



OECD Economic Surveys SOUTH AFRICA

JULY 2015

OVERVIEW



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Executive summary

- *Main findings*
- *Key recommendations*

Main findings

Since 1994 South Africa has made great progress in reducing absolute poverty by rolling out social grants for pensioners, the disabled and children. Access to education, housing, water, electricity and other services has been greatly broadened. As a result, well-being has increased substantially. A sound macroeconomic framework with a stable fiscal position, inflation targeting, a floating exchange rate and largely unimpeded international capital flows underpinned this progress and has earned South Africa the confidence of financial markets.

Notwithstanding the successful transition to a democratic system with strong institutions, the legacy of apartheid is still felt by many South Africans. Inactivity is widespread, settlement structures are too remote from economic centres and severe infrastructure bottlenecks prevent economic activity from delivering the benefits of globalisation to all. Moreover, domestic barriers to firms entering markets are still high, in particular for black entrepreneurs despite policies to foster black economic empowerment. The National Development Plan provides an ambitious framework for stronger, more inclusive growth.

Growth has not been inclusive due to insufficient employment growth

A key factor behind the high income inequality is the low employment rate, especially of black South Africans. The National Development Plan also identifies the need to increase economic growth and expand employment. Job creation is held back by regulatory entry barriers for new suppliers, who could offer better and cheaper services, and by the legal extension of collectively agreed wages, contributing to an insider/outsider divide. Wage formation is complicated by confrontational industrial action. Large numbers of low-skilled job seekers reside where employment opportunities are limited. The lack of a centralised infrastructure for providing active labour market policies means that delivery of existing programmes is fragmented. There is also no national minimum wage, although collective bargaining agreements and sectoral regulations establish widely varying wage floors across much of the economy.

Reforms are under way to tackle infrastructure bottlenecks and support SMEs

The government has identified SMEs as key to bolstering growth and employment but SMEs face high regulatory burdens, and the pattern of social housing hinders business opportunities. Publicly owned network industries, especially electricity but also some transport sectors, have ongoing capacity problems and are characterised by cross-subsidies, insufficient oversight by regulators and limited access of independent service providers to the infrastructure. The government is making large investments to rectify capacity problems; electricity shortages have been particularly damaging for the economy. New public management techniques promise to improve spending efficiency. Public ownership of companies is still significant, even in markets that could be opened for competition. This occupies scarce administrative capacity on all levels of government and is a potential source of inefficiency.

The tax base is narrow and revenues are too small to meet future spending needs

A well balanced and administered tax system underpins a sound fiscal position and finances a high degree of redistribution. However, the public sector will face considerable resource needs in the years ahead to expand social and economic infrastructure. Meeting these needs will require increased revenues, but this must be equitable and not penalise growth. Taxes on personal and corporate income represent half of all tax revenues, but are levied on narrow tax bases. While goods and services taxes are an important source of revenue and are relatively efficient, largely due to the VAT regime, the zero-rates and exemptions are not well-targeted as the associated tax savings disproportionately accrue to better-off households. Carbon emissions are barely taxed but a broad carbon tax is to be introduced in 2016.

Key recommendations

The overarching priorities for strong, sustainable and inclusive growth in South Africa are:

- Focus policy implementation on the objectives in the National Development Plan.
- Remove obstacles for job creation.
- Invest in social and economic infrastructure.

Tackle infrastructure bottlenecks and improve business regulation to support job creation

- Choose infrastructure investments with the highest social returns to facilitate prioritisation and cost control.
- Improve employment opportunities by expanding affordable public transport, including integrating minibuses into the public transport system, and building new, denser settlements closer to economic centres.
- In network industries, complete the introduction of independent regulators and charge them with ensuring non-discriminatory third-party access. Secure additional electricity generation capacity by accelerating the independent power producer programme and facilitating private co-generation.
- Support SMEs by increasing the use of regulatory impact analysis in order to reduce the regulatory burden, eliminating entry barriers and promoting competition.
- Systematically identify and eliminate competition-hampering regulation. Privatisise state-owned companies, such as telecoms, that are in markets with a sufficient degree of competition.

Enhance the responsiveness of the labour market for more inclusive growth

- Establish a public employment service as a one-stop shop for job seekers to lower the cost of job search and hiring costs for employers, which would improve the matching of workers to jobs.
- Increase the role of mediation and arbitration to make wage negotiations less confrontational.

Broaden tax bases to help finance requirements for stronger and sustainable growth

- Broaden personal and corporate income tax bases by reducing deductions, credits and allowances. Increase tax rates on higher incomes.
- Broaden the VAT base and strengthen VAT compliance. Proceed with the introduction of a carbon tax.

ASSESSMENT AND RECOMMENDATIONS

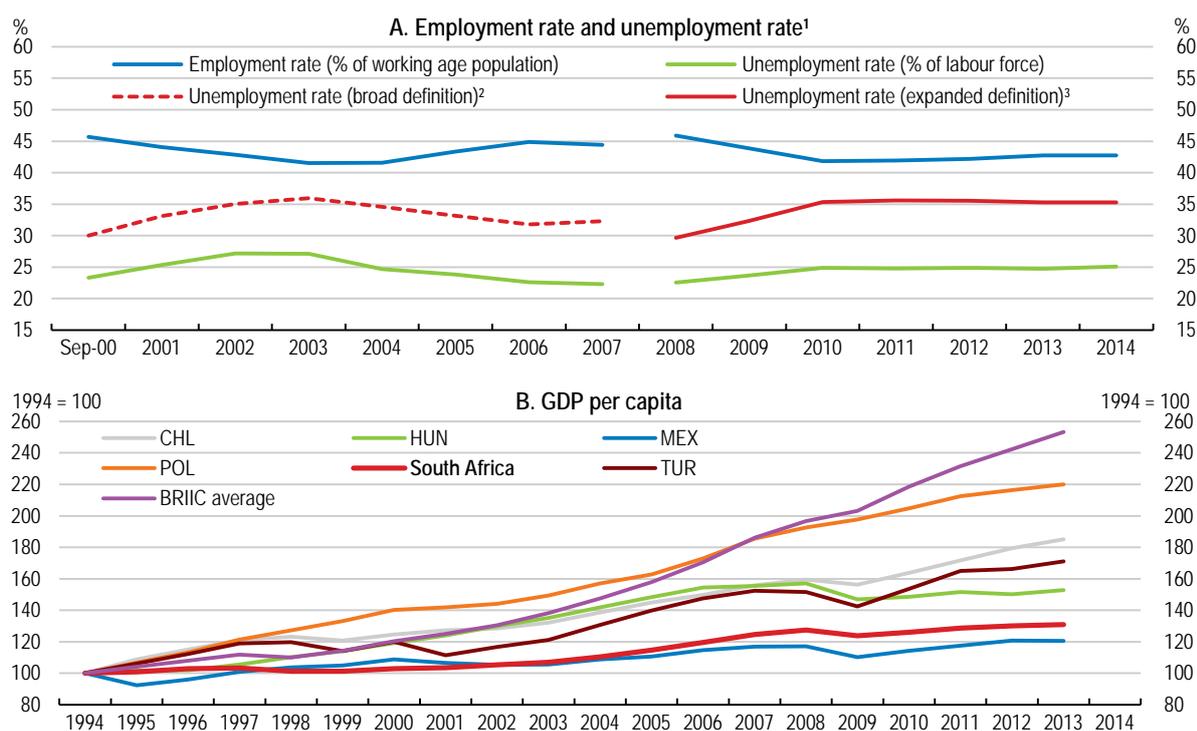
- *Social progress over the past 20 years has been impressive*
- *A stronger recovery was held back by strikes and power cuts*
- *Macroeconomic policies are stabilising inflation and public debt*
- *Promoting inclusive growth by improving the labour market*
- *More effective infrastructure and business regulation to lay the foundations for higher growth*
- *How can the tax system help to meet revenue-raising challenges?*

Social progress over the past 20 years has been impressive

Since the early 1990s, South Africa has gone through a democratic transition with the development of broad-based consultation in the policy formation process, a sound macroeconomic policy framework, and strong institutions to protect the rule of the law. Social progress has been achieved with redistributive grants and wide access to key public services, notably education, health, housing, water, sanitation and electricity. These services account for 60% of government spending (Statistics South Africa, 2014).

Notwithstanding these successes, real GDP growth, at 3.1% from 2000 to 2014, has been weak by emerging-market standards, employment has not risen fast enough to absorb the strongly expanding labour supply and reap the demographic dividend, and unemployment has been chronically high (Figure 1, Panel A). This constellation of developments has contributed to persistently large income inequalities. On the other hand, redistribution through the tax and benefit system mainly took the form of the large expansion of child support grants, disability benefits and old-age pensions, lifting citizens out of poverty, and progressive personal income taxes (Figure 2). The high number of childcare grant recipients reflects the relatively young population. The low number of elderly receiving a benefit is a consequence of the low life expectancy, although two-thirds of older people receive the old age pension.

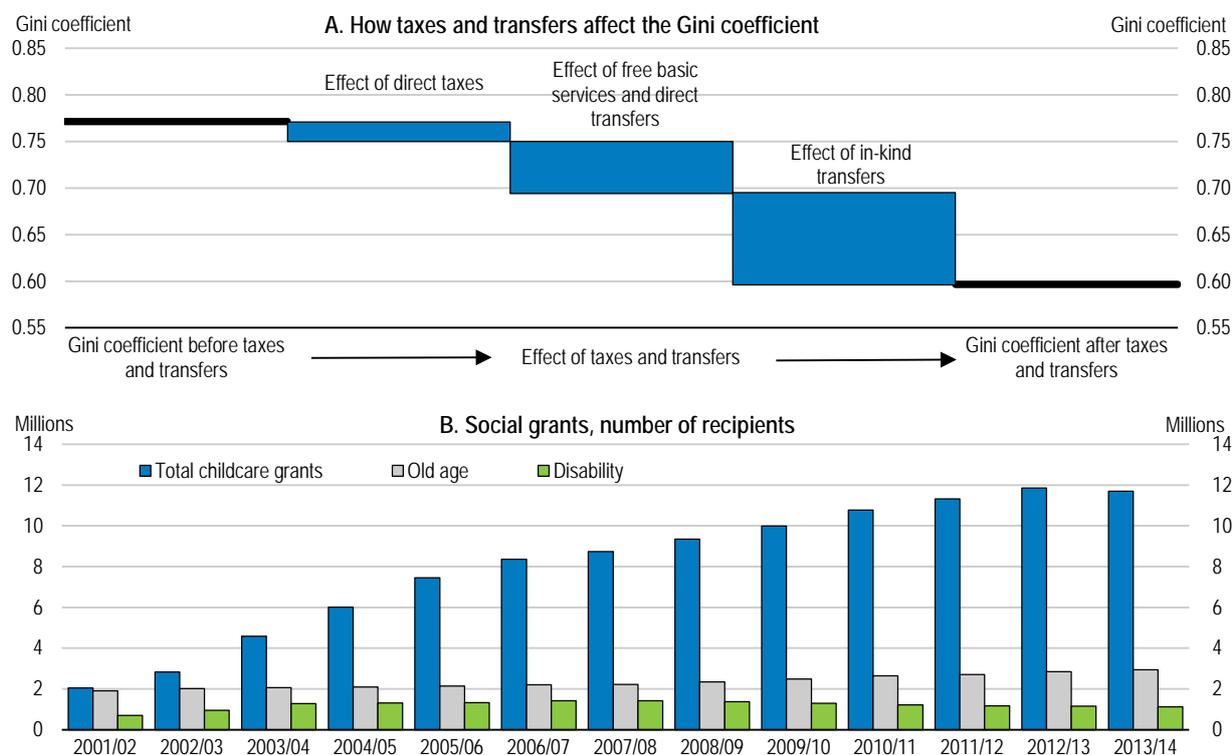
Figure 1. Selected indicators



1. Break in series in 2008.
2. Including discouraged workers, calculated by OECD.
3. In order to be considered unemployed based on the official definition, three criteria must be met simultaneously: a person must be completely without work, currently available to work, and taking active steps to find work. The expanded definition excludes the requirement to have taken steps to find work.

Source: World Bank WDI Database, Statistics South Africa Labour Force Survey (revised) and Quarterly Labour Force Survey.

Figure 2. Social benefits reach many people



Note: In Panel A above, free basic services are water, electricity, sanitation and waste removal. Direct transfers refer to cash transfers or grants and in-kind transfers are public health and education. Indirect taxes have no material effect on the Gini coefficient. The effects of each component of fiscal policy are calculated from the change in the Gini coefficient after taking each policy into account. This approximation holds if policies do not create significant changes in the ordering of the income distribution.

Source: World Bank (2014), "South Africa Economic Update: Fiscal Policy and Redistribution in an Unequal Society", *South Africa Economic Update*, No. 6, World Bank Group, Washington, DC; National Treasury.

The government's National Development Plan (NDP) calls for eliminating poverty and reducing inequality by 2030 by achieving more than 5% real GDP growth on average annually and adding 11 million new jobs (Box 1). Achieving these ambitious objectives will require deep economic reforms. The pace of economic growth and job creation has been below those required by the NDP and policy implementation of the actions it identifies varies considerably. To improve implementation, prioritisation and co-ordination of the actions and objectives of the NDP (as well as other government plans including the New Growth Path), a series of five year plans are to be published with specific policies, targets and indicators. The first of these – the Medium Term Strategic Framework for 2014-19 – was published in 2014. Responsibility for development of the medium-term framework and for monitoring outcomes resides in the Presidency.

This Survey considers ways of bringing about faster and more inclusive economic growth, which is a priority identified in the NDP. It focuses on lifting investment and job creation by improving the business climate and increasing the efficiency of public sector service delivery, particularly regarding infrastructure, as well as ways of raising revenues for new spending plans in the least distortionary way. In this way it complements earlier Surveys that examined equally important reforms relating to education, competition, youth unemployment and green growth. All these reforms are on the same wavelength as the NDP and the government's 2014 Medium Term Strategic Framework.

Box 1. The National Development Plan (NDP)

The NDP is a development strategy with the central objectives of eradicating poverty and sharply reducing inequality by 2030. The NDP specifies a series of targets that need to be met over the next two decades to achieve these objectives, including the creation of 11 million jobs and average annual real GDP growth of 5.7%. Steps to achieving this include improving policy co-ordination and implementation, providing better infrastructure and lowering costs of doing business, and strengthening the functioning of the labour market. The NDP also outlines an action plan to achieve these targets spanning 15 topics and involving a number of institutional and structural reforms. Actions which are particularly relevant to the topics addressed in this Survey include:

Economy and employment

- Develop proposals for an acceptable minimum standard of living and proposals on how to achieve this over time.
- Remove the most pressing constraints on growth, investment and job creation, including energy generation and distribution, urban planning etc.
- Increase the benefit to the country of [South Africa's] mineral resources by: giving clear certainty over property rights (the right to mine); increasing rail, water and energy infrastructure; structure a taxation regime that is fair, equitable and predictable and that recognises the non-renewable nature of mineral resources.
- Business and labour to develop their own proposals to reduce youth unemployment.
- Strengthen dispute resolutions mechanisms in the labour market with a view to reducing tension and violence.

Economic infrastructure

- Incorporate a greater share of gas in the energy mix, both through importing liquefied natural gas and if reserves prove commercial, using shale gas. Develop infrastructure for the import of liquefied natural gas, mainly for power production, over the short to medium term.
- Move Eskom's system operator, planning, power procurement, power purchasing and power contracting functions to the independent system and market operator and accelerated procurement of independent power producers.
- Ring-fence the electricity distribution businesses of the 12 largest municipalities (which account for 80% of supply), resolve maintenance and refurbishment backlogs and develop a financing plan, alongside investment in human capital.
- Consolidate and selectively expand transport and logistics infrastructure, with key focus areas being: upgrading the Durban-Gauteng freight corridor [...]; expanding capacity of the coal, iron ore and manganese lines [...]; building the N2 road through the Eastern Cape; public transport infrastructure and systems, including the renewal of the commuter rail fleet, supported by enhanced links with road-based services.

Environmental sustainability and resilience

- Carbon price, building standards, vehicle emission standards and municipal regulations to achieve scale in stimulating renewable energy, waste recycling and in retrofitting buildings.
- Carbon-pricing mechanisms supported by a wider suite of mitigation policy instruments to drive energy efficiency.

