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BETTER POLICIES FOR BETTER LIVES

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BASIC STATISTICS OF SOUTH AFRICA, latest available year

(Numbers in parentheses refer to the OECD average)[a]

LAND, PEOPLE AND ELECTORAL CYCLE

Population (million)	53.5		Population density per km	43.9	(35.1)
Under 15 (%)	29.3	(18.0)	Life expectancy (years)	57.2	(80.9)
Over 65 (%)	5.7	(16.3)	Men	54.7	(77.8)
Latest 5-year average growth (%)	0.6	(0.4)	Women	58.8	(83.1)
			Latest general election	May 2014	

ECONOMY

Gross domestic product (GDP)			Value added shares (%)		
In current prices (billion USD)	317.7		Primary sector	2.5	(2.5)
In current prices (billion ZAR)	4 033.6		Industry including mining and construction	29.5	(26.8)
Latest 5-year average real growth (%)	2.2	(1.9)	Services	68.0	(70.6)
Per capita (000 USD PPP)	13.7	(41.2)			

GENERAL GOVERNMENT

Per cent of GDP

Expenditure	36.7	(41.3)	Revenue	32.7	(38.0)

EXTERNAL ACCOUNTS

Exchange rate (ZAR per USD)	12.695		Main exports (% of total merchandise exports)		
PPP exchange rate (USA = 1)	5.516		Natural or cultured pearls, precious or semi-precious stones/metals	15.0	
In per cent of GDP			Mineral fuels	11.7	
Exports of goods and services	30.5	(54.3)	Vehicles other than railway or tramway rolling stock	11.5	
Imports of goods and services	31.6	(50.3)	Main imports (% of total merchandise imports)		
Current account balance	-4.4	(0.2)	Mineral fuels	17.5	
Net international investment position (2014)	-7.5		Machinery, mechanical appliances, nuclear reactors, boilers	13.3	
			Electrical machinery and equipment	10.9	

LABOUR MARKET, SKILLS AND INNOVATION

Employment rate for 15-64 year-olds (%)	43.0	(67.0)	Unemployment rate, Labour Force Survey (age 15 and over) (%)	26.7	(6.3)
Men	49.2	(74.7)	Youth (age 15-24, %)	53.3	(13.0)
Women	37.0	(59.3)	Long-term unemployed (1 year and over, %)	8.8	(2.2)
Participation rate for 15-64 year-olds (%)	58.7	(71.6)	Tertiary educational attainment 25-64 year-olds (%)	6.4	(33.3)
			Gross domestic expenditure on R&D (% of GDP)	0.7	(2.4)

ENVIRONMENT

Total primary energy supply per capita (toe)	2.8	(4.1)	CO_2 emissions from fuel combustion per capita (tonnes)	8.1	(9.4)
Renewables (% of total)	10.8	(9.6)	Renewable internal freshwater resources per capita ($1\,000\ m^3$)	0.8	(27.3)
Fine particulate matter concentration ($PM_{2.5}$, $\mu g/m^3$)	26.1	(14.5)			

SOCIETY

Public and private spending (% of GDP)			Income inequality (Gini coefficient)	0.634	(0.325)
Health care, current expenditure	8.8	(9.1)	Poverty headcount ratio at national poverty lines (% of population)	53.8	
Education (primary, secondary, post sec. non tertiary, public)	4.7	(3.5)	Share of women in parliament (%, January 2017)	41.2	(28.4)

a) Where the OECD aggregate is not provided in the source database, a simple OECD average of latest available data is calculated where data exist for at least 29 member countries.

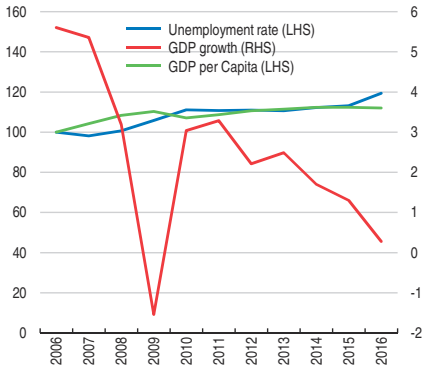
Source: Calculations based on data extracted from the databases of the following organisations: OECD, International Energy Agency, World Bank, International Monetary Fund and Inter-Parliamentary Union.

Executive summary

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

Low growth and high unemployment are weighing on social progress

GDP per capita is stagnating



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

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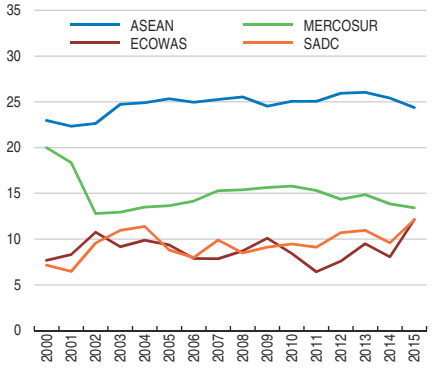
Growth has disappointed in the last few years. Weak consumer demand, persistently falling business investment, policy uncertainty, and the prolonged drought weighed on activity. While power production has improved, important bottlenecks remain in infrastructure and costs of services, which increase the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

Deepening regional integration of the SADC to boost jobs and growth

Share of intra-regional exports

% of total exports



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

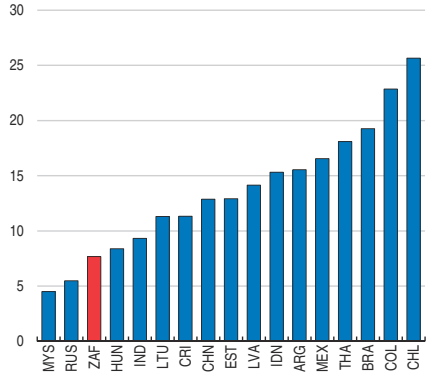
StatLink http://dx.doi.org/10.1787/888933551998

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

Boosting entrepreneurship and growing small businesses will contribute to creating jobs

Early-stage entrepreneurial activity is low

% of working-age population, 2014-16 average



Source: Global Entrepreneurship Monitor.

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

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

Assessment and recommendations

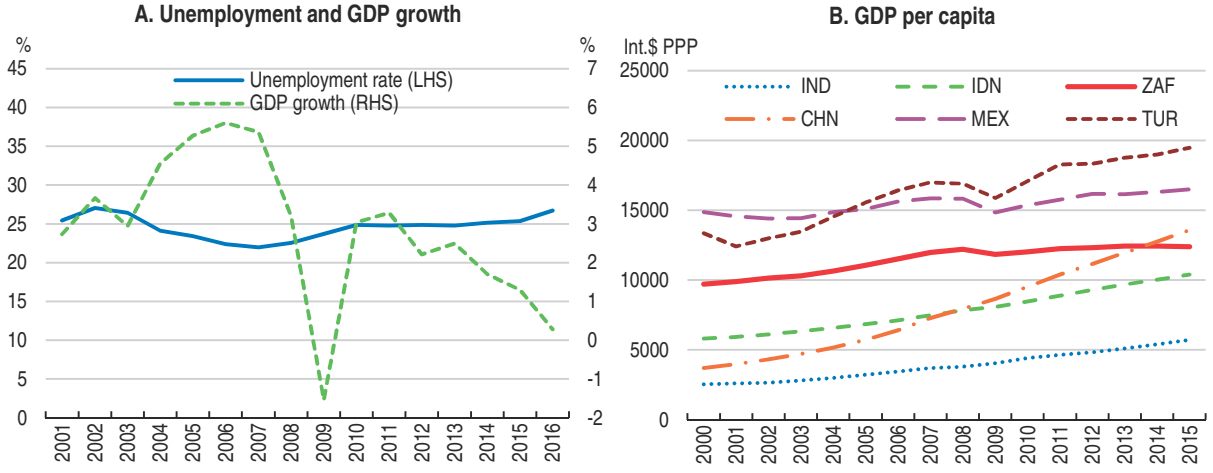
- *Low growth and high unemployment are weighing on social progress and cohesion*
- *Low growth is set to continue*
- *Macroeconomic policies are constrained*
- *Deepening regional integration within the Southern African Development Community*
- *Boosting job creation in South Africa through more start-ups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

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

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

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

Figure 1. **GDP per capita is stagnating**



Note: The unemployment rate has been adjusted for a break in 2008.
Source: OECD, Economic Outlook database; World Bank, World Development Indicators database.

StatLink http://dx.doi.org/10.1787/888933552036

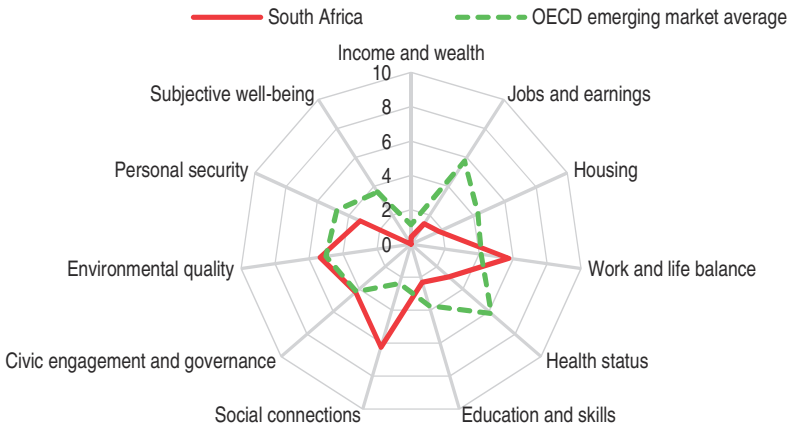
More recently, in a difficult economic context, several actions, in line with the National Development Plan, were taken to restart the economy:

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

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

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

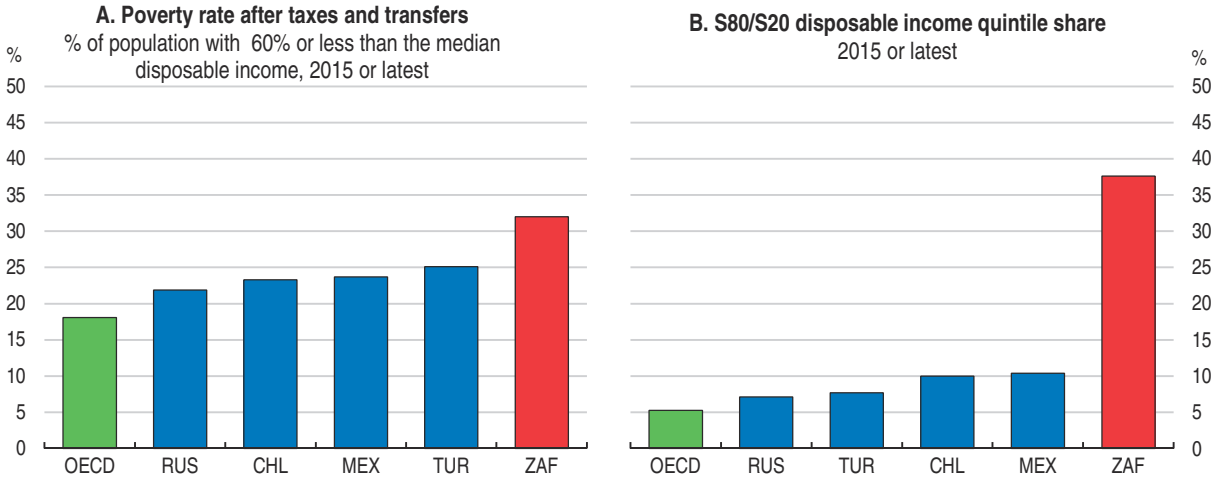
Figure 2. **OECD Better Life Index**



Note: OECD emerging market average includes Chile, Hungary, Mexico and Turkey. Each well-being dimension is measured using one to three indications from the OECD Better Life Indicator set with equal weights. Indicators are normalised by re-scaling to be from 0 (worst) to 10 (best).
Source: OECD (2016), "Better Life Index 2016", OECD Social and Welfare Statistics database.
StatLink http://dx.doi.org/10.1787/888933552055

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

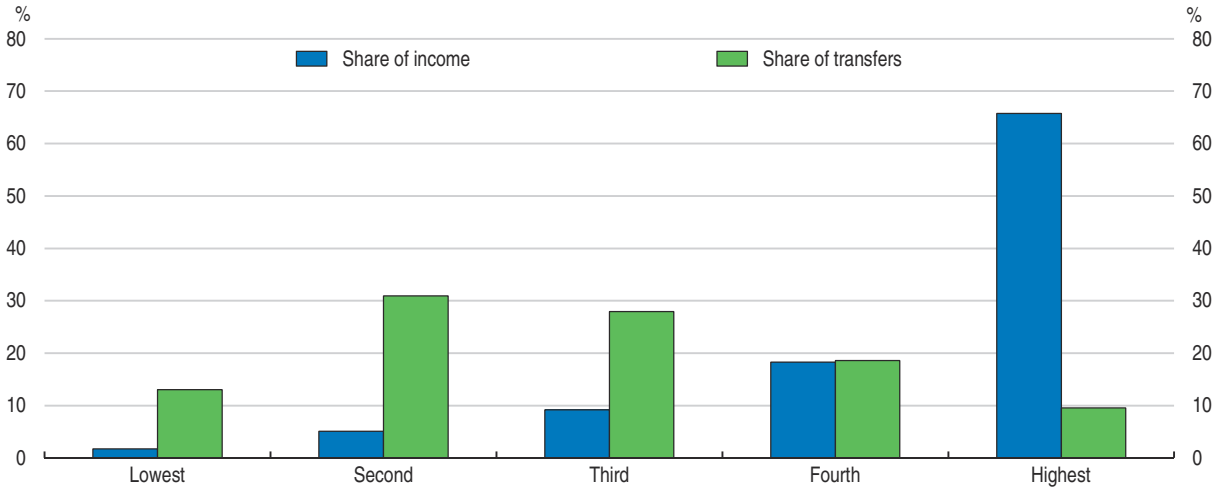
Figure 3. **Poverty and inequality are high**[1]



1. Data for South Africa are provisional.
Source: OECD Income Distribution and Poverty database.

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

Figure 4. **Social transfers reduce inequality and poverty**
Distribution of income and transfers by quintile, entire population, 2015



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

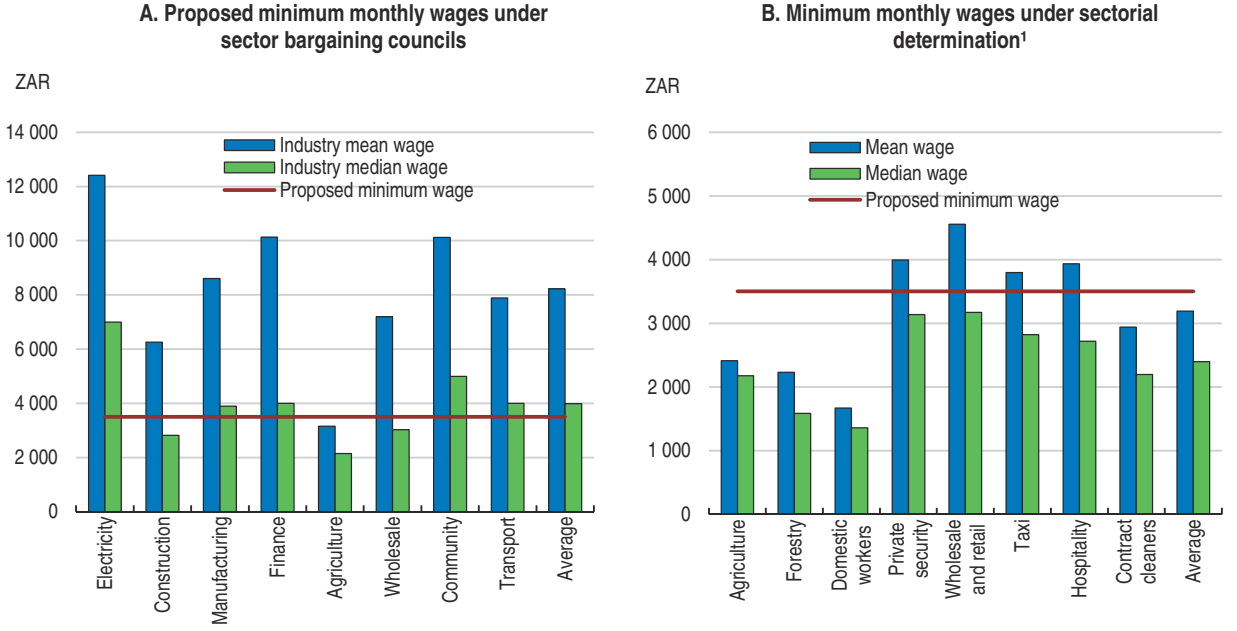
StatLink http://dx.doi.org/10.1787/888933552093

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

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

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

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



1. Minimum wages set by the Ministry of Labour.

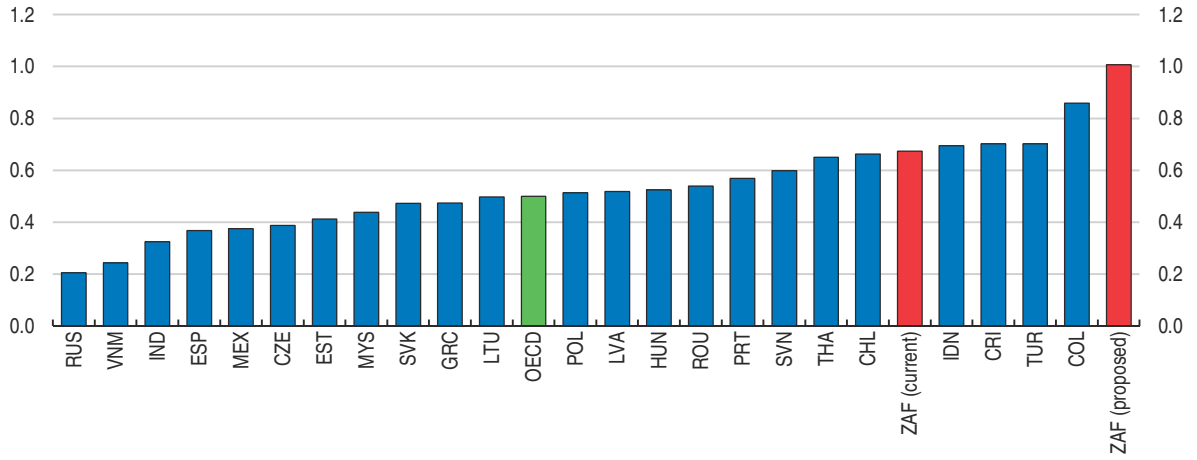
Source: National Minimum Wage Panel Report to the Deputy President, November 2016.

StatLink http://dx.doi.org/10.1787/888933552112

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

Figure 6. **Minimum wages across a selection of countries**

Minimum relative to median wages, 2015 or latest



Source: OECD, ILO, World Bank.

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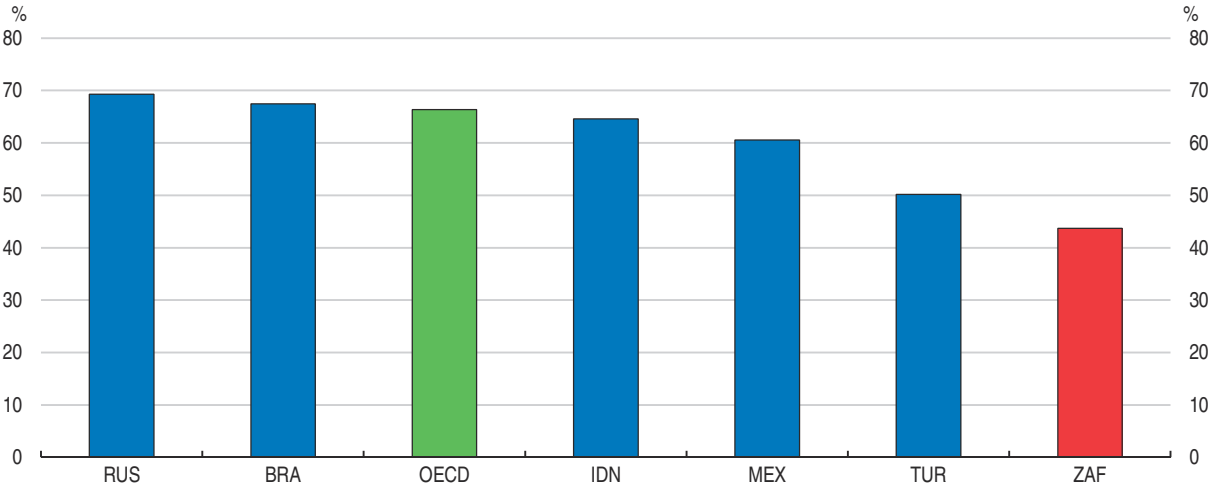
To minimise any potential negative effects of the higher wage it is important to pursue structural policy reforms that increase productivity and job creation. Employment remains the most effective way to reduce poverty and inequality, and increase inclusiveness. South Africa suffers from a low employment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

Figure 7. **Employment rate is low**

Employment to population ratio, 2015



Source: OECD Labour Force Statistics database.

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

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

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

Recommendations from previous *Surveys*	Action taken since the July 2015 *Survey*
Establish a public employment service as a one-stop shop for job-seekers to lower the cost of job search and hiring costs for employers, which would improve the matching of workers to jobs.	An employment services database has been created that increasingly links to other programmes. Centres now include self-help kiosks.
Increase the role of mediation and arbitration to make wage negotiations less confrontational. The arbitration process for dismissals for cause should be accelerated and simplified.	The minimum wage introduction is to be accompanied by labour market stability measures, including amendments to the Labour Relations Act, Picketing Regulations and a Code of Good Practice on Collective Bargaining, Industrial Action and Picketing.

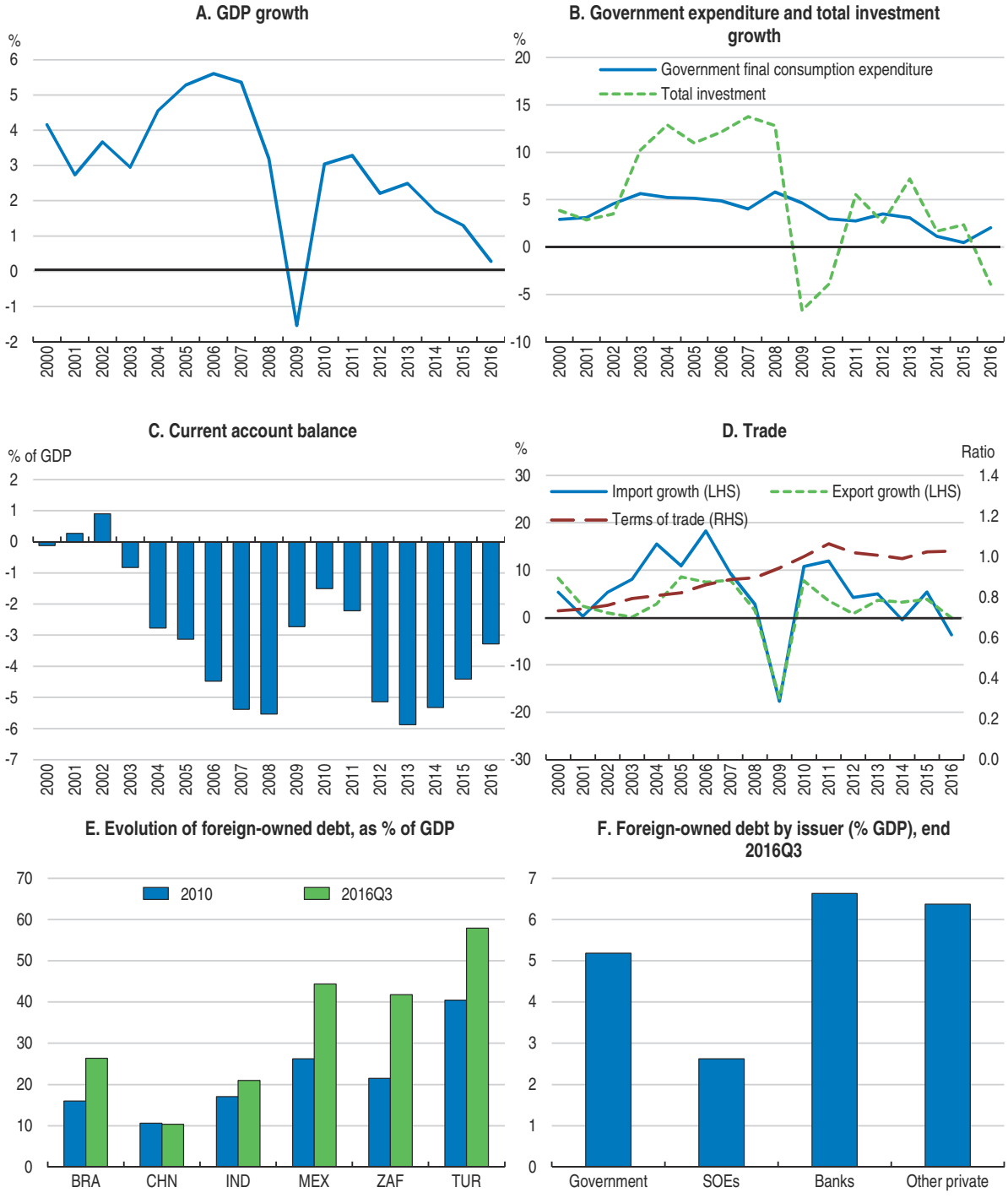
This *Survey* is focusing on other ways to expand the economy and create jobs rapidly. Boosting entrepreneurship and growing small businesses can play an important role in creating jobs for the 27% of workers who are unemployed. Greater regional integration within the Southern African Development Community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

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

Low growth is set to continue

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

Figure 8. **Recent macroeconomic developments**



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

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

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

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

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

Table 2. **Macroeconomic indicators and projections**

Annual percentage change, volume (2010 prices)

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

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

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

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

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

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

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

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

Macroeconomic policies are constrained

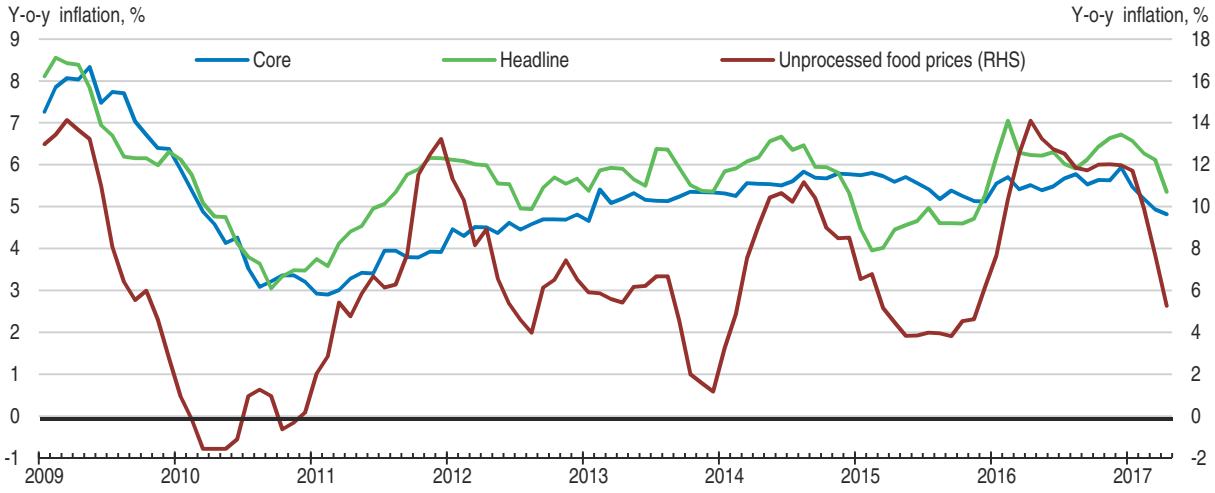
Monetary policy and financial markets under relatively high inflation and low growth

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

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

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

Figure 9. **Inflation dynamics**



Source: South African Reserve Bank.

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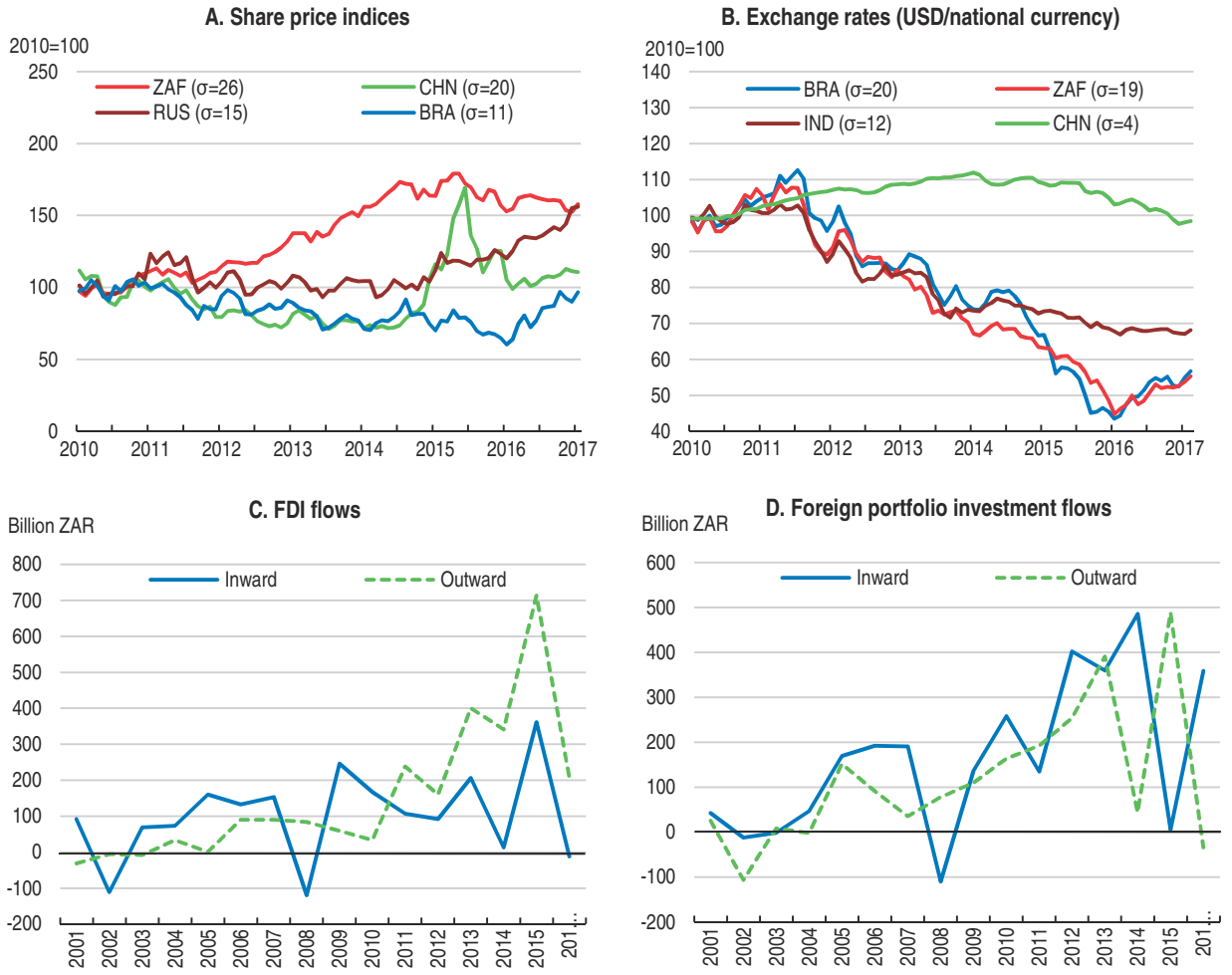
amounts of international portfolio investments. South Africa has been an important destination in the risk allocation strategies of portfolio managers between advanced economies and emerging markets. While attracting capital, the openness affects volatility of the currency and the stock market (Figure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

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

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

Figure 10. **Financial indicators**



Note: In panels A and B, sigma denotes the standard deviation of prices over the period shown.
Source: Thomson Reuters Eikon; OECD, Economic Outlook database; South African Reserve Bank.

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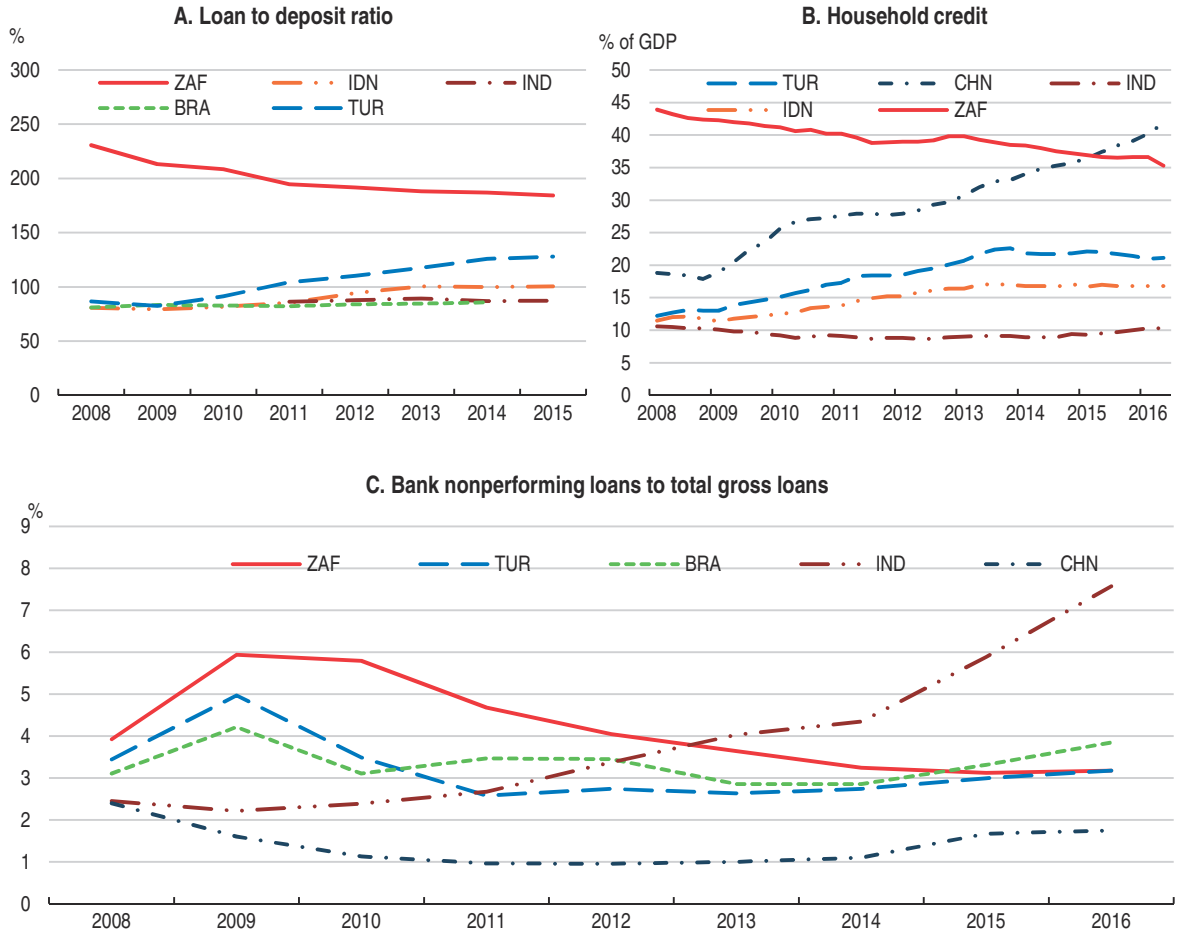
Fiscal policy and public debt: shifting the mix of spending

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

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

Figure 11. **Financial vulnerabilities**



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

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

Recommendations from previous *Surveys*	Action taken since the July 2015 *Survey*
Continue the prudent approach to fiscal consolidation, including the use of spending ceilings, to reduce the structural budget deficit and contain public debt in a growth and equity friendly way. Continue to sell state assets where a higher return can be achieved by using the revenues to finance infrastructure investments.	Fiscal consolidation has continued. 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 level, are subject to a competitive bidding process. Efforts to expand centralised procurement of goods and services and renegotiation of transversal contracts continue.

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

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

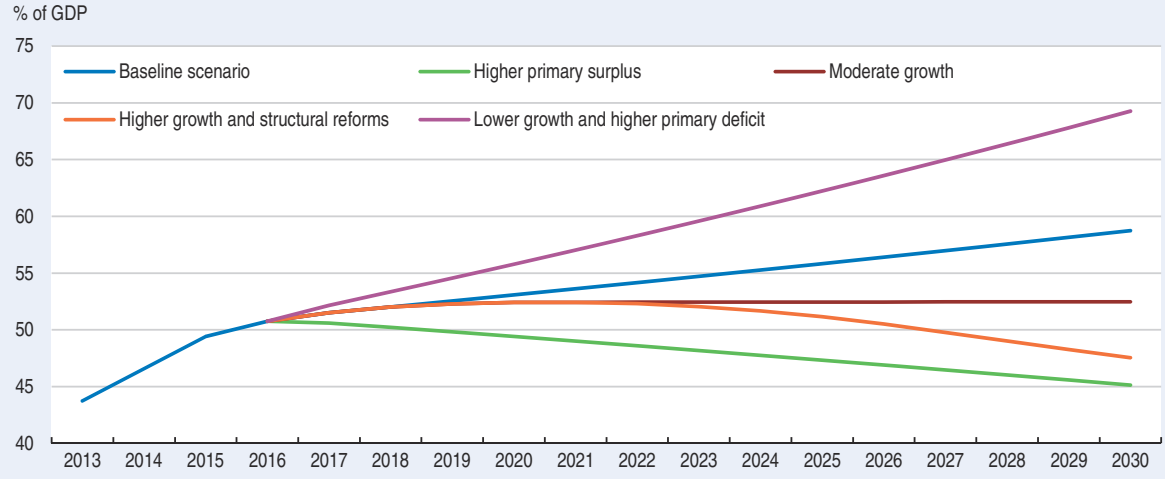
Box 1. **South Africa's debt is sustainable but vulnerable**

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

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

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

Figure 12. **Simulations of debt dynamics**



Source: OECD calculations.

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Table 5. **Government guarantee exposure**

As a % of GDP

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

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

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

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

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

Table 6. **Fiscal indicators**

% of GDP

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

1. Preliminary estimates.
2. Projections.

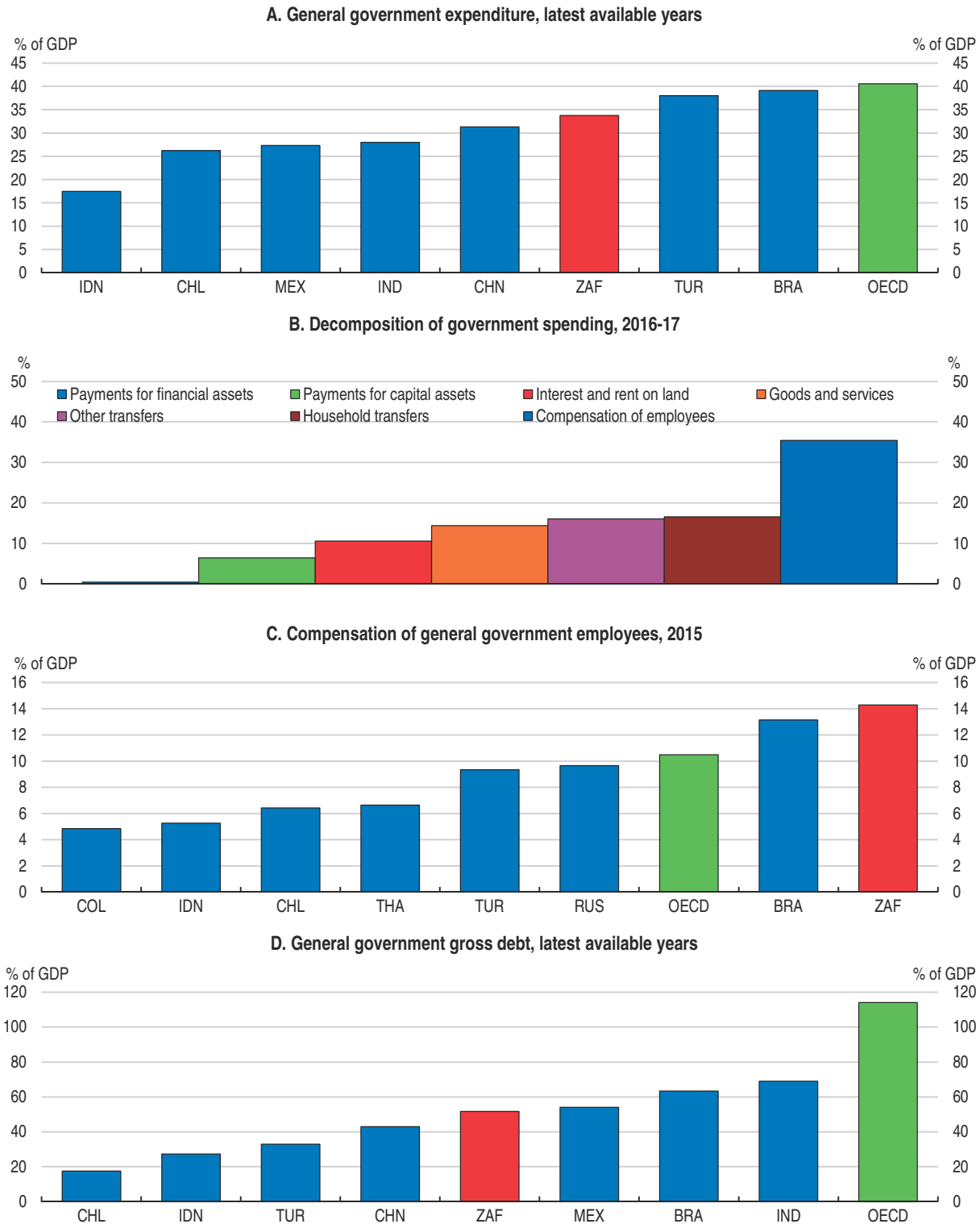
Source: National Treasury (2017), Budget Review 2017.

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

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

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

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



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

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

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

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

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

Table 7. **Past OECD recommendations on broadening tax bases**

Recommendations from previous *Surveys*	Action taken since the July 2015 *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. Draft legislation for the carbon tax has been published.
Increase property taxation by building capacity at the municipal government level.	No action taken.
Increase reliance on environmentally related taxes, such as fuel levies.	A Waste Board is being created which will impose a levy on waste. A levy on used tyres was implemented in February 2017.

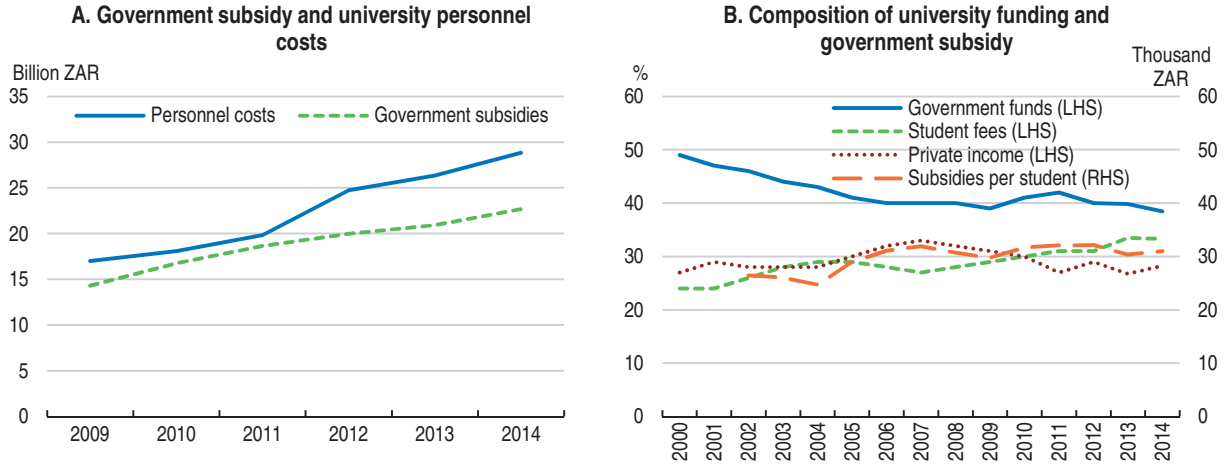
Financing higher education poses a challenge to the fiscal stance

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

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

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

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



1. "Student fees" does not include government allocations to NSFAS.
Source: Department of Higher Education and Training (2016); OECD calculations.

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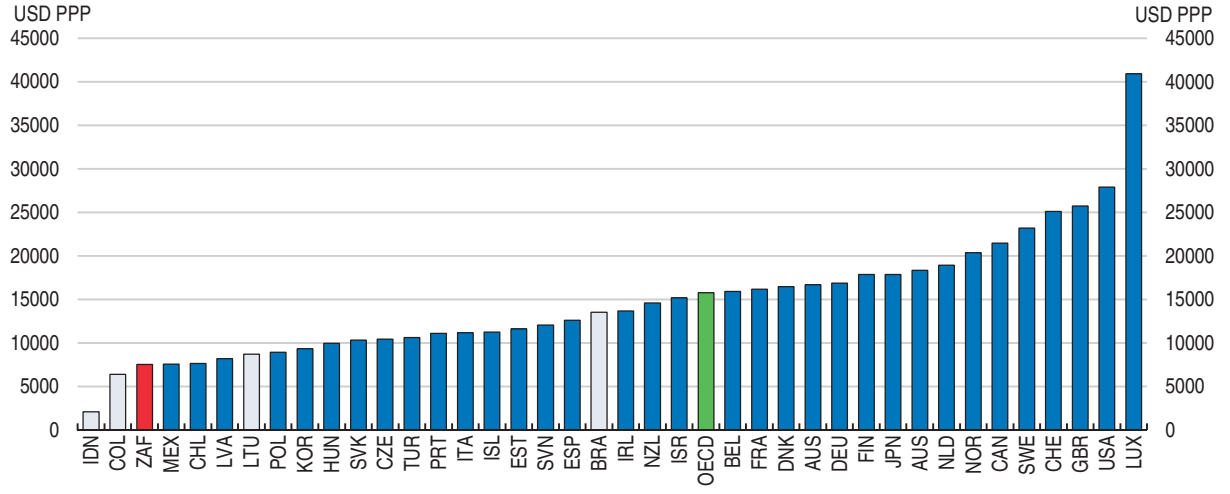
Figure 15. **Annual expenditure per student in tertiary educational institutions for all services**
Expenditure per student, 2013



Note: For Canada and Chile, data refer to 2012 and 2014. For Brazil, Canada, Ireland, Luxembourg and Switzerland data refer to public institutions only.
Source: OECD 2016, *Educational attainment and labour-force status*, Education at a Glance database; DHET 2016, OECD calculations for South Africa.

