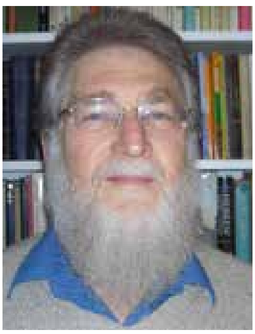
A Hole-digger's Guide to Redemption: Some Reflections on South Africa's Long-running Quest for Economic Growth



JESMOND BLUMENFELD is a freelance writer on Africa. He was formerly Senior Lecturer in the Department of Economics and Finance, Brunel University, London, and Chairman and Convenor of the Southern Africa Study Group at the Royal Institute of International Affairs (Chatham House), London. He is a Research Fellow at the Helen Suzman Foundation.

As the old saying goes, when one finds oneself stuck in a hole, it's time to stop digging. Would that South Africa's policy-makers would heed this dictum in relation to the long-standing and key objective of securing a decisive increase in the country's economic growth rate. More specifically, the ultimate aim is to raise the sustainable annual growth-rate ceiling well above its historical level of around 3.5%. Yet, in the 21 years since the advent of democracy, this overriding objective has proved worryingly elusive.

Promises (or, more often, predictions) of faster growth continue to abound in policy documents, State of the Nation addresses, budget statements and many other public sources. Yet, despite successive re-brandings and re-launches of supposedly pro-growth strategies and initiatives, the economy has remained firmly stuck in its slow-growth hole. Indeed, except in the four years from 2004 to 2007 – when the global economic environment was hugely supportive, and the average growth rate of GDP was able to rise (temporarily) to around 5% - the country's growth record has often failed even to approach its current maximum potential.

While economic growth is a complex organism, subject at different times to different currents and determinants, the basic requirements for raising the long-term growth ceiling are not all that mysterious. In essence, they require identification of the existing constraints on growth and the implementation of policies designed to alleviate those constraints. In so doing, policy-makers also have access to the lessons of past policy efforts, both at home and abroad. In a competitive world, the requisite policies almost invariably will include major improvements in the domestic business and investment climates.

For a country with such great and diverse resources, and so much economic potential, South Africa's poor growth performance surely constitutes mismanagement at best, and negligence at worst. Of course, given its legacy of Apartheid-distorted social and economic structures, the newly democratised State faced daunting policy challenges. But it also presented vast new opportunities. Indeed, in the early 1990s, at the start of its political transition, South Africa was widely deemed to have the potential to become the 'gateway' to, and the 'locomotive' of, the whole of Southern – even sub-Saharan – Africa. Instead, it has severely short-changed its own citizens and become a deadweight drag on the wider region – a sorry way to repay the sacrifices endured by all in the long struggle for political freedom.

By international standards, a target of 5%-6% growth, sustained over 5-10 years is not an excessively immodest ambition. The purpose of this essay is to demonstrate that South Africa's failure to achieve even this limited objective has been due not – as recently claimed by President Zuma – to the primacy of the continuing legacy of Apartheid, but more to the repeated failure by the ANC-led government to incentivise the mobilisation of investment capital, and to re-assure investors that their contribution is welcomed and valued.

In addressing this subject, it is useful to bear in mind four fundamental economic observations:

- First, the key long-term driver of economic growth is positive net fixed investment (or 'fixed capital formation'). In the short – or even the medium – term, the growth rate can be stimulated internally by higher consumption spending (for example, on the back of increases in domestic disposable incomes), or externally by rising export earnings. However, absent appropriate increases in gross fixed investment, such higher growth is not sustainable unless it is accompanied by higher productivity.
- Second, 'positive net fixed investment' materialises only when total ('gross') investment exceeds the rate of depreciation of the existing stock of fixed capital – essentially comprised of buildings, machinery, equipment and physical infrastructures, and the technologies they embody. The annual rate of depreciation of South Africa's capital stock is estimated to run at around 15% of GDP. Historical data show that real output growth rates in excess of 3.5% per year are achievable only when associated with gross investment ratios of 20%-30% of GDP. They also show that, in many of the past 21 years, real gross fixed investment has barely risen above 15% of GDP, implying near-negligible net investment gains.

