

# **Building back better from COVID-19, with a special focus on jobs**



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# **Building back better from COVID-19, with a special focus on jobs**

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# Contents

vi	<i>Acknowledgements</i>
vi	<i>This Work</i>
vii	<i>Abbreviations and Acronyms</i>
1	<b>Executive Summary</b>
7	<b>PART 1</b> <b>Recent Economic Developments</b>
8	Real Sector Developments
13	Labor Markets and Poverty
13	Fiscal Developments
17	Monetary Policy and Financial Sector Developments
18	External Sector
20	Outlook and Risks
31	<b>PART 2</b> <b>South Africa's Labor Markets and Impacts of the COVID-19 Pandemic</b>
32	South Africa's labor market has performed poorly in the past decade
34	The pandemic exerted a heavy toll on the labor market
36	COVID-19 widened inequalities in the labor market
39	Government's Response to the Pandemic and Policy Options Going Forward
41	Rebuilding South Africa's labor market after the pandemic
45	Conclusion
47	<i>References</i>
49	<b>Appendix 1</b>

## Boxes

- |    |  |    |  |
|----|--|----|--|
| 8  | <b>BOX 1.1</b> Structural constraints to growth in South Africa                    | 21 | <b>BOX 1.5</b> South Africa's economy benefits from high commodity prices                          |
| 9  | <b>BOX 1.2</b> COVID-19 infections in South Africa                                 | 27 | <b>BOX 1.6</b> South Africa's public finances are vulnerable to stress in global financial markets |
| 10 | <b>BOX 1.3</b> The impact of the pandemic on micro-, small, and medium enterprises | 33 | <b>BOX 2.1</b> Measuring the labor market impact of the COVID-19 pandemic in South Africa          |
| 15 | <b>BOX 1.4</b> Public expenditure allocation: A cross-country comparison           | 44 | <b>BOX 2.2</b> Unlocking entrepreneurship and self-employment in South Africa                      |

## Figures

- |    |  |    |  |
|----|--|----|--|
| 2  | <b>FIGURE E.1</b> South Africa's contraction in 2020 was deep, and recovery in 2021 will be moderate | 20 | <b>FIGURE 1.12</b> The post-pandemic rebound may be moderate                                     |
| 4  | <b>FIGURE E.2</b> Richer workers lost earnings, but poorer workers lost more jobs                    | 21 | <b>FIGURE B1.5.1</b> Notable improvement in terms of trade from 2020                             |
| 8  | <b>FIGURE 1.1</b> South Africa is falling behind its peers   | 21 | <b>FIGURE B1.5.2</b> Higher mining exports were driven by prices rather than volumes             |
| 10 | <b>FIGURE B1.3.1</b> Early in the pandemic, South African firms saw the largest decreases in sales   | 22 | <b>FIGURE 1.13</b> Household savings are decreasing after rising during the pandemic             |
| 10 | <b>FIGURE B1.3.2</b> South Africa's MSMEs increasingly use digital technologies                      | 22 | <b>FIGURE 1.14</b> Vaccination is lagging  |
| 12 | <b>FIGURE 1.2</b> COVID caused the largest economic contraction in 25 years                          | 25 | <b>FIGURE 1.15</b> 2021 Budget path requires a significant reduction in the primary deficit      |
| 12 | <b>FIGURE 1.3</b> Investment declined sharply  | 27 | <b>FIGURE B1.6.1</b> Public debt is mostly domestic  |
| 13 | <b>FIGURE 1.4</b> Labour market challenges persist   | 27 | <b>FIGURE B1.6.2</b> Local yields remain relatively high   |
| 13 | <b>FIGURE 1.5</b> Despite the lower cost of debt, weak growth now affects fiscal sustainability      | 32 | <b>FIGURE 2.1</b> A decade of poor labor market outcomes   |
| 14 | <b>FIGURE 1.6</b> Public debt dynamics   | 32 | <b>FIGURE 2.2</b> Over the last decade, jobs growth was modest in almost all categories          |
| 14 | <b>FIGURE 1.7</b> Interest payments were already rising before 2020 amid a rising stock of debt      | 33 | <b>FIGURE 2.3</b> South Africa is experiencing a demographic opportunity                         |
| 15 | <b>FIGURE B1.4.1</b> Fiscal deficit widened markedly over the last decade                            | 34 | <b>FIGURE 2.4</b> Young people face acute unemployment rates                                     |
| 15 | <b>FIGURE B1.4.3</b> Wage bill is comparatively high   | 34 | <b>FIGURE 2.5</b> More than 4 million young people are not working or studying                   |
| 15 | <b>FIGURE B1.4.2</b> Interest payments on government debt are comparatively high                     | 35 | <b>FIGURE 2.6</b> The COVID impact: Employment declined fast and recovers slowly                 |
| 15 | <b>FIGURE B1.4.4</b> Public gross fixed capital formation is comparatively low                       | 35 | <b>FIGURE 2.7</b> South Africa's labor market did worse than most of its peers during the crisis |
| 17 | <b>FIGURE 1.8</b> Policy rate is at historically low level   | 35 | <b>FIGURE 2.8</b> The size of the labor market keeps shrinking                                   |
| 18 | <b>FIGURE 1.9</b> Current account dynamics were favourable in 2020                                   | 36 | <b>FIGURE 2.9</b> The share of workers who worked zero hours spiked in Q2 2020                   |
| 19 | <b>FIGURE 1.10</b> Yield spread on government bonds has widened                                      | 36 | <b>FIGURE 2.10</b> Poorer workers were much more likely to lose jobs                             |
| 19 | <b>FIGURE 1.11</b> Financial account was in deficit in 2020  |    |  |

36 **FIGURE 2.11** Among people who kept their jobs, higher-wage workers suffered bigger earnings losses

38 **FIGURE 2.12** Unequal impacts of job losses across demographic subgroups

38 **FIGURE 2.13** Unequal impacts of job losses across labor market subgroups

43 **FIGURE 2.14** Self-employment – South Africa's biggest opportunity to create jobs

## Personal Perspectives

11 **PERSONAL PERSPECTIVE 1.1** Managing guest houses during the pandemic

35 **PERSONAL PERSPECTIVE 2.1** From cleaner to cakemaker

38 **PERSONAL PERSPECTIVE 2.2** Small-scale farmer benefits from emergency funding

40 **PERSONAL PERSPECTIVE 2.3** Restaurants – 86 Public

## Tables

14 **TABLE 1.1** Evolution of consolidated expenditure

16 **TABLE 1.2** COVID-19 relief package in FY2020

20 **TABLE 1.3** Baseline forecasts

23 **TABLE 1.4** Main risks and opportunities to the outlook

39 **TABLE 2.1** Simulated welfare losses in 2020 for the typical South African

40 **TABLE 2.2** Summary of the social protection response

46 **TABLE 2.3** Time horizon, beneficiary population, and fiscal costs of suggested policy measures

49 **TABLE A.1** Employment composition, by labor market category, 2019

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## This Work

This is the 13<sup>th</sup> edition of the *South Africa Economic Update* (SAEU) report — a biannual World Bank flagship publication on the state of South Africa's economy. The report series forms an important aspect of the World Bank's analytical program in various middle-income client countries. Each SAEU comprises two sections: the first summarizes the recent economic developments and outlook, and the second takes a deeper analytical look at a topic of special interest and relevance to the country.

This report, which comes after an interruption of two years, focuses on the impact of the COVID-19 crisis on South Africa, particularly on the job market, where it has exposed severe structural weaknesses. The labor market had been marked by high levels of unemployment and inactivity even before the crisis; these have been exacerbated by the pandemic. Inequality is widening because of significant and unequal job losses, which affected low-wage workers almost four times as badly as high-wage ones. The report suggests a sequenced set of interventions to strengthen job recovery. These include temporary support programs, more permanent changes in government finances, and a redirection of government policies to support job creation and entrepreneurship. The COVID-19 pandemic created an opportunity to accelerate the reforms needed for a higher growth trajectory and a more inclusive and resilient economy.

We sincerely hope that the analysis in this SAEU will contribute to the national debate on this important topic and help inform policy decisions that can re-energize South Africa's economy and labour market.

# Abbreviations and Acronyms

<b>ALMP</b>	Active Labor Market Programs
<b>ETI</b>	Employment Tax Incentive
<b>GDP</b>	Gross domestic product
<b>ILO</b>	International Labour Organization
<b>MTEF</b>	Medium-Term Expenditure Framework
<b>NEDLAC</b>	National Economic Development and Labour Council
<b>NEET</b>	Not in Employment, Education, or Training
<b>NIBUS</b>	National Informal Business Upliftment Strategy
<b>QLFS</b>	Quarterly Labour Force Survey
<b>PMI</b>	Purchasing Managers' Index
<b>SARB</b>	South African Reserve Bank
<b>SARS-CoV-2</b>	Severe acute respiratory syndrome coronavirus 2
<b>TERS</b>	Temporary Employee/Employer Relief Scheme





# Executive Summary

## Main messages

**The government's crisis response has been sound.** South Africa is set to emerge from the crisis weaker than it had been going into it. However, this Economic Update argues that the reasons for low growth and high unemployment do not lie in the government's crisis response, which has generally been sound.

**Economic growth is expected to rebound in 2021, but the medium-term outlook is uncertain.** Growth is expected to reach 4 percent in 2021, slowing to 2.1 percent in 2022 and 1.5 by 2023. The global recovery is helping South Africa, especially given strong performance by China and the United States, two of its main trading partners. With deeper economic reforms, South Africa could benefit even more from the high growth in its trading partners.

**The COVID-19 crisis is widening inequality by contributing to severe and unequal job losses.** Low-wage workers suffered almost four times more job losses than did high-wage ones. Although a modest job recovery has started, it is at risk from the severe third wave of the pandemic.

**Young entrepreneurs are one of South Africa's best hopes of solving the jobs crisis.** Self-employment represents only 10 percent of all jobs, as against 30 percent in most upper-middle-income economies, such as Turkey, Mexico, and Brazil. The emerging start-up sector in South Africa could help close this gap.

**In response to COVID-19, the Government of South Africa implemented one of the most severe lockdowns on the continent.** By the end of June 2021, the country had recorded more than 1.9 million COVID-19 cases and over 60,000 deaths in two waves of the pandemic. Without the government's robust response, the human costs of the pandemic could have been even higher. However, like many other countries, South Africa could not avoid a third wave of COVID-19 infections, which is

unfolding as this report is being published. Only a rapid increase in vaccinations could help contain the pandemic in South Africa.

**The government also enacted a significant relief package to counter the adverse impacts of the lockdown on economic activity, especially for low-wage workers and poorer households (Bhorat and Kohler, 2020).** Despite these measures, the economy shrank by 7 percent in 2020,

a decline exceeded by only three major emerging economies — Argentina, India, and Mexico, all of which are expected to recover strongly in 2021.

For 2021, the World Bank projects growth in the gross domestic product (GDP) of 4 percent, followed by 2.1 percent in 2022 and 1.5 percent in 2023. The global recovery is helping South Africa, especially given strong performance by China and the United States — two of its key trading partners. However, other emerging markets are recovering faster (Figure E.1) which suggests that South Africa’s economy would benefit from being integrated even more effectively into global value chains.

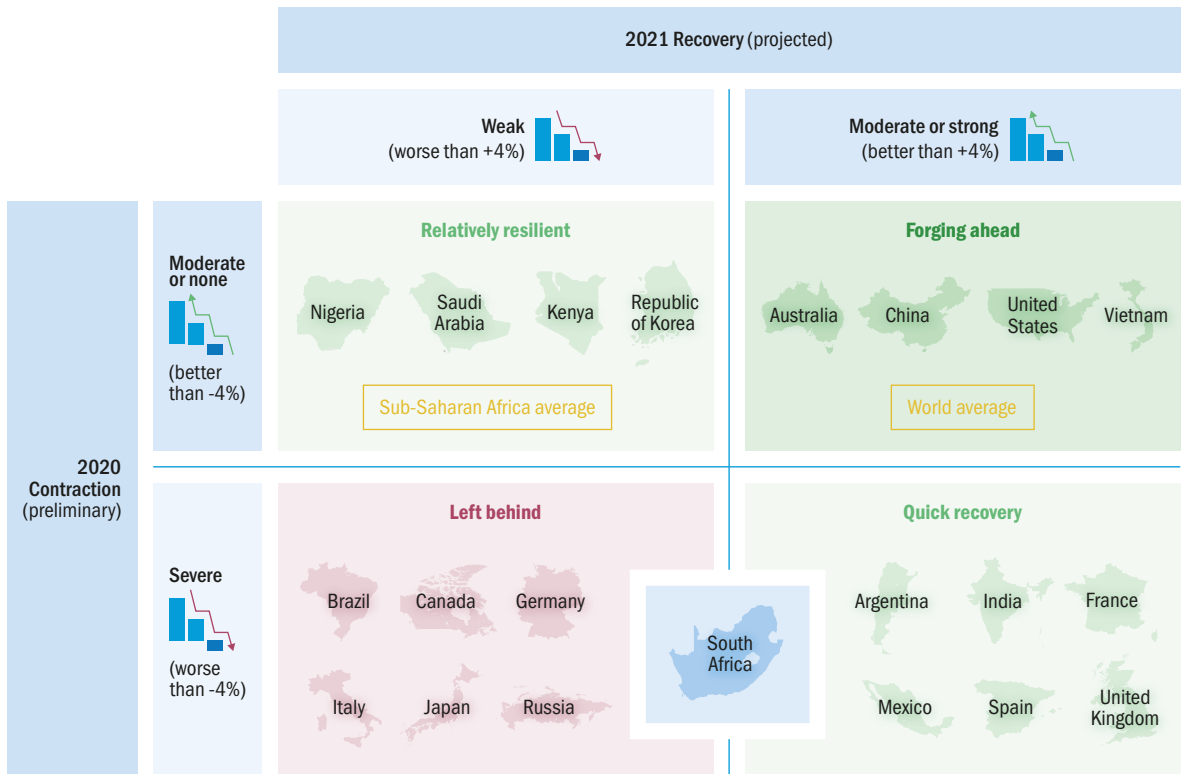
Among other concerns, the crisis is exposing structural weaknesses in the job market. Even at the best of times, South Africa’s labor market had been marked by high levels of unemployment and inactivity. The crisis has made a bad situation worse. By the end of 2020,

despite two quarters of employment growth, the number of employed people had fallen by nearly 1.5 million, and the wages of workers who still had jobs had fallen by 10 – 15 percent. With the combined loss of employment and earnings, the average South African of working-age was about 18 percent worse off at the end of the year than at its start.

Young entrepreneurs are one of South Africa’s best hopes for solving the jobs crisis. There are an increasing number of start-ups, especially in the digital sector, which are growing fast and could in future become an engine of jobs growth. But for the entrepreneurship ecosystem to realize its full potential, its key weaknesses need to be resolved. A vibrant start-up sector could also help close the relative gap in self-employment (own-account workers with own businesses, freelancers). Self-employment represents only 10 percent of jobs in South Africa, as against about 30 percent in most upper-mid-

**FIGURE E.1** South Africa’s contraction in 2020 was deep, and recovery in 2021 will be moderate

COVID-19-related contractions and projected recovery rates, 2020 and 2021



Source: World Bank Global Economic Prospects. Note: 2020 GDP growth rates better than -4% are defined as moderate and worse than -4% as severe. For 2021, projected recovery rates below 4% are regarded as weak and above 4% as strong.

dle-income economies, including Turkey, Mexico, and Brazil. If South Africa were to match the self-employment rate of its peers, it could potentially halve its unemployment rates.

**South Africa is set to emerge from the crisis weaker than it had been going into it; however, this *Economic Update* argues that the reasons for this do not lie in the government’s crisis response, which has been generally sound.** Instead, the pandemic has exposed long-standing structural weaknesses that have progressively worsened since the global financial crisis of 2008–09. For this reason, as the economy recovers, South Africa would benefit most if the government would simultaneously implement structural reforms. These include temporary support programs, more permanent changes in government finances, and a redirection of government policies to support job creation and entrepreneurship. The COVID-19 pandemic created an opportunity to accelerate the reforms needed for a higher growth trajectory and a more inclusive and resilient economy.

## A fragile macroeconomy

**COVID-19 has brought the deepest recession since the end of apartheid.** South Africa’s GDP shrank by 7 percent in 2020, more than in almost all other emerging economies. Falling GDP and fiscal revenues, combined with a sizeable relief package, saw the fiscal deficit growing to 12.9 percent of GDP and public debt to 78.8 percent of GDP. Unlike advanced economies that can service debt at low interest costs, South Africa faces high debt costs; its debt service burden is now close to 5 percent of GDP. This crowds out resources for much-needed developmental spending, including public investment.

**In 2021, South Africa benefited from better global market conditions, which reversed the risk aversion at the beginning of the pandemic.** In the first half of 2020, the worsening global outlook and the loss of South Africa’s last investment grade rating in March 2020 led to significant capital outflows, a widening of government bond spreads, and a depreciation of the currency. However, since the end of 2020, global financial market conditions have improved, benefiting emerging countries such as South Africa. Even though the country is yet to scale up its vaccination program, it has already benefited from improved market sentiment in the Organi-

zation for Economic Co-operation and Development (OECD) and Asia.

**However, South Africa remains vulnerable to rising global yields, given its high financing requirements.**

Favorable commodity prices and weak domestic demand should continue to support the current account balance in 2021. This, along with the country’s flexible exchange rate and low foreign currency-denominated debt, would help reduce its vulnerability to the type of “taper tantrum” that occurred in 2013. However, although the government reduced its financing needs for 2021 because of better-than-expected revenues last year, public sector borrowing requirements will remain elevated over the medium term. This makes South Africa vulnerable to changes in financial market sentiment, given that more than one-quarter of its domestic debt is held by foreigners. Domestic saving levels are high, which could substitute for foreign investment, but this would inevitably crowd out resources for private investment and translate into weaker economic growth.

**For the South African economy to create prosperity, generate jobs, and improve public finances and debt dynamics, there is only one path — higher growth.**

South Africa’s peers have been showing the way. Since 2000, the typical middle-income economy had almost doubled its per capita income before the COVID-19 pandemic. South Africa’s economy grew relatively more slowly in the past two decades, its labor market outcomes worsened in the last decade, and its public finances had been deteriorating rapidly before the pandemic. The country now faces three main, interconnected challenges:

- **Growth.** Should South Africa not use the crisis as an inflection point, it risks suffering another lost decade. After a decade of low growth that left the average South African poorer in 2019 than in 2010, the pandemic has made things even worse for workers and their families. Broad-based structural reforms could unlock growth and competitiveness and support sound public finances. Recent examples include the opening of the energy sector to private sector electricity generation and regulatory changes in the transport sector to improve freight rail and ports. Such reforms are needed to restart private sector investment, create more jobs for the growing working-age population, support fiscal sustainability, and take advantage of external growth drivers.

- Jobs.** The economy suffers not only from weak economic growth on the back of weak private investment but also from persistently high inequality, largely because the worsening labor market has kept more young people out than it has allowed in. South Africa has a working-age population of almost 40 million people, of which only 15 million are employed, including 3 million in the public sector. The pandemic has increased unemployment by more than 1 million to 7 million, which means that South Africa now has a record high unemployment rate of 33 percent. Of equal importance are the 17 million South Africans who are not playing an active part in the labor market. Of these, about 3 million appear to have stopped searching for work altogether.
- Debt.** By straining public finances, COVID-19 also weakened the country's macroeconomic position. South Africa entered the global financial crisis in 2008 with a reputation for fiscal conservatism and prudent debt management. In contrast, it entered the COVID-19 crisis with a fragile fiscal framework, a public debt-to-GDP ratio of 63 percent, and growing contingent liabilities from state-owned enterprises, including the energy utility, Eskom. These debt levels are not yet destabilizing, especially as the country benefits from a deep domestic financial sector. Exchange rate risks are also limited, as South Africa issues only 12 percent of its debt internationally. However, should it encounter

another economic shock, it could enter a very difficult macroeconomic terrain.

