

CONFERENCE REPORT

# CBPEP Colloquium 2020

10-11 March 2020

Menlyn Boutique Hotel, Pretoria



Employment Growth  
in South Africa:  
Constraints and  
Opportunities



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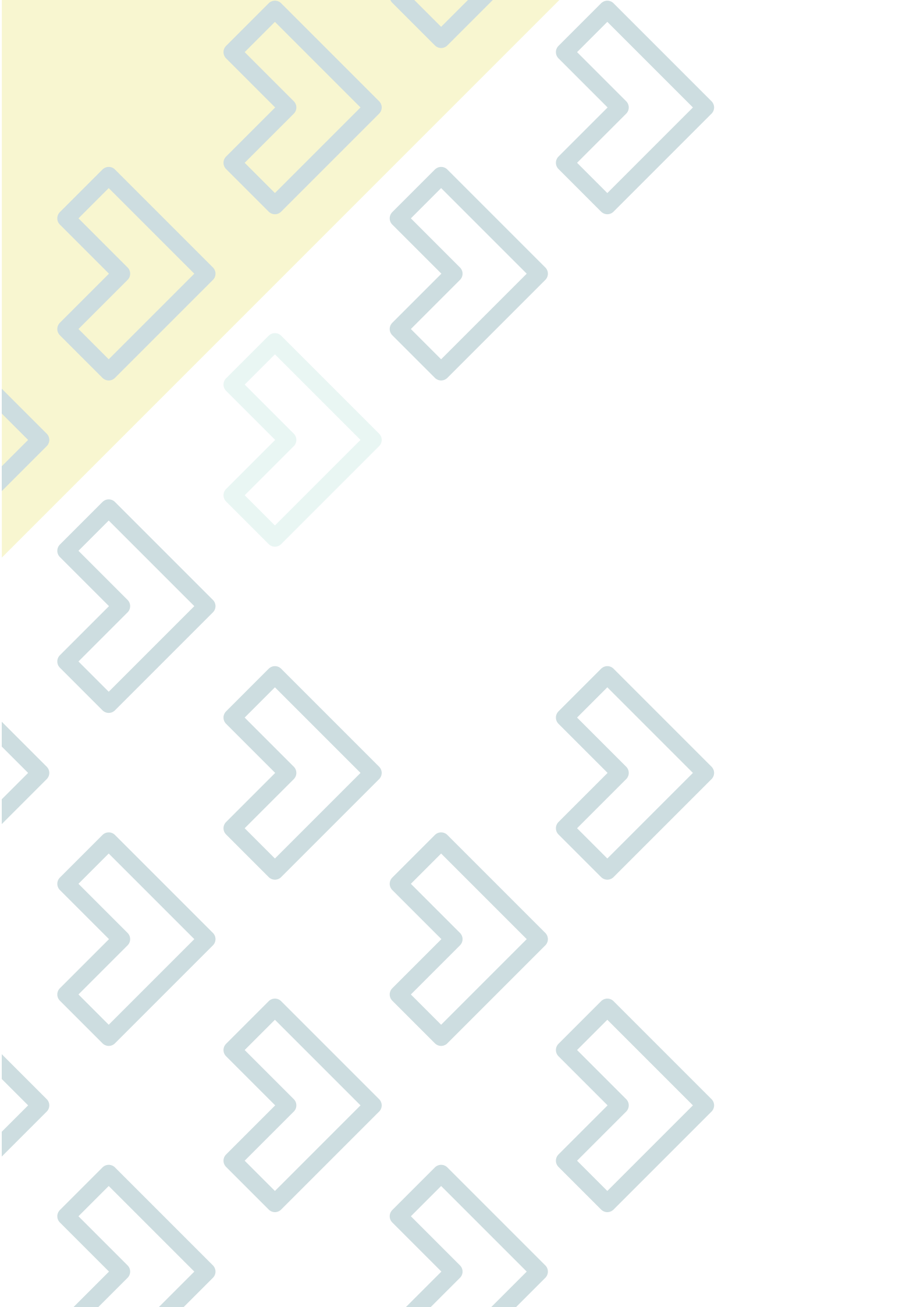
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# List of abbreviations

<b>4IR</b>	Fourth Industrial Revolution	<b>EPZ</b>	Export Processing Zones
<b>AfCFTA</b>	African Continental Free Trade Agreement	<b>EU</b>	European Union
<b>AfDB</b>	African Development Bank	<b>ETI</b>	Employment Tax Incentive
<b>ALMP</b>	Active labour market policies	<b>FDI</b>	Foreign Direct Investment
<b>ANA</b>	Annual National Assessments	<b>FTE</b>	Full-Time Equivalent
<b>ARPM</b>	African Peer Review Mechanism	<b>GDP</b>	Gross Domestic Product
<b>AU</b>	African Union	<b>GEPF</b>	Government Employees Pension Fund
<b>B-BBEE</b>	Broad Based Black Economic Empowerment	<b>GVC</b>	Global Value Chains
<b>BRT</b>	Bus Rapid Transport	<b>HDI</b>	Human Development Indexes
<b>CAD</b>	Comparative Advantage Defying	<b>HHI</b>	Herfindahl-Hirschman Indexes
<b>CAF</b>	Comparative Advantage Following	<b>ICT</b>	Information and Communication Technology
<b>CCRED</b>	Centre for Competition, Regulation and Economic Development	<b>IDC</b>	Industrial Development Corporation
<b>CDE</b>	Centre for Development and Enterprise	<b>IEJ</b>	Institute for Economic Justice
<b>CEO</b>	Chief Executive Officer	<b>ILO</b>	International Labor Organization
<b>CEF</b>	Central Energy Fund	<b>IMF</b>	International Monetary Fund
<b>CSP</b>	Community, Social and Public services	<b>IRP</b>	Integrated Resource Plan
<b>CTFL</b>	Clothing, Textiles, Footwear and Leather	<b>JSE</b>	Johannesburg Stock Exchange
<b>CV</b>	Curriculum Vitae	<b>KZN</b>	KwaZulu-Natal
<b>DBE</b>	Department of Basic Education	<b>LDCs</b>	Least Developed Countries
<b>DBSA</b>	Development Bank of South Africa	<b>LLDC</b>	Land-locked Developing Countries
<b>DFI</b>	Development Finance Institution	<b>MIS</b>	Modernising Informal Enterprise
<b>DHET</b>	Department of Higher Education and Training	<b>MNC</b>	Multinational Corporations
<b>DPME</b>	Department of Planning, Monitoring and Evaluation	<b>MRO</b>	Maintenance, Repair, And Operating Supply
<b>DSBD</b>	Department of Small Business Development	<b>MTEF</b>	Medium Term Expenditure Framework
<b>DST</b>	Department of Science and Technology	<b>NDP</b>	National Development Plan
<b>dti</b>	Department of Trade and Industry	<b>NECSA</b>	South African Nuclear Energy Corporation
<b>ED</b>	Enterprise Development	<b>NEDLAC</b>	National Economic Development and Labour Council
<b>eMBed</b>	Mind, Behaviour, and Development Unit	<b>NEEDU</b>	National Education Evaluation and Development Unit
<b>EME</b>	Exempt Micro Enterprise	<b>NEET</b>	Not in Employment, Education and Training
<b>EPWP</b>	Expanded Public Works Programme	<b>NEPAD</b>	New Partnerships for Africa's Development

<b>NGO</b>	Non-governmental Organisation	<b>SEZ</b>	Special Economic Zone
<b>NMW</b>	National Minimum Wage	<b>SIDS</b>	Small Island Developing States
<b>NPO</b>	Non-profit Organisation	<b>SIP</b>	Strategic Integrated Project
<b>NQF</b>	National Qualifications Framework	<b>SMEs</b>	Small and Medium-sized Enterprises
<b>NSF</b>	National Skills Fund	<b>SMME</b>	Small and Medium Micro Enterprises
<b>OPEC</b>	Organisation of the Petroleum Exporting Countries	<b>SOC</b>	State-owned Companies
<b>PAYE</b>	Pay As You Earn	<b>SOE</b>	State-owned Enterprises
<b>PIC</b>	Public Investment Corporation	<b>SONA</b>	State of the Nation Address
<b>PICC</b>	Presidential Infrastructure Coordinating Commission	<b>SPV</b>	Special Purpose Vehicle
<b>PIRLS</b>	Progress in International Reading Studies	<b>SWS</b>	Support for Work Seekers
<b>PMO</b>	Project Management Office	<b>TFP</b>	Total Factor Productivity
<b>PRASA</b>	Passenger Rail Agency for South Africa	<b>TIS</b>	Traditional Informal Sector
<b>PV</b>	Photovoltaic	<b>TiVA</b>	Trade in Value Added
<b>Q419</b>	Fourth Quarter of 2019	<b>TVET</b>	Technical and Vocational Education and Training
<b>QLFS</b>	Quarterly Labour Force Survey	<b>UIF</b>	Unemployment Insurance Fund
<b>QSE</b>	Qualifying Small Enterprise	<b>UJ</b>	University of Johannesburg
<b>R-CTFL</b>	Retail, Clothing, Textile, Footwear and Leather	<b>UK</b>	United Kingdom
<b>RE</b>	Renewable Energy	<b>UNCTAD</b>	United Nations Conference on Trade and Development
<b>REITs</b>	Real Estate Investment Trusts	<b>UNECA</b>	United Nations Economic Commission for Africa
<b>SA</b>	South Africa	<b>UNIDO</b>	United Nations Industrial Development Organization
<b>SAA</b>	South African Airways	<b>US</b>	United States
<b>SABC</b>	South African Broadcasting Corporation	<b>VAT</b>	Value-added Tax
<b>SACMEQ</b>	Southern and Eastern African Consortium for Monitoring Education Quality	<b>YES</b>	Youth Employment Service
<b>SADC</b>	South African Development Community		
<b>SADTU</b>	South African Democratic Teachers' Union		
<b>SAPO</b>	South African Post Office		
<b>SAPS</b>	South African Police Service		
<b>SARS</b>	South African Revenue Service		
<b>SETA</b>	Sector Education and Training Authority		







# Foreword

The Capacity Building Programme for Employment Promotion (CBPEP) is a multi-year programme funded by the European Union and anchored in and managed by the Government Technical Advisory Centre (GTAC). The aim of the CBPEP is to assist the Government of South Africa to meet the key national objective of reducing unemployment while building institutional and organisational capacity for employment promotion. The CBPEP applies innovative, agile and iterative problem-solving approaches, assisting the government in unlocking the bottlenecks that hamper employment promotion while identifying catalytic opportunities necessary to build state capacity. The CBPEP promotes strategic dialogues, fostering platforms for change while encouraging collaboration between key social partners and the state. Ultimately, the CBPEP intends to strengthen the knowledge and evidence base for effective policy, planning and implementation. Its interventions span the following focus areas:

- active labour market policy interventions;
- small and medium enterprise development, including in the informal sector; and
- further education and training, and skills development.

As the CBPEP enters its last chapter, it is crucial that its resources are harnessed to catalyse priority sectors in the interest of promoting employment across South Africa. The identification of these priority sectors will have to be informed by existing as well as new priorities of government if they are to be effective. To unpack the challenges that plague the high unemployment and low growth rates in South Africa and to identify opportunities for change, the CBPEP brought together leading thinkers in academia and NGOs, and senior decision-makers in government, to participate in a two-day colloquium on Employment Growth in South Africa: Constraints and Opportunities, held from 10 to 11 March 2020. The colloquium was led by Prof Haroon Borhat from the University of Cape Town's Development Policy Research Unit. The leading experts, together with key government decision-makers, debated the issues from both a macroeconomic and microeconomic perspective, while reflecting on cross-sectoral interventions to retain and grow employment in South Africa. The aim of the colloquium was to:

- inform and stimulate the wider public and policy debate, and feed into advisory fora such as the Presidential Economic Advisory Council and the Presidential Jobs Summit; and
- inform the development of priority initiatives of the CBPEP's programme advisory panel.

To ensure meaningful debate and to move away from the conventional "talk shop", the experts were required to prepare a two- to four-page input per thematic area, addressing the status quo while highlighting the challenges and potential innovations to promote employment and growth in South Africa. Those inputs have been edited and refined, and are presented here for information and to help stimulate debate.

We hope that the analysis, recommendations and solutions presented and debated at the colloquium and documented in this publication will provide the necessary insights into and guidance on the public debates and key policy forums for a problem that has only worsened as a result of the COVID-19 pandemic. As certain sectors collapse owing to the stringent COVID-19 measures to curb the pandemic, the insights into the structural challenges of the economy that hamper employment creation and growth are even more relevant.

In the words of our President, Cyril Ramaphosa, "We will restore our country to health and to prosperity. We shall overcome."

**LINDIWE NDLELA**  
Acting Head: GTAC



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# Acknowledgements

The Capacity Building Programme for Employment Promotion (CBPEP) wishes to express its sincere appreciation to all those who made the Colloquium on Employment Growth in South Africa, and the production of this publication, possible. In particular, the CBPEP would like to thank the following people for their endless strategic guidance and support: Ms Subethri Naidoo (Government Technical Advisory Centre (GTAC)), Mr Augustin Bondo Tshiani (EU), Ms Mariam Homayoun (EU), Mr Rudi Dicks (Presidency) and Prof Haroon Borhat (University of Cape Town (UCT)).

The following distinguished thought leaders in the South African economic development space contributed the original content for this publication and checked the various versions of the report: Prof Anthony Black, Prof Haroon Borhat, Prof Kenneth Creamer, Prof Lawrence Edwards, Prof Faizel Ismail, Prof Liberty Mncube, Prof Renosi Mokate, Prof Mike Morris, Prof Fiona Tregenna, Prof Servaas van der Berg, Dr Roderick Crompton, Dr Thabi Leoka, Dr Neva Makgetla, Dr Gilad Isaacs, Dr Morné Oosthuizen, Ms Najwah Allie-Edries, Ms Ann Bernstein, Mr Ayabonga Cawe, Mr Rudi Dicks, Ms Tashmia Ismail, Ms Tamara Paremoer, Ms Kate Rivett-Carnac, Mr Stuart Theobald, Mr Derek Thomas and Mr Etienne Vlok. In addition, compelling presentations were made, but

not documented in this digest, by the President's economic advisor, Ms Trudi Makhaya; Prof Tania Ajam; Prof Michael Sachs; Dr Kate Philip; Mr Mike Brown; and Mr Wandile Sihlobo.

Financial support for the technical inputs to the colloquium, the colloquium event and the development and production of this publication was provided for by the European Union and is gratefully acknowledged. Moreover, the CBPEP is appreciative of the technical oversight and advice provided by GTAC and the members of the CBPEP's Programme Steering Committee. A special thank you for managing and coordinating the event and gathering the content for this report goes to Carla Constantinescu. Further thanks go to Annalien Coetzee (DT Global), Adelaide Mahlangu (DT Global), Paula Tena (DT Global), Sarah Marriott (Development Policy Research Unit [DPRU]) and Wadia Joseph (DPRU) for the behind-the-scenes support leading up to the colloquium.

This publication was prepared at the request of the CBPEP.

[Lushomo.net](http://Lushomo.net) was responsible for the design, layout and production of this publication.

# Introduction

*“From deep-rooted racism to the COVID-19 pandemic, from extreme inequality to ecological collapse, our world is facing dire and deeply interconnected emergencies. But as much as the present moment painfully underscores the weaknesses of our economic system, it also gives us the rare opportunity to reimagine it.”*  
*The Guardian, Letter from Economists, Sachs, Stiglitz, Mazzucato, et al<sup>1</sup>*

Patterns of economic growth, structural transformation and job creation are all intricately woven together. Between 2008 and 2017, South Africa’s gross domestic product (GDP) grew a mere 2% per annum. Manufacturing output growth, often considered the lifeblood of emerging market economies, declined from 3.1% between 1994 and 2007 to a meagre 0.5% between 2007 and 2017. Moreover, South Africa’s official unemployment rate has increased from 21% in 2008 to 27% in 2018. In the same period the economy created 5.2 million jobs, while the labour force grew by more than 7 million. Of the 5.2 million jobs generated, 4.7 million – constituting 90% of all net new jobs – emanated from the tertiary sector. The core of the growth-employment challenge in South Africa is that, while job increases stem from economic growth, both the level and structure of the current growth are insufficient to absorb all new work seekers into the labour market.

Furthermore, high levels of growth in labour-intensive sectors such as agriculture and manufacturing are notably absent, and sectoral output trends show that South Africa has become a services-dominant economy. A key consequence of this pattern of growth has resulted in no significant decline in the persistently high unemployment levels plaguing the South African economy. These persistently high levels of unemployment, adversely affecting young people between the ages of 15 and 30, are associated with escalating levels of social inequality and poverty rates, coupled with a vast majority of the country’s citizens feeling marginalised and alienated from economic opportunities.

The immediate challenge for South Africa is to place the economy onto a path of economic growth and development which structurally transforms the economy *while* generating a sufficient quantum of employment.

The Capacity Building Programme for Employment Promotion (CBPEP) is an EU-funded programme anchored in the Government Technical Advisory Centre (GTAC) at the National Treasury. The overall purpose of the CBPEP is to help build state capacity for employment promotion. There are two important implications that flow from this: firstly, capacity building is integral to the programme, cutting across all result areas; and secondly, capacity building needs to be directed towards the ultimate goal of employment promotion.

To this end, the CBPEP hosted a colloquium on employment and economic growth from 10 to 11 March 2020. This brought together leading thinkers in academia, including speakers from the Presidential Economic Advisory Council (PEAC) and the President’s economic advisor, senior decision-makers in government, as well as leading think tanks, to debate the key challenges plaguing employment promotion and growth, identifying potential innovative solutions while reflecting on cross-sectoral interventions to retain and grow employment in South Africa. The programme was led by Prof Haroon Borat from the University of Cape Town’s Development Policy Research Unit, and the discussions were anchored on several interlinked panel debates:

- Structural transformation and the challenge of economic growth in South Africa

<sup>1</sup> Sachs, J, Stiglitz, J, Mazzucato, M, Brown, C, Dutta-Gupta, I, Reich, R, Zucman, G and others (2020). “Letter from economists: to rebuild our world, we must end the carbon economy”, *The Guardian*.

<https://www.theguardian.com/commentisfree/2020/aug/04/economists-letter-carbon-economy-climate-change-rebuild>, accessed 4 August 2020.

- Macroeconomic constraints on employment and growth, focusing on the role of the state
- Microeconomic constraints on employment and growth, and possible solutions
- Opportunities and constraints in labour-intensive sectors
- The role of the state to unlock employment opportunities in sectors with high growth potential
- Infrastructure in South Africa – the opportunities and constraints for economic growth
- The state-owned enterprise (SOE) debt crisis – what is to be done?
- Social issues and the political economy
- Unemployment and active labour-market policies

*Refer to page 116 for the event agenda.*

The colloquium took place a mere 16<sup>2</sup> days prior to the COVID-19 nationwide lockdown. Preceding the COVID-19 pandemic, the South African economy was already entering treacherous waters, as GDP decreased by 1.4% in the fourth quarter of 2019. Moreover, the Moody's rating downgrade aggravated an already contracting business cycle. According to Statistics South Africa's Quarterly Labour Force Survey for the first quarter of 2020, unemployment increased to 30.1%.

The impact of the COVID-19 pandemic on the domestic and global economy has been likened to that of the 1930s Great Depression. The South African Reserve Bank predicts an economic contraction of 7.3% for 2020. World Bank and International Monetary Fund (IMF) predictions are equally dismal. "We will still have to deal with slashed household incomes due to joblessness and pay cuts, especially in working-class communities; the closure of many small businesses, while most of the survivors face deep liquidity constraints; downsizing or even liquidation for some major companies that were troubled even before the pandemic (among them, Sasol, ArcelorMittal South Africa, Edgars, Massmart, SAA); a 30% cut in municipal revenues; a prolonged depression in domestic and international travel, tourism and restaurants; tight fiscal constraints on national government; depressed global commodity prices, and highly volatile international capital flows.<sup>3</sup>" While the COVID-19 pandemic has changed the nature of sectoral growth, the systemic and structural weaknesses have been

exposed: our country faces a choking economic growth rate, stifled employment, unprecedented levels of unemployment, poverty, especially food poverty, and income inequality like never before. Thus, the issues debated at the colloquium and possible innovative solutions to job creation and growth are more relevant now than ever before in the history of our country.

This report shares the diverse perspectives that were aired at the colloquium. Each presenter was carefully selected and requested to supply a formal input, resulting in 24 papers within this report and four presentations found on the website [www.cbpep.org/colloquium2020](http://www.cbpep.org/colloquium2020). Each contribution was drafted by its author in a unique tone and format, which we have tried to respect in this edited document. As a result, this is not a unified report on how to tackle unemployment or other economic problems. Instead it is a carefully curated collection of thought-leadership pieces on some of the key transformational, growth and employment problems pressing the South African economy.

The thematic contributions contained in this report are summarised below:

- Shrinking tradable sectors – manufacturing, mining and agriculture – are suggested to be the cause of high unemployment and low growth rates. Recommendations include rethinking the education system so that basic education equips learners with skills related to starting and running a business and adopting an export-orientated strategy that increases the profitability of producing tradables for world markets.
- To achieve decent and inclusive employment growth, there is a proposal for a pro-employment macroeconomic framework.
- Low export growth hampers economic growth and employment creation in South Africa. Raising export growth is critical for economic growth and employment creation in South Africa, with recommendations exploring service export promotion while experimenting with export processing zones.
- The impact of market concentration on economic growth and economic inequality is explored, examining why market power is a major issue. The causes of market concentration – both legitimate

<sup>2</sup> The government declared a national state of disaster on 15 March 2020.

<sup>3</sup> Levin, S and Makgetla, N (2020). "There's no turning back the clock after COVID-19 – we need a reconstruction programme". The Daily Maverick.

<https://www.dailymaverick.co.za/article/2020-08-04-theres-no-turning-back-the-clock-after-covid-we-need-a-reconstruction-programme/>, accessed 4 August 2020.

and illegitimate – are discussed, coupled with their impact on slow economic growth, increasing poverty, joblessness and corruption.

- South Africa should integrate its energy policy with its industrial policy to accelerate growth, investment and employment opportunities in South Africa by building competitive new industries that rely on more localised, less monopolistic and green energy production.
- The link between competition, growth and employment is discussed, exploring the importance of competition policy in promoting employment and transformation.
- South Africa could capitalise on labour-intensive (or light) manufacturing. Special Economic Zones (SEZs) can be used to establish industry competitiveness and experiment with reform, stimulating labour-intensive light manufacturing while mobilising the unemployed.
- The relationship between increasing growth, reducing unemployment and prioritising employment-intensive sectors is a nuanced and complicated one. This is unpacked, addressing the tensions between the desire to increase both labour productivity and absorption in developing economies with high unemployment. The suggestion is that in choosing which sectors and activities to prioritise for state support, strong productivity and labour-absorbing properties need to be present.
- The South African clothing and textile manufacturing sectors are critical for economic development and job creation efforts. Over the last few decades these sectors have been negatively impacted by an increase in imports, as well as customs fraud. Several key opportunities, as well as significant constraints associated with prioritising the growth of these sectors, are explored.
- The African Continental Free Trade Area (AfCFTA) has the potential to increase growth, raise welfare and stimulate industrial development on the continent. Adopting a “developmental regionalism” approach to trade integration, through AfCFTA, can catalyse transformative industrial development, cross-border investment and democratic governance in Africa.
- Logistics, coupled with complementary investment, enable competitive connectivity that can drive diversification of the economy and employment in South Africa. Exploring specific corrective measures that need to be implemented immediately and key opportunities that can be exploited, the recommendations highlight the importance of a capable state, institutional reform

and the involvement of the private sector to plan and implement a world-class national logistics system.

- The travel and tourism sector accounts for a large number of jobs in South Africa and the sharing economy has further increased participation in the sector. This commentary explores various barriers affecting the growth of tourism in South Africa, a topical one being COVID-19, which is currently decimating global tourism. Others include negative brand perceptions of the country and access barriers such as the need for visas. Recommendations for employment creation include ways to safeguard the tourism sector during the COVID-19 crisis and labour-intensive approaches to addressing the safety and security concerns of tourists.
- All sectors of the economy rely on chemicals, which are the hidden enablers of economic development. Exploring key opportunities in renewable energy and petrochemical constraints, recommendations point to South Africa increasing its comparative advantage by moving towards a lower carbon intensity.
- Global value chains drive industrialisation activities and are themselves driven by powerful lead firms. From an industrial policy perspective, to stimulate economic growth and create employment, gaining the participation of multinational lead firms is an important part of the process.
- Infrastructure investment is a key factor for economic growth, with constraints to infrastructure development including funding, implementation capacity and political economy issues. Recommendations identify ways to improve infrastructure implementation.
- The extent of the financial losses experienced by many of South Africa's SOEs has resulted in the debt crises they find themselves in, which have been aggravated by the economic slowdown related to the drop in mineral prices, the lack of early state intervention, and unrealistic business models. Recommendations include improved governance structures, structural reforms and even privatisation.
- SOE debt, specifically that of Eskom, is explored, reviewing the potential to reduce debt by half through technical and policy considerations.
- Educational constraints impede employment growth, including the poor quality of early education and too few youths completing post-school education and training. Proposed interventions include more effective tools to measure the progress of students, improved



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access to computer-based subjects, greater accountability for principals and increased parental involvement.

- Understanding the depth, scale and multigenerational nature of the unemployment crisis in South Africa, proposed reforms need to accelerate the growth of the economy while deepening the inclusiveness of this growth and enabling labour-intensive activities to emerge.
- The Jobs Fund cofinances and tests innovative approaches to employment creation and shares successful models for organisations and government to adopt as part of their mainstream strategy. Exploring some of the current gaps in labour market interventions, this paper identifies the potential policy considerations in the job creation landscape.
- The Youth Employment Service (YES) was established to support and drive the employability of unemployed youth in South Africa via a demand-side initiative. Solutions stress the importance of coordinated policy implementation and incentives that can stimulate increased participation of businesses in the programme.
- The Presidential Youth Employment Intervention (PYEI) is designed to effectively transition young people into the labour market by coordinating and scaling up existing youth employment programmes across government, in close partnership with the private sector, in a manner that is different from existing government initiatives.

- Employment programmes have a critical role to play in the South African context and it is imperative that policymakers make better-informed policy and design choices. Exploring the Expanded Public Works Programme (EPWP) in South Africa, the paper highlights the importance of global evidence when it comes to the use and effectiveness of employment programmes and states the need for a deeper and more robust assessment of the impacts of the EPWP.
- With high unemployment numbers, deindustrialisation and inequality, activities in the informal sector remain a crucial source of income in the South African economy. Delving into the barriers to entry, the locational challenges and structural features impede the growth of the informal sector. Key opportunities to growing and promoting employment within the informal sector include developing transport and niched retail sectors.

Our hope is that this snapshot of the current discourse and thinking will serve as a reference for reflection, for a sampling of different views, and that this in turn moves the debate forward, which in turn supports better-informed policies and programmes for job creation in a new world reeling from the impact of the COVID-19 pandemic.

# The South African Economy in Review: Five Key Long-Run Growth Concerns

**Prof Haroon Borat**

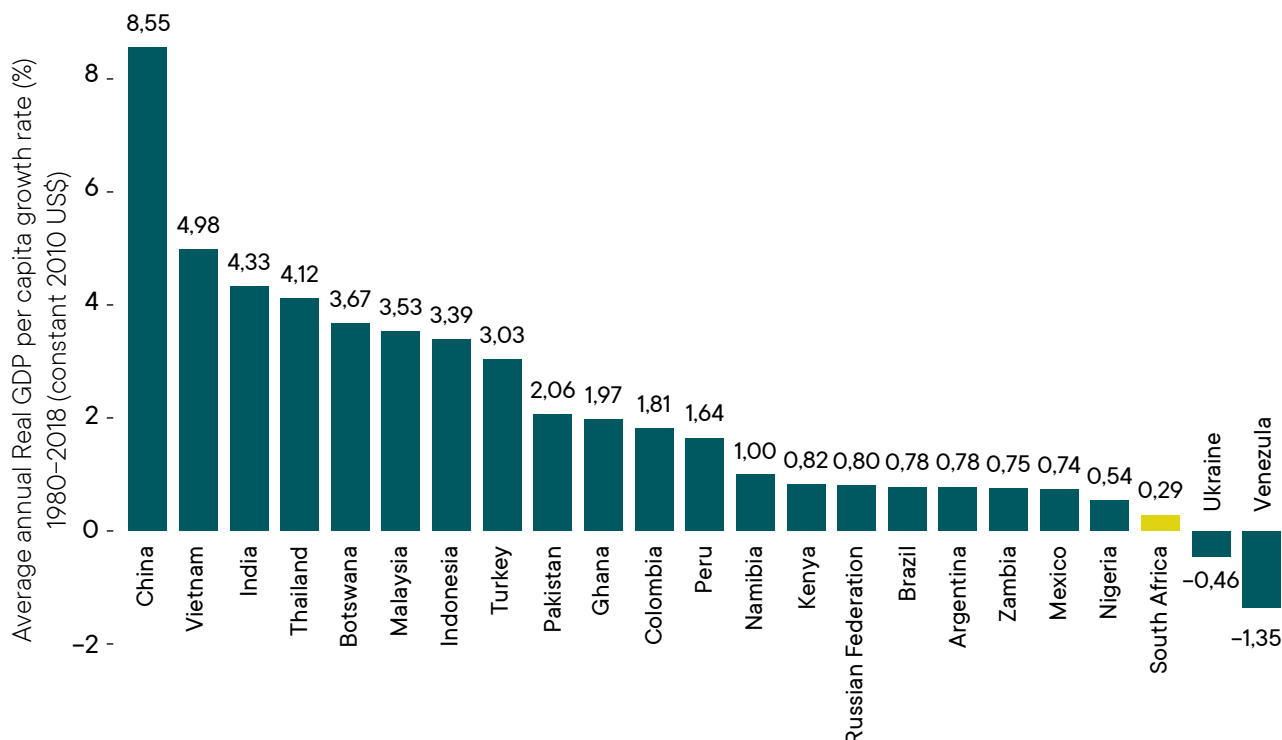
Development Policy Research Unit, School of Economics, University of Cape Town

After South Africa's triumphant transition to a democratic and more inclusive society in 1994, the country's economy initially experienced positive, albeit relatively modest, economic growth, supported by strong macroeconomic policy and effective institutions. However, in recent years the country has been faced with a multitude of interdependent, structural issues, which have constrained the economy from reaching greater levels of welfare gains. In this light, we present here a broad, introductory overview of South Africa's long-run growth challenges, anchored around five key facts about the evolution of the economy over time. In doing so, this overview seeks to describe the broad analytical and policy structure that feeds into the detailed individual sessions, which provide relatively more detail on the themes of this colloquium, namely the macroeconomic and microeconomic constraints, the role of labour-intensive sectors, social policy and the labour market, to name a few. This note does not suggest that the concerns highlighted here are the only relevant or most important ones. There are several others that are equally or more significant and, as such, there are varying degrees of nuance that cannot be included in such a summary. We first consider South Africa's rate of economic growth for the last few decades in a middle-income country context. We then discuss the country's path to de-industrialisation. Next, we examine how South Africa has transitioned into a services-based economy. We then pay attention to the persistence of unemployment, and conclude by showing how the benefits of growth have been unevenly distributed across the earnings distribution.

## **Fact 1: South Africa is stuck in a long-run middle-income growth trap**

In the post-1994 period, the South African economy has witnessed the longest period of positive uninterrupted growth in real GDP since the 1960s. However, compared with its middle-income country peers, economic growth has been pedestrian. These persistently low real GDP growth rates have lent themselves to the analytical conclusion that the country remains in a long-run middle-income economic growth trap. After a period of high economic growth, middle-income countries tend to fall into sustaining low levels of growth that characterise such a trap. Figure 1 presents the average annual real GDP per capita growth rates for a sample of countries currently categorised as middle-income for the period 1980 to 2018. For a nearly 40-year period, the South African economy has grown by an average of just 0.29% per year. Even if the period is amended to the post-1994 period, we still observe a relatively low growth rate of just 2.5% – among the lowest within a sample of middle-income countries. A growth trap is believed to be the result of a variety of constraints on growth. In addition to the persistent effects of policies of the pre-1994 period, it has been suggested that South Africa's relatively low fixed-investment and savings rates are among the main factors holding back growth. Low investment rates are usually the result of low real returns to investment. However, evidence suggests that real returns to capital in South Africa are favourable. In the post-1994 period, these returns have been comparable to China and significantly higher than the prime lending rate – yet investment as a share of GDP remains, of course, much lower for South Africa relative to China. It is possible, then, that domestic and foreign investors in South Africa may not be particularly responsive with respect to the return on capital, due to non-price factors such as perceived political risks and other microeconomic constraints to investment.

**Figure 1: Average annual real GDP per capita growth, 1980–2018**



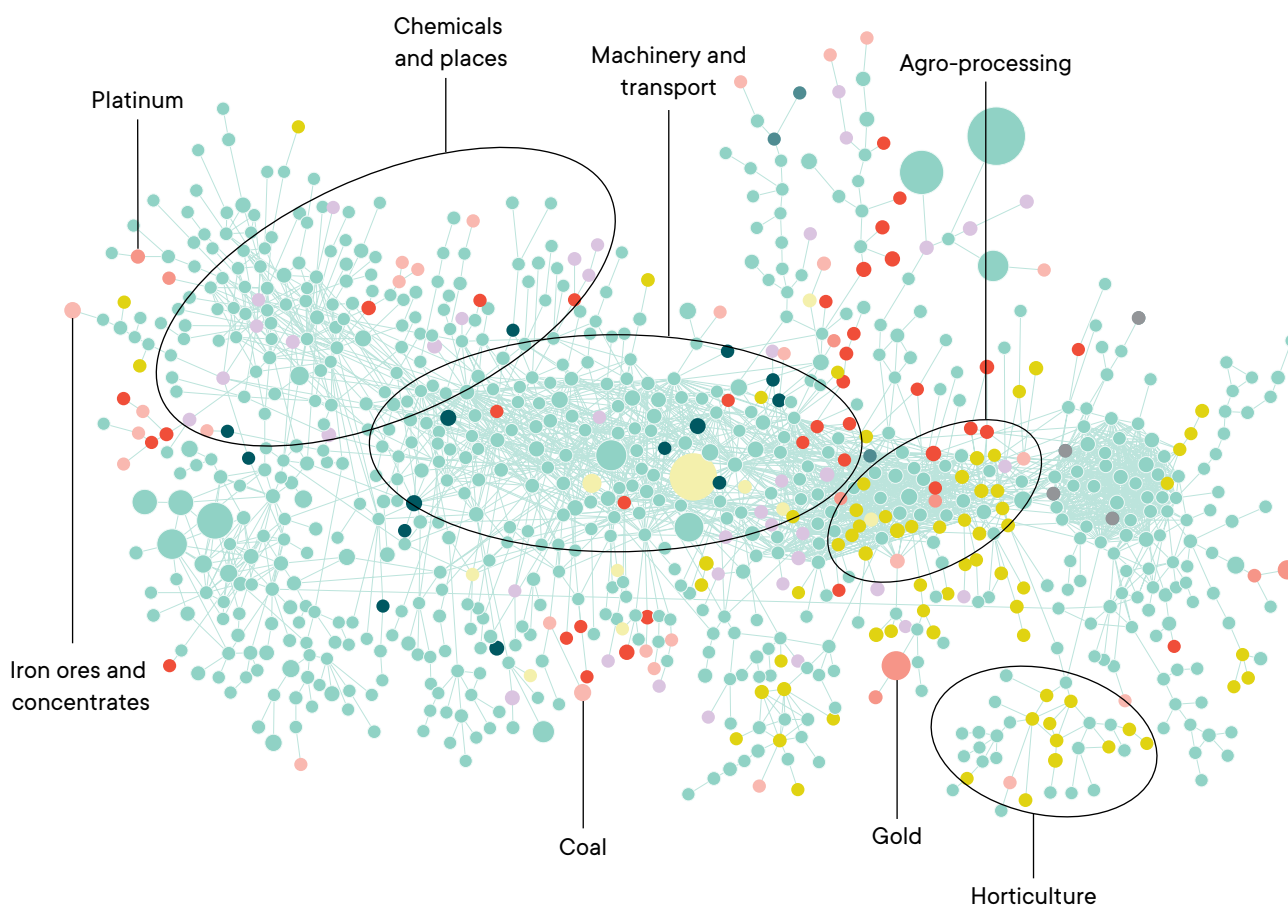
**Source:** World Bank's World Development Indicators. Own calculations.

## Fact 2: South Africa has deindustrialised

Most countries that have succeeded in developing from middle- to high-income status have done so through industrialisation, particularly through labour-intensive manufacturing. Manufacturing, a traditionally high-productivity sector, serves as the lifeblood of industrialisation and a long-run growth trajectory. However, South Africa has experienced what is referred to as premature deindustrialisation, also observed in few countries in Latin America and sub-Saharan Africa. Structurally, high levels of growth in labour-intensive industries such as agriculture and, in particular, manufacturing, have been notably absent. As a consequence, South Africa has become a services-dominant economy, which in turn has inextricably impacted on the nature and levels of labour demand in the economy and has ultimately driven a wedge between wage levels. Growth in the services sector has increased demand for the relative shortage of high-skilled labour, whereas

primary-sector employment generally geared towards lower-skilled workers has declined. This latter group accounts for the large majority of the unemployed.

However, complexity analysis of South Africa's product space – an analytical network which formalises the idea of relatedness between products traded between South Africa and the global economy, presented in Figure 2 – suggests that it is possible that the country is not necessarily experiencing premature deindustrialisation, but rather delayed or stalled industrialisation. The scope of this note prohibits an adequate interrogation of the product space here, but the figure shows that South Africa's exports in 2015 were still largely commodities-based. This was also the case in 1995. Although there is some evidence of diversification into more complex manufactured products, such as those in the chemicals and machinery industries, these product spaces suggest that the country has not undergone substantial structural transformation in the post-apartheid period, at least with respect to its export base.

