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Republic of South Africa
Systematic Country Diagnostic

An Incomplete Transition
Overcoming the Legacy of Exclusion in South Africa

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WORLD BANK GROUP

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Currency Unit = South African Rand (R)
US$1.00 = R12.00

ABBREVIATIONS AND ACRONYMS

AIDS	Acquired Immune Deficiency Syndrome
ANC	African National Congress
AsgiSA	Accelerated and Shared Growth Initiative for South Africa
BBBEE	Broad-Based Black Economic Empowerment
BEE	Black Economic Empowerment
BRICS	Brazil, Russia, India, China, and South Africa
CGE	Computable General Equilibrium
CODESA	Convention for a Democratic South Africa
EPWP	Expanded Public Works Programme
FDI	Foreign Direct Investment
GDP	Gross Domestic Product
GEAR	Growth, Employment, and Redistribution
HIV	Human Immunodeficiency Virus
ICT	Information and Communications Technology
JSE	Johannesburg Stock Exchange
LGBTI	Lesbian, Gay, Bisexual, Transgender, and Intersex
NDP	National Development Plan
NEDLAC	National Economic Development Labour Council
NHI	National Health Insurance
NSFAS	National Student Financial Aid Scheme
OECD	Organization for Economic Co-operation and Development
PEMANDU	Performance Management Delivery Unit
RDP	Reconstruction and Development Programme
RHS	Right Hand Side
SAA	South African Airways
SADC	Southern African Development Community
SADTU	South African Democratic Teachers Union
SCD	Systematic Country Diagnostic
SEIAS	Socioeconomic Impact Assessment System
SMME	Small, Medium, and Micro Enterprise
SOE	State-owned Enterprise
StatsSA	Statistics South Africa
TB	Tuberculosis
TVET	Technical and Vocational Education and Training
YES	Youth Employment Service

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Executive summary

South Africa has come a long way since the advent of democracy, but its transition remains incomplete. The first three clauses of the Freedom Charter—the historic 1955 document setting out the central objectives of the democratic movement—were (i) the people shall govern; (ii) all national groups shall have equal rights; and (iii) the people shall share in the country's wealth. While the first two objectives have largely been achieved since the first democratic elections of 1994, historical disadvantage remains a determinant of income, wealth, and opportunity, notwithstanding some progress. As such, the *economic* transition from a system of exclusion under segregation and apartheid remains incomplete.

Poverty has declined significantly since 1994, but inequality remains extremely high. Improved access to basic services (such as electricity, water, and sanitation), the provision of over 4 million houses through state programs, and the expansion of the social wage have considerably improved living standards for millions of South Africans. A progressive fiscal system, expanded access to credit, jobs in the private and public sectors, and affirmative action policies have reduced inequality between black and white South Africans, although inequality within the black population increased. Overall, inequality has risen since 1994—and in some cases, policies adopted by the government have inadvertently helped entrench it further. According to World Bank Group data, South Africa remains the world's most unequal country.

Creating jobs, especially for young people, is critical to overcome the legacy of exclusion. Jobs are also important to build a stronger social contract. Large-scale job creation reduces economic vulnerability and helps transform the economy to become more representative of the population. Yet only about 60 percent of working-age South Africans participate in the labor force, and unemployment is high (27 percent), especially among young people (over 50 percent). To create more jobs, the economy needs to grow much faster than it has since 1994. But the legacy of exclusion in land, labor, capital, and product markets hampers growth. At the same time, high inequality and the legacy of exclusion fuel the contestation over resources, increasing policy uncertainty and deterring investment, while also undermining the financial stability of state-owned enterprises and their ability to provide quality public services. This too, has weighed on growth. When the distribution of income and assets is contested and a large number of citizens is excluded from job opportunities to join the middle class it puts pressure on the social contract—a fragile social contract is a symptom of the incomplete transition.

The World Bank Group's twin goals are to help countries eliminate poverty by 2030 and boost shared prosperity (that is, reduce inequality). These goals are also enshrined in South Africa's Vision 2030 in the National Development Plan. The World Bank Group is preparing for its 2019–2022 Country Partnership Framework with South Africa, and drafted this Systematic Country Diagnostic (SCD) to strengthen its understanding of key constraints to achieving these twin goals. Although the views outlined here are those of the World Bank Group, they were formed in direct conversation with South Africans, including the National Planning Commission, government officials, the private sector, academics, young people, and members of trade unions. The broad policy priorities identified are expected to strengthen job creation, and reduce poverty and inequality. The narrative resonates with contemporary calls for an "economic CODESA"—a reference to the Congress for a Democratic South Africa negotiations in the early 1990s, which led to the political transition from apartheid. Overcoming the legacy of exclusion requires a stronger social contract, and in the February 2018 State of the Nation Address, President Cyril Ramaphosa announced that a new social compact would be negotiated in close collaboration with business, labor, and civil society. This compact is an essential foundation on which to build the country's future. In this context, the private sector will have to play a more active role in shaping policy and creating jobs.

This SCD identifies five key constraints. These are (i) insufficient skills; (ii) the skewed distribution of land and productive assets, and weak property rights; (iii) low competition and low integration in global and regional value chains; (iv) limited or expensive spatial connectivity and under-serviced historically disadvantaged settlements; and (v) climate shocks: the transition to a low-carbon economy and water insecurity.

The World Bank Group views <u>insufficient skills</u> as the key constraint to reducing poverty and inequality. Skills are critical for both labor supply and demand: they raise the productivity of workers and entrepreneurs, help firms expand production at competitive prices, lead to additional hiring, boost aggregate demand, and contribute to a growing economy. Yet despite slow and steady progress, learning outcomes are still poor by global and regional standards. The legacy of "Bantu education" continues to deprive South Africa of the skills it needs and contributes to low growth, productivity, and competitiveness, alongside high unemployment. Inequality is also reflected in low household savings and high levels of indebtedness. Vision 2030 stresses that improving the quality of education is an essential ingredient for national development.

The <u>highly skewed distribution of land and productive assets</u> is a source of inequality and social fragility, fueling contestation over resources. <u>Property rights</u> are weak or under pressure. Despite some progress, wealth and land ownership remain highly concentrated. Public housing programs provide a growing number of poor households with tangible assets. Yet weak titling of property, especially in poor and informal areas, limits its value, including as collateral to access finance. Security of tenure in the former homelands is fragile. As a result, even where the poor hold land, the value of these assets is limited. Calls for land expropriation without compensation and aspects of the third Mining Charter fuel concern over property rights. A new social compact will require greater certainty about what will be redistributed—and how this will take place—while ensuring that secure property rights provide a sustainable platform for investment. Property rights are critical for all South Africans to leverage their assets in support of economic growth, household incomes, and jobs. Black economic empowerment should be evaluated to ensure that it becomes truly broad-based while minimizing adverse effects on investment.

<u>Low levels of competition and integration into global and regional value chains</u> deter growth and job creation. They also keep prices high, especially for the poor. The country's banks are well integrated into the global economy, but manufacturers have traditionally been protected by natural trade barriers (for example, distance) and a history of import substitution and industrial policy support. The country's product markets have high barriers to entry and are poorly integrated into the global economy. As a result, businesses miss out on opportunities to trade internationally and grow through technology transfers associated with participating in the value chain. This is especially a problem for smaller firms that struggle to find new demand in a stagnant economy and face barriers imposed by incumbents. The skills constraint exacerbates matters, particularly hurting manufacturers, small companies, and emerging entrepreneurs and farmers. Productivity gains from competition and innovation are needed to produce goods more cheaply for all South Africans, especially the poor, allowing their budgets to stretch further. Enabling business to compete effectively will have the dual benefits of overcoming the exclusion of historically disadvantaged South Africans, and ending the country's historical isolation from global markets.

Exclusion is also underpinned by <u>limited or expensive connectivity, and under-serviced historically disadvantaged settlements</u>. Many South Africans continue to live far from job opportunities in under-serviced townships, informal settlements, and the former homelands. This makes commuting expensive. There has been significant migration from rural to urban areas as people seek work. While migration supports poverty reduction, it can also put pressure on existing public services and raise social tensions as new arrivals compete with existing residents for jobs, services, and business. The government has made considerable efforts to reduce these skewed spatial patterns, but has at times inadvertently reinforced them—for example, by adopting housing policies that do not encourage urban densification. Urban planning is increasingly focused on sustainably densifying cities, but this is a long-term process. For some years to come, many South Africans will continue to live in relatively remote locations with limited opportunities for employment. Access to electricity, water, sanitation, good public clinics and schools, and financial services remains much weaker in such areas, limiting opportunities for growth, and weighing down living standards. Improving internet connectivity and low-cost broadband access can help increase connectedness.

Climate change will impose considerable costs on South Africa, which relies heavily on coal to power its economy. Managing the low-carbon transition and addressing water insecurity will be critical. Cheap coal was one of the key factors in the country's development, and the economy remains heavily dependent on coal for energy and mining. In the transition to a low-carbon economy, a viable decarbonization strategy will be needed to ensure that important economic sectors are not negatively affected. This includes implementing the carbon tax and leveraging private investment in energy conservation and clean energy technologies. Although climate change exacerbates the country's water challenges, it is not the source of the structural water deficit. Population growth, urbanization, and economic expansion are increasing demand for water, outstripping fixed supply. Addressing this deficit requires policies targeting water supply, management, and demand. Climate-smart agriculture will be important to guarantee adequate food production for South Africa and the region and to protect farmers' livelihoods, as will insurance products covering climate shocks. South Africa is a water-scarce country, and it will be critical to strengthen the regulatory and investment framework for more resilient and efficient water service delivery, while incentivizing consumers to use water more efficiently.

Public institutions have served South Africa well. Their integrity needs to be upheld and strengthened. The country has a vibrant democratic system, a capable civil service, and a strong and independent judiciary and central bank—as well as a robust media. Corruption, or "state capture," has been undermining the quality of institutions, especially SOEs, since 2009. The renewed emphasis on transparency, strong procurement systems, and accountability (on the boards of state-owned entities and beyond) is needed to ensure service delivery. Improvements in education outcomes will enable citizens to hold government more accountable. Institutions can also be strengthened by improving policy coordination, monitoring, and evaluation. A leaner civil service focused on priorities, coupled with the consolidation of state departments, can improve the quality of policy implementation, and will reduce competition for skilled workers and entrepreneurs with the private sector.

Undoing the legacy of exclusion is a long-term process, and expectations need to be managed carefully. South Africa has come a long way since 1994, and has contained the centrifugal forces tearing at the fabric of a highly unequal society. The global economic recovery, coupled with renewed commitment by the political leadership to strengthen institutions and strengthen the social contract, presents an enormous opportunity. But social progress takes time. Managing expectations will ensure that disappointment does not undermine South Africa's continued progress toward its Vision 2030.

This SCD, based on both new and existing research, was developed through extensive consultation with South African organizations and individuals. Yet knowledge gaps remain. Future areas of interest for the World Bank Group team include interventions in basic education that can raise learning outcomes for the poor; improving the affordability of tertiary education in collaboration with the private sector; developing township and rural economies; exploring how small firms can support growth and job creation; sustainably enhancing national water resources; preparing workers and communities for the low-carbon transition; leveraging the potential of natural resources to benefit historically disadvantaged communities; and encouraging greater foreign direct investment.

Chapter 1

An incomplete transition: Poverty, inequality, and the legacy of exclusion in South Africa

1.1. A history of exclusion in South Africa

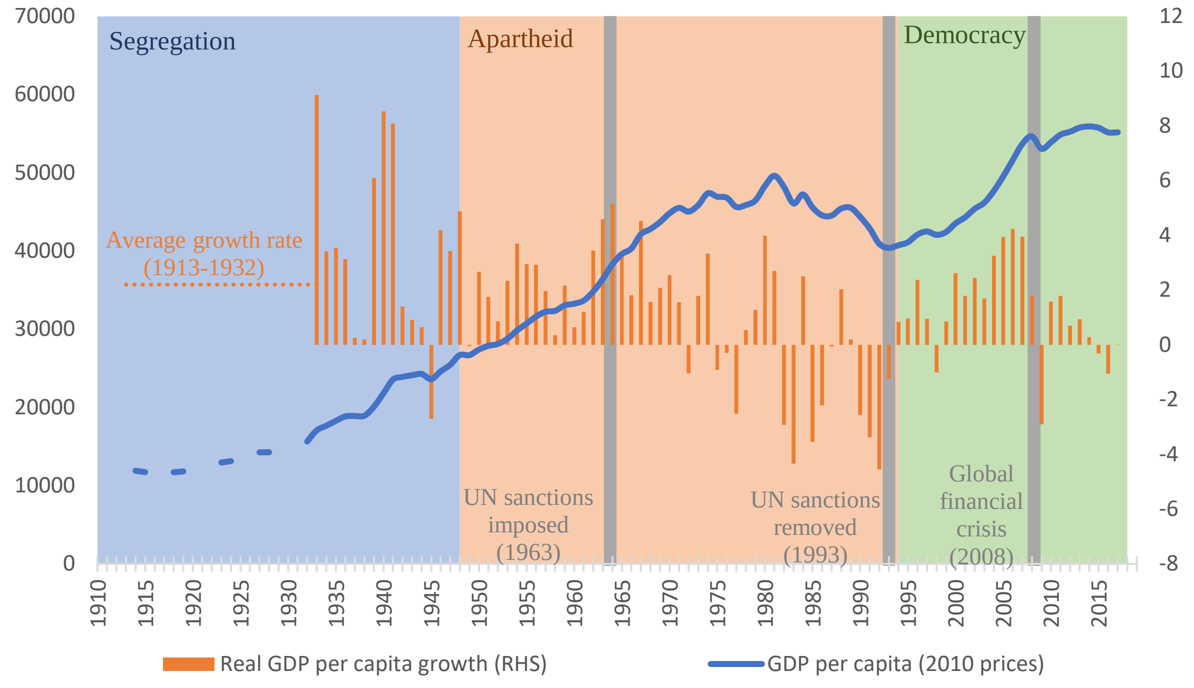
All countries are products of their history. Race-based exclusion is a defining feature of South Africa's history. As this chapter will explain, racial exclusion from opportunity, during periods of segregation and later apartheid, was a political project and economic development strategy in support of a minority. Laws and regulations were developed to restrict the freedoms of South Africans of color in a way that benefited white South Africans. In the early days of racial segregation, policies were designed to reserve arable land for white farmers and secure a low-wage, black[1] workforce for the mines, on the back of which the South African economy initially developed. With the election of the National Party in 1948, the government designed policies to create manufacturing jobs for poor white South Africans. To avoid wage competition, the apartheid government excluded black South Africans from the labor market through a system of job reservation and lower-quality "Bantu education." It also restricted South Africa's integration with the global economy, under a policy of industrial development through tariff protection and import substitution. Later, sanctions deepened the country's isolation, as the international community became increasingly opposed to the injustices of apartheid.

Racial discrimination and separate development became increasingly untenable, and apartheid ended in 1994. The African National Congress (ANC), today's ruling party, was formed in 1912, and became a forceful resistance movement, alongside other organizations, including the Communist Party and, increasingly, the trade unions. The struggle for a nonracial democracy initially resisted racial exclusion through peaceful means. More militant forms of resistance were adopted following the massacre at a nonviolent protest in Sharpeville township in 1960. This included the formation of the ANC's paramilitary wing, Umkhonto we Sizwe. The South African economy grew strongly in the postwar period, though not as quickly as those of other countries at similar levels of development. It then slowed in the 1970s and stagnated in the 1980s under the weight of economic isolation and political unrest (Figure 1.1). As of 1989, defense spending was 15 percent of the government budget,[2] international sanctions had isolated the country, the government debt burden was ballooning, and it was clear that apartheid had become untenable. By the late 1980s, business leaders and some government officials were in secret negotiations with the ANC to resolve the political and economic impasse. Nelson Mandela was released from prison in 1990, heralding the start of the transition to democracy, culminating in his election as South Africa's first black president.

Yet South Africa's transition remains incomplete. The severity of racial exclusion was gradually loosened in the later apartheid years, not least because the economy became increasingly constrained by skilled labor shortages. An incremental lifting of the color bar in the labor market allowed a historically disadvantaged middle class to slowly emerge even before apartheid ended. Yet exclusion remains entrenched to this day: historically disadvantaged South Africans hold fewer assets, have fewer skills, and are still more likely to be unemployed. Overcoming the historical legacy of exclusion has been at the core of policy since democracy was achieved in 1994. The 1955 Freedom Charter set out the broad demands of the democratic movement for a new South Africa. The Charter sets out 10 tenets, the first three of which are: (i) the people shall govern; (ii) all national groups shall have equal rights; and (iii) the people shall share in the country's wealth. The Convention for a Democratic South Africa

(CODESA), negotiated between 1990 and 1993, provided the basis for South Africa's political transition to a nonracial democracy that has delivered the first two tenets. Yet many South Africans are still excluded from the productive economy and the proceeds of national wealth creation, weighing on the social contract. The post-apartheid government has implemented initiatives since 1994 to reduce inequality in both income and assets with mixed results—in some cases, these policies have inadvertently entrenched inequality. As such, South Africa's long transition to an inclusive society remains incomplete—a sentiment that puts into context the ANC's call for radical socioeconomic transformation.

Figure 1.1: Economic development in South Africa, 1910–2017
(gross domestic product per capita and its annual growth)



Source: Nattrass and Seekings (2011: 519), extended and amended by World Bank Group staff.

This Systematic Country Diagnostic (SCD) argues that overcoming the legacy of exclusion is critical for a more resilient society and economy—and is the foundation for reducing poverty and inequality in South Africa. The 2012 National Development Plan (NDP) outlines its Vision 2030 for South Africa: to eliminate poverty and reduce inequality by 2030. It resonates with the World Bank Group's twin goals of eliminating extreme poverty and boosting shared prosperity,[3] and at least two of the United Nations' Sustainable Development Goals. This SCD focuses on the various ways in which inequality rooted in South Africa's historical legacy of exclusion persists—and how to address it. Its approach aligns with the World Bank's World Development Report 2006: Equity and Development. This chapter will demonstrate how poverty and inequality in South Africa are rooted in the historical exclusion in factor and product markets. Chapter 2 argues that persistent exclusion and inequality provide a fragile foundation for a social compact, which interlocks with other types of fragility: fiscal, financial, external, and environmental. They fuel contestation over resources—manifested, for example, in crime and corruption. The legacy of exclusion aggravates policy uncertainty, reduces growth, and undermines South Africa's ability to overcome its exclusion from the global economy. It keeps prices high, especially for the poor, and does not create jobs quickly enough to reduce the high levels of unemployment.

Jobs are perhaps the most important pathway for South Africans to overcome the legacy of exclusion. Chapter 3 will further pinpoint how to enhance the labor supply and demand for more jobs, focusing on the employability of South Africans, the contestability of labor and product markets, and a competitive infrastructure for South African firms—both incumbents and new entrepreneurs—to effectively compete locally and abroad and thus create jobs. Having identified the key determinants of poverty and inequality, Chapter 4 explores the extent to which the public sector effectively responds to the need to accelerate the transition. The final chapter provides a summary of the binding constraints and possible solutions to reduce poverty and inequality from the World Bank Group's point of view, anchored in South Africa's NDP. Annex 1 provides additional figures and country benchmarks.[4]

1.2. Exclusion in land markets and restrictions to free movement

Conflict over land and labor has been an enduring theme in South Africa's history. The Bantu-speaking mixed-farming communities that crossed the Limpopo River by the 4th century AD encountered San hunter-gatherers and Khoikhoi pastoralists. The interactions between these different groups became marred by conflict over time. Ultimately, the more populous and politically centralized Bantu farmers were able to displace their predecessors from much of the more fertile land. Land remained relatively abundant for the mixed-farming groups. The key to accumulating wealth and power in these communities was having control over people and building large followings. Homesteads built around extended families were the building blocks of these societies. While some remained relatively autonomous, many were joined in chiefdoms of varying sizes ruled by members of royal lineages. Centralized states developed in some areas as early as the 10th century, and the well-known Zulu Kingdom that emerged in the early 19th century was grounded in a much longer history of state formation. Regional and long-distance trade networks spanned the interior and linked to the Indian Ocean economy via Mozambican ports long before the arrival of Dutch settlers (or "boers") at the Cape.

From 1652, the arrival at the Cape of settlers of mainly Dutch origin introduced new dynamics to the region. The Dutch settlers subordinated and dispossessed the Khoisan communities in the Cape Colony, but the pastoralist "trekboers" struggled to displace the Bantu mixed-farming communities in the eastern Cape. The establishment of British control at the Cape after 1795 helped swing the balance of power against African societies in the longer term. British control and restructuring of economic and administrative systems—including the abolition of slavery in 1834—led some groups of boers to move northwards. From the 1830s, a protracted struggle over land and labor took place in the interior, resulting in the foundation of independent Boer Republics. These areas were largely fueled by settlers' demands for additional land and labor for their expansive system of farming, and their attempts to secure control of trade to the coast.

The discovery of diamonds and, later, gold in the interior exacerbated these conflicts and contributed to the conquest of African polities and the Boer Republics by 1902. In 1910, the Union of South Africa was proclaimed under British control. The struggles that played out in the 19th century laid the foundations for key features of the political economy of 20th-century South Africa. The first was that African societies were stripped of rights to land. The second was a migrant labor system that was initially shaped by a combination of precolonial economic patterns in the interior and an increase in colonial pressure.

The unification of South Africa in 1910 endorsed many of the policies that had prevailed in the Boer Republics and Natal. Racial segregation provided the foundation of the Union. The South African Native Affairs Commission proposed answers to the "native question" in 1905, based on racial segregation, and subsequent legislation drew on this. The 1913 Natives Land Act denied Africans the right to purchase land outside defined reserves that would later become the homelands (or "Bantustans"). It also attempted to limit rent tenancy and sharecropping by Africans on white-owned land. Although the act was not the cause of land alienation, it entrenched processes that had played out over the previous century. It initially set aside only 7 percent of the land for Africans—although an additional 6 percent was provided by the 1936 Native Trust and Land Act. The number of Africans living on white-owned land, primarily as labor tenants, increased in the first decades of the 20th century, reaching 37 percent of the African population by 1936, while 45 percent lived in the reserve areas. The Native Urban Areas Act restricted black South Africans from entering urban centers unless they were on official work assignments and carrying a pass. This meant that many black South Africans would work in cities but not be allowed to live there. The foundations for South African townships as dormitories, near cities or other hubs of economic activity such as mines, were thus laid early on.[5]

The location and movement of black South Africans were organized to support the colonial economy. South Africa differed from other white settler colonies—such as Australia, Canada, New Zealand, and the United States—in that it had a relatively large indigenous population.[6] While other settler colonies relied largely on immigration from Europe to increase their labor force, South Africa imported white skilled labor. It also drew much more on native labor, supplemented by indentured labor from India in the 1860s—and later China—under discriminatory conditions. Although it banned slavery formally, the colonial administration developed a legal system that governed black labor for the benefit of colonial enterprises.

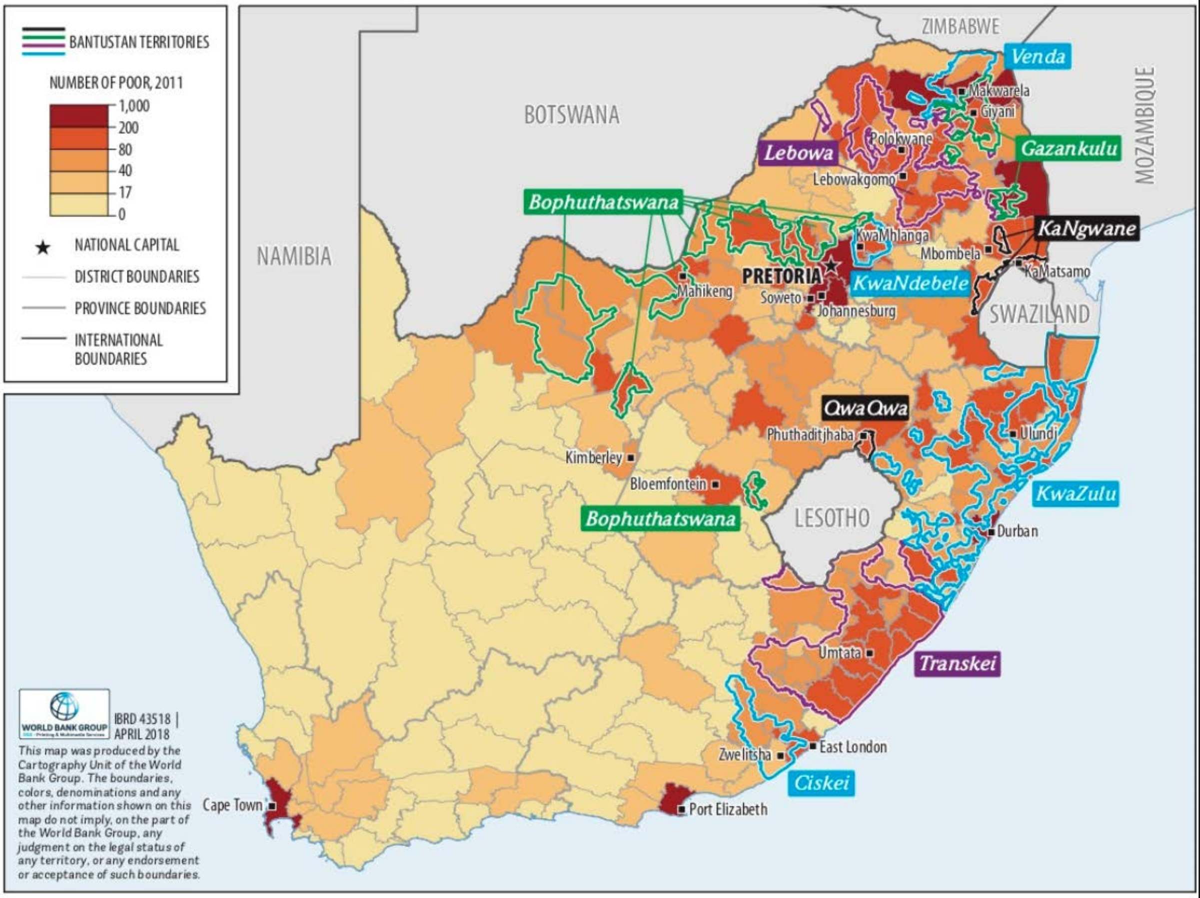
Turning the supply of migrant labor into a large-scale, low-wage system was largely achieved by the 1920s, drawing labor from rural South Africa and southern Africa. The system was based on taxation that also undermined rural production, centralized recruiting, and imposed draconian controls over movement and urbanization under the pass laws. Africans were forced to accept low-wage jobs in the mines and on farms to settle their hut and poll tax duties. The system became entrenched as the dominant form of labor extraction and spread to other sectors as the economy grew. It provided the main source of income for most rural areas, as well as a number of neighboring countries. In the reserve areas, the predominant forms of land tenure permitted were variations on customary communal tenure shaped by colonial interests. This is one of the reasons why South Africa's levels of subsistence farming are unusually low by African standards. The overall effect of these policies was to weaken the rights to land that had existed in precolonial societies. From at least the 1930s, sections of the state and the mining industry recognized that the reserve areas could not sustain the populations that were forced to live within them. Some experts advised creating a small farmer class with sufficient land to be productive and separating around 50 percent of the population from the land. The government rejected this suggestion because of the costs involved and the risk of accelerated urbanization.[7]

Apartheid consolidated racial exclusion, making separate development an official policy objective. The National Party formed a coalition with the Labour Party to form the Pact government (1924–1939), which promoted a nationalist agenda (freedom from what remained of British colonial rule) and white domination, especially in the labor market. The National Party came to power in 1948 on an apartheid (meaning "separateness" in Afrikaans) ticket. Although English capitalists continued to dominate the corporate sector, Afrikaner nationalists reshaped the system of white domination from one reflecting the power of English colonial society to one dedicated to uplifting white Afrikaners and constraining the opportunities of others, especially black South Africans. The National Party government set out to eliminate poverty among Afrikaners (the result primarily of the decline of sharecropping, which had given many poor Afrikaners access to the land) and competition in the labor market with increasingly skilled and semiskilled black and colored workers. Apartheid also formalized and intensified the concept of separate development of the races through legislation such as the Group Areas Act of 1950. This act assigned different race groups to different residential and business sections in urban areas, excluding black South Africans from living in the most developed areas and confining them to townships.

Where land became desirable for the development of white residential or commercial areas, some townships were demolished. Resistance to forced removals was crushed, as in Sophiatown in 1955. Infrastructure was designed to confine townships to their function as labor reservoirs, with access roads limited to the extent needed to transport workers to where they were allowed to work. Yet the public transport system was poor, bringing about the emergence of private operators—today's minibus taxis—connecting poor South Africans to their destinations to this day. Today, long travel distances translate into high transportation costs, reducing the value of real wages and increasing the costs of job searches, as explained further in Chapter 3.

The apartheid government made systematic attempts to reconstruct chieftainship as an alternative political space for black South Africans and to prop up minority rule. With increased international pressure, the homeland/Bantustan policy was implemented in the 1960s. Over time, it created ethnically defined administrations rooted in the reserve system and delegated some political and economic power to them. A minority even opted for spurious independence. The homelands were designed to deepen divisions, rebuild a system centered around chiefs, and co-opt wider sections of the black elite. The homelands achieved limited success in these terms but did create some additional opportunities and forms of patronage for new bureaucrats and expanded elites. They did not provide meaningful rights or economic opportunities for the majority of their inhabitants. Rather, they oversaw a further process of impoverishment of the rural areas—and, as Figure 1.2 shows, this spatial legacy of poverty persists. From the 1950s, under the impact of increased controls over urbanization, mass relocation of black Africans from white farming areas to the homelands, and soaring populations, the remnants of agricultural production collapsed.

Figure 1.2: Poverty map overlaid with map of former homelands
(number of poor, based on 2011 household data)



Source: World Bank Group staff.
Note: Poverty estimated at the national food poverty line.

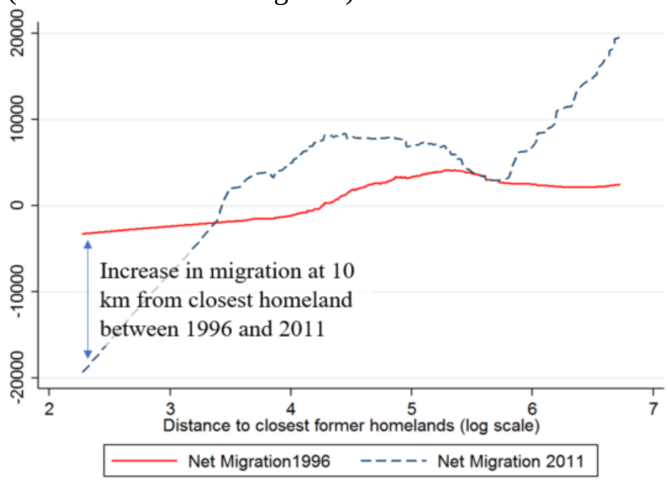
The social situation in the former homelands worsened significantly in the 1980s. In the 1960s, the erosion of rural economies was partly counteracted by high levels of employment in the central economy, which sustained flows of remittances from migrant workers. In the 1970s, the emergence of independent trade unions and state intervention to reduce the number of foreign workers led to a significant wage increase for migrant workers. State pensions were also expanded to rural communities. But from the end of the 1970s unemployment rose rapidly, and in the 1980s, the rural areas were afflicted by severe droughts. Job losses were particularly severe in mining, industry, and agriculture. Unskilled migrant workers were especially vulnerable.[8]

Most destructive of all in the long term were the increasingly dismal prospects for new generations. From the 1980s, school enrollment rapidly increased in the homelands. Young men and women developed high expectations of their futures that excluded unskilled labor or subsistence farming. They were also increasingly inclined to challenge the racial and patriarchal structures that had sustained migrant labor and rural production. But the opportunities that many imagined lay just around the corner did not materialize. Instead, unable to find work or accumulate the resources necessary to marry and establish their own households, many young people in rural areas were trapped in social limbo. They were no longer children, but they could not make the transition to full adult status.[9] This situation helped lay the foundations for South Africa's high levels of crime.

Belated attempts by the apartheid government to attract industries to (or near) homeland areas created limited opportunities for low-wage work, notably labor-intensive clothing jobs for women. But these were mostly reliant on subsidies, and in the absence of supportive infrastructure, they failed to lay any independent basis for regional economic development. Such problems continue to plague current development initiatives such as special economic zones, as discussed in Chapter 3.

The reduction of spatial exclusion, which began in the late apartheid period, has continued under democracy. Race-based restrictions on the movement of black South Africans and ownership of land gradually unraveled in the late apartheid period, but it was only with the abolition of the Bantustan system and the creation of new local government institutions that racial restrictions on ownership were finally uprooted. Chapter 2 explains that although ownership is no longer race-based, the lack of clarity of ownership—especially with regard to land and title deeds in some areas—continues to disadvantage some South Africans. Yet, overall, the right to free movement has set powerful market forces in motion, as South Africans moved from where they were mandated to be to where they had the highest chance of earning a good wage, mostly cities and towns (Figure 1.3). In some cases, the government and the private sector have responded too slowly to this process of rapid urbanization, and new townships and informal settlements have increased around urban areas.[10]

Figure 1.3: Net migration and distance to homelands
(number of internal migrants)



Source: World Bank Group staff.

The ANC government made a tremendous effort to provide adequate shelter, as required under the South African Constitution. Since 1994, the government has managed to deliver 4.3 million houses to more than 20 million South Africans, as originally initiated under the ANC's first development plan, the Reconstruction and Development Programme (RDP). Chapter 3 discusses these successes but also points to some of the challenges the program creates when building houses in areas far from economic activity, thus entrenching historical exclusion. The private sector has also offered housing solutions, as banks have increasingly provided mortgages to a fast-growing black middle class, while informal backyard rental has become a solution in townships. It provides migrants—both domestic and foreign—with shelter and homeowners (most of whom are not rich) with a return on the largest asset they own: their home.

At times, spatial policies in democratic South Africa have inadvertently entrenched segregation. More needs to be done to overcome the legacy of spatial exclusion. Beyond housing, land use planning needs to encourage the sustainable development of agglomeration forces that bring growth and job opportunities for all South Africans. The government has implemented policies to make cities more inclusive, but has at times inadvertently entrenched apartheid-era spatial patterns or supported densification with insufficient attention to the proximity of job-generating activities. Transport continues to be expensive, and recent solutions, such as the Gautrain or the bus rapid transport system, are insufficiently pro-poor. Minibus taxis remain the bridge to the world for many South Africans, yet Chapter 3 argues that costs could be lowered. Overall, spatial connectivity remains an issue for poor South Africans. In addition, although no longer race-based, some city regulations continue to discriminate against poor South Africans, for example, those who would like to seize opportunities from informal trading in urban centers.

Given the extent to which exclusion in South Africa is linked to land, it is unsurprising that land reform remains an emotional topic in South Africa. In rural areas, advancing land reform remains critical. The government implemented various land redistribution programs to realize the 1994 Land Restitution Act, which allows claims on dispossessed land and forced removals from various acts after 1913.[11] The RDP also helped to address land reform through restitution of land rights, land redistribution, and tenure reform. Despite these initiatives, restitution and redistribution proved to be expensive and were saddled with legal complications, such as multiple claimants, burden of proof, price setting, and general implementation. There were also complications around land tenure and the sustainability of commercial farms once transferred. The vast majority of claimants accepted financial compensation. Although 80 percent of land claims had been settled by 2016, the amount of land transferred is still small. The target of transferring 30 percent of arable land to black landholders by 2014 was not achieved, and there is limited information on the current level of transfer. Chapter 2 argues that quickly resolving issues around land reform in a way that redresses historical injustices without undermining livelihoods of rural communities is a critical challenge for South Africa—both to reconcile with past injustices and to promote greater certainty around ownership so as to encourage much-needed investment in agriculture.

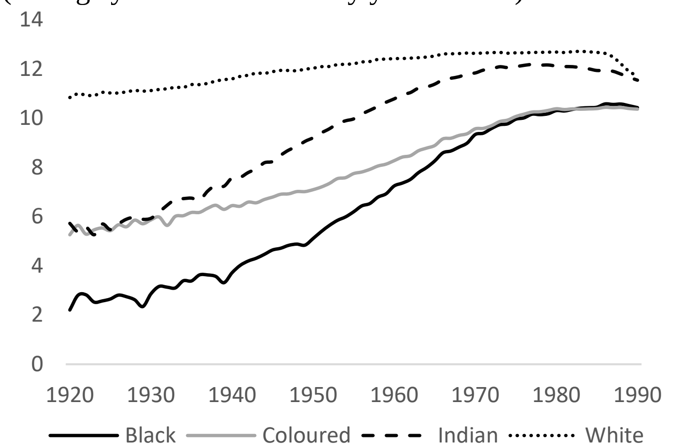
1.3. Exclusion in labor markets

Exclusion in labor markets began even before apartheid, suppressing black South Africans' entrepreneurial activity in agriculture and other sectors. The 1913 Natives Land Act (and related acts) prevented self-employment by black people in agriculture, while the Native Urban Areas Act suppressed other forms of entrepreneurial activity for black South Africans in urban areas, including in trade and manufacturing. This suppression of entrepreneurial activities helps explain why the informal sector—the economy typically dominating poorer parts of developing countries—in South Africa is smaller than in many other African countries, and why foreign micro-entrepreneurs often out-compete South Africans. Other factors include the legacy of policing employment in factories, where informality (in the sense of firms not abiding by the racially restrictive regulations and statutory minimum wages) was not tolerated. Enforcing labor standards and minimum wages across industry remains a key objective of South Africa's collective bargaining institutions and industrial and labor policies, reducing the opportunity for informality today.

Wage employment was subject to job reservation along racial lines. The Job Reservation and Colour Bar Acts, starting with the first iteration of the Mines and Works Act in 1911, reserved many skilled and semiskilled jobs for white South Africans. Economic conditions determined the degree of repression in the labor market. Per capita income doubled in real terms between 1933 and the end of the Second World War because of high gold prices, strong wartime demand, reduced competition from imports, and supportive industrial policies. This resulted in labor shortages, prompting a loosening of restrictions on the movement and hiring of black South Africans. Minimum wages set by the Wage Board (for nonunionized workers of all races) rose for black workers, and the racial wage gap narrowed.[12] More attention was paid to African poverty, and, in 1944, the means-tested, noncontributory old-age pension (that had been introduced for other races in 1928) was extended to black South Africans, albeit at lower levels. After the election victory of the National Party in 1948, this brief trend of liberalization was halted and additional restrictions (notably the 1967 Physical Planning Act) constrained the employment of black workers in urban areas.

Racial discrimination in welfare accompanied racial discrimination in employment. Until the mid-20th century, black South Africans' welfare needs were assumed to be lower than those of white South Africans and underpinned by subsistence agriculture and kinship structures in the former homelands. The extension of the old-age pension to Africans in 1944 was largely in recognition of the growing inadequacy of this social safety net. These pension rights were not withdrawn after 1948, but their real value did not rise until the 1970s, whereas that of white South Africans doubled over the same period.[13] In addition to being racially discriminatory, the South African welfare system assumed that people of working age would be able to find jobs. Job reservation and the provision of protected government employment, notably on the railways, ensured jobs for white workers. When open unemployment emerged in the 1970s among black people (a product of collapsing agriculture in the former homelands, further removals of workers and sharecroppers off increasingly capital-intensive white commercial farms, and rising wages in increasingly capital-intensive manufacturing and mining),[14] no welfare support was available for unemployed job seekers. The pension, which increased sharply in the 1990s (equalizing with the white level in 1993), remained the most important social grant for addressing poverty. Living with a pensioner was sufficient to pull households out of deep poverty.[15]

Figure 1.4: Average years of education
(average years of education by year of birth)



Source: Van der Berg and Hofmeyr (2018) SCD background note.

The education system further entrenched exclusion. Throughout the colonial and apartheid periods, education favored white South Africans. Even though school enrollment rose for historically disadvantaged South Africans under segregation and apartheid (Figure 1.4), the white population reached close to full attainment of 12 years of education as far back as 1920, while the black population has yet to achieve those levels today. The educational divide was exacerbated under apartheid through the 1953 Bantu Education Act:[16] the syllabus was deliberately designed to train black South Africans as unskilled laborers so as not to compete with white employees;[17] basic skills in arithmetic and language were deemphasized.[18] Control over black teachers during apartheid was intentionally bureaucratic and authoritarian to achieve social control, partly explaining the South African Democratic Teachers Union's (SADTU's) aversion to monitoring teacher performance today.[19]

Overall, education outcomes among black and colored South Africans were low, and despite some progress, they remain low to this day, even by Sub-Saharan African standards. The legacy of poor education persists in South Africa and is a major source of both poverty and inequality. After all, education holds the key to obtaining a job and a higher wage in South Africa. Chapter 3 further elaborates how the consequences of apartheid education still persist, affecting jobs, poverty, inequality, and transformation into a more demographically representative economy.

Apartheid labor policies ensured full employment for white South Africans, but at the cost of persistent shortages of skilled labor for business. This resulted in the gradual raising of the color bar and the emergence of a historically disadvantaged middle class. Firms responded to skills constraints by adopting capital-intensive processes and creating new, semiskilled jobs that were increasingly made available to growing numbers of urban black workers. Section 10 of the Urban Areas Act facilitated the growth of a relatively skilled class of urban black insiders, who were the first to benefit from the "floating" upward of the color bar (reclassifying jobs and opening them to black people). This formed the basis for the growth of a predominantly urban black middle class during apartheid. White trade unions agreed to the lifting of the color bar in exchange for shifting white workers into supervisory and other roles. By the mid-1980s, the only remaining color bar was the one restricting blasting certificates to white mine workers.

South African trade unions have a long history of shaping the country's labor markets. Notwithstanding their contribution since the 1980s to ending the apartheid regime, they continue to foster insider-outsider dynamics in the labor market. Gold mining, the engine of the colonial economy, resulted in an influx of skilled British migrants who demanded wages commensurate with levels obtainable in Britain. Faced with a fixed price, profitability in gold mining was underpinned by the only cost that could be controlled: unskilled black labor. When the mines sought to increase the use of cheaper black labor, it sparked the 1922 Rand Revolt. The state crushed the revolt, but it led to the victory in 1924 of the Pact government, which was determined to maintain relatively high labor standards for white workers. The new government established the first Department of Labour and set about creating industrial institutions for white workers, while the 1924 Industrial Conciliation Act provided for the registration and regulation of trade unions and employers associations and facilitated collective bargaining between them in industrial councils. Wage agreements were routinely extended to all firms in the industry, thereby entrenching a high—predominantly white—wage cost structure across industry. When black trade unions were legalized in 1979, they were able to use the industrial councils to improve wages and working conditions for their members. Industrial councils were deracialized but continued to serve labor-market insiders at the expense of job seekers. Chapter 3 suggests that collective bargaining systems may be used by incumbent firms to raise barriers to entry in product markets. Trade unions played a critical role in ending the apartheid government, and their alliance with the ANC and the South African Communist Party secured them a resounding electoral victory in 1994. Industrial councils were turned into bargaining councils after 1994 and remain a pillar of the South African wage bargaining system.

At the end of apartheid, South Africa had a high-skill economy and a large underclass of relatively unskilled unemployed people.[20] As Chapter 2 explains, wages and prices are shaped by the productivity of the tradable sectors in an economy.[21] 'Separate development' resulted in an increasingly capital- and skill-intensive growth path providing jobs primarily for urban insiders—mostly white South Africans, but over time growing numbers of skilled and semiskilled urban workers in South Africa's burgeoning African townships. Given the country's wage structure, only relatively high productivity firms and sectors are internationally competitive. Poor education means that goods produced by unskilled South Africans fetch less in international markets than they cost to produce, given prevailing wages. Together with rapid tariff liberalization in the 1990s and rising statutory minimum wages in South Africa's remaining labor-intensive sectors, such as clothing, this has priced low-skilled South African manufacturing out of business in international competition with low-wage countries, especially those of East Asia. Thus, manufacturing, which has traditionally been a key contributor to low-skilled job creation elsewhere, currently holds only limited potential for jobs in South Africa. Job creation for unskilled South Africans mainly occurs in nontradable sectors—services. Yet this sector can only grow to the extent that the tradable sector pulls it along. Chapter 2 explains that constraints to growth in the tradable sectors undermine job creation for the economy as a whole. Many South Africans thus remain excluded from labor markets to this day.

The democratic government took decisive steps to redress racially based discrimination in the workplace. These are important but can be improved. While the Constitution of 1996 appeared to favor the "soft" form of transformation through training and mentoring, the Employment Equity Act of 1998 focused on quotas, or targets: all employers of firms with more than 50 people have to ensure equitable representation of all race groups according to population demographics. Employers must give preferential treatment to black candidates and produce an equity plan for the Department of Labour; should targets not be met, there are fines. In addition, broad-based black economic empowerment (BBBEE) legislation of 2007 imposes quotas for black executives. That said, according to the Department of Labour, 68 percent of executives in 2016 were white. While such legal prescriptions are important and generally comparable to affirmative action employment policies in other countries (for example, for women), this may particularly hurt hiring in small, medium, and micro enterprises (SMMEs)—although it requires further study.

Overall, South Africa's economy does not create jobs quickly enough, making it more difficult to build the social contract. Growth was relatively jobless in the first few years after 1994. A significant debt burden, inherited from a nearly insolvent apartheid government, and tight fiscal policies to re-establish macroeconomic stability under the government's Growth, Employment, and Redistribution (GEAR) program contributed to low growth. The tight fiscal policies were at least in part motivated by the desire to avoid seeking help from the World Bank and the International Monetary Fund. Low growth also meant relatively low job creation in the 1990s, although both picked up in the early 2000s—only to stall again during the global financial crisis and economic downturn in 2008. Unemployment reached a 14-year peak of 27.7 percent in 2017. Over a third of South Africans are unemployed when including those who have given up looking for work. Overall, labor participation is very low by international standards. The lack of job opportunities, especially for young people, is putting pressure on the social contract. This is observable in the recent protests for free higher education. The #FeesMustFall demonstrations were partly in response to awareness among young people that tertiary education, which has been unaffordable for many, is critical for the prospects of obtaining a job.

1.4. Exclusion in capital and product markets

Persistent exclusion in South Africa's capital and product markets has led to a society with a highly unequal distribution of wealth. On the one hand, exclusion from labor markets depressed wage income, which could have been saved to build wealth. Job reservation and restrictions on property ownership hindered black South Africans from building wealth and accumulating it through inheritance across generations. Additional constraints to wealth creation included restrictions on property ownership for black South Africans and restrictions on starting businesses and competing in South Africa's product markets. These restrictions prevented wealth being built across generations. On the other hand, a growing economy that excluded black South Africans allowed white South Africans to accumulate significant wealth, be it through savings from labor income or by investing in companies. Many of these white people form the foundation of today's corporate South Africa.

Democratic South Africa inherited an economy that made it difficult for historically disadvantaged entrepreneurs to accumulate wealth by competing in the country's rigid product markets. South African cartels and dominant firms are partly a symptom of this. Barriers to entry and rivalry have two consequences: they make it difficult for the historically disadvantaged to become entrepreneurs and catch up with building corporate assets by starting and growing companies, and they raise prices and reduce access to goods and services, making the economy expensive for consumers as well as firms. High consumer indebtedness, black economic empowerment (BEE), and the design of contemporary competition and industrial policy in South Africa are all symptoms of this. Poor South Africans become indebted in trying to catch up with the living standards of rich South Africans. BEE aims to provide the historically disadvantaged with a share of historically accumulated wealth, and the government aims to achieve its redistributive goals by using competition and industrial policy to compensate for the lack of competitiveness partly stemming from obstacles to entry and rivalry.

Finally, democracy inherited a system in which the prices of many goods and services are raised by anticompetitive behavior or by markets that restrict competition—and where many public goods are unequally accessible. Market rules that restrict competition, as well as cartelistic behavior and abuses of dominance, raise prices for consumers. Anticompetitive overcharges on prices for many goods—especially basic ones—directly harm the poor in South Africa. World Bank estimates suggest that at least 200,000 South Africans stood to be lifted out of poverty by efforts to break up cartels in maize, wheat, poultry, and pharmaceuticals.[22] As for public goods, the government has made significant progress in providing the benefits of South Africa's developed public service infrastructure to the whole population. Substantial progress has been made in water and electricity, but exclusion remains entrenched in education and health.

The history of exclusion in capital and product markets stretches back to the discovery of gold. Mining has played a central role in shaping South Africa's economy and society. The discovery of gold on the Witwatersrand in 1886 laid the foundations of South Africa's modern economy: an infrastructure system closely linked to the mining industry, a large financial sector that evolved on the back of mining, and a manufacturing sector supported by industrial policy financed by mining revenue, which in turn reinforced the dominance of very large firms in some markets, such as in chemicals and metals. At the same time, mining is linked to the institutionalization of racial discrimination in labor markets and restrictions of movement of black South Africans. A history of migration, the impacts on household incomes from remittances of migrating family members, disintegrating family structures, and the spread of diseases, such as tuberculosis (TB) and HIV/AIDS, are also linked to it. These phenomena stretch beyond South Africa, as migrant labor was also drawn from other countries in Sub-Saharan Africa.

Through most of the 20th century, South Africa's economic expansion was largely driven by the mining industry. Although other global and local policy factors influenced the performance of non-mining sectors, it was generally true that when the mines prospered, so did the rest of the economy. Policymakers from 1910 onward had to take this reality into account, but they were mostly ambivalent about it. Wary of foreign mining capital, successive governments imposed heavy windfall taxes on mining companies as well as protections for white workers and tariffs that raised the mines' operating costs. These programs were designed to redistribute the benefits of mining toward white, less wealthy, and frequently Afrikaans-speaking voters, and make the country less dependent on mining. Over time, governments tended to modify these demands to ensure that the mines produced the revenue and growth on which the stability of the country depended. This relationship between the state and mining companies that characterized the 20th century has continued into the post-apartheid era, and this is critical to understand some of South Africa's pressing economic challenges, explored in Chapter 2.

The financial sector developed on the back of mining, as did many other firms. Given that South Africa was still a relatively undeveloped country with little savings, banking was crucial to intermediate international finance for the mining sector. The Johannesburg Stock Exchange (Africa's oldest stock exchange) was established to help mines raise capital and was intermediated by banks that were well integrated into the global financial system. South Africa's financial sector is still large, with finance and insurance accounting for 10 percent of gross domestic product (GDP). Other sectors, too, developed in the shadow of mining. Since the 1880s, in the wake of gold mining's expansion in and around Johannesburg, thousands of small and midsize companies emerged there, producing machinery, electrical equipment, explosives, wire cables, cement, bricks, alcohol, and miners' footwear. The mining sector attracted foreign capital and skilled workers into mining and the industries emerging around it, resulting in immigration of engineers, doctors, lawyers, and accountants from Europe and America, and low-skilled migrant labor from other Sub-Saharan African countries. The mines helped to expand higher education for white South Africans, investing especially in subjects such as engineering and science. South African mining technology and capital equipment continue to be world-renowned.

Active industrial policy—supported by revenue from mining and mining-related infrastructure services—helped develop the South African manufacturing industry. The stable and rising price of gold from the 1920s onwards helped earn the foreign exchange required to buy capital equipment and pay for upgrades to infrastructure.[23] But it also kept the rand relatively strong, rendering South African manufacturing relatively less competitive. Although import substitution policies were first introduced in 1924, these kinds of policies, along with an emphasis on participation of state-owned enterprises (SOEs) in markets, intensified under apartheid. As much in the early 1900s as today, building a manufacturing sector was seen as critical to provide jobs. After 1948 there was a renewed emphasis on jobs for poorer white Afrikaners. The end of the Great Depression, the increase in the gold price, and strong demand from the war efforts in Europe contributed to the South African manufacturing boom.

Import substitution and industrial policy, with support from SOEs, helped diversify the economy. South African industrial policy brought together a range of factors. For one, capital was available from South Africa's profitable mining firms, eager to diversify their portfolios. Low-cost electricity supported energy-intensive manufacturing in Gauteng, where most of the mining activity was concentrated, while high rates for minerals cross-subsidized rail transport of industrial output. High tariffs on trade encouraged import substitution. Various import replacement schemes were introduced in the 1950s and 1960s to make South Africa more self-sufficient in the fields of textile, chemical, metal, automotive, and engineering production. Quotas, permits, and other complicated instruments were also introduced.[24] For example, the automotive sector that had originally attracted assembly plants in the 1920s behind high tariffs introduced a weight-based local content requirement in 1961, with complimentary excise-duty rebates if certain escalating targets were met. Furthermore, large SOEs facilitated critical supply industries.[25]

Given the required scale, South Africa's market structure in mining has tended toward concentration. Sanctions against the apartheid government further spurred a concentration of economic ownership across the economy. Following the brutal suppression of the 1976 Soweto uprising, the rest of the world became increasingly aware of and opposed to the system of apartheid. The United Nations Security Council adopted an arms embargo in 1977, followed by increasingly stringent sanctions. This accelerated a drop in investment. To keep capital in South Africa, the country adopted a dual exchange rate system (two exchange rates used for different transactions). South African companies lost access to critical imports because of these sanctions, and import substitution intensified. The dual exchange rate system and the need for import substitution resulted in South African companies becoming more vertically integrated as they invested their capital in activities outside their core business and produced previously imported inputs themselves. Moreover, as foreign ownership of productive assets declined, existing South African companies and investors stepped into the breach. Large South African corporations bought out smaller ones, and the concentration of ownership increased.

Corporate ownership across the economy appears to be relatively skewed toward a few firms that have conglomerate-style structures or that are vertically integrated (that is, parts of the supply chain are owned by one company).[26] While the number of enterprises that own another enterprise is low in South Africa, these firms have significantly more subsidiaries than their counterparts in peer countries. Moreover, a wave of domestic mergers and acquisitions occurred in South Africa after 1994 as the economy opened up to global trade. The number of mergers and acquisitions has remained relatively high since then. These patterns provide some indication of concentration of corporate ownership among a relatively small number of private firms, another potential source of inequality. At the same time, the government is also a player across a number of industries—and often has a dominant position in the country's markets, with many South African SOEs being large and vertically integrated.

Government presence may affect the ability of private players to invest and compete where its presence created an unlevel playing field or where it leads to exclusionary behavior.[27]

Concentration of ownership, however, is not necessarily the main reason for limited competition in South Africa. In understanding the implications of South Africa's ownership structures, it is key to distinguish between the concentration of *capital across the economy* (for example, conglomerate ownership structures), which links to inequality in wealth, and concentration *within market*s (for example, the presence of a dominant firm), which can affect competition. It is also important to note that corporate structure and market structure are not sufficient to explain anticompetitive practices in South Africa. Anticompetitive practices, too, have many historical origins, that are related to features of the regulatory environment, such as historically state-supported price controls, market divisions, the strong role of industry associations, or the award of preferable access to essential facilities. Overall, however, South Africa's legacy of exclusion extends both to exclusion in capital markets and product markets. The concentration of capital adds an important dimension to inequality in capital (wealth) in South Africa, and competition issues remain an important source of exclusion from product markets.

Exclusion in capital markets

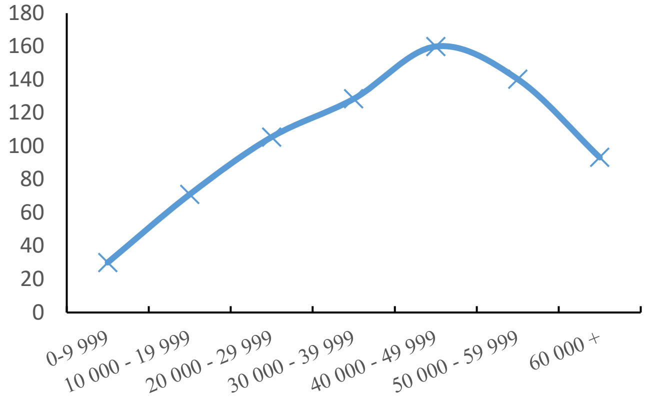
The distribution of financial capital—that is, wealth—is a major source of inequality in South Africa. Wealth inequality is even more extreme than income inequality in South Africa, with a Gini coefficient of 0.81—one of the highest in the world.[28] The top 10 percent of wealthy South Africans own 70.9 percent of total household net wealth in the South African economy, while the poorest 10 percent own 0.1 percent and the poorest 50 percent own only 4.2 percent.[29] Richer households have, on average, nearly 10 times more wealth than poor households. Residential property and pensions are the most important assets for South African households, with pensions increasingly becoming accessible to historically disadvantaged public servants. Overall, being white or South African Indian—for whom apartheid legislation was less harsh—remains a strong predictor of wealth. This implies that the accrual of capital returns across the economy is concentrated among the small group of South Africans who hold wealth. In markets where competition is restricted, higher returns on capital may aggravate this inequality further. In addition, smaller family sizes among the wealthy imply a larger share of an inheritance, as it is split among fewer individuals, further aggravating inequality in assets.