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

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

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

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

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

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

Recommendations from previous *Surveys*	Action taken since the July 2015 *Survey*
Expand the Accelerated Schools Infrastructure Development Initiative programme to address infrastructure backlogs and improve the delivery of learning materials (textbooks, desks, libraries and computers) with priority to the most deprived schools.	136 new schools were built and completed in 2016/17, 167 provided with sanitation facilities, 344 with water and 134 with electricity. The Department of Basic Education committed to provide at least two libraries in each province with the ASIDI allocation.
Provide more school leadership training and support staff in exchange for stricter accountability. Allow the education authorities to appoint and dismiss school principals in a more flexible way (depending on progress on school performance in Annual National Assessments and on external reviews), while making school principals responsible for yearly teacher evaluations and monitoring teachers' daily attendance.	In 2016, the Department of Basic Education introduced a new policy defining the role of school principals and the key aspects of professionalism, image and competencies required. A new collective agreement on quality management of principals is with the teaching union.
Empower the independent federal evaluation unit NEEDU, join the Programme for International Student Assessment (PISA) and the Teaching and Learning International Survey (TALIS) and undertake an OECD Review of Evaluation and Assessment Frameworks for Improving School Outcomes.	No action taken.

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

Deepening regional integration within the Southern African Development Community

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

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

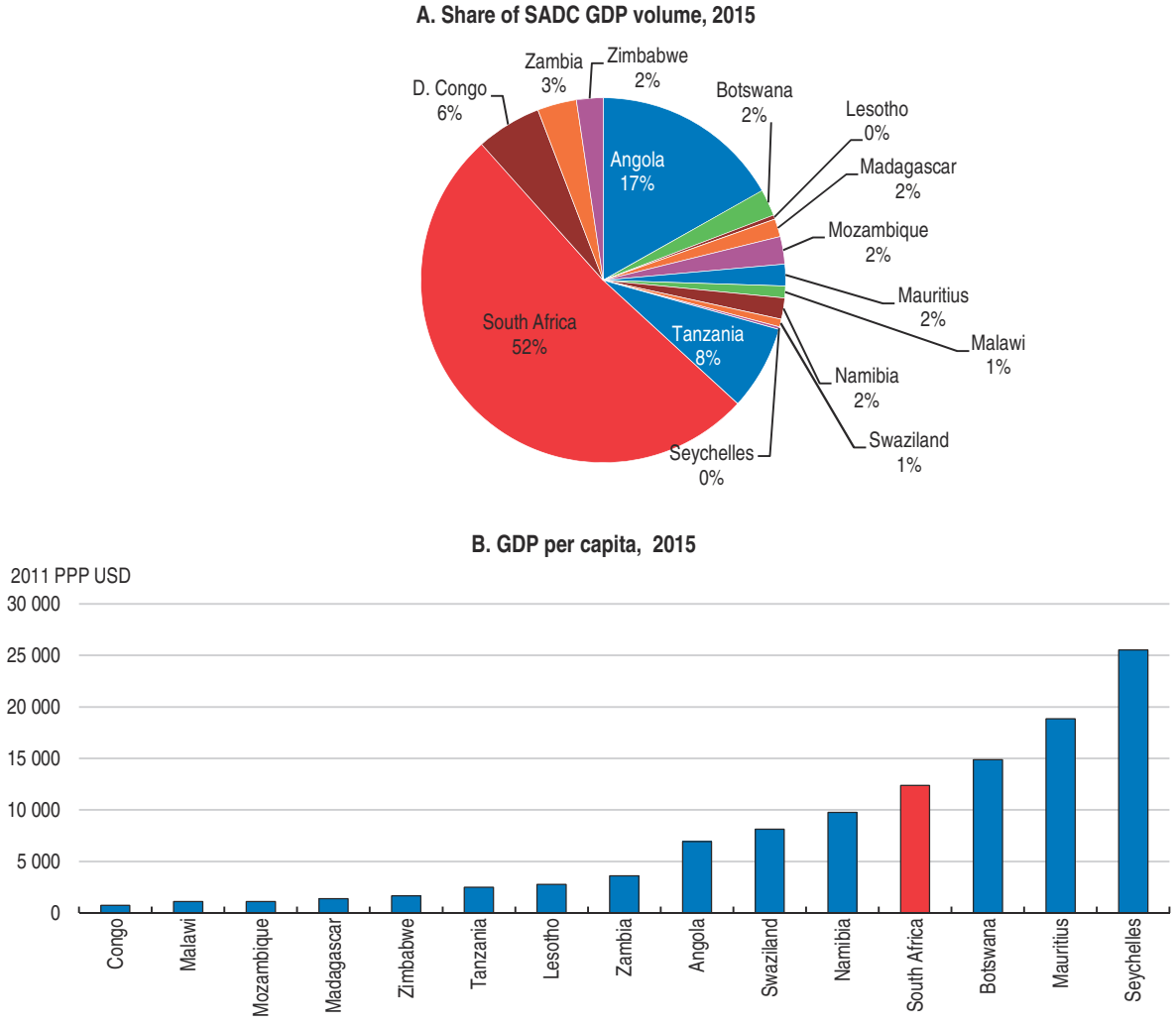
SADC intra-regional trade is low but has great potential

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

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

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

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



Source: World Bank, World Development Indicators database.

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

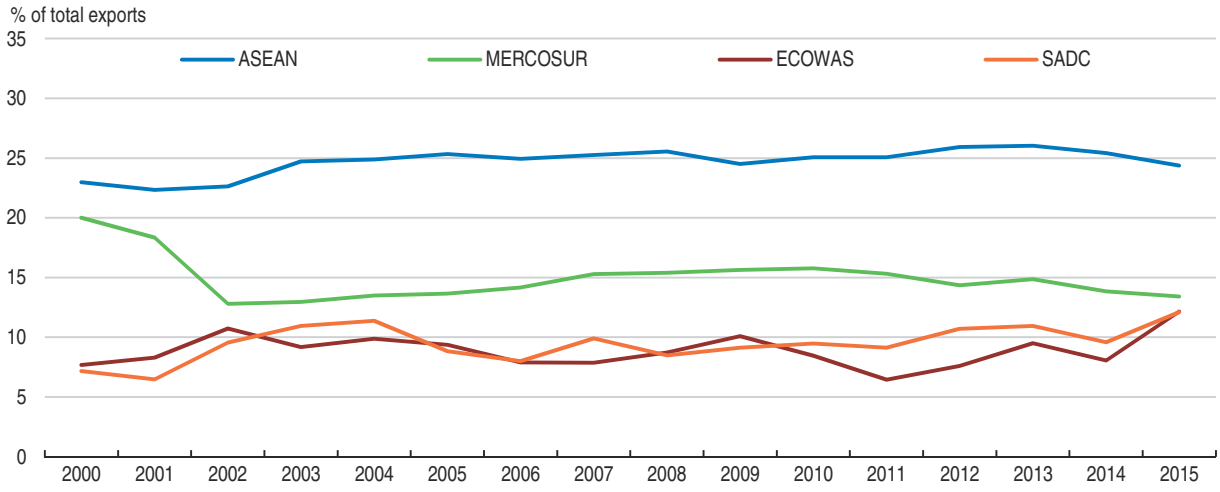
Recommendations from previous *Surveys*	Action taken since July 2015 *Survey*
Further develop pro-growth regional policies which focus on skills formation, investment and infrastructure in a co-ordinated way.	In 2016, SADC approved a USD 3.5 million feasibility study for a regional project to expand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

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

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

Figure 17. **SADC intra-trade compared to other free trade areas**

Share of intra-regional exports



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

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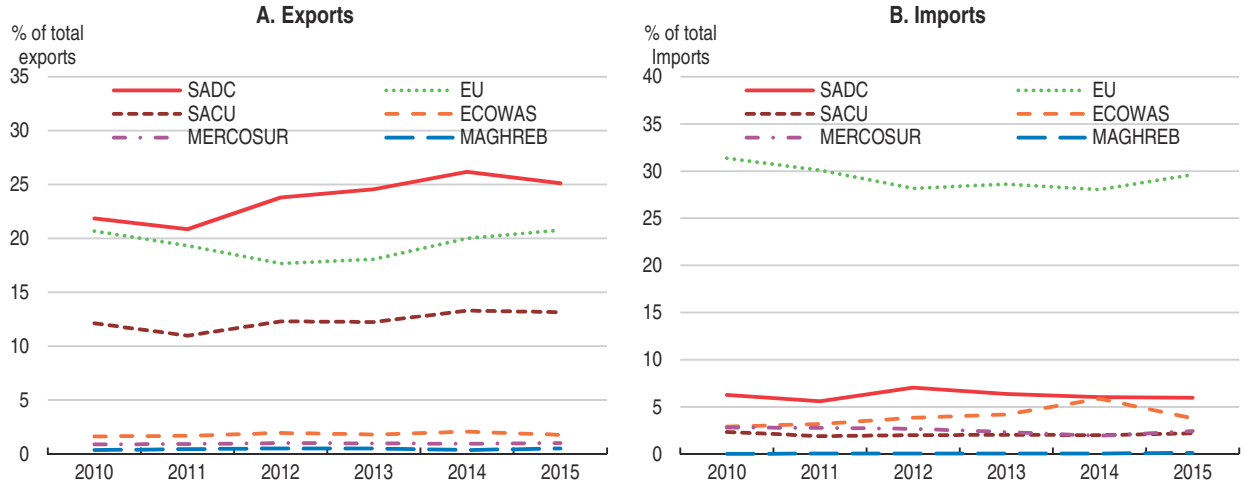
Figure 18. **South Africa trade with SADC compared to other regions**



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

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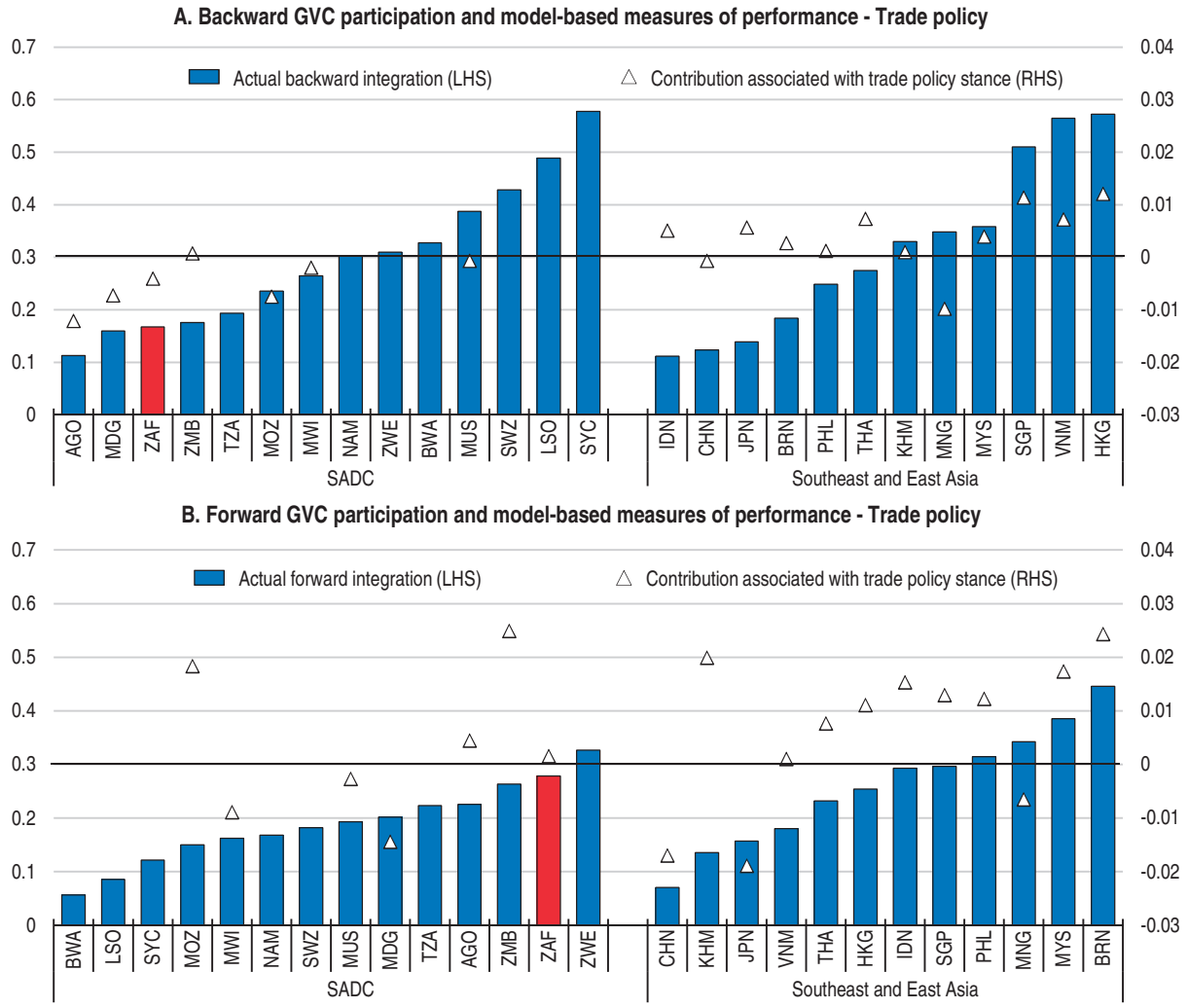
mainly domestic (80%) (Chapter 1). Better trade policies (lower tariffs and larger share of imports covered by free trade areas) could improve GVC participation of SADC countries (Figure 19.A and Kowalski et al., 2015).

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

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

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



Source: OECD calculation based on EORA database.

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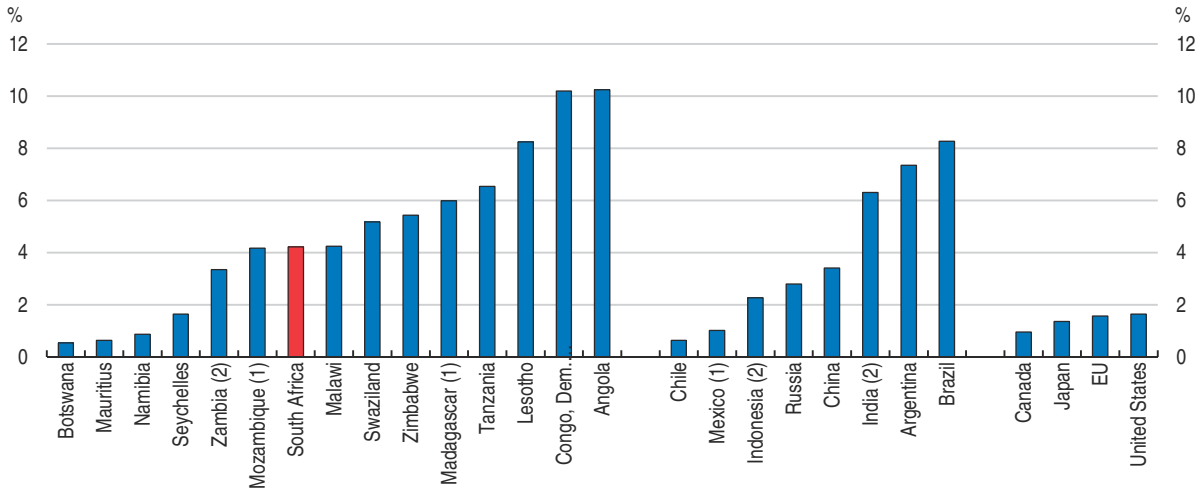
Customs procedures are complex within SADC compared to the OECD and emerging economies on average (Chapter 1). The multiple memberships of SADC countries in different free trade areas increase the difficulty for customs officers to establish the precise preferential tariffs applicable to each product.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

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

Figure 20. **Tariff rates are relatively high in SADC countries**

Tariff rate, applied, weighted mean, all products[3], 2015



1. Numbers are for 2014.
2. Numbers are for 2013.
3. Weighted mean applied tariff is the average of effectively applied rates weighted by the product import shares corresponding to each partner country. Data are classified using the Harmonized System of trade at the six- or eight-digit level. Tariff line data were matched to Standard International Trade Classification (SITC) revision 3 codes to define commodity groups and import weights. To the extent possible, specific rates have been converted to their ad valorem equivalent rates and have been included in the calculation of weighted mean tariffs. When the effectively applied rate is unavailable, the most favoured nation rate is used instead.

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

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

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

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

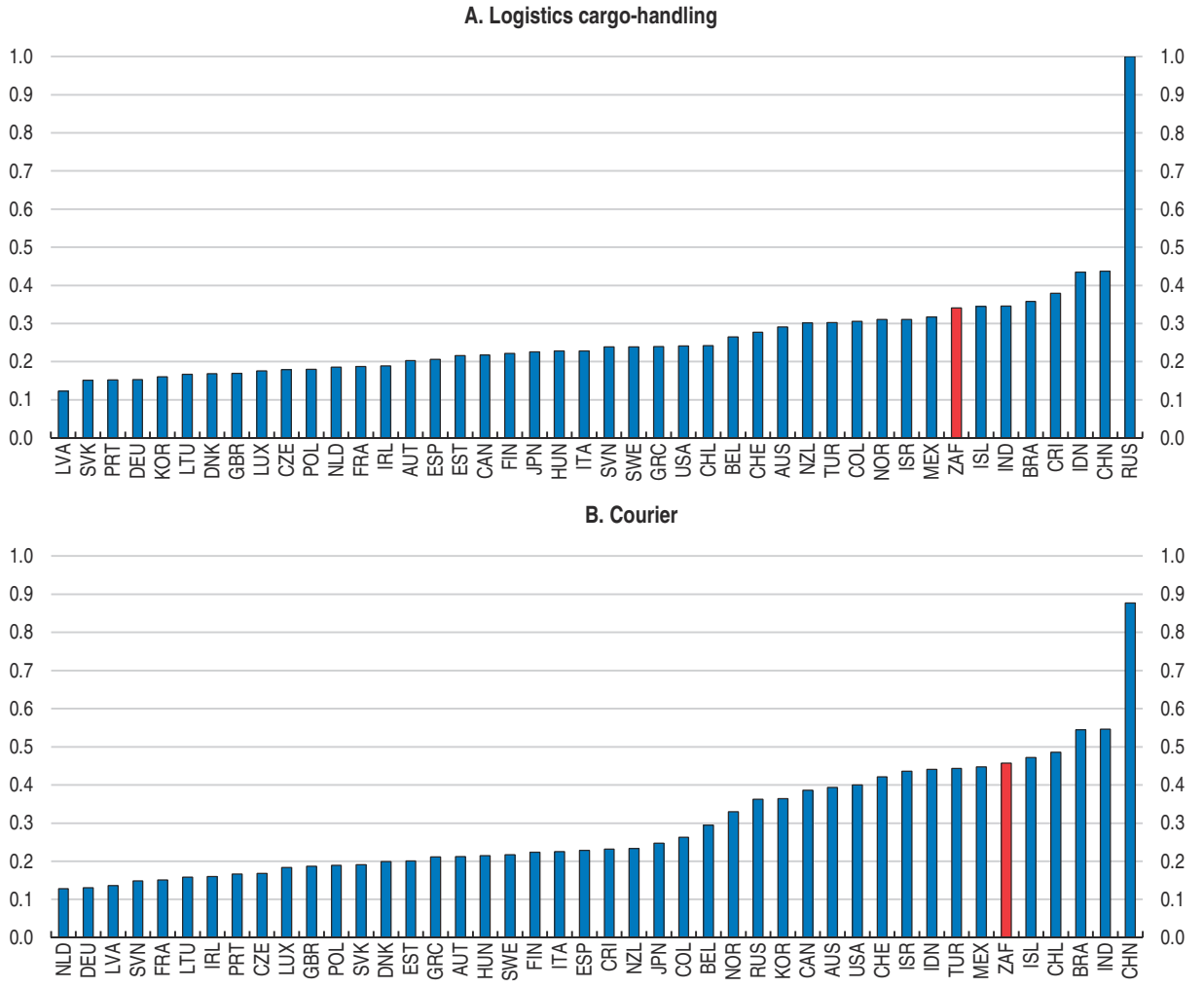
Broadening the scope of the trade agreements could boost regional trade and integration

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

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

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

OECD Services Trade Restrictiveness Index[1]



1. STRI indices take the value from 0 to 1, where 0 is completely open and 1 is completely closed.
Source: OECD Services Trade Restrictiveness Index database.

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

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

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

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

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

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

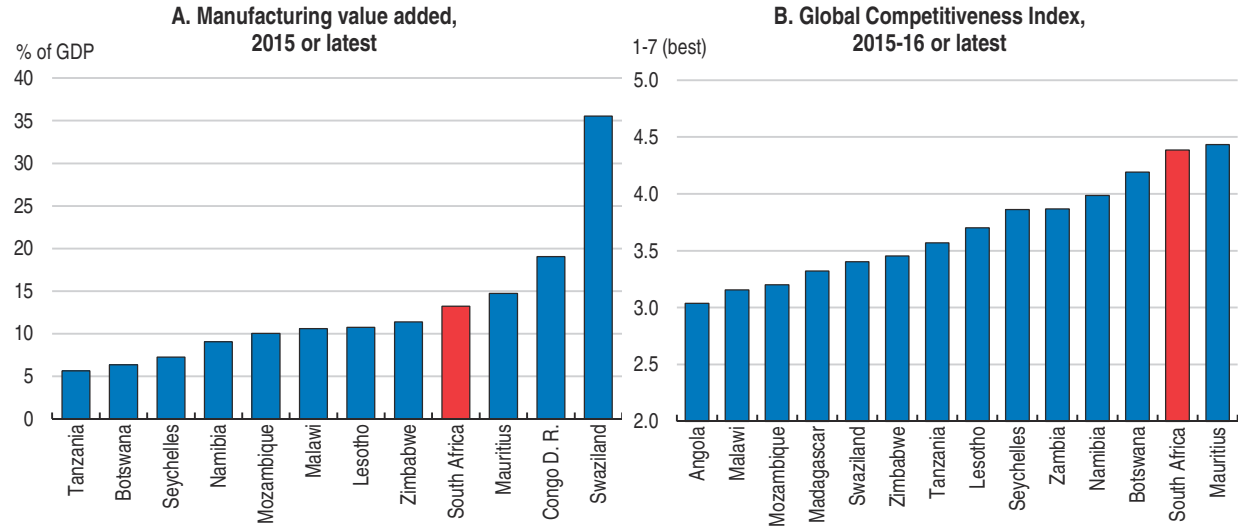
Reforming business environments in the region can strengthen regional integration

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

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

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

Figure 22. **Degree of industrialisation and competitiveness of SADC countries**



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

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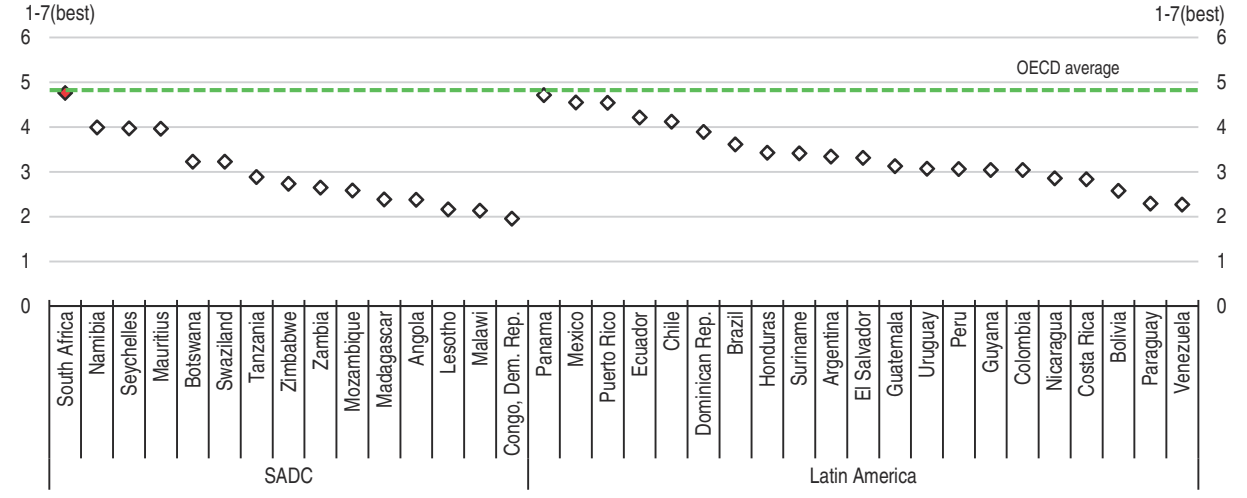
Infrastructure plays a major role in growth in Southern Africa (Foster, 2010) and gaps remain important within SADC. The quantity and quality of transport infrastructure is low. Only South Africa is close to the OECD average on the index of transport infrastructure (Figure 23). Even in South Africa,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

Figure 23. **Transport infrastructure compared to OECD average**



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

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

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

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

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

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

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

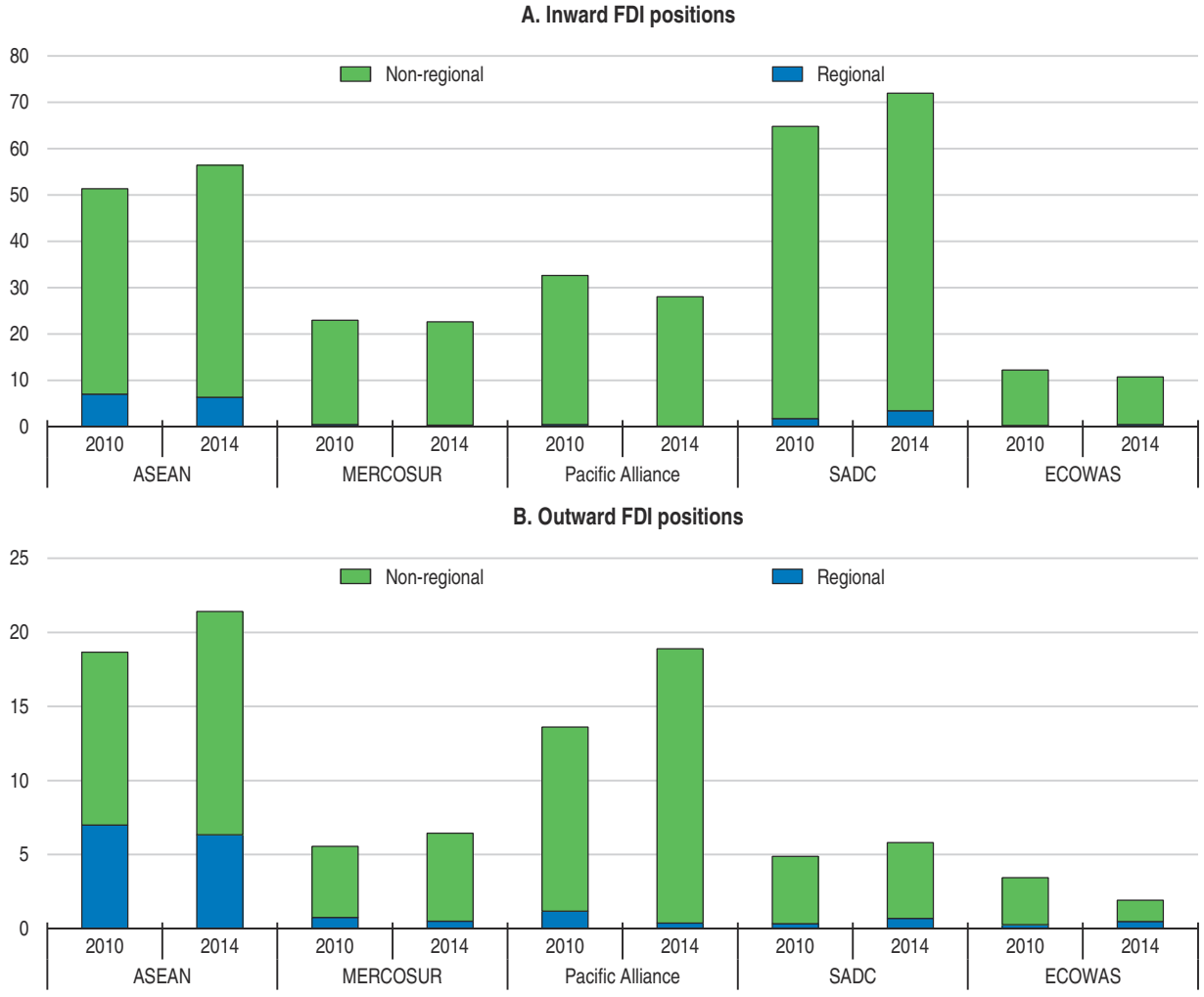
The financial sector in SADC is diverse and fragmented. Currency conversion costs are high and most countries still have restrictive exchange and capital control regulations in place (Maveé et al., 2016). Cross-border transactions face different regulatory frameworks. SADC has put in place memoranda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

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

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

Figure 24. **FDI position of SADC relative to other regional economic communities**

Inward and outward FDI positions by regional cluster, % of GDP



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

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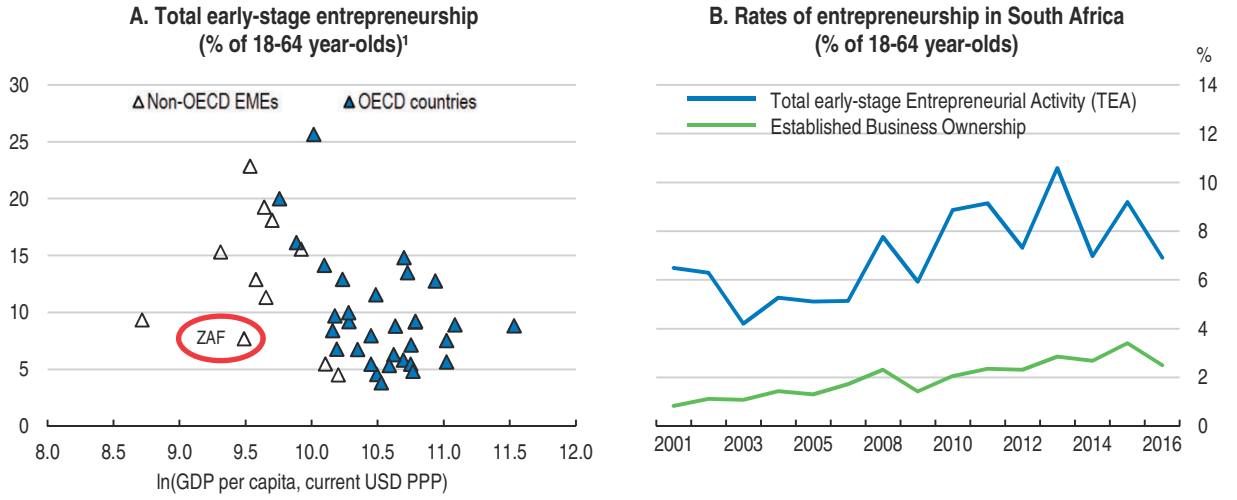
Boosting job creation in South Africa through more start-ups and SME growth

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

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



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

Source: Global Entrepreneurship Monitor; World Bank.

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Regulatory barriers constrain entrepreneurship and small businesses

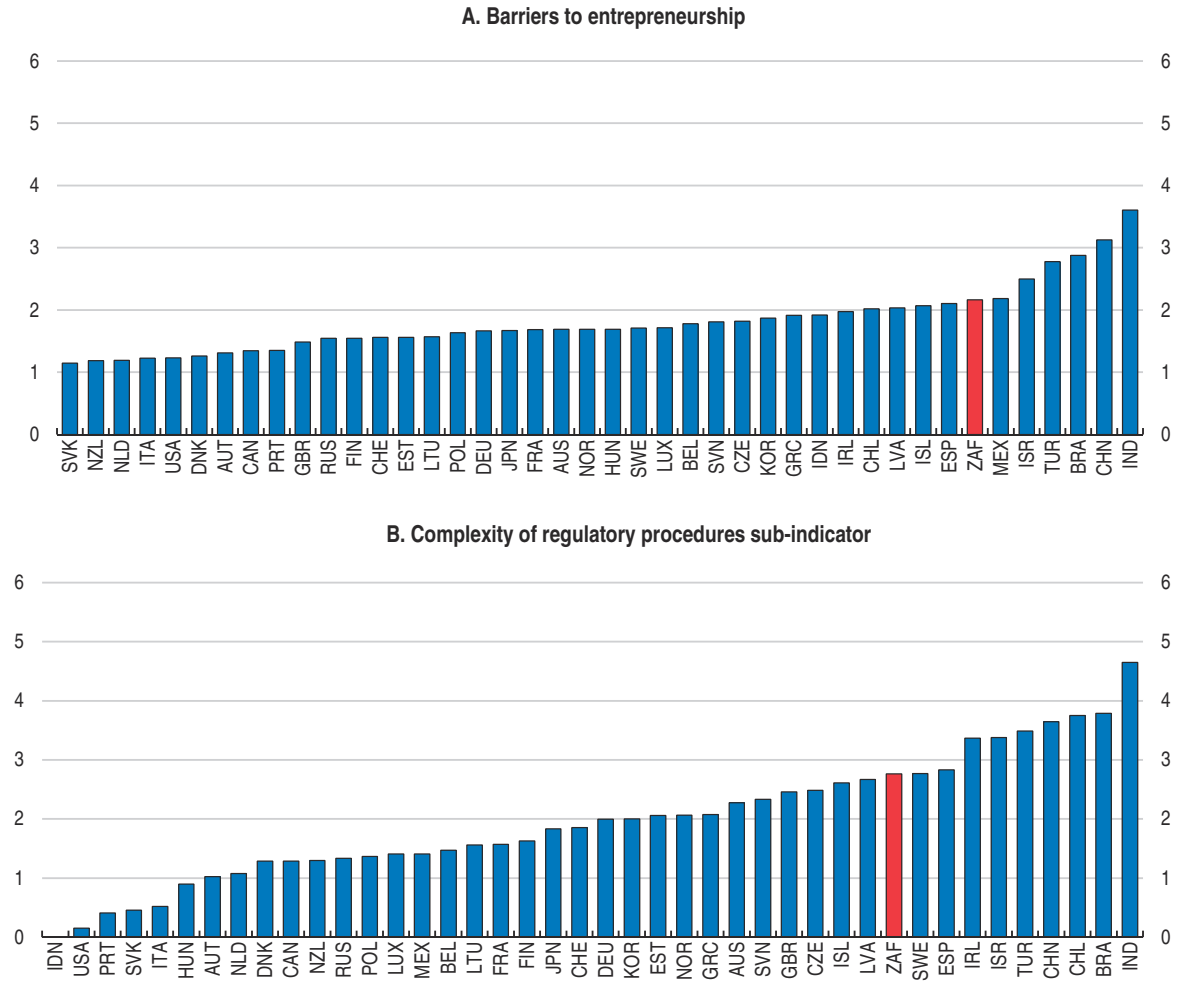
A burdensome regulatory environment has been found to reduce the rate of entrepreneurial activity and business ownership (Ardagna and Lusardi, 2010; Klapper et al., 2008). Regulation is disproportionately more costly for small and young firms and discourages informal firms from formalising (Andrews et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

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

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

Figure 26. **Regulatory barriers to entrepreneurship are high**

OECD product market regulation indicators, 2013[1]



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

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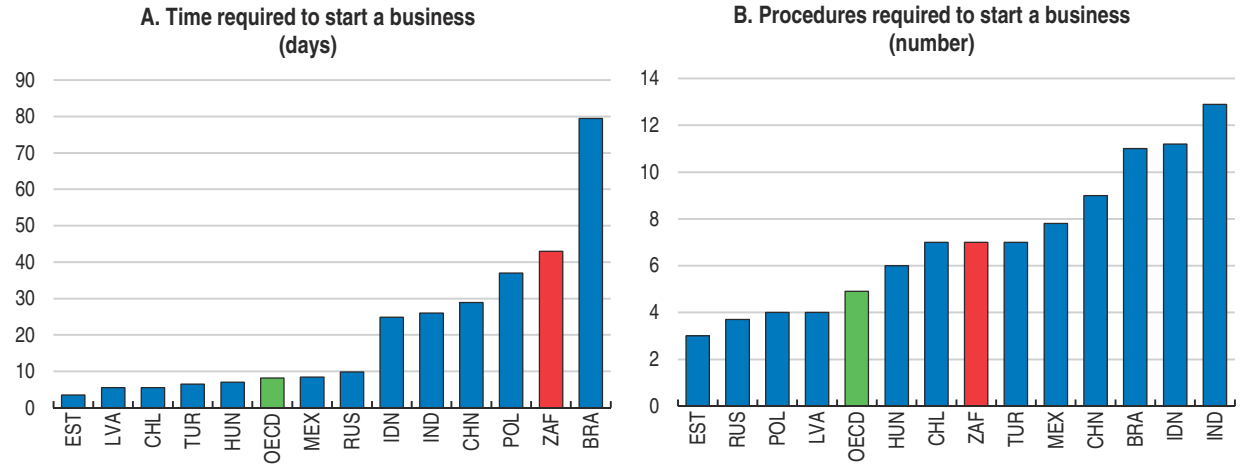
information should be shared within the government so that firms only provide information to the government once. Staff should be aware of government programmes for small business and their requirements.

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

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



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

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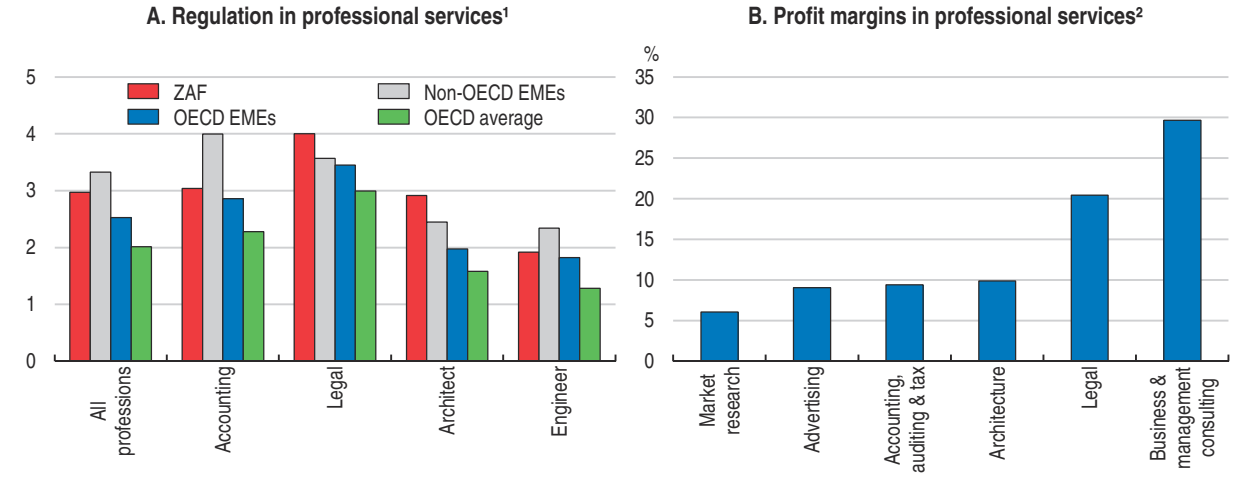
Figure 28. **Some professional services are highly regulated**



1. Scores potentially range from zero to 6 and increase with restrictiveness. The emerging market economies are 5 non-OECD member countries (Brazil, China, India, Russia and South Africa, with varying coverage) and 5 OECD members (Chile, Hungary, Mexico, Poland and Turkey). Data for 2013 or latest.
2. Net profit before interest, tax and dividends as a percentage of turnover in 2015.

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

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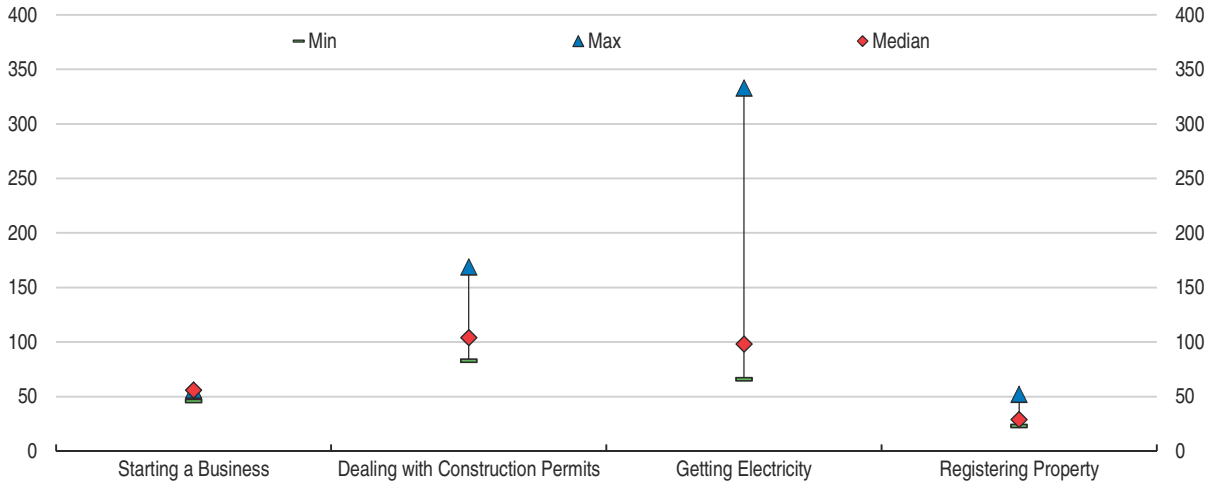
A whole-of-government reform programme to reduce the administrative burden could boost confidence, start-up rates and growth. For instance, reducing regulation to best practice in three areas: licensing and permits (e.g. Portugal, Slovak Republic); communication and simplification of rules and procedures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

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

Figure 29. **There is considerable variation in regulatory procedures across cities**

Number of days taken, by city



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

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

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

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

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

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

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

Table 10. **Past recommendations for lowering regulatory barriers to entrepreneurship**

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

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

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

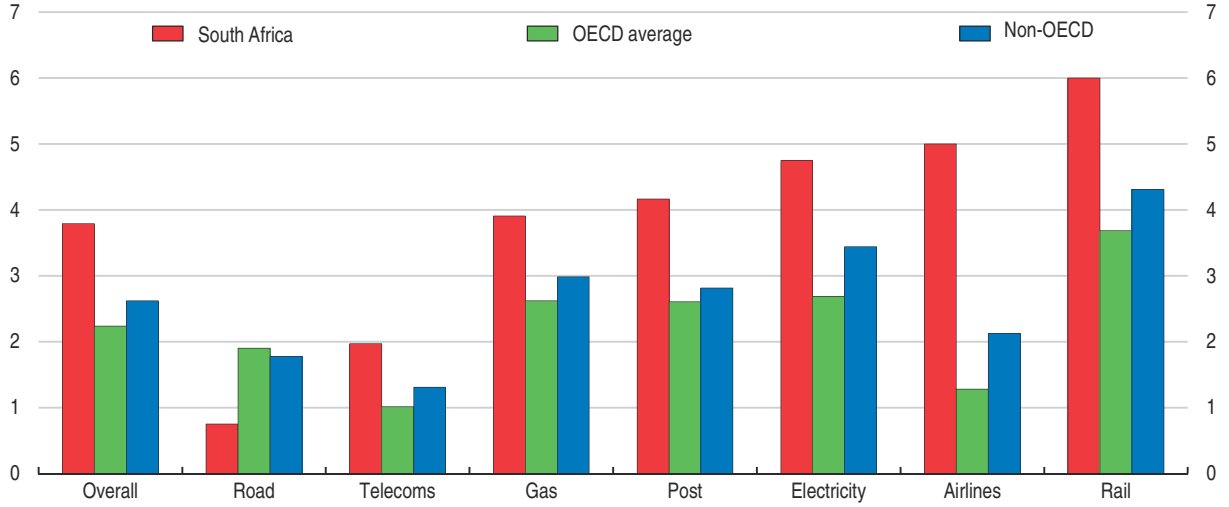
Competition authorities have been active in detecting and sanctioning cartels. Excluding construction projects, some 76 cartels were detected and sanctioned between 2005 and 2015 (World Bank, 2017). Moreover, competition law has broken up cartels in

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

The competition policy framework remains broadly at par with best practices in the OECD, and enforcement action has been ramped up in recent years. However, the Competition Law includes a particularly wide-ranging and all-encompassing public interest clause. This clause assigns to competition policy multiple objectives in addition to ensuring economic efficiency, such as maintaining employment and supporting black economic empowerment. This is particularly problematic in merger cases as there is no clear method for balancing the public interest and competition assessments (OECD, 2008; Smith, 2015). Furthermore, such policy objectives can often be achieved more effectively by alternative means than limiting competition. An OECD Peer Review of Competition Policy or similar expert review could be helpful in terms of identifying clear rules for the application of merger control and other aspects of the competition framework. Finally, ensuring that the integrity of the enforcement of competition policies is guaranteed is crucial. For instance, ensuring incumbents can be effectively challenged in many sectors including fuel, gas, electricity, telecommunications and banking could boost growth rapidly and broaden participation in the economy in particular of black and young entrepreneurs.

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

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



Note: Index scale 0 to 6 from least to most restrictive. Non-OECD data include Brazil, Bulgaria, China, Croatia, Cyprus, Lithuania, Malta and Romania.
Source: OECD (2017), "Sectoral Regulation: Energy, transport and communications", OECD Product Market Regulation Statistics database.
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responsibilities of sector regulators are important determinants of the effectiveness of regulation (Koske et al., 2016). Giving the energy regulator greater independence in decision-making from the government and Eskom (the vertically integrated state-owned company) would improve governance in electricity. The planned Single Transport Economic Regulator should in principle address the gap in ports regulation and also rail highlighted in the 2015 *Economic Survey*. Ultimately, as the industry structure becomes more competitive, the role of the economic regulator should narrow with the Competition Commission enforcing competition.

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

Recommendations from previous *Surveys*	Action taken since July 2015 *Survey*
In network industries, complete the introduction of independent regulators and charge them with ensuring non-discriminatory third-party access. Secure additional electricity generation capacity by accelerating the independent power producer programme and facilitating private co-generation.	The 2017 Budget allocated funds to the Department of Transport to build capacity in rail transport regulation. The creation of the Single Transport Economic Regulator is planned for 2018.
Systematically identify and eliminate competition-hampering regulation.	A red tape impact assessment bill is with the parliament. However, its focus is on reducing costs of red tape rather than increasing competition.
Privatise state-owned companies, such as telecoms, that are in markets with a sufficient degree of competition.	No action taken.

