Will South Africa become another Venezuela?

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June 21, 2018

Notes of Frans Cronje's address to the Cato Institute in Washington DC on 20 June 2018

On the 2nd of February this year, on the anniversary of his announcements in Parliament in 1990 that set South Africa irrevocably on the path to democratic reform, I was asked to address the FW de Klerk Foundation in Cape Town on South Africa's current prospects for reform. It says a great deal about what South Africa has endured over the past decade that the question of reform is again on the domestic agenda. It says even more about how we are perceived abroad that I could be asked to address you here in Washington on whether South Africa is at risk of becoming Africa's Venezuela. Let me start by telling you what I told the gathering in Cape Town and then turn to answering the question you have set for me.

The final decade of apartheid rule was truly catastrophic. Real per capita GDP in 1990 was approximately 20% below that of 1980 – the buoyant growth rates of the 1950s, 1960s, and first part of the 1970s having reversed. The 1985 decision by the American banking group, Chase Manhattan, then the third largest American bank, not to make new loans or extend old ones to borrowers in South Africa confirmed what most South Africa analysts knew; that the country was bankrupt – in all senses of the word – and collapsing under the weight of the contradictions that underpinned its apartheid ideology – a once expanding economy that sought, throughout, to exclude the majority of its citizens from participation in that expansion. The ensuing fiscal crisis, so often an enabler of political reform, coinciding with the collapse of the Soviet Union, set the scene for Mr de Klerk's 1990 announcement and the later election of Nelson Mandela.

Against a policy framework that mainly respected property rights and a market economy, Mr Mandela and his de-facto prime minister, Thabo Mbeki, achieved more than many observers, or indeed South Africans themselves, understand and a true social and economic reformation was set into motion.

Interest rates that peaked at over 20% in 1996 were cut in half. Bond yields were cut in half. The year-on-year change in levels of fixed investment peaked between 2003 and 2008. The year-on-year change in consumer expenditure, equivalent to 60% of GDP, peaked between 2004 to 2007.

The above trends conspired to ensure that the economic growth rate recovered to average around 3% between 1994 and 2003 and 5% between 2004 and 2007 – the first time it had sustained such an average for that number of years since 1970.

In what was arguably the African National Congress's (ANC) greatest policy success, the government debt-to-GDP ratio was cut in half and the saving on the government's interest bill was sufficient to finance the initial rollout of what would become the most expansive welfare system of any emerging market. At the same time, a budget deficit inherited at levels of around -5% was reversed and, remarkably for an emerging market, thirteen years after coming to power the ANC-led government secured a budget surplus.

The economic recovery, and this is very important, secured a profound improvement in living standards:

The number of black people with jobs more than doubled.

The dependency ratio that measures how many people depend on every 100 people who work fell from 380 to 251.

In 1996, an estimated 5.8 million families, or 64% of the total, lived in a formal house. That number more than doubled to over 13 million today while the percentage increased to almost 80%. For every shack erected ten formal houses were built.

Similar numbers are true for water and electricity delivery. For example, the number of families cooking with electricity increased from just over 4 million in 1996 to just under 13 million today – or from less than 50% to more than 80%.

In 1955, only 259 black children graduated high school; twenty years later, in 1975, the number was just above 5 000. In 1990 it was slightly over 100 000. Today, it has risen to just under 400 000.

A year after Mr Mandela's election, less than half the university class was black but today the figure is more than 70%, so the number of people being afforded the opportunity of university study has almost tripled since 1990.

Black children came to exceed the number of white children in the lower grades of some private schools and in parts of the suburban housing market the number of black buyers now exceeds the number of white buyers.

But this trajectory was not to last.

Since the mid-1980s the ANC had taken measures to isolate what it called the 'ultra-leftists' in its ranks. This isolation persisted through the transition and Mandela eras, having been reinforced following Mr Mandela's experience at Davos in 1991 and as his party recognised that its revolution needed to harness more than destroy the industrial economy it was set to inherit. With Mr Mandela's backing, his de-facto prime minister, Thabo Mbeki, successfully drove a surprisingly conservative policy framework that, but for the internal contradiction of its flirtation with dogmatic race-based empowerment policies, might have achieved even more than it did.

But Mr Mbeki committed two strategic missteps that would combine to drive him from power. The first was his mishandling of South Africa's HIV and AIDS pandemic that created a civil society protest lobby around which the isolated left would regroup. At the same time he had gambled on sending the charismatic but deeply compromised former ANC intelligence chief – Jacob Zuma – to wrest from Prince Buthelezi and his Inkatha Freedom Party the mantle of Zulu nationalism that the ANC craved to control.

In December of 2007, the events so set in motion came together as a coterie of trade unionists and youth activists, enabled by an often enthusiastic media and civil society, exploited internal disgruntlement with Mr Mbeki's management style to stage an internal leadership coup that brought Jacob Zuma to power as ANC president – forcing Mr Mbeki's later resignation as president of the country. Largely disinterested in questions of policy and best described by the journalist Peter Bruce as 'a man who never heard an idea he did not like', Mr Zuma's tenure saw the left of the party take control of policy while he and his nationalist backers set about looting the public purse.

