

1991

After Apartheid: Correcting Economic Failure* (1)

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IN FEBRUARY 1990 South Africa embarked on political reform which abandoned the apartheid system while a negotiating process started to establish a representative legislating body. The specific laws which embodied apartheid have already been scrapped. Apartheid had far reaching implications for the economy since policy measures were aimed at maintaining and enforcing the system. The scrapping of the legal framework has not yet rippled through to the abolition of the administrative and institutional framework. In this regard the debate about economic reform and the restructuring of economic policy is of particular importance since it is about an evolutionary process which will shape the institutional framework of the economy. The Annual General Meeting of our Society is an appropriate occasion to raise some of the issues regarding this highly complicated debate.

1. International Aspects

One of the dangers of apartheid was its inward-looking philosophy which frowned upon outside views, particularly those of a critical nature. The present debate about the correction of past mistakes must be placed within an international framework. We were alienated because of apartheid, and at this juncture we could benefit substantially by taking cognisance of changing circumstances in the world economy.

The changing environment in eastern and central Europe (Ash, 1989) is of particular interest since these countries are also facing constraints imposed by a rigid political framework. The Bank for International Settlements (BIS) has recently reported on the problems and progress regarding economic change in eastern Europe (BIS, 1990 and 1991). A major problem

1991 SAJE v59(4) p372

in these countries, shared by South Africa, is the phasing out of a bureaucratic system which regulated the economy. The inhibiting effect of such administrative systems on economic progress is now becoming evident. The rapid phasing out of such rigid structures is imperative. The BIS (1990) explicitly demonstrated that modest reforms have limited success. Truu (1991) raised similar concerns regarding the USSR while Calvo (1987) emphasised the cost of hesitant reforms in Latin America. In the present environment of economic and political change, political parties or political leaders who fall behind could easily become irrelevant as has happened to Mr M. Gorbachev and Mr P.W. Botha.

Effective macroeconomic stabilisation policies during transition have been an important condition for successful economic reform in eastern Europe (BIS, 1991). Anti-inflationary monetary policies coupled with fiscal discipline and a particular sensitivity regarding the exchange rate are among the major areas which require special attention (BIS, 1991).

An issue closely related to stability and reform is the sequencing of liberalisation policies (Corden, 1987). This refers to the preferred ordering of policy measures as well as the relationship between trade liberalisation and macroeconomic stabilisation policies (Bhattacharya and Linn, 1988). The importance of the correct sequence will be discussed in more detail below, but at this juncture it suffices to refer to the extensive evidence on the experience of several countries particularly in the far East as discussed by Bhattacharya and Linn (1988) as well as Balassa (1991) and for Latin America as discussed in Papageorgiou, Michaely and Choksi (1991).

An important element in economic reform in eastern Europe is the development of markets (BIS, 1990). Markets are an integral part of economic and political liberalisation, therefore, deregulation and the establishment of institutional arrangements such as legal contracts to support the trading in goods and services as well as financial assets are important. The latter is of particular importance since financial assets are instruments through which macroeconomic policies affect the economic process. Although South Africa could still go a long way in terms of deregulation, we have the advantage of well established markets, and particularly sophisticated markets in financial assets. Our exposition in favour of markets is nevertheless not to be associated with the ideological support in favour of capitalism as for instance by Anderson and Bark (1988).

An important international development which will affect South Africa is the evolutionary change from a bipolar to a multipolar world (Rose-crance, 1990: 195-204). The immediate post World War II period could be described as a bipolar situation in which the US and the USSR dominated

1991 SAJE v59(4) p373

events. Moreover, the US held a key position in the Bretton Woods system of international trade and payments. The political and economic events in the developed as well as the less developed countries were to a large extent shaped by the interaction between these two world powers. They also determined the strains associated with the cold war which was an important element in world politics and economic bargaining during the 1950s and the 1960s (Van der Wee, 1986).

The multipolar world started with the rise of Japan as a new economic power and the post Second World War recovery of Western Europe. It gained momentum through the establishment of the EEC and the economic decline of the US during the 1960s and the breakdown of the Bretton Woods system during the 1970s. This process was enhanced by the oil crises of the 1970s and 1980 during which certain less developed countries adjusted more successfully than the major industrial countries to the changing economic circumstances. These successful new participants in world trade are today referred to as the newly industrialising countries and they are primarily in South East Asia, but certain Latin American countries could also be classified under this category.

