IRR
South African Institute of Race Relations
The power of ideas

GROWTH & RECOVERY:

A STRATEGY TO #GETSAWORKING

PROPERTY RIGHTS • DEREGULATION • NON-RACIAL POLICY

A plan to put SA on the path to recovery over the years 2021 - 2026

IRR

South African Institute of Race Relations

The power of ideas

Growth & Recovery: A Strategy to #GetSAWorking

Published in August 2020 by the South African Institute of Race Relations

2 Clamart Road, Richmond

Johannesburg, 2092 South Africa

P O Box 291722, Melville, Johannesburg, 2109 South Africa

Telephone: (011) 482–7221

Fax: (011) 482–7690

Author: John Endres

This paper is based to a significant extent on ideas first put forward by the IRR in 2016, in a paper co-authored by Frans Cronje and Anthea Jeffery.

We gratefully acknowledge the input provided by Toby Chance and Shawn Hagedorn.

Cover design by Alex Weiss

Executive Summary

South Africa finds itself in perilous straits. Decades of mismanagement, unbridled spending and harmful economic policies created a dangerous cocktail to which the Covid-19 pandemic has lit a match. There is widespread recognition that something must urgently be done to bring the country back to a positive trajectory. As the International Monetary Fund (IMF) advised the government, there is a pressing need for "growth-enhancing structural reforms".

But what are those reforms? In this paper, the IRR makes some simple proposals that remove impediments to entrepreneurial initiative and individual autonomy, and which – if implemented – will help society as a whole move forward.

The idea underlying all the elements of this plan is that what South Africa needs, more than anything else, is economic growth. Growth offers the only way to get people working and allow them to lift themselves out of poverty. Spurring growth depends on four elements:

- attracting direct investment;
- maintaining and expanding infrastructure;
- creating a climate favourable to job creation; and
- implementing a programme of widespread economic empowerment instead of elite enrichment.

We expect there to be widespread consensus on these four measures. However, we add three necessary conditions which we believe are indispensable for the four policy proposals to work. They are:

- a firm commitment to property rights, implying abandoning plans such as expropriation without compensation, prescribed assets and the monopolistic nationalisation of the healthcare system;
- an end to race-based policies, including Black Economic Empowerment and affirmative action, and their replacement with meritocratic and race-neutral policies like Economic Empowerment for the Disadvantaged (EED);
- and wide-ranging liberalisation of the labour market that removes barriers to entry for young and low-skilled individuals especially.

If implemented, these proposals would give South Africans the opportunities they crave: real socio-economic empowerment and sustainable progress.

In contrast to plans published by the government and other civil society organisations in recent months and years, most of the measures suggested in this paper can be implemented at no or very little cost. In essence, they entail removing impediments to economic activity and following the principle of subsidiarity: putting decision-making power closer to where those decisions have an impact; ideally, in the hands of individuals. For example, the proposed voucher system would put public funds in the hands of disadvantaged South Africans to spend on goods like education, housing and healthcare instead of channelling them through a vast and inefficient bureaucracy.

We recognise that these plans, while financially affordable, potentially carry a high political cost. At least in the short term, this may make them unpalatable to politicians. Conversely, the heavy financial burden of the plans put forward by other organisations, which propose that we spend our way out of trouble, falls on ordinary South Africans in the form of higher taxes, higher debt, higher inflation or outright dispossession.

Given this choice, we argue that firstly, ordinary South Africans should not be made to carry the burden of recovery; secondly, that stimulating growth through state spending is unlikely to work, given the government's track record over the past decade; and thirdly, that – arguing from self-interest – the survival of the incumbent government depends on its willingness to make some hard choices.

Introduction

In 2016, the IRR released a national growth strategy for South Africa. The paper summarised the structural weaknesses limiting the economic potential of the country at the time and proposed ways to address them. Since then, however, South Africa's situation has deteriorated further in the persistent absence of substantive reforms, leaving the country to face the devastating impact of the global Covid-19 pandemic in a weakened state and with very little fiscal room to address the crisis. In response, the IRR revised and updated its paper.

