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Private Sector Strategy

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PRIVATE SECTOR STRATEGY
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ACRONYMS

BPED	Black Private Enterprise Development Project
BSA	Business South Africa
DBSA	Development Bank of Southern Africa
DTI	Department of Trade and Industry
ECA	Enhanced Credit Authority
EU	European Union
IDC	Industrial Development Corporation
IDRC	International Development Resource Center
IFESH	International Foundation for Education and Self-Help
ISCOR	Iron and Steel Corporation
GATT	General Agreement on Tariffs and Trade
GDP	Gross Domestic Product
GEIS	General Export Incentive Scheme
GNU	Government of National Unity
JSE	Johannesburg Stock Exchange
MTI	Ministry of Trade and Industry
OECD	Overseas Economic Cooperation and Development
NAFCOC	National African Federated Chambers of Commerce and Industry
NAIL	New Africa Investments Limited
NEI	National Economic Initiative
NGO	Non-Governmental Organization
NEDLAC	National Economic Development and Labour Council
NEPA	Ntsika Enterprise Promotion Agency
NEI	National Economic Initiative
NP	National Party
NSBC	National Small Business Council
NPI	New Partnerships Initiative
RAIL	Real Africa Investments Limited
RAND	Rapid Assistance for National Development
RDP	Reconstruction and Development Program
SACOB	South African Chamber of Business
SALDRU	Southern African Labor and Development Research Unit
SBDC	Small Business Development Corporation
SME	Small and Medium Enterprise
SMME	Small, Medium and Microenterprise
USAID	United States Agency for International Development
VAT	Value Added Tax
WTO	World Trade Organization

PRIVATE SECTOR STRATEGY

I Overview

The Government of National Unity (GNU) confronts two daunting challenges -- an economic growth challenge as well as a distribution challenge Despite the fact that South Africa is the largest economy in sub-Saharan Africa, it confronts severe macro-economic structural problems While South Africa's current GDP is $107 billion in 1990 prices, real per capita income today is the same as that in 1966/67 and is 20% less than its peak level in 1981 South Africa's economy is one fraught with contradictions Although considered a first world developed country in terms of GDP per capita, this figure masks vast disparities in the distribution of income, historically along racial lines According to the Central Statistical Services' 1994 October Household Survey, Asians earn 40% (R11,212) of the per capita income of whites (R27,847), coloreds earn 27% (R7,650) and blacks earn only 13% (R3,686) South Africa's economy is characterized by three groupings a "first world" formal large enterprise sector, a formal small and medium enterprise sector, and a "third world" microenterprise economy South Africa's first world economy is dominated by a limited number of white or government-owned or controlled corporate conglomerates which control most industrial and export activities The formal small and medium enterprise (SME) sector is predominantly owner operated and domestically focused The third world economy is comprised of micro and "survivalist" enterprises, where barriers to entry are negligible, firm survival rates are nominal, income is minimal and growth opportunities severely constrained Ownership of these firms is dominated by disadvantaged South Africans (blacks, coloreds and Asians)

II Historical Context and Industry Structure

A Recent Economic History

The economic history of modern South Africa began in the late 19th century and the early 20th century with the establishment of a small number of corporations which had their roots in mining South Africa's large reserves of gold, diamonds, platinum and other natural resources As the mining industries grew and prospered, their profits provided much of the investment capital needed to create ancillary industries and to support the expansion of the major urban centers such as Johannesburg, Cape Town and Durban Until World War II, the majority black population was essentially excluded from the industrialization process with the exception of those blacks who were conscripted into employment in the mines and other industrial establishments Until the 1970s, blacks were prohibited from certain types of business and, until much later, were restricted from owning land outside of certain areas

During The Great Depression, several of the larger and more profitable mining companies bought out the weaker houses, concentrating the wealth from these industries in a small number of family-owned businesses They built up large cash reserves which they used to diversify into industrial ventures, real estate, construction, and financial services, among other industries Numerous, pyramid-structured companies were formed in which these mining giants had direct or indirect control, and in the post-war period, the major mining houses acquired an interest in nearly every sector of the economy Many of them went public and were listed on the Johannesburg Stock Exchange, furthering the concentration of wealth among a small number of entrepreneurial families in South Africa

-The Establishment of Parastatals-

When the Afrikaaner National Party (NP) assumed political control of South Africa in the 1940s, one of its first objectives was to create jobs for its white Afrikaaners contituency The Government's strategy was to develop parastatal organizations in certain sectors where the economy was undeveloped and where government ownership could be strategically important in maintaining political control The South African Broadcasting Corporation was established, for example, not only to provide jobs for Afrikaaners, but also to operate as the propaganda arm of the NP Other parastatals which were established at this time were the South African Iron and Steel Corporation (ISCOR), ESKOM, to deliver cheap electricity to white Afrikaaners, and various transportation firms which were given the monopoly on passenger and freight transport by road, sea and air All of these parastatals employed large numbers of Afrikaaners, and laws were passed to prohibit any possible competition against them By 1970, 27% of economically active whites (mostly Afrikaaners) were employed in government agencies or parastatals [1] Afrikaaners in the business sector were supported through government contracts reserved for white firms

-Early Black Business Development Efforts-

Under the National Party, the isolation of the black community from the economic mainstream was intensified by the apartheid laws enacted in 1948 These laws reinforced racial controls over jobs, business opportunities and access to social resources that had eroded during World War II Blacks were assigned to "homelands" carved out of marginal agricultural land and areas not inhabited by the white population They were allowed in urban areas, which were reserved for whites, solely to serve white employment needs Over time, shanty towns grew up just outside city lines as blacks set up temporary "squatter" facilities to eliminate the long commutes to the "homelands "

In the early 1960s, the homeland development corporations were established to create sources of income for blacks living in their designated homelands These corporations had little, if any success, despite attempts to finance small, medium and microenterprises (SMMEs) and offer entrepreneurship training The half-heartedness of their efforts, combined with the

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[1] Merle Lipton and Charles Simkins, "Introduction," in State and Market in Post-Apartheid South Africa, Merle Lipton and Charles Simkins, eds (Johannesburg, South Africa, Witwatersrand University Press, 1993), p 6

abysmal infrastructure and lack of inputs and markets, led to very few viable SMMEs At best, the homeland corporations' contribution may have been the development of basic infrastructure which essentially furthered the aims of apartheid

Until the early 1970s, blacks were forbidden from establishing businesses, with the exception of small convenience stores within the townships and homelands They could not own more than one business or form corporate or partnership structures to support larger business ventures In addition, laws blocked the creation of black-controlled financial institutions, manufacturing facilities, or distribution businesses in white areas Morevoer, blacks were expressly forbidden to participate in technical training programs which might have qualified them for technical jobs Those few blacks who were able to obtain post-secondary school education were generally relegated to teaching in the black communities, preaching in black churches, or serving the black community exclusively

The parastatal Small Business Development Corporation (SBDC) was created in 1981 to assist small and medium sized businesses to develop and thrive in specially constructed "hives" which provided access to a variety of technical assistance, low interest rate loans and loan guarantees Its capital base was originally 50% government appropriations and 50% private shareholdings from the major corporate conglomerates, but after 1986 the principal source of funding was from government The SBDC achieved only limited success in the black community, since its lending criteria, including collateral requirements, were usually too stringent for most small and start-up firms Thus, the SBDC, despite its lower lending rates made possible by appropriated funds for its capital base, has principally served the non-black small and medium sized formal business community, rather than the black SME sector

A variety of other sources of credit provided by NGOs and small indigenous organizations arose in the 1980s in response to black businesses' demand for investment and working capital The Development Bank of Southern Africa (DBSA) was created in the early 1980s to wholesale economic development funds throughout southern Africa, with particular emphasis in the early days on the homeland areas, notably for housing and infrastructure development After the economic boycott began in the mid 1980s, U S private organizations and the United States Agency for International Development (USAID) began to provide funds that were used, in part, to assist black business development, including access to credit In general, however, most of the small black businesses that began in the 1970s and 1980s were severely constrained in their access to capital on commercial terms, experienced, successful black businessmen were forced to personally guarantee their bank loans and to repay them in half the usual time in order to qualify for working capital credit

-The Growing Economic Costs of Apartheid-

Since blacks were legally forced to live far from their places of employment, the Government subsidized the operating costs of those companies that were transporting commuters to and from work Over time, these companies allowed their operating costs to escalate, particularly after the cost of petrol increased in the 1970s, higher subsidies and higher fares were required to close the gap Seizing the opportunity, many black entrepreneurs went into the taxi business and provided commuters with an alternative transport method that was both cheaper and more convenient than the bus companies As state-sponsored entities restructured their operations in the 1980s to compete with the taxis, they laid off hundreds of workers, thereby contributing further to unemployment

Another example of the economic costs of apartheid can be seen in the establishment of the so-called "border industries" at the edge of the black homelands These white owned companies were provided with subsidies in the form of wages, rent, relocation expenses and lucrative tax incentives The total cost of these subsidies grew substantially as many business owners took advantage of them, and in some cases, abused them

By the 1970s, black militancy and the high costs of maintaining racial, geographic, and economic segregation began to erode the NP's political solidarity underlying the apartheid system By the late 1970s, job restrictions on the basis of color were loosened, black labor unions were given the right to organize, movement controls on blacks were liberalized, and blacks were allowed to own property and establish formal businesses of any size As a partial consequence, the real wages of black workers doubled and those of white workers declined While the absolute levels of white and black wages remained far apart, the ratio of white to black wages decreased from 5 5 to 1 in 1972 to 3 9 to 1 in 1980, and to 3 1 to 1 by 1989 [2]