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

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

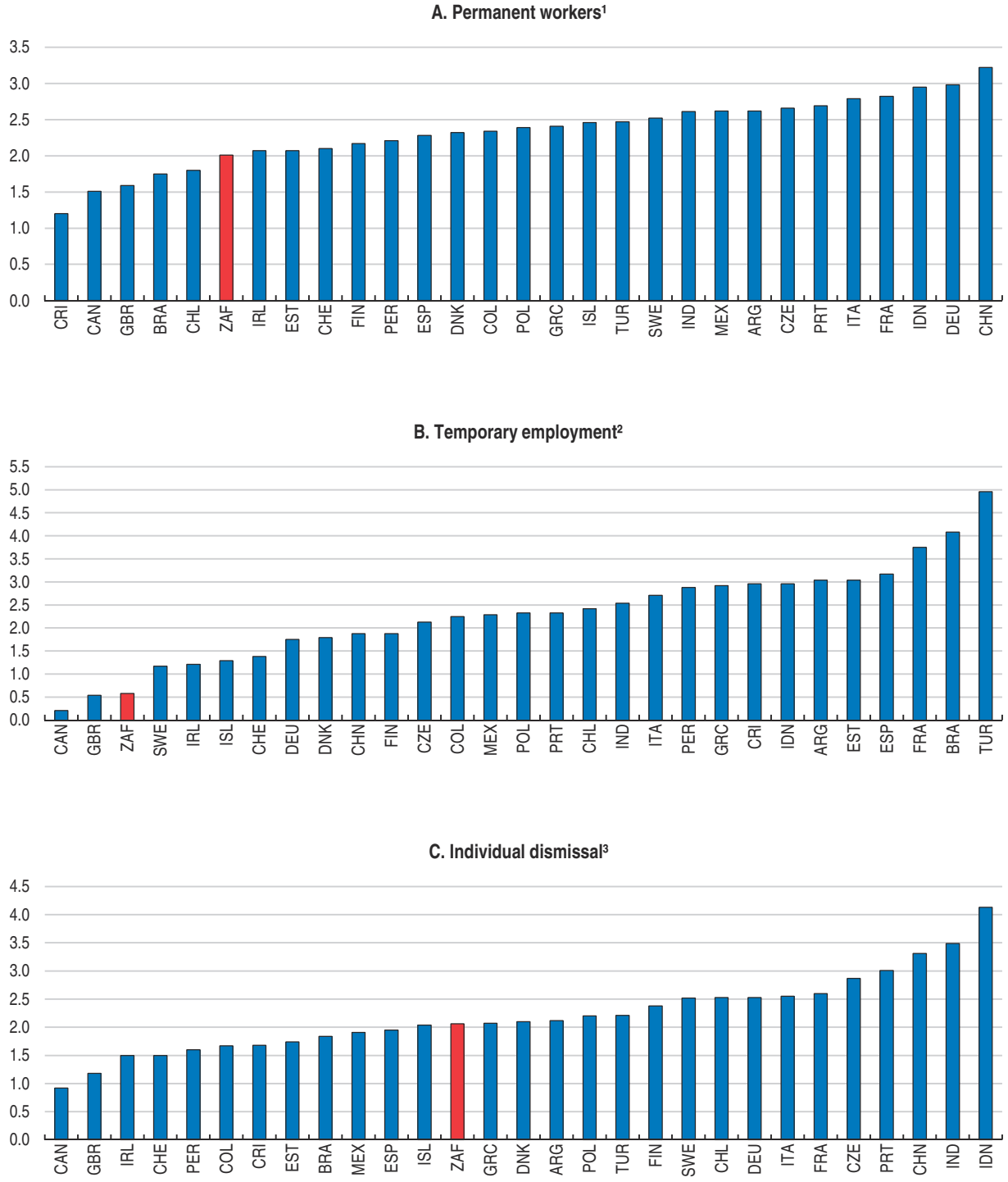
Strengthening the initial sorting of claims brought to the Commission and limiting the number of appeals and the time allowed to appeal would reduce costs of employment termination and therefore the uncertainty involved in hiring staff. More flexibility could be given to small businesses by permitting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

Filling gaps in competencies and finance to enhance entrepreneurship

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

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

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



1. Regulation on individual dismissal of workers with regular contracts and additional costs for collective dismissals.
2. Regulation of fixed-term and temporary work agency contracts and regulation on temporary forms of employment.
3. Regulation on individual dismissal of workers with regular contracts, incorporating three aspects of dismissal protection: i) procedural inconveniences that employers face when starting the dismissal process, such as notification and consultation requirements; ii) notice periods and severance pay, which typically vary by tenure of the employee; and iii) difficulty of dismissal.

Source: OECD Employment Protection Legislation database.

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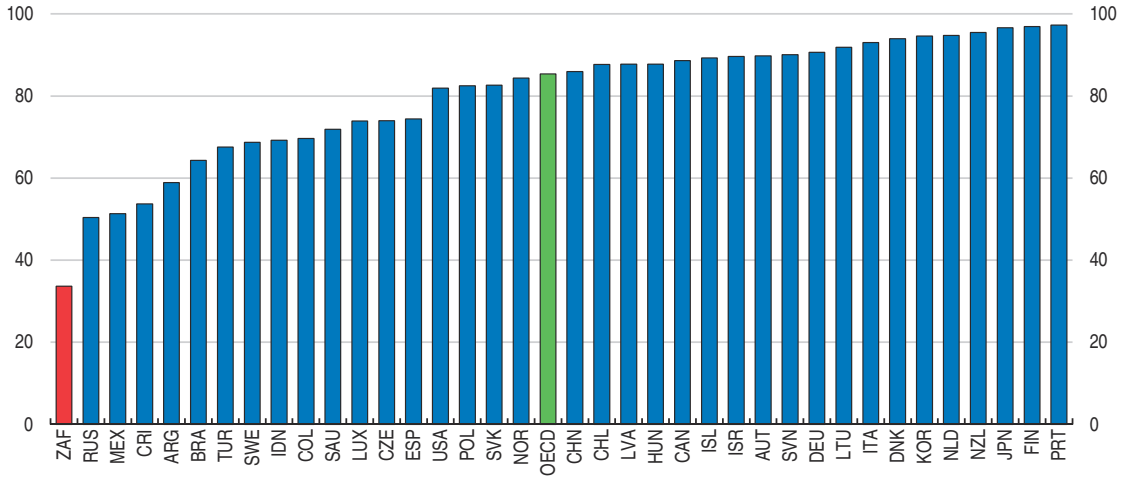
unequal quality of school education, its low average level and high drop-out rates (Figure 32). After school, access to work experience is constrained by the lack of jobs. However, survey data indicate that other supportive factors have improved. According to the Global Entrepreneurship Monitor, the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

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

Upper secondary first-time graduation rates, 2014



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

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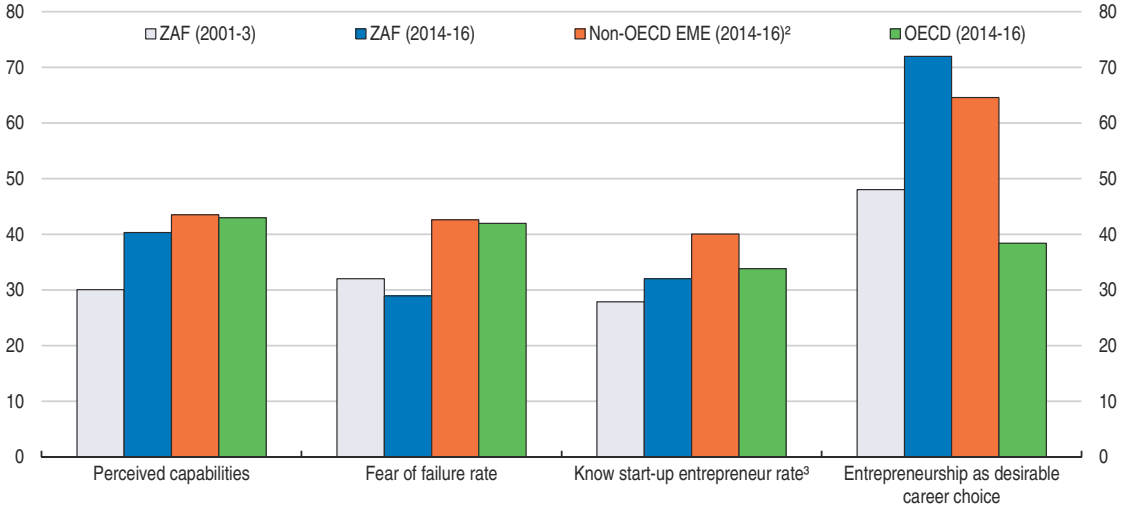
Figure 33. **Attitudes have become more entrepreneurial**[1]

As a percentage of the population aged 18-64 years



1. Perceived capabilities: those who believe they have the required skills and knowledge to start a business; Fear of failure rate: those perceiving good opportunities to start a business who indicate that fear of failure would prevent them from setting up a business; Know start-up entrepreneur rate: those who personally know someone who started a business in the past two years; Entrepreneurship as desirable career choice: those who agree with the statement that in their country, most people consider starting a business as a desirable career choice.
2. Non-OECD EME is the average of: Argentina, Brazil, China, Colombia, Costa Rica, India, Indonesia, Malaysia, Thailand, Russia and South Africa.
3. Data for 2016 are not available.

Source: Global Entrepreneurship Monitor.

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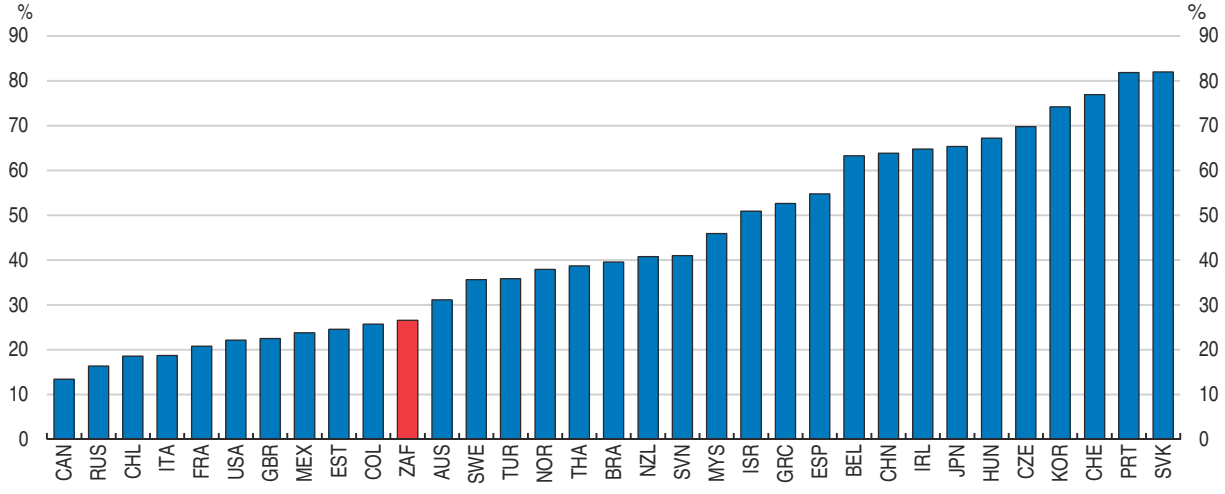
It is critical for entrepreneurship, as well as inclusive growth, that schooling generates basic skills such as literacy, numeracy and problem-solving skills. The performance of the schooling system is poor and unequal, even though it is improving (DBE, 2016; OECD 2016c). In the latest Trends in Mathematics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

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

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

Figure 34. **SME lending is relatively low**

As a percentage of total business lending, 2015 or latest



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

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

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

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

Government programmes should be better co-ordinated

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

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

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

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

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

Challenges for green growth

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

These hazards particularly affect the 4 million people living in informal settlements, largely due to the inadequate provision of basic services such as waste collection and management, modern energy, accessible, and safe water, and sanitation services; people in the poorer, more vulnerable and historically disadvantaged communities suffer the most. In 2015, more than a third of South Africa inhabitants were exposed to extremely high levels of PM2.5. Consequently, mortality from outdoor air pollution was about 480 deaths per million inhabitants (240 deaths from indoor exposure). In terms of welfare costs, the cost of premature deaths from outdoor exposure is equivalent to 7% of GDP (3.6% for indoor) (OECD, 2017c).

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

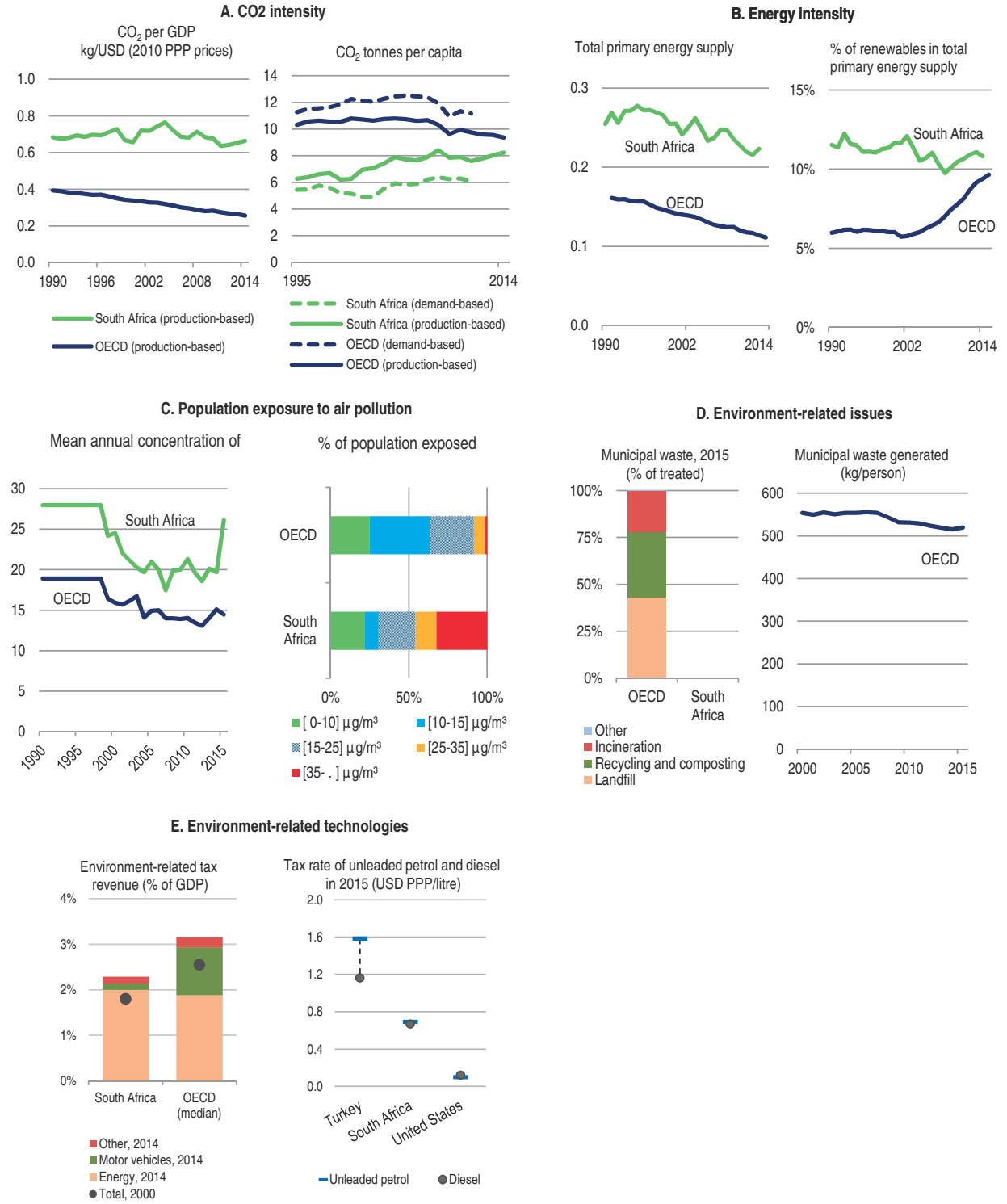
The economy's high energy intensity has been declining, but remains well above the OECD average (Figure 35). CO_2 intensity has not declined at all, and as the economy grows, per capita emissions, have been climbing towards the OECD average. However, South Africa exports much more carbon-intensive products than it imports, so its per capita carbon emissions attributable to domestic final demand, have increased less and remain well below the OECD average.

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

Table 12. **Past recommendations for greener growth**

Recommendations from previous *Surveys*	Action taken since the July 2015 *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.	Draft legislation for the carbon tax has been published.
Reduce implicit and explicit subsidies for energy and coal consumption, and use other instruments, such as cash transfers or supply vouchers, for protecting the poor.	The diesel fuel levy refunds for the electricity sector were reduced from April 2016. The 2017 Budget proposed a review of the VAT exemption of transport fuels in consultation with stakeholders.
Accelerate the allocation of water-use licenses and ensure that charges for water reflect supply costs and scarcity.	The application process for water-use licences has been streamlined to accelerate allocations.

Figure 35. **Green growth indicators for South Africa**



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

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

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ANNEX

Progress in main structural reforms

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

Macroeconomic policy and safeguarding fiscal sustainability

Recommendations from previous *Surveys*	Action taken since July 2015 *Survey*
Continue the prudent approach to fiscal consolidation, including the use of spending ceilings, to reduce the structural budget deficit and contain public debt in a growth and equity friendly way. Continue to sell state assets where a higher return can be achieved by using the revenues to finance infrastructure investments. (*2015 Survey*)	Fiscal consolidation has continued. Additional tax raising measures have been introduced. The expenditure ceiling has been lowered further.
Maintain the current monetary policy stance and continue to carefully monitor the development of core inflation (*2015 Survey*)	The repo rate increased to 7% in March 2016 from 5.75% in July 2015 to anchor inflation expectations.
Increase the emphasis on the cyclically adjusted balance when setting and explaining fiscal policy. (*2013 Survey*).	No action.
The government should continue to seek opportunities to increase the efficiency of public expenditure. (*2010 Survey*).	All suppliers must be registered with a central database. All contracts above ZAR 500 000 at national and provincial, and ZAR 200 000 at municipal level are subject to a competitive bidding process. Efforts to expand centralised procurement of goods and services and renegotiation of transversal contracts continue.
Consideration should be given to strengthening the link between commodity prices and the fiscal balance; if this link is strengthened, establishment of a commodity fund can be considered to ensure that windfall revenues are saved. In the meantime, such windfalls should be used to reduce debt. (*2010 Survey*).	No action taken.
To further increase transparency and signal commitment to price stability over the longer term, the SARB should consider moving in the direction of announcing a future policy-rate path consistent with the inflation objective. At a first stage, this might involve merely signalling the expected direction of future movements in policy rates. (*2010 Survey*).	The SARB started to publish its underlying forecast assumptions and two-year inflation projections in its MPC statements from July 2015 to increase transparency.

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

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

Regional convergence and deeper trade integration

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

Improving labour market outcomes

Recommendations from previous *Surveys*	Action taken since July 2015 *Survey*
Increase the role of mediation and arbitration to make wage negotiations less confrontational (*2015 Survey*). Curtail the within-sector legal extension of collective bargaining agreements and increase the level of centralisation and co-ordination in collective bargaining to allow for greater influence of outsiders on wages and conditions. (*2013, 2010 Survey*).	Amendments to LRA, Picketing Regulations and a Code of Good Practice on Collective Bargaining, Industrial Action and Picketing are to be promulgated to enhance labour market stability and effective dispute resolution and will accompany the introduction of the national minimum wage.
Appoint an independent body including researchers to advise on key decisions regarding the minimum wage, balancing potential employment losses against social benefits (including level, scope and opt-outs). If established, the minimum wage should be regularly reviewed and adjusted in an independent and transparent way. (*2015 Survey*)	The social partners have reached agreement on modalities for the introduction of a national minimum wage of ZAR 20 an hour to be implemented from no later than 1 May 2018. The institutional set-up of a commission in charge of the annual review is still being finalised.
Establish a public employment service as a one-stop shop for job seekers to lower the cost of job search and hiring costs for employers, which would improve the matching of workers to jobs (*2015 Survey*). Efforts to strengthen job search assistance should be intensified. (*2010 Survey*)	The existing 126 labour centres around the country now have self-help kiosks. 3 mobile units have also been established to increase access in remote areas. An employment services database has been created. Counselling and other services that improve work readiness and increase placement have also increased.
Enforcement of existing labour laws relating to labour broking should be tightened, but liberal arrangements for temporary employment should be maintained. (*2010 Survey*)	No action taken.
The arbitration process for dismissals for cause should be speeded up and simplified. (*2010 Survey*)	No action taken.
The use of wage subsidies should be expanded, possibly by building on the existing learner ships, but with a reduced administrative burden. (*2010 Survey*)	The Employment Tax Incentive has been extended until 2019.
Probationary requirements in respect of new hires of young employees should be extended. (*2010 Survey*).	No action taken.

Climate change mitigation and green growth

Recommendations from previous *Surveys*	Action taken since July 2015 *Survey*
Price environmental externalities, including carbon emissions, and scarce resources, particularly water, appropriately. (*2015 Survey*).	A tyre levy has been implemented from 1 February 2017 which will address the externalities associated with tyre disposal.
In designing climate change mitigation policies, favour broad and easy-to-implement instruments with limited demands on administrative capacity, such as a simple carbon tax. (*2013, 2010 Survey*).	Draft legislation for the carbon tax has been published.
Reduce implicit and explicit subsidies for energy and coal consumption, and use other instruments, such as cash transfers or supply vouchers, for protecting the poor. (*2013, 2010 Survey*).	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. (*2010 Survey*).	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 licenses and ensure that charges for water reflect supply costs and scarcity. (*2013 Survey*).	The application process for water-use licences has been streamlined to accelerate allocations.

Tackling infrastructure bottlenecks and improving business regulation to support job creation

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

Making the education system more effective

Recommendations from previous *Surveys*	Action taken since July 2015 *Survey*
Expand the Accelerated Schools Infrastructure Development Initiative programme to address infrastructure backlogs and improve the delivery of learning materials (textbooks, desks, libraries and computers) with priority to the most deprived schools. (*2013 Survey*)	136 new schools were built and completed in 2016/17, 167 provided with sanitation facilities, 344 with water and 134 with electricity. The department committed to provide at least two libraries in each province with the ASIDI allocation. The delivery of learning materials has improved to close to 100% coverage in 2017.
Expand the Funza Lushaka bursary programme for teaching studies and allow more immigration of English teachers. (*2013 Survey*)	The Funza Lushaka bursary allocation has increased by over ZAR 100 million since 2015 and the programme continues to boost the supply of skilled teachers. Around 10 000 newly qualified teachers under the age of 30 have entered the system each year since 2015 (including non-bursary holders). The number of students supported is expected to decline over the medium term due to increases in university fees.
Provide more school leadership training and support staff in exchange for stricter accountability. Allow the education authorities to appoint and dismiss school principals in a more flexible way (depending on progress on school performance in Annual National Assessments and on external reviews), while making school principals responsible for yearly teacher evaluations and monitoring teachers' daily attendance. (*2013 Survey*)	In 2016, the Department of Basic Education introduced a new policy defining the role of school principals and the key aspects of professionalism, image and competencies required. A new collective agreement on quality management of principals is with the teaching union. The use of competency assessments when appointing new principals is under consideration in the bargaining council, but some provinces have voluntarily already implemented this tool.
Empower the independent federal evaluation unit NEEDU, join the Programme for International Student Assessment (PISA) and the Teaching and Learning International Survey (TALIS) and undertake an OECD Review of Evaluation and Assessment Frameworks for Improving School Outcomes. (*2013 Survey*)	No action taken.
Foster on-the-job training with tax credits and simplify administrative procedures for hiring trainees from FET colleges. Widen the scope for apprenticeship programmes organised by public-private partnerships. (*2013 Survey*).	The learnership tax incentive has been revised to provide more support for scarce skills, particularly for artisans, and extended until 2022. The employment tax incentive has been extended until 2019 to allow for further evaluation.
Improvements in basic education should be prioritised, even though the contribution to raising employment will be small in the near term. (*2010 Survey*)	Spending on basic education continues to be the largest share of the national budget.

Other

Recommendations from previous *Surveys*	Action taken since July 2015 *Survey*
Access to credit for business start-ups should be improved, for example by easing collateral constraints. (*2010 Survey*).	No action.
Remaining restrictions on capital outflows should be removed and replaced by prudential regulation. (*2010 Survey*)	Draft legislation to implement a "twin peaks" macro-prudential regulatory framework is in parliament. The bill separates prudential from conduct regulation resulting in the development of two key regulators – the Prudential Regulation Authority, under the South African Reserve Bank, and a new Financial Sector Conduct Authority.
Pension arrangements should be designed with a view to increasing private saving, in conjunction with other goals. Compulsory pension saving by employees is one promising way of doing this, while positive results might also be achieved via compulsory enrolment with an option to withdraw, particularly in combination with a "save more tomorrow" mechanism. (*2010 Survey*)	Reforms were introduced in 2016 to harmonise the tax treatment of contributions to different retirement funds to reduce the scope for tax avoidance salary structuring.

Thematic chapters

Chapter 1

Deepening regional integration within the Southern African Development Community

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

Introduction

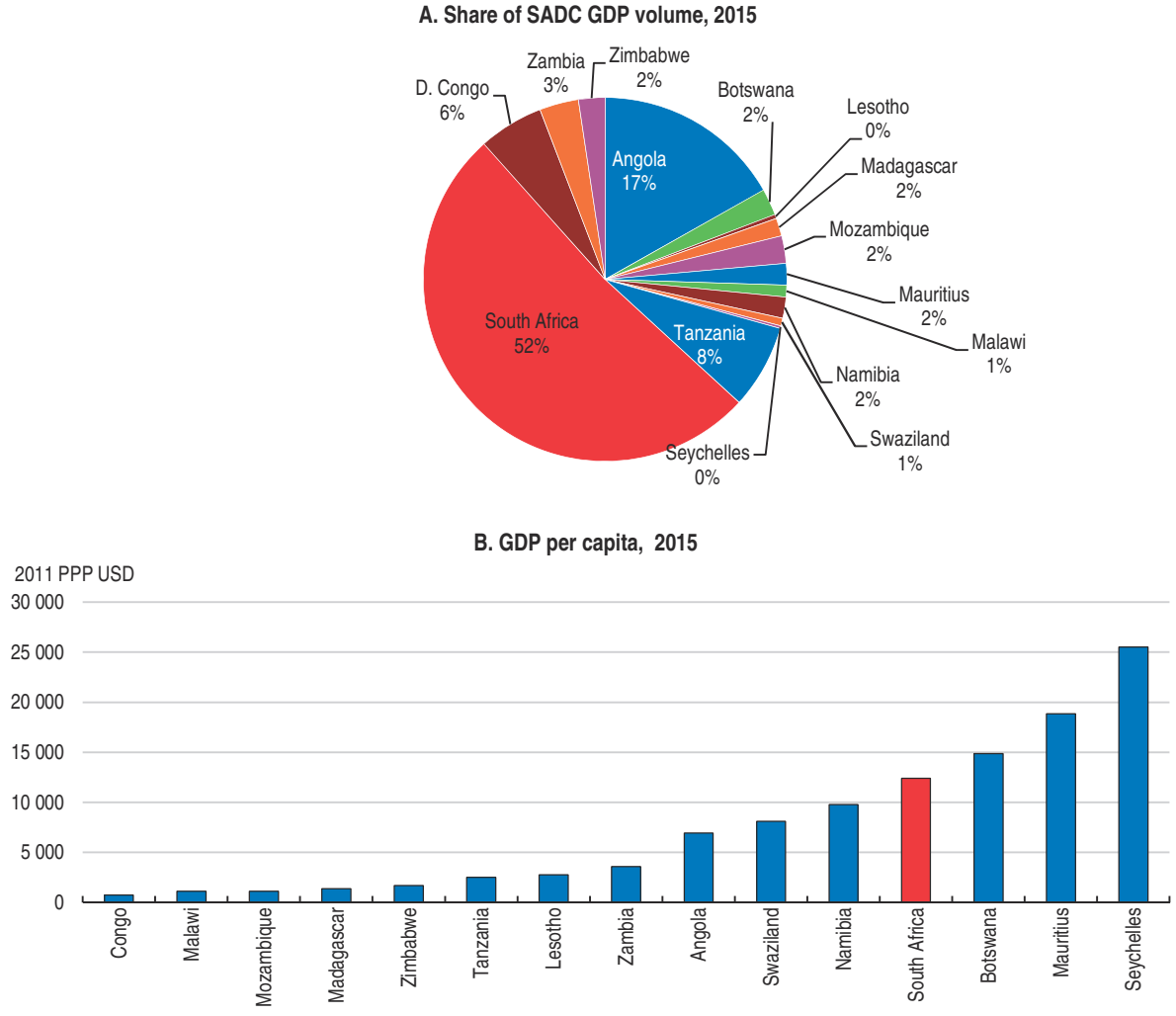
South Africa has been an active participant of regional partnerships in Southern Africa. Deeper regional integration can raise potential growth and create more quality jobs in participating countries. Key pillars are free circulation of goods and services, mobility of workers and interconnected infrastructure. Regional economic integration can be particularly beneficial in Southern Africa, where seven out of 15 countries are landlocked and fragmentation into many small countries is important. Greater integration brings larger markets, more jobs, more trade opportunities, and higher productivity from better resource allocation across member countries (Schiff and Winters, 2003). South Africa has been identified as gaining from greater trade and as being a key driver of regional value chains as a market and as a source of inputs (AfDB et al. 2014). However, it can take time to strengthen integration and develop regional policies to overcome national interests and barriers.

The Southern African Development Community (SADC) was established in 1992 with strong political commitments to integration (Box 1.1). SADC initially has prioritised trade and after long negotiation a free trade area was completed in 2008 with tariffs eliminated on 85% of traded goods among 13 of the 15 members. Angola and the Republic Democratic Congo are still outside the free trade area. South Africa, the largest member (Figure 1.1), has also formed a customs union, SACU, with some members of the SADC, and a monetary union with Lesotho, Namibia and Swaziland. South Africa has also been active in developing pan-African integration that aims at unifying various existing trade agreements.

In practice, economic integration in the SADC has been slow. Integration has not been able to overcome domestic structural constraints such as small market size, skills constraints, undiversified economies, or sectoral policies that protect certain industries such as automobiles or textiles. Also, national policies have remained more important than regional ones for the members explaining slow progress towards fuller regional integration. In recent years, SADC aimed at reviving integration among members by adopting a Revised Regional Indicative Strategic Development Plan for 2015-2020, which contains a clear vision for greater regional integration and sectoral strategies. South Africa should take the leadership in implementing agreed agreements and protocols and in strengthening the institutional framework.

This chapter focuses on SADC, which is South Africa's most important and growing market, and where further integration can have an important boost to growth for its members. It assesses the state of the key pillars of the SADC regional integration process to identify remaining bottlenecks for deeper integration and policy recommendations. The first section assesses the degree of trade integration and its potential as trade has been the most important element of integration, so far. The second section analyses the institutional framework and the principal remaining trade barriers and provides recommendations to boost regional trade integration. The last section covers the other key pillars (industrial policy, infrastructure, investment, financial integration and tax) of regional integration.

Figure 1.1. **Size of SADC countries in terms of GDP**



Source: World Bank World Development Indicators database.

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Box 1.1. **History of Regional Integration in Southern Africa**

SADC: Close collaboration among Southern African countries started already in 1975 when Angola, Botswana, Mozambique, Tanzania and Zambia were meeting regularly to coordinate effort, resources and support to the different liberation movements in the region. In April 1980 in Lusaka (Zambia) the nine independent states of Southern Africa – Angola, Botswana, Lesotho, Malawi, Mozambique, Swaziland, Tanzania, Zambia and Zimbabwe – created the Southern African Development Coordination Conference (SADCC) to reduce economic dependence on South Africa and enhance regional integration. In 1992, at Windhoek (Namibia) the member countries decided to transform "SADCC" from a coordination conference into SADC, the Community. Specifically, they decided to move from an association into a legally binding arrangement. The economic dimension was put forward with the aim to deepen economic co-operation and integration. Membership increased to 15 with the accession of Namibia in 1990, South Africa in 1994, Mauritius in 1995, Seychelles and the Democratic Republic of Congo in 1997, and Madagascar in 2005.

Box 1.1. **History of Regional Integration in Southern Africa** *(cont.)*

SACU: The Southern African Customs Union (SACU) was established in 1910 between the Union of South Africa and the three so-called High Commission Territories of Bechuanaland (now Botswana), Basutoland (now Lesotho) and Swaziland. A new agreement was signed in 1969 between South Africa, Botswana, Lesotho and Swaziland. Namibia joined SACU in 1990 upon its independence from South Africa. The SACU Agreement was renegotiated in 2002 and entered into force in 2004.

The three main features of SACU are: the free movement of goods and services between member countries; the common external tariff; and revenue sharing of the common pool of duties and trade taxes. The revenue-sharing formula has three components: custom, excise and development. The custom revenue is distributed on the basis of each country's share in intra-SACU imports. The excise distribution depends on each country's share of GDP. The development component, which is fixed at 15% of total excise revenue, is distributed according to the inverse of each country's GDP per capita.

Tripartite Free Trade Area (TFTA). A Tripartite Free Trade Area initiative was launched in 2008 between members of the East African Community (EAC), Common Market for Eastern and Southern Africa (COMESA) and Southern African Development Community (SADC). A complementary objective was to solve the complications created by overlapping membership of the different regional economic communities. All members belong to more than one FTA, for instance, eight members of COMESA are simultaneously members of SADC. Overlapping membership creates legal uncertainty, unnecessary costs, and delays in the implementation of reforms.

After four years of negotiations, the TFTA was signed in June 2015 by 24 countries. However, South Africa and SACU members have not signed. The parties committed to conclude outstanding issues on rules of origin, trade remedies and tariff offers by June 2016. However, the deadline was not met, and the start of Phase II negotiations – trade in services and other trade-related matters – has been delayed waiting for the conclusion of negotiations on Phase I.

Source: The Regional Indicative Strategic Development Plan (2002) and *www.sadc.int/about-sadc/overview/history-and-treaty/*.

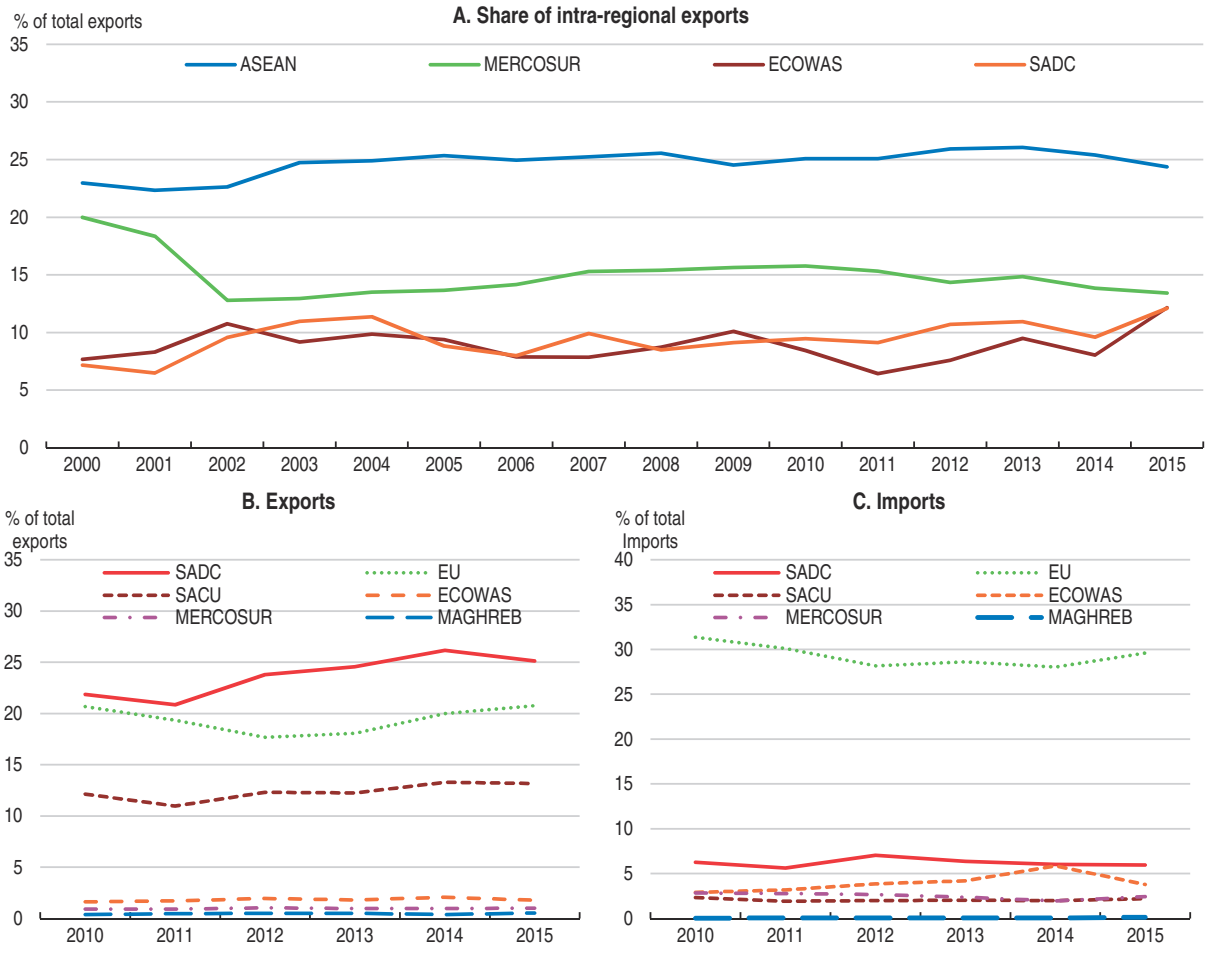
Regional trade is expanding but remains limited

SADC intra-regional trade is low compared to other regional communities

Intra-trade in the SADC is only 10% of the regional total exports compared to about 25% in the ASEAN or 40% in the European Union (Figure 1.2). This is similar to ECOWAS in Africa and somewhat below MERCOSUR. SADC intra-regional trade has increased only modestly since the establishment of the free trade area in 2008 (Figure 1.2, Panel A). SADC trade is also dominated by its largest member, South Africa, which accounts for about half of the group's GDP (Figure 1.1). This makes SADC trade closely dependent on South Africa's economy and interest in fostering more co-operations with SADC countries. South Africa's imports from SADC are low compared to its exports toward SADC countries which creates a structural trade imbalance with the regional partners (Figure 1.2, Panel B). Thus, SADC region is a non-negligible market for South Africa.

The relatively weak performance of SADC intra-trade is, in part, explained by the similar economic structures of its members. However, similarity of products or endowments should not limit trade because countries have different costs of production for the different products and therefore different comparative advantages. Tariffs and non-tariffs barriers

Figure 1.2. **SADC trade compared to other regions**



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

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are rather the obstacle to trade developments (see below). Only five of the members have a revealed comparative advantage (over 100), at the world level in one product (Table 1.1). Their exports are also dominated by non-processed goods, such as crops, minerals and other natural resource products.

Few countries are exporting manufactured or sophisticated industrial products (Table 1.1). This also limits potential for intra-industry trade in which similar or slightly differentiated goods or services (e.g. quality or choice), often manufactures, are exchanged between countries (Krugman, 1979 and 1980). Therefore, trade in manufactured goods between member countries rest on differences in costs of production. For instance, ten out of the fifteen countries are exporting natural or cultured pearls, precious or semi-precious stones, and precious metals in their top 10 export products. Manufacturing exports are also very similar, for instance machinery and mechanical appliances. Estimations by Fall et al. (2014) show that while the development of manufacturing increased intra-regional trade in ECOWAS, it had negative effects in SADC, confirming the low complementarity of SADC countries. The difference of manufacturing effects on intra-trade between SADC and ECOWAS is explained by the impact of Nigeria, ECOWAS leader, which produces more manufacturing goods for the region.

Table 1.1. **Revealed comparative advantages of top 10 export products of SADC countries**

Angola		Botswana		Congo		Lesotho	
RCA	Product	RCA	Product	RCA	Product	RCA	Product
8.5	Mineral fuels, oils[1]	32.5	Nickel	127.0	Other base metals	36.2	Wood
0.9	Pearls, precious stones	22.2	Pearls, precious stones	62.7	Copper	20.4	Apparel and clothing[1]
0.2	Fish and crustaceans	2.6	Meat	19.5	Ores	12.6	Apparel and clothing[2]
0.1	Salt; sulphur	1.5	Salt; sulphur	7.3	Inorganic chemicals	11.0	Products milling industry
0.0	Wood	0.9	Ores	2.4	Wood	9.2	Pearls, precious stones
0.0	Coffee, tea	0.8	Inorganic chemicals	1.0	Pearls, precious stones	6.7	Cotton
		0.1	Electrical machinery	0.9	Coffee, tea	3.4	Articles of leather
		0.1	Plastics	0.8	Cocoa and cocoa preparations	1.7	Footwear
		0.1	Vehicles	0.5	Mineral fuels, oils	1.2	Furniture; bedding
		0.1	Machinery and nuclear reactors	0.5	Commodities[3]	0.3	Electrical machinery
Madagascar		**Malawi**		**Mauritius**		**Mozambique**	
RCA	Product	RCA	Product	RCA	Product	RCA	Product
31.3	Nickel	28.6	Tobacco	27.3	Knitted fabrics	21.3	Aluminium
30.3	Coffee, tea	17.2	Dairy produce	22.3	Prep. of meat, fish	5.7	Tobacco
13.6	Apparel and clothing[1]	12.3	Edible vegetables	20.9	Apparel and clothing	5	Cotton
12.4	Apparel and clothing[2]	11	Coffee, tea	20.4	Apparel and clothing[2]	4.6	Sugars
7.9	Cotton	10.7	Sugars	10.6	Sugars	2.9	Wood
6.2	Other base metals	9.2	Cotton	7.5	Cotton	1.1	Mineral fuels, oils
4	Edible vegetables	8.4	Residues food indust.	6.6	Electrical machinery	0.7	Ores
4	Fish and crustaceans	6.3	Fertilisers	4.9	Fish and crustaceans	0.6	Edible fruit, nuts
0.5	Ores	3.4	Plastics	0.6	Machinery and nuclear reactors	0.3	Machinery and nuclear reactors
0.1	Mineral fuels, oils	1	Machinery and nuclear reactors	0.5	Pearls, precious stones	0.2	Pearls, precious stones
Namibia		**Seychelles**		**South Africa**		**Swaziland**	
RCA	Product	RCA	Product	RCA	Product	RCA	Product
38	Zinc	104.3	Preparations meat, fish	2.1	Vehicles	39.4	Essential oils
18.7	Live animals	29.6	Commodities[3]	2	Iron and steel	24.6	Sugars
15.2	Fish and crustaceans	5.6	Aircraft, spacecraft	1.9	Machinery and nuclear reactors	20.1	Printed books, newspapers
9.1	Inorganic chemicals	5.2	Residues food industries	1.8	Edible fruit, nuts	19.9	Other chemical products
8.8	Meat	4.7	Ships, boats	1.8	Beverages, spirits	8.6	Wood
2.2	Pearls, precious stones	1.6	Tobacco	1.6	Ores	7.8	Apparel and clothing[2]
1.5	Copper	1.3	Optical, photographic	1.4	Electrical machinery	4.5	Prep. of vegetables, fruit
0.8	Edible fruit, nuts	1.3	Animal or vegetable fats and oils	1.1	Aluminium	2.9	Apparel and clothing[1]
0.7	Ores	1.2	Fish and crustaceans	1	Pearls, precious stones	2.8	Organic chemicals
0.1	Mineral fuels, oils	1	Mineral fuels, oils	0.4	Mineral fuels, oils	1.8	Beverages, spirits
Tanzania		**Zambia**		**Zimbabwe**			
RCA	Product	RCA	Product	RCA	Product		
13.9	Edible vegetables	11.7	Copper	20.6	Tobacco		
12.7	Animal or vegetable fats	6.9	Cereals	8.9	Cotton		
10.4	Residues food industries	3.1	Salt; sulphur	4.5	Salt; sulphur		
6.5	Coffee, tea	2.3	Sugars	4.4	Sugars		
3.8	Fish and crustaceans	1.5	Other base metals	2.2	Wood		
3.3	Electrical machinery	1.1	Inorganic chemicals	2.1	Pearls, precious stones		
3.1	Tobacco	1	Tobacco	1.8	Iron and steel		
2.1	Edible fruit and nuts	0.4	Machinery and nuclear reactors	1.4	Coffee, tea		
1.7	Pearls, precious stones	0.2	Pearls, precious stones	1.3	Ores		
1.3	Ores	0.1	Mineral fuels, oils	0.1	Mineral fuels, oils		

1. See Table A1 in Annex 1 for the full name of products.
2. Not knitted or crocheted.
3. Not elsewhere specified.

Source: OECD calculation based on data from IMF, Direction of Trade Statistics (DOTS).

SADC has greater potential for intra-regional trade

Trade impact and potential can be assessed by estimates of gravity equations of bilateral trade which explain trade flows generally well based on distance and size of countries (Tinbergen 1962, Head and Mayer 2015). The data used for the analysis cover bilateral trade flows from 1984 to 2014 and 189 countries and, most of the free trade areas in the world (see Annex 1 and Cadestin and Fall, 2017).

The estimations indicate that most of the free trade areas in the world have boosted trade. Bilateral trade for SADC members has increased by 62% by the free trade agreement. For the EU, the effect is 90% and for the Andean Community 141% over the period (Annex 2, Table A2, Column 2). These results are encouraging for deepening SADC regional integration as they suggest that there is scope to further boost trade in the region. Distance and language proximity are factors favourable to regional trade. Estimations suggest that tariffs and non-tariff measures have hold down trade between SADC members (Cadestin and Fall, 2017).