Much South African wealth is held abroad. South Africa's net international investment position is positive. To an extent, this is a precautionary choice: it is a consequence of uncertainty about the future of policies relating to redistribution of income, assets, and ownership. Chapter 2 will argue that a positive net international investment position is partly a source of resilience, as it is a potential source of capital inflows that reduces the risk of sudden stops (that is, external liquidity drying up for South Africa). But, overall, the concentration of assets and associated fear of expropriation deprives South Africa of much-needed capital for domestic investment.

Since democracy, publicly provided housing has helped build the poor's asset base. The ANC government has been trying to rebalance the ownership distribution of assets. The RDP housing program was designed to provide dignified shelter to South Africans, as mandated by the Constitution. Yet it has provided poor beneficiaries with a residential asset. To date, the government has built more than 4 million houses—a remarkable achievement. There are, however, delays in delivery and registration of deeds.

South Africa's sophisticated financial sector has opened up to many formerly excluded South Africans, helping living standards and asset holdings to converge to an extent but at the cost of indebtedness.[30] Most South Africans have a bank account—not least to receive social grants. The poorest South Africans are the most credit active: 57 percent of South Africans earning between R0 and R9,999 per month have a loan, although of relatively small value (6.2 percent of total debt to formal financial institutions). Access to finance has allowed many South Africans to obtain a mortgage and build wealth, but also finance higher levels of consumption. As a percentage of gross income, the middle class is the most indebted (Figure 1.5), suggesting that some of the catchup in living standards is financed by debt, making this convergence less lasting unless productivity and wage growth accelerate.

Figure 1.5: Household indebtedness
(ratio of debt to monthly gross income by income group)



Source: Van Aardt, de Clercq and van Tonder (2017).

Access to bank finance does little to build assets for the poor. Even though poor households are not the most indebted as a percentage of their income, their debt is least sustainable—70 percent of debtors in the R0–R9,999 category are in arrears with their credit providers. Poor South Africans tend not to use debt to build assets but to make ends meet. Only 5.3 percent of the debt of that income group was used to buy assets such as property and vehicles.[31] The remainder was unsecured, the bulk of which would have been used for consumption. Unsecured lending has soared in South Africa, especially since 2011. Rising default rates (coupled with under-provisioning) required the government in 2014 to bail out one bank, African Bank, which specialized in lending to lower income groups. The monetary authority has since become more vigilant with unsecured lending practices, the most prominent form of lending among the poor, and unsecured lending has slowed significantly. Apart from commercial banks, largely informal finance cooperatives, burial societies, and, especially, stokvels (savings cooperatives) are important for the poor: about 70 percent of South Africans are estimated to participate in stokvels, and stokvel financing is used for debt repayment, emergency savings, education, groceries, and clothing, among other purposes.[32]

Access to finance continues to exclude many SMMEs. South African banks cater in particular to larger firms. Most SMMEs are owned by black South Africans, while most larger firms are still owned by white South Africans.[33] The lack of access to financial products limits the expansion of black firms, which reduces the racial transformation of the economy. In response, the government has put in place financial support initiatives for SMMEs, including financial support. However, the fragmentation of programs as well as unintended exclusion arising from eligibility criteria and the granting process undermine their effectiveness. Chapter 4 highlights the importance of designing such support programs to ensure that aspects of their eligibility criteria and granting process do not unintentionally affect the ability of firms to enter and compete in certain markets (for example, by favoring certain SMMEs over others).

BEE attempts to make ownership of assets and ownership structure more representative of South African society. The democratic government's initial policy to address the legacies of the past was moderate. Initially, an investor-friendly approach was adopted—partly because low domestic savings and the legacy debt incurred by the apartheid government made South Africa more dependent on investment from abroad. The government focused on the basic promise to provide better access to opportunities such as services and education, and only slowly introduced more interventionist measures along the lines of affirmative action, such as the 1998 Equitable Employment Act. The 2003 BEE Act was supposed to racially transform corporate South Africa, as corporate ownership had largely remained in the hands of white South Africans. Yet BEE mainly benefited a small politically connected black elite. To ensure BEE reached more South Africans (that is, become more broad-based), the BEE Act was amended in 2007 to become the BBBEE Act, which was further amended in 2015. The latest BBBEE codes award points for black representation in firm ownership, at senior management level, and at other employment levels; firms' procurement from BBBEE-compliant firms; and spending on developing SMMEs and skills as well as socioeconomic development. A firm's BBBEE score determines its ability to do business with the government—and because BBBEE points are also awarded based on who a firm procures from, incentives for racial transformation move along the value chain. Little evidence exists about the extent to which BBBEE achieves its goals, but Chapters 2 and 3 will argue that it may have unintended consequences for investment.

Exclusion in product markets

Starting or expanding a business can overcome exclusion in product markets, yet this is difficult for South African entrepreneurs. One major constraint for entrepreneurs in South Africa is a weak economy—it is easier to sell in a growing market than take market share from incumbents. Yet growth in South Africa has been relatively low. Chapter 2 argues that this is closely linked to the incomplete transition weighing on investment. In addition, skills constraints from South Africa's legacy of exclusion make the economy less competitive, placing a binding constraint on growth—and thus the demand that emerging entrepreneurs could feed in the domestic market.

More contestable product markets are important for new firms to compete—and to make products more affordable. Embedding competition principles across public policy and sector regulations is critical. In addition to low growth, South African entrepreneurs are faced with rigid market structures that make it difficult for them to enter and compete on a level playing field—while also providing incentives for firms to collude. Anticompetitive practices have been detected in key sectors in South Africa. The country's competition authorities rank as the most active and effective in the world, detecting a large number of cartels, including in the agricultural, household goods, construction, and industrial input sectors. These practices hurt the competitiveness of the economy as a whole—further undermining growth. They hurt consumers, including the poor, and can make it harder for new firms to enter markets. While South Africa's focus on antitrust enforcement in its competition policy has been successful, Chapter 3 argues that making government interventions more pro-competition—beyond enforcement—is important for creating jobs and reducing poverty.

Antitrust enforcement can address practices that may be facilitated by concentration in certain markets. However, focusing on the root causes of concentration will also require examining areas where public policy is inadvertently exclusionary to the detriment of SOEs. Chapter 3 argues that government intervention inadvertently undermines competition and supports incumbents, even when it seeks to address legitimate policy objectives. There may be alternatives that can achieve the same objective with a smaller effect on competition. The chapter will argue that sustainable mechanisms are needed to ensure that interventions could be aligned with competition principles to ensure that market entrants have incentives to enter and are able to compete with incumbents on a level playing field. Ensuring that competition principles are embedded across public policy will minimize constraints on output and reduce prices for consumers and downstream firms (depending on the product in question), thus boosting household welfare, competitiveness, and job creation. Many large SOEs and former SOEs continue to dominate South African markets. Some were corporatized, such as Sasol (petroleum and chemicals) and Telkom (telecommunications), and there are markets where current and former SOEs have been deregulated. Chapter 3 argues that the behavior of some of them undermines the competitiveness of the economy, while in some cases these firms continue to benefit from regulatory protection from competition.

There is little competition from new or foreign firms. The democratic government reintegrated South Africa into the global trading system and voluntarily reduced trade tariffs under the 1995 General Agreement on Tariffs and Trade, the precursor to the World Trade Organization. Yet South Africa's industry struggled to compete in global markets, and unproductive firms shut down or were acquired by more efficient firms, further increasing the vertical integration of corporate South Africa. The government maintained or expanded a system of tax incentives to protect jobs in the manufacturing sector. While this has helped to an extent to maintain the sector, it will not be enough to make it the driver of job creation that it was intended to be—greater competitiveness is urgently needed. Moreover, South Africa's relatively weak integration into global trade systems and value chains reduces access to external markets and makes imports, including technology-intensive capital goods, expensive. This means that exports remain dominated by the commodity sector and there is little growth from productivity gains through adopting global technology.

The rail and port system still caters mostly to mining and is insufficiently equipped to enable South African non-mining firms to access international markets. South Africa's economic hub, the Johannesburg-Pretoria metropolitan region in Gauteng, developed around the nearby gold supply. In other countries, economic centers tended to develop in locations where transport infrastructure, especially major waterways, supported international trade. This was not the case in South Africa, notwithstanding the contributions of Durban and Cape Town to the country's economy. Rail networks were built and linked to ports to export South African mining products from the interior. Rail continues to be designed for bulk transportation in South Africa (with tariff structures putting transporters of cargo at a disadvantage versus bulk transporters), so non-mining businesses have to rely on road freight. In addition, many South African ports are poorly equipped to deal with non-mining merchandise, with port fees 88 percent higher than the global average. This results in a system where transportation costs contribute to pricing many South African non-mining products out of business in international product markets, and making imports expensive, as Chapter 3 shows.

Exclusion from public services

Separate development excluded many South Africans from infrastructure services. Mining South Africa's minerals became feasible only because of its fortuitous location close to another natural resource: coal. Eskom, South Africa's power utility, originally supplied mines with coal-generated electricity at a relatively low cost. Cheap electricity was increasingly expanded to cities, commercial agriculture, and, later, energy-intensive manufacturing. Black South Africans were mostly excluded from this benefit until democracy. A similar story holds for water. As apartheid ended, access to public services increased rapidly, putting pressure on utilities that could not always meet the growing demand. For example, demand for electricity exceeding supply resulted in significant loadshedding in 2007/8 and 2015, undermining growth and job creation (see Chapter 2). Although the government has made significant progress in rolling out infrastructure services, many South Africans remain underserved.

A bimodal health system continues to provide better services for the rich than the poor. Many of South Africa's major health problems have their origin in mining, as mining communities have been one of the main epicenters of communicable diseases, particularly HIV and TB. The prevalence of TB among miners and ex-miners is estimated at 2,500 to 3,000 per 100,000 people (compared with 834/100,000 people in the general population), more than 10 times the World Health Organization's threshold for a health emergency. Yet an unequal health system continues to provide inadequate services to poor South Africans. Much like in education, disparities and inequality are historically entrenched in health outcomes and access to health services. A bimodal health system still serves poor and rich South Africans in separate health facilities, with significant differences in quality and access.[34] Private health care in the form of private insurance payments accounts for more than 50 percent of total health expenditure, but caters to only 16.5 percent of the South African population. It is no coincidence that health is one of the most prominent themes in the NDP.[35]

1.5. Progress since 1994 to reduce poverty and inequality

The ANC led South Africa into its democratic era. A constitutional assembly chaired by Cyril Ramaphosa drafted a new Constitution between 1994 and 1996, and South Africa's transition accelerated. Following the CODESA, the ANC was voted into power in the 1994 general elections.

The 1996 South African Constitution was crafted with a strong sense of positive socioeconomic rights—including access to adequate housing, health care, food, water, social security, and education—in order to overcome the legacy of exclusion.[36] It is an ambitious Constitution for a government that is limited in both capacity and budget, creating a mismatch between aspiration and capability that can sometimes undermine policy effectiveness as much as it at other times prompts rapid development.[37] This explains the active role of the South African courts in the policy space today. Quick progress was made on two of the first three tenets of the 1955 Freedom Charter: all South Africans obtained the right to vote and had equal rights, thus abolishing the legal foundations of separate development. Some progress was also made toward "sharing the national wealth," if interpreted as greater participation in the economy of the historically disadvantaged,[38] although this progress slowed and the transition remains incomplete.

In line with the spirit of the newly crafted Constitution, the democratic government's policy has a strong social emphasis. The RDP focused, among others, on providing houses and the quick rollout of electricity and water services. In 1990, 56.5 percent of South Africans had access to electricity; in 2014, coverage had increased to 86 percent. The improvement is particularly impressive in rural areas, where access increased from 28.4 percent to 71.5 percent. Access to improved water supply already stood at 98.1 percent in cities, which were largely white settlements. For the rural population, where most black South Africans lived, access increased from 66.3 percent to 81.4 percent by 2014, although there are still gaps in access to flush toilets. The government also introduced child support grants, which have helped the government target the poorest population relatively effectively.[39] The rapid integration of the school and health systems into single systems, administered by a national department and nine provincial departments, was one of the most fundamental and perhaps least acclaimed transformations in the first few years after 1994.

Taxing South Africa's modern private sector and access to international capital markets have provided financing for social transformation. After 1994, the government made efforts to assure investors, both domestic and foreign. South Africa's modern economy remained intact and has further opened to historically disadvantaged South Africans over the years. South Africa has also maintained access to international capital markets, and as the government paid back legacy debts, it achieved an investment-grade credit rating in 2000.

Social progress was significant after 1994. Poverty roughly halved between 1996 and 2008 but has stagnated since. It continues to mostly afflict the historically disadvantaged. In 2015, 18 percent of South Africans lived on less than $1.90 a day.[40] At the national poverty lines, 25.2 percent of South Africans did not meet minimum nutritional requirements (the food poverty line). Moreover, 55.5 percent of South Africans could meet their food requirements but not afford other necessities (the upper poverty line). Poverty in South Africa is relatively high for a middle-income country and relatively low by Sub-Saharan African standards. According to Statistics South Africa (StatsSA), using the upper poverty line, 64.2 percent of black South Africans were poor in 2015, compared with 41.3 percent of colored, 5.9 percent of Indian, and 1.0 percent of white South Africans. Poverty was highest in the rural areas, especially the former homelands, at 81.3 percent, compared with 40.6 percent in urban areas. In 2015, 57.2 percent of women were poor, somewhat more than men (53.7 percent). Single mothers are particularly affected by poverty.

Children experience the highest incidence of poverty. In 2015, 66.8 percent of South African children lived in poor households. Young adults are the second-most affected age group: 60.1 percent of 18–24-year-olds experienced poverty in 2015. Poverty was lowest among 45–54-year-olds, increasing modestly again for older South Africans. Among those over 65, 44 percent were poor. Non-monetary measures of poverty and inequality, such as health and education status, did not improve as expected. For example, according to the 2016 South Africa Demographic Health Survey, 27 percent of children under five are still considered short for their age or stunted, and 10 percent are severely stunted—a very high rate for a middle-income country.[41]

Poverty is mostly chronic, underlining the persistence of economic exclusion. South Africa's middle class is small but growing. If defining chronic poverty as a state of persistent poverty, 60 percent of South Africa's poor were classified as poor in all four household surveys undertaken between 2008 and 2015, while nearly 80 percent were poor at least once in that period.[42] Thus, few South Africans have managed to permanently move out of poverty in the last 10 years. This is due to precarious employment, largely unskilled and in the informal sector, without a work contract. And given that many poor households have only one employed family member, the risk of losing a job affects the poverty status of the whole family. The exclusion of poor South Africans also extends to their access to services: among the chronic poor, only 21 percent have access to electricity, running water, a flushable toilet, and formal housing, contrasting with 77 percent who had not been poor in the last 10 years. Using a definition of middle class that includes households with stable income sources that make them unlikely to slip back into poverty, only 20 percent of South Africans are middle class, although this group has been growing and become less determined by race.[43]

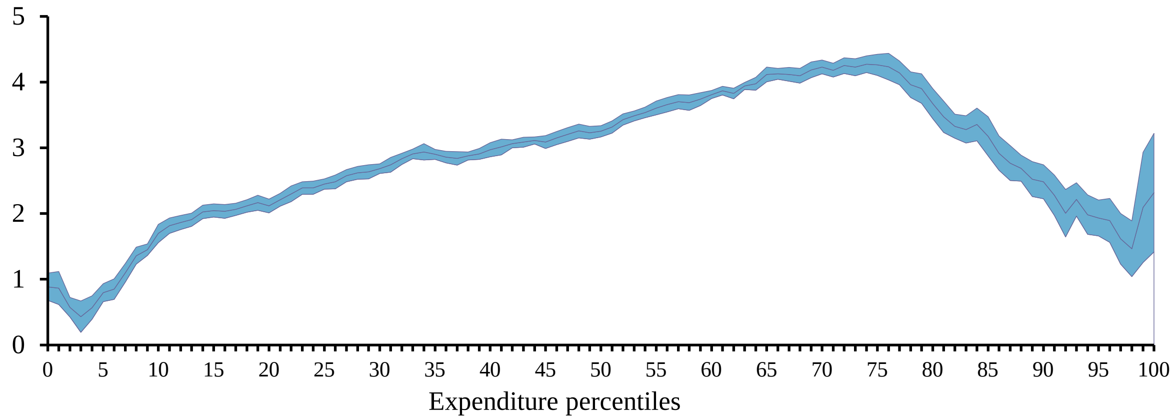
Completing secondary school and, ideally, obtaining a university degree, is the key to reducing poverty. South Africa's poor do not have a meaningful amount of human or financial capital, and they tend to live far from economic activity. Education is key, as 93 percent of those who did not experience poverty in the last 10 years had at least some secondary education. Only 5 percent of household heads among the chronic poor had completed secondary education.[44] Tertiary graduates have a 90 percent probability of employment, which is high internationally, while those with matric (that is, completing high school) face a 70 percent probability of employment, and those with Grade 11 only about 55 percent.[45] Tertiary education also raises incomes significantly—roughly doubling incomes compared with only having matric. According to StatsSA, among the tertiary educated, only 8.4 percent were poor, compared with 72.6 percent with some primary education and 57.8 percent with some secondary education. Completing at least secondary education is critical for reducing poverty: 35.6 percent of South Africans who had completed matric were poor in 2015.

Given limited demand for low-skill jobs in South Africa's economy at present, social grants remain critically important. South Africa has 17 million beneficiaries of social grants, which are paid to families who do not earn income above a certain threshold, usually for children and foster children, the old, and people with disabilities. Grants—together with remittances from relatives—account for 64 percent of income for the poorest 40 percent of South African households.[46]

Persistent inequality, largely along lines of race, remains a central challenge for South Africa's national development. There was a small dip in inequality in the early 2000s due to the expansion of the social protection system and a growing middle class. However, inequality has not improved since 2008. In fact, inequality today is higher than it was in 1995, with a consumption Gini coefficient of 0.63 (meaning that 63 percent of South African expenditure would have to be redistributed for every household to have the same level of consumption). Race still explains about 40 percent of South African inequality, an 8-percentage-point reduction over 10 years. Race also predicts other types of inequality, such as health outcomes, although this gap is narrowing. Education and labor market participation explain about 50 percent of inequality, making it increasingly about class.

Class is becoming an increasing driver of inequality. The South African middle class has been gaining in income share and consumption, especially the upper middle class (Figure 1.6). A combination of higher wages and borrowing resulted in higher consumption expenditure of households in the 40th to 80th percentiles between 2006 and 2015. The expenditure of both the richest 20 percent and poorest 40 percent increased less in real terms in that period than among the upper middle group of the distribution. The overall near stagnation in inequality between 2006 and 2015 masks a structural change in expenditure distribution toward the upper middle class. The transition from race to class as a driver of income inequality does not remove constraints to intergenerational mobility, however, as class is passed on through the family. Parents' occupation now predicts 55 percent of South Africans' inequality of opportunity, compared with only 31 percent for race.

Figure 1.6: Growth incidence curve, 2006 to 2015
(annual average growth rate in consumption, percent)



Source: World Bank (2018a).

Many South Africans with a disability continue to be disadvantaged. According to StatsSA, the national disability prevalence rate is 7.5 percent in South Africa.[47] Despite constitutional provisions, people with severe disabilities struggle to access education and jobs. Households headed by people with disabilities have less access to basic services compared to households headed by people without disabilities. StatsSA also highlights disparities in access to assistive devices across race/population groups and geography.

1.6. Overcoming exclusion and strengthening resilience to sustainably reduce poverty and inequality

A highly unequal society is fragile. Exclusion, and the associated poverty and lack of opportunity, undermines social cohesion, as acknowledged in the NDP. Inequality is still racially skewed, keeping racial tensions alive. Although the Truth and Reconciliation Commission sought to help South Africans come to terms with the past, proposals to provide compensation to victims never materialized in practice. Race remains a divider in South Africa, despite a desire among many South Africans to move on from the legacy of apartheid.[48] High levels of inequality, especially rooted in historical injustice, are difficult for societies to bear, providing a basis for conflict.[49] Widespread student protests (#FeesMustFall) are one manifestation of this conflict, as segments of the "born-free" generation rebel against the ongoing negative impact of a history of exclusion that they had no part in. Debates around the legacies of colonialism and segregation—and radical policy answers to them—at universities are common among young people. #FeesMustFall is also about the perception that the only way into the middle class is through tertiary education. Protest has been mostly visible among urban, young, and relatively educated South Africans. Poor South Africans often engage in so-called service delivery protests, and although those have somewhat increased since the 2009 recession, they generally remain confined to that. Rising discontent was evidenced during the 2016 municipal elections, with support waning considerably for the ANC, especially in metropolitan areas.

South Africa's fragility fuels contestation over resources. The South African economy rests on few shoulders. The top 10 percent of large formal firms account for more than 85 percent of output and 75 percent of private-sector jobs. The tax base is similarly small: the top 10 percent of large companies accounted for 70 percent of corporate tax revenue in 2012,[50] and the richest 10 percent of South Africans pay 87 percent of personal income taxes.[51] Meanwhile, there are 17 million recipients of social grants, nearly a third of the population. Given high unemployment and low labor force participation, the typical

South African worker supports about three dependents, and competition over jobs pits outsiders against insiders. Given monopolistic competition, investors and organized labor earn high returns at the expense of consumers. The inequality of income and assets results in contestation of these resources, be it to redress injustices of the past, provide dignity to the most vulnerable, or strengthen the sense of fairness in society. This is evident in the redistribution of income (for example, through the social wage) and assets (for example, BEE and land). The unequal distribution of resources can also result in illegal and violent forms of contestation, such as crime and corruption. The contestation over resources is a symptom of a weak social contract—in this case society's agreement on the just distribution of resources. A fragile social contract is a symptom of an incomplete transition.

Corruption and crime are illegal manifestations of resource contestation. Inequality within the white community under apartheid was lower than it was across the country when democracy brought formerly excluded South Africans into the political community.[52] This has allowed a new political elite to contest old resources, providing one possible explanation for the perceived increase in corruption. Political assassinations in South Africa can also be seen in light of contestation of the rents associated with public office and control, especially of public procurement processes. Crime, a symptom of fragility (Box 1.1), is another illegal, often violent, form of resource contestation. It tends to afflict the disadvantaged disproportionately, including the poor and minorities.[53] For example, four out of 10 lesbian, gay, bisexual, transgender or intersex (LGBTI) South Africans know someone who has been murdered "for being or suspected of being" LGBTI.[54] Rates of violent crime and homicide,[55] gender-based violence, and child abuse are all high. While men have the highest probability of being murdered, women and children are the victims of most other forms of crime. Wealthier South Africans protect themselves from crime by hiring private security firms and living in enclosed communities, but the poor cannot. Businesses, too, suffer from crime, especially theft, and again it is the larger, more established firms that spend more on security—thus making crime a barrier to entry for new and small firms, including historically disadvantaged entrepreneurs.[56] Violence in South Africa's taxi sector is notorious, although it has moderated more recently.[57]

Fragility discourages investment, undermining the economic growth necessary for social progress. The contestation over resources—and the uncertainty around future policy governing this contestation—threatens the value of assets (property rights), income (taxes), and the functioning of vital infrastructure services (many of which SOEs provide), making domestic and foreign investors cautious. Yet South Africa urgently needs investment to build a more inclusive economy, to upgrade technologically, to enhance competition, and to improve the living standards of South Africans. Low growth, coupled with high spending demands, puts pressure on the fiscus and external balances, thus broadening the reach of fragility, as Chapter 2 argues.

Vulnerability to climate and environmental shocks compounds South Africa's historical fragility. South Africa's fossil fuel-based economy, a consequence of its development based on cheap electricity from coal and the promotion of heavy manufacturing, contributes to global greenhouse-gas emissions. At the same time, the country suffers the effects of climate change and variability, which aggravate droughts and water shortages. The poor, especially in rural areas, are particularly vulnerable to the impacts of climate change and natural disasters—another dimension of inequality in South Africa.

Moving from fragility to resilience holds the key to accelerating South Africa's transition. Jobs play a critical role. The SCD argues that redressing historical exclusion is critical for investment, productivity, and growth. These in turn are critical for creating jobs and increasing wages, especially for those who currently do not work. Jobs make South Africans more resilient by providing them with dignity and the means to realize their aspirations; jobs enable South Africans to build wealth and precautionary savings to insulate them from shocks; and jobs are critical to transforming society by reducing historical racial divisions and strengthening social resilience. To overcome exclusion sustainably, it is critical to strengthen the country's resilience to climate and environmental shocks, prepare cities for an influx of job seekers, and maintain macroeconomic stability. Social and economic change takes a long time, and many South Africans will remain jobless for some time to come. It is therefore critical to continue maintaining and strengthening the social support system, including social grants, and access to adequate public health and infrastructure services.

Box 1.1: The psychology of inequality and crime

Income inequality is one of the main causes of crime in South Africa.[58] This is not only a matter of economic motivations; it is also driven by psychological effects.[59] Frustration from persistent and undeserved inequality can increase the temptation toward criminality. Adolescents in townships more easily adopt intergenerational roots of persistent violence (before democracy, this was partly fueled by an oppressive state) and have diminished social networks, a lack of role models, and a weak family structure, partly as a consequence of a history of migrant labor. It can lead to a lack of agency—that is, feelings of lack of control over one's own life and low self-worth.[60] The perception of reduced agency can help explain school dropout rates among boys and lead to crimes of frustration with no specific goal or crimes of opportunity. Financial vulnerability makes young women more likely to turn to so-called "blessers" (men trading sex for school resources, airtime, and other gifts).[61] High youth unemployment means few economic opportunities for young South Africans.

South Africa's low levels of intergenerational mobility are linked to a persistent lack of opportunity. Especially when (correctly) perceived as unfair and heightened by extreme poverty, this lack tends to lead to impulsive behaviors—such as interpersonal violence and crime—due to a general disillusionment about one's future. Poverty is also directly correlated with present bias,[62] which is an overly heightened focus on the immediate moment. This can derive from a need to focus on coping with pressing needs (for example, feeding one's children), but it leaves less time for long-term decision making. This lack of "future orientation" is associated with low aspirations and reduced investment in long-term goals. In a context where poverty is entwined with inequality, such aspirational failures can lead to high dropout rates from school, unemployment, and crime.[63] However, future orientation can be developed and strengthened, and, as noted below, such interventions have been effective in reducing criminal behavior.

Afterschool programs in the poorest South African townships in the Western Cape teach students that ability is not an inherent trait but can be developed. Aspirations, perseverance, self-affirmation, and self-efficacy are key psychological constructs permeating the lessons. The aim is to improve learning and increase belief in self and community, and in turn reduce risky behavior (including crime). In Liberia, poor young men who often commit crimes and display antisocial behavior were targeted to receive cognitive behavioral therapy, a cash transfer, or both.[64] The combined treatment led to large and sustained decreases in crime and violence, while the cash transfer had a short-run benefit but no persistent effect on poverty. The intervention was designed to promote future orientation and self-discipline; it was not about delivering information but about helping individuals adopt a new "socially aligned" identity and a related set of skills and behaviors. While reducing inequality is important to address crime, such interventions can help increase the self-worth of poor South Africans and protect others from being victims of crime.

A strong and effective government is critical for South Africa's transition. Democratic South Africa inherited the basis of a strong institutional framework, including a supreme parliament, an independent judiciary, a capable central bank (independent since 1996), and a functioning bureaucracy. In general, South Africa's strong institutions continue to serve the country well—although some institutional vulnerabilities have been exposed and exploited—as evidenced in the Public Protector's State of Capture report.[65] Weaknesses in governance endanger South Africa's transition, and have started to be addressed in early 2018 following the change in political leadership. Beyond tackling corruption, a more effective government—a developmental state, as South Africans aspire to—requires the reduction of fragmentation and better coordination in policymaking, better planning, and, crucially, better evaluation of government effectiveness to identify implementation bottlenecks, scale up good programs, and close down bad ones. These issues are discussed in Chapter 4.

Chapter 2

Resilience, economic growth, and jobs

2.1. Toward a more resilient and inclusive society

South Africa is a highly diverse country marked by inequality. Citizens of many races and backgrounds coexist peacefully in the "rainbow nation." South Africa has 11 official languages, of which isiZulu and Xhosa are spoken as the first language by 38.7 percent of the population, Afrikaans by 13.5 percent, and English by 9.6 percent. South Africa is a champion of race, language, and gender equality, and disability inclusion, and it was among the first countries to legalize same-sex marriage.[66] Through its Constitution, enabling legislation, and policies, South Africa has adopted a well-articulated approach to the inclusion of the poor, orphans, and people with disabilities. Many of South Africa's contrasts have an economic dimension. It is an upper-middle-income country on a much poorer continent, with rich citizens living next to much poorer ones, separated by high walls and electric fences in many places, such as its urban hub Johannesburg, which attracts both the region's talents and its refugees. As much as South Africa has reason to celebrate its diversity, wealth inequality poses a challenge to the cohesion of its society. Poverty and inequality, rooted in the historical legacy of exclusion, concern all South Africans.

Inequality is closely linked to fragility. When social divides are large, it is difficult to build a strong social contract by which all citizens choose to abide. Several types of fragility can amplify each other, as this chapter will explain further. For one, South Africa is highly vulnerable to climate change and water shortages. It is also exposed to other global shocks: its economy is small, accounting for only 0.5 percent of global GDP—large by African standards but small by global standards. It is well integrated into the global financial sector (although weakly integrated in global value chains) and is a relatively open trading economy. Despite various benefits from this, as this chapter will show, this situation makes South Africa vulnerable to shocks from the rest of the world economy, such as monetary and fiscal policy in advanced nations, financial crises, or global anticarbon policies. The poorest citizens tend to be the most affected by shocks, with low savings and human capital limiting their ability to protect their assets or find alternative job opportunities elsewhere. This limitation raises claims on redistribution of existing assets and income and puts a premium on jobs. Contestation of resources pits those who have against those who do not, with greater inequality and vulnerability resulting in greater contestation. This chapter will elaborate on the sources of fragility in South Africa and how they act as constraints to overcoming poverty and inequality.

Inequality and fragility have many symptoms in South Africa, with most of them linked to the legacy of exclusion. Different sources of fragility compound each other. Chapter 1 argued that high crime and corruption are as much a consequence of the legacy of exclusion as a symptom of social fragility. Low growth is another symptom of fragility. The future of redistribution or the functioning of critical infrastructure services—associated with corruption and declining institutional quality—result in policy uncertainty that deters investment.[67] Low growth is also a consequence of historical exclusion in education systems, constraining the economy through a lack of skills. Other symptoms include recent downgrades of South Africa's credit rating to sub-investment grade and a highly volatile rand. Low private domestic savings, partly a consequence of too many poor citizens who cannot save, combine with the claim on redistributive public spending, reducing public savings. This is aggravated by public spending related to corruption. High budget deficits undermine fiscal sustainability and weaken buffer stocks needed to insulate the economy from future economic shocks—the rating downgrades encapsulate this deterioration in fiscal resilience. Beyond this, low savings also sustain a high current account deficit, for which South Africa requires international financing. Weak external balances amplify the effect of external shocks. The role of public policy, in cooperation with civil society and the private sector, is to accelerate South Africa's transition sustainably—that is, increasing resilience—by reducing sources of fragility, such as climate change or environmental, fiscal, financial, external, or social risks, as elaborated in this and following chapters.

Jobs play a critical role in addressing and mitigating fragility. As argued in Chapter 1, jobs make individuals and society more resilient. Jobs will enable the excluded to join the middle class, build wealth, and insulate themselves from shocks. This chapter will argue that the legacy of exclusion deters investment and explains poor productivity performance. Yet economic growth is needed to reduce poverty. World Bank estimates suggest that a 1-percentage-point increase in economic growth lifts 170,000 South Africans out of poverty (using the upper poverty line), reducing poverty by another 0.5 percentage points per year.[68] Although more complicated, growth is also needed to reduce inequality. The second part of the chapter will identify how the various types of exclusion discussed in Chapter 1 constrain growth and the reduction of poverty and inequality, while Chapter 3 will unpack some of these constraints further, focusing on those that prevent a fair contestation of product and labor markets by all South Africans. Throughout Chapters 2 and 3, results from the World Bank's computable general equilibrium (CGE) model will be used to project the economy, poverty, inequality, and jobs up to 2030 (Annex 2 provides a description of the model). This will provide a sense of the potential impact of policy changes on these outcomes, which are critical to achieving the NDP's Vision 2030 and the World Bank Group's corporate mission.

2.2. Vulnerability and sustainability

2.2.1. Climate change and environmental sustainability

South Africa is both a contributor to and a victim of climate change. As the 16th largest emitter of carbon dioxide in the world, the country's environmental sustainability is intractably linked to transitioning to a low-carbon economy. At the same time, as the 30th most arid country in the world, sustainably managing its natural resources—water resources, in particular—is critical.

Continuing the transition to a low-carbon economy is crucial. The New Growth Path and the NDP commit to sustainable economic growth, setting a course for climate resilience and low-carbon development. Various policies support low-carbon growth: the 2011 National Climate Change Response Policy outlines the government's plan for adaptation and mitigation, and the draft National Adaptation Plan provides a strategy to develop interventions to increase resilience across key economic sectors. The Nationally Determined Contribution to the United Nations Framework Convention on Climate Change aims to reduce the economy's greenhouse gas emissions by 2030.[69] The government's low-carbon initiatives include flagship programs for energy efficiency and renewable energy, and carbon capture and storage. The proposed carbon tax seeks to make the industrial and power sectors improve fuel use and operational efficiency, promote the use of low-carbon fuels, and drive green growth and economic diversification.

Important low-carbon development initiatives have performed beyond expectations, but driving clean energy development and end-use energy efficiency is also necessary to promote private-sector competitiveness, productivity, and profitability. The Renewable Energy Independent Power Producer Procurement Programme has delivered over 6,400 megawatts of the 2020 target (7,000 megawatts), spurring over R200 billion in private-sector investment, including close to R50 billion in foreign investment.[70] In 2017, however, Eskom, South Africa's state-owned power company and sole buyer of power,[71] stopped signing new power purchase agreements with independent producers, which caused investor uncertainty about the future of clean energy development, including natural gas, as well as commitments to encourage private-sector participation in the energy sector. The issue has now been resolved, and new contracts are being drafted, but most energy generation remains coal-based (over 90 percent) and produced almost exclusively by Eskom (90 percent).[72] The Department of Energy's 2010 Integrated Resource Plan update also cautiously increases renewables from 9.7 percent of total current capacity to 27.5 percent in 2030 and 36.5 percent in 2050. Furthermore, despite the resounding success of its first energy efficiency strategy to 2015, there is no updated national strategy to continue to drive end-use efficiencies.[73] Eskom temporarily stopped its demand-side management program in 2014, only to restart it a year later in a limited fashion.[74] Many companies' energy costs form a high proportion of total operating costs.[75] As a result, they can become more competitive with sustained, comprehensive energy efficiency programs and robust energy services markets with multiple qualified energy services companies, supported by policies that incentivize on-site clean energy generation.

How South Africa diversifies its economy will significantly affect its ability to take advantage of the global low-carbon transition and manage the risks associated with these shifts. South Africa is still heavily dependent on fossil fuels. In 2016, the energy intensity of South Africa's economy was the fourth highest in the world, calculated as units of energy per unit of GDP.[76] It is the fourth-largest exporter of coal globally, exporting 28 percent of production, and fossil fuel and fossil fuel-related exports form 10 percent of the value of its exports. Diversifying energy and production away from fossil fuels is important to reduce vulnerability to shocks from the global low-carbon transition. Industrial policies that strengthen traditional fossil fuel-based industries could result in punitive border adjustment measures by importers of South African goods, hurting growth and jobs. Successful diversification and climate cooperation strategies will need to strike a balance between maintaining traditional energy sectors that generate cash flow; minimizing excessive investments in the fossil fuel-dependent sectors and infrastructures to avoid lock-in; increasing economic flexibility and adaptability; and managing the social and political impact in declining industries, which could amplify social inequalities. A carbon tax bill submitted in December 2017 aims to support structural change while preemptively avoiding risks should trade partners introduce border carbon adjustments. Further analysis should improve diagnostics of South Africa's preparedness for the global low-carbon transition, identify the macro-fiscal risks and sectoral scenarios, and inform national economic and international climate collaboration strategies to manage risks and harness opportunities.

The low-carbon transition requires careful management to minimize adverse impacts on workers and communities. Greening the economy will negatively affect the fossil fuel-based sectors, including coal mining, coal-based energy production, and heavy manufacturing. This is likely to result in further job losses, threatening social sustainability, especially in mining towns. To address the adverse impacts on laid-off workers, and their families and communities, social response programs should be implemented before mines close. Experiences in Europe and the United States show that governments' effectiveness in dealing with social and labor costs depends on their preparedness to manage coal sector reform.[77] Reskilling affected workers—such as through technical and vocational education and training (TVET) colleges (see Chapter 3)—and urban planning to counter urban decay will be vital to reduce social problems.

South Africa is highly exposed to the impacts of climate change, with the poor and vulnerable least able to adapt. While temperatures in South Africa are expected to increase, rainfall patterns remain uncertain. Climate models project that South Africa's mean temperature will rise by about 0.5°C in coastal regions and 1°C in the interior in the coming decades. Toward the end of the century, even under a best-case "high mitigation" future, average temperatures in the interior could increase by up to 4°C.[78] Precipitation changes[79] would cause drier conditions across the country under a "low mitigation" future (that is, the worst-case scenario), with regional variability possible.[80] Under a "high mitigation" future, models indicate wetter conditions in the central and eastern interior, and drier conditions over the rest of the country. Rising temperatures and reduced rainfall threaten the ecosystems that support key natural resources, which vulnerable communities depend on for production, trade, or consumption.[81] A hotter and drier future will increase energy demand to cool buildings and factories, diminish agriculture yields (for example, maize crops) and increase livestock losses, and jeopardize water security because of low rainfall and higher evapotranspiration.

Climate change threatens South Africa's biologically diverse ecosystems and natural resource base—itself a key source of employment and livelihoods. Its natural assets and ecosystems deliver essential goods and services such as clean air, water, food, medicine, and fiber. In addition to a rich mineral endowment, it is the third-most biologically diverse country in the world.[82] The variety of ecosystems, a subtropical and temperate climate, and a 3,000-kilometer coastline support the cultivation of a wide range of agricultural products, from deciduous, citrus, and subtropical fruit to grains, wool, cut flowers, livestock and game, and marine fisheries and aquaculture. This diversity anchors a robust tourism industry that employs more people than mining.[83] However, South Africa is approaching the limits of increasing productivity in agriculture, especially high-potential crop land, and there is a growing need to enhance systems to maintain food security.[84] Considerable natural habitat degradation and loss in terrestrial, freshwater, and marine environments in some parts of the country (such as in Gauteng, KwaZulu-Natal, and North West Province) is threatening species. Changes in the quantity and timing of river flows and severe pollutant and sediment contamination put pressure on rivers and wetland ecosystems.[85] Climate change will exacerbate these problems.

Projected extreme events, such as floods, droughts, and forest fires, threaten the country's economy and infrastructure. They could displace communities, strain water management, and cause deaths. Severe rainfall could affect roads and transport systems, the availability of electricity, and sewage and storm systems, contaminating water resources (including groundwater) and increasing the threat of acid mine drainage.[86] Almost 1,700 bridges, 900 dams, and about 900 powerline crossings[87] could face high flood risks. Droughts have already affected 15 million people in South Africa between 1980 and 2013.[88] They are projected to continue compromising water supplies, negatively affecting agricultural communities and employment, causing farm closures, increasing indebtedness, and triggering internal migration.[89] The 2015/16 drought is estimated to have reduced GDP by nearly 1.5 percent and employment by 1.3 percent;[90] it continues to afflict the southern part of the country, including Cape Town. By 2050, the likelihood of annual severe drought could increase by 39 percent, particularly in the western and coastal regions. Projections point to increased frequency of fires and extreme weather events, longer fire seasons, and an increase in fire severity. Climate shocks damaging agricultural production can undermine food security for the country and Sub-Saharan Africa. Although South Africa can import food, logistical constraints (see Chapter 3) can pose disruptions to the provision of imported food when needed, such as in 2015/16. In addition, shocks to agricultural production drive up food prices, hurting the poor in particular. South Africa has identified estimating the impacts of extreme weather events and the associated adaptation costs for specific infrastructure as areas for future research and monitoring.

Changing rainfall patterns due to climate change will have important ramifications for water security in South Africa. South Africa is the 30th most arid country in the world. It already withdraws the highest proportion of water relative to available renewable resources in southern Africa. The estimated demand for water will reach 17.7 billion cubic meters in 2030, exceeding a supply of only 15 billion cubic meters—not considering the possible effects of climate change. This is due to relatively low levels of mean annual rainfall combined with high demand for water, which has historically been driven by the mining sector and the agricultural sector (which consumes 60 percent of water overall). Spatial misallocations exacerbate water insecurity. Gauteng, which accounts for over a third of South Africa's GDP, has been reliant on major water transfer schemes for decades (including from neighboring Lesotho) to meet its domestic and industrial needs. Such water storage and transfer schemes are likely to become more costly, complex, and contested in the future. The Orange-Senqu River Basin, within which Gauteng is located, is also pivotal for the economies of Botswana, Lesotho, and Namibia. Yet this transboundary river basin is already one of the most over-allocated in Africa and its water quality is deteriorating.

Water supply augmentation is insufficient to address South Africa's water security challenges. Supply-side measures such as delivering water from more distant and less optimal sources are inefficient and costly. Domestic and agricultural water losses, while variable, stand at about 30 percent on average a year. Although not unusual by global standards, the losses are significantly higher than what has been achieved in some South African locations—of between 15 percent and 20 percent—and represent a missed opportunity to generate revenues and preserve scarce resources. Indeed, since the mid-1990s, the national water department has called for more recycling of water to reduce the amount of wastewater to be disposed of while providing a reliable source of water for agriculture. But progress has been slow. Policymakers have been concerned about a possible tradeoff between improving water use efficiency in agriculture and greater economic equity as efficiency measures may benefit those farmers with the finances to make technological adaptations to use water more efficiently—such as moving from spray irrigation to micro-drip irrigation—while excluding previously disadvantaged and poorer farmers. Pricing water to encourage more efficient use and allocating it to more productive and competitive sectors remains a complex challenge against these broader policy choices.

Recent droughts have severely affected families, farms, firms, and the fiscus. The 2015/16 El Niño drought affected 14 million South Africans (25 percent of the population). It affected consumption (maize price doubled) for the poor as well as the livelihoods of smallholder and commercial producers in the grain, livestock, and oilseed value chains—despite significant fiscal transfers (the government allocated about $46 million[91] to drought relief interventions). Meanwhile, large droughts since 2016 in major municipalities (Tshwane, Ekurhuleni, Johannesburg, Cape Town, Nelson Mandela Bay) have resulted in service interruptions, water rationing, and, by late 2017, a sense of imminent crisis in several urban centers.

Such shocks also provide an opportunity to more systematically confront and mitigate the heightened water security risks and growing pressure on water infrastructure and services. Drought needs to be acknowledged as an often-probable risk requiring clear protocols for different responses. Increasing resilience to water shocks requires an integrated approach focused on cost-reflective and transparent pricing, aggressive demand-side management (reducing excessive consumption, increasing efficiency), and diversifying water sources (including groundwater, aquifer recharging, wastewater reuse, and possibly selective desalination), while extending both water and sanitation services as part of broader urban and rural development and longer-term resilience plans and strategies. While shocks can be mitigated, they cannot be eliminated. Risk management solutions at the state, firm/utility, and household level should also be considered, including predictable financing for contingent liabilities, insurance (including for smallholders), and safety nets with flexible delivery systems.

South Africa's historical industrial structure, based on mining and heavy industry, puts pressure on environmental sustainability. Net adjusted savings within a wealth accounting framework for South Africa are positive—between 2 percent and 3 percent of GDP. This suggests that South Africa's development model is broadly sustainable: it (slowly) builds national wealth. This, however, comes at a considerable cost and South Africa's national wealth reduces both from mining and associated emissions. In addition, the mining-energy-heavy industry complex puts significant pressure on South Africa's scarce water resources. The policy emphasis on beneficiating (that is, processing) its natural resources is somewhat at odds with South Africa's commitment to move toward a greener economy, as well as its water scarcity. This is especially true as there is limited evidence at best that South Africa has a comparative advantage[92] in beneficiation or that it is a major source for job creation.

2.2.2. Social sustainability

South Africa's legacy of exclusion puts pressure on social sustainability. Strengthening social protection is critical for social resilience. Crime, corruption, poverty, lack of access to services, and inequality have various historical origins and are both the cause and symptom of fragility. The social wage was important to address the most basic vulnerabilities and establish a social floor for South Africans.[93] Grants (and other transfers, such as remittances) account for 64 percent of income among the poorest 40 percent of South Africans, and 22 percent among those between the 20th and 75th percentile.[94] Nearly two-thirds of the population lives in a household that receives grants. Accordingly, South Africa has one of the highest expenditures on social assistance in the world. The progressive fiscal system of grants, financed with taxes, reduces the consumption Gini coefficient by roughly one-tenth, which is considerable by international comparison.[95] There is little evidence that grants have a negative effect on the willingness to work.[96] The extent to which grant amounts could be raised without discouraging labor force participation requires further study. However, a case can be made for strengthening the social protection system to integrate social safety nets with active forms of employment generation and intermediation, especially for the large number of young people who will remain in the labor market for the next several decades.[97] Beyond this, it is important to continue extending access to basic infrastructure services to communities that are still underserved. Although most South Africans today have access to electricity and basic water and sanitation services, some gaps still need to be closed (see Chapter 1). Improving the quality of education and health services for the poor, and providing adequate shelter (see Chapters 1 and 3), remain important.

Although the Expanded Public Works Programme (EPWP) provides important social protection benefits, jobs in the private sector hold the key to sustainable job creation. As grants target children, the elderly, and people with disabilities, many unemployed South Africans have no direct form of income support: only about 3 percent of the unemployed are covered by the contributory Unemployment Insurance Fund at any time.[98] The EPWP, first introduced in 2003 and championed in the NDP, provides temporary work opportunities. Although elements of the program resemble an active labor market intervention (see Chapter 3), it is perhaps best seen as a poverty reduction measure, especially in rural areas, through the Community Work Programme, which forms part of the EPWP. There is also an argument that the dignity that comes with work brings a sense of social inclusion for otherwise unemployed South Africans. The NDP has set the EPWP a target to create 2 million jobs by 2030. Although the EPWP may serve as a springboard into a job in the private sector (Chapter 3), the program remains largely a social protection measure and therefore cannot replace the private sector as the ultimate engine of job creation.

While the social protection system provides a cushion, high consumer indebtedness reduces the effectiveness of credit as an additional buffer against shocks. As Chapter 1 has shown, access to finance is relatively high in South Africa, and the poor are credit-active. However, they are also highly indebted. This means that instead of serving as an instrument to smooth consumption shocks, credit and its associated debt has become a burden for poor households. This makes them more vulnerable and less able to take risks that could leave them better off, such as moving to areas with better job opportunities.

Given the existing high expenditure on social assistance, and the pressure to expand assistance to the working-age population, a basic income grant could be explored to reduce fragmentation and generate an income floor. A basic income grant has advantages and disadvantages. It would embrace a more inclusive approach to social protection. It would also help protect citizens against a broader variety of shocks and support the long-term unemployed. On the other hand, a basic income grant would add to the cost of social assistance, and a meaningful transfer would be fiscally sustainable only if it replaced some existing programs. The implementation of a basic income grant would therefore generate winners and losers among the population and—depending on its level of generosity—may have ambiguous effects on poverty and inequality that deserve further attention.

Many South Africans migrate to urban areas in pursuit of job opportunities. This helps reduce poverty but can also fuel social conflict. Cities, especially Johannesburg and Pretoria, and towns are the growth hubs in South Africa, attracting job seekers from rural areas—particularly sparsely populated ones—and other parts of the world, especially other African countries. Few poor South Africans emigrate, meaning that international remittances are net negative in South Africa. The most important remittances are internal, sent to rural family members and communities by migrants who have moved to urban areas. Although not all migrants find jobs, simulations suggest that, overall, migration reduces poverty because labor is more productive in cities, resulting in higher consumption.[99] The poor benefit more in secondary cities. For those migrating, costs are lower, as are externalities from congestion. Given the stronger linkages between secondary cities and South African agriculture, increased demand from cities combines with out-migrating labor to both raise demand for rural agriculture and associated jobs while minimizing available agricultural labor, thus improving job opportunities and wages in rural areas. Poor South Africans in cities also benefit from migration but less so than those in secondary cities and rural areas. Although migration helps reduce poverty, the rich in cities benefit the most from the economic forces set in motion by internal migration. Thus, while internal migration reduces poverty, it can increase inequality. This inequality, compounded by pressure on the public service network, can fuel social tension. Xenophobic attacks in townships are one symptom of this. Transport and publicly provided housing put particular pressure on municipal budgets. Chapter 4 discusses municipal financing and delivery capacity in more detail.

Social fragility imposes considerable costs on South African society. Trauma from crime, violence, and road accidents is estimated to account for 10.5 percent of the total number of years of life expectancy lost to South Africans on average.[100] Crime is a significant cost to business:[101] 76 percent of South African firms pay for security, compared with 55 percent globally and 61 percent in Sub-Saharan Africa—although security is relatively inexpensive in comparison. Moreover, 43 percent of firms experience theft and vandalism, nearly twice the regional and global average—although these average losses per crime tend to be smaller than elsewhere. Small firms are particularly vulnerable to crime and do not have the means to protect themselves. Bribes for government contracts are roughly as common in the rest of the region, and higher than the global average. Bribes are also commonly used to obtain employment.[102] The cost of corruption to the public purse is unknown but is significant in light of the State of Capture report. Costs to the economy also result from the uncertainty that the contestation of resources means for investors, eroding security of property rights and threatening the functioning of vital institutions and infrastructure services.

South Africa's courts are critically important given the contestation over resources. The constitutional framework established as a key part of South Africa's transition to democracy built on the country's established court system, active and well-trained lawyers, and a commitment to the rule of law. They provide a viable opportunity for excluded people and communities to claim rights, hold government to account, and expose unfair discrimination in the private sector. South Africa's independent judiciary—appointed on the recommendation of a constitutional body, the Judicial Service Commission—represents a strategic asset for the country to give investors and other stakeholders in the economy confidence that property rights, for example, are secure; intellectual property will be protected by the law; and contractual rights and duties can be enforced through litigation. Given the intense contest over access to resources, evidence of endemic corruption, especially in public procurement, and socioeconomic exclusion of poor communities, the courts are crucial arbiters.

2.2.3. Fiscal sustainability

Fiscal and social sustainability are intertwined. Fiscal sustainability is critical to build buffers that insulate the economy—and especially the most vulnerable South Africans—from shocks. Similarly, given that the Government Employee Pension Fund is the largest holder of public bonds, fiscal sustainability is essential for the stability of the public pension system. South Africa's incomplete transition is putting pressure on both fiscal and social sustainability. Fiscal sustainability ensures that the government has sufficient resources to provide basic services to its citizens. Pressures on municipal budgets are already resulting in power outages as municipalities are unable to pay Eskom. For now, loadshedding in South Africa has become a municipal fiscal issue rather than a power generation constraint (Chapter 3). Environmental, social, and fiscal sustainability are also intertwined. For example, the South African government has been making resources available for drought relief in recent years (including in the 2018 Budget), not least to support the most vulnerable. Water scarcity has become a severe threat for various parts of the country, including Cape Town.

Social fragility threatens fiscal sustainability.[103] In the early years of democracy, the South African government balanced the need to service apartheid-era debt with raising social spending. A narrow but strong tax base helped finance such spending, improving South Africa's creditworthiness. South Africa has a progressive fiscal system, evidenced by its significant impact on the Gini coefficient. Spending pressures have remained high, however, and the government is cognizant of the limits of raising revenue from a very narrow tax base. High spending is consistent with inequality, because in a democracy, the contestation over resources often results in public redistribution. World Bank estimates suggest that the strength of political rights, combined with South Africa's level of inequality, contributes to government expenditure 12 percentage points of GDP higher than in the average African country.[104]

The public-sector wage bill is putting significant pressure on the budget, crowding out resources needed to accelerate South Africa's transition. In addition to social programs or efforts to reduce disparities in basic service provision (see, for example, the discussion on national health insurance in Chapter 3), redistribution includes public wages, notably from individual and corporate income earners and consumers to civil servants. The fast-growing public wage bill can thus also be seen as part of the contestation over resources, promoted by South Africa's public-sector unions (the NDP acknowledges that unions bargain for high corporate rents in the private sector). Recurrent spending, including public wages, has increasingly been crowding out public investment (which is needed to grow the economy), making it difficult to contain the fiscal deficit—especially in an environment of low growth following the global financial crisis. Low growth and high spending pressures have made the government's long-standing commitment to fiscal sustainability more difficult. Public (net) debt has been rising from a low of 22.6 percent of GDP in 2008/09 to a projected 55.6 percent by 2020/21.[105]

Contingent liabilities from SOEs have become a significant risk to fiscal sustainability, costing South Africa its investment-grade credit rating. Weaknesses in South African SOEs hurt the economy by providing unreliable and expensive infrastructure services, creating an uneven playing field for effective private-sector participation in some sectors (see Chapter 3), and increasingly requiring transfers from the central government: World Bank estimates suggest that contingent liabilities in SOEs have now become a significant risk to fiscal sustainability in South Africa.[106] Although there are many reasons for poor SOE performance, mismanagement and corruption resulted in a serious erosion of good corporate governance, some of which was exposed in the State of Capture report and in the parliamentary committee hearings on Eskom that started in the latter part of 2017. Standard and Poor's, Fitch, and Moody's all point to the risks to fiscal sustainability from low growth, rising public debt, and contingent liabilities in SOEs—and the deterioration in institutions, especially SOE governance. This has resulted in consecutive downgrades, moving South Africa's credit rating for domestic and foreign-currency-denominated debt to junk status in 2017, undoing 17 years of defending an investment-grade rating that was hard earned in the early years of democracy.

Containing public wage growth and contingent liabilities in SOEs is critical, as is making fiscal policy more countercyclical. Both public wages and corruption in SOEs are linked to a contestation of resources that is anchored in South Africa's history, hindering growth. Not all of South Africa's fiscal woes have historical roots, although historical legacies may compound them. World Bank research indicates that South African fiscal policy has tended to be procyclical, thus failing to build buffers needed to counter economic shocks, such as the global financial crisis, which has plunged South Africa into a decade of low growth.[107] For example, estimates suggest that the length of the commodity supercycle led South African policymakers to incorrectly time the turn of the business cycle, missing the point at which to tighten fiscal policy and build national savings for the downturn. Such mistiming afflicted policymakers across the world; it had dire consequences for fiscal aggregates. Fiscal space is lower now than it could have been because of low growth. Countercyclical action is particularly difficult in an environment of contested resources, as revenue windfalls are spent rather than saved. Accelerating South Africa's transition will therefore also help strengthen fiscal management.

Given the recent downgrades of its credit rating, it is important for South Africa to strengthen fiscal sustainability. World Bank research suggests that even when Budget Reviews identify the need for fiscal consolidation, the government does not always succeed in doing so.[108] This can be linked both to the misinterpretation of economic momentum and spending pressures that are difficult to contain in light of contested resources and sticky expenditures. The difference in borrowing costs between an investment grade and a sub-investment grade credit rating may be as much as 200 basis points.[109] Higher interest service payments reduce spending on other areas that are important for reducing poverty and inequality. Strong leadership is thus needed to maintain a sustainable fiscal policy. Budgets that deliver on their targets strengthen the credibility of the National Treasury, strengthening its bargaining position within government and government's ability to stick to its fiscal policy commitments.

2.2.4. External sustainability

South Africa's large current account deficit is partly a consequence of social and fiscal fragilities. The current account deficit averaged 3.8 percent of GDP between 2009 and 2017, reflecting investment needs exceeding the low levels of domestic savings—partly a reflection of a high fiscal deficit. Social fragilities worsen savings-investment imbalances. For one, policy uncertainty shocks result in significant capital outflows. This was perhaps most noteworthy following the dismissal of Minister of Finance Nhlanhla Nene in December 2015—and again when Minister of Finance Pravin Gordhan was dismissed in March 2017—in what investors perceived to be an expansion of state capture to the National Treasury. Second, South African companies are increasingly investing outside of the country, with relatively little foreign direct investment (FDI) coming to South Africa in recent years. This is partly a consequence of weakening property rights and institutions, as further explained below.

