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WORKING PAPER

SMALL BUSINESS IN INDUSTRIAL POLICY

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CONTENTS

ABBREVIATIONS

CPI	Consumer Price Index
GVA	Gross Value Added
IDC	Industrial Development Corporation
ILO	International Labour Organization
SEIAS	Socio-Economic Impact Assessment System
UMIC	Upper Middle-Income Countries

1 PROBLEM STATEMENT

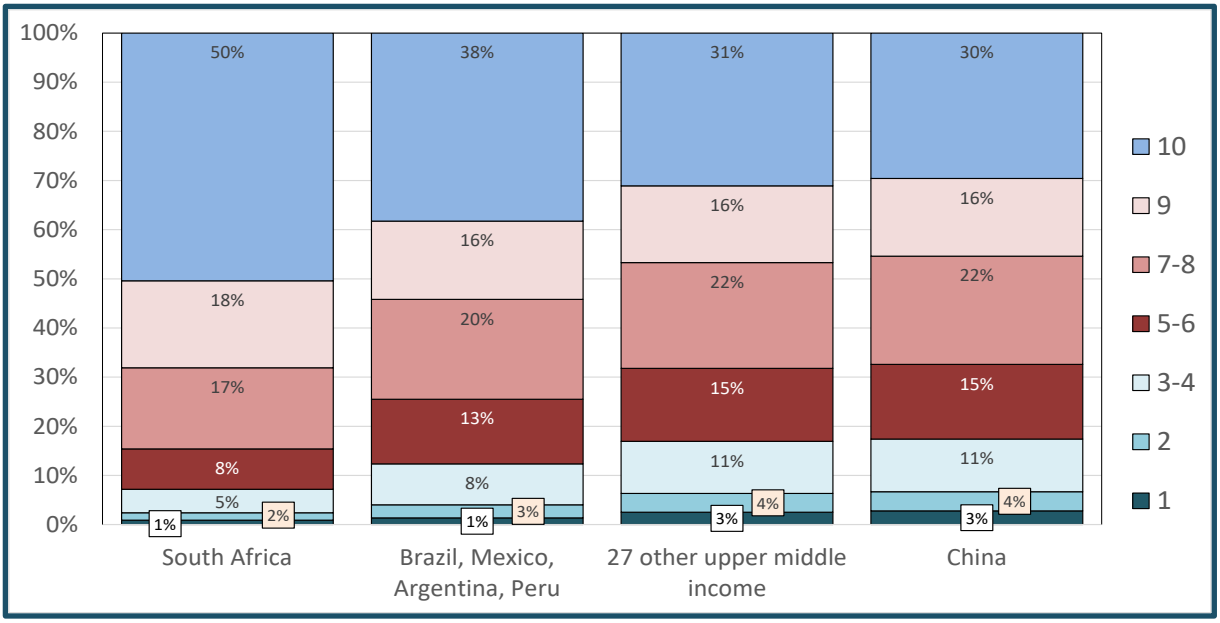
A critical mechanism behind the unusually deep inequality in South Africa is the very small number, by international standards, of small businesses in the country. On the one hand, far fewer people earn livelihoods from their own businesses than in other upper middle-income countries. That fact largely explains South Africa's extraordinarily high level of joblessness. On the other hand, income from productive assets and financial savings is even more unequal than wages and salaries.

It follows that an industrial policy aimed at inclusive industrialisation needs to step up the number of small businesses. This paper analyses the current state of small business, and the systemic obstacles to its expansion, in order to identify strategies to achieve that aim.

We can understand the depth of inequality in South Africa through a comparison of income shares with other countries using José Gabriel Palma's broad definition of classes (Palma 2018:1140).[1] This definition compares the share of household income going to the poorest 50% of households with the middle class, defined as the next four deciles in the income distribution, and the richest class in the top 10%.

In South Africa, the poorest families get an exceptionally low proportion of total household income by international standards, while the richest 10% have an unusually high share (Graph 1). The poorest 50% of all households in South Africa get just 3% of total household income. That is not very far behind the major Latin American economies, at 4%. It is, however, much lower than in other upper middle-income countries, mostly in Asia and Eastern Europe, where the poorest half of households get 7% of all household income. Furthermore, the share of the South African middle class (defined in the source data as the fifth to ninth decile) is around a fifth less than in other upper middle-income countries (that is, it is five percentage points lower). Overall, the income share is lower for the poorest 80% than in other upper middle-income countries, but it is far higher than the norm for the richest 20%, and especially the top decile.

Graph 1. Income distribution by household income decile, late 2010s (a)



Note: (a) Latest available data from 2014 to 2019. Figures for South Africa are for 2014. *Source:* Calculated from World Bank. World Development Indicators. Income shares by decile and quintile. Downloaded from www.worldbank.org in August 2022.

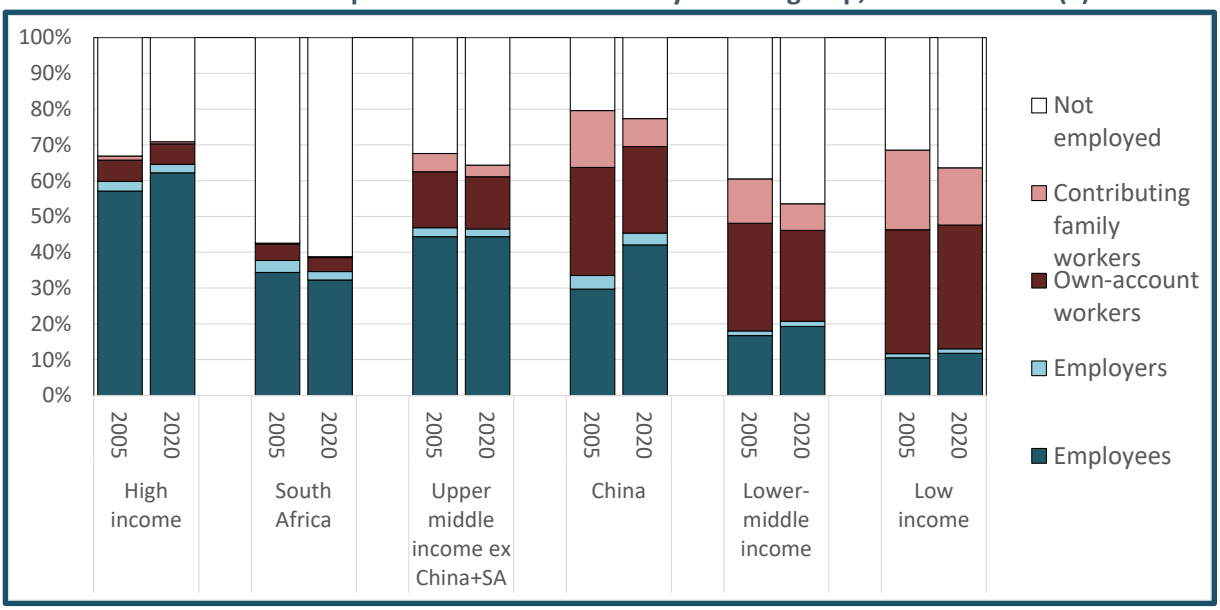
[1] Palma, however, defines the low-income group as the poorest 40%, the middle-income group as the fifth to ninth decile; and the rich as the top decile.

The data likely overstate inequality in South Africa compared to peer economies, to some extent. Around half of upper middle-income countries do not report on income distribution at all. The petrostates – which South Africa resembles due to its heavy dependence on mining exports – are almost entirely silent on the topic, or they publish frankly unbelievable statistics.[2]

South Africa's unusually deep inequality resulted in large part from the extremely depressed number of small businesses, by international standards. As Graph 2 shows, the share of adults employed as small-business owners – particularly as own-account workers with no employees – was far lower in South Africa than in peer economies. In China, business owners made up 35% of all employed people, while in other upper middle-income countries, excluding South Africa, the figure was 20%. In South Africa, the International Labour Organization (ILO) estimated the figure at just 6% – less than a third as high as in peer economies. Even in high-income countries, the share of business owners in total employment was around twice as high as in South Africa.

The comparatively small number of self-employed people was a key factor behind depressed employment overall. In upper middle-income countries excluding South Africa, 60% of working-age adults said they had some kind of employment. In South Africa, the figure has fluctuated around 40% since the early 1990s. That is among the lowest employment levels in the world.

Graph 2. Business owners (employers and the self-employed) as percentage of total employment in South Africa compared to other countries by income group, 2005 and 2020 (a)



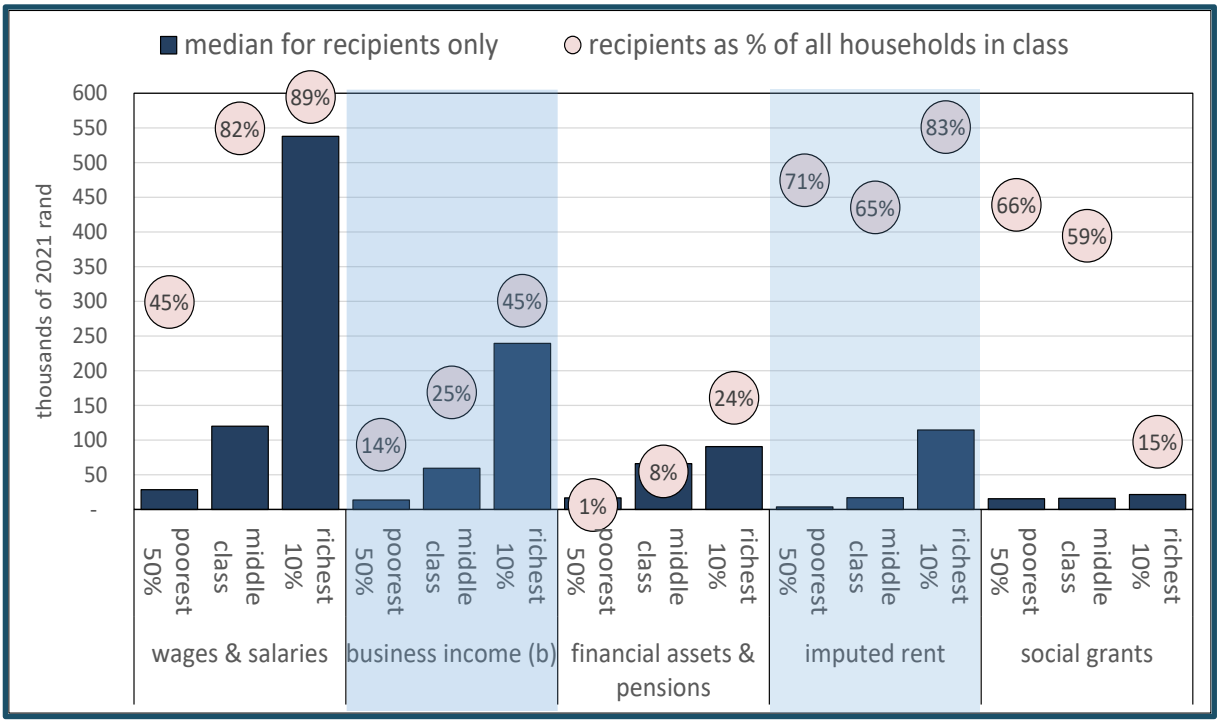
Note: (a) ILO-modelled estimates try to standardise findings for countries, which requires some modification of national data where data are missing or not comparable. *Source:* ILOStat. Employment by sex, age and economic class. Electronic dataset. Accessed at www.ilo.org in August 2022.

For 20% of working people to earn their livelihoods from their own businesses, in line with peer economies, would require a qualitative step-up in numbers. In 2021, there were around 2,5 million employers and self-employed people in the formal and informal sector. To get to 20% would require 4,5 million businesses. That would mean generating two million new enterprises, almost doubling the current figure.

[2] Nigeria, for instance, reported a Gini coefficient of .35, which would make it more equitable than the US and China, and on a par with the UK. Angola reported a coefficient of .51, which would make it far more equitable than South Africa at .63 (World Bank 2022).

The impact on the low level of small-business ownership on income distribution can be seen through a comparison of sources of income by class. The latest detailed information on household incomes comes from the Living Conditions Survey for 2014/15. It shows that only half of all households in the poorest 50% reported any gainful work at all, compared to over 80% of better-off families. That said, earnings from employment and self-employment provided the bulk of total income across all groups (Graph 3). For those with earned income, the gap was larger for business earnings than wages and salaries. Close to half of households in the highest income group got some income from profits, and a quarter had income from financial assets, including pensions. In the poorest 50%, in contrast, only one in seven households owned a business, and one in a hundred had financial earnings.

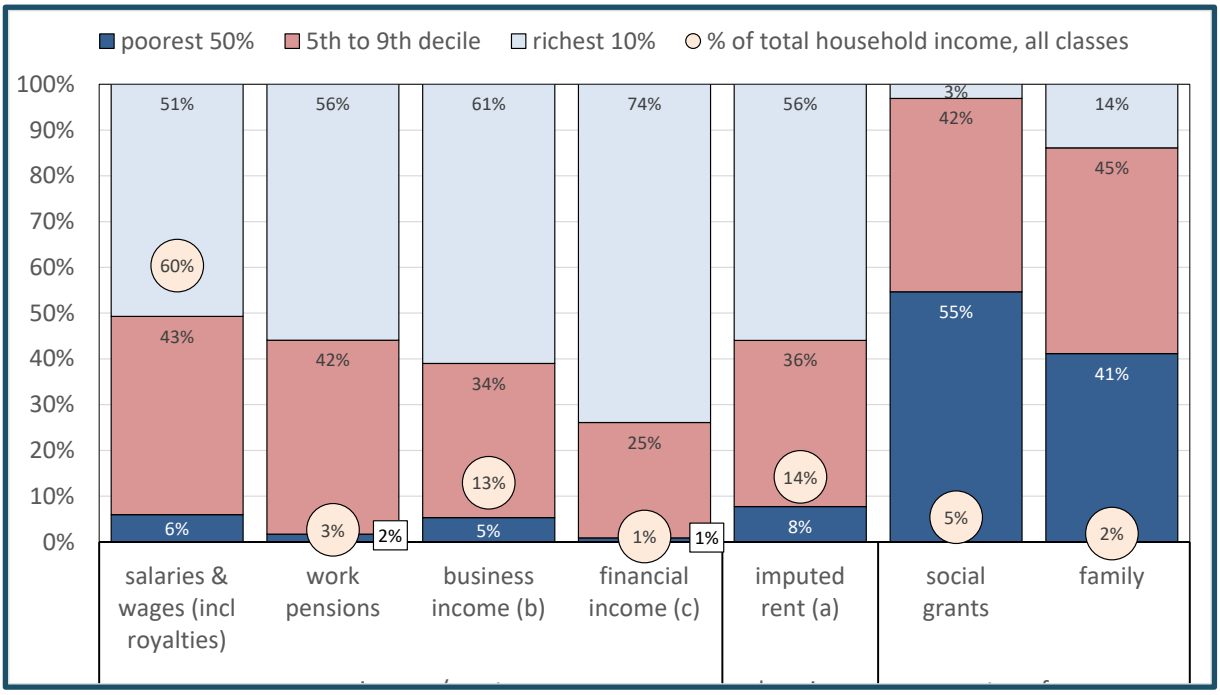
Graph 3. Share of households with any income from pay, profits and other sources, and median annual income from each source for affected households, 2014/15 (in 2021 rand)(a)



Note: (a) Income figures reflated with CPI. Data relates only to households that have the relevant income source, not all households. *Source:* Calculated from Statistics South Africa. Living Conditions Survey 2014/15. Electronic database. Downloaded from Nesstar facility at www.statssa.gov.za in October 2018.

As Graph 3 shows, the distribution of income from business and assets was more unequal than from waged employment. Overall, earnings from business and financial assets accounted for 30% of the difference in average income between the middle class and the poorest households. It generated 40% of the gap between the middle class and the richest decile.

Graph 4. Share of income by class and type of income, 2014/15



Note: (a) Estimated by Statistics South Africa based on estimated value of home owned by occupant. *Source:* Calculated from Statistics South Africa. Living Conditions Survey 2014/15. Electronic database. Downloaded from Nesstar facility at www.statssa.gov.za in October 2018.

The 2014/15 Living Conditions Survey found that one in four middle-class households had some business income, with median earnings of almost R5 000 a month in 2021 rand. Only one in seven of the poorest households had any business income, mostly from survivalist enterprises. Half of those enterprises returned less than R1 100 a month. In the richest decile, nearly half of households had some business income, which provided median returns of R20 000 a month. Moreover, only 0.2% of households in the poorest 50% had any financial investments other than retirement funds, compared to 3% in the middle class and 14% in the richest decile. In 2021 rand, the median income from financial investments came to R750 a month for the few households in the poorest 50% with any financial savings. It was R2 500 a month for middle-class households with financial assets, and R6 000 for the richest households.

As discussed in Section 2, small formal business generally provided decent work for both waged workers and their employers as well as self-employed people. Employees' conditions in small formal business were almost equal to the public and large-business sector, and much better than in informal and domestic work. Small formal enterprises contributed around a third of all employment in South Africa, with the rest distributed between informal and domestic work, large business and the public sector.

In sum, overcoming South Africa's deficit in small business could go far towards supporting more inclusive industrialisation, as long as the new enterprises generated reasonable livelihoods. For industrial policy, the question becomes why South Africa faces such an extreme deficit in this regard, and how to remedy it. To assist in identifying broad strategic directions, the next section of this paper assesses trends in small-business development in South Africa. Section 3 then outlines the mechanisms that have stunted small business, even after the elimination of overtly racial laws. These mechanisms centre on the structure of production and demand combined with the lack of resources, education and experience faced by most potential entrepreneurs. Most recently, loadshedding has become a critical hurdle.

