

The costs of deviating from the efficient level of BEE in South Africa

by

Stephen Hosking*

University of Port Elizabeth

September, 2003

Abstract

Race-preferring policies have a long history in South Africa; the main reason being that they are popular with voters. Both perceptions of justice and personal benefit provide rationales for current race-preferring policies. Of these it is argued that the personal benefit rationale is the more convincing. This paper reviews the current race-preferring policy being implemented in South Africa – that known as Black Economic Empowerment (BEE). It argues from an economic growth perspective that this policy does opposite things - it averts costs that decrease economic growth and gives rise to other costs that reduce economic growth. As these affects operate in opposite ways, it is deduced that an efficient BEE level must exist and that social cost escalation constrains this level. Deviations from what is efficient are predicted to have a negative impact be on economic growth. In South Africa's case the tendency may be to exceed what is efficient.

THERE IS LITTLE DOUBT that many components of the African National Congress's (ANC) economic policy have promoted per capita growth of real GDP in South Africa. Their macroeconomic policy has been instrumental in bringing inflation under control (Lewis, 2002; Fourie and Burger, 2002). Their trade policy has also been enormously beneficial, although there was, perhaps, excessive optimism over the short-run benefits trade liberalization and trade preference negotiations were capable of delivering to South Africa (Easterly, 1996, McCarthy, 1998). Trade preferences negotiated with the European Union and the USA are of enormous potential benefit to South Africa and trade liberalization has probably done much to cushion the negative impact of high interest rates that have resulted from low savings levels and the pursuance of deflationary macroeconomic policy. The ANC government should be complimented on their contribution to economic growth in South Africa through their control of inflation and development of goodwill trade capital.

However, measured by other criteria ANC economic policy has been far less positive. When Apartheid ended, South Africa looked headed to a bright non-racially charged future (Parsons, 1999). A new more widely supported political leadership took power. This leadership expressed commitment to reconciliation and the building of a non-racial society. However, this honeymoon era soon passed and under the influence of majority voter support, economic policy moved steadily toward redistributing income and wealth between the race groups of South Africa. This redistribution policy has become known by various names, one of which is Black Economic Empowerment (BEE). This paper considers the benefits and costs of it from an economic growth perspective and considers what the impact is of deviations from the optimum.

* The original thoughts utilized in this paper were first presented in an Inaugural Address at the University of Port Elizabeth (UPE) in April 2003 on the broader issue of constraints on economic growth in South Africa (Hosking, 2003). The contributions of my wife Gaye and those of colleagues at UPE are gratefully acknowledged.

1. BEE as justice considerations or the result of pursuit of self interest by Black voters?

The dominant school of thought on current race-preferring policy in South Africa is that it is just. The argument that race preferring policy is just is based upon two premises: that Black South Africans were done injustices under successive White governments, particularly the Apartheid ones, and that the just way for the current government to correct these injustice is to implement compensatory race-preferring policy. The first premise is sound, but once again the second is not. There is no doubt that many people were done injustices under previous White governments in South Africa, especially Black people, and the current government should give attention to correcting for these injustices. However, compensatory race-preferring policy is not an appropriate correction. Justice can only relate to individuals, not races (Brassey, 2000). For this reason the only sensible path to follow in the pursuit of justice in South Africa with respect to the Apartheid transgressions is along the lines of the Truth and Reconciliation Commission.

Race-preferring policy simply generates new injustices. The victims of the previous injustice are left to live with their injustice and new victims are created, White and Black. As time passes those benefiting from and those adversely affected by the new compensation measures have increasingly tenuous connections with the injustices the policy seeks to rectify. In the labour markets it is the new entrants that are most affected by the policy – people who had little, if any, connection with social decision making under the Apartheid governments. To impose this policy on them is simply to do them an injustice and to rationalise race-preferring policy under the name of justice is a fraud.

A less intuitively convincing variant of the justice argument is the social contract one - that because affirmative action was agreed to at the constitutional level that it must be part of the social contract. The latter relates to something that everyone would agree to in some or other context. It is not intuitively convincing because is not credible that Whites would unanimously agree to race-preferring policy in which they were disadvantaged.

