

# **Francois Groepe: The role of business in the National Development Plan (NDP), to deal with the threefold challenge of unemployment, poverty and inequality by 2030**

Address by Mr Francois Groepe, Deputy Governor of the South African Reserve Bank, at the Afrikaanse Handelsinstituut (AHI) National Congress, Kruger National Park, 19 October 2012.

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## **1. Introduction**

Chairperson, ladies and gentlemen, I can truly say that I am pleased to be part of the proceedings of the day, hosted at this beautiful venue.

In addressing my topic, namely “The role of business in addressing the threefold challenges that unemployment, poverty and inequality pose to our society”, particularly highlighting the role that small and medium sized enterprises can play in addressing these issues, it is necessary for us to first reflect on the current state of affairs.

## **2. Inequality in South Africa**

Most recently, the World Bank in its assessment of South Africa, said that for South Africa to create jobs and reduce unemployment, it needs to tackle economic inequality. It goes on to say that South Africa can be considered as one of the most unequal countries in the world with the most recent estimate of the Gini coefficient being 0,69. The so-called Gini coefficient is an internationally accepted measure that indicates the degree of income inequality in a country. The higher the coefficient, the more unequal the income distribution is. Despite the fact that this Gini coefficient is disputable given that the Government Social Grants system was not taken into account when this measure was calculated, I am sure that none of us will dispute the fact that inequality and poverty is rife in our country.

In South Africa, it is estimated that the top ten per cent of the population earn as much as 58 per cent of the income, the bottom ten per cent as little as 0,5 per cent, and the bottom 50 per cent less than eight per cent. Inequality is a reality and simply forms part of any deliberations when it comes to steering a new course of development in this country. At the heart of high inequality lies the inability to create employment opportunities on a large enough scale. South Africa’s unemployment rate of 24,9<sup>1</sup> per cent<sup>1</sup> in the second quarter of this year, is amongst the highest in the world. Admittedly, we are no longer an outlier when compared with countries such as Greece and Spain, but that of course does not make it any more acceptable, recognising also that the high unemployment rates in these countries has not been a persistent problem but rather owing to the severe debt crisis facing Europe.

It is worth noting that social grants constitute as much as 70 per cent of the income of the poorest 20 per cent of this country’s citizens. Had it not been for these grants, around 40 per cent of South Africans would have seen a decline in their income in the new South Africa during the first decade post 1994.

To reduce inequality to more reasonable levels over the long run, social assistance is clearly not enough and should be complemented by other initiatives. These levels of social assistance are not sustainable over the long run and may be somewhat counter-productive in the end.

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<sup>1</sup> Statistics South Africa

Focussing on the development of human capital, particularly among the youth, given our youth unemployment level which stands at 50 per cent, is paramount. Similar opportunities have to be created for all, regardless of personal background and circumstances, race, gender or geography - this should be our uncompromising goal. Access to a basic set of goods and services during childhood could be an important predictor of future outcomes, including educational achievements and earnings. These basic services comprise education, health care, essential infrastructure such as water, sanitation and electricity, and early childhood development programmes.

In South Africa, access to these services is affected by factors such as ethnicity, including gender, the composition of households, taking account of the number of children in the household, the education level of parents, the gender and age of the person heading the household, orphan status, and where the household resides.

Encouragingly, near universal access to schooling for those under the age of 16 has been achieved in South Africa, but access to certain other services is found to be lacking. The services that are not that universally readily available include health insurance, safe water supply, improved sanitation, adequate space without overcrowding. Opportunities such as early childhood development programmes, neighbourhood safety and access to electricity are found to be somewhat less problematic.

Following from the assessment that the World Bank has done on South Africa, despite it being found that school attendance is comparable to other countries, the school completion rate falls short of that of our peers. Children's inequality is mainly shaped by circumstance, and inequitable access to opportunities also affects the labour market. The causes of unequal access to available jobs have changed in recent years with education and location becoming more prominent. Education deficiencies now account for more than 50 per cent of the inequality of employment, with the premium for skills rising continuously.

In an assessment of the quality of state education amongst 142 countries, South Africa's ranking was 133, despite having one of the highest rates of government investment in education in the world, with expenditure reaching R207 billion for the 2012/2013 financial year. These outcomes necessitate an urgent and critical review of our education system and its outputs.