The final section indicates the strategic implications for industrial policy that follow from an analysis of the small business ecosystem. Above all, more inclusive industrialisation requires that new kinds of production that open opportunities for small enterprises on a mass scale. That in turn necessitates a much stronger focus on labour-intensive goods and services, plus systemic changes to promote small business through access to productive assets, skills, markets and infrastructure. In most cases, these changes entail a focus, at least initially, on products that meet local and regional needs. That would require a shift from the prioritisation of internationally competitive and innovative producers that has been entrenched in South Africa's approach to industrial policy since the opening of the economy in the early 1990s. On the demand side, changes to retail and business procurement systems need to open more opportunities for smaller producers. In some cases too, the state could extend subsidies on necessities, as it already does, for instance, with housing, basic infrastructure, cleaner technologies, and medicines. In effect, that approach adds new demand for basic goods and services.

Implementing this kind of measure on a large scale would be disruptive. It requires significant restructuring of the current systems for allocating support to industries and enterprises. It also depends on increased capacity for managing the risks associated with high levels of systemic and technological innovation. Such a course redirection would entail profound changes, amongst others, in the ability of industrial policy measures to mitigate the effects of loadshedding on small business; promote labour-intensive clusters and small-scale production on a mass basis; redirect education and training both to improve quality overall and to provide the competencies needed for modern businesses; expand commercial and light industrial sites in townships; take advantage of government spending on basic necessities; induce retail chains and malls to open opportunities for small businesses; and ensure fiscal processes manage, rather than simply avoiding, the risks associated with innovative economic measures.

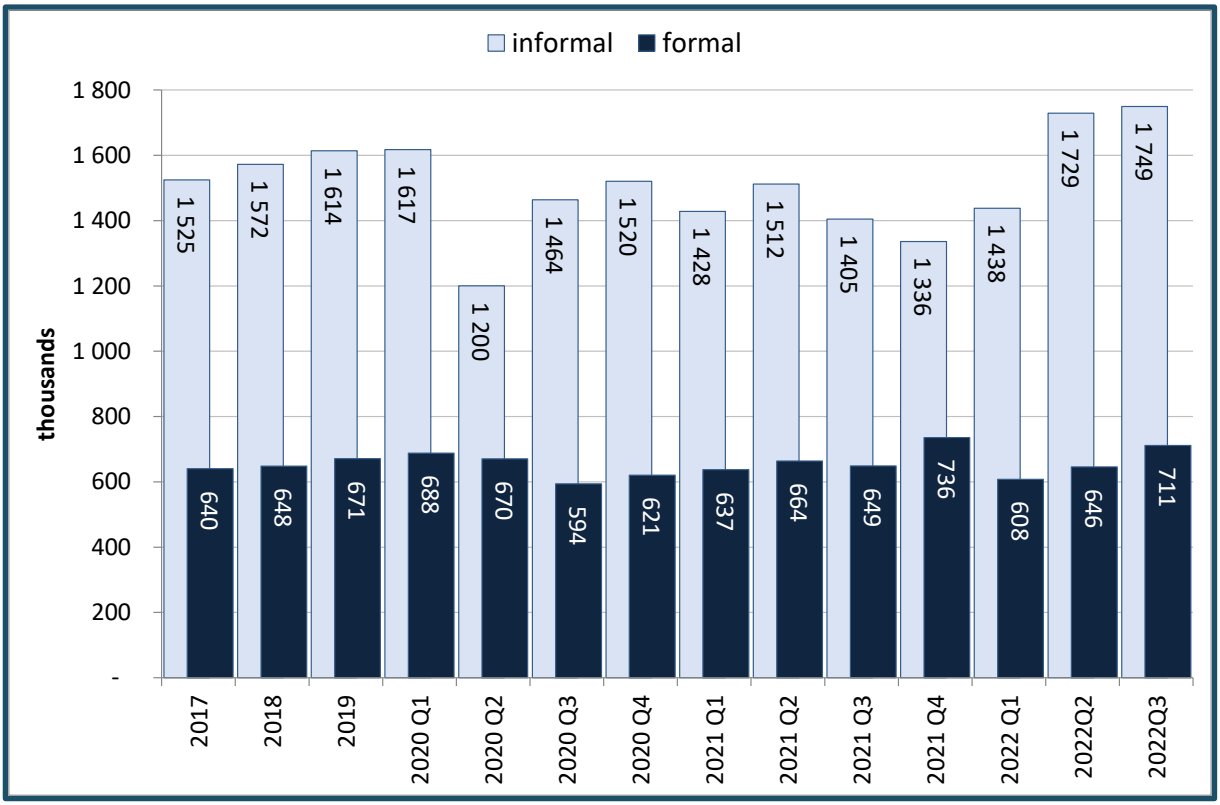
2 THE EVOLUTION OF SMALL BUSINESS IN SOUTH AFRICA

This section reviews the state of small business in South Africa in terms of numbers, industry, employment, incomes and location, mostly using national labour force surveys. The data show steady growth in both formal and informal small businesses through the 2010s, but only a slow recovery after a downturn at the start of the Covid-19 pandemic. Small formal businesses generate around a third of all employment, compared to a fifth each in larger businesses, the public sector and informal enterprise, and just under a tenth in domestic work. Measured by the number of business owners, professional services are the largest industry for the formal sector, while in the informal sector, retail trade outstrips other sectors.

The overview provided here draws heavily on analytical work by Lesego Moshikaro for the TIPS Real Economy Bulletin overview of small business, forthcoming in 2023. It uses data for employers and own-account workers from the Quarterly Labour Force Surveys, which cover 30 000 households. The surveys are not seasonally adjusted, and in the second half of 2021, response rates fell substantially. For this reason, only the first two quarters from 2020 to 2022 are generally comparable. The annual figures average the findings for all four quarters of each year, in line with Statistics South Africa's methodology in the Labour Market Dynamics databases.

The number of small formal businesses and informal businesses with employees increased gradually through the 2010s. The trend reversed from 2020, however, with the Covid-19 pandemic. Recovery began only around 2021. Numbers for formal businesses essentially plateaued from mid-2021 (Graph 5).

Graph 5. Number of small businesses (a) in formal and informal sectors, annually in 2010, 2015 and 2019, and quarterly from first half 2020 to second half 2022 (thousands)

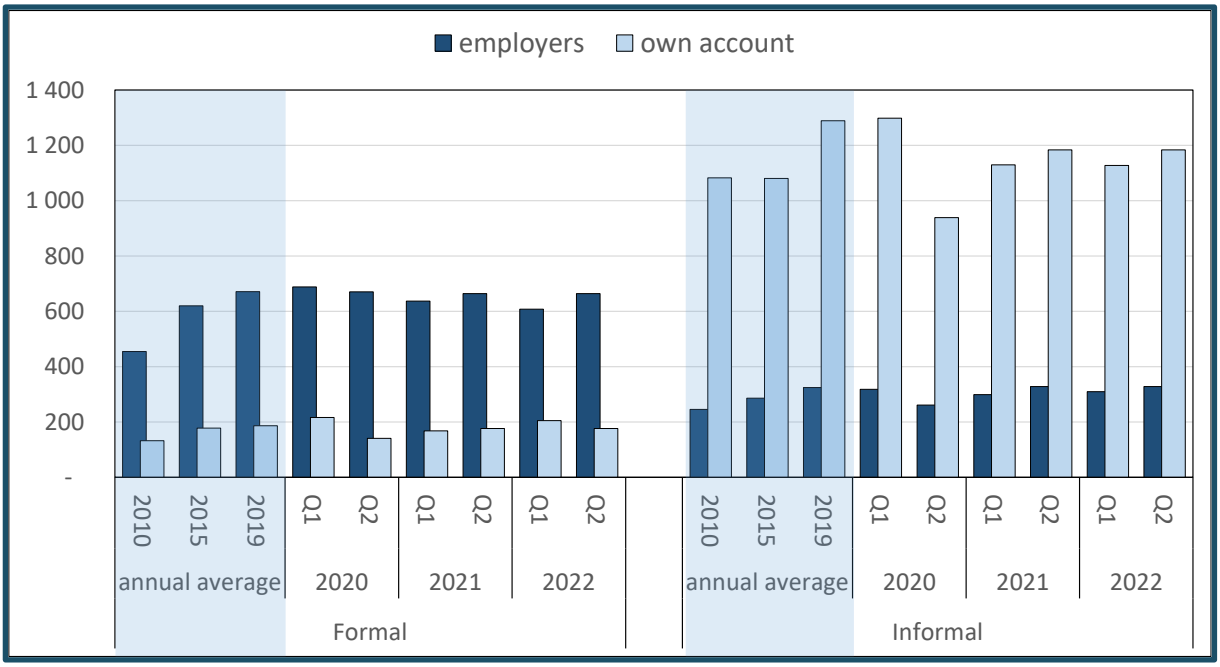


Note: (a) Measured by the number of people saying they are either employers or self-employed. *Source:* For 2010 to 2019, calculated from Statistics South Africa. Labour Market Dynamics for relevant years. Electronic databases. For 2020 to 2022, calculated from Statistics South Africa. Quarterly Labour Force Surveys. Electronic databases. Downloaded from Nesstar facility at www.statssa.gov.za.

Small businesses with waged employees dominate the formal sector. In contrast, most people in the informal sector are own-account workers, largely street traders. In the second half of the 2010s, the slowing economy led to accelerated growth in the informal sector in general, and in micro-enterprise in particular. In the formal sector, from 2015 to 2019, the number of employers climbed 8% and own-account workers by 3%. Growth in informal business was much faster, with the number of employers rising by 13% and informal own-account workers by almost 20%.

The initial pandemic lockdown in the second quarter of 2020 saw a particularly sharp fall in the number of informal own-account workers, with a relatively rapid recovery and then a plateau from the first half of 2022. For formal own-account workers and informal employers, both the decline and recovery were less pronounced. The downturn was largely mitigated by extensive assistance to employers in the first year of the pandemic, primarily through the Unemployment Insurance Fund.

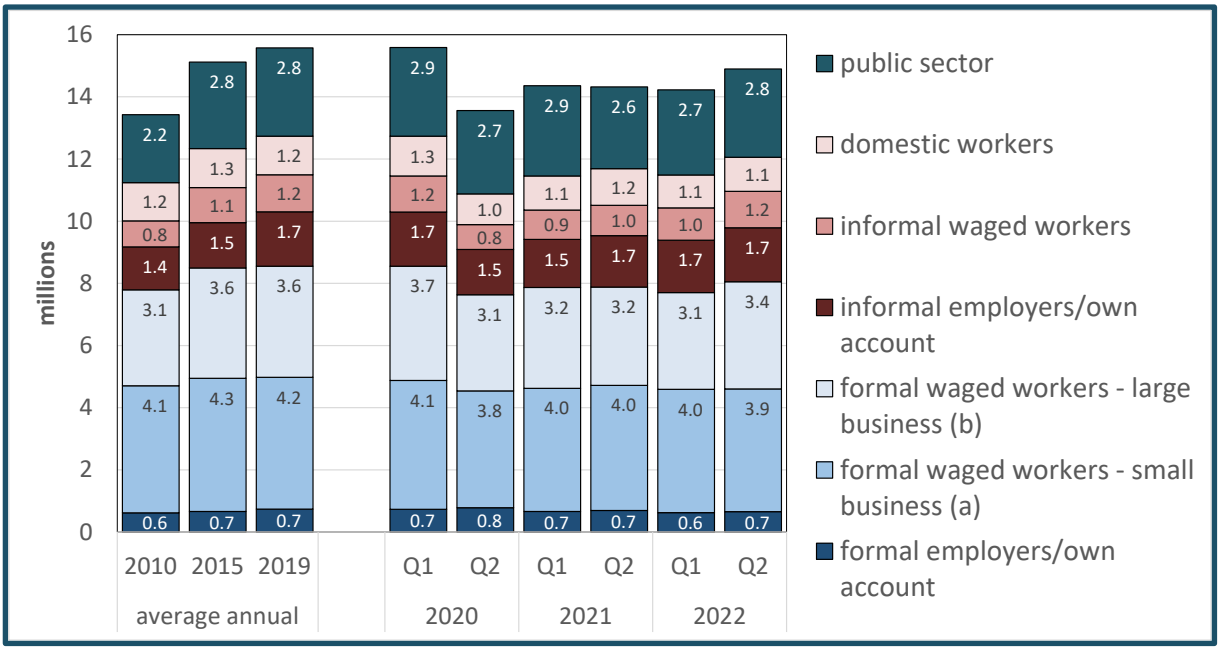
Graph 6. Number of employers and self-employed (a) in formal and informal sectors, annually in 2010, 2015 and 2019, and quarterly from first half of 2020 to second half of 2022



Note: (a) Measured by the number of people saying they are employers or self-employed. *Source:* For 2010 to 2019, calculated from Statistics South Africa. Labour Market Dynamics for relevant years. Electronic databases. For 2020 to 2022, calculated from Statistics South Africa. Quarterly Labour Force Surveys. Electronic databases. Downloaded from Nesstar facility at www.statssa.gov.za.

Small formal business was a critical source of decent work, generating around four million waged jobs in the early 2000s, excluding employers and own-account workers. For comparison, large formal business provided around 3,5 million waged opportunities and the public sector over 2,5 million. Informal and domestic work generated a total of over three million opportunities, of which half was waged work (Graph 7). As the economy slowed in the late 2010s, gains in employment from small businesses in the formal and informal sector, including own-account workers, became increasingly important for overall job creation. This situation became even more marked after the pandemic downturn. As of the third quarter of 2023, informal employment was 0,8% below the third quarter of 2019. In contrast, there were 3,4% fewer formal jobs than before the pandemic.

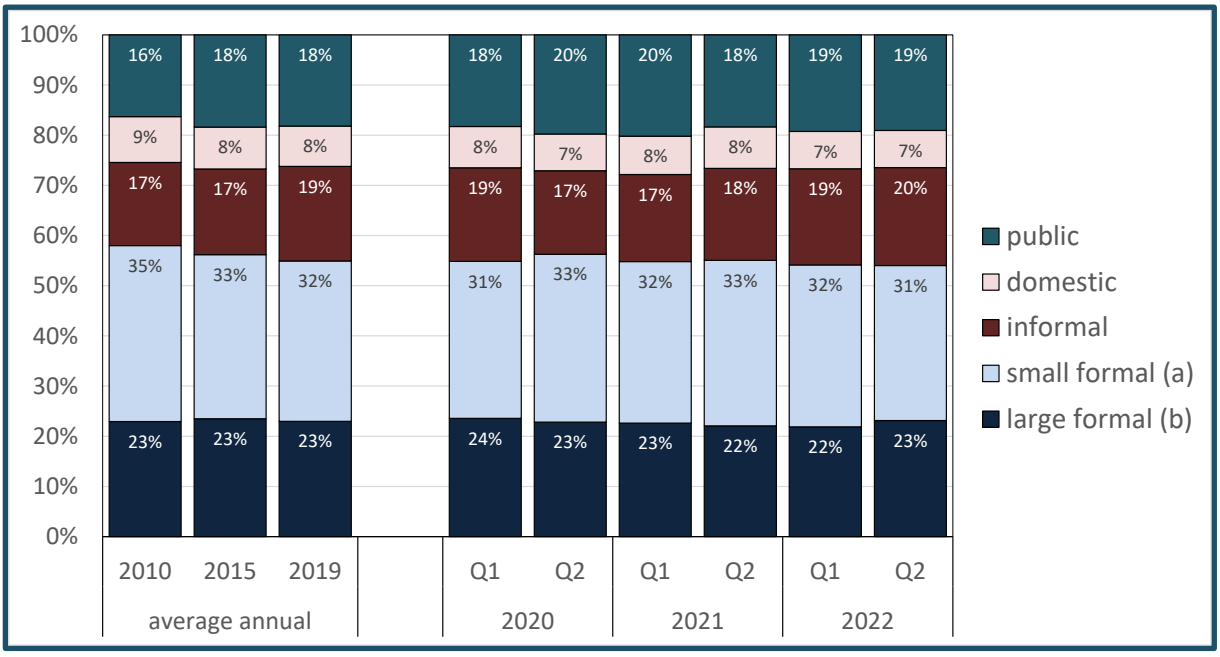
Graph 7. Waged work and business owners by sector and size, annually in 2010, 2015 and 2019, and quarterly from first half 2020 to second half 2022



Note: (a) Under 50 workers. (b) 50 workers or more, or do not know. *Source:* For 2010 to 2019, calculated from Statistics South Africa. Labour Market Dynamics for relevant years. Electronic databases. For 2020 to 2022, calculated from Statistics South Africa. Quarterly Labour Force Surveys. Electronic databases. Downloaded from Nesstar facility at www.statssa.gov.za.

Small formal businesses generated over 30% of total employment, compared to over 20% in businesses with over 50 employees, as Graph 8 shows.

