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OVERVIEW

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This Overview is extracted from the 2020 Economic Survey of South Africa. The Survey is published on the responsibility of the Economic and Development Review Committee of the OECD, which is charged with the examination of the economic situation of member countries.

Executive Summary

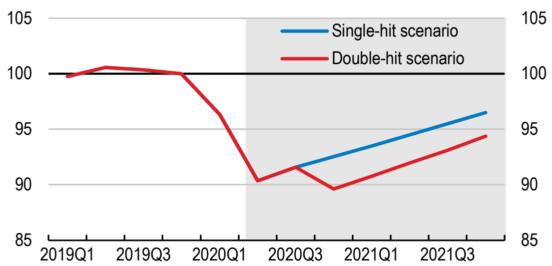
The economy was hard hit

The COVID-19 pandemic and the ensuing lockdown have triggered a sharp drop in activity. South Africa reacted quickly to the outbreak by establishing a nationwide lockdown from March 26. Economic activity was reduced in mining and industry, and stopped in the tourism, entertainment and passenger transport sectors. Starting June 1st, the lockdown was eased to allow more economic activity and movement of people to work. Nonetheless, the spread of the virus continued and the number of cases increased rapidly in June and July.

The 2020 recession follows almost a decade of modest growth (Figure 1). Persistent electricity shortages, rising government debt and policy uncertainty will continue to hold back investment and underscore low growth. The economy is set to recover only progressively from the coronavirus recession as sectors reopen.

Figure 1. Growth has collapsed following a modest performance in the past decade

GDP at constant prices, index 2019Q4 = 100, seasonally adjusted



Source: OECD Economic Outlook 107 database.

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Growth is projected to slump. In the double-hit scenario, a new outbreak affecting South Africa and its trading partner countries will curtail exports, deepening the recession to -8.2% in 2020 and limiting the recovery in 2021, with GDP growth at 0.6%. In the single-hit scenario, where a second wave of the virus can be avoided, economic activity will fall by 7.5% in 2020 before picking up progressively with GDP growth of 2.5% in 2021 (Table 1).

The government relief plan will mitigate the fall in household consumption, but investment, which has been declining over the past two years, will decline to a record low level. The depreciation of the Rand, driven by deteriorating fiscal accounts, will not boost exports as commodity demand remains weak, though prices of some commodities (gold, platinum) are high in the single-hit scenario. High production costs will continue to weigh on economic activity.

Both domestic and global risks weigh on the economic outlook. Domestic near-term risks to growth include load-shedding (rolling blackouts) by the power utility and higher-than-expected electricity prices, which could derail the recovery. By contrast, improvement of business confidence and a faster recovery in Emerging Market countries would have growth spillovers for South Africa, including through higher demand and prices for commodity exports.

Table 1. Macroeconomic projections

Growth rates, unless specified	2019	2020	2021
		Single-hit scenario	
Growth domestic product (GDP)	0.2	-7.5	2.5
Private consumption	1.0	-5.8	2.3
Government consumption	1.5	2.4	1.6
Gross fixed capital formation	-0.9	-13.9	2.4
Exports of goods and services	-2.5	-10.8	5.6
Imports of goods and services	-0.5	-8.6	4.5
Unemployment rate (% of labour force)	28.7	33.9	34.9
Consumer price index	4.1	3.5	3.7
Current account balance (% of GDP)	-3.0	-3.0	-2.5
		Double-hit scenario	
Growth domestic product (GDP)	0.2	-8.2	0.6
Private consumption	1.0	-6.5	0.8
Government consumption	1.5	2.5	2.3
Gross fixed capital formation	-0.9	-15.1	-1.0
Exports of goods and services	-2.5	-12.5	1.5
Imports of goods and services	-0.5	-10.0	2.0
Unemployment rate (% of labour force)	28.7	34.0	35.8
Consumer price index	4.1	3.4	3.3
Current account balance (% of GDP)	-3.0	-3.1	-3.0

Source: OECD Economic Outlook 107 database.

Fiscal policy faces severe challenges

Fiscal policy reacted forcefully to the crisis, mobilising ZAR 500 billion (10% of GDP) for new spending, reprioritisation, tax relief and loan guarantees. All social grants were augmented and new schemes designed to provide support to workers including those in the informal sector. Specific schemes were activated targeting businesses in hard hit sectors such as tourism.

The crisis follows a sharp deterioration in fiscal accounts over the past three years. The government deficit is projected to reach 15% of GDP in 2020. Public debt has been increasing in the last decade and is projected to exceed 80% of GDP by 2020. In the absence of consolidation, the debt level will exceed 100% of GDP in 2022, raising sustainability risks in a context of low growth and high government borrowing rates. The fiscal strategy has to sequentially cope, in the short-run, with the impact of the coronavirus and, in the medium-term, implement a bold consolidation to restore debt in a sustainable path while sparing potential growth.

Compensation of government employees is large. At 12% of GDP, the government wage bill is high. Rising wages are driving wage bill increases rather than employment. Wage negotiations have systematically granted above-inflation increases. When compared to OECD and emerging economies, the remuneration level of civil servants is relatively high. The government has announced its intention to reduce the wage bill. The government could consider indexing public sector wages below inflation for 3 years.

Government exposure to state-owned enterprises (SOEs) is high and represents a significant risk to debt sustainability and public finances. The underperformance of SOEs is widespread due to mismanagement, corruption issues, overstaffing and an uncontrolled wage bill. South Africa needs to establish an effective governance framework for SOEs that clearly sets company-specific goals in terms of profitability, capital structure and non-financial objectives.

An agenda for growth

Supporting the economic recovery in the short-run while undertaking reforms to increase potential long run growth is key. Efforts to improve the business climate, sequencing and prioritisation of reforms will be essential for maximising their growth impact. The tourism sector needs support to weather the effects of the crisis. In the medium term, developing tourism and boosting transport infrastructure investments can contribute to growth and job creation during the recovery. Regulatory restrictions are still relatively high. This includes a high level of government involvement in the economy, barriers to domestic and foreign entry, complex rules for licences and permits, and protection of existing businesses from competition, for instance, in legal services and network industries.

South Africa would benefit from greater integration in global value chains. Participation in global value chains is especially high in the manufacturing industries and could be increased by leveraging the potential of regional value chains. By contrast, the integration of service industries has been held back. South African firms are facing high tariffs in their export markets. Trade facilitation measures should address non-tariff barriers such as improving the quality and access of infrastructure, as well as access to export and insurance credit.

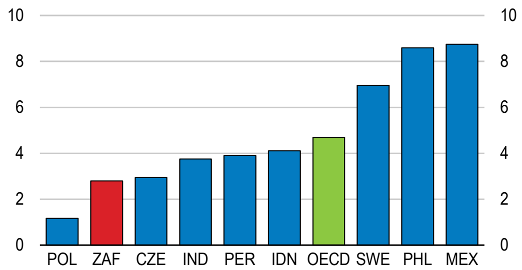
Greener energy policy can bolster growth. South Africa is one of the top-20 greenhouse gas emitters in the world. The CO_2 emission intensity of GDP has fallen slightly since 2000. The introduction of a carbon tax in June 2019 is welcome. The share of renewables in primary energy supply is close to the OECD average. However, coal accounts for 75% of electricity generation and is the main energy source in industrial processes.

Increasing public infrastructure investment would boost potential growth. Public infrastructure investment has declined in recent years. In particular, transport infrastructure remains insufficient and suffers from a lack of maintenance. The government is planning to create an infrastructure fund with the private sector, development finance institutions and multilateral development banks. The success of the infrastructure fund will depend on the capacity to bring in private financing.

Tourism will need prolonged support in the short-run. International tourist arrivals increased from 4.5 million to more than 10 million between 1995 and 2017 and were accompanied by a tripling of employment directly related to tourism. While the role of tourism in the economy has been increasing since the end of apartheid, it remains below the OECD average (Figure 2). Furthermore, the recent COVID-19 pandemic and resulting containment measures have triggered an unprecedented crisis in the tourism sector. Still, the sector offers significant opportunities for an economy with weak growth and high unemployment. Streamlining and implementing electronic visa services for international tourists could increase South Africa's international openness. Reduction of red tape could strengthen the integration of the tourism sector into local value chains and amplify the impact of tourism on the domestic economy. For tourism to translate into inclusive and sustainable growth, the benefits must spread geographically. Necessary transport and accommodation infrastructure is needed to connect tourists to places.

Figure 2. Direct contribution of tourism to the economy

% of GDP, 2018 or latest available year



Source: OECD, Tourism Database.

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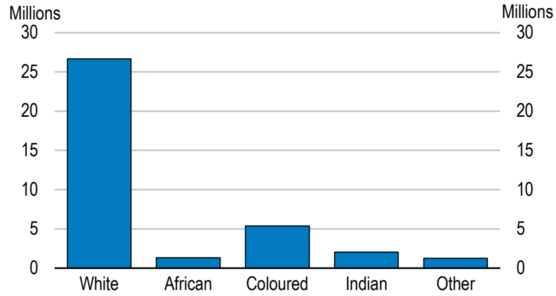
Land is a main source of inequality in South Africa. Owing to the legacy of apartheid, only a small share of land is under ownership by the black population (Figure 3). The land reform initiated in 1994 – consisting of restitution, tenure reform and redistribution – progressed only slowly. To speed up the process of redistribution, current proposals focus on amending the constitution to allow for expropriation without compensation. A new advisory panel is to ensure a fair and equitable implementation of the land reform process. It is important to clearly define the policy objectives and assess the risks of such an amendment, which could include slower growth as a result of further significant deterioration in perceptions of South Africa's investment climate if the land reform is not well designed, communicated or implemented.

Figure 3. Individual land ownership of farms

Landownership hectares by race, 2017



Note: Refers to individually owned land only and does not include traditional land.
Source: Department of Rural Development and Land Reform (2018), Land Audit Report 2017.

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Building an inclusive social protection system

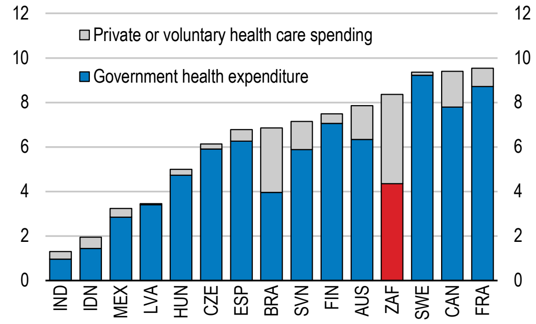
The current social protection system is incomplete. The social assistance system is well developed and is key in reducing poverty. However, the COVID-19 outbreak has revealed some shortcomings in the coverage of informal workers by the social assistance system and highlighted the disparities in access to quality health care. Also, the current pension system does not sufficiently alleviate the risk of old-age poverty.

Pension coverage is not satisfactory. Only around 40% of employees were contributing to a pension scheme in 2018 and most informal workers are not covered. Pension revenues are not adequate. The fragmentation of the pension system argues for its harmonisation. The government intends to introduce a mandatory pension scheme targeting a replacement rate of 40%, including a universal old-age grant.

Life expectancy has improved in the last ten years from 54 to 63 years but remains low. Death rates remain high by OECD standards. Although total health spending is relatively high (8.1% of GDP), a very large part is funded by private out-of-pocket spending, which leads to unequal access and prevents large population groups from obtaining adequate treatments (Figure 4).

Figure 4. Comparing health spending

Health spending,% of GDP, 2017



Source: WHO Global health expenditure database.

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To address the failure of the current health care system to deliver accessible high-quality of care to all, the government plans to introduce a National Health Insurance (NHI) fund and reduce private health insurance. The NHI fund aims to provide universal health coverage by contracting with public and private health care providers based on a large basic basket of health benefits including primary care, emergency and hospital-based services.

In response to the COVID-19 crisis, closer co-operation and pooling of available resources between the public and private sectors has been initiated. Most of the intensive/critical care beds are in the private sector. However, in June, the government and the health private sector representatives agreed on fees for COVID-19 patients that are treated in critical care beds in private hospitals.

MAIN FINDINGS	KEY RECOMMENDATIONS
Mobilise monetary policy instruments and restore fiscal policy room	
The Reserve Bank has reduced the repurchasing rate from 6.25% to 3.50% between March and July. Inflation has receded and core inflation remains stable.	Lower interest rates to further support the recovery.
The government reacted to the pandemic by putting in place a 10% of GDP relief package. Fiscal accounts deteriorated before the crisis. Increasing interest payments and SOEs subsidies are weighing on debt and fiscal space. The government wage bill, at 12% of GDP, is high.	Provide temporary financial support to households and businesses to protect livelihoods and employment Implement the budget consolidation strategy and improve spending efficiency. Index wages in the public service below inflation for 3 years and link to productivity requirements.
Government exposure to state-owned enterprises (SOEs) is high and represents a significant risk to debt sustainability and public finances. Underperformance of SOEs is widespread due to mismanagement, corruption, overstaffing and uncontrolled wage bill. Commissions of enquiry have shed light on widespread corruption in the public and private sector.	Restructure state-owned enterprises to ensure their financial sustainability including staff reduction and bringing in private participation. Separate clearly the responsibilities of the board and the management of SOEs by giving the board the mandate to strategically supervise, monitor and audit the management of SOEs. Improve prosecution process and enforcement of national and foreign corruption offences.
To finance fee-free higher education, government spending on higher education is expected to increase from 1.3% of GDP in the fiscal year of 2017/18 to 2.3% in 2021/22. As the number of students enrolling in higher education increases, the pressure on public finances will become unsustainable.	Introduce student loans to cover higher education fees with repayment schedules depending on future incomes with government guarantees to replace education grants for students from high-income families.
An agenda for growth	
The coronavirus pandemic and the lockdown have strongly hit the economy. In the service, transport and tourism sectors, many small and medium enterprises are struggling to survive. Access to visa is difficult from several sending countries. Tourism in South Africa is concentrated in few regions and does not spread into remoter areas. There are multiple licences required in different administrations to open a small tourism unit.	Increase and extend relief support in sectors hard hit by the crisis, especially for the tourism sector, up to mid-2021, particularly if there is a renewed virus outbreak later in the year. Implement electronic visa programmes on a large scale for emerging target markets. Investments in transport and tourism infrastructure have to be aligned to connect tourists to places. Reduce red tape and the regulatory burden for entrepreneurs and small enterprises.
Regulatory restrictions are still relatively high, especially in network industries. Most of the key sectors of the economy are highly concentrated. Transport costs remains high and competition low.	Give more independence to regulators in energy, transport and telecom industries vis-à-vis line ministries. Accelerate the adoption and implementation of the Single Transport Economic Regulation Bill.
Intensive coal use contributes to high CO_2 emissions, water scarcity and water pollution.	Use the ongoing restructuring of Eskom to diversify power generation and invest in renewable sources of energy.
Public infrastructure investment has declined, contributing to lower growth. The quality of infrastructure is deteriorating.	Increase public investment in transport infrastructure, skills and education. Improve cost containment, planning and implementation.
Promoting sustainable water usage	
The risk of water shortages is rising. Prices are low in agriculture and water use is often unmeasured and uncharged, especially on large farms.	Raise irrigation water prices to discourage water overuse and ensure that costs are covered, for example by charging depreciation costs in full.
37% of South Africans do not have access to reliable water supply and 20% do not have access to sanitation, resulting in water pollution, and adverse health impacts.	Set up an independent water regulator to ensure cost-reflective prices Apply better regulation to costs and environmental performance of municipal water services.
Building an inclusive social protection system	
Access to health care is unequal. Financing of health care is unbalanced with high spending in private health for a small fraction of the population. Quality of health care delivery in public facilities is perceived as being low. Prices of health services in the private sector are high.	Gradually increase the public financing of health care through a form of public insurance at a pace and scale that is affordable. Entrust an independent body to develop a price schedule for reimbursement of health care.
Obesity rates have reached alarming levels in South Africa. Tobacco consumption remains high, as 19% of the adult population are daily smokers and 14.1% of the total population reported binge drinking.	Develop prevention of non-communicable diseases and strengthen the promotion of a healthier lifestyle.

1 Key Policy Insights

Overview and recent trends in well-being, inequality and poverty alleviation

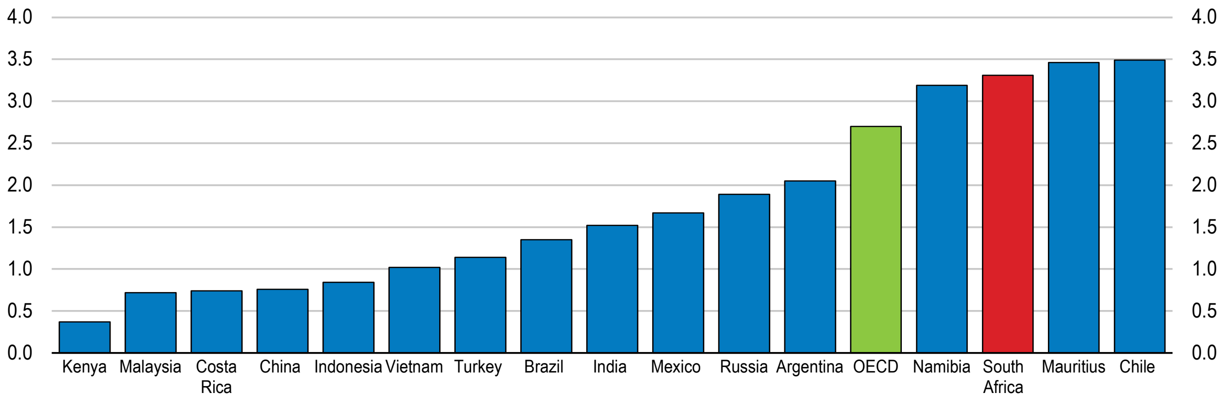
South Africa and the OECD have been strengthening the depth of their relationship since 1998. South Africa participates in 23 OECD bodies and projects and has adhered to 23 OECD legal instruments, including in the areas of anti-corruption, tax, chemicals and science and technology. It is one of the most active among partner countries.

The coronavirus pandemic hit South Africa by the end of March. Early nationwide lockdown helped limit the spread of the virus in April and May. However, the diffusion of the virus has accelerated in July, affecting thousands of individuals. The lockdown has stopped or limited economic activity in many areas. The COVID-19 outbreak is worsening an already fragile economic outlook. Political uncertainties and slow implementation of reforms have been detrimental to growth. Since 2013, growth has been below 2%, leading to stagnating or decreasing GDP per capita. Policy uncertainty has been the main driver of low confidence and economic uncertainty. Institutions such as the independent judiciary have played an important role in upholding the rule of law. The government has started to address concerns about state corruption and mismanagement of big state-owned enterprises (SOEs).

Despite a challenging economic environment and limited fiscal space, the government has maintained a highly redistributive policy. About 68% of government spending goes towards social objectives, including education, health, social grants and basic services. In particular, South Africa has one of the largest social transfer programmes, above the OECD average (Figure 1.1 and Chapter 1). South Africa's child support grant is one of the largest unconditional cash transfer programmes for children in the world. It is widely regarded as one of the government's most successful interventions, particularly due to its high take-up and extensive coverage (Samson et al., 2008). Between 70 and 80% of children in the bottom six income deciles benefits from the grant (Grinspun, 2016). For poor families, the child grant is an important source of financial support, providing for basic needs such as food, schooling and health care (Zembe-Mkabile et al., 2015). For nearly 75% of South Africans aged 60 and older, the old-age grant is the main source of income.

Figure 1.1. A strong redistributive policy

Spending on social assistance programmes in 2015 (% of GDP)



Note: Malaysia, Costa Rica, Turkey is 2013; China and Namibia are 2014; Kenya and India are 2016. Social assistance programmes are defined as non-contributory interventions designed to help individuals and households cope with chronic poverty, destitution, and vulnerability. Examples include unconditional and conditional cash transfers, non-contributory social pensions, food and in-kind transfers, school feeding programmes and public works.
Source: World Bank ASPIRE database, 2018.

