# MOVING FORWARD

## FIXING PAST COMPROMISES AND MISTAKES

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*Luke Jordan develops Hirsch's article towards an agenda for change.*

Alan Hirsch's article is a breath of fresh air. Too much of the debate about our economy focuses myopically on the last few years, or assumes ill faith on either side of the ideological divide. Hirsch rightly looks back beyond 2008 to the years around 1994 and urges us to consider as good-faith errors the actions of policymakers facing complex and intractable problems and constraints.

It must be noted, however, that many of the mistakes Hirsch notes were perpetuated long into the 2000s. That was not for lack of independent advice to correct them. The international panel advising the Presidency's ASGISA (Accelerated and Shared Growth Initiative–South Africa) noted many of these issues in 2008, including a diagnosis of the errors in monetary and fiscal policy that have led directly to today's vulnerability. The refusal of Treasury and the Reserve Bank to consider the ASGISA suggestions long after the political constraints of the 1990s had passed must be borne in mind. That large sections of government policymaking remained ideologically committed to the decisions of the 1990s into the late 2000s – and that it has taken until now for an article as reflective as Hirsch's to appear – indicate deep problems in our state's ability to learn, which may be more serious than any specific errors.

Along with the extended period of commitment to the mistakes of the 1990s, the other important piece of context is the performance of the economy under apartheid. Whatever the myths sometimes peddled by a minority, that performance was disastrous. GDP per capita did not grow at all from 1969 to 1994 – for all of the 1980s, it was declining. At no point in the last twenty years, including the last five years, has the economy performed as badly as it did under apartheid.

That does not, however, mean we are not in a crisis. As Hirsch notes, on most metrics we have underperformed, including on the most important of all – the transformation of the economy to meet the aspirations and harness the capacity of our people. To respond to that crisis, Hirsch's division between "compromises" and "mistakes" is most useful.

It needs, however, two further refinements. First, between mistakes that can be fixed with levels of state capacity as they are now and those where any policy change will yield few, if any, positive results in the absence of deeper improvements in capacity. Second, between compromises that could be revised in the short term and those requiring a much larger shift in the political landscape to reopen. Those refinements then lead to a strategy for sequenced reform:

1. reverse the mistakes that do not require deep changes in state capacity
2. start debate, pressure and negotiation around the compromises that are feasible to be reopened now or in the near future

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3. in parallel to the above, conduct a far more coherent and sustained programme for building state capacity than we have had previously
4. finally, work towards shifting the political ground to enable a reopening of the remaining compromises, while researching options now, so as to move quickly when the time comes.

Needless to say, each of these is interlinked, and detailing the steps required for each, let alone the links between them, would require a lengthier treatment than is possible here. For the moment, then, a brief sketch of possible steps under each heading follows.

## MISTAKES REVERSIBLE IN THE NEAR TERM

### 1. *Housing*

A fundamental tenet of apartheid planning was the exclusion of black people from white cities. This was explicit in coercive legislation, but also implicit in locking black wage-earners out of the mortgage market. Post-1994, the laws were dismantled but the implicit gap was not made good, notwithstanding the occasional debate about "red lining". Today we remain almost alone in the absence of a policy instrument – such as credit guarantees or a housing fund – to address market failures in credit allocation. Millions of people can obtain high-interest unsecured credit but cannot borrow to invest in their own homes. Fixing this could catalyse home building and create, on a conservative estimate, a million jobs at minimal fiscal cost, if structured appropriately. There are clearly risks involved, but a wealth of global experience can be drawn upon to avoid and mitigate them.

### 2. *Tax structure*

Continually cutting personal income taxes for the last twenty years was an unforced mistake in an economy with excess consumption and chronically weak investment. Reversing those reductions, along with higher dividend taxes and other changes, could pay for expanding the minor savings incentives already introduced and for steep cuts in effective taxes on corporate investment. That would, at worst, align tax policy with the rebalancing of our economy, and at best, stimulate a boom in corporate investment without necessarily increasing or decreasing aggregate tax levels. It would be the reverse of the clear mistake post-2009 of trying to stimulate a consumption-heavy economy with consumption-biased fiscal measures.

