AFRICAN DEVELOPMENT BANK

REPUBLIC OF SOUTH AFRICA

COUNTRY STRATEGY PAPER 2018-2022

SOUTHERN AFRICA DEVELOPMENT AND BUSINESS DELIVERY OFFICE (RDGS)

June 2018

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CURRENCY EQUIVALENTS

(February 2018)

Currency Unit	=	South African Rand (ZAR)
UA 1.0	=	ZAR 17.26
UA 1.0	=	USD 1.45
USD 1.0	=	ZAR 11.82

GOVERNMENT FISCAL YEAR

1 April to 31 March

WEIGHTS AND MEASURES

Metric System

ACRONYMS AND ABBREVIATIONS

AG	Auditor General
ANC	African National Congress
BRICS	Brazil, Russia, India, China and South Africa
COSATU	Congress of South African Trade Unions
CPIA	Country Policy and Institutional Assessment
CPIP	Country Portfolio Improvement Plan
CPPR	Country Portfolio Performance Review
CSP	Country Strategy Paper
CTF	Clean Technology Fund
DA	Democratic Alliance
DBDM	Development and Business Delivery Model
EFF	Economic Freedom Fighters
GDP	Gross Domestic Product
IMF	International Monetary Fund
IPAP	Industrial Policy Action Plan
IPP	Independent Power Producers
LOC(s)	Line(s) of credit
MDGs	Millennium Development Goals
MIC	Middle Income Country
MTR	Mid-Term Review
MTSF	Medium Term Strategic Framework
M&E	Monitoring and Evaluation
NDP	National Development Plan
PEFA	Public Expenditure and Financial Accountability Assessment
PFM	Public Finance Management
GORSA	Government of Republic of South Africa
SACU	Southern African Customs Union
SADC	Southern African Development Community
SDGs	Sustainable Development Goals
SMMEs	Small, Micro and Medium Enterprises
SOEs	State Owned Enterprises
TFP	Total Factor Productivity
TYS	Ten Year Strategy
UA	Unit of Account
USD	United States Dollar
WB	World Bank
WEF	World Economic Forum

GENERAL MAP OF SOUTH AFRICA

EXECUTIVE SUMMARY

1. **This report proposes the Bank Group's Country Strategy Paper (CSP) for South Africa for the period 2018-2022.** The CSP has been prepared at a time when South Africa adopted its first Medium-Term Strategic Framework (MTSF) 2014-19 to implement its National Development Plan "Vision 2030". The MTSF attaches top priority to economic transformation, rapid economic growth and job creation, and includes key measures such as crowding in productive investments through infrastructure development, enhancing competitiveness in the productive sectors of the economy, addressing spatial imbalances in economic opportunities, and eliminating unnecessary regulatory burdens, among others. The CSP 2018-22 was prepared based on extensive consultations with the Government of South Africa (GoSA), development partners, the private sector and the civil society. The CSP coincides with the Banks's renewed effort to step up the implementation of its Ten Year Strategy through a sharper focus on the High-5 priorities.

2. **On 19th January 2018, the Committee on Operations and Development Effectiveness (CODE) endorsed the combined Completion Report of the previous CSP 2013-17** and 2017 Country Portfolio Performance Review, together with the PowerPoint Presentation on the proposed pillars of the new CSP 2018-22. On that occasion, CODE welcomed the proposed pillars of this new CSP, namely, Pillar (1) Promoting Industrialization, and Pillar (2) Deepening Regional Integration. CODE also underscored the need for the Bank to address South Africa's economic constraints, including macroeconomic challenges, governance and social reforms including inequality, unemployment and improved service delivery. CODE also expressed the need to ensure alignment between the Bank's project pipeline and the CSP's pillars, commensurate with the magnitude of financial resources accessible by GoSA from the Bank. The proposed CSP has taken into account CODE's recommendations.

3. **The overall objective of the CSP 2018-2022 is to support South Africa's economic transformation and re-industrialization for inclusive growth, job creation and social equity.** To achieve this objective, the Bank will focus on a further improvement of the country's overall business and planning environment through investments in domestic infrastructure, thereby reducing the cost and enhancing the reliability of and access to infrastructure services. As a result, these investments will not only increase the competitiveness of existing and new industrial/manufacturing enterprises, but also improve the connectivity of Townships and rural areas with the highly developed metropolitan areas. To complement these investments in a more enabling general business environment, the Bank will also provide direct support to specific businesses/enterprises in sectors with a high potential for industrialization and higher value added job creation, thereby promoting economic transformation, inclusive growth and improved equality.

4. Additionally, the Bank will support South Africa's further integration into the Southern African region through investments in regional infrastructure as well as soft measures and reforms, notably to reduce non-tariff barriers to trade. This will support the creation of larger markets and facilitate trade, thereby attracting foreign direct investment and thus, promote technological progress, enhanced productivity and higher value added job creation, ultimately spurring economic transformation and industrialization. The Bank will also support GoSA reforms efforts aimed at repositioning SOEs as efficient vehicles for industrialization towards delivering the national development goals of economic transformation and inclusive growth.

5. Accordingly, the new CSP is articulated around the following two complementary pillars: **Pillar 1: Promoting Industrialization;** and **Pillar 2: Deepening Regional Integration.** These areas of focus are a declared top priority of the South African Government for Bank support.

6. **The CSP 2018-22 will support South Africa's development ambitions as an upper Middle Income Country (MIC) in an innovative – yet selective – way.** Most notably, the CSP will address South Africa's infrastructure disparities, which is one of the country's distinctive challenge as a MIC, by supporting infrastructure investments geared towards connecting the

second segment of the economy (especially Townships and rural areas) to the developed metropolitan areas. As alluded to above, the Bank will also support hard regional infrastructure investments and soft measures to improve South Africa's connectivity and facilitate trade with neighbouring countries and beyond. Improved infrastructure and trade openness will also result in increased competition and factor productivity, and reduce technological disparities, all of which are typical challenges South Africa is facing as a MIC. Furthermore, direct support will sought to be provided through the Bank's private sector window to industries/businesses with potential to engage in transformational productive activities and to create higher value added formal employment, with a focus on the industrial sector and Blue Economy. This will be accompanied by legal and regulatory reforms to remove market entry barriers and crowd in private sector businesses/operators.

7. Yet another innovation of the new CSP is the systematic mainstreaming of cross-cutting aspects, notably gender equity, green growth/climate change and governance. In addition, particular attention will be given to systematically leverage co-financing whenever possible and attract private sector investments. The Bank will act as a convener, connector and catalyzer in leveraging resources to support South Africa's development, using innovative financing and risk sharing instruments (syndication; partial credit and risk guarantees). The Bank will also improve its positioning as a knowledge-based institution by providing policy advisory services to the GoSA and the private sector.

8. **The 2017 Country Portfolio Performance Review (CPPR) concluded that the overall performance of the portfolio is satisfactory with a rating of 3.13 on a scale of 1 to 4.** The implementation delays in the portfolio arise mainly from poor quality at entry and delays in recruiting key project implementing unit staff. As at March 2018, the Bank's active portfolio in South Africa covered 24 operations financed through ADB (loans and LoCs), CTF loan, MIC and AWF grants. These operations account for UA 3.49 billion (USD 4.9 billion). The current portfolio is dominated by Light up and Power Africa (62.7%); followed by Industrialize Africa (19.1%), Integrate Africa (16.3%), Feed Africa (1.7%), and Improve the Quality of Life of Africans (0.14%). The cumulative disbursement ratio stands at 88.2% with an average age of 7.

9. The Bank's Board of Executive Directors is invited to consider and approve the CSP.

I. INTRODUCTION

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3. Following this introduction, the rest of the report is structured as follows: section II analyses the country context, including recent political, economic and social developments and cross cutting themes. Section III discusses strategic options, including South Africa's strategic framework, as well as weaknesses, challenges, strengths and opportunities. Section IV presents the Bank's CSP for the 2018-22 period. Section V presents conclusions and recommendations.

II. COUNTRY CONTEXT AND PROSPECTS

4. The following sections present a *summary* of recent political, economic and social developments in South Africa, plus outlook. Annexes 3-10 present a detailed analysis of these developments.

2.1 Political Context and Prospects

5. **South Africa's ruling party, the African National Congress (ANC), conducted an election of the party leadership during its 54th national conference conducted on 16-20 December 2017 in Johannesburg, in which the then Deputy President, Cyril Ramaphosa was elected the new President of the ANC.** The National Executive Committee (NEC) of the ruling ANC party recalled President Jacob Zuma as a head of state forcing his resignation one year ahead of the end of his term. Following his resignation, the new president of the ANC was elected President of the Republic on 15 February 2018. The election of Cyril Ramaphosa, who campaigned on the ticket of fighting corruption and weak governance in public institutions, signalled an end to political uncertainty and ignited optimism among the civil society and businesses. Ramaphosa's election was well received by the public and business confidence has improved. He has vowed to fight corruption in public as well as private institutions (Annex 3).

6. **While South Africa enjoys well-functioning democratic institutions that provide the framework for general adherence to transparency norms, the perception of corruption in public services remains relatively high.** In the Transparency International's Corruption Perception Index, South Africa ranked 72nd (out of 177 to 180 countries), 67th, 61st, 64th and 71st in the years from 2013 to 2017, respectively. The widespread allegations of misuse of public

resources led to reversal of the upward trend since 2015. Similarly, South Africa ranked high at 5th, 4th, 6th and 6th (out of 54 countries) in the Mo Ibrahim Index of African Governance in the years from 2013 to 2016. The downturn from rank 4th to 6th is mainly due to poorer performance in 'Safety and Rule of Law' and in 'Human Development', especially weaker education outcomes. Key governance challenges relate to corruption in procurement of public goods and services and lack of capacity at local government levels. The Auditor General's (AG's) 2017 audit report points out that very few district and metropolitan municipalities obtained clean audit opinions in FY 2015/16[1]. A report released by the former Public Protector in 2016 on state capture alleges wide spread influence peddling by businesses, which are connected to senior government officials. In addition, concerns have emerged regarding poor governance in key State-Owned Enterprises (Annex 25).

2.2 Economic Context and Prospects

7. **<u>South Africa's 'Dual Economy'.</u> South Africa is an advanced upper Middle-Income Country (MIC) and its economy ranks 3rd in Africa, after Nigeria and Egypt. With a per capita income of USD 5,260 (2016), the country ranks 6th in sub-Saharan Africa, but it continues to struggle with the challenges of a 'Dual Economy': high poverty, unemployment, income inequality and spatial socio-economic disparities.** Overall, South Africa enjoys a well-developed economy and plays a dominant role in Southern Africa as the region's economic powerhouse, accounting for about 50% of the region's output. South Africa has a significant footprint in the region in terms of FDI, utilities, telecommunications and retail services. Its economy is closely linked to the countries in the region, particularly to those with which it shares membership in the Southern African Customs Union (SACU). However, South Africa still contends with its 'Dual Economy' (Box 1), which features high poverty, unemployment, notably of the youth, income inequality and spatial socio-economic disparities as the major development challenges today. The 'first segment' of the country's economy is modern, productive, and exhibits 'world-class' features, while the 'second segment' is largely informal, with low productivity and high unemployment. It is predominantly cash-based, serving mainly the poorest of the poor in Townships, former homelands and poor rural areas (Annex 4).

Box 1. South Africa's Dual Economy

South Africa features a Dual Economy with a developed economy in major metropolitan areas coexisting with a developing economy in Townships, informal settlements and poor rural areas. Due to this unique form of rural and urban economic duality, South Africa remains one of the most unequal countries in the world, with disparities across race and gender. The country's Gini coefficient stood at 0.65 in 2016 – the highest in the world. Also, wealth distribution is highly skewed, with only 10% of the population holding 95% of wealth.

The 'first segment' of the economy is as sophisticated as the most advanced economies of Europe, North America or Eastern Asia, with world class banking and financial services, advanced social and economic infrastructure and superior IT networks. On the other hand, the 'second segment', i.e. Townships and rural areas, are characterized by limited formal structures, and massive poverty and inequality. Poverty headcount increased from 53.2% in 2011 to 55.5% in 2015. Today, there are about 4,600 Townships and informal settlements in South Africa. They are clustered across the country's 9 provinces, usually in close proximity to major urban centers and economic hubs. They account for about 38% of the country's working age population and about 60% of the country's unemployed. About 3m people live in informal settlements and 15.3m in townships, i.e. more than a third (35%) of the total population. Poverty is very high in Townships and informal settlements, and access to economic and social services is severely limited.

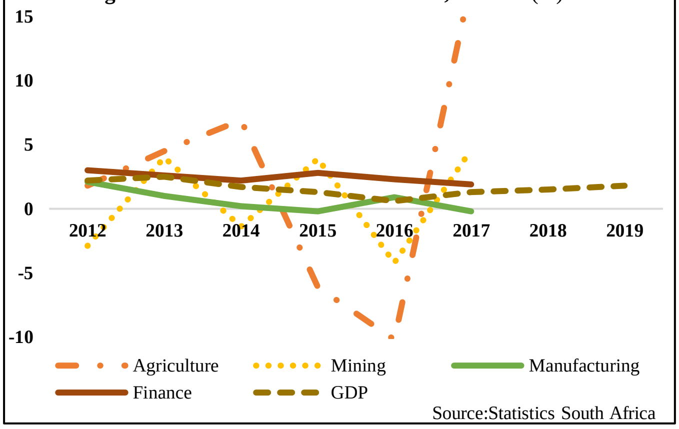
The Township economies are not only disconnected from rural areas, but also structurally unintegrated into the urban centres. Hence, they are neither urban nor rural. There is very little or no industrial production taking place in Townships and informal settlements. Their share in high value added output generation is very low, with most of GDP generated in the developed metropolitan areas.

8. **<u>Economic Structure and GDP Composition.</u> Its dual structure notwithstanding, South Africa's economy is well diversified, with a strong service sector as the main source of GDP. However, the economy has suffered from a longstanding process of de-industrialization over the past decades, which needs to be reversed to effectively tackle South Africa's major development challenges.** South Africa's economy has undergone a major structural

transformation during the past four decades. The share of industry in GDP dropped from nearly 40% in 1980 to 19% in 2016, while that of services increased from 53% to 73% over the same period, reflecting the de-industrialization of the country's economy. The main reasons for this are increasing import competition from Southeast Asia, skills shortages on domestic labour markets, raising labour costs, increasing electricity prices and the withdrawal of subsidies and tariff protections. Both the industrial and the service sectors are located primarily in the large metropolitan areas, with very little industrial and service production taking place in Townships and informal settlements, which is symptomatic for South Africa's 'Dual Economy'. The Agriculture sector has also declined in relative importance over the last decades, yet not as strong as Industry, and from a rather low base, i.e. from 5.8% of GDP in 1980 to 2.4% in 2016. South Africa's economy was ranked 64th out of 124 countries in Harvard's Economic Complexity Index[2] in 2015 (in comparison to Indonesia: 62nd; Vietnam: 67th; and Argentina: 69th), as the economy displays a medium level of complexity, mainly due to a reasonably well diversified manufacturing sector.

9. __Recent Growth Performance and Outlook.__ **South Africa's growth trajectory has been on an overall downward trend in recent years, with real GDP growth declining from 3.3% in 2011 to 0.6% in 2016. However, the trend has turned around in 2017, with growth estimated at 1.3%.** Slower growth in recent years mainly reflects slower growth of the industrial sector, as manufacturing sector output growth dropped from 3% in 2011 to 0.7% in 2016 (Fig. 1), while that of mining further contracted from -0.7% to -4.2% over the same period. Output growth also slowed down in the services sector, with the main sub-sector of finance, real estate and business services sub-sector slowing down from 4.3% in 2011 to 2.3% in 2016. The continued slowdown of growth in recent years is mainly due to the fall in global commodity prices (notably of gold, platinum group metals, iron ore and coal) and the economic slowdown in China, which is South Africa's largest trading partner. Domestic factors also contributed to the economic downturn, as infrastructure bottlenecks in power have constrained production and investment until 2015. In addition, labour relations remained strained amid large skills gaps. Furthermore, increasing policy uncertainty around new laws on mining has eroded business confidence, as evidenced by the continued contraction in private sector real gross fixed investment, which contracted by 0.5% and 6% in 2015 and 2016, respectively. In 2017, the downward trend in growth performance in recent years turned around, with growth estimated at 1.3%, based on improved performance in the finance, agriculture and mining sectors. Standard and Poor's downgraded South Africa's long term local currency credit ratings to a sub investment grade, i.e. BB+ from BBB- on 24 November 2017. The agency affirmed positive outlook for both local and foreign currency credit ratings. South Africa is now fully downgraded to a sub investment grade by two ratings agencies, S&P and Fitch. However, as Moody's maintains South Africa's sovereign credit rating at investment grade, South Africa will not be removed from the World Government Bond Index, thus making higher levels of capital outflows unlikely.

Figure 1. Real GDP and Sector Growth, 2012-19 (%)



Source:Statistics South Africa

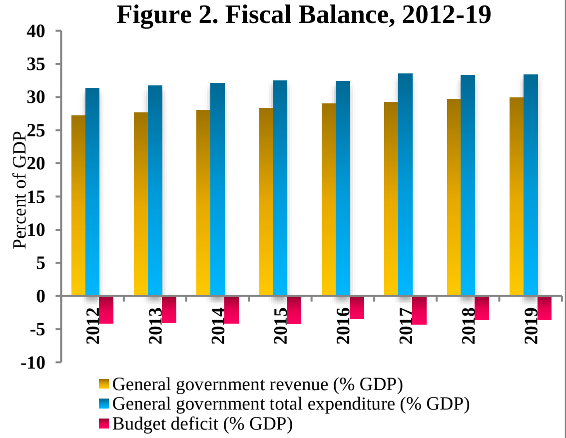
10. **The outlook for 2018 and 2019 is positive, with growth projected at 1.5% and 1.5%, respectively.** Following the recent political developments, business confidence has improved. As the new government implements reforms to address policy uncertainty, strengthen planning and implementation, investor confidence is expected to improve further, thereby leading to higher investment and economic growth. Growth prospects are also driven by a positive and

sustained global growth outlook, more favourable weather conditions and higher agricultural output, more reliable energy supply, improved labour relations, and rising commodity prices. It should be noted that the country is currently facing severe drought in parts of the Western Cape, Eastern Cape and Northern Cape provinces. However, weather conditions have been favourable in most parts of the country since end of 2016. Due to good rainfall, agriculture output increased by 17.7% in 2017 and was the main driver of growth.

11. **<u>Macroeconomic Management.</u> With regard to monetary policy, an overall tight stance since 2014 ensured that inflation remained largely within the Central Bank's monetary policy target range of 3-6%.** Driven mainly by higher food prices, headline consumer price inflation increased slowly but continuously from 5% in 2011 to 6.4% in 2016, which is just above the upper limit of the 6% monetary policy target range. Inflation however fell to 5.3% in 2017 on the back of lower food prices. To subdue inflationary pressures, the Central Bank progressively increased the Repo rate from 5.0% in 2013 (end-period) to 7% in 2016 but has since reduced it to 6.75% in July 2017 and 6.5% in March 2018 as a result of falling food prices, subdued domestic demand and declining international oil prices. Growth in private sector credit decelerated, from 8.6% in January 2013 to 6.4% in November 2017, mainly due to subdued investor confidence, as well as high interest rates. The nominal exchange rate of the Rand depreciated by 86% against the USD between January 2013 and January 2016, due to the decline in commodity prices. However, this downward trend reversed in January 2016 when the Rand appreciated by nearly 20% up to December 2017, primarily as a result of higher export prices of South Africa's main export items.

12. **With regard to fiscal policy, the Government managed to keep the overall deficit within a range of 4-4.5% of GDP in recent years, with spending and revenue levels remaining largely unchanged (as a percentage of GDP), reflecting fiscal discipline.** Expenditure and revenues oscillated around 31-32% and 27-29% of GDP respectively since 2012/13 FY, resulting in overall fiscal deficits between 3.5-4.5% (Fig. 2). The deficit slightly narrowed to 3.5% in FY 2016/17 from 3.7% in the previous FY, given a slight increase in revenue (see tax measures below), while the expenditure level remained relatively unchanged. A closer look at the type of expenditure (FY 2015/16) reveals that most of public spending is for recurrent expenditure (86%), most of which are for wages and salaries, while capital expenditure (most of which are for infrastructure, notably transport and logistics; energy; and water and sanitation) amounts to a modest 12% of total expenditure, calling for a scale-up of capital spending. On the revenue side, taxes are the dominant source of revenue, accounting for 99% of total revenue, with a comparatively healthy 26% of GDP. In 2018, the government introduced new tax policies including the increase in the Value Added Tax (VAT) from 14% to 15% on 1 April 2018. Government has exempted taxes on basic food items to reduce the burden on the poor, and increased the general fuel levy, and tobacco and alcohol excise duties, which will collectively generate revenue of about R 2.6bn. The Government will also implement from 1 April 2018 environmental taxes such as motor vehicle emissions tax, plastic bag levy, and the levy on incandescent light bulbs, as well as a health promotion levy, which taxes sugary drinks. The fiscal deficit is projected to remain stable in the short-term, reaching 3.6% of GDP in both FY 2018/19 and FY 2019/20. As regards public debt, South Africa's total public debt has been increasing steadily in recent years, from 39% of GDP in FY 2011/12 to 51% in FY 2016/17, but public debt remains sustainable. The increase in public debt in recent years was primarily due to an increase in public *domestic* debt (from 35% of GDP in FY 2011/12 to 46% in FY 2016/17). Public

Figure 2. Fiscal Balance, 2012-19



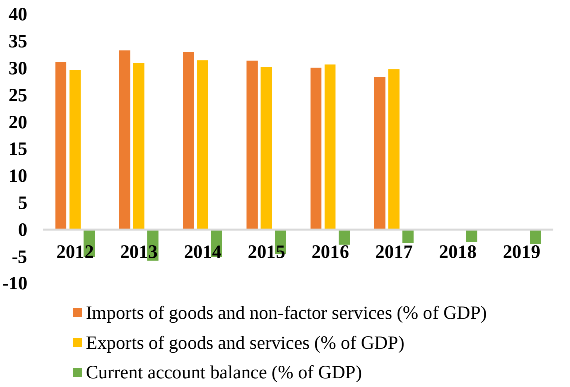
Source: National Treasury

external debt also increased during that period, but only marginally and from a very low base, i.e. from 3.8% of GDP in FY 2011/12 to 5% in FY 2016/17 (Annexes 5 and 15).

13. **Financial Governance/PFM. South Africa's financial governance/PFM systems are robust, but challenges remain at decentralized levels and State Owned Enterprises (SOE)[3].** The latest Public Expenditure and Financial Accountability Assessment (PEFA) completed in 2014 indicates that South Africa has generally sound PFM systems at the national level and commends the country's impressive record of fiscal discipline. However, the PEFA also found that there is room for improvement, specifically at the municipal and provincial governments, given unfavorable audit reports from the Office of the Auditor General (AG) in recent years. The main problem identified by the AG include high levels of irregular, wasteful and unauthorized expenditures. These challenges are not confined to municipal and provincial public institutions but also occur in SOEs. This includes Eskom, South Africa's electricity public utility, which is supported by the Bank. Specifically, the main allegations against Eskom were irregularities in the awarding of contracts to Tegeta Exploration and Resources owned by an influential business family, as well as irregularities in contracts awarded by Eskom to Optimum Coal Mine to supply coal for electricity generation. Government has embarked on a program to reform SOEs to address the governance issues and to increase their efficiency and profitability. The Bank is planning to conduct a study in 2018 to assess how SOEs can effectively fulfil their developmental mandate of fostering economic transformation and inclusive growth. As regards the Bank's CPIA, South Africa has been consistently ranked first in the continent in the assessments since inception.

14. **Current Account Balance. The current account deficit improved continuously in recent years, from -5.9% of GDP in 2013 to -2.5% in 2017, reflecting a decline in imports. The current account deficit was financed mainly by non-FDI flows.** Exports (of goods and services) showed a marginal decline in recent years, from 30.9% of GDP in 2013 to 29.8% in 2017, while imports decreased faster relative to exports over the same period, i.e. from 33.3% of GDP to 28.4% in the same period (Fig. 3). The decline in imports was primarily due to weaker domestic demand for goods and depreciating Rand. The current account deficit is likely to remain stable below 3% of GDP in 2018 and 2019. The current account deficit was financed mainly by non-FDI flows, notably portfolio investment, which increased from 3.0% of GDP in 2013 to 5.9% in 2016, while FDI flows decreased from 0.5% of GDP to -0.4% over the same period, reflecting persistent economic and political uncertainty. In the longer-term retrospective, South Africa's imports and exports increased from 17% and 21% of GDP respectively in the early 1990s to about 30% in 2016 for both imports and exports, which demonstrates that the country's trade linkages have steadily increased over the past decades. Today, South Africa is the 36th largest export economy in the world. Key destinations in 2016 were Asia (30% of total exports); Africa (29%); Europe (24.6%); and America (9%). The Southern Africa Development Community (SADC) alone accounts for about 27% of South Africa's export market. In contrast, imports from SADC (and actually Africa as a whole) accounted for less than 10% of South Africa's total imports, translating into a strong trade surplus with the other countries of the southern African region. About 30% of total imports are from Europe, followed by Asia with about 25%.

Figure 3: Current Account Balance, 2012-19 (% of GDP)



Source: South African Reserve Bank

15. **Private/Financial Sector. South Africa has a vibrant private sector, generating 75% of the country's GDP. The overall business environment is comparatively well developed, but significant challenges remain, notably in terms of energy access, trading across borders and**

red tape. South Africa's ranking in the Doing Business Index has deteriorated in recent years, from 39th, 41st, 43rd and 73rd, to 74th (out of 190 countries) during 2013 to 2017. The main reasons for the deterioration are counterproductive reforms that created more obstacles to doing business, such as the introduction of regulations making access to credit information more difficult, an increase in property transfer taxes making the registration of property more expensive, and higher vehicle taxes[4]. In 2017, South Africa's least favourable Doing Business indicators are "Trading across Borders" (139th), "Starting a Business" (131st), "Enforcing Contracts" (113th), and "Getting Electricity" (111th). On the positive side, the country performed well in "Protecting Minority Investors (22nd) and "Resolving Insolvency" (50th). While South Africa's financial sector is very well developed and diversified, SMMEs face significant challenges to access finance. Financial inclusion is limited. The financial sector comprises 22 registered, mutual and cooperative banks, 5 local branches of foreign banks as well as other financial intermediaries. The financial sector is well developed yet highly concentrated, with 5 banks controlling nearly 90% of total assets in the sector (Annex 9).

2.3 Social Context and Cross-Cutting Themes

16. **Poverty. Despite being an upper MIC, South Africa suffers from high poverty, with the poverty headcount increasing to 55.5% in 2015 from 53.2% in 2011 and 25.2% of the population – i.e. 14m out of 56.5m South Africans – living in extreme poverty in 2015.** Poverty increased over the period mainly due to low economic growth, rising unemployment and high household indebtedness. South Africa has not adopted an official measure of poverty, and uses food poverty line (FPL), lower bound poverty line (LBPL) and upper bound poverty line (UBPL) measures based on monthly household income levels. In 2015, 25.2% of South Africans (14m) lived in extreme poverty or below the national food poverty line of R441 per person per month, while 55.5% of the population (31.4m) lived below the national upper bound poverty line of R992. The majority of the poor live in Townships, informal settlements, and rural areas where subsistence farmers dwell. The Townships and informal settlements are home to 38% of the working age population and account for 60% of those unemployed in the country. As regards the SDGs (Annex 22), national consultations have been initiated to inform approaches to mainstreaming the SDGs into national strategies (Annex 21 for the MDGs).

17. **Gender Equity. The constitution prohibits unfair discrimination on the basis of gender but various challenges still persist.** South Africa is a signatory to several regional and international commitments on women's empowerment and gender equality, including the Convention on Elimination of All Forms of Discrimination against Women (CEDAW); Optional Protocol to the CEDAW; Protocol to the African Charter on Human and Peoples' Rights on the Rights of Women in Africa; and Southern African Development Community (SADC) Protocol on Gender and Development. At the national level, these protocols are domesticated by the 2002 South African National Policy Framework for Women's Empowerment and Gender Equality. The policy establishes a clear vision and framework for gender mainstreaming across laws, policies, procedures and practices and advocates for equal rights and opportunities for women and men in all spheres and structures of government, as well as in the workplace, the community and the family. Government institutions and bodies are required to implement gender mainstreaming as part of their mandates through their Gender Focal Points.

18. **Despite the legal framework, various gender imbalances are noted. Many racial and ethnic groups have maintained traditional gender roles, such that women usually have less power than men.** Gender disparities also continue against women in terms of access to formal employment and productive resources, such as arable land, credit and technology. While South Africa has achieved near universal access to primary education, female access is still a concern. Women typically also face the consequences of gender norms and the unequal division of labour, predominantly due to their role as unpaid caregivers within the family and community. There is a consistent trend of a low labour force participation rate of women compared to men and the gap has remained almost the same over period 2001-2014. Women constitute 42.9% of the workforce compared to 57.1% for men. Women are also under-represented in decision-making.

At the national level, only 42% of all Parliamentarians are female, which was 8 percentage points below the MDG target (of 50%) and the SADC Gender Protocol. In addition, poverty tends to be more prevalent in households that predominantly consist of women because of lower female labour market participation and earnings. There is also a greater incidence of poverty in female-headed households.

19. **Climate Change and Green Growth. South Africa is among the top 20 largest per capita emitter of greenhouse gases (GHG) globally**, by virtue of coal-based power plants accounting for approximately 80% of the country's base-load electricity capacity. Furthermore, the country is relatively water scarce and is therefore vulnerable to the effects of drought and rainfall variability. It is estimated that drought has affected about 17.7m people in the country since 1996 (in terms of total population, the fourth-highest number among African countries). More broadly, economic development, population growth and rapid urbanization exacerbate negative environmental impacts – declining air quality, increasing waste generation, deteriorating ecosystem health and loss of biodiversity. South Africa ratified the Paris Agreement in 2016. The country's Nationally Determined Contribution (NDC), focusses on both adapting to climate change and reducing greenhouse gas emissions.

20. **In recognition of the coal dominated grid and the technical challenges of bringing renewable energy on line whilst meeting baseload requirements, the NDC defines a 'peak, plateau and decline'[5] (PPD) profile,** under which economy wide emissions, particularly those from energy generation, are set to increase, plateau and later decline; the point being that whilst emissions increase from new fossil fuelled plants (peak), the emissions intensity of generation decreases as older inefficient power plants are shut down (plateau), the grid stabilizes and more renewable energy can be brought online (decline). Energy efficiency and renewable energy will play an important role in helping South Africa reduce its GHG emissions; significant progress has been made in clean energy generation mainly through wind and solar and renewable energy generation is expected to increase to 13 225 MW by 2025. The Government has also set up a Green Fund, managed by the DBSA, to support the transition to a low carbon, resource efficient and climate resilient development path that delivers high impact economic, environmental and social benefits. The Fund has prioritized investment in the following three thematic areas: Green Cities and Towns: greening core municipal infrastructure, sustainably built environment and integrated planning for climate resilient cities; Low Carbon Economy; and Natural Resource Management (Annex 10 and Annex 16).

III. STRATEGIC OPTIONS, PORTFOLIO PERFORMANCE AND LESSONS

3.1 Country Strategic Framework

21. **South Africa's National Development Plan (NDP), the "Vision 2030", articulates the country's agenda to eliminate poverty, reduce inequality and achieve a prosperous society in the next two decades.** The NDP's core strategic priorities are: (i) Growth and job creation; (ii) Improving the quality of education, skills development and innovation; and (iii) Building the capability of the state to play a developmental and transformative role. The implementation of the NDP commenced with the adoption of the 2014-2019 Medium Term Strategic Framework (MTSF) by the cabinet in 2013 as the first five year implementation phase of the NDP. In line with the NDP priorities, the MTSF identifies 14 outcomes. These include education, health, safety and security, economic growth and employment, skills development, infrastructure, rural development, human settlements, local government, environment, international relations, an effective public sector, social protection, nation-building and social cohesion. The MTSF implementation progress report (June 2016) indicates that the country has made good progress on the infrastructure outcome between 2013 and 2015, especially in energy and rail freight transport. Progress has also been noted in other outcome areas. However, government was unable to achieve targets under economic growth and employment justifying the orientation of the current CSP. The Industrial Policy Action Plan (IPAP) and the Infrastructure Plan are the other medium term plans for the implementation of the NDP. The government has proposed to

prioritize creation of Special Economic zones and industrial clusters in the IPAP 2017/18 – 2019/20.

