Key Measures that can Materially Enhance Investment, Economic Growth and Employment Creation in South Africa

1. Introduction

There is general recognition that in order to meaningfully address South Africa's high unemployment rate, to facilitate greater transformation and to tackle the high level of poverty that the country requires much higher investment and economic growth rates. The idea of raising the GDP growth rate to above 6% per annum has been mooted as the level of growth necessary to address the unemployment and poverty challenges. An economic growth rate of 6% means that an economy doubles in size every 12 years versus the 18 years it would take to double the economy under a 4% annual growth scenario. Increasing South Africa's GDP growth rate to more than 6% per annum, when combined with substantial microeconomic reforms, would materially address unemployment, facilitate greater transformation (because of the higher growth in economic opportunities), reduce poverty and help address absolute levels of inequality – particularly in relation to the unemployed and women. The vexed question is how to generate a 6% per annum growth rate? BUSA fully recognises the economic growth challenge and believes that an ***enterprise driven*** solution will be the most appropriate route to follow – especially at the small and medium enterprise (SME) level. Clearly all social partners, including business, government, parastatals and labour have a role to play in achieving this end.

The purpose of this document is to highlight a number of BUSA proposed "transactionable" short-term measures that could be considered by the social partners with a view to increasing South Africa's investment, economic growth and employment rates.

2. Moving from the Political Miracle to the Economic Miracle

South Africa's first decade of democracy realised a substantial political miracle for the country. At the same time the ANC government embarked on a series of substantial reforms aimed at stabilising the macro-economy, trying to encourage more equitable access to basic services to the majority of the population and reintegrating South Africa back into the global market place. Clearly the reform agenda has been meaningful and substantial with over 1000 pieces of regulation and over 800 pieces of legislation being changed in the first decade. The institutions that support democracy have been established and strengthened. Good progress has been made in ensuring greater access to electricity, water, housing schooling and healthcare - although the business community believes that service delivery remains an area of concern. On the macroeconomic front momentous progress has been made in stabilising the fiscal situation (at both the deficit and debt levels), reducing price instability (by adopting inflation targeting), opening the economy to greater competition and trade (through various trade deals and the WTO negotiations), and so on.

The results are encouraging. Private sector fixed investment (investment in new plant, machinery, factories, etc.) in the period 1994 to 2004 grew by 5.9% per annum and now accounts for some 71% of total gross fixed investment in the economy. Public sector investment, which includes general government and parastatals grew by 5.8% per year in the same period, although significant deficits in capital spending by parastatals has resulted in large infrastructural bottlenecks, which have constrained the growth in trade and ultimately constrained the generation of economic growth and jobs. Despite these infrastructural constraints South Africa's economic growth rate has risen from 0% in the early 1990's to 2.8% in the first decade of democracy to 4% at the start of the second decade. In the period between 1995 and 2002 the number of jobs in the formal economy increased by 1.6 million people to 11.2 million employed (which dispels the myth that there has been jobless growth).

3. Despite Good Economic Progress, Both Poverty and Inequality remain Challenges

However, despite the significant progress made there is general recognition that South Africa's levels of savings and fixed investment at about 15% and 17% of GDP respectively, the country's relatively low level of FDI and the current economic growth rate of 4% are insufficient to substantially tackle unemployment and poverty in the country. Unfortunately, despite a better growth platform, the level of output growth has been unable to act as a generator of a sufficient quantum of new employment in the domestic economy.

Despite the 1.6 million new jobs between 1995 and 2002, the economically active population (EAP) grew by some 5 million people in that period meaning that employment growth was unable to match growth in the EAP, thus unemployment increased to 4.3 million people or 39% of the EAP by the end of 2002. This 39% unemployment rate is based on the expanded definition of unemployment and includes people employed in the informal sector. The "official" definition of unemployment, which is based on international definitions, includes those people within the EAP who are unemployed but ready to work and have taken steps to look for work without success. By March 2005[1] some 4.3 million people out of an EAP of 16.2 million people were unemployed resulting in the official unemployment rate being 26.5%.

Whichever unemployment rate is used, the levels remain too high and clearly the employment absorption rate of the economy at 30-40 people for every 100 economically active persons is too low for South Africa's requirements. The slower growth in employment has also been characterised by a structural shift in the composition of labour demand with an increase in employment of semi-skilled and skilled workers away from unskilled labour. This shift up the skills curve and the increase in unemployment are not only reflective of the lack of adequate economic growth but illustrates constraints in the supply of adequately skilled labour.