Transforming human settlements

- Develop a strategy for densification of cities and resource allocation to promote better located housing and settlements.
- Substantial investment to ensure safe, reliable and affordable public transport.
- Introduce spatial development framework and norms, including improving the balance between location of jobs and people.

Social protection

- Together with social partners, determine a social floor that can be progressively realised through rising employment, higher earnings and social grants and other aspects of the social wage.

- Pilot mechanisms and incentives to assist the unemployed to access the labour market.
- Expand existing public employment initiatives to create opportunities for the unemployed.
- Develop a consolidated institutional framework that supports coherent policy implementation, integrated social security administration, and effective regulation and oversight of the system.

Source: Action plan items are selected extracts from National Planning Commission (2011), *National Development Plan*.

A stronger recovery was held back by strikes and power cuts

In 2014, the economy faced slower international growth, insufficient infrastructure capacity (particularly of electricity generation, which was hit by a large-scale plant failure in the latter part of the year) and long, violent and costly industrial action in two important sectors. Real GDP fell in the first part of the year as a consequence of the strikes but then bounced back (Figure 3, Panel A). The strikes are estimated to have subtracted about 2 percentage points from growth in the first quarter and a bit less in the third quarter (SARB, 2014a). Subsequently, the recovery has been constrained by a delay in the roll-out of new electricity generation capacity and unplanned maintenance, leading to power outages that continued well into 2015.

Private consumption growth dipped in early 2014, then firmed over the year in line with higher disposable income and confidence (Figure 3, Panel C). Private investment contracted in the first half of the year, and the subsequent recovery has been slowed by headwinds from electricity supply problems (Table 1). Uncertainty around electricity supply and government policy (particularly relating to the resources and agricultural sectors), labour market unrest (discussed below) and further falls in commodity prices also weighed on investment. Exports slowed, export markets weakened, and export performance (exports in relation to market growth) disappointed despite a strong depreciation of the effective exchange rate since the beginning of 2011. This poor performance partly reflects a high reliance on resource exports, which weakened as the commodity boom petered out. Import growth slowed in response to lower domestic demand and rand depreciation, but the worsening terms of trade meant that the current account deficit remained high (Figure 3, Panel B). Although employment creation restarted towards the end of 2014, in early 2015 the unemployment rate was higher than a year earlier, at 26% (Figure 4).

Table 1. Macroeconomic indicators and projections

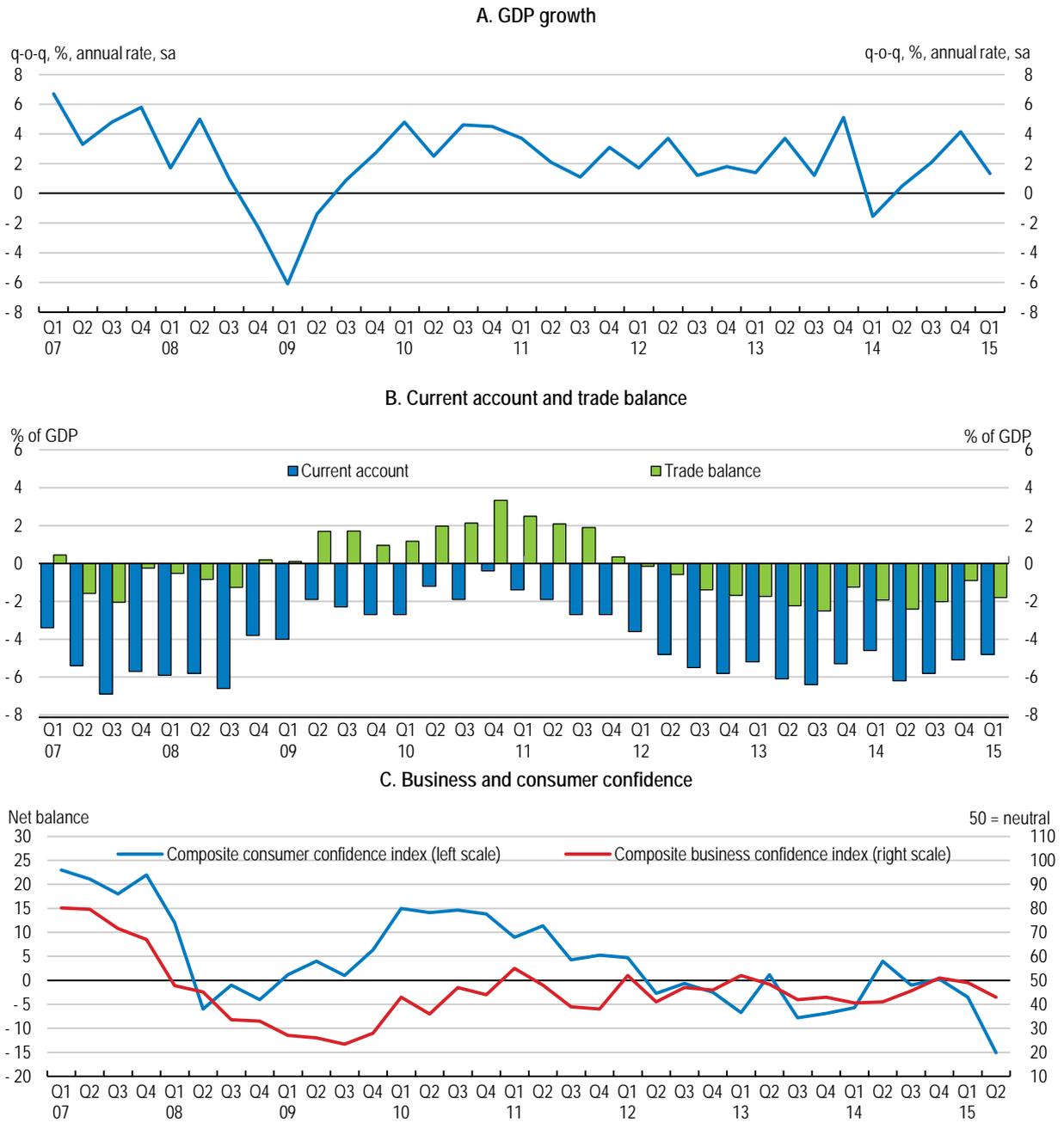
| | 2012 | 2013 | 2014 | 2015 | 2016 |
|---|----------------------------|------|------|------|------|
| | Percentage changes, volume | | | | |
| GDP | 2.2 | 2.2 | 1.5 | 1.9 | 2.2 |
| Private consumption | 3.4 | 2.9 | 1.4 | 1.7 | 2.1 |
| Government consumption | 3.4 | 3.3 | 1.9 | 1.5 | 0.8 |
| Gross fixed capital formation | 3.6 | 7.6 | -0.4 | 2.6 | 4.1 |
| Final domestic demand | 3.4 | 3.9 | 1.1 | 1.8 | 2.3 |
| Stockbuilding ¹ | 0.5 | -2.4 | -0.6 | 0.0 | 0.0 |
| Total domestic demand | 3.9 | 1.4 | 0.6 | 1.8 | 2.2 |
| Exports of goods and services | 0.1 | 4.6 | 2.6 | 4.8 | 5.2 |
| Imports of goods and services | 6.0 | 1.8 | -0.5 | 4.3 | 5.2 |
| Net exports ¹ | -1.7 | 0.7 | 0.9 | 0.1 | 0.0 |
| <i>Memorandum items</i> | | | | | |
| GDP deflator | 5.5 | 6.0 | 5.8 | 5.1 | 5.6 |
| Consumer price index | 5.7 | 5.8 | 6.1 | 4.8 | 5.7 |
| Output gap ² | 0.2 | -0.1 | -1.1 | -1.8 | -2.4 |
| General government financial balance ³ | -3.2 | -3.3 | -4.1 | -4.2 | -3.9 |
| Current account balance ³ | -5.0 | -5.8 | -5.4 | -5.5 | -5.2 |

1. Contributions to changes in real GDP.
2. As a percentage of potential GDP.
3. As a percentage of GDP.

Source: OECD Economic Outlook 97 Database.

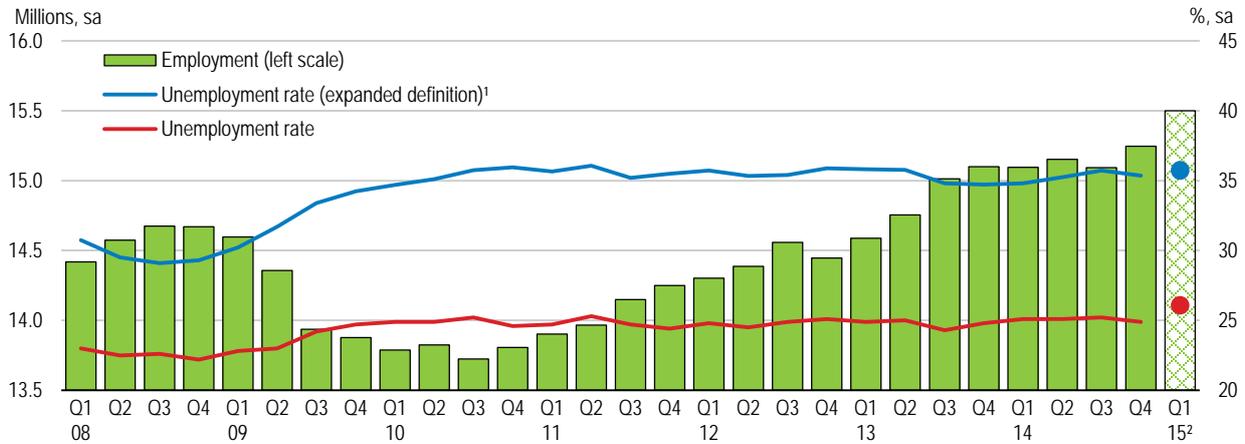
The stubbornly high unemployment rate reflects that the job creating capacity of the economy is not sufficient to absorb an expanding labour force, which is the result of rapid population growth, partly due to immigration, according to UN population data. In addition, many unemployed people have given up job search, meaning that the share of the labour force that would like to work is nearly 50% higher than reflected in the standard unemployment rate.

Figure 3. The economy is slowly recovering, although external imbalances remain high



Source: SARB Database, Statistics South Africa and Bureau for Economic Research, South Africa.

Figure 4. Labour market performance is poor

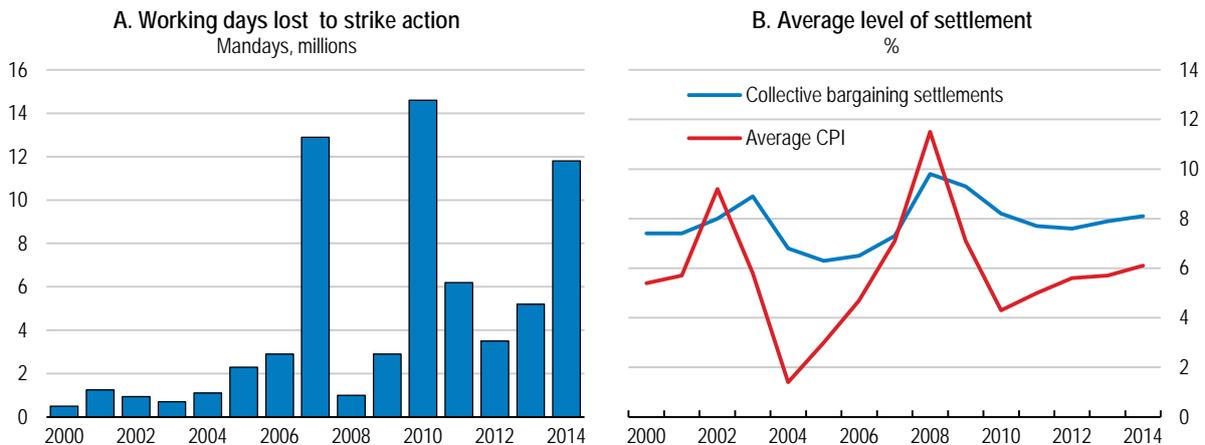


1. In order to be considered unemployed based on the official definition, three criteria must be met simultaneously: a person must be completely without work, currently available to work, and taking active steps to find work. The expanded definition excludes the requirement to have taken steps to find work.
2. Q1 2015 estimates are from the new 2013 master sample.

Source: Statistics South Africa, Quarterly Labour Force Survey, Quarter 1, 2015; SARB Database and OECD calculations.

Strike activity in the private sector has increased sharply (Figure 5, Panel A). In 2014, nearly 12 million working days in the private sector (½ per cent of total private sector working days) were lost in strikes – the largest number in two decades. This was largely the result of an almost six-month-long strike in the platinum mining sector, and a broader one-month strike by metal workers involving 220 000 employees and 12 000 companies. Other costs associated with strike activity include damage to property and violence. Despite the strikes, the wage settlements of 8-10% a year in 1-3 year agreements were similar to those in other sectors and in the preceding four years (Figure 5, Panel B).

Figure 5. Labour market unrest has increased



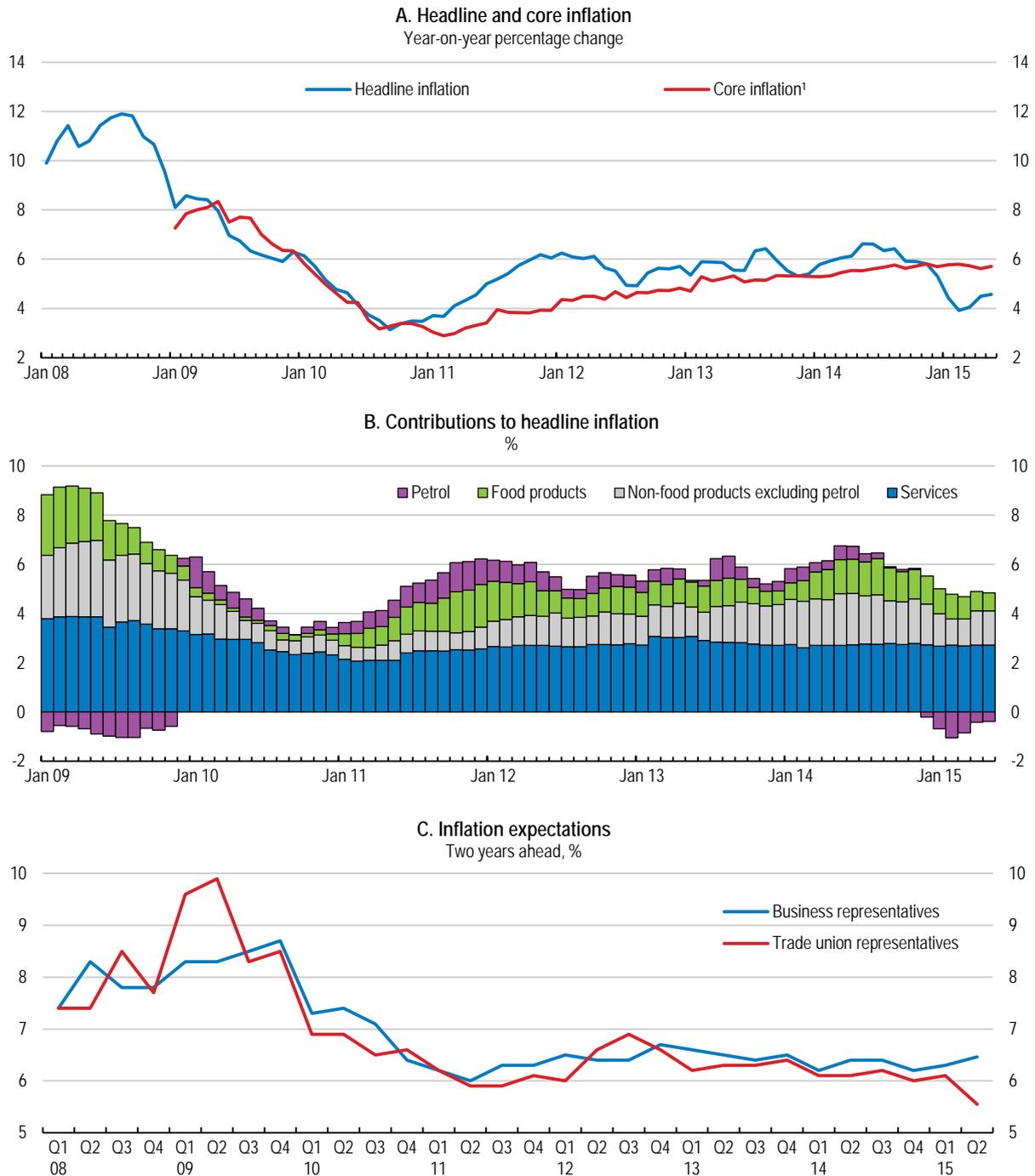
Source: Andrew Levy, Wage settlement survey, quarterly reports.

