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South Africa's Governance and Growth Challenge

By Jeffrey Herbst and Greg Mills

Synopsis

South Africa, once the most advanced African state, has fallen behind its neighbours in economic growth. Its welfare system is also placing undue strain on its revenue base. Is South Africa on an economic decline? Is more effective government part of the answer?

Commentary

THERE IS considerable gloom today about South Africa's economic performance, especially as the rest of Africa, so long seen as a basket-case, is demonstrating unprecedented economic dynamism. The African Development Bank (AfDB) now ranks South Africa in the bottom ten of African countries in its annual economic growth outlook.

After 1994 it was assumed that South Africa, then comprising around a half of the sub-Saharan Africa's total GDP, would be the locomotive of regional economic prosperity and would pull other, less developed neighbours along with it. The reality is, however, disappointingly different.

Africa rising, South Africa lagging behind

As noted by the AfDB (Chart1), while South Africa's real per capita income (in constant US dollars) has increased since 1994, the ratio of its income to the rest of sub-Saharan Africa has decreased. This is especially so in recent years, as Africa in general has performed better than South Africa. Since 2008, South Africa seems to have plateaued while African growth has remained relatively high (accordingly, the ratio drops).

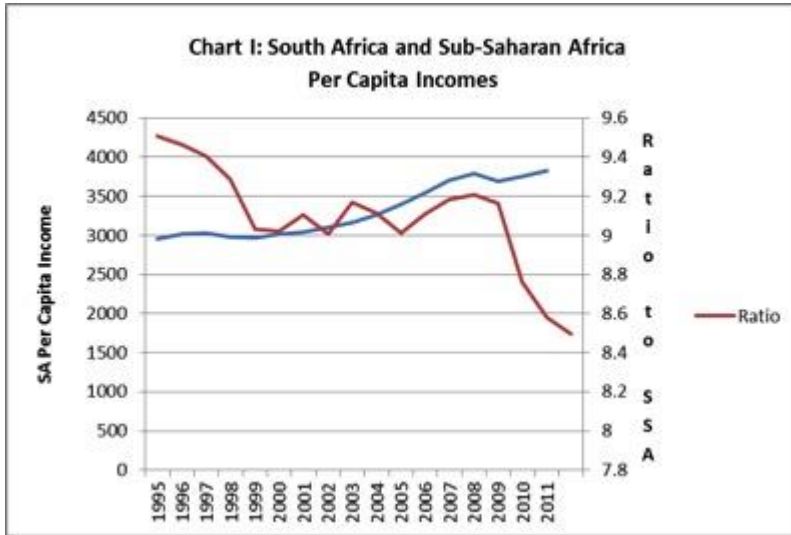


Chart 1: Comparing Per Capita Incomes

Today South Africa's GDP comprises just 30 percent of sub-Saharan Africa's total. In part this is good news, since the African continent is no longer so economically lop-sided and its people unequal.

But South Africa's poor performance suggests that neighbours looking to integrate more closely with it to lift their own prospects might think again. Also, South African businesses are correct in targeting Africa outside of South Africa as a key source of growth. For example, this past year, while the revenue of the South African packaging company Nampak was up seven percent overall, in Africa it was up 19 percent. While its South African trading profits were lower, they were up 39 percent from Africa, comprising more than one-fifth of those of the group.

Similarly, Imperial's African logistics business - including in South Africa - saw operating profit increase by one percent, and revenue by 9.5 percent. However, revenue in Africa, excluding South Africa, was up 23 percent to R4.6 billion, with operating profit up 45 percent to R224 million.

Reasons for South Africa's relative decline

South Africa is locked in a low-growth trap. The AfDB's chief economist Mthuli Ncube says the country's great inequality is a drag on growth, but could be resolved if we can help South Africa create more jobs, intervene in the quality of training, vocational education in job search schemes, capacitating companies to take on more youth and new employees'. Critically, the best way to reduce inequality is through the creation of new jobs.

But the country remains trapped in a high-unemployment bind as well. Growth averaged just over three percent for the two decades from 1993. Unemployment (broadly defined, including discouraged work seekers) has risen today to over 35 percent of the workforce, or more than seven million people.