The multipolar world is driven by economic performance as opposed to military power in the bipolar situation. Moreover, the multipolar world is a communications based society as opposed to the ideological driven bipolar world with its narrow focus on capitalism versus socialism. The multipolar world is characterised by competition and extensive international trade with worldwide linked markets supported by outward oriented trade policies. It is within this performance oriented and competitive environment with little respect for ideologically inspired systems that eastern Europe and apartheid have collapsed. The economic failure of these ideologically driven systems could no longer support their vast military and bureaucratic frameworks and they fell apart. The post-apartheid South Africa should be an integral part of this multipolar competitive world with its globally integrated markets where economic performance as opposed to ideological considerations determine the outcome of economic events. We should become part of this new international community, and its virtuous circle of economic progress.

2. Economic Failure

Several authors have claimed a direct relation between apartheid and economic progress. In many instances this hypothesis was presented as a simple relationship based on the argument of labour exploitation. Recently

1991 SAJE v59(4) p374

Moll (1990) reviewed this literature and demonstrated the lack of empirical support for these views. In similar vein Natrass (1990) contradicted the argument that apartheid had been conducive to economic growth. Lipton (1985) followed a different approach by concentrating on the major sectors of the economy and demonstrating that during certain periods apartheid benefited those market participants with political and economic power and consequently they favoured the apartheid system, but they lost their enthusiasm for the system when its benefits disappeared. This lack of support gained momentum as time progressed. The weight of the evidence is therefore turning against apartheid as an economic booster, and the critical assessment of the politically inspired decentralisation policy is adding weight to this argument as has, for instance, been demonstrated by Maasdorp (1990) and Dickman (1991).

The economic failure of South Africa, particularly during the 1980s, cannot be explained exclusively by blaming apartheid since there is also evidence of general economic mismanagement through monetary and fiscal policy (see for instance Strydom, 1973 and 1986). Moreover, Moll (1990) indicated that during this period the international economy also experienced a slowdown in economic performance. South Africa's economic decline was, however, worse than that of other countries. Measured in real GNP per capita growth from 1965 to 1989 her annual average growth rate of 0,8 per cent compares unfavourably with the weighted average of 2,6 per cent for the upper-middle-income countries. (World Bank, 1991). Compared with the OECD countries, our real GDP growth declined more pronouncedly from the 1960s to the 1980s, while our GDP growth followed a more unstable pattern compared with the OECD countries.

Against this background, and within the limitations imposed by our assumptions, we now embark on a short assessment of the economic performance of South Africa by concentrating on the major goals of economic policy such as real economic growth, inflation, employment and the balance of payments.

Real per capita GDP growth has followed a declining tendency since 1975, falling at a rate of 0,8 per cent per annum from 1975 to 1989. This tendency was somewhat reversed during the late 1970s but the decline gained momentum after 1980, viz. declining at a rate of 1,1 per cent per annum from 1981 to 1989.

Since 1983 employment in the non-agricultural sectors has fallen short of the population growth rate and this gap has widened since 1988. The process of employment creation deteriorated further as from 1989, posing a serious problem in terms of living standards and economic welfare in general.

1991 SAJE v59(4) p375

Real gross domestic fixed investment by the private sector has never recovered to its level of 1981 and since then till 1990 it declined at a rate of 0,9 per cent per annum. Apart from political instability and the discouraging effect of trade sanctions, the major reason for this poor performance is the high cost of investment. The depreciation of the rand and the import surcharge are important contributing factors. Between 1981 and 1991 the rand depreciated by more than 12 per cent per annum on a trade weighted basis. On top of this the fiscal authorities introduced a double digit import surcharge. The devastating effect of this on

investment expenditure is evident by the fact that South African investment expenditure is highly dependent on imports of plant and equipment.

Another important cost effect was the rapid rise in interest rates. Measured by the 90 days bankers acceptance rate, interest rates increased from 4 per cent per annum towards the end of 1979 to a high of more than 22 per cent per annum in January 1985.

Moreover, short-term interest rates portrayed a highly unstable pattern throughout the 1980s which is probably explained by the major contradictions which characterised monetary policy during this period. The monetary authorities applied a Keynesian approach but flirted with monetarism and displayed little understanding for the fundamental conflicting elements underlying these two approaches.

