STRUCTURAL ECONOMIC REFORM IN SOUTH AFRICA:SOME INTERNATIONAL COMPARISONS

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From the early 1970s the need for structural economic reform became evident across the world with the growing realisation that Keynesian-style macroeconomic stabilisation policies were inadequate to ensure sustainable economic and employment growth (Van Bergerijk et al 1999: 1).

The extensive literature on structural economic reform deals with three topics, *inter alia*, namely: contents, sequencing, and political economy aspects (see Van Bergerijk et al 1999: 8 and Williamson 1990, 1994a and 1994b). In the sphere of policy design and implementation, the ultimate issue is the results of reform and, by implication, the correctness or appropriateness of the policy mix. Impatience with results and the speed with which results are achieved is universal, especially if political promises clash with credible economic policies.

Structural economic reform in South Africa gained prominence and momentum after the constitutional change in 1994. By the turn of the millennium, increasing impatience and dissatisfaction with the results was mounting amidst international disappointment with the impact of globalisation on various non-industrial countries and on certain groups within countries. Doubts have been cast over the contents and/or speed of structural economic reform in South Africa.

Against the backdrop of theoretical considerations and benchmarks, this paper seeks to explore the nature and adequacy of structural reform in South Africa, by comparing the South African experience to that of a sample of countries consisting of Australia, New Zealand, Malaysia, Chile and Argentina. The sample thus constitutes countries that exhibit, individually or in sets, characteristics that feature regularly in the South African debate about economic performance. The sample includes: small open economies; emerging market and industrialised economies; countries with colonial legacies; multi-ethnic or -racial communities; autocratic/dictatorial and democratic styles of government; non-resource poor economies; countries enjoying temperate and tropical climatic conditions; geographical features of long coastal borders, desert, mountains and long distances from major markets; pre-reform experiences of major domestic political and/or economic crises; reform experiences covering a wide time range; gradualist and "big bang" reform approaches; mixed successes (but no major failures); strong regional ties with bigger economies; and countries with varying regional roles (although none that is expected to play a major regional leadership role).

The various country experiences are discussed under the following headings: reasons for reform, nature and results of reform, and appraisal. The comparison is descriptive and the topics under review are not necessarily the same in each case. Salient features of the reform, rather than a standard list of issues or data, were the guiding principle in the selection of topics.

1. THEORETICAL PERSPECTIVES AND BENCHMARKING GUIDELINES ON STRUCTURAL ECONOMIC REFORM

(a) *Theory and guidelines*

The debate on structural economic reform has generated two sets of international best practice (IBP) guidelines (see Table 1). First, the Washington consensus (WC) guidelines entail economic liberalisation

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on the back of macroeconomic stability as a necessary condition for sustained economic growth, with the latter in its turn regarded as a necessary (though not sufficient) condition for sustainable poverty reduction and income redistribution in developing countries. Criticism mainly comes from economists in the structuralist tradition of development economics. They argue that social, institutional and economic institutions can exert a powerful

Table 1 Policy guidelines associated with the Washington consensus (WC) and the structuralist synthesis (SS)

Washington consensus guideline		**Structural synthesis guideline**	
Guide-line no	**Description**	**Description**	**Guide-line no**
WC 1	Fiscal discipline: operational budget deficits should be no more than 2% of GDP.	Low budget deficits and generally sound macroeconomic policy are desirables, but can be difficult to obtain.	SS1
WC2	Public expenditure priorities should focus primarily on primary health, education and infrastructure, and an adequate social safety net should be in place.		
WC3	Tax reform: tax systems should be broadly based with relatively low marginal tax rates.		
WC4	Trade liberalisation	Trade reforms based on tariffs are not necessarily superior to those based on a modified use of quotas.	SS2
WC5	Financial liberalisation	Financial liberalisation through increases in interest rates and removal of credit ceilings need not improve resource allocation, and can be seriously destabilising.	SS3
WC6	A single and competitive exchange rate (in real terms)	Changes in real macro prices - such as real exchange rates - are difficult to achieve.	SS4
WC7	Privatisation	Privatisation brings no obvious productivity gains, and foreign companies may be less effective at introducing technical change than national firms.	SS5
WC8	Deregulation	Labour market deregulation may reduce wages and boost exports in the short term, but at a cost in terms of long-term growth.	SS6
WC9	Encouragement of foreign direct investment (FDI)		
WC10	Secured property rights (legal systems should ensure adequate property rights)		
		An educated, healthy and well-paid population is necessary for productivity growth.	SS7
		Flexible and institutionally appropriate channels must be created for flows of information and credit between public and private actors as part of an active industrial policy.	SS8
		Policy changes need to be devised and sequenced in the light of each economy's historical and institutional context.	SS9

influence on the way in which (policy) instruments work, perhaps even undermining the effectiveness of measures that might be regarded as the obvious ones to apply in the context of a developed country (Weiss 1995: 5). The implication is that market-based solutions may not always be effective and that direct controls and interventions may be required from time to time. The 1997-1998 international financial crisis is indicative of the need for improved (financial) market regulation.

An outline of policy guidelines associated with structuralist thinking was compiled by Weiss (1995), who labelled them the structuralist synthesis (SS). These “rules” of the game are arranged in Table 1 so as to place best practice SS guidelines in the same row as best practice WC guidelines that deal with the same topic. Each set of guidelines also contains themes not covered by the other set.

Both sets of guidelines emphasise the importance of macroeconomic stability and, in particular, low budget deficits. Structuralist models often see a useful role for direct measures. Key areas of

disagreement between the WC and SS guidelines are trade liberalisation (or trade reform), privatisation and foreign investment, financial liberalisation and labour market deregulation.

(b) Sequencing

From the diverse experiences of many countries after the early 1980s, a picture emerged of the "best" sequence of economic reform that could be associated with successful structural economic reform. It became apparent that the best reform programme could fail or underperform if steps are taken in the wrong order. If, for example, financial liberalisation takes place too early, it may harm the process of trade liberalisation.

In assessing the reform sequence followed by the countries in the sample, the reference will be to an outline by Weiss (1995:265-267), who suggested the sequence in Table 2 as the ideal sequence of reform - the link to the WC guidelines is unambiguous.

A structural reform programme that meets with IBP according to the WC, will thus be of the form a-b-c-d-e-f. None of the sample countries or South Africa have complied with IBP sequencing. When the country experiences are discussed, the policy sequence will be identified with reference to these numbers.[2] Depending on the chosen policies, some of the numbers may not appear or may appear more than once.

Table 2 The Weiss chronology of the ideal sequencing of structural economic reform

Sequence number	Reform category	Policy focus
a	Macroeconomic measures of stabilisation	Particularly in terms of expenditure restriction and exchange rate adjustment
b	Reform of domestic commodity and labour markets	Removing price and wage controls and phasing out subsidies
c	Tax reform	Broadening the tax base and rationalising many taxes
d	Trade reform	Removal of quotas and reduction of tariffs plus further exchange rate adjustment
e	Domestic financial liberalisation	Removing or raising interest rate ceilings and loosening restrictions on commercial bank activity
f	External financial liberalisation	Removing controls on capital inflows and outflows

There has also been a debate about the speed of reform. Countries such as Bolivia (1985-1986), Poland and Russia (both in the early 1990s) (Gillis et al 1996: 117-118, 126-127) and New Zealand (in the 1980s - see Section 2(b)) have chosen a rapid transformation or "big bang" approach. One reason is the political advantage of speed, which gives dissident pressure groups less time to mobilise opposition. Other countries have opted for a more gradualist approach in recognition of the realisation that there will be more economic advantages if resource reallocation is allowed more time to adjust to a new set of prices and incentives, with less loss of income through transitional unemployment, than in the big bang approach. A risk is that restructuring fatigue may set in and that the slow progress towards improved results may cause impatience and disillusionment, leading to the abandonment of the reform programme.

(c) Political economy aspects

A number of hypotheses and issues present themselves (see Williamson 1994a: 11-28). Regarding the initiation of reform, the *crisis hypothesis* argues that public perception of a crisis is needed to create the

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2 These sequences are derived from a more detailed investigation by the author of the nature of structural reform in the countries concerned.

conditions under which it is politically possible to undertake extensive policy reforms. The contrasting hypothesis is the *mandate hypothesis*, whereby a government may be able to introduce reforms if it campaigned on a programme of reform in the preceding election.

