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SOUTH AFRICA'S PATHWAY THROUGH FINANCIAL CRISIS

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Abstract

When apartheid ended in South Africa in 1994, the incoming democratic administration inherited a political system, economy, and social system in profound crisis, as well as an external financial crisis. A decade later, these crises have receded, the economy and financial system are more resilient and less vulnerable to exogenous shocks, the country is exhibiting macroeconomic stability, low budget deficits, enduring confidence in government's ability to manage the public finances, a unified exchange rate, and a level of inflation lower and a rate of growth of GDP higher than at any time in two decades. The government debt to GDP ratio is declining, gross domestic fixed investment expenditure has revived, and the government has established a track record of social service delivery which in some sectors—notably electrification, clean water provision, and sanitation—approximates international best practice. The paper examines how South Africa dealt with a quadruple economic crisis in 1994, and how the combination of social, political and economic measures undertaken in the immediate aftermath of 1994, in the absence of IMF or World Bank assistance, has helped the country shift away from the financial and economic legacy of apartheid.

Introduction

When apartheid ended in South Africa in 1994, the incoming democratic administration inherited a political system, economy, and social system infrastructure in profound crisis, as well as an external financial crisis. Behind the triumph of the peaceful first democratic election lurked the real and immediate danger that failure to address the economic, social and financial crises quickly would result in a precipitous decline in economic activity and potentially unravel the political transition, which the world had just applauded as one of the twentieth century's political miracles.

At stake was the very capacity of the post-apartheid state to conduct the regular functions of government and to maintain stability in future crises. Indeed, the government's response to this crisis conditioned the ability of South Africa to weather subsequent economic shocks in 1996, 1998, 2000, and 2001, as it was hit by contagion from the East Asian crisis in 1997, the Russian crisis the following year, Brazil's exit from its pegged exchange rate arrangement in 2001 and the continuing Argentinean crisis.

The transition was ultimately successful. A decade after the economic crisis of 1994, South Africa exhibits macroeconomic stability, low budget deficits, confidence in government's ability to manage the public finances, a unified exchange rate, and a level of inflation lower than at any time in two decades. The government debt to GDP ratio is declining, gross domestic fixed investment expenditure has revived, and the government has established a track record of social service delivery which in some sectors—notably electrification, clean water provision, and sanitation—approximates international best practice.

This paper examines how South Africa dealt with a quadruple economic crisis in 1994, and how the combination of social, political and economic measures undertaken in the aftermath of 1994, in the absence of IMF or World Bank assistance, helped the country deal with subsequent crises.

The Crisis

The closing years of apartheid proved extraordinarily expensive and economically crippling. The outgoing administration left in its wake escalating fiscal deficits, extraordinarily high levels of domestic indebtedness by the public sector, and an escalating share of the budget being directed to service interest expense. The increasingly poor quality of expenditure and an inability to reduce deeply rooted and structural inflationary pressures, aggravated the situation. A macroeconomic crisis and a desperate need to invest in domestic social and economic infrastructure mixed with an urgent financial crisis.

South Africa's 1994 financial crisis began a decade earlier. In September 1985, the country experienced a debt crisis brought about by a mismatch in the maturity structure of the country's private sector debt. Compounding the situation, Chase

Manhattan Bank refused to roll over its loans, alarmed by increasing violence and the stubborn refusal of the apartheid government to agree to any political change. What followed was an escalating set of financial sanctions which cut off South Africa from global capital markets.

The apartheid government responded to the 1985 crisis with exchange controls and increasing intervention by the Central Bank, particularly in the form of long-term forward currency transactions. The Reserve Bank had long operated in the forward foreign exchange market, swapping rand for US Dollars with a commitment to repay the dollar liability at the forward rate once the contract matured. This enabled the Reserve Bank to operate in the foreign exchange markets in excess of its reserves and unutilized foreign credit facilities. The result was a Net Open Forward Position (NOFP), which represented the central bank's forward US dollar liabilities less its forward US dollar assets (the "open" position), less the central bank's holdings of international reserves. A sizeable depreciation of the currency after 1985 caused these contracts to incur substantial losses. When South Africa's new government came to office in April 1994, the NOFP stood at US$16 billion - a level which risked default by the central bank on its forward commitments and therefore constrained external investor confidence.

The macroeconomic challenges confronting the new government were no less daunting than the financial crisis. The new government came to power at the end of a four-year recession, which commenced in the first half of 1989. From 1989-1993, real GDP declined by 0.5%, 1% and 2% per annum respectively. Aggregate real gross domestic fixed investment also declined significantly during the recession.

The new government also inherited a low and declining rate of gross domestic saving. During the 1980's the ratio of gross domestic saving to GDP had averaged approximately 24.5%. However, from 1990, this ratio contracted sharply and as the new government took office, the ratio had declined to an average of 18% per annum. At the same time, the economy suffered from significant capital outflows. In the twenty-one month period immediately preceding the installation of the Mandela administration in April 1994, the country had witnessed a capital outflow of R20.4 bn. These conditions severely circumscribed the range of options available to the government for financing the country's shift away from its apartheid legacy.

Confronted with an absence of new inward capital, low and declining reserves as well as persistent and significant recorded and unrecorded capital outflows, the apartheid government was obliged to maintain significant current account surpluses. Accordingly, from the commencement of the recession in March 1989 until the first quarter of 1994, the cumulative current account surplus amounted to R24.1 billion, or approximately 1.5% of GDP.