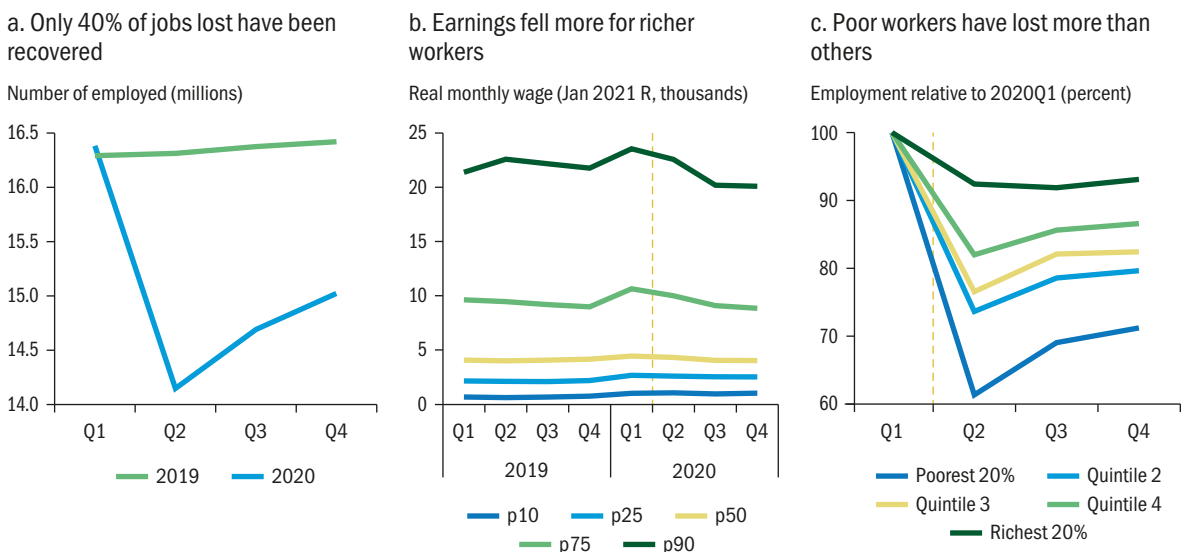
### Rising inequality

**The crisis is widening already high levels of inequality.** A welfare loss of this magnitude is to be expected in a severe crisis. More worrying in a country that is already the most unequal in the world is the differential impact of the crisis on the poorer half of the population. Most notably, the differential sectoral and occupational effects of the lockdowns and demand contractions have translated into greater job losses among poorer workers than among those who are better off (Figure E.2). In contrast, among people who kept their jobs, wages fell more for those with higher earnings. However, since employment losses have wider income implications, the pandemic has, overall, increased the extent of inequality in the country.

**To strengthen job recovery, a sequenced set of interventions would combine time-bound emergency support for poorer workers with reforms to increase the size of the labor market.** This report proposes measures in four categories (see Part 2 for details):

- Strengthen the labor market linkages of temporary government programs.** First, expand and deepen the employment tax incentive to enhance access to jobs,

**FIGURE E.2 Richer workers lost earnings, but poorer workers lost more jobs**



Source: World Bank staff.

particularly for those facing more constraints to integration into the labor market, such as young people and women. Second, continue the Temporary Employee/Employer Relief Scheme (TERS) for lockdown-damaged sectors until a sizeable share of firms are once again operational. Both measures should be time-bound.

- **Consider a moratorium on measures that have negative employment implications.** The government and its National Economic Development and Labour Council (NEDLAC) partners could consider a temporary suspension of regulations that increase the real cost of labor and make job recovery more difficult. The moratorium should be strictly time-bound (12–18 months) and linked to the pandemic and its economic consequences. It should be used primarily to benefit vulnerable people, who have disproportionately lost their jobs during the last year.
- **Revisit the approach to entrepreneurship, self-employment, and micro and small businesses.** First, relax legal constraints and rules that prevent the development of these economic activities. Second, scale up programs that provide both entrepreneurial training and start-up grants to address other barriers to entry. Partly for historical reasons, South Africa has stringent regulations that constrain entrepreneurs and freelance and own-account workers more than in other upper-middle-income countries. As noted, self-employment in South Africa constitutes just 10 percent of total employment, as against about 30 percent in the average upper-middle-income country. Thus, if South Africa were to raise its self-employment ratios to the average of upper-middle-income countries, unemployment rates could potentially be halved.
- **Improve the governance of active labor market programs.** First, systematically incorporate job search and training modules into active labor market programs, such as the Expanded Public Works Programme and the Presidential Employment Stimulus, to help prepare beneficiaries for entering the labor market. Second, incentivize labor intermediation services to help firms re-engage workers and quickly resume business.

Third, give employers access to funds in the Unemployment Insurance Fund to supplement the wages of part-time workers. Fourth, develop institutions for active labor market programs, especially monitoring and evaluation systems to improve the targeting and efficiency of the currently fragmented system.

### In summary

**A sequenced set of policy measures aimed at preserving macroeconomic stability, revitalizing the jobs market, and improving the investment climate is needed to build a better and more inclusive economy after the pandemic.** There is a risk that the recovery leaves behind most of the potential economically active population, particularly young job seekers, which would mean that the pandemic permanently impaired the country's long-term development prospects. Conversely, if South Africa were to engineer a broad-based recovery, this decade could bring new prosperity.

**Addressing structural constraints to growth behind and at the border could support exports and higher growth, and so preserve the sustainability of public finances.** The experience of major emerging economies, including South Africa, shows that the two most potent factors for reducing public debt-to-GDP ratios are economic growth and primary surpluses. The implied priorities are self-evident: a better climate for investment and trade, and prudent fiscal policy.


**To generate employment, South Africa would have to address three chronic problems in its labor market: extremely high rates of inactivity, high rates of unemployment, and low levels of self-employment.** Along with enacting carefully chosen regulations to improve the business climate and investing in the workforce through better education, the government can implement reforms to encourage self-employment and support the growth of micro- and small enterprises. Moreover, active labor market policies could help match job seekers with employment opportunities aligned with their abilities (see Part 2 of this report).



## PART 1

# Recent Economic Developments

### Main messages

- 1. The global economic outlook offers an opportunity for South Africa.** Favorable commodity prices and the global recovery support the recovery of the local economy in 2021. The external sector could be a driver of growth after the pandemic at a time when domestic drivers remain weak. This would also support public finances and might smooth the adjustment needed to achieve the government's fiscal targets.
  - 2. Better growth prospects over the medium term require addressing long-standing structural constraints.** Broad-based structural reforms would unlock growth and competitiveness and support sound public finances. Such reforms are needed to restart private sector investment, create more jobs for the growing working-age population, and take advantage of the external drivers of growth.
  - 3. Fiscal policy priorities are to preserve macro-stability and increase the impact of budget spending.** This requires improving the allocation and efficiency of budget resources while containing overall spending. This would be critical for restoring investor confidence and would avoid the growing interest payments crowding out much-needed economic and social expenditure even further. It would also reduce the vulnerability of public finances to changes in the global financial conditions.
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## Real Sector Developments

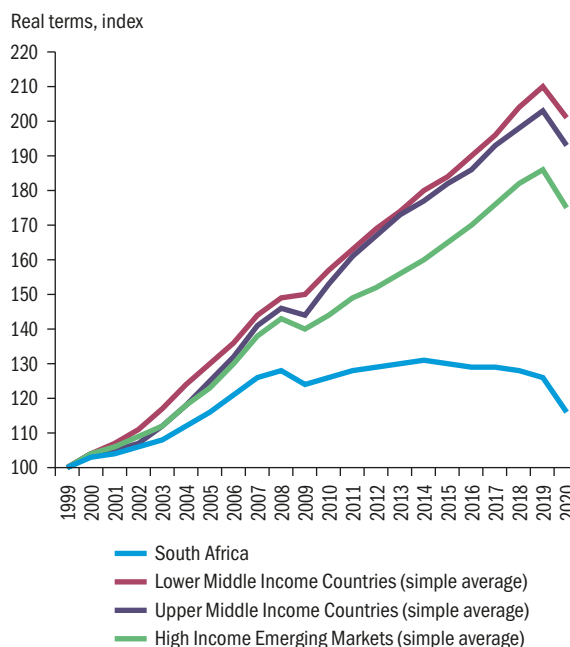
### South Africa entered the pandemic in a weak position

South Africa's economic growth has been slowing since the 2008 global financial crisis. After increasing on average by 4 percent per year between 1999 and 2008, annual growth in the gross domestic product (GDP) decelerated to 1.7 percent over 2010–19. With the population increasing by about 1.5 percent a year, per capita GDP has contracted since 2015 in real terms. Real per capita income is now almost back to its 2005 level. This contrasts with South Africa's middle-income peers—although they had also been affected by the global financial crisis, most have recovered and continued to see growth in real GDP per capita in the past decade (Figure 1.1).

South Africa's low growth is predominantly structural. Many factors contributed to the country's lack of economic dynamism over the past decade. Some are external, such as the end of the commodity super cycle that lasted from the early-2000s to the aftermath of the global financial crisis. However, domestic constraints have played a significant role (Box 1.1).

**FIGURE 1.1** South Africa is falling behind its peers

GDP per capita before and after the global financial crisis, 1999–2020



Source: World Bank staff calculations based on World Economic Outlook data.

### BOX 1.1 Structural constraints to growth in South Africa

South Africa faces a range of constraints to a higher growth trend (World Bank 2018). These constraints have affected the productivity and competitiveness of local firms—both internal (leading to weak profitability, growth, and job creation) and external (leading to a loss of market share in global trade). Over the past decade, they have also eroded business confidence and, hence, private investment. These constraints include:

- Skills scarcity in the labor force.** Despite slow and steady progress, the legacy of “bantus education” continues to deprive South Africa of the skills its economy needs. The country's weak economic prospects and policy uncertainty have contributed to the emigration of skilled workers, whereas its immigration regulations have hampered the inflow of skilled migrants.
- High cost of non-tradable inputs.** The energy, information and communication technology, and transport sectors are dominated by state-owned enterprises. Inefficiencies, a lack of competition, and the absence of a level playing field have contributed to high costs. Power outages have been a feature of electricity supply over the past 14 years.
- Limited competition in product markets.** Corporate ownership across the economy is skewed toward a few large firms that have conglomerate-style structures or are vertically integrated. This created high barriers to entry in product markets, which put smaller and new firms at a disadvantage.
- Policy uncertainty and deteriorating state capacity.** South Africa has strong institutions, a vibrant democratic system, and a generally capable civil service. Yet institutional quality has been eroded. A perceived rise in corruption, associated with “state capture” in the last decade, contributed to policy uncertainty and declining business confidence. Public service capacity has been weakened, as the number of political (rather than merit-based) appointments has grown. This, combined with a lack of skills, has affected service delivery.

The government's Economic Reconstruction and Recovery Plan recognizes these constraints and aims to address them.

## South Africa was hit hard by the COVID-19 crisis

South Africa has been severely affected by the COVID-19 pandemic. Between the first confirmed case in early March 2020 and June 2021, 1.9 million South Africans have been infected with COVID-19, and over 60,000 people have lost their lives (Box 1.2).

The economy contracted by 7 percent in 2020. The demand and supply shocks from the pandemic severely affected economic growth in the first half of 2020. The contraction in global demand already started to affect economic activity in the first quarter of 2020. Combined

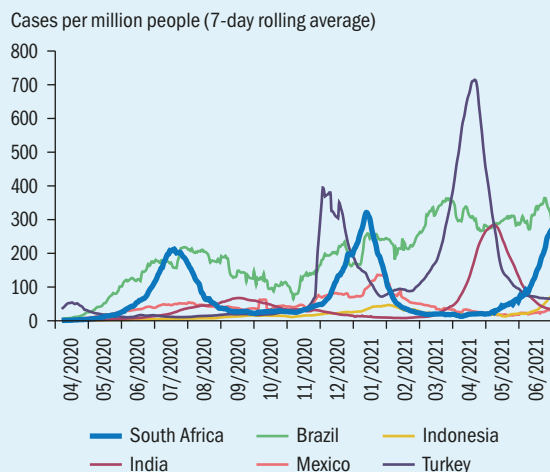
with domestic constraints, such as recurring electricity outages, this led economic activity to contract by 0.4 percent on a quarterly basis in January – March. The strict lockdown that followed brought domestic production to a standstill (Box 1.3), and real GDP fell by 16.6 percent quarter-on-quarter in April – June. The gradual easing of restrictions from May 2020 helped GDP growth rebound to 13.7 percent quarter-on-quarter in July – September. Despite some restrictions during the ‘second wave’ of the pandemic, economic activity continued to normalize in the fourth quarter (October – December). Supported by a rebound in global activity, GDP growth reached 1.4 percent quarter-on-quarter in the last quarter of 2020.

### BOX 1.2 COVID-19 infections in South Africa

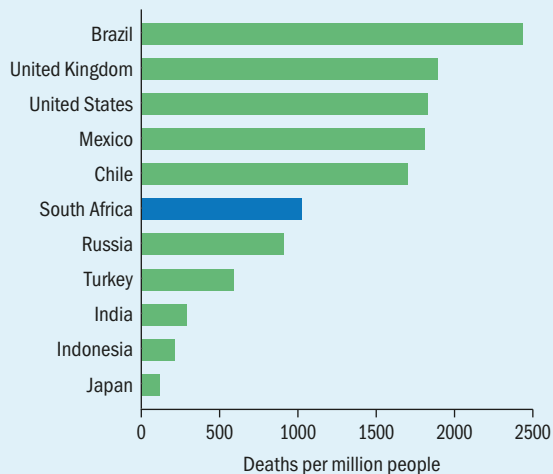
South Africa's first case of COVID-19 was announced on March 5, 2020, after being confirmed by the National Institute for Communicable Diseases. The country entered a strict lockdown from March 27 to April 30, 2020, in part to give the health system enough time to prepare. As the economy gradually reopened, infections increased sharply, peaking at over 10,000 cases per day in July 2020. The death toll, however, remained limited. Following the emergence of the more contagious Beta variant of SARS-CoV-2 towards year-end, the country experienced a second wave in December 2020 and January 2021. Daily infections spiked above 20,000 cases. South Africa has since entered a third wave of the pandemic in June 2021 and confirmed daily infections have once again spiked above 20,000 cases and have exceeded the peak reached during the second wave.

Notwithstanding the country's strong measures to contain the pandemic, the health impact has been severe, as in other emerging countries (Figures B1.2.1 and B1.2.2). By end-June 2021, over 13 million tests had been conducted, and over 1.9 million positive cases had been identified. The recovery rate was 88.6 percent at that time, but over 60,000 people have lost their lives to the virus since the beginning of the pandemic. Over half of these deaths have occurred since early December 2020. The vaccination program has been slow and at the end of June, a little over 3 million vaccinations have been administered. Of these doses, only 470,000 are confirmed complete vaccinations mainly for health care workers through the Sisonke trial which was carried out using the single-dose Johnson and Johnson vaccine and the rest are mostly first doses of the BioNTech Pfizer vaccine which requires two doses.

**FIGURE B1.2.1** Daily new confirmed COVID-19 cases per million people



**FIGURE B1.2.2** Total deaths per million people, June 30, 2021



Sources: National Institute for Communicable Diseases, National Treasury, ourworldindata.org, www.gov.za

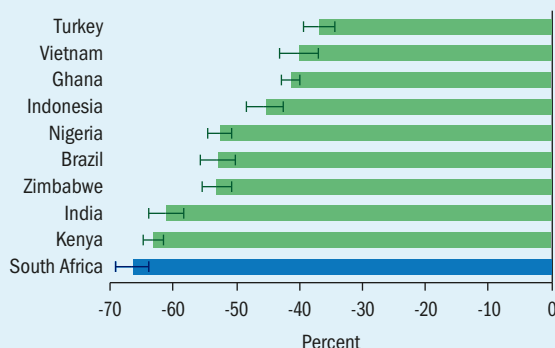


### BOX 1.3 The impact of the pandemic on micro-, small, and medium enterprises

The COVID-19 pandemic and the associated lockdown have profoundly affected micro-, small, and medium enterprises (MSMEs) in South Africa. This partly reflects the large share of MSMEs in sectors such as hospitality or social and personal services, which were among the worst affected by the lockdown. Survey data from May 2020<sup>a</sup> showed that 47 percent of surveyed firms were closed, with informal firms being the most affected. Among firms that remained open, sales dropped by close to 70 percent year-on-year (Figure B1.3.1). Because of the operating constraints, the financial position of the MSMEs deteriorated—about two-thirds of firms in the survey either were already in or expected to fall in arrears. As the lockdown eased, their situation improved, but many still experienced multiple shocks. By November 2020, 14 percent of MSMEs in the survey remained closed, with food services (32 percent) and transportation (29 percent) being the most affected. MSMEs also reported sales to be half to one-third lower than before the pandemic; microenterprises reported the largest declines.

**FIGURE B1.3.1** Early in the pandemic, South African firms saw the largest decreases in sales

Average change in sales, May 2020 survey



Source: South Africa Business Pulse Survey; global comparison from Davies et al. 2021 based on Business Pulse Survey and Enterprise Surveys conducted in sub-Saharan Africa.

Note: Conditional average, controlling for size, sector, and timing of the survey. Conditional averages might differ from unconditional averages reported in country reports.

a. The World Bank conducted a survey of 2,200 firms in May 2020 and a follow-up survey with a smaller sample of 600 firms in November, with the Department of Small Business Development. Both surveys are part of a World Bank effort to measure the impact of COVID-19 on the private sector through the Business Pulse Surveys.

The collapse in MSME activity translated into wage cuts, reduced hours, and layoffs. In the May 2020 survey, 43 percent of firms reported having laid off workers. By November, one-third of firms reported layoffs and almost half reported having to cut wages or hours.

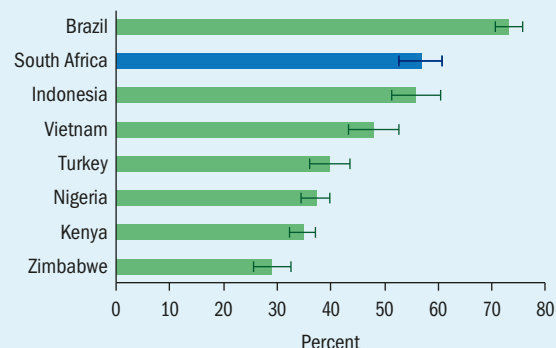
#### The use of digital technologies increased during the crisis.

In the November 2020 survey, 91 percent of firms with more than five employees said they used digital platforms for sales, and 47 percent reported having invested in digital solutions, an increase from May (Figure 1.3.2). Businesses led by young people were more likely to use digital solutions, whereas informal firms were less likely to use such technology.

Access to government support programs improved between May and November 2020, but many needs remained unmet. About 28 percent of MSMEs reported accessing government support by November, up from only 15 percent in May. Microenterprises were least likely to have obtained government support.

**FIGURE B1.3.2** South Africa's MSMEs increasingly use digital technologies

Share of firms using digital platforms, May 2020 survey



Source: South Africa Business Pulse Survey; global comparison from Davies et al. 2021 based on Business Pulse Survey and Enterprise Surveys conducted in sub-Saharan Africa.

Note: Conditional average, controlling for size, sector, and timing of the survey. Conditional averages might differ from unconditional averages reported in country reports.

Among the economic sectors, only agriculture and general government services showed positive growth in 2020. Supported by a bumper harvest and good weather, the gross value added by the agricultural sector increased by 13.1 percent on an annual basis (year-on-year) after a 6.9 percent decline in 2019. Other positive factors were growing external demand and a smaller impact of pan-

demic-related restrictions on farming. General government services increased by 0.7 percent year-on-year, after growth of 1.7 percent in 2019.

Mining activity remained depressed, despite favorable global commodity prices. The real gross value added by mining and quarrying contracted by 11.2 percent

in 2020, although rising commodity prices meant that it declined by only 1.2 percent in value. The need to implement social distancing in mines exacerbated the existing constraints in the sector (e.g., electricity shortages, weak investment, and high operating costs), which had contributed to three consecutive years of negative growth.

**Manufacturing, construction, transport and communication, and trade and hospitality were severely affected by the lockdown restrictions.** They contracted by 25–30 percent quarter-on-quarter in the second quarter of 2020. When the lockdown was eased in the second

half of the year, these sectors recovered to some extent. However, the recovery was limited by ongoing restrictions, especially on international tourism, and persistently weak domestic demand. The next box, Personal Perspective 1.1, shows how the collapse in tourism affected the hospitality business of one South African entrepreneur.

**Finance, real estate, and business services—a major driver of growth in the past—also contracted.** Lower banking activity, a reduction in certain transactions because of the lockdown measures (e.g., property registration), and spillovers from declines in other sectors nega-

### PERSONAL PERSPECTIVE 1.1 Managing guest houses during the pandemic

**Grace Sibara** is doing her best to keep her two guest houses in Limpopo Province afloat, after tourism collapsed almost completely following the lockdowns and social distancing imposed last year to curb the spread of COVID-19. Most of her business was generated by corporate travel, which looks least likely to recover—the segment was dominated by demand from government employees on official business, which has dried up because the government has slashed spending.

Part of the demand for accommodation in her guest houses came from overseas, a market that will remain constrained because of the more contagious Beta variant of the virus identified in South Africa. Some of the top source countries for international visitors banned or discouraged travel to South Africa to prevent the spread of the Beta variant within their own borders. The slow pace of the country's vaccine rollout will also deter foreign visitors for the foreseeable future. "We are not doing well, that is the honest truth," Grace said. "The government is not procuring, and our private clients work from home and are also less likely to travel."

"I've been in this business for 17 years, and we are trying to do what we can to survive. I am always positive, but if it's going to be like this until the end of the year, I don't know. We'll cross that bridge when we come to it." Grace had to retrench half of her permanent staff soon after the stringent lockdown began. There is also no work for the extra people she used to employ in busy periods.

