The tide flows in

Perhaps the most important reason for the apartheid government's Turnaround on the economic rights of Africans was its recognition that it had lost the war against the urbanization of Africans. No doubt, apartheid had slowed down the influx of rural Africans into the urban areas – though the rural areas were generally poor and contributed a tiny proportion of national income, more than half of all Africans still resided in the rural areas in the 1980s. The stream to the cities, if not an engulfing torrent, was strong, steady and inexorable. While thousands of poor African people were deported daily to the homelands, thousands more would return.

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Along with this, the NP had undergone something of a conversion away from a highly regulated economy, which had helped it enrich its supporters, towards a version of free market economics, to protect its newly rich supporters from intervention. Influenced by Thatcherism, the government began to consider the virtues of privatisation, deregulation and small business development – small businesses even for Africans, colored's and Indians, and even in the urban areas.

Policy changes included the establishment of the SBDC in 1981, which was allowed to lend to some 'non-white' business people, and a series of government economic reports, which increasingly emphasized the importance of the small business sector in wealth and job creation, and in political stabilisation (Rogerson 1987). As one critic points out, the enthusiasm of the government about the informal sector may have also reflected its desire to hide already

massive unemployment figures in questionable informal sector employment figures (Nattrass 1990b).

By the end of the 1980s, it was estimated that there were at least 500 000 African-owned businesses in South Africa, including 100–120 000 taxis, 150 000 hawkers and vendors, 50 000 small shopkeepers, and 70 000 backyard manufacturers in South Africa (Khosa 1990; Nattrass 1990b). By another estimate, possibly 40% of all liquor retailed in South Africa was sold in 'shebeens', or speakeasies, in the black townships (Rogerson 1987: 416). Though this seemed like progress, most of these enterprises did not constitute a sound basis for real capitalist accumulation. As the 1990s progressed, their limitations became more and more evident.

The apartheid government also changed tack on the labour market. Black trade unions were legalised in 1979, Africans were allowed permanent urban status in 1986, and job reservation began to melt away in the late 1970s. Gradually, Africans were permitted to progress to skilled, supervisory and managerial positions in enterprises they did not own. But progress was slowed down by prejudice, racial bias and the problem that black schools and colleges changed little for the better; in fact, many deteriorated.

BEE policy in the ANC:

The slow pace of black advancement in the white-dominated economy made BEE a major factor for the new government in 1994. Strangely enough, ANC economic policy documents before the Reconstruction and Development Programme document in 1994 barely recognise BEE as a significant policy thrust. The earlier documents refer to affirmative action in the workplace, to the correction of past inequalities in training, to the dismantling of the monopolistic conglomerates, and to the promotion of small businesses. In Ready to Govern, ANC economic policy included: 'Democratising the economy and empowering the historically oppressed' (ANC 1992: par. D1.1.2). But it stopped there. Unlike issues such as trade policy, minerals policy and foreign investment policy, for example, there were no concrete ideas about the implementation of empowerment programmes.

Why was there a blind spot? This was probably because, until the 1994 elections, the drafting of economic policy documents was left to academics, professional researchers and other intellectuals. BEE had become a corporate buzzword, and perhaps the intellectuals were reluctant to be seen to be pandering to business. Another factor might be that empowerment was a broad issue that cut across the economy, whereas policy groups were narrow and focused on traditional subjects such as trade, public finance, mining, agriculture, or industry. Also, black business remained a fragmented and weakly organised interest group, while the left in the ANC alliance seemed even more wary of black capitalism than white capitalism. The economic policy drafters may have assumed that BEE was implicit

in notions of bringing about equality. They certainly failed to realise
its political importance. ‘Political’ in two senses: first, in the narrow
sense of the ANC communicating effectively with its existing and
potential constituency; secondly, in the broad sense of the
importance of a strong black middle class to underpin democracy.
As Bheki Sibiya, CEO of the united business umbrella organisation,
Business Unity South Africa (BUSA) put it: ‘Political democracy

would not be sustainable without BEE. What is happening in
Zimbabwe is less political than economic, because black empowerment
was not introduced there’ (Engineering News, online daily
newsletter, 28 May 2004).

As its first election manifesto, the RDP was the ANC’s first post-
1990 social and economic policy document in which the political
leadership played a key role in drafting – not only an approving
and amending role. In this sense, even the 1992 Ready to Govern
document, with all the razzmatazz of the national conference in
Johannesburg, was still largely drafted by specialists. The economic
debates at the 1992 conference focused on a few high-profile issues
such as nationalisation and relations with the World Bank and the
International Monetary Fund (IMF) – while numerous potentially
controversial, technocratic formulations went unnoticed.

The RDP recognised that monopolistic white corporate ownership
of the land and economic wealth creates ‘social and racial
tension’ and damages economic potential. It committed the ANC
to ‘democratise the economy and empower the historically
oppressed’. More specifically, it indicated that a ‘central objective

of the RDP is to de-racialise business ownership completely through
focussed policies of black economic empowerment'. Financial
institutions would not be allowed to discriminate on the basis of
race, state agencies and public corporations would provide capital
and tendering procedures to facilitate BEE, and there was a reference
to 'training' and 'upgrading' of black business people and their
firms. The RDP was only specific on BEE in the case of small business
development where the highlighted issues were access to credit,
access to markets, skills, and supporting institutions (ANC 1994:
par. 4.1.5, 4.2.2.6, 4.4.6.3, section 4.4.7).

So, while the RDP recognised the political and economic
importance of BEE, it failed to anticipate the immense challenges
that would emerge when government attempted to implement the
BEE policy. Or maybe it just avoided the issue. When the ANC
took the reins of power in the government of national unity (GNU),
its BEE thrust was fragmented and uncoordinated, and worked

within an extremely vague set of common guidelines as articulated
by the RDP.

Even at the ANC's major congress at the end of 1997, where it
set out a policy framework to inform the 1999 elections and the
coming Mbeki government, the ANC leadership could only point
to the need for a coherent BEE strategy (ANC 1997b). It was still
unwritten.

BEE and government procurement:

One important route for BEE was through procurement –the allocation of public contracts.In 1995–96,an interim strategy called the '10-point plan' was developed within national government for smaller contracts.If the tendering company was fully black-owned and women-owned it could get a bid-price advantage of 13.64% less if only one of the criteria was satisfied (Cargill 1999:chapter 16).

The strategy had several limitations. The criterion of black ownership was not always effective – some white-owned companies hid behind black front-companies for bidding purposes, and some black-owned companies were less progressive than white or foreign companies in their hiring and training programmes. Tender boards learned to avoid some of these pitfalls, but the system remained less than perfect.

Another limitation was the fact that many public tender authorities were newly established after 1994, especially the nine provincial tender boards. They did not fall under the jurisdiction of the national 'State Tender Board' or the 10-point plan. In the absence of an accepted nationwide framework, the policies and practices of the public contract bodies differed widely.

