Submission by Solidarity to the Portfolio Committee on Trade and Industry.
Prepared by the Solidarity Research Institute.
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BBBEE Amendment Bill (2012)

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Solidarity Research Institute

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ABOUT SOLIDARITY

Solidarity is one of the oldest trade unions in South Africa. Its origins date back to 1902 and the Witwatersrand mines. Since its inception, Solidarity – formerly the Mine Workers Union (MWU) – has been closely linked to the course of South African history. In the 1990s a number of other trade unions, including the South African Workers Union, joined the MWU and the trade union's name was changed, first to MWU-Solidarity and subsequently to Solidarity.

Solidarity has members in virtually every industry in South Africa. It also has members in a great number of companies. The main industries in which Solidarity is organised are metal and engineering, mining, electrical, telecommunications, chemical, agriculture and general industries, including tertiary institutions, aviation and other specialised areas.

Solidarity is a trade union in the Christian democratic trade union tradition. It promotes the interests of its members in labour relations and community life, believing that a system of government and labour relations can be judged by the extent to which it recognises the rights of minorities. Solidarity also promotes a system of free enterprise, confident that the employment relationship can be one of mutual gain.

Solidarity does not support any political party. Solidarity seeks to create democratic spaces for its members in which to live and function independently. The trade union believes in mobilising capital to assist its members and their communities in coming up with their own institutions to solve challenges, instead of depending on third party initiatives.

SUMMARY OF OUR COMMENTS ON THE BILL

Solidarity has carefully considered the evolution and nature of Broad-Based Black Economic Empowerment legislation in South Africa. We recognise the core of the Broad-Based Black Economic Empowerment (BBBEE), Act 53 of 2003, as infringing on the property rights of those who own parts of the capital structure; and as the attempted replacement of consumer-led investment allocation with politically led investment allocation. The BBBEE Amendment Bill of 2012 seeks to further these primary goals.

We also recognise that the Act and Bill contain secondary elements not inseparably tied up with the core that undermines property rights. However, in the light of the gravity of the primary matters, we will not address secondary elements.

Our yardstick for the BBBEE Amendment Bill is the extent to which it furthers or undermines the following:

1. The capital structure in South Africa;
2. access to consumer goods in general, and for black, coloured and indian South Africans in particular; and
3. the moral framework of South Africans.

We have come to the conclusion that the BBBEE Amendment Bill will increase the extent to which the BBBEE Act undermines all three of the above-mentioned aspects. The Bill runs contrary to any presumed good intentions of improving the general material well-being of black, coloured and indian South Africans. Not adopting the bill is in the interest of South Africans in general and black, coloured and indian South Africans in particular. If the bill is not adopted, virtually all South Africans would be much better off than they would be if it iss adopted.

Consequently, the sensible step would be to scrap the 2012 BBBEE Amendment Bill.

CONSEQUENCES OF BBBEE LEGISLATION

1. THE CAPITAL STRUCTURE IN SOUTH AFRICA

WHAT IS THE CAPITAL STRUCTURE?

The capital structure supplies South Africans with goods and services to consume. The capital structure is the productive arrangement of durable goods of a higher order that yields goods of a lower order for eventual consumption.

The health of the capital structure is thus of the utmost importance for anyone interested in assuring the greatest possible sustainable flow of goods and services to South Africans for their consumption.

WHERE DOES THE CAPITAL STRUCTURE COME FROM?

The capital structure originates from earlier acts of individual saving. It is past acts of abstention from consumption that has allowed saved resources to be invested in the maintenance and expansion of the capital structure. The size of the capital structure is mainly driven by people's propensity to save and invest and, roughly speaking, the greater the size and efficiency of the capital structure, the greater its future output of goods and services to consumers.

HOW IS THE CAPITAL STRUCTURE ARRANGED?

While savings and investment drive inputs into the capital structure, size isn't all that matters. The other very important aspect of the capital structure is the specific forms and combinations within it, for example, which machines go where, what inputs are combined and how, and under what timeframe. These decisions about the content of the capital structure determine the types of goods and services, and their scarcity or abundance, that will be available to consumers in future.

Capital is not homogeneous. Each form of capital comes at the expense of some other form of capital – and once the wrong kind, or the less efficient kind, of capital has been formed it can only be remedied at the expense of additional resources over and above what would have been necessary to form the right kind of capital in the first place. Bad decisions about capital formation cause the capital structure to produce less important, or even unwanted, goods and services. Clearly, decisions about the arrangements within the capital structure are extremely important and should be made by those people who are best at doing so.

