Chapter 1

ECONOMIC GROWTH AND DEVELOPMENT

CHAPTER OVERVIEW

Growth is the engine of transformation. Social, cultural and political transformation interact continuously and can be limited by the level of progress in economic transformation. Economic transformation is dependent on a stable and growing economy. Of course, growth needs to be deliberately pro-poor if it is to reduce inequality and alleviate poverty. Given an expanding population, the redistributive elements of black economic empowerment (BEE) and progressive policies like an extensive grant system need a growing economy to be sustainable. The marginalised sections of the economy need to be cared for, since alienation undermines the social stability required for investment and economic growth.

The economy has stabilised internally since 1994 and, despite international instability, South Africa has shown steady, slow growth. However, Stephen Gelb points out that fundamental shifts in the structure of the economy towards more highly skilled sectors during this period mean that it has also been 'unequalising'.
Mills Soko's briefing on globalisation and the terms of South Africa's engagement with the world trade system points to another set of factors influencing the type of growth beginning to predominate in South Africa.

In an ideal world, economic empowerment in South Africa would result from the development of dynamic black small and medium enterprises, together with a steady accumulation of equity ownership by a representative proportion of Africans, while employment equity opened up opportunities and professions. In reality, partly because of a poor environment for small entrepreneurships and productive investment, equity transfers remain the dominant driver of empowerment. Linda Ensor's case study illustrates how most equity deals, which target a limited group of 'BEE billionaires', show a failure of imagination. More broad-based share deals are both possible and desirable.

Employment equity is a cornerstone of BEE. The briefing by Chifipa Mhango and Lebo Bodibe incorporates findings of the Commission for Employment Equity's latest report, which shows uneven progress. While blacks occupy an increasing share of management positions and are the most likely to be promoted, on average blacks are also the most likely to lose their jobs. Amongst skilled professionals, African women have lost significant ground since 2000.

Note: *The contribution by Stephen Gelb relies on Gelb, S (2004) The South African economy: An overview. In Daniel, J, Lutchman, J & Southall, R (eds) (2004)* The state of the nation: South Africa 2004–2005. *Cape Town: HSRC Press; and on Gelb, S (2004)* Creating a black business class in South Africa. *Centre for New and Emerging Markets, London Business School, www.london.edu/cnem*

By
Stephen Gelb

Briefing 1 by Mills Soko
Briefing 2 by Lebo Bodibe and Chifipa Mhango

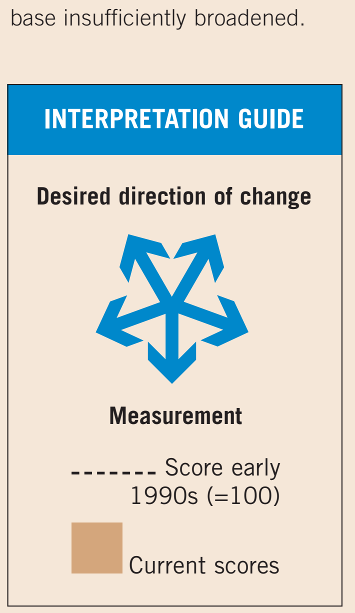
Case study by Linda Ensor

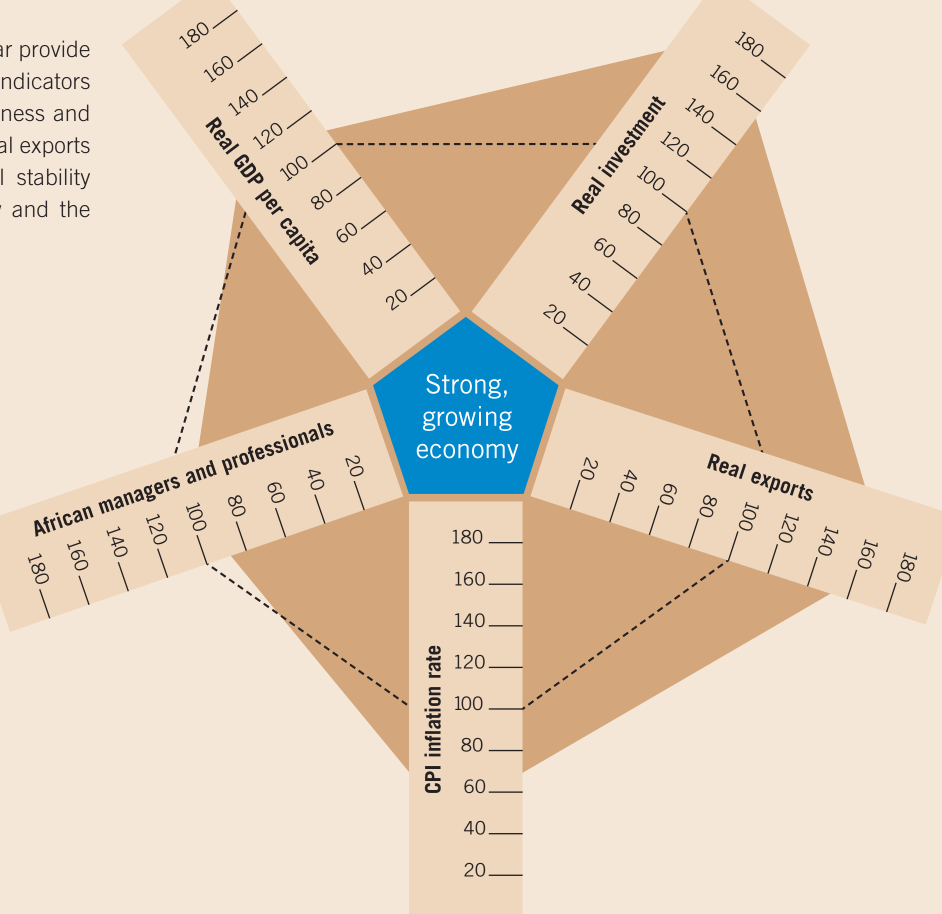
Economic performance scorecard

Transformation goal	A stable, broad-based economy, growing at a rate that creates wealth, given population growth			
Desired outcome	**Indicator**	**Status 1990 to 1994**	**Status 2000 to 2004**	**Direction of change**
Growth	Real GDP per capita[1]	R13 726 (Ave. 1992 to 1994)	R14 601 (2003)	↑
Stability	CPI inflation rate[1]	9% (1994)	6.2% (2003)	↑
Ability to access markets	Real exports[1]	R109 220 million (Ave. 1992 to 1994)	R167 555 million (2003)	↑
Broadened base	Proportion of managers and professionals who are African[2]	36.1% (1995)	31.2% (2003)	↓
Investment	Real aggregate investment[1]	R77 141 (Ave. 1992 to 1994)	R121 820 (2003)	↑

1. *Source: SA Reserve Bank Quarterly Bulletin*, June 2000 and June 2004
2. *Sources:* Statistics South Africa, *October Household Survey 1995; Labour Force Survey 7*, March 2003

The Economic Performance Scorecard and Star provide a snapshot impression of changes in the key indicators of economic growth, stabilisation, competitiveness and a broadened base. They show that whereas real exports and investment have increased and internal stability has improved, per capita growth is still slow and the base insufficiently broadened.





ECONOMIC GROWTH AND DEVELOPMENT: THE FRAMEWORK FOR EMPOWERMENT

Stephen Gelb

When South Africa entered the post-apartheid era in 1994, the expectation was that economic growth would improve from the poor performance of the previous 20 years, which had been an important factor in shifting the society towards transition. However, growth was disappointing. Gross Domestic Product (GDP) growth averaged 2.77 per cent per annum between 1994 and 2003, which has only just exceeded the population growth of 2 per cent per annum. Together with a broad unemployment rate of 42.1 per cent in 2003, the economy cannot be said to have recovered from its long-term decline.

Economic performance has been heavily affected by uncertainty, arising from the need to construct a new institutional framework for economic activity reflecting post-apartheid democratic realities, as well as the need to revive international economic relations which were partially severed by sanctions in the late apartheid years. International reintegration occurred in the context of the shift in international economic processes and policies summarised in the term 'globalisation' (see briefing by Mills Soko, below), and policy in South Africa tilted strongly towards liberalised goods and financial markets, shaped by both the international consensus and the domestic political balance which favoured business interests. This stance was made most explicit in the 1996 Growth, Employment and Redistribution (GEAR) statement, but in fact had been in place from 1994, even while the Reconstruction and Development Programme (RDP) was seen as the government's policy framework.

This chapter looks at key policy interventions, beginning with macroeconomic policy and considering BEE within this framework. It then considers macroeconomic performance and briefly looks at shifts across economic sectors.

MACROECONOMIC POLICY

Macroeconomic policy, which comprises fiscal, monetary and exchange rate policy, has been the major focus of policy interventions from 1994. The government argues that macroeconomic stability has now been achieved and it is moving on to microeconomic issues such as utility costs, transport and telecommunications, and sector-specific strategies. However, we argue here that macroeconomic stability has not been successfully achieved and that the volatility in the exchange rate reflects this instability.

As in many other 'emerging markets' that have embraced financial openness, policy in South Africa has aimed to 'build credibility' with international investors and encourage foreign capital inflows. However, adopting and sticking to the 'right' policies – often restricting economic activity even when domestic conditions support relaxation – has not avoided external volatility and destabilisation.

Macroeconomic conditions have been dominated by foreign exchange crises in 1996, 1998 and 2001, each involving a capital flow reversal and exchange rate collapse. Growth, fixed investment, savings and the balance of payments (discussed below) have all been affected by inconsistent signals from the interest rate and exchange rate, which have offset the intended boost from lower fiscal deficits and inflation rate.

Fiscal policy

Fiscal policy is the economic policy success story since 1994. The new government inherited inflation in single digits (it had cycled around 15 per cent since 1973), but a difficult fiscal position due to politically-related public spending in the dying days of apartheid. The new government inherited the debt burden incurred in defending apartheid. The destructive effects of debt arise because it drives up interest rates and slows down private sector investment, which in turn slows down growth and job-creation. It limits spending on social services because available revenue is consumed by high interest payments. Of course, the debt trap is a situation where countries need to borrow in order to pay interest and the principal debt. If debt is used to fund consumption, then the burden is passed on to future generations.

The deficit rose from 1.4 per cent of GDP in 1991 to 7.3 per cent in 1993, and government debt from 29 per cent of GDP in 1990/1 to 47 per cent in 1994/5. The National Treasury has completely reconstructed the budgetary and expenditure processes, partly in response to post-1994 sub-national provincial and local government structures, but also introducing new systems of financial planning and expenditure management (the three-year rolling Medium Term Expenditure Framework), reporting and accountability (the Public Finance Management Act of 1999).