As the 1980s approached, the white South African corporate establishment, which had been relatively healthy throughout the 1960s and 1970s -- despite growing black unemployment -- began to feel the pain of the country's increasing economic isolation The small number of major white corporations that controlled most of the economy continued to exercise monopoly control in their respective sectors Constrained by foreign exchange controls imposed in 1983 which restricted capital outflows for overseas investments, these firms' profits were used to acquire vertically and horizontally-integrated subsidiaries and to establish financial pyramids which further extended economic control in the hands of a very small number of firms

The NP government also expanded its protectionist program for domestic firms implementing the government's import substitution policy originally instituted in the 1920s Tariffs and quantitative controls were intensified after World War II as a way to protect South Africa's burgeoning industrial sector, which was already suffering from the inefficiencies of monopolistic parastatals After international sanctions intensified in the mid-1980s, the NP government also imposed import surcharges ranging from 5% to 40% to compensate for the balance of payments deficits stemming from the loss of overseas markets

Since the parastatals continued to operate as monopolies, they were generally inefficient,

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[2] Ibid , p 8

poorly managed, and dependent on growing state subsidies to survive It became increasingly difficult for the government to justify the expense of keeping them in operation To curtail the budgetary burden, in the early 1980s a number of the parastatals were sold or commercialized, i e spun off to be operated on a profit-making basis ISCOR was privatized in 1989 by selling shares to the public through a traditional underwriting arrangement, with managers and workers receiving preferential shares However, the government-owned Industrial Development Corporation (IDC) continued to hold 300 million share of ISCOR, as well as millions of shares of other "privatized" parastatals [3]

One effect of its protectionist policies has been to further isolate South Africa from the technological changes being adopted by other advanced countries As South Africa continued to fall behind the technological curve, its industrial productivity began to decline, leading to greater inefficiencies in production and a further erosion of its international competitive position White workers' wages remained high, despite relatively low productivity, reflecting the growing shortage of skilled white workers in the manufacturing sector and creating the impetus to place much lower paid black workers into these positions High transport costs and high tariff rates combined with these other factors to produce relatively inefficient, high cost, and internationally uncompetitive products Inflation eroded the value of the rand, and foreign exchange earnings dropped as the prices of South Africa's major exports declined relative to those of imported manufactures

As the boycotts continued and subsidies increased, GDP stagnated in the late 1980s Real per capita income declined due to flat economic growth and a substantial increase in the size of the black population Many foreign companies disinvested from South Africa, further depressing the economy Between 1984 and 1992, for example, 218 U S firms withdrew from South Africa, reducing the value of U S direct investment in the country to approximately $700 million, down almost $2 billion from the 1981 level [4] In 1987, South Africa experienced a negative net outflow of foreign direct investment capital for the first time

Despite its wealth, and its general lack of dependence upon foreign capital for domestic investment, the white, English-speaking business community finally realized that the political environment in South Africa would have to change if the economy was to reverse its decline A comprehensive business coalition known as Business South Africa (BSA) was formed, and negotiations with the De Klerk government began in earnest for a politically and economically unified South Africa

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[3] W Duncan Reekie, "Should South African Parastatals Be Privatised?" Ibid , pp 131-132

[4] J Daniel O'Flaherty, "Doing Business in South Africa", Ibid

B Industry Structure

For conceptual purposes the private sector in South Africa can be divided into three distinct categories the large scale industrial sector, the formal SME sector, and the informal micro and survivalist sector The first two categories operate within the rubric of the "first world economy", and comprise both outward and inward looking groups of firms The last category fits within the informal "third world economy", and is focused principally on the domestic economy Each of these groups is described briefly below

1 The Formal "First World" Economy The Large Scale Industrial Sector and the Formal SME Sector

The Large Scale Industrial Sector South Africa's "first world" economy is dominated by a small number of white or government-owned or controlled corporate conglomerates which control most of the industrial and export-oriented sectors of the country, plus a large number of small and medium sized firms which are principally owned by whites, coloreds and Asians Many large firms are exporters, particularly among those in the mining, energy (chemical products), and agribusiness sectors Banking and insurance are also dominated by a few large players Although the large private companies are often multinationals, they have little or no foreign capital invested in them, since the divestiture and disinvestment of the 1980s, foreign investors have only a nominal stake in the South African economy today

At the present time, most blacks still remain at the lower end of the spectrum with fewer than 100 black owned medium to large businesses However, opportunities for broader participation by blacks in big business are expanding rapidly, either through more diversified shareholding, broader experience, a greater range of training programs, and/or financial and management support from outside investors

The Formal SME Sector Medium sized businesses, defined as employing from 50 to 200 employees with gross sales not exceeding R10 million, are still owner-operated or controlled in South Africa, although shareholding may be broader than just the owner and his family Unlike the larger companies, but similar to small enterprises, many of these firms still face obstacles and constraints to expanding their business activities In most cases, medium sized businesses are producing for the domestic market, although with adequate information and assistance, some of them could become exporters

According to the Ministry of Trade and Industry, small businesses, employing from 5 to 50 workers, comprise the bulk of established businesses These firms are generally owner-managed or directly controlled by the owners, and operate in an established business or industrial setting in compliance with formal registration requirements It is difficult to classify these businesses by the size of their assets or annual gross revenues, given the wide disparity in the sector

Whereas most of the large corporations are public companies, with multiple sources of capital, many of the small and medium sized enterprises in the formal sector depend upon loans from domestic financial institutions or on the shareholdings of partners and local corporate owners There are no SMMEs listed on the Johannesburg Stock Exchange, and there are no other markets, such as the NASDAQ, to intermediate public ownership of small firms

2 The Informal "Third World" Economy The Microenterprise and Survivalist Sector

The "third world" economy is comprised of microenterprises, "survivalists" and a few small companies owned by the majority black population Their business investment consists of the sweat labor of the individual owners, his/her family members and friends Any additional working capital is usually obtained from a *stokvel (group loan scheme)* or a non-governmental organization (NGO) that has set up a special credit program for microenterprises Within the informal economy, barriers to entry are minor, access to inputs and markets is difficult, competition is rampant, and profits are low Firms emerge, die and re-emerge

Survivalist enterprises are defined as "activities by people unable to find a paid job or get into an economic sector of their choice Income usually falls far short of even a minimum income standard, with little capital invested and only limited opportunities for upward growth into a viable business Poverty and the attempt to survive are the main characteristics of this category of enterprises "[5] A tiny percentage of the survivalists will evolve into microenterprises and perhaps grow even beyond that point as some of these unregistered and unregulated activities become the seeds for more significant firms

In contrast, microenterprises are very small businesses which usually operate "informally," that is without business licenses, value added tax (VAT) registration, etc They are almost always owner-operated and rarely have more than two or three other employees Earning levels vary widely, with many exceeding minimum income levels Some of these expand into legitimate small businesses

Statistics that neatly divide the microenterprise sector into its components are not available A widely quoted Small Business Development Corporation report published in May 1994 provides an excellent overview of the size and relative importance of the overall SMME sector in South Africa's economy In 1993, fully 84% of private sector jobs -- employing 42% of the economically active population -- were in the SMME sector, 72% were located in micro and small enterprises found in both the formal and informal sectors Although exact

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[5] Department of Trade and Industry, National Strategy for the Development and Promotion of Small Business in South Africa, White Paper of the Department of Trade and Industry, (Pretoria, South Africa, Government Printer, February 1995), p 9

measurements are difficult to provide, the 800,000 SMMEs, including those in the informal sector, were estimated to contribute between 37% and 46% of South Africa's GDP that year Of this total, the informal portion of the SMME sector, which reportedly employs 1 9 million people (1 4 million of them non-whites), is estimated to contribute approximately 6-8% of GDP

The importance of SMMEs goes beyond these indicators The declining ability of the formal economy to absorb new entrants into the labor force (from 80% in the mid-1960s to 8% in the early 1990s) has led to a ballooning of the microenterprise/informal sector Most of these newly created enterprises are survivalists and opportunists, but their contribution to short-term employment and relative social cohesion is hard to dispute They fill tiny niche markets for the provision of rudimentary transport, food and groceries, entertainment and basic repair services Microenterprises are also the economic entry point for many women, especially those in rural areas

III Description and Analysis of Key Constraints to Growth and Opportunities for Realizing a Better Life for the Majority of South Africans

A Growth Resource and Policy Constraints Inhibiting Economic Expansion

The South African economy, despite its size and dominance within sub-Saharan Africa, has been on a downward spiral for several decades Growth rates of 5% to 6% in the 1960s slowed to 3% to 3 5% during the 1970s and to 1 5% during the 1980s Indeed, the basic growth rate for real GDP has declined from 6 3% for 1960-1965 to 0 8% for the 1981-1994 period This downtrend in aggregate growth inevitably has impacted real per capital GDP which grew until 1981 and then began its current decline to R6,832 or US$ 2,641 in 1994, corresponding to the level in the mid-1960s and 20% less than its 1981 peak With population growth of 2 5% per annum, and an assumed GDP growth rate of 3-4%, it will take 50 years to double incomes The resumption of higher, sustainable growth is necessary not only to redress the unemployment problem in South Africa,[6] but to provide expanded income for all South Africans, regardless of race It is only through increased growth that the expanded resources will be available to redress the economic and social legacies of apartheid