In 2000, the National Treasury's Preferential Procurement Policy Framework Act was passed, accompanied by regulations in 2001. This law established a common framework for procurement for all organs of state. For smaller contracts, 20% of the evaluation

could be allocated to specific goals – either to cater for contracting
with people historically disadvantaged by unfair discrimination, or

to further the goals of the RDP. Larger contracts could allocate
10% of the evaluation score to these goals. The Act has not proved
easy to implement – some state organs were concerned that it did
not give them sufficient flexibility to achieve empowerment
objectives, while the private sector indicated that the Act and
regulations placed too much emphasis on equity ownership, and
not enough on capacity-building and the promotion of local content.
Public corporations are not bound by the Act, and continue to
maintain a variety of empowerment procurement systems
(BusinessMap Foundation 2003: 17–20).

In spite of the continuing lack of uniformity of empowerment
procurement systems, bidders for government contracts learned
that they had to have a strong BEE component. There is no doubt
that black proprietors and partners in the construction sector, the
information technology business, and in legal, auditing and
consulting firms benefited considerably from even the haphazard
adoption of BEE in government tenders.

Empowerment or enrichment, or is that the wrong question?

One of the most significant BEE exercises began in 1993 when Sanlam, the giant Afrikaans insurance-based conglomerate, unbundled a significant asset into black hands. This was also a pioneering foray by the state-owned IDC, which helped to finance the deal. The IDC was one of the first finance companies to support the larger kind of empowerment projects – the transfer of ownership of privatised or unbundled (the private sector form of privatisation) companies into black ownership. There were various ways to participate: warehousing shares while black buyers were found; financing the transfer of ownership; or taking a minority shareholding in a firm being transferred to black owners.

The IDC became involved in BEE in a tentative way in the early 1990s. One form of involvement was to support the establishment of some small and medium black businesses, even though they were outside of the IDC's usual field of industrial development.

One instance was when the IDC agreed to finance the expansion of a medical clinic in Soweto owned by medical doctor, Nthatho Motlana. Dr Motlana had been a hero in the parents' response to the schoolchild-led revolt in Soweto in 1976, and in subsequent conflicts. He ably conveyed the community's demands, and negotiated with dignity and courage. He had been associated with ANC leaders before the banning of the organisation in 1960, and

retained these links. Dr Motlana strove to serve Soweto effectively as a committed community doctor, and built up a clinic over many years. In the early 1990s when the IDC began dipping its toes in the unexplored waters of BEE, Dr Motlana's clinic made a good pilot project.

Sanlam had begun a more general unbundling exercise in response to market pressures for stock market value. The South African conglomerates had grown large, bloated and inefficient in the 1980s, after picking up assets discarded by foreign firms that were disinvesting under political pressure. (Elsewhere in the world, the 1980s were characterised by wide-scale unbundling and repackaging of conglomerates.) Sanlam anticipated the competition that was to come after the lifting of sanctions, and began to restructure. The fact that it chose to dispose of Metlife, a substantial and profitable life assurer, was probably more influenced by Sanlam's view that this would be a political investment for the future. Sanlam sold a controlling share of Metlife to Dr Motlana's new company called New African Investments Limited, or NAIL, with the help of finance from the IDC. A year later, NAIL was floated on the Johannesburg Stock Exchange, and it grew rapidly. It acquired new assets regularly, mainly in the financial services sector, but also in telecommunications, the media and in the industrial sector. NAIL's acquisition path seemed to depend more on what assets made themselves available, rather than a focused strategy. In this respect, the behaviour of some new BEE conglomerates has been uncannily similar to the behaviour of the old white conglomerates picking up sanctions disinvestments when they became

available. Another resemblance was in the pyramid control strucReaching
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tures, which in South Africa allow holding companies to control
the boards of their subsidiaries' subsidiaries.
NAIL's executive directors soon resembled a kind of political
aristocracy within black business. Motlana and his (non-black)
partner Jonty Sandler were first joined by advocate Dikgang
Moseneke, who had been Deputy President of one the ANC's rivals,
the Pan- Africanist Congress (PAC) during the pre-1994 negotiations.
Moseneke decided to leave politics before the 1994 elections. Then
they were joined by Cyril Ramaphosa, outgoing Secretary-General
of the ANC, lawyer, and former leader of the black National Union
of Mineworkers (NUM). Ramaphosa was a senior ANC negotiator
in the pre-1994 period, and was seen as the chief rival to Thabo
Mbeki for succession to the leadership of the ANC once Mandela
left office. When Mbeki consolidated his claim to succession, and
all parties agreed to the country's final (rather than interim)
Constitution in mid-1996, Ramaphosa decided to leave politics for
the private sector. He entered NAIL with a group of investors called
the National Empowerment Consortium, including several trade
union funds, which helped NAIL buy industrial conglomerate
Johnnic from the giant Anglo American Corporation.
Last executive director on board was Zwelakhe Sisulu, son of
Mandela's friend and mentor Walter Sisulu. Zwelakhe Sisulu had
been a brave journalist, editor, publisher and media union leader
in the apartheid era, and was selected to run the national public
broadcaster, the South African Broadcasting Corporation (SABC)

after its new board was appointed by the new government. Perhaps
worn out by the mammoth task of transforming the public
broadcaster, which was largely accomplished under his management,
he joined the private sector in 1998. NAIL's significant media
interests may well have attracted Sisulu.

In the meantime, NAIL had grown and become one of the
largest black-owned publicly traded companies, known in South
Africa as 'black chip' companies. By the end of 1998, following a
serious correction in the Johannesburg Stock Exchange during the

third-quarter, NAIL had a market capitalisation of nearly R6 billion,
or US$1 billion (Financial Mail 11 December 1998).

NAIL symbolised the rapid accumulation of wealth that several
black-controlled companies enjoyed after 1994. Soon, comparisons
came to be drawn between the rise of black capitalism after 1994,
and the rise of Afrikaner capitalism after the NP came to power in
1948 (Financial Mail 7 February 1997). Afrikaners had previously
been economically subordinate to English-speaking South Africans
who had controlled almost all of the country's wealth. Afrikaners
used insurance companies such as Sanlam as their main accumulation
vehicles. With 60% of the white population being Afrikaans
speakers, and with an Afrikaans-controlled government, Afrikaner
financial services companies had a major market base they could
win over with nationalistic marketing.

The moment when Afrikaner capital truly came of age was when
Federale Mynbou acquired General Mining from Anglo American,
the bastion of South African English-speaking capital. Harry

Oppenheimer had chosen to draw the upstart Afrikaners into the fold of the establishment. As business historian J.G.F. Jones wrote in 1995, ‘the arrival of the Afrikaners into the Chamber of Mines had the important consequence of defusing the ruling Afrikaners’ [unfavourable] view of the mining industry’ (cited in Financial Mail 7 February 1997). Federale Mynbou/General Mining grew into Gencor, a Sanlam-linked company that ranked second only to Anglo American in the South African mining sector, and now, as BHP Billiton, is a leading world player.

