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OVERVIEW

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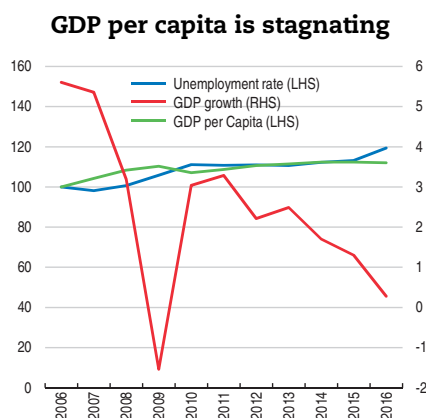
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Executive summary

- *Low growth and high unemployment are weighing on social progress*
- *Deepening regional integration of the SADC to boost jobs and growth*
- *Boosting entrepreneurship and growing small businesses will contribute to creating jobs*

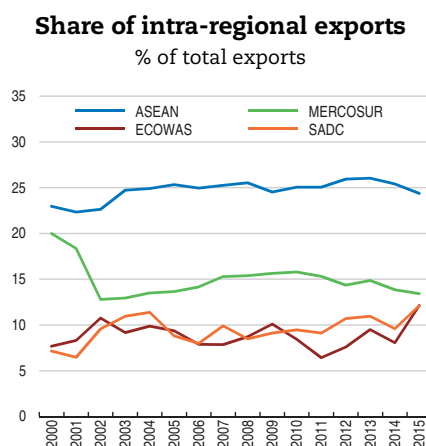
Low growth and high unemployment are weighing on social progress



Source: OECD, Economic Outlook database; World Bank, World Development Indicators (database).

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Deepening regional integration of the SADC to boost jobs and growth



Source: IMF, Direction of Trade Statistics; World Bank.

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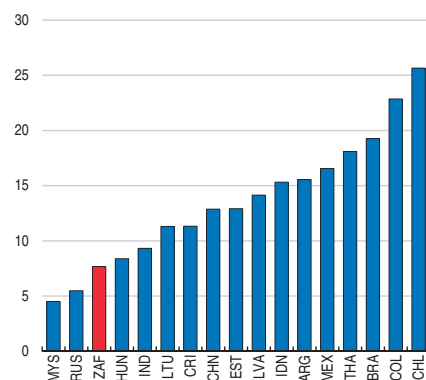
Growth has disappointed in the last few years. Weak consumer demand, persistently falling business investment, policy uncertainty, and the prolonged drought weighed on activity. While power production has improved, important bottlenecks remain in infrastructure and costs of services, which increase the cost of inputs for firms. The economic slowdown has pushed up the unemployment rate and income inequalities remain wide. Reviving economic growth is crucial to increase well-being, job creation and inclusivity. As there is limited room for monetary and fiscal stimulus, bold structural reforms, supported by social partners, are needed to unlock the economy.

Regional integration offers substantial opportunities for South Africa. Despite large growth potential, economic integration in the sub-region has not advanced much. Intra-regional trade in the Southern African Development Community (SADC) is only 10% of total trade compared to about 25% in the ASEAN or 40% in the European Union. Better implementation of existing SADC protocols and agreements would advance integration and create jobs. Reducing non-tariff barriers by improving customs procedures and simplifying rules of origin would reduce trade costs in the region. Weak infrastructure and institutions and barriers to competition limit industrial development. More ambitious and effective infrastructure and investment policies are needed at the regional level.

Boosting entrepreneurship and growing small businesses will contribute to creating jobs

Early-stage entrepreneurial activity is low

% of working-age population, 2014-16 average



Source: Global Entrepreneurship Monitor.

StatLink <http://dx.doi.org/10.1787/888933552017>

Boosting entrepreneurship is crucial to boost job creation. Entrepreneurship is low compared to other emerging economies. Slowing growth has compounded an already difficult environment for new and small businesses. Steps have been taken to ease starting a business, but red tape remains a burden. The quality of the education system and lack of work experience contribute to gaps in entrepreneurial skills. There is scope to broaden the sources of finance. Government policies should provide more financial and non-financial support for entrepreneurs and small businesses. However, a lack of co-ordination and evaluation hampers effective policy-making.

MAIN FINDINGS	KEY RECOMMENDATIONS
Macroeconomic policies	
<p>Macroeconomic policies are constrained. Fiscal space is limited and higher interest payments push public debt up. There is scope to increase the effectiveness and mix of government spending. Also, improvements in the governance of state-owned enterprises are needed.</p> <p>Skills shortages and mismatches are key bottlenecks to growth and inclusiveness. Access to higher education has improved but remains limited.</p> <p>The minimum wage will reduce inequalities and in-work poverty but adjustment to the higher minimum wage may be complicated by labour market rigidities and weak matching of skills. Labour disputes are costly and reduce flexibility and create a barrier to hiring.</p>	<p>Limit annual wage increases in the public sector and where possible redeploy civil servants to priority areas.</p> <p>Increase the effectiveness of public spending to free up resources for infrastructure and education.</p> <p>Deepen implementation of public procurement reform and enforce sanctions for breaches of the Public Financial Management Act.</p> <p>Ensure that state-owned enterprises respect procurement and expenditure rules.</p> <p>Set up a scheme of universal student loans contingent on future incomes, with participation from banks and government guarantees.</p> <p>Proceed with the introduction of the national minimum wage and develop apprenticeship and internship programmes to increase youth inclusion.</p> <p>Streamline conciliation and labour arbitration by strengthening the initial sorting of claims.</p> <p>Limit the number of appeals and time allowed to appeal in labour disputes.</p>
Fostering regional integration to broaden economic opportunities	
<p>Economic integration has been slow, reducing growth potential. Intra-regional trade is low compared to other communities. Non-tariff barriers are pervasive.</p> <p>Customs procedures remain costly and rules of origin complex.</p> <p>The weak trade and production links in the region reflect lack of proper infrastructure and institutions, skill shortages, regulatory barriers and monopolistic behaviours that hamper competition.</p>	<p>Reduce non-tariffs barriers on intra-regional trade within South African Development Community (SADC).</p> <p>Simplify and adopt a single set of rules of origin in the forthcoming tripartite free trade area.</p> <p>Upgrade information technology at custom posts and improve the interconnectivity of systems within the South African Development Community.</p> <p>Lead the harmonisation of competition rules among SADC countries and promote competition in infrastructure-related services across countries.</p> <p>Provide special economic zones with better infrastructure and develop their linkages with local economies.</p> <p>Create a regional fund for infrastructure and increase private sector participation in infrastructure projects.</p>
Lowering barriers to entrepreneurship and improving the business environment	
<p>Red tape and licensing create large burdens for entrepreneurs and small firms. The minimum wage risks adding to the hiring costs faced by small business.</p> <p>Regulation of network sectors and services remains high affecting quality and prices and reducing job creation.</p> <p>Attitudes towards entrepreneurship have become more positive but knowledge and skills gaps persist.</p> <p>Government support for new and small businesses could be better co-ordinated. Although programmes are regularly audited, the use of impact assessments is not systematic or standardised.</p>	<p>Enact a package of reforms to reduce red tape.</p> <p>Introduce a “silence is consent rule” for licensing procedures that have low associated risks. Systematically review and reduce the stock of red tape and licensing requirements.</p> <p>Open up telecommunications, energy, transport and services sectors to more competition.</p> <p>Expand second-chance programmes for early school leavers.</p> <p>Increase entrepreneurial education and work placements in the post-school education system.</p> <p>Evaluate and streamline financial and non-financial support for start-ups and small businesses.</p>

Assessment and recommendations

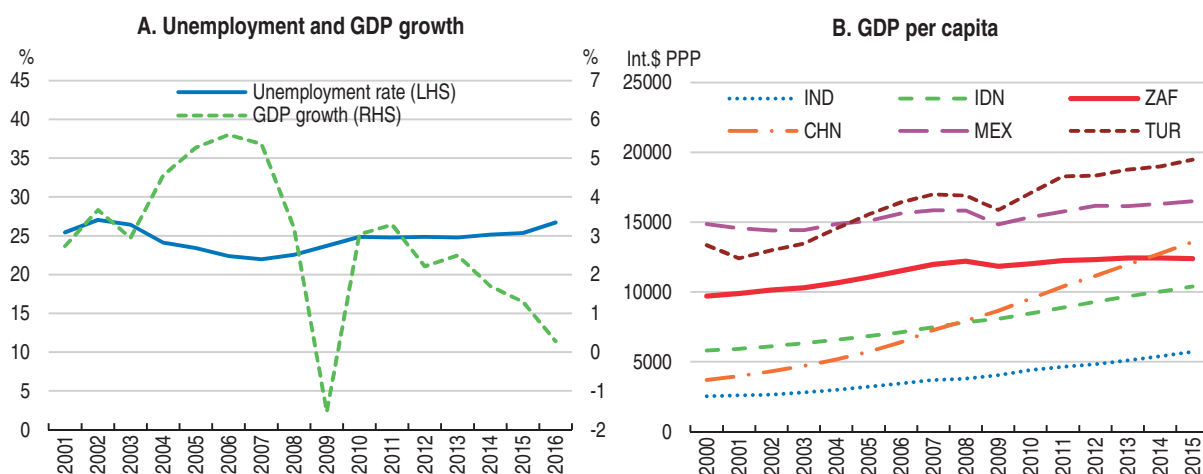
- *Low growth and high unemployment are weighing on social progress and cohesion*
- *Low growth is set to continue*
- *Macroeconomic policies are constrained*
- *Deepening regional integration within the Southern African Development Community*
- *Boosting job creation in South Africa through more start-ups and SME growth*
- *Challenges for green growth*

Low growth and high unemployment are weighing on social progress and cohesion

Over the last two decades, South Africa has accomplished enormous social progress by bringing to millions of citizens access to key public services, notably education, health, housing and electricity. Enrolment in primary school is universal for both boys and girls. Almost 90% of households have access to piped water and 84% have access to electricity (Statistics South Africa, 2016). An ambitious policy of redistributive grants has also been put in place, lifting a large share of the population out of poverty. Its legal framework is well regarded and its judiciary is perceived as independent. The advanced banking system and deep financial markets have made South Africa a regional hub for financial services.

Nevertheless, growth has trended down markedly since 2011 due to constraints on the supply side, in particular electricity shortages and falling commodity prices, and policy uncertainty. Unemployment rose from 25% to 27%. The youth are particularly hard hit by the economic slowdown, with an unemployment rate of 53% in 2016. Persistent low growth has led to the stagnation of GDP per capita compared to other fast-growing emerging market economies (Figure 1).

Figure 1. GDP per capita is stagnating



Note: The unemployment rate has been adjusted for a break in 2008.

Source: OECD, Economic Outlook database; World Bank, World Development Indicators database.

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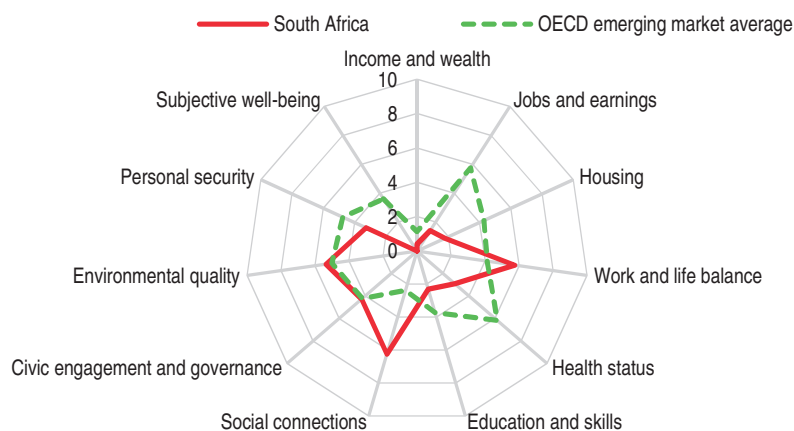
More recently, in a difficult economic context, several actions, in line with the National Development Plan, were taken to restart the economy:

- To increase confidence in the economy, the government has successfully followed a moderate fiscal consolidation policy that has stabilised the debt level and turned the primary balance from deficit to surplus.

- An important investment programme has been developed to rapidly increase electricity production with private sector participation and limit power blackouts.
- To reduce inequalities and poverty, and potentially boost demand, a national minimum wage will be introduced in 2018.


Low growth and high unemployment adversely affect the well-being of South Africans (Figure 2). South Africa lags the OECD emerging market average in the Better Life Index, in particular, in income and wealth, subjective well-being and jobs. Despite increased spending to broaden access to education, low quality is limiting access to jobs. High crime rates and health problems are also weighing on well-being. However, social connections rank high and illustrate the robustness of social institutions and family ties in a difficult economic context (Lilenstein et al., 2016). Also, South Africa performs well on many gender dimensions, though there is scope for progress in women’s access to economic opportunities and assets (land for instance) and in eliminating violence against women. Poverty reduction has been limited in recent years. The poverty rate, at about a third of the population, remains high compared to many emerging economies (Figure 3).

Figure 2. **OECD Better Life Index**

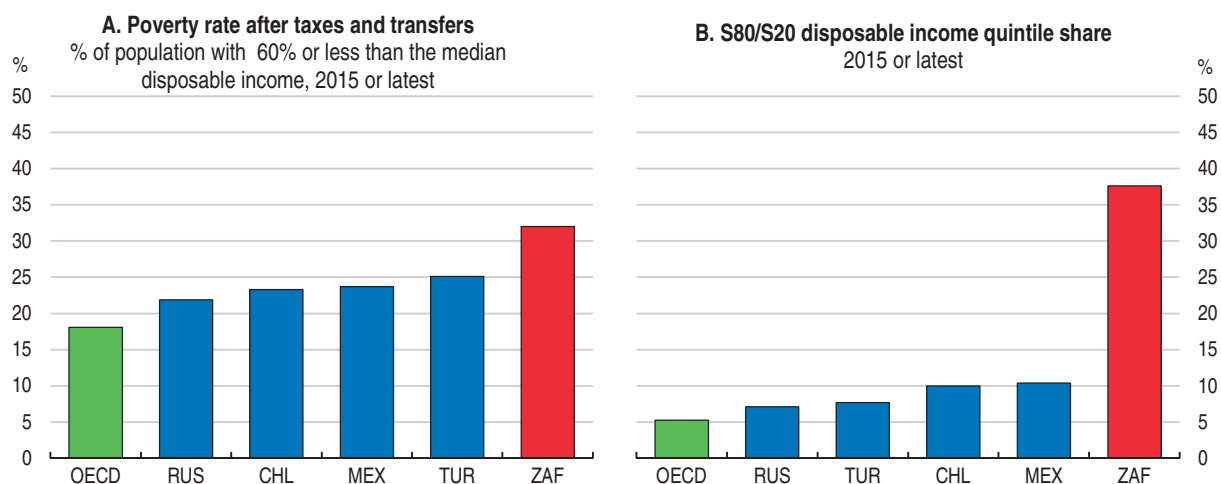


Note: OECD emerging market average includes Chile, Hungary, Mexico and Turkey. Each well-being dimension is measured using one to three indications from the OECD Better Life Indicator set with equal weights. Indicators are normalised by re-scaling to be from 0 (worst) to 10 (best).

Source: OECD (2016), “Better Life Index 2016”, OECD Social and Welfare Statistics database.

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The level of inequality also remains high despite important social transfers (16% of government spending in 2016). Transfers are the main source of household income for the bottom three quintiles and represent a sizeable share of household income for the fourth quintile in 2014 (Figure 4). The top quintile earns 40 times more than the lowest, which is four times more than in Chile or Mexico for example (Figure 3). Inequality, measured by the Gini coefficient (0.62), decreased between 2008 and 2010, but has since almost stagnated (see OECD Income distribution and poverty database). This illustrates the difficulty of reducing inequalities in a slowing economy. In addition, continued low growth with rising population growth poses a challenge for government finances. Widespread unmet needs in education, health and infrastructure are also feeding citizens’ frustration, as well as perceptions of corruption.

Figure 3. **Poverty and inequality are high**¹

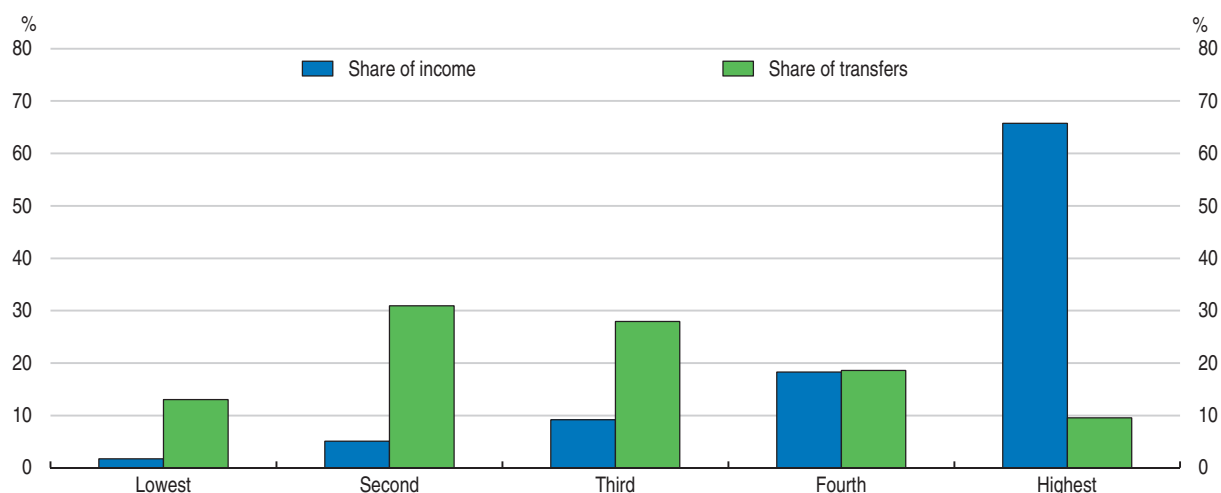
1. Data for South Africa are provisional.

Source: OECD Income Distribution and Poverty database.

StatLink <http://dx.doi.org/10.1787/888933552074>

Figure 4. **Social transfers reduce inequality and poverty**

Distribution of income and transfers by quintile, entire population, 2015



Source: OECD Income Distribution and Poverty database (provisional).

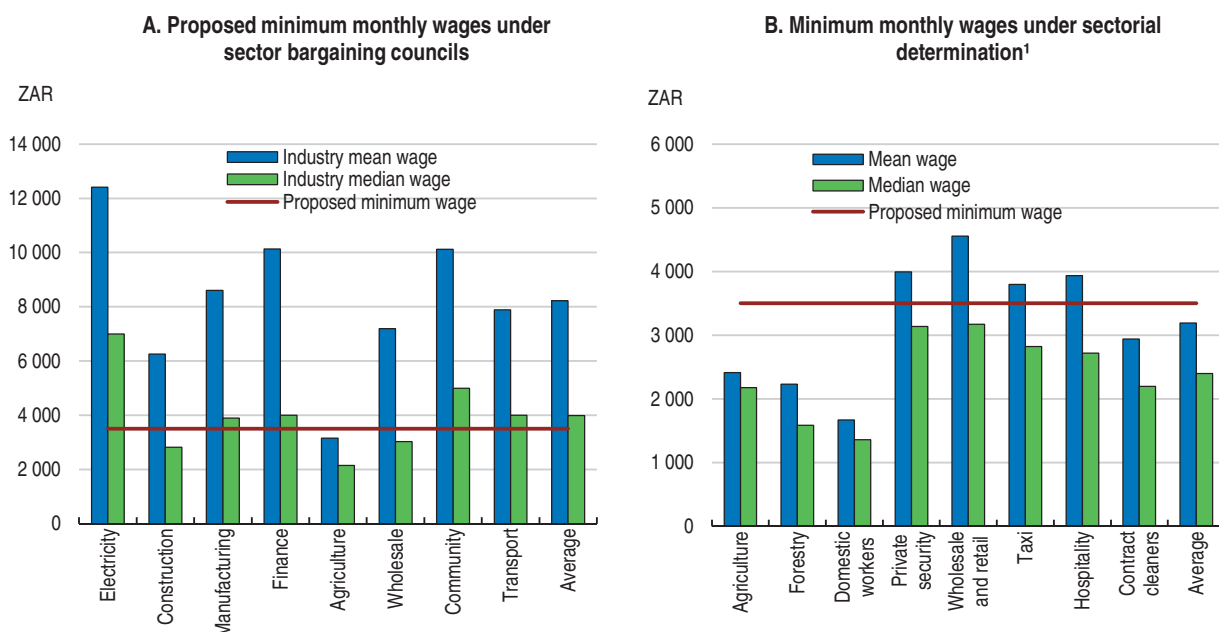
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The government has committed to introducing a national minimum wage to reduce poverty amongst workers and to make growth more inclusive. In November 2016, the National Minimum Wage panel of experts recommended a minimum wage of ZAR 20 per hour (EUR 1.37 hourly at current exchange rates). Business representatives, unions and social partners within the National Economic Development and Labour Council endorsed the proposal. It must still be passed by the Parliament, and is expected to take effect from May 2018. It will then be reviewed annually by a new National Minimum Wage Commission. The Commission should be composed of independent experts and advise on any adjustments taking into account economic conditions, inflation, productivity growth and employment effects, as recommended in the previous Survey (OECD, 2015a).

The national minimum wage will cover all workers. To facilitate transition towards the minimum wage businesses, including SMEs, that are unable to afford it may apply for an exemption for up to 12 months. Also, domestic workers will initially be paid 75% and agriculture workers 90% of the national minimum wage. These will be raised to 100% within two years of implementation, depending on evaluations by the new commission. Amendments to the Labour Relations Act, Picketing Regulations and a Code of Good Practice on Collective Bargaining, Industrial Action and Picketing are to be promulgated to enhance labour market stability and effective dispute resolution.