During the sanctions period, the South African economy confronted negligible competition from outside the country, with few opportunities for exports or investing abroad This political situation helped to focus investment and wealth in a small segment of the population in highly protected industries This inward-looking policy of protective barriers for domestic

[6] Of the approximately 14 3 million economically active South Africans, about 54% or 7 7 million are in formal employment, 1 9 million or 13 4% are in the informal sector and 4 7 million or 32 6% are unemployed (Central Statistical Service, October Household Survey 1994, 1994)

markets and incentives for development of capital intensive "strategic" industries identified by government (including oil extraction and chemical industries) resulted in inefficiency, low productivity and low employment demand The current slumping economy is a result of these past policies which have created significant structural problems Excessive import substitution, deteriorating labor relations, factor price distortions in favor of capital, trade sanctions and a lack of investment in human capital through education and training have resulted in an industrial sector known for its poor productivity and mediocre growth With a diminishing domestic market and an economy that is currently not internationally competitive, the need to address these structural constraints is critical to ensure aggregate growth to facilitate the political imperative of increased equity in the distribution of income and wealth in South Africa

One of the key structural problems contributing to the current economic growth scenario relates to **productivity and factor utilization** (the choice of inputs to production) While South Africa's growth rate has returned to positive levels, the economy's excess capacity could quickly be eliminated either reducing the growth rate of recovery, or placing inflationary pressures on the economy with the anticipated response of monetary authorities to tighten available credit Growth has largely been driven by the expansion of capital usage rather than growth in productivity Since 1980, factor usage increased 109% while productivity declined 9% From 1960-1970, expanding use of labor was the principal source of growth in output Since 1970, however, the importance in the growth of capital stock to increased output has been significant As a result, the labor-capital ratio in general production has declined by 40% to 45% since 1960, contributing to the unemployment problem Not only has there been a significant shift in the utilization of capital versus labor, but the productivity of capital utilized has decreased, as shown in the capital-output ratio These imply that a greater level of net investment is now required than in the 1960s to create an equivalent increase in income and/or employment This points to the imperative to expand the financing of investment to expand the economy Since 1980, an increasing share of investment has been used to maintain the existing capital stock (depreciation), resulting in only 4 3% of GDP or 24% of gross domestic investment being invested in new or expansion activities Similar patterns are evidenced in savings rates from 1981-1990, net domestic saving remained less than 10% of GDP and since 1990, has been only 5% of GDP Increasingly, government budgetary deficits have been a drain on savings

Despite declining capital productivity and a seemingly large labor pool, unemployment continues to grow The structural problem of the **labor market** and the costs of labor, have created a situation wherein the relative costs of capital and labor have continued to favor increased use of capital Historically combative and immersed in the "culture of protest", the employment of unionized labor has been a deterrent to foreign investors accustomed to more conciliatory labor relations While union activity continued to increase real wage rates from 1979-1990 for the historically disadvantaged population and helped to close the racial wage gap, this occurred despite periods of economic slowdown Importantly, labor costs throughout the period from the mid-1970s through 1993 increased relative to non-gold export prices Magnifying the seeming inflexibility of wage rates to general economic conditions, employers' dependence on capital over labor may be most related to the low level of returns from employing disadvantaged South Africans due to low skill levels institutionalized by the discriminatory "Bantu" (African) education policies of the apartheid government Despite the significant gains made since 1991, in 1994, only 45 6% of blacks 14 years or older had completed Standard 6 (equivalent to the American 8th grade), compared with 64 0% for coloreds, 81 4% for Asians and 89 7% for whites [7]

A major barrier to economic growth and manifestation of structural problems in the economy is the economy's lack of **competitiveness** According to a recent report on the Reconstruction and Development Program (RDP) published by the Consultative Business Movement, South Africa was ranked 35th out of 41 countries in 1994 with regard to its international competitiveness in world markets [8] South Africa was one of the first countries to adopt an import substitution strategy to achieve industrialization,[9] and has maintained a protectionist, insulated economy for more than 70 years Consumer goods are most protected, followed by capital and then intermediate goods By sector, manufacturing is most protected, and agriculture is second (quantitative restrictions compound tariff barriers), mining, a sector where South Africa has a natural comparative advantage, is least protected The complexity and opaqueness of its protectionist regime are due to a variety of mechanisms

- all types of tariffs (ad valorem, specific duties, formula duties, and combinations, etc),
- frequent changes in tariff rates in response to requests from business,
- the use of import surcharges, and
- combinations of tariffs and quantitative restrictions (limited to agricultural products and textiles) [10]

In addition to barriers against imports, South Africa has an implicit anti-export bias

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[7] Southern African Labour and Development Research Unit, Project for Statistics on Living Standards & Development Survey (Cape Town, South Africa, University of Cape Town, 1994)

[8] Ranking was in the 1994 OECD report on World Competitiveness reported in Business Day on 6 September, 1994, and cited in Consultative Business Movement, Building a Winning Nation Companies and the RDP, (Johannesburg, South Africa, Ravan Press (Pty) Ltd, 1994), p 48

[9] Pedro Belli, Michael Finger and Amparo Ballivian, South Africa A Review of Trade Policies, World Bank Informal Discussion Paper on Aspects of the Economy of South Africa, No 4, (Washington, D C , World Bank, August 1993), p 2

[10] Ibid , p 16

Imperfect markets at home encourage producers to sell in domestic markets where prices tend to be higher than they would be if a free market existed Secondly, many inputs for export products are imported, and, therefore, subject to customs duties To counteract these disincentives, South Africa uses "export development assistance" schemes such as duty rebates, duty drawbacks and various forms of export subsidies A uniquely South African scheme known as the General Export Incentive Scheme (GEIS), introduced in 1990, provides a tax free subsidy to exports based on the extent of processing, the local content of the export and the rand value of the export [11] GEIS will be phased out as South Africa conforms to the requirements of the World Trade Organization This could rekindle the country's anti-export bias unless structural changes are made to enhance the competitiveness of South Africa's manufacturing sector [12]

In the consumer goods sector there is evidence that protectionist measures -- a combination of quantitative restrictions on imports and high tariffs -- have contributed to high domestic prices for many of these products Price levels may also be affected by restrictions on the number of firms producing certain goods and services in order to protect state-owned suppliers

A recently released study, commissioned by the National Economic Forum proposed a set of "imperatives" necessary to make South Africa globally competitive This study, conducted by Monitor, a respected international strategy consulting firm founded by Harvard Business School profession, Michael E Porter, concluded that a dramatic overhaul of the country's "rusty and outdated" economic engine was required In nearly every sector researched, identical products were being manufactured at significantly lower cost or higher quality by firms in other countries Many industries survived in South Africa only because of protection and subsidy The study blamed South Africa's poor competitiveness on factors including lack of rivalry among firms, government bureaucracy and poor work organization leading to inefficient productivity

Examples include the automobile industry, the steel industry, the sugar industry and the textile industry The price premium for vehicles in South Africa currently costs consumers R4 billion to R5 billion per year Competition between seven automobile manufacturers keeps prices on smaller vehicles well below the level of import parity, however, retail mark-ups of 17% and little competition on price at the retail level ultimately hurt the local automotive consumer Further, quality control techniques are lacking in the automobile industry resulting in excess of 350 defects per 100 vehicles compared with 50 per 100 vehicle in Japan Despite the lower labor cost per hour in South Africa for vehicle assembly (\$5 60 vs \$6 00 in Mexico and \$38 00 in the U S), low labor productivity eliminates this advantage (it takes 63 5 labor hours to assemble one vehicle in South Africa, compared with

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[11] Ibid , p 18

[12] Ibid , p 25

24 3 hours in Mexico and 18 56 hours in the United States) Low rivalry in metal products allows ISCOR to maintain a substantial price premium over imported steel While ISCOR is a globally competitive producer, according to the Monitor study, this advantage is eliminated by transport costs to the coast and to external markets Without the General Export Incentive Scheme (GEIS), the export subsidy provided by government, ISCOR's position falls behind most European producers South Africa's sugar price is twice the world price of R956 per ton, however a tariff of R815 per ton on imported sugar provides effective protection to local producers South Africa's textile prices are the highest of eight world countries surveyed, mainly due to high raw material and conversion costs, resulting from a lack of strategic focus, poor work skills, outdated machinery and poor work organization Throughout the economy are examples of where high input costs, high conversion costs and high systems costs have resulted in a high relative cost position and/or poor quality and non-competitive products Heavy protection has created a government-orientation rather than a consumer-orientation for most firms

The structure and implementation of tariff protection, as a mechanism for isolating and protecting domestic industry deserve mention While on aggregate, simple tariff based protection is average for developed countries, effective protection afforded through tariffs, quantitative restrictions, and other regulations is quite high Protection from international competition is in part ensured by a highly complex and differentiated system of tariffs, with 2,865 classes of items with tariffs ranging from 0% to 1,389% The average nominal rate of 28%-29% is average for developing countries, although high for developed countries, however, the actual rate based on collections is 9 2%, probably caused by the complexity in accurately administrating the tariff rates These averages mask the high degree of protection afforded to certain classification of goods, notably textiles, apparel and leather products and non-metallic minerals It appears that tariff protection serves as an effective barrier to entry in selected industries and potentially others should collection rates begin to approach their respective statutory rates

While South Africa has suffered from extremely low rivalry as a result of protectionism, subsidies and geographic and political isolation, the Ministry of Trade and Industry has recognized the critical need to alter South Africa's competitiveness profile and has declared the days of industrial protection "dead"