The echoes of Anglo American’s pre-emptive move in 1963 in Sanlam’s gesture 30 years later is hardly accidental or coincidental. There can be little doubt that Sanlam’s executives recognised both the political significance of their 1993 sale of Metlife, and its echoes of the 1963 precedent.

Sanlam set a trend, and NAIL was a beneficiary when other conglomerates followed suit. But NAIL soon found that good assets and political credibility were not enough. At the end of its financial year in September 1998, NAIL’s ordinary (voting) shares were

trading at a 23.6% discount to the net value of its underlying holdings, while the low voting N shares were trading at a 41.6% discount (Financial Mail 11 December 1998). There are various explanations, including the same explanation that was applied to the white unwieldy conglomerates in the early 1990s: that the holding company’s management was not adding value to its assets.

Early in 1999 things began to turn sour at NAIL. First, Cyril Ramaphosa resigned his position as Executive Deputy Chairman.

Ramaphosa has not revealed his reasons for leaving NAIL, but one factor may have been differences over the restructuring of Johnnic, where Ramaphosa was chairman of the board (Enterprise Vol. 131, April 1999). Or it may have been because he anticipated a storm that was about to break over NAIL and wanted to distance himself from its cause.

The storm broke in mid-April 1999 when the Financial Mail drew NAIL's minority shareholders' attention to the fact that 'next week they will be asked to approve a R100 million bonanza for four of their executives' (Financial Mail 16 April 1999). The board was asking shareholders to approve the transfer of share options in NAIL's dynamic subsidiary African Merchant Bank, to the four remaining executive directors: Motlana, Sandler, Moseneke and Sisulu. The options were worth about R136 million, or R34 million (US$6.5 million) per executive director.

If the performance of NAIL had reflected strong management, shareholders might not have been outraged, but they were not grateful for the discounted value of their shares. The outcry forced the NAIL board to withdraw this and two other controversial resolutions before the shareholders' meeting. Sandler resigned – portrayed by some as the fall guy – and Motlana joined him, motivated partly, it seems, by weariness brought on by his advancing age (74). The publicly available evidence does not indicate whether any of the executive directors was more culpable than the others of what was a presumptuous rather than an illegal act (Financial Mail 7 May 1999).

What conclusions can we draw? Firstly, BEE is of course riddled

with temptations for enrichment, which may be legal, but not entirely ethical. In this regard the new black companies learned the tricks of the trade from the directors of established South African companies whose incestuous world is somewhat obscured from public scrutiny. A second and more positive lesson, though, was that with South Africa's less-than-perfect company law, and even with its often-somnolent financial press, inappropriate actions can be stopped before they happen. There is some significant degree of transparency, and a reasonable supply of shame. Thirdly, and perhaps most importantly, it pointed to dissatisfaction with the nature of some BEE holding companies and the way they are managed.

For NAIL this was the beginning of the end. Under a new management team, NAIL attempted to focus itself as a media powerhouse, but was thwarted by unfavourable decisions made by the regulator of broadcasting and telecommunications – the Independent Communications Authority of South Africa (ICASA). Rules designed to prevent the emergence of excessive control by a company of the media in particular markets prevented NAIL from accumulating the assets its board believed would make it a viable media company. Since the decision, NAIL has gradually unbundled its portfolio on the path to a complete dismantling of the NAIL empire. Once the black chip amongst black chips, NAIL is limping along the path to dissolution.

Financing BEE: How special were 'special purpose vehicles'?

How are the big empowerment deals financed? Most of the black owners have little wealth, or collateral in any other form. They

have to raise finance with relatively little to offer except that there may be a discount to the ruling price of the transferred shares, and that the cachet of black ownership will be a credit in dealings with the South African government. Since the introduction of BEE charters more recently, the incentive to share equity with black owners has grown considerably.

The early form of a BEE deal used the redeemable preference share in conjunction with the creation of a type of company known

as an SPV, or 'special purpose vehicle' (see Stassen and Kirsch 1999). Once a deal is struck, the financier provides funds to the SPV in exchange for a combination of equity and debt preference shares, the combination depending on the size of the discount on the original sale (usually at least 10%). The BEE company gets the voting rights, but the financier enjoys the performance of the underlying shares, up to a certain hurdle rate. The hurdle rate is usually expressed as a percentage of the prime lending rate. Over the hurdle rate, the returns go to the BEE company.

In essence, in exchange for the cachet of black ownership and a chance to participate in a big share transfer in a relatively illiquid market, the financier gave up a notional half of the upside of the share and took all the downside risk. This was fine in a bullish market, but when markets turned bearish and interest rates rose rapidly, as in the second half of 1998, the dividends from the underlying investment failed to cover the debt preferences hurdle rate. The additional debt was added to the loan capital of the SPV, forcing the BEE company to raise cash or give up some of the

underlying shares to the financier to relinquish debt. Several weakly capitalised empowerment companies and consortia collapsed under this kind of pressure in the late 1990s and in 2002–03.

This raises questions about the SPV system. The ‘good times’ scenario of returns without risk for SPVs had encouraged passivity in the BEE companies, and even carelessness about the way they assembled and organised their holdings. They had little incentive to add value to their assets in any significant way. But their returns were also constrained.

The problem became very obvious in early 1999, in the aftermath of the mini-crash of the second half of 1998. BEE companies had to scramble to avoid mounting debt to their financiers, leading to some significant shake-ups, such as the partial separation of Johnnic from NAIL (Enterprise Vol. 131, April 1999). But it went much deeper. With many of the new BEE holding companies trading at really significant discounts to their underlying assets, black business leaders sometimes became frustrated and embarrassed about their

lack of involvement at the operational level of the firms they owned.

As black business leader, Ruel Khosa, put it in the wake of the NAIL crisis: ‘Our empowerment agenda is driven by the corporations that seek to do business with us, along with the assorted advisors and financiers who in fact stand to benefit more from these initiatives than ourselves. Often we bring to the table nothing more than the pedigree of blackness and expect this to do the magic for us. We bring little by way of strategy, a plan, capital, expertise of

skills to the deals that we get involved in' (Sunday Times: Business Times 25 April 1999).

Initially many BEE deals resulted in a transplanted head that had to get to know its body better, but did not always show the inclination to do so. It's hard to measure the extent to which this was a result of the specific form of BEE SPV, and the extent to which it was a predictable outcome of the adoption of 'pyramiding South African style' by the black business community.

These problems were ignored for a long time because the BEE deals were so lucrative to the successful merchant banks – deal flow overwhelmed everything else for a while. But the merchant banks and the BEE companies were forced to look for ways for the new black owners to share more effectively in the risk, returns, and obviously in the management of the assets being transferred. Some of the financial companies sought out those black companies that emerged from the ground up. Black businesses with an operational track record became increasingly well placed to benefit even from top-down BEE deals vis-à-vis those that only had political connections.

