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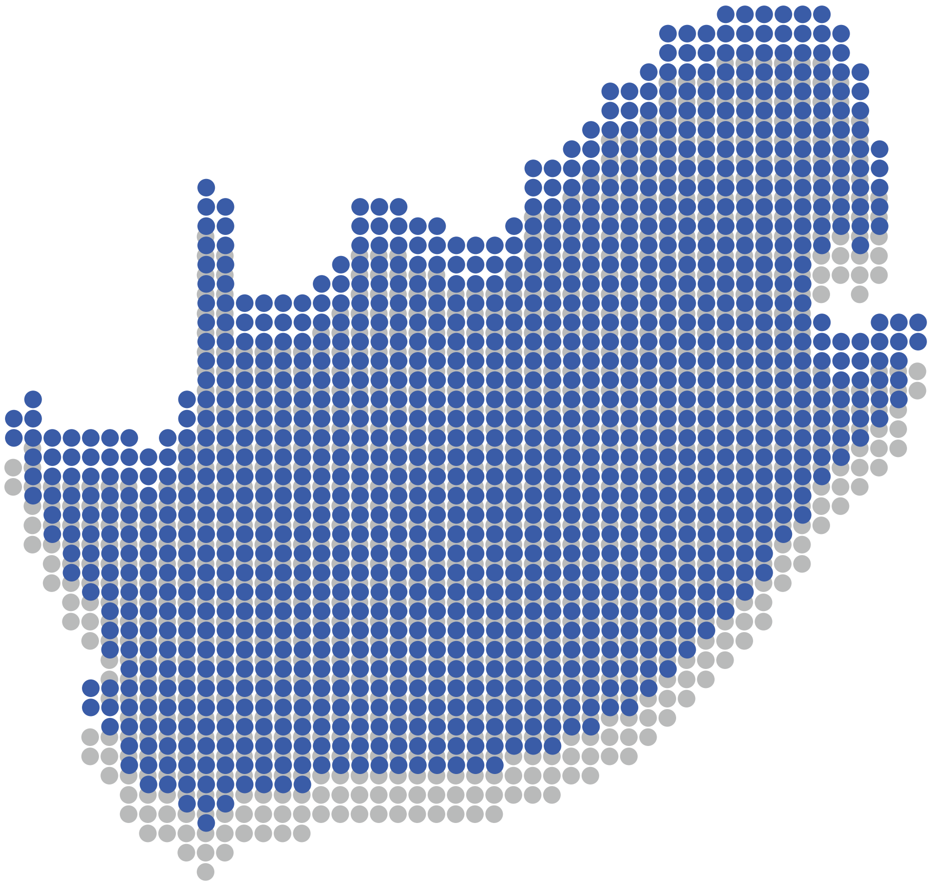
South African Institute of Race Relations

The power of ideas

NGS: NATIONAL GROWTH STRATEGY

INVESTMENT - INFRASTRUCTURE - EMPLOYMENT - EMPOWERMENT



A plan to secure an economic turnaround over the years 2016 - 2018

South African Institute of Race Relations

The power of ideas

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SOUTH AFRICA: A NEW NATIONAL GROWTH STRATEGY (NGS)

Introduction to the strategy

South Africa is in considerable economic trouble. The youth unemployment rate is above 50% and jobs are being lost, rather than created. The economy is hovering on the brink of recession, while gross domestic product (GDP) per capita has shrunk for the past two years. The most optimistic forecasts for the next three years put economic growth at less than 2% of GDP.

Key indicators of business, investor, and consumer confidence are at deep lows. Capital outflows are accelerating, and little new direct investment is taking place. Government debt has almost doubled in the past eight years, while bond yields have risen sharply. The currency has weakened dramatically. Interest rates are rising and consumers are under great pressure. The fiscal deficit is already preventing the government from implementing many of its plans.

Downgrades to sub-investment rankings are likely by year-end. This will significantly weaken the country's financial position and complicate any subsequent attempts at reform. It is essential that South Africa's government avoids these looming downgrades by adopting an effective economic turnaround strategy.

Building on many years of research and analysis, the IRR has developed such a turnaround strategy. Unlike other plans, this strategy is simple and workable. The strategy has four steps, each of which builds on those already taken – and all of which can be initiated by the government within months.

The strategy is designed to be fully implemented over the years 2016 to 2018. Its first aim is to halt the current economic descent. Thereafter, it seeks to bring about an economic turnaround on which the country can build following the 2019 election. Without it, the economic crisis will be very much worse by then and will become even more difficult to repair.