In addition to addressing tariff protection, the structure of ownership contributes to the competitiveness problem This structure is characterized by pervasive conglomeration and the potential for collusion According to <u>South Africa and the World Economy in the 1990s</u>, the practice of "conglomerate forbearance", agreement to refrain from vigorous competition in a given market for fear of retaliation in an unrelated market, is illegal but appears widespread This is reinforced in the pyramid structure of many of the large industrial conglomerates and the proliferation of interlocking directorships Price collusion is evidenced in the cement industry, among others, where four firms are allowed to collude in establishing prices and quotas

Industrial concentration is a potential deterrent to both domestic and foreign investors Approximately 75% of the equity traded on the Johannesburg Stock Exchange is controlled by the major South African economic houses through pyramid structures and interlocking corporate boards (These major stakeholders include Anglo American, Anglovaal Industries, the Rembrandt Group, SA Mutual, Sanlam, and Liberty Life)

A combination of legally sanctioned monopolies for state-owned corporations, "bundled" corporate conglomerates, and protectionist trade barriers has been both the cause and effect of South Africa's relatively high cost economy These arrangements have restricted market entry and led South African consumers to pay higher prices than would have occurred in a more competitive marketplace They have also maintained corporate ownership within a small cohort of the white community and, with few exceptions, have served to exclude blacks from their ownership and managerial ranks An analysis by McGregor Information Services shows that 114 of the 644 listed companies (18%) on the Johannesburg Stock Exchange (JSE) do not have a public shareholder spread of 10%, the minimum required under new listing rules issued in June 1995 [13] The poor public shareholder spread is a reflection of the limited involvement by small and to a lesser extent foreign investors on the stock exchange In April 1995, the four largest bank nominee companies alone held R175 billion of the JSE's market capitalization It is hoped that the new listing requirements, to become effective in the year 2000 for currently listed securities, will bring JSE standards in line with international exchanges, and importantly, to promote broader economic empowerment

There is growing debate within South Africa regarding the future of these institutional and corporate arrangements While there is unanimity regarding the need for privatization and/or commercialization of all of the parastatals, some representatives of the black business and political community would like to see the parastatals privatized in such a way that the rank and file member of the black community can became shareholders in the restructured firms Various proposals have been put forth which would create "trust funds" or other types of financial funds which could loan capital to blacks for investing in South Africa's equity structure or hold shares in trust for certain disadvantaged groups Efforts of this type have meritorious political value and are worth exploring in greater detail

With respect to unbundling the privately held cartels, some sales have already been effected to black consortia and other such spin-offs are under negotiation The issue here is whether this type of unbundling will ultimately improve the competitive nature of the economy or simply maintain the current oligopolies with a broader -- albeit more representative -- ownership Blacks are beginning to take larger financial positions, if not managerial and operational control, in large enterprises These include the new black pyramids such as New Africa Investments Limited (NAIL), Real Africa Investments Limited (RAIL) and the like, as well as the black-led financial houses like Thebe Investments and Kagiso Trust Investments

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[13] The new listing requirements considerably ease access to the JSE for "development" entities by relaxing admission standards for the venture capital and development sectors

To date, those playing in this field represent a tiny, but growing fraction of the black business community

Two other aspects of South Africa's tightly controlled corporate sector must be considered First, breaking up the pyramids and/or privatizing the parastatals is not likely to have any effect on SME development, per se Targeted policy interventions geared towards affirmative procurement and other backward linkages into the SME sector will be as relevant to an unbundled corporation as to a corporate conglomerate, unbundling is not likely to create a more favorable climate for SMEs than any other corporate organizational structure -- or, for that matter, to create new jobs

On the other hand, unbundling and privatization may yield positive advantages with respect to innovation and introduction of technological change These changes, in turn, can contribute to production efficiencies and, potentially downstream, to export-led growth and job creation If unbundled and/or privatized firms are more attuned to efficiency, which is likely to be the case, then they will be more receptive to investments in technological improvements This would enhance the export competitiveness of South African production and provide a boost to the economy In addition, foreign investors will be more interested in South African investment opportunities if barriers to entry and the likelihood of gaining a share of the market are more favorable Over time, therefore, unbundling and privatization will yield new vitality in the economy which will ultimately translate into new jobs and higher incomes for the majority population

Another potential deterrent to foreign investment is the **tax structure** As a result of sharply rising government expenditure in relation to gross domestic product over the past two decades, the overall tax burden has risen sharply While the rate of corporate tax has been reduced, it is not particularly competitive by international standards, while direct personal tax payments have risen sharply in relation to personal income, contributing to both a sharp fall in personal shavings and slower growth in real private consumption expenditure

Overall, major challenges lie ahead in promoting economic growth in South Africa While in the past, the economy was dominated by import substitution strategies, a limited number of primary export commodities and an inward-looking focus, the need to look to international markets and diversify its exports into value-added products is imperative, given the domestic growth projections, population growth rates and desire to redress unemployment and declining real incomes in South Africa The transition to an outward looking focus and an internationally competitive economy will require major structural changes in the economy As documented in a 1991 South African Chamber of Business (SACOB) study, the cost of manufacturing in South Africa is approximately 15% greater than the average OECD country Contributing factors are capital costs (South African manufacturing industry needs 66% more capital, with a price twice that of the OECD countries to produce the same amount of wealth), labor costs (South Africa uses 4 employees to produce the same amount of wealth as 1 employee does in Germany and those 4 employees cost 47% more than the 1 employee in Germany), and materials costs (inputs from the manufacturing sector are approximately 24% more expensive than those available to manufacturers overseas)

While there is no one solution to this critical problem, a new industrial paradigm for South Africa must be developed, including potential interventions such as privatization to encourage greater competition to reduce price cross-subsidization, government resistance to industrial lobbying, reduction in transport costs, reduction in industrial complexity (unbundling), skills development and new organizational priorities including greater use of teams, tariff reduction and the phasing out of export subsidies to level the playing field among global competitors Domestic rivalry plays a critical role in achieving international success by serving as a stimulus to innovation and upgrading in an industry Crucial components of competition are high and rising levels of capital, labor and management productivity in all activities

The signing of the GATT agreement will contribute to turning South Africa from a largely inward-looking to a competitive outward-looking economy However the government faces the critical challenge of formulating and implementing policies which will assist in the creation of an internationally competitive labor-absorbing economy which grows rapidly enough to generate sufficient tax revenue to fund government programs to redress socio-economic problems instituted and nurtured during the apartheid era

South Africa's ability to achieve the kind of rapid economic growth essential for significantly enhancing the economic and social status of the majority population is directly dependent upon its success in attracting foreign direct investors with new technologies and competitive strategies which can broaden its exporting base and strengthen its international competitiveness in traditional export products Despite the existence of an overcapitalized economy that uses insufficient amounts of labor to inefficiently produce goods for markets where it has oligopolistic power, potential exists for sustained economic growth, given the availability of labor, capital and the level of infrastructure development The keys are opening the economy to competition, upgrading the skills of the labor force and enhancing levels of productivity throughout the economy These will help attract the foreign investment necessary for South Africa's growth

B <u>Equity</u> Resource and Policy Constraints Affecting Distribution of Wealth

The reference to a first world economy and third world economy in South Africa are euphemisms for the degrees of inequity in social, political and economic arenas While political participation has been greatly enhanced with the establishment of a majority government in South Africa, social and economic disparities along racial lines are still very evident Measures of economic equality or economic participation, including employment, managerial employment, business ownership and other forms of asset ownership, are in large part products of inequities in the social, political and economic arena

Quality of life indicators show huge discrepancies among racial groups in South Africa Infant mortality rates are seven times higher for blacks (54 3) than for whites (7 3), the disposable income of whites (R27,847) is seven times that of blacks (R3,686)[14] and literacy (as measured by the percentage of people 14 years or older who have completed Standard 6) is twice that for whites (89 7%) as for blacks (45 6%) The Human Development Index, a composite measure of literacy and schooling, longevity and income is 878 for whites and 462 for blacks Not unexpectedly, nearly 100% of whites live in western dwelling compared with 46% for blacks, 90% for coloreds, and 93% for Asians, with 28% of blacks living in shacks or traditional dwellings[15]

Measures of economic empowerment repeatedly confirm the degree of inequity among racial groups Blacks dominate the ranks of the unemployed with 41% of economically active blacks unemployed, representing 87% of the total unemployed in South Africa [16] Not unexpectedly, blacks dominate the informal sector, occupying 69% of the informal positions, both as survivalists and microentrepreuneurs While this sector has been responsible for generating 13 4% of the jobs among the economically active population, or a quarter of the jobs generated by the formal sector, it contributes nominally to the economy as a whole, only 6 7% according to the October Household Survey Therefore, in order to provide overall economic growth, black entry into the formal sector is critical

While the wage gap between blacks and whites of the same sex on similar jobs is closing -- from 40% in 1976 to 24% in 1985 and 11% in 1992, there remains a disparity in the quality of jobs occupied by blacks The "glass ceiling" for black employment is currently at the office clerical level With regard to top management, blacks occupy fewer than 4% of corporate directorships and only 3% of the managers surveyed by the Breakwater Monitor were blacks [17]

With regard to ownership, blacks are concentrated in those sectors in which barriers to entry are lowest -- wholesale and retail trade (especially in the informal sector), catering and accommodation, community social and personal services (especially in the informal sector), construction, transport, storage and communications They are vastly under-represented in finance, insurance and business services, among the fastest growing sectors of the economy 288,000 blacks are self-employed in the formal sector or 6 1% of the total number of blacks employed in the formal economy and 1,010,000 blacks are self-employed in the informal