Greater participation in regional value chains could boost intra-trade

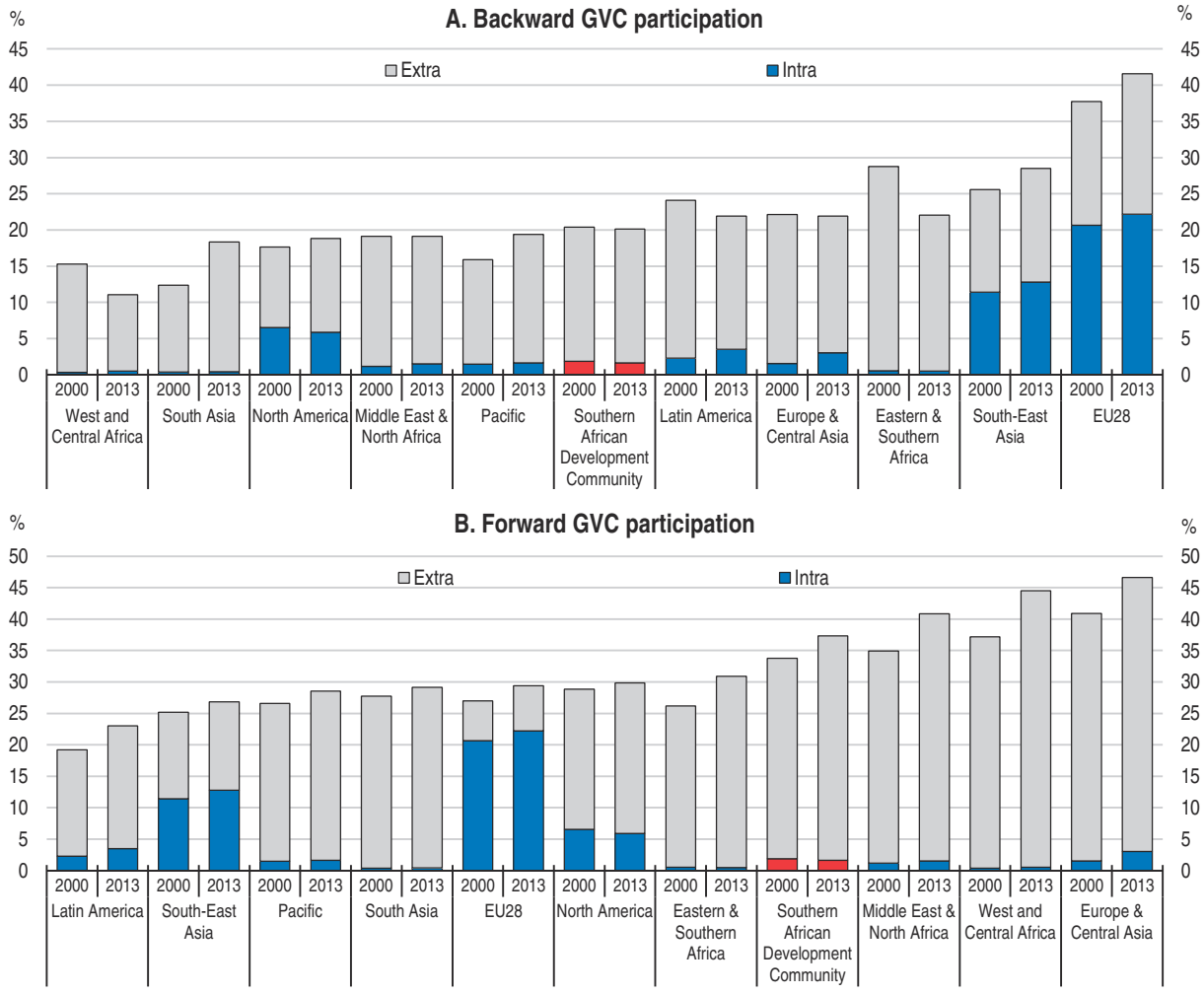
Many emerging countries have boosted trade by participating in global or regional value chains (Kowalski et al., 2015). SADC countries are more integrated in global value chains (GVC) than in regional ones. Most of the foreign value added embedded in exports comes from outside the region (Figure 1.3, Panel A). Moreover, the intra-regional value added embedded in SADC members' exports decreased between 2000 and 2013, while it increased in Latin American and South-East Asian regional arrangements. The overall backward GVC participation of SADC is also low compared to South-East Asian, Latin American, Central Asian and European countries.

Deepening regional integration in SADC will depend partly on the capacity of member countries to increase their sourcing in the region to create more value for exports. This requires access to products at competitive conditions and prices. The origin of exported value added in SADC is mainly domestic (80%) reflecting the dominance of raw materials in their exports. It peaks at 92% for Angola (oil exporter) and 87% for Mozambique (minerals) (Table A3A in Annex 3). The most diversified economies, Mauritius, or most integrated, Lesotho and Swaziland (both members of the SACU customs union with South Africa), have more foreign value added in their exports.

Forward GVC participation, or share of a country's value added in exports of partners, of SADC countries is high just below the MENA, West and Central African, and Central Asia and European countries (Figure 1.3, Panel B). This also reflects the specialisation of SADC countries in exports of raw materials (oil and minerals). South-East Asian countries, and to a lesser extent Latin American countries, have more intra-regional forward GVC participation. South Africa is the only country using significant part of SADC value added in its exports (Table A3A in Annex 3).

The relatively low GVC participation of SADC countries is influenced to some extent by trade policies (tariffs and share of imports covered by free trade areas). Estimations of the determinants of low GVC participation show that for most SADC countries, trade policies contribute negatively to backward GVC participation (Figure 1.4, Panel A and Kowalski et al., 2015). However, trade policies in some countries (Mozambique, Angola, Zambia and South Africa) seem to be more favourable to forward GVC participation.

Figure 1.3. **Intra and extra-regional participation in Global Value Chains**



Source: OECD calculation based on EORA database.

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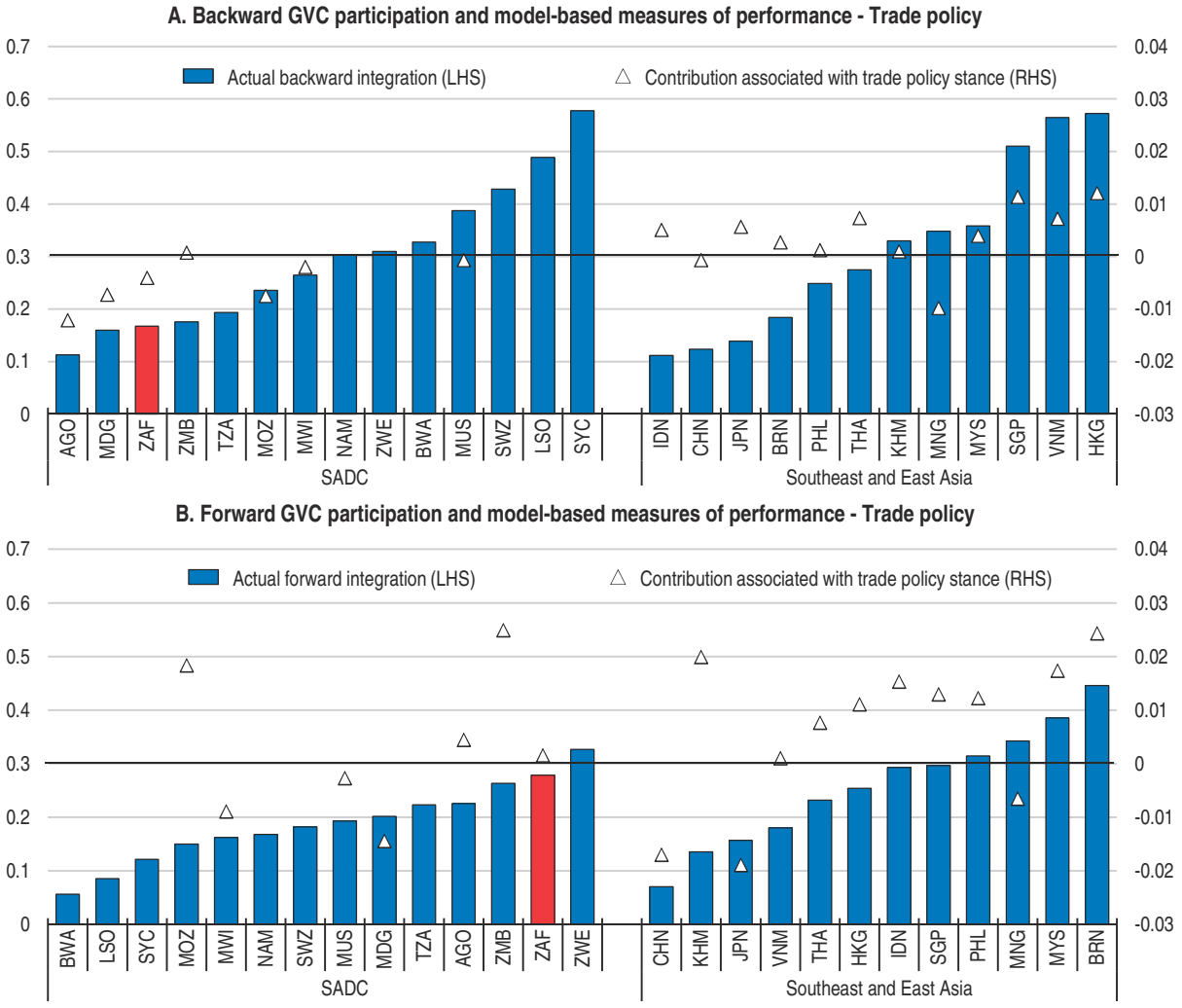
The development of regional value chains is hindered by structural factors

The low development of regional value chains reflects the tendency of the governments to develop and follow the similar industrial and sectoral strategies. As with global value chains, the development of regional value chains is also influenced by trade and protectionist policies. To illustrate these issues value chains are discussed below with examples of three industries.

Car industry value chain: an industry limited by regional market size

The automobile value chain is analysed with firm-level supply chain data (FactSet, 2016) and business interviews with seven car manufacturers and two truck manufacturers with plants in South Africa (OECD, 2017). Interviews with industry representatives suggest that the automobile value chain in SADC is concentrated in South Africa. At the same time, South African plants are a small share in total world volumes of car production: 50 000 vehicles compared to around a million in the producers' home countries and up to 10 million globally. The main players in SADC are global carmakers through affiliates in South Africa producing for the SADC market.

Figure 1.4. **GVC participation and contribution to trade policies**



Source: OECD calculation based on EORA database.

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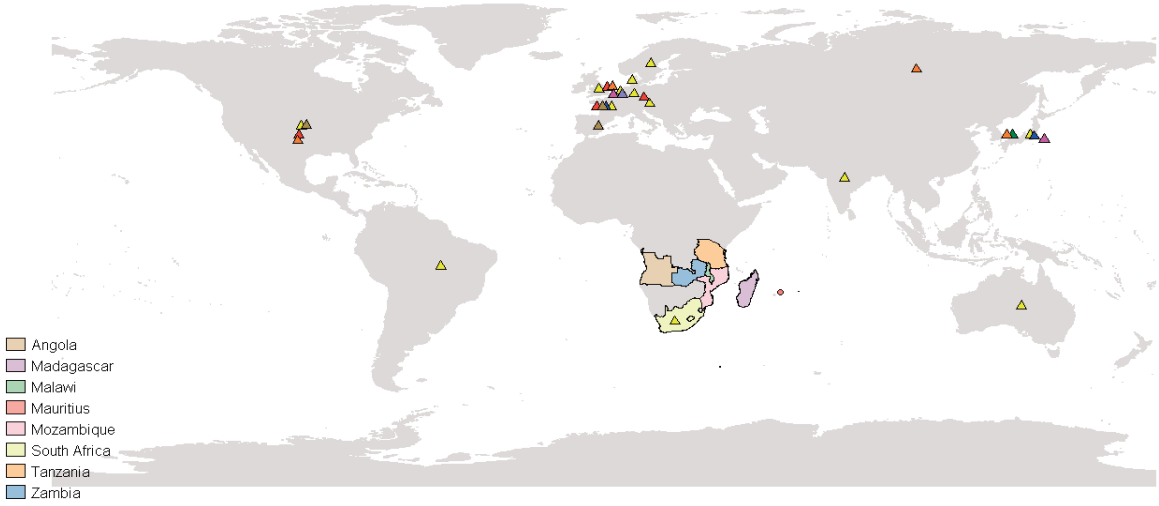
Carmakers source around 45-55% of components locally, primarily from large international component suppliers that have presence in South Africa. However, given low sales volumes in the region, many first-tier component suppliers are not able to locate in SADC, and the remaining components are sourced from their plants elsewhere in the world. The few components produced in the region tend to be simple. Multinational first-tier suppliers of car manufacturers have established subsidiaries in eight SADC countries (Figure 1.5). Local linkages are limited and only South Africa has some domestically owned first-tier suppliers, which produce around 50% of auto parts and components (OECD, 2017).

Globally car production tends to be close to the target market, influenced by low wages, availability of skilled workers and accessible infrastructure. The development of the car industry in SADC is limited by the absence of a big enough market or the inability of the car industry to design a "low cost" and competitive car for the regional market. The South Africa government provides a strong support for the development of the car industry mainly based on tax exemptions. Revising this policy to incentivise the car industry toward a more market

based development strategy targeting regional markets would allow for higher volumes of production and as a result make SADC more attractive to foreign investors.

Figure 1.5. **First-tier suppliers in SADC and their headquarters**



Note: Triangles represent the locations of the headquarters of first-tier suppliers, and shaded areas reflect affiliates within the SADC region. For instance, all yellow triangles are headquarters of firms that operate in South Africa.
Source: OECD report on "Regional Global Value Chains in SADC," 2017, forthcoming; calculations based on FactSet Supply Chain (2016).

Textile and garment value chain: a development limited by regional trade policies

The global textile and garment value chain has four core segments: 1) natural and synthetic fibres; 2) textiles; 3) garments; and 4) retail. The value chain is led by the retail sector: branded merchandisers are involved in global sourcing as lead buyers. The retail stage is concentrated into large, lean retail organisations. While the garment retail sector is relatively concentrated, with 38 multinationals accounting for 70% of global revenues, garment manufacturing is highly competitive, relies heavily on low-skilled labour and has low profit (OECD, 2017).

South Africa has a mature textile and garment industry dating back to a few businesses that started out in the 1920s. The industry developed initially under the high protection and import substitution of the Apartheid regime. It produced mainly for the domestic market, with limited exports in niche products. The development of the textiles and garments industry in SADC more generally was influenced by the Multi-Fibre Agreement (MFA) and subsequent WTO Agreement on Textiles and Clothing (ATC), which governed world trade in textiles and garments from 1974 through 2004. These agreements imposed quotas on garments imports from China, India and Pakistan to protect the textile industries in the United States and Europe. By limiting competition from Chinese and Indian imports, the Agreement helped the less competitive garment manufacturers in SADC to be competitive in their local markets. An unintended result of the Agreement was that Asian garment manufacturers constrained by the quotas relocated to countries in SADC (as well as other countries with no or underutilised quotas) to circumvent the quotas.

Legislation granting African countries preferential export access to the United States in 2000, the African Growth and Opportunity Act (AGOA), further bolstered the development of the garment industry in SADC, particularly in Lesotho, Mauritius, Madagascar and Swaziland. In South Africa, the Agreement boosted garment exports to the United States by 62% in the first 14 years (IDC, 2016). When the MFA/ATC expired in 2004, the whole region suffered. In countries producing garments for export the effect was mitigated by the remaining Agreement with the US, though Madagascar and Swaziland suffered from suspensions for political reasons (Madagascar has since been reinstated), and Lesotho is currently under review. South Africa's textile and garment industry which was primarily focused on the domestic market was hit hardest, suffering from renewed competition from cheap Chinese imports despite reduced quotas. Jobs in the industry in South Africa more than halved, from 180 000 in 2002 to 80 000 in 2013 (IDC, 2016).

Currently, the garment industry in SADC serves primarily the South African rather than the US market, though Mozambique, Zambia and Malawi are gaining importance as destination markets. Four SADC countries – Swaziland, Lesotho, Mauritius and Madagascar – are among South Africa's top 10 suppliers of textiles and garments. As South African textile and garment companies struggle with high wages and strong unions, factories, both national and foreign, have been gradually relocating to other SADC countries. Fabric is sourced primarily from Asia, though a small part originates in South Africa.

Low availability of skilled labour in SADC relative to Asia and weak capacity to manage the entire supply chain are the main bottlenecks for textile industry development. Another obstacle to regional integration and development in the textiles sector is the 45% duty imposed on the import of textiles in all SADC countries (originating from the SADC Rules of Origin). Since South Africa (as well as many other SADC countries) does not produce most textile inputs, the duty places an undue burden on garment manufacturers and retailers.

Rules of origin are another obstacle to develop the sector (Box 1.2). Resolving the divergence between the Southern African Customs Union (SACU) and the rest of SADC in terms of the single versus double transformation rule for free trade is necessary. The double transformation means that a country should have the capacity to produce fabrics and garments, for such garments to enjoy preferential market access under regional trade terms. The rules of origin require companies to source both garments and textiles from within SADC to enjoy preferential export access to the SADC market. This measure, designed to protect the South African textile industry, hinders regional trade within SADC and weakens the region's international competitiveness in garment manufacturing.

The regional poultry chain is hampered by trade and infrastructure barriers

The poultry industry produces and processes agricultural commodities through a quasi-industrial process of batch production of the rearing, processing, and distribution of poultry in fresh and frozen form (Ncube et al., 2016). The poultry market is approximately 1.8 billion dollars in South Africa and is expanding in SADC countries thanks to growing population and middle -class and development of urbanisation. The SADC region, as a whole, is in deficit and South Africa imports of poultry, mainly from Europe and South America, amounted to 270 million dollars in 2014. South Africa has increased duty tariffs on imports from EU countries to protect local producers since January 2015 for 5 years.

The four main stages of the value chain are: agriculture products (maize, soya and sunflower) and their transformation into animal feed; poultry breeding for day-old chicks;

broiler growing; processing and distribution. A participant in the value chain can be vertically integrated and performing all the tasks in the chain or specialised in one segment of the value chain. Also, the countries in the region have different competitive advantages in the value chain. South Africa is the largest producer in absolute terms of both poultry and animal feed; it is also the largest importer and exporter of these products in the region. But Zambia is better placed to produce component crops of maize and soya.

The vertical integration of the largest firms in the sector, mainly from South Africa, is contributing to regional integration as they are expanding across the region. Trade flows of agricultural products are following the expansion of the poultry industry. In Zimbabwe, most imports of raw materials (i.e. maize, soya beans, and oil-cake) for animal feed come from Zambia. Because Zimbabwe has a ban on genetically modified maize, it does not import maize for animal feed production from South Africa which has the cheapest maize source because of its use of genetically modified seeds. As such, Zambia is the closest non-genetically modified maize source (Ncube et al., 2016).

The development of regional integration relies on more flows of agricultural products across member countries and cross-country investments made by large poultry companies. Removal of trade barriers (non-tariff barriers in member countries such as import/export quotas and standards), a further development of the production of soybean meal in the region at a competitive price and better logistic and infrastructure environment would help the sector to grow further.

Policies to foster regional trade integration

Strengthening the institutional framework to achieve SADC objectives

SADC integration has been weakened by problems in implementing the agreements and protocols at the national level, as they often are not incorporated into domestic legislation. This is aggravated by lack of clarity in many of the SADC protocols on obligations and their implementation (Cronjé, 2015). SADC is based on inter-governmental coordination assisted by the SADC Secretariat, which has no supranational decision-making and implementing powers weakening further integration. Multiple memberships of most SADC countries in different regional communities such as SACU, or COMESA also create conflicts with rules and worsen the lack of compliance to agreements. The community needs a leadership, in particular, in the implementation of the agreements; South Africa is well-placed to play that role.

Giving more power to the SADC Secretariat to enforce the regional agenda and hold countries accountable for non-compliance would reinforce integration. In the absence of a regional parliament or body with legislative powers as in the East African Communities, the EU and ECOWAS, national parliaments should also be more involved in the adoption of regional policies. SADC would also benefit from having a central body or statistical agency and website that houses standardised and comparable economic data.

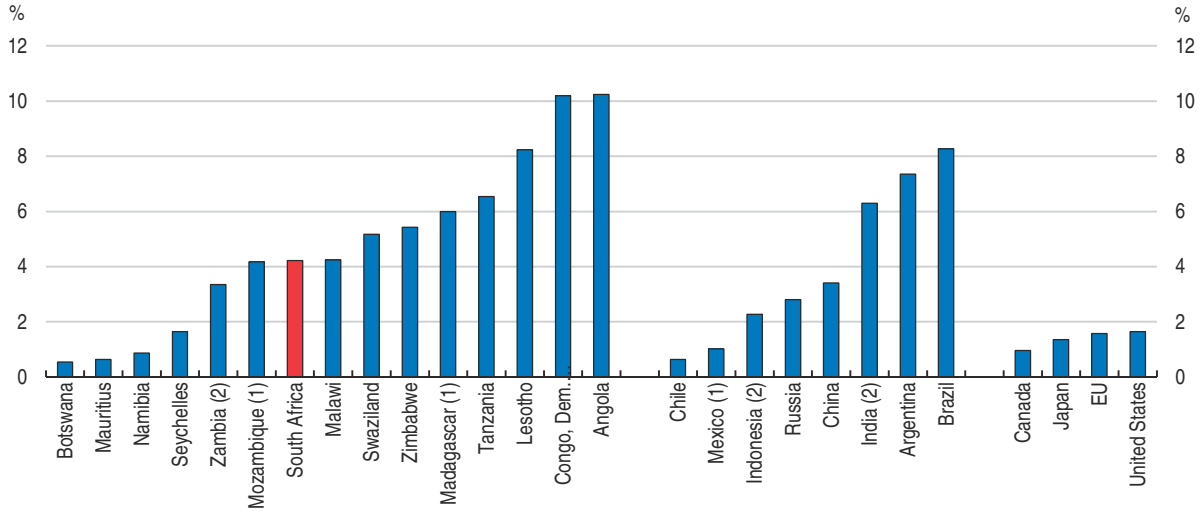
Financing of SADC regional projects and policies remains a major challenge. An important part of the financing relies on international aid. Developing a permanent and stable internal source of funding for regional projects could facilitate the integration process. A defined percentage point added to VAT or customs duties in all countries, as in ECOWAS, devoted to a SADC budget could allow quickly to accelerate important regional projects.

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

Estimates show that quantitative approximates of non-tariff measures affect negatively trade and can be particularly negative for SADC countries (Cadestin and Fall, 2017). Non-tariff barriers include licences, quotas and bans, price controls, competition policies, rules of origin and technical barriers to trade (technical norms). Poor infrastructure is another barrier. In addition, trade of SADC countries faces higher tariffs on external trade than many other regional trade groups (Figure 1.6 and UNCTAD, 2015). For example, for the EU, external tariffs are not detrimental to intra-trade. Low external tariffs are important for imported intermediate inputs. As most of the SADC countries have high external tariff rates, there is room to reduce these tariff rates (Figure 1.6). However, easing non-tariff measures both within the region and with countries outside the region has a great positive potential impact on trade for SADC countries.

Figure 1.6. **Tariff rates are relatively high in SADC countries**

Tariff rate, applied, weighted mean, all products[3]



1. Numbers are for 2014.
2. Numbers are for 2013.
3. Weighted mean applied tariff is the average of effectively applied rates weighted by the product import shares corresponding to each partner country. Data are classified using the Harmonized System of trade at the six- or eight-digit level. Tariff line data were matched to Standard International Trade Classification (SITC) revision 3 codes to define commodity groups and import weights. To the extent possible, specific rates have been converted to their ad valorem equivalent rates and have been included in the calculation of weighted mean tariffs. When the effectively applied rate is unavailable, the most favoured nation rate is used instead.

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

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High trade costs for SADC are due to a mix of poor infrastructure and non-tariff barriers. Using trade gravity estimations allows to measure the costs for trade of these different factors by applying a methodology proposed by Novy (2012) and Arvis et al. (2016) for developing countries. The results show that generally intra-regional trade costs are lower than extra-regional ones on average (Table 1.2). Trade costs are also higher in developing countries than in developed countries on average. In SADC intra-regional average trade cost is higher than in South East-Asia. From SADC, the costliest regions to trade with are Latin America, Eastern and Southern Africa, Europe and Central Asia, South Asia and South-East Asia (Table 1.2). This reveals that the high trade costs for SADC are due to a mix of poor infrastructure and non-tariff barriers.

Table 1.2. **Region to region trade-weighted costs**

	EU28	Europe and Central Asia	Eastern and Southern Africa	Latin America	Middle East and North Africa	North America	Pacific	SADC	South Asia	South-East Asia	West and Central Africa
EU28	47										
Europe and Central Asia	77	57									
Eastern and Southern Africa	184	249	119								
Latin America	128	161	294	107							
Middle East & North Africa	118	126	122	188	92						
North America	81	107	199	65	127	30					
Pacific	115	142	413	186	144	102	55				
SADC	118	167	177	223	162	118	118	94			
South Asia	126	145	148	199	112	112	129	167	99		
South-East Asia	104	120	191	138	140	77	92	167	123	66	
West and Central Africa	155	204	216	204	214	205	277	119	177	204	132

Note: The table expresses the costs of trade from regions in row to regions in column. Figures show ad valorem equivalents of trade costs in percentages, calculated as in Arvis et al. (2016) using the trade cost measure proposed in Novy (2012). This is a comprehensive all-inclusive measure, not only tariffs and transport costs but also direct and indirect costs associated with differences in languages, currencies as well as cumbersome import or export procedures. The weights are based on total trade.
Source: OECD calculations based on ESCAP-World Bank Trade Cost Database.

The decomposition of trade costs performed by Arvis et al. (2016) confirms that in addition to traditional sources of trade costs, such as tariffs and transportation charges, a range of additional policy factors are affecting the pattern of trade in the region. In particular, transport connectivity and trade procedures are sources of trade costs, but they can be tackled by government policies. Also, regulatory and institutional features of countries that affect all firms are important sources of trade costs for developing countries.

The trade facilitation index confirms that more can be done in the SADC region to boost trade by simplifying trade procedures and improving infrastructure. Performance across SADC countries is widely below EU or the OECD average (Figure 1.7). Mauritius and SACU countries have a more friendly trade environment than the rest of SADC. Many SADC countries have a trade enabling environment below the MERCOSUR average country. The following discusses in more detail the nature of some key sub-components of the index.

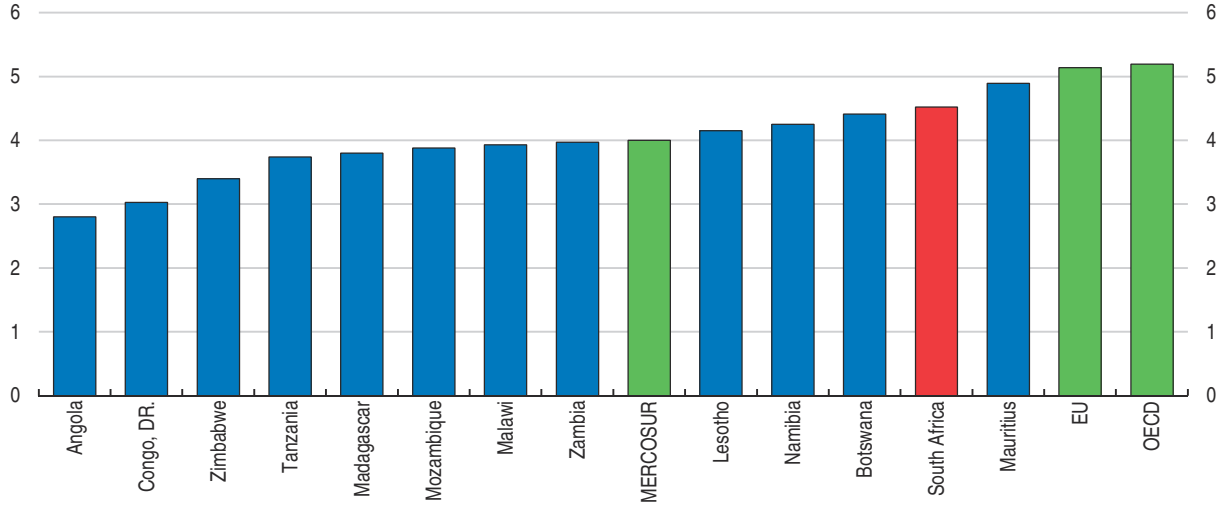
There is room to improve customs policies

Customs procedures are complex within SADC compared to the OECD average (Figure 1.8). The multiple memberships of SADC countries in different free trade areas increase the difficulty for customs officers to establish the precise preferential tariffs applying to each product. Angola has the most burdensome customs procedures, while Mauritius is the most performant. South Africa, the regional leader and source of most regional trade, ranks fourth. Transporters complain that borders do not operate on a 24-hour basis, of electrical and technical shutdowns in the border systems, and incompatibility of customs systems between countries (Vilakazi and Paleo, 2017a, UNCTAD, 2015).

Customs strategies often focus on revenue mobilisation at the expense of trade facilitation. Some SADC members have even raised import tariffs on products originating from the region to raise revenue, in flagrant violation of their regional tariff liberalisation commitments (Shayanowako, 2015).

As recognised by the strategic plan of the SADC Sub-Committee on Customs Co-operation, there is a need to enhance skills of customs officials in areas such as clearance

Figure 1.7. **Trade facilitation index**



Note: The Enabling Trade Index assesses the extent to which economies have in place institutions, policies, infrastructure and services facilitating the free flow of goods over borders and to their destination. Score 1-7 (best).
Source: World Economic Forum, Global Enabling Trade Report.

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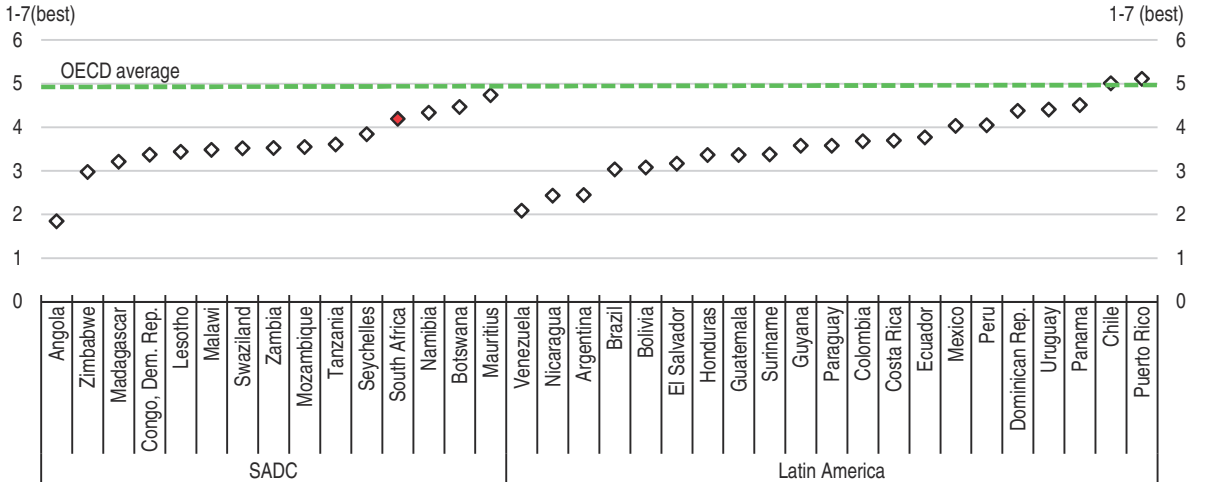
Figure 1.8. **Burden of customs procedures**



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

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controls and risk management, managing trader compliance and applying measures to enforce compliance (SADC, 2011b). In terms of information and communication technologies, scaling up the availability and use of such technologies and better exploiting them would improve automatic data processing and interconnectivity between neighbouring border agencies. Given the skills shortage and compliance difficulties, SADC countries should invest into simple and robust information and communication technologies and infrastructure.

Moreover, the incidence of corruption at customs remains high in the region (Shayanowako, 2015). Introducing a computerized one-stop border control point between SADC members can improve coordination between countries and help fight corruption and

unnecessary red tape. Finally, accelerating the adoption by all SADC countries of legislation facilitating interagency co-operation, advance rulings and post-clearance audit would facilitate intra-regional trade. As recognised in the SADC assessment, considerable gaps remain in SADC countries in terms of compliance and implementation of commonly agreed policies. For instance, only one country was applying the Common tariff nomenclature template, three countries the customs model act and four countries have one stop border posts (SADC, 2011c).

SADC rules of origin are complex

Rules of origin can become a non-tariff barrier. In a free trade area, rules of origin are set to prevent tax avoidance by exploiting differences in tariffs among member countries. Rules of origin are defined to guarantee that substantial transformations happen on imported goods in the importing country of the FTA before the product is traded with another member of the same FTA. Rules of origin are important mostly for manufactured goods. However, as production processes are more and more globalised with global outsourcing and value chains, defining rules of origin not harmful to the competitiveness of industries is difficult.

Different methods are applied across countries and agreements to determine the part of transformation made in importing countries and whether this is substantial (Abreu, 2013; Sandrey, 2015). SADC has adopted rather complex rules of origin, defined product by product and requiring double stage transformation. A simpler alternative would be the across-the-board approach adopted by COMESA (Box 1.2).

In SADC, the rules of origin were mainly designed to protect existing industries from increased intra-regional competition, in particular the textile and clothing industry in South Africa (Brenton et al. 2005). Rather than facilitating development through trade, the complex and restrictive input-sourcing requirements of the SADC rules of origin have a negative impact on trade and attractiveness for industrial investment. In the absence of reform to simplify rules of origin, the manual by the SADC Secretariat for rules of origin (SADC, 2003) should be applied by all member countries to facilitate the application of existing rules of origin.

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

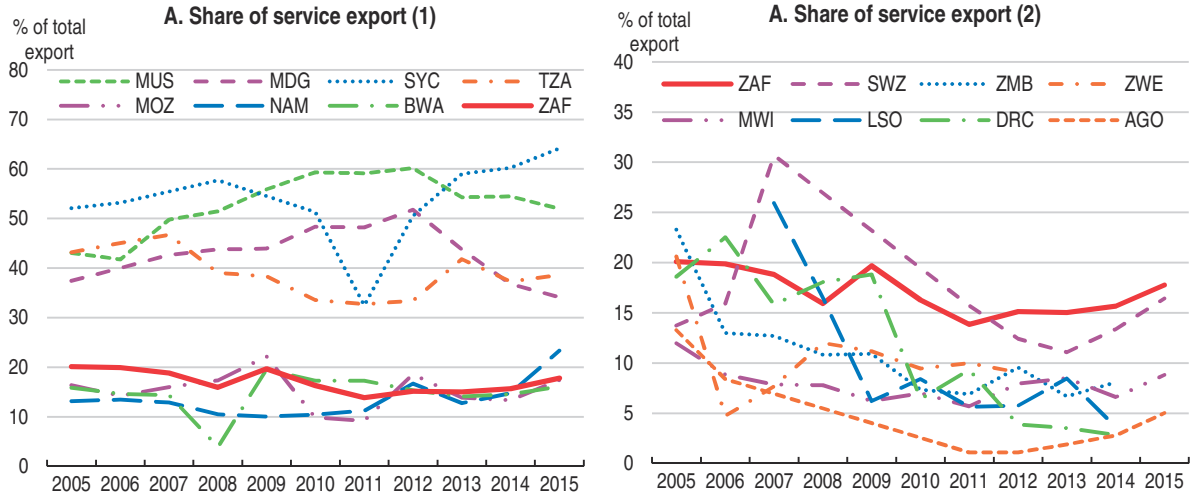
Liberalisation of trade in services could tackle skills shortages and increase business competitiveness

SADC members have adopted a Protocol on Trade in Services in August 2012 aiming to establish an integrated regional market for services (SADC, 2012). The Protocol defines general obligations for member states on the treatment of services and service suppliers from other member states and Third Parties. However, there is no cut-off date for service liberalisation. The initial aim was to conclude the negotiations to remove barriers to the free movement of services in three years. The Protocol was amended in August 2016 as the negotiations dragged on. Six priority sectors (communication, construction, energy-related, financial services, and tourism and transport services) were initially defined for the first round of negotiations. The objective is to open-up markets for trade and investment in the sectors within the region.

Service trade liberalisation within the region would have a positive impact on economic activity and well-being in the different countries. Services are an important part of GDP. In South Africa, the service sector already represents 70% of GDP and 16% of its exports. Services

exports are also more than 30% of total exports already in Mauritius, the Seychelles, Madagascar and Tanzania (Figure 1.9). Restrictions on the provision of some services are high in South Africa compared to other countries (Figure 1.10). Service trade liberalisation would allow consumers and businesses to have access to better services at lower prices through competition effects. For instance, Dihel and Goswani (2016) find that opening of professional services (accounting and engineering services) has had a positive impact on labour productivity in several African countries. They also find that service trade increases GVC participation but access to quality services locally is challenging.

Figure 1.9. **Service export is sizeable in many SADC countries**



Source: International Trade Centre.

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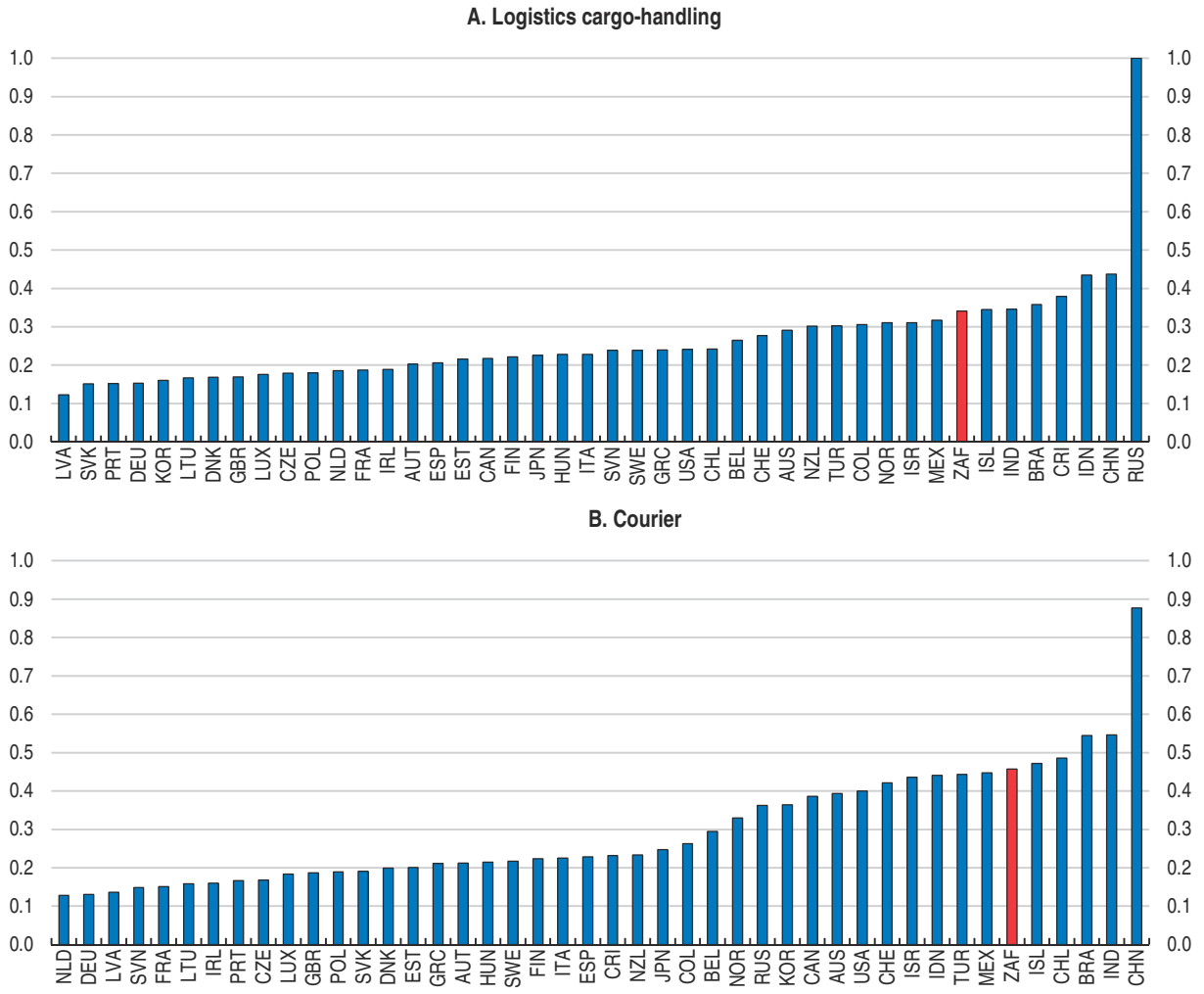
Other estimates of potential gains in service liberalisation also indicate positive macroeconomic impacts. In Dee et al. (2011), a 50% reduction of barriers to investment in services affecting foreign investors globally would increase South African GDP by 0.2% in the long run. A recent estimation by Jensen and Sandrey (2016), using the same methodology with new data and a new version of the Global Trade Analysis Project model, show that the GDP would be 0.4% higher. Moreover, when considering a 50% reduction of barriers to investment in services affecting both national and foreign investors, South Africa's real GDP would rise by 3.2%. As pointed by Dee and Findlay (2008), countries with high barriers to trade for foreigners tend to have high barriers to trade domestically. Therefore, implementing the SADC protocol on service liberalisation would be beneficial to all countries.

A directive for the implementation of the Protocol on services would clarify the overlapping of protocols and set the list of sectors not covered by the Protocol on services. A directive negotiated between member countries under the leadership of the SADC Secretariat could establish a timeline and guidelines for the services liberalisation and provide derogations where needed.

Explicitly developing the concept of "community acquis" in the protocols would simplify the elaboration and the complementarity of different generations of protocols. For instance, the European Union directive on services defined the implementation strategy of the service liberalisation and provides an example of progressive liberalisation (EU, 2006). A legally binding directive to implement the agreement should cover simplification of

Figure 1.10. **Restrictions on foreign provision of some services are high relative to other countries**

OECD Services Trade Restrictiveness Index[1]



1. STRI indices take the value from 0 to 1, where 0 is completely open and 1 is completely closed.
Source: OECD Services Trade Restrictiveness Index Database.

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administrative requirements and procedures and enhance transparency; set minimum standards; develop codes of good conduct to ensure quality; and, recognise each other's systems, practices and requirements (Cronjé, 2014). It should not lower existing standards and norms on services.

A broadening of the Protocol on services toward services not covered by already existing protocols would deepen the scope of trade services integration. Given skill shortages in the region in many domains, such broadening of services covered has an important potential economic impact. For instance, business services such as management consultancy, certification and testing, facilities management and services provided both to businesses and to consumers, such as legal or fiscal advice, or architects services have the potential for market integration. One of the main difficulties in trade services liberalisation in the region is the limitations of the free circulation and movement of people between member countries. It is a major impediment to service liberalisation as many of those activities may require

proximity of providers and recipients, or travel by the recipient or the provider. Therefore, the service liberalisation should move with a clear understanding and rules for freedom of movement and settlement of professionals concerned by service liberalisation.

Also, services trade liberalisation should respect service regulations. For example, in the case of professional services, it is necessary to ease restrictions on the entry of foreign professionals, establishment of foreign companies, and cross-border supply of services without lowering standards. Specific changes could include minimising the restrictions on the kinds of businesses permitted, developing a transparent and consistent framework for accepting foreign-qualified professionals, and relaxing barriers to foreigners participating in partnerships (Dihel and Goswani (2016). Easing discriminatory procurement regulations and reforming immigration laws could complement these steps.

More generally, there is a need for coherent regulatory policies across member states in many regulated services to permit any creation of an integrated market for different services sectors. As domestic regulators determine the conditions of access to and operations in the market, integration of services sectors of different countries requires at least convergence of the national regulatory frameworks and regional regulatory co-operation.

Finally, deeper service integration cannot happen if many network services across member countries remain closed with monopolistic state owned enterprises. A progressive opening of some of these network services would boost services integration. The energy sector, where some interconnection of networks and transactions within the region are already taking place, is a good candidate to start with. It would also help reduce the electricity deficit in some countries. However, that would require important regulatory reforms (see Cronjé, 2014 and OECD, 2015).

The Tripartite free trade area could reduce the complexity created by multiple membership

The adopted tripartite free trade area (TFTA) (see Box 1.1) is currently incomplete and not applicable as it stands (Erasmus, 2015). There is no legally binding instrument and most of the annexes complementing the agreement are only principles. There is also no agreement on tariffs and rules of origin. The current TFTA has also not eliminated the overlap with existing free trade agreements. The TFTA should not try to maintain the coexistence of the three sets of rules. Furthermore, the extension of tariff offers between those Member States not part of the same FTAs will only increase the complexity of trade within the TFTA area. Another example is the maintaining of different rules of origin within the TFTA (see Box 1.2). For a real integrated regional market, it is necessary to define a common set of rules for each pending issue (tariffs, rules of origin) and then agree on the convergence path for their application.

The EU Economic Partnership Agreement with some SADC countries increases regional fragmentation

Economic Partnership Agreements (EPA) were introduced by the Cotonou Agreement signed in 2000 marking a major change in the trade relationship between the EU and developing countries (Box 1.3). These replaced the non-reciprocal trade preferences that existed under the previous agreements by a reciprocal trade arrangement that offers duty free access for EU exports in the developing country member markets. The agreements were to enter in effect in 2008, and a transition period from 2008 to 2020 was planned for signing of EPAs and implementation of reciprocity. The main justification of the EPAs is that it is "WTO compliant".

Box 1.2. **The difficulty of defining common rules within the FTA: The case of rules of origin**

Rules of origin are among the open issues to conclude the Tripartite free trade area signed in June 2015. Article 12 and Annex 4 of the TFTA Agreement set out the criteria and conditions for goods to qualify for preferential rules of origin based on a product list. However, at the time of the launch, only about 25 % of the product list had been negotiated and agreed. The parties agreed to pursue the negotiations and reach an agreement within twelve months. These negotiations are ongoing and the SADC secretariat announced in October 2016 that an agreement has been reached between country experts and is under review by countries. The discussion below illustrates the difficulty and the complexity of setting common rules of origin between the three regional Agreements.

COMESA and EAC have a different approach of the rules of origin compared to SADC. The easiest part of the negotiations is for non-manufactured goods for which the three agreements have common rules. The difficulty is for manufactured goods incorporating imported inputs. The produced good is deemed originating from a member country only if "substantial transformation" happened in the country in the production process. The current regional agreements differ in their approach of the concept of "substantial transformation". For COMESA and the East African Community, which have similar rules of origin, a percentage of local content determines the origin: 35% of value added has to come locally or 60% of ex-factory costs of imported materials of the cost and freight (c.i.f.) value. SADC rules of origin are more complex and defined product by product. The product-specific rules use a variety of methods for determining eligibility, but tend to contain high value-added requirements and low levels of import contents. A review in 2004 resulted in the relaxation of some product-specific rules, but rules for most textiles and clothing items are still based on double-stage transformation.

