POLITICS/INDUSTRIAL RELATIONS

Election '99 – politics and restructuring

The election will produce a "one party dominant state". This will be good for structural adjustment of the economy. During the lifetime of the next parliament we expect major progress on four of the seven variables that require structural adjustment. Existing policies will be pursued with more determination. At the same time, transformation will be stepped up. This may create some alarm amongst investors, but we do not expect it will result in any diversion from policy.

Political violence will occur, but at a relatively subdued level. We forecast a level of violence below the post-1994 levels.

OUTCOME OF THE ELECTION

The opposition will emerge much weakened from the election

Forty-one parties have registered to contest the election. The ANC will be the clear winner with between 60% and 70% of the vote. The most notable feature of the election will be the collapse of the opposition.

Table 1: Collapse of the Opposition

	1994	1999(F)
Opposition share of total vote	38%	35% -
No of parties	6	8/9
Support of official opposition	20%	+/-10%

Worst-case scenario for the opposition:

The NNP remains the official opposition with half its 1994 support base.

Best-case scenario:

The UDM becomes the official opposition with about 10% of the vote. (Please note : we do not forecast they will get 10%!!)

Thus paving the way for one party dominance

Thus, for the period 1999 to 2004 the election could produce a one party dominant state. One party dominance will be reinforced by a number of factors:

Power from the people to the leaders

Firstly, the tradition of the ANC is that of a centrist party controlled by the "collective leadership". That tradition is still very much intact. Secondly, the parliamentary system of proportional representation plus the constitution's barrier to MPs "crossing the floor", put a lot of power in the hands of the party leadership. Thirdly, a Mbeki presidency is generally expected to centralise much more power.

Mbeki is pivotal

After the election SA will therefore have a governing party unchallenged politically and led by a leadership that is likewise unchallenged and secure in the saddle. This places the leader of that party, Mbeki, at centre stage.

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WHAT WILL MBEKI BE LIKE?

Mbeki will push for the right policies

Mbeki's track record on economic policy has by now been established. He piloted privatisation and GEAR through the rather hostile terrain of the ANC body politic; he led a frontal attack on the SACP and Cosatu when they tried to pressurise the ANC into dumping GEAR; he stuck to the basic policy tenets during financial crises and did not deviate from policy; and fiscal discipline remains tight in spite of an election looming.

He has given ample warning that civil service retrenchments are necessary; and is playing a leading role behind the scenes to restructure the education budget by reducing teachers' salaries.

We therefore expect a Mbeki presidency to pursue sound economic policies, including taking the unpopular decisions implied in structural adjustment.

GROWTH AND POLITICS

Higher growth requires structural adjustment

SA's growth rate over the past 49 years – the period for which data is available - averaged just below 3,5% p.a. Yet, current demographic data indicate that to create enough jobs for the new job seekers and lift per capita incomes, growth in excess of 6% p.a. will be required. Saving in SA is too low to finance more than 3,5% p.a. growth. The saving deficit can be covered by foreign capital inflows, but that will require considerable structural adjustment.

…which in turn depends on politics

Structural adjustment in turn depends on politics: does the political leadership have the will and power base to make the changes needed to place the economy on a higher growth path.

We start by analysing the adjustments needed and then test the political will in respect of each of these.

STRUCTURAL ADJUSTMENT = POLICY GAP

Considerable structural adjustment has already taken place. The adjustment still needed, can be referred to as the *policy gap.* We determined the policy gap by comparing SA's policy environment to the ideal policies described in two benchmark studies.