### **3. The National Development Plan**

The National Development Plan (the Plan) offers us some hope in this regard, with its central focus being the elimination of unemployment, poverty and inequality by 2030. Within this Plan, nine main challenges are being highlighted, including, *inter alia*:

- Too few jobs;
- The standard of education for most black learners is of poor quality;
- Infrastructure is poorly located, under-maintained and insufficient to foster higher growth;
- Spatial patterns exclude the poor from the fruits of development;
- Public services are uneven and often of poor quality; etc

It is most encouraging that business investment is identified as the cornerstone of the new proposals within the National Development Plan, aiming to create 11-million jobs and eliminate poverty by 2030. It sets a target of reducing the unemployment rate to 14 per cent in 2020 and to 6 per cent in 2030, while increasing the labour force participation rate from 54 per cent to 65 per cent. Per capita income is also envisaged to increase from about R50 000 per year currently to about R120 000. It is worth emphasising that it is envisaged that 90 per cent of jobs should be in small and expanding firms with the goal of mass entrepreneurship.

The Plan is business friendly in that it suggests that some labour regulations be loosened in an effort to encourage business enterprises to employ more easily, as well as lower entry-level wages to facilitate a higher uptake of young people in the jobs market. Some of the proposals in the Plan are in conflict with those of organised labour, and will require intense negotiations and possibly trade-offs prior to implementation. The Plan takes a pragmatic and broad-based approach to the challenges that South Africa faces in eradicating unemployment. The role that the Plan sees for government's intervention is permeated with a greater willingness to work with the private sector, as it leans towards less regulation of the economy. The Plan envisages small and expanding companies creating around 90 per cent of the new employment opportunities in the economy in the next 20 years. This will place South Africa in step with global employment trends. Small firms would benefit from bold proposals to drastically reduce so-called "red tape" and improve employment and dismissal procedures.

The National Development Plan continues by indicating that the economy will be more enabling for business entry and expansion, with an eye to credit and market access. Regulatory reform and support will also boost mass entrepreneurship. The topic of strained labour relations is also addressed, indicating that it is inconceivable that the economy will evolve into a more labour-intensive structure if tensions between employers and labour persist. These tensions need to be dealt with in a transparent and honest manner to be conducive to enhanced labour absorbing growth. Central to the propositions made in the National Development Plan related to the jobs market, is the statement that over a 20-year horizon, wage growth needs to be linked to productivity growth as it is not feasible to sustain a labour absorbing path unless both are growing in tandem.

In an effort to enhance the labour absorption rate of the economy, the Plan advocates a tax subsidy to employers to reduce the initial cost of employing a young labour-market entrant, and facilitating an agreement with labour unions on entry level wages. The Plan goes further in suggesting a subsidy to the placement sector to secure, prepare and place matric graduates in work opportunities. It is also proposed that dismissal procedures for performance or misconduct be simplified, and that compliance requirements for employment equity and skills development rules for small companies be simplified, or even done away with. A small business should be afforded the opportunity to focus on making its business work, within a nurturing environment that will enable it to grow, in the process creating more employment opportunities.

In developing such a nurturing environment, cognisance should be taken of the fact that small businesses are diverse in nature, each with its own unique set of needs. Small businesses operate in both the formal and informal sector, where some can be classified as survivalist, while others are being managed by individuals with entrepreneurial flair. Also, some are start-ups, other are growing rapidly while others are well-established and of a stable nature. The level of business skills also differs from inexperienced to highly sophisticated. The markets in which they operate range from local, national to global. It is of crucial importance that these diversities be reflected in any policies and actions taken to support the small business sector.

Over and above the focus on the jobs market, the National Development Plan also advances some frank recommendations in areas such as education, health and the public sector, as part of the creation of a nurturing and enabling environment for business to prosper, and create those jobs that we so urgently require. A set of integrated actions is being proposed to address the issue of inefficiency and a lack of service delivery by the state. To improve educational outcomes, the Plan head-on confronts issues such as teacher performance, appointment procedures and accountability. The challenges in public health management are also addressed, and in building a capable state, detailed recommendations are made on professionalising the public service. Some areas of Government where improvements have occurred, include both the Department of Home Affairs and at the South African Revenue

Service, through an improvement in operational procedures, management and delivery systems. These improvements should be emulated by all other organs of state.

The implementation of this Plan will surely require decisiveness on the part of the state and a strategic approach to negotiations, in an effort to build trust between all stakeholders in the economy. The National Development Plan constitutes a powerful, integrated and inspiring development agenda for the state and the whole of South Africa, and for the Plan to bear fruit, it must not only be accepted as a policy framework by Government, but should be translated into a plan of action, with clear milestones along the way, within realistic time frames.

