

TRANSFORMATION

2 March 1998 -South Africa

TRANSFORMATION: SHOULD INVESTORS BE NERVOUS?

Transformation in the private sector is the new policy goal of the ANC. President Mandela gave clear notice of this in his speeches to the Mafeking conference and at the opening of parliament. The ascendancy of Deputy President Mbeki will reinforce the drive towards transformation. (See our December report on "Mbeki and the financial markets"). Transformation will tangibly change the environment in which business and investors have to operate. It contains some risk, and some opportunities.

Conclusions

- Transformation implies some government intervention and regulation - matters will not just be left to "normal" market forces and "natural" developments. In that sense the liberal policy approach is out, and a more activist social-democratic type of agenda is in.
- Transformation is about improving the position of Black people, and should not merely be equated with socialism or statism. Transformation has to co-exist with an irreversible move to an open economy, strong open society dynamics and smaller government policies.
- The transformation agenda is also constrained by globalisation. Malaysia has suspended its 30-year-old transformation policies - called "bumiputra" - in the wake of the South East Asia crisis.
- Consequently, a quasi-socialist or even an economy tightly controlled by government is not very probable.
- Nevertheless, investors will have to live with a certain ambiguity: a competitive and more demanding economic environment as well as social transformation demands.

Risks

- Intervention and regulation flowing from transformation will be disruptive for employers and businessmen; it will create extra costs; and it will require additional management time.
- Some management teams may not be capable of living with these demands and the ambiguity transformation requires.
- Transformation could lead to "capitalism for ethnic cronies". The inefficiencies and lack of competition flowing from that could harm investors (e.g. JCI); result in sub-optimal earnings (e.g. Citizen newspaper in Perskor). On a macro level "capital for ethnic cronies" may deprive the taxpayers of proper proceeds (e.g. the Gencor takeover of Samancor). Ironically, assets acquired cheaply may have benefits for investors.
- Transformation could carry on for too long, thus entrenching uncompetitive behaviour. Globalisation and open society dynamics will help to curb this. However, investors must remain wary of earnings based on protection.
- Transformation could undermine government credibility: on the one hand, GEAR, on the other hand "regulation for transformation".

Opportunities

- Transformation will facilitate the unbundling of many existing assets and conglomerates. This will create unique investment opportunities.
- In the long term, transformation will enhance the supply of skills and expertise into the market place, thus helping to lift a barrier to long term growth, i.e. shortage of human resource skills.
- Transformation will create new interest groups (from union investment companies to black "captains of industry") with a vested interest in seeing the economy grow and profits increase. It could actually increase the scope of a market economy.

What is transformation?

The legacy cannot be overcome through natural forces, intervention is needed.

First the theory and then practical examples of how it is implemented. The theory consists of a three-step argument:

- Apartheid left a **legacy** of distortion. The legacy manifests itself in several ways, inter alia, the distribution of ownership and poverty; limited literacy amongst a large section of the population; lack of skills and training; high levels of unemployment in the Black society; and a social voice which is predominantly white.
- This legacy **cannot be overcome** merely through forces of **natural evolution** like economic growth, education and training of a new generation and natural evolution in the labour market. **Active intervention** by the state is necessary to speed up natural evolution.

By speeding up natural evolution, a **new state of affairs can be effected**. This will result in a change in ownership; more blacks being appointed into high positions of responsibility, exposure and income; a more diverse media, etc. This changed state of affairs can be described as transformation.

Transformation in the public sector

The first was the composition of the civil service

The most pronounced example is affirmative action in the **public service**. In some cases this was bad for productivity and efficiency. This is most notably so at provincial and local government levels. In some other departments, however, it has actually improved efficiencies, e.g. finance, water affairs, transport and some others. The size and cost of the civil service is now up for transformation.

Then re-allocation to the poor in

Even bigger examples exist in the field of **social policy**. Here transformation entails redirecting state resources to benefit the poor.

.... health care

More expensive health facilities are downgraded to release funds that can be used to erect clinics and provide primary health care.

....welfare

Welfare benefits which Whites, Indians and Coloureds enjoyed are scaled down and the smaller benefit is now extended to black families as well. The above examples of transformation are not popular amongst Whites, Coloured and Indians (and also not Cosatu who would like to see a higher welfare benefit for all).

.... and housing

Some social policy transformation is, however, also unpopular amongst Blacks. This is illustrated by the transformation of public housing.

The houses built under the previous government's housing programmes will cost, in current rands, anywhere between R25 000 and R45 000 per house. That did not exactly buy a palace -merely a four-roomed house. Coloureds, Indians, Whites and a limited number of Blacks benefited from these programmes. The largest number of Blacks was excluded.