The inflation-targeting regime has been working quite well. Consumer price inflation has been around or below 6% – the upper limit of the South African Reserve Bank’s (SARB’s) target band – for more than five years (Figure 6). In early 2015 it fell below 4%, driven by falling oil prices, but has subsequently picked up. Firms and trade unions continue to expect increases in consumer prices of around 6%. Core inflation has been rising steadily, and has been between 5½ and 6% for over a year, partly reflecting multi-year adjustments in administered prices, in particular for electricity consumption, and wage indexation that introduces a backward-looking bias and weakens the link with productivity, fuelling strong growth in unit labour costs.

Growth is projected to firm along with exports, which should benefit from the past depreciation of the rand and a pick-up in global growth. The positive effects on profits and incomes will boost domestic private demand, particularly investment. However, electricity generation shortages are holding back economic growth. Even if electricity supply problems are overcome and growth accelerates as expected, growth is likely to remain below the OECD’s estimate of potential of 3% in the near term and will not be enough to materially reduce the unemployment rate.

Growth could be lower than expected if additional delays in the roll-out of new electricity generation capacity prolong power outages, which would be constraining output and exports further. Tighter monetary policy in the United States could further depreciate the rand, helping exports. However, it could also result in renewed financial market turbulence and capital flight from emerging markets, including South Africa, particularly in view of the persistent budget and current account deficits. Renewed protracted industrial action could lead to wage growth further outpacing productivity gains, eroding export competitiveness and potentially forcing the SARB to hike interest rates. A manifestation of these risks could lead to sustained low levels of consumer confidence, weighing on spending on consumer durables, in particular. On the upside, resolving policy uncertainty surrounding investment regimes in the resources and agriculture sectors could remove a significant restraint on growth and unleash private investment. In addition, exports would be boosted by a faster-than-projected recovery in world trade, particularly for commodities. Furthermore, the improving outlook for the US economy and the African continent could boost manufacturing export growth by more than expected.

Figure 6. Inflation pressures have eased



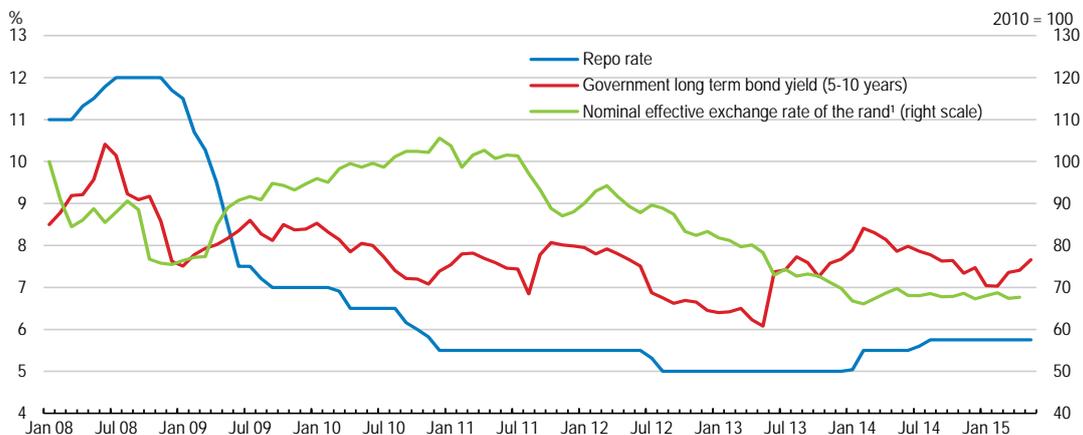
1. CPI excluding food and non-alcoholic beverages, petrol and energy.

Source: Statistics South Africa, SARB Database and Bureau for Economic Research, South Africa..

Macroeconomic policies are stabilising inflation and public debt

The current monetary policy setting is appropriate for the near term. The SARB has maintained the repo rate at 5.75% since mid-2014 (Figure 7), and headline inflation is likely to be low in 2015. However, as the effects of lower oil prices fade away, inflation will move up, although the pace of the increase will be moderated by backward-looking inflation indexation built into future wage settlements. Nonetheless, the SARB may be tested if core inflation continues to rise, even in the absence of faster growth. Moreover, a number of planned policy measures – such as making electricity prices more cost-reflective, introducing a carbon tax and introducing a minimum wage – could have second-round effects on inflation through higher wage growth or inflation expectations. The SARB has rightly pointed to the “urgent need” for structural reforms to increase the pace and inclusiveness of growth (SARB, 2014b). Stronger growth driven by supply side reforms to raise economic capacity would ease the burden on monetary policy and help poor households, which tend to be hurt most by inflation (Finn, et al., 2014).

Figure 7. The policy rate has increased from historically low levels

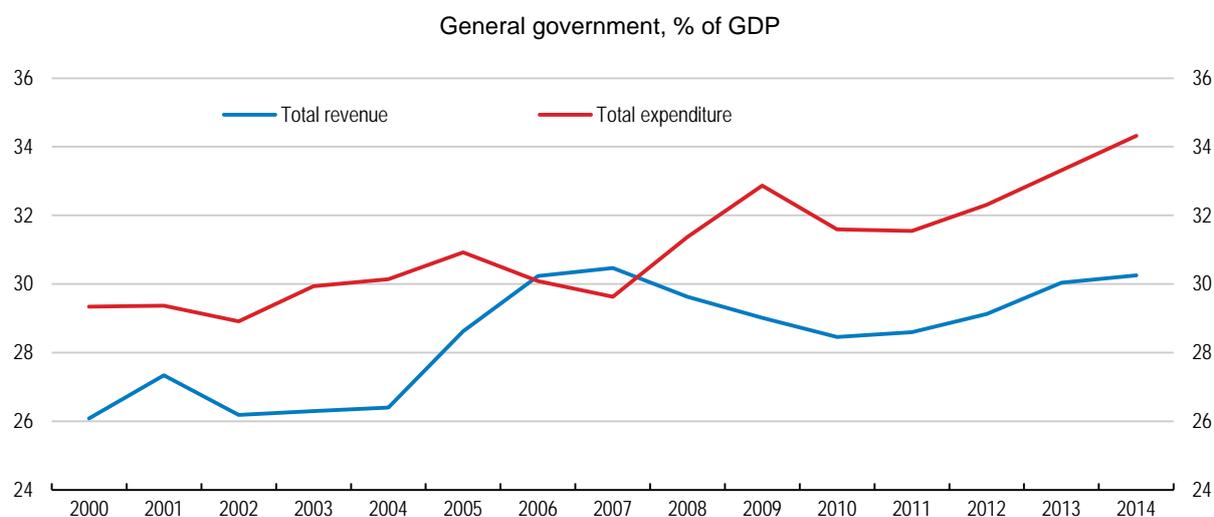


1. A lower nominal effective exchange rate means a depreciation of the rand.

Source: SARB Database.

Fiscal deficits have been persistent, partly reflecting an explicit decision to increase spending based on buoyant revenue projections during the commodity boom (Figure 8). The resulting deficit acted as a countercyclical measure. To contain spending, ceilings were introduced in 2012. In 2014, the deficit on the general government balance widened to an estimated 4.1% of GDP (Figure 9, Panel A). The deterioration mainly reflects lower-than-expected revenues, and spending stayed within the ceiling. For the fiscal years 2014/15-2017/18, the ceiling allows average annual nominal spending increases of 7½ per cent, or 1¾ per cent in real terms (National Treasury, 2014, 2015a). In addition, the government wants to increase the efficiency of its spending programmes, including by curtailing fraud and corruption. As part of this, the government is reviewing its supply chain management to secure competitive and cost-efficient public procurement (National Treasury, 2015b). Further tightening of the fiscal stance in 2015/16 will be implemented through higher indirect and personal income taxes. This mildly restrictive stance appropriately balances the need to sustain growth and limit a further increase of public debt.

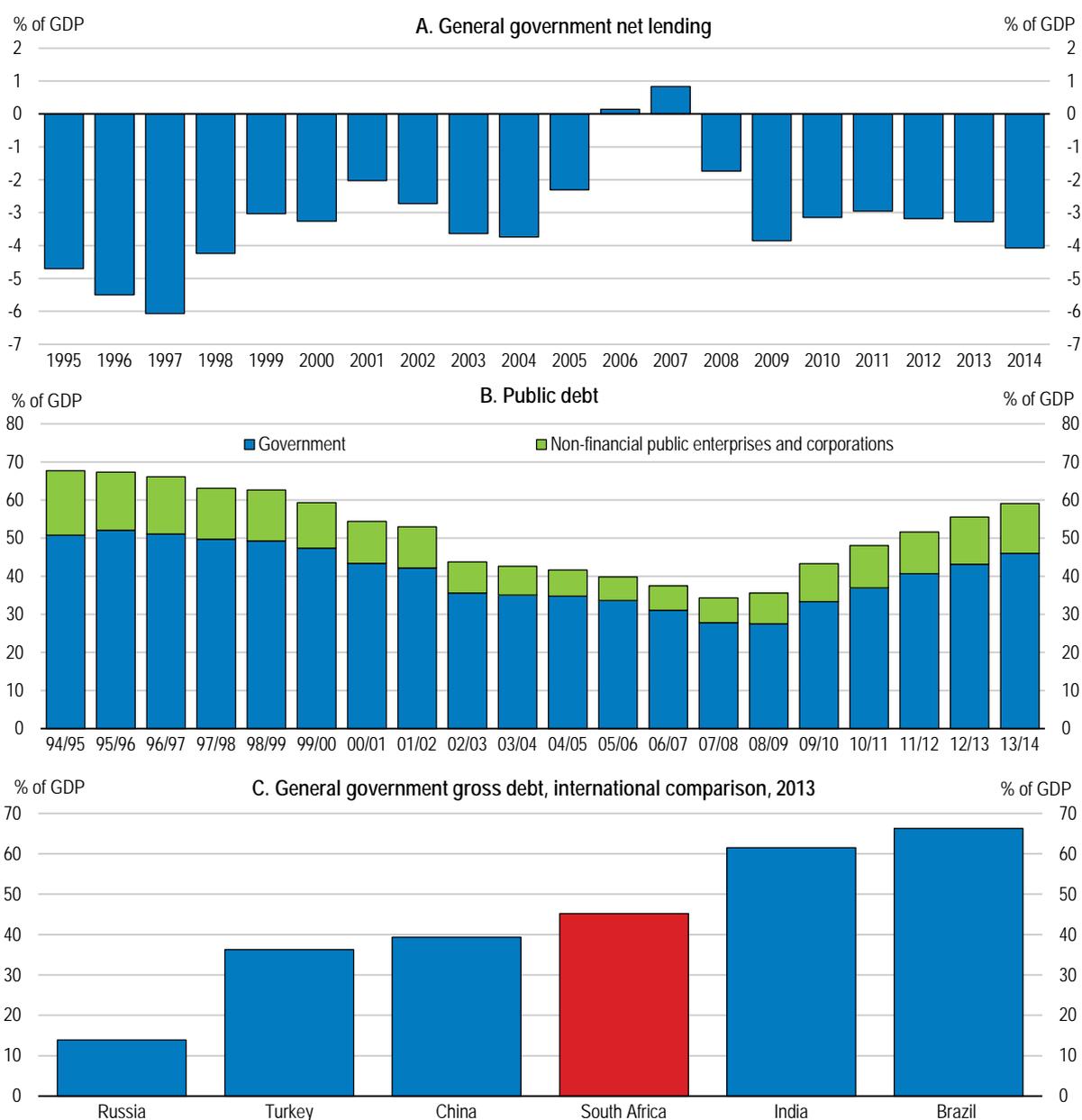
Figure 8. A persistent gap seems to have opened between public spending and revenues



Source: OECD calculations based on *SARB Database*.

General government gross debt has risen by 16 percentage points since 2007/08, reaching 45% of GDP in FY 2013/14, which is nevertheless lower than in some other emerging economies (Figure 9, Panel C). Including state-owned enterprises (SOEs), public debt rose to 58% of GDP (Figure 9, Panel B). The current fiscal policy stance is expected to stabilise the public debt-to-GDP ratio in FY 2017/18, assuming growth would rise to 3% in 2017 (National Treasury, 2015a). However, under currently depressed growth projections, containing public debt will take longer and require a combination of measures to accelerate growth, achieve a higher structural level of taxation, or cut spending more aggressively (Sachs, 2014). Seven percentage points of the increase in the debt burden reflects higher borrowing by SOEs. This partly reflects investments to address binding infrastructure bottlenecks. Part of these financing requirements is planned to be met by selling non-essential state assets. Further funds could be raised by privatising those SOEs which are servicing markets with a sufficient degree of competition or effective oversight by a regulator, particularly SOEs that have a lower return than alternative investments. Transaction costs should be taken into account.

Figure 9. Public finances have deteriorated



Source: SARB Database and IMF WEO Database, October 2014.

Recommendations on macroeconomic policy

- Maintain the current monetary policy stance and continue to carefully monitor the development of core inflation.
- Continue the prudent approach to fiscal consolidation, including the use of spending ceilings, to reduce the structural budget deficit and contain public debt in a growth and equity friendly way. Continue to sell state assets where a higher return can be achieved by using the revenues to finance infrastructure investments.

Promoting inclusive growth by improving the labour market

A key impediment to inclusive growth in South Africa is high and persistent unemployment, especially among blacks. Given the scale of inactivity, a multi-pronged strategy is necessary to raise the pace of growth and promote job creation, as identified by the National Development Plan. This requires measures to foster entrepreneurship, improve the environment for job creation and enhance the functioning of the labour market. Policies are also needed to increase the quality of basic education to increase skills, which is crucial for medium-term growth, and also improve transitions from school to work and better link vocational training to the economy's needs; the OECD has previously made recommendations in these important areas (OECD, 2010, 2013a; Field, et al., 2014; Annex). The government has sought to increase the inclusiveness of growth by implementing: a series of black economic empowerment programmes; a wage subsidy in the form of an employer tax incentive mainly targeting young workers (covering 216 000 employees in December 2014); measures to expand public works programmes; and steps to increase enrolment in post-school education, in order to address persistent skills mismatches.

One of the main planks in the government's strategy to enhance the inclusiveness of economic growth and reduce existing inequalities is to overcome the heritage of restrictions on black entrepreneurship. Black economic empowerment (BEE) policies are key to enhancing the inclusiveness of economic growth and reducing existing inequalities, and are based in part on using public procurement policy, via a points system, to induce firms to include larger numbers of historically disadvantaged population groups (Blacks, Coloured, Indians, Chinese, handicapped, and women) in their production and supply chains as workers, managers and owners. Revisions to the rules introduced in 2015 have extended the reach of the system as more points can be gained from sub-contractors, including SMEs, which may not directly be engaged in public procurement contracts themselves. In addition, oversight and sanctions are being boosted (Darroll, 2015). The points system is complex and it is important to evaluate the cost-effectiveness of all existing and new policies. Furthermore there seems to be scope to redirect BEE more towards fostering black entrepreneurship in order to better achieve the transformational objectives of the programme. This could involve a greater focus on expanding direct support for black entrepreneurs, including through subsidised access to finance, professional help with business plans, and subsidised access to management training programmes. Such measures should foster a more direct role for blacks to manage and control enterprises.

The labour market is currently hindered by high job search costs and skills mismatches, in addition to the lack of demand due to slow growth. Delivery of labour market programs is fragmented and the administrative burden of some programs is excessive (OECD, 2010). This partly reflects the absence of a fully rolled out public employment service. Spatial mismatches between economic activity and housing (discussed below) also add to the costs of job search, because some job seekers must make long trips to search for work and also because access to information on job openings is more limited (OECD, 2010). Developing a central public employment service as a "one stop shop" for job seekers that provides access to training and other support programmes as well as a centralised database of job openings, would lower the cost of job search, improve skills and help improve the matching of workers to jobs.

