Steps Necessary to Revitalise and Create Long Term Growth in the South African Economy

Rob Jeffrey

FREE MARKET FOUNDATION

POLICY PROPOSAL

JUNE 2020

STEPS NECESSARY TO REVITALISE AND CREATE LONG TERM GROWTH IN THE SOUTH AFRICAN ECONOMY

Rob Jeffrey

Independent Economic Risk Consultant

rob@economicrisk.co.za

CONTENTS

Introduction

The South African economy, like many emerging and developing economies, has high levels of poverty. As with many such countries, there are three primary objectives: reducing poverty, unemployment and inequity. These three objectives take precedence over almost all other goals.

The only long term means of achieving these objectives is to increase the country's economic growth rate. South Africa is in a unique position to achieve these objectives as it has an abundance of natural and human resources with a robust infrastructure to build upon. The country's natural resources in terms of commodities are among the richest in the world. It has available a skilled workforce and an abundant unskilled workforce. And, in addition, it has a robust but rapidly weakening infrastructure to build on to support economic growth.

The country is short of capital to finance development. South Africa requires long term finance, not fast return and changeable financial and monetary flows. The time horizon of most investors in real productive assets is between five and twenty-five years. The priority is, therefore, to create the economic political and social environment to foster both foreign and domestic investment.

Investment requires, above all, a stable and secure environment with certainty regarding ownership and future returns, and a high degree of certainty that these will remain in place in the long term. Investors need to have confidence about the future economic, political and social policies and that the current and future governments will continue to support business investment, both foreign and domestic.

Immediate Economic Needs

The country has both short- and long-term economic requirements. The urgent need is that the economy recovers from the lockdown implemented following the coronavirus (COVID-19) outbreak. Every indication shows that whilst the lockdown has achieved slowing the spread of the virus, it has caused and is continuing to cause widespread economic and social damage. Extreme poverty, starvation and hunger have increased at exponential rates which could cause social unrest, violence and even revolution.

The basic fact is that the lockdown has achieved a slowdown in the spread of the disease, but it cannot prevent the disease. Ultimately, it will infect everybody who is prone to it. Whatever measure the government implements, the result will still be a spread of the infection. The latest forecasts are a total of 1 million infections and 45,000 deaths according to the government's own modelling team.

The cure is proving to be worse than the disease. The lockdown achieved its objective of at least preventing the overloading of hospitals and health facilities but is only a temporary measure and has little or no more role to play. The government, therefore, needs to urgently kickstart the economy's recovery and ensure long term growth.

Step 1: The lockdown should be rapidly eased in less than two months. The government should as far as possible maintain distancing and insist that masks are worn

Long term economic growth

Encouraging business investment requires that businesspeople have confidence in the long-term growth future of the country. It is not just a question of returning to business as usual.

After the recovery from the economic downturn caused by government's prevention measures to control the virus, the South African government and people must be seen to be committed to the long-term economic development and growth of the economy.

Steps must be taken to boost the lacklustre economic growth that prevailed before the lockdown. The GDP economic growth must be capable of achieving that recommended in the National Development Plan of 5% per annum. Only by doing this can the primary objectives of reducing poverty, unemployment and inequality be achieved.

Rebuilding confidence

Many of the steps required to be taken are political and involve long term policy issues. They will be challenging but are critically necessary. Nobody disputes that the economy must be transformed. Unfortunately, while many of the policies are well-meaning, they are being used to further corruption and self-enhancing agendas for favoured individuals and a political elite. Other policies would appear to be relatively easy to take care of if there is the necessary political will and support. The following steps need to be taken and addressed. While there appears to be recognition of many of the problems, nothing is being done to address and correct certain issues.