The aim of the Tripartite free trade area is to simplify and boost trade among members which can only be reached with a single set of flexible rules of origin. The concerns with the rules of origin is exacerbated by the heterogeneity of tax systems between member countries (see section on tax competition) and the differences in tariffs applied to non-members.

Also, rules of origin are used as a protectionist measure to shelter domestic producers of "sensitive products" from competition (Erasmus, 2015). At the core of this problem lies a belief that rules of origin can promote industrialisation, particularly the development of upstream-downstream production networks, by making local or regional content a necessary condition for enjoying trade preferences.

Source: Erasmus, G. (2015), "The Tripartite Free Trade Agreement: Results of Phase One of the Negotiations", *Tralac Working Paper* US15WP04/2015 and Annex 4o f the Tripartite Free Trade Agreement (*www.tralac.org/images/Resources/Tripartite_FTA/TFTA%20Annex%2004%20Rules%20of%20Origin%20Revised%20Dec%202010.pdf*).

The negotiations and agreement on EPAs have proved difficult as the European partnership agreement exposes African economies to competition from EU products, especially in agriculture, and can lower customs revenues. So far, agreements have been concluded with five SADC/SACU countries (Botswana, Lesotho, Namibia, South Africa and Swaziland) and Mozambique in 2014. The agreement with SACU countries is being provisionally applied as of 10 October 2016 pending ratification by all EU Member States. Mozambique is expected to ratify in 2017.

Box 1.3. **The Origin of the Economic Partnership Agreement**

The first trade partnership agreement between the European Union and Sub-Saharan Africa countries was the Yaoundé Convention I concluded in 1962, which granted duty-free access of specified goods from 17 Sub-Saharan countries and Madagascar. The agreement was renewed by the Yaoundé Convention II in 1969, and replaced by the Lomé Convention in 1975 between 9 European Community member states and 46 developing countries from Africa, the Caribbean and the Pacific (ACP countries). It provided duty-free access to the European market for agricultural and mineral exports, and preferential quotas for products in competition with European agriculture such as sugar and beef. The Lomé Convention was renegotiated three times (Lomé II, III and IV) over a 25 year period and expanded to 70 countries. The ACP countries received about ECU 30 billion of aid and investment in addition to the trade preferences. These were replaced by the Cotonou agreement between the then 15 EU member countries and 77 ACP countries in 2000 to reduce complexity and make the agreement compatible with international trade rules (GATT and WTO). The Cotonou agreement gave birth to the Economic Partnership Agreements.

Source: Turkson, F.E. (2012), "Trade Agreements and Bilateral Trade in Sub-Saharan Africa: Estimating the Trade Effects of the EU-ACP PTA and RTAs", Centre for Research in Economic Development and International Trade, *Working Paper* 12/07, University of Nottingham.

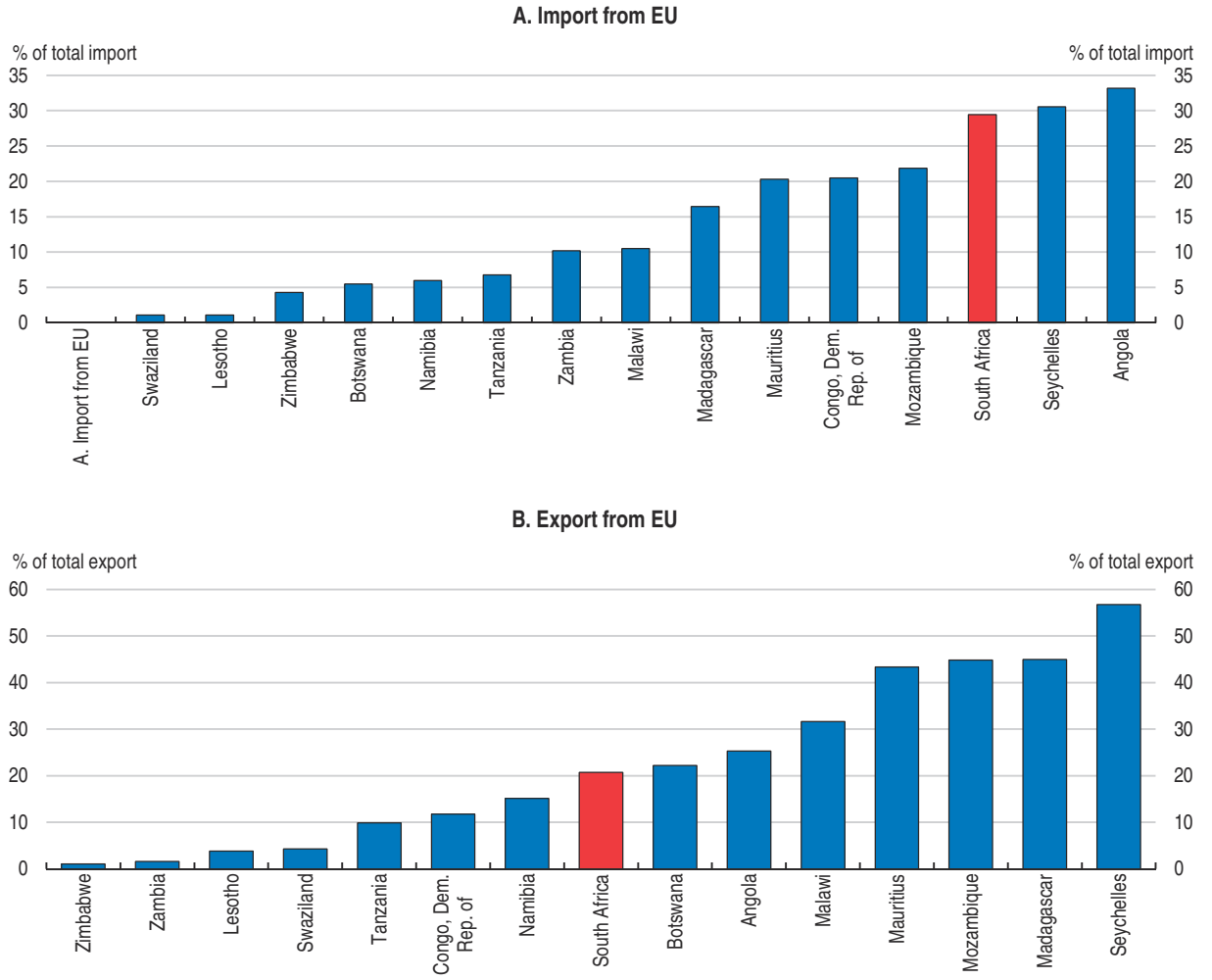
The negotiations were accelerated by the threat of expiring benefits from previous agreement with the EU in October 2016. At the expiration, trade with the EU would be under the EU's Generalised System of Preferences which excludes, for example, beef and table grapes, which would hurt in particular Namibia. Also, South Africa had already a bilateral Trade, Development and Co-operation Agreement (TDCA) concluded in 2000 which is close to the EPA, which expires with the application of EPA.

However some safeguards have been agreed. Export taxes are allowed for some exports for a period of 12 years at predetermined rates. On agricultural exports, flexible activation clauses are included permitting to protect, when deemed necessary, local producers from large inflows of EU goods and the EU has agreed to eliminate subsidies on several exported goods. For instance, Namibia secured a framework for the exports of fish products from its Exclusive Economic Zone. Finally, negotiation on trade in services will continue.

Benefits from the EPA trade agreements may be greater for the EU countries than for the SADC partners. The EU is one of the largest trading partners of SADC, in particular of South Africa, in imports and exports (Figures 1.2 and 1.11), and imports from the EU are likely to increase after the most recent tariff reductions or elimination in the partnership agreement (see poultry section). Exports of SADC countries to the EU may increase by less due to weak competitiveness and undiversified production structure (Mevel et al., 2015 and Fundira, 2017).

The agreement between a fraction of SADC countries and the EU will also increase the fragmentation of SADC trade agreements, which can hamper deeper integration. To avoid further fragmentation of trade agreements within SADC, members should agree to negotiate with external partners only under the SADC umbrella based on a binding and robust framework which guarantees that all countries' concerns are taken into account. The SADC Secretariat should also be reinforced to increase its capacity to represent member countries.

Figure 1.11. **Trade between SADC and the European Union**



Source: IMF, Direction of Trade Statistics database.

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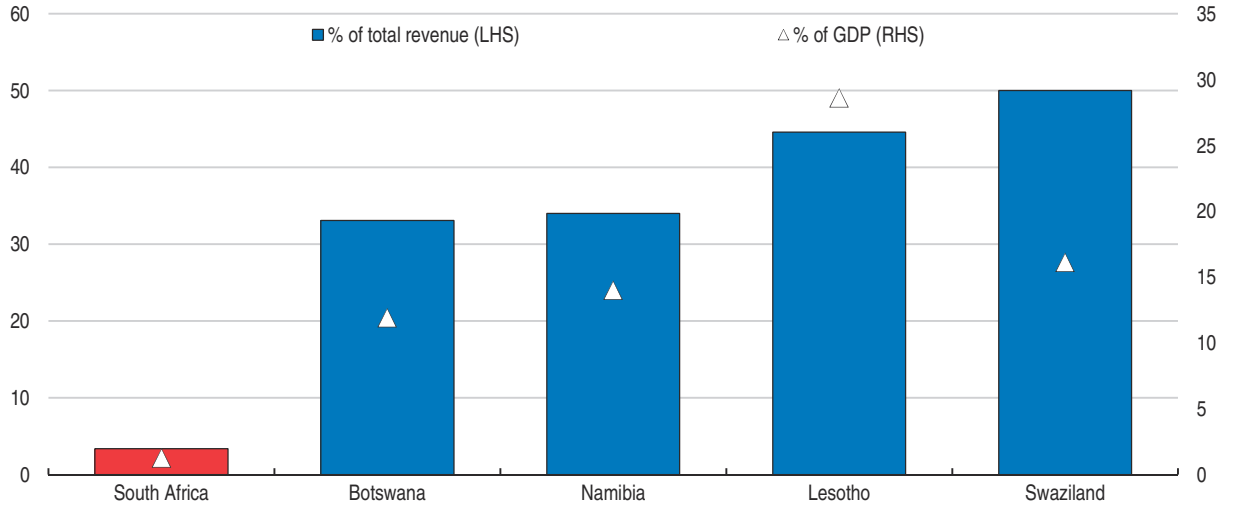
Reforming the Southern African Customs Union (SACU) to foster regional integration

The SACU arrangement has many internal difficulties with knock-on effects on SADC regional integration. Intra-union customs border posts have not been eliminated because revenue sharing is partially based on intra-SACU trade, thus reducing benefits of trade facilitation. Second, there is a substantial income transfer from South Africa to the other members. SACU revenues now represent the main source of government revenues for SACU members, except South Africa (Figure 1.12). This has created perverse incentives across the other SACU members to resist any changes to tariffs and extension of the SACU union to new members (Flatters and Stern, 2006). Moreover, the difficulty of reforming the SACU arrangement is delaying the evolution of the SADC free trade area toward a customs union as intended. Reforming the SACU sharing formula and mechanism of tariff settings would ease the negotiations toward SADC customs policy harmonisation.

Figure 1.12. **Contribution of SACU revenue to member countries' government budget, 2014/15**



Source: SACU, Annual Report 2015.

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Reforming the enabling environment to strengthen regional integration

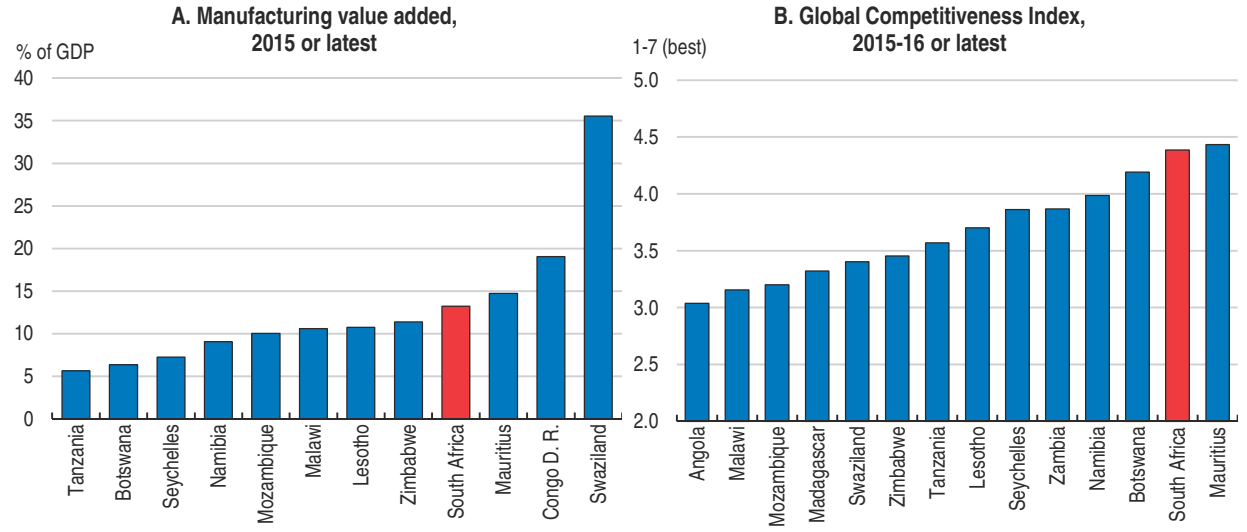
Favouring the development of industries at the regional level

Regional industrialisation has become a top priority in the revised Regional Indicative Strategic Development Plan 2015–2020 of the SADC, which is the main SADC policy document. Member states have also adopted the SADC Industrialisation Strategy and Roadmap 2015-2063 in 2015. The Strategy has three pillars: industrialisation, trade and regional integration and geography (SADC, 2015a). The industrialisation strategy rests on increasing productivity through manufacturing including agro-processing and minerals.

The level of industrialisation is low across SADC countries (Figure 1.13, Panel A). Even in South Africa, which has the most sophisticated industry in the region, the share of manufacturing in GDP is low. SADC countries have failed so far to increase value added in sectors, such as minerals and raw materials where they have some comparative advantages. The justification of SADC regional industrial policy rests on the common features of SADC countries in terms of a small market, lack of competitiveness and needs to co-operate in tackling structural barriers (Figure 1.13, Panel B).

The main barriers to the development of industry in the region are related to the enabling environment. Lack of proper infrastructure and institutions, skill shortages, complex regulations are common across SADC countries, and constitute bottlenecks to the development of industry in any sector. For example, in Mozambique, technical and higher-level skills are lacking, and firms see lack of employee skills as a serious constraint to growth (Newman et al., 2016). Skill shortage is also a major constraint in South Africa (see Chapter 2 and the section on higher education in the Assessment and Recommendations). Regulatory barriers, monopolistic behaviours and dominant state own enterprises are common across countries. These factors reduce competition and increase the average cost of doing business, making the region less competitive compared to Asian economies. Infrastructure is also a binding constraint. Delays at borders cost around USD 400 per truck per day (Vilakazi and Paleo, 2017a); that represents around USD 13 per tonne, which can be as high as one quarter of the rate charged for the route (Lusaka and Johannesburg or Lilongwe to Maputo and Beira).

Figure 1.13. **Degree of industrialisation and competitiveness of SADC countries**



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

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As put by Newman et al. (2016), for industrialisation in African countries, including SADC, setting the environment right, starting with closing the infrastructure gap, is the first priority (see section below).

As already pointed out, institutional reforms at the regional level to facilitate trade logistics should be speeded up. The journey from Kolwezi (D.R. of Congo) to Johannesburg (South Africa), of about 3 000 km, takes fifteen to twenty days, 70% of which is spent as downtime at border crossings (Newman et al. (2016). All measures facilitating trade and exports (one-stop border facilities, efficient customs, logistics, etc.) would reduce costs of doing business.

Third, special economic zones should be better linked to the rest of the economy to create cluster effects. The experience of special economic and processing zones is not positive in Africa (Farole, 2011). Apart from Mauritius, investment and exports are low, and job creation has been limited. Most have relied on tax incentives and holidays, which are insufficient if the business environment remains unfavourable. The most commonly used tax incentives across the region are alternative minimum corporate income tax rates and preferential sector benefits in the tourism, agriculture and manufacturing sectors (Table 1.3). In addition to reduced income tax rates, companies also benefit from sizeable capital allowances and other investments and expenditure deductions, and exemptions from import duty, VAT, withholding and local taxes. Many tax incentives also remain at the discretion of government ministries with some companies with a large enough investment being able to strike individual agreements with the government with generous fiscal concessions.

To make successful special economic zones, more focus should be put on the infrastructure quality, business environment and linkages with the rest of the economy to create agglomeration effects. In SADC, access to regular electricity, capacity to import intermediate inputs without additional duties, functioning road transports, easy customs procedures and supply of skilled workers would make the zones, like the rest of the economies, more successful. In South Africa, a better location of special economic zones closer to agglomerations could increase their effectiveness.

Table 1.3. **Investment incentives across SADC countries**

	Incentives	Sectors/Target	Criteria	Duration
Angola	Exemption or rate reduction for investment	All sectors	1 m USD	6-10 years
DRC	Exemptions/reductions for investment	Excl: mining, Finance and trade	200 K USD	Project duration
Madagascar	Exemptions	microfinance		5 years
	Preferential sector treatment	Industrial and service exporters		2-5 years
	Reduction for investment (50% on investment during the related tax year)	Renewables, tourism, construction, and transformation		Project duration
	Preferential sector treatment (investment)	Mining investment	50 m USD	Project duration
	custom and import duty exemptions	Petroleum exploration		Project duration
	Exemptions for investment	All sectors		4 years
Malawi	Export allowances: 25%	Manufacturing		Project duration
	Investment allowance of 100% for new buildings and 40% for used	Manufacturing		Project duration
	Expenditure allowances (100%)	Mining, Agriculture		
Mauritius	Tax-free economic zones	Exporters in Freeport zone	No minimum	Project duration
Mozambique	Investment allowances of 5% to 10%, up to the total amount of CIT liability.	For productive assets in all sectors		5
	Expenditure deductions of 50-120%	Exploration/mining incentives		5
	Customs and VAT exemptions	Capita equipment in all sectors		Project duration
Namibia	Various allowances (building, employee, export, transport	All sectors, with additional benefits for manufacturing	Exports outside SACU	
	Tax-free economic zones	Manufacturing and exporters in EPZ		Unlimited
Seychelles	Tax-free economic zones	Offshoring		Unlimited
SouthAfrica	Numerous incentives aimed at encouraging investment, R&D and infrastructure development	All sectors, prioritising manufacturing	depends	varied
Tanzania	Reduced corporate tax rate of 25%	newly listings on DSE	30% of shares public	3 years
	Capital deductions:5-100%	Agriculture, manufacturing, mining and tourism		Project duration
	Tax-free export and economic zone	exporters	Export min 80% output	10 years
Zambia	Tax holidays	Agriculture, manufacturing and approved SEZs	500 K USD	5 years
Zimbabwe	Reduced tax rate	Mining	special lease	Project duration
	Reduced tax rate	Manufacturing	exporting min 30% output	Project duration
	Tax holidays	Tourism and industrial SEZs		5 years

Source: OECD compilation.

Finally, access to finance is a major issue in many SADC countries. Apart from attracting foreign direct investment, industrial development requires the participation of local producers to the value chain. There is a need to set up financing schemes that help local entities and SMEs to have better access to finance for the upgrading of their technologies (see Chapter 2).

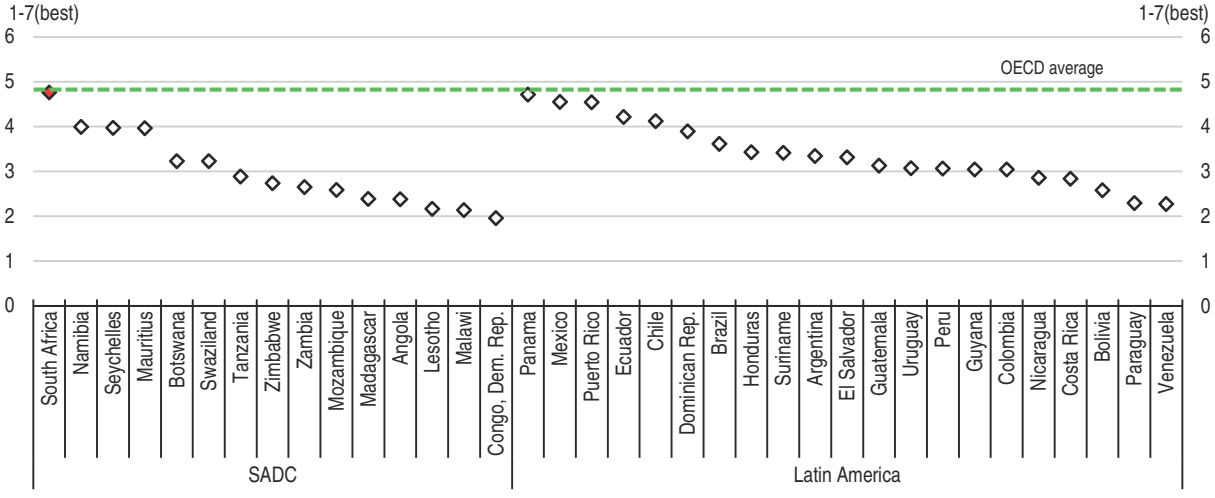
Upgrading regional infrastructure quality and availability

The SADC Regional Infrastructure Development Master Plan recognises that reducing transaction costs for industry and trade is essential to enhance regional integration. Infrastructure plays a major role in growth in Africa and contributed more than other structural policies to per capita economic growth between 1990 and 2005 (Calderón et al., 2008). However, the deterioration in the quantity and quality of energy infrastructure over the same period retarded growth. In Southern Africa, it is estimated to have cost 20 basis points from per capita growth (Foster et al., 2010). Poor infrastructure has been estimated to depress firm productivity by about 40% (Escribano et al., 2010). Therefore, making services related to infrastructure (transports, communications, ICT, energy and

water supply) available, affordable and reliable is indispensable for further regional integration and economic growth.

Despite important efforts in the last decade, infrastructure gaps remain important within SADC. Quantity and quality of transport infrastructure is low. Only South Africa is close to the OECD average on the index of transport infrastructure and most SADC countries have poor transport infrastructure (Figure 1.14). Even in South Africa there is ample room to improve the quantity and quality of infrastructure, and lower costs (OECD, 2015). The energy sector has the largest unmet needs across the region (Foster et al., 2010). Furthermore, Byiers and Vanheukelom (2014) find that outside South Africa, roads and rail are often in a poor state, border crossings are frequently slow, and traders are subject to uneven and arbitrary bureaucratic treatment by border officials and police. They estimate that the effective speed of road transport in Southern Africa is between 6 and 12 km per hour. Rail transport is even worse with an effective speed of 4 km per hour on some routes.

Figure 1.14. **Transport infrastructure compared to OECD average**



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

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At the regional level, there are different policies and initiatives to tackle the infrastructure needs. Strategic plans have been developed and agreed in all areas of infrastructure (transport, energy, meteorology, ICT, tourism and water). The aim is to upgrade the infrastructure, address the deficit and enhance quality. Also, improving maintenance of existing infrastructure and developing cross-border infrastructure and connection are among the top objectives.

Some progress has been made on most of these objectives. For instance, road agencies have been established in almost all countries, easing the collaboration between member countries. Intra-region transport corridors (around 18) have been identified and progress made on feasibility studies and costing (see Figure A4 in Annex 4). For instance, the highway linking South Africa to Mozambique (Maputo development corridor connecting the port of Maputo to South Africa and Swaziland) has been built with the participation of the private sector (SADC, 2015b). In the energy sector, the creation of the Southern African Power Pool helped accelerate regional co-operation resulting in the establishment of the power trading

platform and the connection of 9 of the 12 mainland SADC countries to the regional grid. This has helped, in the last years, imports of electricity from Mozambique to South Africa when the country was facing deep electricity shortage.

More focus should also be put on policies that could lower the cost of infrastructure-related services. Lack of progress on the liberalisation of road transport and the harmonisation of regional policies and regulation remains an important bottleneck (Cronjé (2015). Promoting more competition in the transport sector and harmonising rules across countries will lower the cost of transport and facilitate trade and industrial development. Vilakazi and Paleo (2017a) find that rates charged for goods transport can double between routes depending on the degree of competition. In routes with more competition, for instance between Lusaka and Johannesburg, prices are lower compared to the routes from Lilongwe to Maputo and Beira with weak competition. Vilakazi and Paleo (2017b) also show that there are still enormous differences in terms of rules and conditions of access to the transport market across member countries.

One of the main issues for the development of infrastructure is the funding. For instance, the SADC Regional Infrastructure Development Master Plan estimated capital requirements of USD 500 billion for regional infrastructure. SADC members have agreed to set up a Regional Development Fund as a financing mechanism for economic development and sustainable growth in SADC. The agreement to operationalise the Fund was signed in August 2016 aiming at an initial capital of thirteen billion dollars (SADC, 2016a). Accelerating the ratification of the agreement and subscription of the capital is necessary for the commencement of operations by the Fund.

Participation of the private sector in the financing of needed cross-border infrastructure would help in filling the funding gap. This requires the harmonisation of domestic and regulatory frameworks among countries, for instance by adopting common criteria for bid selection and evaluation, aligning national standards for oversight and transparency of the procurement process (OECD, 2013). Furthermore, transparent pricing and tariff regulations are necessary to attract private participation for instance in cross-border toll roads.

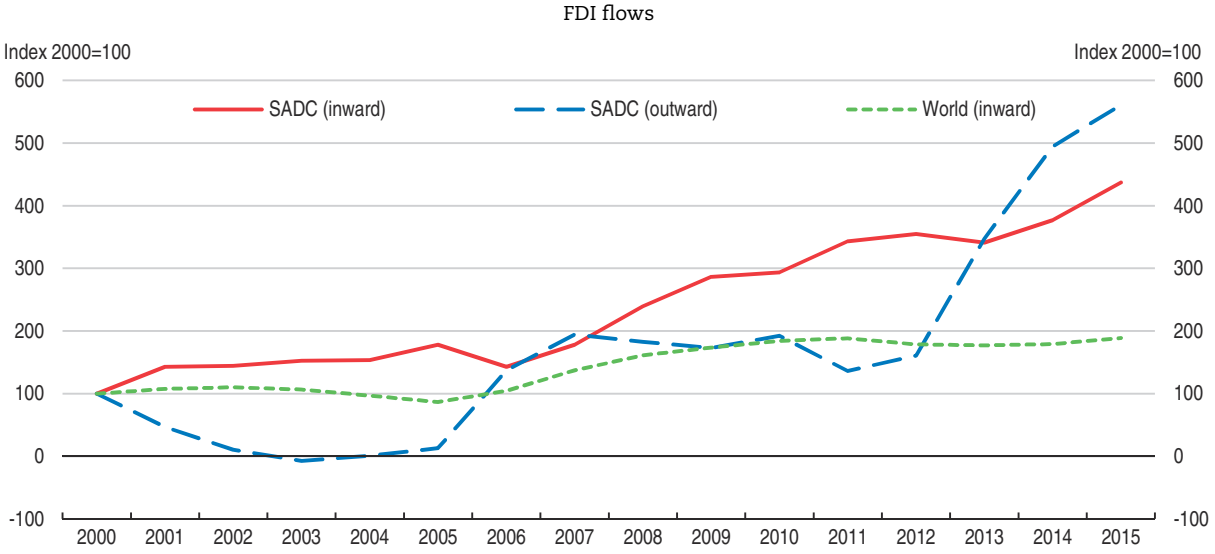
Developing a comprehensive regional investment framework

Investment is a key dimension of regional integration. The limited availability of capital and the large investment needs call for attracting foreign investment in almost all SADC countries. To foster investment across member countries and attract foreign investment, SADC countries have signed a Protocol on Finance and Investment (FIP) in 2006. Investment has risen subsequently along with the acceleration of trade between SADC members. Inward investment in SADC has grown at a faster pace than world investment flows (Figure 1.15).

Despite the signature of the SADC Protocol on investment and financial integration, bottlenecks to investment inside the region remain high. In 2012, the SADC Secretariat developed a model of bilateral investment treaties to harmonise them across the region and help member countries in designing them (SADC, 2012). Furthermore, the SADC Regional Investment Policy Framework has been developed recently, in co-operation with the OECD and NEPAD, to accelerate the harmonisation and implementation of investment policies in the region.

However, investment flows across and toward SADC are still low (Figure 1.16). The stock of cross-regional investment is lower than in other regional economic communities (RECs) in Asia and Latin America. Nevertheless, inward and outward investment in SADC is significantly

Figure 1.15. **SADC experienced a rapid increase of inward investment over the past 15 years**



Note: FDI flows correspond to 5-year moving average, where the reported year corresponding to the latest of the 5 years.
Source: UNCTAD, World Investment Report 2016.

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higher relative to the Economic Community of West African States. The flow of investments from South Africa is rising sharply in selected SADC countries. The decomposition of FDI stocks into cross-border investments from within the region versus outside the region show negligible intra-regional investment flows until 2010. In 2014, the share of cross-regional investment in total FDI has risen to 5% and 12% for inward and outward FDI stocks, respectively. This is still low compared to regional economic communities in Asia, but outperforms regional economic communities in Latin America and West Africa.

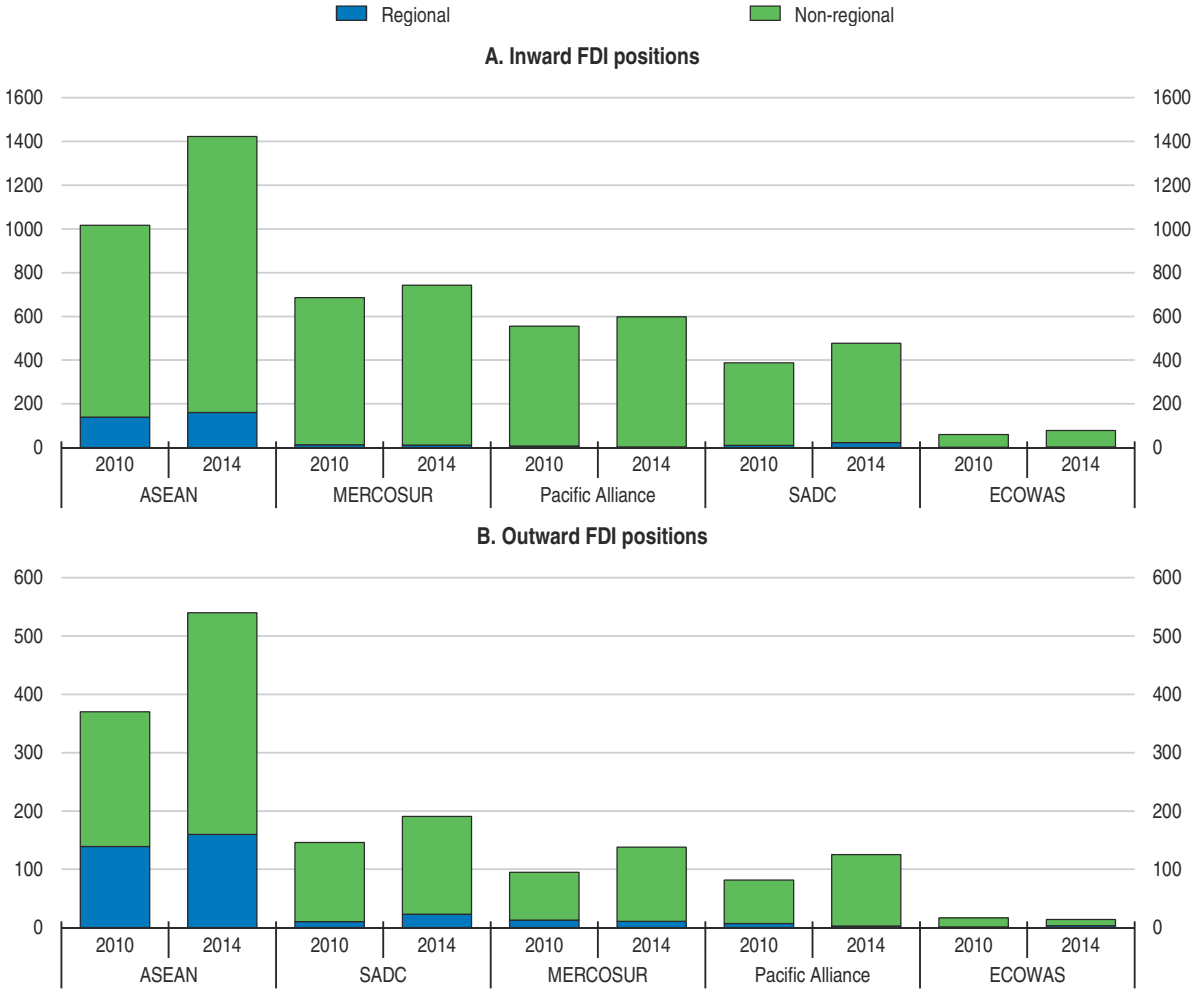
There is a difference between intra-regional and international investments. FDI flows into the SADC region have been concentrated in natural resource sectors (OECD, 2017). Most greenfield investments in five SADC member countries (Botswana, Mauritius, Mozambique, Namibia and South Africa) between 2003 and 2015 went into the extraction of coal, oil, natural gas, and metals (OECD, 2016). Foreign investment remains low in manufacturing both in terms of share in total and absolute terms (OECD, 2017). Intra-regional investments have been mostly driven by the development of regional value chains in the services sector (supermarket, banking, etc.).

In particular, the Regional Investment Policy Framework addresses 5 policy areas that have emerged as priorities for regional co-operation: coherent and transparent investment environment; market access and competition; security and protection of investors' rights; responsible and inclusive investment and regional and international integration (SADC/OECD, 2017a). Incorporating the regional framework into domestic reforms is crucial for the implementation of the Regional Investment Policy Framework.

A SADC/OECD (2017b) benchmarking exercise confirmed that reforming the framework conditions and improving the infrastructure environment are essential to attract investment and to make SADC as attractive as other emerging regions such as ASEAN for investors. For instance, in terms of the number of days to start a business, it takes many more days to set up a firm in SADC than in any other region in the world, with the exception of MERCOSUR. The extent of these reforms varies across SADC Member States (SADC/OECD, 2017b).

Figure 1.16. **FDI flows of SADC compared to other regional economic communities**

Inward and outward FDI positions by regional cluster: 2010 and 2014 (in USD billion)



Source: OECD report on "Regional Global Value Chains in SADC," 2017, data based on IMF (2016), Coordinated Direct Investment Survey (CDIS).

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Establishing a central point to co-ordinate and systematically gather comprehensive, up-to-date information on all laws, regulations, incentive schemes, and procedures related to investment, is necessary in the region to increase attractiveness.

In terms of market access, restrictions on foreign investment have increased in recent years. FDI and other cross-border investment restrictions appear to be relatively high in SADC compared with other regions. The high average for SADC is driven to a certain extent by the recent restrictions on cross-border investment introduced by South Africa (SADC/OECD, 2017b). SADC countries should provide equal competitive opportunities for both foreign and national investors and be transparent with up-to-date information on existing restrictions justified by national goals (promotion of disadvantaged groups).

Further integration of the financial system will ease financing conditions across countries

The financial sector in SADC is diverse and fragmented. South Africa and Mauritius have highly developed financial systems, while Congo D. R. and Tanzania have small and

underdeveloped ones (Table 1.4). Affordable capital across most of the region is scarce, as high risk premiums associated with political and macroeconomic uncertainty drive up costs (World Bank, 2007; AfDB, 2013; SWIFT 2013). Currency conversion costs are high; and most countries still have restrictive exchange and capital control regulations in place (IMF, 2016). Therefore, intra-SADC trade and capital movement remains below its potential, with most businesses finding it easier to source and move capital from outside the continent to support intra-African transactions than within (AfDB, 2013, SWIFT 2013).

Table 1.4. **Indicators of financial depth and size, 2014**

	Liquid liabilities (% of GDP)	Bank Deposits (% of GDP)	Private Credit (% of GDP)[1]	Number of traded companies on stock exchange	Offshore deposits/domestic deposits (%)	Net Interest margin (%)
Botswana	38.82	32.67	30.16	32	9.81	3.21
DRC	12.94	7.16	6.19		27.93	
Lesotho	37.71	23.13	20.4		9.81	
Madagascar	23.05	14.87	11.92		32.4	
Malawi	22.63	14.32	10.81	14	34.53	16.33
Mauritius	99.96	121.9	102.54		96.88	2.49
Mozambique	45.44	43.33	28.64	4	19.15	
Namibia	49.73	50.81	44.61	38	6.96	3.99
Seychelles	54.81	36.63	20.21	4	1 268.35	
South Africa	40.74	76.93	65.86	400	7.26	3.14
Swaziland	24.11	24.4	20.45	7	31.17	3.05
Tanzania	22.12	18.91	12.75		11.38	0.56
Zambia	16.73	19.1	12.04		16.57	1.09
Zimbabwe				68		3.71
SADC	38	37	30	71	25	4.23

1. Credit extended by deposit money banks. Numbers marginally higher for Zimbabwe (15.82) and Seychelles (22.11) if lending by other institutions are included and significantly higher for South Africa (147.28).

Source: World Bank Financial Development and Structure Dataset, 2015. Committee of SADC Stock Exchanges.

Out of the five indicators tracked to assess regional integration on the continent, the financial and macroeconomic integration sub-index has the lowest overall score across all regional economic centres (African Union Commission et al., 2016). Not surprisingly, the index shows that within SADC, financial integration of domestic markets is low. Deeper regional integration can help overcome current issues of scale and development, enable risks to be better managed, make markets more efficient and improve the allocation of capital.

Cross-border transactions face different regulatory frameworks within SADC. To deal with this, SADC has put in place memoranda and guidelines to improve coordination, to harmonise the systems and to establish common regional frameworks for foreign exchange transactions, capital controls, banking procedures and systems and other financial matters (SADC, 2006; SADC, 2009; SADC, 2011). SADC has also developed a model of central bank law that aims to facilitate the operational independence of central banks and create clear standards of accountability and transparency (SADC, 2009 and SADC, 2011). However, these are not binding. Moreover, the memoranda and guidelines often result in countries agreeing or implementing reforms at the lowest common denominator. Encouragingly, an application to harmonise banking supervision processes has been implemented by 14 countries.

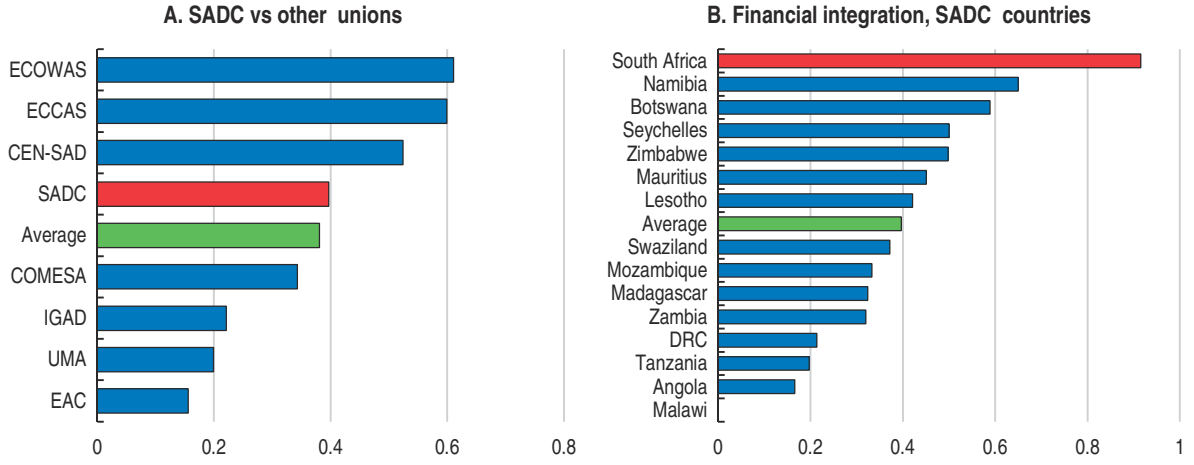
A regional cross-border settlement system, the Integrated Regional Electronic Settlement System (SIRESS) was introduced in 2013 to enhance greater financial integration within the region. SIRESS was first piloted in the four Common Monetary Area countries that use the

South African Rand (South Africa, Lesotho, Namibia and Swaziland) and was later rolled out to other member countries. The system allows for real-time settlement of payment transactions between countries based on a single currency – the South African rand. The system is operated by the South African Reserve Bank (SARB) on behalf of the SADC Committee of Central Bank Governors, with the National Payment System Act of South Africa providing the legal framework for the system. While the system is managed by the SARB, ownership and decision-making processes fall under the governance structures of the Committee of Central Bank Governors.

Prior to the introduction of SIRESS, cross border payments in the region were mostly in US Dollars, often resulting in a double round of exchange costs (SWIFT 2013). For example, South African sending money to Botswana would have to first convert from rand to dollars, then from dollars to pula, incurring transaction fees and commissions. Following SIRESS, transfers now only face one currency exchange without any commission and are instant.

The exact impact of SIRESS on weakening the use of the dollar and facilitating greater trade is difficult to assess as there is limited access to data. However, the higher than average ranking for financial integration in SADC relative to other customs unions in the 2016 World Bank sub-index for financial market integration (that includes a measure of currency convertibility) suggests that SIRESS has played an important role in improving currency convertibility and deepening financial integration since its introduction in 2013 (Figure 1.17).

Figure 1.17. **Financial Integration Index**



Note: Index of two indicators: Regional convertibility of national currencies and Inflation rate differentials (based on the Harmonised Consumer Price Index).
Source: Africa Union Commission et al., Africa Regional Integration Index (2016).

StatLink http://dx.doi.org/10.1787/888933552796

The introduction of SIRESS is a great first step to create foundations for greater integration. By ensuring that settlements are done through the banking system, SIRESS has the potential to improve the monetary base within the region. The interbank nature of the system also facilitates the establishment of a regional short-term money market, with the potential to lower rates and increase transparency and broaden access to credit. Finally, as the use of the rand as the base currency presents some challenges due to the trade imbalance between South Africa and the other countries, SADC countries are considering making SIRESS a multi-currency payment system. Over time, the use of a single currency in

SIRESS presents opportunities to eliminate exchange risk associated with cross-border transactions and enhance intra-SADC trade and investment by making it easy to transact.

In addition to traditional bank transfers and SIRESS, the region has made progress in easing remittances between individuals across SADC countries. Money transfer operators such as MoneyGram and Western Union and retail stores such as Shoprite and PicknPay have taken advantage of existing networks, partnerships, infrastructure and widely used technology such as mobile money to facilitate the ease of cross-border transfers for individuals (Hope, 2016). Cross border SADC regulation does not exist for money transfer, neither is there much harmonisation between countries.

However, this has not always deterred further expansion of these services or the creation of new payment corridors. The creation of a new financial licence category in 2015 in South Africa made it possible for non-bank institutions to become money transfer operators. New market participants and the creation of a special money transfer corridor between South Africa and Zimbabwe have made regulatory barriers between countries less binding for financial mobility. Further facilitating money transfers between countries through non-financial institutions accompanied by appropriate regulations have the potential to boost financial integration.

There is scope for strengthening tax co-operation

Since the adoption of the first SADC memorandum of understanding in 2002, corporate and VAT rates have been reduced across the region and some countries have been trying to rationalise investment tax incentives. However, tax regimes across the region remain complex with large differences in the effective tax rates across different sectors and economic zones (Table 1.5).

Corporate tax rates have declined across most countries over the last decade, in line with global trends. However, statutory corporate rates across most SADC member states remain above the regional average of 28% with alternative minimum rates for some sectors or special economic zones. The OECD average is 25% (range of 8.5 to 35%). Similarly, personal income taxes and payroll taxes still differ quite significantly across SADC member states. In contrast, there is some convergence in VAT rates and the zero-rating of exports, but VAT systems still differ with respect to standard, zero-rated and exempt goods. Despite differences in zero-rated and exempt goods, 10 of the member states have VAT rates between 14 and 16%, and three of five SACU countries have a fairly unified VAT regime. In response, SADC has developed a Guideline for VAT that proposes a minimum standard rate of 10%, discourages the use of multiple tax rates and, instead, encourages the use of an ad-valorem excise tax for goods requiring a higher tax rate than the standard VAT rate (SADC, 2016b). While SADC aims to gradually harmonise the application of zero rating and exemption of goods, specific guidelines have yet to be set. The application and rates of other indirect taxes such as excise duties and other local taxes also remains fairly varied, despite the guidelines set out in the memoranda.

Tax incentives across the region are also varied and complex, differing by sector, investment types, activity, location, domestic and foreign ownership and size of investment. Like corporate income tax rates, tax incentives tend to favour companies investing in the mining, manufacturing and tourism sectors and those located in special economic and exporting zones.

Table 1.5. **Summary of major tax rates across SADC**[1]

	Main tax rates				Alternative minimum corporate income tax rates		
	Personal Income tax (%)[2]	Value added tax (%)	Payroll taxes (%)[3]	Corporate income tax (%)[4]	Mineral resources (%)[5]	Manufacturing[5]	Special economic zones[6]
Angola	17	10	8	30	25-65.75		
Botswana	25	12	0.2	22	22-55	15	15
DRC	40	16	11.2	35	30		
Lesotho	30	14	0	25		10	
Madagascar	20	20	18	20			10
Malawi	30	17	8.5	30			
Mauritius	15	15	10	15			0
Mozambique	32	17	4	32			
Namibia	37	15	1.9	32	35-55	18	0
Seychelles	15	15	2	25			
South Africa	**41**	**14**	**2**	**28**			**15**
Swaziland	33	14	5.5	28			
Tanzania	30	18	16	30			0
Zambia	35	16	9.2	35	30	0	0
Zimbabwe	25	15	5	26	15	15–20	0

1. See table A.5 in Annex for detailed precision on rates.
2. Top marginal or flat rate.
3. The sum of wage contributions and tax based on the payroll, except in Botswana where the base is company turnover.
4. Statutory rate- top or flat, effective rate including surtax for Zimbabwe.
5. General preferential sector rates or rate applicable to select companies or subsectors within industry.
6. Refers to special economic, export processing zones or any other geographic or legal area that functions with a different fiscal regime to the norm.

Source: OECD compilation.

