RADICAL ECONOMIC TRANSFORMATION

In a series of short op-ed articles, Ann Bernstein examines what Radical Economic Transformation could mean for South Africa. It's important to ask who will pay for the radical interpretation of RET. Any economic strategy that increases expropriation, undermines property rights, sets up companies as the enemies of the people and destroys the country's precious know-how will be disastrous for the country's future and all its citizens, especially the poor.

The reason the language of RET resonates and why its populist promise may have emotional and political traction, is that SA's economic policies have failed to generate the jobs and inclusion we need to overcome apartheid's malign legacies. It is significant that RET doesn't mention growth. Achieving faster growth will require some tough-minded choices: labour market reform, reconceptualising black empowerment away from elite enrichment, and stripping away burdensome business regulations. It will require a focus on making cities more productive and our economy more competitive.

That RET has gained so much traction should be a clarifying moment in the debate about South Africa's future direction.

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Erasing know-how and creating fictional enemies will not save SA

By Ann Bernstein, 27 June 2017

'White monopoly capital' may sound politically alluring but it merely diverts attention from real challenges.

By depicting existing companies with their know-how and capabilities as the enemies of its people, SA risks making a historically calamitous mistake, says Ricardo Hausmann, one of the world's leading experts on what drives economic growth, especially in developing countries.

A former minister of national planning in Venezuela, Hausmann is now director of the Center for International Development, part of Harvard University's Kennedy School of Government. Between 2006 and 2008, he led a group of 28 local and international economists advising SA's government on the economic policies needed to unlock the "binding constraints" on faster economic growth. The resulting reports are among the most rigorous and compelling analyses of SA's economic challenges, though most of their recommendations have not been implemented.

He was in SA earlier in 2017 at the invitation of the Centre for Development and Enterprise, giving a series of lectures to various audiences. This is a distillation of some of the key insights offered in those lectures.

He said, historically, there have been two broad ways of interpreting life. One is epitomised by Karl Marx, who said the history of all hitherto existing societies is the history of class struggle where progress requires the success of one class at the expense of another. The other interpretation is to say the story of humanity is not primarily a history of conflict, but one of expanding forms of co-operation, and that progress has expanded that co-operation from families to bands and then to tribes, nations and international co-operation.

A country's policies and politics are influenced by how leaders think about history. If a country's policies are based on Marx's ideas about class struggle, then it will leave out enormous opportunities for co-operation. The gains from co-operation are hugely important: companies work only to the extent that they are able to get their employees to cooperate with one another in ways that create value. If, on the other hand, companies are seen as the embodiment of the class enemy, then policy makers may prefer to see their activities curbed and undercut.

This latter approach is the perspective of some of SA's political leaders. However, they ignore a compelling truth: SA's problems don't come from the companies that exist, but from the absence of companies that do not exist. That is where SA should focus its attention.

Making the companies that exist the scapegoats for the country's difficulties is dangerous. It puts the emphasis on existing companies when the problem for SA is how to expand them and build many more new companies. Without this, it is hard to see how the country will create jobs for the 9-million people (and growing) who don't work.

By setting up companies as the enemies of its people, SA risks making a big mistake.

South Africans need to tell themselves a new, more accurate story about what is going wrong and what needs to be fixed, because the "white monopoly capital" narrative, which proposes "radical economic transformation" as its solution is a recipe for failure.

There is no doubt SA needs economic transformation because there are too many unemployed people and too many people living in poverty. However, the creation of the "white monopoly capital" enemy is based on a fiction, and is counterproductive. Even if you accepted that companies were doing bad things and were the enemy, SA's deep capital markets and billion-dollar companies mean it is not true that companies are owned by white people — 30% to 40% of JSE-listed companies are owned by foreigners and a similar ratio by domestic pension funds whose beneficiaries include millions of contributors, black and white.

Black economic empowerment (BEE) is necessary to tackle the inequities of the past, but it has been implemented in a way that is biased towards making the top of society blacker rather than helping the bottom of society get better.

Too many BEE incentives are about equity and shares, board positions and senior management, with far too little emphasis on generating entry-level jobs. BEE policy has also accentuated the country's skill constraints by scaring off white people and increasing the premium paid for skilled black people.

What is needed is a rebalancing of the scorecard to give more credit to firms that generate opportunities at the bottom, mostly by creating the kinds of low-skill jobs that will make inroads into the employment crisis.