Step 2: Confront and correct issues and problem areas hindering business confidence and investment

The second step requires to confront and correct the following points:

- Reducing corruption and state capture. It is necessary to restore confidence by bringing perpetrators to book and where possible to get back at least some of the money that has been stolen. This step includes withdrawing requirements governing state purchases or making major changes to it as it is currently exploited for corrupt practices.
- Restructuring and improving competence and the finances of SOEs. Many SOEs need to be privatised or at least made into public-private partnerships. This restructuring is necessary to reduce the financial liability on the government. They should not be sold to political cronies but to investors with business experience and with skills to add value to the business. It is clear that government is incapable of managing any businesses efficiently.
- Trim wasteful public expenditure, including the cost of public service remuneration. In particular, to reduce staffing levels recognising that only some are essential and others are non-essential or less critical. The focus should, in all cases, be on the efficiency of service delivery, not on increased employment.
- The government needs to embark on a programme to reindustrialise South Africa and ensure the country has the infrastructure to grow. Apart from ensuring the development of information technology infrastructure, the country needs to expand and improve water infrastructure – a central future problem area, transport, particularly rail, passenger, commodity and freight transport, ports

and related facilities and energy. The government must ensure all infrastructural investment projects are speedily and successfully completed. Power is dealt with in a separate section.

- Education needs to be improved with the focus changing to work-related and skills training and education. Not everyone is suited to academic university education. This means reforming education and skills development to prepare for current and future economic development. In summary, the emphasis should focus more on technical college skills training which is the norm in most other countries, including developed economies such as the United Kingdom, Germany, and Japan.
- Industrial and business relations need to be improved. At present, there are too many political groups that have anti-business and racialistic attitudes. The relationship between government and businesses has deteriorated substantially because of hardening anti-white and anti-WMC attitudes. Most of the capital needed to advance the economy is going to come from Western countries. Eastern capital generally comes with genuine long-term repayment commitments in cash or kind and very often an influx of labour as well. Such an influx does not help unemployment to the extent envisaged. Lack of quality often is an issue that needs to be addressed.
- The government must work towards increasing the ability of investors and firms doing business in South Africa. Regulations governing doing business in South Africa must be eased. Such easing of regulations includes reviewing well-meaning policies such as affirmative action and Black Economic Empowerment (BEE). The economy needs to utilise the best trained and qualified people whatever their race or religion may be. Similarly, the requirement regarding BEE needs to be reviewed. Small family businesses are not in a position to give away 30% or more of their shareholdings. At the same time, it would appear that the political elite are the major beneficiaries in these deals. The same can be said for large companies. Eskom destroyed its own coal supply by requiring coal mining companies to give up 50% control of their shares. Effectively these rules and uncertainty regarding mining legislation have caused the de-industrialisation of the country and the demise of the mining industry.
- Business investment and individuals need certainty regarding ownership and control of their assets. An ongoing problem remains the threat of expropriation of property without compensation. This uncertainty needs to be eliminated as it includes ownership and control of financial institutions and mining companies and many other industries. The issue is linked to the nationalisation of the South African Reserve Bank. Any examination of it shows that the concept has very wide and unacceptable connotations which preclude both companies and individuals investing and fully contributing to the development of South Africa.
- The Government must scrap plans for the National Health Insurance (NHI) scheme and consider an alternative. The plan is unaffordable for a developing country such as South Africa and in the process will wreck what is deemed to be a world-class private healthcare system. South Africa will lose a valuable source of foreign income as foreigners come to South Africa for treatment. It will also encourage highly skilled workers to emigrate to seek employment in other countries with better healthcare support. Healthcare workers, including nurses and doctors, already leave the country to seek better and more secure opportunities elsewhere. The cost ramifications are enormous.
- South Africa needs to examine closely why skilled workers are leaving the country. The numbers that have left the country seeking opportunities elsewhere are substantial; these include persons of all races and religions with an increasing number of the recently trained professionals and skilled people. The emigration figures do not disclose the true situation as most leave the country but do not emigrate. Contrary to the opinion that an emigrant creates a job opportunity for someone, those leaving usually

employ or generate employment for others. It is estimated that emigration, and those leaving the country, cost this country over 1% of GDP and over 100,000 jobs lost per annum.

