INTRODUCTION

Fifteen years after the first democratic elections in South Africa, there is still much debate on the manner and outcomes of the political transition. Some, like author of the bestselling *Shock Doctrine* Naomi Klein, argue that the African National Congress (ANC), led by Nelson Mandela, served as nothing more than a puppet in the negotiations and was tricked into making too many concessions to the National Party (NP), the ruling political party under apartheid. An alternative explanation-- that I set out to prove in this paper--of the ANC’s change from supporting policies characterized by heavy nationalization and redistribution to more free market policies has to do with a necessary commitment to moderate taxation of the rich in order to stay a withdrawal of the White elite from South Africa.

The intent of this paper is to analyze the policy outcomes of the negotiations between the ANC and the National Party in the years surrounding the democratization of South Africa; specifically, the tax policies and the ANC’s commitment to moderate tax levels. It is not my intent to make value judgments about the content or timing of the policies except for their role in the historical and decision-making context. That being said, the timing of the implementation of various policies is of the utmost importance for two reasons: 1. it illustrates the gradual movement away from the ANC’s favorite policy of complete nationalization and redistribution of wealth and 2. The timing helps model the decision-making process for the National Party elites whether or not to withdrawal from the South Africa economy.

In order to model the policy decisions of the ANC, I adapted Daron Acemoglu and James Robinson’s model of political coups. I believe that the ANC’s policy decisions can be viewed as an appeasement and a bargaining chip to reduce the NP’s incentive to withdraw their knowledge and capital from the economic sector. Since both economic withdrawal and political coups result in large-scale destruction of capital and economic resources by the out of power elite in response to democratic policies enacted by the citizens, or recently empowered majority, their model was easily adapted. In *Economic Origins of Dictatorship and Democracy*, Acemoglu and Robinson assert that those countries with the highest inequality are at most risk for coups because the elites stand to lose more wealth through redistribution than in societies that are more equal. However, in South Africa, I felt that since the NP had conceded power peacefully, they were more likely to try to retain power through negotiations rather than militaristic means.

The solved model shows a withdrawal-preventing level of taxes which is lower than the ANC’s favorite policy. This policy will be implemented without White withdrawal so long as the ANC can legitimately commit to a lower rate. However, if the probability that they
will not be able to commit (change policy back to their favorite), then the withdrawal will not be prevented.

The next section is a brief overview to historic policy decisions and policy expectations of the ANC upon entering negotiations. Next, I outline my adopted model and conclude with evidence from policies after negotiations.

THE NATIONAL PARTY AND APARTHEID
1948-1990

The Union of South Africa was officially formed in 1910, after the British defeat of the Boers (Dutch) in 1902. Out of the four colonies comprising the Union (Cape Colony, Natal, Transvaal, and Orange Free State), three of them were run jointly by the British and Afrikaners (Boers), barring blacks, Coloured (mixed decent and Indian) and those of Asian decent from holding office. Over the next decades, and increasing amount of legislation was passed to further protect South African whites, such as the Masters and Servants Act to protect skilled labor positions and the 1913 Land Act, which placed 90% of property ownership in the hands of whites. To combat these laws, blacks and Coloureds, who make up roughly two thirds of the population in South Africa, formed the African National Congress (ANC) in 1912 to “unite…public and private bodies whose aims are the promotion and safeguarding of the interest of the aboriginal races” (Constitution of the South African Native National Congress, 1919).

During this time, the National Party was gaining power among the enfranchised white population. The party promoted further separation of the races and adopted an official policy of Apartheid (legal separation of the races) when it was elected into power in 1948. This separation prohibited the representation of non-whites in government as well as most social interaction. The apartheid dictated much of the social and economic framework of South Africa, including employment sectors, wage rates and housing zones. In June of 1955, the ANC and its allies drafted The Freedom Charter at the Congress of the People in Kliptown, South Africa in an effort to unify and reinvigorate protests. This document served to focus the efforts of the anti-apartheid movement and served as a platform for revolutionaries throughout the country.

