New Equitable Economic Empowerment Framework and Bill

Analysis and Response

Submitted by the Economic Association of Namibia to the Office of the Prime Minister and the Law Reform and Development Committee

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Motivation of the NEEEF

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- It is undeniable that considerable poverty and inequality of wealth and income persists in Namibia.
- We agree that, as stated in the introduction to the NEEEF document, the creation of an equitable and socially just society is of paramount importance to Namibia. We believe this is necessary to ensure economic and social stability and development.
- However, having analysed the proposals made in the NEEEF document and the draft NEEE Bill, the EAN feels that the NEEEF in its current form is unlikely to achieve these important goals.
- With this in mind, and in response to the call for comments, queries and inputs from the public, the EAN has put together the following.

Evidence-based interventions

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- It would strengthen the cause of the NEEEF and NEEE Bill if some statistics are provided
  - Regarding the current ownership structure of businesses by size (number of employees) and by sector (mining, manufacturing etc.) in order to analyse the current situation and to target interventions.
  - Regarding the management structure of companies by size and sector based on information available with the Employment Equity Commission.
- An analysis of the changes in the composition of management in businesses since gazetting the Affirmative Action Act of 1998 would inform intended interventions.

General observations

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- It is important to grow the economy in order to open new opportunities for entrepreneurs and employees and thus increase the participation of disadvantage persons in the economy.
- Growing the economy requires financial resources that might not be sufficiently available if financial institutions provide primarily funding for new ownership structures of existing businesses.
- Investment in quality education at all levels is a fundamental enabler for empowerment.
- The NEEE Bill deviates substantially from the NEEE Framework in that there is less emphasis on equity and empowerment and in the narrowing down of the group of beneficiaries

Economic Ownership Pillar

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In general, ownership is a fundamental pillar of a market-based economy and any prescription concerning the ownership structure could have negative impacts on the economy, the competitiveness of the country and its attractiveness to domestic and foreign investment.

- Ownership forms a key component of the prescriptions of the NEEEF, but real empowerment should go further than being a shareholder
  - Employee shareholding should be explored further and a clear awareness and education strategy should be designed to inform employees about the pros and cons of such an initiative.
  - In order to spread wealth more widely, it should be considered to limit the number of shareholdings individuals and companies can take up.
  - Shareholders may end up sharing in profits, but they may also have to invest further in the company, absorb losses or even lose their entire investment
  - It is uncertain whether ordinary Namibians, many of them first-time investors of limited means, will be able and willing to bear this risk
- The NEEEF also requires that new, previously disadvantaged shareholders may only sell their stake to previously disadvantaged Namibians
  - This is likely to reduce the value of the share when sold on, by reducing the pool of potential buyers
  - The creation of two classes of shares (i.e. previously disadvantaged and otherwise) could lead to a parallel market and rent-seeking behaviour to incorporate the perceived price difference
  - The need to clear transactions for NEEEF compliance could seriously inhibit the smooth operation of the NSX

Economic Ownership Pillar

- A further logistical issue arises in the valuation process before ownership is restructured:
  - Valuing a privately owned firm may be difficult and costly, particularly for small enterprises and one-person professional businesses (lawyers, medical practitioners. Consultants, etc.)
  - The NEEEF and NEEE Bill do not prescribe a specific method of arriving at a fair valuation, and incumbent owners may be unwilling to sell their stake at a valuation they perceive as unfair
- The ownership pillar in its current form applies to all businesses (with the possible short-term exception of existing firms that do not require public tenders or permits). This may prove problematic in certain cases:
  - Sole proprietorships cannot easily divide their ownership
  - Certain business structures require owners to obtain certain professional qualifications (e.g. legal practices, medical practices)

Management Control and Employment Equity Pillar

- A similar issue may arise as in the ownership pillar, with small enterprises lacking an easily separable management structure. The owner of micro and small businesses is often the only 'manager' and outsources functions (s)he cannot fulfil, such as accounting.
  - This may necessitate costly organisational restructuring, and could deter the setting up of new enterprises
- In order to push for a broad-based empowerment that benefits as many persons as possible, limits on multiple board memberships held by one person would be necessary. This is currently contemplated by the Ministry of Public Enterprises for board memberships of SOEs.
- A skills shortage remains an issue at the managerial level:
  - Training effective managers takes time and is often accomplished over many years of experience, making it difficult to achieve swift transformation in this pillar
  - In this regard, it is likely to be very difficult to detect fronting behaviour, as opposed to genuine managerial involvement

Human Resources and Skills Development Pillar

Human resource development and training is a fundamental pillar of empowerment. To be successful it requires close cooperation and coordination between the private and public (education) sectors. These aspects have not received sufficient attention in the framework and bill.

