Comment on the Revised Draft Financial Advisers Bill, 1999

1. Why this Bill should not be adopted

This comment is in the form of an appeal grounded in fundamental economic arguments. Commenting on the detail of the Bill is of lesser importance. The main thrust of this document is therefore a request to the Financial Services Board to think again: to give careful consideration to the harm this Bill will do to the economy. Legislation that imposes costs and raises barriers to entry into the economy causes cumulative harm. As layer upon layer of restrictions, prohibitions and compliance requirements are added to the statute book, so the economy gradually strangles and suffocates.

Yet writing about the economy is too arms-length and theoretical to allow the reader to appreciate the full impact of the kind of legislation you have prepared. Think about a school-teacher of high moral standing and repute in a deprived rural area who, in 2002, decides to set up a part-time business in her home as a financial adviser to her community: to sell life insurance, short-term insurance, and units in unit trusts, and to take in deposits for financial institutions. Let us assume that she wishes to perform this service primarily because of her concern about the inappropriate products being purchased by the members of her community from the representatives of financial institutions who do not understand the real needs of her people. Is she to comply with all the requirements of this Bill you have prepared before she can commence providing such a service? Is she to be judged against the norms of a highly developed economy and have her application for registration declined because she does not meet those norms?

If we, our parents, and their parents before them wished to do the kind of business described above, all we had to do was to convince a company supplying a product that we were suitable to be appointed as agents. Now that black South Africans are free to engage in businesses of this nature we see a plethora of laws emerging that will continue to exclude them. Have black South Africans not been excluded for too long already? Are we really to see this type of law emerging in as great a profusion under a democratically elected majority government as it was under a government that was intent on excluding black people? Is there no understanding for the conditions that have to be created "on the ground" that will allow the poorest members of our population to make economic progress? A developing people needs the freedom to develop. For every one that "may" be saved by your Bill from purchasing an inappropriate financial product there will be ten who are excluded from entering into the financial services business and a hundred who are denied the opportunity to buy an appropriate product because it will never be offered to them. South Africa is an over-taxed, over-regulated, struggling, third-world economy with delusions of grandeur. These delusions were entertained by the past regime at the time they set about destroying the economy with their racist economic restrictions on all South Africans but especially on black South Africans. The former government left the economy burdened with legislation and regulations. The Financial Services Board surely does not have the task of slavishly following what may be perceived to be a politically beneficial but economically disastrous course of action: its function is surely to evaluate the situation taking into account all the relevant information. The micro-economic impact on the people should therefore weigh very heavily in any decision regarding such legislation.

2. South Africa's poor economic performance over the past 55 years

South Africa had about the same GDP per capita as Japan fifty-five years ago but now has a per capita GDP that is only 20% of that of Japan. Between 1980 and 1995 the GDP per capita of South Africans declined by 1.2% per annum. One of the main reasons for the decline is the economic regulation that prevented South African citizens of all races from making the economic progress of which they would otherwise have been capable. Anyone who argues otherwise would have to maintain that apartheid was economically beneficial. Those who do so, are as mistaken as the poor deluded people who voted for the continuation of apartheid, believing that the system would give them a better life than they would have had if everyone had been economically free.

The economic arrangements in South Africa were similar in many ways to the systems employed by the Soviet Union and the other Communist countries. They also failed for the same reasons. The belief that the state can protect people from making unwise decisions is patently wrong: the reason is that the decision-makers within the state are even more likely to make mistakes in regard to a particular individual as they have no way of knowing what that individual's requirements may be. In taking over the lives and resources of citizens, governments inhibit the entrepreneurial flair and initiative of the people and deprive them of their capital through excessive taxes. This outcome of government intervention in economies has been increasingly documented in recent years.

3. High government expenditure reduces growth

South Africa has to improve the growth rate of the economy in order to absorb the presently unemployed and increase the per capita incomes of the whole population. In order to do this, the government must first identify why we have had a shrinking economy for the past 15 years. A clue as to one of the main causes of South Africa's poor economic performance can be found in the study The Size and Functions of Government and Economic Growth by James Gwartney, Robert Lawson and Randall Holcombe which was prepared for the Joint Economic Committee of the US Congress. (Copy attached.) The study analyses government outlays (at all levels of government including local authorities) of the OECD countries for the 37 years from 1960 to 1996.

On page 2 you will find that between 1960 and 1996 the outlays of all OECD countries increased considerably. The greatest increase was in the expenditures of Sweden (35.1%) and the lowest the United States (6.2%). It is significant that those countries with the lowest increases in government expenditure have performed better than the high-spending countries. Exhibit 4 on page 9 of the study shows that the countries whose governments spent less than 25% of GDP had average growth rates of 6.6%. As government expenditures increase, growth rates decline, and countries with government expenditure exceeding 60% averaged growth in GDP of only 1.6%. The latter countries are all highly advanced and it is predictable that developing countries would show even lower growth rates than those achieved by OECD countries at similar levels of government expenditure. Figures on page 7 of the study show that more government and less capital formation also lead to slower growth in productivity.

During the 37 year period of the study only Ireland, New Zealand and the United Kingdom managed to reduce government expenditure as a percentage of GDP during some part of the period. Significantly, the growth rates of real GDP of all three of these countries immediately increased (see page 21).

Exhibit 10 on page 22 of the study tabulates the government expenditure (1975 – 1995) of the 10 countries with the highest growth rates during 1980 to 1995. South Korea, the country with the highest growth rate for the period (7.4%) had government expenditure of around 20% of GDP throughout. The government of South Korea unfortunately made monetary policy errors that caused great financial turmoil in their country and caused the economy to shrink during 1999 yet this terrible crisis in their economy produced similar results to what South Africans have become used to over the past 20 years. According to reports the South Korean economy is recovering rapidly. A calculation as to what South Africa's economy would have looked like if we had enjoyed growth in real GDP of 7.4% per annum over the past 20 years would be most revealing. Some idea can be formed by considering that if the GDP growth of the United States had been 1% per annum less for the years 1870 – 1990, per capita income levels of the United States would today be the same as that of Mexico (footnote to page 15).