**Figure 2: South Africa's product space, 2015**

**Source:** CID (2018)

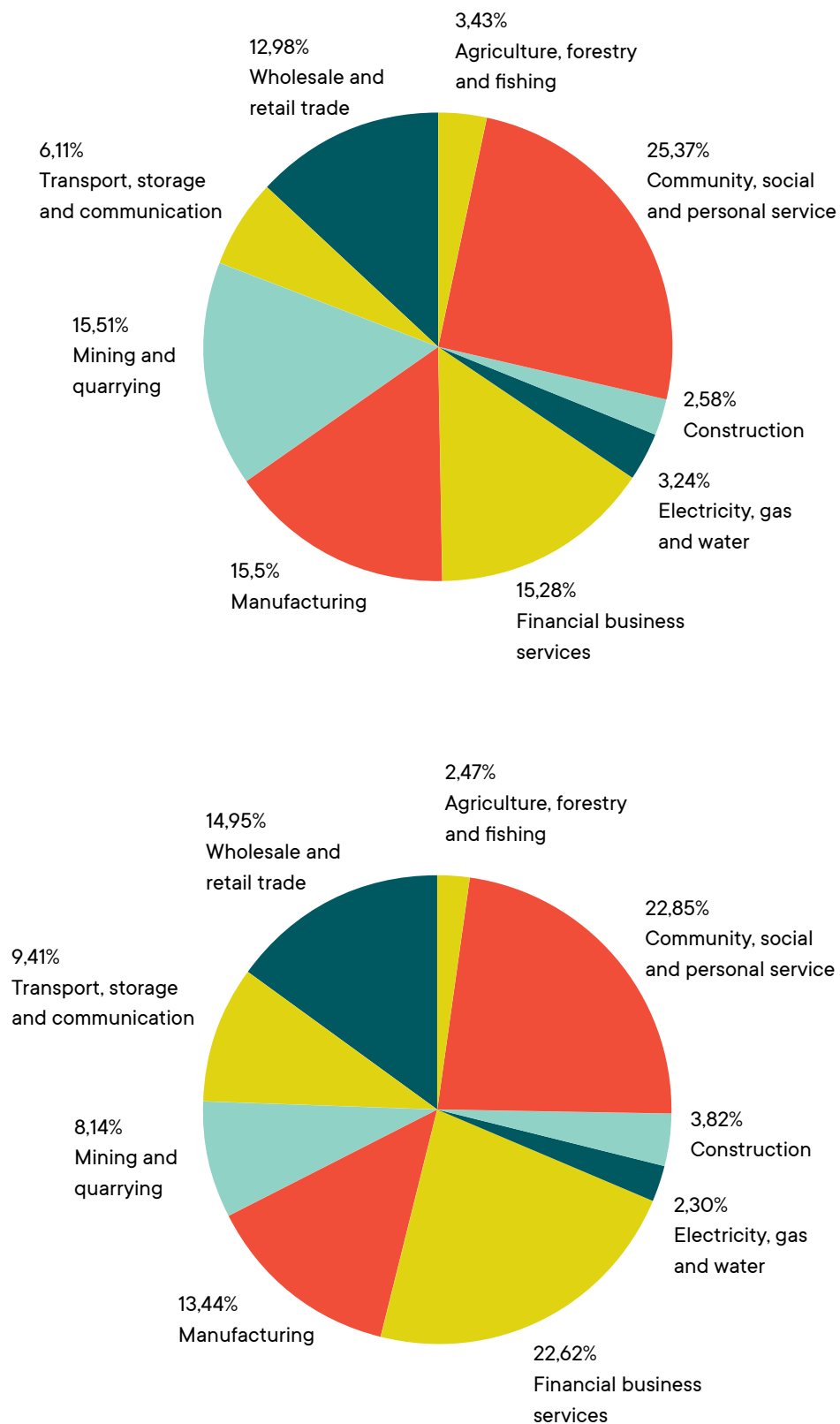
**Notes:** Product groupings or clusters are represented by the following colours: Textiles and Furniture (grey); Vegetables, Foodstuffs and Wood (yellow); Stone and Glass (peach); Minerals (pink); Metals (red); Chemicals and Plastics (light purple); Transport Vehicles (light yellow); Machinery (dark green).

### Fact 3: South Africa has become a services-based economy

As previously discussed, in the post-apartheid period growth in South Africa has been disproportionately attributable to the growth in the services or tertiary sector and, in contrast, high levels of growth in labour-intensive industries such as agriculture and manufacturing have been largely absent. As a consequence, South Africa has become a services-dominant economy. This evolution is made clear in Figure 3, which presents each main sector's contribution to GDP in 1994 compared with 2018. Relative to 1995, the Agriculture and Manufacturing

sectors' contribution to GDP has contracted, while those of services sectors such as Trade, Transport, Storage and Communication, Finance and Construction have notably increased. More than two-thirds of GDP is accounted for by services sectors. Importantly, the sectors can be disaggregated, but we emphasise that there are four key groups to keep in mind: high-productivity services (for example, Finance and Fintech), semi-skilled services (call centres), low-productivity services (or informal-sector services) and the public sector. Of course, no growth trajectory can depend on growth in the public sector. The latter necessarily begs the question of what sectoral alternatives are available for the pursuit of a higher growth trajectory in South Africa.

**Figure 3: Sectoral contribution to GDP in South Africa, 1994 and 2018**



**Source:** South African Reserve Bank (1994, 2018). Own calculations.



## Fact 4: Insufficient employment creation

The post-1994 South African economy has not experienced jobless growth. As shown in Table 1 below, nearly 2 million more jobs were created from 2009 to 2019 (alternatively, employment grew by 1.3% per year). Rather, the economy has been characterised by insufficient employment creation. Hence, although employment has grown in the last decade, the labour force has grown at a much faster rate. More specifically, the labour force grew by more than 4.2 million people in the same period (or 2.1% per year) – more than double the quantum of jobs created over the same period. In other words, the South African

economy has too many work seekers relative to the economy's ability to generate jobs and effectively absorb these individuals into the labour market. If we wanted to give every new work seeker a job, by how much would job supply need to grow? The answer is the annualised target growth rate. In this period here, it is just under 3% per year (as opposed to the observed 1.3%). Importantly, achieving the target growth rate means that the labour market would absorb all new entrants, but would not reduce existing unemployment, which would theoretically remain constant at its 2009 level. Another perspective would be to consider the employment absorption rate of just over 46%. This implies that for every 100 new work seekers, only 46 have found employment.

**Table 1: Several key labour market indicators, 2009 and 2019**

Indicator	2009	2019	Absolute change	Annualised percentage change
Employment ('000)	14 386	16 362	1 976	1.30
Narrow unemployment ('000)	4 342	6 657	2 315	4.37
Narrow labour force ('000)	18 728	23 019	4 290	2.08
Discouraged unemployed ('000)	2 338	3 574	1 236	4.34
<b>Annualised target growth rate (%)</b>			<b>2.98</b>	
<b>Employment absorption rate (%)</b>			<b>46.1</b>	

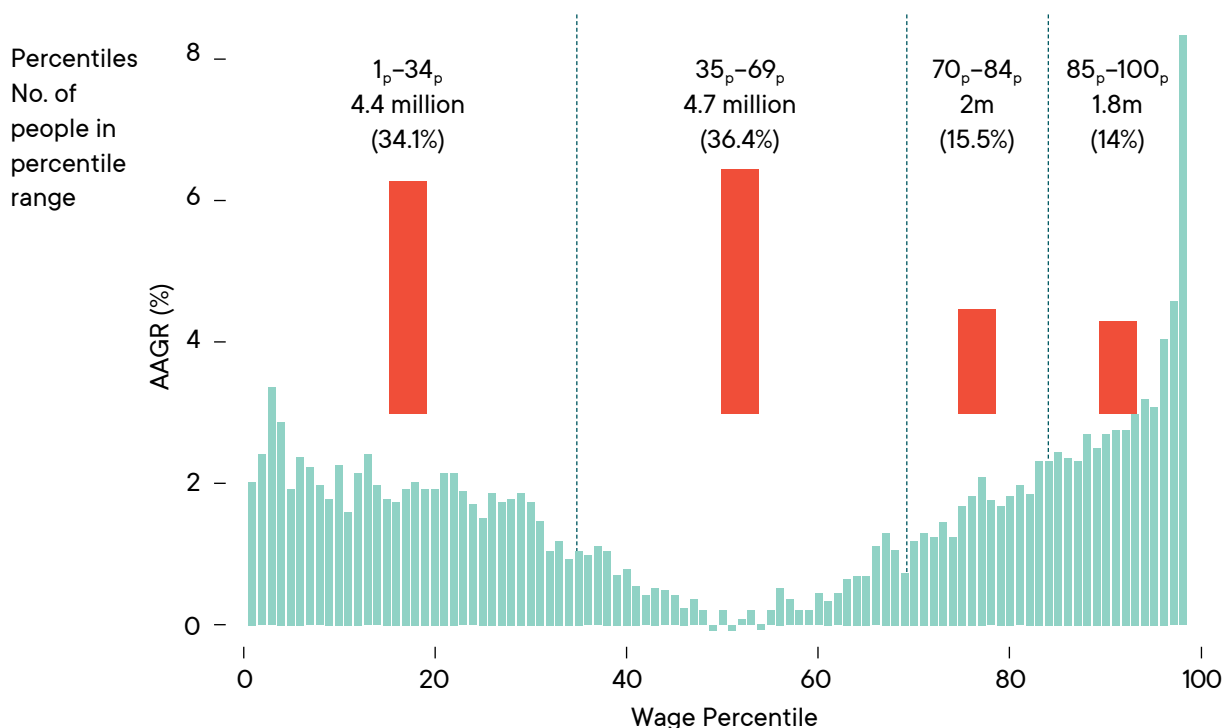
**Source:** Quarterly Labour Force Survey, Stats SA (2009, 2019). Own calculations.

## Fact 5: The rise of the missing middle

The final fact explored in this note relates to the nature of extreme inequality in the South African economy. Across a wide array of measurements for inequality in income, wages and wealth, South Africa is frequently observed as one of the most unequal countries in the world. When analysing within-country aggregate inequality estimates such as the Gini

coefficient, it is important to consider the underlying drivers of inequality. In the labour market, here we consider growth in earnings across the earnings distribution from the period 2000 to 2015, presented in Figure 4. That is, we analyse variation in earnings growth among the poorest earners and across the distribution to the richest earners. The figure highlights an important change in the way we need to think about inequality – the notion of the missing middle.

**Figure 4: Average annual growth rate of real monthly earnings in South Africa, 2000–2015**



**Source:** Post Apartheid Labour Market Series (PALMS) version 3.3. Own calculations.

**Notes:** Adjusted using sampling weights; sample consists of all employed adults of working age with non-missing wage and hours of work data.

This observed hollowing out of the middle distribution (or wage polarisation) shows that about 36% of all wage earners in South Africa (or 4.7 million workers) have experienced the lowest rates of growth in their earnings, relative to poorer and richer earners over the same period. Who are these workers? The evidence suggests that the group consists of a mixture of occupations and sectors that are not necessarily exclusive to the middle of the distribution: Domestic workers, motor vehicle drivers, manufacturing labourers and shop salespeople, to name a few. To explain such inequality in earnings

growth, we consider four broad categories of factors: skill-biased technical change (for example, differences in the return to education), changing sectoral composition, the role of labour market institutions, and how occupational task content interacts with technology. The evidence suggests that all four factors, to varying degrees, have driven this new form of inequality in the South African economy. The idea that those households and individuals in the middle of the distribution have been the most marginalised in recent years in South Africa is one of the key shifts in welfare we have witnessed since democracy.



# Panel 1 at a Glance:

## Macroeconomic Constraints on Growth and Employment – The Role of the State

### Macroeconomic Fundamentals and Global Growth

p20

**Dr Thabi Leoka**

Independent Economist

**Summary:** Shrinkage of the tradable sectors – manufacturing, mining and agriculture – is suggested to be the cause of high unemployment and low growth rates. Through a comparison of South Africa and Malaysia, this commentary explores the various structural problems that underpin this challenge and proposes several recommendations. Recommendations include rethinking the education system so that basic education equips learners with skills related to starting and running a business and adopting an export-orientated strategy that increases the profitability of producing tradables for world markets.

### A Pro-employment Macroeconomic Policy Framework in Africa

p23

**Dr Gilad Isaacs**

Co-Director of the Institute for Economic Justice

**Summary:** To achieve decent and inclusive employment growth, this commentary argues that a pro-employment macroeconomic framework is needed. Exploring what this looks like in an African and South Africa context, the writer suggests that a pro-employment macroeconomic policy framework provides a coherent lens across policy dimensions and decisions.

# Macroeconomic Fundamentals and Global Growth

**Dr Thabi Leoka**

Independent Economist

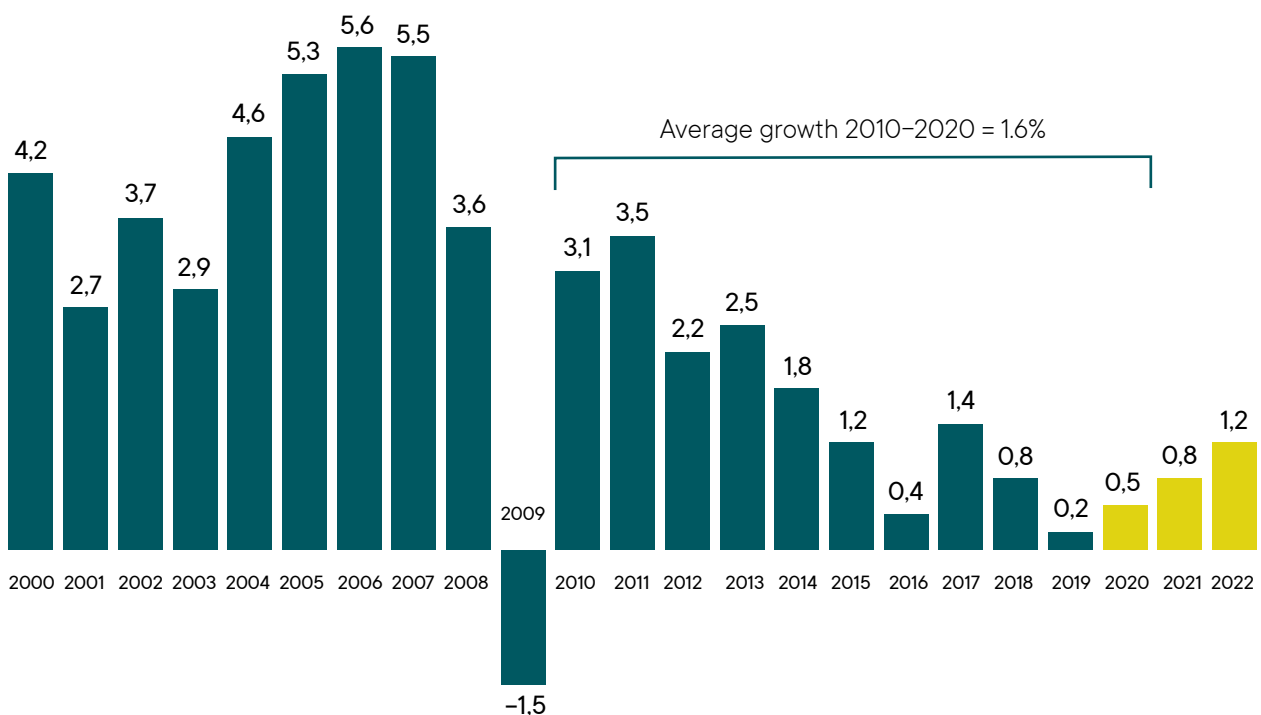
The South African (SA) economy is struggling to grow. Economic growth between 2010 and 2019 is a measly 1.6%. If projections are included, growth between 2010 and 2020 will remain below 2% (Figure 1). The National Development Plan (NDP) aims to increase employment from 13 million in 2010 to 24 million by 2030, however, gross domestic product (GDP) growth would have to average 5% in order to achieve the goals set out in the NDP. Feeble GDP growth has resulted in higher unemployment rates.

Economists track the relationship between jobs and growth using *Okun's Law*, which claims that

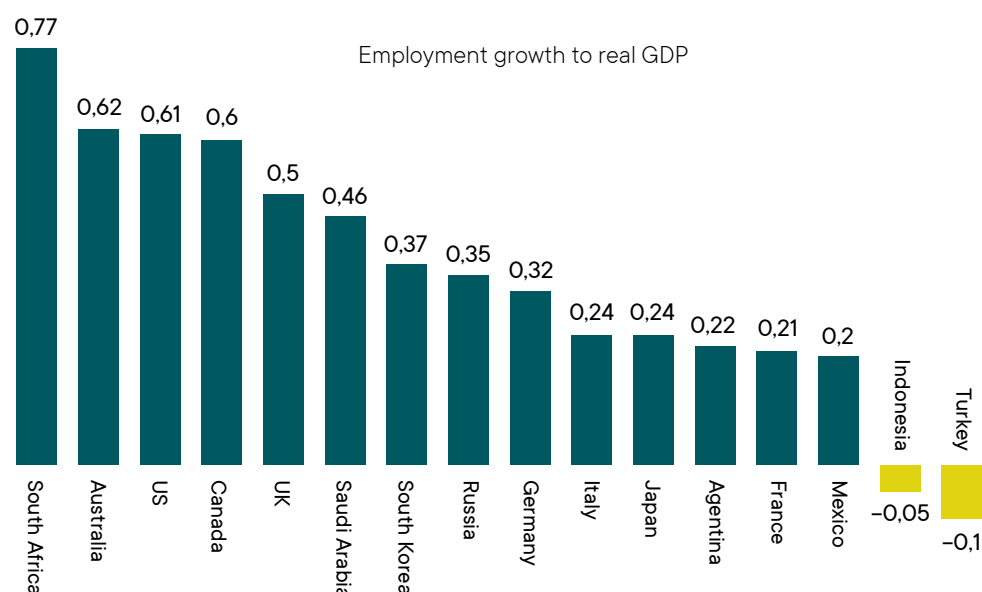
higher economic growth leads to lower rates of unemployment. Economic growth is positive for job creation, but equally important for job creation is that economic growth must increase the productive capacity of sectors that have the potential to absorb labour at a large scale.

Figure 2 illustrates a study by the IMF which looked at a group of countries to see whether growth does indeed create jobs. The study showed that in SA, Australia and Canada, a 1% increase in GDP was matched by an increase in employment of 0.6% or higher.

**Figure 1**



Source: StatsSA, Thabi Leoka

**Figure 2**

**Source:** International Monetary Fund (IMF)

## South Africa's structural problem

When we talk about the unemployment rate, the term “structural problems” is often used to explain why SA struggles to reduce its level of unemployment. SA's structural economic problems are rooted in apartheid, which systematically disadvantaged most of the population, ensuring that black people received sub-par education. Twenty-four years into a democracy, the unemployment rate has doubled. SA's unemployment rate currently stands at 27.5%, and if discouraged workers are included, the rate goes up to 37.3%. This is one of the highest rates of unemployment in the world.

I argue that the high unemployment and low growth rates are both the result of the shrinkage of the tradable sectors – manufacturing, mining and agriculture. The manufacturing sector has continued to decline both in terms of its contribution to economic growth and employment. The manufacturing sector accounted for about 20% of GDP 20 years ago, in 2001 the sector accounted for 15% of GDP, and today the sector only accounts for about 13% of GDP. The mining sector accounted for about 12% of GDP in 2001 and about 8% in 2019 – a decline of 33%. Factors contributing to this decline include increases in labour costs, higher electricity supply costs, high import costs and policy uncertainty.

SA and Malaysia shared many common features during the 1980s. Both countries have medium-sized

economies with a history of deep racial cleavages in which an ethnic majority controls the politics, but economic power lies with an ethnic minority. Output per head and TFP (total factor productivity) were virtually identical and both countries had a similar dependence on mining. In the mid-80s, SA had a larger manufacturing base – roughly 12% of its total labour force was employed in manufacturing, compared to less than 8% in Malaysia, but when SA was de-industrialising, Malaysia industrialised. Malaysia was able to pull an increasing share of its workforce into the manufacturing sector, the sector with the highest labour productivity in the economy, while in SA, the sector lost ground to the tertiary sector. The expansion of manufacturing in Malaysia promoted growth and equity – equity promoting because much of the gains from this process of structural change accrued to the workers themselves. Malaysia's trade performance improved significantly, and over time its export basket became more sophisticated, perhaps due to beneficiation.

The tertiary sector has supported GDP over the years, increasing its contribution to GDP to 20% in Q4 19, making it the largest sector in the SA economy. This structural change is the key driver of unemployment, in my view, as the tradable sectors are intensive in low skilled labour compared to the services sector. The relative shrinkage of manufacturing, together with the economy-wide skill upgrading, has entailed a collapse in demand for relatively unskilled workers. According to the Department of Higher Education, the “Not in



employment, education and training” (NEETS), who are between the ages of 16 and 64 (15 million persons), account for 40.3% of the working age population. We need to concentrate on this group of people and absorb them into the tradable sector.

The tradable sectors (manufacturing, mining and agriculture) remain the most low-skilled, intensive part of the economy by far. In 2004, more than 70% of workers employed in tradable industries were classified as “low and unskilled” workers, in comparison with 25% in the non-tradable sectors.

## Recommendations

- ▶ The sectors that are driving the SA economy are the same sectors that drive the United Kingdom (UK) economy, however, the UK has an unemployment rate of 4.1% and a highly skilled population. For too long, SA has focused on directing investment into the tertiary sector. Of the millions of SA students that start tertiary education, only 30% obtain a degree or a diploma. Many of these students will be absorbed into the non-tradable sector, which requires high skills, but is also low labour absorbing. We need to rethink the education system so that basic education enables learners to understand business, maths, accounting and other skills that are required to assist in starting and running a business. The few that do obtain a diploma or a degree are quickly absorbed into the labour market, becoming a class of their own, which ultimately contributes towards the widening inequality gap.
- ▶ We need to adopt an export-oriented strategy that increases the relative profitability of producing tradables for world markets that will generate economic growth by pulling labour into productive activities. Since tradables are relatively low-skilled in SA compared to service activities, which have been the major beneficiary of recent patterns of structural change, such a strategy will entail shared growth rather than trickle-down growth. The cures for low growth and high unemployment are largely one and the same.
- ▶ In Malaysia, the government played an important role in promoting the manufacturing sector.
- ▶ The socio-economic costs of unemployment are at least threefold. Firstly, the unemployed South Africans of today represent lost economic output. Secondly, workers who are unemployed today are not acquiring the experience and skills that will contribute to their productivity in the future. This foregone future growth will be costly. Thirdly, unemployment leads to social ills that accompany a loss of hope. These social ills include crime, disengagement and a lack of investment in one's future well-being.
- ▶ I argue that higher levels of growth and employment creation require a different pattern of structural change – an expansion of low skill-intensive manufactures at the expense of skill-intensive non-tradables. Skills, or the lack thereof, should no longer be viewed as a serious constraint on future growth.
- ▶ In reviewing the literature on policies and growth, industrial policy and investment policy have a more positive impact on job creation than trade liberalisation, labour flexibility and monetary and fiscal policy.
- ▶ A two-pronged approach is recommended with continued support to domestic aggregate demand and the adoption of policies and reforms that can boost aggregate supply. Without supportive demand policies, supply measures could have little impact in the short run. If companies do not see improved sales prospects, they will not increase capacity. This is why it is important to ensure that the demand is there to sustain supply. The range of supply measures varies from removing bottlenecks in the power sector to reforms in the labour and product markets.
- ▶ Lastly, SA requires a reform in education. Basic education requires a desperate overhaul. The South African Democratic Teacher's Union (SADTU) is mainly to blame for SA's need to import teachers from Commonwealth countries rather than training local teachers. In Switzerland, only 30% of the population has a university degree with 70% of the population going through an apprenticeship system. Switzerland is a world leader in education, innovation and equity. A brilliant basic education equips the Swiss with adequate education that allows them to work without having to attend university.
- ▶ SA universities need to introduce a basic degree at undergraduate level. This model is used in the UK and the United States. Students who want to specialise can do so in postgraduate studies. A basic degree is composed of multiple subjects, e.g. music, geography, maths, economics, history, etc. Students with a general degree are then equipped to work anywhere from banks to accounting firms, infrastructure, etc. This would then allow employers to choose from a wider range of graduates in contrast to the current model where BCom students are confined to commerce and sociology students are struggling to find work.

# A Pro-employment Macroeconomic Policy Framework in Africa

**Dr Gilad Isaacs**

Co-Director of the Institute for Economic Justice

## Introduction

This input into the CBPEP Employment and Growth Colloquium argues that in order to achieve decent and inclusive employment growth a pro-employment macroeconomic framework is needed. It explores what this looks like in the African and South African context, drawing on work undertaken for the International Labour Organization (ILO) and the African Union (AU) by the Institute for Economic Justice (IEJ).

## Context

Creating decent and inclusive employment opportunities in developing economies is commonly (mis)conceived as only being a challenge of increasing economic growth and fixed capital investment. However, despite African countries seeing relatively strong economic growth after 2002, the improvement in employment dynamics was less robust, and has worsened over the last decade. This has meant growth was unable to keep up with the expansion of the labour force, and high levels of informality and poor working conditions persisted. The type of work most prevalent involves low levels of labour productivity and a lack of structural transformation – that is, low levels of diversification and high levels of commodity dependence. This means that domestic manufacturing is weak, and the trade balance is precariously dependent on commodity exports.

The policy context is one in which macroeconomic policy has focused, almost exclusively, on achieving “macroeconomic stability”, generally understood as low inflation, low debt, moderate tax levels, liberalised markets, and stable spending. This has resulted in pro-cyclical fiscal policy and restrained monetary policy; the latter due to either fixed exchange rates in much of Africa or nominal variable targeting, in particular inflation targeting. The heavy lifting of employment creation, and ensuring decent employment, has therefore been left to sectoral and labour policies,

where those exist. This has resulted in not only an undervaluing of the potential role of macroeconomic policies, but a potential disconnect between macroeconomic and sectoral and labour policies.

## Employment objectives

We argue that macroeconomic, sectoral and labour policies should work together to achieve four employment objectives:

- **‘balanced’ employment growth** occurs through resolving macroeconomic imbalances, such as excessive imports or inflation.
- **‘sustainable’ employment growth** occurs through targeting sectors that are able to sustain employment in the long-run (structural transformation).
- **‘inclusive’ employment growth** occurs through targeting sectors that benefit marginalised groups.
- **‘decent’ employment growth** occurs through labour market regulations that simultaneously ensure human capital development and labour conditions that meet the ILO’s Decent Work Agenda.

## Our argument

Our argument is that achieving these employment growth objectives requires us to reassess our macroeconomic policy framework, to rethink both macroeconomic policies themselves, and the combination of macroeconomic, labour, and sectoral policies. In this context, a pro-employment macroeconomic policy framework requires a three-pronged, and interrelated, approach:

1. directly spur employment where possible;
2. resolve macroeconomic imbalances that retard employment; and
3. advance employment-rich structural transformation.

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These should be undertaken while supporting complementary sectoral and labour market policies. A pro-employment macroeconomic policy framework must aim to achieve both 'internal balance' ('full employment') and 'external balance' (a sustainable balance of payments). The latter is important in the African context – policies to raise employment through increasing demand should avoid making the balance of payments chronically worse. Therefore, increasing demand in the economy should go hand in hand with attempts to stimulate more domestic production – that is, increasing supply capacity – rather than sucking in more imports.

Put simply, we should use macroeconomic policy to 1) increase demand in the economy, 2) without unduly increasing imports, and 3) expand domestic supply in the economy. These measures should be mutually reinforcing and maximise the positive relationship between economic growth and employment (so-called *Okun's Law*).

## Policies to raise aggregate demand and aggregate supply

Aggregate demand increases the level of employment through changing the *level* and *composition* of expenditures. Supporting aggregate demand to increase employment sustains the expansion of markets for consumption and investment goods, thereby allowing firms to grow through achieving (static and dynamic) economies of scale. This leads to sustained productivity growth within firms and the economy (the most proximate determinant of long-term economic growth).

There is a larger policy toolkit for increasing aggregate demand than commonly portrayed. This includes expenditure-raising policies, which increase or change the composition of government spending, and expenditure-switching policies, which shift demand from imported products to domestically produced ones. Expenditure-raising policies include: levels of government spending; revenue mobilisation; composition of government spending (consumption vs. investment); spending which impacts the distribution of income; and income policies, such as tax breaks or government transfers. Expenditure-switching policies include: exchange rate management; multiple and dual exchange rates;

import and export taxes and quotas to discourage imports and encourage exports, either targeted (focusing on particular products or sectors) or general; and capital controls and interest rate mechanisms to attract or repel capital flows (thereby impacting pressures on the exchange rate).

Aggregate supply measures target employment growth through increasing the availability and quality of production and the factors used to engage in production. For example, by spending on health or education human capabilities can be raised, similarly, spending on physical infrastructure can increase productivity. This increases employment through economic expansion.

If done correctly, these demand and supply side policies positively reinforce each other. Complimentary sectoral and labour policies can also increase aggregate demand and aggregate supply in the economy.

## An illustration – government expenditure

Government expenditure is one of a number of macroeconomic policy tools that we explore through this framework, illustrating how it can be leveraged to achieve balanced, sustainable, inclusive and decent employment growth. Investment expenditure is unique in that it is able to raise demand for domestic inputs, absorb and enhance labour's productive capabilities, target expansion of supply capacity, and lay the basis for sectoral diversification. At the same time, other forms of expenditure are also important. Targeting inclusive social sectors is essential. Investment in healthcare sectors has been shown to have as good, if not better, employment multipliers than investing in construction, plus it is more inclusive. In the long-run, social sectors build human capabilities and will ensure the expansion of supply capacity. Consumption expenditure, through public sector employment, also stimulates aggregate demand, is more secure employment, often includes a high number of women workers, and through social security transfers has the potential to stimulate aggregate demand and support human capital development. Expenditure choices should also consider their distributional impact, with it now widely accepted that inequality is bad for growth and human capital development.

It is critical that such policy measures advance, not undermine, sectoral and labour policies. For example, infrastructural investment should not reinforce existing imbalances and a lack of diversification, such as investing in rail that only serves coal mining. Similarly, pay levels in the public sector should not be below national minimum wages and public sector employment should be tilted towards including more vulnerable groups. Austerity cuts to health and education will similarly retard human capital development.

## Conclusion

It is counterproductive and illogical to silo macroeconomic policy as targeting “macroeconomic stability” alone. We must view macroeconomic policy in terms of its *transformative* potential. A pro-employment macroeconomic policy framework can, therefore, spur balanced employment growth, sustainable employment growth and inclusive employment growth. Macroeconomic policies should support sectoral and labour-market policy objectives and the tools deployed. A pro-employment macroeconomic policy framework provides a coherent lens across policy dimensions and decisions.



# Panel 2 at a Glance:

## Microeconomic Constraints on Growth and Employment and Possible Solutions

### Exports, Growth and Employment in South Africa

p28

**Prof Lawrence Edwards**

School of Economics and PRISM, University of Cape Town

**Summary:** South Africa must raise exports, is the central thread of this commentary. The writer explores the key features of South African exports that are critical for economic growth and employment creation and discusses policy implications related to promoting service exports and experimenting with an export processing zone.

### Market Structure, Market Power and Competition Policy in South Africa: Growth and Employment Challenges

p33

**Prof Liberty Mncube**

School of Economics and Finance, Wits University; Managing Director, FTI Consulting; and Member of the Presidential Economic Advisory Council

**Summary:** The impact of market concentration on economic growth and economic inequality are explored in this commentary. Examining the level of market concentration in South Africa the writer explores why market power is a major issue. The causes of market concentration – both legitimate and illegitimate – are discussed, as well as the harmful consequences of illegitimate market power, which can slow economic growth, and increase poverty, joblessness and corruption.



## South Africa's Energy Policy: Opportunities and Constraints for Economic Growth and Employment

p36

**Prof Kenneth Creamer**

School of Economics and Finance, University of the Witwatersrand.

**Summary:** South Africa should integrate its energy policy with its industrial policy, to accelerate growth, investment and employment opportunities in South Africa. This commentary explores how building competitive new industries that can rely on more localised, less monopolistic, green energy production, requires overcoming backward-looking vested interests that to date have prevented progress in this regard.

## South Africa's Current Competition Policy Cases: The Search for Economic Growth

p39

**Tamara Paremoer**

Divisional Manager of Mergers and Acquisitions, Competition Commission of SA

**Summary:** The link between competition, growth and employment are discussed in this commentary. Exploring two key areas of the work of the competition authorities: merger control and the protection of employment, and curtailing the abuse of dominance by large businesses, the writer looks at the dynamic effects of competition on employment, as well as the importance of competition policy in promoting transformation.

# Exports, Growth and Employment in South Africa

**Prof Lawrence Edwards**

School of Economics and PRISM, University of Cape Town

There is no shortage of policy recommendations to enhance export performance in South Africa. The Integrated National Export Strategy (2015), the National Development Plan (NDP) Vision 2030 (2017), and the Department of Trade and Industry's Industrial Policy Action Plans all see raising exports and diversifying the export bundle as central policy objectives. Under the NDP, the objective is to increase export volumes by 6% per annum by 2030, with non-traditional exports growing by 10% a year (NDP, 2017:54). The New Growth Plan maintains that "increased exports to the Southern African Development Community (SADC) alone can generate almost 60 000 additional direct jobs by 2015 and 150 000 by 2020".<sup>1</sup>

In this piece, I would like to frame the narrative around the key features of South African exports which are related to growth and employment creation.

## The imperative of raising exports

If South Africa (SA) is to sustain economic growth at a higher level, it has no choice but to raise exports. This is firstly required as export revenue will be necessary in order to offset the rising import bill that will be associated with higher rates of investment, production and consumption. SA has a long history of its growth process being choked off by a lack of foreign exchange. Econometric estimates predict that to sustain an annual economic growth rate of 6%, export growth will need to increase to 8% per annum.<sup>2</sup> This requires a considerable boost to the current growth rate in exports of goods and services that averaged less than 2% per annum from 2011.

Exports need to do more than just support economic growth, they need to *lead* economic growth. The domestic economy is too small in terms of its absorptive capacity – consumption, governments, investment and import expenditure – to drive sustained levels of economic growth. Regional and global growth in demand for goods and services has exceeded economic growth in SA for several years. The region is particularly attractive in that the composition of SA's exports are more oriented to manufacturers in contrast to the rest of the world. By tapping into faster growing foreign markets, exports help overcome the domestic demand constraints to growth. Worryingly, growth in global trade has plateaued, but SA's low share of world trade still implies considerable scope to expand into export markets to drive higher economic growth.

A third reason is that improved growth in exports, particularly of manufactured goods, is needed to drive structural transformation. Manufacturing is declining as a share of gross domestic product (GDP), raising concerns that the economy is prematurely de-industrialising. One explanation for premature de-industrialisation is the failure of the economy to grow a competitive manufacturing industry that competes in export markets on a global level. If South Africa is to grow its industrial base, it will need to do so through expanding exports of manufactured goods.

The shift towards exporting will yield further benefits in terms of raising aggregate productivity. The firm level evidence for SA illustrates that exporters of manufactured goods are up to 50% more productive (value added per worker) than non-exporters. Exporters are also larger in terms of employment (over 70% larger) and pay 27% higher wages (Matthee et al., 2016). Some of this association reflects the selection

<sup>1</sup> Presentation prepared for Portfolio Committee on Trade and Industry's Trade and Investment Policy Workshop, Cape Town 22 July 2015. Accessed 6 March 2020 from <https://www.thedti.gov.za/parliament/2015/INES.pdf>.

<sup>2</sup> This is based on econometric estimates of export and import functions for South Africa. The income elasticity of demand for imports averages around 1.5 reflecting an elastic import response to growth. The elasticity will be higher if growth is investment driven, given the high import content of investment expenditure.

of efficient firms into exporting, but the evidence for SA is that some of this productivity premium arises from learning from exporting and investments in new productivity-enhancing technologies. Growth in exports will thus boost aggregate productivity by raising productivity within the firm, as well as shifting the composition of aggregate production towards these relatively productive firms.

Despite the imperative for raising exports, SA's export performance has been poor over the past decade. Real exports of goods and services as a share of GDP have not yet recovered to pre-financial crisis levels (29% in 2017/18 vs. 0.33 in 2006/07). Exports of mining products have been particularly weak. For example, real mining output, the bulk of which is exported, is lower in 2018 than it was in 1994. Part of this can be attributed to the collapse in commodity prices after 2008, but even during the commodity boom between 2000 and 2007, mining output grew more slowly than the rest of the economy. While mining may not generate much employment directly, it is a major source of foreign currency required to sustain growth, savings, investment and government tax revenues.

Firm and product level export data corroborate the picture of mediocre export performance. Exports are concentrated amongst super-exporters to a degree that exceeds that of comparator countries (Purfield et al., 2014). For example, the top 5% of SA's exporting firms account for more than 90% of its exports. The transition of domestic firms into exporting is low (Edwards et al., 2018) and those that export have been losing dynamism and competitiveness with relatively slow export growth and mediocre expansion into new products and markets (Purfield et al., 2014). While there are many exceptions to the above narrative, the aggregate story is one where exports are not contributing enough to economic growth in SA.

## To export and grow, we need to change how we think about imports

The focus of policy and research is often on export performance, but participation in global value chains (GVC), the vehicle through which manufacturing trade predominantly takes place, entails both exporting and importing. Manufacturing requires access to a broad set of intermediate inputs. What the data reveals for SA is that foreign markets are a key source of these

inputs. This is shown in the Trade in Value Added (TiVA) data that decomposes sources of value added in production, consumption and exports. Foreign value added in SA exports rose from approximately 18% in 1995 to 30% by 2015 as exporters integrated through backward linkages into the global trading environment.<sup>3</sup> At the firm-level, over 50% of direct exporters in manufacturing in SA also directly import intermediate inputs. If indirect imports are included, the share rises further.

Importing is also shown to have a direct effect on firm performance. SA manufacturing exporters that import, have higher export values and export more products to a wider range of countries. Further, the higher the number of varieties of inputs imported, the greater the diversity of exports in terms of number of products and destinations. These two-way traders (importer-exporters) consistently demonstrate premiums in terms of output, employment, wages and productivity compared to firms that do not trade, or only export or import. One explanation is that imports enable SA manufacturing firms to upgrade their technical capabilities through the use of higher quality inputs that embody new technologies and access to a wider range of complementary inputs. For example, a 10% increase in the number of varieties imported by a firm in manufacturing in SA is associated with a 0.3% increase in its productivity (Edwards et al., 2016). The use of imports in production, therefore, reinforces the productivity gains that have been shown to accrue to SA manufacturing firms through exporting.

The implication is that barriers that raise the cost of accessing imports, such as tariffs, transport barriers, non-tariff barriers, etc., hamper export performance and productivity growth (Edwards and Lawrence, 2008). Further, boosting the integration of SA manufacturing firms into foreign markets and GVCs presents an opportunity for the country to raise exports and aggregate productivity.

## Can exports create jobs?

Given the unemployment problem in SA, a key consideration is whether exports can be a major driver of employment. Several characteristics of SA exporters suggest that their direct capacity to significantly reduce unemployment is limited. Mining tends to be relatively capital intensive, and as mechanisation takes hold, employment opportunities through export of minerals may diminish further. Manufacturing has

<sup>3</sup> Based on United Nations Industrial Development Organization (UNIDO) data for 1995 and OECD Trade in Value Added (TiVA) data for 2015.

the potential to raise employment growth through expansion of output, but unless we see a dramatic change in the product composition of exporters, the direct jobs that will be created will not absorb individuals who are currently unemployed. The South African Revenue Service (SARS)'s tax and trade data on firms shows that manufacturing exporters tend to be capital and skill-intensive. These firms, by and large, do not employ low-skill individuals who are currently unable to find employment opportunities.

There are four key considerations in this regard:

Firstly, policy makers and academics tend to discount the importance of services in exports. The Department of Trade and Industry (dti) has a comprehensive set of policies to further industrialise the economy. This includes several trade agreements covering trade in goods (e.g. free trade areas covering goods trade with the SADC and the European Union). A comprehensive services trade agreement is lacking. Yet, the opportunities for service exports to boost employment growth are substantial. For example, the retail industry serves as one of the primary channels through which SA products enter the region. Outward investment by banks and telecommunication companies has established a SA firm presence across Southern Africa. These firms have had to do so without formal service agreements.

Services exports also include tourism, a sector with enormous potential to expand. Tourism expenditure comprises a high share of domestic value added, implying that its growth has strong direct and indirect effects on the rest of the economy, including employment. Other opportunities include business process outsourcing (BPO), which has been effective in creating jobs.

Manufacturing exports are also highly dependent on service inputs. According to the TiVA data, the value added from the services sector accounts for 28% of the gross value of manufacturing exports in SA.<sup>4</sup> The implications are twofold: firstly, growth in manufacturing exports has a strong positive spillover

effect (indirect effect) on demand for services and through this employment in that sector. Secondly, a competitive services sector enhances the competitiveness of manufacturing exports.

