

AFRICAN DEVELOPMENT BANK



REPUBLIC OF SOUTH AFRICA
RESULTS-BASED COUNTRY STRATEGY PAPER, 2008 - 2012
MID-TERM REVIEW AND UPDATE

REGIONAL DEPARTMENT, SOUTH A (ORSA)

OCTOBER 2009

| <u>Table of Contents</u> | | <u>Page</u> |
|--|--|-------------|
| EXECUTIVE SUMMARY | | iv-v |
| 1. <u>INTRODUCTION</u> | | 1 |
| 2. <u>COUNTRY CONTEXT AND PROSPECTS</u> | | 1 |
| 2.1 | Political Context and Governance | 1 |
| 2.2 | Social Context | 2 |
| 2.3 | Economic Context | 3 |
| 2.4 | Medium-Term Prospects | 4 |
| 2.5 | Business Environment and Competitiveness | 5 |
| 2.6 | Trade and Regional Integration | 6 |
| 3. <u>GOVERNMENT STRATEGIC DIRECTIONS, CHALLENGES AND OPPORTUNITIES</u> | | 7 |
| 3.1 | Context | 7 |
| 3.2 | The Medium-Term Strategic Framework | 7 |
| 3.3 | Challenges | 8 |
| 3.4 | Strengths and Opportunities | 9 |
| 4. <u>IMPLEMENTATION OF BANK STRATEGY AND RESULTS</u> | | 10 |
| 4.1 | Bank Positioning in South Africa | 10 |
| 4.2 | Progress towards RBCSP Outcomes | 10 |
| 4.3 | Progress towards RBCSP Outputs | 11 |
| 4.4 | Portfolio Management | 11 |
| 4.5 | Lessons Learnt | 11 |
| 5. <u>BANK STRATEGY AND BUSINESS PLAN FOR THE REMAINING PERIOD</u> | | 12 |
| 5.1 | Strategic Pillars and Areas of Focus | 12 |
| 5.2 | Deliverables and Targets | 16 |
| 5.3 | Financing Instruments | 16 |
| 5.4 | Partnership Framework | 17 |
| 5.5 | Monitoring and Evaluation of Bank Assistance | 17 |
| 5.6 | Country Dialogue Issues | 18 |
| 5.7 | Potential Risks and Mitigating Measures | 18 |
| 6. <u>BANK EXPOSURE AND LENDING LIMITS</u> | | 19 |
| 6.1 | Creditworthiness and Bank Exposure | 19 |
| 6.2 | Sustainable lending Limits | 19 |
| 7. <u>CONCLUSIONS AND RECOMMENDATIONS</u> | | 19 |
| 7.1 | Conclusions | 19 |
| 7.2 | Recommendations | 19 |

ANNEXES

1. South Africa: Policy Results Matrix
2. South Africa: Selected Macroeconomic Indicators
3. South Africa: Development Indicators
4. South Africa: Millennium Development Goals
5. Bank's Ongoing Operations in South Africa as at 31 August 2009
6. Bank's Cumulative Operations in South Africa since 1997
7. Bank's Approved and Indicative programme for South Africa during 2008-2012 CSP Period
8. Intervention by Other Development Partners
9. South Africa as a Hub for Regional Integration and Development in Southern Africa
10. South Africa: Administrative Map

BOXES

1. Impact of the Economic Crisis on South Africa Economy
2. Consultation with Stakeholders
3. Programme for Infrastructure Development in Africa (PIDA)
4. North-South Economic Corridor Development Initiative

GRAPHS

1. Governance Indicators for South Africa and Sub-Saharan Africa
2. Value- Added by Sectors as % of GDP
3. Ease of Doing Business (Rank) 2009

TABLES

1. Projections of Key Macroeconomic Indicators
2. Summary of Strategic Pillars for the 2008-2012 CSP
3. Indicative Bank Programme for 2009-2012 (Lending operations)
4. Indicative Bank Programme for 2009-2012 (Non-Lending operations)

CURRENCY EQUIVALENT

| | | |
|------|---|-----------------------------|
| 1 UA | = | US\$ 1.555333 (August 2009) |
| 1 UA | = | ZAR 12.1237 (August, 2009) |

FISCAL YEAR

1 April to 31 March

This CSP Mid-Term Review/Update was prepared by a team led by Mr. Andrew Mwaba, Country Manager, ZAFO; and included Ms. Eva Ruganzu, Principal Country Programme Officer, ZAFO; Mr. Wilberforce Mariki, Senior Country Economist, ORSA; Ms. Edith Laszlo, Private Sector Specialist, OPSM; Mr. Stephen Olanrewaju, Consultant; and Mr. Ryan Short, Consultant, following a mission which was in South Africa from 13 – 24 July 2009. Contributions were also received from FFMA. Questions on the document should be addressed to Mr. Abdirahman. Beileh, Director, ORSA.

ACRONYMS AND ABBREVIATIONS

| | |
|----------|---|
| ADB | African Development Bank |
| ADF | African Development Fund |
| AIDS | Acquired Immune Deficiency Syndrome |
| AFD | Agence Francaise de Developpement |
| ANC | African National Congress |
| ASGISA | Accelerated and Shared Growth Initiative for South Africa |
| BBEE | Broad-based Black Economic Empowerment |
| CMA | Common Monetary Area |
| CPIA | Country Policy and Institutional Assessment |
| COPE | Congress of the People |
| CPI | Consumer Price Index |
| DBSA | Development Bank of South Africa |
| DCG | Department of Cooperative Governance and Traditional Affairs |
| DTI | Department of Trade and Industry |
| DFI | Direct Foreign Investment |
| DFID | UK Department for International Development |
| DFIs | Development Finance Institutions |
| DoE | Department of Energy |
| EIB | European Investment Bank |
| ESKOM | State Electricity Corporation |
| ESW | Economic and Sector Work |
| EU | European Union |
| FAD | IMF – Fiscal Affairs Department |
| GDP | Gross Domestic Product |
| GEAR | Growth, Employment and Redistribution Programme |
| HIV | Human Immunodeficiency Virus |
| ICA | Investment Climate Assessment |
| IDC | Industrial Development Corporation |
| IFC | International Finance Corporation |
| ILO | International Labour Organization |
| IMF | International Monetary Fund |
| IPPF | Infrastructure Project Preparation Facility |
| JSE | Johannesburg Securities Exchange |
| LDC | Less Developed Countries |
| LIC | Low Income Countries |
| LoC | Line of Credit |
| MDGs | Millennium Development Goals |
| MIC | Middle Income Countries |
| MTEF | Medium-Term Expenditure Framework |
| MTSF | Medium-Term Strategic Framework |
| NEDLAC | National Economic Development and Labour Council |
| NEPAD | The New Partnership for Africa’s Development |
| NEPAD-BF | The New Partnership for African Development Business Foundation |
| NERSA | National Energy Regulator of South Africa |
| NGO | Non-Governmental Organization |
| ODA | Official Development Assistance |
| OPSM | Private Sector Department |
| PDI | Previously Disadvantaged Individuals |
| PIDA | Programme for Infrastructure Development in Africa |
| PPP | Public Private Partnership |

| | |
|----------|--|
| RDP | Reconstruction and Development Programme |
| SACU | Southern African Customs Union |
| SADC | Southern African Development Community |
| Safex | South African Futures Exchange |
| SARB | South African Reserve Bank |
| SMEs | Small and medium enterprises |
| SMMEs | Small Medium and Micro Enterprises |
| SOEs | State Owned Enterprises |
| STA | IMF – Statistics Department |
| STAP | South Term Action Plan |
| TELKOM | State Telecommunications Company |
| TNC | Trans-National Companies |
| Transnet | State Transport Corporation |
| UN | United Nations |
| UNDP | United Nations Development Programme |
| WHO | World Health Organization |
| ZAR | South African Rand |

Executive Summary

1. **Background:** The Country Strategy Paper (CSP) for South Africa covering 2008–2012 (ADB/BD/WP/208/12-Revised), dated February 2008, was approved by the Board of Directors on 9th April 2008. In approving the CSP, the Board provided guidance relating to the need to (i) further strengthen the objectives of the strategy with clear deliverables, (ii) focus more on areas where the Bank has comparative advantage, such as improved financial intermediation services for SMEs development, and (iii) ensure that the study on the impact of South Africa on its neighbours is conducted. The Board requested Management to submit an update of the CSP in twelve months, taking these issues into consideration. This document responds to the issues raised by the Board as presented in Chapter 5 on the Bank's strategy for the remaining period of the CSP. The report also takes into account the strategic direction of the new administration elected into office in April 2009, as articulated in the Medium-Term Strategic Framework (MTSF), and the initial impacts of the global financial and economic crisis.

2. **Developments in the Economy:** South Africa has the largest most sophisticated and diversified economy in Africa. The service sector is dominant accounting for 65% of value-added while the secondary and primary sectors account for 23% and 12% respectively. Real GDP growth during 2003-2007 was strong and stable, averaging 5%, but declined to 3.8% in 2008. The global financial and economic crisis has constrained growth performance, with government projecting 1.2% real GDP growth in 2009. However, recent estimate by Statistics South Africa (August 2009) point to a contraction of 2% in output in the first half of 2009 compared with the corresponding period in 2008, which suggests that official projections may be optimistic. South Africa's financial system has so far been resilient in the face of the global financial crisis. The real economy has been negatively affected particularly export earnings, private foreign investment

and employment. The economy is projected to recover slowly from 2010, though not reaching the pre-crisis levels until 2012/13.

3. Government Development

Agenda: Since democratization in 1994, the government's development agenda has evolved through a number of programmes including the Reconstruction and Development Programme (RDP) in 1994; the Growth, Employment and Redistribution (GEAR) Programme in 1996; and the Accelerated and Shared Growth Initiative for South Africa (ASGISA) in 2006. In July 2009, the new administration of President Jacob Zuma launched the Medium Term Strategic Framework (MTSF) for 2009 – 2014, which provides further strategic details of ASGISA. The focus of the MTSF is to improve the conditions of life of all South Africans and contribute to building a better country and a better Africa. Its central objective is to set the country on a higher and sustainable growth trajectory by 2014.

4. Implementation of the 2008-2012

CSP to date: Within 16 months of the implementation of the CSP, the Bank has financed eight (8) operations in South Africa, made up of three (3) Lines of Credits (LoCs) to commercial banks, One (1) ICT loan, three (3) equity investments, and one (1) grant by the African Water Facility. The interventions, which amount to a total commitment of UA 335.79 million (about US\$521.80 million) aim to contribute to improvement in the financial capacity of South African institutions and equity-based funds to invest domestically and across borders. In the area of economic and sector work (ESW), one activity namely, Study on National Gender Machinery has been completed. A snapshot of the assessment of South Africa as a hub for regional integration and development was done as an input into the CSP Update and presented in Annex 9, while the preparation process of a comprehensive study has been initiated in the context of the Regional Integration Strategy for Eastern and Southern Africa.

5. Strategy and Deliverables for the Remaining CSP Period: The 2008-2012 CSP that is aimed at enhancing the Bank's partnership with South Africa, is based on three pillars namely: (i) *enhancing private sector competitiveness*, (ii) *partnership for regional integration and development*, and (iii) *knowledge management and capacity building*. The authorities confirmed that the three pillars are still relevant and well aligned with the new MTSF and should be retained for the remaining CSP period. The strategy will continue to build on the Bank's comparative advantage in the areas of financial intermediation and infrastructure development, as articulated in the deliverables for the remaining CSP period, though project identification will be a continuous process. The implementation of the strategy will be enhanced by the establishment of the South Africa Field Office (ZAFO), which has a regional focus with operations covering the other SACU countries and Zimbabwe.

6. The operational programme for the rest of the CSP period will focus on national infrastructure development and regional infrastructure aligned with NEPAD and the economic development corridors programmes to promote regional development, as outlined in the Bank's Regional Assistance Strategy. Bank support will mostly be in the form of loans to SOEs and LoCs to finance private sector investments and SMEs; and grants for non-lending activities. Eight lending operations are already at varying stages of processing. Non-lending activities will focus on ESW and capacity building for municipalities, in view of their responsibility for large segments of social services delivery and critical role in poverty reduction. Co-

financing of lending operations with other development partners will be encouraged while ESW will be undertaken in collaboration with national institutions and development partners. The dissemination of key analytical work to foster knowledge sharing will be an important aspect of strategy implementation.

7. Areas requiring dialogue: The Bank will undertake dialogue with the authorities and all country stakeholders on the use of the Technical Assistance Fund for Middle Income Countries (MIC grant) for non-lending activities and project preparation. Another area of dialogue is the sharing of South Africa's best practices for regional capacity enhancement. South Africa could offer expertise and best practices in many fields to benefit other countries in the region, through seminars organized by the Bank jointly with the South African authorities and its institutions. Dialogue will also be extended to explore on innovative ways to enhance support for SMEs development in the country.

8. Conclusion and Recommendation: South Africa has a track record of strong economic performance but the global economic recession has had a negative impact on economic performance. Effective partnership with South Africa presents a significant opportunity to the Bank for both national and regional development. The Board is requested to note this CSP Mid-Term Review and the indicative lending limit set between UA 763 million and UA 1.01 billion per year over the period 2009-2012, for Bank's operations in South Africa.

1. INTRODUCTION

1.1 The Country Strategy Paper (CSP) for South Africa covering 2008–2012 (ADB/BD/WP/208/12-Revised), dated February 2008, was approved by the Board of Directors on 9th April 2008. In approving the CSP, the Board provided guidance relating to the need to (i) further strengthen the strategy with concrete deliverables, (ii) focus more on areas where the Bank has comparative advantage, such as improved financial intermediation services for SMEs development, and (iii) ensure that the study on the impact of South Africa on its neighbours is conducted. The Board requested Management to submit an update of the CSP by twelve months to reflect these issues. Management could not submit the update within the specified 12 months mainly due to the fact that elections were being held in April 2009 and it was deemed necessary to reflect the strategic direction of the incoming administration in the updated CSP. Other partners including the World Bank took a similar stance.

1.2 This document, in addressing the issues raised by the Board, combines the aspects of a review of the implementation of the strategy over the past sixteen months, as well as providing an update of the strategy and deliverables for the rest of the CSP period. The document also reflects the priorities of the new administration as outlined in the Medium-Term Strategic Framework (MTSF) launched in July 2009, as well as the impact of the global financial and economic crisis on the South African economy. Furthermore, an assessment of South Africa as a hub for regional integration and development in Southern Africa was undertaken as an input into the preparation of this document and is presented in Annex 9. The preparation process of the study on the impact of South Africa on the neighbouring countries has been initiated in the context of the Regional Integration Assistance Strategy (RIAS) for Eastern and Southern Africa.

1.3 With regard to the areas of focus for the remaining period of the CSP, the authorities agreed that the three strategic

pillars of the CSP are still relevant and well aligned with the MTSF and should therefore be retained. The pillars are: (i) Enhancing Private Sector Competitiveness (with a focus on infrastructure services and financial intermediation); (ii) Partnership for Regional Integration and Development (focusing on regional infrastructure and facilitation of cross-border investment); and (iii) Knowledge Management and Capacity Building, (focusing on ESW and capacity building for municipalities).

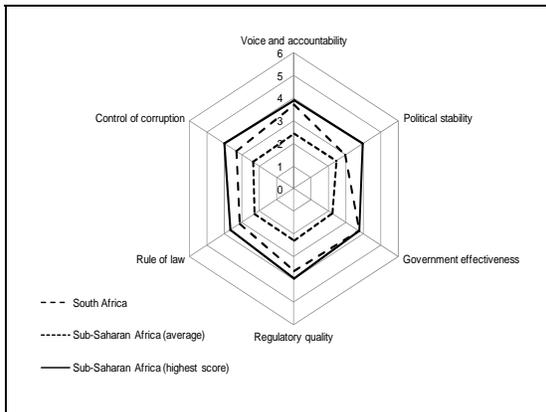
2. COUNTRY CONTEXT AND PROSPECTS

2.1 Political Context and Governance

2.1.1 *South Africa is a constitutional, multiparty democracy characterised by free and fair elections since democratization in 1994.* The general election in April 2009, the fourth election since democratization, represents another smooth transition of power and continuation of the stable political landscape. The African National Congress party (ANC) won about 66% of the votes in the 2009 elections down from 70% in 2005 while the opposition party, the Democratic Alliance (DA), gained 16.7% up from 12.4% in 2005. The 2009 elections also had more varied democratic opposition than previous elections, notably with the emergence of an ANC break-away group, the Congress of the People (COPE).