The conference and wedding facilities at both of her businesses, Hayani Guest House and Hayani Manor, stand idle most of the time. "We still have some walk-ins looking for accommodation. But they want to negotiate prices, and we do give them better rates because we understand that people don't have money," she said.

Grace received a grant from the government's Tourism Relief Fund. The fund was established in 2020 to mitigate the impact of the pandemic on the industry, which employed an estimated 1.2 million people. She said the money helped but did

Source: World Bank staff interviews.

not go very far. Like most other small businesses, Grace did not try to take out a loan, because she was afraid of accumulating debt. But she has large overdrafts on her bank account and a backlog of credit card bills.

Catering for funerals and small functions is generating some income, as is interest from local people looking for short week-end breaks away from the crowds. But the future is very uncertain. "I don't want to be discouraged because I am a hands-on person, and this is what I love. I can't see myself doing anything else," she said. "I don't want to even think of selling now. That would depress me too much."



tively affected the sector. Its gross value added shrank by 4.4 percent in 2020 (the first contraction on record), which reduced overall GDP growth by 0.9 of a percentage point.

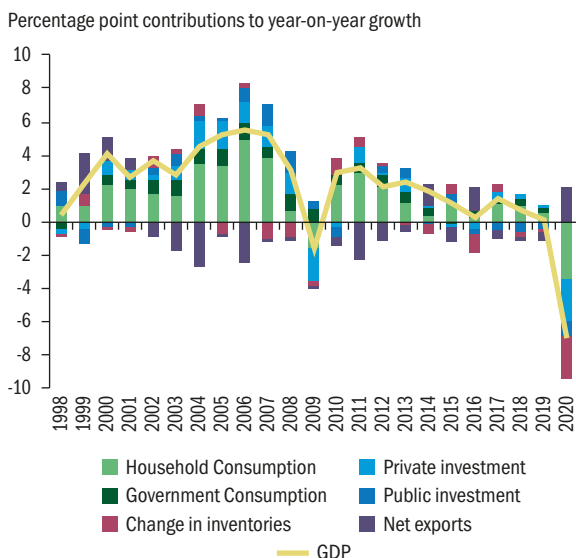
**Domestic demand declined sharply because of COVID-19** (Figure 1.2). The lockdown, along with the economic toll of the pandemic on jobs and incomes, severely affected another key driver of past growth — household consumption, which declined by 5.4 percent overall in 2020. Investment, which has long been affected by low confidence, contracted for the third year in a row by 17.5 percent (Figure 1.3). The decline was broad-based: private sector investment fell by 19.3 percent and public investment by 13 percent. On the back of its COVID-19 relief package, government consumption rose by 0.5 percent in real terms.

**The external sector, which traditionally contributed negatively to growth, supported GDP growth in 2020 because imports declined relatively more than exports.** Weak domestic demand meant that imports volumes contracted by 16.6 percent. The fall in exports was less severe (10.3 percent), as external demand started to recover in the second half of the year. As a result, net exports contributed to growth by 2.1 percentage points.

**The economic recovery that started in late 2020 continued into Q1 2021.** Real GDP increased by 1.1 percent

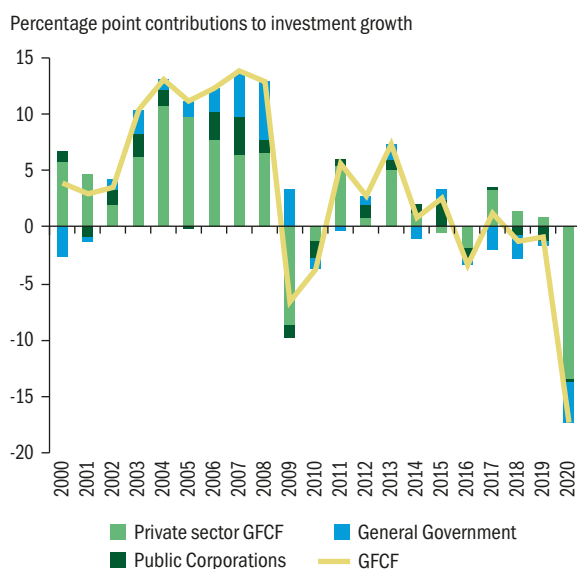
quarter-on-quarter (–3.2 percent year-on-year), down from 1.4 percent in the last quarter of 2020. On the production side, finance, mining, and trade services supported growth, respectively contributing 0.4, 0.3 and 0.2 of a percentage point to overall GDP growth. The finance, real estate, and business services sector grew by 1.8 percent quarter-on-quarter, driven by a rise in mortgage advances, bond registrations, and credit extension. After contracting in the last quarter of 2020, the mining sector rebounded by 4.2 percent quarter-on-quarter, on the back of solid external demand for platinum group metals, iron ore, gold, and chromium. On the expenditure side, the growth in household consumption remained important — it grew by 1.1 percent quarter-on-quarter (against 1.8 percent in the last quarter of 2020) and contributed 0.7 percentage points to overall GDP growth. However, investment remained depressed, contracting by 0.6 percent quarter-on-quarter (13 percent year-on-year). The external sector also contributed negatively to growth (1.7 percentage points), as real exports stagnated whereas real imports rose by 6.1 percent quarter-on-quarter. The change in inventory remained negative (because of destocking), but this was less pronounced than in the fourth quarter of 2020 (–R53.2 billion in real terms, seasonally adjusted and annualized, as against –R117.5 billion in the previous quarter). Thus, the change in inventory contributed to GDP growth by 2.1 percentage points. A major sector

**FIGURE 1.2** COVID caused the largest economic contraction in 25 years



Source: Statistics South Africa; World Bank staff calculations.

**FIGURE 1.3** Investment declined sharply



Source: Statistics South Africa; World Bank staff calculations.

Note: GFCF: gross fixed capital formation.

to destock was mining; likely to respond to favorable external demand while production gradually increases.

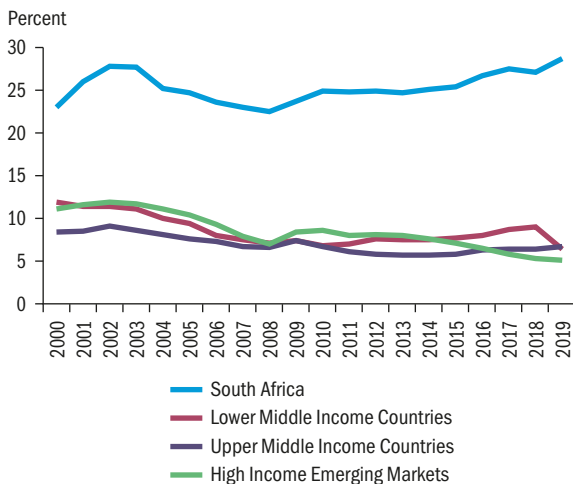
## Labor Markets and Poverty

### The COVID-19 crisis brought significant job losses

South Africa suffers from structurally high levels of unemployment and inactivity. The unemployment rate has exceeded 25 percent since 2016 and reached 29 percent at the start of the COVID-19 crisis (Figure 1.4). To make matters worse, the share of people of working age who were not in employment, education, or training (NEET) was also high, at 24 percent. This meant that even before the pandemic, two in every five people of working age were NEET. South Africa's employment ratio is much lower than its peers'.

**FIGURE 1.4** Labour market challenges persist

Unemployment rate, 2000 – 19



Source: World Economic Outlook; International Labour Organization; World Bank.

**The pandemic weakened the labor market even more.** A record 2.2 million jobs had been lost by mid-2020, and fewer than 40 percent of these had been recovered by the end of the year. In net terms, 1.4 million jobs have been lost since March 2020, more than twice the number the country lost during the global financial crisis. The unemployment rate reached 32.6 percent by March 2021. Part 2 presents a granular analysis of the impact of the pandemic on South Africa's labor market and the government's response.

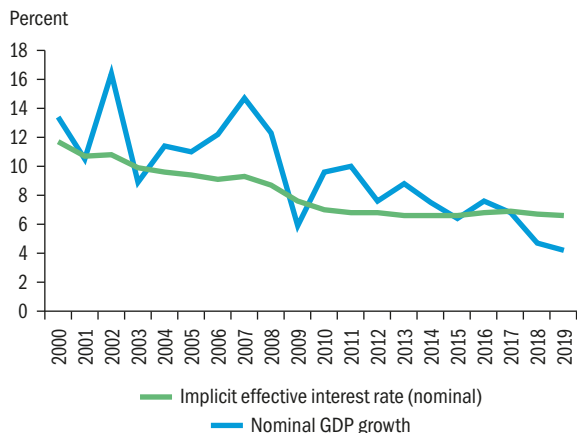
## Fiscal Developments

### The pandemic further damaged the weak public finances

South Africa's fiscal situation has weakened over the last decade. After averaging 0.6 percent of GDP in 2000–08, the fiscal deficit rose to 3.1 percent in 2010–18 and reached 5.7 percent in 2019, just before the pandemic. Fiscal revenues have suffered because of weak economic growth, despite relatively high and stable revenue collection (at over 29 percent of GDP). At the same time, spending has increased sharply, driven by rising interest payments and other committed expenditures. Because revenue projections and spending commitments assumed that economic growth would again become more dynamic, the budget has not adjusted to the declining fiscal space, leading to widening deficits.

**Public debt has been rising rapidly.** It increased from 35 percent of GDP in 2010 to about 63 percent in 2019. Over the same period, interest payments grew from 2.3 percent to 4 percent of GDP. Because real GDP growth has been declining, South Africa's average effective interest rate (interest payments divided by the debt stock) started to exceed its nominal GDP growth from 2017, in contrast to its peers (Figures 1.5 and 1.6). These unfavorable debt dynamics, in turn, made it more difficult to stabilize debt and improve fiscal outcomes, despite the containment of primary deficits (0.6 percent of GDP over 2016–18 against 1.7 percent of GDP over 2010–15)

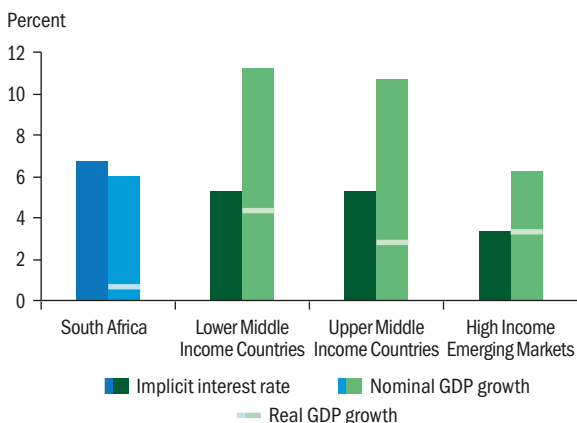
**FIGURE 1.5** Despite the lower cost of debt, weak growth now affects fiscal sustainability



Source: National Treasury; World Bank staff calculations.

**FIGURE 1.6** Public debt dynamics

2015 – 19 average, nominal



Source: World Economic Outlook; World Bank staff calculations.

**South Africa has a large social protection system.** At 3.3 percent of GDP, the country is among the biggest spenders on social protection (World Bank forthcoming). Social transfers are generally well targeted, reaching many poor people. They help alleviate poverty and reduce income inequality, which remains the highest in the world because of the legacy of the apartheid system (Inchauste et al. 2015). While social assistance can protect the most vulnerable members of society, it cannot substitute for growth and jobs to sustainably lift people out of poverty. Given the shrinking fiscal space, recent policy choices attempted to contain the growth of the social assistance budget. The government adjusted social grants by less than inflation in fiscal year 2021, highlighting the difficulty of sustaining the social protection system when public finances are weak.

**The growing public spending has not supported economic growth over the last decade.** Despite an increase in total consolidated expenditure of about 4 percentage points of GDP between fiscal 2009 and 2019 (Table 1.1), GDP growth weakened throughout the decade. Recent literature (Kemp 2020; Janse van Rensburg 2021) shows that fiscal multipliers (the impact of higher public spending on economic growth) have declined over the last 10 years. The reasons behind this trend include the allocation of resources to consumption rather than investment, the growing share of interest payments, and large transfers to underperforming state-owned enterprises (SOEs). Indeed, compared with its peers, South Africa’s public spending has been tilted toward transfers, public sector

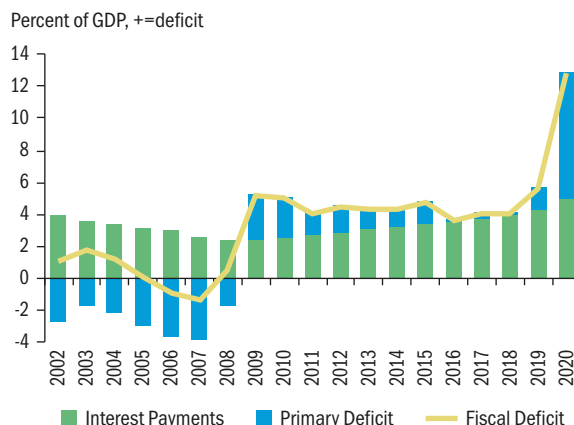
**TABLE 1.1** Evolution of consolidated expenditure

Percent of GDP	2009/10	2019/20	Change (percentage points of GDP)
<b>Total</b>	<b>30.7</b>	<b>34.5</b>	<b>3.9</b>
Compensation	9.7	11.0	1.3
Debt service cost	2.3	4.0	1.7
Goods and services	4.2	4.1	-0.1
Higher education transfers	0.6	0.8	0.2
Transfers to households	4.8	5.4	0.6
Other transfers	6.5	7.0	0.5
Capital spending	1.3	1.0	-0.3
Transfers to SOEs	1.3	1.2	-0.1

Source: National Treasury; World Bank staff calculations.

compensation, and interest payments, to the detriment of capital spending (Box 1.4). About one-third of this increase is due to spending on compensation (1.3 percentage points of GDP). Transfers also grew — to households (0.6 of a percentage point), other governmental and nongovernmental institutions (0.7 of a percentage point, in part due to significant policy shifts, such as the tertiary education subsidy), and to SOEs (from R47 billion in fiscal 2005–09 to R135 billion in fiscal 2015–19). Debt service costs increased by 1.7 percentage point over the past decade, driven by the rising financing needs. This coincided with slower economic and revenue growth. To contain the primary deficit (Figure 1.7), spending was re-

**FIGURE 1.7** Interest payments were already rising before 2020 amid a rising stock of debt



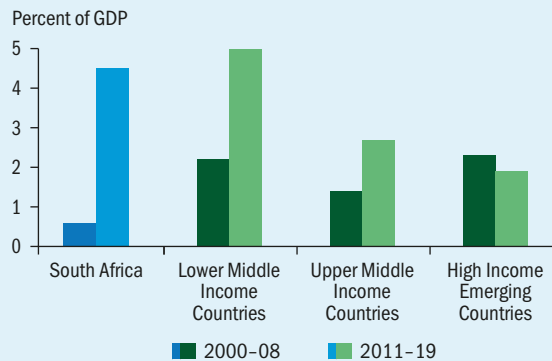
Source: National Treasury; World Bank.

### BOX 1.4 Public expenditure allocation: A cross-country comparison

South Africa's fiscal position has deteriorated markedly over the past decade. While the same has happened in many other countries since the global financial crisis, South Africa's fiscal metrics have weakened more than those of its peers (Figure B1.4.1). The composition of its spending might also have been relatively less conducive to growth because much of it was on interest payments and public sector compensation, rather than capital spending. Interest payments now represent almost 5 percent of GDP, higher than in peers

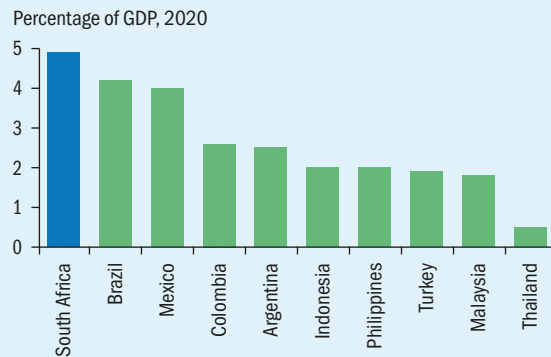
(Figure B1.4.2). Public sector compensation has persistently grown faster than the economy and now represents 42 percent of revenue. This makes South Africa's public sector wage bill one of the largest among its peers, in terms of both GDP and total expenditure (Figure B1.4.3). In contrast, capital spending has been relatively low—it represents only 10 percent of the budget and 3 percent of GDP, about half of the ratios for countries such as Malaysia and Thailand (Figure B1.4.4).

**FIGURE B1.4.1** Fiscal deficit widened markedly over the last decade



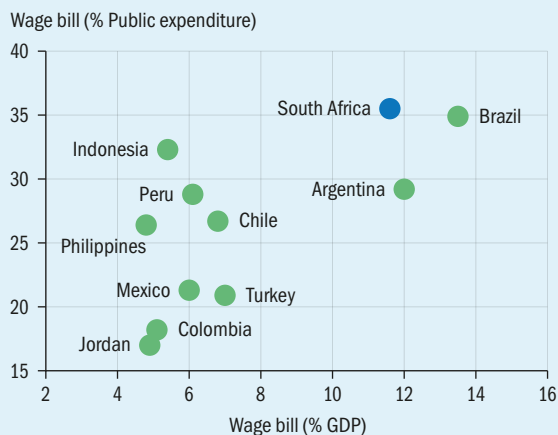
Source: World Bank staff calculations based on World Economic Outlook data

**FIGURE B1.4.2** Interest payments on government debt are comparatively high



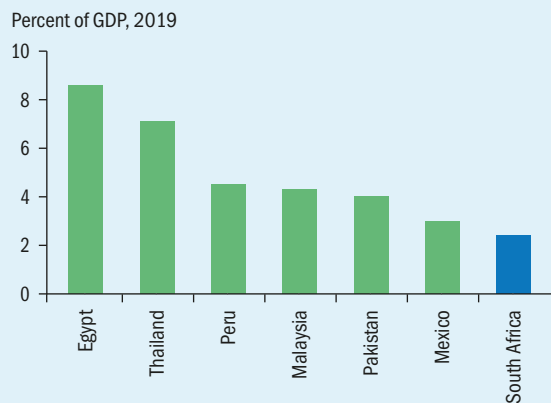
Source: IMF WEO (April 2021), World Bank

**FIGURE B1.4.3** Wage bill is comparatively high



Source: World Development Indicators, World Bank

**FIGURE B1.4.4** Public gross fixed capital formation is comparatively low



Source: World Development Indicators, World Bank

duced on categories such as capital expenditure (0.3 of a percentage point of GDP) and goods and services (0.1 of a percentage point). This was accompanied by tax increases, which partially offset the impact of the rising expenditure on aggregate domestic demand.

**Spending inefficiencies contributed to weaken the impact of fiscal policy on economic and social outcomes.** The efficiency of public spending was reduced by the weak public administration capacity, state capture, poor interagency coordination and integration, and fragment-

ed procurement, which contributed to wastage, leakages (e.g., irregular and overpayments for goods and services, as identified by the Auditor-General (AGSA 2019, 2021)), and the high costs of public services. Thus, higher expenditure was not systematically associated with better public service delivery; this reduced the impact of fiscal policy on the economy (National Treasury 2020).

**The COVID-19 crisis has further weakened South Africa's fiscal position.** Overall, consolidated expenditure in fiscal 2020 is estimated to have been about 4 percent higher than anticipated in the 2020 Budget Review. During the pandemic, the government increased spending to support the health sector, businesses, and households in the lockdown (Table 1.2), funded in part by a reallocation of budget resources. At the same time, the economic collapse — and lost tax revenues — created a significant revenue gap. Revenue is estimated to have been about 12 percent lower than projected in the February 2020 budget. World Bank estimates suggest the deficit doubled in fis-

cal 2020 to reach 12.9 percent of GDP. The debt-to-GDP ratio is estimated at 78.8 percent of GDP in fiscal 2020, and interest payments at 4.9 percent of GDP.

**In these tight financial conditions, the government adjusted its borrowing strategy.** With yields on government bonds rising at the height of the pandemic, the government increased its net international borrowing from an average R 27 billion in fiscal 2017–19 to R 77.5 billion in fiscal 2020; this represents 12 percent of the financing raised, all from international financial institutions. Considering the steeper yield curve, it also issued more treasury bills (17 percent of net domestic borrowing, up from 12 percent on average over the previous three fiscal years). However, the bulk of its financing remained long-term domestic bonds (about R 500 billion, up from R 230 billion on average over the previous three years), with an average maturity of 12.4 years. Because revenue outcomes were better than expected, the government increased its cash balances in fiscal 2020.