Extending the old housing benefit to the entire Black population is financially just not possible. Thus, the current subsidy was pegged at R15 000 - way below the R25 000 to R45 000 benefit previously enjoyed. R15 000 provides, at best, a serviced site with a small top structure consisting of one or two rooms only. Nowhere near the four-roomed houses that used to be built.

"Verwoerd was better than Mandela"

This transformation is not particularly popular with the likes of Cosatu, Sanco and other ANC supporters. In fact, one quite often hears the accusation from those quarters that "Verwoerd built better houses than Mandela". True, except for the small detail that Verwoerd did not build it for about three-quarters of the population.

Policy determines the environment in which business has to operate ..

The third area of transformation deals with the **policy environment** - the introduction of new policies to facilitate/force transformation outside the state in society at large. This phase has become particularly pronounced over the last few months and will gather momentum during 1998. An abbreviated list of such policies, some finalised and other still under consideration) is contained in Table 1:

Table 1	
Government policy	JSE sector affected
State procurement	Construction, IT, printing, consumer supplies
Health/medicine	Health care and pharmaceutical
Mineral rights	Companies with unused mining rights
Education	Printing, private education
Labour:	
Basic conditions Act	All, but mainly mining, agriculture and security industries
Affirmative action	All employers employing > 50 people
Skills development	All employers
Media diversity *	Publishing and broadcasting
Access to capital *	Banks and lending companies
Sport *	
* No firm policy proposals yet, but they will come	

.. and can cover a very wide spectrum

Transformation in the private sector

Transformation in the private sector has so far manifested itself mainly in three developments" empowerment transactions (including joint ventures); affirmative action; and training and development efforts to enlarge the pool of available skills and competencies.

Where are we now?

Business is criticised for not doing enough

Three trends can be identified:

... or the wrong thing ...

... or in the wrong way ..

Therefore government should be more interventionist

- There is a rising level of impatience and even resentment, in the wider black body politic that transformation in the private sector is not taking place quickly enough.
- Affirmative action is criticised on three grounds - some of them contradictory. Not enough black people are being appointed; many blacks that are appointed do not have real power; not enough is being done to develop and train human resources.
- There is a distinct shift occurring as far as empowerment transactions are concerned. The shift requires that empowerment transactions should be mass based and they should involve as many people as possible. The original NAIL kind of transaction is distinctly unpopular, whilst the African Harvest type of transaction is more welcome.

The cumulative effect of all the above is pressure on government to intervene to ensure that transformation - especially in a recalcitrant private sector - takes place.

Transformation not a one-way street

How far will the state interventions envisaged by transformation go? Table 1 illustrates the extent. Will the cumulative effect of Table 1 be to create a socialist state unattractive to investors? This must be measured against other forces operating in society. Transformation is not a one-way street and does not operate in a vacuum. A contest exists between conflicting forces, each helping to constrain the other. Table 2 illustrates the nature of the contest.

Transformation is not the only game in town

Table 2: Line up of competing forces		
Transformation agenda	Economic policy	Open society dynamics
State procurement	Reduce deficit	Bill of rights protect ownership and economic activity
Health/medicine	Cut civil service	Free and diverse media
Mineral rights	Lower tariffs and more competition	Deregulation in radio & TV broadcasting (thus control of news)
Labour:	Abolish forex control	
Affirmative action Skills development	Integrating into a global economy	Black shareholder class Black business developing a vested interest
Competition policy Media diversity Access to capital	Private sector provide capital for infrastructure	Beneficiaries of privatisation, outsourcing and sub-contracting.

Impact on the markets

Black advancement is not about socialism, but it does create confusion about commitment to market policies.

Other forces are also operating

Business could become stronger

It creates opportunities for investors

1. The issue is promotion of Black people, not advancing the socialist agenda. To the horror of many on the left, this realisation is busy dawning. At the same time, however, many investors see transformation as a subtle repudiation of GEAR and they are becoming nervous of that.
2. Government's transformation agenda certainly constitutes intervention in the market. However, it does not add up to even a quasi kind of socialism. In the context of the structural economic adjustment it is experiencing, the prospect for socialism dims even further.
3. Transformation can in many ways reinforce the greater business environment. It will enhance the legitimacy and respectability of business and profit seeking. The emergence of a Black shareholder class as well as a generation of Black business people can actually leave the economy much stronger and with much more legitimacy. (In the same way as the rise of Afrikaner business helped to ameliorate to socialist tendencies of early National Party rule).
4. Investors can capitalise on some of the transformation developments by backing the right companies. As stated earlier, African Harvest is - from a political point of view - the preferable vehicle.