A certain degree of tax competition exists between SADC countries in particular with respect with special economic zones, tax incentives and advantages accorded to investors without transparency in the criteria. This applies in particular to mining, manufacturing and tourism sectors and special economic and export zones. Countries like South Africa, Mauritius and Tanzania also seem to be competing in incentivising companies to set up headquarters.

In an effort to foster greater tax uniformity, incentivise investment and minimise harmful tax competition within the region, SADC has developed guidelines on taxation with specific recommendations relating to the treatment of VAT, excise, customs and tax incentives (SADC, 2002; SADC, 2006; SADC 2016b). The guidelines aim to achieve greater tax transparency, convergence in tax rates across countries, a common approach in the treatment of indirect taxes and incentives, and the substitution of taxes on internationally traded goods with a broad-based consumption tax.

VAT coordination could encourage greater economic integration and limit trade diversion. SADC should develop a standardised maximum list of exemptions and rates of VAT. The SADC guideline on VAT should have mandatory dimension with specific deadlines by which countries should comply, in line with international best practice. This has the benefit of lowering compliance and enforcement costs, and promoting the free movement of goods and trade within the region. An example of successful coordination of VAT is the EU where member states have the freedom to set the number and level of VAT rates but subject to rules which prescribe the minimum standard rate, the number of reduced rates, and the set of goods and services to which they apply.

Key recommendations for deepening regional integration within SADC

- Reduce non-tariffs barriers on intra-regional trade. Harmonise where possible documents for licences, price control measures and technical barriers to trade (technical norms).
- Simplify and adopt a unique set of rules of origin in the forthcoming tripartite free trade area.
- Lead the harmonization of competition rules among SADC countries and increase co-operation between competition authorities.
- Promote competition in infrastructure-related services across countries.
- Create a specific infrastructure fund and increasing private sector participation in infrastructure development.
- Provide special economic zones with better infrastructure and develop their linkages with local economies.
- Upgrade information technology at custom posts and improve the interconnectivity of systems and generalise one-stop border control point between SADC members.

Further recommendations

- Align and co-ordinate VAT rates. Develop a standardised maximum list of exemptions and reduced rates of VAT and make guidelines with specific deadlines by which countries should comply.
- Facilitate the mobility of workers and business people within SADC.
- Reform the framework conditions for doing business to attract more investment.
- Limit the number of procedures, documents and time to set up a business.
- Accelerate the creation of the regional development fund and subscription of the capital necessary for the commencement of operations by the Fund.
- Reform the sharing formula of SACU and mechanism of tariff settings to facilitate further custom policy harmonisation within SADC.
- Establish a central point to co-ordinate and systematically gather comprehensive, up-to-date information on all laws, regulations, incentive schemes, and procedures related to investment.

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Chapter 2

Lowering barriers to entrepreneurship and promoting small business growth

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

Boosting entrepreneurship and growing small businesses can play an important role in creating jobs, reducing inequality and sustaining growth. In many countries new and young firms have been major net creators of new jobs and a force for productivity growth (Criscuolo et al., 2014; OECD, 2015a). In OECD and other emerging economies, employment in small firms accounts for a large share of total employment (OECD, 2016a). However, large incumbent firms continue to dominate many South African markets and rates of entrepreneurship are relatively low compared to other emerging market economies. At the same time, there is large potential for higher rates of self-employment, business start-up and small business growth.

This chapter highlights the need for entrepreneurs in South Africa and discusses ways to create a more enabling environment in which entrepreneurs can establish themselves and grow. The literature highlights the importance of both the policy framework (notably regulation) and individual characteristics of entrepreneurs in affecting rates of firm creation and growth (Djankov, 2009; Ardagna and Lusardi, 2010). The second and third sections of this chapter consider ways of overcoming the high level of regulation and concentration in South Africa (OECD, 2015b). The fourth section explores ways of increasing the skills and the know-how needed for starting and running a business. The final section examines ways of improving access to finance for those that have overcome these other barriers. Previous Economic Surveys have discussed other factors that are also constraining small businesses, such as skills shortages, a lack of public transport, expensive communications services and high crime rates (OECD, 2013a, 2015b).

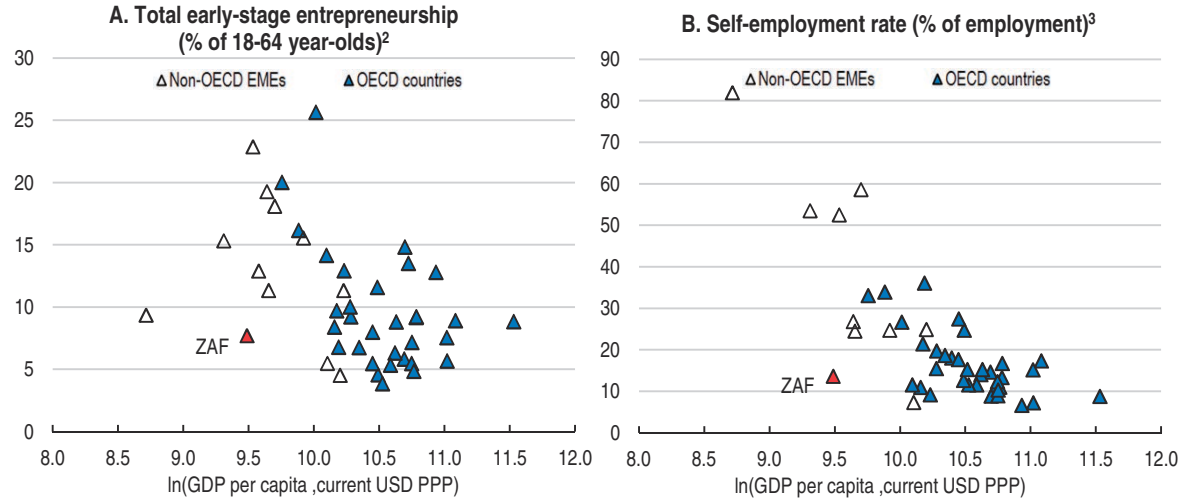
The need for more entrepreneurship and small business growth

Various measures suggest that entrepreneurial activity is relatively low in South Africa. The Global Entrepreneurship Monitor (GEM) has consistently pointed to the low rate of "early-stage entrepreneurial activity", with 8% of 18-64 year-olds planning or starting a business in recent years (Figure 2.1, Panel A). This is about half the rate that might be expected given South Africa's income level. Higher rates of entrepreneurial activity would be expected at lower levels of income if lack of formal sector employment opportunities leads to higher rates of business start-up and necessity-driven informal self-employment. Likewise, self-employment rates are relatively low, at just over 10% of employment (Figure 2.1, Panel B). Although own-account workers account for almost two-thirds of the self-employed, the rate is low compared to other emerging economies.

As in many countries, men and young people are more likely to be entrepreneurs than women or older people (Figure 2.2). The more educated are also more likely to be entrepreneurs. However, within almost every group, the rate of early-stage entrepreneurial activity is higher in other emerging market economies than in South Africa. The biggest gaps are for men, those under 35 years old and the least educated.

Regressions comparing the likelihood of being an entrepreneur based on gender, age and education confirm that these individual characteristics are all important determinants

Figure 2.1. **Rates of self-employment and entrepreneurial activity are low**[1]



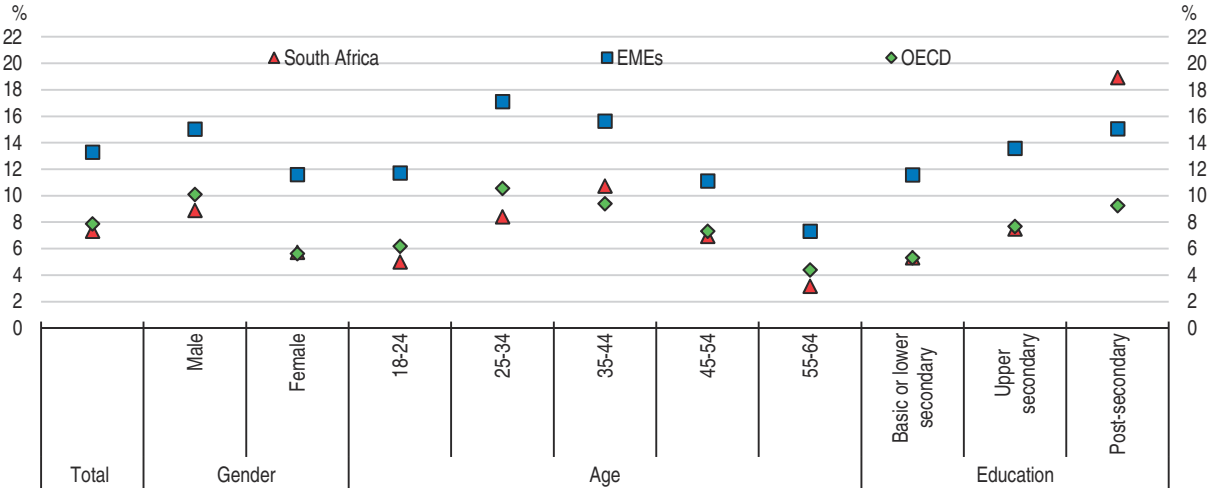
1. Non-OECD emerging market economies (EMEs) are: Argentina, Brazil, China, Colombia, Costa Rica, India, Indonesia, Malaysia, Russia, South Africa and Thailand. Data for GDP are from 2015.
2. Average of 2014-2016 where data are available.
3. Data for self-employment rate are from 2014 or latest available year.

Source: Global Entrepreneurship Monitor; ILO; World Bank.

StatLink http://dx.doi.org/10.1787/888933552815

Figure 2.2. **Entrepreneurial activity is relatively low within most groups**

Percentage of group involved in early-stage entrepreneurial activity, 18-64 year-olds



Note: Early-stage entrepreneurs are actively involved in setting up a business they will own or owner-manager of a new business. Data are for 2012. The emerging market economies (EMEs) are 10 non-OECD member countries (Argentina, Brazil, China, Colombia, Costa Rica, Indonesia, India, Malaysia, Thailand, Russia, South Africa) and 5 OECD members (Chile, Hungary, Mexico, Poland and Turkey).

Source: Global Entrepreneurship Monitor; OECD calculations.

StatLink http://dx.doi.org/10.1787/888933552834

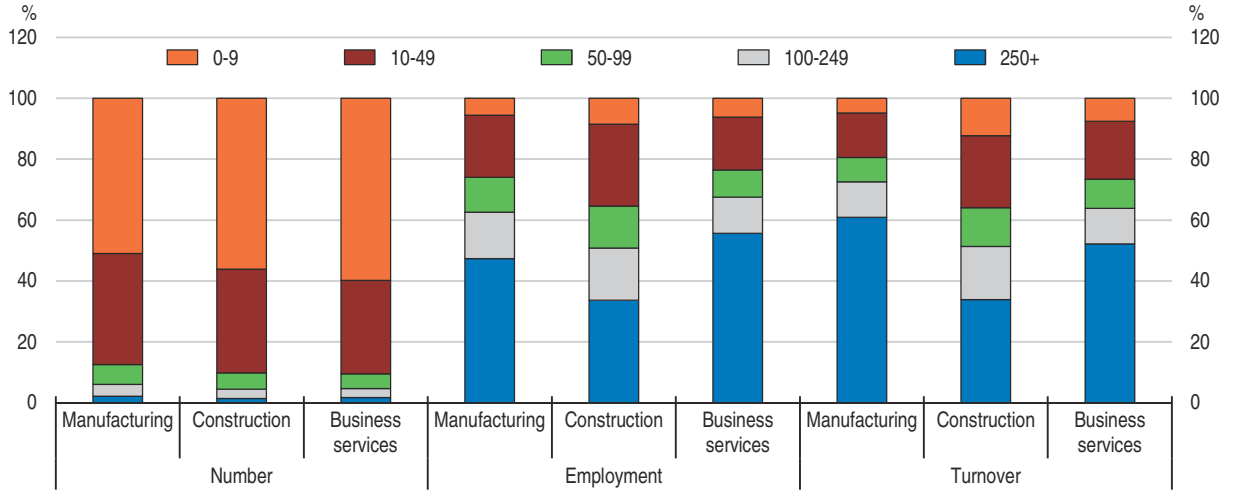
of entrepreneurship (controlling for fear of failure, perception of sufficient skills, and knowing an entrepreneur [Annex 3]). In particular, educational attainment is negatively related to the probability of being a necessity-driven versus opportunity-driven entrepreneur, a result consistent with Ardagna and Lusardi (2010) and others. This analysis also confirms the importance of work experience, self-belief and knowing an entrepreneur

in explaining part of the low level of entrepreneurship in South Africa, which may be linked to having the necessary capital, skills and networks.

Comprehensive and comparable data at the firm level are difficult to gather. There is no single data source, and estimates of the importance of micro to medium-sized businesses vary. For instance, their employment share has been estimated at 47% and 60% (DSBD, 2016; Groepe, 2015). A new firm-level panel dataset allows comparisons on a common basis, although only for firms in the company tax data (Box 2.2; Pieterse et al., 2016). These data reveal that small firms are more numerous and more prevalent in non-financial business services than manufacturing or construction (Figure 2.3). Still, large firms account for a little over half of the turnover or employment in non-financial business services while small firms (less than 50 employees) account for a greater share of the construction industry.

Figure 2.3. **Small firms are most prevalent in business services**

Distribution of firms by number of employees in firm, 2011/12-13/14 average



Note: Business services exclude the financial sector. Data are for employing firms registered for company income tax; see Pieterse et al., (2016) for details.

Source: Based on Tsebe et al. (2017), "Firm dynamics in South Africa", forthcoming.

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The new data confirm the importance of new and young firms for employment growth – a result found in many other countries (Box 2.2; Criscuolo et al., 2014). However, conditions have been difficult in recent years and the data suggest that the exit rate of employing firms may have exceeded the entry rate during 2011/12-2013/14 (Tsebe et al., 2017). This implies that small firms are ageing and markets are becoming more concentrated, underlining the need to boost the rate of start-up and the growth rate of young firms. These developments, together with the low rates of entrepreneurial activity overall, point to a role for policy in improving the regulatory environment, lowering barriers to entry, raising skill levels and expanding access to finance. New cross-country evidence suggests that correcting policy weaknesses could disproportionately benefit young firms (Calvino et al., 2016).

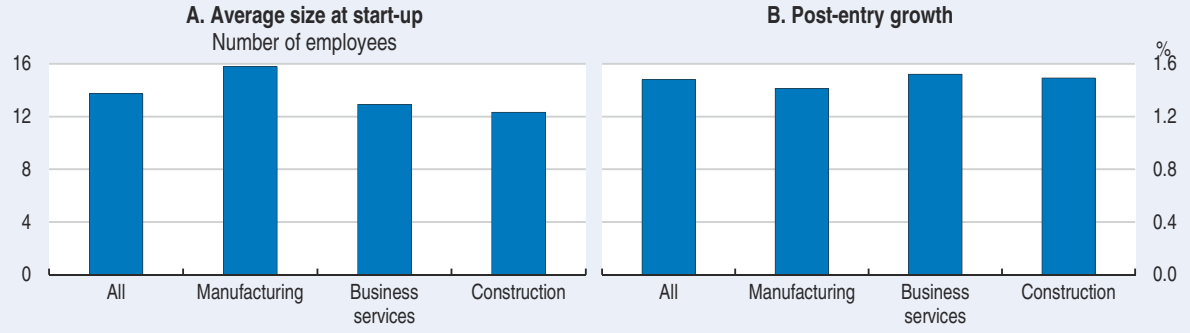
Surprisingly, informality does not explain the low rates of entrepreneurship and start-up. At 31%, the informality rate (as a share of total employment) is considerably lower than the 66% average for sub-Saharan Africa and 51% for Latin America (Oosthuizen et al., 2017). This low level of informality coupled with a high unemployment rate makes South Africa an outlier. The informal economy is not very absorptive, due in part to the legacy of

Box 2.1. **New evidence on firm dynamics in South Africa**

A new firm-level panel dataset allows new insights into firm dynamics. The "SARS-NT panel" was created by the South African Revenue Service and National Treasury (Pieterse et al., 2016). It was built by merging tax records from company income tax, registered employees' tax, value-added tax and customs. It does not include informal firms, sole proprietorships, partnerships or micro-enterprises registered for the turnover tax. The availability of firm-level data allows the dynamics of firm entry, exit and growth to be explored using the OECD's DynEmp framework (Criscuolo et al., 2014; Calvino et al., 2015). Key findings include:

- Young firms have disproportionately contributed to employment growth in recent years. Even as GDP growth slowed, young firms remained net job creators. However, a notable feature is the importance of large incumbent firms for job creation and destruction.
- The exit rate appears likely to have exceeded the entry rate between 2011/12 and 2013/14.
- Dynamics are somewhat different across sectors. The start-up rate is lower in manufacturing than in construction or business services and the average size at start-up tends to be higher (Figure 2.5). But the survival rates and growth rates are more similar across the sectors.
- Around two-thirds of the micro-entrants (less than 10 employees at entry) in 2010/11 survived to 2013/14 but of these, most remained small. A fraction (12%) grew beyond 10 employees but these disproportionately contributed to growth.

Figure 2.4. **Components of net job creation by start-ups**



Note: The figure shows the decomposition of net job creation by entrants in 2010/11 that survived to 2013/14. See Calvino et al., (2015) for details of the methodology which decomposes net job creation of start-ups into: start-ups per 1000 employees; average size at start-up; survival rate; and post-entry employment growth.
Source: Tsebe et al. (2017), "Firm dynamics in South Africa", forthcoming.

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apartheid, but also a number of structural factors such as low skills. The majority of unemployed typically become economically inactive, with only a minority of unemployed individuals transitioning into informal self-employment. Those who find employment are more likely to transition from unemployment to formal employment rather than informal employment (Cassim et al., 2016). Informal self-employment has remained around two-thirds of total self-employment during recent years.

The informal sector itself is heterogeneous and is less stable than formal self-employment (Lloyd and Leibbrandt, 2016). Around one-quarter of informal firms in 2013 were employers, a feature associated with higher profitability and more educated owners (Fourie and Kerr, 2017). Those who started businesses from employment had higher turnover and tended to return to employment if they exited, suggesting that they could not cover their opportunity cost (Lloyd and Leibbrandt, 2016). This suggests that part of the informal sector

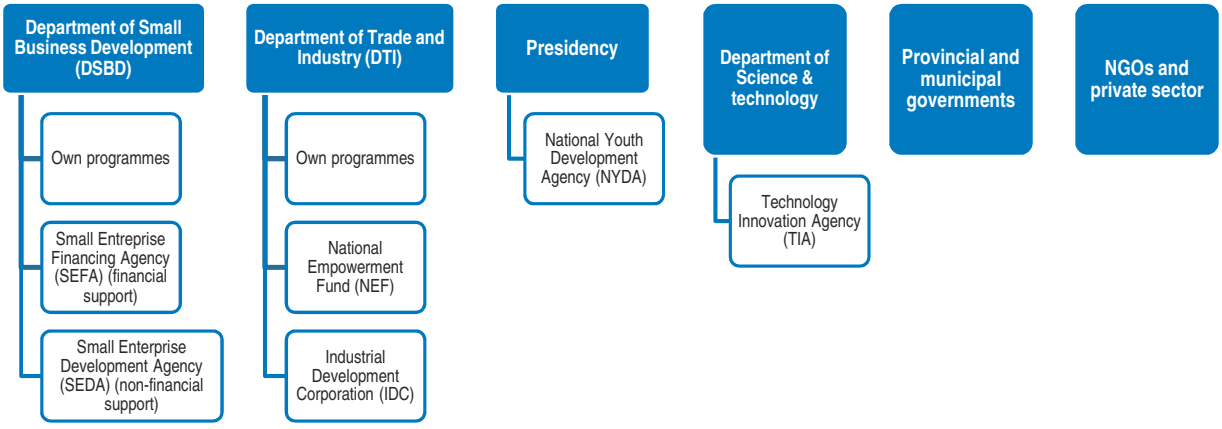
has potential to be formalised. Increasing the number of start-ups and self-employed in the formal and informal sectors in South Africa has the potential to increase employment and labour market participation, reduce inequality and poverty, and make growth more inclusive.

The government's focus on small businesses is increasing

The government identified the need to promote entrepreneurship and increase the prominence of micro, small and medium-sized enterprises in the economy two decades ago. It released an Integrated Small Business Development Strategy in 1995, followed by the Small Business Act of 1996. The Act was updated in 2004 and an updated Strategy was released in 2005. The Strategy was envisaged to be reviewed every five years.

Seeking greater results, in 2014 the government created the Department of Small Business Development (DSBD) and increased funding for programmes for micro, small, medium sized enterprises (MSMEs) and co-operatives. The Department was formed from the Department of Trade and Industry and some programmes and agencies have now moved across with it. There are currently eight actors at the national level delivering programmes targeting MSMEs (Figure 2.5).

Figure 2.5. **Main departments and agencies targeting small business growth**



Note: The National Empowerment Fund is planned to be moved to the Industrial Development Corporation.

The DSBD faces several challenges in delivering on its large mandate. Because the department is new and small (0.2% of the departmental budget allocation), its ability to make change is constrained. Moreover, the dispersion of responsibilities scatters information, and together with a lack of data on enterprises, makes it difficult to ensure that policies are effective. The Department plans to rationalise the variety of definitions of small enterprises within the National Small Business Act and across government to help better design policies and simplify procedures for small firms (Table 2.1). The effects of policies will then need to be monitored to ensure that this does not cause disincentives to grow above the small business thresholds. The Department also needs to advocate for small business in government policy, for instance highlighting incentives programmes that favour large incumbents (Roberts, 2016).

Updating the 2005 Strategy in consultation with stakeholders would help establish clear priorities and give the Department a stronger mandate for change. Public support for the

Table 2.1. **Examples of definitions of small and medium enterprises used**[1]

Firm type	National Small Business Act[2]	South African Revenue Service	Broad-Based Black Economic Empowerment Act and Preferential Public Procurement Regulations
Micro	Employees: ≤ 5 Turnover: ≤ ZAR 0.2 million Gross assets: ≤ ZAR 0.1 million	Qualifying turnover: ≤ ZAR 1 million	Turnover: ≤ ZAR 10 million (less in some industries)
Very small	Employees: ≤ 10-20 Turnover: ≤ ZAR 0.5–6 million Gross assets: ≤ ZAR 0.5-2 million		
Small	Employees: ≤ 50 Turnover: ≤ ZAR 3-32 million Gross assets: ≤ ZAR 1-6 million	Taxable income: ≤ ZAR 20 million	Turnover: ≤ ZAR 50 million
Medium	Employees: ≤ 100-200 Turnover: ≤ ZAR 5-64 million Gross assets: ≤ ZAR 3-23 million		

1. In 2016, ZAR 1 million was equivalent to USD 68 000 at market exchange rates and USD 172 000 at PPP-adjusted exchange rates.
2. Definitions vary by industry.

Source: Departmental websites.

creation of the "SME Toolkit" and more recently "FinFind", which provide general information for SMEs including sources of finance, are a step in the right direction to reduce the dispersion of information. A further push should be made to ensure the DSBD can fulfil its mandate and to consolidate interactions with the government from a customer's perspective.

Lowering regulatory barriers and improving the business environment

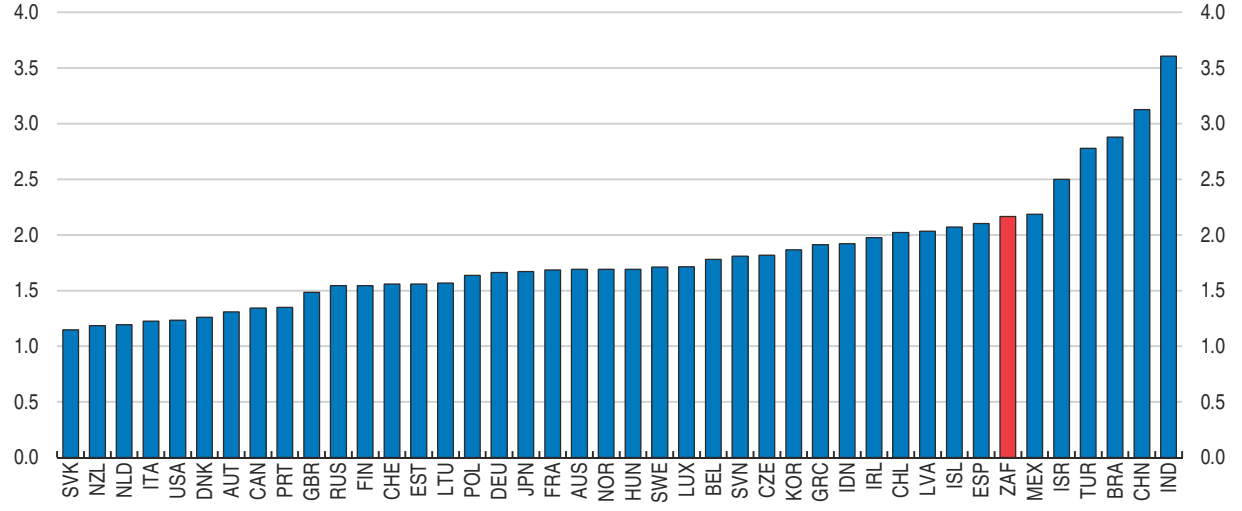
The regulatory environment affects many business decisions, including whether to start a business, whether to register and operate in the formal sector and what kind of business to create. It encompasses the ease of starting a firm and ongoing burden of complying with permits and licensing, tax, product market and labour market regulation, which have been linked to entrepreneurship in empirical studies. The large fixed cost of regulation makes it harder for young firms to grow. The overall level of regulation is often considered high and burdensome in South Africa and a barrier to entrepreneurship (Figure 2.6; OECD, 2015b; ILO, 2016; Herrington et al., 2017). South Africa ranks 74th in the World Bank's Ease of Doing Business. Frequent changes to regulations add to the regulatory burden. In 2013 over 60% of surveyed small businesses were unsure of the regulations that they need to comply with (SBP, 2014). This section highlights three areas with scope to make reforms that should boost entry and small business growth: entry regulations and licensing; making firm closures less costly; and easing the cost of tax compliance. It then highlights the links between regulation and informality that should be considered.

Lowering regulatory barriers to entry and growth

A burdensome regulatory environment, particularly the slow speed of starting a business, has been linked to the rate of early-stage entrepreneurial activity, rates of firm ownership and start-up rates (Ardagna and Lusardi, 2010; Klapper et al., 2008; Djankov, 2009). The time required to start a business has improved in recent years but it is still longer than in other countries (Figure 2.7). In practice it can be even slower: a recent survey found that registering a new business can take up to six months, often due to delays in value-added tax registration (ILO, 2016). A major source of delay is the 30 days to register employees with the

Figure 2.6. **Regulatory barriers to entrepreneurship are high**

OECD product market regulation sub-indicator, 2013



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

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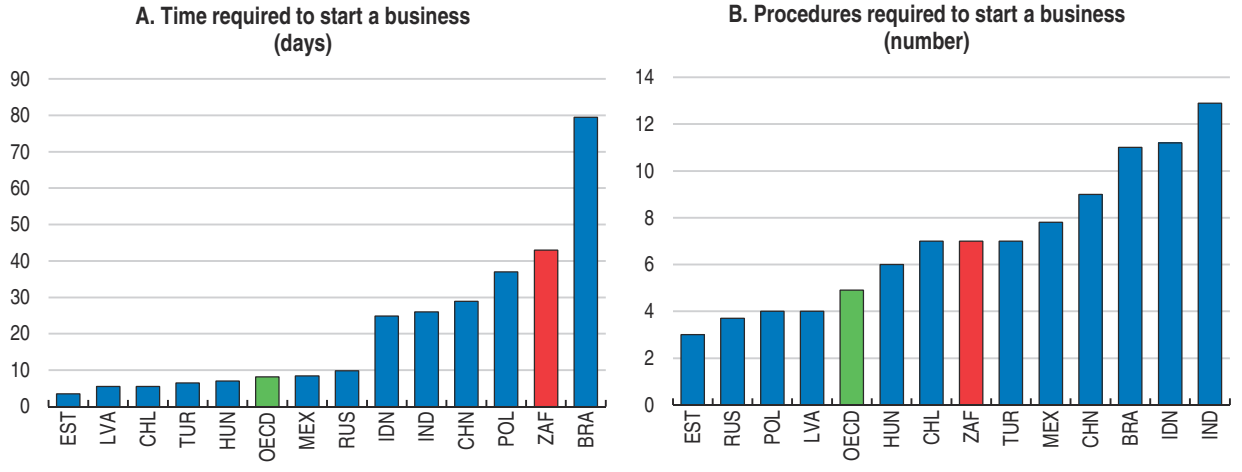
Figure 2.7. **Starting a business is slower than in many other emerging economies**



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

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occupational injuries compensation fund (although it varies with company risk) (World Bank, 2017). In Chile a similar procedure is done within a day. Likewise, other procedures such as getting construction permits, electricity and registering property are faster in other countries.

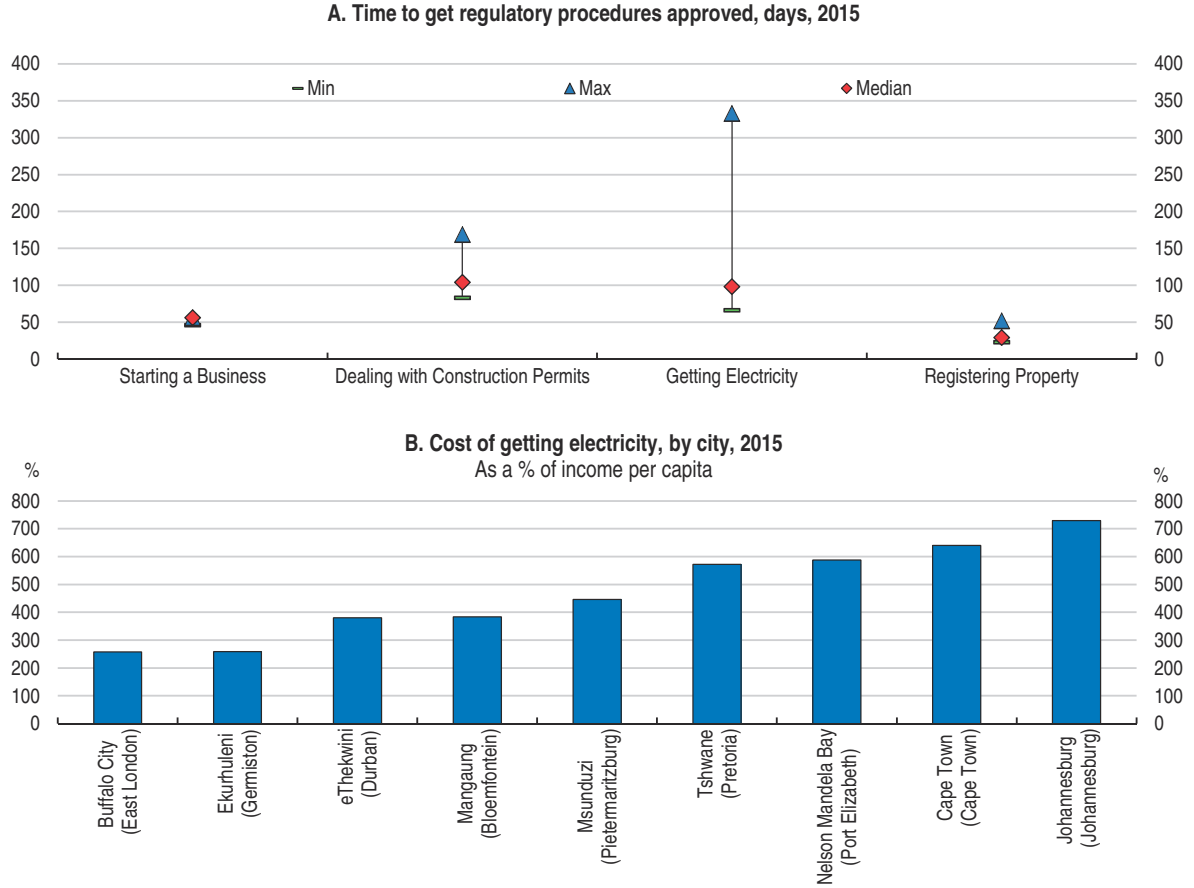
There are a number of initiatives under way to make it faster and easier to start a business. Automation of company registration means that it should now take one day to register a business at the Companies and Intellectual Property Commission. The government has worked with a private bank so that business registration happens at the same time as a company's bank account is opened. More steps could be joined up in this way. Information to register employees with the tax office and the insurance fund could be submitted once. Information should be shared between levels of government to reduce duplication. Chile and

Mexico have reduced each procedure required for start-up to half to two days, partly through effective use of technology such as secure e-signatures (OECD, 2017b).

The government will open investment facilitation one-stop shops in four provinces during 2017 and will expand these to all provinces over the next three years. The offices are primarily targeting foreign investors but should benefit small businesses. Entrepreneurs should be able to register a new business and apply for local and national government permits. The reach of the programme should be expanded through co-locating one-stop shops with other government offices, such as municipal offices. A virtual one-stop shop, or e-portal, should be created to accept applications and notifications and provide a single contact point with the government.

Provincial and municipal governments also add to difficulties in starting or expanding a business, with particularly wide variation in the time and cost of construction permits and getting electricity (Figure 2.8). Getting a business licence in Johannesburg, for example, requires an inspection and approval from five different departments. The government is working with the World Bank to use the variation in the Doing Business indicators in the largest municipalities to uncover best practices and facilitate peer learning through workshops. A similar approach between states (competitive federalism) in India has improved the business environment (OECD, 2017a).

Figure 2.8. **There is considerable variation in regulatory procedures across cities**



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

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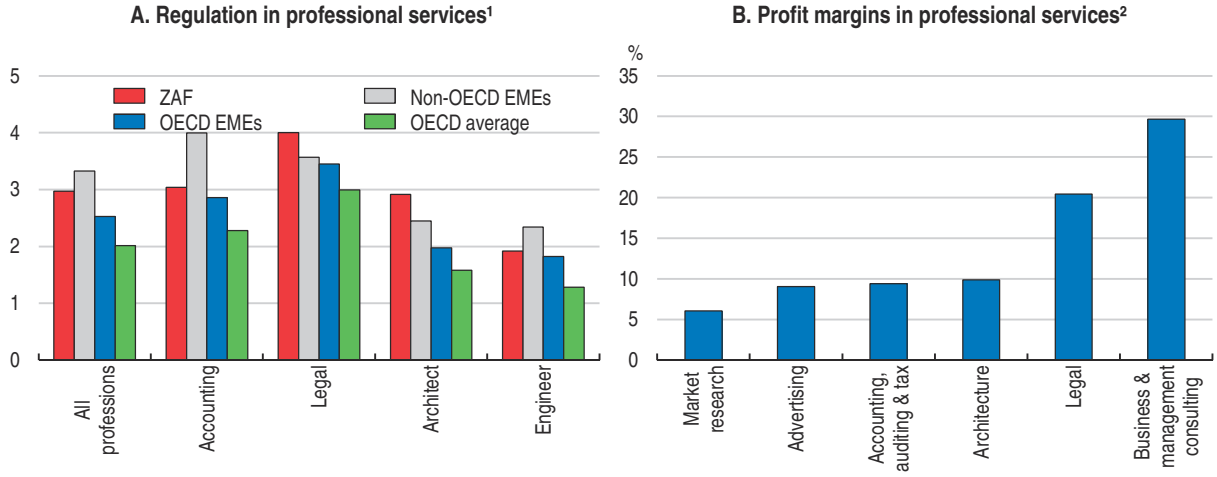
Industry-specific licences also harm entrepreneurship by creating a barrier to entry as well as adding to costs for firms. Such regulation usually aims to correct market failures and achieve other objectives such as consumer protection but can often be excessive (Box 2.1). For example, all tourist guides must complete an accredited course and then register as a guide in the geographical area and type of guiding on their certificate. Additional areas or types of guiding can only be added after another exam (at a cost) and recertification is required every three years. Lower levels of regulation could still provide protection to consumers.

Likewise, professional services are also highly regulated, particularly legal services (Figure 2.9; Box 2.2). Profit margins appear high compared to other professions suggesting that

Figure 2.9. **Some professional services are highly regulated**



1. Scores potentially range from zero to 6 and increase with restrictiveness. The emerging market economies are 5 non-OECD member countries (Brazil, China, India, Russia and South Africa, with varying coverage) and 5 OECD members (Chile, Hungary, Mexico, Poland and Turkey). Data are for 2013.
2. Net profit before interest and tax as a percentage of turnover in 2015.

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

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Box 2.2. **Regulation of legal services and examples of reforms**

Two market failures create a case for regulation of legal services: information asymmetries and externalities. **Information asymmetries** arise because the client cannot assess the quality of the services they are procuring beforehand ("experience goods"), if at all ("credence goods"). This can lead to adverse selection because sellers have an incentive to offer a substandard service at the average price (Canton et al., 2014). Negative **externalities** arise from low quality legal services that, for example, slow the process or result in sub-optimal decisions.

Some regulations are aimed at other policy objectives, such as addressing fairness considerations, ensuring that individuals in all regions of a jurisdiction can access legal services of a certain quality and at a certain price.

Regulation of legal services affects competition in South Africa in four ways:

- **Limiting the number and range of suppliers** through strictly regulated entry criteria (qualifications and training before admission), exclusive rights to certain tasks ("reserved work") and restrictions on sharing profits and offices with non-practitioners;

Box 2.2. **Regulation of legal services and examples of reforms** *(cont.)*

- **Limiting the ability of suppliers to compete** through minimum fees associated with a prohibition on undercutting the fees of another attorney or conveyancer;
- **Reducing the incentive of suppliers to compete** through rules that prevent attorneys from approaching the clients of other attorneys, effectively dividing up the market between incumbents; and
- **Restricting consumer choice and information** by setting limits on advertising.

Regulations may be contributing to higher prices and lower supply. There are 682 citizens per lawyer, compared to 401 in the United Kingdom (adjusting for people that cannot afford legal services) (McQuoid-Mason, 2013). Many law graduates practice in the government or as in-house counsel at large firms as they cannot afford the lengthy unpaid internships required to qualify as an advocate (barrister) or attorney of law.

Experience in other countries shows that regulatory reforms can improve competition and address market failures by improving quality:

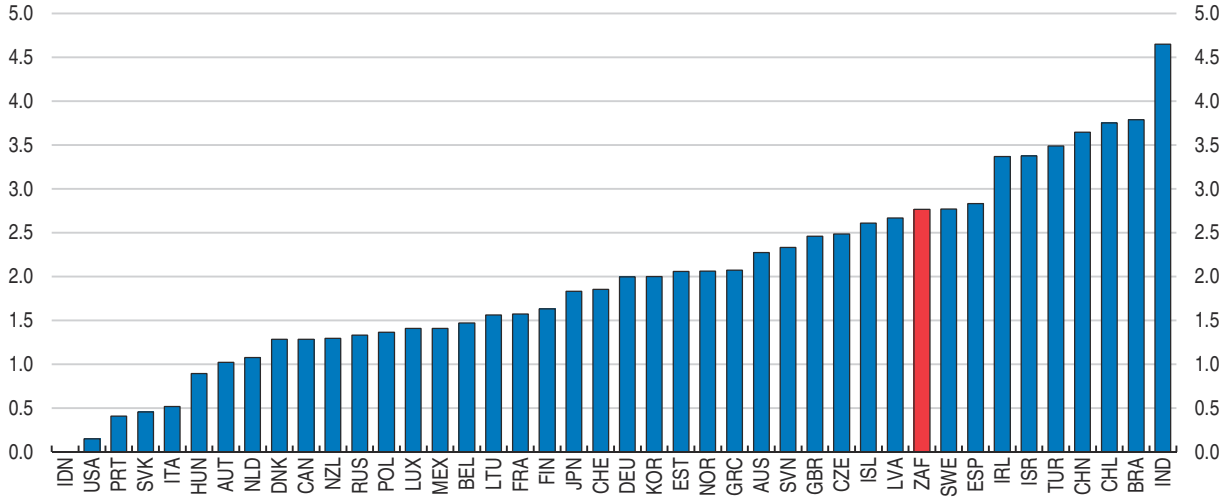
- In the United Kingdom reforms in 2007 aimed to enhance oversight, eliminate barriers to competition and innovation, and simplify regulation. The reforms established an independent regulator to oversee the self-regulatory bodies and an ombudsman for complaints handling. "Alternative business structures" were permitted to provide legal services with full or part-ownership by non-lawyers. Reported consumer satisfaction has risen, professional misconduct cases have decreased and "alternative business structure" firms have captured a significant revenue share of several areas of legal services and introduced innovations (Legal Services Board, 2016).
- In Australia regulatory limits on ownership structures for legal services firms were removed over 10 years. This permitted multidisciplinary partnerships and Incorporated Legal Practices (legal practices owned/managed by non-lawyers). By 2014 around one-third of solicitor firms were ILPs.

the limited competition may be creating rents. Shortages may be contributing to prohibitively high prices that limit entrepreneurs' and small businesses' access to these services (Herrington and Kew, 2016). The case for stricter regulation of professions than in other countries is not clear. Moreover, regulatory reforms can increase the quality of services and access. For example, innovation in legal services and greater supply of quality lawyers could reduce contract enforcement times and lower prices (Box 2.2). Allowing for new organisational forms of legal firms (e.g. allowing non-lawyers to partner with lawyers) and reducing exclusive rights of the legal profession could also increase supply and decrease costs.

A whole-of-government reform programme to reduce the administrative burden could boost confidence, start-up rates, formality and growth. This should focus on reducing the complexity of regulatory procedures (Figure 2.10). For instance, reducing regulation to best practice in three areas – licensing and permits (e.g. Portugal, Slovak Republic), communication and simplification of rules and procedures (e.g. Korea, Russia), and barriers in services sectors (e.g. Australia) – could boost GDP per capita by 1.1% over five years under certain assumptions (based on the framework in Égert and Gal [2016]). A reform package could include: i) "silence is consent" rules for licensing, including at sub-national level, where there is low risk to consumers and the environment; ii) a red-tape reduction programme and review of licensing of services as done, for example, in Mexico with the OECD Competition Assessment Toolkit; and iii) one-stop shops for start-ups and permits. These tools have helped OECD countries to

Figure 2.10. **There is scope to reduce the complexity of regulatory procedures**

OECD product market regulation sub-indicator, 2013



Note: Complexity of regulatory procedures is a component of the barriers to entrepreneurship indicators. Scores potentially range from zero to 6 and increase with restrictiveness. 2008 data are shown for Indonesia and the United States.
Source: OECD (2013), "Economy-wide regulation", OECD Product Market Regulation Statistics database.

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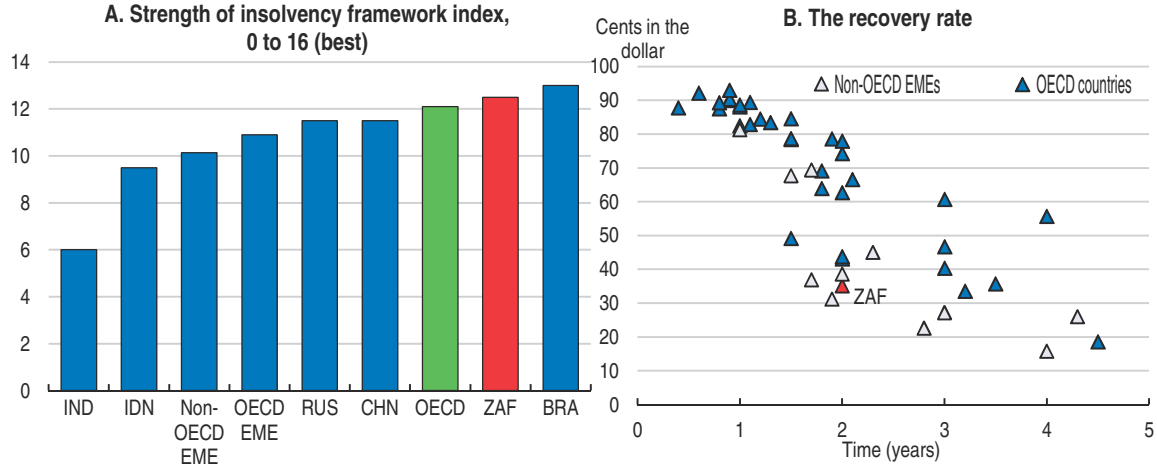
simplify administrative procedures (OECD, 2006). Countries such as Hungary and Portugal have used risk-based assessments to determine which licences are subject to the silence-is-consent rule and what the appropriate time limits are.

Regulations require systematic assessment, both before and after their introduction. A red tape impact assessment bill currently with the parliament goes in the right direction. A new Red Tape Impact Assessment Unit would review all new legislation and determine whether a full "red tape impact assessment" is needed. Since 2015 draft policies, legislation and regulations should undergo a Socio-Economic Impact Assessment (which was designed to be broader than regulatory impact assessments) but the quality has been uneven and there is no obligation to consider firm creation or small businesses. As highlighted in OECD (2015b), the approach should be clear and use uniform criteria to evaluate policies. The proposed legislation would also require all departments and self-regulatory agencies to evaluate existing regulation and reduce red tape by 25% over five years. Expertise could be concentrated and accumulated if the envisaged impact assessment unit was located in the Department of Planning, Monitoring and Evaluation, which is responsible for socio-economic impact assessments. Training should then be provided to boost capacity throughout the public administration. The Department could also be made responsible for driving a regular review of regulation.

Facilitating company restructuring and second chances for entrepreneurs

When business failure is costly, entrepreneurs may be less willing to start a firm or to experiment and investors may be less willing to supply risk capital, thereby reducing self-employment rates, start-up rates and firm growth (Armour and Cumming, 2008; Peng et al., 2010; Adalet McGowan and Andrews, 2016). On the other hand, insufficient protection of creditors would reduce access to finance. By reducing co-ordination failures and information asymmetries, an efficient insolvency regime reduces the cost of credit and facilitates business restructuring. South Africa has a strong legal framework for corporate insolvency (Figure 2.11,

Figure 2.11. **The corporate insolvency regime is strong but the recovery is low**



Note: The emerging market economies are 11 non-OECD member countries (Argentina, Brazil, China, Colombia, Costa Rica, India, Indonesia, Malaysia, Thailand, Russia and South Africa) and 5 OECD members (Chile, Hungary, Mexico, Poland and Turkey).
Source: World Bank, Doing Business database.

StatLink http://dx.doi.org/10.1787/888933552986

Panel A). However, insolvency is relatively slow, which pushes up costs and lowers the recovery rate (Figure 2.11, Panel B).