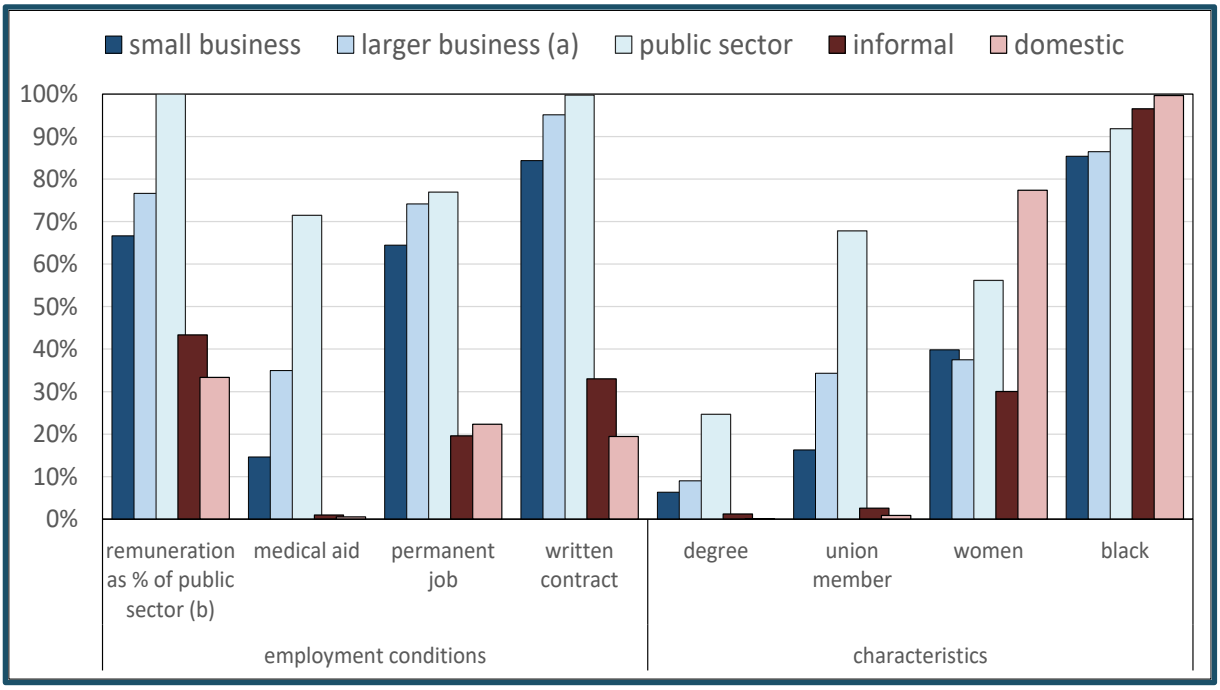
Graph 8. Share of total employment from formal business by size and from other sectors, annually in 2010, 2015 and 2019, and quarterly from first half 2020 to second half 2022



Note: (a) Employers and employees in businesses with under 50 workers. (b) Employers and employees in businesses with 50 workers or more, or do not know. *Source:* For 2010 to 2019, calculated from Statistics South Africa. Labour Market Dynamics for relevant years. Electronic databases. For 2020 to 2022, calculated from Statistics South Africa. Quarterly Labour Force Surveys. Electronic databases. Downloaded from Nesstar facility at www.statssa.gov.za.

Conditions of waged employment in small formal businesses generally lag somewhat behind those in larger companies and the public sector. They are far ahead of informal and domestic employment, however, in terms of pay, benefits, job security and worker organisation (Graph 9). By extension, expanding decent work requires an expansion in small formal business, but upgrading of conditions (and by extension productivity) in informal and domestic enterprise.

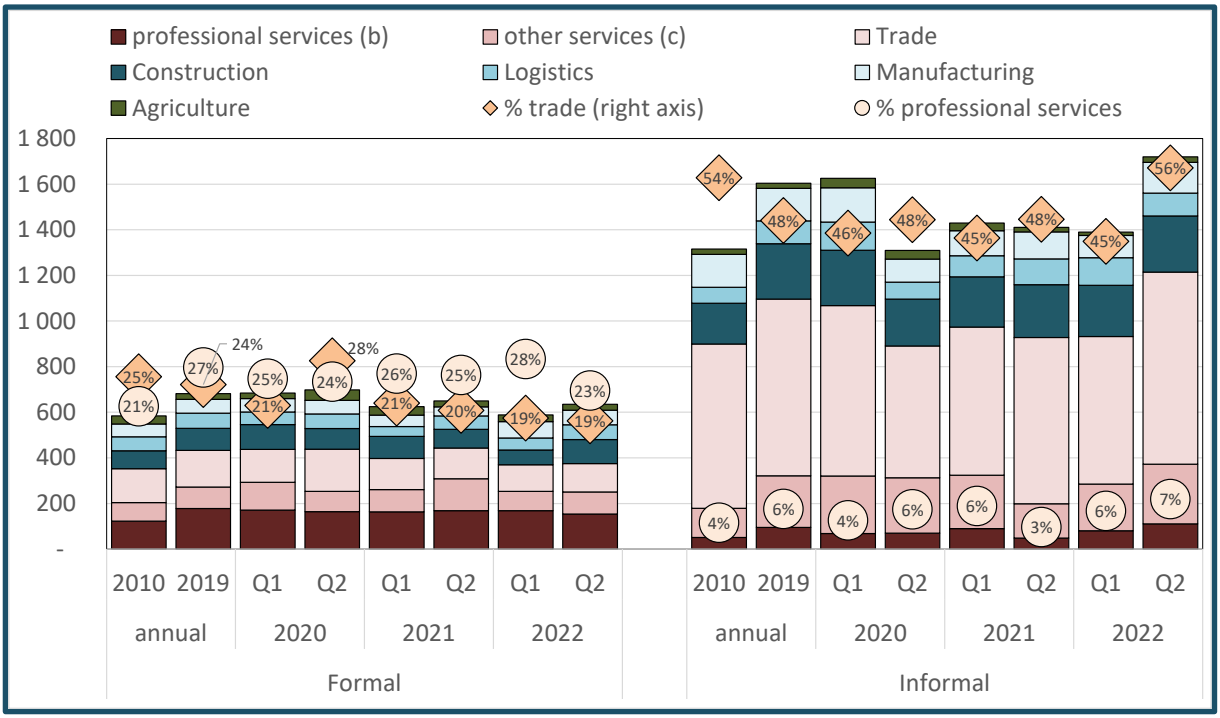
Graph 9. Employment conditions and characteristics of waged workers by size of formal business compared to the public sector, informal business and domestic work, 2019



Notes: (a) Includes employees who do not know the size of their employers, who tend to earn more and have more formal conditions of work than others who know they have 50 or more colleagues. (b) Median remuneration is highest in the public sector, which has by far the largest share of professionals in employment. Figure here is median remuneration in each sector as percentage of the public sector. *Source:* Calculated from Statistics South Africa. Labour Market Dynamics 2019. Electronic database. Downloaded from Nesstar facility at www.statssa.gov.za.

Around a fifth of private formal small businesses provide professional services, ranging from media to education and healthcare to engineering and legal advice. A quarter are in retail and hospitality. The rest are mostly in construction; transport and communications; manufacturing; and agriculture. The number of commercial farms has declined over the past decade, after shrinking by more than half since 1994. In the informal sector, in contrast, retail trade accounts for close to half of all businesses. That figure includes around half a million street traders. The next largest sector is construction, with around a tenth of the total. Only just over 5% of informal businesses provided professional services (Graph 10).

Graph 10. Number of small businesses (a) by sector and industry, annually in 2010, 2015 and 2019, and quarterly from first half 2020 to second half 2022

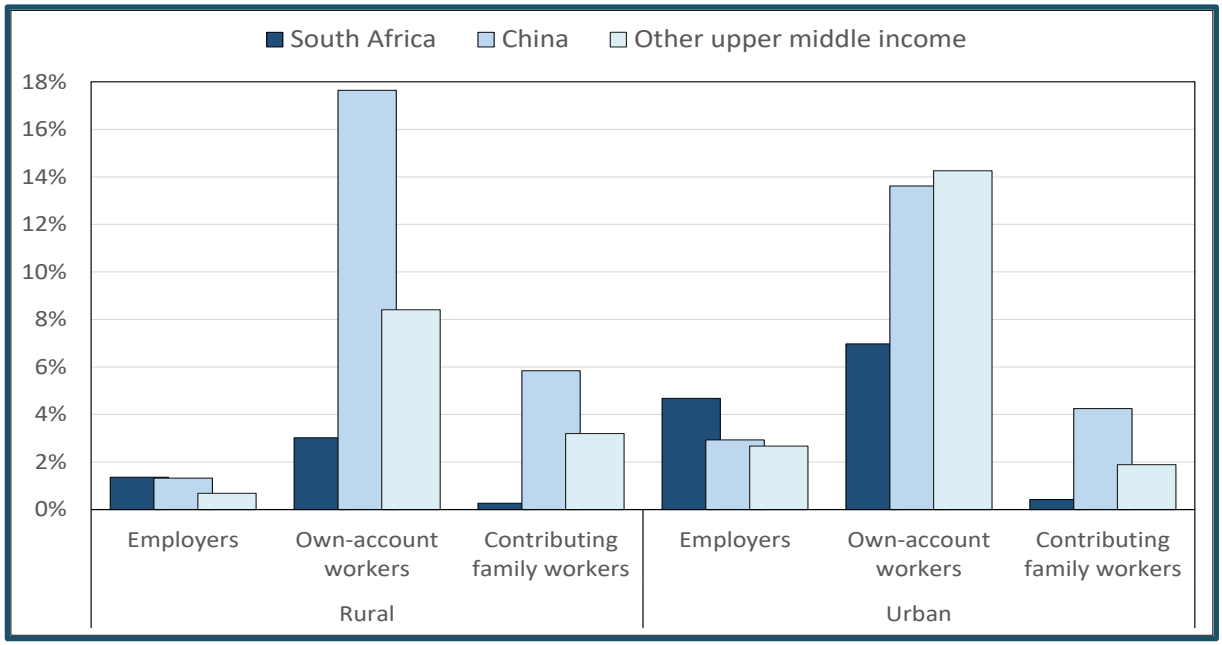


Note: (a) Measured by the number of people saying they are employers or self-employed. (b) Finance, professional business services (legal, accounting, computer-related, etc.), private education, and healthcare. (c) Mostly security and cleaning, personal and childcare, and property management. *Source:* For 2010 to 2019, calculated from Statistics South Africa. Labour Market Dynamics for relevant years. Electronic databases. For 2020 to 2022, calculated from Statistics South Africa. Quarterly Labour Force Surveys. Electronic databases. Downloaded from Nesstar facility at www.statssa.gov.za.

The data show around 60 000 formal small businesses in manufacturing in 2019, around 10% more than a decade earlier. The number is too small to analyse by industry.

By international standards, the share of small business ownership was depressed in both the rural and urban areas. In both settings, the deficit mostly reflected the very low share of own-account workers who own businesses with no paid employees, compared to peer economies. In contrast, employers alone (not including their employees) accounted for around the same share of the labour force in rural areas as in other upper middle-income countries. In urban areas they provided a markedly higher proportion.

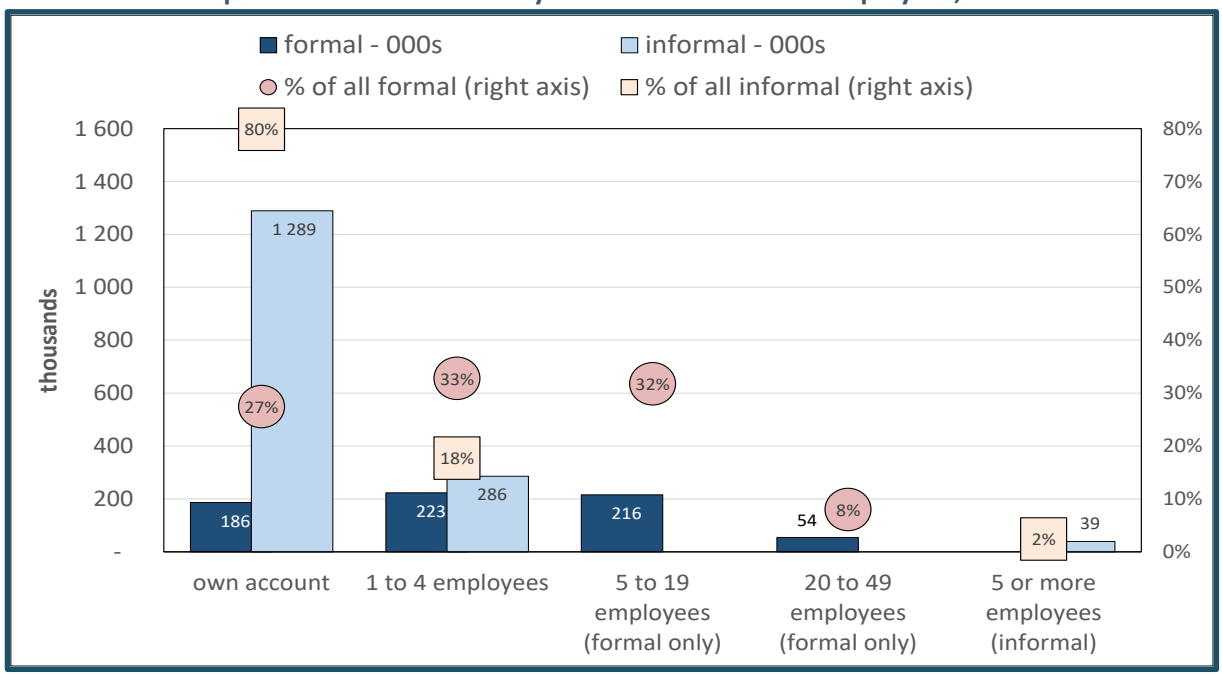
Graph 11. Employers and self-employed as percentage of total income-generating employment, 2020 (a)



Note: (a) ILO-modelled estimates try to standardise findings for countries, which requires some modification of national data where data are missing or not comparable. *Source:* ILOStat. Employment by sex, rural/urban areas and status in employment. Electronic dataset. Accessed at www.ilo.org in August 2022.

The size of small enterprises varied markedly between the formal and informal sectors. This pattern reflected the survivalist nature of many informal activities. In 2019, just over a quarter of small formal businesses were own-account workers, while a third had one to four workers, and a similar share had five to 19 employees. Just under 10% had 20 to 49. In contrast, some 80% of informal entrepreneurs were own-account workers, and almost all the rest had fewer than five employees (Graph 12).

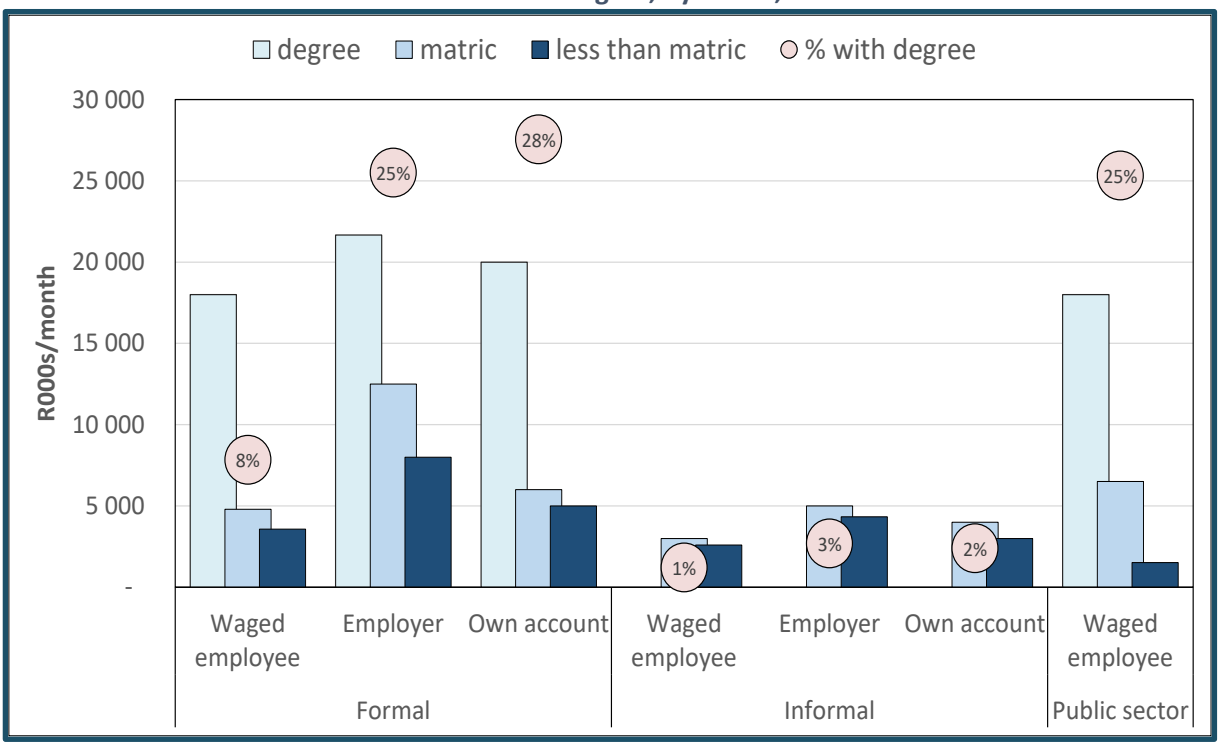
Graph 12. Small businesses by sector and number of employees, 2019



Source: Calculated from Statistics South Africa. Labour Market Dynamics 2019. Electronic database. Downloaded from Nesstar facility at www.statssa.gov.za.

In 2019, owners of small formal businesses reported median earnings of R12 000 a month, or four times as much as the median for employees. Both employees and business owners in the informal sector earned far less, as Graph 13 shows. The higher incomes correlated strongly with higher education levels for employers, however. In the formal sector, earnings were relatively close for waged employees and business owners with a degree. In contrast, the median earnings for employers with matric or less was around twice as high as for waged employees with similar formal education levels. In the informal sector, the number of workers or entrepreneurs with a degree was very low, and the pay gap between employers and employees was also much lower than in formal business.