**TABLE 1.2** COVID-19 relief package in FY2020

	Announced package <sup>a</sup> (Rand, billions)	Estimate for FY20/21 (Rand, billions)
Credit guarantee scheme	200.0	18.0
Wage protection (TERS)	40.0	65.0
Revenue-side support measures (tax deferrals, skills development levy holiday and extension of employment tax incentive)	70.0	40.0
Main budget expenditure	142.0	140.3
Support to vulnerable households	40.9	52.2
Health	21.5	21.5
Support to municipalities	20.0	20.0
Other frontline services	13.6	13.6
Basic and higher education	12.5	12.5
Job creation and support for small, medium and informal businesses	6.1	12.6
Support to public entities	6.0	6.0
Other COVID-19 interventions	1.8	1.8
Provisional allocation for COVID-19 fiscal relief package	19.6	0.0
<b>TOTAL</b>	<b>452.0</b>	<b>263.3</b>
<b>TOTAL, net of budget reallocations and adjustments</b>	<b>343.0</b>	<b>152.8</b>

Source: National Treasury; World Bank calculations.

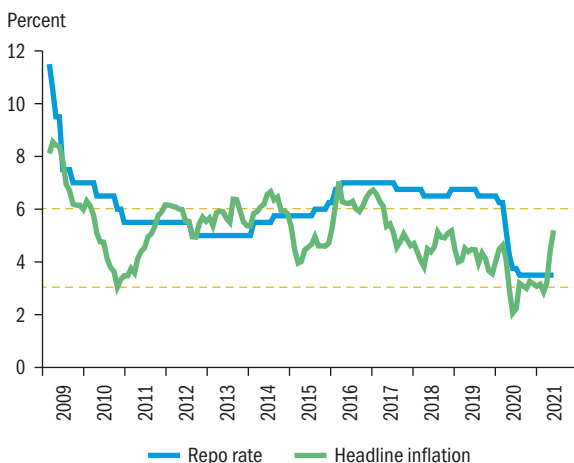
a. April 2020 "Economic Measures for COVID-19" and June 2020 Supplementary Budget, National Treasury

## Monetary Policy and Financial Sector Developments

### Monetary policy was countercyclical to ease the COVID-19 shock

The South African Reserve Bank (SARB) has eased monetary policy to support the economy during the pandemic. Inflation was low before COVID-19, averaging 4.1 percent in 2019 and anchored in the lower part of the target range of 3–6 percent. It declined even further, averaging 3.3 percent in 2020, as fuel prices fell, and domestic demand collapsed during the lockdown. This allowed the SARB to cut the repo rate by a cumulative 2.75 percentage points between January and July 2020 to support the economy (Figure 1.8). By early 2021, inflationary pressures were still contained. Inflation reached 5.2 percent in May because of a low-base effect, but average inflation is well inside the target band, at 3.8 percent in January–May 2021. Monetary policy remains accommodative; at its last Monetary Policy Committee meeting on May 20, the SARB kept its policy interest rate unchanged at 3.5 percent.

**FIGURE 1.8** Policy rate is at historically low level



Source: Statistics South Africa, SARB.

**The SARB's credibility and policy measures helped to limit financial market stress.** In addition to easing the monetary policy stance, the central bank introduced various measures to ensure liquidity in the domestic financial system. After March 2020 it increased the number of repo auctions, reduced the limits of the standing facility

to lend at the repo rate and borrow below the repo rate, raised the size of the main weekly refinancing operations, and extended the maturities of the main refinancing instruments. It also announced a program to purchase government bonds on the secondary market, effectively buying R 32.6 billion in government securities between April and December 2020. All these measures — except the government bond purchase program — have now been rolled back, as liquidity in the financial markets improved from the second half of 2020 and government bond yields have returned to pre-pandemic levels. At end-May 2021, SARB holding of government securities stood at R 41.6 billion.

**Prudential regulations have also been eased.** In response to the pandemic, the SARB provided regulatory relief to the banking system to support lending to the private sector. It allowed temporary relief of bank capital requirements, reduced the liquidity coverage ratio from 100 to 80 percent, and relaxed capital charges and provisioning requirements on COVID-19-related credit exposures.

### The financial sector remains sound

**The financial sector is well capitalized and liquid.** All prudential ratios are above the minimum requirements. The capital-to-asset ratio is around 7.6 percent, and the Tier 1 capital adequacy ratio stood at 16.6 percent at end-2020. Nonperforming loans rose from 3.9 percent to 5.2 percent from end-2019 to end-2020 but remain moderate. Profitability in the banking and life insurance sectors has declined significantly. While the full extent of the deterioration in the loan portfolio in the pandemic is not yet known, and the banks are not expected to return to pre-pandemic profitability before 2022, their capital buffers appear adequate.

**Credit to the private sector has slowed significantly.** Total loans and advances grew by 2.7 percent in 2020, against 6.4 percent in 2019. Although low real interest rates supported household demand for mortgage and instalment sale credit, lower consumer confidence on the back of depressed economic growth and job losses saw growth in credit to households slowing from 6.4 percent in 2019 to 3.9 percent in 2020. Weak business confidence, combined with lockdown restrictions, meant growth in bank lending to corporations slowed to 1.6 percent in 2020 (down from 6.3 percent in 2019). Total claims on the domestic private sector increased by 4.9 percent in 2020 (down from



6.8 percent in 2019). The monetary easing transmission was mostly through a reduction in banks' prime lending rates, which are tied to SARB repo rates rather than through new credits. Private sector credit extension remains weak thus far in 2021: total loans and advances to households grew by 3.9 percent in January – May, and those to corporations contracted by 2.7 percent.

The government launched a COVID-19 loan guarantee scheme to promote lending to the private sector, but the uptake has been low. This initiative aimed to provide substantially guaranteed loans to help businesses affected by the pandemic meet their operational expenses. It had an initial envelope of R 100 billion, with a provision to double it if required. However, the uptake of the scheme has been low: by March 2021, only R 18 billion had been approved by banks and disbursed to small and medium enterprises. Factors cited for the weak uptake include stringent conditions (e.g., banks requesting personal surety from business owners), the delayed rollout of the scheme (which meant that many banks and debtors had already negotiated urgent debt relief measures), and weak credit demand because of depressed economic growth and the uncertain business environment, even before COVID-19 (BASA 2021). In view of the low uptake, the government decided to close the scheme at the end of July 2021.

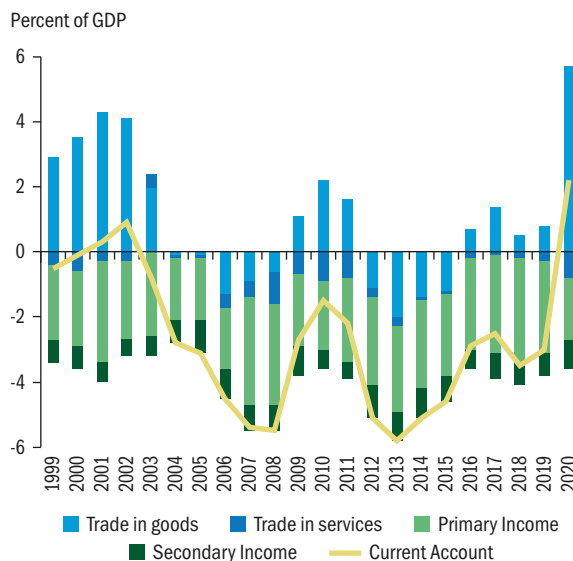
## External Sector

### The pandemic brought the first current account surplus in 18 years

South Africa's structural current account deficit is driven by the large and negative primary income balance. The current account was in deficit in 2003 – 19, averaging 3.6 percent of GDP over the past decade (Figure 1.9). The trade balance has been positive since 2016, as weak growth reduced the demand for merchandise imports. However, the primary and secondary income balances remained negative, respectively at 2.7 and 0.8 percent of GDP, in 2010 – 19. These balances reflect dividend and interest payments to nonresidents and transfers to neighboring countries under the Southern African Customs Union agreement.

Driven by weak imports and favorable export prices, the current account registered a large surplus in 2020. South Africa's current account surplus reached

**FIGURE 1.9** Current account dynamics were favourable in 2020



Source: SARB.

2.2 percent of GDP in 2020. Favorable price dynamics supported exports of goods: net gold exports increased by 61.2 percent and other merchandise exports by 4.1 percent. Merchandise imports contracted by 12.2 percent because of the collapse in domestic demand and lower crude oil prices (the Brent crude oil spot price fell by 33.1 percent year-on-year). The services trade balance worsened from 0.3 percent of GDP in 2019 to 0.8 percent in 2020, mainly because of the devastating impact of the pandemic on the tourism sector. The primary income balance likewise remained negative, albeit smaller (1.9 percent of GDP, as against 2.8 percent in 2019), driven by lower gross dividend payments. The secondary income balance was also negative, at 0.9 percent of GDP.

**Current account dynamics remain favorable at the beginning of 2021.** The current account balance registered a surplus of 5 percent of GDP in the first three months of 2021, because of the surplus on the merchandise trade balance and a smaller deficit in the primary income balance. Goods exports increased by 25.9 percent year-on-year in value terms, supported by high export prices, whereas goods imports grew by only 6.6 percent year-on-year, benefiting from the appreciation of the rand. South Africa's terms of trade improved for the seventh quarter.

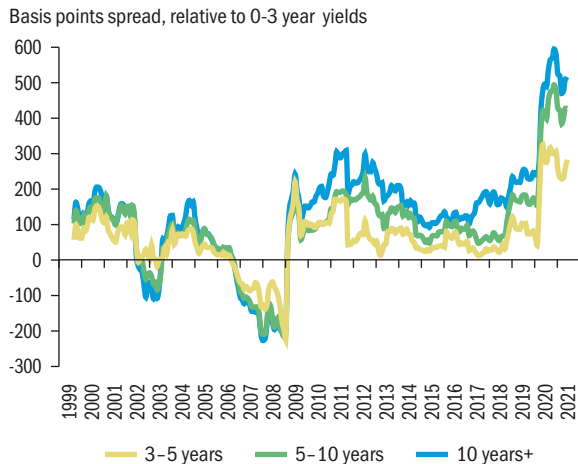
## Global market volatility tested the robustness of the financial sector

South Africa was badly affected by the loss of market confidence in early 2020. The combination of a deteriorating global outlook and the loss of the country's last investment grade rating in March 2020 led to significant capital outflows, a widening of government bond spreads, and the depreciation of the rand to a record low of R 19/ us\$ in April. The generic 10-year bond yields, which were below 9 percent in February 2020, surged to over 12 percent at the end of March. The Johannesburg Stock Exchange (JSE) All Share Index lost more than 20 percent of its value between January and March. Although most emerging markets suffered from rising global risk aversion, South Africa saw more capital outflows than most of its peers. The SARB's government bond purchase program helped restore some investor confidence, with the 10-year government bond yield falling by 100 basis points on the day of the announcement (Arslan et al. 2020).

Global financial market conditions have improved since late 2020, broadly benefiting emerging economies such as South Africa. Progress in the rollout of vaccines, higher global growth forecasts, and high global liquidity have all contributed, but the markets remain volatile. Thus far in 2021, the rand has outperformed other emerging currencies; in fact, it has appreciated to its pre-pandemic level, supported by favorable trade balance dynamics and a benign global financial environment. Having risen since late 2020, the JSE All Shares Index is now above its pre-pandemic level. Nonetheless, in a climate of high uncertainty, portfolio investment flows are still volatile and vulnerable to shifts in global risk sentiment. South Africa's yield curve remains steep because of the weak fiscal situation (Figure 1.10).

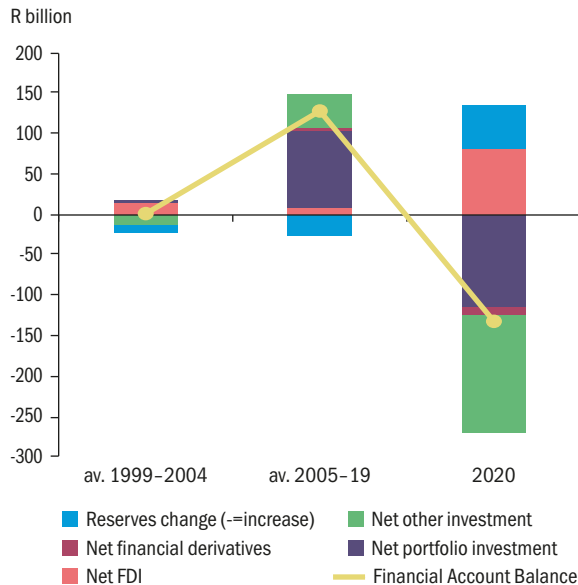
For South Africa, 2020 was characterized by net financial outflows. For the first time since 2003, its financial account balance was negative, at 3.8 percent of GDP, excluding variation in reserves (Figure 1.11). Foreign investment outflows from bond and equity markets reached us\$9.7 billion in 2020, whereas South Africans repatriated us\$2.8 billion. Net inflows of foreign direct investment decreased from us\$5.1 billion in 2019 to us\$3.1 billion; however, the net foreign direct investment balance increased, driven by residents' divestments from foreign subsidiaries of us\$2 billion (as against investments of us\$3.1 billion in 2019). Financial derivatives registered

**FIGURE 1.10** Yield spread on government bonds has widened



Source: SARB; JSE.

**FIGURE 1.11** Financial account was in deficit in 2020



Source: SARB.

net outflows of us\$0.7 billion, slightly higher than the year before (us\$0.4 billion). Other investment saw outflows of us\$8.9 billion, as domestic banks increased their deposits at nonresident banks. The SARB's international reserves amounted to us\$55 billion, broadly unchanged from 2019. The net international investment position remained largely positive at about us\$110 billion as of December 2020.

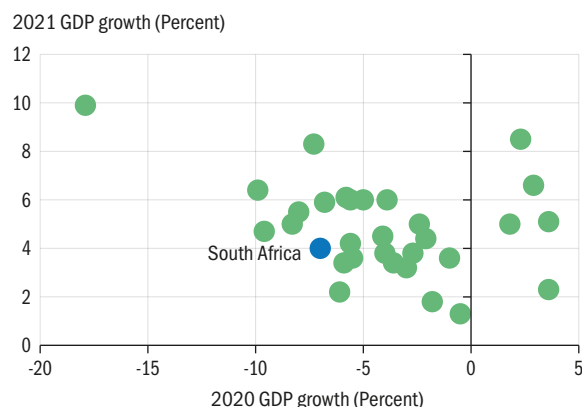
## Outlook and Risks

### Recovery in 2021 will be supported by the favorable global environment

The World Bank projects South Africa's GDP growth to rebound to 4 percent in 2021 (Table 1.3), supported by the global recovery, the vaccination rollout, and favorable commodity prices (World Bank 2021b, Zeufack et al. 2021). On the domestic front, the ongoing normalization of economic activity and base effects will mean higher GDP growth, despite the potential dampening effect of an increase in COVID-19 cases over the winter months and renewed restrictions on economic activity. But growth will still be hampered by longstanding structural constraints. The depressed labor market and tighter fiscal policy may also limit household consumption. This suggests that South Africa's rebound will remain moderate by inter-

national standards, especially considering the magnitude of the output contraction in 2020 (Figure 1.12).

**FIGURE 1.12** The post-pandemic rebound may be moderate



Source: World Bank.

**TABLE 1.3** Baseline forecasts

Annual percent change unless indicated otherwise

	2017	2018	2019	2020 <sup>e</sup>	2021 <sup>f</sup>	2022 <sup>f</sup>	2023 <sup>f</sup>
<b>Real GDP growth, at constant market prices</b>	1.4	0.8	0.2	-7.0	4.0	2.1	1.5
Private Consumption	2.1	1.8	1.0	-5.4	3.8	3.1	2.4
Government Consumption	0.2	1.9	1.5	0.5	-0.3	-1.7	-1.4
Gross Fixed Capital Formation	1.0	-1.4	-0.9	-17.5	-2.7	3.9	3.7
Exports, Goods and Services	-0.7	2.6	-2.5	-10.3	9.7	2.8	2.8
Imports, Goods and Services	1.0	3.3	-0.5	-16.6	9.0	5.0	4.2
<b>Real GDP growth, at constant factor prices</b>	1.5	0.7	0.2	-6.8	4.0	2.1	1.5
Agriculture	21.1	-4.8	-6.9	13.1	0.8	2.5	2.5
Industry	1.1	-0.1	-1.5	-12.0	5.5	1.6	1.2
Services	1.0	1.3	1.2	-5.4	3.6	2.2	1.5
<b>Inflation (Consumer Price Index)</b>	5.2	4.5	4.1	3.3	4.2	4.5	4.5
<b>Current Account Balance (% of GDP)</b>	-2.5	-3.5	-3.0	2.2	1.5	-0.8	-1.9
<b>Net Foreign Direct Investment (% of GDP)</b>	-1.5	0.4	0.6	1.7	0.2	0.3	0.4
<b>Fiscal Balance (% of GDP)</b>	-4.1	-4.0	-5.7	-12.9	-8.4	-7.1	-6.1
<b>Primary Balance (% of GDP)</b>	-0.4	-0.1	-1.5	-8.0	-3.4	-1.8	-0.5
Revenue (% of GDP)	28.7	29.4	29.7	28.2	28.5	28.5	28.6
Interest Payments (% of GDP)	3.7	3.9	4.2	4.9	4.9	5.3	5.6
Non-Interest Expenditure (% of GDP)	29.1	29.5	31.2	36.1	31.9	30.2	29.1
<b>Debt (% of GDP)</b>	53.0	56.6	63.3	78.8	80.0	84.3	87.3
<b>Unemployment rate (%)</b>	27.1	27.0	28.2	29.4	32.6	31.9	29.9

Source: World Bank, Poverty & Equity and Macroeconomics, Trade & Investment Global Practices.

e = estimate, f = forecast.

**Higher growth in its trade partners and favorable global commodity prices will support growth in South Africa.** Globally, the COVID-19 pandemic continues to spread, but vaccination programs have made substantial progress in several countries. South Africa should benefit from stronger external demand. According to the June 2021 Global Economic Prospects (World Bank 2021b),

China and the United States, which are among South Africa's main trading partners, are expected to grow by 8.5 and 6.8 percent, respectively, in 2021, and the economy of the Euro Area is projected to grow by 4.2 percent. Global commodity prices are expected to remain high, translating into favorable terms of trade that will support the external sector (Box 1.5).

### BOX 1.5 South Africa's economy benefits from high commodity prices

**Commodity prices have increased substantially from end-2020 and are now above their pre-pandemic levels, supported by better global growth prospects and in some cases, supply-side factors.** Metal prices are expected to rise by 36 percent in 2021, before falling back in 2022. The demand for base metals is likely to remain strong, given the push toward greener growth (e.g., electric vehicles). Oil prices are projected to average US\$62/bbl in both 2021 (+35.6 percent year-on-year) and 2022. Agricultural prices are expected to rise by 16 percent in 2021, before stabilizing in 2022 (World Bank 2021a, 2021b).

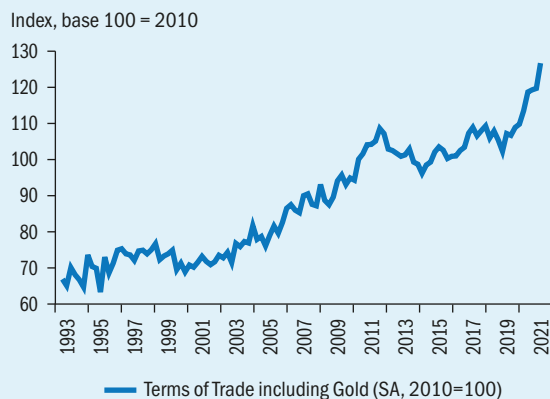
**Commodities play a big role in South Africa's economic trajectory.** The mining sector accounts for only 7 percent of GDP but for over half of all merchandise exports (mostly platinum group metals, gold, iron ore, and coal). Economic growth outcomes have long been linked to commodity cycles. The most dynamic periods of growth in South Africa have been associated with the discovery of diamonds, gold, and more recently, the 2000s commodity super cycle (Havemann and Kerby 2021). Commodity cycles also affect financial variables, such as investment flows, the exchange rate, and the performance of the stock market (Sachs 2021).

**There are uncertainties around current commodity price increases.** South Africa's terms-of-trade gains (Figure B.1.5.1) are likely to moderate after this year. The main risks to the out-

look are related to the evolution of the pandemic. For metals, faster-than-expected withdrawal of the stimulus in China would pose significant downside risks, while the United States infrastructure bill would present an upside risk. Over the medium term, the rebalancing of China's growth from investment- to consumption-driven implies that its growth will be less commodity-intensive than before.