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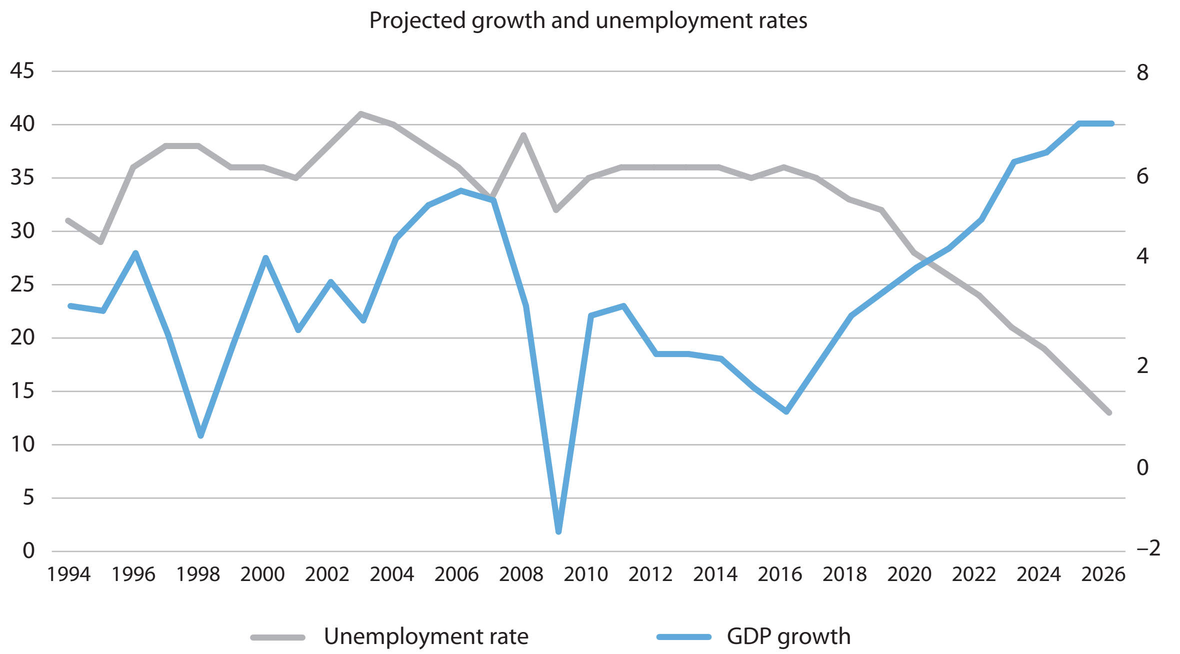
At its simplest, the plan seeks: (1) to improve capital inflows and foreign direct investment (FDI) into South Africa, so as to start raising the growth rate; (2) build and maintain essential economic and social infrastructure to stimulate growth and provide a solid foundation for further economic expansion; (3) translate increased growth into increased employment; and (4) help the disadvantaged climb the economic ladder to increased prosperity, while sustaining current social protection.

If this new growth strategy is adopted and implemented, this will give international ratings agencies reason enough to decide against downgrading the country to junk status. In the short to medium term, the strategy will also deliver significant improvements in investment, growth, and employment. In the long term, it will allow South Africa to realise its great potential as a leading emerging market.

The vital importance of economic growth

Under the IRR strategy, promoting faster economic growth must be the government's over-arching policy priority. Growth is critically important for all South Africans. It increases income levels, expands domestic markets, boosts government revenues, and generates new jobs. Yet government policy is often aimed at speeding up redistribution, rather than growth. However, a different way of dividing up a static economic pie will never be enough to meet the needs of an expanding population. By contrast, if the growth rate could be raised to 7% of GDP a year, the economy would double in size within ten years and average GDP per head would soar.



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Boosting the growth rate in this way will vastly increase the opportunities available to all South Africans. Millions more jobs will be generated, making it possible to bring the unemployment rate down from roughly 35% (on an expanded definition which counts those too discouraged to keep actively seeking work) to less than10%.

On the official definition (which takes into account only active work seekers), unemployment stands at 27%. This is very high by world standards. It is also much higher than the equivalent rates in Brazil (7.5%) Russia (5.3%), India (4.9%), and China (4.0%). Youth unemployment is even worse, standing at 55% on the official definition for people aged 15 to 24, and at 67% on the expanded definition. Among black males, the official rate is 50.7% and the expanded one 68.7%, (according to the most recent data available). Among black women, the equivalent jobless rates are 57.5% and an appalling 72.1%.

More jobs require higher rates of economic growth, as shown by events in the four years from 2004 to 2007. In this period, South Africa's annual growth rate rose to more than 5% of GDP for the first time since 1994. It was also during these years that the unemployment rate fell sharply. There is a lesson in that.

Despite the gains made in these years, South Africa's employment levels remain far below those in most other developing countries. Very many jobs are in issue, for a study conducted some years ago showed that, if the country had employment levels similar to those of comparable emerging economies, six million more South Africans would have jobs.