2.1.2 *South Africa performs well in terms of good governance.* Both the World Bank's Governance Indicators and Transparency International's corruption perceptions index, rank South Africa highly: 73 out of 205, and 54 out of 180 countries respectively in 2008. South Africa has the highest score in Sub-Saharan Africa in terms of government effectiveness. While the country's indicators for political stability, the rule of law and control of corruption are well above the average for Sub-Saharan Africa, they lag behind the highest score in some aspects in that group of countries (see Figure 1).

Figure 1: Governance Indicators for South Africa and Sub-Saharan Africa



Source: World Governance indicators, World Bank (2008)

2.2 Social Context

2.2.1 South Africa is among the wealthiest countries in Africa but depicts significant levels of poverty, high unemployment and inequality. More than 25% of the population lives on less than \$1.25 per day¹. The high Gini coefficient (0.58) depicts a high degree of income inequality. The high level of unemployment (officially estimated at 23.6% in June 2009) is a major contributing factor to poverty. Unemployment is highest amongst the black population at 27.7% compared to 4.6% amongst the white population.² There are also regional variations in unemployment with the highest rates seen in the rural Eastern Cape and Limpopo provinces. Access to basic social services is fair as around 80% of the households have access to electricity for lighting and 88.8% have piped water. Access to decent housing is still a challenge since about 15.4% of the population still lives in informal dwellings³. However, as Annex 4 has reveals, *South Africa has made fair progress towards meeting the Millennium Development Goals.*

2.2.2 To address the poverty and inequality challenges, which are part of the legacy of

apartheid, the Government has implemented a programme of Broad-based Black Economic Empowerment (BBEE), which has been relatively successful in creating a black middle class, which previously did not exist. However, BBEE has been criticised as having failed in achieving its broad-based goal, including deeper transformation of the economy and reduction in inequality. Consequently, there is increasing pressure on government to ensure that empowerment is truly broad-based.

2.2.3 HIV/AIDS pandemic is a major social and economic problem in South Africa. The country has a high HIV/AIDS prevalence rate of 18.8% in adults aged 15 to 49 years, representing some 5.2 million people, of which about 59% are women⁴. It is estimated that the pandemic causes 71% of deaths of people aged 15 to 49, thus limiting average life expectancy in South Africa to 49 years. Also, some 280,000 children are living with HIV/AIDS and there are about 1.4 million AIDS orphans in the country⁵. A strategic plan approved in 2006, sets ambitious goals to reduce new infections by 50% by 2011 and expand access to treatment, care and support to 80% of the affected population.

2.2.4 Gender Equality: South Africa has made significant progress in achieving gender equality. Gender equality is enshrined in the constitution and a National Policy Framework for Women's Empowerment and Gender Equality is in place. South Africa is third in the world (behind Rwanda and Sweden) in terms of female political representation, with 45% of the National Assembly made up of women. This puts the country well on track to achieve the SADC target of 50% female representation by 2015. The female school enrolment is also comparable with those of male at primary and secondary levels and surpasses that of males at a tertiary level (ratio of 1.6:1) in 2007. This may suggest

¹ UN 2008 Human Development Report. Data is for 2006

² Quarterly Labour Force Survey Q1 2009, Statistics South Africa

³ General Household Survey (Statistics South Africa, 2007)

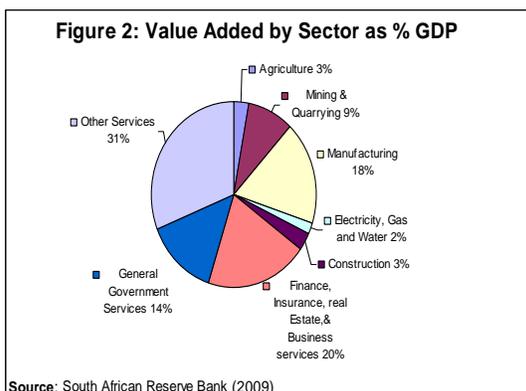
⁴ Statistics South Africa, 2009 ; and Development Indicators, 2008 (The Presidency, Republic of South Africa)

⁵ UNAIDS: South Africa Epidemiological Fact Sheet, September 2008

underachievement of boys in higher education, which should require attention in view of acute shortage of skilled labour across sectors of the economy. Despite positive developments in many areas, there are still problematic areas such as equality of pay between the sexes, weakness in gender mainstreaming in sector ministries, and high incidence of gender violence. In recognition of these problems, the new administration has created a Ministry for Women, Youth, Children and People with Disabilities to focus specifically on issues relating to these groups.

2.3 Economic Context

2.3.1 South Africa has the largest and most sophisticated economy in the sub-Saharan Africa and its economy is relatively well diversified. The service sector is dominant accounting for 65% of value-added while the secondary and primary sectors account for 23% and 12% respectively (see figure 2). The mining -sector is among major contributors to GDP accounting for up to 9% of value added. South Africa is also among world large producers of gold, platinum and chromium and a significant producer of coal and diamonds. The financial and business services sector is well-developed, accounting for 20% of GDP, followed by manufacturing at 18%. Real GDP growth during 2003-2007 was strong and stable, averaging 5%. Although the rate of investment has been encouraging, rising from 18.4% of GDP in 2005 to 23.6% in 2008, the economy is constrained by a low domestic saving rate, which averaged 14.0% of GDP over the past four years.



2.3.2 South Africa pursues prudent macroeconomic policies. Government debt (both foreign and domestic) estimated at 22.6% of GDP in 2008, is relatively low. The budget was generally balanced between 2000 and 2007, with surpluses recorded in 2005 and 2006, but a deficit of 1.0% of GDP was recorded in 2008. Government projects the worsening of the deficit to 3.8% in 2009 due to the global recession. The second round effects of the global recession have had a negative impact on the real economy in the form of declining real GDP growth, falling export earnings, a shortage of international capital for domestic investment and worsening unemployment (see Box 1). According to official output figures, the economy entered recession in April 2009⁶. Real GDP growth, which had fallen from 5% to 3.1% in 2008, was projected to further decline to 1.2% in 2009, and to recover slowly from 2010, though not reaching the pre-crisis levels until 2012/13. Government has engaged in an infrastructure investment drive which it intends to pursue as a form of counter-cyclical spending through the recession. The low level of government debt gives some room for expansionary policies to finance the increased level of budget deficit. Table 1 shows that this counter-cyclical spending will have limited impact on both fiscal deficit and government external debt in the medium term, but the domestic debt will rise (from 18.5% in 2008 to 23.4% in 2011), as part of the deficits are being financed through domestic borrowing.

2.3.3 The South African financial system has shown resilience to the global financial crisis. South African banks held little exposure to “toxic assets” and there were no bank failures in the first half of 2009. However, the ratio of non-performing loans (NPLs) to total loans, though low, has increased from 2% in January 2008 to 5% in

⁶ This is in view of the contraction of the economy in two consecutive quarters – 1.8% in the fourth quarter of 2008 and - 6.4% in the first quarter of 2009 (Statistics South Africa, August 2009).

March 2009, leading the four major banks to tighten lending criteria thereby limiting credit extension.

2.3.4 Monetary policy is implemented by the independent South African Reserve Bank, which operates on an inflation-targeting mandate given to it in 2000. The mandate is to keep Consumer Price Index (CPI) within a 3% to 6% band. However, inflation has been difficult to control, in recent years, being externally driven by rising oil and food prices, and often rises beyond this range with CPI reaching 11.5% in 2008. However, the declining oil prices and the depressed economic conditions in 2009 had eased inflation to 6.7% by July 2009.

2.3.5 Current account deficit has deteriorated from 4.0% of GDP in 2005 to 8.1% in 2008. Capital inflows covered the current account deficit in the first nine months of 2008, with Foreign Direct Investments (FDI) and other inflows rising relative to portfolio flows⁷. In view of the economic recession, the current account deficit is expected to narrow to 6.3% of GDP in 2009, due to contraction in domestic demand on imports. Over the medium-term, imports associated with public and private infrastructure investments are expected to keep it above 6%.

2.3.6 Government response to the global economic crisis has been timely and consultative with social partners, combining a large fiscal stimulus with substantial monetary easing. The government agreed with its social partners (organized labour and the business community) in February 2009, a joint response to the crisis, the centre-piece of which is a R787 billion (about US\$ 100 billion) public investment programme focussing on infrastructure development. Prudent spending in recent years has left the government with some space for counter-cyclical stimulus spending. Other initiatives responding to the crisis include the setting aside of R3.0 billion by the Industrial Development Corporation (IDC), a state-owned development financier, to provide

Box 1: Impact of the economic crisis on South African Economy

The impact of the global economic crisis on the South African economy has manifested in the form of declining export earnings, scarcity of international capital for domestic investment and job losses. Export volumes collapsed in early 2009 as demand for commodities fell precipitously. The export of manufacturing products has been hardest hit and the mining sector was also affected by the drop in global commodity prices and fall in demand. The global credit crunch has resulted in scarcity of international capital which is having a negative effect on capital flow, as risk aversion of northern investors led to capital outflows from emerging markets. South Africa's foreign inflows, FDI and portfolio flows slowed in 2008 but seem to have rebounded in 2009. In general, the international shortage of capital has reduced the availability of financing locally. The higher cost of funding coupled with the increasing NPLs, has increased the level of risks, leading local banks to tighten their lending criteria. Growth in credit extension to the private sector has accordingly slowed significantly, and the issuances of both bonds and shares showed a marked decline from mid-2008 onwards. The economic downturn has translated into job losses with some 475,000 jobs lost in the first half of 2009, taking the official unemployment rate to 23.5% and worsening the poverty levels.

bridge-financing to firms negatively affected by the crisis; the National Jobs Initiative (worth R10 billion) and the Expanded Public Works Programme aimed at creating 4.5 million work opportunities between 2009 and 2014. The social safety net has been extended to include emergency food programmes for poor households and packages are also to be put together to aid vulnerable and employment-intensive sectors through the crisis.

2.4 Medium-Term Prospects

2.4.1 The medium-term prospects of the South African economy are linked to the prospects of global economic recovery given its close integration with the international markets. As the global economy shows signs of recovery, the impetus from strong private and public investments, sound economic policies, the expected economic boost of the 2010 FIFA World Cup, a more competitive currency, a healthy banking system, falling inflation and lower interest rates, will allow for a gradual recovery in consumer spending

⁷ Republic of South Africa National Treasury Budget review 2009.

and economic growth over the medium term. Thus, it is envisaged that real **GDP growth** will gradually recover to 4.0% by 2011; inflation will remain within the 3%-6% band over the period 2009-2011; and current account deficit will fall from 8.1% of GDP in 2008 to 6.3% in 2009, but rise slightly to 6.9% in 2011. As Government maintains its spending plan in the face of declining revenue, the budget deficit is projected to worsen but improving slowly to 1.9% by 2011 (see Table 1).

Table 1: Projection of Key Macroeconomic Indicators

| Indicator | 2005 Actual | 2006 Actual | 2007 Actual | 2008 Estimate | 2009 Forecast | 2010 Forecast | 2011 Forecast |
|-------------------------------------|----------------|----------------|----------------|------------------|------------------|------------------|------------------|
| Real GDP Growth | 5.0 | 5.3 | 5.1 | 3.1 | 1.2 | 3.0 | 4.0 |
| CPI Inflation | 3.3 | 4.6 | 7.2 | 11.6 | 5.8 | 5.3 | 4.7 |
| Current Account Balance (% of GDP) | -4.0 | -6.3 | -7.3 | -8.1 | -6.3 | -6.9 | -6.9 |
| Budget Balance* (% of GDP) | 0.3 | 1.3 | 1.7 | -1.0 | -3.8 | -3.2 | -1.9 |
| Pub. Sector infra. Exp.* (% of GDP) | 4.5 | 4.6 | 6.3 | 8.3 | 9.6 | 9.7 | 9.8 |
| Govern. Domestic debt(% of GDP) | 25.4 | 21.8 | 18.7 | 18.5 | 21.3 | 23.0 | 23.4 |
| Govern. External Debt (% of GDP) | 4.2 | 4.6 | 4.7 | 4.1 | 4.2 | 4.1 | 4.1 |

*Fiscal Year ending in March of the next year

Source: Republic of South Africa National Treasury- Budget Review, 2009.

2.4.2 However, recent estimates present a less optimistic outlook for the economy in the short term. In August 2009, Statistics South Africa estimated a 2% contraction in GDP for the first half of 2009 compared with the corresponding period in 2008. Also, while government projection shows a budget deficit of 3.8% of GDP for 2009, other agencies predict that the deficit could reach 6% of GDP by the end of the fiscal year in March 2010. Moreover, recent analysis indicates that revenue collection is falling short of initial projection and may be as much as R60 billion below target by the end of the fiscal year. This deteriorating outlook may weaken recovery prospects.

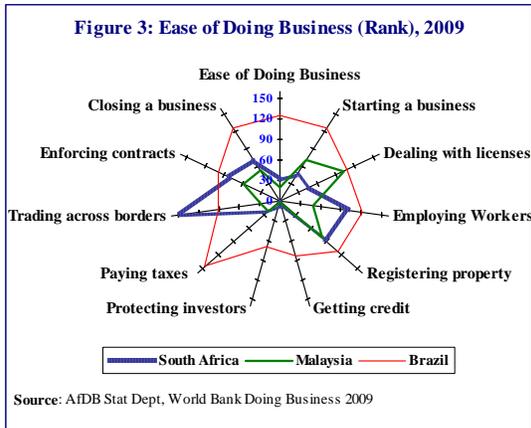
2.4.3 The growing deficit in 2009 has necessitated a public sector borrowing requirement of 7.5% of GDP during the year and more borrowing is envisaged to maintain the spending plan. Both the IMF and World Bank put the borrowing requirement at 10% of GDP. Despite the anticipated increase in government debt however, the ratings

agencies remain confident about the strength of South Africa's economy. In July 2009, Fitch affirmed South Africa's rating at 'BBB+' though with negative outlook⁸. Another positive signal is investors' confidence in the South African economy with the over-subscription of the government's US\$1.0 billion international bond issue in May 2009, the first sovereign debt issuance in international markets for a number of years.

2.5 Business Environment and Competitiveness

2.5.1 The Global Competitiveness Index (GCI) ranked South Africa in the 45th position in 2009 compared to 44th position in 2008 and 35th in 2007 out of 134 countries, showing a strong but declining ranking. South Africa's strength lies in its sophisticated financial markets, efficient goods markets, a high degree of business acumen, high level of spending on R&D and strong collaboration between research institutions and the private sector. The problematic areas as revealed by the companies surveyed include an inadequately trained workforce (22.3% of respondents); crime (19.8%); inadequate supply of infrastructure, notably electricity (12.9%); inefficient government bureaucracy (8.3%); and restrictive labour regulations (8.1%). The World Bank's 2009 Ease of Doing Business index, also ranks South Africa highly on most of the indicators (see figure 3).

⁸ Rating agencies differ in their evaluation and projections of South Africa as shown in Chapter 6.



The country ranks sixth among all upper middle income countries and 32nd globally out of the 181 countries, up from 35th position in 2008. South Africa scored highly in terms of indicators relating to access to credit, investor protection and paying taxes, but less highly in indicators relating to trading across borders and employing workers.