Table 2. Examples of industrial relations policies in OECD countries

| Measure | Country example |
|--|--|
| Pre-negotiation phase | |
| Dispute prevention services | <ul style="list-style-type: none"> In Canada the Federal Mediation and Conciliation Services provide training and other preventative services. |
| Notice to bargain | <ul style="list-style-type: none"> In Chile bargaining begins with the presentation of a “draft collective agreement” by the union or negotiating groups. In Canada written notification is given by the employer or the union requiring the other party to commence bargaining. Negotiations must typically begin within 20 days. |
| Information sharing | <ul style="list-style-type: none"> In Ontario, Canada, the Education Partnership Table facilitates dialogue between all major stakeholders on major issues and policies. In Norway the Technical Calculation Committee for Wage Settlements (TBU) presents figures that form the basis of wage negotiations, e.g. estimates of competitiveness. |
| During wage negotiations | |
| Good-faith bargaining | <ul style="list-style-type: none"> In Australia good-faith bargaining is a requirement for protected industrial action later. |
| Representatives | <ul style="list-style-type: none"> In Mexico and Sweden the employer must bargain, on request, with any union with members among its workforce. |
| Strike ballots | <ul style="list-style-type: none"> In Canada a majority of employees (of those who voted) must have approved the strike. An equivalent provision holds for lock-outs. In Germany 75% of union members must approve a strike. Warning strikes (of up to half a day) can occur without a ballot. In Chile and Korea only a majority is required. |
| Conciliation / mediation / arbitration | <ul style="list-style-type: none"> In Australia a bargaining representative can apply to the Fair Work Commission for dispute resolution assistance, and the commission can order certain actions. In Canada conciliation occurs for at least 60 days. The minister can then appoint a mediator, with 21 days of mediation required for industrial action to be protected. In Korea and Mexico undertaking a conciliation procedure before a strike is compulsory but the outcome is not binding. In Korea the procedure must be finished in 10-15 days. In Germany most collective bargaining rounds are resolved through voluntary arbitration (often prescribed by collective bargaining agreements). |
| Maintenance of activities | <ul style="list-style-type: none"> In Australia the protected status of a strike can be suspended or terminated in certain circumstances, including significant economic harm to employers and employees and/or a threat to public health and safety. The Commission can impose a cooling-off period on protected action where a third party is significantly threatened. In Canada collective bargaining agreements may prescribe that certain activities must continue during a lockout or strike, in the interests of public health or safety. |
| Opt-outs | <ul style="list-style-type: none"> In Germany individual firms can opt out from collective agreements under certain conditions. Opt-outs are typically negotiated at the company level. In Spain recent reforms allowed firms to more easily opt out of a collective agreement for objective economic, technical, production or organisational reasons. If employees’ representatives do not agree, the case can go to arbitration for a binding decision. |
| After negotiations | |
| Peace clauses | <ul style="list-style-type: none"> In Norway if a dispute concerns revision of a collective agreement, the validity of the agreement must have expired before industrial action can be taken. In Chile, Denmark, Germany and Sweden strikes are generally not allowed during the period covered by a bargaining agreement. In Germany “warning strikes” are allowed during negotiations but strikes are not allowed during arbitration. |

South Africa ranks last in the world in terms of co-operation between labour and employers in the World Economic Forum’s *Global Competitiveness Report*. The recent spike in strikes dented business confidence, lowered investment, and is likely to increase the rate of labour substitution in production. Strikes that last longer often reflect competition between unions for members, with the associated high wage demands and disputes over representation leading to fractious wage negotiations. Measures to

increase the role of mediation and arbitration could secure a faster and more peaceful bargaining process. Recent amendments to the Labour Relations Act include allowing any union to request recognition, which should increase the representativeness of unions involved in negotiations, and giving powers to the Commission for Conciliation, Mediation and Arbitration to impose conciliation in certain circumstances. Building trust among negotiating partners is important for the acceptance of productivity-oriented medium-term wage agreements, which would make the introduction of new technologies needed to climb the value chain more acceptable. More procedural measures, like introducing secret ballots, as the government proposed in the 2012 Labour Relations Act Amendment Bill, would improve the representation of workers' rights. Other possibilities would be to require social partners to enter the bargaining process with realistic demands (as in Australia) before protected industrial action can be permitted, or to provide training to bargaining partners, as in Canada (Table 2). Incentives to negotiate could be strengthened by specifying the circumstances in which an action's protected status is retracted.

The government has started a debate about introducing a national minimum wage to reduce poverty amongst almost one-half of all workers that are not covered by minimum wages, which are currently either set by the Department of Labour or agreed in collective bargaining. Labour force survey data suggest that in 2013 nearly 1½ million employees were paid less than the lowest sectoral minimum wage (that for a rural domestic worker) and among these, around half earned less than a wage equivalent to the official upper poverty line (of ZAR 871 per month – the amount required to purchase essential items after meeting basic food needs in 2013 prices). To the extent that such low wages reflect a strong bargaining position of the employer, a general minimum wage could counter poverty without a substantial impact on employment.

A critical factor in introducing a national minimum wage is to balance social benefits against potential employment losses, particularly in light of the currently high unemployment rate. Figures for a national minimum wage suggested by union representatives are above the wage of more than half of the covered employees (Table 3). If such a high national minimum wage were introduced many employers would not be able to maintain employment, particularly SMEs, which have a high share of low-skilled workers (Chapter 1). The job prospects of the low-skilled would fall, leading to a permanent worsening of poverty (Neumark et al., 2013; Sabia, 2014) and incentives to move to informal activity would rise. The interaction between a national minimum wage and existing minimum wages and the collective bargaining system will also be important. If the decision is made to introduce a minimum wage, an independent body should be established to balance potential job losses against social benefits and take into account the interests of the unemployed. It should include independent researchers and be accountable to the National Planning Commission. Because the cost of living differs markedly between regions, provision should be made for differing local conditions through regional variation in the minimum wage, as in Indonesia, or between urban and rural areas, as is generally the case for sectoral minimum wages. This would protect the living standards of those living in costly areas, while not damaging employment prospects elsewhere. The expert council should also consider the pros and cons of opt-out clauses for specific groups, like youth in training programmes. The wage should be reviewed and adjusted regularly in an independent and transparent way.

Table 3. Scenarios for minimum monthly wages based on 2013 information

| Threshold | Threshold monthly wage (ZAR) | Workers below the threshold: | | |
|--|------------------------------|------------------------------|-------------------------------------|-----------------------------|
| | | Number | As share of all covered workers (%) | Current median monthly wage |
| Lowest sectoral minimum wage (domestic workers in rural areas) | 1 491 | 1 400 000 | 15.0 | 820 |
| 50% of the median full-time wage (typical in OECD countries) | 1 950 | 2 800 000 | 29.5 | 1 300 |
| Minimum discussed by COSATU ¹ ("minimum living level" for a family of five with one worker) | 4 759 | 5 200 000 | 54.9 | 1 865 |

Note: Figures in this table are for 2013 and based on the wage distribution of formal sector employees (including workers in the agricultural sector and private households earning above the sectoral minimum wage) in the 2013 Labour Market Dynamics database. Calculations are based on implied hourly earnings and then converted to monthly equivalents.

1. Congress of South African Trade Unions.

Source: COSATU (2015), "Provincial Public Hearings on the National Minimum Wage", 18 February 2015, www.cosatu.org.za/show.php?ID=10042; Statistics South Africa; OECD calculations.

Recommendations to promote inclusive growth by improving the labour market

Key recommendations

- Establish a public employment service as a one-stop shop for job seekers to lower the cost of job search and hiring costs for employers, which would improve the matching of workers to jobs.
- Increase the role of mediation and arbitration to make wage negotiations less confrontational.

Other recommendations

- Appoint an independent body including researchers to advise on key decisions regarding the minimum wage, balancing potential employment losses against social benefits (including level, scope and opt-outs). If established, the minimum wage should be regularly reviewed and adjusted in an independent and transparent way.

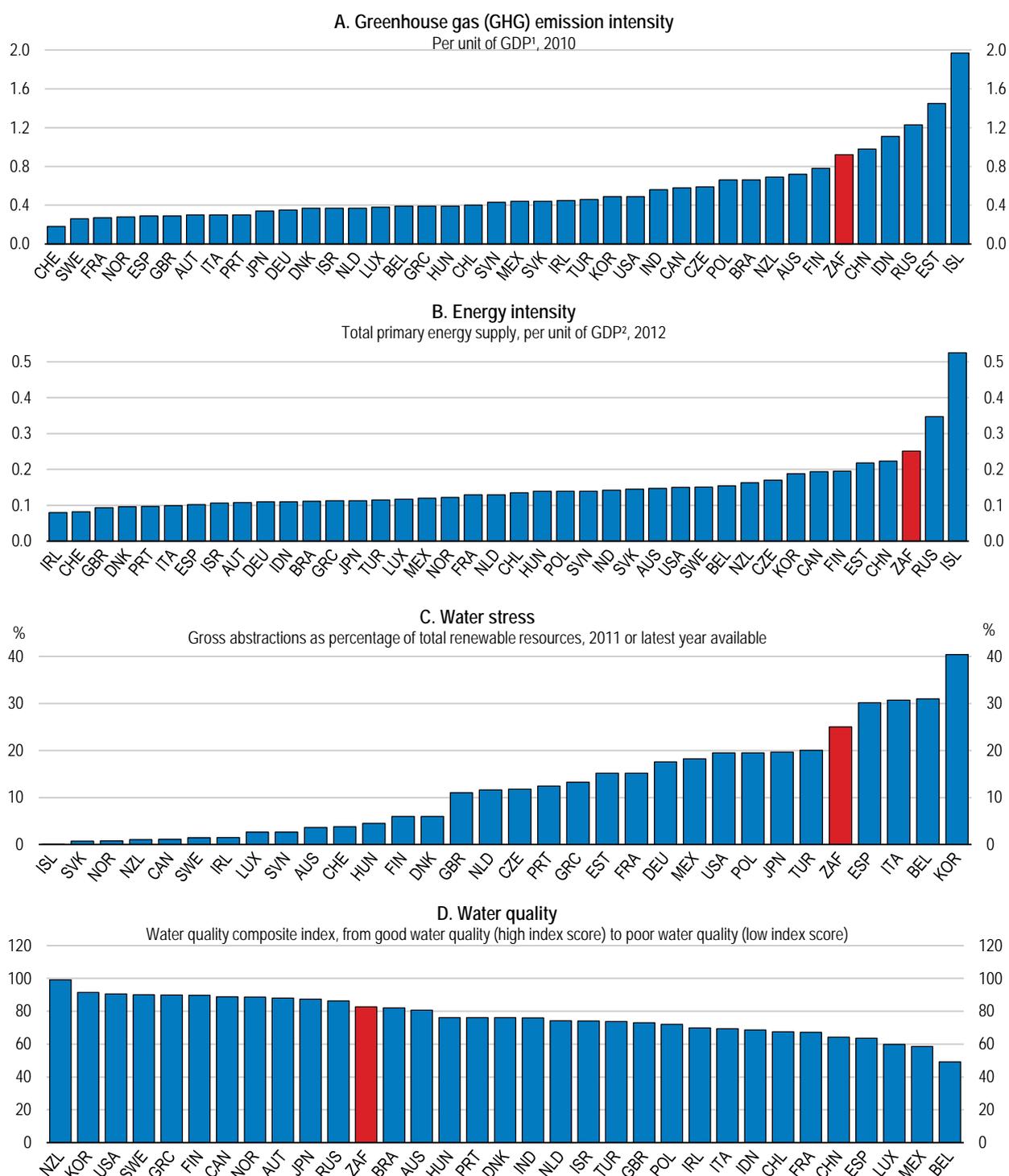
Promoting greener growth through structural change towards a more knowledge based economy

Environmental challenges such as climate change and water scarcity threaten the sustainability of economic growth (OECD, 2013a). South Africa is one of the most energy and greenhouse gas intensive economies (Figure 10), reflecting the huge minerals-energy complex, which relies heavily on domestic coal (Ashman et al., 2014). Coal accounts for around 70% of total energy supply, including over 90% of electricity generation and, in the form of synthetic fuels, 20% of transport fuels (IEA, 2014). Recognising the need to shift the economy's growth path, the government is committed to reducing greenhouse gas emissions by 42% relative to a no-change scenario by 2025. The government's Integrated Resource Plan aims to cap emissions from electricity and envisages that half of new generation capacity will come from renewable energy (Chapter 1). Nonetheless, policy still subsidises fossil fuel consumption through exemptions from the value-added tax, rebates on the fuel levy for certain industries and the free basic electricity allowance (OECD, 2015a). A (postponed) carbon tax is planned for 2016, which will cover almost all sectors, but under its current design and relatively modest effective tax rate, it is alone unlikely to achieve targeted emission reductions (Energy Research Centre, 2013). While its effectiveness could be enhanced (as discussed below), the introduction of this instrument is an important step towards a more sustainable growth path.

The main strategic objectives of the government's Industrial Policy Action Plans, as stated, are diversification beyond commodity exports, moving towards a knowledge-based economy, promotion of a higher labour absorption capacity and overcoming the exclusion of disadvantaged people and regions. These objectives provide an opportunity to accelerate the transition to a greener economy (de Serres et al., 2010; OECD, 2011a). Some elements of the plans include expanding the local renewable energy industry and energy efficiency. But other initiatives, such as increasing downstream processing of minerals, are energy intensive. Renewable energy currently meets a small fraction of total electricity supply but the development of renewable energy supply capacity through an auction programme is proceeding rapidly, with projects totalling 5 200 MW approved since 2012. Experiences from other countries show that green growth can create business opportunities and jobs if relative prices provide the right incentives and if framework conditions encourage innovation (OECD, 2011b). In agriculture, for instance, uncertainty about property rights has reduced investment incentives on competitive and big commercial farms, while communal land suffers from over-use. Mines, on the other hand, exploit loopholes to avoid cleaning up the environmental damage from closed mines, and non-operating mines therefore continue to pose an environmental hazard (Eberhard, 2014).

South Africa has relatively little water, leading to a high abstraction rate (Figure 10, Panel C). Looking ahead, population and economic growth, as well as climate change, will further increase the demand for water (OECD, 2013a). Allocation of water-use licences, appropriate pricing and enforcement are all crucial policy instruments that have yet to be fully deployed (OECD, 2013a, 2013b; Chapter 1). Overall, water quality is comparatively high. However, localised pollution threatens contamination of groundwater by acidic water from flooded old mines, pits, stockpiles and tailings ("acid mine drainage"), reflecting uneven enforcement of the polluter-pays principle in mining (Leiman, 2014). In 2014 the Department of Water Affairs launched the first stage of a large project to clean this water, but funding issues mean that progress in this area has been slow. In other areas, such as agriculture, charging for the discharge of polluted water is yet to be implemented. Experience in countries with strict water pricing rules reveals that such a policy can increase value added per used water unit.