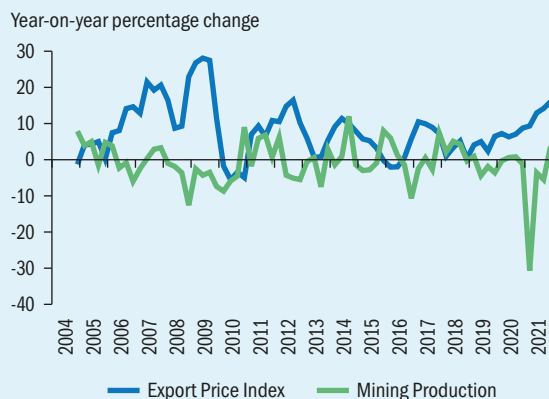
**Favorable terms of trade will benefit growth but will not address structural constraints to a higher growth trend.** The favorable global environment will support South Africa's growth and macroeconomic stability through its impact on the fiscal and external accounts. However, if the cycle is misinterpreted as a new trend, this could mean a delay in much-needed reforms, as happened before (Amra et al. 2019). Also, the impact on mining production may be limited by structural constraints and operational adjustments after the pandemic (Figure B.1.5.2). Investment in the sector remains weak, on the back of policy uncertainty related to both some elements of the Mining Charter and operating costs (electricity, transport, logistics, etc.). In this context, to ensure that South Africa fully benefits from the favorable commodity cycle and set the base for sustainable growth, it will be critical to deliver on reforms to improve business confidence as well as reforms to foster exports (e.g., trade facilitation, logistics, and transport costs, notably in rail and ports).

**FIGURE B1.5.1** Notable improvement in terms of trade from 2020



Source: SARB; Statistics South Africa; World Bank.

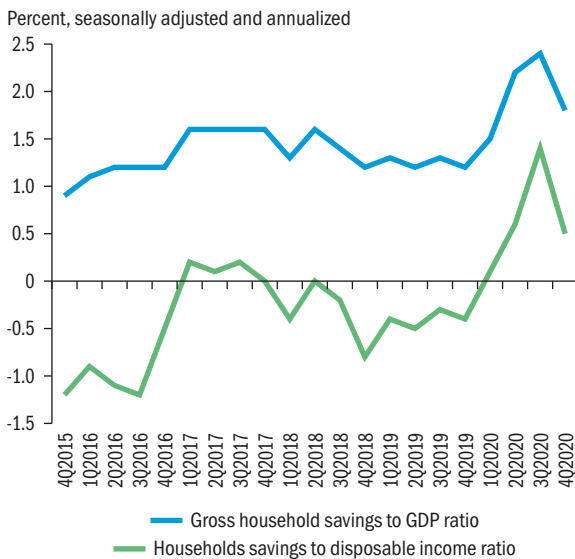
**FIGURE B1.5.2** Higher mining exports were driven by prices rather than volumes



Source: SARB; World Bank.

However, the potential for recovery is limited by domestic constraints. Economic growth momentum continued in the first quarter of 2021, and early indicators (e.g., Purchasing Managers’ Indices) point to sustained recovery into the second quarter. However, constraints such as weak investment, electricity shortages, and transport and logistical costs and bottlenecks will continue to weigh on economic activity. Private sector investment is still depressed, contracting by 15.1 percent year-on-year in the first quarter. It is unclear if household consumption will remain robust in a context of weak labor markets and limited fiscal support once savings return to pre-pandemic levels (Figure 1.13). Finally, the long-term impact of the pandemic on sectors such as tourism, aviation, and hospitality could yet hamper the growth rebound. On the other hand, the recent increase of the licensing threshold for embedded electricity generation from 1 MW to 100 MW could have a significant positive effect on confidence and investment. This could support growth in the short run and help to alleviate the electricity supply constraint in the medium term.

**FIGURE 1.13 Household savings are decreasing after rising during the pandemic**

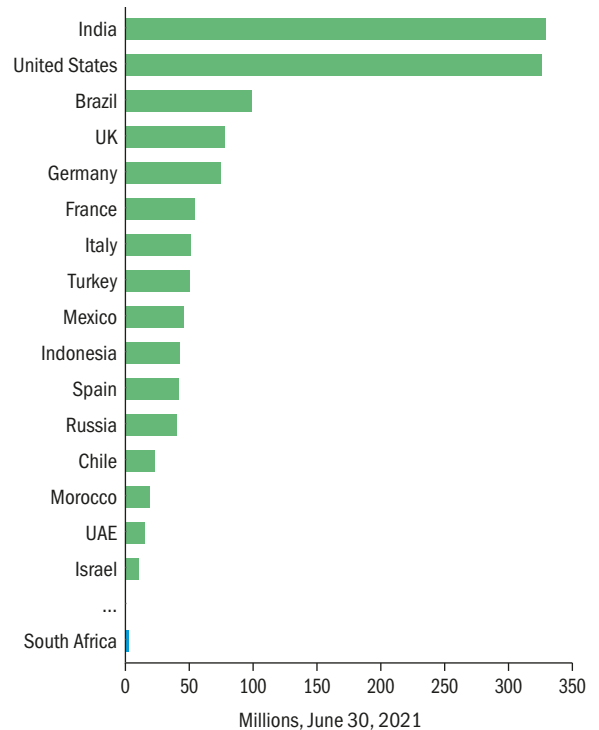


Source: SARB

A severe third wave of the pandemic would put any recovery at risk. As happened elsewhere, the road to recovery after COVID-19 is volatile — there are still major uncertainties around the evolution of the pandemic. In South

Africa, infections picked up strongly in June, prompting the government to declare a ‘third wave’ of the pandemic. It announced a return to alert level 3 lockdown on June 15, with some restrictions to social and economic interactions. Any rebound in economic activity over the coming months will be closely linked to the path of the pandemic and progress with vaccinations. The vaccination program has lagged so far (Figure 1.14), and as of end-May, approximately one million South Africans had been vaccinated.

**FIGURE 1.14 Vaccination is lagging**



Source: Our World in Data.

Note: Counted as single dose and may not equal the total number of people vaccinated

There are other risks, and opportunities, to the short-term growth outlook. Domestically, fiscal slippages could undermine business confidence and slow the recovery. On the other hand, a moderate third wave, combined with a continued favorable external environment, would support a stronger rebound. Globally, a tightening of financial conditions or weaker-than-expected growth would negatively affect South Africa’s outlook (Table 1.4).

**TABLE 1.4** Main risks and opportunities to the outlook

Risk/Opportunity	Potential impact	Policy measures
<b>Opportunities</b>		
Contained third wave of the pandemic, with a short peak of daily infections and hospitalizations.	South Africa would be able to benefit fully from the favorable global environment, with a strong economic rebound over the next three quarters translating into higher growth in 2021. Higher growth would support better labor market outcomes (as economic activity continues to recover) and better fiscal and debt outcomes (as pressures for relief spending fade).	Use increased policy space to strengthen macroeconomic stability, while supporting the growth recovery. Improve public expenditure allocation and efficiency to maximize its impact on growth. Implement structural reforms to raise competitiveness and growth in the medium run.
Fiscal revenue overperformance, driven by higher exports and stronger growth in the short term.	This would ease the fiscal adjustment needed on the expenditure side to achieve the government's fiscal and debt path over the MTEF and could support domestic demand over the medium term.	Maintain fiscal policy path as planned in the 2021 Budget. Use temporary fiscal space, balancing between development expenditure and deficit reduction.
Acceleration of the structural reform agenda, with early and decisive measures to implement key planned policy reforms.	Taking concrete steps to address long-standing constraints to growth would have an immediate signaling effect that could boost investor confidence and raise growth in the short term, while reforms would support higher growth over the medium term.	Use higher growth to restore fiscal and debt sustainability, while improving the impact of fiscal policy on growth. Support policies to increase the job intensity of growth (see part 2).
<b>Risks</b>		
Weaker-than-expected global recovery, with a constrained vaccine rollout or limited vaccine efficacy against new variants resulting in new infection waves, or supply-side bottlenecks potentially translating into lower commodity prices.	Weaker external demand would translate into smaller economic rebound and smaller-than-anticipated contribution of net exports to growth, while domestic drivers of growth are weak. Lower export receipts because of lower global prices would translate into weaker current account balance and fiscal revenues.	Implement structural reforms to increase competitiveness and promote private investment. Allocate fiscal resources to programs with the highest developmental impact and increase the efficiency of public expenditure to support recovery. Maintain monetary policy space consistent with inflation target.
Increased global risk aversion driven by tightening financial conditions (e.g., faster monetary policy tightening in the United States) translating into net portfolio investment outflows and rising risk premia in emerging economies.	Higher yields on government bonds would raise public debt service, increasing the fiscal effort needed to stabilize debt. Higher holdings of government securities in domestic financial sector as portfolio investment outflows intensify would crowd out resources for private investment.	Implement adequate policy mix (budget plans, structural, monetary policy) to maintain investor confidence. Consider increased financing from international financial institutions, which tend to be less burdensome on the budget and domestic financing.
Stronger-than-anticipated third wave of the pandemic as winter conditions make it harder to control infections relative to the second wave (December – January).	Stubbornly high infection rates would stress the health system and require stricter containment measures, negatively affecting growth and job creation. Worsening economic and social conditions would create pressure to extend COVID-19-related relief measures, translating into a larger fiscal deficit.	Roll out vaccine more aggressively. Take the necessary containment and relief measures to limit the impact of the pandemic on people and the economy. Implement structural reforms as the pandemic is brought under control to pave the way for a quicker recovery.
Fiscal slippages: Short term – spending pressures from realization of fiscal risks identified in budget (wage bill, SOE contingent liabilities, local government finances) Medium term – short-lived revenue overperformance from favorable external conditions reduces appetite for fiscal reform.	Both scenarios would likely lead to a weaker fiscal position over the MTEF and would put at risk debt stabilization by 2025/26 as targeted by the government. Higher deficits translating into higher debt service costs would lead to public resource allocations that do not support higher growth.	Implement budget as planned. To the extent possible, address slippages through budget reallocations. Implement structural reforms to boost growth and SOE governance and support improvements in fiscal balances and debt.
Weak implementation of structural reforms, driven by weakening political leadership or lack of capacity	Weak implementation of the structural reforms planned in the Economic Reconstruction and Recovery Plan/ Operation Vulindlela would undermine confidence and translate into persistently weak investment and low growth as seen over the last decade.	Frontload key structural reform plans.

**South Africa's medium-term growth outlook is insufficient to improve economic and social outcomes.** The World Bank projects GDP growth of 2.1 percent in 2022 and 1.5 percent in 2023. This suggests that real GDP per capita in 2023 would still be below its 2019 level. Such moderate growth would not reverse the impact of the pandemic on the labor market, and the unemployment rate is projected to stay around 30 percent in the medium run. With persistent low growth, South Africa's nominal growth would likely remain below or close to effective interest rates over the medium term. Such debt dynamics would increase the fiscal effort needed to preserve debt sustainability.

### Better growth prospects require addressing long-standing structural constraints

**Structural reforms are needed to boost private sector competitiveness and productivity and support higher growth.** The recent World Bank Enterprise Survey for South Africa (World Bank 2020) shows that access to electricity remains the most severe constraint to private sector activity, with 55 percent of surveyed firms reporting it as the biggest obstacle to their business. This needs to be addressed by reforming the electricity sector. The reforms to improve costs and efficiency in network industries (electricity, digital communications, transport, and logistics, etc.) described in the Economic Reconstruction and Recovery Plan and supported by Operation Vulindlela should be fully implemented. Implementing reforms to increase private sector competitiveness (such as those discussed in Box 1.1) will also be necessary to improve business confidence, increase private investment, and catalyze private funding for infrastructure needs, as envisaged by the Infrastructure Fund. Stimulating private investment will be essential to restart growth after the pandemic, especially as public finances are constrained. South Africa's potential needs to be unlocked to support fiscal consolidation and mitigate its impact on economic growth. Although structural reforms take time, the signaling effect of reform can immediately boost confidence. In this context, as noted, the recent announcement of the increase in the licensing threshold for embedded electricity generation from 1 MW to 100 MW is a very important and encouraging first step. It could both improve business confidence and raise economic potential in the medium run.

**These reforms would also support external competitiveness, which could enhance growth.** In addition to reforms behind the border (e.g., electricity supply, business regulations, and competition), public policies to improve firms' competitiveness at the border (e.g., logistics and transports costs, trade facilitation, and trade policy) would support economic growth. The global outlook is driven by a strong recovery in the country's trading partners; thus, increasing its participation in trade and global value chains would allow South Africa to benefit from global growth. A larger role for the external sector in driving the economic recovery would be especially important, as the traditional drivers of growth (household and government consumption) are hampered by a depressed labor market and tighter fiscal policy, which constrains the government's ability to boost aggregate domestic demand.

### Fiscal policy priorities are to preserve macro-stability and increase the impact of budget spending

**The government has committed to making public services sustainable and stabilizing public debt.** It recognizes that the trajectory of fiscal policy and debt has been increasingly unsustainable and has worsened during the pandemic. As the COVID-19 shock subsides and the recovery gathers speed, the government plans to withdraw COVID-19 relief measures, contain expenditure commitments, and improve the impact of fiscal policy on economic and social outcomes (the fiscal multiplier) over the medium term.

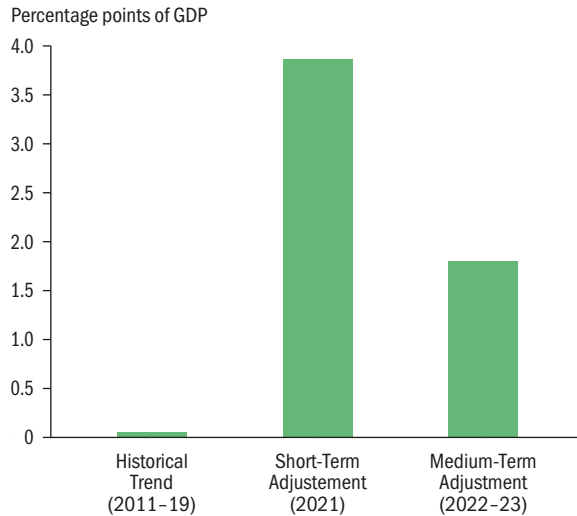
**The government's strategy rests on rebalancing expenditure toward investment and development.** It plans to support the recovery by improving the composition of public expenditure. According to the 2021 Budget Review (National Treasury 2021b), the bulk of budget spending is allocated to learning and culture, health, and social development. Capital spending is budgeted to be the fastest-growing category among non-interest expenditure, increasing by about 12.5 percent annually in 2021–23 (excluding COVID-19-related spending), after contracting by 6.1 percent per year in 2015–19. However, a more granular analysis reveals trade-offs between programs. For example, social grants are to contract in real terms, and this would affect the most vulnerable people at a time when the economic outlook remains difficult.

Based on the government's plans, the World Bank projects fiscal deficits to decrease gradually over the medium term. The consolidated government deficit is expected to decrease to 8.4 percent in 2021 and to 6.1 percent by 2023. Achieving this would require a significant slowdown in expenditure growth over the government's Medium-Term Expenditure Framework (MTEF). The primary balance (the budget balance excluding interest payments) is projected to improve by 4.5 percentage points of GDP in 2021 with the withdrawal of the COVID-19 measures, and by a further cumulative 2.9 percentage points by 2023. As a result, public debt is projected to grow to 80 percent of GDP in 2021 and to 87.3 percent by 2023. Interest payments will continue to be the fastest-growing expenditure category: they are projected to increase from 4.9 percent of GDP in 2021 to 5.6 percent by 2023, or about 20 percent of revenue. Stabilizing public debt in fiscal 2025, as envisaged in the 2021 *Budget Review*, would require further adjustments in the primary balance beyond the MTEF.

**Realizing the government's ambitious fiscal path will be challenging.** The planned reduction in the primary deficit is substantial. It is based in part on projected improvements in social security fund balances once the Temporary Employee/Employer Relief Scheme (TERS) has been withdrawn. The overall reduction appears ambitious, especially compared with the trend over the last decade (Figure 1.15). Also, most of the expected containment of spending presented in the 2021 *Budget Review* relies on restraining the growth of the public sector compensation bill through adjustments to wage increases and nonwage benefits, along with a reduction in headcount through attrition. The budget assumes compensation growth of about 1.5 percent annually (excluding COVID-19 expenditures) over the MTEF, much lower than the average annual growth of 7.4 percent in 2015–19. The position of the National Treasury over the unaffordability of wage increases has been supported by the decision of the Labor Court of Appeals over the compensation increase in fiscal 2020. However, trade unions strongly resist the budgeted compensation envelope over the MTEF. The 2021 *Budget Review* identifies the main fiscal risks as a departure from compensation budget ceilings, the financial position of public entities and local government, and the medium-term debt redemptions of SOEs.

**FIGURE 1.15** 2021 Budget path requires a significant reduction in the primary deficit

Average annual change in the primary deficit



Source: National Treasury; World Bank.

**Fiscal slippages would put debt sustainability at risk.**

For example, the National Treasury estimates that growing the wage bill by (consumer price index) inflation would add total spending of 1.9 percentage points of GDP by fiscal 2023. In the short term, a longer-than-expected pandemic and associated economic crisis would increase pressure on health and social expenditure in 2021. Finally, a reallocation of resources to accommodate spending pressures on certain categories (e.g. SOEs) may result in a budget allocation that is less supportive of growth and development than envisaged in the *Budget Review*.

**Improving the allocation and efficiency of budget expenditure is critical to increasing the effect of fiscal policy on South Africa's economy and its people.**

Resources must go where they can have the highest developmental impact and help to mitigate the effect of expenditure restraint on economic and social outcomes. Improving transparency, accountability, and capacity (especially at subnational levels of government); strengthening procurement processes to avoid overpaying for goods and services; and reducing duplication of work across different agencies would all help reduce waste and increase the impact of public expenditure on the



economy (Burger 2021; OECD 2020; National Treasury 2020; AGSA 2019, 2021). Linking budget allocation more systematically to program outcomes (based on the Treasury's expenditure reviews) would also help to prioritize budget spending and inform the difficult choices needed to restore fiscal sustainability. The government's planned move towards zero-based budgeting recognizes the need to preserve service delivery and protect programs with high economic and development impacts (National Treasury 2021a).

**The current global outlook could translate into better revenue outcomes.** Higher external demand and commodity prices could translate into higher-than-expected fiscal revenue. Should this materialize, there could be pressure on government to increase spending. Higher revenue could help smooth the fiscal trajectory; however, it would not substitute for the structural reforms needed for fiscal policy to play a more countercyclical role and to increase the effect of budget spending on economic and social outcomes. In this context, any decision to increase expenditure should be driven by its expected economic or social impact and not by the perception of renewed fiscal space. Better-than-expected revenue could also allow the government to reach its fiscal and debt targets faster. Lower public sector borrowing requirements would free up (or reduce the cost of) resources for private sector investment and reduce the burden of interest payments on the budget over time.

### South Africa is vulnerable to stresses in global financial markets

**South Africa has generally been resilient to changes in the global environment.** Favorable commodity prices, accompanied by weak domestic demand, will continue to support the current account balance. The World Bank projects that the current account will reach a surplus of 1.5 percent of GDP in 2021 before slipping back into deficit in 2022. From this point of view, South Africa is now less vulnerable to a "taper tantrum" than in 2013, when the current account deficit exceeded 5 percent of GDP. Other important strengths are the country's long-standing flexible exchange rate regime, a relatively strong international investment position, and low external debt; these would contribute to reduce external sector vulnerability should capital flows become more volatile.

**But South Africa's fiscal position makes it vulnerable to changes in sentiment in global financial markets.** As noted, South Africa issues most of its debt domestically in rand. However, an important share is held by foreigners. Currently, about 30 percent of its public debt is held by nonresidents, a share that has declined from a peak of 42.8 percent in early 2018. The country seems vulnerable to persistent foreign portfolio investment outflows, which would mean higher yields at a time when debt-servicing costs are already crowding out non-interest budget spending (Box 1.6). In case of a shock to global portfolio flows, South Africa's significant domestic savings could substitute for foreign investment. However, this would inevitably crowd out funds for private investment, which would likely translate into weaker economic growth. It would also deepen the sovereign-bank nexus (the link between the health of the banking system and the level of sovereign debt).

**Public sector financing needs are expected to remain high during the next few years.** The government has reduced its borrowing requirements for 2021. Fiscal revenues outperformed estimates in fiscal 2020, and weekly issuances were left unchanged for most of the fiscal year, resulting in the National Treasury accumulating cash balances of about R 91 billion instead of a projected decrease of R 48 billion. The Treasury now plans to use R 113 billion from its cash balances in fiscal 2021 to finance the deficit, reducing the financing need from debt securities in the current year. In fiscal 2022–23, however, gross borrowing requirements are expected to remain high, pointing to persistent pressures on debt management and financing. In addition, SOEs financing needs are projected to average around R55 billion annually over the next three years.

**Risks to the financial sector stem from the sovereign-bank nexus and the weak economic environment.** The financial sector's exposure to sovereign risk has increased during the pandemic. Bank holdings of government debt grew substantially from March to December 2020, as non-resident investors reduced their relative exposure to domestic debt and government issued more debt. At the end of the year, domestic banks accounted for about 22 percent of total government bond holdings, up from 16.7 percent in December 2019, while pension funds and insurers accounted for 29 percent. Rising household debt and record-high unemployment are key sources of banking sec-

### BOX 1.6 South Africa's public finances are vulnerable to stress in global financial markets

Rising inflation expectations have led to some tightening of global financial conditions, with yield curves steepening in major advanced economies and, to varying degrees, in local currency- and dollar-denominated bonds in emerging market and developing economies. Portfolio flows to these countries have also weakened, with many currencies slipping. Supported by trade developments and favorable global financial conditions, South Africa's exchange rate has strengthened, outperforming the country's peers. However, it is vulnerable to a rise in yields in advanced countries—if this translates into a rise in domestic yields—given the large public sector borrowing requirement.

