

AFRICA RISK CONSULTING

Country briefing – South Africa

6 November 2013

1 Summary

The economic growth estimate for 2013 has been revised down from 2.8% to 2%. The finance minister's cost cutting measures in the medium term budget are an election ploy. Political protests over 'service delivery' kill one in Bekkersdal (Gauteng Province) and disrupt business in Cape Town. A motor industry strike ends but two manufacturers are considering alternative investment locations. In a bid to subject foreign investment to domestic law South Africa unilaterally annuls the bilateral investment treaty with Germany and other European Union states. A legal campaign to prevent tolls on Gauteng's freeways ends. With no date for tolling to start it is likely to become an election issue for the ruling African National Congress (ANC).

1.1 The finance minister's mid-term budget fails to inspire

Finance minister **Pravin Gordhan** delivered South Africa's mid-term budget on 23 October and could not muster any substantive hope for greater economic growth. Gordhan's macro-economic diagnosis was sobering: the economic growth estimate for 2013 has been revised down from 2.8% to 2%; unemployment remains stubbornly high with 25% of adults officially unemployed; South Africa's households are heavily indebted (75% of after-tax-income¹); the government's expenditure exceeds tax revenue by 4.2% of gross domestic product; savings are too low to finance investment and imports continue to eclipse exports driving the current account deficit higher.² It was a speech bereft of new ideas to end the economic malaise.

The **South African Reserve Bank** warned days after Gordhan's speech that slow economic growth and the barrage of labour strikes could precipitate a downgrading of the country's sovereign credit risk.³ Foreign investors hold 37% of South Africa's sovereign debt. **Standard & Poor's** rates South Africa at BBB (adequate capacity to meet financial commitments, but more subject to adverse economic conditions) and **Moody's** Baa1, putting it on the same level as **Thailand** and **Russia**.⁴

¹ 'Rising household debts limits growth possibilities', Business Day, 8 July 2013

² 'Medium term budget policy statement 2013 – speech', 23 October 2013

³ 'SA at risk of downgrade over strikes, says Reserve Bank', Business Day, 30 October 2013

⁴ 'Moody's flags South Africa downgrade risk on BMW retreat', Moneyweb, 16 October 2013

As South Africa prepares for general elections in 2014, Gordhan's cost-cutting measures garnered the most headlines. From 1 December all government credit cards will be cancelled and government delegations for foreign trips trimmed; ministers will have to fly business class and no public funds can be spent on alcohol except for state banquets.⁵ The cuts follow damaging revelations of public officials' excess and nonchalance. In September **Northern Cape** Premier **Sylvia Lucas** defended her use of a government credit card to purchase R50,000 (\$5,000) worth of fast-food in the first 10 weeks of her tenure. As political head of a region with an unemployment rate of 27.4% and an average household income of R86,000 (\$8,600),⁶ Lucas defended her spending:

"How would we eat if we didn't use taxpayers' money?"⁷

Excess in President **Jacob Zuma's** government (2009 - present) is not new which gives the impression that Gordhan's cuts are primarily an election tactic. First as revenue commissioner and now as finance minister, Gordhan is widely respected amongst South African businesses and the Group of 20 nations. Together with Reserve Bank Governor **Gill Marcus**, Gordhan as quasi-prime minister must temper the government's profligacy and navigate between the demands of the ANC's left and the interests of large domestic and international business.

1.2 Protests rock Cape Town and Bekkersdal

Euphemistically named 'service delivery' protests brought central **Cape Town (Western Cape)** to a halt on 30 October. Approximately 3,500 people protested near Parliament, destroyed market stalls in the city's historic **St Georges Mall** and forced businesses to close. Led by suspended **African National Congress (ANC)** member **Andile Lili** and ANC Cape Town City Councillor **Loyiso Nkhola**, the protesters demanded greater access to housing and for the city to make land available to squatters. The opposition **Democratic Alliance (DA)** controls Cape Town and the Western Cape. Lili is already on bail on public disorder charges after being accused of dumping human waste at **Cape Town International Airport** in a protest in July.⁸