The second consideration is the implicit 'tax' on labour arising from costly and inefficient services related to border processes, transport/freight, communication, as well as electricity. In a global market, competitiveness is driven by the cost of non-traded inputs in production. Because exporters cannot pass higher input costs onto foreign consumers, their only option is to reduce labour costs or restrict exports, and thus employment. This is a particularly pertinent issue in SA, given the extensive control that state-owned enterprises have over many of the key services inputs (border procedures, ports, rail, telecommunication, electricity) used intensively by exporters.<sup>5</sup> Exporters are doubly 'taxed' by inefficiencies in the provision of these services – when they import intermediate inputs and then again when they export their products.

The third consideration is whether it is possible to develop a low-wage labour-intensive export sector. Critically, this boils down to labour costs relative to productivity (assuming efficient and cost-effective trade costs and trade facilitation). The Centre for Development and Enterprise (CDE), for example, has touted the idea of turning the Coega Port facility, combined with an extension of the existing employment tax incentives, into an export processing zone.<sup>6</sup> They argue that this package will make SA labour costs as competitive as those in Cambodia. What matters are unit labour costs, so productivity levels will also have to be compared to assess the net labour cost competitiveness of the proposal. Nevertheless, making use of Export Processing Zones (EPZs) to reduce trade costs through targeted provision of transport infrastructure and services, and labour costs through subsidies is an idea that requires further exploration. EPZs also allow the government to experiment at the margin and overcome constraints to firm operations, which are difficult to resolve quickly at the national level.

<sup>4</sup> Services make up 30% of final demand.

<sup>5</sup> Border procedures (waiting times) and port costs are expensive relative to many competing countries. See the 2018/19 Global Pricing Comparator Study by the Ports Regulator of South Africa. While the relatively high costs have fallen, users in container ports face a Port Authority Pricing premium (including cargo dues) of 198% (terminal handling charges are 211% higher). Further, bulk commodities are charged total port costs that are much lower than the global sample averages, resulting in a relative disincentive to import or export manufactures, e.g. the discount for coal is 56% and for iron ore is 37% relative to the global average (includes cargo dues, terminal handling costs, port authority costs).

<sup>6</sup> See the 2016 Op Ed by Ann Burnstein "Export processing zone could be big boost for bay economy", <https://www.cde.org.za/export-processing-zone-could-be-big-boost-for-bay-economy/>.

Finally, export growth can have large positive indirect effects on employment through demand for services and intermediate inputs. Income from exports feeds into domestic consumption, which then further indirectly stimulates employment growth. Therefore, while the direct impact of growth in exports on employment may be limited, the indirect effects can be substantial.

## Policy implications

Many policies to enhance export performance are already covered in government policy documents. Several policy recommendations follow from the above discussion. This includes promoting service exports and experimenting with an export processing zone. In relation to this, I will discuss three main policy implications:

1. Industrial policy to facilitate export participation needs to look beyond the industry of the firm and consider common constraints and needs of exporters. The firm-level data reveals enormous heterogeneity in exporters and characteristics that do not coincide with their industry status.<sup>7</sup> Export participation by firms is found in all manufacturing industries in SA. They face common challenges in competing and getting their products to the international market. Further, the rising importance of GVC participation in driving exports requires co-ordination across all industries, including the service industry. A narrow sector-driven industrial policy faces the danger of missing these cross-industry commonalities, thus reducing their effectiveness in building a competitive export base.<sup>8</sup>
2. To enhance export growth, it is critical to reduce the cost of trading. Exporters face a double penalty with high transport and trade costs – both with regards to imports and exports. For example, high trade costs associated with poor transport infrastructure and cumbersome import and export procedures are detrimental to GVC participation by manufacturing firms, *irrespective* of their industry classification. Alleviating these constraints to participation can be expected to generate more entry of firms into exporting from all industries, having stronger effects for the medium sized firms. As noted above, state-owned enterprises are in several cases a major source of these high costs.
3. The African Continental Free Trade Area (AfCFTA) presents an enormous opportunity to expand manufacturing exports into the region. Demand for goods by consumers in the region are expected to grow rapidly as income rises and the population grows. With its established trading network in the region, SA firms stand to benefit from this growth. Further, the regional demand for SA goods is strongly oriented towards manufacturers. For example, 66% of SA's exports to the SADC region are made up of manufactured goods in contrast to 38% to the rest of the world. Critical, however, is that SA also opens up its market to imports from the region through, for example, more lenient rules of origin. The current trade imbalance threatens the conclusion of the trade agreement as regional countries fear competition from SA firms, while not seeing increased opportunities to access the SA market.

<sup>7</sup> E.g. the firm-level data shows that major determinants of export participation are firm size and productivity, which are not necessarily related to the firm's industry status.

<sup>8</sup> There are additional dangers of a strict sector-driven industrial policy. Given concentration in industries, industrial policy and the associated incentives are more easily captured by industry lobby groups. The large incentives provided to the vehicle industry have been effective in growing exports, but potentially at the cost of developing a larger more diverse manufacturing export base. Industrial policy targeting industries are further narrowed and reinforced by other policies that coalesce around the industry focus. This includes the Sector Education and Training Authorities (SETAs) that provide training. The skills required for most occupations are not industry-specific, implying that the sector focused training programmes are inefficient vehicles to overcome skill-deficits constraining economic growth. The sector based bargaining councils with sectoral wage determinations implicitly assume that the industry designation is the dominant commonality across all firms in that industry. Further, the dominance of large firms and unions in the bargaining process can result in outcomes that reflect the narrow interests and characteristics of the large concentrated firms to the exclusion of the smaller labour-intensive firms, which may be more similar to firms in other industries than the large productive firms in their own industry.

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# Market Structure, Market Power and Competition Policy in South Africa: Growth and Employment Challenges

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## Overview

South Africa (SA) has a market power and concentration problem. This is so, despite the strong competition regulation institutions. The evidence for the extent of the high levels of market concentration is detailed in my paper written with Thembaethu Buthelezi and Thando Mtani titled “The Extent of Market Concentration in South Africa’s Product Markets”.<sup>9</sup>

Reducing market concentration towards increasing consumer welfare and promoting an inclusive economy is the Competition Act’s most appealing and enduring mirage.<sup>10</sup> The Competition Commission has mounted memorable investigations to uncover cartels, prohibit competition lessening mergers, and to address the abuse of dominance, yet the goal of restructuring the economic order by regulating private enterprise in the public interest has eluded its pursuers. Even the shine of the Commission’s greatest triumphs related to the uncovering of cartels<sup>11</sup> – for example, uncovering and successfully prosecuting cartels in products such as bread, flour, maize meal, flat and long steel, wire products, cement, plastic pipes, bricks, concrete products, and construction – dim in the face of criticisms that product markets remain highly concentrated. This is not to say that competition authorities have not discouraged a great number of anticompetitive practices by firms. They have. Yet, we

continue to observe the indicia of robust, competitive processes, such as high industrial output, innovation, productive efficiencies, employment, and investment, which are all pointing in the wrong direction.

The root of competition harm is illegitimate market power.<sup>12</sup> Market power can be exercised by a firm as a seller (monopoly) or as a buyer (monopsony). Illegitimate market power harms appear in specific markets, while some others are experienced throughout the economy and include slower overall economic growth and increased economic inequality. The consequences for the future, in terms of creating a growing and inclusive economy in SA, are troubling but before detailing these consequences, it is necessary to first understand the extent of market concentration and why market power is a major issue.

## Market structure

For much of its history, SA’s product markets and capital ownership have been abnormally concentrated. Simon Roberts (2004) correctly points out that in the past, four conglomerates controlled the majority of economic activity in the South African economy, namely Anglo-American Corporation, Sanlam, Liberty Life and Rembrandt/Remgro. High market concentration has been a characteristic not only of scale-dependent products, but also

<sup>9</sup> The extent of market concentration in South Africa’s product markets, *Journal of Antitrust Enforcement*, (2019) 7 (3), 2019:352–364 (with Buthelezi, T. and Mtani, T.)

<sup>10</sup> South Africa’s constitutional transformation gave high priority to the redressing of the racialised economic order of the past. In this setting, a stronger competition regulation system was proposed as a tool to help in that process. The democratic government deliberately made competition regulation its preferred means of regulating private enterprise in the public interest. One objective of competition regulation is to reduce market concentration towards lowering prices and, more generally, promote rivalry and competition.

<sup>11</sup> See L. Mncube and S. Grimbeek, ‘A History of Collusion: The Persistence of Cartels in South Africa’ in Frederic Jenny and Yannis Katsoulacos (eds), *Competition Law Enforcement in the BRICS and in Developing Countries*, International Law and Economics (Springer International Publishing 2016); L. Mncube, ‘The South African Wheat Flour Cartel: Overcharges at the Mill’ (2014) 14(4) *Journal of Industry Competition and Trade* 487.

<sup>12</sup> Competition policy is concerned with power of market participants to distort competition in a way that is detrimental to society.



of consumer products. Some of the high market concentration may be a result of the legacy of historic privileges, and some of it may be due to scale factors.

Market concentration reflects the number and size distribution of firms in a market, in other words, it measures the structure of a market. Our paper on the extent of market concentration finds high levels of static market concentration. Indeed, when considering the static measure of concentration across the Commission's defined priority sectors, we observe that all priority sectors (which include: information and communication technology (ICT), energy, financial services, food and agro-processing, infrastructure and construction, intermediate industrial products, transport, and the pharmaceutical sector) record Herfindahl-Hirschman Indexes (HHIs) above 2500.<sup>13</sup> The sector with defined markets that have the highest level of concentration is the ICT sector (at 3539), while the financial services sector is found to have the relatively lowest level of concentration (2788).<sup>14</sup>

The finding that the majority of SA sectors are concentrated, accords with various studies that have been conducted on the concentration levels of SA industries. For example, the World Bank points out that SA manufacturing and export markets appear to have high market concentration – just a few firms account for the bulk of the market, including non-mineral exports where the top 5% of firms account for 93% of total non-mineral exports.<sup>15</sup>

## Market power

The next relevant question is whether the high level of static market concentration and corresponding market power is a result of legitimate or illegitimate

means. One possible (and apt) explanation for the observed high levels of market concentration and corresponding market power is that there is still insufficient deterrence of: (1) anticompetitive collusive conduct, (2) anticompetitive exclusion and exploitation, and (3) mergers, which lessen competition. Illegitimate market power is durable. Firms erect barriers to exclude rivals.

Another possible explanation for the persistence of market concentration is that past privileges, such as previous state support, created large firms with extensive market power. The benefits of these past privileges are likely to be perpetuated by economies of scale, which may act to further reduce the competitive constraints found in a defined market. A firm that attains its dominant position through special regulations or state support is likely to be preoccupied with preserving its position rather than pursuing investment and innovation.<sup>16</sup> One more possible explanation is that those firms that built market power through perhaps state support, have capitalised on this privilege by engaging in extensive lobbying and rent-seeking for regulatory protection.<sup>17</sup> Each of the above explanations can be critiqued, but together they make a compelling case.

For a few markets, a possible explanation is that firms may have engaged in pro-competitive and efficiency enhancing behaviour to expand their market share. This would imply that some firms have obtained their market power through innovation and offering consumers greater value than their rivals. However, only few firms would meet this explanation in SA, given the extent of illegitimate market power.<sup>18</sup>

The causes underlying the persistently high levels of market concentration and corresponding market

<sup>13</sup> The Herfindahl-Hirschman Index (HHI) is the most commonly accepted measure of market concentration. The HHI takes the value of 10,000 in the monopoly case and declines as the level of concentration decreases. Markets with HHIs above 2500 are classified as highly concentrated.

<sup>14</sup> The extent of market concentration in South Africa's product markets, *Journal of Antitrust Enforcement*, (2019) 7 (3), 2019: 352–364 (with Buthelezi, T. and Mtani, T.)

<sup>15</sup> The World Bank (2014) makes the observation that the concentrated firm export structure is persistent. Over the period 2002–12, concentration increased slightly, with the share of the top 5% of exporters growing from 90% (85% for non-minerals) to 92% (87% for non-minerals). See World Bank, *South Africa Economic Update: Focus on Export Competitiveness* (2014), *South Africa Economic Update No 5* and World Bank, *South Africa Economic Update: Promoting Faster Growth and Poverty Alleviation Through Competition* (2016) *South Africa Economic Update No. 8*.

<sup>16</sup> Roberts, S. 2004. Competition Policy, competitive rivalry, and a developmental state in South Africa. In: Edigheji, O. (ed.) *Constructing a democratic developmental state in South Africa potentials and challenges*. World Rights.

<sup>17</sup> Licensing requirements in some markets are but one example of a type of regulatory requirements that may favour incumbents at the expense of new competitors.

<sup>18</sup> For example, the World Bank (2014) points out that the concentration of South Africa's exports, along with the lack of extensive innovation, is consistent with the country's higher concentration of export market share than that of its peers, and the higher price-cost margins associated with it.

power are not clear. The reason for this is that potential candidate explanations may include some, if not all, of the following: past privileges, the behaviour of incumbent firms' crowding out existing or potential competitors either deliberately or through innovation, efficiencies associated with scale, increases in merger and acquisition activity, the rise of dominant information technology firms, and regulatory barriers to entry such as licensing.

## Harms from illegitimate market power

When considering competition harms, the most common approach is to use a partial equilibrium framework. This involves observing at competitive harms within the markets potentially affected by the exercise of market power. From that perspective, the exercise of illegitimate market power is harmful in several ways, among them: (1) wealth transfer and allocative efficiency loss, (2) wasteful rent-seeking, and (3) slowed productivity improvements and innovation in affected markets.<sup>19</sup>

## Economy-wide harms from illegitimate market power

Beyond specific markets, the exercise of illegitimate market power is harmful to the South African economy as a whole. The exercise of illegitimate market power may result in slowed economic growth and increasing economic inequality, among others.

### Slowed economic growth

Aghion and others show that mark-ups on prices, which are used as a measure of competition, are higher in South African manufacturing industries than they are in corresponding industries worldwide. They also argue that competition policy (i.e. a reduction of mark-ups) should have largely positive effects on total factor productivity growth in SA. In particular, a 10% reduction in the mark-ups would increase productivity growth by 2–2.5% per annum. Higher past mark-ups are associated with lower current productivity growth.<sup>20</sup>

### Increased inequality and poverty

Illegitimate market power is often associated with creating barriers to entry, keeping outsiders out

of markets and is a major source of inequality. The monopolist's monopoly profits come at the expense of consumers and workers: as monopolies raise their prices, their profits increase while the well-being of consumers and workers decreases. A study conducted by the World Bank (2016) suggests that competition policy in SA brought substantial benefits to households, especially the poor. By tackling the four cartels in wheat, maize, poultry and pharmaceuticals (goods that amount to just over 15% of the consumption basket of the poor in SA), the reduction in the overcharge in prices to consumers is estimated to have reduced overall poverty by at least 0.40% points. Some 202 000 individuals were made better off and lifted above the poverty line through lower prices that followed the action taken against these four cartels. The savings put an additional 1.6% back into the pockets of the poorest 10% of the income spectrum by raising their disposable income.<sup>21</sup>

Therefore, competition enforcement redistributes wealth without incurring the traditional shadow costs arising from taxation and is an actively beneficial form of redistribution for the economy. Competition enforcement redistributes income and wealth, as well as increases efficiency. For this reason, it should be the first choice of policymakers concerned with equity.

### Increased joblessness

More competitive economies are more dynamic, creating more jobs but of course there can also be short-term job losses as inefficient businesses close.

### Increased corruption

Cartels allow firms to exercise market power they would not have otherwise. An agreement between competitors to fix prices, allocate markets or rig bids is not only anti-competitive, it is also corrupt. It is corrupt because it is a conspiracy against the public. Further, when firms can secure long-lasting economic and political power through their size and lobbying influence, their economic and political power can reinforce each other in a vicious cycle. Market power may give firms the resources to create and exploit political power, which they may use to protect or extend their economic advantages – and then invest some of the resulting rents to extend their political power.<sup>22</sup>

<sup>19</sup> See Market power in the U.S. economy today. Jonathan B. Baker March 2017.

<sup>20</sup> See Johannes Fedderke, Chandana Kularatne and Martine Mariotti, 'Mark-up Pricing in South African Industry' (2007) 16(1) Journal of African Economies 28; Philippe Aghion, Matias Braun and Johannes Fedderke, 'Competition and Productivity Growth in South Africa' (2008) 16(4) Economics of Transition 741.

<sup>21</sup> The World Bank, South Africa Economic Update: Promoting Faster Growth and Poverty Alleviation through Competition (2016) South Africa Economic Update No. 8.

<sup>22</sup> See Market power in the U.S. economy today. Jonathan B. Baker March 2017.

# South Africa's Energy Policy: Opportunities and Constraints for Economic Growth and Employment

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## South Africa's electricity supply challenge

As recent events have illustrated, South Africa (SA) is now being confronted with the reality of a prolonged, possibly multi-year, period of intermittent load shedding. SA's inability to ensure a reliable and sustainable electricity supply to the economy has without a doubt been an important contributor to the countries' low economic growth and inability to create jobs and economic opportunities for its citizens.

Local air pollution, and the severe health impacts as a result of this, are of increasing concern to citizens. SA is a disproportionate contributor to climate change and its power generation is largely coal-based. While not yet widely appreciated in SA, this situation poses a rapidly growing risk for the economy. By 2030, global coal use in electricity generation will have to be reduced by 80% below 2010 levels in order to avoid the worst economic impacts of climate change. The world economic system is responding to this unprecedented crisis. The momentum of financial markets and their regulators to restrict the financing of coal-based economic activity is rapidly escalating. This will add to Eskom's financial woes (and those of Sasol and other SA energy intensive industries) and poses severe risk to the entire economy and financial system.

The structure of SA's electricity sector is from a bygone era when the pursuit of ever-larger economies of scale in coal-fired power generation required the establishment of a large monopoly (Eskom) in an attempt to reduce the cost of funding its ever-growing power station mega-projects.

The global power sector is now undergoing a fundamental technological disruption with renewable energy, storage, and information technology

combining to displace the centralised power generation model with smaller, cleaner and cheaper technologies.

Despite Eskom's best efforts and repeated commitments to improve the situation, the perilous state of its old and new plants will result in random ongoing excessive plant failures for the foreseeable future.

While the situation is indeed dire, SA is in the fortunate position that due to its exceptional wind and solar resource endowment, available land and developed financial sector, it is possible to navigate through this crisis by adopting a different industry model in line with international best practice. The broad outline of this strategy has already been set out in the latest update of the Integrated Resource Plan, which sees the bulk of new power coming from wind and solar resources combined with complementary technologies (gas, battery storage, etc.) to maintain security of supply.

Furthermore, rolling out these new, lower cost, cleaner and smaller-scale generation technologies creates a critical opportunity to move away from the fundamentally problematic monopoly model in the power sector. A new paradigm with a greater role for broad-based participation, innovation and competition is thus required. It is now possible to procure and finance power generation on a competitive basis, thereby opening up broader economic opportunities.

Therefore, to conceive the solution to SA's power problems by simply "fixing Eskom" is to misdiagnose the problem and overlook the immense opportunities for power sector-driven green industrialisation.

## Integrating industrial policy and energy policy

If SA successfully manages its energy transition to a reliable, low-carbon, least cost energy supply, this will have significant implications for the country's industrialisation potential. By integrating the expansion in renewable energy generation capacity with active industrial policy measures, significant potential exists for a Green Industrial Policy for SA, which accelerates growth, investment and employment opportunities.

Such a policy should be based on two key pillars:

- **Localisation of renewable technologies and capabilities** - entailing the localisation of key aspects of the renewable energy infrastructure supply chain; and
- **Building competitive new industries** - using SA's comparatively low-cost renewable energy supply to support the building of new export-oriented industries.

Localisation has significant job creation potential. For example, a comprehensive study conducted in the United States (US) found that in recent years solar photovoltaic (PV) and wind employed 475 000 people, while nuclear and coal employed 240 000. This was despite the fact that wind and solar PV together supply less than 10% of the US electricity demand, and nuclear and coal supply 60%.<sup>23</sup> Local ownership, including specified ownership by black South Africans, of renewable energy projects could be enhanced by adjusting financing arrangements. Furthermore, the black industrialists' incentive programmes should be calibrated to opportunities arising from the Green Industrial Policy.

Through seamlessly implementing and iteratively recalibrating the integrated resource plan (IRP), it is imperative that noise and uncertainty be removed from SA's roll-out of renewable energy capacity. Uncertainties and stop-start episodes serve to reduce the localisation potential of the programme. For example, the decision by Eskom to refrain from signing power purchase agreements for renewable-energy projects procured in 2015 by government,

resulted in some of the manufacturing capacity that had been developed around the renewable energy programme being closed, including a wind tower manufacturing plant in the Eastern Cape and a solar PV manufacturing plant in Kwazulu-Natal (KZN).

## Overcoming backward-looking vested interests to build competitive new industries

In the longer run, the fact that SA has world-class solar and wind potential<sup>24</sup> means that the shift towards increased solar PV and wind power has the potential to reduce the rate of electricity price increases, and over time restore international competitiveness for the SA economy in energy-intensive sectors.

This would confer a fundamental advantage to the SA economy in exporting low-carbon, electricity-intensive, hydrogen-rich products, and so-called "green" products such as "green" aviation fuel<sup>25</sup>, "green" steel and "green" fertilisers and chemicals.

Although renewable energy is included in SA's current "reimagined SA industrial policy", the full potential of this sector is not sufficiently articulated. A clear directive is required that the Green Industrial Policy - dealing with both localisation and the expansion of production of energy-intensive, low carbon-products - should be an industrial policy priority if dynamic, forward-thinking industrial expansion is to be achieved.

SA's industrial policy processes must not be captured by vested interests. Vested interests, that accrue a rent from the current structure of energy production, will need to be engaged as their narrow self-interest stands in the way of SA adopting policies which will move the economy onto a more inclusive, more dynamic growth path.

Vested interests are backward-looking and have the potential to lock the SA economy onto an uncompetitive path not just because they eschew low-cost energy technologies, but also because, due to climate change, high-carbon energy technologies

<sup>23</sup> US Energy and Employment Report, US Department of Energy, January 2017

<sup>24</sup> Wind Atlas South Africa and Solar Radiation Data referenced in the Wind and Solar PV Resource Aggregation Study for South Africa undertaken by the CSIR, SANEDI and Fraunhofer IWES, March 2016 [https://www.csir.co.za/sites/default/files/Documents/Wind\\_and\\_PV\\_Aggregation\\_study\\_final\\_presentation\\_REV1.pdf](https://www.csir.co.za/sites/default/files/Documents/Wind_and_PV_Aggregation_study_final_presentation_REV1.pdf)

<sup>25</sup> Walwyn, D and Crompton, R "South Africa has huge 'green fuels' potential. But it needs to act now", The Conversation (January 2020), <https://theconversation.com/south-africa-has-huge-green-fuels-potential-but-it-needs-to-act-now-129009>

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are increasingly difficult to finance. The articulation and implementation of a Green Industrial Policy in the broad national interest is required. Once a Green Industrial Policy framework is unambiguously in place, it will then be possible to engage with stakeholders to mitigate and ameliorate their position in line with the so-called “just transition”.

A “just transition” should be aligned with the IRP’s roadmap of planned reductions in year-by-year

coal generation requirements.<sup>26</sup> This will enable the coal sector to have a higher degree of visibility and certainty for planning purposes. Workers should be supported, even if changing technologies mean that specific jobs cannot be guaranteed, via retraining and re-equipping workers with marketable skills. In addition, where feasible, renewable energy projects should be located in coal-producing areas to keep up economic activity and employment rates in those areas.

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<sup>26</sup> Table 5 of the Integrated Resources Plan (IRP 2019), South Africa’s Government Gazette 42784, 18 October 2019

# South Africa's Current Competition Policy Cases: The Search for Economic Growth

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The 2018 amendment of the Competition Act identified the de-concentration of the South African (SA) economy and addressing the racially skewed spread of ownership and control as its primary objectives. These amendments flow from the purpose of the South African competition law, which recognises that effective competition is not only important to improve efficiency and deliver lower prices to consumers, but that opening the economy to greater economic participation by all South Africans is also a question of equity.<sup>28</sup> As emphasised by Stiglitz, market power has distributional effects: the rents of monopolies come at the expense of consumers. Therefore, increases in market power increase inequality.<sup>29</sup>

The high levels of concentration, low levels of dynamism and high barriers to entry in the SA economy are well documented, as are the low levels of black ownership and control of firms.<sup>30</sup> These features of the economy impose several constraints to growth. They limit the ability of many South Africans in being able to participate meaningfully in economic activity, and they increase the magnitude of the effects of failure or exit by any one firm (e.g. Edcon merger<sup>31</sup> where more than 43 000 jobs were at risk; and Sibanye/Stillwater merger<sup>32</sup> where 12 900 jobs were lost). Conversely, opening markets to participation enhances mobility and opportunity,

thus increasing equity and efficiency. Competition law assists in removing barriers to productive economic participation by “outsiders” based on the principle that inclusion contributes to dynamism and efficiency.<sup>33</sup>

These dynamic effects of competition, as well as the importance of competition policy in promoting transformation (and transformation, in turn, contributing to greater dynamism), are the key themes of my contribution, which links competition policy, growth and employment.

The contribution is structured around two key areas of work of competition authorities:

1. The first relates to merger control and focuses on retention/protection of employment and the extent to which mergers promote transformation of ownership. Merger control also contributes to addressing concentration by employing forward-looking analysis to prevent further concentration in the economy.
2. The second relates to de-concentration. It focuses on curtailing abuse of dominance and opening markets and value chains to greater competition. I will focus on the ways in which recent market inquiries have focused on facilitating entry by small and black-owned firms.

<sup>27</sup> The views expressed in this paper are my own and do not necessarily reflect those of the Commissioners or the Competition Commission of South Africa.

<sup>28</sup> Fox, E and Barkhoun, M. (2019). *Making Markets Work for Africa*. Oxford University Press.

<sup>29</sup> Stiglitz, J. (2017). *Towards a Broader View of Competition Policy* in Bonakele, T; Fox, E and Mncube, L. (eds). *Competition policy for the New Era. Insights from BRICS countries*. Oxford University Press.

<sup>30</sup> Buthelezi T., Mtani T. and Mncube L. (2018) *The extent of market concentration in South Africa's product markets* and Roberts, S. (2017) *Barriers to Entry and Implications for Competition Policy* in Bonakele, T; Fox, E and Mncube, L. (eds). *Competition policy for the New Era. Insights from BRICS countries*. Oxford University Press.

<sup>31</sup> Parentco (Pty) Ltd/Edcon Limited [LL117Sep16]. Competition Tribunal of South Africa

<sup>32</sup> Sibanye Gold Limited (T/A Sibanye-Stillwater)/Lonmin Plc [LM315Mar18]. Competition Tribunal of South Africa.

<sup>33</sup> Fox and Barkhoun op cit.



## Retention of employment: public interest in merger control

Competition, and particularly mergers, are often seen as job-destructive, but this is not true on aggregate. As emphasised above, more competition tends to result in lower prices, higher quality, greater participation, increased output and an associated increase in job creation overall.<sup>34</sup>

The SA merger regime explicitly incorporates elements of “public interest”, which include the protection and promotion of employment. This means that authorities are required to assess the effect of the merger on public interest, including employment, in addition to assessing its effect on competition. Any adverse effects on the public interest are usually remedied through conditions. Prior to the amendments to the Act, the public interest provisions were the only section of the Act that explicitly called for the consideration of increased participation in deliberations on competition matters. This has now been extended to the abuse of dominance provisions.

The interrogation of the rationale for merger-specific employment losses is particularly important given that a merger represents a break in the implicit contract between worker and employer.<sup>35</sup> The provisions also push back against claims of merger-related efficiencies that are linked to restructuring, and often simply represent a transfer from labour to capital.

In practical terms, the authorities assess the effect of the merger on aggregate employment and on the quality/terms of employment. Public interest conditions often place a two to three year moratorium on job losses (though periods of up to five years have been imposed, for example in Clicks/Netcare<sup>36</sup>) and have a bias towards protecting unskilled workers who are least likely to find alternative employment in the

current economic climate. If job losses cannot be prevented, merging parties will usually establish a re-skilling and employment fund to assist workers in preparing for alternative forms of work, or to support the education of a member of their household (e.g. a reskilling fund was imposed in the merger between CPG/Merchandising business of Imperial<sup>37</sup> and Boundary Terraces/Bravo<sup>38</sup>). In the past five years, more than 165 000 jobs were saved as a result of effective merger control.

These assessments become more complex in a slowing economy with an increasing number of cases involving ailing or failing firms. The authorities are called upon to make much tougher calls because these transactions are assessed against a counterfactual of firm exit. In this case, the retention of *some* employment is always better than the alternate, and the case would usually turn on the competition assessment in light of the likely counterfactual (e.g. Videx/Aveng where the Commission prohibited a merger in various steel products including mining roof bolts on competition grounds, despite 100 job losses that would have been saved if the merger was approved).<sup>39</sup>

In terms of the promotion of a greater spread of ownership, the recent amendments require a two-fold assessment. The authorities must assess the effect that a merger may have on “*the promotion of a greater spread of ownership, in particular to increase the levels of ownership of historically disadvantaged persons and workers in firms in the market*”, as well as its effect on the ability of small and medium-sized businesses, as well as black-owned firms to enter into, participate in and expand in a market.<sup>40</sup> This speaks directly to the themes of de-concentration emphasised above.

The most recent case assessing the issue of promoting a greater spread of ownership and participation is the PepsiCo/Pioneer merger decided

<sup>34</sup> Tirole, J. (2017). *Economics for the Common Good*. Princeton University Press.

<sup>35</sup> Behar, A and Hodge, J. (2008). *The Employment Effects of Mergers in a Declining Industry: The Case of South African Gold Mining*. The B.E. Journal of Economic Analysis and Policy, De Gruyter, vol. 8(1) pages 1–20, August.

<sup>36</sup> Clicks Retailers (Pty) Ltd/The retail pharmacy business carried on by Netcare Pharmacies 2 (Pty) Ltd with Medicross Clinics/The front shops of the in-house retail pharmacies operated by Netcare Pharmacies (Pty) Ltd within Netcare Hospitals. [LM055Jul16]. Competition Tribunal of South Africa.

<sup>37</sup> CPG In Store (Pty) Ltd And The Merchandising Business Of The Consumer Packaged Goods Division Of Imperial Logistics Of South Africa Group (Pty) Ltd. [LM079Jul19] Competition Tribunal of South Africa.

<sup>38</sup> Boundary Terraces 042 (Pty) Ltd/Bravo Group (Pty) Ltd. [LM272Mar19]. Competition Tribunal of South Africa.

<sup>39</sup> See press statement on the Videx/Aveng transaction at <http://www.compcom.co.za/wp-content/uploads/2020/01/Weekly-Media-Statement-November-2019.pdf>

<sup>40</sup> Competition Act, no 89 of 1998 as amended.



on 6 March 2020. The merger will result in the de-listing of Pioneer Foods which will obviously reduce the ability of direct and indirect participation by human development indexes (HDIs) in the firm. To address this concern, PepsiCo agreed to establish a R1.6 billion share ownership scheme (unencumbered) for workers (the majority of whom are black) and to facilitate participation by workers in decision-making by granting them representation at board level in the SA entity.<sup>41</sup>

A final point with respect to mergers is that the authorities are now explicitly required to assess “creeping mergers”, a phenomenon where a single merger, on its own, may not raise competition concerns, however, successive small mergers collectively entrench concentration. This assessment has long been discussed in highly concentrated private hospital markets and is also being used to assess competition in auto markets where we have seen an increasing trend towards corporatisation at the dealership level, accompanied by a worrying lack of transformation.

## Promotion of employment: de-concentration and dynamism

Recently, market inquiries have been at the forefront of the authorities’ attempts to open markets to new entrants. This was especially evident in the grocery retail inquiry where recommendations included the removal of restrictive exclusive leases that prevent the entry and growth of smaller stores and niche retailers in shopping malls, the removal of differential rental rates that disadvantage smaller retailers, the removal of apartheid-era trading time restrictions that limit the growth of “spaza” shops, and a requirement that equivalent trading terms be applied to all retailers and suppliers regardless of size.<sup>42</sup>

The requirements relating to buyer power can also now be regulated through amendments to the abuse of dominance provisions. These changes are important in light of work done by the Commission and by National Treasury, in partnership with the Centre for Competition, Regulation and Economic Development (CCRED) at the University of Johannesburg (UJ), on barriers to entry that emphasises the importance of supermarkets as a route to market, as well as the importance of taking a value chain approach in encouraging entry and growth in consumer goods.<sup>43</sup>

The Data Market Inquiry, which found that SA data prices are high overall and that high prices have a disproportionate impact on poorer consumers, also recommended a substantial reduction in data prices.<sup>44</sup> This talks to the broader emphasis in our abuse of dominance investigations on factors that influence the cost of doing business and the pace of economic activity. These include factors that may have an adverse effect on competition in public transport (for example, the recently referred case against the Passenger Rail Agency for South Africa (PRASA) for refusing to provide access to essential transport infrastructure at Park Station<sup>45</sup>) and ongoing investigations into excessive pricing in relation to ports. However, it is important to note that the competition authorities are more constrained in areas where sectors with natural monopoly features are subject to economic regulation (as they should be). This leaves less room for a competition authority to assess and prosecute excessive pricing. However, where reorganisation and structural separation of natural monopolies are considered, the competition authorities can engage in proactive advocacy efforts to support the efficacy and sustainability of these initiatives.

<sup>41</sup> Competition Tribunal. 6 March 2020. *Competition Tribunal SA approves one of Pepsico’s largest acquisitions Outside US, with wide-ranging package of public interest conditions*. Available [here](#).

<sup>42</sup> Competition Commission of SA. 25 November 2019. *The Grocery Retail Market Inquiry Final Report*. Available [here](#).

<sup>43</sup> See the CCRED series on Barriers to Entry [here](#). The National Treasury’s paper on [Economic transformation, inclusive growth, and competitiveness](#) also references some of the work on Barriers to Entry.

<sup>44</sup> Note that an announcement in this regard was made at 10am on 10 March 2020, on the day the presentation was given. The results have therefore not been included in this paper (which was submitted prior to presenting at the Colloquium), although they were discussed as part of the presentation.

<sup>45</sup> Competition Commission of SA. 10 February 2020. *The Competition Commission Prosecutes PRASA for Abuse of Dominance*. Available [here](#).



# Panel 3 at a Glance:

## Opportunities and Constraints in Labour-Intensive Sectors

### Could the Emperor's New Clothes be Made in the Coega Special Economic Zone?

p44

**Prof Anthony Black**

PRISM, School of Economics, University of Cape Town

**Summary:** South Africa could be doing a lot better with labour intensive (or light) manufacturing. Special Economic Zones (SEZs) can be used to establish industry competitiveness and to experiment with reform, a famous example being the case of the Shenzhen SEZ in China. Using the example of Coega SEZ in the Eastern Cape, this commentary explores how industrial policy support should be used to stimulate labour intensive light manufacturing, mobilising the unemployed as a leading sector.

### Opportunities and Constraints in Expanding Employment-Intensive Sectors

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**Prof Fiona Tregenna**

DST/NRF South African Research Chair in Industrial Development,  
University of Johannesburg

**Summary:** The relationship between increasing growth, reducing unemployment and prioritising employment intensive sectors is a nuanced and complicated one. This complexity is unpacked, and the tension between needing to increase both labour productivity and the absorption of labour in developing economies with high unemployment, is presented as a critical consideration in South Africa. The suggestion is that in choosing which sectors and activities to prioritise for support, we need both those that have strong growth pulling properties and those that are strongly labour absorbing.

## Constraints and Opportunities in the Clothing and Textile Sectors

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**Etienne Vlok**

National Industrial Policy Officer, SA Clothing and Textile Workers' Union (SACTWU)

**Summary:** The South African clothing and textile manufacturing sectors are critical for economic development and job creation efforts. Over the last few decades these sectors have been negatively impacted by an increase in imports as well as customs fraud. Several key opportunities as well as significant constraints associated with prioritising the growth of these sectors, are explored in this commentary. Some of the opportunities that operate in favour of the industry include revived efforts to deal with customs fraud and new initiatives such as the Clothing and Textiles Competitiveness Programme. Challenges include those related to a weak economy and limited leadership and technical skills in the sector to drive growth.

## A Developmental Regionalism Approach to the African Continental Free Trade Area (AfCFTA)

p51

**Prof Faizel Ismail**

Director at the Nelson Mandela School of Public Governance, University of Cape Town

**Summary:** AfCFTA has the potential to increase growth, raise welfare and stimulate industrial development on the continent. It also has the potential to negatively affect some of the smaller, more vulnerable countries. Adopting a “developmental regionalism” approach to trade integration, the writer proposes, will give AfCFTA the best chance to catalyse the process of transformative industrial development, cross-border investment, and democratic governance in Africa. The writer explains how the pillars of this approach are gaining traction across Africa, and need to be engaged by policy makers, both conceptually and in practice.

# Could the Emperor's New Clothes be Made in the Coega Special Economic Zone?<sup>46</sup>

**Prof Anthony Black**

PRISM, School of Economics, University of Cape Town

The South African economy needs to become more employment intensive. In the New Growth Path document there is a diagram which illustrates how the growth rate required to create 500 000 jobs per annum hugely depends on the employment intensity of growth. It's an obvious point – South Africa (SA) needs growth, however, each unit of Gross Domestic Product (GDP) growth needs to generate more employment opportunities than has hitherto been the case.

In spite of massive unemployment and a poverty rate more reminiscent of low middle income rather than upper middle income countries, SA does very badly in labour intensive manufacturing. Why is it that other upper middle income countries with much lower poverty levels that SA (e.g. Mexico, Malaysia, Turkey and Thailand), have large labour intensive sectors and SA does not?

Special Economic Zones (SEZs) can aim at establishing industry competitiveness via improved infrastructure, establishing clusters or dealing with economic distortions. They can also be used to experiment with reform – the Shenzhen SEZ founded in China in 1980 is a classic example. The actual rationale in SA is not very clear. The stated objectives of the SEZ programme are wide-ranging and include stimulating regional growth, attracting foreign and domestic investment and developing strategic industrial capabilities. While the objective of reducing spatial inequalities can be understood in terms of SA's history, this may be in conflict with growth objectives. The location of SEZs in backward regions will impact negatively on their ability to attract investment because of limited infrastructure, skill constraints and weak linkages to supply chains.

Asian manufacturing development offers many lessons. Let me cite two. The first is the opening of the aforementioned Shenzhen SEZ in 1980. As is well known, Shenzhen was at the time a fishing village in southern China. China was an orthodox communist country not at all open to foreign investment. The location for this experiment was chosen partly because it was a long way from Beijing, where there was considerable opposition to the opening up being proposed by Deng Xiaoping. China was able to mobilise its latent comparative advantage in low-cost labour on an unprecedented scale. Justin Lin argues that China went from being a comparative advantage defying (CAD) to a comparative advantage following (CAF) economy and this explains China's massive economic success. In 1980, per capita income in China was just \$194 (i.e. 7% of the SA level of \$2788). Now China has a per capita income of \$9580 compared to SA's \$6354. In 1980, manufacturing wages in China were a tiny fraction of those in SA. Garment sector wages in China are now a third higher than in SA (\$326 vs \$244 per month<sup>47</sup>).

