

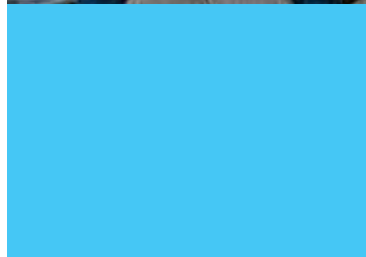


**UNITED NATIONS**  
SOUTH AFRICA



## **RECOVERY FROM COVID-19 IN SOUTH AFRICA:**

A socio-economic analysis of pathways  
towards inclusive and sustainable growth



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*Edited by Ricardo Gottschalk*

# FOREWORD

As South Africa emerges from the COVID-19 crisis, the path towards a sustainable and inclusive recovery is paved with hope – albeit a journey marked by challenges. This volume charts the issues and challenges facing the country as it initiates this path and gears up efforts towards achieving the targets of the Sustainable Development Goals (SDGs). This debut edition is concerned with questions such as how to finance the SDGs and a just transition in the decade of action; deliver on minimum core obligations to ensure that budgetary allocations support a more just and inclusive recovery; bridge gender gaps; make progress towards a more capable and developmental state; build a Social and Solidarity Economy (SSE) for a more inclusive society, and implement a Basic Income Grant (BIG) that is fiscally sustainable. In addition, the volume asks these questions: How best can we support small business development and entrepreneurship? Do we have policy space for an industrial strategy? What strategy will be most effective in the South African context? How will developments in South Africa affect its neighbouring countries and the African region at large?

These issues and questions are at the core of South Africa's National Development Plan (NDP) 2030, and are responded to across the publication's 13 chapters – most of which are authored by United Nations staff based in South Africa who are working on the ground. This volume provides the technical staff with an opportunity to voice and express (in a more articulate and analytical manner) their perspectives based on their day-to-day experiences. Their views and those of the external co-authors, expressed in their respective chapters, are their own, and do not necessarily reflect the positions of the UN agencies and programmes to which they are affiliated.

This volume is, therefore, a new experiment that is nothing short of innovative. It brings the work, learnings and views of the UN in South Africa to a new level. We hope it offers the development community in South Africa and beyond new insights into key developmental challenges that are not only critical to South Africa but also common to other developing countries around the world.

I am grateful to the colleagues in the Resident Coordinator Office who have been relentless in pulling this body of work together. In particular, I would like to thank our Senior Economist, Dr Ricardo Gottschalk, for his efforts in ensuring it reaches completion.

**Dr Ayodele Odusola**

United Nations Resident Coordinator  
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# 1. INTRODUCTION – RECOVERY FROM COVID-19 IN SOUTH AFRICA: WHAT IT TAKES TO ACHIEVE A MORE INCLUSIVE AND SUSTAINABLE GROWTH PATH

*Ricardo Gottschalk*

## 1. Context and setting the issue

South Africa has shown significant improvements since the start of the democratic era. There has been an overall decline in income poverty (urban, rural), wider access to education and health, greater provision of public services with positive impacts on multidimensional poverty, some degree of social mobility, and the expansion of a social protection system covering the poorest and the most vulnerable. Most of these achievements have been the result of government policy and the build-up of a new political-institutional architecture comprising new laws, regulations, and systems. These developments have taken place together with a great deal of activism and the mobilisation of different sectors of South African society.

While these socio-economic gains should be commended, progress has been slow, partial, and interspersed with reversals. The unemployment rate rose from 24.9% in 2010 to 33.9% in the second quarter of 2022, and the percentage of the population living below the food poverty line increased from 21.4% in 2011 to 25.2% in 2015. Inequality, which worsened during the first 12 years of the democratic era, showed some reduction between 2006 and 2009, but progress then stalled (NPC, 2020). Successfully tackling the triple challenges of unemployment, poverty, and inequality are absolute prerequisites for a country aiming to achieve fairness, inclusiveness, and sustained prosperity.

A global narrative since COVID-19 has been that world recovery from the pandemic should not merely be a return to the pre-pandemic status quo. There is a need to re-examine the policy choices and business behaviour of the past 40 years. Underinvestment in public infrastructure and services (including in public health systems), financial deregulation, tax erosion, abusive corporate practices, and insufficient action to deal with climate change are some of the shortcomings of a global order that have contributed to rising economic instability and insecurity for large swathes of the world's population. These trends and practices have also contributed to a world that was, indeed, left largely unprepared and vulnerable to cope with the economic, social, and humanitarian crisis caused by the COVID-19 pandemic.

South Africa has faced similar problems and challenges. However, problems of inequality, extreme poverty, social injustice, and environmental degradation in the country are not only the result of inadequate policies and trends of recent decades; these are deep-rooted issues linked to a long history of an exploitative economic system, political repression and exclusion, racial discrimination, the violation of fundamental rights, asset expropriation, and nature's destruction. Over the past 28 years, these issues, and possible ways of addressing them, have been exhaustively studied and debated by a vibrant society. They have also been studied by a government that, from an initial diagnosis went on to formulate policy to tackle them.

But why has progress been so slow? Why has change been so slow and unsteady, falling short of what has been envisioned and targeted by various national development plans over the years?

There is a common saying among UN and policy circles that “the problem in South Africa is not policy, it is implementation”. While there might be some truth in this assertion, this volume raises the question whether policy itself sufficiently intersects with and impinges on the long-held structural issues facing South Africa to enact palpable change effectively. Against this background, this volume invites the UN experts based in South Africa, whose work has been devoted to finding solutions to some of the most intractable issues, to contribute with an analysis of, and ways forward for addressing, policy issues and challenges that they have grappled with in their day-to-day work. The hypothesis motivating this exercise is that the truth may lie to some extent in both policy and implementation. Accordingly, the volume's contributors were encouraged to explore an array of questions, including: Is a lack of progress due to an incorrect diagnosis of the problem? The adoption of inadequate policies? Limited levels of implementation? Where interventions are at the micro level, is it a lack of attention to the broader macro context that is holding back progress? Is it that there is, perhaps, an excessive focus on the proximate causes and therefore a failure to address the underlying issues? What about slow progress due to a lack of continuity, resources, or capacity?



## 2. Method

This volume benefits from contributions by UN experts who, in most cases, are based in South Africa and have built valuable experience in their areas of expertise over the years. Given the nature of their work, their contributions are manifestly distinct from purely academic research. The analyses and insights that they provide are rooted in their experience in dealing with real issues and obstacles. The result is a volume formed of a collection of chapters based in some instances on an 'off the track' analytical approach while at the same time providing a clearly delineated set of policy proposals on how to bridge South Africa's socio-economic divide and how to support and accelerate change. Because the contributions focus on the work being done by the UN experts, the volume is inescapably selective in its coverage, and gaps remain. However, the intention is that further analyses will be produced in the future so that the identified gaps are gradually filled in. The UN work in South Africa may gain more visibility as a result of the lessons and insights shared with the wider development community in South Africa and beyond.

## 3. Structure of the volume

This volume comprises 13 chapters, including this introduction. It concerns interrelated socio-economic and environmental topics of critical relevance to South Africa. These include the macroeconomic challenges facing South Africa; the financing landscape and financing a just transition; a human-rights approach to budgeting; gender gaps; the developmental state; the social and solidarity economy; the BIG; small business development and entrepreneurship; the industrial policies post-1994; the policy space for industrial policy and the challenges facing neighbouring Lesotho.

Chapter 2, by Ricardo Gottschalk, examines South Africa's current macroeconomic conditions in the wake of the COVID-19 crisis, with a focus on the country's external sector and public debt. On the external front, the country's current account turned into a surplus for the first time since 2002, as has been well documented in the media. This has been due to the commodity price boom since mid-2020, which propped up export revenues. The surplus therefore reflects a cyclical factor which is unlikely to continue as the economy recovers. In the meantime, public debt, which had significantly increased before, as well as at the onset of the COVID-19 crisis, seems to be turning the corner and is now pointing downwards. This is in part due to better tax-revenue collections than initially anticipated. The chapter also discusses the risks that can possibly derail these trends (e.g., rising inflation, social unrest, climate-related disasters). Finally, the chapter deals with those issues and challenges that have been part of the macroeconomic policy discussion. These include the poor gross domestic product (GDP) performance since before the pandemic, the energy supply constraint as a major bottleneck for growth recovery, persistently high and rising unemployment rates, and possible ways to engineer a just transition in tandem with the country's reiterated pledges at Glasgow's COP26 in November 2021.

Chapter 3, by Krivani Pillay, examines the landscape of finance in South Africa in the decade of action. The chapter starts by noting the current efforts of the South African government towards fiscal consolidation in a difficult macroeconomic environment and the consequent limited fiscal space to finance the SDGs. The chapter sees the current fiscal situation as a threat to realising human rights and identifies female-headed households and the poor as among the most likely to be affected.

As the chapter points out, the government is staking hopes on the private sector as a main investment growth driver. To encourage the private sector to play that role, it has activated different leveraging mechanisms, including a range of budgetary-sourced funds such as the Infrastructure Fund, the Green Fund (discussed in detail in chapter 8), the National Empowerment Fund, and the Growth Fund, which South African development banks alongside government departments and agencies should manage and monitor. The chapter notes that these funds, although welcome, are limited in size and it accordingly also discusses other financing instruments such as Public-Private Partnerships (PPPs) and Corporate Social Investment (CSI) initiatives, as well as the need to prevent illicit financial flows. The chapter concludes by pointing out that what is necessary is a more supportive global financial architecture to help South Africa and other developing countries overcome the ongoing obstacles – including the latest ones, such as rising energy and food prices – in their path towards sustainable development.



Chapter 4, prepared by the UN OHCHR ROSA, takes on the topic of a human-rights-based approach to budgeting. The chapter has as its starting point for discussion an analysis of South Africa's low growth trajectory, extremely high levels of inequality, and the existence of several groups (e.g., women, women with children, older persons, persons with disabilities, migrants, sex workers, etc.) particularly vulnerable to different types of shock. Against this backdrop, the chapter defends a human-rights lens about government expenditure and highlights what its minimum core obligations are to fight inequality and vulnerability to ensure a more just and inclusive recovery. It notes that, in the past years, the government decreased resources aimed at social spending, in part because a growing share of fiscal resources has been absorbed by debt servicing. This crowding out, however, runs counter to South Africa's constitutional and international obligations to the allocation of sufficient resources to promote, protect, respect, and fulfil human rights.

While acknowledging the existence of budgetary constraints, the chapter remarks that these constraints are not a given. The adoption of progressive and effective taxation is key to relaxing them – by apportioning the fiscal space for realising human rights. The allocation of expenditure, in turn, can be realigned across different budgetary lines and can include a reduction in subsidies to large corporations and others. The chapter also argues that human-rights budgeting needs to be adopted in combination with other policies such as plans, laws, and regulations – being part of a broader policy process. Finally, the chapter puts forward the view that the budgetary process should include the participation of all actors, including all line ministries and provincial governments, and also engagement with local governments, so that all three tiers of government can identify issues and devise strategies to resolve them. In addition, it should ensure the participation of non-state actors such as Civil Society Organisations (CSO), UN Agencies, and other development partners.

Chapter 5, by Samaneh Hemat and Bandita Sijapati, discusses the issue of gender inequalities in South Africa and what action can be taken to bridge the gaps to create a more gendered-balanced society. The chapter observes that the country has made significant progress towards gender equality since the beginning of the democratic era: the number of women in parliament has increased, gender parity in schools has been achieved, and the gap in adult literacy has been narrowed. However, gender gaps remain, especially in the domains of economic opportunity, voice and agency. The chapter then proceeds to examine in detail what the gender gaps are in human endowment, economic opportunities, and voice and agency. In doing so, it notices how different gender gaps intersect significantly with racial, income, age, urban-rural and other inequalities that are so deeply ingrained in South African society. Perhaps the most salient gaps are in the domain of economic opportunities. These include the persistent wage gaps (correlating closely with occupational gaps), barriers to 'women's control of land and other productive assets', and access to finance and formal financial institutions (which is linked to poverty and inequality).

The chapter highlights the reality that existing progressive legislation aimed at protecting gender rights is countered by lack of implementation and also by customary laws and patriarchal gender norms, which hinder progress in closing gaps. The chapter also stresses the lack of influence women wield in the legislative arena, despite relatively good overall representation in government, and their lack of significant power in the decision-making process. It also emphasises the high prevalence of gender-based violence and its profound psychosocial and economic impacts on women.

The chapter concludes by proposing interventions that can remove the 'overlapping and interdependent systems of discrimination and disadvantage' holding back women in society. Proposed steps include increased access to childcare; overcoming the legal and social barriers to equitable entry and retention in the workforce; improving financial inclusion; giving more support to women entrepreneurs, and strengthening women's voice and agency.

Chapter 6, by Msingathi Sipuka, examines to what extent the policies that the South African government has deployed since the beginning of the democratic era have been effective in responding to the challenges associated with deep, racialised, and gendered poverty and inequalities. According to Sipuka, there has been an attempt, in the post-1994 period, to build a developmental state capable of dealing with such challenges, a state that could forge an inclusive growth path and extend the net of basic public services to the poorest and most vulnerable groups. The chapter maps out government thinking on what a capable and developmental state might look like and which strategy to adopt in order to deliver on its objectives. It asks these questions: How much progress South Africa has made towards such a capable and developmental state? How much of what has been laid down as objectives in its various development plans has been effectively achieved?



As a method of analysis, the chapter condenses the markers proposed by the NDP 2030 to measure progress towards a capable and developmental state in five areas. These cover efforts to strengthen governance and accountability in government, institutional capability, a long-term approach to planning for development, greater coordination between the different government spheres, and work in the public interest.

The chapter finds, first, that the government has made significant progress in reforming the state inherited from the apartheid era into a body that can serve the large majority of South Africans. Progress has been noted especially on the legislative and policy framework fronts. However, outcomes from the implementation of a new policy regime have been, at best, only partial. Second, progress has not been linear. According to various government commissions, the decline in performance of key state institutions such as the South African Revenue Service (SARS) and the National Prosecuting Authority (NPA) has been observed over time. Third, policy coordination between the three spheres of government – national, provincial, and local – needed to maintain coherence in planning and execution, has been a real issue hampering the effectiveness and quality of the range of services they are mandated to provide – from health and education to basic infrastructure.

Finally, despite efforts made with the establishment of the National Planning Commission and the creation of the NDP 2030, long-term planning has lacked clarity, the ability to bolster government structures and performance, political capital behind the NDP, and a common understanding and view of what a developmental state is or should be. The chapter ends on a positive note by stating that, despite the many challenges constraining the building up of a capable and developmental state, opportunities exist for the trajectory to be redirected, notably through continued efforts towards institution-building and the strengthening of implementation.

In a context of growing discontent with the ability of the South African state to provide basic public services, affected individuals and local communities have attempted to fill in gaps through the provision of an array of basic needs such as security, infrastructure (electricity supplies, road repairs, water distribution), new homes (often in informal settlements), community schools for young children, communal vegetable gardens, vaccines, and personal protective equipment (PPE), to name just a few. These initiatives have been accelerated with the pandemic, often with support from Non-Government Organisations (NGO) and private donors (Burke, 2022).

Related to these trends, Chapter 7 (authored by ILO staff and external collaborators), discusses the SSE as a pathway to sustainable and inclusive growth in South Africa. It argues that the SSE has indeed the potential to serve as a bridge to inclusivity. In delving into the world of SSE, key findings the chapter presents include the SSE's potential to lead to sustainable job creation, employ young people, and connect people and communities, in this way becoming a force for altruism and social cohesion. As the chapter points out, where a breakdown in trust occurs (a trend observed during the pandemic), SSE can step in by providing goods and services where gaps exist. Examples the chapter highlights include the provision by social organisations of Wi-Fi and transport services in rural areas, and environmentally friendly bricks for affordable houses in townships. By doing so, SSE does not replace or oppose the state or any other formal organisation; rather, it acts as a bridge between 'informal and formal organisations, economic and social value, social and environmental development'.

It 'favours collaboration over competition and empowerment over control'; it 'connects people through solidarity systems' and builds 'active citizenship and community engagement'. According to findings reported in the chapter, SSE accounts for between 5% and 6% of jobs in South Africa – a percentage share similar to those observed in other countries – and it is the sector with the least barriers to entry for young people. However, because of its country-specific nature, the chapter remarks that a universal definition of SSE remains lacking and that more research is needed to gain a better understanding and a clearer definition of SSE. This may encourage the further development of networks and the role of SSE in the space of policy development.

Chapter 8, by Siyanda Siko from the ILO, explores ways to finance the transition to a green economy. The chapter takes the view that South Africa should aim for a just transition: a path towards a low-carbon, climate-resilient development that also promotes social justice, fairness, and equity. Financing a just transition should include apportioning resources for mitigation, adaptation, capacity-building, and research and development. As the chapter stresses, in a just transition it is important, above all, to protect 'the livelihoods of workers and their communities'. Quoting the SA Industry Task on Climate Change (ITTCC), the chapter also highlights that, in the South African context – which includes concerns about what will happen to communities from coal-mining towns and also workers from across affected value chains such as the automotive industry – it is critical to 'ensure that the skills and workforce we have today are up-skilled, re-skilled and adequately transferred'.

In discussing green finance, the chapter focuses on South Africa's Green Fund. Key questions are these: To what extent does the Green Fund incorporate just transition principles? How well has it worked as a leveraging tool for additional green finance? In response to the first question, the answer is that, although initially focused solely on transition, the Green Fund did incorporate the just component into the transition concept over time, as the Fund evolved and other players in the green space did the same. As for the Fund's leveraging capacity, the point the chapter makes is that the resources allocated to it are just too little when measured against the tasks at hand and, therefore, to be an effective leveraging tool. Given this, what the chapter proposes as a solution is that the Green Fund should be amalgamated with other funds (including external) and that greater coordination should occur between different funding partners (including foreign) in order to leverage resources at scale.

The chapter remarks that, for a just transition, there is a need not just for single or multiple funds, but for a 'domestic climate finance framework' and a 'system thinking approach to ensure a comprehensive and holistic view between climate change mitigation, adaptation and poverty reduction'. Financing is clearly still a crucial missing leg that could join the policy leg – which, the chapter argues, has already been considerably developed through various government initiatives to date. In addition, the chapter calls for the need for the buy-in from labour movements and CSOs, and efforts towards economic diversification (through industrial policy interventions and other initiatives) so that new industries emerge. Although the prevailing narrative is that the creation of new jobs will compensate the destruction of old jobs, it is possible that the net result may well be negative – which, in the end, may leave 'many people behind'.

The truth is that, even if the path towards a green economy is growth-enhancing and net job-positive, automation and the Fourth Industrial Revolution (4IR) are global trends that, in South Africa, may reinforce the levels of inequality, poverty, and unemployment currently witnessed in the country. It is in this context that a long-held debate exists in South Africa about the creation of a BIG. The idea is that such a grant can help resolve this triple challenge and the global trends that are inexorably affecting South Africa. The UN in South Africa has been actively engaged in this debate and is currently supporting the government of South Africa with a proposal to create a Basic Income Fund. The purpose is that, in addition to children, the elderly, and those with disabilities, social grants cover those adults aged 18–59 who can then have a minimum secured income for their basic needs.

Like the previous chapter, which looks at the green economy from a financing perspective, chapter 9, by Matilda Dahlquist from the ILO, discusses the possible adoption of a BIG in South Africa with a proposal to ensure its financial sustainability. The chapter takes as its opening considerations the ILO centenary and the Abidjan declarations, which call for a human-centred future of work, in response to the global trends mentioned. The chapter sees these global trends as an opportunity to reimagine the future and, in it, to consider the creation of a BIG to ensure 'the universal right to social security'. Nevertheless, the chapter raises a concern regarding the fact that, while social protection coverage in South Africa has gradually expanded, from 7 million recipients (back in 2003) to 17 million more recently, the country's tax base has shrunk, with the number of taxpayers and those with decent jobs declining over the years. This, the chapter acknowledges, partly reflects a slow-growing economy with low levels of inclusiveness.



Against these trends, the chapter proposes a BIG that is directly linked to the tax-collection system through SARS. SARS would be tasked with administering and paying out the BIG. The move by grant recipients to SARS would be voluntary and, unlike at present, the system would not be based on means testing or with conditionality attached. The purpose is to move to an integrated system by which net beneficiaries gradually turn into net tax contributors as they become active participants in the labour market, transition from the informal to the formal economy and, if they start their own business, move to formalisation as their business expands. For the latter to happen, the proposed system would have to be coupled with ample support to Small Medium and Micro Enterprises (SMME) and other interventions to enhance employability in different sectors of the economy, including in emerging ones such as the green economy and the SSE, discussed in the previous chapters.

In this context, the question, for the UN, as an important development player in this field, is how it can support job creation in the private sector and what steps it can take in support of small business so that the latter can be an important job-creation vector. In this regard, chapter 10, by Ricardo Gottschalk and Nokuthula Nyamweda, examines the work that the UN system in South Africa is currently undertaking to support small business development and entrepreneurship at the district level. The chapter shows that the UN is focusing on three pilot districts – OR Tambo in the province of Eastern Cape, Waterberg in the province of Limpopo, and eThekweni, in the province of KwaZulu-Natal. It is doing so in partnership with the government at different levels – national, district, and municipal – as well as with civil-society organisations, academia, and the private sector. To date, most interventions have taken the form of projects that support women in business, youth training and upskilling, green farming, and the greater engagement of small entrepreneurs in the circular economy. The chapter discusses the role that the UN can play to overcome some of the challenges it highlights, such as the lack of sufficient coordination in small business ecosystems at the district level and the need for greater exchanges and knowledge- or experience-sharing between different players in the system.

Chapter 11, by Msingathi Sipuka and Simthembile Mapu, takes a broader look at South Africa's economic structure and the space that exists for small businesses, especially in manufacturing, by looking at how the country is faring in the area of industrial development. Accordingly, the chapter examines in some detail South Africa's industrial policies post-1994, with a focus on the Industrial Development Zones. As the chapter explains, the latter have been created to redress issues of spatial industrial inequalities, a legacy of the apartheid regime. The chapter asks why such zones (and their cousins, the Special Economic Zones) are not effective instruments for reducing spatial inequalities – and, in the particular case of the Special Economic Zones, for achieving international competitiveness; and what might be needed so that these zones become true poles of dynamism and revitalisation of South Africa's wider industrial base. The chapter highlights the lack of alignment between the country's industrial policy and its broader macroeconomic policy framework as an important factor explaining why achievements in industrial development to date have been rather limited.

Chapter 12, by Ricardo Gottschalk, takes on the topic of policy space. It argues that, despite the usual policy constraints of international, regional, and bilateral trade agreements that South Africa observes, the country still has space to design and implement those policies in order to realise its developmental goals. The chapter discusses, in particular, the need to carve out space to develop, within the manufacturing sector, the pharmaceutical industry and its technological capabilities to produce vaccines – in scale and scope – that meet the needs of both South Africa and the whole of Africa. How South Africa moves to a greener, fairer, and more inclusive economy, and at what speed, matters a great deal to South Africa itself but also to other countries in the African region. The region has various examples of regional integration initiatives in the areas of trade, macroeconomics, and finance. The African Continental Free Trade Area (AfCFTA), in particular, opens up new opportunities for further regional integration, not just in trade but also in production supply chains. For the southern African region, the implications of developments in South Africa can be particularly far-reaching. Most of southern Africa is already integrated through the Southern Africa Customs Union and the Common Monetary Area.

The final chapter in this volume, by Bryony Steyn from the UN RCO Lesotho, explores the question of how the Kingdom of Lesotho, a landlocked country fully surrounded by South Africa, is affected by its close ties with its larger neighbour. In doing so, it assesses the pros and cons of further integration with South Africa and whether diversification away from it towards other African countries could help it seize the opportunities arising from the AfCFTA. After an extensive analysis that draws on different integration indices for Lesotho, the chapter finds that the country is not as deeply integrated with South Africa as was initially thought. This is particularly the case in the areas of infrastructure and productive integration. Meanwhile, the chapter uncovers the fact that South Africa's integration with the rest of the African continent is much stronger. It concludes that, despite all the possible risks and downsides, further integration with South Africa might be a good strategy for Lesotho. The country could, as a consequence, benefit from more investments in regional value chains and infrastructure development at the regional level. Lesotho, therefore, could promote economic diversification through further integration with South Africa rather than by moving away from it.

Lesotho's dilemmas clearly apply to several other African countries, especially those more closely connected – through macro, trade, and finance – to South Africa. The message is that events in South Africa and the choices the country makes in its path to more inclusive and sustainable development are, besides any geopolitical considerations, of critical importance to African countries, and that any policy and strategic decision South Africa makes should take this reality into account.

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## 2. THE ROAD TOWARDS RECOVERY: THE MACROECONOMIC CONTEXT

Ricardo Gottschalk

### 1. Introduction

There is broad agreement in South Africa that the path to recovery from the COVID-19 pandemic will be arduous. Following four COVID-19 waves in the biennium 2020–2021, recovery has been slow, with GDP returning to pre-pandemic levels only in the first quarter of 2022 but declining again to below pre-pandemic levels in the subsequent quarter. Despite the relaxation of the lockdowns, unemployment continued to rise, reaching record highs at the end of 2021. Along with unemployment, widespread poverty and extreme inequality remain among the key challenges gripping the country.

These and other structural and 21st-century challenges, which are discussed in this volume, help to explain why the outlook for South Africa does not look particularly auspicious. The international context of rising inflation and jittery financial markets in connection with the Ukraine crisis adds uncertainty to any future scenario. However, the prevailing narrative that contributes to that sense of scepticism is that South Africa's macroeconomic conditions for recovery are not good either. According to this narrative, large fiscal deficits and high public debt constrain the fiscal space. Limited fiscal space, then, would make it harder to respond to pressing societal demands for better basic infrastructure and public services, or to enhance the social protection system. In addition, Eskom, a state-owned energy company that is fossil fuel-based and debt-ridden, is viewed as a major systemic bottleneck for rapid recovery.

This chapter discusses some of these macroeconomic challenges but also highlights some positive emerging trends. For instance, the outlook for the fiscal accounts and the public debt is improving. In addition, the public debt profile in South Africa has benefited from positive debt management over the years. The foreign trade sector continues to benefit from the ongoing commodity boom. Although one might argue that this is cyclical, South Africa's external sector also exhibits other kudos, such as a comfortable level of international reserves and the fact that the country is a net creditor in its international investment position.

The next section discusses what the chapter sees as the main risks to recovery. It then highlights what is positive in the current South African macroeconomic outlook. It ends by highlighting some of the key issues that need to be dealt with for an inclusive and sustainable growth path to be achieved.

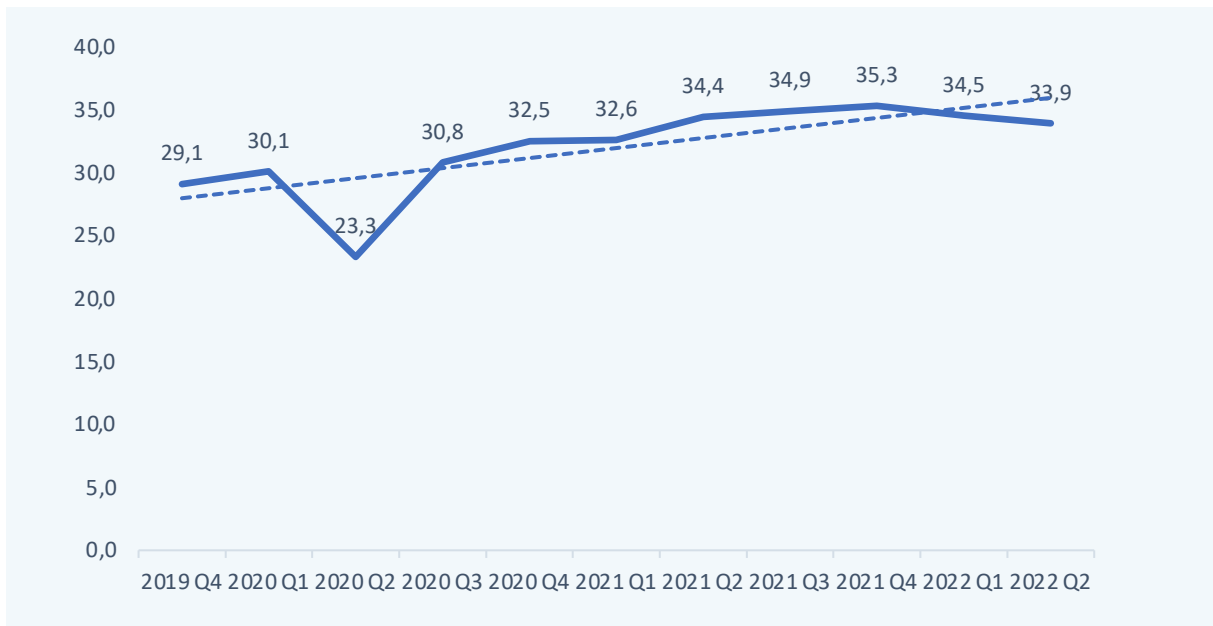
### 2. Key macroeconomic trends: What risks are in store?

In the short to medium term, the main risk to recovery in South Africa seems to come from the external front. The Ukraine crisis is causing high uncertainty in global trade and supply chains. Major disruptions in the supply of energy sources such as gas and oil, in addition to cereals such as wheat and maize, have already caused a sharp rise in prices. The South African Reserve Bank has responded by raising interest rates to curb inflation. This policy response will probably work as a hindrance to recovery, while higher inflation is already hurting above all the poor and the most vulnerable in South Africa.<sup>1</sup>

In dealing with poverty, the South African government is putting emphasis on job creation and employment programmes. However, unemployment increased throughout 2021, reaching the record high of 35.3% in the fourth quarter of the year, against 29.1% at the end of 2019, just before the start of the pandemic. In the first quarter of 2022, total unemployment at last receded down to 34.5% and again to 33.9% in the second quarter of the year, on the back of incipient output expansion – see Figure 1 .

<sup>1</sup> Consumer price inflation in South Africa was at 4.5% in 2021 and is projected by Stats SA to increase to 6.7% in 2022; however, it is forecast to recede slightly to 5.1% and 4.6% in 2023 and 2024, respectively (NT, 2022).

Figure 1: Unemployment rates – South Africa: 2019 Q4 to 2022 Q2 (percentage)



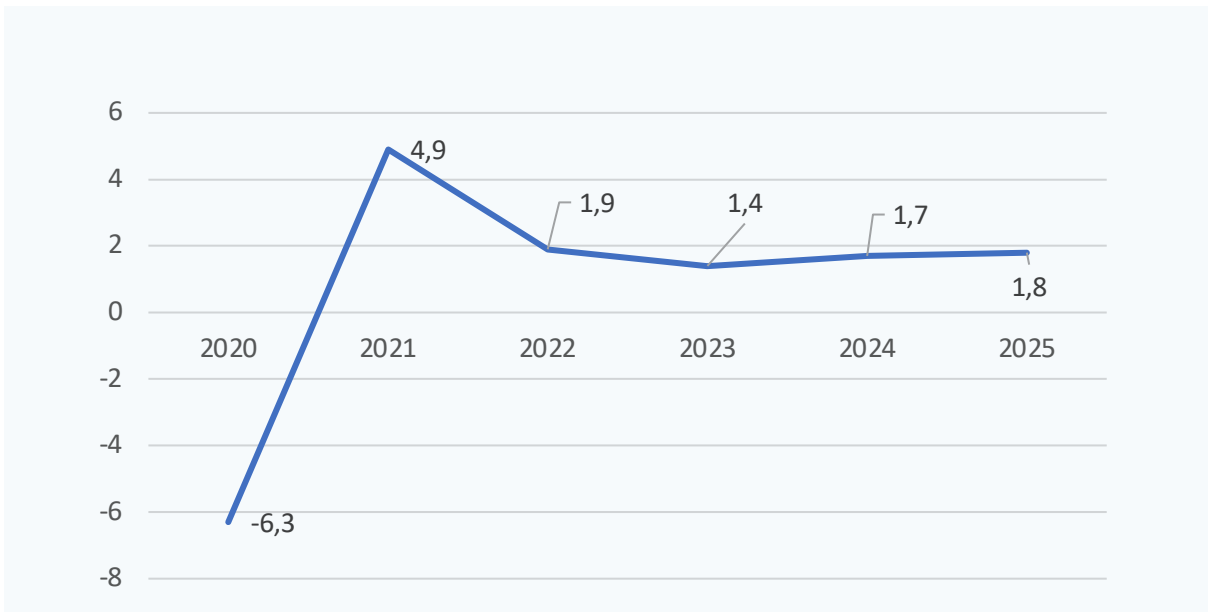
Source: QLFS, Stats South Africa.

Unemployment in its expanded definition declined by 1.4 percentage points, from 45.5 per cent in Q1: 2022 to 44.1 per cent in Q2: 2022. The youth unemployment rate, in turn, decreased by 1.3 percentage points to 46.5 per cent in Q2: 2022 (Stats SA, 2022).

Rising inflation and high unemployment rates, especially among the youth, are rich ground for new waves of civil unrest such as that South Africa witnessed in July 2021. Back in April 2020, at the height of COVID-19 crisis, the national government implemented a support package that included a Social Relief of Distress (SRD) Grant of R350 to adults between 18 and 59 years of age. The grant, although of a temporary nature, is a very important social protection mechanism for the most vulnerable, but it is unlikely that it will be sufficient to stem new waves of unrest arising from precarious socio-economic conditions. Such conditions include a lack of economic opportunities, different forms of violence (especially against women), and xenophobia, which, according to evidence, the pandemic has aggravated. The economy contracted during the quarter of the July civil unrest and new social uprisings would most probably be important deterrents to sustained growth. For the whole of 2021, GDP growth saw a rebound of 4.9% after the steep contraction of 6.3% in 2020 (Figure 2). The best-performing industries in 2021 were mining, agriculture, manufacturing, and trade, all growing at or above 6%. The worst performers were construction (suffering a contraction of 1.9%) and government (with zero growth – see Figure 3).



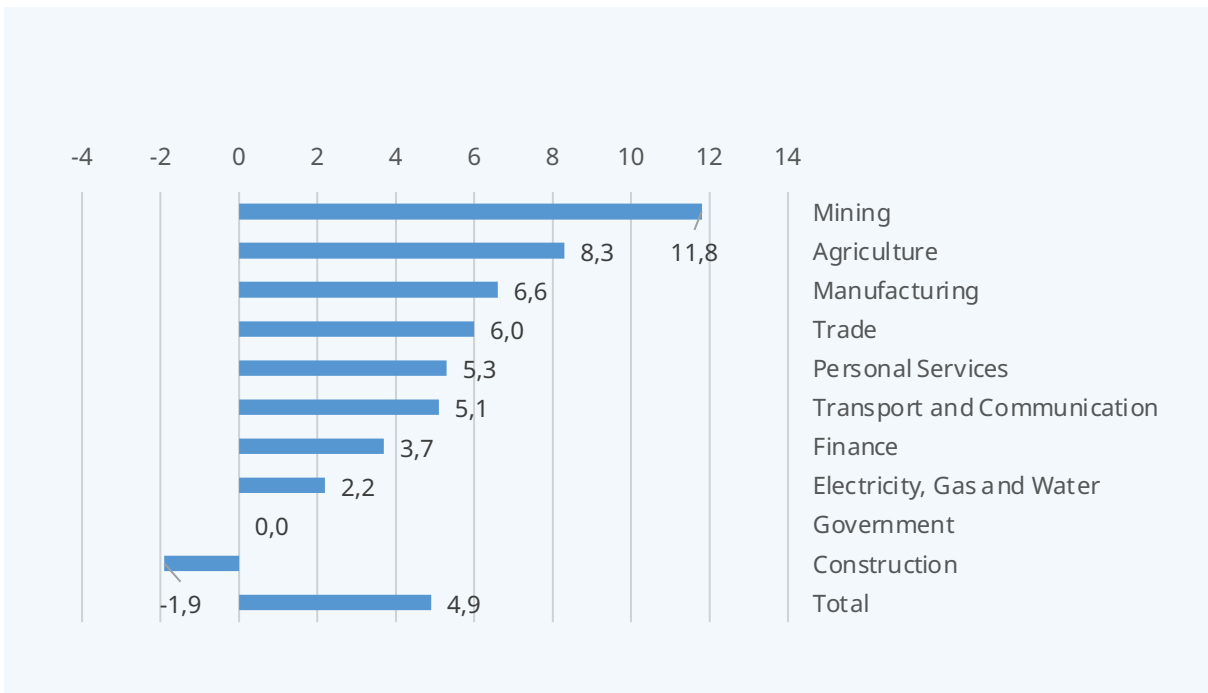
Figure 2: Annual GDP growth – South Africa 2020–2025 (percentage)



Source: SA National Treasury.

<sup>1</sup>Year 2022: Estimate; <sup>2</sup> 2023-2025: Forecast.

Figure 3: GDP growth by industry – South Africa 2021 (percentage)



Source: Stats South Africa.

For the years 2022-2024, GDP growth is forecast to slow down due to the end of the rebound, the softening of the commodity boom, the impacts of the Ukraine crisis and the rises in interest rates. Against these possible constraints to recovery, which include external conditions that interact with domestic factors, South Africa can also see some positive developments in some key macroeconomic variables, to which the chapter turns next.



### 3. Key macroeconomic trends: What positive developments?

#### *The fiscal accounts*

Both the government of South Africa and analysts have consistently warned that the country's fiscal position is fragile. The fiscal deficit reached 10% in 2020 (the year of the pandemic shock) and the debt trajectory was in the ascendency, moving from 51.5% of GDP in 2018 to 57.2% in 2019 and then 70.2% in 2020 (Table 1). For these reasons, the South African National Treasury (NT), the country's department charged with fiscal policy design and implementation, stands firm in its commitment to the goal of fiscal adjustment. According to the NT, this goal is to be achieved mainly through expenditure containment. Given this fiscal policy stance, the government strategy for economic recovery and reconstruction, outlined in October 2020, is to focus on structural reforms so that the private sector can drive economic growth in future.

