What financial means will be available for the development of Southern Africa?

Contribution by Dr Chris Stals, Governor of the South African Reserve Bank, to the Conference on "Future co-operation between the European Community and Southern Africa", arranged by the Club de Bruxelles, Brussels, 14 October 1993

1. Introduction

The data used in this presentation refer to the Republic of South Africa, inclusive of the self-governing and independent national states which are now commonly accepted to be part of South Africa. The information excludes other countries in the Southern Africa region.

The conclusions drawn, however, will most probably be augmented by the inclusion of data for the other countries, as the South African economy is known to be the main generator of income in the region (at this juncture, not necessarily the main generator of growth), and also because of the size of the South African economy in relation to total economic activity in the region.

2. A macro-economic approach

In the search for more jobs, better living conditions and a more fair and equal distribution of income and wealth, it is imperative that the macro-economic growth rate in South Africa should for the rest of this decade, be maintained at an average of at least 4 per cent per annum. The challenge presented by this target, which many South Africans will regard as too modest and too low, is put in perspective if compared with the average annual rate of growth of only 0,8 per cent in the gross domestic product over the past ten years.

Based on past experience and on rather favourable assumptions about possible improvements in the average capital/output and capital/labour ratios, this will require an average expansion of the total production capacity of the South African economy of about 10 per cent of gross domestic product per year, compared with an average of only about 3 per cent over the past ten years, and less than 2 per cent over the past 4 years. Total gross domestic fixed investment, that is providing also for depreciation and depletion, will have to equal close to 25 per cent of gross domestic product per year, compared with only 18 per cent in the recent past.

Increases in productivity can, of course, be another very important source of growth. In the case of South Africa, there is a great potential for increasing both labour and capital productivity. The two alternative sources of growth, namely the expansion of production capacity and increases in multi-factor productivity, are supplementary. In the context of the South African economy, particularly, the improvement of the income generating capacity of the population may deserve priority at this juncture. It will, however, only lead to more frustration and social stress if skills of people are developed more actively without at the same time also creating additional employment opportunities.

The minimum investment requirements over the next seven years to provide sufficient jobs for the growing population, and gradually to reduce the existing unduly high rate of unemployment have been indicated as about 10 per cent of gross domestic product per year for net investment, and about 25 per cent per year for gross investment. The question now arises whether South Africa will have sufficient means available to finance the desired volume of investment. The record of the past seven years again falls far short of this target.

Total gross domestic saving from 1989 to 1992 averaged less than 20 per cent of gross domestic product per annum, compared with the required minimum gross domestic investment of about 25 per cent of gross domestic product. In addition, during the past decade, the net outflow of capital from South Africa absorbed somewhere between 2 and 3 per cent of gross domestic product each year, which further reduced the domestic savings available for the financing of domestic investment.

The deduction is therefore conclusive — based on the savings ratios and consumption levels of the past, South Africa cannot generate sufficient finance for its development programme over the next ten years, and continue to finance a net outflow of capital at the same time. There remains a financing gap of something like 6 or 7 per cent of gross domestic product which, over the longer term, must lead to severe stresses in the financial markets, and in the balance of payments.

3. The social upliftment programme

A substantial part of the future investment programme will have to be diverted into a comprehensive programme of human development. I have already referred to the contribution this can make to the improvement of multi-factor productivity, and therefore to an increase in the economic growth rate. Of particular importance are enhanced programmes for universal education and training in basic industrial skills; other programmes are for improved basic health standards, needed in their own right but also needed to support the effectiveness of training programmes. More projects in the same vein, such as basic housing and water and sanitation, and also small business development support, must be included in this urgent programme of human development.

Various estimates are now circulating in South Africa on the possible cost of such an extensive human development programme. These estimates vary from a completely unrealistic "wish" list, to a more fundamental basic "needs" list, to a more conservative "what is affordable" programme. Based on research work on the elimination of existing backlogs recently undertaken by

the Development Bank of Southern Africa, capital expenditure in addition to present levels, would amount to an estimated R56 800 million. Current expenditure (by general government) for this purpose would also rise by as much as R13 600 million per year within five years.

If it is assumed that the capital expenditure programme will be spread out over a frustratingly long period of ten years, and providing for the incorporation of the programme within the macro-economic constraints already referred to, we once again come back to the same conclusion as before — there is no way that South Africa can do it alone.

4. The macro-economic solution

In order to make any meaningful progress towards easing the economic distress of South Africa at this stage, the country will therefore have to introduce major structural economic adjustments that are now widely debated within the National Economic Forum, academic circles, research institutes, public sector institutions, the government and international institutions with an interest in the emerging new South Africa.