The truth is that opinion on the issue in South Africa is divided approximately by race – with Blacks in support of the policy and Whites opposed to it. For this reason the part of the constitution that incorporates affirmative action reflects little other than the relative weight of Black to White vote power in setting the constitution. Under the majority vote system the holdings, rights and opportunities of those not represented and minorities are at risk from the government. It is well known that less than unanimity based constitutions offer only limited protection to minorities and the disenfranchised - often insufficient as shown in the cases of the Jews in Hitler's Germany, the Blacks in Apartheid South Africa and the Whites in Mugabe's Zimbabwe. In the former two cases it is quite clear that the succeeding generations of those whose race was preferred also now strongly oppose the policy. They have had to reap the consequences of the policy. In Magabe's Zimbabwe, all the signs suggest that the succeeding generation of the current voters are also going to pay for the folly of the current race-preferring policy and will turn against it shortly.

There are both justice and self-interest rationales for BEE, but that the self-interest one is more convincing. This paper, however, has as its focus of attention on another issue – the optimal level of BEE from the perspective of promoting economic growth

2. Background to race-preferring policy in South Africa

Race preferring policies and laws have a long history of voter popularity in South Africa. Up until the 1990s Whites were systematically advantaged under these types of laws and policies. Their imposition was not to prevent economic growth from occurring, but to prevent potential economic growth from being fully realized. Following a long period of high growth in South Africa during the 1950s and 1960s Houghton (1969: 236) commented that:

White voters have used their monopoly of political power to entrench their economic position by restrictions on the movement and advancement of African workers...These contrived scarcities and imperfections in the labor market have a corrosive effect upon economic growth, and prevent optimal resource allocation. Moreover the existence of these barriers discourages initiative and enterprise in both those thus protected and those against whom discrimination is applied.

Just how much economic growth was sacrificed through ballot box political pressure from the White section of the population under the National Party government, we can only guess at. Coincidentally post-1970s economic growth in South Africa under this government was disappointing (Table 1).

Table 1: Economic Growth selected periods, 1946-2002

Time period	Average per annum growth rate of real GDP (%)	Average per annum population growth rate (%)	Average per annum growth rate of real GDP per capita (%)
1946-1950	4,2	2,6	1,6
1951-1960	4,5	2,6	1,9
1961-1970	5,7	2,6	3,1
1971-1980	3,4	2,6	0,8
1981-1990	1,6	2,6	-1
1991-1994	0,3	2,6	-2,3
1995-1999	2,6	1,6	1
2000–2002 est	3,1	1	2,1
2003 est.	2,5	0	2,5

Sources: On GDP growth: Maasdorp (2002:9); SARB (2003) S-109; Seria (2003): 2. On population growth: www.scholars.edu.sg/landow/post/sa/people.html; www.irinnews.org/AIDS/south_africa.asp#data; www.worldpress.org/profiles/South_africa.cfm; www.pbs.org/journeytoplanetearth/profiles/south_africa.html; www.usaid.gov/press/releases/2000/pr000710.html

Could the correlation between disappointing economic growth and race-preferring policy be in the process of being repeated? Since 1994, new race-preferring laws and policies have been introduced by the ANC – also the result of ballot box political pressure. The difference between the ANC’s and the National Party’s policies is that instead of the Whites (particularly Afrikaners) being the ones preferred it is the Blacks that are being preferred.

The scale of reintroduction of race complications into doing business in post-apartheid South Africa is breath-taking: racial criteria for awarding government contracts, race delineated quotas employers must adhere to in hiring workers and managers, race quotas in sport (even), race requirements in asset ownership in selected sectors of the economy and race group threats by government and party officials (*Eastern Province Herald*, 10 August, 2000: 9; *Eastern Province Herald*, 23 October, 2002: 13). Coincidentally economic growth since 1994 has not lived up to expectations (see Table 2).

Table 2: Average per annum per capita real GDP growth for selected groups of countries around the world, 1960 – 2000, weighted by population size

Year	Rich countries ¹ (%)	Post-1980 globalising countries ² (%)	Post-1980 non- globalising countries ³ (%)	South Africa ⁴
1960s	4,7	1,4	2,4	3,1
1970s	3,1	2,1	3,3	0,8
1980s	2,3	3,5	0,8	-1
1990s	2,2	5	1,4	-1,1

Sources: Dollar and Kraay (2003:40).

Notes: ¹ The 24 countries making up this group were the OECD members plus Chile, Hong Kong, South Korea, Taiwan and Singapore.

² The 24 countries making up this group were the top one-third countries in terms of growth of trade as a % of GDP between 1975 and 1997.

³ The 24 countries making up this group were the remainder for which sufficient data were available on trade indices and per capita real GDP growth.

⁴ Estimated from Table 1.