The second lesson is from Korea – or at least from a Korean academic from Cambridge University. Ha-Joon Chang is a well-known heterodox economist and exponent of interventionist industrial policy who argues that countries should pursue dynamic comparative advantage. He was in Cape Town about 10 years ago and I asked him what would be an appropriate industrial policy in a very high unemployment economy such as SA. Industrial policy is generally concerned with moving up the value chain and structural change of the sort successfully undertaken by Korea itself. So his answer surprised me.

<sup>46</sup> This is a play on the book title *Why the Emperor's New Clothes Are Not Made in Colombia: A Case Study in Latin American and East Asian Manufactured Exports* by David Morawetz, published by the World Bank in 1981.

<sup>47</sup> Barrett, P. and Bauman-Pauly, D. (2019) Made in Ethiopia: Challenges in the garment industry's new frontier. NYU Stern Centre for Business and Human Rights. May. <https://bhr.stern.nyu.edu/made-in-ethiopia-res>

He said something to the effect that SA should “mobilise the unemployed as a leading sector”. What does that mean? My take on his response is that industrial policy has to deal with mobilising our greatest unemployed resource, unskilled and semi-skilled labour. This it has manifestly failed to do.

Let’s now come back to Coega. If you drive out of Port Elizabeth (Nelson Mandela Bay) heading east along the N2 highway, you will soon come to a huge area (it’s almost the size of Port Elizabeth itself) of laid out industrial land which contains a few dozen scattered factories. This is a SEZ almost on a Chinese scale with good infrastructure, which includes a fully equipped container port. The difference compared to most Chinese zones is that Coega is almost empty.

Let’s imagine what would happen if the zone was able to create 100 000 jobs in the next five years. Currently, after more than a decade in operation, it has less than 10 000 operations jobs (although many more have been created through construction). 100 000 new industrial jobs would transform the economy of the Eastern Cape. The city of Port Elizabeth would gain new life. Remittances would flow back to the villages and densely populated areas of the Eastern Cape. The multiplier effect would create hundreds of thousands of additional jobs in services, agriculture, construction and the informal sector.

But how could this happen? How could SA compete? This is the challenge for industrial policy. Instead of being fixated on moving up the value chain and high productivity jobs, it has to “mobilise the unemployed as a leading sector”. One could even argue that SA has to move down the value chain. This means providing worker flats close to factories, subsidising training and factory buildings to create an environment attractive for light manufacturing in the zone on a huge scale. There also has to be some modification of labour regulation. At the same time, the President’s investment team and the President himself should head to China, Japan and other countries to speak to investors.

This is not a new idea. It has been posed in a different format by David Kaplan and the Centre for Development and Enterprise.<sup>48</sup> Their proposal suggested competing with very low wage countries such as Cambodia in the garment sector. I am suggesting something different, labour intensive light manufacturing but of products such as consumer

durables and electronics, not competing directly with very low-wage countries such as Bangladesh, Ethiopia and Cambodia in low-end garment manufacturing. The emphasis is on industrial policy support rather than labour deregulation, although labour regulation would need to be seriously looked at.

But what about comparative advantage? It is not being argued that SA can suddenly compete with China, but we can do a lot better in light manufacturing. Mobilising the unemployed as a leading sector means that a prime focus for industrial policy must be to equip the unemployed with skills. Yet the SA government cannot do that. Firms can – the best way to create skills is to create large scale employment within firms. This would have the greatest effect on economy-wide productivity.

In the past, SA has subsidised heavy industry (and the automotive sector) and continues to do so. The favourable power supply agreement between Eskom and the Australian owned South32 Hillside Aluminium smelters is a case in point. Electricity subsidies to South32 probably amount to well over more than R1 million per annum for each of the thousand-odd employees. And of course, this is electricity SA does not have; these smelters gobble up about 3% of SA’s electricity supply. Aluminium is then exported or sold to domestic fabricators at import parity prices. This electricity supply contract is up for renewal. What will the government do?

Much smaller levels of assistance could be used to build competitive advantage in light manufacturing at zones such as Coega. The Nelson Mandela metropole has huge advantages – an experienced labour force and a very large labour pool, under-utilised infrastructure including two ports and an attractive living environment. When combined with SA’s sophisticated financial system and long industrial history, it is surely quite straightforward to build a compelling investment case.

<sup>48</sup> Centre for Development and Enterprise (2016) An EPZ for the Nelson Mandela Metro. *Growth Series Report 7*. Johannesburg. Centre for Development and Enterprise.

# Opportunities and Constraints in Expanding Employment-Intensive Sectors

**Prof Fiona Tregenna**

DST/NRF South African Research Chair in Industrial Development, University of Johannesburg

My basic take here is that the dual imperatives of increasing growth and reducing unemployment in South Africa (SA), complicate the issue of prioritising employment-intensive sectors for expansion/support. Let me start simplistically, nuances and caveats to follow below.

Any given employment outcome can (hypothetically) be achieved through various combinations along a spectrum of growth and employment-intensity. In simple terms, the less employment-intensive is growth, the higher the required growth rate. Economy-wide employment-intensity in turn can be increased either by increasing the share of relatively employment-intensive activities in the economy, or by increasing the degree of employment-intensity within activities, or by some combination of these.

If nothing else happens (that is, no growth in output), increased labour productivity means lower employment. In order for a rise in labour productivity to increase employment, output has to increase more than proportionately. Through growth, overall employment gains can thus exceed any direct labour-displacement arising from increases in labour productivity.

However, productivity increases do not guarantee growth. With the multiple complex domestic and international determinants of a country's growth rate, an increase in labour productivity could be accompanied by a rate of economic growth that is lower than the growth in productivity, associated with lower levels of employment.

Notwithstanding these complexities of productivity growth in relation to the need to create employment, it is clear that countries cannot avoid the imperative of achieving sustained increases in productivity. Without productivity growth, an economy will be unable to sustain economic growth. While there may be short- to medium-term employment growth without productivity growth, the economy is likely to stagnate over time and lose its share in global markets, with negative effects not only on growth, but also on employment.

From a dynamic perspective, an additional complexity is that the employment-intensity of growth also affects the rate of growth. In general, the more productive (less directly labour-intensive) an activity and the greater its scope for cumulative productivity increases, the more growth-pulling the activity is likely to be. Related to this is that the more high-tech activities, that typically have strong future growth potential, are generally less directly labour-intensive.

In analysing patterns in manufacturing across countries and across time, I have found that it is empirically very rare that a country's manufacturing grows (in real value-added or as a share of gross domestic product (GDP)) while simultaneously becoming more labour-intensive (in terms of the simple employment/VA ratio, changes in this ratio will reflect changes in both sectoral composition and the nature of production within sectors).<sup>49</sup> Almost universally, manufacturing growth is accompanied by it becoming less labour-intensive, i.e. more productive.

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<sup>49</sup> See Tregenna, F. (2009) 'Characterising deindustrialisation: an analysis of changes in manufacturing employment and output internationally', *Cambridge Journal of Economics*, 33(3): 433–466; Tregenna, F. (2013) 'Manufacturing productivity, deindustrialization and reindustrialisation' in *Pathways to Industrialization in the 21st Century: New Challenges and Emerging Paradigms*, A.Szirmai, W.Naudé, and L.Alcorta (eds.), Oxford: Oxford University Press; and Tregenna, F. (2015) 'Deindustrialisation, structural change and sustainable economic growth', *UNIDO Inclusive and Sustainable Industrial Development Working Paper Series*, WP02/2015. Vienna: UNIDO.

The conundrum of needing to increase both labour productivity and the absorption of labour is especially pronounced for developing economies that have high unemployment. The availability of labour relative to capital in developing economies suggests the use of employment-intensive technologies and techniques, especially in the context of high rates of open unemployment. However, such technologies and techniques are often not optimal for modernisation and catch-up.

SA is a stark case of the above, with a crisis of unemployment as well as close to zero growth. There is heterogeneity across activities (one dimension of this being the heterogeneity across sectors) in, among other things, the extent to which they are growth-pulling and in the extent to which they are labour-absorbing. In choosing which sectors/activities to prioritise for support, we need both those that have strong growth-pulling properties as well as activities that are strongly labour-absorbing (including of low-skilled labour).

While there is not necessarily a direct trade-off between these, there is thus a degree of trade-off. The trade-off is mitigated by factors including the following:

- There are mid-spectrum activities that are both employment-creating and growth-enhancing;
- Factoring in indirect labour intensity through employment multipliers, some activities do not have especially high direct employment-intensity but do have high total employment-intensity due to their strong backward linkages;
- The high rate of unemployment is itself a constraint on growth, so anything that reduces unemployment (e.g. the expansion of labour-intensive activities) is itself likely to be growth-enhancing.

## Quick additional responses to some of the specific questions posed:

- *Where are the employment promoting opportunities in the sector(s)?*

By far the most employment-intensive sub-sector of the economy, in terms of employment multipliers, is the “other producers” sub-sector of services.<sup>50</sup> Apart from a few minor specific activities (e.g. funeral services, hairdressing etc.), this is basically a residual category for services not elsewhere classified, which is not very useful for policy purposes. The next most employment-intensive sub-sectors come from a mix of broad sectors: clothing, catering and accommodation, agriculture, textiles, wholesale and retail trade, furniture, and wood and wood products. The least labour-intensive include heavy manufacturing sub-sectors such as coke and refined petroleum products, and basic non-ferrous metals; the electricity, gas and water sub-sectors; coal mining; as well as finance and insurance. Overall, agriculture and services are more employment-intensive than the industrial sectors, but there is a high degree of heterogeneity within the broad sectors in terms of their employment-intensity.<sup>51</sup>

From a policy perspective, employment-intensity is of critical importance but cannot be the only consideration when selecting which sectors to prioritise for support.

In terms of the manufacturing sector specifically, based on the perspective discussed earlier, I argue that there is a need for what I have termed a “mixed manufacturing strategy”. This would prioritise a mixture of employment-intensive or labour-absorbing sectors (including the utilisation of semi-skilled labour), and more directly growth-enhancing high-productivity activities.

<sup>50</sup> All observations here on the ranking of sectors in terms of employment multipliers are based on the last time I calculated sub-sectoral employment multipliers (see Tregenna, F. (2016) ‘A sectoral view of employment-intensity in South Africa’ in *Towards Employment Intensive Growth in South Africa*, A. Black (ed.), Cape Town: UCT Press.). While there are likely to have been some changes in sector ranking, I expect overall patterns to have remained fairly constant.

<sup>51</sup> An additional comment on evidence and policy is that in order to promote particular sectors on the basis of their employment-intensity, accurate, detailed, and timely information is required on sectoral employment-intensity. Ways of measuring employment-intensity that are relevant here include the labour-capital ratio, the labour-value added ratio, employment multipliers and employment elasticities. For more on different ways of measuring employment-intensity, see Tregenna, F. (2016) ‘Sectoral dimensions of employment’ in *Employment Targeting: Macroeconomic and Sectoral Approaches*, K. Chatani, I. Islam and F. Lapeyre (eds.), International Labour Organisation.



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➤ *Overview of current constraints that impede employment growth in the sector(s)*

A key constraint on employment growth in labour-intensive sectors is likely to be capacity under-utilisation and weak investment in expanded/new capacity due to lack of demand (both domestic and exports). Associated problems probably include poor upgrading and failure to move up value chains, as well as unit labour costs that are higher than in countries specialising in labour-intensive production. Further research would be needed to identify the binding constraints in different sub-sectors.

➤ *Who should drive the recommended interventions?*

Government with social partners – this links with the current masterplans, social compacting etc. Most interventions to support particular sectors are likely to come through industrial policy measures (noting that these extend beyond industry and are also applicable to agriculture and services), as well as through targeted development finance etc.

# Constraints and Opportunities in the Clothing and Textile Sectors

**Etienne Vlok**

National Industrial Policy Officer, SA Clothing and Textile Workers' Union (SACTWU)

## Background

The South African clothing and textile manufacturing sectors hold significant potential to absorb labour in South Africa (SA) and are considered to be key industrial sectors within the government's economic development and job creation efforts. The importance of the sectors for job creation derives from their high labour intensity, the relatively low-cost to create jobs, the high employment multiplier effect within the broader economy, and their impact on gender equity, broad-based black economic empowerment (B-BBEE), and job creation in rural areas.

## Challenges

For several decades the sectors have been on the backfoot due to the flood of imports that entered SA from the late 1990s. The fast-tracked tariff reduction regime adopted by government exposed these sectors to international competition in a context where they were not able to compete effectively.

The sharp increase in imports in the late 1990s and 2000s resulted in decreased orders, lower turnover and smaller profits, if any. As a result, clothing and textile factories were hard-pressed to secure capital to invest in new skills, capital and technology. This caused factory closures and job loss, but also the loss of skills and technology. And, therefore, for much of the period since the late 1990s, these sectors did not undergo the necessary structural changes required to modernise and transform from being an inward-looking protected industry into a robustly dynamic and internationally competitive industry. This locked the industry into a vicious downward cycle.

A further problem for the local clothing and textile manufacturing sectors has been customs fraud. Customs fraud occurs in multiple forms, including under-invoicing, false declaration of goods, smuggling, rerouting goods via third countries and other activities that are aimed at evading tariffs or customs

rules. Customs fraud is widespread in the clothing and textile sectors. When tariffs are evaded and not paid, measures introduced by government to support South African jobs and industry are circumvented and nullified. Customs fraud substantially hampers efforts to create a country characterised by employment and greater equality. Customs fraud also denies the state the much-needed revenue that could be used for social security programmes or development-related spending, and increases the burden on company and personal income and other taxpayers.

## Importance of the sectors

Despite the problems which the clothing and textile manufacturing sectors faced, they cannot simply be discarded. This is true, not only because they are some of the more important manufacturing sectors in the country, but also because they hold significant potential to assist in combating the unemployment problem in SA.

The sectors' potential as a powerful and low-cost mechanism to create jobs has seen them identified by government as priority industrial development sectors. The sectors offer unparalleled labour absorbing prospects in the context of the extremely high unemployment rate in SA. The clothing sector is the most labour absorbing sector in manufacturing, measured by jobs created per unit of capital invested. This was established by an Industrial Development Corporation (IDC) study which confirmed the labour absorbing bias of the clothing industry, illustrating that its job-creating capacity per unit of output by value was the highest in manufacturing, and about 2.3 times the average for the 44 industrial sectors surveyed.

Furthermore, the multiplier effect of the industry on economic activities elsewhere in the economy is significant. The same IDC study indicated that 2.7 indirect jobs are created for each primary job in textiles. Therefore, support provided to this sector will filter into other sectors and create jobs elsewhere in the economy as well.

The clothing, textiles, footwear and leather (CTFL) industry is also a significant employer of women. A skills audit compiled by the industry Sector Education and Training Authority (SETA) showed that 82% of workers in the clothing sector are women. The industry is concentrated in specific geographic areas which are significant to employers. In towns such as Worcester, Caledon, Atlantis, Isithebe, Newcastle, Port Shepstone, Ladysmith, Phuthaditjhaba, Botshabelo, Babelo, Zwelitsha, Hammanskraal, and Mogwase and around cities such as Durban, Cape Town and Pietermaritzburg, it is a very substantial employer. Since few alternative job opportunities exist in many of these areas, jobs created in the industry can have a massive social impact in such towns.

## Key opportunities and constraints and the role of the state

Below are some of the major employment opportunities and constraints:

- ▶ The main plus bonus that local clothing and finished textile manufacturers have in competing with imports is if they take advantage of their geographical localness in order to provide local retailers and markets with speed and flexibility of supply. Based on the successful Turkish model of supply into the European Union, if local manufacturers can cut lead times and introduce short production cycles, then they can establish a significant advantage in the eyes of retail buyers against imported apparel.
- ▶ The government's introduction of the Clothing and Textiles Competitiveness Programme has supported a large number of firms in their endeavours to embrace their upgrading challenges. This support has helped to re-capitalise local manufacturers, and has also supported the stabilisation of, and even growth in, employment. Importantly, this support has been linked to decent work which has seen companies pay workers the wages owed to them and abiding by labour laws. However, with the constraints on the fiscus, these support measures are diminishing.
- ▶ The South African Revenue Service (SARS) has revived its campaign to deal with customs fraud. In this regard, SARS has been implementing more strategic customs surveillance in recent years to combat the problem of customs fraud in the clothing and textile industry; it has shown a greater willingness to pursue those who defraud the state and undermine local jobs and industry; it has re-established its specialised task team dealing with high-risk sectors like clothing and textiles; and it has conducted more raids of inland hotspots.
- ▶ In recent years, Chinese production costs have risen, driven in part by rising fuel and transport costs, and by the rise in clothing and textile manufacturing workers' wages. Manufacturing in China is now more expensive than in a number of other countries in the world. Elsewhere in Asia, factory disasters have occurred in Bangladesh and Cambodia, amongst others, and have led to the deaths of thousands of clothing workers in those countries. The result of these events is that retailers have begun to reconsider their supply chains in the last few years. This has created a flow of new orders to SA.
- ▶ The weaker South African Rand has impacted the industry by raising the price of importation for domestic retailers and others, encouraging them to use more local manufacturers, but it can also create opportunities for new export orders by local manufacturers.
- ▶ The recently signed retail, clothing, textile, footwear and leather (R-CTFL) Masterplan provides a strong platform to grow the clothing and textile sectors and the jobs therein. It sees all the partners, government, retailers, manufacturers and labour make commitments to contribute to achieving the job creation and growth objectives in the Masterplan.
- ▶ The African Continental Free Trade Agreement (AfCFTA) can be the vehicle needed to push local manufacturers to export more. While the industry was under pressure in the 1990s and 2000s, exports dropped sharply. Even with the much weaker currency today, and more opportunities to export, we have not seen a major export drive. This agreement may assist but it also holds potential threats.
- ▶ The current weak economic growth and the difficulties in those sectors supplied by local manufacturers are placing pressure on local jobs and factories. High interest rates are not helping, making especially working capital expensive but also constraining spending. We need to ensure sufficient and effective tools are available to help manufacturers get through these difficult economic times.
- ▶ The battering that the industry took in previous decades meant that many manufacturers do not have the strategic vision and managerial skills necessary to provide the required leadership. Much-needed technical skills are also difficult to come by. While this does not bode well for the current times, it also undermines local industry's ability to confront and take advantage of the Fourth Industrial Revolution.

# A Developmental Regionalism Approach to the African Continental Free Trade Area (AfCFTA)

**Prof Faizel Ismail**

Director at the Nelson Mandela School of Public Governance, University of Cape Town

The African Continental Free Trade Area (AfCFTA) was launched on the 21 March 2018 at a Summit of the African Union (AU), held in Kigali, Rwanda. President Paul Kagame declared that the launch of the AfCFTA was “historic”. Seen from the long lens of history, this was indeed a historic event. It was the most ambitious expression yet of the dream and vision of Pan-African leaders such as Kwame Nkrumah, Jomo Kenyatta, and others who had begun the long journey towards African unity and integration since the decolonisation and independence of African States in the late 1950s. The AfCFTA officially entered into force at the Summit of the AU on the 7 July 2019, in Niamey, Niger, and was scheduled to be implemented as from 1 July 2020. However, due to the impact of COVID-19 this date has been pushed out to 2021.

Several studies undertaken by the United Nations Economic Commission for Africa (UNECA) economic researchers predict that the AfCFTA has the potential to increase growth, raise welfare and stimulate industrial development on the continent (Karingi and Davis, 2016). However, there are also concerns that some countries, particularly the smaller and more vulnerable economies, may experience the negative impacts of premature liberalisation and fiscal revenue losses (Hoekman and Njinkeu, 2016). It is an opportune moment for African policymakers to ask a few pertinent questions. How can the AfCFTA advance inclusive growth and economic development of the African continent? How can the AfCFTA benefit all African countries? How can the AfCFTA lead to economic transformative and industrialisation of the continent? How can the AfCFTA also catalyse and advance the building and strengthening of democracy, good governance and peace and security in Africa?

This essay argues that adopting a “developmental regionalism” approach to trade integration provides the best prospects for the AfCFTA to catalyse the process of transformative industrial development, cross-border investment and democratic governance

in Africa. “Developmental regionalism” is defined as “cooperation among countries in a broader range of areas than just trade and trade facilitation, to include – for example – investment, research and development, as well as policies aimed at accelerating regional industrial development and regional infrastructure provision, such as the building of better networks of roads and railway” (UNCTAD, 2013). In its 2017 *Assessment of Regional Integration Report* (ARIA VIII), the UNECA also makes the case for a comprehensive approach to the implementation of the AfCFTA. The report argues that “at the heart of the AfCFTA is a developmental approach that recognizes the need for trade liberalization to proceed, and at the same time, address supply capacities and promote structural transformation” (UNECA, AU and AfDB, 2017).

This analytical framework on regional integration thus draws on the work of Davies (1996), the United Nations Conference on Trade and Development (UNCTAD) (2013), and UNECA, AU and the African Development Bank (AfDB) (2017) and extends the concept of “developmental regionalism” to include cooperation among African countries in a regional integration framework on four parallel and interconnected pillars: a) cooperation on building mutually beneficial trade integration (fair trade integration); b) cooperation on industrial development and upgrading in regional value chains (transformative industrialisation); c) cooperation on investment in cross-border infrastructure and trade facilitation; and d) cooperation on the building of democracy, good governance and peace and security.

## First pillar: fair trade

Africa’s member states have a wide variety of categories of countries that may require special attention and specific treatment. The 55 African member states are made up of 34 least developed countries (LDCs), 16 land-locked developing countries (LLDCs) and six small island developing states (SIDS).

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Building trade agreements in favour of small and less developed economies will assist in contributing to fairer outcomes of the AfCFTA and a more balanced and mutually beneficial regional integration process.

African governments should ensure that their stakeholders – business (both big and small), trade unions and civil society non-governmental organisations (NGOs) – are included in the national consultation process and provide their negotiators with clear mandates for negotiations. African countries need to build effective institutions that are inclusive and enable the fullest participation of stakeholders in the negotiating process. This will improve both the quality and the sustainability of the AfCFTA agreements.

## Second pillar: building regional value chains

Most African countries have been growing rapidly since the early part of the new millennium. Reflecting on this trend, the African Centre for Economic Transformation (based in Ghana) commented as follows: “the continent is growing rapidly, transforming slowly”. This prompted some development economists such as the Harvard based Dani Rodrik to argue that “structural transformation is essential to ensure labour-demanding employment and social inclusion” (Rodrik, 2013). Transformation involves the process of moving the economy away from being based on low value-added primary products towards higher value-added production and knowledge-based products. In the economic literature, these processes include *agricultural transformation, export diversification, building technological capabilities among firms and farms, industrial upgrading and industrial deepening*.

African countries are increasingly connected to the global economy through global value chains (GVCs). However, they are mainly suppliers of raw materials and other low-value manufactures and operate at the lowest rung of the ladder in GVCs. The good news is that while Africa’s exports are largely made up of commodities to the developed countries and to China, the composition of its intra-African trade is made up of more technology-intensive *manufactured* products.

Therefore, the development of regional value chains and the insertion of African firms into global value chains will, by their nature, facilitate increased intra-African trade of manufactures and could contribute to sustainable long-term growth. There are numerous industrial sectors in Africa that are

ripe for the development of regional value chains in agro-processing, pharmaceuticals, iron and steel and capital goods, clothing and textiles, leather and footwear and even in the automotive sector.

In advancing regional trade integration in these sectors, African policymakers must recognise the need to carefully nurture small and medium sized enterprises and manufacturing. Thus, adequate policy space should be available to African states to build the necessary trade and industrial policies, laws, regulations and institutions to ensure safe and fair trade, and to build their infant industries. In addition, these industries will need adequate attention to laws and regulations to protect the integrity of Africa’s borders from illegal imports, sub-standard goods and third country trans-shipment. African countries must be able to protect themselves from unfair trade, sub-standard and dumped goods from the north and south, whether this is in the form of second-hand clothing or vehicles.

Cooperation between Africa’s emerging entrepreneurs and industries towards building regional value chains, and to compete more effectively in global markets, will advance transformative industrialisation, obtain a fairer share of the value we obtain from our commodities and our labour, and improve the lives of the people on our continent. The AfCFTA must facilitate this process.

## Third pillar: cross-border infrastructure investment

As stated above, Africa is divided into 55 states of landlocked (16), least developed countries (34) and small-island developing states. The landlocked countries (Botswana, Burkina Faso, Burundi, Chad, Central African Republic, Ethiopia, Lesotho, Malawi, Mali, the Niger, Rwanda, South Sudan, Swaziland, Uganda, Zambia and Zimbabwe) may face very specific challenges. These countries all lack maritime access, are isolated from world markets and suffer high transit costs, which seriously constrain their overall socio-economic development. African countries are making significant progress in building their *hard infrastructure* (ports, road and rail to facilitate intra-regional trade) and *soft infrastructure* (customs cooperation at borders, port efficiency and reduction of roadblocks along major transport routes). For example, much progress has been made to improve the Abidjan-Lagos corridor, which handles more than two-thirds of West African trade, transport and transit activities, as well as modernising the ports in Côte d’Ivoire, Ghana, Togo, Benin and Nigeria.

## Fourth pillar: democratic governance

A political sea-change has been underway in Africa since the end of the Cold War in the late 1980s and early 1990s. Most African states have begun accepting multi-party systems of governance in the new millennium. Multi-party elections have begun to replace military coups. Most African countries have embraced a culture of constitutionalism, rule of law and human rights.

During the AU Summit held in Durban, South Africa, in 2002, the New Partnerships for Africa's Development (NEPAD) Declaration on Democracy, Political, Economic and Corporate Governance was adopted. The declaration committed African countries to work together in pursuit of the following objectives: democracy and good political governance, economic and corporate governance, socio-economic governance and the creation of an African Peer Review Mechanism (APRM). The APRM is a voluntary platform for self-assessment and peer review of governance policies, procedures and institutions by AU member states aimed at institutionalising and consolidating democratic governance.

The APRM is an instrument that is voluntarily acceded to by AU member states. Countries voluntarily subjected themselves to being examined in governance areas within established guidelines. As of the 15 March 2020, the APRM has 37 members with Namibia and The Gambia being the most recent members to accede with at least 20 of its members having already undertaken a first country review. The APRM is unique in both scope and breadth, with the review process extending to all levels of government (executive, parliament and the judiciary) as well as the private sector and civil society organisations. Several academic writers have observed that the APRM is a truly indigenous and locally owned initiative designed by Africans for Africans. This is a truly remarkable achievement that the AfCFTA must build on.

## The way forward

This essay has argued that all four pillars of the developmental regionalism approach have begun to gain traction across Africa and reinforce and strengthen each other in practice. This approach to regional integration in Africa has great potential to catalyse and accelerate a virtuous circle of regional trade integration, transformative industrialisation, cross-border infrastructure, democracy, inclusivity and

good governance across the continent. Policymakers need to make the necessary linkages, both conceptually and in practice.

The implementation of the AfCFTA could become a landmark and the transition to a new phase in the historic journey of Africa to realise the dreams of the Pan-African leaders for a peaceful, prosperous and integrated Africa.

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# Panel 4 at a Glance:

What Role Does the State  
Need to Play to Further Unlock  
Employment Opportunities  
in Sectors with High-Growth  
Potential?

## Logistics as a Catalyst for Economic and Employment Growth

p56

**Derek Thomas**  
CEO, Letsema

**Summary:** Logistics enables competitive connectivity with the world, and along with complementary investment can drive diversification of the economy and employment in South Africa. Exploring specific corrective measures that need to be implemented immediately and key opportunities that can be exploited, this commentary highlights the importance of a capable state, institutional reform and the involvement of the private sector to plan and implement a world-class national logistics system.



## Tourism

p59

**Kate Rivett-Carnac**

Independent Consultant

**Summary:** The travel and tourism sector accounts for a large number of jobs in South Africa and the sharing economy has further increased participation in the sector, as well as raised new policy questions. This commentary explores various barriers affecting the growth of tourism in South Africa, a topical one being COVID-19 which is currently decimating global tourism. Others include negative brand perceptions of the country and access barriers such as the need for visas. Recommendations for employment creation include ways to safeguard the tourism sector during the COVID-19 crisis and labour-intensive approaches to addressing the safety and security concerns of tourists.

## The Chemical Sector

p62

**Dr Rod Crompton**

Director, African Energy Leadership Centre, WITS Business School.

**Summary:** All sectors of the economy use chemicals, they are the hidden enablers of economic development. Exploring key opportunities in renewable energy, and constraints related to petrochemicals, this commentary discusses the details of how South Africa might increase employment in the chemical sector by exploiting South Africa's comparative advantages and moving it towards lower carbon intensity feedstocks and the need for policy interventions to enable this.

## Global Value Chains and Employment and Growth Opportunities for South Africa

p65

**Prof Mike Morris**

School of Economics, University of Cape Town

**Summary:** Global value chains drive industrialisation activities and are themselves driven by powerful lead firms. From an industrial policy perspective, to stimulate economic growth and create employment, gaining participation of multinational lead firms is an important part of the process. Exploring challenges, opportunities and lessons through the renewable energy sector in South Africa, this commentary suggests that from a global value chain perspective there is a need for decisive political intervention to overcome relevant economic problems.

# Logistics as a Catalyst for Economic and Employment Growth

**Derek Thomas**  
CEO, Letsema

## Context

South Africa (SA) desperately needs accelerated and shared economic growth to combat the triple challenge of inequality, poverty, and unemployment. Unfortunately, after a decade of economic mismanagement, the toolbox is bare: our fiscal position is denuded, the institutional and balance sheet capability of the state and the most important (Schedule 2) state-owned entities has been severely degraded, moral authority and trust have been destroyed, and the conceptual space and energy to craft and implement a unifying economic vision is at best limited. Our situation is made more onerous by the demographic youth bulge which should represent a dividend; instead we have high and rapidly growing rates of youth unemployment, offering a genuine existential crisis to our Republic. We need mature spaces and a collective long-term imagination. While we have big problems, we also have huge opportunities. So, how does this relate to the topic of logistics as an enabler of economic growth and employment creation?

## Dutch-disease of the mind

SA consistently imports more than it exports, and our basket of exports (with a few notable exceptions like in Autos) tend to be relatively low value. We rely on commodities, and our industrial production base is narrow. And we have failed to demonstrate a credible ability to diversify our production base into high value manufactured goods and/or employment-intensive value chains with a competitive export orientation. This leaves us with a multi-faceted challenge, which I can't fully explore here. Suffice to say, we appear unable to imagine and commit ourselves to be a producer of high value-added/employment-intensive products to address directly or indirectly our dire employment challenge. The most devastating effect of the traditional 'Dutch-disease' may in fact be on the national imagination and imperative to act. Here I'm implicating both the state and big business. Our

political economy is geared to solve the needs of commodity producers and exporters. There's simply not enough agency in the fight for the design and investment into logistics for a small and nascent high value/employment product set with its export requirements. Our logistics capital expenditure will by necessity largely lock us into an existing path-dependent industrial policy.

## The faraway land

A cursory glance at the world and SA map is revealing. SA is far away from the globe's major trade hubs: North America, Europe, India, China, South Asia, and South America. Intra-African trade is limited compared to other regions. We reside in a relatively poor neighbourhood, where both markets and competitive alternatives in value chains are small and constrained. Compounded by the not inconsequential practice of Import Parity Pricing with its downstream stunting effect, the gods have further conspired to give us a large geographical canvas (national and regional), and placed major population centres and markets inland and at altitude, all further imposing expensive logistics costs on the country and its producers. Then to add insult, we have the pernicious legacy of Apartheid spatial planning and its constraint on urbanisation, resulting in unnaturally high levels of population dispersion. The implication is stark: our goods must travel a far way.

SA is the default global gateway to several effectively land-locked countries in our neighbourhood. Their export competitiveness is presupposed by our national logistics system. We need to recognise and work with our neighbours to ensure that the design and operations of our mutual logistics interests are as efficient and cost-effective as possible. We are tied into an inescapable mutuality of competitiveness that covers the economic livelihoods of more than 200 million people.

## Network infrastructure and the role of the state

In SA, there really is no logistics game without government. Government is the key role player in the provision of our stock of logistics network infrastructure. Roads, rail and ports all pretty much belong to the state. So too do important enabling bureaucratic processes like customs, tax collection, trade and related regulations, and the like. Competitive logistics is an inescapable part of national competitiveness. In this regard, the private sector largely plays on the field created by the state. The private sector relies on this network infrastructure for its operations. Unfortunately, we have several serious hurdles to overcome, some bequeathed by nature and history, and some by the pernicious acts of men.

Six corrective measures must be implemented immediately:

- Appoint serious technocratic, honest and empathetic leaders to the most important state-owned enterprises (SOEs) (this appears to have begun), and give them the political support and space to create genuine world-class institutional capability.
- Appoint serious technocrats to the government bureaucracy with a mandate to design and ensure our national logistics system supports our national competitiveness imperative and to act for the 'missing or nascent economic agents' in the national discourse.
- Create a mandate, framework and spaces for the private sector to effectively partner with the state in both the building of infrastructure and, where appropriate, the running of operations; and seriously harness the capability and imagination of the private sector.
- Remove bureaucratic hurdles to intra-African trade by inter-government relations.
- Ensure a system of accountability within the state to an 'imperative-narrative' that large-scale sustained job creation can only be facilitated by a diversification of our production base with an emphasis on export competitiveness for products that ideally have labour intensive and/or high-value economic chains (competing designs are short-term salves or fiscally dependent).
- Treat every fiscal Rand as sacred. And let no opportunity for employment creation and national competitiveness go unexplored and unexploited.

## What we can do with an empathetic and capable state

Let's allow our imagination to run free for a moment with a capable state in the logistics arena. Five key opportunities can be exploited:

- Investment in increased/improved logistics network infrastructure and their respective interfaces (rail-port, road-port, road-rail etc.) to drive broad national competitiveness, but also for targeted geographies and commodities to drive employment-intensive growth (an example of which is explored below).
- Unlocking the African neighbourhood and intra-African trade by ensuring seamless bureaucratic process and efficient network infrastructure (part of our mutuality is of course bequeathed through the Cape gauge rail network).
- Training: Use our large SOE to train artisans at scale and beyond their narrow requirements; no TVET can compete with their 'live-laboratory' and scale; partnerships can be mandated/built in this arena.
- Programmatic Procurement:
  - Standardised specifications for all major fleet procurement with designated local suppliers and maintenance, repair, and operating supply (MRO) built into asset's useful life design;
  - Long-term logistics assets procurement with visibility; no panic and short-term rush procurement, especially not at scale; this requires much deeper hard infrastructure planning capability within the state;
  - Systematic and programmatic procurement to ensure every Rand of logistics-related investment is effectively spent;
  - This, in turn, allows for private sector investment in the manufacture of productive inputs like steel-derivative products and importantly ongoing maintenance capabilities to be optimally located in SA by virtue of a signalling and visibility effect; and
  - Optimise the degree of local content procurement into logistics network infrastructure.
- Commuter rail:
  - Integration of planning between commuter passenger rail and large employers to ensure safe, cost-effective transport to and from work (remember commuter transport in our spatial context also eats badly into disposable income in this country);

- 
- Free and/or subsidised transport on commuter rail for the unemployed (youth) to help with job search;
  - A strategic and investment plan to take us into the Green economy in logistics, to ameliorate potential risks to our 'tradables' from any moves based on our high carbon footprint; and
  - Harnessing of digital technologies to ensure better planning and operations of complex logistics systems.

## **Playing a big game: unlocking agri through logistics and partnerships**

Agriculture has great employment intensity through the value chain. We should get serious about exploiting this. SA has large untapped productive agriculture opportunities that could create significant amounts of jobs. Unlocking this productive capacity is about, inter alia, logistics-related connections from distant parts of the country to global markets. Sophisticated cold and other high-value chains for speed, traceability, visibility, predictability, and lowest possible value-lowering stress to produce are key. It also means taking historical redress seriously. An obvious example: no honest scholar would dare to suggest that the success of large-scale agriculture in SA was achieved without the preceding

investment into enabling infrastructure by the state over a sustained period. We could contemplate an interesting game of partnerships between established agri-business, the state and new or emerging farmers in areas of the country with untapped potential or which have endured under-investment historically. Now, in some cases, this means a serious discussion around land rights. But large-scale logistics and network infrastructure investments by the state are key. So too is the role of large agri-business who are the only players who can secure the complementary inputs (credit, industrial organisation for farming operations, and global market access). Importantly we can unlock empowerment and employment at scale.

## **Conclusion**

Logistics enables competitive connectivity with the world. Our employment imperative can only be solved by using logistics with complementary investment to drive a broad-spectrum diversification of the economy. We are a far away land with prohibitive logistics costs, but thankfully there are enormous untapped opportunities. Institutional reform is imperative, and of course, a capable state is essential. Without a committed state, the game is up. The private sector can be invited, cajoled, encouraged and crowded-in to the planning and implementation of a world-class national logistics system. Our employment future could be bright. We need a change in narrative.

# Tourism

**Kate Rivett-Carnac**  
Independent Consultant

## Introduction

In 2019, the global travel and tourism sector accounted for 1.5 billion jobs. In South Africa (SA) in 2018 there were just over 739 000 jobs in tourism, or 4.5% of total employment in that year. This was up from 681 619 persons employed in tourism in 2017 and 705 871 persons in 2016. Most of these tourism jobs (by definition jobs created by foreign and domestic visitor consumption as measured by the national Tourism Satellite Account) fall within the road passenger transport industry (222 666), food and beverage industries (139 250), retail trade industries (113 451) and accommodation industry (128 031).

There are different kinds of employment impacts from different tourists, including by purpose of trip, whether first-time or repeat tourists, and by mode of travel. For example, cross-border land tourists who travel to SA for trade purposes are often repeat tourists who have a large impact on retail in border towns and in Johannesburg<sup>52</sup>, while foreign holiday tourists spend more on accommodation services and visits to attractions, and domestic tourists spend a lot on passenger transport.

The sharing economy has recently opened up participation in tourism for many home-owners who now provide short-stay accommodation services<sup>53</sup>, and for drivers who provide e-hailing services. While creating jobs, these new industries present policy questions in relation to workers' rights, optimal and equitable forms of land use, access to assets, and displacement of traditional industries, amongst others.

## Targets

In 2019, President Ramaphosa set a target of 21 million foreign tourists by the year 2030, up from 10.4 million in 2018. But for 2019 as a whole, SA recorded a 2% decline in foreign tourist arrivals.

This year, 2020, is likely to be tough on tourism too, with COVID-19 having a pronounced effect on global travel patterns<sup>54</sup> and industries: airlines closing routes (and, in some instances, filing for bankruptcy), events being cancelled, and accommodation and restaurants being impacted as people stay at home. In short, the sector is being profoundly affected across all industries.

Given this, in relation to COVID-19, big urgent questions are: how do we respond quickly to support the sector and employment in it? How soon will travel and tourism rebound, and will it be the same?

## Barriers

### **Contagious communicable diseases/ COVID-19**

Contagious communicable diseases have major travel and tourism impacts<sup>55</sup>. Right now COVID-19 is decimating global tourism. New viruses like COVID-19, and the uncertainty associated with them, require short-term strategies to ensure the resilience of the sector.

### **Negative brand perceptions of the country**

Negative brand perceptions exist among would-be tourists, in particular, that SA is not a safe destination given the high levels of crime and xenophobia that

<sup>52</sup> As much as R10 billion in cross-border trade in 2018 in Johannesburg. See Tanya Zack in The Conversation <https://theconversation.com/johannesburgs-inner-city-the-dubai-of-southern-africa-but-all-below-the-radar-86557>

<sup>53</sup> A 2019 Genesis Analytics study for Airbnb using the SAM indicates that the economic activity from Airbnb corresponds to 22 000 jobs (not net) in South Africa.