2.5.2 Sub-components of specific indicators such as starting business, dealing with construction permits and enforcing contract help to throw more light on country level efforts at easing business constraints and areas requiring further attention. For example, reducing procedures for starting business from 9 in 2007 to 6 in 2009 and duration (number of days to complete the process) from 35 to 22, eased business start-up in South Africa. Entrepreneurs starting business no longer need to obtain legal assistance or have their incorporation documents notarized, thanks to amendments to the Companies Act, which also allow electronic submission of documents and publication. Also, the number of procedures (17) in dealing with construction permits in South Africa is in line with those of its comparators, but the duration (174 days) is higher than in the comparators such as South Korea (34 days) and Mauritius (107 days). In terms of enforcing contracts, while the number of procedures (30) and duration (600 days) are in line with those of comparators, cost as a proportion of claim (33.2%) is much higher than in comparators such as Seychelles (14.3%), Mauritius (17.4%) and Botswana (28%).

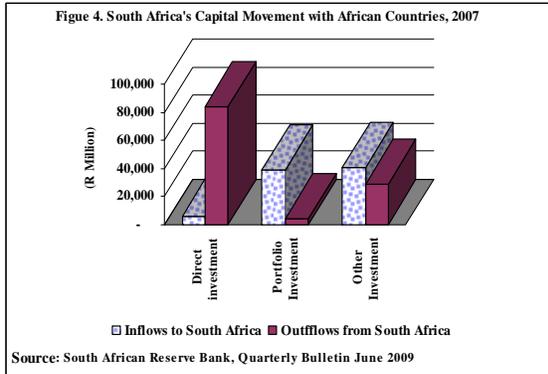
2.6 Trade and Regional Integration

2.6.1 South Africa is a member of a number of important regional institutions such as SADC⁹, SACU and Common Monetary Area (CMA), and plays a key role in terms of trade, investment, resource and revenue flows within the region. SADC encompasses 256 million people, constituting a big regional market and expects to transform into a customs union in 2010. The SADC Trade Protocol envisages a tariff-free regional trade in goods by 2012. The South Africa Rand (ZAR) is legal tender in the CMA, with the other members Lesotho, Swaziland and Namibia pegging their currencies to the Rand. In this context, any volatility in the ZAR, has serious implications for the competitiveness of South African exports and those of the CMA countries, especially in the context of the financial and economic crisis. In the case of SACU, relations within the union deteriorated recently when three of its members namely, Botswana, Lesotho and Swaziland (BLS countries), signed the Interim Economic Partnership Agreements (IEPAS) with the European Union (EU) while the other two (South Africa and Namibia) objected. Managing these differing opinions without damaging the way the union functions remains a major challenge. Also, South Africa is a driving force behind continental and regional initiatives such as NEPAD and Economic Corridor Development.

2.6.2 South Africa is a hub for regional integration and development in Africa. South Africa's GDP accounts for one-third of sub-Saharan Africa's GDP and about 65% of the GDP of the SADC region in 2007, making it almost five times the size of the next biggest SADC economy – Angola. In terms of cross-border investment, South Africa recorded a net capital flow of R32,268 million (about

⁹ Current member states are: Angola, Botswana, the Democratic Republic of Congo, Lesotho, Madagascar, Malawi, Mauritius, Mozambique, Namibia, South Africa, Swaziland, Seychelles, Tanzania, Zambia and Zimbabwe. Members have agreed on a number of convergence targets which are being implemented with varying degree of success.

US\$3,910 million) to the rest of Africa in 2007¹⁰, mostly by way of direct investment (see Figure 4). Net inflows from the rest of Africa are largely portfolio investments and other investments, totalling about US\$5,623 million in 2007.



The net outflow of direct investment indicates the growing investments of South African firms and DFIs in other parts of Africa. These investments also have technological spill-over, providing opportunity for knowledge and technology transfer to the recipient countries. About 48% of the direct investment were destined to seven SADC countries (Botswana, Lesotho, Mauritius, Mozambique, Swaziland, Zambia and Zimbabwe), while the remaining 52% went to the rest of Africa. The net inflow of portfolio investment and other investment into South Africa from the rest of Africa, underline the relatively more developed South Africa's stock and bond markets and the importance of the country as an African financial hub. An analysis of this hub concept in terms of trade, financial and investment linkages as well as remittance flows, is presented in Annex 9.

3. GOVERNMENT STRATEGIC DIRECTIONS, CHALLENGES AND OPPORTUNITIES

3.1 Context

Since democratisation in 1994, the government's development agenda has evolved over time, starting with the Reconstruction and Development Programme

(RDP) adopted in 1994; Growth, Empowerment and Redistribution (GEAR) in 1996; and Accelerated and Shared Growth Initiatives of South Africa (ASGISA) in 2006. The Medium Term Strategic Framework (MTSF), launched by the new Administration in July 2009 provides further strategic details for the implementation of ASGISA priority objectives.

3.2 The Medium-Term Strategic Framework 2009-2014

3.2.1 The MTSF builds on the successes of fifteen years of democracy. While the MTSF is not a departure from the strategic directions outlined in ASGISA, there are some notable shifts in focus. These include greater emphasis on (i) creating sustainable livelihood from sustainable work; (ii) delivery and a need for firm and tangible targets for all spheres of government; (iii) more focus on rural development; (iv) a move to prioritize the green agenda; (v) an interest in a more developmental state, where government policies and interventions drive the process of accelerated development; and (vi) new organizational mechanisms such as the setting up of a National Planning Commission and corresponding structures. The MTSF is informed by the electoral mandate of the new administration and recent dramatic changes in the global economic environment.

3.2.2 The central objective of the MTSF is to set the country on a higher and sustainable growth trajectory by 2014, with an expanded and more diversified economic base, with unemployment and poverty halved (compared to 2004) and with greater equity and social cohesion. The ten MTSF strategic priorities areas are: (i) Speeding up growth and transforming the economy to create decent work and sustainable livelihoods; (ii) Massive programme to build economic and social infrastructure; (iii) Comprehensive rural development strategy linked to land and agrarian reform and food security; (iv) Strengthen the skills and human resource base; (v) Improve the health profile of all South Africans; (vi) Intensify the fight

¹⁰ South African Reserve Bank: Quarterly Bulletin, June 2009.

against crime and corruption; (vii) Build cohesive, caring and sustainable communities; (viii) Pursuing African advancement and enhanced international cooperation, (ix) Sustainable resource management and use; and (x) Building a developmental state including improving public services and strengthening democratic institutions.

3.3 Challenges

3.3.1 South Africa faces a number of economic, social and environmental challenges including the vulnerability to external shocks due to the global economic crisis (see Box 1), high HIV/AIDS prevalence rate (see para.2.2.3), low levels of domestic savings and large current account deficits, emerging infrastructural deficiency, growing unemployment and skills shortage, slow pace of service delivery, as well as high crime rate and the need to intensify fight against corruption.

3.3.2 *A major challenge in the face of the current global economic recession is ensuring macro economic stability while putting forward very aggressive counter-cyclical policies.* This challenge is being complicated by the inability of the economy to sustain growth in the face of external vulnerabilities, low levels of domestic savings and a large current account deficit. The current account deficit has widened due to the decline in exports earnings and increasing levels of investment compared to the low domestic savings rate. This trend could expose the economy to the risk of a currency crisis in the event of a sudden fall in foreign inflows. This highlights the importance of South Africa's push for *a stronger export sector* so as to generate inflows to offset the deficit.

3.3.3 *Emerging infrastructural challenges are already constituting a binding constraint on growth and denting South Africa's investment friendly image.* Notable examples are the shortages in electricity generating capacity and water supply and sanitation. The state-owned utility, ESKOM, started rationing power in January 2008 and estimates that electricity reserve margin stands at 8% as

against its long-term target of 15%. Early in the energy crisis in January-February 2008, a near collapse of the grid forced mines to close for days, costing the economy billions of dollars. Losses from gold and platinum alone, which account for 25% of South Africa's exports, were estimated at R200 million per day during the closure. The low electricity tariff (one of the lowest in Africa) does not also encourage consumers to conserve power. Water supply and sanitation infrastructure is also struggling to keep pace with demand and there are significant infrastructural challenges relating to the railways, the congested ports, short-comings of the logistic system and expensive ICT.

3.3.4 These challenges signal the need to upgrade the country's infrastructure and also initiate reforms in view of the important role of infrastructure in enhancing economic competitiveness and the business environment. Government plans to invest R787 billion in infrastructure over the next three years (2009/10-2011/12) will ease some of these constraints. Eskom is also implementing a 5-Year investment programme (2008-2012) of R385 billion in new energy generation capacity. Independent Power Producers (IPPs) are expected to contribute up to 30% of the capital investment expenditure. The Government is also promoting renewable energy technology. South Africa plans to generate 12% of its electricity from renewable energy sources by 2015¹¹. In terms of reforms, the low electricity tariff is being gradually increased, with the National Energy Regulator of South Africa (NERSA) approving 31% tariff increase in the second quarter of 2009. ESKOM is also discussing a multi-year price determination mechanism with the regulator. Hitherto, low electricity tariff and unclear off-take agreements have limited effective contribution of IPPs to energy supply in South Africa.

3.3.5 *Climate change poses a danger to environmental sustainability and food*

¹¹ Study on the potential of renewable energy in South Africa, commissioned by the Sustainable Energy and Climate Change Project in 2005 even suggest that this could go up to 50% by 2050.

security, and aggravates the water shortage problem. In view of the energy-intensive nature of its industries and the predominance of coal as a cheap source of energy, South Africa is one of the world's biggest polluters per capita. Although accounting for only 1.5% of greenhouse gases emitted globally, South Africa is one of the five highest greenhouse gases emitting emerging markets¹². The country is listed as number 11 on the top 20 global emitters and accounts for 65% of Africa's emissions. Furthermore, climate change is aggravating the water supply scarcity problem. To this effect, the country has developed a long-term mitigating strategy (focusing on renewable energy sources and the public transport system) to reduce greenhouse gases emission. An investment plan is also being prepared to implement the strategy. To further promote renewable energy technology and diversify long-term power supply sources, the energy regulator (NERSA) announced in May 2009, feed-in-tariff, to offer incentives to producers of renewable energy.

3.3.6 Growing unemployment, as a result of job losses due to the impact of the economic recession, and skill shortages are also critical challenges. In particular, the growing youth unemployment problem is a major social worry for the country. One of the main reasons for the high unemployment rate is the "skills mismatch" in the economy – in short, the education system produces some skills which are not suited to the immediate needs of the economy. Finding ways of **alleviating the skills shortage** is therefore an important challenge for the country. This needs to be supported by an **improvement in the quality of the education system, especially at the technical and vocational level.**

3.3.7 Although the government has made strides in the provision of housing, electricity, water supply and sanitation, **service delivery presents a significant challenge especially in the poor neighborhoods.** Poor delivery, combined with high unemployment, has raised levels of tension in poor townships

sparking unrest. 2008 saw an outbreak of xenophobic violence, widely attributed to dissatisfaction with the slow pace of service delivery. This problem is complicated by South Africa's two-tiered economy and capacity constraints at the level of the municipal administration, which is responsible for a large segment of service delivery. **Integrating the two-tiered economy remains a significant challenge.** Other pressing challenges are the need to **reduce the crime rate and corruption**, which could impact negatively on South Africa's international image as a destination for foreign investment.

3.4 Strengths and Opportunities.

3.4.1 Sound macroeconomic policies positioned South Africa to take advantage of the strong world economy from 2004 to 2007 and prudent fiscal policy allowed government to reduce public debt to a low level. This is a significant advantage as it provided space to pursue counter-cyclical policy including funding a large infrastructure investments. **Economic stability** has also allowed South Africa to build up a strong international reputation and positive investor sentiment, which has served the country well in the current crisis where other emerging markets have seen more sustained reductions in inflows.

3.4.2 South Africa's **stable and peaceful democracy and its strong private sector are also major strengths.** The judiciary is strong and independent, providing effective checks and balances on government activity. The country has a progressive constitution, strong institutions and a well-developed regulatory framework. South Africa's **private sector is strong** and of a world class in terms of its sophistication. South African multinationals are leading the way into the rest of Africa and accounting for a significant proportion of inward investment on the continent. The financial sector is particularly important, and has become a hub for financial services in the region, playing an intermediation role for investors by attracting investment capital and then exporting it to the rest of Africa. The

¹² The others being China, India, Brazil and Mexico.

Johannesburg Securities Exchange (JSE) ranks in the top 20 exchanges in the world by market capitalisation.

3.4.3 South Africa also has an *impressive transport infrastructure* which makes it instrumental in supporting an efficient distribution of goods throughout the southern Africa region. The country has well-developed road and rail links, and seven major commercial ports¹³ - although the rail and port network is operating below maximum efficiency. This provides a platform for ground and sea transportation deep into Southern Africa. The *2010 FIFA World Cup*, which South Africa will host, has sparked a massive programme to expand and modernize transport infrastructure for goods and passengers including airports and mass transit systems. This also offers a further opportunity to expand tourism within South Africa and beyond its borders to the sub-region.

4. IMPLEMENTATION OF BANK STRATEGY AND RESULTS

4.1 Bank's positioning in South Africa

4.1.1 The 2008-2012 CSP is based on three pillars namely, enhancing private sector competitiveness, partnership for regional integration and development, and knowledge management and capacity building. The Bank's comparative advantage in South Africa has been in the area of financial intermediation with focus on Lines of Credits (LoCs) for private sector development and cross-border investments. Out of the 16 operations listed in Annex 6, nine (9) are LoCs. The interventions are also concentrated on a few SOEs, DFIs and commercial banks namely DBSA, IDC, ESKOM, Nedbank and Standard Bank. The Bank's support to South African SOEs, DFIs and commercial banks facilitating cross-border investments across the SADC region and beyond, help to

contribute to regional development in Southern Africa.

4.1.2 In line with the Regional Assistance Strategy Paper (RASP) for Southern Africa, 2004-2008, South Africa is also benefiting from a number of Bank Group funded regional projects managed by the SADC Secretariat namely: (i) The Shared Watercourse which is geared towards creating an enabling environment for joint management of regional water resources in the SADC region; (ii) Support of Control of Communicable Diseases (HIV/AIDS, tuberculosis and malaria); and (iii) Open and Distance Learning (ODL) System Capacity Building project aimed at facilitating the region's education systems and institutions to work together more effectively across the member states. By laying emphasis on regional integration as a pillar, this Country Strategy Paper shows synergy with the RASP.

4.2 Progress towards RBCSP Outcomes

The 2008–2012 CSP for South Africa was designed to support a number of development outcomes including increased infrastructural spending, improved household access to electricity; increased access to capital by the private sector, and improved business and investment environment. Although the CSP did not quantify these objectives in terms of baseline data and targets; in the context of this review/update, outcome indicators have been streamlined while baseline data and targets at completion have been specified (see the revised results matrix in Annex 1). Consequently, significant achievements have been observed in the outcome indicators. For example, spending on infrastructure development has been substantially enhanced rising progressively from 6.3% of GDP in 2007/08 to 8.3% in 2008/09 and targeting 9.8% by 2011/12. Household access to electricity increased from 72% in 2007/08 to 80% in 2008/09 (with a target of close to 100% by 2011/12), while private sector investment increased from 15.8% of GDP in

¹³ These are in Durban, Richards Bay, Cape Town, Saldanha Bay, Port Elizabeth, Mossel Bay and East London.

2007/08 to 16.5% 2008/09 targeting about 17% in 2011/12.

Box 2. Consultation with Stakeholders during the Review Mission

The review of the South Africa 2008-2012 CSP was done in collaboration with the National Treasury, the Bank's main counterpart in South Africa, using a participatory approach, involving consultations with the country stakeholders and the development partners established in the country. This is to ensure country ownership of the strategy and to forge collaboration with the various stakeholders and other development partners. Working sessions were held with key officials in line ministries, public enterprises, financial institutions, non-governmental organizations and development partners. The extensive consultations led to successful assessment of the performance of the Strategy and identification of new areas for further collaboration.