The proposed national minimum wage will potentially affect 6 million workers, which is almost half (47%) of wage earners. It should have an important impact in reducing poverty amongst low skilled workers. The impact on sectors covered by bargaining councils is likely to be low as many workers have wages above the proposed national minimum wage (Figure 5, Panel A). Workers in sectors not covered by annual wage negotiations between unions and businesses will be the main beneficiaries (Figure 5, Panel B). Figure 6 shows that the proposed minimum wage is not low by international standards.

Figure 5. **Wage distribution across sectors and proposed minimum wage**



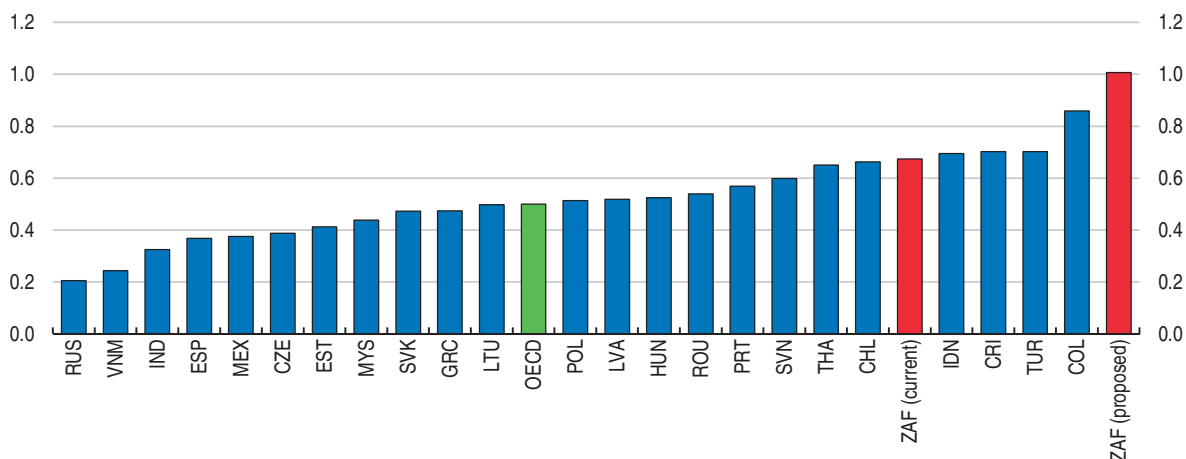
1. Minimum wages set by the Ministry of Labour.

Source: National Minimum Wage Panel Report to the Deputy President, November 2016.

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The impact of the proposed national minimum wage on employment, inflation and informality remains unclear. Empirical studies on minimum wages in emerging economies point to ambiguous effects on overall employment (Broecke et al., 2017). As reported by the panel of experts, the overall macroeconomic impact will depend on the productivity response on the one hand, and on the demand impulse on the other hand. The risk to employment or hours worked is particularly large for agriculture and domestic services, where a large proportion of workers are very low-paid (Bhorat et al., 2014; Figure 5, Panel B). This justifies the proposed lower introductory minimum wage for these two sectors. The set implementation date of 2018 will also imply a lower wage in real terms given the robust inflation rate.

Figure 6. **Minimum wages across a selection of countries**
Minimum relative to median wages, 2015 or latest

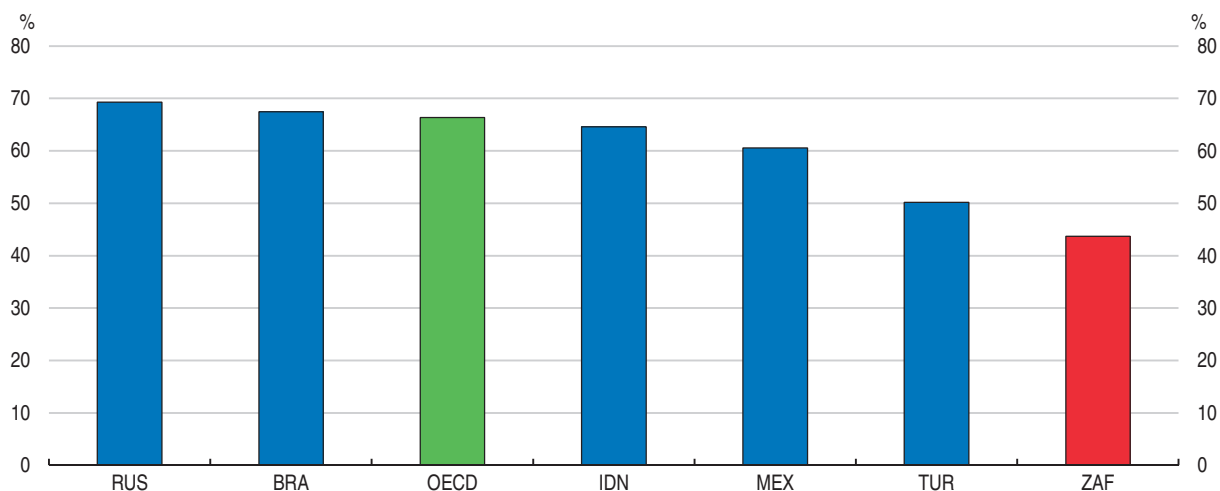


Source: OECD, ILO, World Bank.


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To minimise any potential negative effects of the higher wage it is important to pursue structural policy reforms that increase productivity and job creation. Employment remains the most effective way to reduce poverty and inequality, and increase inclusiveness. South Africa suffers from a low employment rate which is an important obstacle to inclusion (Figure 7). The introduction of the minimum wage should have a short-run positive impact through a positive effect on low-income household consumption but a limited negative impact on GDP in the medium-term. The negative impact would be largely offset by reducing competition barriers (Cahu and Fall, 2017). Moreover, reducing skills shortages would contribute to offsetting the negative impact of the minimum wage and increase youth inclusion.

Figure 7. **Employment rate is low**
Employment to population ratio, 2015



Source: OECD Labour Force Statistics database.

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Developing an effective vocational system will help in addressing skills shortages and redirecting the youth back into training. Only 12% of South African students in upper secondary education were enrolled in vocational programmes in 2013. The technical and vocational education and training (TVET) sector can be further strengthened in terms of qualifications and training of staff, resources and curriculum content to make it more viable and attractive to students and businesses (Field et al., 2014). Generalising apprenticeship and internship as part of the education curriculum in TVET colleges and universities will favour youth entry in the labour market. Second-chance programmes for adults that are flexible and build on the existing matric (final year higher secondary school exam) should also be expanded to enable students to re-enter the school system through TVET colleges and community colleges.

The economy faces many structural challenges. High inflation limits room for monetary policy support, high public debt constrains public spending, high costs of doing business from weak competition and political uncertainty affect investment and confidence. South Africa needs structural reforms that would boost the potential of the economy. OECD Economic Surveys of South Africa (2013, 2015a) have pointed to many reforms to broaden competition in the economy, limit the size and grip of state-owned enterprises (SOEs) on the economy, and improve the quality of the education system.

Table 1. **Past recommendations for improving labour outcomes**

Recommendations from previous <i>Surveys</i>	Action taken since the July 2015 <i>Survey</i>
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.	An employment services database has been created that increasingly links to other programmes. Centres now include self-help kiosks.
Increase the role of mediation and arbitration to make wage negotiations less confrontational. The arbitration process for dismissals for cause should be accelerated and simplified.	The minimum wage introduction is to be accompanied by labour market stability measures, including amendments to the Labour Relations Act, Picketing Regulations and a Code of Good Practice on Collective Bargaining, Industrial Action and Picketing.

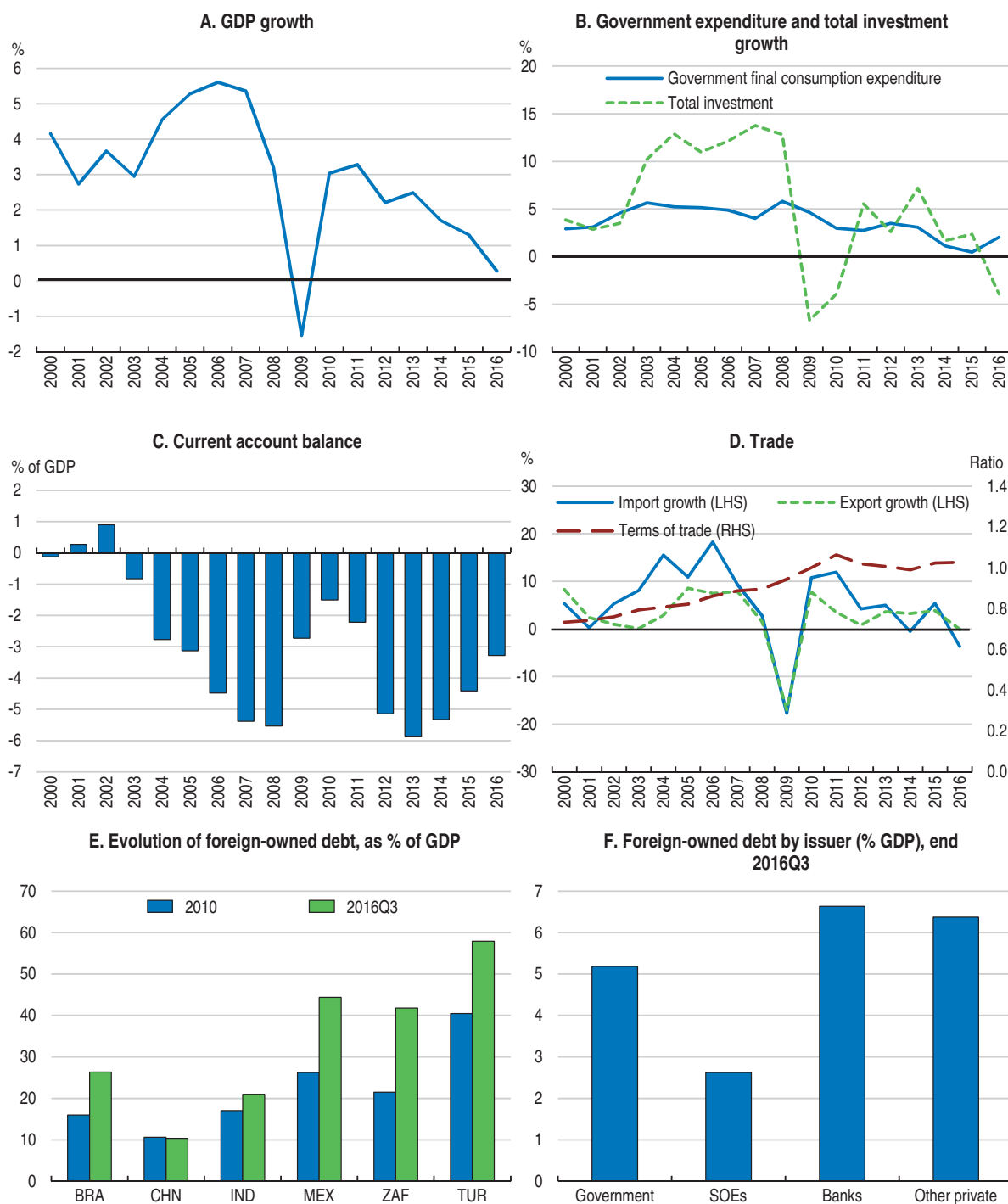
This *Survey* is focusing on other ways to expand the economy and create jobs rapidly. Boosting entrepreneurship and growing small businesses can play an important role in creating jobs for the 27% of workers who are unemployed. Greater regional integration within the Southern African Development Community (SADC) could provide new opportunities for growth. Against this background, the key messages of this *Economic Survey* are:

- Short-run macroeconomic policies offer limited scope to boost growth. Bold structural reforms are needed to increase access to network sectors and services, and to improve the functioning of the labour market. Improving education quality to tackle skills shortages, reducing the cost of energy and developing transport infrastructure can boost the economy.
- Deepening regional integration in the SADC, with strong leadership from South Africa, will expand market size and open new opportunities for growth. South African firms are well placed to benefit from deeper integration.
- Entrepreneurship is low compared to other emerging economies. The environment for new and small businesses is more difficult than in other countries, but closing these gaps would create badly needed jobs.

Low growth is set to continue

Growth has continuously fallen in recent years (Figure 8, Panel A), driven by weak investment due to persistent policy uncertainty and continued low business confidence (Figure 8, Panel B). Household consumption has also been sluggish on the back of high

Figure 8. Recent macroeconomic developments



Source: OECD, Economic Outlook database; IMF, International Financial Statistics; South African Reserve Bank.

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unemployment, moderate wage increases and persistent indebtedness. Government expenditure growth remained moderate as rising debt called for consolidation. Export growth plunged in 2016, further compressing demand (Figure 8, Panel D).

The current account deficit has narrowed as sluggish growth has reduced imports (Figure 8, Panel C). Nevertheless it remains wide due to the low saving rate. The terms of trade have benefitted from rand appreciation in late 2016 and the pick-up of international commodity prices. The current account is financed by portfolio investment flows, creating high exposure to a reversal of capital flows. In 2016, South Africa experienced a high level of equity outflows, partially covered by bond inflows, reflecting investors' portfolio arbitrage and political uncertainty.

Foreign-owned debt, at 41% of GDP in 2016, is relatively high compared to other emerging economies (Figure 8, Panel E). While most of the external debt of the government is denominated in local currency, the majority of the external debt of state-owned enterprises (SOEs), banks, and corporates is in foreign currency (Figure 8, Panel E and F). SOEs are required to hedge their foreign currency risk, but the cost of hedging and/or collateral requirements might increase with the downgrade of SOEs' credit ratings.

The economic slowdown has pushed the unemployment rate from 25% to 27%. Job creation increased marginally due to temporary jobs associated with municipal elections in

Table 2. Macroeconomic indicators and projections

Annual percentage change, volume (2010 prices)

	2014	2015	2016	2017	2018
				(projected)	
GDP	1.7	1.3	0.3	0.6	1.2
Private consumption	0.7	1.7	0.8	0.8	1.5
Government consumption	1.1	0.5	2.0	1.0	0.8
Gross fixed capital formation	1.7	2.3	-3.9	0.5	2.8
Of which Housing	2.8	8.6	-2.4	3.4	4.8
Final domestic demand	1.0	1.6	0.1	0.6	1.6
Stockbuilding ¹	-0.4	0.2	-0.9	-0.2	0.0
Total domestic demand	0.6	1.8	-0.8	0.4	1.6
Exports of goods and services	3.2	3.9	-0.1	2.8	4.5
Imports of goods and services	-0.5	5.4	-3.7	2.7	5.9
Net exports ¹	1.2	-0.6	1.1	0.0	-0.4
Other indicators (growth rates, unless specified)					
Potential GDP	2.8	2.8	2.7	2.4	2.3
Output gap ²	-0.9	-2.3	-4.6	-6.3	-7.3
Employment	1.9	3.9	0.3	1.4	2.6
Unemployment rate	25.1	25.3	26.7	26.9	26.5
GDP deflator	5.5	4.9	6.7	5.6	5.4
Consumer price index	6.1	4.6	6.3	5.7	5.6
Core consumer prices	5.6	5.6	5.7	5.4	5.5
Trade balance ³	-1.7	-0.9
Current account balance ³	-5.3	-4.4	-3.3	-3.1	-3.3
General government fiscal balance ³	-4.1	-3.9	-3.5	-3.3	-3.0
Three-month money market rate, average	5.8	6.1	7.2	7.0	6.5
Ten-year government bond yield, average	8.3	8.2	9.0	9.0	8.5

1. Contributions to changes in real GDP.

2. As a percentage of potential GDP.

3. As a percentage of GDP.

Source: OECD (2017), OECD Economic Outlook: Statistics and Projections (database).

August 2016 (National Treasury, 2017). Inflation accelerated from 4.6% in 2015 to 6.4% in 2016, driven by currency depreciation and the drought-induced increases in domestic food prices.

Growth is projected to rebound timidly to 0.6% in 2017 as investment and exports recover moderately with the improving international economy (Table 2). The projected recovery in corporate investment, financed by accumulated savings, assumes that the economic climate does not deteriorate further. Exports should benefit from the strengthening of the economy in South Africa's main partners (Europe and the United States) and from the recovery in international commodity prices.

Both domestic and global risks can weigh on output growth next year (Table 3). On the domestic side, the level of confidence in the economy is fragile given changes in the political environment. A rise in political tensions could further restrain private investment. On the international dimension, the rand remains highly responsive to US interest rates and therefore exposed to their increases. In addition, as the United Kingdom is South Africa's largest European trading partner, uncertainty about the Brexit may affect imports and financial flows. Finally, the outlook could be better if international commodity prices keep on increasing. Also, falling food prices could boost household demand.

Table 3. **Events that could hit the economy**

Shocks	Possible impacts
Deterioration of the political climate	Political instability could initiate further downgrades of the sovereign credit ratings. Persistent tensions ahead of the ruling party congress in December would restrain investment and private consumption.
Slowing down in China and Europe	A slowdown in China, the second-largest export destination after the European Union, could trigger a fall in the prices of South Africa's main commodity exports and further depress the economy. Also, weaker growth in Europe along with falling sterling and euro would dampen demand for South Africa's exports and worsen the current account deficit.
Reversal of financial flows	Large capital outflows could weaken financial institutions and compromise the financing of the current account deficit and therefore accelerate the depreciation of the rand.

Macroeconomic policies are constrained

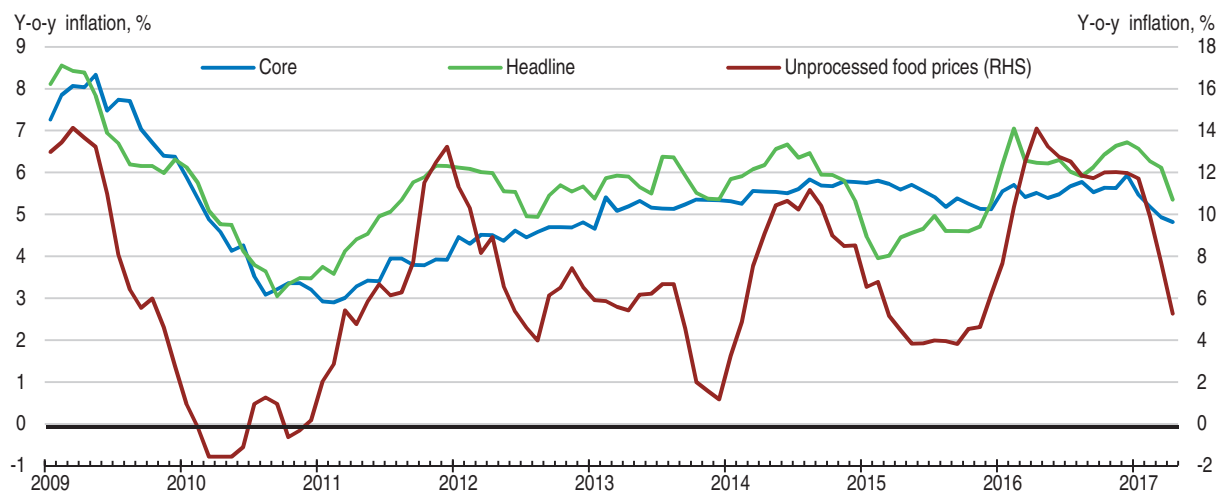
Monetary policy and financial markets under relatively high inflation and low growth

Monetary policy is operating in a difficult environment of high inflation and low growth. Inflation was above the Reserve Bank's target band (3-6%) throughout 2016. One factor was the delayed exchange rate pass-through following the large depreciation of the rand throughout 2015. A long-lasting drought also put pressure on agricultural prices in 2016 but prices have now fallen sharply, bringing headline inflation back inside the target band (Figure 9). Core inflation remained stable throughout 2016, although at the upper limit of the target band, and has also dipped recently. Inflation expectations are around the top of the target band.

The Reserve Bank had maintained the repurchase rate at 7% since March 2016; it cut the rate by 25 bases point in July 2017. Sustained decreases in inflation would create more room to ease monetary policy. However, if the rand depreciates as US monetary policy continues to tighten, there could be second-round impacts on inflation. In this case, the Reserve Bank would need to communicate clearly its readiness to act to ensure that inflation expectations remain anchored.