As an illustration of how dire the situation is and how quickly formerly cherished beliefs are being thrown overboard, consider that under the influence of the crisis and as a result of the economic destruction caused by the government-imposed lockdown, the ANC administration has been forced to make a move it vehemently opposed since 1994: to approach international finance institutions for loans. As it stands, the government has received commitments of $4.3 billion from the International Monetary Fund, $1 billion from the New Development Bank (the "Brics bank") and $288m from the African Development Bank. It is likely that these initial loans will not be the end of the road, but that they are merely the start of an arduous journey from the precipice of financial ruin.

> *By delaying reforms for as long as it did, the government manoeuvred itself into a spot where it has run out of options.*

By breaking the taboo and applying for international donor funding, the ANC government has – as its alliance partners, trade union federation Cosatu and the South African Communist Party, rightly feared – taken the first step on the path to surrendering some of its fiscal sovereignty. Future loans are likely to be granted only upon condition of greater fiscal responsibility, less corruption and wastage, and profound structural reforms.

Of course, such reforms were needed independent of the coronavirus; it was only a matter of time before they became inescapable. The power to decide whether to introduce tough reforms independently or have them imposed from the outside was a function of time. By delaying reforms for as long as it did, the government manoeuvred itself into a spot where it has run out of options. Recovering from the malaise also becomes increasingly difficult as maladministration and economic weakness become more and more entrenched, dragging down more parts of the economy and the body politic.

In response to the crisis, two prominent reforms plans were published in July 2020, one by the ANC ("Reconstruction, growth and transformation: Building a new, inclusive economy") and the other by the Business For South Africa business alliance ("A new inclusive economic future for South Africa"). In effect, these plans are a rehash of what the ANC government has been proposing in various development plans for at least a decade.

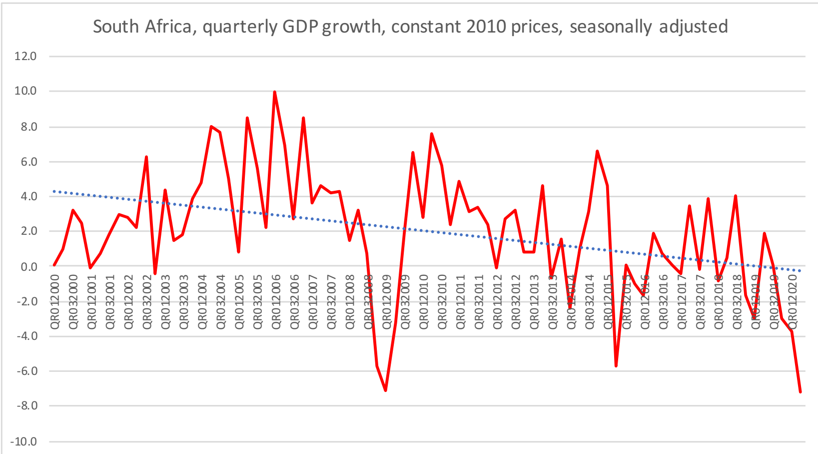
The plans call for collaboration between business, government and civil society in the form of "social compacts"; the creation of employment schemes, use of subsidies, reindustrialisation and infrastructure spending; and investing in the green economy. All of these recommendations, incidentally, are taken from the "New Growth Path" document, released by the economic development department as long ago as 2010. None of the plans have amounted to much, as growth has been dismal over the past decade, while government debt has skyrocketed.

The reason the plans have failed is two-fold, and only one of the two reasons is consistently identified in the public debate: that reason is "lack of implementation" or "weak execution". Certainly, there is some merit to the argument. However, there is an additional reason, which is mentioned less often: it is the underlying ideology, which is fundamentally centralising, collectivist and redistributive in nature. Ultimately, this narrative is even more harmful, because it scuppers the country's chances of charting a way to a more prosperous future. This is why the IRR plan is based on the ideas of decentralisation, freedom of the individual, and production rather than redistribution. In this spirit, it calls for property rights to be respected, race-based policies to be abandoned and markets (especially the labour market) to be deregulated.