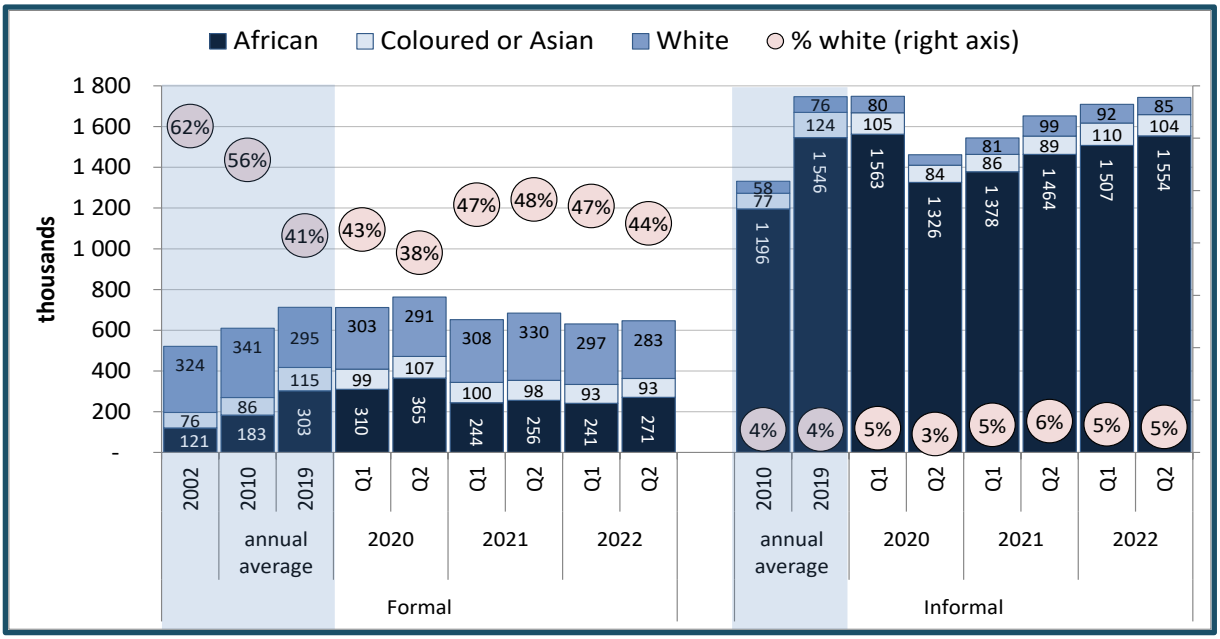
Graph 13. Median monthly earnings by education level for business owners and employees, and share with a degree, by sector, 2019



Source: Calculated from Statistics South Africa. Labour Market Dynamics 2019. Electronic database. Downloaded from Nesstar facility at www.statssa.gov.za.

Small formal business remained disproportionately white-owned after 1994, but the discrepancy declined significantly, although gradually. The share of black-owned formal business climbed from a third in the early 2000s to over half in the late 2010s. The number rose from 200 000 to over 400 000 between 2002 and 2019 (Graph 14). For comparison, in 2020, only a quarter of executives in listed companies were black (calculated from WOW 2020). Black people owned over 95% of all informal business.

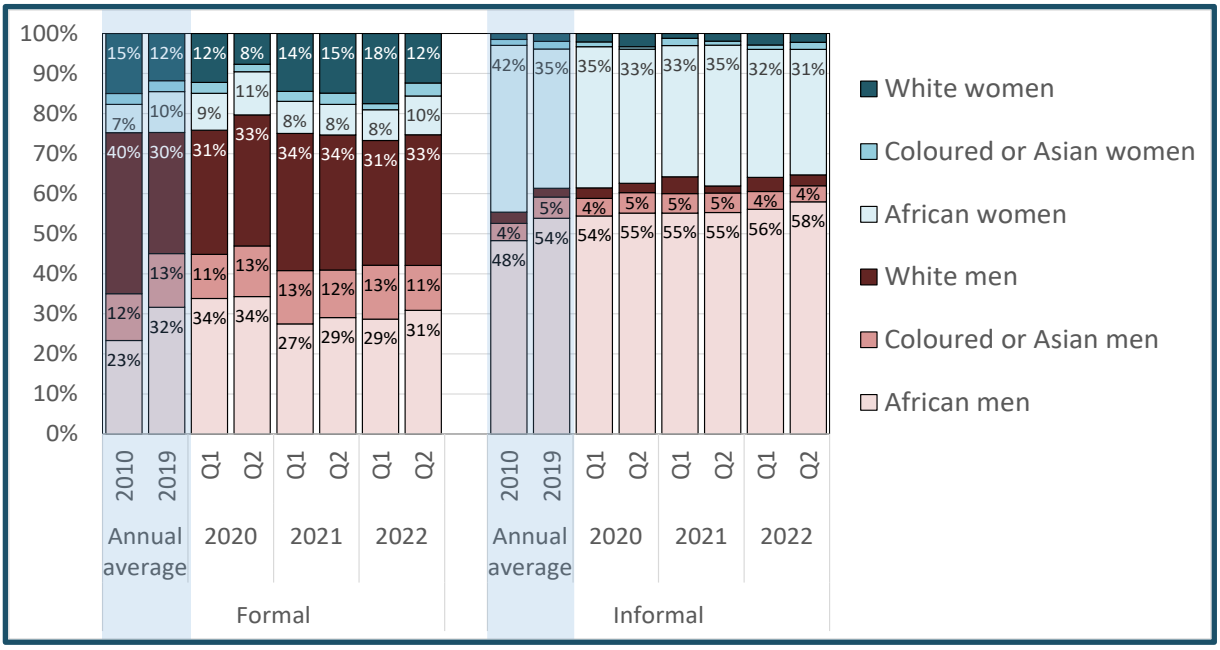
Graph 14. Ownership of formal and informal small business by race, and percentage white ownership, in 2002, 2010 and 2019, and quarterly from first half 2020 to second half 2022



Source: Calculated from Statistics South Africa. Labour Force Survey for March 2002, Labour Market Dynamics for 2010 and 2019, and Quarterly Labour Force Surveys for 2020 to 2022. Electronic databases. Downloaded from Nesstar facility at www.statssa.gov.za.

Around a quarter of small business owners in the formal sector were women in 2019, but half of them were white. The share of African women rose from 7% in 2010 to 10% in 2019, where it plateaued in the early 2020s. African women made up 40% of the South African population and 25% of formal employees in 2019. Women's share in informal business ownership fell from 45% to 40% between 2010 and 2019, as African women's share dropped from 42% to 35%.

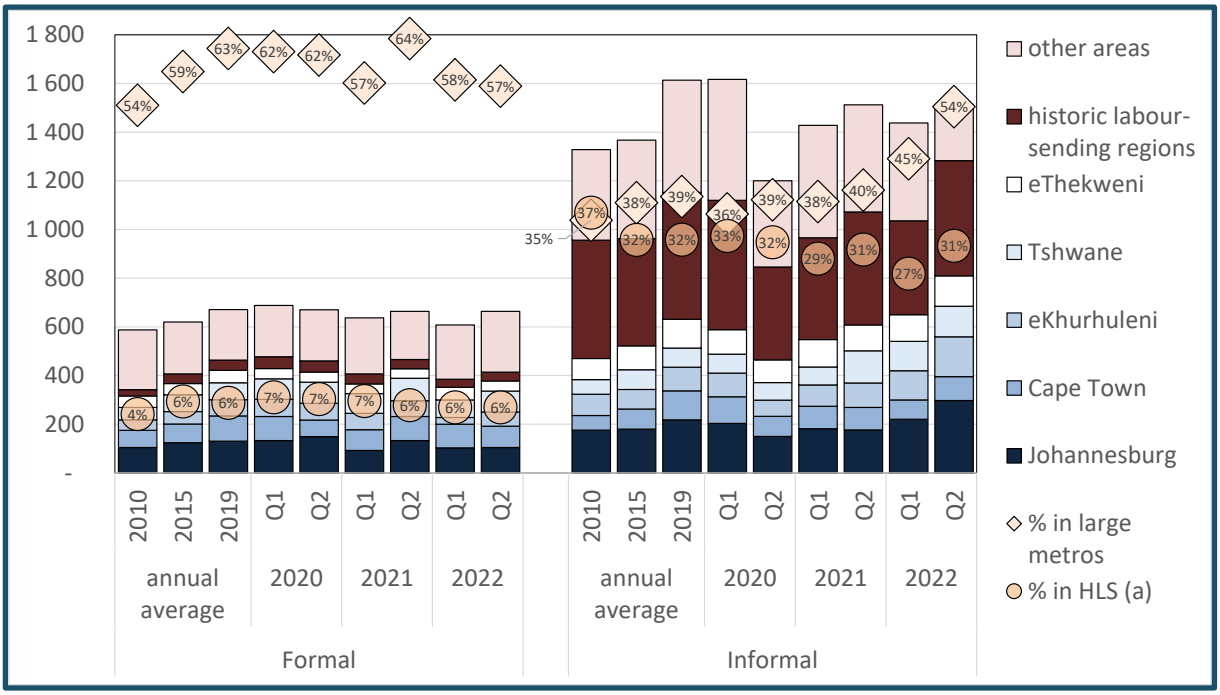
Graph 15. Share of ownership of formal and informal small business by race and gender, annual average for 2010 and 2019, and quarterly for first half of 2020, 2021 and 2022



Source: Calculated from Statistics South Africa. Labour Market Dynamics for 2010 and 2019, and Quarterly Labour Force Surveys for 2020 to 2022. Electronic databases. Downloaded from Nesstar facility at www.statssa.gov.za.

Small formal business was disproportionately located in the metros, but barely present in the historic labour-sending regions. The metros held around a third of the population but almost two thirds of formal businesses. The historic labour-sending regions, which held about 30% of the population, had just 5% of small formal businesses. In contrast, the spatial distribution of informal business largely paralleled the population, with around a third each in the large metros, the historic labour-sending regions, and the rest of the country. During the pandemic, the labour force surveys found a rapid increase in informal enterprise in the metros, and a decline in the historic labour-sending regions (Graph 16).

Graph 16. Formal and informal small business in the five large metros, the historic labour-sending regions, and the rest of the country, annual average for 2010, 2015 and 2019, and quarterly for the first half of 2020, 2021 and 2022



Source: Calculated from Statistics South Africa. Labour Market Dynamics for 2010, 2015 and 2019, and Quarterly Labour Force Surveys for 2020 to 2022. Electronic databases. Downloaded from Nesstar facility at www.statssa.gov.za.

The data on small business underscore the profound differences between formal and informal small business. In stylised terms, small formal business is critically important for the professions, building both physical and social capital; generates a reasonable livelihood for the owners; and contributes significantly to decent work for waged workers. In contrast, small business in the informal sector is often a survivalist fallback, providing only low and often precarious returns for both owners and employees.

3 MECHANISMS THAT SUPPRESS SMALL BUSINESS IN SOUTH AFRICA

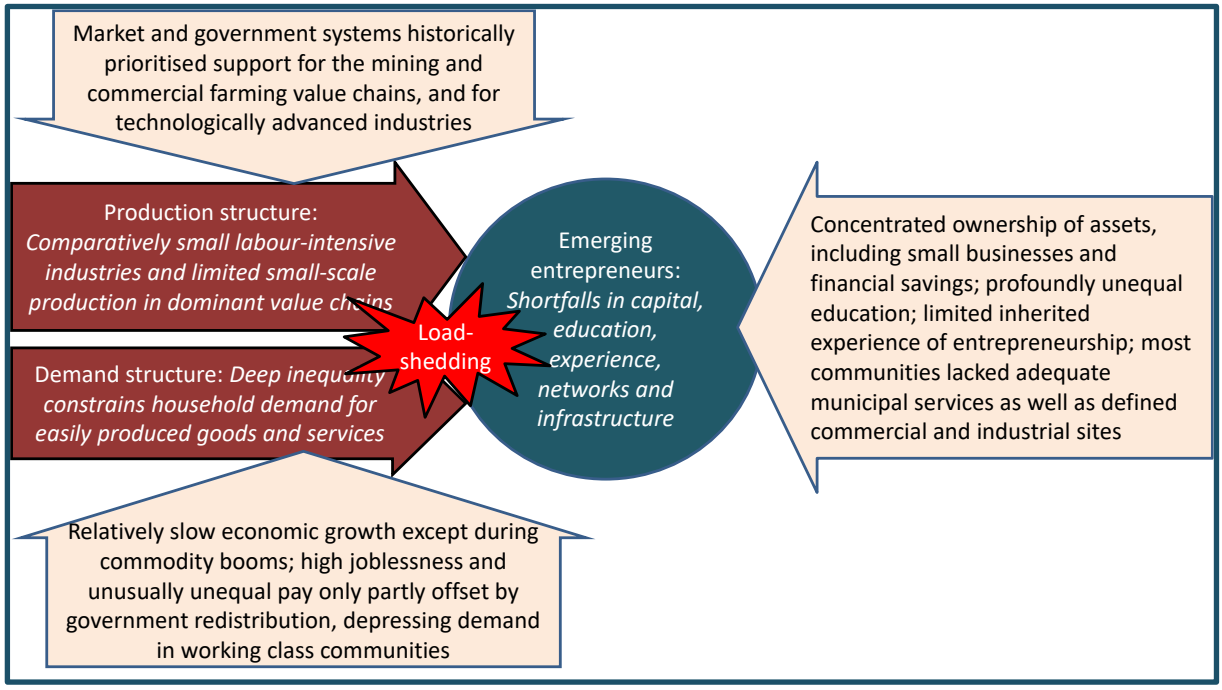
For inclusive industrial policy, a core question becomes why South Africa's deficit in small business persisted after the democratic Constitution banned overtly racial and gendered laws. The answers lie in economic relationships entrenched during the apartheid era that reproduced even in the absence of explicit state support. Critical elements included the production structure, the nature of demand, and the resources and competencies available to potential entrepreneurs. Reshaping these systems required, not just an end to racial rules, but profound disruption across a range of institutions, policies and regulations.

South Africa entered democracy with unusually limited labour-intensive light industry. This heavily constrained opportunities for small formal business. Production of clothing and electronics, which opened the door for small entrepreneurs in most industrialising economies, contributed a notably small share of the economy. Small businesses also faced constrained demand, in part because working-class households had depressed incomes, and in part because they faced challenges in supplying large, formal retail businesses and state agencies. Finally, apartheid left working-class families, and consequently most potential entrepreneurs, with almost no assets except for housing and limited access to quality education and training, and deprived them of business experience.

In this context, market and government institutions evolved primarily to support established formal businesses in existing industries. To support emerging businesses would require far-reaching reconstruction of their offerings and activities.

Figure 1 illustrates the mechanisms that stunt growth in small business. In 2022, loadshedding became the biggest single drag on growth, as discussed in section 0.

Figure 1. Mechanisms that constrained the recovery of small business after apartheid



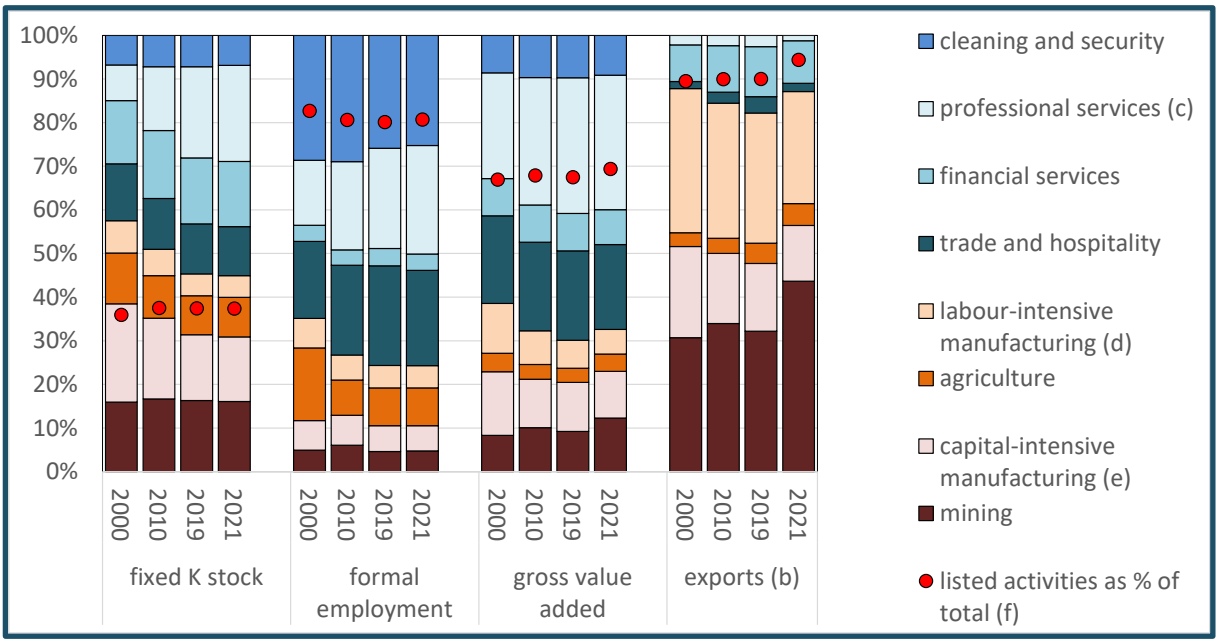
3.1 The production structure

The South African economy was heavily dependent on capital-intensive industries and estate agriculture, especially for exports. These industries effectively shut out most small producers because, by definition, they require large-scale investments for their core production activities. They did provide some space for small specialised support firms, for instance providing engineering, repairs, logistics, marketing, and design services, as well as for basic services such as security, cleaning, and catering.

The bias towards relatively capital-intensive production essentially reflected path dependency in both private investment and government systems. In this context, from 1994 big business and industrial policy both targeted improvements in the productivity of existing activities. They largely ignored the more labour-intensive, less technologically advanced and often less globally competitive industries needed to generate opportunities for small business on a mass scale.

