WHAT IS HOBBLING US?
A RESPONSE TO ALAN HIRSCH

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Tracking the "big five" structural issues to address in South Africa's post-apartheid economic woes.

Alan Hirsch discusses a question raised by Julius Malema: did compromises and policy mistakes of the Mandela era hobble the South African economy? To my mind, there are five structural issues that policy has not addressed adequately – under President Mandela and also under Presidents Mbeki and Zuma – and that contribute to persistent low economic growth, high unemployment, inequality and poverty. These relate to education, investment, productivity, apartheid's spatial distortions, and the weakness of the informal sector.

EDUCATION

Miles Corak (2013a and 2013b) has found a very strong correlation between inequality and intergenerational mobility. Countries where intergenerational mobility is low (meaning the kids of the rich are likely to be rich, while the kids of the poor are likely to be poor) are usually also countries where inequality is high. In contrast, countries where intergenerational mobility is high (meaning whether a parent is rich or poor does not have a bearing on whether their children are rich or poor) are usually also countries where inequality is low. Therefore, a good education system accessible by the poor reduces educational inequality, which in turn creates the foundation for reducing income inequality and increasing intergenerational mobility.

Access to education is important to reduce inequality and improve intergenerational mobility, but the *quality* of education is important for economic growth. Using international math and science test scores, Hanushek and Woessmann (2012) show that, when considering the effects of the quality and quantity (years of schooling) of education on economic growth, it is the former that makes the difference. Countries where learners acquire higher math and science skills are countries that grow faster. This is an important finding, given that South Africa performs dismally in such international comparisons, lagging behind almost all other countries, including many developing countries. Fixing the quality of education should thus be a priority in future.

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National accounts data show that government's stock of social (i.e. health and education) infrastructure as a percentage of GDP has been on a continuous decline over the last two decades. This is despite total (capital plus current) expenditure by government on education and health respectively equalling 6 percent and 4 percent of GDP. It is also important to distinguish between investment with direct and indirect returns. For example, electric power generation yields a direct return in the form of income from consumers who buy electricity. Social infrastructure yields an indirect return: if efficient, it allows beneficiaries to generate more future income, which, in turn, generates more future taxes. The additional taxes are the indirect return. Because it is quite difficult to measure, governments often underinvest in assets with indirect returns. In addition, governments often do not realise that, to actually yield the indirect returns, they need to ensure the social infrastructure is operated efficiently. Therefore, even though more needs to be invested in education, if the quality of education is not improved, the investment will not yield a return.

PUBLIC AND PRIVATE INVESTMENT

"Investment" is what is added to the country's fixed capital stock every year. Gross investment in South Africa averages about 17 percent, which is low compared to many emerging market countries. But to truly comprehend South Africa's failure to invest enough, one has to consider the changing levels of the country's fixed capital stock.

Between 1994 and 2007, the fixed capital stock (infrastructure) of the public sector (which includes central, provincial and local governments, as well as state-owned enterprises) fell from 130 percent of GDP to just 90 percent. Since 2007, it improved slightly to 100 percent due to the construction of the Medupi and Kusile power stations – however, their full effect on the economy is not yet felt, as they are still not fully operational.

The private sector's capital stock also fell, from 170 percent to less than 150 percent in 2014. Thus, investment by both the public and private sectors has been too low to maintain the level of the country's fixed capital stock relative to GDP. The consequences of this low investment include power outages and other service delivery problems, and ultimately, the low economic growth that keeps unemployment persistently high.

> **"Reducing barriers into the informal sector in places where economic activity is absent might represent a starting point to improve employment.**

Between the mid-1990s and the advent of the financial crisis in 2008, the reduction in the public-debt-to-GDP ratio explains up to half of the reduction in the public sector's fixed-capital-stock-to-GDP ratio (Burger, Siebrits and Calitz 2015). With the 1996 Growth, Employment, and Redistribution (GEAR) policy, South Africa followed international norms and reduced its public debt burden, but it did so by allowing its public sector capital stock to deteriorate. This policy mistake was committed during the first 15 years of democracy.