As far as the implementation of reform is concerned, success tends to be assessed in terms of questions such as:

- What is the importance of the presence at the top of a political leader with a vision of history, someone who is not unduly concerned about being reelected (that is, the factor of *political leadership*)?
- Does the existence in government of a team of economists matter, possibly headed by a technopol (that is, the role of *economists*)?
- Is the existence of a comprehensive programme for transformation of the economy and a rapid timetable for implementation a necessary requirement (that is, the importance of a *comprehensive programme*)?
- How crucial is the will and ability to appeal directly to the public and bypass vested interests (that is, the role of *vested* interest)?

2. STRUCTURAL ECONOMIC REFORM IN SELECTED COUNTRIES

In this section a brief overview is given of structural reform in the five countries to which South Africa is compared, with reference to the theoretical issues discussed in Section 1.

(a) Australia

Reasons for reform

Australian economic reform began in seriousness in 1983, when a deep recession was superimposed on long-term structural problems. From 1908 to 1980 Australia had one of the most protectionist trade regimes in the world, a reflection of the same inward-looking development strategy which characterised many countries in the first three post-war decades. The cyclical recession in the early 1980s was associated with what at the time was the largest increase in unemployment since the Great Depression. Inflation reached a cyclical peak of 11 per cent. However, there was none of the acute *sense of crisis* observed in Latin American countries, which experienced runaway inflation and huge capital outflows in the 1980s.

Nature and results of reforms

The major reforms were implemented during the period 1983-1990, with key directional changes introduced in the early to mid- 1980s. The reforms corresponded in many ways to, but predated the Washington consensus and had much more to do with the Hawke regime's sense of internationalisation as a way out for a retrogressing Australian economy, than the copying of a consensus set of IBP guidelines. In important respects, such as labour market reform, the Australian reforms deviated from the Washington consensus. The quid pro quo for union cooperation for the initial reforms was government support for the unions' preferred policies on labour market regulation and centrally determined employment conditions. The reforms did not end in 1990. On the contrary, after some lapse in the first half of the 1990s, significant adjustments followed during the rest of the decade, with privatisation, labour market reform and major tax reforms as prominent measures.

Salient performance results include the following:

- By mid 2000 the economy had recorded nine years of continual growth, averaging about 4 per cent per year, the longest expansion in the Australian economy since the 1960s, and a performance in many ways similar to that of the US.
- Macroeconomic stability was not achieved as a launching pad for sustainable growth performance in the 1980s. The underlying rate of inflation was only reduced to 2 per cent by 1992, after which inflation remained within the monetary target of 2-3 per cent towards the end of the decade. (Gruen and Stevens 2000: 44).
- In late 1989 the rate of unemployment was at a ten-year low, just under 6 per cent. It then rose to a peak rate (for the 1990s) of 11,2 per cent by the end of 1992 (Guern and Steven 2000: 43-45). By the end of the 1990s the rate of unemployment had declined to within sight of previous cyclical lows, although the average for the 1990s was still higher than any of the preceding four decades.
- One of the remarkable results was the *productivity growth*[3] in the 1990s, which returned to rates last seen in the 1960s. Productivity growth appeared to be related to improved use of information technology (IT), rather than the production of the component parts of the new economy (Gruen and Stevens 2000: 42), that is, *using* rather than *producing* IT.
- The increased openness of the economy to domestic and foreign market forces of competition has revealed a shift in comparative advantage. Essentially, Australia was changed from a resource-based economy to a manufacturing-cum-service economy. The product composition of exports changed a lot. For example, in 1986/87 (before tariff reductions started in seriousness), manufactures accounted for less than 14 per cent of merchandise exports. Since the mid-1990s this ratio was about 24 per cent (see EIU 2000b: 30-31).

Appraisal

Australia achieved great success with structural economic reform.

It would appear that neither the crisis nor the mandate hypothesis applied. (*Political economy: initiation of reform*)

The policy sequence of c-f-e-a-d-b (see Table 3) was not according to international best practice and rising inflation towards the end of the 1980s was attributed to premature financial liberalisation. The delay in the labour market reform and the lag in establishing macroeconomic stability reflect a tendency to accommodate some of the structuralists' criticism of the Washington consensus guidelines. The process was gradualist. (*Sequencing*)

No comprehensive programme of or timetable for reform was released. Implementation was ensured by *strong and committed political leadership* (from Prime Minister Hawke and Treasurer Keating), and multiterm incumbency by the same political party. Key vested interests, notably of trade unions, were not bypassed. There was close collaboration between Government and the *trade union movements*, of which Hawke was a leader before moving into politics. Trade-offs, particularly in the form of lagged labour market liberalisation, were concluded that ensured active or passive support for the reforms. The reform process enjoyed high credibility, therefore, a result which was strengthened by consistency in the implementation of the reform measures and rapid results in the form of early and sustained improvements in the economic performance. (*Political economy: implementation*)

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[3] Gruen and Stevens (2000: 37) uses the term "productivity" in the general sense of the word, but refers particularly to labour and multifactor productivity in the market sector of the economy.

Many of the *key liberalisation changes* had been effected by the time of the exceptionally good and sustained American economic performance of the 1990s. Australia was ready to capitalise on this. In a globalised world, this suggests the value of in-tune and pre-emptive structural change, so as to reduce the transmission lag between changes in the world economy and the national economy. (*Contents*)

The economy was effectively cushioned against external shocks by the system of *freely floating exchange rates*. This coincided with a new view that gained precedence over the traditional argument that a current account deficit (that is, the balance of payments) represents a constraint on economic growth irrespective of the cause of the deficit. The new idea was that fiscal policy need not correct for a current account deficit if the latter is the consequence of private sector decisions. In Britain this became known as the Lawson doctrine (after Nigel Lawson, the Chancellor of the Exchequer at the end of the 1980s) (see Bean 2000: 109). Towards the middle of the 1990s the current account deficit was no longer the counter image of fiscal deficits and the external liabilities were increasingly in the form of equity, rather than debt. Consequently, during the Asian crisis foreign investors used the Australia as a safe haven for international funds, notwithstanding the persistent current account deficit, which rose from 3,1 per cent of GDP in 1997 to 5,7 per cent in 1999 (EIU 2000a: 9). (*Contents*)

As with other successful countries, a key factor was the benevolent mixture of *correct, stable, predictable and consistent (macroeconomic) policies, strong political leadership and good luck* (Bean 2000: 110), the latter referring to the existence or occurrence of favourable external economic conditions. The time lag between policy and meaningful results could have been as high as 10 years. (*Contents*)

(b) New Zealand

Reasons for reform

Reforms began in 1984. As Australia, New Zealand was a highly protected and controlled economy, which had experienced a secular decline in economic performance over many years. And as Australia, the economic deterioration was aggravated when the UK joined the EC and the privileged access to the UK market was terminated. The economic data prior to the structural reforms explain the concerns. In 1983 inflation was 15 per cent, unemployment 5,4 per cent and real economic growth 0,4 per cent. The budget deficit-to-GDP ratio was almost 7 per cent and the trade deficit as a percentage of GDP amounted to 6,2 per cent. An immediate reform catalyst was the financial crisis in July 1984, when the newly elected Labour Party Government had to devalue the New Zealand dollar by 20 per cent (Hall 1999: 19).

Nature and results of reforms

Economic reform resembles the "big bang" approach. Most of the reforms, clearly resembling (and also predating the coining of) the Washington consensus, were effected between 1984 and 1987, with financial, exchange rate and foreign investment liberalisation leading the process. As in the Australian case, a Labour Government (led by David Lange) introduced the reforms, soon after its election in 1984. The driving force was the Treasury Minister, Roger Douglas, a trained accountant whose thoughts had become increasingly laissez-faire (although this was not reflected in the Labour Party's election manifesto) and who had the backing - at least in the first three years - of Lange (Williamson and Haggard 1994: 548). The short (three-year) term of office of a New Zealand government appears to have been an important factor in selecting the "big bang" route.

The reform sequence of e-f-b-d-a-c (see Table 3) almost reverses the Weiss chronology. Financial and exchange rate liberalisation led the way and fiscal discipline occurred almost at the end. In fact, the reform period was characterised by a generally tight monetary policy, coupled with a loose fiscal policy

(Bollard 1994: 78). Incidentally, public expenditure reform was judged to serve microeconomic efficiency, rather than macroeconomic stability (Bollard 1994: 76-77), although in 1991 and beyond the national Government was intent on solving the fiscal problem on the expenditure side, rather than raising taxes (Scott 1996: 75). Efficiency-driven reform in the public sector was later given a further major impetus with the introduction of the Fiscal Responsibility Act of 1994. Privatisation revenue played an important initial role in fiscal deficit reduction, but the unsustainability of this method resulted in a much longer period of fiscal adjustment. The aims of tax reform were base broadening, a shift from direct to indirect tax and tax neutrality.

