sections of the Tanzania Harbours Authority (THA);
- Tanzania Telecommunications Company Ltd;
- Tanzania Railways Corporation;
- Tanzania Electric Company (Tanesco);
- National Insurance Corporation; and
- National Microfinance Bank.

"The objective was to improve the performance of these enterprises to create a conducive business environment and to enable them to contribute substantially and meaningfully to the country's economic development efforts. Privatisation of the utility and infrastructure parastatals is expected to dramatically improve services for the betterment of the economy, investors and the people generally," says Rubambe.

*In terms of the privatisation of utilities, Tanzania is ahead of SA. The government decided in 1996 to include utility and infrastructure parastatals in the privatisation programme.*

Government admits to some resistance to privatisation within the parastatals, and to the effect of job losses after privatisation. At Tanesco – under management contract by the SA Netgroup prior to privatisation – police eventually had to escort management from the Tanesco offices after a three month delay.<sup>4</sup>

What this brings into view is the ever-present need for sufficient national agreement to proceed with further privatisation. Union resistance to privatisation in Tanzania, as opposed to SA, appears to be too weak to delay or defer specific privatisations or general privatisation – yet. And political parties, as noted previously,

have still to fashion from privatisation enough of a thorough political platform to convince the electorate to vote out the pro-privatisation CCM government.

Tanzania's privatisation process is part of a broader commitment to liberalising the economy. This is in line with a perhaps not surprising embrace of 'neo-liberal' economic policies, given the kind of economic pressures the country has to deal with. Aid dependency, foreign debt and inherited inefficiencies give any new government as little room to manoeuvre as the government it ousts. SA has no Economic Structural Adjustment Programme (ESAP) or modern equivalent, moderate foreign debt, and the last big loan from the World Bank helped to build the motorway around Johannesburg in the 1960s.

Yet SA has resorted to water concessions as a way of providing new water services. Dar es Salaam Water and Sewage Authority (Dawasa) has just signed a lease agreement with a private operator to manage and run the Dawasa network to provide water and sewerage services in the major city and nearby districts.

Unlike SA's controversial water concessions, the lease is only for 10 years, and has a number of safeguards. And unlike in SA, the need is for a major revamp of existing water provision rather than finance for new water services. The water in Dar is undrinkable, and the pumping and filtration system in dire need of repair.

Moreover, water is widely pirated and badly metered.

While privatisation in Tanzania is driven by desperation at times, privatisation must be integral to broader economic policy, specifically the introduction of competition and a free market. Tanzania is well out of the starting blocks in the race to put in place a free-market framework, though reliance is on regulation at this early stage to keep price increases in check.

But the government's commitment to liberalisation is in no doubt. In telecommunications, for example, the present fixed-line operator has a monopoly on the mainland until 2005, but the Information and Communications Technology (ICT) sector has seen the introduction of significant competition. Six independent data service operators, more than 20 Internet service providers, and four independent service providers (including SA's Vodacom) have been licensed.

Winners of bids in privatisations have in some cases been SA companies, such as Absa, or, ironically, parastatals such as SA Airways. The trade balance is overwhelmingly in SA's favour. SA exports to Tanzania in 2002 were seven times the imports from

<sup>4</sup> Interview with Netgroup, Traders Africa Business Journal, August-November 2003

that country, around R107m<sup>5</sup>, and though in pure economic terms this matters little, it is clearly unsustainable politically unless Tanzania can boost export-led growth to higher levels to attain a better overall trade balance. SA is also a major investor.

Privatisation is usually part of the same prescription as export-led growth. Sadly, Tanzania has not been able to diversify much beyond its traditional agricultural and mineral exports. This too may change, as liberalisation of the economy attracts more foreign investment, though the country has higher hurdles to leap than many others in Africa, with tremendous development backlogs.

Tanzania has just opened its first export processing zone – the \$10m Millennium Business Park project, which is located just outside the Dar es Salaam town centre and caters for light industrial manufacturing, warehousing and storage, showrooms and offices.

Privatisation, as with other policies, is not merely a matter of technical economic management. Inevitably the restructuring of the economy brings the pain associated with real change.

