

Chapter 5 Economic Freedom in South Africa and Constraints on Economic Policy

Richard J. Grant

Introduction

The index published in the *Economic Freedom of the World* (EFW) covers two very distinct eras in South African history. The transition from the apartheid era to the “new South Africa” became a fact in 1994 after years of achievement, uncertainty, conflict, and negotiation. Neither of the two eras proceeded uniformly: each produced manifestations of the natures of the parties that dominated each era. Both of those parties, at some time and to some extent, expanded government power when it suited them. What differed was the underlying culture and philosophical justification that shaped the respect for law and the limits on the extent and directions in which the power was expanded. Another difference is that the party of one era could learn from the experience of the one that came before.

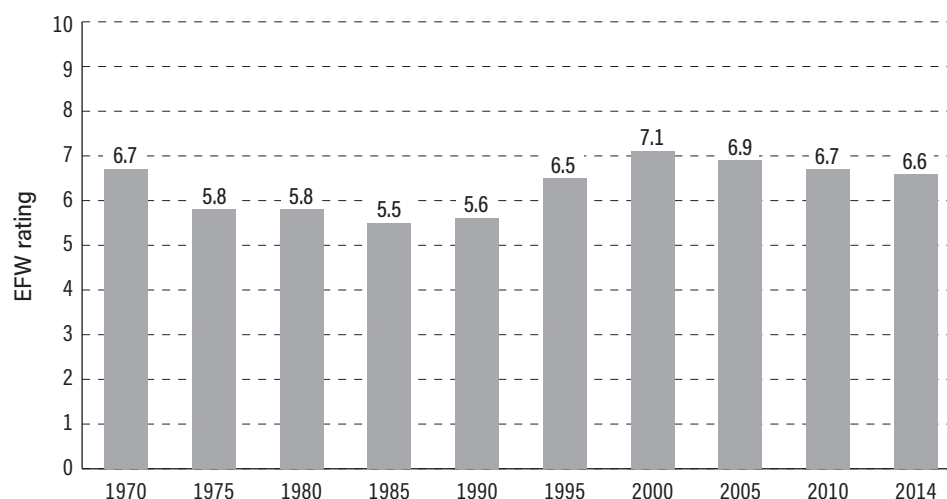
The years from 1970 through the transition of the early 1990s

Perhaps the most interesting period in South African history, at least from the perspective of economic freedom, was the 10-to-20 year stretch that culminated in the transition to universal suffrage in 1994. During the years from 1970 through 2000, South Africa’s overall *Economic Freedom of the World* (EFW) rating followed a clear U-shaped path (figure 5.1). It bottomed out in the mid-1980s at the level of 5.5 before rising to its highest levels in 2000 and 2003. But only four of the five EFW areas followed that path, reaching their lowest levels by 1985 and climbing for the next 15 years. The outlier was Area 2: Legal System and Property Rights, which dropped from 7.4 in 1970 to 6.2 in 1980, and then dropped steeply

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Figure 5.1: South Africa's overall EFW Ratings, 1970–2014



Sources: Gwartney, Lawson, and Hall, 2016, *Economic Freedom of the World: 2016 Annual Report*.

to 2.9 in 1990 before bouncing back to 6.1 in 1995. Area 2 would continue to rise to 6.6 in 2001, where it peaked before entering its current downtrend.¹

The 1960s and 1970s were a period of decolonization in much of Africa, with newly independent nation states and their governments facing steep learning curves. In Western countries, it was a period of expanding governments, social transformation, civil unrest, and worldwide monetary disruption. Divergent inflation rates, particularly that of the US Dollar over gold, led to the breakdown of the Bretton Woods fixed exchange-rate system. The consequent sudden divorce of the US dollar from the last vestiges of the gold standard resulted in an international monetary system composed of national fiat currencies and central banks with little experience in the management of freely floating currencies.

For much of the world, inflation rates soared and fluctuated throughout the 1970s and into the 1980s. South Africa proved unable to resist these disruptions. As the international monetary order came untethered, the rand began to fluctuate, at first in slow steps around its Bretton Woods value, and then it dropped to a value of \$1.50 where it held firm for about three years. Then it strengthened again slightly but by the end of 1980 had begun its long-term decline. As the price of gold and other commodities rose during the 1970s, South Africa's export revenues increased significantly. This also made more tax revenue available to the government.

In 1976 and 1984, Soweto uprisings put South Africa in the international spotlight, in each case bringing pressure for change. In the late 1970s, the United States government prompted IMF gold sales in order to depress the gold price and with the intention to put pressure on the South African government to withdraw its support from the Rhodesian government and thereby to pressure the Rhodesians to extend the franchise (Johnson, 2015). Soon after, Rhodesia began its transition into what is now Zimbabwe.

By the mid-1980s, with economic conditions deteriorating, and particularly after the 1984 Soweto uprisings, much of the world community suddenly

1 For the significance of economic freedom in explaining differences in economic conditions, see Easton and Walker (1997) and Gwartney, Holcombe, and Lawson (1998). Grubel (1998) shows the importance of economic freedom to several measures of human welfare.

came to expect change. Many were expecting such an announcement in a much-anticipated speech by President P.W. Botha in August 1985. But in what became known as the “Rubicon speech”, the president took a particularly hard line and dashed expectations of reform. The public relations impact would prove to be expensive. Shortly thereafter, Chase Manhattan Bank led a credit boycott that was joined by many banks and precipitated a credit crisis and capital shortage in South Africa. Many other multinational companies divested their corporate interests in South Africa.

As recorded in Area 2: Legal System and Property Rights, of the EFW ratings, perceptions of the legal system and governance in South Africa deteriorated markedly during the 1980s. The currency weakened severely and economic growth would remain slow throughout 1980s (and until the transition). Importantly, all of this occurred in the context of the Cold War. Security concerns increased both internally and on the borders. The African National Congress (ANC) and its allies, most obviously the South African Communist Party (SACP), were backed both monetarily and in kind by the Soviet Union. The prospect of a communist government in South Africa necessarily caused Western countries to side with the South African government while at the same time expressing displeasure and urging reform.