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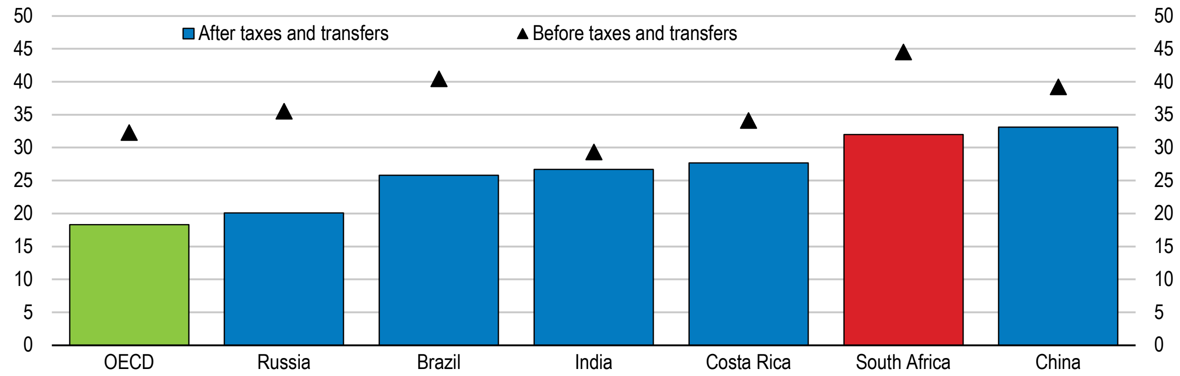
Since the beginning of the COVID-19 crisis, the government has decided to augment all social grants between ZAR 250 to ZAR 300 for 6 months and to extend benefits to some uncovered categories such as informal workers. A temporary caregiver grant of ZAR 500 per month was introduced. Moreover, the government has swiftly put in place an income replacement scheme through the Unemployment Insurance Fund. From mid-April to end of June, the Fund has paid over ZAR 28 billion to 4.6 million workers. These benefits are part of the ZAR 500 billion (10% of GDP) relief plan established by the government. Nonetheless, the COVID-19 pandemic is hitting employment, threatening livelihoods of millions of individuals and affecting social achievements of government policies. There is extensive evidence showing that cash transfers have been successful in reducing extreme poverty and improving health and education outcomes (Figure 1.2 and Chapter 1). Cash transfers dominate the income profile of many poor households, accounting for as much as 71% of total household income for the poorest 20% of the population (World Bank, 2018a; Woolard and Leibbrandt, 2010).

Figure 1.2. Redistribution reduces poverty

% of population with 60% or less than the median disposable income, 2016 or latest available year



Note: Data for South Africa are 2015 and provisional, Costa Rica are 2018, Brazil are 2013 and China and India are 2011.
Source: OECD Income Distribution and Poverty Database.

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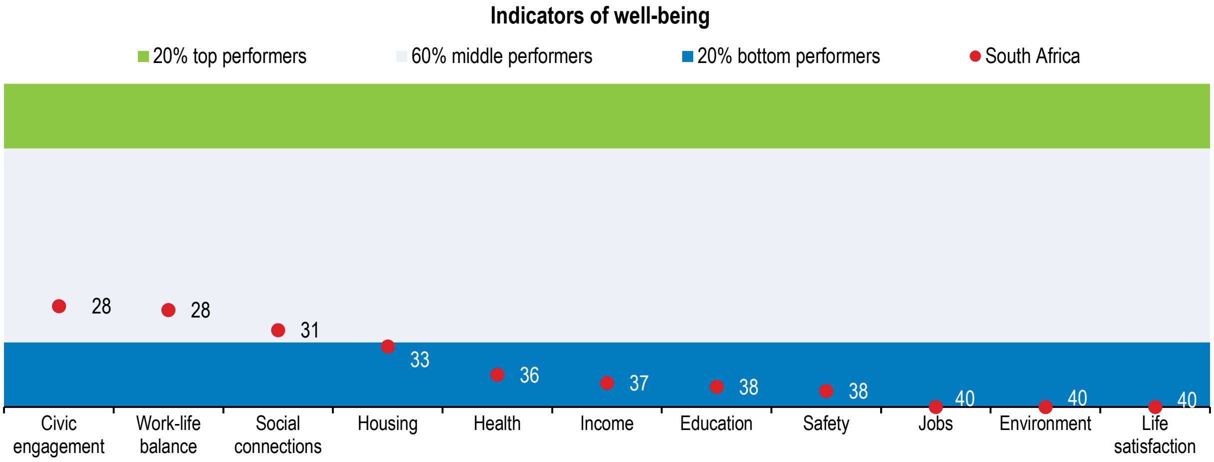
The level of inequality remains high despite important social transfers. Inequality, measured by the Gini coefficient (0.62), decreased between 2008 and 2010, but has more or less stagnated since alongside growth. The difficulty of reducing inequalities stems from a highly unequal distribution of market income and wealth. Widespread unmet needs in education, health and infrastructure and perceptions of corruption are also feeding citizens' frustration.

South Africa ranks low in almost all dimensions of the Better Life Index (Figure 1.3). South Africa lags the OECD average, in particular, in income and wealth, life satisfaction and jobs. Despite increased spending to broaden access to education, low quality of education outcomes has limited access to jobs. High crime rates and health problems are also weighing on well-being. South Africa fares relatively better on social connections, illustrating the robustness of the country's social institutions and family ties in a difficult economic context (Lilenstein, Woolard and Leibbrandt, 2018). While South Africa performs well on many gender dimensions, there is scope for progress on women's access to economic opportunities and assets (land for instance) and on eliminating violence against women.

The economy faces many structural challenges. High public debt and heightened scrutiny by rating agencies and financial markets, illustrated by high premiums on debt, are limiting the fiscal policy room for manoeuvre. In addition, product market regulations remain overly strict compared with other OECD and most emerging countries (Figure 1.4). In particular, the size and grip of state-owned enterprises (SOEs) on the economy, complexity of regulations and barriers to service and network sectors are among the factors that impede competition and growth.

Figure 1.3. Well-being ranks low on many dimensions

Better Life Index, country rankings from 1 (best) to 40 (worst), 2018 or latest available



Note: Each well-being dimension is measured by one to four indicators from the OECD Better Life Index set for 37 OECD countries as well as Brazil, Russian Federation and South Africa. Normalised indicators are averaged with equal weights.
Source: OECD (2020), OECD Better Life Index, www.oecdbetterlifeindex.org.

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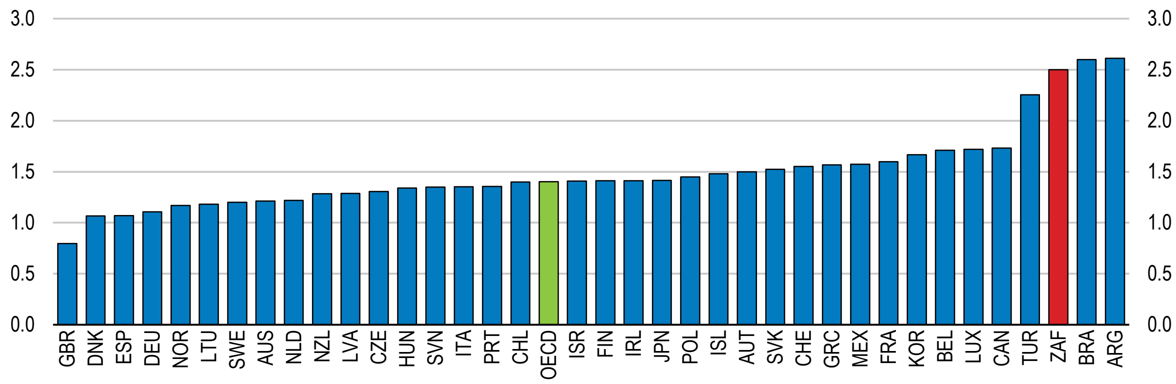
Figure 1.4. Barriers to competition in the economy remain high

Overall indicator, index scale of 0–6 from least to most restrictive, 2018



Source: OECD 2018 PMR database.

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In the short-run, budget support to health policy efforts to test, isolate and treat infected persons should be augmented. South Africa needs to restart growth, by restoring confidence and opening routes for long-term stable growth. An immediate growth strategy has to include fixing SOEs, bringing more policy certainty and, opening-up more sectors – in particular the network industries – to competition. While extending government support to hard hit sectors will be necessary until 2021, fiscal space needs to be created to support these policies and to control debt increases. Broadening the inclusiveness of the market economy through comprehensive social protection against risks and shocks will help build more confidence in the economy and solidarity among the population. Investment in infrastructure, education and skills is necessary to boost potential growth. Developing labour intensive sectors like tourism and agriculture can support the job creation the country urgently needs.

Against this background, the key messages of this Survey are:

- A sound growth strategy – including reforming product markets, boosting investment, infrastructure development, trade policies that augment the benefits from participation in global value chains, more competitive SOEs – can deliver quick wins in terms of job creation and increase potential growth. Efforts to improve the business climate, sequencing and prioritisation of reform will be essential for maximising the growth impact.
- Building an inclusive social protection system that guarantees decent retirement incomes and provides affordable and quality health care will help stimulate household consumption and strengthen productivity, as well as being an important social goal in its own right. The COVID-19 pandemic stresses the need to improve the quality of health care in the public sector while broadening access to private health care services.
- Lifting the barriers impeding the development of the tourism industry and land redistribution, accompanied by technical and financing support for family farmers, can create jobs.

The pandemic has worsened an already fragile economic outlook

The first confirmed case of COVID-19 was registered on 5 March. Since then, the pandemic has spread, affecting most strongly the Gauteng and the Western Cape provinces. South Africa has a dual health system with significant inefficiencies and inequality of access to high-quality healthcare. The private sector, accounting for half of national spending, covers only 17% of the population. Most of the critical care beds and intensive care beds (around 3 000) are in the private health-care sector. However, in response to the COVID-19 crisis, closer co-operation and pooling of available resources between the public and private sectors has been initiated. Also, South Africa has many people who are vulnerable due to other chronic conditions. More than a third of the population is suffering from hypertension, around 4.5 million people have diabetes and over 70% of women and 40% of men are overweight or obese, three factors that accentuate risks with COVID-19.

Containment measures were rapidly adopted and helped to delay the spread of the pandemic. As of 15 March, while there were only few confirmed cases, the government declared a national state of disaster, imposing a travel ban from highly-infected countries, testing and, if needed, isolating individuals returning from infected countries. Within a week, a national lockdown was established, schools and universities were closed, transport shut down and any form of gathering prohibited. The lockdown has given some time for the health care sector to be prepared for an increase in infections.

After June 1st, many economic sectors reopened, with some restrictions requiring distancing in the workplace and gradual re-opening of schools. Opening of restaurants and personal care services started late June.

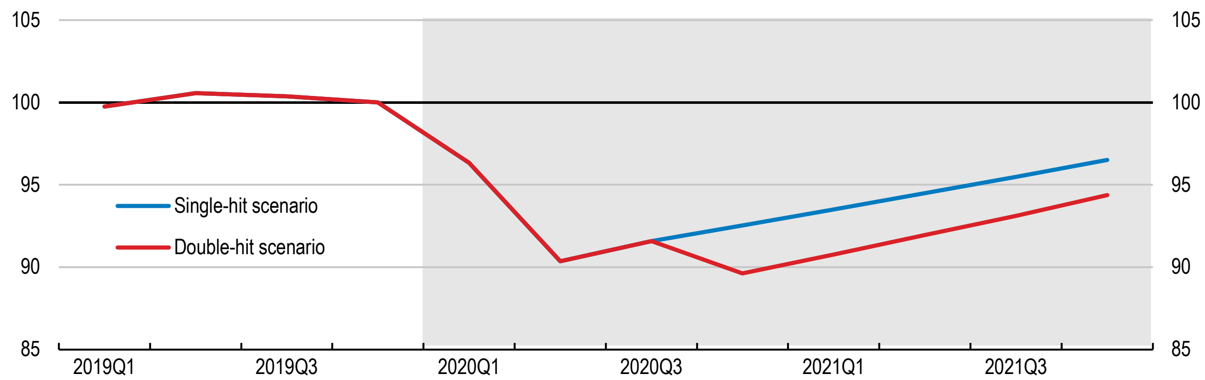
The outbreak and the related containment measures have led to a severe contraction in economic activity. The economy is set to recover progressively from recession as sectors sequentially reopen (Table 1.1). The economy was largely constrained by lockdown measures through mid-March to end of May but then reopened with restrictions lingering in sectors and parts of the country where distancing remained a concern. Activity in the tourism and entertainment sectors and passenger transport collapsed. Export sectors were affected by reduced activity in mining and manufacturing industries. This has provoked a sharp increase in unemployment. Nonetheless, a renewed wave of coronavirus infections remains a possibility. In the double-hit scenario a new COVID-19 outbreak is assumed to occur in October and

November. To minimise the risk of a second wave leading to another large-scale lockdown of the economy and to protect lives, further developing testing to identify those infected and then tracking and isolating to limit further infections will be needed. Augmenting medical capacity to cope with a second wave will help mitigate the impact on the economy of a second wave by facilitating greater reliance on targeted measures to limit the spread of the virus.

The government has put in place a relief/stimulus plan amounting to 10% of GDP to support households and businesses. In particular, social grants were augmented and different sectoral or size-related schemes were established to provide loans, guarantees, subsidies, tax deferral and relief, and wage subsidies The government relief plan will mitigate the fall in household consumption but investment, which has been declining over the past two years, will decline to a record low level. As in many emerging market economies, the financial market experienced considerable capital outflows, aggravated by a deteriorating government fiscal stance. In the single-hit scenario, the depreciation of the Rand will not boost exports, as commodity demand remains weak, though prices of some commodities (gold, platinum) are high. High production costs will continue to weigh on economic activity. Unemployment will increase while inflation will remain muted. These projections are subject to substantial uncertainty and risks as the world continues to grapple with the coronavirus pandemic (Table 1.2). Macroeconomic policy should be ready to act further if required, including by continuing to support selectively economic sectors hard hit by the pandemic.

Figure 1.5. Growth will recover only slowly

GDP at constant prices, index 2019Q4 = 100, seasonally adjusted



Source: OECD Economic Outlook 107 database.

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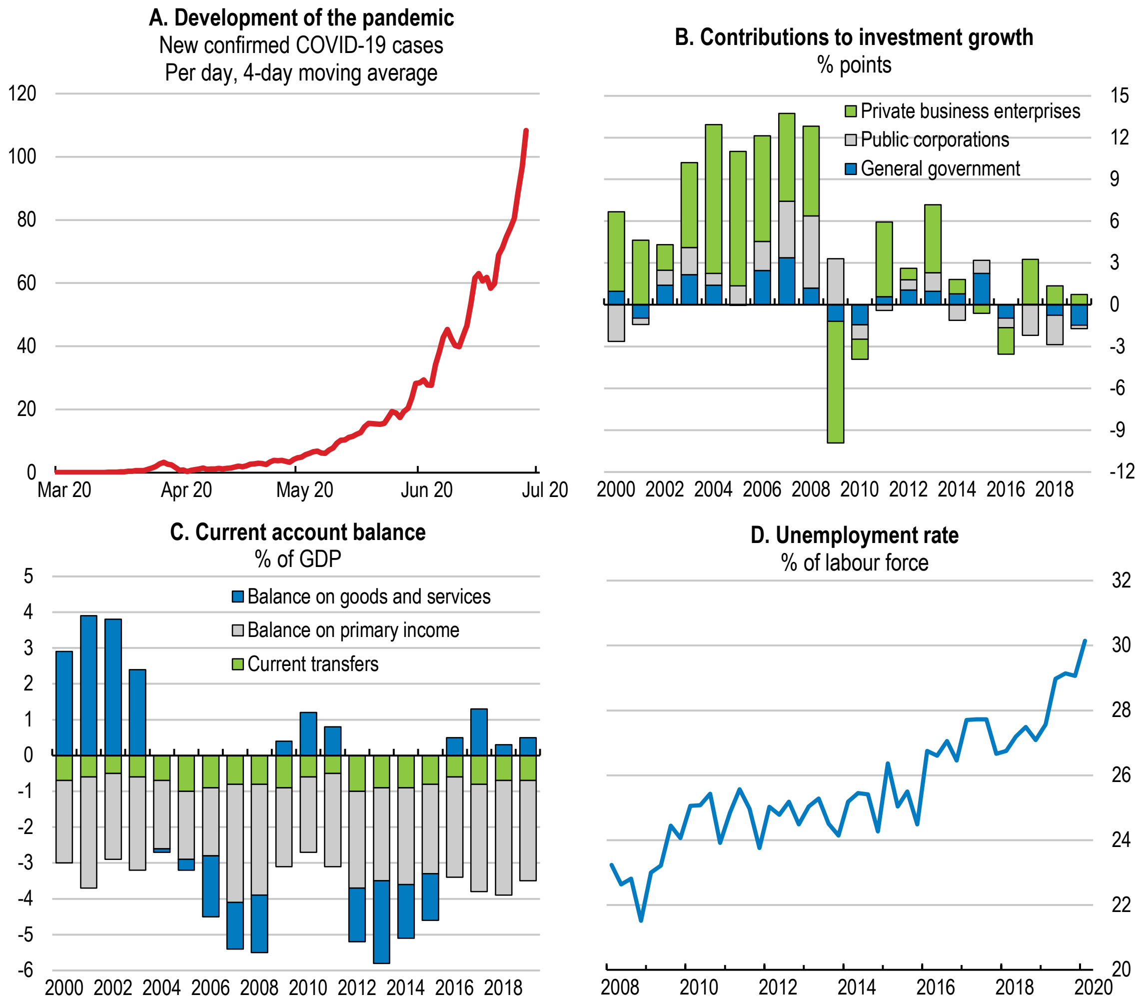
Figure 1.6. Macroeconomic developments have deteriorated



Source: OECD calculations based on Our world in data; South African Reserve Bank; Statistics South Africa.

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Table 1.1. The recovery is projected to be gradual

A. Double-hit scenario

South Africa: double-hit scenario	2016	2017	2018	2019	2020	2021
	Current prices ZAR billion	Percentage changes, volume (2010 prices)				
GDP at market prices	4 348.8	1.4	0.8	0.2	-8.2	0.6
Private consumption	2 584.4	2.1	1.8	1.0	-6.5	0.8
Government consumption	906.3	0.2	1.9	1.5	2.5	2.3
Gross fixed capital formation	846.6	1.0	-1.4	-0.9	-15.1	-1.0
Final domestic demand	4 337.3	1.5	1.2	0.8	-6.1	0.8
Stockbuilding[1]	- 11.3	0.4	-0.2	0.0	-1.1	0.0
Total domestic demand	4 325.9	1.9	1.0	0.7	-7.5	0.8
Exports of goods and services	1 333.0	-0.7	2.6	-2.5	-12.5	1.5
Imports of goods and services	1 310.2	1.0	3.3	-0.5	-10.0	2.0
Net exports[1]	22.8	-0.5	-0.2	-0.6	-0.5	-0.2
Memorandum items						
GDP deflator	_	5.6	3.3	4.2	2.7	3.3
Consumer price index	_	5.3	4.6	4.1	3.4	3.3
Core inflation index[2]	_	4.6	4.2	4.1	3.5	3.5
General government financial balance (% of GDP)	_	-3.8	-3.4	-6.5	-10.0	-8.2
Current account balance (% of GDP)	_	-2.5	-3.6	-3.0	-3.1	-3.0

1. Contributions to changes in real GDP, actual amount in the first column.
2. Consumer price index excluding food and energy.
Source: OECD Economic Outlook 107 database.