Compared to many other emerging markets, financial markets are open and deep, supported by a free-floating currency. Interest rate differentials have attracted large

Figure 9. Inflation dynamics



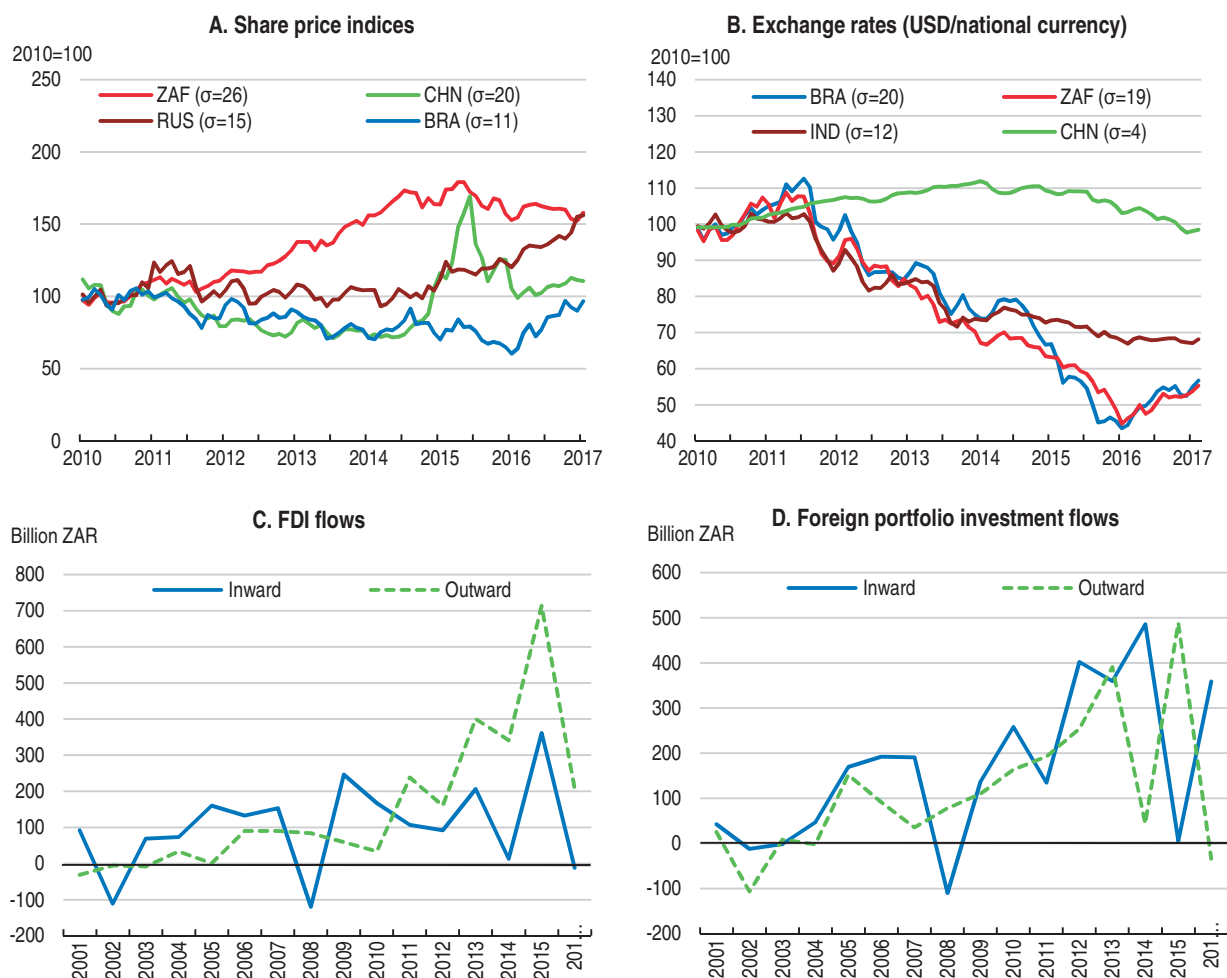
Source: South African Reserve Bank.

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amounts of international portfolio investments. South Africa has been an important destination in the risk allocation strategies of portfolio managers between advanced economies and emerging markets. While attracting capital, the openness affects volatility of the currency and the stock market (Figure 10). South Africa's stock market is more volatile than those in many other emerging economies. The currency volatility is also driven by external factors such as US monetary policy, and national policy uncertainty (Maveé et al., 2016).

Nonetheless, vulnerabilities in the financial sector remain low and banks are under close supervision. Household credit in terms of GDP is high (at 35 %) compared to other emerging economies. Its growth has slowed down since the end of the credit boom in 2010 (Figure 11). Risks are mitigated by the high share of deposits to finance loans compared to other emerging economies. Non-performing loans remain low and stable. One bank, the African Bank, went bankrupt and was wound down without significant systemic repercussions in 2014 pointing to well-functioning exit procedures. Banks also maintain capital adequacy well above minimum regulatory requirements. Nonetheless, given the weak economic climate, banks are exposed to increasing risks of credit default, which although low, have been increasing since January 2016 compared with previous years especially for retail exposures such as mortgages, small- and medium-sized enterprises and retail revolving credit (SARB, 2017).

To deal with the volatility and credit market risks, the government is taking measures to modernise prudential regulations and financial service consumer protection, and to enhance the resolution framework. The Financial Sector Regulation Bill, which introduces group-wide supervision under a single Prudential Authority and establishes a new Financial Sector Conduct Authority, should be put in place during 2017. A financial sector resolution bill, including the establishment of a deposit insurance system, is also planned. These institutions should help to protect consumers, in particular individuals with low financial literacy, and cushion the transmission of external shocks to the financial system.

Figure 10. **Financial indicators**

Note: In panels A and B, sigma denotes the standard deviation of prices over the period shown.

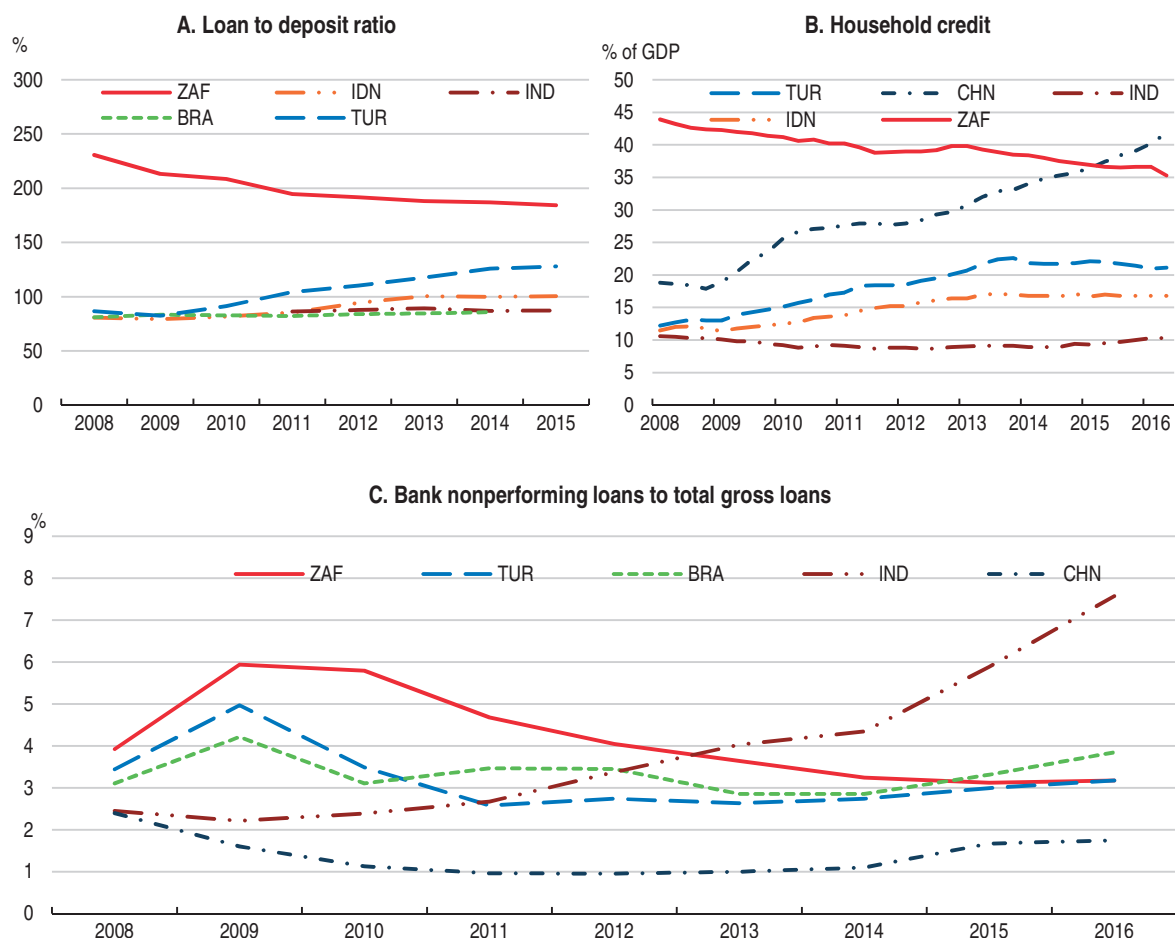
Source: Thomson Reuters Eikon; OECD, Economic Outlook database; South African Reserve Bank.

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Fiscal policy and public debt: shifting the mix of spending

Public debt has risen rapidly to 50% of GDP in recent years (Box 1). Literature on sustainability levels of public debt in emerging market economies tends to limit prudent debt targets to 40-55% of GDP, depending on ability to raise revenue, growth potential and the types of fiscal risks a country faces (Fall et al., 2015). Any improvement from current high inflation rates and low growth rates is favourable for debt dynamics, thus debt is considered sustainable but vulnerable.

The main risks to debt sustainability arise from the ratings downgrades in early 2017 and the rising contingent liabilities in state-owned enterprises (parastatals). Further downgrades may trigger spikes in interest rates and depreciation of the currency with persistent effects on growth and debt. Government exposure to state-owned entities has been accelerating in recent years (Table 5). For example, government guarantees to South African Airways have increased rapidly, making its default the most important risk. The largest exposure is to Eskom, the vertically integrated electricity company. Since 2010, the government has extended ZAR 350 billion (8% of GDP) of guarantees to Eskom's construction of new power

Figure 11. **Financial vulnerabilities**

Source: OECD, Vulnerability Indicators database; Thomson Reuters Eikon; World Bank, World Development Indicators database.


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Table 4. **Past recommendations on macroeconomic policy and fiscal sustainability**

Recommendations from previous Surveys	Action taken since the July 2015 Survey
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. The government should continue to seek opportunities to increase the efficiency of public expenditure.	Fiscal consolidation has continued. Additional tax raising measures have been introduced. The expenditure ceiling has been lowered further. All suppliers must be registered with a central database. All contracts above ZAR 500 000 at national and provincial level, and ZAR 200 000 at municipal level, are subject to a competitive bidding process. Efforts to expand centralised procurement of goods and services and renegotiation of transversal contracts continue.

plants. A further ZAR 220 billion (5% of GDP) of guarantees were granted to independent power producers from which Eskom is contracted to purchase electricity.

Eskom's financial performance relies significantly on its ability to recover costs through tariff increases approved by the regulator and to deal with non-paying customers. Eskom has introduced historically high tariff increases in the last two years. Recently, the regulator limited the increases, a decision challenged in court by Eskom. The uncertainty

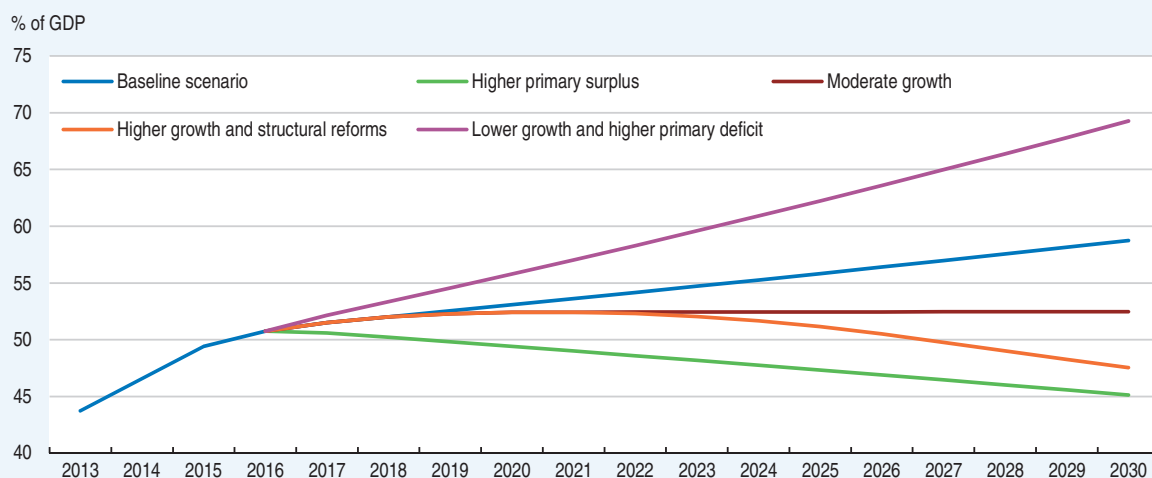
Box 1. South Africa's debt is sustainable but vulnerable

Government debt has increased steadily in the past years to 51% of GDP in 2016, which prompted a moderate consolidation to stabilise the debt level. Debt sustainability depends on growth, inflation, interest rates and fiscal policy (Figure 12):

- In the baseline scenario, “no policy change”, the primary surplus is held constant at 0.1% of GDP (2015/16 level), the real long-term interest rate is 2.7% (difference between average 10-year bond rate and average inflation in 2016), and growth returns to 1.5% per year from 2018. In that case, the debt-to-GDP ratio reaches 59% in 2030.
- If structural reforms that increase potential growth are implemented, a higher growth rate that gradually reaches 2.5% from 2021 and 4% from 2027 onward would accelerate debt reduction.
- If the primary surplus increases to 1% of GDP from 2017 onward, then the debt-to-GDP ratio will decrease to 45% in 2030.
- In a lower growth scenario of 1% and higher primary deficit of 0.3% of GDP, the debt-to-GDP ratio significantly increases to 70% of GDP.

The main lesson from the simulation is that in the current environment of low growth and high inflation, an improving macroeconomic outlook will help the sustainability of debt.

Figure 12. Simulations of debt dynamics



Source: OECD calculations.

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Table 5. Government guarantee exposure

As a % of GDP

	2013/14		2014/15		2015/16		2016/17	
	Guarantee	Exposure ¹	Guarantee	Exposure	Guarantee	Exposure	Guarantee	Exposure
Public institutions	13	6	12	6	11	6	11	7
Of which Eskom	10	3	9	4	8	4	8	5
Independent power producers			5	2	5	3	5	3
Public-private partnerships	0	0	0	0	0	0	0	0
Total	23	10	27	12	25	13	24	15

1. Total amount of borrowing and accrued interest for the period made against the guarantee.

Source: South Africa National Treasury (2017), *Budget Review 2017*.

regarding the scale of future tariff hikes poses significant risks to Eskom's financial position and increases government exposure.

With public debt at 50% and risks rising, the government has been pursuing a consolidation plan for more than three years. The consolidation path followed in the last three years has successfully reduced the primary deficit, which is necessary to stabilise debt (Table 6). Preliminary estimates for 2016/17 indicate that the primary balance will be close to a surplus. The fiscal deficit remains high, but is mainly driven by increasing interest payments (Table 6). However, if the government maintains its primary surplus, the debt level should either stabilise or decline in the coming years (Box 1). As South Africa's debt level is lower than that of many emerging economies, it has contributed to lowering government borrowing costs (Figure 13, Panel D). However, this may now be at risk given the recent downgrades by rating agencies.

Table 6. Fiscal indicators

% of GDP

	2013/14	2014/15	2015/16	2016/17 ¹	2017/18 ²	2018/19 ²
Spending and revenue						
Revenue	27.8	28.4	29.9	29.4	29.8	29.9
Expenditure	31.5	31.9	33.4	32.8	33.0	32.7
Interest payments	3.0	3.1	3.3	3.5	3.6	3.7
Budget balance						
Fiscal balance	-3.7	-3.5	-3.5	-3.4	-3.1	-2.8
Primary balance	-0.7	-0.3	-0.1	0.1	0.4	0.9
Public debt						
Gross loan debt	43.7	46.6	49.4	50.7	52.3	52.9
Net loan debt	38.1	41.0	44.2	45.5	47.0	47.6

1. Preliminary estimates.

2. Projections.

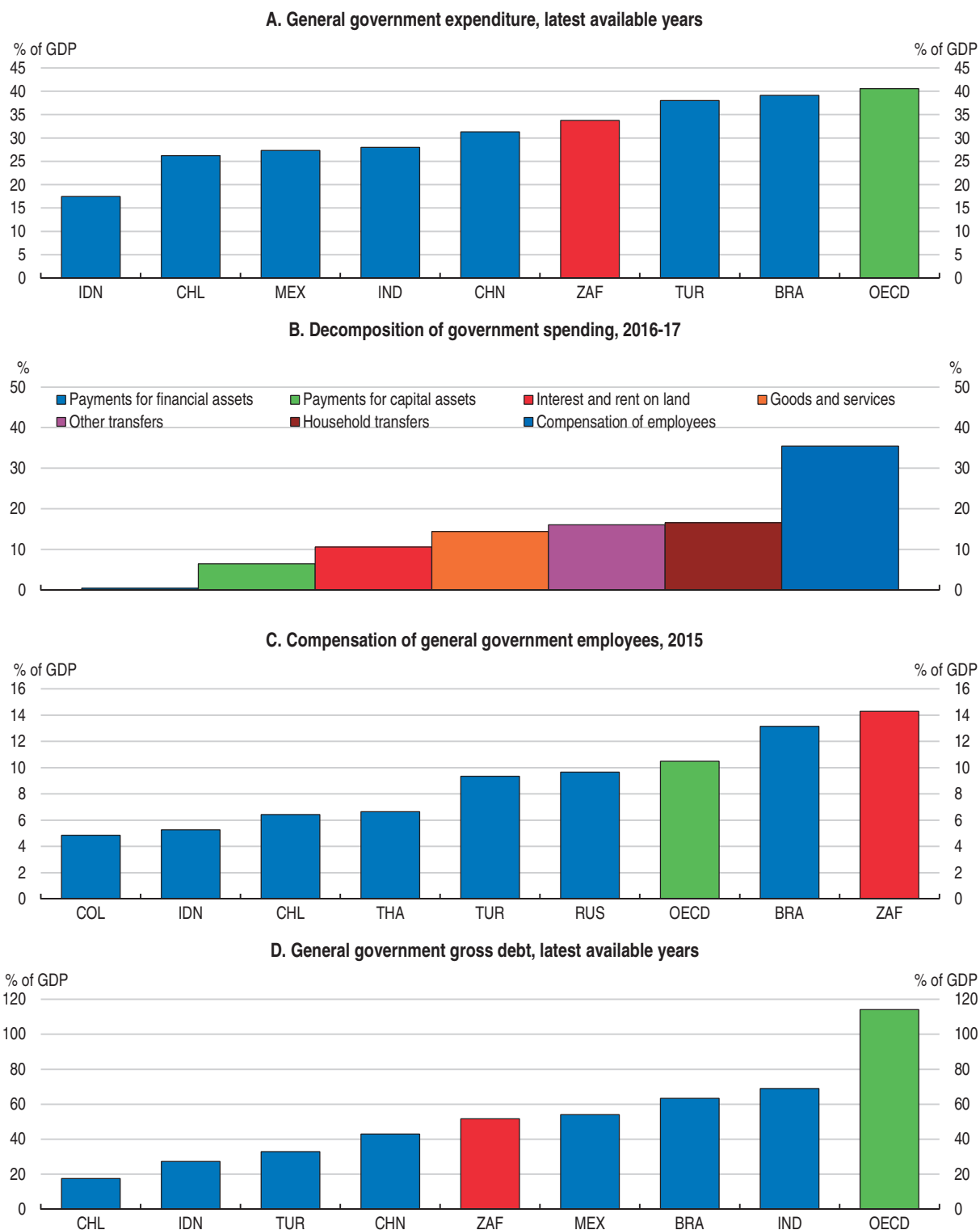
Source: National Treasury (2017), Budget Review 2017.

The fiscal strategy combines containing spending increases and raising tax revenues. Spending, at 33% of GDP in 2016, is about average among emerging economies (Figure 13). However, the structure of spending is skewed by a large share of current spending: the large wage bill (35% of total or 14% of GDP in 2016) compared to OECD and emerging market economy averages and household transfers (14% of total) (Figure 13). Debt-service costs represent 10% of the budget. Together with the wage bill, this is limiting the capacity of the government to meet physical and social infrastructure investment needs necessary to unlock higher growth.


In particular, increasing public investment in infrastructure and education would broaden individual opportunities and inclusion. For instance, investing in transport infrastructure has high economic and social returns (OECD, 2015a). In countries like South Africa where overall government spending is not too high, more public spending on infrastructure and education would increase potential growth while reducing inequality (Fournier and Johansson, 2016).

The consolidation strategy aims at limiting the increase of the wage bill and reducing the spending ceiling. In 2015 and 2016 the government froze the recruitment of civil servants and only permitted the replacement of indispensable workers to limit the growth of the wage bill. Further efforts could be made to limit annual wage increases within the

Figure 13. **Government spending and fiscal stance**



Source: OECD, Economic Outlook database; IMF, World Economic Outlook Database; IMF, Government Finance Statistics; South African National Treasury (2017), *National Budget 2017*.

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government. But redeploying civil servants by, for instance, reallocating vacant positions toward areas where needs are more important (health and education), would increase the effectiveness and productivity of public services.

More effective government spending would increase fiscal space. The Office of the Chief Procurement Officer has made strides in modernising and centralising government procurement practices (National Treasury, 2017a). Efforts to improve supply chain management and reduce the cost of procuring goods, services and construction works (12% of GDP in 2014) should continue. Ensuring that public procurement procedures and spending rules are fully respected, including in state-owned enterprises, could provide spending savings and would reduce risks of mismanagement of public finances and corruption.

Good corporate governance of state-owned enterprises is critical to achieving growth objectives and efficient infrastructure delivery. The OECD Guidelines on Corporate Governance of State-Owned Enterprises provide ways to appropriately separate control and management of SOEs (OECD, 2015b). In late 2016 the Cabinet approved measures for improving the governance of SOEs that go in this direction. Their implementation should be prioritised.

On the revenue side, the 2017/18 budget will raise tax revenues by ZAR 28 billion (0.6% of GDP), mainly through higher personal income taxes, including fiscal drag, and fuel levies. Further increases of ZAR 15 billion are planned for 2018/19. Increasing revenue faces two main obstacles: low growth and lack of trust in the effectiveness of government spending. Rebuilding confidence toward public institutions and the legitimacy of social policies through greater effectiveness of public policies will be key to generating capacity to raise more taxes.

Table 7. Past OECD recommendations on broadening tax bases

Recommendations from previous <i>Surveys</i>	Action taken since the July 2015 <i>Survey</i>
Broaden personal and corporate income tax bases by reducing deductions, credits and allowances. Increase tax rates on higher incomes.	The 2017 Budget created a new top tax bracket with a marginal tax rate of 45%. The dividend withholding tax rate was increased from 15% to 20%.
Broaden the VAT base and strengthen VAT compliance. Proceed with the introduction of a carbon tax.	The VAT exemption for fuels is being reviewed. Draft legislation for the carbon tax has been published.
Increase property taxation by building capacity at the municipal government level.	No action taken.
Increase reliance on environmentally related taxes, such as fuel levies.	A Waste Board is being created which will impose a levy on waste. A levy on used tyres was implemented in February 2017.