Another aspect of South Africa's 1994 crisis was one of investment in infrastructure. The new government inherited a country suffering enormous social and physical degradation which spanned every facet of social development, including the education system, housing, health provision and infrastructure, access to basic sanitation, access to clean water and electrification.[1] Education suffered from severely skewing toward the white population. The system exhibited high absenteeism, high drop out rates, extraordinarily high pupil-teacher ratios. Housing was inadequate, leaving the majority of the population without housing, with differential access to land and with inadequate access to housing finance.[2] Water access and sanitation presented an acute and growing crisis. Pearson (1991) observed that at current rates of implementation in rural areas, it would take 20-30 years for improved water supply to reach the majority of rural inhabitants.[3]

Health was another key area of crisis. There was a strongly higher level of prevalence of diseases among lower income groups, including high levels of tuberculosis, diarrhea and fever; the proportion of the poor with physical and mental disabilities was high in comparison with low-income country averages for these forms of disability; children in particular suffered from generally acutely retarded development, as a result of a high disease burden, low access to health services as well as undernutrition.

The incoming government addressed the desperate need for investment in social services in three steps. Firstly, against domestic and international expectations, it presented a modest first budget. Secondly, it devised a unique fiscal mechanism to finance priority reconstruction and development programmes – the fiscal savings of national departments themselves. Thirdly, it set in motion a series of institutional changes to the structure of the budget and to its preparation, which would serve to systematically shift course away from the looming debt servicing trap, improve the quality of expenditure and increase both tax revenues and the tax base itself. Each of these initiatives – pathways through crisis – is addressed below.

Key Decisions

Three key decisions lay at the heart of the new 1994 South African government's response to the triple crisis. The first of these was the decision not to turn to the IFIs to borrow. The second set of choices were about economic policy and the new government's reconstruction and development programme, which attempted to match scarce government resources with policies through a political process aimed at securing widespread public understanding and acceptance. The third set of decisions was concerned with renovating the country's institutions of economic policy-making.

The decision not to turn to the IMF or World Bank

A remarkable feature of South Africa's pathway through its 1994 crisis was the fact that not once did the country utilize the financial resources of the Bretton Woods Institutions. As the paper will show, the country satisfied the eligibility criteria for both lower and upper tranche credit purchases from the International Monetary Fund in all instances of financial crisis, and would clearly have succeeded in securing both upper tranche drawings from the International Monetary Fund, as well as substantial loan funding from the International Bank for Reconstruction and Development had the authorities applied for such resources. Instead, the selected pathway was one of selfreliance. In the South African case, the puzzle is understanding the reasons why the government chose not to turn to the IFIs. This takes us briefly into a historical treatment of South Africa's relations with the two institutions.

South Africa was a founding member of the Bretton Woods Institutions and for three decades successive apartheid governments borrowed significantly from the two institutions. The first IMF loan of SDR46.2 million was made in 1957/58, contained no conditionality, and unlike later stand-by arrangements, was disbursed in a single upfront tranche.

The country returned to the IMF in 1960 (SDR12.5 million) and again the following year in the wake of the Sharpeville massacre (SDR25 million). Significant credits were provided by the IMF later in the decade, between 1968-1970. These were followed in the 1970's by even more substantial credits of SDR91.2 million, SDR390 million and SDR162 million in 1975, 1976 and 1977 respectively.[4] The 1976 drawing was made under the Contingent Financing Facility (CFF), a facility designed to provide IMF bridging finance in instances of a temporary shortfall in export capacity, brought about by factors outside of the country's control. The drawing occurred barely five months after the Soweto uprising, prompting the Italian Executive Director at the IMF to accuse staff of rigging the Fund's statistical formulae to suit South Africa's need. South Africa's largest drawing, aggregating SDR1 billion and comprising a combined credit tranche and Contingent Financing Facility (CFF) occurred in 1982.[5]

Between 1947 and 1984, South Africa was the second largest African borrower from the IMF.[6] The authorities clearly manifested an appetite for IMF borrowing. Yet increasing international opposition to the apartheid system meant that by late-1982, an approach by the South African Government for a regular Standby Arrangement held its perils. The 1976 and 1982 drawings had occurred in the context of growing opposition among IMF Executive Directors, who variously argued that the causes of South Africa's balance of payments difficulties were the internal apartheid policies of the government itself. Focus had been drawn in particular to the pass laws and labour legislation as examples of destructive domestic economic management.

Moreover, following the election of Jimmy Carter in 1976 and in the discussion on a general quota increase, the US Congress resolved that any increase in quotas would be contingent on South Africa improving its apartheid-based labour legislation. The previously unconstrained access of the apartheid government to IMF resources was beginning to close down. In 1982 South Africa squeaked through with just over 51% of the vote in securing its combined SBA and CFF drawing. This was to prove the last SBA drawing by the South African government. The last CCF drawing took place in 1992. The drawing was once again made in the context of a Contingent Fund Facility arrangement and was motivated on the basis of the very significant regional drought at the time.[7]

South Africa was a founder member of the World Bank and became a member of its affiliates, the International Finance Corporation (IFC) and the Multilateral Investment Guarantee Agency (MIGA) when these were established.

