

## **NATIONALISATION**

**AMID the controversy over calls for the nationalisation of mines and farms, Sim Tshabalala, the head of Standard Bank SA, today sets out the argument against the proposals by the ANC Youth League.**

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The ANC Youth League and other opinion makers have been arguing for a while now that South Africa's mines and banks should be nationalised.

It should be accepted that these proposals are not merely the product of shrewd political manoeuvring. As analysts from across the political spectrum have pointed out, they are the effects of the pain and anger caused by persistent grinding poverty for millions, deep-rooted mass unemployment, and a level of inequality that is both morally unacceptable and constitutes a real threat to social cohesion. The statistics are chilling: 65% of South Africans live on less than R550 a month – less than a monthly satellite TV subscription. 12% are desperately poor, struggling to survive on R150 a month. One in five children shows signs of malnutrition. The unemployment rate for black South Africans under 30 is over 50%. Two-thirds of 15-to-30 year olds who want work have never been able to find a job. The richest 10% of South Africans earn more than the other 90% combined. Few would deny that we are sitting on a powder keg which is ready to explode for there are plenty of struck matches around.

The Youth League is therefore entirely right to be campaigning for 'economic freedom in our lifetime.' The real question is whether their ideas are a sagacious way to achieve this freedom.

The definitive barrier to the nationalisation proposal is its expense and impracticality. Assuming that the proposal would be executed by way of nationalisation with fair compensation, then the question arises: How are the banks to be paid for? The total market capitalisation of South Africa's five biggest banks comes to about R500 billion, which is more than half of the government's total annual expenditure in 2011.

It would be utterly inappropriate to spend public money on this gigantic scale on buying profitable, tax-paying banks when the country is struggling to provide adequate education and health care.

If, however, it is envisaged that the ownership of banks would be seized without compensation, then a cogent explanation needs to be given to the domestic savers, individual pensioners, pension funds, domestic financial institutions and international financial institutions who are shareholders for why they should contemplate such seizure with equanimity. Furthermore, how would the decision make process work? Would South African constitutional law permit this?

Sadly, the campaign to nationalise the banks is billed to cause a great deal of unnecessary damage to South Africa's growth and job-creation prospects. The main ways in which persistent nationalisation talk damages the economy are through its effects on risk calculations and the cost of capital.

South Africa is in ferocious competition with dozens of developing economies for capital, and now with a raft of European nations and financial institutions. While South Africa has been drifting down the international competitiveness rankings, many of our competitor nations are becoming very attractive to investors, thanks to their fast growth and their

clear, consistent and socially sensitive market-oriented economic policies. Potential investors will just go elsewhere if they think that there is a real risk that they could lose their assets to nationalisation in South Africa. This effect is perhaps not immediate, but it is pervasive and long-lasting. If the nationalisation debate grinds on for many more months, there will be fewer new businesses, fewer new jobs, more poverty and less development for decades to come.

These environmental factors matter materially to banks. A bank's capital is, almost literally, its life blood. Whereas a manufacturing concern uses capital for funding plant and machinery, a bank requires capital to shield depositors against the risks it assumes in its lending, investment and trading activities. Accordingly, a bank's ability to take deposits safely and to lend responsibly depends almost exclusively on the size and quality of its capital base and on how much it is costing it (in returns to shareholders or interest payments to bond holders) to maintain that capital. If a bank's capital base becomes smaller and more costly, depositors' funds are put at risk and lending, investment and trading has to contract.

Over the long run and on average, the price of raising capital depends to a large extent on the price of government debt. The price of this sovereign debt, in turn, is strongly influenced by the ratings assigned by the major international ratings agencies. When assigning these ratings, the agencies look at whether the government will be able and willing to pay back its debt. And that comes down to a large extent to social and political issues: How bad is unemployment? How pressing is inequality? Are any large social groups dangerously alienated? Is the government able to collect taxes efficiently and spend them honestly? Does the state respect human rights and property laws?

Persistent and aggressive talk about nationalisation is arguably a signal that the answers to these may result in ratings downgrades in due course as a result of what the ratings agencies call a 'deteriorating policy environment' pursuant to an inability by policy makers to resist the impulse to re-write the rules when political pressures mount.

If that worry gets really serious, it is arguable that South Africa could suffer a 'sovereign downgrade,' as Venezuela did in 2002 when the Chavez government threatened to nationalise the banks there. And if South Africa seemed to be at risk of following Venezuela's example, every South African individual and company - banks included - would find it much more expensive to borrow money.

Unfortunately, a downgrade is not the worst thing that can happen. Because it makes debt more expensive and because more policy errors are likely to follow, a ratings downgrade is often the start of a slide down towards a 'sovereign default.' This is the point at which a country can no longer pay even the interest on its debt. Argentina defaulted in 2001. In the following year, its economy shrank by 10%, unemployment rose by 19%, and the number of people in extreme poverty more than doubled, to 26% of the total population. Frighteningly, Argentina got off quite lightly: on average, the economy of a defaulting country shrinks by 15% in the year after a default.

Thinkers who propound bank nationalisation have a quick reply to this argument - they can say that the damage would only occur if nationalisation talk wasn't soon followed by well executed nationalisation itself. Once the banks are safely in state hands, they could argue, interest rates will be set to respond to the government's developmental imperatives, and will simply ignore the 'whims of international capital.' Furthermore, they can argue that nationalisation, if managed properly, can yield more state revenue and a more equitable distribution of wealth.