The very best people are the very best entrepreneurs. Entrepreneurs are people who make educated guesses, taking the risk upon themselves, in anticipation of future consumer wants and arrange the resources therefor into the appropriate forms of capital. If, for some reason, the very best entrepreneurs are prevented from making the optimal capital structure arrangements, future goods and services to final users end up being more scarce, less useful and more expensive than they would have been, because of the less efficient capital structure.

HOW DO THE BEST ENTREPRENEURS GAIN CONTROL OVER RESOURCES?

In the market, consumers inspire the conduct of entrepreneurs. Consumers, by way of their current, past and anticipated buying habits, direct the ends to which entrepreneurs gear their production processes. Investors, eager to earn the best possible return on investments with the least amount of risk, make sure that the best

entrepreneurs – those with the best profit/risk balance – gain control over the most resources to bring into the capital structure. Ultimately, therefore, all market allocation of resources to entrepreneurs is consumer-led.

When directed by consumers, investors entrust their resources to those entrepreneurs who arrange resources in a way that ensures the greatest possible sustainable flow of goods and services from the capital structure. If a specific entrepreneur does not deliver the returns that were anticipated, this is swiftly corrected by the market's consumer-led process, as investors move their funds elsewhere, leading to the least possible loss for society in general.

WHAT IS THE EFFECT OF BBBEE ON THE CAPITAL STRUCTURE?

At the heart of the BBBEE Act – and intensified by the BBBEE Amendment Bill – is an attempt to redirect resources away from more entrepreneurial and towards less entrepreneurial recipients. It is about the replacement of consumer-led resource allocation with politically led resource allocation. Were it not the case that the intended new recipients were less entrepreneurial, no legislation to circumvent the consumer-led allocation of investment – forcing investors to accept lower yields – would have been necessary.

The effect of this redirection of resources causes a change in the capital structure. As has been pointed out above, the best entrepreneurs are superior to others precisely because of their ability to better anticipate future consumer demand than other people; and their ability to better arrange resources to provide for that future demand than other entrepreneurs.

It follows then that if less entrepreneurial actors play a relatively greater role in the design of the capital structure, the capital structure will be less suited to satisfying consumer demand. This lesser suitability means that the stream of goods and services provided by the capital structure will be less useful to the ordinary people using them in the end.

Additionally, while consumer-led resource allocation tends to be flexible and to encourage investments in underperforming entrepreneurs to be reconsidered, political resource allocation tends to be inflexible and to leave resources underutilised for longer periods of time.

In the next section we consider a stylised version of the effect of replacing the consumer-preferred entrepreneur with a slightly less proficient entrepreneur.

2. ACCESS TO CONSUMER GOODS

WHAT ARE CONSUMER GOODS?

Consumer goods are goods and services that are used directly by the consumer towards whatever ends he or she prefers. This type of goods stands in contrast to producer goods or capital goods, which are used to create consumer goods.

To put this definition in the terminology used so far: consumer goods are the end product of the capital structure.

WHAT IS THE ECONOMIC SIGNIFICANCE OF CONSUMER GOODS?

Consumer goods are the raison d'etre of all production. Production that provides more and better consumer goods – things that enable consumers to better reach their own goals according to their own preferences – are superior to production processes that provide fewer and inferior consumer goods – with which consumers are less able to reach their own goals.

WHO USES CONSUMER GOODS?

Everybody uses consumer goods. Consumer goods are means towards ends – and everybody has ends that they want to reach.

In BBBEE terminology: all people, whether they are white, black, coloured or indian people, use consumer goods.

Anything that lowers the availability of consumer goods therefore runs contrary to the interests of white, black coloured and indian people in South Africa.

WHAT HAPPENS TO CONSUMER GOODS UNDER BBBEE?

Under BBBEE, some resources and control of parts of the capital structure are redirected to politically favoured recipients, who are inevitably less able entrepreneurs. Even if the entrepreneurial ability of the politically favoured recipients are only slightly inferior to that of the entrepreneurs chosen under a consumer-led process, the consequence of BBBEE will nevertheless be a relative decline in the flow of goods and services from the capital structure.

Under a BBBEE-directed allocation of capital, all consumers, including black, coloured and indian consumers, suffer greater economic scarcity than under a consumer-led allocation of capital.

True, there are a few select black, coloured and indian beneficiaries of BBBEE. However, this handful of people's gain is at the expense of black, coloured and indian people in general.

HOW BAD IS BBBEE FOR BLACK, COLOURED AND INDIAN PEOPLE IN GENERAL?