Yet the fiscal accounts have yielded better results than anticipated at the height of the COVID-19 crisis. The 2022 Budget Review, titled 'Supporting the Recovery and building for the Future', presented to the National Parliament on 23 February 2022, indicated that tax-revenue collections were higher by R182 billion compared to the forecast back in the Budget Review of February 2021 – and then, again, higher by R83.5 billion in the Medium-Term Budget Policy Statement (MTBPS) of October 2022 compared to the February 2022 forecast (NT, 2022). These better results reflected higher corporate tax revenues linked to commodity prices and growth recovery. The budget deficit is estimated to be at 4.9% of GDP in 2022/23 – thus lower than the February 2022 forecast of 6.0% and is projected to decrease further to 3.9% in 2024/25 (Table 1).

**Table 1: Fiscal accounts South Africa percentage GDP**

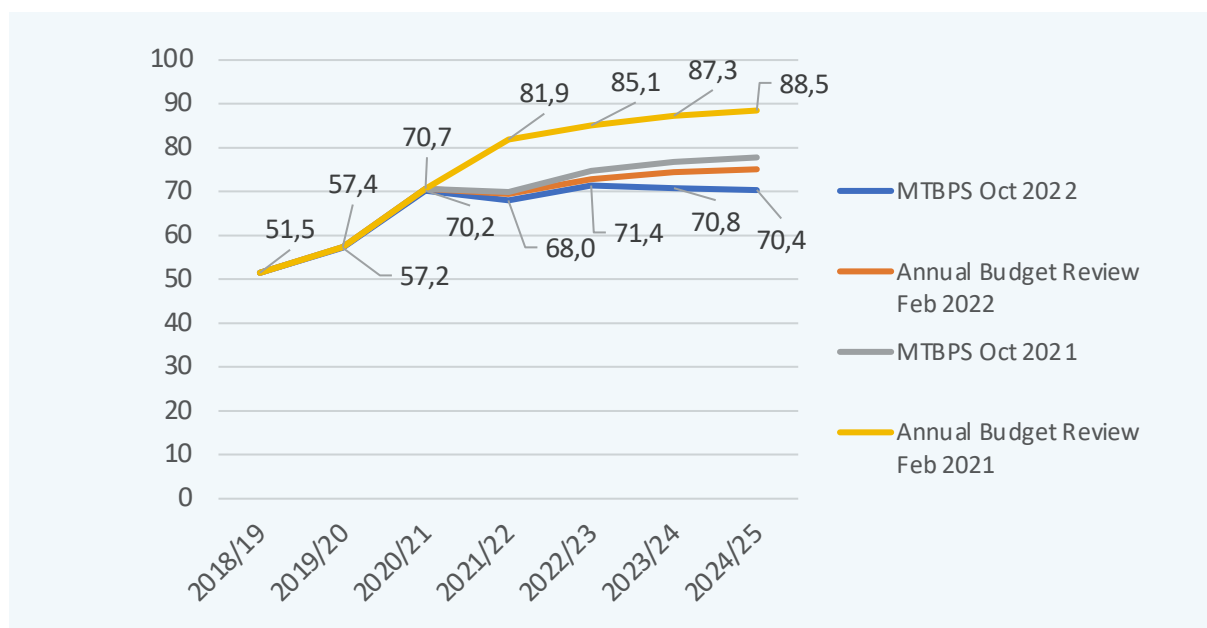
	2018/19	2019/20	2020/21	2021/22 <sup>1</sup>	2022/23 <sup>2</sup>	2023/24 <sup>2</sup>	2024/25 <sup>2</sup>
Fiscal deficit	3.6	5.1	10.0	4.7	4.9	4.1	3.9
Gross debt (MTBPS Oct 2022)	51.5	57.2	70.2	68.0	71.4	70.8	70.4
Gross debt (Annual Budget Feb 2022)	51.5	57.4	70.7	69.5	72.8	74.4	75.1
Gross debt (Annual Budget Feb 2021)				81.9	85.1	87.3	88.5

Source: SA National Treasury, various budgets.<sup>1</sup> Revised estimate.<sup>2</sup> Medium-term estimates.

The public debt, projected to reach 72.8% of GDP in 2022/23 just in February 2022, and 85.1% in the annual budget earlier on in February 2021, has been revised down to stabilise at 71.4 % of GDP already in 2022/23 and decline slightly thereafter (Table 1 and Figure 4).



Figure 4: Gross public debt (as percentage of GDP) – South Africa<sup>1</sup>



Source: SA National Treasury, various budgets. 1Years 2022-2025: Projections.

High debt levels coupled with unfavourable debt dynamics naturally raise concerns about debt sustainability.<sup>2</sup> The revised debt levels and the projected decline have partly reflected circumstantial factors, such as the rebasing of South Africa's GDP, higher inflation and better than expected tax revenue collection. It is therefore also important to look at other debt indicators, such as the debt profile. The profile of South Africa's public debt indicates that it has benefited from positive debt management over the past several years. Two key debt characteristics stand out. The first relates to its composition; the second, to its maturity. Regarding debt composition, in 2020, most of South African debt was denominated in domestic currency – 90%, with the other 10% denominated in foreign currency. Regarding maturity, in that same year, only 13% was short term, whereas the other 87% had an average long-term maturity of 12 years (International Monetary Fund (IMF), 2022). The domestic currency denomination makes debt capacity to pay less susceptible to large currency depreciations. The second characteristic – long-term maturity – makes debt-holders less vulnerable to market financing conditions, which can change very rapidly, as is currently the case under both COVID-19 and the Ukraine conflict.

#### 4. The Rand and the external sector

Since early 2020, the path of the South African domestic currency, the rand, has been punctuated by shifts (see Figure 5). Initially, a sharp depreciation took place in the first four months of 2020. It was mainly caused by a flight to safety by international investors, a phenomenon that affected nearly all emerging markets, and South Africa markedly so. The easing of the first lockdown restrictions, stimulus packages, and first signs of economic recovery around the world helped reduce global uncertainty and fuel a currency comeback to the emerging economies. The magnitude and speed of the comeback was particularly strong in South Africa, causing the rand to revalue. This phase lasted for over a year, until early June 2021. Between then and the end of 2021, the rand followed a more volatile path around a depreciating trend. Between January and late March 2022, the rand appreciated against the US dollar, despite the onset of the Ukraine crisis – and, latterly, it is depreciating as international monetary conditions tighten. A volatile exchange rate is not good for exporters, above all those whose export markets are sensitive to price fluctuations.

<sup>2</sup>A high debt-to-GDP ratio implies that a sizeable portion of fiscal revenues is directed towards interest payments. It is also possible that higher debt can drive interests up, leading to higher interest payments and the emergence of an undesirable debt dynamics. As a growing proportion of fiscal resources is used for debt servicing, resources for real (as opposed to financial) expenditures become limited. Because recurrent real expenditures tend to be rather rigid, real capital expenditures become the variable of adjustment. The implications are that public investments are reduced, which results in both output and revenue growth deceleration, leading to greater borrowing needs and/or further fiscal expenditure cuts. The occurrence of an adverse debt dynamics can, in all probability, limit government's ability to plan adequately to address the country's urgent needs – and, equally worrying, to commit public resources for long-term development.

Figure 5: Rand per US dollar 2 January 2020 to 06 November 2022

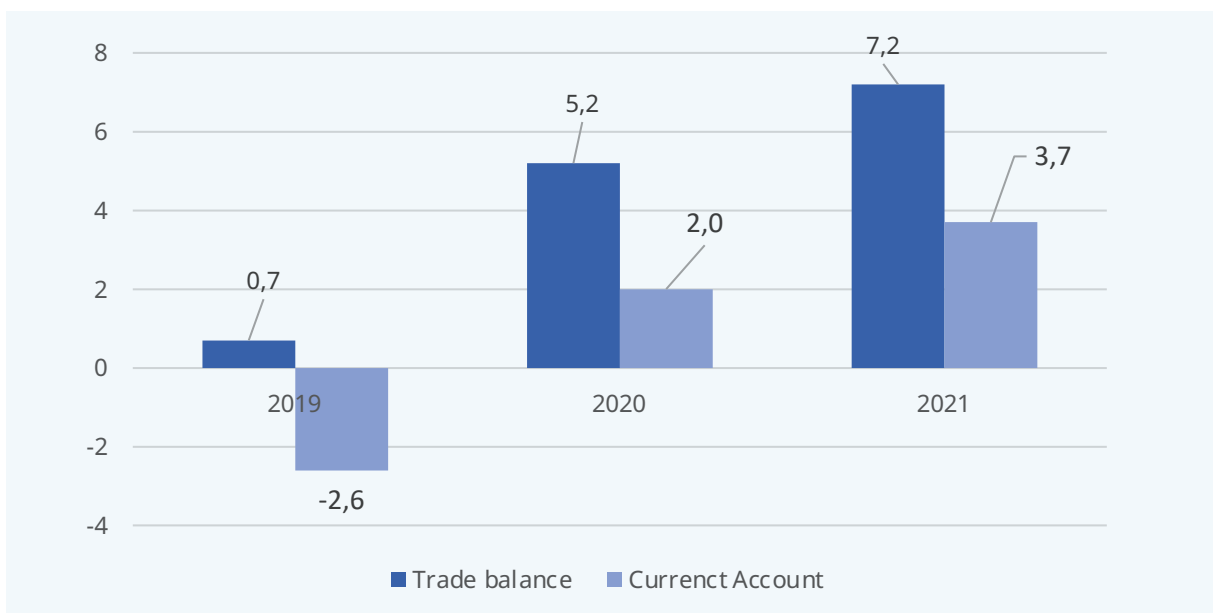


Source: IMF data.

<sup>1</sup> Rands measured against one dollar. Thus, going up means depreciation; going down, appreciation.

In the years 2020 and 2021, the country registered a trade surplus of respectively 5.2% and 7.2% of GDP (see Figure 6). These large surpluses reflected, above all, a rise in commodity prices – especially of minerals such as iron ore, copper, coal, nickel, and platinum. The strong trade account display contributed to the emergence of a current account surplus for the first time since 2002 (Figure 6).

Figure 6: The trade and current accounts of the balance of payments (percentage of GDP)



Source: SARB Quarterly Report Q1 2022.



Other positive trends in South Africa's external accounts include the country's total external debt, which declined from 50.5% of GDP at the end of 2020 to 41.0% of GDP at the end of first quarter of 2022.<sup>3</sup> More than half of this debt is denominated in local currency. In addition, by the end of March 2022, South Africa's gross international reserves stood at \$58.2 billion. This is equivalent to a level of import cover (merchandise imports plus services and income payments) of 4.8 months. Finally, South Africa is a net creditor country on the international stage. At the end of 2021, South Africa's international investment position (IIP) was net positive at a value equivalent to 26.8% of the country's GDP.<sup>4</sup> The country has been a net creditor since 2015. The only poor performer on the external front has been the financial account of the balance of payments: it registered a net outflow of capital of 3.9% of GDP in 2021 (SARB, various issues).

Thus, a few key macroeconomic indicators in South Africa look either good or at least moving in the right direction. These include declining fiscal deficit and projected public debt (and a positive debt profile), a large foreign trade surplus, a current account surplus (though declining and expected to turn negative soon), and a reasonable level of foreign reserves. Where indicators look dismal, such as the unemployment rate, this has to do with deep structural problems, besides jobless growth. The way forward, however, is not necessarily easy. Low levels of public investment – in addition to a structural context of the dominance of capital-intensive industries, market concentration (mining, finance, construction, retail) and a lack of pro-poor tax and land reforms, may hinder growth, or at least inclusive growth. The next section highlights a few additional challenges that South Africa will face on the road to sustainable recovery.

## 5. Selected future challenges

Back in October 2020, at the height of the COVID-19 crisis, the government of South Africa presented to the Parliament of South Africa an Economic Reconstruction and Recovery Plan aimed at economic rebuilding, job creation, and poverty alleviation. In addition, the plan supports a transition to a greener economy.

Following the launch of the plan, a UN South Africa Inter-Agency Group of Economists reflected on it, highlighting possible gaps and suggesting improvements. They called attention, in particular, to the need for 'leaving no one behind'. Accordingly, they expressed their support of workers' protection via the Unemployment Insurance Fund (UIF) and of the SRD Grant and advocated the use of the latter as a platform to a gradual adoption of a BIG. They also called for more investment in the health sector to equip it to better respond both 'to COVID-19 and the country's broader health needs' and to consider support for universal health coverage to ensure access to health care for all.

They also stressed the need to adopt a human-rights-based approach to public budgeting and they backed unreservedly a green transition (see more on these topics in the upcoming chapters of this volume). Regarding the latter, they asked for clarity as to which green technologies will be prioritised in the energy sector and suggested that the technological choices take into full account employability and green jobs creation. They also emphasised the importance of a financial regulatory framework that incentivises finance for green-related projects and that the government itself should play a catalytic role by championing initiatives on large green projects.

They acknowledged limited fiscal space but cautioned that the size of the fiscal stimulus during COVID-19 and its aftermath has been insufficient to ensure sustainable recovery and that the government should have considered stronger counter-cyclical stimulus measures that target the productive sector and local enterprise development (UN SA, 2020).

<sup>3</sup>In truth, part of this decline reflects exchange-rate variations and a rebasing of GDP.

<sup>4</sup>Yet, South Africa witnesses high net income payments abroad. Among the probable reasons is that South Africa pays a lot more for returns on its international liabilities than the returns it obtains from its international assets.

Some of these and other challenges highlighted by the Inter-Agency Group of Economists are discussed further below.

1. **Limited fiscal space:** A first major challenge for South Africa in a period of crisis is the limited fiscal space for a more vigorous recovery, or to build the conditions required for a recovery that is sustainable and green. While it is important to recognise that the government had, and still has, limited fiscal space to act more incisively; that the debt dynamics is an area of concern, and that public debt sustainability should be an important policy objective in the long term, the size of the fiscal stimulus in a crisis context is key, as private-sector investment alone is not enough to revive the economy. In a context of slow recovery, the government could boost public spending to accelerate and sustain growth (UN SA, 2020). Growth itself can expand fiscal space through higher tax-revenue collection. In addition, during the commodity boom, the government could have considered a windfall tax, a policy option advanced economies have adopted in the past and that has been adopted by the UK Treasury and recently agreed by the European Union in the context of the Ukraine crisis.
2. **Just transition:** A second major challenge is how best to support a just transition, which COP26 brought into sharper focus. COP26, which took place in Glasgow, UK, in November 2021, saw a renewal of South Africa's commitments to dealing with climate change and the country's positioning itself towards a just transition. In the midst of these commitments to step up efforts, South Africa, together with the United Kingdom, the USA, France, Germany, and the European Union, released a political declaration on The Just Energy Transition in South Africa. The declaration welcomes South Africa's submission of an enhanced Nationally Determined Contribution (NDC) which strengthens its commitments made under the Paris Agreement. The declaration stresses the need for '... a just, equitable, and inclusive transition for workers and affected communities ... so that no one is left behind' (UK COP26, 2021); and targeted programmes of reskilling and upskilling. The declaration also states South Africa's

intention to decommission and repurpose or repower coal-fired power stations, invest in new low-emission generation capacity such as renewables, increase energy efficiency and pursue green industrialisation such as manufacturing using green technology and a shift to the production of electric vehicles (UK COP26, 2021).

Most importantly, the declaration resolves to mobilise \$8.5 billion to support the just transition in South Africa through multilateral and bilateral grants, concessional loans, guarantees, and private investment. Nonetheless, the consensus that emerged from the declaration is that the financing promises from the international donors in support of South Africa's renewed commitments to climate action are still too little. This is especially true when one considers that these resources are not just grants but also loans to be repaid. In addition, the promised resources include private investments which are to be spread over a period of up to five years. In recognition that this initial loan package is largely insufficient to finance a just transition, just two days before the start of COP27 in Egypt, President Ramaphosa released a plan for public discussion which outlines what will be required for South Africa to achieve its decarbonisation commitments while supporting a transition that is just for workers, communities and the most vulnerable. According to the plan, the financing required amounts to R1.3 billion, or \$72.7 billion,<sup>5</sup> and targets the electricity, new energy vehicles and green hydrogen sectors. The value agreed at COP26 therefore accounts for just 12% of the total finance required (Ngcuka, 2022). The financing issue, with special focus on the 'just' component of the transition, is discussed in chapter 8 of this volume.

3. **Policy space:** A third issue, discussed in chapter 12 of this volume, is the need for additional policy space, particularly for pro-active industrial policy. This need has been amply demonstrated by the COVID-19 pandemic, which exposed South Africa and the African continent at large to their dependence on foreign technology and the supply of essential public and other goods such as vaccines. The chapter that takes on this topic argues that a pro-active industrial policy should target dynamic and technology-driven industries – and discusses in particular the case of the pharmaceutical industry, because of the vital role this industry can play as part of a recovery strategy that is both sustainable and resilient to future pandemic shocks.

<sup>5</sup>Calculated using the exchange rate of 17.9 rands for one dollar, of 06 Nov 2022.



4. **BIG:** A fourth issue is that of financing a BIG. The continuation of the pandemic and its impacts on lives and livelihoods led the national government to extend the SRD grant to the end of March 2024. In this context, a proposal to have the relief grant as part of an embryonic phase of a BIG has been made by a consortium of stakeholders, including the UN, who are working with the government on this matter. Nevertheless, there is the issue of affordability and therefore uncertainty whether the BIG will be adopted soon. That brings us back to the critical issue of fiscal space raised above. It is important, therefore, to find ways to create fiscal space for that initiative – through fiscal reform and other means. The adoption of a UBIG would be a most effective way to accelerate progress towards meeting the SDGs.
5. **Regional challenges:** A final issue relates to the regional challenges but also to the opportunities South Africa faces. One, of course, is the leading role South Africa can play in transforming the aspiration of a pan-African manufacturing platform for vaccines into reality, for which policy space and support from the international community is vital. Another is how best to deal with the rising migration trends, some of which are in response to the still ongoing COVID-19 pandemic. A third relates to AfCFTA: capital is needed for investments in infrastructure networks to integrate Africa so that the benefits of trade integration can be fully realised.

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### 3. THE FINANCING LANDSCAPE: WHAT OPPORTUNITIES FOR SOUTH AFRICA, WHAT CHALLENGES?

*Krivani Pillay*

#### 1. Introduction

While tabling the 2019 Medium Term Budget Policy Statement in October 2019, the then South African Minister of Finance, Tito Mboweni, acknowledged the difficult global and domestic environment, citing the global growth forecast for 2019 being the lowest since the 2008 financial crisis. At that time, economic growth had stagnated in South Africa – and that was even before the large contraction the economy suffered in 2020 due to the COVID-19 crisis. This low growth performance contributed to large revenue shortfalls and to the significant deterioration of South Africa's public finances in the 2010s – which were then further aggravated in 2020 by the lockdowns induced by COVID-19.

The consequence has been a growing public debt, to the point where interest payments began crowding out social and economic spending programmes. Efforts towards fiscal consolidation following the COVID-19 crisis have meant limited fiscal resources have been available to finance the SDGs. The question, then, is this: What impact does the economic downturn have for the decade of action and, in particular, for resource mobilisation towards the implementation of the SDGs?

As noted in other chapters of this volume, government expectations are that the private sector can drive growth, and that this can be done with the support of a national financial system that is large and that has grown rapidly in recent decades. An important part of that financial system is the Johannesburg Securities Exchange (JSE), the largest of Africa's 22 stock exchanges and the 16th largest in the world. The JSE describes itself as the engine room of the South African economy, providing an orderly market for dealing in securities. Its main function is to facilitate the raising of primary capital by rechanneling cash resources into productive economic activity and building the economy while enhancing job opportunities and wealth creation.

From a socio-economic development perspective, the question is whether the private sector, along with the JSE and other parts of South Africa's financial sector, can be effective sources of dynamism to support national priority issues. These include poverty alleviation, job creation, and youth and community development. As this volume stresses elsewhere, South Africa remains a dual economy with one of the highest inequality rates in the world. High inequality is perpetuated by a legacy of exclusion and the nature of economic growth, which is not pro-poor and does not generate enough jobs. Inequality in wealth is even higher. Furthermore, intergenerational mobility is low, meaning that inequalities are passed down from generation to generation with little change in inequality over time (van der Weide et al., 2021).

This chapter explores some of the actual and potential sources of finance for the South African economy with the aim of providing an overview of some of the sources that have been under consideration in the national debate on the topic. Section 2 briefly discusses the current fiscal instance undertaken by the National Treasury and its implications for financing South Africa's urgent socio-economic needs. Section 3 describes some of the instruments the government has to hand to leverage resources for development. Section 4 highlights private finance, other potential sources of finance, and the role philanthropy and NGOs could play, whereas section 5 concludes.



## 2. The government's fiscal instance: Balancing the quest for fiscal sustainability and financing development

The National Treasury is the custodian of the nation's financial resources. It manages the annual budget process and provides public finance management support.<sup>1</sup> The measurable objective is to promote growth, social development, and poverty reduction through sound fiscal and financial policies and the effective, efficient, and appropriate allocation of public funds.

The current government emphasis on fiscal austerity is part of efforts to ensure fiscal sustainability. This policy instance, however, threatens the realisation of human rights, particularly for low-income households, many of whom are female-headed, and the poor (see next chapter). Austerity measures include reductions in expenditure to social services and also the imposition of Value Added Tax (VAT). VAT increased from 14% to 15% from 1 April 2018. This increase was not preceded by an assessment of its human-rights impact, and the measures adopted have resulted in significant budget cuts in the health, education, and other public-service sectors, making these services unaffordable and inaccessible to many.

The implementation of austerity measures in the future may further increase inequalities or even reverse the progress made to date, particularly in the health and education sectors.

The austerity measures reflect concerns over the public debt. The government's debt management strategy is informed by strategic risk benchmarks for interest, inflation, the currency, and refinancing. This ensures that the debt portfolio can accommodate changes in the fiscal stance and minimise debt-service costs and refinancing risk. In recent years, the government has lengthened the debt maturity profile and successfully managed to refinance risk in the long-term debt portfolio, allowing it to consider increased issuance in the 5- to 10-year maturity bracket to reduce debt-service costs.

There is also, of course, the ever-present risk of contingent liabilities, which may increase the debt burden. Indeed, budget bailouts for State-Owned Enterprises (SOEs) are always possible. While the government will not take on the power utility (Eskom's) debt, there is a restructuring plan to unbundle Eskom. In the 2019 Budget Review, the Treasury set aside R23 billion a year for a period of three years to support Eskom financially during its reconfiguration (Creamer, 2019). In addition, in that same year, R5 billion was allocated to South African Airways (SAA), R1.2 billion to South African Express Airways and R2.9 billion to the South African Post Office (SAPO).

Thus, the austerity drive as part of efforts to reverse the ascendent trajectory of South Africa's public debt and put it on a sustainable path cast doubt about the public sector's ability to be a major growth engine and source of resources to support the 2030 Development Agenda and the SDGs. This reality subsists against the fact that the country – and the world – is just seven years away from the end of the decade of action to meet the 2030 Agenda.

Below, this chapter discusses (albeit briefly) leakages in public finance relating to large amounts of illicit financial flows out of the country, high levels of tax avoidance, and the high incidence of irregularities in public funding (some implying corrupt practices). These issues have a serious impact on South Africa's ability to mobilise the maximum available resources for realising the economic social and cultural rights (ESCR)<sup>2</sup> which are part and parcel of what the country aims to achieve within the SDG framework.<sup>3</sup> If these leakages were to be appropriately responded to, South Africa could be in a stronger position to promote growth and social development.

<sup>1</sup>See Government of South Africa (1999). *The Public Finance Management Act, chapter 2*. For an analysis of the Act implementation, see Wildeman and Jogo (2012).

<sup>2</sup>The ESCR is discussed in detail in the next chapter.

<sup>3</sup>See <https://www.ohchr.org/en/human-rights/economic-social-cultural-rights#:~:text=Economic%20social%20and%20cultural%20rights,and%20sanitation%2C%20and%20to%20work>.



### 3. Supporting the decade of action: If not the budget, what instruments are at hand?

In turning towards the private sector as the alternative engine of growth for the coming years, the government is taking initiatives, including leveraging key instruments at its disposal to encourage businesses to keep investing in the economy and supporting business development. This section highlights next some of these instruments.

**Industrial Development Corporation (IDC):** The IDC is a national development finance institution set up to promote economic growth and industrial development. It offers loan amounts of a minimum of R1 million with a maximum of R1 billion per project. Lending criteria include start-up businesses and funding for buildings, machinery, and working capital for businesses operating in South Africa. Existing businesses can also apply for expansionary purposes. Priority sectors include green industries (renewable energy, energy efficiency, and waste management and recycling), agricultural value chain, manufacturing activities (clothing, textiles, pharmaceuticals, plastics, and chemicals), and strategic high-impact projects (logistics industrial infrastructure, mining value chain, tourism and high-level services, media and motion pictures, knowledge economy, ICT, and biotechnology).

**Small Enterprise Development Agency (SEDA):** SEDA is linked to the Department of Small Business Development and provides business development and support services for small enterprises through its national network in partnership with other role players in small enterprise support.

**Infrastructure Fund:** The government has set up a blended-finance Infrastructure Fund. The fund's implementation unit has been established and is housed in the Development Bank of Southern Africa (DBSA). Its aim is to fast-track the development of projects and programmes by drawing on existing capacity in the Presidential Infrastructure Coordinating Commission, the National Treasury, the Government Technical Advisory Centre (GTAC) and the Independent Power Producers Office.

The unit is identifying policy and regulatory hurdles in the public sector that hamper private and public investment. It is collaborating with the private sector through associations such as the Banking Association South Africa, the Association for Savings and Investment South Africa, and the Public Private Growth Initiative. The Infrastructure Fund has been seed funded by the National Treasury to the amount of R100 billion over a ten-year period to co-finance programmes and projects that blend public and private resources. The seed fund is aimed at catalysing one trillion rand of infrastructure delivery in the country. The implementation unit has developed a pipeline of projects for funding that includes proposals from government, the private sector, and the DBSA.<sup>4</sup>

**The Green Fund:** The government of South Africa, through the Department of Forestry, Fisheries and the Environment (DFFE), has set up a Green Fund to support the transition to a low-carbon, resource-efficient and climate-resilient development path that delivers high-impact economic, environmental, and social benefits. The DFFE has appointed the Development Bank of Southern Africa (DBSA) as the implementing agent of the Green Fund, which has an initial allocation of R800 million. The Green Fund aims to provide catalytic finance to facilitate investment in green initiatives that will support poverty reduction and job creation. Importantly, the Fund will support only those initiatives which would not have been implemented without its support (for more details about the Green Fund, see Chapter 8 by Siyanda Siko). The Green Fund is additional and complementary to existing fiscal allocations supporting the transitioning of the South African economy to a low-carbon, resource-efficient and climate-resilient growth path.<sup>5</sup>

**The National Empowerment Fund (NEF):** Established by the National Empowerment Fund Act, 1998 (Act No. 105 of 1998), the NEF was set up to promote and facilitate black economic participation by providing financial and non-financial support to black-empowered businesses. In addition, the Fund is aimed at promoting a culture of savings and investment among black people. The NEF provides business loans from R250 000 to R75 million across all industry sectors, for start-ups, expansion, and equity-acquisition purposes.<sup>6</sup>

<sup>4</sup><https://www.dbsa.org/solutions/infrastructure-fund>.

<sup>5</sup><https://www.dffe.gov.za/projectsprogrammes/greenfund>.

<sup>6</sup><https://www.nefcorp.co.za/about-the-nef/mandate-vision-and-mission/>.



**Tourism Transformation Fund:** The Tourism Transformation Fund helps black-owned enterprises to benefit from South Africa's growing tourism sector. Securing funding has been identified as a major obstacle to establishing new businesses and to growing existing tourism enterprises. The Fund has been established by the Department of Tourism in collaboration with the NEF and is a dedicated capital-investment mechanism that will support black investors and communities to develop and expand tourism-related projects. The Fund aims to catalyse the rise of black-owned youth-, women- and community-owned tourism enterprises.<sup>7</sup>

**Growth Fund:** The Growth Fund is a grant fund specifically for growing South African small businesses which need a cash injection to scale up further and create jobs. The Growth Fund is open to South African-owned businesses that operate in South Africa, are at least one year old and with a turnover or assets above R1 million. The Growth Fund is managed by CDI Capital and the funding has been enabled through R19 million in contributions by the National Treasury's Jobs Fund, the Technology Innovation Agency (TIA), and the Western Cape Department of Economic Development and Tourism (DEDAT).<sup>8</sup>

**National Youth Development Agency (NYDA):** NYDA provides grant finance in the form of micro-finance grants for survivalist youth entrepreneurship and co-operative grants for greater participation of youths in the co-operative sector. The objective of the grant programme is to provide young entrepreneurs with an opportunity to access both financial and non-financial business development support to establish their survivalist businesses. The programme focuses on youth entrepreneurs who are just coming into existence and are beginning to display signs of future potential but are not yet fully developed. The grant finance starts from R1 000 to a maximum of R200 000 for any individual or youth co-operative.<sup>9</sup>

**Fund to help address gender-based violence:** The Gender-Based Violence and Femicide (GBVF) Response Fund1 was launched by President Cyril Ramaphosa in February 2021 to deal with the scourge of GBVF in South Africa. The aim of the independent private sector-led GBVF Response Fund1 is to help drive a coordinated response to this national pandemic. The Fund aims to play a critical role in making change happen, based on research, awareness and practical support to organisations actively engaged in the fight against this scourge.<sup>10</sup>

**National Health Insurance Fund (NHI Fund):** In the late 2010s, South Africa was spending 8.7% of GDP on healthcare, of which 43% was public spending catering to 83% of the uninsured population and some of the insured population which had run out of their medical scheme funding. Some 47% is private health expenditure spent on 17% of the insured population through medical schemes. Even though the spending on health is on a par with that of many OECD countries, the majority of the South African population has to rely on a poorly funded public health system compared to the private sector.

Increasing medico-legal cases in the public health sector is adding to the raising financial burden on the public health system and the rising cost of care in the private sector is increasing the burden on the premium of private medical schemes. In response to these inequities and to change the way the health system is financed in the country, South Africa introduced National Health Insurance (NHI). The NHI is a health financing system designed to pool funds to provide access to quality, affordable personal health services for all South Africans based on their health needs, irrespective of their socio-economic status. NHI will be implemented in phases over a 14-year period that started in 2012.<sup>11</sup>

The funding for NHI will be through a combination of various mandatory pre-payment sources, primarily based on general taxes.<sup>12</sup> The fund is expected to bring equity in financing the health system in the country and ultimately pave a path towards Universal Health Coverage in South Africa.

<sup>7</sup>[https://www.tourism.gov.za/CurrentProjects/Tourism\\_Transformation\\_Fund/pages/tourism-transformation-fund.aspx](https://www.tourism.gov.za/CurrentProjects/Tourism_Transformation_Fund/pages/tourism-transformation-fund.aspx)

<sup>8</sup><https://cdicapital.co.za/1651-2/>

<sup>9</sup><http://www.nyda.gov.za/Products-Services/NYDA-Grant-Programme.html>

<sup>10</sup><https://gbvfresponsefund1.org/>

<sup>11</sup><https://www.gov.za/about-government/government-programmes/national-health-insurance-0>

<sup>12</sup><https://pmg.org.za/bill/886/>

These various instruments and mechanisms described above have been in place for a while. Some of them have probably already made a difference to those they directly targeted. However, research is needed to assess what their real impact to date has been, not only at an individual level, but, very importantly, at the macro and structural levels. This sort of assessment would allow for their revaluation and for the introduction of measures that could strengthen them and render them more effective. A key issue that warrants proper analysis is whether these mechanisms lack the scale to be able to make a difference at a macro level and enact real change in the country.

#### 4. Taking a broader look: What about private and other sources of finance?

With National Treasury arguably facing significant budgetary constraints and public leveraging mechanisms that can go only so far to raise additional funding for development, it is important to consider what private finance – and related sources and financing modalities such as PPPs and philanthropy – can do and the potential it has to play a more direct role in financing key SDG-related investments and other development-oriented interventions.

##### *What role for private finance?*

Global and continental dialogues have consistently embraced the concept of leveraging private financing in infrastructure development, which is so essential to the achievement of so many SDGs, from clean water and sanitation to good health, quality education, and sustainable cities and communities.

However, private financiers often favour profit considerations over development impact. Private financiers also typically pay scant attention to mechanisms designed to enhance the sustainable development outcomes of infrastructure, such as job creation, local content procurement, enterprise development, socio-economic development or the mainstreaming of gender considerations into infrastructure projects.

Since 2018, President Cyril Ramaphosa and his administration have been trying to convince investors that South Africa is an optimal investment destination. In 2018, he set a target to lure investments of \$100 billion by 2023 in an attempt to reignite economic growth, which has been falling far short of the 5.4% annual target set in the NDP, the government's blueprint for eliminating poverty and reducing inequality. There are global private-equity funds that are investing heavily in emerging markets, including South Africa. There are also trade investors and large multinational companies looking to grow their own markets and also to diversify their own risks and capitalise on opportunities.

From an FDI perspective, a key criterion behind investment decisions is to try to better understand the associated risks. FDI in South Africa made a significant recovery in 2018 after several years of low-level inflows, according to the UN 2019 World Investment Report. Since then, the investment patterns have been volatile due to the COVID-19 crisis and its aftermath. The United Nations Conference on Trade and Development, in its World Investment Report 2022, notes that FDI to South Africa saw an increase from \$3 billion in 2020 to \$41 billion in 2021. However, this increase was entirely explained by a share swap between NASPERS – a South African multinational listed on the JSE – and its subsidiary, Prosus, listed in The Netherlands. As a result, there is not yet a clear picture as to where FDI is heading in relation to South Africa.

Private finance is not panning out as a key investment source, as was initially hoped for. But there remains an appetite and space for the private sector to play a role in their ability to provide innovation financing and technical solutions for infrastructure. Co-financing – that is, bringing together private financing with the public sector, development finance institutions (DFIs) and/or development partner funding – could combine concessionary loans with debt financing from international financial institutions. A 'grant loan' element could, for instance, help to keep the service tariff affordable, or be used for interest rate subsidies, investment grants, technical assistance, loan guarantees, or insurance premiums. A reason to consider co-financing is that the involvement of the private sector in infrastructure projects is not always a natural fit, especially development-oriented projects, such as social infrastructure. Such projects have historically been viewed as the business realm of governments – embodied in the monopoly public utility. That said, it is true that, since the various waves of privatisation, private-sector involvement in infrastructure has deepened and matured.



Governments, private contractors, and advisers in the field have benefited from both hindsight and modern evaluation techniques. The approach to private participation in infrastructure (PPI) and public-private partnerships (PPPs) has become more bespoke to individual project requirements and also to the economic and political climate of the day. Some assessments of PPI and PPPs in developing countries have, however, highlighted problems and pointed to very mixed results.<sup>13</sup>

When considering the 'next phase' model beyond PPPs, analysts point to the 5Ps (pro-poor public private partnerships), alliances involving governments, private companies, micro finance institutions, multilateral development banks, and non-profit organisations (including community-based organisations and research or academic institutions). 5Ps focus on the poorest communities, particularly with restricted access to infrastructure services in rural areas. The idea is not to provide services at no cost, but rather to structure the delivery and pricing of services in such a way that they are affordable to poorer communities.

The private sector is motivated by profit, so there is no strong inducement to scale up delivery to poor or remote customers. Therefore, the role of government policies and regulations in protecting disadvantaged groups remains critical (SAIIA, 2015).

### *A closer look at public-private partnerships (PPPs)*

Public-private partnerships, or PPPs, were established under the Public Management Act (1999) and Treasury Regulation 16; and, at the sub-national level, they are governed under the Municipal Finance Management Act (2003) and Municipal Systems Act (2003), which form the legislation under which they now operate. PPPs are still seen by key government players and the private sector as the solution to the shortfall in financing needed to achieve the SDGs. Economic infrastructure – such as railways, roads, airports, and ports, plus key services such as health, education, water, and electricity – is being delivered through PPPs (Polity, 2018).

The NDP prioritises investment in water, energy, telecommunication, transport, and social infrastructure to grow the economy and reduce inequality and unemployment. The plan states that infrastructure investment as a percentage of GDP needs to rise to 30% in 2030. The public sector cannot fund infrastructure alone. Private-sector investments are therefore seen as being needed to help fill in the financing gap for the country to enable it to meet the NDP's target (NT, 2018).

Despite some success of the PPP model in South Africa, the number of new project transactions has declined over the years, mainly as a result of delays and cancelled projects in the health and security sectors. In addition, increasingly restrictive international financial standards for banks (i.e., the Basel III standards) are limiting their ability to provide debt funding.

There have also been some barriers to the successful implementation of some PPPs. These include political interference; poor planning and communication; partners resisting change in adopting new approaches; poor public-sector conduct such as hiring inadequate and unskilled personnel; discrimination and access inequality; unprotected environments, and increased public risk. There have also been some incomplete projects resulting from the depletion of funds.

### *Domestic philanthropy and non-governmental organisations (NGOs)*

According to UNDP South Africa, the overall business environment is well developed, but major challenges remain, notably in energy supply, trading across borders, and red tape. From 2010 to 2015, South Africa received an average of US\$127 million per year in foundation funding. Most of this funding went to health, education, peace, justice, and strong institutions. The main donors were the Bill and Melinda Gates Foundation, the Ford Foundation, and the Andrew W. Mellon Foundation.

<sup>13</sup>See, for example, UNCTAD (2015), Chapter 6; and, for PPP experiences in southern Africa, see Mfunwa (2015).

### *Corporate South Africa CSI initiatives*

Findings from the annual *Dialogue Business in Society Handbook* show that companies spent a not inconsiderable amount on corporate social investment (CSI) in South Africa – an estimated R10.2 billion in 2019, a 5% year-on-year increase in nominal terms against 2018 figures. Education was supported by 94% of the corporates surveyed and accounted for an average of half of companies' CSI spent in 2019, up from 44% in 2018. Social and community development remained the second most supported sector and health the third, with 77% and 51% of companies funding these sectors respectively. The proportion of companies supporting disaster relief stood at 41%, although only 2% of the funds were directed to the sector. Since COVID-19, however, these figures have most likely increased significantly, in response to COVID as well as the other shocks that hit South Africa, such as the civil unrest of July 2021 and the KwaZulu-Natal floods of April 2022.

Of all the companies surveyed, 90% gave to non-profit organisations (NPOs) in 2019. The average proportion of CSI funding directed to NPOs was 54%. The next most common recipient was government institutions (including schools, universities, hospitals, and clinics), which were funded by 72% of companies and received an average of 29% of companies' CSI expenditure in 2019 (Dialogue, 2019).