The problem – the main problem – is that there were not enough of these successful ground-up black companies to facilitate continued fast-paced BEE. This was a key challenge for government.

The BEE Commission, the broad-based Black Empowerment Act and the National Empowerment Fund:

In November 1997 the Black Management Forum (BMF), an
association of black senior managers formed in the 1980s, proposed

the establishment of a Black Economic Empowerment Commission.
As the BMF explained, 'The motivation for the establishment
of the commission is that the notion of true empowerment as
defined by black people does not exist, nor does a common definition
or benchmark' (BEECom 2001: 4). There were no accepted
standards or criteria for empowerment. Organisations were making
it up as they went along, which created ideal conditions for all kinds
of opportunism.

Society as a whole needed a systematic approach. A month later
at its congress in Mafikeng, the ANC endorsed the position of the
BMF and the mandate of the commission, which became known
as the BEECom. Cyril Ramaphosa, former organiser of mine
workers, and senior ANC official and negotiator, who had left
Parliament and entered business in 1996 was appointed Chair of
the Commission, with several other senior black business people
on the Commission.

Three-and-half years later, after extensive discussions with
politicians and the business community, the Commission published
its report. The BEECom adopted a 'broad-based' approach to BEE
– it was about training, small business development, economic

growth, and access to financial services, in addition to the issues of ownership and procurement. As President Mbeki once put it, part of the task of the BEECom was 'to answer the question – how do we promote the formation of a black bourgeoisie which will itself be committed and contribute to black economic empowerment?' (Mbeki 1999).

The ANC picked up the theme of broad-based empowerment in its detailed and substantive resolution on BEE at its five-yearly congress in December 2002. The government was at last ready to launch a comprehensive BEE strategy. The DTI published a policy paper in March 2003; in April the Minister of Trade and Industry appointed an advisory committee to help him finalise a draft law; and in September 2003 the Broad-Based Black Economic Empowerment law passed through Parliament to almost universal acclaim. President Mbeki signed the bill into law in January 2004.

The broad-based concept evolved into the idea of a balanced scorecard to rate the performance of industry sectors and firms with regard to a wide range of empowerment objectives (DTI 2003: appendix A). While most opposition parties supported the bill, the conservative Democratic Alliance (DA) opposed the bill on the grounds that it was aimed to encourage cronyism and patronage politics by the ruling party (Business Day 5 September 2003).

Some deals raise the question of the ease with which senior government officials and politicians glide through a revolving door to powerful positions in the private sector, often in businesses closely related to their portfolios in government. The path of the former

Director-General of the Department of Communications into a major information technology business, and then his role as leader of a consortium to buy a parcel of shares in Telkom raised some eyebrows during 2004. This was not an isolated event – many former top officials and politicians have moved into the private sector. This should not be surprising – as in any democratic revolution, the struggle against apartheid drew many of the best and the brightest people, who in normal societies would have been professors, business leaders or professionals. When the Afrikaner nationalists won power in 1948 in a less democratic regime change, for many Afrikaners, politics or the civil service was a path into the private sector. There would be more cause for concern if this path were not followed in South Africa – the clear distinction between the province of political power and the province of economic power is now well entrenched, unlike the situation in many African countries with weak private sectors. The ethical issue is, more precisely, the manner of the passage from public to private sector, a debate not yet concluded in South Africa.

Though not quite as wide-reaching as the BEECom proposal, influenced particularly by trade union supporters in its ranks, the BEE law entailed a powerful streak of egalitarianism in the description of the law's objectives. The concrete elements of the law had four main elements: the establishment of a Black Economic Empowerment Advisory Council chaired by the President that would

review the implementation of the law; a commitment that the Minister of Trade and Industry would issue a strategy document to

define the parameters of the policy; the empowerment of the Minister to publish codes of good practice for the implementation of the policy; and the Minister was obliged to publish in government gazettes the transformation charters agreed to in industrial sectors (Broad-Based Black Economic Empowerment Act No. 53 of 2003).

It was not expected that there would be an empowerment charter for every sector. Only major sectors (such as mining), those with a significant commercial relationship with the government (such as information technology), or those that operated under significant government regulation (such as the liquor sector) would develop transformation or empowerment charters. A charter is essentially an agreement covering an industrial sector that commits the firms in the sector to achieving over a specified time period a range of objectives, usually including the main elements of the BEE scorecard: equity ownership levels, management composition, employment equity, skills development, preferential procurement, enterprise development (usually black-owned contractors), as well as industry specific goals.

The first charter to be launched was the Liquid Fuels Industry Charter signed in Johannesburg in November 2000. This was followed by the Mining Charter in October 2002, but not before an early government draft of the charter was leaked leading to a sudden and significant loss of confidence in South African mining equities. The Minister of Minerals and Energy had to lead an intensive communication campaign on the charter and the BEE strategy in general to begin to restore confidence in South African shares. The next major charter was the Financial Sector Charter,

released in October 2003, though the implementation details had
to be firmed up over the next year or so. Several other charter
processes got underway in 2003 and 2004; indeed the charter
process proliferated more widely than originally anticipated by the
government. What this seems to reflect is the desire of each

industrial sector to have clear and pertinent BEE rules and objectives,
rather than operating within the broad scope of the law.

The charter experience taught government and the private
sector that it was not only necessary to devise industry specific
charters, but that the process of charter development varied
considerably from sector to sector. In some sectors, the government
took the lead; in others, the black and white industry players sought
to do most of the charter work themselves, and only brought the
government into discussions when they had already progressed quite
far along the road to charter development.

One of the key ingredients of a successful BEE programme is
finance. How do you transfer ownership and all other kinds of
economic assets to black people who have not been able to
accumulate marketable assets as a consequence of the apartheid
system? SPVs have obvious limitations, and the sponsorship of
empowerment deals by the companies being shared out destroys
value and therefore has to be limited. In some cases empowerment
partners bring value to the firm being shared and this may be
considered to legitimise a discount of the equity issued to empowerment
partners, but even taking this into account, there is a huge
amount of financing outstanding.

