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Pathways Through Financial Crisis: South Africa

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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. It did not borrow from the International Monetary Fund. Having fought hard for sovereignty, the new government was unwilling to cede influence to the IMF (or World Bank) or indeed to acquire any dependence on external creditors. Instead, the government of national unity embarked on its own home-grown structural adjustment program. Reconstruction and development, which were planned within fiscal limits that critics allege were far too tight, were accompanied by institutional and policy changes (such as trade liberalization and greater central bank autonomy) designed to encourage international investment. KEYWORDS: financial crisis, South Africa, apartheid, reconstruction, development, contagion, International Monetary Fund, Reconstruction and Development Program.

When apartheid ended in South Africa in 1994, the incoming democratic administration inherited a political system, economy, and social 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 the world had just applauded as one of the twentieth century's political miracles.

At stake was the very capacity of the postapartheid 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 in the following year, Brazil's exit from its pegged exchange rate arrangement in 2001, and the continuing Argentine crisis.

A decade after the economic crisis of 1994, while critics highlight the ongoing challenges of poverty in South Africa,[1] the country exhibits macroeconomic stability, low budget deficits, confidence in government's ability to manage the public finances, a unified exchange rate, and the lowest level

of inflation in two decades. The government debt to gross domestic product (GDP) ratio is declining, gross domestic fixed investment expenditure has revived, and the government has established a track record of social service delivery that in some sectors—notably electrification, clean water provision, and sanitation—approximates international best practice.

This article 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 helped the country deal with subsequent crises. The International Monetary Fund (IMF) was not engaged. The country had borrowed from the IMF until 1976, but from 1974 onward the apartheid regime in South Africa was consigned to the handful of pariah states not represented on the executive board of the institution. However, a change in tone occurred in 1982 under the Reagan administration's decision to "constructively engage." The apartheid regime seized the opportunity to request an IMF loan, which was approved on the grounds that the Fund had to be politically neutral, in spite of entreaties from those who were trying to isolate the South African government. The IMF lent again to South Africa shortly before the end of apartheid.

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 that had taken root in an earlier period.

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 that 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 (the South African Reserve 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 sizable 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 that 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. During 1989–1993, real GDP declined by 0.5 percent, 1 percent, and 2 percent 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 1980s, the ratio of gross domestic saving to GDP had averaged approximately 24.5 percent. However, from 1990, this ratio contracted sharply, and as the new government took office, the ratio had declined to an average of 18 percent 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 billion (20.4 billion rand). 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, with low and declining reserves, and with persistent and significant recorded and unrecorded capital outflows, the apartheid government was obliged to maintain significant current account surpluses. Accordingly, from the beginning 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 percent 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 that 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.[2] Education suffered from being severely skewed toward the white population. The system exhibited high absenteeism, high dropout rates, and

extraordinarily high pupil-teacher ratios. Inadequate housing left the majority of the population without shelter, with differential access to land, and with inadequate access to housing finance.[3] Water access and sanitation presented an acute and growing crisis. Pearson Education, in 1991, observed that at current rates of implementation in rural areas, it would take twenty to thirty years for improved water supply to reach the majority of rural inhabitants.[4]

Health was another key area of crisis. There was a strongly higher level of disease prevalence 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; and children in particular suffered from acutely retarded development overall, as a result of a high disease burden, poor access to health services, and undernutrition.

The incoming government addressed the desperate need for investment in social services in three steps. First, against domestic and international expectations, it presented a modest first budget. Second, it devised a unique fiscal mechanism to finance priority reconstruction and development programs—that is, using the fiscal savings of national departments themselves. Third, 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.

Managing the Crisis

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 international financial institutions (IFIs) to borrow. The second set of choices was about economic policy and the new government's reconstruction and development program, 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 policymaking.

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 IMF or World Bank. As I show in this article, the country satisfied the eligibility

criteria for both conditional and unconditional loans from the IMF as well as for substantial loans from the World Bank. However, the government chose not to turn to the IMF or World Bank.

South Africa was a founding member of the IMF and the World Bank, and for three decades successive apartheid governments borrowed significantly from the two institutions. The first IMF loan of 46.2 million special drawing rights (SDRs) was made in 1957–1958, contained no conditionality, and—unlike later standby 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). The IMF provided significant credits later in the decade, during the period 1968–1970. These were followed by even more substantial credits in 1975, 1976, and 1977.[5] The 1976 drawing was made under what is now the Compensatory 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 formulas to suit South Africa's needs. South Africa's largest drawing, aggregating SDR1 billion and comprising a combined credit tranche and a CFF drawing, occurred amid much contentious debate in 1982.[6]

Between 1947 and 1984, South Africa was the second largest African borrower from the IMF. 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 (SBA) 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 labor legislation as examples of destructive domestic economic management.