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- Third, private fixed investment, including foreign direct investment (FDI), is not readily susceptible to coercion. It can be encouraged – or discouraged – by the general 'investment climate', and its nature and location can be influenced by fiscal or other incentives. However, its *raison d'etre* is the pursuit of profit, and the scale of capital investment is therefore driven by the scale of the anticipated excess of revenues over costs. Legislative, fiscal or regulatory measures that impose additional costs on business enterprises will influence this calculus negatively. The essential point is that private holders of potential financial investment capital are under no obligation to invest in projects that appear to them to be unprofitable or subject to excessive risks. This fact may be frustrating, even galling, for some policy-makers, but it is part of the immutable reality of market-based economies.
- Fourth, privately-driven economic growth is the ultimate source of employment growth. The nature of the growth path – 'capital intensive' or 'labour intensive' – will influence the overall rate of job creation, and public-sector 'works programmes' can temporarily absorb relatively large numbers of otherwise jobless workers. However, sustainably faster economic growth is indispensible for permanently reducing large-scale unemployment.

Development planning. In the latter half of the 20th century, it was common practice in many developing countries for governments to produce grand economic or socio-economic development plans, programmes, scenarios and visions for the future. This practice was encouraged by many development economists of the time and by appeals to some contemporary theories of development. Few, if any, among the consequent plethora of such exercises succeeded in delivering on their promises. The reasons for their failure were manifold, but they generally included excessively ambitious objectives ('targets') and seriously unrealistic assumptions, the absence of credible institutions and implementation mechanisms and, more generally, the contradictions inherent in trying to subject a market-based economy – as most developing-country economies ultimately were – to the constraints, rigours and distortions of a centralised planning process.

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Economic reform and structural adjustment. By the 1990s, the manifest shortcomings of this 'development planning' approach had led to its virtual demise, and attention had shifted instead to the pros and cons of two other country-level approaches, namely:

- the 'economic policy reform' programmes adopted (voluntarily) by a broad range of countries, both rich and poor and socialist and capitalist alike; and
- the far more controversial 'structural economic adjustment' programmes adopted (typically involuntarily, and at the behest of the World Bank or/and the International Monetary Fund) by a significant number of (mostly) developing countries.

The already substantial evaluative literatures on these two approaches diverged somewhat in their respective focuses. The 'policy reform' school was mainly concerned with the 'how to do it' question – in particular how to maximise the benefits of policy reform for society at large. The 'structural adjustment' literature was focused on the social and economic costs – both real and supposed – of the adjustment programmes. However, both were also concerned about the underlying politics of the implementation process, with particular emphasis in the structural adjustment case of its political legitimacy. Also of common concern was a debate, both theoretical and empirical, about the appropriate sequencing of structural and policy reforms.

'Washington Consensus'. The main practical consequence of both approaches was the emergence of the so-called 'Washington Consensus', which set out a number of broadly pro-market policy recommendations for countries adjusting to a globalising world. The recommendations can be summarised as follows:

- at the macroeconomic level, promoting stabilisation of monetary and fiscal policies, and the redirection of public spending away from subsidies towards pro–growth and pro-poor services, including healthcare, primary education and investment in infrastructure; and
- at a more microeconomic level, promoting liberalisation of foreign-trade, foreign-investment, interest-rate and exchange-rate policies, privatisation of state-owned enterprises (SOEs), and broad deregulation (with appropriate safeguards) of most other markets, including the labour market.

The macro-level objectives were relatively uncontroversial, if only because prudent management and the sustainability of public finances were a no-brainer for all but the lunatic fringe, although the parameters of monetary policy stabilisation were somewhat more debatable. Most practical criticisms of the 'consensus' were directed at the recommendations for micro-level reforms, which were open to much more legitimate debate in respect of their sequencing and of their impacts on different – and frequently entrenched – interest groups. Because of its emphasis on liberalisation of markets from governmental 'interference', the Washington Consensus became widely described as a 'neo-liberal' policy programme.

The global relevance of the Consensus was significantly boosted in the 1990s by the collapse of the Soviet Union and the emergence of a new class of former communist 'transition' countries, navigating their way towards more capitalist economic systems. Indeed, their transition was widely, if arguably prematurely, viewed as demonstrating the ultimate triumph of capitalism over communism/socialism.

