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Vasant A. Sukhatme
Macalester College, sukhatme@macalester.edu

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Almost exactly ten years ago today, on February 2, 1990, South African President F.W. de Klerk lifted the ban on the African National Congress, the South African Communist Party, and other political organizations. About one week later, Nelson Mandela was released after more that a quarter century in prison; within four years the first open, relatively free elections were held and Mandela was elected president. A color-blind constitution was adopted in 1996. The second elections were held on schedule in the spring of 1999, and Vice President Thabo Mbeki succeeded Mandela as president. By any measure, the past ten years have been one of momentous change.

A riveting drama is unfolding in South Africa and it was exciting to be there, if only for a brief period, as a participant in the Macalester Faculty International Development Seminar during January 2000. I learned much from my experience and will draw on what I saw and read to enrich what I teach, particularly in my course on international economic development. In what follows, I do not presume to do an "Inside South Africa" piece; this is a complex society and economy and a short visit of three weeks is obviously insufficient for purposes of understanding the country.

South Africa offers a very interesting case study of a particular development strategy which fueled economic growth for a long period, but eventually confronted the rigidities of a legal and political system that could not have the flexibility to sustain that economic growth. The subject matter of development economics is incentives, institutions, and innovation. The story of South Africa is ultimately how a political ideology created a system of preferences and privileges and thereby an institutional framework that resulted in a failure of markets. This failure could not sustain economic growth.

This essay proceeds as follows: I begin with an overview of the economy of South Africa in the context of the institutional arrangements that were set in place. I then analyze how this institutional setting set the stage for its own downfall by creating rigidities that were unable to overcome the slowing of economic growth. Finally, I speculate on the economic prognosis for South Africa. In a postscript, I comment on confronting an Indian identity in South Africa.

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South Africa has a population of about 40 million people, of whom 3% are Indian, 8% "coloured" (the South African term for people of mixed race), 14% white, and 75% black. Only three other countries in sub-Saharan Africa (Nigeria, Ethiopia, and the Democratic Republic of Congo) have larger populations. In physical area, South Africa is the size of France, Germany, and Italy put together. In purchasing power parity terms, South Africa has an average per capita income of about $7,500, which places it in the World Bank's category of upper middle-income countries, along with countries such as Malaysia and Mexico. The average income figure masks significant income and wealth inequalities. In sub-Saharan Africa, only Botswana and Mauritius have higher average incomes.

The United Nations noted in its *1994 Human Development Report* that "If white South Africa were a separate country, it would rank 24th in the world (just after Spain). Black South Africa would rank 123rd in the world (just above Congo). Not just two different peoples, these are almost two different worlds."[1] About one-half of the total income in South Africa accrues to the top 10% of income recipients. This is a far larger figure than for the U.S., but somewhat lower than for Brazil.

The discovery of diamonds in the Kimberley area in 1867 and the discovery of gold in the Witwatersrand in 1886 marked the beginning of a growth period that lasted nearly a century. The rise of mining facilitated the growth of a domestic explosives industry, which grew to encompass the manufacture of industrial chemicals and fertilizer for agriculture. By the early 1930s, the manufacturing sector exceeded agriculture in its contribution to the nation's gross domestic product and, by 1948, it exceeded both agriculture and mining. Until the early 1930s, the growth of population kept pace with the growth of national income; as a result, per capita income grew hardly at all. Between the early 1930s and 1970, however, per capita income in constant prices grew by about 3.5% per year.[2]

The National Party came to power in 1948 on the platform of apartheid. The apartheid era was characterized by a steady growth of government intervention and ownership of the economy. From coal to electricity and from steel to petrochemicals, there was government direction and ownership. Much of that legacy remains today. For example, the life insurance industry is still required to invest a prescribed portion of its assets in government stock. The government's hand was also heavy in agriculture. The land rights of black Africans were very stringently restricted while an extraordinary set of privileges and favorable policies benefited white large-scale agriculture. As a consequence, a very dualistic agricultural sector emerged. This outcome is not unique to South Africa; many countries in the rest of Africa and in Latin America share these features.[3]