4.3 Progress towards RBCSP Outputs

4.3.1. There has been a substantial progress in the implementation of the strategy in terms of output indicators (see Annex 1 & 7). Within a period of 16 months, the Bank has approved eight (8) operations comprising three (3) LoCs to commercial banks, one (1) ICT loan, three (3) equity investments and one (1) grant by the Africa Water Facility. The interventions, which amount to a total commitment of UA335.79 million (about US\$521.81 million), aim to contribute to enhancing the financial capacity of South African institutions and private enterprises in investing domestically and cross borders and support for local livelihood in food production. The LoCs to major commercial Banks (*Nedbank* and the *Standard Bank of South Africa*) aim at financing trade and pipeline projects beyond South Africa. In the case of the *Nedbank* loan, which is already 60% disbursed, infrastructure projects (energy projects) in Uganda, Malawi, Madagascar and Mauritius are being financed. Also, the US\$500 million loan to *Eskom Holdings* (approved in 2007 but negotiation concluded in December 2008) helps improve supply of power to the Southern Africa Power Pool, which caters for other countries in the region. The equity funds support investments in agribusiness, expansion of regional infrastructure and carbon reduction projects.

4.3.2 There has also been some progress in the implementation of the strategic pillar focusing on knowledge management and capacity building. One ESW namely, the National Gender Machinery has been completed. While a snapshot of an assessment of South Africa as a hub for regional integration and development has been undertaken (as noted in Annex 9), a comprehensive study is planned in the context of the Regional Integration Strategy for Eastern and Southern Africa, 2010 – 2014.

4.4 Portfolio Management

The Bank's portfolio in South Africa, as at September 2009, had a cumulative commitment of UA 1,073.83 million (about US\$1,667.48 million). These operations are presented in Annex 6. As noted in paragraph 4.3.1, the portfolio gained momentum from 2008, with the approval of eight new operations with total commitment of UA335.79 million (about US\$521.81 million). About 80% of the new interventions are in the form of financial intermediation that have reach beyond South Africa borders and are aimed at facilitating cross-border investments and trade. Infrastructure development in the power and telecommunication sectors accounts for the remaining 20% of commitments. There are currently ten (10) ongoing operations with total commitment of UA737.04 million (about US\$1,144.80 million), of which two (2) are fully disbursed. Performance of the portfolio is assessed satisfactory, based on supervision reports and available project completion reports.

4.5 Lessons learnt

For the Bank

4.5.1 *Difficulty of financing SMEs:* SMEs play important roles in promoting employment and in poverty reduction. Since it is uneconomical to fund SMEs directly, the Bank attempts to reach this important sub-sector by channelling resources through DFIs

and commercial banks in terms of LoCs for on-lending operations. However in reality, these funds go mostly to corporate firms instead of SMEs because the sub-sector operates in a subsidized environment in which DFIs and commercial banks have no competitive advantage. In South Africa, support for SMEs is largely through Micro-Finance Institutions (MFIs) which are subsidized by the government and a number of development partners, including the European Commission (EC), using grant resources. For the Bank to be effective in this area there is need to explore innovative ways of supporting SMEs development in the country (see paragraph 5.1.6).

4.5.2 Participation in capacity building initiatives: The Bank is not currently active in supporting capacity building initiatives in South Africa, which is of great need, especially in municipalities. For effective participation in capacity building, there is need for continuous consultation with stakeholders and partnership with existing local institutions engaging in capacity support. The Bank has been unable to play this pivotal role, partly due to its absence on the ground. The opening of the Field Office in Pretoria will facilitate Bank's initiatives in this area.

section of stakeholders, including representatives of provincial and local government authorities.

4.5.4 Establishing a sustainable SME sector: Although government intervention is necessary to spur the development of the SMEs sector, subsidies should be seen as a temporary solution, not sustainable in the long run. Government policy should therefore aim at putting the SMEs sector on a self-sustaining path, which will enable them to attract sustainable funding at market price in the long run.

5. BANK STRATEGY AND BUSINESS PLAN FOR THE REMAINING CSP PERIOD

5.1 Strategic Pillars and Areas of Focus

5.1.1 The updated CSP is underpinned by the Government's MTSF, which is anchored on an ambitious infrastructure investment programme of about R787 billion over the next 3 years. This also forms part of the measures put in place by the Government to stimulate the economy and create employment. The areas of focus retained in the CSP remain highly relevant and well aligned to the MTSF. Specifically, the CSP

Table 2: Summary of the Strategic Pillars for the 2008 – 2012 CSP

| | Pillar 1: <i>Enhancing Private Sector Competitiveness</i> | Pillar 2: <i>Partnership for Regional Integration and Development</i> | Pillar 3: <i>Knowledge Management and Capacity Building</i> |
|----------------------|---|--|---|
| Broad Areas of Focus | (i) Support for improved infrastructure (ii) Financial intermediation for private sector development | (i) Support for regional Infrastructure. (ii) Facilitation of cross-border investment and trade | (i) Knowledge generation and sharing. (ii) Improve capacity for enhanced service delivery. |

For the Government

4.5.3 Use of the Technical Assistance Fund for MICs and Bilateral Trust Funds: The review noted lack of awareness by most government and private sector entities of the grant resources available with the Bank to MICs. The Bank jointly with the National Treasury should ensure awareness of these opportunities through dialogue with a cross-

pillars are aligned to the MTSF priorities relating to: (i) economic growth and transformation of the economy to create decent work and sustainable livelihoods; (ii) building economic and social infrastructure; and (iii) pursuing regional development, African advancement and enhanced international cooperation. The three strategic pillars are summarised in Table 2.

Strategic Pillar I: Enhancing Private Sector Competitiveness

5.1.2 *Support for Improved Infrastructure Services (CSP Pillar 1 - Outcome 1)*. Recent emerging infrastructural challenges as noted in paragraph 3.3.3 due to the aging nature of the facilities, has started constituting a binding constraint on growth and denting South Africa's growth and investor friendly image. The Bank's strategy under this pillar will support ongoing efforts by the government and its SOEs in responding to this emerging challenge. In this regard, the Bank will provide support to major infrastructural investment programmes underway focusing on energy, water supply and sanitation, and transport infrastructure.

5.1.3 In the energy sector, the Bank is discussing a major project with ESKOM to support its investment programme. The Bank will also support IPPs and renewable energy technologies. A technical assistance support will be provided to enable carry a study leading to the establishment of an Independent System Operator for the power sector. Apart from mitigating the impact of climate change, ambitious pursuit of renewable energy technologies also offers opportunities to deliver on national priorities of job creation and poverty reduction. The Bank's support for the renewable energy sub-sector would emphasize both analytical work (including feasibility studies) and direct investment. Meanwhile, discussions are underway for the Bank to contribute to a multi-donor Clean Technology Fund, a regional Fund with potential projects in South Africa.

5.1.4 In the transport sector, government plans to spend R9 billion in improving and extending transport infrastructure in nine host cities to cope with the massive influx of visitors expected for the 2010 FIFA World Cup. Investment plans also cover major upgrades to the country's airports and improvements to the general transport system,

including a taxi recapitalisation programme, the consolidation of passenger rail entities and the transformation of the bus industry. Meanwhile, discussions are ongoing with Transnet and Airport Company of South Africa (ACSA) on possible investment support for railway and airport infrastructure development. In the water supply and sanitation sector, preparation of water and sanitation master plan has been agreed with the authorities while discussions are also ongoing on investment projects in this sector.

5.1.5 There is also strong support by the South African authorities for public-private partnerships (PPPs) mechanism for infrastructure provision. In this regard, the Bank will seek to support PPPs for improving service delivery and infrastructure development. In addition to project financing, the Bank would consider the use of guarantees for PPPs in infrastructure.

5.1.6 *Financial intermediation for private sector development (CSP Pillar 1 - Outcome 2)*: The 2008-2012 CSP sought to promote local entrepreneurship in various sectors, including micro-enterprises and SMEs, in view of their critical role in job creation and poverty reduction. However, past efforts by the Bank to reach SMEs through LoCs to DFIs and commercial banks have not yielded the desired results (para 4.5.1). Consequently, the Bank will undertake an ESW on financial intermediation for SMEs to assist in devising an innovative approach to the Bank's support for SMEs development in the country, both in terms of lending and non-lending operations.

Strategic Pillar II: Partnership for Regional Integration and Development

5.1.7 As demonstrated in Annex 9, South Africa is a hub for regional integration and development in Southern Africa. The South African authorities have also endorsed regional integration and regional infrastructure, aimed at improving connectivity and regional development, as having great potential for collaboration with the Bank during the CSP period and have

Box 3: Programme for Infrastructural Development in Africa (PIDA)

The PIDA is a merger of NEPAD Medium to Long Term Strategic Framework (MLTSF) Study for the development of continental and regional infrastructure supported by NEPAD and continental sector policies and master plan initiative supported by the African Union Commission (AUC). The study, launched in February 2008, is being co-financed by the African Development Fund (ADF), the Nigerian Technical Cooperation Fund (NTCF), the EU and DFID-UK. Additional funds are also to be sourced from NEPAD-IPPF, African Water Facility (AWF) and the Development Bank of South Africa (DBSA) for sector studies under the programme.

The objectives of PIDA, covering regional energy, transport, ICT and trans-boundary water resources, are to enable African decision makers to :

- Establish a strategic framework for the development of regional and continental infrastructure based on a development vision, strategic objectives and sector policies;
- Establish an infrastructure development programme around priorities and time horizons up to 2030; and
- Prepare an implementation strategy and process including, in particular, a priority action plan.

The African Development Bank has been designated as the Executing Agency for PIDA and is implementing the study in collaboration with the AUC and the NEPAD Secretariat. The expected completion date of the study is end of 2010.

expressed strong interest in strengthening partnership with the Bank in this respect. The goal of South Africa is to increase the level of its trade with the rest of the continent, including increasing its imports from the continent. Consequently, under this pillar, the Bank's strategy would be to partner with South Africa and its institutions to foster regional development in the SADC economic space. This pillar will focus on two broad areas: (i) Support for regional infrastructure; and (ii) Facilitating cross-border investment and trade.

5.1.8 *Support for regional infrastructure (CSP Pillar 2-Outcome 1)*. To strengthen connectivity and facilitate cross-border activities, the Bank will continue to focus on the development of regional infrastructure in transportation, energy, telecommunications, and water supply and sanitation, according priority to projects that are strategically aligned to the NEPAD and the Corridor Development programmes. Both the Bank and South Africa are key players in these initiatives. Under the NEPAD programme, the Bank helped to develop the Short Term Action Plan (STAP) and leads the periodic

reviews of its implementation progress. The Bank is also currently assisting in formulating the Programme for Infrastructural Development in Africa (PIDA), in collaboration with African Union and the NEPAD Secretariat (see Box 3). PIDA will guide future NEPAD regional and continental infrastructure development and the Bank's interventions.

5.1.9 There are ongoing and planned future Bank's collaboration with South Africa and its institutions in the context of the NEPAD programme. South Africa is playing advocacy role for NEPAD, mobilizing resources for NEPAD infrastructure projects. Also, the Bank is collaborating with DBSA in co-financing NEPAD IPPF projects. Concrete examples are the Nacala Road Corridor Studies and the East African Gas Pipeline project involving Mombasa and Kampala.

5.1.10 The Bank will foster collaboration with South Africa on corridor development programme. Both the Bank and South Africa are mobilizing support for the *North-South Corridor Initiative* launched in April 2009

Box 4: North South Corridor Initiative

The North South Corridor programme is a model Aid for Trade pilot programme aimed at enabling COMESA, EAC and SADC, their Member States and the International Community to implement an economic corridor-based approach to reducing costs of cross-border trade. It seeks to improve competitiveness of producers and traders, thus generating higher levels of economic growth, employment creation and a reduction in poverty. Key aims of the initiative are to improve transport infrastructure in the region and ensure that adequate power supply is made available to support growing demand. During the April 2009 High Level Conference in Lusaka, about US\$1.2 billion was committed by development partners, of which AfDB committed US\$600 million for 4 years, for the upgrading of road, rail, energy, and port infrastructure, and support implementation of trade facilitation instruments. In addition, DBSA has also committed US\$1.2 billion towards energy, transport and information communication technology (ICT) development in the next three years. South Africa is an active player in the North South Corridor initiative. The Tripartite Fund established to accept funding from development partners for the financing of identified projects in the corridor is to be hosted by DBSA.

by Heads of COMESA, EAC, and SADC; their Member States and the International Community (see Box 4). The Bank Group strategy focuses on the development and upgrading of regional transport corridors to facilitate improved links, reduction in travel time and cost, and promotion of interregional trade. A number of Bank Group projects are planned in the corridor up to 2013. The participation of the South African consultants and contractors in the implementation of these planned Bank Group-funded projects will enhance collaboration of the Bank with South Africa in this respect.

5.1.11 Facilitation of cross-border investments and trade (CSP Pillar 2 – Outcome 2): South Africa is increasingly becoming a springboard for trans-national companies' cross-border investment into other African countries. A number of the trans-national organizations have their headquarters in South Africa and are looking into expanding into other African countries. The Bank will play a facilitating role for South African cross-border investment by partnering with South African institutions such as ESKOM, DBSA, IDC and private sector enterprises through the provision of financial support for cross-border investment activities both within SADC and in the rest of Africa. Also, by providing resources to South African institutions and private enterprises for trade financing, the Bank will be supporting South Africa's goal of increasing the level of its trade with the rest of the continent.

Strategic Pillar III: Knowledge Management and Capacity Building

5.1.12 Knowledge generation and sharing (CSP Pillar 3 Outcome 1): The Bank will develop knowledge partnership with South Africa and its Institutions, as well as with development partners in the country. ESW will provide the analytical underpinning of the lending programme and policy dialogue. This aspect of the strategy will also emphasize the sharing of South Africa's best practices within the SADC region and beyond. South Africa's specific areas of strength that are particularly value adding in the context of the global economic crisis

include strengthening domestic resource mobilization (tax systems) and financial system regulation BASEL II. This knowledge sharing will take the form of periodic seminars organised by the Bank in collaboration with South Africa and its institutions.

5.1.13 Another avenue for collaboration is in the area of strengthening statistical capacity both at the country and regional context. The South African Statistical System is among the most endowed in the continent, albeit with some technical capacity constraints. Statistics South Africa (STATS SA) has benefitted from the Bank's technical assistance under Phase 1 of its *Statistical Capacity Building* program. This cooperation will continue in Phase II, which focuses on methodological issues relating to harmonization of price statistics, National Accounts and Purchasing Power Parities (PPPs). Under Phase II, STATS SA besides being a recipient of the Bank's technical assistance, will constitute an important partner in the implementation process with other Regional Member Countries (RMC). Moreover, South Africa has offered to host proposed establishment of a SADC statistical training institute whose goal is to coordinate and provide statistical training to National Statistical Office (NSO) officials in the region.

5.1.14 Improve capacity for enhanced service delivery (CSP Pillar 3 - Outcome 2): Under this pillar, the focus will be on support for capacity improvement in municipalities, in view of their responsibility for large segments of social services delivery, including 40% of electricity distribution in the country. By supporting the capacity enhancement of municipalities to deliver on their mandate, the Bank will be contributing immensely to poverty reduction in South Africa. In this respect, the Bank has initiated discussions with the Department of Cooperative Governance and Traditional Affairs and the DBSA, which manage existing national programmes for municipalities namely, "Project Consolidate" and "Siyenza-Manje" initiative ("Doing the

right thing now”). The DBSA’s Siyenza Manje programme deploys technical assistance to municipalities to enhance implementation capacity. The programme pays the remuneration of the professionals. The Bank will collaborate with DBSA in supporting the technical assistance and training aspects of the programme, using a MIC grant.

5.2 Deliverables and Targets

5.2.1 The operational programme in the updated CSP is anchored on a number of recent Bank’s strategy documents namely, the Bank Group Medium Term Strategy (2008-2012); the Strategy Update for the Bank’s Private Sector Operations, and the Strategic Framework for enhancing Bank Group Support to Middle Income Countries (MICs)¹⁴. In this context, the expected deliverables both lending and non-lending operations, will build on the Bank’s comparative advantage in the area of financial intermediation and infrastructure development and will be guided by the principles of selectivity and collaboration with other partners, both national and international.

Lending Operations:

5.2.2 In line with the CSP pillars, Table 3 contains the indicative projects currently at varying levels of preparation being proposed for financing during the remaining CSP period 2009-2012, subject to an official request for financing. Since project identification will be an ongoing process, the Bank may finance other projects and programmes outside this list, at the request of Government or the private sector entity concerned, if such projects conform to the strategy and the annual sustainable lending limit for South Africa (see chapter 6).