- The human resources pillar focuses on the criterion of money spent on training:
  - This does not necessarily guarantee effective skills development, and an alternate focus in this regard would be on the quality of training, the number of individuals trained and the suitability of their skills acquired
- The criteria for this pillar relate to percentages of wage bill spent on training:
  - This could have the unintended consequence that firms reduce their wage bill, via retrenchments or slower wage growth, in order to comply
- Smaller businesses, which can least afford to be locked out of government tenders, will find it more difficult to comply with this mandatory pillar, as they frequently lack the capacity and structures to offer formal training
- New enterprises usually struggle the first few years to make ends meet. Any additional costs will make it even harder to break even.

Entrepreneurship Development and Marketing Pillar

- The idea of mentorship raised in this pillar is a good one:
  - Close coordination will be needed, however, between government and industry to implement this proposal effectively
  - Lessons can be learned from existing mentorship schemes in the agricultural sector between established and emerging commercial farmers as well as from existing schemes initiated by private companies.
- In terms of procurement, regulations for the firms to benefit will need to be rigorously constructed, in order to combat a proliferation of "middleman" companies
  - In this aspect, lessons can be drawn on from past public procurement issues
- Procurement requirement need to be industry and sometimes even company specific since the operations of a business determine the inputs required and the sources for these inputs.

Corporate Social Responsibility Pillar

- This pillar is also an important aspect of a broad-based empowerment policy. However, it needs to be ensured that CSR spending is not concentrated on a few locations and or a few activities. Furthermore, it needs to be ensured that rural and urban poor communities benefit.
- The specifics of the pillar could be better refined to encourage the most beneficial kinds of CSR spending and to ensure CSR projects achieve a national coverage.
- Similarly to the human resources pillar, criteria would benefit from a closer link to outcomes rather than focusing on monetary inputs.
- Furthermore, similar to the human resource pillar as well, it needs to be ensured that it does not result in additional cost pressure in particular for micro, small and medium-sized or new companies.

Value Addition, Technology and Innovation Pillar

- This pillar seems to overlap in its purpose with the upcoming export levy, and as such is likely to apply mostly to firms in the primary industries
  - This pillar should include the level of detail incorporated by that levy, making judicious use of exemptions in cases where beneficiation destroys value (some fresh fish), is illegal (uranium), or economically not viable since Namibia does not produce the required volumes.

Financing the NEEEF

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- The financing needs to achieve wholesale economic restructuring as proposed in the NEEEF are very substantial.
- In this respect, an overly hasty transformation could have destabilising effects on the macroeconomy, namely:
  - Considerable risks associated with bringing first-time borrowers into the financial markets would be borne either by private banks or by the Development Finance Institutions that are mainly Government owned
  - A significant proportion of the loanable funds of the Namibian economy could be diverted into empowerment transactions, inhibiting other new investments that lay the foundations for economic growth

Potential Economic Impact: Investment

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- The NEEEF in its current form could lead to a slowdown in formation of new businesses in Namibia, as new companies may struggle to be NEEEF compliant
  - This runs contrary to government's NDP4 objective to improve Namibia's ease of doing business. Namibia already ranks poorly on number of days required to open a new business (ranked 179th out of 189 countries by the World Bank)
- Moreover, NEEEF proposes to channel significant funding into empowerment transactions for existing businesses, thus shrinking the pool of investable funds available to new enterprises. This is likely to make it at least more costly to start a business or in the worst case no financial resources are left to finance new, riskier undertakings.

Potential Economic Impact: Investment

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- The ownership pillar of NEEEF suggests entrepreneurs will earn less reward for their efforts, which is likely to reduce the number of new businesses launched:
  - Previously disadvantaged entrepreneurs will have to accept a lower price when selling their shares, as they will only be allowed to sell to a limited market of previously disadvantaged Namibian buyers
  - Previously advantaged entrepreneurs may have to forfeit a large share of their profits to a new part owner who did not contribute to past growth of the business – and did not share the risks of establishing the business – and might not even contribute to further the business beyond acquiring a financial share.
- Inward foreign direct investment is likely to fall, as investors would have to forfeit at least 25% of their profits to become NEEEF compliant. Some investment opportunities that were marginally profitable before NEEEF will not be worthwhile after it takes effect.

Potential Economic Impact: Investment Climate

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- Investors require a certain amount of policy certainty before they will invest, and Namibia has traditionally benefited from her reputation for political stability and policy predictability
- The NEEE Bill would put this reputation at risk, particularly due to features such as:
  - The severity of the punishments for fronting, given the relatively vague definition of fronting practices
  - The open-ended provision for Ministers to decide on the mandatory ownership share in their respective sectors
- Anecdotal evidence suggests that some inward investment has already been postponed due to uncertainty in recent months over the form that the NEEE Bill will take.