BEE is a partial correction for past sins, but growth comes from start-ups and new companies. Start-ups in any country typically face high failure rates. By diverting attention away from creating new companies and imposing costs on existing companies, BEE is probably causing fewer new ones to be created and making sure that more of those that do get off the ground fail. This is a very serious problem in a country where unemployment is the biggest challenge.

Of course, whether a particular set of policies sounds crazy or sensible depends on the conceptual paradigm, or belief system, South Africans use to interpret the nature of the society. And it's easy to see why this story about "white monopoly capital" is politically attractive. But countries can take wrong turns and get into dead-end streets, and if the policies are based on this kind of false narrative, historic mistakes will be made.

There is a similarity with Venezuela, where the ideology of chavismo blamed inflation and a recession on devious business behaviour that had to be controlled through more regulation, more expropriations and more managers in jail. The destruction of people and organisations was perceived as a step in the right direction. By getting rid of those villains, the country would be healed.

While the particular chavista creed that destroyed Venezuela will probably end up collapsing under the weight of its own cataclysmic failure, the lesson other countries should learn is how costly it is to embrace a dysfunctional belief system, and how costly policies based on dysfunctional belief systems can be. In the quest to "return" the wealth to the people, you may end up impoverishing them.

The key mechanism through which poor policies generate cataclysmic results is through the destruction of know-how, the critical though often underestimated ingredient of prosperity and economic growth.

Know-how is the secret ingredient for economic success. It is accumulated and transmitted slowly, mostly on the job, through a protracted process of imitation and repetition we call learning by doing.

Writer and social critic Malcolm Gladwell claims it takes 10,000 hours of imitation and repetition to master something. This is why a large proportion of job adverts require applicants to have experience: workplace experience builds know-how that people can't get by acquiring qualifications.

Know-how can be quickly hired, but it can't be quickly transferred from one person to another. It certainly can't be confiscated or extracted, like teeth, from the brains that possess it. Know-how can, however, be got rid of or fired.

This happened in Venezuela in 2003, when President Hugo Chávez fired people who had collectively accumulated 300,000 years of experience from the oil industry. The result? The industry's output halved and the national oil company is drowning in debt. The know-how in the cement industry was also decimated and as a result, it now produces a fifth of what it did before it was nationalised.

Venezuela's GDP declined by 4% in 2014, 10% in 2015 and 19% in 2016; inflation is expected to hit 2,200% in 2017; the currency fell 92% and 75% of people lost at least 8kg because of food shortages.

Know-how can be scared off and can also be prevented from entering a country if its immigration policies are restrictive. Both are happening in SA. In the 1970s, when SA had a net gain of people moving here from industrialised countries compared to those who were emigrating to industrialised countries, it was an importer of know-how.

This has now become a net loss, with more skilled South Africans moving to industrialised countries than those coming to this country. SA is now a net exporter of know-how. Firing people is how companies lose know-how; emigration is how countries lose it.

SA risks following countries such as Zimbabwe, Venezuela and Algeria, where post-independence or revolutionary governments inherited a stock of know-how in the brains of people the new leaders may not have liked.

"Radical transformation" may lead to the loss of know-how vital to the development of SA, through emigration and exclusion.

Ultimately, the question is whether SA, like Zimbabwe, sees itself as a black African nation with a few unfortunate impurities, or as the "rainbow nation" promoted by Nelson Mandela — a country that is stronger because it builds on its existing know-how for the whole country and celebrates its diversity.

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Radical economic transformation is a flawed Robin Hoodesque fairytale

By Ann Bernstein, 16 May 2017

Assuming assets and incomes will simply be transferred from rich to poor, from white to black, is delusional.

It is far from clear what anyone who talks about radical economic transformation (RET) means by the term. President Jacob Zuma will say it is mostly about the uncompensated expropriation of land. The new adviser to the finance minister, Prof Chris Malikane, will say it means nationalising the commanding heights of the economy. Deputy President Cyril Ramaphosa uses the term mostly to rebrand existing policies and to insist on their urgency even in the face of slowing growth.

As these are quite different ideas about economic transformation and radicalism, a key question to ask about any of them is who will pay for the radical version of RET. One answer to this question is simple, seductive and catastrophically wrong. This is that RET will be paid for by those who benefited from apartheid and from the "neoliberal" order of the past two decades. Between the expropriation of their ill-gotten riches and the imposition of more taxes on their earnings, RET will transfer assets and incomes from rich to poor, from property owners to the landless, from white to black.