<sup>54</sup> Singapore, for example, has indicated it expects a 20 to 30% decline in tourist numbers this year.

<sup>55</sup> The Ebola crisis in West Africa in 2014–6 affected all travel to Africa.

exist, as well as increasing instances of crime against tourists<sup>56</sup>. Inequality also plays a role<sup>57</sup>.

### **Access barriers**

When considering a destination, potential tourists will look at the ease of travel to that country. The need for visas, their cost and processing times impact here, as does the availability, routing and cost of flights. Much has been done to reverse the visa regulations introduced from 2015, but more can still be done. In terms of airlift, a national carrier like South African Airways (SAA) can be powerful if it is strategically deployed as part of a broader country strategy around tourism and trade (think of Ethiopian Air and Emirates).

### **Developing and marketing a diverse and inclusive destination experience**

Many travel packages continue to promote the same old “bucket list” – the Big 5, Cape Town, the Garden Route – while SA has many other compelling attractions and experiences to offer, particularly for repeat tourists. Many of the leisure and business events companies, which are often small or medium-sized, and sometimes family-owned, are nearly all white-owned and operated. Building new markets and new experiences requires that the industry evolves in terms of racial, gender, and geographic participation at every level.

### **Addressing aviation emissions**

Aviation emissions associated with air travel are a fast-emerging threat to long-haul tourism everywhere. Flight shaming is a real issue in certain markets, ecotaxes on aviation are likely to increase the costs of air travel and the global travel industry is itself increasingly responding to the need to be carbon-neutral. This is not a short term issue and will likely only become more pronounced. SA is far away from many of the major global holiday and business events’ tourist markets. In addition to aviation emissions, SA’s dirty energy mix means it is already a carbon-intensive destination.

### **Ineffective local government**

There is an important if somewhat neglected role for local government in tourism. At a minimum,

infrastructure services must work to support residents of towns and the businesses that need to operate. Without water, electricity and adequate roads, it is hard to develop a tourism economy. It is essential that effective governance is restored at the local government level to exploit tourism’s potential.

## **Recommendations for employment creation: innovative interventions**

In our response to COVID-19, we need to safeguard the tourism sector and employment within it. This could include diverting marketing funds towards domestic travel, providing property tax rebates for accommodation establishments and event venues<sup>58</sup> and encouraging development finance institutions (DFIs) and commercial banks to provide bridging capital for cash flow purposes. Broader economic measures to support expenditure and infrastructure investment are also required<sup>59</sup>.

To address safety and security concerns, in December 2019, a Tourism Monitors’ programme was launched generating an initial 1500 job opportunities. It aims to create high visibility of safety personnel in tourist hotspots in order to combat crime. It is a public-private partnership partly funded by the voluntary TOMSA levies collected from tourists by most hotel groups and other industry players, and channelled through the Tourism Business Council of SA. The programme is being driven by the National Department of Tourism in partnership with the South African Police Service (SAPS) and industry. It is likely to be expanded.

In terms of access to the destination, the new e-visa pilot in India should be fast-tracked and e-visas rapidly introduced elsewhere, as well as further visa waivers actively explored. Outside of a clear national development agenda for SAA, WESGRO and agencies of other provinces have been pursuing direct air linkages with carriers servicing major markets like New York. An air access strategy needs to be supported to ensure adequate air links exist with important tourist

<sup>56</sup> Other recent negative brand associations with South Africa include the water crisis in Cape Town (‘Day Zero’ messaging of 2018). These ‘once-off’ events impact tourism for a few years, given forward booking lead times and ongoing negative associations.

<sup>57</sup> Cape Town has in 2020 been included in the Fodor’s ‘No’ list as a tourist destination because of crime, inequality.

<sup>58</sup> Singapore’s government is providing property tax rebates for accommodation, airports; a specific co-funded package for taxis; rental waivers in government food markets and commercial food and beverage tenants; and a temporary bridging loan facility to provide cash flow for tourism enterprises; a leave of absence support programme for companies whose employees have to stay at home.

<sup>59</sup> At the time of publication, a R200 million Tourism Relief Fund had been established to provide once-off cash grants to qualifying small businesses.

markets, particularly given SAA's tenuous situation and COVID-19, which is having a pronounced impact on the aviation industry.

A deliberate programme, possibly an incentive, is required to support the development and packaging of new and existing attractions and experiences for growth markets and underserved market segments. These include Chinese, Indian, African air markets, domestic travel segments, cross-border shoppers, creative and cultural tourists, sports tourists, and adventure and activity tourists. A challenge fund could solicit and co-fund proposals and provide marketing support.

Such an incentive should also support proposals that link to local recreation experiences and assets by supporting local events, informal markets, precinct development, public art programmes<sup>60</sup>, upgrading of green spaces and rivers, and linking and connecting corridors for non-motorised movement. Ultimately, tourists want to participate alongside residents in a set of vibrant, diverse destination experiences. Experiences which cater to local visitors and domestic tourists will be critical in a post-COVID-19 era, as international tourism will take some time to recover.

A number of opportunities exist to address the threat caused by aviation emissions:

- Biofuels fuels: there are pockets of activity and conversations taking place on using alien vegetation and agricultural waste for biofuels. Pilot projects could be expedited. This has significant employment potential and could position SA as the leading biofuels' manufacturer on the continent. There is also a substantial risk to not investing in alternative jet fuels when SA is so reliant on air traffic for tourism and trade.
- Coordinated offsetting into credible poverty alleviation projects with employment creation impacts should be considered in the short to medium term. The carbon tax supports this.
- A medium-term opportunity for overnight high(ish) speed, long-distance commuter trains between Johannesburg, Cape Town and/or Durban once rail infrastructure is fixed, but not at the expense of prioritising local rail commuter transport.

<sup>60</sup> The Rupert Social Impact Art prize for Graaff-Reinet is trying to do this. Tourism development should not be a parallel stream to programmes that develop public spaces, support the creative economy, or green infrastructure.



# The Chemical Sector

**Dr Rod Crompton**

Director, African Energy Leadership Centre, WITS Business School

Chemicals are everywhere in society – plastics, clothing, computers, glues, paints, tyres, fertilizer, cosmetics, toothpaste, explosives and thousands of applications that most consumers never see or think about. Which sector of the economy does not use chemicals? They all do. They are also key to renewable power generation.

Chemicals are the hidden enablers of economic development, the “lubricants” that make modern economic activity possible.

“The whole megatrend with respect to urbanisation, population growth and expansion of the middle class really points to growth in chemicals” (Sasol CEO Fleetwood Grobler (Financial Times, 2020)). Global demand for plastics has grown faster than any other group of bulk materials.

Employment is not in the capital intensive chemical sector itself, but in the other economic activities that it enables. Less than 10 000 people (SAPIA, 2018) produce 80% of South Africa’s (SA) liquid fuels, which have a sales value 40% larger than electricity.

## Constraints

Petrochemicals are the biggest and most important group of chemicals and are conventionally made from oil and natural gas. Petrochemicals thrive in integrated clusters. Unfortunately, SA’s oil refineries are small, ageing and spread across the country.

Typically, an oil refinery has a naphtha cracker attached to it which produces the seven basic petrochemical building blocks (ethylene, propylene, butadiene, benzene, toluene, xylene and methanol). SA had this until Sasol Secunda was built (late 1970s early 1980s for strategic reasons) and the naphtha cracker was closed. Sasol’s coal-to-liquids technology does not produce the full slate of petrochemicals. The ones that it does produce are in proportions that are the inverse of the global norm. This inverse proportion phenomena makes it very difficult for local competitors to challenge

Sasol’s monopoly. Forty years later, SA is still stuck in this petrochemicals cul-de-sac. There seems to be no way out using conventional technologies until manufacturing is substantially larger.

In petrochemicals, the keys to success are low feedstock costs plus good technologies. SA has no conventional feedstocks (oil and gas). In today’s markets, it is doubtful if a conventional crude oil-based naphtha cracker in SA would be competitive given the low feedstock costs in the Organisation of the Petroleum Exporting Countries (OPEC).

The exception may be imported liquefied natural gas (LNG) to petrochemicals for Sasol (Cameron, 2020), presumably based on its depreciated plant and its low cash costs for coal-based liquid fuels (35\$/bbl (McKay, 2019)).

Secunda is under threat from declining gas reserves in Mozambique (said to end in 2025) and carbon taxes. The prospect of Secunda closing, or substantial parts of it, may be within sight. That would be a serious blow to the SA economy. Sasol is the largest firm on the Johannesburg stock exchange (JSE), contributing approximately 20% of liquid fuels supply, and is the only source of petrochemicals.

There are no other immediate feedstock options in SA. Total’s Brulpadda gas find is at least 7 to 10 years away from commercialisation and even then it may not supply SA. It is also a long way from Secunda. Mozambique’s massive gas fields in the Rovuma basin are 3000 kms from Secunda. The pipeline costs would be prohibitive. Government has recently resurfaced the 20 year old prospect of Saudi Aramco building an oil refinery in SA. Most oil industry sources believe this is not commercially viable. Shale gas in the Karoo has yet to be found, even if prospecting regulations are sufficiently relaxed to allow prospecting to happen. The alternative is “business as usual” – growing imports and declining integration between the chemical sector and the rest of the economy.

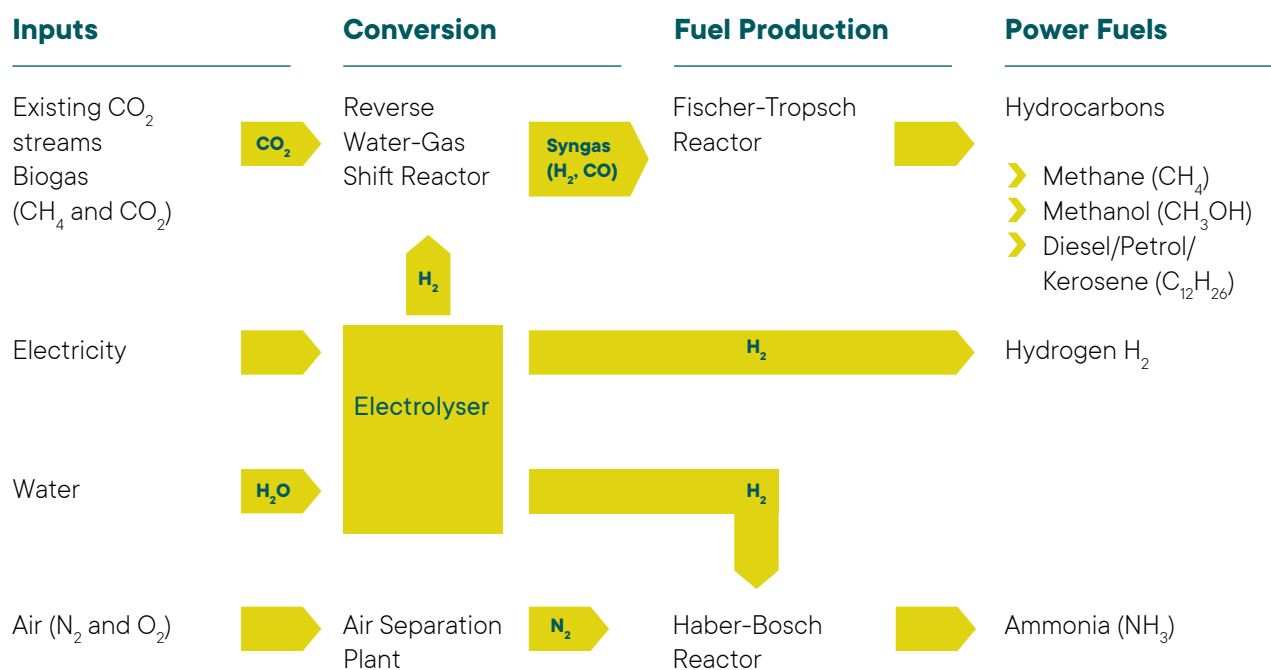
## Opportunities

SA has a natural comparative advantage in solar and wind resources which could be used for renewable power generation. It has water resources (oceans on two of its three sides) and high levels of carbon dioxide (CO<sub>2</sub>) emissions. In addition, Sasol has advanced Fischer Tropsch technology and experience

- a unique advantage. Taken together these constitute an opportunity.

The opportunity is to use cheap renewable electricity to electrolyse water for the hydrogen (split water into hydrogen and oxygen with electricity); capture CO<sub>2</sub>, and use Fischer Tropsch technology to combine them into hydrocarbons as represented in Figure 1.

**Figure 1: Renewable power to hydrocarbons**



**Source:** Bischof-Niemz, T. and Creamer, T. 2019. South Africa's Energy Transition: A Roadmap to a Decarbonised, Low-cost and Job-Rich Future, Abingdon: Routledge.

This will not expand Secunda's limited slate of petrochemicals but it will give it "cleaner", "greener" feedstocks and a much lower emissions profile, which could suddenly turn it from a high to a low emissions producer, which could suddenly open new markets for it. For example, after many years, Sasol was eventually able to produce acceptable jet fuel. There is considerable international concern about jet fuel emissions leading the European Union to begin introducing requirements for "cleaner", "greener" jet fuel. This may be an export opportunity. The same approach can be applied to Sasol's chemicals production.

Current impediments are the cost of electrolysis, but this is expected to come down as demand grows. SA could shift its platinum lobby-driven hydrogen research funding from *how to use hydrogen* (which SA currently does not have and which will serve other countries) to *producing hydrogen* which would serve SA.

Electricity is emerging as "the" energy carrier of the 21st century, replacing oil in the 20th century. The electricity supply industry globally is undergoing a massive technological disruption. Therein lies an opportunity - chemicals required for the new distributed electricity generation sector that is emerging.

The South African Development Community (SADC) has about a 20 000 megawatts (MW) shortage of electricity. The lack of electricity transmission infrastructure and the shift toward distributed generation is creating a market for batteries. Currently, used electric vehicle batteries (which still have a useful life outside of vehicles) are being imported. SA could target battery manufacture but this would probably need a more sensible and market-orientated approach to electricity supply industry reform.

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It is suggested that there is a possible chemical sector growth nexus in low-cost renewable power, a hydrogen economy, cleaner plastics and chemicals, also supplying the emerging distributed power generation and battery equipment sectors.

## Who should drive the recommended interventions?

SA is particularly poor at coordinating and implementing policy interventions. Therefore, I am reluctant to suggest it - unfortunately there seems no other way to activate this nexus of opportunity.

A high-level public/private partnership could drive the initiative. Current Department of Science and Technology (DST) research funding could be redirected in partnership with the private sector and Sasol. The departments responsible for electricity and water would need to make changes to policies and regulations. Whoever is going to be responsible for the "just transition" could play a role. Affected local authorities would need to be supportive.

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# Global and Regional Value Chains and Employment and Growth opportunities for South Africa

**Prof Mike Morris**

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## Conceptual points regarding GVCs and employment

In an era of globalisation, global value chains (GVCs) drive industrialisation activities (manufacturing, services, agri-processing, minerals and energy) on a global and national scale. GVCs are essentially about global and regional linkages, and hence exports and imports play an important role in fostering industrial employment. These global and regional value chains (RVCs) are themselves driven by powerful lead firms which exercise power (i.e. governance) over chain activities. From an industrial policy perspective aimed at stimulating economic growth, this means, firstly that engaging with, and securing participation of, multinational lead firms is a very important part of the process. Secondly, the possibility of the nation state securing a national process of industrialisation without interacting with these lead firms is no longer a reality. Hence GVC analysis requires viewing industrial issues through a political economy perspective.

Looking at employment through the lens of GVCs we can identify three key challenges which local firms have to overcome:

- Accessing entry into chains in order to create greater employment opportunities. However, simply competing on the basis of lowest price in a chain is insufficient, since other firms entering the chain will seek to compete on similar firms leading to a competitive race to the bottom. Access thus impacts the quantitative type of employment activities that GVCs provide.
- Upgrading of production activities within chains to ensure that firms move into greater rent rich linkages within them. This requires building managerial capabilities and worker skill levels to engage in more complex and higher functional

activities. Upgrading impacts the qualitative type of employment opportunities GVCs provide.

- Creating production linkages - forward, backward and horizontal - within chains to widen and deepen local industrialisation. Linkages impact both the quantitative and qualitative type of employment opportunities that GVCs provide.

## South Africa and GVCs

South Africa's (SA) manufacturing exports are dominated by the automotive sector. Linking to the global automotive assemblers located in the country is crucial for local firms (whether they be first, second or third tier suppliers) entering these GVCs, and using these linkages to raise capabilities and skills and create value-added activities. The auto industry is often the most advanced manufacturing sector, and its activities raise the general level of industrial capabilities and skill levels across the economy.

In the apparel labour-intensive industries, GVC imports have increased, from China as well as other Sub-Saharan countries (Lesotho, Swaziland, Mauritius and Madagascar), with negative effects on local production and employment. But this has also substantially raised regional employment in Sub-Saharan Africa. In response to such imports recent SA industrial policy initiatives are having a positive impact on increasing local sourcing as well as raising local sector capabilities and skills levels.

Agricultural exports are mostly of a general commodity nature, with the exception of some niche products. In general, there are insufficient agri-processing (i.e. forward linkage) production activities which create value-added products and more skill-intensive employment.

Minerals are still an important component of the export basket but these are generally confined to raw

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materials. Forward linkages (e.g. beneficiation) within chains are limited, whilst substantial backward linkages into the minerals machinery sector, an important part of country's economic history, have been hollowed out in recent decades.

## Constraints

The SA economy has slowed to a crawl and is beset by economic problems. From a GVC perspective this stems from an inability to tackle critical political problems - e.g. corruption and energy governance failure - which cannot be separated from the operations and failings of the SA state.

Foreign direct investment (FDI) has dried up because global lead firms are extremely wary of investing, primarily for political reasons driving risk. These firms are not being seduced by simple promises of a new dawn. They will not invest in this economy until they see tangible movement, and visible progress, in charging and finding guilty the perpetrators of corruption and state capture. They regard the governance risks as too great and feel that policy certainty is undermined by a lack of overt action. We can see this clearly in the energy crisis and its economic consequences.

The economic problem of failing energy supplies, a consequence of the meltdown of Eskom and the stalling of renewable energy (RE) alternative options, is a good example of political failure impacting economic problems. Stable energy supplies are a necessary foundation for any mature industrial growth in SA. It is clear that Eskom cannot meet this challenge and the carbon intensive path characterising SA's previous industrialisation path has to be superseded. By 2015 SA was a global RE leader, in terms of its highly successful auction bidding policy framework. This led to large foreign owned utilities investing in a vibrant wind and solar RE sector, bringing around \$20 billion in investment. Large multinational corporations (MNCs) (e.g. Siemens, Vestus etc.) which controlled the global RE value chain entered and encouraged their global first tier suppliers (e.g. in tower and blade production) to set up local plants. The knock-on effect for localisation was substantial, facilitating the emergence of suppliers in manufacturing, logistics, and services - i.e. local backward linkages. This green industrialisation path impacted not only new levels of employment, but also skill levels and managerial capabilities, especially in services feeding into this growing RE sector.

However, it all came to an abrupt halt, fundamentally because of political machinations within the state as a corrupt predatory elite (in the private sector and government) diverted funding from state-owned enterprises into their own pockets. In the process they not only bankrupted Eskom, but also blocked the burgeoning private sector driven RE process, which they regarded as an energy competitor. The Zuma government stopped the bidding process and the RE programme ground to a halt by 2015. Continuity and predictability of the bidding process, a necessary foundation for implementation success of the RE programme, was disrupted. FDI consequently dried up, and the industrial localisation momentum was stopped in its tracks. The wind blade MNC shelved its plans for setting up a plant. The tower MNC, with its deep pockets, cut manufacturing capacity and resorted to exporting to other markets while they waited for a new bid window to be opened. Local firms either went bankrupt or found ways of operating with shrinking capacity. Successful service firms built with MNC support were able to use this to export their activities to Europe. The economic stalling of this new green industrialisation path was essentially grounded in political and policy failure.

## Solutions

As is the case in terms of corruption, this green industrialisation problem will not be solved without government showing it is capable of decisive political action. What is required is a fundamentally new approach to Eskom, unbundling it and finding ways to shift its massive corruption induced debt from national players to include global ones. The Green Climate Fund resources can be tapped for blended finance loans, based on shifting from the current carbon intensive emission path to a substantial commitment to a renewable energy path. But this requires unbundling Eskom's current vertically integrated corporate structure into three sets of independent enterprises - generation, transmission, and distribution. This would create a domestic value chain driven by an independent state-owned transmission enterprise which sources energy from public and private sector generating entities and sells electricity to a variety of distribution channels. Unbundling would furthermore create the conditions to resurrect the RE programme, guaranteeing policy continuity and predictability for global players to engage and drive a green industrialisation path.

However, this is not happening because of political failure – an inability on the part of the state to act decisively. There appear to be destructive differences of opinion, strategy and tactics within the Ramaphosa camp paralysing state action. The president has seemed politically unable to ensure unified and definitive government intervention to tackle these economic energy problems. In sharp contrast to his decisive and commendable response to the coronavirus crisis, he has thus far exhibited little of the same leadership in dealing with divisions between his Ministers, within the dominant political party, and government institutions. However, the health crisis may well change the landscape. It is to be expected, that once SA has emerged from this crisis, the President will be able to demonstrate similar

unifying leadership to drive political solutions to what appear to be economic problems, with significant positive consequences for growth and employment opportunities in SA.

In conclusion, without decisive political intervention on the part of the government, some of the major economic problems bedevilling growth and employment will not be overcome. Foreign capital will not invest, MNCs driving global value chains will be extremely wary of setting up operations, and the localisation of industrial activities through linkage development will remain unfulfilled. Employment will not grow in quantitative terms, and the foundational basis of our managerial capabilities and worker skills will not move to a new structural level.



# Commentary:

## Infrastructure in South Africa

### Opportunities and Constraints for Economic Growth

p69

#### **Prof Renosi Mokate**

Executive Chairman of Concentric Alliance

**Summary:** Infrastructure investment is a key factor for economic growth. It has been highlighted as a priority in various development strategies and legal frameworks in South Africa. The challenge is translating these measures into positive outcomes. Some of the constraints to infrastructure development, including funding, implementation capacity and political economy issues are explored in this commentary, along with ways to improve infrastructure implementation.



# Infrastructure in South Africa: Opportunities and Constraints for Economic Growth

**Prof Renosi Mokate**

Executive Chairman of Concentric Alliance

Infrastructure is widely recognised as a key factor for economic growth. It enables economic growth by providing the required networks for the distribution of goods and services, as well as being a source of growth through its value addition to gross domestic product (GDP) and jobs during its construction and implementation phase. Thus, infrastructure investment provides a unique opportunity to tackle multiple developmental and economic challenges at the same time. However, if only it was that easy. Across the world, including South Africa (SA), there seems to be a chronic gap between infrastructure needs and investment in infrastructure.

## Infrastructure as an opportunity for supporting economic growth

Infrastructure investment has been identified as a key driver for economic growth and development in SA. Infrastructure implementation provides an opportunity to, amongst others:

- Improve social service delivery (health, education, security and housing)
- Reshape the apartheid spatial economy
- Transform agriculture
- Support the export market
- Promote backward and forward linkages across sectors
- Exploit fourth industrial revolution (4IR) opportunities to build firms and industries of the future
- Address climate change

The importance of infrastructure investment has been highlighted in the country's various development strategies, in particular the New Growth Path and the National Development Plan. In addition, various structures and a legal framework for supporting

infrastructure implementation have been put in place. In 2011, the Presidential Infrastructure Coordinating Commission (PICC) was established to “ensure a more strategic and coordinated response to infrastructure prioritisation, implementation and funding”. In 2014, the Infrastructure Development Act 2014 (Act no 23 of 2014) was passed codifying the PICC, National Infrastructure Plan and the use of the Strategic Integrated Projects (SIPs) as a mechanism for catalysing the infrastructure rollout process. All the above was underpinned by a systematic process of identifying the country's infrastructure needs and the key drivers for improving success.

There is, therefore, a clear sense of the benefits of infrastructure, certain priorities have been set as well as implementation mechanisms put in place. The challenge is how to translate these measures into positive outcomes.

## Constraints to infrastructure development

As indicated above, one of the challenges that is constantly highlighted is the gap between infrastructure needs and investment in infrastructure. Part of the challenge is the gap between the aggregate quantum of infrastructure need and the quantum of available funding. Is there sufficient funding to meet all the infrastructure needs? A second challenge is the distribution of funding with respect to which institutions hold that funding and where in the infrastructure investment value chain they can allocate their funding, given their mandates and risk appetite. For example, financiers often complain that they cannot find bankable projects. There is a lack of sufficient funding to undertake feasibility studies in order to convert project concepts into bankable projects. A third challenge is planning

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and implementation capacity, as demonstrated by the recent figures that local governments are unable to spend significant amounts of their allocated infrastructure budgets. Fourth, there are a range of political economy issues that create impediments to effective and efficient investment in infrastructure. For example:

- SA's public and private sectors are not in agreement regarding their respective roles in contributing towards SA's infrastructure needs. In addition, the current implementation framework (i.e. Infrastructure Act, PICC, SIPs, etc.) with its state focus, seems to sidestep this issue of how the two sectors should partner.
- How to deal with winners and losers as exemplified by challenges with the implementation of Bus Rapid Transport (BRT) systems in various metropolitan areas.
- Should we adopt the user-pay principle, and if so under what circumstances?
- How to deal with affordability issues.

## **Harnessing infrastructure to support economic growth**

There is an urgent need to look at ways to improve SA's infrastructure implementation in support of economic growth. A lot of work has been done to

assess the country's infrastructure needs. What is required is to determine what successes have been achieved and what the root causes are for the failures encountered. Furthermore, consideration needs to be given to how the various stakeholders involved in the infrastructure investment and implementation value chain in South Africa can better coordinate, share information, and come up with innovative ideas to significantly reduce the infrastructure funding gap. Building the state's capacity to plan and implement infrastructure projects, including mechanisms for tackling the political economy issues identified above is essential. Large infrastructure projects have in the past decade or so been riddled with corruption, design flaws, cost overruns and a waste of valuable resources (e.g. the building of World Cup 2020 stadiums, project implementation at Eskom, Transnet and PRASA); therefore, good governance of state-owned enterprises (SOEs) and infrastructure implementation projects is also critical. There are opportunities for funding through the Multi-lateral Development Banks, as well as other global bodies (e.g. the Global Commission on Economy and Climate), and these should be pursued, particularly with respect to using infrastructure investment to contribute towards a low-carbon growth trajectory. Contribution to employment, through the adoption of labour absorbing approaches, and supporting small and medium-sized enterprises (SMEs) throughout the life cycle of infrastructure projects (i.e. construction, maintenance and upgrading) is also important.



# Panel 5 at a Glance:

## The SOE Debt Crisis: What Is to Be Done?

### Managing State-Owned Companies' Debt

p72

**Dr Neva Makgetla**

Trade and Industrial Policy Strategies

**Summary:** The extent of the financial losses experienced by many of South Africa's state-owned companies (SOCs) are discussed in this commentary, along with an exploration of the factors that have led to the debt crises many find themselves in. Three interrelated issues are highlighted, that are proposed to have contributed to the crises: economic slowdown related to the drop in mineral prices, the lack of early state intervention, and unrealistic business models.

### The SOE Debt Crisis: What is to Be Done?

p77

**Dr Stuart Theobald**

Chartered financial analyst and chairman of Intellidex

**Summary:** Discussing state owned enterprise debt, specifically that of Eskom, this commentary explores how Eskom could reduce its debt load by half. The focus is on two different sets of considerations that should help inform which approach is best in dealing with Eskom's debt. The first are technical considerations, those that are lowest cost and most feasible in line with debt market requirements. The second are policy considerations, those that best fit broader policy reform objectives such as the stabilisation of overall energy supply and reduction in carbon emissions.

# Managing State-Owned Companies' Debt

**Dr Neva Makgetla**

Trade and Industrial Policy Strategies

The bailout for Eskom in the 2020/21 budget comes to R56 billion, with an additional R10 billion provided for South African Airways (SAA). These sums will finance restructuring and current losses, due in part to high payments on debt. Taken together, they equal 3.4% of the total budget. But the budget is only increasing by 5.7%, or 1.2% above inflation, so the bailouts absorb two-thirds of the growth in spending in 2020/21.

In effect, the funding for Eskom and SAA squeeze the funds available especially for the major social services, which constitute 45% of total state spending after interest. As a consequence, the budgets for health, education and police foresee a cut in constant rand. Taken together, their resources increase just 2.8% in nominal terms, while inflation is expected to reach 4.5%, and the population is growing 1.6% annually. Since South Africa (SA) remains one of the most unequal countries in the world, constraining social services in this way will inevitably damage social cohesion and economic development.

These realities underscore the importance of a more consistent evaluation of options for managing the financial crisis at the state-owned companies (SOCs). That, in turn, requires an understanding of the extent of their financial losses and what drives them. On that basis, the different possibilities can be evaluated. Every response entails significant direct and opportunity costs; the available options differ, above all, in terms of which socio-economic groups end up bearing them.

The SOCs operate in three main areas: providing infrastructure, producing other goods and services ranging from arms to nuclear medicine to television and radio shows to construction services, and providing development finance. As a group, they account for a fifth of all capital stock, but only a seventh of annual investment and around 1% of employment. Figures for investment and direct employment vastly understate their impact on the economy, however, since several provide inputs that are critical for national growth and job creation.

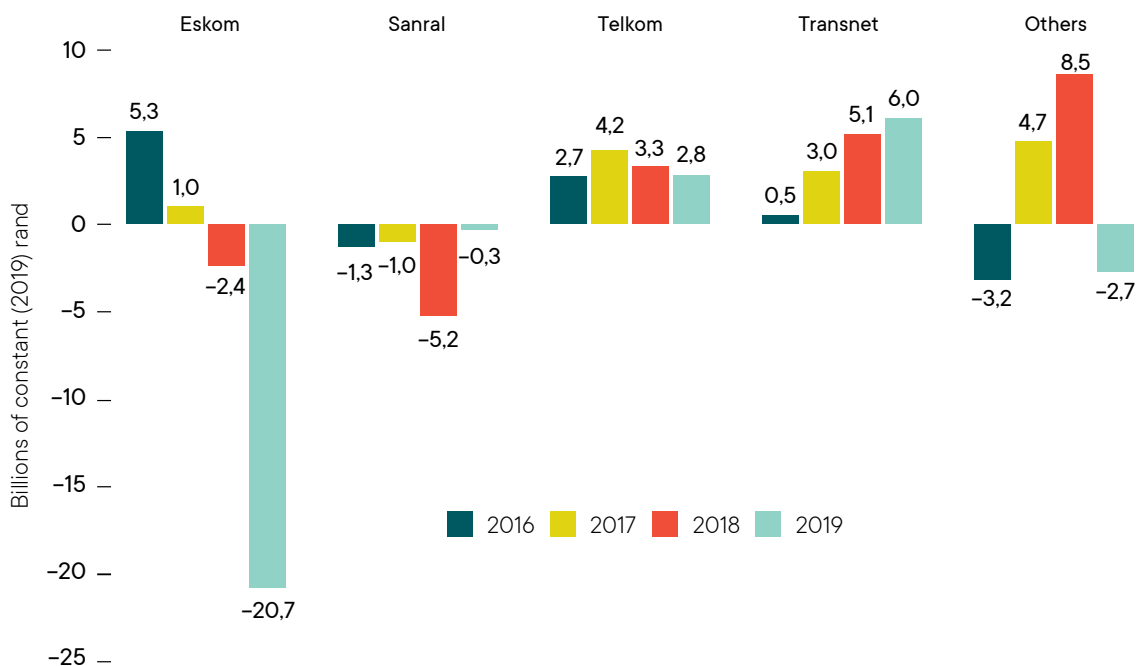
Moreover, the SOCs vary greatly in size, with a few large companies, led by Eskom, Passenger Rail Agency of South Africa is a South African (PRASA) accounting for the bulk of their resources and losses over the past five years.

The assets of the top 25 national SOCs approximated R2 trillion in 2019, with three-quarters belonging to just three – Eskom, Sanral and Transnet. The Public Investment Corporation (PIC) manages another R2 trillion in funds, mostly from the Government Employees Pension Fund (GEPF), mostly invested in the stock market and government bonds. The top 25 SOCs employ 175 000 people, of whom four-fifths work at Transnet, Eskom, PRASA and the Post Office.

In financial terms, public enterprises saw a sharp decline in their performance from 2015. As a group, in 2018/19 the national public enterprises reported R15 billion in losses, with a rate of return on assets of –0.7%. Eskom alone lost R21 billion after paying R25 billion in financing costs. Sanral has also made losses, mostly because it has been unable to generate the anticipated revenue to pay for upgrading the national freeways in Gauteng. In contrast, Transnet has seen rapidly rising profits over the past four years (Figure 1).

From 2016 to 2019, 15 of the top 25 SOCs made losses in at least two years, and seven made losses in all four years. In late 2019, SAA was placed in business rescue and Alexkor and PRASA were under administration. SA Express has not published an annual report since 2017 and SA Nuclear turned out to have misreported losses for the past four years.

Eskom accounted for the bulk of government-guarantees on SOC borrowing in the 2019/20 budget, equal to a tenth of public debt. It also absorbed most of the money used for bailouts, followed at a distance by SAA. In contrast, Sanral and PRASA dominated planned subsidies, reflecting long-run strategies to reduce the cost of commuting and national road transport.

**Figure 1: Profits and losses of the public enterprises, 2016 to 2019**

Source: Most recent Annual Reports

**Figure 2: SOE rates of return on total assets, and number of profitable years<sup>61</sup>**

Source: Latest published Annual Reports for each enterprise

<sup>61</sup> 2016/17 reports were available for Broadband Infraco, the South African Post Office (SAPO), SAA, the South African Broadcasting Corporation (SABC), Central Energy Fund (CEF), Denel, Alexkor, the South African Nuclear Energy Corporation (NECSA), the National Empowerment Fund (NEF), Safcol, and the State Diamond Trade, and for 2017/8 reports were available for all others.

As illustrated in Figure 3 below, Eskom and other public enterprises' share in net national debt commitments and in total government expenditure, year to March, actual from 2016 to 2019, and budget or medium term expenditure framework (MTEF) projections from 2020 to 2022.

We can view the financial crisis at the SOC's through three interrelated lenses.

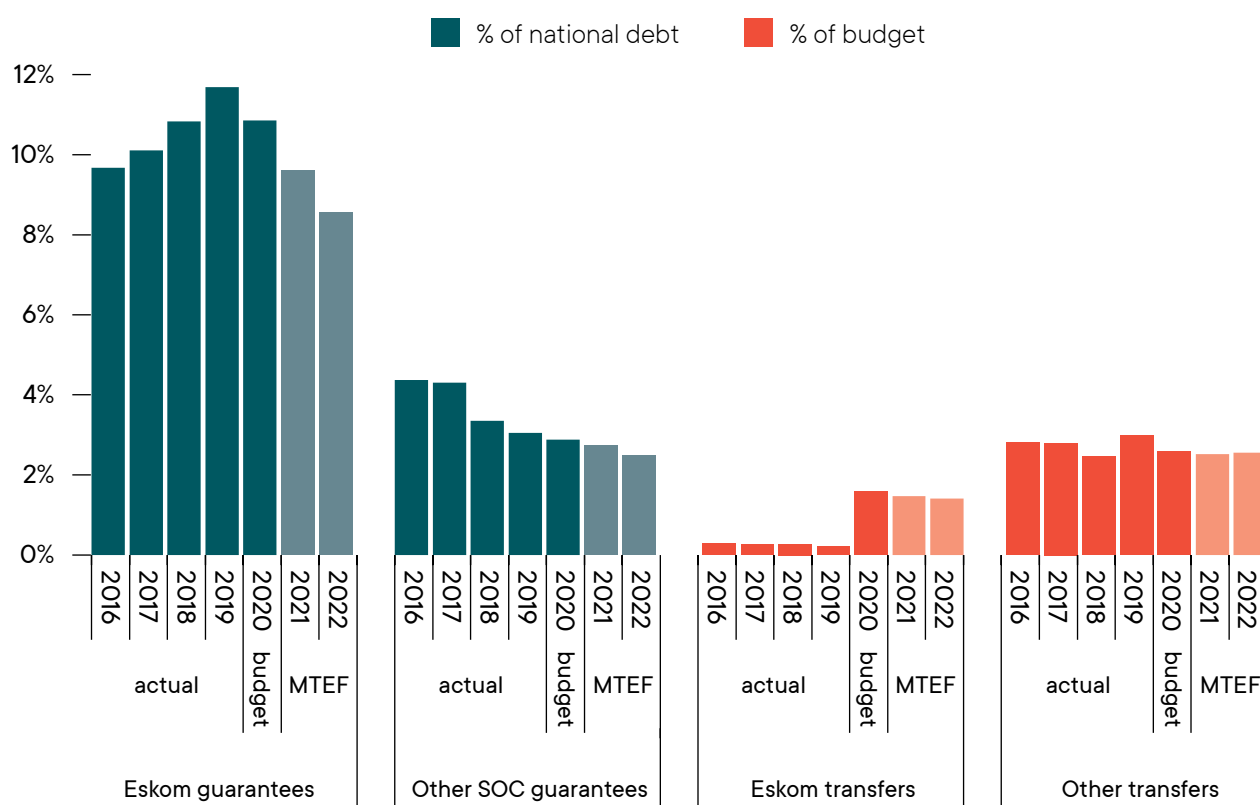
First, at the broadest level, the financial crisis resulted from the economic slowdown that followed the end of the global metals price boom from 2002 to 2011. As Figure 4 below shows, growth in the SA economy tends to parallel changes in metals prices. During the global commodity boom from 2002 to 2011, the SOC's experienced rising demand and revenues. From 2015, in contrast, as international metals prices stagnated and growth slowed, the SOC's found that demand did not meet their expectations. Eskom and Sanral, in particular, had invested heavily in anticipation of rapid economic growth, and their revenues fell far short of the resulting financing needs. In contrast, as the mines faced sharply lower returns from 2011, Transnet throttled back on its investment plans.

Second, in terms of governance, over the past decade the state was prepared to let the SOC's pile up losses over many years, even where they did not generate visible socio-economic benefits. SOC's often generate beneficial externalities that could justify subsidies. In practice, however, analysis of the 12 largest SOC's found that only four had clearly defined developmental mandates. In these circumstances, when an enterprise made persistent losses, the only reasons articulated for bailing it out became saving jobs and an ideological commitment to maintaining public ownership at any cost.