Figure 10. Environmental indicators



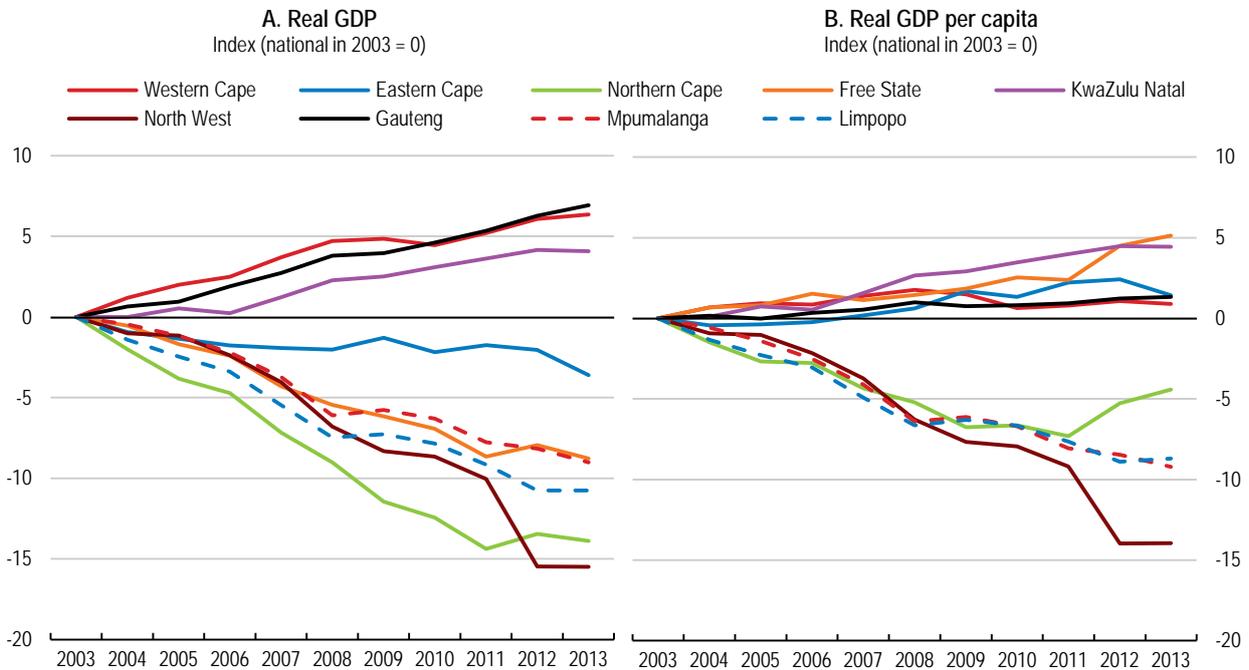
1. Tonnes of CO₂-eq. per thousand US dollars of GDP at 2005 prices and purchasing power parities.
2. Tonnes of oil equivalent per thousand US dollars of GDP at 2005 prices and purchasing power parities.

Source: IEA Databases, OECD Environmental Database, FAO Aquastat Database and United Nations Environment Programme Global Environment Monitoring System (GEMS) Water Programme, <http://www.gemstat.org/>.

Tackling regional income inequality

Regional income inequality has tended to rise. Over the past decade, economic growth has been concentrated in the three richest provinces of Gauteng, KwaZulu-Natal and Western Cape (Figure 11, Panel A). The poorer and weaker performing provinces continue to see a significant decrease in their per capita incomes, except for the Eastern Cape and Free State (Figure 11, Panel B). Compared with similar economies, such as Australia, Brazil and Mexico, the GDP growth gap between low- and high-performing provinces has been larger. This deviation from convergence may be partly explained by slow-moving raw material price cycles, which are currently depressing the North West Province. While internal migration, and particularly urbanisation, can mitigate some of these developments, the growing disparity of the poorest areas is a cause for concern, particularly given the difficulty of migration. Looking ahead, a major policy challenge for policy makers is to reignite growth in the poorest provinces to reduce income inequalities.

Figure 11. Economic growth has been strongest in the richest regions



Source: OECD calculations based on Statistics South Africa data.

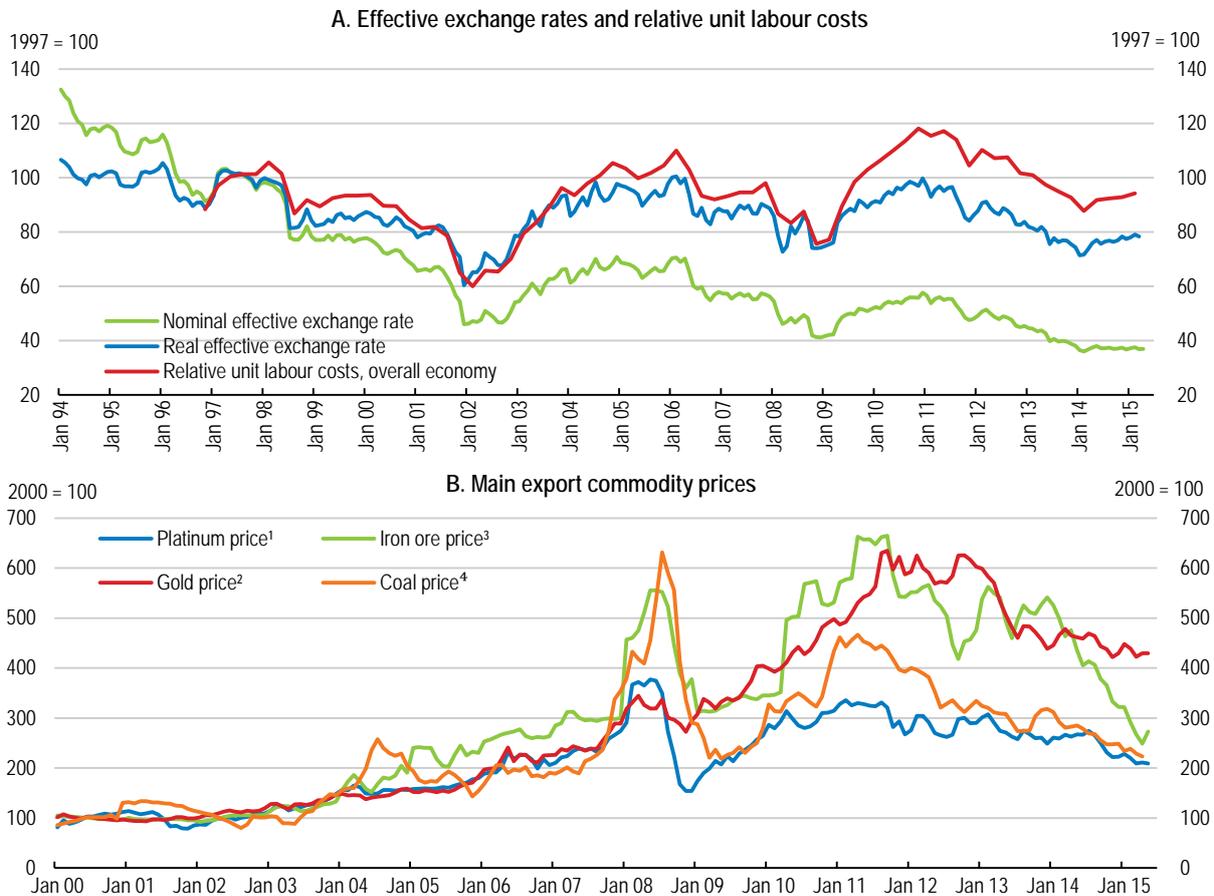
Addressing regional divergence is currently made difficult by infrastructure bottlenecks as well as a widespread mismatch of skills, settlement structures and employment opportunities. Tackling this challenge requires a multi-pronged approach, comprising the expansion of export-oriented manufacturing capacity, reducing entry barriers for domestic suppliers, improving the school-to-job transition and the establishment of a full-scale public employment service, which is capable of offering active labour market policies, including matching, training and mobility support. Regional smart specialisation exercises could help to design and prioritise reform packages aiming at faster growth in poorer regions and higher job creation in richer regions (OECD, 2012).

Supporting deeper integration into global value chains

Until the early 2000s, tariff liberalisation increased the integration of the economy into the world economy (Edwards, 2005). The vehicles sector and other skill- and capital-intensive industries benefited, resulting in larger skill- and capital-intensive firms dominating exports. Fewer than 200 firms now account for almost 90% of manufactured exports (Farole et al., 2014). At the same time, goods from low-skilled and labour-intensive manufacturing industries (such as textiles and leather) were exposed to more intense competition, despite relatively high effective import tariffs (Edwards and Rankin, 2015; Edwards and Jenkins, 2013). High tariffs enabled relatively fast wage growth in these manufacturing sectors, reducing their cost competitiveness and ability to participate in global value chains (Edwards and Rankin, 2015). Bargaining councils and the legal extension of their wage agreements to all firms in an industry may have played a role in this development, as they seem to have led to relatively fast wage growth for low-skilled workers, putting smaller firms, which often use relatively labour-intensive and low-wage production techniques, at a disadvantage (Edwards and Rankin, 2015). External cost competitiveness as measured by relative unit labour costs weakened during the commodity price boom as wage growth outstripped productivity growth, although there has been some correction since 2011 (Figure 12) (Hodge, 2012).

Thus, while some sectors are relatively well integrated into global value chains, the economy's overall participation is the lowest among the OECD and BRIICS countries; the contribution of the service sector to manufacturing exports is also on the low side (Figures 13 and 14). Areas where the economy is most integrated include mining, the automotive industry, regional finance and retail trade. Broadening integration to other industries is key to moving up the value-added production curve. Relying on a model of exploiting natural resources to boost employment corresponds poorly with declining employment in the increasingly capital-intensive mining sector. Rather, there is a need for better framework conditions to improve external cost competitiveness, for example by removing entry barriers, tackling infrastructure bottlenecks and securing a better alignment between wage and productivity growth.

Figure 12. Competitiveness indicators

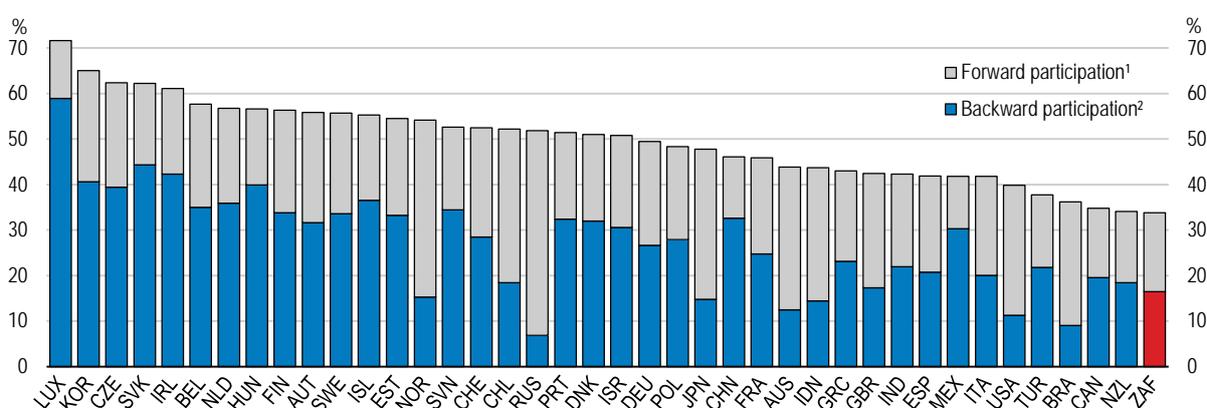


1. London Platinum Free Market USD/Troy oz.
2. Gold Bullion London Bullion Market USD/Troy Ounce.
3. Hamburg Institute for Economic Research, world market price, iron ore, scrap.
4. South African Thermal, USD per metric tonne.

Note: Relative unit labour costs are unit labour costs relative to weighted labour costs in competitor countries. The calculation of this indicator uses a system of weights based on a double-weighting principle, which takes account of the structure of competition in both export and import markets. See <http://www.oecd.org/eco/outlook/economicoutlook.htm> for details.

Source: IMF IFS Database, Datastream, HWWA, SARB Database and OECD Economic Outlook 97 Database.

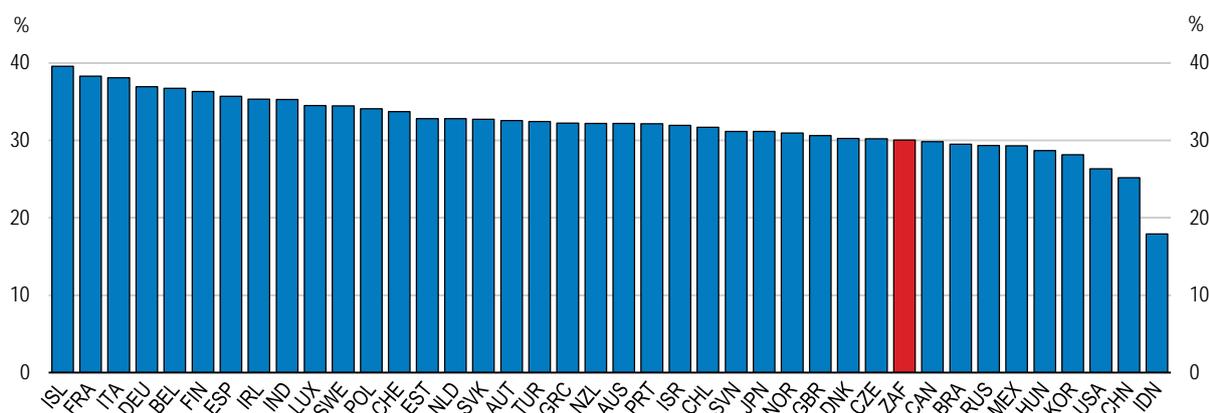
Figure 13. Global Value Chain participation indices, 2009



1. The indicator provides the share of exported goods and services used as imported inputs to produce other countries' exports. This indicator gives an indication of the contribution of domestically produced intermediates to exports in third countries.
2. The indicator measures the value of imported inputs in the overall exports of a country (the remainder being the domestic content of exports). This indicator provides an indication of the contribution of foreign industries to the exports of a country by looking at the foreign value added embodied in gross exports.

Source: OECD Global Value Chains indicators – May 2013.

Figure 14. Services value added embodied in manufacturing exports, 2009



Note: This indicator measures the value created directly or indirectly by services as intermediate inputs in the total value added in manufacturing exports.

Source: OECD-WTO Trade in Value Added (TiVA) - May 2013.

Recommendations to promote green growth, regional convergence and deeper trade integration

- Price environmental externalities, including carbon emissions, and scarce resources, particularly water, appropriately.
- Further develop pro-growth regional policies which focus on skills formation, investment and infrastructure in a co-ordinated way.
- Resume trade policy measures that enhance international integration, including with developing countries, by reducing barriers to trade.

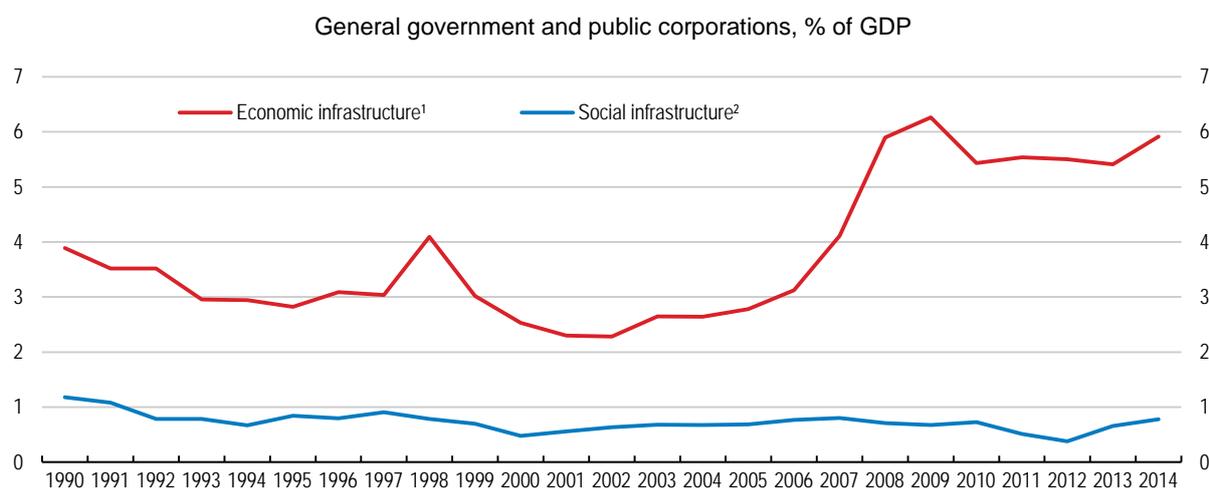
More effective infrastructure and business regulation to lay the foundations for higher growth

The National Development Plan aspires to economic growth of more than 5% per year to achieve its employment, economic and social transformation objectives. That is two percentage points more than the average growth rate over the past couple of decades. Among other things, achieving such high growth will require vastly more infrastructure and an improved business climate.

Developing and using infrastructure to boost employment

The government is addressing partly inherited underinvestment in infrastructure through the National Infrastructure Plan, which foresees additional infrastructure investment over the coming years to the tune of a quarter of 2013 GDP (Figure 15). The vast majority of this investment is in electricity generation and transport infrastructure. However, selection and prioritisation of investment projects have been hampered by the different objectives of line ministries and their SOEs. The ministries are concerned with meeting the objectives of the National Development Plan, including employment and social concerns. The SOEs, on the other hand, are focused on their individual business plans and governance has not sufficed to address emerging problems (Rustomjee, 2015). Co-ordination and oversight take place through the National Infrastructure Plan, the Presidency's Department of Planning, Monitoring and Evaluation and the Presidential Infrastructure Co-ordinating Commission. However, this set-up is designed more to monitor progress in infrastructure investments than to provide an integrated planning approach. In the absence of standard cost-benefit analysis (or other analyses), the authorities lack instruments to prioritise projects and to assess their expected rate of return (Rustomjee, 2015). Systematic evaluation of projects should therefore be introduced to identify those with the largest social return and prioritise projects, with a focus on implementing the objectives of the National Development Plan. A single body should be tasked with oversight. Governance of SOEs should be improved by implementing the OECD guidelines on corporate governance of SOEs.