B. Single-hit scenario

South Africa: single-hit scenario	2016	2017	2018	2019	2020	2021
	Current prices ZAR billion	Percentage changes, volume (2010 prices)				
GDP at market prices	4 348.8	1.4	0.8	0.2	-7.5	2.5
Private consumption	2 584.4	2.1	1.8	1.0	-5.8	2.3
Government consumption	906.3	0.2	1.9	1.5	2.4	1.6
Gross fixed capital formation	846.6	1.0	-1.4	-0.9	-13.9	2.4
Final domestic demand	4 337.3	1.5	1.2	0.8	-5.5	2.1
Stockbuilding[1]	- 11.3	0.4	-0.2	0.0	-1.1	0.0
Total domestic demand	4 325.9	1.9	1.0	0.7	-6.8	2.2
Exports of goods and services	1 333.0	-0.7	2.6	-2.5	-10.8	5.6
Imports of goods and services	1 310.2	1.0	3.3	-0.5	-8.6	4.5
Net exports[1]	22.8	-0.5	-0.2	-0.6	-0.5	0.2
Memorandum items						
GDP deflator	_	5.6	3.3	4.2	2.9	3.8
Consumer price index	_	5.3	4.6	4.1	3.5	3.7
Core inflation index[2]	_	4.6	4.2	4.1	3.5	3.9
General government financial balance (% of GDP)	_	-3.8	-3.4	-6.5	-9.0	-7.6
Current account balance (% of GDP)	_	-2.5	-3.6	-3.0	-3.0	-2.5

1. Contributions to changes in real GDP, actual amount in the first column.
2. Consumer price index excluding food and energy.
Source: OECD Economic Outlook 107 database.

Both domestic and global risks weigh on the economic outlook (Table 1.2). Domestic near-term risks to growth include load-shedding (rolling blackouts) by the power utility and higher-than-expected electricity prices, which could derail the growth strengthening process. Moreover, the level of investor confidence in the economy remains low and vulnerable to policy developments. Globally, the Rand remains highly responsive to US interest rates and international capital market developments. On the other hand, a faster recovery in China would have growth spillovers for South Africa, including through higher demand and prices for commodity exports.

Table 1.2. Possible shocks to the South African economy

Shock	Potential impact
Pandemics	The COVID-19 outbreak in early 2020 highlights the risks of future pandemics leading to loss of life as well as economic dislocation due to interconnectedness of economies and global supply chains.
Rising debt servicing costs	If the government is unable to implement fiscal reforms, spiraling debt dynamics could affect macroeconomic and financial stability.
Electricity load-shedding	Prolonged periods of load-shedding create uncertainty and disturb production processes. It has already proven to be very damaging to growth back in 2014/15.
SOEs bankruptcy	Eskom is the biggest state-owned enterprise and represents the biggest government contingent liability through debt guarantees. A failure to proceed with its reform or severe liquidity problems could lead to negative market reactions and persistent weak investor confidence. SAA, the national airline company, filed for bankruptcy in December 2019.
Escalation of trade barriers	A slowdown or change of composition of growth in China puts mining exports at risk.
Volatility in global financial markets	Lower capital inflows, higher bond yields and a weaker rand will further increase the costs of government financing, reduce the scope for the central bank to reduce rates and lower growth.

Monetary and financial authorities are stabilising financial markets

As a result of the COVID-19 shock, wage and price inflations are likely to remain muted and continue revolving below the Reserve Bank's 4.5 percent inflation target. The Reserve Bank (SARB) has acted swiftly to limit the impacts of the COVID-19 crisis on the economy and the financial system, aided by declining inflation. Between March 19 and July 23 2020, the Reserve Bank reduced the repurchasing rate in four steps, from 6.25% to 3.50%. In addition, the Reserve Bank increased its interventions in the money market to provide more liquidity to financial institutions and ease lending conditions. The Reserve Bank has also initiated a program to buy government bonds in the market, ensuring the liquidity of the debt market.

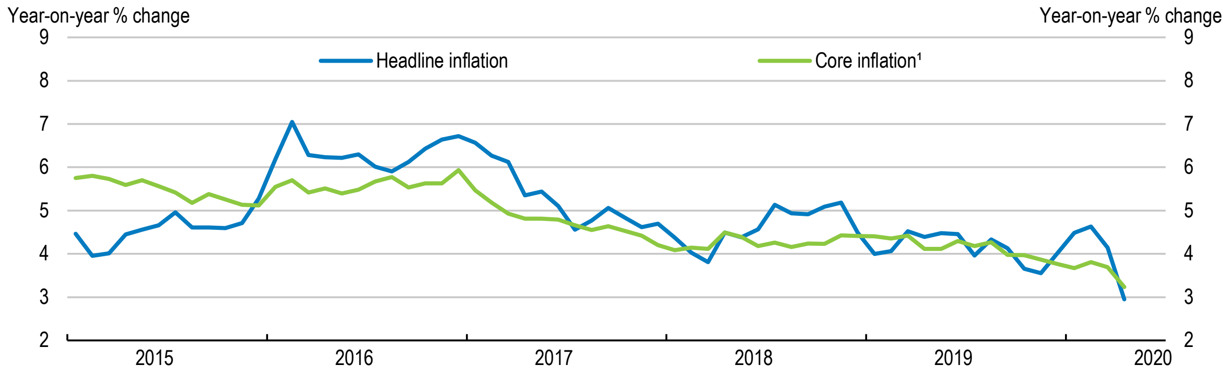
International capital flows and the government fiscal position are creating uncertainties for the monetary policy environment. The Rand depreciated by around 18% against the dollar in the first semester of 2020, with episodes of high volatility. Current debates on the Reserve Bank's independence and the structure of its shareholders threaten the credibility of its actions and, in the current challenging environment, add to policy uncertainty for foreign investors.

Inflation is trending down. At 3% in April 2020, inflation stood at a record low since June 2005. Inflation will be contained in the near term due to the collapse in demand, low imported inflation – particularly from oil – and moderate food price pressures. The main risks to inflation are unexpected constraints in the supply of goods and services and higher electricity price. The output gap will remain negative in the next two years following five years of underperformance. In this context, there is still room to ease monetary conditions, in particular, in the event of a second lockdown due to a new outbreak of COVID-19.

South Africa has sound macroprudential regulations and a robust financial system. Following the outbreak of the coronavirus, the Prudential Authority dropped minimum capital requirements and compulsory reserve funds for lenders, reduced the liquidity coverage ratio from 100% to 80% and relaxed accounting standards for losses in the financial sector (Box 1.1). Banks have built up a capital conservation buffer of 2.5 per cent as required by regulations, hence there is room to draw from this buffer if needed. Financial institutions continued to be highly capitalised with levels well above the minimum regulatory requirement before the crisis (Figure 1.8, Panel A).

Weak SOEs not only pose risks to the government finances, but may also affect to the broader financial system. However, over the last years the banking sector's total exposure to these entities has declined.

Figure 1.7. Inflation has slowed down



1. Consumer price index excluding food and NAB, fuel and energy.
Source: Statistics South Africa; SARB Database.

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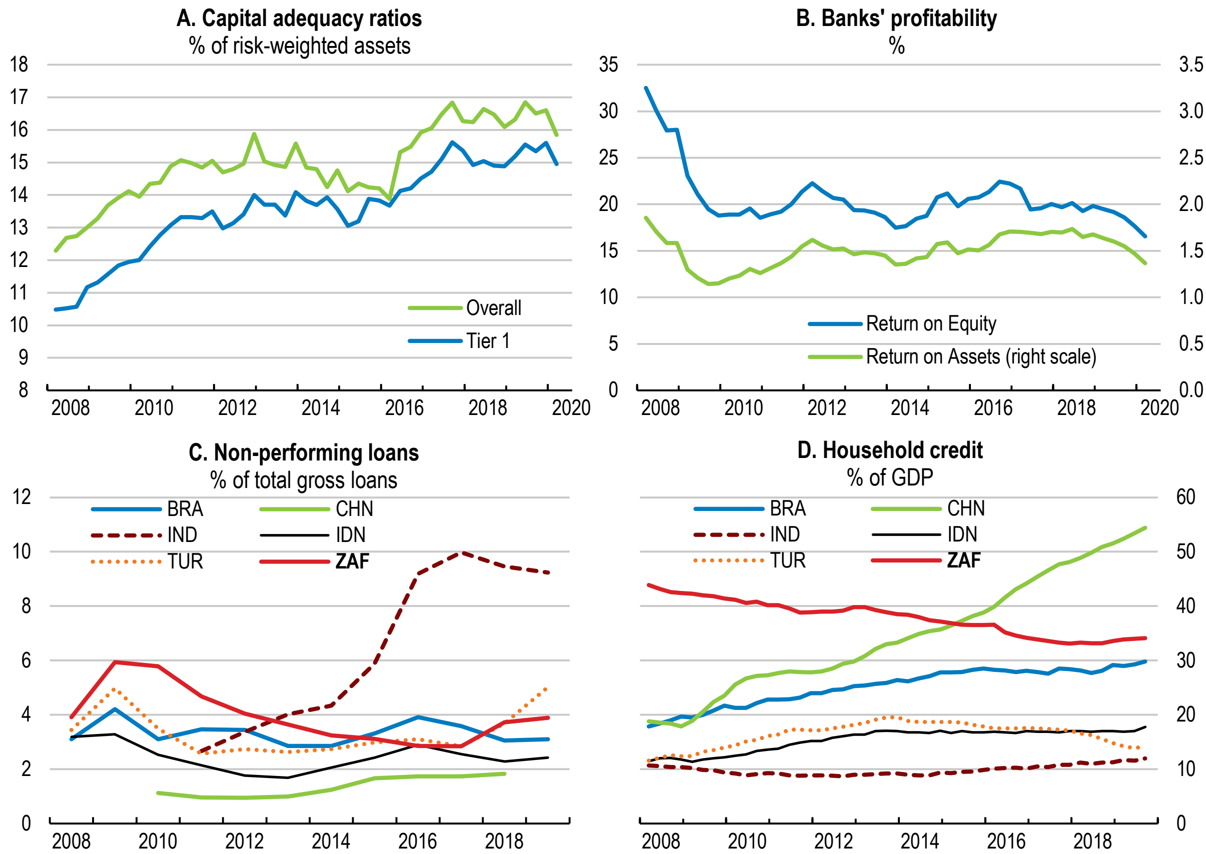
Constrained household finances in the low-growth environment pose risks to the financial sector. Since 2017, default ratios gradually trended upwards reaching 3.9% of total loans in 2019 (Figure 1.8, Panel C). Although this indicates a marginal increase in credit risk, it is well below the non-performing loans ratio of other BRIIC countries such as India (9.2%) and Russia (9.3%). However, risks are likely to increase as a result of the COVID-19 crisis, despite exceptional government support to jobs, households and businesses. Thus, despite a continuous decrease, household debt to GDP ratio is significantly higher than in other emerging market economies, standing at 34.1% in 2019/Q3. While the debt-service cost for households has declined, financial institutions' willingness to extend loans to households will further deteriorate.

Figure 1.8. Financial institutions were robust before the crisis



Source: IMF Financial Soundness Indicators database; OECD Resilience database.

StatLink http://dx.doi.org/10.1787/888934005587

Box 1.1. Financial policy response to the COVID-19 shock

The Reserve Bank reacted quickly to support liquidity on different markets by mobilising its main instruments. These include:

- Through the Intraday Overnight Supplementary Repurchase Operations (IOSRO), the SARB provides intraday liquidity support to the interbank market.
- The Standing Facilities borrowing and lending rates of the SARB will be adjusted to ensure liquidity in the money market.
- In addition, the Prudential Authority (PA) took several measures to help financial institutions to face the consequences of the crisis.
- Temporary capital relief is provided to still comply with international standards. The Regulations provide that banks shall continuously maintain, in addition to the base minimum capital requirement of 8% of risk weighted assets, a systemic risk capital requirement (Pillar 2A), an idiosyncratic risk capital requirement (Pillar 2b), a capital conservation buffer, a countercyclical buffer (CCyB) and a domestic systemically important bank (D-SIB) buffer. Both the CCyB and D-SIB buffers, when imposed, are an extension of the capital conservation buffer. The relief provided is that the Pillar 2A requirement is reduced to zero.
- The PA issued Directive 3 of 2020 includes selected short-term payment holidays and loan restructures. The PA is providing credit risk capital relief to banks. Loans had to be up to date on 29 February 2020 in order to qualify for the relief. Retail (which include residential mortgage advances, retail revolving credit, SME retail and retail other) and corporate (which include corporate, SME corporate and the various specialised lending asset classes) would be able to qualify.

Prudential authority issued a proposal dropping minimum capital requirements and compulsory reserve funds for lenders, reducing the liquidity coverage ratio to 80% from 100% and relaxing accounting standards when determining potential losses.

Stabilising debt and stimulating the economy

The crisis deepens existing fiscal challenges

Fiscal policy reacted forcefully to the coronavirus (Box 1.2). In total, ZAR 500 billion (10% of GDP) are mobilised including ZAR 200 billion for loan guarantees for enterprises, ZAR 70 billion in tax policy measures, ZAR 100 billion to protect and create jobs and around ZAR 41 billion is dedicated to support households. The Temporary Employer/Employee Relief Scheme (TEERS) managed by the Unemployment Insurance Fund has provided income support to around 2 million employees. Social benefits/grants were augmented and two additional grants deployed to cover, in particular, informal workers who never received any kind of social transfers. An important part of the relief plan targeted businesses in the form of new financial facilities, loans, guarantees and subsidies to make sure that viable firms survive the crisis and to limit job destruction. Sectoral plans were put in place to target SMMEs in the tourism and transport areas for instance.

Box 1.2. Fiscal Policy response to the COVID-19 shock

The government has taken a number of measures in response to the spread of the coronavirus and the economic consequences of the lockdown. In addition to medical and health response actions, different measures were put in place to shield households and businesses. The main support packages were:

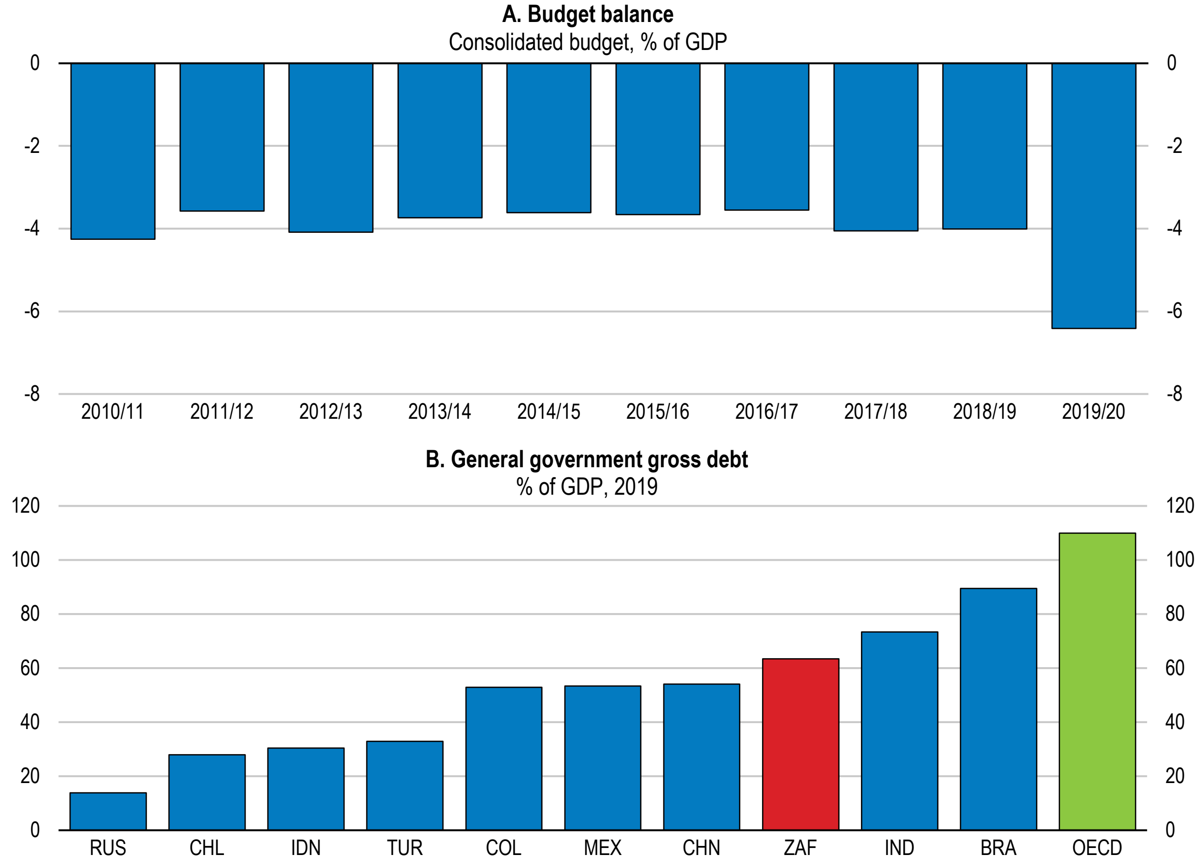
- Grants: A temporary 6-month Coronavirus grant was created. Child support grant beneficiaries are receiving an extra ZAR 300 in May and from June to October they will receive an additional ZAR 500 each month. Other grant beneficiaries are receiving an extra ZAR 250 per month for the next six months. In addition, a special Covid-19 Social Relief of Distress grant of ZAR 350 a month for 6 months is paid to individuals who are currently unemployed and do not receive any other form of social grant or UIF payment.
- UIF Temporary Employer/Employee Relief Scheme: set-up until end of August to cover employees who lost their job or have been on partial unemployment or forced holidays. As of 24 of June, has disbursed ZAR 28 billion for around 4 million employees.
- Tourism Relief Fund: provides one-off capped grant assistance to Small Micro and Medium Sized Enterprises (SMMEs) in the tourism value chain to ensure their sustainability during and post the implementation of government measures to curb the spread of Covid-19 in South Africa.
- Loan guarantee: in partnership with major banks, the National Treasury and the South African Reserve Bank, the scheme assists enterprises with operational costs, such as salaries, rent and the payment of suppliers.

Main COVID-19 tax relief measures

- An increase in the employment tax incentive to safeguard employment and incentivise job creations.
- A deferral of employees' tax liabilities (pay-as-you-earn) and provisional tax payments for businesses to help cushion liquidity shortages.
- A four-month exemption in the skills development levy from 1 May 2020.
- A three-month postponement of the filing and payment date for carbon tax liabilities to 31 October 2020.

Higher deficits and increasing debt levels threaten fiscal sustainability. Before the crisis, South Africa had been running increasingly large deficits and the debt to GDP ratio was trending upward (Figure 1.9 and Table 1.3). This was largely determined by an increasing wage bill, transfers to SOEs and rising debt servicing costs. To a lesser extent, lower revenue collections also contributed to the deficit. The recent decline in monetary policy rates and the Reserve Bank's liquidity interventions are helping to support demand for government bonds. However, government borrowing rates remain high, posing risks to debt sustainability. Since the end of March, all rating agencies have put government debt at sub-investment grades.

Figure 1.9. Fiscal accounts have deteriorated



Source: National Treasury, 2020 Budget Review, 2020 Supplementary Budget Review; IMF, World Economic Outlook April 2019 database; OECD Economic Outlook database.