- Unnecessary laws and taxes which effectively raise the cost of doing business in South Africa must be eliminated. Some of these taxes only have perceived benefits, mainly in the view of vested interest and ideological groups. However, they often unnecessarily invade the rights of the individual and act as a subsidy to businesses that are not as effective and efficient as the products and enterprises producing them on which the tax is imposed. Two that immediately fall into this category are the sugar tax and the carbon tax. In the case of the tobacco and liquor market, they only lead to a substantial increase in the illicit trade. Regarding the liquor trade, the case of the damage caused to society by the prohibition in the United States needs to be studied. Rather than curbing freedoms, the better way is by educating the population regarding the damage certain actions or products bring about.
- Eliminating minimum wages or at least ensuring that these levels are set at extremely low levels. While the action is well-meaning, it only leads to an increase in unemployment and inefficiencies. Equally important, the laws favour inefficiency in the labour force while potentially more efficient unemployed labour remains unemployed.
- Finally, in this list, there are many calls by experts for the promotion and development of small business and entrepreneurship. It must be recognised that real growth in an economy results from the growth and expansion of large and middle-sized companies and the role they play in developing megaprojects. There are two issues involved here. The risk of failure of small and entrepreneurial businesses is high and therefore the costs too. This is true worldwide. Very few startups are successful. Secondly, small firms are incapable of handling the large projects necessary to create growth nodes in the country. Larger companies are capable of doing this whilst at the same time supporting and developing smaller entrepreneurial businesses as their suppliers. Current attitudes toward large companies must change. South Africa has virtually destroyed its construction and mining industries. This process must be reversed.

Step 3: Develop South Africa's key infrastructure

The most effective way of creating growth and other opportunities is to focus on developing South Africa's key infrastructure. This has been done before in South Africa's history when the country was facing other major economic problems and hurdles. This included the major dam build programme, including Gariep, and the development of Richards Bay and Saldanha Bay harbours amongst others. Historically, Dr Hendrik van der Bijl built and developed the drivers of the South African economy, namely Eskom, Iscor, Vander Bijl Engineering, amongst others. It should be noted he did not necessarily believe in nationalised industry. He believed the state must provide the infrastructure for private business to thrive. Too many think that this means embarking on nationalising existing business.

Van der Bijl set out his and the government's philosophy in these words:

> ***"It is not the government's function to do everything for its people, but it is its duty to create conditions that will encourage enterprise, not the type of enterprise that results in the unfair enrichment of some at the expense of others, but enterprise that results in equitable distribution of all the benefits."***

Government and political parties should heed these words. Similarly, the words of Winston Churchill apply to many of the regulations and policies that have been introduced:

> ***"If you destroy a free market, you create an illegal market. If you make ten thousand regulations, you destroy all respect for the law."***

Van der Bijl believed the industrial base of the country depended on a reliable supply of electricity and steel. Hence the development of both Eskom and Iscor. The economy has diversified considerably since then, but the industrial and mining base of the country remains dependent on reliable supplies of these primary products. The manufacturing industries, the secondary and mining industries, in particular, need to be developed through efficient labour and technical training.

ENERGY CONFIDENCE

Business investment requires certainty about energy sources and future potential growth. As a developing economy, South Africa needs both to fulfil its key objectives. Economic growth depends on energy growth and certainty of supply.

The NDP GDP economic growth objective of 5% per annum requires increasing electricity supply at approximately 4% per annum. Facts and science prove that this cannot be achieved by using renewables, particularly wind and solar. Furthermore, it has been proven that wind and largescale solar are environmentally damaging and costly. They require 100% backup and cause major chaos in supplies due to their variability and generally unpredictable supply.

Again, nobody disputes that pollution and damage to the environment from energy sources must be reduced. This paper cannot go into detail on the subject, but the following facts should be noted and followed up.