For the past 20 years, relatively capital-intensive activities – mining, metal refineries, coal-based chemicals, advanced food processing, and paper – have accounted for around half of exports, a quarter of the GDP, and a third of capital stock (excluding infrastructure and property management, which have huge sunk investments). But they generated only just over a tenth of formal employment (Graph 17). The share of capital-intensive activities in GDP and exports increased when international mining prices peaked in 2011 and during the pandemic.

Graph 17. Share in capital stock, formal employment, gross value added and exports, excluding infrastructure, property management and logistics, by industry group, 2000, 2010, 2019 and 2021 (a)

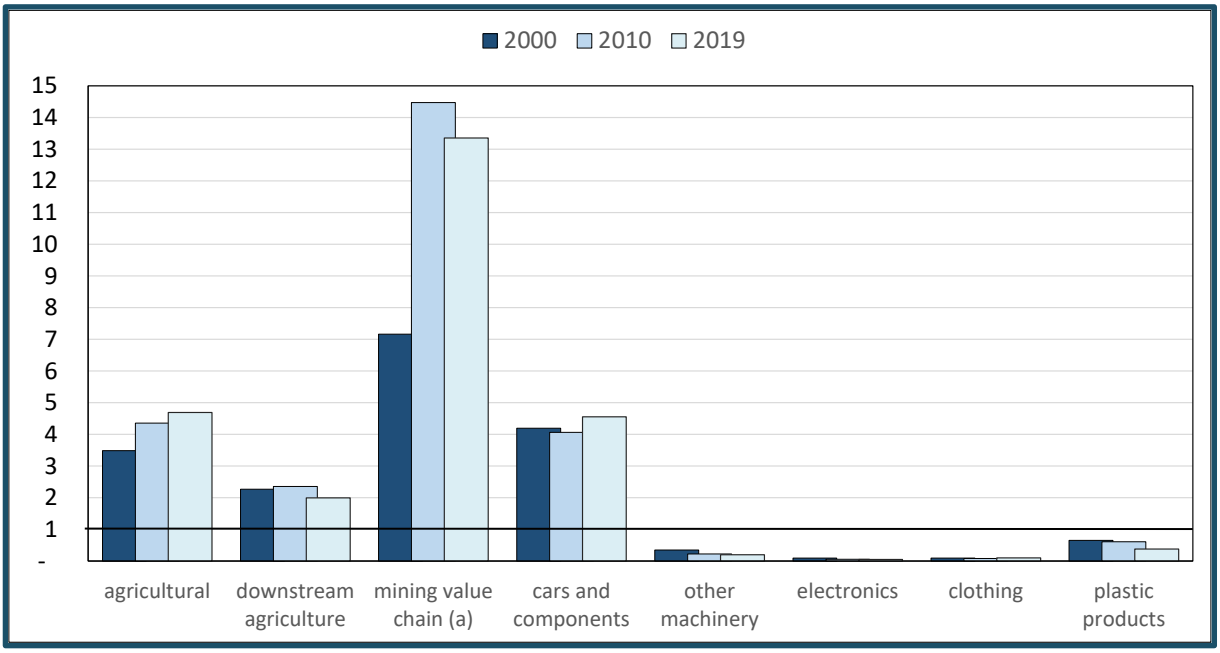


Notes: (a) Infrastructure, property management and logistics includes utilities; property management; transport and communications; and general government across the spheres of the state, since its assets largely reflect infrastructure holdings. These sectors hold around two thirds of total capital stock. Figures for exports by the services are generally understated. Shares outside of employment are calculated using values in current rand. (b) Service exports are systematically undercounted. For instance, Quantec reports no exports for healthcare or construction, yet there is considerable evidence of foreign patients coming to South Africa for treatment, and of construction services provided overseas. (c) Education, health, and business services outside of property management/real estate. (d) Clothing, textile and footwear; machinery and equipment; downstream chemicals and plastics; auto. (e) Food processing and beverages; metals and metal products; wood and paper; basic chemicals. (f) That is, listed industries as percentage of the national total, including infrastructure and property management. *Source:* Calculated from Quantec. EasyData. Standardised industry service. Interactive dataset. Accessed at www.quantec.co.za in November 2022.

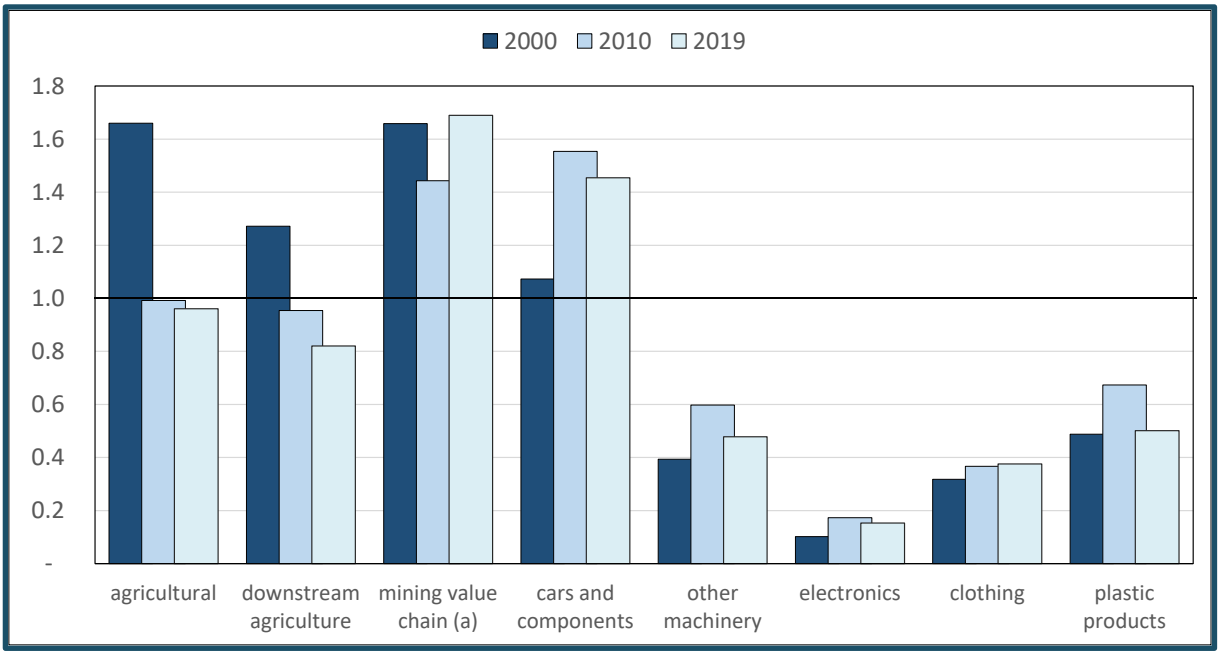
Relatively labour-intensive manufacturing industries contributed a far smaller share of exports in South Africa than in peer economies. This emerges from the ratio between the share of light industries in total exports for South Africa to the share for China and other upper middle-income countries. If this ratio – known as revealed comparative advantage – equalled one, then South Africa would be at the norm for upper middle-income countries. In the event, the ratio was far below one for labour-intensive manufacturing, notably clothing, electronics, other machinery, and plastic products. That is, the share of mass consumer goods in South African exports was far lower than the international norm. In contrast, for heavy industrial products, especially mining and auto, the ratio was much higher than one. South Africa's revealed comparative advantage for light industry did not improve significantly from 2000 to 2019 (Graph 18).

Graph 18. Revealed comparative advantage for major industries for South Africa compared to China and to other upper middle-income economies, 2000, 2010 and 2019

A. South Africa compared to China



B. South Africa compared to other upper middle-income countries (excluding China)



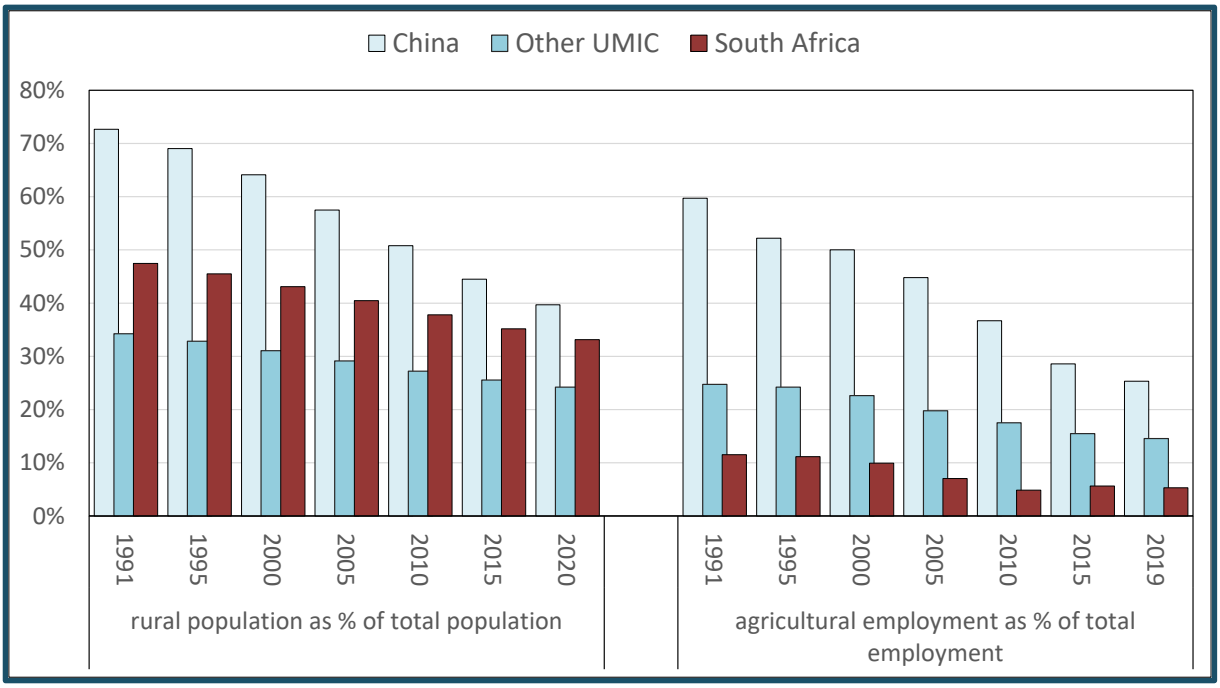
Source: Calculated from UNCTAD. UNCTADStat. Trade Structure. Interactive dataset. Accessed in November 2022 at https://unctadstat.unctad.org/wds/ReportFolders/reportFolders.aspx.

Where export-oriented industrialisation succeeded in China and other Asian countries, it started with clothing, plastic products and other fairly simple consumer goods, and then moved into large-scale assembly of electronic appliances. These industries provided myriad opportunities for relatively small producers. Growth in light manufacturing also created employment on a mass scale, which in turn sustained broad political support for industrial policy measures. In contrast, in South Africa the main growth industries – auto, heavy chemicals and metals refining – did little to expand either small

business or job creation. That reality made it harder for industrial policies to mobilise political (and consequently fiscal) support.

In this context, South Africa's relatively large share of exports from agriculture and food processing was an exception that proved the rule. As a result of apartheid policies, large-scale commercial farming dominated South African agriculture, with high productivity per worker and hectare but limited job creation and a particularly unequal split of value added between workers and employees. As a result, although the rural population in South Africa was as extensive as in peer economies, employment in agriculture, and especially self-employment, was exceptionally low (Graph 19). In other upper middle-income economies, self-employed and working family members in rural areas accounted for around a fifth of total employment, compared to a thirtieth in South Africa.[3]

Graph 19. Share of population living in rural areas and of employment in agriculture in China, South Africa and other upper middle-income countries (a)



Note: (a) Abbreviated as UMIC in the graph. *Source:* Calculated from World Bank. World Development Indicators. Interactive dataset. Accessed at www.worldbank.org in December 2022.

Less than 450 000 of South Africa's 17 million households, or around 2%, got most of their food or income from a family farm in 2021. Of these, 210 000 were in the historic labour-sending regions and 65 000 in commercial farming districts. Almost three out of five family farmers were in the poorest 50% of households (calculated from Statistics South Africa 2021).

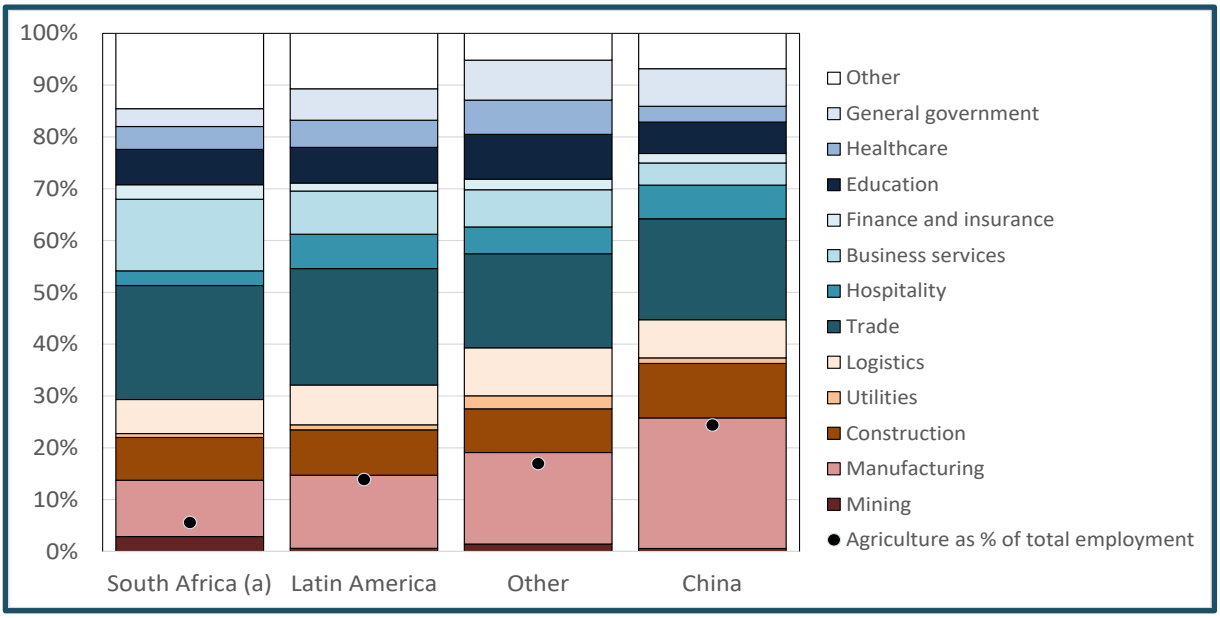
World Bank data on labour productivity in agriculture, underscore South Africa's outlier status in the Global South. In 2019, production per farm worker came to US$10 000 in South Africa. That was 20% below the figure for Brazil, also a deeply inequitable agro-industrial country. But it was much higher

[3] Calculated from ILO, ILOStat. Employment by sex, rural/urban areas and status in employment – ILO-modelled estimates, November 2021 (thousands). Interactive dataset. Accessed at https://ilostat.ilo.org/data/# in November 2022.

than in China, at US$6 000, and other upper middle-income countries at US$7 000. In high-income economies, production per farmworker came to US$45 000.[4]

Very low levels of light manufacturing and the dominance of estate agriculture depressed employment in these sectors compared to other upper middle-income countries (Graph 20). Manufacturing provided 11% of employment in South Africa. For Latin America, the figure was 14%, but it was 25% in China and 18% in other upper middle-income countries, largely in Asia and Eastern Europe. Agriculture generated only 6% of employment in South Africa – almost exclusively for wage workers on estates – compared to 24% in China and 15% in other upper middle-income countries, where smallholdings dominated.

Graph 20. Employment by industry in upper middle-income countries, 2021



Note: (a) 2020. *Source:* For South Africa, calculated from Statistics South Africa. Labour Market Dynamics 2020. Electronic data set. Accessed at Nesstar facility at www.statssa.gov.za in November 2022. For other countries, calculated from ILOStat. ILO-modelled estimates. Interactive dataset. Accessed at https://ilostat.ilo.org/data/# in November 2022.

South Africa's economic systems in both the private and public sector developed over centuries to serve heavy industry and commercial agriculture. Redirecting them to qualitatively expand support for light manufacturing and services would necessitate significant disruption to market institutions of all kinds, from finance to energy to retail chains to training. To give some examples:

- South Africa's massive but extremely inefficient and expensive coal-fuelled electricity plants both facilitated and relied on big mining and refineries. Light industry would do better with more decentralised, affordable and reliable generation systems.
- Transnet provided dedicated facilities for ores, coal and auto, but paid less attention to the needs of smaller manufacturing and agricultural producers.
- In 2022, around 70% of equity investments by government's Industrial Development Corporation (IDC) were in mining and metals (calculated from IDC 2022:80 ff).

[4] Total agricultural output from the World Bank, World Development Indicators. Interactive dataset. Accessed and downloaded from www.worldbank.org in July 2022. Employment from ILOStat, Employment by economic activity – ILO-modelled estimates, November 2020 (thousands). Interactive dataset. Accessed at https://ilostat.ilo.org/data/# in November 2022.