The South African Defense Force had many years of experience fighting near and beyond its borders in southern Africa. The battles were generally of a small scale and easily won by the better-trained and equipped South Africans. During the mid-1980s, and climaxing during 1987 and 1988, the Angolan border war became very expensive as the South Africans faced increasing numbers of Cuban ground troops and Soviet-bloc air power and logistical support. Although the Cubans seemed willing to lose large numbers of troops to achieve their goal, the Soviet Union was clearly weakening and would soon lose its control of Eastern Europe and of several of its own Soviet republics.

Ironically, as Soviet power waned, the strategic importance of South Africa to the Western powers would also appear to wane. All sides had an obvious interest in ending the conflict, and negotiations subsequently resulted in the cessation of open hostilities and in the independence of South West Africa, now Namibia.

The South African government had responded to increasing international pressure and isolation—which included trade and credit sanctions, boycotts by sports teams and entertainers, and restrictions imposed by several countries on the entry of South African passport holders—by increasing its intervention in the economy and tightening its control over civil activities. Some of these interventions were intended to mitigate sanctions and to foster the domestic development of strategically important industries, such as armaments and electronics. This also gave increased importance to state-owned enterprises, such as Sasol, which was created in 1950 to take advantage of South Africa’s abundant coal supplies for conversion to oil, gasoline, and other chemical products. But the economy-wide array of interventions clearly went beyond sanctions mitigation. The excesses of the protectionist and regulatory policies almost certainly made it more difficult for South Africans to conduct business and to cope with sanctions. Economic activity suffered accordingly.

This interventionism and sense of external hostility would explain South Africa’s falling EFW rating through the 1970s and 1980s and why Area 2: Legal System and Property Rights, lagged the other four areas as those measures began to rise in the late 1980s.

Demonstration effect

The 1980s had supplied the world with the demonstration effect in Britain and the United States of the free-market reforms led by Prime Minister Margaret Thatcher and President Ronald Reagan. The resulting Western prosperity, and the increased military capacity that this prosperity enabled, undoubtedly contributed to the collapse of the Soviet Union and to the discrediting of socialism. Certainly, there did remain those who insisted that it was only “actually existing socialism” that had failed. But the ideological confidence of many in the ANC, and even in the SACP, had been shaken at least briefly in the run-up to the transition. Similarly, several members of Parliament and some cabinet ministers had already, by the late 1980s, influenced government policy toward slower growth in spending, a lower inflation rate, greater freedom to trade, and less heavy-handed regulation. There was even very serious consideration by the Minister of Trade and Industry of proposals to privatize major state-owned enterprises such as Sasol (oil) and the steel producer, Iscor (which was privatized 10 years after the transition and is now part of ArcelorMittal).²

The government was further influenced by the recognition that strong governmental powers would be less desirable when someone other than themselves was in office. The prospect of a future ANC government, composed of personnel predisposed to a socialistic world view and inexperienced in actual governance, called for significant institutional and policy improvements before any such transition. As border threats receded and the ban on the ANC was lifted, the EFW scores for Area 2: Legal System and Property Rights, would improve sharply. The role of the military would decline as security concerns shifted, in relative terms, from external threats to internal unrest. Near the end of 1989, when the Berlin Wall came down and the Soviet bloc began visibly to break up, President F.W. de Klerk took the decision to dismantle South Africa’s nuclear weapons program—at that time, South Africa had six completed nuclear warheads as well as delivery capability.

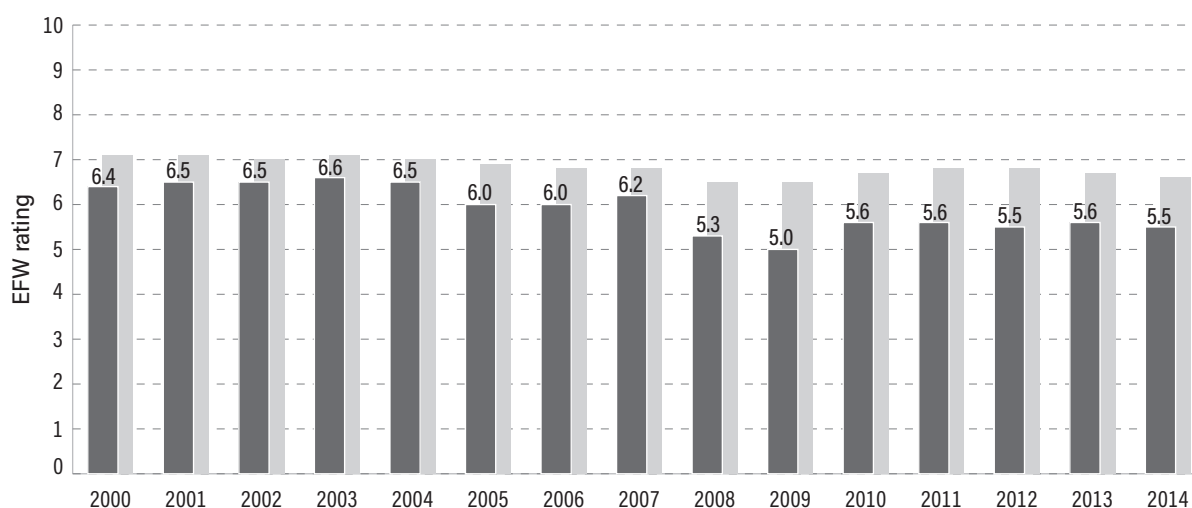
From the late 1980s began a period of about a dozen years of sustained improvement in economic freedom that is unmatched throughout the history of EFW measurement for South Africa. The momentum from the political energy that launched the economic and legal reforms to prepare for, and to carry South Africa through the transition would be sustained for only half a decade by the new government. The period of improvement would continue through the 1990s, but would peak by 2000.

Performance since 2000

After South Africa’s overall EFW rating reached its highest level of 7.1 in 2000, where it plateaued until 2003, the overall trend in economic freedom would be slowly downward, reaching 6.6 in 2014. Four of the five areas would pull the overall trend downward, while only Area 3: Sound Money, would show a positive trend, albeit much slower than in the 1990s.