### 3. *Procurement*

The Public Financial Management Act, the Municipal Financial Management Act, and the regulations related to them manage to achieve the impressive feat of halting the honest and doing little to constrain the dishonest. Many of their provisions are poorly considered and have not been changed for many years, despite ever-rising experience of their deficiencies. It is these Acts that are largely responsible for the long delays in translating theoretical public investment into actual stimulus; and the unpredictability they generate nullifies the prospect of fostering business confidence from such investment. They must be significantly revised as soon as possible. If they are, along with the reforms above, public investment could join household investment and corporate investment to stimulate the economy at minimal change to our overall fiscal position.

### 4. *Higher education, skills and R&D*

These present a cluster of problems, and addressing them decisively belongs in the third category (that of state capacity). Three steps, though, seem achievable in the short term: deep reform of the structure of tertiary education funding for low-income students; a doubling of public funds for research and development (R&D), also under restructured legislation and institutional governance; and, in skills, a change from certifying institutions on the basis of inputs to ensuring easy access to information on outcomes, such as a publicly available database of long-term earnings by graduates of all technical colleges, public or private.

### 5. *Regulating network infrastructure*

As Hirsch notes, our regulatory structures for information and communications technology (ICT) and energy have shown themselves unfit for purpose. Fixing this precedes the more complex debate about privatisation – our mobile networks are all private, but the weakness of the Independent Communications Authority of South Africa (ICASA) has resulted in a closed oligopoly with some of the highest tariffs in the world. The national energy regulator, NERSA, has somehow managed to both deny Eskom the tariffs to responsibly fund new capacity and protect it from competition, most of all through its continued failure to enable distributed » renewables. These agencies need greater capacity, which will take time, but in the interim we can reverse mistakes in their mandates, forms of accountability and monitoring, and their governance structures.

## COMPROMISES FEASIBLE IN THE NEAR FUTURE

### 1. *Competition*

The unfolding merger of AB-InBev and South African Breweries (SAB) has dramatically illustrated how weak our competition regime is. While US authorities required the merged entity to make large divestments to prevent it having an overly large market share, ours, having been unable to touch SAB's monopoly, merely sought a local listing of that monopoly's new owner. To build a modern open economy, we need a much more aggressive competition policy with an explicit mandate to break apart oligopolies. As Hirsch notes, preventing that was a priority of white capital in the transition, and perhaps its greatest success.

Yet the growing concern, here and abroad, with the power of monopolies and cartels, as well as the weakening of their intellectual support in the academy, may be shifting the balance of power. That is already evident in the US and Europe, where anti-trust regulators have become much more assertive. Here at home, a public campaign to revamp our competition law would unite the rhetoric of both the right, with its commitment to opportunity and small business, and the left, with its attacks on concentrations of capital. There are not many topics on which the IMF and EFF are in agreement, but this might just be one.

### 2. *Monetary policy*

At a minimum, the South African Reserve Bank (SARB)'s mandate should be changed to one similar to the Federal Reserve, with a joint inflation and employment mandate. Both research and experience in the last decade has comprehensively dismantled the case for strict inflation targeting, so the grounds are laid for reopening this compromise. The SARB itself seems determined to out-orthodox a dead orthodoxy, but cracks are appearing. Most remarkably, the decision in January to raise the repo rate by 50 basis points could not even muster a majority of the Monetary Policy Committee.[2] At some point, perhaps soon, the ability of SARB to point the finger at others for the capital account crisis it has created will diminish. In the aftermath of a sustained bout of capital flight, against which SARB's refusal to build reserves and Treasury's refusal to tax portfolio inflows has left us defenceless, the "fear factor" preventing a change in mandate might dissipate. Once the herd has bolted, it may be easier to convince people to fix the fences. Such a circumstance will be far from welcome, but should at least be put to use.