Recent OECD research has found that efficient insolvency regimes include a brief time to discharge, allowing creditors to initiate restructuring, having early warning mechanisms, using pre-insolvency regimes and special provisions for small businesses (Adalet McGowan et al., 2017a). Special provisions for small businesses include simplified procedures and out-of-court settlements. Promoting early warning systems would allow debtors to take action earlier and increase the likelihood of a successful restructuring. Systems could include online tests of business health, call centres, training and public centres. Reducing the involvement of courts by completing procedural steps out-of-court would ease the pressure on the judicial system and lower costs.

Recovery rates are higher in economies that use restructuring more often. Legislative changes in 2011 introduced business rescue, but the success rate of just 16% of proceedings started since 2011 suggests that this is still developing. Further efforts to increase take-up are needed, including addressing concerns that practitioners often lack skills, negative perceptions of the process and promoting earlier intervention (Deloitte, 2016). Changes to the licensing of professional services could raise the quality of practitioners. Improvements to the efficiency of the judicial system, perhaps with a specialised insolvency court to build expertise, could help to speed up the process.

Small business owners who guaranteed their insolvent business' debt would find themselves in the personal insolvency regime, which is widely regarded as pro-creditor (Boraine and Roestoff, 2013). It is a court-heavy process. The judge must consider if there is an "advantage to creditors" in declaring the person insolvent, which means the entrepreneur must repay some money to other creditors. After at least one year (depending on circumstances) the debtor can apply in the court for discharge ("rehabilitation"). Otherwise discharge occurs automatically after 10 years. Without discharge individuals are not eligible to open bank accounts or receive government grants. Personal insolvency is not available to debtors with no income or assets. The National Credit Act provides an alternative process for

restructuring debt but with no maximum time limit, which means that interest charges and fees can escalate (Boraine and Roestoff, 2013).

Legal reform has been planned since 1987 and is long overdue to modernise the system and better link it with the insolvency regime. Allowing debts of individual (honest) entrepreneurs to be discharged automatically after three years (as recommended in the European Union) should increase risk appetite and entrepreneurship. The system should be more holistic and give debtors with no income or assets rights to bankruptcy. Reforms to the personal insolvency regime in Ireland and Spain for example, have improved efficiency, lowered costs, and made it easier for individuals to re-enter the economy and "start afresh" (Adalet McGowan and Andrews, 2016).

Compliance with the tax system is costly

Taxes influence decisions about the size and structure of firms (OECD, 2015c). They also impose a larger compliance cost on small firms because of the fixed (time and financial) cost involved. South Africa has two special tax regimes for small businesses: a "small business corporation" regime for small firms with taxable income up to ZAR 20 million (USD 1.4 million) and a simplified turnover tax that was introduced in 2008 to reduce the compliance burden for microenterprises (with turnover up to ZAR 1 million). Self-employed workers (in sole proprietorships or partnerships) can also pay tax under the personal income tax system.

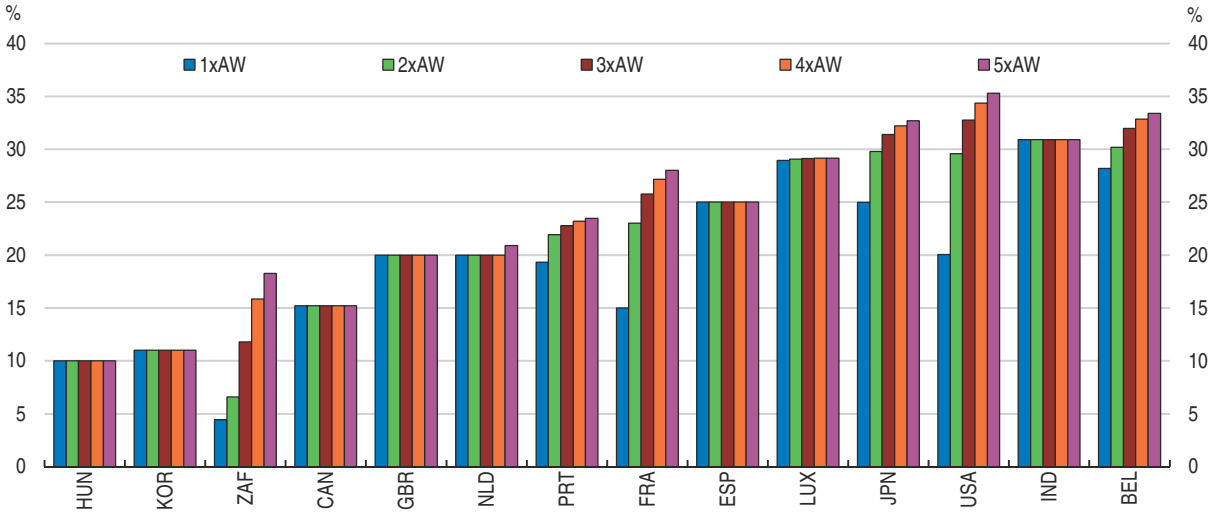
The "small business corporation" regime offers the same basic tax allowance as in the personal income tax system, with the first ZAR 75 750 (USD 5 166) of taxable income not subject to tax. Marginal tax rates increase progressively in increments of 7%, from zero up to the corporate income tax rate of 28%. The regime also provides for accelerated depreciation of assets. The turnover tax is a presumptive tax replacing corporate income tax, capital gains tax, dividend tax and value-added tax. Turnover above ZAR 335 000 (USD 22 800) is taxed at progressive marginal rates of 1 to 3%. Professional services activities are excluded due to concerns about tax evasion.

Compared to other countries, there are relatively large jumps in tax rates for small businesses when their taxable income grows above the thresholds (Figure 2.12). These can create disincentives to grow; there appears to be a disproportionate number of firms declaring taxable income just below both thresholds in the schedule (Boonzaaier et al., 2016). In addition, the depreciation allowance disadvantages young firms which are less likely to be profitable and more likely to be labour intensive. The Davis Tax Committee (2014, 2016) has been critical of the regime. One of the options in its final report was replacing the regime by a "refundable compliance rebate" to compensate small firms for compliance costs (or removing it and redeploying the resources, or retaining it). Alternatively, the scheme could be restricted to young firms, so that after a fixed period firms "graduate" to the standard regime (with measures to ensure firms do not game the system). Mexico's *Regimen de Incorporacion Fiscal* scales up income tax rates over 10 years and offers other non-tax support; although registration has increased it is too early to fully evaluate its success.

The compliance burden appears to be onerous. Paying taxes is comparatively slow (World Bank, 2017). Small businesses' filings are often late – 61% of small business company income tax filings were late in 2013/14 (SARS, 2015) – which may point to difficulties in compiling returns. A key source of burden appears to be the VAT and slow processing of VAT refunds (Smulders et al., 2012; DTC, 2016). Despite 55% of VAT refunds being paid within

Figure 2.12. **The tax rate on small businesses rises sharply with income**

Average statutory corporate income tax rate at different levels of business income (as a multiple of average wage), 2014



Source: OECD (2015), "Taxation of SMEs in OECD and G20 Countries", *OECD Tax Policy Studies*, No. 23, OECD Publishing.

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48 hours in 2015/16, the average length of time was 33 days (SARS, 2015). In Estonia, Finland and Ireland refunds take five working days or less (OECD, 2015d).

SARS has increased its assistance for SMEs with 138 small business desks at its branches and a call centre. These should be used to speed up filing and help resolve problems, which in turn would help more small businesses have tax clearance certificates (these certify that taxes are up-to-date and are needed to apply for tenders or grants). Allowing small businesses to use cash accounting could also ease the strain on cash flows caused by differences in timing between VAT liabilities and the receipt of the income (OECD, 2015c). Greater use of technology could also simplify processes and lower costs. Recent changes to issue tax clearance certificates electronically are welcome. SARS should continue to expand its education and assistance to build capability and encourage compliance.

The informal sector needs special treatment

The regulatory approach to the informal sector was strict under apartheid and subsequently when it has been seen as a threat to formal employment (Fourie and Kerr, 2017; OECD, 2008). However, regulation itself is a driver of informality: a firm that is deciding whether to formalise will compare the costs and benefits from being formal to those from being informal (including the probability of detection and its penalty) (Andrews et al., 2011). A survey of small businesses in South Africa's Free State province found that many businesses cope by engaging in informal practices (31.5% of respondents) or avoiding growing (25.6%) (Christensen et al., 2016).

Simplifying and reducing start-up and licensing procedures would lower barriers to formalisation; in Mexico and Peru faster firm registration resulted in higher rates of registration (Bruhn, 2008; Mullainathan and Schnabl, 2008; Djankov, 2009). The turnover tax aimed to increase formalisation but it has not been as successful as hoped. The Davis Tax Committee recommended that a voluntary disclosure programme be implemented for the tax to allay fears of incurring liabilities for past years and that moving in and out of the turnover tax be more flexible (DTC, 2014, 2016). Clear benefits should accompany

registration, for instance assistance with tax and book-keeping. In Brazil, non-tax-related incentives appear to have contributed to formalisation and take-up of its turnover tax. Ongoing costs of being formal should also be credibly reduced. For example, penalties for honest mistakes in tax returns could be removed or lowered and the tax office could work more closely with small firms to resolve tax debts.

While informality represents a loss of efficiency, the informal sector is a type of second-best outcome where barriers in the formal economy are high, especially due to regulations, or as a buffer in an economic downturn (Andrews et al., 2011). It can also play a role in poverty reduction. Recognising this, the Department of Small Business Development is working on a way of licensing informal retailers to trade at provincial offices rather than needing to formally register with the company's office. Lower licensing requirements could be considered outside of metropolitan areas. The Department is also offering business support services to informal businesses, which may help to build a pipeline of firms to formalise.

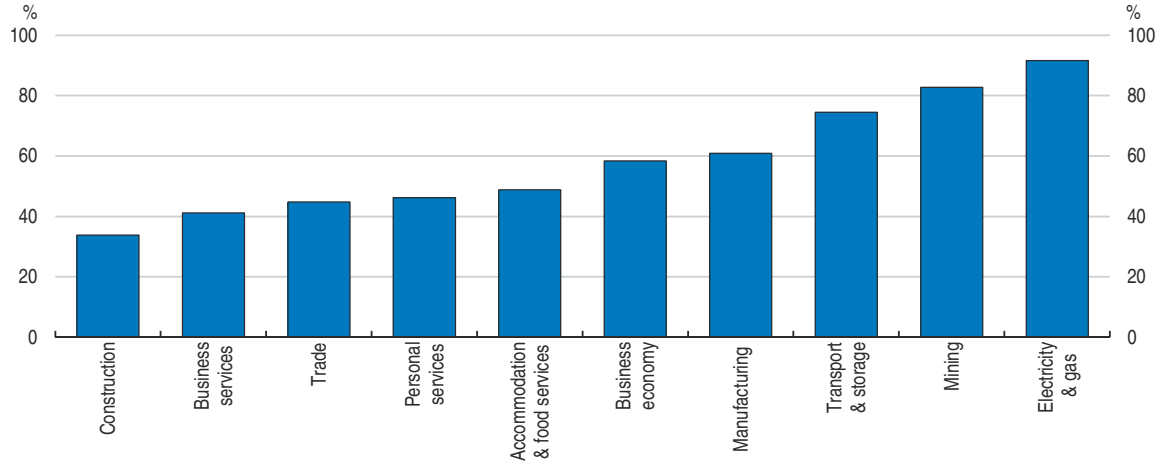
Overcoming barriers to markets

The concentrated structure of the South African economy makes it difficult for small firms to enter some markets and compete. This is partly because large incumbents are able to take advantage of economies of scale and scope. Unsurprisingly, large firms dominate capital-intensive industries like utilities and mining (Figure 2.13). However, large firms also account for half of industry turnover in trade. Vertically integrated firms have created barriers to distribution networks in the beer industry and supermarkets (Matumba and Mondliwa, 2015; Das Nair and Chisoro, 2016). More recent evidence shows that entry rates are lower and concentration ratios higher in industries with a higher share of large "uncompetitive survivors" (Box 2.3).

As highlighted in the 2015 *Economic Survey*, competition policy must play an important role in facilitating access to markets for entrants (OECD, 2015b). The degree of regulatory protection for incumbents could also be lowered in industries like utilities, such as gas and

Figure 2.13. **Concentrated industries are more capital intensive**

Turnover share of large firms (250 or more employees), 2012-14 average



Source: Based on Tsebe et al. (2017), "Firm dynamics in South Africa", forthcoming.

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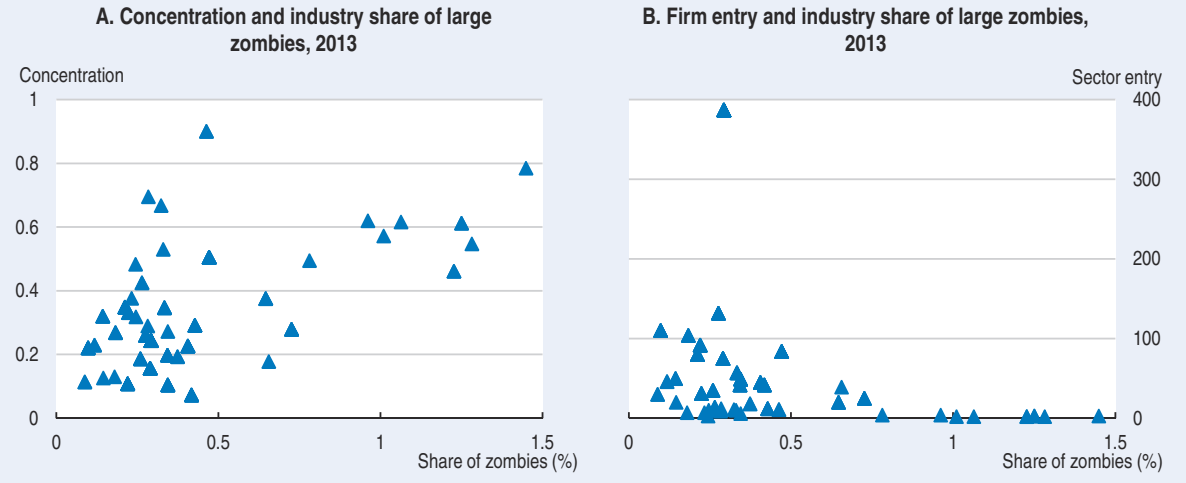
Box 2.3. **Are zombie firms weighing on firm creation and growth rates?**

Recent evidence from 13 OECD countries has highlighted the role of "zombie firms" in depressing productivity growth and raising barriers to entry, where zombies are firms that would exit in a competitive market (Adalet McGowan et al., 2017b). A higher share of industry capital sunk in zombies is associated with lower investment and employment growth of non-zombie firms, especially young firms. Zombies raise the required productivity of entrants by lowering prices and holding up wages.

The new firm-level panel dataset (Pieterse et al., 2016) permits the study of zombie firms in South Africa. Zombie firms as defined as old firms (aged 10 years or more) whose operating income does not cover their interest obligations for two of three consecutive years (the OECD paper uses three years). The analysis suggests that:

- Zombies firms are less prevalent than in the OECD sample (1.5% versus 6%). Large zombie firms (100 or more employees) account for 0.25% of firms.
- Zombie firms are using a larger share of capital (property, plant and equipment) than in the OECD sample (33% compared to 20%).
- The share of zombie firms increased between 2010 and 2014, from 0.5% to 1.5%.
- The share of capital in large zombie firms has risen from 1% to 33%.
- The share of labour in zombie firms (and large zombies) has risen from1% to 5%.
- Large zombies are most prevalent in mining, transport and storage, and food services and accommodation. Sectors with a higher share of zombie firms have: lower investment growth (albeit weakly); higher levels of concentration; and fewer new entrants (Figure 2.14).
- Zombie firms are on average less productive than non-zombie firms.

Figure 2.14. **Large zombie firms may be adding to barriers to entry**



Note: Concentration ratio measures market share of top four firms by sector using all firms. Large zombies have 100 or more employees.
Source: National Treasury calculations base on the SARS-NT dataset.

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Further work is needed to understand the causal relationships. Unlike in OECD countries, market power may be more important in creating entry barriers than the effect of zombie firms on lowering prices. Moreover, zombies may be more common in sectors protected by entry regulation, which generates the associations in the data.

Note: This box is drawn from work by Aalia Cassim and Mulalo Mamburu at the National Treasury of South Africa.

electricity, transport and telecommunications. Simplifying government incentive programmes so that small businesses do not need to hire consultants to prepare an application would improve small businesses' access to these incentives (Roberts, 2016). Ways of increasing access to public procurement and private supply chains, as well as encouraging new markets, are discussed below.

Public procurement is an underused tool to grow small businesses

Public procurement, which represented 12% of government spending in 2014, is an opportunity for small businesses. Most OECD countries use special measures to ensure that small businesses can access these opportunities (OECD, 2013b; Horowitz, 2012). South Africa uses preferential public procurement to economically empower disadvantaged groups, which include small businesses.

The system has been undergoing significant change. Until recently, the primary tool was a Broad-Based Black Economic Empowerment (B-BBEE) scoring system that favours black-owned businesses. All government suppliers must have a B-BBEE certificate. The B-BBEE score itself has a 10-20% weight in the tendering process (price has the other 80-90%). Changes in 2015 made it easier for micro-enterprises to get a B-BBEE certificate and points and gave more B-BBEE points to suppliers that invest in enterprise and supplier development. Suppliers were to get additional points from using better rated suppliers themselves but this has been postponed.

From 2017 preferential procurement is more strongly targeting micro-enterprises and black-owned small businesses. From April 30% of every large contract (under ZAR 30 million or USD 2 million) must be sub-contracted to these firms where feasible. Procuring agencies can further restrict the sub-contracting to black-owned firms, or even more narrowly within this group to firms owned by youth or women or other disadvantaged groups. Agencies can also use pre-qualification criteria to restrict tenders to targeted groups.

The current system provides benefits to small businesses and young firms but also imposes costs. Firms with turnover below ZAR 10 million or younger than one year can receive a B-BBEE certificate by submitting an affidavit. This allows them to supply to the government and is intended to make them more attractive to suppliers of the government. However, to be a "Qualifying Small Enterprise", small firms (turnover up to ZAR 50 million) that are not majority-black owned must comply with the scorecard elements, which can be costly, and engage an accredited verification agent annually.

The additional compliance burden for Qualifying Small Enterprises relative to micro-enterprises creates a strong incentive for firms to remain below the turnover threshold. However, micro and small firms benefit from the incentive for large firms to invest in enterprise and supplier development programmes. Survey data indicate that 40% of established SMEs were not rated and 70% did not supply to government, suggesting that the benefits may not be outweighing the costs of registration (SAICA, 2015). Indeed, in another survey, 76% of SMEs did not agree that B-BBEE leads to enterprise growth (ILO, 2016). Easing certification for small firms and exempting young firms for a longer period (e.g. five years) would soften the threshold effects and ensure that the policy is not burdening firms during their most precarious years.

Many countries use set-asides for small businesses but these often apply to procuring agencies, which gives more flexibility. A number of factors suggest the abovementioned changes could currently be difficult to meet, including the relatively small size of the small

Table 2.2. **Overview of the B-BBEE Scorecard for Qualifying Small Enterprises**

B-BBEE element	Weighting	Summary of requirements	Required spending
Ownership	25 points	Voting rights and economic interest in company in hands of black people and black women	
Management control	15 points	Representation of black people and black women in executive and lower management	
Skills development	25 points	Must also submit skills plan, annual training report and pivotal report	3% of wage bill spent on learning programmes for black people and black women
Enterprise and supplier development	30 points	Target 60% of spend from "Empowering Suppliers"	1% of net profit after tax spent on supplier development and 1% spent on enterprise development
Socio-economic development	5 points		1% of net profit after tax spent on socio-economic contributions benefiting black people
Memo item: "Exempt Micro Enterprise"	100 points (with up to 35 bonus points if the firm is majority or fully black-owned)		

Note: The Broad-Based Black Economic Empowerment Act defines "Black people" as "Africans, Coloureds and Indians" who are South African citizens. "Empowering Supplier" status has been postponed. The "generic scorecard" is not shown here but contains stronger targets.

business sector, previous low rates of compliance with preferential procurement targets (just 25% according to Horowitz [2012]) and interaction with local content requirements. The recent digitalisation of procurement processes means that these changes can be monitored closely. Horowitz (2012) suggests that there is no difference in outcomes between countries that use set-asides and those using other support measures to achieve targets.

The recent introduction of supplier pre-registration is a significant step in reducing the compliance burden for micro and small businesses. Ways of improving access for small and young businesses include: further use of technology (e.g. putting all documents online and allowing for online submissions); limiting compulsory briefing sessions; simplifying forms; and simplifying and unbundling large contracts into smaller lots (when economies of scale are less important, and still subjecting the bid to a competitive tender). Awareness and supplier training should be expanded across the country. Outcomes should be published to increase accountability against targets.

Improving payment times and the technical capacity of departments to comply with mandated payment times should be a priority. In 2015/16 45% of the 457 departments and public entities were not meeting the 30-day payment rule and 13% took over 90 days to pay suppliers (Auditor-General of South Africa, 2016). Cash-flow problems and poor financial management were the main cause. The SMME Late Payment Hotline and website for reporting late payments have helped reduce late payment. Additional steps should be introduced to deter late payment, for example withholding payments to late-paying entities, providing for automatic accrual of interest on overdue payments, or the Treasury paying the supplier and taking on the debt. In the European Union, interest accrues automatically after 30 days, or after 60 days in exceptional circumstances. The National Treasury and the Department of Planning, Monitoring and Evaluation should provide more technical assistance to other departments, public entities and sub-national governments.

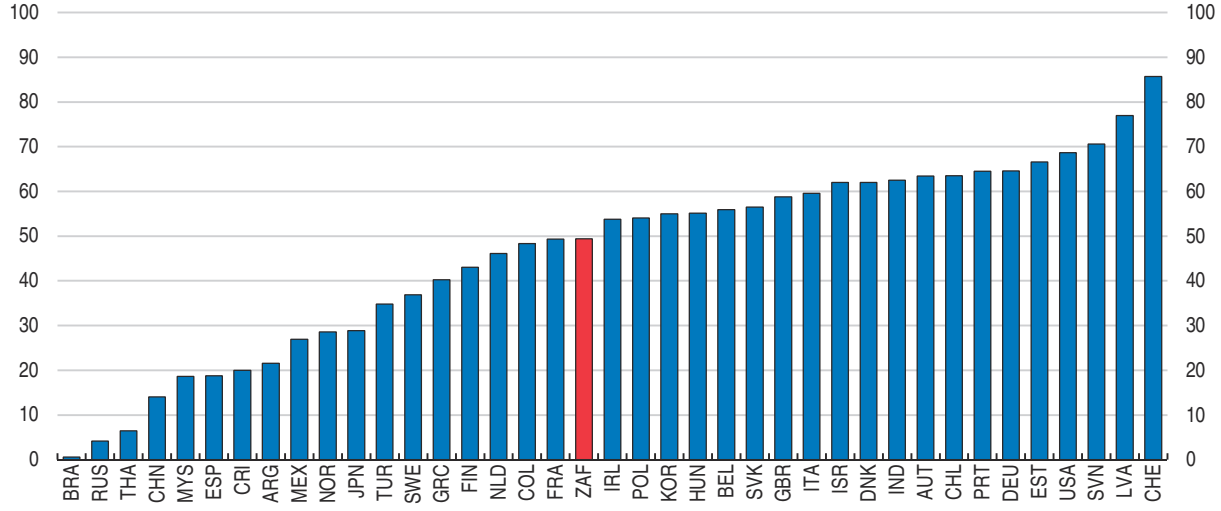
More information is needed to understand the effects of the preferential procurement policy. The combination of the many objectives and requirements risks unintended negative consequences. The recent changes should be reviewed after six months to assess the effects on competition, participation of target groups, firm growth and other costs and benefits so that adjustments can be made accordingly. A full impact evaluation of the preferential procurement framework would also be useful to ensure that the benefits were offsetting costs.

Engaging small firms in export and supply chains

Exporting provides growth opportunities for small firms to overcome a lack of domestic demand, scale up to achieve economies of scale and innovate based on learning. The 2012 Global Entrepreneurship Monitor data suggest that around half of all established business owners had foreign customers, putting South Africa in the middle of OECD and emerging market economies (Figure 2.15). But their share of total exports is small: goods exports of small and medium firms accounted for just 6.7% of total goods exports over 2010-14 (Anand et al., 2016). SMEs that export are more likely to export to Sub-Saharan Africa (91% of their exports), whereas large firms' exports are more spread around major markets (Anand et al., 2016). This is consistent with patterns found in Europe, where exports by SMEs also tend to be to nearby countries (OECD, 2016a).

Figure 2.15. **Many South African entrepreneurs export**

Percentage of surveyed established business owners with customers outside of the country, 2012



Source: Global Entrepreneurship Monitor database.

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Lowering financial and non-financial costs of trade can disproportionately benefit small entrepreneurs. Although South Africa compares favourably against many countries in relation to trade facilitation measures, fees and documentation could be lowered further. In South Africa, border compliance associated with exporting takes 100 hours to complete, compared to 49 hours in Brazil or 20 hours in Mexico (World Bank, 2017). Better transport infrastructure and more competitive pricing would considerably lower transport costs (OECD, 2015b). Since small businesses are more likely to export to neighbours, steps to deepen regional integration, as proposed in Chapter 1, should disproportionately benefit small business.

Exposure to supply chains can also be indirect. In Nordic countries, SMEs that are not part of a larger business group are most likely to participate in value chains by supplying SMEs that are part of a larger group or large firms (Statistics Denmark/OECD, 2017). Facilitating the establishment of small businesses in exporting clusters, through subsidised infrastructure provision for example, could help them to integrate into value chains and benefit from knowledge transfer. The 2017 African Economic Outlook also points to the potential for clusters to enable SMEs to grow through economies of scale, labour pools and agglomeration benefits (AfDB/OECD/UNDP, 2017).

Technology is increasing information and access to markets

Technology is also helping firms reach new markets. According to WTO (2016) all South African e-bay-enabled firms exported, and exported to 29 different destinations. Technology also offers new ways to disperse information about destinations as well as how to start exporting. Government agencies should increase their web presence and promote links to support programmes offered by other organisations (OECD, 2009). A 2014 review of the government's Export Marketing and Investment Assistance Scheme found that most beneficiaries surveyed were micro-enterprises or small but almost one-third of firms reported no exports (DNA Economics, 2014). Another model of increasing information for small business is Finland's public-private partnership with chambers of commerce and exporter groups.

Disruptive innovations have also created new markets in ride-sharing and short-term accommodation, for example. Crowdsourcing solutions or parts of the product development process also help start-ups and small businesses achieve scale, as well as providing a business opportunity to another entrepreneur. They allow people to exploit existing assets, such as cars and housing, or their skills. The platform or app can remove the need for a physical business location. By lowering barriers to entry, these activities have the potential to generate more inclusive job creation through self-employment and business start-up, as well as spur innovation.

These new forms of markets bring challenges for policy-makers including: difficulty in distinguishing between the self-employed and employees, issues of fair tax treatment of incumbents and entrants, and ensuring that regulation remains competition-friendly. Countries appear to be experimenting with different approaches. Belgium has recently introduced an advantageous tax regime for peer-to-peer services providers, which includes an arrangement to tax the income at the source (the platform) (OECD, 2017b). Australia's approach to regulation has been to watch developments but then react quickly (OECD, 2017c). In South Africa, as in other countries, some of the regulations are the responsibility of sub-national governments. Forums for local regulators to share experiences would facilitate the identification and dissemination of best practices.

Growing entrepreneurial competencies

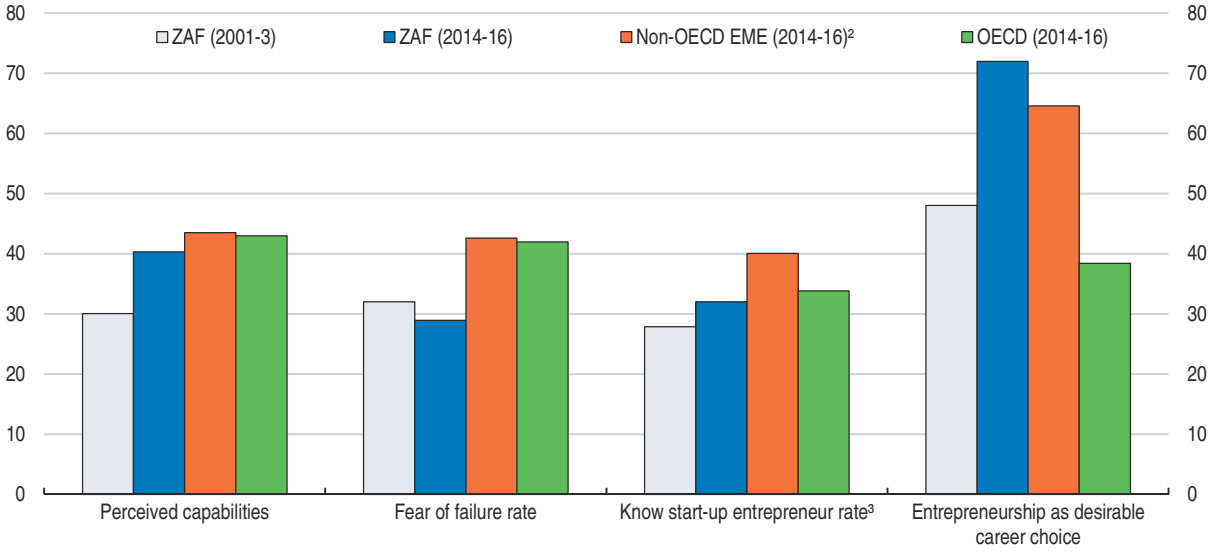
Entrepreneurial competencies – skills, knowledge and attitudes – are associated with a higher rate of entrepreneurial activity and better firm performance. Higher education levels are associated with a higher propensity to be involved in planning or starting an opportunity-based business in South Africa, as elsewhere (Annex 3; Ardagna and Lusardi, 2010; Naudé et al., 2008). Likewise, education is associated with more successful businesses. This is partly because good managers make good decisions about which inputs to use and raise productivity of resources using new and better techniques, maintaining equipment and marketing (Bruhn et al., 2010; OECD, 2015a; Bloom et al., 2012). In South Africa, better-

performing informal firms have higher managerial capital (owner's education and age) and better practices such as keeping financial accounts and commercial premises (Ligthelm, 2012; Fourie and Kerr, 2017).

Entrepreneurial competencies include learned knowledge such as accounting and technology, as well as skills such as resource management and strategic thinking, and attitudes like self-belief and tolerance of uncertainty (Lackéus, 2015). These competencies can be acquired through formal learning and also work experience; however, this can be difficult in South Africa. Access to education expanded enormously in the past two decades but its quality is unequal, as discussed in the *Assessment & Recommendations* and 2013 *Economic Survey*. After school, access to work experience is constrained by the lack of jobs, indicated by the youth unemployment rate of 53% on 2016. Vocational education does not provide students with sufficient work experience, partly due to a shortage of places (OECD, 2017d). Nonetheless, the share of South Africans knowing an entrepreneur has risen, as have self-perceived skills (Figure 2.16). Both factors are determinants of entrepreneurial activity (Ardagna and Lusardi, 2010; Annex 3).

Figure 2.16. **Attitudes have become more entrepreneurial**[1]

As a percentage of the population aged 18-64 years



1. Perceived capabilities: those who believe they have the required skills and knowledge to start a business; Fear of failure rate: those perceiving good opportunities to start a business who indicate that fear of failure would prevent them from setting up a business; Know start-up entrepreneur rate: those who personally know someone who started a business in the past two years; Entrepreneurship as desirable career choice: those who agree with the statement that in their country, most people consider starting a business as a desirable career choice.
2. Non-OECD EME is the average of: Argentina, Brazil, China, Colombia, Costa Rica, India, Indonesia Malaysia, Thailand, Russia and South Africa.
3. Data for 2016 are not available.

Source: Global Entrepreneurship Monitor.

StatLink http://dx.doi.org/10.1787/888933553081

The formal education system needs to perform better

The priority is to increase the quality of education to raise basic skills – maths, literacy, and problem solving – as discussed in other OECD studies (2013a, 2017d). This requires raising the quality of teaching, funding for disadvantaged schools and monitoring outcomes (OECD, 2017d). Raising the secondary school graduation rate – currently the lowest in the G-20 – would also facilitate access to post-school education.

The school system can also support entrepreneurship by providing knowledge related to entrepreneurship and encouraging an entrepreneurial mindset (Lackéus, 2015; OECD, 2010a). Facilitating employer talks, career fairs or job shadowing for secondary school students could be cost-effective ways of providing exposure to the business environment and assisting with career decisions (Kashefpakdel and Percy, 2016; Larson, 2012; OECD, 2010b). This would especially benefit students from disadvantaged backgrounds who lack knowledge about the labour market.This could be piloted initially. Technology can be used to lower the cost of participation; in the United Kingdom a secure platform, "Inspiring the Future", is used to connect schools and colleges with volunteers from a range of professions who donate one hour per year. Changes to the curricula are difficult given the strains on the school system but a first step would be to make business subjects in secondary school more practical as they are generally theoretical (Osiba Management, 2013). Schools could also partner with local businesses to offer extra-curricular activities; after-school training in starting a business has been linked to higher start-up rates (Schøtt et al., 2015).

The vocational education system can also support entrepreneurship. Reviews of the colleges consistently point to the need for stronger links with businesses to increase the relevance of the course content, teachers with practical experience and availability of internships and work placements (Field et al., 2014; OECD, 2017d; Osiba Management, 2013). Entrepreneurship education should also be included in all courses. To increase availability of work placements, awareness of the learnership tax incentive for firms could be raised. Simplifying the procedures associated with applying for funding under the skills development levy could increase the availability of training places (OECD, 2017d). Administrative assistance could be given to small businesses. Better preparing youth for apprenticeship and providing support during the apprenticeship may help raise completion rates and encourage employers' participation (Kis, 2017).

South Africa's universities are fostering entrepreneurship to varying degrees. Some universities have begun integrating elements of entrepreneurship education into their curricula and teaching methods; however, many courses remain theoretical. Centres for entrepreneurship are emerging and conducting a range of activities, including start-up weekends and competitions. Some universities have also created incubators providing seed funding, links to the private sector and a supportive environment. To be most effective, products should not be protected from market forces for too long and rules about intellectual property ownership should be clear. Funding could be increased for strongly performing centres. A forthcoming "situational analysis" by the Department of Higher Education and Training will help to identify lessons and extend good practices. A council could be established to facilitate sharing of experiences with entrepreneurship education, or the Department could play a co-ordinating role.

Second-chance schemes and work experience would help youth

Self-employment is seen in South Africa and some European countries as a way of overcoming high youth unemployment. In South Africa one-third of 15-24 year olds – over 3 million young people – is not in employment, education, or training. The challenges for this group to becoming self-employed are larger than the rest of the population due to a lack of information about entrepreneurship as well as human, social and financial capital (Green, 2013). If they do start a business, it will more likely be in a sector with low entry costs (which is therefore competitive) and be undercapitalised, which raises the risk of failure.

Given the concerns about the quality of basic education and the observed links between start-up, age and experience, investing in up-skilling youth should boost their success later. Second-chance programmes to return to the education system are part of the solution. Community colleges (formerly Adult Education and Training Centres) offer a range of courses including basic literacy and numeracy and the possibility of sitting the matriculation (final year) exams. The programmes should be monitored, adjusted as needed, and sufficiently resourced to ensure their effectiveness.

The links between entrepreneurship and knowing an entrepreneur (and employment) point to the need for policies that offer work experience. The learnership tax credit and employment tax incentive (a wage subsidy) are designed to increase access to work-based training and a first job, respectively. These were recently extended to 2019 and 2022, respectively. Increasing the work experience component in school, university and relevant community college programmes could also be useful but may require stronger incentives for employers to participate. Local governments could support the formation of social networks for those from more disadvantaged backgrounds by providing infrastructure and platforms in disadvantaged areas.

Programmes for enterprise development have been expanded

International evidence suggests that the most effective elements of entrepreneurship and small business programmes have been business training and business development services but there is a wide variety (Grimm and Paffhausen, 2015; McKenzie and Woodruff, 2012; Green, 2013). In South Africa six national departments and agencies offer a range of enterprise development programmes that incorporate elements of training and support services and target different groups of entrepreneurs. Programme goals vary, including encouraging unemployed youth into self-employment and a Gazelles programme for small businesses with high growth potential. Most programmes target historically disadvantaged groups. The subject matter also varies considerably, from financial literacy and basic accounting to marketing, to quality standards. Provincial and municipal government also run programmes, as do a range of non-governmental programmes, including those run by the private sector in line with enterprise development targets of the B-BBEE accreditation system and sectoral charters.

Although there is a range of programmes targeting many types of entrepreneurs, these are not co-ordinated. Experts raise concerns that the programmes are too dispersed, not being delivered competently and are not effective (Table 2.2) and capacity is being spread too thinly. Under-resourcing may also be an issue; it appears that less than 0.5% of GDP was spent on the programmes in Table 2.2. According to Gallup survey results, in 2013 around 30% of South Africans believed they had access to training on how to start or grow a business, compared to 45% in the average OECD country (OECD, 2016a). There seems to be a lack of awareness of support among small businesses (SBP, 2014). Although numbers of participants are monitored, impact evaluations are rare. But past evaluations point to the need to evaluate, refocus and streamline programmes (World Bank, 2007).

The Department of Small Business Development plans to review government programmes. But given its resource constraints, an evaluation could be carried out by the Department of Planning, Monitoring and Evaluation. An independent review, such as an OECD Review of Business Development Services could help by providing the information needed for the Department of Small Business Development to refocus the programmes and ensure value-for-money. Programmes should be rationalised with a focus on delivering

Table 2.3. **Summary of key government training and development programmes**

Non-financial programmes

Business stage	Informal survivalist	Start-ups	Growing micro, small and medium sized businesses	High-growth firms
Training				
Business skills development and training	X		X	X
Mentoring and coaching	X		X	X
Product/process/standard improvement	X		X	X
Business development services				
Information provision	X	X	X	X
Business plans and strategy		X		X
Marketing/sales/customer care	X		X	X
Facilitating access to funding		X	X	X
Facilitating market access and readiness			X	X
Supplier development			X	X
No. of national government departments	2	1	4	3

Note: The programmes use the term "Black" to refer to "Africans, Coloureds or Indians", who must be South African.

Table 2.4. **Average expert ratings for government programmes for entrepreneurship**

(2016, weighted average, 1 = highly insufficient, 9 = highly sufficient)

	Score
A wide range of government assistance for new and growing firms can be obtained through contact with a single agency	2.4
Science parks and businesses incubators provide effective support for new and growing firms	4.0
There are an adequate number of government programmes for new and growing businesses	4.2
The people who work for government agencies are competent and effective in supporting new and growing firms	2.9
Almost anyone who needs help from a government programme for a new or growing business can find what they need	2.1
Government programmes aimed at supporting new and growing firms are effective	2.7

Source: Herrington et al. (2017), GEM South Africa Report 2016/17: Can Small Businesses Survive in South Africa?

quality services. One way of increasing accountability for the programmes would be for the Department to receive all micro and small business-related funding and distribute it across the programmes, including those in other departments. Better co-ordination of programme delivery so that there were single contact points would help clients find and compare programmes. This would also stretch administrative capacity less thinly.

Scaling up support is a challenge given fiscal constraints and the size of the country. Some programmes have used training vouchers with approved providers to overcome capacity constraints. International experience shows that these can be useful if there are enough private sector services to overcome the government's capacity constraints. Mexico's SME Fund achieves scale by using intermediaries, including sub-national governments, universities and chambers of commerce.

Digitalisation can help achieve scale. Technology should also be used more to promote and deliver programmes. A virtual one-stop shop should provide information about support for SMEs and accept online applications for support programmes, as well as providing information on exporting and participating in public procurement, and accepting applications for licences and permits as discussed above. Outdated information should be removed from government websites. Two business schools offer free online courses (without certification). Online courses at lower levels could also be offered, taking care not to crowd out any private providers.

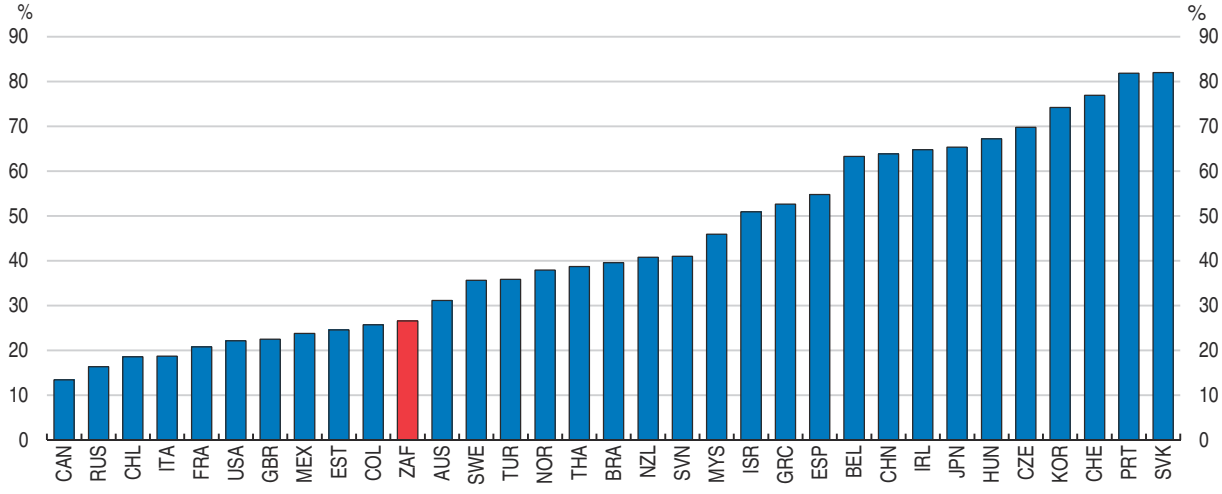
Due to the digital gap, this should be complemented by local options for access; only 52% of 18-34 year-olds used the internet "at least occasionally" in 2015 according to the Pew Global Attitudes Survey. The South African Revenue Service provides one model solution: individuals may submit tax returns electronically at a branch with assistance. Similarly, local offices could provide assistance and access to computers and wifi to take training.

Broadening financing options

As in other countries, South African firms tend to use savings and funds from family and friends in the start-up phase and then debt financing as the firm expands. Despite South Africa's well-developed banking sector and liquid equity market, the GEM expert survey suggests SMEs' access to debt and equity is more difficult than in many emerging market and OECD countries. Finmark Trusts's 2010 survey finds that 87% of small formal-sector firms had never accessed credit (partly through choice). Firm-level surveys suggest that access to finance is more of a problem for very small and informal firms (ILO, 2016) and for young firms (SBP, 2014). The GEM survey found that "problems with finance" led to 28% of firm exits in 2016 (second after profitability), compared to 20% in non-OECD emerging economies and 11% in the OECD (Kelley et al., 2016).

According to the Banking Association of South Africa, 13 banks operate in the SME space. SME lending is a small share of banks' business lending and has been steady at around 11% of total exposures since 2008, despite government efforts (Figure 2.17). One reason may be a response to the increase in impairment rates after the 47% expansion of unsecured retail lending (including to SMEs) between 2010 and 2012 (IMF, 2014). But information on the terms on which firms borrow from banks, rejection rates or credit conditions is not available. Nor are data on non-bank lenders' activities. Gathering this information is crucial for effective policy-making (G20/OECD, 2015). The Reserve Bank or National Credit Regulator should publish effective lending rates or indicator rates for small business loans, which would allow borrowers to compare offers.

Figure 2.17. **SME lending is relatively low**



Note: Definitions differ across countries. Data for South Africa are for 2016.
Source: South African Reserve Bank; OECD (2017), *Financing SMEs and Entrepreneurs 2017: An OECD Scoreboard*; OECD calculations.
StatLink http://dx.doi.org/10.1787/888933553100

The main government agency tasked with improving access to finance for small firms is the Small Enterprise Financing Agency (SEFA), which was created in 2012, subsuming other funding programmes. In 2015, it moved to the DSBD. Its financing programmes comprise a loan guarantee scheme, wholesale finance aimed at supporting microfinance institutions and direct unsecured lending. However together these are small, totalling 0.03% of GDP in 2015/16. Numerous other government bodies also provide financial assistance to young and small firms, many of which target disadvantaged sub-groups, but these are also small. A welcome development is a new website sponsored by the DSBD, SEDA and USAid that acts as a database for available sources of finance as well as providing information about accessing finance.

Table 2.5. **Financing programmes targeting start-ups and small businesses**

Institution	Description	Criteria group
Department of Small Business Development	Grants for survivalist entrepreneurs	Informal businesses.
	Cost-sharing grants for capital investment and skills development for growing small businesses	Majority black-owned and managed
Department of Trade and Industry	Grants for start-up and growing small businesses Four programmes with reimbursable cost-sharing grants aimed at broadening participation Two programmes with cost-sharing grants for investment in specific services industries Two programmes with cost-sharing grants for R&D and innovation	Historically disadvantaged individuals and youth
	Various types of loans for start-up and expansion	Women
Department of Human Settlements	Bridging loans to contractors with government contracts to supply subsidised/affordable housing	Historically disadvantaged individuals
Industrial Development Corporation	Grants for development at seed and start-up phase	Youth
	Loans for seed and start-up phase in renewable energy Long-term loans for SMEs	
	Equity and loans for early-stage innovative businesses	
Technology and Innovation Agency	Grants at seed stage for development of innovative technology with commercial potential in all industry	
National Empowerment Fund	Various types of credit for start-up and growing small businesses	Black-owned businesses
National Youth Development Agency	Grants to survivalist, start-up and growing small businesses	Youth
Small Enterprise Finance Agency	Various types of credit to small businesses at all stages of development, accompanied by some advisory services	
	Wholesale funding to financial institutions Credit guarantees mainly through banks	
Province-specific agencies	Four provinces have schemes providing loans to small businesses Kwa-Zulu Natal also provides other forms of credit	Historically disadvantaged individuals prioritised
National Treasury	Tax incentives for investing in venture capital funds and funds that finance SMEs	

Note: The programmes use the term "Black" to refer to "Africans, Coloureds or Indians", who must be South African. "Historically disadvantaged individuals" includes Blacks, women and disabled people.