### *Illicit financial flows*

Finally, another potential source of finance which could become significant for South Africa could be concretised by vigorously tackling illicit financial flows (IFFs). IFFs can be broadly defined as

all unrecorded private financial outflows involving capital that is illegally earned, transferred, or utilised, generally used by residents to accumulate foreign assets in contravention of applicable capital controls and regulatory frameworks (GFI, 2013).

According to estimates from Global Financial Integrity, South Africa lost more than 100.7 billion dollars during the period 2002–2011. It is ranked number 13 for its illicit outflows among developing countries. At the regional level, IFFs continue to deny Africa much-needed capital for its development. There have been increasing efforts to do something about it in Africa: the High-Level Panel on Illicit Financial Flows from Africa was established following a resolution of the 4th Joint Annual Meetings of the ECA/AU Ministers of Finance, Planning and Economic Development in Africa in March 2011. The Panel has adopted a plan of action which provides a space for CSO actors to support the initiative.

Combatting illicit financial flows remains critically important to South Africa due to their effects on draining foreign-exchange reserves, reduced tax collection, cancelling out of investment inflows, and a worsening of poverty. Such outflows, which also undermine the rule of law, stifle trade and worsen macroeconomic conditions. The United Nations Office on Drugs and Crime is working on combatting illicit financial flows, together with the Asset Forfeiture Unit of the National Prosecuting Agency (NPA), ARINSA. South Africa, through the NPA, plays a key role regionally as secretariat of this network, and through the provision of relevant technical assistance in the context of its Prosecutor Placement Programme.



## 5. Conclusion

Confidence in South Africa is increasing (see Chapter 1), although it is still low due to macroeconomic and policy uncertainty, which hampers investment. Unemployment is expected to remain high despite ongoing recovery. Trade is performing well due to the commodity boom, but this could be affected soon by global tensions. As South Africa has only seven years until 2030, one can only hope that, following the COVID-19 crisis, its recovery will accelerate and that overall investment will pick up to support inclusive and sustainable development and the achievement of the SDGs.

With more rapid growth, more domestic public resources will be made available, but efforts to leverage resources from different sources, including through innovative mechanisms, especially to support green growth, will be of critical importance. There is so much that South Africa can do. What is still needed is a more supportive global financial architecture that helps South Africa, Africa, and other developing regions to overcome the ongoing challenges and obstacles, including the current international tensions and rising energy and food prices, on their road towards sustainable growth and development.

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## 4. MINIMUM CORE OBLIGATIONS OF SOUTH AFRICA TO ENSURE A MORE JUST AND INCLUSIVE ECONOMIC RECOVERY IN A POST COVID ERA: BUDGETARY ALLOCATIONS

OHCHR, ROSA

### 1. Introduction

South Africa's economy has been on a slow growth trajectory since even before the pandemic. There is a 'consensus amongst the social partners that there should be substantial structural change in the economy'. In October 2020, South Africa adopted the post-COVID-19 economic recovery blueprint titled 'The South African Economic Reconstruction and Recovery Plan, 2021' (Recovery Plan, 2020). According to the Government, the reconstruction and recovery plan is aimed at stimulating equitable and inclusive growth (Recovery Plan, 2020).

According to the Minister of Social Development of South Africa, the COVID-19 pandemic 'has laid bare and reinforced the structural inequalities that have defined this country (South Africa) for too long' (UNDP, 2020a). The World Inequality Database (WID) shows that the

top 1% of South African earners take home almost 20% of all income in the country, while the top 10% take home 65%. The remaining 90% of South African earners get only 35% of total income (UNDP, 2020a).

A by-product of such extreme levels of inequality is the vulnerability of large swathes of South Africans to shock-related events. Indeed, the socio-economic impact assessment of COVID-19 in South Africa has highlighted the vulnerabilities of many sections of the population (UNDP, 2020b). COVID-19 has brought to the fore the socio-economic realities faced by several vulnerable groups, including, but not limited to, women, children, older persons, persons with disabilities, persons deprived of their liberty, migrants, refugees, asylum seekers, homeless persons, and sex workers (UNDP, 2020b and Doctors Without Borders, 2020). It has also highlighted the inequalities in the healthcare and the education systems, and in access to social security and work in both the formal and informal sectors.

The Recovery Plan proposes to redress these inequalities by rebooting the economic architecture. The Plan states:

It is [now] an opportunity to build a new, inclusive economy that benefits all South Africans. This is a moment for a permanent and decisive break with our past of low and declining growth, falling per capita incomes, low investment, as well as high and deeply entrenched levels of inequality, poverty, and unemployment (Recovery Plan, 2020).

The Recovery Plan, in line with its emphasis on addressing inequalities, makes as one of its nine priority areas 'Gender equality and economic inclusion of women and youth' (Recovery Plan, 2020). However, while the mention of gender equality and inclusion is important, the inequality net has become wider and has caught up several groups, especially since the advent of COVID-19.

This chapter puts forward the view that one way to resolve prevailing inequalities is to adopt a human-rights approach to the budgeting process, one which has a human-rights lens focused on government expenditure. This approach would be consistent with the view that 'the budget and budget processes are [or at least can be] critical to the advancement and protection of human rights'. However, during the past several years, the reality has been the government allocating fewer resources towards social spending, a trend that has impeded the realisation of socio-economic rights (Budget Justice Coalition, 2020; UNICEF, 2021 a and b). This has arguably been in part the result of high debt-servicing costs. As the South African National Treasury has indicated, the

fiscal environment has been, over the past five years, characterised by interest payments absorbing a growing share of limited public resources, which increasingly crowds out spending on social and economic investment (National Treasury, 2020).



In this regard, 'debt-service costs are now [2021 budget] at 4.8% of GDP, up from 3.3% in 2016/17' (National Treasury, 2020).

A crowding-out of socio-economic investment is in conflict with South Africa's constitutional and international obligations, which require the state to ensure that it allocates sufficient resources to realise human rights. Where austerity measures are adopted, the Committee on Economic, Social and Cultural Rights (CESCR) of the United Nations states that such measures should

be temporary, covering only the period of the crisis, necessary and proportionate; should not result in discrimination and increased inequalities; and should ensure that the rights of disadvantaged and marginalised individuals and groups are not disproportionately affected.<sup>1</sup>

South Africa should therefore meet its minimum core obligations to ensure that the socio-economic rights of all sections of society are realised.

Following this introduction, section 2 elaborates on South Africa's obligation that it allocate sufficient budgetary resources to realising its minimum core obligations. Section 3 discusses the vulnerabilities that different sections of the society face due to non-allocation of sufficient budgetary resources and to structural-historical factors such as the deeply entrenched inequality that characterises South African society. Section 4 proposes human rights-based budgeting for adoption, pointing out its appropriateness while also highlighting possible limitations. Finally, section 5 concludes and provides recommendations to ensure that sufficient budgetary resources are allocated so as to realise human rights.

## 2. South Africa's obligations

The boundaries of human-rights obligations, whether national or international in nature, should be understood in the context of the fourfold framework of obligations. According to this framework, South Africa has a duty to promote, protect, respect, and fulfil human rights. There is no hierarchy to these four pillars: the meaning of each right or freedom determines the pillar that is applicable at any given point.

Article 2(1) of the International Covenant on Economic Social and Cultural Rights (ICESCR) is the primary provision regarding states' obligations to fulfil socio-economic rights. It provides as follows in relation to economic, social, and cultural rights:

Each State Party to the present Covenant undertakes to take steps, individually and through international assistance and co-operation, especially economic and technical, to the maximum of its available resources, with a view to achieving progressively the full realisation of the rights recognised in the present Covenant by all appropriate means, including particularly the adoption of legislative measures.

Accordingly, South Africa has an immediate obligation to realise the socio-economic rights of its citizens without any discrimination<sup>2</sup> to the maximum extent of the available resources. A lack of resources is not an excuse to justify inaction or an indefinite postponement of measures. The state must demonstrate what measures it is instituting towards the progressive realisation of rights, including international assistance and cooperation in addition to internal measures. Therefore, the state is obligated to move expeditiously and effectively, without taking retrogressive measures concerning the achievement of the rights.<sup>3</sup> Omissions could amount to human-rights violations.

<sup>1</sup>Concluding Observations on South Africa Initial Report to the Committee on ESCR, para 19.

<sup>2</sup>Article 2(2) of the ICESCR: 'The States Parties to the present Covenant undertake to guarantee that the rights enunciated in the present Covenant will be exercised without discrimination of any kind as to race, colour, sex, language, religion, political or other opinion, national or social origin, property, birth or other status.'

<sup>3</sup>General Comment 3 of Committee on Economic Social and Cultural Rights on The nature of States' parties obligations (1990) para 9.



The CESCR underscores that states have a core obligation to ensure at the very least minimum essential levels of socio-economic rights.<sup>4</sup> The CESCR further explains that a state party is in a prima facie violation of its obligation under the ICESCR when members of its population are deprived of essential foodstuffs, essential primary healthcare, basic shelter and housing, or the most basic forms of education.<sup>5</sup> The insufficiency of resources cannot be used as a justification for non-realisation of socio-economic rights and, where necessary, international assistance should be solicited and used.

South Africa is therefore faced with a number of challenges in meeting its minimum core obligations to realise socio-economic rights under the ICESCR and the CESCR. The country needs to adopt strategies such as a human-rights approach to its public budgeting process to ensure that it prioritises the allocation of resources to line items that lead to the realisation of socio-economic rights.

### 3. Inequality and vulnerability in South Africa

Development theory is concerned with three core dimensions of human well-being: first, 'the material that emphasises practical welfare and standards of living'; second, 'the relational that emphasizes personal and social relations'; and third, 'the subjective that emphasises values and perceptions' (UNDP, 2009). Yet much emphasis has always been placed on the first – material – dimension. It entails inequalities in standards of living such as inequalities in income, wealth, education, health, and nutrition. This is largely socio-economic inequality.

Concerning economic inequality in South Africa, Natrass and Seekings (2001) observe:

In South Africa, black and white are no longer synonymous with rich and poor. Moreover, South African society cannot simply be divided into rich and poor, as if the distribution of incomes were bipolar. In the final decades of apartheid, the deracialisation of formerly discriminatory policies, upward occupational mobility among black workers, and rising unemployment resulted in declining interracial inequality but rising intraracial inequality, especially among the black population.

In South Africa, inequality is driven by two income gaps:

between an increasingly multiracial upper class and everyone else; and between a middle class of mostly urban, industrial, or white-collar workers and a marginalized class of black unemployed and rural poor. South Africa is one of the most unequal countries in the world when measured by the commonly used Gini Index.<sup>6</sup>

The IMF (2020) developed several charts to provide a situation analysis of the South African inequality trend.<sup>7</sup> The charts cumulatively reflect that:

1. Inequality has remained stubbornly high since the 1990s;
2. Income distribution remains highly skewed;
3. Significant disparities remain across regions;
4. Subdued growth has jeopardised efforts to promote inclusion;
5. High unemployment is a key driver of inequality, and
6. Fiscal policy has been used with effectiveness to reduce inequality, but high debt levels have reduced the government's scope to further use fiscal policy as a redistributive tool.

<sup>4</sup>General Comment 3, para 10.

<sup>5</sup>As above

<sup>6</sup>In economics, the Gini coefficient, sometimes called the Gini index or Gini ratio, is a measure of statistical dispersion intended to represent the income inequality or wealth inequality within a nation or any other group of people. The Italian statistician and sociologist Corrado Gini developed the Index.

<sup>7</sup><https://www.imf.org/en/News/Articles/2020/01/29/na012820six-charts-on-south-africas-persistent-and-multi-faceted-inequality>.



## Heightened vulnerability levels

These six trends, in turn, constitute key factors behind growing vulnerability among the affected population groups. Recent research also shows that there is inequality within inequalities. For instance, the 'male breadwinner' model in the labour market inevitably results in women being excluded from access to entitlements as they participate in the labour market on a different basis, or in the sphere of social reproduction.<sup>8</sup> This means that the model provides another layer for the exclusion of women from accessing entitlements in the labour market as they are not 'male'; yet women already suffer from inequality when compared to men in the labour market or other spheres of life.

Inequality of wealth is also critical to our understanding of vulnerability. Wealth inequality is particularly harmful during economic crises because wealth sustains livelihoods during such times. Research by Valodia and Francis (2020) on income and wealth inequality in South Africa confirms that approximately 18 million South Africans live in the poorest 20% of households (Valodia & Francis, 2020). The poorest 50% of South Africans have an average net wealth of negative R16,000. This means that their assets are less than their liabilities; that is to say, they are deeply in debt. The richest 10% of South Africans, in comparison, have an average net wealth of R2.8 million per person and the top 1% have an average net wealth of R17.8 million per person.

Thus, a society with deeply unequal income and wealth distribution becomes susceptible to all kinds of vulnerabilities such as poverty, climate change, disease, food insecurity, and access to education. These are essentially social services that in themselves are human rights and freedoms well articulated in the Constitution and international human-rights instruments that South Africa has ratified. An estimated 18 million South Africans depend on the social grant for survival, which translates into about 30% of the entire population. The social grant is currently pegged below inflation (Mahlaka, 2021). Pegging grants at below-inflation rates means that recipients remain economically constrained as the payout is eroded by higher inflation rates and the population remains vulnerable to socio-economic factors such as those highlighted above.

The COVID-19 pandemic triggered other forms of inequality in South African society such as 'access to transport, shops, COVID-19 testing, and the different ways the lockdown has been enforced and policed in different communities' (Valodia & Francis, 2020). The pandemic has stripped the South African economy of 'all the trappings that often obscure the true economic relations' and revealed it for what it really is, and the ways in which different societies deal with distress, disruptions, and economic shocks.

Many of the people in the richest portion of the population can continue to earn an income through adaptations such as working from home. Many others could actually save money due to reduced expenditure associated with eating out, vacations, and entertainment. In contrast, among those in lower-paid formal employment, the COVID-19 restrictions during the pandemic exposed them to the risk of job loss, even though the Unemployment Insurance Fund (UIF) provided some temporary relief. Even worse, informal workers had no protection whatsoever (Valodia & Francis, 2020).

Solutions to the inequality challenge are not easy to come by. However, South Africa must adopt new initiatives to achieve inclusive socio-economic transformation.

A desirable response to, and recovery from the COVID-19 and ongoing food and energy crises is one that is human-rights based for the reason that it places people at the centre of all initiatives (United Nations, 2020). In its six key human-rights messages of April 2020, the United Nations rooted for protecting life to be prioritised by ring-fencing livelihoods; attending to the discrimination triggered by the virus; supporting inclusion and full participation in the response; ensuring that restrictive emergency and security measures, if needed, must be temporary, proportional, and aimed at protecting people; promoting inter-country cooperation and aiming to be better and stronger in the future. These messages in a sense summarise the key elements of the UN Secretary General's (UNSG) new social contract that is people-centred and emphasises exerting more responsibility on multi-stakeholder cooperation.

<sup>8</sup>As above, page 4.

The bold, decisive and evidence-based action by the government in response to economic and public health crises is one that the country should expand to deal with other forms of threat to vulnerable populations. Economic interventions should be ‘immediate and drastic’ – and yet informed by evidence on the ground. Research findings from across the country provide such empirical foundation.<sup>9</sup> Otherwise, South Africa will not be able to tackle consequences of the COVID-19 and subsequent crises in a unified way if it does not mitigate the worst of its inequalities.<sup>10</sup> One of the ways to deal with inequalities of wealth and income is through a human-rights-based approach to national budgeting. While this approach is not a silver bullet, it will go a long way towards mitigating the negative consequences of inequality.

#### 4. Human rights-based budgeting

A national budget is a document prepared by a government to present the projected tax revenues and proposals for spending or expenditure for the coming financial year. It articulates, where applicable, new taxes it introduces, those it seeks to retire, as well as any variation (upward or downward) of existing tax rates. This is because governments’ primary source of revenue is taxation. A budget also provides for projected expenditure, primarily through line ministries or government departments. The budgetary process is critical to ensuring the progressive realisation of economic and social rights as it is the main tool with which to distribute resources for health, social protection, and housing, among other needs.<sup>11</sup> In fact, a number of UN treaty bodies have referred to it.<sup>12</sup> In some cases, a budget decision (or the lack of one) may in itself constitute a human-rights violation.<sup>13</sup>

For their part, the services that government departments provide to the public appear to mimic the full range of fundamental rights and freedoms as articulated in the Constitution and international human-rights treaties.<sup>14</sup> Three standards make the connection between human rights and national budgeting ‘straightforward’. These are the right of people to participate in the conduct of public affairs, as guaranteed by the International Covenant on Civil and Political Rights (ICCPR) article 25; the right of access to information, guaranteed in ICCPR article 19; and the principle of accountability, whereby a government is accountable to its people for its actions in the realisation of human rights.<sup>15</sup> Many of the services governments provide are social. In some cases, such services are the material things required to sustain life such as access to healthcare, education, food and water. It is through the appropriate allocation of resources to social departments that governments take important steps towards wealth and income redistribution.

National budgets involve technical processes, but they are also political documents. Much as they are economic blueprints for governments, political debates shape budgets and define priorities in a country. They should embody the values of the decision-makers and, ideally, of the people of the country.

In principle, human rights-based budgeting simply refers to a

process of developing and executing a public budget in a way that is sensitive to human rights standards and the government’s human rights obligations, a process which aims to arrive at a budget that is designed to effectively realise people’s human rights.<sup>16</sup>

<sup>9</sup><https://theconversation.com/south-africa-can-and-should-top-up-child-support-grants-to-avoid-a-humanitarian-crisis-135222>.

<sup>10</sup>Valodia & Francis (2020).

<sup>11</sup>United Nations (2017, p. 11).

<sup>12</sup>See UN Committee on the Elimination of Discrimination against Women (CEDAW), general recommendation No. 24 (1999) on women and health, para. 30; Human Rights Committee (HRC), general comment No. 21 (1993) on the humane treatment of persons deprived of their liberty, para. 4 and Committee on the Rights of the Child (CRC), general comment No. 2 (2002) on the role of independent national human rights institutions in the promotion and protection of the rights of the child, para. 11.

<sup>13</sup>United Nations (2017, p. 33).; Verwey, ed. (2009).

<sup>14</sup>See the section on South Africa’s human-rights obligations above.

<sup>15</sup>United Nations (2017, p. 17).

<sup>16</sup>Blyberg (2015). *Human Rights Budgeting and Budget Analysis for the Scottish Human Rights Commission*



For it to be effective, human-rights budgeting should be backed by human-rights budget analysis. This is an analysis that 'comprises monitoring and analysing the public budget to assess the government's compliance with its human rights obligations'.<sup>17</sup> To ensure greater effectiveness, both the budgeting process and the budget analysis should draw on an assortment of knowledge and expertise. For this reason, it necessarily involves a variety of government actors. Human-rights budgeting requires a good understanding of South Africa's national, regional, and international human-rights norms as articulated above. To that end, people with this knowledge should be intimately involved in the process.

Human-rights budgeting is pinned to principles of the right to participate in one's government based on accessible information; non-discrimination in the raising and expenditure of revenue, including affirmative action programmes, and the immediate and progressive realisation nature of rights.

Non-discrimination in raising and expending revenue is at the core of redressing income and wealth inequalities in South Africa. For instance, the imposition of taxes ought to take into account that taxation is not favourable to wealth in the place of income. In the same way, tax rebates on products such as children's nutrition may benefit formally employed people, while poor households have no access to such rebate.<sup>18</sup> The working and non-working dynamics of the population ought to be taken into account to prevent further exclusion.

As for expenditure, the normative content of human rights determines whether they are capable of immediate realisation or whether reasonable measures need to be taken to progressively realise them, taking into account the availability of resources. In this regard, the Child Grant is famed for its progressive nature regarding the ever-increasing amounts and coverage since its inception.<sup>19</sup> The other aspect is that the government should allocate the maximum available resources towards the realisation of socio-economic rights. The reasonableness of measures could mean appropriate and adequate resource allocation through the national budget to fulfil human-rights obligations.

However, as for civil and political rights, these are regarded as of immediate effect or realisation; therefore, the obligation on the state in allocating resources should take into account these factors. Nevertheless, the view that this category of rights does not require significant resource outlay for their realisation is archaic and should be abandoned. Questions to guide the process include: With regard to a right that is to be immediately realised, is the allocation proposed appropriate and adequate to ensure immediate realisation of the right? Although the extent of resources is incomparable to socio-economic rights, both categories of rights require resources for their full realisation. The government should account for both groups in its human-rights budget approach.

The human-rights budget process is anchored in the participation of all actors. While budgeting is conventionally associated with the ministry or department responsible for finance, the participation of all line ministries or departments and provincial governments is required. The rationale for such a composition is that any institution responsible for policy formulation and programme design and implementation should participate. The national government should, in addition, engage with provincial and local governments: it is an opportunity to synchronise policies and plans for national development. Through these consultations, the three tiers of government are able to identify areas of inequality and adopt complementary strategies for responding to them. Participation should, moreover, include the other arms of the state, namely, the legislature and the judiciary, along with the executive. The legislature debates the budget upon presentation by the executive; therefore, they need representation by agents conversant in human-rights issues.

The participation of non-state actors such as civil society organisations (CSOs) and international organisations, including United Nations agencies, is also necessary. While these may not participate directly, they may do so through budgetary consultations or other forms of engagement in which they add value to the process by sharing empirical evidence they obtain through engagement with grassroots individuals and organisations.

<sup>17</sup>As above.

<sup>18</sup>UNICEF, above.

<sup>19</sup>The child support grant is aimed at lower-income households to assist parents with the costs of the basic needs of their children. The grant is not meant to replace other income but is intended to bridge the gap in the cost of living.

Even more so, human-rights budgeting requires 'reliable disaggregated data in relation to the situation of different groups in society' and it puts 'results, transparency and accountability' at its core (Council of Europe, 2011). Inclusion will eventually bear fruit in the form of the legitimacy of the plan, shared ownership, and effective implementation of policies and programmes (Council of Europe, 2011).

### Whither human rights budgeting?

While human-rights budgeting can redress socio-economic inequalities in South Africa, such a budgetary approach is not without contestation and therefore requires further reflection and clarification.

One argument against a human-rights budgeting is that there are budgetary constraints on a government to eliminate inequality. This is an enduring argument based on the notion that it is not practical to mobilise resources on a sufficient scale for the full realisation of all rights. Notwithstanding this, the answer is that budgetary constraints are not a given: they depend on various factors, one of which is taxation. Through the adoption of a progressive and effective taxation system, for instance, the government can raise public resources to finance expenditure. It is clear that taxation is key to the realisation of human rights. This is because taxes are the key impetus in raising revenue to give fiscal policy space to mitigate inequalities. Accordingly, 'taxation should be looked through the lens of human rights.' It is also possible for South Africa to realign allocations between different budget lines and to reduce subsidies to large corporations such as the market price support and carbon tax exemptions to the South African Coal, Oil and Gas Corporation (Sasol) (Nieto & Godoy, 2016).

A further answer to this argument is that internal limitations such as 'availability of resources' are not a justification for non-performance. The state is expected to use available resources, but is also obligated to mobilise resources over time in order to achieve the full realisation of socio-economic rights in the country.

Second, it is argued that, on its own, human-rights budgeting is not sufficient for realising rights: it has to be part of a larger process. The argument goes further to justify that a government first develops policies, plans, laws, and regulations that are sensitive to human-rights norms and standards before it works on the development of the budget. In this sequence, we should anchor budget formulation in the programmes set out in the policies and plans.<sup>20</sup> This chapter has already commented that human-rights budgeting is not a silver bullet in redressing socio-economic inequalities. It therefore agrees that human-rights budgeting appears more effective in combination with a broader policy framework.

Third, there is a view that the aspirational nature of human rights makes it difficult for governments to concretise them into specific policies and programmes to which a budgetary allocation could be made. This appears to be related to the general argument against a general implementation of human rights. However, treaty bodies exist to play an important role in this regard. They clarify state obligations through some of their methods of work such as general comments or recommendations.

Their role is to interpret authoritatively the provisions of treaties in order to help states to better understand the nature and scope of their obligations, so that the latter can translate rights into concrete policies.<sup>21</sup> Related to this argument is one maintaining that the technical nature of the content of human rights is beyond the expertise of budget decision-makers and the legislature as the oversight institution.

<sup>20</sup>Scotland Human Rights Commission, above, 4.

<sup>21</sup>On the general attitude of states towards general comments as an interpretative tool, see A. Neuberger, 'Hard Law or Soft Law – Does it matter? Distinction between different sources of International Law in the Jurisprudence of the ECtHR' in van Aaken and I. Motoc (eds) *The European Convention on Human Rights and General International Law* (2018) page 47.



Fourth, it is further argued that it is unnecessary to add the human-rights budgeting approach to public budgeting as various expenditures are already related to human rights. The pith of the argument is that all government programming is human-rights related. For instance, the budgetary allocations and expenditures in the departments of education, health or women's affairs would be regarded as nothing less than aimed at fulfilling human rights. Admittedly, in some cases, it is difficult to drive a wedge between 'human rights-related' budgetary allocations and expenditure from other forms of allocation and expenditure, but it should be acknowledged that certain types of spending are more suited to the realisation of human rights than others – for instance, expenditure on education as against expenditure on arms.

## 5. Conclusion

This chapter first set out South Africa's obligations to deliver socio-economic development in the form of socio-economic rights. These obligations are enshrined in its Constitution as well as in international human-rights instruments. In particular, Article 2 of the ICESCR and attendant general comments articulate this obligation with clarity. Significant capital outlay is required to fulfil these obligations.

Following this was a brief discussion on the income and wealth inequalities that exist in South Africa. Because of COVID-19, new forms of inequality within inequalities manifested following the introduction of lockdown measures and the impact of their enforcement. Based on the link between inequality and vulnerability, the human-rights approach to public budgeting was then proposed to deal with such inequalities.

The main conclusion is that a human rights approach to public budgeting is not a silver bullet in dealing with inequalities but would go a long way to redressing them. All stakeholder, inclusive, transparent and accountable budgeting processes would ensure that the situations of different groups of people regarded as excluded from socio-economic development would be identified and strategies adopted to deal with their situations from a budgetary perspective.

Regarding concrete recommendations, this chapter suggests that the South African government, having ratified the ICESCR, must now ensure that it fulfils its minimum core obligation to allocate sufficient budgetary resources to realising socio-economic rights; ensure the participation of all tiers of government and non-state actors such as CSOs, UN Agencies, and other development partners; realign public expenditures such as subsidies to corporations in order to fund other initiatives aimed at reducing income and wealth inequalities in the country; ensure that social protection remains on a progressive trend and reviewed upwards in each annual budget as well as expanding eligibility.

Moreover, the government should remain on the path of adopting anti-inequality policies and programmes based on empirical evidence in similar way to that in which it has approached the COVID-19 pandemic. It should implement these new strategies in order to deal with inequalities in the course of rolling out the Recovery Plan; and, within the latter, budgetary allocations need to adequately cover the essential needs of communities most left behind as a result of the COVID-19 pandemic.

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## 5. TAKING ACTION TO BRIDGE PRIORITY GENDER GAPS IN SOUTH AFRICA

*Samaneh Hemat and Bandita Sijapati*

### 1. Introduction

South Africa has made important progress towards gender equality since the end of apartheid and its first democratic elections in 1994, putting it among the top 10 of all countries to have successfully implemented reforms to improve women's legal rights (World Bank, 2020). In the World Economic Forum's 2021 Global Gender Gap Index (GGI), South Africa ranks 18th globally and 2nd in the Southern African Development Community (SADC). It has made notable progress in improving the numbers of women in parliament, achieving gender parity in participation at the primary and secondary school levels and in closing the gender gap in rates of adult literacy (World Economic Forum, 2021). Nonetheless, a recent gender assessment by the World Bank finds the most persisting gender gaps in the domains of economic opportunity and voice and agency (Smout et al., 2022).

This chapter is based on the findings of the recently published World Bank South Africa Gender Assessment (Smout et al., 2022). It sets out to respond to two key questions: (1) What are the key gender gaps in South Africa across the dimensions of human endowment, economic opportunities, and voice and agency? (2) What are the priority areas for urgent action requiring support to bridge these gender gaps?

The assessment adopts the lens of the three dimensions just mentioned, as framed in the World Bank Gender Strategy (2016–2023) and World Development Report: Gender Equality and Development (2012). In the area of human endowments, the focus is on health and education. In the economic opportunities area, it assesses the progress and gaps as measured by participation in economic activities and access to and control of key productive assets. Finally, in the area of voice and agency, it focuses on freedom from violence, the ability to have influence in governance and political processes, and to exercise control over key decisions. The findings are derived using a mixed-method approach, including primary and secondary research to enable the triangulation of results.

### 2. Gender gaps in human endowments

Over the past two decades, South Africa has made significant improvements in maternal and child health (DOH, Statistics SA, SAMRC, and ICF, 2019) and in reducing the HIV burden. However, health indicators remain poor when compared to other countries at similar levels of development (World Bank, 2018). Gender gaps on access to healthcare are unclear, particularly because of the dearth of data on men's access to healthcare. Existing information, however, suggests that women and transgender persons continue to face barriers in accessing health services, and significant gaps in access to quality healthcare by race persists. For example, seven in 10 white South Africans (72.4%) compared to one in 10 black South Africans (10.8%) are members of a private medical aid scheme. White women (8%) are less likely than black (41%), coloured (29%) and Indian or Asian (33%) women to report a problem accessing healthcare. Seven in 10 (74.4%) South Africans who said the reason they did not consult a healthcare worker was because it was 'too far' were black women. Women in non-urban areas and from poorer households are more likely to experience challenges in accessing healthcare (DOH, Statistics SA, SAMRC and ICF, 2019).

Gender differences occur in the prevalence of stunting and childhood malnutrition (DOH, Statistics SA, SAMRC, and ICF, 2019) that mirrors gaps in sub-Saharan Africa, with boys being most disadvantaged. However, race and family income continue to be a stronger determinant of household hunger than gender. Fertility rates have declined over the past two decades,<sup>1</sup> but the reduction in rates is unequally distributed by race and socio-economic status (World Bank, 2022). The unmet need for contraception is highest among the groups of

<sup>1</sup>Rural provinces tend to have fertility rates of about 3.1 children per woman compared with 2.4 children per woman in urban areas. Fertility rates tend to decrease with increasing household wealth and vary significantly by race. For more detail please see Chapter 3 'Gender Gaps in Human Endowments,' in Smout J., Sijapati, B. and Hemat, S. (2022). *South Africa – gender assessment*. Washington, D.C.: World Bank Group. <https://imagebank2.worldbank.org/search/33813354>



women with the highest fertility rates, particularly among adolescents and youths, therefore increasing the challenges to preventing adolescent pregnancy.<sup>2</sup> There are differences in the use of contraception by education and geography, with increasing levels of contraception use with increasing education and urbanisation (World Bank, 2022). Urban women (14%) are less likely than non-urban women (1%) to begin childbearing in their teen years with the adolescent pregnancy rates higher among black (16%) and colored adolescents (11.9%) (World Bank, 2022). HIV remains a critical challenge for South Africa, despite successes in the rollout of antiretroviral therapies (ART), with women more likely to be infected and higher rates of HIV prevalent among the black population than among other groups (Smout et al., 2022). Access to Sexual and Reproductive Health was negatively affected by the COVID-19 lockdown due to confusion about which services were essential under the regulations. While sanitary pads, tampons and condoms were classified as essential goods in South Africa's lockdown regulations, the closure of schools negatively affected access by young girls and boys. NIDSCRAM survey results indicated that 23% of respondents reported inability to access medication, contraceptives, or condoms (Mbatha, 2020; Burger et al., 2020).

In the education sector, South Africa has achieved gender parity in literacy levels and enrolment, and enrolment at tertiary levels favours women. South Africa ranked 69 out of 153 countries regarding educational attainment in the Global Gender Gap Report 2021, with boys falling behind in enrolments at the secondary and tertiary levels. Boys are more likely to repeat grades than girls and also to drop out in greater numbers (DG Murray Trust, 2019). Four in 10 learners leave the school system before completing school (DG Murray Trust, 2019) but, in general, girls are more likely to progress through the higher grades of secondary school compared to boys (Statistics SA, 2019). As a result of the gender differentials in dropouts, there are substantial gender differences in the numbers of girls and boys who reach the final years of schooling and write their school-leaving exam. Over the past 10 years, the number of males writing matric<sup>3</sup> has declined steadily. In 2018, for every 100 females writing matric, there were only 80 males (Spaull & Makaluz, 2019).

Although higher proportions of women (28.6%) than men (19.2%) enrol at university (World Bank, 2021), gender gaps in pass rates in Mathematics and Physical Sciences subjects at a secondary school level favour boys and, consequently, STEM enrolment at post-secondary level is also higher for males. The largest gender gap in STEM subjects is in the field of engineering enrolments. Social norms play a key role in girls' choices of educational subjects and are a key factor after that in determining the transition from school to work (Naudé, 2017). For instance, graduations in each field also show a gender difference, with far more women graduating in care professions (psychology, health, and education) than in other fields.

### 3. Gender gaps in economic opportunities

In the domain of 'economic opportunity', the low levels of female labour force participation rates, occupational segregation, gender wage gaps, and persistent barriers to women's control of land and other productive assets are critical gender gaps in South Africa.

In the Global Gender Gap Report 2021, South Africa ranked 80 out of 153 countries (score 0.815) for labour force participation, an improvement on its ranking and score from 2006 (90 and a score of 0.58). However, the lower likelihood of women participating in the workforce compared to men, both in the informal and in the formal sectors, persists. Among women, the rates of labour force participation also vary by racial groups. The labour force participation rate of white females is higher than that for women across all other groups, with Indian or Asian women lagging furthest behind (Statistics SA, 2019).

Even in instances in which women do participate in the labour market, they tend to earn lower wages compared to men: women continue to get paid 25% to 35% less than men even if they have the same amount of schooling and similar work experience (Mosomi, 2019). They also earn less than men across all income brackets, except in the poorest 5%. In fact, even in the informal economy, the median monthly earnings for women in 2019 was R1,950, whereas for males it was R2,600 per month. Over time, the wage gap has increased (WEF, 2021).

<sup>2</sup>For more details on Smout J., Sijapati, B. and Hemat, S. (2022). *South Africa – gender assessment*. Washington, D.C.: World Bank Group. <https://imagebank2.worldbank.org/search/33813354>

<sup>3</sup>Final high school year qualification in South Africa.



Occupational segregation contributes in part to the gender pay gap, where women tend to be over-represented in low-paying sectors and underrepresented in most of the higher-paying sectors. As at December 2020, the only sectors in which more women than men were employed were in Community and Social Services<sup>4</sup> (2,175,000 women compared to 1,376,000 men), and Private Households,<sup>5</sup> where women make up the majority (74%) of domestic workers – which also are considered to be vulnerable sectors. For example, the pay scale in the private households sector is low and few workers have access to employment security. On average, domestic workers receive a low minimum hourly wage (R19,09 per hour) compared to other workers to whom minimum wages apply (farm workers, for example, earn R21,69 per hour) (Department of Employment and Labour, 2021).

Despite efforts by the government to increase protection for domestic workers, the household sector continues to be vulnerable due to challenges associated with regulating it as the work being done is in private residences (ILO, 2016).<sup>6</sup>

Across all sectors, women tend to be less represented among supervisors and managers, and race remains a predominant factor that influences both women's and men's ability to reach top management. As at 2019, top management and senior management were 75.6% and 64.7% male respectively (Commission for Employment Equity, 2020). Although many organisations have tried to meet employment equity targets, the representation of women at managerial levels across the private sector remains poor.

The gendered nature of gaps in household and care responsibilities limit women's ability to enter and remain in the labour force. Specifically, the structure of South African families is characterised by uneven responsibilities for childcare and domestic labour, and this gap intensified during the pandemic with the closure of schools and early childhood centres as well as the increased need to care for ill family members.

#### 4. Gender gaps in ownership and control over financial and non-financial assets

In South Africa, there is a gender gap in access to formal financial institutions. In addition, financial exclusion, which is linked to poverty and inequality, disproportionately affects people, including women, at the bottom of the economic pyramid. Gender gaps exist in savings practices and business ownership. Women are less likely to use their accounts or to use mobile money and are more likely to save informally, with fewer women accessing credit from banks or formal financial institutions. Although the South African legal framework does not place any restrictions on women's business ownership, women are less likely to own a business, this gender gap having grown over the past decade. Women continue to face barriers to entrepreneurship, including a lack of financial literacy, basic skills, and limited access to finance.

Although the government has set targets to increase procurement from businesses run and owned by women, a lack of data makes it difficult to measure progress.<sup>7</sup>

Land-ownership rates in South Africa are informed by both race and gender. About 72% of the country's arable land remains in the hands of white South Africans, who account for less than 10% of the total population. Black South Africans own only 4% of the land and Indian South Africans own about 5% (DRDLR, 2018).<sup>8</sup> Regarding gender, ownership by hectare among men is more than twice that of women (DRDLR, 2018). Furthermore, the registry of deeds indicates that plots, erfs,<sup>9</sup> lots, and stands are registered mostly in the name of men, and men continue to own land of greater size than women.

The legacy of colonialism and the customary system influenced by apartheid has had an effect on the land

<sup>4</sup>Community and Social Services refers to all workers in health, education, government, veterinary, library, sporting, agency, and social development services in both the public and the private sector.

<sup>5</sup>Private households normally refers to domestic workers, private childcare, nannies, and garden services workers. This covers those in both informal and formal work.

<sup>6</sup>In 1993, the Basic Conditions of Employment Act (BCEA) was extended to cover domestic workers, changing their status from 'servant' to 'worker' and bringing protections such as maximum working hours, overtime limits, and more days of paid family responsibility leave in recognition of the fact that domestic workers often have to live far away from their families. In 1994, the Labour Relations Act was extended to cover domestic workers, providing them with organisational rights. In the early 2000s, South Africa introduced a minimum wage for domestic workers and the extension of the Unemployment Insurance Fund to these workers.

<sup>7</sup>Smout et al. (2022).

<sup>8</sup>The Land Audit report does not present gender-disaggregated data on ownership by race.