To see the world in these terms is to live in the fairy tale of Robin Hood: a benevolent intermediary relieves the baddies of their gold and gives it back to the poor from whom it was taken in the past. The transfer of resources is almost entirely painless and costless; those who lose out deserve their fate and those doing the transferring never let their private interests get in the way of their public duties.

Despite the lack of clarity about the precise contours of RET, this is assuredly not how it will play out. There is a vast difference between taking gold from the Sheriff of Nottingham and giving it to the poor and transferring working, productive assets from one set of people to another.

Leave aside who is lucky enough to get the new assets — when Robin Hood redistributes gold to the poor, it is worth precisely what it was worth when he took it from the rich. Seizing and transferring a farm, factory or mine, or even a share in any of these, is quite different. Even in the absence of outright corruption and self-dealing on the part of officials, it is overwhelmingly probable that, on average, new owners will know less than existing owners how to ensure the productivity of an asset. Corruption and self-dealing will not be absent.

Thus, the value of the asset after it is acquired will be lower than it was before. Banks, farms and factories will be worth less because the market in these assets will crash: potential buyers and investors will be more concerned that they might be expropriated.

Given the "right" circumstances, asset values could collapse completely — as we have seen in Zimbabwe and Venezuela.

Loose talk about expropriation is already having this effect: investors are rethinking their plans in light of the possibility that they might not be able to reap the rewards of owning assets they currently own or that they might be seeking to acquire or build. One implication of all this is RET cannot work if beneficiaries are to pay market prices using borrowed funds because lenders will doubt that the asset can stand as collateral for the loan. In these circumstances, most expropriated assets would soon be underwater. This is why many who advocate expropriation think that it should be implemented either without compensation or at prices lower than current market values.

However, if expropriation without compensation (or with limited compensation) solves one problem for its proponents, it creates a new one: it greatly weakens the confidence of all asset-owners — including the beneficiaries of expropriated assets — that they will obtain the full benefits of their ownership. To whom can they sell their newly acquired asset? Who would buy it? And at what price?

There are no clear answers to these questions. Because those who have already been expropriated once would be understandably nervous about acquiring assets again, there is unlikely to be as much demand for these assets. Reduced demand implies reduced prices.

RET is self-defeating and those who are its supposed beneficiaries stand to lose out as asset values decline. Whatever losses in value their assets suffer, the small number of lucky recipients of expropriated assets is likely to be better off than before. The same will not be true for anyone else. The costs of RET will fall on a broad swathe of South Africans.

Consider in this regard the 2million public servants. Initially, their losses will take the same form as those of other asset owners: collapsing share prices will cut the legs out from under their pension funds. Worse will follow — as the economy is dragged down by the inevitable collapse in aggregate demand and acceleration of capital flight, tax revenues will dry up. Combined with the government having to bail out its retired employees, this will mean cuts to the public service wage bill: agreements reached at the public service bargaining chamber will not be met, retrenchments and salary cuts could soon follow.

This is precisely what happened during the growth collapses in Greece and Ireland in the past decade. The government will have no option but to follow suit if tax revenues collapse. The government will do its best to avoid this by shaving as much as it can out of the nonwage portion of the budget. If some parts of the infrastructure programme are treated as sacrosanct or expanded for projects such as the nuclear build programme, that means having to cut spending in programmes that transfer resources to poor people. Social grants, RDP housing and higher education funding may be easier to cut than public servants' salaries.

Public servants and the beneficiaries of the government's other spending programmes are therefore likely to suffer the consequences of RET. What about taxpayers? Hurt by collapsing asset prices, galloping capital flight and a rapidly slowing economy, salary-earning, VAT-paying citizens will have to help fund the costly consequences of RET. However, any newly raised taxes will not fund new public services or expanded infrastructure programmes; they will pay for the pensions of retired public servants and the rapidly growing costs of government debt and fill the revenue gaps left by increasingly creative tax-evasion schemes.

RET will reduce asset values and induce a collapse in demand because consumers will be less wealthy and because they will be more risk averse. The slowdown of the economy will hit households hard, while the reduction in tax revenues will harm the intended beneficiaries of public spending and public servants.

Is anyone missing? Oh yes, the poor. No one will suffer more from a shrinking economy than the poor. Millions will suffer. Not only will redistributive transfers and services from the government fall, but food and transport prices will rise. Worse, whatever faint chance they have of finding a job in the current circumstances will vanish completely. Communities and households with very little will be pushed further into deprivation hopelessness and disadvantage. This, surely, is the most critical point about RET: even if it is true there are a minority of people who will benefit from it, the effect on SA's prospects of reducing mass poverty will be catastrophic.