That South Africa has no jobs for more than 6 million people it ought to be able to employ is a human tragedy. It also makes for a colossal waste of human resources. Instead of contributing to the economy, the unemployed depend upon the earnings of others. This makes for a major burden on those with jobs. In many cases, the unemployed live off child support grants and the broader social wage. This social welfare has helped to alleviate poverty, but limited grants from the state are a poor substitute for earned income. They also risk becoming unaffordable.

The massive roll out in grants which took place from around 2001 was made possible by higher levels of economic growth and a decrease in government debt. Interest payments thus came down and additional revenue could be directed to social protection. Since 2008, however, growth has declined, while government debt has almost doubled. Interest payments now absorb at least R150bn in revenue a year, which is much the same as the healthcare budget. The interest bill is also rising faster than any other line item.

The fiscal space which allowed a steady increase in welfare spending has disappeared, while the number of people on social grants now exceeds the number of people in employment. In 2001, before the major roll out of child support grants occurred, there were 312 employed people for every 100 on social grants. Now there are only 86 people with jobs for every 100 people on social grants.

The sustainability of social grants is thus coming under pressure just as dependency on them is growing. With tax revenues stagnating at best, the government will be hard pressed to maintain current cash payments, let alone raise them in line with inflation. Hunger is likely to increase, along with social discontent and violent demonstrations. This will undermine the social stability needed to attract investment.

The only solution is to bring about a massive increase in low-wage employment. People now entirely dependent on social grants would then have an additional source of income. Those with higher paid jobs would have fewer dependents to support. Domestic markets would expand, increasing the demand for goods and services and helping to create more jobs.

Increasing employment in this way is an economic necessity. It is also a political necessity, because it offers the only realistic way of reducing social instability. It is also a moral necessity and a key element in social justice. What the unemployed generally want most is the chance to work, earn an income, and start taking care of themselves and their families. They must be helped to do so, not hindered by policies that are within the power of the government to change.

> *Higher growth, in short, will allow South Africa to escape the vicious cycle which now looms. It will also restore hope of a brighter future, build prosperity, revive business and consumer confidence, and give the country the new start it so badly needs.*

Various steps are needed to help people into jobs. Given the connection between growth and employment, the first essential step is to raise the growth rate. If South Africa is to bring its unemployment rate down to single figures, it must double the number of people in employment. To do this the country must add roughly 1 million net new jobs to the economy every year.

Over the past 22 years, however, South Africa has generated only about 300 000 net new jobs per annum. In addition, most of these jobs were created in the years when economic growth rates averaged around 3% of GDP. If South Africa is to start generating around 1 million net new jobs a year, it will need an annual economic growth rate of between 6% and 8% of GDP.

Higher growth will not only boost employment, but also allow more redistribution in the form of social grants and the wider social wage (free education, health care, housing and the like). This would ensure the sustainability of social grants and alleviate poverty. We would then have both growth and redistribution. Though the government often seems to assume that this is not possible, there is in fact no zero-sum-game between these two objectives.

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Section One: Attract direct investment to get the growth rate up

To get the growth rate up, South Africa needs to push up the ratio of fixed investment to GDP from 20% to 30%. To achieve this, it will have to attract significant amounts of both foreign and domestic capital. To draw capital into the country, the government must ensure that property rights are properly protected. It must also offer returns at rates comparable to those in other emerging markets.

1.1 Property rights

Though the property rights of investors have generally been well respected since 1994, they are now coming under increasing threat. This is a major part of the reason South Africa is battling to attract sufficient capital investment.

The growing threat to property rights is particularly evident in new laws and policies affecting agriculture, mining, oil and gas, the private security industry, and the country’s intellectual property regime. The combined effect of these changes, as we know from our daily experience in consulting to investors, is to deter capital investment by both foreign and domestic investors. Their preference is to put their capital into other markets, including Ethiopia, Zambia, Nigeria, the United Arab Emirates, the United Kingdom, and the United States of America. Only firm action to secure property rights will make it possible to reverse this trend.

The IRR has four specific proposals to strengthen property rights, all of which could be actioned within months:

- Rework the Protection of Investment Act of 2015 to increase the protection on offer to foreign investors, in particular enter into new bilateral investment treaties with major trading and investment partners, based on the SADC Protocol on Finance and Investment of 2006, which was ratified by South Africa in 2008;
- Bring the Expropriation Bill into line with the Constitution under a revised bill similar to that put forward by the IRR;
- Abandon proposed ceilings on farm sizes and a bill seeking to vest all non-urban land in the custodianship of the state;
- Secure intellectual property rights by scrapping the proposed intellectual property tribunal and related policy proposals.

Taking these steps will send a clear signal that the government is serious about policy reform and attracting the fixed investment needed to drive growth and jobs. This on its own may be sufficient to prevent the country being downgraded to junk status by international ratings agencies.