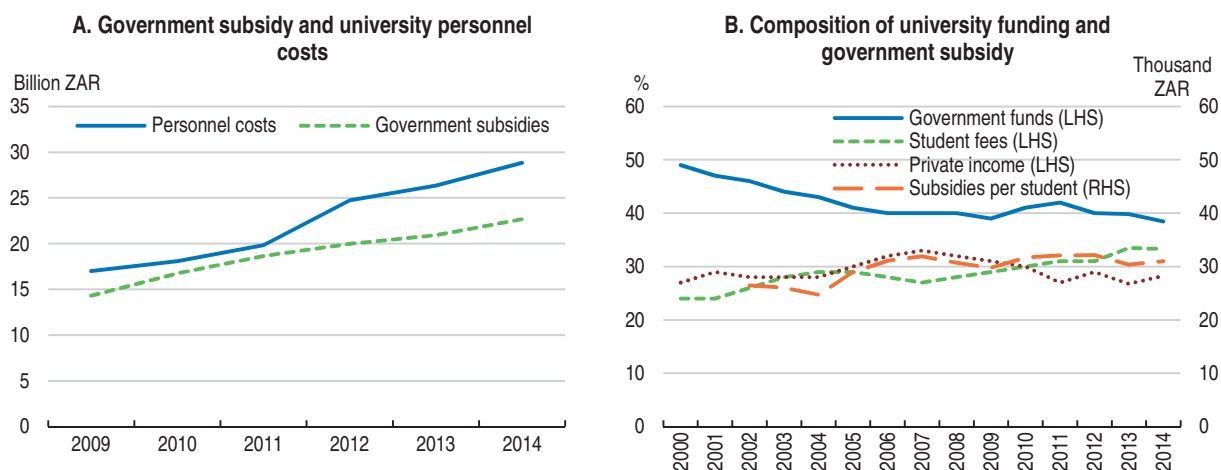
Financing higher education poses a challenge to the fiscal stance

Given limited government resources, the country has to design a sustainable financing scheme for higher education. Enrolment in higher education has expanded significantly over the past five years. In 2015, confronted with rising fees, students started to protest calling for free education. Indeed, financing higher education is difficult for many students from poor and middle-income households. Currently, the National Student Financial Aid Scheme (NSFAS) is the main instrument for providing financial assistance to poor students through means-tested loans. On the other hand, the majority of students from middle-income households continue to struggle to fund their education.

At the same time, universities face rising cost pressures as direct government funding has declined to 40% of universities' overall income, over the past 15 years (Figure 14). In the same period, indirect government funding through NSFAS has increased. Spending per

student is relatively low compared to OECD and emerging countries (Figure 15). Moreover, the teaching subsidy per student has not increased in line with inflation and the total subsidy does not fully cover personnel costs (Figure 14). To cover cost pressures, universities have increased student fees in recent years.

Figure 14. **Government subsidies for university education**¹



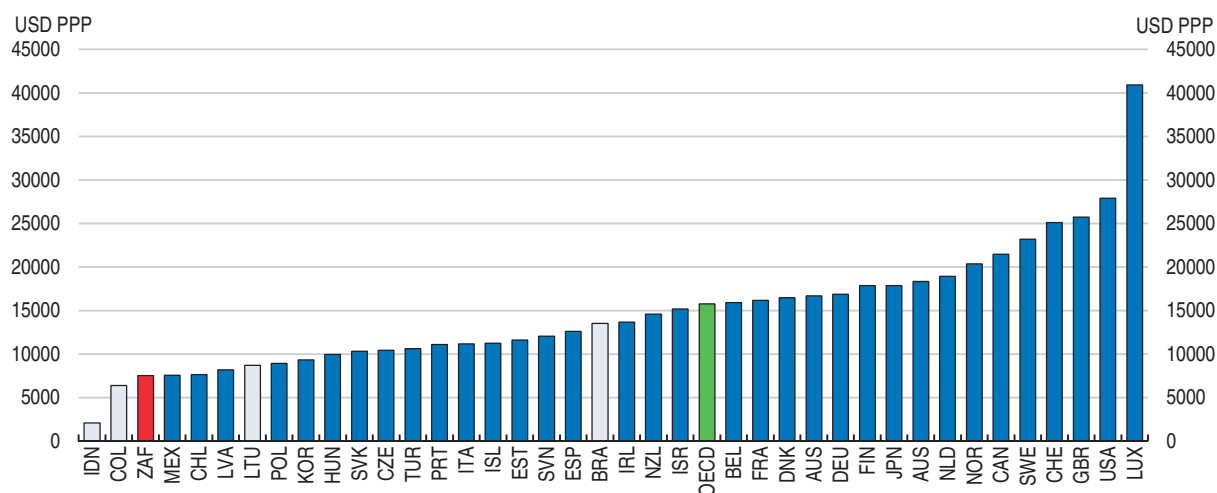
1. "Student fees" does not include government allocations to NSFAS.

Source: Department of Higher Education and Training (2016); OECD calculations.

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Figure 15. **Annual expenditure per student in tertiary educational institutions for all services**

Expenditure per student, 2013



Note: For Canada and Chile, data refer to 2012 and 2014. For Brazil, Canada, Ireland, Luxembourg and Switzerland data refer to public institutions only.

Source: OECD 2016, *Educational attainment and labour-force status*, Education at a Glance database; DHET 2016, OECD calculations for South Africa.

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The protests have sparked a search for new forms of funding for universities and students. A temporary solution was adopted by freezing fees in 2016 with the government largely covering the shortfall. For the 2017 academic year, the government has recommended that universities set a maximum fee increase of 8%. In 2018, the government will establish a

new fund – the Ikusasa Student Financial Aid Programme which is intended to replace the NSFAS (DHET, 2016). It is currently being piloted at six universities and one technical and vocational college. The Financial Aid Programme is close to the current scheme, but with greater coverage of students from the middle class (DHET, 2013; DHET, 2016). Under the new scheme, most poor students will still be fully funded through scholarships and grants, and some middle-class students will receive a combination of grants and loans which progressively decline as household income increases.

The government has increased its financing of higher education. Higher education financing is already a sizeable share of the government budget and the current financing scheme will become financially unsustainable as enrolment expands. Moreover, the financing sources of the new scheme remain uncertain as it relies partially on private donations and bank participation.

As higher education is a public and private good, the government and students should contribute to its financing. Given the high premium to higher education in South Africa, student contributions to financing based on their future revenues would be reasonable (OECD, 2017a). To cover university fees for all students, a financing mechanism involving banks, the government and students could be a solution. Banks would provide universal loans contingent on future incomes, while the government would provide guarantees for repayment based on future tax records of borrowers. The setting of interest rates on the loans should be negotiated between the government and banks. This mechanism would overcome the problem of access while ensuring that the government would not have to advance the funds. Although these loans would be a contingent liability, the fiscal risk could be mitigated by linking repayments to income tax payments.

To limit the selection bias in the loan scheme given the drop-out rate, the loans contingent on future incomes could be reserved to students from the second year onwards. Limiting the selection bias reduces the government's exposure. In addition, the government would still provide grants and bursaries to poor students to cover living costs. However, universities should still be incentivised to provide support to disadvantaged and vulnerable students, and to minimise drop-out rates through additional tuition. Finally, the government could create a permanent representative panel, similar to the panel created to set the 2017 fee increase, to oversee fee increases.

Table 8. Past recommendations for making the education system more effective

Recommendations from previous <i>Surveys</i>	Action taken since the July 2015 <i>Survey</i>
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.	136 new schools were built and completed in 2016/17, 167 provided with sanitation facilities, 344 with water and 134 with electricity. The Department of Basic Education committed to provide at least two libraries in each province with the ASIDI allocation.
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.	In 2016, the Department of Basic Education introduced a new policy defining the role of school principals and the key aspects of professionalism, image and competencies required. A new collective agreement on quality management of principals is with the teaching union.
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.	No action taken.

However, access to finance is not the only reason for the limited take-up of higher education. Poor performance of primary and secondary schools are the main reasons for the limited access to higher education (OECD, 2013a; DHET, 2016). Only 14% of 25-34 year-olds have a university degree. This partly results from high drop-out rates in school, with only 40% of initial students graduating from secondary school. The need to raise quality and access to primary and secondary education should be a priority, and was discussed in depth in the previous Surveys (OECD, 2013a, 2010a). However, raising tertiary education can help firms to grow and create jobs, and enhance competitiveness.

Deepening regional integration within the Southern African Development Community

Regional economic integration can raise potential growth and create jobs in Southern Africa, where 7 out of 15 countries are landlocked and fragmentation into many small countries is important. SADC is already the largest export market and a major investment destination for South Africa. South Africa, as the largest member of SADC, should exercise more leadership in deepening regional integration and implementing existing agreements.

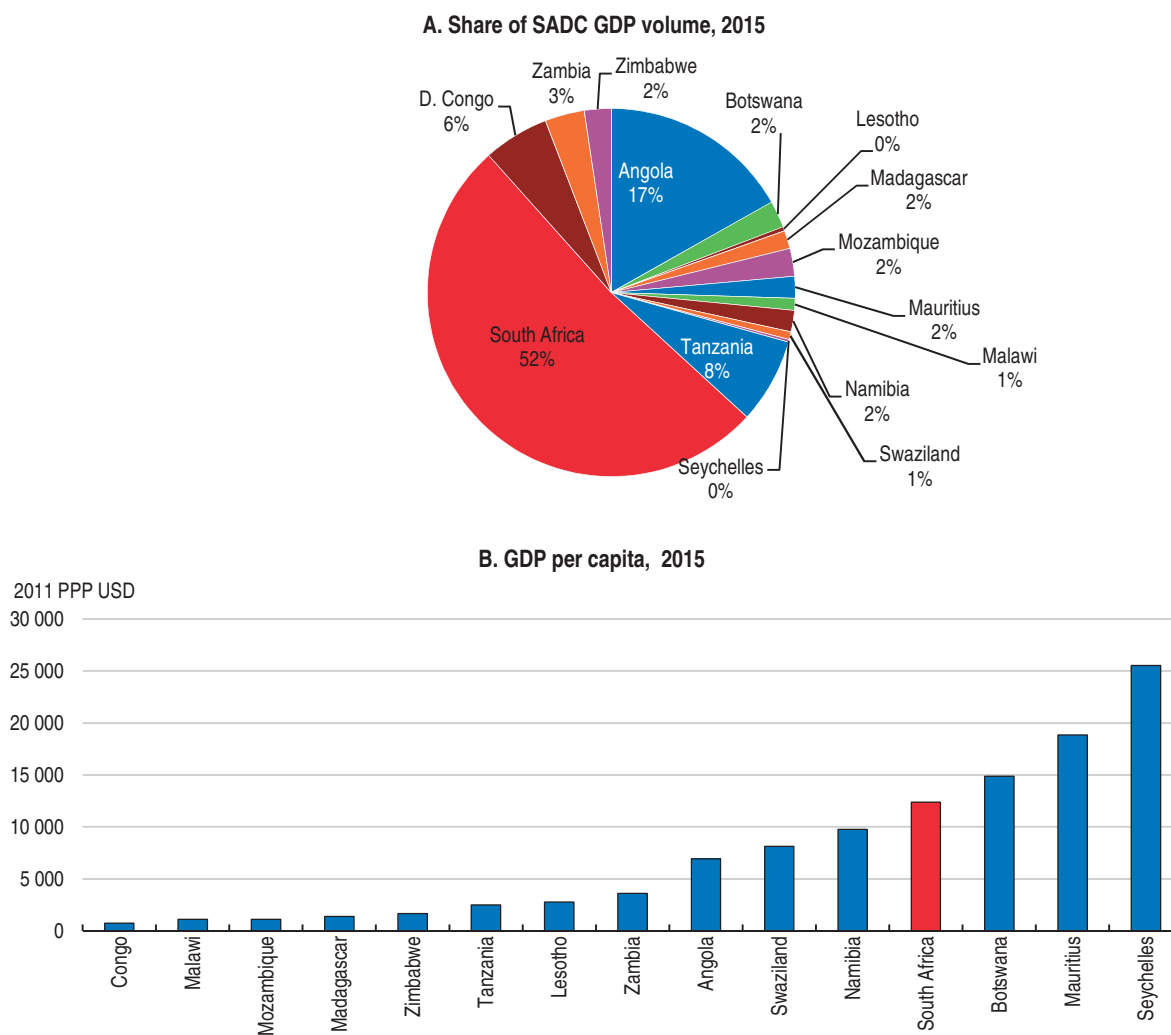
The Southern African Development Community (SADC) was established in 1992 with strong political commitments to integration. SADC initially prioritised trade and after long negotiations a free trade area was completed in 2008 with tariffs eliminated on 85% of traded goods among 13 of the 15 members. Angola and the Democratic Republic of the Congo are still outside the free trade area. South Africa is also a member of a customs union, SACU, with some members of the SADC, and a monetary union with Lesotho, Namibia and Swaziland. Economic integration in practice has been slow. There are important differences in terms of GDP levels and revenue per capita between SADC countries (Figure 16).

SADC intra-regional trade is low but has great potential

SADC intra-regional trade has increased only modestly since the establishment of the free trade area in 2008 and at 10% of total trade is low compared to about 25% in the ASEAN or 40% in the European Union (Figure 17). Intra-regional trade is dominated by South Africa, the largest member, which exports more to the region than it imports from it (Figure 18). This makes SADC trade dependent on South Africa's economy and interest in fostering regional integration.

SADC members have similar economic structures and endowments with exports dominated by non-processed goods such as crops, minerals and other natural resource-based products. They tend to compete with each other rather than be complementary. Manufacturing exports are also very similar. However, high barriers to trade prevent the exploitation of comparative advantages based on differences in costs. The greater diversification of the South African economy compared to other members points to potential to exploit more traditional comparative advantages in more complementary goods, or trade in services. Estimations by Fall et al., (2014) show that while the development of manufacturing increased intra-regional trade in ECOWAS, it had negative effects in SADC, confirming the low complementarity of SADC countries. Potential for intra-industry trade, which generally includes trade in more sophisticated products within the same industry, can be limited given the types of goods traded.

Trade impact and potential can be assessed by gravity equations of bilateral trade (see Chapter 1). The estimations indicate that most of the free trade areas in the world have

Figure 16. **Size of SADC countries in terms of GDP**

Source: World Bank, World Development Indicators database.


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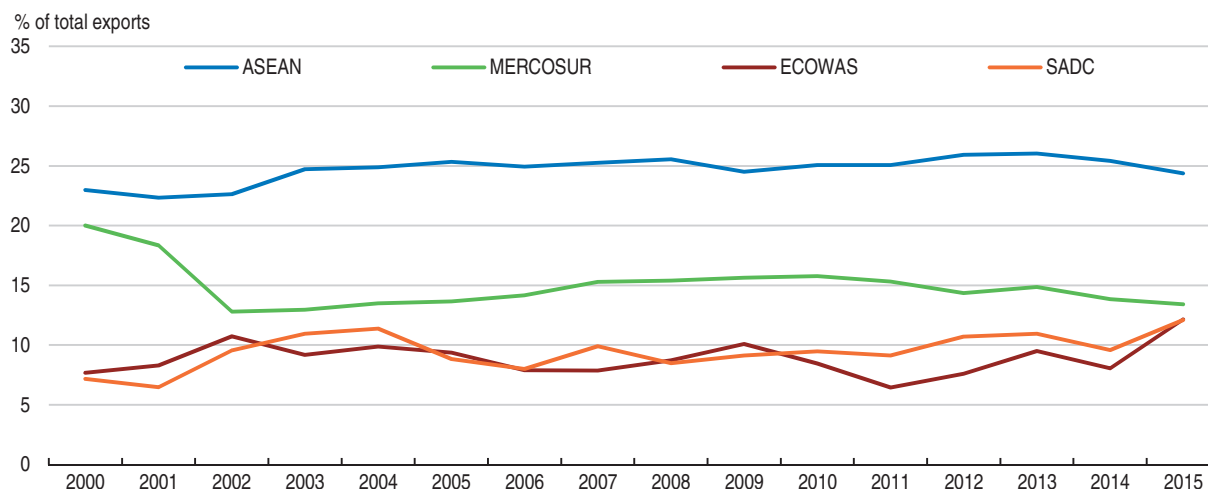
Table 9. **Past recommendations for regional integration**

Recommendations from previous <i>Surveys</i>	Action taken since July 2015 <i>Survey</i>
Further develop pro-growth regional policies which focus on skills formation, investment and infrastructure in a co-ordinated way.	In 2016, SADC approved a USD 3.5 million feasibility study for a regional project to expand and transmit Mozambique's hydro power and diversify South Africa's electricity supply.
Resume trade policy measures that enhance international integration, including with developing countries, by reducing barriers to trade.	A free-trade agreement was reached between SADC and EAC and COMESA in 2016, agreeing on tariff liberalisation and related rules.

boosted trade. Although bilateral trade among SADC members increased by 62% after the free trade agreement, it rose by 90% in the EU and 141% in the Andean community between 1984 and 2014. These results suggest that deeper SADC regional integration can boost growth substantially.

Greater participation in value chains could also foster intra-regional trade. Success will depend partly on the capacity of member countries to increase their sourcing in the region to create more value for exports. The origin of exported value-added in SADC is

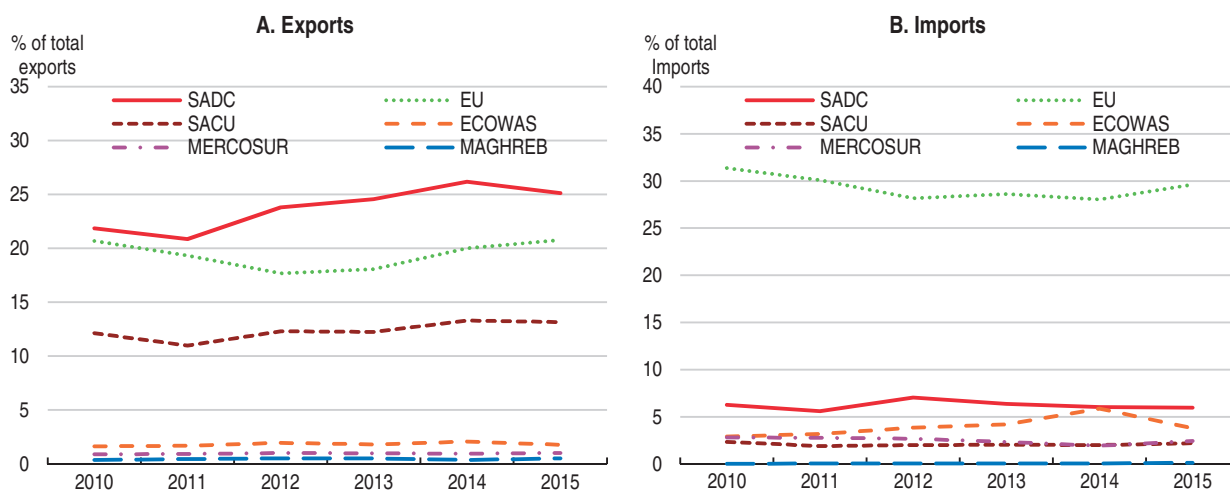
Figure 17. **SADC intra-trade compared to other free trade areas**
Share of intra-regional exports



Source: IMF, Direction of Trade Statistics (DOTS); World Bank.

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Figure 18. **South Africa trade with SADC compared to other regions**



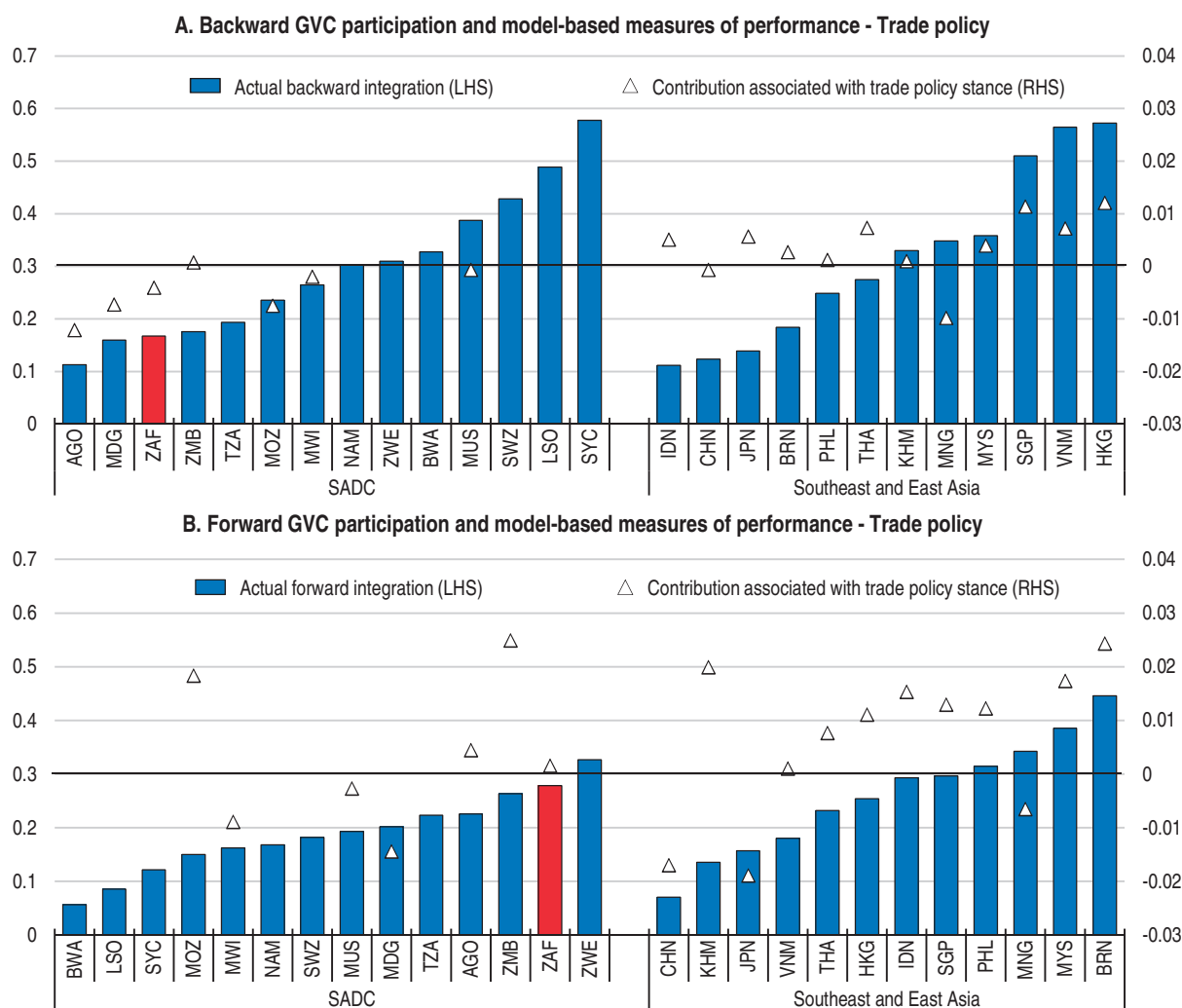
Source: IMF, Direction of Trade Statistics (DOTS).

