

# Background

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## South Africa Needs a Roadmap to Economic Freedom

*James M. Roberts and Ray Walser, Ph.D.*

**Abstract:** *South Africa is one of the world's largest exporters of precious metals used in a multitude of industrial and commercial applications. Continued access to this vast mineral wealth is vital for the economic security of the West. The future political and economic stability of South Africa hinges on its ability to tackle lack of economic opportunity, high unemployment, poverty, and the legacy of Apartheid. South Africa also needs a growing economy in order to address endemic challenges ranging from AIDS and crime to education and infrastructure development.*

*Accelerated economic growth requires increased access for all South Africans to land and capital, limits on government interventions, incentives for private investment, and a strengthening of property rights and the rule of law. Powerful voices in the ruling African National Congress, however, are demanding the nationalization of vital industries, land seizures, and state intervention to advance social equality. Analyzing developments in the ongoing debate between economic freedom and state intervention will go far in helping to shape the future of the "Rainbow Nation" as a regional and international economic player. The U.S. should use available political and economic diplomacy policy instruments (e.g., the U.S.–South Africa Strategic Dialogue, the U.S.–South Africa Trade and Investment Framework Agreement (TIFA) Council, and AGOA—the African Growth and Opportunity Act) to weigh in with the South African government on the side of economic freedom.*

### Talking Points

- South Africa's poor are marginalized—not by the market economy, but by active exclusion from it through excessive regulations that hamper entrepreneurship and investment.
- A significant portion of South Africa's Apartheid-era land confiscations remain in the hands of the ANC government. An audit of all state ownership is urgently needed.
- Returning property to the landless poor can be achieved through the titling of superfluous state-owned land, as well as by providing capital proceeds—from the sale of failing para-statals—directly to the poor.
- South Africa is uniquely positioned to play a major role in Africa, given its highly developed private sector. Regulation-compliance costs for entrepreneurs must be drastically reduced so that small businesses can establish themselves in the formal economy.
- South Africans must be permitted to decide for themselves where, how, and for what level of wages they are prepared to work.

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## A Vitaly Important Country

South Africa is the economic hub and powerhouse for sub-Saharan Africa, accounting for roughly 60 percent of that region's gross domestic product (GDP).<sup>1</sup> South Africa "is the world's largest producer and exporter of platinum; is a significant producer of gold, manganese, chrome, vanadium, and titanium; and also exports a significant amount of coal."<sup>2</sup> It is also the most important country, politically and economically, in sub-Saharan Africa—a role model in a region that contains a wealth of natural resources and untapped market opportunities for U.S. companies. Continued progress by South Africa toward free-market democracy is vital for a healthy global economy and will contribute to U.S. national security.

That progress, though, is threatened. Much of South Africa's population is poorly educated and lacks access to infrastructure and services. The government's affirmative-action mandates to increase farmland ownership threaten to undermine private property rights. Crime, HIV/AIDS, and high unemployment are ongoing concerns.

South Africa's current political leadership is burdened by an intellectual legacy of socialism and collectivism that is reflected in the country's relative lack of economic freedom. South Africa's economic freedom score is 62.7 out of 100—ranking 74th of 179 countries in *The Heritage Foundation and The Wall Street Journal's 2011 Index of Economic Freedom*.<sup>3</sup> South Africa ranks fifth of 46 countries in sub-Saharan Africa.

South Africa continues to have a comparative lack of regulatory transparency (which hinders investment) and inefficient judicial institutions. Its score on freedom from corruption is lower than the world average and South African labor laws are drastically below international standards.

Notwithstanding the current challenges, the country has enormous economic potential. South Africa scored relatively well on *Index* indicators measuring trade freedom, business freedom, and financial freedom as well as in its continuing integration into global commerce which has led to notable increases in productivity. South Africa's already well-established first world infrastructure can be expanded to integrate more of the informal economic sector.

South Africa needs a policy framework that encourages property ownership, and a redress of the lingering overreaches and excesses of the old Apartheid system. Strong and independent judicial and legislative branches must be empowered to oversee the executive, especially in light of the crippling effects of corruption that have already taken a toll on South Africa's growth potential.

The U.S. government can and should use the wide variety of available political and economic diplomacy policy instruments—e.g., the U.S.–South Africa Strategic Dialogue, the U.S.–South Africa Trade and Investment Framework Agreement (TIFA) Council, and the extension of textile provisions in 2012 and eventual renewal in 2015 of the African Growth and Opportunity Act (AGOA)—to encourage and incentivize the South African government to make the difficult structural reforms and policy changes that are needed to set South Africa firmly on the road to economic prosperity.

## The ANC's Intellectual Legacy: Socialism and Collectivism

The governing African National Congress (ANC) party in South Africa was founded in 1912 as the South African Native National Congress to fight for black suffrage. It became the ANC in 1923. Banned between 1960 and 1990, the ANC was at the forefront of the struggle against white minority rule and

1. Nwakego L. Eyisi, "Southern Africa Region Economic Landscape 2011," *Afribiz*, August 17, 2011, at <http://www.afribiz.net/content/southern-africa-region-economic-landscape-2011> (September 27, 2011).

2. U.S. Department of State, Bureau of African Affairs, "Background Note: South Africa," June 2, 2011, at <http://www.state.gov/r/pa/ei/bgn/2898.htm> (September 27, 2011).

3. Terry Miller and Kim R. Holmes, *2011 Index of Economic Freedom* (Washington, D.C.: The Heritage Foundation and Dow Jones & Company, Inc., 2011), at <http://www.heritage.org/index>.

the Apartheid system of state-enforced racial segregation. The ANC received support from the Soviet Union for strategic reasons on the part of the USSR and a large number of leaders who studied and lived behind the Iron Curtain were provided with education that pre-supposed a Marxist vision of the world.<sup>4</sup>

With the ANC no longer banned and the 1990 release of Nelson Mandela, imprisoned for 27 years on Robben Island, a door opened for free elections and the installation of South Africa's first majority government. Following a period of transition, the ANC has governed in a "tripartite alliance"<sup>5</sup> with its two closest political allies: the leftist Congress of South African Trade Unions (COSATU), "the country's biggest trade union federation,"<sup>6</sup> and the South African Communist Party (SACP).