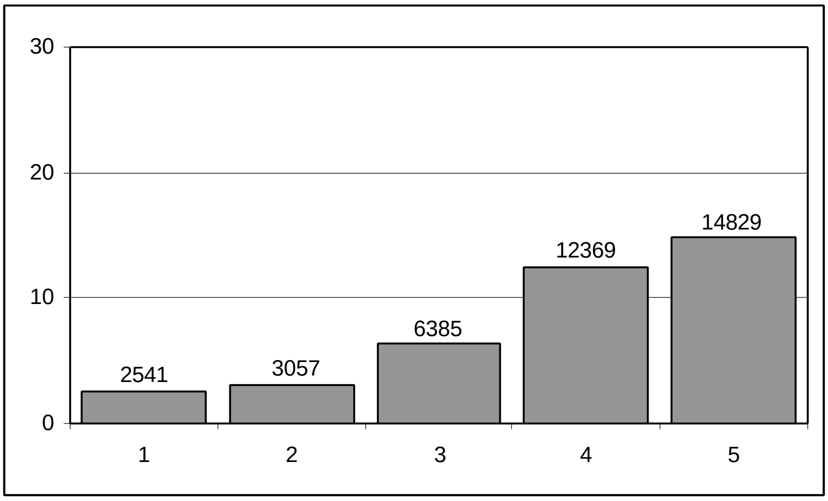
Benchmark SA against international criteria

The **World Economic Freedom Report** published research on the relationship between economic freedom, income and economic growth in various countries. A total of 123 countries were studied, covering the twelve-year period between 1985 and 1996. The results are quite convincing.

More economic freedom, more growth

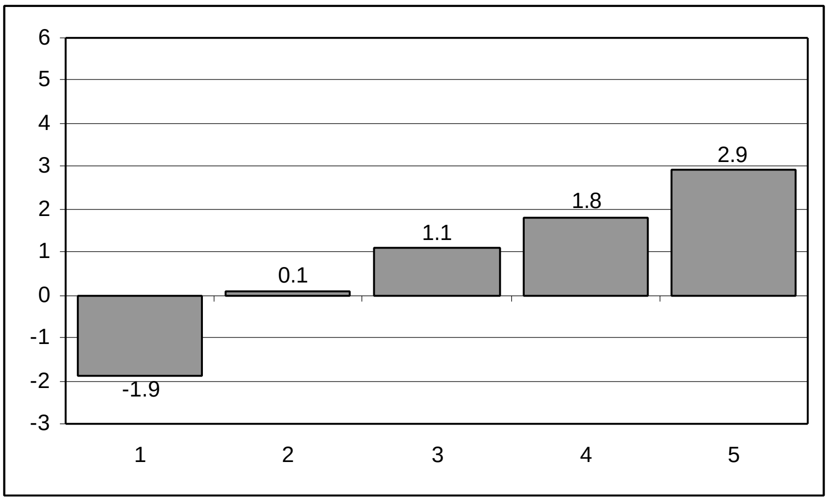
Countries with a higher level of economic freedom also enjoyed a much higher level of growth. Countries with a lower level were poorer and experienced much less economic growth. See the graphs below, where "5" indicates the highest level of freedom and "1" the lowest. Freedom is measured i.r.o. four main variables: money and inflation including exchange control; government operations; taxes; and freedom of exchange with foreigners.

Graph 1: Per Capita GDP (1995 U.S. Dollars)



(The above principle of smaller-government-means-more-growth is corroborated from a study of more than 100 countries by a sub-committee of the US Congress. That study found that countries where the government sector consumes *more than 25%* of GDP tend to *grow significantly slower* than countries where governments consume less than 25% of GDP.)

Graph 2: Growth of Real GDP Per Capita 1985-1996



For the best part of the past 25 years, SA languished in category 2 – second from the bottom. SA's growth rate reflected that rating.

SA improved from category 2 to 3

In 1995 SA advanced to category number 3. The progress from category 2 to 3 was due to changes in interest rate and foreign exchange controls; the termination of military conscription; and reductions in the marginal tax rates from 66% in 1975 to 45% in 1995.

From this benchmark the factors holding SA back, i.e. the policy gaps, are the following:

I.r.o. the freedom benchmark, SA's policy gaps are…

- Exchange control.
- The role of the government in the economy, specifically government consumption; enterprises still in governments hands; and the size of budget deficits.
- Marginal tax rates.
- Uncertainty about political stability which "reduces the security of property rights and the incentive … to invest".

In 1998 the Harvard Institute for Development and the World Economic Forum published the **Africa Competitiveness Report (ACR)**. SA ranked a shocking 7^{th} out of the 23 African countries surveyed.

