Current State of legislation in South Africa

A country overregulated and undergoverned?

In May this year, the speaker of the National Assembly, Max Sisulu, chided its members for the poor quality of legislation that it was approving. Such measures would be returned for correction, either by the National Council of Provinces or after having been found in court to be unconstitutional. Rightly, he reminded the Assembly’s members that they had an obligation to ensure that the legislation processed was both in line with the country’s constitution, and processed with an appropriately diligent and professional understanding of the matters at stake. Failure to do so, he suggested, would compromise the country’s most vulnerable.

Against the background of a series of attacks on the courts and judiciary by prominent government figures for having supposedly overreached themselves in their role in South Africa’s system of governance, Sisulu’s comments struck an audible and urgently needed chord. For while his speech did not reference it specifically, he was alluding to a key obstruction on the path of dealing with one of the country’s most pressing matters: generating sustainable economic
opportunities for a population whose young unemployed are both growing and
growing despondent.

A well-ordered and productive economy needs regulation. Radical free marketers
and anarchists aside, no one disputes this. It is a false debate as to whether or
not regulation is necessary. More profitable is a brief excursion into the etymology
of the term. Regulation derives from “regulate” and by extension, “regular”. As this
implies, it means to establish predictable patterns for behaviour and interaction.
In relation to governance – and the management of economies in particular – this
means establishing acceptable procedures for interaction, and to incentivise what
is desirable and penalise what is the undesirable.

A regulatory system has to be understood from the point of view of what it
hopes to accomplish. Regulation without intention is meaningless, and cannot
be described as anything but a deadweight on society. Economic regulation is
of course a multifaceted concept, and different contexts will demand different
interventions.

**What is at stake?**

It is common cause that unemployment is the seminal problem confronting South
Africa. With an official unemployment rate of 25% – but with around 40% or so
of the workforce out of work, even if they are not definitionally “unemployed” –
a large part of the country’s population is essentially excluded from meaningful
participation in society and opportunities for mobility. The squandering of potential
and the attended consequences for social cohesion that would follow from a
failure to deal with this are enormous and debilitating. Productive regulation would
imply a clear focus on the consequences for employment.

Symbiotically connected to unemployment is the encouragement of an
environment suited to a vibrant business sector. If unemployment is to be reined in,
it will be via the growth and expansion of existing businesses, and the emergence
of new ones. In particular, it is to small business – acknowledged domestically
and worldwide as the chief generators of jobs – that the country must look to
do this. The scale of this is illustrated by Prof Neil Rankin of the University of the
Witwatersrand. To achieve the 5m new jobs that government has committed itself to, some 13,600 additional firms will be required in the manufacturing sector alone. Chris Hart, prominent economist and commentator, suggests that 15m new jobs will ultimately be required, and this will necessitate a staggering 2-3m more small businesses. Ideological perspectives notwithstanding, no convincing case can be made for any other route.

In fact, this is government's perspective, at least officially. Small enterprise development has been a stated goal of economic policy since 1994 (it actually predates democracy, and was identified as a vital goal in the 1980s). The RDP White Paper, for example, stressed the need for the small business sector to expand, to take advantage of opportunities, and in turn, to generate others. It suggested a suite of supportive interventions on the part of government to achieve this, one of which stands starkly out: it proposed "favourable amendments to legislative and regulatory conditions".

Nearly two decades later, this proposal remains painfully relevant. Indeed, the necessity of encouraging small business is regularly acknowledged. So is the importance of a corresponding enabling environment. But government also concedes the inadequacy of its efforts. Finance minister Pravin Gordhan noted last year: “We need to do a lot better to drop the red tape ... we’ve been too slow at removing constraints on small businesses, and we’ve been pathetic in terms of helping small businesses to become more dynamic within our own context as well.”

The Diagnostic Overview, produced as a prelude to the National Development Plan by the National Planning Commission under minister Trevor Manuel, commented: “It is worth making special mention of the limited expansion of small and medium-scale enterprises. In successful economies, it is in these firms where most job creation takes place. South Africa has not yet been successful in laying the ground for faster small, medium and micro enterprise (SMME) entry and expansion. Special concerns relate to an onerous regulatory environment, limited access to finance and working capital, and concentrated markets with limited niche opportunities.”
The regulatory burden is clearly a concern for South African business. According to the first round of our SME Growth Index, 19% of respondents identified it as the key obstacle to business expansion (second only to the general economic climate, an unsurprising outcome at present). By a considerable margin (32% of the total), the labour regime was seen as the key problem. This is more than a perceptual issue. The scale of the burden was illustrated by SBP’s study of the cost of red tape, published in 2005. It estimated that regulatory costs incurred across the economy the previous year amounted to some R79bn, or 6.5% of GDP. Although now somewhat dated, this remains the most comprehensive such study yet undertaken. While this is not the most extreme case in the world, it is notable that South Africa’s regulatory costs relative to GDP more than double those of several other comparator economies, including Sweden, Norway and New Zealand – market economies which are associated with extensive state intervention.