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mainly domestic (80%) (Chapter 1). Better trade policies (lower tariffs and larger share of imports covered by free trade areas) could improve GVC participation of SADC countries (Figure 19.A and Kowalski et al., 2015).

Reducing tariff and non-tariff barriers would foster regional trade integration

Trade of SADC countries faces higher tariffs on external trade than many other regional trade groups (Figure 20 and UNCTAD, 2015). For example, for the EU, external tariffs are not detrimental to intra-trade. Low external tariffs are important for imported intermediate inputs. As most of the SADC countries have high external tariff rates, there is room to reduce these tariff rates.

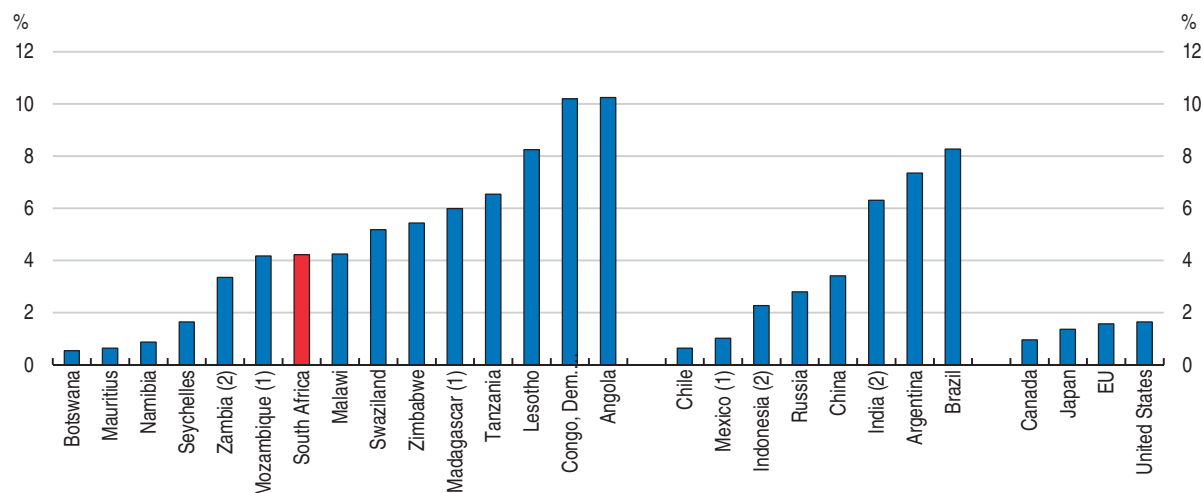
Figure 19. **GVC participation and contribution of trade policies**

Source: OECD calculation based on EORA database.

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Customs procedures are complex within SADC compared to the OECD and emerging economies on average (Chapter 1). The multiple memberships of SADC countries in different free trade areas increase the difficulty for customs officers to establish the precise preferential tariffs applicable to each product. Transporters complain that borders do not operate on a 24-hour basis, of electrical and technical shutdowns in the border systems, and incompatibility of customs systems between countries raising costs (Vilakazi and Paelo, 2017; UNCTAD, 2015).

Customs strategies often focus on revenue mobilisation at the expense of trade facilitation. Some SADC members have even raised import tariffs on products originating from the region to raise revenue – in flagrant violation of their regional tariff liberalisation commitments (Shayanowako, 2015). Moreover, the incidence of custom corruption remains high (Shayanowako, 2015). Introducing a computerised one-stop border control point between SADC members can improve co-ordination between countries and help fight corruption and unnecessary red tape. The data gathered from border control points should

Figure 20. **Tariff rates are relatively high in SADC countries**Tariff rate, applied, weighted mean, all products³, 2015

1. Numbers are for 2014.

2. Numbers are for 2013.

3. Weighted mean applied tariff is the average of effectively applied rates weighted by the product import shares corresponding to each partner country. Data are classified using the Harmonized System of trade at the six- or eight-digit level. Tariff line data were matched to Standard International Trade Classification (SITC) revision 3 codes to define commodity groups and import weights. To the extent possible, specific rates have been converted to their ad valorem equivalent rates and have been included in the calculation of weighted mean tariffs. When the effectively applied rate is unavailable, the most favoured nation rate is used instead.

Source: World Bank staff estimates using the World Integrated Trade Solution system.

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then be collated to provide shared trade and investment statistics for the region. Finally, accelerating the adoption by all SADC countries of legislation facilitating inter-agency co-operation, advance rulings and post-clearance audit would facilitate intra-regional trade.

Rules of origin can become a non-tariff barrier. In a free trade area, rules of origin are set to prevent tax avoidance by exploiting differences in tariffs among member countries. Rules of origin are defined to guarantee that substantial transformations happen on imported goods within the region. Rules of origin are most important for manufactured goods.

SADC has adopted rather complex rules of origin, defined product by product and requiring double-stage transformation. A simpler alternative would be the across-the-board approach adopted by the Common Market for Eastern and Southern Africa (COMESA). In SADC the rules of origin were mainly designed to protect existing industries from increased intra-regional competition, in particular the textile and clothing industry in South Africa (Brenton et al., 2005). The complex and restrictive input-sourcing requirements of the SADC rules of origin have a negative impact on trade and attractiveness for industrial investment. In the absence of simplified rules of origin, the manual by the SADC Secretariat for rules of origin (SADC, 2003) should be applied by all member countries.

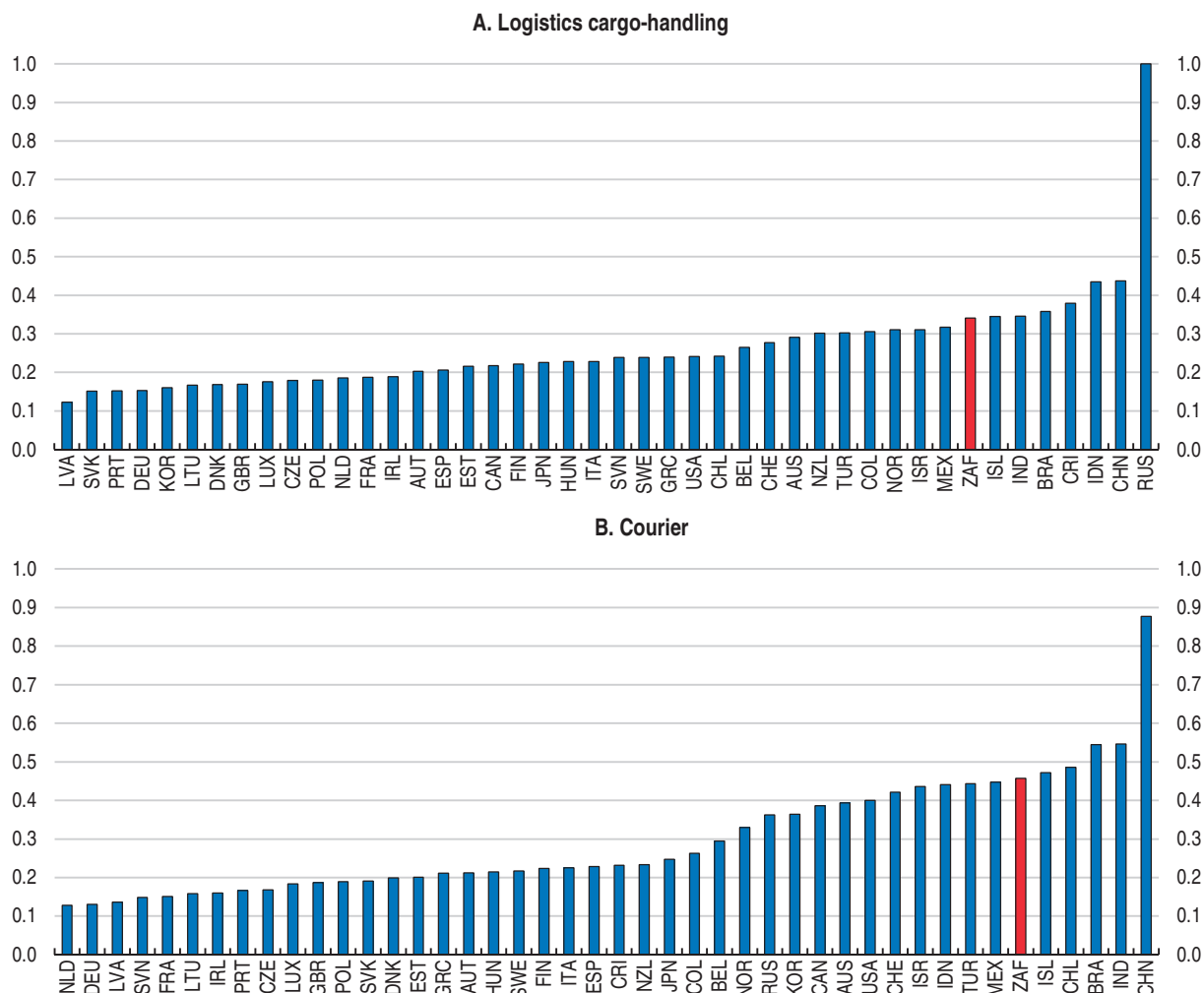
Broadening the scope of the trade agreements could boost regional trade and integration

SADC members adopted a Protocol on Trade in Services in August 2012 aiming to establish an integrated regional market for services (SADC, 2012). The Protocol was amended in August 2016 as the negotiations dragged on. Service trade liberalisation within the region would allow consumers and businesses to have access to better services at lower prices through competition. Services are an important part of GDP: in South Africa the services

sector already represents 70% of GDP and 16% of its exports. South Africa's services trade restrictiveness is relatively high for some services (Figure 21).

Figure 21. **Restrictions on foreign provision of some services are high relative to other countries**

OECD Services Trade Restrictiveness Index¹



1. STRI indices take the value from 0 to 1, where 0 is completely open and 1 is completely closed.

Source: OECD Services Trade Restrictiveness Index database.

StatLink  <http://dx.doi.org/10.1787/888933552663>

For the effective implementation of the SADC Protocol on services, a directive could establish a timeline and guidelines for services liberalisation and provide derogations where needed (Cronjé, 2014). Also, services trade liberalisation should respect service regulations taking into account norms and standards. There is a need for coherent regulatory policies across member states in many regulated services and regional regulatory co-operation.

Moreover, the Southern African Customs Union (SACU) arrangement has many internal difficulties with knock-on effects on SADC regional integration. Intra-union customs border posts have not been eliminated because revenue sharing is partially based on intra-SACU trade, thus reducing benefits of trade facilitation. Second, there is a substantial income transfer from South Africa to the other members. SACU revenues now represent the main source of government revenues for SACU members, except South Africa (Chapter 1). This

has created perverse incentives across the other SACU members to resist any changes to tariffs and extension of the SACU union to new members (Flatters and Stern, 2006). Reforming the SACU sharing formula and mechanism of tariff settings would ease the negotiations toward customs policy harmonisation.

Economic Partnership Agreements (EPA) were introduced by the Cotonou Agreement in 2000, marking a major change in the trade relationship between the EU and developing countries (Chapter 1). Non-reciprocal trade preferences that existed under the previous agreements were replaced by a reciprocal trade arrangement that also offers duty-free access for EU exports in developing countries' markets. However, the negotiations and agreement on EPAs have proved difficult. So far, agreements have been concluded with six SADC countries (Botswana, Lesotho, Namibia, South Africa, Swaziland and Mozambique), which were provisionally applied as of 10 October 2016 pending ratification by all EU Member States. Mozambique is expected to ratify in 2017.

The EPAs contain some safeguards reducing their scope. Export taxes are allowed for some exports for a period of 12 years at predetermined rates. On agricultural exports, flexible activation clauses are included, permitting to protect, when deemed necessary, local producers from large inflows of EU goods and the EU has agreed to eliminate subsidies on several exported goods.

The agreement between a fraction of SADC countries and the EU will increase the fragmentation of SADC trade agreements, which could hamper deeper SADC integration. To avoid this, members should agree to negotiate with external partners only under the SADC umbrella based on a binding and robust framework which guarantees that all countries' concerns are taken into account.

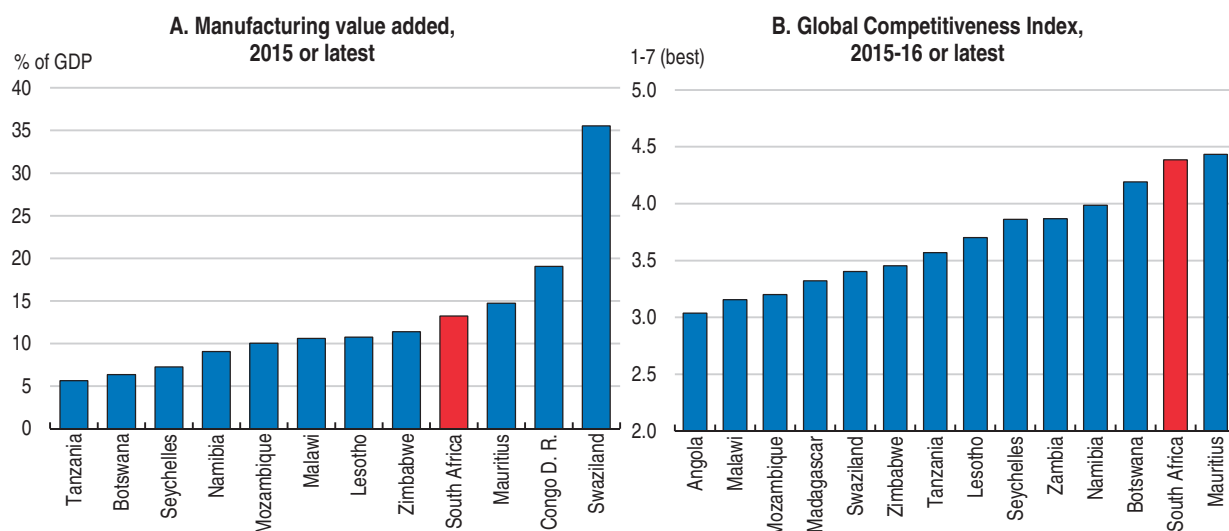
Reforming business environments in the region can strengthen regional integration

The level of industrialisation is low across SADC countries (Figure 22 Panel A). Even in South Africa, which has the most sophisticated industry in the region, the share of manufacturing in GDP is low. SADC countries have failed so far to increase value added in sectors such as minerals and raw materials. Therefore, regional industrialisation has become a top priority in the SADC regional strategy. Member states adopted the SADC Industrialisation Strategy and Roadmap 2015-2063 in 2015. The industrialisation strategy rests on increasing productivity through manufacturing, including agro-processing and minerals transformation.

The main barriers to the development of industry in the region are related to the business environment. Lack of proper infrastructure and institutions, skill shortages, and complex regulations are common across SADC countries, as well as regulatory barriers and monopolistic behaviours that hamper competition. To enhance the business environment, increasing the stock of human capital is necessary. More effort should be put in developing vocational and training skills, and access to higher education. A complementary policy at the regional level would be to advance the negotiations on mobility of workers and business people (Mevel et al., 2015).

The experience of special economic and processing zones is not positive in Africa in general (Farole, 2011), except in Mauritius. Most have relied on tax incentives and holidays, which are ineffective if the business environment remains complex. More focus should be put on infrastructure quality, business environment and linkages with the rest of the economy to create agglomeration effects to make special economic zones successful.

Figure 22. Degree of industrialisation and competitiveness of SADC countries

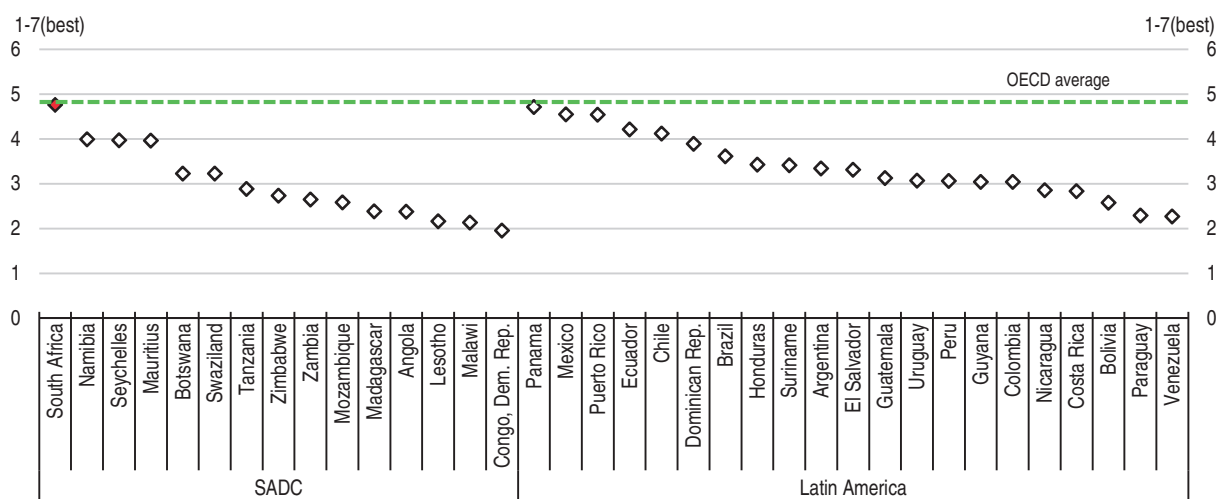


Source: World Bank; World Economic Forum, The Global Competitiveness Index.

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Infrastructure plays a major role in growth in Southern Africa (Foster, 2010) and gaps remain important within SADC. The quantity and quality of transport infrastructure is low. Only South Africa is close to the OECD average on the index of transport infrastructure (Figure 23). Even in South Africa, there is ample room to improve the quantity and quality of infrastructure, and lower costs (OECD, 2015a).

Figure 23. Transport infrastructure compared to OECD average



Source: World Economic Forum, Global Competitiveness Report, 2016-17.

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At the regional level, co-operation on infrastructure has progressed slowly. Road agencies have been established in almost all countries, easing the collaboration between member countries. Also, the highway linking South Africa to Mozambique has been built with the participation of the private sector (SADC, 2015). In the energy sector, the creation

of the Southern African Power Pool helped accelerate regional co-operation resulting in the establishment of the power trading platform and the connection of nine SADC countries to the regional grid.

Infrastructure funding remains an issue. SADC members have agreed to set up a Regional Development Fund in August 2016 aiming at an initial capital of thirteen billion dollars (SADC, 2016). Accelerating the ratification of the agreement and subscription of the capital is necessary for the commencement of operations by the Fund. Encouraging private sector participation could increase funding and enhance project management capacity.

To foster investment across member countries and attract foreign investment, SADC countries signed a Protocol on Finance and Investment in 2006. Investment has risen subsequently along with the acceleration of trade between SADC members, although investment flows across and toward SADC are still low (Figure 24). The stock of cross-regional investment is lower than in other regional economic communities in Asia and Latin America. Intra-regional investments have been mostly driven by the development of regional value chains in the services sector (supermarket, banking, etc.).

Despite the signature of the SADC Protocol on investment and financial integration, bottlenecks to investment inside the region have remained high. The SADC Regional Investment Policy Framework has been developed recently, in co-operation with the OECD and NEPAD, to accelerate the harmonisation and implementation of investment policies in the region. Incorporating the regional framework into domestic reforms is crucial for its implementation.