² Farr, Lord, and Wolfenbarger (1998) show that economic freedom Granger-causes the level of economic well-being for both industrial and nonindustrial countries. They also found that economic well-being has some positive feedback effect on economic freedom and, importantly for this point in South African history, a positive causal effect on political freedom.

Figure 5.2: South Africa's ratings for EFW Area 1, Size of Government, and overall, 2000–2014



Source: Gwartney, Lawson, and Hall, 2016, *Economic Freedom of the World: 2016 Annual Report*.

Given the special place in history that South Africa lived out in the 1980s and 1990s, it is understandable that the upward momentum in economic freedom enjoyed during this period would be hard to sustain given the political and demographic realities. No country has scored a perfect 10, and Hong Kong, which regularly holds the highest ranking, only occasionally, and just barely, breaks above a rating of 9.0 on the EFW index. But South Africa is not holding its position in either the rankings or its absolute rating. By both measures it has declined, giving up its gains. A more detailed study of the five area measures will help us understand why.

Area 1: Size of Government

In 2000, South Africa's performance in Area 1: Size of Government still had a bit of momentum, rising from 6.45 to its peak of 6.55 in 2003. From there, it fell somewhat roughly, reaching 5.02 in 2009 before rising again in 2010 and leveling off near its rating of 5.54 through 2014. That makes Area 1 South Africa's lowest scoring component, well below its overall EFW score of 6.44 in 2014 (figure 5.2). Compared to the rest of the world, this component ranks 118th, which is below South Africa's overall ranking of 105th.

Component 1A: Government Consumption in 2000 had a rating of 5.17 but by 2014 had fallen, albeit gently, to 4.37. This contrasted rather starkly with component 1B: Transfers and Subsidies, which maintained the best score within Area 1 throughout the period. But it did fall gently from 8.62 in 2000 to 8.30 in 2014.

After rising significantly before the political transition, the score for component 1C: Government Enterprises and Investment plateaued at 8.0 over the ten-year period from 1995 to 2004. From there it fell precipitously to a level of 2.0 by 2009 before rising to 4.0 in 2010 where it remained through 2014.

Component 1D: Top Marginal Tax Rates showed improvement from 4.0 in 2000 to 4.50 in 2002, before hitting a volatile period from 2007 to 2009 and leveling off at 5.50 through 2014. This rating for component 1D is an average composed of two sub-components: a rating of 6.0 for Sub-component 1D(i): Top marginal income tax rate, and a 5.0 for 1D(ii): Top marginal income and payroll tax rate.

Area 2: Legal System and Property Rights

After the volatility of the score for Area 2: Legal System and Property Rights in the years leading up to and through the transition, the area score never did return to the high level (7.41) recorded for 1970. It reached its post-transition peak of 6.64 in 2001 from which it began a downtrend until 2009. It bottomed at 5.44 and then entered a consolidation period near its 2014 level of 5.79 (figure 5.3). Not only did the score for Area 2 show a general downward tendency during the period since 2000, it also remained below the overall EFW score in absolute terms during the entire period. But chain weighting is much kinder to the Area 2 score, allowing it to rise above average and spend most of the second half of the period above the overall EFW score. Similarly, despite the low absolute rating of 5.79, Area 2 ranked 67th compared to the rest of the world. This makes it the only South African component rating to place in the second quartile of countries. The other four area scores are all in the third quartile.

The best performing component within Area 2 has been 2D: Military Interference in Rule of Law and Politics, with a steady score of 8.33 since 2000. This compares favorably with the score in the pre-transition period in South Africa and with the ongoing situation in most of the rest of Africa. In contrast, neighboring Botswana's score for 2D has recently fallen from 10 to converge with South Africa's 8.33. Interestingly, this score for the United States fell from 10 and stabilized at 6.67 during the period since 2001.

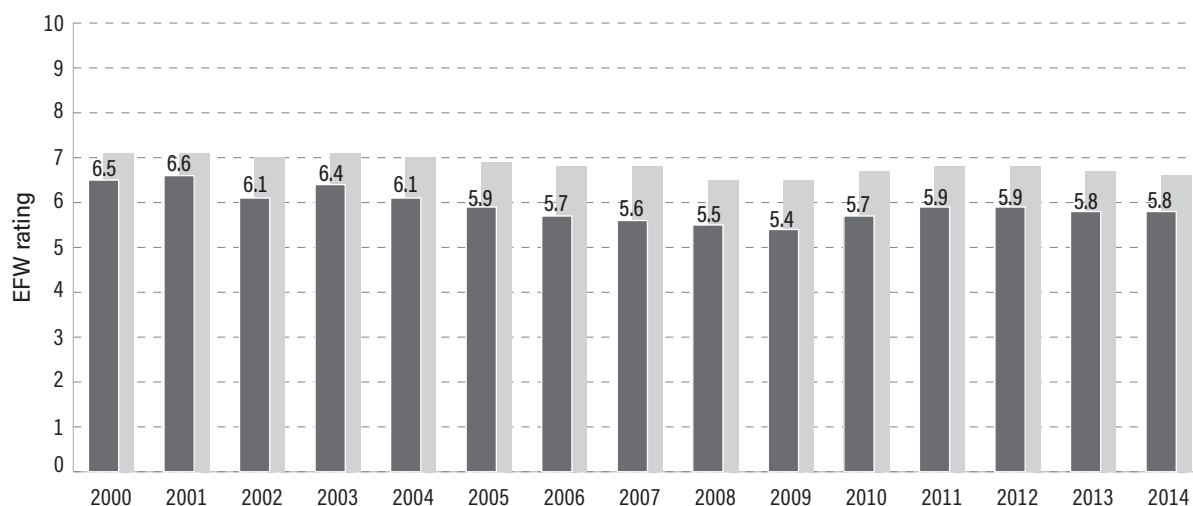
Three of the Area 2 components, 2A: Judicial Independence, 2C: Protection of Property Rights, and 2G: Regulatory Restrictions on Sale of Real Property, had by 2014 converged near the level of 7.4. The score for 2C: Protection of Property Rights peaked in 2007 and the likelihood of a continued downtrend has been made more real by recent talk within political circles of the expropriation of land without compensation.³ The score for component 2G: Regulatory Restrictions on Sale of Real Property has generally risen since its inclusion as an EFW component in 2003, but bureaucratic inefficiencies in the property transfer process remain a serious impediment, imposing delays and other burdens on citizens who undertake transactions in the property market. Component 2A: Judicial Independence has historically enjoyed a good reputation in South Africa but, although its component score has improved slightly since the transition, it appears to have hit a peak (8.0) in 2003 and has fluctuated significantly since then.