The reform of the highly centralised and heavily regulated labour market had to wait until 1991, when the National Party government deregulated employer-employee bargaining arrangements (Bollard 1994: 80). The Employment Contracts Act aimed to replace this with a decentralised, more competitive wage setting system based on bargaining at the individual enterprise level, while removing compulsory unionism.

Trade liberalisation followed, rather than preceded financial liberalisation. “Premature” financial liberalisation has been criticised as one of the causes of the shockingly overvalued currency, such that “growth had no chance under the circumstances” (Williamson and Haggard 1994: 550). But when it came, the removal of protection of domestic industries and the drive down of domestic prices toward international levels were quite drastic.

A remarkable feature of the New Zealand reforms was the implicit bipartisan commitment to the reform agenda: when the fundamentally reformed National Party replaced the Labour Government in 1990, there was no major change in policy, indicating that the liberalisation effort had been consolidated (Williamson and Haggard 1994: 550).

Salient performance results include the following:

- The J-curve pattern of reform results is evident from the fact that initially there was no increase in real GDP per capita and unemployment, being traditionally very low (averaging around 2 per cent in the 1970s), rose to 11 per cent by 1992. By 1999 recorded unemployment was down to 6,8 per cent (EIU 2000d: 8).
- After sluggish growth until 1993, real GDP increased by 3,9 per cent during the ensuing upswing.
- Inflation, which had been between 10 and 20 per cent for two decades, was reduced from 15 per cent in 1986 to 1 per cent in 1993. Subsequently, it remained under control: the average rate of inflation from 1994 to 2000 was 2 per cent.

Appraisal

New Zealand was a pioneer country as far as structural economic reform was concerned. The results showed a J-curve pattern, because the initial results were not promising. Later on the reforms proved to be quite successful, although the results were less remarkable than in Australia, and more doubts remain about the sustainability of the results.

There was evidence of *crisis* conditions, namely the exchange rate devaluation of 20 per cent in 1984, on top of the restrictions to UK market access and deteriorating economic performance. (*Political economy: initiation of reform*)

The policy differed radically from the IBP rules which developed later. Wrong sequencing has been criticised for the overvalued currency at the end of the 1980s and, consequently, foregone economic growth. Labour market reform came right at the end, confirming the reform sequence as a

manifestation of the art of the possible. Basically a *big bang* reform process was followed, although there are also signs of a multistage reform process, stretched out over many years. (*Sequencing*)

No comprehensive programme of, or timetable for, reform was released. Strong political leadership ensured commitment to implementation. Capable Treasury staff played an important supportive role. The reform process became quite credible, driven by an urgency which emanated from the three-year term of office. Structural reform along market principles was shown not to be the prerogative of free-market political parties. On the contrary, a Labour Government (traditionally associated with interventionist policies) was able to deliver a much more conservative reform programme than the National Party which it had replaced. In retrospect, the delays in labour market reform and in achieving fiscal stability, might well have been important factors in the political credibility of the reform programme, in the sense that these delays served as shock absorbers for the social cost imposed by the other reforms. Political feasibility remains an important consideration in policy choice. Recently, some policy backtracking on the liberalisation route appeared when the current (Clarke) Government took office. (*Political economy: implementation*)

Reform-related positive results came with a lag of seven or more years. An important factor was the access to strong regional markets. The share of the manufacturing sector declined and new niche industries developed. Concerns are that the production and export base is not sufficiently diversified and that the reforms did not move the economy higher up the value-added chain. (*Results*)

(c) Malaysia

Reasons for reform

The need for structural reform arose less from the sense of a major or sudden crisis, than from the realities confronting a newly independent and relatively poor country, which did not generate sufficient employment opportunities nor an adequate growth margin to correct social imbalances that had accumulated over the long period of colonial economic transformation (Chee and Lee 1994: 163).

Nature and results of reforms

Three episodes of reform can be distinguished during the period 1957-2000, although the developing nature of the economy meant that reforms have been a continued feature.

The *second* of the above-mentioned episodes (early 1980 to 1997), which is the main focus here, commenced when macroeconomic stability was severely threatened in the early 1980s by the anticyclical fiscal measures to counter the recession. A twin deficit problem resulted: a federal budget deficit of 17,5 per cent of GNP in 1982 and a current account deficit of 14,1 per cent of GNP. Inflation jumped from 6,7 per cent in 1980 to 9,7 per cent in 1981. Having recognised the unsustainability of the situation, Malaysia undertook a voluntary adjustment programme in mid-1982, which was the closest that Malaysia came to an episode of structural economic reform, as experienced in other countries. Fiscal consolidation through budgetary control received high priority. By the end of 1987 the budget deficit had been reduced from its previous high of 17,5 per cent of GNP to 8,1 per cent of GNP - still a very stimulative fiscal stance - and the current account of the balance of payments had been turned into a surplus equivalent to 8,7 per cent of GNP. Four decades of reasonable control over inflation bear testimony to a long-standing commitment to macroeconomic stability.

Concerted measures were taken to reduce the role of government and encourage the private sector as the engine of growth. Owing to privatisation, amongst other things, the ratio of public-sector expenditure to GNP was reduced from a peak of 38,3 per cent in 1982 to 23,4 per cent in 1997. Although supply-side rigidities have basically been addressed through market-oriented measures,

government intervention continues to take the form of selective incentives in order to attract direct foreign investment and spur growth in the manufacturing sector. Customs-free industrial zones (especially for the location of international electronic companies) are an example. Fiscal incentives include tax holidays, investment tax allowance, reinvestment allowance and allowance for exports.

Of particular significance are the measures to improve equity in economic opportunities (or, in South African terms, affirmative action or employment equity measures). As a result of the entrenched political authority of the Malay-based party, UMNO (see Crouch 1996), Malaysia pursued a very active pro-poor programme. For example, almost all government assistance in *education* was directed towards the children of *bumiputera*[4] (EIU 2000b: 15). In the financial field, Malaysian banks are required to provide loans "at reasonable cost" to priority sectors - all *bumiputera* groups, low-cost housing and small-scale enterprises (EIU 2000b: 30). The share of *bumiputera* in equity ownership was increased over a period of 20 years from 2,4 per cent to 20,3 per cent. The *National Vision Policy* has the aim to increase this ratio to 30 per cent by 2010 (Malaysia 2001: 7).

Labour unions do not appear to have been major role players in the reform process and labour market regulation did not feature as an inhibiting factor. Generally speaking, cheap, highly skilled and educated labour is found at all levels of the economy, with migrant workers serving as a buffer for unemployment.

On a very broad canvass, the sequence during the *second episode* may be depicted as e-a-b-e-f (see Table 3), again a major deviation from IBP (as with Australia and New Zealand). Note, furthermore, that the second episode started off with an already liberalised exchange rate regime. It would be more correct, therefore, to depict the sequence as f-e-a-b-e-f.

Salient performance results include the following:

- Very fast economic growth (averaging per annum rates of 5,2 per cent in the 1960s, 8,3 per cent in the 1970s, 6,0 per cent in the 1980s and 6,8 per cent in the 1990s) (Bank Negara Malaysia 1999: 7) were recorded. The economy was hard hit by the contagion effect of the international financial crisis of 1997-1998, but showed remarkable resilience in its recovery. The real economic growth rates for 1997, 1998 and 1999 were 7,5 per cent, -7,5 per cent and 5,4 per cent, and in 2000 growth rates in excess of 7 per cent were predicted for the next three years (EIU 2000b).
- In the mid-1980s unemployment was relatively high due to structural changes in the economy. It actually reached a peak of 8 per cent during the recession of 1984-1986. Lagging the reforms by at least three to four years, unemployment started declining towards the end of the 1990s and into the 1990s, reaching 2,4 per cent in 1997.
- The very good growth performance went hand in hand with remarkable achievements in living standards and equity. The level of absolute poverty declined from 49,3 per cent of all households in 1970 to 6,8 per cent in 1997.
- During the last three decades of the previous century Malaysia industrialised rapidly. Between 1970 and 1999 the contribution of agriculture, forestry, logging and fishing to GDP dropped from 30,8 per cent to 9,8 percent, whilst the share of manufacturing increased from 13,4 per cent to 29,2 per cent. The share of services - the other growth sector - increased from 41,9 per cent to 54,6 per cent.
- The surge in importance of the manufacturing sector is even better demonstrated in the export field. In 1970 manufactures amounted to 12 per cent of total export. By 1990 the ratio had risen to 60,4 per cent (Chee and Lee 1994: 167). Nine years later manufactures accounted for almost 85 per cent of gross export earnings (EIU 2000e: 19).