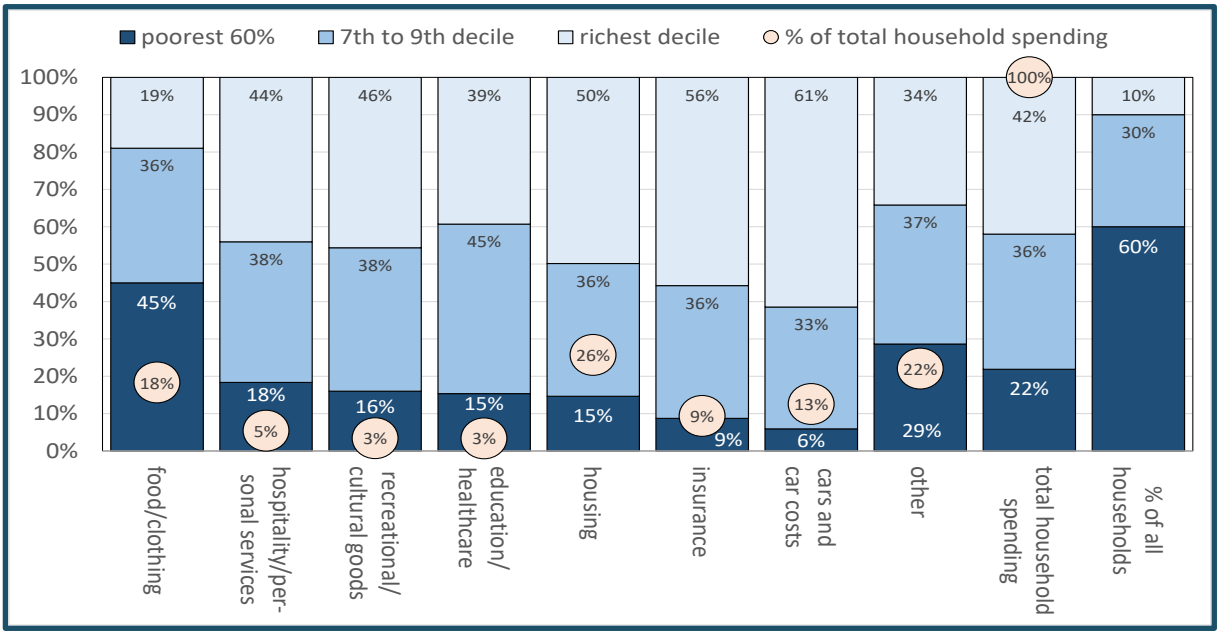
The national response to the electricity crisis in 2022, pointed up the effective bias towards large companies in both public and private institutions. As Eskom, the national electricity utility, experienced repeated breakdowns, it imposed electricity rationing on households and enterprises. Businesses faced scheduled outages of four to eight hours on most days in 2022, making it difficult for many to stay open. In response, the national government changed the regulatory framework to make it easier for large, energy-intensive companies to build their own electricity plants, often with relatively cheap renewable generation. These large companies could raise the high up-front cost for these projects fairly easily. In contrast, for most smaller firms, the initial cost of solar systems proved prohibitive, and access to finance was more difficult. Many relied primarily on generators, which were cheaper to start with, but became hugely expensive when the price of diesel climbed by 40% over 2022. Government only began to consider schemes to assist smaller enterprises to pay for off-grid systems early in 2023, more than a year after loadshedding became a regular occurrence.

3.2 The structure of demand

Outside of professional activities, emerging businesses mostly supply comparatively labour-intensive and simple goods and services for consumers and larger producers. In South Africa, however, the relatively compressed middle class constrained domestic and regional demand for basic consumer products. Small producers also had to compete with much larger and well-established international suppliers. In this context, retail chains and other big companies often found it easier and cheaper to rely on large producers at home or overseas than to deal with small businesses that could not reliably or immediately meet their requirements for scale and quality.

The structure of expenditure by class largely defined consumer expenditure in South Africa. The richest 10% of households accounted for over 40% of all household spending in 2014/15. The share of the top decile ranged from over half for housing, insurance, and personal cars to just under 20% for food and clothing. At the other end, the poorest 60% accounted for under a quarter of total household spending, with a high of 45% for food and clothing and a low of 6% for personal cars. The middle-class share was over a third for most categories, but rose to 45% of total household spending for health and education (Graph 21).

Graph 21. Share of household expenditure by category and class (a)



Source: Calculated from Statistics South Africa. Living Conditions Survey 2014/15. Electronic database. Downloaded from Nesstar facility at www.statssa.gov.za in October 2018.

The implications of unequal demand can be understood through the lens of the township economies. Historically, the apartheid state permitted African urban communities mostly as dormitories for workers at some distance from industrial and commercial sites, with little in the way of recreational, social or economic facilities. The concept of the township economy arose from the long-standing call to address these deficits, as a way to improve social and living conditions. But apartheid urban planning set up the townships explicitly as exclusively working-class areas, with incomes far lower than the leafy suburbs that house the richest 10% or so of the population. In 2019, the median income for African households in township housing in urban areas was R3 500 a month, compared to R15 000 a month for white households in suburban homes. The situation in the historical labour-sending regions was even bleaker, with the median income for African households in township housing at around R2 500 a month.[5] These realities limited opportunities for new businesses to serve their populations.

Disproportionately low incomes for the majority of households in South Africa meant that most people could not afford basic goods and services to improve their living conditions and make it easier to take advantage of economic opportunities. In response, the government provided extensive support through subsidised infrastructure, social services and social grants. These programmes effectively supplemented household demand for basic goods and services, which should open up new opportunities for small business.

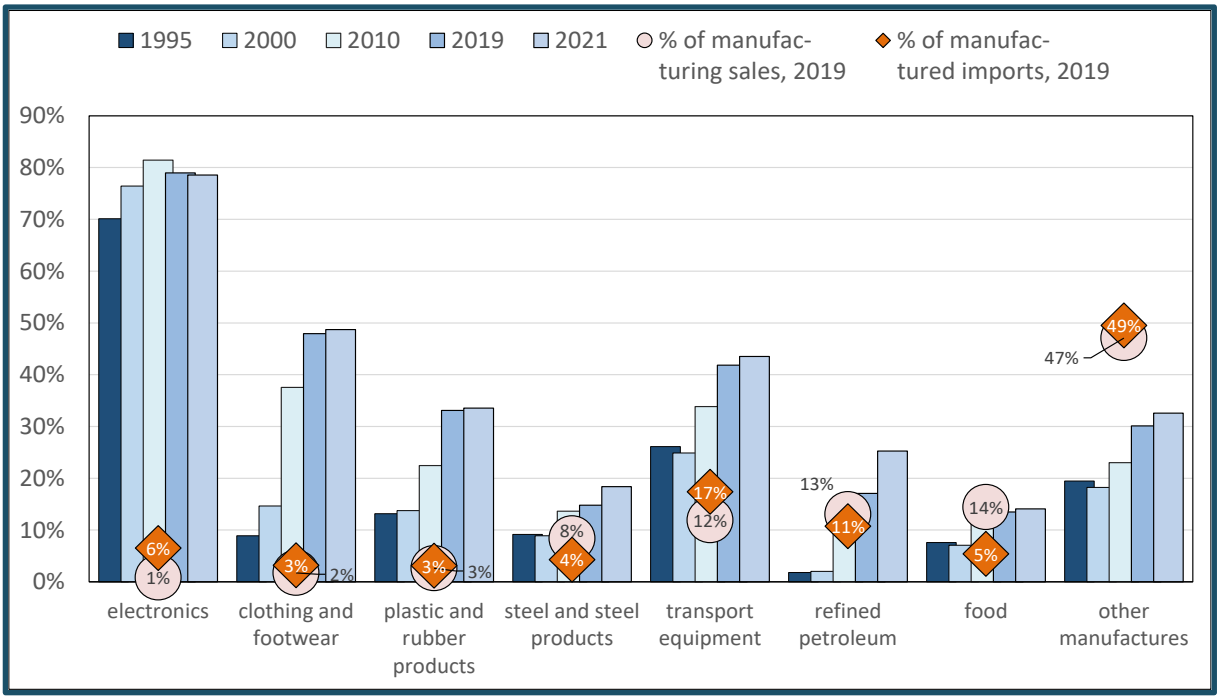
In practice, small businesses faced an array of economic and institutional obstacles in taking advantage of these opportunities. In many cases, newly founded producers could not immediately meet government requirements at an acceptable cost and quality. They might grow into the task, but that would require a bet on the future. Moreover, government procurement systems were not designed to bring in small businesses or to identify which were likely to succeed. Many did not communicate well with potential suppliers; included unnecessary specifications, for instance trademarks or materials, that limited procurement to a few (sometimes only foreign) suppliers; had no capacity to monitor delivery and provide assistance if new producers ran into trouble; and set very short time frames, making it impossible for new producers to gear up.

After 1994, efforts to reform state procurement systems to support small and/or black-owned business centred on regulatory prescripts. They did not generally improve the capacity of agencies to plan procurement so as to facilitate small-business participation; communicate widely and well ahead of time; evaluate the quality of small producers' bids; or help them meet requirements. Generally, they either set quotas, even where suppliers were scarce or uncompetitive,, or avoided buying from new producers at all. The former opened the door to inefficiency and corruption, while the latter effectively shut out emerging producers that could compete on quality and price.

A surge in manufactured imports after the transition to democracy further dampened demand for local producers. The upswing reflected the opening of the economy and, from 2000, the worldwide growth in East Asian and especially Chinese manufactured exports. From 1995 to 2021, imports climbed from under 20% to over 30% of all manufacturing sales in South Africa. Consumer goods outside of food saw particularly high levels of displacement. Over two thirds of electronics were imported consistently from 1995. The share of imported clothing rose from under 10% in 1995 to almost 50% in 2021 (Graph 22).

[5] Calculated from Statistics South Africa. General Household Survey 2019, House. Electronic dataset. Downloaded from Nesstar facility at www.statssa.gov.za. The survey does not directly define township housing, but the size of housing, location and race provide a reasonable proxy. African township housing is defined here as houses belonging to African families with six rooms or less. White suburban households defined as houses belonging to white families with more than six rooms.

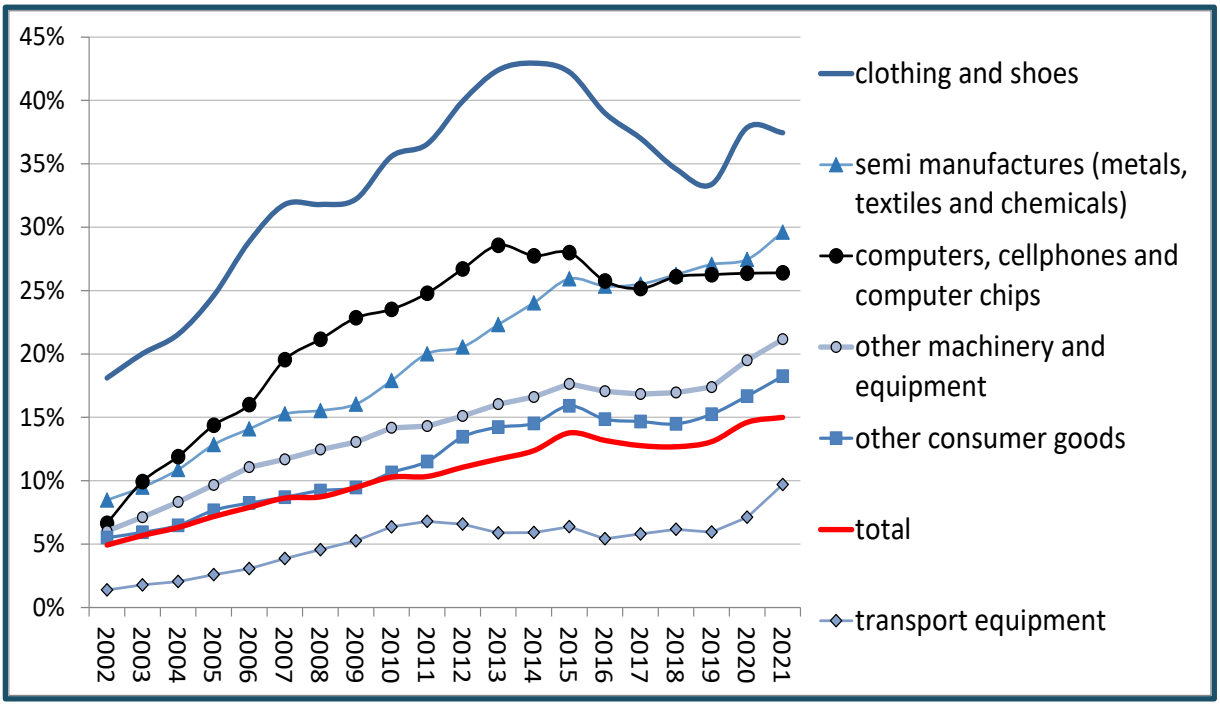
Graph 22. Imports as a percentage of local sales of manufactured goods (a) by industry, 1995, 2000, 2010, 2019 and 2021



Note: (a) Manufacturing sales are calculated as imports plus gross value of production – that is, value added plus intermediate inputs. *Source:* Calculated from Quantec. EasyData. Standardised industry service and RSA trade service. Interactive datasets. Accessed at www.quantec.co.za in January 2023.

The extraordinary increase in Chinese exports of manufactures after 2000 posed a policy dilemma for all importing countries. As Graph 23 shows, Chinese exports of clothing, cellphones, computers and computer chips increased rapidly as a share of world exports until 2014, then plateaued or declined. Other Chinese exports have continued to increase their market share, notably semi-manufactured inputs (textiles, metals and chemicals), other consumer goods, and machinery. For South Africa, purchases from China, as a percentage of all imports excluding petrol, rose from 6% in 2002 to 24% in 2021. China accounted for half of South Africa's clothing and footwear imports; two thirds of electronics (up from 8% in 2002); and a fifth of plastic products (up from under a twentieth in 2002). South Africa effectively paid for these imports by exporting mining products to China and elsewhere, and to a much lesser extent selling food and assembled cars across southern Africa and to the Global North.

Graph 23. Chinese exports as a percentage of world exports by major product, 2002 to 2021



Source: International Trade Centre, Trade Map. Interactive dataset. Downloaded from www.trademap.org in January 2023.

Where imports were cheaper or better quality than local products, the rise in foreign purchases obviously benefited consumers as a whole at least in the short run. On the whole, local producers could not supply the full range of goods available internationally. Often they would require significant time lags to match the price of more established foreign producers. That said, deeply unequal incomes meant that the richest decile gained most in absolute terms.

Industrial policy had to look beyond the immediate transactions, however. The question became when the benefits of promoting local suppliers outweighed the costs in the medium to long run. The benefits of localisation were more obvious in cases where:

- The goods concerned were relative luxuries, rather than necessities for the low-income group;
- Local producers came close to matching imported prices and quality;
- Domestic production promised significant external benefits, especially in the form of substantially higher direct and indirect employment or products optimised to meet local needs; and/or
- Local suppliers had a good chance of becoming internationally competitive over time.

Small business also often faced hurdles in accessing local retail markets. These hurdles differed significantly for formal and informal suppliers.

In the formal sector, the dominant retail chains generally supplied many stores from a single regional centre. They also required very consistent standards and punctual deliveries. Smaller producers often found it impossible to meet the resulting requirements for scale, quality and timeliness. All the South African retail chains have initiated some projects to bring in smaller local producers, but these efforts generally relate to a mere fraction of their total sales. In addition, most malls do not provide space for smaller or irregular producers. They also charge very high rents relative to turnover for small shops.

Small business that targeted larger and public producers also faced challenges, as noted above. Often large public and private institutions had long-standing relationships with major local or foreign

suppliers, and were reluctant to disrupt them, even when smaller businesses could compete. More fundamentally, reshaping procurement systems to encourage smaller suppliers would require significantly more time and capacity, with expanded communications and often longer lead times. As with localisation, the question became when the benefits of bringing in new, smaller suppliers would outweigh the costs. These benefits could be directly for the buyer, who could ultimately gain from a more competitive supply chain, or for society, if the process encouraged more competitive small business. That in turn should foster a more dynamic and equitable economy overall.

For informal enterprise, access to markets was often even more difficult. Formal commercial spaces rarely provided any space for micro-outlets such as street traders or handicraft producers. Bylaws and police actions often restricted traders' access to public spaces such as sidewalks and taxi ranks, especially in higher-income areas. Standing on busy streets was a physical strain, worsened by bad weather, usually without facilities of any kind for food, rest, or storage. The situation was worsened by the difficulty of procuring novel, value-adding products to sell. Formal producers rarely accepted suppliers who did not have a tax number and facility with internet communications and registration.