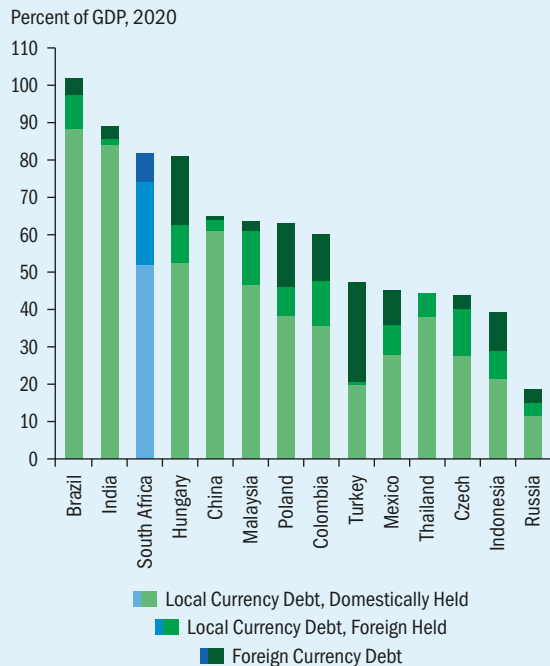
External debt is low (less than 10 percent of total government debt is in foreign currency), but a significant share of domestic debt is held by foreign investors (about 30 percent or 22 percent of GDP), making them the largest bondholder category. This puts South Africa among the countries with the highest share of external or foreign-held domestic debt (30 percent of GDP), together with Hungary (29 percent), Turkey (27 percent), Poland (25 percent) and Colombia (24 percent), and makes it vulnerable to changes in foreign investors' sentiment (Figure B.1.6.1).

In addition, South Africa already has relatively high yields—especially at longer maturities—because of the loss of investor

confidence in the country's macro fundamentals even before the pandemic (Figure B.1.6.2). As a result, its 10-year government bond benchmark rate is around 9 percent. Substantial foreign portfolio investment outflows would likely translate into rising yields, putting additional pressure on public finances. The National Treasury's fiscal risk statement in the October 2020 Medium-Term Budget Policy Statement estimated that a 10 percent increase in interest rates (slightly below a 1 percentage point rise in the 10-year bond rate at the current rate) would translate into an increase in the interest payment bill by 0.1 of a percentage point of GDP and in the government debt stock of 0.5 points of GDP (National Treasury 2020).

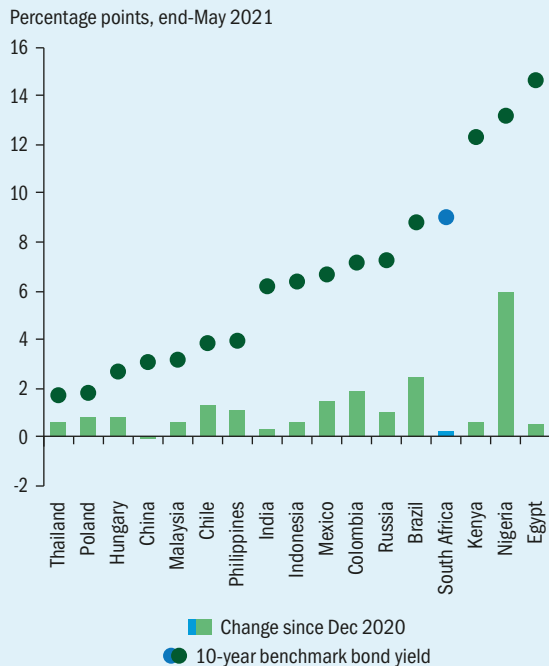
So far, South Africa's bond yields have remained broadly stable relative to end-2020. Another mitigating factor is the long-term profile of its public debt: the average term to maturity is above 12.7 years, higher than in most of its peers, including Chile (10.2 years), Indonesia (8.6 years), the Russian Federation (6.5 years), or Turkey (5.1 years). In the event of a further steepening of the yield curve, South Africa could have some room in terms of debt management to issue shorter maturity tenders while keeping an overall favorable profile. It could also consider raising external borrowing, prudently, especially from international financial institutions.

**FIGURE B1.6.1 Public debt is mostly domestic**



Source: Institute of International Finance

**FIGURE B1.6.2 Local yields remain relatively high**



Source: Haver

tor risk: household debt as a share of disposable income rose from 73.2 percent at the end of 2019 to 75.3 percent a year later. This risk is mitigated by a lower debt service burden (7.7 percent of disposable income at end-2020, as against 9.4 percent at end-2019), because of the low interest rate environment (SARB 2021). Though moderately high foreign currency-denominated corporate debt makes many South African companies vulnerable to exchange rate shocks, they have both financial and natural hedges (e.g., mining companies) to absorb such shocks.

**The SARB has policy space to continue to support the recovery.** Inflation remains moderate, and inflation expectations are stable and anchored towards the lower end of the target band. The World Bank projects inflation to average 4.2 percent in 2021, gradually rising to 4.5 percent in 2022–23. The SARB sees inflationary risks from


higher domestic import tariffs, rising wage demands, and global oil prices. Nonetheless, the Monetary Policy Committee still expects inflation to remain moderate in 2021, which should allow the SARB to maintain its accommodative monetary policy stance. Still, given structurally weak investment and growth, the impact of accommodative monetary policy in stimulating the economy may be limited. Also, the possibility of an early tightening of the cycle in the United States could complicate monetary policy in emerging countries. In such countries, including South Africa, domestic conditions may warrant a continued accommodative monetary policy stance, but global conditions may put pressure on central banks to raise interest rates. The SARB has room to mitigate market liquidity stress if global risk aversion rises — among other measures, it can again expand its secondary market purchases of government securities.



## PART 2

# South Africa's Labor Markets and Impacts of the COVID-19 Pandemic

### Main messages

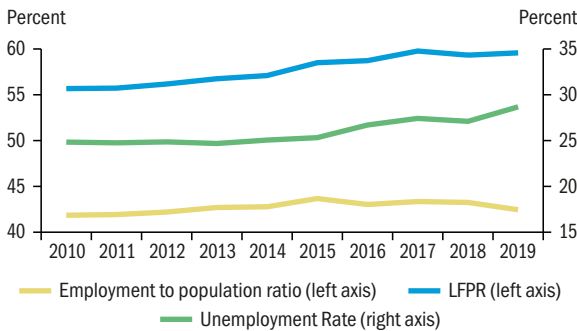
- 1. The pandemic led to severe job losses, and jobs are only slowly coming back.** At the time of writing, less than 40 percent of employment losses had been recovered. South Africa entered the COVID-19 pandemic with already relatively low levels of employment and a decade of weak job generation, far below the standards of most upper-middle-income countries.
  - 2. Job losses are disproportionately concentrated among low-income workers, worsening already severe inequalities.** Low-wage workers endured 4 times more job losses than high-wage workers. The government's policy response was decisive, with pro-poor transfer programs that partially cushioned the negative impacts of the pandemic.
  - 3. Going forward, a policy package that targets labor market outcomes can make a difference in the pace of employment recovery.** This package could be built around four blocks: (1) strengthen labor market linkages of the social transfer system; (2) consider a moratorium on specific pieces of labor regulation; (3) relax constraints to entrepreneurship and self-employment; and (4) improve the effectiveness of active labor market programs through broader public-private partnerships and system enhancements.
- 

## South Africa’s labor market has performed poorly in the past decade

The 2010s were a lost decade for both economic growth and the labor market. In 2010–19, economic activity and employment in South Africa stagnated (Figure 2.1). The country entered the decade with an employment-to-population ratio of just over 40 percent and ended the decade essentially where it started. Most of the working-age population did not have regular employment either at the beginning of the decade or at its end. Employment ratios for upper- and lower-middle-income countries average 63 and 49 percent, respectively. South Africa’s employment absorption capacity lags far behind.

**FIGURE 2.1** A decade of poor labor market outcomes

Employment, labor force participation, and unemployment rates, 2010–19



Source: World Bank staff calculations based on QLFS 2010–19 (Statistics South Africa).

In the past decade, unemployment rose; labor force participation improved but remained low by international standards. Working-age South Africans increased their engagement with the labor market, but they mainly swelled the ranks of the unemployed, particularly in the second half of the decade. Of the 4.2 million new entrants to the labor market who started looking for jobs between 2009 and 2019, only 2 million (46 percent) found one. By 2019, unemployment affected 29 percent of the labor force. When the almost 3 million people that have been discouraged from searching for jobs are included, the expanded unemployment rate reached 39 percent. (See Box 2.1 for a summary of the approach and definitions used in this section.)

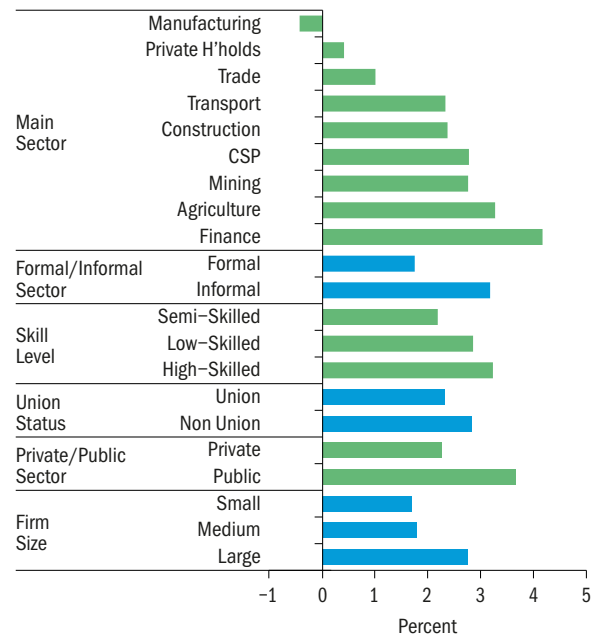
South Africa’s labor market is small and stagnant, because job creation in the private sector is weak, espe-

cially among small and medium firms. In 2010–19, public sector employment grew at an average rate of 3.7 percent, while private job growth only averaged 2.3 percent. There was limited job generation in small businesses (1–9 paid employees), own-account workers (no paid employees), and medium-sized firms (fewer than 50 employees). This sector would typically be a country’s main engine of job creation, but in South Africa most job generation came from larger companies.

Finance and agriculture were the most dynamic sectors for job creation, whereas manufacturing jobs contracted during the decade. Jobs in the finance and agriculture sectors grew at above-average rates, which contributed to employment of high- and low-skilled workers, respectively. But even after this growth, agriculture accounted for only 5 percent of total employment and finance for 15 percent. Given their small share in employment, their growth could not offset the general weaknesses in the labor market. Manufacturing is the only sector that shed jobs in 2010–19; trade and retail saw limited growth, and the other sectors barely kept up with the growth of the workforce (see Figure 2.2 and Appendix 1 for details of the labor market composition).

**FIGURE 2.2** Over the last decade, jobs growth was modest in almost all categories

Employment growth rate, by labor market category, 2010–19



Source: World Bank staff calculations based on data from PALMS v3.3 (DataFirst) and QLFS 2010–19 (Statistics South Africa).

### BOX 2.1 Measuring the labor market impact of the COVID-19 pandemic in South Africa

We examine the labor market impacts of the COVID-19 pandemic by tracking the dynamics of the main labor outcomes during the four quarters of 2020. To do so, we use publicly available data from the Quarterly Labor Force Survey (QLFS), collected by Statistics South Africa. The data are well fitted for this analysis, as this survey is specifically designed to capture labor market dimensions, has a robust sample size, and has been collected for more than 10 years.

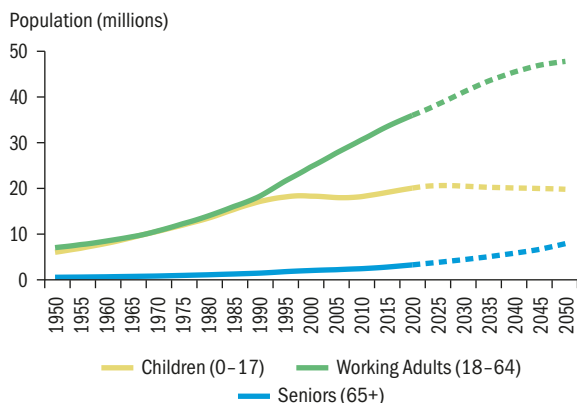
We use the following definitions for key variables, consistent with the official approach of Statistics South Africa and the international standards of the International Labour Office (ILO):

1. **Labor force participation:** the working-age population (age 15 – 64), both employed and unemployed.
2. **Employment:** people (age 15 – 64) who, during the week before the survey, did any work for at least one hour, or had a job or business but were not at work (i.e., were temporarily absent).
3. **Unemployment (narrow):** people (age 15 – 64) who were not employed in the week before the survey and were
  - a. Actively looking for work or tried to start a business in the four weeks before the survey interview; and available for work (i.e., would have been able to start in the week preceding the survey interview); or
  - b. Not actively looking for work in the past four weeks but had a job or business to start at a definite date in the future and who were available to work.
4. **Unemployment (expanded):** includes 15 – 64-year-olds who:
  - a. Fall under the narrow definition of unemployment (i.e., available and searching for work); or
  - b. Were available to work but are discouraged work-seekers or have other reasons for not searching.
5. **Discouraged work-seeker:** a person who was not employed during the week before the survey interview, wanted to work, was available to work/start a business, but did not take active steps to find work during the past four weeks for one of the following reasons: no jobs available in the area; unable to find work requiring his/her skills; or lost hope of finding any kind of work.
6. **Informal sector:** The informal sector has two components:
  - a. Employees working in establishments that employ fewer than five people, which do not deduct income tax from their salaries/wages; and
  - b. Employers, own-account workers, and persons providing unpaid work in their household business who are not registered for either income tax or value-added tax.
7. **Informal employment:** Persons who are in precarious employment situations, not covered by legally mandated labor protections, irrespective of whether the entity for which they work is in the formal or informal sector. They, therefore, comprise all persons in the informal sector, along with employees in the formal sector and persons working in private households who are not entitled to or receive basic benefits (e.g., pension or medical aid contributions) from their employer and who do not have a written contract of employment.
8. **Hours of work:** the number of hours an employed individual usually works each week, from Monday to Sunday.
9. **Wages:** the monthly earnings that an employed person receives in their main job before any deductions.

Reference: Statistics South Africa.

Reinvigorating the labor market is even more important for capitalizing on the projected growth of the working-age population. The country's demographic trendline is encouraging: the population is growing because South Africans live a longer and a healthier life than their parents did, even though their life expectancy remains among the lowest in the world. As in most emerging economies, South Africa's population growth is now driven by adults. Since the late 1990s, the number of adults of working age (18 – 65 years) kept rising, while the number of children barely changed. These trends will continue at least until 2050. This is a major opportunity, because the adult population could reach 60 million in 2050, while the number of children would stay stable at just below 20 million (Figure 2.3). With a much-improved health system, South Africa could have an even

FIGURE 2.3 South Africa is experiencing a demographic opportunity



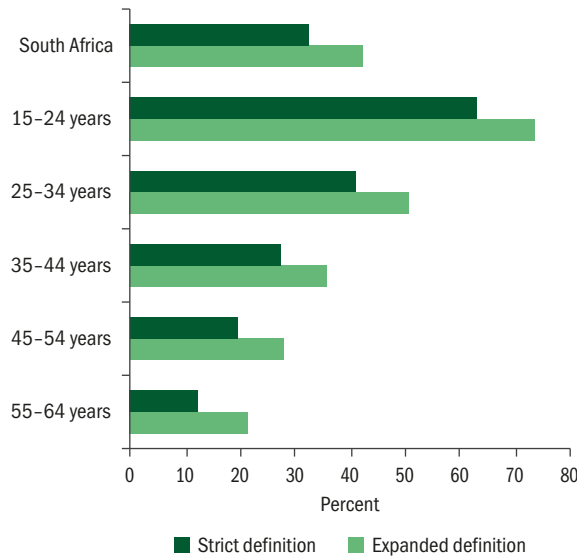
Source: QLFS 2020 (Statistics South Africa).

larger population, reinforcing the current trend. More South Africans would live longer, and the country would keep adding adults to its population. Resuming job creation is key to turning this demographic momentum into a development opportunity.

**To seize the demographic momentum, addressing the labor market integration of young people is critical.** Young people face the highest unemployment rates (Figure 2.4). Among 15–24-year-olds, 63 percent are unemployed and looking for work, whereas among 25–34-year-olds, this rate reaches 41 percent. The incidence of unemployment among young people is twice as high, or more, than among older age groups. Moreover, when the expanded definition (i.e., including discouraged workers) is considered, unemployment rates are as high as 74 percent for 15–24-year-olds and 51 percent for 25–34-year-olds.

**FIGURE 2.4** Young people face acute unemployment rates

Unemployment rates, strict and expanded definitions, by age group

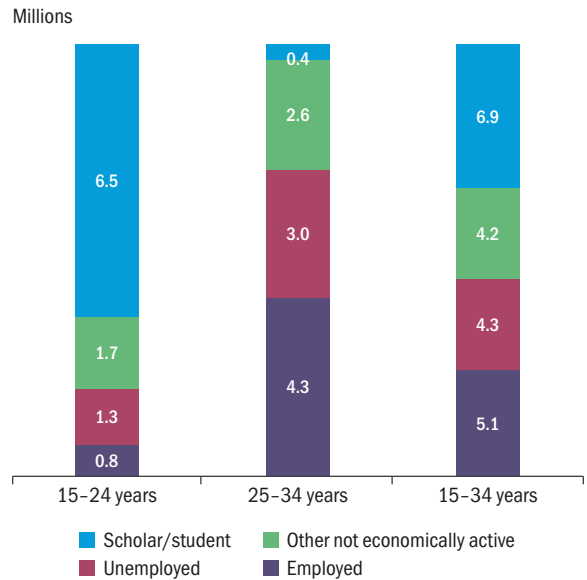


Source: QLFS 2020 (Statistics South Africa).

**Most young people are jobless and out of school.** About 5 million are working, and 7 million are studying. In contrast, about 8.5 million are either unemployed and looking for work (4.3 million) or just inactive (4.2 million) (Figure 2.5).

**FIGURE 2.5** More than 4 million young people are not working or studying

Main activity, by age group



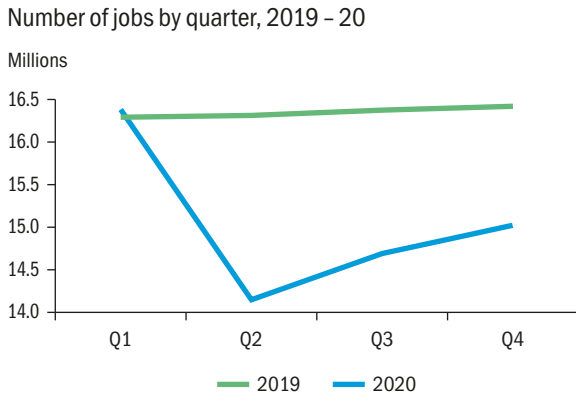
Source: QLFS 2020 (Statistics South Africa).

## The pandemic exerted a heavy toll on the labor market

The labor market was badly affected by the COVID-19 pandemic. In the second quarter of 2020 (which includes the level 5 lockdown, when most economic activity was halted), the economy lost 2.2 million jobs. In a country with a large population but limited employment opportunities, such a shock was significant, representing a decrease of 13.6 percent in overall employment.

**After the initial shock, jobs started to recover, but most have not yet returned.** About half a million jobs were recovered in the third quarter of 2020, and another 300,000 returned in the fourth quarter (Figure 2.6). However, compared with the first quarter, over 60 percent of the lost jobs were still missing. By the end of 2020, 1.4 million jobs had been lost, representing an 8 percent contraction in aggregate employment. To put this into perspective, it took the country six years to add 1.4 million jobs to its pre-pandemic economy.

**FIGURE 2.6** The COVID impact: Employment declined fast and recovers slowly



Source: World Bank staff calculations based on QLFS 2019Q1 – 2020Q4 (Statistics South Africa).

Notes: a. Estimates weighted using relevant sampling weights. b. Sample restricted to working-age population (15 – 64 years).