Finally, several SOC's had unsustainable and unrealistic business models. Eskom, in particular, built its business model on three deeply flawed assumptions:

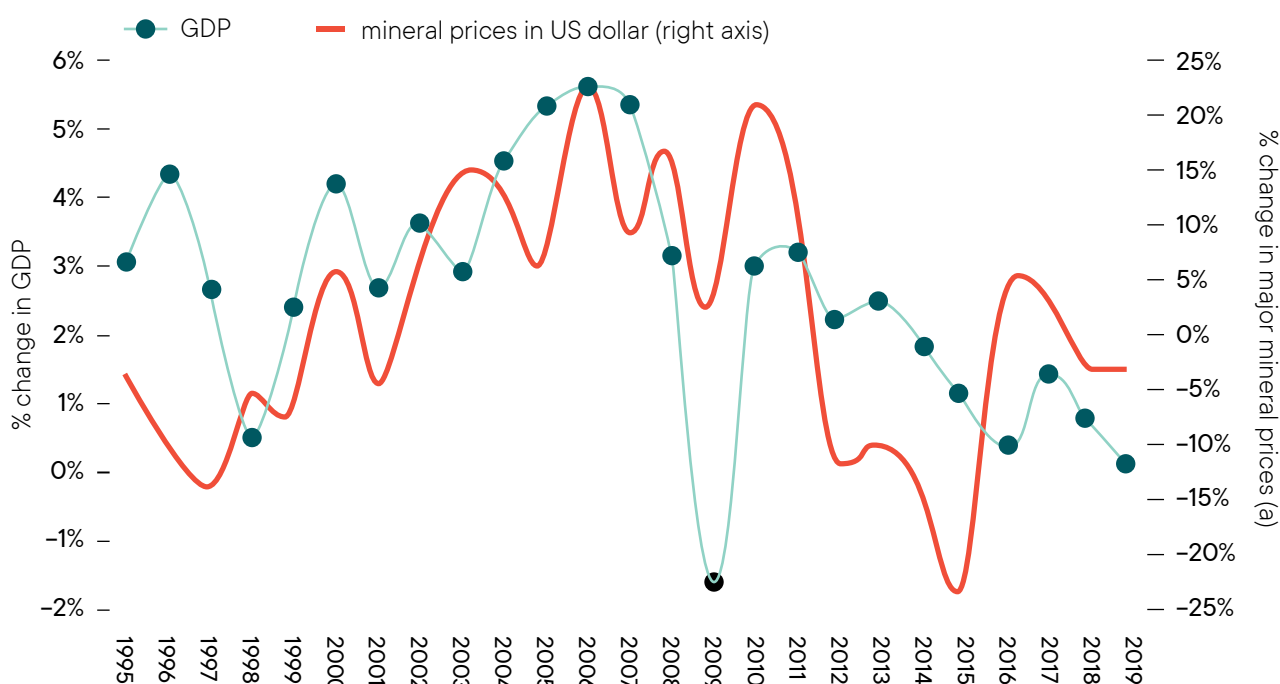
- Demand for electricity would rise continually, irrespective of the tariffs for customers;
- The best way to meet demand is very large, coal-fired plants, rather than newer and smaller technologies that could respond better to shifts in demand as well as limiting carbon emissions; and
- Faced with losses, Eskom's monopoly power would enable it to get either higher tariffs or a government subsidy, so it did not need to focus on cutting costs.

**Figure 3: Eskom and other public enterprises' share in net national debt commitments and in total government expenditure year to March, actual from 2016 to 2019 and budget or MTEF projections from 2020 to 2022**



Source: Calculated from National Treasury, *Estimates of National Expenditure 2019/20*. Print version and excel spreadsheets. Pretoria.

**Figure 4: Growth in GDP and in trade-weighted index of international U.S. dollar prices of major mining exports (a), 1994 to 2019**



**Note:** (a) Index of U.S. dollar prices for coal, iron ore, gold and platinum, weighted by share in exports.

**Source:** For GDP, Statistics South Africa. Quarterly and Regional Fourth Quarter 2019. Excel spreadsheet downloaded in March 2020; for metals price, Index Mundi and Kitco data, downloaded in March 2019; and for trade weights, Quantec EasyData, international trade data at 6-digit HST level in current rand.

In practice, none of these assumptions held in the late 2010s, leading to a pair of vicious cycles.

On the one hand, Eskom faced falling demand as tariffs increased and the international price for mining products stagnated. From 2009, Eskom's sales dropped 10% in volume terms. It argued that it could not cut costs as demand fell, however, so its main response was to escalate tariffs, further depressing demand over time. From 2017, as Nersa increasingly resisted above-inflation tariff hikes, Eskom started demanding government bailouts as well as higher tariffs.

On the other hand, Eskom delayed reconditioning its older plants as it anticipated a capacity boost from Medupi and Kusile. But the new plants were both delayed and technically deficient. As a result, Eskom faced rising breakdowns, which in turn meant that for years it undertook only rushed repairs. At the same time, it resisted any effort to licence other generators in order to protect its monopoly position. Ultimately, in 2019 it imposed rationing on customers in order to provide time for planned repairs and maintenance. That, in turn, further aggravated the slowdown in the economy and in demand for electricity.

The bailouts at Eskom and SAA dwarf the rest of the SOCs. By early 2020, three basic options had emerged: to continue to finance them from the budget; to find ways to utilise financial surpluses at the unemployment insurance fund (UIF) and the Compensation Fund as well as the GEPIF; or to sell their assets for whatever they would bring.

In the case of Eskom, the sale of assets is far too risky for society. In addition to the disruption to the grid, it would likely lead to even higher tariffs in order to incentivise private investors. There are no other suppliers who could scale up to supply or manage the national grid in the short to medium term, so closing Eskom down is not an option.

In contrast, private airlines already outcompete SAA on price and often on quality in terms of both domestic and international travel. The main costs of closing it down are the loss of between 5000 and 10 000 jobs and a reduction in direct flights to SA from some locations, which could damage business engagements as well as tourism.



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As noted above, funding Eskom and SAA through the budget has inordinately high opportunity costs in terms of the impact on basic social services. The R10 billion bailout for SAA, for instance, would be enough to provide an inflation-level increase for both education and health.

The opportunity costs of off-budget financing would be substantially lower. The UIF alone had a surplus of R160 billion in 2020, growing by around R10 billion a year. The Compensation Fund had around half as much. Both the UIF and the Compensation Fund have proven unable to utilise their surpluses to benefit members substantially, as reflected in their growing financial holdings. In terms of the GEPP, because public servants' pensions are defined benefit, the risk of providing lower cost, longer-term funding to Eskom would be borne by the state as employer, rather than by pension fund members. The main opportunity would be the cost of withdrawing a share of their

funds from the stock market, which is already fragile. The amounts involved are, however, trivial compared to overall turnover on the stock exchange.

In sum, analysis of the SOC's financial crisis points to the importance of improving governance, especially to ensure that financial losses trigger a rigorous response. Where an entity cannot demonstrate that its mandate necessitates some losses (that is, where its losses are not offset by external benefits to stakeholders), then it should be forced either to cut costs or to face restructuring, even privatisation. If an SOC meets critical socio-economic functions, then the challenge is to identify the most efficient funding option in terms of government's overall priorities and the opportunity costs. From this standpoint, utilising the surpluses at the social-protection funds and the GEPP makes more sense than cutting core social services.

# The SOE Debt Crisis: What is to Be Done?

**Dr Stuart Theobald**

Chartered financial analyst and chairman of Intellidex

When we talk about state owned enterprise (SOE) debt, it is really a conversation about Eskom. Other SOEs have debt, but it is either manageable based on current financial performance (e.g. Transnet) or part of deep operational problems (Post Office, SABC, etc.). Eskom's balance sheet is enormous, with debt expected to reach R475 billion in 2020. It is in a classic debt trap in that it cannot pay the interest on this debt. In the current financial year, it needs to pay R86 billion to service its debt, including capital repayments due (R48 billion) and interest (R38 billion), but will have only R25 billion of surplus operating cashflows, which must also meet its capital expenditure requirements of R34 billion. That means it needs to raise R95 billion out of a combination of new debt issuance or other forms of funding support from government.

Naturally, this is unsustainable. To rectify this situation, ideally Eskom needs to reduce its debt load by about half. This means removing R250 billion of debt from its balance sheet in order to reduce its debt service costs to within its potential operating cash flows. This must be part of a broad operational fix of Eskom, which should include, in our view, an unbundling of Eskom's generation, transmission and distribution units. The financial solution must be conditional on these operational outcomes being achieved.

The debate on Eskom's finances has been distorted. The point must be to expunge R250 billion of debt. It is not a question of who holds Eskom debt, whether the existing stock or new debt that must be issued, but a question of how we remove R250 billion from Eskom's balance sheet.

Given this objective, there are only four possibilities which I can see:

1. Contributing equity into Eskom such that it has the cash to settle a portion of the debt directly (this is broadly the status quo);
2. Engaging with Eskom debt holders to swap their interest from Eskom debt into debt in which some

other entity is the obligor, such as the SA sovereign or a special purpose vehicle;

3. Forcing a renegotiating of terms. Under threat of default, Eskom could engage debt holders with a view to renegotiating terms (tenure, pricing) of the debt or some other form of restructuring such as a debt-to-equity swap;
4. Disposing of assets. Eskom could, for example, sell some of its plants and use the proceeds to settle debt.

I do not think options three and four are realistic. Of the R450 billion of existing debt, about R297 billion is guaranteed by government, so any default would immediately role into the sovereign. There could be some form of partial default on the balance, but the consequences for overall national funding would be dire in a loss of faith in South Africa (SA) to stand behind its obligations. But the possibility of engaging with non-guaranteed debt holders should still be taken off the table.

Disposals might not actually help matters, quite aside from the politics of privatisation. The carrying value of Eskom's plant on its balance sheet might well be higher than the prices it could raise in the market. Sales, therefore, could reduce its solvency instead of improving it.

Option 1 is broadly the status quo. Government is currently committed to putting R49 billion this year and R56 billion next year into Eskom to enable it to meet its commitments, and will be set to put in R33 billion per year thereafter. This basically covers Eskom's interest bill and ensures it is able to keep operating. The alternatives also come at a cost to government that is not appreciably different to the status quo. But continuing as-is means Eskom would not be able to regain its creditworthiness and be able to enter the debt market again. The only way to make Eskom a sustainable financially independent entity is to expunge a portion of the debt so that its balance sheet is restored to appropriate credit metrics.

There are two different sets of considerations that should weigh on which approach is best in dealing with Eskom's debt. The first are **technical considerations** - which options are lowest cost and most feasible in line with debt market requirements. The second are **policy considerations** - which option best fits broader policy reform objectives such as the stabilisation of overall energy supply and reduction in carbon emissions.

I will consider each of those groups of considerations in turn.

## Technical considerations

Debt restructurings are nothing new. Any company, or indeed any individual, will face debt distress if their cashflows fall short of what is required to comfortably service their debt obligations. Companies, both in SA and abroad, have had to make arrangements with debt holders because of such considerations. Locally, Edcon, African Bank Investments Limited and Cell C are just some recent examples. Eskom differs to these, though, in being far larger in scale and therefore of systemic consequence. There have, though, been some 30 different proposals on what to do on Eskom. Below we sketch out a plan that draws on several of these.

In such debt rearrangements, the following are important issues that have to be considered:

1. Shareholders (i.e. the government) should not be diluted or otherwise prejudiced beyond what is necessary;
2. The cost of the arrangement should be low, representing value for money for all parties by minimising fees;
3. There should be minimal risk of hold-outs creating a situation where activist investors can extort a premium by being the last to agree to a scheme;
4. Minimise litigation risk - the risk that holders will go to court to defend their rights;
5. Is legally sound, recognising the *pari passu* ranking of creditors (which in turn reduces litigation risk);
6. Is simple to execute in not requiring a creditor vote, so minimising execution time;
7. Protects the stability and fiduciary responsibilities of the financial sector;
8. Is sustainable and does not amount to creating moral hazard for Eskom;
9. Is quick and straightforward to implement; and
10. Actually delivers the objective of providing for sufficient balance sheet relief for Eskom.

Some suggestions clearly violate several of these considerations. For example, the Cosatu suggestion that a special purpose vehicle (SPV) should be used to acquire R250 billion of debt from Eskom, funded by the Industrial Development Corporation of SA (IDC), the Development Bank of SA (DBSA) and the Government Employees Pension Fund (GEPF). The proposal did not show how it would achieve point 10 - the acquisition of debt does not mean Eskom would stop servicing it. If the debt were to be expunged, it would have to be by violating point 1 in that Eskom would have to issue shares to the SPV in return for cash to buy back the bonds and cancel them. While the SPV would be a government entity it would complicate the shareholder reporting lines. This would also clearly violate point 7, in that such a step would amount to writing off the value of the assets as Eskom equity would be worthless (there is no prospect of profitability foreseeable). As it is, given existing exposures, the acquisition alone would violate the prudent concentration risk considerations for the IDC, DBSA and GEPF, which already holds 20% of Eskom's debt. As these are state institutions, the state would ultimately bear the liabilities such a move would create anyway, so from a sovereign risk perspective, no net improvement would arise.

## Policy considerations

1. The electricity supply sector should be restructured with an independent transmission and supply operator able to procure energy from all producers. This objective has been policy since the 1998 energy whitepaper and has been reiterated by the president in his 2019 State of the Nation Speech.
2. As a signatory to the Paris Agreement, South Africa has committed itself to reducing carbon dioxide (CO<sub>2</sub>) emissions in the fight against climate change. Eskom is one of the largest emitters of CO<sub>2</sub> in the country. SA is the 14<sup>th</sup> largest CO<sub>2</sub> emitter despite being the 32<sup>nd</sup> largest economy.
3. The transition of the electricity supply system should be just in that individuals and communities should not be prejudiced in the move from coal-dominant production to renewable production.
4. The transition should support wider policy goals of eliminating poverty and reducing unemployment.

To my mind, the right approach, therefore, is a scheme by which the right amount of Eskom's debt can be converted into equity, subject to Eskom achieving policy objectives. At the same time, all possible mitigation tools should be used to reduce the cost of such a scheme.

Functionally, a SPV can be created which acquires R250 billion of Eskom's debt, either in the open market or through block trades from the GEPP and other holders of debt, or by issuing paper to those holders as a substitute for Eskom debt.

The SPV would be an Eskom financial restructuring vehicle that would then actively seek opportunities to lessen the financial burden. It would enter into an arrangement with Eskom through which policy milestones in the unbundling and establishment of an Independent Transmission Market Operator is set. With each milestone, a tranche of the debt is cancelled by issuing shares in Eskom to the SPV worth an amount equivalent to the debt outstanding. The premium on these shares would probably need to be quite low and the SPV could end up owning a large portion of Eskom as a result. But as the SPV would be controlled by government anyway, it would not amount to a loss in control.

Simultaneously, the SPV adds to the Eskom agreement certain CO<sub>2</sub> reduction targets. The SPV could then sell these tons of CO<sub>2</sub> reductions on the global carbon market to raise part funding and reduce the overall cost of the package. As well as selling CO<sub>2</sub>, the SPV may be able to access global concessionary carbon funding at a lower cost than Eskom's existing

borrowing costs and so reduce the cost of funding the debt acquisition. It would act as a central actor in engaging global funding from government development agencies and multilateral funders.

Inevitably, a large part of the SPV's funding needs would have to be a central government transfer. We think the least-worst source of this cash is the sovereign, and therefore it is effectively a taxpayer-funded bailout. We see this as a better option than some form of tax on savers (by somehow forcing pensions to buy valueless instruments). Fiscally it may require a special additional revenue measure, such as a short-term value-added tax (VAT) or income tax levy.

This deals only with the financial problem. Eskom's operational problems remain critical. To cover its operating costs, additional revenue will be required through tariff increases. Consumers, therefore, will bare part of the pain. Additionally, an operational fix is going to require rightsizing Eskom's workforce and reducing its substantial wage costs. This means labour will also carry some of the pain. This sharing of the burden between tax payers, labour and consumers appears fair, though some burden carried by debt holders would also be appropriate. Due to the guarantees and wider market consequences, however, I do not see a feasible way to do so.



# Panel 6 at a Glance:

## Social Issues and Political Economy

### Schooling as an Economic Growth Constraint

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#### **Prof Servaas van der Berg**

Professor of Economics, University of Stellenbosch and  
NRF SARCHI Chair in the Economics of Social Policy

**Summary:** Education plays a critical role in the economy. South Africa has various education constraints, discussed in this commentary, that impede employment growth. These include the poor quality of early education and too few youths completing post-school education and training. The writer interrogates the causes of these constraints and recommends policy intervention programmes including more effective tools to measure the progress of students, improved access to computer-based subjects, greater accountability for principles and increased parental involvement.

### How to Deal with South Africa's Jobs Bloodbath

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#### **Ann Bernstein**

Executive Director, Centre for Development and Enterprise

**Summary:** It is critical to grasp the depth and scale of the unemployment crisis in South Africa, explore its causes and urgently implement the necessary reforms. Illustrating the severity and multi-generational nature of unemployment in South Africa, this commentary explores why economic growth is low and unemployment keeps rising and how policy choices have influenced this reality. The proposal is to focus on reforms that accelerate growth of the economy, while deepening the inclusiveness of this growth. The writer puts forward several implementable reforms that would enable labour-intensive activities to emerge.

# Schooling as an Economic Growth Constraint

**Prof Servaas van der Berg**

Professor of Economics, University of Stellenbosch and  
NRF SARCHI Chair in the Economics of Social Policy

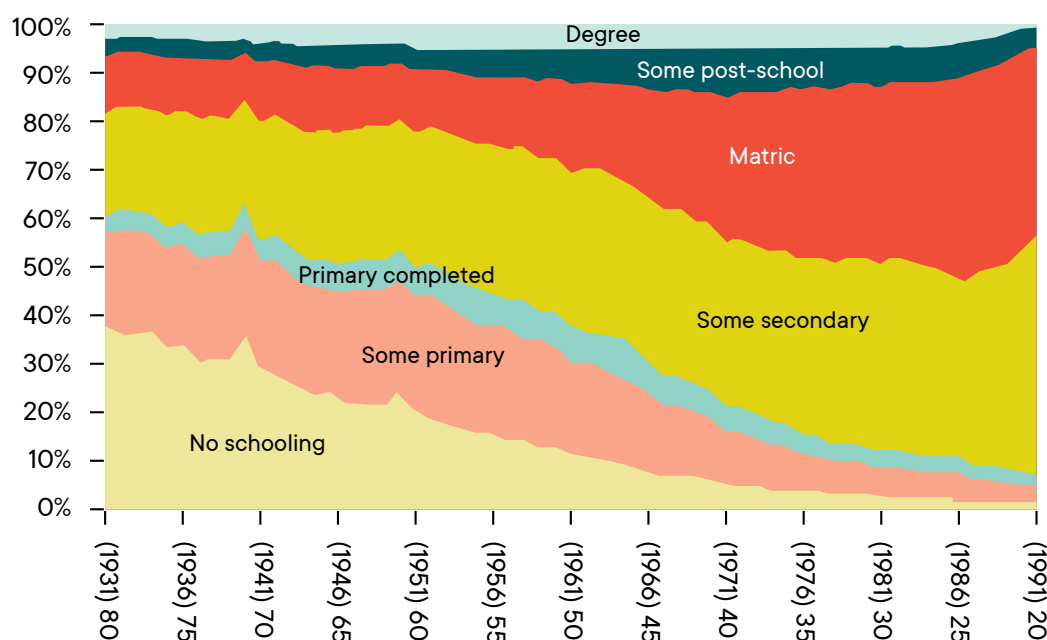
## How does education currently affect employment opportunities in the economy?

Education's main role in the economy is through its impact on productivity. This is reflected in wages, but also in the ability of firms to successfully compete in the market. If productivity is too low, firms cannot compete against cheaper imports. Even when international competition is not the issue, production processes would tend to be capital intensive when labour's productivity is low. One of the ways in which the lack of education constrains employment is because of the imbalance in the **skills mix**. A modern economy requires skilled people across many firms and industries; these skills are often combined with the employment of less skilled people as well. A shortage of senior or middle managers, or of engineers or accountants, prevents some investment, whether domestic or international, from taking place.

Figure 1 illustrates the distribution of the population by age at the time of the 2011 census. It is clear that younger cohorts have far greater levels of education than the older cohorts (the slight decline for some qualifications for younger cohorts is because some of them are still in education), so the labour force is continually being strengthened with more educated cohorts replacing less educated cohorts. However, in a stagnant economy, the opportunities for younger cohorts to get jobs and to learn on the job to supplement their school-based skills is limited: Education cannot be the stimulator of growth, but in a situation of growth, its benefits are more obvious.

Even though average education levels are rising rapidly, there are still severe problems in **education quality** in much of South Africa's education system. This is particularly the case for lower levels of education, where the basic foundations are often poorly laid, as reflected for instance in the fact that only 22% of grade four children reach the

**Figure 1: Qualifications by age (Birth Cohort), 2011**



low international benchmark for reading, which is associated with being able to read for meaning.

It is less common in modern economics to pay much attention to **entrepreneurship** as a separate factor of production, along with land, labour and capital. This may in part reflect the dominance of US thinking in economics, where the presence of the necessary “animal spirits” is often simply assumed. It is clear in developing countries that entrepreneurship is not always present in sufficient quantities. The relationship between education and entrepreneurship is not clear, but it is likely that most of the entrepreneurial activity in the most dynamic parts of a modern economy requires a combination of entrepreneurship and technical know-how.

## Overview of current education constraints that impede employment growth in the economy

Education constraints relate to both the fact that too few South African youths complete post-school education and training, particularly university degrees, and the poor quality of education early in the school career, which limits the ability of children to learn to their full potential. SA's performance in the Progress in International Reading Studies (PIRLS), an international test of reading and literacy, shows that Grade 5 children in SA are far behind most participating countries (though only a few African countries participated).

## Constraints in South African schools relate in large measure to what happens in the classroom

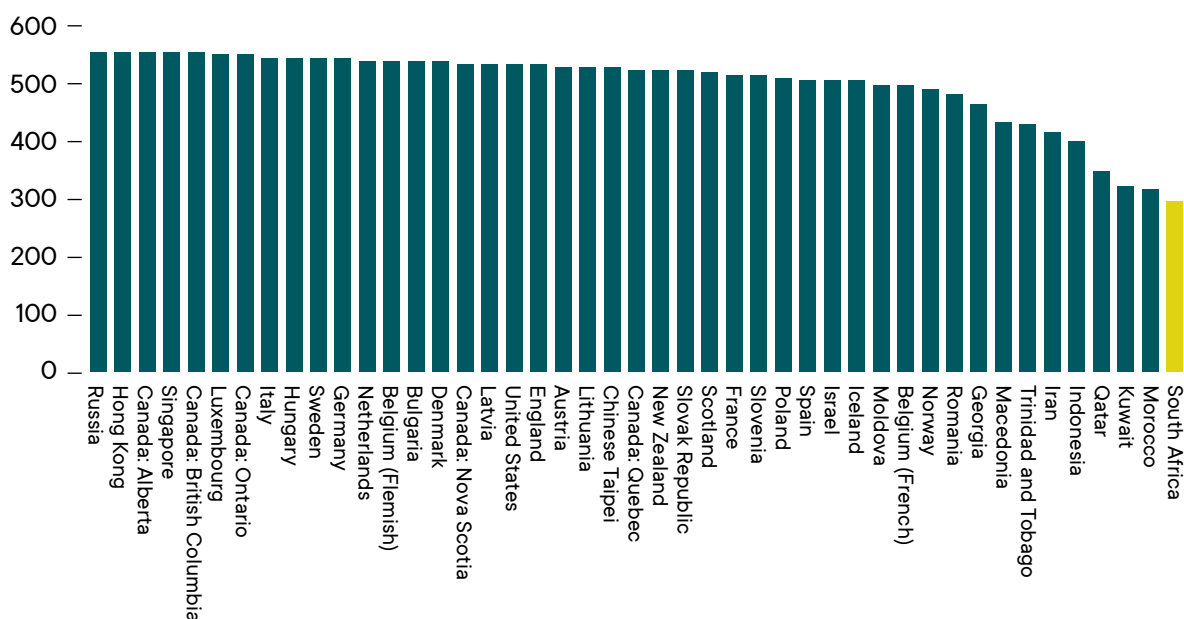
**Resources** are necessary, but insufficient to ensure good teaching and learning. In recent years, resources (particularly textbooks and workbooks) have become more commonly available.

Firstly, classroom problems relate to **how much teachers teach**. We know from a number of sources that less than half the school periods of an average primary school child are used for teaching: Teachers could be absent from the school, absent from the class, or simply not be teaching. One could see that as children losing 100 days of the approximately 200 days that they spend at school every year.

Another important deficiency in our schools is that many teachers do not have full mastery of the **subject content** they are teaching. This was illustrated by the Southern and Eastern Africa Consortium for Monitoring Education Quality (SACMEQ) study that showed that some Grade 6 teachers could not even answer some of the mathematics questions that they should be teaching.

A similar problem relates to **how teachers teach**, i.e. pedagogy. This is particularly problematic when it comes to the most foundational skills, teaching reading and writing in home language in the

**Figure 2: SA Performance in reading in the international context**





Foundation Phase (Grades 1 to 3). Efforts within the Department of Basic Education (DBE) and through a non-governmental organisation (NGO), Funda Wande, to improve this situation are showing some promise, but there is still a long road ahead.

One could mention many other problems in our education system, but if those mentioned above can be tackled successfully, we would make much progress. The impact on the labour force and therefore on employment, though, will be quite slow.

## Recommendations on innovative policy intervention programmes to unlock barriers

One of the reports of the National Education Evaluation and Development Unit (NEEDU) asked whether the issue is that teachers can't, or is it that teachers won't. NEEDU concluded that it is mainly the former, which points to the need for support to rectify the situation. Such support should naturally include pre-service and also in-service training of teachers. However, it should be noted that international evidence is not very positive about changing teacher behaviour through in-service training.

In his 2019 State of the Nation Address (SONA), President Ramaphosa stated the government's intention that, within ten years, every ten-year-old would be able to read for meaning. We will make little progress towards achieving this important commitment if we do not **measure progress**. Widespread testing of reading in the Foundation Phase is essential to determine what progress is being made, but also to determine which schools

and teachers require support. Fears about teacher sensitivities should not prevent us from ensuring the right of every child to a proper educational foundation. We do not necessarily require a national census evaluation, as was attempted with the Annual National Assessments (ANA), but rather a dipstick approach: Subject advisers and other district officials should have tools they can use to see where the problems lie, to be able to provide the necessary support.

School principals hold immensely important positions in our education system. Well-functioning schools can in many instances be directly attributed to parental involvement (which happens more readily in middle-class communities) or to a principal who takes seriously his/her role of providing instructional leadership, i.e. leadership related to learning outcomes. It is essential that **school principals should be held accountable** for this, more so than for many of the bureaucratic responsibilities which often get greater attention. This requires greater monitoring at the district level of how much learning takes place.

One way in which greater **parental interest** in school quality may be elicited is to follow an example that was instituted by an NGO in India. They published short readings in newspapers, and informed readers that a child, in say Grade 3, should be able to read such texts aloud and understand what they have read. This allows at least some community members to test for themselves whether their school is doing its job well in teaching their children.

I have spoken mainly about improving the quality of education, starting in the early grades. This remains the priority, but its impact on the labour market will be slow – which does not mean that it can be

**Table 1: Percentage of grade 12 students in two groups taking technical subjects**

	Black African		White	
	2002	2018	2002	2018
Woodwork	0.6		5.8	
Building-related	0.2		0.7	
Metalwork-related	0.2		1.9	
Motor-related	0.4		3.0	
Electrical-related	0.6	1.1	2.3	2.1
Agricultural (other than Agric Science)	0.2	0.4	1.3	2.0
Engineering-related	0.1	2.1	4.2	5.2
Design	2.1	4.1	16.4	28.3
Computer-related	1.0	3.8	20.6	34.2
Technical maths/science		1.7		4.5
<b>Any of the above</b>	<b>3.6</b>	<b>8.1</b>	<b>40.8</b>	<b>55.8</b>

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neglected. But there is an area in which much more can be done to prepare South African children for a modern economy. In an as-yet unpublished report for a committee of the National Planning Commission, my colleagues Martin Gustafsson, Kholekile Malindi and I found large differences in the extent to which white and black African students took technical subjects in matric<sup>62</sup>. Moreover, while there had been an increase from 3.6% to 8.1% in black African students taking any of these subjects, this is still far less than the 55.5% of white matriculants taking any of these subjects. The greatest differentials relate to computer-related subjects and design. Clearly, before we go to the trouble of introducing coding to very young children, something can be done about **improving access to computer-based subjects** for secondary students, an important skill for a modern economy.

## Who should drive the recommended interventions?

These interventions should, in the first place be the responsibility of the DBE, but provincial education departments need not wait for the national department before undertaking much of this. Naturally, the Department of Planning, Monitoring and Evaluation (DPME) also has a major role to play.

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<sup>62</sup> For reasons discussed in our report, we exclude Consumer Studies, Hospitality Studies and Agricultural Science.

# How to Deal with South Africa's Jobs Bloodbath

**Ann Bernstein**

Executive Director, Centre for Development and Enterprise<sup>63</sup>

Ten million unemployed and rising. South Africa (SA) has the deepest unemployment crisis in the world. In no other country has as large a proportion of the population been without work for as long. What to do about endemic joblessness has been the subject of presidential summits, government initiatives, National Economic Development and Labour Council (NEDLAC) debates, and projects run by the private sector and non-governmental organisations (NGOs), but the crisis has only deepened. The time has long passed for a new approach. If the country is serious about prioritising employment growth, then we need to grasp the depth and scale of the crisis, be honest about its causes, and act with urgency to implement the necessary reforms.

## What can be done?

Only 42% of adults work, a figure that compares poorly against norms of around 60% in the rest of the world, and higher in some developing countries. Of the potential workforce, 38% are unemployed, a figure that is among the highest in the world.

The situation is deteriorating and quickly. Since 2008, the number of working age adults has increased by almost seven million, but the number of people with jobs has increased by less than two million. Between 2008 and 2019, the number of people who want work, but cannot find it or have given up looking, rose from 6.5 to 10.3 million.

Thus, over the past decade, SA's working age population increased by nearly 1700 per day, but fewer than 500 found work. The situation for young people is even worse: between 2008 and 2019 people aged between 15 and 34 increased by 2.2 million, but the number employed actually fell – by more than 500 000.

One of the damaging consequences of a multi-generational crisis of joblessness is that it becomes

self-perpetuating. Insiders use their insider-status and power to ensure that the benefits of economic growth are captured by them rather than by expanded employment. The long-term unemployed also become increasingly ill-suited to the needs of the economy: their skills deteriorate, their training becomes less relevant, and their soft skills and workplace readiness deteriorate. Jobs are platforms for training and the acquisition of know-how. The unemployed are doubly disadvantaged: not only do they have no work, they are also not acquiring workplace experience and skills needed to compete for what jobs are available. The result is that employment tends to be concentrated in households in which previous generations were employed. This is a key reason why addressing unemployment needs to be tackled with much more urgency than it has been.

The central factor creating this crisis must be grasped: unemployment is high because economic growth is low. Growth has been low because governance – policy choices, delivery, institutional effectiveness – has been poor. Before 1994, apartheid was to blame and after 2008, state capture, increased antagonism towards business, and widespread corruption precipitated a near-fatal collapse of governance. Two other factors have been especially important. SA's multi-generational failure to educate its workforce and the spatial legacy of apartheid, which has imprisoned many in poverty traps and retarded urban growth.

High levels of unemployment are not just a consequence of low growth: policy choices have produced an economy that needs less and less of the one human resource that this country has in abundance, unskilled labour. Central to these government choices are those that have discouraged firms from hiring unskilled labour. Industrial policy has favoured skill- and capital-intensive sectors and, within sectors, has incentivised firms to embrace capital- and skill-intensive production techniques.

<sup>63</sup> This article is based on a new CDE publication, *Ten Million and Rising: What it would take to address South Africa's jobs bloodbath*, January 2020. See [www.cde.org.za](http://www.cde.org.za)

The wage-setting system has pushed up wages even in the presence of vast unemployment. Employment costs are pushed higher through a variety of non-wage risks and costs.

Given the depth of the crisis, there is no plausible strategy for dramatically reducing unemployment in the short term. There is, however, considerable scope for reforms that would improve the performance of the economy and deepen the inclusiveness of growth by increasing employment.

The key, of course, is faster growth: technological advance means that even a slow growing economy could shed jobs, so unless growth accelerates, employment growth is much harder to achieve. This is no small task because the constraints on growth are severe: Eskom can't produce enough power, the Passenger Rail Agency of SA (PRASA) trains can't get employees to work, the public sector is over-borrowed and deeply compromised, and emigration appears to be at a multi-decade high. Add to this the ruling party's embrace of policy ideas that can only harm growth and its inability to fix the schools or skills system, and one would be hard-pressed to tell an optimistic story about our near-term growth prospects. That being said, an economy that is on its knees may respond more rapidly to appropriate reforms implemented with speed and determination, than we anticipate now. We will only know if and when government stopped tweaking and tried to do the right thing.

But growth-accelerating reforms alone will not make any growth we get more inclusive. To achieve that, we need to address some of the reasons why too few jobs for unskilled workers are created. Here, the key problems lie in the labour market. Urgent reforms are required but they must be calibrated to minimise impact on the rights and living standards of existing workers, without making it even more difficult for firms to adjust to competition and the vicissitudes of the economy. We also need to get more out of our existing public employment programmes.

The Centre for Development and Enterprise (CDE) is proposing a set of plausibly implementable reforms that would create space for new, more labour-intensive activities to emerge and grow. Some examples are:

➤ SA needs to introduce legal exemptions for small and new firms from collective bargaining agreements to which they are not party. Collective bargaining structures should also be rebalanced to provide greater representation of small and new firms' interests and concerns.

➤ The balance of our industrial policy needs to shift from a bias towards supporting capital-intensive firms and investment in plant and equipment to one that is more supportive of employment growth, especially unskilled workers. One way to do this would be to expand and extend the employment tax incentive to a wider range of workers and for a longer period. Modest reforms to hiring and firing - making it easier and less risky for firms to terminate new employees during their probationary periods, for example - would help de-risk the employment decision for employers.

The legislatively mandated annual review of the national minimum wage (NMW) must engage seriously with its potential disemployment effects in labour-intensive industries. The NMW exemption system needs to be accessible and affordable for smaller firms, the period of exemption not unduly short, and any upward revisions to the NMW level must not simply be indexed to inflation or higher.

One way to test the potential impact of some of the changes CDE is proposing, would be to establish an export processing zone (EPZ) at Coega in Nelson Mandela Bay. This would be aimed at attracting labour intensive, low wage manufacturing firms, the output of which would be for sale exclusively to export markets. The firms would receive exemptions to key aspects of SA's labour laws, especially in relation to the outcomes of collective bargaining, but would be entitled to no incentives other than the employment tax incentive (ETI) which would need to be expanded as we have proposed. Given the limited experience of SA entrepreneurs in global value chains of this kind, concessions would also have to be made to immigration rules so that foreigners might invest in and manage these firms, and so that firms could attract the managers they might need.

SA's current approach to jobs is not working. A new approach is needed, one that is not focused exclusively on ad hoc projects or special initiatives. These can never reach the scale required and they divert leadership, focus and resources away from the country's key task - designing, implementing and successfully managing a policy reform process.

Politically difficult decisions will have to be taken if we are to achieve faster economic and employment growth. SA requires leadership, political will and astute political management if the country is to become serious about the ever-growing jobs crisis.



# Panel 7 at a Glance:

## Unemployment and Active Labour Market Policies

### Lessons from the Jobs Fund

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**Najwah Allie-Edries**  
National Treasury

**Summary:** The objective of the Jobs Fund is to co-finance and test innovative approaches to employment creation, and to share successful models for organisations and government to adopt as part of their mainstream strategy. Exploring some of the current gaps in labour market interventions and the Jobs fund experience of implementing a range of job creation models over 8 years, this commentary outlines potential policy considerations in the job creation landscape.

### Youth Employment Service (YES)

p95

**Tashmia Ismail**  
Youth Employment Service

**Summary:** The Youth Employment Service (YES) was established to support and drive the employability of unemployed youth in South Africa via a demand-side initiative. The writer explains how digital solutions, along with other key factors have played a critical role in the impact achieved by YES. This commentary also explores some of the challenges faced by YES and explains the importance of coordinated policy implementation and incentives that can stimulate increased participation of businesses in the programme.

# The Presidential Youth Employment Intervention – Five Priority Actions to Accelerate Youth Pathways into the Economy Over the Next Five Years

p100

**Rudi Dicks**

Head: Project Management Office, Presidency

**Summary:** The Presidential Youth Employment Intervention is designed to effectively transition young people into the labour market. It is intended to coordinate and scale up existing youth employment programmes across government, in close partnership with the private sector. There are five priority actions that will be implemented over five years to achieve this objective. These include supporting the township and rural economy and providing opportunities for workplace experience. This commentary explores how this intervention is different from past government programmes, and the specific targeted outcomes that will be achieved.

## The Role of Employment Programmes

p103

**Dr Morné Oosthuizen**

Deputy Director: Development Policy Research Unit, School of Economics, University of Cape Town

**Summary:** Employment programmes have a critical role to play in the South African context, and ongoing evaluation of the impact of these programmes is necessary to ensure policy makers make better informed policy and design choices. This commentary discusses the details and development of the Extended Public Works Programme (EPWP) in South Africa, explores global evidence on the use and effectiveness of employment programmes and states the need for a deeper and more robust assessment of the impacts of the EPWP.

## Reflections on the Margins: A Framework for Growth, Work and Market Linkages in the Informal Sector

p106

**Ayabonga Cawe**

Managing Director, Xesibe Holdings and Sessional Lecturer, University of the Witwatersrand

**Summary:** In South Africa, with high unemployment numbers, deindustrialisation and inequality, activities in the informal sector remain a crucial livelihood source. This commentary explores constraints, such as barriers to entry and locational challenges to the growth of informal sector economic activity. Moreover, it explores some of the structural features of the informal sector that prevent it from playing its 'mop-up' role as outlined in the literature. It also touches on key opportunities such as growing transport and niche retail sectors for promoting employment within the informal sector.

# Lessons from the Jobs Fund

**Najwah Allie-Edries**  
National Treasury

## Introduction

Unemployment has a profoundly negative effect on a country's development and prosperity. In South Africa (SA), unemployment remains one of the key economic and developmental challenges that the country is grappling with and a well-coordinated response is required. This summary paper highlights some of the current gaps in labour market interventions, the Jobs Fund's experience after eight years of implementing a range of job creation models, and potential policy considerations in the job creation landscape.

### Box 1: Background to the Jobs Fund

The Jobs Fund was launched in June 2011 in the context of large-scale unemployment in SA. Capitalised with R9 billion, the Fund's aim is to co-finance and test innovative approaches to employment creation and share successful models in such a way that organisations and government are encouraged to adopt these approaches as part of their mainstream strategy.

The Jobs Fund operates on "Challenge Fund principles", which means it has the following core features: 1) funding is allocated to projects on an open, transparent, and competitive basis; 2) projects are co-financed and applicants share risk with the Jobs Fund; 3) the key goal is to overcome cost, technology and infrastructure, and technical expertise barriers (de-risk).

The Jobs Fund supports interventions under four funding windows: **enterprise development** (investments designed to broaden access to economic opportunities [labour demand]); **infrastructure investment** (infrastructure investments that directly enable enhanced investment [labour demand and supply]); **support for work seekers** (for programmes resulting in a job match for the beneficiary [labour supply]);

**institutional capacity building** (for projects aimed at strengthening institutions through which jobs are created [labour supply]).

## Current market gaps in employment creation interventions

### Supply-side interventions

Large sections of the labour market have inadequate or inappropriate skills and characteristics relative to labour demand. This results in high rates of unemployment among the poorly educated and unskilled, who are disproportionately likely to be young, female or black. In addition, job search activities are likely to be both difficult and costly for some of these groups due to their spatial dispersion – travel is the largest job search cost. The lowest wage earners in urban areas pay up to 40% of their incomes on transport costs<sup>64</sup> and over 70% of non-searching youth indicate that their location constrains them from looking for work<sup>65</sup>.