Perhaps partly for this reason, but partly also because of the overlap in policy direction and content between the policy reform and structural adjustment approaches, for many on the political 'left', the Washington Consensus became ideologically tainted. At the extremes, it came to be identified as the putative instrument of global 'neo-colonialism' and 'neo-imperialism'. In the process, its appellation as 'neo-liberal' became for the left less a description and more an ideological category.

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Global policy environment. This, broadly, was the global policy environment in which South Africa began its own transition, politically from a system of white domination to full democracy, and economically from international isolation to international (re)integration.

Although pre-occupied with the sheer magnitude and complexity of the domestic political, social and economic challenges lying ahead, the ANC initially was not wholly immune to these global pro-liberalisation trends. This was evident during the transition period in two key policy areas:

- In the dying years of the Apartheid era, the then-dominant Anglo American Corporation had been promoting both public and private presentations of its 'High Road-Low Road' scenarios for South Africa's future. During the political transition period, these presentations were paralleled by sustained high-level, but low-profile, lobbying by business leaders both at home and abroad, Such 'educational' efforts proved widely influential, most notably in inducing the ANC's leadership to do the seemingly unthinkable by resiling from its hitherto unshakeable policy commitment to nationalisation of the mines, banks and other 'commanding heights' of the economy.
- The ANC also approved and implemented a significant liberalisation of foreign-trade policy, in the form of substantial reductions in import tariffs, thereby exposing some South African exporters to enhanced competition in global markets.

These developments – particularly the *volte face* on nationalisation – were of considerable significance in maintaining interest among potential investors in South Africa, both externally and internally, during the transition. Given the country's rich resource endowments, and the opportunities implicit in the need to redress the vast socio-economic and developmental backlogs that were the legacy of Apartheid, such interest levels were high. However, so also were the levels of uncertainty regarding the country's future political, social and economic stability and, hence, the future business and investment climate.

RDP. Unfortunately, when it came to the drafting of the ANC's manifesto for the first non-racial elections in 1994, in the form of the Reconstruction and Development Programme (RDP), little heed was paid either to the lessons of the development planning era or to fundamental economic realities. This is not to understate the political importance of the RDP as a unifying aspirational document for the whole polity at a time of great danger and uncertainty. Indeed, the RDP was unquestioningly embraced as the foundation stone of the post-election Government of National Unity (GNU), and it is difficult to conceive of any development plan anywhere that has carried a greater degree of political legitimacy. However, the fact remains that the RDP's greatest strength – namely that it was able to represent all things to all people – was also its greatest weakness. In less than two years after the election, the RDP had proven so overambitious, so impractical, and so flawed, both institutionally and politically, that – in the wake of a currency crisis driven by the opacity of economic policy – it was completely abandoned in all but name.

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The main lessons afforded by the failure of the RDP were essentially the same as those that had undermined 'development planning' in the previous decades:

- Symbols, no matter how widespread their political support, are no substitute for real policies in promoting economic development
- The need for difficult political choices and clear identification of priorities cannot be obviated by mere rhetoric or good intentions
- Without clarity of institutional structures development plans have no prospect of successful implementation
- There are unavoidable trade-offs in seeking to address economic growth, socio-economic reconstruction and economic redistribution simultaneously
- Without economic growth, the requisite resources for implementation, including fiscal revenues, will not be forthcoming.

These factors did very little to assuage the legitimate concerns in the financial markets that South Africa would be a safe and welcoming place in which to conduct business.

GEAR. Early in 1996, the RDP was peremptorily displaced by the Growth, Employment and Redistribution (GEAR) programme. Though seldom officially acknowledged, the content of GEAR was influenced by the prior circulation of a 'big business'-promoted strategy document entitled 'Growth for All'. Driven mainly by then-Deputy President Thabo Mbeki, GEAR's main pillars echoed the substance of the Washington Consensus, in that it sought to generate growth via 'responsible' or 'conservative' fiscal and monetary policies, trade liberalisation, deregulation of markets, and privatisation of state-owned enterprises. Moreover, at first glance, GEAR appeared to be cognisant of the aforementioned political and institutional lessons to be derived from the RDP experience.