Even though the public sector's fixed-capital-to-GDP ratio improved slightly over the last number years, government's debt burden increased by more. Again, as in the mid-1990s, the public sector finds itself with a debt burden of almost 60 percent of GDP (45 percent debt of government plus 13 percent debt of parastatals). However, this time there is no room to cut debt by allowing the fixed capital stock to deteriorate.

The current policy dilemma is to stabilise the public sector's debt-to-GDP ratio while also increasing public investment to restore infrastructure. The only way to do this is to cut current expenditure, of which the public sector salary bill is a very significant component. Given the ruling party's alliance with Cosatu, getting the buy-in from public sector unions in the interest of citizens will be economically crucial, but politically difficult.

PRODUCTIVITY

When considered over the entire 1980–2015 period, a 1 percent increase in productivity on average led to a 1 percent increase in real wages. During the 1990s, real wage growth somewhat outpaced productivity growth, but the gap was subsequently closed during the 2000s, when productivity growth outpaced real wage growth (Burger 2016).

The one-to-one relationship indicates that, over these 35 years, labour unions did not posses the power to cause real wages to increase faster than productivity. Labour unions nevertheless did prevent firms that wanted to improve their international competitiveness from reducing real wages in a sustainable manner relative to productivity. Although the business sector clamoured for such wage reductions, the fall in wages required to become competitive was, and is, simply too large for such a policy to be politically feasible. According to the National Development Plan (NDP)'s diagnostic document, wages in South Africa were up to five times those in

China and India, and three times those in Mexico and Malaysia.

From GEAR to the NDP, government policy emphasised the role of exports to spur growth. However, given that the level of real wages in South Africa relative to productivity compares unfavourably with other countries, South Africa needs to question the feasibility of an export-based growth strategy. An alternative approach would be to consider improving the competitiveness of domestic industries relative to imports, so that local production can replace imports and thereby spur economic and employment growth.

APARTHEID'S SPATIAL DISTORTIONS

By locating townships far from central business districts, the apartheid government significantly increased transport costs for millions of people. The poor still spend up to 30 percent of their income on transport. This increases the minimum salary people need to earn just to cover their basic costs, and therefore limits labour supply. High transport costs also make it expensive to search for work, thus effectively keeping people out of the labour market.

By building RDP houses in far-flung townships, the government's post-1994 housing projects re-enforced apartheid's spatial distortions. Recognising the problem, the NDP requires higher density housing closer to places of business, as well as the creation of cheaper public transport.

WEAKNESS OF THE INFORMAL SECTOR

Compared to peer countries, South Africa has a relatively small informal sector: only 17 percent of the employed are in the informal sector. This would not have been a problem if unemployment was low and the formal

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sector large, but that is not the case in South Africa. Depending on which definition of unemployment one uses, there are between two and three times as many people unemployed as there are people working in the informal sector. Why, after failing to find formal sector employment, do the unemployed not enter the informal sector? And even if they fail to find informal sector employment, why do they not become self-employed in the informal sector as people do in Kenya, Uganda, India, Turkey, Mexico and Brazil?

A study of Khayelitsha residents' views on the most significant barriers to self-employment might point to the answer (Cichello et al 2012): they listed crime, the risk of business failure, transport cost, as well as a lack of start-up capital.

In many countries, the main debate is about how to migrate small informal enterprises to the formal sector – but they do not have our high unemployment rates. So, although the migration of small informal enterprises to the formal sector is important in South Africa, reducing barriers into the informal sector in places where economic activity is absent might represent a starting point to improve employment.

CONCLUSION

While South Africa today is certainly better off than in 1994, compromises and mistakes from the Mandela and post-Mandela eras nevertheless have a bearing on the current economic condition. The National Development Plan recognises most of these problems. However, the World Bank's latest estimate is that the economy will need to grow by 7.2 percent from 2018 onwards if poverty is to be reduced in line with the NDP's targets. To unlock economic growth will require significant structural changes, some of which are discussed above, as well as a partnership with the private sector. It also requires that we move beyond planning and focus on effective and efficient implementation. NA

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