Why, then, is anyone interested in promoting RET? Part of the answer, surely, is the obvious one: that the rhetoric is intended to distract voters from the looting of the country's resources and, at the same time, to shore up the populist credentials of an increasingly unpopular political leadership.

The reason the language of RET resonates and why its populist promise may have emotional and political traction, is that SA's economic policies have failed to generate the jobs and inclusion it needs if it is to overcome apartheid's malign legacies.

While effective redistribution to poor and disadvantaged people is clearly a critical component of the policies that will achieve this, growth is more critical still. It is significant that RET does not mention growth. Achieving faster growth will require some toughminded choices: labour market reform, reconceptualising black economic empowerment away from elite enrichment, stripping away burdensome business regulations. It will require a focus on making cities more productive and the economy more competitive.

Hard as some of the choices needed for inclusive growth may be, it is a programme that, unlike RET, has the merit of not being self-defeating. That RET has gained so much traction should be a clarifying moment in the debate about SA's future direction. Happily, a large proportion of SA's citizenry can see through the rhetoric to the greed that lies behind it. Sadly, it is not yet clear if this will be enough to prevent its implementation.

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Gigaba's adviser entirely at odds with economic policy since 1994

By Ann Bernstein, 26 April 2017

Minister causes confusion by backing inclusive growth while lending his ear to proponent of zero-sum class war.

Malusi Gigaba is a confusing figure. What exactly is he saying? Immediately after his appointment as finance minister, he declared his.commitment to a programme of "radical economic transformation", a phrase that, if it means anything at all, must mean policies that are different — radically different? — from those that preceded them.

A few days later, after the first ratings agency downgrade of our sovereign debt, he professed himself shocked that anyone might think he would do anything other than continue the policies of his predecessor. "While the executive leadership of the finance portfolio has changed," a media statement from the Treasury read, "government's overall policy orientation remains the same.

"Dropped from these later statements was the language of radical economic transformation, now replaced by a frequently repeated commitment to his predecessor's goal of "inclusive growth". Can this volte-face be taken at face value? It's impossible to know, because, at about the same time as Gigaba's verbal gyrations, the man he was to soon appoint as his adviser, Prof Chris Malikane, was drafting a document that reflects a view of the world that simply cannot be squared with the idea of inclusive growth.

Malikane's manifesto does not quite call on workers of the world to unite in support of SA's tenderpreneurs, but it comes mighty close.

"The tenderbased black capitalist class is not likely to win [its] battle without the support of the mass of the black and African working class," it argues, "insofar as [it] has begun the war against the dominant white monopoly capitalist class, it has to be encouraged."

The zerosum imagery of class war suffuses Malikane's analysis. He is convinced, for example, of the omnipotence of "white monopoly capital". The first paragraph of his document celebrates the "fast-approaching" end of the first phase of the democratic revolution, a period, he writes, that has been "characterised by the unfettered dominance of white monopoly capital over all levers of power in all spheres of society".

Fearing, perhaps, that he might not be understood literally, Malikane provides a helpful list of the entities supposedly under white monopoly capital's "unfettered dominance". These include (obviously) the private sector but also (less obviously) "all apparatuses of the state such as government, the universities, the courts, the press, the security forces and political parties". One wonders when the captains of industry have the time to run their companies, while also mobilising and monitoring this vast hegemony!

Nor does the silliness end there, with Malikane all but declaring post-apartheid SA's presidents to be traitors. He writes that white monopoly capital has used "creditbased" black economic empowerment "to capture the top leadership of political parties, particularly the leadership of the ruling party". To this, he adds that "the cornerstone of the ownership and control of the state by white monopoly capital has always been the National Treasury, its associated agencies and the Reserve Bank", "leading officials and political principals" of which "have always been appointed by white monopoly capital and legitimated through the ruling party process".

