South Africa's Anti-Growth Strategy

How poor policy and bad governance are wrecking growth

Executive Summary

Introduction

This new CDE report explains the dire growth performance of the South African economy over the past 15 years. Its central argument is that slow economic growth is overwhelmingly the result of bad policy choices and a catastrophic decline in governance, coupled with a devasting lack of leadership.

Poor governance and bad policy are intimately related, and much too little has been done to address them. Indeed, in many domains, we continue to make the same mistakes over and over again, with little sign that political leadership is able to rethink policy and improve governance.

While every instance of bad policy or bad governance damages the economy in a particular way, an important channel through which they collectively impact on macroeconomic outcomes is by the devastating toll they take on confidence in the future. This is critical because confidence in the future — a sense that it will be better and more prosperous than the present — is a vital ingredient to growth because it is this that justifies and drives investment. The brighter and more prosperous the future is expected to be, the higher the level of investment in the present. Conversely, the bleaker the future looks, the less people will invest because they expect lower levels of economic activity in the future. Thus the total effect of each instance of bad policy/governance is greater than the sum of the effects of the individual instances themselves.

This dynamic plays a huge role in explaining disappointing economic growth over the past 15 years. Indeed, the fundamental reason for the decline in growth is that bad policy and governance have meant that confidence in the future has collapsed, resulting in much less investment in physical infrastructure combined with losses to our human capital stock through skilled emigration. Thus, our growth is so slow not because aggregate demand has been too weak, but because the productive capabilities of the economy have deteriorated and our collective capacity to produce goods and services has degraded. We are becoming a poorer society, one that is less and less able to create value and to grow.

South Africa's recent macroeconomic policies and their effects vindicate this: the stimulus provided by deficit spending has produced little or no growth and has, instead, resulted in a rapid build-up of debt, rising macroeconomic risk, and higher interest rates. Given this, it is our view that what South Africa most needs to do is actually quite straightforward: we should stop repeating the policy errors of the recent past and, most importantly, we should demand better governance.

Weakest areas of policy and governance

One of the most important examples of where poor policy choices and bad governance have become a drag on growth is fiscal policy. Bad policy choices (such as unaffordable wage agreements with public servants) and bad governance (especially the failure of Cabinet and the President to respect budget constraints and their wilful blindness over many years to the consequences of unsustainable fiscal policies) have had catastrophic effects on sovereign debt levels, debt service costs and interest rates. The impact on the budget (where more and more spending is absorbed in compensation of public servants and payment of debt service costs) and on investment (where high interest rates have businesses and households reluctant to invest), has been enormous.

Though fiscal policy is a hugely consequential area in which bad policy and governance have had dire long-term consequences, perhaps the most obvious example of how these factors influence growth over the past two decades is that of Eskom - once rated as among the best in the world. Now, it can barely keep the lights on. The key to this malaise is a policy choice that, until recently, ensured that Eskom enjoyed as close as was humanly possible to a monopoly position in the generation of electricity, even as global experience made it abundantly clear that the generation of electricity is much more efficient if there are multiple providers competing with each other.

The policy of maintaining Eskom's monopoly has had a critical weakness: the collapse of governance through corruption and incompetence at Eskom, with the most obvious example of this being the R400 billion that Eskom ploughed into two power stations that don't produce the power they are supposed to, has had catastrophic implications for the whole country. Almost no new generating capacity has been added to the grid even as the performance of existing power plants has deteriorated rapidly. The amount of power available from Eskom's fleet on any given day falling each year relative to the year before from something like 70 per cent in 2016 and 2017 to something more like 55 per cent now. This, even as prices have continued to soar.

Eskom is not the only state-owned company with a statutory monopoly in a critical industry whose operational and financial performance has deteriorated abominably: Transnet's provision of logistics services is increasingly seen as a material risk to the commercial viability of all kinds of economic activity. Apart from the poor performance of the logistics network itself, there are growing indications, and considerable recent reportage, to suggest that the commercial viability of Transnet is increasingly open to question, that it is losing skilled and experienced staff, and that it is likely to place more and more strain on the fiscus if it is to continue to function.

