

# Report on the Evaluation of Government Business Incentives

FULL REPORT

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National Evaluation Plan Report



**planning, monitoring  
& evaluation**

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**AEBEL**

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## Glossary

AA	Accounting Authority
ABC PIMP	Activity-Based Costing Project Implementation Plan
ADA	Agribusiness Development Agency
AECF	Africa Enterprise Challenge Fund
AH	Agri-Hub
AIS	Automotive Investment Scheme
AMERU	African Microeconomic Research Unit
AP	Agri-Parks
APAP	Agricultural Policy Plan
APDP	Automotive Production and Development Programme
ATWS	Adventure Travel World Summit
AVMP	Animal Veld Management Programme
B-BBEE	Broad-Based Black Economic Employment
BBSDP	Black Business Supplier Development Programme
CBO	Community Based Organisation
CFP	Call For Proposal
CIS	Co-operative Incentive Scheme
CCDI	Cape Craft and Design Institute
CHIETA	Chemical Industries Education and Training Authority
CIPC	Companies and Intellectual Property Commission
CM	Component Manufacturers
COSATU	Congress of South African Trade Unions
CPPP	Community Public Private Partnership
CRDP	Comprehensive Rural Development Programme
CSIR	Council for Scientific and Industrial Research
CWP	Community Work Programme
DACST	Department of Arts, Culture, Science and Technology
DAFF	Department of Agriculture Forestry and Fisheries
DAMC	District Agri-Parks Management Council
DBSA	Development Bank of Southern Africa
DDA	District Development Agency
DEA	Department of Environmental Affairs
DFI	Development Finance Institution
DHET	Department of Higher Education and Training
DFD	Development Finance Department
DJOC	District Joint Operating Committee
DoL	Department of Labour
DPME	Department of Performance Monitoring and Evaluation
DRDLR	Department of Rural Development and Land Reform
DSBD	Department of Small Business Development
DST	National Department of Science & Technology
DTI	Department of Trade and Industry
ECIC	Export Credit Insurance Corporation
EDD	Enterprise Development Division
EE	Energy Efficient
EIP	Enterprise Incubation Programme
EMIA	Export Marketing Investment Assistance
EMU	Electric Multiple Units
ETI	Employment Tax Incentive
EU	European Union
EPWP	Expanded Public Works Programme
FICA	Financial Intelligence Centre Act
FSPU	Farmer Production Support Unit
FY	Financial Year

GCT	Green Cities and Towns
GDP	Gross Domestic Product
GERD	Gross Domestic Expenditure on Research and Development
GMS	Grant Management System
GTAC	Government Technical Advisory Centre
GTIP	Green Tourism Incentive Programme
HEI	Higher Education Institutions
HEQF	Higher Education Qualifications Framework
IBTM	Institute of Business Travel Management
IC	Investment Committee
ICT	Information and Communication Technology
IDAD	Incentive Development and Administration Division
IDC	Industrial Development Corporation
IDP	Integrated Development Plan
IGICC	Inter-Governmental Incentives Coordinating Committee
IMASP	International Market Access Support Programme
IMEX	Worldwide Exhibition for Incentive Travel, Meetings and Events
IP	Intellectual Property
IPAP	Industrial Policy Action Plan
IRCC	Import Rebate Credit Certificate
ITAC	International Trade Administration Commission
ITB	Internationale Tourismus-Börse
JIPSA	Joint Initiative on Priority Skills Acquisition
KZN	KwaZulu-Natal
LSF	Large Scale Farmers
LCE	Low Carbon Economy
MCDM	Multi Criteria Decision Model
M&E	Monitoring and Evaluation
MERSETA	Manufacturing, Engineering and Related Services Sector Education and Training Authority
MESE	Meeting Exhibition and Special Events
MHCM	Medium and Heavy Component Manufactures
MHCV	Medium and Heavy Commercial Vehicles
MIDP	Motor Industry Development Programme
MNC	Multinational Corporation
MoA	Memorandum of Agreement
NAMAC	National Manufacturing Advisory Centre
NEDLAC	National Economic Development and Labour Council
NCASA	National Cooperative Association of South Africa
NCPC	National Cleaner Production Centre
NDP	National Development Plan
NSDS	National Skills Development Strategies
NDT	National Department of Tourism
NEET	Not in employment, education or training
NEF	National Empowerment Fund
NEPF	National Government's National Evaluation Policy Framework
NF	Network Facilitator
NGO	Non-Governmental Organization
NGP	New Growth Path
NIPMO	National Intellectual Property Management Office
NMMU	Nelson Mandela Metropolitan University
NPO	Nonprofit Organisations
NRDS	National Research and Development Strategy
NRF	National Research Foundation
NRM	Natural Resource Management

NSF	National Skills Fund
NSI	National System Innovation
NT	National Treasury
NTSS	National Tourism Sector Strategy
NTTC	National Technology Transfer Centre
NYDA	National Youth Development Agency
OECD	Organization for Economic Cooperation and Development
OEM	Original Equipment Manufacture
P-AIS	People-Carries AIS
PAYE	Pay-As-You-Earn
PFMA	Public Finance Management Act
PRASA	Passenger Rail Agency of South Africa
PSET	Post-School Education and Training
R & D	Research & Development
RDP	Reconstruction and Development
RIA	Regulatory Impact Assessment
REID	Rural Development and Industrial Development
RUMC	Rural Union Market Centre
RVCP	River Valley Catalytic Project
SABS	South African Bureau of Standards
SADC	Southern African Development Community
SANEDI	South African National Energy Development Institute
SAQA	South African Qualifications Authority
SARIMA	Southern African Research and Management Association
SARS	South African Revenue Services
SAIT	South African Institute of Tax Professionals
SAT	South African Tourism
SDA	Skills Development Act
SDL	Skills Development Levy
SEDA	Small Enterprise and Development Agency
SEFA	Small Enterprise Finance Agency
SEIA	Socio-Economic Impact Assessment
SETA	<i>Sector Education and Training Authority</i>
SEZ	<i>Special Economic Zone</i>
SFP	<i>Seed Fund Programme</i>
SHF	<i>Small Holder Farmers</i>
SMMDP	Small and Medium Manufacturing Development Programme
SME	Small and Medium Enterprises
SMME	Small, Medium and Micro Enterprises
SOC	State Owned corporations
SPII	Support Programme for Industrial Innovation
SSDD	Skills Supply and Demand Database
STP	SEDA Technology Programme
SWOT	Strengths, Weaknesses, Opportunities & Threats
TEC	Technical Evaluation Committee
TIA	Technology Innovation Agency
TIP	Tourism Incentive Programme
ToC	Theory of Change
TOMSA	Tourism Marketing South Africa
TGCSA	Tourism Grading Council of South Africa
TGSP	Tourism Grading Support Programme
THRIP	Technology and Human Resources for Industry Programme
TLR	Technology Readiness Levels
TSP	Tourism Support Programme
TTF	Tourism Transformation Fund

TTO	Technology Transfer Office
TTU	Technology Transfer Unit
TVET	Technical Vocational Education and Training
TWIB	Technology for Women in Business
UCT	University of Cape Town
UWC	University of the Western Cape
VAT	Value Added Tax
WARD	Women in Agriculture and Rural Development
WBL	Work Based Learning
WCEDP	Western Cape Economic Development Partnership
WIL	Work-Integrated Learning
WP	Work Placements
WTM	World Travel Market
WTO	World Trade Organisation
WYSTC	World Youth and Student Travel Conference
YARD	Youth in Agriculture and Rural Development
YPDP	Youth Pipeline Development Programme

## 1 Executive Summary

### 1.1 INTRODUCTION

The South African Government uses a wide range of incentives to encourage firms to act or invest in specific activities or contribute to certain social or economic outcomes. Whereas individual programmes are monitored and in some cases regularly evaluated, these evaluations provide for a partial assessment of how the system as a whole is working together to support business and benefit society.

The purpose of this evaluation is to bring together a consistent set of information across the entire national system of business incentives, identify overlaps and complementarities, and explore how specific programmes and the system as a whole have been structured to achieve government's wider policy objectives. In doing so, this evaluation assesses whether the system of incentives is working effectively, efficiently and coherently, and makes recommendations on how the system can be improved.

### 1.2 THE CONTEXT OF THIS EVALUATION

Almost all countries provide some form of tax or fiscal incentives to support the business sector. The form and target of this assistance differs markedly by country, but usually includes some combination of tax holidays, investment allowances or credits, reduced tax rates, research and development (R&D) incentives and Special Economic Zones (SEZs). Moreover, whereas low and middle income countries favour simple tax holidays, tax reductions and investment allowances, high income countries generally make greater use of R&D incentives and zone based programmes.

This evaluation takes as its starting point that business incentives are a key component of any national economic policy and programme. When designed well, business incentive schemes serve to support government priorities and provide beneficiary firms with needed and targeted support. On the other hand, badly designed or managed incentive schemes lead to unnecessary waste, economic distortion and displacement, and other unintended consequences. This evaluation therefore aims to support the development of a more considered and coherent approach to the system of business incentives, that will ultimately serve to enhance the economic and social gains on the substantial support and investment that is already provided by government.

In doing so, it is important to recognise that the system of business incentives in place in South Africa is informed by the current economic and social context; and the South African Government's response to the domestic and global economic environment (as reflected in recent policy documents and statements such as the National Development Plan and the Industrial Policy Action Plans). Likewise, the effectiveness and impact of the system of incentives is greatly influenced by domestic economic and social conditions, and the overall state of the world economy.

### 1.3 THE SOUTH AFRICAN BUSINESS INCENTIVES SYSTEM

The South African business incentives system comprises a number of incentive programs spanning all types of incentives, both supply and demand. Importantly, different incentives target different outcomes. But the main purpose of an incentive is to change behaviour at the firm level. Conceptually, change occurs by impacting firm profitability either through: (a) reducing costs; (b) increasing costs (in other words a negative incentive); or (c) increasing revenues. Individual incentive programs, if effective, should result in changed firm behaviour,

causing them to invest in capital, labour, inclusion or research and development. At an aggregate level the response of individual firms results in economy wide effects.

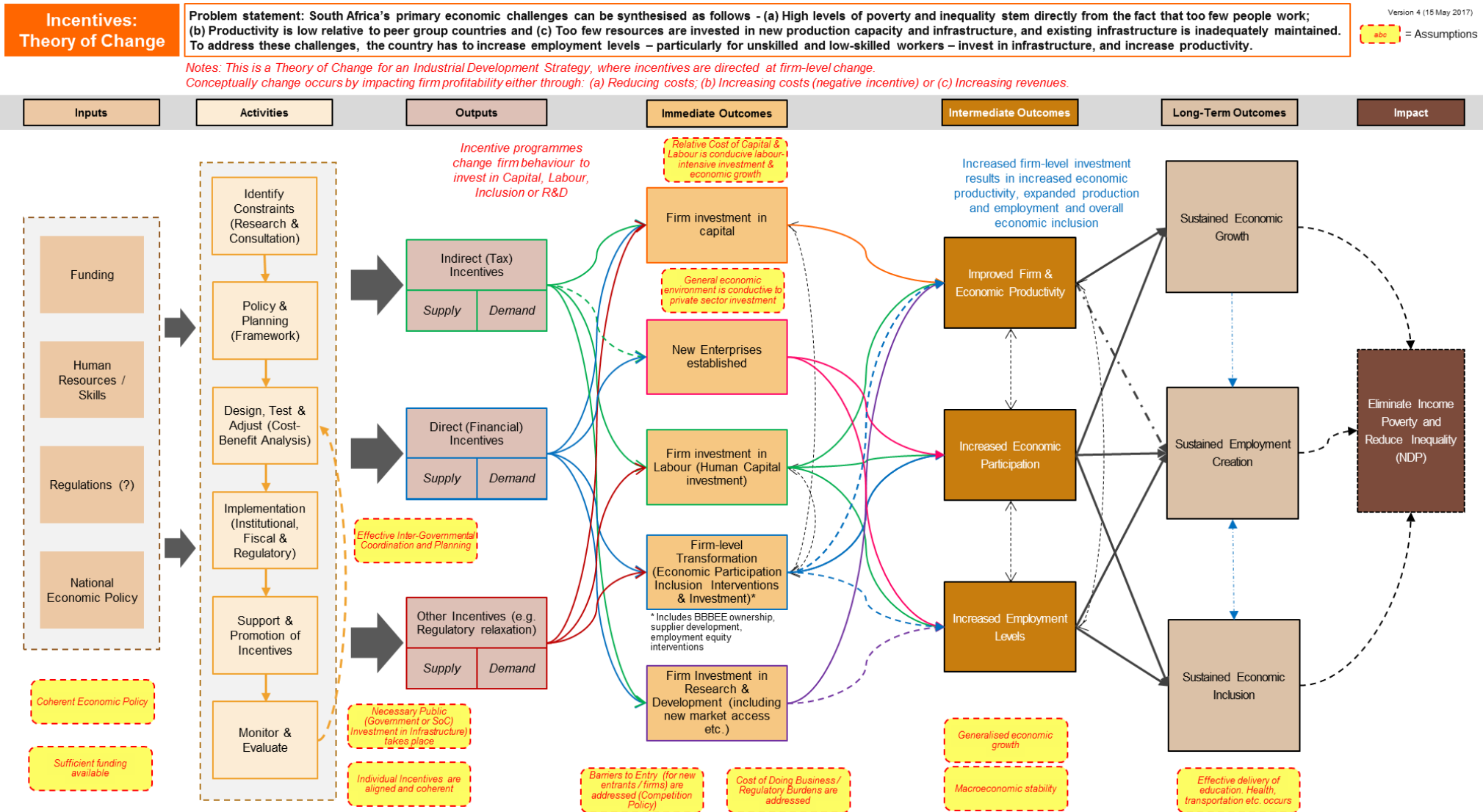
The system-level theory of change developed as part of this evaluation (Figure 1), indicates that if the relevant outputs (individual incentive programmes) are delivered, and these are effective, this should be evidenced in a number of immediate outcomes. These include firm level investment in capital, the establishment of new enterprises, firm investment in labour, firm level transformation, and firm investment in research and development.

It follows, if the immediate outcomes (firm-level investment) are realised through a combination of different business incentives, then the business incentives system, at the aggregate level, should result in increased economic productivity, expanded production and employment and enhanced economic inclusion. These changes are evidenced in the intermediate outcomes. The achievement of these intermediate outcomes are a necessary – but not sufficient condition – to realise the long-term outcomes of sustained economic growth; sustained employment creation; and sustained economic inclusion (which considers both spatial economic development and economic transformation).

Critically, the realisation of these outcomes is dependent on multiple assumptions at all levels of the theory of change. This includes the need for a high level of coordination and the delivery of core infrastructure and services across multiple government department; that inputs costs and the general economic environment is conducive to private sector investment; that key barriers to entry (for new entrants / firms) or expansion are effectively addressed; and that there is generalised economic growth and overall macroeconomic stability. Likewise, for the ToC to hold (and thereby lead to the intended change in firm behaviour), it is critical that incentives are fully costed, monitored and evaluated; well-targeted and supported by clear criteria; appropriately resourced; and implemented efficiently and transparently.

In addition to the system level theory of change, several category-level theories of change were developed in order to assess one or more of the immediate outcomes specified at the system-level. These are described more fully in Section 7.

Figure 1: Theory of change





## 1.4 LITERATURE AND DOCUMENT REVIEW

The broad nature of business incentives and the boundaries defining incentives are not always clear. This makes it difficult to come to a universally agreed definition of business incentives. Internationally, countries offer a wide range of incentives to business, ranging from tax holidays, preferential tax rates, grants, preferential loans, monopoly rights and preferential infrastructure access. Broadly, these can be categorised into three main types: (i) indirect (tax) incentives (which are the most commonly used and researched); (ii) direct (financial) incentives and (iii) other incentives (vary significantly across countries). For the purpose of this evaluation, these same categories will be used to define the scope and describe the different types of incentives in play in South Africa.

There is widespread debate on the economic rationale for government intervention in an economy; and the use of business incentives. Nevertheless, the application of incentives is common across countries, and three common concepts have emerged that are generally used to explain why and when governments should intervene in markets. Firstly, governments may intervene in markets to address issues of market failure and economic inefficiencies, such as free-riding, negative externalities and information asymmetries. Secondly, they may intervene to ensure social protection, distributive justice and fair outcomes in societies and markets. Lastly, Government may intervene to support activities contributing to specific economic and industrial development imperatives.

Incentives are ranked relatively low in investor surveys that consider the main determinants of investment, with other factors such as economic and political stability, the volatility of the currency, local market size, the availability of skilled labour and the transparency of the legal framework usually deemed to be much more important. Nevertheless it is acknowledged that incentives are widely used by governments globally and form an important component of many national economic programmes. Recent economic studies reveal that (investment) incentives can have a positive impact; though these effects are generally small and are not constant across different regions or countries. Geographic and demographic characteristics therefore need to be taken into account in the design of new incentives. In addition, serious attention should be given to the possible displacement effects of government interventions. This usually requires thorough cost-benefit analyses prior to implementation.

The available literature provides useful guidelines on the key considerations policy makers should undertake when designing incentive programmes. Specifically, effective and efficient incentives are (i) formulated within and governed by some broader economic and industrial policy objective or framework; (ii) well targeted (clearly specifying qualifying criteria and conditionalities); (iii) sufficiently co-ordinated across regions and sub-national government levels; (iv) transparent and open for public scrutiny; (v) actively managed and (vi) are not an appropriate alternative to ensuring an overall conducive economic environment for business.

South Africa's key economic policies (the NDP, IPAP and Nine-Point Plan) should play a central role in guiding the thinking behind the design and implementation of incentive programmes. Broadly, these policies identify the key constraints facing the South African economy, and the need to promote faster and more inclusive economic growth as well as address high levels of unemployment and inequality. Specifically, these policies identify weak exports; a small and undiversified economy; poor coordination and collaboration within government and between government and the private sector; spatial disparities; energy production and security challenges; and poor institutional and financial support for businesses as common economic constraints. For small and black-owned businesses, highly unequal access to finance, infrastructure and markets, and regulatory and skills constraints, are especially problematic.

Investment incentives in South Africa have a long history. From the wide-scale and well-funded regional development strategies supporting homeland territories under apartheid, to the redistributive (GEAR) and sector specific policies (such as the Motor Industry Development Programme and the Strategic Industrial Program) employed in the mid-1990s. Between 1994 and 2015<sup>1</sup>, it is estimated that the country spent R 84.3 billion on industrial support and development initiatives<sup>2</sup>.

In addition to the on-budget expenditure on industrial development initiatives, tax benefits provided by government to industry have traditionally prioritised a few manufacturing sectors, such as motor vehicles, clothing and textiles, and the small business sector (though many more tax incentives have been made available for other sectors and purposes, most notably in mining and agriculture). The total value of these industry-specific tax benefits between 1995 and 2015 amounted to R 207.3 billion – more than double on-budget expenditure – and accounting for 71% of total “expenditure” on industrial development initiatives. Expressed in constant 2015 prices, South Africa incurred R 393.15 billion in tax expenditure to support industrial development initiatives over this period<sup>3</sup>. No consolidated evidence could be found on the corresponding amount spent to support other sectors of the economy.

## 1.5 LESSONS FROM THE COUNTRY COMPARISONS

The evaluation included a review of the system of incentives in three comparator countries: Thailand, Chile and Germany.<sup>4</sup> All three countries make wide use of incentives to facilitate investment and encourage specific types of business activities. However, the specific approach and focus of the incentive system in each country, differs markedly depending on national priorities. In Chile, incentives are used to support the development of disparate regions; whereas in Thailand, the focus has been on specific sectors and more recently, to encourage international businesses to locate their regional head-offices in the country. In Germany, the system of business incentives focuses strongly on research and the development and SMMEs.

Many of the incentives pursued in these three countries are mirrored in some form in South Africa. There are however a number of lessons that emerge from these country case studies, which could be further considered in the review of South Africa’s system of business incentives. These include:

- The roles and responsibilities of each organisation within the incentive framework must be clearly defined; in Thailand, a central investment agency responsible for the administration of all incentives coordinates investment activities for Government and makes it easier for prospective investors.
- In Chile, incentives are tailor-made to be attractive to selected sectors or business activities that the country wishes to promote. Effective targeting requires a selection

<sup>1</sup> (Jahed, Amra, & Ellse, 2016)

<sup>2</sup> Important to note that this study, and these estimates, are limited to the programmes of the Departments of Trade and Industry, Economic Development and Small Business.

<sup>3</sup> Jahed, Amra, & Ellse, 2016. This includes duty credits provided to manufacturers of vehicles, clothing and textiles, as well as the reduced headline tax rate for small businesses and the 12i and 12g depreciation incentives for manufacturing investment. It excludes tax benefits to R&D, the mining, oil and agriculture sectors and the general depreciation allowances offered by SARS.

<sup>4</sup> The countries were agreed with the Evaluation Project Steering Committee. The selection is intended to offer an array of different approaches to compare South Africa against, and should not be seen as either comprehensive of all national systems nor considered “best practice”.

process based on industry value chain assessments and only those missing links that are critical in the overall industry development receive additional incentive support.

- In Chile, incentives extend beyond traditional sectors to promote venture capital and the development of local capital fund management industries. This includes allowing banks to invest up to the equivalent of one percent of their asset base in venture capital through investment fund administrators and subsidiaries.
- In Germany and Thailand, more generous incentives are offered to projects that are most likely to generate positive externalities by bringing new technology to the country or investing in less-developed provinces.
- In Germany, the amount of support provided is based on the size of the enterprise, with SMEs qualifying for more generous incentives.
- In Chile and Thailand, the incentive system explicitly seeks to attract or support companies that have global or regional ambitions or linkages (such as regional headquarters), by allowing for some activities outside of the country to qualify for benefits (e.g. R&D); by making it easier for firms to undertake international financial transactions; and by eliminating limits on the hiring of foreign professionals.
- In Chile, M&E is institutionalized and managed to inform and provide feedback to decision-making processes. A mechanism is in place for following up on recommendations. Likewise, independent research, and in particular, the use of randomised control studies, is used to assess the effectiveness and impact of government programmes.
- In Thailand, national plans explicitly target improvements in external and international measures of perception, such as the Transparency International Corruption Index; the Institute for Economics and Peace (IEP) Peace Index and independent competitiveness rankings.

## 1.6 CASE STUDIES

The following 20 incentives were selected for case study analysis as part of this evaluation. *These case studies should not be considered or used as independent evaluation reports.* However, as a collection of studies, there are numerous and important themes that do emerge, for which there is sufficient evidence to draw general conclusions about the design, implementation and review of the system of business incentives in South Africa.

**Table 1: Case studies**

Incentive	Department / Agency
The Manufacturing Competitiveness Enhancement Programme (MCEP)	DTI
The Automotive Production and Development Programme (AIS)	DTI
The Tourism Incentive Programme (TIP)	Department of Tourism
The Black Business Supplier Development Programme (BBSDP)	DSBD
The Cooperative Incentive Scheme	DSBD
The SEDA Technology Transfer Fund	SEDA
The TIA Seed Fund	TIA
The Animal and Veld Management Programme (AVMP)	DRDLR
The Agri-Parks Programme	DRDLR
The Green Fund	DBSA
The Jobs Fund	NT
The Gro-E Youth Scheme	IDC
The MERSETA Apprenticeship Programme	MERSETA
The CHIETA Work Integrated Learning Grants	CHIETA
The Local Content Designation – Rail Rolling Stock	DTI
The Employment Tax Incentive (ETI)	SARS/DoL
The Research and Development Tax Incentive (11D of the Income Tax Act)	DST/SARS
The Industrial Policy Projects Incentive (12I of the Income Tax Act)	DTI/SARS
The Manufacturing Incentive (12D of the Income Tax Act)	SARS
The Small Business Incentive (12E of the Income Tax Act) and graduated tax rate structure	SARS

### 1.6.1 The design of incentives

The majority of the incentives reviewed were not constructed on the back of substantial evidence or research. In no cases was there confirmation of economic cost benefit or options analysis, or the use of regulatory or socio-economic impact assessment (RIA or SEIA) techniques. On the other hand, most incentives were informed by some research activity, and for three of the incentives reviewed this research was deemed to be substantive (this includes two pilot studies). Just three programmes could provide or articulate a theory of change.

It would appear that in many cases, incentives have been implemented to meet pressing political or policy concerns, which apply to a specific sector or group of beneficiaries. This is reflected in the high degree of alignment between the twenty incentives reviewed, and government's national policy objectives. However, in doing so, it would seem that insufficient attention is given to the design of specific programmes, and specifically, whether and how an incentive is the best mechanism to address the stated policy problem.

Finally, there appears to be little coordination and learning in government around the design of incentive programmes. Despite the existence of significant expertise in some units, there are weak mechanisms for sharing lessons and information within departments and across

government, and in most instances, officials do not look beyond sector or line department interests. As a result, new incentives do not capitalise on the experience of previous initiatives, and administrative guidelines and systems are usually constructed afresh. There are also differences in definitions and methodologies used by different entities in government (e.g. those that apply to SMMEs or value-added); and differences in the costing, monitoring and evaluation of incentive programmes.

### **1.6.2 The implementation of incentives**

The Government manages incentives in the same way that it manages budget programmes i.e. in most cases incentives are treated as transfers to public or private enterprises, but in a few cases may be treated as goods and services. This approach is strongly influenced by the Auditor General and the National Treasury, and there is consequently a very strong focus on compliance. While this is important to prevent wastage and abuse, it determines how incentives are administered and reported. This approach is problematic in respect of incentives that require multi-year funding commitments. Technically, roll-over requests are possible, but these are not always granted. While this is perfectly understandable in respect of other (non-incentive) grant programmes it is a significant risk in the case of incentives where third parties make very large and significant investments (often with a matched funding component) based on the anticipation of public money.

In general, the guidelines for specific incentives in South Africa are clear and in almost all cases, publicly available. This points to a high degree of transparency across the system. There are however instances where the application of specific guidelines and criteria is unclear, or where interpretations and processes shift (sometimes becoming tighter and sometimes looser) in response to changing political or economic demands, or financial constraints. Whereas it is important for policies to adjust to changing circumstances, this may in cases reduce the certainty and value attached to some incentives. Appeals and enforcement processes are generally weak or missing.

Most departments report a lack of human resources to effectively manage and monitor incentives. Application and approval systems are mostly incomplete or manual, and this greatly increases the administrative burden for both government and beneficiaries, undermines data collection efforts/data integrity, and hinders the monitoring and evaluation of incentives. Where fully automated systems are in place, they appear to work well. More importantly, in some departments, there is insufficient capacity to undertake site visits, address complaints and verify outcomes. Generally, there is an underestimation of the programme management resources (people, systems and operating budgets) required to properly administer incentive systems.

Finally, there is disagreement as to the use and usefulness of consultants (and other intermediaries). A few programmes recognise the need for specialist consultants to market and distribute incentives more widely or prefer to work through some kind of wholesale organisation and have formally incorporated these mechanisms into the design of the incentive. Similarly, some respondents argue that consultants are necessary to navigate complex rules and procedures; or access information and officials. But most departments see consultants as an unnecessary cost to the beneficiary.

### **1.6.3 The review of incentives**

With few exceptions, monitoring and evaluation is not fully incorporated in the design of new incentives. Just four of the twenty incentives had a comprehensive M&E framework in place, and in half of the cases, there was no indication that M&E processes and indicators had been considered up-front. It follows that appropriate monitoring indicators are seldom defined.

Whereas most incentives report on outputs (i.e. the number and value of grants disbursed to beneficiaries), there is little information on programme outcomes (i.e. such as the resulting increase in employment, revenue or R&D over time). Moreover, where outcome data is reported, it is often collected at the application stage, and not tracked or verified going forward.

Finally, reviews and evaluations are conducted for most incentives, but in many cases these reviews are not sufficiently substantive, or are done internally. There is also a strong focus on project outputs and compliance, rather than on beneficiary and economic outcomes.

## **1.7 KEY EVALUATION FINDINGS**

The terms of reference set out 7 key evaluation questions to be addressed through this evaluation. Information and data was collected from the literature and document review; consultations with government, business and other industry stakeholders; the inventory of business incentives that was developed as part of this evaluation; and the 20 case studies. The main findings from these different components are set out against these 7 questions below.

### **1.7.1 What are the business incentives that are currently offered by the South African Government?**

In total, 244 business incentives were identified and captured in the inventory database. This includes 64 direct incentives; 43 indirect (tax) incentives<sup>5</sup>; 10 other incentives (mostly information services) and 127 different SETA grant programmes. Most (56% in number, not value) of the direct incentives are offered in the form of subsidies or grants. Accelerated depreciation provisions account for the largest number of indirect incentives, though there are also numerous allowances for reduced tax rates and tax exemptions. Only three demand-side incentives were found, two of which are implemented through the government procurement system – and a third which seeks to shift consumer demand in the motor industry.

### **1.7.2 Why are government business incentives important and how?**

In general, incentives are used to assist firms to overcome specific market failures, or to encourage firms to undertake activities which generate wider spill-over benefits for the economy or society. In South Africa, the greatest amount of funding goes to capital incentives, where market failures are not the primary focus. Rather, it would seem that investment incentives are used to mitigate against the cost or uncertainty of doing business in South Africa, and to upgrade or sustain production and employment, especially in priority sectors. In addition, the South African Government sees business incentives as an important mechanism to raise competitiveness, address historical inequalities and increase the participation of historically disadvantaged groups in the economy. Conversely, many incentives are designed to address market failures in the labour market, where there is a significant mismatch between the skills generated by the education system and the needs of business.

### **1.7.3 Is the incentive package achieving the broader objectives and are they aligned with overarching frameworks and plans?**

The incentive system is well-aligned with Government's overall economic objectives – to raise investment and reduce inequality and unemployment – and specific incentives are clearly targeted at industries that are a stated policy priority or addressing key areas of market failure. It is much more difficult to assess whether the system is actually contributing towards the

<sup>5</sup> All of which are administered either wholly, or jointly with another department, by SARS.

achievement of these objectives. This is partly because very few incentives are designed with the purpose of achieving these policy outcomes, or the mechanism through which they do so has not been fully articulated; and partly because firm behaviour and performance is dependent on so many other economic and social factors. As a result, the extent to which these outcomes are realised, is not reported and cannot be measured or evaluated. Moreover, a large part of the incentive system is oriented towards sustaining mature industries and protecting workers in existing companies, rather than facilitating new entrants (companies or sectors) or technology diffusion. Over time, this may limit the ability of the system to contribute towards the creation of new jobs and more dynamic economic growth.

#### **1.7.4 Do these incentive programs complement each other in relation to the frameworks/plans and what are the gaps?**

There is little evidence to suggest that incentives in South Africa are designed, managed or reported in a systematic way. Rather, different departments and agencies assume responsibility for the implementation of their own programmes, to address their specific interests and those of their constituency, while also accounting for the Government's wider policy objectives. In doing so, most incentives come with multiple objectives, many of which overlap and some of which conflict with the primary purpose of the incentive. Moreover, most government departments are unable to manage or report on these multiple objectives, and do not have the skills in-house to advise on aspects which often fall outside of their core mandate. There is also a risk that in loading incentives with too many sub-objectives, some areas that are deserving of more focused intervention, are effectively neglected. Specifically, in South Africa, it would seem that insufficient attention has been given to supporting R&D activities and innovation across all sectors of the economy.

#### **1.7.5 What is the overall Theory of Change (or theories of change) for government business incentives and is it (are they) working as planned?**

The overall system-level theory of change is valid and does capture the intent and programme logic of individual incentives. Based on the interviews, workshops with stakeholders and case studies there is evidence that the logic of the ToC breaks down in a number of key areas at the level of design, implementation and monitoring and evaluation. The lack of adequate M&E (which is directly linked to adequate design and the development of appropriate incentive-level ToCs) means that there is insufficient evidence at the outcome level. While there is some evidence that individual incentives are supporting individual firms and at the intermediate outcome level are contributing to increased economic participation, the available data suggest that at the outcome level key results such as increased economic productivity, expanded production and employment are not being realised to the extent envisaged. This is partly because of broader issues (key assumptions in the theory of change) such as confidence in the general economic environment, the cost of doing business and the competitive structure of many industries; but weaknesses in monitoring and evaluation also mean that the contribution of incentives cannot easily be isolated.

#### **1.7.6 How does South Africa compare with other countries on business incentives?**

South Africa offers an elaborate mix of business incentives that cut across multiple departments and sectors. As such, the system appears less coordinated and focused than those in the comparator countries. This possibly explains why most respondents perceive incentives in South Africa to be of similar value, but less effective, than incentives elsewhere. It would also appear that in some of the comparator countries, greater attention is given to the economic design and targeting of specific incentives, and more rigorous processes are in place for monitoring success. Likewise, these countries seem to place greater emphasis on supporting new businesses and technology; especially in less-developed regions.

### 1.7.7 How can the system of business incentives be strengthened and achieve greater value for money to enhance more inclusive economic growth in the country?

It is estimated that South Africa spent between R 40 billion and R 45 billion on business incentives in 2014/15. This is now probably closer to R 50 billion; equivalent to around 3% of the national budget in 2018/19. Whereas the scale of this transfer is substantial, and most government departments report on the amount spent and the number of beneficiaries, there is limited information available on the outcomes (or returns) on this investment. As a first step in strengthening the system of incentives, greater effort must be placed on specifying the economic rationale (including the costs and benefits) associated with proposed interventions, and ensuring that these costs and benefits are measured, monitored and evaluated fully over time. Moreover, to maximise the potential gains from the system, incentives should be more closely directed at specific policy concerns or market failures, and support firm-level activities that create the strongest potential for spill-overs.

## 1.8 RECOMMENDATIONS

The evaluation demonstrates the substantial scale of business incentives in South Africa and highlights numerous innovations and successes in the delivery of specific programmes. It is however important to emphasise that the focus of this evaluation is on the overall system of incentives, and not on the performance of individual interventions. The following recommendations therefore focus on the general lessons emerging from this study, which cut across most but not all incentives, and how the overall system of business incentives in South Africa can be strengthened.

### 1.8.1 Recommendations to enhance the governance of the incentive system

- R1 Establish an **Inter-Governmental Incentives Coordinating Committee (IGICC)**. This committee should include the National Treasury, DTI, DST, SARS and the DPME
- R2 The Government Business Incentives Evaluation Steering Committee should develop the terms of reference of the IGICC for approval by Cabinet. The primary role of the IGICC is to develop a **National Incentives Policy Framework**. This National Incentives Policy Framework must be informed by existing policy priorities, such as the National Development Plan and the Industrial Policy Action Plan, and should serve to:
- Define the specific types of interventions to be governed by the National Incentives Policy Framework.
  - Articulate the economic rationale and the resulting design principles for different types of incentives<sup>6</sup>.
  - Prioritise (and ideally reduce) the policy objectives that individual incentives are expected to fulfil.
  - Seek to consolidate the number of incentives that are available, under a smaller number of well-functioning departments or agencies.
  - Set specific criteria to be used in the review of all existing incentives and the evaluation of all planned incentives.

<sup>6</sup> As a starting point, the Committee can draw on the principles derived from the literature and synthesised in Section 9.7.2 of this evaluation; and for tax incentives, on the work that has been undertaken by the Tax Policy Unit of the National Treasury.



- Describe the process to be applied in the review of all existing incentives and the evaluation of all planned incentives.
  - Determine minimum standards for the budgeting, administration, accounting, monitoring and evaluation of incentives.
  - Establish roles and responsibilities, including coordination and information-sharing mechanisms.
  - Articulate the need for international, domestic and independent expertise in an advisory capacity.
- R3** Given the economically sensitive nature of incentives, a **Communications Plan** should be developed by Cabinet for immediate public release. This plan should outline the overall review process, governance arrangements, proposed actions and timelines and offer assurance to the market that no immediate changes are envisaged.
- R4** Based on the National Incentive Policy Framework, the National Treasury should develop a **methodology for evaluating the motivation for and the associated economic costs and benefits of new and existing incentives**, relative to alternative policy options. All applications for new incentives should be assessed against the National Incentives Policy Framework, in accordance with the methodology developed by the National Treasury. Moreover, any changes to existing incentives should be subject to such an assessment, and over the next three years, **all business incentives should be reviewed against the National Incentive Policy Framework**.
- R5** Based on the National Incentives Policy Framework, the National Treasury, in collaboration with the DPME, should develop **minimum annual reporting requirements for all government incentives**, including on expenditure, incentive outputs and on all agreed measures of economic or social outcomes. This information should be published in the annual reports of the responsible department or agency and consolidated in the annual Budget Review.
- R6** A **single register of all beneficiary firms** should be developed to be administered by the National Treasury or SARS. All departments and agencies should be required to report information to this register, and the register should be made accessible to all relevant departments and their agencies. Moreover, consideration should be given to making part of the register of beneficiaries (i.e. company names) accessible for public scrutiny<sup>7</sup>.
- R7** The IGICC should oversee the appointment of a service provider to design and development of a **comprehensive and on-line grant and document management system**, which can be used for the administration of all DTI incentives; and by extension, can be made available for the use by any other Department or Agency involved in the delivery of incentives. In developing the system, the service provider should review existing systems across government and identify opportunities for re-use, expansion or collaboration to minimise costs. The system should enhance the administration of incentives and meet minimum reporting and financial management

<sup>7</sup> In determining the information to be included in this register, full consideration will need to be given to the SARS and Tax Administration Act, which governs the use and confidentiality of taxpayer information.

(PFMA) requirements. Consideration should be given to utilising the National Treasury or alternatively the DTI as the procurement / contracting party.

### 1.8.2 Recommendations to enhance the evaluation of the incentive system

- R8** The DPME should **review the status and the depth of all internal and external evaluations**, across all of the incentives identified in this study (with budgets of more than R 100 million per year). Those incentives that have not yet been subjected to an independent evaluation should be prioritised for inclusion in the national evaluation plan.
- R9** All departments responsible for the administration of business incentives (existing and new) should **develop a comprehensive monitoring and evaluation framework**, and sufficient resources should be made available for monitoring and evaluation in programme budgets. Based on the National Incentives Policy Framework, the DPME should issue guidelines to assist departments in the design and implementation of M&E frameworks, and to advise on appropriate costs.
- R10** All **ex-ante assessments and ex-post evaluations of new or existing incentives should be made public**.

### 1.8.3 Recommendations to enhance the application of the Public Finance Management Act

- R11** The National Treasury (including the Budget Office, Public Finance, Office of the Chief Procurement Officer and the Account General), in collaboration with the Auditor General, should develop **a practice note in terms of the Public Finance Management Act** setting out clear guidance as to the treatment of incentives to assist departments in budgeting for and managing incentives over multiple financial years, and to clarify accounting, reporting and verification requirements. Specifically, this note must address the significant risk incentives face with respect to the current roll-over process and ensure the availability of contracted funding amounts.

### 1.8.4 Recommendations to review components of the incentive system

- R12** The National Treasury, in collaboration with SARS, should undertake a **review of all of the tax incentives** identified in this study and assess whether they are still relevant, effective and efficient. In undertaking this review reference should be made to the findings and recommendations of the Davis Tax Commission.
- R13** The Department of Science and Technology, in consultation with the DTI, should undertake **a review of South Africa's overall support offering for the commercialisation of research and development**, including policies and programmes to advance the digital economy, compared to international best practice. Specific attention should be given to the use of demand-side incentives to encourage the up-take and spread of new technologies.

- R14** The Department of Higher Education and Training should introduce a **common budget and programme reporting framework for all SETAs**; and should establish a mechanism through which the SETAs can share ideas and collaborate on skills initiatives that are currently delivered by individual SETAs but could be replicated and delivered more effectively across all sectors.

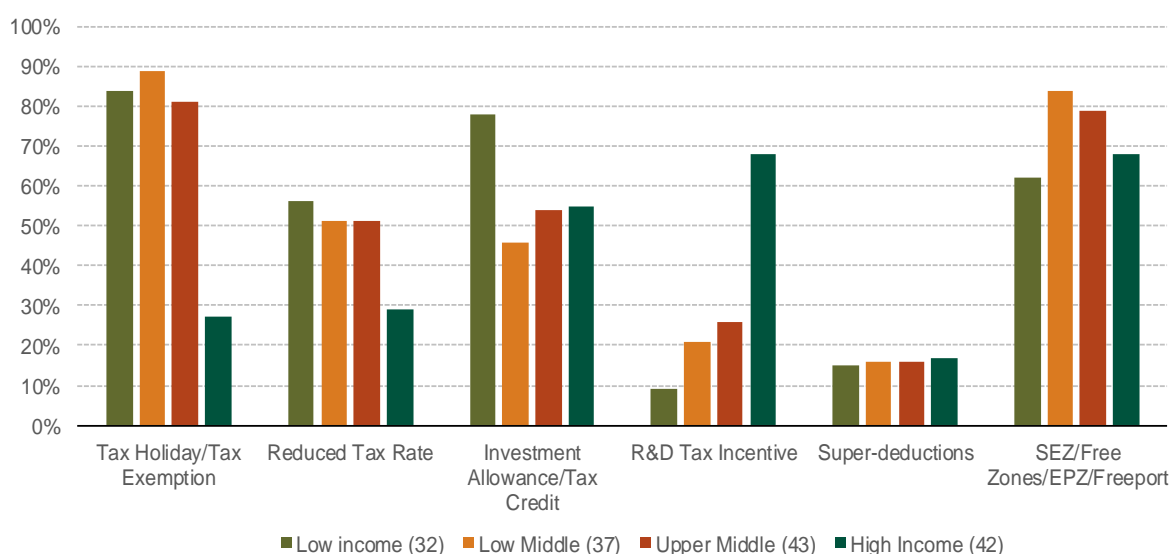
## 2 Introduction

This evaluation takes as its starting point that business incentives are a key component of any national economic policy and programme. However, incentives require careful design, implementation and ongoing review if they are not to create distortions, inefficiencies and contradictions in the economy. This evaluation therefore aims to support the development of a more considered and coherent approach to the system of business incentives, that will ultimately serve to enhance the economic and social gains on the substantial support and investment that is already provided by government.

### 2.1 The context of this evaluation

Almost all countries provide some form of tax or fiscal incentive to support the business sector. The form and target of this assistance differs markedly by country, but usually includes some combination of tax holidays, investment allowances or credits, reduced tax rates, research and development (R&D) incentives and Special Economic Zones (SEZs). Moreover, whereas low and middle income countries favour simple tax holidays, tax reductions and investment allowances, high income countries generally make greater use of R&D incentives and zone based programmes. Figure 2 below shows the percent of countries across four income groups that have indicated the presence of an incentive.

**Figure 2: The use of investment incentives**



Source: Calculations from James (2014). The sample size per income group is in brackets

Despite the widespread use of incentives, there is still debate as to their usefulness and efficiency. For example, in most firm level surveys, incentives are ranked relatively low amongst the main determinants of investment, with other factors such as economic and political stability, local market size, the availability of skilled labour and the transparency of the legal framework usually deemed to be much more important. Nevertheless, it is generally accepted that investment incentives can still play an important role at influencing investment

decisions at the margin.<sup>8</sup> Additionally it is noted that business incentives form a core component in most country's economic policy and programmes and are generally expected within the international investment community.

Similarly, incentives that are designed to achieve specific social and economic outcomes, such as exporting, research and development and skills development, can be very effective in influencing firm behaviour. When designed well, business incentive schemes can therefore serve to support government priorities and provide beneficiary firms with needed and targeted support. On the other hand, badly designed or managed incentive schemes lead to unnecessary waste, economic distortion and displacement, and other unintended consequences.

Finally, it is important to recognise that the system of business incentives in place in South Africa is informed by the current economic and social context; and the South African Government's response to the domestic and global economic environment (as reflected in recent policy documents and statements such as the National Development Plan and the Industrial Policy Action Plans). Likewise, the effectiveness and impact of the system of incentives is greatly influenced by domestic economic and social conditions, and the overall state of the global economy.

## **2.2 Purpose of the evaluation**

The South African Government uses a wide range of incentives to encourage firms to act or invest in specific activities or contribute to certain social or economic outcomes. Whereas individual programmes are monitored and regularly evaluated, these provide for a partial assessment of how the system as a whole is working together to support business and benefit society.

This purpose of this evaluation is to bring together a consistent set of information across the entire national system of business incentives, identify overlaps and complementarities, and explore how specific programmes and the system as a whole have been structured to achieve government's wider policy objectives. In doing so, this evaluation assesses whether the system is working effectively, efficiently and coherently, and makes recommendations on how the system can be improved.

Importantly this evaluation does not evaluate or make any findings and recommendations in respect of the efficacy or efficiency of any individual incentives.

<sup>8</sup> (Blomstrom, 2002)

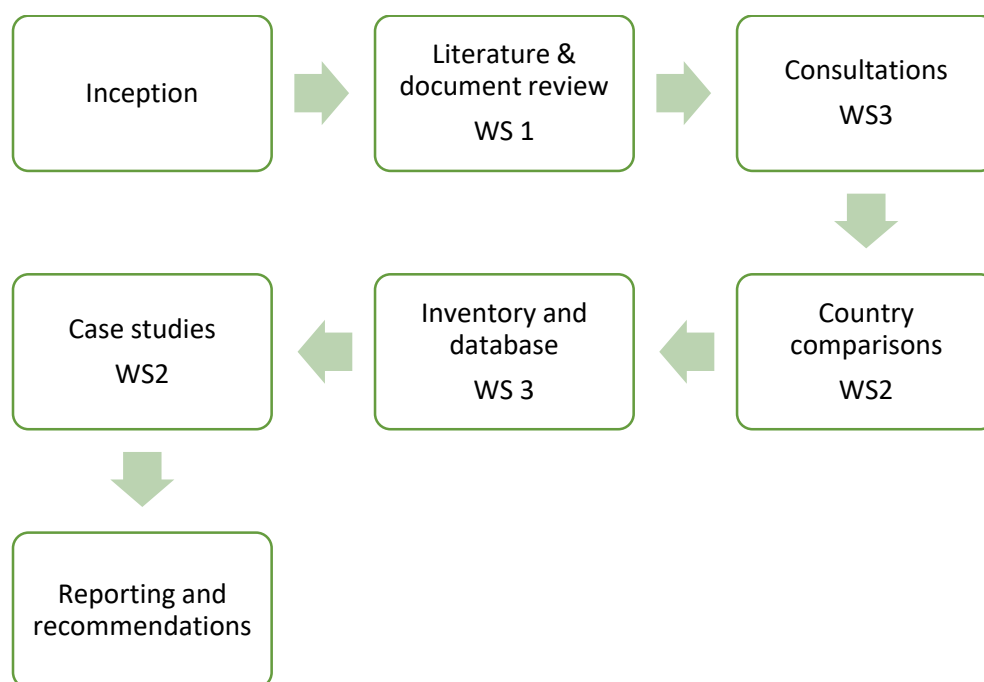
### 3 Methodology

#### 3.1 Evaluation Methods

There are many types of evaluations, each with a different purpose and scope. This particular evaluation is complex and unique in that it includes multiple but rapid implementation evaluations, of numerous different incentive programmes; as well as a formative-type evaluation of the (national) business incentive system. In doing so, this evaluation will provide selected information on the performance of various incentive programmes, but ultimately, it serves to assess the rationale, relevance and design of the system in its entirety.