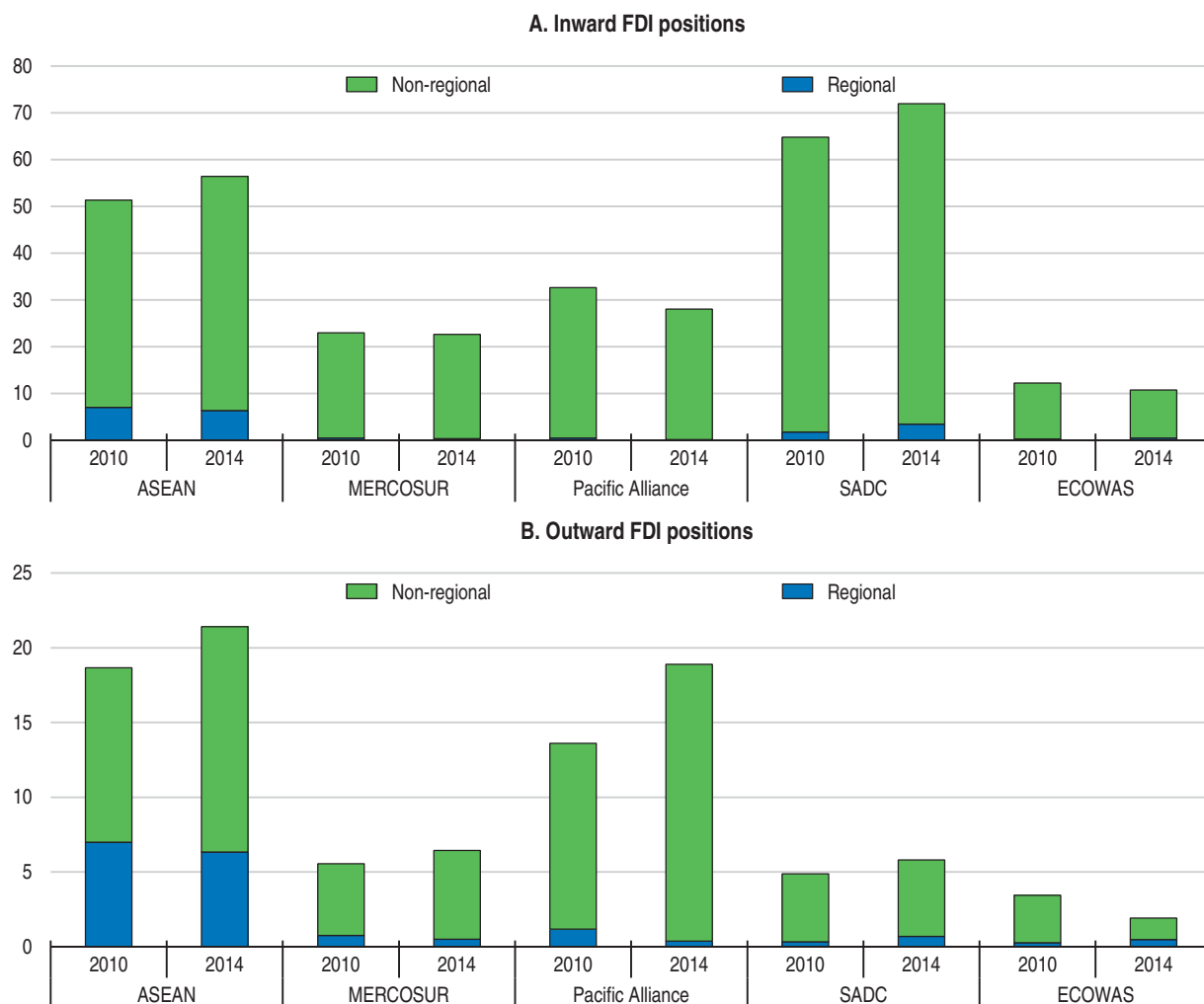
A SADC/OECD (2017) benchmarking exercise confirmed that reforming the framework conditions and improving infrastructure are essential to attract investment. Establishing a central point to co-ordinate and systematically gather comprehensive, up-to-date information on all laws, regulations, incentive schemes, and procedures related to investment, is necessary in the region to increase attractiveness.

The financial sector in SADC is diverse and fragmented. Currency conversion costs are high and most countries still have restrictive exchange and capital control regulations in place (Maveé et al., 2016). Cross-border transactions face different regulatory frameworks. SADC has put in place memoranda and guidelines to improve coordination, to harmonise the systems and to establish common frameworks for foreign exchange transactions, capital controls and banking procedures (SADC, 2009; SADC, 2011).

A regional cross-border settlement system, the Integrated Regional Electronic Settlement System (SIRESS) was introduced in 2013 to ease financial transactions within the region. SIRESS was first piloted in the four Common Monetary Area countries that use the South African Rand (South Africa, Lesotho, Namibia and Swaziland) and was later rolled out to other member countries. The system allows for real-time settlement of payment transactions between countries based on a single currency – the South African rand.

The introduction of SIRESS is an important first step for greater integration. However, as the use of the rand as the base currency presents some challenges due to the trade imbalance between South Africa and the other countries, SADC countries are considering making SIRESS a multi-currency payment system. The use of the rand within SIRESS presents opportunities to eliminate exchange risk associated with cross-border transactions and enhance intra-SADC trade and investment.

Figure 24. **FDI position of SADC relative to other regional economic communities**
Inward and outward FDI positions by regional cluster, % of GDP

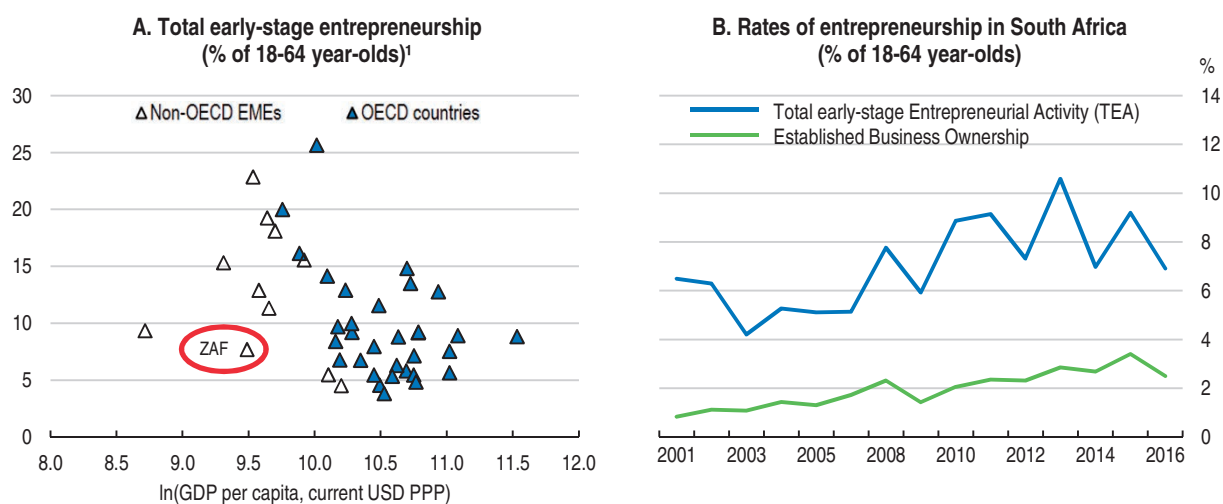


Source: OECD (2017), "Regional Global Value Chains in SADC", OECD 2017 forthcoming.

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Boosting job creation in South Africa through more start-ups and SME growth

A more dynamic business environment, with higher rates of entrepreneurship and small business growth, could play an important role in creating much-needed jobs and investment in South Africa, thereby making growth more inclusive. Large and old firms continue to dominate the economy and employment dynamics. Elsewhere, young firms have been major net creators of new jobs and small firms typically account for a large share of employment (Criscuolo et al., 2014; OECD, 2016a). In South Africa, the rate of early-stage entrepreneurial activity (planning or starting a business in the formal or informal sector) is relatively low compared to other emerging market economies (Figure 25, Panel A). The increasing trend during the 2000s has flattened out (Figure 25, Panel B). The self-employment rate and the share of the population engaged in informal employment are also comparatively low, especially given high unemployment. A new firm-level dataset compiled from tax records suggests that entry rates may be lower than exit rates, reinforcing the dominance of old large firms (Tsebe et al., 2017).

Figure 25. **Start-up activity is low**

1. Average of 2014-16 where data are available. GDP data are from 2015. Non-OECD emerging market economies (EMEs) are: Argentina, Brazil, China, Colombia, Costa Rica, India, Indonesia, Malaysia, Russia, South Africa and Thailand.

Source: Global Entrepreneurship Monitor; World Bank.

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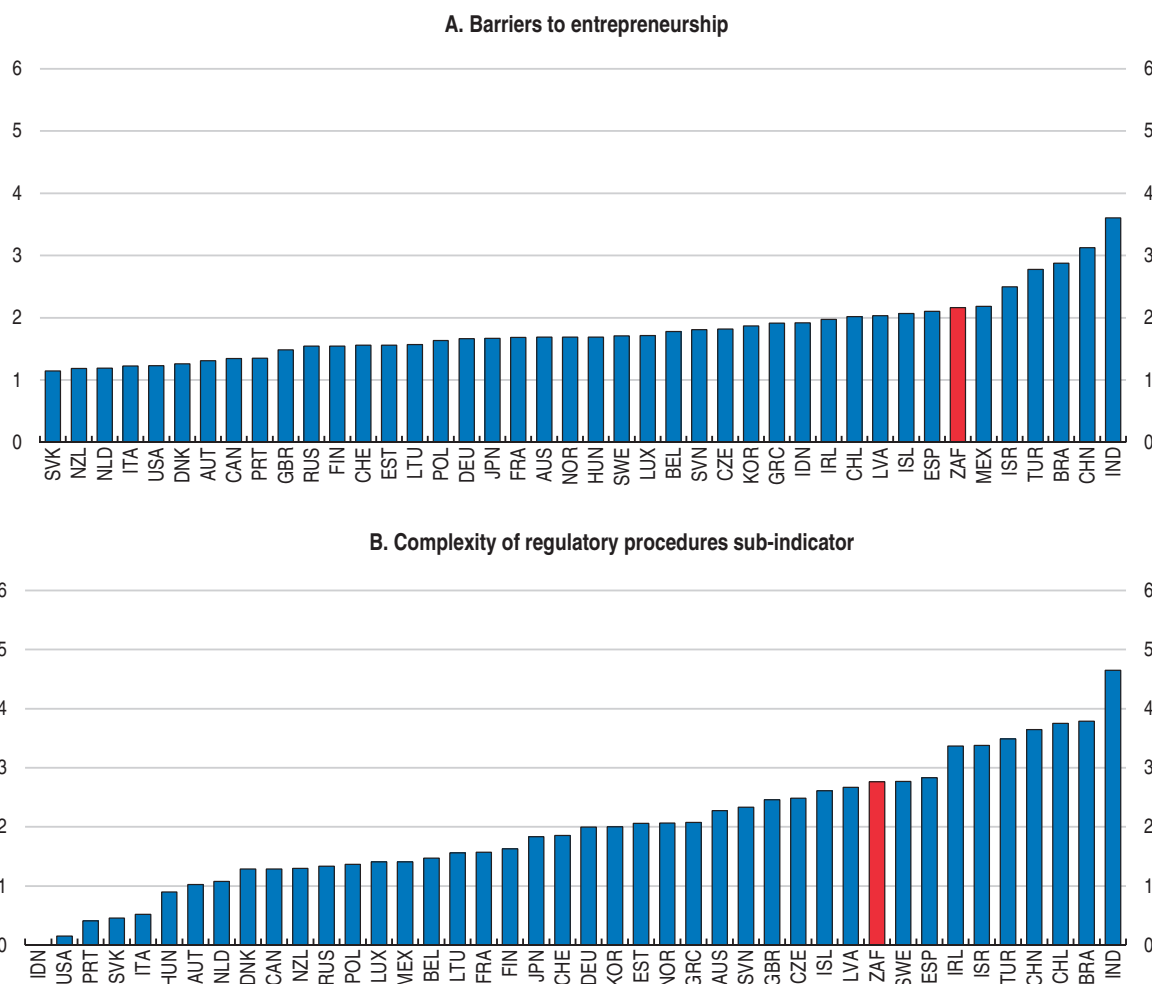
Regulatory barriers constrain entrepreneurship and small businesses

A burdensome regulatory environment has been found to reduce the rate of entrepreneurial activity and business ownership (Ardagna and Lusardi, 2010; Klapper et al., 2008). Regulation is disproportionately more costly for small and young firms and discourages informal firms from formalising (Andrews et al., 2011). South Africa ranks 74th in the World Bank's Ease of Doing Business index and the regulatory burden is high. The complexity of regulatory procedures – such as licensing and the communication of regulation – contributes to the barriers to entrepreneurship (Figure 26). Regulatory protection given to incumbents (in particular, state-owned companies in network industries) creates further barriers (OECD, 2015a). Local governments add to the burden through licence and permit systems, by requiring multiple inspections to obtain a licence, for example.

The government has taken steps to make it easier to register a business, notably by automating business registration. However, other processes to start a business remain more time-consuming and bureaucratic than in other countries (Figure 27). In practice, delays in registration, often associated with value-added tax, can mean that starting a business takes six months (ILO, 2016). Registering employees for the occupational injuries compensation fund can take 30 days (World Bank, 2017). Greater use of technology could speed up processes. Plans to allow electronic registration for the compensation fund will help. E-signatures have helped Mexico and Chile reduce each step of starting a business to 0.5 to 1 day (OECD, 2016b).

The government will open one-stop shops – primarily targeted at attracting foreign investment – in four provinces in 2017. Each province will have a one-stop shop in the next three years. Expanding the physical and virtual reach of these one-stop shops is important to ensure that new and small businesses can access the service. The one-stop shops should allow entrepreneurs to register a new business and apply for local and national government permits. Co-locating these with local governments or other government offices and creating a virtual one-stop shop would improve access to this service. The

Figure 26. **Regulatory barriers to entrepreneurship are high**
 OECD product market regulation indicators, 2013¹

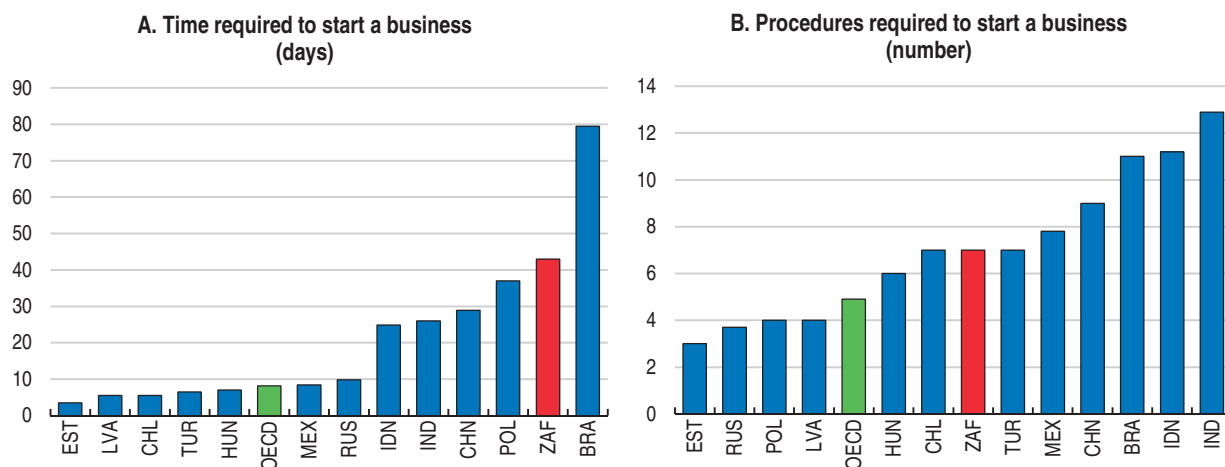


1. Scores potentially range from zero to 6 and increase with restrictiveness. 2008 data are used for Indonesia and the United States. Source: OECD (2013), "Economy-wide regulation", OECD Product Market Regulation Statistics database.

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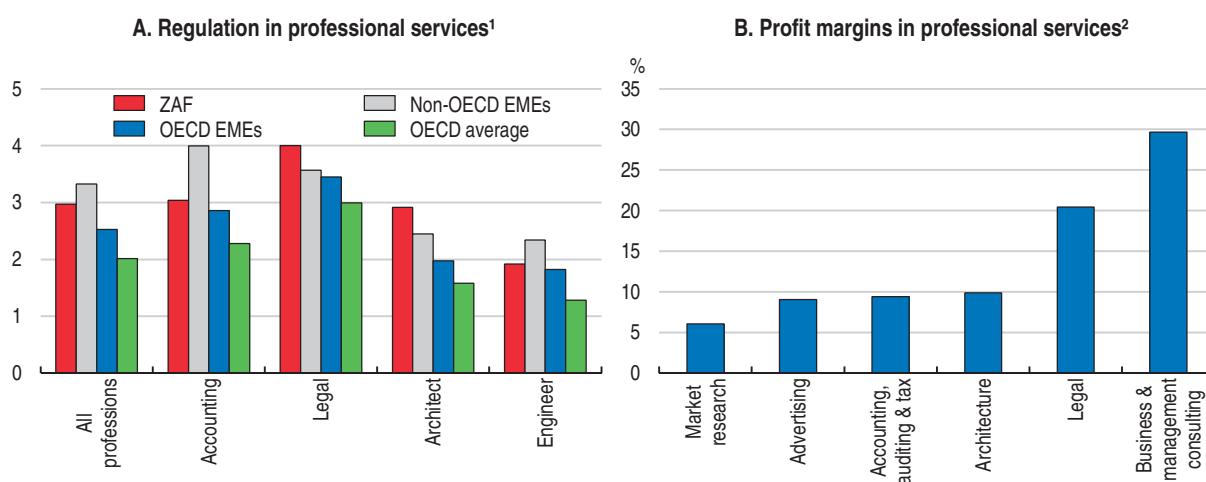
information should be shared within the government so that firms only provide information to the government once. Staff should be aware of government programmes for small business and their requirements.

Sector-specific licences are an entry barrier and an additional cost to business, and their policy aims such as consumer protection can often be achieved in other ways. For example, tourist guides must be trained and registered but they may only register in the geographical area and type of guiding on their certificate. Professional services are also highly regulated, particularly legal services, creating a barrier to entry (Figure 28, Panel A). In the case of legal services, it appears that these may be contributing to high prices (Figure 28, Panel B). There may also be a shortage of lawyers (McQuoid-Mason, 2013). One result may be that small businesses choose to represent themselves when resolving labour disputes, which is costly. Reducing the restrictions on foreign provision of services such as logistics cargo-handling and courier services, which the OECD Services Trade Restrictiveness Index shows are high relative to other countries, would also allow firms to access cheaper and better services.

Figure 27. **Starting a business is slower than in many other emerging economies**

Source: World Bank (2017), Doing Business database.

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Figure 28. **Some professional services are highly regulated**

1. Scores potentially range from zero to 6 and increase with restrictiveness. The emerging market economies are 5 non-OECD member countries (Brazil, China, India, Russia and South Africa, with varying coverage) and 5 OECD members (Chile, Hungary, Mexico, Poland and Turkey). Data for 2013 or latest.

2. Net profit before interest, tax and dividends as a percentage of turnover in 2015.

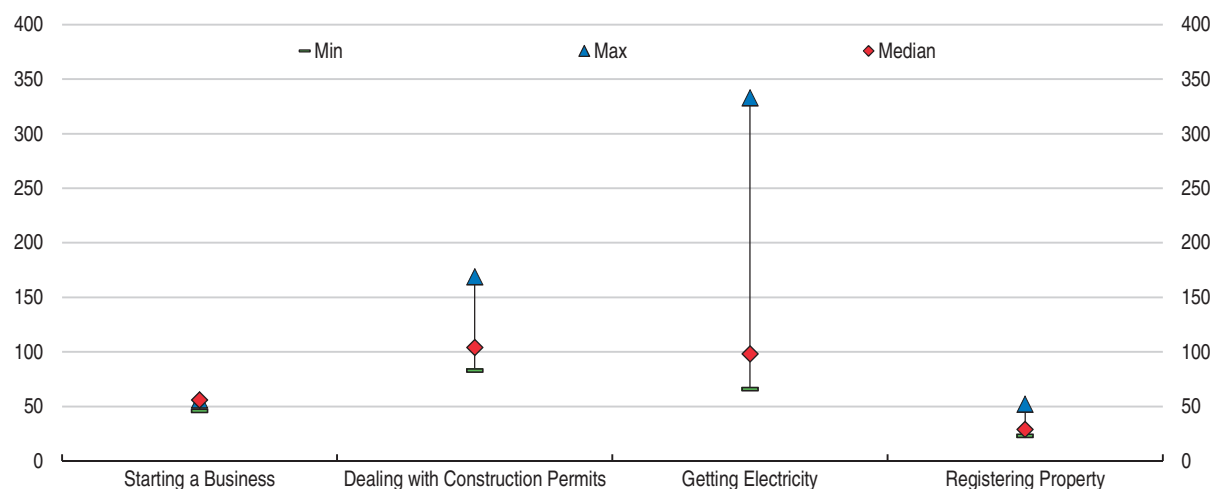
Source: OECD, Product Market Regulation Statistics (database); Statistics South Africa, Annual Financial Statistics survey 2015.

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A whole-of-government reform programme to reduce the administrative burden could boost confidence, start-up rates and growth. For instance, reducing regulation to best practice in three areas: licensing and permits (e.g. Portugal, Slovak Republic); communication and simplification of rules and procedures (e.g. Korea, Russia); and barriers in the services sectors (e.g. Australia) could boost GDP per capita by 1.1% over five years under certain assumptions (based on the framework in Égert and Gal [2016]) and increase formalisation. A reform package could include: i) a “silence is consent” rule for licensing where risks to consumers and the environment are low; ii) a red-tape reduction programme and review of licensing of services as done, for example, in Mexico with the

OECD *Competition Assessment Toolkit*; and iii) one-stop shops for start-ups and permits. The *Doing Business* sub-national indicators highlight the substantial scope for further peer learning between sub-national governments (Figure 29). The government is working with the World Bank to improve these processes in the largest municipalities.

Figure 29. **There is considerable variation in regulatory procedures across cities**
Number of days taken, by city



Source: World Bank (2015), *Doing Business in South Africa 2015*.

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Regulations require systematic assessment, both before and after their introduction. A red tape impact assessment bill currently with the parliament goes in the right direction in trying to reduce the regulatory burden. A new Red Tape Impact Assessment Unit would review all new legislation and determine whether a full “red tape impact assessment” is needed. The new legislation would also require all departments and self-regulatory agencies to evaluate existing regulation and reduce red tape by 25% over five years. Expertise could be concentrated and accumulated if the envisaged Unit was located at the Department of Planning, Monitoring and Evaluation, which is responsible for socio-economic impact assessments. The Department could be made responsible for driving a regular review process for regulation.