Moreover, following the election of Jimmy Carter in 1976, 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 labor 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 percent of the vote in securing its combined SBA and CFF drawing. This was to prove to be the last SBA drawing by the South African government. The last CFF drawing took place in 1992. The drawing was once again made in the context of a CFF arrangement and was motivated on the basis of the very significant regional drought at the time.[7]

When the new government took office in 1994, it was clear that access would be granted to loans from both the IMF and the World Bank. There was just one loan outstanding: that from the CFF, provided by the IMF in 1992. Furthermore, South Africa could draw on a part of the quota it lodged with the IMF without having to accept conditionality. The new government speedily developed a strong relationship with the IMF as an early participant in the Financial Sector Stability Assessment (FSSA) process launched in 2000, and as the first country to voluntarily undergo a follow-up assessment. South Africa resumed its participation in IMF board proceedings, began to adhere to the wide range of international standards and codes coordinated by the IMF, participated as a member of the International Monetary and Finance Committee, and chaired the Joint Meetings of the IMF and World Bank in Prague in 2000. However, it made no use of conditional loans.

In a crucial way, the postapartheid government diverged from the pathway of its predecessors. In 1994, it opted not to draw from the IMF, either in terms of the IMF's regular SBA or from the CFF. During the period 2000–2003, when the IMF developed its contingent credit lines (CCLs), the authorities also did not seek recourse to this facility.

What might be the reasons for nonrecourse, 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? At least three persuasive reasons might explain why the South African government did not draw on IMF resources (nor indeed on World Bank loans).

First, it is possible that the postapartheid, democratic government believed that turning to the IMF 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 decisionmaking. 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 postapartheid government. Although there is some evidence to suggest that this argument has substance,[8] there are also important grounds on which to question it. 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 nonracial democracy. Moreover, by the time the new policymakers 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 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 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 (ANC), whether prior to or after the ANC's election victory in 1994, dwell at all on the approach that would be taken to external borrowing to finance development.[9]

South Africa's external financial relations in the post-1994 period were clearly forged on a foundation of profound reluctance to overborrow in external markets, in order to avoid the potential consequences of an explicit large external borrowing program, 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 program, including accessing IMF or World Bank financial resources, could have the consequence of reducing the economy's growth potential in the short term, 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 such crises as well as shorten their duration.

Finally, the South African government was committed to a strategy for inducing private sector companies and the South African parastatal sector to borrow abroad. The strategy was put into effect by the central bank, which provided forward cover to the private sector to ensure their use of trade credits. It did this by holding a net open forward position (as discussed previously), which had served during the pre-1994 period as a way of accessing external capital. This strategy would later be described by the governor of the South African Reserve Bank (upon the closing of the NOFP in February 2004) as the "surrogate for what would have been IMF or other international capital market borrowing."[10]

The Adoption of a Reconstruction and Development Program

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 the Reconstruction and Development Program (RDP). The program 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 projects would be prudently financed, in order to secure macroeconomic stability. All parties represented in the government 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 program, a new Ministry Without Portfolio was established. The relevant minister was made a full cabinet member and 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 the 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 twenty presidential Lead Projects had been identified. These included a clinic building initiative; an initial allocation for early provision of safe and clean water in rural areas; a pilot land reform program; a pilot project for the 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 program development; urban infrastructure planning to establish an urban reconstruction and housing agency; a R500 million program to extend municipal services; an allocation to conduct a poverty survey and establish a representative statistical council; and a discretionary fund for provincial RDP priority expenditures.

Several legacies of apartheid needed immediate redress. To address the housing crisis, a separate Ministry of Housing had been established, and a cash discount of R7,500 would now be offered to promote the sale of state-financed housing stock to approximately 1 million households. To address the crisis in water and access to basic sanitation, the RDP white paper proposed establishing a national water and sanitation program whose short-term

objective would be to provide a clean, safe water supply of 20–30 liters per capita per day within 200 meters of each household, adequate sanitation facilities per site, and a refuse removal system to all urban households.

The Presidential Lead Projects initiative had three important political 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 starting the process of molding popular expectations toward a medium-term framework; and it established a linkage between delivery and affordability, stressing that the projects and programs would be financed from within the budget.

