

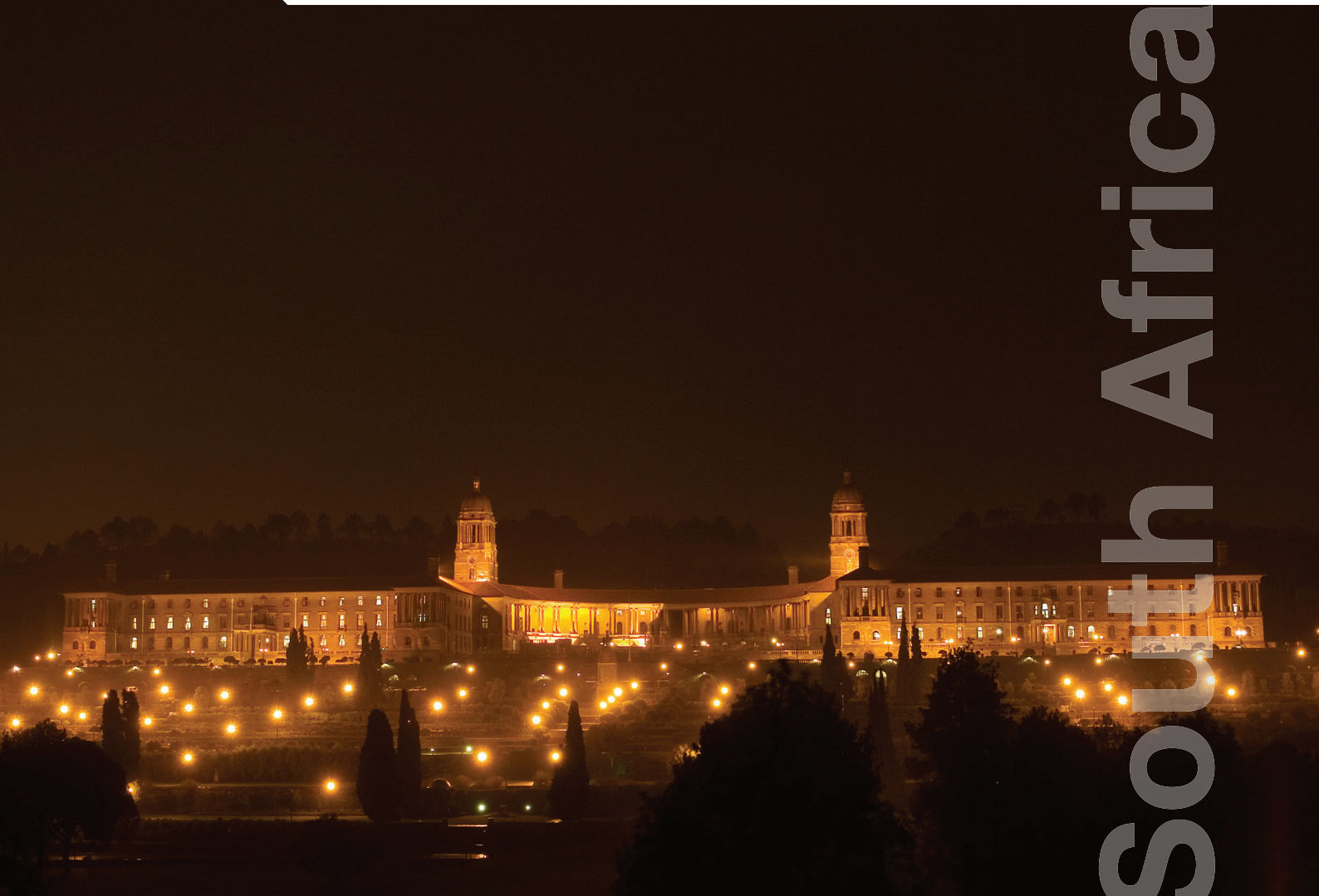


OECD Economic Surveys

SOUTH AFRICA

Executive Summary

July 2020



- The economy was hard hit
- Fiscal policy faces severe challenges
- An agenda for growth
- Building an inclusive social protection system

Key recommendations

Mobilise monetary policy instruments and restore fiscal policy room

- Lower interest rates to further support the recovery.
- Provide temporary financial support to households and businesses to protect livelihoods and employment
- Implement the budget consolidation strategy and improve spending efficiency.
- Index wages in the public service below inflation for 3 years and link to productivity requirements.
- Restructure state-owned enterprises to ensure their financial sustainability including staff reduction and bringing in private participation.
- Separate clearly the responsibilities of the board and the management of SOEs by giving the board the mandate to strategically supervise, monitor and audit the management of SOEs
- Improve prosecution process and enforcement of national and foreign corruption offences.
- Introduce student loans to cover higher education fees with repayment schedules depending on future incomes with government guarantees to replace education grants for students from high-income families.

