AL Coronel: South Africa is a very important economy in sub Saharan Africa. They have natural resources. They have excellent geographical location. They have a very developed financial system and they are open to the rest of the world.

Bruce Edwards: What happens in South Africa matters not only to South Africans, but to the entire region. Today we look at the IMF's latest assessment of an economy that's so many people depend on.

AL Coronel: When growth is high and sustained in South Africa, all of the rest of the region will benefit from it.

Bruce Edwards: The problem is growth is not high and has been slowing for several years. Our guest today leads the team behind this new report.

AL Coronel: I'm Ana Lucia Coronel, and I am the mission chief for South Africa.

Bruce Edwards: And welcome to this podcast produced by the International Monetary Fund. I'm Bruce Edwards.

Bruce Edwards: So you characterize South Africa's growth slow down as being structural in nature. What do you mean by that?

AL Coronel: Structural in nature. So when we think about robust economic growth, we think of a country combining its different factors of production or inputs in an efficient way so that the economy can produce the goods and services that are needed in that economy. In the most basic fashion, these factors of production are land or natural resources, labor or human capital, and physical capital on technology. So what we see in the case of South Africa is that these factors of production are not combined efficiently. They are combined in a sub optimal way.

AL Coronel: For example, despite the abundance of natural resources, it's hard to exploit them. There are too many obstacles to that. Despite, the abundance of a human capital, wages are too high. So it's difficult to employ these capital. Despite the abundance of financing and technology,

AL Coronel: investment becomes difficult to implement because of the obstacles we see there. And because it's very hard to compete with the incumbents. So as a result of this, what we see is that only few workers can be hired. Only few resources can be exploited. And only some capital investments take place. And this has an immediate impact in the factor productivity of the country, and that's what we mean by structural constraints to growth. South Africa has been having this slow growth for a long period of time and for the last five years its growth has been slower than population growth rate, which is a problem in terms of per capita growth.

Bruce Edwards: And so what should be done to remove some of these constraints to economic growth?

AL Coronel: So what needs to be done is to address these obstacles to have better business environment. And to this end we need to tackle the products markets and the labor market.

AL Coronel: So let me start with the products market. For instance, if a firm wants to invest in mining or in agriculture or in services, it should not be subject to too many regulations, complications, conditions, obligations to do it, because it makes their investment difficult and expensive.

Bruce Edwards: Too much red tape. Is that what you're saying?

AL Coronel: Too much red tape. And in addition to that, there are a few large firms that capture the market in almost all sectors. So they charge higher prices than needed for the goods and services they provide. And in the same way there are a few large banks that finance these large firms. So the smaller and medium sized firms, they have a problem of getting enough financing. Therefore, what needs to be implemented are reforms to remove these obstacles to competition, to streamline regulation, and to allow all firms to compete in a fair way in the economy.

AL Coronel: Now on the labor markets, we have a similar problem that wages do not reflect the productivity of workers. So what we can see is that we have less people employed that there should be, because of the power of large trade unions, which negotiate high salaries for themselves. These high salaries are also transmitted to the rest of the economy. But at the same time you have a large group of people who don't have an employment. Their unemployment rate is 30% and 60% for the youth. So that is why labor market reforms are necessary to allow more flexibility in hiring and fire, and more flexibility in setting wages in accordance to the skills of the people. And then you know, another problem that we have in South Africa is the network industries which are being managed by state owned enterprises, which are not very efficient.

Bruce Edwards: So the report does show that this inefficiency within the state owned enterprises is a longstanding issue and it points to corruption as being at the very root of the problem. So to what extent does this hinder economic development in the country?

AL Coronel: Inefficiencies in a state owned enterprises and corruption really certainly hinders economic development in the country, and it does it through several channels. One of these channels is the cost that these services have. It's a very high cost and this is transmitted to the rest of the economy. So for industries in the economy, they have to pay a high cost for the basic services like electricity and transportation. And another problem is the reliability of the services. As we have seen recently, the electricity company Eskom, has had to get into power outages very frequently. And this, of course, affects the rest of the industry and consumption in the country. And another way in which these inefficient state owned enterprises result in lower growth is through the fact that some of the corrupt officials block entry of more efficient private providers constraining investment in the sectors they operate.

AL Coronel: For example, going back to electricity, while some small power providers are working, Eskom is still a large monopoly and it has an insufficient cash flow to invest in more modern power plants and to move away from outdated coal-based plants that have a high maintenance costs. They break down frequently and they are very bad for the environment. So this is something that needs to be addressed. And another factor which is also very important is the fact that these state-owned enterprises, when they run out of resources, they have to resort to the budgets. So then they need a budget transfers. And these resources which could have been used to other more productive activities including in social sectors, have to be given to these large inefficient enterprises. That has been the case of Eskom in the last 10 years. About 9% of GDP, which is a large figure, has been used for bailouts to Eskom. And the projected amount is something like four and a half percent of GDP for the next few years. So that is something that has a lot of impact on the economy.