<sup>9</sup>An erf is a plot of land of approximately half an acre in size.

rights and tenure security of women in the former homelands (Clark & Luwaya, 2017). Both systems relied on male elders to define the content of customary law to the exclusion of women, with the result that women's land rights became dependent on their husbands, fathers, or other male relatives. While there are variations between one communal tenure system and another, women are generally treated as 'minors' and therefore predominantly have access to land as wives, with their security of tenure affected upon the dissolution of a marriage or the death of their husband (Clark & Luwaya, 2017).

Although legal changes to governance at the local level aim to support greater rights for rural women, traditional leadership systems remain patriarchal. Efforts by rural women, particularly single rural women without children, to access residential sites independently of a male guardian after 1994 have faced resistance from traditional leaders, who tend to be primarily males (Claassens, 2012). In fact, women's rights are increasingly becoming precarious due to the overreach of traditional councils through proposed laws such as the Traditional Courts Bill, which excludes people in rural areas from accessing the ordinary justice system, and instead limits their access to traditional councils, which are often not gender-representative (Mogale, 2021).

Despite the progressive laws and policies on land reform and land redistribution, the effects, including on gender differences, have been limited. Legal changes that seek to redress the barriers to equitable land reform were proposed by the 2017 High Level Panel on the Assessment of Key Legislation and the Acceleration of Fundamental Change but progress on the implementation of these recommendations appears to be pending.

## 5. Gender gaps in voice and agency

Finally, in the domain of 'Improving Voice and Agency', women's representation in government overall is good compared to that of many other SADC countries, although challenges remain in substantive representation at all levels. As country experts posit, descriptive representation at the national and local levels of government does not always translate into legislative influence or substantive power in decision-making.

The prevalence of GBV is high in South Africa, but no nationally representative prevalence data is available. Estimates suggest that between 25% and 40% of South African women have experienced sexual or physical intimate partner violence, whereas between 12% and 28% of women report having been raped (Gender Links and the Medical Research Council, 2010). Between March 2009 and February 2019, rape was the most common sexual offence reported to the police (Smout, 2019). However, because underreporting remains a major concern, many researchers posit that the actual rates of GBV may be much higher than official assessments (Jewkes et al., 2011 and 2015; Machisa et al., 2017; Mathews et al., 2016).

Violence exacts enormous economic and social costs in South Africa. The direct cost of GBV in South Africa is estimated to be about R28.4–R48.2 billion (approximately US\$2.3 to US\$4 billion) a year (KPMG, 2014). Likewise, R238 billion (US\$19 billion) a year has been estimated as the direct and indirect cost of violence against children (Save the Children, 2016). These studies include the costs of direct criminal justice service provision, disability-adjusted life years, the costs of psychosocial support, and earnings lost by victims of these crimes. Beyond the human cost of lives lost and altered by violence, responding to violence overwhelms households and communities, drains state resources, and discourages investment in human and financial capital (Willman et al., 2019).

South Africa's response to violence against women has thus far been largely legislative through the criminal justice system, with less emphasis and expenditure on prevention and social care services. According to a recent report, annual state spending on violence prevention is R9 billion, just 7% of the expenditure on response services (Government of Canada et al, 2019). This constraint has been accounted for in the recently passed National Strategic Plan on Gender-Based Violence and Femicide 2020.



## 6. Conclusion

South Africa's efforts at closing gender gaps have been shaped largely by patriarchal gender norms, the legacies of apartheid, and the interactions of race, poverty, and geography. The interconnected nature of the effect of various social categorisations creates overlapping and interdependent systems of discrimination and disadvantage which need to be accounted for when designing interventions to narrow gender gaps. Notably, the constraints and barriers informing gender gaps in the domains of human endowments, economic opportunities, and voice and agency are also cross-cutting. They include gender-inequitable social norms; the weak implementation of laws and policies; insufficient women-friendly workplaces, and a lack of substantive representation of women in governance systems.

Drawing on the detailed analysis in the World Bank Gender Assessment, this chapter highlights five opportunities for action that are fundamental steps for South Africa to take in its journey to bridge priority and persisting gender gaps in the country. These opportunities for action target the drivers of persisting gender gaps and build on existing law and policy commitments already made by the government – namely, the NDP 2030 and the South African Government MTSF 2019–2024. They are interdependent and taken up together can make a significant contribution to improving the outcomes for South African women. It is important to emphasise that this is not an exhaustive list of steps towards narrowing gender gaps in the country; they are, however, fundamental.

They will need to be built on in future by other interventions targeting markets, households, and institutions (informal and formal), which will together influence both gender equality and economic development.

1. **Increase access to childcare and promote gender equitable domestic labour** through legislative amendments, improving the affordability and availability of child-care options for women in both the formal and the informal sectors, and focusing on the social norms that drive the gendered nature of the distribution of household labour.
2. **Improve the school-to-work transition in STEM and other frontier skills sectors** by promoting girls' success in STEM subjects at the secondary and tertiary levels.
3. **Redress the legal and social barriers to gender-equitable entry and retention in the workforce** through legislative amendments that promote pay transparency and identify sectoral targets for women's inclusion.
4. **Improve the financial inclusion and entrepreneurship of women** by introducing preferential procurement targets, strengthening women-focused business development services, and strengthening women's financial literacy and access to credit.
5. **Strengthen women's voice and agency** by confronting (i) women's role in decision-making structures from the local level up, and (ii) the high levels of GBV and HIV and their consequent effect on women and girls.

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## 6. PROGRESS AND CHALLENGES TOWARDS A CAPABLE AND DEVELOPMENTAL STATE

*Msingathi Sipuka*

### 1. Introduction

The legacy of racialised and gendered poverty and inequality that the post-1994 democratic state of South Africa inherited has led successive government administrations to explore and experiment with various policies for an effective response to the development challenges confronting the country. As varied and contested as these policies have been, the idea of a capable and developmental state has been a consistent feature of the national discourse.

Over the years, the post-1994 South African governments have sought to build a state capable of delivering basic public services to the wider population, addressing poverty and inequality head on in their different dimensions, and helping to forge a growth path that was both inclusive and sustainable. The end goal of this capable, functional state was to bring about fundamental change in the lived experience of the majority black population, who had been excluded by the system of apartheid.

The earliest observable commitment to a capable and developmental state by the South African government was contained in the White Paper on Local Government, which introduced the concept of a 'Developmental Local Government' (Smith, Louw & Heydenrych, 1998). Subsequent to this, the capable and developmental state concept started to feature prominently in the government's thinking and lexicon.<sup>1</sup>

The NDP 2030 is South Africa's long-term development strategy and serves as the overarching framework for national planning. The idea of a capable and developmental state features prominently as the foundation for attaining the broader development objectives articulated in the plan. Chapter 13 of the NDP is solely dedicated to the idea of a capable and developmental state and provides instructive perspectives that reflect the government's evolved thinking in this regard.

The chapter provides the following definition of a capable state: '[C]apable in that it has the capacity to formulate and implement policies that serve the national interest' (NPC, 2012:409). In the same chapter, the developmental state is, in turn, defined as '... developmental in that those policies focus on overcoming the root causes of poverty and inequality, and build up the state's capacity to fulfil this role' (NPC, 2012:409).

**Also worth noting is the following extract:**

In a society with deep social and economic divisions, neither social nor economic transformation is possible without a capable and developmental state ... [the developmental state chapter of the NDP] should be read in conjunction with the chapters on tackling corruption (chapter 14), education (chapter 9), health (chapter 10), economic infrastructure (chapter 4) and rural development (chapter 6), which all identify improvements the state needs to make to deliver on its objectives (NPC, 2012:408).

This extract from the NDP demonstrates the importance accorded to such a state by the government of South Africa.

This chapter aims to discuss the capable and developmental state in South Africa. To this end, the chapter asks: How far has South Africa progressed in its quest to build the elements that would constitute a capable and developmental state, as defined above? A related question is this: How capable is this state to deliver on the various NDP objectives listed above, which are closely associated with the SDGs?

<sup>1</sup>Notable examples include:  
*National Industrial Policy Framework (DTI, 2005)*  
*Industrial Policy Action Plans (DTI, 2007 and DTI, 2018)*  
*New Growth Path (DED, 2010)*  
*National Development Plan 2030 (NPC, 2012)*



Since 1994, when the South African state apparatus in place was there to serve the interests and needs of a minority sector of society, significant progress has been made in reforming the state to be able to confront and respond to the needs of the large majority population of the country. Such progress can, in a way, be measured in terms of outcomes in key social indicators, such as maternal mortality, access to primary education, and access to clean water and electricity, which saw clear improvements in the 2000s and 2010s.

However, during this same period, the country also witnessed some partial reversals – for example, stunting in children between 2008 and 2016, not to mention the continuing rise in unemployment, a major cause of poverty which remains stubbornly high (UN CCA, 2020). Therefore, despite progress in the building up of state institutions, the lack of continued improvements in some key socio-economic indicators begs the further question whether South Africa is currently witnessing some erosion in the state's capacity to serve and deliver basic public services and to combat the roots of poverty and inequality.

To help answer this and the other two questions set above, the chapter turns to the NDP and draws on the markers the plan identifies to help gauge the progress and the challenges towards a capable and developmental state.

Following this introduction, section 2 discusses the progress towards a capable state through a framework that condenses the markers proposed by the NDP in five areas of analysis. Section 3 then concludes.

## 2. Markers of progress towards a capable and developmental state

The NDP identifies eight elements that could serve as markers of progress towards a capable and developmental state. These are:

1. Stabilise the political and administrative interface;
2. Make the public service and local government administration careers of choice;
3. Develop technical and specialist professional skills;
4. Strengthen delegation, accountability and oversight;
5. Improve interdepartmental coordination;
6. Take a proactive approach to improving relations between national, provincial and local government;
7. Strengthen local government, and
8. Clarify the governance of state-owned enterprises (SoEs).

These eight elements, in turn, find resonance with an analytical framework that could be used for some insights into the progress made towards a capable and developmental state in South Africa. This framework allows for analysis in the following areas:

- strengthening governance and accountability in government
- institutional capability of government
- long-term approach to planning for development
- greater coordination in government (vertically and horizontally)
- government working in the public interest.

The chapter discusses each of these five areas.

### (a) Strengthening governance and accountability in government

The United Nations Department of Economic and Social Affairs (UN DESA) posits that effective, accountable, and inclusive institutions are essential to achieving the SDGs. This is recognised by SDG 16 and the 2030 Agenda for Sustainable Development. Reinventing public administration is a positive and necessary way forward. Without public administration, modernisation and transformation to adapt to today's needs, realising a better future for all will be impossible. Where capable administrations are lacking, governments are incapacitated; and where governments are incapacitated, sustainable development falls short.

The Auditor-General South Africa (AGSA) conducts regular audits of national and provincial government departments, identified public entities, municipalities, and municipal entities. Through its audit activities, AGSA plays an important role in enabling accountability and therefore promoting sound financial governance practices in South Africa.



The reports of the Auditor-General serve as an important indicator of the state of governance and accountability across government. The presentation made by the Auditor-General on the findings of the local government sector in 2018, for the financial year 2017/18, affirms that 'accountability in local government continues to decline' (AGSA 2018). This phenomenon was captured by several indicators: few municipalities managing to produce quality financial statements and performance reports; high levels of irregular expenditure; failure to act on allegations of financial and supply chain management misconduct and fraud, and shortcomings in the development and maintenance of infrastructure by municipalities, with impacts on the provision of water and sanitation infrastructure (AGSA, 2018).

These consolidated findings by the AGSA, one might argue, reflect the general state of governance and accountability in the local government sector. An aspect that is not reflected in the AGSA's presentation is the unspent budgets in municipalities. The result is often that municipalities are obliged to return unspent funds to the National Treasury. In the context of communities faced with rising unemployment, delapidating infrastructure and many other challenges, unspent budgets are a very much unwelcome public management occurrence, particularly for the most marginalised in society. These events can be attributed to poor governance systems and weak institutional capability.

### (b) Institutional capability of government

It has long been recognised that a country's growth and development are a function of factors such as human capital, productivity, investments in physical capital, and innovation. These factors' availability and the way in which countries deploy them in the process of growth and development are very important. In addition, the role that the political and economic institutions play in the process also matters a great deal.<sup>2</sup>

Since the new national administration in 2018, judicial commissions have been established to probe allegations of institutional failure. The mandates of these commissions range from investigating the general state of institutional compromise across all of government to investigating specific institutions. With the caveat that there is always a political nuance imbued in these initiatives, the evidence at these commissions of inquiry indicates signs of institutional deterioration arising from governance issues. Two examples are the SARS and the NPA.

SARS, established in 1997 as a result of the amalgamation of various tax and customs authorities from the apartheid era, evolved to become a world-class tax authority, recognised by institutions such as the IMF – with the latter's diagnosis conducted in 2014 showing evidence of good international practice in most of the SARS categories. However, according to the Commission of Inquiry into Tax Administration and Governance by SARS, constituted in 2018, SARS was showing shortcomings in governance and breaches of integrity.

These developments, in turn, were having impacts on revenue collection (SARS, 2018). If true, this institutional weakening could affect SARS's ability to carry out its mandate with effectiveness, with implications for the country's budgetary process and therefore government's ability to execute its national programme.

The NPA, in turn, is a single prosecuting authority in South Africa, vested by the country's Constitution with the power and responsibility to charge and prosecute crime on behalf of the state. In 2018, a commission of inquiry was established to investigate the conduct of key senior officials of the NPA. The commission's final report included allegations of malfeasance, political interference, and concerns of impropriety in the institution. Again, if these findings proceed, they do not bode well for an institution that is devoted to the rule of law and mandated to prosecute on behalf of the state against acts of crime. In other words, a weakening of the NPA can have a significant impact on its ability to carry out its prosecutorial mandate.

The question, of course, is how common these governance failures at these two institutions are, whether they have been adequately dealt with, and how widespread such failures have been across different institutions in South Africa.

<sup>2</sup>On this point see, for example, the World Bank's Commission on Growth and Development (2008), which underscores the importance of strengthening such institutions.



### (c) Long-term approach to planning for development

One of the first actions of South Africa's fourth Administration, 2009–2014, was the establishment of the National Planning Commission (NPC). The mandate of the NPC entailed the following: (i) promote and advance the implementation of the NDP across different sectors of society, and (ii) undertake periodic detailed planning in a selected number of sectors.

In July 2019, the country's sixth administration (2019–2024) convened a multi-stakeholder NDP review colloquium with the sole purpose of reflecting on South Africa's progress in implementing the NDP. Noting the centrality of the developmental state in the NDP, Gumede (2019) presented a paper in which he identified long-term development planning as a critical competency of developmental states, citing the cases of Japan and its Ministry of International Trade and Industry (MITI) and South Korea with its Korean Economic Planning Board. These planning institutions had supported their national governments to undertake institutional planning and bring together private- and public-sector finance, industry expertise, and entrepreneurship, guided by public-sector leadership and policy coordination.

In assessing the NDP and South Africa's progress in long-term development planning, the NDP review colloquium came up with a number of key observations, including:

- the development plans or visions of countries viewed as developmental states are usually clear, concise and robust, which cannot be said about the NDP;
- the South African NPC unfortunately failed to enact one of the most important features of a planning commission – namely, the systemic development of human capital to bolster government structures and performance;
- many of the needed capacities are lacking or have dwindled.

Evidence of this assertion is found in the poor institutional performance of key national institutions; and the governing party has yet to align its political capital formally behind the NDP, with various voices in the party and the country's ruling alliance often criticising the plan. This does not help with mobilising government behind this plan, let alone other sectors of society (Gumede, 2019).

Indeed, although the establishment of the NPC and the subsequent adoption of the NDP were commendable steps towards long-term development planning, the inability of the government to bring all the social partners together behind the NDP made the goal of long-term planning hard to achieve. For example, as far back as 2012, when the NDP was released and was at the height of its popularity, the labour movement – most notably the Congress of South African Trade Unions (COSATU), which is the biggest labour federation and alliance partner to the ruling party – came out strongly in its rejection of the plan. A quote from a magazine article on COSATU's view states:

The NDP did not address the real problems around unemployment because it was silent on industrialisation. It said that for the government to generate decent jobs, it had to revamp the manufacturing sector, which would generate the right mix of decent jobs in the economy and complement the services sector. Instead of industrialisation, the NDP puts more emphasis on small- and medium-scale enterprises in the services sector as the main drivers of future economic growth, perpetuating the tradition of unskilled low-wage labour in the country (HSRC, 2014).

These issues point to several factors that have limited South Africa's advance in embedding the culture of long-term development planning in its national planning system. The steps taken to date, such as the establishment of the NPC and the adoption of the NDP, do provide a good platform for the country on this issue but they would require that the government and its social partners build a common understanding and view of a developmental state. This is needed as, from the above, what can be seen is that there is a gap between the way the government defines developmental state – a definition enmeshed with that of a capable state (see above), with what a developmental state has meant to the late industrialisers of the 20th century. The latter appears to be what the labour movement seems to refer to in its divergent position from that of the South African government.

#### (d) Greater coordination in government

The Constitution of South Africa (1996) had foreseen the importance of coordination across the three spheres of government as an enabler of service delivery. Chapter 3 of the Constitution, section 41, makes provision for the establishment of a cooperative system of government firmly anchored in the idea of intergovernmental relations. In this regard, section 41 mandates the three spheres of government to coordinate their actions with one another in the public interest. Further to this, the constitution directs that an act of parliament must be established to give effect to a national intergovernmental relations system and mechanisms.

In 2005, the Intergovernmental Relations Framework Act was gazetted; it provided the necessary legislation to strengthen the coordination of government work across the three spheres. Despite these advances in legislation, a lack of coordination in the government continues to be cited as one of the most constraining issues in fast-tracking delivery to citizens.

The 20-year review of government work (1994–2014) noted that provinces and municipalities are constitutionally responsible for implementing many of the key objectives of government. For provinces, this relates particularly to areas such as education and health, on which a large proportion of provincial budgets is spent. Municipalities are primarily responsible for providing quality, cost-effective municipal services and improving the environment by developing and maintaining appropriate infrastructure.

The national government is expected to provide legislative and policy frameworks and to provide support to provincial and local governments to enable them to fulfil their core responsibilities. The 20-year review concludes by stating that, given the overlapping and concurrent responsibilities between spheres, effective coordination is essential.

Evidence suggests that the country has had great difficulty in moving from policy to actually getting coordination right and this has greatly affected the coherent working of government. There are many examples of how a lack of coordination, in both policy and implementation, plays out across the three government spheres. Moreover, this is not just an issue across spheres of government, but a challenge across government departments within the same sphere.

A critical issue refers to unfunded mandates. The South African Cities Network (SACN) states that unfunded mandates occur when 'cities perform the functions of other spheres of government and bear significant costs out of their own revenue sources'. The Integrated Urban Development Framework, a policy initiative of the South African government, states more broadly that 'unfunded (or underfunded) mandate arises when municipalities carry out functions that do not form part of those allocated to them by the Constitution or legislation'.

An example of unfunded mandates is community safety. Whereas the overall responsibility of achieving safe communities in South Africa is generally considered to rest with the national government, the position is in fact more complex. All levels of government are responsible for community safety. What often remains unclear, however, are the different roles, responsibilities, and, by implication, sources of funding to support these efforts (SACN, 2016).

Other prominent areas in which unfunded mandates find expression in local government are in primary healthcare, museums, and libraries. Of course, the challenges of coordination are not limited to unfunded mandates. Other classical cases include complementary mandates residing with different spheres of government, while plans for these are not aligned. This may include the local sphere being responsible for the building of houses in new settlement areas while the education and health mandates reside in the provincial level. The result is that the local sphere plans and starts building houses while the provincial sphere has neither planned for nor budgeted for the construction of clinics or schools in these new areas. It often takes years for the provincial sphere to deliver these essential services to support the newly established communities, meaning that these relocated communities must travel for kilometres to have access to education and health services.



### (e) Government working in the public interest: An evolving legislative and policy landscape, and the challenge of implementation

In the post-1994 period, successive South African administrations and the legislative sector have had to engage in an extensive process of reviewing and repealing apartheid laws and policies, replacing these with legislation and accompanying policies aligned with the values and aspirations of a democratic state. In 2015 the legislative sector, led by the Speaker of the National Assembly, moved to establish an independent high-level panel of eminent South Africans to undertake the task of reviewing legislation, assessing implementation, identifying gaps, and proposing action steps with a view to identifying laws that require strengthening, amendment, or change.

The High-Level Panel considered its work from three thematic areas, which formed the basis of assessing the policy goals that have informed legislation, of overviewing the trends and making recommendations for future policies. The thematic areas are: (i) poverty, unemployment, and the equitable distribution of wealth, (ii) land reform: restitution, redistribution, and security of tenure; and (iii) social cohesion and nation-building.

Some of the key findings from the High-Level Panel's report are:

- Significant work has been done since 1994 to reorientate the legislative and policy framework of the country to respond to the tasks of a democratic state.
- There is extensive evidence of the challenges that the government faces in implementing policy and giving effect to legislation. To this end, implementation has emerged as a cross-cutting theme in the various topics considered by the panel.
- There are areas in which policy-making proceeds without a clear governing framework that supplies the goals and objectives that law and policy should pursue. For example, in land reform, the panel found that there is no overarching framework that provides a rationale and logic to guide the development and implementation of new land-reform laws and policies.
- Another illustration of policy failure or misalignment of outcomes from the stated policy objectives can be found in the realm of education. Noting the advancements made in creating an integrated education system inherited from apartheid which was largely fragmented and discriminatory, the current reality is that outcomes remain weak, as evidenced by international and regional assessments.
- Skills development efforts have suffered from a lack of a clear policy direction. In this case, policy does not include a clear definition of the target beneficiaries of skills development policy and law. The identification of target groups would then shape the design of policy to meet the needs of those groups to enable them to contribute to the economy and society. The resultant policy priorities would also be reflected in the budget allocated to programmes. However, the lack of specification of clear goals and targets limits the impact that a skills development policy could make to reversing the triple challenge of poverty, inequality, and unemployment.

The findings of the High-Level Panel affirm the established argument that South Africa's legislative and policy framework has evolved significantly since 1994 in response to the tasks confronting the democratic state. The country has gone a long way in repealing the apartheid legislation that had entrenched discrimination over a period of 50-plus years. Added to this, significant work has been done in establishing a policy regime that responds to the immediate challenges of social and economic transformation. But what has been observed through the work of the panel is that the outcomes have not matched the policy objectives in many areas of development. These include education, health, economic transformation, job creation, and dealing with inequalities. These findings certainly affirm much of the evidence that has been produced by various institutions on the relationship between stated policy objectives and actual outcomes.

### 3. Concluding observations

A capable and developmental state constitutes a key thrust of the state South Africa seeks to build in its endeavour to drive national development. This chapter asks the question how much the country has achieved in its efforts to build such a state. A capable and developmental state is seen as a key instrument for redressing deep-rooted socio-economic problems in South Africa, helping national government administrations to become effective providers of basic public services and putting the country on an inclusive and sustainable development path.

There are no clear metrics to assess how well South Africa is doing in building a capable and developmental state or how far it has gone in this endeavour. One way to pursue this task would be to look at possible outcomes according to socio-economic achievements. However, this approach can at best give only a very partial idea of where the country stands as a capable and developmental state, as several other factors influence socio-economic outcomes, some of which are external and therefore outside the control of the country's national authorities and institutions. In addition, such an assessment involves several other unknowns regarding cause-effect linkages, processes, and inter-dependencies between different state institutions and actors – all serving to make this task even more challenging.

To explore this topic, but without the ambition of coming up with clear-cut answers, this chapter uses South Africa's NDP 2030 as an entry point for analysis. The capable and developmental state paradigm features prominently in the NDP, with a clear identification of specific elements that could serve as markers of progress towards it. Based on these markers, this chapter has been able to offer a few considerations.

First, in the initial post-apartheid years, it was clear that the government has made great strides in reforming the state apparatus to turn it into a mechanism to serve the large majority of South Africans who, until 1994, were at best precariously covered by basic public services or social protection mechanisms, or with access to basic rights. As discussed in this chapter, South Africa's legislative and policy framework has evolved significantly over the years with the implementation of a policy regime that responds to the country's many challenges.

Yet, much is still to be done so that outcomes can fully match the policy objectives set out for broader and deeper development across different sectors of the economy and society. In sum, despite commendable achievements to date, concrete results on the ground have been at best partial.

Second, progress has not been linear. The various commissions set up by the government administration from 2018 onwards have brought to light that some setbacks in key state institutions have occurred. This is an important consideration because if key institutions such as SARS and NPA start faltering or exhibiting difficulties in fulfilling their mandates, these developments can, through spill-overs and various transmission channels, affect other institutions and the government's capacity to govern with efficacy. Another likely consequence is that trust in such institutions, the government, and the political system more broadly starts eroding. However, once problems are diagnosed – and this is a role such commissions are meant to play – corrective measures can be adopted so that such institutions can be fully back on track and re-strengthened.

A third point of consideration is that a key issue ensuing from the discussion in this chapter is the great difficulty the country is facing in moving from policy aimed at strengthening policy coordination to getting coordination right, which has greatly affected coherence in the work of government.

A final point refers to long-term planning. The establishment of the NPC and the adoption of the NDP were an indication of a move towards embedding long-term development planning in government. Because of a number of factors, the NDP seems to have failed to occupy the place of an apex planning document both in the government itself and in society in general. The road to attaining the aspiration of a developmental state seems to be constrained by many challenges, but opportunities exist to redirect this trajectory. These opportunities reside largely in the area of institution building, a redefinition of the concept of developmental state itself, to date overly attached to and indeed subsumed in the concept of capable state, and the strengthening of implementation.



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## 7. THE SOCIAL AND SOLIDARITY ECONOMY IN SOUTH AFRICA: A PATHWAY TO AN INCLUSIVE SOCIETY THAT BRIDGES INEQUALITY

*Kerryn Krige, Jens Dyring Christensen, Molefe Pule, Filip de Beule and Alex Bignotti*

### 1. The social and solidarity economy (SSE) as a pathway to an inclusive society in South Africa

The SSE in South Africa is increasingly being recognised as a pathway through which inclusive growth that bridges inequality can be realised. Two research studies conducted before and during COVID-19 affirm the sector's importance in stimulating job creation, especially for young people, while building trust, networks, and social cohesion.

In recognising the value of the SSE, the South African government's Department of Trade, Industry and Competition (DTIC), together with the International Labour Organisation (ILO), the Government of Flanders and the Industrial Development Corporation (IDC), began, in 2017, to develop a policy to foster the development of the social and solidarity economy.

This policy builds on several years of work by different stakeholders. A definition of the SSE put forward by the ILO in Johannesburg in 2009 is now widely used internationally (Borzaga et al., 2017). The IDC launched a Social Enterprise Fund in 2015 and the ILO has delivered various projects in the Free State and KwaZulu-Natal provinces, exploring the rural characteristics and conditions of the SSE. The National Treasury, through the Government of Flanders, saw the publication of The Disruptors book series (Krige & Silber, 2016), and has supported various initiatives through universities and business schools. As a result, South Africa is well positioned for a policy to strengthen the social and solidarity ecosystem.

#### The ILO defines the SSE as a

concept designating enterprises and organisations, in particular cooperatives, mutual benefit societies, associations, foundations and social enterprises, which have the specific feature of producing goods, services and knowledge while pursuing both economic and social aims and fostering solidarity (Borzaga et al., 2017:5).

The SSE is crucial to sustainable economic development and employment globally, and demand for the SSE has 'never been greater' (OECD, 2020:2), considering the global economic landscape that, even pre-COVID-19, was characterised by rising unemployment, inequality, and environmental degradation (Borzaga et al., 2017; ILO, 2019). Because of its interconnected nature, the SSE brings social services to vulnerable or marginalised communities, simultaneously stimulating economic activity, strengthening active citizenship, and enhancing social cohesion (Ayob, 2018; Wallace, 1999). Job creation, decent work, and inclusion are all outcomes of the SSE, with economic activity that benefits the most vulnerable 'more effectively than the profit-first sector' (Richardson, Agyeman-Togobo & Catherall, 2020:48).

The relevance and impact of the SSE can be seen at the global level, with 6.4% of the EU's workforce employed in the more than 2.8 million social economy organisations. In the United Kingdom, 5% of the national workforce is in the sector, with peaks of 9–10% in Belgium, Italy and France (CIRIEC, 2017; OECD, 2020; UK Cabinet Office, 2017). We also see a growth in SSE activity in Asia, with policy development in countries such as Thailand, Malaysia, South Korea, and Indonesia (see, for example, ILO, 2021; Quiñones Jr., 2015); across South America and in Africa; and through regional entities such as the African Union and global research initiatives such as the ICSEM<sup>1</sup> project (Defourny et al., 2020).

The SSE acts as a bridge across sectors and concepts that are seemingly opposite: it bridges informal and formal organisations, economic and social value, and social and environmental development (Littlewood & Holt, 2015; Mair & Marti, 2009; Richardson et al., 2020)". This bridging role is important as it creates a pathway through which the principles of sustainable development, decent work, and inclusive growth can be achieved.

<sup>1</sup>The International Comparative Social Enterprise Models (ICSEM).



## 2. The SSE as a bridge to inclusivity

Emerging markets, with their developed and developing economy characteristics, require bridging mechanisms that meet both the economic and socio-environmental developmental mandates associated with progress (Bruton et al., 2008; Dhanaraj & Khanna, 2011; Webb et al., 2020). The Global Competitiveness Index Report highlights the South African reality, with the country scoring in the top ranks for its financial institutions and the bottom for its social development (Brown et al., 2015; Schwab, 2019; Schwab, et al., 2014; World Economic Forum, 2013). By having pathways that bridge these opposites, South Africa's triple challenge of inequality, poverty, and unemployment can progressively be addressed.

South Africa's inequality is well documented, together with its growing unemployment, which is particularly pronounced among young people (Stats SA, 2019; Sulla & Zikhali, 2018). Gains in poverty alleviation, especially in rural areas, are, according to the country's Statistics Agency, stalling; and inequalities across spatial, gender, and labour dimensions remain severe (David et al., 2018; Stats SA, 2019; Sulla & Zikhali, 2018). Globally, we see that COVID-19 has contributed to the acceleration of these developmental gaps, driving up unemployment and accelerating multi-dimensional elements of poverty and inequality (African Development Bank, 2020; The World Bank, 2020; Zeufack et al., 2020). South Africa has not been immune to these trends. As reported in previous chapters, unemployment went up during the pandemic from already extremely high levels and the socio-economic impact of COVID-19 has probably been worse where economic activity was already weak, creating less elasticity and opportunity for recovery.

It follows that there is a movement of people away from the formal economy to the informal sector, which, even though economic activity continues, is not ideal. Employment in the informal sector can be precarious, with lower income and productivity returns. It can have a harmful effect on workers' rights, including fundamental principles and rights at work, social protection and decent working conditions (Bonnet et al., 2019).

In South Africa, these difficulties are compounded by a breakdown in trust and consequently in social cohesion. The Human Development Report 2019 (Conceição, 2019) flagged South Africa as a country that has seen gains across multiple development indicators, but uniquely has also seen an increase in levels of distrust between its people. Distrust deepens in environments that are resource poor, economically stressed, and where there is a lack of accountability in institutional mechanisms (Amoako, 2019a; Amoako & Lyon, 2014; Webb et al., 2020). Moreover, there is a risk that, as a consequence of COVID-19 and the ensuing economic stagnation, further breakdowns in trust could occur.

SSE entrepreneurs step into this breach, providing goods and services where there are gaps in social service delivery. These are organisations such as Zenzeleni, a co-operative providing Wi-Fi access in very rural areas, or Nhlanhla Ndlovu of Hustlenomics, who uses environmental bricks to build affordable houses in South Africa's townships with a no-cost financing model attached. Social economy entrepreneurs develop mobile science laboratories, no-water latrine systems, and job-seeker applications on mobile phones and deliver transport services in rural areas. The sector, driven by community responses to specific community needs, is therefore diverse and hard to define, built as it is on principles of solidarity, common and collective good, and shared value (Borzaga et al., 2017).

Because of this focus on collective common good, social economy entrepreneurs have an added benefit in that they also strengthen the fabric of society, building active citizenship and community engagement. They are highly reliant on trust and networks, and are therefore accountable to the communities within which they work (Amoako, 2019b; Ayob, 2018; Bohn & Roelfs, 2020).

This is why the SSE offers such an opportunity in South Africa and can play a critical role in the post-COVID-19 rebuild. It provides goods and services in a way that connects people to each other through solidarity systems. It is built on a moral system of exchange, with ethical commitments and regulations, which includes characteristics of communal systems (Biggart & Delbridge, 2004). It is an approach that favours collaboration over competition through systems of empowerment over control (Santos, 2012), and in which decisions are made jointly and benefits are shared (Defourny et al., 2020)



In the South African context, this opens up discussions on new ownership models (see, for example, Beyster, 2017; Fama & Jensen, 1983; Labour Party, 2017; Luo & Chung, 2013; Social Capital Partners, 2020) which shy away from individual benefit and value expropriation and instead explore alternative mechanisms for shared value and inclusive growth.

### 3. COVID-19 and the SSE: Insights from South Africa’s studies into the sector

A series of research studies gives us insights into the SSE in South Africa both before COVID-19 and during the first year of the COVID-19 lockdown, capturing the size and conditions of work of the sector.

In 2019, DTIC together with the ILO conducted a survey of stakeholders attending social economy policy discussions across South Africa. This sample group (n=506) is an important mapping study of the SSE across rural, peri-urban, and urban areas.

A subsequent partnership with the government marketing agency Brand South Africa resulted in the SSE forming part of that entity’s annual national-household survey, with n=2,501 people interviewed in November and December of 2020. The value of these two datasets is that they build a picture of the SSE pre-COVID-19, which is then contrasted with the one that emerged during the country’s first year of COVID-19.

The key findings confirm the potential of the SSE as a job creator and its importance as a bridge between the formal and informal sector and between profit and social motives to economic activity. The altruism that underpins the SSE is linked to social cohesion, with trust and networks being key mechanisms through which accountability is held and communities engage.

### 4. Key finding 1: Sustainable job creation potential of the SSE in South Africa

A 2019 analysis of existing Statistics SA datasets by the dtic<sup>2</sup> shows that the SSE makes up on average 5.6% of jobs in South Africa, as shown in Table 1. This puts the SSE on a par with the agricultural and the transport sectors.

**Table 1: Estimate of size of the social economy in South Africa (2019)**

	Desk-based benchmark estimate: upper	Desk-based benchmark estimate: lower	Average
Number of SSEOs	255 767	231 798	243 782
Share of economic production	4.8%	4.3%	4.5%
Share of total number of jobs	6.4%	4.8%	5.6%
Number of jobs (2019)	1 048 000	786 000	917 000

Source: Statistics South Africa, 2019

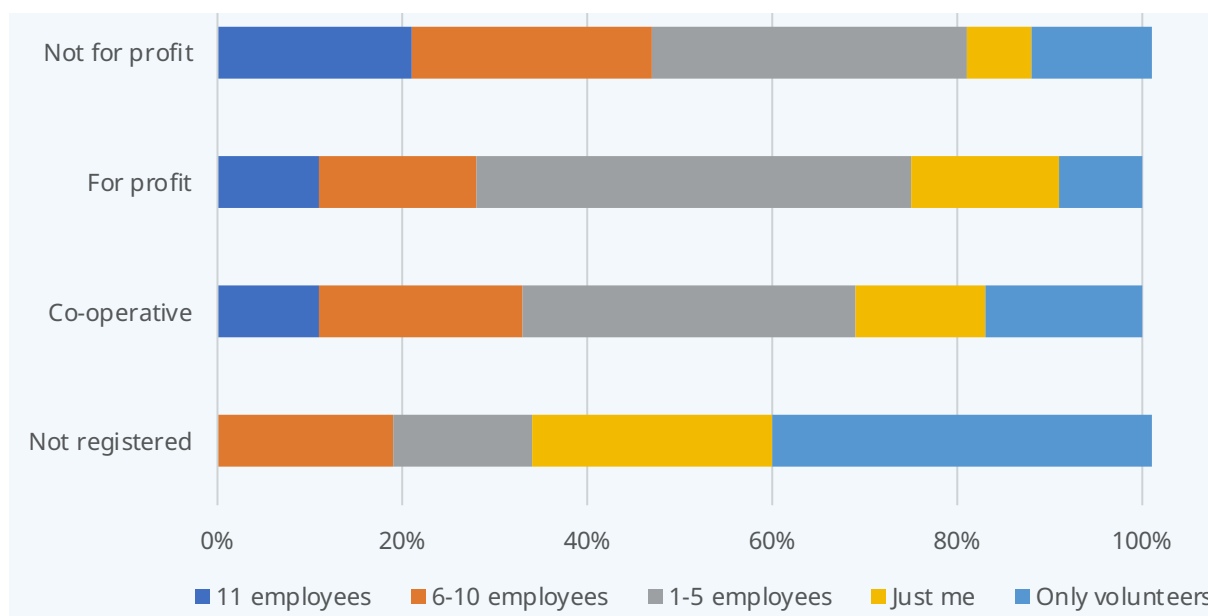
The study by Brand South Africa (2021) confirms this potential, revealing higher numbers. It also shows that registered social economy organisations create permanent job opportunities, whereas informal (unregistered) entities are more likely to involve unpaid volunteers.

The SSE organisations in the dtic/ILO 2019 study in most cases display the characteristics of formality: they are largely registered and have bank accounts. The study also shows that organisations which contract and have legal systems employ more people. Conversely, informal organisations exhibit high levels of volunteerism (see Figure 1).

<sup>2</sup>This analysis reviewed multiple datasets, including the Quarterly Labour Force Survey (2019 publications), Volunteers Activity Survey (2010), Annual Financial Statistics (2017), and National Accounts: Statistics of the non-profit sector for South Africa 2010–2014. For further information, please refer to the Technical Note of the Green Paper on the Social and Solidarity Economy in South Africa, which focused on measuring the social and solidarity economy.



**Figure 1: Volunteerism across informal organisations**



Source: dtic/ILO, 2019

These findings confirm the potential of the SSE as a space for employment and the value of investing in their transition towards formality.

Formality brings benefits, particularly for marginalised people, who are already vulnerable. Formalisation is positively linked to improved productivity, better working conditions and heightened social and economic returns (ILC, 2007; ILO, 2020). If organisations could be supported towards formalisation, the benefits of greater employment opportunities could be realised together with the benefits of reduced vulnerability and improved protection. This involves tackling the stigma of formality, which, regionally, has been associated with over-regulation, irrelevant systems, irregular enforcement, and weak support (Amoako & Lyon, 2014; Berrou & Combarrous, 2012; Webb et al., 2020).