The ACR stressed the importance of open economies (i.e. a high level of economic freedom), the tax regime and policy certainty as the preconditions for economic growth. These factors are almost identical to the criteria used by the authors of the Freedom Report. As far as the ACR is concerned, SA's main policy weaknesses are:

I.r.o. global competitiveness, SA's policy gaps are…

- Labour market (regulation by government; union militancy; work ethic).
- Level of skills and training of the labour force and thus the supply of skills into the labour market.
- The quality of institutions, specifically the inability of the criminal justice system to deal with crime, was highlighted as a major issue in the ACR.

SA'S POLICY GAP

Summarised

From the above international benchmarks, seven variables can be identified as SA's policy gaps:

1. Political and hence policy uncertainty.
2. Exchange control on residents.
3. Government's degree of participation in the economy i.r.o. consumption expenditure; budget deficits and the number of government enterprises.
4. The tax regime.
5. The labour market.
6. Education and skills available to the economy.
7. The quality and integrity of specifically the criminal justice system.

ELECTION OUTCOME AND THE POLICY GAP

A "one party dominant state" with the leadership of the dominant party committed to sound economic policies will have the following impact on the seven variables in the policy gap.

Political and Policy Uncertainty

Political certainty is guaranteed

A one party dominant state means that political uncertainty is not really an issue. What about policy uncertainty?

Policy certainty is confirmed by a variety of measures

All indications are that the current economic policies will not be jettisoned. The 1999 budget gives a good indication of what can be expected: corporate tax cut from 35% to 30%; an almost derisory 4% increase in social pensions four months before an election; ample warning that salaries are consuming too big a portion of the budget and that retrenchments are necessary. Also, Safcol's privatisation is announced the day after the president sets the election date. (Safcol carries considerable surplus staff and retrenchments will occur.) A "4x4" committee (four from Education, four from Finance) is set up in the Deputy President's office to reduce the salary component of teachers' salaries in the education budget, i.e. staff reductions. Similar interesting progress is being made at local government level, where the ANC-dominated Johannesburg city council approved a major restructuring programme involving privatisation and outsourcing three months before election day.

A reversal of all this is most unlikely. On the contrary, policy will be pursued with more vigour and determination. This variable is positive.

Exchange Control on Residents

Incremental improvement

The current incremental approach to abolition will be continued. We do not expect a Big Bang relaxation. Only when stability has returned to the international markets and growth to the SA economy, do we expect more aggressive relaxation. Nevertheless, incremental relaxation will occur.

Government's degree of participation in the economy

Expenditure as a percentage of GDP is declining

Consolidated expenditure (national government and 9 provinces) has declined from a high of 32.9% of GDP in 1997 to 31.9% in 1998; and is budgeted to decline to 31% in the 1999/2000 fiscal budget.

and will be helped along by a lower salaries bill

Further reduction in expenditure will get a considerable boost from civil service retrenchments. Salaries form 39.6% of the national budget. We are happy to forecast at least 20 000 retrenchments in the course of the next fiscal year, with more to come in the following years.

lower interest payment

Repayment of state debt from the proceeds of privatisation and a smaller deficit will help to curb interest payments.

and privatisation

Lastly, privatisation will reduce the number of government enterprises and the government's role in the economy. The history of privatisation and our forecast of transactions for 1999 are as follows:

Table 2: Privatisation

	1996	1997	1998	1999 (f)
No of transactions	1	2	4	7
Proceeds (Rm)	600	6 050	816	3 500

This variable will improve.

The Tax Regime

In the absence of capital gains tax, the top rates will remain

Two aspects are important: the level of marginal tax rates, and the overall tax burden on the economy. We do not have high hopes that the top marginal rate of 45% will be reduced. It was recommended by the Katz Commission as a fair level, given that SA taxpayers are not subject to capital gains tax. Should the latter be introduced, we might see a reduction in the top marginal rate, otherwise not.

In 1996 government committed itself to reducing the overall tax burden on the economy to 25% of GDP. It has not achieved that level.

Table 3: Tax to GDP ratio

	1995	1996	1997	1998	1999 (f)
All taxes as % of GDP (%)	25.3	26.3	26.9	27.3	26.9

Negative side of better collections and low growth

From a political point of view, it is important to note that non-achievement of the tax:GDP ratio is not due to a lack of political will. It is primarily because of much slower GDP growth as a result of the financial crises of 1998 and better collections by a more efficient Receiver of Revenue. Personal income tax relief since 1995 amount to 2.2% of actual 1998 GDP. In 1999, corporate tax rates were cut. The MTEF (Medium Term Expenditure Forecast) postulates a decline. The political will is thus clearly illustrated.