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[4] Meaning sons of the soil.

- A remarkably high savings rate characterises the economy. For example, despite the Asian crisis, the savings-to-GDP ratio fell from 48,5 per cent in 1998 to only 47,3 per cent in 1999.

Appraisal

Malaysia had its share of crisis conditions during the 1980s (the second period of reform), although they were not as serious as the inflation- and debt-type crises experienced by many developing countries during the 1980s. They led to major structural reforms of the voluntary type (that is, without taking recourse to IMF and World Bank structural adjustment programmes). The Asian financial crisis of 1997 to 1998 presented a second external shock and brought another round of structural reforms. (*Political economy: initiation of reform*)

The gradualist reform sequence deviated markedly from IBP guidelines. Generally speaking, the main thrust was market-based, but selective industrial protection occurred and selective fiscal incentives were actively applied. Occasional recourse to exchange controls, and the strong reliance on them after the 1997-1998 crisis, constitute the most controversial element of policy. With the benefit of hindsight, the poor state of the financial (and, particularly the banking) system demonstrates that financial liberalisation did not occur under conditions of adequate financial prudence and market efficiency. In its application of selective incentives and recourse to non-market policies, the Malaysian Government paid more than lip service to the structuralist critique of the Washington consensus. (*Sequencing*)

There is a history of *strong leadership*, committed to economic reform and, in particular to economic growth (and able to draw on a community consensus in favour of growth). According to Hill (1997: 134), Malaysia was guided in the post independence period by pragmatic Malay-Chinese coalitions, in which the dominant Malay leadership viewed *economic growth with redistribution* as the key to advancement. The style of the four Malay Prime Ministers - especially its current, longest-serving leader, Dr Mahathir - has differed. But none has deviated fundamentally from moderate and pragmatic leadership, which in Hill's view must surely be regarded as one of the keys to the country's record as one of the most successful multi-racial countries in the developing world.[5] The political decision-making process was further strengthened by the advice of able technocrats and the government's authoritarian power to resist much pressure from below, and by the administration's sufficient independence of elite- level vested interests to resist many pressures from above (as argued by Crouch (1984: 35). The civil service had its origins in a competent system developed during the colonial period, in which the principles of autonomy, accountability, professionalism, and adequate remuneration were all reasonably well developed. The regular publication of five-year development plans added to transparency and consistency. (*Political economy: implementation*)

The results testify to a mixture of good policies, even though there were significant deviations from IBP sequencing and contents, and of good luck (that is, a favourable external environment). But to have been able to receive Japanese electronic companies, as Malaysia did at the time of the Plaza Accord, implied a measure of inner readiness. Furthermore, high export growth, supported most of the time by an undervalued currency and high ratios of savings and investment, as percentages of GDP, bear witness to strong demand and supply factors in the growth equation. (*Results*)

A J-curve pattern with a relatively short downward leg characterises the second episode of restructuring, in the sense that unemployment reduction lagged the reforms by at least three to four years. Sustainability of the results was hampered by various vulnerabilities in the financial and real sectors[6] of the economy, as exposed by the Asian financial crisis of 1997 to 1998. Future reforms are in the pipeline with a view to strengthening the endogenous economic growth ability (shifting the

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[5] Towards the end of the 1990s, the country's recourse to foreign exchange control, following Mahathir's condemnation of international fund managers, resulted in a loss of country credibility and stature in the international financial markets.

[6] The heavy reliance on palm oil and IT hardware signifies the relative narrow base of the domestic economy.

emphasis from increases in factor input to increases in total factor productivity), which can capitalise on a continued high saving-to-GDP ratio, despite the impact of the above-mentioned crisis. (*Results* and *contents*)

(d) Chile

Reasons for reform

Chilean reforms began in 1973 and also constituted a break with import substitution as industrialisation strategy. By the end of the 1960s the economy was dominated by a large and intrusive public sector and had experienced almost 20 years of inflation in the 30-40 per cent range. Price controls disguised the higher true inflation rate. The moment these controls were lifted in the early stages of the reform process, open inflation rose to 1 000 per cent per year.

The Chilean isolation from the world economy reached its peak during the Allende years. By September 1973 the average nominal import tariff was 94 per cent, while a host of nontariff barriers was also in force. By 1973 macroeconomic populism had resulted in a public-sector deficit of 24,7 per cent of GDP. In 1972 the current account of the balance of payments recorded a deficit equivalent to 3,9 per cent of GDP and by August 1973 the central bank, which also had to finance the budget deficit, had exhausted its foreign exchange reserves. The country had become "probably the worst performer of all in Latin America", was "... experiencing great instability and institutional crises, and nearly faced civil war" (Büchi 1996: 1).

Nature and results of reforms

Structural economic reforms were very comprehensive and far-reaching, and coupled with incisive (albeit nondemocratic) political reforms. Of all the countries in the sample, the turn-around in the Chilean economic system was probably the most dramatic. A classical free-market economy replaced a highly statist and regulated one.

The reforms were a blend of "big bang" and gradualism. The speed and radical nature of the initial reforms in the Pinochet years had a "big bang" ring to them. The subsequent continued process of reform until 1989 and the correction for weaknesses revealed by the financial crisis of 1982-1983, reflect gradualism. These three phases are discussed below.

The first-phase reforms (1973-1982) entailed a medium- and long-term economic strategy drawn up by a group of economists trained in US universities, the so-called Chicago boys (EIU 2000c: 23). Major structural reforms were oriented towards a more open, competitive, private-sector-driven and price-deregulated market economy. Measures entailed: privatisation; the dismantling of the protectionist state; changes in the regulatory framework to make it consistent with a more open and competitive economy; trade liberalisation; reforms in the tax, financial and social security systems; and overall market liberalisation. The reform sequence of f-a-b-d-e-c was not entirely unconventional in terms of the later conceived wisdom of the Washington consensus, but the kick-off with external financial liberalisation invoked a lot of criticism. Besides, the overvalued real exchange rate, backward wage indexing and – during the early 1980s – tariff reduction backtracking, were out of line.

The Allende legacy was one of a rigid labour market, with high minimum wages, complex dismissal procedures and high dismissal cost. Reforms basically started in the late 1970s, aimed at effecting the adjustment required by the other structural reforms and introducing labour market flexibility so as to reduce the high unemployment rate.

In the fiscal field, tax reforms shifted the burden of taxes from production to consumption. A major social security reform (in 1981) established a fully funded private pensions system. This led to a steady increase in domestic savings and the development of the local capital market.

Major reforms were implemented in the financial and real sectors of the economy. Coupled with a large devaluation, the multiple exchange rate was converted into a unified rate (finalised in August 1975). Nontariff barriers were eliminated and the tariff structure was unified - the average tariff rate was reduced from 90 per cent to 10 per cent. At that stage only the *domestic* financial sector was liberalised. International capital flows remained strictly limited until 1979.

In the initial years the authorities did restore some macroeconomic stability through restrictive monetary and fiscal policy, but they did not get inflation entirely under control, as it remained at double digits. Macroeconomic stability was *not* a first step in structural economic reform. The initial results were not very encouraging as far as unemployment was concerned, because it remained very high (depicting a J-curve pattern of structural economic reform).

Two episodes retarded the achievement of early results. *Firstly*, in 1975 Chile suffered a severe external shock when copper prices fell by 45 per cent in real terms, the price of oil rose by a factor of three and access to international capital markets was virtually closed to the Pinochet government. The *second* episode was the external financial crisis 1982-1983. Important lessons were learnt from the 1982-1983 crisis. Some of the reforms, especially those related to financial liberalisation, were naively conceived and/or inappropriately implemented. Little consideration was given to initial imbalances and the appropriate speed and sequencing in reform implementation. Macroeconomic instability clearly impaired the sustainability of the economic performance. Finally, the lack of flexibility in the real exchange rate, in combination with the wage policy of backward indexation, proved to be costly. Subsequently, the exchange rate dispensation became more flexible and wage indexation was lifted in 1982.

The second phase of reform (1985-1989) occurred after the 1982-1983 crisis, which had let to some backtracking on the trade liberalisation route (import tariff increases). In the second half of the 1980s the structural reforms were reinitiated forcefully and more coherently. Import liberalisation was back on track and the current account deficit was managed by repeated exchange rate *devaluations*. Supplementing the contribution of foreign bank credit to finance Chile's external account imbalance, the IMF and World Bank were sources of finance for balance of payments purposes and structural adjustment programmes.

