

A South African developmental State: What is possible?

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The Accelerated and Shared Growth Initiative for South Africa (ASGI-SA) economic policy framework announced by the government in late 2005 has confirmed the return into policy discourse of the role of the state, as compared with the mid-1990s. The focus on state spending on infrastructure and skills development, and the selection of priority sectors both signify a central role for the state in the economy. The government has backed off from its earlier focus on privatisation of the SOEs. There are also indications that the state is willing to 'take on' individual firms, in the examination of a windfall tax for SASOL and the imposition on retailers of quotas on Chinese textile imports.

But does this mean that the South African state is a 'developmental state'? Can we be confident that returning the state to its 'rightful' place at the centre of the policy framework will lead to desired outcomes with respect to growth and development? To answer these questions, we need to begin by reflecting on what is meant by a 'developmental state'.

1. The developmental state – some comparative reflections

It is appropriate to begin with some general characteristics of a developmental state. Such a state is able to carry out four key tasks:

- (i) to formulate a cohesive and focussed set of goals and objectives for national growth and development, and a set of policies to achieve these goals;
- (ii) to co-ordinate the mobilisation and allocation of (financial and human) resources for investment in line with the policies identified;
- (iii) to monitor and evaluate progress towards the objectives as a result of the policies; and
- (iv) to adjust the mobilisation and allocation of resources in response to progress made towards existing objectives, changes in objectives and exogenous pressures and shocks.

Fulfilling these tasks requires a significant degree of centralised direction of resource flows, but getting the balance right is difficult – if centralisation goes too far, there is a

risk that national development objectives will be overwhelmed by and replaced with the particularistic aims of the central authority; if centralisation does not go far enough, the private benefits of individual dispersed agents – especially those who own and control resources – may dominate broader social or national objectives. What kind of state is capable of achieving this balance?

In an economy with private, decentralised ownership of capital for production, the major problem confronting the developmental state is its relations with the owners of capital, i.e. business. A developmental state has the ability to direct firms in their investment and innovation activities, supporting and subsidising their movement into activities which will advance national objectives. But at the same time, the third and fourth tasks above – monitoring and adjusting resource allocations in response to progress and changes in the environment – mean that the developmental state not only sets performance targets for firms, but can impose discipline on firms by withdrawing support from firms which do not meet their targets. In other words, the developmental state incorporates what Alice Amsden called a ‘control mechanism’. (2001)

A key characteristic of a successful developmental state is its ability to “provide leadership in resolving collective action problems” which will inevitably arise in defining and addressing commonly agreed goals. (Bardhan, JEP, 1993) Such leadership can be understood in terms of the formulation of a successful ‘growth model’, a policy framework which synthesizes the interests of different groups to achieve growth, in which the synthesis reflects a growth and distribution ‘bargain’ defining both the contributions to sustained growth and the respective share of the gains from growth amongst those groups incorporated in the model’s framework. For example, Keynesianism used aggregate demand management policies to support domestic market growth, raising profits for firms and wages and living standards for workers together and emphasising the co-operative dimension of the two groups’ interaction. The interests of the same groups might conflict in a different framework, as for example in the fixed exchange rate gold standard system where relations between firms and workers were conflictual. Implicit in this approach is the idea that economic policy debate is a political process in which groups’ interests are (re-) constituted (Hall, 1997; Gourevitch, 1989).

Most early analysis of the developmental state, inspired by examination of the successful developers in East Asia, focussed on the state’s own characteristics, arguing in particular that the state needed to have the ability to act as a ‘corporate’ entity, that is, be an *independent* social actor with a single unified set of goals. This work identified a range of characteristics of the bureaucracy as necessary conditions for a developmental state – meritocratic recruitment, professional norms and ethos, *esprit de corps*, and so on. From this ‘statist’ perspective, the state’s relationship with society could be summarised in Peter Evans’ justly famous label ‘embedded autonomy’: embeddedness reflecting the state’s intensive interaction with society (especially business) to enable flows of information and resources in both directions, in the process of policy formulation, implementation and monitoring; autonomy reflecting the state’s ability to act independently and non-arbitrarily by withdrawing support from individual firms which failed to meet performance targets.