1.2 An effective state and competitive investment climate

Increasing the returns on capital investment in South Africa requires a major uptick in the country's international competitiveness. Among the obstacles needing to be overcome are inadequate infrastructure; a government bureaucracy so inefficient that it now ranks as the second most important barrier (after labour problems) to doing business in the country; rigid labour laws and damaging strikes; ever-shifting BEE requirements; excessive red tape, and sharply rising input costs (made worse in recent years by the rand's decline).

The IRR's proposals to improve domestic competitiveness are:

- Expand and maintain essential infrastructure by entering into effective public-private partnerships, reforming the public service, and privatising most state-owned enterprises, as set out in Section 2;
- Adjust labour market policy by introducing various important reforms and allowing low-wage jobs at rates similar to those paid by the government under the Extended Public Works Programme (EPWP), as set out in Section 3; and
- Replace current BEE requirements with a new system of Economic Empowerment for the Disadvantaged or EED, as described in Section 4.

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These reforms could quickly be set in motion with the necessary political will. Since most South Africans see unemployment as their most pressing problem and would prefer the government to focus on economic growth rather than redress, they would also command broad popular support.

Though the ruling party may have some ideological resistance to these reforms, faster growth will not be possible without them. The ruling party may also be encouraged to embrace these changes by the experience of Singapore under Lee Kuan Yew and China under Deng Xiaoping. Both these leaders embraced economic policies which liberated their countries (or key zones within them) from onerous regulation and helped stimulate high rates of economic growth. Both countries were thus able to emerge as global economic powerhouses within two to three decades. They were also highly successful in lifting their people out of poverty. A central first step for both leaders was to encourage trade, allow markets to function in important spheres, insist on meritocracy, and abandon populist short-term ideas in favour of shrewd long-term reforms.

1.3 Creating an entrepreneur-friendly economic climate

Increased capital investment must be accompanied by the growth of new small and medium enterprises (SMEs). Future job creation will generally take place, not through large corporations employing great numbers of people, but rather through a plethora of SMEs seeking to supply a vast range of goods and services to both domestic and external markets. Profit-seeking, risk-taking entrepreneurship is the key to faster growth and millions more jobs. It thus needs to be recognised and valued for its important contribution to the prosperity and well-being of all South Africans.

Government must focus on creating an economic climate that is friendly and welcoming to all entrepreneurs in all sectors. It must resist the temptation to try and pick 'winning sectors' for special attention and economic incentives. We cannot know what tomorrow's successful sectors will be. New technology is constantly evolving and is doing so ever more quickly. China's current policy shift towards internally-driven and consumption-led growth will have enormous ramifications right across the globe, if only because the Chinese middle class will soon outnumber the entire US population.

In this rapidly changing environment, any attempt to pick a winning sector and support it with tax revenues is bound to be costly and futile. (This is especially so in manufacturing, where new technology, including the development of 3-D printing and robotics, could relatively soon put an end to conventional factory production.) Hence, the government should rather focus on creating an environment in which any commercial enterprise can thrive – and leave it to the global forces already in play to shape the future of South Africa's economy.

To increase growth and help generate a million jobs a year, we must encourage businesses of all shapes and sizes, from micro businesses run by individuals and families to multi-million rand corporations run by professional managers. Nothing must be excluded: domestic service, care-giving, jobs on big farms, peasant agriculture, five-star hotels, small B&Bs, tourism, mining, finance, real estate, engineering, clothing and textiles, property, supermarkets, transport, hawkers. Every lawful enterprise should be welcomed and given the benefit of a business environment friendly to all entrepreneurs.

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Instead of questioning whether foreign investment is really beneficial, South Africa should do all it can to welcome and promote investment from abroad. We must make it easier for established businesses to expand, but we must also encourage start-ups. This can be done by expanding venture capital markets, as well as by increasing financial literacy and providing sound business training. We must also encourage innovation.

In addition, we must allow the informal sector to flourish and remove regulatory impediments to its success. We must recognise that an unregistered township-based entrepreneur – even if he or she does not pay taxes or minimum wages – is good for our economy and will remain so for many years to come. So we must regulate with a light touch and bring about a situation in which people in the grey economy see more 'pros' than 'cons' in complying with the rules.

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The IRR's proposals for creating an enabling climate for entrepreneurship and business start-ups include:

- Exempt small and micro businesses and new start-ups from all labour regulation;
- Turn a general (and multi-year) blind eye to small entrepreneurs in the informal sector who currently fall foul of tax and other business regulations;
- Introduce a permanent amnesty and fast-track compliance process for start-ups which want to become compliant with a new set of business-friendly regulations;
- Outsource more and more of the functions of the state to the private sector through effective public-private partnerships that promote competition and improve efficiency (see **Section 2**).