An agenda for growth

- Increase and extend relief support in sectors hard hit by the crisis, especially for the tourism sector, up to mid-2021, particularly if there is a renewed virus outbreak later in the year.
- Implement electronic visa programmes on a large scale for emerging target markets.
- Investments in transport and tourism infrastructure have to be aligned to connect tourists to places.
- Reduce red tape and the regulatory burden for entrepreneurs and small enterprises.
- Give more independence to regulators in energy, transport and telecom industries vis-à-vis line ministries.
- Accelerate the adoption and implementation of the Single Transport Economic Regulation Bill.
- Use the ongoing restructuring of Eskom to diversify power generation and invest in renewable sources of energy.
- Increase public investment in transport infrastructure, skills and education. Improve cost containment, planning and implementation.

Promoting sustainable water usage

- Raise irrigation water prices to discourage water overuse and ensure that costs are covered, for example by charging depreciation costs in full.
- Set up an independent water regulator to ensure cost-reflective prices Apply better regulation to costs and environmental performance of municipal water services.

Building an inclusive social protection system

- Gradually increase the public financing of health care through a form of public insurance at a pace and scale that is affordable.
- Entrust an independent body to develop a price schedule for reimbursement of health care.
- Develop prevention of non-communicable diseases and strengthen the promotion of a healthier lifestyle.

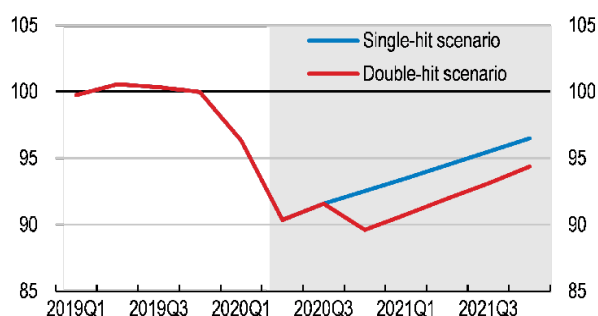
The economy was hard hit

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

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

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

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



Source: OECD Economic Outlook 107 database.

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

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

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

Table 1. Macroeconomic projections
(Growth rates, unless specified)

Double-hit scenario	2019	2020	2021
Gross domestic product (GDP)	0.2	-8.2	0.6
Private consumption	1.0	-6.5	0.8
Government consumption	1.5	2.5	2.3
Gross fixed capital formation	-0.9	-15.1	-1.0
Export of goods and services	-2.5	-12.5	1.5
Import of goods and services	-0.5	-10.0	2.0
Unemployment rate (% of labor force)	28.7	34.0	35.8
Consumer price index	4.1	3.4	3.3
Current account balance (% of GDP)	-3.0	-3.1	-3.0

Single-hit scenario	2019	2020	2021
Gross domestic product (GDP)	0.2	-7.5	2.5
Private consumption	1.0	-5.8	2.3
Government consumption	1.5	2.4	1.6
Gross fixed capital formation	-0.9	-13.9	2.4
Export of goods and services	-2.5	-10.8	5.6
Import of goods and services	-0.5	-8.6	4.5
Unemployment rate (% of labor force)	28.7	33.9	34.9
Consumer price index	4.1	3.5	3.7
Current account balance (% of GDP)	-3.0	-3.0	-2.5

Source: OECD Economic Outlook 107 database.

Fiscal policy faces severe challenges

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

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

Compensation of government employees is large. At 12% of GDP, the government wage bill is high. Rising wages are driving wage bill increases rather than employment. Wage negotiations have systematically granted above-inflation increases. When

compared to OECD and emerging economies, the remuneration level of civil servants is relatively high. The government has announced its intention to reduce the wage bill. The government could consider indexing public sector wages below inflation for 3 years.

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





An agenda for growth

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

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

Greener energy policy can bolster growth. South Africa is one of the top-20 greenhouse gas emitters in the world. The CO₂ emission intensity of GDP has fallen slightly since 2000. The introduction of a carbon tax in June 2019 is welcome. The share of renewables in primary energy supply is close to the OECD average. However, coal accounts for 75% of electricity generation and is the main energy source in industrial processes.