The current account deficit is largely financed by portfolio inflows, which do not require investors to commit their funds for a long time and are thus more suited to an environment marked by high policy uncertainty. These flows are highly volatile and quickly translate domestic and foreign shocks into the exchange rate, making the rand a proxy for risk and uncertainty. The high current account deficit and its financing make South Africa fragile. A current account deficit cannot be maintained indefinitely. South Africa's structural current account deficit, coupled with its reliance on short-term financing, makes it vulnerable to a sudden stop. The South African Reserve Bank currently holds a considerable $56 billion in international reserves, which is below levels recommended by the International Monetary Fund.

Strengthening external sustainability can involve social, fiscal, and monetary measures. Resident capital outflows and the rand's depreciation mean that South Africa is a net creditor to the world.[110] This is also a source of resilience, as it provides a source of capital inflows—and a significant opportunity to supplement low levels of domestic savings for investment. Tighter fiscal policy would help reduce external vulnerability. Both will be supported by measures that strengthen social resilience, as argued above. Evidence from Chile suggests that fiscal buffers also reduce external vulnerability: Chile's establishment of a sovereign wealth fund, financed with mining revenue, has reduced exchange volatility.[111] Currently, the exchange rate is South Africa's most important shock absorber. Larger fiscal buffers coupled with fewer uncertainty shocks due to greater social resilience would also likely reduce the rand's volatility. Finally, resilience could be strengthened through monetary instruments. Research for the Accelerated and Shared Growth Initiative for South Africa (AsgiSA) supported monetary policy leaning against currency appreciation, thus building reserves and avoiding overly strong appreciation that could hurt South Africa's exporting industries. South Africa has experimented with this with some success.

2.2.5. Financial sustainability

The credibility of the South African Reserve Bank has helped reduce the impact of external shocks on the economy. In South Africa, where wages are largely negotiated (see Chapter 3), the South African Reserve Bank's inflation target has helped anchor inflation expectations, and thus reduce pressure on wages that would drive South African firms to greater capital substitution, render the country less externally competitive, and hurt the poor through higher prices.[112] The South African Reserve Bank's credibility, buttressed by its clearly defined independent mandate, which is firmly entrenched in the Constitution, has also helped shelter South Africa's economy from external shocks. According to the International Monetary Fund, pass-through of the exchange rate to domestic inflation is low and has fallen in recent years.[113] This is partly due to South African monetary policy credibility, which is successfully managing inflation expectations.

Strengthening South Africa's transition will also reduce financial sector risk. Such risks include shocks from insolvent SOEs: the deteriorating performance of entities like South African Airways, the Post Office, and Eskom have already made banks cautious about extending further financing. Default by the central government remains relatively unlikely, but the deterioration of sovereign creditworthiness is a concern. In addition, government plans for land expropriation without or below market-price compensation threatens the value of collateral for banks. Strengthening SOE performance and swiftly and prudently resolving land reform issues would strengthen financial sustainability.

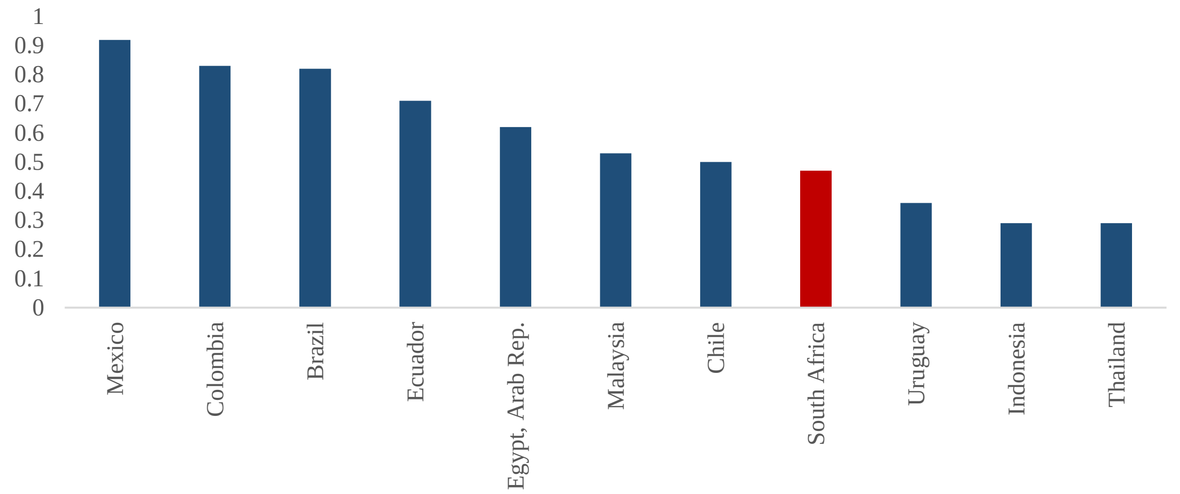
The financial sector is well prepared to weather shocks, and further reforms to strengthen the sector are ongoing. At 2.8 percent, nonperforming loans are relatively low, and banks are adequately provisioned. The South African authorities are modernizing the financial sector's legal and regulatory framework, which will contribute to crisis preparedness. With the implementation of the Twin Peaks regulatory model, the South African Reserve Bank received an explicit financial stability mandate. The bank is strengthening financial sustainability by improving its macroprudential oversight and identification of risks stemming from the heavily concentrated and interconnected financial system, and introducing a resolution framework in line with international standards and deposit insurance. The government is starting a three-year process to reform its Financial Markets Act to improve competitiveness in its financial markets. The planned amendments focus on financial stability and increasing competitive capital markets. They also aim to align domestic legislation with forthcoming changes in the European Union. The amendments build on a previous reform to the 2012 Financial Markets Act and the 2017 Financial Services Regulation Act, which introduced the Twin Peaks regulatory architecture.

2.3. Jobs to strengthen resilience

Jobs play a critical role in strengthening social resilience in South Africa through economic inclusion. A wage is the best way out of poverty; in South Africa one wage sustains many. Poverty is less than a third among those with jobs compared with those without.[114] A job is not a guaranteed pathway out of poverty, but it is the most promising one. The wage from a job sustains many others. South Africa has a long history of migration, much of it linked to the mining sector. Miners would stay in hostels and send money home to their families (Chapter 1). A history of internal transfers persists in South Africa. Among black South Africans, *ubuntu*, a sense of responsibility to the community, remains strong.[115] It is what helps those with opportunities better their lives and, in return, give back to their community—a relationship popularly referred to as "black tax" in South Africa. Traditionally, men were the providers, and data reflect that men transferring money to their partners and children remains the most important interhousehold transfer, especially in poor and otherwise unemployed households.[116] At a smaller magnitude, such transfers can also be observed between parents and children—and vice versa—siblings, other family members, and even nonfamily members. Labor migrant households remain those with the largest internal transfers. Transfers become larger the poorer the receiving household is and increase with the income of the senders. World Bank estimates suggest that these family-based transfers alone reduce poverty for 2 million people.

South Africa has created many jobs since democracy, but not enough. Job growth accelerated in the 2000s, with the South African economy generating 4.1 million jobs in net terms between 2000 and 2016. Given economic growth, average job creation in South Africa has been slightly more modest than in peer countries, with an employment-to-growth elasticity of 0.5 (Figure 2.1). Yet joblessness is pervasive. In the last quarter of 2017, South Africa's labor force participation was 58.8 percent, which is relatively low. It is even lower among women, although, overall, the ratio of women to men in the labor force is not unusually low by global standards. Labor market absorption is very low for people with disabilities.[117] By the last quarter of 2017, unemployment stood at 26.7 percent, and it is much more pronounced among young people: 51.1 percent of 15- to 24-year-olds are looking for work; 68.4 percent of the unemployed have been unemployed long term. Among those who have jobs, 4.7 percent are underemployed, meaning they do not work as much as they would like. In addition, 11.5 percent of South Africans had given up looking for work, taking the broad unemployment rate to 36.3 percent. The large number of South Africans who were historically excluded overwhelms the capacity of the economy to provide jobs for everyone quickly enough.

Figure 2.1: Employment responsiveness to economic growth in South Africa and comparators
(elasticity of employment to economic growth)



Source: World Bank Group staff.

South Africa is a high-skilled economy with a low-skilled labor force, resulting in high unemployment and entrenched exclusion. It has a relatively developed economy that needs high labor productivity to be internationally competitive. The high demand for skilled labor is reflected in unemployment rates. Unemployment stands at only 12.9 percent among those with tertiary education (the rate is lower if only focusing on university education) compared with 28.7 percent for those who completed secondary school and 32.6 percent for those who did not. Wages are also closely linked to skills, as shown in Chapter 1, with a considerable skills premium resulting in low unemployment and high wages for skilled South Africans and low wages and high unemployment for unskilled South Africans. Accordingly, poverty among employed South Africans is lowest in the highest skills group, at 3 percent, and highest in the lowest skills group, at 17 percent.

South Africa's demographic transition means that the labor supply increases. Yet South Africa needs skilled workers, and most labor market entrants are unskilled, thus raising unemployment. Fertility rates have been declining in South Africa, and its demographic pyramid more closely resembles that of developed economies. As fewer children are born, the number of South Africans of working age increases relative to the number of dependents, that is, children and the elderly. Much of this demographic transition is estimated to be complete, although South Africa is expected to have another 50 years before population aging becomes a concern, with the number of elderly dependents increasing relative to the working-age population.[118] This demographic transition could result in growth dividends, as savings increase with falling dependency ratios—but only if labor market entrants find jobs that allow South Africans to save. Yet South Africa's economy is skills-intensive, and too many new labor market entrants are unskilled. Accordingly, unemployment goes up while some discouraged South Africans exit the labor force altogether. Young people are particularly affected by unemployment, as firms prefer hiring experienced workers.[119] As a result, South Africa is missing out on most of its potential demographic dividend.

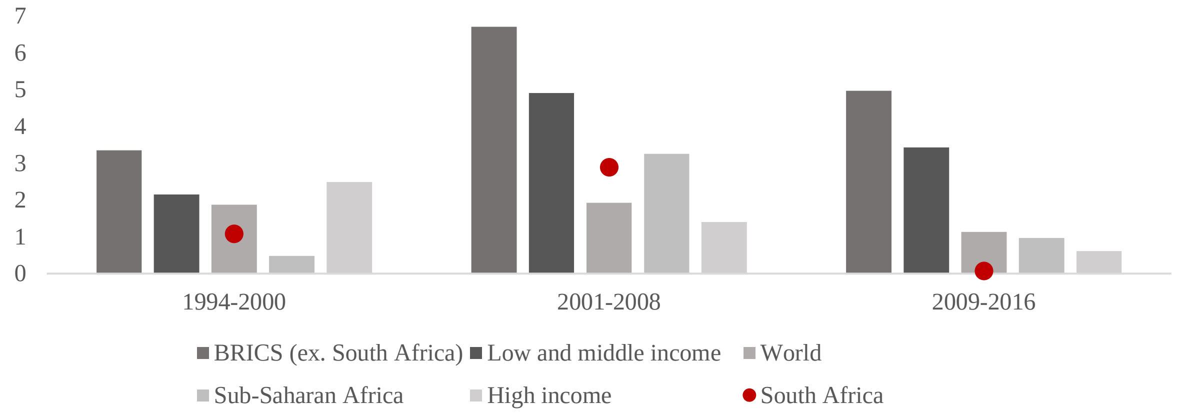
Unemployment also reflects "sticky" wages that do not clear the labor market. There are several reasons for this. One is that South Africa is a relatively expensive country for the poor, raising work-related expenditures—for example, transport or housing nearer to work. This in turn raises reservation wages, which is the floor at which the wage exceeds the costs associated with working, or where it "pays to work." These costs, especially transport costs, decreased between 2010 and 2014,[120] consistent with improving productivity in services sectors, as further explained below. This means that the floor at which it pays to work is supporting jobs, as long as real wages are allowed to adjust. Empirical evidence suggests that in the longer run they do to an extent, although they tend to be "sticky" in the short term.[121] This short-term stickiness is consistent with wage bargaining and minimum wages, as further explained in Chapter 3, providing another type of wage floor that stops wages from adjusting to levels that would reduce unemployment. When wages do not clear the labor market, employment does, which explains high unemployment in South Africa. Reducing it includes reducing reservation wages through further productivity gains in work-related expenditures or subsidies (for example, to transport and housing), making wage negotiations and determined wages more reflective of economic conditions (productivity, inflation, unemployment), and, perhaps most importantly, raising aggregate economic demand, and thus demand for jobs. All of these measures take time and can be costly, meaning that unemployment, especially among the less skilled, is unlikely to fall quickly.

Self-employment in South Africa is relatively low for a middle-income country. In many poorer countries, self-employment tends to capture informal activities, such as hawking. In South Africa, self-employment only accounts for 14.4 percent of total employment, compared with 16.4 percent in Organisation for Economic Co-operation and Development (OECD) countries and 50.4 percent in developing countries.[122] This illustrates that South Africa's labor market is similar to that of a developed economy. Informal employment in South Africa, as elsewhere in the world, tends to be concentrated in retail and other low-skill sectors.[123] It also tends to be higher in the former homelands, reflecting a higher prevalence of subsistence farming but potentially also a higher share of informal trade due to lower penetration of supermarkets, as low population density in these areas may act as a barrier to entry for supermarkets. There is no agreement in South Africa on the extent to which entrepreneurship flourishes, but it is considered to be low. The low levels of entrepreneurship are partly due to the historical limitations on entrepreneurial activity explained in Chapter 1. Given that many young adults who do not have children have no source of nonlabor income (since they do not qualify for child support grants, the main social safety net instrument), casual jobs in townships and informal settlements are common, some of which are entrepreneurial. Indeed, self-employment tends to be driven by a lack of alternative opportunities.[124] Although entrepreneurship is considered prestigious in South Africa, levels are lower than in other countries and appear to be declining.[125] This is in line with a slowing economy and lower demand for products that emerging entrepreneurs could sell.

2.4. Economic growth for jobs and poverty reduction

Growth creates jobs, yet South Africa's economy has lagged behind other countries since democracy and risks falling further behind. Growth per capita averaged 1.1 percent between 1994 and 2000, 2.9 percent between 2001 and 2008, and has stagnated since 2009, turning negative in 2015 (Figure 2.2). South Africa has been consistently outperformed by other BRICS (Brazil, Russia, India, China, and South Africa) and Sub-Saharan African countries since democracy. Countries in East Asia have especially outperformed South Africa: the Republic of Korea, for example, which has a similar economic structure, was much poorer than South Africa in the 1960s, overtook it in the 1990s, and is now over three times as rich on a GDP per capita level (see Chapter 3). As the global economy recovers from the global financial crisis and gathers steam, South African growth remains low, with a stagnant or even negative per capita growth rate between 2014 and 2017 and a modest rebound projected.[126] South Africa is thus at risk of decoupling from the global economy.

Figure 2.2: Average real GDP per capita growth in the world
(annual percentage growth, period averages, 1994-2016)



Source: World Development Indicators and World Bank Group staff.

The most significant period of job creation coincided with South Africa's short spell of relatively high growth between 2005 and 2007. Although growth is important for creating jobs and reducing poverty, it can increase inequality. The economy created few jobs between 1994 and 2000 and shed jobs between 2001 and 2004.[127] Nearly 2 million jobs were created in that period, roughly half of which were lost again after the global financial crisis, between 2008 and 2010. Employment has recovered and exceeded the 2007 employment peak since 2013. Yet job creation lags well behind the NDP target of creating 11 million jobs between 2010 and 2030. This would require creating over 600,000 jobs a year, but the economy has only been producing about 250,000 a year on average since 2010. Higher growth is needed to meet this job creation target, but an average growth rate of 5.4 percent, as envisaged by the NDP, appears unrealistic because of low growth potential. While jobs are critical to reduce poverty, the income from growth accrues to the holders of land, capital, and labor. For those excluded from these, growth does not translate into higher incomes. If growth is driven by productivity, it can in principle help the poor's household budgets stretch further, if translated into lower prices. However, as illustrated below, productivity gains tend to favor the rich in South Africa. In this light, using the World Bank CGE model, the remainder of this chapter and Chapter 3 will explore the impacts of various policies on growth, jobs, poverty, and inequality.

Structurally, growth is underpinned by capital accumulation and demography. South Africa's population growth rate of about 1 percent, roughly in line with the developing country average, and the growth in the working population have been the main foundation of potential GDP. Economic growth picked up in the 2000s, when South Africa experienced an investment boom, largely driven by the mining sector and supported by significant FDI inflows. Although investment continues to be a driver of potential GDP, a low savings rate translates into relatively low investment. South Africa's low domestic savings rate is consistent with high poverty and inequality, as most South Africans cannot afford to save.[128] Domestic savings are equivalent to 16 percent of GDP, with an additional 2 to 4 percent in foreign savings bringing total investment to just under 20 percent of GDP—much lower than the 30 percent envisaged by the NDP. South Africa is a highly capital-intensive economy, a reflection of capital-intensive industries such as mining, commercial agriculture, and heavy manufacturing; a tendency of industrial policy to support capital-intensive processes; and rising labor costs resulting in labor being substituted with capital, as further explained below. Thus, 12 percent of GDP in savings is used to replace depreciating assets, with significantly less savings devoted to new investment.

Productivity growth turned negative in 2012. As the economy adjusted to the opening to the global economy in the first few years after 1994, total factor productivity supported potential growth. This was partly due to the allocation of factors of production to more productive use,[129] as relative price levels adjusted in line with increasing trade, not least with the reduction in tariffs in the 1995 General Agreement on Tariffs and Trade negotiations. Higher FDI, some integration in value chains, notably automotive ones, and reduction in markups are other possible reasons for growth in total factor productivity. These effects have evaporated since the global financial crisis. There has been relatively little new entry into South African markets and FDI has been low compared to peers. Innovation is low and companies spend less than peers on research and development—and this spending has been on a declining path.[130] Low commodity prices following the end of the commodity boom have resulted in the underutilization of capacity, thus also reducing productivity. Structural change has played a very small role in growth since 1994 because South Africa is already a relatively advanced economy, there is limited investment available for structural change, and industrial policy at times shelters unproductive sectors.

Commodity prices and credit have recently lent more muted support to growth. Mining and related products still account for about 60 percent of South Africa's exports, and the country struggles to diversify its exports. The terms of trade improvements—as well as equity valuations on the JSE, where mining and related companies still have a considerable presence—affect aggregate demand in South Africa and thus remain important determinants of growth. Credit is another exogenous determinant of growth, and it has played a critical role in raising household consumption in democratic South Africa. As explained in Chapter 1, borrowing—including unsecured borrowing—increased significantly in the mid-2000s before slowing, as households grapple with high indebtedness and regulators have become more watchful of risky lending practices. Household credit growth has thus been relatively soft in recent years.

Energy shortages were a major constraint for South Africa between 2007/8 and 2015. The public and private investment response has alleviated this constraint for now. Underinvestment in energy resulted in loadshedding, which is estimated to have shaved 0.12 percentage points off potential GDP in 2008 and 0.06 percentage points in 2015, according to World Bank estimates. Although significant private investment in additional capacity has increased supply, additional generation capacity will likely be needed before 2025—according to South Africa's Integrated Resource Plan—based on demand, the pace of decommissioning existing plants, and the slow progress in installing planned capacity. While concerns about capacity have lessened for now, concerns about the cost of electricity have increased — partly because of cost overruns in the public energy-built program and partly because of municipalities using electricity tariffs as own revenue. South African electricity is still relatively affordable by international standards, but rapid cost increases could quickly erode this. Impacts on cost from a carbon tax related to South Africa's fossil fuel-based energy generation (and manufacturing) are further explored in box CGE 2.1.

A lack of skills constrains growth. The legacy of exclusion in education means that South Africa does not have the skills it needs for its advanced economy—and migration is insufficient to relax this constraint (see Chapter 3). Although improvements to. education have expanded the growth potential of the economy, the supply of available skills in the economy does not suffice. The skills constraint can serve as a brake to growth, with the skilled segment of the labor market tightening quickly when the economy expands, raising skills premia and rendering South African products less competitive.

A boost to business and consumer confidence in early 2018 is likely to support growth, assuming progress in tackling South Africa's deep structural challenges. According to the Bureau of Economic Research Business Confidence Index, business confidence in South Africa reached a six-year low in 2016. It has since recovered and further strengthened in early 2018, in light of the change in political leadership. The South African Reserve Bank's business cycle indicators point to a recovery. A boost in confidence may bring much-needed investment to South Africa, resulting in productivity, and economic and job growth. However, some caution is warranted. For one, South Africa's growth of 1.3 percent in 2017, up from 0.6 percent in 2016, was driven by the agricultural sector's recovery from drought. Agriculture accounts for less than 3 percent of GDP and will not be able to carry growth forward. Other sectors, including manufacturing, mining, and South Africa's engine of growth—finance, insurance, and real estate—are growing modestly or intermittently. Underlying growth momentum remains weak. A pickup in growth may be cyclical at best, unless South Africa's structural challenges are tackled, as explored in this SCD. Box CGE 2.1 develops a baseline for South Africa's economy, poverty, jobs, and inequality up to 2030.

CGE 2.1: A baseline for South Africa's economy, poverty, and inequality

A baseline scenario using the World Bank CGE model projects the economy until 2030 in the absence of any major surprises or radical shifts from the current policy stance. This scenario should not be considered as a projection but rather as a possible future, from which the impact of alternative policy stances can be evaluated. It does not prejudge the political feasibility of such a future, which is uncertain given the persistent high level of inequality combined with people's high access to political and judicial instruments to redress them. The baseline assumes zero growth in total factor productivity, given negative growth rates in recent years, and a modest recovery in commodity prices, in line with forecasts in the World Bank's Global Economic Prospects.[131] At the baseline, real GDP grows at an annual average rate of 1.3 percent between 2018 and 2030, slightly above population growth of 1.1 percent. It creates 210,000 new jobs per year, two-thirds of which will be for semiskilled and skilled workers.

Nevertheless, poverty (at the World Bank's global poverty line of $1.90 a day) would decline significantly, from 18.6 percent to 12.7 percent (about 2 million people), due to a significant reduction in inequality. The Gini coefficient would drop from 62.8 in 2017 to 59.5 in 2030, and the share of real disposable income accruing to the poorest four deciles—the "bottom 40"—would increase from 8.6 percent to 10.3 percent, as progress in education among the poorest deciles observed in the past decades would start reflecting on labor market outcomes. In particular, the share of skilled (and semiskilled) labor income accruing to the bottom 40 would rise from 0.5 percent (4.5 percent) in 2012 to 3.6 percent (11.2 percent) in 2030. South Africa is thus on track to achieving the goals of Vision 2030.

The baseline already includes the carbon tax that South Africa actively pursues and assumes a fixed supply of water. Without the carbon tax (representing 0.8 percent of GDP in 2030), carbon dioxide emissions would be 19 percent higher in 2030, in line with the announced objective to decrease emissions by 13 percent to 14.5 percent by 2025 and by 26 percent to 33 percent by 2035, compared with business as usual. Induced distortive effects from the introduction of the carbon tax could cost up to 0.7 percent of GDP by 2030 and be regressive, as the poorest deciles would be the most affected. The fiscal closure rule (of constant government current spending) retained in the simulations reported in this note nonetheless mitigates such effects, as all proceeds from the carbon tax would be fully invested (as opposed to consumed). Given that South Africa's water resources are fully used, water prices are projected to increase by 25 percent in real terms by 2030.

2.5. Exclusion and investment

Greater investment is needed to overcome exclusion. To an extent, low domestic savings translate into low investment, and given South Africa's ability to tap into international capital markets, this is not a binding constraint. Low investment in South Africa in recent years is partly a consequence of low exogenous stimulus to demand. As commodity prices declined, credit growth became constrained by high household indebtedness. Fiscal policy became tighter to prevent fiscal sustainability from deteriorating—and pressure on current spending has been reducing public investment. The limited ability of South African non-mining firms to tap global demand is another reason for the small appetite for expansionary private investment. Low domestic demand and limited ability to tap into accelerating global demand keeps capacity utilization rates relatively high, with little need for new investment. Monopolistic behavior can also undermine investment, as monopolies restrict output to maximize rents. In cases where SOEs participate in markets where private-sector participation is viable, various factors may hinder investment by the private sector in those markets. These include weak regulation or a lack of competitive neutrality that puts the private sector at a disadvantage (Chapter 3).[132]

Although growth alone is insufficient for creating jobs and reducing poverty and inequality, it is an important factor, and greater investment is needed for growth. There is an often-cited concern that machines replace workers, but this effect tends to be more pronounced in countries that are closer to the technology frontier—which does not include South Africa.[133] Yet it creates demand for more products that require workers to produce them, which creates jobs. Research for this SCD corroborates this view, as it finds that investment tends to raise the share of wages in GDP in 34 OECD countries and South Africa.[134] Investment helps create jobs, including better-paid jobs.

Policy uncertainty is a major constraint to investment in South Africa. A perceived rise in corruption is one cause of uncertainty. South Africa has been slipping on several transparency indicators (Chapter 4). Corruption affects businesses in a number of ways. One is the deterioration in the contracting environment, as compromised deals are more difficult to enforce. Another relates to the smooth functioning of key infrastructure services. South African SOEs are at the forefront of corruption allegations, and uncertainty over their continued functioning, at affordable user cost, generates investment uncertainty, while the need for government transfers puts pressure on fiscal sustainability and raises the need for tax hikes. Empirical evidence suggests that an increase in corruption in South Africa between 2001 and 2016 reduced investment by JSE-listed firms[135] by 10.5 percent over that period.[136]

Slow or inconsistent policymaking is another source of uncertainty. Inefficiencies in policy implementation, further explored in Chapter 4, can create policy uncertainty. One example is when Eskom put the signing of power purchase agreements for 14 independent power producers on hold (now resolved), undermining the credibility of government and potentially putting this successful public-private model at risk. A drawn-out legislative process creates uncertainty, especially when the stakes are high.

South Africa's social fragility is yet another cause of policy uncertainty. Inequality forms the foundation for redistribution demands. Both the threat of higher taxation and forms of expropriation or other initiatives for ownership transfer generate uncertainty about future income and wealth. For individuals, tax rates have increased by 1 percentage point since 2016, and the adjustment of tax brackets below the rate of inflation has meant that an increasing number of middle-class South Africans have moved into higher tax brackets. For investors, dividend taxes have increased by 5 percentage points since 2016. Corporate taxes have remained relatively stable, however, and are in line with taxes in other countries. Evidence suggests that structural features such as inequality determine the size of government and the revenue that finances it.[137] High inequality in South Africa is thus a major reason for the government's large size. This also means that reducing inequality holds the key to reducing the threat of progressive tax increases.

Uncertainty about property rights depends on the way in which the government will advance its transformation agenda. Historical legacies are particularly strong in agriculture and mining, which are the sectors where property rights are arguably the weakest. Greater participation of all South Africans in the economy is needed (Chapter 1); however, elements of BBBEE and other redistributive policies impose costs on investors.[138] Research under AsgiSA also warned of the impacts the policy has on the security of property rights, which becomes a particular issue if the future of BBBEE is uncertain.[139] Property rights are perhaps the least secure in the two sectors that are most historically sensitive: agriculture and mining. Moreover, proposals to amend the Competition Act in 2018 to give the competition authorities the ability to order firms to divest their assets across a number of markets where market structure is found to be problematic are intended to strengthen redistribution efforts—but are likely to increase policy uncertainty for business and dampen incentives to invest and expand in South Africa (see Chapter 3). Redistribution processes have been slow. Swiftly resolving legacy redistribution and firming up commitments to ownership are critical for generating a greater sense of security of property among investors.

Overcoming exclusion in land markets while securing property rights

Land reform in South Africa represents an attempt to undo at least some of the legacy of segregation and apartheid. The stated goal is to transfer 30 percent of land to historically disadvantaged South Africans. A 2015 Afrobarometer survey found that fewer than 2 percent of South African respondents identified land as among the top three "most important problems facing this country that government should address," relative to the 71 percent who identified unemployment. Yet land remains an emotional topic in South African politics and is seen as a way to overcome the country's historical legacy. Accordingly, there is an argument that the "willing buyer/willing seller" model—through which the government purchases land from willing sellers at market value for redistribution—is controversial because it conflicts with the idea that land reform is about justice and reparation.[140] The land reform process is progressing slowly: as of 2016/17, about 8.1 million hectares had been reallocated. Women seem to be particularly disadvantaged when it comes to land ownership. The 1998 Recognition of Customary Marriages Act provides men and women with equal legal rights regarding property ownership, including land. However, customary practices result in significant gender gaps in asset ownership. One study in KwaDube indicates that 85 percent of men own land either jointly or alone, compared with only 20 percent of women.[141] Between 2005 and 2010, only 36 percent of the beneficiaries of the land redistribution and tenure program were women.

The government makes land available through two separate processes: redistribution and restitution. Land restitution restores land or provides financial compensation to victims of land dispossession under separation and apartheid; land redistribution is a discretionary intervention whereby the state purchases land on behalf of previously disadvantaged individuals to enable them to farm—and reduce poverty in rural areas. As of July 2017, the Restitution Commission had settled 76,139 claims, of which about 90 percent had been settled by means of financial compensation, involving some 400,000 households in urban and rural areas. Rural claims are particularly complex. Challenges include a lack of clarity as to exactly what land the claimants have a right, untraceable claimants, and competing claims for the same or overlapping land. In 2016, the commission set the goal of completing all research associated with outstanding claims by the end of 2017/18. However, in 2014, Parliament passed the Restitution of Land Rights Amendment Act, which reopened the claims process. Within about two years, more than twice the number of "new order claims" had been lodged as had been brought by the original 1998 deadline. Largely out of concern that tending to the new claims would compromise the government's efforts to conclude the older claims, civil society groups brought a court challenge against the Amendment Act. The Constitutional Court declared the Amendment Act invalid in July 2016, and the processing of new claims has stopped—leaving uncertainty over their future.

Land redistribution has been slow and the impacts on poverty are unclear; yet it is important for social sustainability. According to the White Paper on Land Policy, "[t]he purpose of the land redistribution program is to provide the poor with access to land for residential and productive uses, in order to improve their income and quality of life." However, redistribution has changed significantly over the years.[142] For example, acknowledging that scale is needed for effective farming in South Africa, amounts of land per beneficiary have increased over the years, limiting the number of beneficiaries. This has also meant that redistributed land has increasingly resulted in commercial, capital-intensive farming, such that redistribution at present is not especially relevant to reducing poverty. Moreover, many redistributed farms fail, resulting in job losses and unproductive land. Redistribution projects collapse due to a combination of factors: redistributed land is often of lower quality than restituted land, new owners sometimes lack relevant farming experience, and government support to land reform projects is often weak. Yet farms successfully run by historically disadvantaged South Africans are important to heal the scars of history—and could play a greater role in helping alleviate poverty. Chapter 3 looks at some of the ways in which farming on reassigned land can be made more successful, such as through mentorship models and government support.

As highlighted in the NDP, greater tenure security, a third pillar of land reform in South Africa, is critical to strengthening property rights and fostering investment in the former homelands, which are dominated by communal land. Tenure security is still governed by the Interim Protection of Informal Land Rights Act. This stop-gap legislation has been in place since 1996. The act aims to secure the rights of people occupying land without formal documentary rights, such as rights to household plots, fields, grazing land, or other shared resources. Yet its effectiveness is limited because there is no land administration system underpinning it, so processes are lacking for clarifying and documenting rights or resolving disputes. An important provision of the act is to ensure proper community consultation in cases where external investors wish to access communal land. However, some external investors violate these provisions, while other potential external investors decline to invest either because they are unsure how to negotiate leases of communal land or are anxious about whether the arrangements will be respected. Legislation and institutions to strengthen tenure security in the former homelands is urgently needed, but the 2004 Communal Land Rights Act was annulled by the Constitutional Court, and the current Communal Tenure Bill may suffer a similar fate. At the heart of the long-standing stalemate regarding tenure reform in communal areas is the significant power given to traditional leaders.

More broadly, strengthening property rights goes beyond tenure security in the former homelands. It includes the faster assignment of deeds to RDP houses—by law, ownership for RDP houses is only effected after eight years, and in 2016 there was a backlog of about 900,000 deeds—and the registration of properties in townships and informal settlements that have evolved over generations. Property rights are critical to allowing South Africans to transact and use their property as collateral to obtain credit—for example, to prepare their homes for backyard rental and thus increase the return on their assets, or by developing other types of business, such as shebeens (taverns), spaza shops (convenience stores), and early childhood development centers.[143] Property rights also matter for the large-scale commercial farming sector. The recent rhetoric over land expropriation without compensation—heightened after the ANC and the Economic Freedom Fighters voted in February 2018 to explore amending the Constitution to facilitate this more easily—may undermine investment in commercial farms, threatening jobs and South Africa's food security (although the constitutional review will take food security into account). Strengthening land rights is critical for many South Africans, and it will be an important step in overcoming the legacy of apartheid and ultimately fostering investment by commercial farmers, emerging farmers, and households.

Overcoming exclusion in capital markets while securing property rights

Acknowledging the need to instill greater investor confidence in the mining sector, the NDP prioritizes "giving greater clarity over property rights" and ensuring that the government captures mining rents fairly. A number of changes to mining regulation, ownership, and socioeconomic commitments have negatively affected the sector, contributing to falling investment, output, and employment.[144] Initial changes in the sector's regulation focused on the definition of mining rights, which, in the late 1990s, changed from ownership of the land on which the right was allocated to a lease (that is, the mineral asset remains the property of the state). Thereafter, various instruments, such as the first Mining Charter, in 2004, and the second, in 2010, passed more onerous provisions on to investors and eroded potential returns. The second Mining Charter introduced means of assessing the progress of the industry's transformation against the charter's objectives. Shortcomings had been identified in the elements of ownership, procurement, employment equity, beneficiation, human resource development, mine community development, and housing and living conditions. This contributed to a gradual change in the transformation requirements for the sector, eroding property rights and returns to investors.

The third Mining Charter caused significant discontent among mining companies in 2017. It provided more stringent targets that are proposed to be legally enforceable (for the first time), combined with a range of areas that are uncertain, difficult to measure, and potentially of high cost to shareholders. The main cause of concern relates to a higher cost of compliance, which is particularly affected by the following provisions: increased BBBEE shareholding (which may have to be funded by the current owners of capital in the sector); the rejection of the "once-empowered, always-empowered" principle (where a legislated minimum of BEE shareholding needs to be maintained, even after BEE investors divest); a proposed dividend of 1 percent of turnover to be paid out to BBBEE shareholders every year; and increased socioeconomic investment requirements (such as the requirement to spend a minimum of 70 percent of total mining procurement value on goods manufactured in South Africa, with at least 21 percent from black-owned companies) as well as various enterprise development requirements. Each of these factors may erode investor returns and is thus likely to undermine mining investment in South Africa. In early 2018, the new political leadership and mining firms committed to resolve the dispute over the charter. If successful, this could result in significant new mining investment (CGE 2.2).

CGE 2.2: Greater security of property in mining

The baseline scenario assumes a slow rebound in mineral prices and FDI from 2018. More optimistic assumptions regarding FDI in mining, cumulatively 25 percent higher over the period 2018–2030 than at the baseline, the result of greater policy certainty from, for example, an amicable resolution around the dispute over the third Mining Charter[145] would not make a significant difference. The annual GDP growth rate from 2018 to 2030 would be only 0.2 percentage point higher, and the poverty rate would be 0.1 percentage point lower, but inequality, with a Gini coefficient at 59.6 in 2030, would widen.

Scenario MIN: Greater mining investment				**Additional jobs compared to 2017 (million)**	
	World Bank poverty rate ($1.90)	**Gini coefficient**	**Real GDP index**	**Unskilled/ semiskilled jobs**	**Skilled jobs**
2017	18.6	62.8	100.0	-	-
2030: Baseline	12.7	59.5	119.5	2.26	0.56
2030: Scenario	12.5	59.6	122.9	2.32	0.56

Investors beyond mining also increasingly view BBBEE as a constraint. There are alternatives to broadening participation in corporate South Africa. Investors view the Mining Charter with concern, as it may be a harbinger of empowerment policies affecting other sectors (most recently, the construction sector). European investors are wary of BBBEE ownership regulations (see Chapter 3), not least because of a lack of investors suited to also playing active management roles. Building a community of active black investors will take a long time, and BBBEE regulations may be too demanding at this point. While it is clear that the still racially skewed structure of corporate South Africa needs to be redressed, how to better balance empowerment objectives with property rights and investor certainty is of critical importance. Box 2.1 provides a suggestion to broaden corporate ownership through the pension system, which could make BEE broad-based, strengthen social resilience, and reduce the vulnerability of the poorest.

Box 2.1: Building assets for the poor through the pension system

There are about 32 million working-age people in South Africa. Roughly one-third are covered by an occupational pension scheme at any given time. This leaves the unemployed, informal sector workers, and those not in the labor force uncovered by a contributory pension. The elderly poor draw on the old-age pension, a social pension system that most countries have moved beyond. Yet this is a grant and not a pension asset. Currently, RDP houses and, to an extent, redistributed or restituted land are the only meaningful form of asset transfer in South Africa that may reach the poor. They reach few beneficiaries, and sometimes lock poor South Africans into unproductive areas. Extending a contributory pension system to all South Africans and subsidizing it for the poor (gradually reducing the subsidy with income) would help build assets for all poor South Africans. By investing pension assets in the JSE, the system would provide broad-based empowerment, giving all South Africans a stake in corporate South Africa. It would be important to allow this to be registered as black ownership on the JSE to the point that pension assets are helped by historically disadvantaged South Africans. Further, delegating voting rights to pension fund managers—perhaps themselves from historically disadvantaged backgrounds—would empower poor people and give them a collective voice in shareholder decisions.

A social contributory pension could be financed through a property tax, which would finance assets for the poor with a tax on assets of the wealthier. As property wealth is often inherited, this would also help redress inequality. It would provide incentives to reduce home sizes, helping the much-needed densification of South Africa's spatial economy. Higher property taxes would need to be phased in incrementally to not overwhelm the middle class, especially those who struggle to make it onto the property ladder. An agreement with municipalities would have to be found to facilitate a portion of property tax for national expenditure.

The scenario models a 10-percentage-point increase in the taxation of real estate consumption by raising property taxes (representing an additional fiscal revenue of about 0.6 percent of GDP yearly), saved in a pension fund which the revenue raised subsidizes to 100 percent for the bottom 40 percent of the population. The poor will be able to draw a dividend from the pension, allowing them to participate in the economy by investing their savings on the JSE (that is, in corporate South Africa). The conversion of consumption into forced savings would raise investment by 5.2 percent by 2030 and real GDP by 1.2 percent, lifting an additional 2.9 million South Africans out of poverty. Redistributive impacts would be large: poverty and the Gini coefficient would drop to 8.2 percent and 58.1 respectively. Notably, the modeling suggests that growth would be labor-intensive, thus further supporting poorer households.

Scenario RED: Broad-based redistribution of assets				**Additional jobs compared to 2017 (million)**	
	World Bank poverty rate ($1.90)	**Gini Coefficient**	**Real GDP index**	**Unskilled/ semiskilled jobs**	**Skilled jobs**

2017	18.6	62.8	100.0	-	-
2030: Baseline	12.7	59.5	119.5	2.26	0.56
2030: Scenario	8.2	58.1	120.9	2.28	0.55

An accumulation over a 40-year period with reasonable net returns (assumed here to be 3 percent above inflation) would result in a balance that should be sufficient to generate a pension of about twice the current value of the old-age grant adjusted for inflation. Higher pensions could be generated through additional voluntary savings in the same account. The pension could also include provisions for survivor's insurance benefits purchased on a competitive basis from the market.

Source: World Bank Group staff drawing on Arturo Antón, Fausto Hernández, and Santiago Levy (2012) "The end of informality in Mexico? Fiscal reform for universal social insurance," Inter-American Development Bank.

Policy uncertainty has reduced investment in South Africa. Local businesses have been investing little in South Africa in recent years, resulting in dramatically increased corporate savings. The notion of an investor strike is exaggerated, as low investment is partly a consequence of low aggregate demand.[146] However, there is strong evidence that policy uncertainty is one factor explaining low investment. Instead of investing at home, South Africans have increasingly been investing abroad, partly financed with additional revenue raised from the JSE.[147] Although it is difficult to identify what specific parts of policy uncertainty—corruption, insecure property rights, or others—deter investment, analysis using a news chatter index constructed by the International Monetary Fund that tracks terms related to policy uncertainty in major newspapers[148] and volatility in stock market returns finds that local firms have been investing less in South Africa because of policy uncertainty.[149] This finding is a major explanation for why investment in South Africa has been lagging behind other emerging markets.

Foreign investment is particularly important for South Africa, and policy uncertainty makes foreign investors cautious. The country used to attract a significant amount of FDI. Its stock of inward FDI is high by emerging market standards, and recent FDI has been targeting retail and consumer products in particular. Although inflows continue, they have more recently been lagging behind those of other emerging markets. FDI is critical for South Africa to supplement low domestic savings, import technology, and bring in large foreign firms to compete with large South African firms. Policy uncertainty increases the volatility of the South African rand,[150] undermining FDI.[151] Recent South African legislation has not always been conducive to attracting FDI. For example, the January 2016 Promotion and Protection of Investment Act is perceived by some investors as limiting the recourse investors have should new legislation be introduced that they feel is discriminatory or could hurt their business interests, such as the expropriation bill and the third Mining Charter.[152] A greater role in investment protection is now given to South African courts rather than international arbitration. According to the World Economic Forum, overall investor protection remains strong.[153]

Yet investment is critical for growth, productivity, and competitiveness. Low investment in South Africa is also associated with low productivity from seeking efficiencies, allocating more capital to productive sectors, or entering concentrated markets. Declining investment in knowledge and technology through research and development has mirrored the trend of fixed investment in South Africa. Less technology from capital imports is reducing the pace of technology adaptation.[154] Overall, these trends undermine productivity and South Africa's competitiveness, making it more difficult for the economy to expand—both within the country and into the world—and provide better and cheaper goods to its citizens. Investment supports productivity and competitiveness, creates jobs, raises wages, and reduces poverty. It is also important for reducing inequality.

2.6. Exclusion, productivity, and competitiveness

Democracy provided an opportunity to overcome South Africa's exclusion from the global economy. Finance was better prepared for this new world than manufacturing. As Chapter 1 explained, South Africa's financial sector developed on the back of mining, which is an international business. Banks have been instrumental for South African mines to raise capital, and the JSE has been central to the South African economy and financial sector since the late 1800s. Mining and finance essentially subsidized the development of manufacturing, which was inward-looking and, with little innovation from abroad, relatively unproductive. As the economy opened, South African banks were thus better equipped to compete in international markets than manufacturing. Although South Africa has made some progress in integrating into the world economy since democracy, progress has stalled and is even at risk of reversing.

Productivity in the financial sector accelerated with global integration. Post-1994 reforms focused on reconnecting the sector to the global financial system by adapting technological and regulatory standards. Today, the South African financial market ranks among the most advanced sectors in the economy, on par with the best international standards. These regulatory reforms have resulted in substantial productivity gains, and finance and insurance remain the most dynamic sectors of the South African economy.[155] Weighted by GDP, the JSE has the second-highest market capitalization in the world, after that one of Hong Kong SAR, China. Although South Africa's four large banks continue to dominate the sector, competition will soon increase, as the South African Reserve Bank issued three new banking licenses in 2017 to both domestic and foreign entrants.

Manufacturing, on the other hand, has struggled with trade liberalization. Years of inward-looking development, import substitution, and isolation due to sanctions, physical distance from markets, and high logistics costs had made much of South African manufacturing globally uncompetitive. The rapid reduction in tariffs under the 1995 General Agreement on Tariffs and Trade, coupled with the rise of East Asian manufacturing, destroyed much of South African manufacturing, notably the clothing sector. To stem the rapid decline of industry and the associated job losses, the government implemented industrial policy measures. These may unintentionally protect jobs in declining industries at the expense of jobs in more competitive parts of the economy. This helps explain the fact that capital in South Africa has tended to be allocated to less productive sectors, reducing total factor productivity growth.[156] The incidence of monopolies is also consistent with firms protecting themselves from competition, and Chapter 3 will show that this sometimes happens as a result of apartheid-era market structures being conducive to collusion. Manufacturing therefore remains relatively isolated from the world economy, with the exception of automotive manufacturing, where FDI into the apartheid-era automotive sector helped the country integrate into global value chains, with significant government support.

Table 2.1: Mean hourly wages in $ by education, purchasing power parity, and adjusted for inflation

	Brazil	Chile	Colombia	Ecuador	Indonesia	Mexico	South Africa
No education	2.39	4.37	1.81	2.60	1.31	1.98	2.10
Primary incomplete	2.74	4.28	2.19	2.87	1.74	2.26	2.64
Primary complete	3.05	4.73	2.54	3.24	1.87	2.48	3.44
Secondary complete	3.80	5.47	3.08	3.88	1.99	3.32	5.72
Post-secondary/ tertiary complete	7.92	11.47	6.94	–	3.21	6.28	11.58

Source: Langbein and Weber (2018) SCD background note.

Manufacturing has come under further pressure as productivity gains in finance raise unit labor costs, which are compounded by South Africa's skills constraint. High unit labor costs reduce competitiveness and promote increasing capital-intensity of production. Finance and insurance are South Africa's most dynamic sectors and have seen considerable productivity gains, successfully operating locally, in the region, and in the world. They thus quickly outperformed an increasingly defensive manufacturing sector. While direct services exports remain comparable to other middle-income countries and have been relatively stagnant in recent years, South Africa's dynamic services sector contributes substantial value through the "servicification" of manufacturing. Services are now the most important contributor of labor to exports when also accounting for the forward linkages.[157]

Given South Africa's level of development, the demand in manufacturing tends to be for mid- to high-skilled labor. The expansion of finance puts significant pressure on this segment of the labor market, raising the wage premium to levels that are comparatively high (Table 2.1). While the productivity increases in finance can partly make up for this increase in wages, low productivity growth in manufacturing means increasing unit labor costs. To an extent, manufacturers respond to the rising cost of labor by substituting labor for capital, increasing the capital-intensity of South Africa's economy.[158] Yet this is not always sufficient to counter the cost of South African products, making them globally less competitive and exacerbating trends to hide behind barriers to foreign competition, including industrial policy support, high logistics costs, and anticompetitive behavior. An increase in skilled migration would relieve the skills constraint in the manufacturing sector, according to World Bank simulations (CGE 2.3; see also Chapter 3).

CGE 2.3: Skilled migration

For the skilled migration CGE scenario, skilled migration flows are progressively increased between 2018 and 2030 (+150,000 skilled workers by 2030), resulting in higher skilled labor supply (+5.8 percent in 2030 compared with the baseline) and higher remittances out of South Africa (equivalent to an additional outflow of 1.2 percent of GDP). Relaxing the skills constraint would increase growth (GDP levels by 2030 are 2.1 percent higher than at the baseline), especially because of a strong response in manufacturing. This leads to higher demand for unskilled and semiskilled labor (+70,000 jobs by 2030 compared with the baseline). The Gini coefficient would drop to 59.3 while poverty would remain unchanged at 12.7. Nonetheless, the reduction in inequality would mainly benefit the fifth to eighth deciles, as the share of real incomes accruing to the bottom 40 percent of the population would barely change from the baseline scenario.

Scenario SKM: Skilled migration				**Additional jobs compared to 2017 (million)**	
	World Bank poverty rate ($1.90)	**Gini coefficient**	**Real GDP index**	**Unskilled/ semiskilled jobs**	**Skilled jobs**
2017	18.6	62.8	100.0	-	-
2030: Baseline	12.7	59.5	119.5	2.26	0.56
2030: Scenario	12.7	59.3	121.9	2.33	0.69

The shift in strategic emphasis of South Africa's trade policy from developed markets to African markets can also be understood in the context of levels of competitiveness, which are low by global standards but sufficiently high by regional standards.[159] This is further supported by relatively low barriers to entry in African markets, given relatively short distances and membership of regional trade agreements, such as the Southern African Development Community (SADC) and the Southern African Customs Union. Regional integration holds significant potential, as South African investment in Africa has been supporting development across the continent, especially in services (including finance, retail, and communications). A challenge will be to ensure that South African firms do not simply crowd out domestic firms, but help build value chains, and that South Africa remains an outlet for products produced across African value chains into the rest of the world. This will support growth in the region and benefit both South Africans and other Africans, such as the large number of migrants sending home remittances or those finding jobs in other African countries, through higher growth from regional integration. Further to this point and the previously discussed dynamism of South African services as inputs into other sectors' exports, South African services firms have much to gain from greater services liberalization in the region through the implementation of the 2012 SADC Services Protocol. Industries in other southern African countries would benefit from greater access to these highly competitive inputs.

Public-sector labor demand amplifies the skills constraint, while South Africa's wage bargaining system puts further pressure on unit labor costs. The public sector is the biggest single employer of high-skilled labor in South Africa and sets the tone in wage determination for the whole economy. An increase in demand for skilled labor increases the cost of skills. This increases pressure, especially on the less productive sectors that cannot afford higher wages, like manufacturing. South Africa's wage bargaining system adds to this dynamic, as it is driven by bargaining in the larger private sectors and the public sector.[160] Chapter 3 argues that wage bargaining can further raise wages beyond productivity increases and thus raise unit labor costs across the economy. In some cases, wage bargaining is fierce: in 2014, South Africa experienced a five-month strike in the platinum sector. Although strikes in South Africa are less common than in Brazil and Chile,[161] they can be costly to the economy, as they disrupt production and can deter investment. Increasing fragmentation among unions risks competition among unions (another form of the contestation of resources), potentially making industrial action more adversarial. The government is thus trying to improve labor relations (for example, through better mediation and strengthening the secret strike ballot).

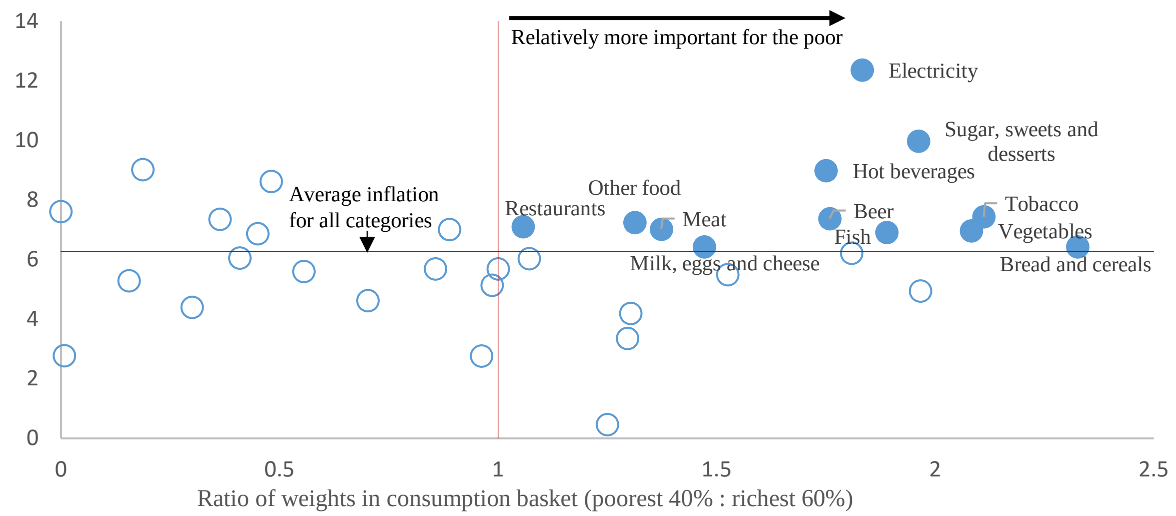
South African productivity is not catching up to the rest of the world. This results in a depreciating real exchange rate. World Bank research documents this lack of catching up, or, in fact, divergence. This is especially the case in manufacturing and mining, reflecting low integration, the level of protection of the economy, and policy uncertainty that deters investment. It results in low innovation from technology transfer through global value chains and relatively low imports of technology-intensive capital goods.[162] A divergence in productivity between South Africa and the world puts the rand on a depreciating trajectory in real terms, making imports more expensive for both consumers and firms. In addition, World Bank research suggests that the real exchange rate is persistently undervalued[163]—an observation that is mirrored in purchasing power parity conversion rates, since, according to the OECD, the rand-dollar exchange rate that would equalize price levels across South Africa and the United States was R5.90 in 2016. The spot exchange rate was R14.70, however. The effects of terms of trade are partly at play in this, especially driven by commodity prices, but a more structural underlying undervaluation can be linked to the differences in productivity in manufacturing and the services sector.

The manufacturing sector's lack of competitiveness also helps explain the weak export response to real depreciations, further supporting persistent current account deficits. South African exports have barely been responding to real depreciations of the rand because the divergence in productivity—and the associated loss in competitiveness—is the reason for the depreciation in the first place. Except for commodity booms, South African exports tend to lag behind global trade growth. South Africa is thus losing global market share.[164] Real depreciations tend to improve the trade balance and the current account, by compressing imports without necessarily a matching export response. In this sense, South Africa's limited diversification is a consequence of low productivity, constituting an external vulnerability, as it limits the adjustment of external balance. Chapter 3 explains that bottlenecks in reliably and cost-effectively delivering critical network and infrastructure services, such as logistics, internet, and electricity, further erodes this competitiveness.

South Africa's access to global financial markets helps finance the current account deficit—but it also makes the rand more volatile. The volatile rand in turn limits global integration of the real economy. Higher productivity would mean higher income that South Africans could save. The current account deficit is consistent with low productivity, low exports, and low savings, relative to investment needs. South Africa finances its current account deficit largely with portfolio flows intermediated by its banks. The historically low interest rates in advanced economies have allowed South Africa to borrow at a relatively low cost.[165] Yet the current account deficit is partly a reflection of limited export diversification, and as mining continues to dominate exports, commodity price shocks are a major driver of rand volatility, as are any other global and domestic shocks that affect the short-term horizon of portfolio investors. The volatile rand makes the returns from trading and cross-border investment expensive, requiring firms to hedge. World Bank research shows that hedging in South Africa is expensive, posing potential constraints to investment and trade that could help South African firms diversify into other globally traded goods.[166] It may also deter investment that could destabilize cartels or support technology transfer. When interest rates in advanced economies are very low, the costs of hedging are raised, especially over the longer term.[167]

South Africa's bimodal economy and skills constraint hurt the poor in particular and keep inequality high. The depreciating, and often undervalued, exchange rate results in costly imports for consumers. The rich are partly compensated with high skills premiums, but the poor are not. This especially hurts the poor when South Africa has to import food, the main item in their consumption basket, as happened during the 2015/16 drought. Second, because the service sector's productivity grows faster than manufacturing, prices increase more slowly for the main consumption goods of the rich (services) than the poor (goods) (Figure 2.3).[168] Notable exceptions to this are housing and transport, which are important services consumed by the poor that affect their reservation wages and thus their ability to work.[169] The different trends in productivity and consumption baskets make South Africa more expensive for the poor and cheaper for the rich, widening inequality. Finally, the lack of competitiveness from low productivity undermines job growth, excluding many South Africans from labor markets.

Figure 2.3: Poor households' exposure to high-inflation expenditure categories, 2009–2017
(average annual inflation, percent)



Source: Dadam, Hanusch, and Viegi (2018) SCD background note.
Note: Electricity is part of the social wage, so the government covers the cost to the poor.

The country's economic structure promotes the dominance of established and large firms, undermining progress in balancing the racial representativeness of South Africa's entrepreneurs. New market entrants, including historically disadvantaged South Africans, face significant obstacles to address two key structural features of South Africa's bimodal, skills-constrained economy. South Africans appear to prefer working for larger firms, making the skills constraint particularly binding for new firms and SMMEs. In addition, large firms find it easier to navigate complex immigration processes so are better able to address the skills constraint with migrants. Substituting labor for capital is thus particularly important for smaller firms, yet they tend to have worse access to finance (Chapter 3). Access to finance constraints are also reflected in more expensive hedging costs for SMMEs, making it particularly difficult for them to seize opportunities in global markets.