The failure to reform has left South Africa in deep economic trouble. In the aftermath of Covid-19 and the subsequent lockdown, the unemployment rate could spike as high as 50%. Jobs are being lost, rather than created, at terrible speed. The economy, already into recession in the final quarter of 2019, is to shrink by 7.1% according to the World Bank and by 7.2% according to National Treasury. The most optimistic forecasts for the next three years put economic growth at 2.6% of GDP for 2021 and 1.5% for 2022 and 2023. At a pedestrian annual growth rate of 2%, it will take South Africa until 2024 to return to its 2019 GDP level.

Key indicators of business, investor, and consumer confidence are at record lows. Capital outflows are accelerating, and little new direct investment is taking place. Government net loan debt tripled from R819bn in 2010/11 to R2,545bn in 2018/19 (of which R291bn were foreign loans, with an implied exchange rate risk).

In the 2020 Supplementary Budget Review, published in June 2020, the Treasury projected a further increase in net loan debt to R4,715bn in 2022/23, although that figure may well have to be revised upwards as tax revenue collapses in a faltering economy. Bond yields have risen sharply, indicating that South Africa's international lenders are viewing the country as an increasingly risky prospect. The currency has weakened dramatically. All three major ratings agencies have South Africa on sub-investment grades. This significantly weakens the country's financial position and complicates any attempts at reform. The fiscal deficit is already preventing the government from implementing many of its plans.



Amidst the Covid-19 lockdown and an estimated loss of up to 3 million jobs, the need for reforms is clear. However, recent pronouncements by the SACP-ANC government indicate no intention to undertake pro-growth reforms. Instead, they display an ideological commitment to repeating the very mistakes that saw South Africa entering the Covid-19 pandemic era beset by multiple other crises.

It is time for a fundamental break with the ideology that has placed South Africans in this dangerous socio-economic situation.

Building on many years of research and analysis, the IRR has developed a realistic turnaround strategy. Unlike other plans, this strategy is simple and workable. It has four successive and constructive steps – all of which can be initiated by the government within months. The strategy is designed to be fully implemented over the years 2020 to 2022. 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. Without it, the economic crisis will be very much worse by then and will become even more difficult to repair.

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 and expanding fixed capital formation; (2) to build and maintain essential economic and social infrastructure to stimulate growth and provide a solid foundation for further economic expansion; (3) to translate increased growth into increased employment; and (4) to help the disadvantaged climb the economic ladder to increased prosperity, while sustaining current social protection. In the short to medium term, the strategy will deliver significant improvements in investment, growth, and employment. In the long term, it will allow South Africa to realise its full potential as a leading emerging market.

The vital importance of economic growth

Under the IRR strategy, arresting current rapid economic decline and promoting sustained economic growth must be the government's overarching policy priorities. 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 and wealth extraction, 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 – especially in a time of severe crisis. By contrast, if the growth rate could be raised to 7%, as the first edition of this paper called for in 2016, the economy would double in size within ten years and average GDP per capita would soar. Achieving such an ambitious growth target would be a great deal more challenging today than it would have been four years ago. However, given the right policies, it is achievable in the medium term. Importantly, it would also require resolving the electricity supply problem, a binding constraint on the economy that limits all prospects of more than anaemic growth.

> *The SA economy could have been up to 30% or R1–trillion larger and created 2.5–million more jobs had the country kept pace with other emerging markets and sub–Saharan economies over the past decade.*

Boosting the growth rate in this way will vastly increase the opportunities available to all South Africans. Thousands of jobs will be saved and millions of new ones created, making it possible to bring the unemployment rate down from the roughly 50% it is likely to reach due to the shocks of the Covid-19 lockdown to under 10%.