The unemployment and skill deficit characteristics of the economy mostly follow a racial bias, as do poverty and income inequality (which is exacerbated by the high unemployment level) – but this is obviously changing. The measurement of poverty in South Africa in terms of the portion of the population living on less than US$2 per day at 23.8%[2] is lower than the 37 other countries that reported numbers in the UNDP bracket of medium human development countries, which averaged 33.4% of their populations below US$2 per day. However, the South African poverty measure is not close to the high human development countries, which have less than 10% of their populations living on less than US$2 per day. Whilst poverty can be measured on an absolute basis, income inequality is a relative measure. The Gini-Coefficient, which measures the portion of national income accruing to the poorest 20% of the population versus the richest 10% helps unpack the income inequality of the country. South Africa's Gini-Coefficient at 59.3 appears to be high by international standards versus the average of the 60 medium human development countries (UNDP) whose Gini-Coefficient averages about 42. The key reason for South Africa being higher than this cohort is because of the country's high unemployment rate (26.5% of EAP) versus less than 10% in these medium human development countries.

Unfortunately, the higher rate of unemployment and the shift away from the employment of unskilled labour exacerbates inequality and poverty particularly in relation to Africans and coloureds who bore the brunt of the racial exclusion from relevant education and training under apartheid. Between 1995 and 2002 African unemployment increased to 47%, for Coloureds to 30%, for Asians to 25% and for Whites to 9%. The female unemployment rate at 45% was significantly higher than the male unemployment rate of 34% (all based on the expanded definition of unemployment).

4. Business fully understands the challenges

Business understands that the unemployment, poverty and inequality challenges require much higher levels of economic growth, economic transformation and the need for a better-educated and skilled economically active population. Preliminary estimates suggest that should South Africa's level of unemployment decline to a level of 10% then the Gini-Coefficient would fall to about 40 and therefore would place the country in line with the international cohort comparison. Therefore one of the central challenges for tackling unemployment and transformation is to get people into productive employment. The mooted 6% growth rate, which doubles the size of the economy every 12-years, is a growth rate that can help to meaningfully address these challenges and is a level of growth to be aspired to.

5. Business proposals to address key short-term issues

Business is firmly of the view that there are no "silver bullets" that will simply quantum leap South Africa's investment, growth and employment performance. Rather, a combination of appropriate economic policies that foster competitiveness, build long-term confidence and which make South Africa an attractive place to do business in the long-term are necessary for the country. Already substantial progress has been made in generating a clear and credible macroeconomic framework over the course of the past decade, in reforming certain parts of the microeconomy and in developing black economic empowerment and transformation policy for the country. Clearly, the stabilisation of the macroeconomy and the focus on access to basic services were vital in that first decade of democracy. However, the focus has now shifted on to a series of microeconomic issues that require reform to enable the pick up in investment, economic growth, transformation and employment that the economy requires.

Central to the microeconomic reform challenges and the 6% economic growth framework is the key theme of encouraging enterprise development especially at the small and medium business level. As per the experiences of a number of developed (USA, UK, etc.,) and emerging economies (Singapore, Hong Kong, etc.,) the growth in small and medium businesses has unlocked the majority of employment created in those countries. BUSA is firmly of the view that government and the social partners should embrace an "***Enterprise Development Strategy***" which embraces the support for and facilitation of small and medium business in South Africa. This will help unleash new opportunities for millions of people in the country. It will also help to meaningfully empower a substantial portion of the population. Over time, the small and medium businesses that succeed today become the large businesses of the future.

Building on the partnership and work done in the Presidential Growth and Development Summit, the following points are issues that business suggests should be considered to facilitate higher investment and growth in the short and medium-term:

5.1 The sound macroeconomic framework foundation achieved through appropriate fiscal, monetary and trade policies should be further built on to continue to grow investor confidence in the country. The stable macroeconomic environment is a necessary component of the mix of complementary policies that the country requires in order to attract investment. However, even at the macroeconomic level the reform agenda is unfinished. At the fiscal policy level the positive signal sent to investors that, through cutting direct taxes, the country is keen to attract investment must be built on. Exchange controls on residents still give the impression that South Africa's economic policies are not robust. BUSA is of the view that a total abolition of exchange controls would provide a significant signal to foreign investors that the country is serious about investment and growth. South Africa has in place a sound supervisory system for the domestic financial market and has adopted a series of appropriate macroeconomic policies, which have consistently earned the country improved ratings from the rating agencies. Despite the emerging market shocks in 1998 and 2001 there is little evidence to suggest that capital controls are a constructive and useful force in economic growth and development. Countries that have pursued sound macroeconomic policies, avoided rigid exchange rate regimes and which have in place sound banking supervisory systems have generally scrapped exchange controls and benefited from the free movement of capital. In the emerging markets universe there are only a few countries that have capital controls (Chile and Malaysia on short-term capital flows – although these have mostly been phased out) – but these countries are the exception and not the norm. From a South African perspective the abolishment of capital controls would broaden and deepen the currency market and would allow broad economic fundamentals to be the true determinants of the exchange rate.