## 5. Key Finding 2: The SSE's potential to employ young people

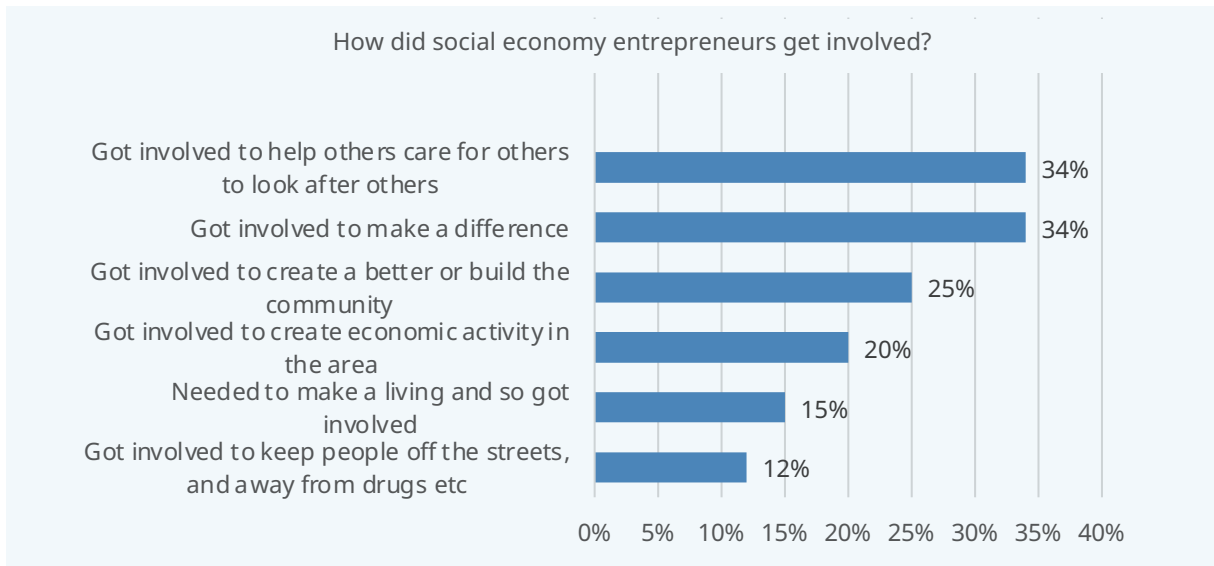
The Global Entrepreneurship Monitor has conducted a number of country-specific studies on Social Entrepreneurship, which include South Africa (see, for example, Bosma et al., 2015; Herrington & Kew, 2016; Terjesen et al., 2009). A finding was that social entrepreneurship in South Africa was the most appealing form of entrepreneurship to young people, one which has the least barriers to entry (Bosma et al., 2015; Terjesen et al., 2009; Visser, 2011). The 2019 dtic/ILO survey did not include sufficient numbers of young people to confirm this finding, but the Brand South Africa (2021) omnibus survey finds that young adults between the ages of 25 and 34 are more involved in social economy practices than other age groups.

This reinforces the assumption that the SSE should not be ignored as a means of stimulating youth entrepreneurship to deal with the un- and under-employment gap of young people in South Africa. This has already been inferred at a regional level, with social organisations considered a crucial mechanism to overcome Africa's youth bulge and employment challenges (Richardson et al., 2020)

## 6. Key Finding 3: Altruism, trust, and networks – the potential of the SSE to connect

Brand South Africa (2021) study finds altruism as a motivator for economic activity. The drive to be involved in the SSE is founded in personal values grounded in notions of doing good. The primary motivations are summarised in Figure 2 below.

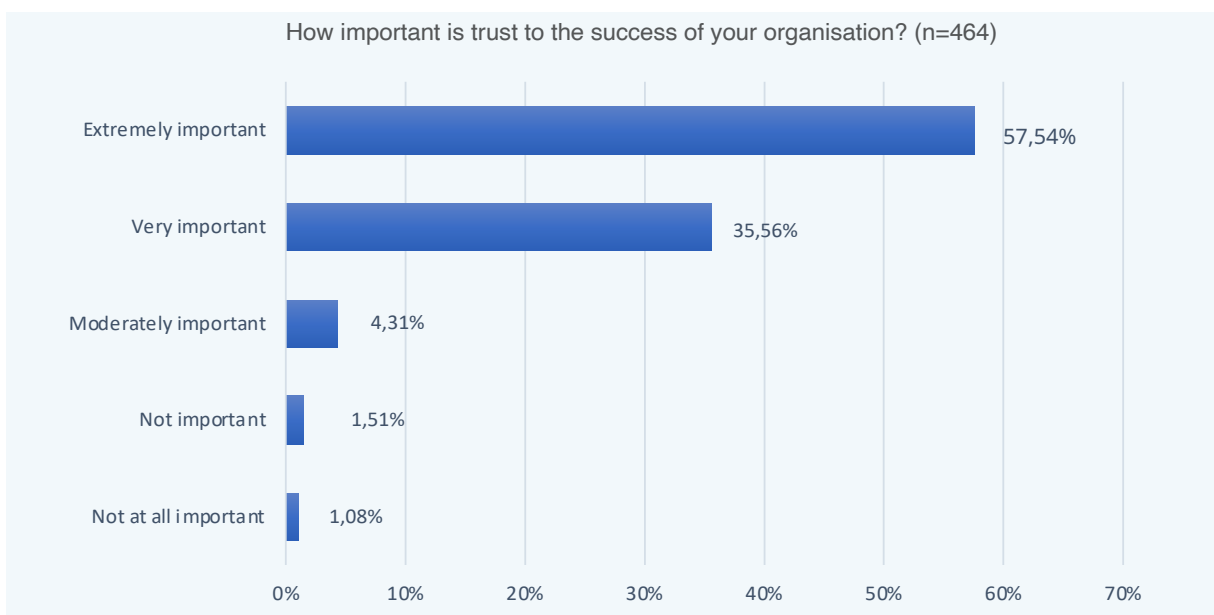
Figure 2: How did social economy entrepreneurs get involved?



Source: Brand SA, 2021.

In turn, Amoako (2019b) describes trust and networks as crucial mechanisms to facilitate and arbitrate transactions. The dtic/ILO 2019 survey highlighted the importance of trust and networks to organisations operating in the social economy. Both are considered crucial to the success of the organisation, as is shown in figures 3 and 4 below.

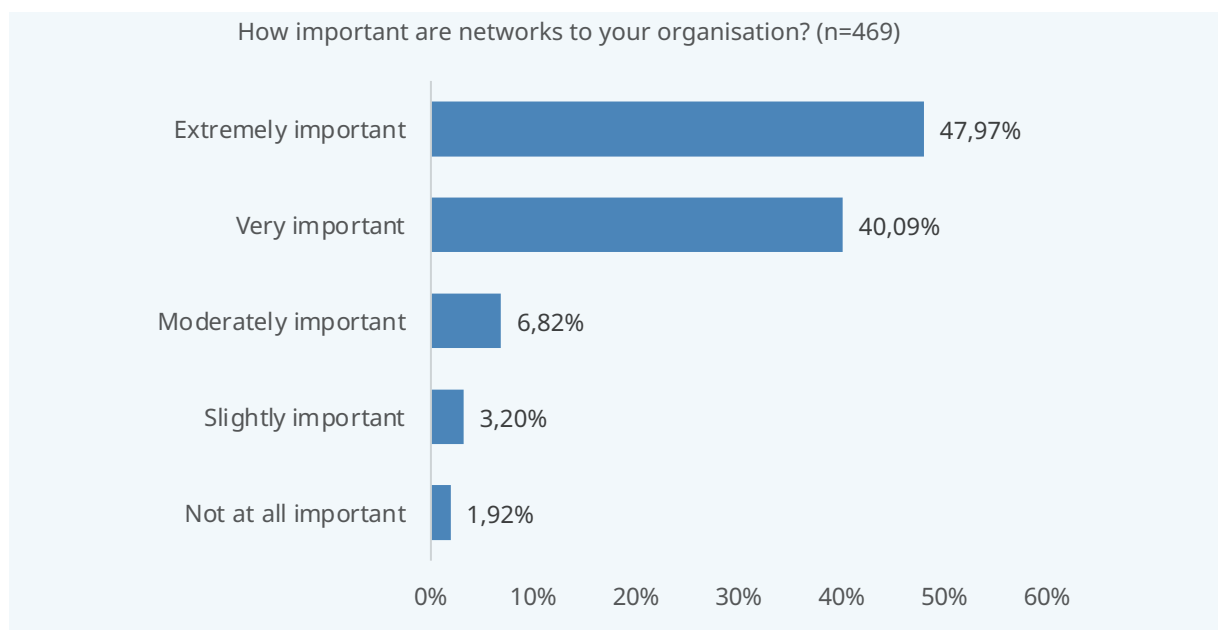
Figure 3: How important is trust to the success of your organisation?



Source: dtic/ILO, 2019.



Figure 4: How important are networks to your organisation?



Source: dtic/ILO, 2019.

The significance of altruism, trust, and networks to the SSE is evidence that the last of these comprises economic activities that are values based. Considering the trust-deficit in South Africa highlighted in the Human Development Report (Conceição, 2019) which is expected to increase as a consequence of COVID-19, the SSE can play an important role in demonstrating that values-based enterprises work. The value of the community-based social economy enterprise is that it relies on trust, networks, and altruism to function, and consequently builds social capital and social cohesion (Ayob, 2018; Jack et al., 2004; Lyon, 2000).

## 7. But what are the risks?

A workshop hosted by the universities KU Leuven (Belgium) and Pretoria (South Africa) together with the ILO in 2018 discussed barriers to understanding and developing the SSE in South Africa (Krige, 2019). Academics from universities in the United States, Europe, and the United Kingdom met together with lecturers from various African universities to discuss shortcomings in developing the learning and research agenda. Priorities ranged from stimulating and encouraging African-led research, the imperative of including young people, and the need to collaborate across institutions. A lack of country-level definitions was flagged as a barrier to policy development, as were limitations in networks that hampered the growth of the SSE (Krige, 2019).

These concerns continue to dominate the literature on the social and solidarity economy, which, because of its context-specific nature, lacks a universal definition, which stunts policy development (Borzaga et al., 2017). Organisations are also often small and localised, which limits information-sharing, leading to the creation of systems of closed networks which constrain growth (Berrou & Combarous, 2012; Granovetter, 1973).

## 8. Conclusion

By comparing data from two studies with a broad sample group, and with fieldwork pre- and during COVID-19, we are able to confirm the value of the SSE as a means of realising sustainable job creation, particularly in marginalised areas. The additional value of the SSE lies in its solidarity mandate, which creates a socially cohesive accountability that is deeply rooted in trust and network-building.

The SSE acts as an important bridge between informality and formality and demonstrates the potential of alternative systems that are anchored in altruism, values, morals, and a collective vision of the common good. Through its policy action, the South African government continues its commitment of 2009, to enable the SSE, recognising its value as a pathway to an inclusive society that bridges inequality.

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## 8. FINANCING THE 'JUST TRANSITION' TO A LOWCARBON AND CLIMATE-RESILIENT SOUTH AFRICAN ECONOMY

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### 1. Introduction

South Africa's climate finance architecture is a complex and evolving network of international, regional, and national funds that provide financial resources to support the transition towards low-carbon climate-resilient development (LCCRD), also known as climate-compatible development (CCD) (Mitchell & Maxwell, 2010; Nakhooda et al., 2015).

#### Climate finance can be defined as

financial support for mitigation and adaptation activities, including capacity-building, research and development, as well as broader efforts to enable the transition towards low-carbon, climate-resilient development (Buchner et al., 2013:2).

It is fundamental in reducing anthropogenic carbon emissions and vulnerability and building resilience to climate change impacts (Stewart *et al.*, 2009). Financing the transition to CCD in South Africa is supposed to consider and resolve issues relating to social justice, fairness, and equity (e.g., poverty eradication, income disparities, an increase in decent jobs, and a reduction of greenhouse gas (GHG) emissions) to ensure that 'no one is left behind'. This is what we might call a just transition.

Similarly, McCauley and Heffron (2018) define 'just transition' as 'a fair and equitable process of moving towards a post-carbon society'. The International Trade Union Confederation (ITUC) describes 'just transition' as a framework that 'secures the future and livelihoods of workers and their communities in the transition to a low-carbon economy' (ITUC, 2015). The International Labour Organisation (ILO) provide further elaboration of the concept and guidelines for its achievement. According to the ILO, 'just transition' can be understood to be an expression in the fight for social, economic and environmental justice. ILO guidelines are designed to ensure that there is social dialogue between government, trade unions, employers, and gender advocates (ILO, 2018). The South African National Planning Commission (NPC) has drawn inspiration from the ILO definition but, more importantly, it has adapted it to the South African context. The World Bank (2018) has also added its voice, as it calls for 'achieving just transition for all'.

The Industry Task Team on Climate Change<sup>2</sup> (ITTCC) acknowledges the uniqueness of South Africa's concept of a just transition, on account of its abundant supply of coal, juxtaposed against its 'still developing' economic status. The ITTCC notes that, in South Africa, the thrust is to 'address the underlying issues of poverty, unemployment and inequality as part of the jobs transition process'. Their proposed idea is to 'ensure that the skills and workforce we have today are upskilled, reskilled and adequately transferred'. Consideration, they add, should also extend to what happens to communities and microeconomies within the coal-mining towns in the Mpumalanga Highveld region.

A researcher from the Energy Systems Research Group at the University of Cape Town (UCT) and expert participants from Meridian Economics concur with an expansive or broader definition of just transition (as opposed to only focusing on workers, as seemed to be the case initially in the Global North). Beyond retraining and relocating workers in sectors that will undergo transition, it would be considered prudent to take a broader view which includes communities that have thus far been excluded from economic activity or socioeconomic development. Despite focusing primarily on workers and coal communities, they propose that 'just transition should be inclusive of workers across the value chain who might lose their jobs (e.g., automotive industry workers, as combustion engines are phased-out)'.

<sup>1</sup>This chapter is based on extracts from my dissertation, submitted in partial fulfilment of the requirements for the degree: Master of Science (MSc) at the School of Oriental and African Studies (SOAS), University of London. A considerable part of the material reproduced here is therefore based on original research and interviews with a wide range of stakeholders engaged in climate change or finance issues. See Siko (2021).

<sup>2</sup>ITTCC is a non-profit organisation, a policy advocacy body and a thinktank whose members are largely energy-intensive and GHG emissions-intensive. The membership (petrochemical companies, mining or minerals companies, and downstream companies such as Consol, Eskom) makes up 20% of South Africa's GDP. The body also assists Business Unity SA member companies with the transition process.



Very importantly, just transition cannot be treated as a depoliticised neutral approach that escapes the influence of politics and the economy. Climate, environment, and energy justice activists and scholars continue to explore the interface between politics and the economy of just transition.<sup>3</sup> This requires analysing the dichotomy and complexities of just transition in the context of financing CCD. In short, it requires looking at climate finance through a just transition lens.

The magnitude of climate finance required to facilitate a just transition is becoming a pressing issue, given the injustices posed by climate change (Stewart et al., 2009).

This chapter seeks to establish whether South Africa's Green Fund<sup>4</sup> along with other green financing has been effective in financing a just transition to CCD. Specifically, it responds to the following questions:

1. To what extent are just transition principles integrated in South Africa's Green Fund?
2. How has South Africa progressed, in terms of funding, in the implementation of CCD projects?
3. How well has South Africa's Green Fund complemented other ongoing just transition initiatives, programmes, and project funds?

Following this introduction, section 2 presents the international and domestic contexts in which climate finance has evolved and operated. Section 3 discusses South Africa's Green Fund: it explores the extent to which it incorporates just transition principles and how much it can do with the resources it has available. Section 4 discusses other climate-finance initiatives and the articulation between the Green Fund and these initiatives. Section 5 concludes, emphasising that a just transition is a complex process, with many difficult trade-offs, which should be carefully managed through dialogues that bring together the different sectors of the South African society.

## 2. Climate finance: the international and domestic contexts

The Intergovernmental Panel on Climate Change (IPCC) special report issued in 2019 highlights the need for a just transition to netzero emissions by 2050. This would be in line with efforts to limit global warming to 1.5 °C (IPCC, 2019). Given the scale of financing needed to support transition, significant international climate finance resources as well as investments will be essential to attaining CCD.

The international climate finance architecture is mainly dominated by blended finance from multilateral institutions such as the UN Framework Convention on Climate Change (UNFCCC), which is designed to help developing countries to undertake climate action. To accelerate global transition to CCD economies, aligning international climate finance instruments with just transition principles is necessary. Multilateral funding instruments such as the UNFCCC Global Environment Facility (GEF), Green Climate Fund (GCF) and the Adaptation Fund (AF), are at the forefront of financing climate action in developing economies, including South Africa. These instruments are complemented by funding provided by development finance institutions (DFIs) through grants, loans, and concessionary finance, and official development assistance (ODA).

### The South African context

The South African NDP, developed in 2012, provides a guiding framework so that, by 2030, South Africa will have transitioned to an environmentally sustainable, climate-resilient, lowcarbon economy and a just society. In 2020, the Presidential Climate Change Coordinating Commission (P4C) was established to advise on South Africa's climate-change response (including a review of the country's progress in meeting its emission reduction and adaptation goals). The P4C's immediate task is to finalise the 2050 vision pathways for a just transition in South Africa, a process started by the NPC (NPC, 2020).

In addition to this process, South Africa has put in place comprehensive macro and sectoral policy frameworks such as the National Climate Change Response Strategy (NCCRS), the NDP as just mentioned, and an Integrated Resource Plan (IRP) to support a just transition.

<sup>3</sup>See, for example, Newell and Mulvaney (2013).

<sup>4</sup>An instrument set up by the government of South Africa, through the Department of Environment, Forestry and Fisheries, DEFF (formerly the Department of Environmental Affairs, DEA), to support the transition to a CCD pathway, delivering high-impact economic, environmental and social benefits. The Development Bank of Southern Africa (DBSA) was appointed as the implementing agent of the Green Fund.

To accelerate climate action and build an inclusive economy, as espoused by the NDP (NPC, 2012), the South African government identified a need to establish a fund that would finance initiatives aimed at building resilience and adaptive capacity and reducing GHG emissions. Efforts to achieve CCD necessitated the establishment of a government funded domestic climate finance instrument, the Green Fund. The Department of Environmental Affairs (DEA) established the Green Fund in 2012. At its inception, its intended purpose was to finance green initiatives that contribute to the country's transition towards a low carbon, resource efficient transition in its funding model — a fundamental precondition to ensure justice in the transition to CCD. Such an initiative is critical for policy-makers as it provides them with the means and instruments that will assist them in making informed decisions on how to finance current and future just transition projects.

To achieve a just and equitable transition, above and beyond the Climate Fund, there is a need for a well-coordinated domestic climate finance framework that deals with climatic impacts in South Africa. Climate finance alone will not solve all climate-change challenges. Given the complexity of climate change, there is a need for a systems-thinking approach to ensure a comprehensive and holistic view between climate-change mitigation, adaptation, and poverty reduction. In developing economies such as South Africa, there is a need to respond to climate-change issues while also overcoming the pressing development challenges such as inequality, poverty, and unemployment.

### 3. The Green Fund: aim and priorities

The groundwork for the establishment of the Green Fund started in 2009–2010. The focus then was primarily on transitioning towards CCD. Its set-up purportedly coincided with the period when the United Nations Environment Programme announced the New Green Deal, and South Africa hosted its first Green Economy Summit in 2011, which culminated in the signing of the Green Economy Accord. Subsequently, the South African National Labour and Economic Development Institute (NALEDI) purportedly conducted workshops, seminars, and research that culminated in the production of a booklet entitled 'Climate Change: a just transition to a low carbon and climate resilient economy'. This cascaded into the private sector's undertaking a process of evaluating the potential to create jobs in green-economy sectors. To that end, the Green Fund was designed to serve as an instrument to support the private sector in the transition to a low-carbon economy, through seed financing.

That took into consideration the nine national green-economy thematic areas, which were eventually amalgamated into three broad categories: (i) investment project support; (ii) research and development, and (iii) capacity development.

#### Integration of just transition principles in policies, plans, and strategies

The chapter turns now to responding to the first of the three questions posed above: To what extent does the Green Fund integrate the just transition principles?

Initially, the Green Fund was not designed to deal with the justice part of the transition process. According to the South African National Department of Environmental Affairs (DEFF), at the conception phase of the Green Fund, the issue of 'justice' was superseded by the thrust on the transition aspect — only coming to the fore after the inception of the Paris Agreement.

Notwithstanding this, evolution was observed towards the incorporation of sustainable development concerns such as socioeconomic and environmental impacts and social inclusivity.

In addition, the evolution towards a just transition has been supported by international financial institutions operating in South Africa. An example of this is the World Bank. According to a researcher from the Energy Systems Research Group at the University of Cape Town (UCT), following the setting up by the World Bank of Climate Investment Funds (CIFs), assessments have since been done to determine whether the CIF projects in South Africa have been transformational and whether they could contribute to a just transition. In addition, the World Bank has a just transition initiative (JTI), and their idea or premise of a just transition (changing development pathways for developing countries, and assessing CIFs projects on more than emissions) resonates with South Africa's conceptualisation discussed above. In the view of the UCT researcher, 'there is real intent to make CIFs transformational, as opposed to simply financing renewables or energy efficiency.'



As the Green Fund seems to have incorporated a just transition concept over time along with other key players doing the same, the next question that then arises is whether the Fund is big enough to finance a transition, let alone a transition that is just.

An initial answer to this question is that, although the Green Fund is widely considered to be a catalytic fund, the resources allocated to it to date – a figure of around R1.2 billion – would not make a significant dent in attaining a just transition.<sup>5</sup> The Banking Association South Africa (BASA) concurs with this view. According to them, the Green Fund ‘... is a good vehicle, but it might not be a big enough vehicle, considering the enormity of the task ahead ... the challenge is too big and thus requires more than the Green Fund to resolve’. South Africa is a resource intensive country in which wealth was created from mining, energy is fossil based, and the social income disparity is enormous. In this context, BASA argues that ‘the Green Fund, in its current form, will only partially satisfy that transition’.

The Green Fund capitalisation amount pales when juxtaposed against the enormous tasks, echoes a Trade Unionist. In addition, although the NPC registers many just transition projects underway, most are in ‘sensitising’ and ‘awareness raising’ as opposed to ‘project piloting’. From a Trade Union perspective,

if workers could see a just transition in motion — if they could see workers being taken from a coal fired power station to a renewable energy plant (i.e., transitioning successfully into a renewable energy sector and eased into a low carbon economy), they would buy into the idea.<sup>6</sup>

According to the DEFF, the total allocation from the National Treasury of R1.195 billion was to cover the period 1 April 2012 to March 2020. In addition, this amount was to cover administrative costs, but not co-financing, as one of the main objectives of the Fund is precisely to serve as a leveraging mechanism to raise private and other resources. Moreover, the actual amount spent has been about two-thirds of the total, with the balance remaining with the Development Bank of Southern Africa (DBSA), which is where the Fund resorts.<sup>7</sup> The common understanding is that no new or further financing of initiatives has been programmed post the publication of the 2017 Review Report.<sup>8</sup>

Interviewees made the point that South Africa does not have the budgetary means to incentivise a change in financial system flows. On this basis, an expert from BASA expressed the view that ‘interventions such as the Green Fund are not significant enough to change the direction of financial systems’. In addition, ‘SA is still in the initial phases of assembling sufficient information to address such limitations and overcome barriers.’

In the light of the above, consensus exists that South Africa has put enormous effort into working on the elements that are necessary to support a just transition, particularly in policy-making. Yet, more needs to be done in funding and implementing CCD projects. The result to date of the funding shortfall is that most programmes and projects financed by the Green Fund are small and incremental as opposed to ‘pivotal, huge impact, tipping projects that can shift past dependencies and unlock potential’.<sup>9</sup>

<sup>5</sup>Interview material.

<sup>6</sup>Interview material.

<sup>7</sup>South Africa's Green Fund has provided financial support to 55 projects in three funding windows (i.e. investment, capacity-building and research and development). According to DEFF, in terms of geographic spread and sectoral allocation, most of the proposals for funding have come from the provinces of Western Cape, Gauteng and KwaZulu-Natal, which happen to be the country's major economic hubs.

<sup>8</sup>The Report (2017) was to review the Green Fund – Has it met its set objectives? Is there room for it to continue? If so, what role should it play? Which sectors should it support?

<sup>9</sup>This view was expressed by, among others, NALEDI and Meridian Economics.

#### 4. Climate finance initiatives or mechanisms to embrace issues of a just transition in South Africa

Given the limited resources held by the Climate Fund, the next question is therefore: What other initiatives and mechanisms have emerged to support the just transition in South Africa. One of the climate-financing initiatives is led by BASA, with four focus areas: housing, infrastructure, sustainable finance, and agriculture or land reform. Moreover, BASA is the designated Secretariat for the National Treasury's Sustainable Finance project.<sup>10</sup> This is seen as

... a really important initiative in SA because it is a partnership between the State, the regulators and some of the state departments and private sector financiers– a broad assembly of financial sector key stakeholders, inclusive of: BASA, long-term savings industry, pension funds, shortterm insurance sector, JSE, SAICA.<sup>11</sup>

Another important potential source of funding is the '30 by 30' project,<sup>12</sup> a global initiative whose main participants are the German Development Cooperation GIZ and the World Bank. It is meant to be implemented over the next five years, South Africa being one of four countries in the world selected for this programme. It focuses on two areas: climate change and green initiatives. BASA is of the view that 'this project will open up considerable opportunities for the country, through the technical and funding support provided'.

Overall, according to the ITTCC, 'from a financing perspective, the uptake of climate funds has been rather low', a view corroborated by experts from BASA.

Against this background, domestic finance (including the Green Fund) is widely considered to have the capability to provide additional funding. A main issue, the ITTCC argues, is that 'it has not been effective in the just transition space – although there is a lot of potential through the fund and platform, it hasn't delivered on expectations'. The ITTCC and NALEDI concur that there is a need to bring together key stakeholders (business, civil society, communities, government, and the actual financiers) for a dialogue about cocreating and codeveloping projects that incorporate principles and address the imperatives of just transition and to discuss how to make the funds accessible in a much easier format. In that context, one question the ITTCC regards as fundamental is: What is the role of Treasury and other role players in the transition?

The next question is whether the Green Fund is complementing other initiatives.

According to the Green Fund shareholder (DEFF), several international donor partners – including the French Development Agency (FDA) and German counterparts (via the binational agreements on just transition issues) – have provided support. The European Union (EU) has focused on vulnerable groups (e.g., entrepreneurs, MSMEs), while the KfW Bank (German Development Bank) is purported to have evaluated how certain financing instruments could be applied in the Green Fund itself, including channelling funds for on-lending purposes, through a sub-programme, where possible. Individual BASA member-companies such as Exxaro, for example, have reportedly completed many community-focused projects that encapsulate just transition (e.g., smart villages, agriculture). It was also revealed that Nedbank has set up to be a Green Fund beneficiary, parallel to its progressive withdrawal from funding coal-related projects.

BASA member banks have partnered, in various initiatives, with such entities as DBSA (Green Fund), IFC, GIZ and the EU in co-funding CCD initiatives.

<sup>10</sup>The National Treasury tries to implement its Technical Paper on Sustainable Finance, with an implementation process subdivided into five working groups, each focusing on a different aspect of its recommendations, and a steering committee that provides oversight and adopts the recommendations emerging from the Working Groups.

<sup>11</sup>Views from an expert informant from BASA.

<sup>12</sup>The idea is that, by 2030, banks should have diverted at least 30% of their lending to green initiatives, reduced involvement in coal to almost zero, and reduced exposure to the brown sectors by about 30%. This global initiative is designed to support the banking sector to move in that direction.



The insufficiency of the Green Fund's current shape or form is indeed widely acknowledged. Consequently, the DEFF's view is that it would be good to have an amalgamated fund for the benefit of certain sectors (e.g., the informal sector), which are invariably disadvantaged. The fund could then assist vulnerable people. In the search for additional funding, part of the answer could be found in pension funds (e.g., from mining houses, the transport sector), which could be used to support the just transition.

One trade unionist's view is that a blended finance mechanism would work better, which could be done through the Green Fund because the DEFF (a Green Fund shareholder on behalf of the government) already has the requisite institutional framework in place.

BASA validated the point that sectors that have benefited substantially over the years (in the form of subsidies) should play a key role in supporting the just transition process. The ITTCC says that an alternative financing model (terms and conditions, pros and cons, etc.) should also entail determining 'how the funds (if amalgamated), will be used, the key focus areas, benefits to various stakeholders, how the implementation will be managed, who owns and/or maintains liabilities'.

## 5. Conclusions

This chapter discussed the extent to which climate finance in South Africa incorporates concerns about a just transition, and whether domestic climate finance resources can be scaled up to help achieve justice and equity in the transition to CCD. The focus of the discussion was on the effectiveness of the Green Fund in financing the just transition to CCD. The consensus, based on a series of interviews summarised in the chapter, is that having the Green Fund as a domestic climate finance instrument resource or facility, and the availability of additional funds that could be drawn upon, possibly in an amalgamated form, is essential in the pursuit of the just transition agenda.

Despite all the shortcomings this chapter highlights, one could say that the journey traversed by South Africa on climate finance is remarkable, given its developing country status. The Green Fund has made significant social and environmental strides in pursuit of a CCD.

The pace of the just transition to CCD will, in the main, be determined by the availability of well coordinated domestic and international climate finance instruments. The development of innovative, responsive just transition centred climate finance instruments can help to reduce socioeconomic inequalities, while simultaneously responding to the country's developmental imperatives. In the prevailing context of trust deficit between the social partners, the biggest hurdle to South Africa's just transition roadmap will be the buy in from civil society or community based organisations as well as the labour movement to what the government and business are trying to achieve in the context of CCD. Any dialogue that brings these four key players into successful partnership – a 'social compact' – will be valuable.

NEDLAC and/or the P4C have a key role to play in shaping the need for a strengthened climate finance instrument that will effectively deliver a just transition to CCD. There is scope for innovative climate finance in the form of 'transition finance' — DFIs could finance Eskom to close down its coal stations early and transition to renewable energy, with enormous transformational impacts.

Economic diversification, as another pillar, will also require funds. Commercial finance could be used for renewables, and there is sufficient private capital to do that. However, considering the scale of the resources required to transition from coal to renewables, concessional finance will be needed, particularly for the incremental cost difference.

The selling-point of the transition to CCD has been the creation of new jobs on a scale that both compensates for job destruction in the old industries and absorbs the new contingents entering the labour markets. That might not necessarily be the case as certain sectors will not create the expected or projected numbers of jobs. Despite the job creation potential, expectations should be tempered because there are many variables that have a bearing on the transition, over and above the financing aspect.

In addition, energy transition does not mean that a miner who was working for a coal mine in Mpumalanga province will now be employed in a renewable energy plant. The concentration of these renewable energy sources comes into play: most are not located in Mpumalanga but in the Northern Cape province and the Western parts of the country. There is, therefore, a need to start creating alternative economies in such provinces as Mpumalanga. It is also a misconception that mine workers should look towards renewable energy power plants to employ them. Post-transition jobs are in the value chain of renewable energy (e.g., manufacturing and packaging of renewable energy components or products instead of importing them). Consequently, what is needed is a 'broader, industrial policy type of intervention' – the establishment of a complete renewable energy value chain designed to absorb workers en masse.

The 'leave no one behind' (LNOB) concept might not necessarily manifest itself in the manner it is meant to be – there are people that might be left behind, despite all efforts. Some might not be able to be re-skilled, perhaps because of their age. Moreover, some sectors might not be able to transition to low-carbon and might therefore have to be shut down, be it in part or as a whole. Tradeoffs are therefore inevitable in this just transition process.

A bottom-up approach should be adopted to flesh out what the just transition vision and process entails. Inclusive dialogues should be held to assess, for example, whether it is feasible for South Africa to attain carbon neutrality by mid-century. If so, what are the measures that need to be undertaken in the short, medium, and long term? What are the implications for the energy-intensive sectors such as petro-chemicals? Does hydrogen have a role to play? How do we blend that with renewables? Is there a role for gas as a transition fuel in the medium term? What are some of the costs required for key components (core-worker support, coordination platform, and regional rejuvenation)? How many workers might be affected? What are the costs of rehabilitation projects and establishing institutional structure?

It is in all stakeholders' interest that the transition from fossil fuels be carried out in an orderly fashion, with the least socio-economic disruptions, and with justice issues being a key part of that. Energy transition dialogues are, therefore, required about the threat to the survival of certain energy-intensive sectors (mining, automotive, etc.), if they are to carry the burden of a just transition. The process will be onerous – no transition is ever easy; however, the ongoing dialogues will ensure that the transition is conducted in as orderly a manner as possible.



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## 9. BASIC INCOME GRANT WITH A SOUTH AFRICAN TWIST: IMPROVING SOUTH AFRICA'S SOCIAL SECURITY SYSTEM THROUGH A HUMAN-CENTRED SOCIAL CONTRACT<sup>1</sup>

Matilda Dahlquist

### 1. Introduction

The COVID-19 pandemic has thrown a spotlight on our civilisation's unsustainable and unjust ways of structuring the global economy, and on our harmful relationship with nature. It has also shown us how intertwined we all are across the planet; that we are in this together; we are only as strong as our weakest link; and that global solidarity is also in all nations' self-interest. This has forced us to take a step back, reflect and adapt, which is a golden opportunity to rethink how we structure our societies and economies, and for what purpose.

The future of work is already here. The pandemic accelerated the pace at which we got here and it has been shaped by numerous global megatrends: globalisation, technological innovation and digitalisation, the climate and ecological crisis, demographic shifts and, indeed, pandemics. Complex factors are working together, worsening the persistent and increasing inequalities, which have deep impacts on the nature and future of work and on the place and dignity of the people in it.

It is in this context of changes and finding ways to reimagining the future that a vivid debate on the concept of a Universal Basic Income (UBI) or Basic Income Grant (BIG), has been born in South Africa. UBI or BIG<sup>2</sup> is widely acknowledged as a transformative instrument that can assist the country to realise the universal right to social security. It can also be considered a tool to manage change and propel a just transition. Generally, the BIG discussions have been guided by different motivations – ranging from interest in its liberating potential (rights, choices, dignity), and poverty and inequality impacts, to legitimate concerns over huge fiscal implications and labour market linkages (or lack thereof). Can South Africa afford it? Can the country manage a BIG sustainably in a way that stimulates the economy and grows the tax base over time? That provides support for those who cannot find a job whilst also incentivising and rewarding those who can find a job?

This chapter contributes to the current public BIG debate in South Africa by proposing some innovative and systemic policy interventions in an attempt to respond to the multifaceted challenges at their core, while supporting and empowering Mzansi's citizens.

The backdrop of this chapter is the International Labour Organization (ILO) Centenary Declaration for the Future of Work – co-created and adopted in 2019 by governments, organised business and labour of the 187 ILO member States – which calls for ensuring a just transition to a human-centred future of work with sustainable development that puts an end to poverty and leaves no one behind. It calls for urgent action to seize the opportunities and overcome the challenges to shape a fair, inclusive, and secure future of work with full, productive, and freely chosen employment and decent work for all (ILO, 2019a and b).<sup>3</sup> The African interpretation of the Centenary Declaration, the Abidjan Declaration on Advancing Social Justice: Shaping the future of work in Africa, was crafted and adopted by African member States in 2019 (only a couple of months before the new coronavirus hit the region).

<sup>1</sup>I want to acknowledge my husband, Bekithemba Mafulela, CFA, CFP® (an establishing social entrepreneur in the financial services industry), without whom this chapter wouldn't have been crafted. Beki was the one who initially came up with the "BIG with a twist" idea that this chapter rests upon and we have spent a lot of time together during the lockdowns discussing it. Thanks also to Ricardo Orlando Gottschalk (UN RCO) and Bernd Mueller (ILO Pretoria) for the valuable feedback on the draft chapter, and to Andrew Allieu (ILO Pretoria) for helpful guidance.

<sup>2</sup>This chapter uses the term basic income grant (BIG) as it is frequently used in South Africa. For consistency and clarity, I use BIG also when I refer to studies that use terms such as UBI, Universal Basic Income Guarantee or Basic Income Support.

<sup>3</sup>Informed by the work of the Global Commission on the Future of Work, which was co-chaired by President Cyril Ramaphosa and Swedish then-Prime Minister Stefan Löfven, the ILO Centenary Declaration for the Future of Work focuses on three areas of action: increasing investment in people's capabilities, in the institutions of work, and in decent and sustainable work. It highlights the essential role of lifelong learning, greater inclusivity and gender equality, human well-being, and universal social protection.



One priority of the Abidjan Declaration is the strengthening of all people's capacities to benefit from the opportunities of a changing world of work through progressively extending sustainable social protection coverage and supporting both the private sector as a principal source of economic growth and job creation, and the public sector as a provider of quality public services. It emphasises the need for comprehensive measures for a just transition and to accelerate processes of structural transformation through value-addition across sectors for the realisation of the SDGs, the African Union Agenda 2063, and the African Continental Free Trade Area (ILO, 2019c).

The mentioned global megatrends directly affect all of Africa, and South Africa in particular, due to its integration into the global economy, not least as a BRICS and G20 member. They not only shape and affect South Africa's economy and labour market, but how the country could create and pursue its goals and priorities, ideally guided and informed by international frameworks such as the ILO Centenary and Abidjan Declarations and the 2030 Agenda. South Africa can co-shape and harness these mega trends, and in fact use the COVID-19 crisis to make much-needed structural changes in the economy to find innovative and systemic solutions to its low, unequal, carbon-intensive, and largely jobless economic growth on its just transition towards a low-carbon, inclusive, climate-change resilient economy and society.

This chapter suggests crafting and establishing a human-centred social contract by introducing a BIG that is directly linked to tax collection in a way that, on the one hand, provides support for those who can't find a job while it, on the other, rewards those who can. Following this introduction, section 2 gives a snapshot of South Africa's social security system, highlighting some of its strengths and challenges. Section 3 shares how COVID-19 impacted South Africa's economy and labour market, and how the BIG debate arose in this context. Section 4 presents a proposal on a BIG with a "South African twist" as a contribution to the ongoing BIG debate in the country, while section 5 dives deeper into "the twist", i.e., how to make the BIG system effective. Section 6 concludes, pointing to the current crises as an opportunity that should be grasped to build solutions for a just and sustainable future.