Together with the adoption of strict fiscal deficit targets

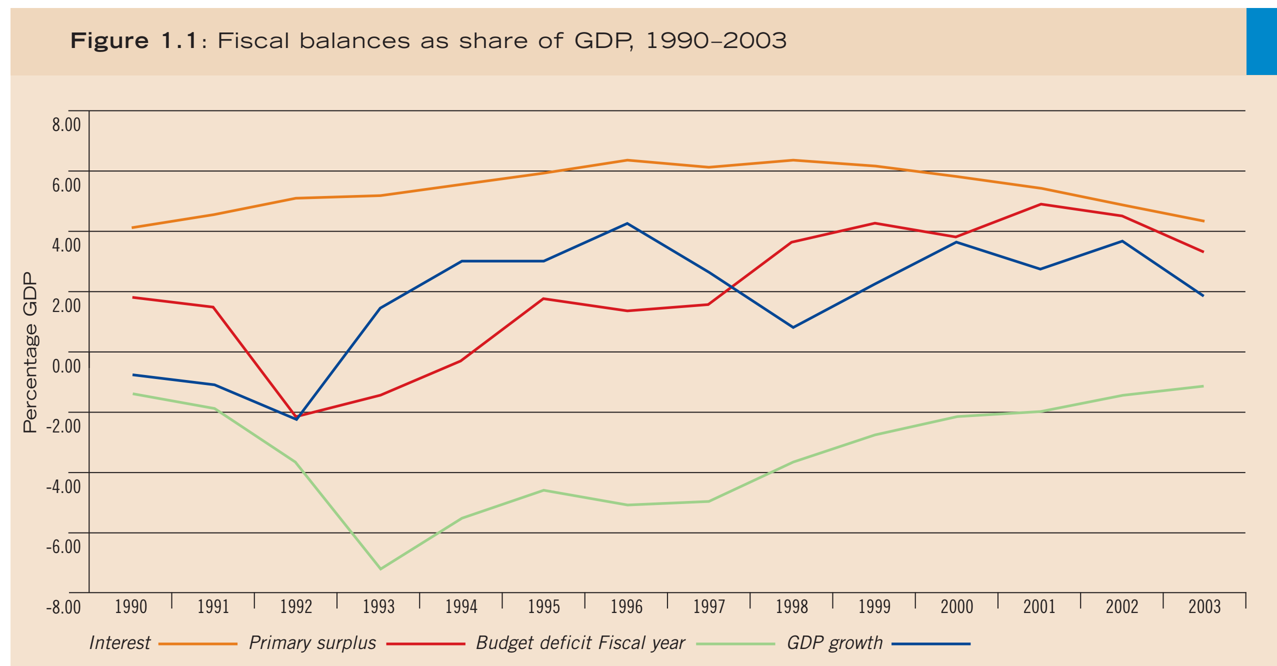


Figure 1.1: Fiscal balances as share of GDP, 1990–2003

from 1994, these reforms have contributed to the deficit's steady decline to below 3 per cent of GDP in 1999. The fiscal deficit has been one of the few GEAR targets actually achieved, perhaps because a powerful ministry had direct control over the policy instrument.

However, other indicators, such as the primary surplus (revenue less non-interest expenditure), suggest that fiscal policy has been erratic. This underlines the fact that fiscal policy cannot easily be used to stabilise economic activity when capital flows suddenly reverse and the exchange rate declines. Real non-interest expenditure grew by 7.8 per cent per annum between 2001 and 2004, after real cuts of almost 2.0 per cent per annum the previous three years. Nevertheless, the primary surplus has actually declined since 2001, suggesting that policy has remained contractionary.

Lower interest rates and fiscal deficits have cut public debt from close to 50 per cent of GDP to below 40 per cent since 1999/2000, bringing down interest expenditure. This made room in the budget for an increased share of social spending, which rose by 23.8 per cent in real per capita terms between 1993 and 1997, with significant redistribution across income and population-group categories: per capita spending on the lowest income quintile increased by 28 per cent and on the next two quintiles by 56 per cent and 31 per cent, respectively.

Since 1994, public investment in social infrastructure has grown faster than in economic infrastructure. Between 1994 and 1997, overall public investment rose in real terms by 9.0 per cent per annum and from 3.7 per cent to 4.7 per cent of GDP, but then declined from 1998, given the broad fiscal stance. After the 2001 Budget, it grew by close to 10 per cent annually for two years. Nonetheless, public capital spending has remained below 5 per cent of GDP since 1992 compared with 10 per cent during the 1980s.

Fiscal policy success has been underpinned by a substantial improvement in revenue collection after the SA Revenue Service was given autonomy in 1997. Reorganisation and modernisation have led to increased efficiency (a smaller backlog of unassessed returns), greater taxpayer compliance and a wider tax base. From 1998/99 to 2002/3, the number of individual and company taxpayers each grew by about 12 per cent per annum. Tax revenue rose as a result – since its low of 22.6 per cent of GDP in 1995/96, it has been maintained just below the GEAR-specified ceiling of 25 per cent since 2001/2. Improved revenue has allowed substantial tax relief – R72.8 billion since 1994/95 – but surprisingly, 86 per cent of this amount has been allocated to personal income tax cuts for the middle classes, supporting higher consumption spending, rather

than alternatives such as public spending on the poor, or lower business taxes to support job creation. The share of personal income tax rose from 33.6 per cent of GDP in 1990/1 to a peak of 42.6 per cent in 1999/2000, before tax relief lowered it to 32.4 per cent in 2003/4. At the same time, company tax rose from 16.4 per cent to 25.6 per cent of GDP, and the income tax burden – the share of aggregate personal income paid in tax – fell from almost 15 per cent to below 12 per cent.

Monetary and exchange rate policy

Together with fiscal policy, monetary and exchange rate policies are the major macroeconomic mechanisms a government has to influence the country's broad economic direction. The monetary authorities in any economy would choose, if they could, to have an open capital market to enable access to external finance, a stable nominal exchange rate to support international trade and also the freedom to adjust interest rates to meet domestic objectives such as output growth and price stability. However, these three goals constitute a 'trilemma': only two can be pursued simultaneously, at least in the medium-term, so policy authorities must decide which one to abandon.

Until 1994, South Africa's capital account was closed, with exchange controls and a dual exchange rate (commercial and financial rand rates) to discourage capital outflows and disinvestment. Domestic business strongly favoured liberalisation to allow capital outflows, and the Reserve Bank was committed by 1994 to opening the capital account. The two-tier currency was abolished in March 1995, and three-quarters of the foreign exchange control regulations were eliminated by 1998. In 1995, branches of foreign banks were allowed to operate and the Johannesburg Stock Exchange admitted foreign brokers. By 2000, there were 12 foreign bank branches and 61 representative offices in South Africa. Inflows of direct foreign investment have also been encouraged by the establishment of promotion agencies to woo foreign multinationals, and by more liberal regulatory regimes in most infrastructural services.

After opening the capital markets, the Reserve Bank initially tried to avoid the 'trilemma' and pursue all three objectives. The Bank was concerned also about excessive inflows, which can cause price inflation and exchange rate appreciation, affecting international competitiveness. Between July 1994 and June 1995, there was a net inflow of R18.6 billion (about 3.8 per cent of GDP), compared with the accumulated net outflow of R50 billion between the debt standstill in 1985 and 1993. Capital account liberalisation in March 1995 was also intended to reduce net short-term inflows by offsetting large gross inflows with capital outflows. Capital inflows now meant higher foreign exchange reserves, enabling the Reserve Bank to reduce – by about two-thirds in the year from March 1995 – its large contingent liabilities of US$25.8 billion in the forward foreign currency market, a source of balance sheet weakness.

Until August 1998, the Reserve Bank continued its policy of high real interest rates to hold back inflation with 'sterilisation' of net capital inflows to limit money supply growth, together with slow depreciation of the nominal exchange rate. Trying to avoid the 'trilemma' was an optimistic strategy, sustainable only if net capital inflows were large, with a longer-term maturity profile.

This was true from March 1995 to January 1996, and again from September 1996 until April 1998, but an open capital market meant that net inflows were susceptible to abrupt reversal, as in February 1996 and May 1998: the first triggered by domestic political uncertainty (though the government probably shared the prevailing consensus that the rand was overvalued and was considering devaluation), and the second in the wake of the Asian crisis. Expecting a rand depreciation, foreign portfolio investors' herd-like behaviour – rushing to sell rand-denominated assets to avoid losses in own-currency value – produced a self-fulfilling prophecy. In both episodes, the Reserve Bank tried to stem the outflow by selling dollars into the market and increasing its forward commitments, a costly and ultimately wasteful exercise. In September 1998, forward commitments were roughly the same as in March 1995. At the same time, real interest rates were significantly hiked – about 2.5 per cent in 1996 and a full 7.0 per cent in 1998 – in a vain effort to attract foreign portfolio capital back. In both crises, the rand eventually re-stabilised at levels about 20 per cent below the pre-crisis level, and net inflows rose.

Late in the 1996 crisis, the GEAR policy statement was issued to restore (portfolio) investor credibility and explicitly committed to all three 'trilemma' objectives;