#### **4. The role of business**

To honour the main purpose of my talk this morning, it is necessary for us to now proceed with a focussed discussion of the contribution that business can make in addressing unemployment, poverty and inequality. It is imperative that youth unemployment receives a special focus, because low participation of young people in the economy constrains future economic growth and will have profoundly harmful consequences for poverty levels, equity, social stability and the self-worth of unemployed people. In South Africa, there are a number of factors that act as disincentives to the employment of new labour market entrants, such as a lack of appropriate skills, high wages in relation to productivity, high training costs and somewhat inflexible labour legislation.

Processes to bring young people into the labour market require somewhat of a developmental approach where dedicated youth programmes need to target the youth and then effectively screen, select and place them. Anecdotal evidence suggests that placement costs are exorbitantly high, creating opportunities for business to innovate more cost effective screening and placement processes, thereby raising the overall effectiveness of the system to absorb labour.

In collaboration with Government, Business can contribute project management, process and administration skills to assist government in addressing capacity shortfalls in the most expedient manner possible. For these collaborations to be productive an environment of trust must be cultivated between all constituencies. In South Africa, the level of trust between government and business is particularly low, and has on numerous occasions been highlighted as a serious impediment to progress. From the side of Business, an acknowledgement should be fostered that trust requires a dual responsibility and that more should be done to build bridges with government. Known instances where private sector service providers have rendered work of extremely poor quality in deliverance of tenders been awarded to them by the state, do not contribute towards establishing trust between parties. In an effort to try and eradicate such practises that undermine trust between parties, there is much room to accommodate private-sector initiatives with the aim of combating these undesirable practises. Similarly, postponing, and in some instances not honouring contractual payments from the state's side for services rendered by private sector companies, also do not contribute to a harmonious relationship from developing between the state and the private sector.

The focus within the National Development Plan on the eradication of corruption from the system is most welcomed, in taking cognisance of the fact that for corrupt state officials to be accommodated within the system, a willing counter party from the private sector is necessary. There are no innocent parties in this battle; a battle that we must jointly tackle, bringing all perpetrators to book.

The National Development Plan recognises the need for increased fixed investment in the economy. In fact, it sets a target of raising the level of gross fixed capital formation from around 17 per cent of GDP currently, to as high as 30 per cent by 2030. Inarguably, well-planned and appropriate infrastructural development is conducive to higher levels of economic growth and job creation. The Development Plan clearly distinguishes between

investment that generates immediate financial returns such as in airports, power stations and toll roads and those projects where financial returns are far less measurable such as in schools and hospitals. The role of business in increasing the overall level of fixed investment in the country, will most appropriately lie in the area of fixed investment where financial returns are more lucrative, through public private partnerships. International experience has shown that private sector participation in infrastructure provision is most successful in the transport and energy sectors. The participation of the private sector contributes to effective cost containment through the profit motive, improves efficiency and leads to more sustainable jobs through more prudent skills transfer. In the process complementing the capacity of the state by addressing gaps that are not viable for the state to attend to and taking on development risks.

An area in which the private sector can excel, given appropriate incentives, is that of research and development which act as a driver of competitiveness and job creation. Many infrastructure investment projects can act as an attractive asset class for private investors due to the predictable nature of returns, thereby providing a low risk investment profile. Infrastructure investment projects may provide a means whereby a consistent real return over inflation can be attained through a low volatility investment vehicle. Private sector funding is, however, subject to policy certainty so that private investors can be assured that they will be able to realise a return on their investments. To this end, the National Development Plan proposes that Regulatory Impact Assessments be done on all new regulations, and that an expert panel be appointed to prepare a comprehensive regulatory review for small- and medium-sized firms in an effort to assess whether special conditions are required for such establishments. The implementation of this proposition by the National Development Plan will create a direct channel for business to assist in the formulation of new regulations.

For the establishment of small-, micro- and medium-sized enterprises or SMMEs, as they are better known, that have a crucial role to play in the creation of sustainable jobs in the economy, a spirit of entrepreneurship within the economy should be cultivated, anew. Instead of talking jobs, I also advocate that we should start talking the establishment of SMMEs and how an environment of support to these enterprises can be created, and also how SMMEs can best interact with their environment to increase their likelihood of survival and ultimately expansion.