Ordinary Tanzanians will no doubt be more impressed by a real change in their economic situation, and that depends not only on privatisation but how effectively it contributes to broader economic and political reforms.

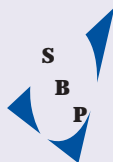
## TIPS Internship

TIPS is inviting students at Honours and Masters degree level in economics or related fields of study to apply for internships at the organisation, specifically over the period November 2003 to February 2004. The following research areas are particularly relevant:

- Trade Policy
- Sector Research
- Small Business

For queries or further information about application procedures, please contact Stephen Hanival at:

Tel: +27 (0)11 645 6404,  
Fax: +27 (0)11 484 4111 or  
E-mail: [stephen@tips.org.za](mailto:stephen@tips.org.za)



small business project

*incorporating the Private sector initiative*

## Invitation

The SMME Economy in South Africa

Monday, 10 November 2003

Since 1994, South Africa has been faced with the challenges of reintegration into world markets as a global economy, while at the same time positioning itself to realise the high expectations of its populace regarding a successful transition towards a more democratic order. To achieve the objectives of economic growth through competitiveness on the one hand, and employment generation and income redistribution as a result of this growth on the other, SA's small-, micro- and medium-sized enterprise (SMME) economy has been actively promoted since 1995. Despite voluminous research, however, the extent to which SA's SMMEs contribute to poverty alleviation, economic growth or international competitiveness is still largely unclear.

Bringing together policymakers, practitioners and the resource community, this workshop aims to debate the lessons learnt in developing the small business sector and the challenges we still face. A key objective of the workshop is to put together a medium-term agenda for further research in this area.

## Programme

1. The Economics of SMMEs in South Africa
  - Rashad Cassim, University of the Witwatersrand
2. SMME Development in the Context of Black Economic Empowerment
  - Reg Rumney, The BusinessMap Foundation
3. Reflections on the Enabling Environment for Private Sector Growth in South Africa
  - Chris Darroll / Judi Hudson, The Small Business Project
4. Prospective Research on the SMME Sector: Preliminary Ideas on a Way Forward
  - Chris Rogerson, University of the Witwatersrand

\*\* *The programme will allow for questions and discussion after each presentation.*

**Date:** Monday, 10 November 2003

**Time:** 8.30am for 9.00am – 12.00am

**Venue:** The Small Business Project offices, 79 Oxford Road, Johannesburg

**RSVP:** Lucille Gavera ([lucille@tips.org.za](mailto:lucille@tips.org.za)) by Friday 31 October 2003

<sup>5</sup> Emmanuel Mwambulukutu, Tanzanian High Commissioner to SA, Traders African Business Journal, August-November 2003.

# FOCUS ON FACTS

## SA's GDFI and Capital Stock Show Modest Growth

Despite the anticipation of increased Gross Domestic Foreign Investment (GDFI) and growth in capital stock after the advent of SA's new democratic dispensation in 1994, it remains a concern that this has not been achieved satisfactorily. TIPS economist Donald Onyango takes a look at these two indicators from 1995-2001 (post-democracy) and 1989-1994 (pre-democracy) and highlights the trends for the 46 sectors that make up the SA economy.