If government wishes to achieve the 6% growth rate mentioned in GEAR it will have to reduce total government expenditure at all levels to below 25% of GDP. This means reducing the current budget by approximately R70 billion i.e. by about one-third. In order to achieve such an objective government would have to reassess its activities and cut back drastically on expenditure. Naturally cuts in government expenditure would make reductions in taxes possible, which would in turn substantially increase private investment in the economy. Despite the difficulties involved in cutting back expenditure so severely, the possibility of having an economy growing at above 6% per annum would make the exercise extremely worthwhile.

4. The cost of the core functions of government

Gwartney, Lawson and Holcombe identify the following activities as being core functions of government:

- Protection of persons and property
- National security
- Education
- Highways
- Sewerage, sanitation and environmental protection
- Federal Reserve System – expenses

They then analyse the expenditure of the United States, Canada, the United Kingdom, Germany, Australia and Sweden for various years and show that the highest expenditure as a share of GDP of any of these countries on core functions was 16.9% (pages 25 and 26). Comparisons for the United States and Canada show that their expenditures on these core functions were higher in 1960 than they were 30 years later i.e. there is a declining trend.

These figures indicate that South Africa should be able to provide the above-mentioned core functions at a cost not exceeding 15% of GDP i.e. for approximately R100 billion. All the other activities of government have a growth-reducing effect on the economy and can be eliminated by leaving them to private delivery.

5. Cutting back government expenditure

Cutting back government expenditure requires a totally different approach to governing the country. Legislation and regulations creating "victimless crimes" must be repealed and care must be taken that no new ones are adopted. Such "crimes" occur when an "offence" consists merely of a failure to comply with a bureaucratic requirement such as failing to obtain a trading licence or failing to register as a financial adviser.

Failure to register causes no one any harm. Giving poor advice which, if followed, causes an individual to suffer financial loss is harmful but registration will not save the investor. Many highly qualified, certified, and apparently competent advisers have given investors bad advice and will continue to do so. The final responsibility will always remain with the investor, and that is as it should be. If this were not so, there would be investors queuing to sue financial advisers whenever there is a stock market crash.

A more pernicious harm, against which the citizen is helpless, is the harm that can be done by government and its advisers. Harm such as causing twenty years of double-digit inflation, incurring massive debts that absorb a large portion of taxes in interest payments, imposing a government-spending-constraint on the growth of the economy, and imposing such a plethora of laws and regulations upon citizens that the economy is strangled to death: that is real harm. It causes economies to shrink rather than grow, it drives productive citizens to leave the country, it drives away foreign investment, it causes citizens to become poorer, and it causes mass unemployment.

6. The relevance of the above information to this comment on the Bill

Every Act adopted by Parliament has costs attached to it. These costs form part of the present 37% of GDP spent by government. Given the high rate of unemployment in the country, the poverty, and the desperate need for economic growth in order to improve the lives of all South Africans, but especially the lives of the poorest amongst us, it is absolutely necessary for government to consider very carefully the costs it imposes on the economy. Legislation is being churned out by every department of government, much of it on the basis that South Africa must have "legislation that compares with the best in the world". When we look at the growth-reducing effects of increased government spending in the advanced countries of the world we must recognise that such increased expenditure in South Africa will have an even greater and more devastating effect.

You may believe that the arguments used against the adoption of this Bill are too far-reaching and general. Yet every Bill that is passed adds to the total burden and one of them will be "the last straw that breaks the camels back". Similar arguments will therefore be directed against every ill-advised piece of legislation such as this one, until someone out there listens.

However, the Financial Services Board should know better than most other institutions of government what the cumulative effect will be of the deluge of legislation that is being adopted by Parliament at the instance of the various government departments. Even where some effort is made to quantify the costs of legislation, the compliance costs imposed on citizens are routinely ignored. In particular, the loss to the economy of all the economic activities that are still-born because they have been killed by bureaucracy is never counted.

7. Comment on the nature of the Bill

7.1 The Bill will have a negative impact on working mothers

This Bill will reduce the number of "financial advisers", or more simply stated, the number of people selling insurance. Many women sell insurance because they can organise their lives round their working days in such a way that they are home when their children come home from school. If this legislation has the same impact as similar legislation in the UK and Australia then a large number of women will lose their source of income. The proposed legislation is consequently of a sexist nature and on those grounds alone should not be adopted.

7.2 The appointment of an "Ombudsman"

The use of the word "Ombudsman" to describe the person envisaged in this legislation is entirely incorrect. An ombudsman is a person appointed by government to ensure that citizens are treated fairly by the civil service. The person envisaged in this legislation is a type of judge who functions under the control of the Financial Services Board instead of being part of the ordinary justice system. This is a very unhealthy development and the legislators should not agree to it.

7.3 Discretionary powers granted by the Bill

This Bill is contrary to the Rule of Law because of the discretionary powers it grants to the executive branch of government. Its effects will be economically harmful to the majority of the population because it will prevent many people from carrying out the work that has been defined as "financial advice", it will make record-keeping excessively costly, and it will deny investment opportunities to the poorest people in the country and to those living in the remotest areas.

Submitted by:
Eustace Davie (Director)
Free Market Foundation of Southern Africa
PO Box 785121, Saxonwold, 2146
Tel: 011 884 0270
Fax: 011 884 5672
Email: fmf@mweb.co.za

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