Between the end of the Second World War and the early 1970s, South Africa grew quite rapidly — at an average GDP growth rate of well over 5% per year; from 1974 to 1984, the growth rate was under 2% per year, and lower still in the 1984–94 period. South Africa experienced a growth failure. In that sense, South Africa was not much different from many other countries in the developing world which had experienced rapid growth in the early years of their independence followed by prolonged anemic growth. In the South African case, the growth rate was remarkably stable in the period between the end of the Second World War and the early 1970s; since then, however, there have been sharp swings in the growth rate. Since 1994, the growth rate has averaged about 2.5% per year, but it appears to be picking up. The oil price shocks of the early 1970s, the growing international isolation of the economy arising from South Africa's apartheid policies, and the rigidities of that policy itself all played a role in the slowing down of the economy.

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There is little doubt that the quality of governance affects long-term economic growth. The effect on growth can be beneficial or detrimental. On the beneficial side, good governance by building up the human agent fosters economic growth. Bad governance inevitably leads to policy distortions and factor market rigidities, which dampen long-term growth prospects. Bad governance also affects the capacity of the government to handle external shocks as they occur.

There is growing consensus among economists that institutions are a key factor in determining a nation's economic performance. The economist Nobel laureate Douglass North defined institutions as the humanly devised constraints that structure human interaction.[4] The institutional framework of a nation or society consists of its formal and informal rules or modes of behavior and norms, its laws, and its enforcement systems. North contends that economic performance is shaped by ideology and institutions. Economic activity involves exchange that, in turn, involves negotiation and enforcement. The attendant costs are called transaction costs. Institutions affect transaction costs, which affect production and exchange. Clearly defined property rights lower transaction costs and widen markets; more can be produced and consumed in an economy that safeguards persons and property from the abusive power of government or coercive entities. By separating and prohibiting many kinds of transactions across racial groups, the system of apartheid meant that many mutually beneficial transactions were not effected. In other words, the system of apartheid raised the cost of doing business.

Apartheid was a state-initiated system of racial discrimination, which segregated people by race, restricted access to schooling for the majority population, and prevented labor mobility. The main pillars of apartheid were the Group Areas Acts, the Population Registration Acts, and the Land Acts. The Group Areas Act and subsequent amendments established distinct urban areas for whites, Asians, and coloureds, and controlled the inflow of the black population to urban areas. The Population Registration Act required that each person's race be defined. The 1913 Land Act effectively partitioned the country into white and black areas, with blacks (then about two-thirds of the population) allocated about 7% of the land, and whites (then about 21% of the population) allocated 93% of the land. The Act made it illegal for blacks to own or rent farms in the white areas.

Forced removals of coloured and Asian populations from white urban areas was also part of the grand design to separate the races. The system of apartheid reserved skilled and semi-skilled jobs for the white population and created an educational system that was incapable of producing nonwhite skilled labor. State spending was allocated differentially on the basis of color. This acted as a severe resource constraint on the continued growth of the economy. The system of racial preferences raised labor costs and the response to growing labor costs was an increasing capital intensity of production.

By the end of the 1970s, apartheid had begun to take a toll on the South African economy, and numerous economic and political changes were beginning to occur to remedy the situation.[5] It is important to note, however, that while the removal of the ban on the ANC was a dramatic event, numerous attempts at political reform had already begun in the late 1970s. The early 1980s had seen the abolition of many of the most obnoxious manifestations of apartheid, followed by attempts at political reform in the form of a new, tri-cameral parliament with houses for whites, coloureds, and Indians, but not for blacks.[6] These attempts were piecemeal and ad hoc, and ultimately did not amount to much.