Chapter 3 explores how to address structural features of South Africa's economy to create jobs and reduce poverty and inequality. It discusses how more South Africans can access jobs. Measures to make South Africans more employable will help growth and show that overcoming exclusion and growth are intimately linked. Similarly, exclusion in labor and product markets undermines productivity and competitiveness, and is aggravated by poor-quality infrastructure services. A more competitive economy that can compete in global markets is important not only for South Africa, but also SADC, which aims to strengthen regional value chains. South Africa plays a critical role in delivering the goods produced in these value chains to world markets.

Chapter 3

Employability, contestability, and competitiveness

3.1. Jobs to overcome exclusion

Jobs empower people. A job is the way out of poverty for South Africans. Although some working South Africans are still classified as poor, a job significantly reduces the likelihood of being poor (Chapter 1). In addition, a job is empowering. Unemployment fosters frustration that makes men in particular more likely to resort to violence, partly helping to explain South Africa's high crime rate. Women who are economically dependent on their partners, be it because they do not have a job or because they are paid less than their partner, are more likely to experience domestic violence. Young women in good jobs are more likely to delay starting a family compared with unemployed or underemployed young people, benefiting child development. Jobs are transforming the racial makeup of the economy. Between 1996 and 2015, the number of black managers increased by 260 percent, and today, 21.1 percent of senior managers are black, 17.6 percent are from other historically disadvantaged groups, and 58.2 percent are white.[1] Given the power of jobs, it is little surprise that unemployment has persistently featured as the top national priority for South Africans polled by the Afrobarometer.

Better jobs can benefit society as a whole. Policy interventions that create better jobs can have social rates of return that surpass the private returns to the firm undertaking the investment, making a strong case for government to intervene in markets to support job creation, including improving the labor supply, labor-market matches, and pro-competition industrial policy to strengthen the demand for labor.[2] A competitive infrastructure system is also important for growth, and thus for generating labor demand.

Improving the employability of South Africans and greater contestability in labor and product markets will allow more job seekers and entrepreneurs to participate in the economy. The legacy of "Bantu education" is only slowly being overcome, while health outcomes continue to reflect a dual society, reducing the ability of many historically disadvantaged South Africans to compete in the labor market. High inequality means that the payoffs from being at the top or the bottom vary dramatically. This provides the backdrop to South Africa's pervasive barriers to entry—they are endeavors to guard the resources of the few from competition by the many. In product markets, competition from new entrants or smaller rivals is impeded by barriers to entry and rivalry resulting from a combination of historical market features,[3] unintended effects of government interventions, and anticompetitive behavior by firms, including current and former SOEs or firms that formerly benefited from state protection. A group of firms that appear to be highly vertically integrated into inputs, offtake, and distribution networks may further restrict entry by raising the risk that new entrants are unable to access inputs or supply channels. Reducing barriers to entry and rivalry in both labor and product markets will allow excluded South Africans to participate in the economy, and as it reduces the cost of labor and products that result from such a lack of competition, it will make the economy more competitive, supporting both growth and job creation.

The lack of competition in the labor market can amplify lack of competition in product markets, and vice versa. Weak contestability in labor markets is reflected in negotiated wages for the insiders at the expense of the unemployed. High rents, that is, super-profits, reflect high barriers to entry in both product and labor markets. The high profits of sheltered firms make it rational for labor to mobilize to obtain their share of these profits, even if those higher wages will price some South Africans out of the market. This chapter looks at whether such rents can be reduced to favor the economy as a whole and the poor especially, by strengthening entry and rivalry—that is, competition—in labor and product markets.

Greater competitiveness—stimulating labor demand—requires better infrastructure services. Fostering productive linkages between market actors can also strengthen labor demand. South Africa's infrastructure services are putting local firms at a disadvantage, at home and in global markets. As Chapter 2 has shown, greater competitiveness will stimulate job creation and help South Africa integrate better into the global economy. For example, opportunities to create productive linkages between large incumbents and new potential entrants that can act as suppliers, service providers, or distributors to incumbents can be mutually beneficial and help to advance entrepreneurship and competition when designed in a pro-competition way. South Africa's large integrated firms make it difficult for new entrepreneurs to penetrate some markets as service providers. This chapter highlights the experience of the Republic of Korea, which has a similar history with large firms but managed to leverage them, both in value chain development and vocational training, to develop successfully.

3.2. Employability

Education

Exclusion remains entrenched in the education system, making historically disadvantaged South Africans less employable.[4] Inequality in education is increasingly based on class rather than race, but historically grounded disadvantage continues. Exclusion is entrenched in early childhood development and basic education, with stark contrasts feeding through post-secondary education and into the labor market. At the tertiary level, student movements have become strong, rallying around the issue of finance (#FeesMustFall) as well as broader political issues, such as the role of Afrikaans as a language of instruction or the aim to reinterpret South African history through an African lens (#RhodesMustFall). Although South Africans from richer households tend to have better access to universities because of better basic education, about 12 percent of learners from the poorest 60 percent of schools do go to university, accounting for 26 percent of university entrants. Thus, tertiary education is not only a concern for the affluent in South Africa. For a middle-income country, South Africa still accommodates a relatively small segment of the population in higher education, about 2 million students. To an extent, this is due to poor outcomes at lower levels of education. Yet one-third of matriculants who are eligible do not go to university, and many others enter late. Currently, 37 percent of tertiary students are enrolled in universities, another 37 percent are enrolled in TVET colleges, 17 percent are distant learners enrolled with the University of South Africa, and the rest are enrolled in either community colleges or private higher education institutes.

A tertiary degree is the door to the middle class, but it remains shut for many historically disadvantaged South Africans. This makes it a major social pressure point. People with a higher education are likely to earn more than those without (see Chapters 1 and 2). A university degree is thus the way out of historical exclusion for many. Finance is one constraint to university access: lack of collateral from students and low completion rates make university credit risky, limiting banks' interest in the student loan market. The National Student Financial Aid Scheme (NSFAS) provided scholarships to nearly half of students from the poorest 40 percent of schools during their first year of study, while only 11 percent of learners from the richest 20 percent of schools received such support, making it a progressive scheme. Yet it still left many students—including poorer ones—uncovered or undercovered (since boarding costs were excluded). Prior to the announcement of free education for poor and working-class students with a family income of less than R350,000 per year in December 2017, a report by the Heher Commission suggested that free university education would be unaffordable to government. The report proposed government-guaranteed loans instead and increasing tertiary education funding from the current level of 0.6 percent of GDP to at least 1 percent to compensate for the reduction in tuition fees. In addition to increased public funding, the Heher Commission recommended that tertiary education institutions identify ways to reduce inefficiencies in resource use. Tremendous savings could indeed be achieved by putting in place retention programs to reduce the high dropout rates, increase the low completion rates, and deploy academics more efficiently. The government is assessing the actual cost of free education for the poor and working class and looking at strategies to mobilize sufficient additional public resources to cover the new financing needs. The government will need to guarantee the long-term sustainability of the new policy and to put in place allocation mechanisms that are equitable and encourage innovation and effective use of public resources among tertiary education institutions.

Greater contestability in the higher education market could help more South Africans contest the labor market. South Africa has relatively few universities and they vary significantly in quality. Students who enrolled in university in 2009 at the University of Cape Town, Stellenbosch University, the University of the Witwatersrand, and the University of Pretoria had undergraduate completion rates exceeding 65 percent, while Rhodes University had an undergraduate completion rate of 58 percent. These universities also have low dropout rates and provide better employment prospects. More competition among universities, including access to new sources of finance from the private sector or philanthropists as in other parts of the world, such as the United States, could make universities across the country more competitive. Greater entry by private universities, with appropriate certification and quality assurance processes in place, such as in many countries in Latin America and Asia, would allow long-term financial viability and innovation in the university system. Greater diversification of tertiary education could also increase access that caters to the needs of students and the labor market.

Not everyone can make it to university. Raising the quality of vocational training will create alternatives. The programs offered do not seem to be optimal for obtaining jobs, so the demand to attend TVET colleges has not grown as much as that for entering universities, which are perceived to offer better job prospects. It is also unclear how many students are obtaining TVET qualifications, as many students enter the examinations, but the data system is not yet capable of capturing the certification. The budget allocation to the TVET system has not significantly increased. A second arm of vocational training is the Sector Education and Training Authorities, which are funded by a skills levy on wages, amounting to a significant budget of R15.2 billion in 2015/16. However, employers are not particularly attracted to the type of training offered, in part because of the unnecessarily high administrative burden: they often see the skills levy simply as an additional tax.[5] Vocational and on-the-job training in South Africa requires significant restructuring similar to the Korean model, where large firms take an active role in partnering with government to supply the skills development programs that industry needs (Box 3.1), leveraging corporate South Africa as an asset for the training system. This model is of particular interest because students from poorer backgrounds often opt for vocational training.

Box 3.1: Leveraging the private sector as an asset to create skills: TVET in Korea

Since 1967, the Republic of Korea has been experimenting with vocational training systems. Originally, the government financed public training facilities and provided subsidies to firms for training. However, this proved insufficient as an incentive for firms to train their employees, so the government made training mandatory. Noncompliant employers could face prison sentences; this was later replaced with financial penalties. In 1995, skills levies, incorporated in employment insurance, became obligatory for all companies. Like in South Africa, those skills levies could be reclaimed when training was provided; and like in South Africa, SMMEs above the minimum employment threshold for the levy found it difficult to provide this training. Korea experimented with the German dual model of on-the-job training and publicly funded instruction. Yet SMMEs' limited capacity to train workers required the country to tailor the model to its own need—leveraging one of its main assets: its large companies.

This resulted in the introduction of training consortiums, a major Korean innovation that leverages the country's large companies as assets for training through the value chain, in partnership with government. The consortiums are mutually beneficial. Large enterprises want inputs from the SMMEs to meet their standards in the supply chain. SMMEs do not have the resources or scale to train to the required skills level. Lead companies in the consortium ensure that the TVET curriculum is relevant and provide training capacity, such as instructors, training modules, facilities, equipment, and even the learning management system. The Korean government provides financial support, while many universities participate in the training. As of 2016, there were 215 training consortiums to reduce the training gap among enterprises, and 155 are led by large companies such as Samsung, Hyundai, SK, and LG; 33 are led by universities; and 27 are led by public training institutions such as Polytech.

The Korean model has already made some inroads into South Africa: Samsung Electronics SA recently opened a television manufacturing plant in the Dube Tradeport. To develop skills in the local community, the entity partnered with the eThekwini Municipality, Coastal KwaZulu-Natal TVET College, and the Department of Higher Education and Training to launch the Samsung Engineering Academy in a local township, KwaMashu. The academy empowers unemployed young people with technical skills in electronics, refrigeration, and engineering. The model may hold potential for expansion.

Source: Uh (2018) SCD background note.

South African schools remain unequal, and the quality of schools in poor areas needs to be improved. Following democracy, there was a significant shift in resources from formerly "whites-only" schools to historically disadvantaged schools, equalizing salary scales and teacher-pupil ratios for publicly funded teachers. South Africa has also significantly reduced gaps in enrollment: less than 5 percent of the compulsory age group children are not attending school. Most South African schools are public, and public schools in more affluent areas are allowed to charge fees. These fees have reduced private (or independent) school penetration to less than 4 percent of total school enrollment. But they have also secured greater teaching resources and better infrastructure for schools with more affluent parents, entrenching inequality. In the 2015 Trends in International Mathematics and Science Study, there was a 41-percentage-point difference in mathematics and a 42-percentage-point difference in science between public fee-paying (richer) and non-fee-paying (poorer) schools (Table 3.1). Overall, educational outcomes are low, and dropout rates among the poor are relatively high (Chapter 1 links dropping out of school to aspirational failures associated with inequality). South Africa performed second-worst among all countries participating in the study. Even by regional standards, South Africa performs below average even though it spends a much higher share on education—6 percent of GDP. South African Grade 6 schoolchildren are on average about a year's learning behind their peers in Kenya and two years behind those in Tanzania.[6]

Table 3.1: Percentage of Grade 9 learners in various school types who performed above the low international benchmark of 400 in the Trends in International Mathematics and Science Study

	Public no-fee schools	Public fee-paying schools	Independent schools
Mathematics	19%	60%	81%
Science	16%	58%	81%

Source: Reddy *et al.* 2015: 8.

Equity is slowly improving in the basic education system, although from a very low base. The number of black African learners attaining levels of mathematics performance in matric that would allow entry into, for example, engineering at university increased by 65 percent between 2002 and 2016.[7] This improvement occurred because good mathematics performance expanded across more township and rural schools. While in 2002 just over half of high-level mathematics performers in the public examination system were white, by 2016 over two-thirds were not. With regards to gender, South Africa has relative gender parity in access to primary schooling, but boys are less likely than girls to be enrolled in secondary school (62 percent versus 69 percent). Among youth aged 14–18 years, boys and girls are both likely to report money as the main reason for not being enrolled at school, followed by a belief that "education is useless," while girls are more likely to cite "family commitment," due to childbearing.[8] While the South African Schools Act allows pregnant girls to re-enroll in school once they give birth, being pregnant or having a baby was cited as the main reason for being out of school among girls aged 15–19. The adolescent fertility rate in South Africa is in line with the average for upper-middle-income countries.[9] Gender gaps in science, technology, engineering, and mathematics are already evident in secondary school, with girls having lower pass rates than boys, and this pattern carries through to the tertiary level.

Equity also has to improve for children with disabilities and LGBTI learners. While the South African Schools Act makes provision for children with disabilities to receive an education, implementation remains a challenge, with 35.5 percent of children with severe disabilities not attending school. In rural areas, 52.1 percent of children with disabilities between the age of five and six years old do not attend school.[10] Bullying and violence against LGBTI students in schools is a serious challenge,[11] and likely results in higher dropout rates for LGBTI students as well as those simply perceived to be sexually or gender nonconforming.

Socioeconomic status remains a key predictor of school performance. After 1994, more affluent black learners quickly moved away from historically black schools, leaving these schools with the poorest members in the community. Allowing schools to charge richer parents fees creates an incentive to maximize school resources by admitting fee-paying students. Schools are particularly poor in rural areas and townships. Only a small number of outlier schools in the poorest 60 percent of schools produce good results. Having educated parents raises learning outcomes for children, and having better-performing students in the same classroom raises overall learning standards. Thus, socioeconomic status is passed on through generations, and the apartheid geography reduces the number of mixed-income schools that could lift quality across schools—better incentivizing schools to take more learners from poorer backgrounds could make them more diverse and improve learning outcomes for the poor.[12] Socioeconomic status appears to trump the resources of schools: all else being equal, hiring more teachers only modestly raises learning outcomes, and better infrastructure does little to improve learning results. Yet vacant positions need to be filled, and there is a shortage of teachers. Entry-level teaching salaries are competitive to attract graduates but rise slowly and are outstripped by private sector salaries over time—making teaching a less attractive profession in the long term. The number of new teachers seems to have risen since the introduction of the Funza Lushaka state bursary program for studying teaching in 2009.

Focusing on the Foundation Phase is critical. Greater accountability for better performance of teachers and use of other resources is important. The curriculum assumes that children have learned how to read by the end of Grade 3, but most South African children do not acquire the most basic reading skills, thus never fully accessing the curriculum despite being promoted to higher grades. Focusing on the early years of basic education is thus critical. South African teachers require further support for this, especially in African languages. This requires both better initial training at universities and in-service coaching of current teachers to ensure that they not only have qualifications on paper but are fit to teach. In exchange for providing teachers with better support, it is important to improve accountability. Teacher absenteeism is high, lesson preparation is often poor, classwork and homework is insufficient, and many teachers lack interest in the progress of learners.[13] South Africa struggles to hold teachers accountable for historical reasons, as explained in Chapter 1. However, a mechanism is needed to hold teachers accountable for students' learning outcomes. In addition, South Africa spends a high proportion of its budget on education, but results are poor, suggesting that resources are ineffectively deployed. If budgets are kept constant, resources per student are naturally going to increase because of falling fertility rates.[14] Improving monitoring and evaluation to identify bottlenecks in the education system, such as the Annual National Assessment that was revoked in 2015 due to pressure from SADTU, will help with this. Moreover, the NDP identifies improving school leadership as a national priority by enhancing the principal appointment process, managing their performance, and providing them with greater powers over school management. However, these policies have yet to be introduced.

Rolling out early childhood development will help overcome historical exclusion, but it will take a long time to yield results. Early childhood development is offered in two forms: Grade R and community-based programs. Grade R is aimed at five- to six-year-olds as a preschool year, primarily for public schools, while community-based early childhood development targets 0- to four-year-olds, and is subsidized by the government and largely provided by nongovernmental organizations. There are disparities in teachers' qualifications and pay, as community-based early childhood development tends to have lower-paid and lower-qualified practitioners. Grants have made early childhood development more affordable for many poor parents and access to Grade R has expanded greatly, particularly in poorer schools, allowing many more parents to join the labor force. Despite this, about half of South Africa's four-year-olds are not currently attending any form of early childhood development program, particularly in rural areas. There is evidence that early childhood development raises learning outcomes at higher education levels in South Africa—yet mostly for the rich. As in basic education, socioeconomic status appears to be a necessary condition for creating a fertile ground for early childhood development to work. It will take time for early childhood development to yield results, as living standards rise and socioeconomic conditions improve. Given limited resources and capacity, focusing on improving Grade R in poorer schools may be more important than adding a second year of early childhood development across the board.

Early years interventions focusing on the first 1,000 days of a child's life (that is, before children have access to early childhood development) are critical for cognitive development. Stunting, which happens in the first 1,000 days of a child's life, is irreversible, affecting brain development. Disadvantaged children are particularly affected by stunting in South Africa.[15] The biggest challenge is how to design sustainable and scalable early childhood interventions. International evidence shows that effective interventions require close coordination among different health, nutrition, social protection, and early education programs.

CGE 3.1: Raising education levels

Two education interventions are considered: improving teachers' capacity and accountability to raise primary- and secondary-school achievements among the poorest deciles (scenario EDU1) and facilitating access to university for poor eligible students through financial support (scenario EDU2). The first scenario simulates higher spending of 0.5 percent of GDP on training for teachers in exchange for the introduction of performance-based human resources management systems and accountability frameworks, increasing the proportion of children in the poorest 40 percent of households passing matric to 30 percent in 2030 (up from 23 percent in 2016) and improving the national pass rate from 43 percent in 2016 to 49 percent in 2030.

In the second scenario, increased public financial support is provided for poor university students currently eligible for NSFAS—but covering accommodation and food in addition to tuition—and to students in some income brackets currently not entering university despite being eligible. This would increase the number of university students by about 85,000 in 2018 (from 985,000 currently), for an additional cost to the public sector of close to 0.5 percent of GDP each year. Such an amount would finance higher demand for education services and other goods and services through transfers to the poorest students.

The simulations suggest that these measures would have a considerable impact on poverty and inequality by 2030. Although the interventions would help address the skills constraint and thus support growth, the cost associated with the simulated programs would subtract from growth (as education spending reduces public investment in the scenario). Thus, growth would be lower than at the baseline, but social outcomes would be significantly better—although the CGE model does not capture potential positive benefits from reducing social vulnerability associated with better education and lower poverty and inequality.

Scenario EDU1, EDU2, EDU3: Improve education				**Additional jobs compared to 2017 (million)**	
	World Bank poverty rate ($1.90)	**Gini coefficient**	**Real GDP index**	**Unskilled/ semiskilled jobs**	**Skilled jobs**
2017	18.6	62.8	100.0		
Baseline	12.7	59.5	117.8	2.19	0.57
Scenario EDU1	11.7	59.1	119.5	2.30	0.57
Scenario EDU2	12.0	58.7	119.1	2.25	0.58
Scenario EDU3	8.5	58.0	118.9	2.29	0.59

Combining both education interventions in scenario EDU3 reduces poverty from 12.8 percent at the baseline to 8.5 percent by 2030, and inequality from 59.5 to 58. These are the strongest impacts simulated in the CGE framework for this SCD, beyond more explicit redistribution measures such as a subsidized pension. The education interventions also support considerable job growth for skilled labor—as expected—but also unskilled labor by relaxing the skills constraint and raising labor demand overall.

Health

Despite relatively high expenditure on the health sector, the country suffers from a high burden of preventable illness and premature death:[16] South Africa spends more than 8.5 percent of GDP on health, more than 2 percentage points higher than the low- and middle-income country average. Over the past two decades, some significant improvements have occurred in maternal and child health[17] and reducing the HIV burden. However, health indicators remain poor when compared with other countries at similar levels of development. Life expectancy is lower than average for lower-middle-income countries (62 years compared with 70 years). Since 1990, South Africa has fallen in rankings across the board in comparison to other BRICS countries.[18] Higher-middle-income countries, such as Mexico, Chile, or China, without a heavy HIV/AIDS burden, and which spend a comparable amount on health per capita (about $600 per capita), have achieved much better health outcomes, pointing to inefficiencies in South Africa's health system that need to be addressed (see also Chapter 4). A lack of competition among care providers in the private sector results in high costs,[19] while the public sector has far fewer resources available per patient. Poor health outcomes hinder participation in the labor market (CGE 3.2): not being treated for HIV/AIDS reduces labor force participation by about 10 percentage points.[20]

South Africa is affected by the "quadruple burden of disease": infectious diseases (particularly HIV/AIDS and TB); noncommunicable diseases; high maternal and child mortality; and trauma. As Table 3.2 shows, the leading cause of death in South Africa is TB, mostly associated with the HIV/AIDS epidemic, affecting more than 7.2 million South Africans. In addition, the 10 leading causes of death increasingly include noncommunicable illnesses that have traditionally been classified as diseases of affluence, such as diabetes, hypertension, and cardiovascular diseases. These diseases are increasingly affecting poor and disadvantaged groups because of changes in diet and lifestyle. Part of the high burden of disease and poor health outcomes is due to high exposure to risk factors, including violence, unsafe sex, unhealthy diet, and alcohol and tobacco consumption (6.3 percent of women and 30.4 percent of men smoke daily).

CGE 3.2: HIV treatment

Half of the HIV-infected working-age population (3.6 million people in 2017) does not receive antiretroviral treatments. This scenario simulates the progressive extension of antiretroviral treatments to 97.5 percent of the infected population by 2030, at the unit (net) cost of R2,800 per year. While producing positive health outcomes, macroeconomic and distributive impacts would nonetheless remain modest, with a net creation of 280,000 jobs by 2030 and a GDP only 0.7 percent higher than at the baseline. By 2030, poverty, the Gini coefficient, and the share of income accruing to the bottom 40 percent would remain largely unchanged compared with the baseline scenario.

Scenario HIV: Extend HIV treatment				**Additional jobs compared to 2017 (million)**	
	World Bank poverty rate ($1.90)	**Gini coefficient**	**Real GDP index**	**Unskilled/ semiskilled jobs**	**Skilled jobs**
2017	18.6	62.8	100.0	-	-
2030: Baseline	12.7	59.5	119.5	2.26	0.56
2030: Scenario	12.7	59.5	120.3	2.53	0.58

Table 3.2: Leading underlying natural causes of death, 2013–2015

Causes of death	2013			2014			2015		
	Rank	Number	%	Rank	Number	%	Rank	Number	%
TB	1	41,904	8.8	1	39,495	8.3	1	33,063	7.2
Diabetes mellitus	5	23,133	4.9	3	23,966	5.0	2	25,070	5.4
Cerebrovascular diseases	4	23,158	4.9	2	24,131	5.1	3	22,879	5.0
Other forms of heart disease	6	22,189	4.7	4	22,928	4.8	4	22,215	4.8
HIV	3	23,825	5.0	6	22,729	4.8	5	21,926	4.8
Influenza and pneumonia	2	24,345	5.1	5	22,813	4.8	6	20,570	4.5
Hypertensive diseases	7	17,104	3.6	7	18,319	3.9	7	19,443	4.2
Other viral diseases	9	14,104	3.0	9	14,508	3.1	8	16,097	3.5
Chronic lower respiratory diseases	10	12,384	2.6	10	12,690	2.7	9	12,667	2.8
Ischemic heart diseases	–	–	–	–	–	–	10	12,239	2.7
Intestinal infectious diseases	8	16,163	3.4	8	14,795	3.1	–	–	–
Other natural causes		207,523	43.6		207,593	43.7		202,840	44.1
Non-natural causes		49,681	10.4		50,692	10.7		51,227	11.1
All causes		475,510	100		474,659	100		460,236	100

Source: StatsSA, 2017; causes of death based on International Classification of Disease 10.

As in education, socioeconomic status is a predictor of health outcomes, and income inequality is mirrored in health outcomes. Inequalities in health status start before birth and are carried through to the early years. Stunting rates are high. Some of the inequalities are a legacy of the apartheid era: for example, in 2005 infant mortality rates ranged from 18/1,000 live births for white children to 74/1,000 for black children. However, health inequalities are increasingly associated more with socioeconomic status, area of residence, and level of education, rather than simply race. For example, infant mortality rates are estimated at 27/1,000 in the Western Cape and 70/1,000 in the Eastern Cape.[21] Limpopo Province, the Eastern Cape, and North West Province, the poorest provinces, are those with the worst health outcomes.

Poor health outcomes are disproportionally concentrated among the poor. Stunting and poor health compromise children's ability to learn and impair their earning potential throughout their lives, affecting the poor disproportionately. Stunting affects children throughout their lives: early years interventions for children are thus critical, as argued above. More generally, poor health outcomes are concentrated among the poor: they are disproportionately affected by HIV/AIDS, TB, and maternal mortality, and are increasingly affected by noncommunicable diseases. For example, the prevalence of high blood pressure, one of the main risk factors for cardiovascular diseases, is 75.8 percent among women with no education and 37 percent among women with a secondary and tertiary degree.[22] A disease that can be classified as almost exclusively affecting the poor is TB, which is currently the leading cause of death in South Africa. One 2011 study estimates that the bottom 40 percent of the population bears 65 percent of the TB disease burden compared with 17 percent for the top 40 percent.[23] Close living conditions, particularly in informal settlements, and long waiting times at primary care clinics contribute to high risk of exposure to TB. Several studies conducted in South Africa reported that high levels of community income inequality were independently associated with increased prevalence of TB.[24] Health is therefore an important issue in spatial planning.

Prevention is key. For many diseases, prevention trumps treatment. In the case of smoking and obesity, raising the cost of tobacco and sugar should reduce the prevalence of health conditions associated with these risk factors, such as cancer and cardiovascular diseases. Higher tobacco taxes and the sugar tax South Africa intends to introduce will likely have positive health effects. Other major diseases have social characteristics that make them a symptom of vulnerability. For example, the incidence of HIV/AIDS is higher among women. This reflects, among other social characteristics, high levels of gender-based violence, including rape, and financial vulnerability (Chapter 1 showed that "blesser-blessee" relationships have been linked to the spread of HIV).[25] Additionally, in some cities HIV is highest among gay and bisexual men, reflecting the exclusion that LGBTI people, and people perceived to be transgressing sexual and gender norms, still face.[26] TB, on the other hand, is linked to poor nutrition and living in dense settlements with poorer sanitary conditions. In both cases, measures that raise the resilience of South Africans by providing them with better economic opportunity, education, and social services are key to reducing the burden on the poor and society as a whole. Additional measures to control the spread of TB include targeting high-risk communities, such as miners and prisoners. TB is an easily curable disease in principle, but a relatively poor public health system results in long delays and interruption in treatment (leading to multidrug-resistant TB, which is much more costly and difficult to treat).

Poor health outcomes are also explained by health services' inability to effectively prevent and treat diseases. **South Africa's two-tiered health system creates separate services for the rich and poor.** International experience shows that effective health services can decisively contribute to improvements in health. The impact of medical care on overall health outcomes is between 44 percent and 57 percent.[27] Disparities and inequality are entrenched in South Africa's historically separate access to health services (Chapter 1). Providing quality health care is one of the top 10 priorities in the NDP. The discourse on health care has mostly concentrated on the disparities between the public and private sectors, whereby the public perceives care from the latter to be of superior quality. The public health system caters to the health care needs of 84 percent of the total population, accounting for 48.2 percent of South Africa's total health expenditure. Primary health care is free for all at the point of care regardless of income, and patients with South African citizenship are eligible to receive free hospital care at the point of service, subject to them satisfying means-test criteria contained in the Uniform Patient Fee Schedule. Although services are "free," patients are frequently told medicines are unavailable or are subject to long waiting times to receive essential care. The private sector, on the other hand, covers about 16 percent of the population, accounting for 51.8 percent of total health expenditure, thus highlighting the inequality in spending and service for rich and poor. It is too expensive for most poor households. Much higher spending on private health services than public services is a major reason for differences in health outcomes.

Inefficiencies in the public health system compound low levels of funding, but they are difficult to redress. The fragmentation of public health care delivery between the national and provincial level is a key source of inefficiency. Another is that the South African public health system is "hospital-centric," with the population accessing hospitals for basic care that could easily be obtained at clinics and community health centers.[28] Hospitals rather than effective preventive and curative primary care dominate care in South Africa. Primary care is underdeveloped and systematically underfunded.[29] Limited services and operating hours limit primary care units. Patients generally bypass primary care and go directly to a hospital whenever they get sick.[30] Yet given the high fixed costs associated with hospital infrastructure, hospitals are more expensive than primary care units. One factor that may explain hospital-centricity is that an efficient primary care system is complex and requires efficient management of individual care units. Given South Africa's skills constraint, the lack of capacity and investment in primary care can be seen as a root cause for the dominance of hospitals. Another reason could be that the public sector has mirrored the delivery structure of the private sector, which is also hospital-dominated. Thus, some shortfalls in South Africa's health care system are, ultimately, a consequence of its financing architecture and the skills constraint. To some extent, skilled migration of medical professionals could reduce this constraint, although there is empirical evidence that better financial prospects abroad and crime at home result in the outmigration of South African doctors.[31]

A national health insurance (NHI) system is intended to improve health care holistically. While the system is a good proposal in principle, it will be difficult to implement. Progress in health and reforms in the health sector are likely to remain incremental. The NHI would combine public and private health resources to create a unified system of health delivery in South Africa. While overcoming the two-tiered nature of the system is desirable, opposition from the private health system is likely because of fear of an overall deterioration of health services, at least in the short term—with uncertainty over the long term. To make a unified health system more palatable to the powerful constituency of South Africa's middle class, demonstrated progress in the public health system will be vital. This will be difficult: given a tight public budget, there are limits to higher resource allocation, and capacity constraints hinder strengthening the quality of primary care. Some progress can be made in the prevention of diseases. Overall, however, health outcomes are likely to converge at the pace of South Africa's transition, as poverty-related illnesses, high exposure to risk factors and violence, as well as high density living and poor sanitation, thwart improvements in health for the poor. Major investments in skills development, to increase the number of doctors and nurses, would create a foundation for high-capacity, more efficient health delivery systems, including at the primary care level. Environmental effects are important and need to be taken into account in South Africa's spatial planning—adequate housing with proper sanitation, for example, is one way of reducing TB.

Housing and transport policy

Much progress has been made to realize the right to decent shelter enshrined in South Africa's Constitution. Locating the poor closer to economic centers and improving mobility is critical to allow them to access jobs. Today, many South Africans, including the poorest 40 percent, own houses. However, housing backlogs remain (2 million as of 2016), the gap/affordable housing market is widening, the number of informal settlements has increased, and 5.1 million people (about 10 percent of the population) still live in shacks. Moreover, human settlements programs, often focused on delivering housing units, have unintentionally perpetuated apartheid spatial patterns—leaving the poor on the periphery of urban areas with fewer economic opportunities. The poor remain concentrated in either older townships or newer publicly provided housing developments, often on the urban periphery, where land is cheaper. The single-story home model originally espoused by the RDP, with low-density land use patterns, propels urban sprawl and does not encourage mixed land use (for example, for job-generating commercial activity). It also adds to the cost of transport and commuting time: the average commuter distance in South African metros is 22–27 kilometers.[32] This means poor South Africans have long travel times and high transportation costs. This is partly because commuting travel patterns are predominantly unidirectional and have poor seat turnover, making public transport inefficient. Long and expensive commutes make it more difficult for the poor to access urban jobs and raise their reservation wage, that is, the wage that makes it worthwhile to work given the associated costs. Estimates suggest that those who commute spend as much as 40 percent of their gross earnings on transport.[33]

Overcoming the spatial legacy of apartheid through more inclusive urban planning can lower living costs of the poor and allow them to access jobs. To achieve this, policy needs to effectively engage with the housing market, not replace it. For example, in certain cases scaling up informal settlements instead of building new developments could reflect market responses and locational preferences of those households who opted to be closer to jobs. Upgrading services and connecting households with opportunities for home improvements is an important rung on the housing ladder that needs to be strengthened. Supporting rental housing, particularly by encouraging private landlords to invest in rental dwellings (including backyard rental) or room rentals through home improvement grants or lending from microfinance institutions, is another alternative. Demand-side rental vouchers could be used as an additional instrument to support low-income households in paying for better-quality private rental housing in a neighborhood of their choice. Such demand-side subsidy schemes are more targeted, transparent, and effective in enabling housing choice and upward mobility, provided that they trigger a response in the supply market. Improving housing transactions will allow South Africans to relocate for jobs. This requires that the eight-year period before transferring ownership of social houses be scrapped and deeds issued faster. Finally, raising property taxes would create incentives to densify by effectively raising the cost of consuming housing services—which increase with the size of the property.

Enhancing coordination between housing policy and transportation at the metropolitan level is important for achieving a more efficient spatial structure. Initiatives such as the Urban Networks Strategy, which stresses coordination between urban transport and housing investments, and the Built Environment Performance Plan, which each municipality produces to ensure various streams of funding are aligned toward a common goal of spatial transformation, are already in place. However, full implementation may take time to realize because of the fragmented planning of transport and human settlements. Spatial policy needs to become more strategic to optimize trip patterns, ensuring that more job-generating land uses locate to residential areas, and vice versa. This will include reviewing housing subsidies to make them spatially neutral and strategic, introducing density bonuses in subsidy schemes for residential homes and businesses, particularly around transport hubs and corridors. Citywide mobility and accessibility planning must integrate the different modes of transport into a single network that collectively responds to passenger needs and supports the poor, while making greater use of technological solutions. More broadly, greater coordination across sectoral departments and spheres of government will be important for more strategic and more integrated housing, transportation, and infrastructure policies and implementation.

Fiscal instruments should be used to incentivize sustainable travel and promote changes in spatial distribution and travel patterns. Formal public transport, including the new generation of integrated rapid public transport networks, depends on high levels of subsidization and lacks adequate incentives to provide affordable and good-quality services. All cities, along with the Passenger Rail Agency of South Africa, have had significant operating deficits that have placed a strain on national and local finances. The minibus taxi industry does not receive subsidies (beyond a scrapping allowance), but this does not seem to be the key constraint to expanding efficient and affordable access to this service, given the high profits of minibus taxi providers. While it experienced significant growth in users, it still needs to improve its level of service and integration with other modes of transport and address the potential negative impacts it generates: congestion, traffic-related accidents, greenhouse gases, and local pollutant emissions.

Minibus taxis are the main mode of transport for the poor. Affordability is a constraint.[34] Most poor South Africans can access some form of transport: only 7.5 percent of poor households report no access to buses, trains, or taxis.[35] Access tends to be worse in rural areas. Across South Africa, 13 percent of the poor have access to a train service, about 50 percent to public buses, and more than 90 percent to minibus taxis. Taxis are within 10 to 30 minutes' walking distance. However, relying on taxis for commuting is comparable in cost to commuting in a small car, demonstrating that despite good coverage, taxis are expensive. Provincial authorities provide taxi permits for existing routes to taxi associations that then distribute them among their members, and local authorities decide on new routes with inputs from associations. This means that associations ultimately control who enters the markets and on which routes, thus limiting entry and expansion into new routes. These associations also set the price among their members, eliminating competition on prices and raising costs for commuters—this is reflected in the healthy profits of minibus taxis. Moreover, the sector's support plan (in the form of a taxi scrapping allowance) provides an advantage to current taxi owners, hindering new entry. There are also inefficiencies in the system, for example, taxis only leave when they are full, meaning that in some cases passengers must travel to the start of a route and then wait for a taxi there.

New approaches to transport options are necessary, including a focus on integrating the minibus taxi sector within the wider network. Innovative business models that are flexible and respond to users' needs while minimizing negative impacts on the environment are needed. These models should be implemented in the context of bottom-up city-level planning, city ownership, and gradual and flexible approaches. They should be enabled by new and cost-efficient technologies that include a better understanding of the minibus taxi sector, commuter rail, and bus services funded with public transport operating grants and of how these forms of transport can be enhanced and integrated into citywide approaches. Technology-based solutions could improve route efficiency, allowing taxis to pick up passengers along the way, and make taxis safer. Fatality rates in taxis are 60 times higher than the overall fatality rate per kilometer driven in the United Kingdom and 40 times higher than the United States.[36]

CGE 3.3: Accelerating spatial integration

In policy scenario SPA1, 1 percent of GDP is invested every year from 2018 into collective transportation systems (mostly consumed by the poorest seven deciles) and publicly provided housing to reduce their price, which would be financed through domestic borrowing. This would modestly increase GDP by 2030 (+0.6 percent), reflecting the positive benefits that cheaper transport and housing prices would have on labor supply. Efforts to foster spatial integration would reduce the poverty rate by 2030 (at 12.0 percent, against 12.7 percent at the baseline), under the combined effects of cheaper consumption (to a large extent) and higher labor opportunities (to a much lower extent, given the modest impact of transport and housing prices on real wages, combined with the low elasticity of labor supply to real wages), and a decline in the Gini coefficient (to 58.6 by 2030). Compared with the poorest households, the fourth to seventh deciles would be the main beneficiaries, as they spend a higher share of their income on housing and transport and receive a larger share of labor incomes. Nonetheless, the share of incomes accruing to the bottom 40 percent would rise by 0.3 percentage points.

Scenario SPA1: Accelerated spatial integration				**Additional jobs compared to 2017 (million)**	
	World Bank poverty rate ($1.90)	**Gini coefficient**	**Real GDP index**	**Unskilled/ semiskilled jobs**	**Skilled jobs**
2017	18.6	62.8	100.0	-	-
2030: Baseline	12.7	59.5	119.5	2.26	0.56
2030: Scenario	12.0	58.6	120.2	2.29	0.56

Whether to bring people to jobs or jobs to people remains a subject of contention in South Africa. Cities tend to be engines of growth. Yet South Africa's peculiar spatial history has resulted in large settlements without much economic activity or notable agglomeration economies, namely townships. There is therefore significant interest in exploring whether economic activity and jobs can be brought to townships, rather than relying on migration or commuting to urban hubs.[37] As Chapter 1 explained, South Africa has a long history of trying to tap "labor reservoirs," townships, and the former homelands for industry. Experiments with industrial parks during apartheid were largely unsuccessful. The impact of special economic zones in democratic South Africa on local job creation has yet to be more thoroughly evaluated, although there is some evidence that such zones tend to work better near cities—because of the need to connect to service sectors[38]—and in a growing economy, when capital flows toward new opportunities. They may work less well and are more costly in remote areas. Migration to cities and towns is likely to continue. Opportunities in rural areas include agriculture and agribusiness, mining, and tourism, while public administration is likely to remain a major formal employer.

Active labor market policies

Active labor market policies are designed to raise the employability of young people, which is critical given South Africa's high youth unemployment. Especially in an environment of weak economic growth, employers keep experienced staff and have little demand for hiring more—which especially affects new labor market entrants. Youth labor participation is further complicated by the complex transition from school to work that is due to a lack of information about job availability and skills in demand, and inadequacy of preparation for work because of an absence of a working adult where these young people reside.[39] If the situation is left unchanged, ineffective interventions will result in unproductive and dependent adults who later become dependent elderly on the social protection system. The challenge is to introduce youth to a job to learn: a first job facilitates a young person's chances in the labor market. Active labor market policies are designed to help address this.

Active labor market policies are measures for productivity, improvement of skill sets, and increases in employability and earning potential for low-skilled individuals.[40] They have had relative success around the world, although context matters.[41] Interventions include training and skills development; entrepreneurship promotion; employment services; and subsidized employment interventions. Since youth can face different constraints that affect access to wage employment or self-employment, these constraints can be addressed through targeted interventions. How these programs are implemented is critical because of the heavy reliance on them to solve unemployment. The government has a multidimensional approach to youth unemployment that includes programs stimulating job creation (employment tax incentive, National Youth Development Fund, Jobs Fund), programs strengthening employability, and programs improving intermediation and information (Harambee, labor centers). The EPWP also aims to provide vital first work experiences, although it is unclear whether this raises job prospects.[42] The impact of some interventions is unknown, as few programs have been thoroughly evaluated, and evidence is mixed. For example, the employment tax incentive appears to positively affect youth employment.[43] A key feature of South African active labor market support is fragmentation between departments, the three spheres of government, and business. There are, however, some successful collaborations between the private and public sector such as the Yes4Youth initiative, which aims to create 1 million jobs for young people (see Chapter 4). Increasingly, countries are looking at integrated approaches to solving youth employment challenges, and below are some of the best practices South Africa can consider.

Labor costs

Labor costs exclude workers by making it less attractive to hire them. Hiring and firing rules and employer-borne labor costs are not unusually restrictive in South Africa, although labor arbitration could be improved.[44] South African labor regulations are fairly benign in terms of nonwage labor costs and firing costs, compared with other middle-income countries. Hiring regulations are somewhat rigid, which may be a particular problem for young people, according to the NDP. There is a perception, however, that labor markets are overly rigid; dismissal processes likely contribute to this perception. Labor disputes are settled by the Commission for Conciliation, Mediation, and Arbitration, or, at later stages, by labor courts. The commission is efficient, but can tie employers up in a drawn-out legal process, making it more difficult to dismiss nonperforming workers. There is also evidence of gross misconduct by employers that results in a relatively high case load for the Commission for Conciliation, Mediation, and Arbitration. Labor courts, on the other hand, are inefficient, again making labor markets more rigid. Improving the functioning of the labor arbitration system would help make the South African labor market less rigid.

Tightening legislation on temporary employment services (labor brokers) may have reduced job growth for unskilled and semiskilled workers. Labor brokers are third-party companies providing workers to formal-sector firms across various occupations, such as contract cleaning services, accounting and secretarial services, and security services. Between 2000 and 2016, job growth in temporary employment services grew five times faster than the overall service sector. Labor brokers are attractive to employers because any dismissals (and associated costs) are borne by the brokers, the jobs are compatible with BBBEE points, and labor brokers internalize screening costs for new employees. Since 2015, however, a temporary employment services employee working in a company for three months or more has to be offered a permanent contract, making these services less attractive to employers. Evidence suggests that this has reduced job growth, especially for unskilled and semiskilled South Africans.[45]

3.3. Contestability of labor markets

Unions and minimum wages can raise the costs of wages for some workers, while excluding others from the labor market. South Africa has a complex system of wage bargaining.[46] In certain low-wage sectors, where union membership is low and the majority of workers are unrepresented, the Minister of Labour sets specific minimum wage levels, called sectoral determination. From 2018, this system will be updated by the introduction of the national minimum wage, which explicitly introduces a single, national wage floor. Second, for a relatively large proportion of the labor force outside the sector-determined system, wages are determined through a bargaining process between employer and employee representatives, mostly trade unions. They can operate within a formal bargaining council structure or an independent negotiating structure, and wages agreed can be extended nationally by the Minister of Labour. Raising wages above increases in labor productivity makes labor more costly. To an extent, employers then substitute labor for capital—or produce less. Both mean that relatively fewer employees will be hired. The national minimum wage may result in employment losses, although further empirical research is needed to evaluate this.[47] Evidence on the impact of union-negotiated wages is mixed, ranging from statistically negligible wage differences between union and nonunion members to job losses between 8 percent and 13 percent, mainly among smaller firms.[48] South Africa ranks low on global indices for flexibility of wage determination as well as on cooperation between employers and their workers.[49] The wage bargaining system is arguably the main rigidity in South Africa's labor market.

Low contestability in the labor market can amplify low contestability in the product market. Existing firms may support unionization and sectoral wage determination to deter entry or push existing competitors out of the market—particularly smaller ones—further exacerbating the job problem by reducing demand for labor.[50] For example, incumbents may have incentives to raise sectoral wages, which strengthens the bargaining position of unions relative to entrants and discourages entry. Minimum wages can reduce the incentives of new firms to enter by raising their costs. Such strategies to deter entrants by raising their costs are more likely to succeed when potential rivals are relatively more labor intensive. Since small and midsize enterprises tend to be more (lower-skill-) labor intensive (partly as a result of their limited access to finance, and consequently lower ability to invest in capital), this deterrence of labor-intensive firms may particularly discourage their entry, while also encouraging capital-intensive means of production, further constraining job opportunities. This is particularly relevant as not all employers are represented in South Africa's bargaining councils, which are dominated by large employers.[51] Critics of the collective bargaining system have argued that the system places a particular burden on small firms (either because these firms tend to be more labor intensive or less productive than their larger counterparts), increases business failures, and discourages start-ups, therefore contributing to South Africa's high unemployment rate.[52]

Accordingly, the impact of product market reform can depend on the labor-market setting. Some international empirical evidence suggests that employment gains from reducing the restrictiveness of product-market deregulation are larger in situations where unions have strong bargaining power.[53] This is because the higher unions' bargaining power, the further away the economy is likely to be from full employment, and thus the greater the employment response will be to a decrease in prices in the economy. Thus, given the power of South African unions, ensuring that product-market regulations do not restrict competition could be particularly important for driving employment in South Africa. Greater competition in South Africa will entail lower rents for organized business and labor, and will thus be, as stated in the NDP, "to the chagrin of existing players." It will benefit society as a whole, especially the excluded, through job creation and budgets that stretch further.

3.4. Contestability of product markets

Competition and industrial policy

Contestability in product markets is important for new firms to enter and compete with each other to offer the best prices for consumers. In South Africa, government intervention undermines contestability, according to OECD indicators. Product market regulations indicators,[54] which determine the degree to which regulations restrict competition, show that South Africa broadly performs on par with peer countries. State control is the area in which South Africa performs most poorly in relation to comparators. It includes aspects such as the scope of SOE involvement in the economy, direct government control of enterprises, price controls, and the use of command and control regulations, followed by barriers to entrepreneurship (see further below on the business climate). Governance of SOEs and government involvement in network sectors and the scope of SOEs imply high state control, reinforcing that it is not simply the number of SOEs present that influences the anticompetitive effect of state involvement in markets but also the provisions relating to the governance of such firms to minimize the distortions in the playing field between public and private sectors.[55] Several of the country's key network industries remain either wholly or substantially under state control, including air transport, energy, telecommunications, and postal services. The product market regulations indicators show that at the sector level, South Africa's energy, transport, and communications regulations are relatively restrictive of competition when compared with peers (particularly the rail, airlines, and electricity sectors), although the level of restrictiveness has fallen since 2008 (the previous available data point). Strengthening competition in South Africa would have a significant impact on growth, and on reducing poverty and inequality (CGE 3.4).

CGE 3.4: Intensifying competition

Competition issues in South Africa are reflected in the large dispersion of rates of return to capital across sectors, with some exhibiting very high markups. Substantial market power in these sectors is likely to result in suppressed demand for capital and labor, low total factor productivity keeping poorly competitive firms in business, and reduced price-competitiveness for sectors that use as inputs the inflated goods and services produced in concentrated sectors. Markups above normal profits (excluding rents from extractive industries) are estimated to amount to close to 10 percent of GDP in South Africa. In scenario MKP1, markup rates would be progressively halved by 2030. In this scenario, investments pick up (+10.0 percent in 2030 compared with the baseline) in line with the new investment opportunities, as do exports (+9.1 percent) with increased competitiveness, resulting in the creation of an additional 405,000 jobs and higher real wages. Inequality would be reduced (as capital owners, mostly concentrated in the richest decile, would see their real disposable income grow less rapidly than poorer deciles), with a Gini coefficient at 58.8 by 2030. With cheaper goods and higher labor incomes, the poverty rate would also be reduced to 11.0 percent by 2030, lifting an additional 1.1 million people out of poverty. It is the highest-impact scenario for growth and job creation among scenarios in this SCD.

Scenario MKP1: Intensify competition				Additional jobs compared to 2017 (million)	
	World Bank poverty rate ($1.90)	Gini coefficient	Real GDP index	Unskilled/ semiskilled jobs	Skilled jobs
2017	18.6	62.8	100.0	-	-
2030: Baseline	12.7	59.5	119.5	2.26	0.56
2030: Scenario	11.0	58.8	125.4	2.65	0.58

Key agricultural and manufacturing markets were historically tightly regulated and protected oligopolies or monopolies, sometimes under state control. After 1994, the government privatized several of its state-controlled enterprises or boards. However, without consistent complementary measures to open these markets to trade and competition, the structures of these markets, based on scale built over decades with government support and a high degree of vertical integration, remained (see Chapter 1). Moreover, the existence of previous anticompetitive regulation has helped facilitate a number of South Africa's cartels.[56] In the case of cement, for example, the industry was divided as a state-sanctioned cartel with price controls from the 1940s until 1996. After the disbandment of the legal cartel, firms continued to divide markets along the traditional lines. Other examples have been documented for bitumen (used for road surfacing and roofing) and fruit exports.[57]

A number of markets appear to have privately "reregulated" following deregulation—partly facilitated by the strong role industry associations play in South Africa, which in some cases is supported by sector regulation. In about a third of all nonconstruction cartel cases detected in South Africa between 2005 and 2015, an industry association was explicitly found to have facilitated a collusive agreement (25 out of 76 cases). In several of the cases, prices were fixed by the associations themselves. As a result, associations need to be managed in a way that minimizes their distortive effect on the market. For example, mandatory membership and information provisions in sector regulation could be reviewed, and associations that comprise incumbents should not be involved in making registration or licensing decisions for new entrants.

The effects of state support for firms persist in sectors without pro-competition regulation. The most well-known examples of private firms that inherited their dominant market positions from former state-owned enterprises are ArcelorMittal South Africa, in the steel sector, and Sasol, an integrated chemicals and energy company that is present across several markets, including vehicle fuels, jet fuel, low- and high-value chemicals (including fertilizers, explosives, wax, and polymers), low-carbon electricity, gas to power, and gas pipelines.[58] These firms are prominent in South Africa's heavy industries and provide inputs for the country's automotive, construction, and agricultural sectors. These are industries that tend to be naturally concentrated, since they display high economies of scale—but in South Africa this has been exacerbated by decades of state support and an entrenched position in the market. Nevertheless, the scale of these industries can still provide South Africa with a cost advantage. The questions to consider are how it can be harnessed and how firms can be encouraged to compete and innovate. This points in part to the need for strong (ex-post) competition enforcement.

The government mainly uses competition law to control the exercise of market power by these firms to encourage efficiencies to be passed on to consumers, but some protections of their positions remain in place. Findings of cartelistic behavior have been made against such firms (for example, in the fertilizer, gas, bitumen, plastics polymers, steel, and scrap metal markets) and in some cases structural remedies have been used to curb their ability to abuse their market power. The Competition Commission of South Africa has had mixed success with using "abuse of dominance" provisions in competition law to discourage excessive pricing by dominant firms, including through import parity pricing practices.[59] Paradoxically, various government interventions remain in place that protect such players—including, for example, protectionist tariffs in the steel sector, and a lack of mandatory third-party access to Sasol's monopoly gas distribution network makes it difficult for new entrants in the gas-trading market. Sasol's manufacturing rivals claim that its vertical integration into manufacturing puts them at a disadvantage since Sasol has more favorable access to energy.

South Africa's industrial policy includes numerous incentives for enterprises. Intended to foster investment and jobs, they often have unintended consequences, undermining their effectiveness. Taking into account concessional loans, in-kind support such as staff training or business development services, and various types of support for social causes, this SCD identified 92 active incentive schemes.[60] World Bank research has shown that South Africa's tax incentives have positive impacts on both investment and jobs in agriculture, construction, manufacturing, trade, and other services.[61] Job multipliers tend to be large in these sectors, further reducing the fiscal cost per worker. In these sectors, industrial policy thus appears to contribute to job creation. This does not, however, take into account general equilibrium effects outlined in Chapter 2: industrial policy may encourage investment to go to relatively unproductive sectors, which would hurt overall productivity. A second source of unintended consequences is the impact industrial policy schemes can have on competition.

The industrial incentive schemes could benefit from considering their potential effect on market dynamics in their design and granting procedures.[62] A number of them have characteristics that may distort the market. First, even under a lenient definition of transparency, 64 percent of reviewed schemes were found to be nontransparent, in that eligibility criteria, contact details, and approval forms/procedures were not published online.[63] In no case was a list of recipients of the scheme publicly available. Of the 92 schemes, 18 percent included an element or elements of discretion (where eligibility criteria allow room for interpretation by the granting authority or where an individual has the ability to make a final decision). Finally, almost half of the schemes were found to have an element of discrimination, such as those based on size, timing of investment, and location. While in many cases some form of discrimination will be necessary for the scheme to achieve its objectives, it is important for agencies to understand cases where discrimination is not essential to the scheme and ensure any potential costs are justified by the benefits. Discretionary practices apply particularly to grants, with 40 percent having an element of discretion. For example, grants under the Black Industrialist Scheme, which targets majority black-owned firms, can be awarded to other firms if the Department of Trade and Industry deems the investment to be "strategic,"[64] although "strategic" is not clearly defined. Some flexibility in award criteria could be desirable to allow schemes to respond to South Africa's needs, but they may need to be further clarified to ensure consistent application of incentives.[65] Given the lack of transparency of incentive schemes, navigating the incentive landscape in South Africa is complex and may favor large incumbent firms.[66]

The complexity of tax incentives and the associated costs might explain the low take-up of incentive schemes. For example, only 1.5 percent of the over 172,000 firms surveyed in 2016 had taken up the government's learnership incentive between 2009 and 2014.[67] Furthermore, only 1.7 percent and 2.1 percent of firms made use of research and development incentives and depreciation allowances, respectively. For 2010, 2011, and 2012, the study found that only 0.03 percent, 0.04 percent, and 0.12 percent of firms took up four available tax incentives, respectively.[68] It also shows that larger firms tend to take up the research and development and learnership incentives. The difficulty of navigating South Africa's various incentives makes it difficult to overcome exclusion, especially of smaller firms. It is a reflection of a business climate that is not always conducive to the private sector, especially SMMEs. It also presents missed opportunities: for example, the low take-up of research and development incentives unnecessarily limits the innovation potential of South African businesses.[69]

Business climate

South Africa's business climate has been deteriorating, but progress is being made in easing doing business regulations, including those that prevent immigration of skilled workers. Policy uncertainty is perhaps the biggest deterrent to investment. Other sources are crime and violence and favoritism of government officials.[70] South Africa's regulatory environment has been slipping too: although still among the best performers in Africa, South Africa has been sliding in the World Bank Doing Business ranking, from 29th in 2007 to 82nd in 2017. Resolving insolvency, enforcing contracts, trading across borders, and registering property are the lowest-ranked indicators. Slipping performance is partly due to other countries reforming faster than South Africa. In recognition of this, the Department of Trade and Industry has been stepping up efforts to reduce the regulatory burden, such as through the one-stop shop InvestSA. The government is also committed to cutting red tape. Progress has been made to ease the restrictive visa regulations for tourists and skilled workers.[71] The NDP recognizes the potential of well-managed skilled migration and the Department of Home Affairs is making changes to the 1999 International Migration Policy. Key recommendations in the 2017 White Paper on International Migration include introducing a points-based system to determine the eligibility criteria for long-term residence visas, using a long-term residence visa to attract investors and skilled migrants, granting critical skills and business visas that cater for family members, allowing international students who graduate in critical skills occupations to apply for a long-term residence visa, and introducing a differentiated skills transfer mechanism to cater for different working conditions.

Although the government has developed a strong support system for entrepreneurs, small firms struggle to take off in South Africa. The NDP identifies small firms as the country's main job creators. Yet recent South African tax data suggests otherwise. Although it is true that most South African firms are small and account for most jobs, net job creation happens in larger and foreign firms.[72] Older firms—which tend to be larger—are more productive.[73] They have established markets and are sufficiently productive to export, and they tend to invest more in research and development. Similarly, foreign firms tend to be more productive as they link into global value chains. Therefore, it is not surprising that those firms are the ones that created the most private formal sector jobs between 2009 and 2015. Small firms are still important for South Africa, and their employment growth tends to be linked to overall changes in aggregate demand—not least because many smaller firms are active in trade, including in the informal sector. South Africa supports small firms through business incubators, "gazelles" programs, the Small Enterprise Development Agency, and the Small Enterprise Finance Agency. These programs make notably strong provisions to empower women.[74]

Public support programs are relatively fragmented, however, and do not appear to have a significant impact on creating new firms—and international evidence suggests that it is new firms that may grow fast and create jobs. Skills are a key constraint for smaller and newer firms: skilled South Africans tend to prefer to work in a larger company, presumably because of higher job security and better career and learning prospects. Linking large and small firms to benefit from each other holds potential (as explained in Box 3.1) for training and supplier development. There is also scope to further strengthen support for innovation at the city level by bringing together the network of fragmented initiatives already in place, and encouraging research and innovation facilities to cluster together to create "innovation districts" that bring more global recognition and capitalize on existing strengths.