3.2 Aid Coordination, Harmonisation and Bank Positioning

22. **As an advanced upper MIC, Official Development Assistance (ODA) levels to South Africa are low.** In FY 2015/16, for instance, ODA to South Africa amounted only to about R1.3bn (about USD 100 million), which is equivalent to 0.1% of consolidated government budget. Aid mainly covered infrastructure, agriculture, education, health, science and technology, environment, human settlement and municipal infrastructure, and governance and capacity building. Institutionalized donor coordination only exists in the area of Public Finance Management (PFM) through the Donor Coordination Forum established in 2010 to support capacity building. RDGS actively participates in the Forum and liaises with embassies represented in Pretoria. RDGS also continues to actively engage the Government in country policy dialogue through various avenues such as the preparation of the Country Policy and Institutional Assessment (CPIA), and the African Economic Outlook. RDGS also held more than fifty business development meetings with public and private sector stakeholders in the period January 2013 to August 2017 leading to a number of new lending operations.

23. **Key development partners.** Major development partners include World Bank, Germany, European Commission/European Investment Bank, UN and its organs, JICA, USAID, New Development Bank (BRICS). Other key financing institutions include China Development Bank, China Construction Bank, and Export-Import Bank of India. ODA from traditional donors is not only limited but also is dwindling: DFID phased out its direct financial aid to South Africa with effect from 2016 and has shifted its resources to regional operations. Many others are also scaling back the provision of grants notably the European Union. Nonetheless, loans, both multilateral and bilateral, have been increasing. Most development partners focus on infrastructure, particularly energy, transport, trade and regional integration, social services, environment and climate change, governance and capacity building (Annex 20). In addition, this provides opportunities for partnerships with other DPs and business generation for the Bank, which RDGS will pursue with top priority.

3.3 Strengths and Opportunities, Weaknesses and Challenges

24. **South Africa's overarching development challenges today are its 'Dual Economy'** featuring high poverty, unemployment, notably of the youth, income inequality and spatial socio-economic disparities. South Africa's strengths and opportunities, and weaknesses and challenges are discussed in detail in the following sections and are summarized in Boxes 2 and 3.

Weaknesses and Challenges

25. **<u>Extreme Inequality.</u> South African society remains one of the most unequal in the world, featuring extreme income inequality, both between different race groups, regions and gender.** Over the past two decades, South Africa has registered a sharp increase in income inequality, with the country's Gini coefficient increasing from 0.63 (2005)[6] to 0.65 (2016) – the highest in the world. Income inequality is visible across all spatial dimensions but it is highly pronounced in Townships/informal settlements and rural areas vis-a-vis the well-developed urban agglomerations. A typical indicator of an extreme income inequality is Sandton city and Alexandra Township, which are located side by side as part of the city of Johannesburg, where the former is one of the most developed urban neighbourhood in the world while the latter is one of the poorest settlements in the country. Income inequality also exists along racial lines and gender. The 2014/15 Government's Living Conditions Survey revealed that South African households earned an average income of R138,168 (USD 10,571) in 2015. The white-headed households earned about 4.5 times more than the black-African headed households, while men-

headed households earned twice as much as women-headed households. Also, wealth distribution is extremely skewed, with 10% of the population holding 95% of wealth (Annex 10).

26. **<u>High Youth Unemployment.</u> High unemployment, especially of the youth (50.9% of those aged 15-24) is South Africa's overarching development challenge today. To address it, the process of de-industrialization needs to be reversed and industries with potential for competitive advantage and job creation be supported.** The official unemployment rate stood at 26.7% (5.9m people out of a total workforce of 22m) at the end of Q4 2017. Unemployment is high in Townships/informal settlements and subsistence rural areas, which account for 60% of the unemployed in the country. Unemployment is below the national average in the developed metropolitan areas, such as Ethekwini/Durban (21.8%) and Cape Town (22.7%), albeit still high. On the other hand, non-metropolitan regions have the highest levels of unemployment, for example Eastern Cape (36%), Free State (35%) and Gauteng province (32%). Four provinces in South Africa are regarded largely as rural and do not have well-developed metropolitan centres. These include Northern Cape, North West, Mpumalanga and Limpopo, with average unemployment rates in these provinces around 27%. With specific regard to the youth, South Africa's unemployment rate was among the highest in Africa at 50.9% of those aged 15-24 and 31.9% of those aged 25-34. The main cause of the high unemployment is the lack of skills arising from low level of education. At the end of 2016, 58.8% of unemployed persons had below matric level of education (completed grade 12), while 32.4% had matric level of education and 8.1% had tertiary level of education. The economy mainly creates skilled jobs and sheds unskilled ones through capital-intensive production techniques.

Box 2. Weaknesses and Challenges

- Reduce high inequality, disparities and high (youth) unemployment.
- Overcome the Dual Economy and the dis-connect between the first and the second segments of the economy (Metropolitan areas vs. Townships and rural areas).
- Lack of adequate skills.
- Inadequate domestic infrastructure: energy, transport, water and ICT.
- Persistent physical and soft barriers to the free flow of goods and persons to other countries of the region.
- Lack of competition in goods and services market.
- Reduce high levels of violent crime.

27. **<u>Infrastructure Deficits.</u> Although South Africa has a comparatively good infrastructure base in the highly developed metropolitan areas, commensurate with its status as an advanced upper MIC, infrastructure services are not sufficiently accessible, reliable and affordable in the 'second segment' of the economy**, which requires substantial investments in energy, transport and water and sanitation. **Energy:** Electricity supply has since 2016 improved following improvements in maintenance, which resulted in higher plant availability capacity, the additional generation by independent power producers, and commissioning of Eskom's new projects – Eskom supplies 95% of electricity consumed in South Africa. Total nominal generation capacity as of March 2017 increased to 44,134MW, against a demand of 32,985MW. South Africa's current energy mix comprises of coal (81%), nuclear (4%), gas (5%), hydro (4%) and wind/ solar (5%). South Africa is an important partner of the Southern Africa Power Pool (SAPP). The Government's Integrated Energy Resource Plan 2010-30 aims to reduce the share of coal in the energy mix to 48% by 2030. **Transport:** The country boasts a well-developed transport infrastructure comprising 750,000 kilometres of road network (of which about 25% is paved), 20,000 km of rail, 9 airports, 8 commercial ports, and 3,800 km of pipelines for petroleum products and gas. Nonetheless, the sector faces challenges emanating from gaps in the penetration, distribution, spread and reliability of affordable public transport, a high road fatality rate of about 24 per 100,000 people[7], and substantial maintenance backlogs in the lower class roads (Annex 8).

28. **Water:** South Africa is a water scarce country and is ranked as the 30th driest state in the world with a water availability of 830 m^3 per capita per year. In terms of access to basic services, 88.8% (2016)[8] of the population had access to improved drinking water sources but only 46.4%

had access to water in their homes, and 80.9% had access to improved sanitation facilities. The country has experienced increasing water demand emanating from irrigated agriculture, urban areas and the mining industry, which respectively accounted for 60%, 18% and 5% of the water consumption in 2013. The main challenge regarding water and sanitations is aging infrastructure, and quality and reliability of water supply for both domestic and industrial use, and sanitation services. **ICT:** South Africa has a well-developed ICT sector. South Africa mobile phone operators have extensive footprint across the continent. Nonetheless, the mobile data costs are very high in South Africa compared to other middle and low-income countries in Africa including Nigeria, Egypt, Ghana and Tanzania. In 2016, about 52% of the population had access to internet. As with the other key infrastructure components, the penetration of the ICT services in Townships/informal settlements and rural areas is limited. Neither public nor private broad infrastructure has adequately penetrated them, reinforcing the digital divide and the dual nature of the economy (Annex 8).

Strengths and Opportunities

29. **<u>Strong Potential to Re-Industrialize.</u> South Africa has a high potential to re-industrialize if the right policy decisions are made.** According to SA's Industrial Policy Action Plan (IPAP) 2017-20 potentials for reindustrialization exist in 13 priority sectors. Sectors identified as priority for maximum growth and employment impacts are the following: (1) Agro-processing; (2) Clothing, textiles leather and footwear; (3) component manufacturing and fuel cells under Automotive and (4) Forestry, timber, paper, pulp and furniture. Primary mineral beneficiation is also one of the 13 priority sectors for industrialization. Although the mining sector contributes about 8% to GDP, it contributes over 25% in export earnings and remains avital sector for economic growth and recovery. Spatially, these priority sectors are located across the country in and around major urban centers but none of them are found in Townships. This is because the latter do not have access to adequate infrastructure: energy, transport, and logistics; ICT; and water supply.

30. Re-industrialization in South Africa faces several key shortcomings including weak policy, planning and program coordination in government; legislative and regulatory delays and burdens; and concentration of manufacturing firms, among others (Annex 6). Promoting re-industrialization requires a well-tailored policy mix, consisting of measures to further improve the general business environment, notably through infrastructure development, but also spatially balanced, targeted support at micro-economic level to specific industries with the potential for competitive advantage and higher-value added job creation. This needs to be accompanied by skills development, for example for artisanal activities, but in particular in high-technology areas with significant value added. At the same time, the connectivity between the underdeveloped Townships/rural areas with the highly developed metropolitan areas needs to be strengthened, by facilitating the mobility of the workforce, promoting backward and forward linkages, and improving access to markets – a clear call for a combination of domestic and regional infrastructure investments. Faster economic growth will also come from the less-developed township economy (together with a recovery of the rural sector). Therefore, South Africa's economic policy agenda will involve a big push to better integrate its township economy with its advanced economy, to allow it to catch up in terms of income and productivity levels and other measures of economic development.

Box 3. Strengths and Opportunities

- Potential for manufacturing-led industrialization and job creation
- Massive mineral resources endowment (world's largest reserves of manganese and platinum) estimated at USD 2.5 trillion.
- Largely untapped Blue Economy
- Access to regional markets and global value chains.
- Well-developed private and financial sectors in the first segment of the economy
- Vibrant multiparty democracy with free press and respect to the rule of law.
- Government that is committed to sound macroeconomic and structural policies.

31. **<u>Agriculture and Blue Economy.</u> Despite its relatively small share in GDP, South Africa's agriculture sector plays a crucial role in terms of employment and has significant potential for transformative agri-business and job-creation.** The agriculture sector's share in total output has declined over the past decades because of the 'industrialisation' of the sector, currently standing at only 2.4% of GDP. This notwithstanding, farming remains vitally important to the economy, with 2.3m households (out of a total of 17m households) that are directly involved in agriculture production, formally employing 875,000 people (5.4% of the labour force) and impacting an estimated 8.5m people (15% of the population) directly or indirectly through employment and income. South Africa is not only self-sufficient in virtually all major agricultural products, but is also a net food exporter. However, the sector is facing several constraints, most notably in terms of sector duality and land ownership. The sector exhibits economic duality similar to the urban/ metropolitan-township economic dichotomy that historically characterizes the South African economy in that the world class commercial farming which dominates the agricultural production in the country coexists with a rudimentary subsistence farming in poor rural areas and former homelands. By 1994, about 87% of the land was owned by the white population and only 13% by black people who accounted for 80% of the population of the country. By 2012, only 7.95m hectares had been transferred to black owners through land reform. This represented only 7.5% of formerly white-owned land. In line with the key objectives of the Bank's Technologies for African Agricultural Transformation (TAAT), the Bank will support scaling out 'proven' and well packaged agricultural technologies and interventions in selected Priority Intervention Areas (PIAs) focusing on subsistence and emerging rural farmers and agricultural commodities, following an inclusive value chain approach. South Africa also has potential in terms of 'Blue Economy'. The Government's Fast Results Delivery program prioritizes sectors such as marine transport and manufacturing activities, including coastal shipping, trans-shipment, boat building, repair and refurbishment; offshore oil and gas exploration; aquaculture; marine protection services and ocean governance; small harbors; and marine and coastal tourism. However, these initiatives are at early stage of implementation (Annex 9).

32. **<u>Regional Integration and Trade.</u> South Africa is a main champion and driver of regional integration in Southern Africa.** South Africa actively participates in various regional initiatives such as the Tripartite Free Trade Area (TFTA), and the Continental Free Trade Area (CFTA) process under the African Union's Agenda 2063 and is a member of SADC and SACU blocks in Southern Africa. South Africa's main trade corridors include the Cape Town-Gauteng and Durban-Gauteng corridor. This trade route connects South Africa's ports to the economic heart of the country – the Gauteng province – and is part of the North-South corridor, a multimodal (road, rail and ports) transcontinental interconnector linking South Africa, Botswana, Mozambique, Zambia, Zimbabwe, Tanzania and Malawi and ultimately connecting Cape Town to Cairo. As noted in paragraph 14, South Africa's trade linkages have steadily increased over the past decades. However, the country has not fully reaped the benefits deeper regional integration offers as it continues to face several challenges that constrain its potential to fully utilise the opportunities from regional integration. These include both hard and soft constraints. The *hard constraints* pertain to the infrastructure deficits, including rail, roads and port developments, energy generation and transmission and development of shared watercourses for the benefit of the regional member countries. The *soft constraints* include prevalence of non-tariff barriers and trade facilitation bottlenecks, such as lengthy border procedures at key regional transit points (such as Beit Bridge where it takes an average of 4 days for trucks to cross the border). This is corroborated by the 2017 Doing Business Report on South Africa, in which the country's worst indicator is "Trading across Borders", ranked 139th out of 190 countries. To further promote regional integration and trade, South Africa should increase investments in regional infrastructure and reduce persistent 'soft' non-tariff barriers to trade (Annex 7).

3.4 Key Findings of the 2017 Country Portfolio Performance Review

33. **Characteristics of the Bank Group 2013-2017 Portfolio.** A total of 12 operations were approved under the CSP 2013-2017: 8 under pillar 1, and 2 under pillar 2, and 2 cross-cutting operations yielding total commitment of UA1.5 billion including syndicated amount of U696m for Eskom's rolling infrastructure programme, the largest syndication in size in Africa. Projects approved during the last CSP are presented in Annex 17a by pillar.

34. **Size and Composition of the Bank Group's Ongoing Portfolio.** *Active portfolio:* as at 5 March 2018, the active Bank portfolio in South Africa covers 24 operations[9] financed through ADB (loans and LoCs), CTF loan and MIC and AWF grants. These operations account for UA 3.49 billion (USD 4.9 billion). The current portfolio is dominated by Light up and Power Africa (62.7%); followed by Industrialize Africa (19.1%), Integrate Africa (16.3%), Feed Africa (1.7%), and Improve the Quality of Life of Africans (0.14%). *Disbursement rate:* the cumulative disbursement ratio stands at 88.2% with an average age of 7.1 years. Notably, 13 of the 24 projects have disbursed 100% (Annex 17b).

35. **Bank Group's Portfolio Performance.** The overall performance of the portfolio is satisfactory with a rating of 3.13 on a scale of 1 to 4. Overall, the Bank's portfolio performance in South Africa has improved significantly since the last CSP and Country Portfolio Performance Review (CPPR) Mid Term Review (MTR) in 2015 (rating of 2.66 on a scale of 0-4). Annex 17c discusses the Bank Group ongoing portfolio performance in South Africa.

36. **The implementation delays in the portfolio arise mainly from poor quality at entry and delays in recruiting key PIU staff.** Some projects and/or components such as the Enterprise Development Resources Pilot Project were poorly designed with too many components and contracts with numerous procurement activities, which coupled with absence of qualified and experienced procurement staff at the Executing Agencies led to delays in implementation. Using advance contracting procedures and doing a thorough procurement assessment of the EA along with fewer bundled procurement packages need to be considered for all future operations.

37. **Portfolio Issues and Improvement Plan.** The Government and the Bank agreed on a CPIP with a detailed action plan to be closely monitored during the implementation of the new CSP. This will help reduce implementation delays and avoid the risk of cancellation. Key recommendations generally include the full application of provisions in the PD 02/2015. The detailed portfolio plan for the ongoing projects is contained in Annex 19.

3.5 Lessons Learned from the CSP 2013-2017 Completion Report and 2017 CPPR

38. **The Bank achieved good results from the implementation of the CSP 2013-2017. However, the new CSP 2018-22 should place more emphasis on accelerating South Africa's re-industrialization, with a view to more effectively addressing the country's overarching development challenges resulting from its 'Dual Economy':** high poverty, unemployment, notably of the youth, income inequality, as well as spatial socio-economic disparities. The CSP 2013-2017 CR and CPPR 2017 generated several lessons to inform the new CSP 2018-2022. At strategic level, the key emerging lesson is that the CSP 2013-17 with its strategic focus on infrastructure development and regional integration rightly supported South Africa's development agenda, and tangible results were achieved in terms of stabilizing energy supply and facilitating cross border investment and trade. However, to more effectively tackle the country's overarching development challenges, especially those it faces an upper MIC (Box 4, p.13), greater effort is needed to accelerate economic transformation and re-industrialization for inclusive growth, job creation and improved equality. Detailed lessons are presented in Annex 11 (Box A11.1). Annex 18 summarizes key findings of CSP 2013-2017 Completion Report.

Box 4: Key Lessons from the Implementation of the CSP 2013-17

i. Greater attention needs to be given to the specific needs and challenges of South Africa as an advanced upper MIC:

- *Infrastructure disparities:* while South Africa's infrastructure base is well-developed in the highly developed metropolitan areas, infrastructure services are insufficient in terms of accessibility, reliability and affordability in the 'second segment' of the economy, notably Townships. This requires substantial investment in infrastructure.
- *Insufficient regional connectivity:* Given the relatively high quality and sophistication of its goods and services commensurate with its status as an upper MIC, South Africa is a net exporter into the Southern Region. However, the country faces several hard and soft constraints that prevent it to fully reap the benefits from regional integration. This requires investments in regional infrastructure and measures to remove non-tariff barriers to trade.
- *Declining total factor productivity (TFP):* TFP increased strongly for about a decade after the end of Apartheid, but has been declining since the mid-2000s (Annex 4), mainly on account of severe skills shortages, infrastructure deficits and weak domestic competition. Therefore, investments in human capital, infrastructure, improved trade openness and competition are necessary.
- *Technological disparities:* South Africa is technologically the most advanced country in Africa. However, sophisticated high-tech/high value added companies are concentrated in the developed metropolitan areas. Therefore, an appropriate environment needs to be created for those companies to expand into non-metropolitan areas, e.g. through adequate infrastructure services and connectivity, incentives, availability of highly skilled labor, research institutions, etc.

ii. The Bank has employed innovative financing mechanisms that have allowed it to make good progress in developing business. These include syndication, co-financing, and private equity participation. Going forward, these efforts should be stepped up, including exploring ways of using Partial Credit Guarantees (PCG) for bond issuance and/or foreign exchange swaps, as well as exploring PPP options as a means of generating business for the Bank.

iii. The strategic scope of the new CSP and its indicative lending program need to be flexible enough to enable the Bank to respond swiftly to emerging needs and to generate business. Cumbersome processes, such as in procurement and conditions for disbursement, will be streamlined to allow for quick project take-off.

iv. More needs to be done to position the Bank as a true knowledge-based institution. Bank analytical work needs to be demand driven and close existing knowledge gaps.

IV. BANK GROUP STRATEGY 2018-2022

4.1 Rationale and Strategic Selectivity

39. **As demonstrated above, South Africa enjoys many strengths and opportunities, but also faces several weaknesses and challenges – the Bank under the new CSP 2018-22 will address these in a selective and innovative manner in areas/sectors where is has a comparative advantage.** The Bank has identified six key selectivity criteria to determine the new CSP's strategic and operational choices, to best support South Africa's economic transformation and overall socio-economic development. These selectivity criteria aim to guarantee a maximum development impact of Bank operations, in line with the country's priorities and the Bank's High-5s.

40. **The first selectivity criterion is the consultations with the GoSA and country stakeholders on the areas of focus of the new CSP.** In particular, during the CSP consultation in June 2017, the GoSA asked the Bank to focus on regional integration and industrialization as South Africa has been facing a protracted period of de-industrialization with dire consequences on employment, poverty and equality. Regional integration is considered as a catalyst to trade, particularly exports of manufactured goods, from South Africa to Africa and a stepping-stone towards integration with the global economy. The GoSA also requested Bank support to address persisting governance challenges, strengthen institutional capacity, skills development, gender equality and climate change. Emerging issues from the CSP stakeholder consultation in June 2017 are summarized in Annex 14.1. The CSP is also informed by the recommendations of the 2016 BDEV evaluation of the South Africa Country Strategies and Program 2004-15 (Annex 23). **The second selectivity criterion is the lessons learned from the CSP 2013-2017.** The CSP

2013-17 Completion Report (CR) generated several lessons which have informed CSP 2018-22, notably on the need to refocus the Bank's support to address the country's overarching challenges of the Dual Economy: high levels of poverty, inequality and unemployment and severe spatial disparities in economic development. Other key lessons relate to the need to ensure high project quality at entry and building the capacity of the PIUs to speed up delivery and maximize the development impact of the Bank's support to South Africa respectively (Annex 11.1 and Box 4).

41. **The third selectivity criterion is the alignment of the CSP with South Africa's national development agenda and the Bank's strategic framework.** The CSP is aligned with South Africa's NDP and MTSF 2014-19, which emphasize economic transformation for inclusive growth, to reduce poverty, unemployment and inequality. The CSP is also consistent with the Bank's Ten Year Strategy with its twin objectives of inclusive and green growth as well as its core operational priorities of infrastructure, regional economic integration and private sector development. The CSP is in line with the Bank's High-5 strategic priorities as articulated in the Bank corporate strategies, Industrialization Strategy for Africa 2016-2025, the New Deal on Energy for Africa 2016-25, Jobs for Youth in Africa 2016-25, Agricultural Transformation in Africa 2016-25. The CSP also takes into account CODE's recommendations of January 2018 (Annex 24). **The fourth selectivity criterion is the Bank's comparative advantage.** The Bank's investments in infrastructure, in particular in energy and transport, have yielded significant results. Specifically, Bank support in the energy sector helped the country successfully reverse an acute electricity supply crisis that has plagued the economy for nearly a decade while also contributing towards strengthening the regional energy market through the Southern Africa Power Pool. The Bank's green energy projects have also helped South Africa accelerate transitioning to an environmentally sustainable green growth path. The Bank provided over USD 3.1 billion and USD 497 million for energy and transport sector projects respectively since 2007 in support of regional integration and industrialization. This confirms that the Bank has a significant comparative advantage in regional integration, infrastructure development and the promotion of industrialization in South Africa.

42. **The fifth selectivity criterion is South Africa's most pressing development challenges.** The overarching development challenges facing South Africa include the 'Dual Economy': high poverty, unemployment and income inequality, as well as spatial socio-economic disparities. More emphasis should be placed on accelerating re-industrialization for economic transformation, inclusive growth, job creation and improved equality. **The sixth selectivity criterion is analytical work.** A significant number of knowledge products have underpinned the new CSP, among others BDEV's abovementioned evaluation; the South Africa section of the African Economic Outlook report 2017 and 2018; the Bank's South Africa Growth Diagnostic Note 2017; various Sector Analytical Notes 2017; Studies by various government institutions and development partners, notably, the World Bank and International Monetary Fund; etc. Annex 12 presents key messages from the Sector Analytical Notes, while Annex 13 presents the list of Economic and Sector Works underpinning this CSP. The key messages from these analytical works point towards the need to address persistent infrastructure deficits, which constrain private sector activity and hence industrialization and employment generation. In addition, deeper regional integration may benefit South Africa in terms of improved access to regional markets, thereby boosting trade, growth and employment.

4.2 CSP Objectives and Strategic Pillars

43. **<u>Overall Objective.</u> The overall objective of the CSP 2018-2022 is to support South Africa's economic transformation and re-industrialization for inclusive growth, job creation and improved equality.** Towards achieving this objective, and based on the rationale provided above, the new CSP will be articulated around the following two complementary pillars: **Pillar 1: Promoting Industrialization;** and **Pillar 2: Deepening Regional Integration.** These areas of focus are top priorities of the South African Government for Bank support.

44. To achieve the above objective, the Bank will focus on further improving the country's overall business environment through investments in domestic infrastructure, thereby reducing the cost and enhancing the reliability of and access to industrial infrastructural services. As a result, these investments will increase the competitiveness of existing and new industrial/manufacturing enterprises. To complement these investments; and in a more enabling general business environment, the Bank will provide direct support to specific businesses/enterprises in sectors with a high potential for industrialization and higher value added job creation, thereby promoting economic transformation, inclusive growth and improved equality. This will be accompanied by Bank support to legal and regulatory reforms aimed at removing constraints to market entry by private businesses/operators. The Bank will also support GoSA reforms efforts aimed at repositioning SOEs as efficient vehicles for industrialization towards delivering the national development goals of economic transformation and inclusive growth. Additionally, the Bank will support infrastructure that has the potential to stimulate industrialization by strengthening the connectivity and economic linkages of Townships and rural areas with the more industrialized and highly developed metropolitan areas.

45. The Bank will also support South Africa's further integration into the Southern African region and the world economy more generally through investments in regional infrastructure as well as soft measures and reforms, notably the reduction of non-tariff barriers to trade. This will support the creation of larger markets and facilitate trade, thereby attracting foreign direct investment and, thus, promote technological progress, enhanced productivity and higher value added job creation, ultimately spurring economic transformation and industrialization.

46. **Innovations. The CSP 2018-22 will support South Africa's development ambitions as an upper Middle Income Country in an innovative – yet selective – way.** Most notably, the CSP will address South Africa's infrastructure disparities, which is one of the country's distinctive challenge as a MIC (Box 4), by supporting infrastructure investments geared towards connecting the second segment of the economy (especially Townships and rural areas) to the developed metropolitan areas towards spurring industrialization. The Bank will also support hard regional infrastructure investments and soft measures to improve South Africa's connectivity and facilitate trade with neighbouring countries and beyond. Improved infrastructure and trade openness will also result in increased competition and factor productivity, and reduce technological disparities, all of which are typical challenges South Africa is facing as a MIC. Another innovation of the new CSP is the systematic mainstreaming of cross-cutting aspects, notably gender equity, green growth/climate change and governance. More specifically, gender analysis will be systematically undertaken during the preparation of each new project, to ensure it fosters equal opportunities. Special consideration will be given to strengthening the capacity of sector ministries and agencies for mainstreaming gender. Specific components targeting women will be included in project design, where feasible. Gender disaggregated and relevant indicators will be integrated in project Results-Based Frameworks (RBF). Furthermore, the Bank's new projects will embed the concept of 'additive manufacturing' (paragraph 51) and be designed to maximize job creation for men and women, to which end training components will be integrated in new projects where feasible. This will allow them to enhance their skills and improve their perspectives on the labour market. As regards green growth/climate change, the Bank will continue its innovative partnership with GOSA to promote the Renewable Energy Independent Power Producers Program (REIPPP) that has been instrumental in effectively addressing the country's decade long electricity crisis. The Bank will also address governance issues, as explained above.

47. Yet another innovation is the CSP's focus on legal and regulatory reforms to remove market entry barriers, strengthen holistic planning and crowd in private sector businesses/operators. Direct support will have sought to be provided through the Bank's private sector window to industries/businesses with potential to engage in transformational industrial activities and to create higher value added formal employment, with a focus on the agriculture sector and Blue Economy. Particular attention will be given to systematically leverage co-financing whenever

possible and attract private sector investments (PPP). The Bank will act as convener, connector and catalyzer in leveraging resources to support South Africa's development, using innovative financing and risk sharing instruments (syndication; partial credit and risk guarantees). The Bank will also improve its positioning as a knowledge-based institution by providing policy advisory services to the GOSA and the private sector.

4.3 Expected Results and Targets

48. **The Bank's CSP 2018-22 will contribute to the achievements of the objectives of South Africa's National Development Plan ("Vision 2030") and its MTSF 2014-19, the Bank's High-5s, and the Sustainable Development Goals (SDGs).** To achieve the expected CSP outcomes and targets, the Bank will use a combination of funding instruments from its public and private sector windows, including a lending program of investment projects, technical assistance, analytical work and policy advisory services. Special emphasis will be given to Bank support from its private sector window, both in terms of financing and advisory services. The CSP's main expected outcomes and targets are presented under the two pillars discussed in the following paragraphs. Annex 1 presents the outcomes and outputs expected from each pillar at mid-term in 2020 and at completion of the strategy at end-2022.

Pillar I – Promoting Industrialization

49. **Main Objective.** The CSP's main objective under this Pillar is to reverse South Africa's decade-long de-industrialization process and boost structural transformation and job creation, thereby reducing poverty and inequality. To achieve this objective, the Bank will apply a three-pronged approach focusing on: (i) a further improvement of the overall business environment through investments in *domestic infrastructure*; (ii) *direct support to specific businesses/enterprises* in sectors with a high potential for industrialization and higher value added job creation; and (iii) *legal and regulatory reforms* aimed at removing constraints to market entry by private businesses/operators. Additionally, the Bank will support Governance reforms to reposition major SOEs as efficient vehicles to deliver the national development plans and associated goals of economic transformation and inclusive growth through industrialization.

50. Pillar I is fully aligned with the Bank's High-5s. Specifically, it will contribute to Industrialize Africa (Industrialization Strategy 2016-25); Feed Africa (Agricultural Transformation of Africa 2016-25); and Improve the Quality of Life for the People of Africa (Jobs for Youth in Africa Strategy 2016-25; Annex 2b). Pillar I will also assist South Africa in achieving SDG 6 (ensure availability and sustainable management of water and sanitation) and SDG 11 (make cities and human settlement, inclusive, safe, resilient and sustainable; Annex 22).

CSP Outcome 1 – Enabling higher industrial/manufacturing value addition through investments in critical industry-enhancing infrastructure

51. Bank activities to enable higher value addition by manufacturing enterprises will include investments in critical domestic industry-enhancing infrastructure, including in transport and water sectors. Bank investments in these sectors will strengthen demand for industrial/manufacturing products while also improving productivity in the overall economy by contributing towards increased access to affordable, sustainable and reliable infrastructure. Therefore, these investments will consolidate the foundations for sustained economic transformation and private investment in high value added manufacturing activities. Households in Townships and informal settlements, as well as rural and urban areas will benefit from any improved and innovative infrastructure. Overall, increased access to more affordable and reliable infrastructure will not only improve household welfare, thereby supporting inclusive growth, but also strengthen the enabling environment and reduce cost for businesses and companies engaging in higher value added economic activities, thereby enhancing their competitiveness and contributing to industrialization, economic transformation and more productive formal wage employment. A number of recent innovations that will be embedded in the Bank's infrastructure projects include mobile phone payment systems for water and 3D printing, also known as

additive manufacturing that will save significant costs in construction through shorter project cycle and fewer wasted resources, as well as boosting efficiency for labour-intensive trades like builders, electricians and plumbers. This will also support the manufacturing sector and industrialization in two ways: by improving efficiency across the economy, and by increasing demand for capital and new technology.

52. The selection of the Bank's infrastructure projects will also take into account geographical considerations to reduce spatial socio-economic disparities that are so typical for the country's 'Dual Economy'. Specifically, the Bank's infrastructure investments will prioritize areas in non-metropolitan South Africa (notably Townships/informal settlements and rural areas) in support of industries with potential for competitive advantage and higher-value added job creation (regional growth poles and centres of local economic development). The Bank's infrastructure investments will aim to strengthen the connectivity between Townships/informal settlement and rural areas with the highly developed metropolitan areas, with a view to attracting businesses, enable backward and forward linkages, facilitating the mobility of the workforce, and to improve access to markets. The improvement of transport system connectivity will also benefit the SEZs, thus boosting industrialization and job creation.

