

INVESTMENT RESEARCH TEAM

JP Landman Political Comment

Is the bad mood justified?

The mood in the country, certainly amongst white people, is quite depressed. An annual opinion poll on how optimistic South Africans are, found that in February 2008 60% of South Africans felt positive. That was down from an average of mid-sixties in previous years. The real outliers were whites; only 31% were optimistic, down from the mid-forties in previous years.

The poll reveals that Cape Town has the least positive residents (49%); the Vaal triangle has the most optimistic (74%); Pretoria and Johannesburg come in at 62% and 67% (interesting if one considers the crime in Gauteng); young people are more optimistic than their elders (66% vs 51%); and the inland areas of SA more optimistic than the coastal areas. This is probably explained by the fact that optimism amongst coloureds and Indians is fairly low (40% and 44% respectively) whilst blacks are very optimistic.

Why such a bad mood? In the previous years this poll was conducted we also had crime and malfunctioning municipalities (think the murder of David Rattray and the whole furore at the beginning of last year). So it cannot be that. In my opinion three factors have contributed: politics, economics and Eskom.

- Politics, particularly the post-Polokwane reaction to ANC elections and decisions about the media, the Scorpions and the judiciary;
- Economic headwinds, particularly rising petrol & food prices which also push up inflation and interest rates and depress general activity; and
- Lastly and the most damaging, Eskom's inability to supply sufficient power.

Eskom is the straw that broke the camel's back. It brought up all the subliminal fears that (whites) have about (black) governance. Never mind the fact that in the mid-seventies Eskom had a similar crisis when the whole country was without power for 18 hours and power tariffs rose by 75% to fix the problem. Somehow the current Eskom crisis is seen as the beginning of the end.

Eskom

Lets deal with Eskom first, because that also tells us something about economics and politics. The question is simple: can SA rise and respond to this crisis in a way that makes the country stronger? At the heart of the Eskom problem is a lack of investment and maintenance. Is that being fixed?

Last year Eskom invested R17.7 billion, 67% more than the previous year. This year it will spend R46 billion and next year R80 billion. By 2012 it would have spent R360 billion.

Sure, it will take time for these investments to work through; 2012 means another four years of pain and interruptions. But distinguish that from a situation where power cuts take place and no investment is taking place to improve matters (as in Mugabe's Zimbabwe). So Eskom will turn, even if it takes four years.

Investment

This investment story repeats itself all over the SA economy. Transnet is investing R78 billion over five years; about R12 billion a year are being spent on roads, and toll roads will add to that amount; municipalities are budgeted to spend R100 billion over three years on infrastructure. Then add airports, broadband telecommunications, hospital upgrading, electrification, school building ... the list carries on and on. I do not even bother to mention the World Cup stadiums. It is noticeable in the media, but not really in total investment spend.

By the way, comfortably more than 90% of these budgets are actually spent. Just take last year when total capex budgets came to R128 billion of which R124 billion was actually spent (97%). All the public attention fell on the R4 billion not spent (3%), very little on the R124 billion actually spent. When last have you built a house, renovated a kitchen or added a bathroom and all those came in 100% within the time you budgeted?!

All over the country there is a frantic search for skilled people. Engineers who were retrenched are being called back; the collapse in Zimbabwe helps SA construction companies fill their complements; labour brokers are bringing people in from foreign shores to work here. The country is booming beyond its ability to supply skills.

Before it depresses you, consider the following statement from the Asian Development Bank about the skills shortage in Asia: "Although this brain drain (skilled workers leaving to work in the developed world) is hardly new to the region, it has added a new, more urgent dimension ... (to the skills shortage)." It goes on to call the skills shortage "a symptom" of Asia's economic success. Lovely problem to have.

One hears a lot that SA spends on social welfare but not on investment. This fiscal year the country will invest 7% of GDP and spend 4.6% of GDP on social security, including the Road Accident Fund, UIF and of course the 12.4 million social allowances paid out every 30 days. Whilst the state probably spends 80% of what is spent on social security (churches, NGOs and individual do the rest), its investment spend is only about 30% of what the country invests. The private sector does the rest.

Can we now please bin this nonsense that we spend more on social welfare than investment?

Politics

So how will politics change this investment outlook? The Polokwane decision on investment is relevant: "The ANC will also continue to roll out a massive state led infrastructure investment programme that will significantly improve the country's logistics, energy and communications capacity. It will also promote strategic investments in productive activities, aimed at diversifying the economy and improving the ratio of investment to GDP." (my underlining)

There are some rather questionable decisions from Polokwane, notably on the media, judiciary and the Scorpions, but not on economics and welfare policies. There are budgets and business plans around capex, political decisions backing it and a rising

numbers of people benefiting from it. I think the investment programme is sustainable.