South Africa sustained positive per capita growth of real GDP from 1946 to the end of the 1970s (Table 1). During the 1960s higher growth rates were achieved than many other countries in the world (Tables 2), but during the 1980s and 1990s pre-the 1994 general election, negative per capita growth of real GDP was experienced (Table 1). After the 1994 election economic growth increased, especially from 1999 onwards. However, compared with the weighted average of other post-1980 globalising countries, per capita real GDP growth has been disappointing (see Tables 1 and 2 for 1990s) and this situation has continued into the 2000s. During the year December 2001 to December 2002 South Africa's real GDP grew by 2,9%, whereas the average for 22 countries reported in the *Financial Mail* (9 May 2003:64) was 3,6%.

To sum up: South Africa enjoyed 10 years during the 1960s when growth in per capita real GDP averaged above 3% per annum and real GDP growth averaged 5,7% per annum. During the 1990s, the post-1980 globalising countries weighted average per capita growth of real GDP per annum averaged 5% (South Africa fits this country description). Given South Africa's 1960s experience and that currently being experienced by other globalisers, the rates of growth achieved under ANC government are disappointing. During the eight years the ANC have governed South Africa, growth of real GDP has averaged 2,8% per annum, almost 3% below the 5,7% achieved in the 1960s and almost 4% less than the weighted average for post-1980 globalisers during the 1990s. Per annum economic growth rates in South Africa have improved

during the 2000s, but are still about 20% below the average for countries whose economic growth rates are reported in the financial media (*Financial Mail*, 9 May 2003:64).

3. Non-white race preferring policy as a growth inhibitor

3.1 Identifying winners and losers

The implementation of race-preferring policy in the labour and capital markets slowly gathered momentum under the Mandela administration, but after 1999 the pace picked up. The principle benefactors (and underlying drivers) of this policy have been the employed Black population and Black owners of capital. The principle losers of this policy have been Whites and those non-Whites that would have gained some benefit out of the investments discouraged by this policy, including future non-White workers and their dependents.

Race-preferring policies produce outcomes that reward members of specific sections of the population. Membership of these sections is not open, for instance, to the rich or poor, but closed, for instance, to members of particular races or gender groups. It could be argued that they enhance economic growth by inducing lower social unrest costs than alternative policies. Alternatively it could be argued that they retard economic growth by distorting the incentive structures available to owners of factors of production in South Africa. Both of these arguments are explored below.

3.2 The economic growth saving argument

The economic growth saving argument is built on two theories: that there are two ways of winning political influence, namely the generations of vote or non-vote political pressure, and that the former is the less costly and therefore preferred. The generation of non-vote type of political pressure is expected to incur higher social costs than vote forms because they discourage investment and dissipate resources. Consequently it is predicted that non-vote political pressure would reduce economic growth by more than vote pressure, if the same political influence outcome is achieved/won. It follows that by implementing BEE in response to voter pressure, that economic growth may be enhanced above what it would otherwise have been.

However, savings in political pressure costs are not the only impact on economic growth. There are also distortion costs generated in the labour and capital markets that have to be taken into reckoning. These costs constrain the benefit that can be achieved by reducing political pressure costs for race preferring policy. Clearly a trade-off has to be made.

3.3 Growth retarding arguments

Labour market distortions

Labour market distortions are evident in policies governing training provision and the hiring of workers. As is the case with many of the current government's ministries, the education one is constrained by the political imperative that it transform South Africa in the direction of improving Black people's opportunities relative to White. This imperative means that the goal of achieving efficiency in throughput of education is sidelined. This happens in many ways – students are not selected first and foremost on the basis of probability of success for courses, staff are not selected first and foremost on the basis of their ability to do the job required, research is commissioned with reduced reference to competency, and there is reluctance to address wastage where it occurs in education deemed to be part of transformation (Hosking, 2000).

One of the laws enacted by the ANC that have race preferring implications for the labor market is the Employment Equity Act. It provides for positive measures to assist designated groups – Black males, women and disabled people. It makes provision for job audits reflecting the numbers of people employed by race, gender and disability, as well as the distribution of wages and benefits between the different worker categories. Plans to increase the proportions of designated groups must be submitted regularly to the Department of Labor, and if satisfactory increases are not achieved in the proportion of people employed from designated groups, fines may be levied on firms.