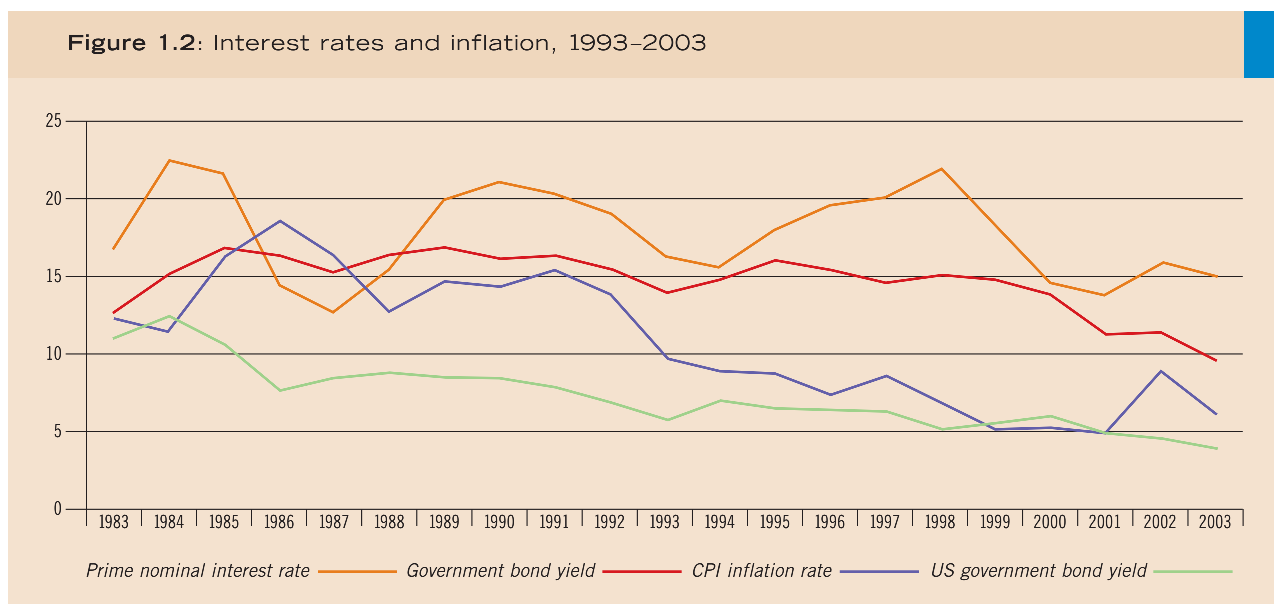
but in September 1998, the Reserve Bank decided the costs of trying to achieve all three objectives were too high, and policy entered a new phase. Capital account liberalisation was not put in question, but the emphasis on low inflation meant that exchange rate stability was abandoned in favour of monetary policy autonomy in the form of inflation targeting from February 2000. The target is set by the Minister of Finance, and the Reserve Bank uses interest rate adjustments to meet it. The initial target was 3–6 per cent by April 2002. Although inflation inertia had broken by 1993 and the Consumer Price Index (CPI) dropped steadily from 10 per cent until 2000 (helped by tariff liberalisation and increased product market competition after 1994), the rand's nominal depreciation of 25 per cent in late 2001 pushed up prices and the inflation target was missed. Nominal interest rates had dropped from 1998 but the Reserve Bank raised them during 2002 to restore price stability; by late 2003, it had met the target and interest rates began dropping. As demonstrated in 2002/3, interest rate increases are often appropriate within an inflation-targeting regime but their timing is often at odds with the business cycle. This underlines the rigidity of inflation targeting, focussing on the sole objective of the price level and ignoring the need to maintain stability in the real economy.

Since mid-2001, the rand has been possibly the most volatile currency in international markets, which further reinforced the negative impact of higher interest rates. In 2001, a third rand crisis occurred, the causes of which remain unclear despite the official Myburgh Inquiry. In real trade-weighted terms, a 25 per cent depreciation between late 1998 and August 2001 was followed by a depreciation of another 25 per cent in the next three months, and then by a 45 per cent appreciation through mid-2003.

Capital flows have been equally unstable, with five abrupt and large reversals in two years from mid-2001, a period of increased turbulence on international financial markets, with the dotcom bubble bursting, the 9/11 attacks, rising commodity prices, the Iraq war and dollar weakening. The impact on South Africa raises questions about Finance Minister Manuel's 2002 claim that 'a flexible exchange rate acts as a shock absorber against global developments ... and helps cushion the economy from external trade and capital shocks and mitigates the impact of economic contraction, especially for the poor.'

On the other hand, floating the exchange rate has enabled the Reserve Bank to eliminate its forward exchange rate contingent liabilities and rebuild its balance sheet, with the additional help of foreign borrowing by the government. This has removed a 'structural' problem for macroeconomic policy and contributed to South Africa's credit rating being upgraded by international agencies. A drop in the long-

Figure 1.2: Interest rates and inflation, 1993–2003



term bond yield and a narrower differential between US and South African yields reflects the stronger financial position of the economy. The positive financial impact must be counterbalanced, however, by the conclusion that policy has, intentionally or not, privileged financial concerns over production and portfolio investment over fixed investment.

Throughout the past decade, exchange rate volatility has meant inconsistent signals from the exchange rate to producers of tradables, increasing uncertainty and the encouragement of 'waiting' in production and investment decisions. At the same time, interest rate policy has been narrowly concerned with lowering inflation, so that it is hard not to conclude that domestic price and fiscal stability have been achieved only at the expense of external instability, giving the lie to the repeated claims by the monetary and fiscal authorities that 'macroeconomic stability has been achieved'.

Policies to raise investment

In macroeconomic policy, 'investment' refers to the expansion of the economy's productive capacity, for example through new technologies, new factories or expanded productive capacity. Investment in fixed assets of this sort by both domestic or foreign firms is critical to economic growth.

Macroeconomic instability has hampered policies intended to raise investment by influencing firms' decisions. One approach has been organising firms for co-ordinated collective action via investment accords and social contracts. Two national 'economic summits' have been held, and the government has intervened to support unity amongst business associations across racial, linguistic and sectoral divisions. High-level presidential working groups have been established for big (domestic) business, black business and foreign business. The Spatial Development Initiatives (SDIs, or corridors focusing government planning and financial resources) included investor forums to facilitate government-business dialogue and to underscore the beneficial impact for markets and input costs.

A second strategy has involved direct tax incentives to firms, but these have suffered from inconsistency of both instruments and targets. Several schemes came and went during the 1990s. In the early 1990s, incentives focused on natural resource-based materials exports and the link between industrialisation and cheap energy, identifying large capital- and energy-intensive materials-processing plants as 'anchor' projects. These incentives were scrapped in 1993, though the SDIs continue their commodity- and capital-intensive focus. A general export incentive scheme (GEIS) was established in 1990 and halted in 1998, to be replaced by duty drawback programmes for exporters, but only in two sectors: autos and apparel. A Tax Holiday Scheme was introduced as part of GEAR in 1996, with incentives for investment in job creation, specific regions and sectors, but low take-up rates led to its withdrawal in 1999.

Black economic empowerment policy

Against the background of these efforts to promote growth, a series of interventions were made to promote transformation and equity in a move towards increased black participation in the economy. The black economic empowerment (BEE) process in the decade since the country's transition from apartheid to democracy is an important aspect of the post-1994 economy.

Ten years ago, equity ownership and management of established South African firms was almost entirely white. Black management in white firms was estimated to be 4 per cent in 1990, though blacks comprised over 85 percent of the population. Until the early 1990s, legislation reinforced market processes in restricting black access to capital. The Group Areas Act of 1950 explicitly limited firm ownership by blacks to specified areas in cities and towns, and later regulations prevented black entrepreneurs from owning more than one business, from establishing companies or partnerships, or owning business premises even in 'black' areas. African firms were further restricted to certain markets, only 25 activities being allowed – mainly retail supply of food and fuel – before the restrictions were partially relaxed in 1976. The spatial and racial restrictions on property ownership meant that black people lacked collateral to borrow for asset acquisition, while the risks of ownership were increased by the insecurity of urban residential and workplace tenure arising from the notorious 'pass laws'.

As a result, black South Africans who started businesses were unable to enter manufacturing because it required relatively large capital commitments with a longer time horizon. This is reflected in South Africa's capital structure, which had a 'missing middle' in the early 1990s – relatively few medium-size firms and

almost no large black-owned firms. A 1990 survey of two (broadly representative) urban African townships found that 70 per cent of firms were in commerce and trade, and only 17 per cent in manufacturing, about half the proportion found elsewhere in Africa. The average firm had only 2.1 employees, including the proprietor, family workers and trainees. More than half of the firms were younger than three years, and women ran 62 per cent of all firms, but only 43 per cent of manufacturing firms.

Land inequality was similarly stark. The Native Land Act of 1913 restricted African ownership to certain specified areas, initially about 8 per cent of the country's land area, which was extended to about 13 per cent in 1936. In the early 1990s, 67 000 white farmers owned 86 per cent of agricultural land, equivalent to 16.2 hectares per rural resident, while 13.1 million Africans lived in the remaining rural areas with less than 1 hectare per person.

There was a powerful political imperative to transfer productive assets to black people and to promote affirmative action for black middle-class managers and professionals (see briefing on employment equity) to legitimise the newly deracialised political system. In May 1990, in his first speech to white executives after his release from prison, Nelson Mandela said: 'it is quite obvious that the ... excessive concentration of power in a few white hands has to change ... but we are very conscious of the critical importance of the confidence in the future of both the national and the international business communities and investors ... and have no desire to go out of our way to bash them and to undermine or weaken their confidence in the safety of their property and the assurance of a fair return on their investments. But we believe that they too must be sensitive to the fact that any democratic government will have to respond to the justified popular concern about the grossly unequal distribution of economic power.'

From the outset, the approach to BEE focused on 'market-driven' reform, as opposed to 'confiscatory' approaches. Debate in the early 1990s included both collective and individual approaches. The former aimed to mobilise existing black-owned finance through 'stokvels' (rotating savings and credit associations) or pension funds for investment in existing and new assets, while the latter focused on transferring some assets from white business to the very small group of established black entrepreneurs. Policy discussion focused on the promotion of black entrepreneurs through conventional strategies organised around SMMEs, while black business organisations developed objectives for the racial transformation of ownership, such as the '3-4-5-6 Plan' of the National African Federated Chamber of Commerce and Industry (Nafcoc). This plan argued for a ten-year time frame for corporations listed on the Johannesburg Securities Exchange (JSE) to have 30 per cent black directors, 40 per cent black share ownership, 50 per cent black suppliers for production inputs and 60 per cent black management.

The first phase of BEE involved white-owned corporations selling a proportion of their non-issued equity to a few pre-identified black purchasers. The sales were financed by loans that were often provided by the vendor and usually secured by future earnings flows of the company itself, meaning that loan repayments assumed rising dividends and share prices. Voting rights of shares sold to black purchasers were often circumscribed. In many instances, the purchaser was a consortium assembled by one or two black individuals, usually with a high political profile but limited experience in business. Consortium members often included mass-membership organisations, such as trade unions, community organisations and even groups with political party linkages, such as youth groups, ex-guerrillas or former political prisoners.

By 1998, there had been over 230 such deals on the JSE, to a value of over R37 billion, but the market crashed that year causing losses for both BEE entrepreneurs and lenders, including financial institutions. The BEE model inevitably suffered. At that time, black-controlled companies accounted for about 7 per cent of market capitalisation, but by 2002 this had dropped to 2.2 per cent. The narrow focus of the process is underlined by the estimate that there were 260 'previously disadvantaged individuals' holding 367 directorships in 387 JSE-listed companies in September 2002. Over 80 per cent of the directorships were non-executive, so that BEE essentially involved investment portfolios rather than operational control over productive assets.