The country borrowed significantly from the World Bank the two decades after the Bank was established. Between 1946-1967, South Africa received 11 loans, aggregating US$241.8 million.[8] These loans were provided to improve the transport system and to assist the electricity utility, the Electricity Supply Commission (ESKOM), to build a series of power generation plants. The magnitude of drawings during this period matched that of several Western European countries and exceeded that of all other African countries. By the late-1960's South Africa had clearly graduated from IDA status and had become regarded as an IDA donor, rather than a potential IBRD debtor and the country's IBRD drawings ceased. By 1976, South Africa had repaid all of its obligations to the World Bank.

The above relationships between the South African authorities and the IMF and the World Bank meant that by April 1994, only one facility remained outstanding, in this instance the CFF facility provided by the IMF in 1992. This suggested that the incoming authorities in 1994 would have had the ability to access resources from both institutions – a Stand-by Arrangement from the IMF and a variety of credits from the World Bank. Moreover, South Africa's quota in the IMF at the time stood at SDR 1.4 billion or 0.93% of total quota, suggesting that the magnitude of resources which could have been drawn upon in terms of upper tranche facilities would have been substantial. Yet the post-apartheid authorities opted not to resort to these facilities. The reasons for this decision are not definitively understood, as there are no specific statements or policy documents arising from 1994 that set out the authorities' strategy in regard to its financial relationships with the IFIs.

Since 1994, South Africa has developed strong, detailed and mutually cooperative relations with both of the Bretton Woods Institutions.[9] Yet in one respect, the post-apartheid authorities have not followed the pathway of its predecessors. There have been no drawings from the IMF, either in terms of the IMF's regular Stand-By Arrangements, or from the Contingent Financing Facility since 1994. During the period 2000-2003, when the IMF developed its Contingent Credit Line (CCL), the authorities also did not seek recourse to this facility.[10]

What might be the reasons for non-recourse, not only since 1994, but also more particularly immediately following the 1994 election, the moment at which the combined political, economic, financial and social crises were at their greatest intensity? There are, to the best of the knowledge of the author, no papers discussing the authorities' strategy in respect of the financial relations between South Africa and the BWI's.

There are at least three potential reasons to explain why the South African government did not draw on BWI resources. First, it is possible that the post-apartheid, democratic government believed that turning to the IMF and World Bank would have constituted a betrayal of hard-won sovereignty, particularly given the successful struggle to overcome the apartheid system and the strong perception, both domestically and externally, that IMF conditionality impinges on sovereign decision making. While there are no pronouncements or policy statements by the authorities to support this argument, the enormous, complex and trenchant policy responses by the new government suggest that there was a strong determination to identify and implement locally agreed, consensus-based solutions. In this context, early access to IMF financial resources would have been seen as both a capitulation of responsibilities and a signal that the new government was incapable of addressing the legacies of apartheid.

A second argument posits that since the IMF had systematically propped up the apartheid government during the liberation struggle, its financing had become so heavily stigmatized that drawing on it would have morally tarnished the post-apartheid government. There is some evidence to suggest that this claim has substance, although there are no formal policy statements that lend it credibility.[11] However, there are also important grounds to question this argument. The post-1994 environment witnessed an extraordinary opening up of policy discussion, a profound willingness to accept new ideas, and an abundant willingness to actively work with South African institutions that had directly supported the apartheid regime in the interests of building a non-racial democracy. Moreover, by the time the new policy makers had assumed office, there had been a series of informal meetings with senior members of both Bretton Woods Institutions. It seems unlikely that this vestige of past historical suspicion would have lingered when all others had faded away.

A third and far more compelling argument to explain the reluctance to borrow from the IMF and, to a lesser extent from the World Bank, is the general reluctance of the post-1994 authorities to rely on any external borrowing at all, whether from multilateral, official or private sources, except as a substitute for domestic borrowing already budgeted for and then only in order to establish a benchmark rate for the country's international borrowing. In this regard it is instructive that none of the key economic policy documents reflecting the views of the African National Congress, whether prior to or after the ANC's election victory in 1994, dwell at all on the approach which would be taken to external borrowing to finance development.[12]

South Africa's external financial relations in the post-1994 period were clearly forged on a foundation of profound reluctance to over-borrow in external markets, to avoid the potential consequences of an explicit large external borrowing programme, including potential currency mismatches, currency risk, interest rate risk and potential exposure to sudden and unexpected denial of access to external sources of funding. While recognizing that a conservative external borrowing programme, including accessing BWI financial resources, could have the consequence of reducing the economy's growth potential, it appears that the incoming authorities took the decision that this would present a more appropriate pathway through and after crisis; that it would serve as a preventive mechanism for future crises; and that in the presence of crisis, low levels of external debt would also serve to mitigate the impact of as well as shorten the duration of such crises.

Another reason is the presence and active use of the NOFP. The NOFP served as an inducement to both private sector companies and to the South African parastatal sector, to borrow abroad, typically by accessing trade credits. In the absence of formal access to external capital during the pre-1994 period, the NOFP effectively served as the catalyst for accessing capital. Hence in formally announcing that the NOFP had been finally closed in February 2004, the Governor of the SARB explained: "As a result of the government's apartheid policies, the country had no access to the international capital markets at the time, including no access to borrowing from the IMF or other official agencies. With the government unable to borrow foreign currency, the country could only use one mechanism to raise foreign capital: providing forward cover to the private sector to ensure their use of trade credits…. The large forward book and the NOFP thus became a surrogate for what would have been IMF or other international capital market borrowing."[13] The surrogate nature of the forward book and the NOFP were clearly applicable in the pre-1994 period. However, in the post-1994 period, with the revival of capital inflows, the NOFP served instead as a device to mitigate currency depreciation. With the NOFP only very recently having been finally closed, it remains to be seen whether this factor will contribute to future currency stability.