## 2. Snapshot of South Africa's social security system and why can be improved

South Africa's social safety net programme has been acknowledged for its social assistance and poverty alleviation, largely thanks to the Department of Social Development (DSD). Indeed, with the country's new democracy came a massive effort to fight extreme poverty, and social grants have been post-apartheid South Africa's most effective weapon (Choga, 2021; World Bank, 2021). Yet the fact that South Africa remains one of the most unequal countries in the world speaks for itself. Its legacy of social and economic exclusion as a result of colonisation and apartheid, coupled with a low, unequal, and largely jobless economic growth perpetuates this inequality, leaving millions of people behind.

In the past couple of decades, South Africa's expanded expenditure on social welfare has been met with a sharply shrinking tax base. Life-saving grants have been paid out with the aim of reducing poverty, but the cost has increased exponentially. In 2003, South Africa had seven million social grant recipients (Hagen-Zanker, 2011), a number that has since more than doubled to approximately 17 million. Part of the challenge is the fact that the economy is not growing fast or inclusively enough, with only around ten million citizens in formal employment and less than half of those paying personal income taxes (StatsSA, 2020). In the past decade, the number of taxpayers has been on a steady decline, and decent wages remain an unattainable reality for many South Africans.

Social redistribution systems, often in the form of grants, are a cornerstone of any welfare state. They redistribute wealth and create a more equal society. But grants alone cannot eliminate poverty if there is no wealth to distribute. To be sustainable, output from the tax base requires input – and a structural problem requires a structural solution.

Furthermore, while rightfully praised, South Africa's grant system has several flaws. It is unnecessarily costly and cumbersome to administer, with rigorous means testing; it has inbuilt unfairness and gaps (excluding income support to those aged 18–59 years); and, arguably, it inadvertently disincentives current and potential recipients from earning more and transitioning to being net-tax contributors over time. South Africa is also increasingly faced with the challenge of growing national budget deficits, with rising social welfare costs contributing to a fragile fiscal situation.

The current social security system lacks a clear link to grow the tax base and fund the state-welfare benefits over the long term. There is lower tax compliance in the informal economy, resulting in tax-revenue leakages and an unsustainable “dual economy”. We need to find a way to formalise the informal economy and collect taxes to fund South Africa’s social security benefits in a way that offers a trajectory towards a sustainable system, while continuing to offer life-saving grants.<sup>4</sup>

### 3. The COVID-19 shock to South Africa’s economy and labour market and the BIG debate

Over and above this gloomy picture are the socio-economic shocks triggered by the COVID-19 pandemic and other recurring global crises. The pandemic hit during trying times and, while the measures in South Africa to curb the spread of the virus have been commended, they have hit the country’s highly unequal economy and its precarious labour market hard. South Africa was already in recession before the arrival of the new Coronavirus, having gone through three quarters of continuous GDP contractions from Q3 2019 to Q1 2020; this led to growing unemployment, which stood at about 30% in Q4 2019. The labour market had some 16.4 million unemployed people in Q3 2019, with the burden concentrated on the youth (aged 15–34 years). This translated into one of the highest unemployment rates in the world at almost 35%, while the unemployment figures for young, female, and black South Africans were even worse (Stats SA, 2019a and b).

As is often the case in crises, the most vulnerable segments of society – including people living in poverty – have suffered the most under the weight of the COVID-19-induced crisis; many lost their sources of income and livelihoods because of the nationwide lockdown and other measures. Indeed, a rapid assessment of the short-term impact of the COVID-19 crisis on the South African economy and the specific features of its labour market (conducted by the ILO and the Institute for Economic Justice (IEJ)) presents a sombre picture of employment outcomes, revealing that groups who were disadvantaged before the crisis have been disproportionately affected. Nine out of ten South African businesses reported losses in turnover (Strauss et al, 2020). The NIDS-CRAM survey exposed an 18% decline in employment between February and April 2020, meaning that three million fewer people were employed in April compared to February 2020. Furthermore, one in three income-earners did not earn in April 2020 (Spaull et al., 2020), when the national lockdown of all but essential workers took place.

In Q2 2020, Statistics South Africa (Stats SA) estimated 2.2 million job losses, of which only 543,000 jobs were regained in the year’s third quarter, meaning a net loss of just under 1.7 million jobs in Q2 and Q3 of 2020 (Stats SA, 2020), wiping out almost a decade of job growth. Women, people in rural areas, so-called “low-skilled” workers and low-income earners were disproportionately affected by these job losses. Food insecurity became at least twice as high as in 2016, and surveys reported that 37% of households were affected (Bridgman, et al., 2020). Hunger was widespread and depressive symptoms doubled in that period. At the time of writing, approximately 70% of adults (18–64 years) lived below the upper-bound poverty line of R1,265 per person per month, with about 40% living below the World Bank’s extreme poverty line of USD 1.90 a day (R436 per month) measure (Jain, 2020).

As noted in the previous chapters, to ease this burden, the government of South Africa introduced a COVID-19 grant of R350 per month for unemployed adults not receiving another grant. While the rollout of the COVID-19 grant faced administrative challenges, it provided much-needed relief for millions of previously unreachable people. Moreover, in 2020, the government put in place top-ups of R250 of all grants, apart from a higher Caregiver’s Allowance of R500 for each caregiver under the child support grant. This was implemented after May 2020 and prevented an even more desperate situation. In essence, people need jobs, but people also need access to other means of income-generation.

<sup>4</sup>I elaborate on one idea to try to achieve this in section 4.



The need for a holistic solution to the structural unemployment, chronic poverty, social security gaps, and exclusion of people from the economy has been well articulated. It is in this context that a public debate on BIGs gained traction (BusinessTech, 2021a and b; People's Assembly, 2021), alongside a thriving, separate debate on the need for a just transition. Several studies show the envisaged positive impact in South Africa (Black Sash, 2020; Choga, 2021; DSD, 2021a, b and c) and globally (Clarke, 2020; Dzhanova, 2020), of versions of a BIG and other income transfers on various social indicators, such as poverty, inequality, and hunger, in addition to macroeconomic benefits. IEJ commissioned further modelling on these impacts. Pamela Choga of the IEJ says in her article that a BIG is “one of the best tools available to reduce poverty, hunger, and destitution” and explores the possibility of implementing a BIG for all adults, adult informal- sector workers, unemployed adults, and adults who are not economically active (Choga, 2021).

Further, the DSD together with the ILO and the SDG Fund established a Panel of Experts to examine the appropriateness and feasibility of a system of BIG in South Africa. The work is painted on the backdrop that, whereas the pandemic indeed worsened certain social indicators, evidence suggests that these features are widespread, long term in nature, and have not responded to government interventions implemented to date. The Panel recommends an institutionalisation of the COVID-19 grant as a platform for an expanded system of BIG to be incrementally improved over time for working-aged people (18–60 years) who presently fall outside the existing systems of income support (DSD, 2021a and b). The COVID-19 grant was extended for a year to March 2023 and, more recently, again to March 2024. The Panel's report considers financing options<sup>5</sup> and effects on the economy, and makes recommendations to government on these (DSD, 2021a and c).

This BIG debate, spearheaded by DSD, is welcome and the current chapter builds on its momentum whilst taking off with some important (and some uncomfortable) questions that have also shaped the public debate: Who will qualify for the BIG? Universal social protection does not require that everyone receives an equal benefit, and it can be argued that South Africa cannot afford (let alone justify) an income grant for all its citizens. But where do you draw the line? Wherever it is drawn, it will be messy (if the line is at an annual income of, for example, R50,000, those who get R51,000 per annum would be better off with a salary cut; it could create incentives to game the system). How will the BIG be administered and rolled out? What incentives, dependencies, and other unintended consequences could a BIG create? How can you make a BIG system fair and just? Efficient and effective? Transparent and consistent? How can you make a new grant system with a BIG relatively more effective for the state over time in the current political economy?

#### 4. Crafting a human-centred social contract though a BIG with a “South African twist”

While a BIG could provide some income security, its impact on poverty and inequality largely depends on its design, including the level of benefit it provides, how it is financed, and how it relates to existing tax and social security systems.

This is a bold proposal that encourages South Africa to consider crafting a human-centred social contract by introducing a BIG with a “South African twist” for all citizens, including minors. Specifically, this chapter proposes to gradually improve South Africa's current social security system under DSD by linking it to tax collection over time. How? By gradually moving the administration of the BIG to the South African Revenue Service (SARS), in collaboration with the South African Social Security Agency (SASSA) under DSD. While recognising the need for further research, this chapter suggests exploring the possibility of giving all South African citizens, including minors through their guardians, the option to opt into a BIG, paid by SARS. The “South African twist” means using the existing personal income-tax rebate system, the pay-as-you-earn (PAYE) to enable a BIG that is better and more effective than the current one.

<sup>5</sup>The financing options include limited debt financing, tax revenue improvements arising from any demand stimulus and carefully calibrated tax increases, where required.

Under this proposal, SARS would be tasked to administer and pay out a BIG to citizens who opt in, while continuing to collect tax and ensuring compliance with the tax law. This would give every citizen a financial cushion, not just during current crises but in the years ahead, until they can fully stand on their own feet. This BIG intervention would be structured as a pull strategy (as opposed to a push strategy). As all South African citizens would qualify for a BIG, including minors, they would opt into a BIG by registering as a taxpayer with SARS<sup>6</sup> and, where applicable, opting out of any current grants from SASSA. This nuanced “either or” approach is intended to make it more efficient and effective for the economy than the current system. When the BIG is linked to SARS and the PAYE system, a citizen must be registered as a taxpayer to obtain a monthly BIG. When a person starts earning an income, he or she pays tax and claims a rebate from their taxable income – this rebate is netted off from the base BIG.

The BIG with a twist has only one condition: tax compliance. As a matter of principle, a person cannot claim a rebate and a full BIG at the same time – no “double dipping”. All citizens’ BIG would deduct any tax credit or rebate claimed against other taxable income. This could create an incentive to take up employment – as you could earn an income, get a rebate, and receive a part of the BIG. In other words, aside from providing a safety net for those who simply don’t find jobs, this BIG system could simultaneously reward those who can find a job. Also, people who receive BIG could shift their time from current survivalist activities to futureproofing themselves or their business. As such, it could possibly contribute to making the transition from a discouraged job seeker to a worker or entrepreneur, far smoother. BIG with a twist could allow citizens to gradually, and automatically, shift from being beneficiaries of, to net-contributors to the welfare system. This gradual move from BIG-recipients to economically-active citizens would happen without the need for means testing; a BIG paid and administered by SARS would not require a system that monitors people – the system would monitor itself. It would try to systematically help citizens to move up the income ladder over time, by creating new and more progressive incentives compared to the current grant system.

Incentivising employment is, however, not the same as creating employment. Questions around where economic and employment growth comes from, and how people can transition into gainful and decent employment, are difficult and complex. BIG with a twist is not a silver bullet to all South Africa’s problems – to leverage off its transformative potential, it would need to go hand-in-hand with pro-employment economic and sectoral policymaking, that promotes a just transition, structural transformation, higher-value adding, and increasingly a greater number of better jobs, as well as accelerated, tailor-made support to SMEs, the engine of economic growth, and skills policies (ILO, 2021 and 2019c).

## 5. Zooming in on “the twist”: how to make the BIG more effective than the current system

No country in the world has been able to roll-out a successful BIG<sup>7</sup> (BIEN, 2022); so what could make South Africa – with its deep, structural “triple challenges”, high and increasing debt levels, and budget deficits – succeed with a BIG system?

Perhaps the biggest and most obvious concern of BIG is its fiscal implications. More research is required to set the starting BIG amount monthly at a level that the economy can sustain while ensuring that it is fair, and achieves the various societal, social, welfare, and economic outcomes required for its long-term impact. The principles of the ILO Social Protection Floors Recommendation, 2012 (No. 202) (ILO, 2012) provide useful guidance in assessing the potential of a BIG in contributing to a social protection base. The IEJ BIG paper referred to above considers several levels: the food poverty line (R585), the lower-bound poverty line (R840), and the upper-bound poverty line (R1,268). This chapter is open to considering all of those. This proposal suggests setting a BIG amount that strikes a reasonable and responsible balance between assisting groups in society in vulnerable situations – not just through the current crises but past them – while aiming at a more effective and sustainable system than the current social security system. The intention is to increase the BIG amount over time, as the country grows wealthier.

<sup>6</sup>This registration could be linked with the existing ID-card system.

<sup>7</sup>However, some countries – including Brazil, Canada, Finland, India, Namibia, and the United States, have piloted it (BIEN, 2022).



The BIG would need to be funded from the fiscus, but exactly from where requires careful analysis. The IEJ BIG paper and the report of the Expert Panel on BIG discuss a series of progressive taxation measures such as a social security tax and a wealth tax, and limited debt financing, for example. However, and as highlighted above, a bold move is required to redress the shrinking tax base and low tax compliance as well as inefficiencies of the current social security system in a way that takes the complex socio-economic situation into account more holistically.

This proposal tries to do so – or at least to spark a conversation around how this could be done. While running a potential deficit over the short term, the country would need to achieve a balanced ecosystem with balanced budgets in the next 5–10 years, in part driven by a growing tax base. In this regard, the BIG with a twist (that sits squarely within the mandate of SARS) is a proposal to encourage tax compliance, fairness, and equity over time, as it supports Mzansi citizens. One important dimension of the effectiveness is that, in practice, the BIG would gradually replace grants below the BIG amount as people, over time, would opt out of grants lower than the BIG and opt in to the BIG. Whilst all citizens qualify, BIG would be paid for everyone who chooses to opt into BIG, who earn below a certain yearly income<sup>8</sup> except persons who are better off not opting into BIG because their current grants are higher.<sup>9</sup> Just like a person cannot claim a rebate and a full BIG at the same time, guardians who register themselves and minors under their care with SARS could choose to obtain BIG for them, instead of a child-support grant until the minors turn 18 and they receive the BIG. Another crucial aspect is that high-income earners would not receive BIG, simply because their income less tax rebate is higher than the BIG (and, frankly, they don't need it). Moreover, as noted above, this BIG system linked to PAYE would not require means testing as the system would monitor itself.

The grants that are higher than the BIG amount, that the government currently administers, would remain largely in their current form and be administered by SASSA. People who qualify for old-age, disability, foster-care, or care-dependency grants would continue to receive these grants. However, the principle of tax compliance and registration with SARS would apply here too. SASSA's role would be to continue to distribute these vital grants, a role which would now also entail checking with SARS any rebate claimed by grant recipients and netting it off their grant. This principle would apply for consistency and contribute to the system's transparency, efficiency and effectiveness.<sup>10</sup>

It is important to note the intention that the total cost of the BIG (or rather, investment in the BIG) would gradually decline, thanks to tax collected from citizens and businesses registering with SARS to receive the BIG, and as a spin-off of the boosted demand from people's greater purchasing power. To create sustainable growth and jobs, and increase the demand for labour, however, this demand should be effective domestically (i.e., no leakage to imported products) and channelled mainly to green products and services. It could equally create huge inflationary pressures, which would then suck out a lot of those growth benefits. So, it is fair to say that this is a complex issue. Ultimately, investment in BIG with a twist, hand-in-hand with the right investment in productive capacities, as well as economic policies to manage these risks, could spur economic growth and decent jobs.

## 6. Conclusions

How will South Africa find solutions to its complex challenges? How can it craft and implement systemic and innovative policy interventions that alleviate extreme poverty and inequality and boost economic growth and decent job creation, without it being at the expense of the planet? How can it best invest in society and its people, and grow its economy in a human-centred, nature-based and sustainable way? This chapter does not offer all the answers, but it's inviting to a wide conversation to seek them. Answers on how South Africa can build a society that is just and resilient to shocks – be they induced by the climate crisis, health emergencies, or global financial shockwaves – with a prosperous economy and labour market equipped for the future of work.

<sup>8</sup>For example, if the BIG is R585 per month (the food poverty line) less rebate, the BIG would in practical terms be paid to everyone who earns <R39,000 per year.

<sup>9</sup>The currently 3.6 million people getting old-age grants, 1 million receiving disability grants, and roughly 500,000 people receiving either foster-care or care-dependency grants would likely choose to continue to do so (Grant amounts from SASSA's *You and Your Grants 2020/21*).

Recipients based on 2019/20 revised estimates from National Treasury's *Budget Review 2020*.

<sup>10</sup>For example, elderly people may be less likely to be employed, but those who are employed would be found in the system without needs testing, thanks to SARS' new role.

This chapter argues that social protection is not a cost; it is an investment. But like any investment, it requires careful analysis. Social protection is at the heart of any just transition effort as it facilitates a shift towards a carbon-free society by increasing resilience and providing vital guarantees against social risks affecting income and health in the context of climate and environmental change (ILO, 2019d and 2015), and other crises. As noted in the introduction, aside from being a transformative instrument to realise the universal right to social security, BIGs could also be a tool to manage change, as it would offer a buffer to cover people's basic needs, thus helping them to navigate and harness the rapid change. A BIG could facilitate shifts from carbon-emitting industries and occupations to green ones, and support people as they reskill or upskill themselves to make that move. The BIG should thus be seen in the spirit of South Africa's just transition commitments.

In essence, the BIG with a South African twist is an idea of a bold policy intervention that aims to offer dignity to people through a minimum basic income with which everyone can meet their needs, whilst creating a pull effect towards formalisation of the informal economy and increasing the tax base over time. It does so by suggesting paying out BIG to all South African citizens (whose rebate does not exceed the BIG) through a much sleeker administration of the benefit system than the current one.

It would gradually improve the current grant system over time, in such a way that the BIG system would be administered by SARS, linked with the PAYE system, tax collection, and the existing ID card system. Note that DSD would still play an essential role in managing and overseeing social security in collaboration with SARS.

What makes the BIG and social contract proposed in this chapter innovative is that it attempts to account for more equity, effectiveness, efficiency, and sustainability than the current system. Equitable because it would uphold human dignity and rights as well as responsibility, enabling wealth distribution while encouraging tax compliance. Effective because it would give all citizens a minimum yet invaluable basic income to meet their needs.

Efficient because it could, contrary to the current system, enable a system that does not require costly and cumbersome means testing or a monitoring system, which would create large efficiency gains and savings. Sustainability because recipients of BIG opt into the payments, and SARS nets off the rebate claimed against other taxable income received, if any, which could create incentive to take up employment. A paid job combined with BIG less rebate provides more than BIG alone.

The BIG with a twist could help to fuel South Africa's just transition. As the formal economy grows, we build in justice and fairness into the fabric of society – intertwined through a human-centred social contract between citizens, community, labour, business, and the state. This social contract would place the dignity and the rights of every human being at its heart, while teaching that every right comes with a responsibility. This would be a society where citizens are empowered and form part of a shared-value economy that does not draw a line between the haves and the have-nots; one where everybody contributes and benefits justly.

To co-create this shift, the BIG with a twist would, of course, need to go hand-in-hand with pro-employment economic and sectoral policy making, that promotes a just transition with structural transformation, higher value-adding and, increasingly, a greater number of better and greener jobs, as well as accelerated, tailor-made support to SMEs. It would also require skilling, reskilling, and upskilling policies and programmes to equip people to tap into opportunities in the future of work – including in the green economy, the digital economy, the care economy, and the social and solidarity economy. Non-negotiables for a just transition include a strengthened social dialogue and collaboration between key actors, including government, business, labour, citizens, community, civil society, academia, and learning institutions.

Many unanswered questions remain.<sup>11</sup> However, hopefully this chapter has shared some bold and concrete ideas that will hopefully spark a conversation to further unpack, tweak, and fine-tune the design of the BIG, and create the evidence on how best to do that. It is after this dialogue and further research that the hard work begins.

<sup>11</sup>For more information about how social protection is one of the key policy areas to promote a just transition and address environmental, economic and social sustainability simultaneously, see the ILO Guidelines for a just transition towards environmentally sustainable economies and societies for all (ILO, 2015). These Guidelines are both a policy framework and a practical tool to help countries at all levels of development manage the transition to a carbon- and resource-efficient economy. They were formulated by the tripartite constituents of the 187 ILO member States with expert input and advice.



Never let a good crisis go to waste. South Africa is uniquely placed to turn the ongoing humanitarian, ecological, and socio-economic crisis – added to a context with deep-rooted structural injustices – into solutions for sustainable development and a just transition to an innovative and inclusive future of work in a green economy.

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## 10. SUPPORTING SMALL BUSINESS DEVELOPMENT AND ENTREPRENEURSHIP IN SOUTH AFRICA: A DISTRICT-LEVEL APPROACH

*Ricardo Gottschalk and Nokuthula Nyamweda*

### 1. Introduction

The previous chapter emphasised the need to support SMMEs and generate jobs. In comparison with other sub-Saharan African countries, South Africa has one of the lowest rates of established small businesses and entrepreneurship capacity. The rate of failure among SMMEs is high, as most small businesses do not survive beyond five years (GEM, 2022). SMMEs struggle as they operate in highly competitive business environments and have limited access to markets.

The question, then, for the UN System in South Africa, is what it can do in this area so that small businesses prosper and become important sources of job creation. It is important, after all, that the different players in both the private and the public sector create an environment that is less restrictive and more enabling to ensure that SMMEs can compete and succeed. Efforts to support small businesses need to have a coherent approach to ensure interventions designed to assist 'leave no one behind'. In response to these needs, the United Nations has embarked on a new programme cycle to support small business development and entrepreneurship. It is doing so at sub-national levels. The principles guiding the United Nations are that its interventions at such levels should be 'human centred, aimed primarily to empower local communities so that their people gain agency for the achievement of their own security, development and broader life fulfilment'. In line with these principles, the UN has decided as a key strategy to build on the organisation's international experiences with Business Support Centres.

### 2. Varieties of Business Support Centres

Business Support Centres (or business centres) are structures established to provide business development services for micro and small enterprises. The motivation behind the provision of business services is to help small businesses and aspiring entrepreneurs to overcome obstacles such as a lack of management skills and limited or a lack of access to finance and markets. The aim is to boost their productivity, competitiveness, and job-creation capacity.

Business Support Centres can be entities set up and managed by the government, private agents, donors, or development agencies. In setting up these centres, a consultative process usually takes place to garner the ideas and opinions of the local economic actors with a view to identifying the local specificities and demands. A key characteristic of these centres is that they operate as a one-stop shop in providing a range of different services to cater to the needs of different business profiles. Many of these centres involve public-private partnerships and provide services free of charge or partially free, while other centres charge registration fees and/or fees for the services provided to guarantee their financial sustainability.

Regarding governance structures, typically, business centres may be set up as an NGO, a non-profit organisation or a not-for-profit company, with a board of directors and a management board comprising representatives of the local community such as local authorities, business associations, and successful individual entrepreneurs (Sievers et al., 2003).

Business centres as just described overlap greatly with the concept of business incubators. The latter can be defined as providers of physical spaces (although they can also be virtual or hybrid) in which they offer incubator services such as mentorship, training, access to networks, and specialist equipment. Incubation itself can be defined as 'a collection of techniques that can be used to prove an idea, develop a team and de-risk ventures for later-stage investors' (Miller & Stacey, 2014, based on Bone et al., 2017). The aim is to 'nurture and grow new and small business by supporting them through the early stages of development' (UKBI, 2013, based on Bone et al., 2017). Created long ago, business incubators are, in their large majority, publicly owned and have become part and parcel of the business ecosystem (Hausberg & Korreck, 2018). A more recent concept that is often commingled with that of incubators are business accelerators.

The latter are entities which provide services ‘through a highly selective, cohort-based programme of limited duration (3–12 months)’ (Bone et al., 2017). They are also more growth-driven, more mentoring and training intensive, and often provide seed funding. Unlike business centres and incubators, which typically raise revenue through registration and other fees, their business model is based on equity in the start-ups they support (Cohen, 2013).

The United Nations has supported the development of business centres in different parts of the developing world over many years. Successful examples of such centres have been established in African countries, including Kenya. The main objectives of these centres are to foster entrepreneurship and enhance capacity for business start-ups. To these ends, these business centres typically provide technical support and IT facilities; a wide range of services, including vocational, technical and entrepreneurial skills training; guidance on access to markets; mentorship and advocacy for ease of access to credit services; support in developing and using innovations and new technologies, and an enabling environment to nurture and promote local capacities. With all this support, the centres operate something like a business incubator with the power to help local informal businesses to grow, create backward and forward linkages, join the formal sector, and become dynamic sources of income and job creation (UNDP, 2014; Mburugu & Oburu, 2016).

In South Africa, many districts and municipalities have already long-established business centres. These centres take different shapes and forms, and their establishment is the result of partnerships involving different actors. In addition, similar centres bringing new ideas and resources are being currently established. The Development Bank of Southern Africa (DBSA), for instance, has started in partnership with the Council for Scientific and Industrial Research to implement what they call Development Labs or just D-Labs. D-Labs are ‘development precincts designed to create economic development spaces within communities where all local participants are connected and have access to digital presence, technologies and information’ (DBSA, 2020). These facilities are expected to provide both science (mathematics, engineering, technology) and arts subjects and support. Like business centres, they also provide training and target the underserved, aiming to boost entrepreneurship and job creation. They are also meant to support infrastructure development linked to high-growth sectors, so that a community-based economic ecosystem is built. In addition, D-Labs aim to unlock access to finance and funding. The idea is that these facilities become safe spaces ‘to unlock and realise socio-economic development’ (Currie & Jooste, 2021; DBSA, undated).

These different forms of Business Support Centres are propositions that greatly overlap with each other, with many areas of commonality. Many of them place great emphasis on women and youths. The potential for future collaboration and partnership in this area is, therefore, very promising, given the complementarities and synergies that these institutions, together with government, may be able to explore together.

### 3. Supporting small business development: the UN approach in South Africa

The business support that the UN in South Africa has started to provide has been to selected districts. These are OR Tambo, a district located in the province of Eastern Cape; Waterberg, a district in the province of Limpopo; and e-Thekwini, a metropolitan area in the province of KwaZulu-Natal. These districts have been chosen as pilot districts by the national government, under the district development model (DDM). The DDM is an initiative launched by President Cyril Ramaphosa in 2019 to support local economic development and service delivery. In addition, the DDM aims to support job creation, local businesses and, more broadly, socio-economic development.

The pilot districts have business ecosystems in place, which already include different kinds of business centre (see above). Given this reality, the UN approach has been not to establish new centres. What it is doing instead is to provide training and services to small businesses and entrepreneurs, drawing on a range of existing providers from the eco-business systems that already exist. Their provision is being targeted at micro- and small-sized enterprises, with a focus on women- and youth-led SMMEs.



The UN engagement in the districts has started with a consultative process to gauge the needs, ideas, and opinions of the local socio-economic actors with a view to identifying local specificities and demands. In addition, the work has included a mapping exercise, aimed at identifying the institutions, agencies and others operating in the space of business development. The ultimate purpose is to avoid duplication and contribute to the formation of strong partnerships. Above all, the mapping exercise and the consultative process are expected to create the opportunity for mutual knowledge-building, enhanced coordination and coherence within an ecosystem, and greater efficacy and results delivery.

Specifically, key steps in this approach have included:

- A broad consultative process that encompasses a wide range of stakeholders, and that therefore includes representatives of the local community such as local authorities, business associations, civil society organisations, traditional leaders, and successful individual entrepreneurs.
- A mapping exercise of the existing institutional architecture that supports business development and entrepreneurship, to have a clearer idea of who the providers of business services are and to identify the existing gaps and obstacles that can be overcome to strengthen support to different kinds of business in the districts.
- Identification of the resources needed to match the district needs and gaps; and a UN focus on the institutional support and services that is in line with its strengths and comparative advantages.

To guide the UN work, some of the key questions being asked currently include:

- What are the critical needs, gaps, and bottlenecks which, if adequately addressed, can give a major boost to small business development in the districts?
- Where are specific interventions required to support women-led entrepreneurship? What main challenges or barriers do they face, and what can be done to overcome these?
- What specific skills are needed to enhance youth entrepreneurship and employability?
- How strong is the existing business ecosystem in a particular district, what are its main deficiencies, and what can be done to enhance its effectiveness?
- What good and successful practices in business support or services are there in the district and how can these be scaled up?

#### **4. The UN business support at the district level: what challenges have been identified to date?**

The issues and challenges, especially those raised by the various stakeholders involved in the consultative process to date, are wide-ranging. These include a lack of adequate infrastructure (e.g., such as water supply and management, energy, roads infrastructure, land) for small businesses to operate and expand in; greater support needed for SMMEs and cooperatives; support for research that investigates local issues and needs. In relation to the latter, stakeholders noted that there is a need to map the existing resources available in the district and understand the context. In addition, they note the need to map what services to small business the district already offers and what institutions are delivering such services.

The above are issues and challenges that are raised recurrently. In connection with these, there seems to be an understanding – or an expectation – by stakeholders that the United Nations can play the part of a sort of development agency or thinktank equipped with research capacity to generate knowledge and research. However, what might be closer to the UN's reality is its capacity to implement programmes and activities that are pre-agreed in workplans designed jointly with the district authorities following wider consultation. In addition, the UN can leverage its convening power to enhance coordination among different actors and tap into its wide pool of UN knowledge from around the world to explore successful ideas and solutions adopted elsewhere, while always accounting for the local context and circumstances. For the United Nations, the challenge is, therefore, to manage expectations and communicate the types of intervention that it can offer, while giving clarity regarding the specification of time frame, resources already available, gaps, and institutions involved.

Ongoing or ready-to-implement projects the United Nations is undertaking in the pilot districts include digital skills development for youths; the circular economy (with a focus on food-waste recovery and plastic recycling); industrial energy efficiency; cleantech innovation, and the economic empowerment of women in the green industry.

Besides the issues raised through the consultative process, the United Nations has, through its direct engagement in the districts, identified various additional issues. These include:

- The need for greater participation of different stakeholders in projects the UN agencies are jointly implementing in the districts.
- The quest for additional funding to help scale up the programmes that already exist.
- The need for both physical and virtual or hybrid interventions to respond to the need to increase geographical reach. This is particularly important for districts that are predominantly rural, and their people are scattered around the districts.
- Need for more communication and exchanges between actors operating in similar areas or developing similar projects, for mutual learning and enhanced synergies.
- A possible need to bring the business services and training the United Nations offers under the same roof. The advantages are that it can help ensure wider accessibility, quality, and regularity in service delivery. Integrating such services into the Thusong Centres (as well as Thuthuzela Care Centres) that exist in the districts might be a way forward.

## 5. Conclusions

Initiatives to support small business development can be found in South Africa in large numbers. The players in this field are many and include government departments, specialised public and private institutions, international organisations and agencies, business associations, financial institutions, NGOs (national, international), and academia. The question is whether the work all these players are doing has sufficient traction and leverage to bring about a real change in the country's profile, from one that is deeply marked by high levels of unemployment, poverty, and inequality to one that is on a path of fast, inclusive, and sustainable growth. A closely related question is whether the many micro-level interventions currently undertaken or planned can bring about real change.

What can be said is that, to date, the various interventions on the ground have benefited those individuals and small business units that were directly targeted by them. There is not, however, a real sense of how many of those individuals and businesses that have benefited there are, whether those gains were sustainable, and what the broader impacts of the successful stories have been. Did they cause palpable changes in the communities in which they operate? What have been their multiplier effects, in terms of income generation and job creation, and what other sorts of positive spill-overs have they generated across their communities and the country at large?

These are some of the questions we ask, to which there are no definitive answers. However, what can be said with a good level of confidence is that micro changes and gains arising from the laborious efforts of many players working in support of small businesses have not produced real change in terms of visible socio-economic transformation (though, of course, there is always a lag between interventions and their results). Work in this field has, of course, identified a number of deficiencies and gaps: a lack of greater coordination between different players with similar missions and interventions, a lack of financial support, and the basic infrastructure needed, as highlighted above by stakeholders operating in the field.

The questions, then, are these: If interventions at the micro level are not enough, what can be done at the national or macro level to support small business development? Is the country's economic structure, characterised by the dominance of large businesses in the main key sectors of the economy, amenable to the development of small business? What can national institutions – government entities, the regulatory and judicial bodies, the capital markets, the financial system – do in this regard? How can they target those most underserved? In the spectrum of institutions, South Africa is known for having deep and sophisticated financial markets. A note to this chapter raises the issue of the role that institutions could play and asks, in particular, why South African banks are not doing more to support small business or those groups that are in need of special support, namely women and youths.



## Role of Institutions in Support of SMMEs – A Note<sup>1</sup>

The role of institutions such as government, finance, NGOs, and private sector, has become increasingly relevant in the area of small business development. Both informal and formal institutions are able to restrain as well as enable the activities of small businesses and foster economic development. Quality of legislation, markets and other institutions can be pivotal for business performance, and consequently, for the economy as a whole. Additionally, an enabling environment for SMMEs – for which business registration, licensing requirements, infrastructure, utilities, taxation, and competitiveness and labour conditions are essential components – must be significantly improved. Among institutions, the role of the financial sector is critical for this endeavour.

### The Role of the Financial Sector

Lack of access to finance for SMMEs remains a critical challenge, inhibiting their growth and sustainability. Contributing factors to low access to finance include the lack of suitable formal financial products available to small enterprises; lack of readily available credit information; perceived risk of small enterprise finance; and the apparent lack of appropriate assets available to small enterprises for the purposes of collateral. All these issues reduce the availability of financial support and increase the cost of credit for small enterprises. Inadequate finance is a critical barrier to SMME growth in South Africa (OECD, 2020). Credit is the prime input for sustained growth of small businesses and its availability is thus a matter of great importance.

The objective of financial support should be to provide short-term credit/working capital to small enterprises for day-to-day requirements such as raw material and other inputs like electricity, water, etc; for payment of wages and salaries; and for long-term credit for creation of fixed assets like land, building, plant and machinery. The South African Government acknowledges that lack of access to finance is one of the major constraints for entrepreneurship and small business development. As a result, the government is committed to addressing the structural constraints facing small businesses in terms of access to formal credit markets (SEFA, 2021).

In the context of such market conditions, Government funding for small business is provided, typically in the form of grants and financing by development finance institutions (DFIs). Some of these DFIs include the Industrial Development Corporation (IDC), the Small Enterprise Finance Agency (SEFA), and the National Urban Reconstruction and Housing Agency (NURCHA). The resources provided by these institutions, however, lack scale and reach. Therefore, mainstream banking finance should become more accessible for SMMEs in South Africa. After all, finance should be provided at scale – and only mainstream banking can do it –for real change to happen at the macro level.

### Can South African banks do better in supporting small business in South Africa?

The banking sector in South Africa stands in very good shape to support the private sector. Its total assets were equivalent to 105.4% of GDP and gross loans and advances, were about 74.6% of GDP in 2021 (SARB, 2022).<sup>2</sup> In April 2022, profitability was positive, measured both in terms of returns on assets and equity (1.10 and 13.9%, respectively<sup>3</sup>). Also in April 2022, the total capital adequacy ratio was at 18% and the leverage ratio at 6.8%, both indicators well above Basel III minimum capital requirements (SARB Prudential Authority, 2022). The sector therefore is large, profitable, well capitalised and meets comfortably the Basel capital standards. Economic recovery further helps ensure the sector remains in good shape, although the ongoing international crisis and central bank responses could alter the sector's balance sheets very rapidly.

<sup>1</sup>Prepared by Nokuthula Nyamweda and Ricardo Gottschalk.

<sup>2</sup>Assets and Loans figures, from SARB (2022), were scaled by Stats SA GDP at market prices.

<sup>3</sup>These figures are of end-April 2022 (SARB Prudential Authority, 2022).

Against this overall positive picture, the banking sector has been wanting in its ability to reach the underserved. It could do more to broaden access to finance, in order to ensure that recovery from the COVID-19 pandemic is more balanced and fairer. According to a study commissioned by the Banking Association South Africa, access to finance is indeed a major challenge, especially for start-ups, smaller businesses and smaller loan sizes. A key issue is the existence of a mismatch between funding demand and supply. Whilst 44% of SMMEs seek funding up to R250,000, financiers tend to offer funding of between R250,000 and R5 million. This results in limited access to finance by small businesses and a large funding gap. The reasons behind that are multi-fold, relating to the banks themselves, the SMMEs and the external environment. Among the financial institutions, a key obstacle to funding SMMEs is their high-risk aversion towards them (BASA, 2018).

The question, then, is how the obstacles to access to finance can be overcome. The BASA-commissioned study suggests a set of actions that might be undertaken to mitigate current obstacles and bridge the funding gap. These include investing in the development of the business and financial aptitudes of entrepreneurs, helping them to develop positive credit profiles and revamping the guarantee scheme of the SEFA.

In addition, the banking sector in South Africa could do more to increase access to finance more broadly. It has the means to go further and target specific groups for access to finance. Specifically, it could create loan windows for the youth and women. These two groups are amongst the most disadvantaged in South African society. Youths between 15 and 34 years, experience considerably higher rates of unemployment compared with the labour force aged 15–64 years. Among women, unemployment is also higher. Women, moreover, earn less and have less access to resources than men (see Chapter 5 in this volume). By providing credit lines to youth and women, the banking sector would be able to offer them better financing and services conditions. These groups would then be less likely to resort to the informal sector thus reducing the risk of facing worse financing conditions and falling into a debt trap. Equally important, helping these groups would mean directly supporting the goals of a more cohesive and inclusive society outlined here and in other chapters of this volume. It would help unleash these groups' talents into productive use. These credit lines would, moreover, inject greater dynamism into the economy by supporting projects and initiatives such as start-ups by youths and women entrepreneurs, whose presence can be attested in a wide range of sectors, from agriculture to manufacturing and services.



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## 11. SOUTH AFRICA'S INDUSTRIAL POLICIES POST-1994: A FOCUS ON THE IDZ/SEZ FRAMEWORK – WHAT IS STOPPING THEM FROM BEING EFFECTIVE INSTRUMENTS FOR INDUSTRIAL DEVELOPMENT?