3.3 Productive, human and social capital

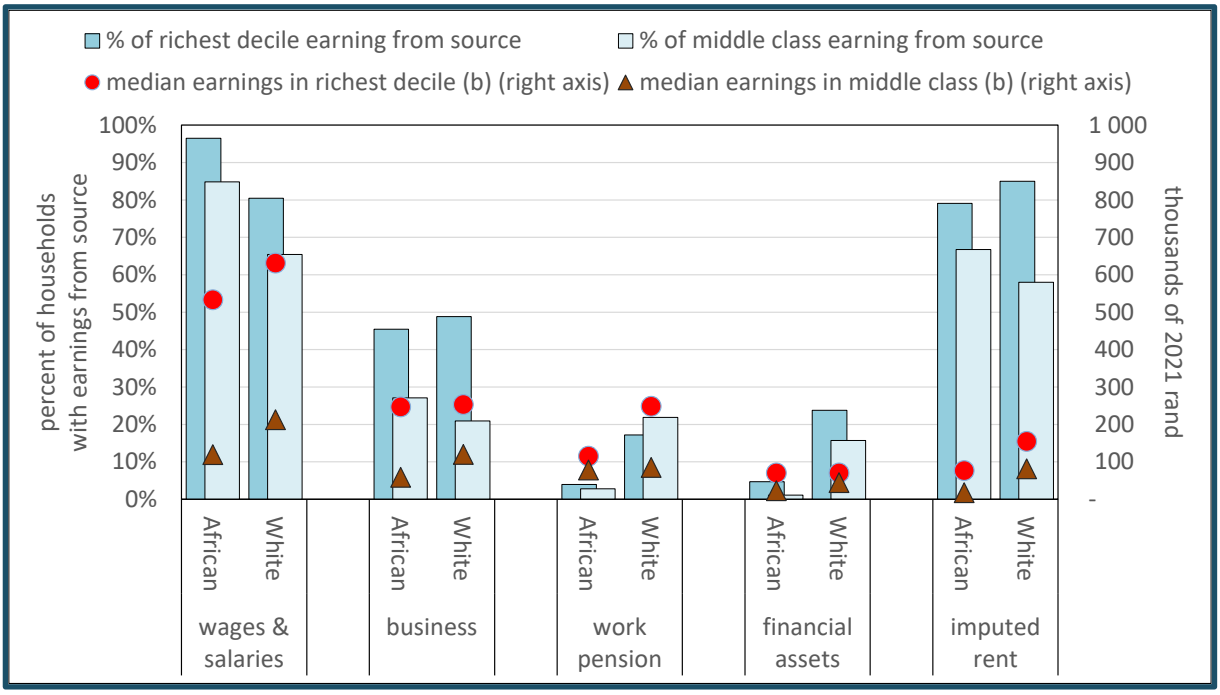
Apartheid explicitly aimed to destroy black-owned business. The critical measures to achieve these ends were restrictions on land ownership and operating licences; profound inequalities in government services, especially education and infrastructure; and residential restrictions. The result was a self-reinforcing network of deep inequalities in ownership, education, experience, access to economic centres and key services. After 1994, government initiatives sought to redress these inequalities, but they only went part way. As a result, it remained extraordinarily difficult for people in working-class communities to start new small businesses.

3.3.1 Asset ownership

Most working-class families in South Africa owned their homes, but had little else in the way of either productive assets or financial savings, as Section 0 outlines. This reality in itself made it both more difficult and riskier to open a new enterprise of any kind or to sustain one through a crisis.

Inherited wealth accounts for most class differences in asset ownership. Racial differentials within classes point to this reality. In 2020, according to the General Household Survey, 3% of the lowest-income 50% of households were white. The figure was 9% for the middle class and some 40% for the richest decile (calculated from Statistics South Africa 2020). Even if they were in the same income class as whites, Africans were far less likely to have any investments. According to the 2014/15 Living Conditions Survey, in the richest decile, 49% of whites had a business and 24% had financial investments. For Africans in this decile, 45% had a business but a mere 5% earned returns from financial holdings outside of work pensions. In the middle class, 27% of Africans owned a business, but only 1% had financial assets outside of work pensions. In contrast, 16% of middle-class white families had financial assets, although only 21% owned a business.

Graph 24. Share of African and white middle-class households earning wages and income from asset ownership, and median value of annual earnings for households that owned the relevant assets, in thousands of 2021 rand, 2014/15 (a)



Notes: (a) Reflated with CPI. (b) Excluding households with no earnings from relevant source. *Source:* Calculated from Statistics South Africa. Living Conditions Survey 2014/15. Electronic database. Downloaded from Nesstar facility at www.statssa.gov.za in October 2018.

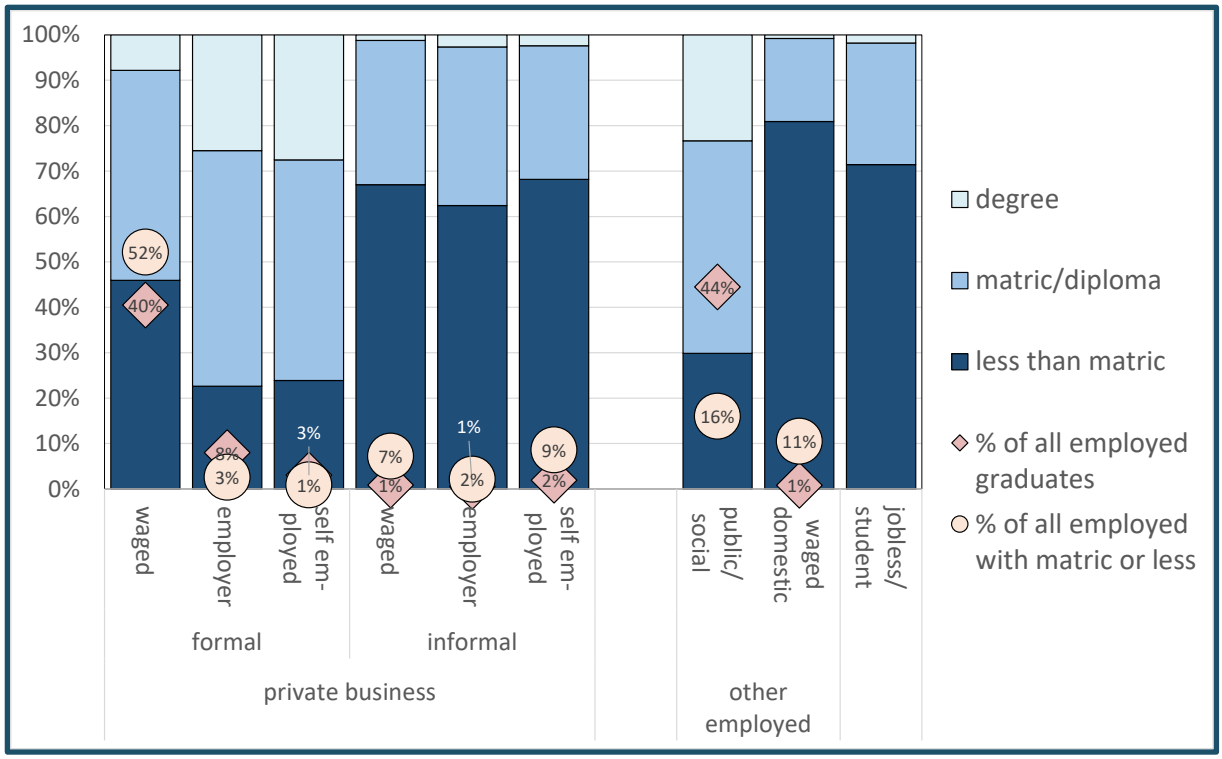
The gradual decline in the over-representation of white business owners showed how historic privilege diminished but still persisted. The number of formal black employers and self-employed people climbed from 195 000 to 440 000 between 2002 and early 2020, rising from 38% to 60% of the total. In contrast, white owners – who tended to be older – fell from 325 000 in 2002 to 295 000 in early 2020. The Covid-19 downturn slashed the number of black owners to 350 000 in the first half of 2021. The number of white-owned businesses only drifted down slightly during the pandemic.

For most South Africans, the only major asset available was their homes. In practice, however, high levels of home ownership did little to expand economic opportunities for the majority of families. In 2015, Statistics South Africa estimated the median value of houses (reflated to 2021 rand) at R1,6 million in the richest decile, R240 000 in the middle class, and under R50 000 in the poorest 50% (calculated from Statistics South Africa 2017). These valuations were not realistic, however, because in most townships and historic labour-sending regions, families could not realistically sell or mortgage their homes. They had little chance of finding alternative accommodation, and their housing was mostly small and far from economic centres. Moreover, many of the poorest families had received an RDP subsidy, which restricted rights to sale. A third of the poorest households that owned formal housing benefited from the subsidy programme, compared to a fifth of the middle class and just over one in 20 in the richest decile (calculated from Statistics South Africa 2020).

3.3.2 Education and skills

Higher education and artisanships are a critical route to ownership of small formal businesses. As Graph 25 shows, a quarter of formal business owners have a degree, compared to under 10% of formal waged workers and less than 5% of informal business owners. Formal business owners are also much more likely to have matric or matric plus a diploma than unemployed people or waged workers in the private sector.

Graph 25. Share of employed and jobless people (including students) with a degree, matric or a diploma, or less than matric, by employment type, and share of employed people with and without a degree by employment type, 2019



Source: Calculated from Statistics South Africa. Labour Market Dynamics 2019. Electronic databases. Downloaded from Nesstar facility at www.statssa.gov.za.

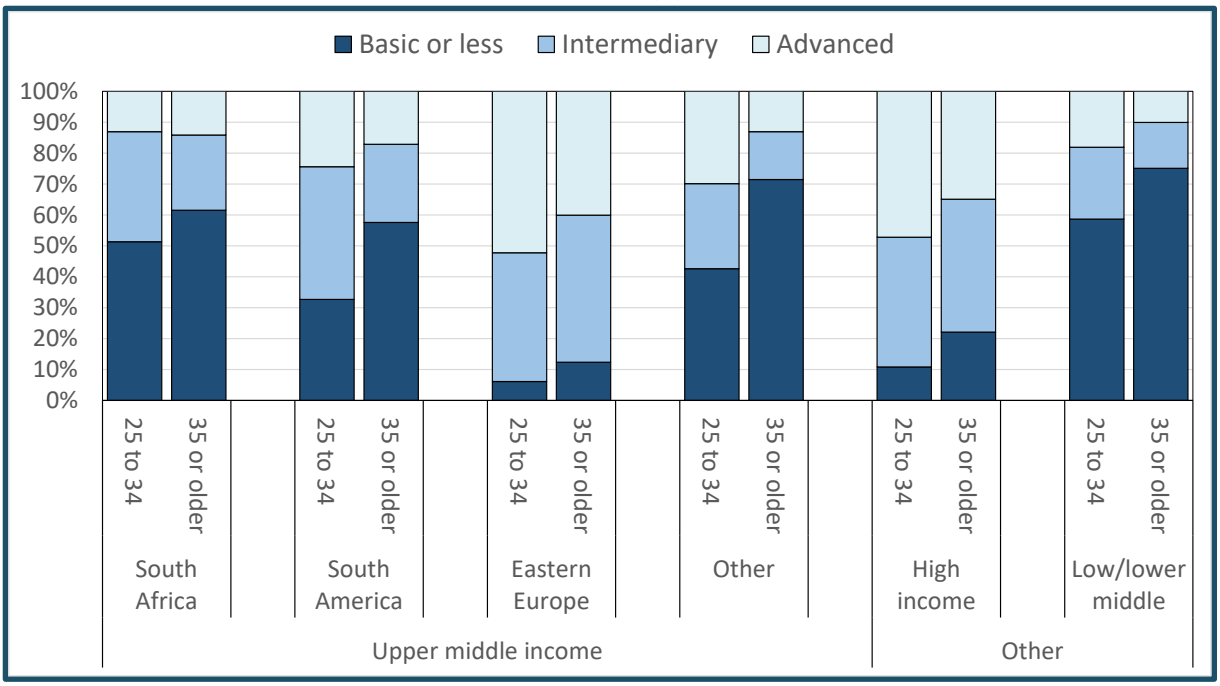
The structure of employment underscores the importance of education for the economy as well as individual prosperity. In 2019, 75% of adults over 25 with a university degree had income-generating employment. That compared to 70% of people with any post-secondary qualifications, 45% of people with matric, and under 20% of those without matric.

South Africa faced a particularly large backlog in qualified crafts workers, with the vast majority learning their trade informally, with little formal quality control. In 2019, some 420 000 people were self-employed in key trades – almost exclusively as mechanics, metal workers and in construction (for instance, in plumbing and bricklaying). Over 55 000 were in the formal sector. Of these, around one in three had a diploma or certificate in addition to their general education. In the informal sector, where over 350 000 were working as craftspeople, less than one in 20 had some kind of qualification after leaving school.

Apartheid laws explicitly aimed to maximise the returns to education for both business owners and employees by limiting access to quality schooling. The resulting backlog persisted through the democratic era. As Graph 26 shows, a markedly smaller share of South African adults had degrees than in other upper middle-income countries, although the dataset does not include China. The

shortfall relative to peer economies was particularly notable for younger people, suggesting comparatively slow progress since 1994.

Graph 26. Education levels of working-aged adults, by region and country income level, late 2010s (a)



Note: (a) Dataset does not include China. *Source:* Calculated from IL., ILOStat. Interactive database. Accessed at https://ilostat.ilo.org/data/# in August 2022.

Lower education levels in South Africa were associated with limited numbers of professionals. In 2020, 6% of all employed people in South Africa were professionals. In Eastern Europe, the figure was 22%, and in other upper middle-income countries (counting only urban areas for China), it was around 10%.

The reproduction of limited access to higher education effectively maintained extraordinarily high returns to qualifications. In the 2010s, South Africa had the largest pay gap between professionals and other workers recorded by the International Labour Organisation.[6] In 2019, half of employed South African university graduates earned over R20 000 a month. For those with a post-secondary diploma, half earned over R8 000; with matric, over R4 200; and with less than matric, over R3 000.

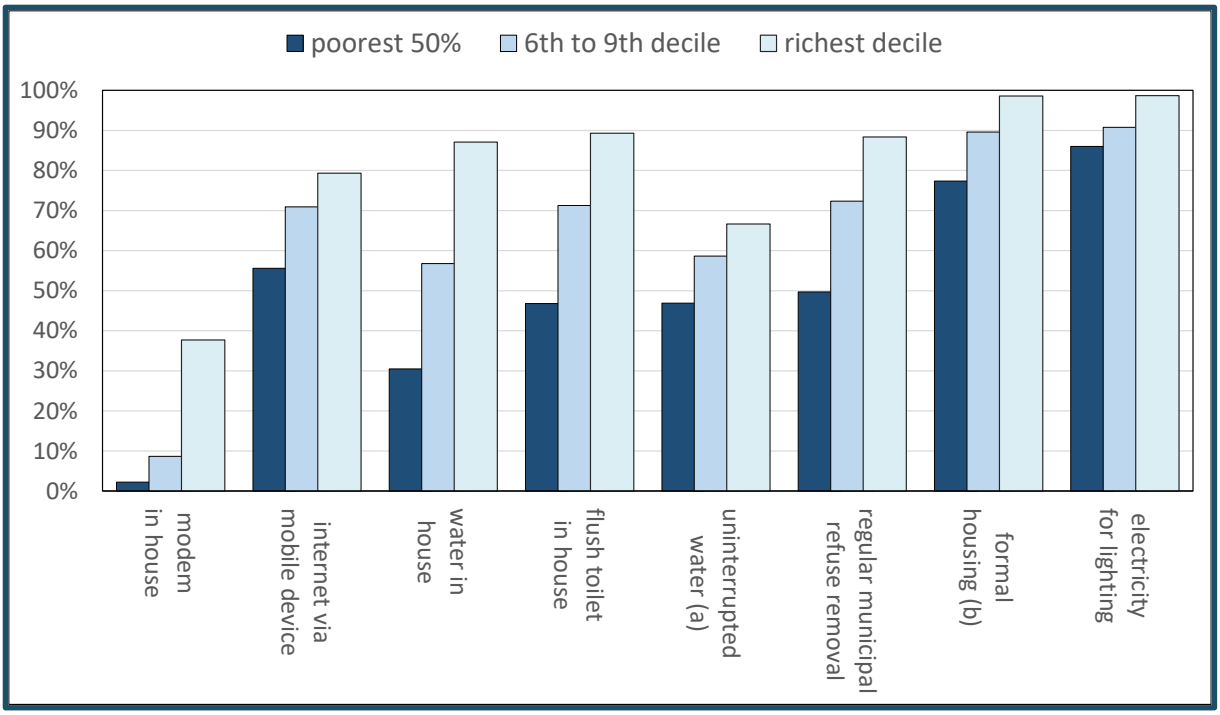
Educational privilege had several roots. Richer households could pay for quality education in both the public and private sectors. South Africa permitted state schools in middle-class and rich communities as well as tertiary institutions to charge substantial fees. That effectively widened the resourcing gap between schools in rich and poor communities, while the best schools still excluded most lower-income learners. In addition, high-income households were more likely to have parents with advanced qualifications, which usually translates into better education for children. The resulting shortfalls in education overall represented a major obstacle to growth in the number of small formal businesses.

[6] Calculated from ILO. ILOStat. Interactive dataset. Accessed at https://ilostat.ilo.org/data/# in August 2022. The data for managers includes owners of informal micro-enterprises, the majority of whom do not have matric. As a result, the figures for returns to managers compared to other workers does not help understand returns to education.

3.3.3 Municipal infrastructure

Under apartheid, systemic underinvestment in municipal infrastructure for the majority of South Africans limited the scope for established and emerging businesses. As the following graph shows, despite massive improvements since 1994, in 2020 access to infrastructure was still heavily affected by class. The data understate the difference because the quality of infrastructure in historically black communities often lagged far behind better-off suburbs and formal industrial sites, reflecting differentials in investment stretching back over a century.