Slow transformation is a symptom of South Africa's incomplete transition. Whether BBBEE is an effective policy for transformation needs to be evaluated. For one, there is uncertainty over the extent to which historically disadvantaged South Africans hold capital already. For example, set-asides in public procurement are intended to support historically disadvantaged South Africans. However, a lack of sunset clauses means that these firms may never achieve competitive levels to compete outside of government procurement. They will thus remain dependent on government at the expense of the taxpayer. Another example is that institutional investors are not counted toward BBBEE requirements. The requirements exclude pensions, most of which are held by historically disadvantaged South Africans. As such investments do not count toward empowerment targets, BBBEE remains relatively narrow in spite of attempts to make it broad-based. And the lack of eligible BBBEE investors makes it difficult for investors to expand their operations, including new and nonlisted investors, such as in the Renewable Energy Independent Power Producer Procurement Programme.

Second, BBBEE incentives to procure from empowered firms can result in inefficiencies across the value chain if relevant firms supplying the required inputs do not exist. This means one of two things. The first possibility is that imports are discouraged—including the high-technology capital goods that South Africa cannot produce itself at present but that would allow domestic companies to become more competitive or produce higher value-added goods. The second possibility is that it creates intermediaries who provide imported goods at a markup, thus making them more expensive. Finally, some firms, especially smaller ones, are unable to meet the training and supplier development requirements, making these requirements both ineffective and costly to firms. While investors are concerned about the costs imposed by BBBEE, from the impact it has on property rights to the availability of competitively priced inputs to the availability of skilled managers to meet BBBEE employment targets, BBBEE has not recently been evaluated.[75] Such evaluation is critical to ensure the right balance between empowerment through BBBEE and job creation through investment.

While procurement tools are the most prominent levers in the government's BBBEE-linked industrial policy efforts, BBBEE conditions on licensing, concession, and authorization requirements have also been used. These schemes raise the cost for some firms to compete (particularly foreign and large firms) and may exclude some firms altogether. It is thus particularly important to ensure that the schemes are designed to minimize distortions and that their impact is monitored. Regarding market entry requirements, proposed amendments to the BBBEE Act of 2003 stipulate that BBBEE requirements must be taken into account in the qualifying criteria for issuing licenses, concessions, and other authorizations.[76] This could affect, for example, the issuing of water licenses, import and export licenses, mining licenses, and liquor licenses.

The government's procurement policies may raise the cost of competing for some firms, particularly foreign ones. For example, under the government's National Industrial Participation Programme, suppliers of goods and services to the government with an imported content of at least $10 million must invest an equivalent of 30 percent of the imported portion of the purchase contract in a local economic activity that has the potential to contribute to the program's objectives. This raises the costs to firms of competing in the bidding market and potentially leads to an inefficient allocation of resources in the domestic economy. Indeed, a policy review of the program by the Department of Trade and Industry noted that "generating projects that were outside of the core business of companies" created issues. Moreover, under the Preferential Procurement Policy Framework Act, the Department of Trade and Industry is able to designate specific industries/sectors where only locally manufactured products that meet a stipulated minimum threshold for local content will be considered. There are 15 designated sectors, but the department has indicated that it will significantly scale up designations in support of domestic manufacturing. Although procurement policies favor local manufacturers, foreign firms are not precluded from bidding as long as they have an agent in South Africa that acts on their behalf. As a general practice, payment is made to the local agent, which may raise the costs of competing for foreign bidders.

Revised public procurement regulations launched in 2017[77] are intended to increase state support to small businesses, rural and township enterprises, and designated groups and promote local industrial development. Among other things, the proposed regulations stipulate that 30 percent of certain categories of state procurement must be set aside for SMMEs, cooperatives, and township-based or rural enterprises. State bodies also have some discretion to introduce prequalification criteria in their tenders based on, for example, restrictions to entities with a specified BBBEE status level; exempted microenterprises; or qualifying small businesses. Reducing the number of bidders present in public procurement tenders holds the additional risk of increasing collusion and reducing the number of bidders able to meet the time, cost, and quality requirements. Efforts are ongoing to combat bid rigging.[78] Since 1999, the Competition Commission of South Africa has found that major construction companies colluded to allocate projects and tenders on over 300 public and private projects. More cases, particularly involving small firms, continue to be uncovered, mainly lodged by government and municipalities. The supply chain management legislative framework is being reviewed. This will culminate in a single public procurement legislation addressing all the legislative and regulatory inefficiencies in the system. The Public Procurement Bill is being finalized and will fully establish the Office of the Chief Procurement Officer; it aims to ensure the supply chain management system is fair, equitable, transparent, competitive, and cost-effective. The bill aims to provide for an agile system of preference that will support socioeconomic transformation.[79]

Access to finance

SMMEs, especially in poor regions,[80] struggle to access finance and thus compete in South Africa's product markets. Chapter 2 showed that the increasing capital intensity of South Africa's economy is partly a response of firms to a lack of skills. Evidence suggests that South African employees prefer working for large firms. Although SMMEs are critical for labor market entrants, they are often only stepping stones to a better job in a larger company that offers more job security, better career prospects, and better benefits. SMMEs thus struggle to maintain skills. This makes it even more important for them to access finance for investments in productivity that allows them to compete. Yet while the market for formal credit is well developed in South Africa, only 45.4 percent of formal SMMEs and 7.9 percent of informal SMMEs have transactional accounts.[81] SMMEs also face higher interest rates than larger firms. Notably, limited access to finance and the high cost of credit also raise the cost of hedging for SMMEs,[82] excluding them from global markets given the highly volatile rand. To an extent, the riskiness of South African entrepreneurs is linked to the legacy of exclusion associated with low education levels, lack of assets or registered land that could serve as collateral, and exposure to theft and vandalism in the areas within which they operate (see Chapter 1). Yet there also appears to be a lack of experience (or interest, due to high costs associated with SMME finance) among established banks to serve the SMME market. Higher capital and liquidity requirements necessitated by Basel III are expected to further deter banks from targeting SMMEs.

A regulatory regime that seeks to decrease the barriers of entry to the sector while balancing prudential and regulatory compliance issues is needed to improve access to finance for SMMEs. The current regulatory framework for financial institutions offers licenses only for commercial banks, cooperatives, mutual banks, and nonbank credit providers. Full commercial bank licenses are required for deposit-taking institutions. Thus, microfinance institutions would need a full commercial bank license to take deposits. However, the minimum capital requirement of R250 million is too high for establishing an institution focused on SMME lending.[83] The cooperative model, on the other hand, is restrictive, as it requires that a common bond be established among its members, while the current regulatory framework for mutual banks limits lending to enterprises. As a result, a credit-only license—the same institutional structure used by payroll lenders—is the only viable option for microfinance institutions, making them dependent on being able to access wholesale funding. The introduction of second-tier regulatory reforms in South Africa would support a more competitive financial services industry by supporting microfinance. The enactment of Twin Peaks regulation, a resolution regime for financial institutions, and a deposit insurance system form a solid foundation for the creation of a separate deposit-taking license for microfinance institutions.

Franchising is a popular model in South Africa and may help SMMEs overcome some of the constraints they encounter, including financing. While SMME growth has been declining, optimism among franchise owners has remained high. Franchisors provide franchisees with local store marketing, legal documentation, accounts management, financial planning, and even finance access to financial institutions.[84] Although this does not resolve constraints on access to financing entirely, it addresses some of the capacity constraints that render employees risky and reduces uncertainty about the business model. This model holds potential for further exploration.

Greater innovation in financial payments systems could support both consumers and entrepreneurs. South Africa's relatively high financial inclusion may help explain why mobile money services have not taken off as they did in other African countries with larger unbanked populations.[85] Yet mobile money could potentially reach about 33 percent of currently unbanked South Africans, as well as a larger number of underserved South Africans. Currently, mobile money and other transfer services in South Africa, mostly offered by some of the commercial banks and retailers, allow users to buy mobile airtime, transmit money and, to a lesser extent, pay bills, and access credit and insurance products. Convenience appears to be the main reason for choosing mobile money services, and it is valued in light of South Africa's high crime rate as it is safer than cash. With regard to effects on poverty and jobs, global experience suggests that mobile money could play a greater role in fostering innovation—in the mobile money industry itself (for example, using blockchain technology) and through supportive services to innovative products. New technologies can help reduce poverty, for example, by improving access to health care services in remote areas, or offering better or cheaper insurance products and microloans.[86] Regulation that encourages greater competition and broader service coverage by allowing non-bank players to participate in the payment system and addressing constraints to interoperability are needed. In addition, regulation fostering greater competition among money-transfer organizations could reduce the relatively high cost of remittances, both for domestic migrants and the many migrants from other parts of the continent.

Market-conduct concerns, including about high fees and charges, disproportionally affect the poor and those in the lower income brackets, affecting both entrepreneurs and consumers. The concentrated banking structure in South Africa gives the largest financial institutions significant pricing power. The 2008 Banking Inquiry pointed out that the complexity of the products offered, inadequate disclosure and transparency, high switching costs, and oligopolistic conditions contributed to high fees and charges in the banking sector and limited competition. These costs disproportionally affect those in the lower income segments as they do not vary by income. Enforcing good market conduct practices and improving information for consumers can positively affect transparency and lower costs. From a regulatory perspective, this will be facilitated through the establishment of the Financial Sector Conduct Authority, following the enactment of the Financial Sector Regulation Bill. Requiring institutions to improve access to information on financial services would help consumers compare different products on their terms, price, benefits, and risks, benefiting entrepreneurs and consumers.

3.5. Jobs in townships and the informal sector

South Africa's informal sector is relatively small, both for a middle-income country and by regional standards.[87] About 18 percent of men and 15 percent of women work in the informal sector. As only very few South Africans have access to unemployment insurance and grants are targeted at children, people with disabilities, and the old, most unemployed South Africans resort to casual jobs, which informality statistics may not fully capture.[88] Unlike in other countries, there is limited evidence that South Africa's informal sector cushions economic shocks, as the informal sector shed proportionately more jobs in the 2008 downturn than the formal sector. Retail (44 percent of the informal sector)—including street traders, spaza shops, and shebeens—and construction (16 percent) dominate the sector. There is evidence that informal shops catering to the domestic markets in townships have been expanding. Notably, there is very little manufacturing in townships and other informal areas. Informality is much more pronounced in townships, the former homelands, and informal settlements—that is, where the modern economy has made fewer inroads or where relatively low population density puts small informal shops at an advantage over large modern supermarkets, which compete on scale. Crime, on the other hand, is a major constraint for informal businesses, putting them at a disadvantage over formal, larger firms that can afford private security services.[89] Many local informal shops are run by foreigners in South Africa. Their relative success has sometimes been explained by an apparently greater propensity to cooperate to buy in bulk. A sense that foreigners outcompete local businesses (or that they capture rents from market divisions by other township entrepreneurs)[90] can result in social tension, at times erupting in xenophobic incidents.

Townships and other more informal settlements are unlikely to become engines of growth. Yet more can be done to support them in creating jobs. Informal enterprises tend to be in the services sector. Sectors with potential include retail and entertainment, especially in less dense areas. Some small-scale manufacturing for niche products is also possible, in areas where scale from mass production and brand recognition are less important. Auto repair is another sector with potential. Overall, informal enterprises are more likely to feed into growing national demand than compete for market share of established firms through productivity gains.[91] So long as markets remain contestable across formal firms, discouraging the expansion of formal firms into informal areas could thwart the efficiency gains from scale, which would penalize residents' budgets. Ensuring that informal entrepreneurs can tap into growing demand based on their comparative advantage, however, can generate jobs in townships and other more informal areas through self-employment or by hiring employees. While controlling crime is difficult, corruption could be contained by reducing the regulatory compliance burden.[92] Rights associated with different forms of tenure are highly uneven across metropolitan areas, in relation, for example, to building standards, municipal bylaws, municipal business registration, application procedures, and administrative penalties and costs. Standardizing these across metropolitan areas to make them less onerous for small, informal business would reduce fines, the confiscation of inventory, and the need for bribes. As argued in Chapter 2, strengthening tenure rights would also make it easier to obtain finance, helping entrepreneurs expand their businesses.

Although cooperatives may hold some potential, the experience in South Africa has been mixed.[93] Since 1994, cooperatives have been strongly promoted as part of strategies to address unemployment and poverty. The 2005 Co-operatives Act regulates cooperatives as a legal entity based on the values of self-help, self-reliance, self-responsibility, democracy, equality, and responsibility. According to the NDP, advantages include their ability to create economies of scale for small producers, create links to markets and value chains, and promote economic transformation and BEE. Although significant public resources have been invested in developing cooperatives, most registered cooperatives appear not to be operational. A few worker and agricultural cooperatives have been more successful among white commercial farmers than in the former homelands. Consumer cooperatives have relatively unexplored potential, especially in areas not yet penetrated by supermarkets. Stokvels are perhaps the most successful South African cooperative, especially (but not exclusively) for poor South Africans. The reasons for the relative lack of success of cooperatives are largely unclear and deserve further study.[94]

3.6. Jobs in rural economies: Agriculture, agribusiness, and sustainable tourism

Despite considerable migration to urban areas, rural areas remain home to most of South Africa's poor. Agriculture only accounts for 2.5 percent of national GDP, but it is an important source of jobs and incomes in rural areas. South Africa is an important producer of food, and a strong agricultural sector is important for food security at home as well as in many countries across the region to which South Africa exports food. Most agricultural output is produced by a small number of large commercial farms (about 43,000 farms), with smaller amounts produced by 11,000–15,000 small-scale farmers and 350,000–700,000 emerging farmers (that is, predominantly black farmers aiming to scale up to large-scale commercial farming). Together, small-scale and emerging farmers account for just over 3 percent of the labor force, adding another 2.5 million–3.5 million informal subsistence farmers.[95] Agricultural employment has declined significantly since the 1990s. This largely reflects the consolidation of farms to achieve scale and become more competitive, coupled with more capital-intensive modern production processes. Nevertheless, agriculture remains important, as acknowledged in the NDP, because of its potential to increase jobs but also as an input industry to an expanding agribusiness sector, which is making inroads into Africa, partly on the back of South Africa's supermarkets. Strengthening use rights, as discussed in Chapter 2, may be the most critical intervention to strengthen smaller-scale agriculture, especially in the former homelands. This would help smaller producers expand their scale: according to the General Household Survey, 87 percent of smallholder households in the former homelands are only farming 1 hectare or less.

Better support should be given to small-scale farmers.[96] Collectively, the nine provincial agriculture departments spend about 0.1 percent of GDP a year on extension services. Apart from livestock health services, many smaller-scale farmers receive little government support: in 2016, only 11 percent of subsistence and smallholder households received government support. Some farmers are organized into groups under national cropping programs, such as Fetsa Tlala, that access government grants and free inputs, but these programs have had mixed results. Land degradation from deforestation, primarily for household wood fuel and charcoal production, is an increasing problem in some more densely populated areas in the former homelands. Access to finance is a major constraint for smaller farmers, and the Land Bank is gradually increasing efforts to support them and link them to the agribusiness value chain. Although national roads are in good condition, rural roads have been deteriorating and urgently require maintenance to improve[97] connectivity in rural areas, including for farmers. The government's agri-parks program aims to provide a system of agricultural production, processing, logistics, marketing, training, and extension services. If successful, such endeavors will raise agricultural productivity, including that of smaller producers. It is important to note, however, that farming is unattractive to many South Africans, and rural outmigration will continue, potentially increasing the amount of underutilized land, especially if tenure reform does not advance.

Moreover, competition issues need to be addressed to give emerging farmers a fair chance and support fair prices for consumers. For example, while the commodity and marketing boards of the apartheid era were dissolved, privately run industry bodies now carry out similar functions in both domestically and export-focused value chains: in grains, potatoes, meat, milk, eggs, poultry, sugar, wine, dried fruit, and others, there are still statutory measures in place that compel players along the value chain to register with and provide information to an industry body. While such bodies can fulfill important roles in coordinating research, setting standards, and ensuring there is an enabling environment for industry development, their function as a coordinating and information exchange platform can facilitate anticompetitive outcomes. Obligations to register with and provide timely information to associations can constitute an extra cost for new entrants. Furthermore, the exchange of information between market players can facilitate collusion by making it easier to reach and maintain agreements. Finally, given that the role of associations is to protect their members' interests, they tend to primarily represent the interest of incumbents—particularly when it comes to setting industry standards. It is thus important that associations are encouraged to consider new entrants and new products when, for example, setting standards or registration and entry requirements.

Variable tariff formulas are in place for wheat, sugar, and maize, raising the prices of inputs for processors and the prices of basic goods for consumers.[98] These are South Africa's three largest field crops in terms of value, and the formula is benchmarked against a dollar-based floor price. The intention of these tariffs is to maintain prices of the commodities above a reference level to prevent a decline in local production levels. However, this means that substantial depreciations in the value of the rand against the dollar can have a significant effect on the value of import duties, leading to complaints of overprotection in rand terms.[99] A number of players in the food processing industry and consumer groups have opposed these tariffs and advocated for a switch to a rand-based system.[100] The wheat tariff, for example, aims to raise producer prices and foster self-sufficiency—although South Africa is not generally considered to have a comparative advantage in wheat production. Instead, it is likely to raise prices for consumers and downstream industry and could act as a focal point for collusion. In addition to tariff protections in the sugar value chain, the sugar industry operates under cartelistic arrangements. The 1978 Sugar Act provides the South African government and the South African Sugar Association with far-reaching powers to regulate and control the production, marketing, pricing, and export of South African sugar,[101] thus undermining the contestability of the sugar market.[102]

As in other sectors, fostering linkages across the agricultural value chain holds potential. Several initiatives have shown success in South Africa.[103] Leveraging International Finance Corporation networks, a qualitative review of selected agribusiness operations showed that key challenges to smaller suppliers include low economies of scale—which is critical for competitiveness in all the sectors—followed by a shortage of skills, experience, and knowledge, and an inability to provide continuity of supply, consistent quality, and access to funding.[104] A number of projects demonstrate significant commitment from private-sector players, including commercial farmers, large-scale agro-processors, retailers, and industry associations. Capacity building and skills development are key to success—further supported by incentives to develop suppliers through the BBBEE codes. Given the requirements for scale and capital, some sectors—such as potatoes, tomatoes, or beef—lend themselves better to SMME supplier development than others, such as milk. Although limited, in some cases lead firms in the agro-value chain (for example, beef) have helped small producers enter local and international markets. Such partnerships hold potential for expansion and could receive more support from South Africa's development finance institutions, such as the Land Bank and the Industrial Development Corporation. This financial support should be complemented with training in areas such as better farming techniques, agronomics, food safety, and the creation of platforms for access to markets.

Sustainable tourism is another sector that holds significant potential in South Africa's rural areas. Travel and tourism is the largest service industry in the world, and it is the second-fastest-growing industry in terms of attracting FDI. Evidence from Africa points to a strong correlation between tourism expenditure and FDI, tourist arrivals, and employment.[105] South Africa welcomed nearly 9 million overseas tourists in 2015, with almost 70 percent visiting the national parks. The industry employed over 710,000 people in 2015, or about 4.5 percent of the workforce, surpassing the mining sector. The economic impact of nature-based tourism motivates local people to play an active role in conserving biodiversity and preventing poaching. Nature-based tourism generates much-needed revenue for protected areas management and biodiversity conservation, and benefits local communities by, for example, creating jobs. South Africa has pioneered the application of public-private partnerships in nature-based tourism management (accommodation, shops, tourism activities) in protected areas managed by South African National Parks, ensuring strong community involvement, especially for historically disadvantaged people.[106] The sector can offer job opportunities for young people and thus features as a priority in the 2018 Budget Mandate Paper.[107] To ensure that South Africa can benefit from overseas tourists, it is critical to avoid policy uncertainty about visa processes. Policy uncertainty led to significant drops in incoming tourists in 2015/16 but has since been resolved. Nature-based tourism depends on wildlife and landscapes, which need to be preserved. The ongoing rhino poaching crisis shows that efforts to preserve wildlife need to continue.

Stimulating tourism may require changes to South Africa's aviation industry, which is dominated by South African Airways (SAA).[108] Although South Africa is leading other African countries on available airline seat kilometers per week, there is still scope for expanding the sector. SAA's dominant position may reduce competition, and thus the number of trips and potential tourists, both from abroad and within the country. SAA was found in two cases in recent years to abuse its dominance to exclude rivals.[109] Financial support to SAA has also been associated with creating an unlevel playing field, resulting in the market exit of SAA competitors Nationwide and 1time.[110] Regulatory restrictions exist particularly for foreign entry. A recent example of the deterrent effect of restrictions on foreign ownership was Fastjet's attempt to enter the domestic transport market by buying 1time, after the latter had gone into liquidation in 2012. Finally, South Africa's bilateral air services agreements appear to restrict competition: one study found that 29 percent of South Africa's bilateral agreements were of the most restrictive type—entailing no fifth-freedom traffic rights, predetermination of capacity, dual approval of tariffs, substantial and effective control in terms of ownership, single designation, exchange of statistics, and a prohibition on cooperative arrangements.[111] A lack of competition in aviation hurts the tourism potential of South Africa.

3.7. Jobs from integrating into global value chains

Integration into global value chains is critical for South Africa to become a more productive, competitive, job-creating economy. The South African automotive sector is an important driver for the economy and SMME development. While its contribution to GDP was 7.4 percent in 2016, the sector represents the largest share of manufacturing output (33.5 percent) and provides about 16 percent of total export earnings. The sector is thus important for direct and indirect job creation and SMME development on the back of forward and backward linkages (with a multiplier of one direct job to three indirect jobs; 541,000 jobs were attributed to the automotive sector in 2015). Gauteng, the Eastern Cape, and KwaZulu-Natal host major original equipment manufacturers of passenger and light commercial vehicles (for example, BMW, Ford, Mercedes-Benz, Nissan, Toyota, and Volkswagen), and heavy commercial vehicles such as trucks and busses (for example, Iveco, JMC, MAN, Scania, and Volvo). The original equipment manufacturers are at the center of the clusters and, along with their suppliers, are supported across the economy at national, provincial, and municipal levels.

The South African government sets ambitious targets and updates policy to stimulate development of the automotive sector. Localization targets are currently difficult to achieve, however. In light of weak growth and domestic demand, the government is implementing a comprehensive update to its Automotive Production and Development Programme. The updated program aims to grow production by more than 70 percent, transform the supply chain, increase local content in the vehicles manufactured in South Africa from the current 35 percent to 60 percent, and double employment in the automotive sector. The government is further implementing incentives within the BBBEE program to increase participation of previously disadvantaged population groups in the economy. In the automotive sector, it provides certain incentives to original equipment manufacturers to use BBBEE-certified suppliers. Localization is difficult, however. First, the market size (about 500,000 cars are produced) does not support deeper localization (beyond 35-40 percent) because of volumes. Second, original equipment manufacturers have limited time, money, and human resources to address the issues of a limited number of local suppliers or their lack of capabilities. Additionally, for Tier II and Tier III suppliers, original equipment manufacturers would have limited incentive to invest in improvements, as those firms are too far from them in their supply chain, while Tier I firms have much fewer capabilities and experience to improve suppliers. With the BBBEE process, which incentivizes transfer of ownership and demographic representation, owners and managers need to be capacitated to run manufacturing firms in accordance with world-class standards to ensure companies remain competitive.

A number of features of automotive downstream markets, such as parts, repair, and service, may restrict competition and inclusion. Incentives in the automotive sector are directed at original equipment manufacturers and relatively little attention has been paid to creating a conducive environment for investment in labor-intensive automotive downstream markets in South Africa, where the entry of small firms is viable. In South Africa, maintenance and repairs during warranty can only be done by authorized providers, who are in turn only permitted to source spare parts from approved providers. The process for approving service providers and the numbers permitted in a specific area are not transparent. The effect of these practices is that some players may be excluded, and inclusion is tied to membership to an association, which may raise the costs of entry. Findings from other jurisdictions suggest that market dynamics from similar practices in other countries were improved by competition interventions, such as the development of framework rules in the automotive aftermarket in the European Union. Authorized repairers were obliged to use matching-quality parts and original equipment manufacturers and prohibited from making warranties conditional on repair and service within an approved network. Based on this, the Competition Commission of South Africa is currently developing a code of conduct for the sector.

Localization difficulties include the capability of SMMEs. South African SMMEs experience a range of constraints centering on managerial capacity and understanding the dynamics and requirements of global value chains. First, most SMMEs are unable to identify their competitive strengths within the value chain, nor do they fully understand that this identification is important to optimize their participation in global value chains. Second, compliance with strict quality, cost, and delivery standards required for participation in global value chains is difficult and costly. Third, to move up the value chain, SMMEs need to take up larger and more complex sets of tasks, such as contributing to product development, monitoring the network of sub-suppliers, and introducing new managerial approaches. The lack of managerial capacity to deal with these complex tasks hinders their ability to respond quickly and effectively to the challenges of global value chains. One of these constraints is that the state of technology is significantly lagging; no backward and forward linkages have been established. The manufacturing capacity of South African suppliers is primarily based on old technology that is not always suited for mass production. Investment in new technology may limit smaller companies' cash flows and profitability. Closing the technology gap requires long-term and risk-willing capital. In addition, technical partnerships with internationally competitive automotive component manufacturers will be needed, as will the promotion of investment opportunities and the establishment of partnerships between South African and international firms to enable technology and knowledge transfer (Box 3.2).

Box 3.2: SMMEs in Korea—developing on the back of big brothers

The Republic of Korea's large firms, the chaebols, were instrumental in the spectacular growth of the country's economy. In the 1960s, South Africa's GDP per capita was 4.8 times higher than Korea's. By 2017, Korea was 3.4 times richer than South Africa. In the 1960s and 1970s, this growth was concentrated in Korea's large companies, both in terms of output and employment (Table B.3.1). Korea's large companies were supported by industrial policy focused on economies of scale for export expansion. This meant that while chaebols benefited from government support, they were still subject to international competitive pressures. Korean industrial policy shifted to heavy and chemical industry in the 1970s, inadvertently creating opportunities for SMMEs as suppliers of parts and materials to the petrochemical, steel, automobile, and shipbuilding industries. It was beneficial for large companies to rely increasingly on SMME suppliers because the relationship reduced fixed costs for larger companies and SMMEs helped absorb shocks from the business cycle for large firms, including by exiting the market in bad times. A mutually beneficial relationship, further supported by government, including through localization requirements, led large companies to support SMMEs with financial support, mentoring, training, and contracts. The percentage of manufacturing SMMEs that supplied other manufacturing companies increased from 20.4 in 1976 to 73.6 in 1991.

Average rate of growth of Korean companies since 1963 (manufacturing sector, %)

		1963–1969	1970–1979	1980–1989	1990–1999	2000–2009	2010–2014
Number of firms	SMMEs	5.2	3.1	9.0	3.3	1.5	2.3
	Large	18.2	5.1	1.9	-5.6	-2.2	3.5
Employment	SMMEs	8.3	10.2	7.3	-0.2	1.0	2.5
	Large	19.8	10.8	2.0	-5.8	-0.7	2.1
Value added	SMMEs	25.4	40.0	21.9	13.4	8.6	4.8
	Large	47.6	35.3	16.4	11.3	8.5	0.9

Source: Korea Federation of SMEs and Korea National Statistics. Note: Small and midsize enterprises have 300 employees or less.

In the 1990s, increasingly open markets and the emergence of global competitors such as Chinese firms forced SMMEs to adapt. This was further accelerated through government policy that shifted from protecting and supporting SMMEs to inducing competition and self-reliance. As a result, SMMEs became more innovative and technology-intensive, allowing them to continue growing faster than larger firms. Nevertheless, the relationship with large companies continued through the value chain and because many Korean entrepreneurs had previously worked in large companies.

There are perhaps two major differences between Korea and South Africa. One is that Korea has heavily invested in education since the 1950s, resulting in much better education outcomes across education levels than in South Africa. This helped prepare Korea for the technological revolution in the 1990s and 2000s. Another difference is that Korea enjoyed proximity to East Asia's growing markets and regional and global value chains, while South Africa remains relatively remote. That said, an important insight from the Korean experience is that, as long as large firms are deterred from abusing their size for anticompetitive practices, they are an asset that can be successfully leveraged for growth and job creation, including in SMMEs.

Source: Jiyoung Choi (2017) SCD background note.

Obstacles to competition in important trade-related services further hinder South Africa's integration into global value chains. The SOE Transnet, for example, dominates the national rail and port system and functions as an integrated logistics provider of cargo and freight with virtually no competition. Moreover, its dual role as a market player and regulator could lead to conflicts of interest in setting a pro-competition regulatory framework. In particular, Transnet functions as the National Ports Authority, with a mandate to issue licenses and concessions to operate terminals at some ports, while another Transnet division operates port terminals and uses port infrastructure. Indeed, the Competition Commission of South Africa is investigating Transnet for exclusionary practices in the provision of port services and excessive pricing of terminal handling fees in its ports business. Moreover, manufactured goods, such as automotive exports, are charged significantly above global average port costs, while commodities are charged below the global sample averages. This is at odds with South Africa's industrial policy strategy of encouraging value addition. The Ports Regulator has committed to correct the discrepancies in 2017/18 with a pricing strategy based on cost-reflective tariffs.

3.8. Infrastructure for a competitive economy and jobs

South African infrastructure is deteriorating, putting South African firms at a disadvantage both in domestic and global markets. This hampers growth in labor demand. South Africa ranks 64th on the World Economic Forum's 2016/17 infrastructure index, second in Africa to Mauritius and ahead of Brazil and India, but worse than China and Russia. Thus, South African infrastructure is still of a relatively high quality for a middle-income country, but quality is deteriorating: 10 years ago, South Africa ranked 49th. Insufficient public investment (Chapter 2), declining capacity—including in the management of SOEs (see Chapter 4)—and slow responsiveness to updating regulations have all contributed to the deterioration. This degradation urgently needs to be addressed to ensure that South African firms have access to inexpensive and reliable services that make their products more affordable. This is critical to compete with imports, contest export markets, and regain and expand market share, including in more developed countries.

Information and communications technology (ICT) is an area where South Africa is unnecessarily lagging. The ICT sector in South Africa has struggled to keep up with the rapid pace of progress elsewhere in the world and has generally failed to deliver the expected digital dividends.[112] By one measure, the ICT Development Index—a multidimensional index of sector performance collated by the International Telecommunication Union—shows that South Africa's global ranking fell from 77th in 2002 to 88th in 2016, during a period when other African countries were making big gains. There are several reasons for South Africa's poor performance in ICT, including the delayed start of market liberalization and the weakness and lack of independence of the sector regulator, which has reduced access of potential entrants to essential facilities on a level playing field. Despite the gradual removal of entry and regulatory barriers, the incumbents (Vodacom and MTN), which were awarded the first licenses for mobile services on an exclusive basis until 2001, now benefit from significant advantages of economies of scale and the network effects characterizing the telecommunications industry. Later entrants to the market have historically been unprofitable, although Cell C, which has been in the market since 2001, declared a profit for the first time in 2015.

The most pressing challenge for market development and competition is that fourth generation (4G) mobile services have still not been licensed in South Africa, even though such services are thriving elsewhere in Africa. The limited availability of spectrum (frequencies to transmit signals) has created challenges for small network providers looking to enter the market and left operators facing significant capacity constraints, contributing to a slowdown in broadband speeds and slow deployment of high-speed services. This policy gap stems from a dispute between the Independent Communications Authority of South Africa, the regulator, and the Department of Telecommunications and Postal Services. While operators and investors have been left frustrated by the impasse, it is users in businesses and households who ultimately suffer from the lack of high-speed wireless services. Once the process moves forward, it is essential that the assignment process is designed to be efficient and encourage competition, taking into account the potential benefits of promoting new entry by smaller players. Another misstep is the attempt to create an open access wireless network.[113] The process has created market uncertainty about how the private sector will be affected. A more enabling digital ICT environment could help South Africa seize many new growth opportunities. Digital technologies and the new business models they enable increasingly drive innovation across different sectors. Although there are several success stories in financial technology (such as SnapScan and Yoko), education (GetSmarter and Snapplify), e-health (LifeQ), and online job platforms (Giraffe, SweepSouth, Domestly, OfferZen), the information technology industry in South Africa remains relatively small.[114]

High prices for telecommunications and internet services constrain the market's development. A recent survey of prices across Africa concluded that the price of 1 GB of mobile data in South Africa costs five times more than in Egypt, but prices have barely fallen in the last two years, in contrast to international trends.[115] South Africa's high prices for internet also negatively affect the markets of its landlocked neighbors, such as Botswana, Lesotho, and Zimbabwe. Future policy objectives for South Africa should include ensuring the policy independence of the regulator and confirming its function so that stalled actions, such as 4G licensing, can progress. The government should also refrain from trying to manage competition. Ultimately, the importance of ICT is greater as a facilitator for doing business in the economy as a whole rather than as a sector in its own right. Thus, a more liberal approach to spectrum management and price competition should be encouraged.

Given weaknesses and inaction in ex ante regulation, the competition authorities have striven to complement ex ante regulation by promoting greater competition ex post in telecommunications markets. Competition enforcement and merger control have been used in South Africa to safeguard competition in downstream network services over the past two decades by ensuring access to essential upstream facilities. For example, there have been two abuse-of-dominance cases against Telkom—the dominant fixed line provider, which is also vertically integrated into downstream network services—relating to conduct intended to exclude its downstream competitors from the market. Merger control has also been used to reduce potential anticompetitive effects from proposed mergers in the sector, which firms have used in an attempt to obtain scarce spectrum. In this way, the competition authorities' enforcement actions have informed pro-competition changes in the sector's regulatory framework. However, this is not an optimal split of institutional responsibility, and there is a need to coordinate and strengthen the comparative roles of the competition authority, the sector regulator, and policymakers.

South Africa has emerged from an energy crisis that resulted in significant loadshedding between 2007 and 2015. For a long time, Eskom prided itself on being one of the largest power utilities in the world and for supplying the cheapest electricity, not least because of access to cheap coal and steady contracts with large offtakers in mining and heavy manufacturing (see Chapter 1). After the last major capital investment program of the 1980s–1990s, Eskom had a large energy surplus, enabling the democratic government to roll out electricity to historically disadvantaged communities. As the surplus fell, the government decided it would open the electricity supply industry to the private sector, adopting principles in line with developed country standards. Yet this proved difficult to implement. For one, there was resistance to separate Eskom generation to facilitate a multisector model and to consolidation of distribution across Eskom and the municipalities. Most importantly, tariffs were low and not cost-reflective. As a result of the slow reforms, by the early 2000s private-sector investment had not resulted in energy generation.[116] With the demand-supply gap fast dwindling, the government instructed Eskom to embark on the next capital investment program. Time pressure and poor planning resulted in electricity undersupply and loadshedding by 2007. The construction of the Medupi and Kusile coal-fired power plants alongside significant investments by private independent power producers, including in renewable energy (especially solar, including photovoltaic and concentrated power, as well as wind), helped Eskom get back to comfortable reserve margins of 13 percent by 2017. As long as growth remains modest, South Africa will be energy secure again and can even export to southern Africa. Yet Eskom had to borrow significantly for the capital investment program, and coupled with its dwindling margins from lower-than-requested tariff adjustments and financial losses from corruption, Eskom's credit rating was gradually downgraded. Eskom now constitutes the largest contingent liability to the national government (Chapter 2).

While steep tariff increases risk undermining South African competitiveness, they are necessary to avoid power disruptions in the future. The issue of steep increases is partly the result of inadequate increases in the past. Given Eskom's difficult financial situation, tariff increases are necessary, but the National Energy Regulator of South Africa has been limiting them. For Eskom to continue to meet its operational and growth needs, tariffs would have needed to increase by 20 percent in 2017. Three major factors account for the current request: 9.4 percent of the request is due to much lower sales volume than was projected under the Multi-Year Price Determination of 2013 (for the period 2014–2018), 7 percent is due to operating costs, and 5.5 percent is due to independent power producers, whose cost is supposed to be passed through. Although scope remains for increased efficiency to moderate the adjustments on the supply side, efficiency can be substantially improved on the demand side for all consumer categories, such as better insulation in residential and commercial buildings and more efficient industrial processes. On the supply side, increased cross-border sales would help reduce the burden of increases on local consumers while Eskom still has a large surplus.

Payment discipline is another factor that affects the cost of supply. For Eskom, this includes nonpayment by a significant proportion of mainly domestic customers and by several municipalities to which it supplies in bulk. To address the latter, Eskom has started interrupting supply to the relevant municipalities during certain parts of the day. This unfairly affects customers who pay their bills to those municipalities on time. However, Eskom does not supply the consumers directly and needs to preserve its financial viability. Despite the sharp 147-percent inflation-adjusted increase in electricity prices between 2007 and 2015/16, South Africa's tariff, at 0.085 $/kWh, is still the lowest, benchmarked against OECD countries.[117] A comparison of industrial electricity tariffs by the International Energy Agency shows that, in 2014, Eskom's industrial electricity tariffs were still among the lowest in the 30 countries surveyed. This suggests that industrial electricity tariffs in South Africa remain price-competitive by international standards and below cost-reflective levels. However, in future, the National Energy Regulator of South Africa could significantly increase tariffs for Eskom to cover increasing debt repayments due to Medupi and Kusile coming online, relatively high noncollection, and funding the massive capital expenditure plan in light of sovereign and sub-sovereign rating downgrades In the absence of these adjustments, Eskom might face bigger liquidity issues, resulting in possible loadshedding.

Much focus has been put on electricity generation and transmission but little on distribution. Transmission and distribution losses represent 9 percent of total energy dispatch. Estimates show outstanding distribution investments of about $4 billion nationwide and a shortage of funding, especially in the small and unviable municipal undertakings. The first step to addressing this issue is to implement the electricity supply industry structure recommended several years ago, under which the 250 or so distributors, including Eskom, would be consolidated and restructured into six viable regional distribution companies. This would bring about economies of scale and hence facilitate the needed rehabilitation work. It is important that the restructuring be implemented in its entirety. This includes unbundling Eskom and creating a generation and a transmission company, as well as an independent system and market operator to facilitate private entry into generation.

South African transport infrastructure is protecting unproductive South African firms and reducing the ability of competitive productive firms to contest local and global markets. The main contributors to the high cost of domestic transportation are the distances between areas with major industrial capacity and consuming markets (Gauteng to the coast), high cost and inefficiency of port operations, the poor quality of general freight rail, insufficient intermodal facilities, high pipeline transport costs, and high road freight costs.[118] These constraints reduce the competitiveness of South African firms.[119] They also raise the relative cost of imports, effectively protecting less-competitive domestic firms.

About 90 percent of South African exports and imports are handled through ports,[120] **but South Africa's ports are expensive.** Public and private entities operate South Africa's ports under a publicly owned and regulated ports system. Transnet is vertically integrated along the entire cargo/freight logistics value chain and dominates the value chain from the landing of cargo or liquids in South African ports to their final destination. For example, Transnet provides landlord services through the Transnet National Ports Authority and operational services to the eight South African commercial seaports. Transnet Port Terminals has a monopoly on automotive roll-on/roll-off terminals and dominates container-handling terminals. As the sole provider and often the sole offtaker of its services, Transnet is subject to a conflict of interest and may have incentives to engage in exclusionary behavior towards potential competitors. Partially as a result, private operators often serve niche markets and are thus barely exposed to competition. Monopolistic pricing is thus one reason for expensive ports, especially as port prices are currently unregulated, while underinvestment (partly a response of monopoly and partly due to cross-subsidization of other Transnet operations) contributes to the relative inefficiency of South African ports.[121] Cross-subsidization affects domestic manufacturers disproportionately. Roll-on/roll-off and container cargo owners face comparatively high cargo dues in South Africa, while bulk cargo owners' (coal and iron ore) cargo dues are below the sample global average, meaning value-added producers effectively subsidize resource exporters—or, imports (mostly container cargo) cross-subsidize exports (mostly resources) on average. The high cost of manufactured inputs protects relatively uncompetitive domestic manufacturers and penalizes domestic firms that rely on imported inputs—including capital goods that could help increase productivity, for example through their technology content.

Similar to South Africa's ports system, the monopolized freight rail system struggles with imbalances and cross-subsidization of transport modes. Freight rail transport relies on lower unit costs, which in turn requires a moderate unfragmented volume base and consistent flow of goods, to cover its fixed costs. This is ideal for bulk users such as coal and iron ore but not general freight rail services, which have a more sporadic flow of goods and a fragmented volume base. Transnet Freight Rail, the only freight rail operator in South Africa, offers general freight transport using the national rail network and two specialized transport lines for coal and iron ore, but the prices of these services are subject to negotiations with Transnet Freight Rail. Where the specialized coal and iron ore lines can realize large economies of scale and economies of distance, the general freight rail service has to compete with road transport operators and is further subject to increasing unit costs. This leads to underutilization, increasing unit costs. In addition to the cost of general freight rail services, the rail system's efficiency is of concern. Intermodal operations at the end terminals—port and inland container depots—contribute to the system's inefficiency, further driving up costs and decreasing competitiveness of South African exporters.

Unlike ports and rail and air transport, road transport has low market entry and exit barriers. Although there is little scope for monopolistic price setting, inputs such as fuel are subject to institutional and monopolistic price setting. Because of its size and widely dispersed economic centers, land freight transport dominates South Africa. The oil price and related fuel price inflation is a large contributor to road transport costs and a key risk to national transport competitiveness. The price gap between South African domestic-road-transport rand per ton-kilometer (R0.65/ton-km) and the best-practice rand per ton-kilometer (R0.57/ton-km) is relatively small but has a substantial impact on total freight costs. South African road freight operators' costs are also affected by regional administrative inefficiencies affecting transport, relating to regulation, market structure, and efficiency with border procedures. These inefficiencies increase prices on cross-border routes by 10–30 percent. Border delays reportedly add about $20/ton to costs per day for a bulk load and have a larger impact on time-sensitive goods such as perishable foods. Border delays also reduce the number of trips per month that transport operators can complete. Furthermore, regional transport operators' costs are increased by the costs of empty return hauls from South Africa's regional markets, as demand for outbound transport services is higher than inbound services.

Chapter 4

State building for an inclusive transition

4.1. A capable government empowering South Africans

South African democracy has been maturing and political contestation is increasing. As much as factor and product markets benefit from greater contestability, as discussed in Chapter 3, so does domestic politics. Although the ANC remains strong in South Africa, political competition has noticeably increased. In the 2016 South African municipal election, the ANC lost its outright majority in four out of eight metropolitan municipalities for the first time since 1994, with, in addition to the City of Cape Town, three now in control of the DA through coalition (Nelson Mandela Bay) and minority governments (Johannesburg and Tshwane). The ceding of these municipalities to the opposition points to the maturity and strength of South Africa's young democracy. Polls suggest that the 2019 general elections may be the first ones with a possible threat of deposing the incumbent. Political competition has increased in South Africa.

Strong institutions underpin South Africa's democracy. Vital to ending apartheid in South Africa was the creation of a new, nondiscriminatory Constitution. CODESA negotiations started in 1991. The parties agreed on a process whereby a negotiated transitional Constitution would provide for an elected constitutional assembly to draw up a permanent Constitution that would dismantle apartheid and build a nation free from racial and ethnical fragmentation under a unitary state based on constitutionalism, moving the country from the brink of a potential civil war to peace and reconciliation. The 1996 Constitution cements a fundamental departure from apartheid through a Bill of Rights giving all South Africans equal rights and obliging the state to "respect, protect, promote, and fulfill" these rights. It established various institutions to safeguard democracy, human rights, and good governance, such as the Constitutional Court, "Chapter 9 Institutions,"[1] and the Office of the Public Protector, which investigates, reports, and remedies improper conduct in state affairs. It defined the independent role of a National Prosecuting Authority, responsible for all criminal prosecutions, and entrenched independence for the South African Reserve Bank. It also established the South African Revenue Service—whose growing professionalism during the 2000s was critical for the efficiency and legitimacy of greater redistribution after 1994 to reverse the legacy of exclusion.[2] South Africa made substantial progress in improving the quality of its public financial management and budgeting systems,[3] ranking joint first in the world in the 2017 Open Budget Index.[4] South African courts are strong and have proven to be critical arbiters for disputes between the government and citizens[5] or the government and investors.[6]

Yet institutional quality and integrity have eroded sharply. Corruption is perceived to be rising in South Africa and is considered to have contributed to operational inefficiencies and financial deterioration in the country's SOEs. In the 2017 Ibrahim Index of African Governance, South Africa was one of the few African countries whose governance standards slipped between 2007 and 2017: South Africa now ranks sixth in Africa. Public management and accountability are the two key drivers of this deterioration. South Africa only ranks 64th among 176 countries on the 2016 Corruption Perception Index by Transparency International, down from 43rd in 2007. Corruption features as a prominent theme in the NDP.

Strengthening institutions is critical to empowering South Africans. South African civil society is strong, and the political opposition is strengthening; this contestation in politics is crucial for addressing high-level issues such as corruption. Greater transparency and accountability mechanisms can support it further. Improving systems for effective delivery will allow the government to better take on the role of a capable developmental state, as foreseen in the NDP. It will improve the delivery of policy that helps South Africans sustainably contest markets, create jobs, and support the most vulnerable (Chapters 2 and 3). It will require greater coordination in policy formulation and delivery, strong monitoring and evaluation of policy implementation to swiftly identify and resolve challenges, and strengthened government capacity. In South Africa's skills-constrained economy, it is vital that the government takes into account the impact that public service employment and wages have on the private sector. In a savings-constrained economy, it is important that public borrowing does not crowd out the private sector and that the government retains finance for critical infrastructure investments. South Africa's fiscal situation has deteriorated markedly, as discussed in Chapter 2, so it is important to become more efficient in both raising and administering public financing.

4.2. Strengthening accountability

Civil society is strong in South Africa. This strength has recently been demonstrated in, for example, the Treatment Action Campaign successfully campaigning for government to make medical treatment available to those living with HIV/AIDS; the call to appoint a commission of inquiry into the Marikana massacre, which led to the dismissal of the then commissioner of police; and the multifaceted campaign that applied pressure to UK-based political communications firm Bell Pottinger in relation to its work for the Gupta family businesses, which resulted in Bell Pottinger closing down.[7] Good governance enables citizens to have a voice and government accountability. The ability of civil society to peacefully express and exercise their views, as well as claim the rights entrenched in the Constitution through activist litigation, has the potential to influence government priorities and service delivery outcomes. As President Ramaphosa suggested in his February 2018 State of the Nation Address, there is space for more partnership between civil society organizations and government to help address challenges of public service delivery and corruption.

The free press is a strong institution in South Africa. The Constitution guarantees free speech and freedom of the media. In 2010, the government introduced the controversial Protection of State Information Bill, which aimed to improve regulation and classification of state information. In its initial form, it severely limited the rights of whistleblowers and journalists. The bill was met with fierce opposition from civil society and the media amid concerns about the implications it may have on exposing corruption. After intense lobbying under the umbrella of the Right2Know campaign, a version of the bill was adopted in 2013, but not signed into law. The South African press has recently been playing a key role in disseminating information about state capture.

The phenomenon of state capture has hastened and deepened the erosion of institutional integrity and independence, but it has been met with an impressive pushback. Following numerous revelations (known as the Gupta leaks) in the media, in 2016 the Public Protector started an investigation into the "alleged improper and unethical conduct by the President and other state functionaries relating to alleged improper relationships and involvement of the Gupta family in the removal and appointment of ministers and directors of SOEs resulting in improper and possibly corrupt award of state contracts and benefits to the Gupta family's businesses." A judicial commission of inquiry has since been established. In March 2018, the National Director of Public Prosecutions reinstated charges of racketeering, corruption, and money laundering against the former president that had been dropped in 2009.

The impact of state capture has been pervasive, but strong political leadership could reverse it. Until very recently, corrupt political interests have not only undermined the investigative independence of the South African Revenue Service but also disabled the National Prosecuting Authority, which has failed to take any substantive action in response to either the Gupta revelations or the evidence in the Public Protector's report of state capture. Trust in political leadership has declined markedly in recent years,[8] undermining the legitimacy of the state and its ability to maintain a precarious social compact. President Ramaphosa has committed to forge a social compact—much in line with the NDP—and strengthen ethical leadership.

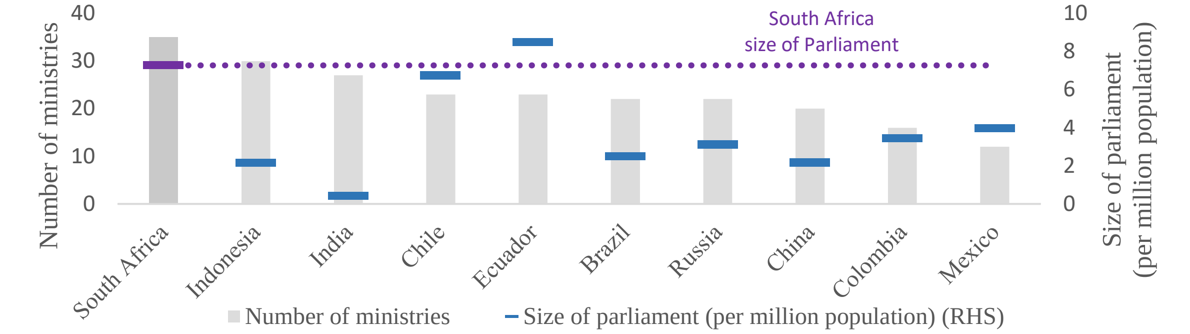
The change in leadership provides an opportunity to improve South African governance. Cyril Ramaphosa was elected as ANC president on the basis of a "change mandate." High on his agenda are key appointments in SOE and other critical state institutions, such as the National Director of Public Prosecutions. Early encouraging signs include the move by the National Prosecuting Authority to seize assets of some of those involved in state capture, including in law enforcement agencies. A renewed emphasis on transparency and accountability following the ANC election could help reverse state capture. However, the ongoing contestation of resources is intimately linked to South Africa's incomplete transition, as argued in this SCD. Strong political leadership is needed to counter potential resistance to the urgently needed reforms.

4.3. Enhancing coordination, planning, monitoring, and evaluation

Politics is relatively divided in South Africa. For one, the government consists of a fragile coalition led by the ANC, which itself is divided. To an extent, this is a reflection of the original mandate of the ANC as a liberation force, where political equality was the unifying theme; economic differences emerged only after that goal was achieved, after 1994. Since then, factionalism has increased in the ANC, and forging greater unity was one of the key themes of the ANC elective conference in December 2017. President Ramaphosa has indicated a departure from policies of the past, most notably with respect to state capture. He will have to continue focusing on forging compromises across the party, which may reduce the effectiveness of policy and implementation.

Fragmentation is high in the South African government. The social contrasts elaborated in Chapter 2 also find their expression in politics: South Africa has many parliamentarians compared with peers (Figure 4.1). This is not unusual, as, in a democracy, a diverse population requires more representatives for the diversity of interests. Finding consensus becomes difficult, however, and is one likely reason for a relatively long legislative process resulting in policy uncertainty. South Africa also has a relatively large number of ministers, a reflection of diversity of interests and issues but also a reflection of an understanding in the ruling coalition that a developmental state has a wide range of responsibilities that require a minister's attention. Accordingly, the size of the civil service is also large: South Africa spends 12 percent of GDP on public wages, one of the highest public wage bills in emerging markets.[9] The risk is that the larger and more fragmented any organization gets, the more difficult it becomes to coordinate it, and South Africa is no exception. President Ramaphosa identified the fragmentation of government as a concern in his February 2018 State of the Nation Address, hinting at a future consolidation of government departments.

Figure 4.1: Number of ministers and members of parliament in selected countries
(number of ministries and size of parliament (per million population))



Source: World Bank Group staff, based on Database of Political Institutions and national official websites.

South Africa's strategic policy direction is relatively broad, making it more difficult to identify priorities and align government policy and budget priorities. Between 1994 and 2012, South Africa had five strategic plans. An analysis of these strategic policy documents shows that the focus of policy has been shifting across successive strategic documents, and the breadth of policy priorities has increased.[10] These strategic shifts can result in policy inconsistency and make it difficult for policies to mature and make an impact. Key themes across the plans are reconstruction and democracy in the 1994 RDP; fiscal policy and the macroeconomy in the 1996 GEAR strategy; and skills in the 2006 AsgiSA. From then on, the plans became longer, covering more topics. There were five key themes in the 2010 New Growth Path. By order of prominence, they were the green economy, skills, economic growth, basic education, and health. Two years later, the NDP, with eight key themes, focused broadly on climate change and natural resources, corruption and security, health, economic growth, fiscal policy and the macroeconomy, basic education, reconstruction and democracy, and skills. These areas are not explicitly prioritized in the NDP but are linked to 114 priority actions of various complexity. Such a large number of themes and priorities in a strategic document makes policy implementation difficult, especially in a fragmented polity and when tough trade-offs have to be made on budget allocation. Despite the NDP's shortcomings, implementing it will be more important than replacing it with yet another plan.

The government is trying to enhance coordination on budgeting. In 2017, the government introduced a Budget Mandate Paper, which is meant to identify budget priorities to be implemented by the National Treasury through the annual Budget Review. This can help deal with fragmentation within the cabinet but it will be important to ensure that priorities do not change with every budget to ensure policy consistency. These priorities are derived from the NDP and reflected in the Medium-Term Fiscal Framework, which is the five-year implementation plan for the NDP. The next Medium-Term Fiscal Framework will be prepared in 2019 and will require the government to establish national priorities for the next five years, which will then need to be reflected in successive Budget Mandate Papers.[11]

Various policies also need to be coordinated better. For example, while there is engagement between the Competition Commission of South Africa, the Bureau of Standards, and the International Trade Administration Commission of South Africa on standards and trade measures that may distort markets, measures to reinforce the need for policymakers to consider the competition impact of new standards or policy measures could strengthen their efficacy in the longer term. In water and sanitation, many aspects of sanitation fall under the oversight of health ministries or units and coordination is often lacking. In formal urban areas, where sewer investments are more common, the coordination is better since it is typically assigned to the water departments or utility, but in informal settlements and rural areas, where nonwaterborne on-site sanitation is more common, investment decisions, maintenance, and enforcement of standards are often disconnected from the water institutions' activities. Another example derives from public support programs for entrepreneurship and innovation. There is considerable scope to improve the effectiveness and targeting of these support mechanisms by consolidating program objectives, budgets, and management arrangements. Finally, the social protection system is fragmented and could be leveraged better to identify people who qualify for grants or to link them to active labor market programs. At the same time, linking nutrition interventions—as an important early child intervention—to avoid stunted growth could have a big impact on supporting cognitive development, especially among historically disadvantaged children.

The need for coordination extends to social partners. South Africa, and the ANC in particular, has a strong tradition of consultation. The government regularly consults social partners, including trade unions and business, through, for example, the National Economic Development Labour Council (NEDLAC). In 2017, the government increased its emphasis on improving employer-employee relations. Moreover, it has entered into a powerful alliance with corporate South Africa through the CEO Initiative to jointly tackle key issues such as youth unemployment (Box 4.1). There is significant scope to further leverage constructive partnerships between the public and private sector by, for example, linking university research better with business needs or by leveraging innovative private-sector solutions for the delivery of public services.[12] In some cases, the public-private relationship needs improving. For example, lack of communication between government and business has resulted in trade deals that could have been more beneficial for South Africa.[13] At a more extreme level, mining companies felt insufficiently consulted on the third Mining Charter and went to court to settle their dispute with the government. President Ramaphosa identified this as a concern in his State of the Nation Address, resolving to work more closely with social partners, including business, labor, and civil society. He moved quickly to find an amicable solution to the dispute. The Chamber of Mines suspended its court case against the government in February 2018.

For the government to achieve its objectives, planning, monitoring, and evaluation should be strengthened. A strong monitoring and evaluation system that feeds back into the planning system is critical to ensure that policies are implemented and their objectives achieved.[14] The Department of Planning, Monitoring and Evaluation in the Presidency is tasked with monitoring the outcome indicators of the Medium-Term Fiscal Framework, drawing on administrative data and data from StatsSA, and conducting various impact evaluations. However, the system faces challenges, including limited linkages to the budget information and system, fragmentation and duplication between reporting and monitoring instruments, and limited use of monitoring and evaluation information. In addition, impact evaluations often suffer from data constraints, and there is no institutionalized system for this information to feed back into the planning system, which is critical for addressing issues. Department-level monitoring and evaluation has yet to achieve levels of effectiveness that would contribute to improved accountability.