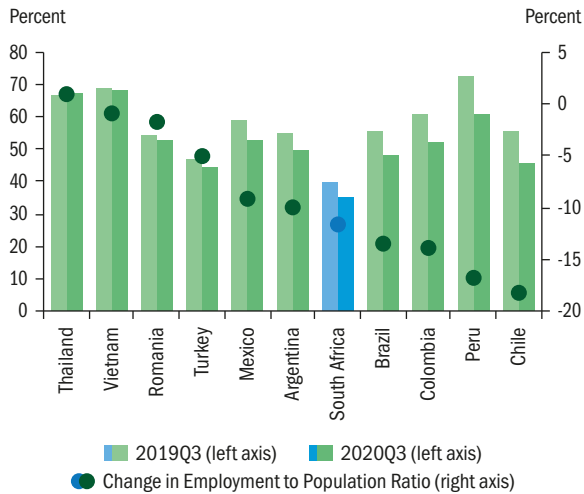
South Africa's labor market was among the most severely affected by the pandemic. Among upper-middle and high-income emerging markets (including Chile, Mexico, Colombia, and Turkey), South Africa's employment losses are relatively large (Figure 2.7). The percentage reduction in its employment ratios in the third quarter of 2020 was not as large as in Brazil or Chile, but were worse than in Turkey, Mexico, and Argentina, for example. Among the group of countries with available data and comparable development, South Africa's labor market ranks as the fifth most severely affected.

Thus, South Africa's employment levels shrank even further, from an already low base. Out of a working-age population of 39 million, only 15 million people are working (Figure 2.8). Had the country's employment rates been more similar those of upper-middle-income countries, its employment size would be 20 – 24 million. By the fourth quarter of 2020, South Africa had 7 million unemployed people; 3 million more were available to work but discouraged from searching for it.

A reduction in hours worked played an important part in absorbing the shock of the pandemic and preventing further job losses. In the second quarter of 2020, about 2.3 million workers had to reduce their working hours to zero, but they could keep their jobs and return to work once the lockdown eased (Figure 2.9). The overall share of workers who were 'locked out' of their jobs and could not work any hours reached 16 percent in the second quar-

**FIGURE 2.7** South Africa's labor market did worse than most of its peers during the crisis

Employment ratios in upper-middle-income countries, Q3 2019 and 2020

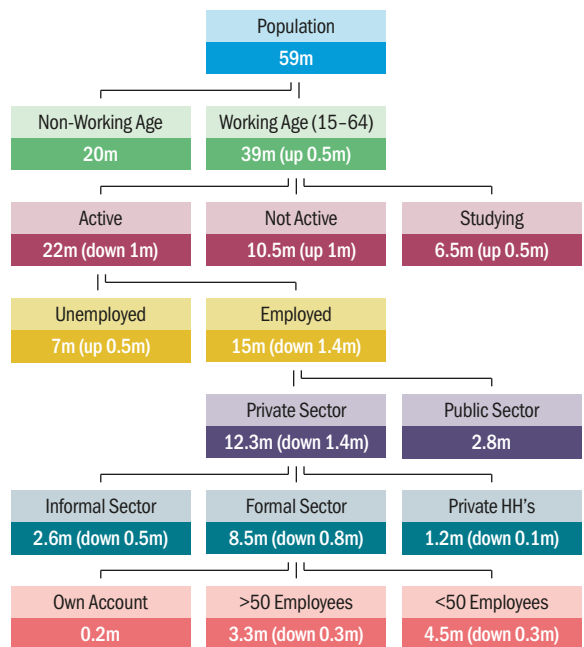


Source: Labor Force Surveys. Countries selected based on data availability.

Note: Change in employment ratio calculated as percentage change relative to 2019.

**FIGURE 2.8** The size of the labor market keeps shrinking

Q4 2020. Annual changes in parenthesis, relative to Q4 2019

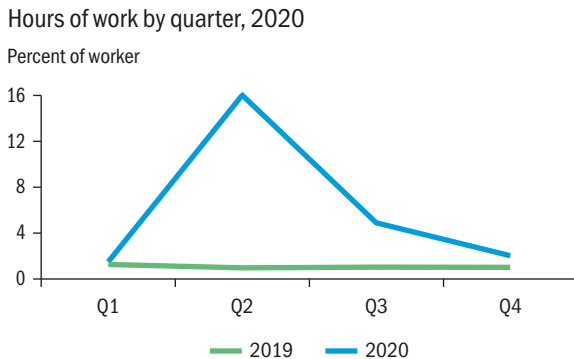


Source: World Bank staff calculations based on QLFS 2020Q4 (Statistics South Africa).



ter of 2020, but quickly recovered back down to 5 percent in the third quarter and 2 percent in the fourth quarter.

**FIGURE 2.9** The share of workers who worked zero hours spiked in Q2 2020



Source: World Bank staff calculations based on QLFS 2019Q1 – 2020Q4 (Statistics South Africa).

Notes: a. Estimates weighted using relevant sampling weights. b. Sample restricted to working-age population (15–64 years).

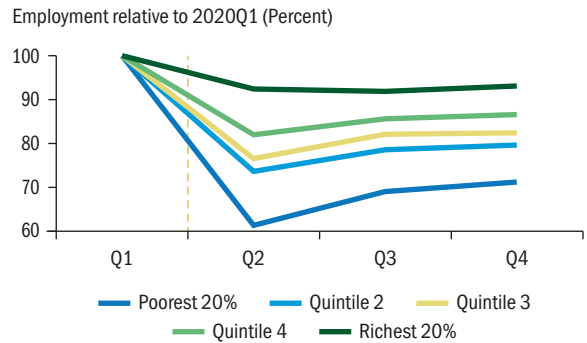
Wages were also adjusted downwards later in the year. Relative to jobs and hours, wages were slower to respond to the crisis. The extensive and intensive margins of the labor market cushioned most of the pandemic shock, as median wages remained broadly constant in the second quarter of 2020. Earnings started to respond later in the year. When compared with the first quarter of 2020, the monthly median wage fell by 10 percent between the first and fourth quarters.

## COVID-19 widened inequalities in the labor market

Pandemic-related job losses widened already high earnings inequalities. Among low-wage workers (i.e., in the bottom 20 percent of the distribution), employment collapsed by 35 percent between the first and second quarters of 2020 (Figure 2.10). In sharp contrast, for those in the top 20 percent of the wage distribution, it declined by less than 10 percent. In other words, low-wage workers suffered almost four times more job losses than did high-wage ones (see Personal Perspective 2.1 below for Davy Tsopo’s inspirational story of how the pandemic prompted him to start his own business). Also, while the third quarter brought a moderate job recovery to low-wage workers, the recovery did not continue into the fourth quarter.

**FIGURE 2.10** Poorer workers were much more likely to lose jobs

Employment losses by quintile of wage distribution



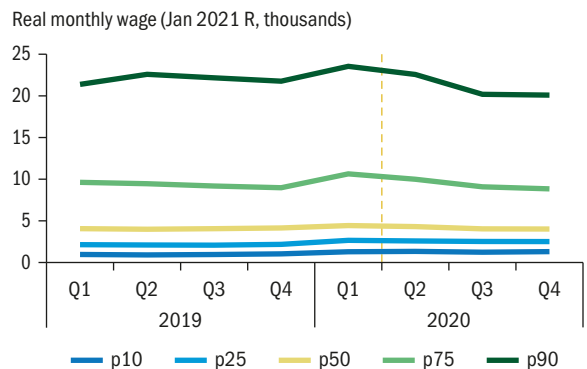
Source: World Bank staff calculations based on data from QLFS 2020Q1–Q4 (Statistics South Africa).

Notes: a. Estimates weighted using computed bracket weights. b. Sample restricted to the employed (employee, employer, or self-employed) working-age population (15–64 years). c. Wages expressed in January 2021 rand. d. Wage data adjusted for bracket responses and outliers. e. Zero working hours replaced with mean working hours for a given year and quarter.

Employment losses also differed among demographic subgroups. Young people, people with limited education, and black and colored workers endured larger losses. However, the impacts were not substantially different between women and men, or between rural and urban populations (Figure 2.11).

**FIGURE 2.11** Among people who kept their jobs, higher-wage workers suffered bigger earnings losses

Real monthly wages by percentile of wage distribution and by quarter of 2019–20



Source: World Bank staff calculations based on QLFS 2019Q1 – 2020Q4 (Statistics South Africa).

Notes: a. Estimates weighted using computed Statistics South Africa sampling weights. b. Sample restricted to the employed (employee, employer, or self-employed) working-age population (15–64 years). c. Wages expressed in January 2021 rand. d. Wage data adjusted outliers. e. Data excludes bracket responses.

### PERSONAL PERSPECTIVE 2.1 From cleaner to cakemaker

When South Africa's first strict lockdown began in March 2020, Davy Tsopo lost his job as a cleaner at a restaurant in Johannesburg. His first child was one month old, his wife was on maternity leave, and he had no idea how he would feed his family or pay his rent in the tiny flat on the fourth floor of their apartment block.

A sympathetic friend shared a Wi-Fi password and told Davy to "keep his mind busy" by watching funny videos on YouTube. Instead, Davy began watching podcasts on baking cakes. He wrote down recipes even though the electric oven in the kitchen he shared with four other families was not connected. When restrictions were eased, the electrician came, and Davy started baking muffins, which he advertised on his Instagram profile.

A female friend at his previous place of work asked him to bake her a cake. "I was puzzled, because she is diabetic," he said. "But she posted a picture of the cake on her Instagram account with a request for support and tagged me." People began sharing the post and ordering cakes. Requests came in from South Africans overseas, who wanted to send cakes to relatives back home.

Davy's friend arranged a Zoom meeting with a baker in the United Kingdom, who taught him how to improve his icing techniques. "Life started to change. Every day I was learning new things and gaining confidence," he said. Davy's wife went back to work early to get her full salary, while he stayed at home to babysit their son during the day and bake cakes in the evening. He won competitions for entrepreneurs, was interviewed on radio and television, and received prizes ranging from computers to a year's supply of cake ingredients.

A year later, Davy was earning more than double his previous salary, and he no longer needed to work regular shifts of over 12 hours, seven days a week. He escaped the fate of many South Africans in 2020, when 1.5 million people—mainly low-income earners—lost their jobs.

Source: World Bank staff interviews.

Davy's transition from cleaner to self-employed baker is an example of the experiences of other people who developed new interests, worked hard, and were supported by the goodwill of other South Africans. His advice resonates with the features of a post-COVID-19-pandemic world, where connectivity, communication, and online networking are essential skills. "Respect social media. If you abuse it, it will abuse you. But if you treat it well, things will change. Look at where I am now," he said.



**Finally, the pattern of job losses was also unequal across labor market sectors and occupations.** Employment in manufacturing, construction, and mining is still below 90 percent of levels in the first quarter of 2020 (Figure 2.12). People working in low- and semi-skilled occupations, in non-unionized arrangements, and in smaller firms were more likely to lose their jobs, as were those in the informal and private sectors.

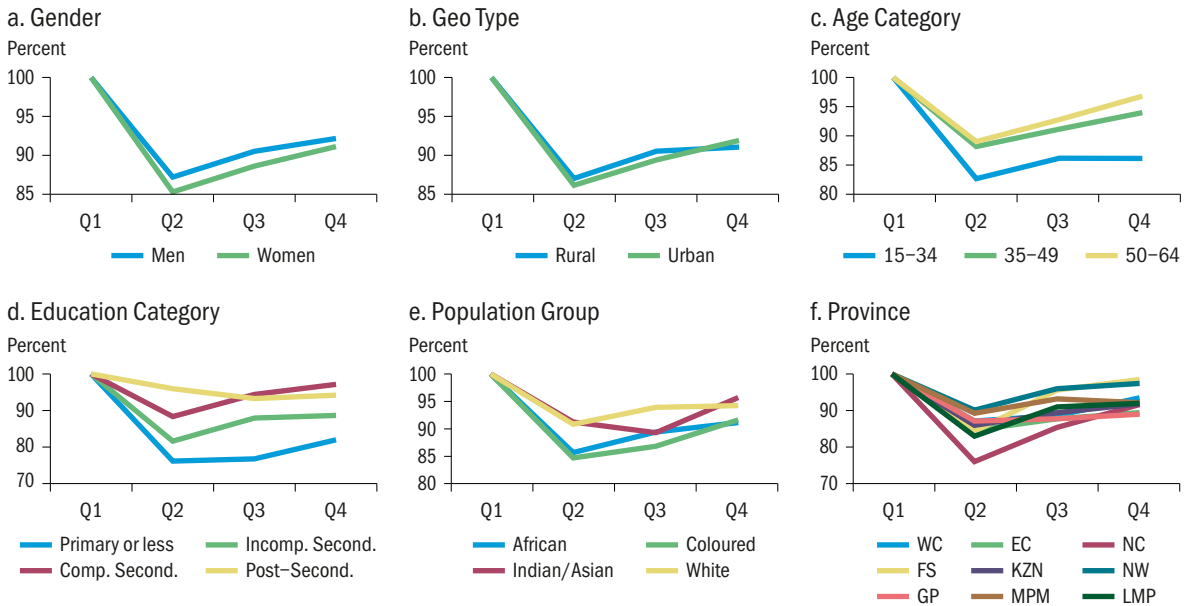
**In contrast, high-wage workers faced disproportionately larger reductions in wages.** This market also started to adjust through earnings a few months into the pandem-

ic. The earnings reduction was disproportionately larger for workers in the top half of the wage distribution. For example, the monthly wage for the 90<sup>th</sup> percentile (workers with wages higher than 90 percent of all workers) decreased by 15 percent, and the monthly wage for 75<sup>th</sup> percentile went down by 17 percent between the first and fourth quarters of 2020 (Figure 2.13). This adjustment partially offsets the widening effects of job losses on inequality.

**With deteriorating employment prospects and wages, Covid-19 brought sizeable monetary welfare loss-**

**FIGURE 2.12** Unequal impacts of job losses across demographic subgroups

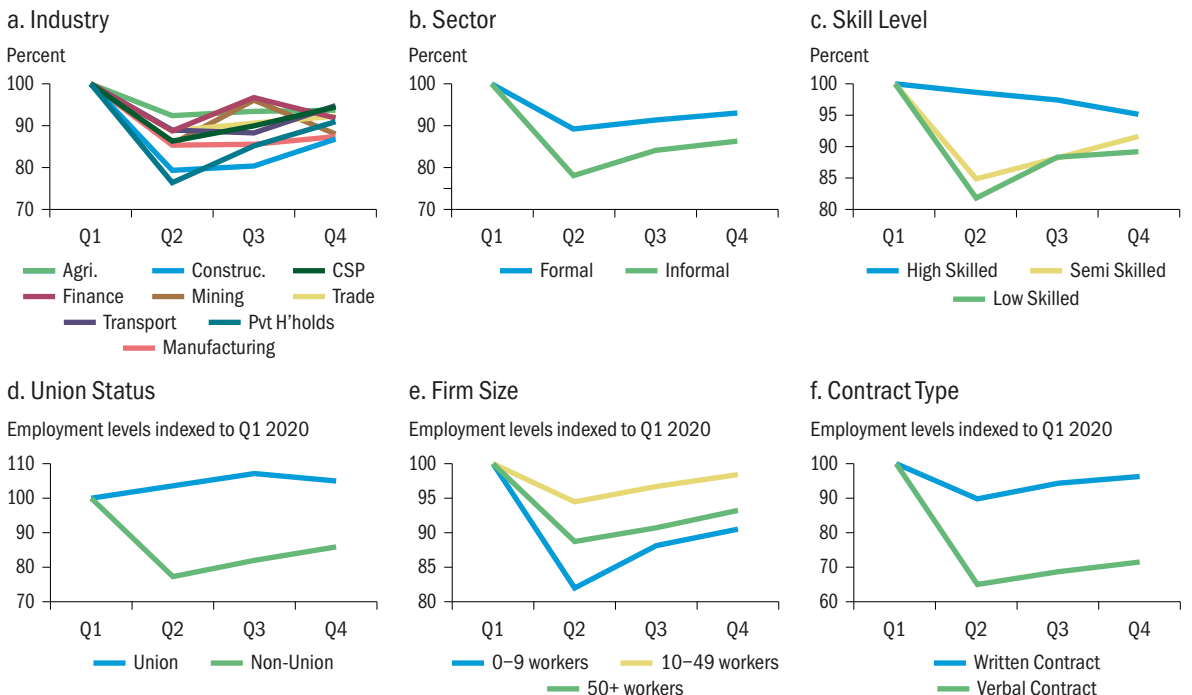
Employment levels indexed to Q1 2020



Source: World Bank staff calculations based on data from QLFS 2020Q1 – Q4 (Statistics South Africa).

**FIGURE 2.13** Unequal impacts of job losses across labor market subgroups

Employment levels indexed to Q1 2020



Source: World Bank staff calculations based on data from QLFS 2020Q1 – Q4 (Statistics South Africa).

es for the typical adult South African. For an average adult South African, welfare — as measured by a composite index of employment and wages — decreased by 18 percent between the first and fourth quarters of 2020 (Table 2.1). The synthetic welfare measure was constructed by weighting median wages by the employment rate.<sup>1</sup>

**TABLE 2.1** Simulated welfare losses in 2020 for the typical South African

Quarter	First	Second	Third	Fourth
Employment rate (%)	42.1	36.3	37.5	38.2
Median wage (R/month)	4,432.90	4,308.60	4,037.70	4,018.20
Expected earnings for average South African	1,866.30	1,564.00	1,514.20	1,535.00
Welfare change (relative to before the pandemic)	1	-16%	-19%	-18%

Source: World Bank staff calculations

## Government's Response to the Pandemic and Policy Options Going Forward

South Africa had a comprehensive social protection system before the COVID-19 pandemic, with a strong pro-poor impact. At the time, 30 percent of the population — about 18 million people — received poverty-based social assistance in the form of at least one social grant payment per month. The three largest grant programs cover 97 percent of all grant recipients: the child support grant (71 percent), the older persons grant (20.3 percent), and a disability grant (5.9 percent). Most beneficiaries were in the poorest quintiles, and the transfers were equivalent to nearly 30 percent of their consumption.

The social protection system was leveraged effectively to provide emergency support to vulnerable people. In response to the pandemic, the government increased

the grant amounts: the older persons and disability grants were increased by R 250 monthly for six months (May–October 2020) for their 4.7 million beneficiaries. More than 12.8 million child social grant beneficiaries received a one-month top-up of R 300 per beneficiary in May. The 7.1 million caregivers to children receiving the child grant, who were registered in the child social grant database in February 2020, received monthly top-ups of R 500 from June to October 2020, under the temporary child social grant caregivers allowance program.

The contributory social insurance system, which includes the unemployment insurance fund (UIF), was also mobilized. Before the pandemic, about 8 million individuals (or 54 percent of employed people) were contributing to the fund. In response to the pandemic, the UIF paid out R 7.5 billion in 1.3 million payments by February 2021.<sup>2</sup> The authorities also introduced TERS to provide wage support in cases where employers had fully or partially closed operations. It covered a portion (38–60 percent) of a firm's wage bill, with a maximum salary threshold of R 17,712 per worker per month, for up to three months. Initially, TERS was only available for those who contributed to the UIF, but this restriction was waived at the end of May 2020. By February 2021, TERS had paid out about R 57 billion in over 13 million payments to more than 4.5 million unique individuals. This is equivalent to about one in every three individuals employed in the formal sector, or half of all UIF contributors.

COVID-19 highlighted the absence of social protection for informal workers, and the COVID-19 social relief of distress program was launched to fill this gap. In a swift response, social relief of distress grants provided R 350 monthly of emergency-relief grants to informal sector workers and unemployed people who were not eligible for other social grants (Table 2.2; also see Personal Perspective 2.2 below for the story of a small-scale farmer). As of December 2020, 6 million people had received at least one payment of the social relief of distress grant. The grant was extended until January and then again to April 2021. This expanded the coverage of the social assistance system to 40 percent of the population.

1. Several assumptions underlie this simple approach, including the use of the employment rate as a proxy for the probability that an average South African can access the median wage. The employment rate decreased from 42 to 38 percent and median wages decreased by 10 percent, making the typical working-age person in South Africa clearly worse off. Before the pandemic, the average working-age person faced an employment rate of 42% and a median wage of R 4,400/month, implying "expected earnings" of R 1,900 ( $4.4 \times 0.42$ ). By the fourth quarter of 2020, they faced an employment rate of 38% and a median wage of R 4,000/month, implying expected earnings of R 1,500 ( $4 \times 0.38$ ).

2. It is not clear from available data how many unique individuals received transfers within those 1.3 million payments. Preliminary information suggests the scheme reached 650,000 unique beneficiaries.

**TABLE 2.2** Summary of the social protection response

Social protection	Pre-Covid-19 grant (rand/month)	Total beneficiaries (millions)	Covid-19 top-up (rand/month)	Periodicity
<b>Social assistance</b>				
Older persons grant and disability grant	1,860	4.8	250	May – October 2020
Child support grant	440	12.7	300 per beneficiary (May) 500 per caregiver (June – October)	May – October 2020
COVID-19 social relief of distress grant	-	6	350	May 2020 – April 2021
<b>Social insurance</b>				
UIF	-	0.65 (TBC)	-	Permanent
TERS	-	4.5	Variable	May 2020 – March 2021

Source: World Bank staff calculations based on National Treasury 2020 and SASSA 2020.