5.2 South Africa needs to adopt an "Enterprise Development Strategy" which supports and promotes the development and growth of small and medium businesses. This strategy will require the social partners to champion enterprise development, and to encourage the evolution of successful role models in the small and medium business arena. Too often small business failure is frowned on by the community at large with the result that entrepreneurs are unwilling to take risks to start new businesses. The national psyche needs to be changed to encouraging risk-taking and to encourage the starting of small or medium businesses. An Enterprise Development Strategy would help create the right conditions for the development of small and medium businesses in terms of lowering the compliance (red tape) costs, addressing the skills deficits related to small business management (by more effectively focusing subsidised learnerships in this area), continuing to lower the direct and indirect tax burden, providing the correct institutional support (cost effectively), linking research centres such as Universities to small business projects to help in knowledge creation and innovation, and so on. Measures designed to help access to funding (as per the Business Link model in the UK) require investigation. South Africa's existing small business support measures have not worked. Much of the failure rate of small businesses can be ascribed to poor management development and leadership at the small business level, but the lack of an enabling institutional and economics environment have played a part in the failure. Research projects that investigate reasons for failures and successes (including tapping into international experience) should be initiated and supported to continually improve the small and medium business success rate. Promotion of SMEs should form an integral part of all sectoral development strategies currently being developed.

5.3 South Africa should adopt a regulatory impact assessment strategy (RIAS) which tests the impact of new legislation on investment, growth, employment and empowerment. Business recognises that much work has already been done on this proposal but wishes to emphasise the likely benefits. The overriding goal of RIA is to ensure that regulation achieves its goals in the most efficient way, and in a way that facilitates investment, growth, employment and development. And RIA should not be seen as static post event damage assessment, but as a dynamic learning and facilitation process, which will ensure continual best practice in policy development. RIAS has been adopted in a number of OECD countries (USA, UK, Australia, Canada, Germany, Greece, Hungary, Italy, Mexico and the Netherlands), the European Commission, and by a number of developing / emerging countries including the Czech Republic, Poland, South Korea and Bulgaria. The adoption of a RIAS will strengthen the policy making process towards the growth, transformation and employment objectives of government. BUSA recognises the progress being made with the RIA pilot project in the Presidency and hopes to see broad implementation of a RIA system once the pilot study has been completed.

5.4 Reducing the compliance costs on business (especially small and medium business). Regulation is designed to create benefits, but also imposes significant costs. The recent Small Business Project report[3] on Counting the Cost of Red Tape for business in South Africa revealed that "Total resources spent by formal business in South Africa on regulatory compliance are high by international standards, and represent a significant slice of the country's overall economic output." The South African regulatory environment for business is wide-ranging and complex – with additional layers of new legislation and regulation added each year. On an international scale South Africa's business regulatory environment ranks well for securities exchange regulation, banking regulation and the legal framework for business, but ranks poorly for start-up regulation, the burden of operating permits, national legislation, local government regulations and the impact of customs. Overall South Africa's business regulatory environment ranked better than poor income countries but was worse than comparable middle income country rankings. The SBP project helped reveal the scale and regressive distribution of regulatory compliance costs in South Africa to be about R79 billion annually or about 6.5% of GDP. In particular SME's incur the largest costs of compliance. These regulatory costs represent real resources, which have alternative uses – such as growing investment. Analysis of the regulatory complexity in the SBP report reveals that the five most time-consuming and troublesome regulations cited by respondents were in ascending order, RSC levies and SETA's training, PAYE / UIF, SARS tax administration, labour laws, CCMA/ bargaining councils and VAT.

If some of the resources currently spent on compliance costs were reduced, business could use the freed up capital to grow investment, innovation, employment and economic growth. In terms of a World Bank report[4] many developing countries could add as much as 2 percentage points onto their GDP growth rate per annum if their regulatory environment was improved to the level of the average country in the top quartile. The cumulative impact of the regulatory environment is an important factor in determining a country's overall economic and development prospects. BUSA recognises that government has taken steps to address some of these most troublesome regulations (such as eliminating RSC levies, and better VAT arrangements for SMEs) and proposes that government set a target for reducing the cost of regulatory compliance from the current 6,5% of GDP to a figure more in line with South Africa's major competitor nations. The SBP recommendations about adopting a System of Regulatory Best Practice (which includes adopting a Regulatory Impact Assessment Strategy), creating more flexible approaches to regulation, adopting regulatory cost surveys and creating greater competition in markets should be considered by government.