Figure 15. Infrastructure investment has been increased



1. Roads, bridges, dams, electricity and water supply, etc.

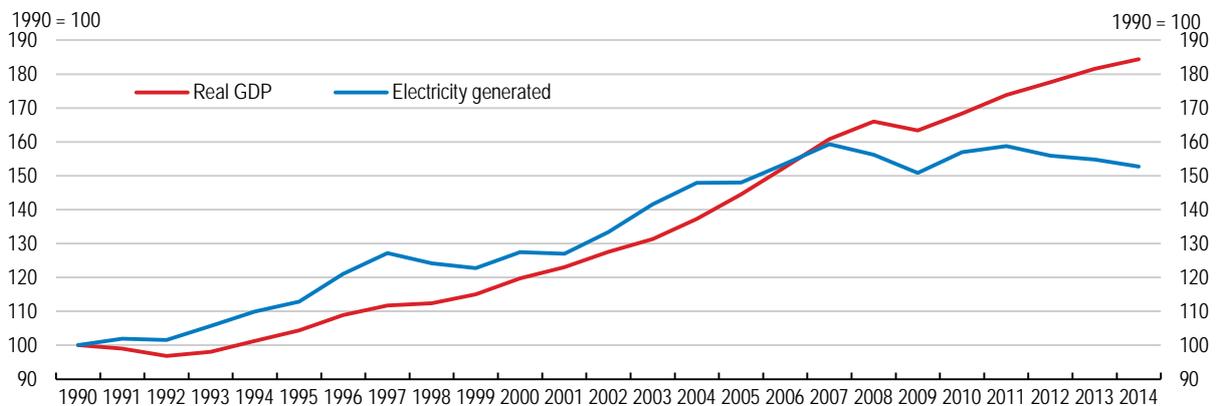
2. Schools, hospitals, etc. and administrative services.

Source: SARB Database.

The lack of infrastructure investment is most noticeable in the electricity sector

Electricity generation has not kept pace with growing demand, and power outages are the result of insufficient investment in expanding and maintaining electricity generation capacity (Figure 16). The economic cost is high: in February the National Treasury (2015a) estimated that a further deterioration in supply could subtract 1 percentage point from GDP growth in 2015. The completion of current investment plans should expand capacity by a quarter by 2021. However, a third of electricity now comes from generators that are more than 40 years old, implying that shortages are likely to reappear (Rustomjee, 2015). Financing of needed further investment will require prices that reflect costs, which is not the case today. The efficiency of the system would be enhanced by the introduction of an independent system and market operator – a bill to that effect still has to be passed by parliament. Further measures to stimulate competition between generators would include the establishment of a wholesale spot exchange and the securing of non-discriminatory third-party access to the transmission and distribution grids for private generators through structural separation (OECD, 2001). Increasing supply from private co-generation would be an effective way of alleviating the current constraint. The auction programme for procuring renewable energy has demonstrated the appetite of private investors to participate in infrastructure projects when sufficient certainty is provided; the extension of the programme to electricity from non-renewable energy sources should be accelerated to increase near-term supply. Its extension should not be so large that it prevents the development of a competitive market. A problem in ensuring third-party access is that a number of municipalities use their distribution tariffs for cross-subsidisation without investing sufficiently in the maintenance of their distribution network. Inadequate collection of electricity bills is an additional problem.

Figure 16. Electricity production is falling behind growth



Source: SARB Database.

Investment in railway infrastructure is addressing capacity constraints

The publicly owned railway freight transporter Transnet, which owns the railway lines, plans to boost infrastructure investment in coming years. Transnet is also expanding capacity on its two dedicated commodity export lines in reaction to capacity constraints during the commodity boom. The financing is secured through long-term take-or-pay agreements with commodity exporters. However, the absence of a network regulator means that it is not clear whether railway fees reflect costs or a degree of market power; the latter would weigh on the external cost competitiveness of exporters (Rustomjee, 2015). The success of these investments hinges on the ability to increase the share of rail freight transport – an objective that has proved difficult in other countries in face of faster and more flexible road transport (ITF, 2014). Structural measures could help to make railways more competitive and thus more attractive.

Separating freight service provision from rail infrastructure could ensure that users are financing investment in infrastructure, but could reduce technical efficiency.

A single transport economic regulator is expected to be established in 2017 and in the interim the Ministry of Transport is addressing urgent issues, such as tariff and access disputes. Introducing a regulator to secure non-discriminatory third-party access to the rail infrastructure would enhance competition, promote efficient operations (including access to the rail network for passenger rail) and lower freight costs to businesses (OECD, 2013c). In a number of other resource-rich countries, such dedicated goods railway lines are private. South Africa could consider whether to adopt a similar approach, particularly as there are no obvious co-ordination problems that require public ownership. Such a measure would encourage a faster adjustment of railway capacity in response to changes in demand than the current planning approach, provided that regulations can be put in place to prevent abuse of market power.

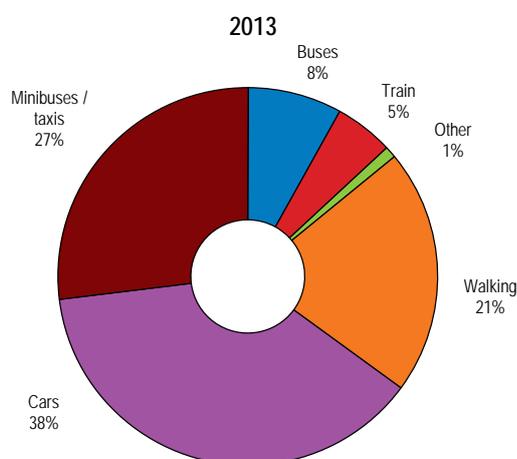
Improving public transportation

Part of the unemployment problem in poor urban neighbourhoods stems from under-developed commuter links. These neighbourhoods can be characterised into three (often mixed) types of urban housing: i) older townships with some access to public railway transport; ii) newer government-provided subsidised housing which tends to be constructed relatively far from economic centres and have little public commuter transport; and iii) informal settlements that are closer to economic centres and have no connection with public urban transport. An insufficient supply of public bus and rail transport services means that poor households tend to commute by time-consuming walking or are rationed by the high costs of minibus services (World Bank, 2014b).

Low-cost public rail commuter transport is provided by PRASA (an SOE) which has not adjusted the geographical reach of its services to take account of changes in spatial use around urban areas. The company is tripling its investment programme, mostly aimed at replacing rolling stock and upgrading stations (Rustomjee, 2015) in order to reverse past underinvestment and the associated decline of service quality. Thus, there is no change in the geographical reach in the current investment programme. Moreover, access to the Transnet-owned railway network is an issue for PRASA in the absence of a sector regulator as Transnet gives preferential access to its own transport services. Better integration with local needs would require an increasing role for local governments as purchasers of commuter services. Local governments can apply to the Minister of Transport to take over the contracting and regulatory functions. So far bus contracting has been devolved to the provinces, while the City of Cape Town has applied for the regulatory function. Further devolution of transport functions, as called for by the National Development Plan, should be accompanied by the necessary development of administrative capacity.

The gap left by the limited availability of public rail transport has been filled by often informally regulated private minibus services offering commuter services to inhabitants of many poor neighbourhoods (Figure 17). The fleet of minibuses has the flexibility to cover many pick-up points without additional infrastructure investments in rail and bus stations. However, the cost for low-income workers is often prohibitively high. Local governments are engaging more with minibus operators, with the rolling out of regular bus services in larger cities (so-called Bus Rapid Transit systems) sometimes involving minibus operators (as shareholders) and drivers. Commuter services could be tendered from formal regulation-compliant minibus operators to integrate minibuses into the system, providing lower-cost commuting solutions and better co-ordination with the planning- and investment-intensive new bus and train services.

Figure 17. Modal composition of commuter transport



Source: FFC (2013), "Effective Devolution of Transport Functions to Municipalities: Towards an Optimal Transport System" in *Submission for the 2014/15 Division of Revenue*, Financial and Fiscal Commission; Statistics South Africa.

Road infrastructure has not expanded in line with international trade (which boosted road container transport between Gauteng and the main port of Durban – more than 600 km away) and higher car ownership. This, and the shift of freight from rail to roads, has led to increasing congestion problems in the main urban areas and deteriorating road quality, arising from denser freight transport and a lack of road maintenance (CSIR, 2013). For example, on poorly maintained provincial roads the higher cost of road usage has increased regional differences in the cost of doing business (Rustomjee, 2015). Addressing these concerns requires a three-pronged approach of: including a larger congestion element in existing road usage tariffs, with a weight-related road charge on trucks; using cost-benefit analysis for larger projects; and a greater degree of co-financing in the allocation of infrastructure grants to local governments (OECD, 2013b). Such measures would help to level the playing field between rail and road goods transport.

High cost port services are eroding external cost competitiveness

The low efficiency and high cost of using ports is reducing the profitability of foreign trade. The ports are owned by the National Ports Authority (NPA), a subsidiary of Transnet, and their capacity, particularly in Durban (the main container hub), is being enhanced to cope with increasing demand (ITF, 2014). While capacity expansion is necessary, there is room for more efficient operation. Different NPA subsidiaries provide various port operations. The dominant position of these subsidiaries has led to tariffs well above the cost of service provision. The associated profits are used to cross-subsidise non-profitable ports and railway operations. Moreover, a relatively low level of efficiency in port operations means that the cost of using the port of Durban is among the highest in the world, undermining the scope for further developing export-oriented manufacturing. Regulation has been stepped up with the creation of an independent regulator, which is reducing cross-subsidisation in the tariff structure by simplifying tariffs and making them more cost-reflective. Additional structural measures to bring costs down include competitive tendering of port services to lower handling fees, and the establishment of the Port Authority as an independent standalone company.

Telecommunications could support growth more

Twenty years ago, the telecommunication system was characterised by very low fixed-line coverage. In the mid-1990s, the mobile phone market was opened up and the five operators achieved nearly full 3G coverage for most of the population, placing South Africa ahead of many OECD countries in terms of liberalisation and technology. However, further liberalisation has stalled in recent years. The full benefits of competition-enabling regulation, such as supporting consumers' ability to switch providers, have not materialised owing to the entrenched position of the incumbents. As a result, prices and service quality compare less favourably than in advanced OECD countries, raising the cost of telecommunications to the detriment of businesses and consumer welfare.

Compared with other countries, there are considerably fewer resellers of mobile phone services (so-called MVNOs) and the roll-out of more modern 4G networks has not yet started due to the cancellation of 4G mobile licence auctions. As a result, the economy has slow internet connections by international standards while fixed-line penetration remains very low (Akamai, 2015). Recent regulatory action includes a lowering of termination rates (charged for the use networks) to European levels (ICASA, 2014). However, promoting competition requires structural measures, including the finalisation of the spectrum auction for 4G licences, steps to facilitate the entry of resellers of mobile phone services and further privatisation.

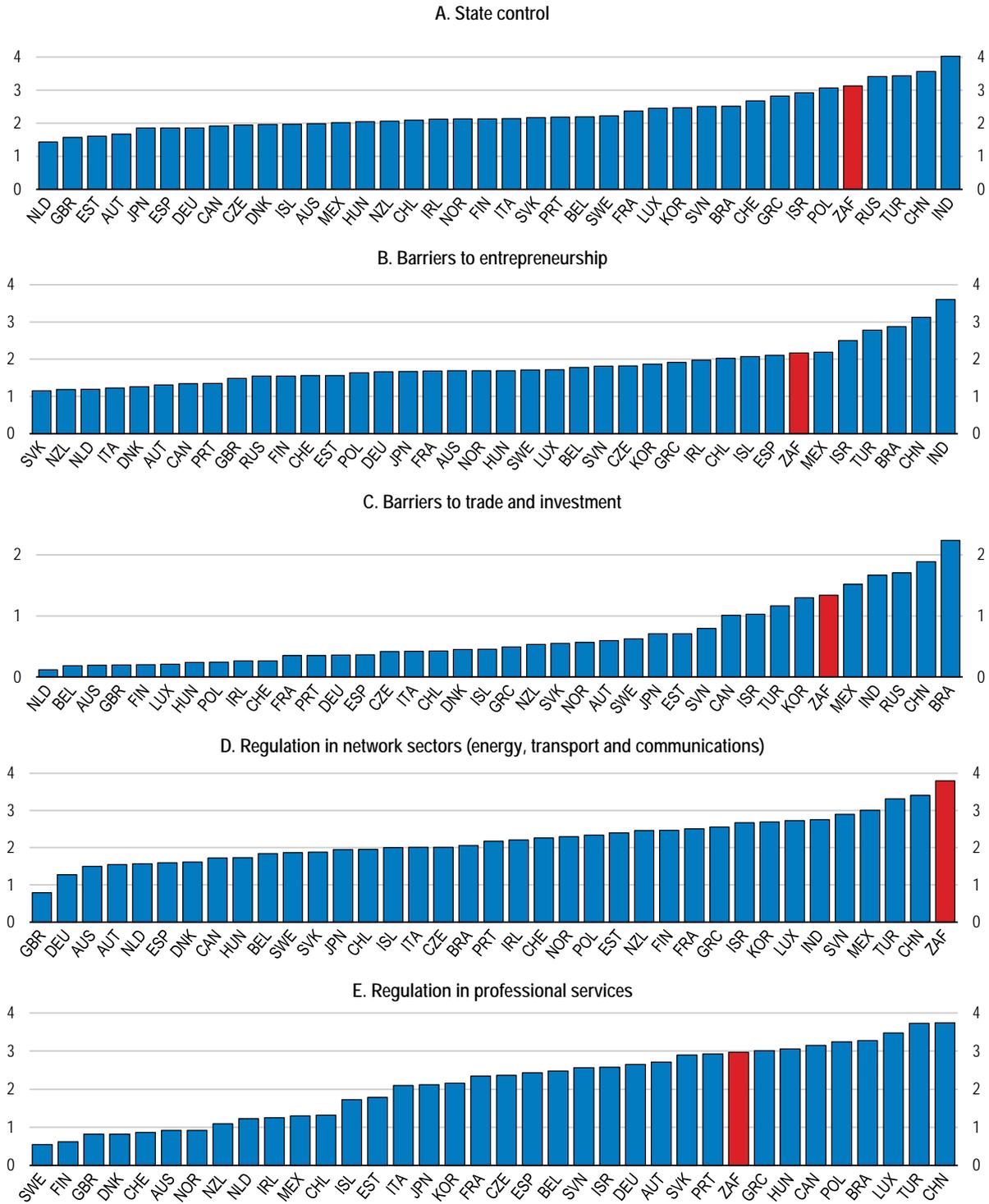
Better business regulation could boost growth and job creation

The current administration has identified SMEs as key to bolstering growth and employment and in 2014 established a Ministry of Small Business Development. Since the international crisis started in 2008, however, SMEs have reduced employment by more than larger firms have expanded theirs. Research from OECD countries highlights the role of young firms as job creators both through new start-ups and firm growth; young SMEs generated 42% of new jobs on average over 2001-11 even though they represented 17% of employment (Criscuolo, et al., 2014). Businesses and entrepreneurs that would like to create and expand SMEs are faced with numerous barriers across a wide range of areas, including extensive business regulation and insufficient infrastructure. These are relatively more costly for SMEs as they lack the administrative capacity and internal flexibility of large firms. In particular, high levels of regulation and labour market institutions that tend to focus on addressing the concerns of large unions and large firms limit SMEs' flexibility.