Against many expectations, the budget proposed a deficit of 6.6 percent of GDP, contrasting markedly with the excessive deficits that had been run up by the previous government, 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 the government's domestic debt, and by their 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. A number of critics have subsequently argued vociferously that the new government went too far in this regard.[11]

The budget engineered an innovative method for financing the RDP. While the budget allocated R2.5 billion to the RDP, it was crafted so as to extract all RDP allocations from within departmental allocations. 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 exercising 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 the RDP was simple: in the first year of financing 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 percent of departmental appropriation. Hence, having prepared and presented their budget estimates to government, departments were forced into a twofold fiscal disciplinary exercise. First, the Department of Finance would pare down the relevant budget estimates and agree to a specified departmental allocation. Second, even after coming to such a determination, departments were obliged thereafter to find an additional 2.5 percent 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.

The impact of the first postapartheid budget was radical. Along with engineering a way to finance urgent priority RDP projects, the government had forced all national departments to investigate the quality of their expenditure, had established a culture of fiscal discipline at the departmental and provincial levels, and had highlighted the fact that many years of apartheid budgeting had resulted in enormous wasteful expenditure, which as it became identified through the rigor and scrutiny of the budget process, could now form an important source of funding for postapartheid social reconstruction.

The RDP budgetary mechanism was not a onetime device. Embedded in the relevant legislation was a provision that in subsequent annual budgets, the extracted RDP allocations would increase incrementally by a further and additional 2.5 percent per annum, systematically slicing away the excess budgetary allocations institutionalized during the apartheid era. Responsibility for identifying the departmental "surpluses" rested with the departments themselves. Confronted with the prospect of finding 5 percent (1995–1996), 7.5 percent (1996–1997), and then 10 percent (1997–1998) of their approved budgets redirected back to the RDP, national departments soon set about identifying and removing wasteful expenditure.

A further key element of the first postapartheid budget was its modest expectation with regard to raising external finance: the budget envisaged raising a modest R1.8 billion (US$500 million) from international capital markets. This represented a mere 4.9 percent 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 postapartheid budget would endure. The authorities have incurred very modest new external debt since 1994. The reasons for this aversion have 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—and 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 the 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 percent in 1985 when the moratorium was declared, to 2.1 percent at the end of June 1994. The new democratic government had accordingly inherited a comparatively very low level of external central government borrowing.

Two additional features of the country's debt profile warrant mention: first, at the end of 1993, external indebtedness was approximately equally balanced between the public and private sectors; second, 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 reemphasize 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 decisionmaking could be compromised by the need to service large amounts of external debt; the terms of such servicing would be highly unfavorable 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 new and previous policymakers 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 find 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, through access to either 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 favor 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.

A longer-term program, launched in late October 1994, quickly followed the short-term RDP. The six-point program included a series of fiscal belt-tightening measures, a process of reprioritization of government expenditure, a program to restructure the public service, and a program to reorganize state assets and enterprises. In later years, this program 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.[12] A detailed initiative was also launched to restructure fiscal federal relations. This process marked the launch of the constitutionally mandated Financial and Fiscal Commission, an institution and process described in more detail later in this article. Finally, government announced the process of developing an internal monitoring capacity for the above five substantive programs.

The six-point program 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 program brought with it new expectations—in particular, heightened expectations of a substantial and early privatization program, which would later prove to disappoint external market expectations. In addition, the critics of South Africa's home-grown structural adjustment program would later argue that while it led to praise by international financiers for South Africa's fiscal policies, it did not contribute to employment generation in the first decade after democracy and fell short of achieving targets for the delivery of housing and water.[13]

Reconfiguring Institutions of Economic Decisionmaking

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. 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. 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, and tariff reductions were initiated within two months of the elections. This was followed immediately 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, deliberately shorter than those required under the General Agreement on Tariffs and Trade (GATT), to signal the government's determination to accelerate industrial competitiveness in these areas.

These market-opening signals were aimed at international markets to allay suspicions that the election of the ANC could prompt a reversion to inward-oriented and export substitution policies.

To promote access to international capital, the Ministry of Finance made 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. First, it set the seal on South Africa's reemergence in international capital markets and represented the final seal in the process of closing out financial sanctions. Second, it enabled a benchmark price to be determined for South African sovereign debt in international capital markets. Third, 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. Fourth, 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 previous governments had confronted during the apartheid era of having to finance public debt solely from domestic capital markets. In so doing, it presented the possibility that the government's debt cost might be reduced, 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 endeavor to test international appetite for South African sovereign debt, the roadshow resulted in a significant $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 United States, 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.