Carbon dioxide is proven not to be harmful or environmentally damaging. Decision-makers are encouraged to also watch the film directed by Michael Moore, *Planet of the Humans*, read some of the latest science and update themselves on the facts and reality of the destruction of the environment and economic activity and the increase in energy poverty in countries where high penetration solar and wind have been introduced such as Southern Australia, Germany, Ontario Canada, and California.

The only energy sources available in South Africa capable of providing certainty of supply and economic growth at competitive prices are nuclear and HELE coal supported by limited gas and domestic solar. Both reduce South Africa's carbon footprint while nuclear is carbon emissions free. The steps necessary to foster investor investment and restore faith in South Africa's future economic growth are as follows.

Step 4: Free IPPs from wind and solar

Independent power producers (IPPs) are absolutely necessary for providing longer-term additional electricity generation to support supply from Eskom. They are, however, currently focussed on highly variable and unreliable wind and solar. They should concentrate on nuclear and coal which supply secure, reliable power at low cost.

No future purchases should be made of electricity provided by IPPs from windfarms or solar unless they provide for all the additional costs associated with variable intermittent power. Apart from being unreliable, they cause major supply problems. They are, in fact, heavily subsidised. Their costs should include all backup costs and economic costs of downtime arising from the inadequate supply, inefficiency and other substantial additional costs they cause.

Step 5: Backup power

Independent companies buying electricity from IPPs must provide their own backup electricity. Should it be expected that Eskom delivers the power, it must be at the full cost of back up power which includes a lengthy list of additional costs for having such resources available

Step 6: Municipalities get power from the grid

Municipalities should not be allowed to buy electricity from IPPs. The grid should be the sole provider of power to municipalities, ownership of which should remain with the state or Eskom. Where IPPs have already been built, electricity should be charged at a price that includes the full cost of backup power which consists of a lengthy list of additional expenses for the inefficiencies they cause and having such resources available.

Step 7: Focus on HELE coal and nuclear power

The government needs to announce a programme whereby at this stage all future baseload power will be based on HELE coal and nuclear power. An immediate announcement should be made of a new coal-fired HELE powerstation inland and a nuclear power station at Thyspunt. Thyspunt is selected as this will guarantee power for the Eastern Cape and maximise alleviation of poverty in the area.

Step 8: Reinstate PBMR

Step 8: The Government should announce a programme to reinstate the Pebble Bed Modular Reactor (PBMR) project. The PBMR remains a real opportunity to support its nuclear programme. An impact study on the PBMR prepared and written in 2009 found that this was an ideal project for South Africa to undertake. This report should be released and reviewed by the Government.

CONCLUSION

This paper is a brief review of the steps that are necessary for South Africa to return to a long-term economic growth path and achieve its primary objectives of reducing poverty, unemployment and inequity.

The author is available to assist the government and the country in achieving its objectives.

Rob L Jeffrey
Economic Risk Consultant
M: 082 4695752
E: rob@economicrisk.co.za

ABOUT THE AUTHOR

Rob Jeffrey is an independent economic risk consultant.

He is the former MD of Econometrix and continues to consult for them. His areas of specialisation and expertise include global and domestic economic trends and strategies to foster economic growth, the development of several vital sectors of the economy, including industry, mining, agriculture, credit and financial services. One of Rob's significant areas of expertise is the South African electricity and energy requirements of the South African economy.

He has been the author or co-author of numerous reports, papers, presentations and articles on matters related to national industrial, energy-related, economic policy and the carbon tax. He co-authored, submitted and presented reports on the economic consequences of introducing the carbon tax to the Davis Tax Committee.

Rob has broad practical experience and expertise in the industrial, construction, and engineering sectors. He was MD of Dorbyl Structural Engineering, Chairperson of the Constructional Engineers Association (CEA), the CEA representative on SEIFSA, and an executive member of the Association of Steel Merchant Stockholders. He has sat on numerous councils and advisory panels.

Rob graduated with a B.Sc. in Mathematical Statistics and Applied Mathematics at the University of the Witwatersrand and has Masters' Degrees in economics from Cambridge University and Business Leadership from the University of South Africa.