Box 4.1: The CEO Initiative—A powerful public-private partnership

South Africa has a strong private sector. The efficacy of corporate governance compares to developed country standards and is underpinned by the King IV guidelines, a private-sector initiative that is considered a best-practice example of corporate governance globally. Under King IV and the Companies Act, South African companies are corporate citizens with responsibilities and obligations to society. The CEO Initiative is to be partly understood in this context.

Formed in 2016 at the request of the President, the CEO Initiative is a partnership between more than 200 South African business leaders and the government. It is anchored by the Minister of Finance and Jabu Mabuza, who is the business convener. Its core purpose is to find ways that business can work with government to address issues related to the country's sovereign credit rating and foster inclusive growth. CEOs from leading companies volunteer their time and expertise. The country's leading business organizations, including Business Unity South Africa, Business Leadership South Africa, and the Black Business Council, are also represented.

Over the past two years, the CEO Initiative has worked with the government to monitor the country's fiscal and economic health and make recommendations to avert a downgrade of South Africa's sovereign credit ratings. It has also initiated a number of projects to support inclusive growth. Notably, the CEO Initiative has established the R1.5 billion SA SME Fund, which aims to support the growth and expansion of small and midsize companies with high growth potential. The initiative has also developed the Youth Employment Service (YES) program, which aims to partner with the government to place a million young people in workplaces. To catalyze growth, the initiative is working with companies in the Vaal Triangle to revitalize the area's industrial base, collaborating with stakeholders in the tourism industry to identify ways that they could more closely work with and support the government, and exploring ways in which partnerships in the agricultural sector could help finance new entrants to the sector. Most recently, the CEO Initiative offered to support the government with capacity and expertise in its work to address the finances and governance of key SOEs.

Source: Joanne Yawitch, National Business Initiative, Chief Executive Officer, and Sizwe Mbele, Business Leadership South Africa, Strategy Director.

The planning process could be strengthened not only by feeding more information into it from the monitoring and evaluation system, but also by assessing proposed policies. Planning is being improved by better appraising the value of planned public investment programs through ongoing work on a Budget Facility for Infrastructure. Mandatory departmental social and environmental impact assessments are a recent innovation to reduce unintended consequences of proposed legislation, but they, too, suffer from data constraints. Given concerns about competition, described in Chapter 3, introducing regulatory impact assessments that focus on competition could help reduce the unintended anticompetitive impacts of government policy.

Planning should ensure that unintended consequences of policies are reduced, not least with respect to the contestability of markets. Given the importance of ensuring that South Africa's market rules allow legacy issues to be overcome by encouraging firm entry and rivalry, as shown in Chapter 3, it is key that policymakers are engaged in ongoing efforts to identify and minimize distortions from government interventions that restrict competition and embed competition principles in public policy to improve service delivery. There are various options for how this might be done. In some countries, public bodies must seek the opinion of competition authorities before implementing a new legal instrument, and in others, the public body must provide a formal response to the competition authorities' opinion if its advice is not followed. Other countries have embedded an assessment of market impacts in their regulatory impact assessment processes. While the regulatory impact assessment process has not taken off in South Africa, another potential tool that could be used to review the impact of new policy and legal instruments is the socioeconomic impact assessment system (SEIAS). However, it is only obligatory for new bills to carry out the SEIAS, and not, for example, for new regulations or standards. The SEIAS is also not applicable to existing policies. Other mechanisms would thus be needed to examine and reform existing regulations.

Too many programs remain unevaluated. This includes crucial job-creating programs, such as active labor market interventions. Various other programs, including industrial policy initiatives and small business support, also have job creation as an indicator—yet in many cases measuring job creation is ad hoc. Potential adverse impacts of the current BBBEE framework on investment should also be evaluated. Not only do programs require further monitoring, but the performance of public facilities requires better monitoring to identify and address problems. Education is one area where the Annual National Assessment, discussed in Chapter 3, would provide vital information to the government about where the education system requires solutions.

Fragmentation across the three spheres of government also raises coordination issues. The Constitution significantly changed the management of public finances and reduced fragmentation through the establishment of national, provincial, and local government.[15] At the heart of the reform was a dire need for enhanced transparency and accountability about the allocation and use of limited resources to address imbalances of the past. Provincial and local governments function as delivery agencies of the national sphere, rather than as representative institutions accountable to citizens.[16] Significant disagreement exists between politicians and service providers, on the one hand, and citizens, on the other, on how well accountability between service providers and citizens is working. The disconnect between service providers and citizens on accountability in this relationship is acutely felt in the education, health, and water and sanitation sectors. Key service delivery pressure points for users often relate to the provision of affordable housing, as well as the associated electricity, water, and sanitation services and public transport at the local government (municipality) level. In South Africa, municipalities are primarily responsible for the distribution of electricity and water and the provision of sanitation services which are key revenue sources for them. The Constitution, however, assigns urban development and specific urban functions, such as housing and public transport, as a concurrent national and provincial legislative function—thus providing wide latitude for national and provincial government to support these specific urban functions.

Through Operation Phakisa, the government aims to implement priority programs better, faster, and more effectively. Operation Phakisa ("Phakisa" means "hurry up" in Sesotho) is an initiative designed to fast-track the implementation of solutions for critical development issues. The Presidency created this delivery unit following Malaysia's PEMANDU. The unit has conducted several pilots on, for example, the ocean economy, health, and mining, to support detailed problem-solving, priority setting, planning, and delivery support. The initiative has generated some momentum and a greater focus on improving service delivery in selected areas. It has also had its limitations, given the limited integration into a more systematic approach to planning, budgeting, management, monitoring and evaluation, sustainability, and political and institutional take-up. Nevertheless, it has led to additional delivery unit approaches in the Western Cape and Gauteng provinces, which are exploring innovative ways to enhance service delivery in core sectors.

The Constitution provides for an equitable share of nationally collected revenue to provinces and local governments, both vertically and horizontally. This division is informed by the Financial and Fiscal Commission. The equitable share allocation formula aims to ensure that all municipalities can provide basic municipal services to poor households and address any residual mismatch between revenue and expenditure assignments. The equitable share is structured as an unconditional grant and further supplemented by several conditional grants. During the 2015/16 financial year, about R226 billion ($16.5 billion) was spent on urban functions in South Africa, with about 81 percent on recurrent expenditures and 19 percent on capital infrastructure. Municipalities financed about 90.2 percent of the total expenditure, with national departments financing 4.2 percent and provincial departments the remaining 5.6 percent structured as conditional infrastructure-related grants. An analysis of local government infrastructure grants indicates that in 2004 there were only two capital grants of significance, as opposed to the 10 infrastructure grants in the 2013/14 budget. The study recognizes that, although the creation of such grants was often in response to challenges in the municipal infrastructure sector (such as backlogs) or new policy developments (such as the public transport grant), the grant system has not been managed holistically. The result is a complex system of grants without a coordinated strategy or cohesion, hampering effective planning and management of infrastructure by local government.

Bottlenecks in the delivery of policies across spheres of government partly explain the under-provision of critical public investment. According to the World Bank, "the conditionality of many grants restricts municipal investment to building new infrastructure rather than make cost-effective investments in rehabilitating, upgrading, or replacing existing infrastructure. This persistent extension of a municipal asset base can undermine sustainable asset management practices, particularly if there is not also targeted investment in economic infrastructure that boosts the rate-base. Social infrastructure investment may not be matched by a corresponding increase in own revenues, via tariffs and rates, to fund the operations and maintenance of a new infrastructure asset."[17] Limited guidance exists for the roles of national sector departments that are responsible for functions and services delivered at the local government level. This ambiguity has led to duplication of process and grants, and distorted accountability. The role a sector department is expected to play in overseeing and supporting grant implementation needs to be clarified. Tension often exists over the sharing of functions and responsibilities between districts and municipalities, which also hampers the effective allocation of funds and associated provision of infrastructure.

4.4. Strengthening government capacity and the civil service

Citizens identify many service delivery shortfalls. It is clear from the national debate and the growing number of protests that, despite good progress in many areas, urgent and unfulfilled needs remain in a large part of South African society. Dissatisfaction with service delivery was the second highest motivation for public gatherings between 2009 and 2013.[18] StatsSA reported[19] in 2016 that at the local government level, where service delivery problems are most acutely felt by citizens, key challenges include a safe and reliable water supply, roads, housing, cost of electricity, crime and violence, and job creation. Service delivery concerns and violent protests in South Africa have increased. While the Municipal Hotspot Monitor registered 21 major service delivery protests on average between 2004 and 2008, this increased to 100 between 2009 and 2011 and 164 between 2012 and 2016. The first half of 2017 alone saw 95 protests.[20]

There are a number of reasons for low capacity. For one, selection of senior civil servants has become increasingly political rather than merit-based. The electoral system at the local government level includes both constituency election representation (councilors are directly elected by citizens in a specific ward) and proportional representation (citizens also cast a vote for a political party, which then deploys representatives to its reserved council seats). In practice, elected councilors are also exposed to influence by party politics and need to toe the line to avoid a recall. This often also spills over into the key management positions (municipal manager, chief financial officer, and others), making the effective separation of the political and administrative levels impossible. In addition, frequent turnover in key positions directly affects audit outcomes and enhances possibilities for financial mismanagement, weak internal controls, procurement weaknesses, and corruption.

Municipalities fail to comply with municipal legislation and other bylaws, fueled by slow responses to implement corrective actions and a lack of sanctions. According to the Auditor-General, the 2014/15 audit outcomes showed that the audit area with the lowest improvement rate was compliance with key legislation that governs municipal operations. Apart from improvements in compliance on supply chain management and the quality of submitted financial statements, all other areas showed little change or worsened. Slow responses to implement corrective actions and a lack of sanctions continue to fuel the problem. Consequences of noncompliance and weak controls resulted in the following 2014/15 audit findings: irregular expenditure (mostly as a result of noncompliance with supply chain management legislation) more than doubled since 2010/11 to R14.75 billion; fruitless and wasteful expenditure was more than R1 billion higher than in 2010/11, at R1.34 billion; and unauthorized expenditure (mainly overspending of budgets) increased threefold from 2010/11, to R15.32 billion.

The financial viability of municipalities is uncertain. Audit outcomes for 2014/15 indicated that the financial health of 92 percent of municipalities needs intervention, up from 82 percent in 2012/13. About 26 percent of the municipalities had a material uncertainty about their ability to continue to operate in the foreseeable future. Increasing net deficits and net current liability positions, growing debtors, and creditors not being paid on time are indicators in question. Key contributing factors are the weakening revenue management and expenditure commitment controls and weak management of projects and associated grants. The State of Local Government in South Africa Report further notes that the "distribution of the equitable share always favors metros over local municipalities and that the national government has failed to devise a sustainable strategy for supporting municipalities that are inherently different and confronting unique problems that are linked to their location in a distorted spatial economy." During 2009–2014, a total of 39 municipalities were placed under administration. One possible solution is to use public-private partnerships in a more systematic way to develop public projects.

There is also a lack of public participation. According to the Institute for Democratic Alternatives in South Africa's Local Governance Unit, it is widely felt that local government planning and decisions do not always adequately address the needs of the disadvantaged sectors of the community. This contradicts one of the key building blocks for local governance, which is that stakeholder involvement should underpin decision making. It is estimated that only 3 percent of the national population has participated in integrated development planning processes.[21] Contributing factors include ineffective ward committees that do not adequately communicate with communities.

A lack of skills is a significant problem for government, especially at the subnational level. Local government has a severe lack of managerial and other skills and experience in the field of municipal service provision. This includes key positions such as mayors, municipal managers, financial and human resource managers, and engineers. The problem is worse in poorer and more rural municipalities. Consequences include weak planning and budgeting processes, disproportionate pay for officials who do not perform as required, weak controls, and bad financial oversight—which not only undermines service delivery but can also cause corruption. Maintenance of infrastructure is neglected, compromising existing services. Performance management systems allow for blame shifting, further fueling citizens' dissatisfaction. Notably, attracting skilled civil servants to remote communities is a problem for administrative staff, as well as key frontline services such as health and education.

To attract skills, the government needs to evaluate the impact of hiring decisions on the private sector. In South Africa's skills-intensive economy, skilled labor comes at a premium, and Chapter 2 has shown that the public wage bill has an impact on labor across the economy—making South African firms less competitive and undermining growth. Moreover, the wage bill has become increasingly unaffordable and has been reducing much-needed investment. A focus on adequately staffing the most important functions of government also requires identifying those areas where the quality of service delivery would not be majorly affected by having fewer civil servants. Consolidating government departments could improve coordination and reduce duplicate functions, thus releasing much-needed skills to the private sector. Recent analysis in the 2017 Medium Term Budget Policy Statement has shown that salaries at lower payment grades are significantly higher than in the private sector, suggesting that wage growth could be much more moderate in those income brackets—wages for senior civil service positions tend to be competitive (although the 2018 Budget shows that those wages have barely been rising with inflation).

4.5. Strengthening budget transparency and fiscal management

South African budgeting is transparent. South Africa has a medium-term planning and budgeting system, providing information on program outcomes, outputs, and financial performance, rather than just input-based costing. Strong budget credibility, predictability, and discipline are key features of the South African national budget system, which is anchored in a Medium-Term Strategic Framework that is regularly updated through a consultative process. The budget system achieved the highest score (jointly with New Zealand) in the 2017 Open Budget Index, up from third in 2015 and second in 2012. However, public finances face "growing strains and risks," as reported by the National Treasury in the 2017 Budget Review. These include underperformance in tax collection despite tax increases, with concerns about tax morality and administration; policy changes without adequate consideration of the budgetary consequence, such as higher education; and fiscal deficits from infrastructure projects that are poorly designed or ineffectively delivered, and substantial unsettled bills between public-sector entities for water, electricity, and property taxes.

South Africa has a strong public financial management framework. Several key changes in the public finance management architecture were embodied in the Constitution and the 1999 Public Finance Management Act, covering both the national and provincial spheres of government. Similar principles apply to municipalities through the 2003 Municipal Finance Management Act. The Constitution granted extensive power to the National Treasury to determine the financial management framework for all organs of state, in all spheres of government, making it a pivotal institution in government. Political heads of department are responsible for policy outcomes while the departmental head—the accounting officer—is accountable to Parliament for departmental outputs and financial management.

The Public Service Regulations entrench a performance contract system to provide an outcomes-based accountability framework linked to clear delivery and fiduciary responsibilities. South Africa's senior civil servants (four levels from director-general down to director) are subject to a performance agreement that outlines their yearly targets. These targets are clearly linked to governmental and ministerial objectives, as well as to departmental strategic plans and budget. The director-general and the minister develop the main performance agreement, which provides a basis for the performance agreements for the other three levels. These performance agreements facilitate accountability of senior managers, with clear objectives and targets being agreed with and evaluated by their supervisors. A process to investigate allegations of financial misconduct is now defined, along with clear sanctions such as fines and imprisonment, in cases of willful or grossly negligent noncompliance with specific provisions of the act. The Public Finance Management Act requires each minister to table in Parliament, six months after year-end, an annual report that discloses service delivery information for each program and audited financial statements. The independent Accounting Standards Board issues standards of generally recognized accounting practices for all spheres of government.

Public financial management was extended to not only cover expenditure management but also the management of revenue, assets, and liabilities. The government established control frameworks to support decentralized financial management and accounting systems. The strong focus on expenditure control was complemented with an equally strong focus on managing revenue, assets, and liabilities. This is in line with the intent to reform the accounting and reporting systems to an accrual basis in the future—reporting the financial impact of events when they occur, rather than when the cash impact materializes. The National Treasury retained specific controls, such as authorization to open bank accounts, incurring liabilities, and issuing guarantees. Procedural Treasury Regulations, such as prior approval for expenditures, were mostly delegated to accounting officers. The government also initiated phased delegation of central procurement functions to accounting officers. The point of departure in the revision of regulations was that "one is accountable for what one controls." Internal audit, under the guidance of independent audit committees, was made a compulsory control measure for all entities.

The governance relationship between ministers and the SOEs they control was redefined, and such entities were brought into the ambit of the Public Finance Management Act. The concept of "ownership control" was introduced to bring public entities under the government's control through the Public Finance Management Act and its regulations. It further supports the assignment of responsibility to ministers to exercise ownership control powers to ensure that the public entity complies with this act. The third benefit of this was to ensure the assignment of specific responsibilities, similar to that assigned to accounting officers of departments, to the governing body of each public entity. Fourth, the impact would include these public entities in the annual consolidated financial statements of the different governments, as required by international accounting standards. Similar provisions in existing acts of public entities were overridden by the new Public Finance Management Act, and arrangements were made to prevent future establishment of public entities without the Minister of Finance's approval. The previous Reporting by Public Entities Act was withdrawn.

Procurement is a key weakness. South Africa scored low on the 2014 Public Expenditure and Financial Accountability indicator on public access to complete, reliable, and timely procurement information. The procurement policy framework has very complex overlapping objectives, including increasing cost efficiency and addressing other pricing issues, improving the quality of services and products, empowering black South Africans economically, and increasing industrial participation and localization. These are often competing, and they remain difficult to implement and measure. In response, the National Treasury created the Office of the Chief Procurement Officer, whose primary role is to enhance transparency and value for money in procurement decisions. The 2015 Public Sector Supply Chain Management Review Report noted that the lack of strategic importance of public-sector supply chain management and the lack of clarity about the roles and responsibilities of technical staff and political office bearers create scope for interference in procurement decision making, and thus corruption. The report recommended identifying and implementing innovative ways to improve employees' capacity and using technology to streamline transactions, improve oversight, and maintain relationships with the private sector and citizens.

Public investment management could be further improved. Government acknowledges that public investment to promote growth and social development needs to be more effective. This requires strategic investment choices that are made in tandem with effective project development and execution, sustainable financing arrangements, and robust project appraisal. Current challenges in infrastructure delivery include fragmented capital budgeting, weaknesses in project preparation, and issues with technical aspects of infrastructure planning, execution, and delivery. This results in strategic choices that are not grounded in robust technical analysis; poor estimation of the lifecycle costs of assets; a failure to budget appropriately for capital, operating, and maintenance costs; and flawed approaches to procurement, project implementation, and management. The new Budget Facility for Infrastructure is a reform to the budget process that creates an institutional process to support the execution of national priority projects. It establishes specialized structures, procedures, and criteria for committing fiscal resources to public infrastructure spending. The main objective is to put in place a mechanism that improves the rigor of technical assessment and budgeting for the capital, operational, and maintenance costs of large infrastructure projects and programs.

4.6. Strengthening governance of SOEs

SOEs fulfill critical functions in South Africa.[22] There are many SOEs, at all levels of government, including commercial and noncommercial SOEs and their subsidiaries. Commercial SOEs include four types of incorporated and nonincorporated entities: SOEs operating under the Companies Act, which are the focus of this note; state-interest companies in which the state has a material interest but no control; statutory corporations that provide strategic goods and services; and financial intermediaries that provide financing where there is market failure. Noncommercial SOEs mainly carry out public functions and include research entities, regulatory entities, and advisory bodies. Together the asset base of all SOEs is reported to be over R1 trillion, equivalent to about 27 percent of GDP. The most important commercial SOEs are the 20 or so at the national level (Schedule 2 of the Public Finance Management Act) and the 14 water boards and water companies (Schedule 3b). These SOEs play a significant role in the economy, contributing more than 8.5 percent of GDP and maintaining networks and services in key sectors, such as the infrastructure, finance, national security, and social sectors.[23]

Commercial SOEs have had mixed performance results. A 2012 report by the Presidential Review Commission covering 2006–2010 shows that the overall performance of commercial SOEs in terms of revenue and profits was positive, but return on assets was low. During this period, total aggregate revenue grew by a compound annual growth rate of 6.9 percent, while the average net profit margin was 13.8 percent. The profit margin falls to 2 percent when the proceeds from unbundling Vodacom in 2010 are excluded. Return on assets was low, with an average of 0.7 percent. A few SOEs delivered significant returns, but others performed poorly and incurred losses. Among the profitable SOEs were Transnet, the Central Energy Fund, the Development Bank of Southern Africa, and the South African Post Office. However, South African Forestry Company Limited and the South African Broadcasting Corporation made significant losses for two of the five years, SAA had two years of losses, and Denel and Alexkor incurred losses in all five years.

Schedule 2 SOEs that are exposed to commercial discipline and stakeholder oversight performed significantly better than Schedule 3b SOEs. But performance in general shows that there is scope for SOEs to become more effective. Engagement with customers and the private sector indicated dissatisfaction with SOEs' service delivery while levies and fees kept growing. For example, in transport, where Transnet and the South African National Roads Agency are major players, addressing the cost of transport is critical for export success, but inefficiencies combined with access and pricing policies and delays in the ports and rail network have eroded the competitiveness of exporters and negatively affected trade. Inefficiencies stem from underinvestment; a fragmented regulatory framework and lack of competitive pricing due to the absence of an economic regulator for rail (Transnet sets its own tariffs and the Department of Public Enterprises monitors performance standards through the shareholder compact); a weak institutional structure; and a monopoly in the rail and port network and resultant cross-subsidization between Transnet's operating divisions. The opposition to the South African National Roads Agency's e-tolling system results in diminished opportunities for private financing of sections of the national road network and an increase in public financing requirements for road provision and maintenance.

Performance challenges also arise in the developmental and transformation policies and programs that SOEs are required to implement to address economic inequalities and underdevelopment. For example, SOEs are expected to provide capital for the attainment of BEE objectives, but the Presidential Review Commission report indicates that BEE programs have been unsuccessful. This has led to the enactment of the BBBEE Act and the establishment of the BBBEE Advisory Council to provide leadership and direction for implementation. While SOEs are aware of their role in supporting social, economic, and political objectives, financial and resource constraints hinder achieving results.

Operational and financial challenges affect SOE performance, but weak governance frameworks and practices are the root cause of underperformance. SOE performance is hindered by the lack of technical skills, lack of financing capacity to sustain operations, inadequate infrastructure, and lack of long-term planning. To this end, efficiency or productivity improvement programs need to be put in place to enable SOEs to achieve their objectives. At the same time, the key issue is one of governance—that is, the underlying rules, processes, and institutions that govern the relationship between SOEs and government as their owner/shareholder. SOEs face significant governance challenges that arise from multiple and competing objectives leading to interference in SOE management; lack of a clearly defined state ownership framework combined with a decentralized and heavy oversight structure; politicized boards and management with rising levels of corruption; uncertainty on funding strategies and tariff policies resulting in lack of financial sustainability for SOEs; and lack of a proper performance management system and disclosure practices to ensure transparency and accountability.

Improving governance frameworks and practices will be key to achieving better SOE performance and realizing the government's broader goals of infrastructure development and economic growth. Improved governance should help SOEs access commercial financing for investments and growth and become financially sustainable. Better-governed SOEs would also make it easier to attract private-sector participation and investment in SOE operations, especially in critical sectors such as energy. Improving SOE performance should help SOEs deliver on the state's developmental goals.

Improving SOE governance will require clarifying SOE objectives; improving the enabling environment for SOE governance; strengthening the state's role as owner/shareholder; professionalizing SOE boards and management and their application of good corporate governance practices; promoting the financial sustainability of SOEs; and enhancing the transparency and accountability of SOEs.

4.7. Financing for the developmental state

South Africa's fiscal sustainability has come under strain. With limited room to raise additional revenue, controlling expenditure, reducing the cost of debt, and forging partnerships with the private sector have gained in importance. South Africa's revenue-to-GDP ratio is 29 percent, the 88th-highest in the world.[24] This suggests that there is room to gradually raise tax collections in the long term. Mining is one area where tax collections appear to be weak,[25] but this topic can only be approached once confidence is restored in the mining sector. In the short term, raising taxes and cutting expenditure would likely undermine growth as long as the economy is weak. Prudently weighing tax increases and containing expenditure, as practiced in past budgets, will remain the government's best option. The 2018 Budget raises value-added tax for the first time since 1993, combined with higher spending on social grants to mitigate the impact on the poor. A continued commitment to debt stabilization can anchor expectations that help contain spending pressures and avoid further credit-rating downgrades. As explained above, the wage bill is exerting pressure on the budget, which reduces public investment and raises skills premiums—containing public-sector wage demands is critical. Moreover, raising the quality of spending, through better planning and monitoring and evaluation, will increase policy efficiency. Debt service is the fastest-growing expenditure category, so carefully managing the public debt is important to contain costs. If done properly, public-private partnerships can be an effective procurement technique that can also contain costs, manage the lifecycle of assets, and mobilize private investment for public infrastructure projects.

South Africa can increase and diversify long-term financing through capital-markets-based solutions. Commercial banks, which have traditionally been the main providers of long-term capital, are facing challenges to continue lending long term due to the Basel III prudential regulations. The government is pursuing efforts to establish an enabling environment for developing new long-term capital markets instruments to increase liquidity in banks' assets and expand the investor base to institutional investors. Instruments include securitization and covered bonds for housing finance and project bonds for infrastructure finance. The government bond market is relatively efficient but could be more liquid and transparent, given South Africa's financial sophistication. A more liquid and transparent bond market could help lower government debt financing, if the credit rating remains unchanged. An important step in this direction is the launch of a new electronic trading platform for government bonds. The platform is expected to be on par with similar ones in the European Union, bringing improved liquidity and transparency to the domestic government bond market. This would make the bond market more competitive and attractive to international banks and institutional investors and thus reduce government borrowing costs.

Multilateral financing is another option for South Africa to access long-term finance and guarantees. South African development finance institutions such as the Development Bank of Southern Africa, regional institutions such as the African Development Bank, BRICS institutions such as the New Development Bank, and international institutions such as the World Bank Group provide foreign and local currency-denominated financing instruments for the national government, SOEs, and subnational entities such as municipalities. The government is increasingly using guarantees to leverage the balance sheets of such organizations to reduce sovereign risk and borrowing costs.

The private sector can be more effectively mobilized in public-private partnerships to provide finance and procure service providers. South Africa has used public-private partnerships since 1998. The National Treasury houses a Public-Private Partnerships Unit. To date, the government has concluded 31 public-private partnerships worth R65.3 billion.[26] These projects include hospitals, transport and roads, tourism, and head-office accommodation. They have been funded through a combination of equity, debt, and government capital contributions. Notable public-private partnership schemes include the Gautrain Rapid Rail Link and the Dolphin Coast and Mbombela water and sanitation concessions. Not all partnerships have been popular with South Africans, such as e-tolls for some roads in Gauteng. The government established the Presidential Infrastructure Coordinating Commission to promote infrastructure development projects, focusing on implementation and long-term plans to ensure continued rollout. Eighteen strategic integrated projects have been developed and the commission will guide their implementation. Notwithstanding the commission's creation, the government has made little progress in the past few years on implementing projects and developing projects that effectively leverage public resources through public-private partnerships. Thus, South Africa has not yet taken full advantage of its "early mover advantage" to develop an appropriate and sustainable stock of projects.

Chapter 5

The World Bank Group's view on priorities for reducing poverty and boosting shared prosperity

"No political democracy can survive and flourish if the mass of our people remain in poverty, without land, without tangible prospects for a better life. Attacking poverty and deprivation must therefore be the first priority of a democratic government."

1994 RDP, quoted in 2012 NDP

5.1. Toward greater inclusion

South Africa has come a long way since 1994 in addressing the historical legacy of exclusion. Race has become less of a determinant of opportunity for historically disadvantaged South Africans, the labor force and corporate management have become more representative of South African society, the distribution of land and corporate assets is becoming less racially skewed, and more South Africans own homes. Access to basic services has increased considerably, and the social wage provides a minimum standard of living and protects the most vulnerable. The education system is slowly improving, although in many schools from a very low base. Although inequality remains high, poverty has fallen significantly since 1994. Social change takes time, but it has been ongoing in South Africa.

South Africa continues to become more inclusive. Poverty and inequality are reducing. By 2030, this SCD expects extreme poverty to have fallen to 12.8 percent, from 18.6 percent in 2017 (using the World Bank's global poverty line), lifting another 2.1 million South Africans out of poverty. Inequality is also expected to decline considerably, from a consumption Gini coefficient of 62.8 in 2017 to 59.5 in 2030. This reduction is mostly due to slowly but steadily improving education outcomes. As growth is expected to average 1.3 percent between 2017 and 2030 at the baseline for this SCD, consumption will grow faster for the poor than for the rich. It is inclusive growth—consistent with the reduction in inequality—but it is slow growth. About 2.8 million additional jobs are expected to be created. This falls short of the NDP target of creating 11 million jobs between 2011 and 2030, but it is consistent with slow economic growth. Similarly, poverty is unlikely to be eradicated by 2030, as targeted by the NDP. The projected decline in inequality, on the other hand, appears to approach the NDP target.

More needs to be done to achieve South Africa's Vision 2030. South Africa's transition remains incomplete, as—notwithstanding considerable progress in advancing the Freedom Charter's historical goal that "the people shall share in the country's wealth"—the legacy of exclusion persists: too many historically disadvantaged South Africans remain disadvantaged today, chronically poor, without land or property, and without tangible prospects for a better life. Employment among historically disadvantaged South Africans remains relatively low and entrepreneurs face many obstacles. This makes it more difficult to strengthen South Africa's democracy and its underpinning social contract. It is even more difficult in an environment of low growth, when social change hinges on redistributing existing resources rather than sharing in growing opportunities. Since the global financial crisis and the end of the commodity boom, the contestation over resources has increased, governance has been deteriorating in some areas, and progress in reducing poverty and inequality has stalled. Bold reforms are needed to accelerate social progress and to counter the erosion in institutional quality. Some people are calling for an "economic CODESA": a social compact framing the progress of South Africa's transition. This is a historical opportunity for President Cyril Ramaphosa, the architect of the original CODESA, which paved the way for democracy.

This chapter outlines the World Bank Group's views on key constraints to and potential priority interventions for reducing poverty and boosting shared prosperity—the twin goals. These goals form the foundation of the World Bank Group's corporate mission, which it received from its member states, including South Africa. The World Bank Group offers financial and nonfinancial services to advance these goals in its member countries. The Country Partnership Framework identifies the areas where governments and the private sector intend to leverage these services. To ensure that World Bank Group interventions are effective and address the most binding constraints to the twin goals, SCDs are prepared ahead of every new Country Partnership Framework. Based on broad consultations and background research, this SCD identifies the following key constraints for South Africa, by order of priority: insufficient skills; a skewed distribution of land and productive assets, and weak property rights; low competition and integration into global and regional value chains; limited or expensive connectivity and under-serviced historically disadvantaged settlements; and climate shocks: transition to a low-carbon economy and increasing water insecurity. These will inform core engagement areas under the 2019–2022 Country Partnership Framework.

The World Bank Group consulted widely for this SCD. The SCD draws on a large number of background notes (Annex 3). It aligns with the World Bank's "World Development Report 2006: Equity and Development" and is anchored in the NDP. The SCD was prepared in close collaboration with the National Planning Commission, the "guardian" of the NDP. A broad range of stakeholders were consulted (see Annex 4), including various government departments (especially the National Treasury and the Department of Planning, Monitoring, and Evaluation), the South African Reserve Bank, members of the private sector and South African trade unions, young people in three South African townships, academia, and members of the diplomatic corps. In line with the various types of exclusion discussed in this SCD, four one-day workshops were held, on "Skills and Jobs" (labor markets), "Poverty, Jobs, and the Spatial Economy" (land and location), and "Business and Jobs" (capital and product markets). Chapter 2 draws on an SCD workshop on "Macro-Volatility and Social Cohesion." While the views on priorities for reducing poverty and inequality presented in this chapter are those of the World Bank Group South Africa country team, they have been shaped in consultation with South Africans over the course of a year.

5.2. Root causes of poverty and inequality

Key constraints to the twin goals were identified through a root cause analysis, drawing on Chapters 1–3. Root causes are the initiating factors of a results chain that need to be solved. For this SCD, poverty and inequality are at the bottom of the chain. Addressing root causes is particularly impactful as the effects ripple through the results chain and will help lift multiple other constraints that are further down the chain: symptoms. A root cause approach is also likely to result in more sustainable outcomes as root causes are affected by fewer other factors that could derail these outcomes. Root causes in this SCD are historical (especially linked to institutions that have evolved over many decades and centuries) or linked to natural factors, such as geography, endowments, and the climate. Tackling root causes takes a long time so this SCD also looks at areas that can yield some quick wins, by addressing a fundamental problem itself or by creating confidence by demonstrating that a fundamental problem is being tackled. Finally, addressing root causes requires political will and implementation capacity. Governance is not treated as a root cause in the SCD but as a mediating factor in deciding which root causes are the most feasible and the most likely to yield results. Governance is therefore also recognized as a key enabler to help address the root causes identified.

Five root causes were identified (see Figure 5.1). One relates to skills, which are critical for jobs and economic growth. Household consumption lies at the core of poverty (the level of consumption) and inequality (the distribution of consumption). High and persistent unemployment, especially among the youth, is a major concern. To create more jobs, increasing labor demand and raising the productivity of the labor force are key. Skills are critical for both labor supply and demand: they raise the productivity of workers and entrepreneurs and help firms expand their production at competitive prices, raising aggregate demand in the economy for more goods and services. The legacy of "Bantu education" continues to deprive South Africa of the skills it urgently needs, explaining low growth, productivity, and competitiveness; high unemployment; and very high wages for some and very low wages for others. Low household savings and high indebtedness reflect the low income of most South Africans. In this light, a root cause of both poverty and inequality in South Africa lies in the legacy of "Bantu education" and the associated exclusion in South Africa's education system (Figure 5.1), which has only been slowly improving since democracy.

South Africa's historical, highly skewed distribution of land and productive assets is a source of inequality and social fragility, and it fuels the contestation of resources. Property rights are weak or under pressure. South Africa's level of inequality in assets is even starker than its level of income and consumption inequality. Wealth and land are still held by very few South Africans. Since democracy, the black middle class has expanded, building wealth mostly through labor income and credit. Publicly provided housing constitutes an important asset for an increasing number of poor South Africans. Yet weak titling of property, especially in poorer and more informal areas, limits the value of property, including as collateral to access finance. Tenure security in the former homelands remains weak. Thus, even when the poor hold assets or land, their value is limited. Such inequality strains socially acceptable standards of fairness, fueling a contestation of resources. Land reform and elements of BBBEE aim to change the ownership distribution of assets, thus reducing the property security of their owners. It is a major source of policy uncertainty, especially in agriculture and mining. Inequality in assets thus has three impacts on the twin goals: (i) inequality in income from land and productive assets; (iii) limited access to finance, especially for the poor; and (iii) low job growth as weak property rights suppress investment and economic growth.

Low competition and integration into global and regional value chains deter growth and job creation. They also keep prices high, especially for the poor. South African banks are well integrated into the global economy. Manufacturing, on the other hand, has traditionally been protected by natural trade barriers, such as distance, and a history of import substitution, sanctions, and industrial policy support. State intervention, before and after 1994, has inadvertently supported market structures that can thwart competition; monopolistic practices are relatively common. SOEs remain dominant: they are often vertically integrated and can undermine competition. At times their inefficiency hurts the economy's competitiveness. South Africa's product markets have high barriers to entry and rivalry and are poorly integrated into the global economy. Firms thus miss out on opportunities to tap into global markets and grow through technology transfers associated with participating in the value chain. This is especially a problem for SMMEs that struggle to find new demand in a stagnant economy and face barriers by incumbents. Matters are made worse by the skills constraint, which particularly hurts manufacturing firms, SMMEs, and emerging entrepreneurs and farmers. South Africa's relatively low integration into the world economy means that it may miss out on the opportunities arising from the increase in global growth, as the world recovers from the global financial crisis of 2007/8. Productivity gains from competitiveness, competition, and innovation are needed to produce better goods more cheaply. Cheaper goods are especially important for the poor, allowing their budgets to stretch further. South Africa has increasingly been focusing on regional value chains, which is sensible for sourcing inputs from the SADC region. However, the regional pivot risks becoming a retreat from global markets. It may hurt South Africa as much as the region, since South Africa could help regionally produced products reach global markets.

Limited or expensive connectivity and under-serviced historically disadvantaged settlements continue to reflect the legacy of separate development. Many South Africans continue to live far away from job opportunities, in townships, informal settlements, and the former homelands. Where they are closer to opportunities, especially in urban areas, they still live on the outskirts. This makes commuting expensive. Costs are exacerbated by a functioning but anti-competitive minibus taxi sector. There has been significant migration from rural areas in pursuit of jobs in cities. While migration supports poverty reduction, it can put pressure on the sustainability of existing public services and raise social tensions with existing residents as they compete for jobs, services, and business. The democratic government has been making considerable efforts to reduce apartheid spatial patterns. At times, it has, however, inadvertently reinforced them, for example through housing policy. Spatial planning is becoming increasingly focused on sustainably and strategically densifying cities, but changing the spatial landscape is a slow process. Many South Africans will continue to live in relatively remote and isolated locations. This means fewer job opportunities as well as fewer opportunities to interact with South Africans with a higher socioeconomic status through, for example, mixed schools. Access to infrastructure services, such as electricity, water and sanitation, flush toilets, good public clinics and schools, and financial services, remains much weaker in historically disadvantaged communities, keeping living standards and growth opportunities low in these areas.

Climate change will increasingly impose considerable costs on South Africa, which relies heavily on coal to power its economy and confronts severe water shortages. South Africa is heavily dependent on coal for growth. In the transition to a low-carbon economy, a viable decarbonization strategy will be needed to ensure that important economic sectors are not negatively affected. South Africa will also experience the consequences of a hotter and drier climate, such as prolonged droughts that debilitate natural ecosystems and amplify water insecurities. Urbanization and economic growth continue to increase the demand for water, outstripping available renewable supplies of water. Indeed, Cape Town and other cities are seeing their water services severely rationed, with piped water supplies potentially running dry in the near future. Efforts to build resilient cities will need to go much further than current management plans. Drought-proofing requires long-term source diversification, more aggressive demand management, and the reallocation of water to more productive and efficient uses (through cost-reflective pricing or water permit trading)—while carefully balancing fiscal and resource sustainability concerns. Climate shocks, including extreme events like droughts and floods, along with increasing incidences of disease and sickness, will disproportionately hurt the poor. Moreover, the policy response may compound the impact. Those whose livelihoods depend on low-value, energy- and coal-intensive activities (for example, coal miners and steelworkers) and water-intensive activities (for example, small landholders that depend on cheap, unsustainable irrigated water) will be the first compelled to adapt to climate change and to endure its hardships. South Africa needs to create job opportunities consistent with a low-carbon growth agenda, increase the resilience of vulnerable natural resources, and prepare long-term social protection systems that protect vulnerable communities.

A number of symptoms link to these root causes, aggravating the impact on poverty and inequality. Jointly, they undermine fiscal, external, and financial sustainability. The contestation over resources finds many legal manifestations. They include BBBEE and land reform, as well as competition for fiscal resources: #FeesMustFall is putting pressure on the budget as students demand resources for the key to the middle class: a university degree. The NHI attempts to address the high disparity in the quality of health services, also putting pressure on the budget. Public sector unions demand higher wages—essentially redistribution from taxpayers to civil servants. All these spending pressures are weighing on the budget, making it difficult to contain the fiscal deficit, especially in an environment of low growth, when the contestation over resources intensifies while revenue growth slows. This is aggravated by illegal forms of resource contestation, such as corruption. Climate shocks also require spending by the government to support affected communities. Jointly, these various types of expenditure pressures are making it more difficult to maintain fiscal sustainability. A high budget deficit in turn is reflected in a high current account deficit, undermining external sustainability. The current account deficit is largely financed with volatile portfolio flows. Shocks such as domestic policy uncertainty make the rand a highly volatile currency, which in turn becomes a constraint for much-needed long-term investment. Finally, weakening sovereign and SOE creditworthiness raises borrowing costs throughout the economy. It becomes a concern for banks, which hold much of the public bond portfolio, posing a threat to financial sustainability. This is further aggravated by the threat of land expropriation without compensation undermining collateral.

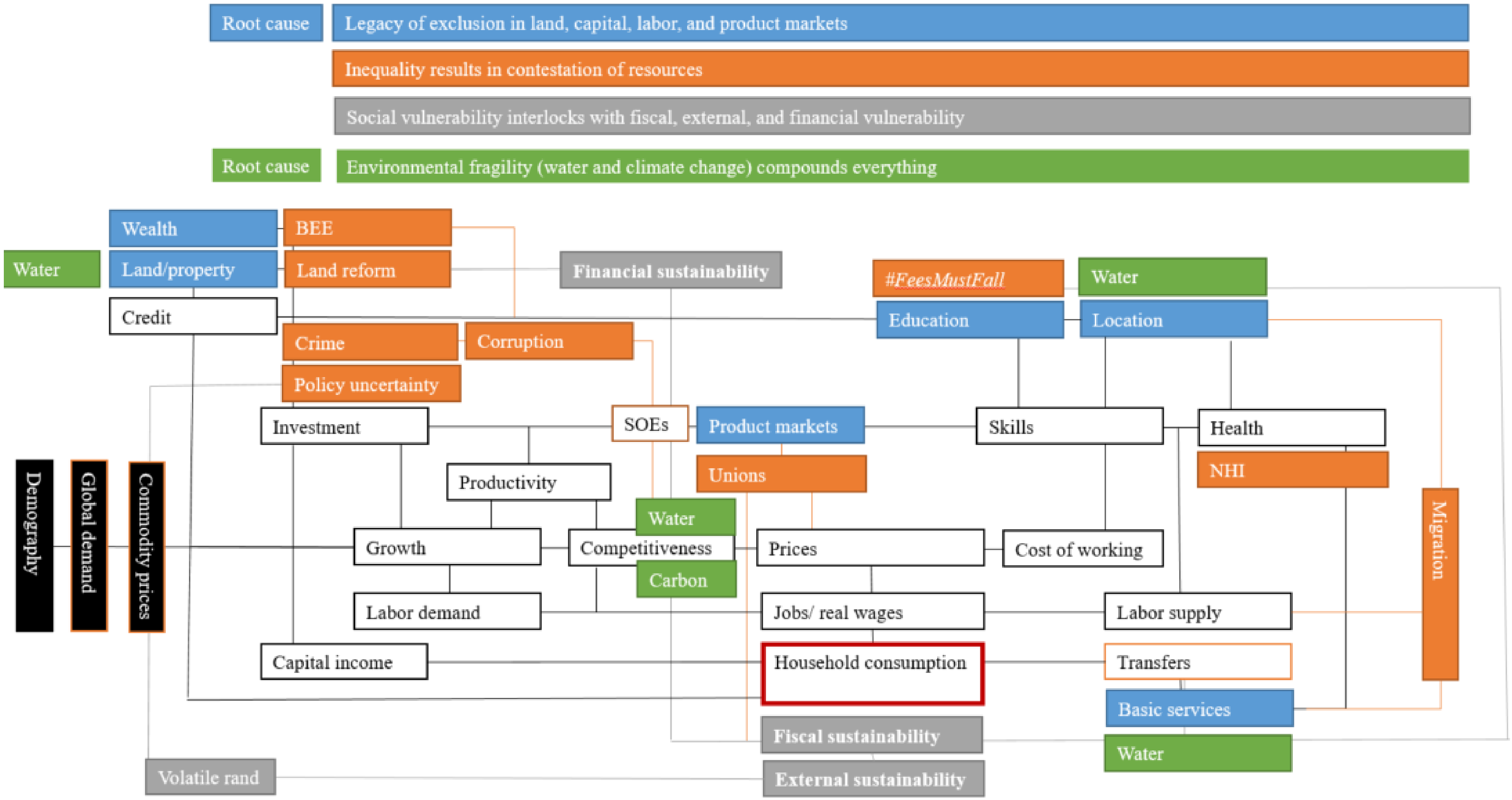
Root causes and symptoms combine to slow the transformation of South African society. For example, poor South Africans and historically disadvantaged entrepreneurs have comparatively poor access to finance. The financial sector caters well to large formal companies but finds it more difficult to provide services to SMMEs. This difficulty partly derives from the fact that entrepreneurs are inherently risky for banks: they do not have collateral because they do not own assets or do not have deeds for their property; they have had a poorer education, making it more difficult to compile a convincing business plan; and they live in areas that experience high levels of crime, another form of resource contestation, making banks less likely to lend to them. In addition, low growth—a symptom of the incomplete transition—results in fewer job opportunities, especially for unskilled and young South Africans, as well as fewer opportunities for emerging entrepreneurs to tap new market demand. Problems with property registration, limited financing opportunities, rigid product markets, and low demand also pose problems to making land reform successful, leaving many emerging farmers stranded. Thus, the economy provides few opportunities for historically disadvantaged South Africans to enter the middle class.

5.3. The World Bank Group's view on priorities for the twin goals

The World Bank Group considers the five root causes to be the key constraints to reducing poverty and inequality. The root causes are aligned with priority areas in various national policy plans since democracy (Figure 5.2). A quantitative text analysis of the RDP, the GEAR strategy, AsgiSA, the New Growth Path, and the NDP points to nine key focus areas in South African policymaking between 1994 and 2012. All of these key areas are reflected in the most recent strategic document: the NDP. Two areas are considered to relate mostly to symptoms rather than root causes: (i) crime, corruption, and the deteriorating quality of institutions, and (ii) macroeconomic stability. They are thus not prioritized under this SCD as root causes.

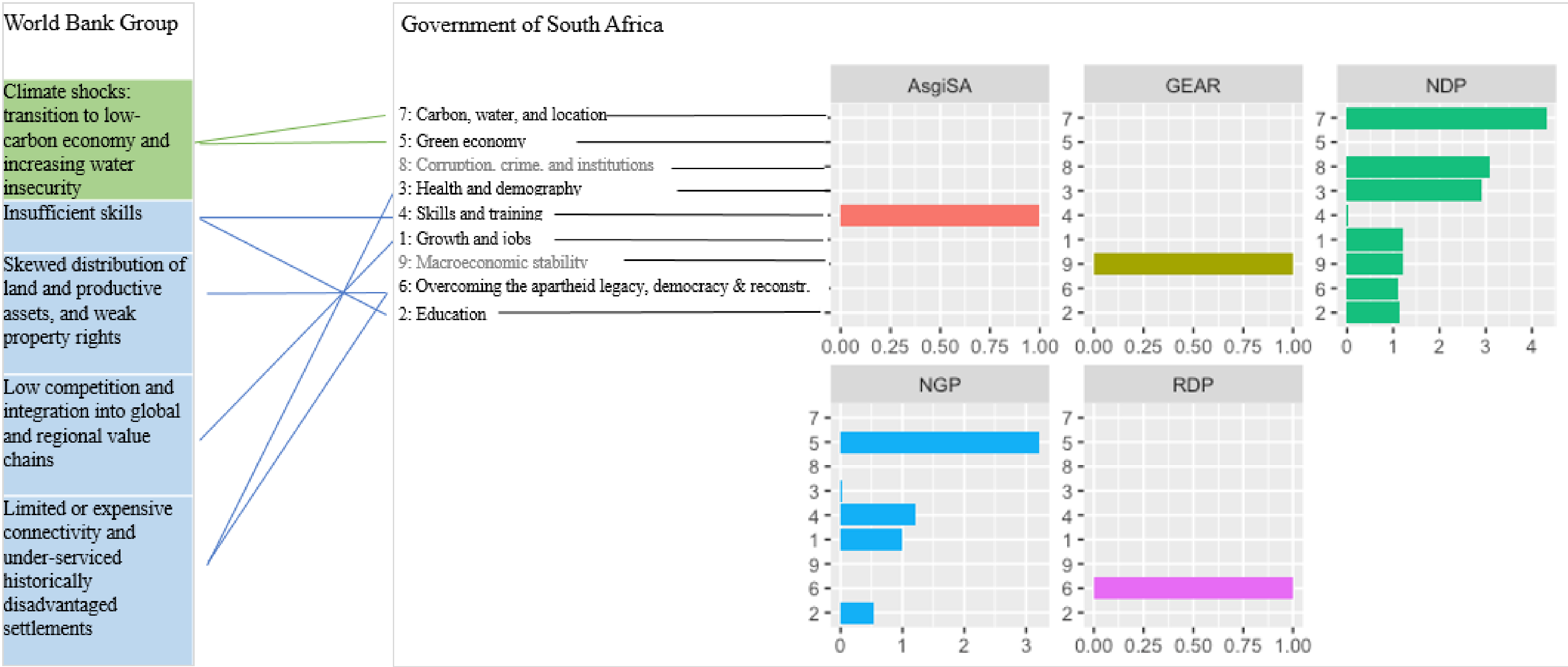
The priorities identified across the five root causes are based on the likely impact of possible policies on poverty and inequality. To gauge the impact of potential solutions, the World Bank Group country team drew on insights from secondary literature, background notes, and various consultations, and used information from this exercise in a number of CGE simulations (Chapters 2 and 3). The results are summarized in Table 5.1. According to this analysis, more competition, greater certainty on property rights (for example, in the third Mining Charter), and skilled migration would have significant impacts on economic growth and jobs. Poverty and inequality would fall the most by improving education and greater redistribution. The largest impact on unskilled/semiskilled jobs would come from improved HIV/AIDS treatment. Combining all interventions simulated through the CGE model, extreme poverty (using the World Bank definition) could fall to 4.9 percent by 2030, 8 percentage points lower than at the baseline; the Gini coefficient could fall to 55.2, compared to 59.5 in the baseline. These interventions would get South Africa closer to the poverty reduction target expressed in the NDP's Vision 2030. The significant reduction in inequality would bring South Africa in line with BRICS peers.

Figure 5.1: Root cause analysis



Source: World Bank Group staff.
Note: Blue and green boxes have been selected as root causes; orange and grey boxes are considered to be symptoms of root causes.

Figure 5.2: Root causes, priority areas, and alignment with South African national policy since democracy



Source: World Bank Group staff, based on Mikhaylov (2018) SCD background note.
Note 1: A quantitative text analysis was conducted on the corpus of the 1994 RDP, the 1996 GEAR plan, the 2005 AsgiSA, the individual chapters of the 2010 New Growth Path, and the individual chapters of the 2012 NDP. In a statistical, probabilistic topic modeling analysis nine overarching topics were identified across all development plans, as displayed above. Values on the x-axis of the charts represent proportion of themes in the documents/chapters.
Note 2: Although the SCD does not identify corruption, crime, and deteriorating institutional quality as a root cause, they are considered a symptom of the incomplete transition. The World Bank Group country team identified corruption as the top constraint to policy effectiveness (see Table 5.2). Similarly, increasing macroeconomic vulnerabilities are considered a symptom of other factors, including the contestation for resources and low economic growth.

Table 5.1: Policy solutions for reducing poverty and inequality, creating jobs, and boosting economic growth

Summary and scenario combining all simulations				Additional jobs comparted to 2017 (million)	
	World Bank poverty rate ($1.90)	Gini coefficient	Real GDP index	Unskilled/ semiskilled jobs	Skilled jobs
2017	18.6	62.8	100.0	-	-
2030: Baseline	12.7	59.5	119.5	2.26	0.56
MIN1 Greater certainty in mining	12.5	59.6	122.9	2.32	0.56
EDU1 Improve basic education	11.7	59.1	119.5	2.30	0.57
EDU2 Improve university access	12.0	58.7	119.1	2.25	0.58
EDU3 EDU1 and EDU2 combined	8.5	58.0	118.9	2.29	0.59
SKM1 Skilled migration	12.7	59.3	121.9	2.33	0.69
HIV1 Expand HIV treatment	12.7	59.5	120.3	2.53	0.58
SPA1 Spatial integration	12.0	58.6	120.2	2.29	0.56
MKP1 Greater competition	11.0	58.8	125.4	2.65	0.58
RED1 Redistribution	8.2	58.1	120.9	2.28	0.55
All combined Combining all scenarios	4.9	55.2	133.7	3.12	0.78

Source: Chapter 2 and 3, derived from World Bank CGE model.

The country team selected the priorities identified by the SCD based on the expected impact on the twin goals (Table 5.2). A country team meeting was held in February 2018, when the root cause analysis was validated. Potential interventions to tackle the challenges linked to the root causes were then discussed. Country team members voted in an anonymous survey on how strong they believed the impact of specific interventions would be on the twin goals. In considering their vote, the World Bank Group team was also asked to rate the strength of the evidence gathered during the SCD, to help identify solutions that have both strong evidence and a high expected impact.

Potential low-hanging fruits for reform were also identified. Low-hanging fruits are areas that meet one or a combination of the following criteria: low cost, yielding quick results, high feasibility, and the potential to launch a virtuous circle. Low-hanging fruits help strengthen investor confidence and thus provide a positive boost to investment, growth, and job creation. The World Bank Group's view on potential low-hanging fruits to address poverty and inequality are highlighted in Figure 5.2.

Table 5.2: The World Bank Group's views on constraints and priority areas for reducing poverty and inequality

	Constraint by priority	Priority intervention areas	Impact on twin goals	Evidence base
1	**Insufficient skills**	Strengthen nutrition and early years intervention	High	High
		Train teachers in basic education / strengthen teacher accountability	High	High
		Expand affordable university access; encourage entry of private universities	High	High
		Reform TVET system, incl. stronger collaboration with the private sector, and prepare labor force for structural change, incl. low-carbon transition	High	High
		Foster skilled migration	Moderate	Moderate
		Strengthen active labor market policies	Moderate	High
2	**Skewed distribution of land and productive assets, and weak property rights**	Strengthen tenure security and capacity for land reform	High	Moderate
		Strengthen extension services, financing, training, access to inputs and capital equipment, and marketing and transport infrastructure for small-scale and emerging farmers	High	Moderate
		Improve property registration and transaction processes, including for RDP houses	Moderate	Low
		Accelerate roll-out of social and affordable housing, in partnership with private sector	Moderate	Low
		Make BEE more broad-based (e.g. through a contributory social pension); strengthen BEE accreditation system; evaluate and limit unintended investment impacts of BEE	High	Moderate
3	**Low competition and low integration in global and regional value chains**	Implement sustainable mechanisms to embed competition principles in sector/market rules and regulations (incl. trade tariffs) and in the design of trade, energy, and industrial policies	High	High
		Strengthen investor-friendly regulation and attract FDI	Moderate	Moderate
		Strengthen capacity of the financial sector to lend to SMME and provide hedging products for SMMEs, and support microfinance institutions	Moderate	Low
		Foster supply chain development / localization, including in agribusiness and automotive; support financing for supply chain development	High	High
		Reduce logistics costs and raise efficiency in ports and cargo rail through better regulation and partnerships with the private sector	Moderate	High
		Align ICT regulation with international best practice	Moderate	Moderate
4	**Limited or expensive connectivity and under-serviced historically disadvantaged settlements**	Foster strategic densification of cities (esp. secondary cities) and diversification of land use	Moderate	Low
		Expand basic TB and HIV interventions as part of strengthening primary care to under-serviced settlements	High	Moderate
		Expand basic services in under-serviced settlements	High	Moderate
		Better integrate transport planning and land use, strengthen intermodal transport, and strengthen regulatory framework in support of competition in minibus taxi sector	Moderate	Low
5	**Climate shocks: transition to low-carbon economy and increasing water insecurity**	Carbon pricing (carbon tax and carbon budget)	Low	Low
		Leveraging private investment in energy conservation, and clean energy generation technologies (e.g. renewables and natural gas)	Moderate	Moderate
		Strengthen regulatory and investment framework for more resilient and efficient water service delivery	High	Moderate
		Incentivize consumers to use water efficiently (e.g. through cost-reflective pricing)	Low	Low
		Promote insurance against climate shocks	Moderate	Moderate

Source: World Bank Group South Africa country team consensus based on February 2018 survey.
Note: Gray shading indicates potential low-hanging fruits for reform.

Insufficient skills are the first most important constraint to the twin goals. The World Bank Group country team identified interventions that focus on children and young adults as the most critical. Interventions expected to have the most impact include strengthening nutrition and early years interventions; training school teachers and holding them more accountable; expanding affordable university access; and reforming the TVET system. Leveraging the private sector in strengthening the university and vocational training system will be important. Because building skills takes time, skilled migration is needed to address skills shortfalls in the interim. However, this hinges both on the potential pool of skilled professionals interested in moving to South Africa and the government's willingness and capacity to attract and process visa applicants.[1] Finally, active labor market policies are expected to have a moderate impact on poverty and inequality—while they improve employability in many countries, they can be expensive, they tend to only address core labor supply issues—low labor productivity—on the margins, and their effectiveness is limited by low economic growth: there are relatively few new positions they can help fill. There are, however, opportunities in this area. The private sector has shown interest in partnering with the government, for example, through the YES Campaign of the CEO Initiative.