In the Metlife case, and in numerous other transactions, the
IDC helped to finance the deal. But with net assets of about R25
billion and a range of other responsibilities in its mandate, the
capacity of the IDC to finance BEE is limited.
Late in the Mandela government, legislation for a National
Empowerment Fund (NEF) was finalised. The idea behind this Fund
was that the government needed an instrument to enable ordinary
people – historically disadvantaged people to be specific – to benefit
from the fruits of privatisation, and to benefit from economic
empowerment opportunities.
Privatisation had three main goals in South Africa, goals that
sometimes proved to be mutually incompatible. The first was to
help to reduce the national budget deficit. The bulk of the proceeds
of privatisation (about R26 billion of a total of R36 billion by the

end of 2004) went straight into the Treasury, not without some
skirmishes between the Minister of Finance and ministers of
portfolios affected by the privatisation (for example, Transport or
Communications) who believed that the funds should be reinvested
in that sector. In many cases, though, the privatisation contract
was conditional on the new owners or shareholders contributing
to significant new investment in the field for which the privatised
company was responsible. The semi-privatised national telecommunications
company, Telkom, was required to lay down two
million new telephone lines as a condition for the successful bidders.
The new services or infrastructure were generally aimed at the
poor – the redistribution of services and infrastructure being the

second goal of privatisation. The third goal of privatisation was to
improve the efficiency of the economy. So, for example, the semiprivatisation
of Telkom was accompanied by the removal of the
Telkom monopolies over fixed line and overseas telecommunications,
but delayed by five years to give Telkom an opportunity to
prepare for competition and to meet the redistribution requirements.
In practice, regulatory uncertainty has led to Telkom being
allowed to maintain its monopoly longer than originally planned.
In addition to those three goals – paying off the national debt,
extending services and improving economic efficiency – a fourth
goal emerged that was more specific to the South African
experience. It was that the historically disadvantaged individuals
and communities could use the opportunity of privatisation to get
access to some of the wealth they had been barred from.
Privatisation had to include the redistribution of wealth in South
Africa. But what did this mean? Did it mean that individuals would
be given equity, and if so, how would shares be distributed to avoid
criticisms of favouritism? And what about the small entrepreneurs
who needed capital to grow their companies rather than supplement
their income or pension? Finally, who was going to pay for it: the
new owners, consumers, or the taxpayer?
In the end a rather complicated solution was found. Those

fractions of privatised companies that were reserved for the
historically disadvantaged (usually about 10% of the portion sold)
would be sold to a trust, which would draw on state funds (taxpayers'
money) to pay for the shares. Shares set aside by early 1999 were:

10% of Telkom at R1.8 billion; 15% of Sun Air at R7.5 million; 10% of the Airports Company at about R400 million; and 15% of Aventura (a holiday resort manager) at R13 million (Cargill 1999: chapter 17). The trust was set up by specific legislation in 1998 (National Empowerment Fund Act No. 105 of 1998). The trust would share this wealth in three ways: firstly there would be a portfolio management trust, which would manage rare large parcels of shares that would eventually be sold to black companies or consortia; secondly, some of the shares would be included in a venture capital fund, where the assets would be used to support capital injections into emerging smaller black companies; and, thirdly, some assets would be transferred to an investment trust/ mutual fund, which would encourage smaller black investors to buy units at a significant discount, not tradable for a period of time to encourage habits of saving and investment. In the case of the latter two funds, the portfolios would clearly have to be diversified in order to give them greater stability and balance. The venture capital fund could become a joint-venture company with private partners if it proved adept at picking high-potential prospects.

In practice it did not work out exactly that way. The only shares transferred to the NEF were 1.5% of MTN (the second cell phone operator), transferred at a value of R171 million. The government provided an additional R14 million as part of the NEF's R100 million commitment to a venture capital fund called NEF Ventures Trust, which is a joint venture between the NEF and the IDC.

The remaining shares were not transferred to the NEF for a variety of reasons, but mainly because even after several years of

operations it had failed to convince anyone that it could make a
serious contribution to empowerment. A new CEO was appointed
in October 2003 to turn it around. The new CEO was Sydney Maree,

a black athlete who during the apartheid era immigrated to the
United States to compete as a middle-distance runner. One of South
Africa's greatest-ever athletes, Maree held the world record for the
1 500 metres in the early 1980s. Maree returned to South Africa
in the 1990s and held several jobs in the financial sector, and by
2003 was a senior officer in the JSE, and was a special adviser to the
Minister of Trade and Industry, Alec Erwin.

After Maree was appointed to the CEO post, the government
committed itself to re-capitalising the NEF with a R2 billion
injection. This was part of R10 billion that the Minister of Finance
indicated in his 2003 budget speech would be set aside for BEE.

The new NEF would have four main product areas: accreditation
and advisory services to improve standards and information for
BEE; the 'generator' venture capital fund for small firms; the
'accelerator' venture capital fund for medium firms; and the
'transformer' fund, which is designed to invest in BEE enterprises
that seek a listing on the JSE. Sadly, Maree was suspended from his
position, accused of being complicit in some irregular transactions,
only six months after his tenure began – yet another sorry episode
in the history of the NEF.

In addition to the NEF, the Minister of Finance announced the
expansion of the Isibaya Fund of the Public Investment Corporation
(PIC). The PIC is responsible for the investment of over R400 billion

on behalf of the government, most of which belongs to the government employees' pension fund. The Isibaya Fund was created to invest up to 3.5% of the PIC funds into socially responsible investments, including the financing of BEE deals. Initial reports indicate that about R2 billion will be invested in BEE small and medium businesses between 2004 and 2007, but the fund has been slow to find its feet (City Press: Business 13 June 2004).

The challenge of financing BEE deals is a very serious one. EmpowerDEX, an empowerment consultancy, estimated early in 2005 that it would cost about R389 billion in financing to advance black ownership to 25% of the JSE (EmpowerDEX 2005: 3). Competing for the use of funds are the growing investment plans

of the public sector and the private sector. Symptomatic of this conflict was an extended argument within the Financial Sector Charter process about the allocation of funds set aside by the financial institutions in terms of the charter for investment – how much of the money should be used for investment in housing for the poor, how much for infrastructure investment by the public sector, and how much for empowerment? Yet, even if the entire amount set aside by the Financial Sector Charter had been allocated to empowerment, it would have amounted to less than a third of the amount estimated by EmpowerDEX needed to finance the purchase of only a quarter of the JSE.

BEE outcomes:

It is not easy to measure the outcomes of the BEE policies and programmes. Many of the outcomes are not necessarily measurable in straightforward terms. One can examine objective measures such as the number of black managers recorded by the Department of Labour and the extent of black ownership of companies listed on the JSE. But this would be a representative number, not a complete account. For example, in the petroleum sector most of the firms are not listed in Johannesburg, so the 25% stakes of each of Caltex, BP, Shell and Total South Africa sold to empowerment partners would not be reflected in the outcome of a survey of the JSE.
In addition, measurement can be influenced by the range of interpretations of what BEE is. For some analysts (e.g. EmpowerDEX) BEE control over the JSE is measured through an account of all BEE-held shares, while for others (e.g. BusinessMap Foundation) only BEE-controlled companies count. In addition, the passing of the BEE Act in 2003 and the emergence of the escalating BEE charter trend has meant a new wave of BEE deals beginning in 2000 with the signing of the first charter, and this is likely to continue for a decade. An analyst for Nomura Securities perspicaciously said in 1998 that BEE was likely to dominate the
Johannesburg Stock Exchange for the next 10–15 years. The pace continues to accelerate – the BusinessMap Foundation indicates
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that 2003 was a record year for BEE deals, valued in excess of R30

billion (BBQ, Vol. 7, No. 1, 2004: 101). Measuring BEE in South Africa is like trying to hit a rapidly moving target.