In creating an enterprise-friendly business environment, South Africa should also recognise how economic freedom advances economic growth. Over the past 50 years, compelling evidence of the link between the two has been assembled through the indexes on economic freedom compiled by the Fraser Institute in Canada and the Heritage Foundation in the US.

Empirical data gathered by the Fraser Institute shows, for example, that between 1990 and 2010, the countries that were the 'least free' in the world experienced an average annual growth rate (in GDP per head) of around 1.6%. By contrast, the 'most free' countries clocked up 3.6%, or more than double. Because of these very different growth performances, the least free countries recorded GDP per head in 2010 at $5 200, while the most free recorded almost $38 000 - almost seven times as much. Moreover, the average per capita income of the poorest 10% of people in the least free countries was $1 200, whereas in the most free countries it was nearly $12 000 – almost ten times as much.

Section Two: Infrastructure maintenance and expansion

As the economy grows, there will be a massive need to expand infrastructure and ensure that existing infrastructure is properly maintained. The government's role should be to reform regulations and contract with private sector providers to do the work. It should also increase public service efficiency by appointing on merit, using all available skills, and holding managers and bureaucrats to account. In addition, it should privatise many of its 700 state-owned enterprises to help generate revenue for infrastructure and bring private sector efficiencies to bear.

If economic growth is to take off and reach 7% of GDP a year, available infrastructure will have to be greatly expanded while existing infrastructure will have to be far better managed and maintained. Though privatisation will help to bring in some of the revenue needed to fund new infrastructure, this is unlikely to be enough – especially at the start of the turnaround process.

South Africa must thus learn from the experience of the International Finance Corporation (IFC), which forms part of the World Bank and has helped to implement many successful private-public partnerships elsewhere in Africa. Such partnerships have often been used to deliver new infrastructure, or to manage existing infrastructure and so enhance its efficiency and reliability while reducing operating costs.

South Africa must thus learn from the experience of the International Finance Corporation (IFC), which forms part of the World Bank and has helped to implement many successful private-public partnerships elsewhere in Africa.

Various models can be used, including:

- The build-own-operate (BOO) model, in which a private provider builds new infrastructure (such as a water desalination plant) and operates it in return for user fees which a competitive bid process and private sector efficiencies help to keep reasonably low;
- The build-own-transfer (BOT) model, in which the private sector takes on the construction task, so helping to avoid delays and cost overruns, and then transfers the new plant, railway line, port upgrade or other infrastructure to the state at an agreed price;
- The 'affermage' or lease agreement, in which the public sector retains ownership of the relevant infrastructure, but transfers responsibility for day-to-day operations to the private sector in return for agreed fees payable against stipulated performance criteria; and
- A more limited management contract, often used in small towns in Africa, where responsibility for operations, billing, and collections is transferred to private companies, while the costs of service are kept affordable through public funding for capital development.

As experience in Africa shows, some of the larger public-private partnerships on the continent have relied not only on local firms but also on big-name multinational corporations. Some have also succeeded in raising significant funding (covering up to 85% of costs) from external financiers such as the World Bank, the African Development Bank, and other major financial institutions.

Such public-private partnerships could quickly revitalise essential economic infrastructure: from the generation and distribution of electricity to South Africa's transport infrastructure and its ailing water and sanitation systems. They could also be used to improve the operational efficiency of municipalities and government departments, enhance financial management, and curb fraudulent, irregular and wasteful spending.

Public-private sector partnerships of this kind could also be used to expand social infrastructure, such as schools, clinics, hospitals, and rental housing developments, many of which could be owned and operated by private companies. These firms would find ready and expanding domestic markets in the millions of South Africans who would not only be drawn into jobs but would also have the benefit of education, healthcare, and housing vouchers, as set out in **Section 4**.

Greater private sector involvement in the provision, maintenance, and management of economic and social infrastructure would provide a major boost to capital investment. It would also improve state efficiency in key spheres and stimulate job creation in construction and a host of other areas.

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Public service efficiency would rapidly increase with the help of these public-private partnerships. In addition, existing employment equity rules would be replaced by a new transformation framework, as set out in **Section 4**. Recruitment into the public service would also be based on merit (widely defined to take account of disadvantage), and all available skills would be used. Management would be greatly improved, along with accountability and financial probity.

Where public-private partnerships are not appropriate, state-owned enterprises should be privatised through open and competitive processes that guard against corruption, cronyism, and the development of new monopolies.

Section Three: How to generate more jobs and draw more people into the labour market

As capital and investment flows improve, the labour market must also be reformed to convert that investment into the generation of a million new jobs a year. If the labour market is not reformed in this way, too many people will still be left out of the economy and social instability will persist.