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Table 1.3. Fiscal indicators

% of GDP

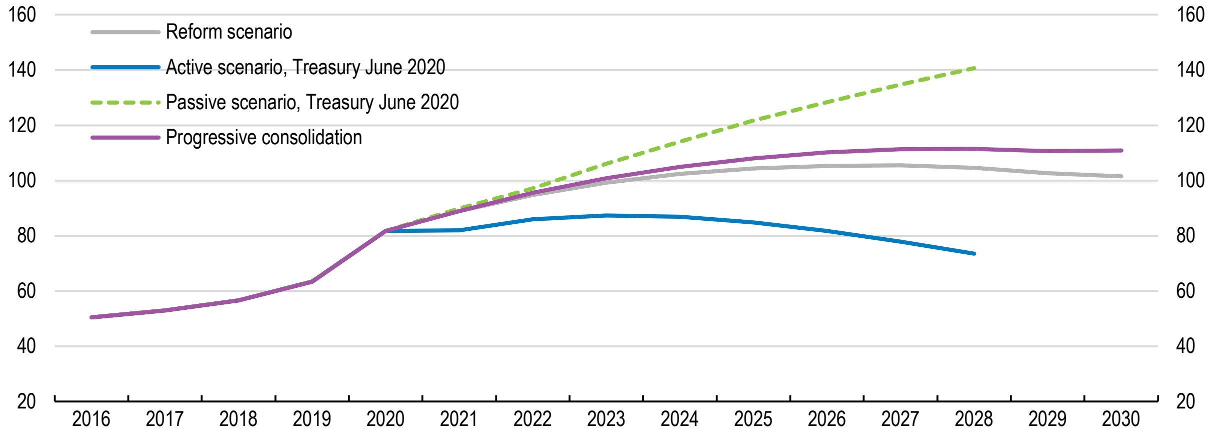
	2016/17	2017/18	2018/19	2019/20	2020/21[1]	2021/22[2]	2022/23[2]
Spending and revenue							
Revenue	25.7	25.5	25.9	26.1	22.6	23.8	24.5
Spending	29.5	29.9	30.6	32.6	37.2	33.1	32.2
Debt-service-costs	3.3	3.5	3.7	4.0	4.9	4.9	5.4
Budget balance							
Fiscal balance	-3.8	-4.4	-4.7	-6.5	-14.6	-9.4	-7.7
Primary balance	-0.5	-1.0	-1.0	-2.6	-9.7	-4.4	-2.3
Public debt							
Gross loan debt	50.5	53.0	56.7	63.5	81.8	82.0	86.0
Net loan debt	45.4	48.1	51.7	58.4	77.4	79.9	83.9
Contingent liabilities	15.16	15.67	17.31	19.00	19.19	19.06	19.00

1. Preliminary estimates.
2. Projections
Source: National Treasury, Budget Review February 2020 and Supplementary budget, June 2020.

Debt has been increasing in the last decade and is projected to exceed 80% of GDP by 2020, a level that is considered high in various studies of vulnerabilities in emerging markets (Fournier and Fall, 2015). The National Treasury presented two debt scenarios in the June Supplementary Budget. In the passive scenario, in which the government takes no steps in response to weaker growth and higher spending than those outlined in the 2020 Budget Review, debt would spiral rapidly, exceeding 100% of GDP from 2022 (Figure 1.10). It would not be sustainable in the South African context of low growth and high borrowing rates. In the active scenario, the deficit would be reduced strongly starting in 2021 and the debt level would start decreasing from a peak of 87% of GDP in 2023. Figure 1.10 shows that if the government fails to implement bold economic and fiscal reforms and the reduction of the deficit is only progressive, the debt level will only stabilise by 2028. Reforms are therefore urgently needed (Box 1.3). Ensuring fiscal sustainability will require measures that will curtail wage bill growth and SOE financing and contain spending growth in higher education, raise revenue and improve the efficiency of public spending.

Figure 1.10. Actions are necessary to guarantee the sustainability of government debt

Gross debt, % of GDP



Note: The Active and Passive scenarios are from the Supplementary budget presented by the National Treasury before the parliament in June. It shows the debt dynamics in a no action configuration versus implementing spending cuts that reduces the deficit. The progressive consolidation scenario corresponds to an improvement of the deficit by 1 pp of GDP each year until 2030 and to a 2% GDP growth from 2025. The reform scenario takes into account the effects of implementing structural reforms that would increase potential growth to 3.5% from 2025.
Source: National treasury, Supplementary Budget, June 2020 and OECD calculations.

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Problems with tax administration have affected revenue-collection performance. Improving collections hinges on restoring the efficiency of the South African Revenue Service (SARS) and implementing the recommendations of the SARS reform commission.

Box 1.3. Announced measures in the Budget Review in the last two years partially or not implemented

Measures announced in February 2019 Budget Review

- Splitting Eskom, the national electricity company, into three viable operating entities under a single state-owned holding company.
- Establish a more competitive electricity sector by diversifying the generation of electricity across a multitude of power producers.
- Allocation of telecommunications spectrum
- Change performance bonus payments within the public administration.
- Reform the Procurement Bill

Measures announced in February 2020 Budget Review

- Speed procurement processes in the electricity sector by changing the Electricity Regulation Act to boost electricity supply from independent power producers.
- Establish and independent regulation authority for ports.
- Accelerate the auction process of telecommunication spectrum.
- Finalise the Economic Regulation of Transport Bill to improve third-party access to freight rail.
- Improve government spending efficiency, reduce waste and finalise the Public Procurement Bill
- Reform the provincial grant system
- Review of the tax incentive system to repeal or redesign those that are redundant, inefficient or inequitable
- Introduce a remuneration framework for public entities and state-owned companies to eliminate excessive salaries and bonuses awarded to executives and managers.
- Improve the wage-setting mechanism for the broader public services.
- Reduce the government wage bill by ZAR 160 billion (around 10% of non-interest expenditure) over the next three years through a combination of modifications to cost-of-living adjustments (wage increase), pay progression and other benefits.

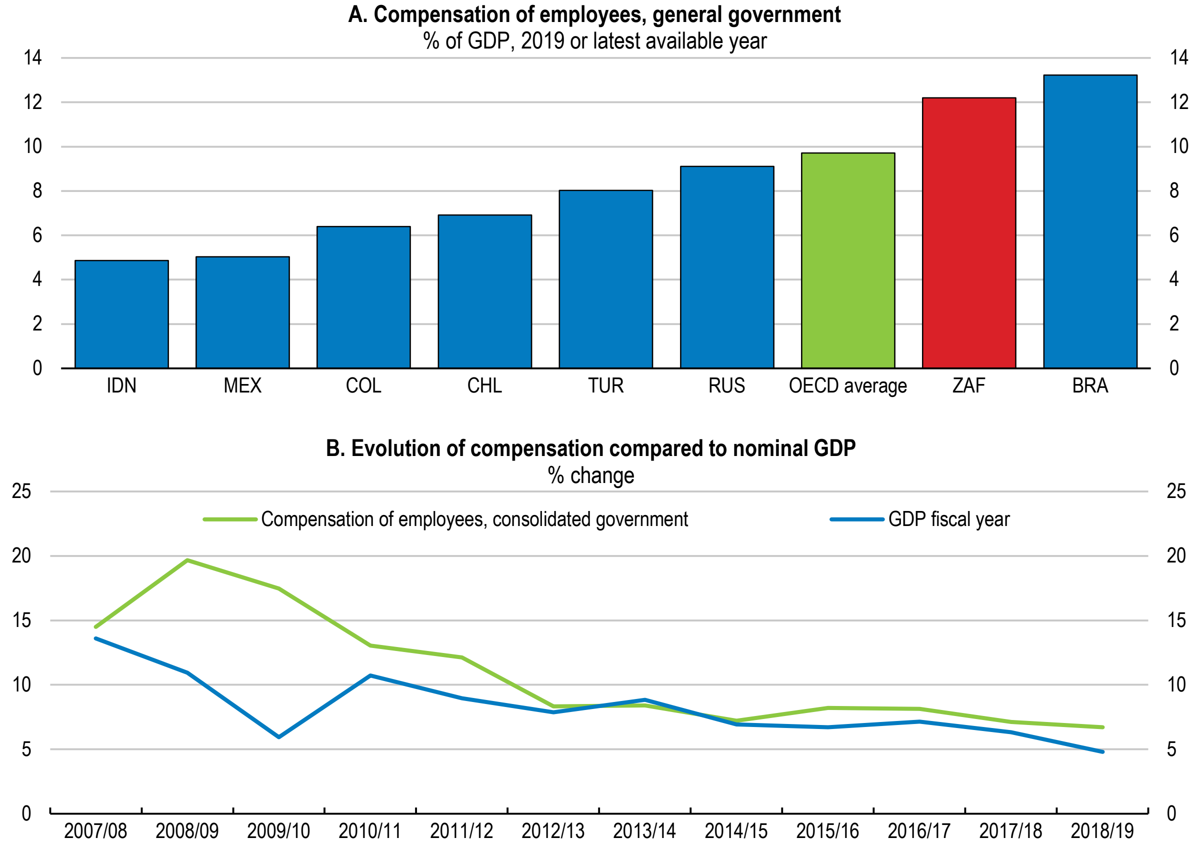
Table 1.4. Past OECD recommendations on broadening the tax base

Recommendations from previous surveys	Action taken since the July 2017 Survey
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. The carbon tax has been adopted in July 2019.
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.

Managing spending pressures: The government wage bill

The general government wage bill at 12% of GDP is one of the highest among OECD and partner countries (Figure 1.11). At 38% of total consolidated government spending, the compensation of employees was the largest spending item in 2019 (National Treasury of South Africa, 2020). In the last decade, compensation spending increased at an average of 11% per year, growing at a rate higher than nominal GDP (Figure 1.11, Panel B).

Figure 1.11. Compensation of general government employees



Source: IMF, Government Finance Statistics database; Budget Review 2020, National Treasury, South Africa.

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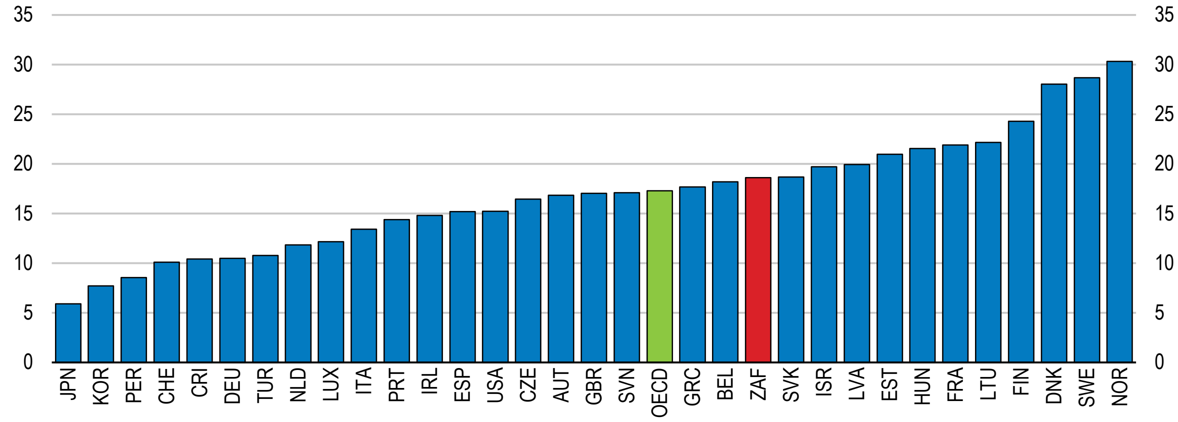
Public sector wage increases are the main driver of government spending rather than increases in employment. In the last decade, the number of public sector employees rose only by around 100 000. Public sector employment is close to OECD average but relatively high when compared to emerging economies (Figure 1.12). Moreover, since the implementation of government recruitment freeze in 2011, the number of public sector employees has been trending down. The remuneration policy explains the increase of the wage bill. In real terms, per capita remuneration in the public sector rose by 3.1% on average annually, and by even 4.1% for civil servants with long tenure (more than 10 years) in the last decade (National Treasury, 2018b). Wage negotiations have systematically granted above-inflation increases. Moreover, promotion policies contributed to wage bill increases. In 2006/07, 31% of public servants were in the salary levels 1–4 and 10% in the levels 9–16; by 2017 the respective figures were 19% and 21% (National Treasury, 2018b). In addition, occupation-specific salary dispensations (OSD) have been introduced for specialised personnel, including medical doctors, nurses, teachers, police officers, lawyers, magistrates and engineers allowing for extra pay for these categories. In some cases, this led to substantial increases in remuneration in the year of their introduction.

Figure 1.12. Public employment is close to the OECD average

Employment in general government as a percentage of total employment, 2017 or latest available year



Note: Total employment refers to the domestic employment.
Source: OECD National Accounts database; ILO, ILOSTAT database; Statistics South Africa, Quarterly Employment Statistics (QES).

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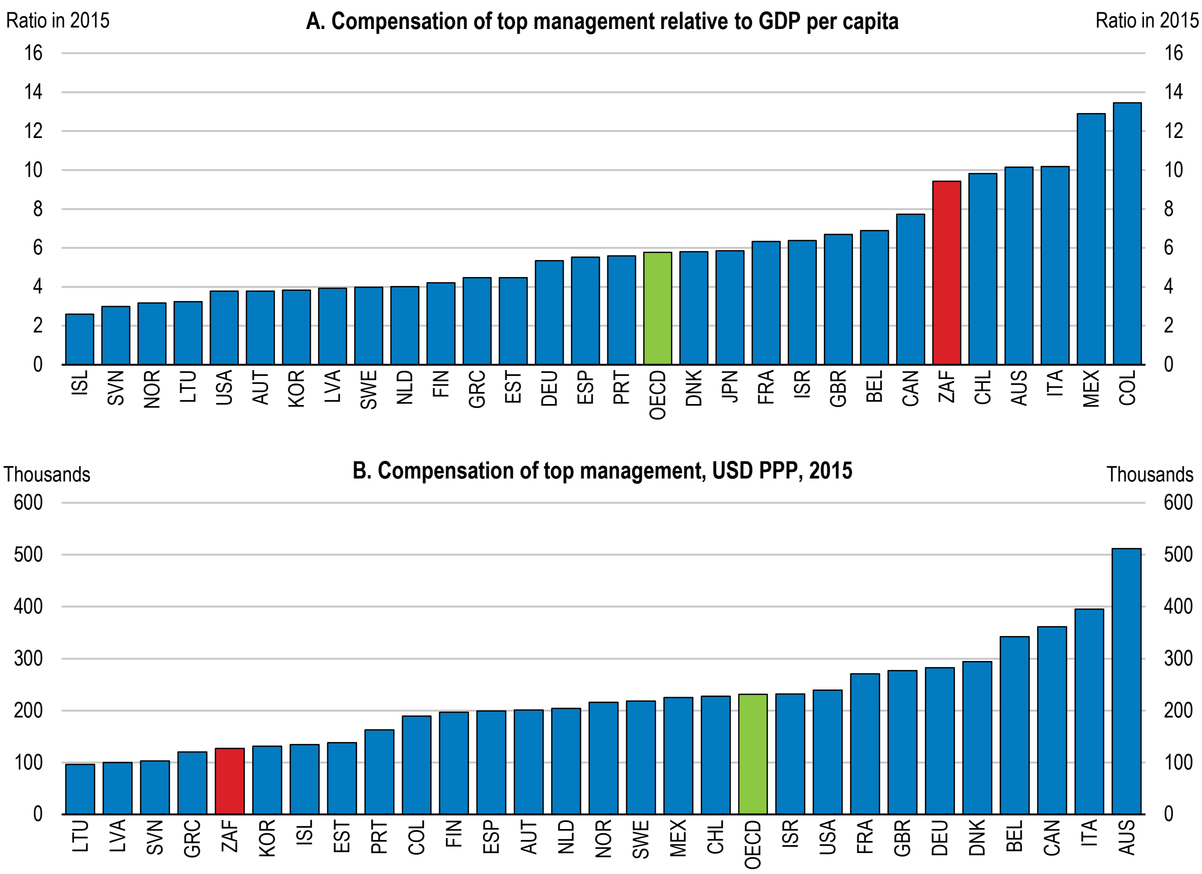
The remuneration level of civil servants is relatively high when compared to OECD and other emerging economies. Figure 1.13 compares the remunerations of top management in the public sector (just below the minister or secretary of states) across OECD countries and South Africa. Top managers in the South African civil service earn an average revenue corresponding to nine times of the GDP per capita in 2017, while the ratio is below six for the OECD average (Figure 1.13, Panel A). Compared in terms of US dollar purchasing power parity (PPP), the remuneration of South African public sector managers is comparable to their counterparts in Norway (Figure 1.13, Panel B). Even for non-management senior officials, teachers and education personnel, South Africa has one of the highest levels of remuneration both in terms of GDP per capita and US dollar PPP (Figure 1.14, Panel A and B).

In addition to the freeze in public sector recruitment, the government is seeking new measures to limit its wage bill growth. In the 2019 budget, the government announced an early retirement plan targeting 30 000 employees aged between 55 and 59 years old, targeting around ZAR 20 billion in savings. Take up of the early retirement plan has been slow and the targeted savings will not be realised. The government has announced in the 2020 budget its intention to cut the wage bill by ZAR 160 billion over three years, mainly through a combination of modifications to cost-of-living adjustments (wage increase), pay progression and other benefits.

The government could consider indexing public sector wages below inflation for three years. An inflation minus 2 percentage points in the public service could generate around ZAR 30 billion savings over three years. As inflation has receded and given the wage gains of recent years, the real cost to civil servants would be limited as they would still benefit from annual progression in the pay scale. Such a measure could create fiscal space for government investment in infrastructure and education (Table 1.5). Furthermore, wage indexation should be linked to productivity developments, taking into account practices in Australia and Nordic countries.

Figure 1.13. Remuneration of civil servant managers is relatively high



Note: South Africa data refer to 2017. The managers include 25 103 individuals and 2% of personnel and not on occupation-specific salary dispensations, which is larger than for other countries.
Source: OECD Government at a Glance 2017 and MTBPS 2018, National Treasury South Africa.

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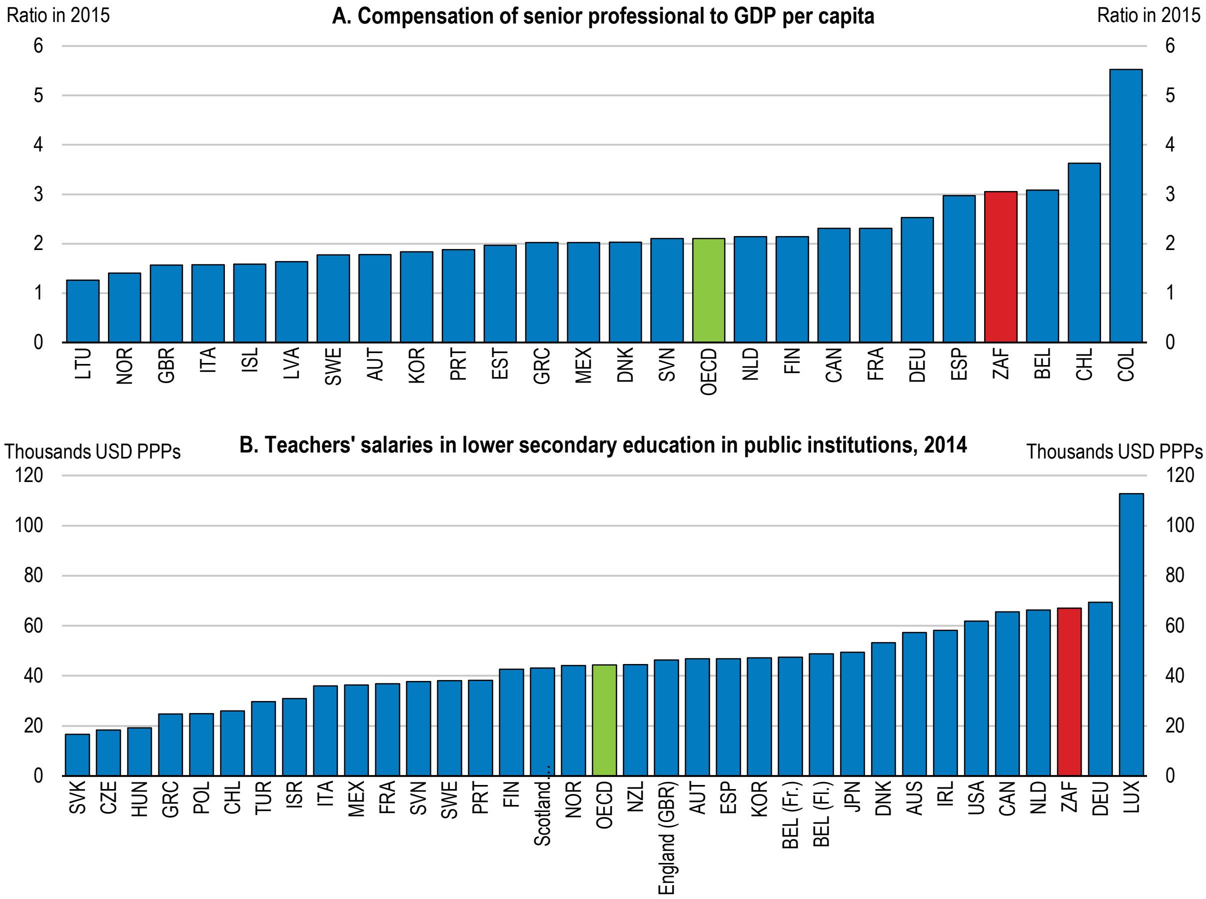
Figure 1.14. Remuneration of non-managers is also high



Note: For panel A, South Africa number regroups all non-managers on regular pay scale and refers to 2017. For Panel B, South Africa number is for all staff on education including non-teachers and refers to 2017.
Source: OECD Government at a Glance 2017 and MTBPS 2018, National Treasury South Africa.