The skewed distribution of land and productive assets, and weak property rights, are the second most important constraint to the twin goals. Among the high-impact areas, this priority focuses on greater property security for farmers, including current farmers and beneficiaries of land reform. The country team believes that strengthening tenure security, especially in the former homelands, and the capacity for land reform will be important to quickly resolve uncertainty in agriculture and foster investment in the sector, while creating opportunities for farmers in rural areas. Notably, the emphasis is not on land reform alone, but also on making sure that emerging farmers are sufficiently supported to make their land productive. At the same time, the country team identified the need to improve the current BBBEE system, making it more broad-based, while minimizing any adverse impacts on investors. BBBEE arguably undermines property rights the most in mining through the third Mining Charter. An amicable, swift resolution will bode well for investment, and early conversations between the Chamber of Mines and President Ramaphosa in February 2018 have made progress on this.

Low competition and low integration in global and regional value chains is the third most important constraint to the twin goals. Overcoming the exclusion of South Africans in South Africa requires overcoming South Africa's exclusion in the world economy, following a history of import substitution, protectionism, and sanctions. The country team saw high potential to make progress toward the twin goals by strengthening the contestability of markets by, for example, implementing sustainable mechanisms to embed competition principles in sector/market rules and regulations (including trade tariffs) and in the design of trade, energy, and industrial policies. More investor-friendly regulations and other measures (such as strategic equity investment) to attract private investors—including foreign investors—into concentrated markets will be vital to make product markets more contestable. Partnering with domestic and foreign firms and new investment in global value chains will bring new technology to South Africa, innovate and boost productivity, and allow the country to catch up with more developed economies. Firms across the spectrum of South African companies will benefit from accessing global and regional markets through value chains, while large firms can play the role of lead firms in the value chain that help open new markets and develop suppliers. Better access to regional and global markets requires better, cheaper, and more integrated logistics, especially in port and cargo rail. No modern economy can compete globally without up-to-date ICT architecture. Aligning South Africa's ICT regulatory framework with global best practice is therefore critical. Finally, SMMEs' access to finance needs to be improved. In many cases the lack of access is a symptom of other constraints, including low aggregate demand, insufficient skills, or poor collateral. Yet there is also some evidence that commercial banks lack the capacity to operate in the SMME-lending space, while microfinance institutions have yet to seize opportunities from new enabling legislation. Strengthening the private sector's capacity to provide services to SMMEs may enable entrepreneurs to expand their businesses and create jobs, especially in poorer areas.

Limited or expensive connectivity and under-serviced historically disadvantaged settlements is the <u>fourth</u> most important constraint to the twin goals. The country team considered the expansion of TB and HIV interventions and strengthening primary care to under-serviced settlements to have a high impact on poverty and inequality, as well as the expansion of other basic services more broadly. Densifying and sustainably diversifying cities, strengthening transport connectivity, integrating transport planning and land use, improving intermodal transport, and strengthening the regulatory framework in the minibus taxi sector are important to overcome the legacy of spatial exclusion, and reduce transportation costs and travel time for the poor. Yet impacts on poverty and inequality are expected to be moderate as spatial patterns only change slowly, especially in an environment of low economic growth, resulting in relatively few new job opportunities even in urban centers.

Climate shock, including the transition to a low-carbon economy and water insecurity, is the <u>fifth</u> most important constraint to the twin goals. Water insecurity has become a particular problem for South Africa. It affects the poor disproportionately and renders South African industry—including agribusiness, which is particularly important for poorer, rural areas—increasingly less competitive, as water prices rise with increasing demand and fully utilized water resources. Promoting investments in renewable sources of energy will contribute to South Africa's low-carbon transition, while attracting private investment for more sustainable and efficient water usage will reduce pressure on strained water resources. Strengthening insurance instruments, in close collaboration with the private sector, is expected to have a moderate impact on the twin goals, while improving water efficiency through the tariff structure is expected to have a low impact. The country team rated climate mitigation mechanisms, such as a carbon tax and investments in renewable energy, as having low to moderate impacts on poverty, although they are critically important for South Africa to tackle climate change. Finally, climate-smart agriculture will be important to guarantee adequate food production for South Africa and the region.

5.3. Governance constraints and low-hanging fruits for quick results

Fiscal sustainability has weakened since the global financial crisis, putting South Africa's credit rating under strain. This SCD has argued that containing the fiscal deficit and public debt is particularly difficult in a highly unequal country, with low growth, a narrow tax base, and high spending pressures. Low per capita growth means that resources per South African decline, increasing contestation over resources. Maintaining fiscal sustainability is particularly difficult when growth is low. It will require strong political leadership to strengthen the budget's credibility and avoid further downgrades of South Africa's credit rating. In the longer term, tackling the root causes of inequality will be critical for fiscal sustainability.

Institutional quality has been eroding in South Africa. Corruption has been increasing. It affects the service delivery of SOEs and the national budget, crowding out other important spending priorities and generating uncertainty over the government's ability to guarantee efficiency and public services in future. The court system has proven strong and, together with the media, is a pillar of South Africa's institutional architecture and a bulwark against corruption. While it does not affect every element of policy implementation, the country team acknowledges corruption as the most important constraint to effective policy delivery (Table 5.3). Strong political resolve demonstrated in early 2018 is critical for containing corruption, allowing law enforcement agencies to prosecute those associated with corruption. In addition, strengthening the accountability of government by maintaining the freedom of the press, strengthening institutional procurement and transparency processes, and promoting an active citizenry (as advocated in the NDP), can contain corruption. Containing corruption will not be easy, as it is a symptom of the "incomplete transition." Eventually, overcoming the legacy of exclusion will also be important for containing corruption: for example, more educated citizens are more active citizens and better able to hold politicians accountable.

Table 5.3: Governance constraints

Governance priorities	Priority rank
Corruption	1
Low accountability for performance	2
Weak monitoring and evaluation	3
Fragmentation of programs	4
Weak corporate governance in SOEs	5
Unintended consequence of policies	6
Capacity gaps in the civil service	7
Limited capacity by civil society to hold government accountable	8
Limited participation of the private sector in policy formulation	9
Limited participation of the private sector in service delivery (public-private partnerships)	10

Source: World Bank Group South Africa country team consensus based on February 2018 survey.
Note: Gray shading indicates potential low-hanging fruits for reform.

Institutional and capacity constraints may hamper effective policymaking and implementation. Consultations revealed that South Africans feel they have the right policies but that implementation fails. It is thus important to be particularly mindful of constraints that may adversely impact implementation. Drawing on insights summarized in Chapter 4, the World Bank Group country team identified the following as the most important governance constraints in South Africa (Table 5.3): one, low accountability for performance (for example, in schools and hospitals); two, weak monitoring and evaluation (including for important jobs, entrepreneurship programs, and industrial policy); three, fragmented programs (across line departments, agencies, and the three spheres of government); and four, weak corporate governance in SOEs. Some of these are easier to address than others. Strengthening accountability may require compromises with vested interests (lobbies or unions), which can be costly. Low accountability is also a consequence of poverty and associated dependency relationships. Monitoring and evaluation requires data sharing across implementing agencies, which can hamper implementation, especially when fragmentation is high and coordination weak. Overcoming fragmentation, however, often requires political will and complicated institutional changes. With regards to SOEs, bringing in private-sector experience and accountability to SOE boards (for example, through partial privatization) could strengthen governance.

Capacity gaps are closely linked to insufficient skills. A strong partnership with the private sector is critical to ensure that skills are deployed to where they add the most value to the economy and society. Low capacity in the civil service is ranked as the seventh most important constraint. South Africa's skills constraint affects both the private sector and government, especially municipalities and some line departments. The private sector and the public sector compete for skills, raising the skills premium and making skilled labor more expensive for firms. This hampers the private sector in growing, innovating, providing new products, and creating jobs. Focusing top civil servants on priority areas can help strengthen implementation of public projects while containing competition for skills with the private sector, the ultimate engine of job creation.

Social progress can be accelerated through measures that deliver results relatively quickly and thus boost confidence. The World Bank Group country team was asked to identify any low-hanging fruits among the identified priorities (Tables 5.2 and 5.3). These include identified interventions in basic education (teacher training) and tertiary education (broadening access to universities in a fiscally sustainable manner and strengthening partnerships with the private sector in vocational training), as well as health interventions (HIV, TB, and clinics). Among areas believed to have a moderate impact on the twin goals, low-hanging fruits may include strengthening investor-friendly regulations and, to a more limited extent, reducing logistics costs in port and rail. Confidence-boosting measures also include better monitoring and evaluation, as well as improving the private sector's participation in policy formulation. This could include a quick resolution of the dispute around the third Mining Charter, greater participation in education and training, or greater consultation in impact assessments for draft policies, including land expropriation without compensation in the agricultural space.

The SCD has brought together a large amount of evidence on key constraints to achieving the twin goals and potential solutions. Knowledge gaps remain. Areas that the World Bank Group country team would like to better understand are summarized in Table 5.4.

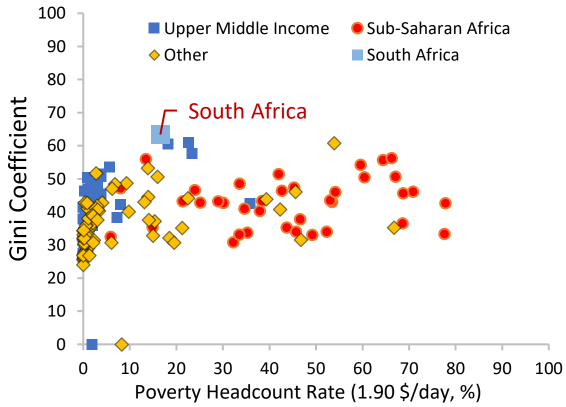
Table 5.4: Knowledge gaps and areas for future research

Education (linked to priority 1)
How can South Africa raise learning outcomes faster in basic education for the poor?
How to reduce school drop-out rates?
How to improve affordability of tertiary education and foster collaboration with the private sector?
How can South Africa improve education and job opportunities for people with disabilities?
Social protection and building the asset base of the poor (linked to priorities (1-2)
How to strengthen the social protection system in support of active labor market policies
Would a basic income system be appropriate for South Africa, and how could it be linked to building assets for the poor?
How to reduce violence and protect the main victims of crime (women, children, SMMEs)?
Development of townships and rural economies (linked to priorities 2-4)
What is the potential of creating jobs in townships and rural economies and what are the most promising intervention areas?
What private-sector incentives work in attracting businesses to historically disadvantaged areas?
How can tenure security be strengthened in the former homelands?
What is the potential of natural resources (land, wildlife, water, fisheries) to generate sustainable sources of financing for the country and local communities, particularly in rural areas?
What is the most efficient way to encourage investment in agriculture and strengthen food security, while accelerating land reform?
Leveraging the private sector (linked to priorities 3-4)
What is the role of SMMEs for growth and jobs in South Africa and what programs work in supporting them?
What are the main constraints to FDI?
What are the political economy constraints to reforming trade policy and SOE delivery (especially logistics)?
How can BBBEE be broadened while minimizing adverse unintended impacts on investment?
How can South Africa stimulate mobile money for greater entrepreneurship, innovation, and better financial solutions for the poor?
How to further support localization and strengthen value chains around competitive lead firms?
What is the role of beneficiation of minerals for jobs and poverty?
Climate change and water insecurity (linked to priority 5)
What are the short- and long-term impacts of severe water shocks on farms and firms?
How can South Africa better prepare citizens that are likely to be affected by the low-carbon transition, for example, through re-skilling and socially sustainable urban planning?
How can South Africa enhance sustainable water resources?

Annex 1: Selected social and economic indicators

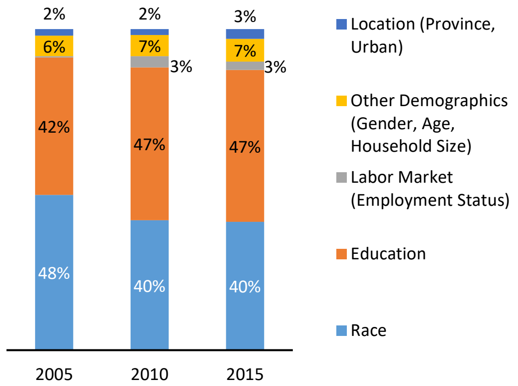
1. Poverty, inequality, and jobs

Figure A.1: Poverty and inequality are high
(Gini coefficient and poverty headcount rate)



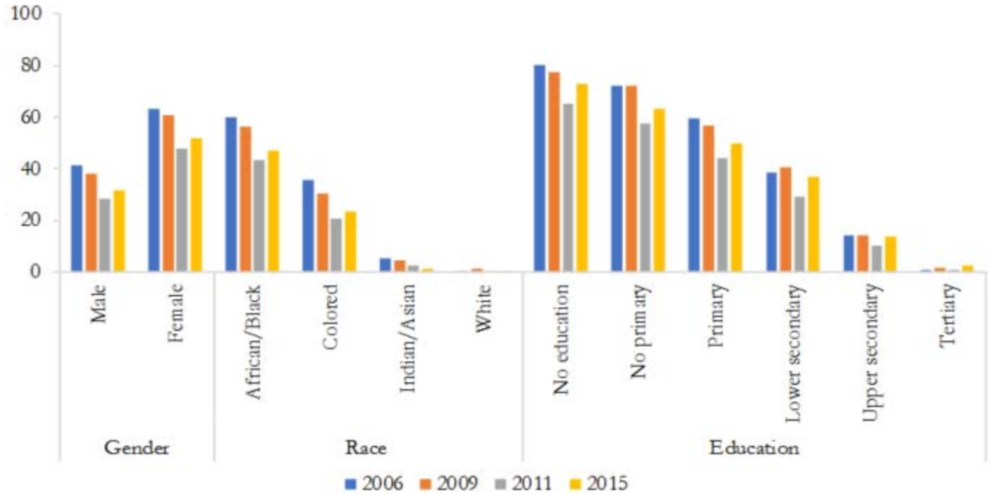
Source: World Bank (2018a).

Figure A.2: Race and education majorly determine inequality
(human opportunity index)



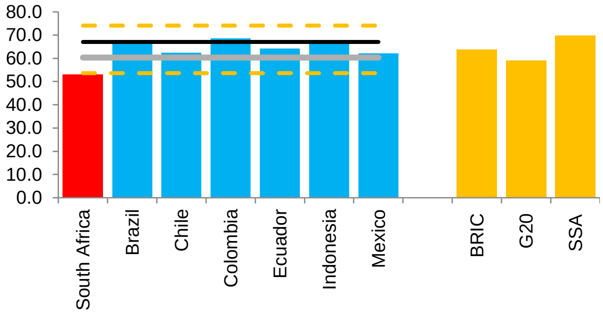
Source: World Bank (2018a).

Figure A.3: Who are the poor in South Africa?
(poverty headcount ration, percent)



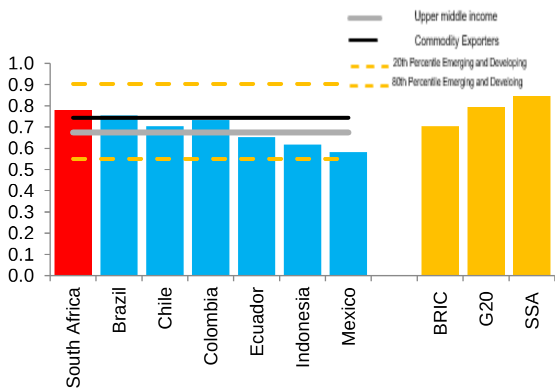
Source: World Bank (2018a).

Figure A.4: Labor force participation is low
(labor force participation rate, total, % of total population ages 15+, 2014-2016)



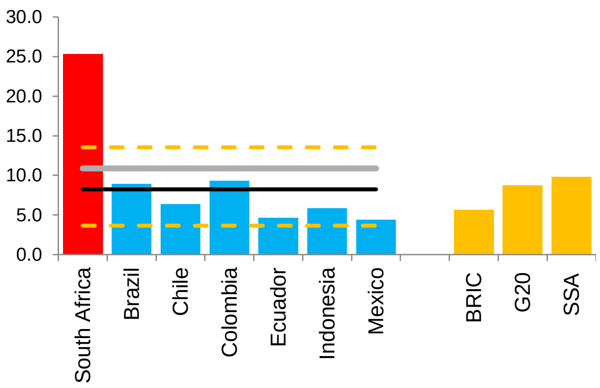
Source: FindMyFriends using WDI.
Notes: modelled ILO estimates. See figure A4.5 for the legend.

Figure A.5: The ratio of women to men in the labor force is uneven but slightly more favorable than in peers
(women in labor force, ratio to men, 2014-2016)



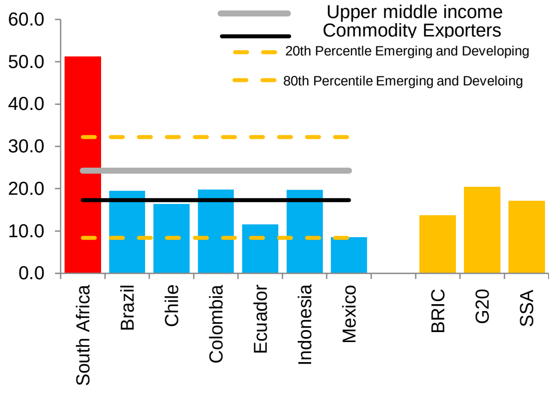
Source: FindMyFriends using WDI.

Figure A.6: Unemployment is significantly high
(unemployment, total, % total labor force, 2014-2016)



Source: FindMyFriends using WDI.
Notes: modelled ILO estimates. See figure A4.8 for the legend.

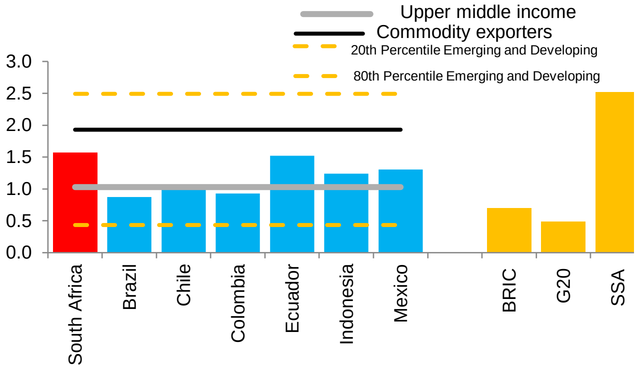
Figure A.7: Unemployment amongst the youth is particularly high
(unemployment, youth total, % total labor force ages 15-24, 2014-2016)



Source: FindMyFriends using WDI.
Notes: modelled ILO estimates. See figure A4.8 for the legend.

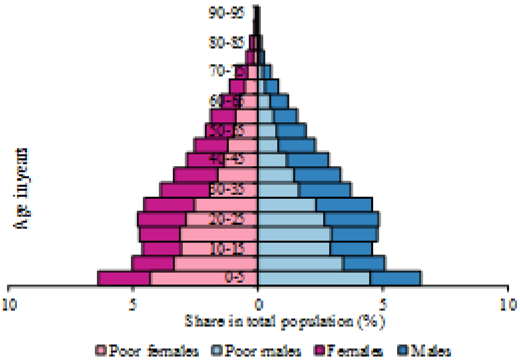
2. Demographics

Figure A.8: South Africa has a relatively high population growth rate
(population growth, annual %, 2014-2016)



Source: FindMyFriends using WDI.

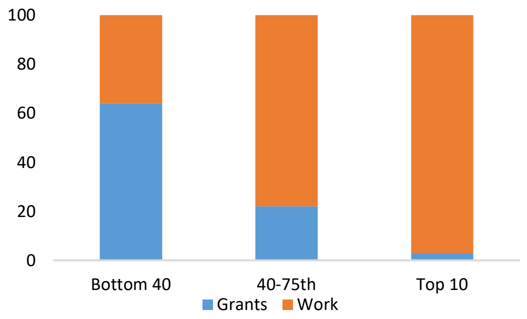
Figure A.9: South Africa's window of demographic opportunity
(share in total population, %)



Source: World Bank (2018a).

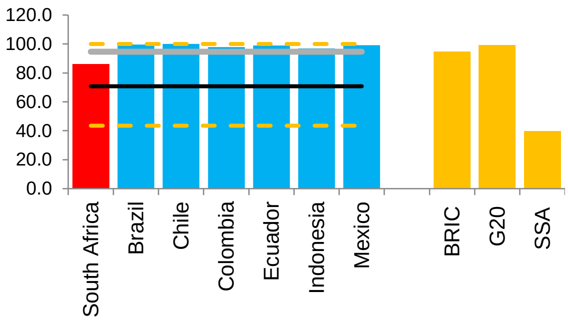
3. Social protection and the social wage

Figure A.10: Social grants are critical for the poor
(percent of total income)



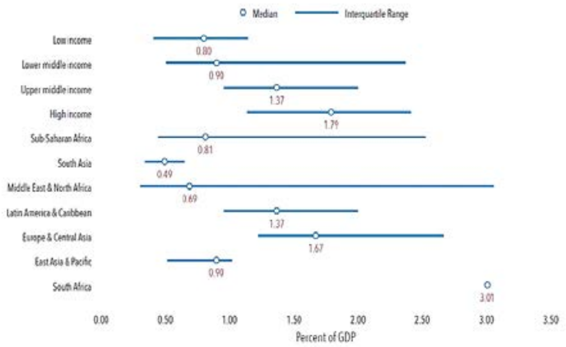
Source: World Bank (2018a).

Figure A.11: Access to electricity has improved but further progress is needed
(access to electricity, % population, 2014-2016)



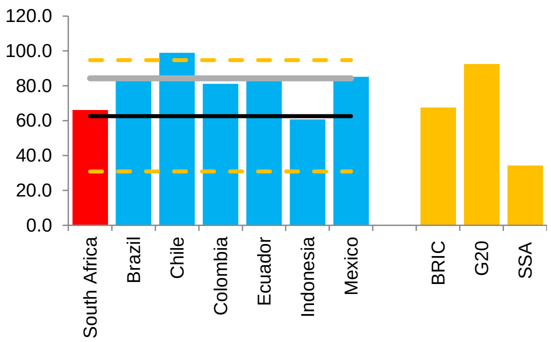
Source: FindMyFriends using WDI.
Notes: See figure A4.8 for the legend.

Figure A.12: Social Assistance Expenditures are relatively high
(percent of GDP)



Source: World Bank ASPIRE database.

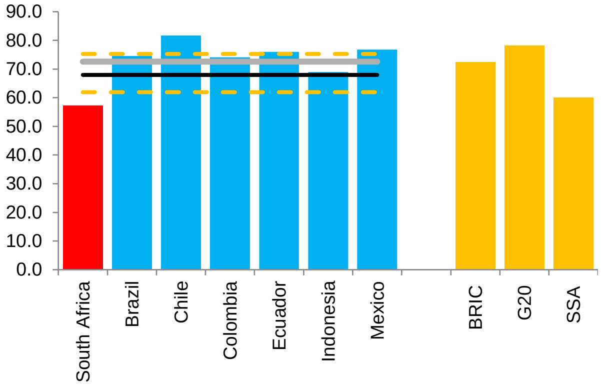
Figure A.13: Access to sanitation facilities has improved but remains relatively low
(improved sanitation facilities, % population with access, 2014-2016)



Source: FindMyFriends using WDI.
Notes: See figure A4.15 for the legend.

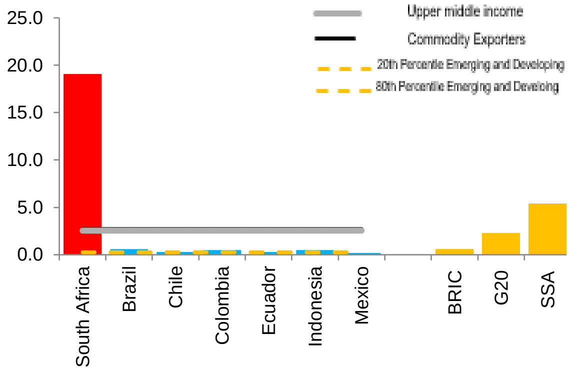
4. Human capital

Figure A.14: Life expectancy at birth is low
(total years, 2014-2016)



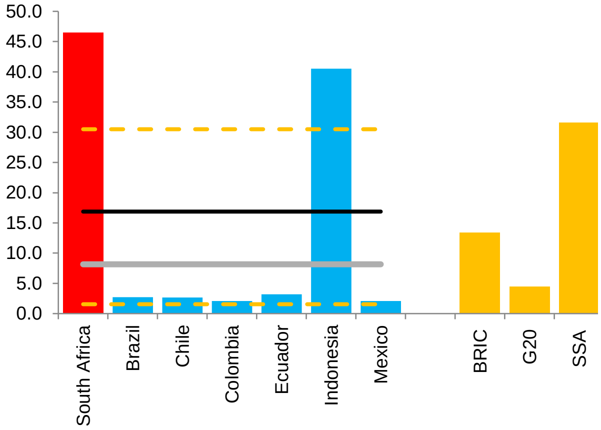
Source: FindMyFriends using the Health Nutrition and Population Statistics.
Notes: See figure A4.15 for the legend.

Figure A.15: The HIV Prevalence rate is one of the highest in the world
(prevalence of HIV, total, % population ages 15-49, 2014-2016)



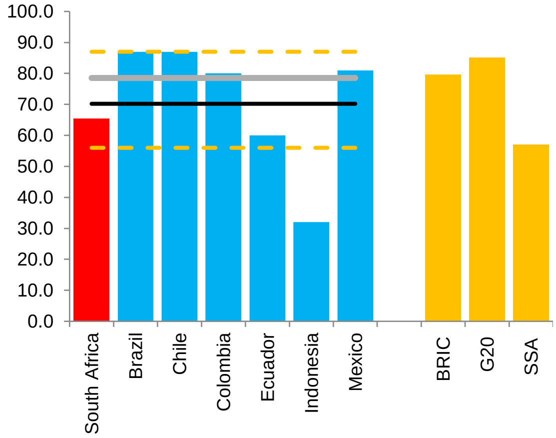
Source: FindMyFriends using the Health Nutrition and Population Statistics.

Figure A.16: South Africa's Tuberculosis death rate is considerably high
(tuberculosis death rate, per 100,000 people, 2014-2016)



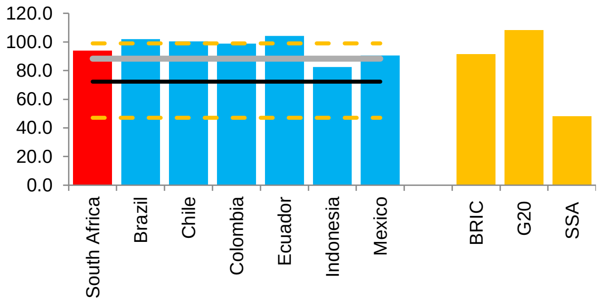
Source: FindMyFriends using the Health Nutrition and Population Statistics.
Notes: See figure A4.15 for the legend.

Figure A.17 Tuberculosis case detection rates are low
(all forms, 2014-2016)



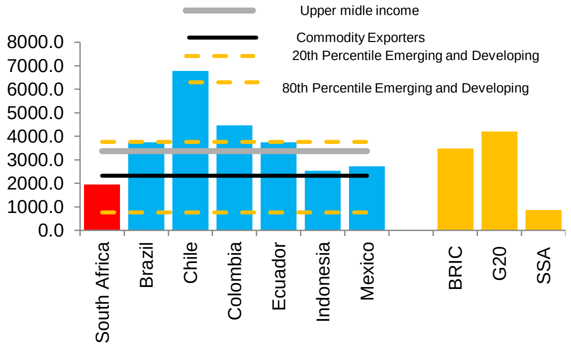
Source: FindMyFriends using the Health Nutrition and Population Statistics.
Notes: See figure A4.15 for the legend.

Figure A.18: Secondary enrolment is comparable to peers
(gross enrolment ratio, secondary, both sexes, %, latest available outcome)



Source: FindMyFriends using the Ed Stats Database.
Notes: See figure A4.19 for the legend.

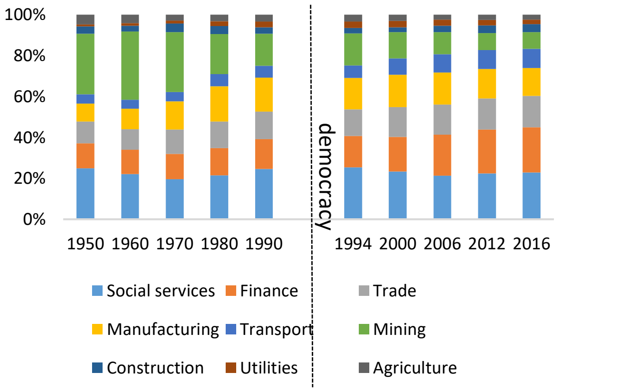
Figure A.19: South Africa's enrolment at tertiary level lags significantly
(enrolment in tertiary education per 100,000 inhabitants, both sexes, latest available outcome)



Source: FindMyFriends using the Ed Stats Database.

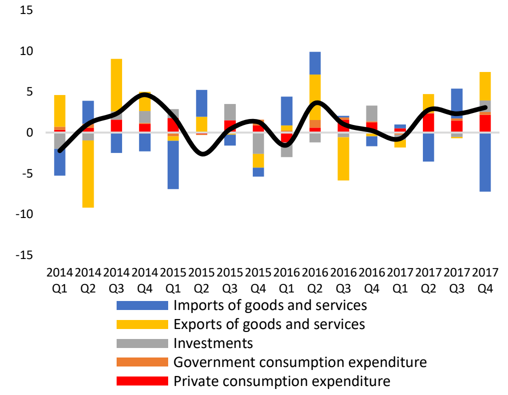
5. Economy

Figure A.20: Mining has given way to finance, real estate, and business services in South African GDP
(percent of supply-side GDP, 2010 prices)



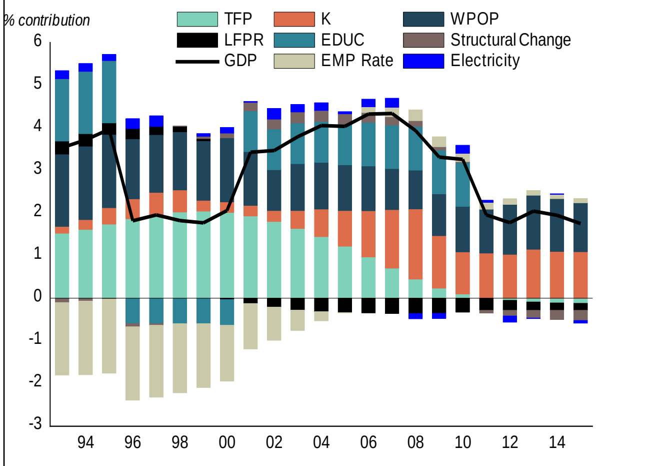
Source: Quantec and World Bank Group staff.

Figure A.21: Growth is low but has been picking up in late 2017
(percentage change and contributions to growth, quarter-on-quarter seasonally adjusted annualized rate)



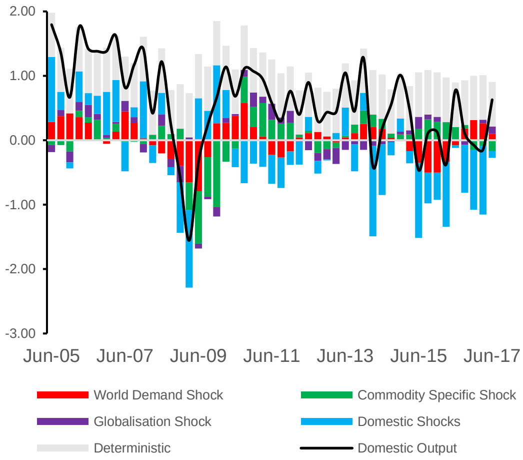
Source: StatsSA.

Figure A. 22: Potential growth is largely driven by capital accumulation and demographics
(decomposition of growth in potential GDP)



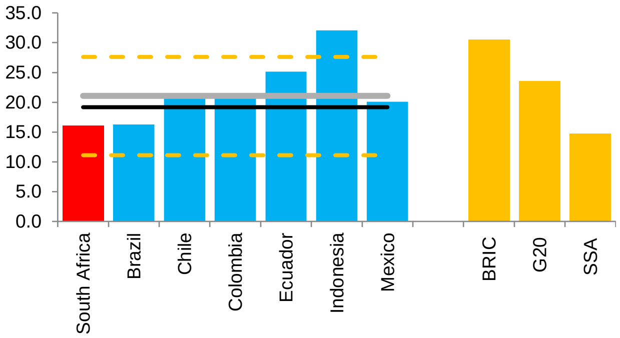
Source: World Bank Group staff.
Notes: TFP: total factor productivity; LFPR: labor force participation rate; K: capital; EDUC: education; EMP rate: employment rate; WPOP: working age population.

Figure A. 23: Commodity prices remain important for South African growth, although domestic shocks are most important
(historical decomposition of GDP based on types of shocks)



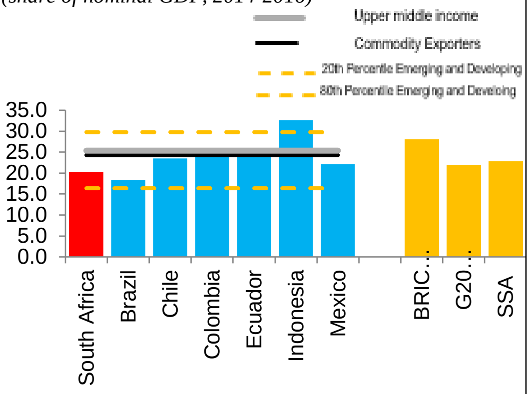
Source: World Bank Group staff.

Figure A.24: Gross national savings are low…
(share of nominal GDP, 2014-2016)



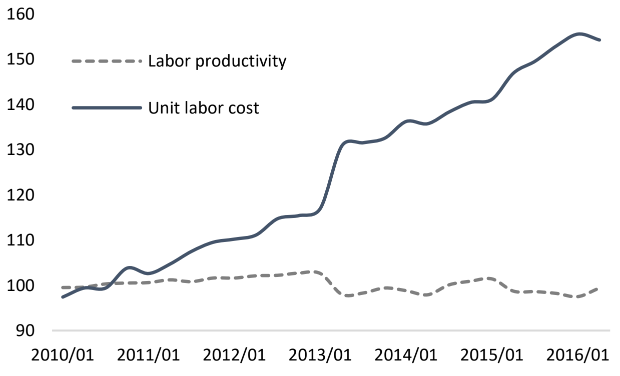
Source: FindMyFriends using WDI.
Notes: See figure A4.25 for the legend.

Figure A.25: … reflected in low investment
(share of nominal GDP, 2014-2016)



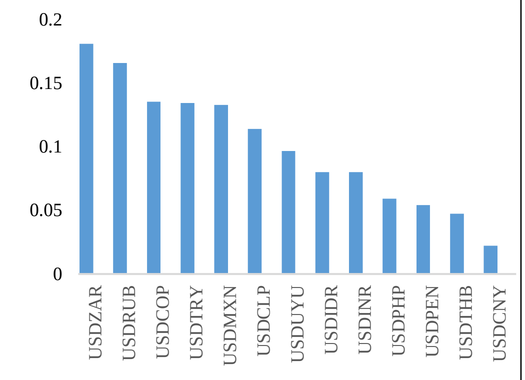
Source: FindMyFriends using WDI.

Figure A.26: Unit labor costs have been increasing while labor productivity is relatively stagnant
(index)



Source: World Bank (2017a).

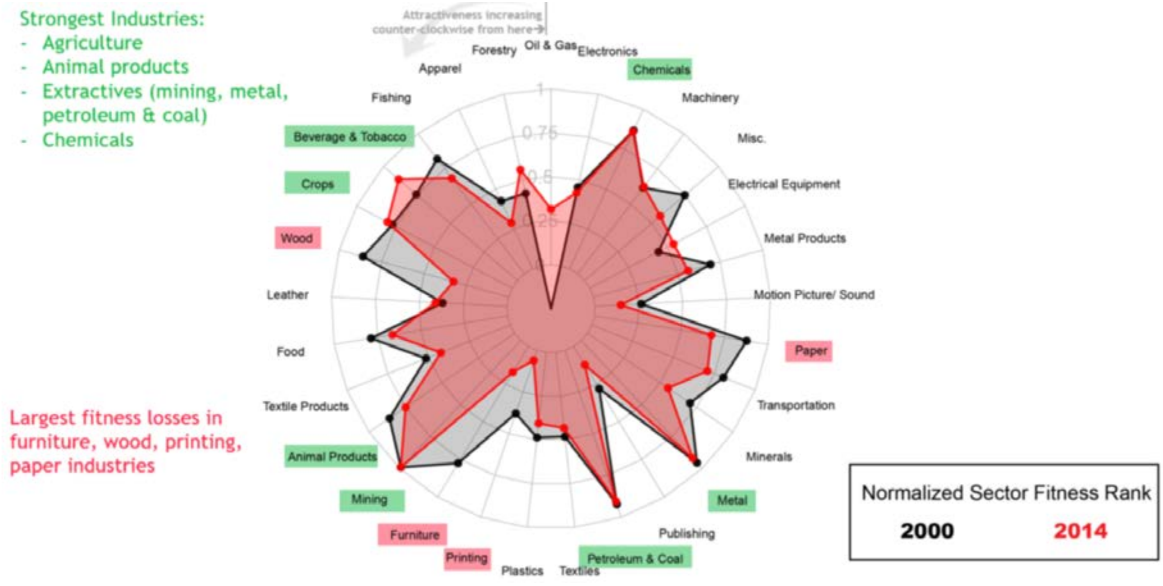
Figure A.27: The rand is a highly volatile currency
(10-year historical annualized volatility; currency pairs)



Source: World Bank Group staff.

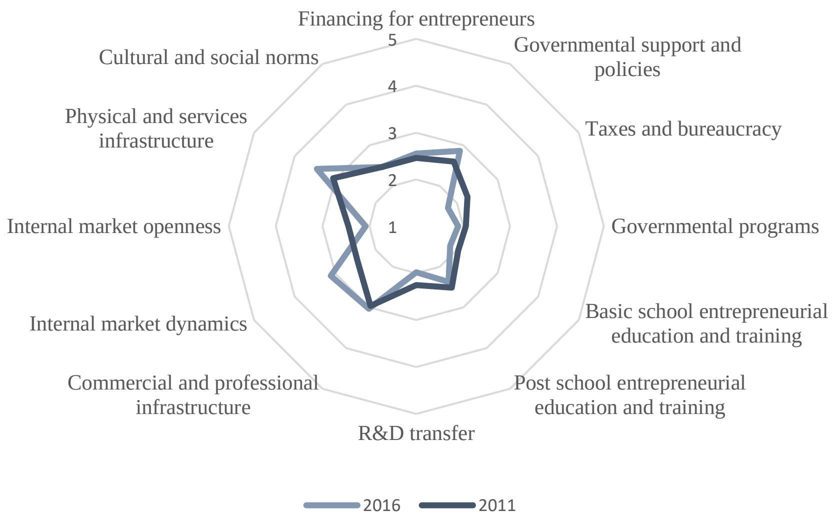
6. Private Sector

Figure A.28: Results from IFC's Country Opportunity Spotlight



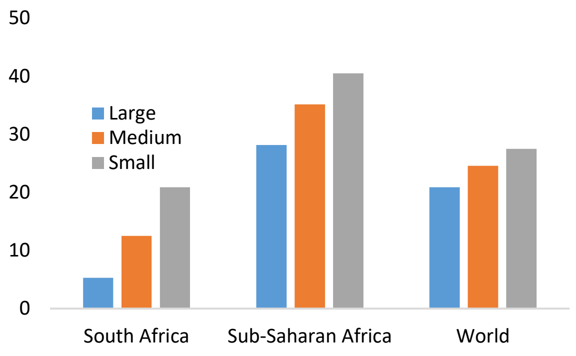
Source: International Finance Corporation.

Figure A.29: Entrepreneurial Ecosystem
(score: 5 is best)



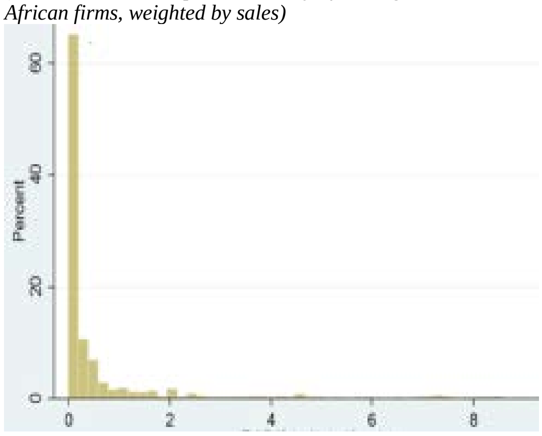
Source: Global Entrepreneurship Monitor.

Figure A.30: Access to finance is a constraint for entrepreneurs especially with lack of skills or collateral
(percentage of firms identifying access to finance as a constraint)



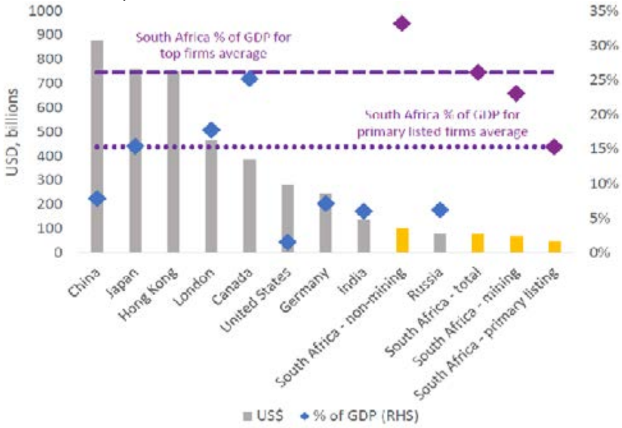
Source: World Bank Enterprise Surveys (2007).

Figure A.31: Few South African firms engage in research and development
(research and development intensity of tax-registered South African firms, weighted by sales)



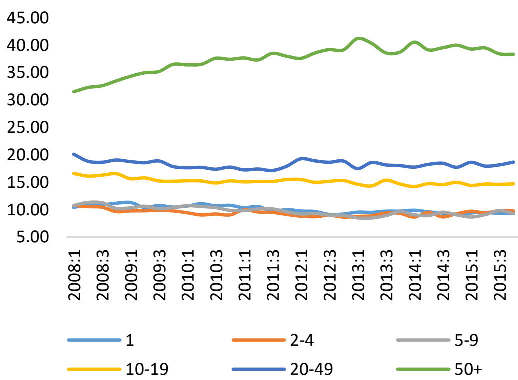
Source: World Bank (2017b).

Figure A. 32: South African firms are not necessarily large by international standards
(assets of publicly listed firms, billion US dollars and percent of national GDP)



Source: GoogleFinance, YahooFinance and World Bank staff.

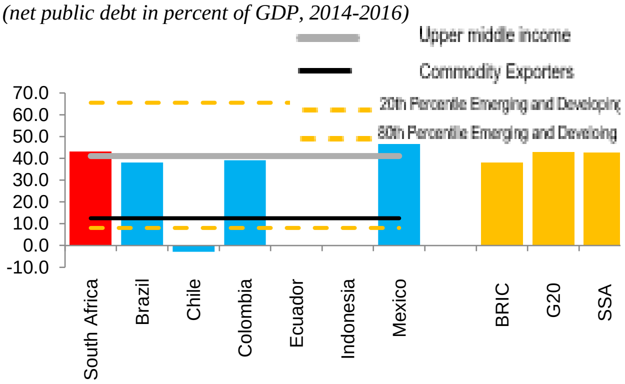
Figure A.33: Over a third of all jobs are in large firms.
(percent of total employment by firm size)



Source: StatsSA and World Bank Group staff.

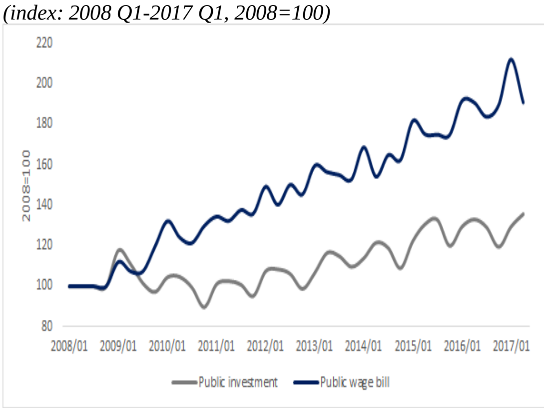
7. Fiscal policy

Figure A.34: General government net debt is in line with peers, although it is rising
(net public debt in percent of GDP, 2014-2016)



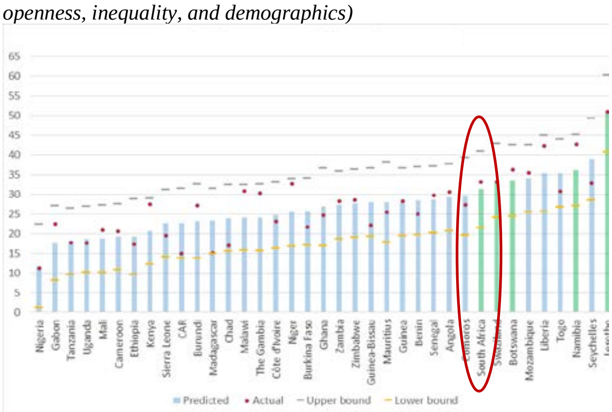
Source: FindMyFriends and WDI.

Figure A.35: Public wages have been rising crowing out public investment in South Africa
(index: 2008 Q1-2017 Q1, 2008=100)



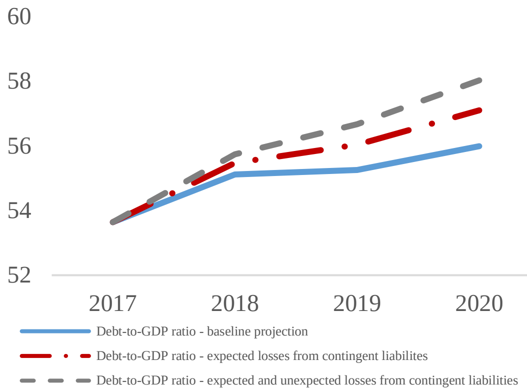
Source: South African Reserve Bank and World Bank Group staff calculations.

Figure A.36: Demographics, openness of democracy, and inequality levels predict the size of government well.
(government expenditure in % of GDP as predicted by democratic openness, inequality, and demographics)



Source: Dessus S., Herderschee J, Kwaramba M and Munditi N (2017).

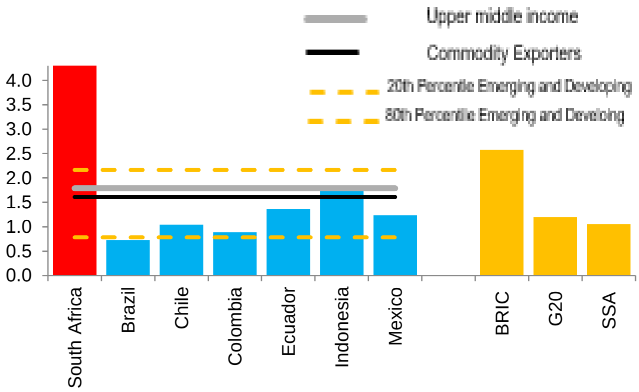
Figure A.37: Contingent liabilities in SOEs could derail the public debt trajectory
(public debt in percent of GDP; scenarios)



Source: Bogoev and Bachmair (2018) SCD background note.

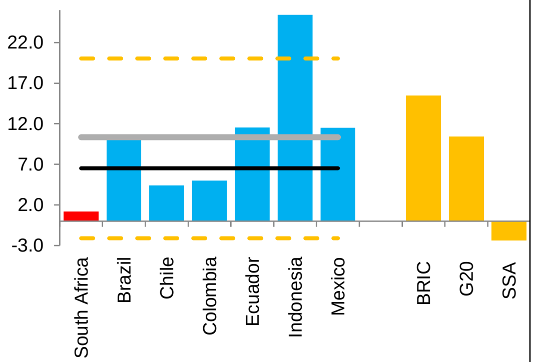
8. Climate change and sustainable development

Figure A.38: The carbon-intensity of the South African economy undermines sustainable development
(adjusted savings: carbon dioxide damage, % of Gross National Income)



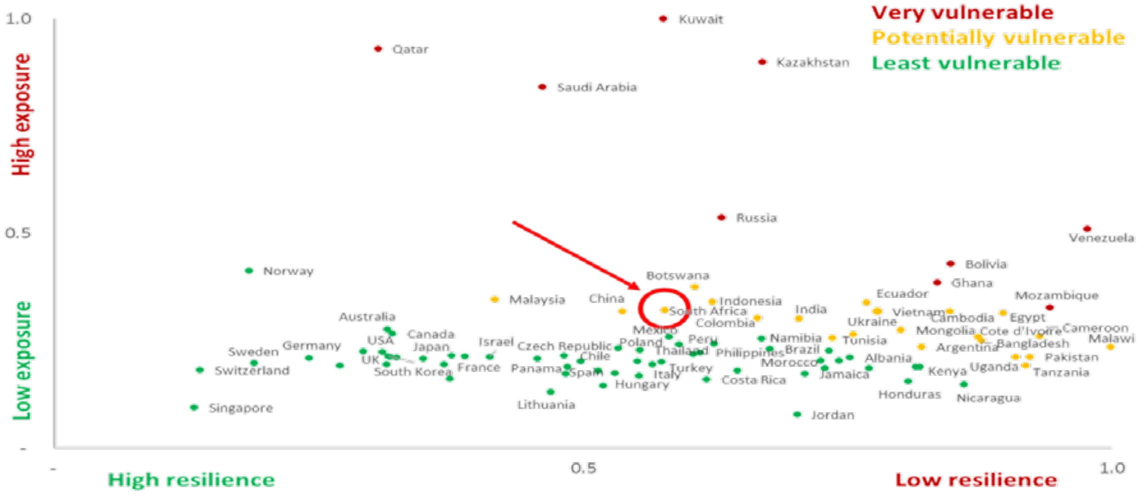
Source: FindMyFriends using WDI.

Figure A.39: South Africa is building national wealth, although adjusted net savings are low
(adjusted net savings (including emission damage; % of Gross National Income)



Source: FindMyFriends using WDI.
Notes: See figure A4.38 for legends.

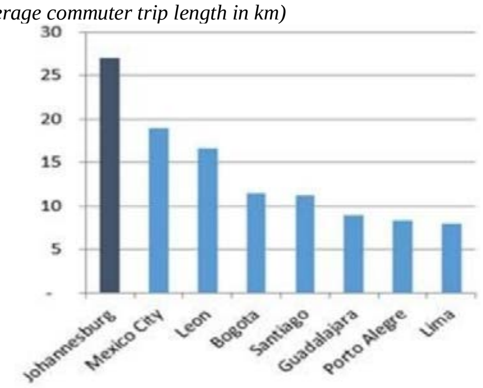
Figure A.40: Map of preparedness to low-carbon transition



Source: WBG based on several databases.

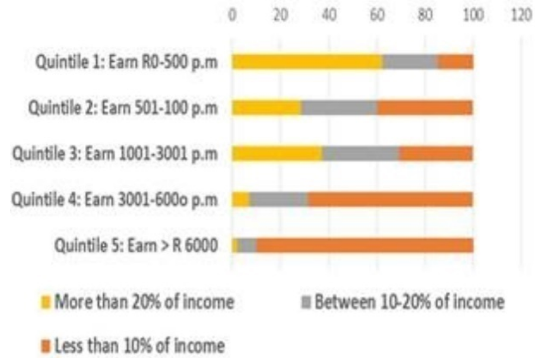
9. Spatial economy

Figure A.41: Travel distances for jobs in South Africa's cities are long by international standards
(average commuter trip length in km)



Source: Munoz-Raskin and Scorcia (2017).

Figure A.42: Over 60% of the poorest spend more than 20% of their income on transport
(percentage spent on public transport)



Source: National Household Survey 2013.

10. Macro-poverty outlook

	2015	2016	2017	2018 e	2019 f	2020 f
Real GDP growth, at constant market prices	1.3	0.6	1.3	1.4	1.8	1.9
Private consumption	1.8	0.7	2.2	2.1	2.0	2.1
Government consumption	-0.3	1.9	-0.3	-0.3	1.2	1.4
Gross fixed capital investment	3.4	-4.1	0.4	3.0	3.4	2.8
Exports, goods, and services	2.8	1.0	-0.1	1.5	2.2	2.1
Imports, goods, and services	5.4	-3.8	1.9	3.3	3.1	2.8
Real GDP growth, at constant factor prices	1.3	0.4	1.2	1.4	1.8	1.9
Agriculture	-6.4	-10.2	17.7	4.0	1.7	1.8
Industry	1.1	-1.3	1.5	1.6	1.9	2.1
Services	1.7	2.0	0.5	1.2	1.8	1.8
Inflation (consumer price index)	4.6	6.3	5.3	4.9	5.1	5.4
Current account balance (% of GDP)	-4.4	-3.1	-2.1	-2.5	-2.2	-2.1
Financial and capital account (% of GDP)	4.4	3.1	2.1	2.5	2.2	2.1
Fiscal balance (% of GDP)	-3.7	-3.5	-4.3	-3.6	-3.6	-3.5
Debt (% of GDP)	49.0	50.6	52.1	53.0	54.6	55.5
Primary balance (% of GDP)	-1.0	-0.5	-1.1	-0.2	-0.1	-0.1

Source: World Bank (2018c).
Note: e: estimate; f: forecast.

Annex 2: The World Bank's computable general equilibrium model

A computable general equilibrium (CGE) model was built for South Africa in order to develop prospective scenarios for the ongoing World Bank Systematic Country Diagnostic. The model aims to provide a consistent framework to explore possible medium-term developments, based on the main structural features of South Africa's economy. The CGE is a typical neoclassical model with endogenous prices, market clearing, and imperfect substitution between domestic and foreign goods, allowing for endogenous factor accumulation. As in any CGE, prices are endogenous on each market (goods and factors) and equalize supplies (imports; South African production for the domestic market; factors supply) and demands (final demand from households, the government, investors, and the rest of the world; intermediate demand from producers; factors demand), so as to obtain the equilibrium. The equilibrium is general in the sense that it concerns all the markets simultaneously. This type of modeling allows combining detailed databases with a sound micro-based theoretical framework capturing the interdependence and inter-linkages of markets. With such characteristics, CGE models are useful tools to assess the long-term impact of shocks and structural reforms. The underlying assumption of market clearance and monetary neutrality renders, on the contrary, CGE models not well tailored to assess short-term impacts of macroeconomic policies in economies with well-developed financial markets such as South Africa. The model is calibrated for the year 2012, based on a Social Accounting Matrix (SAM) built by Chitiga-Mabugu (2016). The SAM and the model comprise 55 sectors of activity (and corresponding products), 10 household types (corresponding to the 10 income deciles), 12 trading partners, and seven factors of production: informal labor, formal unskilled, formal semiskilled, formal skilled, capital, mineral and water resources.

Supply is modeled using nested constant elasticity of substitution functions, which describe the substitution and complement relations among the various inputs. Producers are profit-maximizers and constant returns to scale are assumed. Output results from two composite goods: intermediate consumption (excluding energy) and value-added plus energy, which are imperfectly substitutable. The intermediate aggregate is obtained by combining all products in fixed proportions (Leontief structure). The value-added is then decomposed in two substitutable parts: labor and a capital-water-mineral-energy bundle. Energy types (electricity and refined petroleum) are also imperfectly substitutable. Demand for capital makes a distinction between "old" capital and "new" capital. The model thus integrates the notion of vintage capital to distinguish the process of allocating capital already installed from that resulting from contemporary investment (putty/semi-putty production function). "New" capital can be allocated more flexibly than "old" capital. Accelerating investment therefore strengthens the capacity for adjustment of the productive sectors to changes in relative prices.[1] Flexible factors prices clear markets through the equalization of demand and supply,[2] but factors markets also include sectoral rigidities: some sectors pay workers (of the same type) better than others; and in some sectors, capital remuneration exceeds its marginal productivity. As a consequence, before-tax prices of goods domestically produced often exceed their marginal costs.[3]

Income from labor and capital accrue to the different households in proportion of their initial share in total incomes. Households pay direct taxes, receive grants from government, and transfer/receive funds from other households[4] and trade partners. Their net disposable income is allocated to final consumption and savings, in fixed proportions of their nominal values. Government and investment demands are disaggregated in sectoral demands once their total value is determined according to fixed coefficient functions.