53. **Main Outcomes.** The key expected outcomes include: (i) Manufacturing sector employment to reach 2 million from the current 1.8 million; (ii) 35 km of 4-lane freeway constructed, linking the N3 and R21 highways in Gauteng Province, thereby reducing travel time and GHG emissions; (iii) 100 direct jobs created during construction of the project; (iv) traffic congestion in the eastern corridor on the freeway alleviated by increasing peak time average travel speed from 40km/hr to 70km/hr; and (v) 10,000 transport sector SMEs getting access to improved finance, resulting in access to 720,000 daily commuter trips across South Africa in safer, more fuel efficient vehicles. Key expected outcomes in the water sector include: (vi) 300 schools sanitation facilities properly maintained by franchisees; and (vii) 20,000 beneficiaries served by multiple technology-enabled water use services by 2022 from zero in 2017. Detailed information on the expected results under CSP Outcome 1 are presented in Annex 1.

CSP Outcome 2 – Supporting industrial clustering to promote SME/SMI development and job creation

54. Bank activities in terms of *direct support to specific businesses/enterprises* in the SME space will include private sector loans to selected private sector manufacturing firms with specific emphasis of SME cluster development. The following three categories will be considered: Firstly, private sector loans in support of sectors identified as a top priority for transformative industrial cluster development and inclusive economic growth, and higher value added job creation including Clothing, textiles leather and footwear; Component manufacturing and fuel cells under Automotive sector program; Forestry, timber, paper, pulp and furniture; and Primary mineral beneficiation sectors (Annex 6). Secondly, the Bank will support agro-businesses and agro-preneurs, as the agriculture sector offers potential for agricultural processing and value chain development, and thus transformative growth, industrialization and higher value added job creation. Thirdly, from a spatial development perspective, the Bank will provide assistance for the development of specific industrial clusters with potential for competitive advantage and higher-value added job creation in Townships and other underdeveloped areas, with a view to further reducing spatial socio-economic disparities. This approach acknowledges the fact that some Townships have unique characteristics that attract specific types of industries that collaborate technologically or strategically.

55. Furthermore, the Bank will support *legal and regulatory reforms* to remove entry barriers to markets of private businesses and operators, thereby enhancing competitiveness. For example, in the ICT sector, the Bank will support the Government to undertake a comprehensive affordability benchmark study that will inform policy and regulatory decisions on quality and price of infrastructure deployment and affordability of access devices. The study will help expedite the issuance of proposed incentives that the government had identified to introduce to

attract the domestic handset-manufacturing sector. The Bank will further participate as a partner in the newly launched ICT Connectivity Financing Platform for SADC of which South Africa is a lead country. The Bank will also address persistent Governance issues related to SOEs and support reforms to reposition them as efficient vehicles to deliver the national development goals of economic transformation and inclusive growth. The Bank will strengthen the governance of SOEs through capacity building and TA components in new projects and put in place systems and procedures to enhance transparency.

56. **Main Outcomes.** The main expected outcomes are: (i) SMME participation in manufacturing increased from current level of 45% of manufacturing output to 65% at the end of the CSP period; (ii) 2 Industrial Parks built; (iii) 1 dehydrated vegetables processing plant built; (iv) 2 Gas to Ethanol manufacturing plants built; (v) 9,169 jobs created by 2022 by an ongoing agriculture sector project, of which at least 50% are women; and (vi) 1,180 direct jobs created by the ongoing mineral beneficiation project. Detailed information on the expected results under CSP Outcome 2 are presented in the Results-Based Framework in Annex 1.

Pillar II – Deepening Regional Integration

57. **Main Objective.** The CSP's main objective under Pillar II is to improve access of South Africa's businesses to new markets and increased demand by connecting and integrating the country better into the region as well as beyond. Therefore, under this pillar, Bank support will focus on resolving the infrastructure constraints that have hindered regional trade and investment. Access to larger markets is crucial to enable the generation of economies of scale and incentivize private sector companies to invest in the production of higher value added commodities (local/regional/global value chains), thereby spurring industrialization and structural transformation, and generating formal productive wage employment. To achieve this objective, the Bank will invest in *regional infrastructure projects* and address *'soft' issues of regional integration and trade* such as trade facilitation and finance to support South Africa's integration in the sub-region and beyond.

58. Pillar II is consistent with the Bank's High-5 and will contribute to Light Up and Power Africa (New Deal on Energy for Africa 2016-25); Integrate Africa (Regional Integration Policy and Strategy 2014-23); Improve the quality of life (Jobs for Youth in Africa Strategy 2016-25; Annex 2b); as well as SDG 10 (build resilient infrastructure, promote inclusive and sustainable industrialization) and SDG 7(ensure access to affordable and reliable energy; Annex 22).

Outcome 3 – Improving cross-border connectivity for increased trade and industrial productivity

59. Bank activities in support of deepening regional integration will focus on improving cross-border connectivity through *regional infrastructure* investments in energy and transport. Bank investments in regional energy will enhance power generation that will feed into the Southern Africa Power Pool (SAPP) and strengthen the regional power transmission network. Bank investments in regional transport will strengthen the North-South corridor, a multimodal (road, rail and ports) transcontinental interconnector linking South Africa, Botswana, Mozambique, Zambia, Zimbabwe, Tanzania and Malawi and ultimately connecting Cape Town to Cairo. Bank support in the energy and transport sectors will ensure that these services will become more accessible, affordable and reliable, and build a foundation for the structural transformation, industrialization and the creation of higher value-added jobs. More affordable energy and improved cross-border transport connectivity will improve private sector competitiveness and attract local and foreign businesses, facilitate trade, thereby contributing to economic growth and job creation, and ultimately reduce poverty and inequality. This will also spur South Africa's exports into the continent and enhance industrialization in the country and the region. Bank support will also help to open up rural areas and Townships in South Africa that offer abundant economic opportunities, through accessible, affordable and reliable transport services, to facilitate the access of products to the national, regional and international market. Under Pillar 2, the Bank will also provide support to the financial sector for cross border investment and trade.

This will support South African and foreign firms to invest in high value added manufacturing activities in the region. The Bank will also pursue innovative projects such as cross border rail projects and support to the development of cross border cities to deepen regional integration.

60. Bank support to regional integration will also focus on removing *soft constraints to regional integration and trade*, notably non-tariff barriers (NTBs), as well as the harmonization of legal, policy and regulatory frameworks, and the provision of trade finance. Specifically, the Bank will support the establishment of One-Stop Border Posts (OSBP) to facilitate trade between South Africa and the its neighbours, and support reforms to strengthen the free movement of goods, services, capital and people. Removing NTBs will increase skill and technology transfer and transfer of best practice that are all important in improving productivity of manufacturing firms, thereby boosting industrialization, job creation and inclusive growth. The Bank will also provide loans to development financing institutions and commercial banks who will on lend to businesses in the region and the continent thereby deepening regional financial integration as well as directly contributing to industrialization, economic growth and job creation in the region and boosting the demand for goods and services from South Africa.

61. **Main Outcomes.** The main expected outcomes are: (i) power exports to SAPP to increase to 86,375 GWh from the current 15,093 GWh; (ii) 20 more trade financing Issuing Banks in Africa supported by Nedbank sub debt from 46 trade finance Issuing Banks in Africa in 2017; and (iii) Increase in General Freight Transport volume capacity to 83.4 MT; (iv) household access to electricity to increase from the current 84.2% to 94.7%. Detailed information on the expected results under CSP Outcome 3 are presented in the Results-Based Framework in Annex 1.

4.4 Indicative Lending Programme

62. **The CSP's Indicative Lending Program (IOP) was established in close cooperation and agreement with the GOSA and preliminary discussions with private sector investors, and is geared towards accelerating economic transformation and re-industrialization.** Annex 1 presents the results expected to be achieved by the CSP. Annex 2a presents the CSP's IOP for the period 2018-2020. It should be noted that this IOP is indicative and flexible: it will be updated and amended on an ongoing basis when new business opportunities arise, based on continuous dialogue with the GOSA and South Africa's private sector, with the overall aim to achieve the CSP's objectives and expected results. Annex 2b presents the IOP's contribution to the High-5s. The IOP for the CSP's remaining period 2021-22 will be established during the CSP's mid-term review in 2020.

4.5 Non-Lending Activities

63. **The Bank Group's non-lending program, including policy and advisory services, will be demand-driven, reflect the Bank's comparative advantage, and complement the IOP.** Demand-driven ESWs will inform country dialogue on structural reforms needed to accelerate industrialization and regional integration towards strengthening economic transformation and growth. The non-lending activities will consist of technical assistance and knowledge works to close knowledge gaps in Bank focus areas in particular on the fourth industrial revolution and impact on manufacturing and job creation; effective formulation and implementation of competition policy; IPAPs and regional market information. South Africa has well developed research and tertiary education institutions, which produce excellent knowledge products in virtually every sector of the economy. The main challenge is how to effectively use these knowledge products to drive reforms and enhance economic development. The Bank will use MIC Grants and Trust funds to scale up TA support wherever needed. Annex 1a presents the CSP's non-lending program, including one ESW on growth diagnostics, a study on SOE governance, and two technical supports in private sectors finance and nutrition activities.

4.6 Financing the CSP

64. **The Bank Group lending and non-lending activities will be financed through a range of instruments including ADB, AWF, CTF and MIC grants.** These will be complemented by

innovative financing instruments such as syndication, co-financing, and private equity participation. These efforts will be stepped up during the new CSP, including exploring ways of using Partial Credit Guarantees (PCG) for bond issuance and/or foreign exchange swaps.

65. **Assistance from the Bank's Private Sector Window.** Options will be provided by the Bank for direct support to businesses with potential to engage in industrial/manufacturing development activities and to create higher value added employment. The Bank will continue to provide Lines of credit to DFIs and commercial banks for on-lending to micro- and small-sized enterprises headed particularly young people and women. The Bank's Private Sector Window will also finance infrastructure projects especially through public-private partnerships (PPP), in order to attract supplemental resources given large demand for investment in the sector. Bank resources need to play a catalytic role in leveraging additional resources by using the Bank's innovative instruments and co-financing. Special emphasis will be placed on syndication. The Bank will continue to use credit enhancement products, including guarantees, guarantee syndication and loan syndication products as commercial co-financing options. Most notably, the Bank made its largest syndication for the Eskom corporate loan in 2017 and the syndicated Eskom B-loan attracted finance from nine commercial banks.

4.7 CSP Monitoring and Evaluation

66. The Results-Based Framework (RBF) in Annex 1 provides the basis for the monitoring and evaluation (M&E) of the results to be achieved from the CSP 2018-22. The RBF is aligned with South Africa's NDP and MTSF 2014-19 and presents the outputs and outcomes envisaged by CSP mid-term in 2020 and upon completion of the strategy in 2022. The RBF highlights the indicators related to the High-5s. Bank diagnostics, such as annual CPPRs, will track implementation progress for the planned operations. South Africa has a well-developed M&E system and statistical capacity. This will enable the Bank conduct results assessments on regular basis.

4.8 Country Dialogue

67. The Bank will continue its close dialogue with the GOSA, Development Partners and other country stakeholders. Key areas for dialogue include: industrialization, regional integration, macroeconomic management, notably public debt; public sector governance, in particular of SOEs; gender mainstreaming; climate change; role of technology and portfolio performance. The Bank will also strengthen efforts to generate business, notably through PPPs and co-financing.

4.9 Risks and Mitigation Measures

68. Major risks in South Africa that could hamper implementation of the CSP include: (i) subdued global economic environment, particularly sluggish global economic growth prospects, which could impede growth in demand for South Africa's manufactured goods; (ii) macroeconomic risks, particularly rising public debt levels; and (iii) Risks related to non-implementation of reforms especially in energy sector. The Bank will continue to analyse these key risks and identify other potential ones related to the planned Bank operations, and propose mitigation measures. Annex 11, Box A11.2 highlights risks to the implementation of the CSP 2018-2022 and the proposed mitigation measures.

V. CONCLUSIONS AND RECOMMENDATIONS

69. **Conclusions.** The Bank's CSP 2018-22 for South Africa will address the country's specific needs as an advanced upper MIC. Hence, more emphasis is placed on accelerating the country's re-industrialization and strengthening regional and global integration, with a view to more effectively addressing its overarching development challenges of the 'Dual Economy': high poverty, unemployment and income inequality, as well as spatial socio-economic disparities.

70. **Recommendations.** The Bank's Board of Executive Directors is invited to consider and approve this CSP 2018-22 for South Africa.

ANNEX 1: COUNTRY STRATEGY 2018-2022 RESULTS-BASED FRAMEWORK

Note: Statistics South Africa and National Accounts data informed the baseline for the RBLF and will also be used in monitoring the implementation of the CSP at mid-term and end-term. The relevant High 5 corporate strategy that each indicator contributes to is indicated in brackets: LUPA = Light UP and Power Africa ; FA = Feed Africa; **IndA** = Industrialise Africa ; IntA = Integrate Africa; and IQLA= Improve Quality of Life for the People of Africa

Government Sector Objectives	Constraints hindering achievement of desired outcomes	Final Outcomes (by 2022)	Final Outputs (by 2022)	Mid-Term Outcomes (by 2020)	Mid Term Outputs (by 2020)	Bank Group Interventions during CSP period (ongoing & proposed)
PILLAR 1: PROMOTING INDUSTRIALIZATION						
ENABLING HIGHER INDUSTRIAL/MANUFACTURING VALUE ADDITION THROUGH INVESTMENTS IN CRITICAL INDUSTRY-ENHANCING INFRASTRUCTURE IQLA						
Maintenance, strategic expansion, operational efficiency, capacity and ensuring of competitiveness of logistics and transport infrastructure. (*NDP Sub-Outcome 3*)	Lack of fully reliable public transport availability across the country, resulting from apartheid spatial planning	Manufacturing sector employment to reach 2 million (baseline, Dec 2017= 1.8 million) 720,000 daily commuter trips across South Africa in safer, more fuel efficient vehicles Alleviation of traffic congestion in the eastern corridor [increase of peak time average travel speed from 40km/hr to 70km/hr]	10,000 transport sector SMEs will benefit from improved access to finance (baseline 2017 = 0) 35 km of 4-lane freeway constructed (PWV15 section) linking the N3 and R21 highways in Gauteng Province (Baseline 2017=0)	Manufacturing sector employment to reach 1.9 million (baseline, Dec 2017 = 1.8 million) 360,000 daily commuter trips across South Africa in safer, more fuel efficient vehicles Employment opportunities created during construction [100 direct jobs during construction]	5,000 transport sector SMEs that will benefit from improved access to finance (baseline 2017 = 0) 20% of 35 km of freeway constructed (PWV15 section) linking the N3 and R21 highways in Gauteng Province (Baseline 2017=0)	**<u>Proposed Operations</u>** -Support to commuter transport -Development of the PWV15 Freeway in Gauteng Province **<u>Ongoing Operations</u>** None
All South Africans will have access to affordable, sufficient and safe water and hygienic sanitation	Limited water resources; Unevenly distributed water resources; Deteriorating quality of water and sanitation services and pollution;	20000 beneficiaries served by multiple water use services (baseline 2017=0)	300 schools sanitation facilities properly maintained by franchisees (baseline 2017=0) 5 SMEs franchisees sustainably operating for school sanitation maintenance in East London district	20000 beneficiaries served by multiple water use services (baseline 2017=0)	300 schools sanitation facilities properly maintained by franchisees (baseline 2017=0) 5 SMEs franchisee sustainably operating for school sanitation maintenance in East London district	**<u>Proposed Operations:</u>** -Mokolo Crocodile Project Phase II **<u>Ongoing Operations</u>** -Community driven multiuse water services -Social franchising operation and maintenance
SUPPORTING INDUSTRIAL CLUSTERING TO PROMOTE SME/SMI DEVELOPMENT AND JOB CREATION (IndA)						
Address the structural imbalance and high level of concentration in the economy, promote SMME development and close the skills gap to enhance the labour absorptive capacity of the economy. The productive sectors account for a growing	The Dual economy and slow growth of sustainable enterprises and industries in rural areas and townships that are characterized by strong rural-urban linkages. Weak productivity and competitiveness amid, weaker global demand and high currency volatility	Creation of 9169 jobs by an ongoing agriculture sector project of which at least 50% are women To Be Provided	2460 emerging farmers to benefit from ongoing loans to commercial farmers and Government Jobs Fund 2 Industrial Parks built (Baseline 2017=0)	Creation of 9169 jobs by an ongoing agriculture sector project of which at least 50% are women To Be Provided	1230 emerging farmers to benefit from ongoing loans to commercial farmers and Government Jobs Fund 2 Industrial Parks built (Baseline 2017=0)	**<u>Proposed Operations</u>** -IDC Line of Credit III -DBSA LoC VI -Nedbank sub debt <u>-Kathu Industrial Parks</u> <u>-Gas to Ethanol</u> <u>-Dehydrated Vegetables</u> -Lines of Credit to SMEs (through NHFC)

share of production and employment		Total direct jobs generated 1180 SMME participation in manufacturing increased from 45% (2014) to 65%	2 Gas to Ethanol built (Baseline 2017=0) 1 Dehydrated vegetables plant built (2017=0) Manganese ore produced 3 million tonnes 4 Specialized Industrial Facilities set up in pilot TVET Colleges and support SMMEs in community	Total direct jobs generated 1180 SME participation in manufacturing increased from 45% (2014) to 55%	1 Gas to Ethanol built (Baseline 2017=0) 1 Dehydrated vegetables plant built (_2017=0) Manganese Ore produced 2.8 million tonnes 4 Specialized Industrial Facilities set up in pilot TVET Colleges and support SMEs	**Ongoing operation** -Kalagadi industrial beneficiation project -DTI Enterprise Development Pilot Project -Land Bank
PILLAR 2: DEEPENING REGIONAL INTEGRATION						
IMPROVING CROSS-BORDER CONNECTIVITY FOR INCREASED TRADE AND INDUSTRIAL PRODUCTIVITY						
ENERGY (LUPA); ; (IntA)						
Development of energy infrastructure to enhance economic growth, employment, poverty reduction; and environmental sustainability	Lack of resources for expanded energy infrastructure investment High cost and uncertainty of green energy technology Negative Growth on electricity demand Aging generation plants and inadequate transmission lines High and rising tariff costs	Household access to electricity – 94.7% (Baseline 2016 = 84.2%) Power exports to SAPP - 86,375 GWh (Baseline 2017= 15,093 GWh)	MWs commissioned – 3,382 MW (Medupi +) 680 MW (proposed) 552 Kms of transmission lines constructed (Baseline 2017 =) Number of substations constructed or refurbished – 60 (Base 2017 =) Number of flue gas desulphurization units installed - 0	Household access to electricity – 91.2% (Baseline 2016 = 84.2%) Power exports to SAPP - 58,216 GWh (Baseline 2017 = 15,093 GWh)	MWs commissioned - 3,382 MW (Medupi +) 50 MW (proposed) (Baseline 2017 = 2382MW Medupi) 552 Kms of transmission lines constructed (Baseline 2017 =) Number of substations constructed or refurbished – 60 (Baseline 2017 =) Number of flue gas desulphurization units installed - 0	**Proposed Operations:** - Eskom Transmission Improvement Project - Medupi FGD retrofit project -Eskom Battery Storage project -Botswana-South Africa Interconnector **Ongoing Operations** -Medupi power project -Xina solar one project -Eskom Holdings Ltd -Eskom II power projct
TRANSPORT (IntA)						
Maintenance, strategic expansion, operational efficiency, capacity and	The economy is constrained by inadequate investment and ineffective operation and	TBD	TBD	TBD	TBD	**Proposed Operations** -South Africa – Swazi Rail

ensuring of competitiveness of regional logistics and transport infrastructure.	maintenance of existing regional infrastructure	83.4 MT General Freight Transport volume capacity (2023)	101 additional locomotives	TBD	TBD	**Ongoing Operations** -Transnet expansion Corporate Loan II -Transnet Ltd
FACILITATION OF CROSS BORDER INVESTMENT AND TRADE (IntA)						
Deepen regional integration and trade, free movement of persons, business, labour and services across the region, and enhance cooperation	Limited FDI inflows; Tight foreign exchange controls; High cost of funds for South African Banks; Lack of knowledge of regional market;	Robust trade financing operation in Africa				**Proposed Operations:** -None
			20 more trade financing Issuing Banks in Africa supported Nedbank sub debt (Baseline 46 =2017)	Robust trade financing operation in Africa	20 more trade financing Issuing Banks in Africa supported by Nedbank sub debt (Baseline 46 =2017)	**Ongoing Operations:** - IDC Line of Credit III -DBSA LoC VI -Nedbank LoC -Nedbank sub debt

ANNEX 2a: INDICATIVE LENDING AND NON-LENDING PROGRAM 2018-2020

Year	Operation	Sector	Financing Sources (UA Million)							Co-financing
			ADB Public	ADB Private	AWF	CTF	AGTF	MIC Grant / Trust Funds	Total	
	A. Indicative Lending Pipeline									
	Pillar 1: Promoting Industrialization								**277.13**	
2018	Kathu Industrial Park	Industry		8.6						
2019	Gas to Ethanol	Industry		22.8						
2019	Dehydrated Vegetables	Industry		18.8						
2019	Lines of Credit to SMEs (through NHFC)	Finance		40						
2018	Support to commuter transport	Transport		36.93						
2019	Mokolo Crocodile Water Supply and Sanitation Phase II	Water	150							
	Pillar 2. Deepening Regional Integration								**587.5**	
2018	Eskom Battery Storage Project	Power	73							
2018	Medupi FGD Retrofit Project	Power	284							
2020	Botswana South Africa Interconnector (BOSA)	Power	50							
2018	Eskom Transmission Improvement Project	Power	162				18.5			AGTF
2019	Development of the PWV15 Freeway in Gauteng Province.	Transport	TBD							
	B. **C. Indicative Non-Lending Operations**								**4.8**	
2018	National Housing Finance Corporation	Finance						1		
2018	Study on effective delivery of SOE developmental mandate	Governance						1.2		
2019	Growth Diagnostic Study	ESW						1.2		
2019	Study on ICT services affordability benchmark	ICT						0.2		
2020	Promotion of private sector development to improve access to nutrition	Social						1.2		
	Total		**719**	**127.13**	**0**	**0**	**18.5**	**4.8**	**869.43**	

ANNEX 2b: CONTRIBUTION OF THE INDICATIVE LENDING AND NON-LENDING PROGRAM TO THE HIGH-5s

Year	Operation	Sector	Light Up and Power Africa	Feed Africa	Industrialise Africa	Integrate Africa	Improve Quality of Life for People of Africa
	D. Indicative Lending Pipeline						
	Pillar 1: Promoting Industrialization						
2018	Kathu Industrial Park	Industry			●		●
2019	Gas to Ethanol	Industry			●		●
2019	Dehydrated Vegetables	Industry		●	●		
2019	Lines of Credit to SMEs (through NHFC)	Finance			●		●
2018	Support to commuter transport	Transport			●		●
2018	Mokolo Crocodile Water Supply and Sanitation Phase II	Water			●	●	●
	Pillar 2. Deepening Regional Integration						
2018	Eskom Battery Storage Project	Power	●			●	●
2018	Medupi FGD Retrofit Project	Power	●			●	●
2020	Botswana South Africa Interconnector (BOSA)	Power	●			●	●
2018	Eskom Transmission Improvement Project	Power	●			●	●
2019	Development of the PWV15 Freeway in Gauteng Province.	Transport			●	●	●
	Indicative Non-Lending Operations						
2018	National Housing Finance Corporation	Finance			●		●
2018	Study on effective delivery of SOE developmental mandate	Governance					●
2019	Growth Diagnostic Study	ESW	●	●	●	●	●
2019	Study on ICT services affordability benchmark	ICT			●	●	●
2020	Promotion of private sector development to improve access to nutrition	Social		●	●		●

ANNEX 3: POLITICAL CONTEXT AND PROSPECTS

1. South Africa's constitution, adopted in 1996, established a society based on democratic values, social justice and fundamental human rights. The country has strong democratic systems and since the end of apartheid in 1994, it has conducted free and fair elections. The press continues to be robust and free and the opposition parties are active and enjoy full political freedom. The ruling party, the African National Congress (ANC) enjoys support from its historic coalition partners that include the Congress of South African Trade Unions (COSATU) and the South African Communist Party. The ANC conducted an election of the party leadership during its 54th national conference conducted on 16-20 December 2017 in Johannesburg in which the Deputy President, Cyril Ramaphosa was elected the new President of the ANC. The National Executive Committee (NEC) of the ruling ANC party recalled President Jacob Zuma as a head of state forcing his resignation one year ahead of the end of his term. Following his resignation, the new president of the ANC was elected the President of the Republic on 15 February 2018. The election of Cyril Ramaphosa, who campaigned on the ticket of fighting corruption and weak governance in public institutions, signalled an end to political uncertainty and ignited optimism among the civil society and businesses. His election was well received by the public and business confidence has improved, with the exchange rate of the rand having appreciated to a three year high. The President has vowed to turn around the SOEs weakened by maladministration and corruption. Even before being elected president of the Republic, in his capacity as the new ANC President, he took a swift action to replace the Board of Eskom with some of the finest individuals with acclaimed track record in fighting corruption. The new President has vowed to fight corruption in public as well as private institutions. This will not only unlock the potential of the SOEs as instruments of economic transformation but also enhance investor confidence and economic growth.

2. While South Africa boasts well-functioning democratic institutions that provide the framework for general adherence to transparency norms, the perception of corruption in public services remains relatively high. In the Transparency International's Corruption Perception Index, South Africa ranked 72nd (out of 177 countries), 67th, 61st 64th and 71st in the years from 2013 to 2017, respectively. The reversal of the upward trend observed from 2015 to 2017 was largely due to widespread allegations of misuse of public resources. South Africa similarly ranked high at 5th, 4th, 6th and 6th (out of 54 countries) in the Mo Ibrahim Index of African Governance in the years from 2013 to 2016. The downturn from rank 4th to 6th is mainly due to poorer performance in 'Safety and Rule of Law' and in 'Human Development', especially weaker education outcomes. Key governance challenges relate to corruption in procurement of public goods and services and lack of capacity at local government levels. The Auditor General's (AG's) 2017 audit report points out that very few district and metropolitan municipalities obtained clean audit opinions in 2015/16 fiscal year. A report released by the former Public Protector in 2016 on state capture alleges wide spread influence peddling by rich businesses who are connected to senior government officials. In addition, concerns have emerged regarding poor governance in key state-owned enterprises (SOEs).

ANNEX 4: ECONOMIC CONTEXT AND PROSPECTS

1. **South Africa's 'Dual Economy':** South Africa is an advanced upper Middle-Income Country (MIC) and its economy ranks 3rd in Africa, after Nigeria and Egypt. With a per capita income of USD 5,260 (2016), the country ranks 6th in sub-Saharan Africa but it continues to struggle with the challenges of a 'Dual Economy': high poverty, unemployment, income inequality and spatial socio-economic disparities. Overall, South Africa enjoys a well-developed, service-based economy. The country plays a dominant role in Southern Africa as the region's economic powerhouse, accounting for about 50% of the sub-region's output. South Africa has a significant footprint in the region in terms of FDI, utilities, telecommunications and retail services. Also, its growth momentum is intrinsically linked to that of the economies in the region, particularly those with which it shares membership in the Southern African Customs Union (SACU). However, the country still contends with the challenges of a 'Dual Economy' (Box A4.1), which features high poverty, unemployment, notably of the youth, income inequality and spatial socio-economic disparities as South Africa's major development challenges today. The 'first segment' of the country's economy is modern, productive, and exhibits world-class features, while the 'second segment' is largely informal, with low productivity and high unemployment. It is predominantly cash-based, serving mainly the poorest of the poor in townships, former homelands and poor rural areas (see Box A4.1).

Box A4.1: South Africa's Dual Economy

South Africa features a Dual Economy with a developed economy in major metropolitan areas coexisting with a developing economy in townships, informal settlements and poor rural areas. Due to this unique form of rural and urban economic duality, South Africa remains one of the most unequal countries in the world with disparities across race and gender. The country's Gini coefficient stood at 0.65 in 2016 – the highest in the world. Also, wealth distribution is highly skewed, with only 10% of the population holding 95% of wealth.

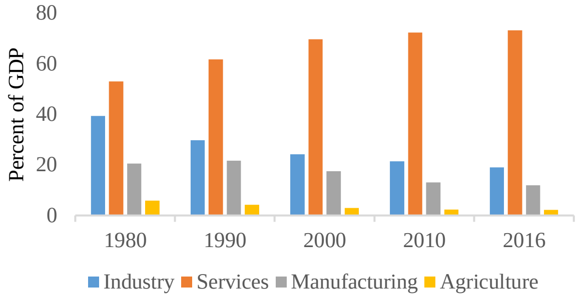
The 'first segment' of the economy is as sophisticated as the most advanced economies of Europe, North America or Eastern Asia, with world class banking and financial services, advanced social and economic infrastructure and superior IT networks. On the other hand, the 'second segment', i.e. townships and rural areas, are characterized by limited formal structures, and massive poverty and inequality. Poverty headcount increased from 53.2% in 2011 to 55.5% in 2015. Today, there are about 2,700 townships and informal settlements in South Africa. They are clustered across the country's 9 provinces, usually in close proximity to major urban centers and economic hubs. They account for about 38% of the country's working age population and about 60% of the country's unemployed. About 3m people live in informal settlements and 15.3m in townships, i.e. more than a third (35%) of the total population. Poverty is very high in townships and informal settlements, and access to economic and social services is severely limited.

The township economies are not only disconnected from rural areas, but also structurally unintegrated into the urban centres. Hence, they are neither urban nor rural. There is very little or no industrial production taking place in townships and informal settlements. Their share in high value added output generation is very low, with most of GDP generated in the developed metropolitan areas.

2. **Economic Structure and GDP Composition:** Its dual structure notwithstanding, South Africa's economy is well diversified, with a strong service sector as the main source of GDP. However, the economy has suffered from a longstanding process of de-industrialization over the past decades, which needs to be reversed to effectively tackle South Africa's major development challenges. South Africa's economy has undergone a major structural transformation during the past four decades (Fig. A4.1). The share of industry in GDP dropped from nearly 40% in 1980 to 19% in 2016, while that of services increased from 53% to 73% over the same period, reflecting the de-industrialization of the country's economy. Both the industry and the service sectors are located primarily in the large metropolitan areas, with very little industrial and service production taking place in townships and informal settlements, which is symptomatic for South Africa's 'Dual Economy'. The government has institutional

mechanisms and instruments to address rural economic duality in former homelands and subsistence rural areas. However, more focused overarching national institutional framework is required to address urban economic duality where high levels of poverty and unemployment persist in over 2700 townships and informal settlements.