Under President Mandela and his successor Thabo Mbeki, the ANC rapidly evolved from a guerrilla and resistance movement to the dominant party in a multiparty system, commanding popular support at elections in the range of 70 percent. Leaders and rank-and-file ANC members with little or no training or preparation for governing and managerial positions soon found themselves in positions of power.

Mandela, who was president from 1994 to 1999, and Mbeki, president from 1999 to 2008, followed an economic program based on a prudent economic policy known as Growth, Employment and Redistribution (GEAR), which featured a commitment to open markets, privatization, and maintaining a favorable investment climate. Economic growth was robust in the first years of freedom but ultimately it could not overcome deep structural problems, leaving today's South Africa with a two-tiered economy, widespread poverty in the still-too-large informal economy, and a formal unemployment rate above 25 percent.

By the middle of the past decade, a long-running struggle for leadership between President Mbeki and Deputy President Jacob Zuma revealed deep cleavages within the ANC. Government efforts to prosecute Zuma in separate cases on charges of rape and corruption foundered; critics claimed it was in part due to allegations of politicized justice.

In a protracted internal ANC fight, support for Mbeki evaporated, and senior ANC leaders shifted support to the previously ousted Zuma. Mbeki finally resigned as president in September 2008, replaced by an interim president, Kgalema Motlanthe. The schism also saw the emergence of a break-away party begun by former senior ANC members, the Congress of the People. Zuma assumed the presidency after elections in 2009 with the ANC winning 65.9 percent of the vote. The Democratic Alliance (DA), with 67 seats in the National Assembly, is the leading opposition party.

The desire by ANC governments to redistribute wealth and reduce income inequality has tempted some South African politicians to impose increasing demands on the productive sectors of the economy. Economic policy debate since the end of Apartheid has focused on the diversion of national resources into wealth transfer schemes through such programs as Black Economic Empowerment (BEE) and the Employment Equity Act of 1998. Critics maintain, however, that too few have benefitted from these measures.

Under government edicts, companies above a certain size were required to develop transformation charters to distribute equity shares and to reach certain employment targets. As former DA leader Tony Leon observed, however, efforts to legislate greater equality through BEE "have also created a rent-seeking that had a corrupting effect on the governing party."<sup>7</sup>

4. African National Congress, "Welcome to the Personal Page of Josiah Tshangana Gumede," at [http://www.anc.org.za/list\\_by.php?by=Josiah%20Gumede](http://www.anc.org.za/list_by.php?by=Josiah%20Gumede) (October 11, 2011).
5. The Economist Intelligence Unit, "EIU Country Commerce Report on South Africa," February 2011, at [http://country.eiu.com/FileHandler.ashx?issue\\_id=937857078&mode=pdf](http://country.eiu.com/FileHandler.ashx?issue_id=937857078&mode=pdf) (September 27, 2011).
6. "Payback Time? The New President Runs Into Trouble with Some of His Erstwhile Supporters," *The Economist*, June 11, 2009, at <http://www.economist.com/node/13834140> (September 27, 2011).
7. Tony Leon, *On the Contrary: Leading the Opposition in a Democratic South Africa* (Cape Town: Jonathan Ball, 2008), p. 640.

Political dominance by the ANC opened the door for the arrival of a species of operatives known as “tenderpreneurs,” shadowy individuals and groups (such as the Ten Percent Brigade) with political connections to the ANC who receive government contracts based on these ANC connections.<sup>8</sup> With the temptation to corruption on the rise, and politicians succumbing to it, the ANC lost its enthusiasm for its premier anti-corruption watchdog organization, the Directorate of Special Operations (the “Scorpions”), that had operated within the National Prosecuting Authority.

The Scorpions—an interagency collection of more than 500 police investigators, accountants, and undercover operatives on detail from various government departments—investigated and prosecuted organized crime and corruption. Eventually, the Scorpions came into conflict with then-head of the South African Police Service, Jackie Selebi.<sup>9</sup> The Scorpions were officially disbanded in January 2009 by President Motlanthe (who served from September 2008 to May 2009 to complete the second elected term of President Mbeki).

### High Crime Rate Undermines Rule of Law and Investor Confidence

Although the judicial system is inefficient, the legacy of Anglo-Saxon rule of law has meant that it remains, fortunately, relatively free from political interference. Crime in South Africa affects all busi-

ness sectors and is a significant deterrent to opening operations in the country. The difficulties with fighting crime relate to unacceptable levels of corruption within the policing system. Lost jobs and lost investment opportunities are among the many consequences of crime for the business sector.<sup>10</sup> In fact, many skilled emigrants cite crime as a major factor for leaving South Africa.<sup>11</sup>

Recent legislative proposals that would tighten control of the state-run broadcasting corporation and a “Protection of Information” bill, which was debated in parliament in September 2011 but later pulled by the government after public protests against it as a form of censorship,<sup>12</sup> have been seen as attempts by the government to shelter its officials from demands for greater transparency in governance and the investigations of a free press.

Over the past decade, allegations of corruption and bribery have been leveled at senior ANC officials, including President Zuma. Since 2004, Zuma’s name has featured prominently in a major corruption scandal related to the 1999 signing of contracts for \$5 billion worth of arms manufactured by European companies.<sup>13</sup> Other scandals have involved former national police chief Selebi, who was convicted on corruption charges in 2010,<sup>14</sup> and a number of parliamentarians. With corruption cases proliferating, South Africa’s place on Transparency International’s “Corruption Perceptions Index”

8. Ido Lekota, “Giving Black Empowerment a Bad Name,” *Sowetan*, July 28, 2011, at <http://www.sowetanlive.co.za/columnists/2011/07/28/giving-black-economic-empowerment-a-bad-name> (September 27, 2011).
9. Fred Bridgland, “Corruption Investigator, Gerrie Nel, Is Charged with Fraud and Perjury in South Africa,” *The Sunday Times*, January 10, 2008, at <http://www.timesonline.co.uk/tol/news/world/africa/article3162321.ece> (September 27, 2011).
10. “Crime Affecting Business in South Africa,” International Business Wiki, at [http://internationalbusiness.wikia.com/wiki/Crime\\_affecting\\_Business\\_in\\_South\\_Africa](http://internationalbusiness.wikia.com/wiki/Crime_affecting_Business_in_South_Africa) (September 27, 2011).
11. Murray Williams, “SA’s Woes Spark Another Exodus,” IOL News, October 6, 2006, at <http://www.iol.co.za/news/politics/sa-s-woes-spark-another-exodus-1.296516> (September 27, 2011).
12. Nickolaus Bauer and Katharine Child, “‘Secrecy’ Bill Withdrawn...For Now,” *Mail & Guardian*, September 19, 2011, at <http://mg.co.za/article/2011-09-19-secrecy-bill-withdrawn--for-now/> (September 27, 2011).
13. Peroshni Govender, “S. Africa May Reopen Arms Deal Probe, Pressuring Zuma,” Reuters, August 1, 2011, at <http://af.reuters.com/article/southAfricaNews/idAFL6E7J10B620110801?pageNumber=2&virtualBrandChannel=0> (September 27, 2011).
14. “South Africa Ex-Police Head Selebi Guilty of Corruption,” BBC News, July 2, 2010, at <http://www.bbc.co.uk/news/10485558> (September 27, 2011).