Fiscal adjustment entailed a number of things. The tax burden (as measured by the ratio of total tax revenue to GDP) fell from a high of 27 per cent in 1975 to 16,2 per cent in 1990, accompanied by a dramatic reduction of the share of direct (notably income) taxes. Owing to further privatisation, and the high rate of economic growth, the cutback in the size of government was such that VAT rates were reduced from 20 per cent to 16 per cent.

Importantly, economic policy shifted in favour of saving and exports (Corbo et al 1997: 53). Owing to the external shocks and the sharp recession in the early 1980s, the saving rate had fallen to 2,1 per cent of GDP in 1982. In the short run this was increased by an improvement in the public sector saving rate and the terms of trade; in the medium to long run, by the rate of economic growth. The rate reached a peak of 27,6 per cent in 1995. None of the government measures constituted special tax breaks. Export was promoted by means of the restoration of macroeconomic stability and the generation of a sharp real depreciation. There was a powerful supply side response to this from the trading sector, which had achieved large efficiency gains during the preceding period of real appreciation. As in the case of saving - and of Australia and New Zealand - *no special tax incentives* were given.

An important feature of the Chilean reforms was the social programme reforms (see Corbo et al 1997: 27-36). This explains why the country ranks internationally so much higher in terms of HDI (ie the Human Development Index) than per capita GNP. The first aim was to improve the welfare of the poorest groups of the population (ie provide a safety net). Successes were achieved in pensions, public education and public housing; less success was recorded with certain aspects of the health sector.

The third phase of reform occurred after 1990. High priority was given to overall macroeconomic equilibrium and control and the reduction of inflation. The foreign exchange regime was gradually liberalised during these years. Most of the structural reforms of the previous 15 years - many of which were sectoral and microeconomic in nature - were maintained or improved upon: trade reform was extended (with a reduction in the uniform tariff rate from 15 to 11 per cent early on in the Aylwyn term, and then to 9 per cent in 2000 - with lower rates applying in the case of free-trade agreements); new capital markets were developed and new banking laws promulgated; privatisation was continued; education reform was broadened; the judicial system was modernized and made more efficient; and integration with world financial markets increased. These reforms have been named "second- and third generation" reforms. Owing to the nature of the democratic process, inter alia, the structural economic reform process *slowed down* after 1990.

Reduction in poverty and the unequal distribution of income received priority. Measures included a tax increase equivalent to about 2 per cent of GDP to finance an equivalent increase in social expenditure. The democratic governments also increased minimum wages as a means of reducing poverty and income equality. There is empirical evidence, however, that 80 per cent of the reduction in poverty could be explained by the positive effect of economic growth, in the context of a relatively well functioning labour market, and only 20 per cent by the social expenditure programme (Larrañaga 1994).

After the international crisis of 1998, a number of further policy measures were taken (IMF 2000). In September 1999 the sliding exchange rate band system was abandoned in favour of a freely floating exchange rate. Monetary policy changed from targeting a year-end inflation level to targeting a continuous inflation range of 2-4 per cent. In the fiscal field the intention was to achieve a "structural" fiscal surplus of 1 per cent of GDP in 2001. Many microeconomic reforms could be listed as well, measures aimed at improving the efficiency of goods and factor markets.

Salient performance results include the following:

- During the second reform phase (1985-1989) an average real growth of 6,3 per cent was recorded, a rate evened or exceeded in all but two of the years from 1990 to 1996 (Büchi 1996: 22 (Table 10)). Despite a 1,1 per cent GDP contraction in 1999, real economic growth averaged 5,5 per cent per annum from1995 to1999 (EIU 2000e: 26).
- Real GDP per capita grew at an annual average rate of 5,6 per cent between 1990 and 1998 (Aninat 2000: 3-4).
- The rebound in the economy after the financial crisis of 1997-1998 testifies to its resilience and vindicates the choice of a flexible exchange rate system, free of central bank intervention (other than to smooth short-term fluctuations).[7]
- Since the mid-1980s, that is, with a lag of anything between 3 years (if the date of the labour reforms are taken as reference point) and 10 years (if the dates of the other major reforms serve as basis), there were real improvements with regard to job creation: employment increased by 4,1 per cent per annum and the unemployment rate fluctuated around 7,4 per cent (it actually dropped from 17 per cent in 1983 to 5,3 per cent in 1989 (Cáceres 1991: 22)). During the 1990s

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[7] Inclusive of the low growth years of 1997-1999, the average real economic growth during the 1990s was 6,4 per cent. The negative economic growth of 1,1 per cent in 1999 was followed up by a 5,4 per cent growth in 2000 (provisional estimate).

the average level of unemployment was significantly below the high levels encountered during the 1980s.

- The rapid rate of growth in exports (the engine of growth for the economy) and imports raised the international trade-to-GDP ratio from 29 per cent in 1973 to 56,6 per cent in 1995. Manufacturing exports as a percentage of total exports increased from 7,2 per cent (1973) to 42 per cent (1995), while a considerable diversification took place in terms of products, exporters and countries. (See Corba et al 1997: 16.)
- The surge in exports disguises the effect on employment and output in manufacturing. The contribution of manufacturing to the economy has fallen from 24,7 per cent in 1970 to 14,7 per cent in 1999.
- New sectors that have developed are cellulose, fruit, salmon (within 15 years this industry was established and developed into the second biggest salmon exporter in the world - Norway being number one), wines, methanol production and a variety of services, including tourism (EIU 2000f: 21).
- Poverty was reduced rapidly. The proportion of the population that lives in poverty was reduced from 44,6 per cent in 1987 to 24 per cent by the middle of the 1992 (Corbo et al 1997: 62) and 21,7 per cent in 1998 (Aninat 2000: 6)[8]. Similarly, reductions were also recorded in the income distribution inequality, especially if secondary income of households (that is, monetary subsidies and health and housing expenditures financed by the government) is included.

Appraisal

Without a doubt, the crisis hypothesis applies to structural economic reform in Chile. Political turmoil and the military coup into which it erupted, added to the crisis conditions. (*Political economy; initiation of reform*)

The reforms depicted a mixture of the *big bang* (first phase) and the gradualist approach (second phase). The sequence of f-a-b-d-e-c was not according to IBP guidelines (see Table 3). The main "error" was a premature financial liberalisation, which led to an appreciation of the currency (an overvalued currency), combined with the backward indexation of wages. In addition, although inflation was reduced dramatically in the early stage of reform, macroeconomic stability was not established as a point of departure. Very low inflation was only achieved 15 years after the first reforms were initiated. Chile recorded high economic growth without first reducing inflation to the low levels witnessed in New Zealand and Malaysia (and in Argentina below). (*Sequence; policy contents*)

Chile experienced strong leadership of a special kind. One view is that the absence of opposition or criticism (in a country in which the political process had been "brutally massacred" and political opposition wiped out), was the crucial factor in the reform results (Bradford 1994: 318-319). A kinder assessment is that in the Chile of the 1970s an authoritarian regime was a necessary condition for the type of reforms that were introduced. A view in support of this statement is that at the time public opinion, and especially the different groups, would not have allowed the implementation of the Chilean economic model under democratic rule (Corbo et al: 1997: 70). Given the autocratic birth of the reforms, it is of great significance, therefore, that a national consensus about the basic thrust of the Pinochet reforms surfaced when democracy returned during the 1990s. (*Political economy: implementation*)

[8] Without defining extreme poverty, Aninat (2000: 4) mentions that it fell from 12,9 per cent in 1990 to 5,6 per cent in 1998.