StatLink http://dx.doi.org/10.1787/888934005739

Table 1.5. Illustrative annual fiscal impact of reforms proposed by the OECD

Per cent of GDP on an annual basis

	Per year
Expenditures	
Index wages in the public service below inflation for 3 years	-1.0[1]
Substitute government spending on higher education by bringing in bank loans	-0.5
Increase public investment on infrastructure	+1.4
Measures not estimated	
Improve the energy mix by substituting coal by renewables as an energy source	
Reform state-owned companies and partial privatisation	

1. Over three years, the medium-term budget horizon.
Source: OECD calculations.

Table 1.6. Past recommendations on macroeconomic policy and fiscal sustainability

Recommendations from previous surveys	Action taken since the July 2017 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	Spending increases have slowed before the crisis. Additional tax raising measures have been introduced. The expenditure ceiling has been lowered further.
The government should continue to seek opportunities to increase the efficiency of public expenditure.	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 levels are subject to a competitive bidding process. Efforts to expand centralised procurement of goods and services and renegotiation of transversal contracts continue.
Limit annual wage increases in the public sector and where possible redeploy civil servants to priority areas (*2017 Survey*)	No action taken.
Deepen implementation for public procurement reform and enforce sanctions for breaches of the Public Financial Management Act (*2017 Survey*)	No action taken.
Ensure that state-owned enterprises respect procurement and expenditure rules (*2017 Survey*).	No action taken.

Reforming state-owned enterprises to limit government contingent liabilities

Government exposure to state-owned entities is high and represents risk to debt sustainability and public finances (Table 1.7). In 2020, the total amount for approved guarantee to SOEs is ZAR 484 billion, with associated exposure estimated at ZAR 385 billion. The financial performance of SOEs is putting considerable pressure on public finances. The COVID-19 crisis is worsening the financial situation of many SOEs. In the 2020 government budget, ZAR 44 billion are allocated to SOEs but it is likely that transfers to SOEs will be higher. South Africa Airlines to which the government granted ZAR 19 billion guarantees is in a bankruptcy process. The underperformance of SOEs is widespread due to mismanagement, corruption, overstaffing and uncontrolled spending. Most of the main state-owned enterprises are in a very bad financial situation, some resorting to borrowing to finance their operational costs and not being able to meet their debt and interest payments (National Treasury of South Africa, 2019). The government has started to reform key SOEs. New boards and executives have been appointed at several of these entities and public inquiries into state corruption have also started. The impact of these reforms rests on the level of discipline that is either imposed by markets or the state. The current governance framework falls short in implementing either form of discipline.

Table 1.7. Government exposure to state-owned enterprises is high

	2017/18		2018/19		2019/20	
% of GDP	Guarantee	Exposure[1]	Guarantee	Exposure[1]	Guarantee	Exposure[1]
Public institutions	10.0	7.0	9.9	7.5	9.4	7.5
Of which:						
Eskom	7.4	5.3	7.1	5.8	6.8	5.8
SANRAL2	0.8	0.6	0.8	0.8	0.7	0.8
Trans-Caledon Tunnel Authority	0.5	0.4	0.9	0.3	0.8	0.3
South African Airways	0.4	0.2	0.4	0.3	0.4	0.3
Land and Agricultural Bank of South Africa	0.2	0.1	0.2	0.0	0.2	0.0
Development Bank of Southern Africa	0.3	0.1	0.2	0.1	0.2	0.1
Independent power producers	4.3	2.6	4.1	3.0	3.9	3.1
Public private partnerships3	0.2	0.2	0.2	0.2	0.2	0.2

1. Total amount of borrowing, adjustments to inflation-linked bonds as a result of inflation rate changes and accrued interest.
2. The exposure in 2017/18 excludes adjustments to inflation-linked bonds as a result of inflation rate changes.
3. These amounts only include national and provincial PPP agreements
Source: Budget Review 2020, National Treasury.

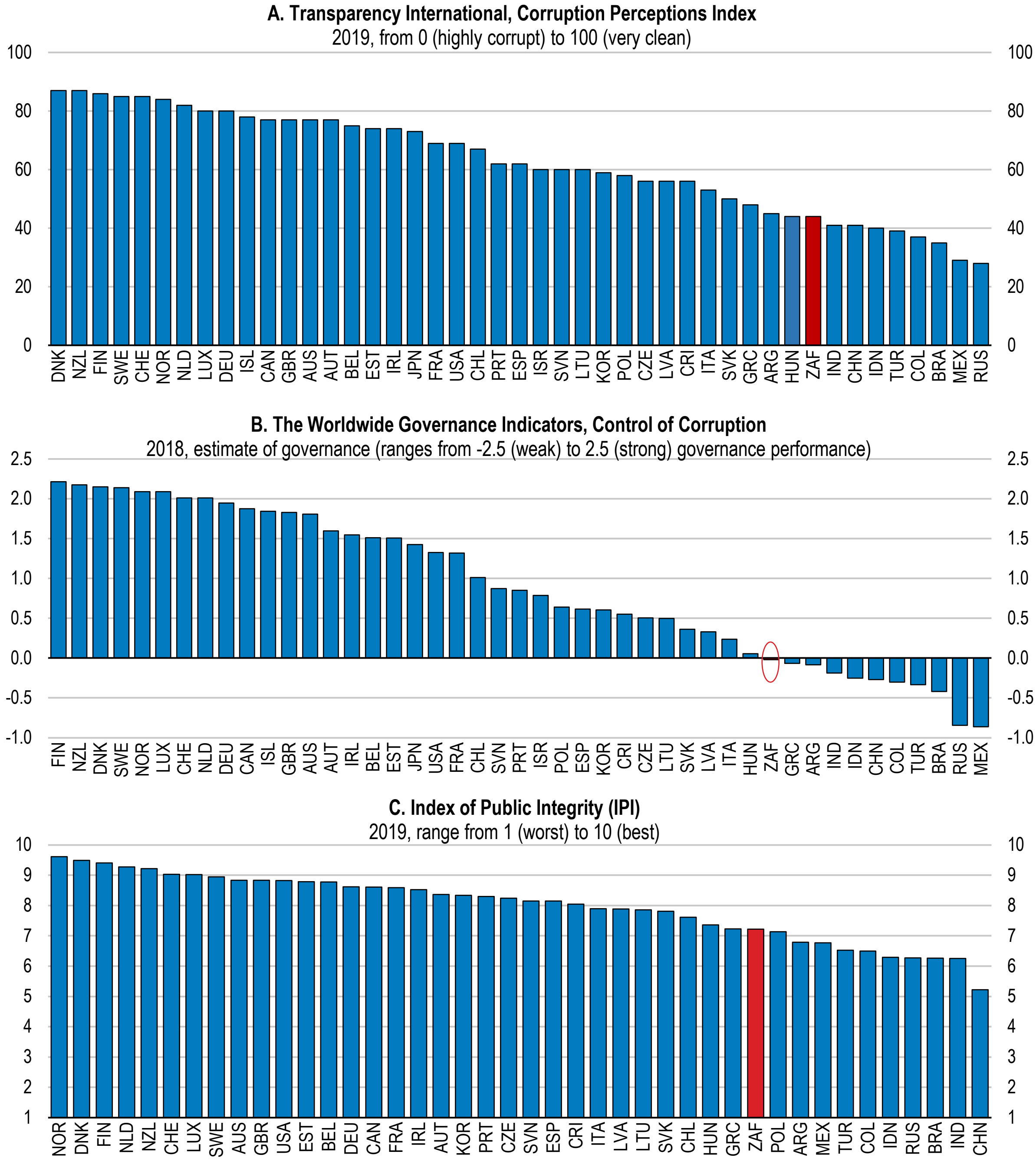
Eskom, the biggest state company and power producer, poses a significant risk to debt sustainability and to South Africa’s economy. Since 2010, the government has extended a total of ZAR 350 billion of guarantees to Eskom’s construction of new power plants, ZAR 297 billion of this guarantee has materialised A further ZAR 220 billion of guarantees were granted to independent power producers from which Eskom is contracted to purchase electricity. The Eskom risk has become a reality when it became apparent that Eskom was no longer able to meet its operational costs and interest and capital payments. This has forced the government to allocate ZAR 23 billion per year over the next three years to support Eskom face its obligations and reconfiguration. (National Treasury of South Africa, 2019). To reform Eskom, the government has announced the partial breakup of the company, dividing it into generation, transmission and distribution businesses (National Treasury, n.d.). Ultimately, each entity will be a separate firm (juridical personality) under one holding company (Eskom). The breakup will make each entity more competitive and will help attract private investors to these entities. It would also reduce the potential for corruption. The government and Eskom’s new management should proceed with the implementation of Eskom’s restructuring and application of standard accounting and management principles as called for in the OECD Guidelines on Corporate Governance of State-Owned Enterprises. Moreover, the government should proceed to a deep restructuring of SOEs to guarantee that they cover their operating costs, including lay-off of unnecessary staff and bringing in private participation.

Official inquiries into allegations of corruption and state capture are underway

Major state-owned companies such as Eskom, Transnet, SAA, Denel and SARS have been at the centre of state capture allegations, which has damaged their financial health, management and functioning. State capture refers to a type of systemic political corruption in which private interests significantly influence a state’s decision-making processes to their own advantage through illicit, non-transparent provision of private gains to public officials. Government has begun the process of reforming these key entities, including appointing new boards and executives, which in turn have lodged criminal cases related to allegations of corruption with the police. The Judicial Commission of Inquiry into Allegations of State Capture and the Commission of Inquiry into Tax Administration and Governance by the South African Revenue Service have both highlighted serious governance failures. The State Capture inquiry is instructed to enquire, investigate and make recommendations into all allegations of state capture, corruption and fraud in the public sector. President Ramaphosa also established commissions of inquiry into the Public Investment Corporation (PIC) and the National Prosecuting Authority (NPA) in late 2018, with both still ongoing.

Governance failures of SOEs are reflected in inefficiency, corruption and financial mismanagement that have harmed service delivery, increased pressure on the budget and eroded investor confidence. In 2019, South Africa received a score of 44 on Transparency International’s Corruption Perception Index, placing it 70th out of 180 countries (Figure 1.15). This is in line with the global average score of 43 and many of South Africa’s peers, but lower than the OECD average of 69. Corruption promotes mistrust, undermines democratic institutions and the rule of law, corrodes social fabric, and threatens sustainable economic development.

Figure 1.15. South Africa performs poorly on corruption measures



Note: The Corruption Perceptions Index (Panel A) measures the perceived levels of public sector corruption in 180 countries and territories. The index score is on a scale of zero (highly corrupt) to 100 (very clean).
Source: Transparency International, Corruption Perceptions Index 2019; World Bank, The Worldwide Governance Indicators, 2019 Update; European Research Centre for Anti-Corruption and State-Building, The 2019 Index of Public Integrity.

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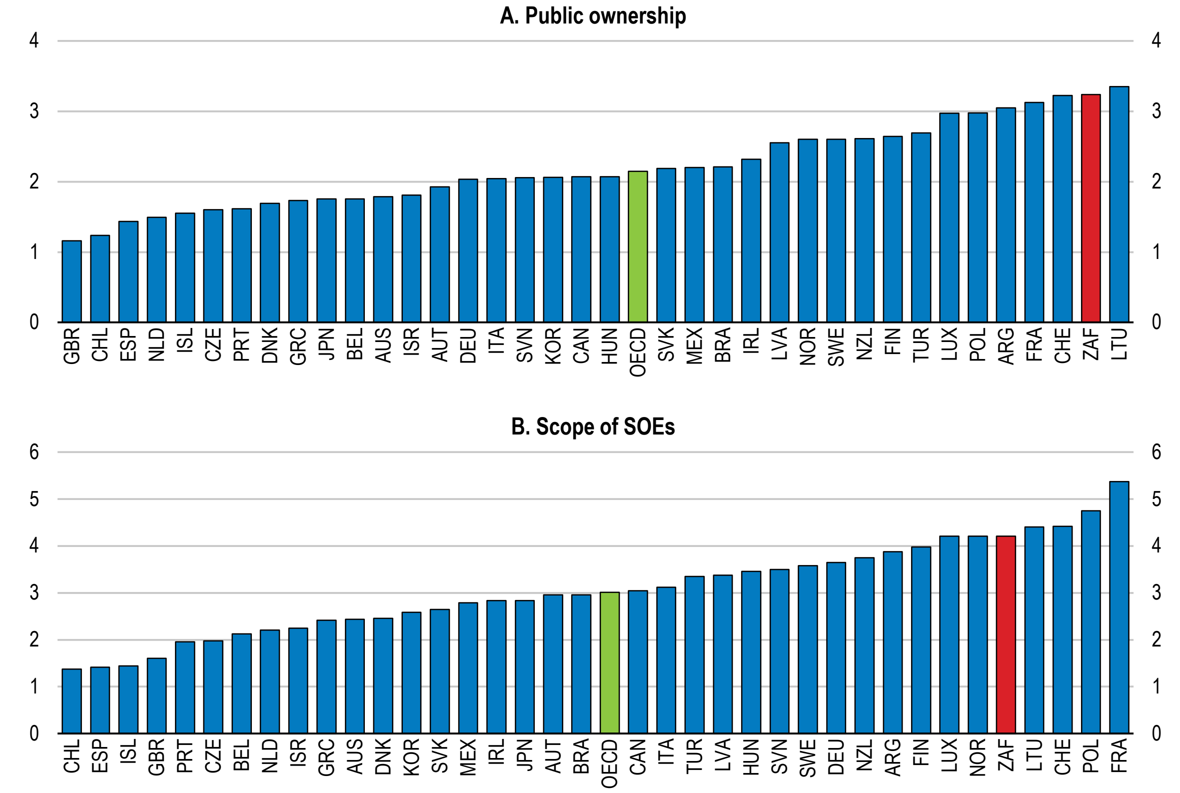
South Africa has addressed a number of the recommendations made by the OECD Working Group on Bribery in the South Africa Phase 3 report (OECD, 2014) on combating bribery of foreign public officials. However, many investigations have not progressed to prosecution. Better enforcement of national and foreign corruption offences is needed to restore public confidence and proper functioning of public services.

An effective governance framework for SOEs is needed

Beyond the risk that SOEs pose to government finance, they also represent an important part in the economy. South Africa has one of the highest public ownership of firms with an extended scope in the economy among OECD and emerging economies (Figure 1.16 and 1.17). Such a prevalence of public entities has effects on the competitiveness of the economy through the cost of intermediate goods (in particular network services) and competition (entry-exit) in these sectors. In the case of South Africa, where most public firms are underperforming, it has detrimental effects on the cost of doing business.

Figure 1.16. Public firms grasp on the economy is high

Index scale of 0–6 from least to most restrictive, 2018



Source: OECD 2018 PMR database.

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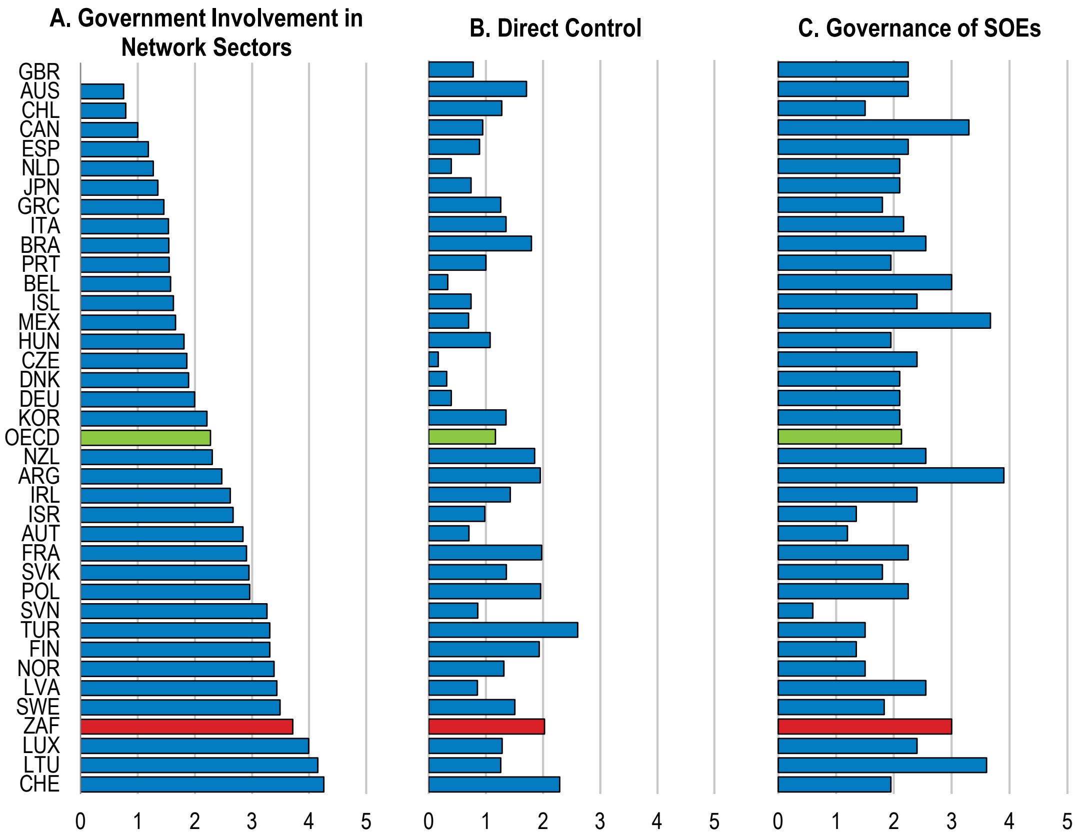
South Africa needs to establish an effective governance framework of SOEs, setting clear company-specific objectives in terms of profitability expectations, capital structure and non-financial objectives that SOEs are expected to deliver (OECD, 2015c). Transparency and accountability of SOEs can increase confidence and predictability, which are key factors for attracting much needed investment and private participation in areas traditionally dominated by the state. OECD Guidelines on Corporate Governance of State-Owned Enterprises provide key principles that could help in setting up a contractual framework between SOEs and the state. In particular, professionalising SOEs' boards including the participation of competent independent members is instrumental for transparency and proper monitoring of SOEs. A clear distinction between the roles and powers of the board and the executive management is necessary, along with the assurance of operational independence of the executive management and the limited temporary governmental intervention. The state should act as an informed and active owner to set the objectives, to validate the strategy, to guarantee the governance of SOEs is carried out in a transparent and accountable manner, and to ensure SOEs are subject to high quality accounting, disclosure, compliance and auditing standards.