declined from 38 in 2001 to 54 in 2010.<sup>15</sup> By comparison, neighboring Botswana ranks 33rd.

The opposition Democratic Alliance party has published a dossier detailing the appointments of several people to key positions in the public service—often at very large salaries—despite a dubious track record which suggests them unfit for public office. The DA report notes that in “most cases the evidence would suggest they were appointed as a reward for their political support for a particular faction or agenda in the ruling party; at the very least, as a result of an inability to act against the corrupt or set the appropriate precedent.”<sup>16</sup>

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Instances of family members, friends, and associates receiving contracts are rampant and undermine the ability of private entities to compete for outsourced government services. In the process, the quality of services being delivered to the government has been drastically reduced. This is most apparent to the observer when assessing the condition of the legacy infrastructure from the old Apartheid state—it is obvious that the government is not properly maintaining existing roads, bridges, and other infrastructure.<sup>17</sup>

Sipho Pityana, chairman of a constitutional watchdog group, the Council for the Advancement of the South African Constitution (CASAC), argues that corruption is crippling South Africa.<sup>18</sup> Pityana

is a former deputy general in the departments of foreign affairs and labor. A study by CASAC identifies three potentially devastating legal and institutional weaknesses in South Africa:

1. No effective monitoring and enforcement agencies,
2. No institution with a clear mandate to drive educational campaigns on corruption, and
3. No true independence for organizations tasked with fighting corruption.

In 2011, opposition Member of Parliament Ian Davidson tabled a bill aimed at tackling corruption which limits the ability of state employees to do business with the state.<sup>19</sup>

Finally, the debate over policy directions often trends toward populism and playing the blame game. To fight poverty, the Left demands radical approaches and swifter redistribution. COSATU, for example, has repeatedly argued that the soul of the ANC must remain with its “working class formation and left-wing liberation movement.” Strike movements led by COSATU in recent years have been costly, with demands for increases exceeding rates of inflation and locking out the jobless. COSATU has steadily warred against prudent, market-based solutions saying they have failed to bring about “meaningful change.”<sup>20</sup> The implication is that the time for gradual adaptations and natural growth is running out.

Many members of South Africa’s Communist Party (SACP) on the other hand have become increasingly critical of corruption among ANC leaders and the creation of what South African journalist

15. Transparency International, 2010 Corruption Perceptions Index, at [http://www.transparency.org/policy\\_research/surveys\\_indices/cpi/2010/results](http://www.transparency.org/policy_research/surveys_indices/cpi/2010/results) (September 27, 2011).

16. “Introduction: The Crooked Comrades Monitor,” Democratic Alliance, at <http://www.da.org.za/campaigns.htm?action=view-page&category=7364&sub-page=7365> (September 27, 2011).

17. Khume Ramulifho, “Malema’s Tenderpreneurship Symbolic of Rot in ANC–DA,” Politics Web, February 21, 2010, at <http://politicsweb.co.za/politicsweb/view/politicsweb/en/page71619?oid=161679&sn=Detail&pid=71619> (September 27, 2011).

18. Sapa and Sowetan Live, “Corruption is Crippling South Africa,” Sowetan Live, March 16, 2011, at <http://www.sowetanlive.co.za/news/2011/03/16/corruption-is-crippling-south-africa> (September 27, 2011).

19. Ian Davidson, “If the ANC is Serious About Fighting Corruption, They Will Support Our Bill,” Democratic Alliance, March 23, 2011, at <http://www.da.org.za/newsroom.htm?action=view-news-item&id=9251> (September 27, 2011).

20. Patrick Craven, “South Africa Not Transforming—COSATU,” Politics Web, August 4, 2011, at <http://www.politicsweb.co.za/politicsweb/view/politicsweb/en/page71654?oid=249418&sn=Detail&pid=71616> (September 27, 2011).

Jacob Dlamini has called a “black bourgeoisie”<sup>21</sup> by government programs, such as BEE.<sup>22</sup>

The fiery leader of the ANC Youth League, Julius Malema, has staked out an even more radical position, one that some have compared to the program of Robert Mugabe in Zimbabwe: demanding nationalization of mines and banks and expropriation of land without compensation. Ironically, Malema has been accused by the SACP of practicing cronyism, through a trust fund that allows him to live a lifestyle well in excess of his income.<sup>23</sup>

As the ANC moves to chart a future course that will be developed at the next party Congress which is scheduled for 2012, followed by presidential elections in 2013, many observers worry that cronyism, corruption, and radical populism will further tarnish the luster of the “Rainbow Nation.”

## Land and Property Rights

Land reform in South Africa has been slow—with the market viewed by the government not as crucial to efficient allocation, but as an obstacle.<sup>24</sup>

The government’s land reform policy consists of transferring failed state assets and inherited Apartheid land confiscations to the poor through property titling and share ownership, as well as the transfer of inhabitable superfluous state-owned land to poor households on a nonracial basis. Complex social tensions surround the ownership of land and the topic remains a massive source for populist leftist and ANC Youth League rhetoric. That rhetoric,

however, almost never focuses on shortcomings in the government’s program and instead centers almost exclusively on who currently owns private property.<sup>25</sup>

Research by the Centre for Development and Enterprise in Johannesburg shows there is a significant portion of empirical evidence demonstrating that the private sector and markets make major contributions to South Africa’s development in general and to land reform in particular.<sup>26</sup> The report notes it is vital to understand private-sector perspectives on land reform and that the positive role of the private sector in land reform can and should be expanded.