This is related to the next best performing component, which is 2B: Impartial Courts; it had a score of 6.89 in 2014. Its downtrend since the transition appears to be correlated with the earlier downtrend in the judicial independence score, but it has stabilized since 2008 while the judicial independence score has strengthened.

The remaining components of Area 2 all lie well below the average and have remained there since their respective introductions to the EFW index. Since it was added to the index in 2003, Component 2F: Legal Enforcement of Contracts has remained steady with a very low 3.93 rating. This means that South Africans bear a heavy burden in terms of the time and monetary costs involved in enforcing contracts. Such high costs are clearly a drag on the number and scope of transactions, both business and personal, that may be undertaken.

3 Norton (1998) shows that not only are property rights required for economic development and growth but that well-specified property rights improve the well-being of the world's poorest inhabitants.

Figure 5.3: South Africa's ratings for EFW Area 2, Legal System and Property Rights, and overall, 2000–2014



Source: Gwartney, Lawson, and Hall, 2016, *Economic Freedom of the World: 2016 Annual Report*.

South Africa is known for its high crime rates (Johnson, 2009, 2015; Mercer, 2011). Component 2I: Business Costs of Crime has consistently been the worst in Area 2. It entered the index with a dangerously low value of 2.7 in 2005, but by 2008 had fallen to a frightening 1.16 before rising by 2011 to plateau near its 2014 level of 2.95. This reflects the fact that crime drains significant resources from business activity, thereby limiting the extent of trade. It also reduces trust and openness in the workplace and limits community relations.

Directly related to this, and a large part of the problem, is reflected in Component 2H: Reliability of Police, which entered the index in 2005 with a 3.88 rating and has struggled to rise to 4.39 in 2014. Although quality varies widely, police are generally seen as poorly trained, poorly managed, and are very often suspected of corruption. But more sympathetically, the breadth and magnitude of the task facing them would be daunting to any police force, especially in the context of an underperforming economy and with a government that misallocates resources and is itself widely perceived as corrupt.

In terms of quality, there is a wide divide between the court system and the police services. The presence of the weaker link will reduce the efficacy of the other. This partly explains the consistently low score for Component 2E: Integrity of the Legal System, which entered the index in 1995 with a 4.11 rating but by 2000 had fallen to a floor of 3.33 where it remained until 2002. After a brief jump to 5.0, its rating plateaued at 4.17 from 2004 until 2012. In 2013, it fell back to 3.33 where it remained in 2014. As is true in any country that is overburdened with intrusive or inappropriate laws, regulations, and taxes, a so-burdened population can be expected initially to lose its respect for particular laws and then, if the intrusions persist over time, for law in general. Such loss of respect will be magnified in communities where people feel particularly ill-served or disadvantaged. To the extent that this is true, the “popular observance of the law” will suffer. One observes this in South Africa.⁴

⁴ Similar effects and their impact on the evolution of law and the context of economic freedom are described by Benson, 1998.

Area 3: Sound Money

The score for Area 3: Sound Money began to improve after 1980 and accelerated through the transition period (figure 5.4). Since 2000, Area 3 has been the best performing of the five EFW components. From a level of 7.9 in 2000, it fluctuated mildly before declining to 7.5 in 2008 and then moving back up to peak at 8.3 in 2011. Since then it has been in a mild decline, reaching 8.0 in 2014, slightly above its level in year 2000. But a rating of 8.0 gives this a component ranking of only 99th in the world, just a few places above South Africa's EFW ranking of 105th.

The best performing component within Area 3 has been 3B: Standard Deviation of Inflation, which contributed a score of 9.49 in 2014. All of the monetary components declined from the beginning of the post-Bretton-Woods era, but 3B declined the least. Changes to the inflation rate were the most pronounced across 1980, during the run-up through double-digit inflation to a peak of over 18% in 1986. South Africa's double-digit inflation era ran from about 1974 through the end of 1992. The most significant drop in the inflation rate occurred in the early 1990s; it then gradually declined to below 6% by the end of 1999. In 2000, the EFW Component 3C: Inflation was 8.93 but declined to 8.17 in 2002, during a brief period of rising inflation and disruptive weakness in the rand. Then, over the next two years, the score for 3C rose to its highest level of 9.72 in 2004, a year of near price stability.