- **Macro success.** On the macro level, GEAR succeeded almost beyond expectation. It was responsible for instilling into the government – now led by a tripartite alliance comprising the ANC, COSATU and the SACP – a strong and hitherto enduring commitment to conservative monetary and fiscal policies. Unfortunately, the common sense inherent in the pursuit of macro stabilisation did not inhibit the powerful left wing within this ruling alliance from expressing trenchant and ideologically motivated opposition to these policies. To its credit, the government held to its more technocratic course, thereby earning significant 'credibility' in the financial markets.

- **Micro failure.** By contrast, in the face of determined 'internal' leftist opposition to this 'neo-liberal assault', GEAR failed badly on the micro policy front. Leaving aside the long-term policy issues – such as promoting and diversifying the country's export profile and tackling the critical shortage of skills – which were manifestly not going to be resolved within a single generation, GEAR effectively imploded in respect of two other fundamentals, namely the labour market and privatisation. In short, the labour market was subjected to more, rather than less, regulation; and an extensive privatisation programme, restyled on ideological grounds as a 'restructuring' of SOEs, and which took some five years to draft, was simply never seriously implemented.

- **Labour costs.** The Affirmative action (AA), employment equity (EE) and improved employment conditions policies, including new rules on hirings and firings, were amongst the earliest post-apartheid legislative measures enacted by the new government. This was clearly a necessary political priority, given that the labour market was the locus of some of the worst attributes of apartheid-era policies. Few would therefore seriously begrudge those already in employment, along with the newly employed beneficiaries of AA and EE, their enhanced rights and rewards. However, there can be no doubt that a primary effect of the increases in labour-market regulation was to raise the direct costs of employment. Taken together with the indirect costs associated with the displacement and loss of existing (mainly white) skills, and the lower productivity of some new recruits, these cost increases will have rendered many existing private enterprises less willing to create significant new job opportunities – and, though difficult to prove formally, probably deterring some new investments.

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- **Privatisation.** The absence of a vigorous privatisation programme, along with the virulence and radicalism of the opposition, even in principle, to the disposal of state-owned enterprises was arguably even more damaging to the investment climate.

At the time of the transition, South Africa had well in excess of 300 SOEs, accounting collectively – and startlingly – for some 50% of the country's fixed capital assets[1]. A national framework agreement (NFA), negotiated in 1995 between the government and the trade unions, permitted some restructurings in principle but afforded labour an effective veto over the decision-making process. Between 1997 and 2003, only around a score of (mostly small) operations were privatised, in most cases only partially so. A formal 'restructuring' policy framework, mandated by the cabinet in 1999 and published a year later, was intended to address the "perceived market uncertainties about the government's restructuring priorities". In practice, the policy was subsequently sidelined, and following the 2004 general election it appears to have been quietly shelved.

Two observations seem appropriate here. First, given the current dysfunctional state of several of South Africa's key SOEs, and while acknowledging that not all privatisations are desirable and successful, it seems improbable that a more substantial and principled privatisation effort would not have brought about at least some efficiency gains, along with a much-needed boost to private investment.

Second, it is doubtful whether market perceptions of the government's priorities were much improved. On the contrary, the unabated virulence and scale of the 'leftist' opposition within the ruling alliance bore testament to the fundamental internal schism about the role of the State in post-apartheid South Africa. Moreover, the ANC's tolerance of this opposition left a continuing question mark in potential investors' minds about the government's inability and/or unwillingness to assert its stated policy priorities in favour of GEAR's objectives, even though the programme remained official policy. Indeed, the ANC appeared to have accepted an implicit trade-off in which abandonment of GEAR's micro-level platform was regarded as the price to be paid for securing adherence to its macro-level objectives. If so, while such a trade-off may have worked politically (in that it kept the tripartite alliance together, albeit at times rather tenuously), it did very little for the creation of a growth-enhancing business climate.