In these circumstances South Africa became a consumption rather than an investment driven economy. The sharp fall in personal savings as a percentage of personal disposable income from 12,7 per cent in 1979 to 1,3 per cent in 1990 bears evidence to this effect.

This behaviour pattern is not independent of the rising tax burden. Measured in tax revenue as a percentage of GDP (the tax ratio) the tax burden rose from approximately 19 per cent during the 1970s to more than 27 per cent in 1990. It requires little argument to conclude that the rising tax burden had to finance expanding government spending, particularly current expenditure which had to support a growing administrative and military burden which went hand-in-hand with the apartheid system. Real government consumption expenditure rose from approximately 13 per cent of GDP towards the middle of 1978 to more than 20 per cent in the first quarter of 1991.

The excess demand of the early 1980s, measured by large current account deficits, coupled with a weak currency played havoc with the inflation rate. Our inflation diverged markedly from that of our major trading partners, particularly during the 1980s. During the first quarter of 1984 inflation was 10 per cent up on the previous year and *it* accelerated to more

1991 SAJE v59(4) p376

than 20 per cent during the first quarter of 1986 whereafter it decelerated gradually and during the first six months of 1991 it was 14,7 per cent higher than the previous year.

In these circumstances the balance of payments evolved into a major constraint. Net capital inflows dropped towards the second half of the 1970s, and with the exception of 4 years, the 1980s recorded massive net capital outflows, reaching R6 208 million during 1988. The foreign debt of South Africa escalated from 21,3 per cent of GDP in 1980 to a high of 42,9 per cent in 1985 whereafter it fell to 19,1 per cent in 1990. The deteriorating balance of payment situation, the poor performance of the economy and political upheaval finally culminated in the debt crisis and the subsequent debt rescheduling.

3. Taking Many Actions Simultaneously

There is no simple solution to the economic problems in South Africa. One cannot reverse adverse developments by the stroke of a pen or a singular "big push" or for that matter a "kick-start" project. Our proposals on ways to reverse these economic failures are based on the assumption that we have to take action on many fronts. The most important challenge is to revive the economic growth process, therefore switching from the present vicious circle of expanding poverty to a virtuous circle of growth and development. Taking many actions simultaneously is aimed at reversing this process while eliminating growth constraints. This raises many policy issues and we concentrate here on macroeconomic policies. Microeconomic aspects are considered in section 3(c).

South Africa's monetary policy has made substantial progress in the last two years in the sense that our monetary authority subscribes to an internationally accepted intellectual framework which considers monetary policy as a major instrument to combat inflation while adopting ultimate and intermediate policy targets which are attained through market-related policy instruments. Fiscal policy is lagging behind and our exposition focuses on several proposals regarding fiscal reform. The evidence suggests that the typical Keynesian aggregate demand management policies which are associated with a growing share of government in GDP and which were easily defended under the apartheid regime are unlikely to be successful options in the new environment. In terms of the literature on public choice a rising share of government in the economy is associated with government failure (Buchanan 1979: 271-76). The evidence discussed above supports the international

1991 SAJE v59(4) p377

reaction against the typical Keynesian aggregate demand management policies which became closely associated with government failure (Levacic, 1990). Three elements in this debate are of particular relevance. The first is related to supply-side economics which raises the problem of cutting back the tax burden and the second is concerned with the control of government spending, while the third is about major reforms in the composition of public spending.

(a) Fiscal proposals

The three aspects mentioned above could be classified as fiscal proposals. Changes in government revenue involve delicate

political and economic issues as has been evident during the Reagan presidency when taxes were cut in terms of supply-side arguments but government failed in controlling the growth in public spending, therefore, ending up with escalating budget deficits. The problem with proposals regarding tax cuts is the lack of comparable international standards. This problem could be solved by following the West European tradition where closely interrelated economies within the EEC have been forced to harmonise their tax systems. South Africa has made progress in this regard by switching to a value added tax (VAT) which is currently applied in many countries, therefore, making international comparisons much easier. To participate in international markets, particularly capital markets, our tax rates need to be in line with those of our major trading partners. We can benefit from the advantages of international capital flows through investment only if our tax rates do not discourage capital inflows or distort the rate of return on capital *vis-a-vis* the rest of the world. Our corporate tax rate appears to be grossly out of line with that of our major trading partners. The growth in public expenditure is not a typical South African problem but because of the expanding pressures of the apartheid system the control of the growth in government spending was more difficult here than elsewhere. The monetarist approach of setting growth targets for monetary aggregates as policy objectives has been extended to a broader anti-inflationary policy framework by Vines, Maciejowski and Meade (1983) as well as by Brittan (1981). Targeting certain economic variables as a policy objective in the absence of any market incentives to control these variables effectively is an appealing argument, and the principle of monetary as well as exchange rate targeting has been adopted by most central banks in the Western World (BIS, 1990). The logic of this argument can be extended to fiscal policy by introducing targets for the growth in key fiscal variables