More recently, a proposed set of amendments to the Labour Relations Act and Basic Conditions of Employment Act signal a further significant burden on business, attracted widespread and ongoing attention. Beyond this, a draft Business Registration Bill has been produced. While not widely distributed, it sought a thoroughgoing revision of key aspects of the business regulatory environment. Its stated aims are quite laudable, principally to simplify the establishment of businesses. In practice, it would impose potentially onerous requirements – and by implication limitations – on anyone seeking to conduct “business” in South Africa. It appears that this process has now been placed on hold (about which more below). But it certainly speaks to an ongoing trend, and a contradiction at the heart of South Africa’s economic governance. It is striking that with the apparent acceptance of the regulatory burden in constraining business growth – and particularly the supposedly sought after small businesses – so little appears to have been ventured to correct it. Indeed, a case could be made that South Africa is tending in the other direction. Why is this?

**Drafting**

One explanation is that legislation is simply carelessly drafted. Putting together a good law is a process requiring careful research and evaluation of the issues...
at hand, determining what a desirable outcome would be, and crafting a reasonable and achievable response – keeping in mind the limitations imposed by constitutional and legal environments. The failure to do this is the kernel of Sisulu's concerns.

Poor drafting means one of three things. Firstly, it does not pass constitutional muster. Despite protestations from the ruling party and government about the courts being misused to undermine government, no constitutional democracy can tolerate laws that contradict its constitution. And it is the duty of the courts to enforce this. The embarrassment and frustration felt in government lies in what is drafted and passed.

Secondly, legislation may be ineptly written. The Companies Act of 2008 was a case in point. This law was of crucial importance to the economy and would provide the legal operating framework for the country’s businesses. Yet it was riddled with mistakes, ambiguities and poor grammar. The amendment needed to correct it was less a case of surgery than transplant, making alterations to well over 100 of its sections.

It was commented that this Act was drafted without taking note of other legislation and processes germane to South Africa’s economy. Concerns were also expressed about the familiarity of the drafters with South African conditions.

Thirdly, it might forge ahead heedless of evidence and warnings about its consequences. This has been a recurrent theme in critiquing South African legislation since the transition to democracy. Is a law necessary? Is it the best route to achieve its overall objectives? Is it affordable? Is it implementable? Will it have unintended consequences?

Government does recognise these dangers – at least to a degree – and hence in 2007 Cabinet accepted the principle of subjecting legislation to Regulatory Impact Assessments (RIA). This should be an excellent shield against reckless policy making. The controversial labour bills were subjected to a partial RIA, conducted in 2010, but its influence appears thus far to have been unimpressive.
The RIA cautioned against proceeding with the bills in their extant form, making a strong case that they would impose significant burdens on business, raising business costs, and ultimately costing jobs. Updated versions of the bill have largely ignored the RIA. A more prudent course would have been not only to take its concerns on board, but to go further and subject the entire suite of amendments to an RIA – at least, this would have been the case if the impact on jobs was a driving motivation.

Subsequent economic modelling conducted by SBP and Prof Neil Rankin on certain provisions of the new labour bill amendments indicates that, if enacted, these measures will cause South Africa to shed some 285,000 jobs.

**Motivations: this way and that…**

Business regulation, and small business regulation in particular, suffers from a case of ambiguous motivation. In some cases, it is not clear what considerations lie behind substantive measures. Why would they be desirable or necessary?

Measures under consideration illustrate this point well. A strong feature of the draft Business Registration Bill was to be the formalisation of unregistered and informal enterprises. At first glance, this seems understandable – why should anyone object to bringing businesses operating semi-illegally into the legislative net, not least regarding tax obligations? But the bill demands more, and seeks to formalise the country’s considerable informal economy. But it is largely the absence of regulatory restraint which makes the informal sector possible. There are naturally some negative consequences, but informal sector economies provide a livelihood – however meagre or imperfect – that would otherwise not exist. Attempting to force (or “encourage”) informal traders to formalise their operations would be to erect a barrier to them. In the absence of other alternatives, this seems quite counterproductive.

Moreover, the bill contains some severely punitive measures. Administrative fines, for example, may be levied for offences, and can be set in the millions of rands.