During the 1980’s, the National Party began to suffer from international pressures to end the apartheid in South Africa. These pressures came in the form of sanctions, trade boycotts and a changing international atmosphere that encouraged corporations to move their headquarters out of South Africa and reduce trade with any group that supported the apartheid. This boycott was most critical in the gold and diamond sectors, which then comprised a majority percentage of South Africa’s foreign commerce. When the price of gold decreased 25.2% between 1983 and 1985, it had a significant impact on total exports and, in 1985, United States banks recalled their loans, intensifying the debt crisis (Aron, 2002). Because of this, South Africa had limited access to foreign capital, experienced falling productivity, and was restricted to costly short term finance between 1985 and 1994.
To offset the unfavorable international climate, the National Party began making significant changes to its economic policy. As evidenced by Figure 1, total manufacturing exports began a sharp and sudden increase around 1987. Between 1986 and 1988, South Africa experienced a 74.3% growth rate in total manufacturing exports. This sudden and significant growth may be attributed to the changing economic policy of the NP, placing emphasis on controlling public expenditure, widening the tax base, deregulating the financial system, rapid trade liberalization, and privatization (Nattrass, 1994). Formally, The White Paper on Privatization and Deregulation in the Republic of South Africa was published in 1987 to open up South Africa more fully to market forces. For example, Iscor, the huge state-owned iron and steel company, was privatized in October 1989, with other public enterprises, such as postal services (SAPO) and telecommunications (Telkom), being commercialized (Lazar, 1996). These actions indicate the National Party’s dislike for high tax rates and their commitment to business interests.

**Figure 1: Total Manufacturing Exports & Imports vs. Production 1980-2000**

![Total Exports and Imports vs. Production 1980-2005 in Th USD](image)

<table>
<thead>
<tr>
<th>Year</th>
<th>Total Exports (1000$)</th>
<th>Total Imports (1000$)</th>
<th>Production (1000$)</th>
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<tr>
<td>1980</td>
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<td>2005</td>
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**Source:** CEPII & World Bank 2004

**TRANSITION TO DEMOCRACY 1990-1994**

The African National Congress (ANC), led by Nelson Mandela, began negotiations with the National Party (NP), South Africa’s ruling party under the apartheid, in 1990. Over the next four years, concessions were made by both sides in negotiating the end of the apartheid rule and the transition to democracy in South Africa. During this period, the ANC emphasized the dominant role of the state in closing the income and standard of
living gap, which materialized in the policy objectives upon the start of negotiations in 1990.

**Policy Objectives: National Party vs. ANC**

It was clear at the onset of negotiations that the demands made by the ANC were shaped by the language and aims of *The Freedom Charter*, originally drafted in 1955 as a means of formalizing and condensing grass roots movements. The 1955 document calls for the transfer of "the mineral wealth beneath the soil, the Banks and the monopoly industry...to the ownership of the people as a whole", specifically through the nationalization of these industries. The ANC, 35 years later, was still firmly opposed to privatization of government agencies and advocated nationalizing many sectors as a primary means of overcoming apartheid wage and hiring biases. ANC officials and politicians equated privatization with huge white-owned corporations that flourished under the Apartheid. They planned to use nationalization of industries as a means of overcoming hiring biases and diminishing the skilled-labor gap between whites and blacks. The ANC (in concordance with *The Freedom Charter*) identifies the more socially-focused goals of eradication of poverty and hunger, both of which became widely prevalent in the majority black society during the Apartheid, as primary objectives of the new administration.

NP policies also identified poverty relief, education and training for black youth, and the need for increased investment as areas of great need. However, economic policies between the two parties differed greatly. The most significant differences were in regards to privatization, market intervention and economic role of the state, and amount of government expenditures. In 1993, the South Africa Ministry of Finance published *The Key Issues in the Normative Economic Model*, which summarized the policies of the outgoing NP administration and stood in stark contrast to ANC economic thinking. Continuing with policy trends from the 1980’s, the NP called for greater privatization and a smaller public sector, lower taxes and shifts within the budget from consumption to investment expenditures. The NP further stipulated that poverty reduction should be mostly handled by the private sector, especially in regards to housing projects with only small subsidies to low income groups which would be recoverable through user charges (Lazar, 1996).