¹⁴ The Strategic Framework outlines measures to deepen support to MICs including better business processes; innovation in financial services and lending products; mainstreaming delivery of advisory services; provision of softer resources; and enhancing communication with MICs.

| Lending Operations | | | | | |
|---------------------------|--|-------------|-----------------|---------------------|--------------------|
| <i>N</i> | <i>Project Name</i> | <i>Type</i> | <i>Currency</i> | <i>Amount (Mil)</i> | <i>Status</i> |
| 1 | Airport Company of South Africa-ACSA | Loan | US\$ | 100 | Appraisal |
| 2 | ESKOM Sovereign Guaranteed Loan | Loan | US\$ | 2,630 | Appraisal |
| 3 | Transnet – Railway Infrastructure | Loan | US\$ | 100 | Concept Review |
| 4 | Industrial Development Corporation LoC | LoC | US\$ | 100 | Concept Review |
| 5 | NEDBANK Second LoC | LoC | US\$ | 150 | Initial discussion |
| 6 | DBSA 5 th LoC | LoC | US\$ | 500 | Initial discussion |
| 7 | DBSA International | Equity | US\$ | 25 | Initial discussion |
| 8 | Clean Energy Technology Fund | Equity | TBD | TBD | Concept Review |

Non-Lending Activities:

5.2.3 Analytical work and capacity building activities will be undertaken in collaboration with government institutions and development partners, and financed through the MIC grant and other Bilateral Trust Funds managed by the Bank. The non-lending activities already discussed with the indicated institutions are listed in Table 4. The Bank will consider other non-lending activities that may be identified during dialogue with the South African authorities as well as development partners.

| Non-Lending Activities | | | | |
|-------------------------------|--|-------------|-----------------------------|----------------|
| <i>N</i> | <i>Name of Activity</i> | <i>Type</i> | <i>Cooperating Partners</i> | <i>Status</i> |
| 1 | Capacity Building for Municipalities | Grant | AfDB/DBSA /DCG&TA | Identification |
| 2 | Water and Sanitation Master Plan | Grant | AfDB/DCG &TA | Identification |
| 3 | Establish MDG Baselines at Local level | Grant | AfDB/UNDP | Identification |
| 4 | Study on Establishment of an Independent Power System Operator | Grant | AfDB/DoE | Identification |
| 5 | Study on Financial Intermediation for SMEs | Grant | AfDB/DTI | Identification |

5.3 Financing Instruments

5.3.1 In view of the global economic crisis, demand for Bank’s resources is likely to increase over the CSP period. The Bank will, in this respect, position itself to support the country, through the various financing instruments available for MICs, including:

- ADB sovereign guaranteed loans;
- Non-sovereign guaranteed loans and PPPs including LoCs and equity;
- Technical Assistance Fund for MICs and Bilateral Trust Funds;
- NEPAD Infrastructure Project Preparation Facility; and
- Liquidity and Trade Financing Facilities.

The focus of the Bank's lending will be to SOEs, DFIs and the private sector entities.

5.4 Partnership Framework

5.4.1 Donor coordination arrangements: Although there is no institutionalized donor coordination mechanism in South Africa, donor presence remains strong in the country in terms of interventions. Apart from the Bank Group, South African major development partners with field presence in the country include the World Bank, IMF, the European Union (EU) and its member states and the United Nations (UN) Agencies (see Annex 8 for details of their interventions). South Africa puts a great deal of emphasis on mutual commitment to the implementation of the Paris and Accra Declarations regarding harmonization, alignment and managing for results. The Government holds partners responsible for honouring their commitments in these respects and requires partners to inscribe this commitment in their partnership agreements and country assistance strategy documents.

5.4.2 To this end, development partners are encouraged to collaborate and intervene collectively, in line with their comparative advantages. Consequently, development partners have formed five working clusters to ensure close collaboration with respective government institutions. These are: (i) Economic and Employment Cluster, (ii) Governance Cluster, (iii) Social Cluster, (iv) Crisis Prevention Cluster, and (v) Gender Mainstreaming Cluster. On its part, the Bank will work within the clusters and adhere to the provisions of the Paris and Accra Declarations in its operational dealings with South Africa.

5.4.3 AfDB Collaboration with other development partners: The Bank will actively promote co-financing of lending operations and joint ESW with other partners. Meanwhile the Bank is collaborating with the World Bank and the World Economic Forum on the preparation of the African Competitiveness Report. Also, co-financing activities by the AfDB, World Bank, Agence Francaise de Developpement (AFD) and European Investment Bank (EIB) are envisaged under the ESKOM energy investment programme, NEPAD and Corridor Development programmes. The CSP review mission also initiated discussions with the UNDP on collaboration in the area of establishing MDGs baseline data at provincial level to facilitate effective monitoring of MDGs indicators.

5.5 Monitoring and Evaluation of Bank Assistance

5.5.1 **Monitoring and evaluation** of the strategy results will be undertaken in the context of the results matrix using two sets of indicators. The first sets of indicators are based on the MTSF, which will be assessed annually by the Office of the President. The Government's Medium Term Expenditure Framework (MTEF), which is an instrument for the implementation of the MTSF, is also among key reports that will be used to monitor progress in the implementation of the strategy. The other set of indicators relates to the Bank's deliverables as specified in section 5.2. Towards the end of the CSP period, a completion report will be prepared in early 2012 to assess progress towards the CSP outcomes and outputs and draw lessons to inform the next CSP.

5.5.2 **Enhanced Bank collaboration:** The coordination and monitoring of the implementation of the Bank's strategy in South Africa will be led by ZAFO, with support from the headquarters and the network of field offices in the SADC region. The Bank's presence in South Africa will facilitate better portfolio monitoring and follow-up as well as deepen policy dialogue

with the government and other country stakeholders. It will also enhance collaboration with the development partners already established in the country and with regional and continental organizations such as SACU, SADC and NEPAD. The Field Office will also facilitate rapid response to South Africa's demands and better engagement in knowledge building and sharing activities.

5.6 Country Dialogue Issues

5.6.1 *Use of MIC Grant:* South Africa has hardly utilized MIC resources owing largely to lack of awareness of the significance of such resources in the implementation of government development initiatives. The Bank will engage the authorities, and other stakeholders in dialogue on the use of MIC grant, especially for non-lending and project preparation activities.

5.6.2 *Use of South Africa's best practices and expertise for regional development:* South Africa has advanced in many areas ranging from institutional reforms and set-ups, policy formulation and implementation, public sector operational efficiency, PPP arrangements, technological innovations, and many other areas that can be emulated by other countries in the region. The Bank will extend dialogue with various public and private institutions in South Africa on ways to disseminate such best practices to other countries to enhance regional development.

5.6.3 *Support for development of SMEs:* In South Africa, SMEs play important roles in promoting employment and in poverty reduction. However, as pointed in paragraph 4.5.1 and 5.16, the Bank's attempts to reach this important sub-sector has not proved very successful. In view of this constraint, the Bank will extend dialogue with the authorities and other stakeholders on the ground on innovative ways of supporting SMEs development in the country.

5.7 Potential Risk and Mitigating Measures

5.7.1 The major risk to the implementation of the proposed strategy is the high expectations of the government by the most disadvantaged groups. The social partners of the new administration expect to see radical changes in the welfare of the poor communities and the disadvantaged groups. The major challenge is how to manage this high level of expectations and demands, which tends to put considerable pressure on the new administration to produce immediate results. This pressure is being worsened by the impact of the global economic crisis in terms of job losses and welfare erosion, which have started to result in social unrest and industrial actions for increased wages and salaries. Yielding to these pressures could further worsen the already deteriorating fiscal deficits. The Government is taking steps to minimise this risk by including social actions in the fiscal stimulus plan aimed at creating jobs and minimizing the impact of the global recession on the vulnerable groups.

5.7.2 Reliability of power supply (electricity) is a major determinant of South Africa's economic growth. ESKOM, the state-owned electricity entity has been unable to meet demand leading to rationing of power effective January 2008. For ESKOM to generate sufficient power, it requires massive investment estimated at about R385 billion. Although initiatives are underway to secure the required funds through various sources, including the African Development Bank, the ongoing global economic recession possesses challenges to access to adequate resources. Initiatives underway by the government to support ESKOM, including granting of sovereign guarantee on external loans and gradual adjustment of electricity tariffs to ensure cost-reflective, will enable mitigate risks to reliable power supply to the country and its neighbours.

6. BANK EXPOSURE AND LENDING LIMITS

6.1 Creditworthiness and Bank Exposure

6.1.1 As a middle income country, lending to South Africa will be guided by the Bank's credit worthiness analysis and exposure indices, as well as performance under the Country Performance and Institutional Assessment (CPIA). An analysis of the Bank's CPIA results over the period, 2006 and 2008 indicates that South Africa has shown consistently strong CPIA rating having been rated overall above 3.75 in all the years, and placed in the First Quintile and number one overall among 53 countries and in all the four broad policy clusters.

6.1.2 The most recent Bank's internal rating (June 2009) classifies South Africa among the "Very Low Risk" countries¹⁵. However, in view of the expected slowdown in the overall economic activities over the medium term, the Bank has downgraded South Africa's "outlook" from "Stable" to "Negative". External ratings agencies namely, *Fitch*, *Moody's* and *Standard & Poor's* (S&P) rate South Africa in the investment grade category at BBB+, Baa1 and BBB+, respectively. However, the "outlooks" diverge. Fitch and S&P have "Negative" outlooks, which were revised downward in September 2009, while Moody's has "Stable" outlook.

6.2 Sustainable Lending Limits

The annual sustainable level of commitment of South Africa is between UA 763 million and UA 1.01 billion. With the Sovereign Guaranteed loan of UA 1.7 billion to Eskom tabled for Board consideration in late 2009, the country's Sustainable Lending Limit for the period 2010 to 2012 will be reduced to between UA 220 and UA 390 million. The annual lending volumes are however, indicative and subject to change

(both upwards and downwards), in the light of timing and size of a possible General Capital Increase (GCI).

7. CONCLUSIONS AND RECOMMENDATIONS

7.1 Conclusions

South Africa has a strong economic performance track record and presents significant investment opportunities to the Bank. Medium-term outlook remains encouraging but there are a number of challenges including vulnerabilities to external shocks in the context of the global economic recession as well as high poverty, unemployment and inequality. The Bank will combine lending operations, especially to SOEs and the private sector, with knowledge deepening and sharing to enhance its advisory role and policy dialogue. The Bank will continue to take advantage of the investment opportunities, especially in the areas of infrastructure development and financial intermediation. The establishment of the South Africa Regional Office (ZAFO) will enhance the Bank-South Africa partnership.

7.2 Recommendations

The Board is requested to take note of this Mid-Term Review of the 2008-2012 Bank's CSP for South Africa, which has attempted to respond to the issues raised by the Board during the approval of the strategy in April 2008. The Board is also invited to note the indicative lending limit set between UA 763 million and UA 1.01 billion per year over the period 2009-2012, for Bank's operations in South Africa.

¹⁵The Bank's Country Risk rating ranges between "1 – 10"; with "10" being the most risk country.

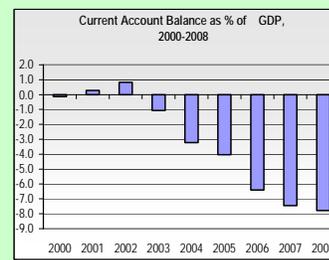
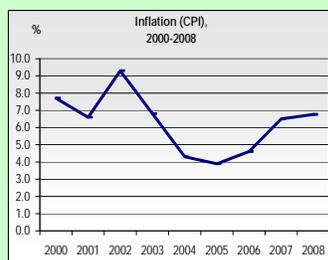
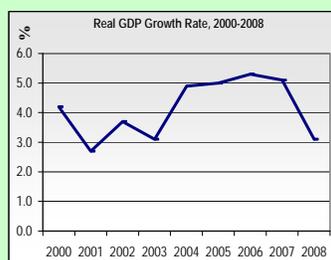
Annex 1: South Africa CSP Result Framework Monitoring Matrix

| Broad Government Objectives | CSP Outcomes for the Country | | | | Bank Operational Priorities and Performance | |
|---|--|--|--|--|---|--|
| | <i>CSP Outcomes During the CSP period</i> | <i>Intermediate Outcome Indicators to achieve expected CSP Outcomes</i> | <i>Progress towards intermediate outcome indicators at mid-term</i> | <i>Target Level of Outcome at end of CSP Period</i> | <i>Bank deliverables (outputs) from operations</i> | <i>Progress towards achievement of Bank deliverables at mid-term</i> |
| <p>Targeted investments in the rural areas and urban neighbourhoods and peri-urban townships to improve the quality and the distribution of infrastructure facilities in order to bring them at par with the rest of South Africa</p> <p>i. Increase Levels of Investment in the First Economy.</p> <p>ii. Lower Cost of Doing Business and Enhance Levels of Competition</p> <p>iii. Promote expansion of job creating manufacturing and services sectors</p> <p>iv. Promote enterprise growth, especially Black-end women-owned and managed</p> <p>ii. Pay particular attention to further growth of the small and medium business Sector.</p> <p>(i) Increase regional trade and investment.</p> | Pillar I : Enhancing Private Sector Competitiveness | | | | | |
| | 1. Support the improvement of Infrastructure Services | | | | | |
| | Increase public investment at all levels of government for infrastructure spending, | Increased share of public spending in infrastructure from 6.3 % of GDP in 2007/08 to 9.8% in 2011/12. | Public sector spending on infrastructure is estimated at 8.3% of GDP in 2008/09. | Increased Gross Fixed Capital Formation (GFCF) from 20.6 % in 2007 to around 25% in 2012. | Support to infrastructure and other projects that contribute to the improvement of the enabling business environment | Finalization of negotiations of the US\$500 million loan to Eskom , which was concluded in December 2008. Preparations are also underway for extension of another loan amounting to US\$2.6 billion to Eskom for a Power Generation Project. |
| | Improved household access to electricity. | Increased number of households access to electricity from 72% in 2007 to around 100% by 2012. | The power supply company (Eskom) capital expenditure program from 2009 - 2012 is estimated at R385 billion (about US\$ 48 billion) | Increased access to electricity by Households to round 100% (the national target by 2014) | | |
| | 2. Improve Financial Intermediation for Private Sector Development | | | | | |
| | Increased access to capital by private sector. | Increased share of private sector investment to GDP from the level reached in 2007 of 15.8% to 17.0% by 2012 | Despite the economic downturn, private sector investments, bolstered by robust financial sector, maintained an upward trend to 16.5% of GDP in 2008. | Increased share of private investment to GDP to around 17.0 percent of GDP by 2012, in line with the national target of overall investment of 25% of GDP by 2014 | Support to financial sector institutions for promotion of private sector investments | (i) Among interventions approved by the Bank include three Lines of Credit extended to major commercial banks (Standard Bank of South Africa and Nedbank), for financing pipeline projects with private sector investments in South Africa and beyond. The Bank's participation in equity funds is also a channel to promote development of private sector investments in South Africa and beyond. |
| | Pillar II: Partnership for Regional Integration and Development | | | | | |
| | 1. Support for Regional Infrastructure | | | | | |
| | Improved regional infrastructure development, especially along the economic development corridors to facilitate intra-trade flows in the SADC region | Increased trade flow between South Africa and SADC countries from 15% of total exports in 2007 to around 17 % by 2012, as well as increased share of imports from the region from the current level of around 7% | Trade flows between South Africa and SADC countries has been on the increase facilitated by SADC and SACU trade relations and gradual improvement in infrastructure development. | South Africa's volume of trade with the rest of Africa and in particular with SADC countries have substantially improved by 2012. | Support infrastructure projects in South Africa and in the SADC region that facilitate development of regional trade. | The approved seven projects for South Africa since 2008, have dimensions of regional development impact. More specifically, the Nacala Road Project (a multinational road) will link Zambia and Malawi with Nacala Port in Mozambique, and will significantly influence trade flows through improved transport communication between these countries. |