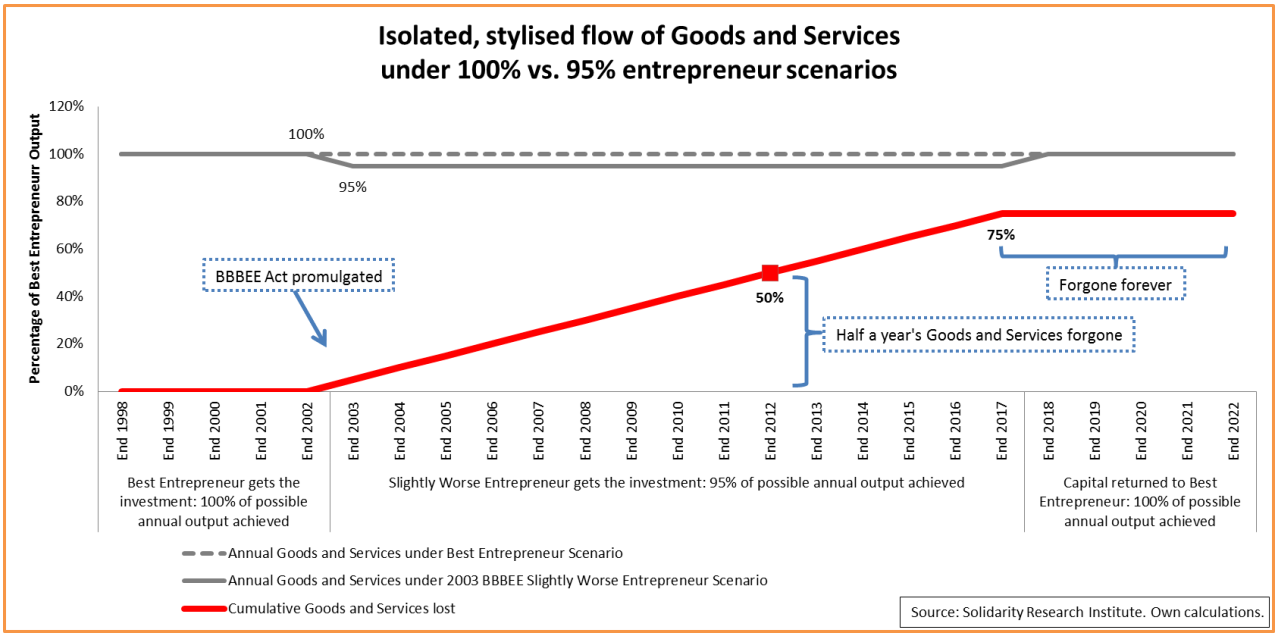
The general detrimental effect of BBBEE can be illustrated by way of a stylised flow of goods and services from hypothetical resource allocations to people with varying entrepreneurial ability. It is important to note that, for the unseen loss to consumers to be significant, the entrepreneurial abilities of politically favoured investment recipients need only be slightly less than the entrepreneurial abilities of those who would have gained control over the allocation of resources to the capital structure under a consumer-led allocation.

In the stylised model set out below, the assumption is therefore that the politically favoured investment recipients are only 5% less good than the consumer-favoured investment recipients. The final effect nevertheless proves to be substantial.

FIGURE 1: ISOLATED CASE OF PRODUCTION BY A 95% ENTREPRENEUR

Figure 1 illustrates the flow of goods and services from a single entrepreneurial process under two scenarios. The flow of goods and services from production under control of the consumer-favoured entrepreneur (the best) is used as a benchmark for comparing the flow of goods and services from the politically favoured entrepreneur, who is 95% as accomplished an entrepreneur as the best one.

Figure 1:



The stylised figure above compares the flow of goods and services from two different entrepreneurial processes on a 25-year timeline. Between the end of 1998 and the end of 2002, investment is allocated to the consumer-favoured entrepreneur. The consumer-favoured entrepreneur, being the best at transforming inputs into consumer goods, produces 100% of potential output with those inputs.

However, in 2003, the BBBEE Act is promulgated. The incentives of the act are such that it causes the capital to come under the control of a politically favoured recipient, who is, fortunately, also an able entrepreneur, only slightly less so than the consumer favourite. With the same inputs, he can produce 95% of the goods and services of the consumer favourite. The annual loss to consumers is therefore only 5% as measured against the 100% consumer favourite benchmark, as indicated by the difference between the solid and the dotted line.

This situation continues between the end of 2002 and the end of 2017, when the capital is either transferred back to the consumer favourite, or the politically favoured recipient for some reason becomes the favourite under a consumer-led process.