This evaluation was carried out in six stages over 18 months as illustrated and explained below. Given the complexity and scale of this project, the consulting team was divided into 3 main work-streams, each with a dedicated work-stream leader. In addition, an independent quality assurance team was appointed to input into the methodology and recommendations and provide technical oversight for the duration of the project.

**Figure 3: Project stages and work streams**



Following the inception phase, the available literature on the use and effectiveness of incentives, internationally and in South Africa, was reviewed. The review focused on different economic definitions of incentives, the rationale for government intervention and principles of good practice, and the South African policy experience.

Based on the literature review, an initial theory of change was developed for the system of business incentives and validated in a workshop with the Steering Committee. The evaluation framework and all associated research instruments were derived from this theory of change. The theory of change has subsequently been extended to cater for different categories of incentives.

A core task of this project was to compile a usable inventory of all business incentive programmes available at the national level, including all grants and tax and financial concessions. For the purpose of this evaluation, an Excel-based database was designed and

developed, prior to the data collection exercise. This database includes three main worksheets, which together provide information on 244 identified incentives.

The first sheet records all available information on the design and implementation of the incentive. This includes:

- A basic description of the incentive, and its start and end date;
- The implementing department or agency, with contact details;
- The main objectives of the incentive, and any specific criteria or target sectors; and
- A categorisation of the incentive and the type of support provided.

Some incentives have multiple sub-programmes, and the same information is then recorded, for all substantive sub-programmes, in the second sheet of the database.

The third and final sheet records all available performance information, for the identified incentives and their sub-programmes. This includes:

- Budget information, for the three-year period from 2013/14 to 2015/16;
- Programme outputs, such as the number and type of firms and employees supported; and
- Programme outcomes, such as the amount of investment, exports, R&D, skills or transformation generated as a result of the incentive.

During the data collection process, it became apparent that the sector, education and training authorities (SETAs) offer numerous incentives to their members, all of which are similar in design and implementation. Moreover, the SETA programmes are funded and function differently, from most other business incentives. For these reasons, a separate (but identical) database was used to capture and analyse the information collected from the SETAs.

Two sets of consultations were undertaken over the study period. Firstly, at the national level, interviews were conducted with 22 officials and 13 business people and academics. These interviews provided insights into the design, implementation and evaluation of incentives, and the coordination of incentives across government.

Secondly, case studies were completed of 20 specific incentives. These studies included interviews with a further 74 officials and 79 representatives from industry.

The study also included country comparisons of business incentives in three countries: Chile, Thailand and Germany.

The results from all of this analysis and the consultations are presented in this consolidated, draft report.

### **3.2 Evaluation questions**

The evaluation comprises two main elements: firstly, an assessment of the entire system of business incentives, and secondly a number of case studies of specific business incentives.

In respect of the overall assessment the following key questions were posed in the terms of reference:

- 1) What are the business incentives that are currently offered by the South African Government (inventory of incentives)?
- 2) Why are government business incentives important and how? (brief background to government business incentives)
- 3) Is the incentive package achieving the broader objectives and are they aligned with overarching frameworks and plans?
  - a. Do they appear to be effective and efficient in relation to the National Development Plan (NDP) and National Industrial Policy Framework?
- 4) Do these incentive programs complement each other in relation to the frameworks/plans and what are the gaps?
  - a. Are the incentive instruments helping to align private sector and government objectives?
- 5) What is the overall Theory of Change (or theories of change) for government business incentives and is it (are they) working as planned? (the TOC should provide a detailed explanation how the schemes were conceptualised and how they are working in practice)
- 6) How does South Africa compare with other countries on business incentives?
- 7) How can the system of business incentives be strengthened and achieve greater value for money to enhance more inclusive economic growth in the country?
  - a. How do we strike a balance between strategic use of demand side instruments and fiscal support?
  - b. What incentive instruments work best be it direct fiscal transfers, tax instruments, and concessional finance or demand side instruments?
  - c. Does South Africa realise a return on investment from these business incentives against the cost of delivering them?

Additionally, the evaluation required the selection of 20 case studies from the inventory of incentives that was developed as part of this project. Each case study covers the following additional questions:

- What is the Theory of Change and Logframe for the selected incentive programme? Does the Theory of Change appear to be working?
- Is the incentive programme achieving its intended objectives? (e.g. number of jobs created against the set targets and the extent to which outcomes achieved)
- Is it aligned with the overarching plans and frameworks? (i.e. National Development Plan, 9 Point Plan and National Industrial Policy Framework)
- Is there a return on investment against the cost of delivering the incentive programme?



### **3.3 Limitations of the evaluation**

The main limitation of this evaluation is the lack of outcome information across most of the incentives captured in the inventory and investigated further in the case studies. Moreover, for many incentives, reliable expenditure and output data is not available. As a result, it was not possible to calculate the return of investment for most of the incentives reviewed, and for the system as a whole. Where output and expenditure data are available, appropriate ratios (i.e. average cost of jobs created) have been calculated.

It is also important to acknowledge that the case studies and consultations that took place over the course of this evaluation do not represent the full spectrum of business incentives that are currently offered in South Africa, nor do they reflect the experiences of all implementing agents and beneficiaries. As such, the report is affected by the composition of the respondents, their individual experiences of the system of businesses incentives, and the specific incentive programmes captured in the case studies.

Despite these limitations, the information that has been collected and analysed from various different sources through this evaluation, is remarkably consistent, and provides sufficient evidence to draw general conclusions about the design, implementation and review of business incentives in South Africa.

## 4 Document and literature review

### 4.1 Introduction

There is extensive local and international literature on the use and effectiveness of incentives. This literature has been reviewed as a first step in this project. However, given the breadth of this literature, the focus of this review is on the following key evaluation questions:

- What types of business incentives work best (e.g. demand vs. supply side incentives), and under what conditions (assumptions)?
- In what ways do business incentives influence firm behaviour (outputs) and contribute to wider economic or social outcomes?
- What structures or systems can be put in place to maximise the benefits and mitigate the costs (risks) associated with incentives?

It is also important to recognise that the system of business incentives in place in South Africa is informed by the current economic and social context; and the South African Government's response to the domestic and global economic environment (as reflected in recent policy documents and statements such as the National Development Plan, the Industrial Policy Action Plans and the President's Nine-Point Plan). The Government's priority plans and objectives for business, as outlined in these policies and plans, are also considered as part of this document and literature review.

### 4.2 Understanding business incentives

#### 4.2.1 Definitions

At the outset of this evaluation it is important to reach agreement on what is included in the scope of the study, and what is not. Arriving at a finite definition of a 'business incentive' is a relatively difficult task. The broad nature of their application and the boundaries defining incentives are not always clear, making it difficult to come to a universally agreed definition. No internationally agreed upon definition of a 'business incentive' could be found, and the various existing definitions are either very broad (covering virtually all government policies and programmes that impact on the private sector) or very narrow (covering only specific types of assistance, usually limited to investors).

Bartik (2007) for example, describes incentives as "cash or near-cash assistance provided on a discretionary basis to attract or retain business operations owned by large businesses".<sup>9</sup> He highlights property and income tax exemptions, access to low-interest financing and complementary land or buildings as examples of such business incentives.<sup>10</sup> Whether it be to promote and attract foreign and domestic investments, support job creation or the development of rural or underdeveloped geographic regions, these incentives are directed towards supporting overall economic performance and development. Hurwitz (2015) defines an incentive as "a reward intended to induce, entice [sic], or spur action".<sup>11</sup> Hurwitz also notes

<sup>9</sup> (Bartik T. , 2007)

<sup>10</sup> (Bartik T. J., 2005)

<sup>11</sup> (Hurwitz, et al., 2015)

that, in an effort to improve the socioeconomic conditions of communities, policy makers offer incentives so as to increase investment and employment by the private sector.

In addition, the literature review reveals that a multitude of different terms are used to describe 'business incentives', including, *investment incentives*; *economic development incentives* as well as *industrial incentives*. Thus, in effect, any measure targeted at or assigning general preferential treatment to businesses, sectors or industries can broadly be considered an incentive. For example, if country X decides to institute an across-the-board reduction in its corporate tax rate so that it induces firms to relocate from a neighbouring country Y, this constitutes a generally applied incentive, even though it may not be regarded in country X to be part of a specific incentive scheme. However, in this evaluation, it is proposed that a more purposeful and therefore narrower definition be applied. Specifically, any government measures that are applied to induce a specific economic response from business in a specific location, sector or industry (e.g. a lower corporate tax rate being offered to medium-sized manufacturing firms in a particular region), are categorised as incentives in this report.<sup>12</sup>

This definition is in line with the approach of UNCTAD and the OECD. According to UNCTAD (2003), an incentive is 'any measurable advantage accorded to specific enterprises or categories of enterprises by (or at the direction of) government'.<sup>13</sup> The Organisation for Economic Co-operation and Development (OECD) defines investment incentives as "measures designed to influence the size, location, or industry of an FDI investment project by affecting its relative cost or by altering the risks attached to it through inducements that are not available to comparable domestic investors".<sup>14</sup> Similarly, Tuomi (2012) defines investment incentives as "legislative measures aimed at stimulating investment".<sup>15</sup>

Business incentives can be administered at both a national and/or provincial level and come in various forms including, but not limited to, direct transfers (grants), tax rebates and concessional financing.<sup>16</sup> The main types of business incentives used and available internationally are described in Section 4.2.2 below.

#### 4.2.2 Types of business incentives

Internationally, countries offer a wide range of incentives to business, ranging from tax holidays, preferential tax rates, grants, preferential loans, monopoly rights and preferential infrastructure access. Broadly, these can be categorised into three main types: (i) indirect (tax) incentives (which are the most commonly used and researched); (ii) direct (financial) incentives and (iii) other incentives (vary significantly across countries). Tax incentives are also commonly referred to as fiscal incentives although it is recognised that fiscal incentives often include both tax and non-tax financial incentives, such as subsidies.

Direct incentives include cash payments/grants or payments-in-kind (such as land or infrastructure transfers) made to the investor and are a direct cost to the government's budget requiring "upfront use of government funds".<sup>17</sup> Indirect incentives usually refer to tax incentives and generally provide for a reduction in taxes, including tariff rates on imported inputs. Lastly,

<sup>12</sup> (Jordaan, 2012) and (OECD, 2003)

<sup>13</sup> (UNCTAD, 2003)

<sup>14</sup> (OECD, 2003)

<sup>15</sup> (Tuomi, 2012)

<sup>16</sup> (The Federal Reserve Board, 2007); (Jordaan, 2012) and (Council for Community and Economic Research, 2015)

<sup>17</sup> (UNCTAD, 2000, p. 11)

other non-financial incentives encompass a multitude of benefits including reduced administrative procedures, legislative exemptions and Special Economic Zones.<sup>18</sup>

Another way of categorising incentives is by the specific stage in the project development cycle that they target and thereby support, namely:<sup>19</sup>

- Conceptualisation of the project, including assistance for feasibility studies and research and development;
- Capital expenditure, usually involving some form of subsidy to the creation or expansion of the productive capacity of businesses; and
- Competitiveness enhancement, such as technical or financial support to improving efficiencies and enhancing the competitiveness of established companies and commercial or industrial sectors.

In this evaluation, it is initially proposed that the first and most simple classification is used, as is described below.

#### **4.2.2.1 Indirect (tax) incentives**

Tax incentives include all legislative or administrative offerings that provide for the more favourable tax treatment of specific activities (such as research and development) or sectors (such as manufacturing), compared to what is granted to industry in general. UNCTAD (2000) defines tax incentives as exemptions from the general tax regime that reduce the tax burden of businesses so as to induce them to invest in a particular project or region; the SADC MOU on taxation, signed in 2002, defines tax incentives as “fiscal measures that are used to attract local or foreign investment capital to certain economic activities or particular areas in a country”.<sup>20</sup> A general “across-the-board” tax rate cut would not be considered a tax incentive.

#### **4.2.2.2 Direct (financial) incentives**

Direct incentives refer to the upfront provision of finance, from Government, primarily to reduce the initial high capital costs faced at the beginning of a new investment. They may however be offered to upgrade or stabilise an investor’s operations. These range from cash grants, loans, interest subsidies as well as the provision of job training subsidies.

#### **4.2.2.3 Other incentives**

There are a number of ‘other’ non-fiscal, non-financial incentives which include, but are in no way limited to the following: regulatory incentives, subsidised services, market privileges, information/education and research and even export assistance through exporter development/support programmes. In all the incentive cases discussed thus far, the firm, and not an individual, is the initial and direct recipient of the business incentive.

Table 2 below provides a non-exhaustive summary of the various types of incentives that are applied, internationally, in each of these categories.

<sup>18</sup> (Barbour, 2005)

<sup>19</sup> (Government Investment Incentives, 2015)

<sup>20</sup> (Southern African Customs Union, 2002)

**Table 2: Summary of types of Business Incentives**

Type of Incentive	Characteristics
<b>Fiscal (tax) Incentives</b>	
Tax holidays	Temporarily exempt (fully or partially) a new firm or investment from certain specified taxes such as corporate income tax and can sometimes be coupled with the exemption from administrative requirements.
Special zones	Specified geographic locations in which qualifying firms can locate and thus benefit from exemption of various taxes and/or administrative requirements. These are often directed towards exporters and located close to ports.
Investment tax credits	Deductions of a certain proportion of an investment from its total tax liability.
Investment allowances	Deductions of a certain proportion of an investment from its total taxable profits and will thus vary between firms based on profits.
Accelerated depreciation	Accelerated depreciation of assets through a faster depreciation schedule than that available to the rest of the economy
Reduced tax rates	Lower tax rates offered to a new firm or investment compared to the prevailing tax rates
Tax exemptions	Exemption from various taxes such as VAT, tariffs and excise on imported capital equipment or inputs.
Loss carry forward	Write-off of losses against gross profits of following years
Financing incentives	Such as the reduction of tax rates applied to finance providers and may include lower withholding tax rates on dividends
<b>Financial Incentives</b>	
Subsidies/grants	Outright grants, upfront subsidies and subsidised loans
Public guarantees	Government insurance at preferential rates/publicly funded venture capital participating in investments involving high commercial risk
Public loans	Subsidised financing through parastatal lending or equity
Land and infrastructure incentives	Sale of public land/buildings at below market prices
Job training subsidies	Subsidised training programs and education commitments or subsidies to reduce investor's staffing costs
<b>Other incentives</b>	

Type of Incentive	Characteristics
Regulatory incentives	Exemption from specific rules and regulations
Reduced administrative procedures	Streamlined administrative procedures or exemptions from certain administrative requirements
Special Economic Zones	Such as Export Processing Zones which offer a combination of fiscal and non-fiscal incentives within a particular geographic location
Sectoral incentives	Legislation and/or policies that promote investment into certain sectors, or by certain investors
Reduced input prices	Special prices being offered for government services (e.g. bulk services, oil)
Market privileges	Special or preferential access to certain markets for specific goods or services
Information, education and research	Includes business information offices, classes and training, development centres, small business incubators, centres of excellence, research oriented industrial parks, applied research grants, technology transfer programs
Demand side instruments	Used to induce a certain behaviour (e.g. increased spend on R&D or innovation) by supporting increased public/private demand for that good or service

*Source: Author's compilation from multiple sources*

### 4.2.3 Supply and demand side incentives

Most of the above-mentioned incentives work through the supply-side; they seek to encourage firms to raise investment, production and employment. But many countries also make use of demand-side incentives and instruments to drive demand for a particular outcome – such as innovation, education, energy-efficiency, public transport or healthcare – which in-turn encourages business to increase supply or speeds up the uptake and diffusion of specific types of goods or services.<sup>21</sup>

Demand-side incentives are often directed towards supporting private and public (government) demand for research and development (R&D), innovation and technology.<sup>22</sup> Generally, this includes some form of direct or indirect government intervention to promote the demand for innovative technologies and thus increased investment by firms in R&D activities. This is evidenced in numerous demand side programmes that have been implemented in the European Union, the United States of America, UK, Korea and the Netherlands (see

<sup>21</sup> (European Commission, 2015)

<sup>22</sup> (European Commission, 2015)

Box 1 below). Demand can also be ‘managed’ through the introduction of new functional requirements for products or services or by improving user involvement in production.<sup>23</sup> According to Chang (1997), South Africa needs to consider the role of demand side policies in its overall industrial policy framework as these have to work together with supply side policies already in existence across industries.<sup>24</sup>

Demand-side instruments can broadly be defined into four categories based primarily on the “type” of demand being influenced (as outlined in Table 3 below).

**Table 3: General Typology of Demand-side incentives**

Instrument	Characteristics
<b>Public demand: State procurement for own use or to catalyse private market</b>	
General procurement	Innovation is considered as a key criterion in general government procurement
Strategic procurement	Government specifically demands an existing innovation to accelerate market introduction and diffusion
	Government stimulates the development and introduction of innovation by formulating new, demanding needs (usually includes forward commitment procurement)
Co-operative and catalytic procurement	Government participates in a group of demanders and organises the co-ordination of the procurement and specification of needs
	Government organises private procurement but does not utilise the innovation itself
<b>Support for private demand</b>	
<i>Direct support</i>	
Demand subsidies	Direct subsidies granted to consumers or industries for purchases of innovative technologies thus lowering the entry costs of an innovation
Tax incentives	Amortisation options for certain innovative technologies
<i>Indirect support</i>	
Awareness building	Government creates increased awareness and confidence in certain innovation by hosting innovation campaigns, advertising new solutions & conducting demonstrations

<sup>23</sup> (Elder, 2013)

<sup>24</sup> (Chang, 1997)

Instrument	Characteristics
Information campaigns	Government supports co-ordinated private market activities signalling performance and safety features
Training and further education	Consumers are made aware of innovative possibilities and simultaneously placed in a position to actually use them
Articulation and foresight	Societal groups & potential customers are given voice in the market place providing signals to future preferences/fears and signalled to market
User-producer interaction	Government support to firms to enable them to include user needs in innovation activity (i.e. innovation platforms)
<b>Regulation of demand or of the producer</b>	
Regulation of product performance and manufacturing	Government sets production requirements thus making end buyers well informed on manufacturing processes and product performance
Regulation of product information	Regulation leaving the innovators with the freedom to choose technologies, but changing the incentive structures for those choices (e.g. quota systems)
Process and "Usage" norms	Government creates legal security by setting up clear rules on the use of innovations e.g. use of electronic signatures
Support of innovation-friendly private regulation activities	Government stimulates self-regulation (norms & standards) of firms and supports/moderates the process
Regulations to create a market	Government action creates markets for the consequences of the use of technologies (e.g. institutional set up of emissions trading) or sets market conditions which intensify the demand for innovation
<b>Systemic Approaches</b>	
Integrated demand measures	Strategically co-ordinated measures combining various demand-side instruments
Integration of demand-and-supply-side logic and measures	Combination of supply and demand side instruments for selected technologies or services
	Conditional support for user-producer interaction (R&D grants if user is involved)
	Specific instruments such as pre-commercial procurement

Source: (Elder, 2013)



**Box 1: Demand side incentives in various country cases***The European Union*<sup>25</sup>

In an effort to boost the demand for innovations, the European Commission launched an Action Plan in 2012 to analyse the demand-side policies carried out in the EU and their impact, to present their work in this field and to mobilise EU countries and regions in applying demand-side policies.

Specifically, the demand-side policies being implemented through the European Innovation Partnerships are directed towards supporting and increasing the uptake of innovations in society. Interventions range from the introduction of legislation directed at increasing consumer confidence in innovation products, safety regulation, standards and public procurement. These demand-side tools usually complement supply side instruments such as public grants and funding schemes.

*The United States of America (USA)*<sup>26</sup>

The USA has numerous demand side initiatives including: an award-based programme (Small Business Innovation Research – SBIR) to encourage small business engagement in R&D, with the potential for commercialisation supported through public procurement; defence related R&D procurement schemes that aim to bridge the gap between fundamental research and its military application; Smart Grid Technology Standardisation (regulatory reform) to promote the use of clean energy through common interoperability standards; and the Health Information Technology for Economic and Clinical Health Act (HITECH) which is used to catalyse the use of health care technology in order to enhance medical service delivery.

*The United Kingdom (UK)*<sup>27</sup>

The UK Ministry of Defence's Innovation Procurement Scheme aims to drive innovation by supporting public demand and general procurement of new technologies and services. Similarly, the National Health Service (NHS) Pre-commercial Procurement scheme aims to improve service delivery by identifying, positioning and contracting firms to design, prototype and demonstrate their solutions to a set of clinical needs. Forward commitment procurement schemes also exist to develop and address gaps in the market for environmental innovations – this is done through supporting public demand and public procurement. Additional support for innovation is provided through the Small Business Innovation Research Programme, which is a public procurement scheme developed to provide innovative solutions to challenges faced by the public sector.

*Denmark*<sup>28</sup>

The Danish Program for User-Driven Innovation provides financial support to firms to study users or improve collaboration with users to identify and act on innovation needs in strategic sectors such as design, welfare, health and food.

*Netherlands*<sup>29</sup>

The Ministry of Economic Affairs' Small Business Innovation Research Programme (SBIR) is driven mainly through the public procurement of innovative solutions to socially relevant research needs in areas such as renewable energy, health care, security and food.

<sup>25</sup> (European Commission, 2017)

<sup>26</sup> (European Commission, 2015)

<sup>27</sup> (European Commission, 2015)

<sup>28</sup> (European Commission, 2015)

<sup>29</sup> (European Commission, 2015)

### 4.3 Economic rationale for business incentives

The literature around the economic rationale for business incentives must be viewed in the context of the wider debate on economic systems of governance and the extent to which a government should intervene in an economy. The use and acceptance of government intervention in markets has varied greatly over time; and so too has the use and acceptance of business incentives and other forms of economic protection and support. The historical context and global trends matter. However, regardless of these swings in economic history and ideology, a number of common concepts have emerged that are generally used to explain why and when governments should intervene in markets.

#### 4.3.1 Why governments offer incentives

In his outline of a modern theory of regulation, Stiglitz<sup>30</sup> highlights market failures, irrationality and distributive justice as the three main reasons for government intervention. Much of the literature supports his views, and two major categories for government intervention are usually cited: inefficient market operations and inequitable social outcomes.<sup>31</sup> Promoting economic development is also often highlighted as an important motivation behind state initiatives. Each of these are discussed in further detail below.

##### 4.3.1.1 Addressing market failures and economic efficiency

Adam Smith's theory of an 'invisible hand' ensuring efficient and optimal market outcomes is well-known and forms the theoretical basis for many capitalistic arguments.<sup>32</sup> From this theory stemmed Pareto Efficiency – the idea that free market operations, through bargaining and responding to pricing information, will result in the most efficient allocation of resources whereby the situation of no one person or entity can be improved without the worsening of another.<sup>33</sup>

However, subsequent research has shown that Smith's reference to the 'invisible hand' was "an otherwise obscure passage" in his writings which was mentioned "only once [while] he repeatedly noted situations where "natural liberty" does not work."<sup>34</sup> Schlefer (2012), in fact, argues that economic theorists agreed the concept was flawed in the 1970s and, although many practitioners have continued to espouse the benefits of the 'invisible hand' in favour of free markets, Arrow and Debreu's work shows that it only holds under certain conditions.<sup>35</sup> These include situations of perfect competition, excluding any externalities, information asymmetries and public goods.

Public goods are, by their nature, non-rival and non-excludable – the availability of the good is not dependent upon its usage rates. The problem of free-riding is therefore often associated with public goods, as there is no incentive for the wider public to pay a tax for a good or service they can freely access without depletion.<sup>36</sup> In this instance, government intervention is needed

<sup>30</sup> (Stiglitz J. E., 2008)

<sup>31</sup> (Wright, 2009); (Scottish Government, 2011) (Authority, 2006) (Zorn, Sensible State and Local Economic Development, 1985)

<sup>32</sup> (Stiglitz J. E., 2008)

<sup>33</sup> (Arrow, 1951) (Debreu, 1959)

<sup>34</sup> (Schlefer, 2012)

<sup>35</sup> (Arrow, 1951), (Debreu, 1959)

to ensure fairness in the payment for public goods, so that no one person or entity is bearing the full cost burden whilst others benefit from its availability for free.

Similarly, in markets, government intervention is needed to ensure that the ‘rules of the game’ are fair and that “producers and consumers bear the full costs and benefits of their activity,” a necessary condition for efficient outcomes.<sup>37</sup> In essence, an entity’s utilisation of resources should not impact upon another person or institution. Such consequences are referred to as externalities, which can be negative or positive but are often not priced into market operations. Pollution is a notable example of a negative externality whereby one firm’s production processes could increase profits at the cost of greater damage to the environment. Although it reaps financial rewards for such actions, society as a whole pays for the costs of a weaker environment (impact on health etc.). Conversely, Government expenditure on improving a country’s schooling system produces positive externalities, which employers and the wider public would benefit from without having had to share the cost burden. In both scenarios, there is a role for government to introduce regulation and or initiatives/programmes that formalise the cost of the externality and ensure the entity responsible for its existence either covers the associated expenses or is reimbursed for the benefits others are enjoying.

Information asymmetries are always present in markets and result in unfair exchanges or outcomes. Government intervention is often needed to ensure all parties are equally informed - that contracts are just, health and safety standards are upheld, labour markets are regulated fairly and private services are equitably available to all who can afford them.<sup>38</sup> Information asymmetries also lead to moral hazards, whereby certain parties are insulated from the dangers or costs of their actions and are thus more likely to take greater risks.<sup>39</sup> Some would argue that, in such situations, governments have a duty to protect the party being exploited and prevent moral hazards from occurring. Similarly, most governments implement stringent market competition rules and regulations to avoid one firm monopolising a market at the expense of consumer welfare.<sup>40</sup>

Each one of these market failures would result in inefficient outcomes and a sub-optimal allocation of resources.<sup>41</sup> They also highlight the need for government intervention in correcting these failures. However, despite some ambiguity, the literature also highlights a few criteria that market failures must meet before government intervention can be justified. For example, Wright (2009) argues that a market failure is not a good enough excuse for intervention – rather, the failure must be “material” and “of significant magnitude.”<sup>42</sup> There must, furthermore, be suitable interventions available that are shown to be effective, will address the root cause of the market failure and which produce justifiable benefits that outweigh its costs.<sup>43</sup>

Some development economists (Stiglitz, Dosi, Freeman, Nelson, Cimoli and others) question the usefulness of market failure as a concept for determining when and where government should intervene<sup>44</sup>. Specifically, they suggest that the assumptions underlying this concept are too unrealistic or pervasive to be of use of policy makers. Despite these potential

<sup>37</sup> (Authority, 2006)

<sup>38</sup> (Stiglitz J. E., 2008) (Carden, 2013)

<sup>39</sup> (Authority, 2006)

<sup>40</sup> (Authority, 2006)

<sup>41</sup> (Stiglitz J. &, 1986)

<sup>42</sup> (Wright, 2009)

<sup>43</sup> (Wright, 2009); (Authority, 2006)

<sup>44</sup> (Altenburg, 2011)

shortcomings, Altenburg (2011) concludes that it is still important to “scrutinise” the logic underlying government intervention in particular markets: “governments need an analytical tool that helps to decide when market processes should be unleashed and when intervention is needed”<sup>45</sup>.

Altenburg (2011) cautions that even when economic interventions may be justified on the back of market failures, there is some risk that inappropriate policies may lead to an even worse outcome. This may be because the underlying assumptions are incorrect, or because the policy is captured by powerful and vested interest groups. “The question is thus not whether industrial policies should be adopted or not, but, more pragmatically, how they should be designed and how they can be implemented more effectively”<sup>46</sup>.

#### ***4.3.1.2 Ensuring social protection, distributive justice and fair outcomes***

Despite the risk and existence of market failures, there are often cases in which markets do result in the efficient allocation of resources, yet there is no guarantee that these optimal economic outcomes are socially fair or desirable. There is thus a further role for government to intervene, in such circumstances, to ensure social protection and distributive justice. These cases can be generalised into three types of efficient but inequitable outcomes:<sup>47</sup>

- When market outcomes are not fairly distributed between the ‘haves’ and the ‘have-nots’
- When citizens are not all being treated equally, especially those situated in the same situations
- When the interests of future generations and the defenceless are not being protected

For example, South Africa’s apartheid history has given rise to a situation whereby the majority of the country’s citizens were formally excluded from economic participation. Some citizens received preferential treatment to education and employment whereas others were forcibly restricted. The market economy is clearly incapable of correcting for the prejudice and networks that are entrenched in South African society in general, and business in particular. As such, there is a clear need for Government intervention to create an environment in which socially fair and just outcomes can be achieved as quickly as possible and throughout the South African economy. Similarly, Government has an important role to play in providing a minimum level of economic security or support to the large number of South Africans that remain excluded from the formal economy.

In such situations, Government’s must inevitably make difficult decisions as to which party’s interests they will prioritise. “What the most appropriate policy mix is depends not only on the maturity of the market economy and observed market failures, but also on the ability and willingness of governments to “fix” them without creating perverse incentives and reducing allocative efficiency”<sup>48</sup>. However, it is not always the case that state intervention has to come at the price of optimal market outcomes as “efficiency and equity considerations are not always mutually exclusive.”<sup>49</sup> For example, as in the South African situation described above,

<sup>45</sup> (Altenburg, 2011) pg. 14

<sup>46</sup> (Altenburg, 2011) pg. 1

<sup>47</sup> (Authority, 2006)

<sup>48</sup> (Altenburg, 2011) pg. 17

<sup>49</sup> (Scottish Government, 2011)

interventions that target more equitable outcomes in education and employment are also likely to improve overall economic efficiency as well as social stability, justice and citizen life satisfaction.<sup>50</sup>

#### ***4.3.1.3 Supporting economic and industrial development***

Much of the existing literature regarding business incentives refers to economic development incentives, suggesting that such incentives are often used as direct tools to influence and promote economic development in general, or the development of specific sectors which are deemed to be strategically important for policy purposes. Indeed, two of the most often cited motivations for providing business incentives relate to economic development. Firstly, it is argued that incentives attract foreign or local investment into an economy, stimulating job creation and consumer demand for goods and services; and secondly, the consequent increase in public revenues enables governments to offer more public services or cut tax rates.<sup>51</sup>

Because countries and/or regions often lack in a number of attributes that make a location attractive to investors – good infrastructure, educated workforce etc. – they tend to view incentives as a key policy tool to attracting both local and foreign investment. Incentive policies are thus aimed at enticing private interests towards public development goals by offering incentives which are said to improve the market conditions in which firms operate.<sup>52</sup>

Whereas some industrial development incentives are functional – and serve to improve the overall economic environment in which firms operate – most are selective and focus on industries that are deemed to be “strategic”. In many instances, governments negotiate specific deals for individual firms<sup>53</sup>. In such situations, business incentives can be viewed as government prerogatives directed to firms with the objective of inducing some specific type of economic activity that would otherwise have not occurred – or could have occurred but to a lesser degree – without the assistance. Furthermore, the incentive allows recipients to reduce administrative and other costs to investing or increasing its activities and is tied directly to the level of a desired (and clearly outlined) activity that the firm must undertake – such as creating jobs or facilitating increased research and development.<sup>54</sup>

On the other hand, “while such interventions seem to have produced good results in a number of countries (mostly in newly industrialising Asia), they can come at a cost. First, “picking winners” by government bureaucrats may direct resource allocation to inefficient uses. Second, arbitrary interference in business is likely to discourage private investors to take risks. Third, investors are encouraged to engage in rent-seeking activities. Selective measures are thus a double-edged sword, especially if they are not based on transparent rules.”<sup>55</sup>

Whereas there is no “magic policy recipe automatically yielding industrialisation and catching-up”<sup>56</sup>, Cimoli et al (2008) do “identify some regularities in the ingredients and processes driving

<sup>50</sup> (Scottish Government, 2011)

<sup>51</sup> (Fisher, 2004)

<sup>52</sup> (Feiok, 1988)

<sup>53</sup> (Altenburg, 2011) pg. 15

<sup>54</sup> (Bolnick, 2004)

<sup>55</sup> (Altenburg, 2011) pg. 15

<sup>56</sup> (Cimoli, 2008) pg. 5

industrialisation, so one can trace some basic ingredient and principles that successful policy arrangements historically had and have in common”<sup>57</sup>. These include:

- (i) “an ‘emulation philosophy’ vis-à-vis the most promising technological paradigms;
- (ii) various measures safeguarding the possibility of ‘infant industry learning’, involving also the purposeful ‘distortion’ of market signals as they come from the international arena;
- (iii) explicit policies of capability-building directed both at education and training but also at nurturing and shaping specific corporate actors;
- (iv) a ‘political economy of rent-management’ favourable to learning and industrialization, while curbing the exploitation of monopolist positions;
- (v) measures aimed to foster and exploit a weak Intellectual Property Rights regime, especially with respect to the companies of the developed world;
- (vi) strategies aimed at avoiding the ‘natural resource course’;
- (vii) ‘virtuous’ complementarities between industrial policies and macroeconomic management.”<sup>58</sup>

While industrial policy interventions tend to be primarily directed towards facilitating domestic investment and attracting inward foreign investment, they can also target outward investment activities. This is usually promoted through direct measures such as financial, fiscal, information and other support services such as export credits, investment guarantees, or development assistance policies.<sup>59</sup> The “increasingly footloose” nature of companies across the world have therefore raised the perceived importance of business incentives as an important part of most country’s economic development plans or strategies.<sup>60</sup>

#### 4.3.2 Risks of government intervention

Despite the available justification for government intervention to address market failures, there is some possibility that government intervention might not improve market outcomes or may even make things worse. In such cases, the risk of government failure is as important as that of market failure.<sup>61</sup>

Specifically, it is often difficult for governments to assess the likely impact of their actions, as any cost-benefit analysis undertaken ex-ante will be subject to the same information asymmetries facing markets players.<sup>62</sup> For example, when it comes to taxation, it is possible for the effects of any proposed changes to be fairly accurately modelled, but there will always be an element of uncertainty around the actual behavioural response as “the public sector does not have any better information than the market about how individuals and firms value goods and services.”<sup>63</sup> In addition, governments face the challenge of potentially “crowding out” or “displacing future private sector activity” because there are substitution and income

<sup>57</sup> (Cimoli, 2008) pg. 5

<sup>58</sup> (Cimoli, 2008) pg. 2

<sup>59</sup> (Sauve & Soprana, 2016)

<sup>60</sup> (Bartik T. J., 2005) (Zorn, 1985)

<sup>61</sup> (Stiglitz J. E., 2008)

<sup>62</sup> (Authority, 2006)

<sup>63</sup> (Authority, 2006)

effects attached to their interventions, which could cancel out or decrease any efficiency gains.<sup>64</sup>

Government interventions are further subject to political and administrative failures. This could be due to a host of reasons, including a lack of skills and motivation or because government decision-makers face a set of incentives that differ from those facing the private sector.<sup>65</sup> Moreover, “policy makers are [generally] not cognizant of the fact that industrial location incentives [are] not costless,” usually focusing mostly on the immediate benefits that arise therefrom and whether firms respond positively to their offerings.<sup>66</sup>

Finally, incentives inevitably favour certain firms over others and are therefore at risk of rent-seeking and corruption. “Business-government relations in industrial policy are not governed by relations of reciprocity, embedded autonomy, or transparent, formal, organized dialogue. As a result, industrial policy is vulnerable to cronyism (see Lazzarini 2011)”<sup>67</sup>.

Thus, in considering a new business tax or policy initiative, serious attention should be given to the possible displacement effects of government interventions in existing markets, including those that are not directly targeted by the incentive. Moreover, accurate assessments of the costs and benefits associated with such interventions must be undertaken to maximise the benefits and mitigate the costs and risks associated with any form of Government intervention, and careful selection and monitoring mechanisms must be put in place. Alternative and lower cost mechanisms to empower individuals and the private sector to address market failures themselves, through improved co-ordination or direct negotiation, should also be considered in some situations.<sup>68</sup>

#### **4.3.3 Incentives, their impact and influence on firm behaviour/output**

In most firm level surveys, incentives are ranked relatively low amongst the main determinants of investment, with other factors such as economic and political stability, local market size, the availability of skilled labour and the transparency of legal framework usually deemed to be much more important. Moreover, according to a survey of 7 000 companies in 19 Sub-Saharan African countries undertaken by UNIDO (Figure 4), the relative importance of investment incentives has declined over time.

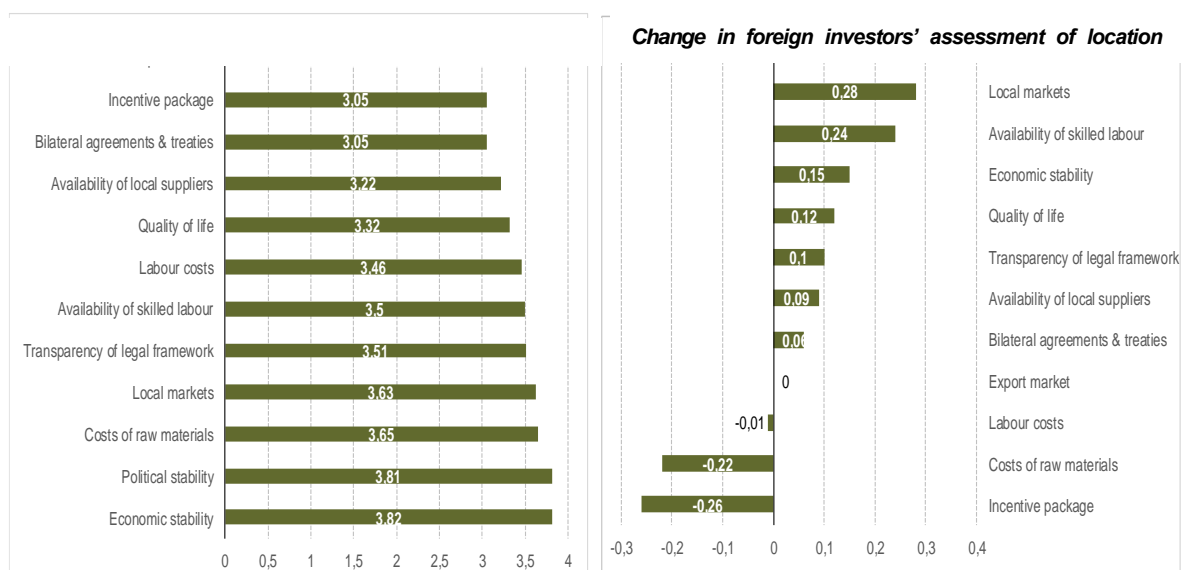
<sup>64</sup> (Authority, 2006)

<sup>65</sup> (Authority, 2006)

<sup>66</sup> (Zorn, 1985 )

<sup>67</sup> (Almeida, 2012) pg. 30

<sup>68</sup> (Authority, 2006)

**Figure 4: The relative importance of investment incentives (2008 – 2011)**

Source: (UNIDO, 2011)

Nevertheless, it is generally accepted that investment incentives can still play an important role at influencing investment decisions at the margin.<sup>69</sup> In light of the difficulties facing governments when implementing systems of business incentives, it is therefore important to consider the types of incentives that work best in different scenarios. The body of evidence on this topic has experienced a marked shift over time, from originally asserting that business incentives do not work and have minimal impact upon economies, to showing that tax incentives, in particular, can affect economic development and growth rates in certain circumstances. The prevailing view, based on the meta-reviews summarised in Table 4 below, is that “lower taxes or more incentives are likely to result in greater economic growth”, though the size of their impact is still debatable.<sup>70</sup>

**Table 4: Summary of metareview: Impact of economic development incentives on growth**

Review	Types of incentives studied	Methodology of studies	Impact of incentives	Comments
Due (1961)	Taxes	Statistical	Minor at best	Most studies show
Oakland (1978)	Taxes	Econometric	Minor at best	
Newman & Sullivan (1988)	Taxes	Econometric	Recent studies able to identify small but	Technical review of literature

<sup>69</sup> (Blomstrom, 2002)

<sup>70</sup> (Fisher, 2004)



Review	Types of incentives studied	Methodology of studies	Impact of incentives	Comments
			statistically significant impact	
Eisinger (1988)	Taxes, non-tax discretionary incentives, and abatements	Econometric, survey and case study	Ambiguous impact, tending towards minor or none	
Bartik (1991)	Taxes	Econometric	Majority of studies show positive, statistically significant impact	Clustering of elasticity estimates between -0.1 and -0.6 (inter-metropolitan) and between 1.0 and -3.0 (intra-metropolitan)
Wilder & Rubin (1996)	Enterprise zone designation and incentives	Various	Variable impact on investment/employment growth	Variable impact in part due to variation in state programs
Wasylenko (1997)	Taxes	Econometric	Most studies show a positive, statistically significant impact, but with smaller estimates than found by Bartik (1991)	Clustering of elasticity estimates between 0.0 and -0.26
Fisher & Peters (1997)	1) Non-tax discretionary incentives  2) Industrial revenue bonds  3) Enterprise zones	1) Econometric  2) Econometric  3) Econometric and survey	1) Most studies show positive impact  2) Ambiguous results  3) Ambiguous to no discernible impact	1) No elasticity estimates since results highly questionable
Man (2001)	Tax increment financing	Various	Ambiguous, though majority of studies show positive impact	
Peters & Fisher (2002b)	Enterprise zones	Mainly Econometric	Minor to no discernible impact	

Source: (Fisher, 2004)

Importantly, although the recent literature points to the positive impacts of incentives, these effects are generally small and are not constant across different regions or countries. There

are also few studies considering the revenue generating ability of business incentives systems and whether they are ultimately profitable or not.<sup>71</sup> Hence the geographic and demographic characteristics, as well as the design of incentives, are important factors determining their success.

Tax incentives, for example, generally have muted effects due to the small contribution of taxes to the overall costs of a business.<sup>72</sup> However, research conducted in the USA has shown that they are far more effective in smaller regions, such as suburbs or metropolitan areas, where various substitutable options are available and differences in wages or tax rates are more noticeable.<sup>73</sup> Within larger areas, such as states or provinces, tax exemptions or reductions seem to have less of an impact upon private sector decisions as there are other, more important elements that differ across regions which will outweigh differences in tax or wage rates.<sup>74</sup> These elements include labour market dynamics, the availability of natural resources and easy access to markets.<sup>75</sup> Hence, as the size of the geographical area increases, the importance of taxes and fiscal incentives decrease.<sup>76</sup> Research has further shown that the costs of creating jobs through incentives such as tax deductions are high, and that the resulting increase in the tax revenue base does not always offset the loss from the deductions.<sup>77</sup>

Bartik (2005) points out that the social benefits arising from business incentives will be limited in situations where markets already experience high levels of employment, where the new jobs created absorb low levels of local workers or offer lower wages and where there are environmental or public infrastructure costs to be covered. It follows that there are several situations in which the social benefits arising from the provision of business incentives are likely to be maximised <sup>78</sup>:

- If there are current blockages and market failures to the usage of local resources which the incentives assist to overcome e.g. because of the incentives offered, local businesses experience greater levels of customer demand.
- If they result in greater levels of local employment or the movement of individuals to higher paying jobs that reduces reliance upon state services, decreases environmental degradation levels and increases the tax revenue base.
- If they result in greater usage of public infrastructure and facilities that were previously not maximised in terms of usage rates, as this allows for greater tax revenue from increased business activities without an accompanying rise in infrastructure expenditure.

All this evidence needs to be considered in designing an appropriate, effective and efficient system of business incentives. Some of the resulting design implications are outlined in Section 4.4.

#### 4.4 Incentive design considerations

Very limited literature is available specifically on the actual design of incentive programmes and most of the literature is centred around describing the types of incentives available in a

<sup>71</sup> (Fisher, 2004)

<sup>72</sup> (Fisher, 2004)

<sup>73</sup> (Bartik T. J., 2005) (Zorn, 1985 )

<sup>74</sup> (Bartik T. J., 2005)

<sup>75</sup> (Grady, 1987)

<sup>76</sup> (Zorn, 1985 )

<sup>77</sup> (Bartik T. J., 2005)

<sup>78</sup> (Bartik T. J., 2005)

country or region, and in some cases, how these are managed/coordinated. This review reveals two key points: firstly, most of the available literature focuses specifically on incentives directed towards attracting Foreign Direct Investment (FDI) and less so on incentives directed towards expanding investment by domestic firms; secondly, most of the literature on incentives is directed at tax/fiscal and financial incentives, with very little coverage of other non-tax incentive programmes. In addition, specific reviews of the design of overall systems of incentives are limited. Turkey is a special case (as outlined in Box 2) in that it explicitly refers to its investment incentives as a *system*.