Lowering the cost of failure and therefore risk of entrepreneurship may also boost start-up rates (Peng et al., 2010). Personal insolvency procedures are often important for entrepreneurs because they are required to give personal guarantees (Adalet McGowan and Andrews, 2016). The South African regime is widely regarded as pro-creditor (Boraine and Roestoff, 2013). It is a court-heavy process and discharge is only automatic after 10 years; the European Union recommends three years for honest entrepreneurs. Moreover the regime is only accessible to those with means to partly pay creditors; those without income or assets remain in debt. Legal reform has been planned since 1987. Modernising the regime could reduce the risks associated with entrepreneurship.

The corporate insolvency framework compares fairly well to other countries but the recovery rate is low (World Bank, 2017). Recovery rates tend to be higher where restructuring is used more often (Adalet McGowan and Andrews, 2016). Although a business rescue regime was introduced in 2011, its success rate of just 16% of proceedings suggests it is still

developing. Further efforts to increase take-up are needed, including increasing the supply of practitioners and promoting early warning indicators.

Public procurement is also being used to support small businesses by increasing their access to markets. In South Africa preferential procurement has focussed on previously disadvantaged groups, which includes small business. High levels of procurement spending – 12% of GDP in 2014 – imply that procurement policies have a large reach. From 2017 preferential procurement is more strongly targeting microenterprises and black-owned small businesses. From April 30% of every large contract must be, where feasible, sub-contracted to these firms. Procuring agencies can further restrict the sub-contracting to black-owned firms, or even more narrowly within this group to firms owned by youth or women or other disadvantaged groups. Agencies can also use pre-qualification criteria to restrict tenders to targeted groups. The recent digitalisation of procurement processes means that these changes can be monitored closely. The changes should be reviewed after 12 months to understand their costs and benefits on value-for-money and targeted groups. Publishing information on procurement from targeted groups by each government purchaser would increase transparency and accountability.

Further steps should be taken to level the playing field for small firms. The online portal should always contain tender documentation and allow online submission. Compulsory briefings should be limited. Speeding up payment times would help small firms' cash flows; 45% of procuring agencies exceeded the 30-day limit in 2015/16 (Auditor-General of South Africa, 2016). Many OECD countries provide specific training and online information for small businesses (OECD, 2013b). The scoring system used to get a certificate to participate in procurement is burdensome for small firms (ILO, 2016; Herrington et al., 2017). Extending the exemption from one year to five years would allow new firms to grow before they needed to bear this compliance cost.

Table 10. Past recommendations for lowering regulatory barriers to entrepreneurship

Recommendations from previous <i>Surveys</i>	Action taken since July 2015 <i>Survey</i>
Support SMEs by increasing the use of regulatory impact analysis in order to reduce the regulatory burden, eliminating entry barriers, and promoting competition.	A red tape impact assessment bill is with the parliament. It would create a regulatory impact assessment unit that reviewed existing legislation.

Current competition policies constitute a barrier to entry and limit growth and inclusiveness

A more effective regulatory framework including more competition would contribute to better pricing of services and incentives to invest. This would improve competitiveness and productivity. South Africa's economy suffers from a lack of openness that affects the cost of doing business and impedes entry of new firms and growth of SMEs, thereby limiting its inclusiveness. The competition policy tends to favour incumbents, in particular big ones, in exchange for their B-BBEE programmes (Roberts, 2016). The existing structure of ownership and control excludes the majority and feeds the view that the only way to gain access to wealth is through corruption and rent-seeking (Roberts, 2016).

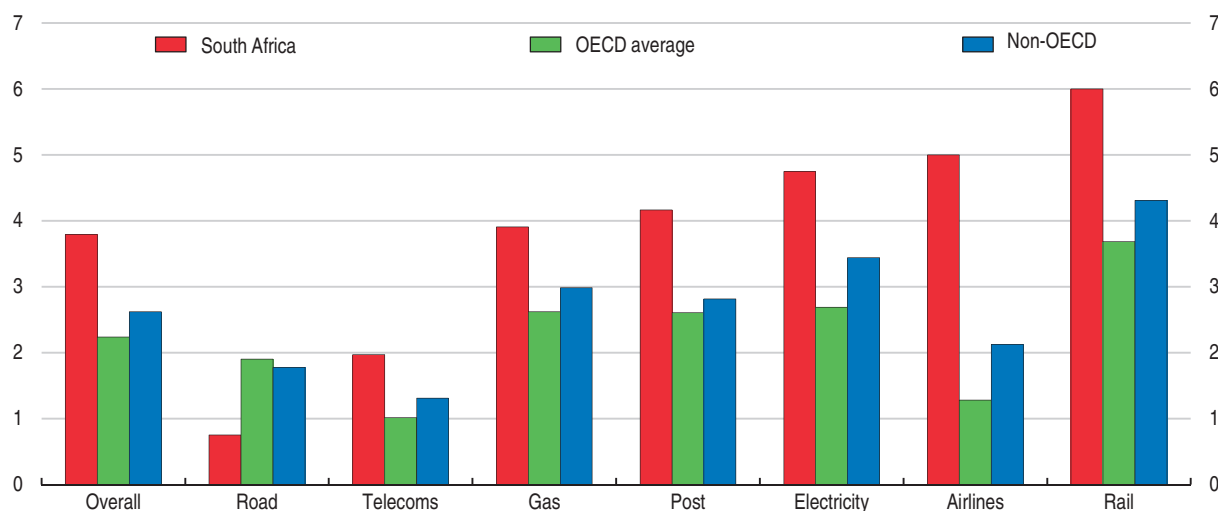
Competition authorities have been active in detecting and sanctioning cartels. Excluding construction projects, some 76 cartels were detected and sanctioned between 2005 and 2015 (World Bank, 2017). Moreover, competition law has broken up cartels in

construction and achieved lower prices for consumers, for instance in telecommunications. Amended legislation on leniency policy and criminalisation of cartel activity has been enacted and may help in reducing cartel behaviours.

The competition policy framework remains broadly at par with best practices in the OECD, and enforcement action has been ramped up in recent years. 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, 2008; Smith, 2015). Furthermore, such 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. Finally, ensuring that the integrity of the enforcement of competition policies is guaranteed is crucial. For instance, ensuring incumbents can be effectively challenged in many sectors including fuel, gas, electricity, telecommunications and banking could boost growth rapidly and broaden participation in the economy in particular of black and young entrepreneurs.


Better regulation of network industries is also important as these sectors provide inputs that are essential for firms in other sectors. In South Africa, state-owned companies dominate energy, rail transport, airports and operate in other sectors such as telecommunications. These sectors are all heavily regulated (Figure 30). For instance, as the 2015 *Economic Survey* highlighted, the electricity and parts of the transport sector have experienced capacity problems in recent years and are characterised by cross subsidies between types of users, as well as insufficient regulatory oversight and limited access of independent providers to the infrastructure (OECD, 2015a). Government investment is helping to overcome some capacity constraints. The funding, staffing, accountability and

Figure 30. **Regulation varies across industries, 2013**



Note: Index scale 0 to 6 from least to most restrictive. Non-OECD data include Brazil, Bulgaria, China, Croatia, Cyprus, Lithuania, Malta and Romania.

Source: OECD (2017), "Sectoral Regulation: Energy, transport and communications", OECD Product Market Regulation Statistics database.

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responsibilities of sector regulators are important determinants of the effectiveness of regulation (Koske et al., 2016). Giving the energy regulator greater independence in decision-making from the government and Eskom (the vertically integrated state-owned company) would improve governance in electricity. The planned Single Transport Economic Regulator should in principle address the gap in ports regulation and also rail highlighted in the 2015 *Economic Survey*. Ultimately, as the industry structure becomes more competitive, the role of the economic regulator should narrow with the Competition Commission enforcing competition.

Table 11. Past recommendations for reducing the restrictiveness of regulation and improving competition

Recommendations from previous <i>Surveys</i>	Action taken since July 2015 <i>Survey</i>
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.	The 2017 Budget allocated funds to the Department of Transport to build capacity in rail transport regulation. The creation of the Single Transport Economic Regulator is planned for 2018.
Systematically identify and eliminate competition-hampering regulation.	A red tape impact assessment bill is with the parliament. However, its focus is on reducing costs of red tape rather than increasing competition.
Privatise state-owned companies, such as telecoms, that are in markets with a sufficient degree of competition.	No action taken.

A better functioning labour market will help job creation and SME growth

Diminishing rigidities in the labour market would help accommodate the potentially negative impact of the national minimum wage on employment, productivity and competitiveness. Although there is a widespread perception amongst businesses that employment protection is high in South Africa and procedures of worker dismissal are long and costly, employment protection legislation measured by the OECD Employment Protection Legislation indicator is not particularly rigid compared to OECD or other emerging economies (Figure 31). However, procedures within the Commission for Conciliation, Mediation and Arbitration on labour issues are perceived as too long, which particularly affects small businesses. These costs are relatively more burdensome for new and small businesses.

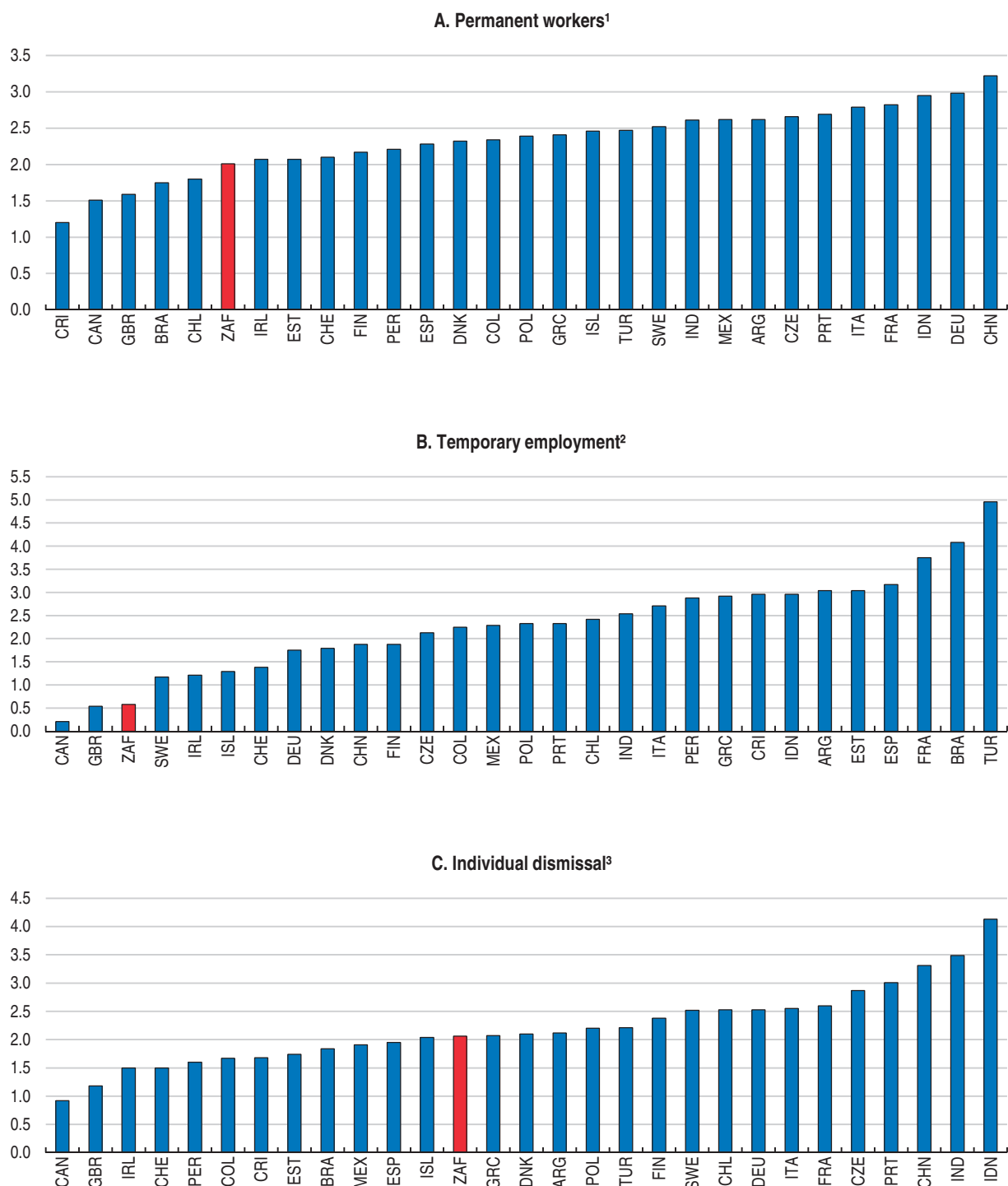
Strengthening the initial sorting of claims brought to the Commission and limiting the number of appeals and the time allowed to appeal would reduce costs of employment termination and therefore the uncertainty involved in hiring staff. More flexibility could be given to small businesses by permitting them to end employment due to unsatisfactory performance at the end of the probation period without unnecessary justifications (small businesses in Spain may use a one-year trial period) or protecting them from unfair dismissal cases for a given period, as in Australia. Moreover, to reduce hiring costs for SMEs, the services offered by public employment offices should continue to be improved, which would also better match workers to jobs (OECD, 2015a).

Filling gaps in competencies and finance to enhance entrepreneurship

Entrepreneurs draw on a range of knowledge, skills and attitudes. These include learned knowledge (like accounting and technology), resource management skills, strategic thinking skills and self-belief (Lackéus, 2015). Some of these competencies can be learned formally and others are acquired through experience. The biggest challenge in South Africa is the

Figure 31. **Indicators of employment protection legislation**

2014 or latest, 0 = very loose and 5 = very strict



1. Regulation on individual dismissal of workers with regular contracts and additional costs for collective dismissals.

2. Regulation of fixed-term and temporary work agency contracts and regulation on temporary forms of employment.

3. Regulation on individual dismissal of workers with regular contracts, incorporating three aspects of dismissal protection:
i) procedural inconveniences that employers face when starting the dismissal process, such as notification and consultation requirements; ii) notice periods and severance pay, which typically vary by tenure of the employee; and iii) difficulty of dismissal.

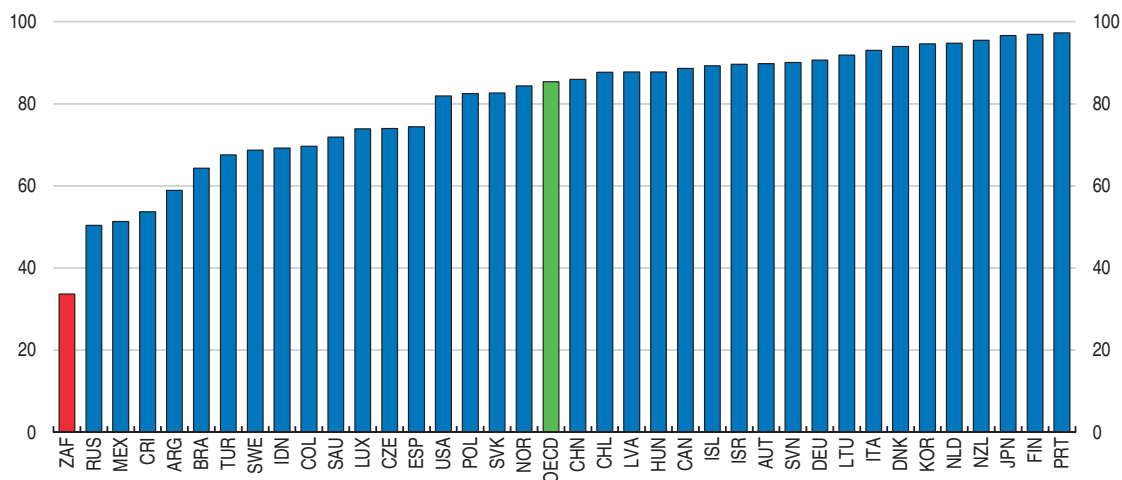
Source: OECD Employment Protection Legislation database.

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unequal quality of school education, its low average level and high drop-out rates (Figure 32). After school, access to work experience is constrained by the lack of jobs. However, survey data indicate that other supportive factors have improved. According to the Global Entrepreneurship Monitor, the share of South Africans knowing an entrepreneur has risen, as have self-perceptions of skills needed for starting a firm (Figure 33).

Figure 32. **School completion rates remain low**

Upper secondary first-time graduation rates, 2014

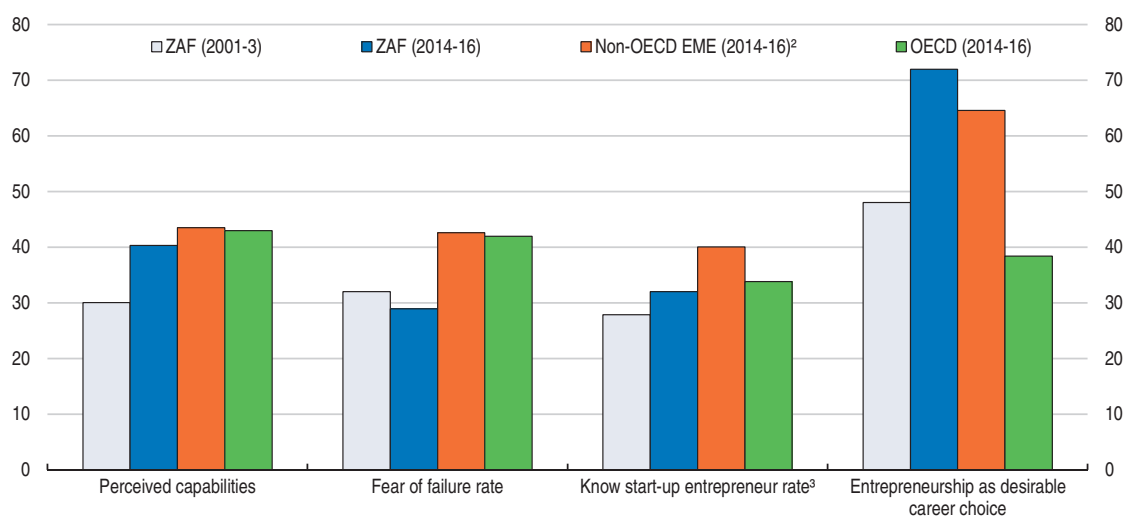


Source: OECD (2016), *Education at a Glance*.

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Figure 33. **Attitudes have become more entrepreneurial¹**

As a percentage of the population aged 18-64 years



1. Perceived capabilities: those who believe they have the required skills and knowledge to start a business; Fear of failure rate: those perceiving good opportunities to start a business who indicate that fear of failure would prevent them from setting up a business; Know start-up entrepreneur rate: those who personally know someone who started a business in the past two years; Entrepreneurship as desirable career choice: those who agree with the statement that in their country, most people consider starting a business as a desirable career choice.

2. Non-OECD EME is the average of: Argentina, Brazil, China, Colombia, Costa Rica, India, Indonesia, Malaysia, Thailand, Russia and South Africa.

3. Data for 2016 are not available.

Source: Global Entrepreneurship Monitor.

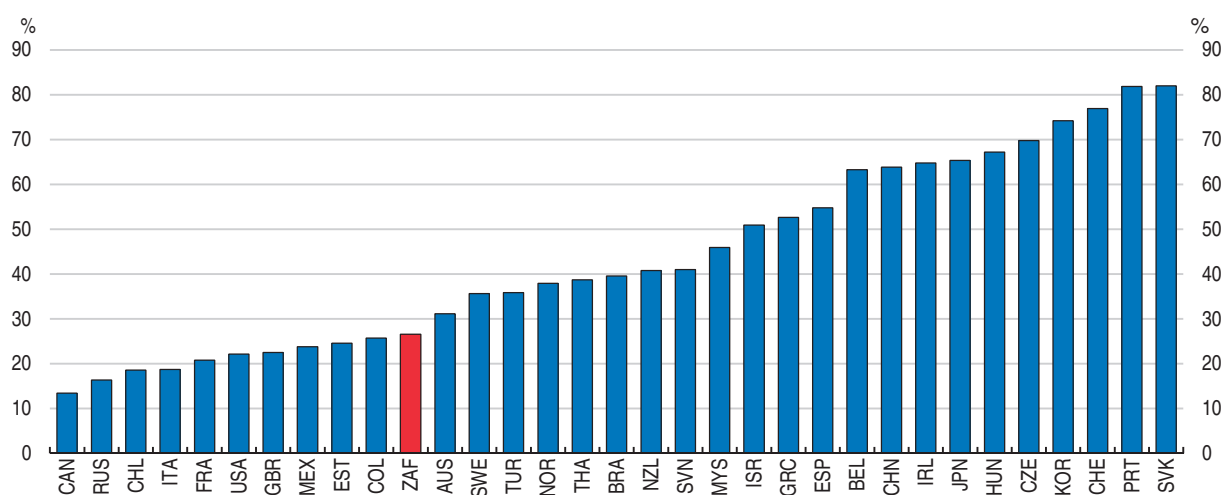
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It is critical for entrepreneurship, as well as inclusive growth, that schooling generates basic skills such as literacy, numeracy and problem-solving skills. The performance of the schooling system is poor and unequal, even though it is improving (DBE, 2016; OECD 2016c). In the latest Trends in Mathematics and Science Study (TIMSS) results, average maths and science scores of South African grade nine students were more than two years behind the average OECD country and at the bottom of the participating emerging countries (Mullis et al., 2016).

Entrepreneurship could be incorporated in the education system. Facilitating employer talks, career fairs or job shadowing for secondary school students could be cost-effective ways of providing exposure to the business environment and assisting with career decisions (Kashefpakdel and Percy, 2016; Larson, 2012; OECD, 2010b). These could be piloted in the first instance. They would especially benefit students from disadvantaged backgrounds who lack knowledge about the labour market. Entrepreneurship education programmes in TVET are “too academic and theoretical and lack the practical element” (Osiba Management, 2013). More practical course content and more use of work placements would be facilitated by better links between the system and businesses (Field et al., 2014; OECD, 2017b). Lessons could be drawn from the university sector, where centres for entrepreneurship and incubators with links to the private sector have been established. Providing extra funding to strongly performing institutions and creating a forum for sharing experiences would encourage improvements.