Nevertheless, the extension of black ownership in the economy has been progressing fairly slowly. In terms of direct ownership, black people still only owned about 1.6% of the JSE by September 2003, and held another 14.1% through institutional investors (Financial Mail: Top Empowerment Companies April 2004: 10). Over 90% of BEE wealth in the market is held indirectly through institutions, and the PIC (the agency responsible for investing government financial assets such as pension funds) holds 58.8% of that. The majority of BEE investment – 68.9% – is invested in the resources and financial sectors. This is in line with the fact that these two sectors constitute 70% of market capitalisation on the JSE (EmpowerDEX 2003).

If we look at the boards of the JSE's top 100 companies, there were only 14 (1.2% of total) black directors in 1992. By 2002, there were 156 black directors – 13% of total directors. In 2002, there were 24 black executive directors, that is 5.2% of total executive directors compared with one executive director (0.2%) in 1992. Of the top 100 companies, 71 had black representation on their boards (EmpowerDEX 2003).

If we look at the JSE as a whole, there were 435 black directors in September 2004 compared with 432 in 2003 – 16.6% of the total. Only 7.7% of executive directors were black. Only 3.2% of all directors were black women, and only 0.8% of executive directors. Only 4% of boards had a majority of black directors, and 64% of boards had no black directors at all (EmpowerDEX 2005).

For affirmative action in the workplace, the history of the measuring tool is short – launched with the Employment Equity Act of 1998, data is only available for the period since 2000. Steady progress is being made on employment equity in the private sector whilst the public sector is becoming representative of the population. In the public sector, 72.5% of employees were African, 3.6% Indian, 8.9% coloured and 14.7% white, as of 31 March 2003. With regard

to gender, 52.5% of public servants were female and 47.5% were male. At senior management level, 56% were African, 8.2% Indian, 10.1% coloured, and 25.6% white. The gender breakdown for senior management was 22.1% female and 77.9% male. As the data show, great strides have been made in employment equity within the public sector, although the gender bias in senior management is still skewed in favour of males.

State-owned enterprise board composition by late 2003 was 63% African, 2.5% Indian, 9.9% coloured and 24.7% white. Regarding gender, 76.5% were male and 23.5% female. At senior management levels, 56.5% were white and 43.5% were black with a gender breakdown of 75% male and 25% female. Again it would be fair to say that the boards and senior management of state-owned enterprises are becoming more representative, with the caveat that gender equity lags.

If we look at the top levels of occupation categories as defined in the 2001 census, we find that black South Africans constituted 61% of all professionals, technicians and associate professionals, and 44% of managerial positions in the economy (Statistics South

Africa 2003).

Looking at the private sector on its own, progress is being made, in that 22% of all new managers in 2000 were African and 47% of all new promotional opportunities went to African managers. However, progress is slow. By 2001, only 13% of top managers were black, and only 16% of senior managers. Moreover, each category had only improved by 1% since 2000. At the middle management/ professional level, progress is even slower.

Progress towards gender equality is similarly slow in the private sector, with only 11% of top management being female in 2001, and 18% of senior management. For both categories and for middle managers/professionals, the annual rate of progress is very slow, at between 1% and 1.7%.

Notes:

1. In general, I use the work 'black' to mean other than white. All 'non-white' people were economically discriminated against. But economic discrimination was more severe for black Africans, compared with 'coloureds' and 'Indians'.
2. This story is vividly told through the eyes of one African farmer in Charles van Onselen's The Seed is Mine: The Life of Kas Maine, a South-African Sharecropper,
1894–1985 (1996).
3. See Davies (1979), for a class analysis approach; Horwitz (1967), for an economically conservative but anti-Afrikaner account, and for something in between, Lipton (1986).
4. I am greatly indebted to Chapter 1 of Stassen and Kirsch (1999), and Cargill's (1999) publication as a whole, for this section of Chapter 6.
5. See earlier in this chapter, and the anticipation of this problem in Lewis (1995: 172).

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CHAPTER SEVEN

The two economies and the challenge of faster growth

The persistence of two economies

On 24 August 2003, President Thabo Mbeki wrote the following lines in his weekly letter published in the ANC's electronic newsletter:

It is sometimes argued that higher rates of economic growth, of 6 percent and above, would, on their own, lead to the reduction of the levels of unemployment in our country. This is part of a proposition about an automatic so-called trickle-down effect that would allegedly impact on the 'third world economy' as a result of a stronger 'first world economy'.

None of this is true. The reality is that those who would be affected positively, as projected by these theories, would be those who, essentially because of their skills, can be defined as already belonging to the 'first world economy'.

The task we face therefore is to devise and implement a strategy to intervene in the 'third world economy' and not assume that the interventions we make with regard to the 'first world economy' are necessarily relevant to the former.

The purpose of our actions to impact on the 'third world economy' must be to transform this economy so that we end its underdevelopment and marginalisation. Thus we will be able to attend to the challenge of poverty eradication in a sustainable manner, while developing the 'third world economy' so that it becomes part of the 'first world economy' (Mbeki 2003a).

This was not the first time that the ANC had recognised the extent of poverty and inequality in South Africa and argued that without

government action these problems would remain. But it was the strongest form of articulation of this position since the Reconstruction and Development Programme (RDP) had been written nearly 10 years earlier. The effect of the introduction of the ‘two economies’ paradigm in mid-2003 was to refocus the attention of the government and the ANC on the persistence of poverty and inequality. What more could be done to address this social and political challenge, and how did addressing this challenge fit into a coherent overall approach to economic and social development?

The approach taken by the ANC to the April 2004 elections was unusual for a ruling party. While the organisation missed few opportunities to celebrate the achievements of ‘10 Years of Freedom’ in 2004, it was not afraid to highlight the socio-economic disappointments of the freedom era. The party leaders spent much of the campaign identifying with the needs of the disadvantaged. President Mbeki even focused attention on the plight of the growing numbers of white people who were poor and unemployed.

The manifesto of the ANC highlighted the plight of the unemployed:

The economy has created 2-million net new jobs since 1995.
But the number of people seeking work has sharply
increased; many workers have lost their jobs; and many have
been negatively affected by casualisation and outsourcing.
As a result many, many South Africans do not have jobs or
decent self-employment; poverty is still a reality for millions
as many do not have appropriate skills, while many cannot
get credit to start or improve their own businesses (ANC
2004).

Similar points were made about the quality of services delivered to the masses, about the challenges of crime and disease, and about the circumstances of the youth and women.
The organisation sought a mandate to increase and improve the interventions of government. It believed that its successes over the first 10 years would give it sufficient credibility to remain the popular choice of the disadvantaged. As it won an increased majority of nearly 70% of voters, its strategy was obviously successful.
The targets the new government had set for itself included halving the rates of poverty and unemployment, improving skills delivery, improving the quality and accessibility of government services, rolling back diseases including HIV and AIDS, TB and malaria, and reducing corruption and the number of serious and

priority crimes. Priority crimes identified by the Minister of Safety and Security include hijackings; cash in transit robberies; and crimes involving violence like murder, rape and child abuse.