Bruce Edwards: So have you seen any tangible efforts on the part of the government to address these issues?

AL Coronel: I think the economic authorities are trying very hard to address these issues, but as in other countries they are facing challenges in trying to build consensus among society and among key politicians to be able to implement these reforms. You know, people want to grow faster and to tackle unemployment, but very few are open to change. More recently we have seen that the economic authorities have stepped up their communication strategy by directly referring in their documents, in their speeches to the urgent need to advance structural reforms to re-ignite growth. So that is very positive. And along these lines they have done some important but small, I would say still, steps to be able to address these issues.

AL Coronel: For example, they have eased some of the visa restrictions for tourism. They have also prepared the ground for starting auctions of broadband spectrum.

Bruce Edwards: So opening the market.

AL Coronel: Opening the market, allowing private sector participation and some private sector participation is already operating in the country. But still there is room to do more. And on labor markets exactly the same, right? There are powerful groups including the trade unions who prefer not to change the way in which the situation is working now. So the authorities prefer to act cautiously to resist pressures from these unions, but they are aware of the need to make the labor market more flexible.

Bruce Edwards: So in the end, this consultation, this most recent economic review of the country, what does it tell you about the direction South Africa's economy is taking?

AL Coronel: Yeah. The direction of the country will really depend on the debt of the reforms and the pace of its implementation. The IMF has been very insistent in providing recommendations, right, going into greater granularity in terms of the structural reforms that need to be taken. And in this occasion of the annual consultation, directors reiterated these messages. Importantly, they're going to make authorities know what to be done and they know how to do it, which is not always the case in every country. So that is a big positive in South Africa. But of course, South Africa's future growth critically hinges on reform implementation to get credibility and we really think time is of the essence in that regard.

Bruce Edwards: So yes, time is of the essence. A couple of years ago, people were very optimistic about the business environment in South Africa. It seems that that optimism has subsided somewhat where business confidence is at the lowest it's ever been. Why is that?

AL Coronel: Well, in a way, yes, it has subsided because after Mr. Ramaphosa's accession to the presidency in February 2018 and particularly after May 2019 when the election took place, market expectations for growth enhancing reforms were very high. However, because of sluggish implementation of reforms and persistent policy uncertainty, these good expectations have not been validated. And as a result, the business confidence is now at around two decades low. I would say this is only marginally better than the lowest register toward the end of the apartheid and during the episode of the large market volatility at the end of the nineties.

AL Coronel: But we have to say that despite these weak domestic confidence, because of favorable global financing conditions, several investors continue to be interested in South Africa particularly to bring their portfolio inflows to the country. So that is a factor that's still helping the economy but is not necessarily going to last forever.

Bruce Edwards: So this is a long list of to do's that we're hearing, but what do you think are the priorities at this stage?

AL Coronel: Yeah, I can think of three or four on maybe all of them have the same importance. The first priority is to exploit the immense potential that the economy has by doing everything possible to ensure growth that will create employment. And we have already discussed what are the measures needed and the policies needed for this growth, but getting consensus for these reforms is key. Another priority is, of course, making sure that these growth should benefit all segments of the population. And for that it's very important to address the inequality existing in the country, which is quite high on date to the time of apartheid. And for these education is a key factor, giving opportunities to the most marginalized is a key factor and there is a work that needs to be done in that regard.

AL Coronel: A another priority and a very important one is to preserve macroeconomic stability. As you may have heard, the debt in South Africa has increased too much and too fast, and it's very important to get it back to a sustainable trajectory. And this is only possible if the fiscal deficit becomes lower by saving in compensation, saving in these transfers to state owned enterprises that we were talking about and focusing this subsidies only on the real people who need them, the poor and nobody else.

AL Coronel: I will just mention a fourth priority. That is to preserve the autonomy and independence of the central bank. The central bank is a very important and efficient institution in South Africa and it's independence has been under threat by politicians. It could be just a threat, but it's very important to preserve these independence, because it's the only way to keep a price stability in the country.

Bruce Edwards: And so do you see the political will to make these things happen? And are you confident that next year the next consultation will show an economy that's moving in the right direction?

AL Coronel: We are very confident that the authorities will take the steps that are needed because these steps will benefit all sectors of society, including those who at the moment are opposing them, because lower unemployment and lower inequality will improve the political dynamics of the country and that will create a virtuous cycle of inclusive growth and employment in the future.

Bruce Edwards: Thank you so much.

AL Coronel: It was a pleasure.

Bruce Edwards: Ana Lucia Coronel heads the South Africa team in the IMFs African department and oversees the writing of the IMFs annual assessment of South Africa's economy. You can read this latest one at IMF.org. Look for more IMF podcasts wherever you get your podcasts. Subscribe if you like what you're hearing and you can also follow us on Twitter @imf\_podcast. Thanks for listening.