In **Bekkersdal (Gauteng Province)**, a small town 60 km south-west of **Johannesburg**, a month long protest became violent in late October over the municipality's poor delivery of public services.⁹ At least one man was killed in the protests and several others were injured in street battles with the police. Schools were closed and students sitting their final year exams were moved to an undisclosed location. Gauteng **Premier Nomvula Mokonyane** was forced to leave a church service in a police armoured carrier after she tried to address the community. She reportedly said that the ANC did not need Bekkersdal 'dirty votes'.¹⁰ Mokonyane is allied to Zuma but has been rejected by the Gauteng ANC branches as their candidate for premier in 2014 in favour of current provincial secretary **David Makhura**.¹¹

⁵ 'Spend fest over for government high rollers', ewn.co.za, 23 October 2013

⁶ Census 2011, Statistics South Africa

⁷ 'Fast-food bill of R50k 'not excessive' says N Cape Premiers office', M&G, 16 September 2013

⁸ 'Poo war crusaders released on warning', ewn.co.za, 13 July 2013

⁹ 'Chaos erupts in Bekkersdal', ewn.co.za, 24 October 2013

¹⁰ 'Nomvula Mokonyanes 'dirty votes' comment angers Bekkersdal', City Press, 25 October 2013

¹¹ 'Zuma ally Mokonyane rejected by ANC branches', Business Day, 1 November 2013

‘Service delivery protests’ are a frequent occurrence across South Africa but have the highest prevalence in urban and peri-urban areas. In the first eight months of 2012 (the most recent data available) there were 226 protests or an average of 28 a month.¹² The most common grievances are access to housing and land, and the provision of electricity and water.¹³ Party politics does not feature as an overt motive but as with the Cape Town protests, there can be a political motive shrouded in legitimate concerns expressed through civil unrest and violence.

1.3 Is the government ambivalent about foreign investment?

A three-year wage agreement between the **National Union of Metal Workers (NUMSA)** and the motor industry on 15 October ended a six-week strike. The motor industry strike, and BMW’s reaction in particular, showed the frustration at the limits of the government’s, and by extension the ANC’s, influence in an election year.

This latest strike, together with a preceding strike, cost **German** motor manufacturer **BMW** 13,000 vehicles in lost production or 12.5% of its entire yearly output.¹⁴ BMW broke the corporate mold when during negotiations with NUMSA it announced that the German parent company was no longer considering the South African operation as a candidate to manufacture a future model.¹⁵ The announcement of the decision was a deliberate step to advance negotiations and urge greater government involvement – itself an unusual move in corporate-labour-government relations in South Africa.

“BMW has clearly had enough of the labour situation and the risk/reward of further investment (in South Africa) doesn’t make sense to them.”¹⁶

The decision by BMW Germany to not consider South Africa in 2013 runs counter to the important decision in 1996, just two years into the new dispensation, to invest R1bn (\$100m) to upgrade its **Rosslyn** plant (north-west of **Pretoria**, Gauteng) to a full production facility. BMW’s investment was a major public relations coup for the nascent ANC government.¹⁷

NUMSA called BMW’s latest announcement “blackmail” and “insulting”.¹⁸ The absence of the government in the protracted strike, despite the wider cost to the national economy, was glaring. In 2012 the motor manufacturing industry accounted for 6.2% of the national GDP.¹⁹ Trade and Industry minister **Rob Davies** met BMW SA managing director **Bodo Donauer** one week after the strike ended and after **Nissan** indicated it planned to shift some new production to **Nigeria**.²⁰

¹² Multi-level government initiative - barometer

¹³ Multi-level government initiative - barometer

¹⁴ ‘Strike costs BMW SA big opportunity’, iol.co.za, 3 October 2013

¹⁵ ‘BMW has had enough - analyst’, Engineering News, 4 October 2013

¹⁶ Peter Attard Montalto, Nomura analyst, quoted in ‘BMW has had enough - analyst’, Engineering News, 4 October 2013

¹⁷ BMW Rosslyn plant history

¹⁸ ‘BMW threats insulting – Numsa’, ewn.co.za, 7 October 2013

¹⁹ ‘BMW to add 600 jobs at Rosslyn plant’, M&G, 3 April 2012

²⁰ ‘BMW confirms new model lost to SA through strike’, Business Day, 11 October 2013.