Some of these aspects will undoubtedly also be covered in the deliberations at this Conference. I will restrict the rest of my remarks to the obvious financing gap that will soon become a serious limiting factor in the economic development programme of South Africa, unless we should now very urgently address the problem.

As a matter of course, South Africa will have to do more to solve its own problems, for example by:

* increasing domestic savings, particularly of the personal sector which had declined from an average of 4,1 per cent of personal disposable income in the early 1980's to only 2,2 per cent over the past five years;

* reducing dissaving by general government, by restricting the deficit on the Budget of the central government which had increased from 1,6 per cent of gross domestic product in 1989/90 to 8,8 per cent in 1992/93, to not more than 3 per cent of gross domestic product; and

* increasing multi-factor productivity, thus contributing to an increase in economic growth by a more effective use of the existing production capacity.

South Africa will, on the other hand, also have to make itself more attractive for the foreign investor, in order to reduce the capital outflows which will not only serve to diminish the financing gap, but also the ever-threatening trade or foreign exchange gap of the balance of payments. Indeed, the appropriate programme for strengthening the balance of payments extends well beyond the capital account of the balance of payments, and covers also a dynamic trade policy and aggressive marketing of services, for example tourism, to the rest of the world.

5. The balance of payments constraint

For obvious reasons, South Africa will in the present circumstances find it extremely difficult to close the financing gap entirely through its own internal efforts. At a minimum, the net outflows of capital which averaged about 2 per cent of gross domestic product or about US $2 billion per annum over the past eight years, will have to be arrested. If an average economic growth rate of 4 per cent per annum should be maintained for the rest of this decade, an average net inflow of capital of somewhere between 1 and 2 per cent of gross domestic product will have to be realised.

For this purpose, South Africa will therefore have to look at:

* donor funds or international aid;

* short-term trade finance;

* long-term loan funds in the form of bilateral negotiated loans and private placements and public loan issues;

* portfolio investments in South African bonds and equities; and

* direct investment in foreign-controlled South African subsidiaries.

Taking account of South Africa's relatively low level of foreign debt, the country has ample capacity to absorb and service additional foreign capital inflows. Hopefully, the European Community will play an important part as a supplier of funds in all the various categories mentioned above.

6. The role of monetary policy

More than three years ago, monetary policy in South Africa set itself the target of first stabilising the domestic financial situation and of then liberalising the system, more in particular foreign financial relations, thus preparing the way for the financial system to support a higher level of economic growth on a sustainable basis.

Much progress has been made towards achieving the first of these objectives. The money supply is now increasing at a rate of below 5 per cent per annum, the amount of outstanding bank credit is rising at well below 10 per cent per annum, and both the producer and consumer rates of inflation are now firmly in the single digit range.

The domestic financial system has also been

strengthened in many ways. Financial regulation of banks and financial markets now applies sophisticated risk management techniques rather than minimum prudential requirements based on balance-sheet aggregates. Sound and good competition amongst relatively free participants establishes well-founded market prices for most financial services, including interest rates.

With the lifting of sanctions and the normalisation of South Africa's international financial relations, the way is being opened for some liberalisation of the foreign exchange market. This should indeed become an important element of the next step in the evolutionary process of making South Africa more competitive in the international markets, and also enabling the financial sector to play a greater role in the expanding of relations in the Southern African community.

The daunting question for monetary policy is, however, whether the financial resources required for the economic development programme can be generated without disruption of the monetary equilibrium now coming within our reach, that is after all the strenuous efforts of the past few years. The South African Reserve Bank believes that it will not be possible to achieve a higher level of economic growth on a sustainable basis, to increase domestic saving, to apply the necessary disciplines to both private and public sector consumer expenditure, to attract foreign capital and indeed to ensure a smooth transition to a new fully democratic South African society, unless overall financial stability will be maintained within the country.

The Reserve Bank's efforts to pursue a stable financial environment is often opposed from many sides within the South African community. There is, however, no gain without pain and in carrying a very heavy burden in this regard, monetary policy is often accused of being over-restrictive and unsympathetic to the many legitimate needs of the country. It is, however, precisely because of these needs that monetary policy must continue to be on the guard against financial profusion. The financing gap which is so clearly illustrated by the macro-economic data presented here today, calls for financial prudency, and not for extravagance.

I have noted with interest that the European Community has provided an amount of Ecu 6,2 million for a voters education programme in South Africa. Has the time not come also for a financial and technical contribution towards a similar programme for the enhancement of economic literacy in the country? For without a better understanding of the limits and constraints of macro-economic potentials, the disappointment of unrealistic economic expectations could easily become the most important threat to the survival of the new democracy in South Africa.