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[14] Central Statistical Service, October Household Survey 1994, (Pretoria, South Africa, Central Statistical Service, October 1994)

[15] Southern African Labour and Development Research Unit, Project for Statistics on Living Standards and Development Survey, (Cape Town, South Africa, University of Cape Town, 1994)

[16] Central Statistical Service, op cit

[17] Breakwater Monitor, (Cape Town, South Africa, Graduate School of Business, University of Cape Town, March, 1994)

sector, representing 89 5% of the total number of blacks employed in the informal economy According to the Project for Statistics on Living Standards and Development Survey, of those household members from disadvantaged groups involved in SMMEs, it was found that 59 1% were involved in survivalist activities, 38 5% were involved in microenterprises and only 2 3% were involved in small enterprises Women dominated in the survivalist category, with incomes below the minimum income level

With regard to other asset ownership and participation in the formal financial economy, of the 22 million adult South Africans identified during the 1994 election, 10% had checking accounts, and 15% had credit cards Twenty five percent of blacks in urban and metropolitan areas owned their own homes in 1994 (58% of blacks live in urban areas) while 74% of the blacks in rural areas own their own residences According to the All Media and Products Survey, 1994, 26% of adult blacks have savings accounts , 0 8% own investments, 4 4% own whole life policies, 1 7% are entitled to a retirement annuity or personal pension policy and 11 4% of black households own motor vehicles

C Constraints to SMME Growth Barriers to Greater Vertical Integration of SMMEs into the Economy

These statistics confirm that the legacy of the apartheid system remains a serious barrier toward the inclusion of the majority population into the economic mainstream While a sluggish economy can be blamed in part, the lack of investment in historically disadvantaged human capital is a key factor, as are the lack of access to capital, inadequate premises and marketing problems Given that blacks dominate the ranks of the unemployed (87% of the unemployed are black), and the high labor absorptive capacity of the small business sector and the relatively low average capital cost per job created in this sector, it is necessary to examine the specific constraints facing the small business sector

The small business sector in South Africa has been neglected during much of the 20th century following the discovery of diamonds and gold, and the establishment of a modern capitalist economy with almost exclusive white control Given South Africa's legacy of big business domination, constrained competition and inequitable distribution of income and wealth, the small business sector is seen as an important force to generate employment and more equitable income distribution, to activate competition, exploit niche markets both domestically and internationally, enhance productivity and technical change and in the longer term, stimulate economic development Micro and small enterprise has characteristically been the entry point for blacks, and notwithstanding the importance of creating opportunities to grow into medium and larger scale businesses, the SMME sector has and can be an important vehicle for black economic empowerment

Constraints on SMMEs, compared with big business in South Africa or the small business sector in other developed and developing countries have been particularly harsh Previous disabling legislation included the Black Land Act of 1913 and the Development Trust and Land Act of 1936 which prohibited blacks from acquiring lack outside designated areas, the

Blacks Consolidation Act of 1945 and the Blacks Act of 1952 which restricted freedom of movement, the Group Areas Act of 1966 which restricted ownership of land and premises, the Labour Relations Act which restricted job access, and "Bantu" education which institutionalized an inferior system of education for blacks The legacy of apartheid effectively deprived the majority of South Africans of viable business opportunities because

- "Bantu" education restricted opportunities for the acquisition of technical and professional skills by blacks and there was a total absence of entrepreneurial education or a culture of entrepreneurship for blacks,

- potential black entrepreneurs were prevented from participating in business apprenticeships outside of the homelands and partnerships with more established non-black owned enterprises,

- the Group Areas Act enforced racially segregated residential areas, thereby uprooting millions from their places of residence and business, while segregation increased the distance between black residential and working areas, thereby increasing the cost of doing business,

- the curtailment of property ownership rights of blacks severely restricted blacks' ability to obtain financing based on collateral, it also excluded blacks from the long-run process of capital appreciation in property and share prices, and

- apartheid particularly restricted the business involvement of black women because marriage laws left women with no contractual capacity, and while marriage laws have changed, customary law and cultural and behavioral biases as well as restrictions in terms of access to land severely hinder women's capacity as businesspersons

While many of the pillars of apartheid have been eliminated, constraints remain relating to the access to markets, finance and business premises (at affordable rentals), the acquisition of skills and managerial expertise, access to appropriate technology, the quality of business infrastructure in poverty areas, and the legal and regulatory environment confronting SMMEs These constraints have been particularly harsh on entrepreneurs in rural areas and on women While the micro and survivalist enterprise are least able to cope with the constraints linked to finance, market access and acquisition of skills, small and medium scale entrepreneurs are confronted with problems including international competition, technology transfer and skills training

In order to equalize the **technical and professional skills** of blacks with that of the white population, there is the need for literacy training, basic education, managerial and business training and technical training, from the lowest levels of specialized vocational training to the highest levels of university education In-firm training and education are also needed, and opportunities for black South Africans to study abroad and undertake internships in foreign and domestic firms are essential if the creative management structures found elsewhere are to be transferred to the South African working environment

Not only do SMMEs offer an alternative to unemployment for many blacks, but they can become a vibrant, innovative part of the South African business community, open to introducing new technologies, new products, and potentially, new items for export markets However, a major constraint which has affected the capacity of the black business community to grow, even when profitable opportunities are available, is the difficulty in gaining **access to working capital** from white-controlled banking institutions In the case of smaller firms, establishing a banking relationship for the first time can be almost impossible, many capable blacks have not yet amassed the property needed as collateral in pledging their personal assets against their business loans The recent development of loan funds strictly for the black SMME community, particularly when they are combined with technical assistance and on-the-job training in business planning and management skills, is the first step in redressing this need Loan guaranties have also been used effectively to increase access to capital, especially to minimize the need for collateral Benefits have accrued directly to the small business borrower but also to the SMME sector at large by motivating traditional sources of capital to lend into new and previously under-serviced markets

Existing business support organizations, including the SBDC, the National Economic Initiative (NEI) business opportunity centers, and others have shown the value of business hives and incubators, particularly when business development services are made available As contemplated in the DTI White Paper on small business, nationwide access to this kind of support at the local level is needed to overcome black business inexperience and deficiencies These interventions can be instrumental in helping a firm identify and **develop a market niche and develop strategies to reach the targeted market** These should be complemented by the involvement of purchasing agents from large corporations which are seeking to develop suppliers from the black community These individuals can help transform small and medium black suppliers into quality producers with an "on time, at-your-service" mentality

Another area where SMMEs need help in expanding their businesses is in the area of **supplier and market information** Many SMMEs are locked into traditional suppliers, from which they buy small quantities of inputs at relatively high prices, and sell to traditional buyers, with which they have little room for price maneuvering They need better information on where they can find access to quality suppliers, interested buyers, product specifications needed to satisfy those buyers, information about appropriate technologies and possible joint venture partners With these inputs, the SMME operator can begin to act like a true entrepreneur, making choices about input sourcing, production methods and market targets

The SMME business community does not have **adequate physical and business-oriented infrastructure** for traditional business activities There is inadequate public investment in electrification, sanitation, roads, freight distribution systems, wholesale markets for fresh produce, public transportation for employees to get to and from work, security for workers and property, and public safety in the locations where many of these SMMEs are found On the business side, telephones break down, repair men are unavailable, postal workers and courier services will not deliver in their neighborhoods, and affordable business premises are inadequately configured or supplied with electricity, telephones and plumbing Traditionally, these services and facilities are the responsibility of either the private sector or local government authorities The long history of neglect in the townships and other locales where SMMEs are emerging has brought these needs to the attention of the RDP One role which the local service center, proposed by the DTI, could play is as a local ombudsman to seek outside assistance to obtain required services Familiarity with the maze of parastatal and private organizations that supply infrastructure services and repairs could be of great assistance to an SMME

Data Research Africa[18] indicates that while **legal and regulatory issues**, such as licensing and confiscation of goods are not a major problem for SMMEs, a percentage of businesses could avoid fines and arrest if information on business regulations, from registration and sanitary requirements to labor laws and tax requirements, were less confusing for SMMEs Non-compliance is frequent, often unintentionally, and the resulting fines can be painful to pay Instruction booklets for SMMES in simple language, particularly if they are complemented with assistance from local small business service centers, could ease the burden imposed by the regulatory maze within which many SMMEs must operate

IV What Other Organizations are Doing to Address Constraints and Take Advantage of Opportunities for Sustainable Private Sector Development

A Government Policies and Priorities

The Reconstruction and Development Program (RDP) acknowledges the structural problems in the economy and lays out a plan to address those problems and regenerate economic growth and a more equitable distribution of the benefits of such growth Employment creation is the central priority with attention focused on reversing the low levels of investment and saving and the capital outflow to improve the environment for productive investment In addition, the RDP charges the GNU with utilizing labor intensive methods in the public sector through the National Public Works Program Its economic policy strategy embraces industrial restructuring and trade and industry policies designed to foster a greater outward orientation so as to create and sustain high employment levels in the economy The RDP acknowledges the need to modernize its human resources programs to meet the challenges of changing production processes and reform labor market institutions to facilitate effective and equitable collective bargaining and the restructuring of employment patterns

Overall, the RDP endeavors to promote a more equitable pattern of growth, an equitable