More recent work on the developmental state (Chibber, Kohli) has argued that this view assumed too easily that the states in successful East Asian developers were able to simply dominate their business classes, which, it was taken for granted, were undeveloped and weak relative to their national states. This work questions whether state dominance over business was any greater in economies such as Korea or Taiwan than elsewhere, and on this basis rejects the argument that it is state

dominance over business as a *class* which is the critical factor determining why some states achieved success as developmental states, and others did not. This view, located in a state-*in*-society perspective (Migdal), understands the East Asian states to have had more modest levels of power within their societies, similarly to other states in Asia and Africa. Yet the East Asians nonetheless emerged as successful 'developmental states' because the business classes in their societies acquiesced in and supported both the economic development model – national objectives and policies – put forward by the state, and, importantly, also acquiesced in the state's disciplining of *individual* firms.

This view argues that a developmental state emerges in the course of rapid growth and development, that is, in the context of a successful growth model, rather than existing as a developmental state *prior to* rapid development. Furthermore, the developmental state reflects *inter alia* an co-operative relationship between the state and business, that is, it emerges with the acceptance and collaboration of business, in the sense that business as a *class* engages with the model of development, reflected in sustained high levels of business confidence. Thus the developmental state is able to dominate individual firms within business, but not the totality of business. In other words, the developmental state rests on a virtuous circle of growth, profitability and investment implicit in the model itself. This does not mean that a developmental state focuses *only* on the state-business relation – other classes, including labour, can be incorporated into the growth model. Indeed, the successful East Asian developers were characterised by high levels of income distributional equality, both prior to and during their growth accelerations, and the process of *shared* growth was crucial to their success (Campos & Root).

2. The state in post-apartheid South Africa

This argument has been elaborated primarily in the context of explaining the relative failure of the post-colonial Indian state, a state with clear developmental aspirations, to meet its objectives. But resting on the idea that the state has relatively modest power vis-à-vis the business class, it is appealing as a starting point for examining the state in post-apartheid South Africa.

At the time of the democratic transition, the South African state was 'weak' in that it had limited ability to organise and exercise power for the "centralized, institutionalized, territorialized regulation of many aspects of social relations" (Mann, 1993). This is true 'by definition' because the state was unable to prevent the transition from apartheid authoritarianism to non-racial democracy. At the height of its power, in the 1970s, the apartheid state had had substantial 'infrastructural power' in relation to white and black populations, the "power to penetrate and centrally co-ordinate the activities of civil society", which depends on organisational, institutional and administrative infrastructure (Gelb, 2001). Though able to avoid being overthrown and force a negotiated transition, the apartheid state's authority - its ability make decisions binding on the population – became attenuated through the 1980s, as it proved unable to establish infrastructural power vis-à-vis the new forms of black social organisation which had emerged from the late 1970s. The new democratic state inherited the structures of the old, and state weakness at the point of transition was reflected in difficulties in regulating behaviour of individual citizens and in carrying out many of its basic functions including policing, border control and taxation. Over the past five years, public agencies in these areas have been transformed or re-constituted, and the state has enhanced its management and regulatory capabilities in exercising such basic functions. (Beall et al, 2005)

But increased state capacities in relation to these basic functions has not been matched by increased capacity in relation to economic growth and distribution, what Linda Weiss has called “transformative capacity ... the ability to coordinate structural economic change in response to external pressures” (Weiss, 2006). Since 1994, only limited progress has been made in improving economic growth from its dismal performance since the mid-1970s, as GDP growth averaged only 2.9 percent per annum between 1994 and 2004. Private fixed capital investment averaged only 12.1 percent of GDP between 1994 and 2003, compared with more than 13 percent in 1982 and 14 percent in 1988 (after the foreign debt standstill), and 10.6 percent average even between 1990 and 1993, when the economy was in deep recession and the political situation fundamentally uncertain. Though many believe that South African economy has ‘turned the corner’ and established itself on a higher growth path with growth of 4.5 percent in 2004 and 4.9 percent in 2005, serious vulnerabilities remain, especially from the external sector: imports grew nearly 10 percent in 2003 and 15 percent in 2004, and in early 2006, the current account deficit was an excessive 6.4 percent of GDP, its highest level since 1982.