Figure A4.1: Structural Change of the Economy 1980-2016



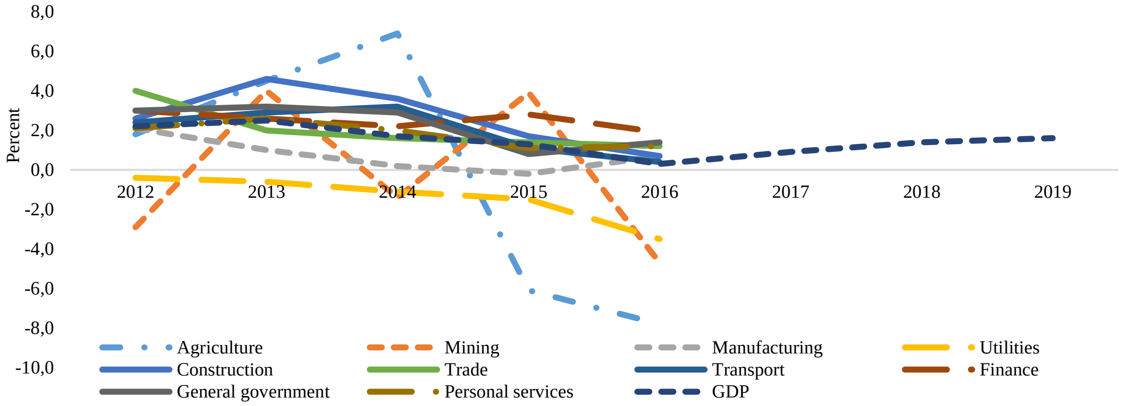
Source: South African Reserve Bank

3. As regards GDP composition, the Service sector, with 73% of GDP (2016), is South Africa's most important sector, reflecting the country's status as an advanced, service-based economy. Indeed, the sector is highly diversified and sophisticated with Finance, Real Estate and Business services being the largest sub-sector (accounting for 20.2% of GDP), followed by General Government services (17.3%); Trade, Catering and Accommodation (15.2%); Transport, Storage and Communication (10.1%); and Electricity and Water (4%); among others. The Industrial sector, with 19% of GDP (2016), contributes a comparatively small share to GDP, mainly comprising Manufacturing (12%) and Mining (7%). The Industrial sector has been shrinking over the past decades as mentioned above, but remains important in terms of export earnings[10]. It also remains relatively well diversified despite the decline and its rather modest share in GDP today, with a reasonably diverse spectrum of manufacturing sub-sectors, ranging from textiles, chemicals, machinery, metals and minerals to food and beverages and other sub-sectors[11]. The share of Manufacturing in GDP declined from 22% in 1990 to a meagre 12% in 2016. The share of manufacturing employment in total formal employment also declined, from about 20% to 12% over the same period. The main reasons for this continuous process of de-industrialization are increasing import competition from Southeast Asia, skills shortages on domestic labour markets, raising labour costs, increasing electricity prices and the withdrawal of subsidies and tariff protections. The Agriculture sector has also declined in relative importance over the last decades, yet not as strong as the Industry sector, and from a rather low base, i.e. from 5.8% of GDP in 1980 to 2.4% in 2016. South Africa's economy was ranked 64th out of 124 countries in Harvard's Economic Complexity Index[12] in 2015 (in comparison to Indonesia: 62nd; Vietnam: 67th; and Argentina: 69th), as the economy displays a medium level of complexity, mainly due to a reasonably well diversified manufacturing sector.

4. **Recent Growth Performance and Growth Drivers:** South Africa's growth trajectory has been on an overall downward trend in recent years, with the real GDP growth rate declining from a moderate 3.3% in 2011 to a meagre 0.6% in 2016. However, real GDP growth has improved in 2017 reaching 1.3%. The key drivers of the improved growth in 2017 are the finance sector, which grew by 1.9%, the agriculture sector, which grew by 17.7% and the mining sector, which grew by 4.6%. Slower growth in recent years reflects slower growth of the industrial sector, as manufacturing sector output growth dropped from 3% in 2011 to 0.7% in 2016 (Fig. A4.2), while that of mining further contracted from -0.7% to -4.7% over the same period. Output growth also slowed down in the services sector, with the main sub-sector of finance, real estate and business services sub-sector slowing down from 4.3% in 2011 to 1.9% in 2016. The continued slowdown of growth in recent years is mainly due to the fall in global commodity prices (notably of gold, platinum group metals, iron ore and coal) and the economic slowdown in China, which is South Africa's largest trading partner. Domestic factors also contributed to the economic downturn, as infrastructure bottlenecks in power have constrained production and investment until 2015. In addition, labour relations remained strained amid large skills gaps. Furthermore, increasing policy uncertainty around new laws on mining has

eroded business confidence, as evidenced by the continued contraction in private sector real gross fixed investment, which contracted by 0.5% and 6% in 2015 and 2016, respectively. However, following recent political developments, business confidence has improved. As the new government implements reforms to address policy uncertainty, further improvements in business confidence are expected. This is expected to boost private sector investment and growth.

Figure A4.2: Real GDP and Sector Growth (percent)



Source: Statistics South Africa

5. **Total factor productivity as a main driver of growth:** a decomposition of South Africa's growth for the period 1994-2016 shows that total factor productivity (TFP) was the dominant source of growth in South Africa in the first decade of democracy and marginally higher contributor to growth in the entire post-apartheid period (see Table A4.1). On average, the TFP contributed 1.5 percentage points to growth in the entire post-apartheid period compared to 0.9 and 0.3 percentage points by capital and labour respectively. However, since 2006, capital has become a key driver of growth due to increased level of its deepening.

Table A4.1: Sources of Growth in South Africa, 1994-2016

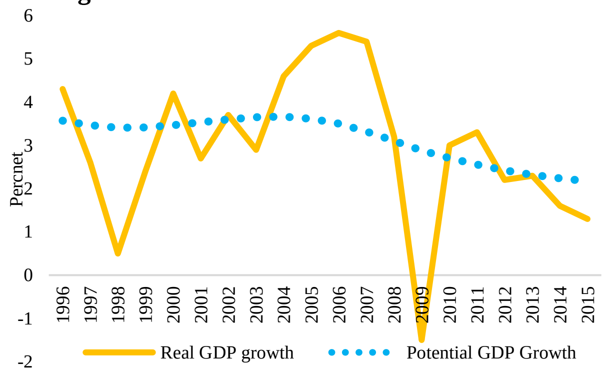
	1996-2000	2001-2005	2006-2010	2011-2016	1996-2016
Real GDP growth (%)	2.7	3.7	3.0	1.8	2.8
Real GDP per capita growth (%)	0.7	2.0	1.8	0.5	1.2
Factor growth rates (%)					
Capital	0.9	1.1	3.1	2.5	1.9
Labour	-0.5	1.1	0.8	0.8	0.5
Total factor productivity	2.5	2.6	1.1	0.2	1.5
Growth decomposition (percentage points)					
Capital	0.4	0.5	1.5	1.2	0.9
Labour	-0.2	0.6	0.4	0.4	0.3
Total factor productivity	2.5	2.6	1.1	0.2	1.5

Source: Own computations from South African Reserve Bank and Statistics South Africa data.

6. The key driver of TFP gains in South Africa in the first decade of post 1994 period was the democratic transition that transformed the political system, ending decades of international isolation and leading to trade liberalization. Improved macroeconomic policies, reforms and strong institutions led to rapid gains in TFP and in efficiency in the following decade. Yet growth in TFP has lost momentum in recent years due to structural constraints, in particular severe skills shortages, infrastructure deficit and weak domestic competition. The marginal contribution of labour to growth is consistent with slow rise in employment and increasing levels of unemployment while capital intensity continues to rise. Because TFP was the dominant source of economic growth in South Africa for the post-apartheid period, increasing TFP growth through investment in human capital, infrastructure, as well as improved trade openness, fostering competition will remain crucial to enhance economic growth.

7. **South Africa's annual potential output growth increased marginally** between 1996 and 2004, edging up from 3.5% to 3.7%, but declined persistently from 3.5% in 2006 to 2.1% in 2015 (Figure A4.3). The main cause of falling potential output growth since 2004 is the decline in total factor productivity growth and efficiency. In the immediate post-apartheid years, the economy overheated and grew above potential (inflationary growth triggered by excess demand), generating a positive output gap, but as potential growth increased marginally in the first decade after 1994, the output gap remained largely negative, and the economy continued to grow below potential. In the second decade of democracy, in particular after the global financial crisis, actual and potential growth continued to decline and the negative output gap continued to narrow. For instance, the annual negative output gap declined from about 2% of potential output in 2004 to 0.4% in 2014.

Figure A4.3: Annual Actual and Potential



Source: Own Computations from SA Reserve Bank data

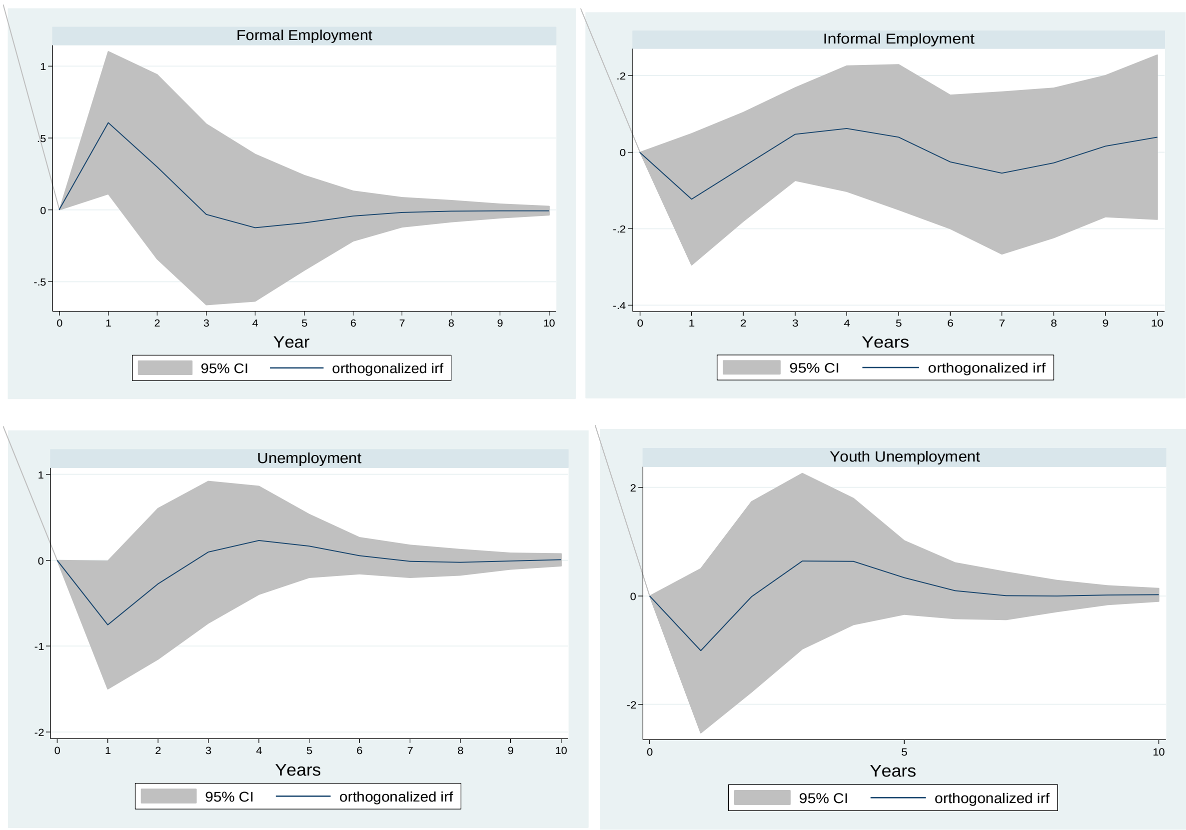
8. **Growth-Employment-Inequality Nexus in South Africa: Jobless growth?** Although South Africa has experienced sustained economic progress post-apartheid, this growth has not been inclusive and the relationship between growth and (un)employment is relatively weak. Using data from World Development Indicators (1994-2016), we estimate the effect of real GDP growth on (un)employment using a Structural Vector Autoregressive (SVAR) model of the form:

$$x_t^i = a + \sum_{j=0}^{2} \delta_j gGDP_{t-j} + \sum_{j=1}^{2} \gamma_j x_{t-j}^i + \varepsilon_t$$

$$gGDP_t = b_0 + \sum_{j=0}^{2} \varphi_j x_{t-j}^i + \sum_{j=1}^{2} \beta_j gGDP_{t-j} + v_t$$

where x_t^i denotes formal employment, informal employment, unemployment and youth unemployment. The impulse response functions (IRFs) of employment to shocks from real GDP growth are presented in the figures below. A one percent shock on growth has a minimal contemporaneous effect on formal employment. The path of the shock is positive, increasing by 0.5 percent in the first year of the shock but returns to the long-run path after three years. This is can be explained for instance by increased casual employment following increased public investments that follows improved growth. Public works are normally more labor intensive in the first year, after which contractors reduce the number of workers they engage. After the completion of the public investment projects in the third year, casual laborers are terminated and employment falls to the original path. As more capital intensive methods of production are employed with increased economic growth, more youths are made redundant increasing youth unemployment as shown in the figure below. Consequently, informal employment rises after the end of the first year and stays above the original long run path, increasing by about 0.1 percent in response to real GDP growth shocks in the subsequent years (see Figure A4.4). It is noteworthy in the figures below, that informal employment first falls by about 0.1 percent in the first year as more casual workers are absorbed into the labor-intensive public projects, but this is temporary as informal employment starts rising again. Both overall and youth unemployment increases after the fall in the first year and stays marginally above the initial path for the rest of the period. This effect of growth on employment can be attributed the capital-intensive nature of South Africa's growth.

Figure A4.4: Response of (informal) Employment and (Youth) unemployment to Shocks on real GDP Growth



Source: World Development Indicators (1994-2016)

9. To gain further insights into sectoral employment trends, we use the same data as above to estimate the effect of real growth in GDP on employment by gender (i) and by sector (j) using a pooled Ordinary Least Square (OLS) estimation technique. These sectors are the agriculture, industry and services sector and the regressions estimated are presented below

$$lnEmploy_t^j = \alpha_0^j + \alpha_1^j lnGDP_t + f^j + f_t + \varepsilon_t^j$$

$$lnEmploy_t^i = \alpha_0^i + \alpha_1^i lnGDP_t + f_t + v_t^j$$

where $lnEmploy_t^j$ denotes employment in sector j at time t as a percentage of total employment, $lnGDP$ denotes the rate of growth of real GDP, f^j and f_t are sector-fixed effects and time effects and $lnEmploy_t^i$ is employment of gender i as a percentage of total employment. The results shown in the Table A4.2 below indicate that although female employment is more responsive to growth, female workers are also more exposed to unemployment than their male counterparts. In addition, unemployment is more responsive to economic downturns among male youths than their female counterparts, possibly because more male youths are employed in public works as casual laborers and are easily laid-off during periods of economic slowdown than the female youth. Finally, whereas the vulnerability of male workers declines with growth, female workers become more vulnerable with increased growth.

Table A4.2: Elasticities of (un)employment, self and vulnerable employment with respect to real GDP growth

	Male	Female	All		Agriculture	Service	Industry
Employment	**.015**	**.025**	**.018**		**.024**	**.007**	**- .021**
Unemployment	**-.044**	**-.055**	**-.0497**				
Youth Unemployment	**-.038**	**-.028**	**-.033**				
Informal Employment	**-.024**	**.008**	**-.008**				
Vulnerable employment	**-.004**	**.133**	**.066**				

Note: An elasticity greater 1 indicates that employment grew faster than GDP while elasticity less than 1 indicates that GDP grew faster than employment. In all the cases, employment growth was slower than GDP growth.

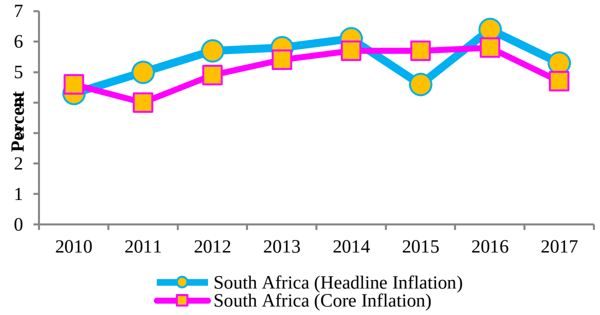
10. **<u>Policies to enhance employment-creating growth and how the AfDB can help:</u>** As the analysis above shows, youths are mainly affected by growth slowdowns and growth improvements. Policy interventions aimed at tackling unemployment in South Africa must therefore intentionally target the youth. Some of the possible areas of policy emphasis should be targeting youth in procurement contracts, beefing up youth funds to accelerate youth entrepreneurship particularly in light industries, helping the youth access regional markets and easily cross border constraints that prevent regional trade that may benefit the youth. There is also need to improve skills of the youth in sectors that are specific to manufacturing. Necessary collaboration with TVET colleges and the private sector such as the National Tooling Initiative Programme that are already initiated by the Metals Engineering sector should be encouraged and appropriated resourced. The Bank has been involved and continues to be involved in improving youths' readiness for the job market in South Africa through support to skills improvement in the manufacturing and light industries and financing of SMEs through lines of credit to private credit providers with specific loan requirements to target the youth and women. The Bank is focusing on deepening regional integration and industrialization in this CSP and will be deliberate with programees that support youth cross border trade activities and involvement in light manufacturing.

11. **<u>Growth Prospects:</u>** Medium term growth forecast has been upgraded by the AfDB to 1.5% in 2018 and South African Reserve Bank to 1.5% in 2019. The positive outlook is attributed to expected better performance of the agricultural sector and expectations of sustained boost in business and investor confidence following positive political developments since end of 2017. In addition, real fixed capital formation by the private sector expanded by 3% and 4.1% in the first and third quarter of 2017 respectively after having declined for more than four previous consecutive quarters. Growth prospects are also driven by a positive and sustained global growth outlook, more favourable weather conditions and higher agricultural output, more reliable energy supply, improved labour relations, and rising commodity prices. It should be noted that the country is currently facing severe drought in parts of Western Cape, Eastern Cape and Northern Cape provinces. However, weather conditions have been favourable in most parts of the country since end of 2016. Due to good rainfall, agriculture output increased by 17.7% in 2017 and was the main driver of growth. Adequate rainfall is expected for most parts of the country in 2018. Standard and Poor's downgraded South Africa's long term local currency credit ratings to a sub investment grade, i.e. BB+ from BBB- on 24 November 2017. It also downgraded the country's long-term foreign currency sovereign credit rating two steps below a sub investment grade, i.e. to BB from BB+. The agency affirmed positive outlook for both local and foreign currency credit ratings. South Africa is now fully downgraded to a sub investment grade by two ratings agencies, S&P and Fitch. However, as Moody's maintains South Africa's sovereign credit rating at investment grade, South Africa will not be removed from the World Government Bond Index, thus making higher levels of capital outflows unlikely.

ANNEX 5: MACROECONOMIC MANAGMENT

1. **Macroeconomic Management:** With regard to monetary policy, an overall tight stance since 2014 ensured that inflation remained largely within the Central Bank's monetary policy target range of 3-6%. Driven mainly by higher food prices, headline consumer price inflation increased slowly but continuously from 5% in 2011 to 6.4% in 2016 (Fig. A5.1), which is just above the upper limit of the 6% monetary policy target range. Inflation however fell to 5.3% in 2017 on the back of lower food prices. To subdue inflationary pressures, the Central Bank progressively increased the Repo rate from 5.0% in 2013 (end-period) to 7% in 2016 but has since reduced it to 6.75% in July 2017 and 6.5% in March 2018 as a result of falling food prices, subdued domestic demand and declining international oil prices. Growth in private sector credit decelerated, from 8.6% in January 2013 to 6.4% in November 2017, mainly due to subdued investor confidence, as well as high interest rates. The nominal exchange rate of the Rand depreciated by 86% against the USD between January 2013 and January 2016, due to the decline in commodity prices. However, this downward trend reversed in January 2016 when the Rand appreciated by nearly 20% up to December 2017, primarily as a result of higher export prices of South Africa's main export items.

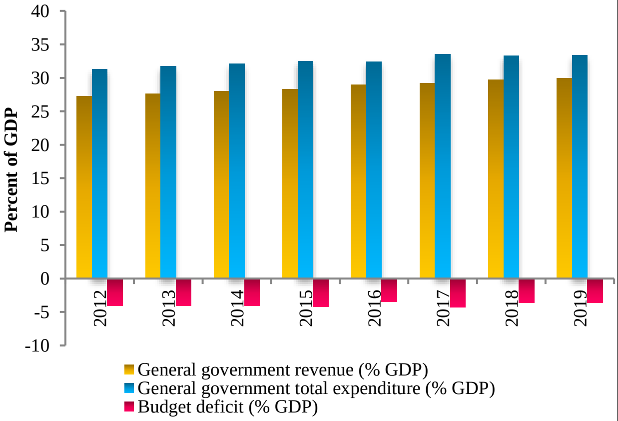
Figure A5.1: Inflation
(Average Consumer Prices)



Source: Statistics South Africa

2. With regard to fiscal policy, the Government managed to keep the overall deficit within a range of 4-4.5% of GDP in recent years, with spending and revenue levels remaining largely unchanged (as a percentage of GDP), reflecting fiscal discipline. Expenditure and revenues oscillated around 31-32% and 27-29% of GDP respectively since 2012, resulting in overall fiscal deficits between 3.5-4.5%. The deficit slightly narrowed to 3.4% in FY 2016/17 from 4.1% in the previous FY, given a slight increase in revenue (see tax measures below), while the expenditure level remained relatively unchanged (see Figure A5.2). A closer look at the type of expenditure (FY 2015/16) reveals that most of public spending is for current expenditure (86%), most of which for wages and salaries, while capital expenditure (most of which for infrastructure, notably transport and logistics; energy; and water and sanitation) amounts to a modest 12% of total expenditure, calling for a scale-up of capital spending. On the revenue side, taxes are the dominant source of revenue, accounting for 99% of total revenue, with a comparatively healthy 26% of GDP. In 2018, the government introduced new tax policies including the increase in the Value Added Tax (VAT) from 14% to 15% on 1 April 2018. Government has exempted taxes on basic food items to reduce the burden on the poor. The government also increased the general fuel levy and tobacco and alcohol excise duties which will collectively generate revenue of about R2.6 billion. The government will also implement from 1 April 2018 environmental taxes such as

Figure A5.2. Fiscal Balance, 2012-19

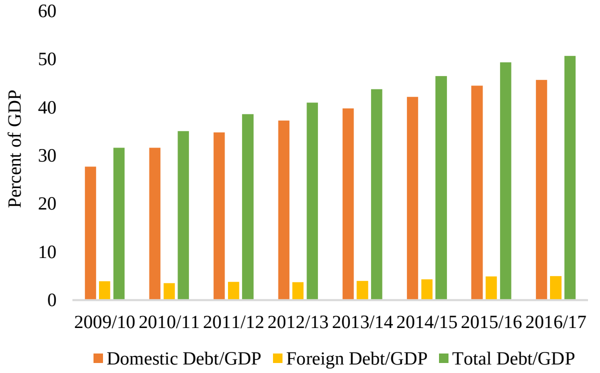


Source: National Treasury

motor vehicle emissions tax, plastic bag levy, and the levy on incandescent light bulbs, as well as a health promotion levy, which taxes sugary drinks. The fiscal deficit will remain at the same level reaching 3.6% of GDP in both 2018/19 and 2019/20 FYs.

3. **Public Debt:** While South Africa's total public debt has been increasing steadily in recent years, from 39% of GDP in FY 2011/12 to 51% in FY 2016/17, public debt is still sustainable. The increase in public debt in recent years (Fig. A5.3) was primarily due to an increase in public *domestic* debt (from 35% of GDP in FY 2011/12 to 46% in FY 2016/17). Public *external* debt also increased during that period, but only marginally and from a very low base, i.e. from 3.8% of GDP in FY 2011/12 to 5% in FY 2016/17. However, the 2017 Medium Term Budget Policy Statement (MTBPS) released in October 2017 highlighted that a sharp deterioration in revenue collection and further downward revisions to economic growth projections have significantly eroded Government's fiscal position. Tax revenue is projected to fall short of the 2017 Budget estimate by R51 billion in the current year, the largest under-collection since the 2009 recession. As a result, total public debt is projected to reach over 60% of GDP by 2022, with debt service reaching 15% of budget revenue by 2020/21. The latest WB/IMF Debt Sustainability Analysis undertaken in 2017 concluded that South Africa's public debt-to-GDP ratio is sustainable in the baseline scenario with growth rate of 2.2%, but sensitive to shocks and would increase to 71% by 2022 if growth was 1% lower than the baseline. It is, therefore, imperative that the Government implement a policy-mix to boost economic growth.

FigureA5.3: Trends in Public Domestic and Foreign Debt / GDP Ratios 2009/10-2016/17



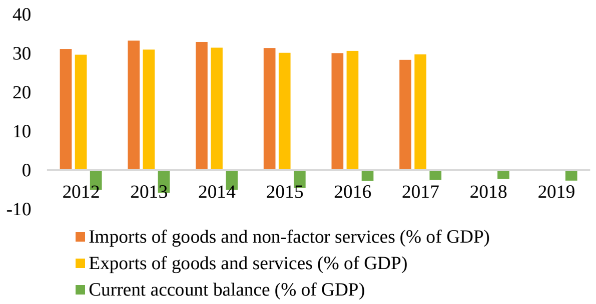
Source: National Treasury

4. **Financial Governance/PFM: South Africa's financial governance/PFM systems are robust, but challenges remain at decentralized levels and State Owned Enterprises.** The latest Public Expenditure and Financial Accountability Assessment (PEFA) completed in 2014 indicates that South Africa has generally sound PFM systems at the national level and commends the country's impressive record of fiscal discipline. However, the PEFA also found that there is room for improvement, specifically at the municipal and provincial governments, given unfavorable audit reports from the Office of the Auditor General (AG) in recent years. The main problem identified by the AG include high levels of irregular, wasteful and unauthorized expenditures. These challenges are not confined to municipal and provincial public institutions but also occur in SOEs. This includes Eskom, South Africa's electricity public utility, which is supported by the Bank. Specifically, the main allegations against Eskom were irregularities in the awarding of contracts to Tegeta Exploration and Resources owned by an influential business family, as well as irregularities in contracts awarded by Eskom to Optimum Coal Mine to supply coal for electricity generation. Government has embarked on a program to reform SOEs to address the governance issues and to increase their efficiency and profitability. As regards the Bank's CPIA, South Africa has been consistently ranked first in the continent in the assessments since inception.

5. **Current Account Balance:** The current account deficit improved continuously in recent years, from -5.9% of GDP in 2013 to -2.5% in 2017 (Figure A5.4), reflecting a decline in imports. The current account deficit was financed mainly by non-FDI flows. Exports (of goods and services) showed a marginal decline in recent years, from 30.9% of GDP in 2013 to 29.8% in 2017, while imports decreased faster relative to exports over the same period, i.e. from 33.3% of GDP to 28.4% in the same period. The decline in imports was primarily due to weaker

domestic demand for goods and depreciating Rand. The current account deficit was financed mainly by non-FDI flows, notably portfolio investment, which increased from 3.0% of GDP in 2013 to 5.9% in 2016, while FDI flows decreased from 0.5% of GDP to -0.4% over the same period, reflecting persistent economic and political uncertainty. In the longer-term retrospective, South Africa's imports and exports increased from 17% and 21% of GDP respectively in the early 1990s to about 30% in 2016 for both imports and exports, which demonstrates that the country's trade linkages have steadily increased over the past decades. Today, South Africa is the 36th largest export economy in the world. Key destinations in 2016 were Asia (30% of total exports); Africa (29%); Europe (24.6%); and America (9%). The Southern Africa Development Community (SADC) alone accounts for about 27% of South Africa's export market. In contrast, imports from SADC (and actually Africa as a whole) accounted for less than 10% of South Africa's total imports, translating into a strong trade surplus with the other countries of the southern African region. About 30% of total imports are from Europe, followed by Asia with about 25%.

Figure A5.4: Current Account Balance
(% of GDP)

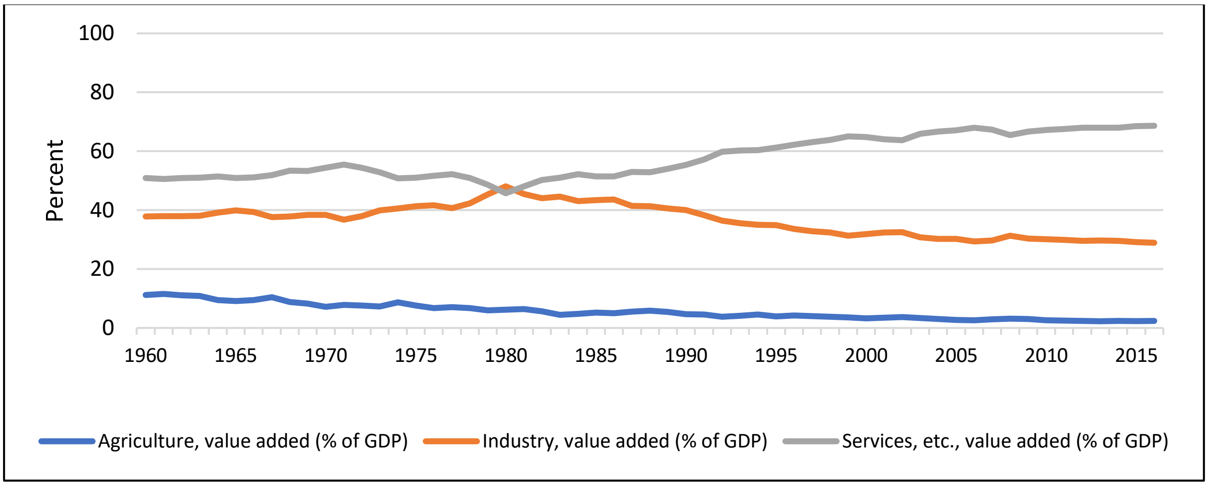


Source: South African Reserve Bank

ANNEX 6: POTENTIAL FOR RE-INDUSTRIALIZATION

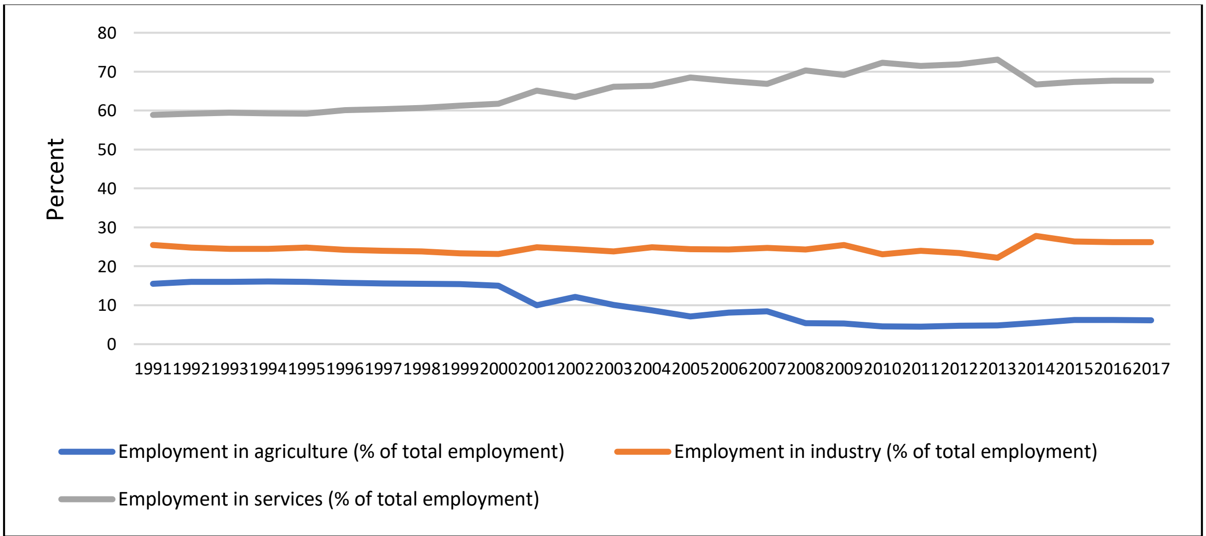
1. **Stemming persistent de-industrialization:** South Africa's deindustrialization started in 1980 when the South African economy underwent structural changes. The structural shift manifests itself in the visible decline of the share of the industry sector and the rise in the share of the service sector as a percentage GDP. As shown in Figure A6.1 below, the share of value added in industry as a percentage of GDP has persistently declined from 40% in 1980 to 19% in 2015 (2016). In the same period, the share of service has progressively increased from 53% to 73% of GDP.

Figure A6.1: Sectoral Decomposition as a percentage of GDP



As can be seen in Figure A6.2, employment opportunities in the industrial and agricultural sectors have been declining over the years while the share of the service sector has been consistently increasing over the years.