In young people aged 15 to 34 years, 40.1% are not in employment, education or training (NEET)<sup>66</sup>. Youth in rural and marginalised areas such as townships are in need of skills development and work opportunities.

The enormity of the youth unemployment challenge suggests that more work is needed in the piloting and testing of innovative ways to improve the employability of unemployed young persons, as well as in the speed in which job creation models, that are known to work, are scaled and replicated.

### Demand-side public and private sector interventions

There are a number of factors that act as deterrents for employers to take on labour. These include structural issues, such as the relatively high regulatory

<sup>64</sup> Kerr, A. (2015) Tax(i)ing the poor? Commuting costs in South Africa in REDI3x3 Working paper 12, Sept 2015

<sup>65</sup> Mlatsheni, C. and Ranchhod, V. (2017) *Youth labour market dynamics in South Africa* in REDI3x3 Working paper 39, July 2017

<sup>66</sup> STATSSA (2020) Quarterly Labour Force Survey, Quarter 4 of 2019.



burden associated with employing people, uncertainty due to weak economic conditions, perceived political instability, mixed messages regarding economic and labour policy, and infrastructure backlogs. However, other constraints include costs associated with moving people to and from their place of work, institutional hurdles faced by public-private partnerships, and limited access to finance (especially for small firms).

According to literature, small, medium and micro-enterprise businesses (SMMEs) are regarded as the biggest contributors to the creation of new jobs<sup>67</sup>. The National Development Plan (NDP) envisioned that by 2030 SMMEs will contribute a 60–80% gross domestic product (GDP) increase, and generate 90% of the 11 million new jobs<sup>68</sup>. As reflected in the literature, as well as in evaluations of Jobs Fund Enterprise Development projects, SMMEs face a number of challenges ranging from a lack of access to finance, technical training, markets, infrastructure and business support services.

A number of apartheid era rooted challenges hamper the establishment of new informal economy enterprises and limit the growth of existing firms in the sector, which affects the sector's ability to create jobs. These constraints include poor linkages to the mainstream economy (established value chains and markets), lack of infrastructure to support their productivity, lack of business systems and technology platforms which deepen information asymmetries and limit access to finance<sup>69</sup>, and a constraining regulatory environment. This is in spite of the fact that the NDP projects that the informal economy could create up to 2 million new jobs (or self-employment opportunities) by 2030.

## Direct and indirect government business incentives

Established enterprises and big businesses also play a role in employment creation, firstly in maintaining jobs and secondly in the creation of new jobs.

In SA, investment incentives are used to mitigate the cost or uncertainty of doing business, and to upgrade or sustain production and employment, especially in priority sectors.

Incentives are also used to improve competitiveness, address historical inequalities and increase the participation of historically disadvantaged groups in the economy. There are also many incentives that

are designed to address market failures in the labour market, where there is a significant mismatch between the skills generated by the education system and the needs of business.

While job creation, transformation and SMME development are addressed by between 40% and 50% of direct incentives, investment stands as the single most common objective and is reflected at approximately 80% of the direct and indirect incentives captured in the inventory carried out by government<sup>70</sup>.

A review of over 200 business incentives resulted in the identification of a number of gaps which may affect the rate of employment creation. Both gaps and recommendations to address these gaps are included in Box 2 below.

### Box 2: Business incentives review recommendations

- A large part of the incentive system is oriented towards sustaining mature industries and protecting workers in existing companies, rather than facilitating new entrants (companies or sectors) or technology diffusion.
- Insufficient attention is given to the rationale and design of new incentives, and the monitoring and evaluation of existing programmes.
- All departments responsible for the administration of business incentives should develop a comprehensive monitoring and evaluation framework, in which all substantive incentives (with budgets of more than R100 million a year) should be subjected to an independent evaluation, the results of which should be made public.
- Despite the existence of significant expertise in some units, there are weak mechanisms for sharing lessons and information within departments and across government, and in most instances, officials do not look beyond sector or department interests.
- The DTI together with the National Treasury should invest in the design and development of a comprehensive and online grant and document management system, that also houses a single register of all beneficiary firms. This should be administered by the National Treasury or SARS.

**Source:** (DPME, 2018)

<sup>67</sup> Globally, over 95% of enterprises are SMMEs and employ 60 – 70% of the working population.

<sup>68</sup> National Planning Commission (2012). National Development Plan 2030.

<sup>69</sup> There is also insufficient quality business credit record data in South Africa for funders to access, which further exacerbates the challenge of accurate and appropriate credit scoring.

<sup>70</sup> Department of Planning, Monitoring and Evaluation (2018). Report on the Evaluation of Government Business Incentives

## Experience of the Jobs Fund

The Jobs Fund has over 140 contracted projects that implement a range of job creation models across several sectors/industries in the economy.

As a result of this diverse portfolio, the Jobs Fund has built up a wealth of knowledge regarding job creation programmes and the labour market that can contribute to policy discussions.

The Jobs Fund supports both supply and demand-side interventions under four funding windows, and good practice, challenges and policy considerations under each area are discussed below.

### Support for workseekers interventions

The aim of the support for workseekers (SWS) funding window is to link active workseekers to formal sector opportunities and job placement.

SWS interventions focus particularly on unemployed youth and include job search projects, training activities and support for career guidance, and placement services. The programmes supported must effectively pathway the beneficiary into a suitable job.

Key considerations for support for workseekers programmes are discussed below.

#### Demand-led training

The design of models which train unemployed youth in preparation for placements with employers must be in response to the skills gaps and employment opportunities identified by employers. This ensures that the right profile of youth is selected, the optimum number is recruited, and the correct skills intervention is designed so as to result in a good employer-employer match. Advanced selection criteria and assessment are thus critical in good matching. Box 3 provides further detail.

Accredited training is not the silver bullet in addressing supply-side labour inefficiencies. Agile interventions that can easily be tailored are more efficient at addressing market requirements and reducing turnaround times. Beneficiaries are therefore placed in jobs at a much faster rate.

#### Box 3: Innovative selection criteria and assessment

Employers should be encouraged to use innovative candidate selection and assessment criteria; going beyond traditional numeracy and literacy tests and matric/tertiary results. These include:

- Attitude, behavioural and aptitude-based assessments, and
- Work environment simulators.

These assessments have been found to efficiently and accurately identify the right candidates for the positions available.

#### SETA accreditation inefficiencies

In many instances, long Services Sector Education and Training Authority (SETA) accreditation processes have slowed the ability of Jobs Fund projects to place beneficiaries into jobs. Delayed SETA certification has prevented youth being absorbed into jobs after the completion of their training/skills intervention. This was particularly evident in health-related programmes (e.g. the training of social auxiliary workers and pharmacy assistants), where certificates had to be issued by the SETA prior to the learner being legally recognised as being able to fill the position.

Other Jobs Fund projects are structured in such a way that workseekers secure permanent placements on the back of programme certificates (not SETA issued) after successful completion of the training intervention.

#### Adequate stipends

Learner stipends need to be better aligned with sector contexts and the constraints faced by learners. The National Minimum Wage Act 9 of 2018 stipulates a stipend range between R1204 to R7023, depending on the National Qualifications Framework (NQF) level. However, in many instances, the vast majority of the stipend is used on transport costs with little left over for food and other consumables. This increases drop-out rates.

In order to lower drop-out rates, Jobs Fund projects have employed various strategies, including:

- Considering the “2-taxi rule” when matching employees to employers, i.e. it must not take the employee more than two taxis to reach work; and
- Supplementing stipends with other creative incentives, e.g. offering meals and healthcare services at work.

## Tracking employment trajectories

The pathway to employment in SA is often characterised by a staggered employment pattern, where young people secure increasingly shorter employment opportunities, only to fall out of these soon thereafter.

Given the volume of youth who are looking for work, an efficient approach is required in order to screen and assess young people for the appropriate pathway in their transition journey and to assist them along the way.

## Policy coordination

Some Jobs Fund projects have found that employers increasingly prefer to take on new entrants in a learnership/internship programme rather than on a permanent/longer-term employment basis due to incentives on offer such as the employee tax incentive (ETI). As a result, there is a constant cycle of learnerships/internships on offer but these learners/interns are often not absorbed as employees into the participating organisations after completion of the programme (e.g. the dti's Monyetla Project).

Although it can be argued that many more youth are afforded the opportunity of a learnership as a result, i.e. much-needed workplace experience, the opportunity cost is that increased internship placements result in *fewer employee placements* (i.e. fewer longer-term secure opportunities for youth in the organisation).

It is important to ensure that the skills being developed are appropriately matched to the demand. In doing this, the probability of a positive match increases, as it is responding to an identified skills gap. Effective matching, therefore, de-risks the employment decision and promotes better job absorption and retention. This is further supported by findings from the University of Johannesburg's Siyakha research<sup>71</sup>.

## Infrastructure investment

The aim of this Jobs Fund funding window is to co-fund local infrastructure investment projects, which directly enable enhanced investment and job creation, e.g. local market and business hub facilities, critical transport and communication links.

## Improving labour supply and demand

Enabling infrastructure can both facilitate skills transfer and capacitate workseekers, and increase demand for goods and services.

An example of this is the Mercedes Benz Learning

Academy project, where a specialised learning academy was built with state-of-the-art equipment and simulators to training artisans in the automotive sector. As a result of an improved supply of home-grown skilled labour, Mercedes Benz increased the demand for vehicle production at the SA plant. The knock-on effect is that this stimulates the automotive value-chain, with both upstream and downstream benefits.

## Increase SMME participation in the economy

For SMMEs, some infrastructure/equipment can reduce the high entry costs for business. This enables them to channel capital towards increasing their business productivity, which fuels their growth and demand for jobs, e.g. A2Pay.

## Key considerations

Demand-led investment is crucial, this ensures that the build adequately responds to the needs of the market and will be fully utilised.

There are currently inefficient regulatory approval systems within some spheres of government upon which infrastructure builds can progress. This inevitably undermines the speed at which infrastructure projects can reach completion and this thus limits the job creation potential of projects.

Infrastructure builds, however, must be paired with:

1. Capacity to manage the facilities, and
2. Capacity to deliver support services to beneficiaries/communities (in cases where the project model includes a support programme, e.g. the construction of an SMME hub where enterprise development support and business development support services are offered to participating SMMEs).

## Institutional capacity building

Institutional capacity-building projects are aimed at strengthening institutions through which jobs are created. There are limited Jobs Fund projects that operate under this window, but findings have been included below.

## Long-term support required

It often takes longer than three years to support non-profit organisations (NPOs) and similar organisations to the point where they have sufficient capacity to sustain their operations without additional public funding. In some instances, these organisations will always require public funding to continue operating.

<sup>71</sup> Graham, L. et. al. (2019) Siyakha Youth Assets Study. Published by Centre for Social Development in Africa, University of Johannesburg

## **Job creation potential limited in the short-term**

Projects under this funding window do not offer quick wins in terms of employment creation. These projects will improve operational efficiencies, remove barriers to doing business, catalyse innovation and thereafter scale up the potential for job creation (supply and demand). As mentioned above, this generally takes more than three years to achieve.

## **Enterprise development**

This funding window aims to support SMMEs to unlock their job creation potential. The Jobs Fund co-invests in projects that are engaged in the development of new business models, product development, local procurement, marketing support, equipment upgrading, or enterprise franchising designed to broaden access to economic opportunities and job creation.

### **Elements of successful enterprise development interventions**

Five key elements of success have been identified when supporting SMMEs to sustainability. These are access to:

1. Enabling infrastructure,
2. Appropriate finance,
3. Markets,
4. Training and mentorship, and
5. Business development support/services.

### **Business incubation**

SMME incubators have been found to be an effective way of addressing unemployment as they reduce early-stage failure rates and develop critical entrepreneurial skills for business success. However, interventions need to focus their efforts on growth sectors, carefully selecting incubatees and then ensuring all five of the key enterprise development (ED) intervention elements are included. Without this, SMMEs tend to move from one incubator to the next and never graduate out of dependency.

When it comes to the incubator as an organisation, those that are sustainable have well thought-out operating models, and funding models are well capacitated.

### **Labour regulation compliance**

SMMEs often cite labour regulation compliance as an administrative burden on an already stretched capacity. As a result, some SMMEs are reluctant to take on young job seekers on a permanent/long-

term basis as they view it as inherently risky for the longevity of their business:

- Labour legislation locks them in to retain employees even when it no longer makes commercial sense for them - may bankrupt the business.
- Reporting regulations are onerous (Unemployment Insurance Fund (UIF) reporting, Pay As You Earn (PAYE) reporting, Skills Development Levy, etc.)
- Cashflow is negatively affected during quiet periods as salaries still need to be paid.

### **Minimum wage compliance**

Early-stage businesses and smallholder farmers battle to comply with minimum wage stipulations, particularly within marginalised areas.

Smallholder farmers starting out are unable to pay themselves minimum wage but are expected to pay their workers minimum wage. This can cripple their efforts to expand, when most of their revenue is spent on wages, instead of agricultural inputs and equipment to expand their operation. Without the correct inputs, they are unlikely to reach economies of scale and thus sustaining a profitable agriculture enterprise will become more and more difficult. This can impede the pace of successful land reform and empowerment, labour absorption in mostly priority nodes and overall farm success.

Businesses in the primary economy face similar challenges.

### **Expansion of informal/primary economy opportunities**

Townships and the informal economy offer unique opportunities for economic growth and labour absorption, however, the regulatory environment requires some level of reform to allow these businesses the legroom to grow.

For example, legacy municipal by-laws and other regulations and practices constrain the growth of informal enterprises. For example, most township land is zoned as residential and informal trade permits are difficult to obtain.

#### *Access to Infrastructure*

Entrepreneurs in townships and other marginalised areas need infrastructure to support their productivity, e.g. office space, storage and sorting facilities, as well as those for light industrial/manufacturing. Instead of building new hubs and other types of shared facilities that would serve this

purpose, there is also an opportunity to re-purpose currently under-utilised public infrastructure such as hubs, community centres and libraries. This, however, would require that all these spaces are mapped and current use established.

The lack of business systems, including information technology platforms, affordable mobile data and internet connectivity further worsens the gap between formal and informal sector business as a result of information asymmetry.

#### *Markets and Funding*

Township enterprises are disconnected from local and international formal markets, including those now made possible through the advancement of technology (e.g. Amazon, Alibaba). There is also limited access to funding because informal sector businesses do not have systems that help them collect and process basic trading and financial data, and they lack collateral to secure the funds in the first place.

## Conclusion

Although many job creation programmes and initiatives have been designed to address unemployment in SA, there is a general sentiment from implementers, scholars and government, that these have largely been uncoordinated. The recently launched Presidential Youth Employment Initiative begins to address this by planning a systemic approach that will identify/create and coordinate the myriad of services to pathway the unemployed into income-generating activities. This will inevitably require a supportive regulatory environment that needs to complement the efforts of this campaign.

# Youth Employment Service (YES)

**Tashmia Ismail**

Youth Employment Service

## Why YES?

Inequality and youth unemployment remain burning issues for South Africa (SA) despite a variety of economic investments over the past 25 years in areas such as skills development, Broad-based Black Economic Empowerment (B-BBEE) projects, public infrastructure spending and small business support. The lack of coordination and integration between many well-intended public sector and private sector interventions has undermined the chances of success. In the private sector, well designed and impactful B-BBEE interventions are siloed and rarely scale, whilst other B-BBEE spend is executed as an administrative requirement with limited impact tracking of this considerable spend.

The result is that youth are getting left further behind with few bridging mechanisms to create paths from failed schooling into economic participation.

Youth face significant challenges in accessing work opportunities. On average, a high school graduate's first job can be expected at age 30, and 40% of 15 to 24-year-olds are raised in homes with no employed adult (The Economist, 2019). A sobering 56% of youth entering the labour force each year do so without a matric certificate. Tragically, unemployment has become the norm in many parts of our country, with the nature and extent of the youth unemployment problem taking on the proportions of a national crisis.

Given the size of this problem, it was clear that this required a scaled, national initiative which brought together the stakeholder groups of government, labour and business. This realisation found form in the Chief Executive Officer (CEO) Initiative in 2017 which, in turn, led to the formation of the Youth Employment Service (YES) and four other special purpose vehicles created to address pressing economic issues.

Born from the CEO Initiative, YES was established as a business-led non-profit organisation (NPO) and was officially launched by President Cyril Ramaphosa in March 2018. Legislative amendments to the Codes of Good Practice were negotiated before the YES NPO could become functional, and this was done

through the course of 2018. By December 2018, YES registered its first companies and could begin to fulfil its intended purpose to support and drive the employability of unemployed black youth via a demand-side initiative that was made possible through innovative policy amendments to the B-BBEE codes.

The YES team worked with government and, in particular, the Department of Trade and Industry (dti), on an amendment to the Codes of Good Practice. The Government Gazette on YES was published in August 2018, followed by a Practice Note in late October 2018. This gave legal standing to YES registration. This legislation took the YES team just under two years to finalise and rewards companies who invest in youth work experiences with one or two levels up on the B-BBEE scorecard. To date, 660 companies have paid their registration and have committed to youth jobs, and, of these, approximately 150 companies have already received YES B-BBEE levels.

The policy amendment and the granting of the registration platform role to the YES NPO allow YES to drive an undiluted focus on creating 12-month work experiences for black youth. A single platform strategy prevents for-profit motives from confusing market players and avoids a loss of focus on delivering a standardised and monitored "quality work experience" for youth. It also aims to prevent this initiative from becoming another B-BBEE box-ticking exercise for the lowest cost product resulting in poor outcomes for youth. On the government side, housing YES in an NPO outside of government structures avoids the bureaucracy, lack of speed and innovation, which could also scupper the aims and scale of the initiative.

## Digital training and monitoring and evaluation of placed youth

YES digitally delivers year-long market relevant work readiness and essential skills training through digital infrastructure and zero-rated apps. The behaviour-based content is delivered via two mobile applications



loaded onto smartphones and delivered to youth who are placed in newly created 12-month work experiences in businesses.

The placed youths' progress is monitored through big data analytics using data from digital surveys, which youth complete over the year-long work experience. This helps create a portfolio of evidence, which is integrated into a curriculum vitae (CV) and reference letter. This assists locked out youth in becoming digitally literate and enables them to forge digital pathways into the economy.

## Socio-emotional skills building and work experience learning by doing

The learning methodology that sits behind the digital learning programme is made up of multiple dimensions, many of which sit in the behavioural and psychological literature. There is a strong argument that poverty reduction programmes that are based on behavioural insights, in fact, are more effective than traditional economic models (Anand and Lea, 2011). Hence, the desire to not only offer youth a work experience, but also training inputs which shift their behaviours by offering a mentor, role model and teacher, in a pocket. The YES digital work readiness programme provides content that focuses on addressing gaps in key socio-emotional skills and practical work readiness skills. YES has followed several educational trends towards a type of learning model that includes micro learning in bite-sized pieces via social e-learning and mobile learning (Penfold, 2016).

Content developed by YES is not traditional, text-based content. Instead, learnings are delivered through short, sharp key messages that are embedded in stories, which take the form of videos, animations and voice overs, providing an experience of graphic-rich, visual and context relevant education to the end-user. These are based on learning methodologies that have been proven to shift behaviours.

Recent experimental psychology studies from the United States (US), and by the Mind, Behaviour, and Development Unit (eMBeD) in Peru, Indonesia and SA, have shown that small, context-sensitive psychosocial stimulations aimed at influencing a youth's mindset can have large effects on educational and labour market outcomes among vulnerable groups in particular (Garcia-Cohen, 2011; Yeager-Walton, 2011; Vakis, et. al, 2017).

## YES impact to date

The impact of YES has been dramatic. In 14 months since December 2018, YES, together with 660 private sector partners, has been able to create over 34 000 one-year work experiences for youth with current absorption rates sitting at 43%. The cumulative salaries of these youth total over R1.4 billion, which goes directly into youth wallets. Over 61% of YES placements are female, 75% have dependents and 85% are from grant households.

In addition to YES salaries, YES has partnered with R-Labs on a rewards programme called Zlto (pronounced Zlato). YES Youth, who complete and publish their certificates on the digital work readiness course, and who participate in community volunteer programmes, such as clean-ups and recycling, collect Zlto points. YES has disbursed R8 million to YES Youth in rewards to drive engagement rates and supplement incomes.

Second year registrations for the programme are strong with **103** companies already in the system for year two of YES, out of a total of 969 registered firms. Over 115 firms have already received their year one YES B-BBEE levels up on the scorecard.

Although there have been some discussions on the one-year work experience, as opposed to a permanent job, YES has a macroeconomic goal of driving as many young people as possible into opportunities to prove their capabilities, build confidence, break employment droughts and enable a foothold into economic participation. The numbers cited above would not have been possible had employers been asked to provide permanent employment at the outset.

YES Youth are led via their smartphones, which are given to them at the time of placement, and through training apps loaded on the phones, to build CVs, create online profiles, publish their certificates to LinkedIn and to leave with a credible CV and reference letter, especially if they are not absorbed. This exit strategy is supported by several studies.

In a cross-country European Union (EU) study looking at an employers' perspectives on employability, a key finding was that work experience mattered in getting a job interview (Humburg, van der Velden and Verhagen, 2013). The analysis showed the importance of work experience and further reinforced that relevant work experience could compensate for having lower grades or a field of study which did not fit the job closely. In this vein, Abel, Burger and Piraino (2017) found



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that including a reference letter with an application increases employer call-backs by 60%. Women in particular benefit from this approach. A reference letter for women increases employer response rates by 89%, and in job seeking, employment rates for women who have reference letters doubles.

Twelve focus groups with placed YES Youth have been held across the country, and feedback has shown that youth value and understand the importance that some experience and a reference letter will have in their future job search.

YES stimulates demand-side job creation through company investment and by leveraging government's existing recognitions, such as the Employment Tax Incentive (ETI) and the YES specific B-BBEE initiative for broad-based transformation. This part of the business is described as **YES Central**.

In summary, YES opens new jobs by lobbying business and places unemployed youth into these opportunities with a suite of digital tools to raise their post-YES employability. YES placed youth have spent over **five million** learning minutes on the work readiness training app and are learning how to transact digitally; upskill through digitally delivered curriculum; build a digital presence in the jobs market; communicate via a range of digital channels, including YES chat platforms; and are receiving relevant grapple hooks into participating in a Fourth Industrial Revolution (4IR) future.

A second strategic avenue is the development of YES Hubs, either as greenfield ventures or piggybacked with partners. Given the risks identified in the YES Central model, where companies may become fatigued in paying for large numbers of youth each year, and given the limitations around the B-BBEE benefit, the YES Hub strategy creates alternate channels to continue to add youth job numbers towards our ambitious targets.

Specifically, YES Community Hubs aim to encourage new cohorts of Small, Medium and Micro Enterprises (SMMEs) through innovative value chain initiatives, inclusive growth models, linkages of formal and informal economies and knowledge spillover through training and technology transfer. This is done in collaboration with industry champions and by building SME support services via YES Hubs in communities where the unemployed live. In this way, the YES Hub is a hybrid model which works on the demand side and supply side, by bringing resources from the first economy through infrastructure, technology, and

training investment into the heart of low-income communities in an endeavour to drive small business growth, capacity for existing small business and new jobs for youth.

Further positive labour effects are being recorded as the number of companies participating in the YES initiative share their experiences. Employers are benefitting by using the large numbers of youth taken in with fixed-term contracts as a recruitment pipeline and filter. The fixed-term 12-month contract allows employers to test large cohorts and then to absorb those with strong potential. The selected youth are offered permanent employment and companies feel more at ease when investment is made in more expensive and specialised training. Employers have cited high risks and costs incurred when employing youth who have not been tested on the job, and are subsequently found to be a poor fit. Thus, the YES year is providing a de-risking role to some businesses.

## Challenges

Generally, we see alignment between economic policy at the national, provincial and local government levels. However, often coordination in the implementation of that policy is lacking and this is felt by organisations such as YES as it navigates relationships at multiple levels.

As a case in point, youth unemployment is a national priority, and the Employment Tax Incentive (ETI) was designed by National Treasury specifically to address this. However, the SA Revenue Service (SARS) application of the ETI means that the ETI is only claimable in a select set of scenarios. Smaller businesses with insufficient pay-as-you-earn (PAYE) values would have to wait months to claim ETI cash back from the SARS system, whilst "wealthier" bigger businesses have a smooth ETI claims process with simple monthly deductions made off their large PAYE values.

Yet, lower skilled youth are far more likely to be employed at small businesses which also have a larger national footprint with jobs closer to where youth live. Findings reported in the Small Business Growth Index show that those with less than a matric are 19 percentage points more likely to be in small firms, compared to those with matric or higher. Moreover, on average, firms employing between 40 and 50 people have a staff complement of 17% comprising young people under the age of 30 (SBP Alert, Bulletin 3, 2015). Thus, small businesses can act as key drivers for youth employment and should be supported

in their costs to hire youth. To really encourage employment of the large numbers of lower skilled youth, the ETI benefit should be working hardest at SMME level given this data, and yet here it is most difficult to claim.

Promoting the capacity of SMMEs, which are SA's largest employers (yet still lagging substantially when benchmarked against other lower unemployment economies), with youth labour, particularly in marginalised, underprivileged and underinvested areas of the economy, should be top of the agenda. Yet, the YES Practice Note guideline requires a qualifying small enterprise (QSE) (entity with between R10 million and R50 million turnover) scorecard verification, when all other exempt micro enterprise (EME) verification is done by affidavit. This makes it incredibly challenging and expensive for EMEs (under R10 million annual turnover) to participate in YES.

Similarly, while B-BBEE policy has at least succeeded in stimulating corporate investment in skills development and enterprise development, there is surprisingly little coordination between the private-sector and public-sector programmes in this space, especially with regards to enterprise development. YES works across these stakeholder groups seeking to coordinate through partnership.

There are many companies who are keen to participate in YES but are precluded from the B-BBEE benefits as they are early in their transformation journey and thus do not qualify. To participate for the incentive, a firm must achieve sub-minimums on their priority elements on the scorecard. You need to be doing B-BBEE well before you can participate in YES. However, by removing sub-minimum requirements, thousands more firms would be eligible to join YES and could start their compliance and transformation journey by offering work opportunities to unemployed black youth. YES could effectively become the gateway into deeper transformation.

The slow pace of policy refinements and integration of feedback needs to be improved. Intelligence gathered from market case studies where the policy is applied needs to be monitored and processed efficiently. Slow response times hamper much-needed policy refinements and improvements resulting in private sector investors losing interest and trust in the programme, thus jeopardising the intended effects and slowing the speed of results.

The coordination of various ministries around policy, better communication and feedback, and a shared sense of responsibility on the outcomes, would also enable policy to work better. The YES programme is evidence that small policy change can have a large impact and that it need not depend on fiscal spend.

There is also much territorialism around existing projects run by various arms of government and the private sector. New programmes introduced into the market experience the same reaction as new ideas in a company - they are set upon by what are known as "organisational antibodies", where the newest idea and entrant are stigmatised and attacked because "that's not the way things are done around here" mentality prevails.

The views of incumbents and powerful networks or cliques supported by many years of state or other funding, may have the effect of crowding out smaller and newer ideas. This phenomenon is well laid out in the innovation and business model literature by Clayton Christensen and in the literature of change management. Longstanding relationships, shared and sometimes vested interests, an established way of working between partners across business, labour and government, can result in complacency and monopoly effects as the consequences of disrupting the status quo is difficult for a smaller new entity to withstand. As in a corporate greenhouse created to nurture innovations, new programmes at country level, if they are to have a chance at success, must be incubated and protected as they build their processes and evidence of impact.

Low economic growth and low confidence in government hamper YES's ability to drive investments from business. When events out of SA's control, like COVID-19, impact sectors like tourism, there is no buffer in local economic growth and this has amplified depressing effects on innovations in job creation.

Newer entities and new policy need to be given some runway to iterate and improve. Data on how the application of the policy is working needs to be gathered over at least a full roll-out period for enhancements to be made and before full-scale results can be expected. Setting unachievable and politically motivated targets have a demotivating effect, setting an entity or a policy up for failure.

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# The Presidential Youth Employment Intervention – Five Priority Actions to Accelerate Youth Pathways into the Economy Over the Next Five Years

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## Introduction

The most recent statistics from the Quarterly Labour Force Survey show that the rate of unemployment is 38.5% on the broad definition, its highest level in over a decade. More concerningly, the rate of unemployment for those aged between 15 and 24 years is now at 58.2%.

Youth unemployment is a national crisis that demands urgent, innovative and coordinated solutions. The Presidential Youth Employment Intervention is a direct response to the challenge that too many young people are not transitioning from learning to earning. Of the 1.2 million young people entering the labour market each year, more than 65% remain outside of employment, education and training. Those young people who do manage to access opportunities tend to zigzag on often broken pathways, falling in and out of education and short-term work so that they are unable to realise their potential and get a foothold in the economy.

Many young people who were previously disillusioned have resumed their search for work this year, causing the unemployment rate to increase as they become active in the labour market. While this suggests a renewed hope of finding work, the scale of youth unemployment requires **bold and urgent action** to provide young people with meaningful opportunities to progress.

President Ramaphosa has made addressing this crisis one of his foremost priorities. **A growing youth population should not be a threat to South Africa (SA)**, but rather its greatest source of potential. Young people hold the key to transforming our economy, boosting growth and fostering creativity and innovation. They are essential to increasing productivity and improving the livelihoods of all South Africans.

The Presidency has therefore established a Project Management Office (PMO) to coordinate and drive an integrated plan to create two million new jobs for young people during the next decade, over and above average job growth. The aim of this plan is to expand the range of opportunities available to young people - whether in further education and training, skills development, employment, work experience, entrepreneurship, or youth service - so that we can work towards a South Africa in which **every young person has a place to go**.

The depth and persistence of youth unemployment, as well as its structural nature, are such that minor projects and isolated initiatives will not make a meaningful difference. Effective solutions must therefore support and give prominence to what is working in the system, encourage innovation, and catalyse changes in the system that benefit millions - not hundreds or thousands - of young people over the next decade.

*"The fact that the unemployment rate among young South Africans is more than 50% is a national crisis that demands urgent, innovative and coordinated solutions..."*

*It is therefore essential that we proceed without delay **to implement a comprehensive plan – driven and coordinated from the Presidency – to create no fewer than two million new jobs for young people** within the next decade. This plan will work across government departments and all three tiers of government, in partnership with the private sector."*

- President Ramaphosa

## Five key interventions over five years

The Presidential Youth Employment Intervention is government's plan to address this challenge. It is designed to effectively transition young people into the labour market, aiming to significantly reduce the high rate of youth unemployment. It is intended to coordinate, enhance, and scale up existing programmes across government and through close partnerships with the private sector. Bringing together a wide range of partners within and beyond government, it is the largest and most comprehensive plan to address youth employment in South Africa's democratic history.

To pursue this objective and to unlock the energy and potential of young people, we will implement five priority actions over five years to catalyse long-term change:

- 1. Building a national Pathway Management Network** for young work-seekers to view and access available learning and work opportunities, and receive a range of support services and work readiness training to help them navigate into employment and other economic opportunities. Young people will receive a basic package of support in person, online and over the phone, complete online assessments and training and be matched to a wide range of opportunities.
- 2. Implementing agile, demand-led workforce development programmes** that allow young people to develop the capabilities required to take up

new opportunities in growth sectors such as global business services, digital and technology, tourism, agriculture, and social services over five years, and support those sectors to expand. This will be achieved through short learning interventions matched to real demand in the economy, in partnership with the Department of Higher Education and Training (DHET), the National Skills Fund (NSF), private sector bodies such as the Public-Private Growth Initiative and the relevant Sector Education Training Authority.

- 3. Supporting the township and rural economy** by creating inclusive markets in opportunity areas such as the food economy, the green economy, health, and education. To enable self-employment and enterprise, focus will be placed on systemic enablers such as connectivity, public infrastructure and market access in addition to the direct enterprise support and financing provided by the Department of Small Business Development (DSBD) and its agencies.

- 4. Providing opportunities for workplace experience** through the Youth Employment Service, and ensuring that every student enrolled in Technical and Vocational Education and Training (TVET) colleges can access work-integrated learning to complete their qualifications and enter the workplace.

- 5. Revitalising the National Youth Service** to create opportunities for young people to meaningfully contribute to their communities, develop critical skills required to participate effectively in the economy, build confidence and expand their networks and social capital. A Presidential Youth Service programme will channel young people's energy into advancing social cohesion, nation building and development.



## Focus on implementation

The plan will be supported by the Project Management Office (PMO) in the Presidency, which will manage delivery and performance, working closely with implementing departments and agencies. This will allow for a clear line of sight and reporting to the President on the implementation of key priorities coordinated by the Presidency. A working group has been established drawing in leading experts from across government departments, the private sector, social partners and young people themselves, which has developed work streams for each pillar of the plan.

What makes this intervention different from past government programmes? The implementation of this plan is guided by **five core principles**, which ensure that it will improve outcomes and achieve greater scale:

1. The intervention *builds on existing policies, plans, and agreements* and focuses on addressing gaps in the policy landscape;
2. It is *driven from the Presidency*, and coordinated by the Project Management Office to ensure effective accountability for implementation;
3. It brings together a wide range of partners, and *breaks down silos* between government departments, between the levels of government, and between government and the private sector;
4. It is *designed around young people*, and is responsive to their needs and concerns; and
5. It addresses constraints to job creation on *both the supply and demand side* by maximizing the allocation of resources.

The overriding focus will be on **rapid and effective implementation**, and the coordinating and convening power of the PMO – with the authority to act quickly to unblock bottlenecks and facilitate necessary interventions – will ensure that the objectives of the plan are met.

## Targeted outcomes

During the first **five years** of the programme, the following key outcomes will be achieved:

- Three million young work-seekers between the ages of 15 and 35 will have engaged in a National Pathway Management Network and accessed services to help them grow their employability and identify and pursue work opportunities;
- 1.5 million temporary, paid work opportunities will have been created (including one million work-based placements, 250 000 work-integrated learning opportunities and 250 000 service opportunities); and
- 500 000 young people will be engaged in sustainable work opportunities through workforce development programmes.

# The Role of Employment Programmes

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Active labour market policies (ALMP) encompass a range of interventions that aim “to give more people access to the labour force and good jobs” (OECD, 2020). These include incentives aimed at retaining employment, creating employment, searching for and remaining in jobs, or accumulating human capital, as well as interventions that facilitate labour market matching (Brown and Koettl, 2012), although this is just one approach to categorising them. Employment programmes are one example of an ALMP, specifically one that provides incentives for searching for and remaining in employment.

South Africa (SA) faces an immense unemployment challenge. By the end of 2019, the unemployment rate stood at 29.1%: 6.7 million people were unemployed, while a further 3.7 million were unemployed but not actively seeking work (StatsSA, 2020). The unemployed are more likely to be young, to be less educated and to be female; they tend to reside in households with few, if any, wage earners.

Introduced initially as a means of addressing the lack of jobs, the National Public Works Programme was subsequently reinvigorated as the Expanded Public Works Programme (EPWP) in 2004 following the Growth and Development Summit, with a clear jobs target. However, Phase I of the EPWP had numerous other objectives, including economic development and poverty alleviation, skills development, small and medium micro enterprise businesses (SMME) development, service delivery, and the creation of exit opportunities (NDPWI, 2019). Phase II had fewer objectives, with training and SMME development omitted, and aimed for two million full-time equivalent (FTE) work opportunities over the five-year period to March 2014. Phase III re-incorporated the objectives of training and SMME development and, at least on paper, saw a shift from a focus on job creation and reducing unemployment to a focus on poverty alleviation and the preparation of participants for the labour market. According to the business plan, Phase IV will place greater emphasis on “social protection, convergence and capitalising on developmental opportunities” (NDPW, 2019).

The EPWP is a substantial government intervention. In Phase III, it provided more than 4.5 million work opportunities (75% of its target) with an average duration of 90 days, and transferred R41 billion to poor households. Phase IV targets 5.0 million work opportunities (2.4 million FTEs) over the five years.

Employment programmes have an important role to play within the context of the SA labour market. Arguably, the central role of the EPWP as it has been implemented in SA, is the alleviation of poverty. The programme facilitates a large-scale transfer of resources to some of SA's poorest citizens and represents the only direct avenue of access to financial support from the state for millions of working age adults. As with the various social grants, the benefits of this transfer of resources are felt much more widely, within households and within communities. This role is further enhanced through the deliberate targeting of work opportunities at youth, women, and people with disabilities.

Second, the programme promotes labour market attachment. The importance of this aspect is accentuated by SA's high unemployment rate, the large number of non-searching unemployed, and the high share of the unemployed who have never worked before or who are long-term unemployed. At the same time, participants may have the opportunity to develop some of the soft skills – such as daily work attendance, arriving on time, and working in teams – necessary for employment.

From the perspective of achieving longer-term beneficial impacts, a third key role for employment programmes in SA is related to training. SA's long-standing skills challenges have been extensively documented. Historical discriminatory policy within the areas of education and training, combined with current challenges in the capacity of the education system to generate skilled jobseekers, have coincided with trends of skills-biased technological change. The resulting shortages of skilled workers have seen vacancies and upward pressure on wages at the upper end of the skills distribution, while insufficient demand to absorb jobseekers at the lower end of the distribution has contributed to widespread unemployment. The



training components of employment programmes therefore have the potential to assist in addressing this problem, although it should be noted that the macro-level effectiveness of training interventions may be constrained by high unemployment (as was found to be the case in Spain, for example (Escudero, 2018)).

There appears to have been very little work done to gauge the true impact of the EPWP, beyond a simple tallying of person-hours of work and calculated total wages. During the first three quarters of the 2019/2020 financial year, EPWP reported expenditure of R13.9 billion, of which R7.7 billion represents “calculated wages” and person-years of work including training of 266 986. This translates into a cost of R52 000 per FTE, or R29 000 in wages per FTE. However, beyond these types of figures we know little in terms of impact. For example, we do not have a sense as to the employment outcomes of participants post-participation; we do not know what the broader impact on poverty and inequality is; we do not understand the way in which the duration of work opportunities may influence behaviour in areas such as job search or spending; we are unable to gauge the effect of the training component of the programme; and we do not know how any of these might vary for different target populations.

Global evidence suggests that there may be significant problems associated with the use of employment programmes. A review by Brown and Koettl (2012) of global evidence on ALMPs highlights, for example, the strong locking-in effect of employment programmes (i.e. negative impact on job search during participation), the risk of potential employers avoiding participants due to low-productivity stigma, and the widely-documented lack of longer-term positive effects. In SA, we have no real sense of the extent to which these issues characterise the EPWP. That said, Brown and Koettl (2012) do note the additional value of the *outputs* of these programmes (e.g. basic infrastructure) and their ability to bolster the social safety net.

Escudero (2018) reviews data for 31 advanced countries between 1985 and 2010 and finds that the set of interventions within which public employment programmes fall was associated with lower unemployment rates and higher employment rates, overall and for the low-skilled; they are also associated with higher labour force participation rates amongst the low-skilled, but lower rates amongst the overall population.

A higher resource allocation to programme administration and policy continuity have been found to have favourable impacts in terms of unemployment

rates, employment rates and participation rates (Escudero, 2018). This may partly be related to the better monitoring and evaluation that such allocations may enable. In their meta-analysis of 207 studies evaluating ALMPs from around the world, Card et al. (2018) argue that impact should be measured using different time horizons and separately for different types of participants. They find that “public sector employment programs have negligible, or even negative program impacts at all time horizons” (Card et al. 2018). They also find that effects are weaker for youth and older workers, but stronger for females and the long-term unemployed. That said, they find that standalone training interventions (“human capital programs”) have positive medium-term impacts, even though short-term impacts may be negligible. This may suggest potential for employment programmes to improve their overall effectiveness with the appropriate incorporation of a training component, while also raising concerns around the impact of the EPWP for young people specifically given its targeting of youth.