The political decision-making process was strengthened by a number of factors: the existence of a team of like-minded (sic!) economists (the "Chicago boys") who worked together in developing and implementing the economic reforms; the drastic institutional transformation that provided the reforms with *lasting power*; and a critical mass of technical people who can do the job in all its details (Büchi 1996: 4). The latter is probably one of the reasons why Chile still maintains a high standard of governance and is the least corrupt country in Latin America (EIU 2000c: 24). (*Political economy: implementation*)

Jadresic and Zahler (2000) conclude that Chile's rapid growth was essentially due to *good policies* and an improvement in the country's *political situation*, and not to good luck in the external sector. (*Contents*)

The Chilean reforms are widely recognised as a model of success, but errors were made in what at the time was a high-risk trial-and-error endeavour. A J-curve applied, with results taking anything from three to ten years to materialise. Backtracking in terms of the market-based model of IBP occurred along the way, but this was only temporary. The reforms entailed the development of new areas of comparative advantage under a policy regime that dictated greatly enhanced international competitiveness. The Chilean experience demonstrates that a resource-rich country, which does not enjoy major comparative advantages in manufacturing, can restructure successfully and gain competitive advantage in the supply of resource-based products in a knowledge- and information intensive global economy, despite the distance from markets. (*Results*)

(e) Argentina

Reasons for reform

Reforms in Argentina began in 1990, in response to the poor economic performance recorded during and after the debt crisis of the 1980s. Growth of real output stagnated, financial markets collapsed, prices rose as the currency steadily depreciated, and capital fled the country in pursuit of safer havens. Most public enterprises were running large deficits, and the external debt kept mounting. The central government, hampered by low tax collections and desperate for revenues, turned to the central bank for finance through the taxation of deposits and money creation. Inflation, which had risen gradually over the previous three decades, soared - reaching average annual rates of 2 600 per cent in 1989 and 1990. In the face of these developments, the banking system practically disappeared. Although it tried a number of times to bring inflation under control, the central government was unable either to balance its budget or to escape its reliance on inflationary financing. The hyperinflation of 1989 and 1990 finally provided the impetus for reform, which began with the Convertibility Plan of 1991. (See Pou 2000: 1.)

Nature and results of reforms

On taking office in 1989, the Peronist government of President Carlos Menem opted for what had become a more or less standardised success recipe: trade and financial liberalisation, privatisation and deregulation, and a number of other measures, *on the back of macroeconomic stability*. The reform sequence of d-a-e-c-b deviates in virtually all respects but one from the conventional wisdom, in that a very early step was the stabilisation plan, whereby the US$:Ps exchange rate was fixed on par and a currency board was established. These policy reforms pre-empted major reforms in the financial sector industry: a mix of liberalisation (the replacement of the public pay-as-you-go pension system by a system combining public transfers and private capitalization) and more stringent regulation (consolidation in the banking sector, reinforced by stricter regulations aimed at increasing resilience to external shocks).

Other structural reforms entailed the elimination of price and interest rate controls, the deregulation of most activities, a further liberalisation of the foreign investment regime, and the removal of most export taxes and quantitative restrictions on imports. In the fiscal field the Government increased consumption and income taxes and gradually eliminated many of the more distortionary taxes (such as

the one on exports). New and stronger laws increased the government's ability to control tax evasion, while accelerated economic growth increased public revenues. The government also reduced most industrial subsidies and encouraged the entry of new, often international, firms into the local market.

The Convertibility Plan of 1991, coupled with the instrument independence of the central bank (since 1992) (Pou 2000: 2), constituted the pivotal factors in the reform programme. The fixed exchange rate, the *de facto* elimination of monetary policy discretion and the reduction in inflation enhanced investor confidence and facilitated foreign capital inflow. The Plan's untouchability has been enhanced by the high degree of dollarisation of the financial system and the large dollar-denominated liabilities of both private and public sectors, which means that a devaluation will be very costly. Compared to the flexible exchange rate regimes in Australia and Chile, the Convertibility Plan affords Argentina less flexibility to adjust to external shocks, particularly if the fiscal position is unsustainable. The impact of the international financial crisis and the Brazilian devaluation of 1999 was a (test) case in point. The Argentine recession was deeper and seemingly longer, and the recovery slower and less robust, than in Chile, for example.

Appraisal

It is unlikely that the bitter and drastic medicine of the Convertibility Plan would have been taken, had it not been for the *hardship and magnitude of the preceding economic crisis.* Argentina demonstrates the absence of a mandate for reform in no uncertain terms. The policy somersault by Mendes was only rivalled by the strength of his leadership. (*Political economy: initiation of reform*)

The reforms had a *big bang* character, but did not correspond with the IBP sequence (see Table 3). The policies were unambiguously market-based, with macroeonomic stability as a key achievement in the early stages. Structural adjustment was facilitated by IMF loans and the accompanying conditionalities, especially in the fiscal field. The strict monetary rule of the currency board solved the inflation problem, but at the cost of economic (and policy) flexibility to adjust rapidly to adverse external shocks, especially in the light of the unsound fiscal position. Fiscal unsustainability arose more from the high amount of foreign debt, than from a high budget deficit. (*Sequencing*)

Although the reforms delivered two periods of good economic results during the 1990s, the ability to sustain it in the face of adverse external shocks or to recover rapidly after the shocks, remained unconvincing. Alleged reasons are the unsustainable fiscal position and regulated labour market and the fact that the reform measures were out of line with IBP guidelines. The country's higher exposure to the adverse impact of the Brazilian devaluation, compared to Chile, for example, together with the *de facto* overvalued currency due to the peg to the US dollar, resulted in an under-utilisation of its growth potential. High unemployment and extensive poverty remain major issues. The reform process has a long way to go, as suggested a few years ago by the then Managing Director of the IMF, Michel Camdessus (1997: 4), when he argued the need for a "second generation" of structural reform in Latin America, "... geared more toward achieving high-quality growth of a kind that will be genuinely sustainable over the long term in our globalizing world economy." (*Contents* and *results*)

3. STRUCTURAL ECONOMIC REFORM IN SOUTH AFRICA

Table 3 compares elements of the South African profile to that of the countries discussed in the previous section. To facilitate comparison, each factor is also indexed (the South African figure being equated to 100).

South Africa is the third biggest country according to land surface, the biggest according to population size and the fourth biggest according to GDP. Its population density is second to Malaysia and its per capita GDP is the lowest. It has the highest ethnicity factor in terms of the composition of the population, Malaysia being next in line. South African reforms are the most recent, although reforms did occur prior to 1994 as well. The reform sequence of all the countries deviate markedly from the Weiss chronology.

Table 3 Comparing South Africa to the sample countries

Factor		**South Africa**	**Australia**	**New Zealand**	**Malaysia**	**Chile**	**Argentina**
Land surface	Sq km (1000)	1 221	7 682	271	330	757	2 737
	Index	**100**	**629**	**22**	**27**	**62**	**224**
Population	Million (1999)	43	19,1	3,8	22,7	15,0	36,6
	Index	**100**	**44**	**9**	**53**	**35**	**84**
Population density	Number per sq km	35,2	2,5	14,0	68,8	19,8	13,4
	Index	**100**	**7**	**40**	**196**	**56**	**38**
GDP	US$ m (1999)	131	394	54	79	67	283
	Index	**100**	**301**	**41**	**60**	**51**	**216**
GDP per capita	US$	3 049	20 649	14 134	3 473	4 469	7 734
	Index	**100**	**677**	**463**	**114**	**147**	**253**
HDI	International ranking	103	4	20	61	38	35
Ethnicity factor		Very high	Very low	Medium	High	Low	Very low
Main years of reform		> 1994	1983-90	1984-87	>1960; 1980-87	1973-82	>1988
Reform sequence		a-f-d-e-c-b	c-f-e-a-d-b	e-f-b-d-a-c	e-a-b-e-f	f-a-b-d-e-c	d-a-e-c-b

Source: First five factors: EIU *Country Profile* and *Country Risk Service*; HDI: UNDP *Human Development Report*; Others: based on country discussions in this article.

Reasons for reform

The focus period is from 1994, the year of South Africa's change to full democracy, to 2000. The reasons for reform are to be found in at least three areas. The first was the *deteriorating economic performance.* Secondly, for decades *sociopolitical factors* in the form of apartheid legislation and government regulations had limited – if not prohibited – the active and unrestrained participation of the entire population in the market economy and constrained the development of human skills to participate competitively. From this perspective, the need for reform corresponds to the description in Section 2(c) of the Malaysian experience at the time of independence: a need that arose … from the realities confronting a … country, which did not generate sufficient employment opportunities nor an adequate growth margin to correct social imbalances that had accumulated over … (a) long period. The third factor necessitating reform was the discontent with the *received economic system,* of which the appropriateness was under fire, fuelled by the domestic and international condemnation of the political system.

Nature and results of reforms

Structural economic reform occurred against the backdrop of a long history of extensive government intervention in and distortion of the economy. The South African story of industrialisation (the long reliance on import substitution and the more recent shift to an export-driven approach), of Keynesian-style stabilisation policies, of price controls and extensive regulation of goods and factor markets, and of inefficient government business enterprises, matches the experience in the comparator countries.

Before the change of Government in 1994, there was great concern that the future economic system would entail heavy government intervention and that the new government would resort to

macroeconomic populism. The style of ANC-related documents and wild political statements in the build-up to the first post-apartheid elections strengthened the fears. Between 1990 and 1992 six documents emanated from organisations which had formal or informal associations with the liberation process. The populist character of some of the documents and the absence of unambiguous political direction about the likely future economic policies, added to the expectation of populist economic policies. In the business and international financial world the fears of populism were eventually laid to rest by the publication of the Government's macroeconomic strategy on growth, employment and redistribution (*GEAR*) (RSA 1996a) and the track record of economic policy (especially macroeconomic policy) since 1994.