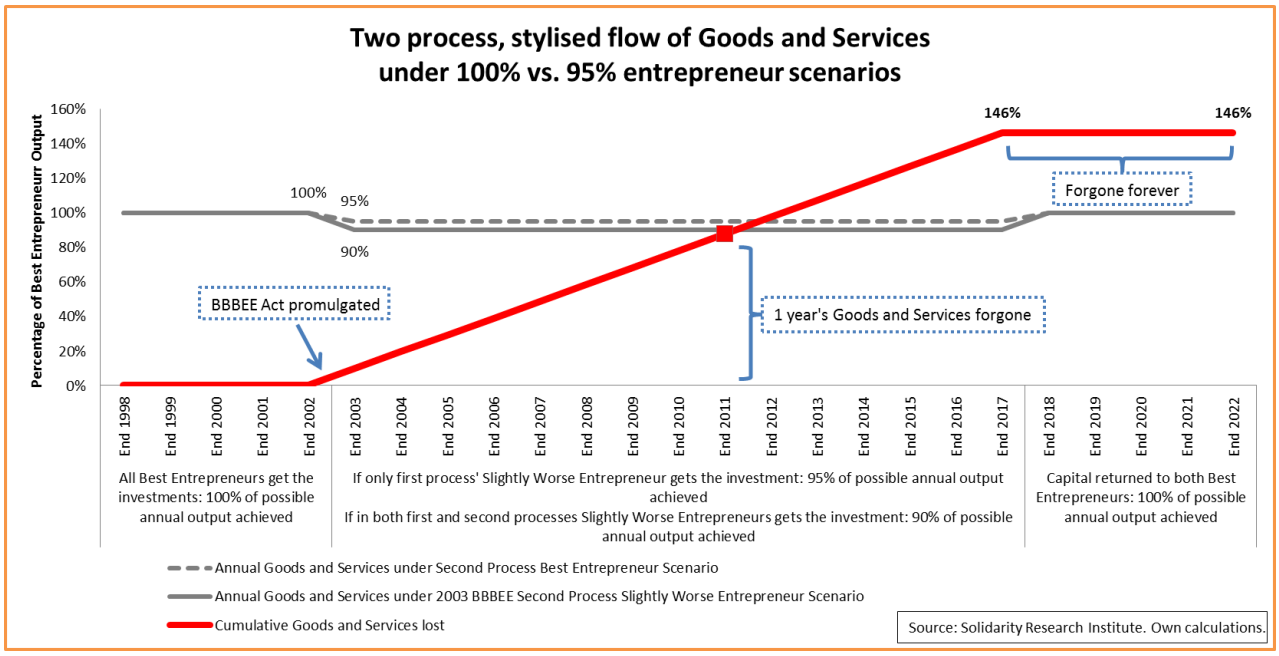
Now note the red line, which indicates the cumulative effect of each year's 5% losses. By the end of 2012, within 10 years, the cumulative cost to consumers in goods and services forgone is already 50% of what the consumer favourite would have produced in a year. That is, half a year's worth of production has been lost to consumers. The situation continues until the end of 2017, when production is restored to benchmark levels. However, by this time, three quarters worth of a year's goods and services have been lost.

What's more, even though benchmark production is now restored, the 75% loss can never be recovered. Thanks to a politically favoured entrepreneur only slightly less able than the consumer favourite, consumers have forever lost out on 9 months' worth of production.

FIGURE 2: TWO PROCESS CASE OF PRODUCTION BY TWO 95% ENTREPRENEURS

Figure 1 considered the case of a single entrepreneurial process if taken over for a limited time by an entrepreneur 95% as competent as the consumer favourite.

Figure 2 now considers the case of a second entrepreneurial process. The goods and services produced in Figure 1 are now not final consumer goods, but serve as inputs for the production process of final consumer goods in Figure 2. Again, the cases of having the process under the control of a 95% entrepreneur as compared to a 100% entrepreneur are illustrated.



The timeline in Figure 2 is identical to the timeline in Figure 1. However, in the case of Figure 2 the dotted line, while representing the flow of consumer goods from the consumer favourite entrepreneur, is at 95% instead of at 100%. This is because the flow of goods and services from the politically favoured entrepreneur in Figure 1 to the consumer favourite entrepreneur in Figure 2 is only 95% of what it could have been under the consumer favourite in Figure 1.

If the capital structure in Figure 2 was to remain under the control of the consumer favourite (here producing at only 95% because of receiving only 95% from Figure 1's politically favoured entrepreneur) between the end of 2003 and the end of 2017, the loss of final consumer goods would have reflected the same ultimate loss as was experienced in the isolated version of Figure 1: 75% of a year's production.