The Adoption of a Reconstruction and Development Programme

Confronted with very significant inadequacies in housing, sanitation, health care and education, in the context of very substantial inequalities in income and wealth, the incoming administration developed and launched a Reconstruction and Development Programme (RDP) as an immediate step after assuming office. The RDP integrated five broad approaches: meeting basic needs within an achievable time span; developing human resources, revitalizing and opening the economy; democratizing society and stressing reconciliation; and ensuring that all RDP programmes would be prudently financed, in order to ensure macroeconomic stability. All parties represented in the GNU endorsed the RDP.

The RDP quickly became identified as the new government's chief instrument for transforming government and for beginning to address the social legacy of apartheid. To give institutional substance and direction to the programme, a new Ministry without Portfolio was established. The relevant Minister made a full member of cabinet and made responsible for the RDP. A Cabinet Committee was established to process all matters relating to the RDP. A Parliamentary Standing Committee and a Senate Portfolio Committee were also established immediately following the elections, to advise the Minister on implementation of the RDP, to assess its performance and to monitor its impact on people's lives. Institutional mechanisms were also established for the coordination of RDP delivery, monitoring and assessment at the Provincial level. To give emphasis to the priority which national government assigned to the RDP, the national RDP office was housed in the Office of the President.

Within 100 days of the new government, planning for implementation of the RDP had been finalized and 20 Presidential Lead Projects had been identified, publicly announced and launched, four of these on the opening day of the new Parliament.[14] Squarely confronting both immediate need and immediate popular expectations, a new agenda was being established, at breathtaking speed.

The detailed RDP strategy was presented in an RDP White Paper and released to the Parliamentary Standing Committee on 21 September 1994. In less than five months after taking office, the substantial blueprint for a sustainable exit from over forty years of apartheid government had been set out.

The White Paper contained detailed proposals to address the social challenges of apartheid. For example, in order to address the housing crisis, the RDP proposed building on a series of immediate measures that had already been implemented by the new government. A separate Ministry of Housing had already been established; and a cash discount of R 7,500 would now be offered to promote the sale of state-financed housing stock to approximately 1 million households. To commence the process of addressing the crisis in water and access to basic sanitation, the RDP White Paper proposed establishing a national water and sanitation programme whose short-term objective would be to provide all households with a clean, safe water supply of 20-30 litres per capita per day within 200 metres of the household, adequate sanitation facilities per site and a refuse removal system to all urban households.

The Presidential Lead Projects initiative had three significant and immediate effects: it directly addressed popular expectations for immediate social service delivery by offering tangible and visible delivery in specified areas; it established a programmatic framework for such delivery, thereby commencing the process of moulding popular expectations toward a medium-term framework; and it established a linkage between delivery and affordability, stressing that the projects and programmes would be financed from within the budget.

Again all expectations, the budget proposed a budget deficit of 6.6% of GDP, contrasting markedly with the excessive deficits which had been run by the previous government, in particularly in the closing years of apartheid. The approach was facilitated by a determination by the new authorities to begin to address the burgeoning level of government's domestic debt; and by the determination to utilize the budget as an instrument to reprioritize the government's objectives. With many years of wasteful expenditure as background, the first step would focus on identifying and progressively removing the excessive expenditures of the apartheid era.

The budget engineered a remarkable method of financing the RDP. While the budget allocated R2.5 billion to the RDP, the budget was crafted in a manner that enabled the fiscus to claw back the entire RDP allocation from within departmental allocations in the budget itself. The process confirmed the determination of the government to address apartheid's historical legacies without recourse to expansionary and ultimately inflationary fiscal policies. It also served to instill an immediate sense of expenditure saving within departments, thereby establishing an early culture of fiscal prudence, spending within departmental means and setting in motion an urgent quest, within departments themselves, to identify redundant and low-priority expenditures.

The approach to RDP was simple: in the first year of financing of the RDP, all departments of national government were obliged to pay back, immediately after the relevant departmental appropriations had been made, an amount equivalent to approximately 2.5% of departmental appropriation. Hence, having prepared and presented their budget estimates to government, departments were forced into a two-fold fiscal disciplinary exercise. First, the Department of Finance would pare down the relevant budget estimates and agree to a specified departmental allocation. Secondly, even after coming to such a determination, departments were obliged thereafter to find a further 2.5% of their allocation and to return this to the Department of Finance at the start of the budget cycle. The consequence of this budgetary device was to generate a fund, the RDP Fund, representing the collective pool of additional RDP-related budgetary savings. The RDP Fund was then used to finance RDP-related projects.

At the conclusion of the first post-apartheid budget, the new government had engineered a way to finance urgent priority RDP projects, had forced all national departments into an extraordinary process of internal investigation into the quality of their expenditure, had established an early culture of fiscal discipline at departmental and provincial level and had highlighted the fact that many years of apartheid budgeting had resulted in enormous wasteful expenditure, which as it became identify through the rigour and scrutiny of the budget process, could now form an important source of funding for post-apartheid social reconstruction.