3.1 A sensible labour regulatory environment

The joblessness rate cannot be meaningfully reduced without major reforms to labour regulation. The government itself acknowledges that entry-level wages are generally so high that they lock the unskilled and inexperienced out of jobs. Rules which push up labour costs – including the extension of bargaining council agreements to non-parties and the sectoral wage determinations made by the labour minister in areas with little union presence (farm and domestic labour, for instance) – must be scrapped. Proposals to introduce a national minimum wage must be abandoned. Instead, private employers should be allowed to take a leaf out of the government's book.

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Under its Expanded Public Works Programme (EPWP), the government has provided millions of people with short-term 'work opportunities' for which it pays a stipend of some R80 a day. This is far below the minimum wages required under sectoral determinations and the like. The government provides these work opportunities at these low wages because it hopes they will pave the way to better jobs. Often, however, they do not. By contrast, if people were allowed to work for the same low wages in the private sector, they would generally receive better training, notch up more experience, and have better prospects of moving into higher paying jobs over time.

Equally in need of reform are the laws currently governing strikes. Mandatory and secret strike ballots must be introduced, along with effective sanctions against unions which incite or perpetrate violence during stoppages. Rules regarding dismissals and retrenchment must also be reformed. Greater flexibility in the hiring and firing process is essential, as business needs to be able to adjust to peaks and valleys in demand. Employers will thus hire freely only if they can dismiss freely. The presumption that dismissals are unfair unless the employer can prove otherwise should be removed. Instead, employers should be free to dismiss workers under the notice periods agreed in their employment contracts.

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Our proposals, in a nutshell, are to amend the Labour Relations Act of 1995 and the Basic Conditions of Employment Act of 1997 by:

- Introducing secret pre-strike ballots (along with further secret ballots during prolonged strikes to test continued commitment to staying out);
- Holding unions accountable for intimidation and violence during strikes;
- Scrapping the extension of bargaining council agreements to non-parties often unable to afford them;
- Putting an end to sectoral or other minimum wages;
- Allowing private sector employers to pay wages to unskilled workers at rates similar to those under the EPWP; and
- Allowing employers to dismiss or retrench under agreed notice periods in contracts of employment.

These labour reforms, if matched by significant new fixed investment, will secure a steep dive in South Africa's unemployment rate.

3.2 Increased demand for unskilled labour

Manufacturing's capacity to provide low-skilled jobs should be used to the full, especially where opportunities exist to export manufactured goods into Africa and beyond. However, given an increasing impetus towards mechanisation, the sector is unlikely to offer nearly enough jobs for the unskilled. South Africa must therefore look to various other sectors too.

It must also seek to revive and reinvigorate the two sectors that have long employed large numbers of unskilled people: agriculture and mining. Both are also tradeable sectors with major capacity to generate export earnings.

Though commodity prices are currently low, China's growing middle class market will in time generate increasing demand for minerals needed for high-tech goods. Various other mining countries are also doing better than South Africa, even in this difficult global environment, which shows that South Africa's mining sector can still be turned around with the necessary reforms. Moreover, in a more flexible labour environment, there would be less impetus to mechanisation and thus a significant demand for unskilled labour.

Agriculture offers much potential, once threats to property rights are removed. South Africa should be able to increase its production, find new markets in the US, Europe, and China (the US, for example, would happily buy up our entire avocado crop), and do much more to meet the food needs of the expanding middle class across the rest of Africa. Our exceptionally experienced and productive commercial farmers could also provide training and consultancy services, not only to emergent farmers here, but to others across the continent.

As the infrastructure programme expands, a host of unskilled jobs will also open up in the construction sector. Very many people will be able to find work in the energy, transport, and water sectors, for example, or in the building of schools, clinics, and houses. Skilled artisans and technicians will be needed too, which will require effective reforms to current TVET colleges and sound apprenticeship training programmes, as further outlined in **Section 4**.

Tourism should be a key focus, for it will help to draw many unskilled people into jobs and new small businesses. Waste collection and recycling also has great potential to absorb unskilled labour and generate new SMEs. So too does the retail sector, both formal and informal, which is likely to expand rapidly as more people find jobs, the domestic market grows, and markets in Africa expand.. Many more domestic service, cleaning, security, and transport jobs can also be created as the middle class expands.

(Many more skilled people and professionals will, of course, be needed too. This need will be met through reforms to education, public-private partnerships with foreign firms, incentives for skilled immigration, and key changes to transformation laws to encourage the use of all available skills.)

Section Four: How to broaden and speed up economic participation

Once capital inflows increase, infrastructure expands, and large numbers of people starting moving into jobs, South Africa will be at least half way to economic recovery. However, other interventions are also needed to empower the disadvantaged and to expand and secure social welfare.