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Black economic empowerment (BEE). The turn of the century brought a major new policy thrust with very substantial consequences for the domestic business and investment climates. During most of President Nelson Mandela's administration from 1994 to 1999, racial reconciliation was a primary socio-political goal, while economic policy was – as noted earlier – concentrated mostly on the elimination of labour-market discrimination instead of taking the necessary steps towards fostering a more investor-friendly and growth-enabling business environment. Except in respect of the labour market, black economic empowerment was not an official policy priority. Instead, the empowerment thrust was largely privately driven, with a range of (mostly) large and white-run corporations bestowing significant – and high profile – equity stakes on consortia of black investors who financed the deals through the medium of 'special purpose' empowerment vehicles.

While some of these schemes delivered handsome and quick returns, many of the financing structures were seriously flawed: they lacked commercial focus; they did not represent new investments; and they carried very high market risk. When global stockmarkets fell sharply in the late 1990s, a significant number of these empowerment deals suffered serious capital losses. Arguably even more damaging was the embarrassing revelation that this form of empowerment was creating a small new black capitalist get-rich-quick elite with little interest in redressing the fundamental inequalities of income and wealth in South African society.

BEE was largely put on hold from 1998 to 2001 while a Commission, chaired by Cyril Ramaphosa, sought to define BEE anew and develop a coherent vision and strategy for the project. Meanwhile, Mandela's successor, Thabo Mbeki, was elevating socio-economic 'transformation' to the highest policy priority, with particular emphasis on the empowerment of hitherto 'historically disadvantaged' South Africans in every sphere of economic life.

In 2001, Ramaphosa's commission claimed that the lack of meaningful economic participation by blacks, coupled with 'ingrained racism', constituted a 'structural impediment' to the efficient functioning of markets and, hence, to economic growth. It proposed the formulation of a comprehensive 10-year state-driven integrated national de-racialisation strategy, including a wide range of highly specific empowerment targets, including black ownership, equity, directorships, and managerial posts. There was also a call for at least 50% of all government and parastatal procurements to be reserved for black-owned suppliers.

Presumably concerned about the legislative burden implied by such an overarching response, and fearing that such heavy-handed intervention in the private sector would cause investors to take fright, the government held back from endorsing the commission's proposals. Instead it opted to pursue a more piecemeal sector-by-sector approach, through the concept of negotiated sectoral empowerment 'charters', in terms of which the relevant employers, labour representatives and government departments would reach consensus on the targets and mechanisms for increasing empowerment. Moreover, in the face of biting criticism of the narrow scope of the class of beneficiaries, the strategy was re-named 'broad-based' BEE (or BB-BEE).

While many (white) employers had, by this stage, come to terms with the inevitability – and the desirability – of some form of black empowerment, the scope for government intervention in the affairs of private enterprises was considerable. Firms wanting to be eligible to tender for any public sector procurement contracts had no choice but to take on black 'empowerment partners'. The issuing of licences in sectors such as media, telecommunications and gaming, the acquisition of new rights in the mining and energy sectors, and approvals of public-private partnerships became contingent on the meeting of increasingly onerous empowerment obligations.

In this light, it was scarcely surprising that, during the mid-2000s, when global commodity prices were booming and mining companies worldwide were investing heavily in new prospects and operations, South Africa attracted a disproportionately small share of the action.

Moreover, the road to these outcomes was a bumpy one with sometimes potentially disastrous consequences. Most notoriously, in mid-2002, excessive zeal on the part of the ministry of mines in seeking to set unrealistically high BEE targets led to panic selling of mining shares, and considerable time and effort was needed to rebuild investor confidence in the negotiations. No less damaging to confidence and goodwill, were the public excoriations by ministers and other senior (black) public figures of white business leaders who had the temerity to question the empowerment strategy or even to allude to the additional costs being imposed on firms. In this light, it was scarcely surprising that, during the mid-2000s, when global commodity prices were booming and mining companies worldwide were investing heavily in new prospects and operations, South Africa attracted a disproportionately small share of the action.

Despite several tightenings of loopholes, raisings of bars, shiftings of goalposts, and threats of 'sticks' – including, recently, proposed criminalisation of recalcitrant white employers – rather than 'carrots', BEE has patently failed even in its own terms. Twelve years after the passing of the first BB-BEE Act, criticism of the strategy remains widespread both within and outside of government. Far from stimulating investment and growth, BEE has added substantially to enterprise costs.