#### Box 2: Turkey's Investment Incentive System <sup>79 80</sup>

Turkey is one of few country's that has a clearly defined system of investment incentives. The Investment Support and Promotion Agency of Turkey (ISPAT) is responsible for all government investment support and promotion activities and reports directly to the Prime Minister. For purposes of the incentive system, the country is divided into six regions based on their level of socioeconomic development. Investment incentives are offered for general, regional, large-scale and strategic investments. The provision of these incentives is governed by the socioeconomic categorisation of regions coupled with prioritised sectors. Below is a brief description of each type of incentive:

**General Investment Incentive Scheme:** This scheme is applied uniformly across regions for any project that meets the specific conditions and minimum fixed investment amounts, which differ across regions. However, certain types of investments are excluded from the investment incentive system in general and would thus not benefit from this scheme. Key incentives offered in this regard include exemption from customs duties and Value Added Tax (VAT) exemptions.

**Regional Investment Incentive Scheme:** In each region, a set of sectors to be supported are determined based on regional potential and the overall scale of the local economy. The intensity of the support given to these regions and sectors varies depending on the level of development in the region. In addition, the minimum fixed investment amount is defined separately for each sector and region.

**Large-Scale Investment Incentives Scheme:** A set of twelve (12) investment areas are prioritised through the Large-Scale Investment Incentive Scheme in an effort to promote Turkey's technology, R&D capacity and overall competitiveness. These sectors range from chemical products, harbours and airports to electronics, mining and pharmaceuticals, all of which have varying minimum fixed investment criteria. The incentives in this scheme include VAT and customs duty exemption; contributions to investments; social security premium support for both employers and employees; land allocation and income tax withholding allowances, all of which are applied at varying degrees depending on the region in which the investment is located

**Strategic Investment Incentive Scheme:** This scheme aims to support the production of intermediate and final products with high import components with a view to reduce Turkey's current account deficit. In addition, it aims to encourage high-tech and high value-added investments with the potential to strengthen the country's international competitiveness. Only investments meeting a set of four criteria are supported by the scheme which are universally applied across all six regions.

Despite the apparent lack of information on incentives systems, as they are applied and managed in specific countries, the OECD, G20 and IEDC have all developed broad frameworks to guide countries in the design and implementation of incentives systems. The main lessons emerging from these three organisations are briefly outlined below.

<sup>79</sup> (Invest in Turkey, n.d.)

<sup>80</sup> (Doing Business in Turkey.com, n.d.)

#### 4.4.1 OECD guiding principles

The OECD, in its '*Guiding principles for policies toward attracting foreign direct investment*', identifies the critical policy decisions involved in the formulation of FDI incentive systems. Although the focus of the report is on FDI incentives, it provides useful insight into the types of questions policy makers should ask when designing any incentive system. The report begins by arguing that the use of incentives to attract foreign direct investment should not be used as a substitute for ensuring the use of appropriate policy measures in general and supporting the development of an overall enabling business environment.

Broadly, the factors that should inform the final policy decision are broken down into six categories, as outlined below:<sup>81</sup>

i. *Desirability and appropriateness of offering FDI incentives*

Policy makers should decide on whether offering an incentive is the best option to address a particular problem; or whether the desired impact could effectively be achieved through improvements (regulatory or processes and systems requirements) in the overall business environment. This will depend significantly on how well the link between incentives, and constraints in the enabling environment, are understood by policy makers. Tax incentives, for example, generally rank low in importance for investors in low-income countries<sup>82</sup>; and may not always serve to address the specific barriers to investment in a particular country.

ii. *Frameworks for policy design and implementation*

Key considerations in this regard include determining the main objectives of the incentive, and more importantly, how implementation will play out in reality. It also includes considerations around the delegation of powers in the policy making and incentive development and implementation process across the various spheres of government. In addition, policy makers need to determine the role that other public institutions will play in this process and who the ultimate accounting body will be in terms of design, implementation and finally monitoring and evaluation.

iii. *Appropriateness of the choice of strategies and policy tools*

The choice of incentive strategies and policy tools should be aligned with and linked to overall national, regional and sectoral policy objectives so as to avoid any policy conflicts or contradictions. This will require first, some consensus on the overall policy objectives; and secondly, ensuring that all incentive policies are in line with these objectives and are best suited to address the policy issue at the lowest cost possible. This notion is also noted by Hurwitz (2015) in stating that innovative approaches to incentives need to be closely coordinated with economic development strategies.

iv. *Design and management of individual programmes*

The specific design and management of individual programmes/incentives should consider the resources needed to support the implementation and monitoring of these programmes; and should be cognisant of how incentive design can influence the behaviour of recipients in the immediate, short, medium and long-term horizon – “guarding against predatory practices”. Other relevant design considerations that need to be addressed include: spending limits; targets; evaluation tools; delegation of powers

<sup>81</sup> (OECD, 2003)

<sup>82</sup> (International Monetary Fund, 2015)

to implement; and the duration of incentives. In addition, the design and management of individual programmes should address all three preceding points to ensure policy coherence and efficiency.

v. *Transparency of procedures*

Ensuring that a certain level of transparency around the offering of FDI incentives is maintained is of critical importance in ensuring the accountability of implementing bodies. Furthermore, the OECD emphasises the importance of sound and comprehensive cost-benefit analysis of both the individual incentive programmes and across the entire incentive policy context to be applied throughout the implementation period – both prior to an investment project and on a regular basis sometime thereafter.

vi. *Extra-jurisdictional consequences of FDI incentive strategies*

Policy makers need to ensure that incentives do not violate or contradict the country's international and regional commitments and that sufficient consideration has been made as to how their incentives could impact or influence responses in other jurisdictions.

In essence, the six categories identified by the OECD act as a conceptual guide for policy makers in identifying, navigating and resolving the critical questions that they are likely to face when developing incentive programmes and managing incentive systems. Key to this is ensuring that systems of incentive programmes complement and work not only with each other but with the overall policy objectives of national government.

In a separate document, the OECD also notes that designing efficient and effective incentive programmes should focus on maximising the benefits and minimising costs of each incentive offered. This can be achieved through choosing incentives that are closely aligned to the activity that they are meant to promote, avoiding offering multiple incentives (e.g. across multiple ministries), and only adopting incentives that can be easily administered by programme administrators.<sup>83</sup>

#### **4.4.2 The G20 Development Working Group**

In 2015, the G20 Development Working Group requested the IMF, OECD, UN and World Bank to evaluate the evidence on the effectiveness and efficiency of investment incentives in developed and developing countries and to review the options available to low income countries. Overall, the report found that the effectiveness of tax incentives tends to vary by country and sector and that taxation plays a more significant role in attracting investment in developed compared to developing countries, where other factors tend to be more important. In addition, the review found that the portion of investments that would have taken place in the absence of incentives (the “redundancy rate”) is higher in most developing countries. See Table 5 below.

<sup>83</sup> (OECD, n.d)

**Table 5: Redundancy of tax incentives based on investor surveys**

Country	Affirmative answers to the question if an incentive was redundant	Country	Affirmative answers to the question if an incentive was redundant
Burundi (2011)	77%	Rwanda (2011)	98%
El Salvador (2013)	37%	Serbia (2009)	71%
Guinea (2012)	92%	Tanzania (2011)	91%
Jordan (2009)	70%	Tunisia (2012)	58%
Kenya (2012)	61%	Uganda (2011)	93%
Nicaragua (2009)	15% or 51%*	Vietnam (2004)	85%
Mozambique (2009)	78%	Thailand (1999)	81%

Source: (International Monetary Fund, 2015)

\*51% for non-exporting firms outside free zones

Given these findings, and to address issues of efficiency and the effectiveness of investment incentives, the report proposes the following guidelines:<sup>84</sup>

1. An effective incentive package should be viewed as part of the country's overall industrial policy, and be available on equal terms to both foreign and local investors.
2. All incentive policies and programmes must be well coordinated with each other as well as with other policies and governed by a coherent policy framework designed to improve the overall investment environment.
3. Good governance of incentives means that government's decision-making processes, policies and the administration must be transparent and subject to public scrutiny and evaluation. As such, the economic rationale for tax (and similarly, any incentive) should be clearly articulated to enable public debate on the country's policy priorities.
4. Incentives need to be well-targeted and based on clear, verifiable and rules-based eligibility criteria. This is believed to be best facilitated through incentive programmes that are governed by minimal administrative discretion in the awarding of incentives.

<sup>84</sup> (OECD, 2011)

5. Incentives should not be of an ex ante nature (granted prior to the investment), but should rather promote activities that create the strongest potential for spill-overs, including linkages between foreign and local firms, education, training as well as research and development.
6. Incentives that lower the cost of investment by reducing the cost of capital are preferred over profit-based tax incentives, as they make a great number of investment projects more profitable at the margin.
7. The costs and benefits of an incentive programme should be assessed both ex-ante and ex-post and should be guided by clearly stated assumptions and methodologies, with the assessments eventually being published and publicly available.
8. Setting sunset clauses on tax incentives rather than offering them permanently can have some attraction in that the expiry provides for a natural point of evaluation and appraisal.

#### 4.4.3 IEDC: Best practice in incentives portfolio management<sup>85</sup>

The International Economic Development Council (IEDC) is a non-profit, non-partisan membership organisation serving the economic development profession. In its 2014 report titled *Seeding Growth: Maximising the Return on Incentives*, it provides a set of guiding concepts for best practices in incentive portfolio management. Here, an incentive portfolio is assumed to encompass a set or system of incentives.

##### *i. Setting the context*

To ensure the efficient development and effective management of incentives, policy makers must create an environment conducive for the use of incentives. In line with the recommendation from the OECD, this can be done through the development of comprehensive strategic plans that encompass all policy priorities and by ensuring that incentive programmes are in line with the objectives identified in the strategic plans. Furthermore, clearly defined monitoring processes must be built into the incentive programme up-front. Sufficient human and financial resources must also be secured for the effective management of incentives portfolios.

##### *ii. Designing effective programmes*

The IEDC suggests a seven-step incentive programme design process as illustrated below:

<sup>85</sup> (Hurwitz, Brown, Knight, O'Malley, & Parkins, 2014)



iii. *Analyse and monitor portfolio performance*

The task of portfolio monitoring should ideally begin as soon as the investment agreement has been made (regardless of whether funds have been disbursed or not) and will involve data collection and analysis as well as calculating or at least estimating the return on incentives. All data collected should facilitate the assessment of whether recipients are achieving their committed objectives and will empower governments to fully understanding where and how incentives are being utilised and by whom.

iv. *Actively manage the portfolio*

Active management of the portfolio of incentives is useful for two key reasons: firstly, using the collected and analysed data to make informed decisions on whether incentive programmes should be retained, expanded or terminated; and secondly, management activities should clearly outline what remedial actions will be taken when incentive recipients fail to meet investment criteria.

v. *Communicate with shareholders*

Here shareholders refer to government, incentive recipients, the public and any other parties that the economic development agency is accountable to. Regular communication on programme design and effectiveness of the portfolio of incentives as a whole, and of individual programmes, is encouraged to allow for comparative analyses and periodic comprehensive reviews of all programmes.

In essence, the last three stages focus on ensuring that the correct processes are in place to monitor the performance of incentive programmes specifically, and the portfolio of incentives in general, through regular reporting, data collection and evaluation.

#### 4.4.4 Other literature

In a 2005 report, Barbour provides a list of 'best practice guidelines' for policy makers based on a review of the literature. Although broad, these guidelines focus on the process and



procedures surrounding incentive policy and are particularly useful for the context of this study. These guidelines suggest that an incentive should:<sup>86</sup>

- Encourage investment in the targeted sector or location at the lowest cost and avoiding opportunities for tax planning.
- Be guided by specific policy objectives and be implemented in an easy to understand and transparent manner.
- Be consistently applied so as to provide investors with certainty over its application period.
- Avoid trying to address specific cyclical events due to lags in the effects of intervention in the real economy. They should thus focus on addressing structural challenges hindering economic progress.
- Be developed, implemented, managed and monitored by a single entity.
- Have low administrative costs for government and recipients.
- Be well coordinated at the national and sub-national levels.
- Include monitoring and evaluation processes.
- Have sunset clauses for both the incentive schemes and for the duration of benefits to any firm.
- Impose a cap on expenditure or taxes foregone to the fiscus.
- Be non-discretionary and applied consistently against an open set of transparent criteria.

Given that incentive programmes are most effective when underpinned by some policy objective, Rodrik (2008) identifies three key principles underpinning successful industrial policy and thus successful incentive programmes<sup>87</sup>. Firstly, the establishment of an effective collaborative relationship between government and the private sector is important in empowering government to better identify potential opportunities and challenges. Secondly, effective industrial policy should incentivise the private sector to take on risks that it otherwise would not; however, this should be done with the understanding that the support is temporary. Lastly, policy makers should ensure that their policies serve society at large and should not be to the exclusive benefit of a single interest group. As such, transparency and accountability are critical to the successful implementation of industrial policies (and incentives).

Rodrik (2004) also proposes a set of institutional design principles that he argues should inform the formulation of industrial policy. To begin, the success of industrial policy (and its interventions) often depends on the presence of high-level political support, as such, political leadership should be at the centre of all industrial policy action. Second, there is a need for some form of coordination and deliberative processes that will facilitate information sharing and learning on challenges and ideas pertaining to industrial development and investment. Third, transparency and accountability need to be promoted by ensuring that industrial policies are considered a key tool to expanding opportunities for all as opposed to a select few. In specifying these institutional design considerations, Rodrik highlights that it is impossible (and undesirable) to specify the policy outputs from these institutional design considerations *ex ante* as they are influenced and determined by the opportunities and challenges identified in the

<sup>86</sup> (Barbour, 2005, p. 9)

<sup>87</sup> (Rodrik D. , Normalizing Industrial Policy, 2008)

deliberative processes outlined above. But he does outline ten design principles for industrial policy which may serve as a useful guide in framing the design of all interventions, including incentives.<sup>88</sup>

1. *Only “new” activities should be awarded incentives* – this will support diversification and the generation of new areas of comparative advantage, all of which are typically central to industrial policy.
2. *There should be clear criteria to assess success and failure* – due the fact that not all interventions will yield positive or desired results, there is a need to ensure that the impact of policy can and is measured effectively. Ultimately, Rodrik argues that criteria for success should depend on productivity and not solely on employment or output.
3. *There should be a built in sunset clause* – this will assist in ensuring that resources do not end up being tied up for extended periods of time in activities that are not producing the desired outcomes.
4. *Public support should be directed towards activities and not sectors* – Rodrik argues that sector-specific support can lead to misdirection of industrial promotion effects and that activity-focused support is more effective in addressing and correcting market failures (which may be dominant in a particular sector, but are likely to exist to some degree across several sectors). Therefore, cross-sectional activity-focused programs can be more effective at addressing market failures.
5. *Subsidised activities should have the potential to produce spill overs and demonstration effects* – unless a subsidised activity has the potential to crowd-in other investments and/or technological and information spill overs, it should not be supported.
6. *Authority to carry out industrial policy should lie in agencies which demonstrate sufficient competence* – and there should be strong coordination links between these agencies to support good administration.
7. *Close monitoring of implementing agencies needs to be done by a principal with a clear stake in the outcomes and who has political authority at the highest level* – due to the fact that the implementation of industrial policy calls for high levels of autonomy on the part of implementing agencies, there is a need for clear lines of accountability to avoid any unintended abuse of powers self-interested behaviour. By having a high-level official as the key accounting officer of these agencies can be useful in supporting high levels of accountability.

<sup>88</sup> (Rodrik D. , 2004)

8. *The maintenance of open channels of communication between implementing government agencies and the private sector is critical* – this will empower implementing agencies with relevant information and a deeper understanding of the real challenges faced by business.
9. *Learning from and reducing the associated costs of making mistakes (i.e. picking losers) is important* – in recognising that picking losers (not winners) is a real possibility when government intervenes in industries, it is important to build in certain safeguards against such events. The key goal here is not so much minimising the chances of choosing losers but rather minimising the costs associated with these choices and maximising the opportunity to learn and make the necessary changes to the programme design.
10. *Implementing agencies need to be able to adapt to changes in the policy environment* – because industrial policy plays itself out in dynamic and fluid environments, agencies must be able to adapt to changes and at the same time be able to phase out policies that no longer work with more relevant policies

Some of these issues are reiterated in a review of the history of government intervention in industrial development in El Salvador, by Hausmann and Rodrik (2005)<sup>89</sup>. Here they propose three key components meant to create an institutional design that addresses the dynamic inconsistencies of intervention policies: (i) the strategy must be considered a high-level goal of the government so as to garner the commitment of the political leadership and compel bureaucrats to take their jobs seriously; (ii) it must have a high degree of transparency and accountability and (iii) there must be a set of rules (including sun-set clauses) that will prevent the policy from serving purposes other than those for which it is designed.

Moreover, according to Hausmann, Rodrik and Sabel (2008), when remedying market failures, governments need to be adequately informed and equipped to identify and implement the necessary industrial policy interventions. The authors argue that it is not so much the types of industrial policy instruments used or which sectors are prioritised nor should the focus be on the budget to be allocated; the key questions to ask are around whether the relevant institutions have been established. These institutions should be able to continuously engage with bureaucrats in conversations about pertinent themes in the private sector, and must have sufficient capacity to respond effectively and swiftly to the economic opportunities that these public-private conversations identify<sup>90</sup>

#### 4.4.5 The role of the WTO

A final consideration in the design of incentives and incentive policies are the rules and guidelines of the World Trade Organization (WTO), to which South Africa subscribes.

The WTO was established in 1995 under the Marrakesh Agreement, signed by 123 nations in 1994; replacing the General Agreement on Tariffs and Trade (GATT), which commenced in 1948. The WTO deals with issues relating to the regulation of trade between participating countries by providing a framework for negotiating trade agreements and includes a comprehensive dispute resolution process aimed at enforcing participants' adherence to the WTO agreements. The WTO agreements cover goods, services and intellectual property and

<sup>89</sup> (Hausmann & Rodrik, 2005)

<sup>90</sup> (Rodrik, Hausmann, & Sabel, Reconfiguring Industrial Policy: A Framework with an Application to South Africa, 2007)

outline the principles of liberalisation as well as permitted exceptions. Furthermore, the WTO agreements require governments to make their trade policies transparent by notifying the WTO about laws in force and measures (including incentives) adopted.

South Africa is an original member of the WTO and as a Southern African Customs Union (SACU) Member State, it is a signatory to a series of agreements signed by the Union.

The Agreement on Subsidies and Countervailing Measures (SCM Agreement) provides guidelines on the use of subsidies (a type of incentive), as well as on how those subsidies that cause direct or indirect harm or are considered to disrupt the industry/trade interests of another member may be counteracted. Here, a subsidy is defined in terms of three conditions: (i) subsidy must originate from a government or public sector agency in the WTO member state; (ii) the subsidy must be a financial contribution (such as preferential loans, loan guarantees, tax reductions, income or price support as well as any goods and/or services provided by the state – excluding public infrastructure); and (iii) a subsidy must grant a benefit to the recipient through the subsidy.

The SCM Agreement differentiates between specific (directed to specific companies, industries or groups of companies) and general subsidies. All WTO members are required to notify the Organisation of all subsidy programmes they are implementing and the countervailing measures they intend to introduce and maintain. The countervailing measures may be imposed when a member's industry is adversely affected as a direct consequence of a subsidy in another member state. Subsidies are classified into three categories either prohibited; actionable and non-actionable.

- Any subsidies that specifically distort international trade and are therefore likely to hurt other countries' trade are prohibited. This includes, for example, subsidies that require recipients to meet certain export targets, or to use domestic goods instead of imported goods.
- Actionable subsidies are acceptable in terms of the SCM Agreement as long as they do not directly or indirectly adversely affect another member's industry or trade interests. In such cases, a complaining country must prove that the subsidy has an adverse effect on its interests, otherwise the subsidy is permitted.
- Non-actionable subsidies (which were temporarily suspended in January 2000) are general subsidies and selective forms of support for research and development for disadvantaged regions and for the adaptation of environmental facilities.

All the above will have a direct influence on, and should thus guide, the development, design and implementation of incentive programmes. Incentives do not comply with this international agreement can lead to international sanction.

#### **4.5 Economic policies and objectives in South Africa**

The literature reveals the importance of aligning incentive programmes with wider national policy objectives.

The main purpose of this document review is to identify the common challenges or constraints that these policies serve to address; the economic outcomes that they seek to achieve; and to describe how government expects to coordinate its efforts in supporting overall business and sector development.

Table 6 below provides a summary of the key policies outlined in the National Development Plan 2030 (NDP), the Industrial Policy Action Plan (IPAP) 2014/15 – 2016/17, and the Nine-

Point Plan. It highlights the (i) main constraints identified, (ii) the proposed interventions and (iii) the desired outcomes specified in each of these strategic documents. Recognizing the wide scope of these documents, the assessment below only concentrates on those issues, objectives and activities directed towards business and/or sector support and development.

Overall, the NDP, IPAP and Nine-Point Plan are all centred on identifying and implementing specific (and somewhat similar) measures to support faster and more inclusive economic growth and address the high level of unemployment facing the country. The key constraints identified in all three policy documents vary slightly in their wording and prioritisation and include: low economic growth coupled with high unemployment and inequality; weak exports; an undiversified economy; poor coordination and collaboration within government and between government and the private sector; spatial disparities; energy production and security (including the ocean economy); and poor institutional and financial support for businesses (including red-tape). The sector-focused IPAP raises some industry specific challenges that are not explicitly highlighted in the NDP and the Nine-Point plan. These include pricing issues, such as monopolistic pricing of privately owned intermediate inputs into the manufacturing sector and inconsistent administered prices, as well as poor infrastructure and transport and logistics.

Similarly, the proposed interventions outlined in these policy documents all emphasise the role of government in supporting increased investment, exports and market diversification; and the central role of SMMEs and enterprise development in achieving these outcomes. Public-Private partnerships, the improved coordination of public and private agencies, and the provision of incentives and programmes to shift jobs and investment into rural areas and townships are also common intervention themes.

**Table 6: Summary of key South African policies**

Policy	Key constraints identified	Proposed interventions	Desired outcome/impact
NDP	<ul style="list-style-type: none"> <li>• Low economic growth</li> <li>• High unemployment and inequality</li> <li>• Low levels of competitiveness</li> <li>• Low levels of exports</li> <li>• High costs of regulatory compliance</li> <li>• Poor access to finance for SMME</li> <li>• Low levels of public sector investment</li> <li>• Weak public service accountability &amp; coordination</li> </ul>	<ul style="list-style-type: none"> <li>• Increasing exports &amp; diversification into new sectors (through incentives &amp; programmes)</li> <li>• More efficient &amp; competitive infrastructure</li> <li>• Reduced cost of regulatory compliance</li> <li>• Larger, more effective innovation system (including R&amp;D)</li> <li>• Support for small business &amp; entrepreneurs (development agencies, finance and incubation)</li> <li>• Expanded skills base (education &amp; vocational training)</li> <li>• Strengthened financial services</li> <li>• Commitment to public &amp; private procurement</li> <li>• Higher rate of public sector investment</li> <li>• Enhanced commercial diplomatic services</li> <li>• Business, enterprise &amp; sector development &amp; support</li> </ul>	Faster and more inclusive economic growth and job creation
IPAP	<ul style="list-style-type: none"> <li>• Irrational &amp; inconsistent administered prices</li> <li>• High transport &amp; logistics costs</li> <li>• Skills deficits and mismatches</li> <li>• Monopolistic pricing of privately owned intermediate inputs into manufacturing sector</li> <li>• High finance costs and onerous terms</li> <li>• Poor intra-governmental coordination &amp; policy coherence</li> <li>• Poor infrastructure</li> </ul>	<ul style="list-style-type: none"> <li>• Development of rational &amp; consistent administered prices (electricity, water and port tariff pricing)</li> <li>• Development of better rail &amp; road infrastructure (emphasis on rail)</li> <li>• Improved demand-led skills interventions and training</li> <li>• Reducing costs of intermediate inputs through tariff adjustments</li> <li>• Reduce costs of financing &amp; better terms (access)</li> <li>• Roll-out of the Public Infrastructure Investment Programme facilitated by the Presidential Infrastructure Co-ordinating Commission</li> <li>• Strengthening of public procurement &amp; supplier development</li> <li>• Industrial financing</li> <li>• Formulation and implementation of a developmental trade policy</li> <li>• Strengthening implementation of competition policy &amp; supporting competitive outcomes</li> <li>• R&amp;D programmes in knowledge-intensive areas &amp; enhancing participation of innovative enterprises &amp; high-tech SMEs</li> <li>• Strengthening the institutional functioning and support for SEZs</li> <li>• Support regional integration through stronger cross-border infrastructure &amp; sector development</li> </ul>	Faster and competitive economic and employment growth
Nine-Point Plan	<ul style="list-style-type: none"> <li>• Electricity challenges</li> <li>• Inadequate economic infrastructure</li> <li>• Cumbersome regulatory processes</li> </ul>	<ul style="list-style-type: none"> <li>• Promotion of agri-parks, cooperatives and clusters</li> <li>• Development of an Agricultural Policy Action Plan</li> <li>• Enhancing agro-processing exports</li> </ul>	Grow the economy and create jobs

Policy	Key constraints identified	Proposed interventions	Desired outcome/impact
	<ul style="list-style-type: none"> <li>Poor government coordination</li> </ul>	<ul style="list-style-type: none"> <li>Advancing beneficiation &amp; support to the engineering &amp; metals value chain</li> <li>Focusing on identified sectors, subsectors and products for local procurement</li> <li>Transforming manufacturing sector to unlock potential of black entrepreneurs</li> <li>Supporting &amp; funding value chains in emerging innovative sectors</li> <li>Promoting state procurement from SMMEs, cooperatives as well as township &amp; rural enterprises</li> <li>Fast track implementation of solutions to critical development issues highlighted in NDP (poverty, inequality and unemployment)</li> <li>Results driven approach to bringing key stakeholders from the public &amp; private sectors, academia &amp; civil society</li> <li>Support for local and international investment</li> <li>Stabilisation of electricity supply</li> <li>Procurement of power from Independent Power Producers using renewable sources</li> <li>Improved business and labour relations</li> <li>Broadband roll-out</li> <li>Expanded water and sanitation infrastructure</li> </ul>	

Source: DNA Economics

## 4.6 Investment incentives in South Africa

### 4.6.1 A brief history of industrial development incentives in South Africa

South Africa has had a long history of industrial development interventions aimed at supporting the attainment of specified industrial and economic development goals. Prior to 1994 the Apartheid Government made wide-scale use of industrial incentives and well-funded regional development strategies to support homeland territories; while also developing a sizable manufacturing and industrial base through high tariff barriers and government intervention in state-supported enterprises. Most of this had to be reformed in the mid-1990s as the new Government sought to unwind historical land and employment structures and South Africa began to reintegrate into the global economy.<sup>91</sup>

The Growth, Employment and Redistribution (GEAR) strategy was the first post-1994 document that described the role that investment incentives could play in promoting competitive and labour-promoting industrial development. GEAR emphasised the role of tax incentives, to be introduced for a set period of time, and proposed three specific interventions: (i) an accelerated depreciation scheme aimed at supporting the expansion of existing manufacturing firms; (ii) a tax holiday scheme targeted at new projects in key regions and industries and (iii) a set of incentives to assist small-scale enterprises.<sup>92</sup>

Numerous incentives were consequently introduced post-1994, including the Motor Industry Development Programme (MIDP), the Strategic Industrial Program (SIP) and several matching grant-based incentives for technological innovation and skills development.<sup>93</sup> In general, South Africa's approach over this period was deemed to be "cautious...on the whole there has been a reduction in the number and complexity of tax incentives and grants, and there is more emphasis on evaluating their impact. The result is that, today, South Africa operates a system of investment incentives that is comparatively well defined ..."<sup>94</sup> Table 7 below provides a summary of the key industrial policies implemented since 1994.

**Table 7: The key incentives and industrial development policies in South Africa since 1994**

Year	Policy/incentive	Description
1995	Improving manufacturing performance in SA	Government identified the need to improve the productivity of manufacturing
1995	Supply-Side Document	Supply-side investment incentives, R&D support and human resource development initiatives introduced by the dti in attempt to increase economic productivity
1995 and 2013	Motor Industry Development Programme (MIDP) which was later replaced by the Automotive Production and Development Programme (APDP)	MIDP was developed to reintegrate the sector into the global economy by relaxing tariffs that had previously protected the sector. It was replaced by the APDP in 2013
1996 - 1999	Tax holidays and increased depreciation for manufacturing projects	Attempted to promote new investments in the manufacturing sector

<sup>91</sup> (Barbour, 2005)

<sup>92</sup> (Department of Finance, n.d)

<sup>93</sup> (Barbour, 2005)

<sup>94</sup> (Barbour, 2005)



Year	Policy/incentive	Description
2001	Strategic Investment Programme (SIP)	Aimed to promote manufacturing activities through the provisions of tax deductions on the initial capital allowance
2001	Microeconomic Reform Strategy (MERS)	Centred on addressing the failures of existing macro-policies to attract investment by focusing on infrastructure and access to finance as critical to improving competitiveness
2002	Integrated Manufacturing Strategy (IMS)	Proposed interventions to develop the manufacturing sector through increased market access, promotion of beneficiation and regional production
2006	Sector specific programmes	Interventions in a number of sectors to enhance competitiveness as well as increasing exports and employment. Sectors included: aerospace; agro-processing; business processing; chemicals; clothing & textiles and tourism.
	Various tax incentives	Targeting manufacturing, mining, R&D and small business
2006	Accelerated and Shared Growth Initiative (ASGISA)	ASGISA replaced GEAR and was intended to be the overarching growth policy by focusing on microeconomic constraints to growth such as poor infrastructure, skills, technology and the need for SMME support and development of clusters.
20017	National Industrial Policy Framework (NIPF)	The NIPF has been described as the first comprehensive industrial policy since the SIP. The framework outlines the country's approach to industrialisation to be supported by 13 strategic programmes <sup>95</sup> .
2007-present	Industrial Policy Action Plan (IPAP)	All the iterations of the IPAP based on the NIPF & present the focus areas of support including sector-specific & cross-cutting interventions. The IPAP also contains Key Action Programmes, timelines and role players.
2010	12i Tax allowance incentive	These tax incentives were aimed at improving the manufacturing sectors productivity by supporting green- and brownfield investment and supporting training.

<sup>95</sup> Which were: (1) sector strategies; (2) industrial financing; (3) trade policy; (4) skills & education for industrialisation; (5) competition policy & regulation; (6) leveraging public expenditure; (7) industrial upgrading; (8) innovation and technology; (9) spatial & industrial infrastructure; (10) finance & services for small enterprises; (11) leveraging empowerment for growth & employment; (12) regional & African industrial & trade framework and (13) coordination, capacity & organisation

Year	Policy/incentive	Description
2012	Manufacturing Competitiveness Enhancement Programme (MCEP)	MCEP was introduced to support the manufacturing sector on the back of the negative effects of the global financial crisis & to respond to market and institutional failures affecting the sector. Overall, the programme aimed to promote manufacturing firms' competitiveness and retain employment in the sector.

Source: (Jahed, Amra, & Ellse, 2016)

#### 4.6.2 Overall cost and performance

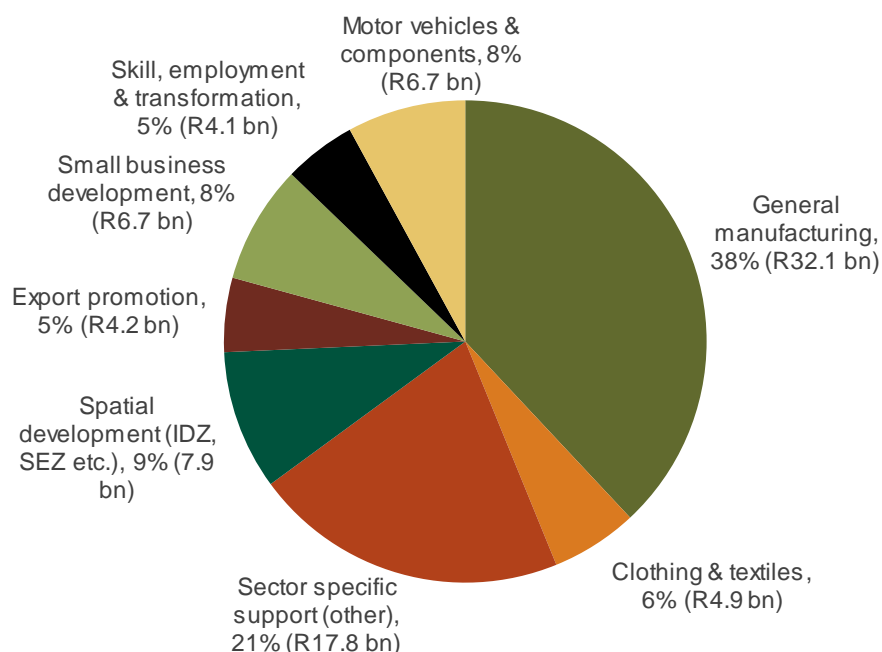
In a recent report published by the Parliament of South Africa, investigating the costs and outcomes of (national level) industrial development initiatives between 1994 and 2015<sup>96</sup>, it is estimated that the country spent R 84.3 billion on industrial support and development initiatives over the 21-year period under review<sup>97</sup>. The general manufacturing, sector specific and spatial development (such as IDZs and SEZs) sector/functions received the largest share of expenditure with 38%, 21% and 9% of total expenditure being allocated to these sectors respectively.<sup>98</sup>

<sup>96</sup> (Jahed, Amra, & Ellse, 2016)

<sup>97</sup> It is important to note that this review was limited to the programmes of the Departments of Trade and Industry, Economic Development and Small Business.

<sup>98</sup> (Jahed, Amra, & Ellse, 2016)

**Figure 5: Total expenditure on industrial development by sector/function 1994 - 2015 (in nominal prices)**



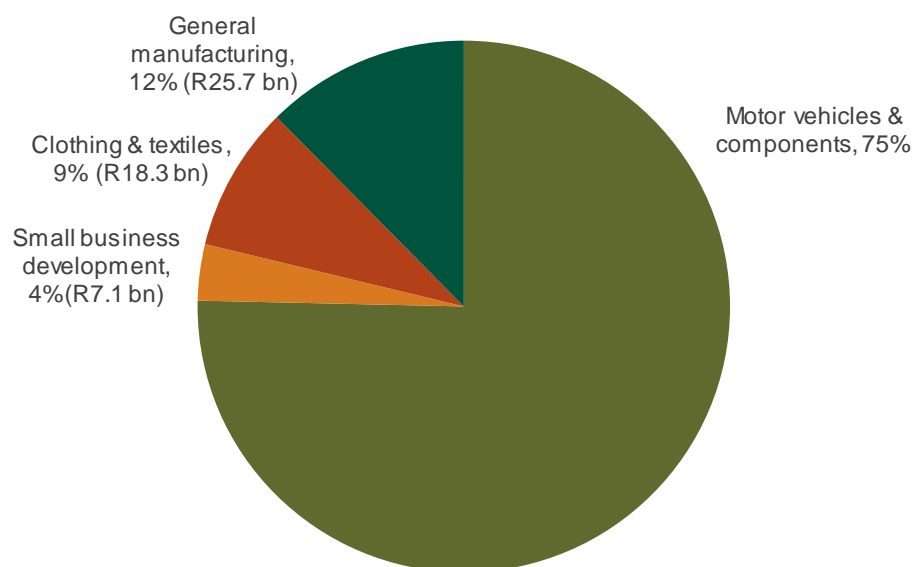
Source: (Jahed, Amra, & Ellse, 2016)

In addition to the on-budget expenditure on industrial development initiatives, tax benefits provided by government have traditionally been offered to only a few sectors, namely motor vehicles, manufacturing, clothing and textiles and the small business sector. The total value of these tax benefits between 1995 and 2015 amounted to R 207.3 billion – more than double on-budget expenditure – and accounting for 71% of total “expenditure” on industrial development initiatives<sup>99</sup>. Expressed in constant 2015 prices, South Africa incurred R 393.15 billion in tax expenditure to support industrial development initiatives over this period.<sup>100</sup>

<sup>99</sup> This includes duty credits provided to manufacturers of vehicles, clothing and textiles, as well as the reduced headline tax rate for small businesses and the 12i and 12g depreciation incentives for manufacturing investment. It excludes tax benefits to R&D, the mining, oil and agriculture sectors and the general depreciation allowances offered by SARS.

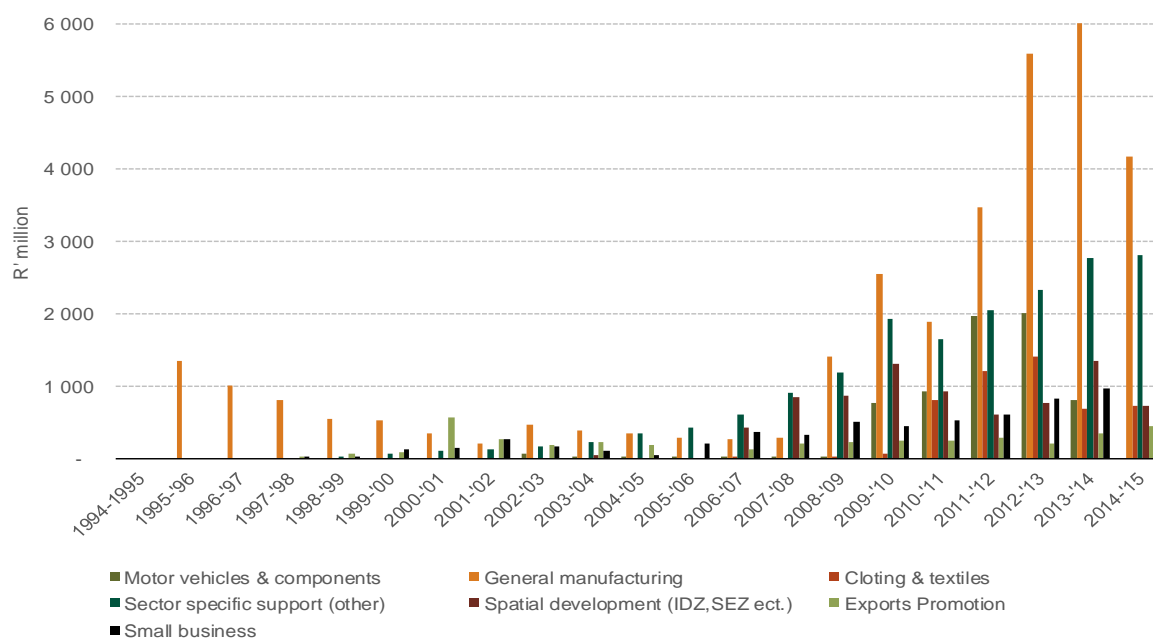
<sup>100</sup> (Jahed, Amra, & Ellse, 2016)

**Figure 6: Total (industrial development) tax benefits provided by sector 1994-2015 (in nominal Rands)**



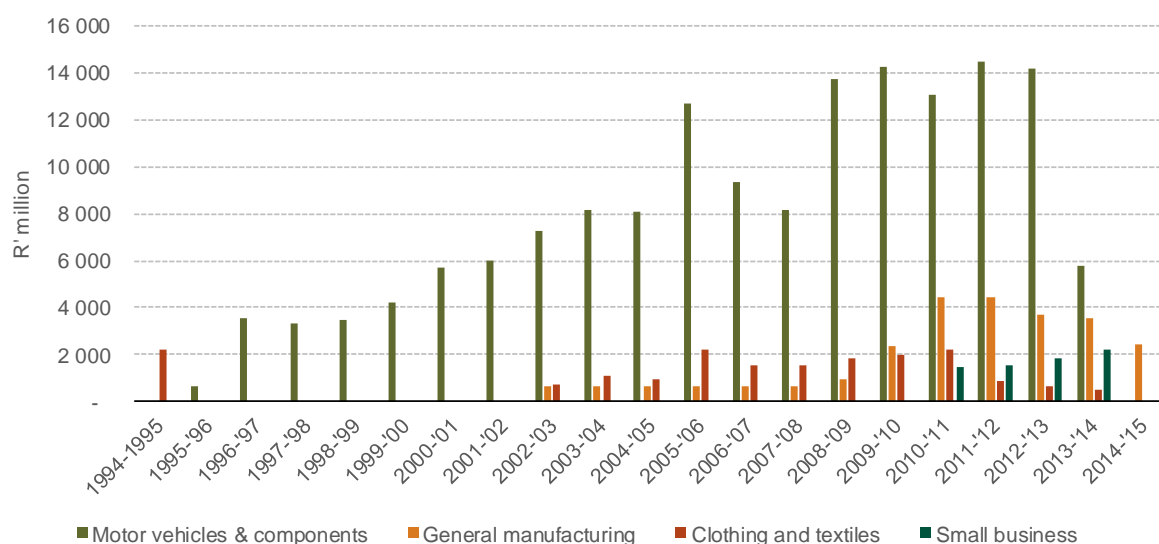
Source: (Jahed, Amra, & Ellse, 2016)

It is also important to note that the amount of funds dedicated to industrial development has increased markedly over time, from an average of 0.5% of total budget expenditure between 1994/95 to 2004/05, to over 0.9% since 2005/06. This is largely due to the introduction of MCEP in the aftermath of the global financial crisis. Similarly, support for small business development has grown strongly since 2007 (see Figure 7 below).

**Figure 7: Direct expenditure on 'industrial development' (1994/95 – 2014/15)**

Source: (Jahed, Amra, & Ellse, 2016)

Similarly, tax expenditure by sector has experienced notable shifts over time – as depicted in Figure 8 below. Whereas historically, most of this support has gone to the motor industry, this appears to have changed in recent years.

**Figure 8: Tax expenditure on 'industrial development' (1994/95 – 2014/15)**

Source: (Jahed, Amra, & Ellse, 2016)

According to a World Bank (2017) report, South Africa's industrial development policy instruments have mostly consisted of encouraging the "redeployment of private investment toward the industrial sector...nonetheless, such initiatives translated into neither a significant reallocation of private capital towards industrial sector, nor higher industrial employment<sup>101</sup> However, according to World Bank estimates, investment tax incentives offered by Government to the manufacturing sector have contained (at a modest cost) the decline in investment and loss of jobs recorded in the sector since 1994. Specifically, the Bank finds that:

- The Marginal Effective Tax Rate (METR) – which is a measure of the difference in investment rates of return before and after taxes – varies across sectors and is lower than the corporate income tax rate of 28%, with the electricity and manufacturing sectors being the most taxed sectors.
- The total implicit cost of investment tax incentives for the fiscus is significantly larger than that reported in the Budget Review, although it was still modest in 2012 compared to the overall amount spent on industrial policy instruments
- Private investment would have been lower by a quantum of R 5.1 billion in 2012 had capital tax allowances not been offered over that period, suggesting that capital allowances can be considered effective and efficient tools in promoting private investment.
- Although capital allowances led to a reduction in the demand for labour, employment in the beneficiary sectors would have been lower by approximately 30,000 jobs had the allowances not been offered.

## 4.7 Implications for the evaluation

This literature and document review serves to highlight a number of economic and policy debates surrounding the use of incentives globally, and some of the specific reasons and priorities for government intervention in South Africa. The main implications of this review, for this evaluation, are summarised below.

### 4.7.1 Defining incentives – what is in and what is not?

Due to the broad use and application of incentives, it not possible to come to a universally agreed definition on what is or is not a business incentives. However, for the purpose of this evaluation, incentives can broadly be categorised into three main types: (i) indirect (tax) incentives (which are the most commonly used and researched); (ii) direct (financial) incentives and (iii) other incentives.

### 4.7.2 The economic rationale for incentives in South Africa

The use and acceptance of government intervention in markets and the use of business incentives has varied greatly over time. Nevertheless, three common concepts have emerged that are generally used to explain why and when governments should intervene. Firstly, governments may intervene to address issues of market failure and economic inefficiencies, such as free-riding, negative externalities and information asymmetries. Secondly, they may intervene to ensure social protection, distributive justice and fair outcomes in societies and markets. Lastly, governments may intervene to support activities that contribute to economic and industrial development and growth.

<sup>101</sup> (World Bank, 2017)

### **4.7.3 The policy rationale for incentives in South Africa**

South Africa's key economic policies (the NDP, IPAP and Nine-Point Plan) should play a central role in guiding the thinking behind the design and implementation of incentive programmes. Broadly, these policies identify the key constraints facing the South African economy, and the need to promote faster and more inclusive economic growth as well as address high levels of unemployment. Specifically, they identify weak exports; an undiversified economy; poor coordination and collaboration within government and between government and the private sector; spatial disparities; energy production and security challenges and poor institutional and financial support for businesses as common economic constraints. For small and black-owned businesses, highly unequal access to finance, infrastructure and markets, and regulatory and skills constraints, are especially problematic.

### **4.7.4 The design and effectiveness of the system of incentives**

The available literature provides useful guidelines as to the key considerations policy makers should undertake when designing incentive programmes (and system). Specifically, based on OECD and G20 criteria and the wider literature, a successful incentive system is (i) formulated within and governed by some broader economic and industrial policy objective or framework; (ii) well targeted (clearly specifying qualifying criteria and conditionalities); (iii) sufficiently co-ordinated across regions and sub-national government levels; (iv) transparent and open for public scrutiny; (v) actively managed and (vi) not an alternative to ensuring an overall conducive economic environment for business.

## 5 Country comparisons

Because every country and society is unique, it is never possible to choose a perfect international comparator. The countries chosen for comparison in this study were decided on the basis of a number of criteria, including their similarity to the South African market in terms of economic structure and population size; the economic performance and quality of governance in each country; and evidence of a structured incentive system and accessible documentation.

From an initial short-list of 11 countries, the following three countries were selected for this comparative analysis in consultation with the project Steering Committee:

- Thailand
- Chile
- Germany

A brief comparative overview of the economic, demographic and governance characteristics of these countries is provided below.