The model assumes imperfect substitution among goods originating from different geographical areas. Import demand results from a constant elasticity of substitution aggregation function of domestic and imported goods (with a substitution elasticity of 2.0 between imports and domestic products; and 5.0 between imports origin). Export supply is symmetrically modeled as a constant elasticity of transformation function (with a substitution elasticity of 2.0 between domestic products and exports; and 5.0 between export destination). Producers decide to allocate their output to domestic or foreign markets responding to relative prices.

Several macroeconomic constraints are introduced in this model. First, the small country assumption holds, the South African economy being unable to change world prices; thus, its imports and exports prices on world markets are exogenous. Capital transfers are exogenous as well, and therefore the trade balance is fixed, so as to achieve the balance of payments equilibrium. Second, the model imposes fixed real public expenditures to reflect the government's choice of delivering a given amount and quality of public services and ability to borrow. Tax rates and foreign transfers to government are exogenously determined and thus government savings are residually determined. Third, investment is determined by the availability of savings from government, households and the rest of the world. The numeraire of the model is the exchange rate vis-à-vis all trade partners. Balance of payments equilibrium is thus obtained through quantities and real exchange rate adjustments.

The dynamic path of the model depends on a number of endogenous behaviors and exogenous factors. Endogenous savings/investment determines the total physical capital stock of the next year.[5] Labor supply results from an exogenous trend (reflecting working-age population growth and education projections) and a response (with a supply elasticity ranging from 0.1 for highly skilled workers to 0.3 for unskilled workers) to real wages (average wage per labor type divided by the typical consumer price index of the labor type). Participation rates thus depend on labor remuneration and cost of working. Water and mineral supplies (or depletion rates) respond to changes in their remunerations, with elasticities depending on the extent of available commercial reserves. Population growth is set exogenously, as is total factor productivity growth. World prices, and net financial transfers from the rest of the world are also set exogenously. In line with the World Bank Group's twin goals of eliminating extreme poverty and boosting shared prosperity by 2030 (which are also those retained in South Africa's NDP), the model is run annually from 2012 to 2030.

A microsimulation module using CGE results as inputs allows to project poverty in its various dimensions. The module simulates trajectories of poverty and distributional change under several growth and policy scenarios, drawing on the macroeconomic from the CGE, including (1) demographic variables (composition of the population by age and education), (2) labor market variables (employment by sector, wages, and farm profits), (3) exogenous income variables (public transfers and taxes, private transfers). Thus, it simulates the poverty and distributional implications of demographic change, changes in occupations and labor incomes, as well as public transfers. Demographic changes are simulated using reweighting techniques, while the core of the simulation model is an empirical representation of the income generation process, with household income being composed of individual labor incomes and net public and private (including remittances) transfer income and other income sources. The analysis is based on the latest South Africa Living Condition Survey 2014/15.

A baseline scenario is developed based on a number of assumptions. Population is set to grow at the annual average of 1.2 percent from 2012 to 2030 (from 52.4 million to 65.1 million) while the working-age population (15–64 years old) is set to grow at 1.3 percent over the same period (source: StatsSA). Keeping constant pass rates (matric and tertiary education) at their 2016 levels, the supply of skilled and highly skilled labor is projected to annually grow faster (1.6 percent and 2.0 percent respectively) than that of unskilled labor (0.8 percent) between 2018 and 2030. Water supply is assumed to stay constant at its 2012 level until 2030, as all possible South African water reserves are already exploited. In contrast, mineral reserves are considered infinite, and their depletion rate is being driven by world prices versus production costs. Total factor productivity is (optimistically, given recent trends, and after accounting for the projected change in the skills mix) set to stagnate over the period 2018–2030. Total factor productivity growth over the period 2012–2017 is set to match recorded GDP growth. Net foreign financial flows are set to grow at 2 percent annually. The progressive introduction of a carbon tax and all direct and indirect tax rates (including import tariffs) are assumed to stay unchanged from 2017. Real public consumption grows at the annual rate of 2 percent, and public transfers to households to stay constant in real per capita terms. International prices of minerals (coal, gold, other mining) follow projections of the World Bank's Global Economic Prospects.

Annex 3: Background notes for the SCD

Title	**Authors**
Rural Development and Land Reform	Michael Aliber (Fort Hare)
Systemic, Sectoral Risk, and the Myth of a Corporate Savings Glut	Vincent Dadam (University of Pretoria)
Exchange Rate Volatility, Uncertainty, and Corporate Investment	Georgios Chortareas (King's College) and Emmanouil Noikokyris (Kingston University)
What is the Impact of Investment on Labor Income?	Georgios Chortareas and Emmanouil Noikokyris
Exchange Rate Volatility and FDI Inflows: Evidence from Cross-Country Panel Data	Yashvir Algu, Marek Hanusch, and Ha Nguyen
Real Exchange Rate Misalignment and Its Relationship to Output Growth in South Africa	Ha Nguyen
Why is South Africa Cheap for the Rich and Expensive for the Poor? Revisiting Balassa-Samuelson in an Unequal Society	Vincent Dadam (University of Pretoria), Marek Hanusch, and Nicola Viegi (University of Pretoria)
Does Employing Workers or Accepting Work Pay? Analyzing Labor Costs in South Africa	Jörg Langbein and Michael Weber
Fiscal Policy in South Africa	Rashaad Amra (Parliamentary Budget Office), Marek Hanusch, Charl Jooste, and Asli Şenkal
A Computable General Equilibrium Model for South Africa	Sébastien Dessus
Find Friends South Africa: Country Benchmarking	Faya Hayati
Education in South Africa	Servaas van der Berg and Heleen Hofmeyr (both Stellenbosch University)
Health in South Africa	Paolo Belli, Thulani Matsebula, Maria Ngarachu, and Melusi Ndhlalambi
Assessment of Contingent Liabilities and Their Impact on Debt Dynamics in South Africa	Fritz Bachmair and Jane Bogoev
Between Gatekeeper and Gateway: Taking Advantage of Regional and Global Value Chains by Addressing Barriers to South Africa's Trade Competitiveness	Peter Draper, Heinrich Krogman, Anna Ngarachu, and Lesley Wentworth (all Tutwa Consulting), and Jakob Engel

Lead Firms in Agribusiness: Selected Case Studies	Leon Lourens (Incubation Institute)
A Review of Indicators of Ownership Structure across South African Markets and Selected Examples of Market Regulations that Shape Competition	Sara Nyman, Seidu Dauda, and Julian Koschorke
The Design of Incentive Schemes in South Africa: Through the Competition Lens	Sara Nyman, Seidu Dauda, and Julian Koschorke
The Role of SOEs in South African Markets and Their Impact on Competition	Sara Nyman, Seidu Dauda, and Julian Koschorke
The Development of South African Policy Planning: A Quantitative Text Analysis	Slava Mikhaylov (University of Essex)
Hedging a Volatile Currency: A Qualitative Review	Blessing Mudavanhu (Dura Capital)
Minibus Taxis, Public Transport, and the Poor	Andrew Kerr (University of Cape Town)
Wage Setting and Labor Regulatory Challenges in a Middle-Income Country Setting: The Case of South Africa	Haroon Bhorat and Benjamin Stanwix (both University of Cape Town)
Gender in South Africa	Daniel Kirkwood
Job Training in Korea	SooBong Uh (Korea Tech)
Cooperation between SMEs and Large Companies, Experience of Korea	Jiyoung Choi
Crime, Violence and Resilience in South African Society	Alys Willman, Margarita Puerto Gomez, Chandré Gould (Institute for Security Studies), and Gareth Newham (Institute for Security Studies)
Corporate Governance in South African SOEs	Sunita Kikeri
The Informal Sector and its Scope for Growth	Kate Philip (TIPS)
Co-ops in South Africa	Kate Philip (TIPS)
Public Employment in South Africa	Kate Philip (TIPS)
Governance in South Africa	Gert van der Linde

Note: All authors are World Bank staff unless otherwise indicated. Chapter 4 reflects the Governance note. All other notes are made available through three volumes of background notes.

Annex 4: Consultations

1. Government

Meetings were held in collaboration with the National Planning Commission, the Department of Planning, Monitoring, and Evaluation, the National Treasury, and the South African Reserve Bank. Other stakeholders from, for example, local government and academia were invited as relevant. The agendas of these workshops can be found on the following pages.

2. Business

Various efforts were made to consult the private sector on emerging themes of the SCD in 2017, validating thinking and obtaining unexplored ideas. Most outreach happened through business associations and at various conferences organized by private-sector stakeholders.

- June 20, 2017: Meeting with a mixed group of people made up of business leaders and influencers at the World Bank offices in Pretoria on root causes of poverty and inequality.
- August 22, 2017: Discussion with members of the Pietermaritzburg Chamber of Business, during its KwaZulu-Natal Lean Conference on poverty and inequality in South Africa.
- October 2, 2017, and November 24, 2017: Discussions with the Manufacturing Circle during their annual general meeting (on poverty and inequality) and the launch of the "Map to a Million" Initiative respectively (focusing on constraints to trade, summarized in SCD background note (Draper and Engel, 2018)).
- November 27, 2017: Focus group discussion with the South African Chamber for Commerce and Industry, focusing on constraints to trade and summarized in SCD background note (Draper and Engel, 2018).
- November 29, 2017: Focus group discussion with AgBiz, focusing on constraints to trade and summarized in SCD background note (Draper et al., 2018).
- November 2017: Various interviews with clients from the International Finance Corporation network on opportunities for linking SMEs to agribusiness supply chains and rural transformation, summarized as SCD background note (Lourens, 2018).
- November 2017: Various interviews with private companies and SOEs on constraints to hedging, summarized as SCD background note (Mudavanhu, 2018).
- Various presentations, at the Uber Mobility Summit on transport for the poor on May 22, 2017, to members of the CEO Initiative on skills and jobs on March 22, 2017, and on constraints to growth and reducing poverty and inequality at the UBS 8th Annual Economics Conference on October 20, 2017.
- Various discussions with South Africa's local and foreign investment community and economists of commercial banks about emerging thinking in the SCD.

3. Labor

A meeting was held with trade unions in NEDLAC on September 22, 2017, to discuss education.

4. Youth

During November 2017, three interactive workshops focusing on inequality were held with the youth in communities in peri-urban areas in three of South Africa's provinces, namely Thokoza in Gauteng, KwaMhlanga in Mpumalanga, and Umlazi in KwaZulu-Natal. Facilitated by a youth-led policy think-tank, Youth Lab, the workshops discussed inequality using a range of participatory exercises, focusing on inequality in standards of living, spatial inequality, and social inequality. Participating youths presented solutions to manifestations of inequality particularly affecting their own communities. They identified the following priority economic and social intervention areas: Thokoza: (i) high rate of unemployment because of lack of education, resources, and skills; (ii) limited access to multiracial schools. KwaMhlanga: (i) failure to sustain small businesses; (ii) rapid increase in teenage pregnancy. Umlazi: (i) Lack of support for small businesses; (ii) high crime rate. These issues are discussed in the SCD. A summary of the consultations is available on request.

5. Development partners

Various bilateral discussions were held with the diplomatic corps and other international institutions through the preparation period of the SCD. A roundtable discussion with development partners was held on March 12, 2018.

Workshop 1: Skills for Jobs (Labor)

planning, monitoring and evaluation — Department: Planning, Monitoring and Evaluation, REPUBLIC OF SOUTH AFRICA | national planning commission — Department of Planning, Monitoring and Evaluation, REPUBLIC OF SOUTH AFRICA | WORLD BANK GROUP | Ministry of Strategy and Finance

Agenda

23 March
Skills for Jobs

8.00	Registration
8.30	Opening, JP Landman, NPC Commissioner
8.45	Explanation of workshop format, Colin Mitchell, facilitator
9.00	Introduction, Marek Hanusch and Paolo Belli, World Bank
9.30	Q&A
9.45	Progress on the NDP in education and skills, Thabo Mabogoane, DPME
9.15	Q&A
10.30	**Skills and labor market linkages: Current thinking and key themes** Miriam Altman, NPC Commissioner
11.00	Coffee and: What we are not going to discuss in this workshop
11.30	**Active labor market policies**, Jamele Rigolini, WB
12.00	Lunch and discussion
13.00	**TVET and on-the-job training** Andreas Blom, WB Professor Soobong Uh, Korea Tech Tashmia Ismail-Saville, Boundless World and CEO Initiative
14.15	Coffee and discussion
15.15	**The World Development Report on Education**, Deon Filmer, WB, by VC **Basic education**, Andreas Blom, WB
16.00	Coffee and discussion
17.00	Pulling it all together
17.30	Final remarks: Paul Noumba Um, WB Country Director

Workshop 2: Poverty, Jobs, and the Spatial Economy (Land)

Agenda

5 April

Poverty, Jobs, and the Spatial Economy

8.00	Registration
8.30	**Opening:** Sue Bannister, NPC Commissioner
8.45	**Policy implementation—and challenges—at the municipal level,** Roland Hunter, Cities Support Programme, National Treasury
9.00	**Introduction: Poverty, Jobs, and the Spatial Economy: Analytical framework for the day,** Marek Hanusch, Somik Lall, and Precious Zikhali, World Bank
9.30	**Q&A**
10.00	Discussion and coffee
10.30	**Progress on implementing the NDP's spatial agenda,** Ahmedi Vawda and Tsakani Ngomane, DPME
11.00	**Q&A**
11.30	**Connecting the poor to jobs: Housing,** Kecia Rust, World Bank consultant
12.00	**Q&A**
12.30	Discussion and lunch
13.30	**Connecting the poor to jobs: Transportation,** Gershwin Fortune, World Bank
14.00	**Q&A**
14.30	**Fostering jobs for the poor in rural areas,** Guo Li, World Bank
15.00	**Q&A**
15.30	Discussion and coffee
16.00	**Pulling it all together,** Colin Mitchell, World Bank facilitator
17.00	**Final remarks:** Ivan Velev, World Bank Country Program Coordinator

Workshop 3: Business and Jobs
(Capital and product markets)

planning, monitoring and evaluation
Department: Planning, Monitoring and Evaluation
REPUBLIC OF SOUTH AFRICA

national planning commission
Department of Planning, Monitoring and Evaluation
REPUBLIC OF SOUTH AFRICA

WORLD BANK GROUP

Ministry of Strategy and Finance

Agenda
5th May
Business and Jobs

8.00	**Breakfast and registration**		
8.15	**Opening remarks:** World Bank Country Director, Paul Noumba Um National Planning Commission, Elias Masilela, NPC Commissioner Embassy of the Republic of Korea, Ambassador H.E Yeon Ho Choi Competition Commission of South Africa, Tembinkosi Bonakele, CCSA Commissioner		
8.50	**Department of Planning, Monitoring and Evaluation on Business and Jobs** Rudi Dicks, DPME		
9.15	**Q&A**		
9.30	**Organizing framework for the day** **Embedding competition principles in public policies to promote inclusion and transformation:** Jose Guilherme Reis, Sara Nyman, and Sebastien Dessus (WB) ■ Evidence on the benefits of boosting competition for growth and poverty alleviation ■ Designing polices and regulations to minimize barriers to barriers to entry and rivalry		
10.00	**Q&A and coffee**		
10.30	*Preview of key constraints to be discussed in Sessions 1A-1C*		
10.45	***Session 1A:* Competition policy for inclusion (enforcement),** Presenter: Liberty Mncube, CCSA Discussant: Soohyun Yoon, Korea Fair Trade Commission	***Session 1B:* Integration into global and regional value chains** Presenter: Jose Guilherme Reis, (WB)	***Session 1C:* Broad-based black corporate ownership,** Presenter: Catiana Garcia-Kilroy (WB)
12.30	***Lunch*:** Soohyun Yoon, Korea Fair Trade Commission: Competition advocacy in Korea		
14.00	*Preview of key constraints to be discussed in Sessions 2A-2C*		
14.15	***Session 2A:* Financial inclusion,** Alejandro Alvarez de la Campa (WB)	***Session 2B:* Doing Business regulatory environment,** J. Gabriel Goddard (WB)	***Session 2C:* Public Procurement for SMEs,** John Sikazwe (WB)
16.00	**Pulling it all together and prioritization,** Colin Mitchell (WB consultant) ■ Groups report back to plenary on key insights		
17.00	**Concluding remarks:** Elias Masilela, National Planning Commission		

Workshop 4: Macroeconomic Volatility and Social Cohesion

South African Reserve Bank   WORLD BANK GROUP   Ministry of Strategy and Finance

Agenda

29 November 2017
Macroeconomic Volatility and Social Cohesion

8.00	**Breakfast and registration**
8.15	**Opening remarks,** Paul Noumba Um (WB) and Elias Masilela (NPC)
8.30	**Monetary and fiscal policy framework for macroeconomic stability in an uncertain world,** Chris Loewald (SARB) and Catherine Macleod (NT)
9.00	**Rand Volatility and Social Cohesion** ■ **Theoretical framework: Volatility, investment, and inequality,** Nicola Viegi and Vincent Dadam (both UP) ■ **Determinants of rand volatility: Reconsidering the evidence,** Nasha Mavee (IMF) ■ **Empirical evidence: Volatility and investment** o **Micro-level:** Manolis Noikokyris (Kingston University London) and Georgios Chortareas (King's College London), by VC o **Macro-level:** Marek Hanusch, Yashvir Algu, and Ha Nguyen (all WB)
10.00	**Q&A and discussion / coffee**
10.30	**Hedging against currency volatility** ■ **South African and global experience**, Catherine Macleod (NT), Blessing Mudavanhu (Dura Capital), and Julie Dana (WB) ■ **Hedging support by ECIC**, Ben Fugah (ECIC)
11.00	**Q&A and discussion**
12.00	**Lunch**
13.00	**Fiscal policy** ■ **Fiscal rules for macro-stability and social sustainability: The Chilean experience,** Rodrigo Valdes (former Minister of Finance of Chile)
14.00	**Q&A and discussion / coffee**
15.00	**Monetary policy** ■ **Managing volatility,** Nicola Viegi (UP) ■ **The cases of Brazil and Mexico:** Marcos de Carvalho Chamon (IMF), by VC
16.00	**Q&A and discussion**
17.00	**Concluding remarks**, Chris Loewald (SARB)

ECIC: Export Credit Insurance Corporation; **IMF:** International Monetary Fund; **NPC:** National Planning Commission; **NT:** National Treasury; **SARB:** South African Reserve Bank; **UP:** University of Pretoria; **WB:** World Bank Group

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World Bank. 2018e. Mining Sector Review: South Africa, forthcoming.

Endnotes

Chapter 1

[1] Throughout this SCD, unless otherwise indicated, "black" refers to the official South African race classifications of African, colored, and Indian or, more broadly, historically disadvantaged South Africans.
[2] Batchelor (1998).
[3] The World Bank Group includes the World Bank, the International Finance Corporation, the Multilateral Investment Guarantee Agency, and the International Center for Settlement of Investment Disputes.
[4] Annex 1 includes a number of country benchmarks, using comparators that were selected using the World Bank's FindMyFriends tool. The countries are Brazil, Chile, Colombia, Ecuador, Indonesia, and Mexico. They were identified based on similarity on the following structural indicators: Geography/natural endowments: Population density, share of natural resource exports in total exports; Demography: population size, age dependency ratio, population growth; Institutions: Ease of Doing Business rank, credit rating; Technology: GDP per capita (in $). South Africa is also compared to country groupings, including BRIC (Brazil, Russia, India, China), G20 (Group of 20), Sub-Saharan Africa, upper-middle-income countries, commodity exporters, and the 20th and 80th percentile of emerging and developing countries.
[5] Beinart and Delius (2014).
[6] Estimated at 1.5 million people in 1800 and 4 million in 1900 (Feinstein 2005).
[7] Delius (2017).
[8] Ibid.
[9] Ibid.
[10] Diepsloot is a township between Johannesburg and Pretoria that did not exist during apartheid (World Bank 2014b).
[11] Forced removals under the Natives Land and Group Areas Acts, or the Prevention of Illegal Squatting Act 1951.
[12] Nattrass and Seekings (2011: 536-541).
[13] Nattrass and Seekings (2011: 564).
[14] Seekings and Nattrass (2005) chapter 5.
[15] Seekings and Nattrass (2005).
[16] The Bantu Education Act was repealed in 1979 and replaced by the Education and Training Act, which essentially created an "independent" education system for each of the four apartheid racial groupings. This race-based education system was only fully dismantled in 1994, though some modest concessions were made toward the end of this period that allowed white schools to enroll some black children.
[17] Verwoerd (1966).
[18] From the Commission of Inquiry into Teaching in Transkeian Primary Schools in South African Institute of Race Relations, *A Survey Of Race Relations 1963*.
[19] Van der Berg *et al.* (2016: 39).
[20] Seekings and Nattrass (2005), chapters 5 to 9.
[21] Balassa (1964) and Samuelson (1964).
[22] World Bank (2016b).
[23] Gold exports accounted for 50 percent of exports in 1890s, 60 percent by 1914, and 70 percent by 1930 (Feinstein 2005).
[24] South Africa was one of the original signatories of the General Agreement on Tariffs and Trade, 1947.
[25] Including Eskom in 1923, steel producer Iscor in 1928, and the Industrial Development Corporation in 1940.
[26] Nyman, Dauda and Koschorke (2018) A Review of Indicators of Ownership Structure across South African Markets and Selected Examples of Market Regulations that Shape Competition. SCD background note.
[27] Ibid.
[28] World Bank (2018a). Wealth is defined as household assets minus liabilities.
[29] Van Aardt, De Clercq and Van Tonder (2017) Background note for World Bank (2018a).
[30] This paragraph draws on World Bank (2018a) and StatsSA (2017a).
[31] Ibid.
[32] Philip (2018) Co-ops in South Africa. SCD background note.
[33] Bhorat, Asmal, Lilenstein, and Van der Zee (2017) SMMEs in South Africa: Understanding the Constraints to Growth and Performance. Background note for World Bank (2018a).
[34] See, for example, Ataguba *et al.* (2014) or McIntyre *et al.* (2007).
[35] Mikhaylov, S. 2017. SCD background note: Quantitative Text Analysis.
[36] Kende (2003)

[37] For example, in the case of the Constitutional Court's decision in 2002 to order the government to roll out antiretroviral drugs to pregnant mothers with HIV; Minister of Health and Others v Treatment Action Campaign and Others (No 2) (CCT8/02) [2002] ZACC 15; 2002 (5) SA 721; 2002 (10) BCLR 1033 (July 5, 2002). http://www.saflii.org/za/cases/ZACC/2002/15.html (accessed January 17, 2018).
[38] The notion of sharing the national wealth was at the time of the Freedom Charter inspired by socialist thinking, including a focus on greater nationalization. After 1994, mines were nationalized in an agreement with mining firms, which retained the right to run them. Sharing the national wealth in this SCD refers to participating in an inclusive economy.
[39] World Bank (2014a).
[40] Adjusted for purchasing power parity.
[41] SADHS (2016). "Short or stunted" are defined as two standard deviations below the median height for the relevant age, while "severely stunted" is three standard deviations below.
[42] World Bank (2018a).
[43] Schotte, Zizzamia and Leibbrandt (2017).
[44] Ibid.
[45] Van der Berg and Hofmeyr (2018) SCD background note.
[46] World Bank (2018a).
[47] StatsSA (2011).
[48] This was a strong message emerging from consultations with South African youth in three townships.
[49] Willman *et al.* (2018) SCD background note.
[50] According to South African Revenue Service data.
[51] World Bank (2014a).
[52] Acemoglu *et al.* (2007).
[53] Willman *et al.* (2018) SCD background note.
[54] South Africa Institute of Race Relations (IRR) report, *We're Queer and We're Here!* November 2017.
[55] South Africa ranks 123rd out of 163 in the 2017 Global Peace Index.
[56] According to Stone (2006), however, crime does not necessarily affect firms more in South Africa than in other emerging markets, although perceptions around crime are more pronounced.
[57] Kerr (2018) SCD background note.
[58] Bhorat *et al.* (2017).
[59] World Bank (2015a)
[60] Pinnock (2006).
[61] Thobejane *et al*. (2017).
[62] Mullainathan and Shafir (2013).
[63] Adebayo (2013).
[64] Blattman *et al.* (2017).
[65] Public Protector, South Africa. 2016. *State of Capture*. Report No 6 of 2016/17. http://saflii.org/images/329756472-State-of-Capture.pdf (accessed January 17, 2018).

Chapter 2

[66] In practice, while South Africa's post-apartheid Constitution was the first in the world to outlaw discrimination based on sexual orientation, social attitudes toward the inclusion of sexual and gender minorities still lag, with recent data demonstrating wide gaps between the ideals of the Constitution and public attitudes toward LGBTI people. See Afrobarometer survey report: Good Neighbors? Africans Express High Levels of Tolerance for Many, But Not for All. Released March 2016.
[67] Ostry *et al.* (2014).
[68] This is a relatively low growth-poverty elasticity, consistent with the World Bank's (2006) finding that high inequality results in low growth-poverty elasticities. "On average, for countries with low levels of income inequality, a 1-percentage-point growth in mean incomes leads to about a 4-percentage-point reduction in the incidence of dollar- per- day poverty. That power falls to close to zero in countries with high income inequality. Policies that lead to greater equity thus lead to lower poverty."
[69] South Africa's Intended Nationally Determined Contribution. The "peak-plateau-decline" mitigation trajectory was first presented in the National Climate Change Response Policy.
[70] Government of South Africa. Independent Power Producer Procurement Programme: An Overview (as of June 30, 2017). Department of Energy.

[71] The National Energy Regulator has awarded only one other license, to POWERX, to purchase electricity from generators and sell it to municipalities and other customers.
[72] Eskom Integrated Report, 2017.
[73] Department of Energy. December 2016. Post-2015 National Energy Efficiency Strategy, 1st Draft.
[74] Eskom, Effective Management of Energy Demand, Update, April 2016.
[75] StatsSA (2015).
[76] Enerdata (2017).
[77] World Bank (2018d).
[78] Government of South Africa (2017).
[79] Climate model projections for precipitation change are much less consistent than temperature forecasts.
[80] That is, possible increases in rainfall over the central and/or the southern interior regions, and the Cape South Coast.
[81] Department of Environmental Affairs (2013).
[82] Government of South Africa (2015a).
[83] StatsSA. Tourism Satellite Account for South Africa, final 2013; provisional 2014, 2015, 2016.
[84] 2015/16 to 2019/20 Strategic Plan of the Department of Agriculture, Forestry, and Fisheries.
[85] Government of South Africa. 2015. National Biodiversity Strategy and Action Plan. Pretoria: Department of Environmental Affairs.
[86] Department of Environmental Affairs (2016).
[87] According to the Department of Environmental Affairs' Adaptation Scenarios Factsheet Series.
[88] Department of Environmental Affairs (2016)
[89] South Africa Weather Service. http://www.weathersa.co.za.
[90] Ntombela *et al.* (2016).
[91] Exchange rate used here is $1 = R15.3.
[92] Draper *et al.* (2018) SCD background paper.
[93] Bruni (2016).
[94] In total, 61 percent of poor South African households obtain child support grants, and 92 percent of old, poor South Africans receive old-age grants, according to StatsSA. About 1.1 million South Africans with disabilities receive grants.
[95] World Bank (2014a).
[96] World Bank (2018a).
[97] Active labor market programs are further discussed in Chapter 3.
[98] This paragraph is based on Philip (2018) SCD background note.
[99] According to ongoing World Bank research.
[100] Belli *et al.* (2018) SCD background note.
[101] Based on the 2007 Enterprise Survey for South Africa.
[102] World Bank (2017a).
[103] World Bank (2006).
[104] Dessus *et al.* (2018).
[105] According to the 2017 Medium-Term Budget Policy Statement.
[106] Bogoev and Bachmair (2017) SCD background note.
[107] Jooste *et al.* (2018) SCD background note. See also Frankel *et al.* (2008).
[108] Jooste *et al.* (2018).
[109] Hanusch *et al.* (2016).
[110] In other words, South Africa's net international investment position is positive.
[111] Presentation by Rodrigo Valdes, November SCD workshop on "Macroeconomic volatility and social cohesion."
[112] Dadam (2017) SCD background note.
[113] 2017 Article IV consultation of the International Monetary Fund. See also Rigobon (2007).
[114] World Bank (2018a)
[115] This also became evident in consultations with South African youth for this SCD.
[116] Posel (2016).
[117] According to the Commission for Employment Equity (CEE) Annual Report of 2013–2014, only 0.95 percent of the country's economically active people are people with disabilities.
[118] World Bank (2015b).
[119] Statistics South Africa. 2017. Quarterly Labour Force Survey, Quarter 2: 2017, page 25.
[120] Langbein and Weber (2018) SCD background note.
[121] Von Fintel (2015).

[122] World Development Indicators.
[123] The Real Economy Bulletin. 2017. Special Edition: The State of Small Business in South Africa.
[124] South Africa Survey of Employers.
[125] 2016 Global Entrepreneurship Monitor.
[126] For recent economic developments and the 2018-2020 outlook see World Bank (2018c).
[127] This paragraph draws on World Bank (2017a).
[128] World Bank (2011a).
[129] World Bank (2017a).
[130] World Bank (2017b).
[131] Specifically, the model assumes the following: Population is set to grow at the annual average of 1.2 percent from 2012 to 2030 (from 52.4 million to 65.1 million), while the working-age population (15–64 years old) is set to grow at 1.3 percent over the same period (source: StatsSA). Keeping constant pass rates (matric and tertiary education) at their 2016 levels, the supply of skilled and highly skilled labor is projected to annually grow faster (1.6 and 2.0 percent respectively) than that of unskilled labor (0.8 percent) between 2018 and 2030. Water supply is assumed to stay constant at its 2012 level until 2030, as all possible South African water reserves are already being exploited. In contrast, mineral reserves are considered infinite, and their depletion rate is being driven by world prices (using World Bank projections) versus production costs. Total factor productivity is set to stagnate over the period 2018–2030. Total factor productivity growth over the period 2012–2017 is set to match recorded GDP growth. Net foreign financial flows are set to grow at 2 percent each year. But the progressive introduction of a carbon tax and all direct and indirect tax rates (including import tariffs) are assumed to stay unchanged from 2017. Public consumption is assumed to grow at the annual rate of 2 percent in real terms, and public transfers to households to stay constant in real per capita terms. International prices of minerals (coal, gold, other mining) follow Global Economic Prospects projections.
[132] Nyman *et al.* (2018) SCD background note on The Role of SOEs in South African Markets and Their Impact on Competition.
[133] World Bank (2017b).
[134] Chortareas and Noikokyris (2018) SCD background note on What is the Impact of Investment on Labour Income?
[135] Weighted by their capital.
[136] Chortareas and Noikokyris (2018) SCD background note on Exchange Rate Volatility, Uncertainty, and Corporate Investment.
[137] Dessus *et al.* (2018).
[138] World Bank (2018e).
[139] Acemoglu *et al.* (2007).
[140] Aliber (2018) SCD background note.
[141] ICRW. 2011. Gender Land and Asset Survey, South Africa.
[142] Aliber (2018). SCD background note.
[143] Philip (2018) SCD background note on The Informal Sector and Its Scope for Growth.
[144] Morris *et al.* (2012).
[145] Based on estimating the change in elasticity between commodity prices and investment due to changes in the Mining Charter.
[146] Dadam (2018) SCD background note.
[147] Hassan and Paul (2014).
[148] Dadam (2018) SCD background note.
[149] Chortareas and Noikokyris (2018). SCD background note on Exchange Rate Volatility, Uncertainty, and Corporate Investment.
[150] Maveé *et al.* (2016).
[151] Algu *et al.* (2018) SCD background note.
[152] In a February 2017 survey, European Union investors rank "paradigm shifts on the BBBEE scorecard" as a top concern, including the compliance cost of BBBEE, black shareholding in the company, and BBBEE local content requirements.
[153] Based on 2014/2016 average, World Economic Forum Global Competitiveness Index.
[154] World Bank (2017b).
[155] For a review of the banking regulatory framework in South Africa, see Gilbert *et al.* (2009). In financial market regulation, the South African authorities have always followed international best practices, even when the country was politically isolated.
[156] World Bank (2017b).
[157] Cali and Hollweg (2017).

[158] World Bank (2017a).
[159] Draper *et al.* (2018) SCD background note.
[160] Dadam and Viegi (2015).
[161] According to 2005–2015 ILO data.
[162] World Bank (2017b).
[163] Nguyen (2018) SCD background note.
[164] Draper *et al.* (2018) SCD background note.
[165] World Bank (2018c).
[166] Mudavanhu (2018) SCD background note.
[167] Although South Africa's real interest rate is not significantly different from global interest rates, relatively high inflation (not least due to the wage bargaining system) results in high *nominal* policy rate divergence.
[168] Dadam *et al.* (2018) SCD background note and Leibbrand *et al.* (2016).
[169] Langbein and Weber (2018) SCD background note.

Chapter 3

[1] Institute for Race Relations (2017).
[2] Robalino and Walker (2017).
[3] This relates especially to legacy positions of large firms and the need to achieve economies of scale, and unequal access to skills and capital for certain parts of the population.
[4] This section draws on Van der Berg and Hofmeyr (2018) SCD background note.
[5] OECD (2017: 50).
[6] According to the Southern and Eastern Africa Consortium for Monitoring Educational Quality.
[7] Van der Berg and Gustafsson (2017).
[8] Government of South Africa (2015).
[9] South Africa's adolescent fertility rate is 47 births per 1,000 women aged 15–19.
[10] See White Paper on the Rights of Persons with Disabilities, approved by Cabinet in 2015.
[11] Center for Justice and Crime Prevention (2012).
[12] SCD consultations indicated that young people acknowledge the value of mixed-race schools, associated with a better standard of living.
[13] Armstrong (2014).
[14] World Bank 2016a).
[15] Child stunting decreases with increasing wealth quintiles, from 36 percent among children in the lowest wealth quintile, to 24 percent among those in the middle wealth quintile, and to 13 percent among children in the highest wealth quintile.
[16] This section draws on Belli *et al.* (2018) SCD background note.
[17] Under-five mortality rates decreased from 59 to 42 per 1,000 live births over the last two decades, while infant mortality decreased from 45 to 35 per 1,000 live births over the same period. Both the percentage of births delivered by a skilled provider (84 percent in 1998 and 97 percent in 2016) and the percentage delivered in a health facility (83 percent in 1998 and 96 percent in 2016) have significantly increased. See Belli *et al* (2018) SCD background note.
[18] Ibid.
[19] Concerns that price rises in the health care sector have exceeded headline inflation in recent years spurred the Competition Commission of South Africa to open a market inquiry into the private health care sector in 2014. Potential reasons include market power among hospitals, insurance firms, and medical practitioners, and barriers to entry and expansion at various levels of the health care value chain and the regulatory framework. Moreover, between 2005 and 2015, the Competition Commission of South Africa uncovered seven cartels in the health care sector, including in pharmaceutical products, prosthetic products, and medical services. In four of these cases, a trade association was explicitly found to have played a role in the collusive agreement.
[20] Levinsohn *et al.* (2011).
[21] Nannan *et al.* (2012).
[22] *Belli et al.* (2018) SCD background note.
[23] Ataguba *et al.* (2011).
[24] Wood *et al.* (2010: 75-80); Bhorat and Westthuizen (2012); Pellicer *et al.* (2011).
[25] Maxmen (2016).
[26] Cloete *et al.* (2014).

[27] Arah et al. (2006).
[28] McIntyre *et al.* (2007).
[29] Coovadia *et al.* (2009).
[30] South Africa has considerable hospital capacity, albeit heavily concentrated in urban areas and at the higher levels of care.
[31] Bezuidenhout *et al.* (2009).
[32] To compare this with selected other cities: average commuting distances are seven, 11, and 19 kilometers in Lima, Bogotá, and Mexico City, respectively, according to Munoz-Rasking and Scorcia (2017).
[33] Kerr (2017) SCD background note.
[34] This section draws on Kerr (2017).
[35] Access here means sufficient proximity to be able to use a transportation service, without judgment as to whether it is affordable.
[36] Ibid.
[37] World Bank (2014b).
[38] Ongoing World Bank research.
[39] Centre for Development and Enterprise (2017).
[40] Kluve *et al.* (2016).
[41] Card *et al.* (2015).
[42] Philip (2018) SCD background note on Public Employment in South Africa.
[43] Center for Development and Enterprise (2017).
[44] This section draws on Bhorat and Stanwix (2018) SCD background note.
[45] Ibid.
[46] Ibid.
[47] World Bank (2018a) suggests that a national minimum wage is likely to have negative employment effects.
[48] Langbein and Weber (2018) SCD background note.
[49] Worldwide Governance Indicators and World Economic Forum Global Competitiveness Index.
[50] See, for example, Bachmann *et al.* (2014), Braun (2011), and Chappell *et al.* (1992).
[51] Flowerday *et al.* (2017).
[52] Bhorat *et al.* (2009).
[53] Fiori *et al.* (2012) and Griffith *et al.* (2007).
[54] OECD Product Market Regulations convert qualitative information concerning laws and regulations that may affect competition into quantitative indicators of the restrictiveness of regulations to competition. They cover both economy-wide regulations and sector-specific regulations for certain network sectors (energy, transport, and communications), professional services, and retail services. One shortcoming is that they measure only the restrictiveness of regulations "on the books" and do not cover implementation.
[55] Many markets in which SOEs participate lack a clear economic rationale for government participation. Significant vertical integration of South Africa's SOEs can incentivize exclusionary behavior. There are 21 identified primary SOEs in South Africa that are present in more than 170 markets. However, only 32 percent of these markets exhibit characteristics that would generally provide an economic rationale for government participation in the economy. Many of these SOEs are highly vertically integrated, based on the presence of a market failure such as natural monopoly or significant externalities that would lead to over- or underproduction. As an example, the Airport Company of South Africa is also active in the hotel market, which is not typically thought of as requiring state participation. In the vast majority of cases, a rationale for government participation is not publicly available. When state entities are vertically integrated as the main suppliers or offtakers of products in the value chain, it may provide an incentive for SOEs to exclude potential competitors from the market, especially when coupled with shortcomings in sector regulation. Eskom, for example, is active in generation, transmission, distribution, and retail of electricity. As such, the company has few incentives to allow competitors in generation or retail to access its transmission infrastructure or let them purchase electricity from Eskom for on-sale to consumers. These risks are compounded by the fact that in some cases SOEs have been able to gain market share through government support that was unavailable to private competitors, against the principles of competitive neutrality. Such government support remains relatively common, with SOEs benefiting from government subsidies, debt guarantees, bailouts, or advantageous access to essential facilities. It is worth noting that three SOEs have been found guilty of abusing their dominance by excluding competitors or charging excessive prices, while another is currently under investigation. See Nyman *et al.* (2018). SCD background note on The Role of SOEs in South African Markets and Their Impact on Competition.
[56] World Bank (2016b).
[57] The complaint was not upheld by the Competition Tribunal.
[58] Sasol (2017).

[59] Import pricing parity refers to the practice of setting domestic prices at the world price (in local currency terms), which includes transportation and insurance fees, taxes, and other costs that the buyer would have to incur if importing the goods in question. In an industry with a highly dominant player, this becomes problematic if domestic prices would otherwise fall below the imported price (including in the case of a rand depreciation), since setting prices at import pricing parity would stop these lower prices from being passed through to consumers, given that the product cannot be easily sourced from other domestic suppliers. The Competition Commission of South Africa has pursued two excessive pricing cases based on import pricing parity against both AMSA and Sasol; however, excessive pricing cases are difficult to prove (across jurisdictions and not only in South Africa), and the firms were not found guilty.

[60] Nyman *et al* (2018) SCD background note on The Design of Incentive Schemes in South Africa: Through the Competition Lens.

[61] World Bank (2017a).

[62] The following information is sourced from Nyman *et al.* (2018) SCD background note on The Design of Incentive Schemes in South Africa: Through the Competition Lens.

[63] Ideally, incentive schemes would make eligibility criteria publicly available (including online), provide contact details, specify approval procedures, provide application forms, comply with a standard approval time, publish recipient lists ex post, and be preceded by a publicly available impact assessment like the SEIAS. Given the fact that impact assessments are not mandatory for incentive schemes, a less strict definition was applied that removes the SEIAS requirement. However, even without the SEIAS criterion, no incentive scheme is unambiguously transparent. Once the requirement to publish a list of recipients is removed as well, two incentive schemes are classified as transparent. According to the most lenient definition, which takes away the condition to have a standard approval time, less than 40 percent of schemes are considered transparent.

[64] According to the Department for Trade and Industry's 2015 program guidelines for the Black Industrialist Scheme.

[65] For example, the Support Program for Industrial Innovation leaves undefined what precisely creates the significant advance in technology required by the program. See https://www.thedti.gov.za/financial_assistance/financial_incentive.jsp?id=48&subthemeid.

[66] Perhaps as a result of the complexity of the incentive schemes, there appears to be a sizeable number of consultants who have specialized in advising companies attempting to apply for incentive schemes. The need for consultants to navigate the complexity of incentive schemes puts smaller firms that might not be able to pay potentially prohibitively high consultant fees at a disadvantage. A 2014 review of Support Program for Industrial Innovation found that smaller enterprises incur greater additional costs than larger firms in applying for the incentive because of the use of consultants, and they noted that more skilled consultants were more expensive. Elements of discretion also tend to favor well-connected firms with existing relationships with policymakers, relationships that new and smaller firms tend to not have.

[67] Boonzaaier *et al.* (2016).

[68] Research and development (Section 11D and 11B); Learnership allowances (Section 12H); Strategic industrial policy (Section 12I); Film incentive (Section 24F); Urban development zones (Section 13quat).

[69] Schaffer *et al.* (2017).

[70] According to the Global Competitiveness Index.

[71] Draper *et al.* (2017) SCD background note.

[72] Aterido *et al.* (forthcoming).

[73] The National Treasury-South African Revenue Service data also suggest that small firms are more productive, which is inconsistent with the other parts of the evidence described in this paragraph. It is likely to be a sampling issue, as unproductive firms are less likely to formalize and pay tax, and are therefore missing from the National Treasury-South African Revenue Service dataset. As was described earlier, most small firms are missing from the National Treasury-South African Revenue Service data, suggesting that formalization is a problem in South Africa, either because small firms are relatively unproductive or because formalization is too much of a regulatory hurdle.

[74] Kirkwood (2017) SCD background note.

[75] An evaluation of early stage BEE (2004–2006) does not find adverse effects on investment, labor productivity, or firm profitability, but no major studies on this have been conducted since, especially on more recent BBBEE. See Acemoglu *et al.* (2007).

[76] Proposed amendments to the regulations in terms of the Broad Based Black Economic Empowerment Act of 2003 as amended (the "Codes of Good Practice") were published in a gazette on February 17, 2016, (Gazette number 39704) for public comment.

[77] See https://www.thedti.gov.za/economic_empowerment/docs/PPPFA%20Regulation.pdf, accessed online on March 31, 2018.

[78] Competition Commission of South Africa presentation, Paris, 2017.
[79] See http://www.treasury.gov.za/publications/other/SCM%20Review%20Update%202016.pdf, accessed online on March 31, 2018.
[80] Ibid.
[81] According to the 2010 Finscope SME Survey.
[82] Mudavanhu (2018) SCD background note.
[83] As stipulated in the 1990 Banks Act.
[84] According to a 2017 survey by the Franchise Association of South Africa on the South African Franchisee.
[85] Finmark Trust (2017).
[86] World Bank (2017b).
[87] This section draws on Philip (2018) SCD background note on The Informal Sector and its Scope for Growth.
[88] Insights from SCD youth consultations.
[89] According to the World Bank's 2007 Enterprise Survey for South Africa.
[90] According to ongoing World Bank research.
[91] World Bank (2014b).
[92] Aghion *et al.* (2010).
[93] This paragraph draws on Philip (2018) SCD background note on Co-ops in South Africa.
[94] Wessels (2016).
[95] According to the World Bank's 2016 Appraisal Document: Land Bank Financial Intermediation Loan.
[96] This paragraph draws on Aliber (2018) SCD background note.
[97] According to the 2015 OECD Economic Survey of South Africa.
[98] When the dollar price of imported wheat over a set period of time falls below the floor, import duties rise based on the difference between the two.
[99] According to the International Trade Administration Commission of South Africa Wheat Tariff Review of 2016 (see http://www.itac.org.za/upload/document_files/20170623102216_Report-538.pdf). To address this concern, based on the recommendation from the International Trade Administration Commission of South Africa, the real effective exchange rate was incorporated into the variable tariff formula.
[100] In early 2016, the International Trade Administration Commission of South Africa conducted a review of the system. To address issues of overprotection when there was an extreme fall or appreciation in the value of the currency, it recommended that a new variable should be introduced into the formula, namely, the Real Effective Exchange Rate Index. Prior to this, in 2005, the International Trade Administration Commission of South Africa had recommended that a switch be made to ad valorem tariffs. However, subsequent to representations made by the National Chamber of Milling, Grain SA, and the Department of Trade and Industry in 2008, the International Trade Administration Commission of South Africa ultimately recommended a return to the variable tariff formula.
[101] Sugar Act 9 of 1978, together with amendments in 1984, 1987, and 1992.
[102] Section 4, subsection 2(b) of the act.
[103] Steenkamp *et al.* (2017).
[104] Lourens (2018) SCD background note.
[105] Bezuidenhout and Grater (2016).
[106] "Empowerment plans," including shareholding by historically disadvantaged individuals or groups; training and affirmative action in employment; business and economic opportunities for local communities.
[107] According to National Treasury's 2017 Medium-Term Budget Policy Statement.
[108] This section draws on Nyman *et al.* (2018) SCD background note on The Role of SOEs in South African Markets and Their Impact on Competition.
[109] See, for example, https://www.comptrib.co.za/sapphire/main.php?url=/cases/complaint/retrieve_case/110, accessed on March 31, 2018.
[110] This section draws on Nyman *et al.* (2018) SCD background note on The Role of SOEs in South African Markets and Their Impact on Competition.
[111] Surovitskikh and Lubbeb (2014).
[112] World Bank (2016c).
[113] See http://www.digitalfoundation.org.za/2017/01/will-open-access-wireless-networks-meet-coverage-objectives-south-africa/; accessed on March 31, 2018.
[114] The digital economy contributes less than 3 percent of GDP and 17.5 percent of service exports, compared to 55 percent of service exports in Brazil and 40 percent in China, according to the World Bank (2017b).
[115] According to 2017 Research ICT Africa *Policy Brief No. 3*. http://www.researchictafrica.net/polbrf/Research_ICT_Africa_Policy_Briefs/2017_Policy%20Brief%203_South%20Africa.pdf.
[116] An exception was the failed divestiture of Kelvin Power Station.

[117] According to NUS Consulting, based on a comparison of fixed, 12-month contract electricity prices starting in June 2015 for the supply of 1,000 kilowatts of capacity with 450 hours of use.
[118] Botes (2005), Pieterse *et al.* (2016), and Havenga *et al.* (2017).
[119] Ibid.
[120] Havenga *et al.* (2017).
[121] In terms of operational efficiency, South African ports' performance is below the sample global average on most indicators, barring utilization of container ports and cargo dwell times.

Chapter 4

[1] Chapter 2, Section 7(2), and Chapter 9 of the Constitution created independent institutions to support and protect the system of democratic governance (the South Africa Human Rights Commission; the Electoral Commission; the Commission for the Promotion and Protection of the Rights of Cultural, Religious and Linguistic Communities; the Commission for Gender Equality; the Auditor-General; and the Public Protector).
[2] Hausman and Zikhali (2016).
[3] Alam *et al.* (2016).
[4] See https://www.internationalbudget.org/open-budget-survey/open-budget-index-rankings/, accessed on March 31, 2018.
[5] For example, in the case of high-level corruption or when communities claim socioeconomic rights, such as the right to access antiretroviral drugs necessary for the treatment of HIV/AIDS.
[6] For example, the third Mining Charter.
[7] Other notable civil society organizations include Corruption Watch, a Transparency International chapter working to fight corruption in South Africa; the Right2Know Campaign, centered on freedom of expression and access to information to meet people's social, economic, political, and ecological needs and to live free from want, in equality and dignity; the Council for the Advancement of the South African Constitution, which has made a number of important interventions in defense of constitutional principles and accountability, including most recently its High Court action that resulted in the court finding that the National Director of Public Prosecutions was unlawfully appointed; and Save South Africa, a campaign made up of organizations, civil society groups, South African citizens, and supporters of the founding principles of South Africa's democracy, united in their determination to hold leaders accountable to the values of the Constitution, and to ensure that leaders act with integrity and respect.
[8] As reflected in consecutive waves of the Afrobarometer.
[9] According to the 2016 Article IV consultation of the International Monetary Fund.
[10] Slava (2018) SCD background note.
[11] Plangemann (2016).
[12] World Bank (2017b).
[13] Draper *et al.* (2018) SCD background note and consultations.
[14] Plangemann (2016).
[15] Purfield (2016).
[16] World Bank (2011b).
[17] Ibid.
[18] Alexander *et al.* (2015).
[19] StatsSA (2016).
[20] Municipal IQ: Municipal Hotspot Monitor.
[21] Powell (2009).
[22] This section draws on Kikeri (2018) SCD background note.
[23] Key among the infrastructure SOEs are Eskom, Transnet, water boards/companies, Airport Corporation of South Africa, SAA, and the South African National Roads Agency (responsible for national roads). Other SOEs in the 20+ group include financial SOEs, including the Development Bank of South Africa and the Land and Agricultural Bank; SOEs in the national economic security space, including Denel (defense), the Central Energy Fund, PetroSA, Armscor, and the Trans-Caledon Tunnel Authority; and social and developmental SOEs, including the South African Post Office, Post Bank, the South African Broadcasting Corporation, and South African Forestry Company Limited.
[24] According to the October 2017 World Economic Outlook of the International Monetary Fund.
[25] International Monetary Fund (2015).
[26] According to the Annex of the National Treasury's 2017 Budget Review.

Chapter 5

[1] Additional research is ongoing on the impact of migration on jobs and wages (World Bank 2018). Preliminary results are positive across skills levels as well as across the informal and formal sectors. Given this new emerging research, the evidence base is more likely to be rated moderate to high in future, if the results remain conclusive.

Appendix

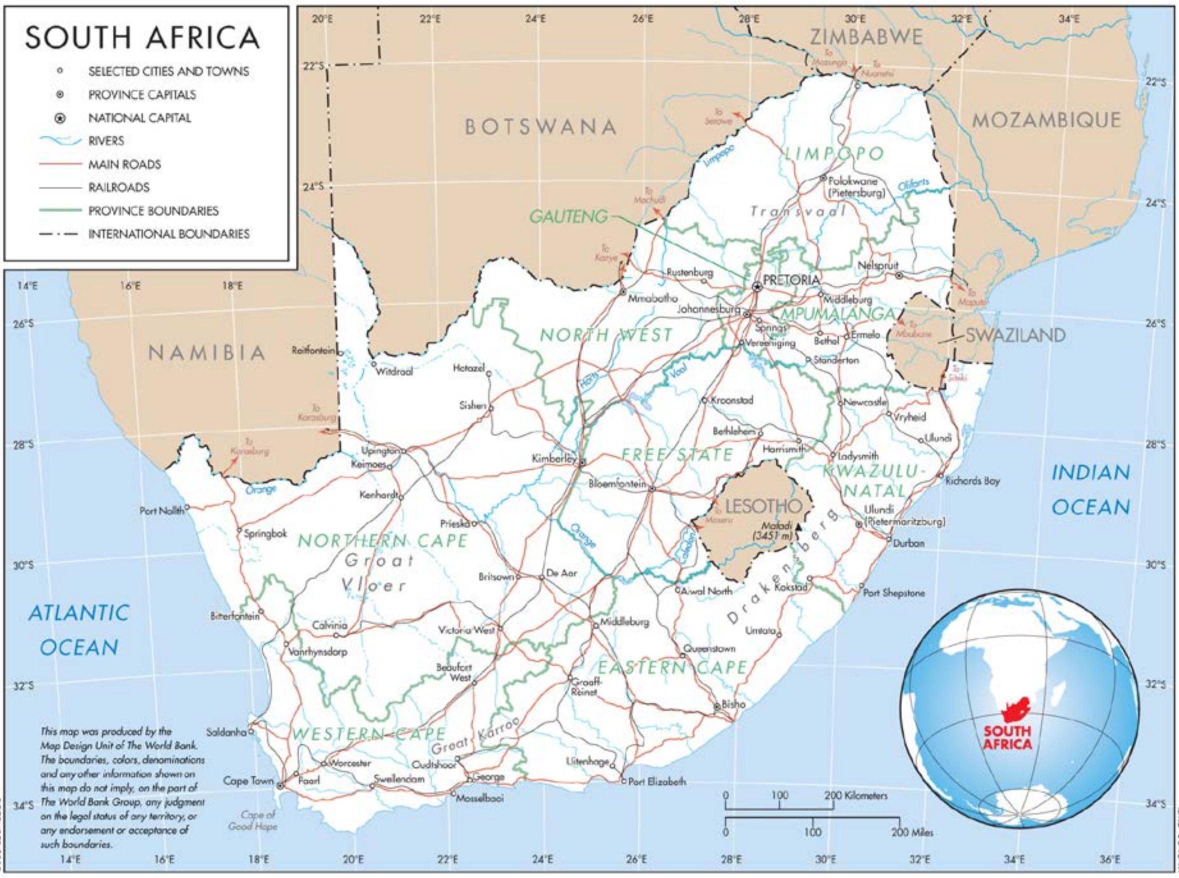
[1] For all sectors, elasticities of substitution between intermediate consumption and value-added plus energy are set to 0.9 for old capital and 1.8 for new capital; elasticities of substitution between labor and the capital-water-mineral-energy bundle are set at 0.9 for old capital and 1.8 for new capital; elasticities of substitution between labor types are set at 0.1; elasticities of substitution between capital, water, mineral, and energy are set at 0.9 for old capital and 1.8 for new capital. Elasticities of substitution between energy types are set at 0.9 for old capital and 1.8 for new capital.

[2] An alternative version of the model allows for the distinction between public and private investment, the former being allocated exogenously to sectors, while the latter is allocated to the different sectors so as to equalize marginal capital productivities. Return on public investment takes the form of higher total factor productivity in the sectors where it is allocated. Such a version of the model is used to simulate additional public investments in SPA1.

[3] Sectoral wage premia are calibrated using actual labor remuneration per labor types in the different sectors. Super profits are calibrated using actual sectoral gross operating surpluses over capital stocks. Data retrieved from Quantec.

[4] Net transfers received by the poorest 40 percent households from richer deciles average 8 percent of their disposable incomes.

[5] Initial capital stock in 2012 is set at 2.7 times GDP at factors cost (data source is Quantec). Capital stock of a given year equals capital stock of the previous year plus investment minus depreciation (set at 5 percent of the previous year capital stock).


SOUTH AFRICA
SELECTED CITIES AND TOWNS
PROVINCE CAPITALS
NATIONAL CAPITAL
RIVERS
MAIN ROADS
RAILROADS
PROVINCE BOUNDARIES
INTERNATIONAL BOUNDARIES
ZIMBABWE
BOTSWANA
MOZAMBIQUE
NAMIBIA
SWAZILAND
LESOTHO
LIMPOPO
GAUTENG
MPUMALANGA
NORTH WEST
FREE STATE
KWAZULU-NATAL
NORTHERN CAPE
EASTERN CAPE
WESTERN CAPE
INDIAN OCEAN
ATLANTIC OCEAN
PRETORIA
Johannesburg
Polokwane (Pietersburg)
Nelspruit
Rustenburg
Mmabatho
Kimberley
Bloemfontein
Upington
Springbok
Port Nolloth
De Aar
Middelburg
Queenstown
Bisho
Port Elizabeth
Uitenhage
George
Mosselbaai
Oudtshoorn
Worcester
Cape Town
Paarl
Saldanha
Calvinia
Vanrhynsdorp
Victoria West
Beaufort West
Graaff-Reinet
Aliwal North
Kokstad
Umtata
Port Shepstone
Durban
Ulundi (Pietermaritzburg)
Richards Bay
Ladysmith
Harrismith
Bethlehem
Kroonstad
Vereeniging
Springs
Standerton
Ermelo
Bethal
Newcastle
Vryheid
Sishen
Hotazel
Kenhardt
Prieska
Britstown
Keimoes
Witdraai
Reitfontein
Bitterfontein
Swellendam
Groot Vloer
Great Karroo
Transvaal
Drakensberg
Cape of Good Hope
Orange
Vaal
Limpopo
Olifants
Makadi (3451 m)
0 100 200 Kilometers
0 100 200 Miles
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DECEMBER 2008
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