A similar problem exists in relation to the recent proposed amendment dealing
with increased on “actual” rates of pay (Basic Conditions of Employment Act s55(1)(4)(b)) It is not clear exactly why this has been proposed. Intuitively, it would in theory benefit wage earners by boosting the prospects for mandatory increases, while Business Unity South Africa has suggested that it arises from a belief that it is somehow unfair that workers earning above the minimum wage are not automatically entitled to increases. However, our modelling predicts, based on an evaluation of seven sectors of the economy, that we can expect this measure to cost cumulatively between 11,684 and 105,155 jobs, depending on the assumptions applied to measure it. The impact across the economy would likely be considerably more severe. If employment is a consideration – surely not unreasonable in a time of great consternation about unemployment and a context of economic difficulty – this measure can most charitably be described as imprudent.

A distinct aspect of the question of motivation is the ideological pull over policy. In short, certain concerns loom larger than others, and the creation of a fertile business environment is simply not a priority. This is particularly the case in respect of labour market matters, where the ruling party is mindful of the sensitivities of its trade union allies, and, for political reasons, is wary of alienating them. Furthermore, to an indeterminate, but noticeable, degree, business is viewed with suspicion. It is held to be geared towards essentially selfish interests. Calls for liberalisation could thus be understood as a cynical ploy to dodge social responsibilities.

When the cornerstones of the post-1994 labour regime were being legislated – the Labour Relations Act and the Basic Conditions of Employment Act in particular – the suggestion that it might prove a disincentive for investment, and too onerous for small businesses in particular, were generally dismissed by government. In some circles the view was expressed that this would merely open the door for widespread evasion of labour legislation. Big business, it was argued, might simply masquerade as “small business”.

The current labour bills express a different dimension of the same concern. Attempts to limit “atypical work” – by which is meant part-time work and limited-duration contracting, and not simply “labour broking”, although this idea seems to be firmly entrenched, even among some legislators – appear to be based on the
notion that some forms of work are by nature demeaning and undesirable, and that a duty exists on the part of businesses to accommodate these workers on a permanent basis. It is questionable how deeply the issue of rising business costs was considered – or, indeed, if it was thought a legitimate consideration at all – or whether consequent job losses were a major concern.

Concerns about labour standards, and the evasion of legislation are doubtless valid, at least in part. The more pertinent question is whether the aggregate interests of the country would not better be served by conceding the need for a different regimen for small businesses (with an eye on the job creation benefits), and accepting the attendant risks, and dealing with wilful and egregious evasion through monitoring and enforcement.

There is considerable evidence that labour legislation has had a dampening impact on employment creation, particularly by smaller firms. Much of this is anecdotal, although it is supported by a considerable body of hands-on research, and it stands out as a major disincentive in our SME Growth Index – the most comprehensive primary study into the sector in South Africa to date.

In the event, the conclusion that presents itself is that employment creation ranks lower in the drafters’ minds than regulated protection.

In fairness, there have been some about turns on aspects of the labour regime in relation to small businesses – such as differentiating between overtime rates for small and large firms. But these have tended to be sporadic, somewhat grudging concessions. And it appears that insufficient principled commitment exists in policy-making circles for this to signal any sort of recognition that such differentiation is necessary.

A State of Incapability

If the business environment is complicated by an unfocused or unsympathetic official mindset, the erratic and often anaemic performance of the state in practice introduces another element of unpredictability. It is often said that while South Africa has wonderful legislation, it falls down in implementation. But this is a
false division. Nazmeera Moola of Macquarie First South, and columnist for the Financial Mail, commented last year: “Many years ago a couple who had become legislative drafters asked me about SA's rape laws. I said we had good laws but poor implementation. They countered there is no such thing: before a law is written it must take into account the capacity of the system to implement it. If the system cannot carry it out, the law is by definition a ‘bad law’.”

The draft Business Registration Bill would be one such law. Potentially, it could – and seems to intend to – wipe out the informal sector through mandatory registration. In reality, this is unlikely, simply because of the immensity of the task that it sets the state and the implausibility of it succeeding in doing so. Given that the informal sector employs in excess of 2m people (conservatively estimated), the scale of the administrative task is truly Herculean. As South Africa's experience with company registrations and the attendant databases has not been uniformly happy, difficulties in this regard are to be expected. In addition, government would need to communicate its plans to the country’s informal traders, and (presumably) rely on them to present themselves at designated offices for registration. The direct and opportunity costs for someone earning a few rands a day to do this would be considerable. If present procedures are a guide, they would need to pay for their registration, and might be required to make an application and return at a later date to collect whatever documents are prescribed. These would be new and onerous burdens for little apparent reward.