There are two reasons why these replies don't work. First, South Africa usually runs an external deficit -we rely on savers in the rest of the world to lend us money to fund new enterprises and new infrastructure (the National Treasury estimates R1.2 trillion of public sector infrastructure spend in the short term). If we nationalised the banks, that lending would dry up, and South Africans would have no choice but to invest and consume less, shrinking the economy and destroying jobs.

Second, experience from all over the world shows that nationalised banks and state-run banking systems usually turn out to be expensive misadventures - precisely because they are not managed properly. In the years following African independence, many governments believed that the existing private banks were being run to benefit 'foreign shareholders' rather than in the interests of indigenous business and national development. The solution was often to nationalise banks, and to direct them to offer loans at preferential interest rates to favoured firms and sectors. These banks were handicapped from the start by their confused mandates: governments did not make it clear whether these state banks were to be cautious, profit-making commercial banks or highly risk-tolerant development institutions with unequivocal fiscal support in the event of losses. Worse, an expectation was created that the government would shield its banks from the consequences of making bad loans. Both of these problems were bad enough for the nationalised banks' efficiency. But what really doomed the state banks was continual pressure to lend to politically favoured individuals and 'connected' firms. In almost all cases, Africa's state banks were in deep trouble within a decade, and bankrupt within 20 years.

In Nigeria, the Federal Government took controlling interests in the major banks in the mid 1970s; more state banks were created in the 1980s. The entire Nigerian banking system was insolvent by 1994. In Ghana, the state took over the banking system in 1975. By 1984, bank deposits had fallen by 62%. By 1986, the amount of credit available to the private sector had fallen by 63%. It cost 4.4% of Ghana's total national income in 1991 to recapitalise that country's banks. Tanzania nationalised its banks in 1967. Just like in Ghana, saving declined sharply and the private sector found it almost impossible to obtain credit. Service fell apart: by the mid-1980s, Tanzania's monopoly state bank had even lost the capacity to process cheques. It took 11% of GDP to recapitalise the bankrupt Tanzanian state bank in the early 1990s. There are many similar cheerless stories from the rest of the world: for example, the people of Brazil had to absorb an expense of 6% of GDP in 2001 when its two biggest state banks failed. In Uganda, the government created a state banking monopoly in 1972. By the early 1990s, this bank was struggling to provide even the most basic banking services; 75% of its loans had gone bad; and its monthly wage bill had to be paid directly from the Ministry of Finance. In 2002, as part of its programme of financial liberalisation, the government of Uganda sold this bank to Standard Bank .

Those African countries that have avoided experiments with wholesale bank nationalisation - notably Botswana, Kenya, Mauritius and South Africa - are also those with the most advanced financial systems and the most developed economies on the continent. This isn't a coincidence: worldwide, the statistics show, there's a strong positive relationship between the appropriate development of the financial sector and national wealth.

Yes, there are exceptions to this pattern of state bank failure. Some state banks in India and China have been very successful. But, crucially, these have been run on strictly commercial lines in highly competitive financial markets.

Overall, therefore, it is entirely fair to say that the argument in favour of nationalisation is refutable by carefully examining the consequences of the change advocated and showing that it gives rise to outcomes that the proponents of this argument do not desire and that the opponents abhor. We can even put numbers to this: a study by three world-class

economists of the banking systems of 92 countries over the thirty years to 1995 found that for every 10% of the banking system owned by the state, a country's annual growth rate fell by 0.25%. This dry little statistic has huge real world implications: on this argument, if the proposals on bank nationalisation became a reality, the South African economy would soon start to shrink, and unemployment would rise to an even more appalling level

Finally, South Africa's banks need to do more than just refute the pro-nationalisation arguments. We need to work harder as committed corporate citizens to reduce poverty, unemployment and inequality. As long as these persist at current levels, no spirited protestations will be convincing to those that are excluded and marginalised who find banking and finance undemocratic.

It is important to acknowledge that South Africa's banks are already doing a lot to try to address South Africa's socio-economic problems. They provide billions in value add to different components of the South African economy. They have funded a cumulative total of billions in empowerment deals, and they spent billions with BEE suppliers last year. These banks directly employ thousands of people.

But, given the scale and depth of South Africa's problems, the banks can and should do more to contribute to transformation, growth and development. It is arguable that they need to look hardest in these areas: investment in job-intensive sectors, smme financing, co-operative financing, infrastructure financing and agriculture financing. Since they are prudent commercial enterprises, our banks are set up to lend most easily to long-established businesses. It is almost inevitable that these will tend to be quite capital-intensive and to be run by still largely white management teams. Such are the effects of the history of South Africa.

The sector is duty bound to innovate around and lean harder against this natural tendency of lending mostly to big clients. The challenge is to aim to support many more companies that can really deliver broad-based black economic empowerment (job-intensive sectors, smme financing, co-operative financing, infrastructure financing and agriculture financing) and more jobs and do so profitably on commercial grounds.

Fortunately, the commercial banks, government, development finance institutions and other social partners are already in detailed conversations about how to combine public and private finance to stimulate more growth and more job-creation, to deliver on the above objectives.