| | | | | | | |
|---|--|--|--|--|--|--|
| | 2. Facilitation of cross-border Investment | | | | | |
| | Increased capital investment by South African institutions in Africa region | Increased share of South Africa investment in Africa region from the current level of around 6% of total foreign investment by 2007. | South Africa's transnational corporations have increased their presence in African countries, majority seizing significant share of domestic market. Case example are telecom companies (Vodacom and MTN) which are major operators in Tanzania, DRC, Lesotho, and Mozambique. | Increased South Africa's investments in the African region (in line with the country's economic growth rate of around 3 - 4% over 2008-2012) to around 7-8% of total foreign investments | (i) Support to Development Finance Institutions in South Africa (ii) Partner with institutions in South Africa that support cross-border for private sector development | As noted above, all seven interventions approved since 2008 aim at promoting projects beyond South Africa. A case in point is the LoC to Nedbank, which financed projects in Uganda, Malawi, Madagascar, and Mauritius. |
| | Pillar III: Knowledge Management and Capacity Building | | | | | |
| | 1. Improve Knowledge Generation and Sharing | | | | | |
| i. Strengthening the capacity of the state to implement programs and provide services, especially at municipal level. | Improved Bank knowledge on the dynamics and challenges to the South Africa's economy for effective Bank Group interventions in the country | A Medium Term Strategic Framework is in place to guide Bank Group interventions in the country | A Medium Term Strategic Framework to guide Government's program in the electoral mandate for 2009 – 2014 was released in July 2009. | A long term national development program/vision is in place to guide Bank Group interventions in the country | Contribute though undertaking of economic and sector works and provision of technical assistance | One study on National Gender Machinery has been undertaken. Moreover, preparations are underway for the undertaking of a Regional Integration Strategy for Eastern and Southern Africa countries, which will be informed by a number of studies, including the 'Impact of South Africa on its Neighbours'. |
| | 2. Improve Capacity for Enhanced Service Delivery | | | | | |
| (ii) Support to municipalities to improve planning and implementation of programs | Improved capacity of municipalities in delivering basic services | Increased coverage of capacity building program to municipalities from 130 municipalities covered by 2008. | "Siyenza Manje" a capacity building program to municipalities spearheaded by the DBSA covers all 160 municipalities with skill shortages | Improved capacity of municipalities in delivering basic services through increased coverage of capacity building programs i.e. "Siyenza Manje" and "Project Consolidate". | Develop capacity of municipalities by partnering with South African institutions and other development partners. | Initial discussions have been launched to partner with the DBSA and Department of Cooperative Governance and Traditional Affairs in their program on capacity building for municipalities. |

Annex 2: South Africa Selected Macroeconomic Indicators

| Indicators | Unit | 2000 | 2003 | 2004 | 2005 | 2006 | 2007 | 2008 |
|-------------------------------------|---------------------|-----------|-----------|-----------|-----------|-----------|-----------|-----------|
| National Accounts | | | | | | | | |
| GNI at Current Prices | Million US \$ | 138,465 | 135,145 | 172,574 | 231,064 | 260,242 | 279,802 | ... |
| GNI per Capita | US\$ | 3,050 | 2,870 | 3,630 | 4,820 | 5,390 | 5,760 | ... |
| GDP at Current Prices | Million US \$ | 132,964.3 | 167,964.2 | 214,274.6 | 241,623.8 | 255,958.8 | 283,555.0 | 259,452.4 |
| GDP at 2000 Constant prices | Million US \$ | 132,935.6 | 145,965.2 | 153,117.5 | 160,773.3 | 169,294.3 | 177,928.3 | 183,443.8 |
| Real GDP Growth Rate | % | 4.2 | 3.1 | 4.9 | 5.0 | 5.3 | 5.1 | 3.1 |
| Real per Capita GDP Growth Rate | % | 2.7 | 2.0 | 3.9 | 4.1 | 4.6 | 4.5 | 2.6 |
| Gross Domestic Investment | % GDP | 15.9 | 16.8 | 17.8 | 18.4 | 20.7 | 21.9 | 23.6 |
| Public Investment | % GDP | 4.3 | 4.4 | 4.3 | 4.4 | 5.0 | 6.2 | 7.1 |
| Private Investment | % GDP | 11.6 | 12.4 | 13.5 | 14.0 | 15.7 | 15.8 | 16.5 |
| Gross National Savings | % GDP | 15.8 | 15.8 | 14.5 | 14.0 | 14.0 | 14.1 | 14.0 |
| Prices and Money | | | | | | | | |
| Inflation (CPI) | % | 7.7 | 6.8 | 4.3 | 3.9 | 4.6 | 6.5 | 6.8 |
| Exchange Rate (Annual Average) | local currency/US\$ | 6.9 | 7.6 | 6.4 | 6.4 | 6.8 | 7.1 | 8.3 |
| Monetary Growth (M2) | % | 7.2 | 14.8 | 8.8 | 19.9 | 21.2 | 20.2 | 9.0 |
| Money and Quasi Money as % of GDP | % | 54.1 | 56.5 | 56.6 | 61.0 | 65.4 | 68.3 | 69.0 |
| Government Finance | | | | | | | | |
| Total Revenue and Grants | % GDP | 23.8 | 24.0 | 24.9 | 26.3 | 26.8 | 28.3 | 22.7 |
| Total Expenditure and Net Lending | % GDP | 25.8 | 26.4 | 26.2 | 26.6 | 26.2 | 27.3 | 23.6 |
| Overall Deficit (-) / Surplus (+) | % GDP | -2.0 | -2.3 | -1.4 | -0.3 | 0.6 | 0.9 | -1.0 |
| External Sector | | | | | | | | |
| Exports Volume Growth (Goods) | % | 16.8 | 0.1 | 2.9 | 8.0 | 5.7 | 8.2 | 3.0 |
| Imports Volume Growth (Goods) | % | 5.4 | 8.0 | 14.5 | 10.3 | 18.8 | 10.4 | 6.4 |
| Terms of Trade Growth | % | -9.1 | 0.9 | 0.7 | 0.8 | 4.7 | 3.7 | 3.8 |
| Current Account Balance | Million US \$ | -171.9 | -1,805.8 | -6,919.6 | -9,773.0 | -16,397.2 | -21,142.2 | -20,213.8 |
| Current Account Balance | % GDP | -0.1 | -1.1 | -3.2 | -4.0 | -6.4 | -7.5 | -7.8 |
| External Reserves | months of imports | 2.7 | 2.2 | 3.0 | 3.6 | 3.6 | 4.0 | 3.4 |
| Debt and Financial Flows | | | | | | | | |
| Debt Service | % exports | 13.8 | 12.7 | 10.6 | 8.3 | 8.3 | 8.8 | 8.1 |
| External Debt | % GDP | 27.8 | 23.4 | 21.0 | 19.1 | 22.3 | 26.5 | 34.0 |
| Net Total Financial Flows | Million US \$ | 493.3 | 5,427.0 | 10,236.0 | 14,782.5 | 8,476.9 | 11,497.2 | ... |
| Net Official Development Assistance | Million US \$ | 487.3 | 641.3 | 628.1 | 680.3 | 720.4 | 794.1 | ... |
| Net Foreign Direct Investment | Million US \$ | 887.9 | 733.7 | 799.2 | 6,643.8 | -527.1 | 5,692.1 | ... |



Source : ADB Statistics Department; IMF: World Economic Outlook, September 2008 and International Financial Statistics, October 2008;
 ADB Statistics Department: Development Data Platform Database, April 2009. United Nations: OECD, Reporting System Division, January 2009.

Notes: ... Data Not Available

Last Update: April 2009

Annex 3: South Africa - Development Indicators

| Social Indicators | South Africa | | Africa | Developing countries |
|--|--------------|---------------------|-------------|----------------------|
| | 1990 | 2008 * | | |
| Area ('000 Km ²) | | 1,221 | 30,323 | 80,976 |
| Total Population (millions) | 36.6 | 48.8 | 985.7 | 5,523.4 |
| Population growth (annual %) | 2.3 | 0.5 | 2.3 | 1.4 |
| Life expectancy at birth, total (years) | 61 | 49 | 55 | 66 |
| Mortality rate, infant (per 1,000 live births) | 49.7 | 43.8 | 83.9 | 53.1 |
| Physicians per 100,000 People | ... | 75.3 | 39.6 | 78.0 |
| Births attended by skilled health staff (% of total) | ... | 92.0 | 51.2 | 59.0 |
| Immunization, measles (% of children ages 12-23 months) | 79.0 | 83.0 | 83.1 | 81.0 |
| School enrollment, primary (% gross) | 121.6 | 98.0 | 99.6 | 106.0 |
| Ratio of girls to boys in primary education (%) | 98 | 96 | 92 | 100.0 |
| Illiteracy rate, adult total (% of people ages 15 and above) | ... | 12.0 | 33.2 | 26.6 |
| Access to Safe Water (% of Population) | 81.0 | 93.0 | 64.3 | 84.0 |
| Access to Sanitation (% of Population) | 55.0 | 59.0 | 37.6 | 53.0 |
| Human Develop. (HDI) Rank (Over 179 Countries) | ... | 125 | ... | ... |
| Human Poverty Index (% of Population) | ... | 22.6 | 38.7 | ... |
| | | South Africa | | |
| Economy | 2000 | 2007 | 2008 | 2009** |
| GNI per capita, Atlas method (current US\$) | 3,050 | 5,760 | ... | ... |
| GDP (current Million US\$) | 132,964 | 283,555 | 259,452 | 227,848 |
| GDP growth (annual %) | 4.2 | 5.1 | 3.1 | 1.1 |
| Per capita GDP growth (annual %) | 2.7 | 4.5 | 2.6 | 0.6 |
| Gross Domestic Investment (% of GDP) | 15.9 | 21.9 | 23.6 | 24.3 |
| Inflation (annual %) | 5.4 | 7.2 | 11.5 | 6.7 |
| Budget surplus/deficit (% of GDP) | -2.0 | 0.9 | -1.0 | -3.7 |
| Trade, External Debt & Financial Flows | 2000 | 2007 | 2008 | 2009** |
| Export Growth, volume (%) | 16.8 | 8.2 | 3.0 | 4.5 |
| Import Growth, volume (%) | 5.4 | 10.4 | 6.4 | 6.0 |
| Terms of Trade (% change from previous year) | -9.1 | 3.7 | 3.8 | 1.8 |
| Trade Balance (mn US\$) | 4,708 | -5,749 | -5,588 | -4,583 |
| Trade balance (% of GDP) | 3.5 | -2.0 | -2.2 | -2.0 |
| Current Account (mn US\$) | -172 | -21,142 | -20,214 | -14,491 |
| Current Account (% of GDP) | -0.1 | -7.5 | -7.8 | -6.4 |
| Debt Service (% of Exports) | 13.8 | 8.8 | 8.1 | 8.8 |
| External Debt (% of GDP) | 27.8 | 26.5 | 34.0 | 44.4 |
| Net Total Inflows (mn US\$) | -493.3 | 11,476.7 | ... | ... |
| Net Total Official Development Assistance (mn US\$) | 487.3 | 794.1 | ... | ... |
| Foreign Direct Investment Inflows (mn US\$) | 887.9 | 5,692.1 | ... | ... |
| External reserves (in month of imports of goods & services) | 2.7 | 4.0 | 4.0 | ... |
| Private Sector Development & Infrastructure | 2000 | 2006 | 2007 | 2008 |
| Time required to start a business (days) | ... | 35 | 31 | 22 |
| Investor Protection Index (0-10) | ... | 8 | 8 | 8 |
| Main Telephone Lines (per 1000 people) | 109 | 97 | 96 | ... |
| Mobile Cellular Subscribers (per 1000 people) | 184 | 821 | 871 | ... |
| Internet users (000) | 2,400.0 | 3,700.0 | 3,966.0 | ... |
| Roads, paved (% of total roads) | 20.3 | ... | ... | ... |
| Railways, goods transported (million ton-km) | 100,434 | ... | ... | ... |

Source: ADB Statistics Department, based on various national and international sources

* Most recent year

Last Update: March 2009

** Forecast

Annex 4: South Africa: Millennium Development Goals

| MDG Goal | Indicator | 1990 | 2000 | 2004 | 2007 |
|---|---|--------------|-------------|--------------|-------------|
| Goal 1: Eradicate Extreme Poverty | Poverty (US\$1 a day head count ratio, %) | ... | 7.6 | 8.6 | ... |
| | Share of Consumption to poorest quintile (%) | 3.6(1995) | 3.5 | 3.5 | ... |
| Goal 2: Achieve Universal Primary Education | Primary education completion (gross intake to final primary grade, %) | ... | 91.1 | 92.2 | 98.0 |
| | Secondary Enrolment (gross, %) | 74.3 | 86.0 | 94.8 | 91.0 |
| Goal 3: Promote Gender Equality | Ratio of girls to boys in primary and secondary school (%) | 103 (1997) | 100.6 | 100.4 | 100.6 |
| | Women in non-agricultural sector (% of total non-agricultural employment) | ... | ... | 16 | ... |
| Goal 4: Reduce Child Mortality | Child mortality (under 5 mortality rate per 1000) | 81 (1998) | 91 | 106 | |
| | Measles immunization (% of children ages 12-23 months) | 63.0 (1998) | 75.8 | 83.1 | 84.5 |
| Goal 5: Improve Maternal Health | Maternal mortality ratio (modelled estimate per 100,000 live births) | 80.69 (1997) | 97.64 | 165.5 (2003) | ... |
| | Births attended by skilled health staff (% of total) | 82.0 (1995) | 84.4(1998) | 92 (2003) | ... |
| Goal 6: Combat HIV/AIDS and other diseases | HIV prevalence (% of the pop. ages 15-49) | ... | 14.2 (2001) | 16.8 | 18.8 |
| | Incidence of TB (per 100,000 people) | 301 (1990) | 576 | 925 (2005) | 940 (2006) |
| Goal 7: Ensure environmental sustainability | Access to improved water source (% of the population) | 61.7 (1994) | 71.0 | 79.9.0 | 87.2 |
| | Access to improved sanitation facilities (% of the population [2004]) | 49.9 | 57.6 | 66.1 | 72.6 |
| Goal 8: Develop a global partnership for development (new technologies) | Fixed-line and mobile phone subscribers (per 1000 people) [2005] | ... | 304 | 825 | ... |
| | Internet users (per 1000 people) | 53 (2000) | 64..9 | | 81.6 (2007) |

Source: UNDP: South Africa Millennium Development Goals; South Africa: Development Indicators 2008; AfDB, Stat Department

**Annex 5: Bank's On-Going Operations in South Africa
As of August 2009**

| | Operation | Date of Approval | Type of Investment | Currency | Approved Amount (Million) | Amount Approved (UA Mill.) | Amount Disbursed (UA Million) | % Disbursed |
|----|--|------------------|--------------------|----------|---------------------------|----------------------------|-------------------------------|---------------|
| 1 | Fourth Line of Credit to DBSA | 21/07/2006 | LoC | USD | 100.0 | 67.19 | 67.19 | 100% |
| 2 | Eskom | 28/06/2007 | Loan | USD | 500.0 | 334.03 | 334.03 | 100% |
| 3 | Nedbank Ltd | 11/09/2008 | LoC | USD | 100.0 | 63.70 | 38.22 | 60% |
| 4 | Standard Bank of South Africa | 11/09/2008 | LoC | USD | 220.0 | 140.14 | 82.82 | 59.1% |
| 5 | Agri -Vie Equity Fund | 28/01/2009 | Equity | USD | 15.0 | 9.48 | 0 | 0% |
| 6 | Emerging Africa Infrastructure Fund | 11/03/2009 | Loan | US\$ | 48.75 | 31.24 | 0 | 0% |
| 7 | New Dawn Satellite Project | 11/03/2009 | Loan | US\$ | 25.0 | 16.00 | 0 | 0% |
| 8 | Evolution One Equity Fund | 27/05/2009 | Equity | ZAR | 100.0 | 7.89 | 0 | 0% |
| 9 | Integrated Water Harvesting Project | 14/04/2009 | Grant | Euro | 0.374 | 0.343 | 0 | 0% |
| 10 | LoC to Standard Bank of South Africa Ltd. (Global Trade Liquidity Program) | 07/09/2009 | Loan | US\$ | 100.0 | 67.00 | 0 | 0% |
| | Total (UA Million) | | | | | 737.04 | 522.26 | 70.86% |