The OECD's product market regulation indicator suggests that regulatory restrictions are still relatively high. This includes a high level of government involvement in the economy, tariff barriers, restrictions on foreign direct investment, complex rules for licences and permits, obstacles to the creation of start-ups, and protection of existing businesses from competition (particularly in the network industries). All of these issues are particularly detrimental to the creation and operation of SMEs (Figure 18). In addition, businesses are faced with frequent regulatory changes that increase uncertainty, with surveys indicating that only about 40% of SMEs are confident that they know all the relevant regulations (Darroll, 2015). Policy action in this area should focus on reducing the overall regulatory burden and creating a more stable regulatory framework to facilitate forward planning. Standard application of regulatory impact assessments to new laws and rules could be helpful in securing cost-efficient and effective regulation. Lighter or simplified regulations could be experimented with in special economic zones located close to poor urban areas, to help attract businesses to where labour supply is abundant, overcoming spatial mismatches between housing and economic activity (World Bank, 2014b).

Figure 18. The regulatory burden is high across the economy

Index scale of 0-6 from least to most restrictive, 2013



Source: OECD (2014), *Product Market Regulation Database*.

The competition policy framework is broadly at par with best practices in the OECD, and enforcement action has been ramped up in recent years. Amended legislation on leniency policy and criminalisation of cartel activity is still not fully operational, as in a number of OECD countries. However, the Competition Law includes a particularly wide-ranging and all-encompassing public interest clause. This clause assigns to competition policy multiple objectives in addition to ensuring economic efficiency, such as maintaining employment and supporting black economic empowerment. This is particularly problematic in merger cases as there is no clear method for balancing the public interest and competition assessments (OECD, 2008a; Smith, 2015). Furthermore, such other policy objectives can often be achieved more effectively by alternative means than limiting competition. An OECD Peer Review of Competition Policy or similar expert review could be helpful in terms of identifying clear rules for the application of merger control and other aspects of the competition framework.

Labour market regulation in South Africa reduces employment turnover and wage flexibility, which limits the ability of SMEs to expand and adjust to the more intensive competition that arises from regulatory changes and lower trade barriers. Few SMEs in the manufacturing sector produce intermediate inputs for the domestic market and many exporters rely on imported intermediate inputs (Edwards and Rankin, 2015). Surveys point to the problems of the strict labour laws, with more than a third of SMEs reporting that this framework (and particularly bargaining councils) represents the largest obstacle to new hiring (SBP, 2013). Moreover, wage outcomes from the bargaining councils tend to be relatively high for low-skilled workers. According to one estimate, the presence of bargaining councils reduces employment by 8-13% in affected industries, with losses concentrated among SMEs, which rely heavily on low-skilled workers (Magruder, 2012). Labour market reform to support creation and expansion of SMEs could include the introduction of full or partial opt-outs from sector wage agreements and the reorganisation of bargaining councils to ensure broader coverage.

Recommendations to tackle infrastructure bottlenecks and improve business regulation

Key recommendations

- Choose infrastructure investments with the highest social returns to facilitate prioritisation and cost control.
- In network industries, complete the introduction of independent regulators and charge them with ensuring non-discriminatory third-party access. Secure additional electricity generation capacity by accelerating the independent power producer programme and facilitating private co-generation.
- Improve employment opportunities by expanding affordable public transport, including integrating minibuses into the public transport system, and building new, denser settlements closer to economic centres.
- Support SMEs by increasing the use of regulatory impact analysis in order to reduce the regulatory burden, eliminating entry barriers, and promoting competition.
- Systematically identify and eliminate competition-hampering regulation. Privatised state-owned companies, such as telecoms, that are in markets with a sufficient degree of competition.

Other recommendations

- Experiment with support schemes and regulation for special economic zones to move jobs to poor urban neighbourhoods.

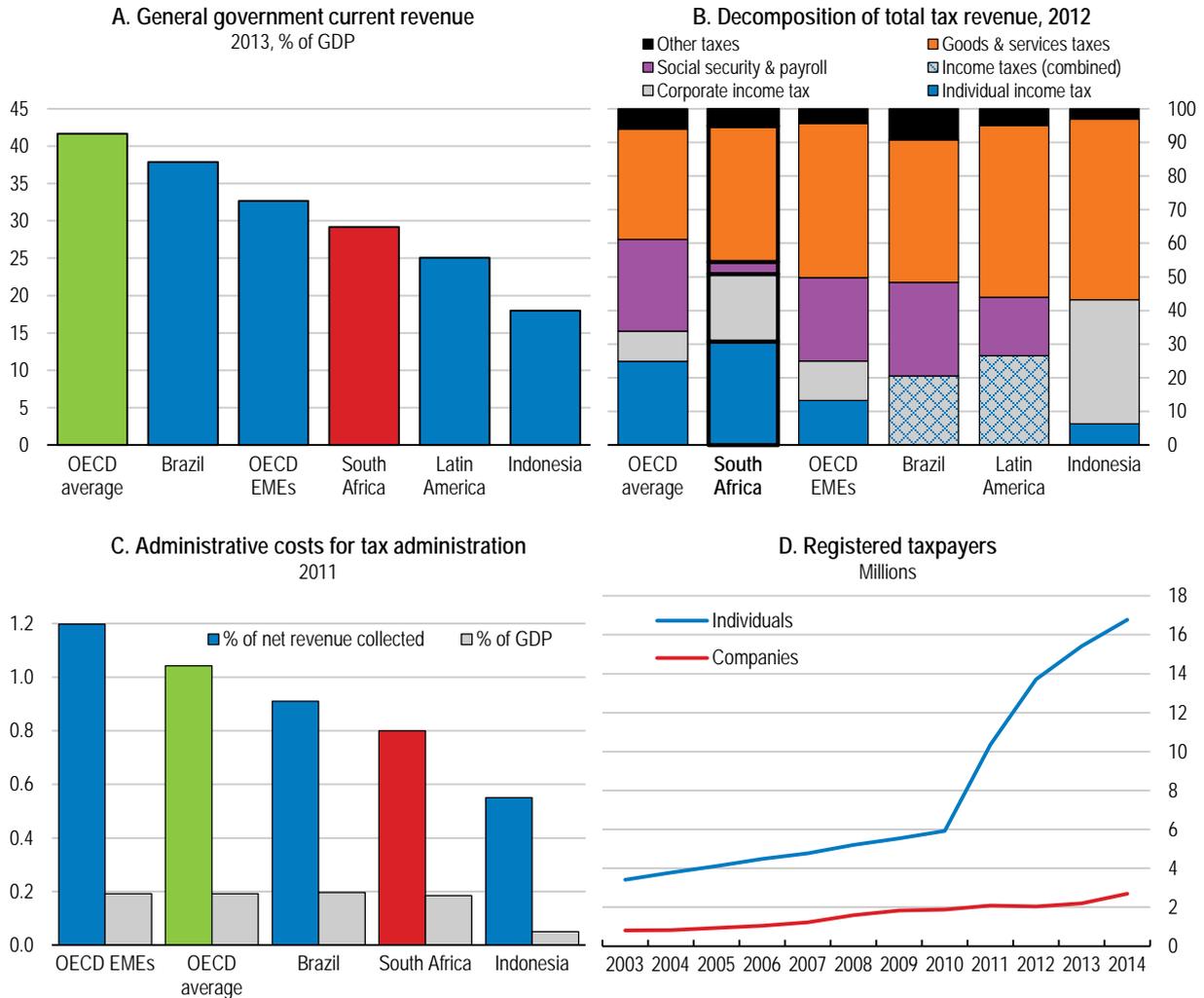
How can the tax system help to meet revenue-raising challenges?

As an emerging economy, South Africa's spending needs for social and economic infrastructure have been increasing – a trend that is likely to continue. The infrastructure projects identified above, as well as the planned national health insurance, need to be financed. However, there is no fiscal space due to the sizeable deficit and growing debt. The National Treasury (2015a, 2015b) and others, including the IMF (2014), have identified considerable room for improving spending efficiency by reducing waste and corruption. In this environment, the public is reluctant to accept significantly higher taxes. Nonetheless, even with higher spending efficiency, additional revenues will be needed. Compliance with higher taxes will be greatly improved if public sector efficiency gains can be shown simultaneously.

Over the past 20 years, great progress has been made by the National Treasury and the South African Revenue Service in raising revenues more efficiently and effectively. In addition, the combined tax and transfer system significantly reduces inequality (World Bank, 2014a). Nonetheless, revenues are still below the average of OECD emerging market economies (Figure 19). While the top tax rates for personal and company income tax have been lowered, a range of tax-base-broadening measures, together with economic growth, have raised tax revenue relative to GDP. In recent years, the tax base has been broadened through increased registration of individuals (although many of these earn less than the taxable income threshold) and (to a lesser extent) companies, as well as by closing loopholes. Compliance costs have been reduced through an extensive modernisation programme at the revenue service. Indeed, by commonly used measures, the administration of the tax system is now comparable to that in many OECD countries. The composition of taxes is also broadly similar to that of OECD countries without large social security contributions. Looking ahead, the key challenge is to secure financing for infrastructure needs and planned increases in social spending without exacerbating inequality or compromising long-term growth.

Despite broadening measures, the tax base remains relatively narrow due to the unequal distribution of personal and company income. Only 6½ million individuals paid income tax in 2013/14 out of an estimated working-age population of 35 million (National Treasury and SARS, 2014). This partly reflects the low employment rate and high wage income inequality, which mean that the threshold for beginning to pay tax is well above the median wage. The statutory personal income tax system is progressive with marginal tax rates from 18% to 41%. From a growth perspective, raising revenues through base broadening is preferable to raising marginal rates. In addition, deductions and allowances, such as an allowance for interest income, are often conferred to higher income earners; thus, scaling them back would increase the progressivity of the system. In the 2015 budget, some scaling back is achieved through freezing the interest income allowance in nominal terms.

Figure 19. The tax system is relatively well structured and administered efficiently



Note: "OECD EMEs" are five emerging market member countries: Chile, Hungary, Mexico, Poland and Turkey. All averages are unweighted. In Brazil and Latin America not all income tax revenue can be clearly attributed to individuals or corporation so these are treated as one category in Panel B.

Source: OECD Revenue Statistics Database; OECD Latin America Revenue Statistics Database; IMF GFS Database; OECD Economic Outlook 97 Database; OECD National Accounts database; IMF WEO Database, October 2014; OECD (2013), Tax Administration 2013; National Treasury and SARS (2014), Tax Statistics.

Further revenue could be raised by reducing the basic tax allowance (lowering the income level for beginning to pay income tax), thereby unwinding some of the tax relief provided by increases in the allowance (and other income brackets) in real terms during the 2000s. The creation of a new first tax bracket with a lower marginal tax rate could also be considered, taking into account concerns about equity and ability to pay, as well as compliance. This could be accompanied by increases in the marginal tax rates on high incomes, which are lower than in many OECD countries despite South Africa's high inequality. While leakage is a risk, the tax administration is better placed to monitor compliance than when the rates were lowered. Introducing an in-work tax credit or other activity incentives for low-income earners could provide support to low-income earners and partly offset the cost to long-term growth that would be expected following higher income taxation (Arnold et al., 2011).

Company taxation is high relative to OECD countries but lower than in non-OECD emerging economies. This partly reflects the statutory tax rate of 28%, compared with an OECD average of 25%. Given the negative effects of high statutory tax rates on productivity and investment, the focus should be on base broadening. Effective tax rates are reduced by numerous tax incentives, many of which appear to be used for industrial policy with little cost-benefit analysis and contribute to large differences in marginal effective tax rates on investment across industries (World Bank, 2015). Each incentive scheme should be examined and those which are not cost effective should be removed. The simplified tax regimes for small businesses (with tax rates increasing from 0% to 28% and accelerated asset write-offs) and microbusinesses are also considered ineffective (Davis Tax Committee, 2014).

As the level of company tax payments does not appear to be a main concern of SMEs (Herrington et al., 2013), other targeted reforms – such as reduced red tape – would likely be more useful than special tax regimes (Chapter 1). Rather than using a turnover tax to reduce compliance costs for microbusinesses and lower the barrier to formalising, VAT registration could be encouraged in conjunction with simplified processes for payment. Currently, the turnover threshold for compulsory VAT registration is much higher than in any OECD country (on a PPP-adjusted basis) but many firms register voluntarily. More focus should be put on reducing compliance costs, which are comparatively high (FIAS, 2007). In Chile and Mexico all firms must register but there are special regimes and support for SMEs. At the other end of the distribution of firms, base erosion and profit shifting are considered important issues, despite continuous amendments to existing legislation. International co-operation on this issue should continue.

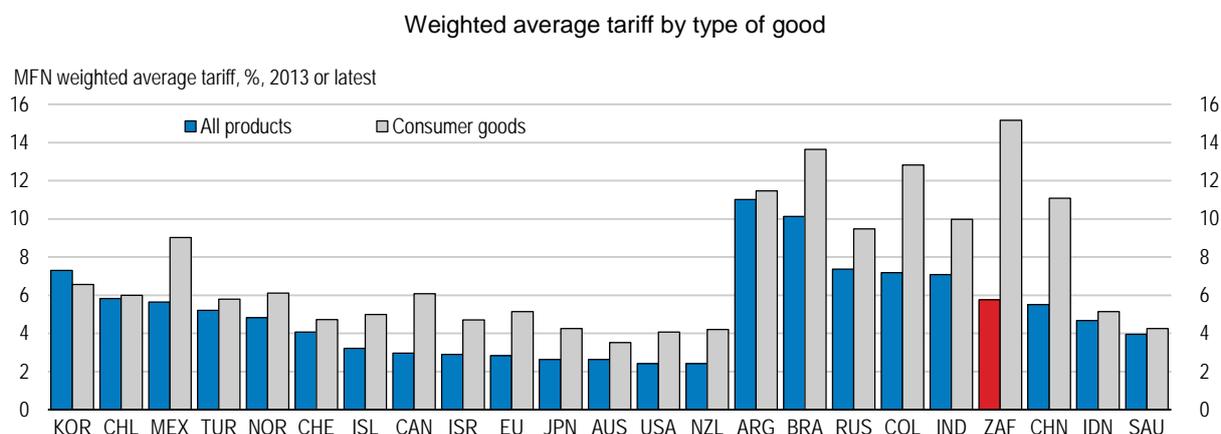
Special taxation arrangements apply to the mining sector. Previously low marginal effective rates have been boosted by the 2010 introduction of a national royalty regime (World Bank, 2015). The new regime applies a profit-linked royalty rate (of between 0.5% and 7%) to gross sales, linking rates to commodity prices in order to capture some of the windfall gains in a commodity boom, while maintaining some revenue stability and investment incentives. The new regime has boosted the tax take from the industry, despite profit-linked royalty rates being depressed by the fall in commodity prices. On the other hand, OECD calculations suggest that the highest royalty rate would not have been applied during the height of the commodity boom. It seems there is scope to raise the effective royalty rate as the system matures but the need for regulatory stability, as discussed above, means that disruptive changes to the regime should be avoided. However, in the nascent oil and gas industries consideration should be given to a profit-based tax on resource rents, as adopted in Alaska, Algeria, and China, for example.

The VAT system is the second largest source of government revenue. Consumption taxes are relatively efficient taxes and are therefore less harmful for economic growth (Arnold et al., 2011). The current regime is well designed – it has few items with preferential treatment (exemptions or a zero-rate), a relatively low rate and is mildly progressive (World Bank, 2014a). However, such exemptions and zero-rates are not well targeted, as the associated tax savings disproportionately accrue to better-off households, including for many food items (National Treasury, 2007; Jansen and Caltiz, 2015). Further revenues could be raised within the existing system by reducing leakage. Nevertheless, the rate may need to be raised to finance large spending plans. Additional consumption tax revenues could be raised via higher excise duties on items like alcohol and tobacco, although there is a risk of revenue leakage from informal cross-border trading. Likewise, the list of luxury goods subject to excise should be updated to reflect changes in consumption patterns.

The import tariff regime should also be reviewed. Despite substantial trade liberalisation in the 1990s, the process of tariff reduction has largely stalled (Figure 20). As highlighted in OECD (2008b), consumer goods face higher duties than upstream goods, raising effective rates of protection and the final price to consumers. A substantial part of this burden falls on low-income households via the high tariffs on clothing and footwear – which have relatively large weights in their consumption basket. The OECD

Economic Assessment of 2008 recommended reducing the level and dispersion of import tariffs to encourage competition and long-term productivity growth (OECD, 2008b). As most tariff revenues collected are passed on to other members of the Southern African Customs Union through a fixed formula, the net budgetary effect would be small.