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Leon Louw, executive director of the South African Free Market Foundation, notes the irony that the South African government currently owns much of the land that was forcibly taken by the Apartheid state and recalls Hernando de Soto’s famous description of much of it: “dead capital.”<sup>27</sup> Louw calls for that land to be returned to the disenfranchised under a system of property-titling and private ownership, but the government has been reluctant to do it on that basis.<sup>28</sup>

21. Jacob Dlamini, “ANC in Dire Need of a Lesson in Political Humility,” *Business Day*, March 17, 2011, at <http://www.businessday.co.za/articles/Content.aspx?id=137437> (September 27, 2011).

22. John Campbell, “Jacob Zuma’s Political Challenges,” Council on Foreign Relations blog, August 3, 2011, at <http://blogs.cfr.org/campbell/2011/08/03/jacob-zumas-political-challenges/> (September 27, 2011).

23. Chris Makhaye, “SACP Lashed Malema,” *The New Age*, August 1, 2011, at [http://thenewage.co.za/24398-1007-53-SACP\\_lashes\\_Malema](http://thenewage.co.za/24398-1007-53-SACP_lashes_Malema) (October 8, 2011).

24. “Land Reform in South Africa: Getting Back on Track,” Centre for Development and Enterprise *Research Report*, May 16, 2008, pp. 2–20, at [http://www.cde.org.za/article.php?a\\_id=284](http://www.cde.org.za/article.php?a_id=284) (September 27, 2011).

25. “ANC Youth League Wants More Radical Land Policy,” *The Times Live*, April 21, 2011, at <http://www.timeslive.co.za/Politics/article1033787.ece/ANC-Youth-League-wants-more-radical-land-policy> (September 27, 2011).

26. “Land Reform in South Africa,” Centre for Development and Enterprise.

27. Leon Louw, “Transfer Land from the State to the People Now,” 26778 Land Claim Action Group, June 13, 2007, at [http://www.broederstroomlandclaim.co.za/Transfer\\_land\\_from\\_the\\_state\\_to\\_the\\_people\\_now.pdf](http://www.broederstroomlandclaim.co.za/Transfer_land_from_the_state_to_the_people_now.pdf) (September 27, 2011).

28. *Ibid.*

With private ownership come opportunities to use land titles to obtain loans against what one owns in order to start new enterprises and invest in further training or education.<sup>29</sup> The government's inheritance of Apartheid government land confiscations should be returned to the people to unlock this potential. This could be done through privatization of failing state assets and the resources that the state currently owns to entrepreneurs and businesses. The proceeds that the government realizes from the privatizations could be used to fund education and job training, and provide incentives to private banks to make loans to low-income applicants who want to acquire new skills or start businesses.<sup>30</sup>

South African commentator Temba Nolutshungu, who was detained in solitary confinement under Apartheid-era laws<sup>31</sup> for his anti-Apartheid activities, has been a leading advocate of such a move—pointing to successes in some of the former Soviet Bloc countries:

There are many ways to enable the self-empowerment of the poor without engendering a sense of victimhood. One way, recently mentioned in the press, is to allocate shares in state-owned enterprises, as was done in the newly formed Czech Republic, and to transfer inhabitable superfluous state-owned land to poor households on a nonracial basis.<sup>32</sup>

Unfortunately, land titling has been slow and not focused on the land already owned by the government. The leftist elements in the ANC alliance—COSATU and the SACP—view the poor as exploited by the market (capitalism), rather than

marginalized from it. Thus, the landless poor, unable to take tenure of property they live on and thereby acquire collateral to participate in the market economy, are instead caught in a vicious cycle: First, they are trapped in their landless dependency on the state; second, the Left then cites these statistics as proof that the redistribution (expropriation) by the state of additional privately held land is a national necessity.<sup>33</sup>

According to a report by the South African Centre for Development and Enterprise, “Land Reform in South Africa,” after South Africa's first democratic elections in 1994, small-scale farmers expected the opportunity to buy the land they had formerly leased from their homeland governments in order to acquire full commercial status.

The report notes, however, that most are still awaiting transfer of title to the land, leaving them unable to use that title as security for production and farm infrastructure loans.<sup>34</sup> Anger has already mounted among farmers—both black and white—in the Eastern Cape at the provincial government's failure to release state-owned farms for redistribution as well as at the failure to enforce property-rights protections against land invasions.

### **Willing Private Buyers Blocked by an Unwilling Seller**

Across the globe, almost all state-dominated land reforms have had a very poor outcome.<sup>35</sup> Nevertheless, although the South African government's current concept of land reform includes the willing buyer, willing seller concept, its plan assumes

29. Timothy Besley and Maitreesh Ghatak, “Creating Collateral: The de Soto Effect and the Political Economy of Legal Reform,” London School of Economics, March 2008, at <http://econ.lse.ac.uk/staff/mghatak/creatingcollateral.pdf> (September 27, 2011).

30. Temba Nolutshungu, “Affirmative Action,” *Business Day*, March 12, 2010, at <http://www.businessday.co.za/articles/Content.aspx?id=103451> (September 27, 2011).

31. The Terrorism Act of 1967 and the General Law Amendment Act of 1963.

32. Nolutshungu, “Affirmative Action.”

33. “The NDR and Socialism. The NDR and Capitalism: Key Strategic Debates,” *African Communist*, November 2007, at <http://www.sacp.org.za/pubs/acommunist/2007/part3.pdf> (September 27, 2011).

34. “Land Reform in South Africa,” Centre for Development and Enterprise, p. 5.

35. Klaus Deininger and Hans Binswanger, “The Evolution of the World Bank's Land Policy: Principles, Experience and Future Challenges,” *World Bank Research Observer*, Vol. 14, No. 2 (August 1999), at <http://econ.queensu.ca/students/phds/khana/econ239/readings/deininger.pdf> (September 27, 2011).

that the government—not the market—will identify those willing buyers and sellers. Moreover, radical factions within the ANC, particularly the one headed by Julius Malema, ANC Youth League president, have been trying to conflate the government's failure to date to proceed with land reform (falsely branding it as market failure) with calls for aggressive and forcible expropriation of even more private land into the government's hands.<sup>36</sup>

Land concerns are high in the cities, too, and people face even more pressure due to the higher land values. Residents in urbanized townships often have reason to doubt the security of their property titles. The noisiest debate surrounding the radicals' assault on property rights centers on the "nationalization debate," as it has been aptly termed in South Africa. The rhetoric emanating from the Left on this issue reflects the tensions within the ANC resulting from the push by some to return to a more socialist reading of the "Freedom Charter," the document considered by many a founding declaration of opposition to Apartheid, which was at the time conflated with Western capitalism ("imperialism") as a whole.