Annex 6: Bank's Cumulative Operations in South Africa since 1997

| s/n | Project Name | Project Amount (Million) | Currency | Approval Date | Amount Approved (UA Mill) | Amount Disbursed (UA Mill) | Undisbursed Amount (UA Mill) | % Disbursed |
|-----|---|--------------------------|----------|---------------|---------------------------|----------------------------|------------------------------|-------------|
| 1a | First LoC to DBSA | 70.00 | US\$ | 09.09.1998 | 53.85 | 53.85 | - | 100 |
| 1b | First LOC to DBSA | 340.00 | ZAR | 09.09.1998 | 51.03 | 51.03 | - | 100 |
| 2 | Second LoC to DBSA | 500.00 | ZAR | 10.11.1999 | 61.81 | 61.81 | - | 100 |
| 3 | Third LoC to DBSA | 100.00 | US\$ | 16.07.2003 | 72.26 | 72.26 | - | 100 |
| 4 | Fourth Loc to DBSA | 100.00 | US\$ | 21.07.2006 | 67.19 | 67.19 | - | 100 |
| 5 | First LoC to IDC | 100.00 | US\$ | 28.06.2000 | 74.25 | 74.25 | - | 100 |
| 6 | Second LOC to IDC | 357.50 | ZAR | 05.11.2004 | 18.87 | 18.87 | - | 100 |
| 7 | Programme to Support SME Franchising | 48.35 | ZAR | 19.05.2004 | 4.77 | 4.77 | - | 100 |
| 8 | Loan to ESKOM | 500.00 | US\$ | 28.06.2007 | 334.03 | 334.03 | - | 100 |
| 9 | LoC to Nedbank | 100.00 | US\$ | 11.09.2008 | 63.70 | 38.22 | 25.48 | 60 |
| 10 | LoC to Standard Bank | 220.00 | US\$ | 11.09.2008 | 140.14 | 82.82 | 57.32 | 59.1 |
| 11 | Agri-Vie Equity Fund | 15.00 | US\$ | 28.01.2009 | 9.48 | - | 9.48 | 0 |
| 12 | New Dawn Satellite Project | 25.00 | US\$ | 11.03.2009 | 16.0 | - | 16.00 | 0 |
| 13 | Emerging Africa Inf. Fund | 48.80 | US\$ | 11.03.2009 | 31.24 | - | 31.24 | 0 |
| 14 | Evolution One Equity Fund | 100.00 | ZAR | 27.05.2009 | 7.89 | - | 7.89 | 0 |
| 15 | Integrated Water Harvest Project (Africa Water Facility) | 0.374 | Euro | 14.04.2009 | 0.343 | - | 0.343 | 0 |
| 16 | LoC to Standard Bank of South Africa Ltd. (Global Trade Facility Program) | 100.00 | US\$ | 07.09.2009 | 67.00 | - | 67.00 | 0 |
| | Total | | | | 1073.83 | 859.09 | 147.74 | 80.0 |

**Annex 7: Bank Group Approved and Indicative Program
for South Africa during CSP period 2008 – 2012**

Table A: Approved Operations

| | Project | Date Approved | Amount Approved (Million) | | Amount (UA Million) | Disbursement | |
|----|---|---------------|---------------------------|--------|---------------------|---------------------|-------------|
| | | | | | | Amount (UA Million) | (%) |
| 1. | LoC to Standard Bank of South Africa | 11.09.2008 | US\$ | 220.00 | 140.14 | 82.82 | 59.1 |
| 2. | LoC to Nedbank Ltd | 11.09.2008 | US\$ | 100.00 | 63.70 | 38.22 | 60.0 |
| 3. | Agri-vie Equity Fund | 28.01.2009 | US\$ | 15.00 | 9.48 | 0.0 | 0.0 |
| 4. | New Dawn Satellite Project | 11.03.2009 | US\$ | 25.00 | 16.0 | 0.0 | 0.0 |
| 5. | Emerging Africa infrastructure Fund | 11.03.2009 | US\$ | 48.80 | 31.24 | 0.0 | 0.0 |
| 6. | Evolution One Equity Fund | 27.05.2009 | ZAR | 100.00 | 7.89 | 0.0 | 0.0 |
| 7. | Integrated Water Harvest Project (African Water Facility) | 14.04. 2009 | Euro | 0.374 | 0.343 | 0.0 | 0.0 |
| 8. | LoC to Standard Bank of South Africa Ltd. (Global Trade facility Program) | 7.09.2009 | US\$ | 100.00 | 67.00 | 0.0 | 0.0 |
| | Total | | | | 335.79 | 121.04 | 36.0 |

Table B: Indicative Bank Programmes

| Lending Operations | | | | | |
|------------------------|--|--------|----------------------|----------------|--------------------|
| No. | Project Name | Type | Currency | Amount (Mill) | Status |
| 1 | Airport Company of South Africa-ACSA | Loan | US\$ | 100 | Appraisal |
| 2 | ESKOM Sovereign Guaranteed Loan | Loan | US\$ | 2,630 | Appraisal |
| 3 | Transnet – Railway Infrastructure | Loan | US\$ | 100 | Concept Review |
| 4 | Industrial Development Corporation LoC | Loan | US\$ | 100 | Concept Review |
| 5 | NEDBANK Second LoC | Loan | US\$ | 150 | Initial discussion |
| 6 | DBSA 5 th LoC | Loan | US\$ | 500 | Initial discussion |
| 7 | DBSA International | Equity | US\$ | 25 | Initial discussion |
| 8 | Clean Energy Technology Fund | Equity | TBD | TBD | Concept Review |
| Non-Lending Activities | | | | | |
| No. | Name of Activity | Type | Cooperating Partners | Status | |
| 1 | Capacity Building for Municipalities | Grant | AfDB/DBSA/DCG&TA | Identification | |
| 2 | Water and Sanitation Master Plan | Grant | AfDB/DCG&TA | Identification | |
| 3 | Establish MDG Baselines at Local level | Grant | AfDB/UNDP | Identification | |
| 4. | Study on Establishment of an Independent Power System Operator | Grant | AfDB/DoE | Identification | |
| 5. | Study on Financial Intermediation for SMEs | Grant | AfDB/DTI | Identification | |

Annex 8: Interventions by Other Development Partners

World Bank: The World Bank's Country Partnership Strategy (CPS) covering 2008-2012, approved in January 2008, sets out the institution's framework of engagement with South Africa during the CPS period. The CPS is based on two pillars: (i) urban and rural development and (ii) regional integration and partnerships for Africa. Priority areas of engagement within the two pillars are: private sector development, building partnerships for Africa, social protection, land reform and agriculture, public sector service delivery, and knowledge sharing and facilitating dialogue. The CPS adopts a flexible approach, in which specific activities are agreed on a yearly basis in a manner consistent with South Africa's planning and budgeting cycle instead of having a pre-determined list of operations. The CPS is currently being reviewed to reflect recent global developments and the strategic priorities of the new developments.

The World Bank's work in South Africa focuses largely on country analytical work (including investment climate assessment) and the provision of technical assistance. In terms of investment operations and in line with the focus on urban infrastructure, the World Bank, like the AfDB, is also considering supporting the ESKOM energy investment programme over the next 3 years. With respect to regional integration, the World Bank's strategic interventions involve, among others, use of its private sector windows (IFC and MIGA) to facilitate South African companies' investments in other African countries. The IFC has built a very strong operational presence in South Africa, and its portfolio in the country is the second largest after Nigeria. Apart from supporting South African companies going north and globally, the IFC also provides advisory services and financing within South Africa for underserved niches in the local market especially for smaller businesses with focus on the informal sector and education.

IMF: The IMF remains in Article IV mode with South Africa. The last Article IV Consultation report for the country was presented to the Executive Board of the IMF in August 2009. The institution has also offered technical assistance to South African Departments in the past. For example, in 2003, its Fiscal Affairs Department (FAD) reviewed the draft royalty bill (published in March 2003) with the National Treasury. Also, in March 2005, its Statistics Department undertook a review of South Africa's Labour Force Statistics and recommended steps to produce statistics that are more reliable and of better quality, and more closely aligned to ILO standards.

The European Commission (EC) and EU Member States have in place a joint Country Strategy covering 2007–2013, implemented through a multi-annual indicative programme (MIP), with a grant allocation of about 1 billion Euro, while the EIB also provides an equivalent amount in loan terms. The EC concentrates largely on the social sector. Two thematic areas of intervention accounting for 80% of the MIP are employment promotion and skills development, and social service delivery. In the area of social service delivery, the focus is on primary education (early years of schooling and teachers' training), primary health care, and HIV/AIDS with emphasis on prevention of mother-child transmission. Other areas of engagement absorbing the remaining 20% of the MIP are governance and regional and Pan African Initiative.

The United Nations (UN) Agencies: The UN agencies in South Africa operate a Common Country Programme Action Plan for South Africa (CCPAP), 2007-2010, working in five clusters in line with their specialization. These clusters are: (i) Economic and Employment Cluster chaired by ILO, (ii) Governance and Administration Cluster chaired by UNDP, (iii) Social Cluster chaired by WHO, (iv) Crisis Prevention cluster chaired by UNHCR, and (v) Gender Cluster chaired by UNIFEM. The UNDP is the overall coordinator of all the UN agencies in the country.

Annex 9: South Africa as a Hub for Regional Integration and Development in Southern Africa

South Africa is the biggest economy in Africa, dwarfing neighbouring countries. The country accounted for 65.8% of SADC GDP in 2007, making it almost five times the size of the next biggest economy, Angola (see Figure 1). Even in sub-Saharan Africa, South Africa looms large, accounting for a third of the region's GDP in 2007. The economic dominance of South Africa does, however, seem to be following a downward trend. The share of both SADC and Sub-Saharan Africa's GDP has declined since 2000, from 69.1% and 38.9% to 65.8% and 33.4% respectively.

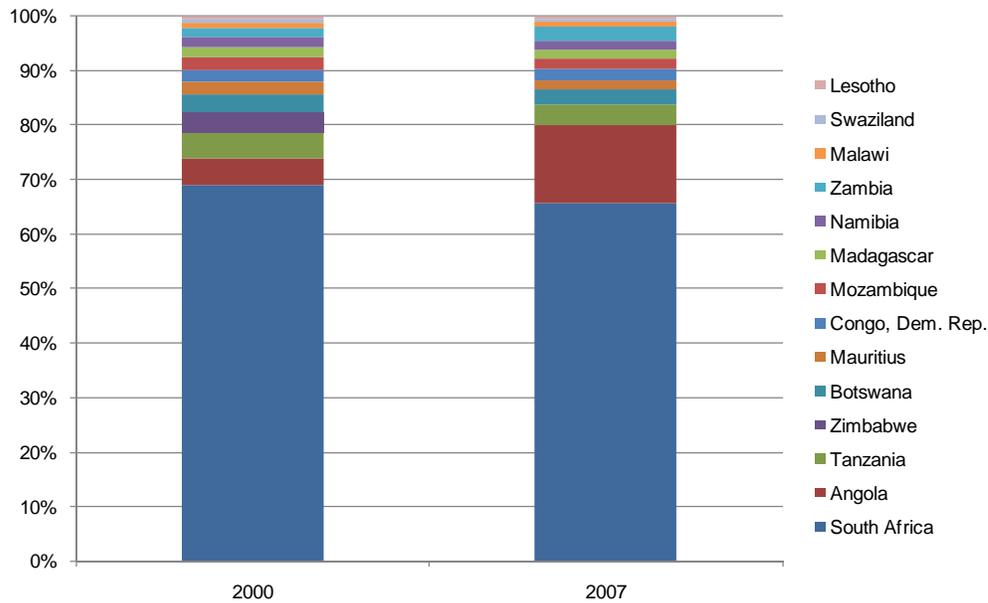


Figure 1: Distribution of nominal GDP by SADC country, 2000 versus 2007¹⁶

Source: World Bank Development Indicators, 2009

As the dominant economic force in the region, the development of Africa is closely linked to the development of South Africa. An IMF study in 2005¹⁷ used an empirical model to test the extent to which South African growth contributes to growth in the rest of Africa. The study found, controlling for other factors that drive growth and for regional trends, that **growth in South Africa is correlated with growth in the rest of Africa**. Specifically the study estimated that a 1% rise in growth in South Africa will lead to a rise in growth in the rest of Africa of 0.4% to 0.7%. Interestingly the authors also found that the correlation is not accounted for by trade variables, suggesting that other factors, like investment must be responsible for the relationship.

The different contributions of South Africa to regional integration and development are considered below.

¹⁶ Note: Data was not available for Zimbabwe in 2007.

¹⁷ Arora and Vamvakidis 2005, *The Implications of South African Economic Growth for the Rest of Africa*.

Regional relations

South Africa is a member of the Southern African Development Community (SADC)¹⁸ which was established in 1992 with the aim of integrating the different economies in the region. SADC encompasses 250 million people and nine million square kilometres. The SADC countries have agreed macroeconomic convergence targets which have been met with varying degrees of success. The SADC Trade Protocol aims to have all regional trade in goods tariff-free by 2012. The 14 member countries of SADC (including South Africa) collectively produce roughly the same amount annually as Turkey¹⁹.

South Africa is also a member of the Southern African Customs Union (SACU), made up of Botswana, Lesotho, Namibia, South Africa and Swaziland, and the Common Monetary Area (CMA) in which the other partners are Lesotho, Swaziland and Namibia, all of whom have pegged their currencies to the rand.

South Africa is also a driving member of the New Partnership for Africa's Development (NEPAD) which was adopted by African leaders in July 2001, at a summit in Lusaka, Zambia. NEPAD is a mandated initiative of the African Union, a pledge by African leaders to eradicate poverty and provide a comprehensive, pan-continental, integrated development plan that addresses key social, economic and political principles for the continent. The five initiating states of NEPAD were South Africa, Nigeria, Algeria, Senegal and Egypt. There is a small secretariat based at Midrand, South Africa.

Trade linkages

South Africa is both an important source of imports and a destination for exports for other southern African countries. However, South Africa is not especially reliant on surrounding countries for trade, partly as a legacy of apartheid trade patterns which aligned South Africa more with Europe and other developed economies. From 1994 to 2002, an average of only 2% of Africa's total trade was conducted with South Africa although even this was a three-fold improvement on the average level between 1970 and 1993. From South Africa's perspective the proportion is even lower: on average only 1.5% of South Africa's trade was with Africa between 1994 and 2002²⁰. According to trade statistics by UNTAD 2008, the share of South Africa's imports from the Sub-Saharan Africa maintained a progressive upward trend, rising from 2.2% of total imports in 2000 to 7.1% in 2007, while exports to the region averaging 14-15% over the period. This trend suggests improved trade relations with the region, spurred largely by the ongoing regional economic cooperation under SADC and SACU.

For the countries closest to South Africa, the country represents a very important trading partner. For example, as shown in Figure 2 below, 75% of Swaziland's exports goes to South Africa and 88.4% imports come from South Africa. Goods and services from South Africa also make up more than 80% of imports for Namibia and Botswana.

¹⁸ Current member states are: Angola, Botswana, the Democratic Republic of Congo, Lesotho, Madagascar, Malawi, Mauritius, Mozambique, Namibia, South Africa, Swaziland, United Republic of Tanzania, Zambia and Zimbabwe.

¹⁹ *Africa's Challenges in International Trade and Regional Integration: What Role for Europe?* South African Institute of International Affairs, 2009. Occasional paper No. 32.

²⁰ IMF 2005, *The Implications of South African Economic Growth for the Rest of Africa*.