**Table 8: Country characteristics**

Country	GDP per Capita (PPP) 2016	Population Size (mn) 2017	Government Effectiveness <sup>102</sup>	Average GDP Growth Rate 2005 – 2015	Ease of Doing Business <sup>103</sup> 2016	Manuf. (% of GDP) 2015
South Africa	\$ 13 200	55	0.27	2.9%	74	13.2
Chile	\$ 23 500	18	1.08	3.9%	57	11.9
Thailand	\$ 16 100	68	0.36	3.4%	46	26.9
Germany	\$ 47,000	80	1.74	1.4	17	22.8

The country studies are based largely on a desk-top review. Together the studies provide interesting lessons for South Africa in reviewing past policies and developing new programmes and strategies. Importantly these country case studies are not meant to offer “best practice” but provide an overview of selected international practice which can be considered.

### 5.1 Thailand

Thailand’s incentive system is largely managed by two key organisations: Thailand’s Board of Investment (BOI) and the Revenue Department (RD). Generally, the BOI provides tax and non-tax incentives to mostly manufacturing companies in certain industries and regions, while the RD offers tax incentives to Regional Operating Headquarters (ROH), which are Thai-incorporated companies that provide managerial, administrative, and technical services as well as other supporting services to associated enterprises<sup>104</sup>.

<sup>102</sup> The World Bank Worldwide Governance Indicator. The indicator ranges from -2.5 (weak governance performance) to 2.5 (strong governance performance).

<sup>103</sup> The World Bank Doing Business Indicators. A ranking of 1 indicates the most business friendly environment out of the 190 countries measured.

<sup>104</sup> EY (2014). Incentives in the ASEAN region. Available: [https://www.eytax.jp/tax-library/thought-leadership/pdf/Incentives\\_in\\_ASEAN\\_Region\\_2014\\_E.pdf](https://www.eytax.jp/tax-library/thought-leadership/pdf/Incentives_in_ASEAN_Region_2014_E.pdf)



### **5.1.1 Monitoring and evaluation**

The BOI undertakes regular revisions of their incentive programs in line with the Investment Promotions Act. However, there is no existence of a monitoring and evaluation framework in their policy documents and it is therefore unclear how programmes are reviewed and on what basis amendments are made.

### **5.1.2 Institutional Framework**

Despite the added complexities brought by an amended investment incentive policy framework, the role and responsibilities of each organisation within the framework is clearly defined. The BOI has improved its investment facilitation function, making it easier for investors to establish or expand their investments.

### **5.1.3 Incentives redundancy**

There is evidence of Thailand offering exorbitant incentive packages in comparison to the norm and other countries in the region. This leads to unnecessary revenue leak, which can be damaging when tax expenditure is only marginally less than income from tax. The evidence suggests that firms would have invested at a less costly package<sup>105</sup>.

### **5.1.4 Provision for guarantees**

Specific incentives offered to investors by the BOI include guarantees to protect investors from political interventions. These include guarantees against nationalization; against competition by new state enterprises; against state monopolization of the sale of products similar to those produced by promoted firms; against price controls; against tax-exempt import by government agencies or state enterprises of competitive products; and, of permission to export.

### **5.1.5 Incentives with regional development objectives**

The BOI actively encourages investment in the least-developed provinces of Thailand, offering maximum incentive packages to projects that locate in one of these provinces. These Provinces are classified as those whose average per capita income has been below 85% of the national average during the previous three years.

## **5.2 Chile**

A number of key lessons with respect to the institutional arrangements underpinning a business incentives system; the design of the business incentives themselves; and the monitoring and evaluation of the system as a whole, can be gained from the Chilean experience. These lessons are summarized briefly below.

### **5.2.1 Institutional arrangements**

The design and implementation of a business incentives system is a complex undertaking which requires strong institutional support.

There is a need for a clear distinction of structure and functions between the various ministries, committees and agencies involved in this process. Such entities may be respectively responsible for economic policy formulation, business incentive design, the administration and implementation of incentives, and the dissemination of information regarding the business incentives system.

<sup>105</sup> Muthitacharoen, A. (2016). Assessing Tax Incentives for Investment: Case Study of Thailand. Available: [https://www.pier.or.th/wp-content/uploads/2016/03/workshop2016\\_paper3\\_Athiphat.pdf](https://www.pier.or.th/wp-content/uploads/2016/03/workshop2016_paper3_Athiphat.pdf)

At the same time, there is a need for strong coordination between these various institutions. Consequently, a business incentives system can benefit from the presence of one institution that takes ownership for driving the system as a whole and coordinating the various institutions involved in the incentive process.

### 5.2.2 Design

Business incentives can take on a diversity of forms including tax credits, tax reductions, tax exemptions, transfer / transaction cost exemptions, custom duty exemptions, accelerated depreciation, relaxed regulations, and co-financing arrangements. Business incentives can also be implemented for a variety of reasons. These include promoting investment and employment in remote geographical zones or specific sectors; stimulating R&D and technological innovation; and supporting early-stage entrepreneurship and SMMEs.

When deciding what type of incentive to implement, the government thus needs to have a clear vision of what exactly it is trying to achieve. Effective targeting requires a selection process based on industry value chain assessments and providing additional incentive support only to those missing links that are critical in the overall industry development. Focusing on a few key sectors can also enhance the business incentive system's relevance and impact. It is necessary to ensure that various incentives do not undercut or work against one another.

Finally, in order to achieve maximum effectiveness, a business incentives system needs to be implemented in the context of a stable political and economic environment, which provides investors with a sense of certainty.<sup>106</sup>

### 5.2.3 Monitoring and evaluation

Monitoring and evaluation in the context of a business incentives system is essential for understanding the relative effectiveness of various incentive programmes. This in turn is necessary for assisting government in efficiently channelling public money towards programmes that achieve maximum impact.

M&E needs to be institutionalized and managed if it is to achieve its objective of informing and providing feedback to decision-making processes. At the same time however, M&E systems are dynamic and will necessarily be subject to changes over time. M&E systems thus need to allow for pragmatic, flexible development.<sup>107</sup>

A business incentives M&E system should include performance indicators and evaluations that operate in a complementary manner. In this context, the unit of analysis, methods and topics need to be clearly defined. Furthermore, there should be a mechanism in place for following up on recommendations.

## 5.3 Germany

The following lessons emerge from this case study of the German approach to business incentives:

- The “life-cycle” approach to enterprise development seems sensible: grants at start-up to share the risk, recruitment and training support in initial phases of the new enterprise, and

<sup>106</sup> Baker & McKenzie. (2004). Doing Business in Chile. Cornell University. Available at: <http://digitalcommons.ilr.cornell.edu/cgi/viewcontent.cgi?article=1028&context=lawfirms>

<sup>107</sup> Guzman, M., Irarrázaval, I., & de los Ríos, B. (2014). Monitoring and Evaluation System: The Case of Chile 1990–2014. ECD Working Paper Series No. 29. IEG World Bank Group.

R&D support to ensure continued and enhanced competitiveness once operational seem appropriate.

- The integration of regional incentive programmes with investment, labour and R&D support measures is comparatively sophisticated, and could be effective in communicating regional and sectoral priorities in a relatively simple manner. Slight variability in the percentages of support available are likely to be more effective at limiting potential distortions created by a much more sectorally and regionally targeted approach. The applicable percentages can be “tweaked” if up-take rates are not consistent with desired outcomes.
- Scalability of support based on the size of the enterprise. Based on the design of the various measures, large scale foreign investors receive far more limited incentives (in percentage terms if not by absolute value) than SME investors.

#### **5.4 Key lessons from the country comparisons**

The three comparator countries make wide use of incentives to facilitate investment and encourage specific types of business activities. However, the specific approach and focus of the incentive system in each country, differs markedly depending on national priorities. In Chile, incentives are used to support the development of disparate regions; whereas in Thailand, the focus has been on specific sectors and more recently, to encourage international businesses to locate their regional head-offices in the country. In Germany, the system of business incentives focuses strongly on research and the development and SMEs.

Many of the incentives pursued in these three countries are mirrored in some form in South Africa. There are however a number of common lessons and principles that emerge from these country case studies, which could be further considered in the review of South Africa’s system of business incentives. There are also some possible gaps or shortcomings in the South African framework, when compared to what countries elsewhere are doing. The following table highlights the main lessons and some of the potential gaps, based only on the country comparisons.

**Table 9: International comparison (C = Chile; G = Germany; T = Thailand)**

	Country	Practice in comparator countries	Practice in South Africa
1.	T	The roles and responsibilities of each organisation within the incentive framework must be clearly defined; a central investment agency responsible for the administration of all incentives can help to coordinate investment activities for Government and make it easier for prospective investors.	Whereas the largest number of direct incentives are administered by the DTI, these incentives have historically been spread across different agencies and divisions; and outside of the DTI, numerous other departments and entities offer various other forms of business incentives. SARS is responsible for the administration of all indirect incentives, often in collaboration with other departments.
2a.	C	Incentives are tailor-made to be attractive to selected sectors or business activities that the country wishes to promote. Effective targeting requires a selection process based on industry value chain assessments and only those missing links that are critical in the overall industry development receive additional incentive support	South African incentives are targeted at a number of a priority sectors, most notably in manufacturing, agriculture and mining; however, it is not clear whether this prioritisation has been based on a critical assessment of the value chain within these sectors and any others.
2b.	C	Incentives extend beyond traditional sectors to promote venture capital and the development of local capital fund management industries. This includes allowing banks to invest up to the equivalent of one percent of their asset base in venture capital through investment fund administrators and subsidiaries.	South African incentives are generally focused on traditional sectors and make use of traditional funding mechanisms. On the other hand, the Government has recently begun to explore new and more innovative funding mechanisms, including through the Jobs Fund.
3a.	G, T	Incentives are offered uniformly to both qualified domestic and foreign investors.	South Africa does not discriminate between domestic and international businesses in the allocation of incentives.
3b.	G, T	More generous incentives are offered to projects that are most likely to generate positive externalities by bringing new technology to the country or investing in less-developed provinces.	Whereas most South African incentives encourage R&D expenditure and some are focused on specific locations (SEZs); most funding is targeted at specific sectors or industries rather than specific economic outcomes.
3c.	G	The amount of support provided is based on the size of the enterprise, with SMEs qualifying for more generous incentives.	Most South African incentives do make special provisions for SMMEs, and numerous incentives have been specifically developed to support small business.
3d.	C, T	The incentive system explicitly seeks to attract or support companies that have global or regional ambitions or linkages (such as regional headquarters), by allowing for some activities outside of the country to qualify for benefits (e.g. R&D); by making it easier for firms to undertake international financial transactions; and by eliminating	The South African incentives system does not explicitly seek to encourage the establishment of international or regional headquarters in the country.

	Country	Practice in comparator countries	Practice in South Africa
		limits on the hiring of foreign professionals (or providing 1-year resident visas for foreign entrepreneurs).	
4a.	C	M&E is institutionalized and managed to inform and provide feedback to decision-making processes. A mechanism is in place for following up on recommendations.	The Department of Planning, Monitoring and Evaluation facilitates M&E for priority programmes across Government; but there is no institutionalised process in place to evaluate all business incentives and ensure that recommendations are acted upon.
4b.	C	Independent research, and in particular, the use of randomised control studies, is used to assess the effectiveness and impact of government programmes.	Whereas there is some evidence of independent research to assess the impact of specific incentives, most evaluation studies are not rigorous and are usually commissioned after the fact.
5a.	C	The establishment of a National Innovation Council for Competitiveness, a public-private partnership that acts as permanent adviser to the President on matters of science, innovation, education and the knowledge economy.	South Africa has established The National Advisory Council on Innovation (NACI) to advise the Minister of Science and Technology and the Cabinet on the role and contribution of science, mathematics, innovation and technology, including indigenous technologies, in promoting and achieving national objectives.
5b.	T	National plans explicitly target improvements in external and international measures of perception, such as the Transparency International Corruption Index; the Institute for Economics and Peace (IEP) Peace Index and independent competitiveness rankings.	Whereas many Government departments or divisions make use of international indices for strategic purposes, no evidence could be found that the South African Government explicitly targets and tracks its performance against international perceptions' indices of the business or governance environment in its economic policies and plans.

## 6 Theory of Change

### 6.1 Purpose

In evaluations, the theory of change is used widely to determine the pathways through which an intervention contributes to outcomes. These theories are built on evidence, research or an intuitive understanding of how a programme works.<sup>108</sup>

### 6.2 Framing the Theory of Change

The proposed theory of change described below and illustrated in the graphic takes its lead from the National Development Plan (NDP). Importantly the theory of changes seeks to capture the intervention logic of a *system* of business incentives rather than a single incentive.

According to the NDP, South Africa's primary economic challenges include:

- High levels of poverty and inequality that stem directly from the fact that too few people work;
- Productivity that is low relative to peer group countries;
- Too few resources are invested in new production capacity and infrastructure, and existing infrastructure is inadequately maintained.

These problems encourage the persistence of several negative outcomes, the most serious of which are low levels of employment, and high levels of poverty and inequality. The NDP's diagnostic argues that poverty and inequality can only be tackled through economic growth and transformation that raise employment and distribute the benefits of growth more widely. Without rapid economic growth, rising standards of living for the majority of the population are neither feasible nor sustainable.

To address these challenges, the country has to increase employment levels – particularly for unskilled and low-skilled workers – invest in infrastructure and increase productivity. Importantly the NDP notes that the state is critical for shaping the economic environment, and the efficacy of the state is a key determinant of how fast the economy grows and how its benefits are distributed.

The economic prescription set out on the NDP proposes the following key actions:

- 1) Creating an environment for sustainable employment and economic growth
- 2) Promoting employment in labour-absorbing industries
- 3) Promoting exports and competitiveness
- 4) Strengthening the capacity of government to implement its economic policy
- 5) Demonstrating strategic leadership among stakeholders to mobilise around a national vision

<sup>108</sup> Funnel, S. and P. Rogers (2011) *Purposeful Program Theory: Effective use of theories of change and logic model*. John Wiley & Son. San Francisco.

Clearly actions 1 to 3 underpin the overall purpose of South Africa's system of business incentives.

### 6.3 A Theory of Change for business incentives

The theory of change takes as its starting point *an Industrial Development Strategy, where incentives are directed at firm-level change.*

#### Inputs – Activities – Outputs

South Africa's primary economic challenges include high levels of poverty and inequality which stem directly from the fact that too few people work; low productivity relative to peer group countries and insufficient investment in new production capacity and infrastructure.

The country's economic growth path therefore aims to increase employment levels – particularly for unskilled and low-skilled workers – invest in infrastructure and increase productivity. The primary path adopted by the country is an industrial development strategy.

Business incentives are one set of government instruments that can be utilised to support this industrial development strategy. Incentives are used to change firm behaviour to invest in Capital, Labour, Transformation or Research and Development (R&D).

At the **level of inputs**, a system of incentives requires funding, human resources and skills, appropriate regulations and a national economic policy framework. Importantly a key assumption is that government has sufficient funding to support the cost of such incentives as well as their administration. Equally important as an assumption is that the country has a clear and coherent economic policy to which all incentives in the system are aligned. The absence of such a coherent policy – or worse competing policies – may result in contradictory incentives in the system.

At the **activity level** (note that we are dealing with incentives at the generic level at this point), the design or implementation of any incentive rests on an assessment of the key firm-level constraints to be addressed. Ideally incentives are designed and tested through a collaborative, consultative and evidence-based approach to address specific identified barriers to firm investment. An incentive policy and plan is therefore required that sets out the need for the incentive, the expected outcomes to be achieved (i.e. how it will change behaviour), and the likely impact. Ideally, incentives are designed in detail and tested and adjusted if required following the application of a cost-benefit analysis (including an overall assessment of its fiscal cost and economic benefit). This should include some assessment of how individual incentives interact with other incentives in the system. Once design and testing are finalised, incentives are implemented. This requires the necessary institutional, fiscal and regulatory frameworks to be in place. Government is then required to promote and support such incentives (for instance managing the application procedure, selection requirements etc.) as well as monitor and evaluate its implementation to assess whether outcomes are being achieved. Importantly there should be an ongoing feedback from the M&E activities into the re-design and/or calibration of incentives to continually assess costs, outcomes and impact.

**Incentives (Programme Outputs)** can be aimed at the supply side or demand-side and could be one of three types or a combination thereof: Indirect (Tax) Incentives; Direct (Financial) Incentives and Other Incentives (e.g. regulatory change). The South African business incentives system comprises a number of incentive programs spanning all types of incentives, both supply and demand. Importantly, different incentives target different outcomes. But the main purpose of an incentive is to change behaviour at the firm level. Conceptually change

occurs by impacting firm profitability either through: (a) reducing costs; (b) increasing costs (in other words a negative incentive); or (c) increasing revenues. Individual incentive programs, if effective, should result in changed firm behaviour causing them to invest in capital, labour, inclusion or research and development. At an aggregate level the response of individual firms results in economy wide effects.

Within the business incentive system critical assumptions that must hold include the existence of effective intergovernmental coordination and planning. In particular, from a systems perspective, it is important that individual incentive programs do not contradict each other or incentivise behaviours that undermine other policy objectives or even other incentive programs. Likewise, for the ToC to hold (and thereby lead to the intended change in firm behaviour), it is critical that incentives are fully costed, monitored and evaluated; well-targeted and supported by clear criteria; appropriately resourced; and implemented efficiently and transparently.

Additionally, a key assumption is that government is able to coordinate and deliver the variety of supporting services and other components required for an incentive programme to be effective. In other words, incentive programmes on their own are unlikely to be sufficient conditions for changed firm behaviour. As already identified in the NDP, a key assumption underpinning the effectiveness of business incentive programmes is that the necessary public sector (government or state-owned company) investment in infrastructure takes place. The key point being that business expansion and growth requires significant and supportive economic infrastructure in the way of roads, electricity, water and specialised industrial zones to be in place, as these provide a platform for effective firm investment and growth.

### Immediate Outcomes

The theory of change indicates that if the relevant outputs (individual incentive programmes) are delivered, and these are effective, this should be evidenced in a number of **immediate outcomes**. These outcomes will vary dependent on the nature of the business incentive, and some of these outcomes may be the consequence of a number of different incentives. Individual incentives do not result in all immediate outcomes but may only target one of the specified outcomes. Equally one incentive programme may in fact target and result in a number of immediate outcomes that have been identified. The key **immediate outcomes** that are noted include firm level investment in capital, the establishment of new enterprises (new business formation), firm investment in labour (human capital investment), firm level transformation (this could include a variety of outcomes including economic participation / inclusion interventions and investment, which would include BBBEE ownership, supplier development and employment equity interventions), and firm investment in research and development (which could also include research and development in respect of new market access).

There are a number of **critical assumptions** that must hold if these immediate outcomes are to be realised. Firstly, the relative cost of capital and labour is conducive to labour-intensive investment and economic growth. Secondly, that the general economic environment is conducive to private sector investment in whatever form required. Thirdly, that key barriers to entry (for new entrants / firms) or expansion are effectively addressed - in other words, there is an effective competition policy and regulation in place. Finally – in parallel to any incentives – the overall cost of doing business and general regulatory burdens need to be addressed (although it should be recognised that incentives, if sufficient, may induce firms to undertake investment in conditions that may not be entirely favourable from a regulatory or cost of doing business perspective).



## Intermediate Outcomes

If the immediate outcomes (firm-level investment) are realised through a combination of different business incentives (which result in different immediate outcomes), then the business incentives system, at the aggregate level, should result in increased economic productivity, expanded production and employment and enhanced economic inclusion. These changes are evidenced in the **Intermediate Outcomes**. The intermediate outcomes include improved firm and economic productivity; increased economic participation and increased employment levels.

These intermediate outcomes are inter-related. For instance, it is unlikely that increased employment levels are possible without improved firm and economic productivity and increased economic participation. Arguably, increased economic participation is a critical element (as noted in the NDP), as without more generalised economic participation and income growth, the domestic economy is unlikely to grow sufficiently to absorb increased labour. The one proviso in this inter-relationship is that with respect to firm and economic productivity. It is foreseeable that such productivity improvements could occur without any employment and economic participation effects (this is already evident when one considers that firms could choose to only invest in capital, for instance, increased mechanisation). Conceptually, it is therefore critical that incentive programmes drive all immediate outcomes if the balance of intermediate outcome is to be achieved.

However, in order for incentives to be effective (i.e. result in increased investment) and effect intermediate outcomes at the aggregate level, two key assumptions must hold - that there is generalised economic growth and overall macroeconomic stability. Importantly, these assumptions are not within the control of individual incentives programmes.

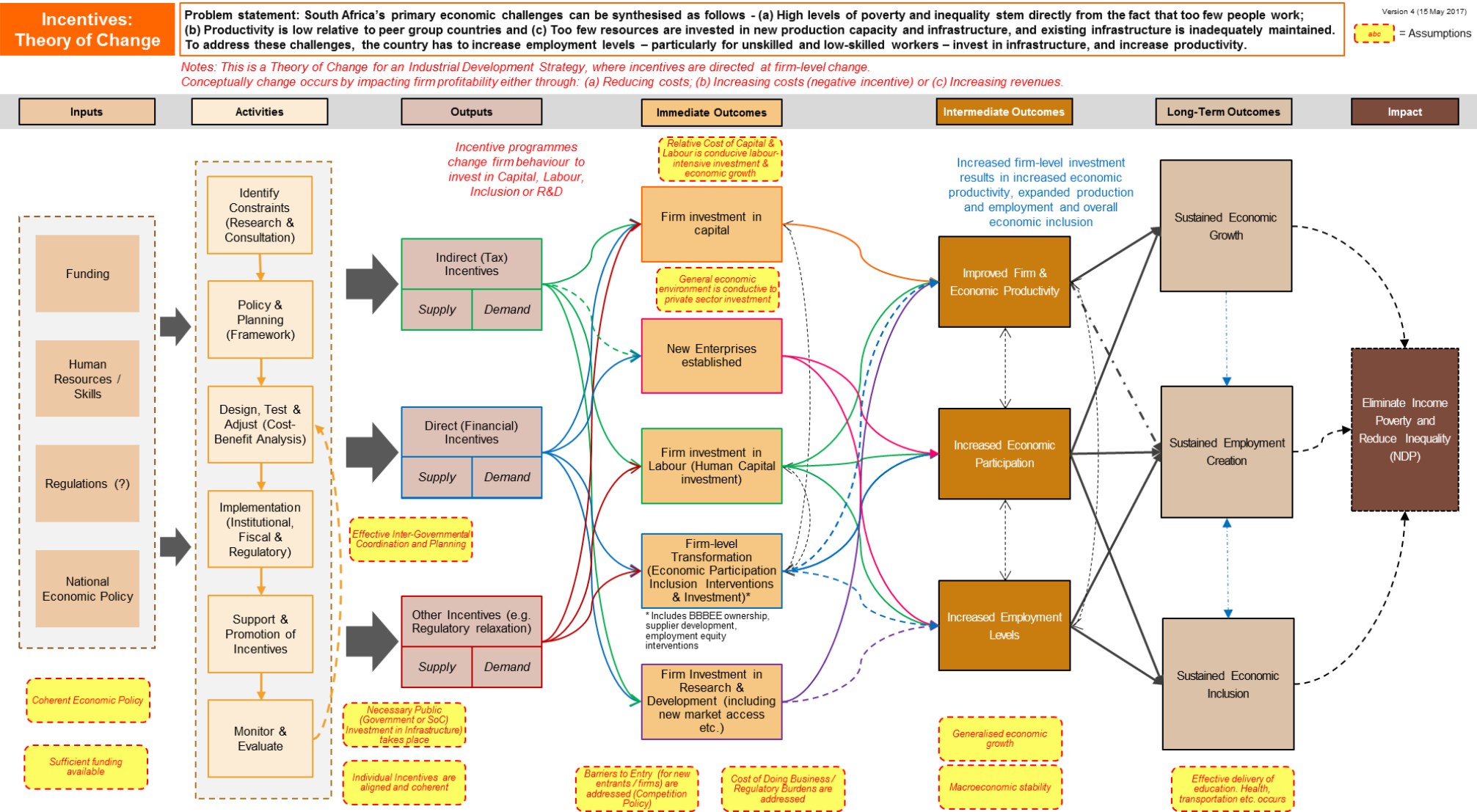
## Long-Term Outcomes and Impact

Intermediate outcomes are a necessary – but not sufficient condition – to realise the Long-Term Outcomes. If all intermediate outcomes hold then we would expect to see **long-term outcomes** in respect of Sustained Economic Growth; Sustained Employment Creation and Sustained Economic Inclusion (which considers both spatial economic development and economic transformation). However, it must be recognised that in order to achieve all three long-term outcomes in equal measure most of the intermediate outcomes will need to be achieved. In other words, the incentive system needs to be appropriately balanced and structured to ensure that firm and economic productivity are accompanied by increased economic participation and increased employment.

Critically, the realisation of the long-term outcomes is also dependent on the effective delivery of a range of other social goods and investments (mainly by government), including: education, health, transportation etc.

If sustained economic growth, sustained employment creation and sustained economic inclusion are achieved we are likely to see **Impact** in respect of eliminating income poverty and reducing inequality.

Figure 9: Theory of change



## 7 Category-level theories of change

### 7.1 Categories of business incentives

#### 7.1.1 Conventional classification

Internationally, countries offer a wide range of incentives to business, ranging from tax holidays, preferential tax rates, grants, preferential loans, monopoly rights and preferential infrastructure access. Broadly, these can be categorised into three main types: (i) indirect (tax) incentives (which are the most commonly used and researched); (ii) direct (financial) incentives and (iii) other incentives (vary significantly across countries). Tax incentives are also commonly referred to as fiscal incentives although it is recognised that fiscal incentives often include both tax and non-tax financial incentives, such as subsidies.

Direct incentives include cash payments/grants or payments-in-kind (such as land or infrastructure transfers) made to the investor and are a direct cost to the government's budget requiring "upfront use of government funds".<sup>109</sup> Indirect incentives usually refer to tax incentives and generally provide for a reduction in taxes, including tariff rates on imported inputs. Lastly, other non-financial incentives encompass a multitude of benefits including reduced administrative procedures, legislative exemptions and Special Economic Zones.<sup>110</sup>

Most of the above-mentioned incentives work through the supply-side; they seek to encourage firms to raise investment, production and employment. But many countries also make use of demand-side incentives and instruments to drive demand for a particular outcome – such as innovation, education, energy-efficiency, public transport or healthcare – which in-turn encourages business to increase supply or speeds up the uptake and diffusion of specific types of goods or services.<sup>111</sup>

The inventory of business incentives categorises all identified incentives by type, and whether they work through the demand or the supply side. Table 10 shows the distribution of the South African system of business incentives against this conventional classification.

**Table 10: Distribution of business incentives by conventional classification**

Business incentives	Supply	Demand
Indirect	43	0
Direct	191 (127 SETA)	0
Other	10	3

There are two main problems with the conventional classification for the purpose of our analysis. Firstly, as illustrated in the table above, almost all South African incentives are on the supply-side, and the majority are direct. There would therefore be little use in developing distinct theories of change for most of the other sub-categories (i.e. the other blocks in the

<sup>109</sup> (UNCTAD, 2000, p. 11)

<sup>110</sup> (Barbour, 2005)

<sup>111</sup> (European Commission, 2015)

table). Rather, it would seem that it is important to break-up the large number of direct supply-side incentives, in some more meaningful way.

Secondly, the conventional classification describes the form of the incentives, but does not differentiate between the orientation and objectives of different groups of incentives. There is for example, no reason to expect that the theory of change for all direct supply-side incentives, would differ significantly from all indirect-supply side incentives. Moreover, in both cases, these theories of change would likely resemble the system-level theory of change.

### 7.1.2 Proposed classification

An alternative and more useful way to categorise the system of business incentives in South Africa, can be extracted from the system-level theory of change itself. As shown in Section 2, the initial system level theory of change identifies 7 immediate outcomes, towards which all business incentives contribute in some way. For example, where some incentives are targeted largely at increasing investment in capital (equipment, production facilities or technology), others are largely directed at raising skills or employment.

The inventory of incentives provides a preliminary assessment of the main objectives of each incentive, by each immediate outcome. The resulting distribution is shown in Table 11. It is important to note that many incentives are directed at more than one objective or immediate outcomes, so these results are not additive. Nevertheless, the table reveals that the majority of incentives in South Africa are targeted at raising investment in new capital or business, or supporting skills and employment. A lesser but significant number contribute towards transformation, R&D and marketing.

**Table 11: Distribution of business Incentives by immediate outcomes**

Business incentives	Total
Capital investment incentives (incl. equipment and new technology)	76
New/small business incentives and enterprises sustained	
Skills and employment incentives	72 (excl. SETAs)
Transformation/empowerment incentives	23
R&D incentives (including innovation and exploration)	18
Marketing incentives (including export promotion)	19

There are undoubtedly linkages and overlaps between these different groups of incentives; there are also likely to be conflicts or contradictions. Understanding these linkages, overlaps and contradictions, by each of these categories of incentives, will provide important lessons for the design and implementation of the system as a whole. Moreover, reviewing the assumptions underlying the system of incentives, by each of these different outcomes and categories, will serve to validate and expand on the assumptions that have been identified at the systemic level to date.

For these reasons, the category level theories of change have been structured around the system-level theory of change; and specifically, each category is closely aligned with one or more of the immediate outcomes specified at the system-level.

## 7.2 Capital incentives

The inventory of business incentives reveals that the largest number of incentives in South Africa (excluding programmes implemented by the SETAs) somehow contribute towards investment in new equipment, technology or production capabilities. Moreover, depending on the objectives and criteria incorporated in the design of these incentives, most of these incentives also seek to achieve other national policy outcomes. This includes the establishment of new enterprises, the sustenance of existing enterprises, transformation and employment. On the other hand, the existing suite of capital incentives in South Africa do not contribute significantly to investment in research and development and marketing. This could prove to be an important short-coming given the shift, globally, towards information and technology intensive manufacturing and services.

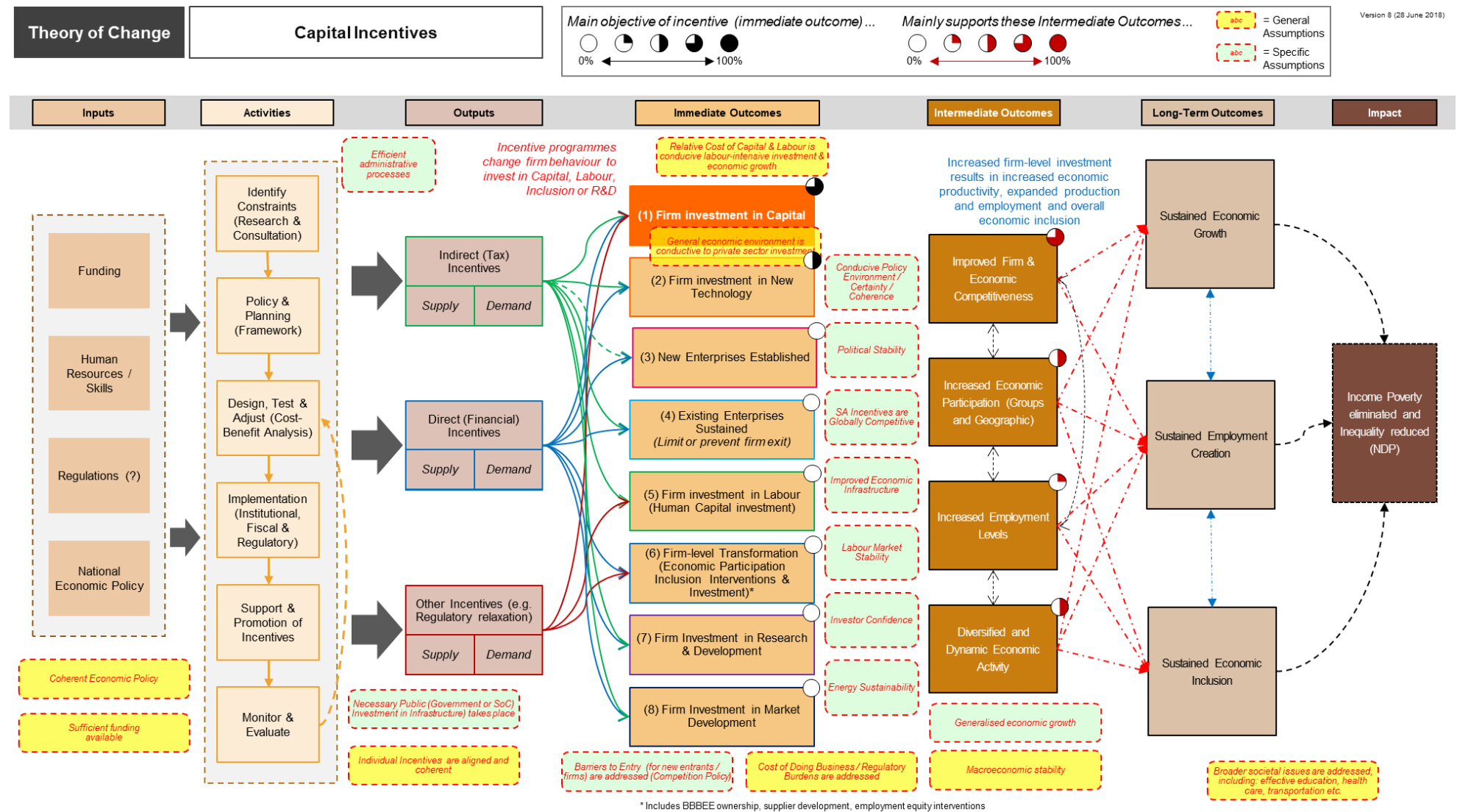
Two potential gaps in the system-level theory of change, were revealed by the category-level discussion and analysis:

- Firstly, firm investment in technology needs to be differentiated from investment in research and development. Thus, either the existing outcome related to investment in capital needs to be explicitly expanded to include investment in technology, or a new immediate outcome should be added to the system-level theory of change to reflect this important objective
- Secondly, consideration should be given to adding a reference to spatial development to the intermediate outcomes. A number of capital incentives have been specifically constructed to redress Apartheid-era planning, by promoting investment in previously neglected but highly populated regions. This could be incorporated in the system-level theory of change by expanding the current description of economic participation to include support to both marginalised groups and areas.

Finally, a number of assumptions were identified that are key to the achievement of this category-level theory of change. These include:

- A conducive, certain and cohesive policy environment
- An efficient administration
- Political stability
- The relative competitiveness of the package of incentives available in South Africa, compared to other countries
- Labour market stability
- Sustained and long-term economic growth in South Africa
- The availability and sustainability of energy supply

Figure 10: Theory of Change: Capital Incentives



### 7.3 New and small business incentives

The current inventory of incentives does not specifically differentiate between investment in capital for existing and large businesses, and investment support for small or new businesses. This is largely because most capital incentives are available to both large and small businesses. However, given the strong focus on SMME development in South Africa, the inventory may need to be revised to account for those incentives that are exclusively available to SMMEs. Moreover, few incentives target the establishment of new businesses, partly because most incentives require a minimum set of compliance documentation, which would only be available to existing enterprises.

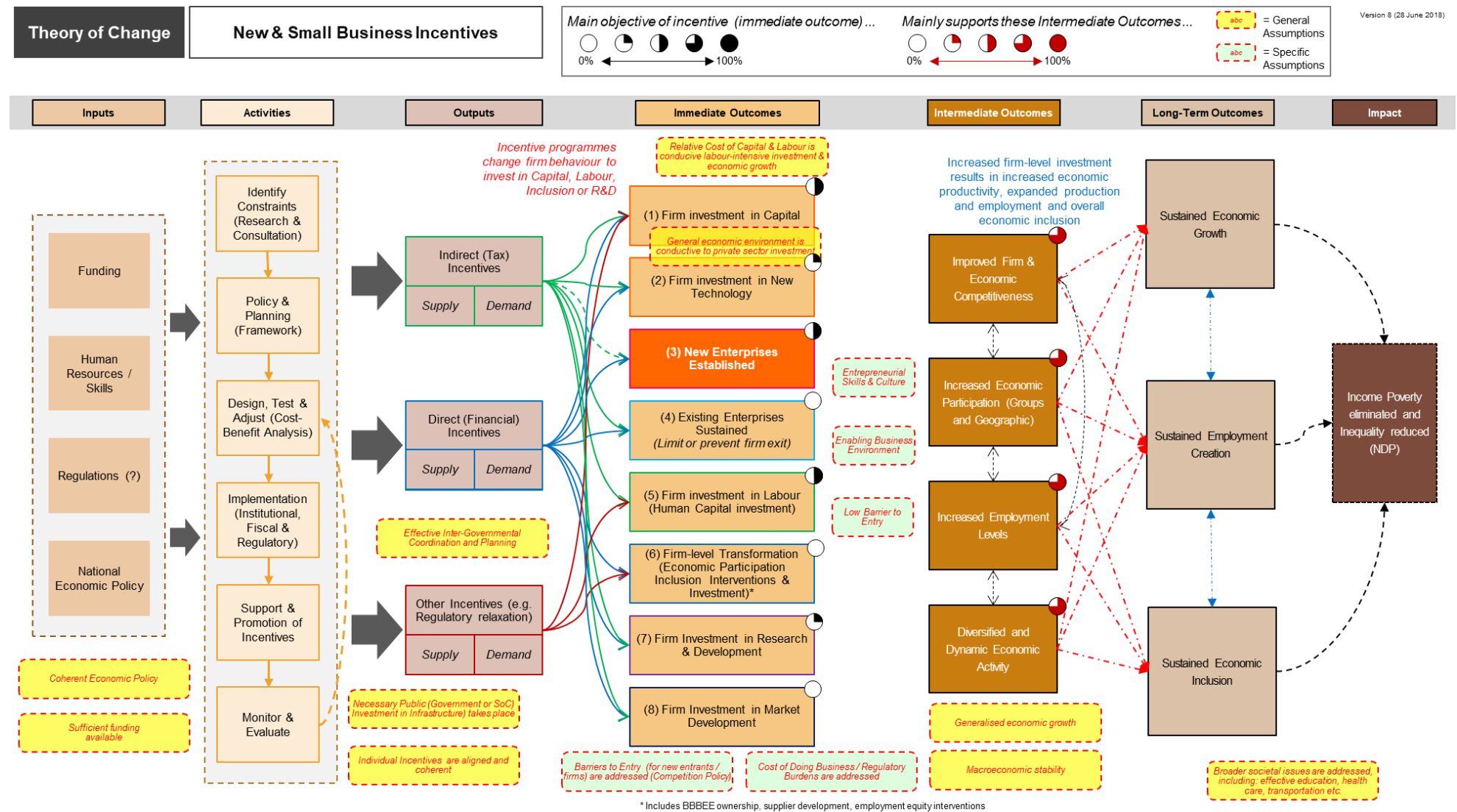
The primary objectives of the incentives considered in this category are to raise investment in capital or employment by existing small businesses, and to thereby contribute towards their growth and long-term sustainability. In addition, and to a lesser extent, these incentives also contribute towards the establishment of new businesses, or investment in research and development, largely through incubation type programmes. There is also a recent but relative narrow focus on firm-level transformation, with some incentives providing better or exclusive preferences to black-owned businesses. Incentives in this category were not deemed to contribute towards market development or business rescue (enterprises sustained).

The importance of early stage ideation and incubation was highlighted during the discussion. This may not point to a gap in the existing theory of change, as long as the research and development outcome is broadly defined to include the full R&D value-chain. Moreover, it shows the important link between research and development activities, and the establishment of new businesses, in the system-level theory of change. Likewise, at the intermediate level, the definition of improved firm and economic productivity, should possibly be expanded to include competitiveness.

The following assumptions were identified as especially relevant for this category of incentives:

- The existence of entrepreneurial skills and culture
- An enabling business environment
- Low barriers to entry throughout the economy
- A long-term perspective in the design of incentive programmes

Figure 11: Theory of Change: Small Business Incentives





## 7.4 Research & development incentives

Incentives within this category comprise two sub-categories – incentives that are purely (almost 100%) focused on the promotion of R&D – for instance the R&D tax incentive; and other incentives that may have a broader set of objectives including R&D. This second sub-category often includes R&D as part of a package that aims to encourage firm investment in capital / technology as well as the development of new markets and the establishment of new firms.

R&D incentives are acknowledged as important given the country's overall objective to become a knowledge economy and increase national expenditure on R&D to 1.5% of GDP.

The primary logic of these incentives is to encourage firms to increase the amount of investment in research and development. However, a critical assumption noted is that the impact of such incentives on firm and economic productivity etc. is indirect. Specifically, it is noted that increased R&D in itself is not sufficient. Instead what is required is the translation of R&D into new products, new services and new firms. This requires an effective innovation system to be in place and supported by the necessary institutions such venture capital, incubators.

While the main outcome supported by successful R&D is improved firm and economic productivity (the economic argument underpinning this being that R&D drives total factor productivity), R&D through innovation can also contribute towards another outcome – “Diversified and Dynamic Economic Activity”. As such R&D incentives become important for the development of new industries and new sources of economic growth.

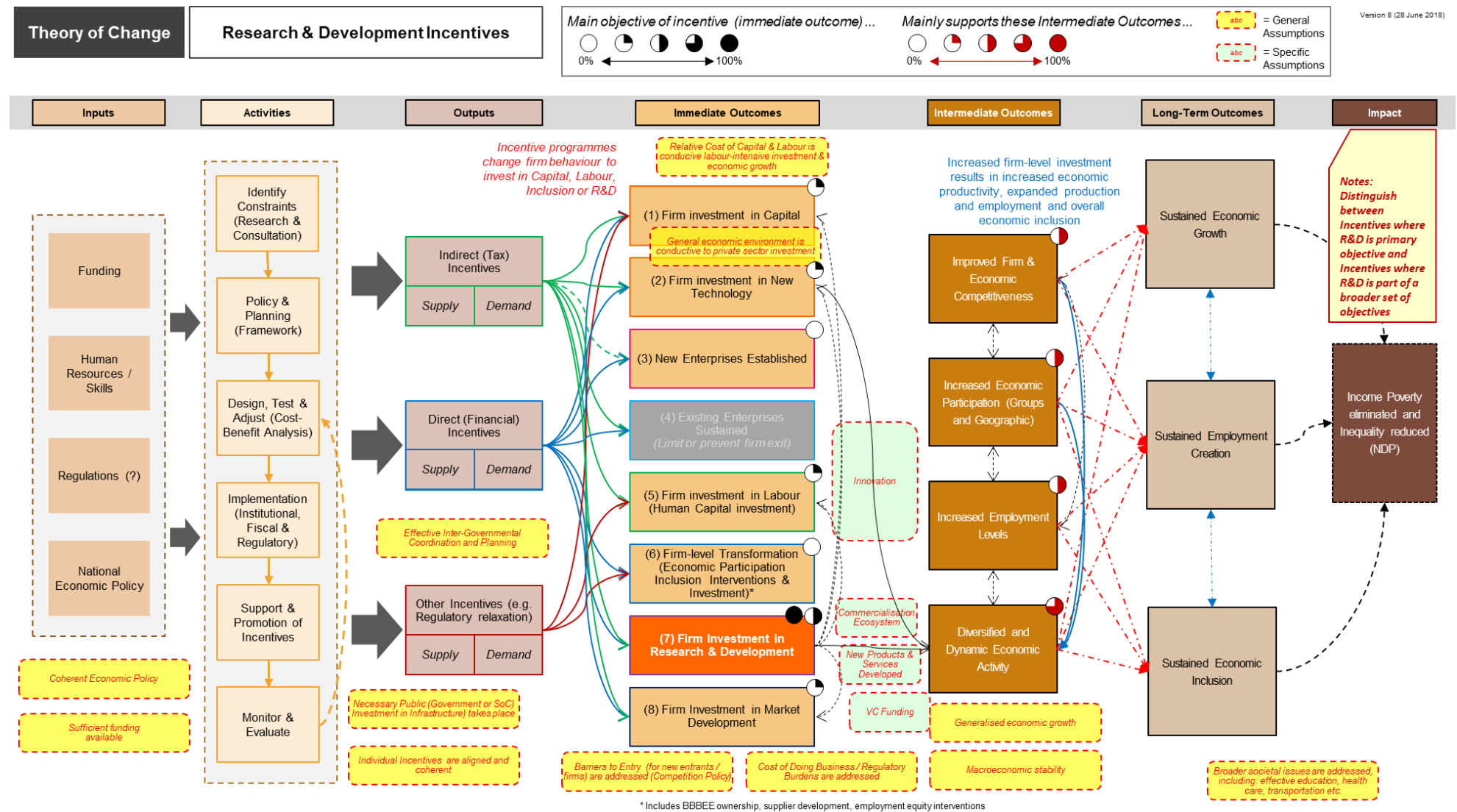
An overarching concern with these incentives is that often R&D leads mainly to increased investment in technology and capital (take for example ICT). This may have short-run negative effects on employment.

Equally important is that if the regulatory regime is inadequate, the benefits of R&D may not accrue locally as firms export such technology. Another risk is that such incentives – if not well calibrated – encourage primarily the importation of technology.

The following assumptions were identified as especially relevant for this category of incentives:

- An effective innovation system
- An effective commercialisation system that can translate knowledge outputs into products and services
- An effective funding system, especially venture capital
- Appropriate and effective property rights policy and legislation
- Economic infrastructure (for instance broadband)
- The existence of knowledge gaps

Figure 12: Theory of Change: Research &amp; Development Incentives



## 7.5 Export and marketing incentives

Export and marketing incentives are primarily aimed at encouraging firms to enter new international markets (geographic expansion) or become new exporters of goods and services. Particularly in manufacturing, export-led growth is often seen as an important contributor to sustained economic growth.