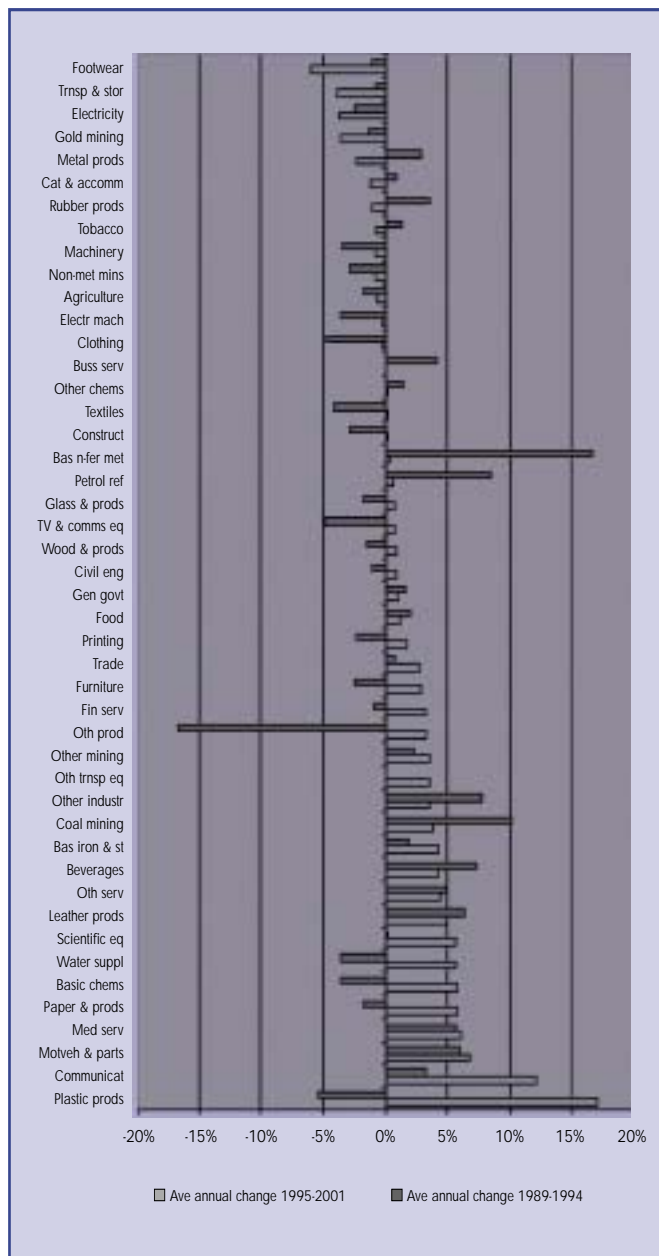
For a number of manufacturing sectors, there has been robust growth in capital stock between 1995 and 2001, as can be seen from Table 1 and Figure 1, notably Plastic Products (17.1%), Communication Services (12.1%), Medical Services (6.1%) and Paper and Paper Products (5.8%). Low capital stock growth has occurred in the Footwear, Transport and Storage, and Electricity sectors (-6%, -3.9% and -3.7% respectively). But apart from Communication Services, these sectors are relatively small in terms of their total share of capital stock.