Given government's own target of 25%, SA must score a low rating on the policy gap "tax regime".

The Labour Market

Relief will be forthcoming on 2 of the 4 basic pieces of legislation

We expect some relief. It will involve two of the four pieces of legislation regulating the labour market.

Two acts will not be amended to grant relief. These are the Skills Training Act and the Employment Equity Act (regulating affirmative action).

Some exemptions from the more onerous obligations of the Basic Conditions of Employment Act will be granted to small business. Some exemptions might even be granted to big business as well (e.g. overtime and Sunday work). The extensions of agreements negotiated at bargaining councils in terms of the Labour Relations Act, will probably also be somewhat curtailed. This should help smaller employers.

But there could be more regulation on retrenchments

There is one risk remaining: retrenchments might become subject to more regulation. An agreement to this effect has been negotiated at Nedlac, but government must still draft the regulations giving effect to it – precisely how wide they will cast the regulatory net, is uncertain.

The input from the ILO is that the labour market is flexible enough

Rightly or wrongly, government does not subscribe to the business view that the labour market is too tightly regulated. In this it is supported by research from the International Labour Organisation ("ILO"). The ILO compared the law on hiring, firing and temporary contracts with New Zealand, Brazil, Chile, Spain, South Korea and Zimbabwe and concluded: "SA … does not appear to be particularly stringent compared with other middle-income countries." Most importantly the ILO also concluded: "(SA labour law) has not impeded … rightsizing, especially in export industries." The large number of retrenchments in SA industry confirms this observation.

However, it is clear that government accepts some relief must be granted. This was signalled clearly in the ANC's New Year's message and by Pres Mandela when he opened parliament.

We therefore expect some relief on this variable.

Education and Skills Available to the Economy

Workplace training has taken a leap forward

The Skills Training Act (along with its counterpart the Skills Training Levy Bill) will ensure that about R1 billion p.a. is raised via a levy on payrolls to finance training authorities jointly managed by employers and employees. (Finance has already committed themselves to count this levy as a tax when calculating the tax:GDP ratio and it has been done in the MTEF forecasts.)

Assessed together with measures taken by the Dept of Education, several training specialists we surveyed are unanimous that the training and development infrastructure in SA is now on par with that of countries like New Zealand and Germany.

Fine structures and legislative frameworks are of course not equal to fine implementation, but progress is certainly being made.

The supply of skilled workers through the tertiary education system show some interesting trend breaks:

Tertiary education is beginning to produce the right skills mix

- Whilst the intake of first-year students at all universities (except Stellenbosch and Cape Town) is falling, the first-year intake at technicons is increasing.
- Technicons have a much higher proportion of commerce and engineering graduates than universities – thus providing more appropriate skills to the economy.

This variable, the supply of skills to the economy, is thus set to improve.

The Quality and Integrity of Institutions (specifically the Criminal Justice System)

Several institutions have improved, the SAPS amongst them

Our report on progress made at the SAPS was sent to you on 1^{st} March, 1999. We will therefore not repeat the information here. The main conclusion was that an improvement is under way. Enough evidence has emerged that the same can be said of a number of other institutions, which are now performing better than in the past: the Receiver of Revenue, the Post Office, Telkom, Water Affairs etc.

However, the rebuilding of the SA public sector will take a long time. We therefore rate this variable a slight improvement only.

Overall Conclusion

So far it is all good news for the financial markets. Four of the seven policy gaps identified will improve (policy certainty, government's role in the economy, the labour market and supply of skills). More limited, progress will be made with the remaining three (exchange control, tax and quality if institutions).

The cumulative effect of the above would be to improve the growth performance of the SA economy beyond the historical 3.5% p.a.

THE ELECTION AND TRANSFORMATION

However, the election will also herald the dawn of more profound transformation. Some aspects will unsettle sections of the investment community. This could have the effect of creating – unjustifiably – uncertainty about policy.

Three major "transformation trends" can be identified.