*Msingathi Siphuka and Simthembile Mapu*

### 1. Introduction

This chapter reviews the post-1994 industrial policy framework in South Africa, focusing on the challenges and shortcomings of the framework to date. It grapples with the sense that, in both of its main two phases, the framework fell short of delivering on its promised goals. These goals include industrial restructuring towards technological upgrading, value addition and diversification, and faster growth and employment generation. Over time, the industrial policy framework incorporated Industrial Development Zones (IDZ) and Special Economic Zones (SEZs) as part of its toolkit in order to respond, respectively, to issues of spatial industrial inequalities and international competitiveness. As with the broader policy framework, yet again, these zones failed to achieve their aimed goals fully. In that light, the chapter tries to identify what might be missing in their policy design and implementation so that these zones can become true drivers of industrial development.

The chapter asks, in particular, whether IDZs can be effective instruments to redress the spatial industrial inequalities in South Africa, and what factors might be working as deterrents to the achievement of this policy goal. Drawing on practitioners' views, the chapter suggests that an important missing component in the current approach to IDZs is the need for greater efforts towards integrating them with the industrial ecosystem that already exists in the spaces and regions where the zones are located. Only then, the chapter posits, will it be possible for them to be poles of dynamism and revitalisation for the broader industrial ecosystem in which they operate.

Following this brief introduction, section 2 discusses the industrial policy framework adopted since 1994, detailing the key characteristics of each of its two main phases. Section 3 discusses the IDZs, highlighting their expected role in responding to the spatial and regional industrial inequalities in South Africa. Section 4 then discusses the move from the IDZs towards the SEZs. The final section discusses the specific challenges facing the IDZs and SEZs and ends by highlighting possible tensions between what South Africa aims to achieve with each of these two policy instruments.

### 2. Post-1994 industrial policy framework

The newly democratic government that took power in 1994 faced the immediate task of re-dynamising the economy, which, since the 1980s, had been hindered by slow growth and de-industrialisation. In the area of industrial policy, the policy positions adopted to accelerate growth in the manufacturing sector were premised on the process of trade liberalisation, which had started back in the 1980s.

According to Zalk (2014:2), the post-1994 industrial policy can be divided into two periods: 1994–2007 and post-2007. Zalk argues that industrial policy in the 1994–2007 period was mainly informed by the broader economic policy choices made by the government with the adoption of the Growth, Employment and Reconstruction (GEAR) macroeconomic policy framework. Zalk describes GEAR as a framework characterised by free market economic reforms, which in broad terms was in line with the tenets of the Washington Consensus. According to these tenets, market liberalisation would translate into more efficient capital allocation and higher levels of private investment, leading to higher growth and employment.

An important policy instrument of the industrial policy regime post-1994, which was thus in line with GEAR and the Washington Consensus, was trade liberalisation. The rationale behind this policy choice was that the opening of national markets through a significant reduction of tariffs would help South Africa to identify its own comparative advantages and begin to redirect investments towards those industries or sectors within its economic structure that had such advantages. As early as the late 1980s, the South African government had started to move in this direction, but efforts at trade liberalisation took root and moved at an advanced pace when the WTO was created (replacing GATT) in early 1995. Following the Uruguay round of negotiations, which came into effect in 1995, South Africa reduced its tariffs at a drastic pace, far outstripping the commitments it had made at the WTO.



Although the drastic tariff reductions did not apply to two key industries – the automotive and the clothing and textiles sectors, it nevertheless had a debilitating effect on South African manufacturing. This development was a key reason behind the quest to aim for a robust manufacturing sector and to protect jobs in the country (Zalk, 2014:5).

Takala (2008:19) notes, however, that the pro-market policies, which included the removal of demand-side support and tariff reductions, were only part of the broader scope of policies undertaken in the post-1994 period. To a large extent, choices tended to reflect more of a selective policy regime that combined, at once, neoliberal initiatives and strong state support – for example, to sectors such as minerals and energy, automotive, and clothing and textiles.

### **National Industrial Policy Framework (NIPF)**

According to Fotoyi et al. (2016:19), between 1994 and 2007, South Africa's programme to promote industrial development was not guided by an overarching industrial policy. Many of the initiatives that were undertaken responded to the orientation of the macroeconomic policy in place. It was only in 2007 that the country adopted what could be considered as an overarching point of reference for industrial policy in the form of the National Industrial Policy Framework (NIPF). Developed with the goal of unlocking the potential of the manufacturing sector, the NIPF provided the basis of the Industrial Policy Action Plans that continue to define industrial policy priorities in South Africa to date.

The NIPF offered a different approach to industrial policy as compared to the period 1994–2007 (Zalk, 2014:335). The NIPF acknowledged that sustainable economic development had to prioritise a deepening of the country's industrial base and that long-term growth could not be mainly based on a consumption-led model or on commodity exports. Therefore, industrial policy would have to prioritise diversification beyond the traditional sectors and require the promotion of value addition. The NIPF also envisaged that a move towards value addition would be labour-absorbing and in this way contribute to job creation and a reduction in the country's high rates of unemployment.

The vision of the NIPF (2007:7) is mainly aimed at attaining the following high-level objectives:

- The long-term intensification of South Africa's industrialisation process and change towards a knowledge economy.
- The promotion of a more labour-absorbing industrialisation path with a particular emphasis on tradable labour-absorbing goods and services and economic linkages that foster employment creation.
- The promotion of a broader-based industrialisation model characterised by greater levels of participation of historically disadvantaged people and marginalised regions in the mainstream of the industrial economy.
- The contribution to industrial development on the African continent with a strong emphasis on building the region's productive capabilities.

The NIPF identifies eleven strategic programmes that need to be adopted to promote deeper industrialisation:

- Development of sector strategies.
- Making available industrial financing for new industrial projects.
- Development of an appropriate trade policy that is in line with the goal of industrialisation.
- Promotion of skills development and education for industrialisation.
- Leveraging off the public expenditure in infrastructure development.
- Promotion of industrial upgrading.
- Increase in investment in innovation and technology.
- Support for small enterprise development.
- Leveraging empowerment for growth and employment.
- Regional and African industrial and trade framework.
- Coordination, organisation, and capacity for implementation of industrial policy.

In explaining the environment within which the NIPF (and IPAP – see below) were developed, former Minister of Trade and Industry Rob Davies, argued that attempts by the Department of Trade and Industry (DTI)<sup>1</sup> to develop industrial policy were criticised by orthodox economists who were largely sceptical of any attempt by the state to intervene in the market to ‘pick winners’. Their argument was that the state was incapable of doing it and that it would lead to unnecessary market distortions (Davies, 2021:93). This view was in contrast to that of international scholars such as Ha-Joon Chang, Joseph Stiglitz and Robert Wade, who have provided ample evidence-based analysis of successful examples of industrial policy among the late industrialisers such as the Republic of Korea.

### Industrial Policy Action Plans (IPAP)

The NIPF did not provide the details of how the framework would be adopted. To further articulate implementation, the government proceeded to formulate what it called the Industrial Policy Action Plan (IPAP), which set out the details of key actions and time frames. The 2007 IPAP was to be the first of numerous IPAPs that were to follow over the years. To date, there have been a total of six IPAPs that have been developed since 2007.

Reflecting on the IPAP processes, Davies (2021:95) notes a number of policy positions that were taken to create the conditions for the successful implementation of the NIPF. These positions ranged from industrial finance, implementation, monitoring, evaluation, and coordination to economic restructuring and the alignment of macroeconomic policy with industrial policy objectives. A summary of how the IPAP approached some of these positions is presented below.

**Coordination and implementation:** To avoid the IPAP falling into the common trap of never moving from approval to implementation, the DTI took responsibility for the overall coordination to ensure implementation. To that effect, the IPAPs would be a series of three-year implementation plans that would be reviewed annually. Different government departments were identified with allocated functions to ensure that the IPAP was a government-wide responsibility and not just a DTI document. There would be regular monitoring of implementation coordinated by the DTI, where executive authorities of implementing departments and agencies would meet regularly to assess progress.

The reviews developed through monitoring would inform the priorities of the next iteration of the IPAP.

**Industrial financing:** The IPAP framework acknowledged industrial financing as a critical enabler to the realisation of the objectives set out in the NIPF and the IPAPs. It was aware that the instruments available to South Africa in the form of industrial development finance institutions (DFIs) were not of similar scale of those from the newly industrialised countries. Therefore, the IPAP made a number of key recommendations to consider this issue. The first recommendation was that public resources would need to be made available to ensure implementation of the IPAP and that, in the first instance, this use of resources would need to be done through existing DFIs such as the Industrial Development Corporation (IDC). In the long run, the country would need to review its development finance architecture to support the goals of industrial policy.

**Need for structural transformation:** The IPAP, through an analysis of sector contribution to GDP over time, came to the conclusion that the existing structural make-up of the economy in which growth was driven by consumption was simply not sustainable, especially as the consumption was financed through debt. To rectify this macro-imbalance, the IPAP called for an increase in the total gross fixed capital formation which would enable industrial growth.

**Aligning macroeconomic policy with industrial objectives:** The IPAP made the observation that macroeconomic policy formulation was not aligned with industrial policy objectives and the overall restructuring of the economy. In this regard, it made the call that macroeconomic policy should be aligned with a growth path that supported the country’s productive sectors and ensured greater value addition. Monetary policy, in particular, should be closely aligned with the objectives set out in the industrial policy framework. A key issue in this regard is the over-valuation of the rand, which (i) makes South African products more expensive in global markets and (ii) makes global products cheaper in domestic markets.

<sup>1</sup>See, for instance, DTI (2007a and b).



The first has a negative impact on exports of manufactures, while the second contributes to the flooding of the South African market with imported products.

Trade policy alignment with industrial policy objectives: Another key theme in the first iteration of the IPAP was the need to adopt a 'developmental approach' to trade policy in which the need for industrial development would shape the country's stance on tariff and trade policy issues.

Localisation: The last key theme of the IPAP was localisation. Up to the point of concluding the IPAP, South Africa had not ratified the WTO's Optional Protocol on Transparency in Government Procurement. This fact meant that the South African government could use the opportunity to promote the procurement of locally produced goods through its public entities and in that way promote, in particular, non-mining-related manufacturing.

Notwithstanding the role that localisation might play, the DTI (2018) argued that its primary instrument to drive industrialisation had been the use of incentive packages to support existing and new entrant firms with investments in plant, machinery, equipment, export marketing activities, and so forth.

After 10 years of the industrial policy framework, a review by Kaplan (2019) of the performance and success of industrial policy implementation over this period noted that a key instrument of the industrial policy framework has been the use of investment subsidies targeted at three main sectors: Automotive and components, clothing and textiles, and mineral beneficiation.

Key highlights from Kaplan's (2019) review show the following trends:

- Despite all the interventions starting with the NIPF and the IPAPs, the reality that confronts South Africa is that, in 2019, manufacturing output had not improved against the 2008 levels. Over the same period, comparative emerging economies had increased their manufacturing output by 50%. These outcomes are very far from the targets set out in the various industrial policy documents that sought to increase the contribution of manufacturing to GDP relative to other sectors. In fact, the levels of contribution of manufacturing to GDP have decreased (rather than increased), from 16% to just 12%.
- In terms of total number of jobs to be created in the manufacturing sector, the various industrial policy documents (NIPF and IPAP) had set a target of an additional 350,000 jobs in the manufacturing sector between 2008 and 2020. This period has instead seen the opposite: a total of 320,000 jobs lost, as confirmed by the IPAP in 2018. This loss has certainly contributed to the exacerbation of unemployment in the country.
- The total number of jobs in the manufacturing sector has declined not only because the sector's contribution to GDP and its overall output are decreasing, but also because 'the employment intensity and the number of jobs per unit of output' is low and has been declining over time.
- The NIPF and the IPAPs have consistently identified the increase in manufacturing exports as one of their policy priorities. The results have been rather poor, with manufactured exports stagnant during the years 2009–2019. In addition, exports from non-mineral manufacturing have in fact declined over this period. This suggests that, contrary to the goals of the industrial policy framework, the country's industrial path has not been able to break the limitations of the Minerals and Energy Complex (MEC).

What we can conclude is that, despite the progressive move from an industrial approach that was close to the Washington Consensus paradigm to one that adopted heterodox thinking based on the experiences of newly industrialised countries, the results have not been as positive as initially expected. Despite some success stories that DTI in its own reports identifies in a few targeted industries, the overall statistics clearly indicate that the diversification of manufacturing output growth beyond MEC-aligned manufacturing is still proving difficult for South Africa. What might be argued is that, without the NIPF and the IPAPs, the picture would have been even worse, as there has also been some successful stories, for example in the automotive and clothing industries (see next chapter on policy space for industrial policy). Thus, the true failure may not lie so much in the design or implementation of the industrial policy framework. A stronger contender for this failure might be, instead, the absence of change in and thus a lack of alignment of the macroeconomic policy over the past 10–15 years.

### 3. Industrial Development Zones

The fundamental premise of apartheid policy was the spatial separation of the different racial groups in the country, with different areas receiving preference on the basis of which racial group occupied the space. According to Nel and Rogerson (2015:25), the post-apartheid democratic government was hesitant to approach economic development from a spatial and regional perspective. Regions were still largely racially profiled and spatial and regional interventions may have been interpreted as a continuation of race-based policies. Therefore, as Nel and Rogerson argue, much of the work carried out in the area of economic development post-1994 was 'spatially neutral'. That is, national policy was not necessarily targeting specific regions or spaces. What it aimed at was to create a macroeconomic framework that would help South Africa to attract investment without any spatial focus. However, slow growth and growing unemployment has led to a revival of interest in interventions that are premised on some form of spatial focus.

The spatially prioritised areas would be regional economies whose economic fortunes are considered to be catalytic in redressing the broader challenges of poverty and unemployment in the context of a cluster of spaces. It is mainly within this revived interest in spatial and regional development that the government introduced the Industrial Development Zones as part of its industrial policy framework.

According to Govender et al. (2018:14), the South African government approved the Industrial Development Zones policy and in so doing moved to establish and operationalise three IDZs in accordance with the Manufacturing Development Act of 1997. All three IDZs, in line with international best practice, were located in close proximity to major transport hubs, in particular ports. Their location was indicative of the policy intention of using these IDZs as hubs that would focus on export promotion. Govender et al. add that further policy objectives for the IDZ included:

- Establishing industrial clusters with the purpose of either creating or deepening existing agglomeration economies.
- Creating world-class infrastructure that would be a catalyst for strategic investments into identified regional economies, boosting output and employment.
- Using the location of global companies in these regions to promote technology diffusion into local economies and support regional competitiveness and innovation.

Over the past 20 years a number of government-led and independent evaluations have been conducted to assess the success of the IDZs relative to their stated policy objectives. One such report by the DTI (2013) noted that critical constraints that have prevented optimal performance of the IDZs include: fragile governance, lack of incentives, poor stakeholder coordination, lack of clarity of roles between the host municipality and the IDZ in terms of investment attraction activities and a lack of integrated planning.

These identified weaknesses and the non-attainment of the policy goals of the IDZs necessitated a review of the entire policy, the result of which was a shift towards what was referred to as Special Economic Zones (SEZs), which led to the adoption of Special Economic Zones Act in 2014 (Nel and Rogerson, 2015:25).

### 4. Transition from Industrial Development Zones to Special Economic Zones

In 2012 the DTI released a policy paper titled 'Policy on the development of Special Economic Zones in South Africa'. The policy document (DTI, 2012:5) makes a number of critical observations about the IDZ programme, which pointed to the need for a shift towards SEZ. The first and perhaps most significant is that the performance of the IDZ programme had been modest at best, particularly when considering the capital outlay put in place to establish these zones. The policy document proceeds to present various factors that contribute to the underwhelming performance of the IDZs. Some of these factors are similar to those pointed out earlier and include:



- The lack of IDZ specific incentives did not make the IDZs attractive to investors (which is a significant challenge).
- The ad hoc funding arrangements did not allow the IDZs to be flexible in their planning and make provision for long-term financial management.
- Lack of targeted investment promotion and the lack of a national marketing organisation with international structures hampered fulfilment of this role.
- An incoherent planning system of the IDZs precludes integrating them into the planning framework of national, provincial, and regional governments. (This issue is critical, particularly for regional governments such as the Nelson Mandela Metropole, because, even though the IDZs are hosted within their jurisdictions, there is no strong cooperation between them and the local authority.)
- The current IDZ model placed too much focus on the enterprises and activities inside the IDZ and did not pay any attention to the dynamic regional space within which it was operating – the so-called out-of-zone activities. To be a successful export region, the building of capacities is required at a regional level and not just in the zone.

These weaknesses in the IDZs represent real limitations to their ability to fully mature and play a decisive role in regional development, by building regional industrial capabilities, being innovation and knowledge hubs, ensuring industrial deepening and diversification, and promoting exports.

So, what do the new SEZs offer that is different from the IDZs which will make them more agile and successful? The DTI policy document cited above notes the first challenge of the IDZ model as the lack of incentives to attract investors into the Zones. If the new SEZ policy is to be a game changer and make meaningful progress, this key issue will need to be resolved. In this regard, there are numerous incentives that are available to SEZ investors, aimed at ensuring that South African SEZs are truly competitive relative to peer-SEZs around the world. These incentives include preferential 15% corporate tax, a building allowance, an employment tax incentive, tax relief for businesses operating within a customs control area, and tax incentives for Greenfield investment<sup>2</sup>

## 5. Issues to consider in repositioning IDZs and SEZs as drivers of industrial development

In its attempt to reposition the IDZs and SEZs as drivers of industrial development, South African policy-makers must consider and respond to a number of issues which could derail these efforts. The challenges and proposals presented below reflect the perspectives of practitioners working in different IDZs around the country, gathered through informal interviews.

A first commonly observed challenge is that policy-makers have not been able to ensure integration – or at least complementarity – between the IDZs and the existing industrial base from the old industrial districts of the region where the IDZs are located. Practitioners in the local government sphere have expressed the view that there is in fact competition between the investment promotion functions of the different cities where the zones are located and the zones themselves.

A key reason pointed out as to why this situation exists is to do with a bureaucratic process, which makes the zones inwardly focused. The process is guided by Annual Performance Plans (APPs) and, as a result, the focus is on chasing different targets, such as the number of investors attracted to the zone. This is often done without really giving any real consideration to the type of investors that are brought in, what role they play in the local economy, and how they can operate and do business with existing investors or other businesses in the ecosystem. The pressure on the IDZs to grow and develop without due consideration to efforts towards their integration with the rest of the economy comes from the DTIC and provincial governments: these government entities need to demonstrate that the policy interventions of IDZs (and SEZs) are making a difference.

<sup>2</sup>It should be noted that these incentives are subject to specific conditions.

But even if integration is not taking place, there is still the question why the IDZs or SEZs are not developing as expected or becoming strong platforms of industrial and manufacturing exports. An explanation of this question lies in the incentive structures of the various practitioners operating in the zones. In the case of SEZs, which are zones targeting the external markets, these incentives (see previous section) directly affect the competitiveness of the zones relative to their international peers. Investment promotion, and its success, is dependent on a number of issues, including but not limited to: costs, ease of doing business, country risk from a political stability perspective, and financial systems. There is a view that, among the factors that determine competitiveness, the cost of doing business is the most difficult to sell to investors seeking to operate in the South African zones. This relates to utility costs (e.g., water, electricity), setup costs, and development costs.

In theory, the incentive structure allows the zones to reduce these costs for investors, which should enable them to compete internationally. However, accessibility to the incentives is not that easy. For example, one of the most notable incentives to potential investors is the tax incentive, namely the section 12R incentive. This offers investors a 15% tax rate if they set up in the zones. This corporate tax incentive is accessed through an application to SARS. There are a few challenges attached to this incentive, though, the first being the fact that it took five years to become operational (the Act was amended in 2013 but the incentive came into operation only in 2018); secondly, when it became operational, there was already an amendment in 2015 which included a new provision that excluded entities in SEZs from qualifying if more than 20% of their deductible expenditure or more than 20% of their income resulted from transactions with related companies (the 20/20 challenge).

Samsung South Africa at the Dube Tradeport and SPS Molecor at the Richards Bay Industrial Development Zone are examples of investors who are not able to take advantage of this incentive due to the 20/20 challenge. A recently conducted assessment across the different SEZs shows that very few investors have indeed had access to it.

This has forced the sector to act collectively in calling on the DTIC and the National Treasury to review the criteria for accessing the incentive. The overall sense is that the incentive structure as currently designed does not allow South African SEZs to be competitive with their international peers. To add to the challenges confronting the SEZs, the section 12R tax incentive has been suspended since 2021.

The issues relating to the incentive structure in place indicate a lack of policy coherence at the national level, particularly between the National Treasury and the DTIC. As an interview respondent pointed out,

the National Treasury limits the growth of the SEZs with their conservative approach to the incentive structure; and the government department, which is meant to lead the SEZ programme, namely the DTIC, is constrained in its ability to influence the Treasury on the incentive structure SEZs can offer.

As part of repositioning the SEZs as an effective policy instrument to drive industrialisation, the South African government will need to seriously consider how it responds to some of these challenges. It should be noted, though, that a tension exists between the points raised by the practitioners – that is, between their quest for integration and that for an effective incentive structure for greater international competitiveness. The reason is that tax incentives directed solely at firms located in the zones do not provide a level playing field for the firms operating outside the zones, and this might be a reason for integration not being pursued more forcefully as a policy objective after all.

This tension takes us to the question of what a more suitable industrial policy instrument for South Africa might be. The IDZs, whose success does not depend primarily on tax incentives to operate and grow, and their cousins, the SEZs, are platforms to enable international competitiveness. They therefore need an effective tax-incentive structure in order to succeed. The advantage of the IDZs is that they can be instruments to foster and revitalise South Africa's industrial base through progressive integration. SEZs, meanwhile, are not designed for that purpose, at least not in the early stages of their development – when their main focus should be external markets, as both buyers and sellers of manufactured goods and services.



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## 12. POLICY SPACE FOR INDUSTRIAL STRATEGY: WHAT FOR SOUTH AFRICA?

Ricardo Gottschalk

### 1. Introduction

In South Africa, but also elsewhere in the developing world, a situation has emerged that recovery from the COVID-19 pandemic should be supported by pro-active industrial policy. The rationale behind this is that developing countries should strive to reduce their dependence on foreign technology and the supply of essential public and other goods, such as vaccines. A pro-active industrial policy should, therefore, target dynamic and technology-driven industries. A key player under consideration is the pharmaceutical industry due to the vital role it can play as part of a recovery strategy that is both sustainable and resilient to future pandemic shocks.

For many years now, developing countries have faced increasing constraints in the space they have for industrial policy. In an interdependent world, this space has been circumscribed by international rules and agreements, especially in the areas of trade, finance, intellectual property, and investment. The World Trade Organisation (WTO), which superseded the half-century-old General Agreement on Tariffs and Trade (GATT), is commonly cited as being responsible for a more limited policy space. The trade negotiations under the Uruguay Round, which preceded the creation of the WTO, contributed significantly to this reality, with new provisions on patents and copyright under the Trade Related Aspects of Intellectual Property Rights (TRIPS), the agreement on Trade-Related Investment Measures (TRIMs) and the General Agreement on Trade in Services (GATS). With these three new trade-related agreements, the WTO clearly expanded its coverage way beyond trade, which lends support to the claim that the organisation 'reached inside the border in subsidies, health and safety and intellectual property' (Rodrik, 2018).

This chapter takes a closer look at WTO trade-related agreements to assess how much policy space they have curtailed but also how much space has been left. It then considers the regional trade agreements. Its purpose is to show that the WTO and its agreements are not the only constraints on industrial policy and that regional and bilateral agreements often impose even tighter restrictions. It then discusses how South Africa has navigated the multilateral trading system both before and after apartheid, showing that while it first gave up space, it later started to fight to take some of it back. The chapter ends with a discussion on what policy space South Africa and other countries can use or carve out for their pharmaceutical industries. The chapter concludes with a note that, although limited, space does exist. However, countries need to invest in the development of their negotiation capacities to be able to secure these in their international negotiations.

### 2. A closer look into TRIPS, TRIMs, and GATS<sup>1</sup>

TRIPS is a set of obligations concerning intellectual property, such as patents, copyrights, and trademarks. Under TRIPS, imitative innovation such as reverse engineering – a process by which one tries to understand a manufactured product through detailed examination in order to create a similar product – is severely restricted. Notwithstanding this, there is some flexibility that permits countries to support domestic production. This flexibility comes from the TRIPS mechanism of compulsory licensing. Under compulsory licensing, authorities may license a company to make a patented product without the permission of a patent owner. This type of flexibility, however, has not been deployed in any meaningful way by countries or incorporated in their national laws and regulations. A possible explanation for the low use of this flexibility is that countries may have entered regional or bilateral trade agreements with stricter rules compared to those in TRIPS.

TRIMs is an agreement that protects foreign investors from national policy conditions adopted to influence their operations and performance in the host country. These conditions (or measures) can take the form of meeting a minimum percentage of local content or, in the trade balance arena, specific export targets. The consequence is that TRIMs constrain the ability of national policy-makers to encourage the creation of domestic demand and technological spill-overs to the benefit of local producers or to ensure that international investors are externally competitive and therefore able to generate much-needed foreign exchange for other developmental purposes. Still, national policy-makers have some room to deviate temporarily from

<sup>1</sup>The next few paragraphs draw on UNCTAD TDR (2014), pp. 82–86.



the provisions of the agreement under certain conditions, to impose non-quantitative sector-specific entry conditions, and to apply local content requirements for the procurement of services.

GATS is an agreement that establishes principles relating to trade in services, including finance, tourism, education, and health. GATS can be far-reaching, as it may cover a wide range of areas such as domestic laws, guidelines, subsidies, licensing standards, and even unwritten practices. This characteristic of GATS is balanced out by the fact that GATS provisions are based on a 'positive list', implying that countries can decide which areas to liberalise first and on what terms.

From the above, one can deduce that both restrictions and flexibility in such agreements exist. With this, one may raise the question how much loss of policy space is due to the WTO rules and agreements and how much is due to other constraining factors. After all, the WTO is not the only institution behind reduced policy space – and, perhaps, even not the main one. Indeed, many experts argue that the WTO rules are not as binding or restrictive as is commonly claimed (Jackson, 2021; Page, 2007). Regional and bilateral trade and investment agreements have meddled greatly in domestic trade and financial and investment policies, reducing the ability of national policy-makers to formulate and implement industrial strategies. In addition, in the latest wave of globalisation, the global value chains and global financial markets have further limited the space for industrial policy, first due to a governance system dominated by large international corporations, which have reshaped the rules of engagement in international trade, and second by constraining the ability of policy-makers to adopt autonomous macroeconomic policies in support of national development strategies.

### 3. The restrictive facet of regional trade agreements

Regional trade agreements (RTAs) have been in existence for many years, but they proliferated from the early 1990s onwards. These agreements have further constrained the space for industrial policy through more stringent enforcement, reduced exceptions, and new investment provisions. The last of these have covered government procurement, competition policy, and the harmonisation of standards. RTA measures, therefore, have been both more comprehensive and stringent than the WTO provisions.

They have been a move towards 'deep integration' and therefore way beyond the usual business of standard trade agreements, which are focused on the reduction of tariffs, quotas, and other barriers to trade. But even on tariffs, RTAs are tougher as they target reductions in applied tariffs rather than the upper bound rates, as is the case under WTO negotiations; they therefore reduce the room for the use of tariffs as instruments of industrial policy. On GATS-related issues, RTAs sometimes adopt a negative, rather than a positive, list approach. RTAs often are also stricter on TRIPS commitments due to more stringent enforcement, fewer exceptions (e.g., a compulsory licence only for emergency situations) and extended obligations (e.g., on counterfeiting, piracy). Finally, in relation to TRIMs, the principle of non-discrimination towards foreign investors is in many instances reinforced by prohibiting export-performance targets, technology transfer, and even restrictions on the nationality of senior management (UNCTAD TDR, 2014:86–87).

However, not every developing country has entered into RTAs – or at least North–South RTAs, which are those that tend to be more binding. Therefore, countries that are bound to WTO rules and agreements but not much else may still have some reasonable space for industrial policy. Their work is to use this space to the maximum extent. Unfortunately, those countries that have entered several regional (and bilateral) agreements probably have considerably less room to manoeuvre. South Africa is one such country and therefore faces bigger challenges in designing policies for industrial growth and development.

### 4. South Africa in the multilateral trading system: protecting space for industrial policy

The end of the apartheid regime coincided with the conclusion of the Uruguay Round. This round lasted eight years, a period during which the apartheid negotiators did not fight for smaller tariff cuts. On the contrary, they aligned South Africa with the interests of the group of developed countries and agreed to deep tariff cuts. The result was that the industrial tariff cuts implemented by South Africa were significantly greater compared to those of other developing countries. These cuts, it has been argued, have contributed to premature de-industrialisation in South Africa (Davis, 2019).

Since then, the WTO has held ministerial conferences every two years, trying in each of them to push for further liberalisation in a wide range of areas. At the same time, developing countries started to strengthen their negotiating power and fight back to stop further erosion of the policy space that was left after the Uruguay Round. The Doha Round, which was meant to be a development round, started in 2001 but was never concluded, owing to the unbridgeable divergences between the various negotiating country groups. Since the beginning of the democratic era, South Africa has played an active role in the various ministerial conferences and has, with varying degrees of success, made great efforts to protect those South African industries considered most vulnerable to deep industrial tariff cuts.

In parallel with the fight to preserve policy space through active participation in the negotiations at the multilateral level, in 2007 South Africa adopted the National Industrial Policy Framework, which has served as a guide for the policy action plans that followed. These plans comprised both vertical and horizontal industrial policy measures, including sector-specific tariff changes and fiscal incentives. An expert assessment is that the policy action plans, and their measures, did not generate the expected results. A reason pointed out for this outcome was the lack of sufficient alignment between the industrial policy and the broader macroeconomic framework. Another reason was the insufficient backward and forward linkages between megaprojects and smaller enterprises (UNCTAD TDR, 2014; Zalk, 2014). A more recent assessment is that, along with some disappointing results, the policy action plans did have some important sector-specific successful stories, such as in the automotive and clothing industries (DTI, 2018).

## 5. What about the pharmaceutical industry in South Africa and other developing countries?

For pharmaceutical businesses in developing countries, a critical component that stands out from the multilateral trading system are the obligations relating to the Intellectual Property Rights (IPRs). Over the years, these have been increasingly used by large multinational firms not simply to protect large investments in R&D but as an instrument with which to enhance market power. The strategic use of IPRs has led to excessive patent protection, including the broadening of their scope and the length of their lives. The result has been their abusive use by incumbent firms to the detriment of others. The strategic use of IPRs has, therefore, been increasingly debated as it has reduced the ability of pharmaceutical firms from developing countries to benefit from technology transfers. These transfers are important in enabling such firms not only to grow and compete but, very importantly, to play a social role as providers of accessible medicines and other health products to a wider population. If TRIPS does incorporate exceptions in defence of the public interest and innovation – and protect smaller firms from the aggressive behaviour of the dominant multinational companies, ‘often these [exceptions] are not clearly specified and are difficult to utilise in practice’ (UNCTAD TDR, 2017:134). There is some evidence that multinational enterprises are gaining markets in emerging economies such as Brazil, China and India as a result of their aggressive patent-related practices (UNCTAD TDR, 2017:134–136).

The COVID-19 pandemic has brought a sharper focus to the challenges inherent ‘in building productive capabilities in health’ (UNCTAD WIR, 2021:134). Since then, countries have increased screening procedures for foreign investment in the health sector, aiming at protecting the sector from foreign takeovers of domestic firms. Screening has been adopted mainly by developed countries and emerging economies and been especially prevalent in the pharmaceutical industry. Developing countries whose initial point is incipient production capabilities have, instead, adopted investment incentives to promote the manufacture of medical equipment and research.

Regarding international agreements, the IP rights of the TRIPS under the WTO have perhaps been the most binding constraint on the transfer of technology and the promotion of domestic manufacturing in the health sector. Notwithstanding such a constraint, which comes in the form of a minimum standard to protect IP rights, flexibilities are also provided under the WTO regime. These include leeway for the scope of inventions, eligibility criteria for the protection of patents, and the reduction of conditions under which a known pharmaceutical substance can have patent protection (UNCTAD WIR, 2021:144).



A compulsory licence can be used, provided the manufactured products are destined primarily for domestic consumption or exports to markets with no or at best limited manufacturing capacity. Countries can also resort to a temporary waiver to respond to emergency situations, but that requires agreement among all the WTO member states.<sup>2</sup> The extent to which countries can exploit these flexibilities depends, in large measure, on their own manufacturing, research, and, not least of all, negotiation capacities to deal with the intricacies of international rules and regulations.

## 6. Concluding remarks

International rules and regulations do constrain the space for the promotion of industrial policy. However, this space is not set in stone. Alongside restrictions, flexibility also exists, which countries can use, and South Africa is well positioned to take full advantage of it. The country has senior officials with strong international negotiating capacity, policy-makers with the ability to design and implement industrial policy, a strong national research system, and a government with the coordination capacity to bring on board key national players and to work closely with the private sector.

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<sup>2</sup>Indeed, on 17 June 2022, a global agreement at the WTO was reached giving a waiver to certain sections of TRIPS so that developing countries may produce COVID-19 vaccines (Green, 2022). See also the *Conversation* (2022), which nonetheless notes the limited scope of the waiver and the fact that it is temporary, covering only a five-year period.

## 13. REGIONALLY INTEGRATE AND DIVERSIFY: POLICY CHOICES FOR LESOTHO IN ITS PATH TOWARDS RECOVERY

*Bryony Steyn*

### 1. Introduction

Lesotho is a small, land-locked lower middle-income country, completely enclaved by its big brother, South Africa.

More than 60% of Lesotho's trade is with South Africa<sup>1</sup>. Aircraft from Lesotho's single international airport fly to only one destination: South Africa. Of the 179,579 estimated Basotho emigrants (Nationals of Lesotho), 178,647 (over 99%) live in South Africa, where 82% are economically active (Lesotho Bureau of Statistics, 2016; Census, 2016). Not only are Basotho dependent upon South Africa for employment, but Basotho migrants transfer large amounts of remittances back to Lesotho.

In 2020, formal remittances to Lesotho equated to US\$ 427 million, or 26% of GDP (World Bank, 2020a) and provided critical support for 17% of families in Lesotho (Lesotho Vulnerability Assessment Committee, 2020). In addition, models of informal remittances estimate that up to 30% of adults in Lesotho may be dependent upon remittances (IOM). The Lesotho Maloti<sup>2</sup> is pegged to the South African Rand. The government of Lesotho is highly reliant upon Southern Africa Customs Union (SACU) revenue to finance up to 50% of its public budget (Parliament of the Kingdom of Lesotho, 2020), which in turn is dominated by the performance of the South African economy.

These are just a few examples of Lesotho's dependence upon South Africa, which is explored in more detail throughout this chapter.

However, is the Kingdom of Lesotho's closeness to South Africa an advantage or a disadvantage? How well are the two nations truly integrated? And despite its small size, should the Kingdom of Lesotho reconsider its dependence upon South Africa, especially in pursuit of the benefits promised by the African Continental Free Trade Area (AfCFTA)?

This chapter considers the impact that economic developments in South Africa have on the Kingdom of Lesotho and the role that economic integration plays in the relationship between the two countries' economies. Using the above analysis, the chapter explores the potential growth drivers and enablers for the Kingdom of Lesotho in the context of Building Back Better post-COVID-19, and whether the Kingdom would be better positioned to strengthen its ties with South Africa or to diversify away from its larger neighbour.

### 2. An economic snapshot

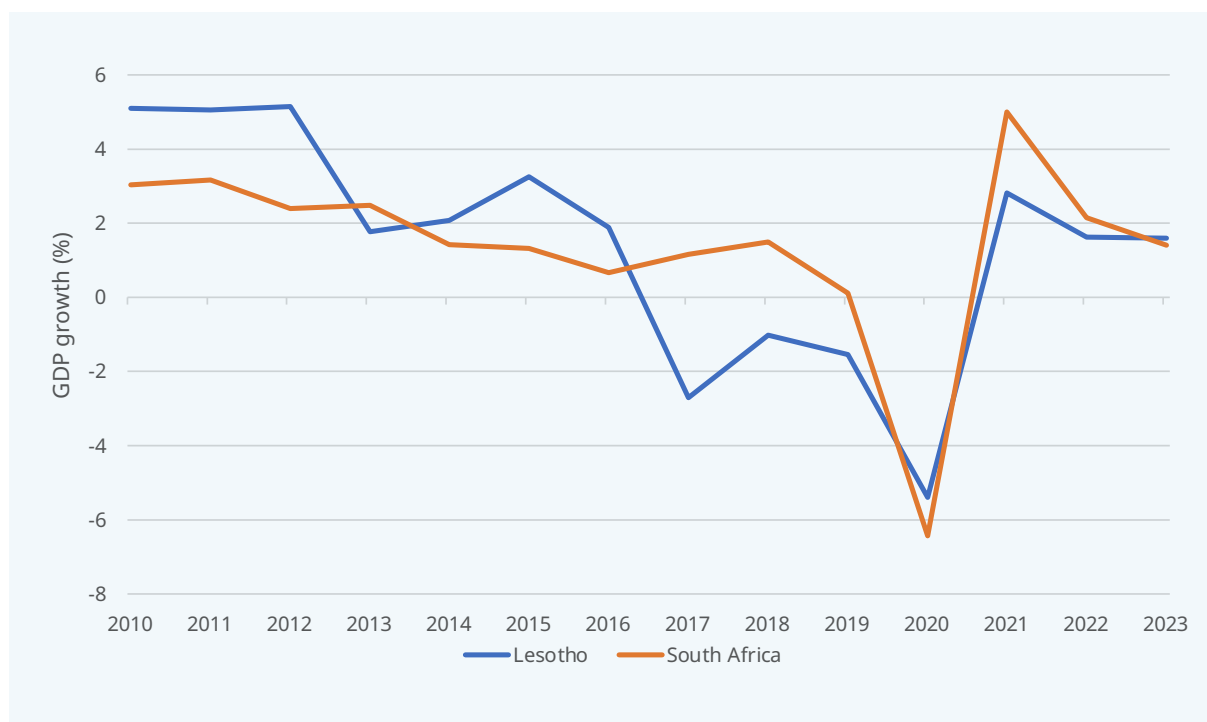
Over the past decade, both Lesotho and South Africa have experienced disappointing economic growth (see Figure 1). There are many similarities in the nature of growth in South Africa and Lesotho. Economic growth has failed to be pro-poor in both countries and has been characterised by a failure to create jobs and by rising income inequality. COVID-19 has only exacerbated underlying vulnerabilities in Lesotho and South Africa.