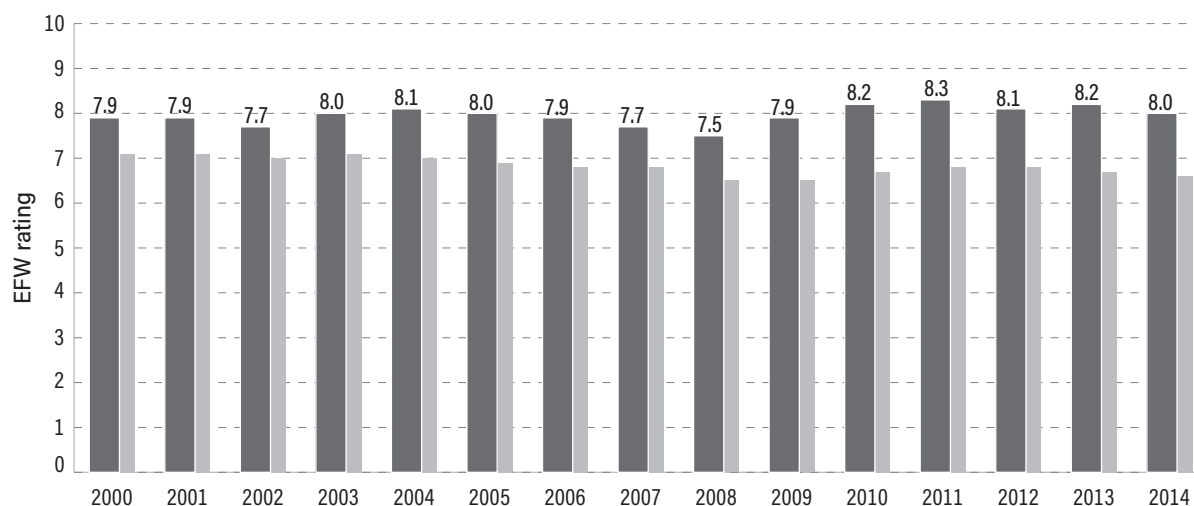
Although inflation remained relatively low during the next two years, by 2008 it briefly hit double-digit levels again before falling back to levels closer to 6%, around which it has fluctuated in recent years. The 3C score reflected these changes, reaching 8.72 in 2014. The score for 3A: Money Growth is based on the M1 monetary aggregate and has moved very closely with the inflation score. It was 8.93 in 2014.

With few exceptions, the scores for 3A, 3B, and 3C have been above the average score for Area 3: Sound Money. Pulling the average down has been component 3D: Freedom to Own Foreign-Currency Bank Accounts. This is part of the broader exchange-control restrictions that have distorted capital movements in and out of South Africa, particularly by citizens, during the past several decades. Although current restrictions are much less severe than they were at their peak—a period that included a dual exchange-rate system—since 2000 the score for 3D has been flat at 5.0 and seems unlikely to change in the current policy environment. To put its impact in perspective, if the ownership of foreign bank accounts were unrestricted, the Area 3 score would have been more than a point higher throughout its history and would have been 9.29 in 2014.

Area 4: Freedom to Trade Internationally

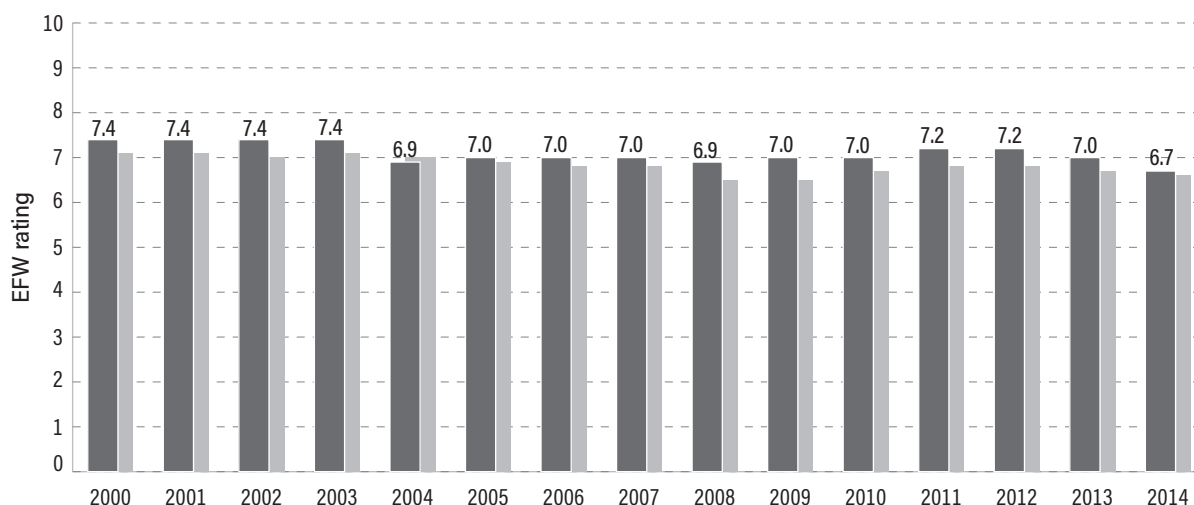
Since the transition and the end of sanctions, the freedom to trade internationally has been a much less complicated topic. Pressure for inward development and import substitution has persisted across regimes but by 1990, when the ban on the ANC was lifted and the political class was seeking greater openness, the rating for Area 4: Freedom to Trade Internationally was rising and would plateau at 7.4 from 2000 until 2003 (figure 5.5). In 2004, it would drop to another plateau and would remain at or slightly below 7.0 until 2010. After a brief rise, it would decline again to sit at 6.7 in 2014, only slightly more than its score during the transition 20 years earlier. It is also only slightly better than South Africa's 2014 overall EFW score of 6.64; its world ranking for Area 4 was 101st, which is also slightly better than its overall EFW ranking of 105th.

Figure 5.4: South Africa's ratings for EFW Area 3, Sound Money, and overall, 2000–2014



Source: Gwartney, Lawson, and Hall, 2016, *Economic Freedom of the World: 2016 Annual Report*.

Figure 5.5: South Africa's ratings for EFW Area 4, Freedom to Trade Internationally, and overall, 2000–2014



Source: Gwartney, Lawson, and Hall, 2016, *Economic Freedom of the World: 2016 Annual Report*.

Component 4A: Tariffs has tracked fairly closely the overall Area 4 score and in 2014 had a score of 7.3, which was slightly above the average. The tariff sub-components, 4A(i): Revenue from trade taxes and 4A(ii): Mean tariff rate both score well above average with ratings of 8.71 and 8.48, respectively. Neither of these suggests a tariff burden that is far out of line with the rest of the world, but the wide range of specific tariff rates does imply either a degree of conscious protectionism or an internal policy of centralized management of production and consumption patterns. Sub-component 4A(iii): Standard deviation of tariff rates has deteriorated significantly from its level of 5.92 in 2000, from which it fell to 3.22 in 2011. Since then it has gradually improved, rising to its 10-year high of 4.71 in 2014, but remaining well below its 2000 level.