ASGISA/NGP/NDP. While GEAR has never been formally annulled, the past decade has witnessed the promulgation of three further plans, namely the 2005 Accelerated and Shared Growth Initiative for South Africa (ASGISA), the 2010 New Growth Path (NGP), and the 2012 National Development Plan (NDP). Undaunted by previous failures to stimulate faster growth, the ambition and lack of credibility of these documents beggars belief:

- ASGISA promised to increase the growth rate to an annual average in excess of 6% by 2010, and to halve unemployment and poverty by 2014
- The NGP aimed to create 5 million new 'decent' jobs by 2020 – current total employment is only around 8 million – thereby reducing the unemployment rate from 25% to 15%
- The NDP – which extends to no fewer than 444 pages, with a 70-page Executive Summary – envisages the creation of 11 million new jobs, and an economy close to full employment by 2030. As with the RDP, the NDP has attracted formal support from most sections of public life including the ANC, but crucially not from the 'left' within the tripartite alliance. This fact threatens to derail the programme – which otherwise contains largely sensible and unobjectionable policy recommendations – and will likely render it incapable of implementation.

The issue of corruption, which is central to the business environment, offers an instructive example: from GEAR through to the NDP, every plan has contained a strong commitment to combating corruption. … Instead, the breadth and depth of corruption, especially (though not only) in the public sector, has become increasingly endemic.

Adverse investment climate. Apart from their excessively ambitious targets, and concerns about their effective political backing, all these plans have lacked one crucial element, namely a credible commitment to creating an investor-friendly business environment. The issue of corruption, which is central to the business environment, offers an instructive example: from GEAR through to the NDP, every plan has contained a strong commitment to combating corruption. Yet the rhetoric has never been translated into effective policy. Instead, the breadth and depth of corruption, especially (though not only) in the public sector, has become increasingly endemic.

More generally, there is a seeming aversion to, even hostility towards, business and enterprise. It is true that there have been occasional references – in budget speeches and the like – to the important economic role played by the private sector as a partner in meeting the country's economic challenges. However, looking back over the past 21 years, it is difficult to recall many – if any – instances of government ministers, or other senior political figures within the tripartite alliance, standing up for the rights and needs of private businesses in generating growth, employment and incomes in the wider economy. Instead, the private sector is routinely criticised for its collective 'sins' of omission and commission in its conduct.

One of the private sector's most neglected needs is for greater certainty about the policy environment. Instances abound of policy statements being made, only to be subsequently 'clarified' or amended. More fundamentally, some legislation has been passed but not promulgated because of gross deficiencies in its formulation.

SMEs. These facts highlight one of the greatest ironies in South Africa's hitherto disappointing search for growth. Evidence from around the world demonstrates conclusively that smaller businesses ('SMEs') are a primary source of output and employment growth. During the Apartheid era, black-owned SMEs were a rarity, at best discouraged or at worst disallowed by a host of restrictive laws and regulations. It was a reasonable expectation that the end of Apartheid would lead to a veritable explosion in black entrepreneurship within the SME sector, strongly lifting output and employment growth rates. However, this outcome has clearly not materialised.

Since there has been no evident shortage of SME finance collectively from government, big business and aid agencies, there can be only two possible explanations for this conundrum: either black South Africans are inherently less entrepreneurial than other nations; or growth in the SME sector is still being artificially inhibited by restrictive policy and regulatory environments. The former explanation seems highly improbable; given the ANC's high propensity to restrict and regulate economic activity in general, the latter explanation is highly probable.

This situation should provide the country's policy-makers with substantial food for thought. Instead of producing periodic grand plans and visions with near-zero prospects of implementation and realisation, and imposing ever more restrictions and obligations on business, they might usefully consider sweeping away many of the measures that are evidently holding back the growth of the SME sector. In short, let them stop digging ever deeper into their slow-growth hole, and unleash instead the latent power of smaller enterprises to generate truly broad-based and real black empowerment in the form of jobs and incomes for the masses. Once that outcome has been achieved, there will be time enough – and reason enough – to regulate their behaviour more closely.