In response to this, black business associations (with government support) established a non-statutory – but politically powerful – Black Economic Empowerment Commission (BEECom) in 1999. It delivered a report in 2001 recommending a more interventionist strategy,

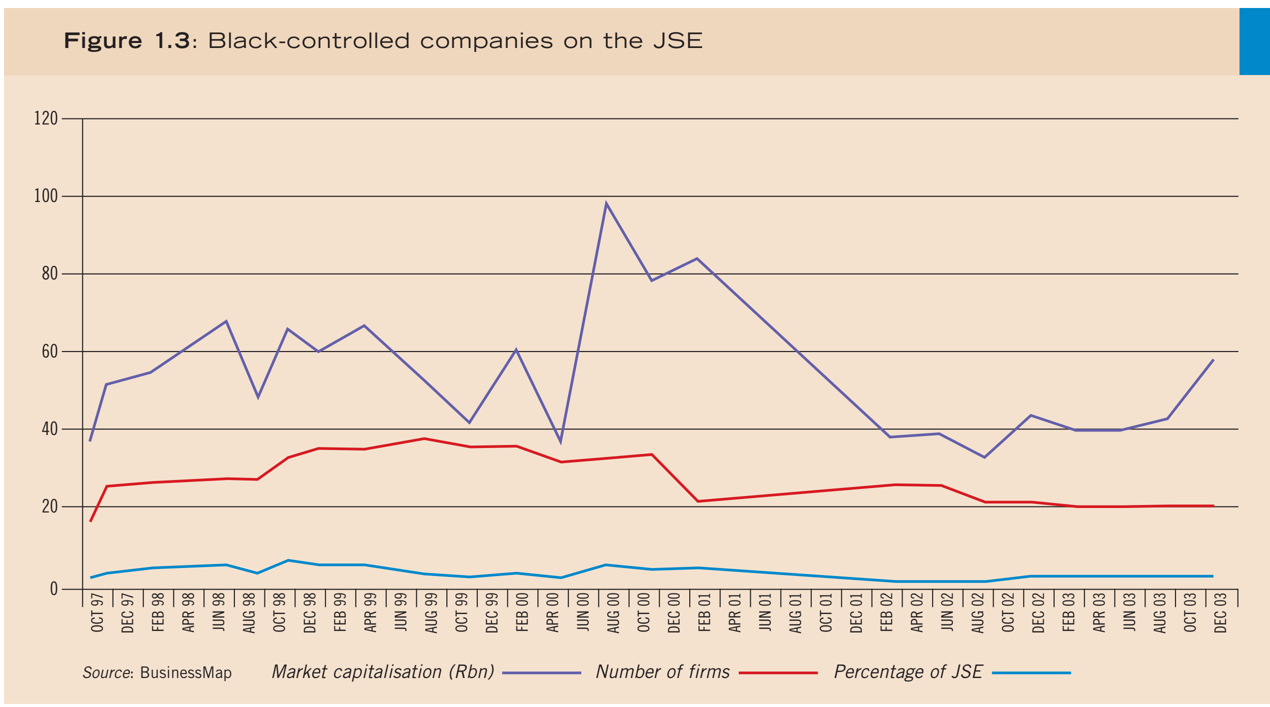


Figure 1.3: Black-controlled companies on the JSE

Source: BusinessMap

focused – like the Nafcoc plan a decade earlier – on ten-year targets for ownership, management, high-level occupations and government procurement.

The BEECom report has resulted in a new phase in the BEE process, involving a series of sectoral 'transformation charters' formulated via consultation processes involving various stakeholders (government, white-owned firms, and black entrepreneurs and managers), and specifying targets reflecting sectoral circumstances. The charters' concerns include not only black ownership, but also black management, black skills development and, in some cases – such as the Financial Services Charter – services provided to black customers.

These are all emphasised in the Broad-based Black Economic Empowerment Act of 2003 which is designed to change the emphasis in the incentive system for public contracts away from almost exclusive weighting for black ownership in firms or consortia to job-creation and skilling as well. This was a response to criticism of the lack of impact of BEE on the conditions of the majority of South Africans, in particular their employment opportunities.

The government has also committed to supporting BEE financially: in the 2003 Budget, R10 billion was committed to 'broad-based' approaches, including support for small and medium firms, rather than big transactions. However, the government employees' pension fund is a major investor in large-scale BEE equity transfers, with private sector funders and white-owned corporations looking for ways to reduce risk.

Sector charters

Sector charters are an important development in the transformation process. These are negotiated (to a greater or lesser extent) agreements within industrial sectors which set targets for the shift in ownership and employment towards blacks, and which generally specify extensive skilling programmes. The most important and influential ones have been the completed mining and financial services charters, with the information and communication technology sector charter imminent. The transport and wine industry charters are due for completion by the end of 2004, while work has started on charters for other sectors such as health care, forestry and cosmetics.

The charters have no legal force but provide a powerful set of incentives for corporate transformation, since the scorecards and other measures they specify will be taken into account in awarding procurement contracts in both the public and private sectors. Debate and

dispute over how to measure black ownership is heating up, since the incentives facing existing white owners differ from those facing potential empowerment beneficiaries in the black population.

In addition, it remains to be seen if the charters can extend access to ownership, and especially operational control, to a larger group of black businesspeople, and – as important – help create a group of black entrepreneurs with experience in building the productive base of the economy. Although there is a growing group of black managers in formerly white corporations, they have come into already large and established entities, with different issues of risk-taking and investment decision-making than those facing new firms.

Economic growth and job-creation are thus equally powerful imperatives facing South Africa, and the dilemma is that from a short-run, economic perspective, BEE does not automatically contribute to this process

The mining sector is obviously a key area. In 2002, a mining sector charter was formulated by the government. Its leaked first draft targeted 51 per cent black mining ownership by 2014 from a starting level of 14 per cent. The equity market reacted badly and mining shares plummeted, leading the government to lower the target to 26 per cent.

Not all the charter processes have been government driven. Ten industry associations in banking and insurance, including the industry's black professional association, led the formulation of a financial sector charter in 2003. The government played a supportive and mediating role. This charter was greeted with acclaim even by the South African Communist Party because it targets service provision to poor black people. The 'unbanked' – people with little or no access to financial institutions – are currently estimated to be more than 50 per cent of the adult population.

The sustainability question

Sectoral targets in transformation charters do not resolve the problem of finding a sustainable financial model for BEE, underlying which is the issue of burden-sharing. BEE has involved a process of transferring rents – defined as returns above the opportunity cost of a good or service, linked to a quality providing a competitive advantage – to black middle-class individuals, reflecting the premium on the political asset of being black. However, in a slow-growing economy like South Africa's – over the past ten years GDP growth averaged 2.8 per cent per annum – the distribution of the cost of the rents has become a big issue.

Recent innovations in BEE deals have focused on efforts to shift the burden away from existing owners of large white businesses. One approach forces the costs onto BEE beneficiaries by delaying the transfer of shares until the price has risen to the point where the transaction becomes viable. If the growth performance of the company (and of the economy) do not warrant it, the deal falls away or a much smaller equity stake is transferred.

An alternative argument – the 'Brenthurst Initiative' proposed by the Oppenheimer family, which owns De Beers – suggested the burden should be shifted onto society at large through tax incentives to companies transferring equity, which they argued would encourage firms both to transform racially and to invest in new capacity. Lacking a mechanism to ensure that firms receiving tax benefits actually invested, the government rejected the idea. Since the recipients of rents – the BEE beneficiaries of equity transfers – do not control the 'empowered' corporations, performance targets in exchange for government financial assistance for equity transfers are unenforceable.

As implied here, the issue of burden-sharing is closely linked to the impact of BEE on investment and growth. Although the positive contribution of BEE to growth is a constant rhetorical theme in South Africa, the relationship between the two has a long-run and explicitly political character. Unless the face of South African business becomes blacker, it will be increasingly viewed as illegitimate from the vantage point of the poor and unemployed, who now comprise over 40 per cent of the labour force.

Economic growth and job-creation are thus equally powerful imperatives facing South Africa, and the dilemma is that from a short-run, economic perspective, BEE does not automatically contribute to this process. There is no feedback between growth and distribution within BEE, in the sense that the rents received by BEE

beneficiaries are not necessarily redirected to the expansion of demand that supports output and profit growth.

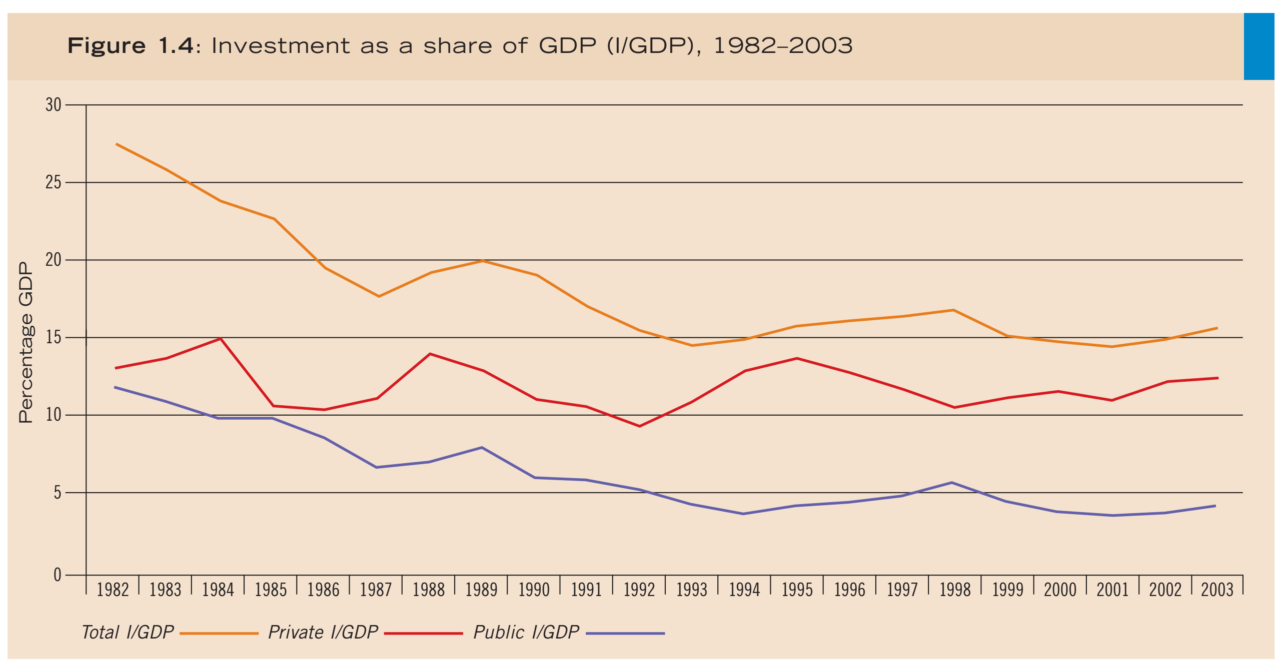
Another unresolved problem facing BEE is the challenge of creating a group identity for South African business through unified business associations. Historically, business organisations have obviously been divided along ethnic and racial lines, and several unification initiatives have foundered on political infighting, made more complex by white business becoming increasingly fractured by size and economic interest. Large corporations in natural resource-based industries and finance increasingly have less in common with medium-sizeand small firms in manufacturing and non-tradable services with respect to international financial and trade liberalisation. In 1994, 19 mostly white associations joined to form Business South Africa as a peak association, while retaining separate identities and membership. Eleven black organisations meanwhile formed a Black Business Council. In 2000, merger discussions between the SA Chamber of Business (Sacob) and Nafcoc started but stalled, with members oriented to the domestic market and opposed to tighter anti-inflation policy. Recently, Business Unity SA has been formed as a single national voice for business, but ethnic, racial and sectoral divisions remain. The charter process has perhaps been more important in building political unity within business because it has involved 'bottom-up' negotiations which are more likely to produce durable commitments.