Given the success of liberal macroeconomic policy reforms carried out by the ANC in South Africa in the two decades since the end of Apartheid, it is hard to explain the re-emergence of the hard-left rhetoric of nationalization. Leftist academic Patrick Bond's explanation<sup>37</sup> is simply that the leftist wing in today's ANC has chosen a literalist reading of the Freedom Charter.<sup>38</sup> The argument from the Left is,

essentially, that capitalism is simply an extension of the Apartheid system designed to keep the wealthy in a position of privilege at the expense of the poor.

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The logical conclusion of this Marxist reading of economics is state redistribution of wealth. Shadow Minister for Trade and Industry Tim Harris, however, identifies the true culprit. The poor have remained poor not because of market-friendly macroeconomic reforms, but because of economic distortions at the micro level, where the influence of COSATU has been stronger to the detriment of adoption of the sorts of reforms that have paved the way for greater prosperity in Brazil and other emerging markets.<sup>39</sup>

### **Rigid Labor Laws = Higher Unemployment**

By international standards, South Africa fails drastically when it comes to labor freedoms. Those fortunate enough to be employed are provided with a relatively high level of job and income security.

In contrast, the unemployed are essentially locked out of the market<sup>40</sup> and, sometimes, the formal economy. Current low productivity levels in the employed workforce are not high enough to justify

36. *Ibid.*

37. One explanation is simply that the leftist wing in today's ANC has chosen a literalist reading of the Freedom Charter. See Garreth Bloor, "The Liberation Legacy: Literalist and Normative Torchbearers Battle for the Post-Society Economy," *African Yearbook of Rhetoric*, Vol. 2. No. 1 (2011), p. 109, at <http://rhetoricafrica.org/PDF/AYOR%20%20-%20Table%20of%20Contents.pdf> (October 8, 2011). The view from the Left can be understood by reading Patrick Bond, "In Defence of Naomi Klein's Analysis of South Africa," LINKS, at <http://links.org.au/node/618> (September 27, 2011).

38. In *Nationalisation*, a new book compiled by anti-Apartheid activist Temba Nolutshungu, various authors argue that the Freedom Charter did not advocate nationalization as a policy course in its normative goals of equality, dignity, and material advancement. Nolutshungu, *Nationalisation* (Johannesburg: Free Market Foundation, 2011).

39. "DA: Statement by Tim Harris, Democratic Alliance Shadow Minister of Trade and Industry on Cosatu's 'Growth Path,'" Polity, September 15, 2010, at <http://www.polity.org.za/article/da-statement-by-tim-harris-democratic-alliance-shadow-minister-of-trade-and-industry-on-cosatus-growth-path-15092010-2010-09-15> (September 27, 2011).

40. Eustace Davie, "Jobs, Jobs, Jobs? Then Denationalize the Unemployed," Free Market Foundation, June 28, 2011, at <http://www.freemarketfoundation.com/ShowArticle.asp?ArticleType=Publication&ArticleId=1709> (September 27, 2011).



existing minimum-wage laws and other labor regulatory requirements imposed by the government that private companies are already required to meet. Yet unemployed jobseekers, who would be willing to work for the lower-than-minimum-wage rates that the low productivity levels would dictate, are effectively barred from doing so by the very same laws the government passed—supposedly for their protection.<sup>41</sup>

South African labor law illustrates a classic case of the human suffering engendered by the “economic calculation problem” caused by central economic planning that was first critiqued by Ludwig von Mises in 1920 (and later further elaborated by Friedrich A. Hayek).<sup>42</sup> Wages are set by nationally centralized bargaining councils that are frequently out of touch with realities in areas where their decisions affect employment levels.

One reason why labor is not more competitively priced may be that many agreements reached in wage-bargaining councils, by some employers and trade unions, are extended to other businesses in those industries. This imposes higher costs on businesses, which have to be offset by increased productivity. Since this usually requires firm-specific interventions, centralized bargaining can sever the link between negotiations over pay and improved productivity.<sup>43</sup>

South Africa’s unemployment rate is a significant source of discontent that is swelling amongst youth. Only 41 percent of the working age (16 to 64) population have any sort of job—formal or informal. The official unemployment rate in South Africa stands at 25 percent and is expressed as the number of unemployed as a percentage of the labor force.<sup>44</sup> Yet that statistic understates the scope of the crisis as it only takes into consideration those looking for work—not the millions who have given up any

prospect of finding a job. The same report referred to above shows that since the year 2000 economic growth has relied heavily on government spending, an unsustainable long-term plan.

South Africa would do well to encourage additional exports of manufactured goods to accelerate job creation, but doing so would require the removal of a number of identified constraints: the high costs of doing business and the high costs of labor as primary amongst them. There is firm evidence that South Africa’s labor costs are higher than in other developing countries:

The number of people hired by firms is determined by their costs and productivity. Labour costs include the wage and non-wage costs of employment, such as the cost of dismissing and replacing unproductive workers. Low labour costs encourage firms to employ more people, while higher labour costs encourage them to adopt production methods relying on a smaller number of people, frequently with higher skills.<sup>45</sup>

The latter is particularly troubling given that the majority of unemployed South Africans are qualified only for low-skilled jobs—although the good news is that those jobs offer the hope of upward mobility through on-the-job training. Unfortunately for those jobseekers, however, South Africa’s wage bargaining council takes decisions made about one business and imposes their higher costs willy-nilly on all businesses in the same sector. These higher costs act as a disincentive on employers to hire large numbers of unskilled and inexperienced workers, especially since the costs of firing those who do not perform well is very high due to other government-mandated labor regulations. Centralized wage bargaining severs the link between productivity and wages:

41. “A Fresh Look at Unemployment,” Centre for Development and Enterprise Workshop No. 9, June 2011, at [http://www.cde.org.za/article.php?a\\_id=400](http://www.cde.org.za/article.php?a_id=400) (September 27, 2011).

42. Ludwig von Mises, “Economic Calculation in the Socialist Commonwealth” (1920), Ludwig von Mises Institute, at <http://mises.org/econcalc.asp> (October 4, 2011).