It was an awful combination made worse by its early years coinciding with the global financial crisis.

The consequences were best read against the global economic growth rate. Having parted ways through the 1980s, South Africa's economic growth rate again showed a high degree of coincidence with the global rate from 1994 to the peak of 2007, through the financial crisis, and back out of the crisis – but only to 2012. From 2013, as the fragile global recovery saw the world's growth rate increase year after year, South Africa's growth rate peeled away on a sharply downward trajectory.

The first quarter of this year recorded a 2.2% contraction giving South Africa the distinction of being the only country tracked weekly in *The Economist* to record a negative 2018 first quarter.

The reasons for the divergence, particularly after 2013, related not to global circumstances but to counterproductive domestic policy and specifically a raft of efforts to dilute property rights and place the state at the centre of the economy – attempts that have not to date been reversed and in some cases have been given alarming new momentum.

After 2007, as the government jettisoned its once promising policy framework, threats were made to nationalise industries from mines to banks. Rafts of new expropriation legislation were drafted. Several bilateral investment treaties were cancelled. Moves were made to erode IP rights protections. My colleagues recorded 27 cases in which their advocacy efforts in support of property rights, a market economy, and the rule of law held back the tide of even more damaging policy.

The consequences were predicted and predictable.

The rate of formal private sector job creation plateaued after 2007. The rate of increase in welfare extension slowed sharply. Per capita GDP, which in 2006 had for the first time exceeded the previous 1981 high point, plateaued and in real terms has declined since 2014.

For the government and the ruling party the political ramifications were almost instantaneous.

Overlay the economic and jobs and welfare data with polling information and a degree of coincidence is revealed. Popular confidence in the future of the country, and by extension the government, peaked in the 2004 to 2007 window (as fixed investment, economic growth, and formal sector job creation peaked).

However, such confidence fell by almost 40 percentage points over much of the subsequent decade in near unison with the year-on-year changes in real household income levels. Those income levels in turn show a close inverse coincidence factor to levels of violent anti-government protest action.

You can extend the coincidence factor to voting data. In 2006, at South Africa's post-1994 economic peak, and 18 months before its fateful 2007 conference, the ANC secured over 66% of the vote in a local government poll – close on the heels of its record 69% showing in the national election two years before that, a moment at which it performed more strongly than when Mr Mandela had led the party a decade earlier. But the post-2007 economic reversal triggered a spectacular reversal in the party's support levels to below 54% in the 2016 local poll – a like with like comparative drop of over ten percentage points for the decade.

Here a very dangerous point was reached. The fear of surrendering political power brought forth not reformist thinking but racial nationalist incitement as well as the 'state capture' thesis via which the left of the party hoped to evade responsibility for the mess they had been central in creating by placing the blame solely on the shoulders of Mr Zuma and his kleptocratic allies.

It was alarming to see the extent to which fallacious nonsense came to define public policy debates such as that 'white privilege' and 'white monopoly capital' explained black poverty when, as just one example, South Africa was recording some of the worst school-level literacy and numeracy rates of any emerging market. Likewise capitalist greed was diagnosed as the cause of youth unemployment with the prescription that 'higher minimum wages' would deliver socio-economic equality. 'The West' was blamed for sabotaging the South African economy when fixed foreign investment stock held by European and American firms dwarfed that of China and South Africa regularly recorded trade surpluses with the United States while running up significant deficits with China.

In December of last year matters came to head as, by a margin of 179 of the over 4 700 ballots cast, the ANC voted to eject Mr Zuma and replace him with Mr Cyril Ramaphosa – a lawyer and former trade unionist turned tycoon – on a ticket that played heavily into the state capture narrative and promised to reverse rampant corruption.

But while corruption and 'state capture' had done much harm, these were by no means new phenomena and played in many respects a supporting, less than a leading, role to the counterproductive policy climate upon which the bulk of the blame for the decay of the past decade must be placed.

Most serious of all was the assault on property rights – that continues unabated. In February 2018 South Africa's Parliament instructed a parliamentary sub-committee to review the property clause in the Constitution (Section 25) to ‘make it possible for the state to expropriate land in the public interest without compensation’ – or EWC as the policy is locally known. The committee has invited submissions (my advocacy colleagues supported over 50 000 South Africans in making submissions in favour of property rights that were hand delivered to Parliament last Friday) and is expected to report back to Parliament in September this year.

The government claims that EWC is vital to liberate black South Africans from poverty – in the main by confiscating commercial farmland and giving it to small-scale peasant producers. Yet South Africa is now a predominantly urban country in which tertiary industries dominate the structure of GDP.

Agriculture accounts for just on 2% of GDP, is both highly mechanised and commercialised, and financed through balance sheets tied to property prices. South Africa’s farmers are also amongst the most expert in the world and easily exceed the efficiencies of farmers in many western democracies when the absence of subsidies is considered.