Of course, occupational segregation is not unique to South Africa. For example, the caste system in India resulted for many years in certain kinds of occupational segregation. In South Africa, the black population was restricted to mining, agricultural labor, and low-skilled jobs in the urban areas. The structure of incentives in such a system restricts the social and occupational mobility of a large fraction of the population. The structure of incentives led to an inefficient use of labor and a very unequal distribution of income. It is, of course, important to bear in mind that the structure of incentives refers not only to the set of relative prices that prevails in an economy but also the degree of access to markets, barriers to entry, and discrimination.[7]

South Africa was not a predictable candidate for pursuing an import-substituting industrialization strategy; it did not have the domestic market size to make a real go of it. Large countries are more likely to pursue an import-substituting industrialization path. Brazil and India are the quintessential case studies. Numerous country case studies have shown the ill effects of import-substituting industrialization strategies. One of the major unintended effects has been the growth of a capital-intensive, high-cost industrial structure that is not able to compete in world markets. The resulting industrial structure is also not able to generate much employment. Further, the system of apartheid and the strategy of import-substituting industrialization gave rise to a class of activities that the trade economist Jagdish Bhagwati called directly-unproductive, profit-seeking activities.[8] Such kinds of activities, also called rent-seeking, waste scarce resources and do not contribute to increased output or efficiency even where they produce pecuniary returns.

As noted, between the end of the Second World War and the early 1970s, South Africa's GDP grew by about 5% per year. If this growth rate had persisted between the early 1970s and the end of apartheid in 1994, per capita income in 1994 would have been nearly 2.5 times larger than it actually was. Perhaps a significant part of this "lost" income is due to the policies of apartheid and import-substituting industrialization.

To be sure, South Africa experienced quite handsome growth in the early years — but this did not last long and was followed by a protracted period of slow growth and stagnation. In that sense, again, the experience of South Africa was not hugely different from many other African countries.

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It is straightforward to identify the central problem of South Africa's transition to a stable, multiracial, and growing economy: the economy needs to be set on a path of steady growth at a rate that will make a dent in the problem of unemployment, while ensuring that the previously dispossessed majority secure access to educational and other resources. The economy still depends on the export of gold, diamonds, and other mineral products with the associated repercussions arising from fluctuations in the world prices of these products. It is also clear that South Africa's economy needs to be thoroughly restructured if it is to become internationally competitive. There is no evidence that there will be any large-scale transfer of physical assets or capital from the minority white to the majority black population. As a result, the gap in income and wealth between the races is going to be slow in closing.

Al Harberger has noted that "the easiest starting point for a successful growth experience is a once-prosperous economy that has suffered from bad policies. Releasing that economy from its trammels and correcting an accumulation of past mistakes can sometimes set in motion a prolonged episode of astounding growth."[9] South Korea, China, and Malaysia appear to be examples of what Harberger has in mind. In the face of the daunting problems of growth and employment creation, South Africa has moved quite quickly to get on the path of steady, non-inflationary growth. The government has launched an ambitious reconstruction and development program to improve housing conditions for the black majority, create employment, and provide greater access to medical care and education. The government is financing the program in a fiscally conservative manner and encouraging both foreign and domestic investment. On the basis of my observations, I conclude that as South Africa sets out to correct the inequities of the past by enabling the majority to acquire education and training, a rapid growth phase is certainly not to be ruled out.

It is not particularly surprising that the South African economy reached a period of stagnation under a set of restrictive policies; it is perhaps more surprising that the economy grew as long as it did under that restrictive regime. Studies by economists on the growth performance of numerous countries has taught the development economics profession that, sooner or later, policies come home to roost. If an economy chooses a certain set of policies with its attendant distortions in relative prices or incentives or rewards, the economy will earn its "just reward" for that set of policies. The engines of economic growth in the apartheid era were mineral extraction and manufacturing primarily for the domestic market, behind high tariff walls. These engines stalled in the face of rigidities created by the policies followed.

The Cape Town newspapers of the last few days of our stay in South Africa were full of all manner of good news on the economic front: South Africa was experiencing a steady inflow of foreign equity capital; the Johannesburg stock market was on a steady upward trend; the inflation rate was trending steadily downward; and the dollar value of the South African Rand was holding steady. This combination of news leads me to conclude that the global capital markets view the country's prospects favorably. I have no basis on which to disagree.

To be sure, I did not meet people from all walks of life or many professions. Yet, I came away from South Africa feeling quite optimistic about its ability to face the problems of transition and build a stable and prosperous country in the southern part of Africa. A fascinating drama is unfolding in South Africa. I will watch it with great interest.