Economics

Even if we accept lower economic growth over the next few years, say 4% rather than the 5% we enjoyed the last few years, the beauty of SA is that per capita incomes will still rise and at an accelerating rate. In the fourteen years since democracy, per capita incomes have increased by 26%. At 4% growth for the next seven years to 2014, per capita incomes can again increase by ...26%!! Consider what has happened in the last fourteen years, it can happen again over the next seven.

Yes consumption expenditure will fall and all sectors exposed to that will feel the pain: retail, advertising, car sales and so on. Huge squeals to come from there. But that growth is being replaced with investment that creates jobs, which will in turn stimulate consumption spending. In a year or two interest rates will ease, there will be scope to do tax cuts and per capita incomes will continue to increase.

Back to Basics

The basics have not changed. For me the most important pre-condition of progress is sustained rising per capita incomes. Regular readers will know that I have punted this view for years. Thus, an article in a recent Economist that we should measure per capita income growth, rather than just economic (or GDP) growth, was music to my ears.

The music became more beautiful when a brilliant analysis on Ugandan population growth drew the following comparison: "(...) from 1993 to 2003, GDP growth rates across Asia managed to outstrip the growth in the labour force, in China comfortably so. By contrast, average GDP growth in sub-Saharan Africa in the same period was 2.9%, all but cancelled out by a growth in the labour force of 2.8%."

This statement probably tells us more about the reasons for sub-Saharan Africa's failures than any other explanation. If a country cannot grow its economy quicker than its population, it is going absolutely no where. SA is clearly not in that league.

It is instructive to note that per capita incomes have been declining in Zimbabwe in every single year since 1999 (Hanke, 2008). Fitting then that precisely ten years after the decline started, even Mugabe could not rig the election. Also instructive to note that per capita incomes in SA started to decline in 1977. Thirteen years later FW de Klerk unbanned the ANC and released Nelson Mandela. Declining per capita incomes have political consequences.

Messiness

The latest pin-up in financial writing (justifiably so in my view) is Nassim Taleb ("The Black Swan" & "Fooled by Randomness"). He offers this simple but highly relevant insight: "That things in the real world are far messier than in recorded history or in memory." Things were not as clean as some whites' memories tell them. I have a dear friend who knows and experienced Afrikaner politics quite intimately. In the 1990s he always said that we must go back to 1948 before we can get to 2000. The

liberals freak out when they hear this. Those who understand tradition recognise that messiness is part of progress. Gosh, look at China today and the UK in the 1800s – hardly examples of messy free progress.

For a long time there was nothing messy in Zimbabwe – good education and health that they could not afford but never debated, little crime, a clean country and little civil society and debate. Not messy at all. Did they progress?

Challenge & Response

Arnold Toynbee taught us that the ability to respond to crises is the critical difference between societies that succeed and those that fail. Progress does not come from having no challenges; rather it comes from responding successfully to challenges.

In the eighties and nineties SA responded most successfully to its political/constitutional crises. Remember when Whites were to be killed, Black ethnic violence to erupt, the rightwing to lead an armed resistance and so on and so on. Nothing of the sort happened – the country responded successfully to its constitutional crises.

In the late nineties SA had a low growth crisis; a 1% economy that looked as if it could not break through a 3% growth ceiling. And now growth is sufficient to lift per capita incomes quicker than Australia, Brazil, Germany, France, Italy, the UK and US. The country responded successfully to the challenge of low growth.

So What?

- Rising incomes mean resources to tackle problems, create jobs, fight poverty and build infrastructure. To paraphrase Bill Clinton, it is about per capita incomes, stupid.
- Over the next seven years per capita incomes can rise as much as during the last fourteen years. This will trump the negative fallout from politics. The economist Prof De Kiewiet wrote several decades ago that SA progresses through “political disasters and economic windfalls.” Between rising incomes and post-Polokwane political uncertainty, it will happen again.
- SA is responding to its infrastructure crisis (which will be around for a while, make no mistake) with a massive investment programme.

All that remains now is to put one foot in front of the other, carry on and expect a lot of messiness. Sometimes I think it is our inability to live with messiness that paralyses us. If Whites can make this paradigm shift their mood might not be so bleak. More importantly, they can capitalise on the opportunities.