MACROECONOMIC PERFORMANCE

In the face of the policies that were put in place, what were the outcomes? Internal macroeconomic stability was much greater than in the apartheid era, as demonstrated by a significantly lower inflation rate, which is of significance to the poor. However, other key factors have not yet picked up.

Both investment and savings are somewhat low. Fixed investment has fluctuated markedly since 1994, rising from 1993 in response to GDP increases, then slowing from 1996 through to 2001, probably due to external volatility. More rapid investment from 2002 may be due to currency appreciation, which has lowered the cost of imported machinery. From a longer-run perspective, even though profitability and productivity in the private sector improved significantly during the 1990s, private investment averaged only 12.1 per cent of GDP between 1994 and 2003, compared with more than 13 per cent in 1982 and 14 per cent in 1988 (after the foreign debt standstill), and a 10.6 per cent average between 1990 and 1993 when the economy was in deep recession and the political situation in deep uncertainty.

Figure 1.4: Investment as a share of GDP (I/GDP), 1982–2003



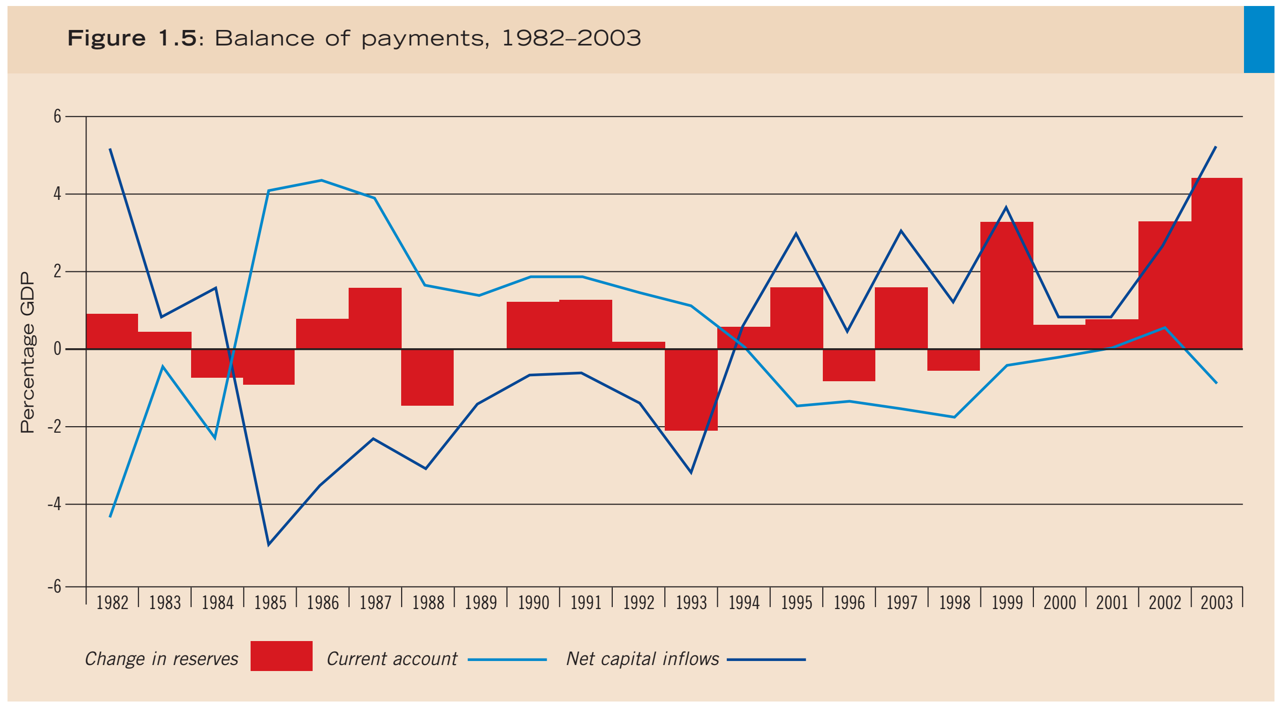
Poor private sector investment has been partly due to sluggish aggregate demand in the face of contractionary fiscal policies, exchange rate volatility and interest rate fluctuations. However, low confidence is also related to uncertainty about the 'socio-political environment', and this may in turn reflect reluctance to make long-term financial commitments because of anxiety that the future operating environment may be affected by South Africa's high inequality. As noted above, the 'gap' in investment demand has not been filled by a substantial increase in public sector investment, which, though rising, remains well below the 1980s' levels as a share of GDP.

National savings since 1994 have ranged from 14.5 to 17.0 per cent of GDP, also well below the 1980s' levels. Policy since 1994 has been premised on the neo-classical economic view that savings are a constraint on investment and growth: the tight fiscal stance from 1993 was justified by the need to raise government savings. These were negative during the early 1990s' spending spree, but have been above 2.5 per cent of GDP since 1999. More generally, it does not appear that investment has been held back by low savings, since these have exceeded investment in all but two years since 1994, and corporate savings have been sufficient to finance corporate investment.

At the same time, the propensity of corporations and households to save from income may have dropped, so that income growth would yield a smaller volume of savings than before. Corporate savings have declined in real terms and as a share of GDP since 1996, notwithstanding a rise in net profit from 24.7 per cent of GDP in the 1980s to 31.1 per cent since 1994, suggesting higher dividend payouts in preference to retained earnings to fund investment. Households have been increasing consumption out of income: their savings have fallen from the very low level of just over 1 per cent of GDP in 1995, compared with a 1980s' average of 2.8 per cent. Consumption growth of 3.33 per cent per annum since 1994 has been faster than growth of both GDP and of household disposable income per capita, which grew at only 0.83 per cent per annum. After 1993, household wealth rose with dropping inflation and rising asset values (especially housing), enabling a consumption spurt in the mid-1990s, which continued as interest rates declined from 1998 and lowered household debt levels.

In the balance of payments, reopened access to

Figure 1.5: Balance of payments, 1982–2003



international borrowing since 1993 has enabled South Africa to return to the 'normal' developing economy position with a current account deficit and net capital inflows. The current account deficit has remained small since 1994, never rising above 2 per cent of GDP, and since 1999 has been very close to zero. Both imports and non-gold exports have risen by around 50 per cent since 1993 (measured as a share of GDP). Volume indices show that imports grew very rapidly until 1997 with trade liberalisation and then levelled off. Higher exports – partly driven by currency depreciation – include a much larger share for manufactured goods, particularly materials processed from natural resources. Gold exports have declined: the gold production index dropped from 120.7 in 1986 to 86.6 in 1999. With a very small deficit in non-factor services (including tourism and transport), the overall trade balance has consistently been in surplus, averaging just over 1 per cent of GDP between 1995 and 1998 but then rising to 3 per cent since 1999. A deficit in factor services (including international wage, interest and dividend payments) has been a problem for decades, but since 1994 has been below its 1980s' levels (20 per cent lower in US dollar terms), even though it rose from 1.9 per cent of GDP in 1995 to 2.6 per cent in 2000, in part due to the relocation to the UK and US of major corporations.

In the capital account, net capital inflows have exceeded the current account deficit and would have been sufficient to finance higher domestic fixed investment had this been required. Instead, capital inflows have been used to build foreign exchange reserve stocks. Though volatile, portfolio inflows have been the largest component, larger than direct investment or bank loans, reflecting both well-developed financial markets and the sequencing of external liberalisation. By 2000, gross non-resident transactions (purchases plus sales) represented 52 per cent of turnover on the equity market, and 23 per cent on the bond market. Between 1995 and 2002, South Africa received two-thirds of gross market-based capital flows to sub-Saharan Africa, and 101 per cent of net portfolio equity flows; South Africa's shares of all developing country inflows were 3.3 per cent and 22.0 per cent, respectively. Inflows of foreign direct investment since 1994 have disappointed, with gross inflows averaging US$1.86 billion per annum between 1994 and 2002. South Africa differs from other middle-income countries in receiving far smaller direct investment than portfolio inflows. Firm surveys confirm that foreign direct investment inflows have been small: the median capital stock of foreign firms that entered South Africa after 1990 was only US$2 million in 2000.

SECTOR PERFORMANCE

Significant changes in the sectoral composition of output and of trade between 1990 and 2003 have exacerbated the impact of low growth on employment levels and the labour force skills structure. The shares of total output contributed by mining and by manufacturing declined, and services increased, with transport and communications and financial services growing particularly strongly.

Within manufacturing, labour-intensive sectors (food and beverages, textiles and clothing, and footwear) grew slowly at around 0.2 per cent per annum, and declined from 23 per cent of value-added in 1990 to 20 per cent in 2000. Basic metals, wood products and chemicals were the fastest-growing sectors. Basic metals and wood products grew by more than 4 per cent per annum and increased their shares of value-added from less than 13 to 16 per cent and from 3.4 to 3.9 per cent, respectively.

The shift to more capital-intensive sectors was linked in part to international trade. Between 1993 and 1997, import penetration in labour-intensive sectors rose from 55.5 per cent to 67.5 per cent, driven by trade liberalisation and squeezing domestic production and employment. At the same time, the share of exports from capital-intensive sectors rose from 56.1 per cent to 60.8 per cent. Overall, the composition of merchandise exports shifted from minerals to basic processed goods (chemicals and plastics, wood products and basic metals) and machinery and equipment after 1990, reflecting increased domestic beneficiation of natural resources. This is illustrated by vehicle component exports, which rose rapidly, stimulated by the Motor Industry Development Plan. However, motor exports are dominated by catalytic converters and leather car seats, both beneficiated natural resources rather than assembled products, constituting 48 per cent (up from 9.4 per cent in 1994) and 13 per cent of 2001 motor exports, respectively. Assembled vehicle exports also rapidly increased from 25 900 units in 1999 to over 100 000 in 2001.

CONCLUSION

As we see above, the structures of output and exports have changed significantly since 1994. This has led to a 'skills twist' in the labour force, where jobs have been created for high-skilled workers at a relatively rapid rate, while unemployment amongst low-skilled workers has grown. Since employment is the major source of income for poor people, this suggests that economic growth in South Africa since 1994 should be characterised not only as low, but also as 'unequalising'.