**Macroeconomic Research Group: Making Democracy Work**

In 1993, the Congress of South African Trade Unions (Cosatu) in official allegiance with the ANC, Macroeconomic Research Group (MERG) and Industrial Strategy Project (ISP), published *Making Democracy Work: A Framework for Economic Policy in South Africa*. MERG/ISP policies represented the changing economic climate through a shift in language from ‘redistribution’ to ‘restructuring’. While both promote heavy state intervention, restructuring emphasized the ideological shift away from nationalization. In three years of negotiations, ANC economists Trevor Namuel and Tito Mboweni had changed ANC policy due to an examination of other nationalization models based on criteria defined by efficiency, profitability, cost, and opposition from key businesses. As
an alternative, MERG promoted Import-Substituting Industrialization (ISI), which encouraged domestic production to limit the dependence on imported goods (Nattrass, 1994). However, these inefficiently-protected markets created substandard goods that could not survive in export markets.

The first six years of MERG policies were anticipated to be a public investment phase, with heavy investment in infrastructure and emphasis on job creation. A sustained growth phase from 1999 to 2004 was to follow this initial investment, with projected 5% GDP growth by 2004. Goods produced by ISI policies would not generate enough earnings to subsidize the massive outlay of government finance necessary for the level of infrastructure creation called for by MERG. Furthermore, Ross Weiner in *South Africa’s Manufactured International Trade in the Post-Sanction Epoch* used a model of Relative Revealed Comparative Advantage (RRCA) to identify the sector and geographic niches in which South Africa claimed a comparative advantage. Weiner identified the medium-wage, low-technology and resource intensive sectors, indicating that South Africa will prosper most when specializing in producing products in these sectors (Weiner, 2008). Because of this, as well as further evolving economic policies of the ANC, MERG was never adopted as the official stance of the ANC.

In *The Shock Doctrine*, Naomi Klein cites the change in emphasis as a weakness within the party. She states that the ANC lost focus on its goals to end poverty and correct the damage caused under the apartheid because they moved away from the nationalization policy supported in *The Freedom Charter*. For instance, she quotes Mandela’s first speech upon his release from prison in 1990 when he reiterates the ANC’s original goal of nationalization of banks and mines in but then, in the same paragraph, mentions how confused he was by modern media equipment, illustrating his long isolation from current events and world news. Klein’s comments do not hold, considering the dynamic nature of political party policy over time and the theory of negotiations as outlined in my model below.

**ELITE WITHDRAWAL MODEL**

The decision of the ANC to move away from nationalization policies can be modeled as a commitment to tax policies that would prevent a large-scale exodus of National Party (NP) elites from South Africa. Such a withdrawal of capital from the country would be devastating to the economy, leaving a relatively uneducated and unskilled Black citizen base. Obviously, the ANC would make concessions to ensure that this did not happen.

In considering the forces involved in a withdrawal decision, it became clear that they were much the same as those in the elite coup model utilized by Daron Acemoglu and James Robinson in *Economic Origins of Dictatorship and Democracy*. They illustrate that coups are more likely to occur in highly unequal societies, such as South Africa, that support heavy redistribution policies. However, in the case of South Africa, withdrawal or termination of elite investment and business is much more likely than a political takeover.
In the years surrounding the transition to democracy, much emphasis was placed by the ANC on redistributive policies, as outlined in *The Freedom Charter*. This created an atmosphere of apprehension among elites in South Africa, who were not sure about the future of tax policies and were anticipating steep hikes in corporate and personal taxes. As stated by Acemoglu and Robinson, “in an unequal society, the elites have more to gain by changing the regime than in a more equal society” (2006).

This model has two actors, the NP and ANC representing the rich and poor (respectively) in South Africa. The NP is comprised of a proportion of the population, $\delta$ holding $\theta$ of the total wealth (where $\theta > \delta$). The ANC is a proportion $(1-\delta)$ of the population (where $(1-\delta) > \delta$), holding $(1-\theta)$ of the wealth. These actors exist in a model which outlines the costs of National Party withdrawal:

$$Y^i = \zeta \iota(SA) y^i + (1-\zeta)[(1-t)y^i + (t - C(t))y]$$

Here, $\zeta$ denotes the National Party's decision to withdraw from the country ($1$=withdraw, $0$=stay). The notation $\iota(SA)$ represents the associated costs of withdrawal from South Africa. Since the NP control a proportion $\theta$ of the wealth that is significantly larger than their relative share of the population, the costs associated with withdrawal ($\iota(SA)$) are very high and denoted by $1-\phi$ where $0 < \phi < 1$.