Figure 1.17. Government involvement in the economy through SOEs is high

Index scale of 0–6 from least to most restrictive, 2018



Source: OECD 2018 PMR database.

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Managing spending pressures: Financing higher education

South Africa has severe skills shortages and poor basic education outcomes despite high levels of fiscal spending (OECD, 2015 and 2017a). Higher education has been a growing component of expenditure. At the end of 2017, the outgoing President Zuma announced the introduction of fee-free higher education for students from poor and working-class families. The announcement came on the back of students protesting against continuously rising tuition fees and the need to expand access to higher education. In 2015, only 12% of the 20–24 year old participated in post-secondary and tertiary education – significantly below the OECD average of 35% (OECD, 2019). Despite high private returns to higher education in South Africa, financial constraints are the main barrier for potential students to enrol (OECD, 2013b). Moreover, financial support during the course of study affects graduation rates. Indeed, van Broekhuizen et al. (2017) show that students from low-income families that received student aid during their course of study were more likely to graduate than non-supported students.

Since the beginning of 2018, the eligibility for National Student Financial Aid Scheme (NSFAS) was expanded significantly. The annual income threshold for students' families increased from ZAR 160 000 in 2017 to ZAR 350 000. This translates into about 90% of students being eligible under the new scheme (World Bank, 2019). In addition, the NSFAS was converted from a combination of bursary and income-contingent loan scheme into a full bursary for first time entrance to university with a family income under

ZAR 350 000 per annum. Under the new scheme, the NSFAS covers the full cost of study for undergraduate university and technical vocational education and training (TVET) college students. This includes tuition fees, prescribed study material, meals, and a certain level of accommodation and/or travel allowances. In addition, an 8% increase in tuition fees for students from families with an annual household income of between ZAR 350 000 and ZAR 600 000 will be covered by the government through subsidies to universities (National Treasury, 2018a).

In 2018, the support only applied to students in their first year of study. In 2019, the arrangement expanded covering first and second-year students. NSFAS students that were already in undergraduate university from families with household incomes below ZAR 122 000 per year saw their loans converted into grants. Government spending on the National Student Aid Scheme is therefore expected to more than triple by 2022 due to the reform (Table 1.8). In total, government spending on higher education as share of GDP is expected to increase from 1.3% in the fiscal year of 2017/18 to 2.6% in 2022/23.

Table 1.8. Development of government spending on higher education

	Audited outcome	Audited outcome	Audited outcome	Revised estimate	Medium-term expenditure estimate		
	2016/17	2017/18	2018/19	2019/20	2020/21	2021/22	2022/23
ZAR million							
University transfers	39 446	41 851	59 139	73 358	79 178	84 333	88 168
TVET	7 232	7 725	10 946	12 571	13 074	14 644	15 279
Community College	1 775	1 933	1 979	2 061	2 514	2 687	2 780
Other	645	748	802	869	944	1 090	1 146
National Student Financial Aid Scheme	11 216	9 957	21 827	30 542	34 792	36 622	38 185
Total	60 314	62 214	94 693	119 401	130 501	139 375	145 558
% of GDP	1.36%	1.32%	1.92%	2.32%	2.66%	2.67%	2.63%

Note: Years refer to fiscal years going from March to February.
Source: National Treasury (2020a, 2020b), National Budget 2020 and 2020 Supplementary Budget.

Reducing financial barriers for access to higher education is an important objective in South Africa's context. In OECD countries, higher levels of educational attainment tend to translate into higher earnings, thus investments in education also tend to generate higher social returns, because tertiary-educated adults pay higher income taxes and social contributions and require fewer social transfers (OECD, 2018b). In South Africa, however, these investments on education may not be recovered soon from a budgetary point of view. The impact on tight fiscal resources should be considered and alternative financing mechanism could be mobilised, to at least partially cover the cost. Moreover, under the current tax system and depending on the assumed discount rate, the net present value of government expenditure for university undergraduate education remains on average negative – even when considering favourable assumptions of continuous employment (Box 1.4). TVET education is less spending intensive, and is therefore more likely to have a positive net present value. However, quality often tends to be low and may lead to the risk of skill mismatch.

Alternative financing mechanism could alleviate students' credit constraints while reducing the impact on fiscal resources. Under the current NSFAS, 95% students are receiving the same support, regardless of their positions in the household income distribution. Instead of the government taking on all expenses for students from families with an annual income below ZAR 350 000, support should also depend on the level of household income. Thus, students from poor families could be fully supported, whereas students whose families are closer to the eligibility threshold should receive less. Such a change has to come with greater access to loans from commercial banks, allowing topping up student aid. These student loans could be designed as income – contingent loans backed up by the government to ensure that students from higher-income families are not constrained in their educational choices due to access to financial resources. Efficient administration of the scheme, including collection of repayments, is crucial.

Box 1.4. Years until costs of higher education are amortised through income tax on returns of higher education

A common argument for governments to support students in financing higher education lies in the higher expected tax returns resulting from higher average wages. Applying a mincer-type wage regression for South Africa shows that returns to higher education are high when compared to a person with matriculation (high school graduation certificate) as highest educational degree (Table 1.9).

Table 1.9. Returns to higher education

Sample of persons with at least matric degree aged 25 to 60

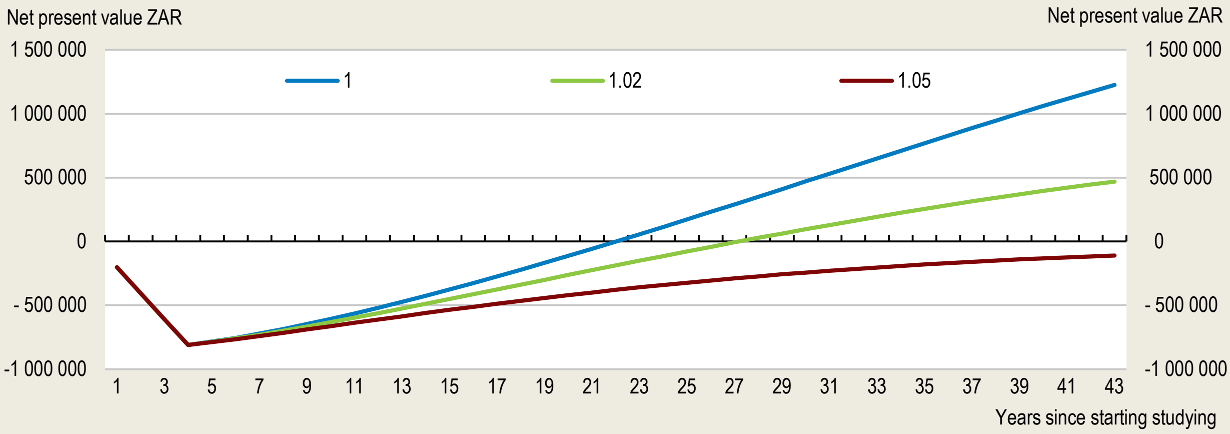
Dep vat: Average gross monthly wage	Coefficient	Standard Error
Base category (matric only)		
TVET degrees		
Certificate requiring Grade 12/Std. 10	1488.19	(1436.77)
Diploma requiring Grade 12/Std. 10	8125.61***	(1502.03)
University degrees:		
Bachelors Degree	17988.02***	(2147.17)
Bachelors Degree and diploma	20021.14***	(3447.15)
Honours Degree	24542.55***	(3239.85)
Higher Degree (Masters or Doctorate)	66783.84***	(4462.40)
Average wage	16296.01	

Note: additional controls include age, age squared, as well as dummies for gender, race, province and living in an urban area. Estimation results based on individual data for 2017.
Source: own calculations based on National Dynamic Income Study.

Total costs per student in 2018 for TVET amount to roughly ZAR 64 000 per year and for university about ZAR 203 000 per year (World Bank, 2019). This amount includes registration and tuition fees, students' expenses for meals, accommodation and books, as well as government subsidies to higher education institutions and repayment of uncovered NSFAS loans from pre-2018. Under the new fee-free higher education system for students from the poor and working-class families, governments therefore spend for a 4-year degree (bachelor with diploma) about ZAR 800 000 per student. Assuming that wages develop in line with inflation, and that this student will have continuous employment with the average wage for that degree, it will take about 20 years until the additional tax incomes from the degree (compared to having matric only) exceeds the higher education costs incurred for the student (Figure 1.18). However, when adjusting the discount rate assuming that governments value today's income more than the one in the future, it can take much longer.

Figure 1.18. Time until additional income tax payments break even with incurred costs

For different discount rates, Bachelor and Diploma (4 years) degree



Source: OECD calculation.

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Table 1.10. Past recommendations for making the education system more effective and inclusive

Recommendations from previous surveys	Action taken since the July 2017 Survey
Set up a scheme of universal student loans contingent on future incomes, with participation from banks and government guarantees. (2017 Survey)	Set up a scheme of universal student loans contingent on future incomes, with participation from banks and government guarantees.
Expand the Accelerated Schools Infrastructure Development Initiative programme to address infrastructure backlogs and improve the delivery of learning 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.
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 Evaluation and Assessment Frameworks for Improving School Outcomes	No action taken.

A growth strategy for South Africa

Policies to stimulate the recovery beyond the immediate relief plan will be needed until mid-2021. Improved investor confidence is critical to reverse weak investment and employment growth. High levels of policy uncertainty and safety concerns can deter foreign investment. The high cost of crime is impacting business – South Africa ranks as 131st out of 140 countries in terms of the business costs of crime and violence (WEF, 2019). Clearer and swifter implementation of reforms would reduce uncertainty and facilitate long-term planning, accelerating reforms' growth impact. Efforts to improve safety would help raise investment and improve living standards for all South Africans.

Reforming product and services markets

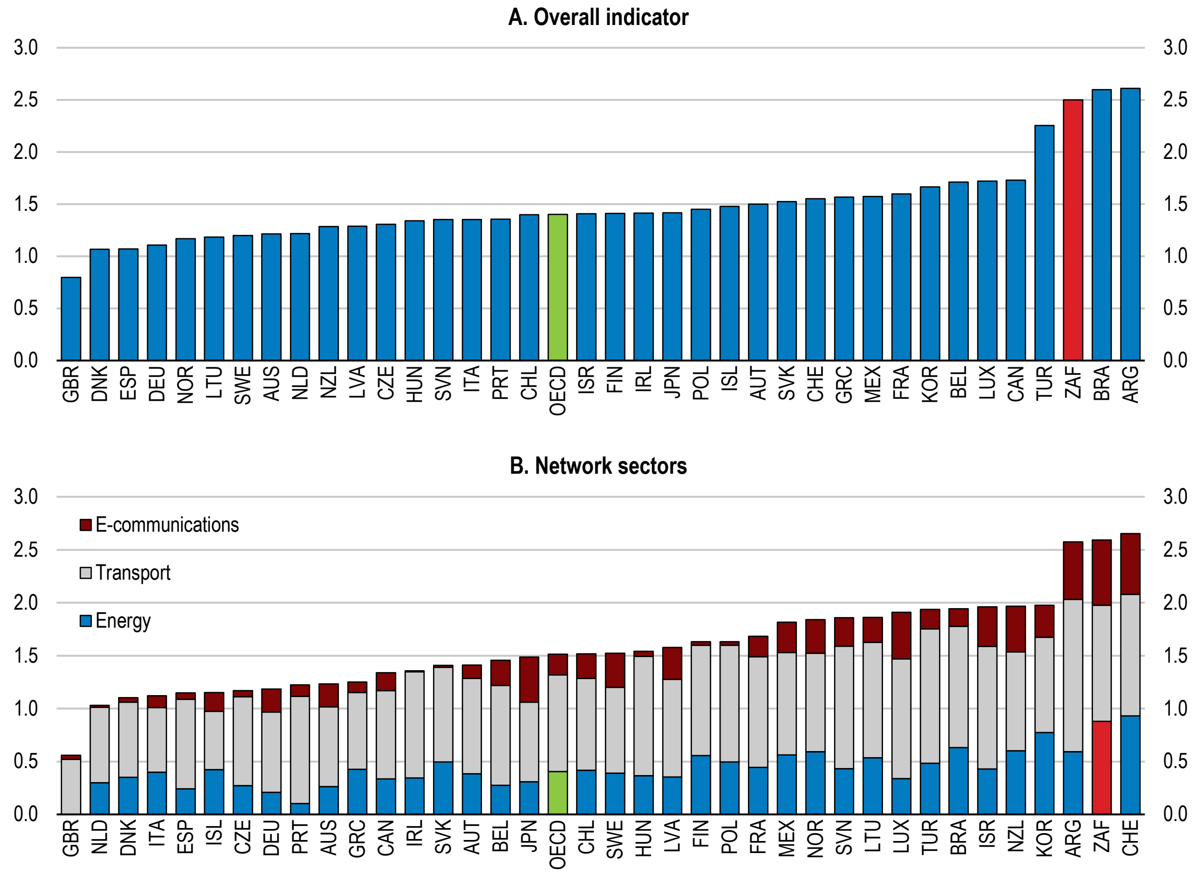
South Africa is looking for new ways to boost growth and inclusiveness in the long run. The 2017 OECD Economic Survey highlighted the role deepening regional integration and boosting entrepreneurship could play to bolster inclusive growth. Improving school and vocational training outcomes, better skilling the labour force and reducing skills mismatch and higher education performance are necessary for growth. Moreover, a better functioning labour market will help job creation and SME growth. Accelerating the procedures within the Commission for Conciliation, Mediation and Arbitration on labour issues would help small businesses (OECD, 2017a). In addition, the better functioning of product and services markets are important for growth as they shape the cost of intermediate inputs, productivity and participation in production processes (Égert and Wanner, 2016; Gal and Hijzen, 2016; McGowan, Andrews and Millot, 2017). Regulatory policies play an important role in defining barriers to entry and exit and therefore affect competition, while competition policies affect efficiency of production, allocation of resources and dynamism of markets. In South Africa, there is room to boost potential growth through less restrictive regulatory policies and more effective competition policies.

Product markets and services regulations remain restrictive

The OECD product market regulation indicators suggest that regulatory restrictions are still relatively high (Figure 1.19). This includes a high level of government involvement in the economy, barriers to domestic and foreign entry, complex rules for licences and permits, and protection of existing businesses from competition. In particular, regulatory restrictions are high in network industries (Figure 1.19, Panel B).

Figure 1.19. Regulatory restrictions are still high

Index scale of 0–6 from least to most restrictive, 2018



Source: OECD 2018 PMR database.

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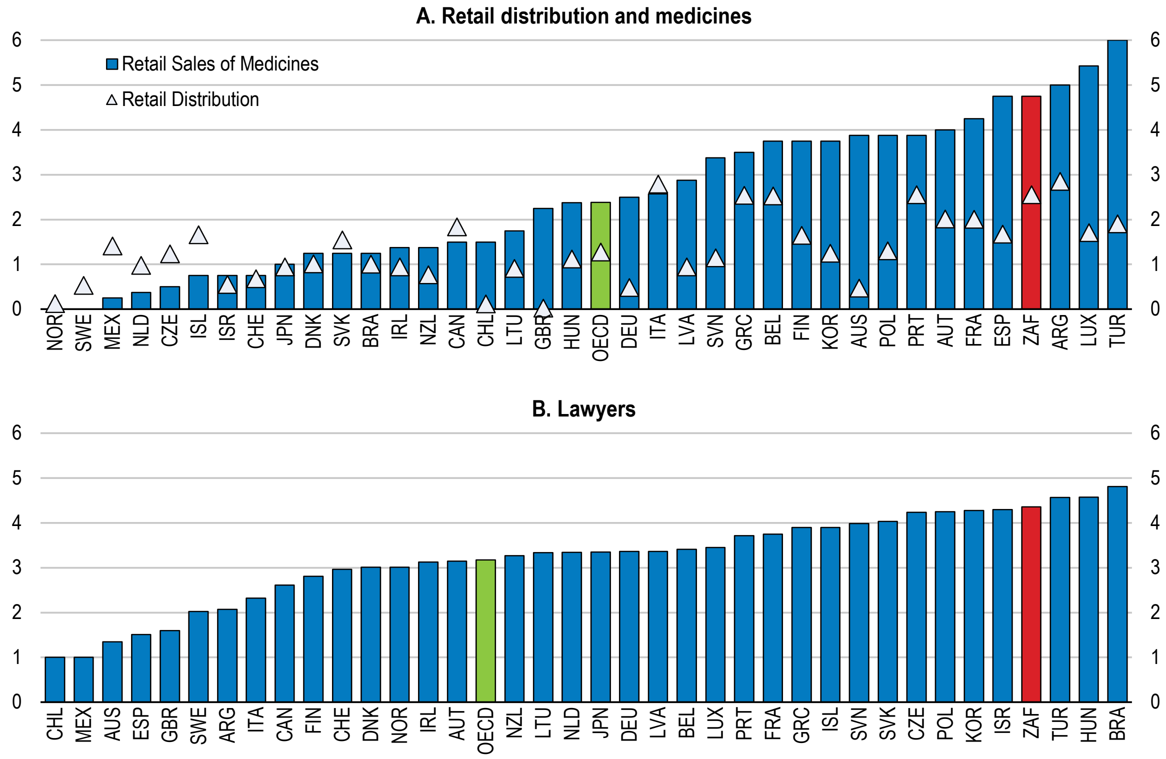
A more effective regulatory framework including more competition would contribute to better pricing of services and incentives to invest. South Africa's economy suffers from a lack of openness that affects the cost of doing business and impedes entry of new firms and growth of SMEs, thereby limiting its inclusiveness. For instance, regulatory restrictions in retail distribution and retail medicines are high compared to OECD and emerging economies (Figure 1.20, Panel A). Access to many professional services is also heavily regulated, in particular access to a lawyer profession is cumbersome and costly (Figure 1.20, Panel B). Access to professional services should be further facilitated, and under clear criteria, foreign qualifications should be recognised. Increasing access to professional services will increase access to legal services for small businesses and individuals through lower and more competitive prices (Canton, Ciriaci and Solera, 2014).

Figure 1.20. Regulations remain restrictive in retail and professional services

Index scale of 0–6 from least to most restrictive, 2018.



Source: OECD 2018 PMR database.

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The government has published a Single Transport Economic Regulation Bill in February 2018 for public comments. The Bill aims at creating a Single Transport Economic Regulator and a Transport Economic Council to regulate all parastatals in the transport sector. The Bill provides the Transport Regulator with extensive powers including price control, licensing, access to transport infrastructure and enforcement of fair competition. The government should accelerate the adoption and implementation of the Bill. Furthermore, the mandate of network regulators should emphasise increasing competition as an objective. The overlapping of government ownership of SOEs and the authority of ministerial departments on some sectoral regulators does not promote active regulatory policy and effective competition policy. Regulations for telecommunications sector have not been effective in strengthening competition and have been slow in facilitating entry in the sector (Banda, Robb and Roberts, 2015). Giving the energy and telecommunication regulators greater independence in decision-making from the government and state-owned companies would improve governance in these sectors. Closer and more productive relationships between the competition authorities and sector regulators could lead to stronger competition policies by sector regulators.

Bolder competition policies are needed

Most key sectors of the economy are highly concentrated (Buthelezi, Mtani and Mncube, 2019; Banda, Robb and Roberts, 2015). Though concentration is not necessarily reflecting a lack of competition, a high degree of concentration is an indicator of potential competition issues. Buthelezi et al. (2019) found that at least 70% of South Africa's sectors have dominant firms in defined product markets. Also, they found that the average market share of the identified dominant firms in defined markets and across sectors is about 52.5%. If the sample is limited to markets with firms defined as presumptively dominant, the average market share, across sectors, is about 62% (Table 1.11). The Herfindahl-Hirschman index by sector corroborates this high market concentration. The high levels of concentration in several key sectors result in an economy that largely excludes the majority of the population from ownership of important economic assets. So far, regulatory, competition and industrial policy all have failed to stimulate dynamic rivalry and open routes for new entry and expansion into new dynamic sectors of the economy (Makhaya and Roberts, 2013).