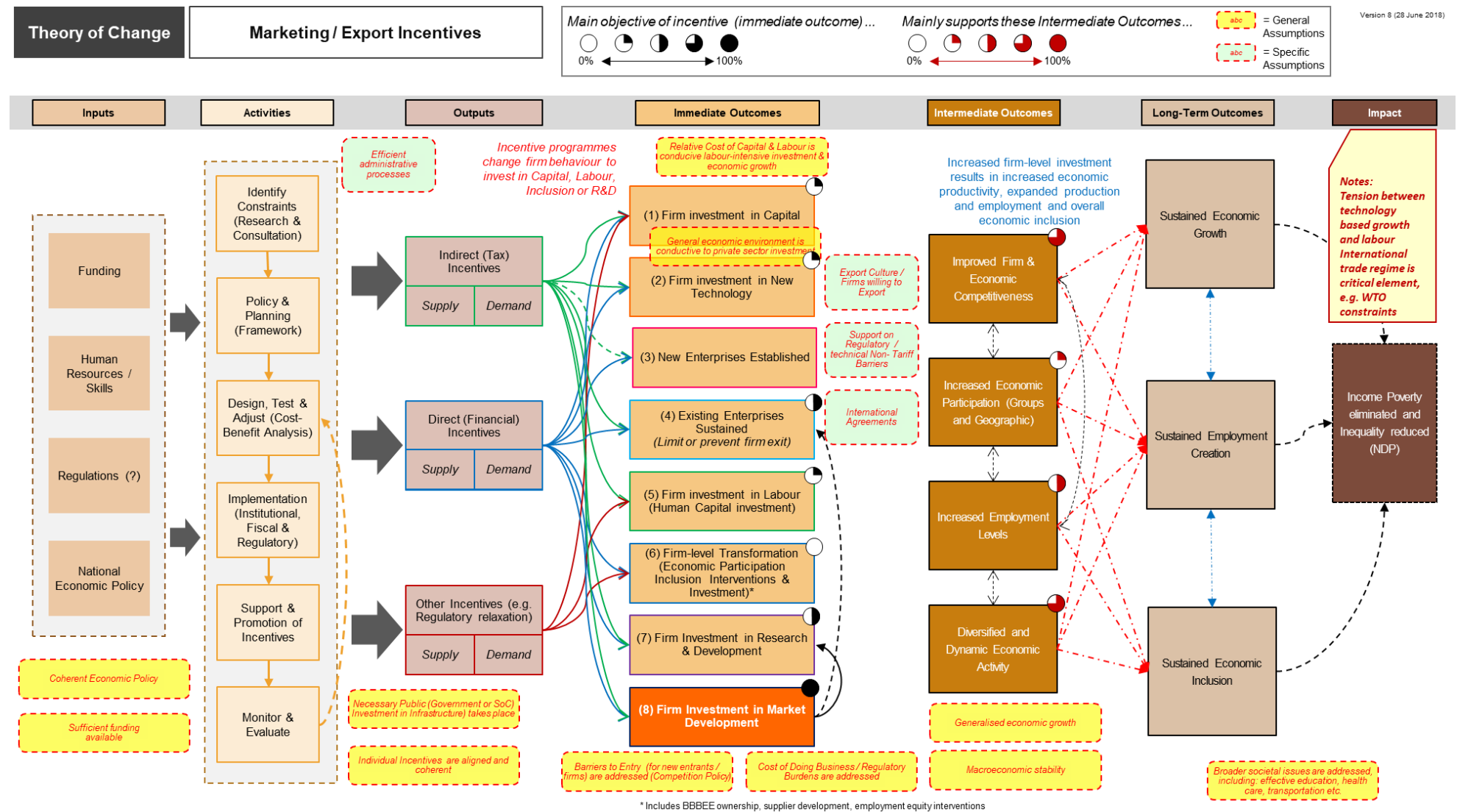
These incentives generally tend to be highly focused (i.e. 80% -100%) at supporting firms' investment in developing new or export markets. Importantly, however, these incentives may be considered a stimulus to other changes in firm level behaviour; for example, they are often coupled with R&D, which may be required to enhance the competitiveness of goods and services. If effective this investment by the firm, supported by incentives, should result in increased demand for products and services. This should then stimulate increased investment in capital or technology as well as labour. However, it is noted that in some instances capital and technology or labour investment is required upfront to establish productive capacity or specialised capabilities in order to compete in a new market or to export.

Again, it was noted that these incentives on their own are insufficient to drive the outcomes. Of particular concern are the variety of international agreements and regulatory barriers (tariff and non-tariff) that inhibit exports (for example WTO rules etc.). Consequently, the effectiveness of these incentives is highly reliant on the broader regulatory context as well as the provision of significant support to overcome non-tariff barriers. Equally, firms who wish to export or enter new markets often require very significant technical support as well as investment in broader economic infrastructure in order to meet quality, technical and other conditions (for instance phytosanitary or cold-chain requirements).

The following assumptions were identified as especially relevant for this category of incentives:

- An exporting culture and general willingness of firms to export (it is noted that often this willingness is cyclical, i.e. linked to domestic economic conditions)
- Support institutions in respect of regulatory and non-tariff barriers
- Technical support to export
- Appropriate international agreements
- Economic infrastructure to facilitate the export process (e.g. low-cost broadband, rail and road infrastructure etc.)

Figure 13: Theory of Change: Export &amp; Marketing Incentives



## 7.6 Employment incentives

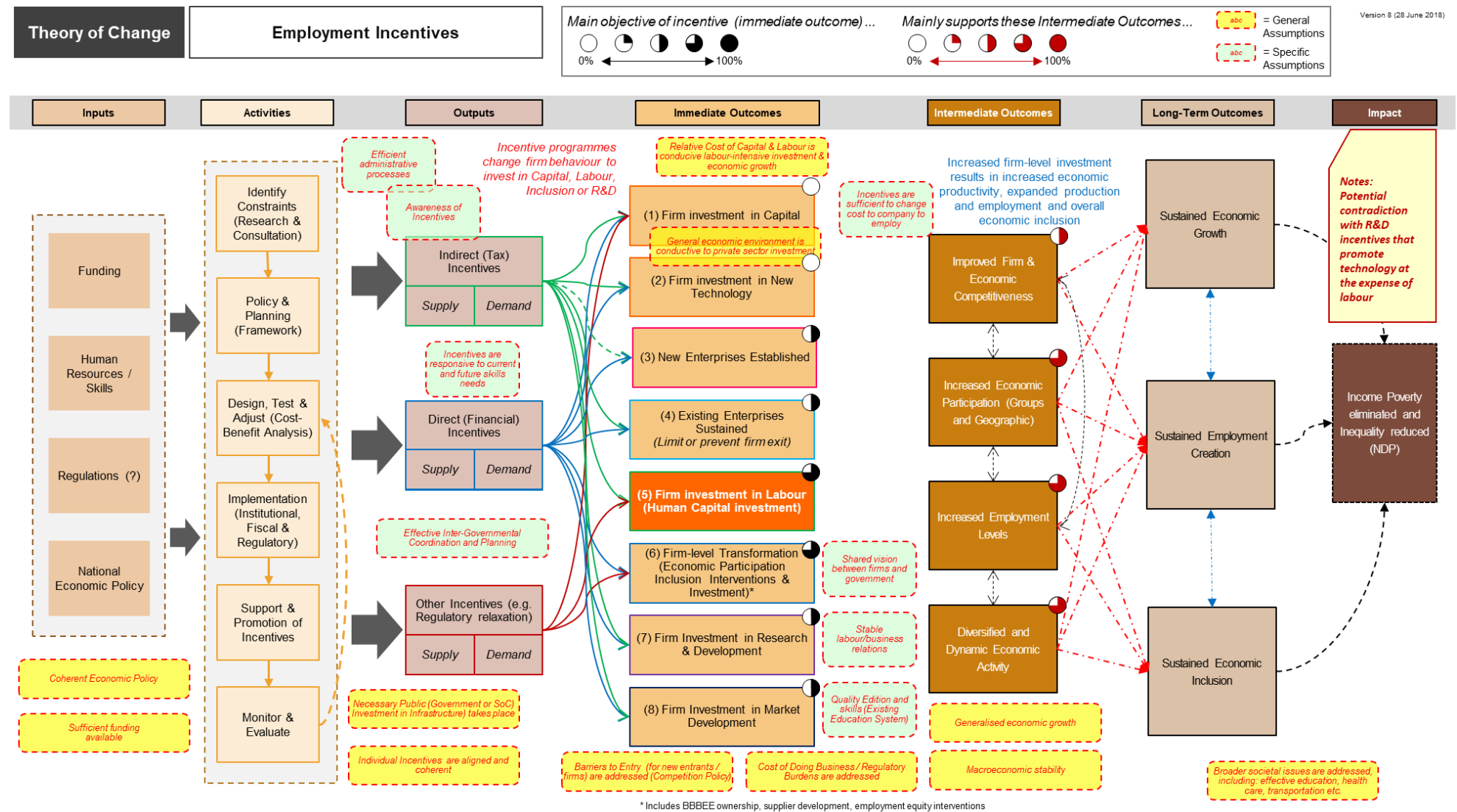
While the inventory includes mainly employment incentives that focus on improving the quality of the workforce through skills development (for instance SETAs), there are a number of incentives that target the quantity of employment directly (like the Employment Tax Incentive (ETI)). While both types of employment incentives can be complementary, they could also be contradictory, especially when firms are incentivized to upgrade the skills of their existing workforce in order to prepare their workers for new capital and technology at the cost of any additional employment. The system level ToC should take cognizance of this possible contradiction.

The combined effect of the quality and quantity targeted employment incentives on the immediate outcome can be seen in two ways: either sequentially, with second round effects on firm decisions, or simultaneously. Thus, in terms of the timing and importance of the employment incentives to affect immediate outcomes, they are likely to change predominantly firm investment in labour and firm level transformation, followed by establishing new businesses, sustaining existing businesses, investing in R&D, and investing in market development, and to a lesser extent firm investment in capital. All of these are seen to affect structural transformation with respect to the economic structure and social composition of the workforce.

The following assumptions were identified as necessary conditions for this category of incentives to be effective:

- Design and targeting of incentives:
  - Incentives must be able to respond timeously to current and future skills needs
  - Simple in design in order to adapt to changes in demand for skills
  - Sufficiently effective to change cost of production
- Overall environment:
  - Quality of education and skills provided by the existing education system
  - Stable economic conditions
  - Shared vision between firms and government to grow employment numbers
  - Stable labour/business relations

Figure 14: Theory of Change: Employment Incentives



## 7.7 Transformation incentives

Because most other incentives categories already attempt to affect economic transformation, the following category ToC for transformation incentives was developed for incentives that target social transformation. However, it needs to be kept in mind that the majority of incentives discussed in the other category ToCs include a social transformation clause that links access to incentive programmes with social transformation objectives. Thus, the following category ToC should be seen in combination with any of the other category ToCs.

Considering that the inventory of incentives looks at incentives that are targeted to affect firm decisions, transformation incentives will affect firm level transformation in the broader sense. As such, firm-level transformation should be seen as an overarching theme in this ToC rather than a separate immediate outcome per se. In this sense, firm level transformation would present itself in the form of increased investment in capital and labour as well as the establishment of new businesses. To a lesser extent, transformation incentives would change firms' decisions to invest in market development, sustain existing enterprises or invest in R&D.

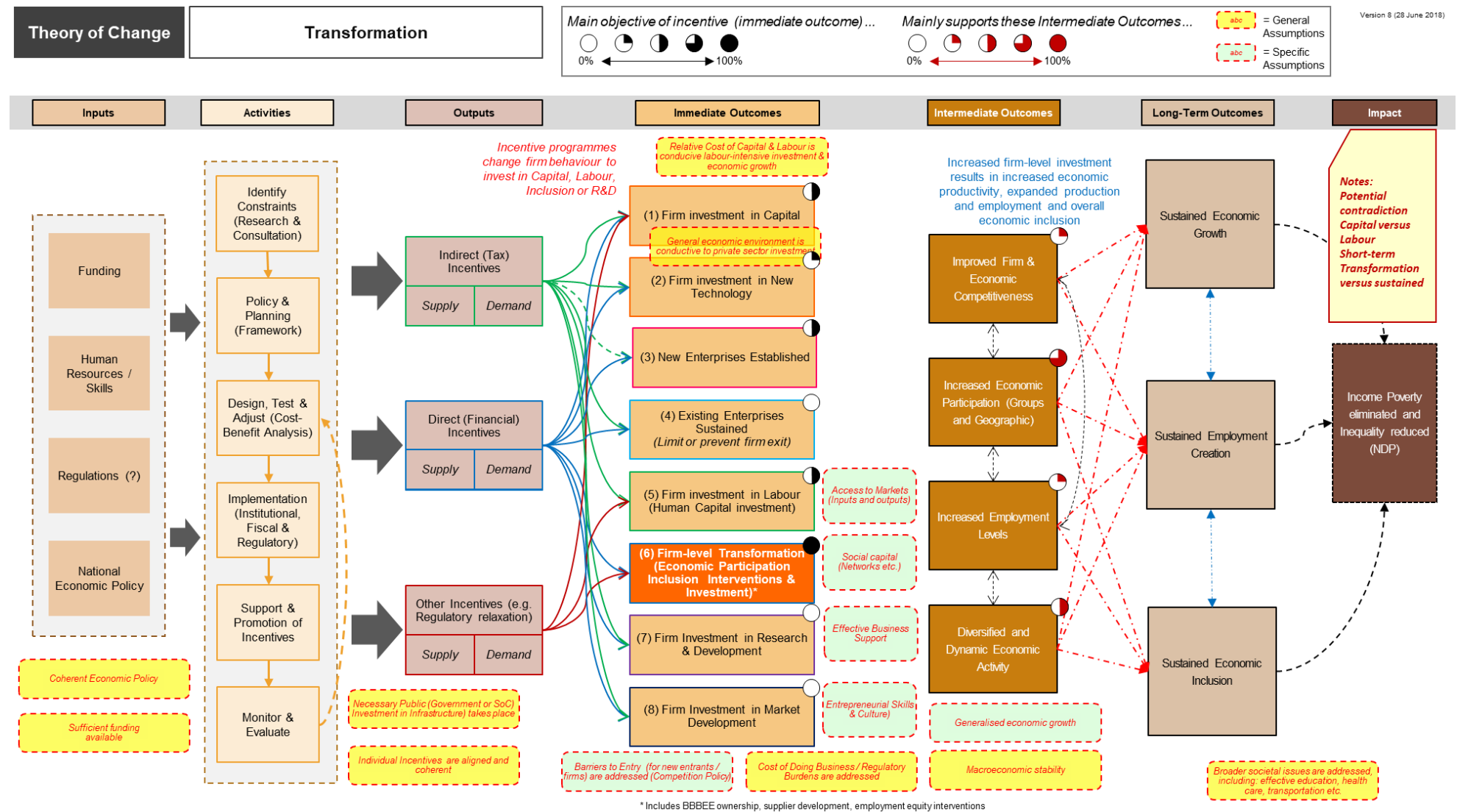
As a possible contradiction at the immediate outcome level, social transformation incentives are likely to create a trade-off between the establishment of new businesses and sustaining existing businesses, especially in the case where existing businesses do not meet transformation targets. This trade-off could lead to a net loss of employment and economic activity in the short-run in order to facilitate increased inclusive employment and economic growth in the long-run.

Irrespective of the trade-off in the short run at the immediate outcome level, transformation incentives are expected to increase economic participation and inclusive growth. If transformation is genuinely broad-based, this should also lead to increased employment levels. Assuming that access to market opportunities to a larger proportion of the South African population also increases the number of companies, one could expect this to contribute to an increase in economic activity and to positively affect firm and economic competitiveness.

A number of assumptions determine the effectiveness of transformation incentives. These can broadly be summarized as factors that prevent companies of designated groups from penetrating the domestic and international market. In particular, these barriers would include:

- Access to a sufficiently skilled workforce
- Market concentration and anti-competitive behaviour by incumbents
- Sufficient business support for newly established companies
- Social capital and entrepreneurial culture among the designated groups

Figure 15: Theory of Change: Transformation Incentives





## 8 Case Studies

### 8.1 Case study selection

The inventory developed as part of this study served to identify 107 different business incentives across 6 broad categories; and then more than 120 incentive-type programmes implemented by the Sector Education and Training Authorities (SETAs). In order to identify 20 of these incentives for case study analysis, the following criteria were considered:

- The category of the incentive (**primary criteria**)
- The importance (size) of the incentive (**secondary criteria**)
- The implementing agency
- The type of incentive
- The relative performance of the incentive (Steering Committee)
- Whether the incentive has been previously evaluated
- Whether the incentive is still operational.

Based on these guiding criteria, the following 20 incentives were selected:

**Table 12: Case study selection**

Incentive	Agency	Category	Type
The Manufacturing Competitiveness Enhancement Programme (MCEP)	DTI	Capital	Direct
The Automotive Production and Development Programme (AIS)	DTI	Capital	Direct
The Tourism Incentive Programme (TIP)	Department of Tourism	Marketing	Direct
The Black Business Supplier Development Programme (BBDP)	DSBD	Transformation	Direct
The NYDA Grant Programme ( <i>replaced with DSBD Cooperative Incentive Scheme</i> )	NYDA	New and small business	Direct
The SEDA Technology Transfer Fund	SEDA	New and small business	Direct
The TIA Seed Fund	TIA	R&D	Direct
The Animal and Veld Management Programme (AVMP)	DRDLR	Transformation	Direct
The Agri-Parks Programme	DRDLR	Marketing	Direct
The Green Fund	DBSA	R&D	Direct
The Jobs Fund	NT	Skills and employment	Direct
The Gro-E Youth Scheme	IDC	Transformation	Direct
The MERSETA Apprenticeship Programme	MERSETA	Skills and employment	Direct
Services SETA Programme ( <i>replaced with the CHIETA Work Integrated Learning Grants</i> )	Services SETA	Skills and employment	Direct
The Local Content Designation – Rail Rolling Stock	DTI	Marketing	Indirect
The Employment Tax Incentive (ETI)	SARS/DoL	Skills and employment	Indirect
The Research and Development Tax Incentive (11D of the Income Tax Act)	DST/SARS	R&D	Indirect
The Industrial Policy Projects Incentive (12I of the Income Tax Act)	DTI/SARS	Capital	Indirect
The Manufacturing Incentive (12C of the Income Tax Act)	SARS	Capital	Indirect
The Small Business Incentive (12E of the Income Tax Act) and graduated tax rate structure	SARS	New and small business	Indirect

Appendix 4 provides a summary of the objectives, instruments and criteria of the 20 case study incentives.

## 8.2 Approach

The case studies are based on a combination of desk-top background research, the collection of documents, and in-depth interviews with key respondents. For each case study, respondents were selected purposively according to their ability to provide information relevant to the research questions, and most cases included:

1. Those responsible for the design, management and administration of the incentive.
2. A limited number of applicants (beneficiaries, and where possible, non-beneficiaries).
3. Relevant industry bodies or chambers.

The total number of officials, company representatives and other individuals interviewed is summarised in the table below.

**Table 13: Number of interviews**

	Officials	Applicants	Other
<b>Total number of interviews</b>	74	50	29

Three different interview templates were developed: one for government officials, one for beneficiaries (including industry associations), and one for applicants that did not receive the incentive. These are included in Appendix 1. The templates were piloted during the first case study – MCEP – and then revised for the purpose of the remaining studies.

## 8.3 General findings from the case studies

The case studies cover multiple programmes, entities and types of incentives and beneficiaries. Some of the observations emerging from these studies are therefore context, company or agency specific. However, there are many findings that cut across multiple case studies, which serve to highlight patterns and trends in the design, implementation and review of business incentives in South Africa.

For each of the main stages in the incentive cycle, all incentives have been assessed against three generic criteria, and a number of specific performance standards. These criteria link to the activity level of the system theory of change. The results of these assessments have been tabulated across the twenty case studies. The results have also been disaggregated, by category of incentive.

### 8.3.1 The design of incentives

The majority of the incentives reviewed were not constructed on the back of substantial evidence or research. In no cases was there confirmation of economic cost benefit or options analysis, or the use of regulatory or socio-economic impact assessment (RIA or SEIA) techniques. On the other hand, as illustrated in Table 14, most incentives were informed by some research activity, and for three of the incentives reviewed this research was deemed to be substantive (this includes two pilot studies). It is notable that for two of the three transformation-focused incentives, no research was evident, possibly highlighting the need for further investigation in this area.

Just three programmes could provide or articulate a theory of change or results chain; and all of these examples were in the skills and employment category. This probably reflects the complexity of the unemployment challenge in South Africa, and the considerable thought that has been expended by Government in trying to address labour market issues. Where the need for an incentive is well-defined, and the nature of the economic problem or market failure is understood and specified, the resulting incentives tend to be more effective (or at the very

least, the agency is able to report more fully on whether the incentive is contributing towards stated outcomes).

It would appear that in many cases, incentives have been implemented to meet pressing political or policy concerns, which apply to a specific sector or group of beneficiaries. This is reflected in the high degree of alignment between the twenty incentives reviewed, and government's national policy objectives. However, in doing so, it would seem that insufficient attention is given to the design of specific programmes, and specifically, whether and how an incentive is the best mechanism to address the stated policy problem.

Finally, there appears to be little coordination and learning in government, around the design of incentive programmes. Despite the existence of significant expertise in some units, there are weak mechanisms for sharing lessons and information within departments and across government, and in most instances, officials do not look beyond sector or line department interests. As a result, new incentives do not capitalise on the experience of previous initiatives, and administrative guidelines and systems are usually constructed afresh. There are also differences in definitions and methodologies used by different entities in government (e.g. those that apply to SMMEs or value-added); and differences in the costing, monitoring and evaluation of incentive programmes.

Table 14: The design of incentives

Case study	Specific problem / constraints clearly identified			Aligned with national policy framework			Backed by substantive research		
	Theory of change (or equivalent) clearly articulated	Specific market, institutional or policy failure clearly articulated	Incentive targeted at beneficiary group, not at a specific problem	Target group and specified change reflected in national policy frameworks	Target group reflected in national policy frameworks	No mention of target group in national policy frameworks	Evidence of substantive research (pilot, CBA, SEIA etc.)	Evidence of some research to inform incentive design	No evidence of prior research to inform incentive design
<b>Capital incentives</b>									
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2									
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<b>New and small business</b>									
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<b>Transformation</b>									
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<b>Research and development</b>									
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<b>Marketing</b>									
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<b>Skills and employment</b>									
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### 8.3.2 The implementation of incentives

The Government manages incentives in the same way that it manages budget programmes i.e. in most cases incentives are treated as transfers to public or private enterprises, but in a few cases may be treated as goods and services. This approach is influenced by the Auditor General and the National Treasury, and there is consequently a very strong focus on compliance. While this is important to prevent wastage and abuse, it determines how incentives are administered and reported. This approach is problematic in respect of incentives that require multi-year funding commitments. Technically, roll-over requests are possible, but these are not always granted. While this is perfectly understandable in respect of other (non-incentive) grant programmes it is a significant risk in the case of incentives where third parties make very large and significant investments (often with a matched funding component) based on the anticipation of public money.

In most cases, applicants are screened through the application of technical and administrative criteria, with the final adjudication panel playing a largely fiduciary role. Some programmes place greater emphasis on this screening process – and in doing so, they are able to identify more deserving beneficiaries. This requires stronger technical capacity at the front-end of the incentive application process. Other departments treat this as an administrative process, and applicants are effectively processed on a first-in, first out basis.

In general, the guidelines for specific incentives in South Africa are clear and in almost all cases, publicly available. This points to a high degree of transparency across the system. In some cases these guidelines include turnaround times for the completion of certain processes, but in most instances, it would seem that departments are unable to keep to these timeframes (and often by a large variance). There are also instances where the application of specific guidelines is unclear, or where interpretations and processes shift (sometimes becoming tighter and sometimes looser) in response to changing political or economic demands, or financial constraints. Whereas it is important for policies to adjust to changing circumstances, this may reduce the certainty and value attached to some incentives. Appeals and enforcement processes are generally weak or missing.

There is sometimes a mismatch between the size of the incentive, and the compliance requirements and resources that are in place. Specifically, some small grant systems appear to impose very onerous requirements on prospective beneficiaries, whereas some large programmes come with much more flexible and open criteria. Likewise, the degree of risk-sharing differs markedly by incentive. In general, it is not clear how some criteria and thresholds are set, and the implications of these different requirements are not always understood. There are also instances where criteria are imposed, during programme implementation, to achieve multiple and additional policy objectives as they emerge; and cases where unwritten selection criteria are introduced to direct the incentive at specific target groups (such as specific provinces).

Most departments report a lack of human resources to effectively manage and monitor incentives, and in three cases, these constraints are deemed to be severe. Application and approval systems are mostly incomplete or manual, and this greatly increases the administrative burden for both government and beneficiaries, undermines data collection efforts/data integrity, and hinders the monitoring and evaluation of incentives. Where fully automated systems are in place, they appear to work well. More importantly, in some departments, there is insufficient capacity to undertake site visits, address complaints and verify outcomes. Generally, there is an underestimation of the programme management resources (people, systems and operating budgets) required to properly administer incentive systems. Again, this reinforces the focus on administrative compliance that largely takes place during the application phase. The capital-focused incentives, which are typically much larger in value, appear to be better-resourced than all other categories.

Finally, there is disagreement as to the use and usefulness of consultants (and other intermediaries). A few programmes recognise the need for specialist consultants to market and distribute incentives more widely or prefer to work through wholesale organisations and have formally incorporated these mechanisms into the design of the incentive. But most departments see consultants as an unnecessary cost to the beneficiary; and there is evidence that consultants push through volumes of soft applicants, thereby distorting the performance of some programmes. Industry respondents argue that consultants help them to navigate South Africa's complex system of incentives, and to obtain access to government officials.

Table 15: The implementation of incentives

Case study	Transparent guidelines and well-articulated criteria			Efficient systems and processes			Sufficient support, promotion and enforcement capacity		
	Guidelines are publicly available, and all criteria are well-defined and understood	Guidelines are publicly available; some uncertainty around specific criteria	Lack of information on programme guidelines and criteria	Application, approval and payment systems work well and on time	Systems are generally effective; but evidence of blockages and delays	Systems are immature, and processes seriously delayed	The programme is well-resourced by appropriate personnel	There is evidence of capacity constraints in some areas	Programme suffers from serious capacity constraints in critical areas
<b>Capital incentives</b>									
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<b>New and small business</b>									
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<b>Transformation</b>									
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<b>Research and development</b>									
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<b>Marketing</b>									
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<b>Skills and employment</b>									
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### 8.3.3 The review of incentives

With few exceptions, monitoring and evaluation is not fully incorporated in the design of new incentives. Just four of the twenty incentives had a comprehensive M&E framework in place, and in half of the cases, there was no indication that M&E processes and indicators had been considered up-front. Unsurprisingly, where a theory of change was developed (i.e. for most of the skills and employment incentives), so too was an M&E framework. It follows that appropriate monitoring indicators are seldom defined.

Whereas most incentives report on outputs (i.e. the number and value of grants disbursed to beneficiaries), there is little information on programme outcomes (i.e. such as the resulting increase in employment, revenue or R&D over time). Moreover, where outcome data is reported, it is often collected at the application stage, and not tracked or verified going forward. For four of the incentives reviewed (of which three are indirect incentives), there was insufficient data available to assess performance. It is notable and commendable that the DTI reports on all incentive outputs to Parliament on an annual basis.

Finally, reviews and evaluations are conducted for most incentives, but in many cases these reviews are not sufficiently substantive, or are done internally. There is also a strong focus on project outputs and compliance, rather than on beneficiary and economic outcomes. Moreover, for five of the case studies, there was no evidence that a meaningful evaluation has taken place (or is planned). It is therefore difficult to measure outcomes and value for money across the system as a whole, and to know whether specific incentives are working or not.



Table 16: The review of incentives

Case study	Comprehensive M&E framework			Detailed performance information			Rigorous evaluation process		
	M&E framework developed & costed during design; outcome indicators clearly defined	Some M&E processes in place prior to implementation; output indicators clearly defined	No indication that M&E processes and indicators defined up-front	Information on programme & beneficiary performance (outcomes) collected & reported annually	Information on programme performance (inputs and outputs) collected and reported annually	Insufficient data collected or reported to assess performance	Independent evaluation conducted, appropriate to programme size, and made public	Internal or 'inappropriate' evaluation conducted; or evaluation not made public	No evidence that a meaningful evaluation has been conducted
<b>Capital incentives</b>									
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<b>New and small business</b>									
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<b>Transformation</b>									
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<b>Research and development</b>									
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<b>Marketing</b>									
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<b>Skills and employment</b>									
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## 9 Key Evaluation Findings

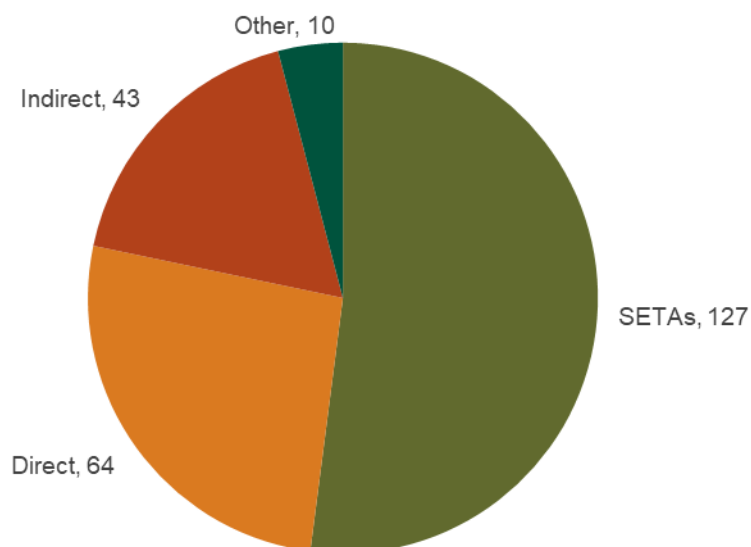
The terms of reference set out 7 key evaluation questions to be addressed through this evaluation. Information and data was collected from the literature and document review; consultations with government, business and other industry stakeholders; the inventory of business incentives that was developed as part of this evaluation; and the 20 case studies. The main findings from these different components are set out against these 7 questions below.

### 9.1 What are the business incentives that are currently offered by the South African Government?

In total, 244 business incentives were identified and captured in the inventory database. This includes 64 direct incentives; 43 indirect (tax) incentives; 10 other incentives (mostly information services) and 127 different SETA grant programmes. Most (56% in number, not value) of the direct incentives are offered in the form of subsidies or grants. Accelerated depreciation provisions account for the largest number of indirect incentives, though there are also numerous allowances for reduced tax rates and tax exemptions. Only three demand-side incentives were found, two of which are implemented through the government procurement system – and a third which seeks to shift consumer demand in the motor industry.

A core task of this project was to compile a usable inventory of all business incentive programmes available at the national level, including all grants and tax and financial concessions. In doing so, a generally inclusive definition of business incentives was used, and the database includes all programmes or benefits provided by national government and its agencies, that are specifically intended to contribute to the creation of new businesses or change the behaviour of existing businesses. In total, 244 business incentives were identified.

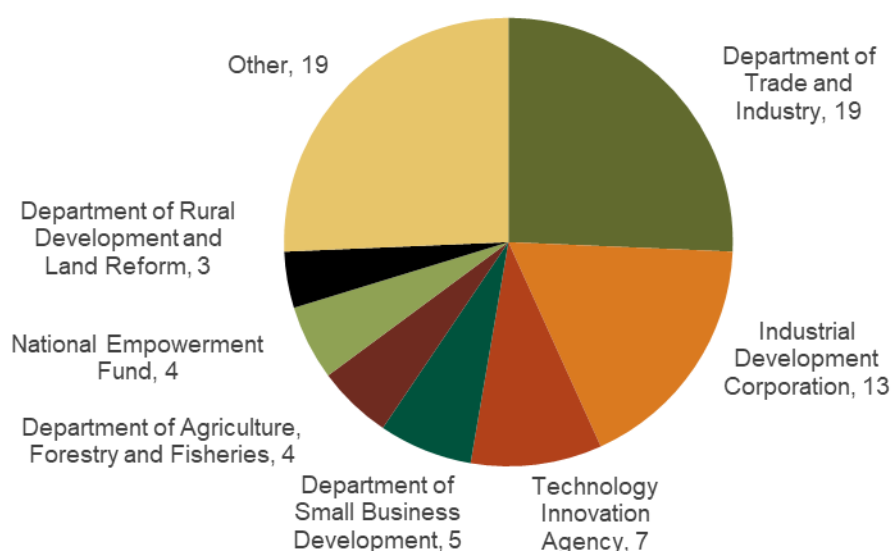
Figure 16 provides a high-level breakdown of the different incentives incorporated in the database. The greatest number of programmes are spread across the 21 SETAs. Whereas each SETA receives substantial funding from the Skills Development Levy to support skills development and training activities in the relevant sector, a large proportion of this funding is returned to firms in the form of mandatory grants, as long as they comply with certain prescribed procedures. These grants are not included in the database. Rather, the focus is only on the discretionary grants (and associated programmes) implemented by SETAs that specifically look to encourage member firms to undertake additional training or skills development activities, or which support firm creation or employment creation in the sector more broadly.

**Figure 16: General classification of business incentives (Number of incentives in the system)**

Source: *Inventory of business incentives*

The next largest category of incentives are the direct programmes of national departments and their agencies. This includes a diverse collection of grant, lending and infrastructure development initiatives. As shown in Figure 17, the Department of Trade and Industry manages more than a quarter of these direct incentives, followed by the IDC. In total, 23 different national entities are involved in the implementation of direct incentives in South Africa.

The 43 indirect incentives are implemented by the South African Revenue Services, though in most cases, the development and marketing of these incentives is done in partnership with the relevant line Ministry or the National Treasury.

**Figure 17: Direct incentives by department and agency (Number of incentives in the system)**

Source: *Inventory of business incentives*

Whereas information on the location, purpose and type of incentive is generally available, some form of budget or expenditure information is available for around 60% of the (non-SETA and non-tax) incentives in the database, and there is little information available on the outputs

produced by most business incentives. For example, whereas around a third of the (non-SETA and non-tax) incentive programmes report on the number of firms supported, just one reports on the average size and BEE status of these firms, and several report on firm ownership.

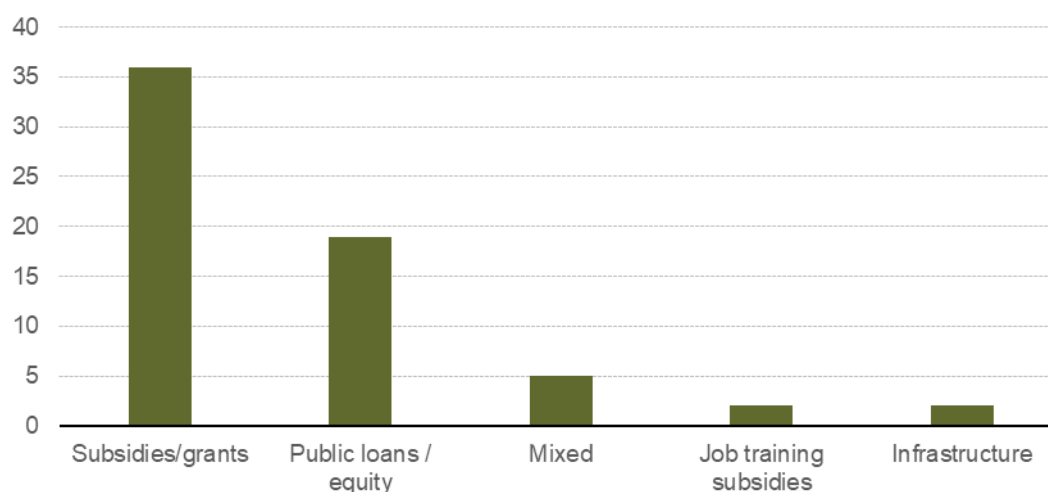
Likewise, data on incentive outcomes is scarce. Whereas 10 incentives reported on the net increase in employment in supported firms and 5 on the number of jobs sustained, just 4 reported on the net increase in total fixed investment, 2 on the number of new firms created, and just 1 on the net increase in firm revenue. Moreover, in most instances, this information is self-reported by firms and cannot be verified. Almost no disaggregated outcome data was found.

Reporting on performance, by SETA's was more complete, though it was noticeable that the SETAs do not report financial or performance information in a consistent way. Programme (incentive) level expenditure data was only available for around a third of all interventions. On the other hand, with just one exception, all SETA programmes report on the total number of beneficiaries – though in some cases, they report on the number of firms, and in other cases, the number of individuals that benefited from training or skills development activities. Once again, this data is not disaggregated in any way to show different groups of beneficiaries.

### 9.1.1 Type of incentives (non-SETA)

The largest number of direct incentives are in the form of grants or subsidies. Almost half of these grants are managed by the Department of Trade and Industry, with the Department of Small Business Development and TIA also responsible for multiple grant programmes. Loans and equity arrangements account for the next largest number of direct incentives, with the IDC accounting for 10 of the 19 programmes. The IDC also provides 2 mixed facilities – which combine both loan and grant funding. The two infrastructure incentives involve the provision of technological or agriculture infrastructure for small businesses.

**Figure 18: Types of direct incentives (Number of incentives in the system)**

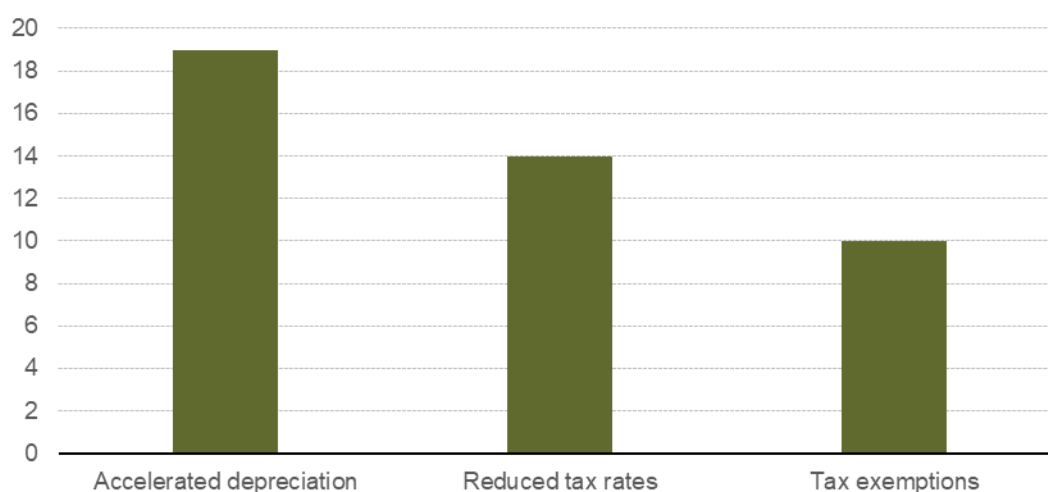


Source: Inventory of business incentives

Most of the indirect incentives available through SARS provide for the accelerated depreciation on specified assets (such as housing or dams) or expenditure (such as machinery or exploration). The Government also provides for reduced tax rates in certain circumstances, or for specific types of businesses or activities. Finally, in some the earnings of specific types

of businesses (such as shipping companies and sole proprietorships) or in certain sectors (the film, mining and oil and gas industries), are exempt from specific taxes or levies.

**Figure 19: Types of indirect incentives (Number of incentives in the system)**

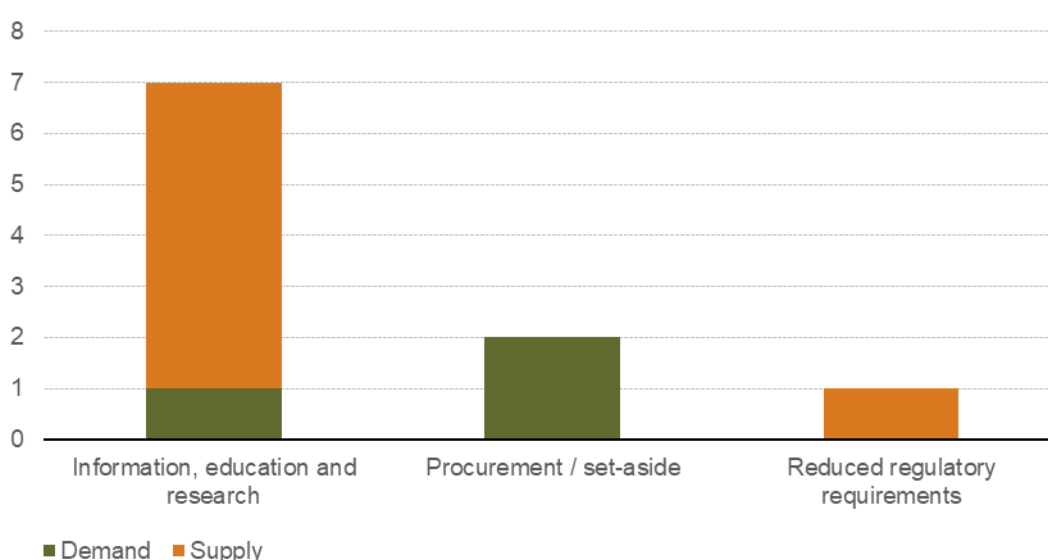


Source: Inventory of business incentives

Other incentives available from Government include information services, which generally involve the provision of market studies or technical advice to firms in specific sectors; government procurement to encourage the use of domestic content and technology transfers; and a concession on BEE regulations in the mining sector to promote beneficiation.

Only three demand side incentives were identified – two of which are implemented through the government procurement system – and a third which seeks to shift consumer demand in the motor industry through fuel efficiency labelling of vehicles and public information programmes.

**Figure 20: Types of other incentives (Number of incentives in the system)**



Source: Inventory of business incentives

## 9.2 Why are government business incentives important and how?

In general, incentives are used to assist firms to overcome specific market failures, or to encourage firms to undertake activities which generate wider spill-over benefits for the economy or society. In South Africa, there is a significant mismatch between the skills generated by the labour market and the needs of business – and many incentives are therefore designed to address the failures in this particular market. However, the greatest amount of funding goes to capital incentives, where market failures are not the primary focus. Rather, it would seem that investment incentives are used to mitigate against the cost or uncertainty of doing business in South Africa, and to raise or sustain production and employment, especially in priority sectors. In addition, the South African Government sees business incentives as an important mechanism to address historical inequalities and increase the participation of historically disadvantaged groups in the economy.

The literature and document review describes the main reasons for government intervention in general, and the use of business incentives in particular. The conventional economic rationale for government intervention is to address **market failure**. Specifically, there is a strong economic case for government regulation and or initiatives that contribute to wider economic benefits (externalities) – such as R&D and skills development; and interventions that assist business to overcome the information asymmetries that are always present in markets –including efforts to increase competition or knowledge sharing.

However, despite some ambiguity, the literature also highlights a few criteria that market failures must meet before government intervention can be justified. For example, Wright (2009) argues that a market failure is not a good enough excuse for intervention – rather, the failure must be “material” and “of significant magnitude.”<sup>112</sup> There must, furthermore, be suitable interventions available that are shown to be effective, will address the root cause of the market failure and which produce justifiable benefits that outweigh its costs.<sup>113</sup>

Despite the risk and existence of market failures, there are often cases in which markets do result in the efficient allocation of resources, yet there is no guarantee that these optimal economic outcomes are socially fair or desirable. There is thus a further role for government to intervene, in such circumstances, to ensure **social protection and distributive justice**. These cases can be generalised into three types of efficient but inequitable outcomes:<sup>114</sup>

- When market outcomes are not fairly distributed between the ‘haves’ and the ‘have-nots’
- When citizens are not all being treated equally, especially those situated in the same situations
- When the interests of future generations and the defenceless are not being protected

For example, South Africa’s apartheid history has given rise to a situation whereby the majority of the country’s citizens were formally excluded from economic participation. Some citizens received preferential treatment to education and employment whereas others were forcibly restricted. The market economy is clearly incapable of correcting for the prejudice and networks that are entrenched in South African society in general, and business in particular. As such, there is a clear need for Government intervention to create an environment in which socially fair and just outcomes can be achieved as quickly as possible and throughout the

<sup>112</sup> (Wright, 2009)

<sup>113</sup> (Wright, 2009); (Authority, 2006)

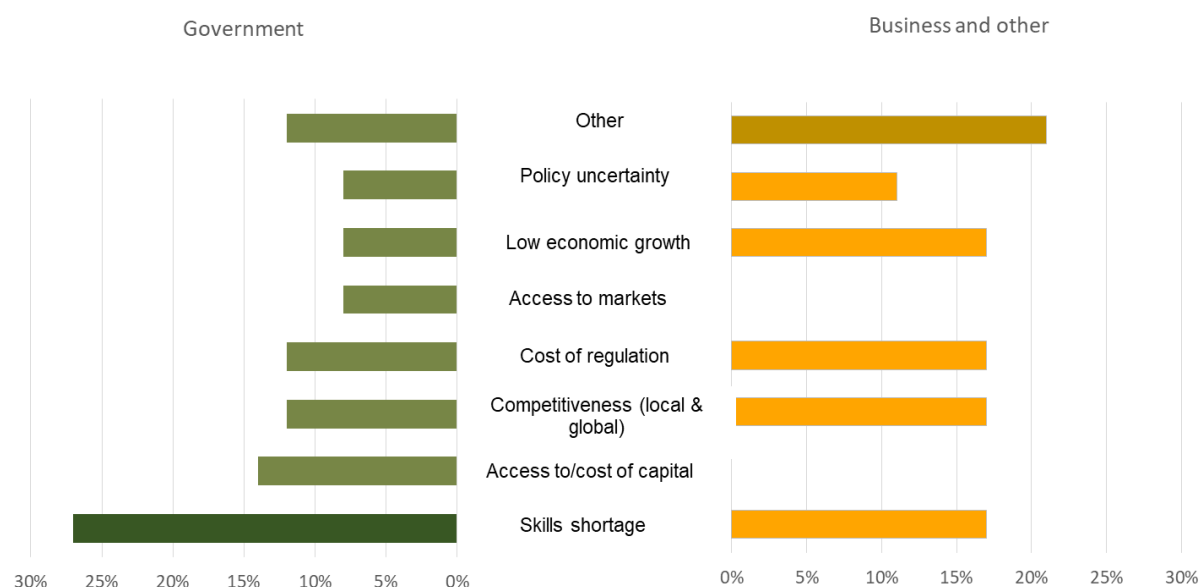
<sup>114</sup> (Authority, 2006)

South African economy. Similarly, Government has an important role to play in providing a minimum level of economic security or support to the large number of South Africans that remain excluded from the formal economy.