The RDP budgetary mechanism was not a once-off device. Embedded in the relevant legislation was a provision that in subsequent annual budgets, the RDP claw-back would increase incrementally by a further and additional 2.5% per annum, so systematically slicing away the excess budgetary allocations institutionalized during the apartheid era. Responsibility for identify the departmental “surpluses” rested with the departments themselves. Confronted with the prospect of finding 5% (1995/6), 7.5% (1996/7) and then 10% (1997/8) of their approved budgets redirected back to the RDP, national departments soon set about identifying and removing wasteful expenditure.

A third key element of the first post-apartheid budget comprised its modest expectation in regard to raising external finance: the budget envisaged raising a modest R1.8bn (US$500 million) from international capital markets. This represented a mere 4.9% of the gross borrowing requirement of the central government. The budget also made it clear that South Africa’s external borrowing strategy would henceforth be based on broadening the country’s access to international financial markets, and not as an attempt to source additional financing. Instead, any external funding raised would, besides being a modest and limited share of the total gross borrowing requirement, serve as a substitute for domestic finance.

The approach to external indebtedness adopted in the first post-apartheid budget would endure. The authorities have incurred very modest new external debt since 1994, reflecting a generalized aversion to external indebtedness. The reasons for this aversion have their roots in the 1985 debt crisis. That crisis, albeit brought about by a mismatch in the maturity structure of the country’s debt and not as a result of an overborrowed situation, as well as its impact on the course of macroeconomic development in the subsequent decade, had a marked impact on the new policymakers.

In 1993, as the country approached its political transition, the fourth interim standstill repayment arrangement following the 1985 moratorium was finalized, resulting in the repayment of approximately US$5 billion of foreign debt remaining from the 1985 moratorium. Moreover, the debt moratorium, which had originated as a consequence of external banks' refusal to roll over private external indebtedness, had also diminished government's own access to external borrowing. As a consequence, the foreign debt of the central government had declined, as a percentage of total central government debt, from a peak of 12% in 1985 when the moratorium was declared, to 2.1% at end-June 1994. The new democratic government had accordingly inherited a comparatively very low level of external central government borrowing.

Two further features of the country's debt profile warrant mention: firstly, at end-1993, external indebtedness was approximately equally balanced between the public and private sectors; secondly, the largest portion of public indebtedness represented long-term debt, while the largest share of private indebtedness represented short-term debt.

In addition, the timing of the fourth debt repayment served to re-emphasise among incoming ANC policymakers, the profound hazards of overborrowing in external markets. Even though the proximate cause of the 1985 debt crisis had been a maturity mismatch and not an excessive external debt burden, the magnitude of the 1993 repayment served to instill caution among new policymakers: sovereign decision making could be compromised by the need to service large amounts of external debt; the terms of such servicing would be highly unfavourable if servicing were to take place in a liquidity constrained environment; and it would be better to limit external borrowing and to utilize the relatively advanced domestic financial markets, notably the banking sector, to raise government financing.

The first budget of the new government in 1994 reflected the emergent consensus among both new and previous policy makers alike: it was preferable for the government to limit its recourse to external financing, except as a mechanism to substitute for domestic borrowing which it would already have made; and to use the few opportunities it would take up to borrow internationally, to extend the yield curve and to provide an international interest rate benchmark for its external debt. The new government would henceforth eschew the temptation to correct South Africa's underborrowed position, either through access to private or multilateral international capital. It had eschewed the relatively easy pathway – borrow externally now, run the gamut of attendant risks and hope to grow your way out of these quickly – in favour of a longer, more systematic strategy focusing on addressing the structural impediments to economic growth. The pathway of minimal external borrowing had been selected and would endure.

The short-term RDP was quickly followed by a longer-term programme launched in late October 1994. The six-point programme included a series of fiscal belt-tightening measures, a process of reprioritization of government expenditure, a programme to restructure the public service, and a programme to reorganize state assets and enterprises. In later years, this programme would be amended and refined; and by the end of the tenth year of the new government, this process would prove to have resulted in the reduction in public debt of R24 billion as a result of the proceeds of privatization of state-owned utilities.[15] Fifthly, a detailed initiative was launched to restructure fiscal federal relations. This process marked the launch of the constitutionally mandated Financial and Fiscal Commission (FFC), an institution and process described in more detail later in this paper. Finally, government announced the process of development of an internal monitoring capacity for the above five substantive programmes.

The Six-Point programme provided a further fillip to domestic and external investor confidence. It signaled that simultaneous with the pursuit of the RDP, the new government would seek to address other structural challenges that hampered effective governance. Yet the programme brought with it new expectations, in particular heightened expectations of a substantial and early privatization programme, which would later prove to disappoint external market expectations.

Reconfiguring Institutions of Economic Decision-Making

In one of his earliest decisions following the election, President Mandela reappointed the Governor of the South African Reserve Bank, emphasizing the need for continuity both in experience and in policy.[16] He then also reappointed the Minister of Finance from the outgoing apartheid government and continued with the appointments made by the outgoing government of the most senior officials vested with responsibility for fiscal revenue and expenditure.[17] The resulting continuity in the economic team bolstered domestic and international confidence in the economic and financial capacity of the new government. Several institutional innovations were soon also made including the creation of a new and very senior-level Treasury Committee comprising the two Deputy Presidents the Minister of Finance and the Minister charged with responsibility for the RDP.