The timing of the game is outlined below, starting with an initial tax policy decision by the ANC, a choice whether or not to leave the country and finally a commitment by the ANC to the previously set tax rate.
Assuming that South Africa is now functioning under full democracy, the ANC has the right to set whatever tax policy they wish. If the threat of withdrawal by the NP is zero, then the ANC will set its favorite tax policy, \( t_{\text{ANC}} > 0 \). In context, \( t_{\text{ANC}} \) can be assumed to be very high around 1990-1993 when ANC leaders rallied around talk of nationalization and redistribution. If there is at least some threat of withdrawal, the ANC will promise a more moderate tax rate, \( t_{\text{bar}} \), where \( 0 < t_{\text{bar}} < t_{\text{ANC}} \).

Once this is set, the NP decides whether or not to remove their accrued skills and wealth from the country. If they do withdraw, they take all of their possessions minus the cost of leaving. Therefore, the value to each under withdrawal is:

\[
V_{\text{ANC}}(W, \varphi) = y_{\text{ANC}} + \gamma\varphi y_{\text{NP}} \quad \text{and} \quad V_{\text{NP}}(W, \varphi) = (1-\varphi)y_{\text{NP}}
\]

The NP gives up its right to future voting upon its withdrawal and the tax policy would be left to be reset by the ANC. The ANC would be left with a fraction of the NP’s previous wealth (\( \gamma\varphi \)), assuming that the NP couldn’t take it all but some proportion \( \gamma \) was completely destroyed. Since the ANC would be left with a fraction of the previous income of the country, the effectiveness of a high tax policy may be limited and \( t_{\text{ANC}} \) after a withdrawal may not be as high as an initial setting.

If the NP decides not to withdraw from the country, then, with probability \( p \), the initially promised tax rate \( (0 < t_{\text{bar}} < t_{\text{ANC}} -- \text{indicating a commitment to non-nationalization}) \) will stick.

If there is certainty that the ANC will commit to this low-redistribution policy, utility derived by the two groups will be:

\[
V(y_{\text{ANC}} | t) = y_{\text{ANC}} + t(y - y_{\text{ANC}}) - C(t)y \quad \text{and} \quad V(y_{\text{NP}} | t) = y_{\text{NP}} + t(y - y_{\text{NP}}) - C(t)y
\]

The ANC will fail to commit to this policy and reset the tax policy at their own favorite, \( t_{\text{ANC}} \) with probability \( 1-p \), resulting in the following total value functions:

\[
V_{\text{ANC}}(D, t) = y_{\text{ANC}} + p[ t(y - y_{\text{ANC}}) - C(t)y] + (1-p) [t_{\text{ANC}}(y - y_{\text{ANC}}) - C(t_{\text{ANC}})y]
\]

\[
V_{\text{NP}}(D, t) = y_{\text{NP}} + p[ t(y - y_{\text{NP}}) - C(t)y] + (1-p) [t_{\text{ANC}}(y - y_{\text{NP}}) - C(t_{\text{ANC}})y]
\]

By solving these equations, a withdrawal restraint can be constructed such that NP withdrawal decision is:

\[
\varphi < (1/\theta) \left[ \delta C(t_{\text{ANC}}) - t_{\text{ANC}}(\delta - \theta) \right]
\]

Therefore, the NP will withdraw if ANC policies are too redistributive and they risk losing too much of their property and wealth to taxation.
HISTORICAL EVIDENCE AND CONCLUSIONS

Evidence for the applicability of this model is best presented through the subsequent economic programs implemented by the ANC-controlled government after 1994. The first two years of economic policy were characterized by the heavy redistribution plan, the Reconstruction and Development Program (RDP). After that, policies became successively more capitalist, indicating a move further away from the nationalization policies contained in \( t^{ANC} \). Also, as time went on, ANC leaders were more likely to be able to commit to the less redistributive policies of \( t \)-bar. This also increased the probability \( p \) that they would commit, reducing the overall threat of elite withdrawal from South Africa. The next few sections look more in-depth at the RDP and Growth, Employment and

RECONSTRUCTION AND DEVELOPMENT PROGRAM
1994-1996

After the first democratic elections in 1994, President Nelson Mandela and the newly ANC-controlled government implemented the Reconstruction and Development Program (RDP). Although nationalization policy had been phased out over time, many of the idealistic aims of The Freedom Charter were integrated into the RDP. For instance, the stated goals of the RDP included eliminating poverty and inequalities created by the apartheid, ending discrimination in business, and addressing regional economic and trade imbalances in southern Africa (RDP, 1994).