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## MISTAKES REVERSIBLE, BUT ONLY WITH GREATER CAPACITY

### 1. *Basic education*

Any and all of the above will be only a short-term palliative if we do not fix our education system. To do so, however, it must be understood that reforming public education is perhaps the single hardest task in public life. This is not about resources or about "smarts". Mark Zuckerberg poured R1.5 billion into an attempt to fix the schools in a single city in the US and achieved little. In South Africa, simply reversing the curriculum mistakes of the 1990s will not (and has not) taken us far. We must deliver textbooks and build better facilities in schools, but that also will not be enough. We need to remove teachers who cannot pass their own tests, and treat all other teachers as professionals – the most important professionals in our society – with higher pay and fundamentally overhauled training. Still, that will not be enough. Perhaps the most depressing indicator of our long-term future is the simplicity and shallowness of our national debate on education, the one that we must change as soon as possible or risk yet more lost generations.

### 2. *Agriculture*

Hirsch rightly notes that the excessive liberalisation of agricultural markets post-1994 was a mistake. Reversing this, however, requires the rebuilding of agricultural extension services, which spread knowledge, technology, inputs and access to markets throughout the agricultural economy. The deployment of such services is a classic "wicked problem", requiring highly trained extension officers who can transmit technical ideas but not override local knowledge, and who have significant autonomy but are linked in networks of monitoring, learning and continuous improvement. The contrast to our experience – of highly paid "consultants" who produce "business plans" that dismiss local knowledge and who then disappear – could not be starker. We cannot reverse the liberalisation mistake without a thorough, thoughtful overhaul and expansion of extension services, drawing on experience elsewhere, especially that of Latin America. This is a requirement, too, for serious and substantial land reform – indeed, the absence of such services has been the principal cause of the many failures of even the limited reform conducted to date.

### 3. *Industrial policy*

It is now well established that effective industrial policy is less a question of resources and more the capacity to learn – to attempt new policies or programmes, learn from them, and adjust them in a continual process. This is akin to the processes of continual improvement that are now necessary to compete in any global industry, and must be distinguished from frequent changes in policy direction, or policy incoherence. It requires extensive cross-silo coordination within government and outside it, with infrastructure departments, environmental regulators, business associations, labour unions and others. Reinvigorating industrial policy requires not simply fiscal resources but a much more concerted effort to build the capacities to coordinate, learn and continuously improve. Rather than build those capacities, we have had a proliferation of empty cabinet committees, lurching policy documents, and "learning" by interminable debate instead of learning by doing. There are signs this may be changing, with green shoots appearing in initiatives from transport equipment to coping with the mining crisis, but we need to do more – while also realising that unavoidable automation means these will never produce the jobs they once did.

### 4. *Restructuring our cities*

Fixing the apartheid structure of our cities means dealing with a tangle of issues that include credit-market access, planning, policing and transport. This knot cannot be cut with policy statements. But forcing municipal officials to fill out spreadsheets and attend courses is not capacity building. What is needed is more emphasis on the nuts and bolts of governing, from the art of managing difficult meetings to the rhythms and forms of monitoring and problem solving. Alongside that, we need a network of locally affiliated mini-thinktanks and research units, like those spread across the US and China, to find, evaluate and disseminate innovations on the hardest topics in municipal management. Again, the devil is in the detail: occasional conferences informed by outside and theoretical analyses will not achieve much. What must change, above all, is the cultural attitude prevalent in Pretoria that local government jobs are "easy" or "basic", and that those doing them are incompetent or corrupt, to be enchained rather than enabled.

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## COMPROMISES TO REOPEN ON NEW POLITICAL GROUND

### 1. *Labour relations and corporate governance*

As Hirsch notes, the levels of trust in our economy deteriorated from a low base throughout the 1990s. Unless this is resolved, we are unlikely to compete in global markets, no matter how far the rand falls. Those markets – in agriculture, industry or services alike – today require quality levels that are possible only with advanced techniques in production. Those techniques are likewise the only route to the productivity growth we need to expand the constraints within which we bargain. But those techniques require trust between managers and workers: lean production and continuous improvement are impossible without it.