The third and final reason given for the use of government incentives, is to influence and promote ***economic and industrial development***. Whereas some industrial development incentives are functional – and serve to improve the overall economic environment in which firms operate – most are selective, and focus on industries that are deemed to be “strategic”. In many instances, governments negotiate specific deals for individual firms.<sup>115</sup> In such situations, business incentives can be viewed as government prerogatives directed to firms with the objective of inducing some specific type of economic activity that would otherwise have not occurred – or could have occurred but to a lesser degree – without the assistance. Furthermore, the incentive allows recipients to reduce administrative and other costs to investing or increasing its activities and is tied directly to the level of a desired (and clearly outlined) activity that the firm must undertake – such as creating jobs or facilitating increased research and development.<sup>116</sup>

In order to establish the relevance of the system of business incentives in South Africa, respondents were asked to identify the three main challenges and constraints that South African firms currently face. Table 17 reports the challenges ranked by frequency of being reported by government officials and non-government officials respectively.

**Table 17: Firm constraints and challenges in South Africa**



Source: Stakeholder interviews

As is shown in the table government officials involved in various incentive programmes predominantly consider access to the inputs of production (skills and capital) as the main challenge for firms operating in South Africa. This is followed by a generally unfavourable business environment with high regulatory costs, low economic growth and restricted access to markets. Together, these constraints are likely to affect the competitiveness of South African firms locally and globally and reduce market access. While business and other non-

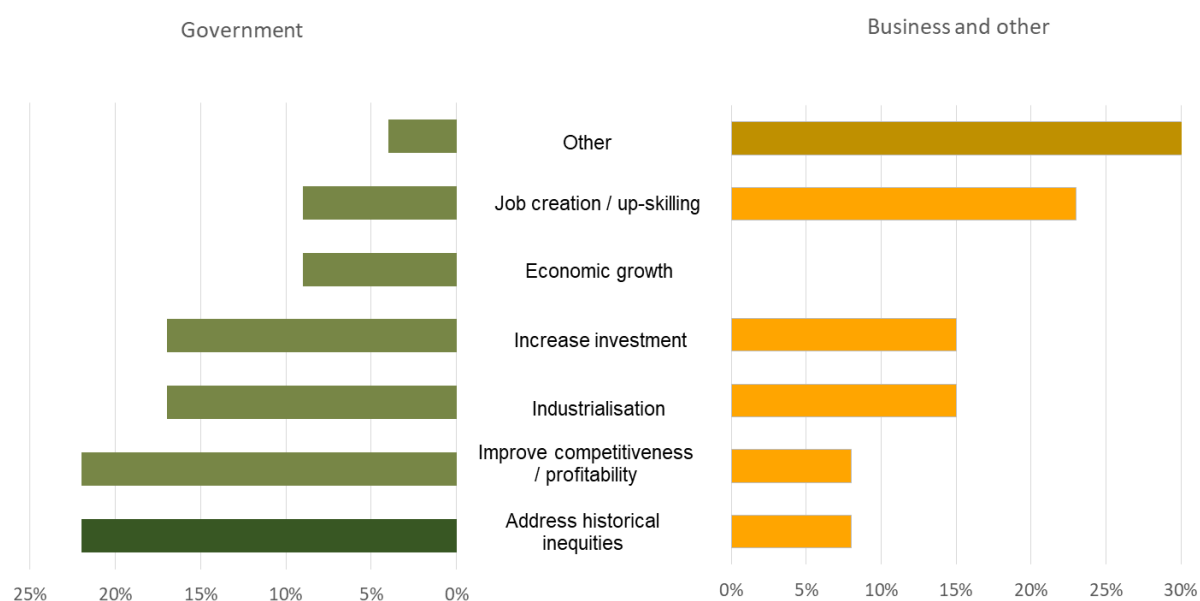
<sup>115</sup> (Altenburg, 2011) pg. 15

<sup>116</sup> (Bolnick, 2004)

government representatives are also concerned about access to skills, they perceive the general business environment as particularly problematic.

Given these challenges, respondents were asked to describe the three main objectives of the system of business incentives. As shown in Table 18, government officials consider that the main purpose of incentives is to address transformation, competitiveness and industrialisation. For representatives of business and other organizations, the system of business incentives is mainly directed at creating jobs, followed by industrialisation and investment.

**Table 18: Objectives of business incentives**



Source: Stakeholder interviews

Based on these responses, government incentives have a critical role to play in addressing inefficiencies in South Africa's labour market, and specifically, the ability of the education system to provide business (and the economy more broadly) with the skills needed to grow. For Government, incentives are also intended to play a social and distributive role, in supporting economic transformation and the participation of historically disadvantaged groups in the economy. The inventory of business incentives compiled as part of this study confirms that most incentive programmes target job creation, skills development and transformation.

However, it is notable that the majority of South Africa's incentives are directed at raising investment, or supporting specific sectors of the economy. This is acknowledged, as an objective of the system, by both government and business respondents; but it is not clear that the cost of capital is in itself a primary constraint (especially for established businesses).

Rather, based on views expressed in this study, low growth and the cost of government regulation and services (most notably transport), constrain the development and competitiveness of South African firms. Whereas capital incentives may serve to mitigate some of these costs and encourage firms to invest in sectors of priority to government, they do not serve to address the underlying challenges confronted by industry more broadly.



### 9.3 Is the incentive package achieving the broader objectives and are they aligned with overarching frameworks and plans?

The incentive system is well-aligned with Government's overall economic objectives – to raise investment and reduce inequality and unemployment – and specific incentives are clearly targeted at industries that are a stated policy priority or addressing key areas of market failure. It is much more difficult to assess whether the system is actually contributing towards the achievement of these objectives. This is partly because very few incentives are designed with the purpose of achieving these policy outcomes, or the mechanism through which they do so has not been fully articulated; and partly because firm behaviour and performance is dependent on so many other economic and social factors. As a result, the extent to which these outcomes are realised, is not reported and cannot be measured or evaluated. Moreover, a large part of the incentive system is oriented towards sustaining mature industries and protecting workers in existing companies, rather than facilitating new entrants (companies or sectors) or technology diffusion. Over time, this may limit the ability of the system to contribute towards the creation of new jobs and more dynamic economic growth.

In general, the available business incentives are well-aligned with the government's overall economic growth, transformation and job creation objectives. More than half of the case study programmes were deemed to be strongly aligned with national policy frameworks, including the NDP and IPAP. For the remaining nine incentives, the target group was specifically mentioned in these frameworks, though the desired change was not fully described.

However, the extent to which these incentives have made a meaningful contribution to reducing overall levels of poverty, inequality and unemployment in South Africa, is uncertain. This is partly because there are so many other factors that influence the achievement of these objectives; but also because there is insufficient information available on the outcomes of most incentives, and the system as a whole.

Respondents were asked to assess the extent to which the system of incentives actually contributes towards the achievement of a number of stated policy objectives. Table 19 shows the average perception of government and non-government respondents; a higher average number indicates a larger perceived effect of the system on the policy area.

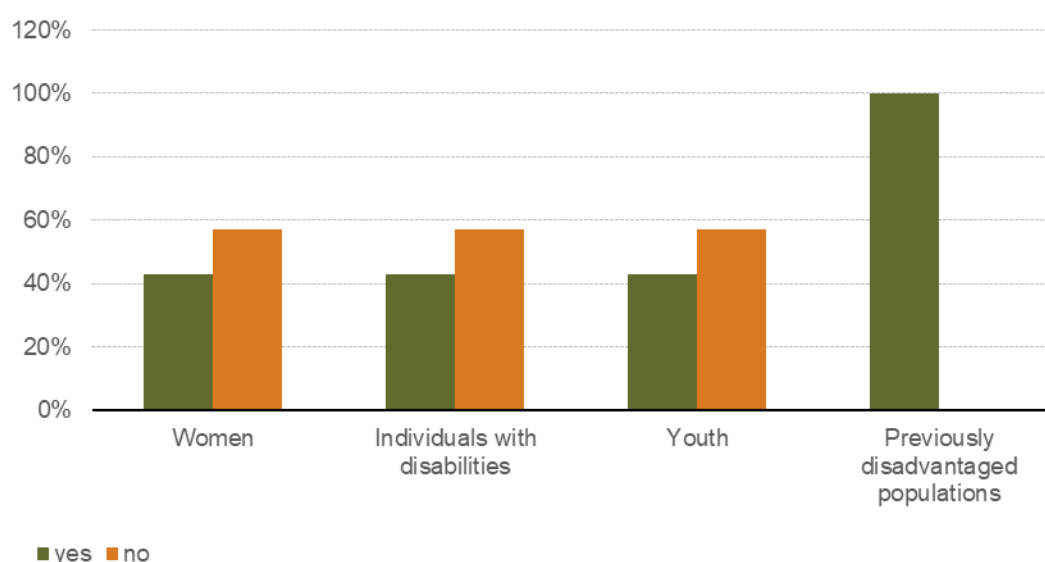
**Table 19: How effective is the system of business incentives in addressing key policy objectives?**

	Raising firm investment in capital or machinery	Creating new businesses	Raising firm investment in training	Raising firm investment in employment	Increasing economic participation in the economy for disadvantaged groups	Raising firm investment in research and development (R&D)	Raising firm investment in marketing
Business and other organizations	2,7	2	2,7	2	2,3	1,8	2
On average:	somewhat effective	somewhat ineffective	somewhat effective	somewhat ineffective	somewhat ineffective	somewhat ineffective	somewhat ineffective
Government officials	3,1	2,1	2,9	2,3	2,5	2,3	2,1
On average:	somewhat effective	somewhat ineffective	somewhat effective	somewhat ineffective	somewhat effective	somewhat ineffective	somewhat ineffective

Notes: average response calculated from response options 1-4 whereby 1 indicates “completely ineffective”; 2 “somewhat ineffective”; 3 “somewhat effective”; and 4 “completely effective”. *Source: Stakeholder interviews*

Government officials are generally more optimistic that the system of incentives has an effect on firm behaviour and key policy objectives, compared to respondents from business and other non-government organisations. Nevertheless, there is a high degree of agreement across these different groups. Specifically both groups claim that incentives targeted at investment in capital and training are effective. This is not surprising given that the majority of business incentives are directed at these policy issues. There is a mixed perception as to the effectiveness of transformation incentives, with government officials seeing these as somewhat effective (though less so than investment and training incentives). Across all other policy areas, incentives are perceived as somewhat ineffective.

Looking at transformation more deeply, respondents were asked whether incentives were responsive to a number of specifically designated groups. The results are shown in Figure 21. Whereas the majority of government and non-government respondents do not believe that incentives respond explicitly to the needs of women, people with disabilities and the youth, all respondents indicate that the system is responsive to previously disadvantaged population groups.

**Figure 21: Responsiveness of incentives to designated groups**

Source: Stakeholder interviews

Respondents were also asked to identify the type of policy challenges that South Africa is likely to face in the near future (over the next 15 years), and almost all expressed a concern that investment in South Africa is not aligned with the needs of a modern economy. Specifically, the impact of the fourth industrial revolution has not been considered in the current system of incentives, which has been designed to facilitate investment in sectors and production processes that are generally mature, and may become obsolete. More problematically, there is some risk that existing incentives may serve the interest of dominant firms and sectors that are unable to adapt, thereby extending the lives of unsustainable firms.

#### 9.4 Do these incentive programs complement each other in relation to the frameworks/plans and what are the gaps?

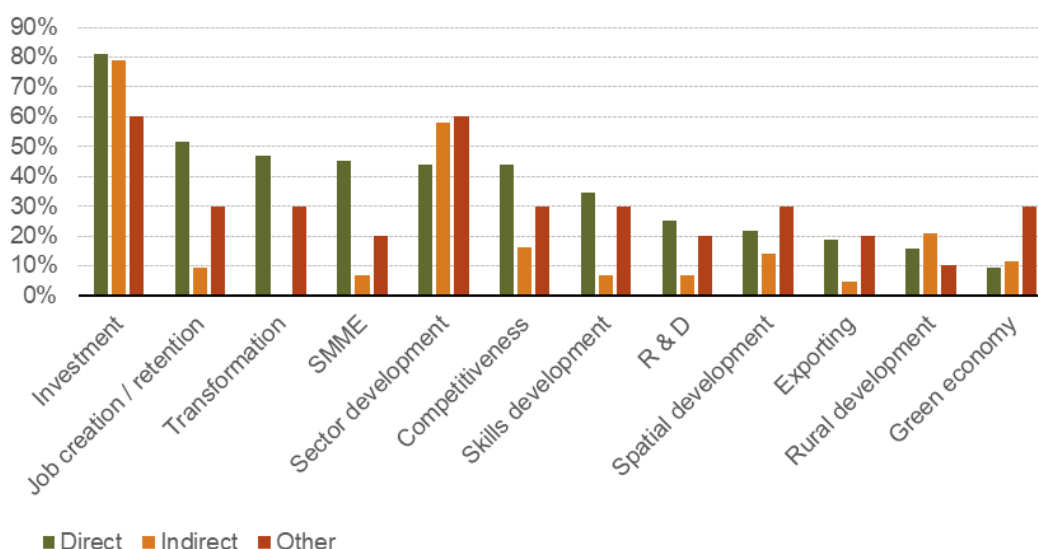
There is little evidence to suggest that incentives in South Africa are designed, managed or reported in a systematic way. Rather, different departments and agencies assume responsibility for the implementation of their own programmes, to address their specific interests and those of their constituency, while also accounting for the Government's wider policy objectives. In doing so, most incentives come with multiple objectives, many of which overlap and some of which conflict with the primary purpose of the incentive. Moreover, most government departments are unable to manage or report on these multiple objectives, and do not have the skills in-house to advise on aspects which often fall outside of their core mandate. There is also a risk that in loading incentives with too many sub-objectives, some areas that are deserving of more focused intervention, are effectively neglected. Specifically, in South Africa, it would seem that insufficient attention has been given to supporting R&D activities and innovation across all sectors of the economy.

Business incentives in South Africa are designed to achieve multiple objectives. Based on the available information, each incentive in the inventory database was assessed against 12 different policy objectives; the overall results are presented in Figure 22. On average, direct incentives seek to achieve more than 4 policy objectives; indirect incentives are generally more targeted, at 2 incentives on average.

Investment stands out at the most common single objective, and is reflected in around 80% of the direct and indirect incentives captured in the inventory. Job creation, transformation and

SMME development are addressed by between 40% and 50% of direct incentives, but are seldom a focus of indirect incentives. Interestingly, a reasonable amount of 'other' incentives aim to support the green economy, or encourage energy efficiency, but this is not a major concern across direct and indirect incentives. Moreover, research and development appears to be a surprisingly low priority.

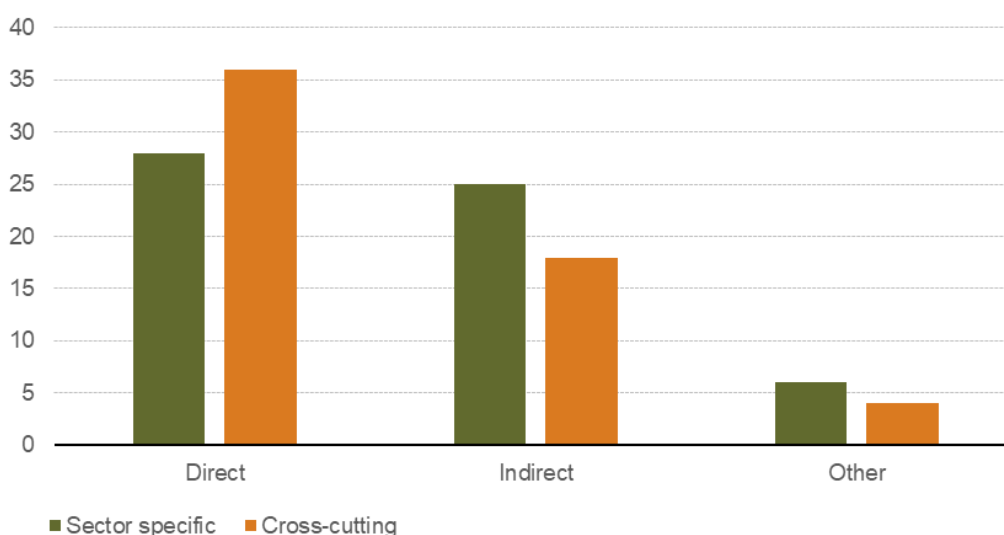
**Figure 22: Incentive objectives (% of total)**



Source: Inventory of business incentives

As indicated in Figure 22, a large proportion of incentives have a sector focus. This is confirmed in Figure 23. The majority of indirect and 'other' incentives are targeted at a specific sector, or in some cases, a limited set of sectors. Whereas most direct incentives are cross-cutting – and available to all qualifying businesses – a large number are still restricted to priority sectors. These sectors are generally reflected in the published guidelines and criteria, though in some cases, sector priorities are not immediately transparent.

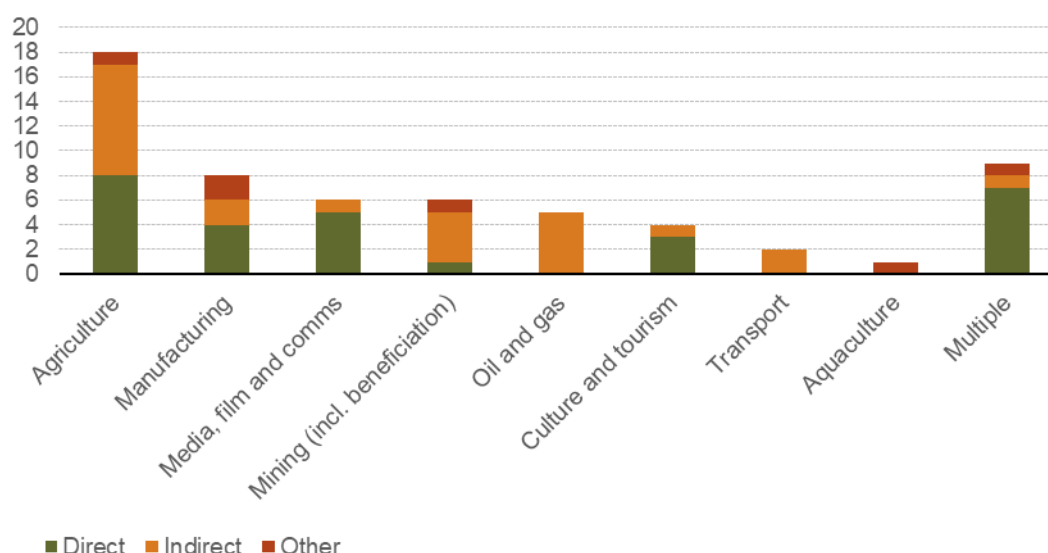
**Figure 23: Sector and cross-cutting incentives**



Source: Inventory of business incentives

Looking more closely at the focus of the identified sector-specific incentives, agriculture is the most common priority for both direct and indirect incentives (at least in terms of the number of incentives available, but not necessarily in value). Most of the remaining indirect incentives are targeted at the mining, oil and gas sector. All but two of the agriculture and mining tax incentives are reasonably old – pre-dating 1994; with eight from the 1960s. The oil and gas tax incentives are more recent, and were all implemented in 2006/07. Whereas manufacturing accounts for a significant number of direct incentives, it is interesting to note that the services sector in general, and the media, film, communications, tourism and cultural industries in particular, are also regarded as priorities.

**Figure 24: Priority sectors**



Source: *Inventory of business incentives*

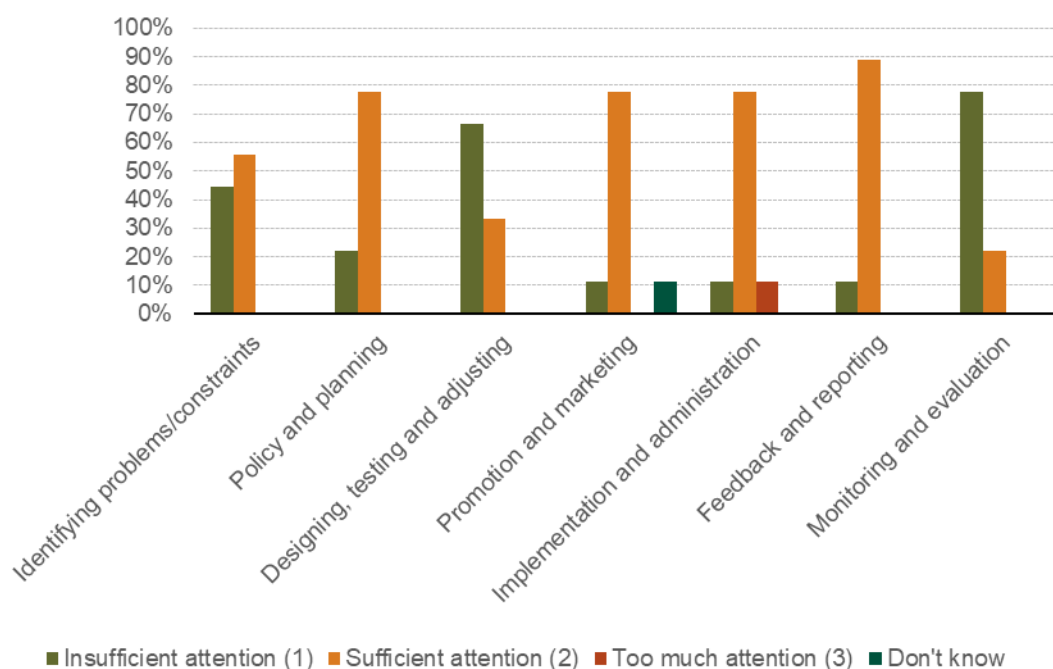
In design, it would therefore appear that the system of business incentives is targeted at the government's stated policy priorities, including sectors of specific strategic interest. That said, the apparent leaning towards mature sectors, such as agriculture and mining, and the relatively low priority given to R&D and the digital economy, suggests that the system is biased towards existing sectors and large incumbent firms, rather than emerging industries and businesses. Likewise, many incentives focus on sustaining jobs in these sectors, rather than creating new employment opportunities. This observation was confirmed during many of the case study interviews.

The case studies also highlight a number of gaps in the implementation of incentives in South Africa. The majority of the incentives were not constructed on the back of substantial evidence or research. In no cases was there confirmation of economic cost benefit or options analysis, or the use of regulatory or socio-economic impact assessment (RIA or SEIA) techniques; and just three programmes could provide or articulate a theory of change or results chain. Most departments report a lack of human resources to effectively manage and monitor incentives, and application and approval systems are mostly incomplete or manual. This greatly increases the administrative burden for both government and beneficiaries. With few exceptions, monitoring and evaluation is not fully incorporated in the design of new incentives, and reviews are usually done internally and focus on project outputs and compliance.

These observations were confirmed during the wider government and industry consultations. Respondents were asked to assess the design, targeting, implementation, and monitoring and evaluation of the system of incentives in South Africa. In their opinion, too little attention is paid to identifying the actual needs and problems of the target groups; the designing, testing and adjusting of incentive programmes; and the evaluation of these incentives programmes.

All of these processes require critical and consultative engagements with stakeholders. On the other hand, the planning of the incentive programme; promotion and marketing; implementation and administration, and the reporting on outputs receives enough attention. These processes are more procedural and require potentially less engagement with beneficiaries.

**Figure 25: How much time and effort is paid to the different stages of incentive implementation?**



Source: Interviews with stakeholders

## 9.5 What is the overall Theory of Change (or theories of change) for government business incentives and is it (are they) working as planned?

The overall system-level theory of change is valid and does capture the intent and programme logic of individual incentives. Based on the interviews, workshops with stakeholders and case studies there is evidence that the logic of the ToC breaks down in a number of key areas at the level of design, implementation and monitoring and evaluation. The lack of adequate M&E (which is directly linked to adequate design and the development of appropriate incentive-level ToCs) means that there is insufficient evidence at the outcome level. While there is some evidence that individual incentives are supporting individual firms and at the intermediate outcome level are contributing to increased economic participation, the available data suggest that at the outcome level key results such as increased economic productivity, expanded production and employment are not being realised to the extent envisaged. This is partly because of broader issues (key assumptions in the theory of change) such as confidence in the general economic environment, the cost of doing business and the competitive structure of many industries; but weaknesses in monitoring and evaluation also mean that the contribution of incentives cannot easily be isolated.

Overall the six incentive category ToCs have confirmed the validity of the system-level theory of change. Specifically, the six incentive ToCs confirm the broad logic of the incentive system in driving firm level change (such as investment in machinery or technology) to effect changes in the economy.

However, on the basis of learnings from the six category ToCs, a few minor adjustments have been made at the Immediate Outcome and Intermediate Outcome levels. These changes are outlined below.

### 9.5.1 Immediate Outcomes

At the Immediate Outcome level – based on a review of the six incentive category ToCs – it was agreed that additional Immediate Outcomes needed to be included as follows:

- **Enterprises Sustained** – Accommodating incentives specifically targeted at preventing firms from exiting the economy, for instance business rescue or risk support.
- **Firm Investment in New Technology** – This was added in order to capture the nature of key economic sectors (such as ICT, Finance etc.) and related incentives that are more precisely aimed at technology rather than capital.

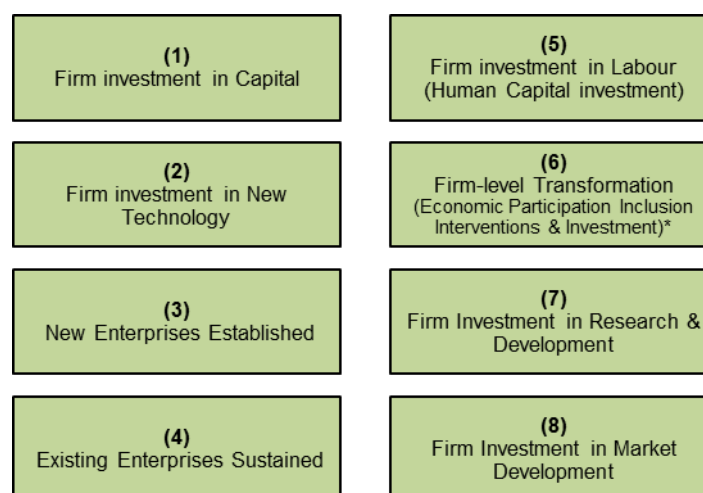
In addition, the original “Firm Investment in R&D and Market Development” has been separated into two separate Immediate Outcomes:

- **Firm Investment in Research and Development** and
- **Firm Investment in Market Development.**

It is noted that while these two outcomes are at times closely inter-related – for instance market development or exporting may require R&D – they are generally served by different types of incentives.

As a result, eight **Immediate Outcomes** have been identified for the overall system theory of change:

**Figure 26: Revised Immediate Outcomes**



### 9.5.2 Intermediate Outcomes

At the Intermediate Outcome, in developing the category-level ToCs, an additional Intermediate Outcome emerged:

- **Diversified and Dynamic Economic Activity.**

The thinking here is that many incentives – although aimed at improved firm and economic competitiveness or increased employment – are specifically aimed at creating a more resilient economy characterised by dynamic and diversified economic activity. This speaks to structural

transformation in the economy (for instance addressing concentration in key sectors) or the lack of innovation.

Finally it was noted that the initial Intermediate Outcome – “Improved Firm and Economic Productivity” should be relabelled as **Improved Firm and Economic Competitiveness**, and the intermediate outcome “Increased Economics Participation” should be expanded to include marginalised groups and **geographic areas**, in order to better capture the intent of the incentive system.

Overall then four revised **Intermediate Outcomes** have been identified for the overall system theory of change:

**Figure 27: Revised Intermediate Outcomes**



While the overall system-level theory of change is valid, there is evidence (based on the interviews, workshops with stakeholders and case studies) that the logic of the ToC breaks down in a number of key areas. The figure overleaf presents the incentive-system ToC with annotations and comments on key areas of concern.

Notably the evidence suggests that the main weaknesses are at the level of design, implementation, and monitoring and evaluation. At the point of initial conceptualisation there is insufficient research and problem analysis and generally no proper theories of change are developed. Critically this means that the precise problem statement the incentive aims to address is not always well articulated and the causal pathways and consequent indicators not well defined. This fails to provide a systematic foundation to assess the impact of the incentive.

Furthermore, at the design stage there appears to be no consideration of alternatives (other or no incentives) to address the problem identified and it is not clear that proper cost benefit or other similar assessments are undertaken that would seek to identify potential unintended consequences.

The case studies in particular highlight that implementation is key weakness with programme administrators citing the lack of sufficient people, and inadequate management information system as key constraints. Overall the ToC need to consider the adequacy of these inputs – the scale and complexity of many of the incentives requires sufficient capacity and resourcing to effectively administer and monitor.

Monitoring is primarily focused on outputs (typically funds expended) and evaluation systems are weak – hampered by the absence of clearly defined programme ToCs / log frames in many cases. Of concern – as evidenced in the case studies – is that in many instances there is inadequate evaluation of incentive outcomes and impact, with very limited data available. This hampers both an assessment of incentives at an individual level and more critically makes any assessment of overall system-wide effects challenging. This also relates to the logic in the ToC with respect to regular review and revision of incentives. There appears to be little evidence



that there is an effective feedback loop from the monitoring and evaluation function to the review, redesign and even termination of incentives on the basis of sound evidence. Where incentives do demonstrate an active and consistent review process the incentive appears to work more effectively, is better targeted and is able to secure better buy-in from key stakeholders (not in the least where such review processes are transparently conducted with industry recipients).

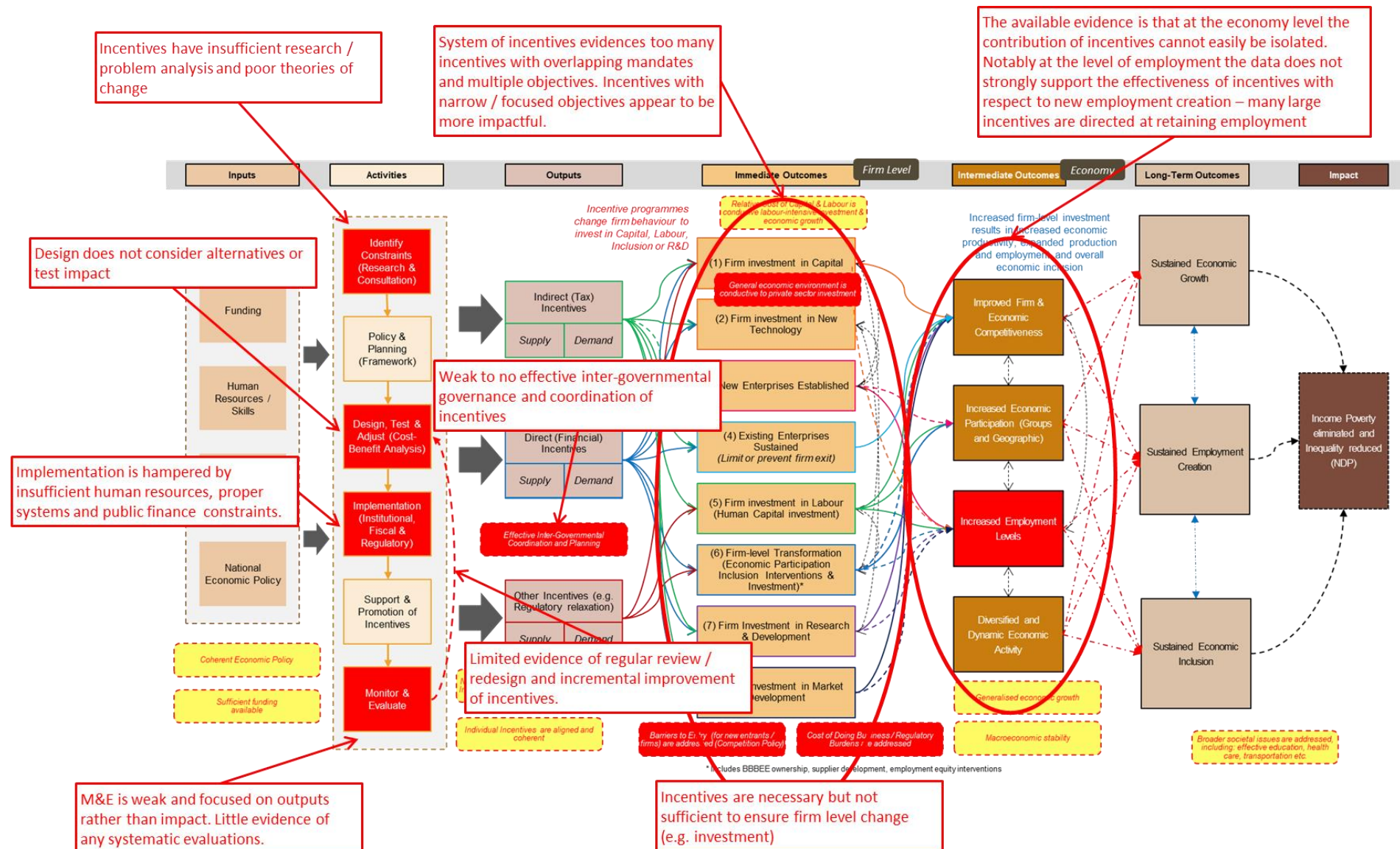
Of related concern is that the evidence suggests that the key assumption with respect to an *effective system of incentives* – effective intergovernmental coordination and planning – is largely absent. As noted elsewhere the “system” is not coherent, appears to be duplicative and possibly even contradictory at points.

Overall the ToC, supported by the research, evidences a system of too many incentives with overlapping mandates and multiple objectives. In particular the layering of multiple objectives (which was noted in the development of specific incentive level ToCs) creates a dilution effect and hampers both the administration and acceptance of incentives. The case studies suggest that where incentives have narrow or more focused objectives (or at least a primary objective with some secondary objectives), they appear to be more impactful.

Overall the research was not able to comprehensively test whether the system of incentives is achieving its outcomes and having the desired impact. In part, as already noted, this is because the M&E systems are weak and focused on outputs rather than outcomes and impact. While there is some evidence that individual incentives are supporting individual firms and at the intermediate outcome level are contributing to increased economic participation, the available data suggest that at the outcome level key results such as increased economic productivity, expanded production and employment are not being realised to the extent envisaged. This is partly because of broader issues (key assumptions in the theory of change) such as confidence in the general economic environment, the cost of doing business and the competitive structure of many industries; but weaknesses in monitoring and evaluation also mean that the contribution of incentives cannot easily be isolated.

While the data is limited, the research suggests that at the economy level the contribution of incentives cannot easily be isolated. Notably at the level of employment, the data does not strongly support the effectiveness of incentives with respect to new employment creation – many large incentives are directed at retaining employment. Nevertheless, the overall ToC we would argue remains valid. The issue is rather the key assumptions that must hold in order for incentives to be effective.

Figure 28: Revised Theory of Change: Overall System Level



## 9.6 How does South Africa compare with other countries on business incentives?

South Africa offers an elaborate mix of business incentives that cut across multiple departments and sectors. As such, the system appears less coordinated and focused than those in the comparator countries. This possibly explains why most respondents perceive incentives in South Africa to be of similar value, but less effective, than incentives elsewhere. It would also appear that in some of the comparator countries, greater attention is given to the economic design and targeting of specific incentives, and more rigorous processes are in place for monitoring success. Likewise, these countries seem to place greater emphasis on supporting new businesses and technology; especially in less-developed regions.

The evaluation included a review the system of incentives in three comparator countries: Thailand, Chile and Germany. All three countries make wide use of incentives to facilitate investment and encourage specific types of business activities. However, the specific approach and focus of the incentive system in each countries, differs markedly depending on national priorities. In Chile, incentives are used to support the development of disparate regions; whereas in Thailand, the focus has been on specific sectors and more recently, to encourage international businesses to locate their regional head-offices in the country. In Germany, the system of business incentives focuses strongly on research and the development and SMMEs.

Many of the incentives pursued in these three countries are mirrored in some form in South Africa. There are however a number of lessons that emerge from these country case studies, which should be further considered in the review of South Africa's system of business incentives. These include:

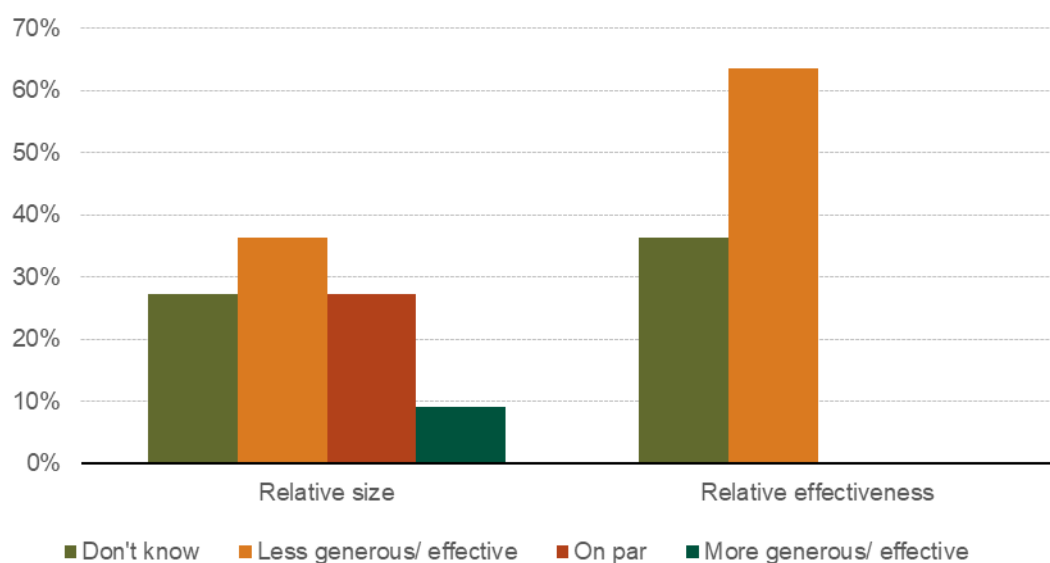
- The roles and responsibilities of each organisation within the incentive framework must be clearly defined; in Thailand, a central investment agency responsible for the administration of all incentives coordinates investment activities for Government and makes it easier for prospective investors.
- In Chile, incentives are tailor-made to be attractive to selected sectors or business activities that the country wishes to promote. Effective targeting requires a selection process based on industry value chain assessments and only those missing links that are critical in the overall industry development receive additional incentive support
- In Chile, incentives extend beyond traditional sectors to promote venture capital and the development of local capital fund management industries. This includes allowing banks to invest up to the equivalent of one percent of their asset base in venture capital through investment fund administrators and subsidiaries.
- In Germany and Thailand, more generous incentives are offered to projects that are most likely to generate positive externalities by bringing new technology to the country or investing in less-developed provinces.
- In Germany, the amount of support provided is based on the size of the enterprise, with SMMEs qualifying for more generous incentives.
- In Chile and Thailand, the incentive system explicitly seeks to attract or support companies that have global or regional ambitions or linkages (such as regional

headquarters), by allowing for some activities outside of the country to qualify for benefits (e.g. R&D); by making it easier for firms to undertake international financial transactions; and by eliminating limits on the hiring of foreign professionals.

- In Chile, M&E is institutionalized and managed to inform and provide feedback to decision-making processes. A mechanism is in place for following up on recommendations. Likewise, independent research, and in particular, the use of randomised control studies, is used to assess the effectiveness and impact of government programmes.
- In Thailand, National plans explicitly target improvements in external and international measures of perception, such as the Transparency International Corruption Index; the Institute for Economics and Peace (IEP) Peace Index and independent competitiveness rankings.

In addition, respondents were asked how the overall offering of government incentives in South Africa compare to other countries that are considered direct competitors for South Africa (for instance, Brazil). As indicated in Figure 29, a significant number of respondents were unable to assess the relative size and effectiveness of government incentives. For those that did, the amount allocated to the system of incentives in South Africa is perceived to be more or less on par with elsewhere, but significantly less effective. These perceptions were common across government officials and business and other organizations.

**Figure 29: Incentives in South Africa compared to competitor countries**



Source: Interviews with stakeholders

The perceived discrepancy between the relative size and the relative efficiency of business incentives in South Africa, suggests that the available funds are not aligned with the actual needs of the target groups. The country comparisons provide some ideas as to where and how funds could be better directed (for example towards smaller businesses and R&D). They also reinforce the importance of rigorous research and substantive evaluations in design and implementation of an effective incentive system.

## 9.7 How can the system of business incentives be strengthened and achieve greater value for money to enhance more inclusive economic growth in the country?

It is estimated that South Africa spent between R 40 billion and R 45 billion on business incentives in 2014/15. This is now probably closer to R 50 billion; equivalent to around 3% of the national budget in 2018/19. Whereas the scale of this transfer is substantial, there is limited information available, from most departments and agencies, on the outcomes (or returns) on this investment. As a first step in strengthening the system of incentives, greater effort must be placed on specifying the economic rationale (including the costs and benefits) associated with proposed interventions, and ensuring that these costs and benefits are measured, monitored and evaluated fully over time. Moreover, to maximise the potential gains from the system, incentives should be more closely directed at specific policy concerns or market failures, and support firm-level activities that create the strongest potential for spill-overs.

### 9.7.1 How do we strike a balance between strategic use of demand side instruments and fiscal support?

There is little evidence of the use of demand side instruments in South Africa. Moreover, the only demand side incentive reviewed as part of this evaluation – the local content designation on rail rolling stock – appears to have encountered significant implementation problems, and the cost of this intervention is unknown. On the other hand, the literature identifies a wide range of demand side incentives, which are used elsewhere, usually to promote the demand for innovative technologies and thus increased investment by firms in R&D activities. Interventions range from the introduction of legislation directed at increasing consumer confidence in innovation products, safety regulation, standards and public procurement. These demand-side tools usually complement supply side instruments such as public grants and funding schemes.

Importantly, the demand-side instruments cited in the literature do not use procurement as a blunt instrument for raising local content in a specific sector, but rather look to boost public and private sector demand for new technologies or services. Thus, instead trying to strike a balance between the use of supply and demand side incentives, it will first be useful to review the design and implementation of existing demand side instruments in South Africa, against international best-practice. In doing to, it will be critical to estimate the likely economic cost (and associated benefit) of current demand-side interventions, and any proposed revisions or additions.

### 9.7.2 What incentive instruments work best be it direct fiscal transfers, tax instruments, and concessional finance or demand side instruments?

Although the recent literature points to the positive impacts of incentives, these effects are generally small and are not constant across different regions or countries. The impact of tax incentives, in particular, are questionable, given the small contribution of taxes to the overall cost of the business, and the fact that they are only of benefit if and when a company is making a profit. For these reasons, the G20 recommends that incentives that lower the cost of investment by reducing the cost of capital are preferred over profit-based tax incentives, as they make a great number of investment projects more profitable at the margin.

More importantly, the literature highlights that the geographic and demographic characteristics of the country or target group, as well as the specific design of incentives, are critical factors in determining success. Thus, rather than favouring one type of incentive over another, there are a number of common design principles that could be used in the design and

implementation of all incentive programmes. These ten guidelines are synthesised from the work of the G20, OECD, IEDC and Rodrick (see Section 4.4):

- Authority to implement incentives should lie in agencies which demonstrate sufficient competence. Implementing agencies need to be able to adapt to changes in the policy environment – because industrial policy plays itself out in dynamic and fluid environments, agencies must be able to adapt to changes and at the same time be able to phase out policies that no longer work with more relevant policies.
- All incentive policies and programmes must be well coordinated with each other as well as with other policies and governed by a coherent policy framework designed to improve the overall investment environment. This will require first, some consensus on the overall policy objectives; and secondly, ensuring that all incentive policies are in line with these objectives and are best suited to address the policy issue at the lowest cost possible.
- Good governance of incentives means that government's decision-making processes, policies and administration must be transparent and subject to public scrutiny and evaluation. In addition, policy makers need to determine the role that other public institutions will play in this process and who the ultimate accounting body will be in terms of design, implementation and finally monitoring and evaluation.
- The economic rationale for any incentive should be clearly articulated to enable public debate on the country's policy priorities. In doing so, policy makers should explain why offering an incentive is the best option to address a particular problem; or whether the desired impact could effectively be achieved through improvements (regulatory or processes and systems requirements) in the overall business environment.
- The economic costs and benefits of an incentive programme should be assessed both ex-ante and ex-post and should be guided by clearly stated assumptions and methodologies, with the assessments eventually being published and publicly available.
- Incentives need to be well-targeted and based on clear, verifiable and rules-based eligibility criteria. This is believed to be best facilitated through incentive programmes that are governed by minimal administrative discretion in the awarding of incentives, and are available on equal terms to both foreign and local investors.
- Incentives should be directed towards activities and not sectors – sector-specific support can lead to misdirection of industrial promotion effects. Activity-focused support is more effective in addressing and correcting market failures (which may be dominant in a particular sector, but are likely to exist to some degree across several sectors).
- Incentives should not be of an ex ante nature (granted prior to the investment), but should rather promote activities that create the strongest potential for spill-overs, including linkages between foreign and local firms, education, training as well as research and development. Unless a subsidised activity has the potential to crowd-in other investments and/or technological and information spill overs, it should not be supported.
- Clearly defined monitoring processes must be built into the incentive programme up-front, including clear criteria that can be measured to assess success and failure. The specific design and management of individual programmes/incentives should consider the resources needed to support the monitoring and evaluation of these programmes.

- There should be a built in sunset clause – this will assist in ensuring that resources do not end up being tried up for extended periods of time in activities that are not producing the desired outcomes, and provides for a natural point of evaluation and appraisal.