Table 1.11. Market shares of dominant firms

Average market shares.

Priority Sectors	Entire sample	Markets with firms defined as presumptively dominant	Average Herfindahl-Hirschman index
Information communication technologies	49.30%	55.20%	3539
Energy	50.10%	60.80%	2832
Financial services	62.20%	68.80%	2788
Food and agro-processing	52.90%	60.50%	2861
Infrastructure and construction	45.50%	52.60%	2859
Intermediate industrial products	51.40%	63.30%	2958
Mining	57.10%	62.00%	
Pharmaceuticals	52.40%	59.60%	3003
Transport	57.10%	67.40%	3254
Other	51.80%	61.50%	2891
Total	52.50%	61.60%	

1. The HHI takes account of the differences in the sizes of market participants, as well as their number. The HHI gives a score that can range from close to zero (when a market is occupied by a large number of firms of relatively equal size) to 10,000. The HHI takes the value of 10,000 in the monopoly case and declines as the level of concentration decreases.
2. Determination of dominant position in terms of Section 7 of the Competition Act requires a definition of the relevant market and a computation of market shares. If the market share of a firm is found to be more than 45%, a dominant position is presumed.
Source: Buthelezi, Mtani and Mncube (2019).

The Competition Amendment Act adopted in 2018 is welcome and represents an important step in strengthening the powers of the competition authorities. The main changes affect the definition of the pursuit of abuse of dominance. In particular, changes include the following: the shift of the burden of proof to the respondent with regard to excessive pricing; a broader definition of exclusionary conduct; the requirement of the dominant firm to demonstrate that its price discrimination policy is not harmful; a change in collusion provisions with a penalty for horizontal restrictive practices and markets dividing; and finally more extensive powers are given to the Competition Commission to run market inquiries and provide remedies to change the market outcomes (Government of South Africa, 2019).

The Competition Amendment Act ensures that the effect of high levels of concentration is properly accounted for, and in particular, their effect on market access of SMEs and businesses owned by previously disadvantaged individuals when conducting market inquiries. However, complementary policies are needed in terms of access to capital and knowledge to facilitate market access by disadvantaged groups. In particular, a streamlining of the Black Economic Empowerment (BEE) framework is needed to facilitate access to real partnerships and financing without hampering competition.

Table 1.12. Past recommendations to improve regulations and competition

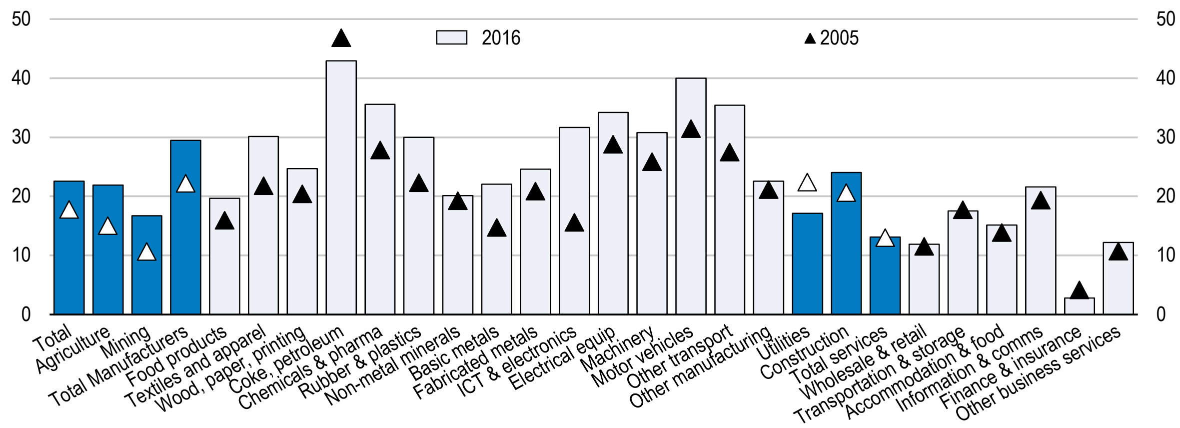
Recommendations from previous surveys	Action taken since July 2017 survey
Regulation of network sectors and services remain high affecting quality and prices and reducing job creation	Open up telecommunications, energy, transport and services sectors to more competition.
In network industries, complete the introduction of independent regulators and charge them with ensuring non-discriminatory third-party access. Secure additional electricity generation by accelerating the independent power producer programme.	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 was planned for 2018 but is still ongoing.
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.

Reaping the benefits of participating in global value chains

South Africa's participation in global value chains is more pronounced than that of many of its peers, but remains below the OECD average. In 2015, 23.5% of South Africa's domestic value added was driven by foreign demand compared to the OECD average of 31.9%. However, South Africa's domestic value added was higher than in other emerging countries such as Argentina (10.9%), Brazil (12%), Indonesia (18.3%) and Turkey (20%). Tariff liberalisation in the early 2000s mainly benefited the skill– and capital-intensive manufacturing sector allowing greater integration in global value chains (OECD, 2015a). Thus, the foreign value added content to exports increased from 22% to about 30% between 2005 and 2016 in the manufacturing industries (Figure 1.21). By contrast, deepening of integration into global supply chains stalled in the service industries over the same period. This development reflects an increase in South Africa's services trade restrictiveness of recent years in all services sectors (OECD STIR database).

Figure 1.21. Foreign value-added content of gross exports

Foreign value-added content of gross exports, % of gross exports, by industry



Note: Lighter shade denotes subsectors of manufacturing and services respectively.
Source: OECD Trade in Value Added (TiVA) database.

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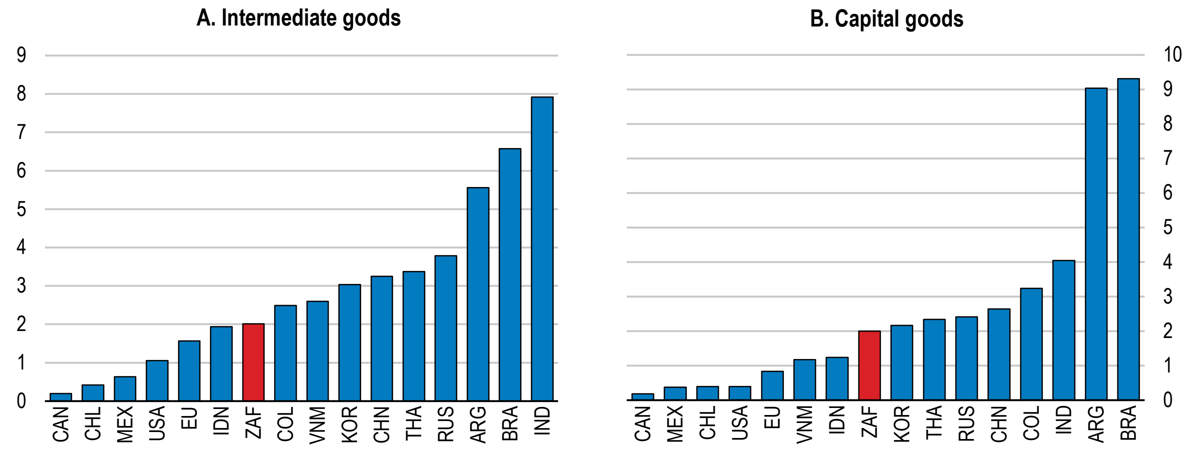
South African firms benefit from more global openness to trade (see Fall and Langle 2020). Tariff barriers on imports are significantly lower in South Africa than in other emerging countries such as Brazil, India and Argentina (Figure 1.22). Competitive pricing of intermediate inputs is important due to the high import intensity of many South African exporters. Thus, comparatively low import tariffs on intermediate goods increases the competitiveness of exporting firms. By contrast, tariff barriers on South African exports to developing countries – including Brazil, China and India – far exceed those to developed countries

(Edwards and Lawrence, 2012). South Africa has to increase trade access for its firms to fast-growing developing economies to harness growing demand in these countries. It is necessary to push for reduced tariffs on South African exports and the removal of non-tariff barriers. Moreover, further measures should focus on advancing the SADC free trade agreement and pursuing new and re-negotiated trade agreements in markets where there is growing demand for key export products. As recommended in previous surveys, trade facilitation measures should address non-tariff barriers, such as improving the quality and access of infrastructure, as well as the access to export credit and credit insurance.

Figure 1.22. Import tariffs on intermediate and capital goods are relatively low compared to some emerging peers

Effective applied trade weighted average tariff, %, 2017 or latest available year



Source: World Integrated Trade Solution database (WITS).

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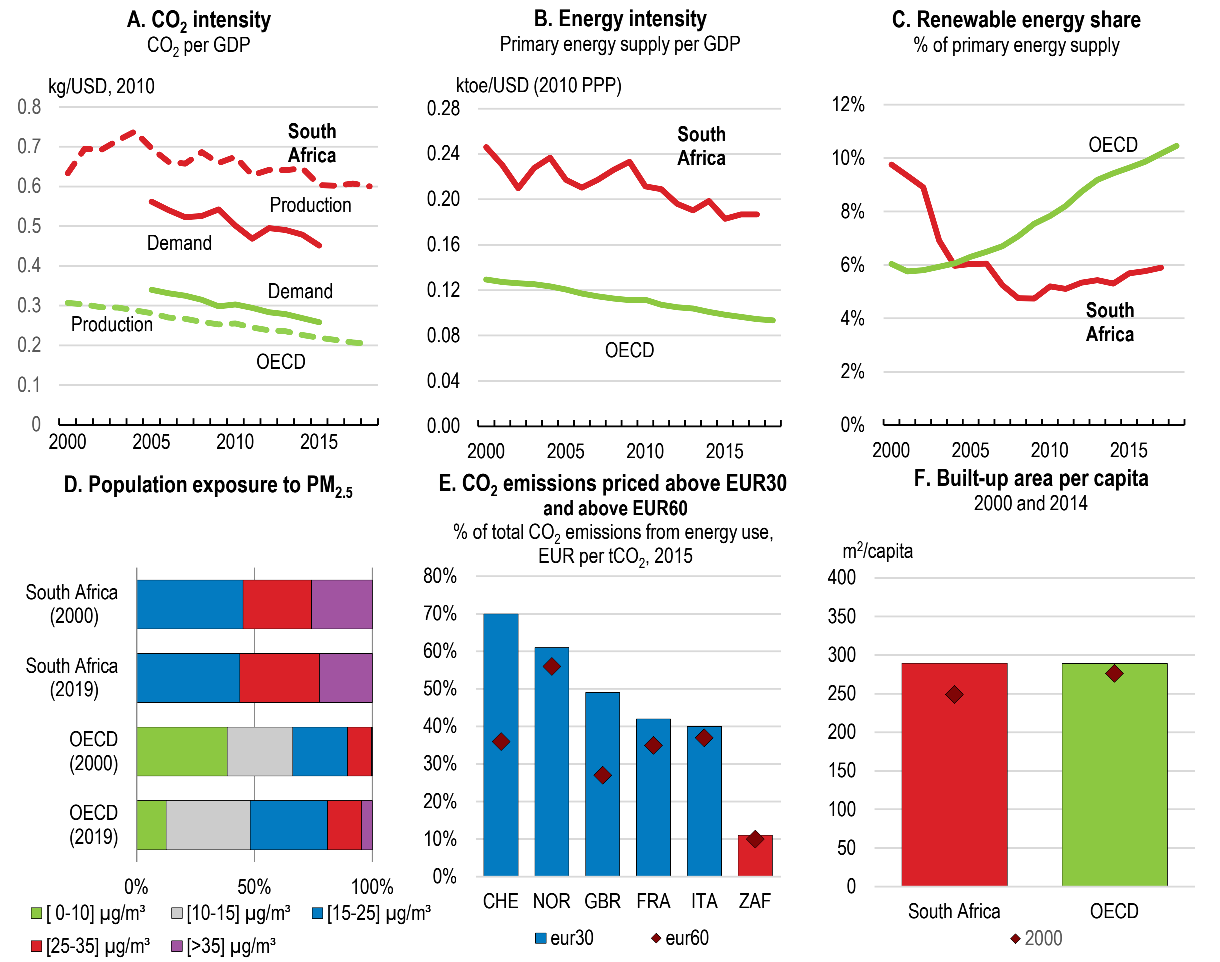
Key investments to boost growth

Greener energy policy to limit environmental impact and contribute to inclusive growth

The CO_2 per GDP emission intensity is high and has fallen little since 2000 (Figure 1.23, Panel A), in part reflecting the high-energy intensity of the economy (Figure 1.23, Panel B). The share of renewables in primary energy supply is close to the OECD average. Coal accounts for almost all electricity generation and is the main energy source in industrial processes. It is also used by households and service businesses but on a much smaller scale (OECD, 2018d). Strong coal use contributes to air pollution, to which South Africans are heavily exposed (Figure 1.23, Panel D), with important impacts on premature mortality (Roy and Braathen, 2017) and child development (World Health Organisation, 2018). Low-income households are especially vulnerable, as house prices are lower in polluted areas. South Africa continues to urbanise as indicated by growing built-up areas per capita (Figure 1.23, Panel F). Good urban planning is therefore key to avoid urban sprawl and ultimately in reducing transport related emissions. Urban policies that integrate land use, housing and transport within travel-to-work areas make cities healthier, more attractive and competitive (OECD, 2017c; OECD, 2015d).

Figure 1.23. Green growth indicators



Note for Panel A: Included are CO2 emissions from combustion of coal, oil, natural gas and other fuels. Gross Domestic Product (GDP) is expressed at constant 2010 USD using PPP.

Note for panel E: Switzerland: Largest share of emissions priced at EUR 30 and above.

Source: OECD (2020), Green Growth Indicators, OECD Environment Statistics (database); OECD National Accounts (database); IEA (2020), IEA World Energy Statistics and Balances (database); OECD (2020), Exposure to air pollution, OECD Environment Statistics (database) using IHME GBD 2019 concentration estimates (forthcoming); OECD (2020), Land cover, OECD Environment Statistics (database); OECD (2018), Effective Carbon Rates 2018.

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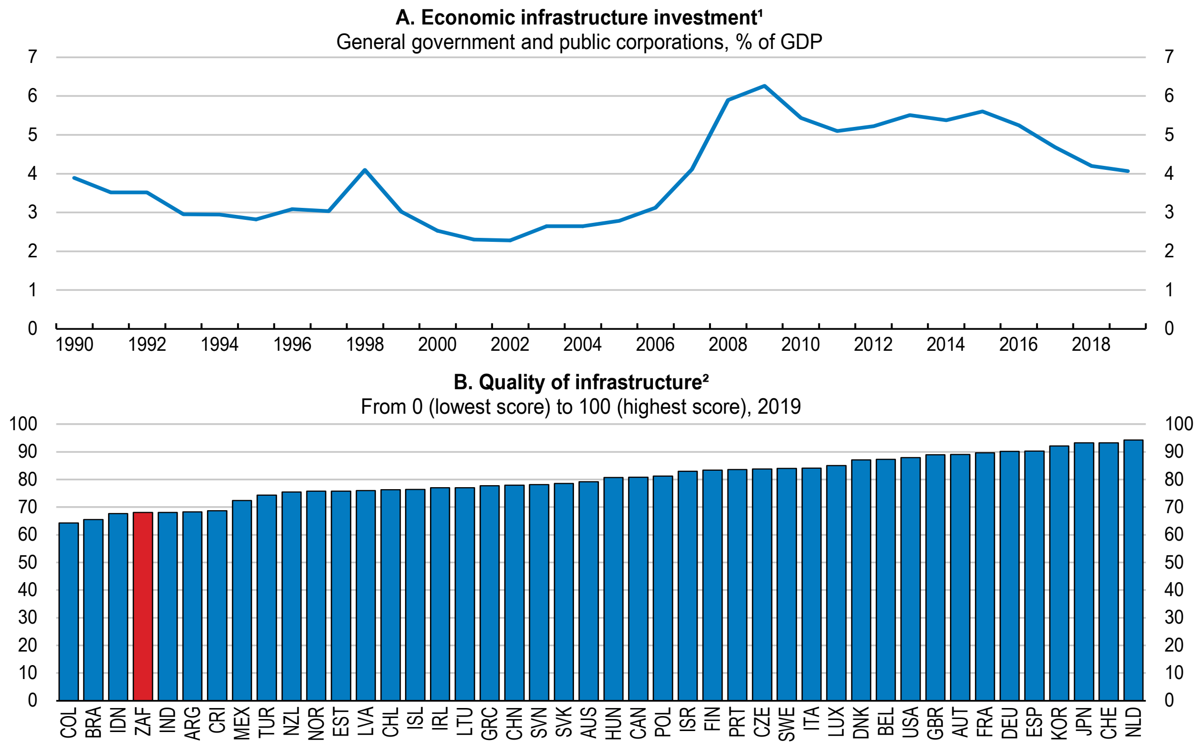
In its 2018 draft Integrated Resource Plan (IRP), South Africa has taken steps to reduce CO_2 emissions in electricity generation. It has announced to decommission 35 of currently 42 Gigawatts (GW) of coal-fired capacity by 2050 and the expansion of renewable electricity generation. However, close to 6 GW of new coal-fired plants are under construction and a further 1 GW is planned. New plants expose South Africa to the risk of having to write them off early (OECD, 2017c). The IRP may be sufficient for South Africa to reach the upper end of the target range for GHG emissions in 2030 contained in its Nationally Determined contribution (NDC) to the Paris climate agreement. However, this would still imply higher emissions than in 2010 (Climate Action Tracker, 2018).

Coal use in electricity generation and industrial production is untaxed, contributing to modest pricing of CO_2 emissions (Figure 26, Panel E). South Africa’s introduction of a carbon tax in June 2019 is a welcoming step forward. The new tax prices a ton of CO_2 at between EUR 0.40-3.40, depending on the industry, well below the low-end estimate of the climate cost of carbon of EUR 30 per ton. The tax is set to rise by 2% above inflation every year. South Africa should envisage a more ambitious approach to carbon taxes. Carbon tax revenues would provide ample opportunity to compensate low-income households, for example with lump-sum transfers, and equipping them with more energy-efficient housing and appliances. Because of the growing competitiveness of renewable energy, costs for consumers could be reduced by diversifying the power mix. Early anticipation and preparation of the transition is vital to minimise adverse social effects in the coal mining locations. Replacing coal-fired power plants with renewables could increase energy security as well as reduce the costs of water stress. Coal mining and coal-fired power are an important source of chemical water pollution. The restructuring of Eskom could be used to increase the share of renewables as a source of energy. These investments would contribute to greener growth and reduce the environmental footprint of the economy. The social consequences of these transfers should be managed.

Infrastructure investment is needed to increase potential growth

Public infrastructure investment has dropped in recent years constrained by a tight fiscal stance (Figure 1.24). This has contributed to lower growth in a context of declining private investment. Moreover, quality of infrastructure is deteriorating, which calls for more investment in maintenance.

Figure 1.24. Public infrastructure investment has stalled



1. Roads, bridges, dams, electricity and water supply, etc.
2. The Infrastructure indicator of the Global Competitiveness Index 4.0 assesses the quality and extension of transport infrastructure (road, rail, water and air) and utility infrastructure (electricity and water).
Source: SARB database; World Economic Forum, The Global Competitiveness Report 2019.

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The speed, quality and efficiency of many public investment projects also have been low. Project planning, including long-term maintenance has been inadequate (National Treasury of South Africa, 2019 and 2020a). To overcome these issues, the government has put in place a technical task team (Budget Facility for Infrastructure) to improve prioritisation, planning and financing. The task team is budgeted ZAR 625 million in 2019 for project preparation and implementation. Moreover, the government is strengthening local government infrastructure plans and urbanisation projects to increase flexibility, private sector financing and local government infrastructure spending. The aim is to mobilise ZAR 20 billion additional spending per year at the local level.