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Transform, but please also grow

During the past week, a parliamentary committee hear evidence on the new Equality Bill, the Labour Minister implemented the new Equity Act that regulates affirmative action, and Government announced details of how its new procurement policy will promote black economic empowerment.

These Bills are all driven by the transformation agenda. Transformation in this context means measures to cut a bigger slice of the economic cake for blacks: more of the job market, equity ownership and economic activity.

Transformation is needed in SA. It must be encouraged and supported. The history of Malaysia after independence is a good example of how things can go wrong if transformation is not effected. After 1948, Afrikaners used transformation to gain a piece of the economic action.

Transformation alone, however, is not good enough. Economic growth is equally important. Much of sub-Saharan Africa is an example of what can go wrong if mountains of transformation are accompanied by molehills of growth.

The problem is that there is a clash between the requirements of growth and of transformation. We should not kid ourselves about that. Sustainable growth mercilessly demands ever-increasing efficiencies and more value for money.

Many acts of transformation meet that test. We find examples in public corporations, Government and private companies. But there are also examples where they do not. Likewise, many transformation-for-Afrikaners measures also did not meet the test of ever-increasing efficiencies. The Afrikaner businesses that survived (and many did not) were built on efficiency and not mere transformation.

Furthermore, transformation requires discrimination in favour of some, which implies discrimination against others. This extracts an economic cost -, as we know only too well from the price we are still paying for excluding blacks from SA's economy.

These experiences should encourage us to seek a balance between transformation and growth. We must proceed with transformation and we must do so in an effective manner. Going for either growth only or transformation only will not serve SA.

Of the three Bills before Parliament, the one on Government procurement seems to meet the test of a delicate balance: 90% of a decision must be based on price, 10% on social considerations.

On the Equity Act, the devil will be in the detail.

The equality Bill, however, simply misses it. Not even a clumsy attempt is made to balance the requirements of growth and transformation. It is a bad Bill and should be replaced by one that recognises the delicate balance between growth and transformation.

After the last week's hearings, parliamentarians considering the Equality Bill can be in no doubt as to what the economic consequences of the Bill will be.

They received overwhelming input. They cannot later say they did not know. The responsibility to fix the legislation is theirs.

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Racism, confidence and the economy

South Africa started the year with forecasts of 3.5% growth. Now even the optimists accept that the figure will not exceed 2.5%. Confidence or, more specifically, a lack of it is generally regarded as the main reason for the sluggish performance. Both the Minister of Finance and the Governor of the SA Reserve Bank have expressed concern that the lack of confidence is retarding economic growth.

Unless confidence is restored, growth will not reach 4% - the least needed to overcome the poverty, unemployment and deprivation suffered by millions of South Africans. The lack of confidence results in dismal investment. Foreign investors take their cue from the locals. If the locals stand on the sidelines, so will they. They might invest in the financial markets, but SA is certainly not inducing them to commit fixed investment.

The current debate on racism is taking place against this background. Largely, but obviously not exclusively, it rages around blacks and whites and their different perceptions of racism. This is not building confidence and, as a result, the economy ends up being the main victim.

To take the debate forward and foster a process of confidence-building, both blacks and whites must now make some acknowledgements.

White people must accept that racism is still embedded in our society and was not eradicated by the new dispensation; secondly, though many whites were not racist and opposed racism deeply, almost all benefited from the institutional racism practiced in SA. For example, whites had access to First World education at Third World prices and could accumulate capital through land ownership in select areas. Most blacks could do neither.

Lastly, blacks were mostly the victims of the racism practiced. Granted, as DA leader Tony Leon points out, some blacks did benefit - in the former homelands, for instance. The overwhelming majority did not.

The fact that most whites could have done much better if SA had an open, non-discriminatory economy does not detract from the above.

Black people, in turn, should acknowledge that racism and its legacy cannot be overcome without a growing economy. Poverty, unemployment and general deprivation are often cited as evidence of racism. This is debatable but, even if one accepts this, how can the legacy of racism be overcome other than through growth and job creation?

Secondly, there is a trade-off between transformation and economic growth. Transformation currently enjoys a higher priority than economic growth. And you cannot live by transformation alone. Economic ownership will be extended to blacks much more rapidly if growth exceeds the current 2.5%.

These two sets of acknowledgements will help to build consensus on critical national issues. They will also help to build the confidence that the economy needs so desperately. And they will take the campaign against racism forward.

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