In order to achieve these goals, emphasis was placed on rapid infrastructure creation, especially in the energy, housing and water sectors. Furthermore, the RDP states that “reconstruction and development will be achieved through the leading and enabling role of the state, a thriving public sector, and active involvement by all sectors of civil society which…will lead to sustainable growth” (RDP, 1994). This statement expresses the ANC’s continued commitment to the primary (although not exclusive) role of the central government in funding the infrastructure creation.

Funding Structure & Commitment to T-bar

According to the RDP, programs would not be funded by raising taxes, but by “[increased] tax revenue … from rising incomes and from more businesses and more employment as the economy [grew]” (RDP, 1994). The immediate effects on incomes was overestimated by the South African government, as there was still a significant gap in the education and skill levels of white and non-white citizens. As a result, the level of non-whites hired to newly created jobs fell short of the anticipated level and tax revenue declined.

In 1994, President Mandela was reluctant to tax businesses and corporations, for fear of private sector backlash against the democratic government. Mandela made a strategic decision to keep private sector taxes low in an effort to encourage business investment and continued presence in South Africa. Also, in accordance with the RDP goals for
employment, higher taxes were avoided as an incentive for corporations to hire more workers. Had taxes been raised, corporations would have been more likely to incur cutbacks, keeping only the most skilled workers, which at the time would have been predominantly white. Near the end of 1994, a 5% RDP levy was approved, aimed at reducing the budget deficit and freeing funds for the RDP. This showed the level of commitment by the ANC to restrict the tax policy.

Here, Naomi Klein calls for a one time reparation tax against South African businesses who participated in the apartheid. Klein claims that this tax would have been able to completely fund RDP programs and allowed the South African government to achieve its energy and housing goals. However, if the government had enacted a high levy and collected more tax revenue, they would have failed in their commitment to uphold T-bar and may have risked withdrawal.

GROWTH, REDISTRIBUTION AND EMPLOYMENT STRATEGY 1996

Hindered by finance limitations and subject to evolving economic policy to incorporate free market strategies, the RDP was replaced by the Growth, Employment, and Redistribution Strategy (GEAR) in 1996. GEAR was presented as the macroeconomic side of the RDP and showed the increased inclusion of free-market economic policies. GEAR identified redistribution of government assets, fiscal discipline and market-led economic growth as the impetus to eradicating poverty and inequality in South Africa (Cheru, 2001). Also, South Africa realized the importance of foreign capital in its financing efforts and, with GEAR, aimed to “maintain an attractive business environment and encourage both foreign and domestic investment” (Icon Group, 2002). Foreign exchange controls, especially for residents of South Africa, were gradually reduced, allowing citizens “a one-time investment of up to 500,000 rand in offshore accounts” and the ability to hold foreign currency accounts in domestic banks (Icon Group, 2002).

CONCLUSIONS

By using this model and viewing the expected results in a historic context, much light is shed on policy decision-making during the democratization of South Africa. The model estimates that the ANC will commit to more moderate tax policies if there is a significant threat of withdrawal by National Party elites. It can be said that the threat of withdrawal by the NP was real during democratization, as they held a significant proportion of the economic resources and the business interests in the state and therefore had much to lose from redistributive policies. Over time, the ANC leadership appeased the NP with real and firm commitment to low taxation of businesses, focusing instead on more social integration programs instead of income subsidies for poor Blacks. South Africa still has a long way to go before becoming fully integrated and still faces a high degree of inequality. However, since the ANC has adopted more free market policies, the threat of elite withdrawal has diminished greatly and will eventually cease to be a threat in South Africa.
Works Cited


\[\text{\textsuperscript{\textnormal{1}}} http://www.kitco.com/scripts/hist\_charts/yearly\_graphs.plx \text{ CITE}\]

\[\text{\textsuperscript{\textnormal{2}}} \text{ Based on CPII Production Data, 2008}\]

\[\text{\textsuperscript{\textnormal{3}}} \text{ Raw Data from CEPII Production Statistics Database}\]