More aggressive empowerment

- Firstly, the "Mandela umbrella" will be replaced with a much more aggressive push for black empowerment and black appointments. This will take place in various spheres where government has the power to influence matters, like the parastatals and the judiciary. The private sector will also feel the pressure for more black empowerment and affirmative action (e.g. the oil industry is already under severe pressure to do something quite meaningful about black empowerment; the media sector for its "concentration of ownership").

  Pressure will be particularly focused on black empowerment, which will result in share ownership and direct decision-making powers. Min Derek Hanekom's wine trust, for example, has been severely criticised by the Mbeki supporters for not granting equity ownership to blacks.

  A further aspect of black empowerment could see women playing a much bigger role. That raises the possibility of a much higher profile for every white's favourite … Dr Zuma!

Business and investors may not like this aggressive approach.

More centralisation of decision-making

- Secondly, in the name of transformation, more powers will be centralised in the president's office. More and more critical functions will be run directly from there.

  The financial markets will probably be neutral about this aspect. Reaction will depend on the results achieved. Civil society groups, however, will detest the centralisation of power and will see a creeping dictatorship.

Moral revival

- Thirdly, a Mbeki administration is set on launching a moral crusade, which will be aimed at all in SA society, including interest groups under the ANC's umbrella. He has already criticised the work ethic in the civil service; violence during strikes; a refusal to pay for services; corruption and "careerism" in the ANC; and the "free for all atmosphere" which implies "rights and no obligations".

  This crusade could be particularly important i.r.o. the quality and integrity of institutions. The financial markets will like this.

  However, Mbeki's crusade will also take aim at the media and the private sector. He has already taken aim at corruption and tax evasion in business; the media for not doing enough for transformation; (white) business for not having enough of a commitment to socio-economic development and (black) business for concerning themselves with enrichment and not empowerment.

Transformation and the policy gap

Transformation will not derail policy

Will these transformation crusades undermine policy? Our view is that it will not. Transformation is unlikely to reverse fiscal discipline; the move to a more open economy; less government consumption (through privatisation and a smaller civil service) or a bigger role for the private sector via public-private partnerships. This can only mean more growth and a better environment for business.

OTHER ELECTION ISSUES

Two-thirds majority?

It is not the polls that count, but behaviour of those who registered

In assessing whether the ANC will get a two-thirds majority, we do not regard general electoral support as reflected in various polls as the key indicator. The issue is rather how *those who have registered as voters* cast their votes.

Registration trends favour the ANC

IEC figures indicate that people from the "informal settlements" have registered in bigger numbers than those from "formal settlements". The ANC draws most if its support from the informal settlements, and opposition parties theirs from the formal settlements. Clearly, the registration trends favour the ANC. A two-thirds majority is therefore possible.

What are the Risks?

"Power corrupts…"

Hundred and fifty years ago Lord Acton warned that "power corrupts, and absolute power corrupts absolutely". It also applies to the ANC, and will apply even more strongly if two-thirds majorities are perpetuated into the future.

Damage can be contained for the period 1999 to 2004

However, for the period 1999 to 2004 we do not foresee any disastrous consequences. *Firstly,* the ANC is unlikely to make any unilateral changes to the constitution. They are acutely aware of the need to maintain stability and legitimacy. *Secondly,* Mbeki's moral crusade will help to curb corruption. *Thirdly,* internal forces in the alliance are still alive and well and make for healthy debates about issues.

What are the Benefits?

Good for economic stability

A two-thirds majority could speed up the implementation of various controversial economic policies. A government with such a power base will be much less vulnerable to pressure from Cosatu and the SACP.

Unemployment could change the political landscape

Ironically, a two-thirds majority could also contain the seeds of its own demise. As long as people are constrained by the threat from the opposition, hegemony is promoted. Remove the threat and hegemony and cohesion might loosen. Add the high levels of unemployment, and by 2010 an entirely different political landscape could exist.

Political Violence

Political violence is part of the SA landscape and will occur. However, the levels will be considerably lower than at the time of the previous election - indicating some progress.

Table 4 : Political killings

	1994	1995	1996	1997	1998	1999F
	2 476	1 044	683	470	350	432
% change		-58%	-35%	-31%	-26%	+23%

Notes

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