Are there alternatives? At the heart of a growth strategy must be sustainable employment creation for low-skilled workers. This, in turn, requires private sector development. Notwithstanding the value in welfare terms of public works schemes or public sector enterprises, the majority of jobs they create are most often not permanent as fiscal limits impose themselves. A strategy that takes account of the need for private sector development need not rely only on domestic market expansion (as much criticism of government policy suggests) but can focus also on creating export-oriented firms.

To achieve this will require both a new macroeconomic policy framework, with interest rates and exchange rates that can allow much greater risk-taking and international competitiveness, and a transformed and prioritised small, medium and micro enterprise (SMME) policy.

The ongoing dilemma of BEE is to find a way to make it economically sustainable – to be able to ensure that it contributes to growth and production of value, and that this generation does not benefit at the expense of the next. The primary focus of BEE needs to be shifted away from the equity and management of large white-owned business towards the development of a class of productive private entrepreneurs. This does not mean informal-sector and survivalist traders (microenterprise, an important element in poverty alleviation) but small and medium formal-sector businesses, run by black owner-managers, which have the potential to grow their labour force to between 50 and 200 workers. Whether or not such a strategy is politically feasible in South Africa today is an open question.

briefing 1

GLOBALISATION: ENTERING A RAPIDLY CHANGING WORLD

Mills Soko

Globalisation has had a profound impact on the world economy over the last few decades. The traditional international division of labour, which was characterised by the concentration of manufacturing industrial sites in Western Europe, the United States and Japan, has been supplanted by a new global production system. Segments of industrial production are relocated from industrialised to lower-wage, developing countries. Advanced industrial processes, previously carried out domestically, are increasingly part of global production chains. Production has become a transnational process and is no longer a national phenomenon (Caporaso, 1987). Thanks to globalisation, world trade has grown rapidly in the last 20 years, expanding considerably faster than world gross domestic product (GDP). Coupled with this has been a sizeable increase in foreign direct investment (FDI), both absolutely and as a percentage of GDP (World Commission on the Social Dimensions of Globalisation, 2004: 25–27).

It is against this backdrop that South Africa signed the Marrakesh Agreement of the General Agreement on Tariffs and Trade (GATT) in 1994. This not only restored the country's credentials as an established trading nation following many years of operating outside the GATT disciplines, but also signalled its commitment to liberalise its trade policies in accordance with the rules-based international trade system. By embracing the World Trade Organisation (WTO) and its regulations, South Africa committed itself to far-reaching changes to its trade regime. These include the replacement of quantitative restrictions with tariffs; the simplification and rationalisation of the complex and unwieldy tariff structure; the abolition of import surcharges; and the phasing out of the General Export Incentive Scheme.

Additional industrial supply-side measures have been introduced to overcome South Africa's poor international competitiveness and export performance. These include tax incentives to encourage investment in

competitive and labour-absorbing projects; the promotion of small, medium and micro enterprises as a means of job creation and income generation; and the implementation of employment and training policies designed to enhance the growth potential of industry (Department of Finance, 1996). All these measures are designed to facilitate the emergence of South Africa as an open, vibrant and competitive, outward-oriented manufacturing economy with a diversified export base.

Overall, it would appear that trade reform, in the context of a globalising world economy, is having a notable impact on the South African economy. There has been positive progress, such as increased total factor productivity and exports as well as low inflation (Jonsson & Subramanian, 2000). Moreover, a cursory examination of manufacturing performance has revealed an increasingly resilient and growing export sector. Prior to 1994, South Africa's manufacturing was beset by a crisis, dwindling at an annual average rate of about 2 per cent between 1989 and 1994, and reaching its nadir in 1993. However, the contribution of manufacturing to GDP saw a sustained upward trend since 1994, with manufacturing exports growing by 12 per cent annually in real terms, despite currency volatility. The benefits of this are mitigated by the fact that, as Stephen Gelb points out in this chapter, it is capital-intensive export initiatives that tend to be thriving in the new dispensation. Nonetheless, manufactured products have increasingly become as integral to South Africa's GDP as commodity exports, which buffers the economy's vulnerability to volatile commodity prices (Hanival & Onyango, 2003).

A striking feature of post-apartheid South Africa's external trade has been the exponential increase in the country's exports to other parts of Africa. Spurred by the New Partnership for Africa's Development (Nepad) – as well as South Africa's export-driven growth strategy – South African exports, mostly manufactured goods, to other sub-Saharan African countries posted a 9 per cent growth in 2002. To encourage South African trade and investment expansion into Africa, the South African Reserve Bank decided in November 2002 to relax capital controls on domestic companies wishing to invest in other African countries or seeking to grow existing operations – it increased with immediate effect the limit from US$79 million to US$216 million. The limit was increased further in 2003 to R2 billion per project for investment in Africa and R1 billion per project for investment outside of Africa (Games, 2003).

Most growth has been recorded in the Southern African Development Community (SADC) region where South Africa is the biggest foreign investor, with direct investment exceeding US$5.4 billion by 2000 (*Financial Mail*, 7 February 2003). Trade and investment have flowed into almost every sector of the African market, with mining, retail, telecommunications and leisure industries predominating. Even so, huge trade disparities remain between South Africa and the rest of the African continent. South Africa's overall trade with Africa excluding the Southern African Customs Union (SACU) totalled US$856 million in imports and US$3.7 billion in exports in 2001 (United States Trade Representative, 2002: 25). This trade imbalance needs to be reduced if mutually beneficial trade between South Africa and its continental trade partners is to be realised – and also to pre-empt potential hostility toward South Africa as an excessively dominant trading and investment partner.

A striking feature of post-apartheid South Africa's external trade has been the exponential increase in the country's exports to other parts of Africa

While globalisation has created opportunities for South Africa, it has also spawned a number of challenges that must be tackled as the country pursues its goal to become a dynamic, prosperous emerging market economy. First, South Africa has to contend with the threat to its manufacturing sector – especially to its vulnerable textile industry – posed by the ascent of China and India in the global economy. China's WTO entry in 2001 implies that it will benefit from greater access to global markets, especially textile markets. A number of studies have argued that most developing countries will lose market share to China, which is more competitive in labour-intensive manufactures as a result of the expected scrapping of the Agreement on Textiles and Clothing in 2005. It is projected that China's share of world exports will rise to 6.8 per cent in 2005 (Cass *et al.*, 2003). Most developing countries are also likely to lose FDI share to China, as greater investor confidence in China is fostered by the implementation of its WTO liberalisation commitments.

Although the majority of FDI is concentrated in, and continues to originate from, a small number of developed countries (UNCTAD, 2003), the acceleration of globalisation in the 1990s cemented China's position as an attractive destination for FDI and as a low-cost manufacturer. Already from 1990 to 2003, more than US$480 billion in FDI flowed into China, accounting for 97 per cent of all FDI the country has received since it opened up in 1979 (Pei, 2004).

Apart from its positive strengths in the textile sector, India has solid competitive advantages in information technology (IT) services and telecommunications. According to the consulting group McKinsey, the IT boom in India will expand five-fold by 2008, to a US$57 billion annual export industry employing 4 million people and constituting 7 per cent of India's GDP (Kripalani *et al.*, 2003). Boasting a well-educated, low-cost English-speaking workforce and harbouring a burning ambition to become a developed economy by 2020, India is poised to harness the enormous creativity and innovation of its services industry to its optimal benefit.

However, the China–India challenge also presents an opportunity for South Africa. South Africa has sought to forge strategic collaboration with both countries and Brazil in order to enhance trade with them, and to work towards the attainment of a balanced, fair and just multilateral trading regime. This constitutes an essential part of South Africa's global trade agenda, a key objective of which has been a determination by South Africa to reduce the historical dependence of its external trade on the European Union and to extend its 'trading wings' from Africa to other regions of the world – mainly East Asia, Latin America and North America. This strategic posture provides a firm platform from which South Africa can join forces with its key allies in the Group of 20 developing countries coalition to consolidate the gains made at the 2003 WTO ministerial summit in Cancún and to pursue further the campaign to reform global trade processes. Also, the fact that two-way trade between China and India is flourishing, and that China is Brazil's fastest-growing trading partner, point to a huge potential for South–South trade.

Second, South Africa has to manage carefully fundamental changes in the trade policy landscape brought about by the globalisation of production. The global trade liberalisation agenda is no longer concerned solely with the elimination of tariff and non-tariff barriers to trade: it now entails a more ambitious agenda that seeks to extend WTO disciplines to an array of issue-areas such as intellectual property rights, services, investment, competition policy and public procurement. This has important implications for domestic regulatory policy.

Third, greater attention needs to be accorded to strengthening the institutions and policies of both the SADC and SACU. Regional integration has the potential to assist developing countries to expand trade, generate FDI and improve growth. It can also help member states to overcome their structural deficiencies (such as the absence of complementarity in production, poor transport and communications infrastructure, and undeveloped financial systems) and facilitate their incorporation into global economic linkages. Moreover, it can enable countries to engage meaningfully with globalisation while ameliorating their fragile positions in the world economy.

Fourth, South African policy-makers are faced with the challenge of reconciling international trade obligations with domestic social and economic pressures. Trade policy has distributional consequences which are often fairly dispersed and intangible. Given that it localises gains and losses, trade reform is prone to producing uneven effects on different industrial sectors. This explains, for example, why the automobile industry in South Africa has adapted better to globalisation than, say, the footwear and textile sectors.

Lastly, it is worth noting that despite South Africa's economic achievements in the last decade (particularly in bolstering its manufacturing capacity and diversifying its export base) its terms of incorporation into the world economy today remain precarious. South Africa continues to be a small, open, fragile economy that is largely an exporter of traditional commodities and an importer of capital goods and technology: there is still a long way to go before it can regard itself as a fully-fledged industrialised nation. The nature of adaptation strategies that the country deploys in the future to respond to globalisation trends will determine to a large extent its fortunes in the international economic system.

briefing 2

EMPLOYMENT EQUITY: UNEVEN PROGRESS

Lebo Bodibe and Chifipa Mhango

A comparison between several earlier and current datasets shows some progress in employment equity. However, the conclusion is not unambiguous: at the professionally qualified and middle management level, the employment equity report datasets, for example, show a drop in both black and female representation between 2000 and 2002, driven by a significant drop in the proportion of black women in this category. Overall, the increase in representation for women at the top levels and categories of employment has been significantly less than the increase for blacks. Representation of black women at top management levels has increased, but from very low levels.

The overall pattern of promotions and dismissals shows that if you are black and at a senior level, you are more likely to be promoted – but on average, black employees are more likely to be dismissed.