5.5 Reduction of logistical infrastructure bottlenecks. BUSA recognises the steps taken by the government to address this issue through the DPLG "Project Consolidate", the NT "Infrastructure Development Improvement Program" and the Cabinet approved high level capital amounts proposed for electricity and rail transport infrastructure. BUSA remains concerned that a number of key areas such as rail and ports do not have sufficient skills and capacity to develop the necessary efficient and cost effective infrastructure and services required. If these areas do not meet the required investment and efficiency levels then South Africa will not be able to materially raise the economic growth rate. BUSA reiterates the need for greater co-operation between the private and public sectors in these key areas. BUSA urges that the development of the National Freight Strategy should be expedited for engagement with business, with a view to implementing a coherent freight strategy across all modes of transport.

5.6 Partnerships at the local level should be encouraged to facilitate real delivery of services. Current estimates suggest that 60% of government's programmes should be delivered at the local government level, although it is at this level where large capacity constraints exist. The GDS recognised the importance of active participation of business in the development of Integrated Development Plans.

Although Business is invited to participate in these processes, the focus remains of addressing the needs of the underdeveloped areas. While this is a key area requiring attention, the provision of reliable and affordable supplies of water, energy, telecommunications and transport routes are key imperatives for economic growth. Private sector participation in the delivery of these services should be considered. Efforts by organised business at local level to work with local authorities, particularly in the promotion of SME's remains a challenge largely as a result of a lack of enthusiasm on the part of the authorities. Mechanisms to promote partnerships at this level need to be explored.

5.7 A more comprehensive assessment of the lack of competition in key markets is required. While the GDS did propose the establishment of the administered prices and import parity pricing task teams the outcomes of these task teams has been slow. What business is concerned about is the lack of competition in key markets in terms of the opportunity cost of foregone economic activity. For example, in the case of telecommunications the lack of adequate competition has resulted in poor service and high telecommunication costs. This has fed through to the low internet usage per 1000 people, which in turn affects learning, innovation and technology development. It has also hampered the development of the call centre industry in South Africa. Issues such as the cross-subsidies between subsidiary companies of parent parastatals requires identification and resolution.

5.8 Benchmarking factor inputs versus key competitor countries. The two factor inputs that elicit much debate and controversy are the relative costs of capital and labour in South Africa. Any debate on the cost of labour has organised labour up in arms about worker rights and labour standards, while the discussion on the cost of capital has tended to take a narrow view of the simple interest rate cost of capital. Clearly each factor input has its own set of complexities and issues. What business is proposing is a benchmarking exercise, which highlights the absolute and relative costs of each factor input. For example, it is not only important to understand if the cost of capital is high in South Africa – but also important to understand the relative productivity of capital. In the case of the cost of capital factors such as effective tax rates, real interest rates, the currency premium, etc., could be investigated versus South Africa's competitors. On the labour market side simple wage rates per industry plus relative wage rates per unit of output could be investigated. If wage rates increases are not matched by increased productivity, then employment is most certain to decrease. The purpose of the exercise would be to better inform all stakeholders of the relative position of South Africa versus the competition. Such a project could then make suggestions on the types of measures that are necessary to reduce the respective costs of each factor input to help facilitate greater investment.

5.9 Labour market policy. In the context of the need for much greater employment growth business is suggesting the need to investigate micro changes to labour market policy which may increase the willingness of local businesses to employ more labour. This does not suggest undermining labour rights or changed standards. Such an investigation should be conducted by an independent credible research institution.

5.10 Alignment of National Skills Development Strategy with employment creation. Ways that implementation of the National Skills Development Strategy could be aligned with employment creation goals need to be explored. In addition approaches to the re-skilling of workers who may be retrenched, should be integrated into sector skills plans. BUSA recommends that the study proposed by the BUSA Standing Committee on Social Policy be used to develop a strategy to address these issues.

(Footnotes)

1 Labour Force Survey, March 2005, Statistical Release PO210, Statistics South Africa.

2 UNDP Human Development Report 2004.

3 Small Business Project, "Counting the Cost of Red Tape for Business in South Africa, June 2005.

4 World Bank, "Doing Business in 2005 –Removing Obstacles to Growth", Oxford University Press, 2005.