43. “A Fresh Look at Unemployment,” Centre for Development and Enterprise.

44. *Ibid.*

45. *Ibid.*, p. 3.

Another important effect of centralised wage bargaining...is that it prevented entry-level workers, especially young workers with neither skills nor experience, from offering their labour to employers at a discount. Given that young inexperienced workers were less productive than others, preventing them from offering their labour more cheaply meant that employers would be reluctant to take them on.<sup>46</sup>

Labor-market research shows almost all those who are unemployed have not been offered a job, as opposed to having declined a job due to low pay.

### Minimum Wage Laws Increase Unemployment

South Africa needs low-skilled workers to work for export-oriented employers. In the case of the Newcastle region of South Africa, where the unemployment rate is 60 percent, workers accepted payment below the national minimum-wage threshold; as a result, the town has attracted more clothing manufacturers to invest in factories and create new jobs.<sup>47</sup> So, while at the national level the bargaining council is literally closing down factories by imposing higher wage costs, workers in places like Newcastle are proving that they will accept lower wages for the chance to work.<sup>48</sup> This situation illustrates the degree to which centralized bargaining has lost touch with the economic realities facing the unemployed citizens of rural South Africa.

According to South African economist Richard Tren,<sup>49</sup> labor laws are shutting the jobless out of work and causing unimaginable social and economic harm. In South Africa, there are approximately five million people actively looking for jobs.

In addition, there are an estimated three million who are out of work but have given up the seemingly hopeless struggle of looking for a job. Eight million people, then—equivalent to the combined population of Johannesburg and Cape Town—are without jobs and increasingly without hope. South African policymakers should heed the words of anti-Apartheid activist and current Soweto (a largely low-income part of Johannesburg) community leader Winnie Serobe: “Surely the labor laws that were written with the interests of workers at heart were not intended to prevent the poor from getting jobs? But they do.”<sup>50</sup>

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***South Africa can no longer afford to ignore unemployment and the policies that keep millions out of work while denying the benefits of new innovation and enterprise to the country as a whole.***

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One way of giving hope to the millions of unemployed is to give them back their power to decide for themselves how and when they want to work. One solution could be that people who are unemployed for more than six months receive a two-year special exemption certificate (SPEX), which would (1) exempt them from all labor legislation and (2) protect any employer who hires them from prosecution under the labor laws.<sup>51</sup>

South African Chamber of Business (SACOB) president, Humphrey Khoza, foresaw the current situation back in 1998. “If the regulation of the labor market is not revisited, I am concerned that South Africa will pay a very heavy price in terms of lost jobs—with all of the attendant negative social con-

46. *Ibid.*

47. *Ibid.*

48. Slindile Khanyile, “Clothing Factories Threaten Shutdown,” IOL, May 4, 2011, at <http://www.iol.co.za/business/business-news/clothing-factories-threaten-shutdown-1.1064169> (September 27, 2011).

49. Richard Tren, “Give Back to the Jobless the Right to Choose,” Free Market Foundation, October 5, 2004, at <http://www.freemarketfoundation.com/ShowArticle.asp?ArticleType=Issue&ArticleId=1835> (September 27, 2011).

50. Garreth Bloor, “How I Would Promote Individual Liberty in South Africa,” South African Libertarian Society blog, July 3, 2011, at <http://libs.wordpress.com/2011/07/03/garreth-bloor-%E2%80%93-how-i-would-promote-individual-liberty-in-south-africa/> (September 27, 2011).

51. Eustace Davie, *Jobs for the Jobless: Special Exemption Certificates for the Unemployed* (Johannesburg: FMF Books, 2003).

sequences for aspects such as poverty and crime.”<sup>52</sup> South Africa can no longer afford to ignore unemployment and the policies which keep millions out of work while denying the benefits of new innovation and enterprise to the country as a whole. Around the country, millions of South Africans are complaining about promises not being kept on service delivery and about the failure of the government to provide them with housing. Tren believes many of these complaints would disappear if South Africa’s unemployed could find jobs.<sup>53</sup>

Nolutshungu and economist Eustace Davie of the Free Market Foundation argue that the effect that South African labor laws have on the unemployed is similar to that which the iniquitous 1913 Natives Land Act had on black farmers. “Like white farmers then, employers are now subject to severe penalties for contravening the legislation. In both cases barriers to entry were legislated. In 1913 the law prevented blacks from owning land or farming. Today the labor laws prevent job seekers from getting jobs.”<sup>54</sup>

Overall, the ANC has liberalized trade agreements without liberalizing labor markets. As in any economy, the goods and services that businesses produce must compete internationally in a tough marketplace—leading to relative price flexibility on the output side for businesses. But the highly regulated labor market means that wages are high and inflexible—leaving enterprises to suffer from flexible output prices and inflexible input prices. This places South African businesses at a distinct disadvantage.

## Taxes & Bureaucracy: Hindering Economic Growth

South Africa has a high personal income tax rate (for earnings in the top bracket at 40 percent, it is one of the highest in the world) while corporate tax stands at a relatively moderate 28 percent.<sup>55</sup> According to South African economist Jasson Urbach, “High marginal tax rates reduce the incentives of entrepreneurs to risk their capital and sacrifice their time and energy to earn higher incomes. Higher marginal tax rates also interfere with the ability of individuals to pursue their goals and results in lower after-tax incomes for workers and therefore small disposable incomes.”<sup>56</sup> The results are fewer savings, resulting in lower capital formation for further investment.

For this reason, the opposition Democratic Alliance party favors a tax cut for newly established, small enterprises, as well as a tax cut on interest earned from savings, as a means to promote greater saving amongst ordinary individuals.<sup>57</sup>

The international literature on welfare and state dependence indicates that effective social safety nets can encourage a reluctance to work on the part of beneficiaries. Alongside these studies and some South African research, has come the suggestion that the rapidly expanding welfare state (including welfare grants, subsidies for housing, and basic services) may be one reason for low labor-force participation rates, with many choosing not to work.<sup>58</sup>

An indication of the extent to which government has grown is evident from the increase in govern-

52. Thabo Kobokoane, “Sacob Worried About ‘Restrictive’ Labor Laws,” *Business Time*, at <http://www.btimes.co.za/98/1018/news/news03.htm> (September 27, 2011).