**Table 1: Growth in capital stock for 46 industries, 1989-2001 (1995 constant prices)**

Average annual rank 95-01	Sector	Average annual Δ 95-01 (%)	Average annual Δ 89-94 (%)	Average annual rank 89-94	Average share 95-01 (%)	Rank of average share 95-01	Average share 89-94 (%)	Rank of average share 89-94
1	Plastic products	17.1	5.4	45	0.1	36	0.1	35
2	Communications services	12.1	3.2	12	7.4	5	3.6	10
3	Motor vehicles & parts	6.8	6.0	7	0.6	21	0.5	21
4	Medical services	6.1	5.6	8	0.9	17	0.7	17
5	Paper & products	5.8	-1.8	31	0.6	22	0.5	22
6	Basic chemicals	5.8	-3.5	39	1.0	16	0.9	15
7	Water supply	5.7	-3.5	40	1.1	14	1.1	13
8	Scientific equipment	5.7	0.1	22	0.0	46	0.0	45
9	Leather products	5.0	6.3	6	0.0	45	0.0	46
10	Other services	4.4	4.9	9	0.4	25	0.3	26
11	Beverages	4.3	7.4	5	0.7	19	0.6	19
12	Basic iron & steel	4.3	1.8	16	2.8	12	2.2	12
13	Coal mining	3.8	10.1	2	1.0	15	0.7	18
14	Other industries	3.6	7.7	4	0.0	42	0.0	42
15	Other transport equipment	3.6	0.0	23	0.1	33	0.1	34
16	Other mining	3.5	2.3	14	3.8	8	3.8	9
17	Other producers	3.3	-16.7	46	0.0	41	0.1	39
18	Financial services	3.2	-0.9	25	12.7	2	12.8	3
19	Furniture	2.8	-2.4	35	0.1	39	0.1	40
20	Trade	2.7	0.7	21	4.5	7	4.4	6
21	Printing	1.7	-2.3	33	0.2	32	0.1	32
22	Food	1.2	2.0	15	1.3	13	1.0	14
23	General government	1.0	1.6	17	19.8	1	19.7	1
24	Civil engineering	0.8	-1.0	26	0.2	28	0.3	29
25	Wood & products	0.8	-1.5	29	0.1	34	0.1	33
26	Tv & communications equipment	0.7	-4.9	44	0.1	40	0.1	41
27	Glass & products	0.7	-1.8	32	0.1	35	0.1	37
28	Petrol refining	0.6	8.5	3	3.6	9	3.3	11
29	Basic nonferrous metals	0.3	16.7	1	0.8	18	0.3	25
30	Construction	0.2	-2.8	36	0.3	27	0.3	27
31	Textiles	0.1	-4.1	42	0.2	30	0.2	31
32	Other chemicals	0.1	1.4	18	0.7	20	0.7	16
33	Business services	0.0	4.1	10	9.9	3	9.2	4
34	Clothing	-0.2	-4.7	43	0.1	38	0.1	38
35	Electric machinery	-0.2	-3.6	41	0.2	31	0.2	30
36	Agriculture	-0.6	-1.8	30	3.5	10	4.0	8
37	Non-metallic minerals	-0.7	-2.8	37	0.5	24	0.5	20
38	Machinery	-0.8	-3.4	38	0.2	29	0.3	28
39	Tobacco	-0.8	1.3	19	0.0	44	0.0	43
40	Rubber products	-1.0	3.6	11	0.1	37	0.1	36
41	Catering & accommodation	-1.1	0.8	20	0.5	23	0.5	23
42	Metal products	-2.3	2.8	13	0.4	26	0.4	24
43	Gold mining	-3.6	-1.3	28	3.4	11	4.4	7
44	Electricity	-3.7	-2.4	34	6.2	6	8.1	5
45	Transport & storage	-3.9	-0.8	24	9.7	4	13.2	2
46	Footwear	-6.0	-1.0%	27	0.0	43	0.0	44

[Source: TIPS SA Standardised Industry Database]

**Figure 1: Growth in Capital Stock 1989-2001 (1995 constant prices)**



Between 1989 and 1994, high capital stock growth rates were evident for Basic Non-Ferrous Metals (16.7%), Coal Mining (10.1%) and Petroleum Refining (8.5%), while at the opposite end of the scale, Other Producers had the lowest capital stock growth rate of -16.7%, followed by Plastic Products (-5.4%) and Television and Communication Equipment (-4.9%).

In terms of overall shares in total capital stock, Table 1 and Figure 1 show that industries with a relatively high share in the total capital stock, such as Financial Services, Wholesale and Retail Trade, and Business Services, have reported only modest growth rates in both 1995 to 2001 and 1989 to 1994.

### Investment Rates

The investment rate for the economy as a whole, shown in the last row of Table 2, is still below 20%. This corresponds with the rates observed in countries such as Argentina, Mexico, Venezuela, Egypt, Nigeria



and Pakistan<sup>1</sup> but does not compare well with investment rates in other 'emerging markets' such as Brazil, Chile, Philippines and India (20%-25%), China, Thailand and Malaysia (35%-40%), Indonesia (25%-30%) and Korea (30%-35%).

Table 2 and Figure 2 show that the Petroleum Refining sector had the highest investment rate (74.2%) between 1995 and 2001, with Basic Iron and Steel coming in a distant second at 49.9%. The Basic Chemicals sector posted an average investment rate of 37.3%. The lagging sectors in this period were Other Producers, Other Industries and Construction, which respectively had investment rates of 0.4%, 1.5% and 5.1%. The Food sector's investment rate was 21.4% and Textiles' 18.5%, while Clothing stood at 5.7%.

In comparison, 1989 to 1994 saw the Petroleum Refining sector top the table once again with an investment rate of 93.6%, followed by Water Supply (45.6%) and Electricity (40.9%) in third place. Bringing up the rear were Other Producers (0.5%), Other Industries (2%) and Furniture (2.5%).