The government is also planning to create an infrastructure fund with the private sector, development finance institutions and multilateral development banks. The fund aims to increase the number of blended-finance projects to enhance oversight, improve the speed and quality of spending, and reduce costs in public infrastructure. The government plans to spend ZAR 526 billion in infrastructure investment over the next three years (National Treasury of South Africa, 2019). The success of the infrastructure fund will depend on commercially viable model to attract private financing. Developing well-structured public-private partnerships could boost infrastructure investment and in particular, participation of private capital in ports and rail. Increasing public investment from 3.6% to 5% of GDP would boost potential growth (Box 1.5). However, better cost-benefit analysis is required alongside improved cost containment, planning and implementation (such as the example of Denmark).

Box 1.5. Quantification of the impact of structural reforms

The OECD long-term model comparing projections based on different policy scenarios with the baseline “no policy change” scenario suggest that improving product market regulations would significantly boost potential GDP. Also, boosting education performance to increase effective average years of schooling of the working age population has a large impact on potential growth through effective labour force and productivity. Investment has been falling in recent years, increasing public investment, in particular on infrastructure, has also positive impact on potential growth. Although policy complementarities are not explicitly modelled, better regulations would crowd in business investment, technology adoption and human capital accumulation, leading to multiplicative effects.

Table 1.13. The impact of policies to boost potential GDP

	2025	2030	2040	2050
	% difference in level of potential GDP, relative to no policy change			
Reforming PMR	0.8	3.4	10.4	16.6
Increasing public investment	0.4	0.8	1.2	1.4
Increasing education attainment	0.3	1.5	7.1	15.9

Note: The following scenarios were modelled: improve product market regulation policies to the OECD average by 2030; increase educational attainment by additional two years by 2040; and increase public investment by 1.4 percentage points of GDP from 2025. These estimates do not include the impact of the COVID-19 crisis on potential growth.
Source: Estimates based on “OECD Long-Term Scenarios for the World Economy” database.

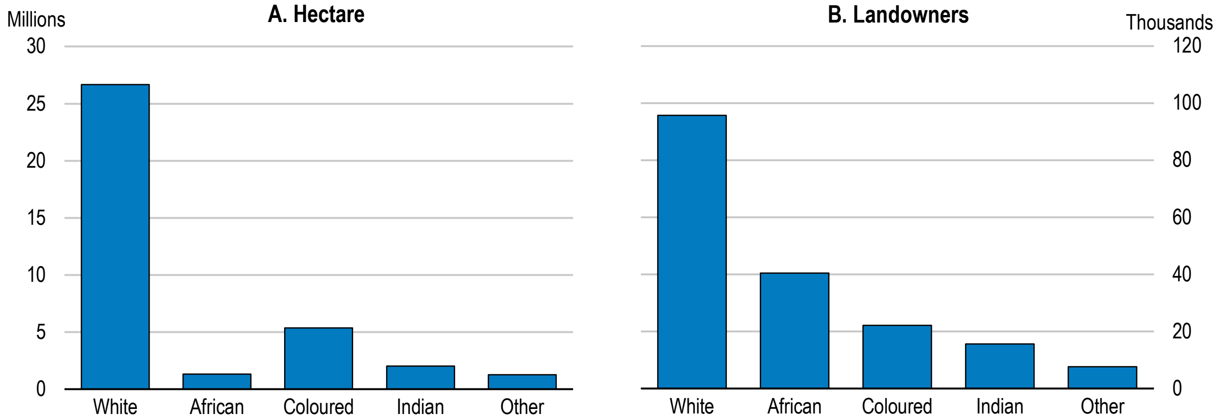
Accelerate the land reform process to lift the uncertainty it creates

Land is a key source of inequality in South Africa. The apartheid regime dispossessed and relocated the black population to townships and homelands. Contained in these spatially segregated areas, the majority of the black population was left without the right to own land (Burger, 2018). After the end of apartheid, the government implemented a programme for land reform to redress past injustice consisting of three dimensions: restitution, tenure reform and redistribution. Land restitution addresses claims on dispossessed land and forced removals from various acts after 1913. The tenure reform aimed to provide more secure access to land in the former homelands. Lastly, land redistribution deals with land not covered by restitution and tenure reform, transferring white-owned commercial farmland to black farmers (Cliffe, 2000).

Progress on the land reform has been slow. While the land reform has implications for the development of both urban and rural areas, recent focus has turned to redressing structural inequalities in the agricultural sector. By 2016, only 8%-9% of farm land has been transferred through restitution and redistribution – well below the target of 30% that should have been achieved already in 1999 (Cousins, 2016). In addition, many settled restitution claims have not been fully implemented such that the overall impact of the land reform on transforming the agricultural sector has been limited. According to the land audit report of 2017, about 72% of the individually-owned farm land was under white ownership, compared to only 4% under African ownership (Figure 1.25). In addition, there are relatively more black farmers per available hectare resulting in significantly smaller individually-owned land parcels. While the average per capita farm land size is about 280 hectares, for black farmers this is only about 32 hectares (Department of Rural Development and Land Reform, 2018).

Figure 1.25. Individual land ownership of farms and agricultural holdings

By race, 2017



Note: Refers to individually owned land only and does not include traditional land.
Source: Department of Rural Development and Land Reform (2018), Land Audit Report 2017.

StatLink http://dx.doi.org/10.1787/888934005948

Initially the land redistribution was based on a "willing buyer - willing seller" principle, with limited success. To speed up the process of land reform, the government introduced several policy changes. In 2016, a bill was passed that allows the compulsory purchase of land in the public interest. The bill enables the state to pay for land at a value determined by a government official and then expropriate it with an administratively fixed compensation for the public interest (OECD, 2018a). In the context of limit financial resources, the government turned more recently to discussions aiming to allow for expropriation of land in the public interest without compensation for the current owners. In December 2018, parliament voted for a constitutional amendment to adopt expropriation without compensation following a report prepared by Joint Constitutional Review Committee established earlier that year. To ensure a fair and equitable implementation of the land reform process, an Advisory Panel was set up, consisting of academics, business professionals, social entrepreneurs and activists related to the agricultural economy and land policy.

It is important to clearly define the policy objectives and assess the risks of such an amendment as even a careful implementation could undermine agriculture performance and reduce investment. Expropriation without compensation should focus on state- and communal-owned land to minimise the potential negative effects. The government should carefully consider before expanding this policy to include privately owned land. According to the OECD Policy Framework for Investment (2015), "Secure and well-defined land rights encourage new investments and the upkeep of existing investments as well as sustainable land management". Going forward, investors need to be ensured on the security of their property rights.

The land reform should focus on tenure security. About a third of the South African population lives in former homelands on communal land with insecure tenure ship (Burger, 2018). Under apartheid, people living in homelands were granted the permission to some farmland and a homestead at the will of the governing chief. After 1994, chiefs have not ceased any power over their communal land resulting in continuous insecure tenure and use rights for the population living there. Thus, the Traditional Leadership and Governance Framework Act 41 of 2003 and the Communal Land Rights Act 11 of 2004 provided traditional councils and chiefs with the power to allocate use rights to land. Although the continued existence of traditional authorities is conditional on 40% of their members being elected and at least a third of the council members being women (TLGFA), many of the traditional councils have never met these conditions (Burger, 2018). Better enforcements of existing laws to ensure a better democratic process in traditional communities are needed. In addition, solutions to secure tenure rights have to be developed and implemented.

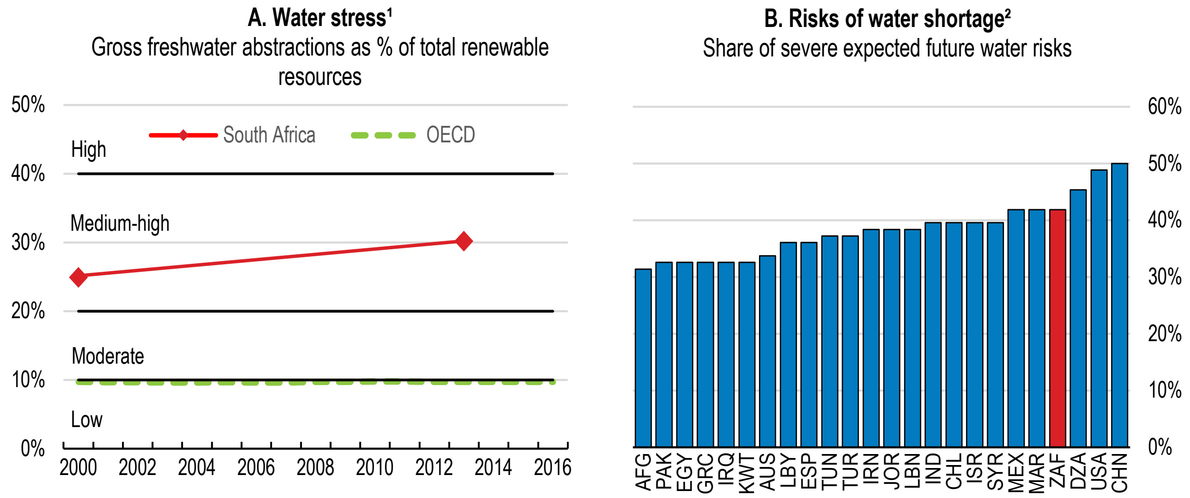
In particular, communal land in South Africa is characterised by overlapping use rights of community members. Developing a framework that secures tenure has to take into account this layered structure of land use. The subdivision of communal land into individually and privately owned title deeds will change existing structures.

Providing land to emerging farmers has to be accompanied by supportive measures. To ensure that reallocated farmland is best used, it is important to support farmers in terms of financial access, but also with respect to education, marketing and distribution (OECD, 2018a). The Inter-Ministerial Committee on Land Reform is therefore developing a package of post-settlement support measures to enhance the productivity of restituted land, including communal land. These measures include financial support and programmes by the Department of Agriculture, Forestry and Fisheries (DAFF) to support smallholder farmers, providing infrastructure for production, marketing, agro-processing, land preparation and establishment of orchards or gardens as well as production inputs, training and mentorship (Department of Agriculture, 2018). It is welcome that these supportive measures go beyond direct subsidies, as those may create a dependency and become fiscally unsustainable. Existing measures therefore have to be evaluated regularly with respect to their reach and effectiveness to support emerging farmers.

Better manage scarce water resources

Water stress has increased with economic and population growth (Figure 1.26). South Africa’s economy is particularly vulnerable to draught effects, as is the case in countries with modest water endowments and income levels. Lacking access to water supply and sanitation appears to be by far the main water-related drag on economic activity and welfare, ahead of water scarcity in agriculture (Sadoff et al., 2015). Abstractions per capita are modest but the endowment with renewable water resources is small. Low rainfall has aggravated scarcity further in recent years. Water supply was rationed in Cape Town, where national disaster was declared in 2018. Water scarcity is concentrated in the South West and part of the North East. South Africa is likely to experience higher temperatures and less rainfall as a result of climate change (Calzadilla et al., 2014). Expected future risks of water shortages are high in international comparison.

Figure 1.26. Water stress and water shortage



1. Water stress is defined high when abstractions exceed 40% of renewable resources and low when they are less than 10%.
2. Shares of severe water risk, future expectations, across reviewed studies. Derived from the analysis of 64 global studies.
Source: OECD (2018), Water: Freshwater abstractions, OECD Environment Statistics (database) ; FAO ; OECD (2017), Water Risk Hotspots for Agriculture, OECD Studies on Water, OECD Publishing, Paris, https://doi.org/10.1787/9789264279551-en.

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Water stress has resulted in environmental degradation. More than 50% of South Africa's wetlands have been lost, and 33% are in poor ecological condition (Department Water and Sanitation, 2018). The wetlands are of strategic importance to protect natural water resources but do not consistently benefit from a protected status. Pollution aggravates the consequences of scarcity and adds to biodiversity loss. Only one third of mainstream rivers are in good condition (OECD, 2013a). Biological and chemical quality of surface water has not improved recently according to the South African Water Research Commission. Groundwater often fails to meet drinking water standards. Poorly managed wastewater treatment and agricultural water use contribute to pollution.

These developments suggest there is limited scope for boosting water abstractions. Extensive water dam infrastructure leaves little scope for expansion (Pegasys Strategy and Development, 2012). Desalination of seawater is still costly relative to water prices (Donnenfeld, Crookes and Hedden, 2018). It is energy-intensive and pollutes the ocean (Jones et al., 2019). Upscaling other non-traditional water resources, notably fog and rainwater harvesting, requires research and development. Groundwater and water reuse are projected to have more potential. Sustainable groundwater use is, however, particularly demanding in terms of governance and regulatory enforcement (OECD, 2017b; Akhmouch and Clavreul, 2017). Some South African aquifers are overexploited (Cobbing, 2018). Reuse will require more effective water treatment, a priority discussed below. More efficient use of water is hence key to free water resources for the environment and needed economic development.

The value of time savings that result from using a water source or latrine closer to home, for education and productive activities typically accounts for a large share of total welfare losses from lacking access to water supply and sanitation. This affects especially women and girls. The estimated losses also include healthcare costs, lost productive time due to being sick, and premature mortality (OECD, 2011). Only 64% of the population have access to reliable drinking water supply and 80% to sanitation services (Department Water and Sanitation, 2018). Indeed, inadequate sanitation contributes to infant disease and mortality (OECD, 2013a). The impact of water scarcity on agriculture is assessed by comparing actual agricultural output with the output that could hypothetically be produced if the capacity constraints of water dams were lifted in periods of water scarcity. This includes welfare effects through the prices for agricultural goods (Sadoff et al., 2015). South Africa is committed to achieve universal and equitable access to safe and affordable drinking water as well as to adequate and equitable sanitation and hygiene for all by 2030, in line with the Sustainable Development Goals.

South Africa's approach to water resource management aims to take account of equity, efficiency and ecology (OECD, 2013a) and is seen as integrating the OECD principles of water governance, for example by involving stakeholders in decision-making. However, implementation is difficult (Neto et al., 2017). The impact of regulation on the ground is weak and transparency insufficient. For many years, South Africa has been in the process of introducing catchment management authorities (OECD, 2013a), but water is licensed at the national level, far from local conditions (Neto et al., 2017). Weaknesses in transparency of decision-making processes, ad hoc interventions by the government in the assignment of decision-making powers, limited stakeholder involvement especially of less powerful water consumers, as well as lack of coherent implementation of policies in related areas, such as land use, are also seen as key factors weakening the governance of water management. Systems to monitor surface and groundwater are insufficient and deteriorating, holding back implementation of the polluter pays principle. In 2018, water quality monitoring mostly ceased for lack of funds. The National Water and Sanitation Masterplan emphasises the need for building technical capacity (Department Water and Sanitation, 2018).

Lacking resources reinforces the case for cost-reflective water pricing, subject to affordability. Therefore, South Africa's government adopted a new water pricing strategy, which took effect in 2017.

Water prices are too low in agriculture

Agriculture contributes 2.6% of GDP and accounts for 4.5% of total employment. About one-third of production is exported. Large capital-intensive, export-oriented farms account for around 90% of production and 86% of cropland. Subsistence farms, mostly owned by black farmers employ 86% of farm workers.

Agriculture accounts for 61% of water use. Long-term global climate change may lower agricultural productivity more in irrigated agriculture than in rain-fed agriculture. Expansion of irrigation may therefore not be an effective strategy to adopt (Calzadilla et al., 2014). Nonetheless, climate change may improve South Africa's comparative advantage in agricultural production, as productivity in other regions of the world may be hit more.

Access to irrigation is unequal. Large farms, mostly owned by white farmers, often use water without restriction and free of charge. One reason is absent metering. Consumption is assessed on the basis of registered water use. Large farms also benefit from historic free water rights that predate the end of apartheid. The reallocation of water rights, foreseen in the 1998 National Water Act has advanced little. Smaller and poorer farms, mostly owned by black farmers, have newer water rights and pay for licences but lack equipment, including for efficient water use (Calzadilla et al., 2014[46]; Department Water and Sanitation, 2018; OECD, 2013a). Prices for raw water abstraction appear to be substantially lower than those for household or industrial use.

The government plans to phase in compulsory metering and make prices reflect costs better. However, the new pricing strategy foresees capping some costs included in prices (for example, infrastructure wear and tear), while not taking into account the opportunity cost of capital (Department of Water and Sanitation, n.d.) so prices may not reflect full supply cost. Resource-poor farmers can also benefit from a 10-year transition period, with full exemption from water prices in the first 5 years (Department of Water and Sanitation, n.d.).

Prices of water supplied to agriculture should reflect full supply costs, including operations and maintenance as well as the capital cost of infrastructure. Such prices should ideally also cover the opportunity cost and environmental externalities of water withdrawals (OECD, 2018e). Water prices that reflect supply and scarcity costs could help restore natural water flows. They may also facilitate the reallocation of water rights, improving priority use and equity. Moreover, charging adequate water prices would also provide revenues to finance needed investment to maintain infrastructure, improve monitoring, as well as research in non-traditional water supply. Higher irrigation prices risk raising poverty through higher food prices, notably for horticultural products, so some revenue may need to be set aside for transfers. Modelling suggests that using the revenues from higher charges in full to lower taxes on food provides environmental benefits, boosts economic growth and reduces poverty (Letsoalo et al., 2007).

Where countries have raised water charges, efficiency improved while agricultural output did not fall (OECD, 2010). Modelling suggests that reallocating irrigation water to higher-value produce within each river basin could boost productivity and employment opportunities in South Africa (Hassan and Thurlow, 2010). More efficient irrigation diminishes the risk of water pollution with pesticides and fertilisers (Olmstead, 2010). The Department Water and Sanitation is developing an Eutrophication Strategy to reduce pollution.

To ease implementation and make progress in the near term, prices that reflect at least full supply cost, combined with metering, could first be introduced for large water users, in the dry regions. A competitive allocation of water entitlements to large-scale water users may be worthwhile exploring to discover scarcity costs. Resource-poor farmers could receive lump-sum payments equal to the value of their water allocation rather than be exempt from pricing. This would make them at least as well off and could improve incentives for efficient use, including through water-saving equipment and metering. It could also provide an income stream to finance investment. For efficient water use, especially in drought periods, it will be useful to maintain opportunities for farmers to trade irrigation water entitlements over short periods with each other.

Municipal water services are inefficient

Municipalities are in charge of water supply to households and most businesses, as well as sanitation. They account for 27% of water abstractions. 41% of municipal water supply is unbilled, unpaid or lost. 56% of wastewater treatment and 44% of water treatment works are in a poor or critical condition, contributing to pollution (Department Water and Sanitation, 2018). However, there are also examples of excellent water services. For example, the municipality eThekwini was awarded the Stockholm Water Industry Award in 2014. Turning performance around is a key objective in the National Water and Sanitation plan.

Benchmarking tools allow identifying inefficiencies and best practice. South Africa already uses benchmarks. However they mostly relate to processes (such as data collection) or inputs (such as technical skills), rather than costs or environmental performance. In the United Kingdom, water and sewerage companies provide the economic regulator with indicators of costs and environmental impact. The Water Utility Performance Indicators network (IBNet) by the World Bank is an international benchmarking tool that provides guidance (OECD, 2011). There may be a case for a regulator to ensure better and more consistent regulation of municipal water services (OECD, 2013a).

Table 1.14. Past recommendations for climate change mitigation and green growth

Recommendations from previous surveys	Action taken since July 2017 survey
In designing climate change mitigation policies, favour broad and easy-to-implement instruments with limited demands on administrative capacity, such as a simple carbon tax.	Carbon tax has been implemented in 2019.
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.
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.	NERSA approved an average annual price increase of 9.4% for 2016/17 and 2.2% for 2017/18.
Accelerate the allocation of water-use licences and ensure that charges for water reflect supply costs and scarcity.	The application process for water-use licences has been streamlined to accelerate allocations.
Price environmental externalities, including carbon emissions, and scarce resources, particularly water, appropriately.	A tyre levy has been implemented from 1 February 2017 that addresses the externalities associated with tyre disposal.

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