The negative impacts on economic growth of this labor law are many. White worker participation in the domestic economy is discouraged causing negative human capital outflows (Maasdorp, 2002:23) and canceling out some of the gains being won through massive education investment by the state (Quintal, 2002). Part and parcel of the same problem is that in addition to this push effect, there is also a pull effect – in the form of higher levels of remuneration Europe, North America and Australia. From an economic growth perspective, the loss of skilled labor is a negative factor (Maasdorp, 2002). A second important consequence of discouraging White worker participation in the domestic economy is that they take their asset holdings out of South African as well. This policy therefore, encourages disinvestment of scarce financial capital. Yet another negative impact of this law is that it facilitates slack in the employed Black workers. This slack has is caused by the protection of Black workers from competition in the skilled labor market, and leads to the development of entitlement thinking amongst Black workers (Maasdorp, 20002:22).

Capital market distortions

In the capital market race preferring policies create distortions in many spheres. One of the laws enacted in this area is the Mineral and Petroleum Resources Development Act (2002). Its adoption was heralded the development of the mining charter - a mechanism by which Black ownership of equity in the mining industry could be progressively increased (initially a 26% stake is the target). The consequences of this have been similar to those experienced in the labor market as a result of introducing the Employment and Equity Act. The mining charter has led major domestic mining companies like Anglo American and

Xstrata announcing that they were putting on hold further investment in South Africa (Lunsche, and Ryan, 2002; *Business Day*, 8 April 2003:10). If there were no other countries for these types of companies to invest in, this deterrence would not be serious, but there are (Lunsche, and Ryan, 2002). Another distortion occurs in the orientation of Black entrepreneurial activity. In the capital market has been inefficiently (and non-productively) channeled around the equity transfer honey pot created by the equity transfer policy. The end result has been predictable – less new investment than there would otherwise be.

Investment levels have remained low. In both 2000 and 2001 Gross Capital Formation made up 15,9% of GDP – down from the 18% it was in 1995. Real private sector investment increased by only 2,7% per annum between 1995 and 2000 (the Growth, Employment And Redistribution target being 11,7%). Real growth in total fixed capital between 1995 and 2000 was only about 2,3% per annum (calculated from Table 3).

Table 3: Gross Fixed Capital Accumulation at constant 1995 priced from 1994 to 2000

Year	Public Sector (Rmillions)	Private Sector (Rmillion)	Gross (Rmillions)	% Change of gross on prev. yr.
1994	21 353	57 282	78 635	-
1995	23 508	63 534	87 042	10,7
1996	26 461	68 422	94 883	9
1997	28 605	71 726	100 331	5,7
1998	34 938	70 431	105 369	5
1999	28 996	68 130	97 126	-7,8
2000	24 907	72 517	97 424	0,3
2001	24 271	76 389	100 660	3,3
2002	25 434	81 478	106 912	6,2

Source: SARB (2001:S117); SARB (2002:S117); SARB (2003:S117)

The per annum inflows of foreign direct investment as percentages to GDP were also mostly way below the targeted 4% per annum (see Table 4)

Table 4: Foreign Direct Investment as a percentage of GDP, 1995- -2001

Year	FDI as % of GDP
1995	0,8
1996	0,6
1997	2,6
1998	0,4
1999	1,1
2000	0,7
2001	5,9

Source: SARB (2001:.S90 and S-106).

Significantly, those South African corporations in the forefront of international trade are becoming increasingly outspoken about the impact of policies like race-preferring ones that increase their costs and reduce their competitiveness relative to those of their competitors. Barloworld Chief Executive Tony Phillips reflected current sentiment amongst these corporations on the proposed Truth and Reconciliation Commission (TRC) tax:

‘All these costs reduce the effectiveness of SA businesses as competitors on the world stage. We have a shrinking number of corporations that are winning internationally and the more we burden them, the less likely they are to succeed.’ (Paton, 2003: 22).

The more drastic the race-preferring policy implemented, the greater the distortion that can be expected and the longer the policy is applied the longer this constraint can be expected to undermine economic growth.

4. Conclusion

It is deduced that there are costs of not implementing BEE and costs of Implementing BEE. For this reason policy setting with respect to BEE should be guided by the trade-offs. In principle an optimum BEE imposition from the perspective of economic growth may be defined. The danger South Africans face (current and future generations) is that policy may err towards exceeding the optimum.

When Apartheid ended, South Africa looked headed to a bright non-racially charged future. A new more widely supported political leadership took power. This leadership expressed commitment to reconciliation and the building of a non-racial society. However, this honeymoon era soon passed and under the influence of majority voter support, economic policy moved steadily toward redistributing income and wealth between the races groups of South Africa.

The impact of this trend, together with government failure in the use of government revenue, the management of the labour market and the upholding of property rights, was negative for economic growth. Expected returns to savers and investors within South Africa have been insufficient to compensate for the escalation in risk costs, White human and financial capital has been alienated (in a country where both types of capital are scarce) and Black human and financial capital has been channelled toward the capture of the fruits of redistribution rather than the generation of new enterprises.

