

BER – IN THE MEDIA | 30 SEPTEMBER 2025

SA's remarkable growth decline – and how to avoid a repeat

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Since 2013, South Africa has experienced a remarkable growth reversal. Per capita income has fallen almost every year, the country's growth potential has been reduced, productivity has fallen, and fixed investment growth, having slowed to a crawl, has lately turned negative.

The concern is that with growth stuck in low gear, the next five years will be a repeat of the 2015-2019 era when growth averaged a mere 1% - one of the slowest five-year periods in SA's history.

Understanding why the economy slowed so quickly pre-Covid, and essentially decoupled from global growth, is key to understanding how it could behave in the years ahead, and how to avoid making the same mistakes.

In a new Impumelelo Growth Lab note, "Accounting for South Africa's remarkable growth deterioration," we argue that SA's growth reversal in the decade after 2010 was caused mainly by a collapse in productivity growth, led by inefficient state-owned enterprises (SOEs).

The story about how the government ran more than R300bn over budget, and years over deadline, on the Medupi and Kusile power stations during the state-capture era (2010-2019) is well known, but what is under appreciated is how this huge investment in unproductive capital at Eskom dragged down the entire economy.

It was bad enough that the electricity sector's capital stock more than doubled over this period while the amount of electricity produced contracted, but there is a second part to the productivity slowdown story. Not only did the electricity sector's productivity collapse, but it also became a larger part of the economy as resources were increasingly diverted towards it.

Similarly, government's share of the economy also increased even as it became less productive.

By contrast, agriculture, transport, finance and manufacturing became more productive over this period, but their share of the economy fell. So, not only did key sectors become less productive during the state-capture years, but the economy pivoted out of relatively productive sectors into these unproductive sectors – the worst of both worlds.

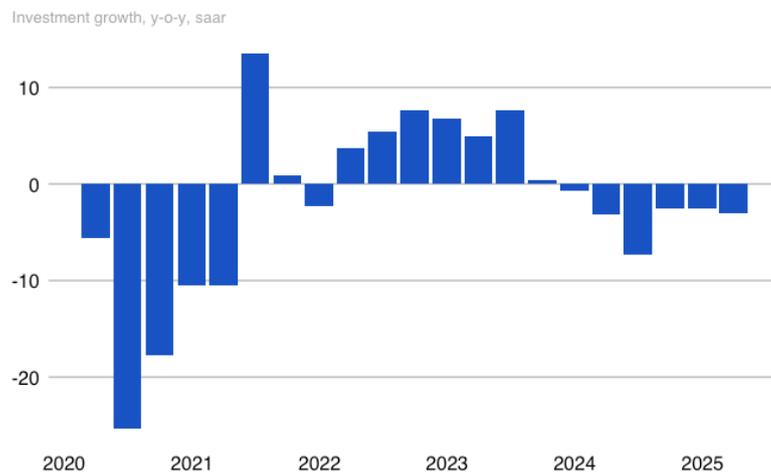
Little wonder then that SA’s *potential* GDP growth collapsed from 2015-2019 from around 2% a year to zero, according to BER estimates. In the mid-2000s, SA’s potential growth rate was around 4% with productivity growth accounting for about half of the growth miracle over this period.

Two key factors – increasing trade openness and the restructuring of the economy as it integrated back into the world economy- supported SA’s productivity boom during the early 2000s.

In addition, SA enjoyed a significant reduction in political uncertainty, positive capital inflows and deep fiscal and monetary reforms, which slashed the debt ratio and lowered the entire structure of SA’s interest rates. The upshot was the strongest private sector fixed investment upswing (relative to total fixed investment) in the country’s history.

However, in the decade after 2010, an extraordinary reversal occurred in which growth in the productive capacity of the economy ground to a halt. In addition, total fixed investment remained stagnant at around 14% of GDP for much of this period. In 2023 and 2024, private fixed investment fell below R500bn (to 10.8% and 10.4% of GDP respectively) - far too little to support any meaningful expansion in the country’s capital stock. This has kept SA’s potential growth rate exceptionally weak.

Fig 1: Investment growth (gross fixed capital formation) has turned negative



Source: SARB, BER

Why has private fixed investment performed so poorly? There are three main culprits - the structural constraints imposed by the electricity shortages and poor ports and rail performance; a rise of economy-wide borrowing costs; and a significant increase in political uncertainty and deterioration in state performance. All these factors weighed on business confidence.

At the same time, fiscal policy became anti-growth. Instead of catalysing investment in infrastructure or productivity-enhancing reforms, government spending was absorbed by the ever-increasing public sector wage bill.

To make matters worse, this was partly financed by raising taxes which dampened growth further. The upshot was a crowding out of capital spending and soaring public debt - from 26% of GDP 2008 to around 76% now - with little to show for it.

The rapid increase in the debt ratio, and a rising country risk premium, contributed to rising real interest rates on government debt. This contributed to a significant rise in economy-wide borrowing rates and meant that monetary policy could provide little support for growth.

So, will potential GDP remain trapped under a 1% ceiling over the next few years or could accelerated reforms allow it to rise back to 2% or even 3%?

Despite the stark deterioration in the economy after 2010, its continued downward slide is not inevitable. The rapid growth SA achieved in the preceding years suggests that it *is* capable of growing faster, provided the right conditions are in place. Currently they are not.

The BER believes that a policy reset to the pro-growth policies of the immediate post-1994 period would reverse the decline of the last decade. The 1994 choices included the significant restructuring of SOEs (Eskom and Transnet are currently shifting in the right direction, but progress remains glacial); trade openness that improved manufacturing export competitiveness; and sound macroeconomic policies that delivered fiscal sustainability and lower inflation.

If we've learnt anything from the past decade, it's that raising the investment rate is key to growth. Indeed, in the BER's positive reform scenario, modelling an increase in investment growth of around 2% points a year (among other things) helps to lift GDP growth towards the 2% a mark.

Of course, investment requires business and consumers to be optimistic about the future. Unfortunately, confidence is an elusive quality in SA right now; each day brings headlines that seem to show that the bad guys are winning.

But even though the downside risks loom large, and our base case is to expect sub-2% growth for the next two to three years, we continue to believe that a strong reform push, coupled with greater political and policy certainty, and improved fiscal and monetary policy co-ordination, could unlock a virtuous cycle of investment, business confidence and growth.

We've done it before against much greater odds; there is no reason why we cannot do it again. But we have to act with far greater urgency and decisiveness.

This article first appeared in the Business Day on 30 September 2025. The full report can be found on ber.ac.za/growth

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