In this light, what is proposed as "structural reform" – labour flexibility and an assault on unions on the right, higher minimum wages and employee share ownership on the left – are at best beside the point and at worst harmful, and what is required is a grand bargain that retains institutional coherence and starts to restore trust. One such might be the institution of supervisory boards with labour representatives alongside incentives or mandates for much higher levels of employee ownership, in exchange for some firm-level flexibility in wages and tighter regulations for strike ballots. The right's continued hatred and demonisation of unions and the left's attachment to a dead Marxist-Leninism make this unlikely without a significant change in the political landscape. Even when it does become possible, many difficult questions will need to be resolved, from the structure of such boards and the incentives for employee share ownership to ways to enable flexibility without creating a backdoor to yet greater inequality. There are, fortunately, a growing number of precedents to draw upon. A conscious programme of experimenting with them might be the most useful role for the special economic zones (SEZs) to play.

### 2. *Land reform*

Aside from stronger extension services, the obstacles to more aggressive land» reform are neither constitutional nor economic, but political. Constitutionally, a progressive and steeply rising land value tax could achieve *de facto* land reform, with the useful feature of encouraging unimproved and land held for leisure to be redistributed first. "Economies of scale" in agriculture, if they exist at all (and most evidence suggests that, for most crops, they do not), come from organisational form not ownership. Innovative forms of cooperatives and management companies can and do outperform single-owner farms. The real barriers are political, including a cynical lobby group's scare-mongering about "Zimbabwe", a partisan press's inability or unwillingness to do independent research on the issue, and the governing party's increasing reliance on a rural vote and hence regressive forms of communal landownership. It does not help that proponents of reforms insist on direct state involvement – via the *de jure* means of expropriation rather than *de facto* means of taxation – while not engaging at sufficient depth on the state's capacity to support the recipients of redistribution. Regardless, the resonance of the land question, the risks involved, and the paramount need to build functioning extension services first, means that it likely requires a structural change in our politics to bring about.

### 3. *Wealth tax and a guaranteed inheritance*

When, even today, there is serious debate in the US about reparations for slavery, it is remarkable that such a debate has not occurred in South Africa for apartheid. Regardless of the moral case, the economic rationale for a drastic reduction in inequality is now well established. Some of the steps above would help, but not enough. One solution would be a wealth tax that funds a form of "guaranteed inheritance", a grant to every child on reaching the age of 18. Such a scheme has been advocated from Thomas Paine through Anthony Atkinson. It would address multiple forms of inequality at once, redressing the past while limiting the accumulation of within-race wealth inequality in the future, and could once again be accomplished through the state's authority to tax. Nevertheless, it would require significant political consensus and support to have a chance of passing, let alone have enough teeth to combat inevitable leakage. It will likely have to wait for a crisis yet deeper than any we have faced so far.

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This is a daunting agenda, which makes sequencing all the more important. The distinction between "mistake" and "compromise" provides a means to an agenda, one that might be all the more practical and effective if focused on redressing the imbalances in our economy. And then a strategy becomes clear, at least in outline.

It starts with creative and pragmatic ways to stimulate investment by households, businesses and the public sector. The momentum generated by investment could then be harnessed to reopen bad compromises on competition and monetary policy. Alongside that, state capacity must be built urgently and systematically in agricultural extension services, new industrial policy, and urban management – and, above all else, in basic education. Then, if and when the political ground shifts, we may be in a position to revisit and reopen deeper compromises on corporate ownership, land reform and wealth and opportunity.

Fortunately, there may be the beginnings of a plan. Not all elements of it are equal, however. State capacity matters most. Without a much more capable state, one conceived and debated very differently from today's, all the other reforms will offer at best a short-term palliative. A more capable state, which continuously learns to fix the continually new coordination problems that plague a modern economy, may loosen a range of structural constraints – most importantly, low productivity growth and a malfunctioning education system.

Unfortunately, little in the world is changing in ways that afford South Africa the luxury of time. By the time another twenty years have passed, the crisis of employment, growth and inequality that is already swelling in most of the world is likely only to have worsened. As much as correcting our earlier existing mistakes, we have to address the deeper issues in state learning that allowed the last twenty years to pass without detecting and correcting them. Alongside the urgent steps to pull us out of our crisis, our most vital task must be to build a state that might cope with the unforgiving and uncertain decades ahead.[1] NA

NOTE

1 The SARB's 25-point hike in March was also supported by only 3 of 6 MPC members.