Trade-opening policies were legislated in the first year of the new government's life and tariff reductions were initiated within two months of the elections. This was followed immediately thereafter by a comprehensive tariff reform and reduction package. The government's approach, while comprehensive, remained strategic and sensitive to the needs of specific industries. The automobile and the clothing and textile industries were granted eight and twelve year tariff adjustment periods.[18] The opening up of South Africa's domestic markets and the determination of the newly elected authorities to seek and establish new export markets sent an important signal to international markets. Suspicions that the election of the ANC could prompt a reversion to inward-oriented and export substitution policies were quickly allayed.

To promote access to international capital, the Ministry of Finance took a decision soon after the 1994 elections, to seek an international credit rating for South African Government sovereign debt instruments. Within six months of the elections, the process had resulted in a successful investment-grade credit rating from US-based Moodys. This was subsequently followed by a similar rating from a Japanese credit rating agency.

Success in the rating process yielded several important and immediate benefits. Firstly, it set the seal on South Africa's re-emergence in international capital markets and represented the final seal in the process of closing out financial sanctions. Secondly, it enabled a benchmark price to be determined for South African sovereign debt in international capital markets. Thirdly, it enabled South African parastatal enterprises to follow through the sovereign rating with applications for stand-alone ratings of their own, thereby further increasing sources of access to international capital. Fourthly, the sovereign rating provided the opportunity to develop an alternative source of funding to domestic capital markets. This released, symbolically as it transpired in view of the subsequent conservative approach to external indebtedness, the constraint confronted by previous governments during the apartheid era, of having to finance public debt solely from domestic capital markets. In so doing, it presented the possibility that government's debt cost might reduce, as domestic commercial banks began to face competition from foreign lenders. The final key benefit of the early rating process was that it underscored the soundness and fiscal prudence of the country's financial policies since the elections.

The new finance authorities also embarked on a major international roadshow in December 1994. Largely intended as an endeavour to test international appetite for South African sovereign debt, the roadshow resulted in a significant US$750 million Republic of South Africa bond issue, at an investment grade rating of 1.93 basis points above the US Treasury Bill rate. The exercise, comprising simultaneous presentations in the US, Western Europe and the Far East, successfully consolidated the growing international perception of South Africa as a stable country with a well-developed physical, financial and institutional infrastructure.

Three other more specific institutional innovations by the new government stand out. The new government soon made the Central Bank independent by a constitutional provision. The old apartheid order had maintained high real rates of interest to attract as much external capital as possible, as well as to staunch the import consequences that would occur from a domestic investment boom. But new investment was now needed in a democratic environment to rebuild the economy. Recourse to loose monetary policy may have been a handy short-term expedient but any fears that this would occur were quickly and decisively addressed in the decision to accord the Central Bank constitutional independence.[19]

A second innovation was the reorganization of state and national revenues. A new constitutionally-mandated Finance and Fiscal Commission (FFC) was created comprising eighteen members, nine national and nine provincial representatives to propose appropriate fiscal federal arrangements for the new democracy. The challenge for the FFC was significant since apartheid had spawned a web of duplicate fiscal structures, at provincial, parastatal, Bantustan and other levels of administration, each of which had made escalating claims on the fiscus. Moreover, the constitution envisaged a system of defined revenue sources, including revenue sharing, for each level of government; as well as a clearly established non-arbitrary system of intergovernmental transfers. This vision required each level of government to manage a given pool of resources, rather than to look to a higher or lower level of government to make up any shortfall. The FFC framework (which survives to the present), coupled with explicit legislation, which limits the borrowing powers of sub-national levels of government, has enabled South Africa to avoid a fiscal crisis.[20]

A final institutional reform was the creation of a National Economic Development and Labour Council (NEDLAC) in February 1995 which brought into a national forum Ministers and senior officials of Government, General Secretaries and senior office bearers of Labour, captains of industry and senior officials of employer organizations, and senior representatives of community organizations. The goal was to discuss and try to reach consensus on issues of social and economic policy.

The work of NEDLAC was soon apportioned to four chambers: the Labour Market Chamber; the Trade and Industry Chamber; the Development Chamber; and the Public Finance and Monetary Policy Chamber. Sub-committees and task groups of the Chambers were established to deal with specific issues. The Council as a whole met four times per year including an Annual Summit, which reviewed and gave strategic direction. The research and information sharing generated by NEDLAC was utilized by all four partners (government, business, labour and community) in developing economic policy. In 1996, NEDLAC acquired further responsibilities, comprising a dispute resolution function between trade unions and Government &/or Business on issues of socio-economic policy.[21]

The institution of NEDLAC and the prompt commencement of its work was a key decision for the new government. Planning for the new council took almost nine months, as the institutional, funding, reporting and other components of the council were negotiated among government, business, labour and the community sector. However, once established, the work of the council assumed considerable momentum. By end-1995, the Trade and Industry Chamber had discussed and agreed upon a variety of new institutional measures and programmes.[22] In addition, the Labour Chamber had commenced detailed discussions on a new Labour Relations Act, a discussion that would continue well into 1996.