That EWC could be contemplated at all, not least given the experience of Zimbabwe, is madness and would wipe billions of dollars off the balance sheets of the agricultural economy, place the banking industry at risk, and trigger a sharp withdrawal of fixed investment while driving food prices upwards, provoking urban protest action.

Yet demonstrating the extent to which ideological dogma continues to override common sense the government has assured that it will expropriate with a mind to protecting the economy and food production – a vacuous assurance as several significant investment transactions, set to have been executed in the event of Mr Zuma’s departure, in industries beyond agriculture have again been frozen – and as our first quarter growth number attests.

Nor is there much by way of public demand for a future of subsistence peasant farming – something that is in any event, from a rainfall perspective, impossible in the western three quarters of the country. However, clever political manipulation of historical land injustices has been very effective in whipping up racial nationalist sentiment – a polite form of hate speech as a colleague called it – despite few people wanting to leave cities and return to the countryside.

Moreover, the land expropriated without compensation will not be transferred to new black owners. Instead, it will be held by the state as a patronage tool to deepen dependency on the state. In this lies the terrible betrayal that the majority of South Africans, long denied the advantages of freehold title, will be dispossessed again – and this time in the name of their empowerment.

The group I lead became the most prominent anti-apartheid think tank in the world. We campaigned in South Africa, here, and around the world for property rights for many decades. There is no question of addressing historical dispossession. But this can only be done within a policy framework that finances and extends title to black South Africans – as a model my colleagues have developed demonstrates could easily and cost effectively be done.

The government is also fostering the perception that uncompensated expropriations will be limited to land. However, Section 25 clearly defines ‘property’ as ‘not being limited to land’ – and there is no indication that the ruling party plans to change this definition.

The ramifications will extend far beyond the agricultural sector to many other spheres. This is partly because while the government may yet take ‘custodianship’ of all land, the ruling party has already proposed a number of ‘regulatory’ expropriations which are likely to be implemented – without compensation having to be paid – once EWC amendments are in place.

Regulatory expropriations arise where the state itself does not take ownership of property, but its regulations deprive existing owners of many of the powers and benefits of ownership. Proposed regulatory expropriations already in the pipeline – many of which would have major ramifications for American investors – include:

- 51% indigenisation (local ownership) requirements for all foreign companies in the private security industry, including those (such as Fedex) which simply transport security equipment;

- price and export controls on all mineral products ‘designated’ by the mining minister, which will affect companies directly involved in the sector as well as those with upstream and downstream linkages to mining;

- a 20% free carry for the state in all future off-shore oil drilling projects (under provisions which have already been adopted by Parliament and cannot easily be changed);

- price controls on all companies providing health services and medical devices or technologies under the National Health Insurance (NHI) proposal; and

- compulsory licences for patented pharmaceuticals under a new intellectual property rights regime recently approved by the Cabinet. This will affect all pharmaceutical companies involved in innovative research and could set a precedent for similar derogations from TRIPS patent protections in other emergent markets.

Many American firms are already worried about the government’s cancellation of its bilateral investment treaties (BITs) with the United Kingdom and 12 European countries. Though the US never had such a treaty with South Africa, American companies previously drew comfort from the protections against expropriation which these BITs contained.

The EWC proposal is thus not an isolated aberration – as a report we release today on the implications for American firms makes clear. Rather, it is part of an incremental assault on property rights and the free market in South Africa, and American companies operating in South Africa have much to lose if the EWC proposal is translated into law.

The risk of uncompensated losses could in time encourage many of them to disinvest from the country, especially as South Africa makes up so small a part of the global economy. But an American withdrawal will further isolate the US from the African continent, paving the way for China, in particular, to strengthen and consolidate its regional influence.

Africa is ever less the ‘hopeless continent’. Long-term economic and social trends are encouraging – from the number of years a child spends in school to urbanisation numbers and the proportion of people who can spend a few dollars a week buying things.

From a security, resource, protein, and consumer perspective, Africa is of increasing geostrategic importance. Yet anyone who doubts the potential extent to which the tide of official opinion may look to freeze the US out of Africa need only read Ambassador Nikki Haley’s comments on South Africa’s, the purported bastion of liberal democracy in Africa, voting record in the UN.

The risk now, as more than 30 years ago, is that if the South African government cannot be persuaded of the need to turn and proceeds to change the constitution in pursuit of EWC, or achieves the same end without a constitutional amendment, the country may stagger under the weight of a new set of contradictions – a once upwardly mobile and increasingly urban, tertiary industry-focused economy in which the government, under popular pressure born of a period of low economic growth, turned to Marxist dogma and racial incitement in an effort to stave off the popular frustrations of its people.

If this occurs, the chain of events triggered by EWC will reverse many of the economic as well as political gains of South Africa’s democratic transition and no outcome, no matter how severe, would then be off the charts – more so for the fact that property rights anchor human liberty in all free and open societies.