Figure A6.2: Sectoral Employment shares in South Africa



2. **Recent government policies to support industrialization in South Africa:** Supporting industrial development has been an integral component of South Africa's government modus operandi to economic development. The country's industrial policies can be broadly divided into three phases: the pre-1994, 1994-2007 and post-2007 eras. Import Substitution using State-owned enterprises, ring-fenced by extensive tariff and non-tariff trade restrictions, has been the distinctive feature of South Africa's pre-1994 industrial approach to support industrialization. A state-owned development bank, the Industrial Development Corporation (IDC), was

established to solely promote industrial financing. Mining and mining-related industrialization, dominated by a capital-intensive "minerals energy complex", was stimulated by the discovery of precious minerals – particularly gold – in the late nineteenth century. The "upstream" processing of mineral- and other natural resource-based commodities, using low-priced electricity from cheap coal, fueled the development of a range of capital- and electricity-intensive industries that processed minerals and other primary resources into semi-processed commodities. However, the absence of the impetus to develop the more labor-intensive and value adding "downstream" manufacturing sectors, contributed in making South Africa's industrialization less competitive internationally during apartheid-era. After the transition to a democratic government in 1994, priority was given to intensify Washington Consensus-type reforms in order to liberalize key markets. The rationale was that this industrial policy shift would lead to more efficient allocation of capital and thereby increasing investment, growth and employment rates as part of the 1996 Growth, Employment and Redistribution (GEAR) strategy. However, not much has been realized in industrial development, growth and employment following these reforms. Consequently, in 2007, the government of South Africa lunched the National Industrial Policy Framework (NIPF) and its first implementation blueprint, the Industrial Policy Action Plan (IPAP). This was a structural-based approach that takes into account structural constraints such as infrastructure bottlenecks, limited capital formation and industrial financing. The objectives of the NIPF are to facilitate diversification beyond current reliance on traditional commodities and non-tradable services, long-term intensification of South Africa's industrialization process and movement towards a knowledge economy, promotion of a more broad-based and labor-absorbing industrialization path, and contributing to industrial development on the African continent with a strong emphasis on building its productive capabilities.

3. **South Africa's Industrial Policy Action Plan (IPAP) is underpinned by six pillars:** (1) **Industrial Financing:** This pillar aims to improve access to finance by manufacturing enterprises. As opposed to services, the manufacturing sector is constrained by limited access to finance. The DTI provides financial incentives to manufacturers; (2) Public procurement: The government uses public procurement to promote local manufacturing of key products. In this regard, 23 products/sectors have been designated by DTI for local production; (3) Special Economic Zones: The government has developed several Special Economic Zones (8 new and 5 old) to attract investment in mostly rural and underdeveloped regions which are outside of Gauteng, KwaZulu Natal and Western Cape, the three most developed provinces. The role of the government in SEZs is to provide infrastructure to encourage private sector investment; (4) Innovation and technology: The role of the DTI under this pillar is to foster commercialisation of innovations and new technologies by firms; (5) African industrial development (Regional integration through industry): The DTI aims to promote investment led regional integration where concrete industrial projects that promote integration among the regional member countries are supported. This aims to foster regional investment, trade and industrial development integration; industrial knowledge repository, value chains research, and cross border industrial projects, among others; (6) Developmental trade policy: Under this pillar the DTI works to address tariff and NTBs to trade and investment across the region. It supports standardization of products, address tariff and other NTBs hindering cross border trade. It also involves technical infrastructure realignment and developmental tariff reform.

4. **Constraints to Industrialization in South Africa:** South Africa's reindustrialization faces several key shortcomings. These are: (1) Weak policy and program coordination in government: The various government entities conduct their programs in uncoordinated manner. This limits the impact of policies and programs on industrial development; (2) Legislative and regulatory delays and burdens: There are so many legislative and regulatory requirements to make investments in the manufacturing sector. These include for instance,

environmental and social regulations; Home Affairs; Customs and taxation; Licensing; and Electricity which take a long time for an investor to acquire or comply with. To address this challenge, the government (DTI) has recently launched One Stop Investment Shops. Three such shops have been established since 2016, one each in Pretoria, Durban and Cape Town. The Shops offer a variety of services to those interested in conducting business in South Africa. In addition to the regulatory requirements to establish factories, there are regulations that hinder the expansion of the sector. For instance, the regulation of prices of key inputs such as electricity and petrol has negative impacts on growth of the sector; (3) Concentration of manufacturing firms: Manufacturing firms are dominated by few large firms and entry to the market is limited. The Competition Commission is working hard to address the uncompetitive behavior in this and other sectors; (4) Logistics constraints: South African manufacturing exporters face high logistics costs; especially port tariff is very high. DTI is currently negotiating with Transnet to lower port tariffs; (5) Lack of infrastructure: South Africa has been scrambling to build infrastructure in recent years but infrastructure has been neglected for several years (e.g. electricity) which negatively affected the sector performance; (6) Lack of skills: The education system is not producing the skills needed by the manufacturing sector. In recent years, sector specific skills development programs have been launched in collaboration with the TVET colleges and the private sector such as the National Tooling Initiative Program initiated by the Metals Engineering sector; (7) Fiscal constraint: The government is facing revenue shortfalls, which is making it difficult to provide financial incentives to the needy manufacturers. In addition, manufacturing firms face challenges to access credit (8) Limited demand: High unemployment (28%) limits the demand for manufactured goods which in turn hinders investment and growth in the sector. In addition, exchange rate volatility can reduce firm's incentive to invest in risky assets such as factories thereby reducing growth of the manufacturing sector.

5. **Strong Potential to Re-Industrialize:** South Africa has a high potential to re-industrialize if the right policy decisions are made. According to SA's IPAP 2017-20 potentials for reindustrialization exist in 13 sectors: (1) Automotive; (2) Clothing, textiles leather and footwear; (3) Metal fabrication, capital and rail transport equipment; (4) Agro processing; (5) Forestry, timber, paper, pulp and furniture; (6) Plastics; (7) Chemicals, pharmaceuticals and cosmetics; (8) Primary mineral beneficiation; (9) Green industries; (10) Water and sanitation; (11) Marine manufacturing and associated services; (12) Electro-technical and white goods industries; and (13) Aerospace and defense. Sectors identified as priority for maximum and growth and employment impacts are the following: (1) Agro-processing; (2) Clothing, textiles leather and footwear; (3) component manufacturing and fuel cells under Automotive and (4) Forestry, timber, paper, pulp and furniture. Primary mineral beneficiation is also one of the 13 priority sectors for industrialization. Although the mining sector contributes about 8% to GDP, it contributes over 25% in export earnings and remains avital sector for economic growth and recovery. Spatially, these priority sectors are located across the country in and around major urban centres but none of them are found in townships. This is because the townships do not have access to adequate infrastructure: energy, transport, and logistics; ICT; water supply and so on. There are existing Industrial Parks in Townships that have stopped functioning since 1994 because of lack of upgrading and maintenance of the infrastructure. The AfDB is supporting a feasibility study on the revitalization of a few of these Industrial Parks in townships through a MIC grant to the Department of Trade and Industry (DTI). The government is keen to revitalize these parks to assist SME from Townships to invest in them. In addition, in line with the amended Preferential Procurement Policy Framework Act (PPPFA), between 2011 and 2017, the Department of Trade and Industry designated 23 sectors/products for local production. Of these 23 sectors/products, 4 sectors/products namely, Power pylons and Substation Structures; Textiles, Clothing, Leather and Footwear; Wheelie Bins; and Steel Products and Components for Construction are 100% to be produced locally.

The local content threshold for the remaining sectors/products vary from 10% - 90%. The 23 sectors/products designated for local production are selected from these 13 priority sectors. Clothing, textiles leather and footwear sector is fully designated for local production while only selected products were chosen from the other 12 sectors.

6. **South Africa's re-industrialization requires a well-tailored policy mix**, consisting of measures to further improve the general business environment, notably through infrastructure development, but also spatially balanced, targeted support at micro-economic level to specific industries with the potential for competitive advantage and higher-value added job creation. This needs to be accompanied by skills development, for example for artisanal activities, but in particular in high-technology areas with significant value added. Deeper regional integration and the removal of barriers to trade to improve access to markets and consumers in the region as well as beyond would further improve the environment for re-industrialization. More importantly, the government must address the 8 key challenges hindering the expansion of the manufacturing sector discussed in paragraph 9 above. At the same time, the connectivity between the underdeveloped Townships/rural areas with the highly developed metropolitan areas needs to be strengthened, by facilitating the mobility of the workforce, promoting backward and forward linkages, and improving access to markets – a clear call for a combination of domestic and regional infrastructure investments. Given the saturated growth potential of South Africa's formal advanced urban economy, faster economic growth must largely come from the less-developed township economy (together with a recovery of the rural sector). Therefore, South Africa's economic policy agenda will involve a big push to better integrate its township economy with its advanced economy, to allow it to catch up in terms of income and productivity levels and other measures of economic development.

7. **Opportunities exist to catapult South Africa to the Fourth Industrial Revolution:** Despite these recent initiatives, which undoubtedly will improve South Africa's industrial progress, more needs to be done to diversify the market for manufactured goods away from the poor performing domestic market to target more non-traditional markets in the region and globally. Measures to deepen regional integration are therefore paramount to hasten the pace of industrial development. Further, South Africa needs to take advantage of technological revolution sweeping across the African continent to be at the forefront of the Fourth Industrial Revolution. Technological innovation for instance has a great potential to unlock the high unemployment rate in South Africa by boosting manufacturing. To get a glimpse of the impacts of innovation on industrial development in South Africa, we estimate the Autoregressive Lags Distributed (ARDL) models below, using data on the number of mobile cellular subscriptions in South Africa as a measure of innovation.

$$\begin{aligned}\Delta\, Manufacturing_t &= b_0 + \sum_{j=1}^{p} \delta_j\, \Delta\, Manufacturing_{t-j} + \sum_{j=0}^{p} \gamma_j\, \Delta\, Innovation_{t-j} \\ &+ \sum_{j=0}^{p} \beta_j\, \Delta\, gGDP_{t-j} + \varepsilon_t\end{aligned}$$

$$\begin{aligned}\Delta\, Employment_t &= a_0 + \sum_{j=1}^{p} \rho_j\, \Delta\, Employment_{t-j} + \sum_{j=0}^{p} \varphi_j\, \Delta\, Innovation_{t-j} \\ &+ \sum_{j=0}^{p} \vartheta_j\, \Delta\, gGDP_{t-j} + \epsilon_t\end{aligned}$$

where $Manufacturing_t$ denotes the manufacturing value added at time t, $Innovation_t$ measures innovation using the number of mobile cellular subscriptions, $\ln gGDP_t$ denotes the real GDP growth rates and $Employment_t$ is the share of jobs in the industry sector as a fraction of total employment. The results shown in Table A6.1 below summarizes the short-run, long-run and the dynamic relationships between innovation, manufacturing and jobs.

The result shows that the amount of value added in the manufacturing sectors increases significantly as a result of technological innovations in the long-run. The impact of innovation is not significant in the short run, understandably because of the long gestation period of manufacturing projects following the introduction of any innovation in the sector.

Table A6.1: Growth effect of a percentage change in mobile subscription on Manufacturing in South Africa.

D.rmanu	Coef.	Std. Err.	t	P>|t|	[95% Conf.	Interval]
ADJ						
rmanu						
L1.	-.3172053	.0824538	-3.85	0.001	-.4911677	-.1432429
LR						
mobile	254.4025	23.11353	11.01	0.000	205.6373	303.1678
ggdp	2.92e+09	8.47e+08	3.45	0.003	1.13e+09	4.71e+09
SR						
mobile						
D1.	-81.1162	43.93229	-1.85	0.082	-173.8052	11.57283
_cons	1.09e+10	2.96e+09	3.67	0.002	4.61e+09	1.71e+10

8. **Entry points for the AfDB in support of South Africa's industrialization:** The results above showing that technological innovation has the potential to catapult South Africa into the fourth industrial revolution are important because they point to one of the areas where industrial policies should focus – nurturing technological innovation for industrial development. Regulatory bottlenecks that prevent the penetration of recent technological breakthrough including mobile phone payment systems should be reviewed. The Bank is ready to partner with the South African government through technical assistance to review some of these regulatory constraints. Further, development of regional infrastructure should remain a policy focus in order to reduce constraints to regional investments and integration beyond the traditional regional markets and the Bank is ready to be a partner in the development of necessary regional infrastructure. The pace of review of trade and non-trade barriers and standardization of products that are hindering cross border trade and investments should be hastened to expand market to South Africa's industrial products. The Bank is ready to support in the review of these procedures as necessary. The Bank has also been supportive of the private sector in the past through guarantees that has helped de-risk investments and this has provided a good opportunity for private investments focusing on the manufacturing sector to feel that their investments are safe. The Bank intends to continue with its support to South Africa's private sector particularly in the manufacturing sector through a diversity of risk-mitigation instruments to reduce their risk exposure. Furthermore, the Bank will continue to lend to financial institutions with clear targets for the on-lending to light manufacturing sub-sector to support their growth. Priority will be given to light manufacturing that are labor-intensive to ensure that not only the Bank support improves the pace of industrialization in South Africa, but also helps reduce unemployment simultaneously. Bank already supports light manufacturing by small enterprises within some communities in South Africa through the Enterprise Development Pilot Project implemented by the Department of Trade and Industry (DTI), which is setting up specialized industrial facilities in pilot TVET colleges. The Bank is also keen to support the revival of industrial parks and is already financing a feasibility study on the revitalization of a few industrial parks in townships through a middle-income-country (MIC) grant to the DTI.

ANNEX 7: REGIONAL INTEGRATION AND INCLUSIVE GROWTH

1. South Africa is a main champion and driver of regional integration in Southern Africa. South Africa actively participates in various regional initiatives such as the Tripartite Free Trade Area (TFTA), and the Continental Free Trade Area (CFTA) process under the Africa Union's Agenda 2063. The country also participates in bilateral agreements such as the African Growth and Opportunity Act (AGOA), and the European Union/SADC Economic Partnership Agreement, which South Africa and five other Southern African States (Botswana, Lesotho, Namibia, Mozambique and Swaziland) initialled on 15 July 2014. Other existing trade agreements include the European Free Trade Area/SACU (May 2008) and EU-South Africa (January 2000). South Africa's dominance in SACU exerts significant ramifications to the other member countries, Botswana, Lesotho, Namibia, Swaziland (BLNS), mainly through the revenue-sharing formula. Under this arrangement, the five countries deposit their customs and excise collections into a common revenue pool. BLNS get a significant share of their revenue from the customs component. These revenues are, therefore, by their nature volatile as they depend on business cycles in SACU's major trading partners, and on the performance of the South African economy. The fiscal outturns in these countries, with the exception of Botswana, therefore largely reflect the trajectory of the South African economy.

2. The main trade corridors in South Africa include the Cape Town- Gauteng and Durban–Gauteng corridor. This trade route connects South Africa's ports to the economic heart of the country – the Gauteng province – and is part of the North-South corridor, a multimodal (road, rail and ports) transcontinental interconnector linking South Africa, Botswana, Mozambique, Zambia, Zimbabwe, Tanzania and Malawi and ultimately connecting Cape Town to Cairo. Durban is the busiest port in South Africa, and is the 3rd container port in the southern Hemisphere. The Durban port carries 36m tons of cargo per annum, of which 70% is transported by road. The primary road infrastructure is of very good quality. However, the port tariffs in South Africa are among the highest in the world. South Africa is connected with its neighbours in SADC via air, road, rail and port networks. The country also plays a dominant role in the Southern Africa Power Pool, accounting for about 77% of the Pool's total installed capacity. However, the costs of these modes are generally high. The country actively participates in SADC shared water management scheme and benefits from regional water supply network from the mountain kingdom of Lesotho. The regional market also offers an important platform for the internationalisation of South African brands, with a number of companies being significant investors in diverse sectors from natural resources extraction, basic industries and utilities, manufacturing, retails and other services[13]. This is a win-win for both RSA and its neighbours- it contributes to the growth of South African firms and exports while contributing to the development of neighbouring countries. South Africa is also the major source of FDI in a number of Southern African countries such as Lesotho, Botswana and Swaziland. The country also serves as the gateway for harnessing global multinational firms investing into the region, and as a conduit into global value chains.

3. South Africa's trade linkages have steadily increased over the past decades, but the country has not fully reaped yet the full benefits deeper regional integration offers. South Africa's imports and exports increased from 17% and 21% of GDP respectively in the early 1990s to about 30% in 2016 for both imports and exports, which demonstrates that the country's trade linkages have steadily increased over the past decades. However, South Africa faces several challenges that constrain its potential to fully utilise the opportunities from regional integration. These include both hard and soft constraints. The *hard constraints* pertain to the infrastructure deficits, including rail, roads and port developments, energy generation and transmission and development of shared watercourses for the benefit of the regional member countries. The *soft*

constraints include prevalence of non-tariff barriers and trade facilitation bottlenecks, such as lengthy border procedures at key regional transit points (such as Beit Bridge where it takes an average of 4 days for trucks to cross the border). This is corroborated by the 2017 Doing Business Report on South Africa, in which the country's worst indicator is "Trading across Borders", ranked 139th out of 190 countries. To further promote regional integration and trade, South Africa should increase investments in regional infrastructure and reduce persistent 'soft' non-tariff barriers to trade.

4. Regional integration is an important part of South Africa's quest to promote inclusive economic growth. Potentially, there is a two-way causal relationship between growth and regional integration. It is widely acknowledged that growth accelerates the pace of regional integration on the one hand and on the other hand high level of regional integration also causes improvement in economic growth. To test for this causality relationship, we estimate the impact of regional integration on South Africa's real GDP growth using the bivariate Structural Vector Autoregressive (SVAR) model below

$$RI_t = a_0 + \sum_{j=0}^{2} \delta_j gGDPer_{t-j} + \sum_{j=1}^{2} \gamma_j RI_{t-j} + \varepsilon_t$$

$$gGDPer_t = b_0 + \sum_{j=0}^{2} \varphi_j RI_{t-j} + \sum_{j=1}^{2} \beta_j gGDPer_{t-j} + v_t$$

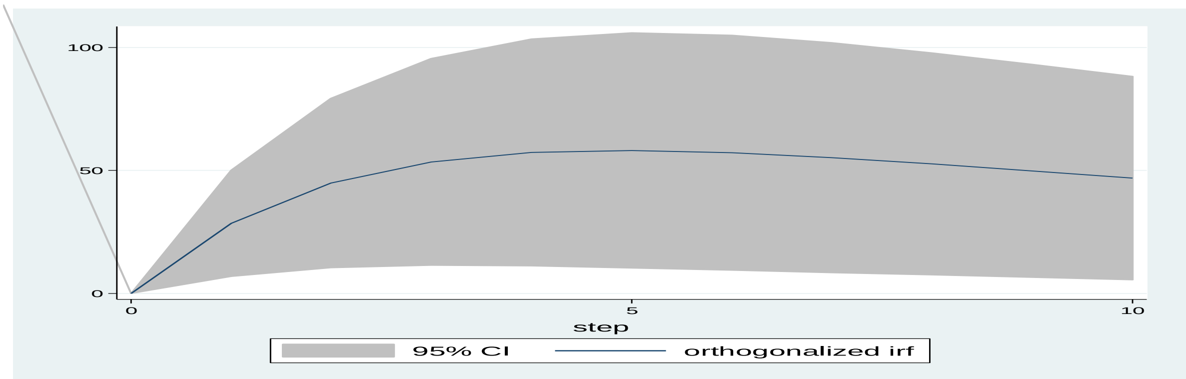
where RI_t and $gGDPer_t$ denote regional integration and growth in real GDP per capita. Using the number of export partners as a measure of regional integration, we find out that causation runs from regional integration to growth and not the other way around, implying that (higher) regional integration is strong predictor of (higher) GDP per capita (see Table A7.1) below.

Table A7.1: Granger Causality Wald Tests

Equation	Excluded	chi2	df	Prob > chi2
gdppercapita	x_partners	7.7701	1	0.005
gdppercapita	ALL	7.7701	1	0.005
x_partners	gdppercapita	.78513	1	0.376
x_partners	ALL	.78513	1	0.376

Figure A7.1 below presents the impulse response function of higher regional integration on GDP per capita growth. The impulse response show that regional integration has a positive and persistent effect on growth signifying that the possibilities of poverty eradication become higher with higher regional integration. Deepening regional integration therefore is one of the pathways to poverty reduction.

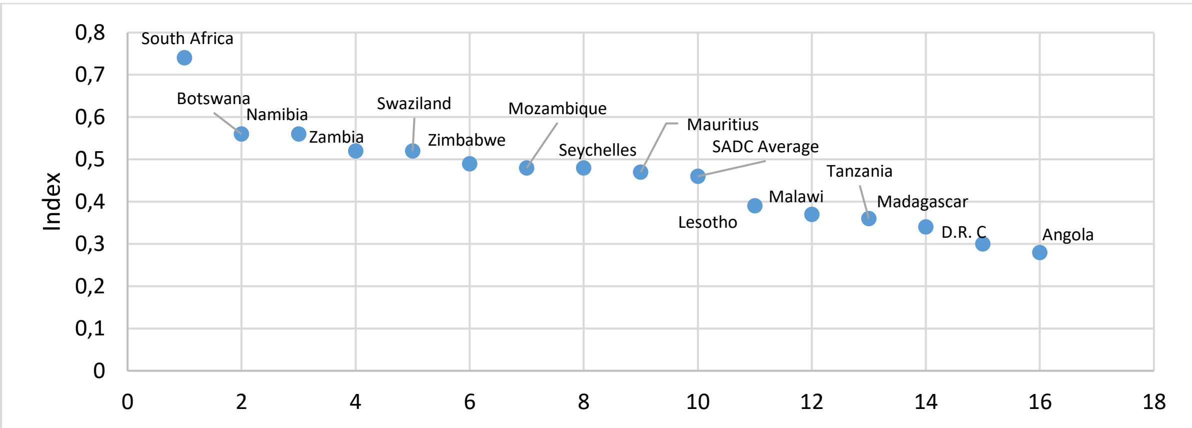
Figure A7.1: Growth impacts of deeper Regional Integration (measured by the number of export partners)



Source: The World Integrated Trade Solution (WITS) (1992-2016)

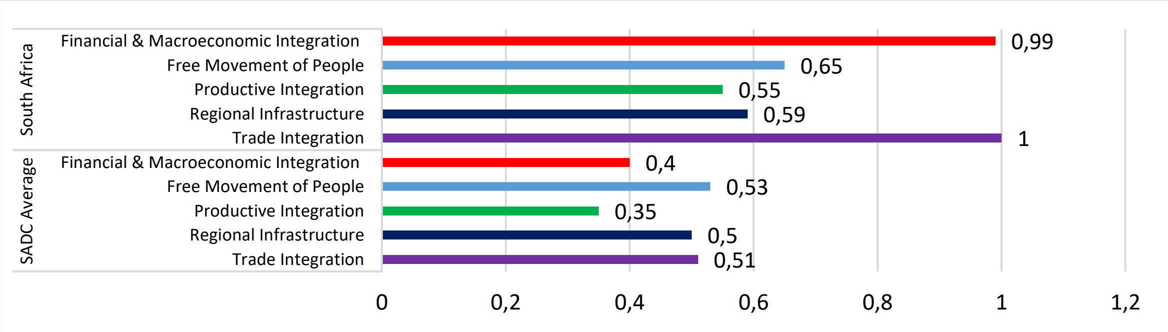
5. South Africa is reasonably well integrated in regional/global value chains, but greater export sophistication and diversification holds untapped potential. South Africa's main exports (2015) are Gold (10.7% of total exports), Diamonds (10.5%), Platinum (10%), Coal (6.8%) and Cars (6.4%). Main imports (2015) are Crude and Refined Petroleum (16.5% of total imports), Computers and other IT/electrical items (6.5%) and Cars (5.2%). South Africa is reasonably well integrated in regional/global value chains (2015), with 34% of total exports constituting intermediate goods; 26% raw materials, 24% consumer goods and 15% capital goods, which reflects the medium level of complexity of the country's economy, as outlined in paragraph 7. Similarly, exports remain fairly concentrated in terms of product differentiation, with the majority of all manufactured exports being produced by a relatively narrow spectrum of manufacturing sub-sectors. This is a clear call to revitalize the manufacturing sector and diversify South Africa's export base, with a view to reaping the full benefits of global value chains. Using the AFRICA Regional Integration Index which is calculated based on five dimensions (Trade Integration, Free Movement of People, Regional Infrastructure, Financial & Macroeconomic Integration and Productive Integration), South Africa ranks first out of the 15-member countries in the SADC bloc (see Figure A7.2).

Figure A7.2: Regional Integration Score of SADC Member Countries



6. In terms of the different categories of integration, South Africa is the best performer in SADC on Trade integration (with a score of 1), and Financial integration & macroeconomic policy convergence (score: 0.91); second best performer in Productive integration (score: 0.55), fourth in Infrastructure Integration (score: 0.6) and sixth in the Free movement of persons with a score of 0.65 allowing nationals from all other SADC countries to enter visa-free (Figure A7.3).

Figure A7.3: Rank of South Africa vs SADC Average



7. The main challenge facing regional integration in South Africa is that majority of countries with which South Africa is have strong trade links particularly in SADC are agro-based. Yet meaningful integration can only be sustained with trade on industrial goods. Policy measures to support industrialization are therefore important in helping deepen regional integration. The other serious challenge facing South Africa's regional integration efforts include the nationalist sentiments that hamper the full liberation of trade. Regional initiatives to support cross-border industrial growth as well as regional knowledge sharing on industrial development will help cement South Africa's place as a regional industrial powerhouse and stem the tide of the recently witnessed deindustrialization.

8. The While the Bank has been present in funding regional infrastructure projects, renewed focus should be directed at projects that are not only regional in nature but also geared towards improving industrial development. One important area for intervention should be a review of the several containing regulatory and legislative bottlenecks that hinder free-flow of cross border labor and capital. The Bank will also leverage the role of other regional-level institutions such as the New Partnership for Africa's Development and the African Capacity Building Foundation, as well as the BRICS Bank and the Asian Infrastructure Investment Bank in addition to exploring lending opportunities to the sub national government.

ANNEX 8: INFRASTRUCTURE

1. South Africa has a comparatively well-developed infrastructure base, notably in the highly developed metropolitan areas, commensurate with its status as an advanced upper MIC. However, infrastructure services are not sufficiently accessible, reliable and affordable in the 'second segment' of the economy, which requires substantial investments in energy, transport and water and sanitation. **Energy:** Electricity supply has since 2016 improved following improvements in maintenance, which resulted in higher plant availability capacity, the additional generation by independent power producers, and commissioning of Eskom's new projects – Eskom supplies 95% of electricity consumed in South Africa. Total nominal generation capacity as of March 2017 increased to 44,134MW, against a demand of 32,985MW. South Africa's current energy mix comprises of coal (81%), nuclear (4%), gas (5%), hydro (4%) and wind/ solar (5%). South Africa is an important partner of the Southern Africa Power Pool (SAPP). The Government's Integrated Energy Resource Plan 2010-30 aims to reduce the share of coal in the energy mix to 48% by 2030. Energy efficiency and renewable energy will play an important role in helping South Africa reduce its GHG emissions. Significant progress has been made in clean energy generation mainly from wind and solar. Renewable energy generation is expected to increase to 13,225 MW by 2025. The Bank's future engagement with South Africa will focus on both renewable and non-renewable generation, taking into cognizance the risk exposure to the energy sector and Eskom in particular. As regards access to energy, about 84.2% of South African households had access to electricity in 2016 (compared to 79% for India and 100% for the other BRICS). However, about 16% of households, most of which are in Townships, informal settlements and rural areas, still do not have access to electricity in South Africa.

2. The key challenges in the energy sector are: (i) aging generation plants and inadequate transmission lines; (ii) negative growth in electricity demand; (iii) financial viability and sustainability of the energy sector; (iv) funding constraints to meet required capital investments; and (v) high and rising electricity tariffs which have dampened demand by energy intensive users, thereby curtailing further expansion of the productive sectors of the economy. The energy intensive consumers in manufacturing and mining, for which electricity accounts 20-50% of their production costs, consider the current tariffs as too high, hindering the expansion of their businesses and undermining job creation. In particular, reliable supply of electricity at competitive rates to remote townships and rural areas is inadequate, thereby reinforcing the dual characteristics of the economy. To connect the townships and rural areas with the 'first segment' of the economy, and enable productive value added economic activity, substantial investments in the energy infrastructure are required. The National Energy Regulator (NERSA) determines the level of electricity tariffs charged by Eskom. For the 2017/18 financial year, Eskom got a tariff increase of only 2.2%, which was much lower than expected and well below inflation. For the 2018/19 financial year, NERSA awarded Eskom a 5.23% despite Eskom having submitted a request of 19.9%.

3. **Transport:** The country boasts a well-developed transport infrastructure comprising 750,000 kilometres of road network (of which about 25% is paved), 20,000 km of rail, 9 airports, 8 commercial ports, and 3,800 km of pipelines for petroleum products and gas. Nonetheless, the sector faces challenges emanating from gaps in the penetration, distribution, spread and reliability of affordable public transport, a high road fatality rate of about 24 per 100,000 people[14], and substantial maintenance backlogs in the lower class roads. Also, the heavy reliance on roads for freight transport puts additional pressure on the maintenance needs. The most critical pitfall in the transport and logistics sector, however, is its inequitable penetration and distribution in Townships/informal settlements and rural areas compared to the developed metropolitan areas. Townships and informal settlements are located at the periphery and poorly connected to the main urban centres, which aggravates economic duality, inequality,

unemployment and poverty. Lack of reliability and high cost of transport is a major burden for Township dwellers, accounting for as high as 40% of their monthly income. Under this CSP, the Bank will support South Africa Commuter Transport Project, which entails the financing of a mass transit financial solutions provider that onlends to small and medium transport enterprises (SMEs) that may otherwise not be able to access financing. With the funding, SMEs will acquire fuel efficient, environmentally-friendly, good quality vehicles (minibus taxis) to be used for mass transit in South Africa. Regarding logistics, South Africa's major coal freight rail network is good but the branch rail line network is classified as poor. Freight rails are constrained further by, among others, rolling stock shortage and conditions, heavy haul commodity prices and demand, and lack of capacity at key corridors that export the main mineral commodities such as coal, iron ore and manganese. Port tariffs remain among the highest in the world for manufactured goods.

4. **Water:** South Africa is a water scarce country and is ranked as the 30th driest state in the world with a water availability of 830 m^3 per capita per year. In terms of access to basic services, 88.8% (2016) of the population had access to improved drinking water sources but only 46.4% had access to water in their homes, and 80.9% had access to improved sanitation facilities. The country has experienced increasing water demand emanating from irrigated agriculture, urban areas and the mining industry, which respectively accounted for 60%, 18% and 5% of the water consumption in 2013. To meet this demand, most of surface water resources are mobilised through more than 4000 dams and several water transfers, but groundwater development is still limited. This pressure over surface water resources is worsen by a degradation of surface water quality due to acid mine drainage and poor operation and maintenance of sewerage treatment plants. The main challenge regarding water and sanitations is aging infrastructure, and quality and reliability of water supply, and sanitation services. In 2016, only 63% of South Africans surveyed by Statistics South Africa rated the quality of water they drink as good. The quality of water and sanitation services is even poorer in Townships and informal settlements. Moreover, over 11% of the population who do not have access to piped water also live in rural areas, informal settlements and Townships. Extended drought in the Western Cape province of South Africa has recently shown the extent of the country's water security vulnerability. Cape Town was forced to utilise extensively its water storage from its dams and faced an eminent danger of depleting its storage. The authorities were forced to apply sever water restrictions that has not been experienced in the past. The measures yielded positive results but over the medium and long term, South Africa needs to rationalise the use of its water resources and invest more on infrastructure to further improve water security against the impact of climate change.