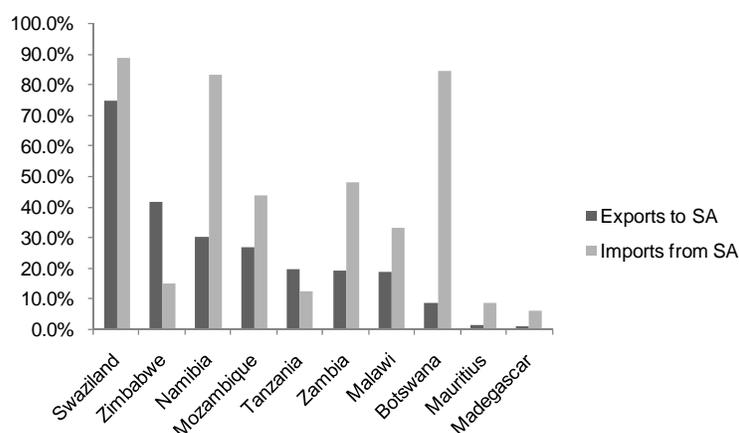


Figure 2: SADC countries trade with South Africa as a proportion of total trade in 2005

Source: TIPS

Financial linkages

South Africa has by far the most developed financial system in the southern African region and plays a critical role as a financial intermediary for rest of the continent. Banking sector inflows to South Africa from the rest of Africa account for around 43% of total investment inflows, whereas they represent only around 15% of investment outflows. This is evidence of South Africa's significant role as a financial "hub" for the rest of Africa, attracting financial resources from all over Africa which are then reinvested in real assets around the continent.²¹ In addition, all of South Africa's Big Four banks and insurers like Old Mutual, African Life, Metropolitan Life and Santam have aggressively expanded their presence in the rest of the continent since 1994.

Investment

Much has been made of the increase in "South-South" investment in recent years, and South Africa is no exception. South African direct and portfolio investment in other African countries in the period from 1998 to 2002 was equivalent to 5% of GDP on average in those countries.²² According to the UN, in 2000 South Africa was responsible for 70% of all intra-African investment flows. Moreover, South African investment played an even larger role in neighbouring countries, accounting for between 9% and 20% of GDP in Lesotho, Mauritius, Mozambique, Namibia and Swaziland²³. More up-to-date data on South Africa's intra-African investment flows is hard to come by, but it seems likely that these levels have grown as, in the last seven years, a wide range of South African corporations have extended their activities into the rest of Africa.

As illustrated in Figure 3, in 2003 the biggest sectors for investment were infrastructure (26%), mining (21%), and oil gas and petroleum (18%), with other significant sectors being tourism, industrial, telecommunications (5%), and agri-

²¹ *Economic Development in Africa Report 2009*. United Nations Conference on Trade and Development.

²² IMF Working Paper 05/58 2005, *The Implications of South African Economic Growth for the Rest of Africa*

²³ IMF Working Paper 05/58 2005, *The Implications of South African Economic Growth for the Rest of Africa*

business (5%). In sub-Saharan Africa, cellular operators Vodacom and MTN jointly have more than 17 million subscribers outside of South Africa.²⁴

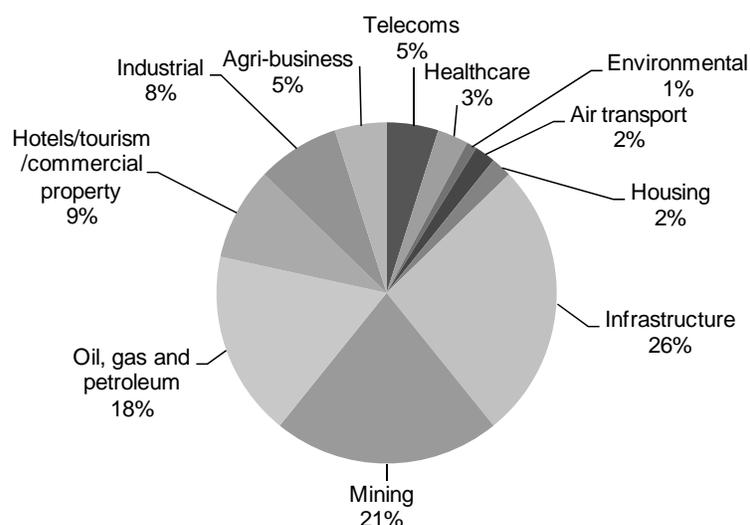


Figure 3: Project profile of South African activity in Africa; 2000 – 2003

Source: South Africa Foundation, 2004

A range of companies including Sasol, AngloGold, De Beers, MTN, Vodacom, SAB, Murray and Roberts, Barloworld, the Protea Group, SAA, and various retail outlets such as Shoprite have followed this trend in recent years, establishing operations in other African countries. South African State-Owned Enterprises (SOEs) also have a presence in Africa, including Eskom, the Industrial Development Corporation and the Development Bank of Southern Africa. Eskom exported 13, 589 Gigawatt hours of electricity to neighbouring countries between April 2006 and March 2007, around 6% of the company's total sales²⁵. In fact, according to *Business Leadership South Africa (BLSA)*²⁶, in 2004, 92 of the top 100 South African companies were active in other parts of Africa, with just under half having investments which might be regarded as significant. This is compared to only 18 of the top 100 in 1993. The 92 companies between them made 232 investments in 27 countries employing 72 000 people between 1994 and 2004.

Financial sector firms were some of the first to expand into the rest of Africa, and all of South Africa's Big Four banks (Standard Bank, ABSA, First National Bank and Nedbank) now have operations in the region. By 2004 Standard Bank had representation in 17 African countries outside of South Africa. FNB, active in Namibia and Botswana in 1994, had by 2004 expanded into only one other African country, Swaziland. ABSA and Nedcor had no majority ownership presence in 1994 although they did have substantial shareholding in some Namibian banks. By 2004 Nedcor had expanded fully into Namibia (holding 93% ownership of Commercial Bank of Namibia), and maintained substantial minority shareholdings in Zimbabwe and majority stakes in Malawi, Mauritius, Lesotho and Swaziland. In 2004, ABSA had minority shareholdings in Namibia and Zimbabwe, and majority ownership in Mozambique and Tanzania²⁷.

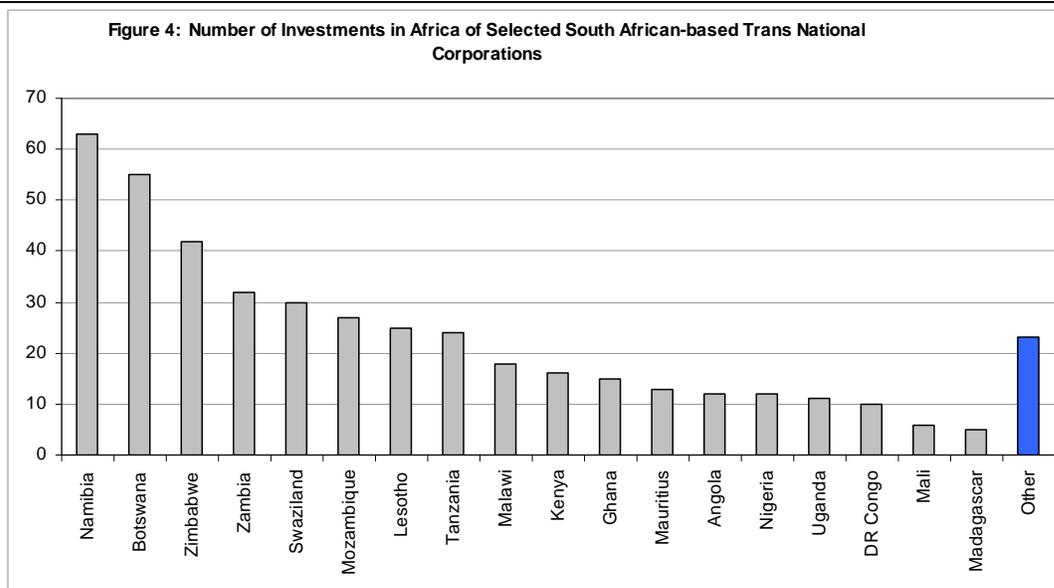
Figure 4 illustrates the geographical distribution of investments by South African firms in the rest of Africa in 2004. Again, neighbouring countries appear to be the most linked to South Africa in terms of the number of South African firms active in these areas.

²⁴ OECD 2006. *Developing Country Multinationals: South-South Investment Comes of Age*.

²⁵ Eskom Annual Report 2006 – 2007.

²⁶ Business Leadership South Africa, 2004. Presentation: *South African Multinationals and Economic Development in Africa*.

²⁷ Paragraph based on Genesis Analytics 2004, *A survey of the SADC region: South African financial institutions, regional policies and issues of access*.



Source: South Africa Foundation 2004²⁸

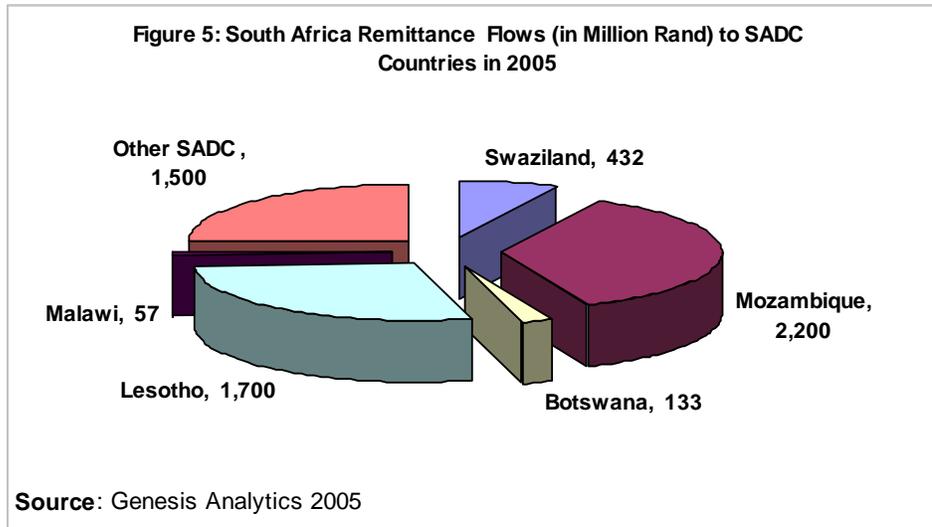
According to BLSA²⁹, South African investment is beneficial to countries in a number of ways. South Africa firms contribute to economic growth and exports in those countries, they create employment, and increase revenue generated by government. In addition, they can be a positive force for the development of the private sector and formalise what are often very informal markets, leading to greater price stability, price discipline and improved choice for consumers. Skills transfer may also take place, particularly business and management skills, and firms which are subject to more stringent standards in South Africa, a relatively developed economy, may drive the adoption of good corporate practice and governance in the host country. A final benefit of investment by South African firms is that it is likely to lead to an increase in business confidence in the region, attracting further investment from firms in other countries.

Migrant labour and remittances

For many years South Africa has also played an important role in the region providing an income for large numbers of migrant workers (both legal and illegal) from nearby countries, in particular Swaziland, Lesotho and Mozambique. Most of these workers were employed on South Africa's mines, but more recently mining companies have been keen to reduce the number of foreign employees in favour of South Africans, and so migrant workers have become more distributed throughout the economy as seasonal agricultural workers, domestic workers and in other areas. As shown in Figure 5, this results in large remittance flows from South Africa to other SADC countries. Since the economies in question are small, remittances can often be large relative to GDP and therefore represent a significant inflow.

²⁸ The South African Business Foundation 2004. *South Africa's Business Presence in Africa*

²⁹ Business Leadership South Africa, 2004. Presentation: *South African Multinationals and Economic Development in Africa*.



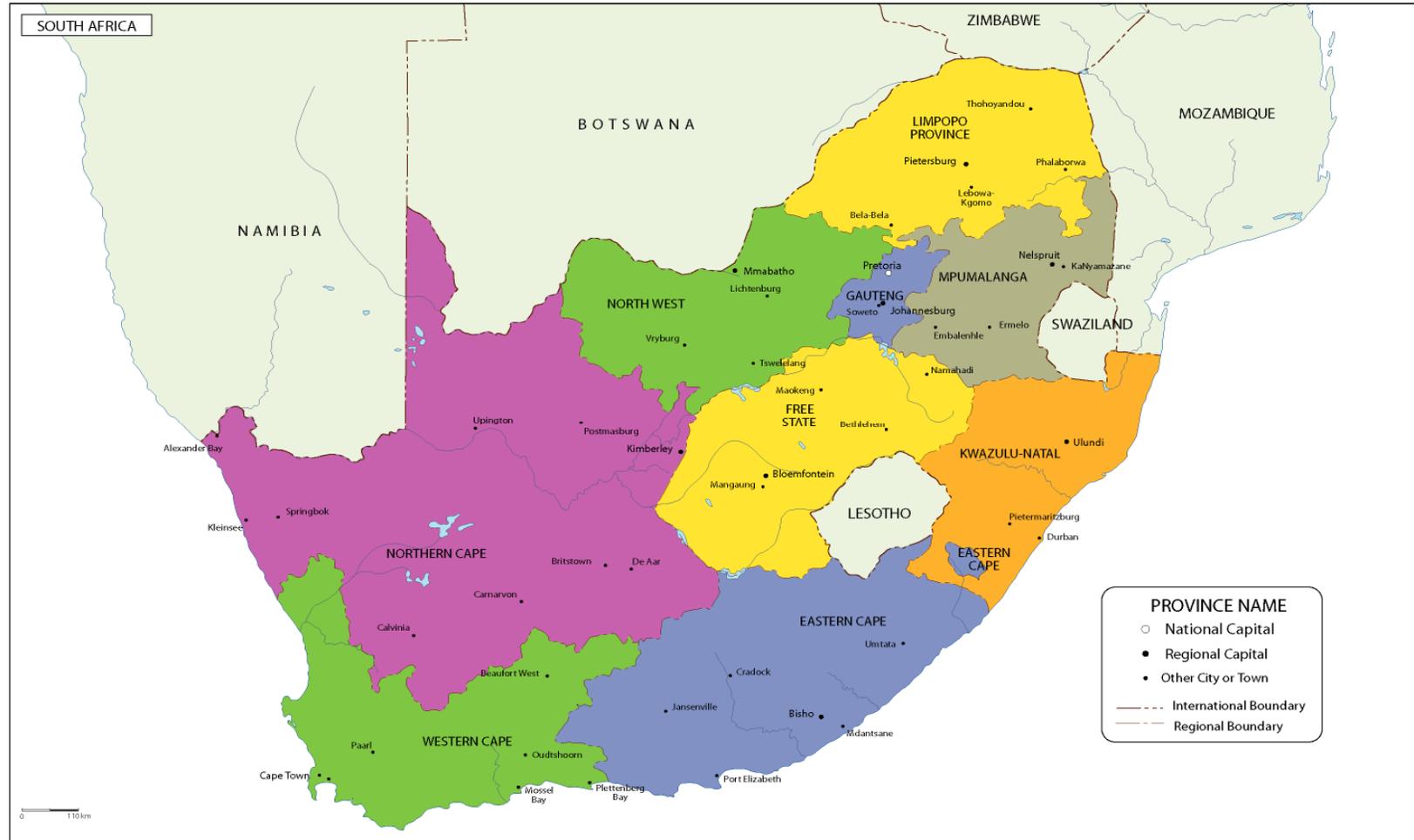
Source: Genesis Analytics 2005

Other factors

Finally, there are a number of less quantifiable ways in which South Africa may be a force for greater integration and development in the region:

- Leadership – as the largest economy in the region, and being well integrated into the global economy, South Africa plays an important leadership role amongst its peers.
- Business confidence – South Africa's stable economy and attractive investment environment are important in drawing FDI to the region and enhancing investors' perceptions of Africa.
- Technology spillovers – through the involvement of South African firms in the rest of Africa the opportunity for knowledge and technology transfer is created, directly benefiting recipient countries.

ANNEX 10 SOUTH AFRICA: ADMINISTRATIVE MAP



This map was provided by the African Development Bank exclusively for the use of the readers of the report to which it is attached. The names used and the borders shown do not imply on the part of the Bank and its members any judgment concerning the legal status of a territory nor any approval or acceptance of these borders.