However, if, in 2003 under the new BBBEE Act, the capital structure was once more brought under the control of a 95% entrepreneur, the relative-loss effect of the 95% entrepreneur in Figure 1 would compound with the relative-loss effect of the entrepreneur in Figure 2. This is represented by the solid grey line dropping to 95% of the 95% level, which brings it to rest at just over 90%. Now, instead of experiencing simply a 5% loss in consumer goods per year, consumers can expect to have access to about 10% less (or less suitable) consumer goods per year than they would have had access to under a consumer-led allocation of investment.

Within 9 years, by the end of 2011, consumers will have lost out on just as much consumer goods as the 95% entrepreneur would have produced in that whole year. When, in 2017, the consumer-led allocation of capital is restored, consumers have paid for BBBEE by sacrificing the equivalent of a year and a half's worth of consumer goods production. This unseen, but nevertheless real, loss to consumers in their quality of life can never be recovered.

CONCLUSION ABOUT BBBEE'S EFFECT ON CONSUMER GOODS

Even if the politically favoured entrepreneur is only slightly less entrepreneurial than the consumer favourite, the underproduction of consumer goods turns out to be significant over time. The effect becomes especially pronounced when associated and subsequent production processes suffer similar political interventions.

The cost of BBBEE is borne, even if it is not always easily recognised, by consumers, who pay for the enrichment of a few by having to sacrifice significant flows of goods and services.

Ironically, BBBEE – even if there is no corruption involved and even if the BBBEE entrepreneur is only slightly less able than the entrepreneur a consumer-led process would have identified – comes at the expense of ordinary South Africans. This includes the 89% of them who are not white – precisely the people who are supposed to be helped by BBBEE.

BBBEE, in so far as it is intended as a mechanism to improve the material position of black, coloured and indian South Africans by transferring, through a political process to some of them ownership or control over parts of the capital structure, has the exact opposite effect. Notwithstanding the likelihood that a select, politically connected few might benefit materially, the vast majority of black, coloured and indian South Africans are left worse off.

Seen as a question of whether BBBEE is materially good for black, coloured and indian people, it must be recognised that it is not and cannot be. While the BBBEE Act of 2003 is itself not the subject of the invitation that lead to this submission, it must be recognized that the BBBEE Amendment Bill of 2012 is a proposal to increase the harmful effect of the Act.

3. THE MORAL FRAMEWORK OF SOUTH AFRICANS

While all governments share economic interventionism, some – of the more prosperous and free countries – are constrained by a popular belief in non-interventionism. This belief about what constitutes a state's proper relation to its citizens stands between occasional interference within a rule-of-law framework on the one hand and legalised plunder[1] on the other. If politicians are constrained by this popular belief, they tend to identify conduct that is prohibited; if not, they tend to identify conduct that is prescribed.

It is this constraining belief that supporters of the BBBEE Act and the BBBEE Amendment Bill seem to be freed of. Whereas non-interventionism forms the rule from which governments deviate in prosperous and free societies, interventionism appears to have become the rule in South Africa.

When a government starts to operate in this fashion of disrespecting property rights, of taking from some that which is theirs and giving it to others who happen to be political favourites, such a government sows seeds for a general disrespect for property rights. And a general disrespect for property rights is incompatible with a harmonious society.

The BBBEE Act and the BBBEE Amendment Bill share their point of departure with the policy of Indigenisation that brought such hardship and societal degeneration to Zimbabwe.

Solidarity maintains that a respect for property rights lie at the core of a prosperous and peaceful society. This is also why we welcome the progress noted in the National Development Plan, where it is stated that 95% of land restitution claims – claims for the restoration of unjustly deprived property – have been settled.

However, BBBEE is not a restitution process, but a political redistribution process. As we have pointed out in our explanation of the effect of BBBEE on the production of consumer goods, this policy is paid for to a large extent by the very people it allegedly wants to help.

By exacerbating economic hardship and undermining respect for property rights, BBBEE is laying the groundwork for a less harmonious and less prosperous society.

[1] In 1849 Frederick Bastiat distinguished between legal and illegal plunder, where the former is identified by asking whether there is taken under law from some persons that which belongs to them and given to other persons that which does not belong to those other persons. "See if the law benefits one citizen at the expense of another by doing what the citizen himself cannot do without committing a crime." (See page 13 in Bastiat, F. 2010, original 1849. The Law. New York: Foundation for Economic Education.)

CONCLUSION

The BBBEE Amendment Bill of 2012 should be scrapped.

The bill seeks to intensify the harmful process of political allocation of capital by:

1. Undermining the capital structure of the economy;
2. resulting in fewer or more expensive goods and services to South Africans in general and to black, coloured and indian consumers in particular; and
3. destroying the respect for property rights that should form part of the moral framework of the citizens of any civilised country, including South Africa.