A second innovation was the reorganization of state and national revenues. The new constitutionally mandated Financial and Fiscal Commission (FFC) was comprised of 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 nonarbitrary system of intergovernmental transfers. This vision required each level of government to manage a given pool of resources, rather than 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 that limits the borrowing powers of subnational levels of government, has enabled South Africa to avoid the kind of fiscal crisis that Argentina suffered as state governments overspent.

A final institutional reform, the creation of the National Economic Development and Labour Council (NEDLAC) in February 1995, brought into a national forum ministers and senior officials of government; general secretaries and senior office bearers of labor; 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. Subcommittees and task groups of the chambers were established to deal with specific issues. The four annual meetings of the council as a whole included 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, labor, and community) in developing economic policy. In 1996, NEDLAC acquired further responsibilities, which included a dispute resolution function between trade unions, government, and business on issues of socioeconomic policy.

To establish NEDLAC and promptly begin its work was a key decision for the new government. Planning for the new council took almost nine months, since the institutional, funding, reporting, and other components of the council were negotiated among government, business, labor, and community sectors. By the end of 1995, the Trade and Industry Chamber had

discussed and agreed on a variety of new institutional measures and programs, including the National Investment Promotion Agency; Enhancing Technical and Marketing Support for Small, Micro and Medium-Sized Enterprises; and the Export Finance Guarantee Scheme. In addition, the Labour Chamber had commenced detailed discussions on a new labor relations act, a discussion that would continue well into 1996.

Within two years of its establishment, NEDLAC had forged agreements and held discussions concerning, for example, a National Development Agency, job creation in public works programs, guidelines for local development, the Water Services Act, the Insolvency Act, the Mine Health and Safety Act, the Integration of Labour Laws Act, a Regional Industrial Development Program, a National Small Business Development Bill, and a South Africa–European Union Trade Agreement.

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, including 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 hand 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 the 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 galvanize 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 favored.

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, was 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 multiyear 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 into the interdepartmental budget for the forthcoming 1995–1996 budget. In a few short months, the authorities had secured the processes to simultaneously tap international capital markets and international donor and concessional resources.

Conclusion

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 more orthodox measures, such as trade liberalization and the control of inflation, helped minimize the impact of subsequent crises.

IMF financing proved unnecessary for crisis resolution. While many emerging market economies have opted for IMF-supported programs to help address 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. Instead, the South African government opted for an aggressive strategy to send positive signals to international markets—through fiscal prudence, trade opening, and a credit rating—at the same time as opting to minimize external government debts of all kinds. 🌐

Notes

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1. Ashwin Desai, *We Are the Poors: Community Struggles in Post-Apartheid South Africa* (New York: Monthly Review Press, 2002); Patrick Bond, *Turn Left, Walk Right: South Africa's Frustrated Global Reforms* (Scottsville, South Africa: University of Natal Press, 2004).

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

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

4. Pearson Education, South Africa, 1991.

5. IMF International Finance Statistics, 1985; V. Padayachee, *The IMF and World Bank in Post-Apartheid South Africa: Prospects and Dangers,* Institute of Social Economic Research, University of Durban-Westville, 1990; A. Seidman and N. Seidman, *South Africa and the US Multinational Corporations* (Westport, CT: Lawrence Hill, 1978).

6. James Boughton, *The Silent Revolution* (Washington, DC: International Monetary Fund, 2001), pp. 590–595.

7. A serious regional drought in 1992 had prompted the authorities to seek an SDR 614.4 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. See, for example, Siedman and Siedman, *South Africa and the US Multinational Corporations;* D. Gisselquist, *The Political Economics of International Bank Lending* (New York: Praeger, 1981); and Padayachee, *The IMF and World Bank.* 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.

9. None of the key policy documents prior to 1994 mention the policy approach to be taken with regard to external borrowing. There is no mention of external borrowing strategy in, for example, African National Congress, *Ready to Govern,* ANC Policy Guidelines for a Democratic South Africa, 1992; or in MERG, *Making Democracy Work.* Moreover, external borrowing strategy is also not referred to in the Reconstruction and Development Programme white paper, nor in the government's subsequent macroeconomic strategy adopted in 1996 (Ministry of Finance, *Growth, Employment and Redistribution: A Macroeconomic Strategy,* Ministry of Finance, Government of South Africa, 1996).

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

11. See Desai, *We Are the Poors,* and Bond, *Turn Left, Walk Right.*

12. Government of South Africa, *Towards a Ten Year Review: Synthesis Report on Implementation of Government Programmes—A Discussion Document,* Policy Coordinating and Advisory Services (PCAS), The Presidency, 2003.

13. Bond, *Turn Left, Walk Right.*

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