In reality, it is unlikely that this law would be observed by anyone other than profitable unregistered businesses fearful of prosecution (essentially formal-style operations operating below the radar) – but this is enabled by current legislation, and is in any event a function of enforcement. Most informal traders would be likely to ignore it, even if they were made aware of it. However, they could be exposed to harassment, both legal and extortionate, for being outside the law.

South Africa’s history should warn about the mismatch between ambition and capability. It is, by way of illustration, questionable whether the state institutions established to support small business have added much value to the sector. This has implications for the usefulness of policy proposals, such as that recently floated by the Black Business Council for a ministry of small business. This is not
in itself an unworthy idea, but unless it is staffed with people familiar with and committed to the interests of small business – and prepared aggressively to push for the sector’s interests, even in the face of politically more weighty interests, such as those of labour – it is hard to imagine why this should achieve more than its antecedents, or, for that matter, the Department of Trade and Industry in whose bailiwick small business currently resides.

**Looking ahead**

Government’s stated aspirations – in this respect reasonably shared across South African society – are for a prosperous, socially stable country, in which all are included in a vibrant economy. It also – this time, with less concurrence – envisages this achieved through an economic process in which a powerful and directed developmental state flexes the economies muscles to the benefit of all.

Ideological questions aside, the prospects of success in this endeavour are questionable. Identifying the challenges facing a country, coming up with a programme to address them and determining an appropriate nature and degree of regulatory aspect of such a programme are essential functions of government. Perhaps more important is the ability to match these ambitions with the capacity to put them into practice. South Africa is in the paradoxical position of being both overregulated and undergoverned.

In respect of South Africa’s regulatory environment, the evidence speaks of severe governmental deficiencies.

These deficiencies stand as a significant obstacle – real and potential – to the growth and development of a robust small enterprise sector. It is a failure that is expressed in the dearth of jobs and the growing sense of social despondency.

It should, however, be recognised that it is not entirely the fault of government. Regulatory reform is not a matter capturing broad attention. Among activist groups identifying themselves are “progressive” or “pro-poor”, including most of the trade unions, churches, and social movements, it is almost entirely unrecognised – a combination of disinterest, hostility to business and lack of understanding of the
issues involved. Government agencies supporting small business have failed to act as effective advocates. Big business, while sharing many of the concerns of their smaller counterparts have agitated for reform while being able to live without it – relationships with government features prominently here. Small business itself is mostly unorganised and excluded from policy debates. This leaves a small number of think tanks, a few intellectuals, elements of the political opposition and the financial press to make the case. As persuasive as the arguments may be, they push against a far stronger combination of institutional power, inertia and hostility.

One argument that has been made in defence of poorly drafted legislation is that our judiciary has enough common sense to apply it in the spirit of its intention. To suggest that it will have vast unintended or unmanageable consequences is to raise false alarms. This is, however, not an available option. The judiciary must apply the law as it exists. Where a law is overly broad in its stated application, this will be the universe on which it will impact. Where a law is vague or ambiguous, consistency should not be expected at all. Different courts or legal scholars will reach different – and as far as it goes, equally “valid” – interpretations. The outcome will be a regulatory jam, thorough which no one can navigate with any certainty. Meanwhile, respect for and adherence to the law and its attendant institutions will suffer.

Our research suggests that in significant respects this is already happening. If we are to get back on track we need to adhere to a simple maxim proposed by the American economist Thomas Sowell, the true measure of a policy was not the intention of its framers, but the quality of its outcomes.

This means in the first instance putting each legislative proposal through a rigorous and comprehensive RIA process. The provisions of legislation must be carefully considered in light not only of their intentions, but their likely actual outcomes, both intended and unintended. Where the consequences have significant downsides, these must be frankly admitted. The political choice then needs to be made as to whether these are acceptable when measured against the intent of the bill, and its associated outcomes in this regard. In some instances, the intended outcomes may come at a cost in unintended consequences that is
difficult to justify. In such cases, the only rational response is to rethink and redraft the bill. In some instances, the intended outcome may not be attainable without severe unintended consequences. (This is a good description of much contained in the recent labour bills.) Legitimate concerns may not always lend themselves to resolution by law or regulation. This is an uncomfortable reality for policymakers, but a reality nonetheless.

In these instances, the necessity of the bills themselves must be questioned.

In the final analysis, a productive regulatory environment will only be possible when laws and regulations are carefully and fully thought through, their assumptions tested, and their probable impacts rationally considered and thoroughly debated. If South Africa is serious in its aspirations for a roaring small business sector and a job-generating economy, this is long overdue.