It is a common feature across countries to make available large amounts of money in an effort to try and facilitate the growth of SMMEs. Disconcerting though is the fact that limited systematic research or data are available informing the various policies in support of SMMEs, especially in developing countries. Moreover, empirical evidence concerning the relationship between the size of firms and growth has been mixed. Recent work on this topic by Haltiwanger, Jarmin and Miranda suggests that so-called “start-ups” and surviving young businesses are most critical for job creation and contribute disproportionately to overall employment growth. It is found from this study that was carried out across 99 developing economies between 2006 and 2010 that small- and medium-sized enterprises are the largest contributors to employment across countries but that SMMEs contribute more to employment in low-income countries than in higher-income countries. Across countries, firms that are both small and that have been in existence for more than 10 years employing between 5 and 99 employees have the largest proportional share of total employment compared with other size-age groupings. Small and mature firms do not only employ the largest number of people, but they also create the most new jobs, across country income groups.

While SMMEs are found to create more jobs, their contribution to productivity growth is found to be less than that of larger firms. Growth and increases in productivity amongst SMMEs require that policy should be focussed on the likely obstacles faced by SMMEs that range from a lack of access to finance, the need for business training and literacy programs as well as addressing other constraints such as taxation, regulations and corruption.

It is interesting to note that SMMEs in the United States have created as much as 80 per cent of all new jobs over the past 10 years and account for over 98 per cent of all employers. In India, the figure is closer to 90 per cent and similarly in Ghana it is estimated to be in excess of 90 per cent. In South Africa, small firms employing less than 50 people are falling short of 70 per cent of employment. Of some concern is the fact that South Africa is ranked 44th in the world for “ease of starting a business”. It takes around a month and 5 procedures to start a new business in South Africa, whereas in New Zealand, one combined procedure executed within one day, can accomplish the same outcome. The World Economic Forum places South Africa in the 112th position regarding the “Burden of Government Regulations”.

The proper implementation of the National Development Plan will be conducive to an increased level of entrepreneurship in the economy, as the ease of doing business improves. The obvious outcome of such a process will be the creation of jobs with longevity, unlike those jobs that sometimes follow projects undertaken by the state in an effort to address the scourge of unemployment, that are not sustainable over the long run. Small businesses generally have the capacity to attract those who are low to moderately skilled, and are therefore best placed to engage the overwhelming pool of the unemployed. Small businesses should not only rely on tax incentives for encouragement to expand their businesses but should also drive the agenda in an effort to engage government in seeking most appropriate ways to incentivise their activities. The premise of this approach lies in the fact that small business is in the best position to tell what is restricting their own operations, unlike officials who sometimes have limited insight into sector specific issues. In short, instead of pushing the proverbial string from behind to make it move, rather start pulling it from the front by collectively making small business’ voice heard, more so than in the past. In this regard business formations, such as the AHI, have an important role to play.

Larger companies holding monopolies based on incumbent technologies generally have less incentive to innovate than potential rivals, and could therefore eventually lose their technological leadership role, when technological innovations are introduced by new firms, as they leapfrog ahead, taking on risks. The adoption of solar energy technology is an example of an area in which small businesses could leapfrog ahead, as countries become more inclined to embrace a Green Growth development approach, as we enter the so-called Solar Age.

The benefits derived from the expansion of business linkages should also not be underestimated. So-called vertical business linkages that can be both backwards, where large companies acquire goods and services from small businesses, or forward, where large companies sell to small enterprises or distribute their goods and services through them, should actively be pursued. Small enterprises should also consider to more actively join themselves in groups to increase their capacity to access markets through combined production for large orders or collective purchasing to secure better purchase prices. Such initiatives can also be beneficial in assisting small-scale farmers entering the agricultural sector.

More opportunities should also be created for informal business socialisation which is important for entrepreneurial success, through sharing of experiences, developing of peer networks and the establishment of role models to be emulated. Peer groups create an environment in which members can share their challenges, brainstorm solutions and acquire additional information that can be to their benefit in running their businesses. Learning from the peer group can contribute to small business development, establish business linkages, build business confidence, expand business relationships, help shape corporate expectations and also contribute to the cultivation of business professionalism. Once again the AHI is well positioned to facilitate such interaction learning and sharing which can be crucial in assisting SMMEs to reach new levels of performance.

## **5. Conclusion**

Ladies and gentleman, I wish you well during your deliberations for the rest of the day as we search for new and innovative ways to address the challenges that we collectively face in an effort to make this country of ours truly great, in amplification of the inspiring achievements of Teams SA at the London 2012 Olympic games, that have made us all proud.

I thank you.