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Finally, some thoughts on being an "Indian" in South Africa. As an Indian immigrant to the U.S., it was interesting to compare my experience with that of the South African Indians. Between 1860 and 1910, many thousands of Indians came to South Africa as indentured laborers to work the sugar plantations in Natal; these were followed by migrants who came in search of employment and business opportunities. In contrast, Indian emigration to the U.S. was not significant until the late 1960s and early 1970s. The first wave consisted largely of academics pursuing undergraduate or graduate work. Businesspeople and "high-tech" computer professionals have become a more significant part of this inflow only recently.

South African Indians, now many third, fourth, and even fifth generation, and comprising just over one million in a nation of 40 million, seem well assimilated into the fabric of their country. The combined culture is stable and represents the full spectrum of backgrounds, resulting in a broadly inclusive amalgamation of Indian and South African traditions. I observed that most Indians do not speak the old language but maintain many of the old customs and rituals; a strong ethnic identity still persists. The Indian population includes many prominent people in the academic world, in government, and in the corporate world: there are many tenured Indian faculty at leading universities; there are Indians in President Mbeki's cabinet; there are Indians on the board of the South African central bank. In the U.S., similar ascendance is more recent, and we are still in cultural transition. Thus, my visit, especially to the densely Indian-populated city of Durban, felt a bit like a look forward to the future of Indians in the United States.

While growing up in India, I had, of course, read about India's struggle for independence from British colonial rule. The great Indian leader Mahatma Gandhi first went to South Africa in 1893 as an attorney representing an Indian businessperson in Natal in a business lawsuit (and ended up spending nearly twenty years in South Africa). By that year, many Indians had completed their indentures and moved from the sugar plantations and coal mines to urban areas. They competed successfully with the white settlers in establishing small trading and commercial firms and this had aroused considerable anti-Indian sentiment. The small white settler population was intent on enacting a number of laws discriminatory toward Indians and blacks. It was in that background of growing anti-Indian sentiment that Gandhi arrived in South Africa. He quickly became involved in the public life of the Indian community and served as the first secretary of the Natal Indian Congress, which was established in 1894. It is said that it was in South Africa that he fine-tuned his techniques of nonviolence and mass action.

Gandhi's most important legacy to South Africa is the philosophy of nonviolence. The legacy is taken seriously. Nelson Mandela and others in the senior group of the ANC have continued to talk of multiracial reasonableness. But so did many others we met, including the (non-white) parents of a current Macalester student from South Africa and several members of a coloured family in Cape Town who have been host family for students from Macalester and other U.S. colleges. In our conversations, I was struck by the wish expressed by these people to look to the future and not dwell on the historical inequities of the apartheid era. The outlook for South Africa is good. ◉

Notes

1. United Nations Development Programme, *Human Development Report 1994* (New York: Oxford University Press, 1994), 98.

2. Stuart Jones and Andre Muller, *The South African Economy, 1910–90* (New York: St. Martin's Press, 1992).

3. Masiphula Mbongwa, Rogier van den Brink, and Johan van Zyl, "Evolution of the Agrarian Structure in South Africa," in Johan van Zyl, Johann Kirsten, and Hans P. Binswanger, eds., *Agricultural Land Reform in South Africa* (Cape Town: Oxford University Press, 1996), 36–63.

4. Douglass C. North, "Institutions, Ideology, and Economic Performance," in James A. Dorn, Steve H. Hanke, and Alan A. Walters, eds., *The Revolution in Development Economics* (Washington, D.C.: The Cato Institute, 1998), 95.

5. Stephen R. Lewis, Jr., *The Economics of Apartheid* (New York: Council on Foreign Relations, 1990), 133.

6. The Prohibition of Mixed Marriages Act was repealed in 1985.

7. Keith Griffin and Terry McKinley, *Implementing a Human Development Strategy* (London: Macmillan Press, 1994), 28.

8. Jagdish Bhagwati, "Directly-Unproductive, Profit-Seeking Activities," *Journal of Political Economy* 90 (1982): 98–102.

9. Arnold C. Harberger, "A Vision of the Growth Process," *American Economic Review* 88 (1998): 1–32.