EMPLOYMENT EQUITY REPORTS

The Commission for Employment Equity report for 2002/3 indicates that, on average for the companies reporting, 18.4 per cent of top managers were black in 2002, compared to 12.7 per cent in 2000, and 22 per cent of senior managers were black in 2002, compared to 18.5 per cent in 2000. Of the top managers, only 10 per cent were African. At the same time, women's share in these positions shifted from 12.4 per cent in 2000 to 13.7 per cent in 2002. At the professionally qualified level, the share of both blacks and women dropped between the two years. The drop was caused primarily by a drop in African female representation, which decreased from 20.5 per cent to 4.9 per cent, counter-balanced by an increase in white male representation from 37.8 per cent to 47.4 per cent. The data were drawn from a return of 8 250 employer reports for 2000, and 6 990 for 2002, representing 3.3 million and 2.6 million employees, respectively.

Table 1B.1: Employment equity by occupational level

Occupational level	Blacks' percentage share		Women's percentage share	
	2000	2002	2000	2002
Top management	12.7	18.4	12.4	13.7
Senior management	18.5	22.2	21.0	21.6
Professionally qualified and experienced specialists and mid-management	44.0	31.4	43.2	30.9

Source: Commission for Employment Equity, Annual Report 2002/3

Employment equity is a key aspect of Black Economic Empowerment (BEE) and is framed within the Employment Equity Act of 1999, which requires employers with 50 or more employees to take positive action to ensure equal opportunity to suitably qualified employees from designated groups, and that such employees are equitably represented in all occupational categories and levels of the workforce. Historically, population group and gender are unequally distributed in the South African workforce profile, with the lower levels and categories of occupation having a much larger proportion of blacks and women (closer to their population share), and the higher levels and categories a significantly smaller proportion.

In terms of the Act, employers who have more than 50 employees need to report on the progress of their plans to the Department of Labour once in two years, while employers of more than 150 persons need to report annually. Employers with fewer than 50 employees can report voluntarily. In 2000, the first year of reporting, it was estimated that 60 per cent of designated employers reported.

The South African employers and organisations whose data were used for the 2001/2 report identified the lack of people from designated groups with appropriate skills; low turnover of staff in positions targeted for corrective action, high mobility of people from designated groups once appointed; and economic constraints as key barriers to forwarding employment equity. Other

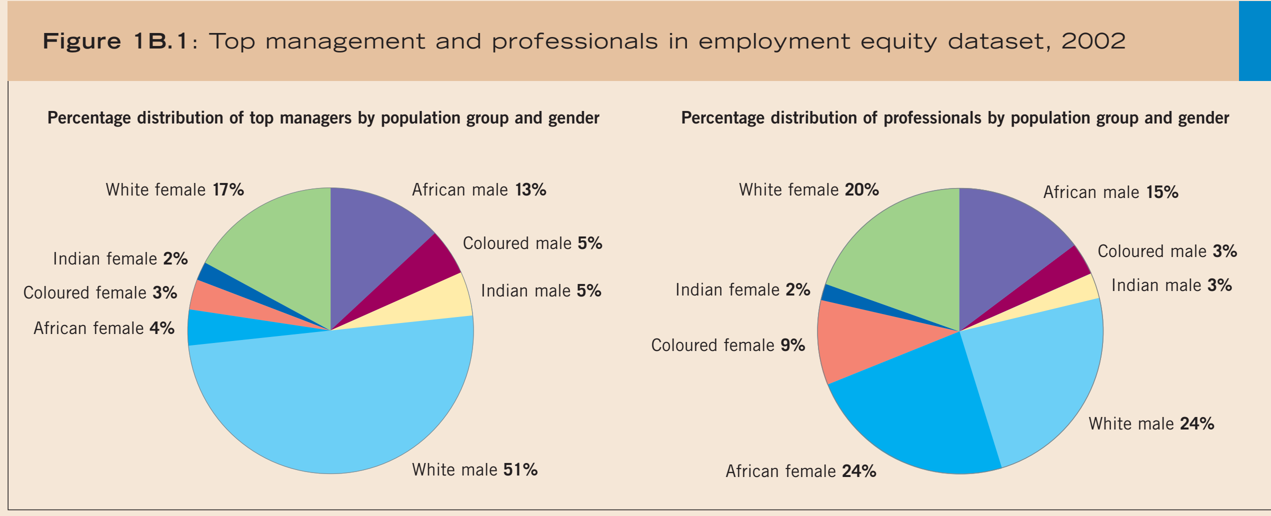
important factors have to do with lack of workplace facilities suitable for women and people with disabilities, staff development, training and succession planning.

Data are presented in the report both by occupational level and occupational category. When taken by occupational category, there were 19 506 African people (17.3 per cent) in top and senior management. Blacks account for 32 per cent and whites for 68 per cent of all top managers (including chief executive officers, presidents, vice-presidents, chief operating officers, general managers, divisional heads and postmasters). Altogether, 56 per cent of professionals were black and 44 per cent white.

The Commission's data show a more equal distribution of employment in the technician and associate professional categories. Blacks and whites (male and female) each account for 50 per cent of employment. In terms of elementary occupations (news vendors, garage attendants, car washers, gardeners, farm labourers and so on), blacks account for 98 per cent and whites for 2 per cent.

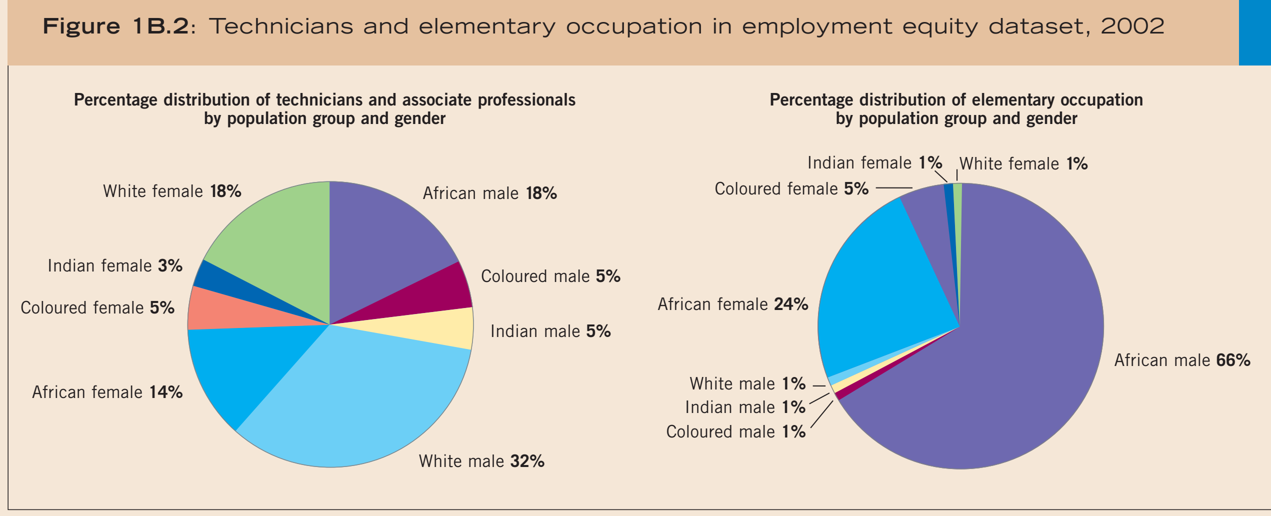
The report also provides data on promotions and staff

Figure 1B.1: Top management and professionals in employment equity dataset, 2002



Source: Commission for Employment Equity Report, 2002/3

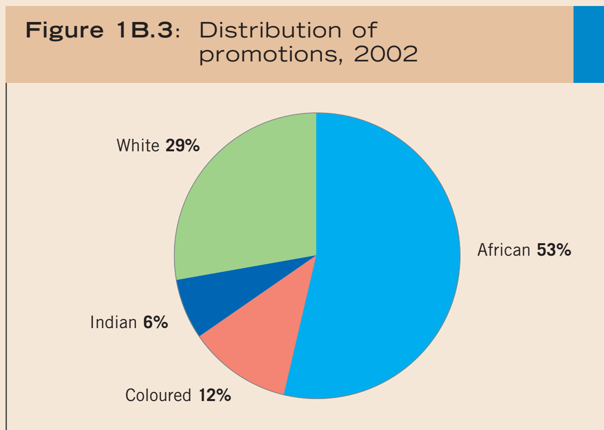
Figure 1B.2: Technicians and elementary occupation in employment equity dataset, 2002



Source: Commission for Employment Equity Report, 2002/3

losses. In 2002, 82 per cent of all staff dismissals were black (compared to the 70 per cent for the companies and organisations whose data were taken into account for 2001). Of the losses for which the reason was resignation, blacks accounted for 77 per cent. Regarding promotions, the 2002 distribution was very similar to 2001, with 71 per cent of all promotions being of blacks. At the top and senior management levels, 39 per cent of all promotions were of blacks, despite only 11 per cent of employees at these high levels of occupation being black.

Figure 1B.3: Distribution of promotions, 2002



Source: Commission for Employment Equity Report, 2002/3

EMPLOYMENT EQUITY IN THE PUBLIC SERVICE

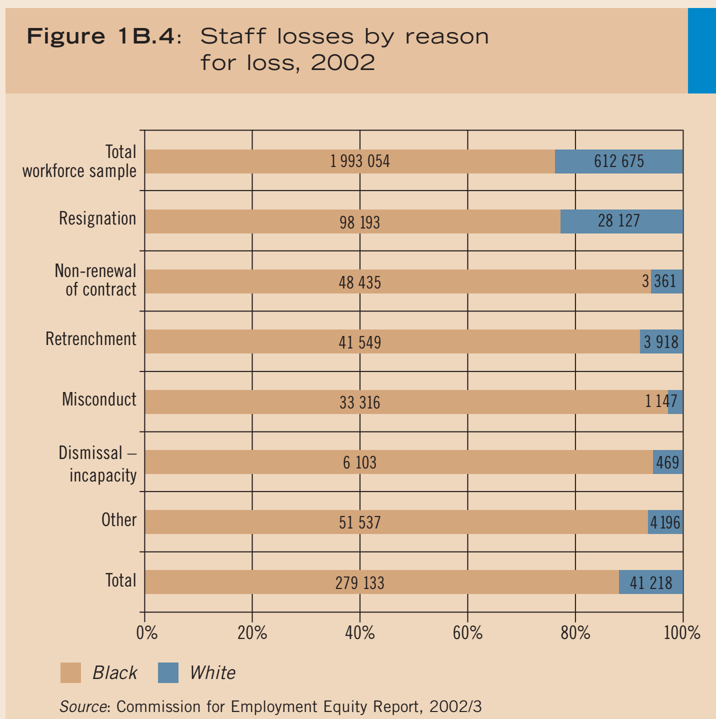
Thompson and Woolard (2002) found that, according to the personnel salaries database, 51 per cent of all managers in the public service, which employs more than a million people, were African in 2001, compared to 30 per cent in 1995. Black representation increased from 40 per cent to 63 per cent over the same period. These aggregate numbers hid differences in patterns between senior and middle management levels. Among senior management, black representation increased from 37 per cent (1995) to 55 per cent (2001); in middle management, from 41 per cent (1995) to 64 per cent (2001). Overall, black representation increased from 76 per cent in 1995 to 86 per cent in 2001. Representation of women amongst managers increased from 17 per cent in 1995 to 35 per cent in 1999. Between 1999 and 2001, however, it dropped.