Even though business confidence at present is as high as it has been for two decades, the South African economy has yet to escape from its low-level equilibrium trap. This suggests that, notwithstanding the re-entry of the jargon into our political discourse, the South African state is not yet a ‘developmental state’. This will have to emerge out of a sustained growth process based on a developmental model. Is this likely or possible? As implied already, it depends largely on the stance of business towards the model and the possibility for the state not simply to support firms’ investment in line with the development model’s objectives, but crucially to exercise discipline in relation to the performance targets which accompany that support.

3. South African business and the potential for a developmental state

To examine the stance and likely reaction of business to state efforts to support and discipline firms, we need to assess the two major trends in the trajectory of South African business as a *class* over the past dozen years. These trends are black economic empowerment (BEE) and internationalization, reflected not simply in exports but in outward direct investment.

(i) Black Economic Empowerment.

BEE has taken place in two phases. In the first phase, from 1993, individual companies within big business took the initiative and began to implement market-driven schemes, involving sales of subsidiaries funded by debt which was often provided by the vendor. The shares themselves provided security, and loan repayments were premised on rising dividends and share prices. By 1998, there had been over 230 such deals on the JSE, to a value of over ZAR37 billion, but the market crash that year caused losses for both BEE entrepreneurs and lenders, including financial institutions. Growing criticism of BEE led to new interventions. In 1999, Black business associations (with government support) established a non-statutory Black Economic Empowerment Commission and in 2001 the commission recommended a more interventionist government strategy, which has characterised BEE’s second phase. During 2000, the government published a liquid fuels sector “transformation charter”, which inaugurated a new policy approach involving official and voluntary sectoral charters. The concerns in the charters include black management control and skills development as well as ownership, and these are emphasised in the Broad-based Black Economic Empowerment Act.

Criticisms of the BEE process are now commonplace – the narrow focus of beneficiaries, ‘fronting’ and other shady practices, unstable financial models to enable black aspirants without accumulated financial capital to purchase large blocks of assets in existing white corporations, the limited feedback from the redistribution of asset ownership to economic growth resulting from ‘rent’ payments out of profits to ‘empowered’ black individuals and from credit constraints on firms due to loan-financed empowerment initiatives (Gelb, Southall).

But two key institutional aspects of the BEE charter process are relevant here over and above these concerns. The first is that business has engaged in a *collective* process, partly self-organised and crucially organised within sectors, to formulate performance targets and sanctions for individual firms for failing to meet the targets, which are embodied in the charters. This reflects an acceptance by business as a class of ‘disciplinary planning’, that is, collective action against individual entities on the basis of transparent, public and non-arbitrary regulations. It is also important to emphasise that the incentives facing individual firms in the context of BEE charters are non-perverse: market competition reinforces firms’ incentives to conform to BEE transformation targets and bear the costs of doing so, in order to protect their markets (in both public and private sectors), because each firm knows that its competitors are doing the same. This is the importance of the charters being sectorally-based and negotiated.

Secondly, the requirements imposed upon corporations by the BEE charters to procure increasing shares of their inputs from BEE firms, creates a cascading process *across* sectors which has the potential to promote black entrepreneurs (as both owners and managers) while also creating incentives for procuring firms to assist suppliers to improve efficiency, quality and performance. Naturally, this is subject to regulation and monitoring to avoid fronting and similar practices, but this is a given for a developmental state.

As noted, the state’s role in the early phase of BEE was very limited indeed, and it was largely pressure from aspirant black business which led to the establishment of the quasi-official BEECom, which in turn led to the emergence of charters (a fundamentally South African institution) as a mechanism to address the collective action problem. Indeed, the state’s involvement is still somewhat limited and confined to setting broad objectives, strategic capacity being limited and regulatory capacity to monitor and discipline still in their infancy. Nonetheless, the charter process continues and over time is likely to have a positive effect on the state’s capacities, in part due to pressure to improve from business and other social actors.