The deterioration of infrastructure is not confined to the assets owned and managed by Eskom and Transnet. There are mounting concerns about the quality of South Africa's roads throughout the country, including in the economic heartland of Gauteng. The same is true of water infrastructure, sanitation and wastewater services, and commuter rail services provided by Prasa. Add to this the deteriorating state of hospitals, police stations and other offices (Parliament burnt down in 2021 and repairs have yet to even begin!), and the cumulative impact of bad maintenance and procurement is evident.

A key commonality underlying all of these trends is the cadre-deployment strategy followed by the ruling party. This has seen the appointment of wholly unsuitable people into key organisations mandated to provide and maintain infrastructure, while also saddling them with a profound and unconstitutional conflict of interest: it is simply impossible to fully and faithfully serve the interests of the ANC and fulfil one's fiduciary duties to the public organisations they head.

Equally important has been the signal failure of South Africa to address the cancer of corruption, which metastasized during Jacob Zuma's presidency, and which remains a profound threat to the future. Corruption distorts economic activity in the short-term, raises the costs of doing business, and, by undermining faith in a better future, reduces investment levels, too.

The same can be said of South Africa's high levels of crime, and, in particular, of the emergence of new kinds of criminality such as the construction and procurement mafias, whose actions impact very directly on the investability of the economy. Add to that the very clear sense that the events of July 2021 might be repeated at some point, and it's very hard to make a compelling case for the economy's long-term prospects.

Implications

Commentators often make the mistake of thinking that economic growth is somehow inevitable. This is not the case: for most of human history, per capita economic output simply did not grow. When economies do grow, however, it is because one or both of two processes is occurring: (i) the economy is accumulating more productive resources (especially physical and human capital), and/or (ii) new technologies are allowing the society to combine the existing stock of productive resources more efficiently to increase output.

Seen in this light, it is clear why our economy is shrinking. South Africa's stock of productive assets has been declining over time because of low levels of investment.

This is overwhelmingly because of declining confidence in the future which is a consequence of poor policy and bad governance.

Those poor policies and bad governance are not a figment of nay-sayers' imagination; they manifest across a range of domains, from electricity and logistics to BBBEE and local government, from high levels of corruption to deteriorating confidence in mining policies, from catastrophic levels of corruption to unsustainable levels of public spending and debt and finally to a failure to deal with criminality. The result? The costs of doing business are higher than they should be, and the potential rewards from investment are lower and more uncertain leading to lower levels of investment and less growth.

The impact of poor governance and policy on confidence in the future is compounded by a devastating lack of leadership.

The president is responsible for both key policy choices and the way in which they are implemented. And yet he consistently fails to govern in the interests of the country rather than the elite of his own party. At no time has he provided a frank, comprehensive and compelling diagnosis of South Africa's ills – an essential foundation on which to start to move forward. Instead, he tries to manage crises by offering 'solutions' that seldom address those crises' root causes and none of which might plausibly set the country on a new path.

Nor, despite the crumbling state around him, has he moved away from a state-driven approach to growth. Indeed, he has not really prioritised growth at all. While sometimes seeming to favour a greater role for business and markets in growth and employment, he continues to hobble market expansion. Not only does this mean that his actions fail to generate growth, but he also gives market-led reform a bad name when his words are not matched by actions. Indeed, he and his government (with only rare exceptions) fail to understand and appreciate how markets and business functions. This is a question of both ideology and of ignorance, and the result is policy failure across a wide spectrum of activity.

Despite rhetoric to the contrary, South Africa does not have a growth strategy.

It has leaders who say they want growth, and it has a lot of policy documents that describe how important growth is. However at no stage has the country's political leadership made a decisive choice to prioritise growth or put in place the components of sound policy and good governance essential to an effective growth strategy. Instead, we have a state that is increasingly a brake on growth and unable to deliver on its most basic functions, presiding over deteriorating infrastructure and rapidly rising levels of indebtedness, and in which the corrupt thrive at the expense of good managers, and where the lives of whistle-blowers are increasingly at risk.

This is the polar opposite of a growth strategy: it is a trajectory along which the productive capacities of the economy are diminishing, not expanding and in which almost all signals to investors and entrepreneurs flash red rather than green.

Read the full report available on CDE's website (www.cde.org.za)

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