53. Moeletsi Mbeki, “Corruption and Dependence: South Africa’s Road to Ruin or Salvation?” *Troubled Kashmir*, August 6, 2011, at <http://www.troubledkashmir.com/index.php/world-press-today/629-corruption-and-dependence-south-africas-road-to-ruin-or-salvation-moeletsi-mbeki> (September 27, 2011).

54. Temba A. Nolutshungu and Eustace Davie, “No Farming, No Jobs!—1913 Land Act and 2008 Labour Laws,” Free Market Foundation, May 27, 2008, at <http://www.freemarketfoundation.com/ShowArticle.asp?ArticleType=Publication&ArticleID=1444> (October 3, 2011).

55. Miller and Holmes, *2011 Index of Economic Freedom*.

56. Jasson Urbach, “Flat Tax will Revitalize SA Economy,” *The African Executive*, February 2010, at <http://www.moneyweb.co.za/mw/view/mw/en/page302588?oid=347570&sn=2009%20Detail> (September 27, 2011).

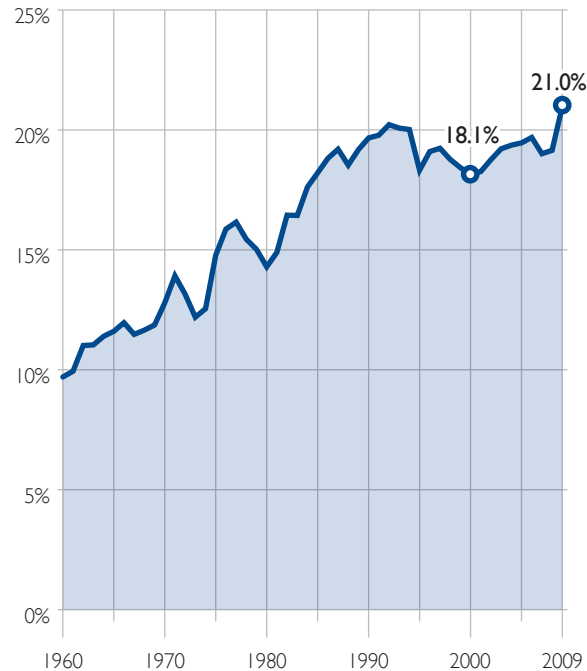
57. Garreth M. Bloor, e-mail correspondence with the Democratic Alliance party’s economic research department, September 9, 2011.

58. “A Fresh Look at Unemployment,” Centre for Development and Enterprise, p. 9.

## Rise in Government Spending

After declining during the 1990s, government spending in South Africa has risen nearly 3 percentage points since 2000.

### General Government Final Consumption Expenditures as a Percentage of GDP



Sources: World Bank, South Africa data, at <http://data.worldbank.org/country/south-africa> (September 14, 2011), and OECD, Country statistical profiles: South Africa, at <http://stats.oecd.org/index.aspx?queryid=23123> (September 14, 2011).

Chart 1 • B 2617  [heritage.org](http://heritage.org)

ment expenditure as a percentage of GDP, which, according to Urbach, grew rapidly between 2001 and 2009.<sup>59</sup> There is some evidence that labor-force participation rates were lower in the mid-1990s when South Africa had a less expansive welfare system. There should be additional research done in South Africa on this important question.

South Africa's state-owned Telkom has caused significant headaches for the economy. South Africa has drastically slower Internet connectivity than the rest of the continent, which impedes business. "According to statistics published by Speedtest.net, South Africa's internet speeds are slower than those in Rwanda, Uganda, Tunisia and even Azerbaijan."<sup>60</sup> One report in 2009 showed that in one case it was faster to send a 4GB message by carrier pigeon than through the aged telecommunications infrastructure of the state-owned Internet provider.<sup>61</sup>

### **Proposals being considered by the African National Congress to nationalize South Africa's mines would trigger government growth and hinder new private investments in the sector.**

Unfortunately, the inefficiency and lack of market responsiveness of Telkom is just one example of poor service from a wide variety of state-owned enterprises (SOEs) that are consuming vast quantities of public funds. The opposition Democratic Alliance party estimates that the government has spent nearly U.S. \$30 billion supporting SOEs in the past six years.<sup>62</sup> SOEs are a drain on the treasury and deliver services less effectively and less efficiently than the private sector.

Proposals being considered by the African National Congress to nationalize South Africa's mines would trigger more government growth and hinder new private investments in the sector. In 2010, President Zuma "indicated that mines will not be nationalized," but the ANC's National General Council "did agree in principle to folding existing state-owned mining assets into a single para-statal that could partner with other companies. Party leadership said it will study other countries' experiences with nationalization and revisit the issue at

59. Jasson Urbach, "Will South Africa Choose Entitlement or Enlightenment—Amandla or Inkululeko?" Africa Heritage Society, August 23, 2011, at <http://www.africaheritagerivonia.com/?p=33> (September 27, 2011).

60. "South Africa Internet Speed 93rd in the World," Skyrove, at <http://www.skyrove.com/south-africa-internet-speed-93rd-in-the-world/> (September 27, 2011).

61. "SA Pigeon 'Faster than Broadband,'" BBC News, September 10, 2009, at <http://news.bbc.co.uk/2/hi/8248056.stm> (September 27, 2011).

62. Bloor, e-mail correspondence with the DA party's economic research department.

the ANC policymaking congress in 2012.”<sup>63</sup> Thus, although mining nationalization is not yet the official policy of the ANC, its consideration has already had a detrimental effect on investor confidence in the long-term stability of the country as an investment destination.

In an article titled “Nationalisation Is Bad for Consumers, Workers, the Poor and Democracy,” Eustace Davie argues that rather than nationalizing the coal industry, the South African government should spend its time and money to improve shortcomings identified in the World Bank/International Finance Corporation’s annual “Doing Business”<sup>64</sup> survey on South Africa. “This requires the removal of barriers to entry into economic activity, such as unnecessary licences, permits, and prohibitions, including those that prevent private firms from competing on a level playing field with state-owned enterprises.”<sup>65</sup>

### Reducing Regulatory Burden for New Businesses

South Africa is not friendly toward small businesses. Although there are a wide range of government agencies charged with enhancing private entrepreneurship, the biggest obstacle faced by would-be private businesses is the government itself: Government policies are a major hindrance to the launch of new enterprises and private job creation.