4.1 Effective empowerment policies

South Africa's black economic empowerment (BEE) and employment equity policies are by far the most ambitious and far-reaching affirmative action programmes in the world. Partly for this reason, many misperceptions have grown up around their effects. Some people criticise them for harming the economic prospects of whites, but there is little evidence of this. At the same time, most people assume that these policies are effective in helping the poor and that they enjoy broad popular support. These assumptions are no less flawed, as a recent IRR opinion survey has shown. According to this survey, employment equity and BEE help only around 15% of black South Africans, while bypassing the remaining 85%. In addition, the great majority want an emphasis on merit and efficiency, rather than racial identity. They also want whites and blacks to work together in expanding opportunities for all. These survey outcomes show that there is very little political risk in reforming the current rules.

In private, the great majority of the IRR's business subscribers say that BEE deters their investment in South Africa and hampers business operation. However, they rarely express this view outside their own boardrooms, for fear of political retribution. In public, they find it easier to stress their commitment to the current rules – even as they quietly divert their investments to other markets.

At the same time, many businesses would prefer to remain in the country and to play a genuine and constructive role in expanding opportunities for the disadvantaged. The IRR has thus won considerable support, behind the scenes, for its alternative policy of 'EED' or 'Economic Empowerment for the Disadvantaged'.

EED selects its beneficiaries on a socio-economic basis, as does the social grant system. It also puts its emphasis on the inputs needed to empower the poor. It thus rewards investors for expanding opportunities through direct investment, job creation, contributing to tax revenues and export earnings, topping up venture capital funds, appointing staff on a 'wide' definition of merit (which takes account of disadvantage), and entering into effective public-private partnerships to improve education, healthcare, and housing and to maintain and expand economic infrastructure.

The IRR thus proposes a paradigm shift to a system which no longer bypasses the poor but takes effective steps to empower the disadvantaged. The EED system is also different in that it uses carrots rather than sticks to encourage and reward the key contributions made by business.

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The EED alternative offers a win-win solution that breaks the current dichotomy between the needs of investors and the government's transformation goals. The key policy changes required are to:

- Replace current BEE and employment equity rules with EED; and
- Rework relevant scorecards to prioritise fixed investment, job retention and creation, along with the other contributions earlier identified.

The IRR is confident this new approach to empowerment will be far more effective in helping all South Africans climb the ladder to economic success. It will also win the sincere support of investors and the business community.

There is an urgent need for this reform. Current employment equity and BEE policies are unable to help the disadvantaged, as the IRR's field survey shows. Worse still, they are deterring investment, limiting growth, and adding to the unemployment crisis. That means they are hurting, rather than helping, the victims of past racial discrimination. These policies are nevertheless being steadily ratcheted up, with great harm to the economy. Present empowerment rules are thus sufficient in themselves to prevent any sustainable growth recovery. This is the single biggest hurdle to real transformation.

4.2 Expanding and sustaining social protection

Even when the economy starts turning around and millions more jobs are created, the state will still play an important role in improving the living standards of the disadvantaged. It may also have to do this for two or three decades to come. Essentially, it needs to ensure the effective provision of sound education, healthcare, and housing (plus the more efficient delivery of electricity, sanitation and water through public-private partnerships, as set out in **Section 2**). The state must also continue to provide monthly cash social grants for children, pensioners, and the disabled.

However, major reforms are needed to make social protection more effective. In essence, the government must develop appropriate policies, set targets, and raise the necessary revenue, while the private sector, communities, and individuals must take charge of delivery and implementation. This can be achieved through the use of vouchers and the outsourcing of service provision.

The IRR has done extensive research on education vouchers, but the underlying idea can easily be extended to healthcare and housing. In education, the key concept is that government must continue to fund education out of tax revenues, but need no longer provide it. Instead, it should allow communities, non-governmental organisations, or private investors to take charge of schools. Most of the education budget would then be divided among pupils and distributed to their parents in the form of education vouchers, which would be used solely to purchase schooling.

> *Major reforms are also needed to make social protection more effective. In essence, the government must develop appropriate policies, set targets, and raise the necessary revenue, while the private sector, communities, and individuals must take charge of delivery and implementation.*

Parents will then be empowered to enrol their children at any school of their choice. As fee-paying consumers, parents will also have the power to hold school principals and teachers to account. Since schools will have to compete for the custom of parents, this will give them a powerful incentive to upgrade their teaching and improve their overall performance. The vouchers, in short, will generate a market for education, which will bring about a rapid improvement in the quality of education – as has already happened in other countries where vouchers have been introduced. As a variation on the basic idea, the state could also contract with private providers to run its schools, so turning them into 'contract schools' of a kind found in the US and the UK.

Education vouchers must also be used to improve failing TVET colleges and ensure that good quality technical and vocational training is made available to millions of poor South Africans. This would help expand essential skills, take the pressure off universities to increase their intake beyond practical limits, and equip people to earn a good living for themselves.