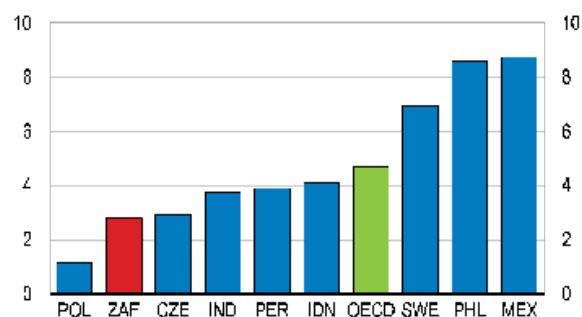
Increasing public infrastructure investment would boost potential growth. Public infrastructure investment has declined in recent years. In particular, transport infrastructure remains insufficient and suffers from a lack of maintenance. The government is planning to create an infrastructure fund with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

Tourism will need prolonged support in the short-run. International tourist arrivals increased from 4.5 million to more than 10 million between 1995 and 2017 and were accompanied by a tripling of employment directly related to tourism. While the role of tourism in the economy has been increasing since

the end of apartheid, it remains below the OECD average (Figure 2). Furthermore, the recent COVID-19 pandemic and resulting containment measures have triggered an unprecedented crisis in the tourism sector. Still, the sector offers significant opportunities for an economy with weak growth and high unemployment. Streamlining and implementing electronic visa services for international tourists could increase South Africa's international openness. Reduction of red tape could strengthen the integration of the tourism sector into local value chains and amplify the impact of tourism on the domestic economy. For tourism to translate into inclusive and sustainable growth, the benefits must spread geographically. Necessary transport and accommodation infrastructure is needed to connect tourists to places.

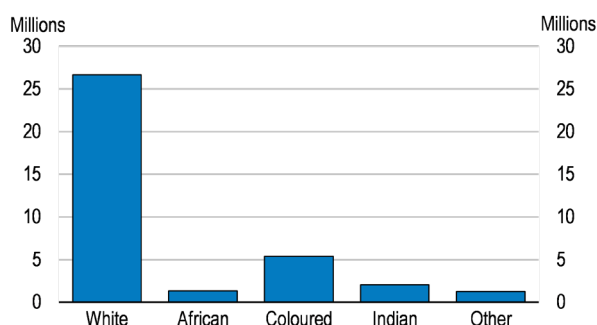
Land is a main source of inequality in South Africa. Owing to the legacy of apartheid, only a small share of land is under ownership by the black population (Figure 3). The land reform initiated in 1994 – consisting of restitution, tenure reform and redistribution – progressed only slowly. To speed up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

Figure 2. Direct contribution of tourism to the economy
% of GDP, 2018 or latest available year



Source: OECD, Tourism Database.

Figure 3. Individual land ownership of farms
Landownership hectares by race, 2017



Note: Refers to individually owned land only and does not include traditional land.

Source: Department of Rural Development and Land Reform (2018), Land Audit Report 2017.





Building an inclusive social protection system

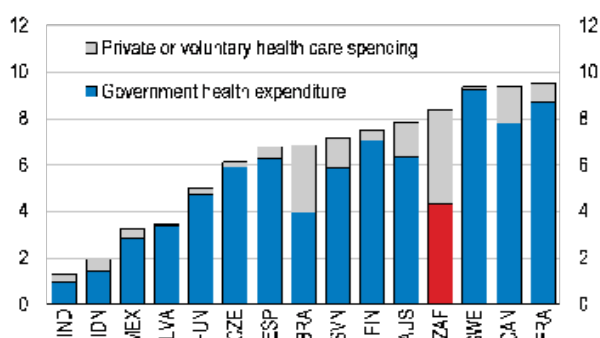
The current social protection system is incomplete. The social assistance system is well developed and is key in reducing poverty. However, the COVID-19 outbreak has revealed some shortcomings in the coverage of informal workers by the social assistance system and highlighted the disparities in access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

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

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

Figure 4. Comparing health spending

Health spending, % of GDP, 2017



Source: WHO Global health expenditure database.

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

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

SOUTH AFRICA

The COVID-19 outbreak is worsening an already fragile economic outlook. Since 2013, growth has been modest and unemployment has been rising. Policy uncertainty has been the main driver of low confidence and subdued investment. Following a sharp fiscal deterioration in recent years, the crisis also heightened debt sustainability challenges. Curbing the public sector wage bill, restructuring SOEs and containing spending growth in higher education are urgently needed to improve spending efficiency and restore fiscal sustainability. Supporting the economic recovery in the short-run while accelerating structural reforms to increase potential growth is key. In the medium term, developing tourism, boosting transport infrastructure investments, promoting renewable energies and strengthening the social protection system can contribute to more sustainable and inclusive growth..

SPECIAL FEATURES: SOCIAL PROTECTION AND TOURISM

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