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[18] Data Research Africa, Micro-Enterprises in South Africa Results of a Survey on Regulations, (Durban, DRA, 1992)

distribution of assets, services and access to markets and the maintenance of macro-economic stability In order to attract investment, the RDP hopes to create transparent and consistent policies and national treatment for foreign investors with access to foreign exchange to enable them to remit after-tax profits, service debt, purchase inputs and repatriate proceeds on the sale of assets Trade policy embraces the gradual trade liberalization in all sectors of the economy, with assistance in capacity building, retraining of workers and better utilization of technology to assist firms as tariff protection is gradually removed With regard to competition policy, the GNU plans to introduce anti-trust legislation to discourage over-concentration of economic power and interlocking directorships, and practices that effectively abuse market power and exploit consumers With regard to SMMEs, key areas of support identified in the RDP are access to advice, favorable amendments to legislative and regulatory conditions, access to marketing and procurement services, access to finance, access to infrastructure and premises, access to training, access to appropriate technology, and encouragement of interfirm linkages

1 Small, Medium and Microenterprise Sector

The growth and development of small, medium, micro and survivalist enterprises has been accorded significant importance within the economic growth and development strategy of the Government of National Unity's Reconstruction and Development Program According to the Ministry of Trade and Industry, "the importance of small enterprise development lies in its ability to instill an entrepreneurial culture, provide a viable alternative for youths looking in vain for blue or white collar jobs, generate new job opportunities, spread development to the regions, create an environment for innovation and spread industrial skills and know-how among a broad spectrum of the population"[19] In order to implement its SMME strategy, as articulated in the White Paper, an 18 person Chief Directorate in the Department of Trade and Industry is being created While the Small Business Chief Directorate will be responsible for small business promotion, the proposed Ntsika Enterprise Promotion Agency (NEPA) and the National Small Business Council (NSBC) would serve as the links between government and the SMME sector The NEPA will function as a quasi-government SMME policy, coordination, facilitation and implementation agency for the Department of Trade and Industry The NEPA will keep Government and the public informed of SMMEs' contribution to national economic development and of the implications of policy and regulatory reform The NEPA will provide an export support program for the sector, coordinate the local service centers which will provide information and advise to SMMEs at the grassroots level, as well as have a policy arm, develop generic business development and training materials, and develop affirmative procurement and marketing strategies for SMMEs The NSBC, by contrast, will serve as a voice for small business because of the primary participation by representatives of provincial small business desks (themselves small

[19] Ministry of Trade and Industry, Strategies for the Development of an Integrated Policy and Support Programme for Small, Medium and Micro Enterprises in South Africa A Discussion Paper, (Cape Town, South Africa, Ministry of Trade and Industry, 1994), p 5

business entrepreneurs) A wholesale finance institution would improve SMMEs' access to capital and provide seed capital to NGOs for institutional development As currently envisioned, a redesigned credit guaranty scheme would also be administered by the wholesale finance facility Both the wholesale finance facility and SMME credit guaranty scheme would be initially funded by government

2 Larger Scale Enterprise Sector

While the GNU has inherited tremendous economic and socio-economic challenges, it has accepted its priority of extending public services and social infrastructure to those who had unequal access in the past Concurrently, it is attempting to instill confidence in local and foreign investors that South Africa will become and remain an attractive environment for safe and profitable investment One very critical development during the past year was South Africa's signing of the GATT agreement, with full consent of all parties for membership in the World Trade Organization (WTO) This will contribute to turning South Africa from a largely inward-looking to a more competitive outward-looking economy The economy, however, must grow rapidly enough to generate sufficient tax revenue to fund the government's social-economic agenda The GNU has tried to engage the private sector in the policy debate through the creation of the National Economic Forum, replaced by the National Economic Development and Labour Council (NEDLAC), a tripartite body of government, labor and business

President Mandela, and importantly his Minister of Trade and Industry, Trevor Manuel, have adopted an approach which strongly supports the growth and development of a strong private sector and a gradual removal of government regulations and subsidies as the economy adjusts to a free market environment One important policy measure implemented in February 1995 was the elimination of the dual exchange rate system This was lauded by the business community as the first step in exchange control liberalization, which along with privatization, tariff and tax reform, are requisites to attracting foreign direct investment Other important policy issues are being addressed including affirmative hiring and tendering programs for blacks, tying productivity to wage increases, privatization, and development of a comprehensive industrial policy In order to reintegrate South Africa into the global economy, it must look to means to transform itself from a primary products exporter and capital goods importer to an exporter of value-added products The protected existence of monopolistic parastatals and the oligopolistic industrial sector have stifled technological innovation and in turn, competitiveness The GNU is beginning to look at such critical issues as the abuse of market power through the current Competition Board and through anti-trust legislation being considered

Very significant changes are already being evidenced in the large scale industrial sector In June, most probably reinforced by the findings of the Monitor Study on South Africa's competitiveness, the Minister of Trade and Industry unveiled final proposals for dramatic reform of the motor, textile and clothing industries designed to compel South African industry to become internationally competitive The plans will ultimately result in significantly cheaper cars and clothing, with the proposed phased tariff reductions in these sectors reduced to half their current levels[20] These tariff reduction proposals are being implemented faster than the GATT schedule to force industry to cut costs, increase productivity and become globally competitive To facilitate these changes, the GNU is offering some relief with a 50% subsidy on management consultancy fees for five years and the continuation of the duty credit certificate scheme which gives exporters relief on import duties Further, new conditions on training, productivity increases and human resources development will be announced and applied

The private sector, for its part, is moving proactively to anticipate the changes implied under a new economic order The textile and clothing federations have announced the creation of a dedicated, independent export council to be known as the South African Clothing and Textile Export Council This council will be comprised of members of the two industries with a mandate to facilitate job creation through export performance, now at less than 10% of domestic production This is but one example of the very positive catalytic role that the private sector can play in the creation of a more dynamic, more competitive and more outward-looking industrial sector in South Africa

B Role of Development Assistance in South Africa

USAID is the largest bilateral grant donor, including in the area of private sector development Until 1995, due to the Comprehensive Anti-Apartheid Act of 1986, USAID's funds were channeled outside of government, largely through the NGO community USAID's predominant focus was on black economic empowerment, largely targeting the micro and small enterprise end of the sector This is the focus of most bilateral donors

The World Bank and IMF have representative offices but to date, have not provided any loan facilities to the South African government It appears that the GNU would prefer to avoid the conditionality attached to these multilaterals' facilities The UNDP recently opened a small office in Pretoria Given its relative unfamiliarly with the South African environment, it has not yet assumed a prominent role in donor coordination often evidenced in other countries In the private sector arena, USAID assumed a leadership role in initiating and leading a donor discussion group (previously a donor coordination group) The Chief Directorate in the DTI has asserted itself in convening a private sector donor coordination group Most bilateral donors are in the formulative stage regarding designating appropriate private sector modes of assistance An indicative list of priority activities for some of the bilateral donors is listed below

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[20] Import duty on built-up motor cars, commercial vehicles and minibuses would shrink from 115% currently to 65% in 1995 to 40% by 2002 by roughly 4 percentage points per year, while import duty for components would decrease from 49% currently to 30% in eight years Rate reductions for clothing would decline from 90% to 40%, for household textiles from 55% to 30%, for fabrics from 45% to 22%

Germany - Germany is South Africa's number one trading partner and largest investor, not surprisingly, it has negotiated a double taxation agreement and is in the process of negotiating an investment protection treaty Its development program focuses on poverty alleviation, working with SMMEs through NGOs in training, especially credit training It is also supporting joint ventures through the German Investment and Financing Corporation German aid officials believe that the private sector can development itself given a supportive enabling environment and will therefore provide support to the NEPA in its policy formulation function and its human resources development efforts, especially in vocational training

Britain - Private sector support is one of five priority areas for British ODA They are using NGOs as conduits for business skills training and counselling to SMMEs and are focusing on poverty alleviation among youth, women, rural areas and small growth businesses They provided technical assistance to DTI in developing the concept of local service centers In the future, they will consider supporting local service centers, supporting SMME entrepreneurship training, providing training for NEPA staff and focus activities on rural enterprise development

The Commonwealth Development Corporation (CDC) - CDC, with Investec and Fedsure Mortgages has capitalized the R100 million Enterprise Capital Fund to make equity and quasi-equity investments in medium-sized enterprises owned/managed by disadvantaged South Africans

European Union - The EU is focusing its assistance on access to capital through micro-lending activities It is considering providing funds to the wholesale finance facility's proposed new loan guaranty scheme as well as funding for the wholesale finance facility's credit program It is also pursuing matchmaking services to promote joint ventures, attempting to accelerate licensing and technology transfer of European Union practices in South Africa

Denmark - Denmark's focus is on small business development with emphasis on developing business partnerships between Danish and South African firms It is also involved in institutional building in South African including support for NGOs serving SMMEs Its latest initiative is its work in developing with DTI manufacturing technology centers for the NEPA to be located in numerous communities throughout South Africa This concept of targeted technology transfer has worked successfully in Denmark and is being piloted in South Africa using Danish funding It is also funding the interim costs of staff seconded from other organizations to the NEPA

Japan - The Japanese often look to the host country for leadership in directing the placement of its assistance To date, they have lent the Development Bank of Southern Africa (DBSA) $100 million to on-lend to regional development corporations for SMME promotion and have created a $100 million equity fund to help fund joint ventures and provide intermittent participant training in Japan Recently, the Japanese have funded the important Monitor study on South Africa's competitiveness

Norway - Norway often ties its assistance to Norwegian firms It is still examining potential areas of assistance including assisting GNU in policy formulation, strengthening professional advisory services, strengthening education institutions' support for private sector development, institutional development for savings and credit institutions (possibly support for government's wholesale finance facility), and promoting joint ventures between South African and Norwegian firms