It is very hard to see how the appointment of a ministerial adviser with views of this kind is compatible with Gigaba's proclaimed commitment to policy continuity and to inclusive growth. Consider, in this regard, the policy priorities set out in the Treasury's 2017 Budget Review, released barely two months ago, the opening chapter of which is entitled Transformation for Inclusive Growth. Apart from celebrating the steady consolidation of public spending, the predictability, progressivity and stability of public spending and the robust independence of institutions such as the Reserve Bank, the priorities identified include:

- Safeguarding the country's investment grade credit rating through structural reforms;
- Finalising various pieces of legislation to provide the certainty needed by investors in mining and agriculture;
- Concluding the transition to digital television signals and allocating spectrum to broadband services to reduce the cost of bandwidth;
- Expanding the independent power producer programme to accelerate employment growth and create opportunities, especially for blackowned firms;
- Ensuring that economic regulatory functions are performed effectively and that they reinforce our adherence to global standards in financial sector regulation;
- Tackling shortcomings in state infrastructure planning and execution; Improving education and skills development;
- Strengthening competition laws to lower barriers to business entry and expansion, while increasing private sector participation in sectors dominated by the public sector;
- Providing support and incentives for labourintensive sectors; and
- Overcoming cities' spatial fragmentation. This is not a list with which everyone would wholeheartedly agree. And it may, in any event, be too long and diffuse for effective implementation. Certainly, the Centre for Development and Enterprise (CDE) would have some reservations about priorities (or lack thereof) and the precise formulation used in relation to some of the issues identified. Nevertheless, this is clearly a programme aimed at mass inclusion premised on rapid employment growth facilitated by increased investment and economic growth.

This programme is totally incompatible with Malikane's approach. His "strategy" culminates in a list of priorities that would make Hugo Chavez proud. It starts with the need for a "New Economic Plan" (a phrase capitalised in the Leninist way) that would include:

The nationalisation of the Reserve Bank (along with all other banks), as well as the mining industry and SA's insurance companies;

- The expropriation without compensation of all land, the occupiers of which would immediately have to pay rent;
- The criminalisation of all violations of SA's labour laws; and The dramatic expansion of free public services (including "decolonised education").

It would be an exaggeration to say that Malikane's priorities overlap with none of those identified as essential to the pursuit of inclusive growth in the Treasury's Budget Review — both, for example, express a desire to see monopoly power eliminated; both would like to see black-owned business get a larger slice of public spending. However, the overlaps that might exist are not the point.

Malikane casually proposes the overthrow of pretty much every aspect of economic policy as it has been practised since 1994. The Treasury's proposals seek to chart a left-of-centre path through a more or less orthodox programme of structural reform premised on private property, markets, sound institutions and macroeconomic stability. There is simply no way these radically different approaches can be reconciled.

Gigaba is — to put it politely — misleading himself and the rest of us if he says that such a reconciliation is even conceivable.

Perhaps the most striking gap between Malikane's views and those articulated in the Budget Review is not in the detail of the policy proposals but in the fundamental assumptions. For Malikane, policy is a reflection of the balance of warring classes and his priorities are premised on the classically Marxist idea that progress will come when the expropriators have been expropriated. He believes, in effect that ripping assets out of the hands of their current owners is a precondition for social progress, a conclusion that, however viscerally satisfying it might be, is at odds with all historical evidence.

All one need do, in this regard, is think through the effect of nationalisation and expropriation policies in Venezuela in recent years: output collapse of devastating proportions, inflation, emigration, food shortages and a retreat into kleptocratic authoritarianism. One has to ask why this is the man the new minister of finance has chosen to be his adviser. Radical expropriation is diametrically opposed to the idea of inclusion. A commitment to inclusive growth is a concept that implies that policies need not be zerosum in character. Optimal policies almost never are.

The Treasury's repeated commitment to improving investor certainty and business confidence makes it clear that the programme of inclusive growth it advocates is founded on certain key understandings. These insights build on the experience of the past 23 years of democratic government: without the private sector and the appropriate environment for investment, the growth that is vital for expanding opportunities and wealth and the inclusion of millions of South Africans left out of the modern economy will never be forthcoming. The Budget Review says as much more than once. The Treasury, in other words, has understood that the gains business might make are not at the expense of the mass of workers but a precondition to the expansion of employment and the reduction of poverty.

To get a feel of how distant Malikane's expropriation first approach is, consider that in eight pages of text supposedly about economic policy, the phrase "economic growth" does not appear even once; the word "employment" appears six times, on five of those occasions it is as a qualifier for the word "equity".

It is impossible to reconcile Malikane's views with those of the Treasury. In this context, it is reasonable to ask which of two very different views Gigaba adheres to. Business leaders and all South Africans need to know. Will the real Malusi Gigaba please stand up?

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