<sup>1</sup>See, among other sources, Lesotho Bureau of Statistics (2018).

<sup>2</sup>Lesotho's national currency.



Figure 1: Economic growth



Source: IMF World Economic Outlook, October 2021

In Lesotho, 2020 marked the fourth consecutive year of economic contraction. Economic growth started to slow in 2013, and by 2017 the economy contracted by 2.7%, largely driven by massive political instability that necessitated the intervention of the SADC. The economy continued to contract by 1.0% in 2018 and 1.5% in 2019 as political instability continued, and climate change triggered droughts and floods that eroded agricultural production (World Bank, 2021a); adding to this, government expenditure focused on the wage bill at the expense of development-enhancing investments.

COVID-19 triggered an economic contraction of 5.4% in Lesotho in 2020<sup>3</sup> as movement restrictions and border closures resulted in massive job losses. The unemployment rate (modelled by ILO) is estimated to have increased from 24% in 2019 to 25% in 2020 (ILO, 2021). Meanwhile, an additional 2.8% of the population are estimated to have fallen into poverty in 2020 (at the US\$1.90 per day poverty line) (World Bank, 2021a). In South Africa, the economy has consistently grown below 1.5% since 2014, falling to just 0.1% growth in 2019 (IMF, 2021). Energy constraints, subdued private investment, and increased uncertainty are some of the factors that have played a role in South Africa's recent poor growth record (IMF, 2021).

COVID-19 contributed to an economic decline of 6.3% in South Africa in 2020 and an increase in the unemployment rate from 29.1% in 2019 to 32.5% in 2020 (Stats SA, 2020), and pushed an additional 2 million South Africans into poverty (at the poverty line for upper-middle income countries of \$5.50 per day) in 2020 (World Bank, 2021b).

<sup>3</sup>IMF predicted figure.

### 3. The state of economic integration

The literature largely presents a positive relationship between integration and economic growth (Kowalski, 2015; Central Bank of Lesotho, 2008; African Union, 2019).

The UN Economic Commission for Africa (UNECA) (2004) presents three major gains from regional integration. First, integration enables economies of scale and encourages competition between economic agents. Secondly, integration, in part through enabling economies of scale and in part through eroding market distortions, promotes greater investment in production and value chains. Thirdly, integration increases the bargaining power of countries, particularly for small countries.

The Kingdom of Lesotho and the Republic of South Africa are already relatively well integrated, at least theoretically, under the Southern Africa Customs Union (SACU) and the Common Monetary Area (CMA).

SACU is the oldest customs union in the world, and comprises Botswana, Lesotho, Namibia, Swaziland, and South Africa. It targets the facilitation of movements of goods across borders between its member states and an empowered bargaining position for its member states in global markets. SACU members apply no customs duties between themselves and apply a common external tariff (CET) on imports from non-SACU countries, which is later shared between member countries.

The CMA consists of Lesotho, Namibia, Swaziland, and South Africa, and is also long-standing, existing at least informally before the creation of the South African Reserve Bank in 1921 (Central Bank of Lesotho, 2008). The CMA enables all members to peg their currency to the South African Rand, in this way instilling South African monetary and exchange rate policy across the area.

The recent signing of the AfCFTA also points to the consensus that stronger integration triggers better growth outcomes. Comprising 55 countries, with a total population of more than 1.2 billion and a total GDP of more than \$3.4 trillion, the AfCFTA is set to become the largest trading bloc in the world, measured by the number of participating countries (World Bank, 2020b). The sheer scale of the AfCFTA promises African countries the opportunity to benefit from economies of scale, more integrated value chains, industrialisation, job creation, and a stronger negotiating voice at global forums. The UN Economic Commission for Africa (UNECA) estimates that AfCFTA could offer welfare gains of up to 4% and boost intra-African trade by up to 52% (UNECA, 2021). However, such gains are not automatic and will require considered and supportive policies that encourage stability, investment, job creation and industrialisation.

The Kingdom of Lesotho ratified the AfCFTA in November 2020<sup>4</sup> and South Africa did so in February 2019 (UNECA, 2020).

Using the Africa Regional Integration Index (ARII)<sup>5</sup>, the chapter briefly considers five aspects of regional integration – trade integration, infrastructure integration, productive integration, macroeconomic integration, and the free movement of people – to investigate how well integrated Lesotho and South Africa are in reality and whether Lesotho's integration with a declining powerhouse still poses an advantage to the Kingdom, especially given the challenges of post-COVID-19 economic recovery.

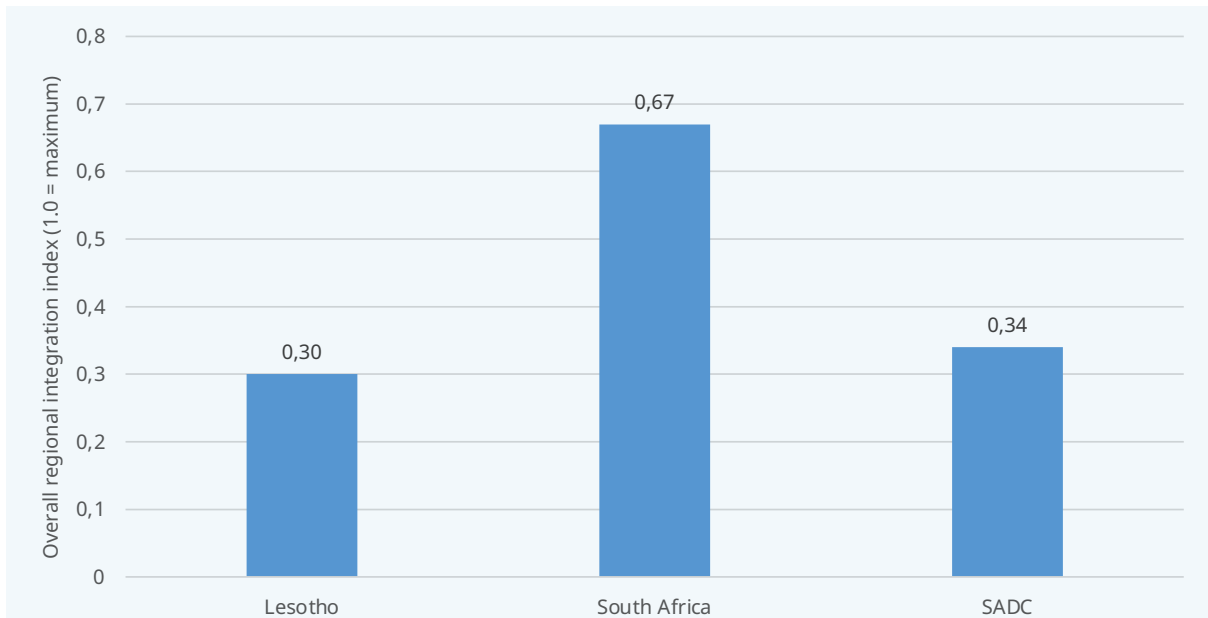
<sup>4</sup>UNECA, 2020, Media Centre. Tunisia and Lesotho join a growing number of countries to ratify AfCFTA one month to start of trading.

<sup>5</sup>ARII is a joint publication of the African Union Commission, the African Development Bank, and the United Nations Economic Commission for Africa. Information on the ARII can be found at the following website address: <https://www.integrate-africa.org/>



As a precursor, Lesotho is already calculated to be poorly integrated overall under the ARII, whereas South Africa, although still with space to improve, is scored as the most integrated African country (Figure 2).

**Figure 2: Overall integration**

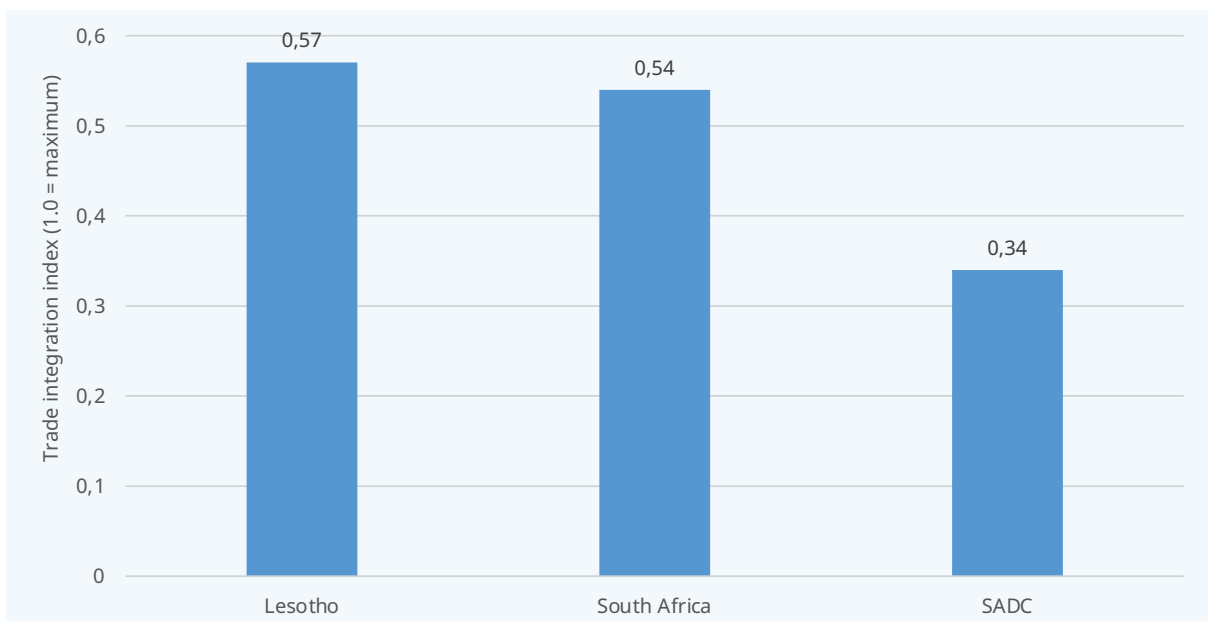


Source: Africa Regional Integration Index

#### 4. Trade integration

Overall, African trade integration is weak. However, four SACU member states, including Lesotho and South Africa, score within the top five countries in Africa for their level of trade integration as measured under the ARII (Figure 3).<sup>6</sup>

**Figure 3: Trade integration**



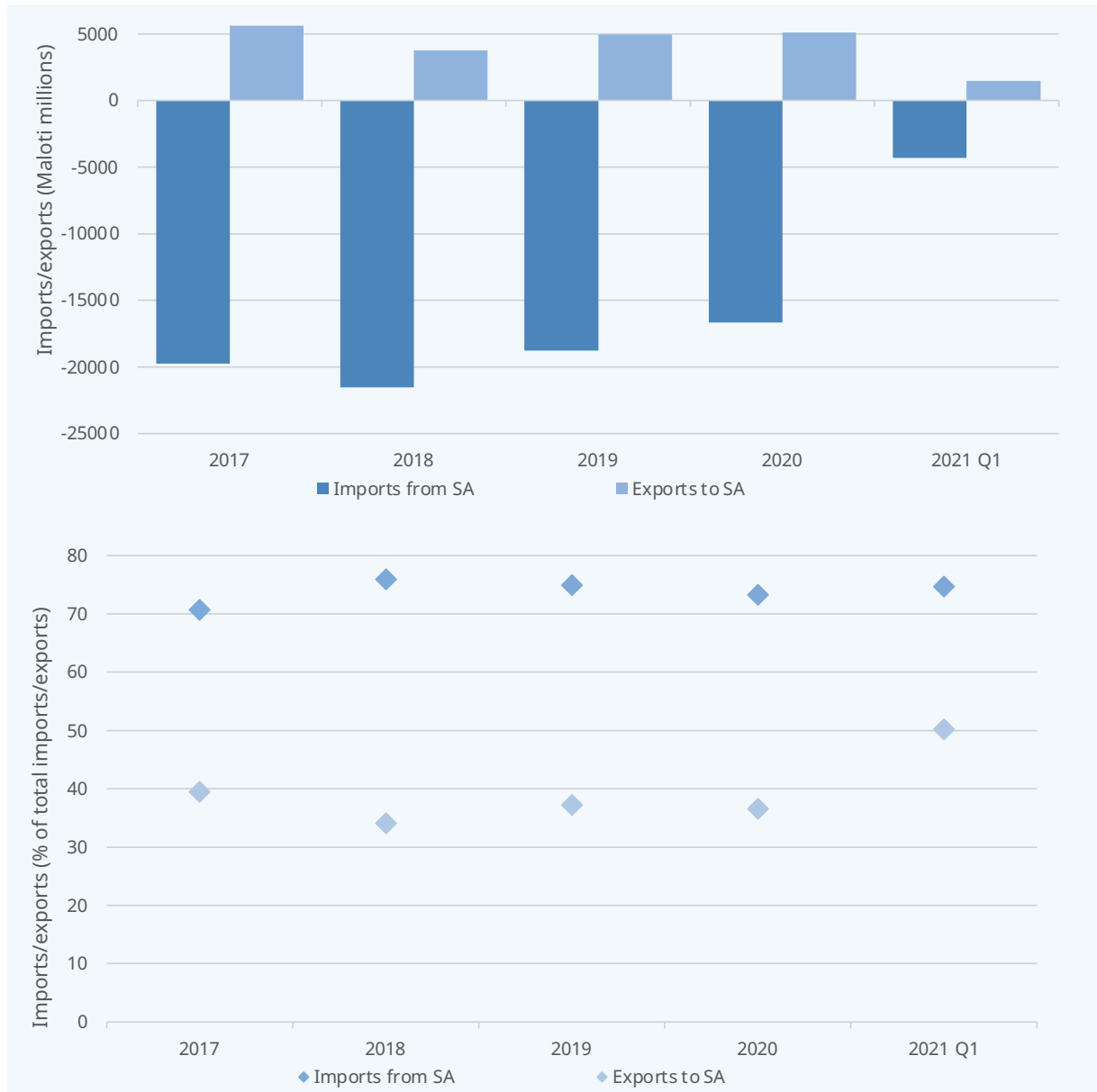
Source: Africa Regional Integration Index

<sup>6</sup>The ARII trade integration index considers a country's share of intra-regional exports, imports and trade, average intra-regional import tariffs, and whether a country has ratified or signed the AfCFTA.



Indeed, the trade integration index captures the fact that Lesotho is heavily dependent on trade with South Africa (Figure 4). More than 70% of Lesotho's imports are from South Africa, and approximately 35% of Lesotho's exports are to South Africa. Since 2017, when the economy of Lesotho fell into recession, Lesotho's imports from South Africa have been following a downward trend, while Lesotho's exports to South Africa have been demonstrating an upward trend, causing the trade deficit to narrow.

Figures 4a and b: Trade between Lesotho and South Africa



Source: Lesotho Bureau of Statistics

The fixed exchange rate and tariff-free agreement under SACU all support trade between the two countries and benefit Lesotho by enabling the Kingdom, which has a limited domestic manufacturing base, to import a larger number of goods at a lower price and/or by preventing what would otherwise be an even larger balance of payments deficit (Central Bank of Lesotho, 2008).



Furthermore, Lesotho benefits enormously from the reallocation of the Common External Tariff under SACU. South African trade is the largest contributor to SACU CET revenues, yet the government of Lesotho is highly dependent upon the revenues to finance its public budget. SACU receipts are estimated to have accounted for 36% of total government revenue in 2019/20 (Ministry of Finance, 2021), 52% in 2020/21 and 39% in 2021/22 (Parliament of the Kingdom of Lesotho, 2020). While the government depends on SACU revenues to finance its budget, it is also vulnerable to their volatility and has not enacted an insurance mechanism to smooth its expenditure. Instead, SACU receipts, and the rapid disbursement of SACU revenue, have tended to have a procyclical effect on government expenditure and has therefore stoked economic volatility.

In theory, SACU and, more recently, the AfCFTA, should benefit Lesotho's exports. Lesotho boasts relatively cheaper labour costs and so the absence of barriers to trade should make Lesotho's goods more competitive in the region (Central Bank of Lesotho, 2008) (assuming other costs such as infrastructure, electricity and transport are not punitive). A competitive export base should, in turn, drive employment creation and a demand for productive and infrastructural integration, further increasing the competitiveness of exports.

Lesotho's largest export commodity is 'miscellaneous manufactured goods', which demonstrates that Lesotho is to some degree taking advantage of its access to tariff-free markets and low cost of labour to export goods with added value. However, the persistent trade deficit implies that Lesotho still has room to improve the competitiveness of its exports. It is likely that Lesotho's export growth is more constrained by the small domestic manufacturing sector than by competition with South Africa or by South Africa's sluggish economic growth. A relatively unsupportive, and unpredictable, business environment, exacerbated by political instability, has dissuaded foreign direct investment into Lesotho and limited manufacturing growth and diversification. Perhaps one of the more supported and successful manufacturing sub-sectors is the textiles industry; it is heavily labour intensive and has created more employment than any other industry in Lesotho, and yet has only created 45,000 jobs (African Growth and Opportunity Act, 2021). Regarding trade, South Africa and SACU present opportunities for Lesotho, but Lesotho must also adopt business, investment, and other policies to take full advantage of the existing opportunities.

## 5. Infrastructure integration

Improvements in infrastructure integration may support:

1. physical trade through better transport networks;
2. production through more energy access, distribution and efficiency, and
3. trade facilitation and overall efficiency through adoption and expansion of newer information and communications technology.

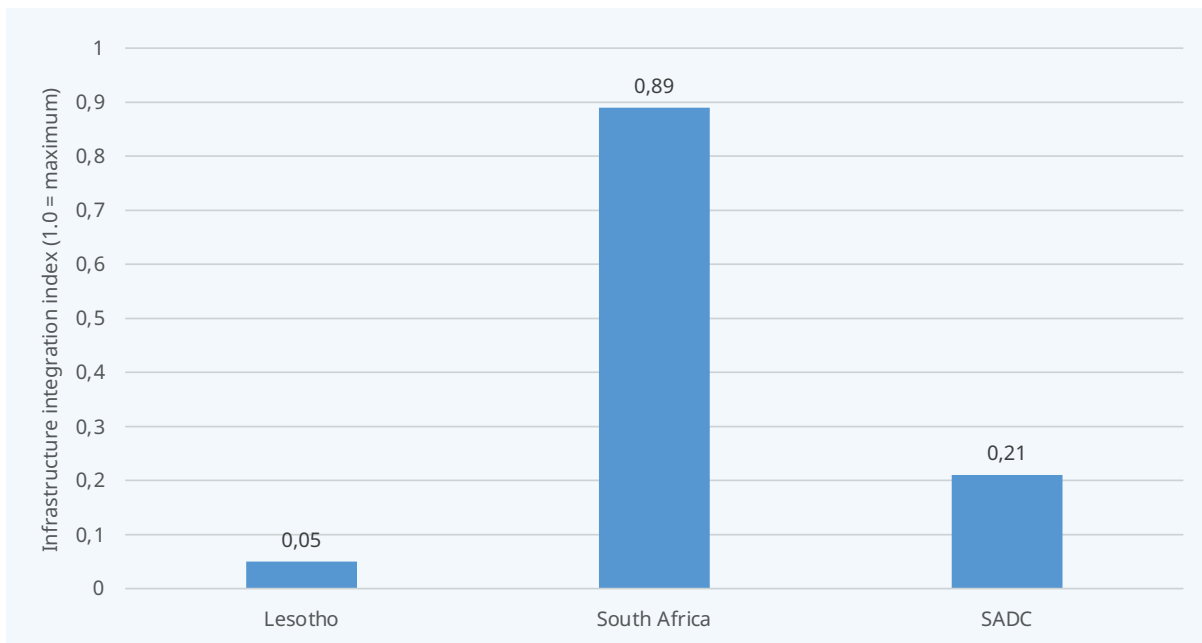
Indeed, infrastructure integration is key to maximising the growth potential associated with regional integration. As the ARII Report 2019 states,

Regional integration cannot happen without adequate infrastructure. In our highly technological world, strong economic links in trade, finance, production, and social development depend on well-designed, well-connected infrastructure (African Union et al., 2019).

The ARII ranks South Africa as the most integrated country by infrastructure on the continent, whereas Lesotho is one of the least well integrated; only Madagascar and DRC score worse in the SADC<sup>7</sup> (Figure 5).

<sup>7</sup>The ARII infrastructure integration index considers the AfDB infrastructure development index and the proportion of intra-regional flight connections.

**Figure 5: Infrastructure integration**



Source: Africa Regional Integration Index

In 2020, Lesotho’s performance in AfDB’s Infrastructure Development Index declined from the 34th to the 38th position of a total of 54 countries covered by the index. The limited availability of electricity, limited access to and poor quality of the internet, and limited access to improved water and sanitation all contributed towards Lesotho’s poor infrastructure score (African Development Bank, 2020). It is also worth noting that much of Lesotho’s infrastructure is sensitive to climate change, in particular the increasing occurrence of floods and the consequent destruction these extreme weather events cause. Lesotho’s potential infrastructure development would need to adapt to the increasing impact of climate change and may need greater maintenance than in the past.

Lesotho’s weak score limits not only its integration, but also its overall economic development, and cannot be attributed to the situation in South Africa, despite South Africa’s electricity limitations, as South Africa performs well on the index.

## 6. Productive integration

Productive integration refers to the integration of value chains between countries. If countries are able to engage in value chain development so that individual countries work to their comparative advantage to add value to a product, then the group as a whole may benefit from greater economies of scale and greater trade competitiveness. Greater trade and infrastructure integration, and well-functioning logistics, should enable greater productive integration. According to the ARII Report 2019,

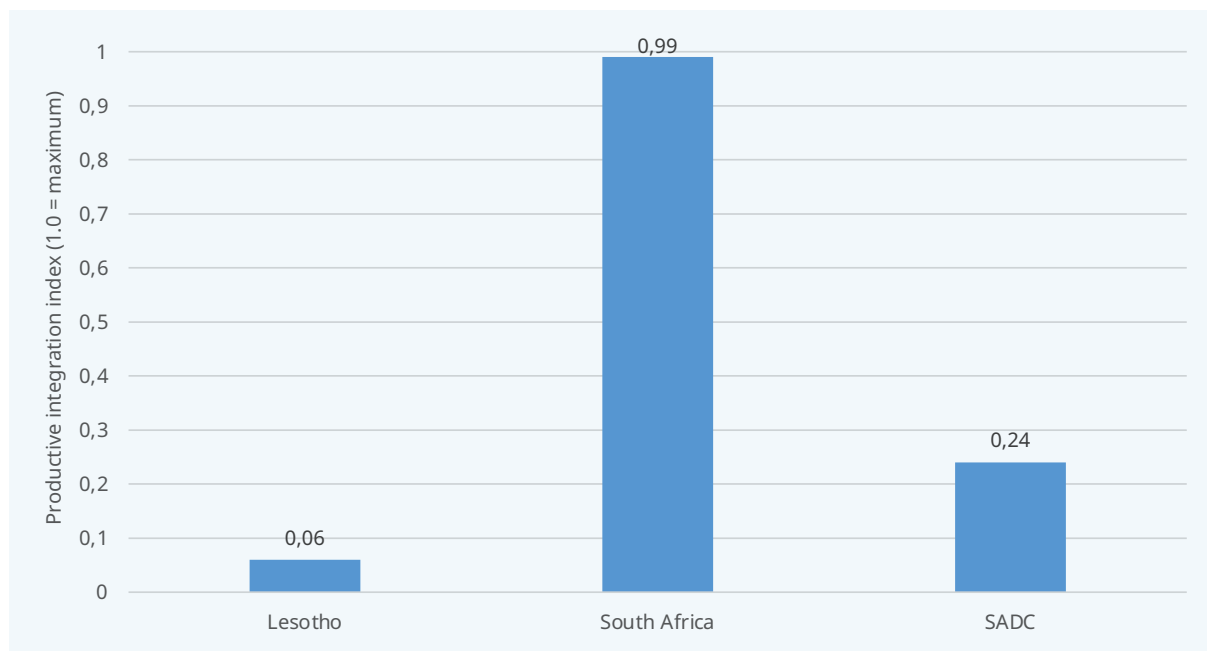
South Africa is the continent’s leader in productive integration, showcasing a perfect score. Regional imports and exports of intermediate products to and from South Africa account for a larger proportion of regional trade in South Africa than they do in any other country on the continent and South Africa has the highest score on the merchandise trade complementarity index (African Union et al., 2019).

Lesotho falls in the bottom five countries on the continent as measured by the ARII’s index of productive integration<sup>8</sup> (Figure 6). Lesotho’s poor scoring is due to its weak integration in regional value chains.

<sup>8</sup>The ARII productive integration index considers the share of intra-regional intermediate imports and exports, and the merchandise trade complementarity index.



Figure 6: Productive integration



Source: Africa Regional Integration Index

Given Lesotho's small size, especially compared to the dominance of neighbouring South Africa, its landlocked geography, and its lack of transport links beyond South Africa, the country could benefit significantly from integrating itself within South Africa's more diversified production chains. Furthermore, if Lesotho were to better integrate itself within South Africa's value chains, then it may not just operate under its comparative advantage, but it could also target a gradual transition towards an increasingly sophisticated (and labour-intensive) comparative advantage without having to develop an entire value chain, which the Kingdom is simply too small to achieve.

This is not to recommend that Lesotho only seek to position itself within value chains in South Africa. Under the AfCFTA, Lesotho may be more selective and position itself within regional or continental value chains. However, given South Africa's dominant economy and perfect productive integration score, greater productive integration with South Africa may be a beneficial starting point, while also opening up the Kingdom to operating within wider value chains across the continent.

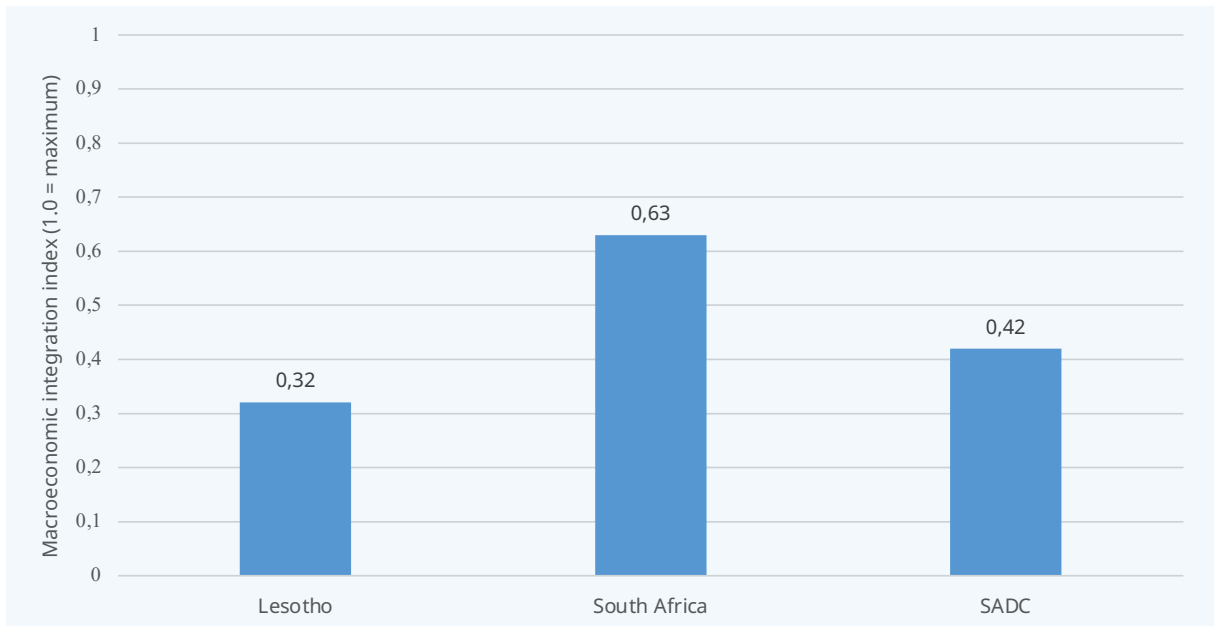
## 7. Macroeconomic integration

Coordinated, stable and predictable monetary and fiscal policies, stable inflation, and high currency convertibility between countries constitute a set of macroeconomic conditions that enable investors to better calculate the costs and benefits of investments, and which are likely to encourage inward (and outward) foreign direct investment.

Despite having relatively stable inflation, Lesotho does not score particularly well on macroeconomic integration (Figure 7) due to the weak convertibility of the Lesotho Maloti and a lack of bilateral trade treaties.<sup>9</sup> The Common Monetary Area (CMA) does enable currency convertibility between Lesotho, Namibia, Swaziland, and South Africa; however, Lesotho retains strict capital controls, which works against currency convertibility with countries outside of the CMA.

<sup>9</sup>The ARII macroeconomic integration index considers the regional inflation differential, the regional convertibility of currency, and the number of bilateral investment treaties in place.

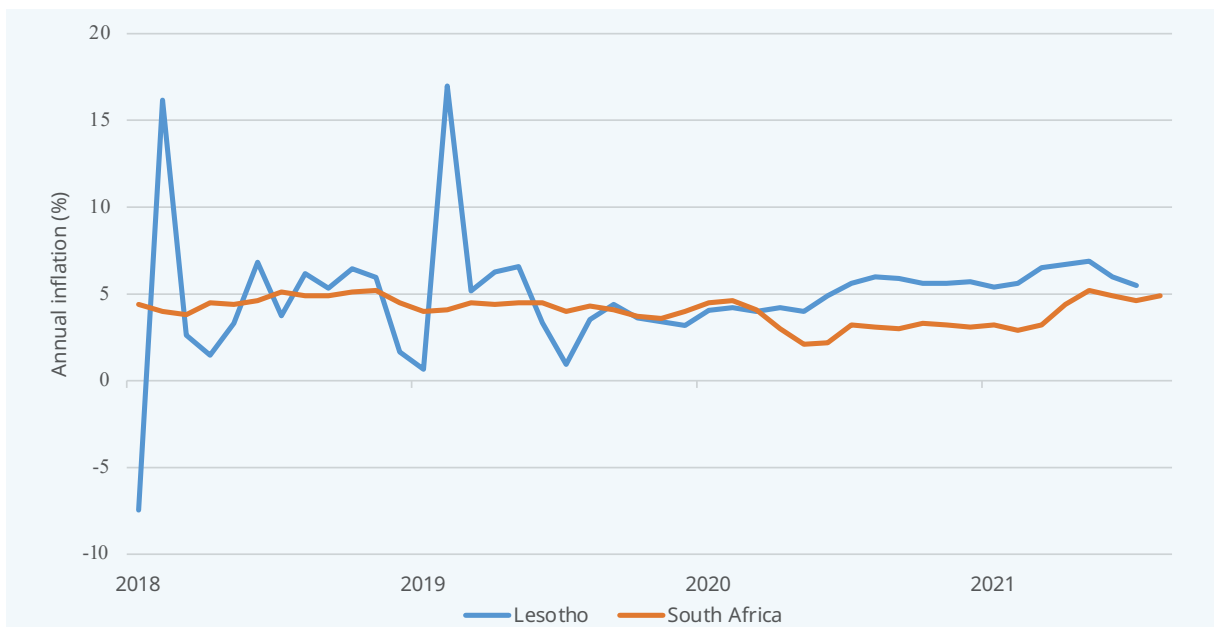
**Figure 7: Macroeconomic integration**



Source: Africa Regional Integration Index

The Central Bank of Lesotho estimates that there is a net benefit to Lesotho from being a part of the CMA by inheriting South Africa's more credible monetary policy, despite losing its own monetary policy autonomy.<sup>10</sup> South Africa's inflation is much more stable than Lesotho's (Figure 8), which tends to be more volatile to spikes in food prices. In addition, the exchange rate peg probably prevents large currency fluctuations, which would be costly, if possible, for the Central Bank to defend, and most likely does support macroeconomic stability.

**Figure 8: Headline inflation**



Source: Lesotho Bureau of Statistics and South Africa Department of Statistics

<sup>10</sup>Central Bank of Lesotho, 2008. Regional economic integration in Africa: benefits for Lesotho. Economic Review, November 2008.

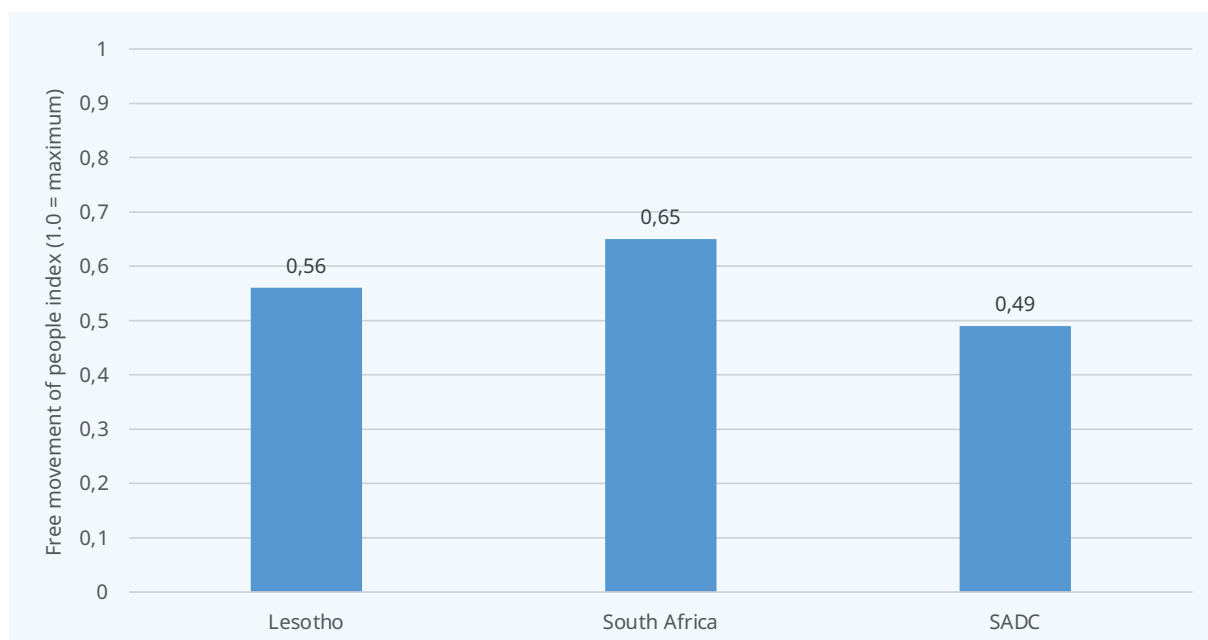


## 8. Free movement of people

Finally, integration through the free movement of people, as recommended by the Free Movement of Persons (Kigali) Protocol, should encourage economic development through enabling skills transfer and businesses to easily monitor overseas investments, and so encouraging foreign direct investment.

Both Lesotho and South Africa score slightly above the SADC and the African average for the free movement of persons<sup>11</sup> (Figure 9). However, only Lesotho has ratified the Free Movement of Persons (Kigali) Protocol.

Figure 9: Free movement of people



Source: Africa Regional Integration Index

Whereas Lesotho's and South Africa's score is only average, Lesotho is very dependent on the movement of people to South Africa. As mentioned previously, the 2016 Census estimated that more than 99% of Basotho migrants lived in South Africa (Lesotho Bureau of Statistics, 2016). By 2019, the Migration Data Portal estimated that the total stock of emigrants stood at 342,000 (16% of the population) (Migration Data Portal, 2019), the majority of whom are still anticipated to reside in South Africa.

The loss of the population (particularly the working-age population) has a mixed effect in Lesotho. There is a definite brain drain in Lesotho, but given the lack of employment opportunities in the Kingdom, the South African economy does help to absorb the excess labour force, while the remittances earned constitute a considerable amount that feeds through the economy, helping to boost GDP. Moreover, these resource flows are estimated to support 17% of families in Lesotho (UN Lesotho, 2020).

However, Lesotho's porous borders enable high levels of irregular migration, which is compounded by socio-economic factors such as poverty, unemployment, a lack of job opportunities in rural areas, and high food insecurity caused by recurrent droughts. High levels of irregular migration, and the use of unofficial border crossings, have further exacerbated the vulnerability of migrants and exposed them to risks of trafficking in persons, for which Lesotho has a poor record. Perhaps if South Africa were to embrace the Free Movement of Persons Protocol, it may dissuade trafficking and enable migrants to search more meaningfully for economic opportunities.

<sup>11</sup>The ARII free movement of people index considers the number of countries that may obtain a visa on arrival, and that require a visa, and whether or not the country has ratified the Free Movement of Persons Protocol (Kigali).

COVID-19 has highlighted the vulnerability of Basotho migrants in South Africa and increased the need to create employment opportunities domestically: 100,000 labour migrants returned from South Africa at the onset of the pandemic, and more are estimated to have returned as the pandemic continued. Many migrants were unemployed and newly vulnerable, dependent on the state for social protection, yet not eligible for social protection programmes (IOM, 2020).

## 9. Conclusions

A question that was latent but not directly addressed throughout the chapter is whether Lesotho should focus on integration with South Africa or the African continent instead.

The integration discussion in this chapter suggests that, in reality, economic integration between South Africa and Lesotho is in some important respects limited. From the discussion above, infrastructure and productive integration are particularly limited. This limits the spill-over from South Africa to Lesotho. However, integration between South Africa and the rest of the continent is much stronger. Therefore, by strengthening its integration with South Africa, Lesotho would also be strengthening its integration with the whole continent.

Lesotho would therefore benefit most from improving its infrastructural and productive integration, and, to a lesser extent, its macroeconomic integration. Lesotho could, in particular, benefit substantially from increasing its electricity production, its access to and quality of the internet, its access to improved water and sanitation, and its integration into regional production chains. However, these improvements will require some degree of political stability to be implemented, which may be the largest constraint on Lesotho's economic growth in the recent period.

Ultimately, it may not be detrimental for Lesotho to catch the odd cold from South Africa. Better integration with its larger neighbour, and the associated investments in regional value chains and infrastructure, would do more to develop Lesotho's economy than to render it helpless to South Africa's downturn. In addition, if the proposed policy adjustments actually increased employment, alongside economic development, in the Kingdom, then increased integration with South Africa may paradoxically reduce Lesotho's vulnerability to South Africa's economy.



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