LABOUR FORCE SURVEY DATA

The September 2003 Labour Force Survey (LFS) data, classify 127 738 managers as African, accounting for 23.8 per cent of the total. According to the LFS, 41 per cent of professionals are African.

When the number of managers, professionals, technicians and associated professionals in 2003 is expressed as an index of 1995, it shows a growth of 14 per cent. The largest growth took place in the professional category, which shows 74 per cent more African professionals in 2003 than in 1995.

Figure 1B.4: Staff losses by reason for loss, 2002



Source: Commission for Employment Equity Report, 2002/3

EMPLOYMENT EQUITY AND FOREIGN INVESTORS[1]

The EDGE Institute carried out a survey of foreign firms that have entered South Africa for the first time since 1990, as part of a larger Centre for New and Emerging Markets (NEM, London Business School) project on foreign investment. In the process, CNEM/EDGE investigated BEE attitudes and performance among foreign investors.

The survey, which took place in 2002 during the early stages of the shift to BEE charters, shows that foreign entry has not been a significant vehicle for expanding

Table1B.2: Employment equity by occupational category for Africans, 2003

Category	Number	Percentage	As index of 1995
Managers	127 738	23.8	134
Professionals	210 790	40.7	174
Technicians and associate professionals	573 095	53.4	99
Managers, professionals, technicians and associate professionals	911 623	42.1	114

Source: October Household Survey, 1995; LFS, September 2002, March 2003 (calculations by Ingrid Woolard)

Table 1B.3: Employment equity in firms with foreign ownership (N=162)

	Percentage of BEE interest in all firms		Percentage of BEE interest per firm with BEE	
	At entry	2000	At entry	2000
Ownership	2	3	41	33
Executive management	5	11	29	25
Professionals	6	17	24	33
Operations management	14	28	30	34
Skilled non-managerial	31	46	45	50

BEE ownership, which is not surprising. However, foreign affiliates have been fairly effective in promoting black participation in high-skill job categories.

Table 1B.3 presents data on four skilled labour categories. BEE impact at the top end of the labour force is much more substantial than in ownership. BEE executive management in foreign affiliates has risen from 5 per cent to 11 per cent, with nearly half the affiliates (46 per cent) having black executive managers at the time of the survey, compared with only about one in six (17 per cent) at the time of entry. Amongst professionals, operations managers and other skilled categories, the proportion of companies with BEE employees and the proportion of BEE employees in the sample as a whole had both risen substantially since affiliates entered.

There is significant sectoral variation in BEE performance amongst foreign firms. Trade and hospitality firms have transformed most, while finance and business services and IT firms did surprisingly poorly. Investors' home country seems to matter: firms from English-speaking countries have transferred ownership and executive management positions but not other high-skilled jobs, while East Asian firms have transferred no equity but have numerous blacks in all high-skill jobs. Small firms (with fewer than 100 employees) have done far better than large ones in promoting blacks in all the skilled job categories, including executive managers.

[1] *This section is from Gelb, S & Black, A (2004) Foreign direct investment in South Africa. In Estrin, S & Meyer, K (eds)* Investment strategies in emerging markets. *London: Edward Elgar.*

case study

CREATIVE EMPOWERMENT: GENUINELY BROAD-BASED, FOR A CHANGE

Linda Ensor

The creation of a black empowerment elite is arguably due to a failure of imagination on the part of would-be reforming corporations. They play it safe and follow the same template, with the same beneficiaries, rather than thinking out of the box. The beneficiaries, too, were originally envisaged as conduits to share ownership by the black community, in a genuine broadening of the base of economic ownership.

By now, it is a truism that there is a 'billionaires' club' of beneficiaries of major black economic empowerment (BEE) deals that aim to increase black ownership of public companies. The image of BEE has been tainted. Public opinion increasingly sees it as having deviated from its original intention of transforming the racial profile of economic ownership in the country, becoming tarnished by charges of elitism, grossly conspicuous consumption and the creation of a super-wealthy class.

The names of Tokyo Sexwale, Cyril Ramaphosa, Saki Makozoma and Patrice Motsepe recur in these empowerment deals all too frequently, with very few examples of participation by employees and communities.

An exception to the trend was the R1.3 billion deal that Imperial Holdings reached with empowerment group Ukhamba Holdings. Refreshingly, the deal was truly broad-based and provides a model for how black empowerment transactions should be structured. It involved no debt, did not require existing shareholders to bear the cost of the transaction and was based on profit-generation to give the black empowerment company an incentive to contribute to future profits.

Imperial Holdings is a diversified industrial group with interests in banking, life assurance, short-term

insurance, leasing and fleet management, aviation leasing, logistics and transport, car rental and tourism distributorships, and motor vehicle dealerships. It employs 28 000 people in 26 countries – 14 200 of them black South Africans – and has a revenue of R35 billion, a net attributable profit of R1.6 billion, total assets of R23 billion and a market capitalisation of about R13 billion. Listed on the Johannesburg Securities Exchange, its major shareholders are the Public Investment Commissioners (19.5 per cent), Old Mutual (11.7 per cent), Ukhamba (10.1 per cent) and Sanlam (7.8 per cent).

Aware of the need to promote BEE, not only from an equity perspective but also to secure its future business survival, the group set up a trust, the Ukhamba Trust, in 1998 as a vehicle through which employees could acquire a stake in a joint-venture investment holding company, Ukhamba Holdings (Pty) Ltd, and share in its wealth.

The trust owns 50.1 per cent of Ukhamba Holdings, and Imperial Holdings the remaining 49.9 per cent. All previously disadvantaged employees can participate in the Ukhamba Trust by purchasing as many linked units as they wish on a monthly basis. To date, 2 192 employees have invested over R5 million in the trust.

Imperial Holdings provided Ukhamba Holdings with R15 million in seed capital to use for investment purposes, with other funds coming from employees through the trust and borrowings. The group also included Ukhamba Holdings as a partner in its expansion programmes, allowing it to establish businesses in the core and non-core activities of the group. This allowed Ukhamba Holdings to create a niche for itself as a provider of products and services to Imperial Group companies and other customers. It currently has total assets of R55 million, an annual turnover of R67 million and profit after tax of R7 million. Ukhamba also has over 1 000 employees on its payroll.

Wholly-owned subsidiaries of Ukhamba Holdings such as Ikaheng Human Resources, Ukhamba Fleet Services, Rainbow Sanitation, Ukhamba Industrial Equipment and Cell C rental franchise outlets at several airports. These companies are involved in activities including fleet services, staff recruitment, maintenance of sanitary facilities, forklift leasing and retail.

As profits increased, so has the value of the Ukhamba Trust units, which have grown 220 per cent over the five years since the launch of the project, from the R50 initial issue price to R160 per unit.

The innovative and distinctive empowerment deal concluded between Imperial and Ukhamba Holdings provides that Imperial issue 22.8 million new deferred ordinary shares in the group valued at R1.3 billion to Ukhamba Holdings. These deferred shares will be converted into ordinary shares on an annual basis over seven years or more depending on headline earnings achieved by Imperial. The shares represent 10.1 per cent of the group.

The deferred ordinary shares came with normal voting rights, which allow shareholders to vote at annual general meetings of the company. So Ukhamba can act immediately as a 10.1 per cent shareholder, even though all the deferred shares have not been converted yet. However, it will only receive dividends and other forms of payment on its shares on conversion.

The structure of the deal means that it is not funded by existing shareholders, nor does it require Ukhamba Trust to find the capital. Instead, it is funded by future earnings growth. Ukhamba Holdings will earn a percentage of Imperial's profit if the group exceeds certain headline earnings projections, and it is from these profits that the shares will be purchased at market value.

The deferred shares will be converted into ordinary shares based on a formula that anticipates complete conversion in about seven years. Conversion at a rate of not less than one million shares per year is guaranteed for the first seven years if earnings growth exceeds 10 per cent. Thereafter, the guaranteed conversion rate per year varies between 500 000 and 1.25 million shares.

Ukhamba Holdings will have a strong incentive to contribute to Imperial's performance, since greater value will be attributable to Ukhamba as Imperial achieves higher headline earnings growth. The minor dilution of the share capital that will take place will be compensated for by earnings-based value creation.

In terms of the transaction, the Ukhamba Trust's beneficiaries will be expanded to include all of Imperial's approximately 15 000 black employees so that they can all participate in the growth of the group.

The deal also includes a restructuring of the shareholding of Ukhamba Holdings, so that both Imperial and the Ukhamba Trust give up 3 per cent of their shareholding to the Imperial and Ukhamba Community Development Trust. This trust has been created to promote the teaching of English, mathematics and science in

schools in informal settlements. Imperial has donated R1 million to the trust to kick-start the project before income starts flowing from their shareholding.

Ukhamba Holdings has undertaken to generate and enhance future business opportunities for Imperial, sustain and improve the empowerment status achieved by Imperial as a result of the transaction, and assist Imperial in training its black employees.

The deal takes the black empowerment shareholding in Imperial to 25.1 per cent, if account is taken of the stake held through a number of institutional shareholders that manage and administer funds on behalf of black people. This takes Imperial to the threshold at which it qualifies as a 'black-empowered' company.

Imperial Holdings is quite candid about the absolute necessity for BEE as a strategic business imperative, quite apart from it being equitable. It is a matter of survival. The deal was intended to not only preserve Imperial's position in the sectors of the economy in which it operates but also to secure additional business due to its status as a black-empowered company.

Imperial CEO Bill Lynch said Imperial's five-year business plan had been examined to determine expected earnings with and without empowerment credentials. 'There is no question that companies that don't engage in empowerment will be somewhat diminished in future,' he said.

Imperial made about 4 per cent of its revenue from government business and Lynch hoped the deal would boost this. 'It is envisaged that Ukhamba, as a shareholder of Imperial, and by virtue of Imperial's enhanced BEE status, will generate and enhance future business opportunities for Imperial,' he said. Indeed, in the months following the announcement of the deal in December 2003, the group was awarded contracts worth about R150 million. Lynch said the contracts were awarded 'where empowerment credentials were relevant and acknowledged'.