The economic achievements of the first 10 years:

The achievements of the first 10 years were considerable. Macroeconomic
policies stabilised a very unsteady economy. The fiscal
deficit came down from a giddy 9.1% in 1993, to 2.5% or less in
the 2000s. Public sector debt came down from 64% of GDP (gross
domestic product) in 1994 to about 50% of GDP in 2004. The
management of public finances improved to the point that the
Finance Minister now has room to embark on relatively ambitious
expansionary strategies without causing alarm, or even concern,
amongst financial commentators; and he is able to raise debt at far
more favourable rates because of the considerable improvements
in South Africa's sovereign credit ratings.
Monetary policy has had considerable successes too. In 2004,
the inflation rate fell to its lowest level since 1959, and the Governor
of the South African Reserve Bank (SARB) was able to bring
nominal interest rates down to their lowest level since the early
1980s. Moreover, an overhang of US$25 billion in the forward
book was completely eliminated, and the central bank's reserves
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are growing steadily, with gross reserves at about US$15.1 billion
by January 2005, and net reserves US$3.5 billion less.
In addition, a major trade reform has been accomplished with
average non-agricultural tariffs declining to less than 5%, and
imports and exports have diversified far beyond raw and semiprocessed

mineral products. The result appears to have had a considerable positive effect on total factor productivity, and hence on the capacity of the economy to grow (Cassim et al. 2002). It also contributed to the fight against inflation, as some imports cheapened and some domestic suppliers met real competition.

In sectoral terms the story is mixed. Some of the more successful sectors have been the automobile sector where exports have grown from virtually nothing to between 120 000 and 180 000 vehicles annually (depending on the exchange rate); the wine industry; and the tourism sector. Platinum mining has boomed, but this has been a response to the market rather than the result of policy interventions.

In the field of skills development, a new, very ambitious national system has been established with gradually mounting successes. The national innovation system turned round a declining trend in research and development. Black economic empowerment (BEE) has made considerable advances, and some restructuring of public enterprises has been completed.

As a result of better policies and a more favourable environment, the growth performance of the economy improved from averaging 1.4% growth and negative per capita growth in the decade before 1994, to averaging 3% GDP growth per annum and positive per capita growth since 1994.

The commitment of resources to the delivery of social services and social transfers has resulted in these aspects of government activity rising from about 44% of government expenditure in 1994 to over 56% of expenditure in 2003. In addition, the extension of infrastructure services such as water, sanitation, housing, electricity

and communications has been considerable. For example, the
number of housing subsidies approved since 1994 reached 2 million
in 2004, while the proportion of households with access to electricity
rose from 32% in 1994 to over 70% by the early 2000s (Policy Coordination
and Advisory Services, The Presidency 2003: 24–25).

There is no question that both the performance of the economy
and delivery to the poor have both improved considerably. The
problem is that growth remains modest in international terms,
the rate of unemployment has risen, and poverty remains an
inescapable reality for about one third of the population. The
government's own Ten Year Review report warned that, in spite of
the positive advances, 'if all indicators were to continue along the
same trajectory, especially in respect of the dynamic of economic
inclusion and exclusion, we could soon reach a point where the
negatives start to overwhelm the positives' (Policy Co-ordination
and Advisory Services, The Presidency 2003: 102).

Major challenges:

The first problem is the rate of growth. Though President Mbeki agued against a trickle-down approach, he was not under the illusion that one could address poverty and inequality without at the same time fuelling the engine of growth. In the same weekly letter in which he pointed to the intractability of poverty and inequality, he also wrote about the need to raise the rate of growth: '. . . the economy is growing at rates that are lower than those we need and desire . . .' (Mbeki 2003a). It is worth looking at the growth challenge in more detail.

South Africa's growth performance did improve after 1993.

When we look at it in comparative terms, though, it is evident that the rate of growth is still less than impressive.

Figure 7.1 shows that the growth performance has moved strongly beyond the very poor performance of the early 1990s. Growth is much steadier than before, and the consecutive quarters of growth since 1998 represent a more consistent performance than ever before in South Africa's recorded economic history. However, the rate of growth is pedestrian. It is consistently below the rate of growth of developing countries in general (of course, strongly influenced by the performance of China and increasingly India) and below the rate of the newly industrialised countries (NICs) of Asia. South Africa's rate of growth is similar to the pattern of the major advanced economies – the difference being that their per

capita income is six or seven times as high as South Africa's, on average.

An improvement in South Africa's per capita income at a rate of around 1% per year is not nearly fast enough to roll back poverty and unemployment. One recent study of the performance of the South African economy estimated that it would be possible to halve the rate of unemployment if the economy grew at 5% per annum on average until 2014 (Texeira and Masih 2003: 15).

The underlying reason for the lukewarm rate of growth has been a long-term decline in the rate of investment. As Figure 7.2 indicates, the rate of investment declined sharply in the 1980s, which coincided with a decline in the rate of growth. Though growth stabilised at an improved level in the mid-1990s, the low rate of investment has constrained a significant increase in the rate of growth. As it is, the ability of the growth rate to recover with a low rate of investment suggests that the efficiency of investments

Figure 7.1: Comparative GDP growth rates.

improved during the 1990s, a postulate that is supported by a range of evidence on total factor productivity (for example, Texeira and Masih 2003: 12). What Figure 7.2 also shows is that the economy was capable of investment rates over 25% of GDP in the past, as well as growth rates of 6%. This was not only true in the early 1980s, but also for periods in the 1960s and 1970s.

Figure 7.3 takes the investment and growth story a little further. It shows that it was not only private sector investment that declined – in fact, public sector investment declined more dramatically than private sector investment. Public sector investment declined from

a peak of about 16% of GDP in the late 1970s to around 4% of GDP since the mid-1990s. Part of that decline is a result of two important companies leaving the public sector in the late 1980s – Sasol and Iscor. But if you study the graph carefully you will see that the damage was already done.

When you compare South Africa's performance to other countries over the same period, the deterioration in its investment performance becomes even more obvious. In the early 1980s, and before, South Africa's investment performance was similar to Australia and South Korea – between 20 and 30% of GDP. Subsequently South Africa's performance fell dramatically, stabilising in 1994 at around 16% of GDP, while Australia continued to maintain an investment performance above 20% of GDP, and Korea never fell below 25% of GDP.

Why this dramatic deterioration in the investment performance of the economy, and what are the policy implications of the answer to that question? One of the obvious reasons is the declining appetite of private investors for the South African economy in the 1980s because of its political instability, and in the 1990s because of uncertainties about the redistributive policies of government, high interest rates and a high crime rate (Gelb 2001). The government lost much of its capacity to invest in the 1980s, as the growth rate declined and the tax collection system weakened, and its attention drifted from building the apartheid system to desperately defending it.