On the official definition (which takes into account only active work seekers), unemployment stood at 30.1% in the first quarter of 2020. This is very high by world standards. It is also much higher than the equivalent rates in Brazil (12.9%) Russia (6.2%), India (11.0%), and China (5.7%). Youth unemployment is even worse, standing at 59% on the official definition for people aged 15 to 24, and at 70% on the expanded definition that includes people who could work but who have given up looking for a job. Among black males, the official rate is 57.1% and the expanded one 69.3%, (according to the most recent data available). Among black women, the equivalent jobless rates are 68.3% and an appalling 78.7%, respectively.

To create more jobs, higher rates of economic growth are required, 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 have remained far below those in most other developing countries, with current circumstances worsening an already perilous employment situation. A study by the Bureau for Economic Research published in 2018 showed that "the SA economy could have been up to 30% or R1-trillion larger and created 2.5-million more jobs had the country kept pace with other emerging markets and Sub-Saharan African economies over the past decade".

That South Africa has no jobs for millions of 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 no substitute for earned income. They also risk becoming unaffordable.

The massive roll-out in grants which took place from around 2002 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 more than tripled. Debt service costs now absorb over

R200bn per year and are expected to rise to over R300bn in 2022/23, a figure greater than the entire healthcare budget. The interest bill is rising faster than any other line item. As the Treasury put it in its 2020 Supplementary Budget Review, "rising public debt means that an ever-increasing share of tax revenue is transferred to bondholders." The expansion of welfare during the initial reaction period to the Covid-19 pandemic, while understandable as a measure to protect vulnerable South Africans against the consequences of lockdown, adds further to the pressures on the fiscus and taxpayers. Those pressures will worsen in the absence of economic growth and, in fact, unprecedented economic decline.

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, 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. This is brewing a recipe for disaster. With tax revenues stagnating over much of the last decade and set to aggressively decline amidst the Covid-19 lockdown crisis, the government will be hard pressed to maintain current cash payments, let alone raise them in line with inflation. For 2020/21, the government is expecting to collect R1,100bn in revenue (R300bn less than projected at the beginning of the year), but intends to spend R1,809bn – implying a revenue shortfall of R709bn. Hunger is likely to increase broadly, with reports of parents going hungry to shield their children, 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. But most importantly, it is a moral necessity and a key element in social justice and empowerment. 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.

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 digits, it must at least 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 two decades, however, South Africa has generated only about 300,000 net new jobs per annum, with even this anaemic job growth likely to be wiped out by the consequences of the Covid-19 lockdown. 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, although this is probably not achievable in the short terms, given the electricity and policy constraints the country faces. Higher growth will boost not only employment but also tax revenues, consequently allowing more redistribution in the form of social grants and the wider social wage (free education, healthcare, housing and the like). 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.

Higher growth, in short, will allow South Africa to escape the vicious cycle which we are currently stuck in. 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. The following sections describe just how to do that.

Attract direct investment to get the growth rate up

1. Safeguard 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 land and real estate, agriculture, mining, oil and gas, the private security industry, private healthcare 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 two specific proposals to strengthen property rights, both of which could be implemented within months:

- As a first priority, abandon Expropriation without Compensation (EWC) by scrapping nil compensation clauses, both in the proposed constitutional amendment bill and the Expropriation Bill of 2019; bring the Expropriation Bill into line with the Constitution under a revised bill similar to that put forward by the IRR; and abandon the idea of the state's taking custodianship of all land, both urban and rural;
- 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 (BITs) with major trading and investment partners that incorporate standard provisions found in South Africa's BITs with countries such as China, Cuba, Iran and Russia.

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.

2. Create an effective state and a competitive investment climate

Attracting direct investment and increasing the returns on it requires a major uptick in the country's international competitiveness. Among the obstacles needing to be overcome are inadequate infrastructure; an inefficient government bureaucracy; 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).

> *Though the ruling party may have some ideological resistance to these reforms, faster growth will not be possible without them.*

Necessary 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 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.

3. Create 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 only through large corporations employing great numbers of people, but also 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 at an increasingly rapid pace. 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. It may turn out that China will soon become an attractive, diversified export market for South Africa, rather than just a supplier of vast quantities of cheap, mass-produced goods and buyer of unprocessed raw materials.