Potential Economic Impact: Balance of Payments

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- The potential drop in inward investment to Namibia would worsen the balance of payments deficit
  - In recent years the large trade deficit, whereby imports have exceeded exports, has been offset somewhat by strong inward capital flows
  - If inward investment slows, the trade deficit could cause foreign reserves to diminish even faster than has been observed in the past few months, risking an eventual balance of payments crisis
- As the NEEEF would also close off certain investment avenues for previously advantaged Namibians including those who have sold shares in their business to previously disadvantaged Namibians, it could accelerate capital outflows as these individuals choose to invest their capital abroad

Potential Economic Impacts: Growth

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- Lower inward investment and slower business formation would reduce the GDP growth rate in the medium- and long-term
- Since the focus of NEEEF and the NEEE Bill is on existing businesses, it could well affect the diversification and innovation of the economy with detrimental consequences for growth and employment creation
- While GDP growth is recognised to be a secondary goal in respect to the NEEEF, lower growth also implies weaker growth in government revenue, which is crucial to the provision of public services which are helping to reduce inequality of living standards

Potential Economic Impacts: Inequality

- Previous and current empowerment policies have tended to fall into a similar trap, whereby an elite cadre of middle persons and dealmakers are given an opportunity to enrich themselves further, with little or no benefit to the majority of ordinary Namibians.
  - This effect is evident at present in large infrastructure projects and other operations when foreign companies partner with Namibian nationals without their true participation in the operations, without skills and knowledge transfers and hence without real empowerment
- The structure of the NEEEF leaves it as open to such window-dressing as previous policies, in spite of the strongly worded rhetoric and harsh disciplinary measures contained in the NEEE Bill.
  - Those to benefit from empowerment via NEEEF need only fit a broad definition of race, gender or disability, without any regard as to wealth accumulated in recent decades. "Previously disadvantaged" does not always equal "currently disadvantaged", but the NEEEF in its current form would make these definitions interchangeable in a legal sense.
  - The NEEE Bill narrowed the beneficiaries down to previously racially disadvantaged, thereby excluding the other two categories stipulated in the Namibian Constitution, namely women and people living with disabilities.

Potential Economic Impacts: Inequality

- It is proposed that banks will have to devote at least 3% of non-retail funding to empowerment transactions. This provision will be vulnerable to how empowerment transactions are defined, and loose definitions may give rise to empowerment in name only:
  - Since the NEEEF draws no distinction between members of the post-Independence business elite and those still suffering deprivation, banks could achieve compliance by scaling up lending to the former group (who in any case would be more creditworthy than those who are truly disadvantaged)
- Similarly, the ownership and management pillars risk giving rise to such a concentration of empowerment deals in a few hands:
  - Established firms are more likely to cherry-pick the most experienced and knowledgeable board members and managers who fit the definition of "previously disadvantaged", without including the majority of marginalised Namibians

Potential Economic Impacts: Financial Stability

- The prescriptions of the NEEEF with regard to funding the economic transformation assume a major role to be played by private banks
- Absent of any means to compel these banks to finance broad-based empowerment transactions, they are likely to lend primarily to wealthier, already-established previously disadvantaged Namibians
- This suggests that the riskier and less secured empowerment loans will have to be provided by the state-owned financial institutions, DBN and SME Bank. This could have negative consequences on the balance sheets of these institutions, necessitating future public bailouts
- On the other hand, compelling commercial financial institutions to engage in more riskier lending might result in violations of supervisory regulations set by the supervisory authorities (Bank of Namibia and Namibia Financial Institutions Supervisory Authority) and in failing stress tests.

Alternative Proposals

- Above all, there is a need for genuine cooperation between the private sector and government, over and above consultation such as is underway at the moment
- In the ownership pillar, community shareholding schemes could be explored, as well as employee share schemes for those enterprises that are large and stable enough to support them and that are unlikely to close with resulting loss of employees' shareholding capital.
- As touched on in the NEEEF document, varied approaches will be required in different sectors, and this is an idea that must be pursued further, as opposed to broad prescriptions across the economy. Hence the Framework needs to provide sufficient space for sectoral flexibility.

Alternative Proposals

- Lessons need to be taken on board from the experiences of countries in the region, such as South Africa and Zimbabwe, on how empowerment policies should not work:
  - Namibia can avoid the mistakes that have seen other countries eventually roll back unsuccessful empowerment initiatives
- Ultimately, however, sustainable empowerment has to occur through education and skills transfer:
  - This should focus on quality outcomes, rather than monetary inputs
  - The idea of mentorship enlisting experienced and/or retired professionals could be considered
  - More emphasis could to be placed on internship and apprenticeship programmes

The Way Forward

- The Economic Association of Namibia is committed to the ideal of an equitable society that the NEEEF aspires to create.
- We very much welcome the openness to consultation that government has shown in the process of drafting the NEEEF, and our door is open to offer:
  - Impartial economic research (specific or general) to inform final policies in this area
  - Public fora at which to discuss the NEEEF proposals
  - Any other inputs into the policymaking process

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