### PERSONAL PERSPECTIVE 2.2 Small-scale farmer benefits from emergency funding

Like many other South African small-scale farmers and entrepreneurs, Nomhle Nhlapho, a single mother, had a tough year in 2020. She had to close one of the two bakeries that she ran in the heart of Johannesburg, and she battled to find outlets for the vegetables that she grew on her 2.4-hectare plot 70 km away from the city.

“It was myth-busting time. People argue that you can’t go wrong with agriculture; people will always need food. Well, sales and prices went down. We had to adjust outputs so we could minimize the damage. Overall, it was a year of big losses,” she says.

Agriculture was one of the few sectors that grew strongly during the year, as rainfall was good in many areas, and food production and transport were exempt from the tough lockdown restrictions imposed at the end of March 2020.

But the country’s 2 million small-scale farmers suffered, partly because outlets appeared to be “fixed” in favor of commercial farmers and partly because they had fewer resources to deal with unexpected shocks from extreme weather. Many would not have survived without emergency funding from the government, which focused on young, female, and disabled farmers.

“For me, it was very helpful. Of my inputs, excluding labor, water, and salaries, I can estimate that 60 percent were covered as a result of the grant,” Nomhle says. “I also shifted what I was growing to okra and spinach from watermelons, baby marrow, and squash.”

Nomhle was less fortunate with her bakeries. She had to close the one that she operated in the city center, which is less affluent than the surrounding suburbs. This meant she had to retrench eight people.

Source: World Bank staff interviews.

“It was a very sad occasion, and tears dropped. What was so tough was that everyone wanted to help revive the business. It was a collective thing,” she says. There were no other options, as landlords tried to give relief by removing levies, but the rent still stood, she adds.

Business is still not what it used to be, as universities are mainly teaching online, and there are fewer people on the streets. School attendance is also lower. “I had to dip into my savings, and go into debt,” Nomhle says.



## Rebuilding South Africa's labor market after the pandemic

While the pre-pandemic structural reform agenda is still of the utmost importance, South Africa could also consider a complementary package of policy actions to support the economic recovery. Addressing structural constraints to inclusive growth, as described in Box 1.1, remain a priority, and policies in this regard could perhaps be accelerated because of the pandemic. Addressing the high costs of nontradeable inputs, SOE reform, low competition in product markets, and skills scarcity, however, would take time to bear fruit, even if action is taken now. It is, therefore, opportune to consider actions that can complement this agenda and ease the jobs recovery in the shorter term.

A policy package to support the labor market could provide a mix of time-bound emergency employment programs and measures to spur entrepreneurship and self-employment. Time-bound emergency programs would offer programs and policies that would not be appropriate in the long run because of fiscal costs or job quality issues but could temporarily help people transition into the labor market. They shift the focus away from emergency aid for households and toward incentives for employers to hire people and for workers to enhance their employability. There are also areas such as entrepreneurship and self-employment where South Africa lags other upper-middle-income countries and could make gains in the short to medium run. Finally, the country's approach to active labor market programs could yield efficiencies for this and future crises. These suggestions are discussed in turn in the next subsections.

### Strengthen labor market linkages of the social transfer system

To improve the labor market effects of social transfers, existing programs could be adjusted to focus on integrating people into the labor market in a fiscally sustainable way. This could be done through two channels:

- First, **expanding and deepening the employment tax incentive to encourage hiring in the private sector**, particularly for those who face more constraints to labor market integration, such as young people and

women. The employment tax incentive (ETI) has been shown to incentivize short-term employment by the private sector in South Africa. The international evidence finds that this program is particularly effective in crisis and rebound periods, but less so when the economy is healthy; this would suggest expanding the program until the economy recovers.

- Second, **continuing TERS for lockdown-damaged sectors** until a sizeable share of firms are operational again. The TERS program has helped to maintain the link between workers and employers, which is expected to facilitate firms' return to business and people's return to work. If TERS is cut short, the link might be broken, which would increase both unemployment and the cost to firms as they search for and train a new workforce. The program would need to be time-bound, ending when the economy reaches a predetermined level of activity. While TERS has been extended several times, another extension should be considered. If targeted to the sectors most affected by the lockdown (e.g., tourism, hospitality, and restaurants), it should be financially viable for the UIF (see Personal Perspective 2.3 below for an insight on how restaurants have struggled).

### Consider negotiating a moratorium on specific regulations with social partners

The government could consider a temporary suspension of regulations that increase the real cost of labor and make job recovery more difficult. A moratorium should be considered on specific pieces of the existing and future legislative and regulatory architecture that are likely to hinder re-employment outcomes. Such a moratorium should be used primarily to benefit vulnerable people, who have disproportionately lost their jobs during the deep economic crisis triggered by the pandemic.

The specific policies that should be subject to a moratorium could be negotiated at the National Economic Development and Labour Council (NEDLAC) for common agreement and adoption to boost hiring as the economy is rebuilding. The moratorium should be strictly time-bound and linked to the pandemic and its economic consequences. For example, it could last 12–18 months, with an agreement among social partners that the relevant legislative processes would resume at the end of that period.

### PERSONAL PERSPECTIVE 2.3 Restaurants—86 Public

Mwezi Macingwane’s business, like many other entrepreneurs in South Africa’s restaurant industry, was battered by alcohol bans, curfews, and social distancing restrictions during the pandemic. To keep their business afloat, he and his business partners dipped into a ‘rainy day’ fund they had started to build for 86 Public, the large, high-end bar and pizzeria they established in Johannesburg in the middle of 2018.

Restaurants make most of their money from alcohol sales. When restaurants were allowed to reopen without serving drinks, the partners opted to keep their restaurant shut. When their fund was depleted, Mwezi and his main business partner, Henry Cock, started an online fundraising campaign: Henry ran 100 km in the 6-meter passage in his home during the 5-week period when people were not allowed to go outdoors. Like many other South African restaurants, they also raised money with an appeal to loyal customers, bolstered by a network of friends overseas.

Their efforts were successful—86 Public is operating, albeit with 70 percent of its pre-pandemic turnover. All 45 of its permanent staff kept their jobs, although the structure of their salaries changed.

“We didn’t think we’d manage. We thought we’d default on our lease,” Mwezi said. “We managed to renegotiate that, but 30 percent of the shops in the complex where we operate are still shut.” Mwezi said he is not angry at the government for trying to stop the loss of life. By end-June 2021, South Africa had recorded over 60,000 COVID-19-related deaths.

The spacious lower floor of his restaurant, where the bar is located, is well ventilated when the windows are open. There is an outdoor patio dining area upstairs, which Mwezi said “saved us” when people started to avoid indoor spaces. What also worked in their favor were the games, quiz, and speed-dating nights they had held before the pandemic struck, which helped to deepen the restaurant’s relationship with its regular customers.

Many others in the restaurant business were unable to weather the storm. No hard figures are available, but the Restaurant Association of South Africa estimates that one-third of the 11,000 establishments in its database were forced to close in the 12 months after the imposition of first lockdown at the end of March 2020. This was devastating for the estimated 330,000 employees in the restaurant and hotels sector. Most had low-paying jobs, and the loss of even that income has left many families destitute.



Source: World Bank staff interviews.

### Help people create jobs in self-employment and micro and small businesses

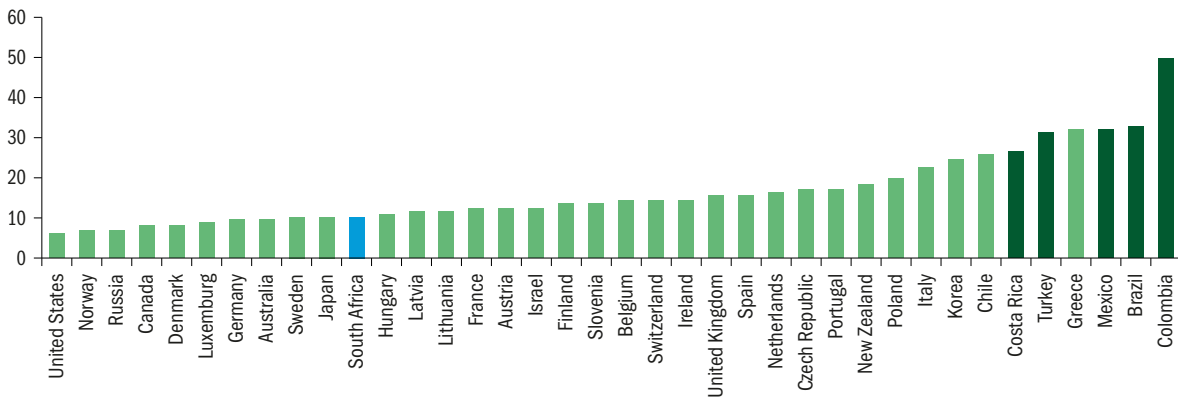
In South Africa, it is relatively more difficult for people to start their own business or work as own-account workers. Only 10 percent of employed workers are self-employed, against about 30 percent in upper-middle-income countries on average (Figure 2.14). A rough but striking illustration is that if self-employment were to reach levels more typical of upper-middle-income countries, unem-

ployment in South Africa would be about half its current rate. A rate of self-employment of 30 percent (without decreasing the other forms of employment) would increase the number of workers by about 3.5 million, or about half of people who are currently unemployed.

**Legislative reforms and well-designed programmatic interventions could grow the class of entrepreneurs, micro and small businesses, and self-employed people in South Africa.** Two deserve serious consideration:

**FIGURE 2.14** Self-employment — South Africa's biggest opportunity to create jobs

Employment levels indexed to Q1 2020



Source: OECD and STATS SA.

- First, relaxing legal constraints and rules. The regulatory constraints on entrepreneurship, micro and small businesses, and self-employment in South Africa are well documented (Box 2.2). Softening licensing and registration requirements, strict policing, zoning laws, and industry-specific protections, and harmonizing overlapping approaches between national, provincial, and local governments are initiatives worth considering. The objective is to get people working—the opportunity cost and human capital loss of unemployment are significant. This is even more important when considering the demographic opportunity and the acute rates of unemployment among young people.
- Second, facilitating entrepreneurial training and contests and lotteries for start-up grants. A rich international literature finds that programs that provide low-skilled entrepreneurs with business skills, socio-emotional competencies, and access to grant financing have much higher success rates in launching sustainable self-employment endeavors than loan programs or financing alone. For example, the *You-WIN!* competition in Nigeria, which attracted 24,000 applicants who wanted to start a new business or expand an existing one, awarded each winner about us\$50,000 on average and offered them a 4-day business plan training course. After 3 years, entrepreneurial activity, including entry, survival, employment, and profits, had increased sharply. For instance, winners who had wanted to start new firms were 37 percentage points more likely to be operating a business

and 23 percentage points more likely to have a firm with 10 or more workers. Winners tended to innovate more and earned higher sales and profits. Grants allowed firms to acquire more inputs (capital and labor) without changes in business networks, mentors, self-efficacy, or uses of other sources of finance (McKenzie 2017). South Africa's programs that offer this suite of services could be scaled up.

### Strengthen active labor market programs through public-private partnerships

South Africa makes extensive use of active labor market programs, but there is much room for systemic improvement. A review of more than 100 active labor market programs (including entrepreneurial development, public works programs, training, work readiness, placement, and labor intermediation services) offered at the national level (with a combined budget of R 100 billion) finds that the constellation of programs may not be the right ones to address the employment challenges facing the country. Although most unemployed people are vulnerable youth, programs are largely designed for better-off entrepreneurs or young people with more skills. Few explicitly include vulnerable young people; instead, the initial eligibility conditions effectively crowd them out. This is due in part to the decentralized approach—the 20 departments in the review offer programs to meet their departmental mandates rather than working together to help resolve the national unemployment challenge.



## BOX 2.2 Unlocking entrepreneurship and self-employment in South Africa

For most of the 1990s and 2000s, formal policy documents neglected the informal sector, which tends to be the entry point for entrepreneurs, start-ups and own-account workers. However, in the past decade this has gradually changed. Strategy documents such as the National Development Plan envision that 2 million more informal sector jobs will be created by 2030—a 66 percent increase on current numbers. The Department of Small Business Development developed a policy plan called the National Informal Business Upliftment Strategy (NIBUS). Launched in 2014, NIBUS was the first national policy document focused directly on the sector. It suggested a more coherent and supportive government approach that aimed to “create an enabling regulatory environment and thriving informal sector” (DSBD 2016, 7), which is key to unlock entrepreneurship and self-employment.

At present, however, the main problem appears to be one of implementation. The department’s 2017 annual report noted that NIBUS had not been taken up with much effort because of a “lack of leadership, lack of ownership of the project, under-capacity, and poor planning and execution of the project” (DSBD 2017, 16). It also revealed that R 53.6 million of the funds allocated to NIBUS had gone unspent in the previous year. According to the ‘Implementation Roadmap’ that accompanied NIBUS, there was a plan to set up a national task team to coordinate the rollout of its strategy, with support at the provincial and municipal level. However, it is unclear whether this has taken place.

A range of policy issues still needs to be addressed to foster entrepreneurship. One of the most accessible avenues in the short term is to ease restrictive regulations that deter entry into self-employment. As noted by Turok and others (2017, 37), “regulatory obstacles are the primordial, predominant, essential obstacles for informal enterprise growth”. Among the regulatory changes worth highlighting are:

**Policing of informal traders.** Street traders form the majority of self-employed workers, yet most cities appear to restrict their ability to operate through fines and even the confiscation of goods. Unnecessarily punitive sanctions are strong limiting incentives for those who work, or may look to begin work, in the sector.

**a. Licensing and registration requirements.** The allocation of licenses and requirements for business registration for various types of informal business activities is a well-documented area of concern. For example, a survey of informal businesses in Diepsloot revealed that one in every three owners felt that formal permits and regulations were a significant constraint (World Bank 2014).

**b. Zoning laws.** Land-use zoning laws place undue restrictions on business operations in townships and poorer urban settings where workplaces, public spaces, and private homes often overlap. In addition, trading is currently restricted in many public places, including parks, at national monuments, near government buildings, and at large public events where temporary trading could take place.

**c. Industry-specific regulations that exclude informal firms.** The informal sector is treated as a homogenous set of activities largely defined by trade. However, the sector includes an array of activities by entrepreneurs in a range of sectors where regulatory constraints create barriers to growth. For example, small, local construction companies in townships could be better linked into procurement plans to upgrade and maintain infrastructure. Other industries that could benefit from linking informal firms to state procurement and services include waste picking, light manufacturing, and various personal services.

**d. Sector-specific regulations that include informal firms.** For example, sector-specific bargaining councils determine sectoral wage rates. The practice of extending bargaining council agreements to nonparties raises the costs of informal firms and threatens their viability. In terms of harmonizing regulatory approaches, there is very little communication and policy coordination on the informal sector between national, provincial, and local government. In the absence of a national strategy, provinces, municipalities, and cities have devised their own piecemeal regulatory frameworks. These frameworks are reactive and haphazardly enforced, with little or no monitoring of the impacts. In the short term, it may be possible for the department to use NIBUS to guide the regulatory agenda and ensure increased coherence.

**The lack of coordination of active labor market programs and the absence of a strong private sector voice contribute to significant inefficiencies.** Different departments offer similar programs for similar target groups or offer potentially complementary programs without exploiting such complementarities; some programs underperform in terms of their potential to support jobseekers; and synergies are not exploited to create a net of support for jobseekers. Many active labor market programs place the public sector at the center of employment creation, which is costly and unsustainable, rather than working

with the private sector to identify how to leverage labor and product markets. As a result, there are significant overlaps, gaps, and general inefficiencies in serving unemployed people. Four changes should be considered.

- **Leverage temporary employment programs to guide workers toward sustainable job opportunities.** Workers who participate in large public employment programs — including the Expanded Public Works Programme and the Presidential Employment Stimulus — could be incentivized to systematically incorpo-

rate well-developed career orientation and skills training modules into the program. Many of these tools are online, and access could be facilitated while young people are at work. Continuing in the program could be conditional on workers submitting evidence of having engaged in these employability efforts.

- **Incentivize private labor intermediation organizations to assist firms in restaffing as they resume business.** Both non- and for-profit organizations provide job-matching services. Financial incentives (e.g., tax breaks or vouchers for each jobseeker placed) could be used to encourage these firms to create results (job matches) more quickly, with particular attention to vulnerable young people who may have trouble finding their own jobs. These intermediation firms should also work more intensively with employers to explore how to diversify the composition of their labor force toward more vulnerable populations.
- **Employers will benefit from incentives to increase the duration of work shifts offered.** Although the continuation of TERS is recommended while firms resume business, funds in the UIF could also be used to supplement the incomes of workers who are rehired in a part-time capacity.
- **South Africa needs to develop the institutions for a system of active labor market programs and collaborate with private sector solutions.** The mix of programs is not a problem per se. Instead, the lack of vision for the system, coordination across programs, private sector engagement, and results management leads to inefficiencies, high spending, and gaps in the net of programs. An immediate step is to identify, empower, finance, and hold accountable an agency to take on the strategic and coordinating role. Ideally, the agency would lead one of the larger active labor market programs that work with more vulnerable (young, rural, female, black, or other excluded groups) or unemployed people. It could begin to align other programs and actors around its program focus and engage the private sector to identify mechanisms for labor absorption via the real economy. Crucially, the agency would be responsible for developing a monitoring and evaluation system to allow it to use results management for better targeting and efficiency.

## Conclusion

**The proposed policy measures are complementary to the broader structural reforms needed to unlock inclusive growth in South Africa.** Addressing the structural bottlenecks that hold back the resumption of a dynamic growth path, as described in Box 1.1 and captured in government strategy documents, remains critical. However, as their impact will only materialize in the longer run, and given the urgency of the pandemic crisis, the policy package discussed in this section would serve as a value-added complement to the structural agenda.

**It is useful to consider the proposed measures in terms of their coverage or target population, fiscal costs, and time horizon of impacts.** The four suggested policy actions differ in reach, cost and timeline, and these dimensions are important to consider for prioritization purposes. The measures on employment-linked transfers (the employment tax incentive and TERS) and the NEDLAC-negotiated moratorium would be time-bound, with a short time horizon of impacts. The transfers could support the jobs of about 2.3 million people at a fiscal cost of about R18 billion per year. The moratorium would have a negligible fiscal cost, and its coverage would depend on the specific sectoral focus of the negotiation among social partners.

**The benefits of the more systemic measures — self-employment regulatory barriers and active labor market programs — would emerge in the medium to long run, and their fiscal cost would be low to medium.** Lifting legislative and regulatory bottlenecks to self-employment would have a marginal fiscal cost, with benefits to be reaped in the short to medium term. The intended beneficiary population of these measures would be the more than 10 million unemployed or discouraged people of working age. The number of adults who decide to engage in self-employment would depend on several other considerations but based on the experiences of other upper-middle-income countries, could be as many as 3 million individuals. The revamping of active labor market programs could bring benefits in the medium to long run; their fiscal cost does not necessarily have to be high relative to the resources already allocated to such programs in South Africa.

**TABLE 2.3** Time horizon, beneficiary population, and fiscal costs of suggested policy measures

Policy area	Time horizon of impacts	Target population	Estimated fiscal cost per year
1. Temporary transfers			
Employment tax incentive	Immediate	1.1 million individuals	Low (R 4.9 billion)
TERS	Immediate	1.2 million individuals	Medium (R 13 billion)
2. Moratorium on legislation to ease recovery	Immediate	Depends on sectoral focus	Low
3. Self-employment	Short to medium term	3 million individuals	Low
4. Active labor market programs	Medium to long term	Over 3 million beneficiaries	Medium

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## APPENDIX 1

**TABLE A.1** Employment composition, by labor market category, 2019

Subgroup	Employment	Share of total employment (%)
<b>Gender</b>		
Male	9,153,273	56.0
Female	7,196,582	44.0
<b>Age</b>		
15 - 34	5,954,388	36.4
35 - 49	7,248,619	44.3
50 - 64	3,138,160	19.2
<b>Population group</b>		
African/Black	12,269,465	75.0
Colored	1,699,135	10.4
Indian/Asian	528,164	3.2
White	1,853,090	11.3
<b>Education</b>		
Primary or less	1,857,866	11.4
Secondary incomplete	5,348,882	32.7
Secondary complete	5,402,275	33.0
Post-secondary	3,538,760	21.6
<b>Geotype</b>		
Urban	12,482,427	76.3
Rural	3,858,740	23.6
<b>Province</b>		
Western Cape	2,507,115	15.3
Eastern Cape	1,370,415	8.4
Northern Cape	319,777	2.0
Free State	797,787	4.9
KwaZulu-Natal	2,642,676	16.2
North West	959,958	5.9
Gauteng	5,096,542	31.2
Mpumalanga	1,232,526	7.5
Limpopo	1,423,060	8.7

Source: World Bank staff calculations based on QLFS 2019 (Statistics South Africa).

Notes:

a. Sample restricted to the working-age population (15 - 64 years).

b. All estimates account for complex survey design and are weighted using relevant sampling weights.

c. The 'utilities' sector has been omitted because of its small sample size.