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 market 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, artisanal manufacturing, informal traders. Every lawful enterprise should be welcomed and given the benefit of a business environment friendly to all entrepreneurs.

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 as this will give birth to multiple start-ups.

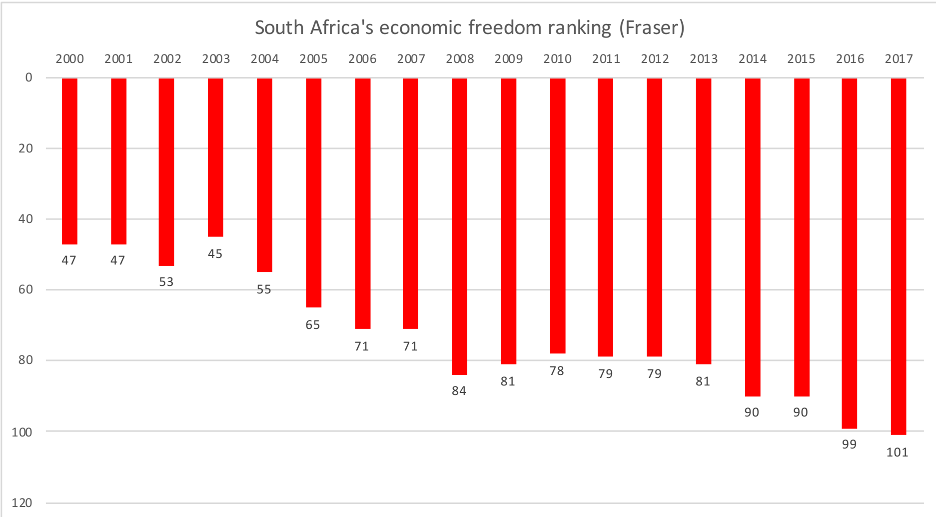
In addition, we must allow the informal sector to flourish and remove regulatory impediments to its success. We must recognise that unregistered township-based entrepreneurs – even if they do not (yet) pay taxes or minimum wages – are good for our economy and will remain so for many years to come. So 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.

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 the section "Maintain and expand infrastructure").

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 Heritage Foundation shows, for example, that between 2004 and 2019, countries that improved their economic freedom scores grew their economies at an average rate of 2.8% per year, while those who became economically less free grew at only 1.9%. The 1 percentage point difference favouring freedom-gaining countries remains constant, whether one looks back 5, 15 or 25 years. Because of these very different growth performances, the least free countries, as measured by the Fraser Institute, recorded GDP per head in 2017 at $6,140, while the most free recorded almost $36,770 – almost six times as much. Moreover, the average per capita income of the poorest 10% of people in the least free countries was $1,503, whereas in the most free countries it was nearly $10,646, over seven times as much.



Interestingly, as the 2019 Fraser Institute report found, "the average income of the poorest 10% in the most economically free nations was two-thirds higher than the average per-capita income in the least-free nations". South Africa's economic freedom rating peaked at a value of 7.1 in 2000 (rank: 46th) and then dropped continuously to 6.6 in 2019 (rank: 101st). As economic freedom decreased in South Africa, GDP growth dropped, from near 4% to under 1%.

Maintain and expand infrastructure

If economic growth is to take off and reach the stretch goal of 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. This is especially true of the electricity and transport infrastructure. 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.

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 the section "Broaden and speed up economic participation".

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.

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 the section "Broaden and speed up economic participation". 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.

Generate more jobs and draw more people into the labour market

1. Provide a sensible labour regulatory environment

The unemployment 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 national minimum wage introduced at the start of 2019 – must be scrapped. Instead, private employers should be allowed to take a leaf out of the government's book.

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 R90 a day. This is significantly below the national minimum wage generally required. The government provides these work opportunities at these low wages because it recognises the importance of earned income and 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 still need to 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 to job creation, 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.

Our proposals, in a nutshell, are to amend the Labour Relations Act of 1995 and the National Minimum Wage Act of 2018 by:

- Introducing effective pre-strike secret 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 the national minimum wage;
- 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 alarming unemployment rate.