Within two years of its establishment, NEDLAC had forged agreement among all social partners on a broad swathe of economic and social issues of national importance, paving the way for legislation, which would be regarded as having been built on compromise, consensus and a common national interest.[23]

Coordinating International Development Assistance

In the aftermath of unexpectedly peaceful elections, South Africa quickly became the recipient of a wide variety of offers of international development assistance, comprising grant aid, concessionary finance, commercial loans, trade credits, guarantee facilities and various other forms of technical cooperation. Sensing a unique opportunity for South Africa's dual economy to benefit, on the one hand from improving international capital market access and on the other from profound international bilateral official and private donor and concessional support to redress the social, economic and political legacies of apartheid, the Finance and RDP Ministries moved quickly to establish an Inter-Departmental Coordinating Committee (IDCC) to coordinate international development assistance to South Africa. The IDCC was established within weeks of the election. It was chaired by the Ministry of Finance and included all key departments, including the RDP, Trade and Industry and Foreign Affairs, as well as the South African Reserve Bank. The mechanism served to galvanise donor support. Clearly and decisively controlled by the government, the mechanism offered donors the ability to contribute directly and in an identifiable fashion, to those aspects of apartheid's redress that they favoured.

The institutional framework for the IDCC proved versatile and effective. Through close interaction between the donor community, the IDCC and relevant departments or provinces, donors were able to specify preferred areas of funding; while the RDP Ministry, in conjunction with relevant line departments were able to quickly identify existing or proposed on-budget projects that could be funded with donor funds. It was as if the lessons of international experience, of decades of institutional and process-related obstacles to efficient use of international aid, had been quickly and efficiently learned, bringing international direct assistance directly within the budget, providing for multi-year financing of such assistance and overcoming the challenges posed by tied aid. Within months of the establishment of the IDCC, donor assistance comprising pure grant funding had begun to be integrated inter departmental budget for the forthcoming 1995/96 budget. In a few short months, the authorities had secured the processes to simultaneously tap international capital markets as well as international donor and concessional resources.

Conclusions

The South African example illustrates that the pathways through and out of crisis are complex. The quadruple crisis inherited by the new democratic government in 1994 required an eclectic mixture of policy decisions. Continuity in the economic team was combined with new institutional developments including an independent central bank and innovative budgetary mechanisms. Overall economic policy was embedded in a long-term vision of the country's economic, political and social future. This was expressed in social policies and inclusive political processes such as the NEDLAC. These measures set a framework within which the more orthodox measures such as the control of inflation and trade liberalization helped to minimize the impact of subsequent crises.

IMF financing proved unnecessary for crisis resolution. While many emerging market economies have opted for IMF-supported programmes to assist in addressing financial and other crises, the South African authorities managed their crises in the absence of any requests for IMF financial support. This is notwithstanding a situation of low foreign exchange reserves. A part of the explanation of this puzzle may lie in the extensive use of the forward foreign exchange market and the assumption by the central bank of an NOFP.

Endnotes

[1] For a detailed summary of the major social and physical infrastructure challenges confronting the new government in 1994, see Macro Economic Research Group (MERG), (1993), *Making Democracy Work: A Framework For Macroeconomic Policy in South Africa*, Centre For Development Studies, South Africa, 1993.

[2] See for example De Loor, J. (1992). *Report Prepared by the Task Group on National Housing Policy and Strategy*, RP79, Pretoria: Government Printer, which recommended a massive increase in state spending to address inadequacy in housing provision; and Planact (1993). *Analysis, Critique and Strategic Implications of the De Loor Report*. Johannesburg, Planact, which challenged even these assumptions and recommended even further policy measures to address the housing challenge once the new government had been elected.

[3] Pearson (1991).

[4] International Finance Statistics, (1985) and Padayachee, V. (1990*). The IMF and World Bank in Post-Apartheid South Africa: Prospects and Dangers*. Institute of Social Economic Research. University of Durban-Westville.

[5] The facility comprised a 14-month Stand-By Arrangement for an amount equivalent to SDR364 million (57% of the then quota); and a purchase equivalent to SDR 636 million (100% of the then quota), under the CFF. Of the SBA, the authorities drew SDR159 million, but made no further drawings thereafter. The two facilities were repaid by means of a series of repurchases commencing with an early repurchase in 1983 and subsequent repurchases in 1986 and 1987. The final repurchase took place in November 1987.

[6] Padayachee, *Op. Cit.*, p.27. Padayachee provides detailed insights into the specific relationship between the IMF, in particular its large industrial country shareholders, and the apartheid government, with clear evidence that the facilities provided to South Africa were soft on conditionality and ignored arguments by a range of IMF Executive Directors, including the Belgium Executive Director at the time, that South Africa had alternate means of financing its balance of payments need, in particular by selling a portion of its gold reserves. Padayachee's paper also highlights the refusal, as late as 1982, by the large industrial countries to attach conditionality to the explicitly economic factors retarding growth, including labour market rigidities arising from apartheid labour laws. Further detail on the close relationship between the apartheid government and the large industrial country shareholders in both the IMF and the World Bank is found in Seidman, A. and Seidman, N. (1978). *South Africa and the US Multinational Corporations*, Lawrence Hill and Company, Westport, Connecticut.

[7] A serious regional drought in 1992 had prompted the authorities to seek an SDR614.4 million (US$850 million) Compensatory and Contingency Financing Facility from the IMF. The resources, used to help compensate for a shortfall in export revenues and an

unexpected increase in cereal imports, were received in December 1993 and assisted the country in maintaining its foreign exchange reserve levels.