Table 4 Sequence of a selection of South African economic restructuring policies since 1993

Date	**Reform category**	**Policy measure**	**Weiss's chronology step**	
			✔	✕
Through-out period	Macroeconomic measures of stabilisation	High real interest rates (generally speaking)	A	
17 March 1993	Macroeconomic measures of stabilisation	First in series of budgets aimed at reducing budget deficit, which fell from 8,5 per cent of GDP in 1992/93 to 2,5 per cent in 2000/01	A	
13 March 1995	External financial liberalisation	Abolition of financial rand and start of process of gradual phasing out of foreign exchange control	F	
1995 and beyond	Trade reform	SA signing of WTO agreement on trade liberalisation in January 1995; multiyear implementation period	D	
1995-00	Domestic financial liberalization	Various measures to continue domestic financial market liberalisation started in 1980s; after 1995: enhanced market entry (with permission in 1995 to foreign banks to open branches in South Africa); development of new markets (eg a formalised gilt market and further development of market for financial derivatives); introduction/development of new financial instruments (eg commercial paper, equity options and futures contracts; continuous deregulation of the Johannesburg Stock Exchange; replacement in March 1998 of Bank rate with a more market-related repo rate; etc.	E	
1995	Reform of domestic commodity and labour markets	Promulgation of Labour Relations Act, legalising collective wage bargaining at sectoral level		b
1995-00	Tax reform	Various tax measures to broaden the tax base; increase (and later decrease) in marginal personal income tax rates; increase in tax burden; lower company tax rates	C	c
1998	Reform of domestic commodity and labour markets	Promulgation of various labour Acts to protect workers' rights, legalise affirmative action, reduce wage gaps and institute a training levy on firms		c
Nov 1998	Domestic financial liberalization	SA offer on financial services liberalisation made to the WTO	E	
1998-2000	Reform of domestic commodity and labour markets	Gradual, but slow start in privatisation actions	B	

Table 4 presents the most important policies in terms of the Weiss chronology using the alphabetical characters listed in Table 2. If the nature of reform corresponds to the Washington consensus, the character appears in the ✔ column. If not, it appears in the ✕ column. Measures that do not feature in the chronology, but are important components of IBF guidelines, are added.

An important anchor of the process of economic reform was the Bill of Rights of the new Constitution (RSA 1996b). A market-based economic system is enshrined in which individuals are reasonably free to engage in economic activity when, where and how they please. In this sense, the Constitution may be viewed as the arbitrated settlement of the debate about an appropriate economic order for South Africa. By binding future governments to policies that preserve a market-based economy, the constitutional provisions discourage policy inconsistency and "suicidal" levels of government intervention in economic activity. The constitutional establishment of an instrument-independent South African Reserve Bank (SARB) strengthens these provisions. On their own, however, the constitutional provisions are not sufficient conditions for a market economy. The ultimate test is performance in terms of sustainable growth, employment, equity and poverty reduction.

Structural economic reform has been gradualist in design and implementation. The main political figure was President Thabo Mbeki, the custodian for the development of *GEAR* when he was still Deputy-President. The Finance Minister, Trevor Manuel, bought into the strategy, and his determination to effect fiscal discipline became an anchor of the economic strategy and a target of rather severe criticism from especially the labour union movement. A lack of coordination within government characterised the implementation and signals the absence of a strong political leader driving the process, as in New Zealand and Chile, for example. The strongest support was in the National Treasury, where the medium-term expenditure framework and the annual Budget Policy Statement became important instruments of coordination and consistency as far as fiscal policy was concerned. South Africa cannot claim, however, to have fielded the same strong teams as Chile, New Zealand and Malaysia. At the same time, the changes were nor as dramatic and abrupt as in Chile and New Zealand.

The essence of the economic strategy is to secure macroeconomic stability as a necessary condition for sustained economic growth and job creation, with the latter as a necessary, though not sufficient, condition for sustainable poverty reduction and income redistribution. The reform sequence of a-f-d-e-c-b is as out of line with IBP as in the other sample countries. An intended increase in labour market flexibility was a feature of *GEAR*, the aim being to increase the labour absorption capacity of the economy. However, labour market deregulation was not only absent; it actually went the other way. Progress with privatisation has been very slow, due to strong activist opposition from the main trade union, Cosatu. However, the opportunities for privatisation in South Africa were arguably less that in Chile or even Malaysia and New Zealand, where the involvement of government enterprises in various economic activities in the pre-reform period had been far more extensive. In South Africa, mining and banking were never in government possession, for example.

Industrial and export development constitute an important dimension of the reform programme. Key factors in enhancing South African competitiveness have been the tariffication and import tariff reduction agreements with the WTO, the lower inflation rate, lower company income tax, a new competition policy, and selective government incentives to promote investment and employment. In the latter respect, the South African industrial policy shows closer resemblance to the Malaysian approach, rather than the Australian, New Zealand and Chilean policy of minimum government intervention.

Next, salient performance results are discussed.

The secular decline in economic growth experienced during the past three decades (1960-1990), may have been turned around. It is debatable, however, whether the higher growth can be attributed to major capacity building on account of measures of structural reform, or the mere improved utilisation of existing production capacity. Investment in production capacity is not taking place at an alarming rate. In 2000, gross fixed capital formation, expressed as a ratio of GDP, amounted to 14,9 per cent – along with the figure for 1993, the lowest in the past 15 years. This compares poorly to all the sample countries, except perhaps Argentina. The gross capital formation-to-GDP ratio in South Africa not

only deteriorated sharply after recording a rate of 28 per cent in 1980. International comparative figures for 1998 show that the country was being outperformed all over the place.

The performance of the reforming South African economy shows no J-curve pattern regarding economic growth, possibly reflecting the gradual (and relatively non-dramatic) nature of the reforms and the positive impact of the cyclical upturn which began in 1994. While reformed economies such as Australia, Malaysia and Chile could reap the benefit from the strong growth in international trade during the 1990s (the "good luck" hypothesis), South Africa did not share in this to the same extent in terms of high economic growth, because of its late start with and the gradualist nature of the reforms. The drawn-out negotiations on a trade agreement with the European Union demonstrated how tough it is to gain access to major markets, an experience shared with Australia, New Zealand and Argentina. By the end of the 1990s backtracking pressures were mounting in South Africa, as evidenced by growing domestic support of anti-globalisation demonstrations and anti-privatisation labour union strikes. At the time of writing, substantive labour market deregulation was still not forthcoming.

The economic growth rate averaged 2,7 per cent per annum from 1994 to 2000 and is still far below what is needed to arrest the rate of unemployment growth, let alone reduce the rate or the level of unemployment. From 1995 to 1999 the unemployment rate (using the official definition of unemployment) increased from 15,8 per cent to 23,5 per cent (Roux 2001: 3). This is by far the poorest result of all the sample countries. The only sector in which a significant growth in employment occurred, was in trade (inclusive of catering and accommodation services) (14,4 per cent). In the private sector the high non-wage cost of labour was an important factor in the reduced labour absorption rate of the economy. Labour productivity increased by an average annual rate of 4,5 per cent from 1993 to 2000, but this could be attributed to the reduction in jobs rather than enhanced labour skills.

The delay in labour market deregulation reflects a trade-off in favour of higher wage and non-wage cost and employed worker protection, at the cost of increased employment. Contrary to Australia, this trade-off was not accompanied by a passive, let alone active, support of the reform agenda (as manifest in *GEAR*). Recent measures aimed at increasing employment, such as the wage incentives announced in the 2001/02 Budget (RSA 2001: 76-77), may make sense from a politico-economic point of view (ie managing the poor employment performance of an economy with strong dissident labour unions). An alternative view is that such measures are a poor substitute for deregulation of the type that addresses the cause of labour market inefficiency at source. The low skills level, coupled with emigration of and early retirement of highly skilled workers, adds to the skills constraint and hampers the outward shifting of the production possibility curve.

In 1993, for the first time in 19 years, inflation moved into single-digit territory, when it fell to 9,7 per cent. Although major progress was made in improving macroeconomic stability in the first few years of the period under discussion, the return to stability was more gradual than in Argentina and Chile (whose instability was of course much more severe to being with) and more akin to the Australian experience. The inflation target range of 3-6 per cent, to be met for the first time at the end of 2002, testifies to a continued higher inflation tolerance than in all the sample countries. Comparatively speaking, the South African track record with regard to macroeconomic stability is satisfactory, but not spectacular.