2. Increase demand for unskilled labour

The manufacturing industry'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 three sectors that have long employed large numbers of unskilled people: agriculture, mining and tourism. All 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 the minerals needed for high-tech goods. This is an opportunity South Africa should make use of in future, not least because of its extraordinary mineral endowment, estimated at around $2.5 trillion, and favourable access to markets via sea routes. Various other mining countries are 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. Between 2010 and 2018, employment in South African mining shrank by 50,000, annual capital expenditure dropped by 45% and the real output value in dollar terms was down by 10%. The sector's feeble performance is attributed to the unstable electricity supply, logistical bottlenecks, regulatory uncertainty, a lack of cost competitiveness compared to other mining regions, and strained relationships between mining companies and both labour and mining communities. All these factors add to a 'risk premium' for investors. Moreover, in a more flexible labour environment, there would be less impetus to mechanisation and a greater demand for relatively 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.

Tourism also has much to offer in terms of job creation and economic growth. The tourism sector is jobs-intensive and thus has the potential to employ millions of South Africans. Much like agriculture, tourism has plenty of room for unskilled and low-skilled labour. The Organization for Economic Co-Operation and Development (OECD) recently highlighted the fact that South Africa should do much more to support its tourism sector with regards to Covid-19 relief, and beyond. Prior to the Covid-19 pandemic, the tourism sector contributed approximately 8.6% to GDP and employed roughly 1.5m people both directly and indirectly. The OECD stated that "…the recent COVID-19 pandemic and resulting containment measures have triggered an unprecedented crisis in the tourism sector. Still, the sector offers significant opportunities for an economy with weak growth and high unemployment." This indicates that the OECD views South Africa's tourism sector as a key sector for economic growth going forward and one we should exploit to its full potential.

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 the section below.

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 take off. Many more domestic service, cleaning, security, and transport jobs can also be created as the middle class grows.

(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 empowerment laws to encourage the use of all available skills.)

Broaden and speed up economic participation

1. Implement 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 support. These assumptions are no less flawed, as IRR opinion surveys have shown. According to these surveys, 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, rather than on meeting racial targets. It thus recognises and rewards business 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 them. The EED system is also different from BEE in that it uses carrots rather than sticks to encourage and incentivise the key contributions that a vibrant business sector makes to prosperity and upward mobility.

The EED alternative offers a win-win solution that breaks the current dichotomy between business needs 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 wider 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 surveys show. 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. As the South African Communist Party (SACP) put it in 2017: "Enriching a select BEE few via share-deals, or measuring empowerment progress in terms of direct individual black percentage ownership of the JSE, or (worse still) looting public property in the hands of state owned corporations in the name of broad-based black empowerment is resulting in the very opposite – increasing poverty for the majority, increasing racial inequality, and persisting mass unemployment."

2. Expand and sustain social protection

Even when the economy starts turning around and millions more jobs are created, the state will still need to 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 the section "Maintain and expand infrastructure"). 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 pay for schooling.

Parents will then be empowered to enroll 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 patronage 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 should 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.

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 fewer than 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. In informal settlements, such vouchers could also be used to upgrade shacks and improve living conditions. This would reduce government inefficiency and allow people to meet their housing needs without having to wait endlessly on the state to deliver.

Support for vouchers is high: in December 2018, 93% of black respondents in an IRR field survey (up from 86% in 2016) supported the idea of education vouchers. Black support for healthcare vouchers came in at 91% (up from 83% in 2016), while support for housing vouchers was strong as well, at 83% in both years.

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 become more sustainable, however, as growth rises and tax revenues expand. The effect of negative growth and plummeting tax revenues can be seen in the fact that 72.4% of South Africa's gross tax revenue is taken up by public servant salaries (which cost 51.4 cents in every rand paid in tax) plus debt repayments (21 cents in every rand). This leaves just 27.6% for everything else, including social grants, education, healthcare and infrastructure development. If the trend is not reversed, social grants will soon become unaffordable.