At the same time, South Africa has developed a welfare system which is placing unsustainable demands on its tax base. *The Economist* noted recently that 'Almost 44 percent of households rely on welfare payments to make ends meet. In five of South Africa's nine provinces at least half of households rely on welfare. The share of individuals claiming social grants has been steadily rising, toward 30 percent.' South Africa is at or past the limit of redistribution via the tax system and will have to grow more quickly in order to reduce poverty significantly via job creation.

More effective and not simply more government is part of the answer. While the effect of the apartheid legacy should not be overlooked or understated, it is the steady decline in governance since the advent of non-racial democracy in 1994 and especially in the 21st century that is of more concern, in spite of the improved scrutiny that goes with democracy.

For example, South Africa's ranking on Transparency International's Corruption Perception Index fell from 38th in 2001 (above Costa Rica) to 69th in 2012, and on the Index of Economic Freedom from 58th in 1999 to 74th in 2012. Its position on the World Economic Forum's Global Competitive Index slipped from 45th in 2008 to 53rd in the 2013-14 ranking.

While it does well on some aspects of governance such as the quality of its institutions (41st) and accountability

of private institutions (2nd), it scores poorly on other key indicators such as the diversion of public funds (99th), wastefulness of government spending (79th), public trust in politicians (98th), and security (109th).

Similarly South Africa's score on the World Bank's Worldwide Governance Indicators that measures 215 economies across a range of governance indicators fell from the 74.6 percentile in 1998 to the 64.9 percentile in 2011.

Other big African countries including Ethiopia and the Democratic Republic of Congo have similarly struggled compared to the rest of the continent, despite recent high economic growth rates nudging at times over ten percent. It appears that scale in Africa is not an advantage. As a result, South Africa's relatively large population may be another challenge to be overcome through better governance.

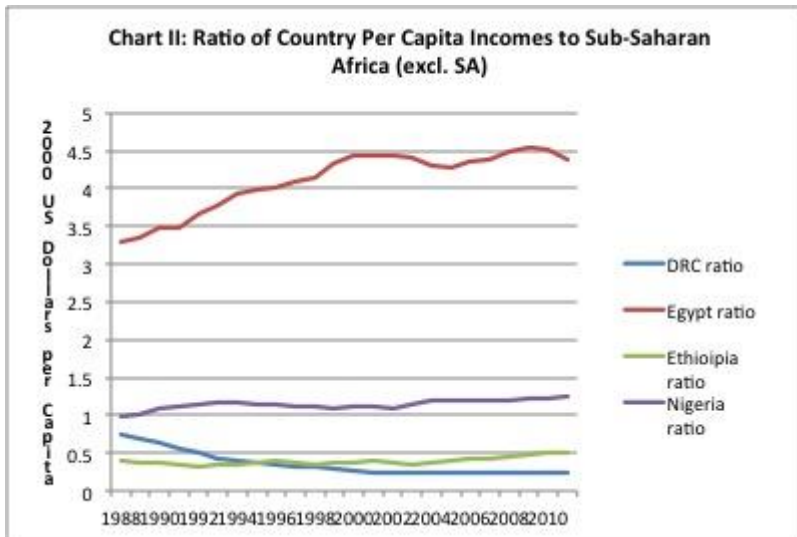


Chart II: Ratio of Per Capita Incomes

Indicators of governance

Of course it would be politically expedient to selectively dismiss the governance challenges signalled by these indices.

China, for example, is among those unhappy about its lowly ranking on the *Doing Business* rankings, in 91st place. Instead of doing something about it, they are among a group which includes anti-business NGOs which have pressured the World Bank to scrap the index. However, since it reflects a willingness - and ability - to implement market-friendly policy reforms designed, as the economist Steve Hanke notes, to reduce the costs imposed by government on businesses and increase prosperity, one can only assume critics are unwilling or unable to do so.

South Africa has, in fact, performed consistently in the *Doing Business* rankings, up from 41st in 2012 to 39th in 2013. Yet in key areas it performs badly and in others too well. In trading across borders it sits at 145th, and in getting electricity 150th. But in accessing credit it is number one.

If South Africa can emulate the approach of those countries at the top of the *Doing Business* table - of transparent and efficient government - it will create the jobs it so sorely needs. There is no other path to reducing poverty.

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