These guidelines are validated by the case study findings. Where the economic rationale for the incentive is well-defined (and ideally the theory of change has been articulated), it is easier to measure and see success. Likewise, those departments that have invested more in the implementation and administration of incentives, are able to manage and report on programmes more effectively. On the other hand, incentives that target specific sectors or types of organisations, are generally unable to demonstrate positive economic outcomes, when compared to those that focus on specific activities (such as R&D or job creation). Finally, there is much less information available on the performance (and therefore the benefit) of tax and demand-side incentives, when compared to on-budget grant programmes.

### **9.7.3 Does South Africa realise a return on investment from these business incentives against the cost of delivering them?**

As indicated earlier, for most incentives, there is insufficient data available on outputs, or outcomes. As such, it is not possible to calculate the return on investment for the system. The only data that is available for almost all of these incentives, is on expenditure.

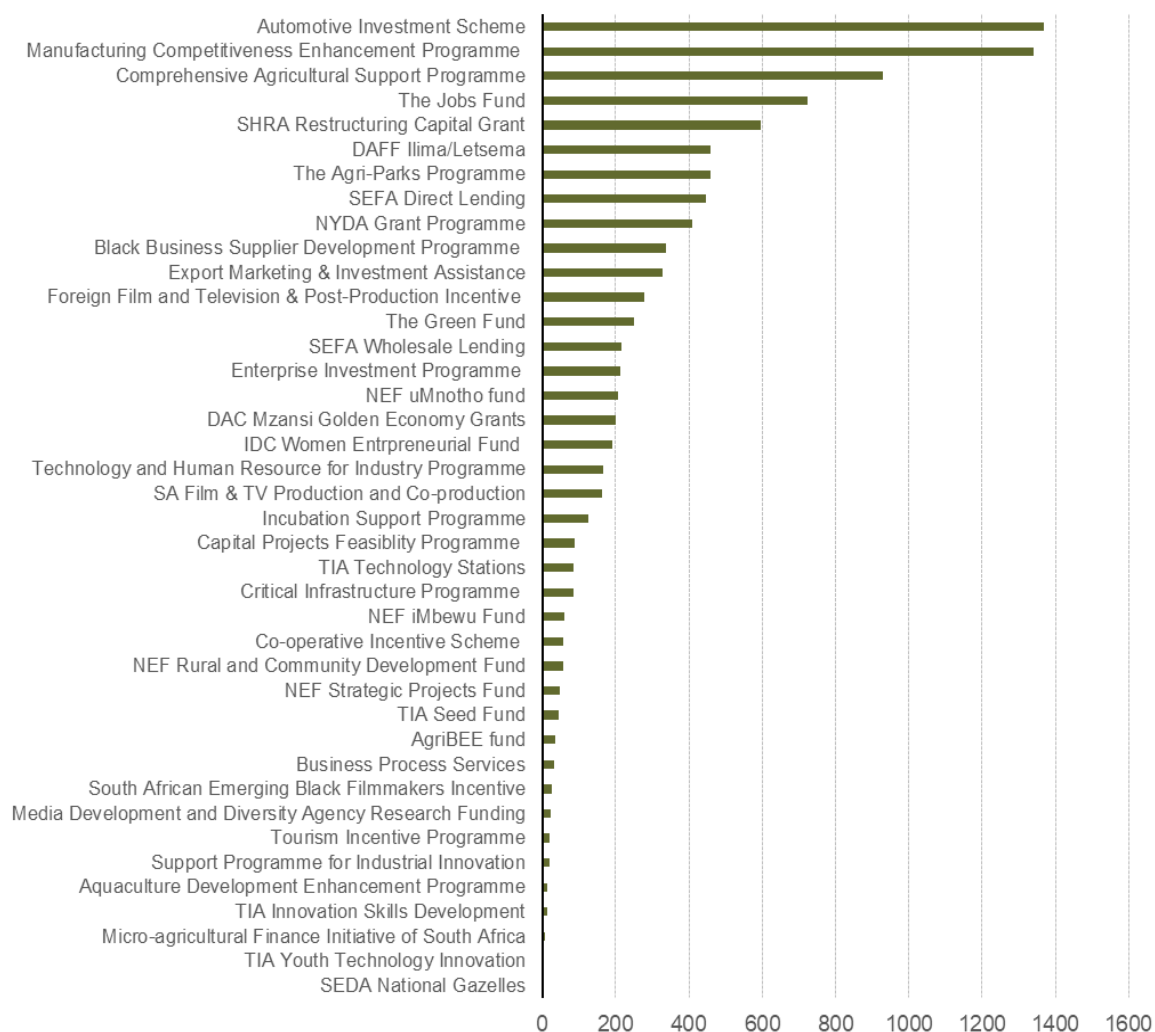
Figure 30 presents the available expenditure data for 41 of the 64 direct incentives included in the inventory. Where possible, budget information has been used, but in some cases, actual expenditure or approval data is shown. In total, just over R10 billion was allocated across these incentives in 2015/16. It is notable that the four largest incentives, together account for 43% of these funds. Moreover, as would be expected, around 40% of these funds are accounted for by the Department of Trade and Industry.

Expenditure data on indirect incentives is presented by the National Treasury in Annexure B (Tax Expenditure Statement) of the National Budget Review. The Treasury estimates for 2014/15 are shown in Figure 31. In total, around R30 bn was spent in this year alone, about three times that spent on direct incentives. Government's support to the automotive sector dwarfs all other incentive programmes – both direct and indirect – with the total contribution of the APDP estimated at R25 billion in 2014/15. The four smallest incentives, together account for R178 mn of tax expenditure; less than that spent on Urban Development Zones. That said, it is important to note that according to the DTI, the full amount (R20 bn) allocated to 12i had been approved by 2016/17, but these claims are not yet reflected in the expenditure data.

In total, the 20 SETAs spent around R10 bn in 2014/15; but expenditure data on the identified SETA incentive programmes is incomplete and therefore incomparable. On the other hand, the SETAs do report consistent information on the number of beneficiaries, annually. Figure 32 shows that the total number of firms supported fell sharply from 2014/15 to 2015/16; while the number of individual beneficiaries has increased steadily over this period. This largely reflects a shift away from the provision of general assistance to SMMEs, by a few SETAs, and subsequently a stronger focus on skills development. Nevertheless, it would appear that a number of SETAs retain sizable SMME and Cooperative support programmes.

Assuming that around 30%<sup>117</sup> of the total SETA budget is directed at firms, then the total amount spent by the national government on the business incentives reflected in the inventory, in 2014/15, would amount to between R40 bn and R45 bn.

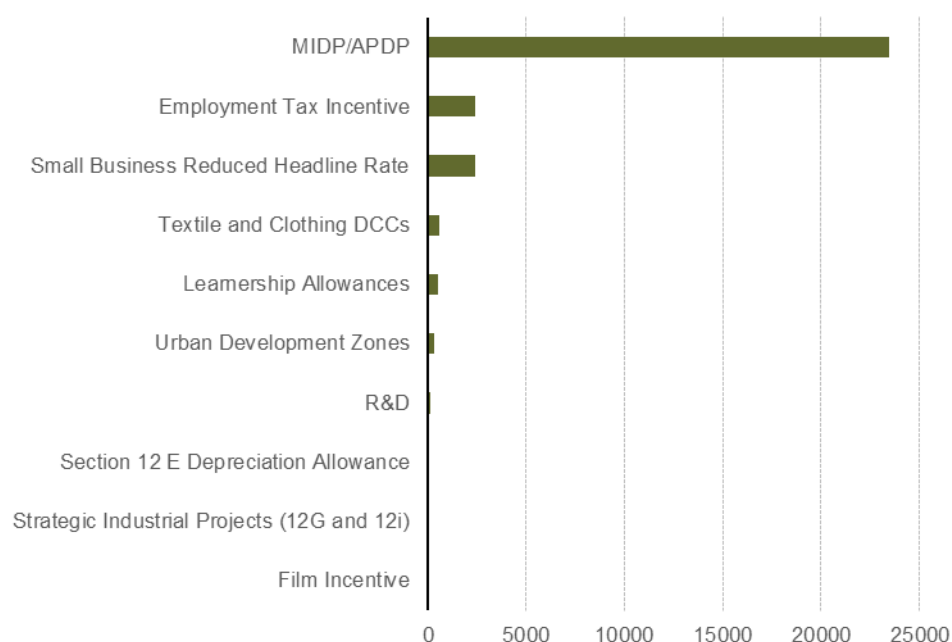
<sup>117</sup> This is based on an estimate across a few SETAs that do provide detailed budget information

**Figure 30: Total expenditure – direct incentives (R mn, 2014/15 <sup>118</sup>)**

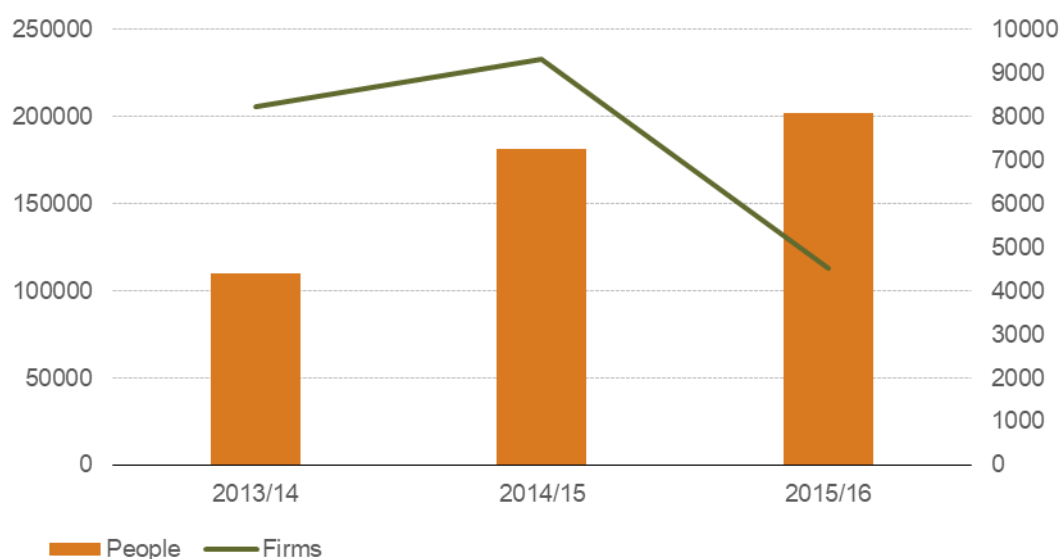
Source: Inventory of business incentives

<sup>118</sup> For the Aquaculture Development Enhancement Programme, and the three film-specific incentives, 2015/16 expenditure data has been used



**Figure 31: Total expenditure – indirect incentives (R mn, 2014/15)**

Source: Inventory of business incentives

**Figure 32: Total outputs - SETAs**

Source: Inventory of business incentives

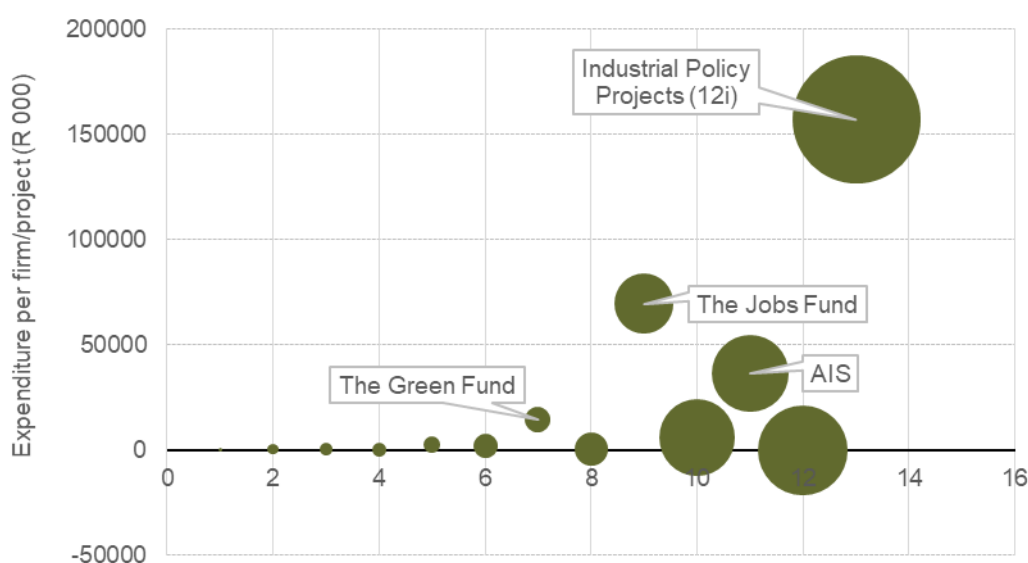
Whereas it is not possible to calculate and show the return on investment on the system of incentives as a whole, for some of the case studies, information on outputs (firms or projects supported) and outcomes (jobs created or sustained) is available. This is consolidated and compared in Table 20.

**Table 20: Incentive outputs and outcomes**

Incentive	Cumulative expenditure	Cumulative beneficiaries (firms)	Cumulative jobs created	Cumulative jobs sustained	Cumulative period
MCEP	R6,9 bn	1 154		236 318	2012/13 – 2015/16
Automotive Production and Development Programme (AIS)	R8,7 bn	239 projects	4 219	54 522	2012/13 – 2016/17
Industrial Policy Projects (12i)	R9,9 bn approved	63 projects	7 699 projected		2015/16 – 2016/17
Cooperative Incentive Scheme	R54,4 mn	176		941 members	2017/18
SEDA Technology Programme	R 75.8 mn*	130*	429 (65%) ** 660 (100% estimate)		* Full programme 2012/13 – 2014/15 ** Impact assessment sample 2012/13 – 2014/15
Black Business Supplier Development Programme (BBDSP)	R641 mn	1 456		23 667	2014/15 – 2015/16
The Gro-E Youth Scheme	R419 mn	146	No data	No data	2013/14 - 2017/18
The Green Fund	R782 mn disbursed as of 2015/16	53 as of 2015/16	1 802 as of 2015/16		2012/13 – 2015/16
Technology Stations or TIA Seed Fund	R250,8 mn (funds disbursed) *	533 (applications funded) *			2013-2017
The Research and Development Business Incentive (12b)	R716 mn (tax expenditure)	341 (Oct 2017)		20 434 (R&D personnel only)	2012/13 – 2015/16
Tourism Incentive Programme (TIP)		279			2015/16 - 2017/18
The Agri-Parks Programme	R2 bn (R450 mn per year)	25 000 target over 10 years	100 000 target over 3 years		Total allocation (specified in 2015/16)
The Jobs Fund	R6.4 bn	92	127 420	100 097	2011/12 – 2016/17
Employment Tax Incentive	R2,4 bn	32 368	686 402 jobs supported		2014/15
MERSETA Apprenticeship Programme	R385.2 mn in grant allocations	1054	5 000 apprenticeship registrations	3 200 apprenticeship completions	2015/16
CHIETA Work-integrated Learning Programme	R39 mn WIL Expenditure Utilisation (2016/17)	N/A	3 366 WIL beneficiaries (2016/17)	N/A	2016/17

Based on the table above, it is possible to calculate the average amount spent per firm or project (i.e. beneficiary), across most of these incentives, for the years for which data is available. Figure 33 shows the total amount spent by the incentive each year (the size of the bubbles), against the average cost per firm or project. It highlights that 2 of the largest incentives (12i and the AIS), in absolute size, are distributed across relatively few projects or firms. The average 12i and AIS beneficiaries receive benefits of R157 mn and R36 million respectively. The Jobs Fund is also large in size, but it is important to note that these funds are disbursed through intermediary organisations, so the ultimate number of beneficiaries is much larger. The Green Fund also spends a relatively large amount per beneficiary. On the opposite end of the scale, the Tourism Incentive Programme and Employment Tax Incentive spend the least per beneficiary, at R54 000 and R74 000 respectively.

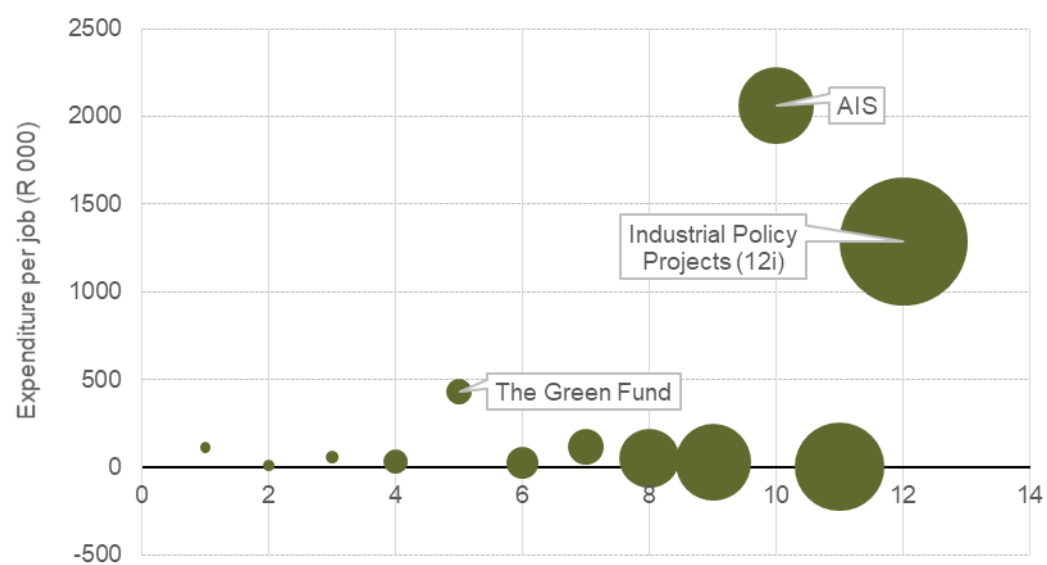
**Figure 33: Expenditure per firm or project supported**



Source: Case studies and own analysis

Similarly, Figure 34 shows the total amount spent by the incentive each year (the size of the bubbles), against the average cost per job created or sustained. Based on the available data, the AIS spends more than R2 mn for every direct job created in the automotive sector, followed by 12i at R1.3 mn. The next most 'costly' incentive is the Green Fund, at R430 000 per job. Most of the other incentives spend less than R100 000 for every job created or sustained, with the Employment Tax Incentive the most cost-effective at just R3 500 per job.

Whereas the above analysis should not be construed to provide an estimate of the return on any of these incentives, it does indicate that a large proportion of the incentive pool, is going towards relatively few capital-intensive firms. Of greater concern, is the lack of more detailed information on incentive outcomes, which effectively prevents the calculation of more useful measures of economic return and success.

**Figure 34: Expenditure per job created or sustained**

Source: Case studies and own analysis

## 10 Conclusions

The evaluation found that South Africa currently has some 244 business incentives. Of these incentives 64 can be categorised as direct incentives; 43 as indirect (tax) incentives; 10 as other incentives (mostly information services) and 127 as different SETA grant programmes. Most (56% in number, not value) of the direct incentives are offered in the form of subsidies or grants. Accelerated depreciation provisions account for the largest number of indirect incentives, though there are also numerous allowances for reduced tax rates and tax exemptions. Only three demand-side incentives were found, two of which are implemented through the government procurement system.

### 10.1 Relevance of the System of Incentives

The economic literature notes three rationales for the introduction of business incentives: (1) to address market failure; (2) to ensure social protection and distributive justice; and (3) to influence and promote economic and industrial development. While the South African incentive system includes incentives that cover all three rationales, the largest amount of funding goes to capital incentives, that are primarily used to mitigate against the cost or uncertainty of doing business in South Africa, and to raise or sustain production and employment, especially in priority sectors. In addition, the South African Government sees business incentives as an important mechanism to address historical inequalities and increase the participation of historically disadvantaged groups in the economy.

The dominant view (evidenced in interviews with government officials as well as firms) is that access to the inputs of production (skills and capital) are the main challenge for firms operating in South Africa. This is followed by a generally unfavourable business environment with high regulatory costs, low economic growth and restricted access to markets. Within this context the main objectives of the system of business incentives are considered differently in government and business. For government officials the main purpose of incentives is to address transformation, competitiveness and industrialisation. For business and other organizations, the system of business incentives is mainly directed at creating jobs, followed by industrialisation and investment.

The evaluation concludes that the system of government incentives is generally relevant to the South African economic context, in line with international trends and broadly aligned with current policy initiatives. In general, the available business incentives are well-aligned with the government's overall economic growth, transformation and job creation objectives. More than half of the case study incentives were deemed to be strongly aligned with national policy frameworks, including the NDP and IPAP.

Furthermore, the evaluation notes that within the current economic context, the system of incentives has a critical role to play in addressing inefficiencies in South Africa's labour market, and specifically, the ability of the education system to provide business (and the economy more broadly) with the skills needed to grow. Incentives also have an important social and distributive role to play, in supporting economic transformation and the participation of historically disadvantaged groups in the economy. However, the majority of South Africa's incentives are directed at raising investment or supporting specific sectors of the economy. This is acknowledged, as an objective of the system, by both government and business respondents; but it is not clear that the cost of capital is in itself a primary constraint (especially for established businesses). Rather, based on views expressed in this study, low growth and the cost of government regulation and services (most notably transport), constrain the development and competitiveness of South African firms. Whereas capital incentives may serve to mitigate some of these costs and encourage firms to invest in sectors of priority to government, they do not serve to address the underlying challenges confronted by industry more broadly.

In summary while the system of incentives is relevant and broadly aligned to policy, there are concerns with respect to the overall coherence of the system.

## 10.2 Effectiveness of the System of Incentives

The evaluation notes that the logic of the incentive system breaks down in a number of key areas, limiting its overall effectiveness. However, the lack of adequate M&E (which is directly linked to adequate design and the development of appropriate incentive-level ToCs) also means that there is insufficient evidence at the outcome level. Specifically, while there is some evidence that individual incentives are supporting individual firms and at the intermediate outcome level are contributing to increased economic participation, the available data suggest that key results such as increased economic productivity, expanded production and employment are not being realised to the extent envisaged. This is partly because of broader issues (key assumptions in the theory of change) such as confidence in the general economic environment, the cost of doing business and the competitive structure of many industries; but weaknesses in monitoring and evaluation also mean that the contribution of incentives cannot easily be isolated.

Government officials are generally more optimistic that the system of incentives influences firm behaviour and key policy objectives, compared to respondents from business and other non-government organisations. Nevertheless, there is a high degree of agreement in many areas across these different groups. Specifically, both groups claim that incentives targeted at investment in capital and training are effective. This is not surprising given that the majority of business incentives are directed at these policy issues. There is a mixed perception as to the effectiveness of transformation incentives, with government officials seeing these as somewhat effective (though less so than investment and training incentives). Across all other policy areas, incentives are perceived as somewhat ineffective.

The case studies in particular highlight that implementation is a key weakness with programme administrators citing the lack of sufficient people, and inadequate management information systems as key constraints.

The evidence suggests that a key assumption with respect to an *effective system of incentives* – effective intergovernmental coordination and planning – is largely absent. The “system” is not coherent, appears to be duplicative and possibly even contradictory at points. Furthermore, the evaluation found a system of too many incentives with overlapping mandates and multiple objectives. In particular the layering of multiple objectives dilutes the signalling of individual incentives and hampers both the administration and acceptance of incentives. The case studies suggest that where incentives have narrow or more focused objectives, they appear to be more effective.

## 10.3 Efficiency of the System of Incentives

For most incentives, there is insufficient data available on outputs, or outcomes. As such, it is not possible to assess the efficiency of the system or calculate the return on investment for the system. The only data that is available for almost all of these incentives, is on expenditure.

It is estimated that South Africa spent between R 40 billion and R 45 billion on business incentives in 2014/15. This is now probably closer to R 50 billion; equivalent to around 3% of the national budget in 2018/19. In 2015/16 just over R 10 billion was spent on direct incentives (41 out of 64 incentives for which expenditure data was available). In 2014/15 around R30 bn was spent on indirect (tax) incentives, while the 20 SETAs spent around R10 bn on incentive-type programmes in 2014/15.

While it is not possible to calculate and show the return on investment on the system of incentives as a whole, for some of the case studies, information on outputs (firms or projects

supported) and outcomes (jobs created or sustained) is available. The data highlights that two of the largest incentives (12i and the AIS), in absolute size, are distributed across relatively few projects or firms. The average 12i and AIS beneficiaries receive benefits of R157 million and R36 million respectively. On the opposite end of the scale, the Tourism Incentive Programme and Employment Tax Incentive spend the least per beneficiary, at R54 000 and R74 000 respectively.

Likewise, based on the available data, the AIS spends more than R2 million for every direct job created in the automotive sector, followed by 12i at R1.3 million. The next most 'costly' incentive is the Green Fund, at R430 000 per job. Most of the other incentives spend less than R100 000 for every job created or sustained, with the Employment Tax Incentive the most cost-effective at just R3 500 per job.

Whereas the above analysis should not be construed to provide an estimate of the return on any of these incentives, it does indicate that a large proportion of the incentive pool, is going towards relatively few capital-intensive firms. Of greater concern, is the lack of more detailed information on incentive outcomes, which effectively prevents the calculation of more useful measures of economic return and success.

#### **10.4 Impact of the System of Incentives**

Overall the evaluation was not able to comprehensively test whether the system of incentives is achieving its outcomes and having the desired impact. Thus, based on the available data, the extent to which these incentives have made a meaningful contribution to reducing overall levels of poverty, inequality and unemployment in South Africa, is uncertain. This is partly because there are many other factors that influence the achievement of these objectives; but also, because there is insufficient information available on the outcomes of most incentives, and the system as a whole.

## 11 Recommendations

The evaluation demonstrates the substantial scale of business incentives in South Africa and highlights numerous innovations and successes in the delivery of specific programmes. It is however important to emphasise that the focus of this evaluation is on the overall system of incentives, and not on the performance of individual interventions. The following recommendations therefore focus on the general lessons emerging from this study, which cut across most but not all incentives, and how the overall system of business incentives in South Africa can be strengthened.

### 11.1 Recommendations to enhance the governance of the incentive system

- R1 Establish an **Inter-Governmental Incentives Coordinating Committee (IGICC)**. This committee should include the National Treasury, DTI, DST, SARS and the DPME
- R2 The Government Business Incentives Evaluation Steering Committee should develop the terms of reference of the IGICC for approval by Cabinet. The primary role of the IGICC is to develop a **National Incentives Policy Framework**. This National Incentives Policy Framework must be informed by existing policy priorities, such as the National Development Plan and the Industrial Policy Action Plan, and should serve to:
- Define the specific types of interventions to be governed by the National Incentives Policy Framework.
  - Articulate the economic rationale and the resulting design principles for different types of incentives<sup>119</sup>.
  - Prioritise (and ideally reduce) the policy objectives that individual incentives are expected to fulfil.
  - Seek to consolidate the number of incentives that are available, under a smaller number of well-functioning departments or agencies.
  - Set specific criteria to be used in the review of all existing incentives and the evaluation of all planned incentives.
  - Describe the process to be applied in the review of all existing incentives and the evaluation of all planned incentives.
  - Determine minimum standards for the budgeting, administration, accounting, monitoring and evaluation of incentives.
  - Establish roles and responsibilities, including coordination and information-sharing mechanisms.
  - Articulate the need for international, domestic and independent expertise in an advisory capacity.
- R3 Given the economically sensitive nature of incentives a **Communications Plan** should be developed by Cabinet for immediate public release. This should outline the overall review process, governance arrangements, proposed action plan and timelines and offer assurance to the market that no immediate changes are envisaged.
- R4 Based on the National Incentive Policy Framework, the National Treasury should develop a **methodology for evaluating the motivation for and the associated economic costs and benefits of new and existing incentives**, relative to alternative

<sup>119</sup> As a starting point, the Committee can draw on the principles derived from the literature and synthesised in Section 9.7.2 of this evaluation; and for tax incentives, on the work that has been undertaken by the Tax Policy Unit of the National Treasury.



policy options. All applications for new incentives should be assessed against the National Incentives Policy Framework, in accordance with the methodology developed by the National Treasury. Moreover, any changes to existing incentives should be subject to such an assessment, and over the next three years, **all business incentives should be reviewed against the National Incentive Policy Framework.**

- R5** Based on the National Incentives Policy Framework, the National Treasury, in collaboration with the DPME, should develop **minimum annual reporting requirements for all government incentives**, including on expenditure, incentive outputs and on all agreed measures of economic or social outcomes. This information should be published in the annual reports of the responsible department or agency and consolidated in the annual Budget Review.
- R6** A **single register of all beneficiary firms** should be developed to be administered by the National Treasury or SARS. All departments and agencies should be required to report information to this register, and the register should be made accessible to all relevant departments and their agencies. Moreover, consideration should be given to making part of the register of beneficiaries (i.e. company names) accessible for public scrutiny.
- R7** The IGICC should oversee the appointment of a service provider to design and develop **a comprehensive and on-line grant and document management system**, which can be used for the administration of all DTI incentives; and by extension, can be made available for the use by any other Department or Agency involved in the delivery of incentives. In developing the system, the service provider should review existing systems across government and identify opportunities for re-use, expansion or collaboration to minimise costs. The system should enhance the administration of incentives and meet minimum reporting and financial management (PFMA) requirements. Consideration should be given to utilising the National Treasury or alternatively the DTI as the procurement / contracting party.

## **11.2 Recommendations to enhance the evaluation of the incentive system**

- R8** The DPME should **review the status and the depth of all internal and external evaluations**, across all of the incentives identified in this study (with budgets of more than R 100 million per year). Those incentives that have not yet been subjected to an independent evaluation should be prioritised for inclusion in the national evaluation plan.
- R9** All departments responsible for the administration of business incentives (existing and new) should **develop a comprehensive monitoring and evaluation framework**, and sufficient resources should be made available for monitoring and evaluation in programme budgets. Based on the National Incentives Policy Framework, the DPME should issue guidelines to assist departments in the design and implementation of M&E frameworks, and to advise on appropriate costs.
- R10** All **ex-ante assessments and ex-post evaluations of new or existing incentives should be made public.**

### 11.3 Recommendations to enhance the application of the Public Finance Management Act

- R11** The National Treasury (including the Budget Office, Public Finance, Office of the Chief Procurement Officer and the Account General), in collaboration with the Auditor General, should develop a **practice note in terms of the Public Finance Management Act** setting out clear guidance as to the treatment of incentives to assist departments in budgeting for and managing incentives over multiple financial years, and to clarify accounting, reporting and verification requirements. Specifically, this note must address the significant risk incentives face with respect to the current roll-over process and ensure the availability of contracted funding amounts.

### 11.4 Recommendations to review components of the incentive system

- R12** The National Treasury, in collaboration with SARS, should undertake a **review of all of the tax incentives** identified in this study and assess whether they are still relevant, effective and efficient. In undertaking this review reference should be made to the findings and recommendations of the Davis Tax Commission.
- R13** The Department of Science and Technology, in consultation with the DTI, should undertake a **review of South Africa's overall support offering for the commercialisation of research and development**, including policies and programmes to advance the digital economy, compared to international best practice. Specific attention should be given to the use of demand-side incentives to encourage the up-take and spread of new technologies.
- R14** The Department of Higher Education and Training should introduce a **common budget and programme reporting framework for all SETAs**; and should establish a mechanism through which the SETAs can share ideas and collaborate on skills initiatives that are currently delivered by individual SETAs but could be replicated and delivered more effectively across all sectors.

## 11.5 High-level Implementation Plan

The recommendations should be implemented according to the following sequence / prioritisation.

**Table 21: High-level implementation plan**

Step	Recommendation	Action	Responsibility
1	<b>Establish an Inter-Governmental Incentives Coordinating Committee (IGICC)</b>	<ul style="list-style-type: none"> <li>Prepare terms of reference for approval by the Cabinet</li> </ul>	PSC
		<ul style="list-style-type: none"> <li>Appoint members to the Inter-Governmental Incentives Coordinating Committee.</li> </ul>	PSC
2	<b>Communications Plan</b>	<ul style="list-style-type: none"> <li>Prepare a communications plan setting out the proposed arrangements and actions i.r.o. of the incentive system.</li> </ul>	PSC
3	<b>Incentives Policy</b>	<ul style="list-style-type: none"> <li>Secure service providers / OECD/ other</li> <li>Develop Policy</li> <li>Consult key stakeholders on proposed framework</li> <li>Present for comment to Economic Cluster</li> <li>Submit to Cabinet for approval.</li> <li>Publish Framework.</li> </ul>	IGICC
4	<b>Incentives Review Process</b>	<ul style="list-style-type: none"> <li>Develop and agree a methodology for the economic assessment of existing and new incentives</li> <li>Develop required templates and tools (e.g. submission requirements; certificates etc.)</li> </ul>	National Treasury
5	<b>Minimum annual reporting requirements</b>	<ul style="list-style-type: none"> <li>Develop and agree minimum annual reporting requirements.</li> <li>Publish / include requirements as part of annual National Treasury reporting requirements.</li> </ul>	National Treasury and DPME
6	<b>On-line grant and document management system</b>	<ul style="list-style-type: none"> <li>Develop terms of reference</li> <li>Undertake procurement of a service provider</li> <li>Review existing systems and make recommendations on proposed system</li> <li>Develop system</li> <li>Pilot system</li> <li>Roll-out system</li> <li>Maintain system.</li> </ul>	IGICC oversight Utilise NT or DTI for procurement and contracting
7	<b>Monitoring and Evaluation</b>	<ul style="list-style-type: none"> <li>Review the status and the depth of internal and external evaluations.</li> <li>Develop an evaluations plan in consultation with relevant line departments.</li> <li>Develop guidelines to assist departments in the design and implementation of M&amp;E frameworks and advise on appropriate costs.</li> </ul>	DPME
		<ul style="list-style-type: none"> <li>Develop a comprehensive monitoring and evaluation framework.</li> </ul>	Relevant line departments

Step	Recommendation	Action	Responsibility
		<ul style="list-style-type: none"> <li>Publish all ex-ante assessments and ex-post evaluations of new or existing incentives on the DPME website</li> </ul>	DPME
8	PFMA Practice Note	<ul style="list-style-type: none"> <li>Convene a workshop with relevant departments, National Treasury functions (including the Budget Office, Public Finance, Office of the Chief Procurement Officer and the Account General) and the Auditor General.</li> <li>Develop and agree a practice note to the Public Finance Management Act setting out clear guidance as to the treatment of incentives.</li> <li>Publish practice note.</li> </ul>	National Treasury
9	Register of Beneficiary Firms	<ul style="list-style-type: none"> <li>Design and implement a single register of all government incentive beneficiary firms.</li> <li>Maintain the register on an ongoing basis.</li> </ul>	National Treasury or SARS.
10	Review of Tax Incentives	<ul style="list-style-type: none"> <li>Develop terms of reference for review (in line with Davis Tax Commission recommendations).</li> <li>Procure service provider (if required).</li> <li>Undertake review and present recommendations to IGICC.</li> <li>Present final recommendations to Cabinet.</li> </ul>	National Treasury and SARS
12	Review of R&D Incentives	<ul style="list-style-type: none"> <li>Develop terms of reference for review.</li> <li>Procure service provider (if required).</li> <li>Undertake review and present recommendations to IGICC.</li> <li>Present final recommendations to Cabinet.</li> </ul>	DST
12	SETA Standardisation & Cooperation Framework	<ul style="list-style-type: none"> <li>Develop and agree a common budget and programme reporting framework for all SETAs.</li> <li>Establish a mechanism through which the SETAs can share ideas and collaborate.</li> </ul>	Department of Higher Education and Training

## Annexure 1: References

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## Annexure 2: Evaluation Framework

### Methodological considerations

#### 11.5.1 Defining Business Incentives

At the outset of this evaluation it is important to reach agreement on what is included in the scope of the study, and what is not. Arriving at a finite definition of a 'business incentive' is a relatively difficult task. The broad nature of their application and the boundaries defining incentives are not always clear, making it difficult to come to a universally agreed definition. No internationally agreed upon definition of a 'business incentive' could be found, and the various existing definitions are either very broad (covering virtually all government policies and programmes that impact on the private sector) or very narrow (covering only specific types of assistance, usually limited to investors).

In addition, the literature review reveals that a multitude of different terms are used to describe 'business incentives', including, *investment incentives*; *economic development incentives* as well as *industrial incentives*. Thus, in effect, any measure targeted at or assigning general preferential treatment to businesses, sectors or industries can broadly be considered an incentive.

However, in this evaluation, it is proposed that a more purposeful and therefore narrower definition be applied. Specifically, *any government measures that are applied to induce a specific economic response from business in a specific location, sector or industry* (e.g. a lower corporate tax rate being offered to medium-sized manufacturing firms in a particular region), are categorised as incentives in this evaluation.<sup>120</sup> Moreover, in accordance with the terms of reference, this definition is applied only to national-level incentives and agencies in South Africa.

Internationally, countries offer a wide range of incentives to business, ranging from tax holidays, preferential tax rates, grants, preferential loans, monopoly rights and preferential infrastructure access. Broadly, these can be categorised into three main types: (i) indirect (tax) incentives (which are the most commonly used and researched); (ii) direct (financial) incentives and (iii) other incentives (vary significantly across countries). Tax incentives are also commonly referred to as fiscal incentives although it is recognised that fiscal incentives often include both tax and non-tax financial incentives, such as subsidies.

Direct incentives include cash payments/grants or payments-in-kind (such as land or infrastructure transfers) made to the investor, and are a direct cost to the government's budget requiring "upfront use of government funds".<sup>121</sup> Indirect incentives usually refer to tax incentives and generally provide for a reduction in taxes, including tariff rates on imported inputs. Lastly, other non-financial incentives encompass a multitude of benefits including reduced administrative procedures, legislative exemptions and Special Economic Zones.<sup>122</sup>

In this evaluation, it is proposed that the following classification is used.

- **Indirect (tax) incentives:** Tax incentives include all legislative or administrative offerings that provide for the more favourable tax treatment of specific activities (such as research and development) or sectors (such as manufacturing), compared to what is granted to industry in general. A general "across-the-board" tax rate cut would not be considered a tax incentive.

<sup>120</sup> (Jordaan, 2012) and (OECD, 2003)

<sup>121</sup> (UNCTAD, 2000, p. 11)

<sup>122</sup> (Barbour, 2005)

- **Direct (financial) incentives:** Direct incentives refer to the upfront provision of finance, from Government, primarily to reduce the initial high capital costs faced at the beginning of a new investment. They may however be offered to upgrade or stabilise an investor's operations. These range from cash grants, loans, interest subsidies as well as the provision of job training subsidies.
- **Other incentives:** There are a number of 'other' non-fiscal, non-financial incentives which include, but are in no way limited to the following: regulatory incentives, subsidised services, market privileges, information/education and research and even export assistance through exporter development/support programmes. In all the incentive cases discussed thus far, the firm, and not an individual, is the initial and direct recipient of the business incentive.

Most of the above-mentioned incentives work through the supply-side; they seek to encourage firms to raise investment, production and employment. But many countries also make use of demand-side incentives and instruments to drive demand for a particular outcome – such as innovation, education, energy-efficiency, public transport or healthcare – which in-turn encourages business to increase supply or speeds up the uptake and diffusion of specific types of goods or services.<sup>123</sup>

**Demand-side incentives are often directed towards supporting private and public (government) demand for research and development (R&D), innovation and technology.<sup>124</sup> Generally, this includes some form of direct or indirect government intervention to promote the demand for innovative technologies and thus increased investment by firms in R&D activities.**

Demand-side instruments can broadly be defined into four categories based primarily on the "type" of demand being influenced:

- Public demand: State procurement for own use or to catalyse private market, e.g. Strategic procurement
- Support for private demand, e.g. Demand subsidies (direct), Information campaigns (indirect)
- Regulation of demand or of the producer, e.g. Regulation of product performance and manufacturing
- Systemic Approaches, e.g. Integration of demand-and-supply-side logic and measures

The prevalence and effectiveness of these types of demand-side incentives, in South Africa, will also be considered as part of this evaluation.

### 11.5.2 Considering the Type Evaluation

The findings from the evaluation must inform how the broader system can be strengthened to maximise impact and value for money. This will help to strengthen the contribution of business incentives to the achievement of priorities outlined in the National Development Plan, the MTSF and the 9 Point Plan.

Considering these multiple objectives, this evaluation is a combination of a design, implementation and partial impact evaluation.

<sup>123</sup> (European Commission, 2015)

<sup>124</sup> (European Commission, 2015)

Summarised in the figure below and table overleaf are the salient feature of these three types of evaluation, as described in the National Evaluation Policy Framework (NEPF, 2011).

**Figure 35: Evaluation Types**

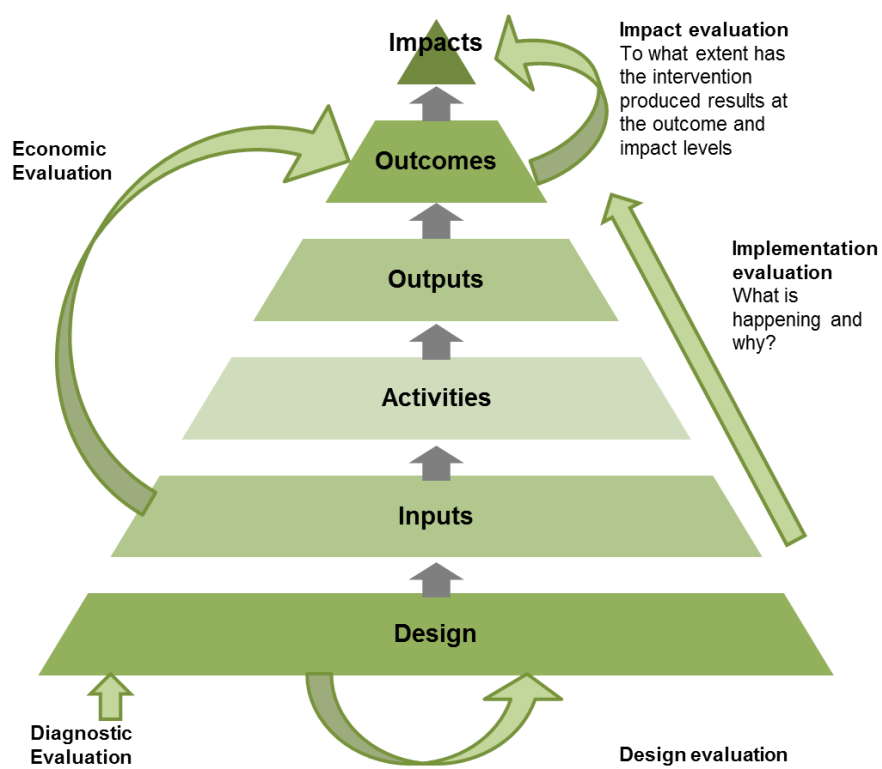


Table 22: Evaluation Approach - Components

Evaluation type	Design Evaluation	Implementation Evaluation	Impact Evaluation
<b>Definition</b>	<ul style="list-style-type: none"> <li>Analysing the theory of change, inner logic and consistency of a programme, either before a programme starts, or during implementation to see whether the theory of change appears to be working.</li> <li>It also assesses the quality of the indicators and the assumptions.</li> <li>Design evaluation can happen as a stand-alone evaluation before the programme has been implemented, to refine the design prior to implementation. It will also be undertaken as part of significant implementation evaluations, where the design of the intervention will be reviewed.</li> </ul>	<ul style="list-style-type: none"> <li>An assessment of programme delivery, strategies, procedures and processes.</li> <li>An implementation evaluation can answer questions about what is happening in practice, how it is happening, and why it is happening.</li> <li>Implementation evaluation can happen any time after the programme has been implemented, as a stand-alone evaluation, as part of a series of evaluations, or as one component of an impact or economic evaluation.</li> </ul>	<ul style="list-style-type: none"> <li>Impact evaluation establishes whether the intervention had a welfare effect on individuals, households, and communities, and whether this effect can be attributed to the concerned intervention.</li> </ul>
<b>Main purpose</b>	<ul style="list-style-type: none"> <li>The purpose of a design evaluation is to ensure that the design of an intervention is robust before it is implemented.</li> <li>The design evaluation focuses on the key design elements (relevance, theory of change etc.), to see whether they are present, and if present whether they are well defined and likely to result in an intervention which works.</li> <li>Other questions that can be asked are the adequacy of human resources and administrative capacity for management of the programme.</li> <li>The design evaluation also ensures that the key indicators and sources of evidence are available for subsequent monitoring and evaluation activities, and that the</li> </ul>	<ul style="list-style-type: none"> <li>The purpose of an implementation evaluation is to understand how a policy, plan or programme is working, and how it can be strengthened.</li> <li>An implementation evaluation typically focuses on the activities undertaken, how these are likely to contribute to the outputs, whether the assumptions and the theory of change seems to be working in practice, and may well suggest whether it is likely that the planned outcomes will be achieved.</li> <li>Implementation evaluations will often infer the effectiveness of a policy (Does the policy seem to be working?), infer the efficiency of resources (value for money) and adaptability – suggesting when and</li> </ul>	<ul style="list-style-type: none"> <li>Impact evaluation as an approach that measures changes in outcomes, and the well-being of target beneficiaries, that are attributable to a specific intervention.</li> <li>Impact evaluations assess the causal links between an intervention and identified changes, usually comparing with a counterfactual (what would have happened if the intervention had not happened).</li> </ul>

Evaluation type	Design Evaluation	Implementation Evaluation	Impact Evaluation
	<p>system is adequate to provide the data needed to assess the programme's results and impacts. This prepares the basis for reliable monitoring and evaluation throughout the programming period.</p>	<p>how to modify the policy/programme. Impact evaluations can be much stronger on effectiveness as they measure results and attribution at outcome and impact levels.</p>	
<p><b>Typical question</b></p>	<ul style="list-style-type: none"> <li>Is there a thorough diagnostic analysis of the status quo</li> <li>Have different options been properly considered?</li> <li>Is there a strong theory of change?</li> <li>Is the target group clearly identified and how they can be defined?</li> <li>Is there a good logframe?</li> <li>Is implementation properly planned?</li> <li>Summary: Will it work?</li> </ul>	<ul style="list-style-type: none"> <li>The overall evaluation question that an implementation evaluation addresses is "What happens during implementation of the programme?" Sub-questions might include: "What does the programme consist of? What are the key characteristics? Who are the programme participants? What do staff members do? How are the different components of the programme internalised and incorporated into existing organisational systems? How do the service users/end-users experience the programme? Does the theory of change appear to be working and is it likely that the outcomes will be achieved? What needs to be done to</li> <li>Key evaluation elements include:</li> <li>Documenting how implementation is happening in practice;</li> <li>Comparing actual implementation to planned implementation, assessing quality of institutions, state of formal and informal networks that make programme run etc.;</li> <li>Making recommendations for improving implementation (which may be about different processes, changes to design etc.);</li> <li>Anticipating likely achievement of the outcomes, unpacking how the theory of</li> </ul>	<ul style="list-style-type: none"> <li>What was the overall impact of the intervention?</li> <li>Did the intervention (programme, project or policy) work? Did the intervention produce the intended impacts in the short, medium and long term?</li> <li>Was the impact attributable to the policy/programme under review?</li> <li>For whom, in what ways and in what circumstances did the intervention work?</li> <li>How much did the intended beneficiaries benefit and to what extent did the impacts meet their needs?</li> <li>What unintended impacts (positive and negative) did the intervention produce?</li> <li>Much broader - is this the best intervention to achieve the desired outcome?</li> <li>What is the nature of the impacts and their distribution?</li> <li>Are impacts likely to be sustainable and durable?</li> <li>Did these impacts reach all intended beneficiaries? If not, why not?</li> <li>What other factors have influenced the intervention to achieve impact?</li> </ul>

Evaluation type	Design Evaluation	Implementation Evaluation	Impact Evaluation
		<p>change is working in practice (and in some cases it may be combined with an impact evaluation which would confirm the achievement of outcomes or impacts);</p> <ul style="list-style-type: none"> <li>Considering whether a programme can be replicated.</li> </ul>	<ul style="list-style-type: none"> <li>How did the intervention work in conjunction with other interventions, programmes or services to achieve outcomes?</li> <li>What helped or hindered the intervention to achieve these impacts?</li> <li>How did the intervention work to achieve (or not to achieve) impact?</li> <li>How did the intervention contribute to the intended impacts?</li> <li>What were the particular features of the intervention that made a difference?</li> <li>What variations were there in implementation?</li> <li>What has been the quality of implementation in different sites?</li> <li>To what extent are differences in impact explained by variations in implementation?</li> <li>Much broader - what is the best way to implement a given policy?</li> </ul>

Sources: DPME (2014), *Guideline 2.2.11 Design Evaluation* *Guideline 2.2.12 Implementation Evaluation*; *Guideline 2.2.13 Impact Evaluation*.