5. **ICT:** South Africa has a well-developed ICT sector. South Africa mobile phone operators have extensive footprint across the continent. Nonetheless, the mobile data costs are very high in South Africa compared to other middle and low-income countries in Africa including Nigeria, Egypt, Ghana and Tanzania. In 2016, about 52% of the population had access to internet. As with the other key infrastructure components, the penetration of the ICT services in Townships/informal settlements and rural areas is limited. Neither public nor private broad infrastructure has adequately penetrated them, reinforcing the digital divide and the dual nature of the economy. Investment in the ICT sector in Townships/informal settlements and rural areas is critical for the industrialization of this segment of the economy. The Networked Readiness Index (NRI) Report of 2016 ranked South Africa's regulatory and political environment as good scoring 5 in a scale of 0-7 which ranked the country at 65 out of 139 countries globally and the ICT industry is mostly business driven, However, in terms of innovation and business environment the country is rated significantly worse and that there are indications of slow progress with regards to technology and venture capital availability and government procurement of the latest technologies. As indicated above on mobile data pricing,

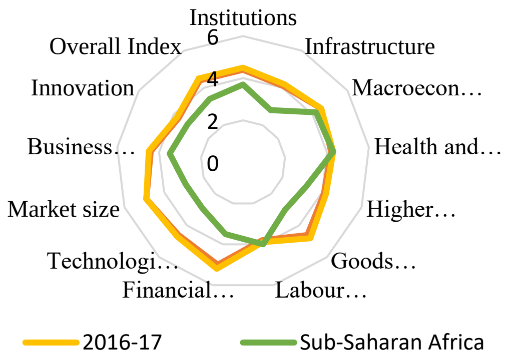
the industry regulator (the Independent Communications Authority of South Africa- ICASA) is performing a difficult balancing act between setting affordable tariffs and ensuring that capital can be found to invest in maintaining and renewing networks. Policy and regulatory recommendations that seem to be emerging from Working Groups regarding the Internet for All Initiative in South Africa include the following: (1) Operators do not seem to be able to control data prices at Spaza shops which are high to end users; (2) ICASA and the Universal Service and Access Agency of South Africa (USAASA) need to devise a scheme where operators give away certain amounts of free data and they get to offset this against their Universal Service Fund (USF) contributions; (3) On affordability of access to devices, the industry is eager to dialogue with the government on the 7% VAT on handsets; and (4) The government has indicated that it will introduce, as a policy with a set of thirteen incentives to promote the domestic handset manufacturing sector. The ICT stakeholders are willing to create a coalition of interested local and foreign investors to take advantage of the incentives.

ANNEX 9: SECTORAL ANALYSIS

1. **<u>Private Sector:</u>** South Africa has a vibrant private sector, generating 75% of the country's GDP. The overall business environment is comparatively well developed, but significant challenges remain, notably in terms of energy access, trading across borders and red tape. South Africa's ranking in the Doing Business Index has deteriorated in recent years, from 39th, 41st, 43rd and 73^{rd,} to 74th (out of 190 countries) during 2013 to 2017. The main reasons for the deterioration are counterproductive reforms that created more obstacles to doing business, such as the introduction of regulations making access to credit information more difficult, an increase in property transfer taxes making the registration of property more expensive, and higher vehicle taxes. In 2017, South Africa's least favourable Doing Business indicators are "Trading across Borders" (139th), "Starting a Business" (131st), "Enforcing Contracts" (113th), and "Getting Electricity" (111th). On the positive side, the country performed well in "Protecting Minority Investors (22nd) and "Resolving Insolvency" (50th). In spite of the deterioration in the Doing Business Index in recent years, South Africa still performs better than its BRICS peers China (78th), Brazil (123rd) and India (130th) in 2017.

2. **South Africa performs quite well in the World Economic Forum's (WEF) Global Competitiveness Index, but challenges persist.** South Africa ranked 47th (out of 138 countries) in the 2016/17 WEF Global Competitiveness Index, slightly better than 49th and 56th in the previous years. The best indicators are 'Financial market development' and 'Market size', while performance in terms of 'Infrastructure', Innovation', and 'Labour market efficiency' is less favourable (Fig. A9.1). Furthermore, while South Africa's global competitiveness has improved, local competitiveness remains limited as the economy remains fairly concentrated, with anti-competitive behaviour widespread in key sectors of the economy and significant barriers to firm entry. This is perpetuating the economy's dual characteristics, by limiting growth and expansion of small businesses not only within the developed economy in the major urban centres but also in Townships and informal settlements. The high level of concentration also fostered cartels in virtually all sectors of the economy with punitive pricing behaviours to small businesses as well as consumers.

Figure A9.1: South Africa Global Competitiveness Scores (0-6; 6 = best)



Source: World Economic Forum

3. **<u>Financial Sector</u>:** While South Africa's financial sector is very well developed and diversified, SMMEs face significant challenges to access finance. Also, financial inclusion is limited. The financial sector comprises 22 registered, mutual and cooperative banks, 5 local branches of foreign banks as well as other financial intermediaries. The financial sector is well developed yet highly concentrated, with 5 banks controlling nearly 90% of total assets in the sector. South Africa has signed into law the Financial Services Regulation Bill (also known as the Twin-Peaks model of financial regulation) on 21 August 2017. The Bill creates two brand new financial sector regulators: (1) the Prudential Authority; and (2) the Financial Sector Conduct Authority. The first is responsible for regulating the prudential aspects of banks and all non-bank financial institutions, and the second for regulating market conduct and fair treatment of financial consumers. The South African Reserve Bank (SARB) oversees the two regulatory bodies and provides overall financial sector regulatory oversight. Despite the financial sector's high degree of sophistication, access to finance by SMMEs remains a key challenge. Small businesses consider the lack of access to finance as one of the key challenges

for their development and expansion. This is particularly acute in Townships/informal settlements where the majority of the population are unemployed and have limited collateral resources to borrow. SMMEs typically have a low survival rate (with 63% failing within the first 18 months of operation), mainly due to lack of access to finance; inadequate technical and business management skills; lack of experienced mentoring of entrepreneurs; and barriers to business entry. Furthermore, although South Africa appears to be financially inclusive in terms of number of transaction accounts held by adults (70%), most of these accounts are created by government or employers to deposit grants or wages and are not widely used for transactions by the account holders. Only about 25% of low income households use their accounts for transactions. The bulk of low income households are till financially excluded.

4. **Agriculture:** Despite its relatively small share in GDP, South Africa's agriculture sector plays a crucial role in terms of employment and has significant potential for transformative agri-business and job-creation. As discussed above (paragraph 7), the agriculture sector's share in total output has declined over the past decades, currently standing at only 2.4% of GDP. This notwithstanding, farming remains vitally important to the economy, with 2.3m households (out of a total of 17m households) that are directly involved in agriculture production, formally employing 875,000 people (5.4% of the labour force) and impacting an estimated 8.5m people (15% of the population) directly or indirectly through employment and income. South Africa is not only self-sufficient in virtually all major agricultural products, but is also a net food exporter. In other terms, the Agriculture sector is more meaningful to South Africa's economy than its small share in GDP actually suggests. It has significant potential to be further developed and to reap the benefits from value chains and provide more formal wage employment in agri-business, thereby reducing the Dual Economy's rural-urban spatial dichotomy. Indeed, South Africa enjoys a high degree of biodiversity, which together with a 3,000 kilometres coastline, favours the cultivation of a highly diverse range of marine and agricultural products.

5. However, the sector is facing several constraints, most notably in terms of land ownership. By 1994, about 87% of the land was owned by the white population and only 13% by black people who accounted for 80% of the population of the country. By 2012 only 7.95m hectares had been transferred to black owners through land reform. This represented only 7.5% of formerly white-owned land. The majority of the black population have been uprooted from rural agricultural land during the apartheid regime and live in Townships/informal settlements without access to land even if they decide to go back to rural areas and engage in agricultural activities. Therefore, land reforms are crucial to enable the full exploitation of South Africa's agricultural potential and to create jobs. This needs to be accompanied by the development of the requisite infrastructure with a view to providing irrigation for agricultural production and to connecting rural centers of production to urban markets – domestic, regional and global. The smallholders sector is constrained by several factors including: low agriculture productivity, limited access to credit, inefficient input and output markets, low technology development, unreliable infrastructure services, heavy dependence on rain-fed agriculture, and poor participation. To improve productivity and value addition to raw agricultural produces, a system of small SMEs created by youth, rural entrepreneurs and emerging farmers can be instrumental in terms of providing financing to the producers. However, this requires a new legal/legislative framework to grant these SMEs the financial service provider (FSP) status. In line with the key objectives of the Bank's Technologies for African Agricultural Transformation (TAAT), the Bank will support scaling out 'proven' and well packaged agricultural technologies and interventions in selected Priority Intervention Areas (PIAs) focusing on subsistence and emerging rural farmers and agricultural commodities, following an inclusive value chain approach.

6. **Blue Economy:** South Africa also has potential in terms of 'Blue Economy'. The Government's 'Operation Phakisa' (Fast Results Delivery) program prioritizes sectors such as

marine transport and manufacturing activities, including coastal shipping, trans-shipment, boat building, repair and refurbishment; Offshore oil and gas exploration; Aquaculture; Marine protection services and ocean governance; Small harbours; and Marine and coastal tourism. However, these initiatives are at early stage of implementation. South Africa forms part of the international Blue Economy community as it participates in the Indian Ocean Rim Association (IORA), founded in 1997. The agricultural production in South Africa is dominated by commercial farming with a world class operations and management.

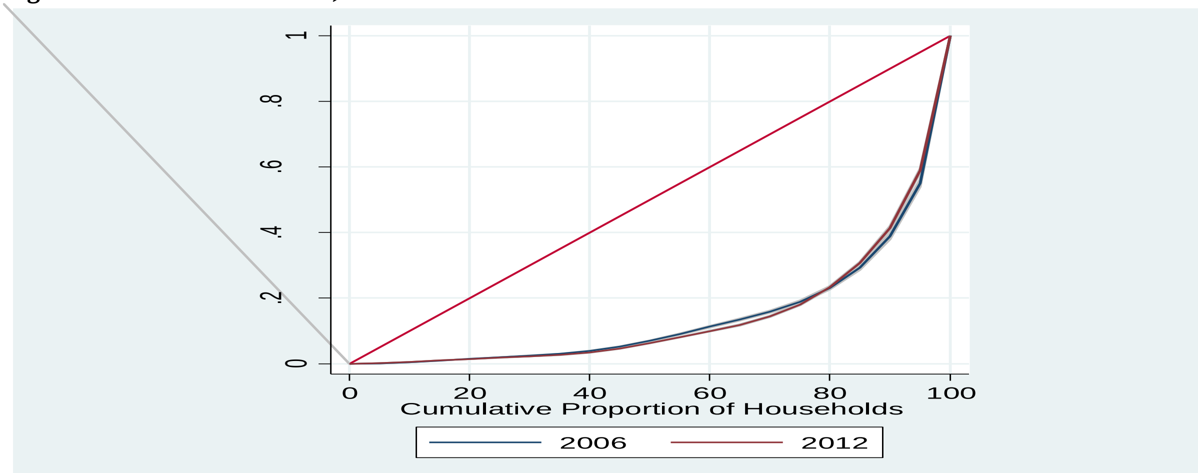
ANNEX 10: SOCIAL CONTEXT AND CROSS-CUTTING THEMES

1. **Poverty Trends:** Despite being an upper MIC, South Africa suffers from high poverty, with the poverty headcount increasing to 55.5% in 2015 from 53.2% in 2011 and 25.2% of the population – i.e. 14m out of 56.5m South Africans – living in extreme poverty in 2015. Poverty increased over the period mainly due to low economic growth, rising unemployment and high household indebtedness. South Africa has not adopted an official measure of poverty, and uses food poverty line (FPL), lower bound poverty line (LBPL) and upper bound poverty line (UBPL) measures based on monthly household income levels. In 2015, 25.2% of South Africans (14m) lived in extreme poverty or below the national food poverty line of R441 per person per month, while 55.5% of the population (31.4m) lived below the national upper bound poverty line of R992. The majority of the poor live in Townships, informal settlements, and rural areas where subsistence farmers dwell. The Townships and informal settlements are home to 38% of the working age population and account for 60% of those unemployed in the country.

2. **Extreme Inequality:** South Africa's society remains one of the most unequal in the world, featuring extreme income inequality, both between different race groups and gender. Over the past two decades, South Africa has registered a sharp increase in income inequality, with the country's Gini coefficient standing at 0.65 (2016) – the highest in the world. Income inequality is visible across all spatial dimensions but it is highly pronounced in Townships/informal settlements and rural areas vis-a-vis the well-developed urban agglomerations. A typical indicator of an extreme income inequality is Sandton city and Alexandra Township, which are located side by side as part of the city of Johannesburg, where the former is one of the most developed cities in the world while the latter is one of the poorest settlements in the country. Income inequality also exists along racial lines and gender. The 2014/15 Government's Living Conditions Survey revealed that South African households earned an average income of R138,168 (USD 10,571) in 2015. The white-headed households earned about 4.5 times more than the black-African headed households, while men-headed households earned twice as much as women-headed households. Also, wealth distribution is extremely skewed, with 10% of the population holding 95% of wealth.

3. More than two decades after the transition to democracy in 1994, South Africa continues to wallow in great inequality with stark disparities between the haves and the have nots. Despite numerous policy reforms that aim at creating stepping ladders for the poor and middle class in order to reduce this gap, the country continues to have a two-tiered economy. The Lorenz curve in Figure A10.1 shows that inequality has not changed in South Africa between 2006 and 2012.

Figure A10.1: Lorenz Curve, 2006 and 2012

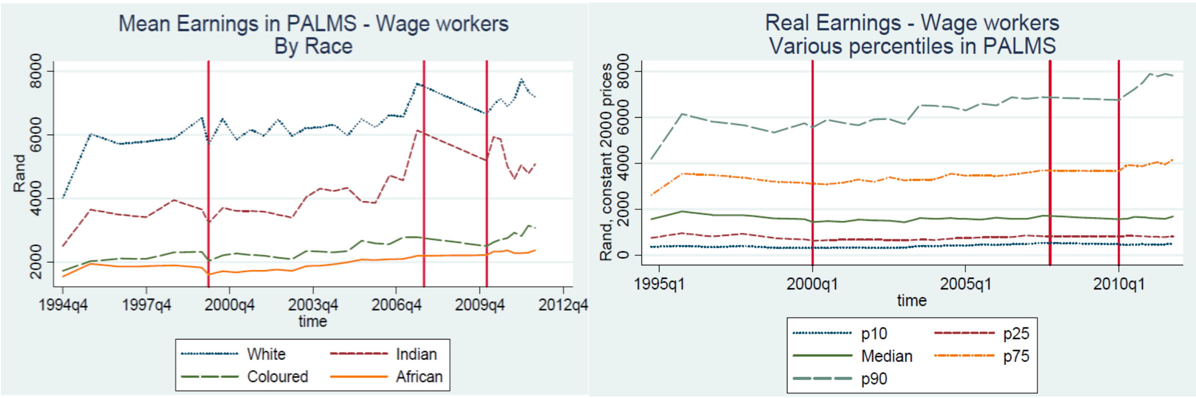


Source: Statistics South Africa (2006 and 201)

5. The Lorenz Curve shows that in 2006, the “poorest” 80 percent of the population received a little bit more 20 percent of total income in South Africa. Despite the numerous policy reforms to reduce inequality, the status quo has not changed after 6 six years as the same segment of the population receives more than 20 percent of total income in South Africa. Put differently, the “richest” 20 percent of South Africans received 80 percent of total income between 2006 and 2012.

6. To explain the source of inequality, the left panel of figure A10.2 below shows the trends and distribution of wage by race while the right-hand panel presents the distribution of real wage by income percentiles as well as the relative position of the different percentiles in relation to median wage. This figure confirms that the persistent inequality in South Africa is driven by people at the top 90th and 75th percentiles as these percentiles have moved away from the median; the rate of the increase is greater at the 90th percentile than the 75th percentile.

Figure A10.2: Trend of Real Wage by race and by percentiles



Source: PALMS – Post-Apartheid Labour Market Series

7. The increasing wage differentials between the 90th and 75th percentiles with the remaining groups increased the gap between the mean and the median of the earnings distribution. Thus, contrary to popular belief that inequality is growing between those at the top and bottom of the economy, it is the gap between the 90th and 50th percentiles that grew the fastest in the ten years after the transition to democracy.

8. Policies to tackle inequality generally fall in two categories; redistribution policies aimed at taxing more the rich and building more wealth at the bottom. The South African government has in the recent past introduced a number of fiscal initiatives to redistribute wealth from the top to the bottom. This includes the initiative to review the South African tax system (the Davis Committee) launched on 7 July 2013 by the former Minister of Finance. The Davis Committee has specifically suggested the increase in investment and inheritance tax rates to increase tax revenues for redistribution. Policies to build wealth at the bottom naturally should target the youth who are faced with high levels of unemployment. Supporting the youth though financial and other incentives to get involved in light manufacturing holds great promise for wealth creation at the bottom, while helping them penetrate regional markets to increase through ease of cross-border trading regulations and taxation.

9. Moreover, there is the need for government sponsored job creation schemes including support to entrepreneurship in the industrial sector and active labor market policies to increase youth employability through skills development specifically in light manufacturing sector where the trend of recent deindustrialization presents a great opportunity for the youth. The Bank has been active in providing support to the lower income groups in South Africa through skills development and will continue to focus on areas that can help the youth get more involved

in light manufacturing. The Bank will also accelerate its policy advocacy and technical support in areas of tax system review to ensure that tax system is progressive.

10. **Sustainable Development Goals (SDGs):** National consultations have been initiated to inform approaches to mainstreaming the SDGs into national strategies. With regard to the Millennium Development Goals (MDGs), South Africa achieved most MDGs in education, health and empowerment of women but did not achieve those relating to extreme poverty, unemployment, infant mortality and maternal health. South Africa achieved the MDG goal of universal access to primary education before the year 2015 for children between 0-13 years, ratio of male to female enrolment at both primary and secondary education, reduction in prevalence of HIV for those aged between 15-24, as well as access to water and sanitation (Annex 11). Gross primary school enrolment for those aged 7-13 was 99% in 2014. Gross female primary school enrolment was 97% while that for males was 102% in 2014 implying near gender parity participation. HIV prevalence among the youth aged 15– 24 has declined over time from 7.3% in 2002 to 4.6 in 2017. South Africa has the largest antiretroviral treatment program covering 3.5m people in 2016. However, other MDG goals have not been achieved.

11. The Government has put in place a comprehensive social welfare system to address the social challenges. Additionally, a national minimum monthly wage of R3500 or R20 per hour was introduced in 2016, to be implemented from May 2018. Currently, nearly 16m out of 56.5m South Africans, i.e. 28%, receive social grants. Child support grants are also provided and since 2011 include children up to the age of 18. In addition, the Government provides free basic services to the households regarded as indigent. These services include free basic water, electricity, sanitation, and free school and school meals for children. The social welfare system has substantially contributed to contain the increase in poverty and hunger but it has reached a limit in the difference it can make and pockets of marginalised groups are not accessing social assistance benefits. To effectively reduce poverty, inequality and regional/spatial disparities, South Africa’s most pressing challenge today is to generate jobs, notably for the youth and women.

12. **Gender Equity:** the constitution prohibits unfair discrimination on the basis of gender but various challenges still persist. South Africa is a signatory to several regional and international commitments on women’s empowerment and gender equality, including the Convention on Elimination of All Forms of Discrimination against Women (CEDAW); Optional Protocol to the CEDAW; African Charter on Human and Peoples’ Rights of Women in Africa; and Southern African Development Community (SADC) Protocol on Gender and Development. At the national level, these protocols are domesticated by the 2002 South African National Policy Framework for Women’s Empowerment and Gender Equality. The policy establishes a clear vision and framework for gender mainstreaming across laws, policies, procedures and practices and advocates for equal rights and opportunities for women and men in all spheres and structures of government, as well as in the workplace, the community and the family. Government institutions and bodies are required to implement gender mainstreaming as part of their mandates through their Gender Focal Points.

13. Despite the sound legal framework, various gender imbalances are noted. Many racial and ethnic groups have maintained traditional gender roles, such that women usually have less power than men. Gender disparities also continue against women in terms of access to formal employment and productive resources, such as arable land, credit and technology. While South Africa has achieved near universal access to primary education, female access is still a concern. Women typically also face the consequences of gender norms and the unequal division of labour, predominantly due to their role as unpaid caregivers within the family and community.

14. There is a consistent trend of a low labour force participation rate of women compared to men and the gap has remained almost the same over period 2001-2014. Women constitute 42.9% of the workforce compared to 57.1% for men. Women are also under-represented in decision-making. At the national level, only 42% of all Parliamentarians are female, which was 8 percentage points below the MDG target (of 50%) and the SADC Gender Protocol. In addition, poverty tends to be more prevalent in households that predominantly consist of women because of lower female labour market participation and earnings. There is also a greater incidence of poverty in female-headed households.

15. **High Youth Unemployment:** High unemployment, especially of the youth (50.9% of those aged 15-24) is South Africa's overarching development challenge today. To address it, the process of de-industrialization needs to be reversed and industries with potential for competitive advantage and job creation be supported. The official unemployment rate stood at 26.7% (5.9m people out of a total workforce of 22m) at the end of Q4 2017. Unemployment is high in Townships/informal settlements and subsistence rural areas, which account for 60% of the unemployed in the country. Unemployment is below the national average in the developed metropolitan areas, such as Ethekwini/Durban (21.8%) and Cape Town (22.7%), albeit still high. On the other hand, non-metropolitan regions have the highest levels of unemployment, for example Eastern Cape (36%), Free State (35%) and Gauteng province (32%). Four provinces in South Africa are regarded largely as rural and do not have well-developed metropolitan centres. These include Northern Cape, North West, Mpumalanga and Limpopo, with average unemployment rates in these provinces around 27%. With specific regard to the youth, South Africa's unemployment rate was among the highest in Africa at 50.9% of those aged 15-24 and 31.9% of those aged 25-34. The main cause of the high unemployment is the lack of skills arising from low level of education. At the end of 2016, 58.8% of unemployed persons had below matric level of education, while 32.4% had matric level of education and 8.1% had tertiary level of education. The economy mainly creates skilled jobs and sheds unskilled ones through capital intensive production techniques.

16. **Climate Change and Green Growth:** South Africa is among the top 20 largest per capita emitter of greenhouse gases (GHG) globally, by virtue of coal-based power plants accounting for approximately 80% of the country's base-load electricity capacity. Furthermore, the country is relatively water scarce and is therefore vulnerable to the effects of drought and rainfall variability. It is estimated that drought has affected about 17.7m people in the country since 1996 (in terms of total population, the fourth-highest number among African countries). More broadly, economic development, population growth and rapid urbanization exacerbate negative environmental impacts – declining air quality, increasing waste generation, deteriorating ecosystem health and loss of biodiversity. South Africa ratified the Paris Agreement in 2016. The country's Nationally Determined Contribution (NDC), focusses on both adapting to climate change and reducing greenhouse gas emissions.

17. In recognition of the coal dominated grid and the technical challenges of bringing renewable energy on line whilst meeting baseload requirements, the NDC defines a 'peak, plateau and decline'[15] (PPD) profile under which economy wide emissions, particularly those from energy generation, are set to increase, plateau and later decline; the point being that whilst emissions increase from new fossil fuelled plants (peak), the emissions intensity of generation decreases as older inefficient power plants are shut down (plateau), the grid stabilizes and more renewable energy can be brought online (decline). Energy efficiency and renewable energy will play an important role in helping South Africa reduce its GHG emissions; significant progress has been made in clean energy generation mainly through wind and solar and renewable energy generation is expected to increase to 13 225 MW by 2025. The Government has also set up a Green Fund, managed by the DBSA, to support the transition to a low carbon,

resource efficient and climate resilient development path that delivers high impact economic, environmental and social benefits. The Fund has prioritized investment in the following three thematic areas: Green Cities and Towns: greening core municipal infrastructure, sustainably built environment and integrated planning for climate resilient cities; Low Carbon Economy; and Natural Resource Management.

ANNEX 11: LESSONS LEARNED, RISKS AND PROPOSED MITIGATION MEASURES

BOX A11.1 LESSONS LEARNED

Regarding Strategy

i. Greater **attention needs to be given to the specific needs and challenges of South Africa as an advanced upper MIC and more emphasis should be placed on accelerating the country's re-industrialization, with a view to more effectively addressing its overarching development challenges of the 'Dual Economy'**: high poverty, unemployment and income inequality, as well as spatial socio-economic disparities. The CSP 2013-17 with its strategic focus on infrastructure development and regional integration rightly supported South Africa's development agenda, and tangible results were achieved in terms of stabilizing energy supply and facilitating cross border investment and trade. However, more needs to be done to effectively address the country's overarching development challenges today: high poverty, youth unemployment, income inequality and spatial socio-economic disparities.

ii. **The strategic scope of the new CSP and its indicative lending program need to be flexible enough to enable the Bank to respond swiftly to emerging needs and to generate business.** A key lesson in this regard is the need for strategic and operational flexibility that would allow the Bank to respond expeditiously to emerging needs and Government and private sector requests and proposals for sovereign and non-sovereign funding. To enable such flexibility of the lending program and to allow the Bank to respond to emerging opportunities for business generation, the CSP's pillars need to be formulated broad enough, while in the same time ensuring a reasonable degree of selectivity.

iii. **More needs to be done to position the Bank as a true knowledge-based institution.** Bank analytical work needs to be demand driven and close existing knowledge gaps. Also, due cognizance should be taken of the fact that resource constraints underscore the need to rationalise and limit the number of ESWs, with a greater focus on quality than quantity. Collaboration with development partners, academia, think tanks and Government agencies should be a key principle for all new ESWs. Last but not least, the Bank needs to become more active in terms of providing (ad hoc) high-quality policy advice to the Government.

iv. **It is important to clearly identify baselines and realistic target outputs and outcomes in the CSP Results-Based Framework (RBF), based on the Theory of Change.** While the CSP's RBF was revised at mid-term, it was not robust enough and contained a rather large number of outcomes and outputs that were too ambitious in view of the rather short implementation period. Also, some indicators were too high level (e.g. "unemployment rate") and, therefore, not exclusively attributable to Bank assistance. The RBF of the new CSP will avoid these shortcomings and incorporate the Theory of Change.

Regarding Portfolio

v. **High quality at entry**. More emphasis should be placed on the quality at entry for private sector projects. Disbursement without proper scrutiny of the funding structure was depicted in two major private sector operations.

vi. **The use of the Bank's procurement system led to significant delays in some small projects funded by MIC grants**. The use of country systems for procurement could minimise procurement delays and errors.

vii. **Addressing capacity constraints**. More regular training sessions for PIU staff in Bank rules and procedures could help resolve the capacity issues as well as providing more "learning by doing' sessions to procurement staff at executing agencies that have weak capacity.

For the Government:

viii. Start-up delays due to signature delay for both sovereign and non-sovereign operations: the government needs to consider speeding up signature procedures for both public and private sector operations to avoid implementation delays and cancellation of the project.

ix. The government should accelerate the adoption of a new unified public procurement law. The government should also request for the use of advance contracting procedures especially for complex infrastructure projects.

x. Disbursement delays due to outstanding justifications: The government should impress upon the executing agencies the need to justify expenditure on time to avoid disbursement delays.

For the Development Partners:

xi. Good collaboration with the development partners active in the country: Further dialogue to identify potential areas for co-financing will be pursued in the new CSP period. Joint supervision missions with all donors are regularly carried out for the energy sector projects.

xii. **South Africa is an Upper MIC and therefore donor support is limited and there does not exist a systematic donor coordination mechanism** except in few sector/thematic areas where the Bank is active. More needs to be done to enhance donor coordination in emerging thematic areas.

BOX A11.2: RISKS TO THE IMPLEMENTATION OF THE CSP AND THE PROPOSED MITIGATION MEASURES

Global Economic Environment	
Medium likelihood of occurrence ○ Subdued global economic growth could impact on demand for south Africa's manufactured goods. This could affect the Government and Bank's efforts to promote industrialization.	*Mitigation Measures (Expected impact: high)* ○ South Africa is already diversifying manufactured exports away from advanced economies to Africa.
Macroeconomic Risk	
Low likelihood of occurrence ○ High debt levels could pose fiscal sustainability risk. Unsustainable debt levels could limit further government borrowing for infrastructure investment projects constraining regional integration.	*Mitigation Measures (Expected impact: high)* ○ Debt levels still remain sustainable and government already implementing balanced fiscal consolidation measures.
Contractual Risk in Energy Infrastructure	
Medium likelihood of occurrence ○ The reluctance of Eskom to sign a Power Purchase Agreement (PPA) with the Renewable Energy Independent Power Producers (REIPP) will derail Government and Bank's efforts to promote environmentally sustainable and green growth.	*Mitigation Measures (Expected impact: high)* ○ Government is already negotiating a new tariff structure for REIPP projects. Agreement expected to be reached at the end of 2017 under the new proposed tariff framework of 77 cents per kilowatt hour for REIPPs.

ANNEX 12: KEY MESSAGES FROM THE AfDB SECTOR ANALYTICAL BRIEFS UNDERPINNING THE CSP

1.Energy Sector	2.Transport Sector	3.Water and Sanitation	4.Private sector
○ Nominal installed generation capacity as of March 2017 was 44,132MW, of which Eskom currently operates 42,810MW from 28 power stations; 81% comes from coal. Energy supply has been stabilised for a short to medium term given subdued demand. Access to electricity is 84% in 2016. More investment is required to meet higher demand and achieve universal access to electricity by 2025. About 20 000 MW additional capacity will be required by 2025. ○ The status of electricity production in South Africa has a huge impact on security of supply for the region. South Africa is a member of the Southern African Power Pool (SAPP), Eskom exports electricity to 7 neighbouring SADC countries and imports from 3. ○ The Integrated Resource Plan for 2010-2030 aims to ensure electricity generation capacity to 2030 while integrating renewable energies into the mainstream energy economy to meet national emissions targets. Renewable energy to account for 42% of energy mix in 20 years.	○ The country's road network of about 750,000 km long is the largest on the continent, and is ranked as the 10th largest in the world. Only about 20% is tarmacked. The replacement cost of the road network is estimated at ZAR 2 trillion (~ USD 150 billion). The freight and passenger railway network in is about 20,000 km but needs massive investment to upgrade. ○ At the policy level, the Government is in the final stages of the review of the National Transport Master Plan (NATMAP 50). The NATMAP 2050 is intended to sustain the country's projected growth and focus on integrated transport planning. ○ The transport sector in the country faces some challenges, the key being addressing the spatial outlay of the country and the provision of efficient transport services to the population. While SA may be described as having a well-developed transport system, there are evident gaps in the penetration, distribution, spread and reliability of affordable public transport. An integrated modal approach looking at road and rail would be required.	○ South Africa is a water scarce country ranked as the 30th driest state in the world with a water availability of 830 m3/capita/a. This is significantly less than Namibia or Botswana (respectively 2500 and 1080 m3/capita/a) which are known as arid countries. Rainfalls and water resources are unevenly distributed throughout the country with annual precipitations ranging from 100mm in the western part of the country to 1500mm in the southeast. ○ Faced with the above mentioned challenges, the Government developed the National Water Resources Strategy 2 (NWRS2) in 2013, whose goal, is as follows: Water is efficiently and effectively managed for equitable and sustainable growth and development. ○ This strategy includes three objectives: (i) Water supports development and the elimination of poverty and inequality, (ii) Water contributes to the economy and job creation and (iii) Water is protected, used, developed, conserved, managed and controlled in an equitable and sustainable manner.	○ Premature deindustrialization: Manufacturing and industrial activities in general have been on the wane over the last 2 decades, reversing the diversification which the economy enjoyed throughout most of 1970s, 1980s and 1990s and propelling the services sector as main contributor to growth. The transition to services happened earlier, and faster than elsewhere. ○ To address its inclusive growth and youth employment challenges, South Africa will need to reindustrialize. Through significant upstream and downstream linkages to other sectors in the primary, secondary and tertiary sectors, goods-productive industries could play a critical role in jobs creation. ○ The economy continues to suffer from an oligopolistic structure that create a barrier to entry and limit inclusiveness as well as growth. In various sectors, old and large firms continue to dominate the economy and hence preventing an optimal openness which could improve the cost of doing business and encourage the entry of new firms and the growth of SMEs.