(ii) *Internationalisation.*

This is less discussed than BEE. Though it is commonplace that South African firms have moved rapidly to invest in Africa, internationalisation is in fact much more widespread and South African business is growing very rapidly throughout the developing world, as well as in Europe and North America. The EDGE Institute’s database of outward foreign investment includes 2100 foreign operations by South African firms, of which 40 percent are in Southern Africa, and 22 percent in the rest of Africa. A further 20 percent are in the OECD countries. Sectorally, the distribution is skewed very heavily in favour of services sectors: infrastructure and construction, financial and business services, retail and consumer services, ICT and media and tourism together comprise 69 percent of all foreign operations. Mining is only 8 percent and manufacturing 20 percent. Outside of Southern Africa, services are still 64 percent. The move outside South Africa involves the full spectrum of South African business – 82 of the Top 100 listed companies on the JSE are included in the

340 companies involved in outward investment, and a substantial majority of all JSE-listed companies, together with numerous major unlisted corporations and all the major state corporations.

Most of this investment is 'market-seeking' that is, aimed from the firm's perspective at overcoming the limits and constraints of market size in South Africa. A small number of (mainly mining) firms can be seen as 'resource-seeking' but this is mainly to supply third countries, rather than the South African market, and so has some similarities in this respect with market-seeking investment. For many of the service sector firms, the investment process is driven by need, in the sense that cross-border sales (exports) require market *presence*, that is, direct investment, which is of course not the case for manufactured products. The small number of resource-seeking firms reflects that most outward investment from South Africa is *not* the result of 'runaway shops' that is, the relocation of production to a cheaper cost base – South African FDI is very different in this respect from East Asian FDI, and indeed, many of the outward investors have also invested heavily in South Africa over the past 5 years.

It is important to note that a minority of these South African firms see themselves as relocating entirely out of South Africa – for most, South Africa remains their base. Of the 49 South African corporations operating in Asia, for example, only 5 can be classified as 'émigrés' such as Anglo American, BHP Billiton or Dimension Data who have established off-shore primary market listings and head offices. The rest remain based in South Africa, including six associated and subsidiary companies of the émigrés which have their own separate Asian presence. It is worth noting that several of the companies which have shifted out of South Africa have found the international arena a much tougher proposition than they expected (Anglo American, Old Mutual, Dimension Data). It is also worth

As with the early phase of BEE, internationalisation of South African business has been a spontaneous process, not led or driven by the South African state. Indeed, the state has little idea of the extent and scope of outward investment by South African firms, let alone its impact and consequences. With the exception of the relaxation of exchange controls and the negotiation of multiple regional trade agreements which encourage investment in a general and unstructured way with no action to support individual firms or specific types of investment, the South African state has offered at best moral support (through such initiatives as NEPAD) and informal and sporadic support such as a few introductions in host countries. The absence of state involvement in this process is both remarkable and a huge gap, in that there has been no effort to optimise the social benefits to South Africa of this major exercise. One response might be to 'close the door', that is, stop or control outward investment flows on the grounds that firms should be encouraged or coerced to invest in the domestic economy. Unfortunately, the horse has already bolted, and it is too late for such action, even if it were deemed appropriate. But as noted, most firms moving abroad are also investing in the South African economy – the low rate of domestic private investment is not in this sense the result of outward investment.

On the other hand, state assistance and support for market entry plays a key role for firms from many other countries. The example of China is well-known from the media, but similar approaches are true of India, Brazil and many European countries. There is certainly scope for state support to South African firms in this regard, and it would appear that firms would welcome such assistance.

4. Towards a developmental state in South Africa

Considerable potential for constructing a co-operative relationship between state and business in South Africa leading towards a developmental state lies in creating a link between these two key business trends, BEE and outward investment, and indeed bringing the latter onto the policy agenda.