Figure 20. Tariff barriers are still relatively high for consumer goods



Source: UNCTAD Trade Analysis Information System (TRAINS).

Property tax revenues represent only a small share of total revenues. They mostly comprise municipal taxes on land and buildings, in addition to less important transaction-based taxes. National legislation provides a framework for municipal taxes but their rates vary considerably. Greater use of this source of tax revenue would provide a number of advantages. It is one of the least harmful taxes for growth (Arnold et al., 2011) and can be equity enhancing. It could also allow municipalities to reduce their reliance on fees from electricity and water distribution. Higher recurrent property taxes could also allow distortionary transaction-based taxes to be scaled back. However, severe deficiencies in administrative capacity at the local level limit the feasibility of increasing tax rates in the near term. In particular, valuation rolls are not up to date, collecting property taxes appears to be difficult, and perceptions of corruption at the local government level are high. Therefore as a first step, problems at the local level should be addressed through capacity building and law enforcement.

Environmentally related taxes have increased in scope and size but could be expanded further to help secure a more sustainable growth path. Overall, carbon emissions are hardly taxed, reflecting that taxes on transport fuels cover only 10% of emissions, but electricity from non-renewable sources is subject to a low rate of tax and almost half of emissions are not taxed (OECD, 2015b). The government should proceed with plans to introduce a carbon tax to secure equal abatement costs across activities (thus replacing other taxes), as recommended in the 2013 *Economic Survey* (OECD, 2013a). Implementation should ensure that the rate rises gradually to effective levels. At the same time, exemptions should be scaled down slowly to avoid disruptive changes to the cost of production for heavy polluters. Such a process will slowly align South Africa's climate change policy stance with those in most OECD countries. This would also gradually reduce the economy's dependence on energy- and carbon-intensive production, while making production more labour intensive (Alton et al., 2014). As in the case of removing VAT exemptions, measures to compensate the poorest households could include cash transfers or vouchers. The tax system could also be used to address other environmental problems, in particular by implementing plans to apply polluter-pays principles to water discharged in the

agriculture and mining sectors and continuing the development of a levy to help fund the clean-up of past pollution in the form of acid water from mines (OECD, 2013a, 2013b).

Recommendations to meet revenue-raising challenges

Key recommendations

- Broaden personal and corporate income tax bases by reducing deductions, credits and allowances. Increase tax rates on higher incomes.
- Broaden the VAT base and strengthen VAT compliance. Proceed with the introduction of a carbon tax.

Other recommendations

- Increase property taxation by building capacity at the municipal government level.
- Reduce the complexity of the tariff regime and investigate areas where tariff reductions on consumer goods are possible.
- Increase reliance on environmentally related taxes.

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ANNEX

Progress in main structural reforms

This annex summarises key recommendations made in previous Surveys and actions taken since the OECD Economic Survey of South Africa published in March 2013.

Macroeconomic policy and safeguarding fiscal sustainability

| <i>Recommendations from previous surveys</i> | <i>Action taken since March 2013 survey</i> |
|---|---|
| Adjust the macroeconomic policy mix, using the full available scope to reduce interest rates to support economic activity while reducing the structural budget deficit somewhat faster than currently planned. (2013 Survey). | Monetary policy has been accommodative. The repo rate was maintained at 5% - its lowest level - until January 2014 when it was raised to preserve inflation expectations. Expenditure targets were met in 2014/15 for the third consecutive year. Although lower-than-expected economic growth has not allowed a faster closing of the budget deficit, the government remains committed to narrowing the deficit over the medium term. |
| Move towards the introduction of fiscal rules, notably an expenditure rule. Increase the emphasis on the cyclically adjusted balance when setting and explaining fiscal policy. (2013 Survey). | An expenditure ceiling was introduced in the 2013 Budget Review. Government remains committed to keeping non-interest expenditure within this ceiling and has lowered the ceiling in response to slower than expected revenue growth. |
| The government should continue to seek opportunities to increase the efficiency of public expenditure. (2010 Survey). | The 2015 Budget strengthened the budget preparation process by placing greater emphasis on efficient resource allocation. The expenditure ceiling has helped to ensure that departments shift funds towards priority areas, while reducing less essential expenditure. In 2014, the government also issued cost containment guidelines which include restrictions on air travel and accommodation budgets. The Office of the Chief Procurement Officer is reforming national and provincial procurement systems in order to improve transparency and reduce supply chain management costs. A review of supply chain management is underway. |
| Consideration should be given to strengthening the link between commodity prices and the fiscal balance; if this link is strengthened, establishment of a commodity fund can be considered to ensure that windfall revenues are saved. In the meantime, such windfalls should be used to reduce debt. (2010 Survey). | No action |
| To further increase transparency and signal commitment to price stability over the longer term, the SARB should consider moving in the direction of announcing a future policy-rate path consistent with the inflation objective. At a first stage, this might involve merely signalling the expected direction of future movements in policy rates. (2010 Survey). | Since January 2014, press statements following the Committee meetings signalled that interest rates would be normalised over time. |

Improving framework conditions for business

| <i>Recommendations from previous surveys</i> | <i>Action taken since March 2013 survey</i> |
|--|--|
| Product market regulation should be made less restrictive, particularly as regards barriers to entrepreneurship. Simplify regulations and ease compliance. (2013, 2010 Survey). The burden of product market regulation should be lightened and competition policy strengthened. (2010 Survey). | Special Economic Zones will include a "One Stop Shop" for government regulations. The Department of Trade and Industry is also establishing a "clearing house" for strategic projects. However, these initiatives are not yet operational. The Department of Environmental Affairs is fast tracking the assessment procedure for Environmental Impact Assessments for some projects. The Competition Commission found 21 companies guilty of collusion in the construction sector. These companies have collectively paid ZAR 1.4 billion in damages. |
| The level and dispersion of import tariffs should be reduced further to encourage competition and long-term productivity growth. (2010 Survey). | No action. |

Improving labour market outcomes

| Recommendations from previous surveys | Action taken since March 2013 survey |
|---|--|
| Curtail the within-sector legal extension of collective bargaining agreements and increase the level of centralisation and co-ordination in collective bargaining to allow for greater influence of outsiders on wages and conditions. (2013, 2010 Survey). | The collective bargaining process is under review under the auspices of the NEDLAC Task Team on labour relations. |
| Enforcement of existing labour laws relating to labour broking should be tightened, but liberal arrangements for temporary employment should be maintained. (2010 Survey). | The Labour Relations Act has been amended to extend rights of permanent employment to temporary employment. |
| The arbitration process for dismissals for cause should be speeded up and simplified. (2010 Survey) | No action. |
| Efforts to strengthen job search assistance should be intensified. (2010 Survey). | No progress thus far. The Employment Services Act 2014 formally establishes a public employment service. |
| The use of wage subsidies should be expanded, possibly by building on the existing learnerships, but with a reduced administrative burden. (2010 Survey). | The Employment Tax Incentive, which mainly targets young workers was implemented in January 2014. In December 2014, the employment tax incentive supported the employment of over 216 000 young workers. |
| Minimum wages should be differentiated by age. (2010 Survey). | No action |
| Probationary requirements in respect of new hires of young employees should be extended. (2010 Survey). | No action |
| Programmes to develop entrepreneurship among the young in disadvantaged groups should be expanded. (2010 Survey). | In 2013 the Youth Enterprise Development Strategy was established to increase youth entrepreneurship. In 2014 a Youth Fund was launched to provide financing for youth-owned businesses. |

Making the education system more effective

| Recommendations from previous surveys | Action taken since March 2013 survey |
|--|--|
| Expand the Accelerated Schools Infrastructure Development Initiative programme to address infrastructure backlogs and improve the delivery of learning materials (textbooks, desks, libraries and computers) with priority to the most deprived schools. (2013 Survey). | The ASIDI was a one-off project to fix 400 schools. The delivery of learning materials has improved from a reported 92% of learners having access to the required textbooks in all grades and subjects in 2013/14 to close to 100% coverage in 2014/15. Gauteng province has committed to expanding the use of technology in education and has started by piloting the use of smart boards, tablets and the requisite connectivity in selected schools in poor areas, as well as using smart board technology for grade 12 teaching in all no-fee schools in the province. |
| Expand the Funza Lushaka bursary programme for teaching studies and allow more immigration of English teachers. (2013 Survey). | The Funza Lushaka bursary allocation has increased by just under ZAR 100 million since 2013. In total, nearly 10 000 newly qualified teachers have entered the system each year since 2013 (including non-bursary holders). |
| Provide more school leadership training and support staff in exchange for stricter accountability. Allow the education authorities to appoint and dismiss school principals in a more flexible way (depending on progress on school performance in Annual National Assessments and on external reviews), while making school principals responsible for yearly teacher evaluations and monitoring teachers' daily attendance. (2013 Survey). | An Advanced Certificate for Education for principals has been introduced, which all new principals must complete. However, the training of principals is not yet linked to accountability for Annual National Assessment results. |

| Recommendations from previous surveys | Action taken since March 2013 survey |
|---|--|
| Empower the independent federal evaluation unit NEEDU, join the Programme for International Student Assessment (PISA) and the Teaching and Learning International Survey (TALIS) and undertake an OECD Review of Evaluation and Assessment Frameworks for Improving School Outcomes. (2013 Survey). | The governance structure of NEEDU has not yet been finalised. |
| Foster on-the-job training with tax credits and simplify administrative procedures for hiring trainees from FET colleges. Widen the scope for apprenticeship programmes organised by public-private partnerships. (2013 Survey). | The employment tax incentive introduced in 2014 has reached around 200 000 employees and about 23 500 employers. In 2014, 85 900 occupationally-directed (apprenticeship or learnership) opportunities in collaboration with TVET colleges, SETAs and employers were created. An additional 37 423 learning programme opportunities in the form of 3 380 apprenticeships, 4 513 bursaries and 29 530 learnerships will be further provided by the SETAs. A total of 123 of the 212 targeted FET college partnerships with industry for 2014 have been established. |
| Improvements in basic education should be prioritised, even though the contribution to raising employment will be small in the near term. (2010 Survey). | There was a ZAR 2.1 billion increase in the fiscal allocation to the department of basic education in the 2014/15 budget but it was mainly for improvement in conditions of service for employees. Other initiatives prioritised by the sector include the Annual National Assessments, expanding workbooks, school infrastructure, the National Education Collaboration Trust. |

Climate change mitigation and green growth

| Recommendations from previous surveys | Action taken since March 2013 survey |
|---|---|
| In designing climate change mitigation policies, favour broad and easy-to-implement instruments with limited demands on administrative capacity, such as a simple carbon tax. (2013, 2010 Survey). | The National Treasury published the carbon tax policy paper for stakeholder consultation in 2013. A paper on carbon offsets was published in April 2014 for public comment. Draft legislation is due to be released in mid-2015 and the scheme is to be implemented in 2016. |
| Reduce implicit and explicit subsidies for energy and coal consumption, and use other instruments, such as cash transfers or supply vouchers, for protecting the poor. (2013, 2010 Survey). | The Energy Efficiency Savings Tax Incentive was implemented in November 2013 and rewards businesses who can prove energy efficiency savings. More than 100 companies have registered and the incentive is being adjusted to make it more effective. |
| Electricity prices should be allowed to rise further, in order to fully cover capital costs. Favourable pricing arrangements for large industrial users of electricity should be renegotiated. (2010 Survey). | The 2015 Budget announced a reduction in the diesel fuel levy refunds for certain industries from 1 April 2016 and a review of the diesel refund system. The free basic electricity/energy allowance for low-income households remains in place. |
| Accelerate the allocation of water-use licenses and ensure that charges for water reflect supply costs and scarcity. (2013 Survey). | The regulator, NERSA, has approved above inflation increases in electricity prices in recent years. |
| Greater use should be made of other green taxes, such as fuel levies. (2010 Survey). | The Strategic Integrated Project (SIP) 18 was launched in June 2013. It aims to address water supply and sanitation backlogs, including fast-tracking the issuing of water licences. The Department of Water Affairs and Sanitation received 599 water use license applications since April 2014, of which 184 have been finalised and 415 are in progress. |
| | The 2015 Budget raised fuel levies to around 40% of the retail fuel price. A levy on waste from tyres is in process and is expected to be implemented during 2015. |

Other

| <i>Recommendations from previous surveys</i> | <i>Action taken since March 2013 survey</i> |
|--|--|
| Further urbanisation should be facilitated to mitigate spatial mismatches: urban transport should be developed and affordable urban housing expanded. (2010 Survey). | Public transport continues to expand with an emphasis on integrated planning. Major metropolitan areas have invested in bus rapid transit systems. Operations on Phase 1 of Rea Vaya (Johannesburg) and My CiTi (Cape Town) services were expanded and the Tshwane Rapid Transit (A Re Yeng) started operating in 2014. The National Urban Reconstruction Housing Agency provided funding for 14 projects to the value of approximately ZAR 873 million for affordable housing (translating into 1 619 sites and services in 2013/14). |
| Access to credit for business start-ups should be improved, for example by easing collateral constraints. (2010 Survey). | A Department of Small Business Development was established in 2014 to support small businesses but has yet to announce measures to assist in accessing credit. The venture capital company scheme has been amended, effective from 1 April 2015, to make the tax deductions more valuable. |
| Remaining restrictions on capital outflows should be removed and replaced by prudential regulation. (2010 Survey). | The exchange control manual is being simplified and the following restrictions on individuals and institutions have been relaxed: <ul style="list-style-type: none"> • Authorised dealers may process corporate investment up to ZAR 1 billion annually (from ZAR 500 million) and may carry forward any unused allowance. • Residents' foreign capital allowance increased from ZAR 4 million to ZAR 10 million per calendar year or upon emigration, or ZAR 20 million per family unit. • The subcategories under the individual single discretionary allowance are removed and the annual ZAR 1 million allowances may be used for any legal purpose abroad. |
| Pension arrangements should be designed with a view to increasing private saving, in conjunction with other goals. Compulsory pension saving by employees is one promising way of doing this, while positive results might also be achieved via compulsory enrolment with an option to withdraw, particularly in combination with a "save more tomorrow" mechanism. (2010 Survey). | The taxation of pension contributions has been substantially simplified and harmonised across savings vehicles. The new treatment of retirement savings will be implemented on 1 March 2016. All contributions to retirement saving will be deductible up to 27.5% of the greater of remuneration or taxable income, with a cap of ZAR 350 000. The current pre-retirement preservation proposal is under discussion with social partners at NEDLAC. Once discussions have concluded, the proposal will be implemented following final consultations. Draft legislation on pre-retirement preservation is expected in 2015. Compulsory enrolment in a pension scheme is part of the broader social security reforms which is still under discussion at NEDLAC. |

Chapter summaries

Chapter 1. More effective infrastructure and business regulation

Growth has been insufficient to lower the persistently high level of unemployment, particularly among black low-skilled workers. Achieving a sustained increase in growth requires a stronger performance of the business sector. This chapter analyses how such a stronger performance can be supported by better infrastructure and business regulation. Infrastructure investment is being increased to address bottlenecks in many network sectors. However, a lack of an integrated planning approach may hamper optimal project selection. Moreover, there seems to be little focus on applying economic instruments to use infrastructure more effectively. Small and medium sized enterprises are key to raise private sector employment. However, they are faced with a large range of barriers that hinders their creation and expansion, including high levels of regulation and skill shortages. In addition, their growth potential is hampered by spatial use of land that limits economic opportunities and induces high commuting costs, particularly for low-wage workers, which reduces access to jobs.

Chapter 2. How can the tax system meet revenue raising challenges?

Reforms over the past two decades have produced a well-balanced, modern tax system. However, considerable revenues will be needed in the years ahead to expand social spending and infrastructure in order to raise growth and well-being. The challenge is to generate these revenues without penalising growth or exacerbating inequality. Income taxes represent around half of total tax revenue but are levied on small tax bases, partly reflecting the distribution of income. A revenue source less detrimental to growth is consumption taxes, which are mostly raised by the relatively broad value-added tax. Nonetheless, there is some scope to raise further revenue, particularly through broadening the base of these taxes. Revenues from property taxation are currently limited by the inefficient municipal rates system, which does not function well. An important additional source of revenue is environmentally related taxes. In the design of the tax system, consideration should also be given to the appropriate taxation of the natural resources sector, which remains an important issue for a resource-rich country like South Africa.

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