There have been negative investment implications of government and political failures in both the labour and capital markets. They are seen in decisions by most of South Africa’s big corporations to relocate control of their companies out of South Africa, in the demand by owners to diversify their South African asset holdings into non-South African assets, in low levels of foreign direct investment and in the high levels of White human capital outflow from South Africa.

The problem with the South African economy is not that it is not growing, but that it is growing by less than it can. The cause of this problem is not with the failure of macroeconomic, trade or investment policies, nor that labour is unavailable, nor that the country lacks resources and investors willing to invest in productive assets in the country (see, for instance, *Eastern province Herald*, 12 May, 2003). The problem is that the outcomes of collective choice are distorting the reward structure in South Africa to such an extent that crucial resources required to compete in the global markets are alienated. If South Africa is to win competitions on the global stage for trade and investments it will need to make the best use of its resources.

Increasingly the message to South Africans from market sources of pressure will be that to grow at the rate it has the potential to and aspires to do, it will have to draw indiscriminately on all the resources available to it and use them efficiently. This requirement will have to be traded off against the desire to minimize the political cost savings of implementing Black race-preferring policy. The optimum BEE level of implementation is where BEE averts the reduction of at least as much economic growth through preventing non-vote political pressure generation as it reduces growth through inducing inefficient distortions into the economy. Both economic growth and justice are adversely affected by the implementation of this policy and the longer it is implemented the greater the cost will be in growth foregone and new injustices committed.

References

Brassey, M. (2000) 'The Employment Equity Act: Bad for Employment and Bad for Equity', *Industrial Law Journal*, : 1359-1366.

Business Day (8 April 2003) 'Xstrata bypasses SA': 10.

Dollar, D and Kraay, A. (2003) 'Trade, Growth and Poverty', Research Development Group: The World Bank, www.worldbank.org/research/growth.

Easterly, W. (1996) 'Why is Africa Marginal in the World Economy?', In *Can South and Southern Africa become Globally competitive Economies?* Ed. Maasdorp, G. London: MacMillan Press.

Eastern Province Herald (24 June, 1999) :17

Eastern Province Herald (10 August, 1999) 'Cosatu set to challenge Government over fiscal, industrial policies – Action to stem job losses':2

Eastern Province Herald (23 October, 2002) :13

Eastern Province Herald (12 May, 2003) 'SA well positioned as investment destination':9.

Financial Mail (9 May 2003): 64

Fourie, FCvN and Burger, P. (2002) Fiscal sustainability and the South African Transformation Challenge', Economics Working Papers Series, University of the Free State. Wp01/02.

Hosking, S.G. (2000) 'Government induced teacher failure in South Africa – causes and analysis', *Development Southern Africa*, 17 (5):641-665.

Hosking, S.G. (2003) 'Economic Growth and Reform in South Africa, 1994-2002, during and after the Honeymoon.' *Inaugural and Emeritus Addresses D55*, University of Port Elizabeth.

Houghton, D.H. (1969) *The South African Economy*. Cape Town: Oxford University Press.

Jenkins, C. (1999) 'Capital Accumulation and Economic Reform in South Africa', TIPS1999 annual Forum, Muldersdrift, South Africa.

Lewis, J.D. (2002) 'Promoting growth and employment in South Africa', *South African Journal of Economics*, 70 (4): 725-776.

Maasdorp, G. (2002) 'Economic Survey, 1970-2000', in Jones, S. (2002) (Ed.) *The Decline of the South African Economy*. Cheltenham: Edward Elgar: 7-30.

McCarthy, C.L. (1998) 'Problems and Prospects of African Economic Development', *South African Journal of Economics*, 66(4): 421-451.

Parsons, R. (1999) *The Mbeki Inheritance*. Johannesburg: Ravan Press.

Paton, C. (2003) 'Donar Fatigue' *Financial Mail*, 4 April, 171 (1): 22-23.

SARB (2001) South African Reserve Bank Quarterly Bulletin. No. 221. Pretoria: Reserve Bank.

SARB (2002) South African Reserve Bank Quarterly Bulletin. No. 225. Pretoria: Reserve Bank.

www.scholars.edu.sg/landow/post/sa/people.html

www.irinnews.org/AIDS/south_africa.asp#data

www.worldpress.org/profiles/South_africa.cfm

www.pbs.org/journeytoplanetearth/profiles/south_africa.html

www.usaid.gov/press/releases/2000/pr000710.html