5. Poverty & Fragility	**6. Governance**	**7. Natural Resources**	**8. Environment and Climate Change**
○ Despite being one of the largest economies in Africa and a stable democracy with strong institutions, two decades after the end of apartheid, the economic, social, and political landscape today, is marked with various forms of fragility. Economic drivers of fragility include: infrastructure bottlenecks, rising premium gaps between skilled and unskilled labour, limited competition in goods and services market and slow pace of economic transformation. ○ Political drivers of fragility include: policy uncertainty and distrust between the private sector and the government, porosity in public finance management, limited institutional capacity at the subnational level, and highly politicised labour market. ○ Social, spatial and environmental drivers: rising intra and inter racial income inequality, violence and risk of violence against immigrants, high poverty and inequality, limited reach of social protection system, limited social cohesion, deforestation and desertification and low energy and water security.	○ Despite the successful transition towards a system of democratic governance, international benchmark indicators show that governance in South Africa remains stagnant and further reforms are needed to strengthen accountability and transparency. The country's performance in the Transparency International Corruption Perception Index leaves considerable room for improvement. ○ South Africa's public financial management (PFM) system has undergone substantial reforms since the mid-1990s. Early reforms shaped macroeconomic stability, improved revenue collection, realigned public spending, and sought to improve the efficiency of resource allocations and effective service delivery. ○ South Africa does not have a stand-alone procurement law that guides on all aspects of public procurement. The PFMA Act No. 1 of 1999 is one of the most important pieces of legislation passed by the first democratic government in South Africa. In addition to that, more than 80 different legal instruments govern public sector Supply Chain Management (SCM).	○ The most important minerals to the South African mining industry, which in 2015 contributed 80% of minerals sales, are coal, gold, platinum group metals (PGMs) and iron ore. The country produces annually some 260 million tons of coal and still has enough resources to last for over 200 years at current depletion rates. ○ South Africa, a renowned mining country has not yet joined the EITI even though the country was instrumental in the formation of the Kimberley Process, an initiative that not only aimed and curbing trade in conflict diamonds but also advocated for increased transparency in the diamond industry. ○ The South African mining industry is regulated under the Mineral and Petroleum Resources Development Act 28 of 2002. Given the different points of view between Government and the Chamber of Mines, regulation of the country's mining industry is regarded by industry as a source of uncertainty in the industry, which impacts on the country's attractiveness to investors.	○ The sectors that account for the majority of national energy consumption include industry (27.4 MTOE per year), transport (17.9 MTOE) and the residential sector (16.8 MTOE) (IEA, 2014). Coal is the largest contributor to South Africa's greenhouse gas (GHG) emissions from fuel combustion (~343 MT CO_2e), followed by oil (~73 MT CO_2e). ○ Through the implementation of a range of policies and plans, South Africa intends to transition to a low-carbon development path. Significant progress has been made in implementing climate compatible sectoral plans, such as the integrated energy and electricity plans (IEP and IRP) and the IPAP. ○ South Africa's mitigation component proposes a "deviation from business-as-usual" form of commitment which takes the form of a peak, plateau and decline trajectory for GHG emissions. By 2025 and 2030 emissions have been projected to range between 398 and 614 Mt CO_2–eq, as defined in national policy. The latter is the benchmark against which the effectiveness of mitigation actions will be measured.

9. Agriculture	**10. Human Development**	**11. Gender**	**12. Financial Sector**
○ South Africa has a dual agricultural economy, with both well-developed commercial farming and more subsistence-based production in the deep rural areas. While 12% of South Africa's land can be used for crop production, only 22% of this is high-potential arable land. The greatest limitation is the availability of water, with uneven and unreliable rainfall. Around 1.3-million hectares are under irrigation, and around 50% of South Africa's water is used for agriculture. ○ The share of agriculture in GDP has decreased over past four decades, currently contributing around 2.4%. However, farming remains vitally important to the economy with 638 000 people formally employed although it's estimated that around 8.5-million people are directly or indirectly dependent on agriculture for their employment and income. ○ Low degree of integration into a market economy by subsistence farming reduces the chances to improve productivity. Adding value to agricultural raw products through processing can help reach markets, which is highly inclined towards large-scale farmers, requiring higher quality standards that cannot be	○ In spite of being the most advanced country in Africa, South Africa has its fair share of interrelated challenges of poverty, food insecurity, unemployment, HIV and AIDS, and other adverse social conditions. Millions of people live below the poverty line. The poverty profile of South Africa based on the Living Conditions Survey put the percentage of people living below the upper poverty line of R620 per person per month at 27% in 2011. ○ A new index from the World Economic Forum (WEF) highlights South Africa's skills shortage and its poor ability to nurture talent through educating, training and employing its people. The country is ranked 88th out of 130 economies in 2016. The WEF's human-capital index ranks economies on how well they are developing and deploying their human capital, and creating workforces which are prepared for the demands of competitive economies. ○ In addition to challenges faced in social protection, skills development and health, youth are more affected by the high unemployment rate in South Africa, of over 27% in 2016, with their unemployment averaging	○ Despite advances in the legislative and policy frameworks, life experiences of the majority of women in South Africa have remained unchanged and difficult since independence. Women continually bear the triple jeopardy of poverty, unemployment and inequality. These, and the additional burdens of Gender Based Violence (GBV) and HIV AIDS, further aggravate women's inequality. Women affected by these challenges are mostly black and specifically African. This is an indication of the deep-rooted effects of colonialism, apartheid and patriarchy. ○ The Policy Framework for Women's Empowerment and Gender Equality establishes a clear vision and framework for gender mainstreaming across laws, policies, procedures and practices. It requires that Director-Generals and Ministers implement gender mainstreaming within their departments and institutions, report on progress made, and use the recommendations outlined within the policy to enhance the socio-economic empowerment of women. Gender Focal Points (GFPs) have been placed in the offices of the Director-Generals	○ While South Africa's financial sector is very well developed and diversified, SMMEs face significant challenges to access finance. Despite the financial sector's high degree of sophistication, access to finance by SMMEs remains a key challenge. Small businesses consider the lack of access to finance as one of the key challenges for their development and expansion. Furthermore, although South Africa appears to be financially inclusive in terms of number of transaction accounts held by adults (70%), these accounts are created by government or employers to deposit grants or wages and are not widely used for transactions by the account holders. Only about 25% of low income households use their accounts for transactions. The bulk of low income households are still financially excluded. ○ South Africa has signed into law the Financial Services Regulation Bill (also known as the Twin-Peaks model of financial regulation) on 21 August 2017. The Bill creates two brand new financial sector regulators: (1) the Prudential Authority; and (2) the Financial Sector Conduct Authority. The

achieved with the fragmented smallholder domain. Hence, rural household income remains low and chances for employment are limited.	about 56% in July 2017 and exceeding 60% in several poverty nodes in the country. The government's National Development Plan (NDP) targets to increase student enrolment in Higher Education Institutions (HEIs) to 1.62 million by 2030. Enrolment in HEIs (both public and private) stood at 1 050 851 in 2012, indicating that an increased enrolment of 35% is needed between 2012 and 2030 to achieve the NDP target.	to support gender mainstreaming in all programmes and ensure that the strategic plans of their departments have gender indicators. ○ South Africa has achieved near universal primary education even though boys' enrolment slightly exceeds that of girls at an average of 51 % over the last ten years. The trend reverses in secondary school where data shows that the number of female learners in secondary school exceeds that of male learners. 7. Higher participation of females is observed at the tertiary level too. Enrolment at public Higher Education Institutions (HEIs) is dominated by women taking up (58.3%) of total enrolments according to 2013 statistics.	first is responsible for regulating the prudential aspects of banks and all non-bank financial institutions, and the second for regulating market conduct and fair treatment of financial consumers. The South African Reserve Bank (SARB) oversees the two regulatory bodies and provides overall financial sector regulatory oversight.

ANNEX 13: ECONOMIC AND SECTOR WORKS UNDERPINNING THE CSP 2018-2022

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ANNEX 14: CSP 2018-2022 CONSULTATION PROCESSES

ANNEX 14.1. SUMMARY OF EMERGING MESSAGES FROM CONSULTATIONS WITH STAKEHOLDERS

Government Authorities

- Poor performance in South Africa's economic growth and job creation over the past two decades is attributed to rapid expansion of non-tradable goods sectors at the expense of tradable goods, i.e. manufacturing and mining (i.e. deindustrialization). Over the past four decades, there has been a rapid structural shift from production to services, the latter now accounting for nearly three-fourths of GDP while industry accounts for less than 20% of GDP. To address high unemployment and poverty, reindustrialization is crucial. Re-alignment of policy and programme levers (infrastructure projects and local procurement) to increase the share of the productive sectors.
- Enhanced integration across the sub region and the continent is crucial for economic growth and job creation in South Africa. Africa has increasingly become an important destination for South Africa's exports of manufactured goods accounting for nearly 35% of the same in 2016.
- South Africa features a dual economy with a developed economy centred on major metropolitan areas coexisting with a developing economy in townships and poor rural areas. Address Dual Economy Challenges by improving government services in less developed communities: The townships or informal economy have been neglected due to lack of basic economic infrastructure.
- Policy coherence across the state: Coordination and implementation of policy across the various state structures will ensure effective delivery of basic economic and social services and help reduce poverty, inequality and unemployment.

Development Partners

- The Bank's focus on energy including investments on renewable energy independent power production and transport infrastructure, as well as regional integration are consistent with the country's binding development constraints.
- Strengthen governance at SOE and local government levels is crucial to build business confidence and accelerate the private sector investment to create much needed jobs.
- Opportunities for partnership and co-financing exist in a number of areas including infrastructure, governance, climate change, as well as joint Economic Sector Works.

Private sector and Civil Society Organizations

- Improved working relationship with the three key players in the economy business, government and labour is critical to revive the economic growth.
- It is also important to engage and address concerns around expropriation of land, mining rights and foreign and domestic monopoly capital appropriately and support SMMEs across all spheres to accelerate their participation in the economy.
- The voice of civil society is much diminished given the difficulties and waning influence of the umbrella origination the South African NGO Coalition (SANGOCO). Most of the demand for accountability is through the court system (Litigation Avenue). In the case that government initiates consultation with civil society, usually this is to select NGOs. The perception is that some of these do not have grass-root reach/community voices.
- The civil society groups should be supported to conduct advocacy work and programme particularly in respect of women empowerment and youth employment.

ANNEX 14.2: KEY STEPS OF CONSULTATIONS WITH STAKEHOLDERS DURING CSP PREPARATION

Key Steps of Consultation with Stakeholders

CSP Workshop:

- The South Africa CSP 2018-2022 was formulated with close consultations with the Government, the private sector, the development partners and the civil society groups.
- A two-day workshop was jointly organized by the Government (National Treasury) and the AfDB on 21-22 June 2017 for consultation with the Government Departments and State Owned Enterprises.
- In the Workshop the following items were discussed:
    - The CSP 2013-2017 implementation progress report,
    - The South African recent macroeconomic development,
    - Constraints to inclusive growth,
    - SMME development,
    - Cross border investment and trade,
    - Governance and local government capacity,
    - The South CSP 2018-2022 areas of focus, and
    - Sector project implementation progress reports, regulatory framework and reforms, gender, and climate change and green growth.

Bilateral Consultation Meetings

- In addition to the Workshop, the CSP Task Team conducted bilateral consultation meetings with the private sector, development partners active in the country and the civil society groups for two weeks from 19 - 30 June 2017.
- The following issues were discussed in the bilateral meetings:
    - Views of stakeholders on recent economic development and prospects,
    - Business environment and investor confidence,
    - Civil society groups and their role in ensuring accountability in public institutions,
    - Aid coordination and co-financing opportunities with the development partners
    - Joint Economic and Sector Works
    - Lessons learned by the development partners operating in South Africa,

Ongoing Dialogue with the Government

- Dialogue continued with the Government and other stakeholders after the approval of the CSP Pillars by CODE in January 2018.
- A consultation was conducted with the Industrial Policy Unit of the Industrial Development Division of the South African Ministry of Trade and Industry on 24 January 2018.
- This unit is responsible for the Industrial Policy Action Plan (IPAP) which guides the government industrial policy.
- The DTI and AfDB agreed to work closely together to identify areas of collaboration to address challenges of de-industrialization in South Africa in the current CSP period.
- Further dialogue took place with the National Treasury at the RDGS offices on 30 January 2018 and Economic Development Department (EDD) on 6 February 2018. Authorities reiterated their support to the two pillars of the CSP and encouraged the Bank to undertake a study on developmental mandate of the SOEs. EDD promised to share list of ESWs with the Bank.

ANNEX 14.3: ENTITIES CONSULTED DURING THE CSP MISSION AND WORKSHOP

South Africa CSP 2018-2022, CSP 2013-2017 Completion Report and CPPR 2017 Workshop Participants 21-22 June 2017 - Public Sector Institutions.

	Name	Title	Institution
1	Ms. Mmakgoshi Phetla-Lekhethe	Executive Director	AfDB
2	Mr. Simon Qobo	Chief Director	National Treasury
3	Ms. Nandi Mkunqwana	Director	National Treasury
4	Mr. Sibusiso Gumbi	Senior Economist	National Treasury
5	Mr. Liso Zape	Senior Economist	National Treasury
6	Mr. Jeffrey Quvane	Director	National Treasury
7	Mr. Victor Luvhengo	Senior Economist	National Treasury
8	Ms. Larissa Van der Westhuizen	Analyst	National Treasury
9	Mr. Sipho Bhanisi	Director	National Treasury
10	Mr. Thabang Masoga	Seniour Analyst	National Treasury
11	Ms. Brenda Mathekga	Senior Analyst	National Treasury
12	Mr. Lloyd Ramakobya	Director	National Treasury
13	Mr. Eric Visser	Research Unit	Reserve Bank
14	Ms. Josina Solomons	Research Unit	Reserve Bank
15	Mr. Malcolm Simpson	Acting DG	EDD
16	Mr. Kaemete Tsotetsi	Chief Director	EDD
17	Ms. Nontombi Marule	Director	DTI
18	Ms. Zanele Sanni		DTI/Trade-Invest Africa
19	Mr. Noncedo Mviko		DTI
20	Mr. B. Diar		Department of Public Enterprises
21	Mr. James Dlamini		Department of Public Enterprises
22	Mr. Tshepo Makhubela	Director	DPE
22	Mr. Gertrude Molokoane		ESKOM
23	Ms. Sincedile Shweni		ESKOM
24	Dr. S. Plum		SA Water Research Commission
25	Mr. Nhlanhla Nkabinde		TCTA
26	Ms. Bopang Kutsoane		Department of Transport
27	Ms. Inge Mulder	CFO	SANRAL
28	Mr. Philip Geldenhuys	Treasury Manager	SANRAL
29	Ms. Mapule Mahlare	Back Office Treasury Manager	SANRAL
30	Mr. Sipho Khumalo	DDG	CBRTA
31	Ms. Helen Du Toit		CBRTA
32	Mr. Crynos Mutendera		CBRTA
33	Mr. Khanyile Selebo		CBRTA
34	Mr. Sibusiso Khoza		CBRTA
35	Dr. Dumisani Magadlela		DBSA
36	Ms. Thembi Khoza		DBSA
37	Mr. Mark Kuipers	Chief Director	National Treasury / Capacity Building
38	Ms. Shahkira Parker		Department of Environment
39	Mr. Nehru Pillay	General Manager, Research & Intelligence	Land Bank
40	Ms. Gloria Maaka-Tlokana	DDG	DHET
41	Ms. Brenda Swart	Finance	DHET

42	Mr. Molefi Monaledi	DDG	DHET
42	Ms. Nelisiwe Vilakazi		Department of Social Development
43	Ms. Nonhlanhla Buthelezi	Chief Director	Department of Human Settlement
44	Mr. Price Booi		Department of Women
	Dr. Beason Mwaka		Department of Water and Sanitation
45	Ms. Refiloe Moloi-Owoyomi		Department of Water and Sanitation
46	Ms. Ediretse Mokara		ATAF
47	Mr. Itumeleng Mataboge		ATAF

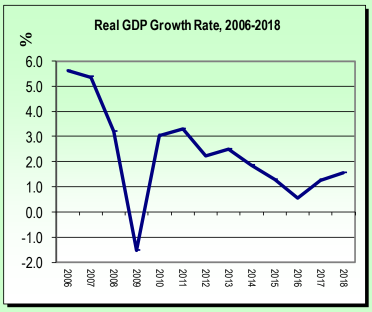
South Africa CSP 2018-2022, CSP 2013-2017 Completion Report and CPPR 2017 Bilateral Consultations – Government, Development Partners, the Private Sector and Civil Society Groups

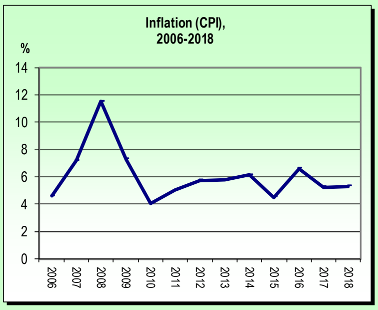
No	Name	Title	Institution
1	Mr. Monale Ratsoma	Deputy Director General	National Treasury
2	Mr. Simon Qobo	Chief Director	National Treasury
3	Ms. Nandi Mkunqwana	Director	National Treasury
4	Mr. Victor Luvhengo	Senior Economist	National Treasury
5	Ms. Mmakgoshi Phetla-Lekhethe	Executive Director	AfDB
6	Mr. Marek Hanusch	Country Economist	World Bank
7	Ms. Catherine Tovey	Programme Leader, Sustainable Development	World Bank
8	Mr. Sebastien Dessus	Programme Leader, Equitable Growth and Institutions and Finance	World Bank
9	Ms. Fatou Leigh	Economist	UNDP
10	Mr. Letsholo Mojanaga	Programme Manager, Inclusive Growth	UNDP
11	Mr. Gardner Rusike	Associate Director- Sovereign & IFP Ratings	Standard and Poor's
12	Mr. Vuyisa Tafa	Coord. Public Finance and Monetary Policy Chapter	Nedlac
13	Ms. Portia	A / Head of Programme Operations	Nedlac
14	Mr. Omar Vajeth	Head and Senior Transaction Advisor	SAPP
15	Ms. Jean Madzongwe	Transaction Advisor	SAPP
16	Ms. Martha Stein-Sochas	Regional Director	AFD
17	Mr. Arthur Germond	Deputy Regional Director	AFD
18	Ms. Sandra Freudenberg	Senior Project Manager Energy and Climate	KfW
19	Mr. Zeng Liang	Deputy Head, Treasury and Trading	China Construction Bank
20	Mr. Mohammed Adam	Deputy Head, Corporate and Institutional Banking	China Construction Bank
21	Ms. Barbara Peng	Manager, Marketing	China Construction Bank
22	Mr. O. Khwinana	Business Executive, Strategic Organizational Development & Leadership	Office of the Auditor General
23	Ms. Mandisa Tshikwatamba	CEO	SEDA
24	Mr. Lusapho Njenge	Chief Strategy and Information Officer	SEDA
25	Mr. Montfort Mlachila	Senior Resident Representative	IMF
26	Ms. Julie Beckenstein	Head SSA Country Risk	Fitch / BMI

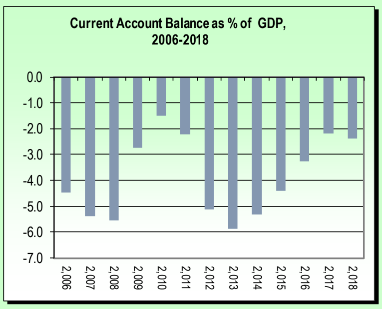
27	Ms. Tutsi Dhombo	Account Manager, Southern and West Africa	Fitch /BMI
28	Mr. Hardin Ratshisusu	Deputy Commissioner	Competition Commission
29	Mr. Liberty Ncube	Chief Economist	Competition Commission
30	Ms. Alex Kuhn	Divisional Manager	Competition Commission
31	Mr. Carmelo Cocuzza	Head of Regional Representation	EIB
32	Mr. Ryno Byeleveldt	Business Analyst	EIB
33	Ms. Lynette Milne	Head, PICC Technical Unit	Presidential Infrastructure Coordination Commission
34	Mr. Thando Nyaka	Infrastructure Specialist	PICC
35	Mr. A. J. Alonzo Wind	Deputy Mission Director (Bilateral)	USAID
36	Ms. Rebecca Ottke Krzywda	Deputy Mission Director (Bilateral)	USAID
37	Mr. Lloyd Jackson	Office Director	USAID
38	Ms. Ashley King	Regional Energy Officer	USAID
39	Mr. Bart Van Uythem	First Counsellor, Head of Economic and Infrastructure Sector	European Union
40	Ms. Milly Chesire	Project Manager	European Union
41	Mr. Kenneth Thlaka	Executive Director	SANGONET/SANGOCO
42	Mr. Leonard Radzuma,	Acting Chief Executive Officer	TCTA
43	Mrs. Halima Nazeer,	Chief Financial Officer	TCTA
44	Prof. Ola Busari,	Chief Strategy Officer	TCTA
45	Mr. Nhlanhla Nkabinde,	Executive Manager, Project Finance and Treasury	TCTA
46	Mr. Augustin Wambo Yamdjeu		NEPAD, Agriculture
47	Mr. Khulekani Mathe		The Banking Association of South Africa
48	Mr. Levy Maduse	National Programme Officer	UNIDO
49	Ms. Yulia Privalova Krieger	Deputy Representative	UNICEF South Africa
50	Mr. Mokutule Kgobokoe	DDG, Policy Planning and Monitoring and Evaluation	Department of Agriculture, F and Fs
51	Ms. Bafedile Bopape	Chief Director, Policy Development and Planning	Department of Agriculture, F and Fs
52	Mr. Doctor Thath	Acting Chief Director, M&E	Department of Agriculture, F and Fs
53	Mr. Nkhangweleni Ramashia	Chief Director, Development Finance	Department of Agriculture, F and Fs
54	Ms. Bongeka Mdleleni	Deputy Director, Africa Relations	Department of Agriculture, F and Fs

ANNEX 15: SELECTED MACROECONOMIC INDICATORS

Indicators	Unit	2000	2013	2014	2015	2016	2017 (e)	2018 (p)
National Accounts								
GNI at Current Prices	Million US $	135,589	392,078	364,291	330,757	301,284	...	...
GNI per Capita	US$	3,020	7,340	6,750	6,070	5,480	...	...
GDP at Current Prices	Million US $	132,964	366,645	350,638	317,509	295,739	324,841	341,095
GDP at 2000 Constant prices	Million US $	132,964	202,243	205,978	208,614	209,793	212,440	215,710
Real GDP Growth Rate	%	4.2	2.5	1.8	1.3	0.6	1.3	1.5
Real per Capita GDP Growth Rate	%	2.6	1.4	0.8	0.3	-0.3	0.4	0.8
Gross Domestic Investment	% GDP	15.9	21.2	20.5	21.0	19.4	18.5	18.7
Public Investment	% GDP	4.3	7.1	6.9	7.4	7.2	6.7	6.6
Private Investment	% GDP	11.6	14.1	13.6	13.6	12.2	11.8	12.1
Gross National Savings	% GDP	15.2	15.3	15.2	16.6	16.1	16.3	15.8
Prices and Money								
Inflation (CPI)	%	7.7	5.8	6.1	4.5	6.6	5.3	5.3
Exchange Rate (Annual Average)	local currency/US$	6.9	9.7	10.9	12.8	14.7	13.3	13.5
Monetary Growth (M2)	%	61.9	5.7	7.9	10.1	4.6	6.3	...
Money and Quasi Money as % of GDP	%	81.7	114.9	115.3	119.2	116.1	124.0	...
Government Finance								
Total Revenue and Grants	% GDP	23.8	27.8	28.3	29.5	29.2	28.8	29.7
Total Expenditure and Net Lending	% GDP	25.8	31.5	31.9	33.1	32.7	33.1	33.4
Overall Deficit (-) / Surplus (+)	% GDP	-2.0	-3.7	-3.6	-3.7	-3.5	-4.3	-3.7
External Sector								
Exports Volume Growth (Goods)	%	70.0	3.7	2.8	4.6	-0.6	-0.1	3.6
Imports Volume Growth (Goods)	%	33.6	6.2	0.0	5.5	-4.0	1.9	4.1
Terms of Trade Growth	%	-20.8	-0.8	-1.4	3.4	1.5	6.9	-2.7
Current Account Balance	Million US $	-172	-21,556	-18,636	-13,942	-9,626	-8,105	-8,098
Current Account Balance	% GDP	-0.1	-5.9	-5.3	-4.4	-3.3	-2.5	-2.4
External Reserves	months of imports	2.3	4.9	5.1	5.5	6.4	5.7	5.2
Debt and Financial Flows								
Debt Service	% exports	56.6	43.5	40.2	56.2	53.7	44.4	51.8
External Debt	% GDP	27.1	37.2	41.3	39.1	48.3	49.8	46.3
Net Total Financial Flows	Million US $	-494	-473	5,974	6,330	3,941	...	...
Net Official Development Assistance	Million US $	486	1,295	1,077	1,420	1,181	...	...
Net Foreign Direct Investment	Million US $	887	8,300	5,771	1,772	2,270	...	...





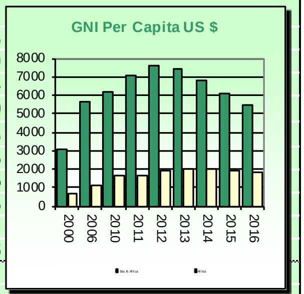


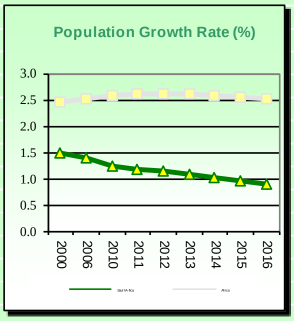
Source : AfDB Statistics Department; IMF: World Economic Outlook,April 2018 and International Financial Statistics, April 2018;
AfDB Statistics Department: Development Data Portal Database, April 2018. United Nations: OECD, Reporting System Division.

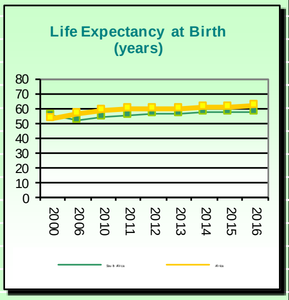
Notes: ... Data Not Available (e) Estimations (p) Projections Last Update: May 2018

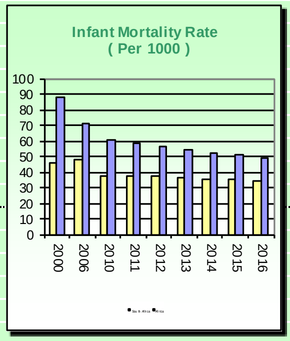
ANNEX 16: COMPARATIVE SOCIO ECONOMIC INDICATORS

	Year	South Africa	Africa	Develo-ping Countries	Develo-ped Countries
Basic Indicators					
Area ('000 Km²)	2017	1,219	30,067	94,716	35,018
Total Population (millions)	2017	56.5	1,244.8	6,252.1	1,190.0
Urban Population (% of Total)	2017	64.3	40.5	49.2	81.4
Population Density (per Km²)	2017	45.7	42.4	66.0	34.0
GNI per Capita (US $)	2016	5 480	1 836	4 442	41 208
Labor Force Participation *- Total (%)	2017	53.7	65.8	62.3	60.3
Labor Force Participation **- Female (%)	2017	46.6	55.3	47.8	52.5
Sex Ratio (per 100 female)	2017	97.0	100.2	107.5	105.3
Human Develop. Index (Rank among 187 countries)	2015	119	...	...	...
Popul. Living Below $ 1.90 a Day (% of Population)	2011	16.6	...	16.3	0.6
Demographic Indicators					
Population Growth Rate - Total (%)	2017	0.8	2.5	1.3	0.6
Population Growth Rate - Urban (%)	2017	1.4	3.5	2.4	0.9
Population < 15 years (%)	2017	28.8	40.8	27.9	16.6
Population 15-24 years (%)	2017	18.8	19.2	16.7	11.9
Population >= 65 years (%)	2017	5.2	3.5	6.8	17.4
Dependency Ratio (%)	2017	51.5	79.6	54.6	52.0
Female Population 15-49 years (% of total population)	2017	26.9	24.0	25.6	22.6
Life Expectancy at Birth - Total (years)	2017	57.9	61.9	70.2	80.7
Life Expectancy at Birth - Female (years)	2017	59.5	63.3	72.3	83.5
Crude Birth Rate (per 1,000)	2017	19.9	33.9	20.6	10.9
Crude Death Rate (per 1,000)	2017	12.5	9.0	7.5	8.6
Infant Mortality Rate (per 1,000)	2016	34.2	49.3	33.1	4.5
Child Mortality Rate (per 1,000)	2016	43.3	72.6	44.3	5.3
Total Fertility Rate (per woman)	2017	2.3	4.4	2.6	1.7
Maternal Mortality Rate (per 100,000)	2015	138.0	444.1	237.0	10.0
Women Using Contraception (%)	2017	66.4	37.6	62.1	...
Health & Nutrition Indicators					
Physicians (per 100,000 people)	2005-15	76.7	41.6	121.6	293.5
Nurses and midwives (per 100,000 people)	2005-15	511.3	120.9	211.3	873.4
Births attended by Trained Health Personnel (%)	2010-16	...	55.9	76.6	98.9
Access to Safe Water (% of Population)	2015	93.2	71.6	89.4	99.5
Access to Sanitation (% of Population)	2015	66.4	39.4	61.5	99.4
Percent. of Adults (aged 15-49) Living with HIV/AIDS	2016	18.9	3.6	1.1	...
Incidence of Tuberculosis (per 100,000)	2016	781.0	221.7	163.0	12.0
Child Immunization Against Tuberculosis (%)	2016	74.0	82.1	84.9	95.8
Child Immunization Against Measles (%)	2016	75.0	74.4	84.0	93.7
Underweight Children (% of children under 5 years)	2010-15	...	18.1	15.3	0.9
Prevalence of stunding	2010-15	...	33.3	25.0	2.5
Prevalence of undernourishment (% of pop.)	2015	4.6	17.5	12.3	2.7
Public Expenditure on Health (as % of GDP)	2014	4.2	2.6	3.0	7.7
Education Indicators					
Gross Enrolment Ratio (%)					
Primary School - Total	2010-16	99.7	101.7	103.8	102.6
Primary School - Female	2010-16	97.3	98.8	102.2	101.8
Secondary School - Total	2010-16	98.8	51.8	...	106.6
Secondary School - Female	2010-16	111.5	49.7	...	106.4
Primary School Female Teaching Staff (% of Total)	2010-16	48.6	46.0	51.3	81.0
Adult literacy Rate - Total (%)	2010-16	94.4	68.6	...	...
Adult literacy Rate - Male (%)	2010-16	95.4	76.0	...	...
Adult literacy Rate - Female (%)	2010-16	93.4	61.7	...	...
Percentage of GDP Spent on Education	2010-16	6.0	4.9	4.1	5.2
Environmental Indicators					
Land Use (Arable Land as % of Total Land Area)	2015	10.3	8.0	11.3	10.1
Agricultural Land (as % of land area)	2015	79.8	37.4	38.1	35.1
Forest (As % of Land Area)	2015	7.6	21.0	31.4	28.8
Per Capita CO2 Emissions (metric tons)	2014	9.0	1.1	3.5	11.0









Sources : AfDB Statistics Department Databases; World Bank: World Development Indicators; last update : January 2018
UNAIDS; UNSD; WHO, UNICEF, UNDP; Country Reports.