Nico Vermeulen, director of the **National Association of Automobile Manufacturers of South Africa (NAAMSA)** thinks that the timing of the strikes and “*perhaps the intransigence of the unions*” were motivated by broader political considerations.

“If the unions were making a stand about their power to the politicians, I think they succeeded in making their point. It came at a high cost to the manufacturers, but they have put plans in place to try and recover some of the lost production. The final agreement is for three years so that will provide some stability for the industry.”²¹

The ANC government’s position on attracting and keeping foreign investment is confused. Officially, South Africa welcomes foreign investors. However, schisms within cabinet and amongst the ANC’s labour allies present a more complicated picture. NUMSA is a major union within the **Congress of South African Trade Unions (COSATU)**, the ANC’s erstwhile alliance partner, together with the **South African Communist Party (SACP)**.

The ideological divide is replicated within cabinet. When the **United States** retailer **Walmart** acquired **Massmart** in 2010, three government ministers opposed the merger and appealed the **Competition Tribunal’s** approval of the deal. While the merger eventually prevailed, the ANC government’s divided reaction highlighted a truth about President Jacob Zuma’s coalition cabinet – that it expends much of its energy trying to hold the partnership together rather than governing South Africa. The ideological arm-wrestling has recently claimed the scalp of Competition Commissioner **Shan Ramburuth** who has been replaced by **Tembinkosi Bonakele**, an ally of the left-wing economic development minister **Ebrahim Patel**.²² The minister will now have a freer hand to use the commission as a catalyst agent but political interference is not a direct concern with the oversight role of the competition tribunal and the appeal court.²³

1.4 South Africa cancels bilateral investment treaties

As part of a greater plan to reshape its investment policy framework, South Africa announced the cancellation of the bilateral investment treaty with Germany on 25 October.²⁴ In total 13 investment treaties with **European Union** states will be annulled and replaced by general domestic legislation. What is surprising is that South Africa acted unilaterally to end the treaties before enacting the replacement legislation.²⁵ Existing foreign investments will continue to be guaranteed under the bilateral agreements for 20 years, but new investors are wary that their rights won’t be as strongly protected as before. The **Promotion and Protection of Investment Bill** was published in the Government Gazette on 1 November for public comments. The key provisions include no automatic right for foreign investors to international arbitration but that South African courts, statutory body or an unspecified independent body will hear disputes²⁶.

²¹ Nico Vermeulen, director of the National Association of Automobile Manufacturers of South Africa

²² ‘Acting competition commissioner on the job’, ewn.co.za

²³ Competition attorney, Johannesburg

²⁴ Bilaterals.org, ‘SA annuls bilateral investment treaty with Germany’, 28 October 2013

²⁵ ‘SA annuls bilateral investment treaty with Germany’, Business Day, 28 October 2013.

²⁶ Government Gazette – Notice 1087 of 2013, 1 November 2013

Trade and Industry Minister Rob Davies said that *“the bill will create a comprehensive, uniform legal framework to govern investment. This includes enacting black economic empowerment (BEE) legislation.”*²⁷

An executive of a German state finance agency based in South Africa says:

*“We knew the investment treaty was going to end, but not knowing what will replace it is a concern. Germany is a major investor here (South Africa). This vacuum, because we understand the bill will take at least six months to become law, creates uncertainty. The law will then have to be reviewed in Germany and then **Brussels**. It will be a long time before it’s settled. Together with the possible end of the double taxation treaty, German investors are right to be guarded.”*

1.5 Freeway electronic-tolling closer to reality

The **Opposition to Urban Tolling Alliance (Outa)** has ended its legal campaign to stop the implementation of the electronic-tolling (“e-tolls”) of Gauteng’s freeways after it failed to raise the required funds to pursue the matter through the courts. It is now urging motorists to exert *“civil courage”* and *“passive resistance”* to not purchase electronic tags critical for the tracking and billing process.²⁸