In terms of the change in investment rate between 1995 to 2001 and 1989 to 1994, the most dramatic change was seen for Basic Chemicals,

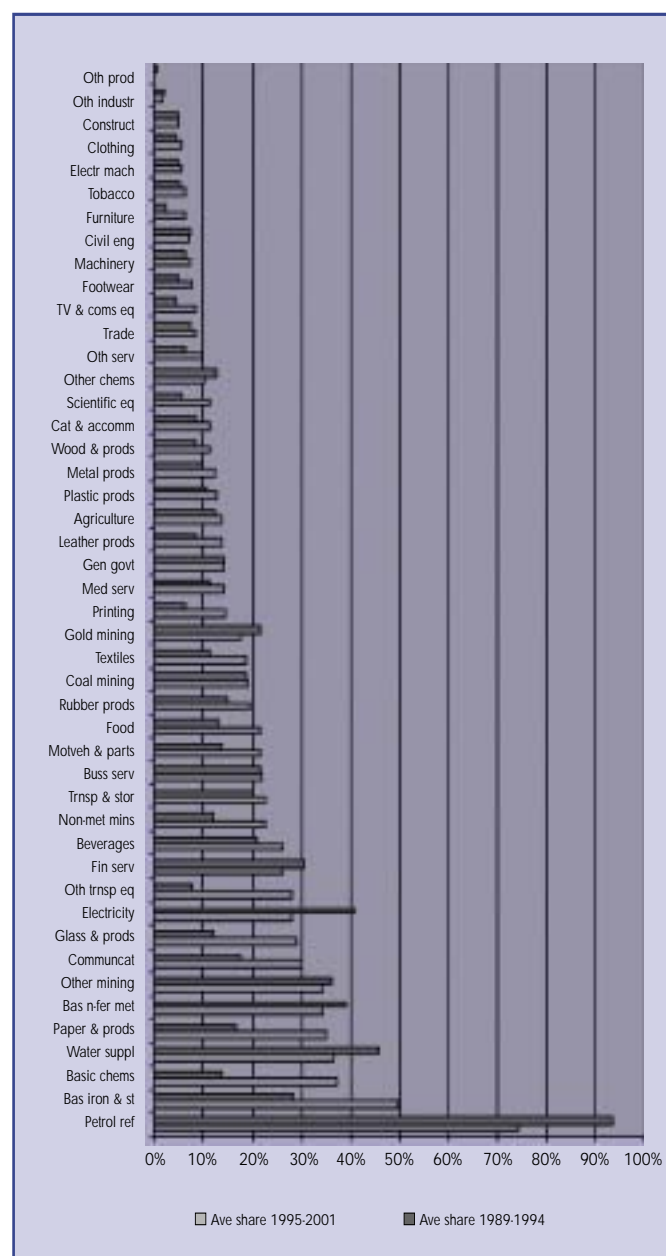
**Table 2: Investment rates for 46 sectors, 1989-2001 (1995 constant prices)**