Component 4B: Regulatory Trade Barriers begins the period since 2007 at 7.56, slightly above the Area 4 average, but dropped sharply in 2004 to plateau near 6.0 for the next six years. After a slight rise through 2013 it plunged again to a level of 4.94 in

2014. Of the two subcomponents that make up 4B, it was not 4B(i): Non-tariff trade barriers that caused the erratic movements. Certainly 4B(i), which dropped slightly from 6.62 in 2000 to 6.22 in 2014, does indicate an ongoing and slightly worsening policy resistance to the competition of imported goods in the domestic market. (This does also include the effects of tariffs.) But the big impact on stability of the component score comes from 4B(ii): Compliance cost of importing and exporting, which measures the time cost at the border of importing or exporting ordinary dry goods.

One of the more visible interferences in the lives of South Africans is measured by Component 4D: Controls of the Movement of Capital and People, which has improved only slightly from 4.12 in 2000 to 4.60 in 2014. This places it way below the Area 4 average. Its Sub-component 4D(i): Foreign ownership/investment restrictions tracks relatively closely to the Area 4 average, falling from 7.46 in 2000 to 6.73 in 2014. South Africans have faced some form of exchange controls and capital controls for most of the past century. This has made it difficult to expand and diversify businesses or portfolios. Although size limits on the various controls have been loosened over the years, the time and resources consumed in fulfilling the bureaucratic requirements has continued to be a burden and a source of increasing uncertainty.

Similarly, the limits on foreign exchange purchases have also been raised but continue to impose costs on a wide range of activities. Of the 13 specific capital controls recorded by the International Monetary Fund, the latest report (2016b), like previous reports, listed South Africa as imposing 12 of them. This is what is measured by Sub-component 4D(ii): Capital controls, which fell from a rating of 2.0 in 1995 to 0.77 in 2000 and has remained flat at that low level ever since.

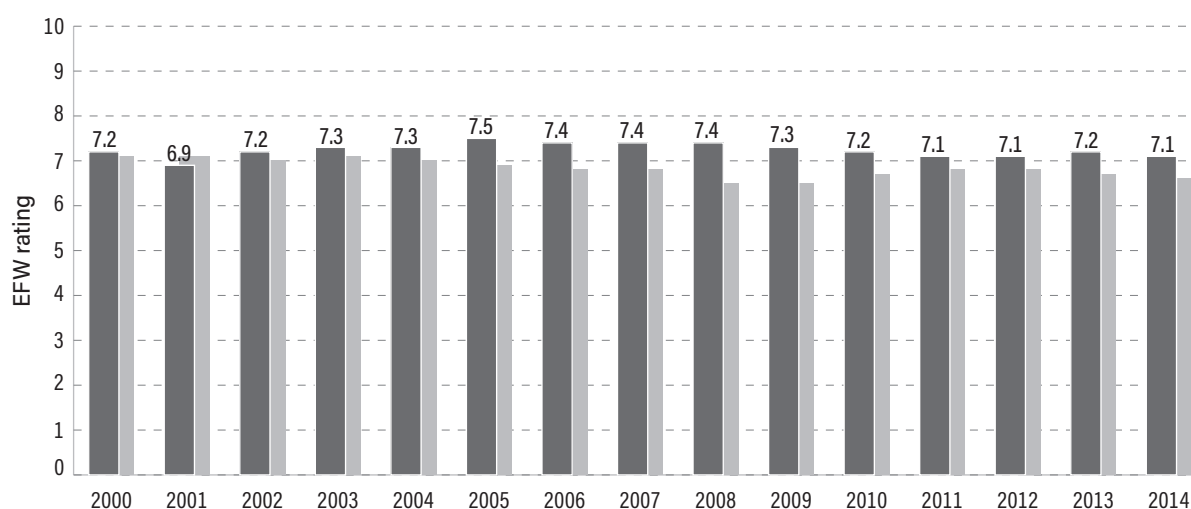
Despite the existence of capital controls, the South African rand is officially convertible and there is no significant parallel black-market trade in the currency that would generate a distinct shadow exchange-rate. That is why Sub-component 4C: Black-Market Exchange Rates has, since 1995, had an unchanging score of 10. But this perfect score should not be interpreted to mean that there are no costs imposed on those who attempt to move their capital through or around the bureaucratic restrictions.

It has long been recognized that capital controls are ultimately people controls, and in South Africa that evolved to have a more restrictive impact on citizens and residents than on foreigners. Most countries have visa requirements that limit the physical entry and activities of foreigners who might wish to visit. Sub-component 4D(iii): Freedom of foreigners to visit measures the percentage of countries for which the visited country requires foreign entrants to hold a visa related to the purpose of the visit. Since the measure began in 2005, South Africa had a flat score of 7.97, but that measure dropped to 6.29 in 2013 when visa restrictions were expanded to curb a heightened influx of migrants seeking employment. This was a response to political pressures from citizens and legal residents who saw a direct competitive threat to their livelihoods from the increasing labor supply. Protests against the presence of the migrants often broke out in violence.

Area 5: Regulation

The measure Area 5: Regulation is broad and has been fairly stable, improving from 7.20 in 2000 before peaking at 7.5 in 2005 and then gently falling to 7.1 in 2014 (figure 5.6). That gave it the second-highest score among the five EFW areas, a position that it has held for most of the time since the transition. Compared to other countries, Area 5 ranked 81st in 2014, putting it high in the third quartile.

Figure 5.6: South Africa's ratings for EFW Area 5, Regulation, ■ and overall, ■ 2000–2014



Source: Gwartney, Lawson, and Hall, 2016, *Economic Freedom of the World: 2016 Annual Report*.

Given the breadth and complexity of Area 5, *Economic Freedom of the World* provides the separate ratings and international rankings of the area's three components. South Africa's score for Component 5A: Credit Market Regulations has consistently been the highest, rising gently from 9.61 to 10 in 2006 and then falling fairly smoothly to 9.08 in 2014. That gave it a 2014 ranking of 61st and a place in the second quartile of countries.