1991 SAJE v59(4) p378

such as the following: public expenditure on wages and salaries, administrative prices and current government expenditure. The targeting of the growth in these fiscal variables should be related to the inflation target which the Reserve Bank applies in deriving its monetary growth targets. This would make fiscal policy an effective instrument in controlling inflation. Moreover, this proposal integrates monetary and fiscal policy since they are both linked to the inflation target. This proposal would exert pressure on the public sector to control wage increases and it would also discipline administered price increases. We have often experienced gross inconsistencies between monetary and fiscal policies in the sense that under conditions of stringent monetary policy, public sector wage increases were far in excess of not only the current inflation rate but also of wage increases in the private sector. Moreover, stringent monetary policy has often been contradicted by large increases in administered prices such as postal tariffs, transport tariffs, hospital fees and the fuel price. Our proposal would eliminate these contradictions.

The targeting of public sector variables with the aim of cutting inflation has been applied in eastern Europe, particularly in Poland and Yugoslavia, where important success has been ascribed to these procedures (BIS, 1991). We are therefore confident that these proposals could play an important part in introducing discipline with regard to public sector spending, by committing government to an anti-inflation policy and integrating monetary and fiscal policy. The budgetary discipline of this proposal means that the Minister of Finance will have to report to Parliament on his success in attaining these targets just as the Governor of the Reserve Bank reports on the attainment of monetary targets.

In the past, fiscal policy was a major instrument for enhancing apartheid through decentralisation policies, regional development and constitutional development. Rough estimates indicate that the government budget allocates approximately R6 000 million per annum on the maintenance of apartheid structures. (See however Van der Berg, 1991.)

The restructuring of fiscal policy in terms of public choice goes far beyond the cutback of expenditure on apartheid structures. It is primarily concerned with major changes in the priorities regarding public expenditure (Van der Berg 1991). The 1989/90 State Budget, for instance, allocated almost 23 per cent of total expenditure to defence, security and custody. This relatively large number is a typical apartheid inspired public choice framework which cannot be maintained in the future. Fiscal policy has to change its apartheid face. The rhetoric on social upliftment which characterised the 1991/92 budget speech is a far cry from the fundamental

1991 SAJE v59(4) p379

changes that have to be made in reshaping government spending in terms of new public choice criteria.

(b) *Balance of payments*

The balance of payments constraint referred to under section 2 above can only be relieved by expanding our participation in world trade. International trade is well-known as a growth factor and in South Africa this pattern has been particularly evident since 1985, because the growth rate in exports in volume terms continuously exceeded that of real GDP.

During recent years economic development through export promotion became the favoured argument in the literature. Earlier research by Balassa (1981) which defended export-oriented development as opposed to import substitution has been expanded by Balassa (1991), Corden (1987), as well as Bhattacharya and Linn (1988). The weight of the evidence seems to be in favour of these outward looking or trade oriented policies. The success of trade oriented policies and thus trade liberalisation is dependent on two supporting elements, as has already been indicated above, *viz.* supporting macroeconomic stabilisation policies and a proper

sequencing of the liberalisation process. Stabilisation policies refer to effective anti-inflationary monetary policy supported by fiscal discipline while sequencing refers to the ordering of liberalisation policies. Trade liberalisation is a complex subject, comprising many interactions between the real and monetary sectors. Moreover, the process of liberalisation is closely related with social and political aspects. The outcome of the evidence in the literature is that trade liberalisation without effective macro-economic stabilisation policies is likely to fail as, for instance, discussed in Papageorgiou, Michaely and Choksi (1991). Furthermore, the evidence suggests that sequencing is highly important and Bhattacharya and Linn (1988) argue that the real sector should be liberalised prior to the financial sector. One could also stage a powerful argument supporting export promotion prior to import liberalisation.