In the current context of constrained fiscal resources, it is crucial that we are able to carefully evaluate the benefits of government interventions in relation to their costs. We are currently not able to do this. This is not just a matter of counting participants and FTEs: evaluations must consider the success of the programme in terms of its stated objectives and must establish the extent to which the country is getting value for its money. Careful evaluation of the impact – both direct and indirect, and both immediate and over longer time horizons – of public employment programmes is therefore critical.

Because we have been unable to accurately assess the various impacts of the EPWP, it is not possible to determine whether there are more cost-effective interventions for achieving specific objectives. At the same time, it is not possible to evaluate programme innovations or alternative “packages” of interventions. This constrains our ability to effectively innovate and fine-tune the programme.

The scale of the EPWP creates the potential for robust assessment of the impacts of the programme and its design in terms of its stated objectives. At the same time, there is much interest in understanding the effectiveness of public employment programmes, particularly in developing countries. With proper, thoughtful data collection and collaborations between government and the research community, there is much that we can learn from the EPWP, allowing policymakers to make better informed policy and design choices.

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# Reflections on the Margins: A Framework for Growth, Work and Market Linkages in the Informal Sector

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Over two million South Africans, at different times and in different sectors and contexts, participate in the informal sector (in a wide array of activities), with just under half of these being informal traders in 1.4 million enterprises, which collectively employ 800 000 people (StatsSA, 2017; Skinner, 2018; Doms, 2020). In South Africa (SA), policy recognises (through the Informal Business Framework of 2014) a wide array of activities from spaza retail through to construction and artisanal work, alongside services like hairdressing and child care. As Phillip (2010) observes, due to a wide array of reasons, SA informal enterprises are largely in retail, “often in a dependent relationship to the core economy”. More recently, technological and structural shifts in the formal economy have spilled over into the informal sector and influenced the work content and form of many roles in the informal sector (as we shall discuss below). Key challenges remain, however, in realising the potential of the informal sector to contribute to employment creation efforts.

The theoretical framework on the role of the informal sector in developing and post-transitional economies sees it as a “buffer” in periods of widespread frictional unemployment. In most nations, informal sector activities straddle the “criminal” and what one might call the “extra-legal”. In SA, these enterprises have been unambiguously criminalised. Moreover, there is clearly no “mop-up role” played by the informal sector (as is suggested in the literature) in business cycles (Burger and Fourie, 2018). Rogan and Skinner (2017) using Quarterly Labour Force Survey (QLFS) data suggest that there were significant and disproportionate job losses in the informal sector following the 2008/2009 financial crisis. This suggests that rather than just being a buffer during the tough times, the sector might require extra policy support during recessionary period.

Activities in this sector are seen as “marginal” to the “observable” and computable experiences of the

formal economy. Yet in the context of SA, with high unemployment numbers, deindustrialisation and inequality, activities in the informal sector remain (although marginal) a crucial livelihood source. The National Development Plan (NDP), in its formulation of an inclusive economy, promotes an approach that includes “informality” within the ambit of what is seen as “legitimate economic policy and practice” (Doms, 2020).

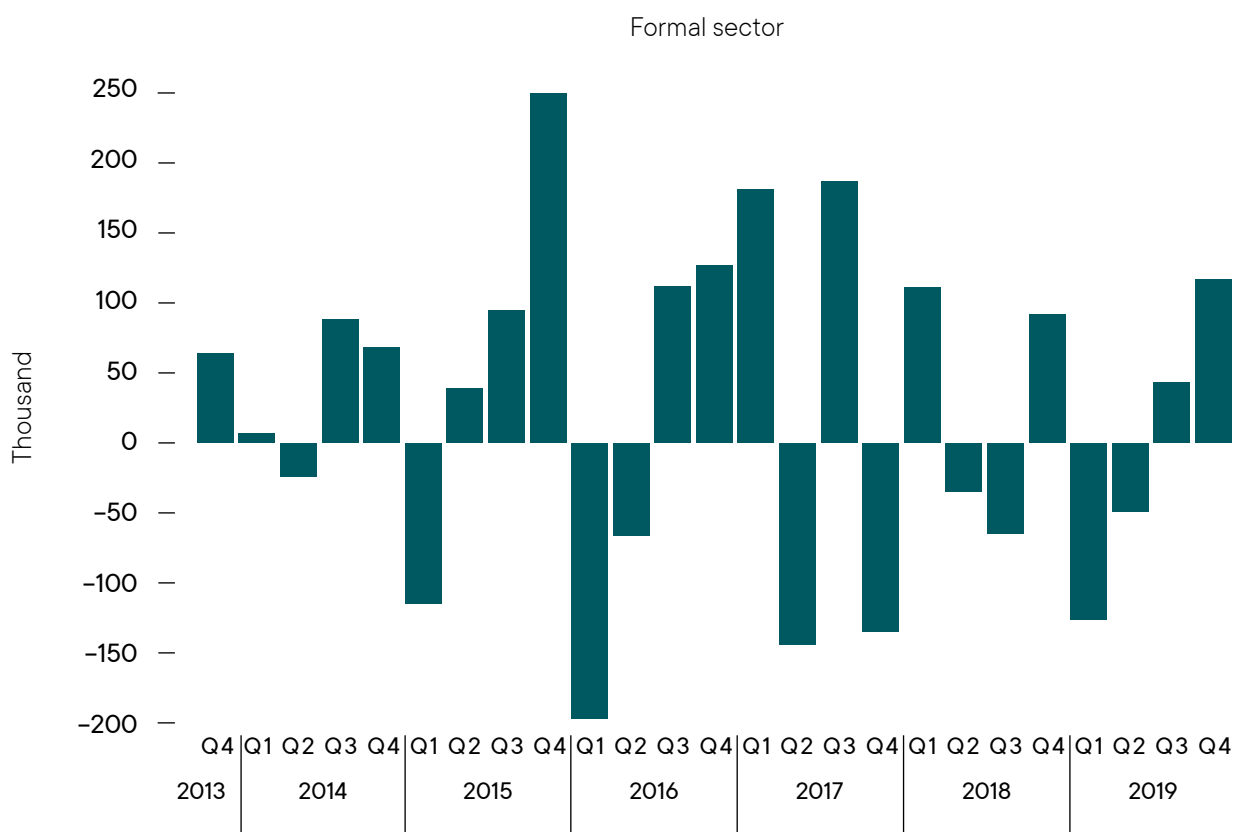
The size of the informal sector, as a percentage of the non-agricultural workforce, has remained relatively unchanged between 2008 and 2014, hovering around 16% and 18% over the period (Rogan and Skinner, 2017). **This pales in comparison to other informal sectors across other economies in sub-Saharan Africa.**

## Where are the employment promoting opportunities in the sector(s)?

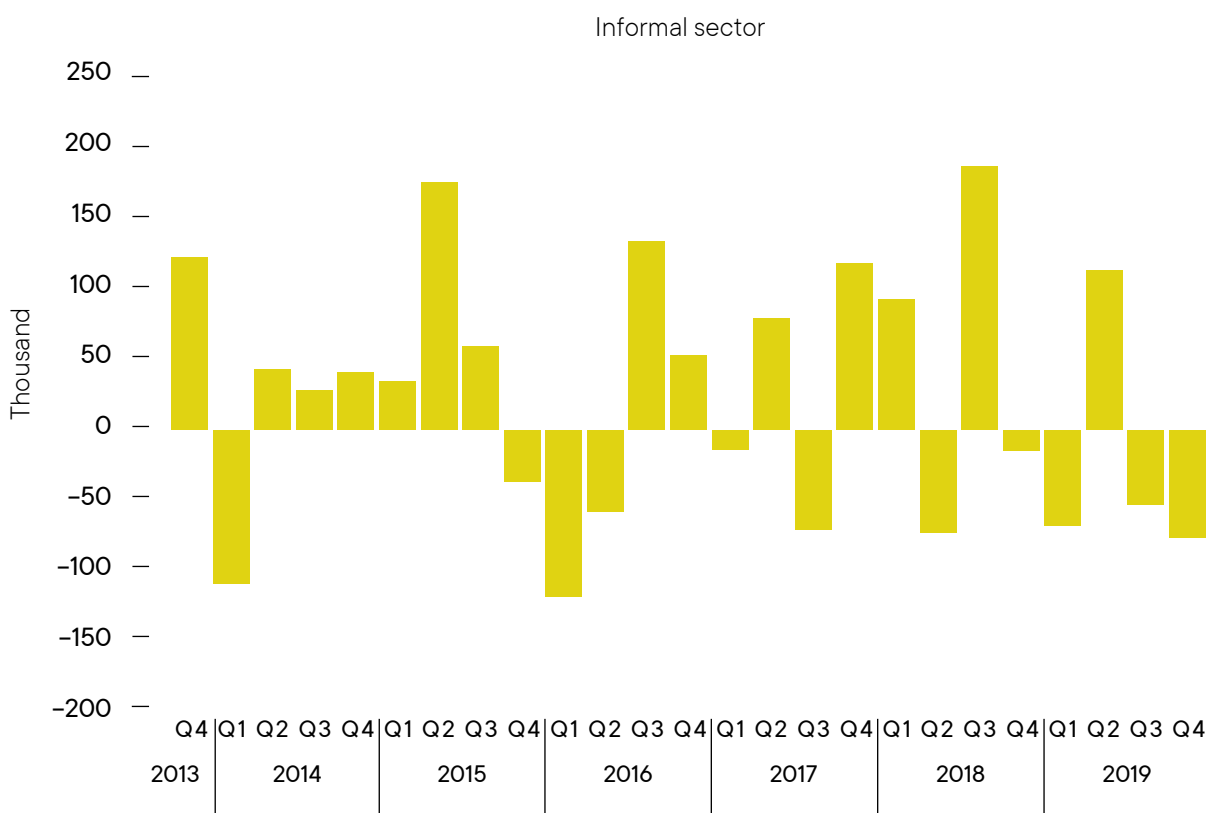
Recent declines in informal sector employment have largely been in community, social and public services (CSP), retail and construction. Retail remains the highest employer in the informal sector. Two other sectors have also been growing in employment – transportation (most notably the minibus taxi and e-hailing sectors) and financial/business services. The informal sector is not homogenous, but a diverse sector with multi-sectoral enterprises of different sizes and productive capability.

Cultural movements or technological developments, such as alternative communication systems, have resulted in a modern informal sector led by creative professionals such as architects, designers, musicians and software developers.

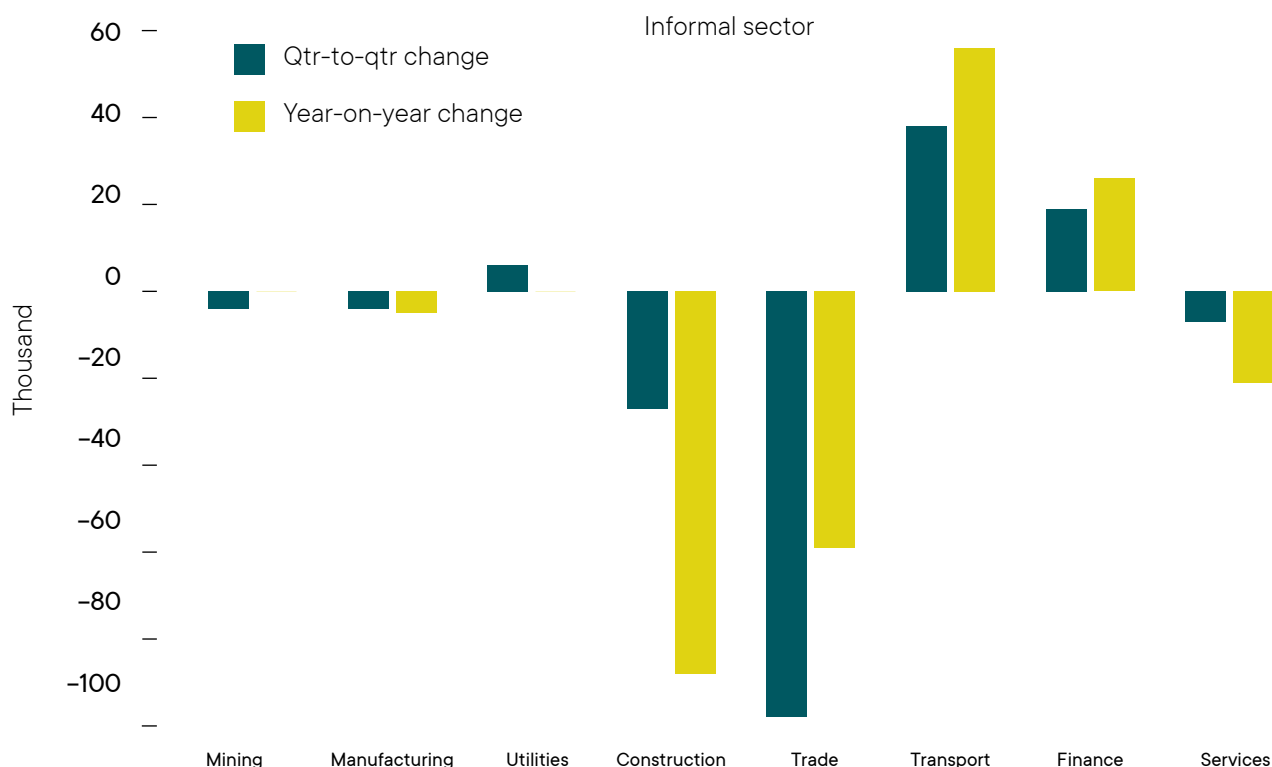
**Figure 1 (a): Quarter-to-quarter employment changes in the formal sector, Q4: 2013 to Q4: 2019**



**Figure 1 (b): Quarter-to-quarter employment changes in the informal sector, Q4: 2013 to Q4: 2019**



Source: StatsSA (Quarterly Labour Force Survey, Q4 2019)

**Figure 2: Quarter-to-quarter and year-on-year changes in the informal sector by industry**

Source: StatsSA (Quarterly Labour Force Survey, Q4 2019)

## Overview of current constraints that impede employment growth in the sector(s)

### Barriers to entry into the informal sector

Burger and Fourie (2019) suggest that following an increase in the unemployment rate, the ability of both the formal and the informal sector to reabsorb the unemployed is very limited. The barriers occur on multiple levels. The sector might be informal, yet its activities are governed by a raft of written and unwritten rules (as is the case in the minibus taxi industry and in many hawkers associations) that govern market entry, division of markets and space and the distribution of “rents”. These “barriers” influence both enterprise creation and destruction and by extension the capacity to employ. Moreover, whilst recent attempts to “unify” the taxi industry through co-operatives and corporatisation may bring greater regularity and uniformity to the industry, they may have implications for workers and other value chain actors.

### The allure of formalisation

Policy interventions for numerous, primarily fiscal, reasons see “formalisation” or “corporatisation” as the teleological ambition of policy measures to support the informal sector. Cronin (2005) presents the challenge of “formalisation” or “modernisation” of the minibus taxi industry as a debate between the role of the industry in the expansion of the national “forces of production” and the tensions brought about by its accumulation path as a “brake” to technological innovation and productivity. Moreover, the “dualism” of the South African economy and its historic development path, provides the social and economic *raison d’être* for its existence. The sector now transports 15 million commuters per day, about 68% of all commutes.

The profitability of the sector continues to be possible due to the spatial and economic divisions of old. Attempts to formalise the sector, through the “taxi recapitalisation” programme have often sought to undermine existing employment multiplier effects within the sector. For instance, early plans of recapitalisation envisaged “maintenance contracts” for the repair of the new fleet, that would be carried out by “franchised formal sector dealerships”

(Cronin, 2005). This, had it been undertaken, would have decimated the jobs of cleaners, backyard repair mechanics and many others in the value chain, whilst also having an impact on the margins of many individual and collective operators (due to repairs now having to be undertaken during normal peak hours, rather than the practice of doing these on weekends or at night).

What has occurred though, is the use of taxi scrapping allowances of currently between R91 100 to R124 000 per vehicle to incentivise investment in new vehicles that comply with required regulatory design features that protect consumers, without the expectation of a full-scale formalisation of the industry. Such a process has also been rolled out alongside a data-gathering exercise aimed at developing a national database of taxi operators nationwide, working alongside the taxi associations (Nzimande, 2019). This is an example of regulation that protects end-users and other stakeholders, whilst allowing for the organic albeit “informal” development of the industry.

## Locational challenges

Much of the informal sector is currently located in the township areas’ marginal to main economic centres, which has given rise to the notion of the “township economy” whose support, by extension, would also improve the conditions of those whose productive activities are characterised by informality. 40% of SA’s urban population live in the townships, yet due to restrictive local laws, low incomes, high transportation costs, low investment levels and marginal enterprise activity, the potential of this market for informal enterprises remains untapped.

Externally, for retail-focused informal activity (which is the bulk of informal activity), the entry of large national retailers in local markets with centralised procurement channels has foreclosed the possibility for any supply chain integration (Rakabe, 2016). Regulatory changes (through broad-based black economic empowerment (B-BBEE) scorecard incentives) have incentivised a few retail chains to localise procurement, however, on the supply side there exist numerous challenges for informal enterprises to “modernise” enough to benefit from the surge of interest in townships and peri-urban settlements by real estate investment trusts (REITs) and their anchor tenants – large national retailers. As Rakabe (2016) notes, “the presence of larger formal firms provides no viable prospects for linkages with the township informal enterprise”.

## Weak distinction in policy support between TIS and MIS

The presence of formal firms in close proximity to informal enterprise is an opportunity, but absent of a consideration of the nature and growth potential of these firms, policy faces some of the challenges mentioned above. Distinctions between “traditional informal enterprises” (TIS) and “modernising informal enterprises” (MIS) are important (Ranis and Steward, 1999; Moreno-Monroy et al., 2012 quoted in Rakabe, 2016). TIS are typically small in size, engaged in low capital/productivity work undertaken by family labour, often operating from household premises. MIS are relatively larger, using dynamic technology and relatively skilled labour.

These firms with better labour productivity tend to not only employ more workers, but pay them relatively better. Conversely, the work of TIS in last mile retailing of goods with processed meats from the formal sector meant that they bore the brunt of the recent listeriosis crisis (with adverse employment impacts). The challenge might have emerged in the formal processing sector, but its impact was far-reaching in the informal trade sector. This suggests that policy ought to also consider the “spill-over impact” of formal sector developments and policy on informal sector value chains of both traditional and modern informal enterprises.

The narrow product mix, customer base and weak regulatory compliance of the non-retail informal sector reduces the scope for downstream and upstream linkages with formal firms. A lost opportunity. Not only for greater accumulation and productivity, but also for improved employment outcomes.

## Recommendations on innovative policy interventions or programmes to unlock barriers

There are a few “principles” to consider in how we think about how policy can encourage greater employment in the informal sector. The questions (nor the answers) are neither neat nor simple. Firstly, policy ought to rethink enterprise support beyond the notion of a business as a legal entity, but rather consider these activities as human endeavours worth support (Dooms, 2020). For example, an opportunity exists to support informal hawkers with locational advantages (shelters close to taxi ranks and areas

with high footfall) on favourable terms in exchange for compliance with health and safety regulations. Policy, as suggested above, in our context must aim to protect end-users and primarily consumers, without pre-emptively constraining the activities of these enterprises.

Secondly, and in line with the MIS and TIS approach discussed above, policy support should be focused on the accumulation of capabilities (knowledge, governance, economic and social) that improve an entrepreneur's chance of benefitting from existing economic opportunities – both formal and informal (Dooms, 2020).

Lastly, there are strong opportunities (notwithstanding current demand conditions) in three areas of informal productive activities where the greatest “modernisation” opportunities exist:

- Transport – the minibus taxi industry (production, value chain issues and subsidisation) considering the Competition Commission report on the matter and growing informalisation of the e-hailing and food delivery sectors.
- Retail – the largest segment of the informal sector, with great scope (due to linkages in intermediate inputs and primary production) for formal business-business linkages and the benefits of formalisation in line with the decent work agenda. Opportunities in this sector, as Philip (2018) observed, are in sectors with niche production opportunities, with differentiated products; not already mass-produced in the formal sector.
- New industries – emerging areas of work have also featured strongly in the contemporary informal sector, these include micro-work (temporary, task-related work often secured through the internet; software development, platform economy work (in transport, domestic work and other sectors).

## Who should drive the recommended interventions?

These interventions need to be driven at multiple levels of regulatory and policy action (national, provincial and local) in areas of licensing, locational support, by-law enforcement and infrastructure provision. An opportunity also exists for private sector support through enterprise and supplier development support that assists in not only modernisation efforts, but also data gathering and market intelligence. There

is also a role for the organisations that represent informal sector players (hawkers associations, taxi associations inter alia) to interface with existing public work programmes (in cross-cutting areas like food production, care work, transport and clothing production and sale), as a way to ensure the expansion of the markets of modernising informal enterprises.

As the scope for market-based employment and labour demand is narrowing, societies need to look at ways to address the need for economic inclusion through participation in work (Phillip, 2018). Such participation in work (for social reasons beyond just earning an income) where it occurs in the informal sector, must be encouraged. For this to happen, policy needs to enable the growth of those informal sector enterprises with the greatest potential for scale and accumulation, and pursue “positive” regulation for those in traditional, albeit less productive, but crucial sectors.

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# Author profiles

**Prof Haroon Borat**, University of Cape Town  
**The South African Economy in Review: Five Key Long-Run Growth Concerns**

Haroon Borat is Professor of Economics and Director of the Development Policy Research Unit at the University of Cape Town. His research interests cover labour economics, poverty, and income distribution. He studied at the Massachusetts Institute of Technology (MIT) and was a Cornell University research fellow. He holds a prestigious National Research Chair, serves on numerous boards, and is a Brookings Institute non-resident Senior Fellow.

**Dr Thabi Leoka**, Independent Economist  
**Macroeconomic Fundamentals and Global Growth**

Thabi Leoka is an economist who has worked for various organisations in the financial sector. Thabi was recently appointed by President Ramaphosa to the Presidential Economic Advisory Council and the Public Investment Corporation Commission of Inquiry. Thabi is also a non-executive director of SA Express. She also sits on the Statistic South Africa (Stats SA) Council, where she chairs the Economic Committee.

**Dr Gilad Isaacs**, Co-Director of the Institute for Economic Justice  
**A Pro-employment Macroeconomic Policy Framework in Africa**

Dr Gilad Isaacs is a co-director at the Institute of Economic Justice and an economist and lecturer at Wits University. He has worked for the International Labour Organization (ILO) and the Global Labour University (GLU). He has a PhD in Economics from SOAS University of London and a Master's in Political Economy from New York University.

**Prof Lawrence Edwards**, School of Economics and PRISM, University of Cape Town  
**Exports, Growth and Employment in South Africa**

Lawrence Edwards is Professor at the School of Economics, University of Cape Town, Researcher within the Policy Research on International Services and Manufacturing (PRISM), and Research Associate of the Southern Africa Labour and Development Research Unit (SALDRU) at the University of Cape Town. He is also an IZA Research Fellow. Lawrence's research interests focus on international trade, trade policy, firms, and labour markets.

**Prof Liberty Mncube**, School of Economics and Finance, Wits University; Managing Director, FTI Consulting; and Member of the Presidential Economic Advisory Council  
**Market Structure, Market Power and Competition Policy in South Africa: Growth and Employment Challenges**

Prof Liberty Mncube is a Managing Director at FTI Consulting and an Associate Professor of Economics at Wits University. He is a former Chief Economist of the Competition Commission of South Africa and served on the Advisory Panel which developed draft amendments to the Competition Act. Prof Mncube received a PhD in Economics from the University of KwaZulu-Natal and an MSc in Economics from the University of York.

**Prof Kenneth Creamer**, School of Economics and Finance, University of the Witwatersrand.  
**South Africa's Energy Policy: Opportunities and Constraints for Economic Growth and Employment**

Prof Kenneth Creamer is a senior lecturer at the Wits School of Economics and Finance. He holds Master's degrees in Law and Financial Economics from Wits and SOAS respectively, as well as a PhD from Wits. Dr Creamer is a member of the South African Student Solidarity Foundation for Education (SASSFE), which raises funds for tertiary students in need, and also a member of publisher Creamer Media.

**Tamara Paramoer**, Divisional Manager of Mergers and Acquisitions, Competition Commission of SA  
**South Africa's Current Competition Policy Cases: The Search for Economic Growth**

Tamara Paremoer is an economist with more than 15 years' experience in the public and private sector. She is the Divisional Manager of Mergers and Acquisitions at the Competition Commission. Prior to that, Tamara worked as Case Advisor to the Competition Commissioner, providing advice on economic and strategic matters.

**Prof Anthony Black**, PRISM, School of Economics, University of Cape Town  
**Could the Emperor's New Clothes be Made in the Coega Special Economic Zone?**

Anthony Black is Professor of Economics at the University of Cape Town and Director of the research unit Policy Research in International Services and Manufacturing (PRISM). He has published widely in the fields of industrial policy, the automotive industry, trade, regional integration, foreign direct investment, and employment.

**Prof Fiona Tregenna**, DST/NRF South African Research Chair in Industrial Development, University of Johannesburg  
**Opportunities and Constraints in Expanding Employment-Intensive Sectors**

Fiona Tregenna holds the South African Research Chair in Industrial Development and is based at the University of Johannesburg. She is also a part-time member of the Competition Tribunal, serves on a number of boards and advisory panels, and consults for international organisations such as UNIDO, UNCTAD, and the ILO. She has a PhD in Economics from the University of Cambridge.

**Mr Etienne Vlok**, National Industrial Policy Officer, SA Clothing and Textile Workers' Union (SACTWU)  
**Constraints and Opportunities in the Clothing and Textile Sectors**

Etienne Vlok is the National Industrial Policy Officer of the South African Clothing and Textile Workers' Union (SACTWU), responsible primarily for the union's Save Jobs campaign, as well as industry, trade, and procurement matters. Etienne is also part-time commissioner at the International Trade

Administration Commission (ITAC). He has been a COSATU and SACTWU representative on various government, industry, and NEDLAC task teams tackling a range of employment, wage, economic, and manufacturing issues.

**Prof Faizel Ismail**, Director and Professor at the Nelson Mandela School of Public Governance, University of Cape Town  
**A Developmental Regionalism Approach to the African Continental Free Trade Area (AfCFTA)**

Faizel Ismail is Director of the Nelson Mandela School of Public Governance and Professor of Economics at the University of Cape Town. He chairs the International Trade Administration Commission (ITAC) and served as South Africa's Ambassador and Permanent Representative at the WTO (2010–2014). He has a PhD in Politics from the University of Manchester; and an MPhil in Development Studies from Sussex University and an LLB from the University of KwaZulu-Natal.

**Mr Derek Thomas**, CEO, Letsema  
**Logistics as a Catalyst for Economic and Employment Growth**

Derek Thomas is CEO of Letsema, a consulting and investment firm with 25 years' experience in transport and logistics. Derek holds Economics Master's degrees from Wits University and the University of London respectively. Derek served on the board of Barloworld Logistics and currently serves on the board of Transnova, a logistics advisory firm.

**Ms Kate Rivett-Carnac**, Independent Consultant  
**Tourism**

Kate is an independent advisor on inclusive tourism development and the green economy. She has held positions within private sector consultancies, national government, at a development finance institution, and has served as an advisor to a national Minister. Kate holds an MPhil in Sustainable Development Planning and Management from Stellenbosch University.

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**Dr Rod Crompton**, Director, African Energy Leadership Centre, WITS Business School.

### **The Chemical Sector**

Previously Dr Rod Crompton ran Crompton Consulting, worked at NERSA, the Department of Minerals and Energy, the DTI, and was MD of the Minerals and Energy Policy Centre. He has served on several boards and currently serves on the board of Eskom.

**Prof Mike Morris**, School of Economics, University of Cape Town

### **Global and Regional Value Chains and Employment and Growth opportunities for South Africa**

Mike Morris is Emeritus Professor, School of Economics, University of Cape Town, and Honorary Research Associate of the Institute of Development Studies, University of Sussex. He has published on global and regional value chains, political economy, industrial clusters, industrial policy, commodity-based industrialisation, apparel and automotive industries, and renewable energy.

**Prof Renosi Mokate**, Executive Chairman of Concentric Alliance

### **Infrastructure in South Africa: Opportunities and Constraints for Economic Growth**

Prof Renosi Mokate is the Executive Chairman of Concentric Alliance. Prior to that, she was Dean of the Graduate School of Business Leadership at the University of South Africa (UNISA), Executive Director of the World Bank, Deputy Governor of the South African Reserve Bank, Chairman and CEO of the Financial and Fiscal Commission, CEO of the Central Energy Fund, and has held many other leadership positions. She holds a PhD and an MA from the University of Delaware, Newark.

**Dr Neva Makgetla**, Trade and Industrial Policy Strategies

### **Managing State-Owned Companies' Debt**

Dr Neva Makgetla is a Senior Economist at Trade and Industrial Policy Strategies (TIPS). Until 2015, she was Deputy Director General for economic policy in the Economic Development Department and, prior to that, Lead Economist at the Development Bank of Southern Africa. She has worked at a senior level for the Presidency and other government departments. For seven years, Dr Makgetla also headed up the Congress of South African Trade Unions (COSATU) Policy Unit. She has a PhD in Economics.

**Dr Stuart Theobald**, Chartered financial analyst and chairman of Intellidex

### **The SOE Debt Crisis: What is to Be Done?**

Dr Stuart Theobald is executive chairman of Intellidex, a research and consulting house focused on capital markets and financial services. He is also a research associate of the London School of Economics' Centre for Philosophy of Natural and Social Science and writes a fortnightly column in Business Day. Stuart holds an MSc and PhD from the LSE and the Chartered Financial Analyst designation.

**Prof Servaas van der Berg**, Professor of Economics, University of Stellenbosch and NRF SARChI Chair in the Economics of Social Policy

### **Schooling as an Economic Growth Constraint**

Servaas van der Berg is Professor of Economics at the University of Stellenbosch in South Africa and holds the National Research Foundation's South African National Research Chair in the Economics of Social Policy. He has served on the Scientific Advisory Committee of Southern and Eastern African Consortium for Monitoring Educational Quality (SACMEQ) and is a fellow of the prestigious International Academy of Education.

**Ms Ann Bernstein**, Executive Director, Centre for Development and Enterprise

### **How to Deal with South Africa's Jobs Bloodbath**

Ann Bernstein heads the Centre for Development and Enterprise, a think tank focusing on economic growth, employment creation, education, urbanisation, and the role of business in South Africa. Ann is a regular commentator in South Africa's newspapers, radio and TV and is also a frequent opinion editorial writer in leading newspapers.

**Ms Najwah Allie-Edries**, National Treasury

### **Lessons from the Jobs Fund**

Najwah Allie-Edries heads up the Project Management Office of the South African National Treasury's R9-billion Jobs Fund and is involved with leading academic programmes at the University of Cape Town and University of Johannesburg. She has held senior positions in the Public Investment Corporation's CBS Property Group, National Treasury, the Government Employees Pension Fund, the South African Revenue Service and the Development Bank of South Africa, and has also worked with the United Nations and the Canadian Labour Market and Productivity Centre.

**Ms Tashmia Ismail**, Youth Employment Service  
**Youth Employment Service (YES)**

Tashmia Ismail-Saville is the CEO of the Youth Employment Service (YES), a joint initiative between business, labour, and government, which addresses South Africa's youth unemployment challenges. Tashmia has extensive expertise in setting up organisations. She has also made considerable contributions locally and internationally in the areas of innovation, inclusive business, digitisation of knowledge, business development, and economic and behavioural research across academia, business, and government.

**Mr Rudi Dicks**, Head: Project Management Office, Presidency  
**The Presidential Youth Employment Intervention – Five Priority Actions to Accelerate Youth Pathways into the Economy Over the Next Five Years**

Rudi Dicks is the Head of the Project Management Office in the Presidency. He served as Deputy Director General at the Department of Planning Monitoring and Evaluation, Executive Director of the National Labour and Economic Development Institute (NALEDI), and various other positions at the Congress of South African Trade Unions (COSATU). Rudi studied at Wits Business School (Management Advanced Programme) and has a Post-Graduate Diploma in Economic Principles as well as a Master of Science (MSc) in Finance from the University of London.

**Dr Morné Oosthuizen**, Deputy Director: Development Policy Research Unit, School of Economics, University of Cape Town  
**The Role of Employment Programmes**

Morné Oosthuizen is Deputy Director of the Development Policy Research Unit (DPRU) in the School of Economics at the University of Cape Town. His research interests include intergenerational transfers, economic demography, and the demographic dividend, poverty, inequality, and labour markets.

**Mr Ayabonga Cawe**, Managing Director, Xesibe Holdings and Sessional Lecturer, University of the Witwatersrand  
**Reflections on the Margins: A Framework for Growth, Work and Market Linkages in the Informal Sector**

Ayabonga Cawe is a lecturer at Wits University and the Managing Director of Xesibe Holdings, a Johannesburg-based advisory, content development, and facilitation firm. He has consulted widely on labour market and inequality issues for a number of organisations, including the International Labour Organisation, the German Development Agency (GIZ), and the Department of Economic Development. He holds an MCom from Wits University.

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# Event Agenda

## Day 1:

10 March 2020

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09:00 – 09:05	<b>Welcome: Brief Introduction on the CBPEP and Aims of Event</b> Ms Lindiwe Ndlela, Acting Head, Government Technical Advisory Centre (GTAC)
09:05 – 09:35	<b>Overview: Structural Transformation and the Challenge of Economic Growth in South Africa</b> Prof Haroon Borhat, University of Cape Town
09:35 – 10:50	<b>Panel 1: Macroeconomic Constraints on Growth and Employment – The Role of the State</b> <ul style="list-style-type: none"><li>• <i>Macroeconomic Fundamentals and Global Growth</i> Dr Thabi Leoka, Independent Economist</li><li>• <i>Expenditure and Taxation: The Pursuit of Long-Run Growth</i> Prof Tania Ajam, University of Stellenbosch</li><li>• <i>Pro-Employment Macroeconomic Policies for Africa</i> Dr Gilad Isaacs, Institute for Economic Justice and Wits University</li></ul> Moderator: Mr Ron Derby, Power fm
10:50 – 11:05:	Break
11:05 – 12:35	<b>Panel 2: Microeconomic Constraints on Growth and Employment and Possible Solutions</b> <ul style="list-style-type: none"><li>• <i>Trade, Exports and Firm Competitiveness</i> Prof Lawrence Edwards, University of Cape Town</li><li>• <i>Market Structure and Competition Policy in South Africa: Growth and Employment Challenges</i> Prof Liberty Mncube, Wits University</li><li>• <i>South Africa's Energy Policy: Opportunities and Constraints for Economic Growth and Employment</i> Prof Kenneth Creamer, Wits University</li><li>• <i>South Africa's Current Competition Policy Cases: The Search for Economic Growth</i> Ms Tamara Paremoer, Competition Commission</li></ul> Moderator: Prof Haroon Borhat, University of Cape Town
12:35 – 13:35:	Lunch
13:35 – 15:05	<b>Panel 3: Opportunities and Constraints in Labour-Intensive Sectors</b> <ul style="list-style-type: none"><li>• <i>Opportunities and Constraints in Expanding Employment-Intensive Sectors</i> Prof Anthony Black, University of Cape Town and Prof Fiona Tregenna, University of Johannesburg</li><li>• <i>Growth and Employment in Agriculture: Key Opportunities and Constraints</i> Mr Wandile Sihlobo, Agricultural Business Chamber of SA</li></ul>

- *Growth and Employment in Clothing and Textiles: Key Opportunities and Constraints*  
Mr Etienne Vlok, South African Clothing and Textiles Workers Union

- *Trade Negotiations and Inclusive Growth: Opportunities and Risks*  
Prof Faizel Ismail, University of Cape Town

Moderator: Ms Kathy Nicolaou-Manias, CBPEP

15:05 – 15:20: Break

15:20 – 16:50 **Panel 4: What Role Does the State Need to Play to Further Unlock Employment Opportunities in Sectors with High-Growth Potential?**

- *The Green Economy*  
Dr Grové Steyn, Meridian Economics
- *Tourism*  
Ms Kate Rivett-Carnac, Independent Consultant
- *The Chemical Sector*  
Dr Rod Crompton, Wits University
- *Logistics and Transport Sector*  
Mr Derek Thomas, Letsema
- *Global Value Chains and Growth Opportunities for South Africa*  
Prof Mike Morris, University of Cape Town

Moderator: Mr Ron Derby, Power fm

16:50 – 17:00 **Conclusions and Thanks**  
Mr Glen Fisher, CBPEP

17:00 – 19:00: Cocktail Event

## Day 2:

11 March 2020

09:00 – 09:05 **Welcome**  
Ms Kathy Nicolaou-Manias, CBPEP

09:05 – 09:20 **Infrastructure in South Africa: Opportunities and Constraints for Economic Growth**  
Prof Renosi Mokate, UNISA

09:20 – 10:00 **Panel 5: The SOE Debt Crisis: What Is to Be Done?**  
Dr Neva Makgetla, Trade and Industrial Policy Strategies  
Mr Stuart Theobald, Intellidex  
Mr Mike Brown, etf-SA.co.za  
  
Moderator: Ms Pippa Green, South African Press Council

10:00 – 11:20 **Panel 6: Social Issues and Political Economy**

- *The Role of the Fiscus - Limits and Opportunities*  
Prof Michael Sachs, Wits University
- *Schooling as an Economic Growth Constraint*  
Prof Servaas van der Berg, University of Stellenbosch
- *Inequality as an Economic Growth Constraint*  
Prof Murray Leibbrandt, University of Cape Town
- *Constructing a Social Plan for Growth*  
Mr Neil Coleman, Institute for Economic Justice



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	<ul style="list-style-type: none"> <li>• <i>Jobs and Inclusion</i> Ms Ann Bernstein, Centre for Development and Enterprise</li> </ul> <p>Moderator: Ms Pippa Green, South African Press Council</p>
11:20 – 11:35:	Break
11:35 – 13:30	<p><b>Panel 7: Unemployment and Active Labour Market Policies</b></p> <ul style="list-style-type: none"> <li>• <i>Expanded Public Works Programme and Community Work Programme</i> Dr Kate Philip, Independent Expert</li> <li>• <i>The Jobs Fund</i> Ms Najwah Allie-Edries, National Treasury</li> <li>• <i>Youth Employment Service (YES)</i> Ms Tashmia Ismail, YES</li> <li>• <i>The Presidential Youth Intervention</i> Mr Rudi Dicks, Presidency</li> <li>• <i>The Role of Employment Programmes</i> Dr Morné Oosthuizen, University of Cape Town</li> <li>• <i>The Informal Economy</i> Mr Ayabonga Cawe, Xesibe Holdings</li> </ul> <p>Moderator: Ms Pippa Green, South African Press Council</p>
13:30 – 13:40	<p><b>Closing and Thanks</b> European Union Representative</p>
13:40 – 14:30:	Lunch
14:30 – 16:30	<p><b>Programme Advisory Panel – Closed Session</b> <b>Designing the Economy for the Future: A Long-Term Perspective to Growing Employment in SA</b></p> <p><b>Panel Discussion</b> Mr Rudi Dicks, Presidency Mr Andrew Donaldson, University of Cape Town Prof Haroon Borat, University of Cape Town</p> <p><b>Facilitated Discussion</b> Chaired by Ms Subethri Naidoo, GTAC</p>

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