*Note : n.a. : Not Applicable ; ... : Data Not Available. * Labor force participation rate, total (% of total population ages 15+)*
*** Labor force participation rate, female (% of female population ages 15+)*

ANNEX 17a: PROJECTS APPROVED DURING THE CSP PERIOD 2013-2017

	Project	Amount UA million	Window	Planned in CSP	Remarks
A. Lending Operations					
Pillar 1: Infrastructure Development					
1	Xina Solar One Project	49.9	ADB	Yes	Approved in 2014
		30.6	CTF		
2	Eskom II Power Project	300.1	ADB	Yes	Approved in 2015.
3	Eskom II "A" Loan	7.4	ADB	Yes	Approved in 2015
4	Housing Investment Partners Trust	32.2	ADB	Yes	Approved in 2016
Pillar 2: Support to Regional Integration					
5	Transnet Expansion Corporate Loan II	198.5	ADB	Yes	Approved in 2014
6	LOC to IDC	146	ADB	Yes	Approved in 2017
	Sub Total	**764.7**			
	Resource Syndicated	**696**			
B. Non-Lending Operations (Excluding ESWs)					
1	Broadband Infraco (BBI) grant	0.8	MIC grant	Yes	Approved in 2014
2	Operationalizing Community Driven Multiple Use Water Services	1.0	AWF	No	Added after dialogue with government Approved in 2014
3	Use of Social Franchising Mechanisms for Operation and Maintenance Support to School Sanitation in Eastern Cape	0.9	AWF	No	Added after dialogue with government Approved in 2014
4	Education for Sustainable Development in Natural Resources	0.2	MIC grant	No	Added after dialogue with government Approved in 2016
5	Municipal Financial Management Technical Assistance Project	0.7	MIC grant	No	Added after dialogue with government Approved in 2016
6	Enterprise Development Pilot Project	1.2	MIC grant	Yes	Approved in 2015
	Sub Total	**4.8**			
	Grand total	**1,465.5**			

ANNEX 17b: STATUS OF BANK GROUP ACTIVITIES IN SOUTH AFRICA (5 March 2018)

N	Long name	Window	Approval date	Amount App.	Amount Dis.	Dis. Ratio	Age
1	STANDARD BANK OF SOUTH AFRICA PROJECT FINANCE LINE OF CREDIT	[ADB]	9/11/2008	151,295,294.0	151,295,294.0	100.0	9.5
2	NEDBANK GROUP LINE OF CREDIT	[ADB]	9/11/2008	68,770,588.2	68,770,588.2	100.0	9.5
3	INDUSTRIAL DEVELOPMENT CORPORATION (IDC) LOC II	[ADB]	5/19/2010	137,541,176.4	137,541,176.4	100.0	7.8
4	NEDBANK LIMITED	[ADB]	11/8/2017	20,631,176.5	0.0	0.0	0.3
5	NON SOVEREIGN GUAR.LINE OF CREDIT TO IDC	[ADB]	11/5/2004	10,467,969.5	10,467,969.5	100.0	13.3
6	FIFTH LINE OF CREDIT TO DEVELOPMENT BANK OF SOUTHERN AFRICA	[ADB]	2/3/2011	206,311,764.6	206,311,764.6	100.0	7.1
7	LAND AND AGRICULTURAL DEVELOPMENT BANK OF SOUTH AFRICA	[ADB]	6/20/2012	58,562,067.0	58,562,067.0	100.0	5.7
8	IDC LINE OF CREDT III	[ADB]	9/27/2017	76,130,687.1	0.0	0.0	0.4
		[ADB]	9/27/2017	68,770,588.2	0.0	0.0	0.4
9	HOUSING INVESTMENT PARTNERS TRUST - HIP2	[ADB]	10/12/2016	33,380,378.2	0.0	0.0	1.4
				831,861,689.6	**632,948,859.7**	**76.1**	**7.6**
10	KALAGADI INDUSTRIAL BENEFICIATION PROJECT	[ADB]	5/18/2011	101,851,991.9	101,851,991.9	100.0	6.8
				101,851,991.9	**101,851,991.9**	**100.0**	**6.8**
11	STATISTICAL CAPACITY BUILDING PROGRAM PHASE II (SCB-II)	[ADB]	7/7/2011	490,600.0	490,600.0	100.0	6.7
12	SOUTH AFRICA MUNICIPAL FINANCIAL MANAGEMENT TECHNICAL ASSIST	[ADB]	9/7/2016	683,527.0	111,478.4	16.3	1.5
				1,174,127.0	**602,078.4**	**51.3**	**4.1**
13	ESKOM HOLDINGS LIMITED	[ADB]	6/28/2007	343,852,941.0	343,852,941.0	100.0	10.7
14	ESKOM RENEWABLE ENERGY - UPINGTON CSP	[CTF]	5/30/2011	34,385,294.1	0.0	0.0	6.8
15	ESKOM II POWER PROJECT	[ADB]	12/15/2015	309,931,189.6	309,931,189.6	100.0	2.2
26	ESKOM II - A LOAN	[ADB]	12/15/2015	6,877,058.8	6,877,058.8	100.0	2.2
27	MEDUPI POWER PROJECT ESKOM (LOAN IN EURO)	[ADB]	11/25/2009	793,765,950.0	658,117,431.5	82.9	8.3
		[ADB]	11/25/2009	622,514,772.3	614,967,895.9	98.8	8.3
18	XINA SOLAR ONE PROJECT	[ADB]	6/23/2014	51,510,653.4	49,228,764.8	95.6	3.7
		[CTF]	6/23/2014	28,539,794.1	28,539,794.1	100.0	3.7
				2,191,377,653.3	**2,011,515,075.7**	**91.8**	**5.7**
19	MIC - EDUCATION FOR SUSTAINABLE DEVELOPMENT IN NATURAL MINER	[MIC]	2/19/2016	205,950.0	157,077.5	76.3	2.1
20	ENTERPRISE DEVELOPMENT PILOT PROJECT	[MIC]	4/23/2015	1,200,000.0	135,902.9	11.3	2.9
				1,405,950.0	**292,980.4**	**20.8**	**2.5**
21	TRANSNET EXPANSION CORPORATE LOAN II	[ADB]	12/18/2014	204,967,234.5	175,686,201.0	85.7	3.2
22	TRANSNET LTD	[ADB]	6/23/2010	158,293,267.1	158,293,267.1	100.0	7.7
				363,260,501.6	**333,979,468.1**	**91.9**	**5.5**
23	OPERATIONALIZING COMMUNITY-DRIVEN MULTIPLE-USE WATER SERVICE	[AWF]	7/22/2014	1,143,705.8	457,482.3	40.0	3.6
24	SOCIAL FRANCHISING OPERATIONS & MAINTENANCE OF SCHOOL SANITA	[AWF]	12/12/2014	1,018,202.0	282,512.4	27.7	3.2
				2,161,907.8	**739,994.7**	**34.2**	**3.4**
				3,493,093,821.3	**3,081,930,448.9**	**88.2**	**7.1**

ANNEX 17c: KEY PERFORMANCE INDICATORS FOR ONGOING PORTFOLIO

South Africa: Key Portfolio Performance Indicators		
Selected Indicators	**Mar-2017**	**Mar-2018**
Portfolio performance (Flashlight Report) % satisfactory	72	70
Average size of projects (UA million)	146.6	145.5
Average project age (years)	5.1	5.8
No. active operations (#)	24	24
Average disbursement rate (%)	81.2	88.2
No. of ageing projects (#)	0	0
Slow disbursing projects (#)	2	2
Problematic projects (#)	1	1
Value of problematic projects (UA million)	197.7	35.5
% of problematic projects	5.6	1.1
Average time from approval to effectiveness (years)	1.4	1.4
Projects experiencing signature, effectiveness and first disbursement delays (#)	1	1

ANNEX 18: KEY FINDINGS OF THE 2013-2017 CSP COMPLETION REPORT

1. **The CSP 2013-2017 directly responded to the key development priorities identified under the National Development Plan (NDP) and Medium Term Strategic Framework (MTSF) 2014-19**, notably infrastructure development and deepening regional integration. About 76% of funds approved during the CSP period went to Pillar (1) ‘Infrastructure development”, primarily in support of Eskom's rolling capital expansion program, and a renewable independent power producer project while about 23.5% went to Pillar (2) ‘Support to regional integration’, to fund a freight rail infrastructure project and Lines of Credit for cross border investment. Support was also provided to promote enterprise development, access to low cost housing, improved community water use and sanitation and governance.

2. **The CSP 2013-2017 assistance programme was successfully implemented.** A total lending amount of UA 769.5 million was approved by the Bank for operations during the CSP period 2013-17, while USD 975 million (UA 696 million) were syndicated from international financial institutions, raising the total amount of resources provided to South Africa during the CSP period to UA 1.5 billion. The original CSP document envisaged 7 operations (6 operations under pillar 1, and 1 operation under pillar 2) expected to be approved during the CSP period. The lending pipeline was revised during the CSP MTR, with 8 additional operations to be approved during the remaining CSP period (5 additional under pillar 1, and 3 additional under pillar 2). A total of 12 operations were approved under the CSP: 8 under pillar 1, and 2 under pillar 2, and 2 cross-cutting operations. Five non-lending operations including knowledge products were approved during the CSP period. The Bank used credit enhancement products, including guarantees, guarantee syndication and loan syndication products as commercial co-financing options. Financing has been channelled through ADB, CTF, AWF and the MIC Trust Fund. The Bank leveraged its resources to catalyse other external sources of finance for lending operations. Out of the 12 projects the Bank approved under the CSP, 9 projects were funded by the Bank alone while 3 were co-financed with commercial banks and government. Most notably, the Bank made the largest syndication by any DFI amounting to USD 975 million for the Eskom corporate loan in 2017. The syndication efforts will continue during the next CSP cycle 2018-22. The syndicated Eskom B-loan attracted finance from nine commercial banks. The Bank will continue to play a catalytic role to attract potential financiers, to augment its own financing. The CR of the CSP 2013-17 combined with the 2017 CPPR, as well as the pillars proposed for the new CSP 2018-22, were approved by the Bank Group’s Committee on Operations and Development Effectiveness (CODE) on 19 January 2018.

ANNEX 19: 2017 COUNTRY PORTFOLIO IMPROVEMENT PLAN

Major Issues	Action Required	Responsible	Measurable Indicators	Timeline
Quality at entry				
Start-up delay (especially signature delay for SO and NSO). This is mainly due to (i) lack of clarity on the procedures for the review and approval of the letter of agreement; (ii) absence of skill-mix at project commencement, (iii) long approval procedures, and (vi) poor design.	Sensitize the PIUs and the MoF during the launching of the project on the importance to speed up the signature process to avoid delay and cancellation of the project.	Govt/Bank	Letter of Agreement signed and the project declared effective within 6 months.	Immediately for new projects
	Ensure all PIU staff/experts are recruited before project commencement.		Qualified and experienced project staff are recruited within 3 months after signature.	
	Provide guidance to the PIU to work, in parallel, on the ToRs, EOIs, the procurement plan and conditions for first disbursement while waiting for signature of the letter of agreement. Provide guidance on disbursement applications, procurement and financial management requirements.		Conditions to first disbursement met, Procurement launched.	
	Ensure that high quality and comprehensive feasibility studies were conducted before project approval		Less than 10% of new projects delayed because of poor feasibility studies/designs	
Management and monitoring of the Portfolio				
Delays in project implementation due to (i) poor coordination / oversight of contractors, (ii) weak PIU capacity, (iii) limited knowledge of Bank's procedures, and (vi) poor communication between different stakeholders.	Organise project review/ monthly meetings with contractors.	Govt/PIU/Bank	At least four project reviews / coordination meetings organised annually.	Immediately for existing and new projects
	Task managers, RDGS experts, including fiduciary, to continue organising regular meetings with the PIUs to follow-up closely with them and resolve constraints.		At least three meetings held annually	on-going
	Provide training on the Bank's procedures		At least one training session held anually	on-going
	Improve communication by organising frequent meetings (quarterly) between the Bank, the MoF and the line ministries/PIUs.		Four quarterly review meetings held per annum	Immediately

Procurement				
Absence of a unitary Procurement Law in the Country, very complex procurement legal framework, indented with several legislative instruments	Review of existing Procurement legal framework and drafting of a unified Public Procurement Law.	Govt	Adoption of new unified public procurement law	2018
Limited procurement experience and knowledge of Bank Procurement Rules & Procedures	* Regular training sessions for PIU staff in Bank Rules and Procedures; * Consider use of Borrower Procurement Systems for low risk procurements.	Bank	One training organized for each new operation.	Ongoing
Project start up and delays in commencement of procurement activities and lengthy procurement processes for complex procurements	Systematically use of Advance Contracting procedures especially for complex infrastructure projects.	Govt/PIU	50% reduction in procurement lead time targeted compared with present	Immediately
Disconnect between the Procurement Plan and Work plan	Systematic synchronization of updates for both plans.	Govt/PIU	Submission of updated procurement and work plans every 6 months	Immediately
Complex procurement arrangement for low risk projects	Simplify the procurement arrangement for low risk contracts	PIUs/Bank	Number of new projects with simplified procurement arrangements: Half of new operations should have less than 5 procurement activities. All new projects should uses advance contracting.	On-going
Financial Management				
Delays in project implementation and use of funds advanced to the Project	Enhance the review of the project work plans and their planning and budgeting to ensure that they are realistic aimed at facilitating project implementation and timely use of funds	Project Implementing Agency	Timely implementation of work plans within the stipulated timeframes	Ongoing
Inclusion of financial information in periodic project reports submitted to the Bank to facilitate their proper understanding to enable project monitoring	Additional financial information relating to the actual and planned expenditures by project components together with the variances during the period in addition to counterpart contributions should be included in periodic reports submitted to the Bank	Project Implementing Agency	At least thre quarters of projects submit comprehensive project quarterly progress reports to the Bank for loans and semi annually for grants	Ongoing on a quarterly basis
Delays in submission of Annual Project Audit Reports.	Project Implementation Teams to properly plan for the external audit including the timely engagement/recruitment of the auditors	Project Implementing Agency	90% of projects submit project audit reports timely, i.e. before the due date.	Within 6 months after the end of the respective period end
	Bank to continuous monitor and follow up on the arrangements for the project audits as part of project supervision missions	Bank		Continuous
Justifications of the special account expenditures not submitted frequently enough.	Justifications of the special account expenditures need to be submitted every semester	Govt/PIU	Semi-annual follow up report prepared on SA justification status	
Disbursement				
Slow disbursements *(NB: low disbursement rate is not as such an implementation challenge but often a result of delayed implementation due to low quality at entry, delay in signing/disbursement effectiveness, inadequate knowledge of the implementing agencies on the Bank's procurement & disbursement procedures)*	Justification of disbursement needs to be submitted on time to be able to submit the following request and avoid delays.	Gov't/Bank	Disbursement rates increased.	Immediately

ANNEX 20: DONOR MATRIX

Development partner	Capacity building and institutional support	Environment and climate	Investment climate	Education	Health	Private sector	Agriculture	Water	Energy	Transport	PPP	Trade	Governance
African Development Bank						+	+	+	+	+	+	+	+
World Bank	+		+						+				+
Germany		+		+	+	+			+				
IMF	+												
European Commission/EIB	+			+	+	+			+	+			
UN and its Organs	+	+			+								+
Japan-JICA	+	+		+						+		+	
USAID			+		+							+	+
France-AFD									+				
New Development Bank									+				
Switzerland	+	+		+									

ANNEX 21: PROGRESS TOWARDS MILLENNIUM DEVELOPMENT GOALS

	2000	2015	Status
Goal 1: Eradicate extreme poverty and hunger			
Employment to population ratio, 15+, total (%)	44.1	42.7	Not achieved
Percentage of people who report experiencing hunger	29.9	12.9	Achieved
Poverty headcount ratio at $1.25 a day (PPP) (% of population)	17.0	8.5	Achieved
Prevalence of stunting in children under-five years of age (%)	23.9[1]	23.8[1]	Not achieved
Goal 2: Achieve Universal Primary Education			
Adjusted net enrolment ratio in primary education (%)	96.6	99.3	Achieved
Literacy rate, adult total (% of people ages 18 and above)	73.5	84.3	Not achieved
Secondary school completion rate, total (% of relevant age group)	36.3	46.1	Not achieved
Adjusted net enrolment ratio in tertiary education (%)	14	19.4	Not achieved
Goal 3: Promote Gender Equality and Empower Women			
Proportion of seats held by women in national parliaments (%)	25	42	Not achieved
Ratio of female to male primary enrolment	0.97:1	0.99:1	Achieved
Ratio of female to male secondary enrolment	1.13:1	1.03:1	Achieved
Goal 4: Reduce Child Mortality			
Immunisation, measles (% of children aged 1 year)	66.4	87	Not achieved
Mortality rate, infant (per 1,000 live births)	54	23.6	Not achieved
Mortality rate, under 5 (per 1,000)	59	34.3	Not achieved
Goal 5: Improve maternal health			
Births attended by skilled health staff (% of total)	67	85.6	Not achieved
Contraceptive prevalence (% of women ages 15-49)	27.6[2]	52.7	Not assessed
Maternal mortality ratio (modelled estimate per 100,000 live births)	134	141	Not achieved
Goal 6: Combat HIV/AIDS, Malaria And Other Diseases (Tuberculosis)			
Incidence of tuberculosis (per 100,000 people)	134,000	530,000	Not achieved
Prevalence of HIV, female (% ages 15-24)	22.8	21.7	Achieved
Prevalence of HIV, population (% ages 15-24)	9.3	7.1	Achieved
Prevalence of HIV, total (% of population ages 15-49)	15.6	18.8	Not achieved
Goal 7: Ensure Environmental Sustainability			
CO2 emissions (kg per PPP $ of GDP)	1.18[2]	1.08	Possible
Improved sanitation facilities (% of population with access)	49.3	76.8	Achieved
Improved water source (% of population with access)	76.6	90.8	Achieved
Goal 8: Develop A Global Partnership For Development			
Net total ODA/OA per capita (current USD)	0.19	0.12	Achieved
Internet user households (% of households)	n.a	53.3	Achieved
Mobile cellular subscriptions (per 1000 people)	24	145	Achieved
Telephone lines (per 1000 people)	11.1	7.1	Achieved

Note: 1 : 2008; and 2: 2010; n.a; data not available; Last update September 2015 Source: Statistics South Africa

ANNEX 22: PROGRESS IN ACHIEVING THE SDGs

South Africa

Table 4: Progress Toward Achieving the Sustainable Development Goals

	2000[1]	2010[2]	2016[3]
Goal 1: End poverty in all its forms everywhere			
Proportion of population living below the international poverty	35.2	...	...
Proportion of population living below the national poverty line (%)	...	53.2	...
Proportion of employed population below the international poverty	...	...	...
Proportion of employed population below the international poverty	...	...	...
Goal 2: End hunger, achieve food security and improved nutrition and promote sustainable agriculture			
Prevalence of undernourishment (%)	...	...	...
Prevalence of stunting among children under 5 years of age	...	...	...
Prevalence of stunting among children under 5 years of age	...	0.8	...
Total official flows (official development assistance plus other	61.9	34.3	...
Goal 3: Ensure healthy lives and promote well-being for all at all ages			
Under-five mortality rate (per 1 000)	66.7	53.7	43.3
Maternal mortality ratio (per 100 000)	85.0	154.0	...
Total net official development assistance to medical research and	14.8	16.7	...
Goal 4: Ensure inclusive and equitable quality education and promote lifelong learning opportunities for all			
Proportion of children and young people at the end of primary	...	...	...
Proportion of children and young people at the end of primary	...	...	...
Gender parity index of teachers in primary education who are trained	1.1	...	...
Goal 5: Achieve gender equality and empower all women and girls			
Proportion of women aged 20-24 years who were married or in a	...	...	...
Proportion of girls and women aged 15-49 years who have	...	...	...
Proportion of seats held by women in national parliaments (%)	...	44.5	41.8
Goal 6. Ensure availability and sustainable management of water and sanitation for all			
Proportion of population using safely managed drinking water	86.5	91.1	...
Proportion of population using safely managed drinking water	57.2	63.5	...
Level of water stress: freshwater withdrawal as a proportion of	...	...	...
Total official flows for water supply and sanitation (Constant	10.6	50.9	...
Goal 7: Ensure access to affordable, reliable, sustainable and modern energy for all			
Proportion of population with access to electricity (%)	66.1	82.7	...
Proportion of population with primary reliance on clean fuels and	...	74.6	...
Renewable energy share in the total final energy consumption (%)	18.5	16.9	...
Goal 8: Promote sustained, inclusive and sustainable economic growth, full and productive employment and decent work for all			
Unemployment rate, (aged 15 over) (%)	...	...	...
Unemployment rate, (aged 15-24) (%)	...	...	...
Proportion of children aged 5-17 years engaged in child labour	...	...	...

Table 4 (Cont'd) : Progress Toward Achieving the Sustainable Development Goals

	2000[1]	2010[2]	2016[3]
Goal 9: Build resilient infrastructure, promote inclusive and sustainable industrialization and foster innovation			
Manufacturing value added per capita (Constant 2010 US $)	864.6	952.2	...
Manufacturing value added per capita (Constant 2010 US $)	11.2	11.1	...
Total official international support to infrastructure	48.0	1110.2	...
Goal 10: Reduce inequality within and among countries			
Labour share of GDP, comprising wages and social	6.9	9.8	...
Total resource flows for development (US $ Millions)	-494.2	4860.4	...
Goal 11: Make cities and human settlements inclusive, safe, resilient and sustainable			
Proportion of urban population living in slums (%)	33.2	...	...
Annual mean levels of fine particulate matter (PM2.5) in	...	...	...
Goal 12: Ensure sustainable consumption and production patterns			
Total material footprint (Thousands of metrics tons)	416200	450000	...
Total material footprint (Thousands of metrics tons)	9.3	8.8	...
Total domestic material consumption (Thousands of	605975	639635	...
Goal 13: Take urgent action to combat climate change and its impacts			
Goal 14: Conserve and sustainably use the oceans, seas and marine resources for sustainable development			
Coverage of protected areas in relation to marine areas (%)	13.3	13.3	13.3
Goal 15. Protect, restore and promote sustainable use of terrestrial ecosystems, sustainably manage forests, combat			
Coverage by protected areas of important sites for mountain	26.5	28.6	28.6
Proportion of important sites for terrestrial biodiversity that are	20.2	21.2	21.2
Red List Index	0.8	0.8	0.8
Goal 16: Promote peaceful and inclusive societies for sustainable development, provide access to justice for all and			
Proportion of children under 5 years of age whose births have	...	...	...
Unsentenced detainees as a proportion of overall prison	...	...	...
Goal 17: Strengthen the means of implementation and revitalize the Global Partnership for Sustainable Development			
Volume of remittances (in United States dollars) as a proportion of	0.3	0.3	...
Debt service as a proportion of exports of goods and services	5.6	2.6	...
Total amount of all resources made available to strengthen	...	2547.3	...
Proportion of individuals using the Internet (%)	5.4	24.0	...

Sources : ADB Statistics Department Databases; United Nations Statistical Division, Online Database on Sustainable Development Goals (https://unstats.un.org/sdgs/).

1 Latest year available in the period 2000-2005; 2 Latest year available in the period 2006-2010; 3 Latest year available in the period 2011-2016

ANNEX 23:BDEV RECOMMENDATIONS AND ACTIONS TAKEN

BDEV South Africa CSP 2004-2015 Evaluation Recommendations	How the CSP Reflects the Recommendations
RECOMMENDATION 1: Focus on selected areas where the Bank has a comparative advantage	Extensive consultations were undertaken with all stakeholders to identify Bank's comparative advantage in the next five years. A Brief growth diagnostic study was also conducted which informed South Africa's key development challenges and potential areas for partnership.
RECOMMENDATION 2: Address the mismatch in objectives of Lines of Credit	The updated guidelines for processing the Lines of Credit were not made available at the time of the CSP finalisation.
RECOMMENDATION 3: Use South African experience to inform revisions to the Bank's approach to private sector operations, design and monitoring.	The revised guidelines on private sector operations were not available at the time of the completion of the CSP document. RDGS will make sure that during the project kick-off meeting, the ADOA template and reporting templates will be shared with the client. There shall also be meeting correspondence between the parties, acknowledging the items that were discussed (including reporting requirements). Follow-on disbursements will not be made unless the recipient is in compliance. In addition, the LOC agreement will include a flexibility whereby the template could be changed to report on emerging issues by the task manager.
RECOMMENDATION 4: Identify new flexible funding mechanisms better suited for MICs	The Bank has employed innovative funding mechanisms in South Africa including syndication, co-financing, Clean Technology Fund, Partial Credit Guarantees (PCGs), hedging support options, and private equity participation and is currently exploring ways of applying PCG to either: (i) a bond issuance and/or (ii) foreign exchange swaps. has been seeking guidance concerning possibilities of lending to sub national governments in South Africa. This could widen the horizon of financial products offered in the country. Municipal financing options should therefore be explored further. The existing Bank guidelines already allow to lend to sub national governments. More innovative financing instruments will continue to be used.
RECOMMENDATION 5: Complete the decentralisation process	The implementation of the new Development and Business Delivery Model will complete the decentralisation process and streamlining of business processes.
RECOMMENDATION 6: Share the lessons from South Africa's experience in the energy sector	The Energy Unit of RDGS will implement this recommendation during the current CSP period.

ANNEX 25: OVERVIEW OF STATE OWNED ENTERPRISES IN SOUTH AFRICA

State Owned Enterprises (SOEs) play important roles in economic development. SOEs constitute a significant segment of the South African economy. Post 1994, there was great expectation that SOEs would contribute to the socio-economic transformation of the country and contribute to amongst others job creation, skills development, industrialization and regional integration. However, this has not been realized due to a number of challenges ranging from strategic to governance, financing and performance. This, in part, informed the decision in May 2010 to set up the Presidential Review Committee (PRC) on SOEs whose mandate was to redefine the configuration and the role of SOEs in South Africa to address the economic, social and service delivery challenges facing the country.

The PRC estimated that there were 300 SOEs at national level and 715 SOEs in the country as a whole including state owned entities at sub national level, and other forms of SOEs such as trusts, section 21 companies and chapter 9 institutions. SOEs in South Africa are classified into three broad categories: (1) Commercial (State Owned Companies, Development Financing Institutions (DFIs), State Investment Companies, and Statutory Corporations); (2) Non-commercial (Research entities, Service delivery entities, Regulatory entities, Departmental agencies, etc.); and (3) Constitutional Institutions and Tertiary Education Institutions.

Commercial SOEs in South Africa operate in key sectors of the economy including (1) Energy (Eskom); (2) Transport (Transnet; South African Airways; South African National Roads Agency (SANRAL); Passenger Rail Agency of South Africa (PRASA)); (3) Water (Trans Caledon Tunnel Authority (TCTA); Rand water; Amatola water; etc.); (4) Telecommunication and Postal services (Telkom SA; South African Post Office; Broadband Infraco; etc.); (5) Mining (Alexkor; Mintek; etc.); (6) Housing (National Housing Corporation; Rural Housing Loan Fund; etc.); (7) DFIs (Industrial Development Corporation (IDC); Development Bank of Southern Africa (DBSA); Land Bank; Small Enterprise Finance Agency (SEFA); etc.); and (8) State investment companies (Public Investment Corporation (PIC); etc.).

The main challenge facing SOEs in South Africa is lack of an overarching SOE strategy. That is there has not been a clear national Government policy on how SOEs fit into national development strategies and priorities. This has in turn resulted in widespread 'lack of clarity of purpose' for many SOEs and undermined alignment of SOE activities with the state developmental agenda. In addition, weak capacity at shareholder Government departments; lack of standard reporting templates; absence of horizontal performance assessment and lack of SOE central authority to set performance target have all undermined the effectiveness of the SOEs in delivering their developmental mandates.

In addition, funding models for social and economic development mandates of SOEs are blurred and confusing, leading in some instances to under-capitalization, which impedes the SOE's ability to contribute to meeting national challenges. As a result, SOEs continue to constrain the South African economy by absorbing large amounts of scarce capital, with low productivity, and often limited service coverage. The majority of the SOE portfolios do not produce a sufficient return to cover capital costs. These low returns are achieved despite subsidized capital, monopoly market power (e.g. Eskom and Transnet), and ongoing government cash transfers. The low returns on SOE investment has contributed to negative fiscal impact on public finance and South Africa's slow economic growth. This could be due to poor labor and capital productivity, obsolete management practices, and inadequate regulatory arrangements for utility tariffs. SOEs can also constrain private sector growth because of poor service provision. However, not all SOEs are performing poorly. DFIs and state investment companies are performing well both in terms of governance and delivery of their developmental mandate. Recent media coverage regarding the performance of some key SOEs such as Eskom, South African Airways has also brought sharply into focus issues of governance of SOEs in South Africa. These include perceptions of undue influence and political interference in the running of SOEs, lack of acountability, conflict of interest; shortfalls in procurement and contract management processes; instability in leadership with frequent changing of the Board and executives which can further impede the internal control environment and need for clarity as regards the compensation of executives.

Low SOE returns are not unique to South Africa, and are common throughout the developing and developed world. Chronic SOE portfolio underperformance highlights a fundamental flaw in the SOE model. SOEs enjoy a competitive advantage in three key areas: (i) Preferred access to government contracts; (ii) Subsidized capital, with lower SOE debt and equity costs than private firms, allowing them to remain marginally profitable despite being less efficient than their private competitors; and (iii) Monopoly services provision, in some cases.

Policy makers around the world are aware of SOEs' chronic underperformance, fiscal costs, and negative impact on growth and poverty alleviation. Consequently, efforts to reform SOEs have been ongoing for decades. Reforming the SOE sector is also vital for private sector development, as it will create opportunities for private investment, reduce the costs of doing business, and improve basic service delivery.

To reposition SOEs, the PRC in its recommendations called for amongst others the development of overarching SOE Strategy covering ownership, governance, and oversight policy for SOEs; ensuring that governance policies and practices are in place and that there are streamlined points of contact between regulators, agencies, government and SOE; adopting a standardised evaluation criteria modelled on best practice to make performance monitoring more effective; providing adequate funding and skills development. Most of these are also echoed in the NDP 2030 which notes that the major SOEs need clear public-interest mandates and straightforward governance structures that enable them to balance and reconcile their economic and social objectives. Amongst others the NDP calls for improving coordination between policy and shareholder ministries; clarifying lines of accountability; ensuring appointment processes are credible and that there is greater stability in appointments. The NDP aspires that by 2030 South Africa should be served by efficient, financially sound and well-governed SOEs that address the country's developmental objectives and are globally competitive.

END NOTES

[1] The Bank has provided technical assistance for capacity building in public finance management at local Government levels. This will continue under the new CSP.

[2] The economic complexity of a country is dependent on the complexity of the products it exports. A country is considered 'complex' if it exports not only highly complex products but also a large number of different products.

[3] South Africa's PFM system is generally sound. However, lack of capacity at local government levels and non-compliance to PFM rules at State Owned Enterprises have been major concerns. The Bank is supporting capacity building for public finance at the local government levels while the Government has since early 2018 taken measures to improve governance in State Owned Enterprises.

[4] The rationale for introduction of these reforms were to protect consumers in the case of access to consumer information and to raise more revenue in the case of higher duties.

[5] By 2025 and 2030, emissions will be in a range between 398 and 614 Mt CO2–eq (lower and upper limit, respectively)

[6] Vimal Ranchhod and Murray Leibbrandt, 2014. Why Didn't Inequality Decline in South Africa? SALDRU, UCT 4th November 2014

[7] The International Transport Forum's 2013 Road Safety Annual Report ranked South Africa the worst out of 36 countries in road safety.

[8] Statistics South Africa, General Household Survey, Republic of South Africa, 2017

[9] One of the recent success stories in South Africa portfolio is the turnaround of the Kalagadi project.

[10] The mining sector, which is largely private-owned, accounted for about 25% of exports (2015).

[11] The 9 major *Manufacturing* sub-sectors are as follows: Agro processing (food and beverages); textiles clothing and leather; wood, paper and related; petroleum and chemicals; non-metallic minerals; metals, machinery and equipment; electrical machinery and apparatus; transport equipment; and furniture. In the *Mining* sector, coal, gold, platinum group metals (PGMs) and iron ore are the most important sub-sectors.

[12] The economic complexity of a country is dependent on the complexity of the products it exports. A country is considered 'complex' if it exports not only highly complex products but also a large number of different products.

[13] Key South Africa brands include Shoprite, Mr. Price, Pick and Pay and Ackermans in the retail sector; MTN in mobile telephone sector; DSTV, and Standard Bank, First National Bank, NedBank, etc. in financial services, with Development Bank of Southern Africa, and the Industrial Development Corporation providing development financing beyond South Africa.

[14] The International Transport Forum's 2013 Road Safety Annual Report ranked South Africa the worst out of 36 countries in road safety.

[15] By 2025 and 2030, emissions will be in a range between 398 and 614 Mt CO2–eq (lower and upper limit, respectively)