The other two components were significantly lower but also quite stable during most of their recent history. 5B: Labor Market Regulations stood at 5.47 in 2000 and then spent most of the recent period almost flat near 6.0 before rising to 6.37 in 2014. That is still a low score but it placed 87th in the world and in the third quartile. Component: 5C Business Regulations followed a similar path, starting slightly higher at 6.53 in 2000 and ending slightly lower at 5.89 in 2014. That half-point difference placed its ranking way down at 133rd and in the fourth quartile.

Each of these components is made up of several sub-components. Two sub-components, 5A(i): Ownership of banks and 5A(iii): Interest rate controls, have both held steady with a score of 10 throughout the period since 2000. For this very good reason, neither of these scores has been overly interesting compared to the sub-category that measures the amount of South African government debt as a ratio of total private-sector credit—and might be described as a measure of the crowding out of private-sector credit.

By 2007, the proportion of South African government debt to GDP had fallen to below 30% from about 40% at the beginning of the decade. It would then rise to approach 50% of GDP by 2015. This matches the move by the score for Sub-component 5A(ii) Private-sector credit from 8.82 in 2000 to touch 10.0 in 2006 and then to fall quite significantly to below 7.0 before bouncing back slightly to 7.25 in 2014. This is consistent with the deterioration of the score for Area 1: Size of Government beginning in 2006, which was pulled down by the significant increase in the proportion of total investment attributable to government and government enterprises—and reflected in the severe drop in the Component 1C score from 2006 through 2011.

Conscription in South Africa ended a few months before the transition. But even with the Sub-component 5B(vi): Conscription holding a steady score of 10 since

then, it was not enough to pull Component 5B Labor Market Regulations much above its decade-long plateau of 6.0 until 2014. Within that category, the two highest scoring sub-components are 5B(iv): Hours regulations, which was flat at 8.0, and 5B(v): Mandated cost of worker dismissal, which hovered around 8.0 and remained above average throughout the post-transition period.

The trade-union movement has long been influential in South African industry and politics, and continues to play a very important role as the third leg, along with the South African Communist Party (SACP), in the electoral foundations of the ruling African National Congress (ANC). The strength, aggressiveness, and ideological confidence of the major trade unions and of the strongest umbrella group, the Congress of South African Trade Unions (COSATU), has ensured the embodiment in law of the assumption that the employment relationship is inherently a power struggle, rather than a voluntary exchange of services, and that employees must be protected through militant political and mass action from exploitation by their employers. The resulting law has been reflected in a low, and generally falling, score for Sub-component 5B(iii): Centralized collective bargaining, which trended downward from 4.52 in 2000 to a low point of 2.79 in 2013 before regaining a bit of ground and rising to 3.87 in 2014.

The lowest of the subcomponents has been 5B(ii): Hiring and firing regulations, which is a survey measure of the flexibility of employment relationships. It entered the transition period at the already low position of 5.55 before the changing power balance with the ascent of the ANC plunged it to 2.05 by the year 2000. Since then, it has hovered slightly above 2.0, falling briefly to 1.55 before returning to its high of 2.48 in 2014.

Sectoral and national minimum wages

A slightly more complex measure of employment flexibility is Sub-component 5B(i) Hiring regulations and minimum wage, which combines two measures of the degree of legal restrictions on fixed-term employment contracts and a ratio measure of the effectiveness of a minimum wage on first-time employees. From a rating of 4.52 in 2000, it dipped to 3.3 and from 2004 it plateaued at 4.43 until 2012, then rose to a high of 5.57 through 2014. Beginning in 2017, this sub-component should be affected by the introduction of a new National Minimum Wage (*Business Tech, 2017*) to the extent that this wage is effective, as shown by an increase in the ratio of the minimum wage to the average value-added per worker. The new minimum wage, which from 2017 until July 2019 will be merely a recommended level with compliance encouraged through “technical assistance and persuasion”, will have an initial recommended value of R20 per hour (National Minimum Wage Panel, 2016). That is about US\$1.48 at an exchange rate of R13.50 per dollar. In terms of purchasing power parity (using the World Bank PPP conversion ratio for 2015 of R5.53 and then adjusting for a one-year inflation differential), the new minimum wage would have purchasing power of about US\$3.50.

The new minimum wage became policy in early 2017 and although the enforcement process will not include financial penalties until July 2019, the technical assistance and persuasion phase has begun—in some cases with officials recommending that employers pay the new minimum retroactively. The existing regulatory context has already created difficulties and the loss of flexibility for employers, especially those at the margin. Given that low-skilled wages in South Africa generally range between R2,700 and R3,650 per month, and a

R20-per-hour wage translates to more than R3,500 per month, employers would be forced to adjust accordingly and many workers could be priced out of the labor market.

The official unemployment rate in South Africa has for many years hovered in the range of 25% for the working age population. During 2016, the unemployment rate averaged above 26%. The expanded measure of unemployment—which includes working-age people who have become “disillusioned” with their employment prospects and have dropped out of the labor force—has generally been about 10 percentage points higher than the official rate and, according to Statistics South Africa (2017), averaged above 36% during 2016. The youth unemployment rate (ages 15 to 24 years) has consistently been about double the overall average, and during 2016 continued to fluctuate between 50% and 55%.

Currently observed economic effects are undoubtedly affected by expectations about future policy. But the current and past EFW ratings reflect only policies that have been implemented to date. Since 1997, South Africa has had an array of industry-specific minimum wages, the levels of which have been determined by the Employment Conditions Commission (ECC) in their periodic “sectoral determinations”. That system, while restricting market choices to the extent that the sectoral determinations produced effective minimum wages, did recognize that each industry would be characterized by different wage levels and, as the system has been structured, the imposition of minimum wages has been neither universal nor uniform (Grant, 2016). Nevertheless, in a country where a quarter of the workforce has been unemployed for so long that it seems normal, the low EFW score for Sub-component 5B(i) Hiring regulations and minimum wage seems to have particularly strong explanatory power.