Improving access to credit

Access to credit for young firms is limited by their lack of collateral, short credit history (or none at all) and (often) lack of skills to make a suitable application (Ayyagari et al., 2007; Beck et al., 2005; Herrington et al., 2017; OECD, 2016b). Most banks require collateral for lending. The increase in home ownership rates to 67% in 2013 has increased access to collateral but it is still limited by the unequal distribution of wealth. Clear property rights (with timely insolvency procedures) are crucial for lending markets; in rural areas, traditional areas and informal settlements this is a further challenge.

The government is investigating the feasibility of a national registry of movable assets, which would improve access to collateral. In Mexico a registry led to four-fold increase in

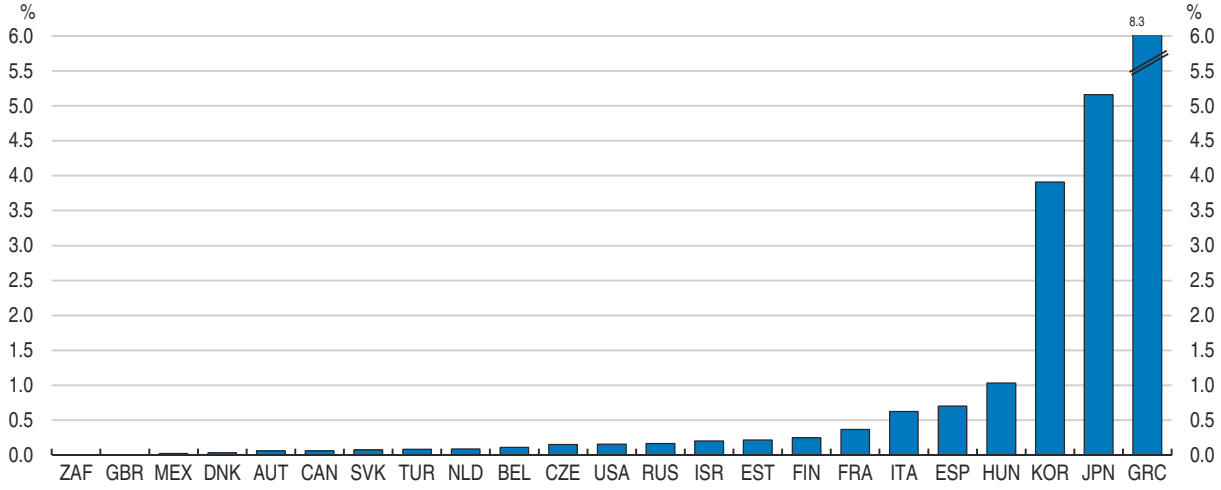
the number of business loans and a saving of USD 1.1 billion in fees associated with registering collateral (OECD, 2016b). The registry could also include intangible collateral, such as receivables and intellectual property. Experience from other countries points to the importance of strong contract enforcement for receivables-backed financing (OECD, 2015e). Another possibility is to support the sale of receivables (factoring). In India, the government is building an electronic trading platform for factoring and invoice discounting.

Improving the quality of information available to lenders would help them better assess risk, thereby lowering interest rates. Efforts by the industry body that receives data and transmits it to the 14 private credit bureaus (SACRRA) to improve data quality and harmonise reporting should be supported. Raising the quality of loan applications would also improve institutions' abilities to assess risk. Government physical and virtual one-stop shops could provide advice on the standard information for a loan application and where to get assistance on putting together a business plan.

Government loan guarantees are a standard policy tool to help overcome binding collateral constraints due to market failures by leveraging private sector expertise (OECD/European Union, 2014). SEFA provides loan guarantees to two banks and several non-bank lenders. However, the scheme is small – equivalent to less than 0.001% of GDP in 2015/16 – and lending fell by 90% from 2006 to 2013 (Figure 2.18). Some features of the programme may be limiting take-up; for example, SEFA assesses all applications from the banks, and customers must provide collateral, which can vary from 10-90%. Lack of awareness by potential borrowers and loan officers is also hampering the scheme's use. An alternative way of administering the scheme could be to first provide the guarantee without the lender, which is increasingly common in Europe (OECD, 2016c). Accompanying the programme with advice or other support could make the schemes more attractive to borrowers and lenders alike. The scheme should be expanded when it is working.

Figure 2.18. **Government loan guarantees are low**

Government loan guarantees as % of GDP, 2015 or latest



Note: Data for South Africa are all guarantees provided by SEFA to financial institutions at 31 March 2016.
Source: OECD (2017), *Financing SMEs and Entrepreneurs 2017: An OECD Scoreboard;* SEFA Annual Reports; OECD Economic Outlook database.
StatLink http://dx.doi.org/10.1787/888933553119

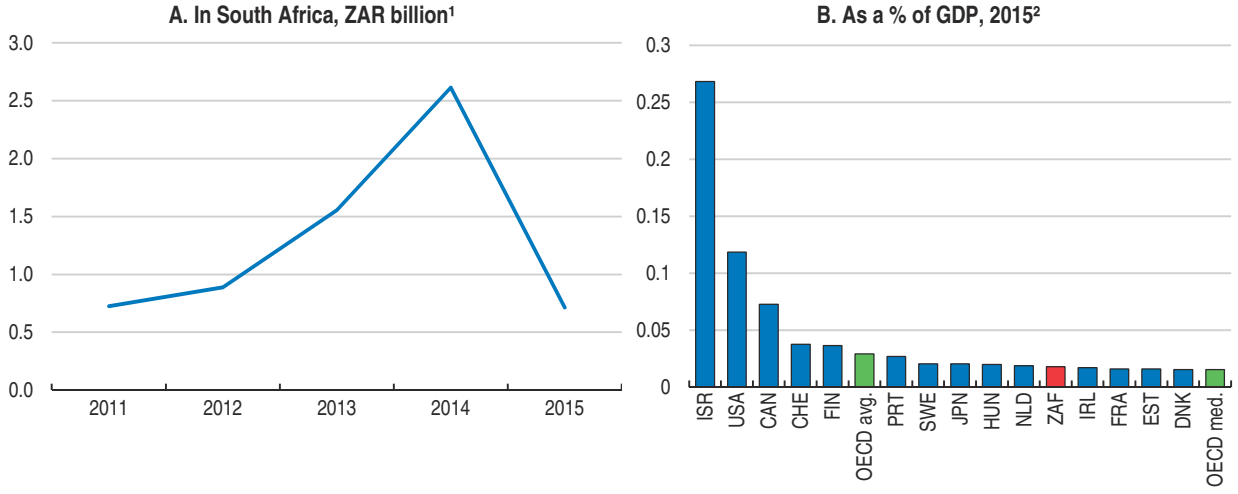
There are a range of other government soft loans and grants available for entrepreneurs and small businesses, particularly for disadvantaged groups. Yet 37% of SME respondents to an ILO survey believed it would be impossible to obtain finance from a government support institution, such as SEFA, and 47% thought it would be difficult (ILO, 2016). The current programmes duplicate efforts and spread capacity thinly. The impairment rates on SEFA's direct lending programme reached 67% in 2016 (SEFA, 2016). The suite of financing products available should be reviewed and streamlined to focus on programmes that are effective in promoting start-ups and firm growth. One of Start-up Chile's strengths is its regular reviews and adjustments to close gaps and reduce duplication, as well as the accompanying non-financial support (OECD, 2016b). Joining SEFA and SEDA could lead to more effective support.

Risk capital has expanded

Venture capitalists and business angels have an important role to play in filling the financing gap for young innovative firms where information asymmetries and screening and monitoring costs are higher and internal funds are lower (Wilson, 2015). Policy support for venture capital has been associated with firms in OECD countries receiving financing at a younger age (Andrews and Criscuolo, 2013). These funds also provide valuable mentoring and support services. Venture capital investment in South Africa had been growing rapidly until 2015 (Figure 2.19, Panel A), in line with the global decline in venture capital funding, especially for early-stage investment (KPMG 2017, OECD 2016c). There is a dearth of pre-seed and seed funding; only one early-stage venture capital investment in 2014 and 2015 was seed capital (SAVCA/KPMG, 2016). Nonetheless, the overall level is higher than in the median OECD country (Figure 2.19, Panel B).

Figure 2.19. **Venture capital is relatively well developed**

Seed capital, start-up and early-stage investments



1. Based on the second (revised) value, except for 2015 which is the first release.
2. OECD average and median are based on 27 countries with data for pre-seed, seed and early-stage financing. Data for Japan are from 2014.

Source: OECD (2016), *Entrepreneurship at a Glance*; KMPG-SAVCA Private Equity Industry reports; OECD National Accounts database.

StatLink http://dx.doi.org/10.1787/888933553138

The main tool used to encourage private venture capital investment is a tax credit for investors in the funds themselves. Following recent reforms the number of registered venture capital companies under the scheme increased from 3 to 46 by February 2017. The

incentive leverages private sector expertise, which increases innovation performance, and avoids the risk of capture associated with government programmes. In other countries this type of incentive has at times been controversial; in Canada the tax credits became the key selling point of otherwise poorly performing funds (Carey et al., 2016). The sunset clause in 2021 provides an opportunity to assess its effects.

A promising new public-private fund – the SA SME Fund – should increase the supply of seed funding. In line with best practice, it aims to provide high potential entrepreneurs with access to appropriate mentors and a network. The size of public support has not been announced; if successful, it should receive additional public funds but always ensuring that the public's share is a minority of total funds. The DSBD should consult widely to understand why the supply of seed funding is low.

Exit markets are also important to maintain a vibrant venture capital (and angel investment) industry. According to the industry body, the most common exit is by trade sale, followed by sale to management, which is common in other countries (Wilson, 2015; SAVCA, 2015). Well functioning public equity markets allow venture capital backed firms to raise more capital or the venture capital investor to exit, improving the overall financing system (Nassr and Wehinger, 2016). The secondary stock exchange – the Alt-X – was growing strongly ahead of the crisis with 37 listings in 2007 but only saw eight listings in 2015 as tough economic conditions limit recovery to pre-crisis levels. Policymakers could support this market by assisting industry bodies in providing training courses to investors on these more difficult-to-understand investments since the cost may be too high for those who are only investing a tiny share of their portfolio (Wilson, 2015).

In 2015, the government created a tax incentive for companies to invest in micro and small businesses through a type of business entity that enjoys the same tax concessions as a not-for-profit company. The aim is to increase funding to micro and small businesses outside the scope of venture capital companies. A key issue is whether the benefit of increased support for small business outweighs the foregone tax revenue. This will depend on whether: the quality of support is higher than alternative sources; young firms benefit; and the scheme is used for tax avoidance. The way that this new vehicle fits into the existing tax, investment and lending environment should be monitored closely.

Sources of finance should be broadened

A greater range of financing options would support start-ups and young firms, as advocated by the OECD-G20 High-level Principles on SME Financing (G20/OECD, 2015). In South Africa just six banks hold 90% of banking sector assets. Access to financial services for firms has been found to be lower in bank-dominated financial systems (Beck, et al., 2013). World Bank data indicate that interest margins and profits are high in South Africa. Barriers to entry in the banking sector include minimum capital requirements, having a physical presence, access to clearance and payments and limitations on exit (IMF, 2014; Makhaya and Nhundu, 2015). Foreign banks face higher barriers than in most other OECD members or partner countries (OECD, 2016d). Three new banks have applied for or received a banking licence in the past year – two online banks and the post office bank – which should increase access to credit. Nonetheless, barriers to entry should be lowered, taking due care to maintaining financial stability, perhaps by beginning with non-bank lenders, for example.

Technology is bringing innovation with two online banks and also two non-bank lenders that provide working capital to SMEs. In 2015, online peer-to-peer lending accounted for 91%

of the alternative finance market in South Africa, with the industry showing large potential for further growth (CCAF, 2017). The Reserve Bank has indicated its willingness to allow innovation in the sector. Forthcoming changes to the regulation of the financial system will create a prudential regulator – the Reserve Bank – and a market conduct regulator. Non-bank lenders should be included. Regulation could be adapted to foster the use of financial innovations such as crowdfunding, and regulatory sandboxes could be used to encourage their development. For example, Austria and Germany adjusted their financial regulations to promote crowdfunding while maintaining investor protection. There is also scope for greater use of factoring (sales of receivables): these were equivalent to around 4% of GDP in 2015 but were 14% in the United Kingdom (according to Factoring Chains International). Factoring could mitigate the aversion of banks to lend to young and small businesses. The government could facilitate this by ensuring that the transfer of its own obligations is allowed.

Efforts to increase financial inclusion, including mobile banking, will benefit informal firms by providing access to payments systems, allowing them to build a credit history and improving their access to credit. According to Finmark Trust's 2016 survey, 77% of adults have a bank account but only 14% had borrowed from banks. However, household debt is relatively high, at 75% of disposable income in 2015 (up from 55% in 2004), and elevated impairment rates may be weighing on lending. The number of micro-lenders has fallen, which may be due to interest rate and fee caps that were introduced in 2007 to protect borrowers (and lowered in 2016). Replacing the caps by a full system of oversight, disclosure of interest rates and fees and appropriate protection against reckless lending could lead to greater supply of micro-credit while maintaining protection for borrowers. The government should also promote awareness of co-operative banks and stokvels (two forms of saving clubs that make small-scale loans).

Key recommendations for lowering barriers to entrepreneurship and promoting small business growth

Key recommendations

- Enact a package of reforms to reduce red tape.
- Implement a "silence is consent" rule for licensing procedures that have low associated risks. Systematically review and reduce the stock of red tape and licensing requirements. Subject new legislation to impact assessments that include the effect on small businesses.
- Create virtual and physical one-stop shops that provide information for start-ups and small businesses, allow registration, and accept applications for permits and support programmes.
- Evaluate and streamline financial and non-financial support for start-ups and small businesses.
- Rationalise delivery of support programmes so that there are single contact points for clients.
- Facilitate second chances for honest entrepreneurs by shortening the period during which bankrupt entrepreneurs are required to repay past debt from future earnings to three years. Allow those with no income or assets to become insolvent.
- Ensure government suppliers are paid within the required 30 days and provide for automatic accrual of interest on overdue accounts.
- Increase accessibility of public procurement contracts by providing more information online and accepting online applications. Increase training on public procurement for small businesses and procurers. Publish information on the distribution of contracts.

Key recommendations for lowering barriers to entrepreneurship and promoting small business growth *(cont.)*

- Expand second-chance programmes for early school-leavers.
- Increase entrepreneurial education and work placements in the post-school education system. Continue to improve basic numeracy and literacy skills through the basic education system.

Further recommendations

- Update the 2005 Integrated Small Business Strategy and ensure that the responsibilities and resources of the Department of Small Business Development are aligned.
- Lighten the regulatory burden of B-BBEE codes on young firms.
- Provide information and advice on exporting to start-ups and small businesses through the one-stop shops.
- Collect and publish data on borrowing conditions by firm size to increase transparency in the lending market and encourage competition.
- Lower barriers to entry for foreign banks and other lenders, being mindful of financial stability and consumer protection.
- Work with lenders to improve the government-backed credit guarantee scheme to make easier to use and access, and increase take-up.

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ANNEX 1

Export products in SADC

Table A1. **List of exported products in Table 1**

Aircraft, spacecraft, and parts thereof	Aluminium and articles thereof
Animal or vegetable fats and oils and their cleavage products; prepared edible fats; animal ...	Articles of apparel and clothing accessories, knitted or crocheted
Articles of leather; saddlery and harness; travel goods, handbags and similar containers; articles ...	Beverages, spirits and vinegar
Cereals	Cocoa and cocoa preparations
Coffee, tea, maté and spices	Commodities not elsewhere specified
Copper and articles thereof	Cotton
Dairy produce; birds' eggs; natural honey; edible products of animal origin, not elsewhere ...	Edible fruit and nuts; peel of citrus fruit or melons
Electrical machinery and equipment and parts thereof; sound recorders and reproducers, television ...	Essential oils and resinoids; perfumery, cosmetic or toilet preparations
Fertilisers	Fish and crustaceans, molluscs and other aquatic invertebrates
Footwear, gaiters and the like; parts of such articles	Furniture; bedding, mattresses, mattress supports, cushions and similar stuffed furnishings; ...
Inorganic chemicals; organic or inorganic compounds of precious metals, of rare-earth metals, ...	Iron and steel
Knitted or crocheted fabrics	Live animals
Machinery, mechanical appliances, nuclear reactors, boilers; parts thereof	Meat and edible meat offal
Mineral fuels, mineral oils and products of their distillation; bituminous substances; mineral ...	Miscellaneous chemical products
Natural or cultured pearls, precious or semi-precious stones, precious metals, metals clad ...	Nickel and articles thereof
Optical, photographic, cinematographic, measuring, checking, precision, medical or surgical ...	Ores, slag and ash
Organic chemicals	Other base metals; cermets; articles thereof
Plastics and articles thereof	Preparations of meat, of fish or of crustaceans, molluscs or other aquatic invertebrates
Preparations of vegetables, fruit, nuts or other parts of plants	Printed books, newspapers, pictures and other products of the printing industry; manuscripts, ...
Products of the milling industry; malt; starches; inulin; wheat gluten	Residues and waste from the food industries; prepared animal fodder
Salt; sulphur; earths and stone; plastering materials, lime and cement	Ships, boats and floating structures
Sugars and sugar confectionery	Tobacco and manufactured tobacco substitutes
Vehicles other than railway or tramway rolling stock, and parts and accessories thereof	Wood and articles of wood; wood charcoal
Wool, fine or coarse animal hair; horsehair yarn and woven fabric	Zinc and articles thereof

ANNEX 2

Estimates of determinants of trade flows

Bilateral trade patterns are regressed with size and distance between countries in various specifications of the models (see Feenstra 2004, Head and Mayer 2015). In the literature, the best estimation results have been obtained with the Poisson pseudo-maximum likelihood method (Poisson-PML), which is robust to different patterns of heteroskedasticity and measurement errors (Santos Silva and Tenreyro, 2006). Also, introducing exporter and importer fixed effects to capture both market-size effects and multilateral-resistance indexes are now common in the equations (Harrigan 1996, Redding and Venables, 2004). Properly defining the multilateral-resistance variables brings the structural dimension as put forward by Anderson and van Wincoop (2003), Anderson and Yotov (2010), and Balistreri and Hillberry (2007) among others.

Moreover, Fally (2015) shows that estimating gravity equation with Poisson PML and fixed effects is consistent with the equilibrium constraints imposed by more structural approaches such as those of Anderson and van Wincoop (2003) and Anderson and Yotov (2010). In particular, the estimated fixed effects in the Poisson PML specification are consistent with the definition of outward and inward multilateral resistance indexes and the equilibrium constraints that they need to satisfy. The Poisson PML estimator is also able to handle the zero bilateral trade flows.

In this study, gravity regressions with fixed effects and Poisson PML are mainly used to estimate the gravity equations; clustered ordinary least squares estimates are also provided for comparisons with literature but with controls for multilateral resistance terms. Following the gravity literature, bilateral trade flows can be expressed as, for each exporter i and importer j, trade flows Xij should satisfy:

$$X_{ij} = \frac{Y_i}{Z_i^{-\theta}} * D_{ij}^{-\theta} * \frac{E_j}{P_j^{-\theta}} \quad (1)$$

where, Yi refers to total output in country i; Ej refers to total expenditure in country j; Dij captures trade costs from i to j; and the parameter θ reflects the elasticity of trade flows to trade costs, which may have different structural interpretations depending on the theoretical model (see Head and Mayer, 2015). Finally, the terms $P_j^{-\theta}$ and $Z_i^{-\theta}$ are the inward and outward "multilateral resistance" indexes as defined by Anderson and van Wincoop (2003). To qualify as structural gravity equations, the two resistance terms should satisfy the following constraints:

$$P_j^{-\theta} = \sum_i \frac{Y_i D_{ij}^{-\theta}}{Z_i^{-\theta}} \quad (2) \qquad \textit{and} \qquad Z_j^{-\theta} = \sum_j \frac{E_i D_{ij}^{-\theta}}{P_i^{-\theta}} \quad (3)$$

When a log-linear form is estimated, the equation, with additional control variables writes

$$lnX_{ij} = a_0 + a_1 lnY_i + a_2 lnE_j + a_3 lnC_{ij} + a_4 P_i + a_5 Z_j + \varepsilon_{ij} \quad (3)$$

Where $C_{ij} = \delta_2 Distance_{ij} + \delta_3 CommonBorder_{ij} + \delta_4 CommonLang_{ij} + \delta_5 Colony_{ij}$ and/or other control variables, for instance dummy variable for free trade arrangements.

Estimations with the Poisson pseudo-maximum likelihood estimator are in level and additional variables enter in multiplicative form.

Table A2. **Estimate results**

VARIABLES	(1)	(2)	(3)	(3)	(4)
	X	X	X	Ln_X	X
Border	-0.0285	-0.428	0.399***	0.626***	0.513***
	(6.611e+06)	(6.590e+06)	(0.0646)	(0.0861)	(0.0679)
Common language	-0.000883	-0.00468	0.0899	0.326***	-0.0682
	(2.774e+06)	(3.430e+06)	(0.0911)	(0.0685)	(0.0962)
Lang. spoken by at least 9% population	-0.00775	0.0604	0.289***	0.287***	0.259**
	(4.492e+06)	(4.502e+06)	(0.0928)	(0.0678)	(0.101)
Common coloniser	-0.00194	0.108	0.207	0.937***	0.139
	(726,827)	(690,154)	(0.131)	(0.0581)	(0.143)
fta_apta		0.177**	-0.448**	-1.822***	
		(0.0823)	(0.214)	(0.303)	
fta_gafta		0.0694	-0.852***	0.806***	
		(0.144)	(0.219)	(0.126)	
fta_sadc		0.487**	2.038***	0.965***	
		(0.247)	(0.252)	(0.261)	
fta_mercosur		0.0216	0.542**	0.750***	
		(0.0948)	(0.236)	(0.233)	
fta_andean		0.881***	0.853***	1.527***	
		(0.294)	(0.185)	(0.283)	
fta_comesa		0.215	1.716***	1.265***	
		(0.194)	(0.273)	(0.235)	
fta_ecowas		0.0131	1.827***	1.350***	
		(0.186)	(0.280)	(0.195)	
fta_asean		-0.0467	0.0494	-0.640***	
		(0.0888)	(0.152)	(0.223)	
fta_nafta		0.361***	0.975***	-0.614**	
		(0.0560)	(0.105)	(0.300)	
fta_eu		0.647***	0.409***	-0.208***	
		(0.0766)	(0.0894)	(0.0597)	
fta_wto	0.0369				
	(0.0346)				
Ln weighted distance			-0.771***	-1.667***	-0.851***
			(0.0369)	(0.0217)	(0.0305)
Cost business start-up					0.149
					(0)
Tariff charged					-0.0110**
					(0.00553)
Tariff faced					-0.00737
					(0.00540)
Country fixed effects	Yes	Yes	Yes	Yes	Yes
Country Pair fixed effects	Yes	Yes	No		
Observations	527,457	527,457	559,555	372,302	
R-squared	0.993	0.993	0.912	0.737	0.892

Note: *** p < 0.01, ** p < 0.05, * p < 0.1
Source: Cadestin and Fall (2017), " Effectiveness of trade policies in SADC", *OECD Working Papers*, forthcoming.

ANNEX 3

Participation in Global Value Chains

Table A3A. **The origin of value added in exports – backward participation**

Panel A. SADC countries, intra-regional, 2013

		To														
		AGO	BWA	COD	LSO	MDG	MOZ	MUS	MWI	NAM	SWZ	SYC	TZA	ZAF	ZMB	ZWE
From	AGO	0.00	0.05	0.10	0.23	0.12	0.11	0.07	0.13	0.25	0.05	0.15	0.06	0.08	0.07	0.06
	BWA	0.01	0.00	0.10	0.65	0.04	0.05	0.01	0.43	0.10	0.02	0.06	0.02	0.00	1.27	0.77
	COD	0.04	0.05	0.00	0.20	0.07	0.11	0.03	0.14	0.04	0.05	0.14	0.05	0.08	3.62	0.05
	LSO	0.01	0.02	0.02	0.00	0.02	0.03	0.01	0.03	0.01	0.01	0.04	0.01	0.00	0.01	0.01
	MDG	0.01	0.02	0.03	0.08	0.00	0.05	0.78	0.05	0.02	0.02	0.11	0.02	0.02	0.02	0.01
	MOZ	0.02	0.07	0.05	0.10	0.04	0.00	0.03	0.83	0.06	0.31	0.08	0.03	0.22	0.18	0.05
	MUS	0.02	0.05	0.06	0.16	2.90	0.12	0.00	0.12	0.04	0.05	1.32	0.06	0.03	0.12	0.09
	MWI	0.01	0.06	0.03	0.16	0.03	0.31	0.02	0.00	0.03	0.04	0.07	0.20	0.10	0.25	0.17
	NAM	3.51	0.23	0.04	0.09	0.03	0.08	0.02	0.07	0.00	0.03	0.06	0.03	0.00	0.11	0.09
	SWZ	0.04	0.01	0.02	0.25	0.05	1.50	0.06	0.24	0.01	0.00	0.07	0.07	0.00	0.06	0.10
	SYC	0.01	0.02	0.04	0.11	0.08	0.06	0.04	0.06	0.02	0.02	0.00	0.01	0.01	0.03	0.01
	TZA	0.01	0.02	0.13	0.35	0.02	0.08	0.02	0.82	0.02	0.02	0.06	0.00	0.03	0.20	0.07
	ZAF	12.17	64.09	17.50	1.09	4.55	37.20	9.68	31.35	63.11	69.79	8.15	9.81	0.00	43.63	49.04
	ZMB	0.77	0.24	7.54	0.31	0.08	0.21	0.07	2.27	0.19	0.18	0.17	0.45	0.73	0.00	1.16
	ZWE	0.01	0.01	0.02	0.03	0.02	0.04	0.01	0.04	0.01	0.02	0.07	0.01	0.00	0.01	0.00
	Domestic	92.02	65.92	82.80	51.63	83.09	87.24	61.21	81.30	67.04	51.29	62.17	62.37	78.81	83.71	58.63
	Foreign	7.98	34.08	17.20	48.37	16.91	12.76	38.79	18.70	32.96	48.71	37.83	37.63	21.19	16.29	41.37

Panel B. Regional communities, 2013

		To										
		E28	ESA	LAT	MEN	NAMR	PAC	ROW	SAS	**SADC**	SEA	WCA
From	E28	53.38	28.97	21.58	43.22	19.35	16.38	52.53	25.61	37.79	17.85	40.64
	ESA	0.05	2.27	0.04	0.11	0.02	0.06	0.16	0.12	0.29	0.03	0.48
	LAT	2.58	4.07	16.05	2.29	13.25	2.32	2.28	2.78	3.68	2.60	4.53
	MEN	4.83	8.74	2.31	8.00	3.72	2.90	3.08	7.10	5.82	6.25	4.43
	NAMR	8.02	7.11	30.77	8.55	31.31	20.47	7.70	9.37	9.85	11.88	8.17
	PAC	0.72	2.99	0.80	1.26	1.24	8.45	0.76	3.29	2.73	3.89	1.75
	ROW	14.12	13.12	8.98	14.61	7.61	20.17	21.44	22.63	10.79	9.11	12.77
	SAS	1.47	9.80	1.51	5.45	1.55	1.54	1.27	2.35	3.55	2.09	4.14
	SADC	0.87	5.86	0.71	0.94	0.92	0.97	0.67	1.70	8.10	1.11	2.87
	SEA	13.45	15.97	16.81	15.27	20.24	26.56	9.62	24.63	16.83	44.91	15.56
	WCA	0.51	1.09	0.44	0.30	0.78	0.19	0.48	0.43	0.59	0.30	4.65
	Foreign	58.42	77.96	78.10	80.89	81.17	80.62	78.06	81.65	79.89	71.50	88.92
	Domestic	41.58	22.04	21.90	19.11	18.83	19.38	21.94	18.35	20.11	28.50	11.08

Note: This figure provides a visual representation of backward GVC participation across different countries or regions. Each entry identifies the origin of value added embodied in column nation's gross exports.
Source: Author's calculation based on EORA database.

Table A3B. **Destination of value added used by trading partners for exports**

Panel A: Forward participation, intra-regional, 2013

		To																
		AGO	BWA	COD	LSO	MDG	MOZ	MUS	MWI	NAM	SWZ	SYC	TZA	ZAF	ZMB	ZWE	Domestic	Foreign
From	AGO	0.00	0.00	0.00	0.00	0.00	0.00	0.01	0.00	0.02	0.00	0.00	0.00	0.20	0.00	0.00	70.0	30.0
	BWA	0.13	0.00	0.22	0.58	0.07	0.03	0.07	0.40	0.31	0.06	0.08	0.08	0.57	4.03	0.83	76.1	23.9
	COD	0.04	0.01	0.00	0.02	0.01	0.01	0.02	0.01	0.02	0.01	0.02	0.02	1.05	1.26	0.01	53.0	47.0
	LSO	0.18	0.09	0.10	0.00	0.08	0.04	0.14	0.08	0.08	0.07	0.16	0.07	0.53	0.12	0.02	72.3	27.7
	MDG	0.03	0.01	0.02	0.02	0.00	0.01	1.42	0.01	0.02	0.02	0.04	0.02	0.63	0.02	0.00	71.9	28.1
	MOZ	0.12	0.07	0.06	0.06	0.04	0.00	0.13	0.50	0.13	0.49	0.07	0.06	16.70	0.36	0.03	69.7	30.3
	MUS	0.06	0.03	0.04	0.04	1.52	0.02	0.00	0.03	0.03	0.03	0.52	0.06	1.01	0.11	0.03	74.3	25.7
	MWI	0.08	0.06	0.05	0.09	0.03	0.10	0.08	0.00	0.07	0.05	0.06	0.44	7.27	0.49	0.11	71.9	28.1
	NAM	14.96	0.18	0.04	0.04	0.02	0.02	0.06	0.03	0.00	0.03	0.04	0.04	0.21	0.17	0.05	75.3	24.7
	SWZ	0.40	0.02	0.06	0.25	0.11	0.90	0.40	0.26	0.05	0.00	0.11	0.26	0.34	0.24	0.12	74.8	25.2
	SYC	0.12	0.04	0.08	0.09	0.14	0.03	0.27	0.06	0.06	0.05	0.00	0.05	1.00	0.09	0.02	68.6	31.4
	TZA	0.06	0.02	0.14	0.15	0.02	0.02	0.06	0.38	0.03	0.02	0.04	0.00	1.65	0.32	0.04	74.0	26.0
	ZAF	0.53	0.51	0.18	0.00	0.04	0.09	0.29	0.14	0.97	0.83	0.05	0.16	0.00	0.67	0.26	67.5	32.5
	ZMB	1.04	0.06	2.41	0.04	0.02	0.02	0.06	0.32	0.09	0.07	0.03	0.23	12.64	0.00	0.19	70.9	29.1
	ZWE	0.12	0.04	0.05	0.05	0.07	0.03	0.13	0.07	0.06	0.07	0.16	0.07	0.51	0.07	0.00	72.0	28.0

Panel B: Forward participation, World, 2013

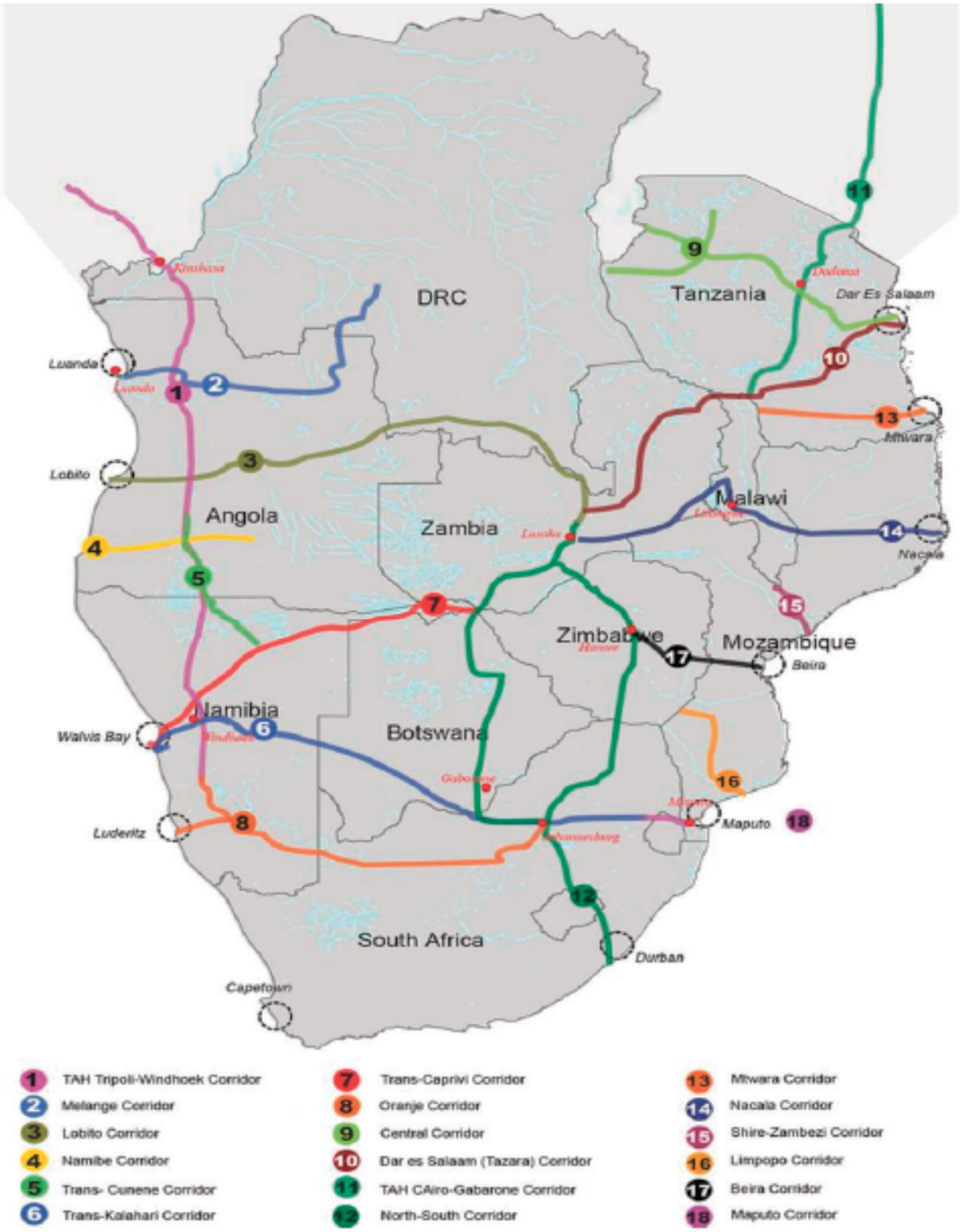
		To												
		E28	ESA	LAT	MEN	NAMR	PAC	ROW	SAS	**SADC**	SEA	WCA	Domestic	Foreign
From	E28	75.5	0.0	1.9	2.5	3.5	0.4	4.8	0.7	0.5	10.0	0.1	66.5	33.5
	ESA	57.6	1.6	2.6	4.9	3.2	1.2	11.2	2.4	2.8	11.4	1.1	71.6	28.4
	LAT	38.4	0.0	15.3	1.4	25.2	0.7	2.2	0.8	0.5	15.4	0.1	77.3	22.7
	MEN	55.5	0.1	1.7	3.7	5.4	0.6	2.3	1.5	0.6	28.4	0.1	66.4	33.6
	NAMR	39.7	0.0	9.7	1.7	19.7	1.9	2.4	0.9	0.4	23.3	0.1	73.1	26.9
	PAC	25.6	0.1	1.8	1.8	5.6	5.7	1.7	2.2	0.9	54.5	0.1	73.9	26.1
	ROW	63.6	0.0	2.6	2.7	4.4	1.7	6.2	1.9	0.4	16.3	0.1	50.7	49.3
	SAS	48.7	0.2	3.2	7.4	6.6	1.0	2.7	1.5	1.1	27.5	0.3	73.7	26.3
	SADC	51.6	0.2	2.7	2.3	7.0	1.1	2.5	1.9	4.4	26.0	0.3	68.1	31.9
	SEA	36.1	0.0	2.9	1.7	6.9	1.4	1.7	1.3	0.4	47.7	0.1	72.7	27.3
	WCA	61.5	0.1	3.4	1.5	12.0	0.4	3.7	1.0	0.6	14.5	1.2	66.6	33.4

Note: This figure provides a visual representation of forward GVC participation across different countries or regions. Each entry identifies the destination of value added embodied in row nation's gross exports.
Source: Author's calculation based on EORA database.

ANNEX 4

Road infrastructure needs in SADC

Figure A4. **Corridors in Southern Africa**



Source: Byiers, B., and J. Vanheukelom (2014), p 7.

ANNEX 5

Detailed information on taxes

Country	Notes
Payroll Taxes	
Angola	In addition to payroll taxes, Angola also has a minimum wage
Botswana	Payroll tax of 0.2% is actually a skills training levy whose base is company turnover
DRC	Includes 9% social security, 2% employment fund and 0.2% ONEM
Lesotho	No payroll taxes
Madagascar	Includes 13% social security and 5% for health insurance
Malawi	Includes 7.5% for pension and 1% TEVETA levy
Mauritius	Includes 6% pension (NPF), 2.5% savings (NSF) and 1.5% training tax
Mozambique	Contributions are for social security
Namibia	Includes social security 0.9% and workmen's compensation (1-8)
Seychelles	Contributions are for pension
South Africa	Includes 1% SDL and 1% UIF. 1.62% occupational injuries excluded.
Swaziland	Includes 5% provident fund, 0.46% min mandatory compensation insurance
Tanzania	Includes 5% SDL, 10% social security, 1% workers compensation tariff
Zambia	Includes 5% pension and 4.22% workers compensation
Zimbabwe	Includes 3.5% social security, 1% manpower, 0.5% standards development
Corporate income taxes	
Angola	Mineral Resources: 25% general mining. Oil: 30 national concessionaire companies, 50% production or sharing agreement, 65.75% foreign and other ventures
Botswana	All mining companies taxed at least 22 per cent, except for diamond companies that are taxed on a formula basis with rates up to 55%, cannot be less than 22%. Accredited innovation hubs, IFSC companies taxed and manufacturing companies approved by finance minister taxed at 15%
DRC	There is a minimum tax rate of 1% for small companies which also apply to loss making companies as well as companies with CIT of less than 1% of turnover.
Madagascar	Rate of 20% applies to companies with a turnover exceeding MGA 20 million. Companies with less subject to CIT of 5% on 70% of turnover, with a minimum tax of MGA 16 000. Industrial and other exporting service providers eligible for CIT exemption during the first two to five years and a reduced CIT of 10% thereafter.
Malawi	Agricultural and power generation taxed at 0% for first ten years, then 15% if incorporated in Malawi, else 20%. 35% for Malawi branches of external companies
Mauritius	Banking and telephone service providers liable to additional levy on profits of between 3.4-5%. Companies in freeport export processing zone exempt from taxes.
Namibia	Oil and gas extraction: 35%, hard rock and companies rendering mining services: 37.5%, diamond mining 55%.
Seychelles	25% on first SCR 1m and 30% on the remainder except for some financial, telecom and alcohol companies 33%.International Business Companies (IBCs) tax exempt.
South Africa	Special tax regime for small businesses. Gold mining companies taxed using a special formula. Funds are treated as separate taxpayers and taxed at five separate rates. 30% individual policyholder, 0% untaxed policyholder funds, 28% for the rest.
Swaziland	The Minister of Finance, along set guidelines, may nominate a business as a developmental for a grant with tax concessions such as a lower corporate tax rate

Country	Notes
Tanzania	5% of turnover for technical and management service providers to mining, oil, and gas entities. 25% for three years for new listings on DSE. 0.3% for companies with perpetual unrelieved tax losses. Tax holiday in SEZ's only for ten years
Zambia	Agriculture and agro-processing: 10, export of non-traditional products and production of organic fertiliser and chemical manufacture of fertiliser Tax holidays only valid for 5 years, reduce with standard rate kicking in 5-10 years in
Zimbabwe	3% AIDS levy imposed on base rate of 25% making effective rate 25.75%. Mining company holding special lease 15%. Tax holidays in SEZs only valid for 5 years. Reduced manufacturing rates apply to companies exporting min 30% of output

ANNEX 6

Determinants of entrepreneurial activity

Estimates of the determinants of early-stage entrepreneurial activity follow Ardagna and Lusardi (2010). The data source is the 2012 Global Entrepreneurship Monitor, and the results are based on the data from 43 countries. Variable definitions for the individual characteristics generally follow Ardagna and Lusardi except that work status has been aggregated due to the smaller sample here. The logarithm of GDP per capita (PPP-adjusted) is used to control for country fixed-effects but allow for exploration of South Africa-specific fixed effects by interacting a dummy variable for South Africa with key variables of interest.

Columns 1 and 3 support the patterns shown in Figure 2.3. They show that individual characteristics discussed in the text generally remain significant. The relationship with education highlights the difference between entrepreneurs who are motivated by opportunity and necessity. The coefficient on the South Africa dummy variable is negative for total and opportunity-drive entrepreneurs.

Columns 3 to 6 include more individual characteristics (as in Ardagna and Lusardi). The negative fixed effect for South Africa becomes zero, suggesting that these other variables are important determinants of entrepreneurship in South Africa. Education remains significant for opportunity-based entrepreneurs.

Columns 7 and 8 show that the relationship between some individual characteristics and being an opportunity-based entrepreneur is different in South Africa. In particular, having secondary education, being middle-income and having self-belief matter more. But the link with knowing an entrepreneur is weaker.

Table A6. **Marginal effect of individual characteristics on entrepreneurship**

Dependent variable = 1 if engaged in early-stage entrepreneurial activity and 0 otherwise

	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
	Total activity	Opportunity-based	Necessity-based	Total activity	Opportunity-based	Necessity-based	Opportunity-based and South Africa interaction term. Evaluated at	
							ZAF = 1	ZAF = 0
25-34 years	0.030***	0.020***	0.008***	-0.004	-0.006**	0.002	**-0.036*** **	**-0.009** **
	(0.006)	(0.005)	(0.002)	(0.003)	(0.003)	(0.002)	**(0.003)**	**(0.004)**
35-44 years	0.020***	0.009	0.010***	-0.012***	-0.014***	0.003	**-0.030*** **	**-0.022*** **
	(0.007)	(0.007)	(0.003)	(0.004)	(0.004)	(0.002)	**(0.003)**	**(0.007)**
45-54 years	-0.008*	-0.013***	0.005**	-0.025***	-0.023***	0.001	**-0.020*** **	**-0.038*** **
	(0.004)	(0.004)	(0.002)	(0.003)	(0.004)	(0.002)	**(0.002)**	**(0.006)**
55-64 years	-0.034***	-0.033***	-0.001	-0.027***	-0.025***	-0.000	**-0.028*** **	**-0.041*** **
	(0.006)	(0.006)	(0.003)	(0.004)	(0.005)	(0.002)	**(0.002)**	**(0.008)**
Female	-0.038***	-0.033***	-0.004	-0.001	-0.003	0.002	-0.006***	-0.004
	(0.005)	(0.004)	(0.002)	(0.004)	(0.003)	(0.002)	(0.001)	(0.004)
Upper-secondary	0.009	0.013*	-0.003	0.001	0.004	-0.003**	**0.068*** **	**0.006**
	(0.009)	(0.007)	(0.002)	(0.004)	(0.003)	(0.001)	**(0.007)**	**(0.005)**
Post-secondary	0.020**	0.026***	-0.006***	-0.002	0.003	-0.005***	**0.049*** **	**0.005**
	(0.008)	(0.007)	(0.002)	(0.004)	(0.003)	(0.001)	**(0.005)**	**(0.005)**
Working				0.061***	0.043***	0.013***	**0.080*** **	**0.064*** **
				(0.011)	(0.007)	(0.004)	**(0.009)**	**(0.011)**
Middle income				0.000	0.000	0.000	**0.000**	**0.000**
				(0.000)	(0.000)	(0.000)	**(0.000)**	**(0.000)**
High income				-0.001	0.004	-0.005*	**-0.016*** **	**0.007**
				(0.006)	(0.005)	(0.003)	**(0.001)**	**(0.008)**
Know an entrepreneur				0.003	0.010*	-0.008***	-0.022***	0.016*
				(0.006)	(0.005)	(0.003)	(0.002)	(0.009)
Have skills				0.060***	0.043***	0.011***	**0.059*** **	**0.062*** **
				(0.005)	(0.004)	(0.002)	**(0.006)**	**(0.004)**
Fear of failure				0.090***	0.065***	0.018***	**0.098*** **	**0.085*** **
				(0.008)	(0.007)	(0.002)	**(0.011)**	**(0.008)**
ZAF dummy	-0.044***	-0.037***	-0.005	-0.024***	-0.020***	-0.001	-0.054***	-0.032***
	(0.016)	(0.012)	(0.004)	(0.003)	(0.003)	(0.001)	(0.005)	(0.004)
Observations	91,835	91,835	91,835	91,835	91,835	91,835	91,835	91,835
Pseudo-R2	0.0280	0.0321	0.0144	0. 1687	0.1743	0.0748	0.1751	0.1751

Note: Estimates are from logit regressions. The omitted categories are: 18-24 years; male; basic education; not working; do not know entrepreneur; do not believe have skill for start-up; do not fear failure; lowest third of household income distribution. Values shown are marginal effects, corresponding to the impact of a discrete change in the explanatory variable on the probability of engaging in early-stage entrepreneurial activity. Robust standard errors clustered at the country level are shown in parentheses. ***, ** and * denotes statistical significance at the 1%, 5% and 10% level, respectively. Bolding in columns 7 and 8 indicates the ZAF interaction term is significant at the 5% level. The logarithm of GDP per capita is included as a control variable in all regressions.

Source: OECD calculations based on the 2012 Global Entrepreneurship Monitor.

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The economy faces many structural challenges while high inflation limits room for monetary policy support and high public debt constrains public spending. South Africa needs structural reforms that would boost the potential of the economy, in particular, broadening competition, limiting the size and grip of state-owned enterprises on the economy, and improving the quality of the education system.

Greater regional integration could provide new opportunities for growth by expanding market size. South African firms are well placed to benefit from deeper integration. However, lowering tariffs and non-tariffs barriers on trade, developing regional infrastructure and harmonising regulations are needed to foster regional integration.

More entrepreneurs and thriving small businesses would contribute to inclusive growth and job creation. Barriers to entrepreneurship include bureaucratic procedures and licensing, which are also an ongoing burden on small firms. An education system that better equippes students with basic and entrepreneurial skills would grow the pipeline of entrepreneurs. A better evidence base is crucial for more effective financial and non-financial support programmes to boost start-up rates and small firms' growth.

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