Changes in the structure of the economy are shown in Table 5. The declining share of manufacturing (and the secondary sectors) resembles the same pattern of "deindustralisation" during the period of structural economic reform that could be detected in some of the other countries. The exception is Malaysia, where the major growth sector was manufacturing. The South African growth sectors have been that of financial services and of community, social and personal services, a pattern discernable in the sample countries as well.

Table 5 Changes in the sectoral composition of GDP in South Africa, 1970-2000

Kind of economic activity	**Gross value added, as % of GDP (current prices)**			
	1970-79	**1980-85**	**1986-93**	**1994-00**
Primary, of which	**19.2**	**19.8**	**14.1**	**10.4**
Agriculture, Forestry and Fisheries	7.1	5.3	4.7	3.8
Mining and Quarrying	12.1	14.5	9.4	6.6
Secondary, of which	**29.3**	**30.2**	**29.5**	**25.9**
Manufacturing	21.8	22.0	22.4	19.7
Electricity, Gas and Water	3.1	3.6	3.9	3.2
Construction	4.4	3.7	3.2	3.0
Tertiary, of which	**51.6**	**50.0**	**56.4**	**63.7**
Trade	12.9	12.0	13.6	13.6
Transport, Storage and Communication	9.3	8.5	8.7	9.4
Financial Services	12.9	12.5	14.4	18.1
Community, Social and Personal services, of which	16.4	17.0	19.6	22.6
General Government	10.8	12.0	14.7	16.8
Other Services	1.7	1.7	2.0	2.8
Other Producers	4.0	3.3	3.0	2.9

Source: South African Reserve Bank *Quarterly Bulletin*.

Since 1994 exports in real terms grew faster than 5 per cent per annum in all but two years, thus signifying a demand factor of rising importance. There is some evidence that trade liberalization and increased trade with the rest of the world have induced a structural change in production towards capital-intensive sectors. This shift is paradoxical as the high unemployment and abundance of unskilled labor in South Africa suggest that the economy should become less capital intensive as it adapts towards the relative labor abundance. These results also help explain why the manufacturing sector has not seen any major job creation despite the rapid growth in exports. (See Lewis 2001: 61-62.)

Socioeconomic demands, poverty alleviation and the reduction of severe income inequalities have largely been addressed by a systematic reprioritisation of government expenditure between and within functions. Delivery problems remain, but in areas like water supply and primary health services, major advancements have been made. Furthermore, the after-tax income distribution was improved by giving significant tax relief in the lower- to middle-income range. The reduced budget deficit and public debt were important factors in the reduction in inflation and interest rates, with the consequent reduction in the debt service burden of government. This created further scope for expenditure reprioritisation.

Despite the platform of improved macroeconomic stability, long-term growth and employment projections do not hold the prospect that the future economic performance will be better than (say) before 1985 or make a dent on unemployment. Moreover, South Africa is still trailing countries like Australia, New Zealand and Chile regarding the efficiency and consumer benefits from more flexible labour markets, deregulated domestic goods markets (in which privatisation plays a role) and efficiency in the delivery of government services.

Appraisal

Based on theory and the experience of the sample of countries, a few assessments and observations may be presented about the experience with and further deployment of structural economic reform in South Africa.

Crisis conditions informed the reforms, but they were not of the same type as in Argentina and Chile (the crisis hypothesis). The crisis dimension of inadequate human development and poverty reduction corresponds to the Malaysian pent-up urge for development. The dimension of secular deterioration in economic performance corresponds to the Australian and New Zealand experience. (*Political economy; initiation of reform*)

As in the case of Australia and Malaysia, the South African reform was gradualist, which made sense in the light of the enormous amount of change that had to be effected democratically in a divisive society. There are signs, however, of restructuring fatique and mounting opposition. Generally speaking, the reforms deviated substantially from the IBP sequence and entailed a mix of market-based and interventionist policies. Some of the interventions correspond to the SS-guidelines listed in Table 1. On the back of improved macroeconomic stability, the new competition policy, together with tariff reduction and the lower company tax rate (since 1999), has enhanced performance and efficiency in the domestic markets. These measures, together with exchange rate depreciation, also benefited exports. Of late, the adoption of inflation targeting went hand in hand with greater exchange rate flexibility, thereby strengthening the ability to manage external shocks *via* the financial markets. Except for a CCFF loan from the IMF in December 1993, with its mild conditionalities and small World Bank project finance, no major recourse to IMF (or World Bank) finance was taken. Like Malaysia, structural adjustment has, therefore, been voluntary. Self discipline and policy discretion is preferred to externally imposed disciplines. One area in which South African policies deviated from market-based IBP guidelines, is in the labour market, where the suggested reforms were not forthcoming. (*Sequencing* and *contents*)

By not yielding to pressures for macroeconomic populism, the Government earned substantial policy credibility. The opposition by major labour unions (notably Cosatu) resulted in comparatively slow progress with regard to privatisation and almost no labour market deregulation. The South African government did not get the labour union support which their counterparts in Australia and New Zealand enjoyed. Since the sequence and contents of all structural reforms are exercises in political feasibility, a society gets what it wants. So far the South African choice has *de facto* been for a package of lesser or incomplete reforms, compared to those of the more successful countries in the sample. Since labour and product market reform are crucial microeconomic factors in enhancing efficiency and shifting the production possibilities frontier outwards, the potential growth performance will remain at a lower level until these reforms are also addressed vigorously. In the short to medium term, skills shortages are aggravated by emigration and poor educational outputs. (*Contents* and *political economy: implementation*)

Regarding implementation, certain role players, such as the Minister of Finance and the Governor of the South African Reserve Bank, generally took a strong line as far as the pursuance of macroeconomic stability was concerned.[9]. Fiscal policy and the medium-term expenditure framework provided direction and a measure of consistency in policy implementation, but the ad hoc nature of policies (eg in the tax field) and the lack of coordination and conflicting signals regarding the policy principles and direction between government agencies, have reduced the effectiveness of the reforms. (See Siebrits and Calitz 2001.) (*Political economy: implementation*)

South Africa has done well for a country emerging from a very complicated socio- and politico-economic history. Since it can take anything up to ten years before meaningful results are achieved, it would be imprudent, after “only” seven years, to write off the structural reform programme in South Africa as a failure. A better approach would be to address certain shortcomings in the process, an attitude already detected in the 2001 Budget Speech (RSA 2001). In all the sample countries the leading figures experienced periods of doubt and/or backtracking, but they did not permanently go off course. (*Contents*)

From the comparator country experiences it appears that sustainable economic performance was achieved on the back of macroeconomic stability, an efficient and credible financial system, effective public governance and increased total factor productivity. Two important factors need to be emphasised. Firstly, the value of a flexible exchange rate system, to act as a shock absorber for external shocks, and to maintain international real competitiveness, has been clearly demonstrated. The second

[9] Between 1994 and 2001 three Ministers of Finance (Derek Keyes, Chris Liebenberg and Trevor Manuel) and two Reserve Bank Governors (Chris Stals and Tito Mboweni) followed this line.

factor is that a successful social safety net and effective expenditure programme to reduce poverty and income inequalities are important ingredients of a successful programme of structural economic reform; in the medium to long run, however, these programmes cannot be substitutes for vigorous economic growth. (*Contents*)

Judging by the experience in the sample countries, it can take up to ten years to properly entrench new structures and policies. The reform process can in fact entail more than one clearly identifiable stage, as in Chile and Malaysia. Naturally, subsequent reforms tend to be less dramatic and more incremental, but are important nonetheless. *Second generation reforms* address matters such as the structuring of the right institutions, improving the administrative, legal, and regulatory functions of the state and addressing the incentives and actions that are required to have private sector development and to develop the institutional capacity for reforms (see Wolfenson 1999). They also include actions to improve governance and enhance the efficiency and effectiveness of social service delivery. The pervasive institutional reforms in Chile are a case in point. Looking at the South African experience, elements of first- *and* second-generation reforms are evident from the steps taken so far (see Table 4). The perspective of reform as an on-going and multistage approach is also clearly visible. In his 2001 Budget Speech (RSA 2001) the Minister of Finance was of the opinion that, having achieved macroeconomic stability, which is still a matter of some debate, economic growth was henceforth to be promoted primarily by microeconomic reforms to boost the supply side of the economy, rather than by demand stimulation. This latter category includes aspects of first- and second-generation reforms. (*Contents*)

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