The current social grant system is highly efficient because the cash 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; introduce a cap of 20% of total government expenditure on social grants (the social development department currently receives around 16% of total state expenditure).

Concluding comments

Think-tanks such as the IRR can help to act as catalysts for positive change, by developing simple workable policy alternatives and showing their benefits. The alternative, of continuing as we are, would mean that South Africa continues on its downward economic trajectory. In this case, the ruling party is likely to 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 governing party would thus be wise to acknowledge that many of its current policies, including its single-minded pursuit of demographic transformation, are at odds with the urgent need for investment, growth, and jobs.

South Africa is now in serious economic trouble. Ratings downgrades to sub-investment levels, combined with mountainous debt levels, a growing sense of disillusionment, falling trust in the government, increasing lawlessness and low investment levels have worsened our economic position and made it much more difficult to stage a recovery after the 2020 Covid-19 crisis. In a recent article, Joseph Stiglitz and Hamid Rashid write that "history shows that for many countries, a restructuring that is too little, too late merely sets the stage for another crisis." For South Africa, the time has come for bold reforms. Anything less will only prolong the pain.

Policymakers may be ideologically reluctant to embrace the reforms we propose. However, much of what we describe 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 Xiaoping 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, based on pragmatic policies, show how much can be achieved and should put paid to any notion that South Africa cannot also become prosperous and influential.

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 IRR's National Growth Strategy avoids these pitfalls. It will have a measurable impact on investment, growth, employment, and income levels within 18 months. It will restore confidence in the economy, which is at low ebb both because of the coronavirus crisis and because of many years of low growth and lacklustre governance.

As a side effect, the proposals would also address many of our current weaknesses related to corruption, lack of accountability and general lawlessness. For instance, much of the inefficiency in policing and law enforcement, plus the lack of accountability, stems from existing empowerment and accompanying cadre deployment policies in the public service, municipalities, SOEs, the National Prosecuting Authority and the Hawks. A large part of the corruption, wasteful spending, and 'construction mafia' violence is related to BEE; and many of the violent protests, including the truck burnings (over 1400 in 2019 alone), are fuelled by joblessness and thus indirectly by the National Democratic Revolution. Overall, stamping out corruption requires not only changes to EE and BEE rules, but also independent, effective investigation and prosecution instead of endless, costly commissions of inquiry.

Similarly, a system of highly decentralised disbursement of public funds through vouchers would help empower poor households and end corruption in schools, while effective public-private partnerships on infrastructure should help maintain and preserve what we already have.

Furthermore, the social instability resulting from a lack of prospects and a sense of general lawlessness has a negative impact on South Africa's ability to attract and retain the skills and talent it desperately needs. Highly skilled South Africans are emigrating in search of greener pastures and a better future for their families. Conversely, skilled foreigners who might consider moving to South Africa are dissuaded by onerous, opaque and arbitrary visa regulations, a perceived risk to their personal safety, and the perception that South Africa is a country on the descent, with failing institutions and collapsing infrastructure. The effect of these negative factors is cumulative, and reversing the cycle is a question of political will rather than available resources.

The proposals we describe above are inexpensive compared to others that call for massive stimulus, primarily through infrastructure spending. Furthermore, they would help turn the mood in the country around. At present, there is a feeling of despondency and helplessness in the face of what appears to be an inexorable slide towards ever greater immiseration and hopelessness. This sentiment weighs heavily on the economy, inhibiting both consumption and investment, disrupting social peace, and leading to frustration and anger.

This mood cannot be turned around through talk only, no matter how hard our leaders try. Instead, it requires action: a fundamental shift towards greater individual freedom, along with a removal of the impediments to growth and investment. South Africans cannot be united by social cohesion summits or social compacts. But they will unite behind a plan to rebuild their own lives, and at the same time, reconstruct their country.

Our proposals provide the foundation for sustainable growth rates of 7% of GDP within a decade, provided that the Eskom growth constraint is removed and the policy environment is appropriately reformed. 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.

IRR

South African Institute of Race Relations

The power of ideas

(011) 482 7221

info@irr.org.za