France - The French Development Bank is providing a line of credit to the Rural Finance Facility to fund a program of small credits to small business enterprises and social development in rural and peri-urban areas

Canada - Canada, through the International Development Resource Center (IDRC), provided technical assistance for the design of local service centers and is considering additional funding for the operational costs of the local service centers

A statement made to USAID by our GNU counterparts was that the government didn't necessarily need donors' money, per se, but access to the best of technical assistance USAID and other donors are currently tailoring assistance to anticipate government and the private sector's needs, while trying to capitalize on the comparative advantage and experience each respective country can bring to bear in developing South Africa's private sector

V Strategic Options Based on USAID Comparative Advantage

A General Parameters

In developing an appropriate strategy for USAID's private sector activities during the next five years in South Africa, the following realities must be acknowledged Firstly, if a political base for market-oriented economic policies is to be nurtured and maintained in South Africa, economic access and participation are absolute requisites Secondly, redistribution alone will not address the staggering unemployment rates in South Africa, especially among the disadvantaged population A resumption of higher, sustainable growth is required to address the demands for employment and higher incomes among all South Africans It is only through increased growth that it will be possible to provide the expanded resources necessary to redress the social and economic legacies of apartheid The current growth rate of approximately 3% annually is not sustainable without significant structural reform and is inadequate to address the unemployment crisis The challenge is to build on South Africa's functioning private sector-led economy, excellent physical and financial infrastructure, while expanding access and opportunity to those previously excluded without damaging the forces that have created the strong economic foundation of South Africa today Therefore, while the private sector strategy initiatives will focus on access to resources, it must be accompanied by an economic reform agenda to stimulate broad-based economic growth in South Africa The issues of competitiveness and productivity are central to this agenda

Our program must be responsive to Vice President Gore's New Partnerships Initiative (NPI), notably its focus on empowerment through citizen participation and ownership, the emphasis on the role of local NGOs, universities, foundations, small businesses and decentralized government in sustainable development, mobilizing U S non-governmental resources to support local capacity building, improving the enabling environment for NGOs and small business, with a goal of graduating from U S assistance

This latter point is critical in shaping our program -- the recognition of the limited duration and declining funding levels available to achieve our economic empowerment goals Donor assistance, overall plays a minor role in the South African economy, representing less than 1% of South Africa's GDP This highlights the need for U S support for putting policies, institutions and participatory mechanisms in place as foundations for future growth, even in the absence of U S assistance The USAID assistance interventions in the private sector can best be designed as **change agents** to catalyze internal processes and delivery mechanisms to continue in the future, independent of USAID assistance USAID's selected interventions will therefore focus on the use of the private sector to increase opportunities for access to and ownership of assets to address the immediate need to reverse the legacy of exclusion in South Africa, but also to contribute to longer-term economic growth

B Cross-Cutting Themes

In order to operationalize the transformational nature of our assistance in South Africa, USAID private sector programs will capitalize on U S comparative advantage, using techniques to maximize the impact of our assistance These include

- Funding for models to be broadly replicated and implemented as appropriate
- Risk-sharing or the leveraging of USAID/South Africa resources with other local and international sources of funding to enhance sustainability
- Increasing access to the best of U S and local expertise
- Incorporating training where the lack of skills is the binding constraint to private sector development
- Identifying and disseminating lessons learned most importantly with our South African partners in development

C Strategic Choices

One significant strategic decision regarding our future program direction regards our focus on informal sector activity Until now, more than half of our program resources were targeted to benefit the informal sector, with assistance channeled through NGOs delivering technical assistance, training and credit to this sector As was discussed earlier, while the informal sector has generated approximately 2 million jobs, many of these are survivalist operations with nominal contribution to the economy at large At present, the informal sector accounts for less than 7% of GDP Given the need to not only redistribute income and assets but to lay the foundation for the overall growth of the South African economy, USAID must augment its work in this area with formal sector activities in support of SMEs We will continue to work through NGOs to reach the informal sector as part of the continuum of SMMEs

One area in which the United States can bring its comparative advantage to bear is in the area of capital markets development The problem in South Africa is not lack of capital, per se, but facilitating access throughout the economy Not only does the United States have sophisticated capital markets, but has utilized financial engineering techniques, including securitization, to ensure that assets are available and broadly owned throughout the economy In addition, techniques for increasing access to ownership opportunities and the chances for new business success have been effectively employed in the United States, including franchising and affirmative procurement Other techniques to facilitate broader asset ownership, including employee stock ownership plans and profit sharing schemes, have been used to great effect to disperse ownership widely

Reflecting on U S comparative advantage, and the limited duration of the USAID program in South Africa, the Private Sector Division has selected as its sub-goal, economic empowerment, one of the components of the Mission's goal of sustainable transformation in South Africa This sub-goal reflects the dual objectives of improved equity and economic growth as ingredients for the sustainable transformation of the economy from its apartheid legacy of exclusion The selection of particular interventions to be supported and facilitated by USAID were screened using the Porter paradigm and John Page's recent report for the World Bank, "The East Asian Miracle"

In the Porter paradigm, four necessary ingredients are identified to attract investment and stimulate economic growth -- capital, infrastructure, policy/regulatory environment, and human/technical resources We then looked at each of these factors to identify which interventions would result in improved equity of access for historically disadvantaged South Africans

<u>Access to capital</u> has repeatedly been cited as the number one binding constraint to ownership and private sector economic empowerment by the historically disadvantaged population This is an area where USAID has been involved since 1987 through its work with South African microenterprise finance organizations and where USAID's worldwide comparative advantage in capital markets development can be brought to bear Given the finite resources of USAID, and capital resource availability in South Africa, our focus will be on increasing access to South African private sector capital resources, using innovative financial engineering techniques and leveraging USAID funds to the greatest extent possible, including use of guarantees, equity and quasi-equity instruments Hence, the selection of our strategic objective "**increased access to financial markets for the historically disadvantaged**

population"

The area of infrastructure was not designated as an area of focus for USAID private sector initiatives for several reasons

(1) the physical infrastructure of South Africa on the whole is very sound Substandard service delivery in the townships is being addressed as part of the RDP,
(2) the costs and duration of infrastructure development are beyond the transitional scope of the USAID program,
(3) other facilities are available to finance infrastructure development, including through the DBSA and World Bank

USAID, while not investing in infrastructure development itself, could facilitate the ownership and access to infrastructure through privatization, sub-contracting, unbundling and build-operate-maintain schemes

The area of policy and regulatory reform is a key area for USAID intervention Policy interventions can be short-term and high impact in nature Many of the barriers to economic growth and equality of access in South Africa are policy based The key determinants of rapid growth among the High Performing Asian Economies during the 1965-1990 period were high levels of savings and investment (primarily private sector), high investment in education and human capital, productivity growth from high internal competition, a positive enabling environment, and the sharing of benefits of growth Levels of savings and private sector investment are largely policy based, as is productivity growth from high internal competition and openness to foreign technology An enabling environment for private sector growth includes transparency of rules, nurturing a consultative relationship between business, government and labor coalitions and creating a focus on export-led growth Government policies, be they fiscal, monetary or bureaucratic, can create a competitive environment conducive to foreign and domestic investment and economic growth Accordingly, another strategic objective supported by the Private Sector Division is **"improved capacity of key government and non-government entities to formulate, evaluate and implement economic policies"** [21]

The area of human and technical resources is undoubtedly a critical area for attention in South Africa The depth of the damage caused by the exclusionary policies of apartheid have created great disparities between the majority population and minority population The

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[21] This strategic objective will focus on the development and enhancement of the macroeconomic policy capacity within the South African community through strengthening government departments involved with macroeconomic policy issues, strengthening economic "think tanks", training individuals in economics and policy analysis and strengthening centers of economics training in South Africa The majority of activities supporting this strategic objective will be undertaken by the Economics Division of the Office of Economic Development of USAID/South Africa

challenge of equalizing basic and tertiary educational opportunities among the races is being pursued by our Human Resources Development Division The need for strengthening human and technical resources will focus on strengthening the capability of historically disadvantaged South Africans to lead policy work relating to economic growth and ownership It will also be pursued as part of institutional strengthening that facilitates the extension of credit necessary for asset ownership by historically disadvantaged South Africans Strengthening institutional capacity to facilitate expansion of business ownership among historically disadvantaged South Africans is an acknowledgement of the limited duration of our program and our desire to build on the already significant institutional structure in South Africa to ensure program sustainability beyond a period of intensive donor support

D Private Sector Objectives and Intermediate Results

Summarizing the discussion above and the rationale cited throughout this strategy, the following strategic objectives and intermediate results have been identified for the private sector Indicative interventions are listed below

STRATEGIC OBJECTIVE: INCREASED ACCESS TO FINANCIAL MARKETS FOR THE HISTORICALLY DISADVANTAGED POPULATION.