What would the state get in return for supporting outward investment? In the context of ASGI-SA and of its more general BEE strategy, the state has identified four relevant developmental objectives. The first is to broaden the base of BEE and in particular to promote the emergence of a black business class involved in *producing* goods and services. The second is to provide broader access to public goods and services to the marginalised and excluded poor (the so-called 'second economy'), including infrastructure provision education and skills training, and information about economic opportunities. The third objective is to reduce the 'costs of doing business' in South Africa, especially by lowering indirect costs beyond the shop floor, that is, transport, communications, logistics and institutional aspects of the business environment, by undertaking the massive infrastructure expenditure programme. The fourth and last is to directly create semi-skilled employment by promoting labour-intensive exports of services. This is the significance of the choice of tourism and business process outsourcing as priority sectors in ASGI-SA, as exports which can be supplied from the domestic economy.

As noted, a large proportion of South African outward direct investment comprises services such as finance, infrastructure and retail whose provision (largely) requires direct market presence rather than cross-border supply. The cross-border supply of these services via FDI would not *directly* create jobs in South Africa, though there is potential for significant indirect job creation. In other respects such as forex earnings, expanding the scale and competitiveness of South African firms, these sectors reflect similar benefits to the ASGI-SA priority sectors. It would therefore be a natural extension to provide support to these entities to assist them in securing market share in foreign markets, in exchange for meeting performance targets in the domestic economy, relating to BEE procurement and provision of services to the poor. Such support would be an alternative rather than an addition to existing 'rewards' for BEE performance, which involve eligibility for supply contracts in the domestic market.

The key question is how discipline could be imposed on non-performing firms. In principle, as suggested by the BEE charters, South African business accepts discipline over individual firms. Nonetheless, for firms to be disciplined, market conditions must reinforce performance targets, that is, the latter must be consistent with enhanced competitiveness. Because meeting BEE targets are a prerequisite for competing for specific markets in the domestic economy, both public and private sector, firms would have an incentive to meet the targets. In other word, accepting the support but ignoring the targets would lead to market gains abroad but market losses at home, a risky strategy for any firm. Firms accepting this form of support would continue to have an incentive to lower the costs of meeting BEE targets within South Africa. The pressures on domestic firms to engage with the state in this manner would be intensified by judicious liberalisation of many domestic services sectors to allow new entry and promote market competition in the domestic economy, which would also have a beneficial impact on the cost of services to consumers and producers. Finally, meeting BEE targets in South Africa would require firms to put more efforts into developing new products and processes to so that expanding supply to low-income consumers would also boost profitability, and this in turn could serve firms well as they aim to expand foreign markets and lower costs of production abroad, at least amongst developing economies.

Conclusion

Comparative analysis suggests that there are three key lessons from the developmental state experience, both successful and unsuccessful. The first is that developmental states are 'made, not born': establishing a developmental state is a *process* which accompanies growth, rather than a pre-condition for growth. Secondly, 'if you can't beat them, you have to join them': influence over the direction of resources is absolutely essential, and if a society is characterised by private ownership of capital, the path to a developmental state necessarily lies through the construction of a co-operative relationship between the state and business. At the same time, however, the third lesson is that 'charity begins at home': growth is sustainable only if it is shared across the society, so that the developmental state must be broad-based and provide leadership not just for narrow segments of the society.

I do not mean to suggest that establishing a connection between BEE and outward FDI by South African business along the lines sketched out here would be *sufficient* to establish a developmental state in South Africa. But it is necessary. One index of the absence of a developmental state in South Africa lies in the repeated failed attempts to reach a 'pact' – or as I labelled it above, a growth and distribution bargain – amongst the 'social partners' (labour, business, and government) which could underpin growth. Notwithstanding the labour movement's criticisms of ASGI-SA, the latter approach clearly narrows the economic policy gap between it and government. By bringing BEE (appropriately defined and monitored) together with related performance targets into the growth process, i.e. tying them directly to firms' expansion prospects, the concerns of labour about the content of earlier policies should be addressed. Leaving aside political contingencies and individuals, which are beyond the scope of this discussion, there should be little reason for labour not to support policies which extend ASGI-SA to incorporate the major shifts and restructuring already underway within business.