Start-ups and small businesses often face financing constraints due to their lack of credit history and lack of collateral. In South Africa the highly unequal distribution of wealth and low employment rate make informal finance – the usual form of start-up capital – less accessible. Credit scoring is well developed and formal lending is dominated by banks. Bank lending to small and medium-size enterprises appears low, accounting for 26% of business lending (Figure 34). The number of microfinance providers has decreased and a survey by ILO (2016) found that microfinance ranked last of 11 possible sources of finance to start a

Figure 34. SME lending is relatively low
As a percentage of total business lending, 2015 or latest



Note: Definitions differ across countries. Data for South Africa are for 2016.

Source: South African Reserve Bank; OECD (2017), *Financing SMEs and Entrepreneurs 2017: An OECD Scoreboard*; OECD calculations.

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business. Venture capital had been increasing until 2015, but there is a shortage of pre-seed capital, as discussed in Chapter 2. However, overall, there is a dearth of data on finance for small businesses.

Bank- and non-bank financing options for SMEs should be broadened, as in many countries (G20/OECD, 2015; OECD 2015c). Barriers to entry in the banking sector are reducing competition and financial innovation, and could be lowered. These include high minimum capital requirements, difficulties accessing clearance and payment systems, limitations on exit and additional barriers to foreign banks (even if they are not taking deposits) (IMF, 2014; Makhaya and Nhundu, 2015; OECD, 2016d). Regulation could be adapted to foster the use of financial innovations such as crowdfunding, and regulatory sandboxes could be used to encourage their development. India is creating an electronic exchange for trading receivables. Providing access to financial services especially for new and informal entrepreneurs would allow them to build a credit history and support efforts to improve financial inclusion. Fostering the development of the Alt-X secondary stock exchange, for instance through investor education, would support the growth of venture capital by providing an exit market and benefit the overall financial ecosystem (Nassr and Wehinger, 2016).

Government programmes should be better co-ordinated

The government provides financial and non-financial support programmes for micro and small businesses, some of which target sub-groups, such as youth or previously disadvantaged groups. Sub-national governments have been increasingly active in running support programmes for entrepreneurs and small businesses, including informal businesses and those in townships. There is also a range of non-governmental programmes, including those run by the private sector associated with their spending targets under Broad-based Black Economic Empowerment policies.

International evidence suggests the most effective elements of entrepreneurship programmes have been business training and business development services (Grimm and Paffhausen, 2015; Green, 2013). Most programmes focus on these types of services; however, there is little evidence of their effectiveness. Experts raise concerns that the programmes are too dispersed, not being delivered competently and are not effective (Herrington et al., 2017). Effectiveness is hampered by a lack of awareness by target groups and at contact points. The disconnect between the Small Enterprise Development Agency, which provides non-financial support, and the Small Enterprise Finance Agency, which provides most financial support, should be reduced.

Understanding and streamlining government support would improve its effectiveness. The Department of Small Business Development was only established in 2014 and is relatively small, receiving 0.2% of the government departmental budget (National Treasury, 2017b). It should map all (financial and non-financial) support programmes for entrepreneurs and small businesses, including sub-national and non-government programmes. If it had responsibility for all support, it could then streamline government programmes to focus on those where it achieves maximum effect. The Department of Planning, Monitoring and Evaluation could inform this process by undertaking an impact evaluation of current programmes.

One-stop shops, including a virtual one-stop shop, should provide a single contact point for start-ups and SMEs to interact with the government. This would enable them to more easily find available support and would stretch administrative capacity less thinly.

Technology should also be used more to promote and deliver programmes, which would help achieve scale. Partnerships with the private sector may also help achieve scale: the new public-private fund (the SA SME Fund) to provide seed capital and mentoring is a promising example.

Challenges for green growth

In South Africa more than one-third of disease in children under the age of five years is due to environmental hazards. These hazards include inadequate sanitation, which results in an estimated 1.5 million cases of diarrhoea in children under five years; and the paraffin and coal use for cooking in households, which causes 2 500 deaths per year, including 1 500 children under five years (OECD, 2013c).

These hazards particularly affect the 4 million people living in informal settlements, largely due to the inadequate provision of basic services such as waste collection and management, modern energy, accessible, and safe water, and sanitation services; people in the poorer, more vulnerable and historically disadvantaged communities suffer the most. In 2015, more than a third of South Africa inhabitants were exposed to extremely high levels of PM_{2.5}. Consequently, mortality from outdoor air pollution was about 480 deaths per million inhabitants (240 deaths from indoor exposure). In terms of welfare costs, the cost of premature deaths from outdoor exposure is equivalent to 7% of GDP (3.6% for indoor) (OECD, 2017c).

Coal is the basic energy source in South Africa, providing three quarters of total primary energy supply and largely explaining the high carbon intensity of GDP. Renewables have a relatively stable share, comparable to the OECD average but showing no sign of increasing. Seasonal biomass burning may have other serious effects, as recent research links it with reduced rainfall in an already water-stressed region (Hodnebrog et al., 2016)

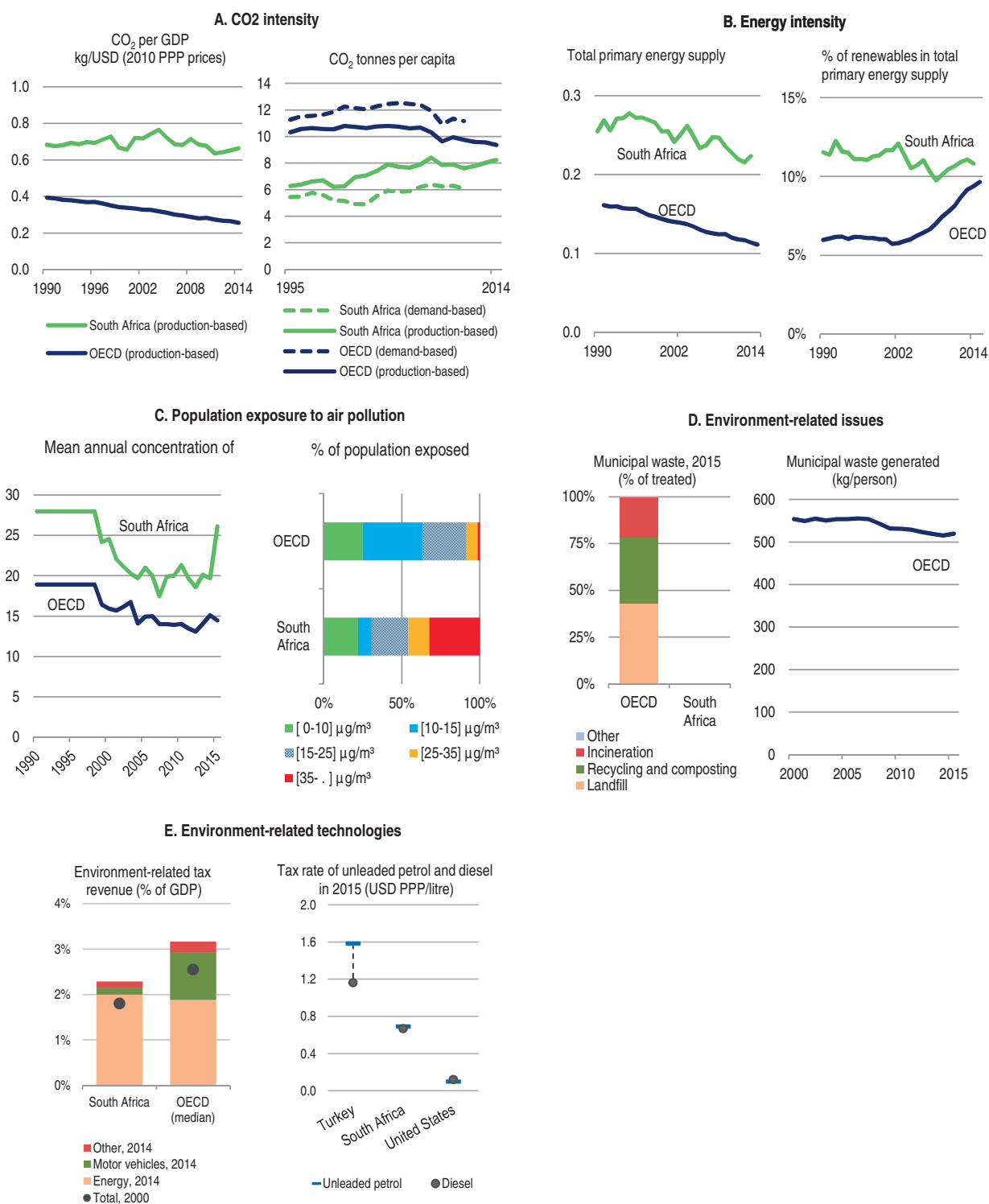
The economy's high energy intensity has been declining, but remains well above the OECD average (Figure 35). CO₂ intensity has not declined at all, and as the economy grows, per capita emissions, have been climbing towards the OECD average. However, South Africa exports much more carbon-intensive products than it imports, so its per capita carbon emissions attributable to domestic final demand, have increased less and remain well below the OECD average.

Municipal waste generation is around half the OECD average, at some 250 kg per person per year in 2011. Municipal waste collection services are not well developed especially in the informal settlements, where waste is collected from perhaps only half the homes. Less than 5% of household waste is recycled, compared with the OECD average of around 35%.

Table 12. Past recommendations for greener growth

Recommendations from previous <i>Surveys</i>	Action taken since the July 2015 <i>Survey</i>
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.	Draft legislation for the carbon tax has been published.
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.	The diesel fuel levy refunds for the electricity sector were reduced from April 2016. The 2017 Budget proposed a review of the VAT exemption of transport fuels in consultation with stakeholders.
Accelerate the allocation of water-use licenses and ensure that charges for water reflect supply costs and scarcity.	The application process for water-use licences has been streamlined to accelerate allocations.

Figure 35. Green growth indicators for South Africa



Source: OECD (2017), Green Growth Indicators (database).

StatLink <http://dx.doi.org/10.1787/888933552492>

Energy taxation raises revenue of about 2% of GDP, just above the average (median) OECD country. Revenue from other environmental taxes is under 0.2% of GDP. In many OECD countries vehicle taxation is increasingly related to environmental objectives and raises significant amounts of revenue – about half as much as energy taxation in the median country – but in South Africa it is negligible.

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ANNEX

Progress in main structural reforms

This annex reviews action taken on recommendations from previous Surveys since the July 2015 Survey.

Macroeconomic policy and safeguarding fiscal sustainability

Recommendations from previous <i>Surveys</i>	Action taken since July 2015 <i>Survey</i>
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. (2015 <i>Survey</i>)	Fiscal consolidation has continued. Additional tax raising measures have been introduced. The expenditure ceiling has been lowered further.
Maintain the current monetary policy stance and continue to carefully monitor the development of core inflation (2015 <i>Survey</i>)	The repo rate increased to 7% in March 2016 from 5.75% in July 2015 to anchor inflation expectations.
Increase the emphasis on the cyclically adjusted balance when setting and explaining fiscal policy. (2013 <i>Survey</i>).	No action.
The government should continue to seek opportunities to increase the efficiency of public expenditure. (2010 <i>Survey</i>).	All suppliers must be registered with a central database. All contracts above ZAR 500 000 at national and provincial, and ZAR 200 000 at municipal level are subject to a competitive bidding process. Efforts to expand centralised procurement of goods and services and renegotiation of transversal contracts continue.
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 <i>Survey</i>).	No action taken.
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 <i>Survey</i>).	The SARB started to publish its underlying forecast assumptions and two-year inflation projections in its MPC statements from July 2015 to increase transparency.

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

Recommendations from previous <i>Surveys</i>	Action taken since July 2015 <i>Survey</i>
Broaden personal and corporate income tax bases by reducing deductions, credits and allowances. Increase tax rates on higher incomes. (2015 <i>Survey</i>)	The 2017 Budget created a new top tax bracket with a marginal tax rate of 45%. The dividend withholding tax rate was increased from 15% to 20%.
Broaden the VAT base and strengthen VAT compliance. Proceed with the introduction of a carbon tax. (2015 <i>Survey</i>)	The VAT exemption for fuels is being reviewed. Draft legislation for the carbon tax has been published.

Regional convergence and deeper trade integration

Recommendations from previous <i>Surveys</i>	Action taken since July 2015 <i>Survey</i>
Further develop pro-growth regional policies which focus on skills formation, investment and infrastructure in a co-ordinated way. (2015 <i>Survey</i>)	In 2016, SADC approved a US\$3.5 million feasibility study for a regional project to expand and transmit Mozambique's hydro power and diversify South Africa's electricity supply.
Resume trade policy measures that enhance international integration, including with developing countries, by reducing barriers to trade. (2015 <i>Survey</i>)	A free-trade agreement was reached between SADC and ECOWAS in 2016, agreeing on tariff liberalisation and related rules.

Improving labour market outcomes

Recommendations from previous <i>Surveys</i>	Action taken since July 2015 <i>Survey</i>
<p>Increase the role of mediation and arbitration to make wage negotiations less confrontational. (2015 <i>Survey</i>).</p> <p>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 <i>Survey</i>).</p>	<p>Amendments to LRA, Picketing Regulations and a Code of Good Practice on Collective Bargaining, Industrial Action and Picketing are to be promulgated to enhance labour market stability and effective dispute resolution and will accompany the introduction of the national minimum wage.</p>
<p>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. (2015 <i>Survey</i>)</p>	<p>The social partners have reached agreement on modalities for the introduction of a national minimum wage of ZAR 20 an hour to be implemented from no later than 1 May 2018. The institutional set-up of a commission in charge of the annual review is still being finalised.</p>
<p>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 (2015 <i>Survey</i>). Efforts to strengthen job search assistance should be intensified. (2010 <i>Survey</i>)</p>	<p>The existing 126 labour centres around the country now have self-help kiosks. 3 mobile units have also been established to increase access in remote areas. An employment services database has been created. Counselling and other services that improve work readiness and increase placement have also increased.</p>
<p>Enforcement of existing labour laws relating to labour broking should be tightened, but liberal arrangements for temporary employment should be maintained. (2010 <i>Survey</i>)</p>	<p>No action taken.</p>
<p>The arbitration process for dismissals for cause should be speeded up and simplified. (2010 <i>Survey</i>)</p>	<p>No action taken.</p>
<p>The use of wage subsidies should be expanded, possibly by building on the existing learner ships, but with a reduced administrative burden. (2010 <i>Survey</i>)</p>	<p>The Employment Tax Incentive has been extended until 2019.</p>
<p>Probationary requirements in respect of new hires of young employees should be extended. (2010 <i>Survey</i>).</p>	<p>No action taken.</p>

Climate change mitigation and green growth

Recommendations from previous <i>Surveys</i>	Action taken since July 2015 <i>Survey</i>
<p>Price environmental externalities, including carbon emissions, and scarce resources, particularly water, appropriately. (2015 <i>Survey</i>).</p>	<p>A tyre levy has been implemented from 1 February 2017 which will address the externalities associated with tyre disposal.</p>
<p>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 <i>Survey</i>).</p>	<p>Draft legislation for the carbon tax has been published.</p>
<p>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 <i>Survey</i>).</p>	<p>The diesel fuel levy refunds for the electricity sector were reduced from April 2016. The 2017 Budget proposed a review of the VAT exemption of transport fuels in consultation with stakeholders.</p>
<p>Electricity prices should be allowed to rise further to fully cover capital costs. Favourable pricing arrangements for large industrial users of electricity should be renegotiated. (2010 <i>Survey</i>).</p>	<p>NERSA approved an average annual price increase of 9.4% for 2016/17 and 2.2% for 2017/18.</p>
<p>Accelerate the allocation of water-use licenses and ensure that charges for water reflect supply costs and scarcity. (2013 <i>Survey</i>).</p>	<p>The application process for water-use licences has been streamlined to accelerate allocations.</p>

Tackling infrastructure bottlenecks and improving business regulation to support job creation

Recommendations from previous <i>Surveys</i>	Action taken since July 2015 <i>Survey</i>
Choose infrastructure investments with the highest social returns to facilitate prioritisation and cost control. (2015 <i>Survey</i>)	Infrastructure projects remain concentrated in energy, education, health, water and transport sectors.
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. (2015, 2010 <i>Survey</i>)	Public transport has been expanded further in major cities. The first upgraded PRASA train went into commercial operation in March 2017. Construction continues of bus rapid systems continues in 13 cities across the country, including the four major cities with systems already in operation.
Experiment with support schemes and regulation for special economic zones to move jobs to poor urban neighbourhoods. (2015 <i>Survey</i>)	The government has introduced a programme to revitalise old industrial parks located in poor black urban settlements across the country. Work is at various stages in 6 of the 10 identified parks.
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. (2015 <i>Survey</i>)	No action taken.
Support SMEs by increasing the use of regulatory impact analysis to reduce the regulatory burden, eliminating entry barriers, and promoting competition. (2015 <i>Survey</i>).	All policy proposals are now required to have a Socio-Economic Impact Assessments completed which allow for clear consideration of the regulatory impact on small business, where necessary.
Systematically identify and eliminate competition- hampering regulation (2015, 2013, 2010 <i>Survey</i>). Privatised state-owned companies, such as telecoms, that are in markets with a sufficient degree of competition (2015 <i>Survey</i>).	A red-tape reduction bill is with parliament. It would create a regulatory impact assessment unit that reviewed existing legislation.
Product market regulation should be made less restrictive, particularly as regards barriers to entrepreneurship. Simplify regulations and ease compliance. (2013, 2010 <i>Survey</i>).	Department of Trade and Industry will establish three “One Stop Shops” in 2017 to reduce compliance times, with one already opened. Information and assistance will be under one roof. The Sub National Ease of Doing Business project to reduce regulatory barriers within South Africa’s largest municipalities is underway. The Department of Small Business Development is assessing the regulatory burden of several sectors and pieces of legislation, with a view to partnering with the relevant departments to reduce these.

Making the education system more effective

Recommendations from previous <i>Surveys</i>	Action taken since July 2015 <i>Survey</i>
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 <i>Survey</i>)	136 new schools were built and completed in 2016/17, 167 provided with sanitation facilities, 344 with water and 134 with electricity. The department committed to provide at least two libraries in each province with the ASIDI allocation. The delivery of learning materials has improved to close to 100% coverage in 2017.
Expand the Funza Lushaka bursary programme for teaching studies and allow more immigration of English teachers. (2013 <i>Survey</i>)	The Funza Lushaka bursary allocation has increased by over ZAR 100 million since 2015 and the programme continues to boost the supply of skilled teachers. Around 10 000 newly qualified teachers under the age of 30 have entered the system each year since 2015 (including non-bursary holders). The number of students supported is expected to decline over the medium term due to increases in university fees.
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 <i>Survey</i>)	In 2016, the Department of Basic Education introduced a new policy defining the role of school principals and the key aspects of professionalism, image and competencies required. A new collective agreement on quality management of principals is with the teaching union. The use of competency assessments when appointing new principals is under consideration in the bargaining council, but some provinces have voluntarily already implemented this tool.
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 <i>Survey</i>)	No action taken.
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 <i>Survey</i>).	The learnership tax incentive has been revised to provide more support for scarce skills, particularly for artisans, and extended until 2022. The employment tax incentive has been extended until 2019 to allow for further evaluation.
Improvements in basic education should be prioritised, even though the contribution to raising employment will be small in the near term. (2010 <i>Survey</i>)	Spending on basic education continues to be the largest share of the national budget.

Other

Recommendations from previous <i>Surveys</i>	Action taken since July 2015 <i>Survey</i>
Access to credit for business start-ups should be improved, for example by easing collateral constraints. (2010 <i>Survey</i>).	No action.
Remaining restrictions on capital outflows should be removed and replaced by prudential regulation. (2010 <i>Survey</i>)	Draft legislation to implement a “twin peaks” macro-prudential regulatory framework is in parliament. The bill separates prudential from conduct regulation resulting in the development of two key regulators – the Prudential Regulation Authority, under the South African Reserve Bank, and a new Financial Sector Conduct Authority.
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 <i>Survey</i>)	Reforms were introduced in 2016 to harmonise the tax treatment of contributions to different retirement funds to reduce the scope for tax avoidance salary structuring.

Chapter summaries

Chapter 1. Deepening regional integration within the Southern African Development Community

Deepening regional integration within the Southern African Development Community (SADC) will raise potential growth for all member countries. Integrated economies will increase market size, trade opportunities and improve resource allocation across member countries. Key pillars of functioning regional integration are the free circulation of goods and services, mobility of workers and interconnected infrastructure. To boost regional integration, remaining tariff barriers and non-tariffs barriers should be removed. Ensuring greater compliance to agreements by SADC members will also facilitate intra-trade and cross-investments. More co-operation between competition authorities should facilitate harmonisation of competition rules in particular in services and transport-related services which would ease circulation of good and services. The other key pillars of regional integration (industrial policy, infrastructure, investment, financial integration and tax) are also reviewed.

Chapter 2. Lowering barriers to entrepreneurship and promoting small business growth

Lowering high levels of unemployment and inequality are amongst the largest challenges facing South Africa. More entrepreneurs and thriving small businesses would contribute to inclusive growth. Measures of entrepreneurial activity are lower in South Africa than in other emerging economies. Barriers to entrepreneurship include bureaucratic procedures and licensing, which are also an ongoing burden on small firms. Public procurement is being used to overcome the dominance of large incumbents, but so far its net effect on small firms is not clear. An education system that better equipped students with basic skills as well as entrepreneurial skills would grow the pipeline of entrepreneurs. New forms of financing are slowly emerging in a system that is dominated by banks. A better evidence base is crucial for more effective financial and non-financial support programmes to boost start-up rates and small firms' growth.