Vouchers for technical and vocational training must be made available, not only to current pupils, but also to the millions of youngsters who have either dropped out of school or gained a school-leaving certificate with little value to them or prospective employers. This would help absorb the 3.4 million young people who are not in education, employment, or training (Neets). Again, this would help expand the skills needed for the infrastructure programme and other economic activities. It would also restore a sense of hope to millions of youngsters currently without prospects or marketable skills.

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A similar idea in healthcare would see the state providing vouchers to poor households, which could use them to purchase medical cover, mainly in the form of low-cost medical schemes, topped up by health insurance. Using their health cover, households would be able to access services either from private practitioners or from the state clinics and hospitals the private sector would be contracted to operate.

Much the same idea can also be applied to speed up the provision of housing. At present, despite a large housing budget, the government is building only about 100 000 low-cost houses a year. Since there are 2.1 million households on the national housing waiting list, it will take the state some 20 years simply to clear the current backlog – let alone meet future needs. To improve efficiency and empower the poor, much of the housing budget should thus be used to fund housing vouchers for poor households. These vouchers could be used to access mortgage financing and so help people build their own homes. This would reduce government inefficiency and allow people to meet their housing needs without having to wait endlessly on the state to deliver.

Fixing education, healthcare, and housing provision in this way will greatly enhance skills, improve living conditions, and empower people to get ahead. These interventions will be needed for many years, especially as wages will generally be low at the start of the turnaround process.

Because earned income will initially be limited and not everyone who wants a job will be able to find work, current social grants for children, pensioners, and the disabled must be retained for some 20 or 30 years. These grants will also become more sustainable as growth rises and tax revenues expand.

The current social welfare system is highly efficient because the grants are paid directly to households, which can then decide how best to spend the money. This is in keeping with the IRR's core idea that the state should help with financing while individuals and the private sector should take charge of delivery.

Our proposals on social protection are therefore to:

- Introduce education, healthcare, and housing vouchers to expand skills and social protection;
- Maintain current social grants, which will become more affordable as growth rates and tax revenues rise and debt levels decline.

Concluding comments

It is not for the IRR to dictate to the government and ruling party what to do. Too many groups overstep that mark and think they should decide policy or try to push for changes through the courts. Think-tanks such as the IRR can help to act as catalysts for change, but only the government has a mandate to take policy decisions on behalf of large numbers of people. Our role is thus to develop simple workable policy alternatives and show the benefits of these.

At the same time, if South Africa continues on its current economic trajectory, the ruling party could lose power before the end of the decade. As people become poorer and lose hope, they also lose their earlier confidence in the ANC, as various opinion surveys now show. The ruling party would thus be wise to acknowledge that many of its current policies, including its transformation ones, are at odds with the urgent need for investment, growth, and jobs.

South Africa is now in considerable economic trouble. Looming ratings downgrades to sub-investment levels will worsen our economic position and make it much more difficult to stage a recovery after the 2019 general election.

At the same time, the government is still capable of reform. In the period from 1994 to 2007, it did much to raise the growth rate and lower debt levels, while simultaneously expanding social protection and improving living standards. The National Growth Strategy is thus within the power of the government to start implementing very soon – and then to drive forward to highly successful outcomes.

Many in the government may be ideologically reluctant to embrace these reforms. However, much of what we propose is drawn from the successes achieved by Lee Kuan Yew in Singapore in the 1950s and 1960s, which in turn helped inspire the reforms driven by Deng Xiaping in China in the 1970s and 1980s. Both these men were nationalist leaders who dramatically changed the fortunes of their countries and turned them into influential global economic powerhouses. Their extraordinary successes show how much can be achieved – and should put paid to any notion that South Africa cannot also become rich and influential.

> *If the bulk of the National Growth Strategy is adopted and implemented, this will stave off looming downgrades to junk status. The strategy will also have a measurable impact on investment, growth, employment, and income levels within 12 months. At the same time, it will provide the foundation for sustainable growth rates of 7% of GDP within a decade.*

Many other growth plans have, of course, been drafted for and by the government. Often they are too vague, complex, and impractical. Sometimes their time frames are so long that they seem irrelevant. Others seek instant fixes and thus rely on gimmicks such as 'wage subsidies' and 'industrial development zones', which ignore the structural reasons for poor economic performance. Yet others have focussed on 'low hanging fruit' to the detriment of needed structural reforms.

The National Growth Strategy avoids these pitfalls. If the bulk of the National Growth Strategy is adopted and implemented, this will stave off looming downgrades to junk status. The strategy will also have a measurable impact on investment, growth, employment, and income levels within 12 months. At the same time, it will provide the foundation for sustainable growth rates of 7% of GDP within a decade. This will allow South Africa to combat unemployment, poverty and inequality, live up to its great potential, and emerge as a prosperous middle-income economy by the 2030s.