95-01 Rank	Sector	Period average 95-01 (%)	Period average 89-94 (%)	89-94 Rank	Δ in ratio 1 <sup>st</sup> - 2 <sup>nd</sup> half (%)	Δ in ratio Rank
1	Petrol refining	74.2	93.6	1	-19.5	46
2	Basic iron & steel	49.9%	28.3	7	21.6	2
3	Basic chemicals	37.3	13.9	18	23.5	1
4	Water supply	36.5	45.6	2	-9.1	44
5	Paper & products	35.0	16.6	14	18.4	4
6	Basic non-ferrous metals	34.6	39.0	4	-4.3	43
7	Other mining	34.6	36.1	5	-1.4	39
8	Communications services	30.0	17.7	13	12.4	6
9	Glass & products	28.9	11.8	23	17.0	5
10	Electricity	28.2	40.9	3	-12.7	45
11	Other transport equipment	27.8	7.7	31	20.1	3
12	Financial services	26.3	30.2	6	-3.9	42
13	Beverages	26.2	20.9	10	5.3	14
14	Non-metallic minerals	22.9	11.9	22	10.9	7
15	Transport & storage	22.5	20.0	11	2.5	24
16	Business services	21.9	21.6	8	0.3	32
17	Motor vehicles & parts	21.6	14.0	17	7.6	10
18	Food	21.4	13.0	19	8.4	8
19	Rubber products	19.4	15.0	15	4.4	15
20	Coal mining	19.2	19.0	12	0.2	33
21	Textiles	18.5	11.1	25	7.5	11
22	Gold mining	17.5	21.4	9	-3.9	41
23	Printing	14.6	6.4	35	8.2	9
24	Medical services	14.2	11.2	24	3.1	20
25	General government	14.2	14.1	16	0.1	34
26	Leather products	13.8	8.4	30	5.4	13
27	Agriculture	13.5	12.4	21	1.2	28
28	Plastic products	12.9	10.5	26	2.3	25
29	Metal products	12.3	9.7	27	2.6	23
30	Wood & products	11.4	8.6	28	2.8	21
31	Catering & accommodation	11.3	8.5	29	2.8	22
32	Scientific equipment	11.1	5.6	37	5.5	12
33	Other chemicals	10.3	12.9	20	-2.6	40
34	Other services	9.6	6.5	34	3.1	18
35	Trade	8.5	7.1	33	1.4	26
36	Tv & communications equipment	8.5	4.5	42	4.0	16
37	Footwear	7.9	4.8	41	3.1	19
38	Machinery	7.1	7.3	36	0.8	30
39	Civil engineering	6.9	6.6	32	-0.6	38
40	Furniture	6.4	2.5	44	3.9	17
41	Tobacco	6.4	5.2	38	1.2	29
42	Electric machinery	5.7	5.1	39	0.6	31
43	Clothing	5.7	4.4	43	1.3	27
44	Construction	5.1	5.1	40	0.0	35
45	Other industries	1.5	2.0	45	-0.5	37
46	Other producers	0.4	0.5	46	-0.2	36

[Source: TIPS SA Standardised Industry Database]

Note: the investment rate is defined as gross domestic investment divided by value added

**Figure 2: Investment Rates for 46 sectors, 1989-2001 (1995 constant prices)**



where the investment rate almost trebled from 13.9% to 37.3%. Basic Iron and Steel's investment rate nearly doubled from 28.3% to 49.9%. Other significant changes were evident for Other Transport Equipment and Paper and Paper Products. Petroleum Refining and Electricity showed the most dramatic plunge in investment rates.

## Conclusion

By comparing capital stock growth rates in the second half of the decade with the earlier period, it is clear that a range of smaller sectors are continuing to grow their capital stock at above-average rates. However, this can also be said of some of the traditional sectors such as Basic Chemicals and Basic Iron and Steel. This is confirmed by an examination of the investment rates, where it appears that the larger industries, which had benefited in the past from State intervention, still claim relatively high rankings. The restructuring of the SA capital stock towards a more diversified pattern is therefore expected to take longer than was initially anticipated.

<sup>1</sup> Please refer to the World Bank's World Development Indicators - <http://devdata.worldbank.org/data-query/>

The **Trade and Industry Monitor** is a publication of  
Trade and Industrial Policy Strategies (TIPS).

Contact TIPS:  
Ground Floor, Broll Place  
Sunnyside Drive  
Sunnyside Park  
Parktown  
Johannesburg.

P O Box 87643  
Houghton  
2041

Tel: +27 (0)11 645 6404  
Fax: +27 (0)11 484 4115  
Web: [www.tips.org.za](http://www.tips.org.za)

To be placed on the mailing list for the TIPS Trade and Industry Monitor, please contact Matthew de Gale at  
Tel: +27 (0)11 645 6404, Fax: +27 (0)11 484 4115 or E-mail: [matthew@tips.org.za](mailto:matthew@tips.org.za)

For information about and contributions to this publication, please contact Lucille Gavera at  
Tel: +27 (0)11 645 6404, Fax: +27 (0)11 484 4115 or E-mail: [lucille@tips.org.za](mailto:lucille@tips.org.za)

Design and Layout: DTPworkshop, Johannesburg • Printing: Contiprint, Johannesburg