***CAPITAL - Related Intermediate Result* Increased Access to Financial Markets for Informal and Microenterprises of the Historically Disadvantaged Population**

■ ***Improved policy environment for facilitating access to capital for historically disadvantaged informal and microenterprises***

Interventions

- Increase responsiveness of Government policies to address the needs of historically disadvantaged informal and microentrepreneurs regarding access to capital (technical assistance, training)

- Strengthen the capacity of government to analyze, design and implement policies to stimulate the development of SMMEs in South Africa (technical assistance, training)

- Strengthen the capacity of industrial chambers and other business fora to increase businesses' access to financial markets through policy formulation relating to affirmative procurement and export promotion (technical assistance, training)

- Strengthen the ability of business organizations (South African and American) to represent their constituent interests, especially in identifying barriers to entry and developing policy interventions to address these constraints (technical assistance)

- Strengthen the ability of business organizations (national and regional) to lobby for more facilitative regulatory environment (technical assistance)

■ *Improved capacity of the financial sector to service historically disadvantaged informal and microentrepreneurs*

Interventions

- Increase capacity of NGOs to provide finance to informal and microentrepreneurs through improved access to commercial credit (technical assistance, training)

- Increase access to capital by microenterprises utilizing the USAID loan guaranty program and training of bankers in cash flow lending techniques (loan guaranty, training)

- Strengthen the capacity of banks to lend to the historically disadvantaged microentrepreneur (technical assistance, training)

■ *Improved capacity of historically disadvantaged informal and microentrepreneurs to respond to financial market requirements*

Interventions

- Increase capacity of microentrepreneurs to source credit (technical assistance, training)

<u>CAPITAL - Related Intermediate Result</u> Increased Access to Financial Markets for Small, Medium and Large Enterprises of the Historically Disadvantaged Population

■ *Improved policy environment for facilitating access to capital for historically disadvantaged small, medium and large enterprises*

Interventions

- Strengthen the ability of business organizations (South African and American) to represent their constituent interests, especially in identifying barriers to entry and developing policy interventions to address these constraints (technical assistance)

- Strengthen the ability of business organizations (national and regional) to lobby for more facilitative regulatory environment (technical assistance)

- Strengthen the capacity of government to analyze, design and implement policies to stimulate the development of SMMEs in South Africa (technical assistance)

- Strengthen the capacity of industrial chambers and other business fora to increase businesses' access to financial markets through policy formulation relating to affirmative procurement, export promotion and promoting franchising opportunities (technical assistance, training)

■ *Improved capacity of the financial sector to service historically disadvantaged small, medium and large enterprises*

Interventions

- Increase access to capital by small enterprises utilizing the USAID loan guaranty program and training of bankers in cash flow lending techniques (loan guaranty, training)

- Increase access to capital by small and medium-scale enterprises using risk sharing mechanism of the enhanced credit authority, with particular application in franchising, unbundling, privatization and sub-contracting (loan guaranty)

- Increase opportunities for ownership of corporate assets through deal structuring to unbundle corporate assets to benefit the historically disadvantaged, permit employee and management buy-outs, encourage franchising and sub-contracting and potentially privatize government assets with the intent to disperse ownership widely (technical assistance, training)

- Strengthen the capacity of banks to lend to the historically disadvantaged small business operator (technical assistance, training)

- Utilize the USAID loan portfolio guaranty program as a model for new government loan guaranty scheme (technical assistance) and to leverage private sector resources (loan guaranty)

- Utilize unbundling and privatization transactions consummated as models for other transactions (technical assistance)

- Leverage private sector and other donor resources in transactions financed by the Southern African Enterprise Development Fund (equity investment)

- Utilize Enhanced Credit Authority to leverage private sector resources (loan guaranty)

■ *Improved capacity of historically disadvantaged small, medium and large enterprises to respond to financial market requirements*

- Increase access to equity and quasi-equity capital through provision of technical assistance to bring potential investees to the "bankable" stage and to ensure their profitability after receiving equity injections (technical assistance, equity investment)

- Strengthen the local consulting capacity to structure transactions to access equity capital, unbundle corporate assets and work in privatization, as appropriate (technical assistance, training)

STRATEGIC OBJECTIVE: IMPROVED CAPACITY OF KEY GOVERNMENT AND NON-GOVERNMENT ENTITIES TO FORMULATE, EVALUATE AND IMPLEMENT ECONOMIC POLICIES.

Intermediate Result ***Strengthened Government Departments and Ministries***

Interventions

- Work with the public sector (Department of Trade and Industry) on improving international competitiveness in the face of trade liberalization and exploiting regional trade integration in southern Africa (technical assistance, training, exposure tours)

- Strengthen the capacity of government to address the problem of competitiveness (promoting quality management and "just in time" production techniques) and economic growth through focusing on industrial and trade policies and investment promotion (technical assistance)

OTHER SPECIAL INTERVENTIONS

- Work with business organizations (South African and American) to better represent their constituent interests, especially in the areas of trade and export promotion as well as investment promotion (technical assistance)

- Strengthen capacity of organizations in South Africa to promote U S trade and investment (technical assistance) through policy and regulatory reform

- Strengthen the capacity of industrial chambers and other business fora to increase businesses' access to markets through policy formulation relating to affirmative procurement, export promotion and promoting franchising opportunities (technical assistance, training)

VI Implementation

A Relationship of Activities to Results

Below is a summary of the currently planned activities to be undertaken by the Private Sector Division and the areas in which they will contribute toward achievement of our strategic objective of facilitating economic growth and increasing ownership of business assets by historically disadvantaged South Africans

ACTIVITY	GENERAL DESCRIPTION	RESULTS
NGO Support Facility	Channel grants to NGOs serving SMME sector through intermediary organization Sector micro and small	Improved capacity of financial sector to service historically disadvantaged informal and microenterprises (NGOs serving SMMEs) Improved capacity of historically disadvantaged informal and microentrepreneurs to respond to financial market requirements
DTI Technical Support Facility	Grant to DTI to develop and implement SMME program and address trade and investment policies Sector all with particular emphasis on SMMEs	Improved policy environment for facilitating access to capital by historically disadvantaged population Strengthened government departments and ministries

Equity Access Systems (EASY)	Technical assistance to improve access to equity capital Sector small, medium and large	Improved capacity of the financial sector to service historically disadvantaged small, medium and large enterprises Improved capacity of historically disadvantaged small, medium and large enterprises to respond to financial market requirements
Rapid Assistance for National Development (RAND)	Structure transactions to unbundle corporate assets, promote management and employee buy-outs, build-operate-maintain schemes and possibly, privatization Sector medium and large	Improved policy environment for facilitating access to capital for historically disadvantaged small, medium and large enterprises Improved capacity of the financial sector to service historically disadvantaged small, medium and large enterprises Improved capacity of historically disadvantaged small, medium and large enterprises to respond to financial market requirements

Business Linkages for Under-Utilized Enterprises (BLUE)	Strengthen capacity of business membership organizations to transfer technical knowledge to their memberships (affirmative procurement) and serve in a policy/advocacy role Sector small and medium	Improved policy environment for facilitating access to capital for the historically disadvantaged population Strengthened capacity of industrial chambers to increase businesses' access to markets through policy formulation relating to affirmative procurement
International Foundation for Education and Self-Help II (IFESH II)	Increase opportunities for disadvantaged South Africans to enter the managerial ranks in banking through management and technical skills training Sector small and medium	Improved capacity of the financial sector to service historically disadvantaged small, medium and large enterprises
Southern Africa Enterprise Development Fund (SAEDF)	Provide source of equity capital for promising business ventures Sector small, medium and large	Improved capacity of the financial sector to service historically disadvantaged small, medium and large enterprises
Trade Support Activities	Promote U S -S A trade and investment through facilitating commercial linkages and promoting trade and investment missions Sector medium and large	Strengthened government departments and ministries Strengthened capacity of organizations in South Africa to promote U S trade and investment

Other Tools • Micro and Small Enterprise Development (MSED) Loan Guaranty Program • Enhanced Credit Authority (ECA)	Risk sharing arrangement with private sector financial resources to increase commercial access to credit Sector micro and small (MSED) small, medium and large (ECA)	Improved capacity of the financial sector to service the historically disadvantaged population Improved capacity of the historically disadvantaged population to respond to financial market requirements

B Management Implications

The portfolio of activities presented will be designed and implemented by a staff of 2 American private sector officers and 3 professional South African project management specialists Implementation of the Southern African Enterprise Development Fund will be guided by a professional venture team situated in Johannesburg, with ancillary support to be provided by the southern Africa Regional Office in Botswana Additional support for the MSED loan guaranty program will continue to be provided by USAID's Global Bureau's Credit and Investment Staff The potential exists for an additional South African to backstop the Enhanced Credit Authority should need warrant it The costs of this individual would be borne by the Global Bureau

C Funding Scenarios

Please see attached tables outlining resource allocation by activity under a high and a low funding scenario

D Summary

As is evident above, an array of interventions will be utilized employing technical assistance, training, equity capital and loan guaranty facilities to further opportunities for access and ownership of assets by historically disadvantaged South Africans The interventions to be pursued present an array of opportunities for microenterprises through large scale businesses USAID intentionally presents this stepping stone approach so that blacks have opportunities to move beyond microenterprise into the mainstream economy, including into large business ownership and management We will work through three principal intermediaries

- the private sector, principally through business membership organizations,
- the NGO community serving the SMME sector, and
- the public sector, principally the Department of Trade and Industry

Overall, we believe the selected interventions reflect the development dynamics of South Africa's private sector, USAID's comparative advantage and acknowledge the limited duration of the private sector program USAID will use its resources to create replicable and sustainable models for the private sector and will seek to leverage its resources with that of the private sector to maximize program impact Indeed, we have designed a program that is transformational, yet we believe sustainable, for South Africa

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Other Resource Materials

A copy of the USAID-funded Manual for Action in the Private Sector (MAPS) may be obtained by writing to the

Office of Economic Development
USAID South Africa
PO Box 55380
Arcadia 0007
Pretoria

Two other studies,
1) Enhancing the Investment Climate and
2) Barriers to Entry
are currently under preparation by NAFCOC and will be available through USAID later this year