When the democratic government took over in 1994, it recognised that another key constraint on investment was high

nominal and real interest rates. These had risen as a consequence of mounting government debt, almost entirely raised domestically in rand-denominated bonds, and because of the tight monetary policy pursued by the central bank as part of the fight to bring the inflation rate down. The new government felt that conservative fiscal and monetary policies would ultimately raise the rate of investment through reducing the cost of capital. This was a key part of the rationale of the Growth, Employment and Redistribution (GEAR) strategy. Indeed, GEAR did succeed in lowering the cost of borrowing as South Africa's investment rating steadily improved, the risk premium declined, and the interest rate followed the rate of inflation's downward trend.

One thing that GEAR did not really reckon on was that most of the response of the private sector to lower inflation and interest rates would not be to invest more, but to consume more. As Davies and Van Seventer put it, 'The evidence suggests that the consequences of reducing the role of the public sector have not been as positive as might have been hoped . . . the reduced public deficit was matched by a falling private savings rate rather than rising investment' (2004: 151).

Why, beyond the uncertainties of the 1990s, did private investment not grow more quickly? One factor was that the underlying rate of growth was not particularly strong in a global context, as we have already shown. Other economic constraints were the volatility of the currency and the fact that the interest and inflation rates were still relatively high. Moreover, the South African and the southern African regional market are not very

large in global terms at about one sixth of the Mercosur trade pact in Latin America.

But the constraints on investment in South Africa were not limited to objective economic conditions. A new untried government – an African government at that – continued to invoke suspicion and mistrust amongst local and international investors, sometimes clouded by ignorance and prejudice. Accurate or inaccurate interpretations of the government's ability or willingness to address issues such as crime, HIV and AIDS, and the Zimbabwean impasse, as well as founded or unfounded concerns about the inflexibility of the labour market and the implications of affirmative action and empowerment, all added grist to the mill of pessimists. Some observers were concerned that the deep inherited inequalities could not be effectively turned around, which risked rising social conflict and instability.

Most of these negative factors could only be countered in the passing of time with the growing reputation of the ability of the South African government to deliver effectively and consistently.

Another important factor influencing the rate of investment was the role of the state. In the high period of apartheid, public investment reached 16% of GDP, which was unrealistically and inappropriately high. But its rapid decline to 4% of GDP was a severe shock to the system. One of the objectives that the RDP shared with GEAR was to eliminate government dissaving (public borrowing exceeding public investment) and to increase the rate of public investment as a proportion of government spending. It was a constant concern of the National Treasury that public spending,

especially by the provinces, was so heavily weighted towards social transfers and salaries, and so little was devoted to investment expenditure. It is a notable fact that in spite of all its macroeconomic successes, government has not yet been able to completely eliminate dissaving.

There are several reasons for this. One stems from the inexperience of management in national, provincial and particularly local government, which has hindered its ability to develop and implement capital projects. The restructuring of the system of local government in 2000 added to discontinuities, even if temporarily and for good reason. Another limitation on public investment has been the cautious conservatism of the ANC government – a reluctance to incur debt where the outcome of the expenditure was risky or speculative, deriving from a fear of losing sovereignty as a result of indebtedness. Besides, beyond some obvious social infrastructure programmes, there were few very good public projects on the table for the first several years of the democratic era. Another constraint on government investment was the pressure on provinces to employ teachers and health-care workers, and to increase social transfers – at the expense of capital projects.

All these issues were recognised by government. As soon as the deficit was reduced to a manageable level and the revenue system was delivering due to better management and more optimal tax policies, the Treasury shifted to a strongly pro-investment stance. The 2001 budget introduced a renewed focus on infrastructure

investment with targeted allocations to national departments and a supplementary infrastructure grant to the provinces (National Treasury Budget Review 2003: 130). This was extended in subsequent budgets with the establishment of the Provincial Infrastructure Grant (PIG) and the Municipal Infrastructure Grant (MIG). These are conditional grants to provinces and municipalities that have to be spent on capital projects within defined parameters. Public enterprises were also encouraged to review their investment patterns, and in 2004 government announced that it would review both the investment plans and the financing mechanisms for public enterprises.

The initial response to this shift in stance was slow. Most of the government and provincial departments, municipalities and public enterprises have taken time to gear up to higher rates of investment. But Treasury continues to press forward, and in some key areas such as provincial spending on roads, hospitals and schools, investment spending is growing fast. Total public sector investment plans for the three-year Medium Term Expenditure Framework period 2004/05–2006/07 totalled R267 billion according to Treasury estimates early in 2004 (National Treasury Budget Review 2003: 131). If this level of spending were realised, public sector investment would rise from 4% of GDP to over 6% of GDP.
But, even if the rate of growth increased as a result of higher public and private sector investment, would this directly offer improvements for the lives of the marginalised poor in South Africa? Not to a great extent directly, because the location of the marginalised

poor in the society has tended to trap them in a state of poverty and dependence on remittances and social transfers. President Mbeki introduced the metaphor of two economies to highlight this challenge.

The challenge of the second economy:

The second economy does not exist at a certain place, and it does
not consist of an integrated economic system as such. It is essentially
a condition – the condition lived by millions of people on the
margin of the modern, industrial economy. They are linked to the
industrial economy, but are not in it. They are people without a
steady income based on their own economic activity. In other words,
The two economies . . . 245
they are households with no members in steady employment,
whether in the formal or informal sector, and without a significant
income-generating asset of their own. Such people mostly live in
the informal settlements clustered around our towns and cities, in
rural slums, and in poor, remote rural communities. For analytical
purposes, the second economy is a metaphor for 'the marginalised'.
This [second] economy is a product of the colonial and
apartheid economy and society created by successive minority
regimes, during a period of three centuries. More recently,
the process of global integration has exacerbated certain
features of the divided economy in that competition from
countries with cheap, relatively skilled labour makes it more
difficult to find employment for unskilled South African
workers in the tradable sector (Mbeki 2003: 2).
It is not easy to measure the number of people or households that

we can classify as part of the second economy. As unemployment is
a key indicator of poverty, one approximation would be to measure
the total number of employed people as a proportion of the
economically active population: 74% (Statistics South Africa 2005).
But many households have more than one member in full-time
employment. A more accurate measure would be to take the
number of households falling below a poverty line. A 1999
measurement indicated that 3.7 million households out of 11.4
million households were below the poverty line, based on the poverty
line developed in the 1998 Poverty Report prepared for The
Presidency (Bhorat 2003: 23).
1
These measures suggest that about
30% of the households in South Africa are marginalised households.
International studies have shown that highly unequal societies
are generally not able to roll back inequality without some significant
interventions by the state. They have also shown that where
inequality is reduced, risks of instability are reduced and the
economies tend to grow faster (Birdsall and Londono 1997; Fields
2000). There is a very powerful case for carefully designed and

properly managed interventions to build a staircase between the
two economies, and to meld them together.