The **South African Roads Agency (Sanral)** is the government company that oversees the implementation of the e-tolls. It has asked for the department of justice to establish special courts to try non-payers.²⁹

*‘By our calculations there could be as many as 2.1 million summons issued for non-payment. Even if special courts are established, it would never cope with the volume (of cases). As we have argued, the cost of collecting and enforcement outweighs the revenue. It’s not sustainable.’*³⁰

The **Economic Freedom Fighters (EFF)** party led by former **ANC Youth League** leader **Julius Malema** has adopted the cause and held a protest march to the Gauteng Premier’s office in central Johannesburg on 1 November. It has given government two weeks to terminate the tolling system after which it has threatened ‘civil disobedience’.³¹ The EFF’s adoption of the e-tolls as a campaign cause is likely to alienate the ANC-aligned COSATU that has opposed the tolls. The DA scored a public relations success when it unveiled billboards that read: *“E-tolls, proudly brought to you by the ANC”* along major highways in Gauteng. The DA believes it can win a majority in Gauteng in the 2014 election.

²⁷ ‘Investment bill, approved for publication by Cabinet, faces scrutiny’, Business Day, 25 October 2013

²⁸ Wayne Duvenage, Chairman of Outa

²⁹ ‘Sanral wants special courts for e-toll non payers’, TimesLives, 14 October 2013

³⁰ Wayne Duvenage, Chairman of Outa

³¹ ‘EFF gives govt 2 weeks to scrap tolls’, ewn.co.za

The implementation of the e-tolling system is riddled with intrigue and complications. The sudden unexplained resignation of **Salahdin Yacoubi**, CEO of **Electronic Tolling Collection (ETC)**, the company tasked with collecting toll fees, is the latest twist in this long-delayed project.³² ETC moved quickly to appoint **Jamie Surkot** as CEO. Surkot was previously a general manager of the **Kapsch TrafficCom Group** that is ETC's holding company. Kapsch TrafficCom is an **Austrian** company and it will earn a reported R664m (\$66.4m) a year in revenue.³³ COSATU and Outa have argued that Kapsch TrafficCom will transfer the revenue outside of South Africa – a charge Sanral denies.³⁴ The proposed tariffs are open for public comment and the tolling system is slated to come into effect in early 2014.

2 Implications

Economic growth remains elusive and will remain so for the remainder of Zuma's term. Gordhan's next major speech will be in February 2014 to deliver the national budget. He will be under pressure from the ANC to ease fiscal conservatism by introducing economic stimulus measures and increase social welfare spending. The medium term budget's attempt to slash government expenditure will save an estimated R1bn (\$100m) but it comes years too late and ignores the perennial challenge to deliver better value for each rand spent.

President Zuma's administration lacks a coherent and focused economic policy. With the ANC in election mode it is attempting to hold together its various factions and its alliance partners, COSATU and the SACP. In a dire economic market labour unions will continue to pursue hardline negotiating positions with corporations in a vulnerable position. The post-election cabinet will mirror the current cabinet in that Zuma will continue to balance numerous interests creating a *de facto* coalition. With low-growth prospects and high unemployment, service delivery protests are likely to rise in the second quarter of 2014.

The effect of the cancellation of the bilateral investment treaties will depend in part on the protection afforded to foreign investors in the pending bill. The bill's reliance on the local justice system will not appease skeptical investors. Foreign investment is a key factor to achieve government's goals of faster economic growth and employment despite the woefully inarticulate policy.

The introduction of the e-tolls in Gauteng, South Africa's economic and political hub is a deeply unpopular move with commuters and some businesses. The opposition DA has already exploited the general discontent over e-tolls, leaving the ANC to hope that the system is delayed until after the election. The e-toll project is severely delayed and raises the doubts to the government's ability to plan and implement large and costly infrastructure projects.

³² 'E-tolls boss quits', TechCentral, 1 November 2013

³³ "Cosatu appalled that Austrian company will make R670m", citypress.com, 14 July 2013

³⁴ "Cosatu appalled that Austrian company will make R670m", citypress.com, 14 July 2013