Tax policy is one of the greatest inhibitors of small business development. The enormous volume and complexity of the tax laws and the administrative sophistication required to comply with these laws are daunting even for well-educated and well-funded entrepreneurs. These laws must be simplified.

It is impossible to determine how many potential entrepreneurs have been prevented from ever getting started because of onerous compliance requirements. Continuing compliance costs represent an additional financial burden to small businesses and are often a factor in business failures. The Small Business Project’s “Reducing the Cost of Doing Business in South Africa” report found that, on average, it costs formal-sector companies in South Africa about U.S. \$10,000 per year to comply with regulations.<sup>66</sup>

And these are just the costs to comply with the red tape—the costs that accumulate because forms have to be understood, filled in, and submitted. No sane person can expect the poorest of the poor and, indeed, the majority of South Africans, to finance this enormous financial burden. Unless the current status quo is reformed, the majority of South Africans will remain locked into the informal sector with disastrous consequences for job creation.

### What the U.S. Should Do

The U.S. can promote changes that will benefit South Africa, the region, and the U.S. by encouraging positive modifications in the current ANC government’s policies. The Obama Administration should:

- **Emphasize Economic Freedom.** The Obama Administration should assign top priority to fully operationalizing the U.S.–South Africa Strategic Dialogue and the U.S.–South Africa Trade and Investment Framework Agreement (TIFA) Council as vehicles through which to encourage and incentivize economic freedom policies as the key to enhancing prosperity in South Africa and across the African continent.

63. U.S. Department of State, Bureau of Economic, Energy and Business Affairs, *2011 Investment Climate Statement*, March 2011, at <http://www.state.gov/e/eeb/rls/othr/ics/2011/157358.htm> (September 27, 2011).

64. “Doing Business 2011: Making a Difference for Entrepreneurs,” *Doing Business*, November 4, 2010, at <http://www.doingbusiness.org/reports/global-reports/doing-business-2011/> (September 27, 2011).

65. Eustace Davie, “Nationalisation Is Bad for Consumers, Workers, the Poor and Democracy,” MoneyWeb, September 30, 2010, at <http://moneyweb.co.za/mw/view/mw/en/page292681?oid=508589&sn=2009+Detail&pid=292523> (September 27, 2011).

66. “Government Failing to Reduce Cost of Doing Business in SA,” MoneyWeb, May 6, 2011, at <http://www.moneyweb.co.za/mw/view/mw/en/page292681?oid=536538&sn=2009+Detail&pid=295050> (September 27, 2011).

The U.S.–South Africa Strategic Dialogue was established through a Memorandum of Understanding between the two governments. The first meetings were in 2010 and focused on cooperation between the U.S. and South Africa in key areas, such as health, education, food security, law enforcement, trade, investment, energy, and nonproliferation. This diplomatic forum—chaired by senior representatives from both governments—underscores the importance of strong U.S.–South African relations. In these semi-annual meetings, the U.S. should insist that the agendas focus primarily on trade, investment, and energy issues.

The U.S.–South Africa Trade and Investment Framework Agreement Council is another venue for promoting economic freedom. The Administration should schedule frequent meetings of the Council with the goal to encourage negotiation of a U.S.–South Africa Bilateral Investment Treaty (BIT) and, eventually, a U.S. free trade agreement either bilaterally with South Africa or with the larger Southern African Customs Union (SACU) of which South Africa is the dominant member. These agreements not only will encourage and protect new foreign direct investments in South Africa by U.S. companies but will also drive the South African government to liberalize and open additional sectors of the economy to foreign investment.

Other specific areas for policy improvement include:

*Business Freedom.* Despite recent reform measures, progress in diversification of South Africa's economic base has been limited and uneven, indicating a need for regulatory changes that would encourage more dynamic private-sector development.

*Trade Freedom.* Import and export restrictions, including tariff rate quotas on agricultural and textile imports, services market barriers, import and export permit requirements, burdensome technical standards, preferential government procurement procedures, burdensome regulations, inconsistent customs administration, and the use of anti-dumping laws to limit imports

that add to the cost of trade should be eliminated.

- **Extend the African Growth and Opportunity Act (AGOA).** The AGOA was enacted in May 2000 and has been expanded and extended by Congress several times. AGOA provides preferential access for beneficiaries' exports to the U.S. from more than 30 sub-Saharan African countries. Among the textile provisions of AGOA is an important one that permits the use of third country fabrics; that provision will expire in September 2012. AGOA as a whole is set to expire in 2015.

Trade with South Africa, particularly U.S. exports, continues to grow. Signaling Administration and bipartisan support for a renewal and extension of AGOA will help to build confidence among all partners. Free trade agreements encourage the strengthening and deepening of democratic free market institutions (both in the government and in civil society) in developing countries. Since the only source of genuine and lasting development is from private-sector-led economic growth through trade and investment, strong protection of property rights, and the rule of law, the U.S. Congress should extend and renew AGOA.

## Conclusion

It is not money or a lack of capacity that keeps South Africa from achieving its potential. It is the political will of national leaders and the policies that they pursue that will determine whether South Africa achieves a future that is consistent with the international well-wishes and positive sentiment expressed around the world when the country successfully transitioned to a non-racial democracy.

A free economy under the rule of law correlates with greater degrees of democratic flourishing in which human rights and opportunity are realities that later generations will accept as the norm. Achieving the normative goals of the ANC, such as human dignity, economic opportunity, and improved material conditions, must be assessed and measured against the soundness of economic policy decisions made to achieve them. It is the duty of both the South African opposition and civil society to hold the ANC to account. The failure of South

Africa to address widespread poverty and hopelessness is a drain on its economy—affecting the economic security of the West—as well as a recipe for political instability within its borders and perhaps beyond.

—James M. Roberts is Research Fellow for Economic Freedom and Growth in the Center for International Trade and Economics, and Ray Walser, Ph.D., is Senior Policy Analyst for Latin America in the Douglas and

Sarah Allison Center for Foreign Policy Studies, divisions of the Kathryn and Shelby Cullom Davis Institute for International Studies at The Heritage Foundation. The authors gratefully acknowledge the research and valuable contributions to this paper made by Garreth M. Bloor. A South African, Garreth Bloor, at age 23 one of the youngest people to ever be elected to Cape Town's City Council, is chairman of the city's economic development portfolio, and a graduate student at the University of Cape Town.”