Such principles to adhere to when opening up the economy is important not to repeat past mistakes in this regard. The liberalisation of capital flows and financial markets was the main thrust of economic policy as outlined in the Report of the Commission of Inquiry into the Monetary System and Monetary Policy in South Africa (De Kock Report). The importance of starting the economic liberalisation in the real sector was overlooked, while complementary actions in the domestic economy did not follow suit.

1991 SAJE v59(4) p380

The devastating effects of these contradictory policy procedures on the balance of payments has been illustrated above. The potential for expanding our trade with the industrial countries is almost self-evident but we must not overlook the importance of the southern African region. South Africa could make an important contribution in this regard while benefiting from the new wave of trade-oriented policies in the region. During 1988 the intra regional trade of Africa as a percentage of its trade with the rest of the world was almost 6 per cent compared with 25 per cent for the developing countries and 77 per cent for the developed countries. The potential for intra regional trade in southern Africa suggested by these figures requires no further exposition.

(c) Fighting poverty

Although the longer term patterns of income distribution has changed in South Africa, the gains from economic growth are likely to be distributed more unequally within the black population as indicated by McGrath (1990). Moreover, blacks in the modern sector are likely to gain more from the gains of economic growth. This emphasises the importance of employment creation, particularly in the formal sector of the economy. The significance of education and skills training is therefore evident (McGrath, 1990). These issues are closely related to the problem of fighting poverty which, apart from employment and education comprises issues such as housing, health care and welfare services (see World Bank 1990). Generally speaking the subject of fighting poverty falls into two sections, namely investment in people (housing, health care, welfare and education) and employment (informal sector as well as the formal sector). Although we do not overlook the importance of investment in people as an important source of fighting poverty, our exposition concentrates on employment. Education, health care and housing are probably the most critical areas in this debate. This subject is complicated by the fact that, in terms of international standards, South Africa's expenditure on education and health are respectable magnitudes. Unfortunately in their present forms these two systems are ineffective, discriminatory and wasteful. They require total reform and the introduction of a unitary non-racial education system is long overdue.

Employment creation for blacks through the informal sector has been encouraged during recent years as an important solution for the unemployment problem. Although we would not for one moment discourage informal sector employment, one cannot overlook the fact that this sector,

1991 SAJE v59(4) p381

in terms of its size, could only make a marginal contribution towards solving the unemployment problem. Two complementary proposals should be considered.

The first is the launching of big projects by government in expanding or upgrading the infrastructure. The growth rate of gross domestic fixed investment by public authorities has been declining since the 1970s since fiscal discipline was applied to this category of government expenditure as opposed to consumption expenditure. There is ample room for improvement in this regard. This does not imply that government itself should embark on these projects on a grand scale since many could be contracted out to the private sector. Infrastructural investment by government could, therefore, make an important contribution towards employment.

A second area of employment creation is through solving the land question. The land issue in South Africa is an emotionally laden question since it is closely interwoven with the deprivation of blacks through the apartheid system. International and domestic research confirmed that the very large agricultural units in the arable parts of the country are ineffective. Smaller agricultural units would be more productive (Dolny, 1991). We propose that the proceeds from privatisation be used by government in solving the land issue. Privatisation funds could be used to restructure the arable sections of agriculture into smaller farm units where black farmers could play an important part. This could create employment and at the same time government could address the land issue. We are of course aware of the fact that these black farmers would be in need of training and special financial facilities but we are

convinced that the proceeds from privatisation could play an important role in meeting these obligations.

4. Summary

Correcting economic failure in a non-apartheid South Africa is a major challenge because political and economic reforms are unlikely to gain momentum in a stagnant economy. Revitalising the economic growth process requires many simultaneous actions while taking cognisance of changing patterns in the international economy. The actions suggested here are not exhaustive but they would make an important contribution towards introducing a virtuous circle of growth and development as opposed to the present environment which is characterised by a vicious circle of impoverishment.

1991 SAJE v59(4) p382

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1991 SAJE v59(4) p383

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Endnotes

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Presidential Address to the Economic Society of South Africa at its 64th Annual General Meeting at Stellenbosch on 2 October 1991.

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