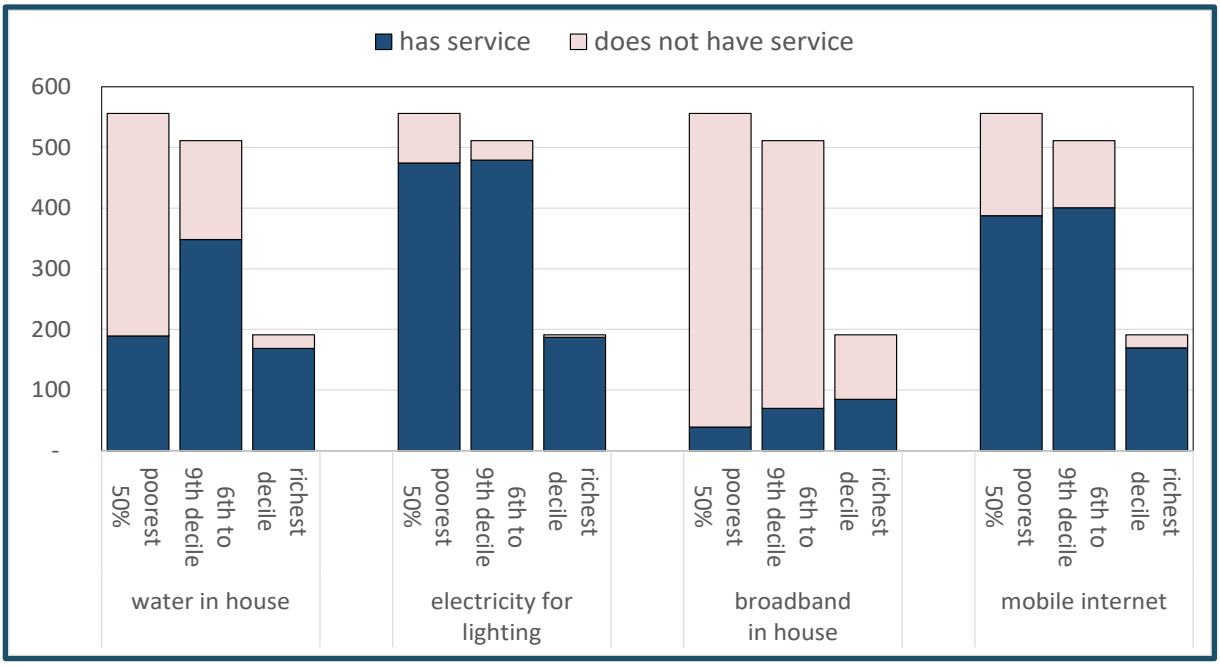
Graph 27. Access to infrastructure by class, 2020



Notes: (a) Interruption to water supply in the past 12 months. (b) That is, housing that is not traditional or informal. *Source:* Calculated from Statistics South Africa. General Household Survey 2020. Electronic database. Downloaded from Nesstar facility at www.statssa.gov.za.

The lack of adequate infrastructure was a key constraint on actual and potential entrepreneurs in working-class communities. In 2020, 550 000 households in the poorest 50% reported that they got most of their income from business ownership. Of these households, one out of seven did not have electricity and one in four did not have water on site, whether indoor plumbing or a standpipe in the yard. Over nine out of ten did not have internet at home, although most connected through a cellphone. In the middle class, 510 000 households relied primarily on business income, as did some 200 000 in the richest decile of households. As Graph 27 shows, these households had substantially better access to energy, communications and water.

Graph 28. Infrastructure for households that depend primarily on business income, by class, in thousands of households, 2020



Source: Calculated from Statistics South Africa. General Household Survey 2020. Electronic database. Downloaded from Nesstar facility at www.statssa.gov.za.

Various factors maintained the persistent inequality in access to infrastructure. They included the following:

- The democratic government inherited first-rate infrastructure in historically white, well-off communities, often with established commercial and light industrial sites. Black neighbourhoods had far worse facilities, especially in the historic labour-sending regions. Catching up would have been difficult in any circumstances. Local governments faced hard choices around how far to go in extending infrastructure to historically deprived areas, since given limited funding it would necessitate some reduction in standards for rich areas. In the process, they often failed to set up defined sites for businesses of any kind.
- Massive migration to urban areas, especially in Gauteng, both reflected the historic backlogs in government services in the historic labour-sending regions and added to pressure on urban infrastructure. The population of Gauteng increased by 110% from 1994 to 2021, compared to 35% in the rest of the country (and under 10% in the Eastern Cape and Free State).[7] In-migration expanded markets for small businesses, but the new migrants often earned low incomes, at least initially. Moreover, many ended up in informal settlements where infrastructure for businesses – especially water and sanitation removal as well as defined commercial and industrial sites – barely existed.
- To a large extent, household access even to public infrastructure still depended largely on communities' ability to pay through rates and tariffs. National transfers to municipalities went some way to equalising expenditure. Still, communities in the historic labour-sending regions spent around a quarter as much per resident as the metro areas, up from a twentieth in the early 2000s.

[7] Calculated from Quantec, EasyData. Regional service. Interactive dataset. Accessed at www.quantec.co.za in November 2022.

3.4 Loadshedding

In 2022/23, the extraordinary spike in loadshedding became the largest single drag on small businesses. It escalated their costs in a variety of ways, including the following.

- Many businesses invested in off-grid generation capacity, mostly diesel or solar systems. The cost of diesel in itself became a severe burden as loadshedding hit higher levels and petrol prices climbed. Solar generation was almost free, but required a significant up-front investment in panels and batteries. Over time, as Eskom and municipal tariffs increased, it would normally pay for itself in financial terms, but getting long-term financing often proved difficult for smaller and especially emerging enterprises.
- Continual interruptions to electricity meant production equipment was more likely to break down, especially where it involved continual processes (for instance in chemicals, metals refining, and poultry production). Electronic equipment also packed up more as power surges became more frequent.
- Loadshedding increased breakdowns in municipal grids, leading to more and longer outages. In some cases, it opened the door to cable theft, further interrupting electricity. Loadshedding also affected the water supply, as pumping stations and purification facilities went offline.
- Closures during loadshedding reduced output and sales. Where lower or delayed production meant businesses could not meet commitments, they faced penalties or termination of contracts.
- Many employers ended up paying for wages and salaries during loadshedding despite the fact that no work could be done. In some cases, employers had to pay for overtime to make up for production lost during loadshedding. Both employers and employees had to deal with changes in shift times.
- Businesses complained that customers were less likely to come in during loadshedding, especially in services and retail.
- Increasingly, skilled people considered emigration, as loadshedding suggested a profound breakdown in social systems.
- Some businesses said crime increased during loadshedding.

Small businesses, especially new ones, had less resources to deal with these additional costs while Eskom recovered – a process expected to take years and to bring higher tariffs. For industrial policy, a core question became how to mitigate the costs of loadshedding for small business as long as it persisted. As of early 2023, the best solution was to invest in solar, because low generation costs would over time pay for the high initial investment. The challenge was to obtain financing to cover the fairly extended period – generally five to ten years – required to pay for the new equipment from the savings relative to municipal and Eskom tariffs.

Municipalities often resisted off-grid solutions because, for metros and some secondary cities, surpluses generated by electricity sales were an important source of income. In the event, these surpluses declined sharply as Eskom prices climbed and sales sank through the 2010s. In constant terms, total municipal revenue from electricity fell 7% from 2015 to 2019, with a sharper fall in 2020 due to the pandemic. Municipal revenues could be protected by setting up relatively small-scale solar generation at community level to serve industrial and commercial sites. Most local governments would require assistance with financing and often technical support.

4 IMPLICATIONS FOR INDUSTRIAL POLICY

Industrial policy in South Africa has long incorporated a range of measures to support small business. To date, however, it has not led to the qualitative step-up in numbers needed to overcome the huge deficit left by apartheid. This section outlines some broad strategies to improve these outcomes.

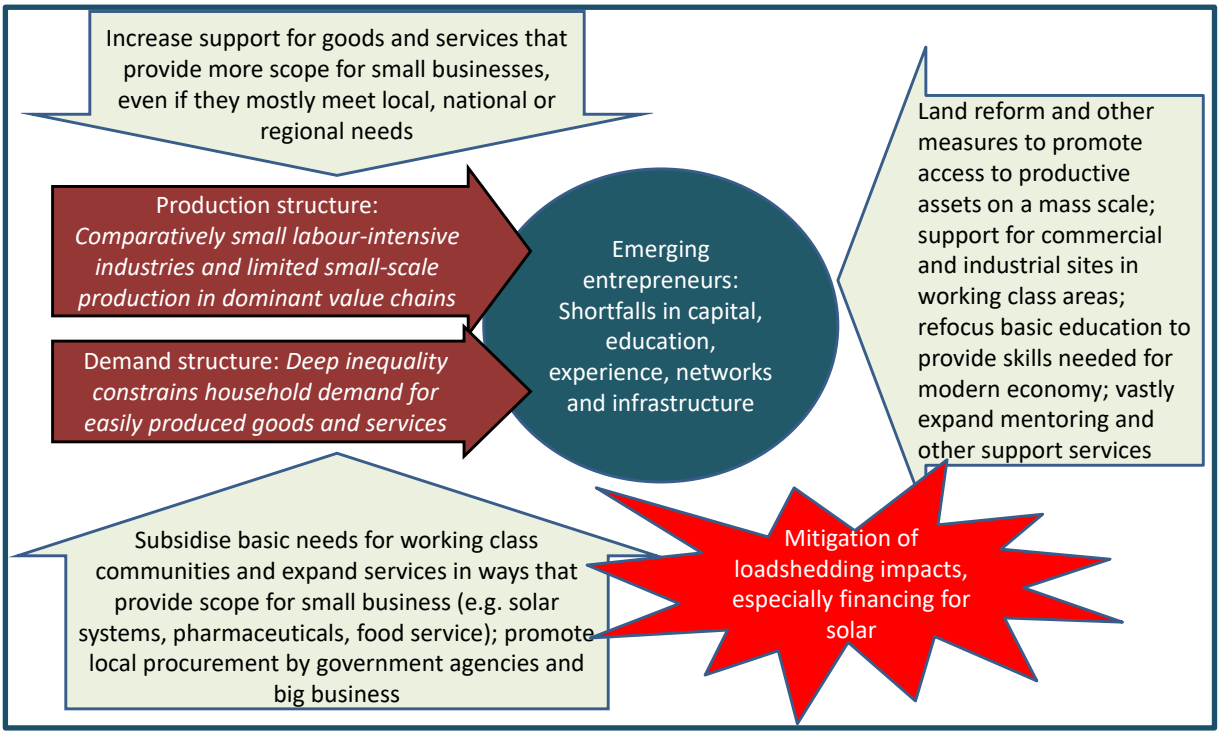
Industrial policy has had two main thrusts that affect small business. First, it has sought to encourage competitive industries, both within the long-standing mining and agricultural value chains plus auto assembly, and through diversification into innovative products. Second, it aimed to support small business directly, mostly by providing financing and secondarily by supplying expertise and services, for instance through incubators and technology hubs.

This approach does not fully address the challenges facing small business that are summarised in Figure 1. Critical issues include the following, as illustrated in Figure 2.

1. Industrial policy would have to qualitatively shift focus to promote more labour-intensive industries, even if they seemed likely to focus on local and regional markets for the foreseeable future. That in turn would require re-thinking what constituted sustainable production to prioritise the impact on joblessness and inequality, rather than focusing narrowly on short-run global competitiveness.
2. A shift towards smaller business and more labour-intensive goods and services would also require strategies to expand demand for small producers. These initiatives could include, for instance, programmes to provide basic necessities to working-class communities and to significantly strengthen local procurement by government agencies, big business and formal retail.
3. A step-up in programmes to meet the needs of actual and potential entrepreneurs for access to resources. These strategies would have to provide productive assets on a mass scale, improved infrastructure and sites, markets, and relevant education, skills development, mentoring and operational support. They would have to be reasonably holistic, because usually meeting just one set of needs – for finance, say, or for training – is not adequate to shift the ecosystem for emerging entrepreneurs.
4. Urgent measures to mitigate the impact of loadshedding on small businesses.

These strategies will only work if government addresses broader policy constraints on the economy. A core obstacle is a tendency towards pro-cyclical fiscal decisions that essentially track mining prices and consequently export revenues. Another key challenge is that policy disputes within government and between economic stakeholders devolve into long-standing logjams for lack of rapid and authoritative dispute-settlement mechanisms.

Figure 2. Industrial policy measures to promote small business on a mass scale



Some advocates for small business blame government actions, rather than economic systems and structures, for the failure of small business to recover from apartheid. This approach leads them to emphasise (and often exaggerate) regulatory and financial burdens. These observers generally point to permits and licences, especially at local government level, that aim to protect consumer and community health and safety; taxes, municipal rates, and tariffs for services; and labour standards. They often identify unnecessary costs, but do not deal with the deeper structural and systemic problems left by apartheid. In any case, any regulatory review has to balance the costs to small businesses against the intended social benefits.

The strategies required radically to expand the number of small businesses would necessarily impinge on the implicit (and already crumbling) social pact that enabled the transition to democracy. That social pact essentially promised the historically privileged to respect existing property ownership, however unfairly shaped by the state, and to maintain centres of excellence in education and other government services. As a result, the richest decile of households became far more representative, but class-based inequalities in ownership and education persisted. The pact promised the majority a substantial improvement in government services; an acceleration in economic growth; and greater economic and social mobility, including by opening their own businesses. In practice, these promises were unmet thanks to a combination of:

- Slow growth except when mineral prices were high, and
- Reluctance to raise tax rates or restructure state spending as required to support small business on a mass scale and to sharply upgrade infrastructure and education in working class communities.

Fundamentally, strategies to grow small business and labour-intensive industries necessitate support for extensive growth, which expands output by bringing more resources into production. In contrast, industrial policy has focused primarily on raising productivity in existing companies (that is, intensive growth). In practice, economic expansion always combines extensive and intensive growth. Unless

there is a huge growth in demand, however, only more extensive growth can accelerate expansion in small businesses and in employment.

We can understand the policy implications of a shift to more extensive growth by contrasting stylised facts about current development strategies with the requirements for promoting small business and labour-intensive production on a mass scale. Currently, industrial policy measures focus primarily on internationally competitive formal producers, notably in agriculture, mining, the auto industry, energy and finance. These producers are highly productive by international standards but generate relatively few jobs, as discussed in Section 0. In contrast, more extensive growth would require vastly increased support for small businesses and labour-intensive producers with less advanced technologies and little scope for exports. Ideally the emerging clusters would become competitive in the longer run, often on the basis of mass employment of lower-skilled workers rather than high-tech innovation.

Examples of measures to support extensive growth include the following:

- Smallholder agricultural schemes feeding into formal markets and processing plants, which typically require significant private or public support around extension, financing and marketing.
- Platforms for crafts, entertainment, hospitality and services that encourage higher quality and standards while providing assistance with marketing, for instance by subsidising venues, streaming and marketing for concerts or rolling out subsidies for early childhood development centres in working-class communities.
- New industrial and commercial sites for small businesses around working-class communities.
- Government subsidies to low-income households to invest in goods and services that would significantly improve living standards and productivity. Actual and potential examples include solar lighting and heating systems; mopeds, e-bikes and bicycles; computers and broadband connections; daycare and preschools; and school feeding schemes.

The government and private interests have initiated many such programmes since 1994, but on a limited scale that cannot overcome the shortfall in small business left by apartheid. Scaling them up to the required size would require incomparably greater resources and capacity. Ultimately, it would necessitate a paradigm shift in industrial policy to redefine competitiveness and sustainability. The ultimate aim would be to support small businesses than can survive in the medium term without subsidies, even if they will never break into export markets or replace national and regional imports on a large scale. This redefinition reflects the prioritisation of sustainable inclusive growth over improvements in formal production and profits.

Large-scale expansion in employment and self-employment also needs greater investment in human capital. Above all, that means improved education in working-class areas as well as greater access to quality schools and universities for young people from low-income households. Industrial policy needs to engage more consistently in shaping educational outcomes. The core question is: What skills do school leavers need for employment and self-employment in today's economy? Crucial competencies include facility in languages, especially English as the economic creole; computer skills, which most schools in working-class communities still do not offer; basic mathematics for accounting and production; problem-solving and business operations; and design. Given South Africa's unfortunate history, an effective industrial policy needs to prioritise strategies to fast-track realistic educational reforms to ensure that school leavers, even without matric, have the competencies they need to get a decent job or open a small business. Those reforms have to take into account both teacher capacity and the limitations of the existing education system, without simply accepting either as permanent.

Skills development to enable self-employment also represents a critical step. Industrial policy mandates need to engage more with programmes to expand artisanships and workplace training, and to shape offerings at trade and vocational colleges while upgrading their effectiveness.

Currently there are only inadequate platforms to ensure alignment between industrial policy, general education and skills development. Improving coordination would require systemic changes to ensure adequate consultation between the relevant national and provincial departments and agencies.

Industrial policy measures also have to deal more pro-actively with the impacts of loadshedding. As noted, the critical measure for small businesses is to provide financing for new solar capacity at the level of individual enterprises, commercial and industrial sites and/or municipalities. Industrial policy institutions already have systems to provide financing and technical support, which could take this strategy forward. It could draw on funding available for reducing carbon emissions for the initial outlays in the form of medium-term loans.

Finally, shifting to more inclusive growth requires substantial disruption to systems across the economy as well as to government budgeting and operations. That in turn requires institutional capacity to deal with the inevitable risks, both economic and political. Currently, government procedures aim primarily to minimise risk, especially through the budget process, rather than managing it. In consequence, officials face pressure to downsize or eliminate disruptive programmes, rather than trying to mitigate risks or fix measures that have unintended consequences.

Risk management entails the following:

- Strong systems to evaluate the costs, benefits and risks of policies and programmes in advance, taking into account the differentiated impact on different classes, on the model of the Socio-Economic Impact Assessment System (SEIAS).
- Careful monitoring of programmes to scale them up rapidly if they work and, if problems arise, to fix them rather than simply closing them down.
- An ability to accept that despite such efforts some programmes will fail, without reverting to long-standing but dysfunctional programmes in an effort to avoid visible failures.
- Dispute-resolution systems to deal with contestation and disagreements expeditiously rather than letting deadlocks prevent innovation.

Thirty years after the transition to democracy, South Africa has barely dented the shortfall in small business it inherited from apartheid. That shortfall remains a key factor behind deep inequality and high joblessness. Addressing the deficit requires far more rigorous and consistent intervention to address critical systemic factors left by apartheid, ranging from the dominance of capital-intensive industries to the structure of demand and procurement, to the needs of emerging entrepreneurs for assets, relevant competencies, adequate infrastructure and sites, and mitigation of loadshedding. Disruptive change on the necessary scale is inevitably risky, but it is imperative to shift South Africa onto a path of more inclusive growth.

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