### 11.5.3 A Systems Perspective

This evaluation has specifically been requested to adopt a systems perspective. The Cornell Office for Research on Evaluation (CORE) at Cornell University and the Research on Evaluation and Developmental Systems Science Lab (REDSS) note the following key points in respect of a systems evaluation perspective:<sup>125</sup>

- An organization is a system, and is composed of a collection of parts. Systems involve parts, wholes, and their interrelationships.
- Any program necessarily occurs within a complex environment composed of “nested systems”. “Nested systems” refers to the structure where a system is embedded within another system, which is embedded within yet another system.
- Human systems are dynamic. A dynamic system is necessarily composed of evolving relationships and programs. Consequently, evaluation needs to be dynamic and should change in order to successfully link with the needs and maturity of the program being evaluated
- Programs have lifecycles, and move through various phases. Different evaluation approaches are appropriate for different program phases. In other words, like programs, evaluations should evolve.
- Many organizations have multiple programs and many programs are implemented in multiple organizations. Nested and dynamic systems create an environment where there are multiple perspectives. Each stakeholder has their own perspective. Each stakeholder of a program has specific expertise, and brings a distinct perspective and motivation for evaluation.

In respect of this evaluation the Systems approach requires that consideration be given to where each incentive fits into the lifecycle of the incentive programme (in other words their maturity); as well as the institutional arrangements that exist to manage individual incentives and the overlaps between them. These inter-relationships need to be considered in determining the types of questions that need to be asked of each incentive programme and the system as a whole.

### Logical framework and Indicator Table

The logical framework lists all of the outputs that were to be delivered through the implementation of the strategy as well as their intended results (outcomes and impacts).

A fundamental component of this logical framework is the inclusion of a long-list of performance indicators which could be used to measure and monitor the success of the strategy.

<sup>125</sup> The Guide to System's Evaluation Protocols: Phase 1 Planning. Montclair State University 2016.



An important first-step in this evaluation will be to assess whether these indicators exist; and for this reason, the next phase of the project will also serve to verify the existence and usefulness of all of these indicators.

*N.B. Whereas this evaluation will focus on the collection and analysis of data related to the outputs and direct (immediate outcomes) of the incentives system in South Africa, it will also be useful to show how South Africa has performed against the longer-term and impact levels of the log-frames. These higher level indicators will not form part of the evaluation itself, but will provide some context and serve to test some of the growth and development assumptions that underlie the theory of change. Moreover, in most cases, it is not certain what data is collected by implementers of incentives in South Africa; an important and early step in this evaluation will be to assess the depth, quality and consistency of this data across all national departments and agencies.*

Table 23: Draft logical framework and indicator table – the South African System of Business Incentives

	Summary	Indicator(s)	Currently measured	Source of data	Frequency and Means of verification	Assumptions
IMPACT	Eliminate income poverty and reduce inequality	Poverty headcount ratio	Yes	In line with the NDP poverty line		
		Gini co-efficient May need to add HDI Gender Empowerment Measure (GEM) Gender Development Index	Yes	The World Bank		
LONG-TERM OUTCOMES	Sustained economic growth	Average annual GDP growth	Yes	South African Reserve Bank		<i>Effective delivery of education, health, transportation etc. occurs</i>
	Sustained economic inclusion	Aggregate measures of BBBEE	?	DTI		
	Sustained employment creation	Unemployment rate	Yes	Statistics South Africa		
INTERMEDIATE OUTCOMES	Improved firm and economic productivity	National and sector productivity rates (actual output)	?	SARB, StatsSA, Productivity SA, UNIDO		<i>Increased firm-level investment results in a <b>net</b> improvement in economic productivity, production, employment and overall economic inclusion</i>
		Relative productivity / competitiveness	?	Institute for Management Development (IMD) World Competitiveness Yearbook		
	Increased economic participation	Aggregate measures of skills and supplier development (disaggregated by age, gender, race etc)	?	DTI, DoL		

	Summary	Indicator(s)	Currently measured	Source of data	Frequency and Means of verification	Assumptions
		Number of black (PDI) owned firms				
	Increased employment	Annual number of jobs created (nationally and in targeted sectors) Disaggregated by age, gender, race etc	Yes	StatsSA		
IMMEDIATE OUTCOMES	Firm investment in capital	Net increase in fixed investment by supported firms (foreign and local)	?	DTI, DST, NT etc.		<i>Incentive programmes change firm behaviour to invest in <b>additional</b> Capital, Labour, Inclusion or R&amp;D</i>
		Net increase in foreign investment by supported firms	?	DTI, DST, NT etc.		
	New enterprises established	The total number of new firms supported and established (nationally and by targeted sectors)	?	DTI, DST, NT etc.		
		The aggregate size of new firms supported and established	?	DTI, DST, NT etc.		
		The total employment of new firms supported and established (disaggregated by age, gender, race etc)	?	DTI, DST, NT etc.		
		The total investment by new firms supported and established	?	DTI, DST, NT etc.		
	Firm investment in labour	Net increase in employment by supported firms (disaggregated by age, gender, race etc)	?	DTI, DST, NT etc.		
		Additional spending on skills development by supported firms (disaggregated by age, gender, race etc)	?	DTI, DST, NT etc.		

	Summary	Indicator(s)	Currently measured	Source of data	Frequency and Means of verification	Assumptions
		Net number of jobs saved at supported firms (disaggregated by age, gender, race etc)	?	DTI, DST, NT etc.		
	Firm-level Transformation	% PDI and gender ownership of firms supported	?	DTI, DST, NT etc.		
		Number of PDI and women-owned firms supported (and as % of the total)	?	DTI, DST, NT etc.		
		BBBEE level of firms supported Including supplier development focus	?	DTI, DST, NT etc.		
		Net increase in PDI/women employment by supported firms	?	DTI, DST, NT etc.		
		Additional spending on PDI/women skills development by supported firm	?	DTI, DST, NT etc.		
		Net number of PDI/women jobs saved at supported firms	?	DTI, DST, NT etc.		
		Number of PDI and women-owned firms supported and integrated into firm or government supply chains	?	DTI, DST, NT etc.		
		Net increase in sales by supported firms into firm or government supply chains	?	DTI, DST, NT etc.		
	Firm investment in research and development	BBBEE level of firms supported Including supplier development focus	?	DTI, DST, NT etc.		
		Net increase in marketing expenditure by supported firms	?	DTI, DST, NT etc.		
OUTPUTS	Indirect (tax) incentives	Number of firms receiving tax benefits (and by targeted sectors)	?	DTI, DST, NT, SARS etc.		<i>Effective Inter-Governmental Coordination and Planning and sufficient funding available</i>
		Total value of tax benefits received (and by targeted sectors)	?	DTI, DST, NT, SARS etc.		
		Average value of tax benefits received (and by targeted sectors)	?	DTI, DST, NT, SARS etc.		
	Direct (financial) incentives	Number of firms receiving financial benefits (and by targeted sectors)	?	DTI, DST, NT etc.		
		Total value of financial benefits received (and by targeted sectors)	?	DTI, DST, NT etc.		

	Summary	Indicator(s)	Currently measured	Source of data	Frequency and Means of verification	Assumptions
		Average value of financial benefits received (and by targeted sectors)	?	DTI, DST, NT etc.		
	Other incentives	Number of firms benefiting from other incentives (and by targeted sectors)	?	DTI, DST, NT etc.		
		Total value other benefits received (and by targeted sectors)	?	DTI, DST, NT etc.		
		Average value of other benefits received (and by targeted sectors)	?	DTI, DST, NT etc.		

## Evaluation Matrix

All evaluations are guided by a set of evaluation questions that provide guidance to evaluators on how to assess, validate and test the theory of change. The evaluation matrix is a structured approach that allows evaluators to elucidate the main evaluation questions, identify the reasoned assessment criteria, the sources of data and the methods of analysis. The table also relates the evaluation questions that have been developed by the evaluation team to the evaluation questions that were specified in the project terms of reference ('ToR EQ').

### 11.5.4 Evaluation criteria

Evaluation criteria are objective principles or yardsticks against which government programmes should be measured. When done well, evaluations can yield significant amounts of data and information. Evaluation criteria are used to organise the analysis and findings to provide useful information to government on the extent to which the intervention was relevant, appropriate, efficient, effective and achieved sustainable results. These evaluation criteria can be found in the National Evaluation Policy Framework (2011) and set the overall analytical framework for all evaluations conducted in South Africa.

These analytical frameworks however need to be customised to each evaluation. In this context it is important to note that the primary unit of analysis are individual business incentive programmes. However the questions also need to cover an assessment of the system of incentives as whole (as outlined above).

In the context of the evaluation of Business Incentives, these criteria refer to the following:

- **Relevance** examines the extent to which the Incentive was the right response to an identified set of problems.
- **Coherence** evaluates whether the various aspects of the Incentive work together and with other interventions (especially other Incentives)
- **Efficiency** measures whether Incentives and results were delivered in an optimal and cost-effective manner.
- **Effectiveness** assesses the extent to which the Incentive achieved its intended objectives and whether it was implemented fully and as planned.
- **Sustainability** establishes whether the capacity and programmes developed and the results achieved by the Incentive are likely to be sustainable.

Moreover, throughout the evaluation, the team will consider whether the outcomes that are observed, including any changes firm-level responses, would have taken place without the incentives. In other words, has the incentive contributed directly or indirect to any additional benefits over and above what would likely have occurred without it? The principle of '**additionality**' is therefore indicated as a secondary evaluation criteria across many of the questions presented in the matrix below.

**Table 24: Evaluation matrix – Overall System**

No	Secondary evaluation questions	ToR EQ	Evaluation Criteria	Sources of data	Analytical methods
<b>EQ0</b>	<b>Overarching system level questions</b>				
S.0.1	What are the business incentives that are currently offered by the South African Government (inventory of incentives)?	1	Relevance		Document review / content analysis; Key informant interviews (KIIs)
S.0.2	Why are government business incentives important and how? (brief background to government business incentives)	2	Relevance		Document review / content analysis; Key informant interviews (KIIs)
S.0.3	Is the incentive package achieving the broader objectives and are they aligned with overarching frameworks and plans?	3	Relevance Coherence		Document review / content analysis; Key informant interviews (KIIs)
S.0.4	Do they appear to be effective and efficient in relation to the National Development Plan (NDP) and National Industrial Policy Framework?	4	Relevance Coherence Effectiveness		Document review / content analysis; Key informant interviews (KIIs)
S.0.5	Do these incentive programs complement each other in relation to the frameworks/plans and what are the gaps?	5	Coherence Effectiveness		Document review / content analysis; Key informant interviews (KIIs)
S.0.6	Are the incentive instruments helping to align private sector and government objectives?	6	Relevance Coherence Effectiveness		Document review / content analysis; Key informant interviews (KIIs)
S.0.7	What is the overall Theory of Change (or theories of change) for government business incentives and is it (are they) working as planned? (the TOC should provide a	7	Coherence Effectiveness		Document review / content analysis; Key informant interviews (KIIs)

No	Secondary evaluation questions	ToR EQ	Evaluation Criteria	Sources of data	Analytical methods
	detailed explanation how the schemes were conceptualised and how they are working in practice)				
S.0.8	How does South Africa compare with other countries on business incentives?	8	Effectiveness Efficiency		Document review / content analysis; Key informant interviews (KIIs)
S.0.9	How can the system of business incentives be strengthened and achieve greater value for money to enhance more inclusive economic growth in the country?	9	Effectiveness Efficiency		Document review / content analysis; Key informant interviews (KIIs)
S.0.10	How do we strike a balance between strategic use of demand side instruments and fiscal support?	10	Relevance Effectiveness Sustainability		Document review / content analysis; Key informant interviews (KIIs)
S.0.11	What incentive instruments work best be it direct fiscal transfers, tax instruments, and concessional finance or demand side instruments?	11	Relevance Effectiveness Sustainability		Document review / content analysis; Key informant interviews (KIIs)
S.0.12	Does South Africa realise a return on investment from these business incentives against the cost of delivering them?	12	Efficiency Effectiveness Sustainability Additionality		Document review / content analysis; Key informant interviews (KIIs)



**Table 25: Evaluation matrix – individual incentives**

No	Secondary evaluation questions		Evaluation Criteria	Sources of data	Analytical methods
<b>EQ1</b>	<b>To what extent is the incentive an appropriate response to the underlying problems?</b>				
S.1.1	What is the problem analysis?		Relevance		Document review / content analysis
S.1.2	Do the objectives of the incentive correspond to the problems identified in the problem analysis?		Relevance		Document review / content analysis
S.1.3	Has the problem analysis changed over time and do the current objectives correspond to the updated problem analysis?		Relevance		Document review / content analysis; Key informant interviews (KIIs)
S.1.4	Has there been a need to reformulate the objectives of the Incentive?		Relevance		Document review / content analysis; Key informant interviews (KIIs)
<b>EQ2</b>	<b>How well do the various aspects of the incentive work together and with other interventions?</b>				
S.2.1	Is the incentive strategy internally consistent? Are there any critical gaps?		Coherence		Data triangulation Document review / content analysis
S.2.1.1	To what extent are the elements of the strategy logic [theory of change] complementary, mutually supportive and non-contradictory?		Coherence		Document review / content analysis
S.2.1.2	Are the activities and outputs of the incentive consistent with the overall National Development Plan, 9 Point Plan and National Industrial Policy Framework?		Coherence		Document review / content analysis
S.2.2	Is the incentive externally consistent? Are there any critical gaps or contradictions?		Coherence		Data triangulation Document review / content analysis; Key informant interviews (KIIs)

No	Secondary evaluation questions		Evaluation Criteria	Sources of data	Analytical methods
S.2.2.1	To what extent was the incentive underlying theory of change consistent with the policy statements of its key stakeholders when it was designed?		Coherence		Document review / content analysis; Key informant interviews (KIIs)
S.2.2.2	Is the Incentive consistent in its application through different organs of state (if applicable)?		Coherence		Document review / content analysis; Key informant interviews (KIIs)
S.2.2.3	Are there potential overlaps between the Incentive and other Incentives?		Coherence		Document review / content analysis
S.2.2.4	Do the objectives and activities of the Incentive (or specific measures) support or contradict those of other incentives?		Coherence		Document review / content analysis
S.2.2.5	What sort of impact have other existing policies (supportive and contradictory) had on the incentive?		Coherence		Document review / content analysis; Key informant interviews (KIIs)
<b>EQ3</b>	<b>To what extent has the Incentive been effective?</b>				
S.3.1	Has the incentive been implemented as planned? If not, why not?		Effectiveness		Data triangulation
S.3.1.1.	What of the Incentive has actually been implemented?		Effectiveness		Document review; Key informant interviews (KIIs)
S.3.1.2	What element of the incentive (if any) have not, or have only to a minor extent, been implemented?		Effectiveness		Document review; Key informant interviews (KIIs)
S.3.1.3	Why have certain aspects of the Incentive not yet been implemented?		Effectiveness		Document review; Key informant interviews (KIIs)
S.3.1.4	What were the challenges experienced during the implementation of the Incentive, and how could these be overcome?		Effectiveness		Document review; Key informant interviews (KIIs)

No	Secondary evaluation questions		Evaluation Criteria	Sources of data	Analytical methods
S.3.1.5	What are the measurable results at the output level to date?		Effectiveness, Additionality		Document review; Key informant interviews (KIIs)
S.3.1.6	Did the underlying assumptions relating to the conversion of activities into outputs hold?		Effectiveness, Additionality		Document review; Key informant interviews (KIIs)
S.3.1.7	If these assumptions did not hold, what were the implications for the strategy's ability to convert activities into outputs?		Effectiveness, Additionality		Document review; Key informant interviews (KIIs)
S.3.2	What has been the capability of the incentive to deliver the envisioned intermediate outcomes?		Effectiveness		Data triangulation
S.3.2.1	Is there evidence of firm-level response, e.g. increased investment in capital, labour, transformation or R&D?		Effectiveness		Document review; Key informant interviews (KIIs); Quantitative analysis
S.3.2.2	To what extent did external economic and political developments contribute to these outcomes (or the absence thereof)?		Effectiveness		Document review; Key informant interviews (KIIs)
S.3.2.3	To what extent did the Incentive contribute to the emergence of the aforementioned outcomes?		Effectiveness, Additionality		Document review; Key informant interviews (KIIs)
S.3.2.4	Did the underlying assumptions relating to the conversion of outputs into intermediate outcomes hold?		Effectiveness, Additionality		Document review; Key informant interviews (KIIs)
S.3.2.5	If these assumptions did not hold, what were the implications for the strategy's ability to convert outputs into intermediate outcomes?		Effectiveness, Additionality		Document review; Key informant interviews (KIIs)
S.3.3	Have the envisioned long-term outcomes of the Incentive been achieved or likely to be achieved?		Effectiveness		Data triangulation
S.3.3.1	Is there evidence of a firm investment in capital, new enterprise establishment, firm investment in labour, firm-level transformation or firm investment in research and development?		Effectiveness		Document review; Quantitative analysis

No	Secondary evaluation questions		Evaluation Criteria	Sources of data	Analytical methods
S.3.3.2	If so, to what extent could this be attributed to the Incentive?		Effectiveness, Additionality		Document review; Key informant interviews (KIIs); Data triangulation
S.3.3.3	If not, what are the reasons for this envisioned failure, and how could they be overcome?		Effectiveness		Document review; Key informant interviews (KIIs)
S.3.3.4	Did the underlying assumptions relating to the conversion of intermediate outcomes into long-term outcomes hold?		Effectiveness, Additionality		Document review; Key informant interviews (KIIs)
S. 3.3.5	If these assumptions were not valid, what have the implications been for the long-term outcomes of the Incentive?		Effectiveness		Document review; Key informant interviews (KIIs)
S.3.3.6	Have any unexpected long-term outcomes (both positive and negative) occurred?		Effectiveness, Additionality		Document review; Key informant interviews (KIIs)
S.3.4	To what extent do the institutional arrangements support the performance of the incentive, with specific reference to coordination, administration and management arrangements?		Effectiveness		Data triangulation
S.3.4.1	To what extent is the intergovernmental relation functional in respect of incentives?		Effectiveness		Document review; Key informant interviews (KIIs)
<b>EQ5</b>	<b>Have the resources of the Incentive been converted into results in an optimal manner?</b>				
S5.1	How was the budget for the Incentive allocated to specific programmes / interventions?		Efficiency		Budget and expenditure analysis
S5.2	Was this allocation of budget appropriate and sufficient?		Efficiency		Budget and expenditure analysis; Data triangulation
S5.3	How cost effective are the Incentive components?		Efficiency		Budget and expenditure analysis

No	Secondary evaluation questions		Evaluation Criteria	Sources of data	Analytical methods
S5.4	How economically have the resources used been converted into direct outputs and into effects, respectively? Could this be improved (and how)?		Efficiency		Budget and expenditure analysis; Key informant interviews (KIIs)
S.5.5	Do, in general, the prerequisites for the efficient implementation of the Incentive exist, or are there any assumptions underlying the theory of change that require attention/ action?		Efficiency		Document review; Key informant interviews (KIIs)
S5.6	What system is used to monitor and evaluate the various aspects of the Incentive and has it been effective in this regard?		Efficiency		Document review; Key informant interviews (KIIs)
<b>EQ6</b>	<b>What is the likelihood that the Incentive will obtain sustainable, long-term benefits?</b>				
S.6.1	Are the outcomes that the Incentive has achieved to date likely to be sustainable going forward?		Sustainability		Document review; Key informant interviews (KIIs)
S.6.2	To what extent is the design of the institutions supporting the Incentive appropriate to ensuring its sustainability?		Sustainability		Document review; Key informant interviews (KIIs)
S.6.3	Does the incentive seem appropriate and sustainable based on external policy, economic, and political trends?		Sustainability		Document review; Key informant interviews (KIIs)
<b>EQ7</b>	<b>What are the conclusions and recommendations of the evaluation?</b>				
S.7.1	Overall, what have been the main strengths and weaknesses of the Incentive, and what are the reasons for these?				Analysis of findings with respect to the evaluation criteria
S.7.2	What are the main lessons that have been learnt with respect to the Incentive?				
S.7.3	What are the successes of the Incentive that should be replicated nationally?				

No	Secondary evaluation questions		Evaluation Criteria	Sources of data	Analytical methods
S.7.4	What should government do differently or better in the future to address similar challenges?				
S.7.5	What can South Africa learn from the experiences of other countries?				
S.7.5	How do the ToC and logframe/results framework need to be revised based on the findings of the evaluation?				
S.7.6	What specific recommendations are offered to improve the incentives performance with a view on the future direction(s) of the Incentive?				

## Annexure 3: Evaluation Instruments

### Government

#### A 1.1 Introduction

A brief description of the incentive. Based on desktop review but validated in consultation with incentive manager/administrator.

#### A 1.2 Background

- When it was implemented, by whom, and for who

#### A 1.3 Purpose and objectives

- The stated purpose and objectives of the incentive

#### A 1.4 Instruments and criteria

- The main instruments / sub-programmes
- The main design features / qualification criteria

#### A 1.5 The design of the incentive

*Questions in this section should only be directed at policy officials that were involved in the conceptualisation, design and approval of the incentive.*

#### A 1.6 Policy context and alignment

A brief explanation of why the incentive was created/provided.

Questions	Respondent
Who requested the establishment of this incentive? Industry? Principals?	
To what extent does this policy respond to a specific government policy or programme? And to which specific action in this policy or programme does the incentive contribute?	
What other external (e.g. economic) or internal (e.g. policy) factors influenced the decision to develop this incentive?	

Table to demonstrate alignment between the specific objectives/criteria of the incentive and any specific actions described in key Government economic strategies/plans. Based on desktop review.

**Table 26: Alignment with government economic policy**

Incentive objectives	NDP	9 point plan	IPAP

## A 1.7 Policy problem and statement

A brief explanation of why the incentive was created/provided.

Questions	Respondent
What specific business, policy or economic challenges was this incentive designed to respond to?	
What is the main/underlying cause of this particular challenge (market failure)?	
Why was government intervention needed to address this particular challenge?	
How does the incentive address the specific challenges that have been identified?	
What would have happened if government did not provide this incentive?	

## A 1.8 The diagnostic and design process

A brief explanation of how the incentive was created.

Questions	Respondent
What research and analysis was done in the design of the incentive (CBA, RIA, etc.)	
What alternative options were considered and analysed?	
Why was this specific approach and instrument preferred?	
What specific criteria (and conditions) were considered, included and why?	
Have these criteria and conditions changed over the course of the incentive? And if so, why?	
Does this incentive target any specific, vulnerable groups (woman, youth, PDIs)? And how?	
Who was consulted in the design of the incentive? Other departments? Industry?	
How was the initial budget for the incentive determined?	
If you could redesign the incentive, now, what would you do differently?	
How was monitoring and evaluation considered and incorporated in the design of the incentive?	



## A 1.9 The implementation of the incentive

*Questions in this section should only be directed at officials that are involved in management and administration of the incentive.*

### A 1.10 Implementation process

A brief description of how the incentive was implemented and how it works in practice.

Questions	Respondent
Was the incentive implemented as planned/designed? If not, what changes had to be made?	
Where is the incentive located in the organisation? How does it interact with other organisation functions and divisions?	
Was the incentive piloted or tested in any way prior to full implementation?	
What promotional or marketing activities have taken place?	
Did you experience any other particular challenges in the implementation of the incentive programme?	
Are there any best-practices emerging from the implementation of this incentive that can be replicated elsewhere?	

### A 1.11 Administration and systems

A brief description of the staff and systems that are in place.

Questions	Respondent
How many staff are in place to manage the incentive, by function? Is this sufficient?	
What specific systems have been put in place to facilitate the implementation (applications and claims) of this incentive?	
When do beneficiaries apply for the incentive (i.e. prior or after undertaking investment)?	
How do beneficiaries apply for the incentive; and how well does this process work?	
How are applications decided/approved and by who?	
Which criteria are particularly important/useful in the approval of the incentive? And which are difficult or superfluous?	
How much discretion is there in the approval process? And has this changed over time?	
What determines the success/failure of specific applications?	
How are beneficiaries informed? And what feedback do they receive?	
How are claims processed and paid; and how well does this process work?	
What specific documentation/forms must be completed? What other information must applicants provide at each stage in the process?	
Do beneficiaries make use of any other business incentives? Are there any	

linkages/dependencies between these incentives?	
Did you experience any particular challenges in the administration of the incentive programme?	
Are there any best-practices emerging from the administration of this incentive that can be replicated elsewhere?	

## A 1.12 Access and transparency

What documents and other information is made public and in what way.

Questions	Respondent
How do beneficiaries learn about the incentive? Directly? Intermediaries	
How do beneficiaries access the incentive? Directly? Intermediaries?	
Are all guidelines and criteria made available to the public? And how?	
Is the award of incentive made public? And how?	
Is the performance / evaluation of the incentive made public? And how?	

## A 1.13 Performance

Collect as much data as possible on the performance of the incentive.

Questions	Respondent
What is the annual budget for the incentive? If possible, separated between overhead costs and disbursements.	
How much is approved for expenditure each year?	
How much is spent each year?	
How many applicants are received per year?	
How many of these applicants are approved?	
Do applicants generally receive what has been requested? If not, why?	
How many of these applicants proceed with the incentive/claim from the incentive?	
Why do applicants not claim the incentive?	
What is the average time taken to process applications (from submission to approval)?	
What is the average time taken to receive payment (from claim to payment)?	

## A 1.14 Incentive monitoring, evaluation and results

*Questions in this section should only be directed at officials that are involved in the monitoring, evaluation and reporting of the incentive.*

## A 1.15 M&E process and system

Describe the M&E processes, systems and data that is place.

Questions	Respondent
Does a formal M&E plan, such as a ToC, logframe or any other monitoring mechanism, exist?	
Were any monitoring indicators defined during the design phase?	
What baseline (industry or firm level) information was collected during the design phase?	
How is M&E currently performed, how often, and by who?	
What specific data is collected and analysed, and how? How is it used and reported?	
How do you monitor compliance? And what is done if a firm is not compliant?	
For how long do you track beneficiaries after the claim is paid?	
What evaluations have been conducted, when and by who? What are planned?	
What were the main findings from these evaluations?	
How do the results from evaluations feed into reforms or policy change?	

## A 1.16 Achievements and results

Described what can be deduced from the information that is reported. And highlight reporting challenges and gaps.

Questions	Respondent
What firms have been supported by the incentive? Provide as much detail on firm 'demographics' – province, BBBEE level, size, gender, youth etc.	
What outputs have been generated by the incentive? Investment, jobs etc. Provide evidence (with regards to jobs, provide number of individuals and full-time equivalents).	
What other gains or benefits (outcomes and impacts) have been achieved? Provide evidence.	
How exactly did the incentive contribute towards the achievement of these outputs, outcomes and impacts?	
Would these outputs, outcomes and impacts have been achieved in the absence of the incentive? Provide evidence.	
How could the incentive programme have been more effective in achieving its intended outcomes?	

Are there any economic, sector or institutional factors that may have impeded the effectiveness of the incentive programme?	
Is there any additional issue or matter that you would like to raise regarding the implementation or performance of this incentive?	

**A 1.17      Return on investment**

Based on the information collected above, show the relative return on the incentive in terms of the cost to Government for every output claimed (e.g. rand per job).

**A 1.18      Observations and learnings**

Summary of results.

## Industry

### A 1.19 Introduction

A brief description of the incentive. Based on desktop review but validated in consultation with incentive manager/administrator.

### A 1.20 Background

- When it was implemented, by whom, and for who

### A 1.21 Purpose and objectives

- The stated purpose and objectives of the incentive

### A 1.22 Instruments and criteria

- The main instruments / sub-programmes
- The main design features / qualification criteria

### A 1.23 The design of the incentive

### A 1.24 Policy context and alignment

A brief explanation of why the incentive was created/provided.

### A 1.25 Policy problem and statement

A brief explanation of why the incentive was created/provided.

Questions	Industry
What are the main/underlying challenges that this particular incentive needs to address?	
Why was government intervention needed to address this particular challenge?	
How does the incentive address the specific challenges that have been identified?	

### A 1.26 The diagnostic and design process (ask these questions last)

A brief explanation of how the incentive was created.

Questions	Industry
Were you consulted in the design of the incentive?	
If you could redesign the incentive, now, what would want Government to do differently?	

### A 1.27 The implementation of the incentive

### A 1.28 Access and transparency

What documents and other information is made public and in what way.

Questions	Industry
How did you learn about the incentive? Directly? Intermediaries	

How did you access the incentive? Directly? Intermediaries?	
Are all guidelines and criteria made available to the public? And how?	
Is the award of incentive made public? And how?	

## A 1.29 Administration and systems

A brief description of the staff and systems that are in place.

Questions	Industry
When did you apply for the incentive (i.e. prior or after undertaking investment)?	
How did you apply for the incentive; and how well does this process work?	
Do you know how your application was decided/approved and by who?	
In your view, how much discretion is there in the approval process?	
In your view, why was your application successful?	
How were you informed? What feedback did you receive?	
How are claims processed and paid; and how well does this process work?	
What specific documentation/forms must be completed? What other information must be provided at each stage in the process?	
Do you make use of any other business incentives? List all.	
Did you experience any other particular challenges in the administration of the incentive programme?	
Are there any best-practices emerging from the administration of this incentive that can be replicated elsewhere?	

## A 1.30 Performance

Collect as much data as possible on the performance of the incentive.

Questions	Industry
Did you receive what you applied for? If not, why?	
Did you proceed with the incentive/claim post-approval? If not, why?	
Approximately how long did the application process take (from submission to approval)?	
Approximately how long did the payment process take (from claim to payment)?	
How much does it cost to apply for this incentive? Direct (intermediary fees) or indirect (time).	

### A 1.31 Incentive monitoring, evaluation and results

#### A 1.32 M&E process and system

Describe the M&E processes, systems and data that is place.

Questions	Industry
Were you subjected to any monitoring or evaluation studies? If so, what information were you requested to provide?	
Were you subjected to any compliance investigations? If so, what were the findings and implications?	
Are you required to report on performance, how often, and for how long must you do so?	

#### A 1.33 Achievements and results

Described what can be deduced from the information that is reported. And highlight reporting challenges and gaps.

Questions	Industry
Why did you apply for this specific incentive?	
What was the incentive used for? Why would this not have taken place in the absence of the incentive?	
What outputs have been generated by the incentive? Investment, jobs etc. Provide evidence.	
What other gains or benefits (outcomes and impacts) have been achieved? Provide evidence.	
How exactly did the incentive contribute towards the achievement of these outputs, outcomes and impacts?	
Would these outputs, outcomes and impacts have been achieved in the absence of the incentive? Provide evidence.	
How could the incentive programme have been more effective in achieving its intended outcomes?	
Are there any economic, sector or institutional factors that may have impeded the effectiveness of the incentive programme?	

#### A 1.34 Return on investment

Based on the information collected above, show the relative return on the incentive in terms of the cost to Government for every output claimed (e.g. rand per job).

#### A 1.35 Observations and learnings

Summary of results.

## Annexure 4: Case studies – objectives, instrument and criteria

Incentive	Objectives	Instruments and criteria
<b>The Manufacturing Competitiveness Enhancement Programme (MCEP)</b>	The MCEP was implemented in 2012/13 “to promote competitiveness in manufacturing while ensuring job retention in the sector”, and to maximise manufacturing value addition in the short term (Industrial Development Corporation, 2017).	The MCEP initially had a total budget of R5.75 billion (later increased to R6.9 billion) and encompassed two main components: an industrial financing loan facility administered by the IDC and production incentive grants administered by DTI. The applicants of the MCEP had specific criteria to fulfil and also had to provide all the relevant documents pertaining to the functioning and daily business operations.
<b>The Automotive Investment Scheme (AIS)</b>	The AIS was introduced by the DTI in 2010 to strengthen and diversify the automotive industry through the investment in new and/or old replacement models and components, increase plant production volumes and to sustain employment and/or level the automotive value chain.	The AIS provides for a basic grant of 20% of the value of the qualifying investment in productive assets by automotive manufactures; and 25% for component and tooling companies. To be eligible for the AIS, existing original equipment manufacturers (OEM) should produce 50 000 units per plant per annum, and new enterprises should demonstrate the ability to produce at least 50 000 units per plant within the three years.
<b>The Cooperative Incentive Scheme (CIS)</b>	The CIS was implemented in 2004/5 by the DTI to improve the viability and competitiveness of co-operatives, by supporting new investment in systems, facilities and machinery, and through the provision of business development services. This is done by specifically targeting black-owned cooperatives (coops). The programme also contributes towards the achievement of the Broad-Based Black Economic Empowerment (BBBEE).	The CIS is currently offered as a 100% cash grant to primary coops. The Coops can apply to receive a maximum of R350 000 cash grant. To be eligible for CIS grant coops need to be incorporated and registered, majority black ownership, be economically active, rendering services and/or selling goods and adhere to coop principles.
<b>The SEDA Technology Transfer Fund (TTF)</b>	The TTF was implemented as means of funding the acquiring appropriate technology by SMMEs. The fund aims to promote and support the transfer of appropriate technology to SMME's that are likely to have a high impact on economic growth and job creation.	The TTF fund approves and disburses a maximum amount of R600 000 (including VAT) to small enterprises and existing businesses. The applicants of the TTF grant have specific criteria to follow depending on whether the grant is internally or externally funded.
<b>The Animal Veld Management Programme (AVMP)</b>	The AVMP was implemented by the Department of Rural Development and Land Reform in 2013 to improve land use in communal areas. The programme also aims to regenerate the production capacity of communal areas and municipal commonages; and to enhance and enterprise development that will lead to job creation and income opportunities in the communal areas and commonages.	The AVMP provides support to farmers on communal land, including the commonage. This support is directed at the 24 poorest districts municipalities in South Africa. The AVMP does not have a dedicated budget nor does it have a specific selection criteria on the provision of support either than that the farmers are disadvantaged or farming on communally owned (state) land.



Incentive	Objectives	Instruments and criteria
<b>The Black Business Supplier Development Programme (BBSDP)</b>	The BBSDP was fully implemented in 2004 to promote Small, Medium and Micro Enterprises (SMMEs) that exhibit potential for growth into the main stream economy. This programme also aims to grow black owned enterprises; complement current affirmative procurement and outsourcing initiatives of corporate and public sector enterprises; and to enhance the capacity of grant recipient enterprises to successfully compete for corporate and public sector tenders and outsourcing opportunities.	The BBSDP offers a maximum grant of up to 1 million to qualifying businesses. The BBDSP grant requires the applicants to be a majority black owned enterprise with a predominantly black management team. It also requires the enterprise to have a turnover of R250 000 to R35 million per annum, a year of operating as a business entity and be a registered VAT vendor.
<b>The Gro-E Youth Scheme and Youth Pipeline Development Programme (YPDP)</b>	The Gro-E Youth Scheme was introduced in 2013 in order to provide targeted financial and non-financial support to youth enterprises that contribute towards the creation of jobs and Growing the South Africa's economy. The YPDP was introduced in 2015 and it aims to improve the readiness of potential applicant and thereby increase their probability of IDC consideration.	The Gro-E Youth Scheme is offered as a loan financing that ranges between R1 million to a maximum value of R50 million. However, when the Gro-E Scheme is coupled with the YPDP the assistance can extend to include grants and loans for business support and development services. The Gro-E scheme requires a minimum youth stake of more than 25% in equity and other specific criteria. Whereas the YPDP requires the applicants to be a youth owned business irrespective they qualify of the Gro-E youth Scheme or not.
<b>The Green Fund</b>	The Green Fund was initiated in 2012 and it aims to provide catalytic finance to facilitate investment in green initiatives that support job creation and poverty reduction. This fund also aims to respond to market weaknesses currently hampering South Africa to transition into a green economy by promoting and reinforcing green interventions.	The Green Fund targets investment, research and capacity building projects which are funded through capital grants, project development grants and project development loans. The eligibility criteria of fund requires applicants to be a registered legal entity or identifiable person, have the ability to participate in government procurement and be in good financial standing.
<b>The TIA Seed Fund Programme (SFP)</b>	The SFP was launched in 2013/2014 as a supply side mechanism for the South African Research Development landscape. The SFP aims to support the pathways for the commercialisation of research to encourage economic activity and job creation within the country.	The SFP programme has been organised along to sub- programmes, the HEI and SMME sub-programme, that are maximum limit of R650 000 for any grant application. The eligibility for the grant requires to meet the specific requirement for fundable activities, align with the objectives of commercial development and execute the project within the stipulated time frame.
<b>The Scientific and Technological Research and Development Tax Incentive (R&amp;D Tax Incentive)</b>	The R&D Tax incentive was implemented to encourage South African companies to invest in scientific or technological research and development. This incentive also aims to help companies build capabilities and innovation by creating new products, processes, devices and techniques, and/or significantly improving existing ones.	This incentive is available to business of all sectors of the economy undertaking R&D in South Africa and will be eligible for a 150% tax deduction of its operational R&D expenditure. For the applicants to be eligible for the deduction, the R&D activities against which the expenditure is incurred has to be approved by the Minister of Science and Technology.

Incentive	Objectives	Instruments and criteria
<b>The Tourism Incentive Programme (TIP) &amp; The International Market Access Support Programme (IMASP)</b>	The TIP programme was launched in 2015 to support the growth of small tourism establishments that will encourage job creation. This programme aims to enhance tourist experience by improving iconic tourist attractions and promoting compliance. The TIP programme also aims to drive down input cost and making tourism facilities more sustainable through energy efficient sources.	The IMASP reimburses tourism enterprises for airfares, accommodation, exhibitions and participation expenses. This grant requires enterprises to have enough cash as it covers partial cost depending on the number of times the applicant has participated in the programme. The eligibility of grant requires the enterprise to be registered and privately owned; with a turnover of less than R45 million; be tax and BBBEE compliant; and have experience with marketing local packages to the international market.
<b>The Agri-Parks Programme</b>	The Agri-parks programme was launched into 2015 with the intentions of kick-starting rural economic transformation in earmarked rural areas. This programme also aims to promote the development of skills and providing support to small holder farmers; establishing farmer-owned and controlled agro-processing value chains; and to bring under-utilised land into full production.	The locations of the Agri- Parks are chosen based on the geographical location, supporting infrastructure including roads and suitable commodities. The beneficiaries of the Agri-Parks programmes are smallholder farmers. This programme also requires famers to create a sizable farming network, to improve the viability of the proposed Agri-Park once an area has been identified and a potential Agri-Park location.
<b>Local Content Designation- Rail Rolling Stock</b>	The local designation content was implemented in 2012 to leverage public sector procurement in supporting economic growth, creating new jobs, attracting new investment and reducing South Africa's trade deficit. This incentive also aims to mitigate the cost of currency fluctuations; increase the response time to varying demand; and to enhance the consistency and quality of supply. This designation seeks to support the local manufacturing, upgrading and assembly of diesel and electric locomotives, electric multiple units, wagons, coaches, signalling equipment and tracks.	The rail rolling bidders have to meet the local content thresholds that have been set the National Treasury. The formula to be used during the bid and adjudication process is: $LC = (1 - x/y) * 100$ , where $LC$ is local content, $x$ is the imported content in ZAR and $y$ is the bid price in ZAR excluding value added tax. All bids that meet this minimum threshold are evaluated in terms of the 80/20 or 90/10 preference point system in the Preferential Procurement Regulations, 2011.
<b>The Job Fund</b>	The Jobs Fund was announced in 2009 to identify and provide solutions to overcome short-term barriers to job creation and active labour markets. This fund also aims to identify and learn from effective interventions and programmes that would contribute to job creation and a better functioning labour market.	The Job fund is offered as a grant of above R10 million and can be utilised to finance the operating or capital expenditure of partner organisations. The grants are offered to organisations on the basis of sustainability, additionality, value for money innovation and job creation. They are also required to be able to mobilise the financial resources necessary to co-fund the project.
<b>The Employment Tax Incentive (ETI)</b>	The ETI was implemented in 2014 with the primary objective of bringing youth into employment. This incentive also aims to support both formal and informal job learning, as to improve the long-term job prospects of incentives for the participants.	The ETI is an automatic tax incentive which does not require firms to formally apply. Employers who are registered for Employee's Tax (PAYE) with SARS will be able to claim the incentive provided that meet the specific criteria that has been set out by SARS.
<b>The Manufacturing Engineering and Related Services Sector</b>	The MERSETA Apprenticeship programme was implemented to ensure that employers would be encourages	The MERSETA programme approved R360 million towards apprenticeships, where employers were awarded an apprenticeship grant of R165 000 per learner

Incentive	Objectives	Instruments and criteria
<b>Education and Training Authority (MERSETA) Apprenticeship Programme</b>	to hire apprentices and provide them with opportunities to acquire the workplace based training they need to become qualified.	over the duration of the grant. For the employers to be eligible for the grant they must have a workplace readiness certification, trained artisans to oversee the apprentices, workplace skills plan (WSP) and be part of an accredited training provider.
<b>The Chemical Industries education &amp; Training Authority (CHIETA) Work Integrated Learning Grants</b>	The CHIETA work-integrated grants aims to increase access to occupationally directed programmes and offer the chemical industry employers financial incentives to provide students with workplace experience so that they can fulfil the requirements of their study programmes.	The CHIETA discretionary grants receive a vast majority of their fund from the Skills Development Levy and dedicate 49.5% towards the discretionary grants. The discretionary grants programmes require participants to be a levy-paying company that is registered with the CHIETA. The eligibility criteria also require companies to be up to date with their levy payments, submit approved WSO and annual training reports.
<b>Tax Industrial Policy Project Incentive (12I)</b>	The Industrial Policy Project Incentive is designed to promote company investment within the domestic manufacturing sector. In addition, this incentive seeks to promote general linkages; create direct employment; and promote skills development within South African borders.	This tax incentive was designed to support both Greenfield, as well as Brownfield investments for capital investments and training. The Investment allowance ranges between R350 million- R 900 million depending on the type and status of the investment. Whereas the training allowance ranges between R20 million- R30 million per project depending on the status of the project. The eligibility of the project requires greenfield projects to invest a minimum of R50 million in qualifying assets; and brownfield projects to invest R30 million in qualifying assets.
<b>The Manufacturing Incentive (12C)</b>	The manufacturing incentive for plant and machinery was enacted in 2002 to facilitate the growth of the manufacturing sector. According to the 2002 budget review, having this tax incentive will provide a broad based stimulus to investment spending in the short term. This incentive also eases the impact of the recent currency depreciation on new investment, thus protecting the competitiveness of South African firms.	This is an automatic tax incentive programme which only applies to plant or machinery used directly in the process of manufacturing or similar processes. The manufacturing incentive offers a rate of 20% per year over five years for normal depreciation; 40% first year and 20% for 3 years for accelerated depreciation; and 40:20:20 basis for new and unused plant and machinery.
<b>The Small Business Incentive (12E)</b>	The small business incentive was initially proposed by the National Treasury and enacted in 2001. This incentive was introduced as small business enterprises play an important role in economic development and employment creation.	The small business incentive provides a reduced tax rate for small business companies and allows for a full up-front write-off for manufacturing assets. The small business company regime offers a preferred rate of 0, 7%, 21 % for initial proportions of taxable income earned by the company up to R550 000. This incentive also allows companies to claim accelerated depreciation write-offs as outlined in section 12c. The eligibility of this incentive requires companies with a turnover that cannot exceed R20 million.