Business regulations

Some of that explanatory power is clearly shared by the types of regulatory burdens measured by Component 5C Business Regulations, particularly the two worst sub-components, 5C(i) Administrative requirements and 5C(ii) Bureaucracy costs.⁵ Both of these ratings, which are based on *Global Competitiveness Report* questions published by the World Economic Forum, began in 2000 at slightly below 7.0 and then dropped quite rapidly to end up together at 3.15 and 3.11 respectively in 2014. These falling ratings partly reflect the loss of bureaucratic efficiency that occurred in government departments due to significant personnel changes after the transition in 1994. Notably, the processes of obtaining permits and of completing property title transfers take longer and are more prone to error. Not unrelated to this has been the decline of the scores for 5C(iv): Extra payments/bribes/favoritism, which is the next worst performing sub-component. In 2000, the rating for 5C(iv) was 6.77 and from there it zigzagged up and down until peaking at 7.54 in 2005. Then it traced a fairly steady decline to 4.20 in 2014.

The time and cost of starting a business have improved since 2000. After dropping slightly after the transition, Sub-component 5C(iii) Starting a business rose quite sharply from 5.83 to 8.68 in 2002. From there it rose gently as high as 9.39 in 2013

5 The name and composition of subcategory 5C(ii) have changed beginning with the current edition of *Economic Freedom of the World* to “Regulatory Burden” and will be based on the “Regulatory Risk Rating” from IHS Global. The rating for 2014 will change from 3.1 to 4.0 and will mark a discontinuity between two data series.

before dropping back to 8.62 in 2014. The two other sub-components measuring business regulation entered the EFW index in 2004 and have also both improved. As a proxy for licenses in general, 5C(v) Licensing restrictions takes the measure of the time and monetary costs required to obtain a license to construct a standard warehouse. It entered the index at 8.08 and sat at that plateau until 2009, after which it rose to a peak of 10.0 in 2013 before falling back to 8.62 in 2014. The rating for 5C(vi) Tax compliance never reached those heights but entered the index at 6.08 and rose to 7.76 in 2007, where it has remained on a plateau ever since. This measure looks at cost from the perspective of the taxpayer, and it is worth noting that the South African Revenue Service (SARS), the nation's tax collecting authority, has a reputation for being one of the very few efficiently managed government agencies.

Loss of government economic policy flexibility

The trend in South African economic freedom since the transition has been downward in both absolute rating and international ranking. Many of the government policies that have contributed to this decline in economic freedom are of such broad impact that they are not limited to any particular EFW area or component, but their presence will be detected to some extent by each of the several components that they affect. To the extent that specific economic outcomes and general standard of living are reflected in, and predicted by, a country's overall EFW score and its trend, then South Africa's potential for economic progress appears to be increasingly limited.

New South Africa, new racial discrimination

One of the more salient features of the new South Africa is that its arrival did not eliminate racial discrimination but rather repackaged it to serve a different set of elites. This fact is most clearly displayed through the intensification of affirmative action programs since the transition. In government employment, hiring preferences based on a hierarchy of race and gender emerged almost immediately. By 2003, the implementation of Black Economic Empowerment (BEE) regulations pressured racially based hiring and procurement on private businesses and gave preference to businesses that surpass a specified minimum percentage of black ownership (Atud, 2011).

Shortly thereafter, BEE was expanded to Broad-Based Black Economic Empowerment (B-BBEE), which gave rise to a periodically updated Code of Good Practice (South Africa, 2004; South Africa, Dep't of Trade and Industry, 2013). The Code specifies an accreditation system based on points awarded to companies that demonstrate the required percentages of "black" (defined as people who are non-white) equity ownership, management positions, and employees. Scrutiny also extends to company training programs as well as to whether the company's suppliers are "empowered", which means that they have a BEE-compliant racial composition.

BEE limits economic freedom in several ways. It affects economic freedom both for employees and employers by creating new sets of regulations and effectively restricting who may be hired. It also limits economic freedom in the allocation of capital.

A National Minimum Wage (NMW)

As discussed above, since 1997 South Africa has had a system of sectoral minimum wages, with each job classification within the affected industries subject to different minima. Just as such constraints reduce options within the labor market, they also limit choices of business and production structure (Davie, 2011). The addition of a national minimum wage will bring restrictions to employment in those sectors not previously covered by the sectoral minimum wages, and will disproportionately affect those workers in the lowest income sectors, although the new regulations do make some allowance to mitigate the impact in particular sectors, such as for domestic workers.

The important point here is that with the addition of each restriction—and as this is reflected in a declining EFW score—the current capacity of any country’s economy to bear such a new burden is reduced. When advocating a new interventionist program, it is common for the advocates to point to the existence of such programs in other countries and to cite statistics that appear to lend support to their claims. Setting aside arguments over the efficacy of such statistical studies, proponents of new interventionist programs that would reduce a country’s EFW rating should first consider the country’s capacity for such an indulgence as reflected in its current EFW rating. South Africa sits in the third EFW quartile internationally and has an official unemployment rate near 25%. Increasing the effectiveness of the minimum wage levels in such a context would appear to be a more expensive indulgence than would be a proportionate minimum wage increase in a higher income country in the top EFW quartile.

Impact on the economy

As economic freedom has decreased, the GDP growth rate has declined, as would be expected, from near 4% to less than 1%, with four quarters of negative growth spread across the past three years. Inflation dropped below 6% and into its target range only in mid-2017. A bank loan will charge double-digit interest rates, and no one’s property or job is secure.

The main primary industries, mining and agriculture, have been stagnant and most recently in decline. Mining suffers from a lack of property rights, from sometimes violent labor disputes, and from regime uncertainty. Agriculture also suffers from property rights uncertainty and unreliable labor, but also from a high probability of violence against farm managers and owners and their families.

In the secondary sector, manufacturers had been afflicted until recently by unreliable electricity supplies. Along with electricity, gas and water supplies have improved. Private investment in fixed capital has been in decline and the construction industry has been stagnant. Labor productivity has been trending downward for many years while unit labor costs have recently begun to rise.

Only the tertiary sector, consisting of services, commercial activities, communications, and transportation has done well over the past several years. These are more flexible industries, relatively less dependent on property and fixed capital investment than other industries. In the new South Africa, one needs to be flexible and mobile.

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