[8] Refer Padayachee *Op. Cit.*, p33 and Table 2.

[9] For example, South Africa was an early participant in the Financial Sector Stability Assessment (FSSA) process, launched in 2000; and was the first country to voluntarily undergo a follow-up FSSA. South Africa has resumed its participation in IMF Board proceedings, following its participation in the process of voting for an IMF Executive Director in 1996, after two decades of non-presence in the IMF Executive Board; adheres to the wide range of international standards and codes coordinated by the IMF; participates as a member of the International Monetary and Finance Committee; and has chaired the Joint Meetings of the IMF and World Bank, in Prague, 2000.

[10] The CCL proved a failure among the emerging market economies for which it had been designed. Intended as an insurance facility for highly-performing emerging markets who could pre-qualify for IMF resources in the event that their access to financial resources deteriorated, no emerging market economy applied for the facility and by 2003 the facility was withdrawn.

[11] See for example Siedman and Siedman, *Op. Cit.*; Gisselquist, D. (1981). *The Political Economics of International Bank Lending*. Praeger, New York; and Padayachee, *Op. Cit.*. The authors observe that access to IMF financing invariably occurred immediately following political challenges to the apartheid state, including in the immediate aftermath of the Sharpeville massacres in 1960; and five months after the 1976 Soweto uprising. Gisselquist's analysis is particularly direct, suggesting that IMF funding, both in 1976 and 1977, was used to stabilize sentiment among South Africa's foreign bank creditors after Soweto.

[12] None of the key policy documents prior to 1994 mention the policy approach to be taken in regard to external borrowing. There is no mention of external borrowing strategy in, inter alia: African National Congress (1992). *Ready to Govern*, ANC Policy Guidelines For a Democratic South Africa; and MERG, *Op. Cit*. Moreover, external borrowing strategy is also not referred to in the Reconstruction and Development Programme White Paper, nor in government's subsequent macroeconomic strategy adopted in 1996 (Ministry of Finance (1996), *Growth, Employment and Redistribution, A Macroeconomic Strategy*. Ministry of Finance, Government of South Africa.).

[13] South African Reserve Bank (2004). *Announcement by Mr. TT Mboweni, Governor of the SARB, Regarding the Squaring-Off of the Oversold Foreign Exchange Forward Book*, p.1

[14] Aside from the four projects announced at the inauguration of Parliament, sixteen additional lead projects were announced in the 1994/95 budget a month later. These included a clinic building initiative, an initial allocation for early provision of safe and

clean water in rural areas, a pilot land reform programme, a pilot project for return of disposed land, a small scale farming pilot initiative, a substantial allocation for the immediate rehabilitation and rebuilding of schools, a national literacy campaign (which was donor funded), funds for provincial RDP programme development, urban infrastructure planning and to establish an urban reconstruction and housing agency; a R500 million programme to extend municipal services, an allocation to conduct a poverty survey and for the establishment of a representative statistical council and a discretionary fund for Provincial RDP priority expenditures.

[15] Government of South Africa (2003). *Towards a Ten Year Review: Synthesis Report on Implementation of Government Programmes – A Discussion Document*. Policy Co-ordinating and Advisory Services (PCAS), The Presidency.

[16] The reappointment of the Governor was announced in the President's inaugural address to Parliament. See Mandela, *Op. Cit*. In his address, the President specifically noted the importance for all South Africans of the quest to reduce inflation.

[17] At the time, the Director-General: Finance oversaw the revenue aspects of the national budget, while the Director-General: State Expenditure oversaw expenditure. Each individual headed a separate department. Following the 1994 election, the decision was taken to re-appoint both incumbents. A decision was subsequently taken to merge the two departments into a single Department of Finance.

[18] The time period for adjustment was deliberately set shorter than that provided for by the General Agreement on Trade and Tariffs (GATT) and signaled the early determination by the new authorities to accelerate industrial competitiveness in these sectors.

[19] Six thematic-based committees, representing all parties in the newly elected Parliament, were tasked with the responsibility for preparing the various elements of the Final Constitution. Theme Committee Six was vested with responsibility for, inter alia, the central bank, the auditor-general's office and the Finance and Fiscal Commission. The Committee addressed each of these provisions and came to a comparatively early conclusion to its work.

[20] The achievement should not be underestimated. Provincial overspending and over-borrowing have been ascribed as important contributors to Argentina's crisis, as well as to crises in a range of other emerging markets.

[21] The dispute resolution mechanism is provided for In terms of Section 77 of the Labour Relations Act.

[22] The included the establishment of a National Investment Promotion Agency, Enhancing Technical and Marketing Support for Small, Micro and Medium-Sized

Enterprises and agreement on an Export Finance Guarantee Scheme. These measures were subsequently legislated.

[23] The range of agreements was extraordinary and diverse, and included agreement and commonly agreed upon reports on, inter alia: a National Development Agency, a framework agreement on job creation in public works programmes, guidelines for local development, discussion on the Water Services Act, amendments to the Insolvency Act, discussion on the Mine Health and Safety Act, and the Integration of Labour Laws Act, evaluation of a Regional Industrial Development Programme, discussion of a National Small Business Development Bill and the commencement of discussion on a South Africa – European Union Trade Agreement.

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