South Africa's Development Path and the Government's Programme of Action

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Late in 2003 the policy unit in the Presidency produced and distributed widely a preliminary assessment of the performance of the South African government during the first decade of freedom. While the overall assessment of *Towards a Ten Year Review* was that government had performed reasonably well, the report also suggested that for the next period, government had to review its priorities and step up its performance. The social transition from a racially/spatially divided society to a free society was not an easy transition. Poverty persisted and unemployment grew as the number of new jobs failed to keep up with the number of people liberated into the job market. Discussions within government focused on two questions: firstly, how to increase the rate of growth above an average of 2.8% per year so that the economy could pay for an improved quality of life; and, how to address the challenge of the "second economy"—those marginalized people who were unlikely to benefit from an improved rate of growth without government and its partners reaching out to them.

The body of this article is intended to take the reader through some of the thinking done in government in an attempt to address these two challenges.

Election and Manifesto

The third democratic South African elections resulted in a decisive victory by the ruling party. The mandate of the successful party had the following key points, which became priorities for government:

- Reduce unemployment by half by 2014
- Reduce poverty by half by the same date
- Provide the skills required by the economy
- Ensure that South Africans are able to exercise their constitutional rights with dignity
- Government services should be provided with compassion
- Government services should improve, including services which will reduce the major preventable causes of death, including health and crime prevention services
- Reduce the number of serious and priority crimes and cases awaiting trial
- Position South Africa as an effective progressive force in global relations.

Achievements and weaknesses

In the first ten years of democratic government, our achievements were considerable. From a perilous set of national accounts, we achieved macroeconomic stability and credibility—inflation fell to the lowest level since 1959, and interest rates are at their lowest level in 20 years. The economy moved from protectionism to competitiveness through trade and competition policy reforms. South Africa is now experiencing its longest period of continuous growth in recorded history.

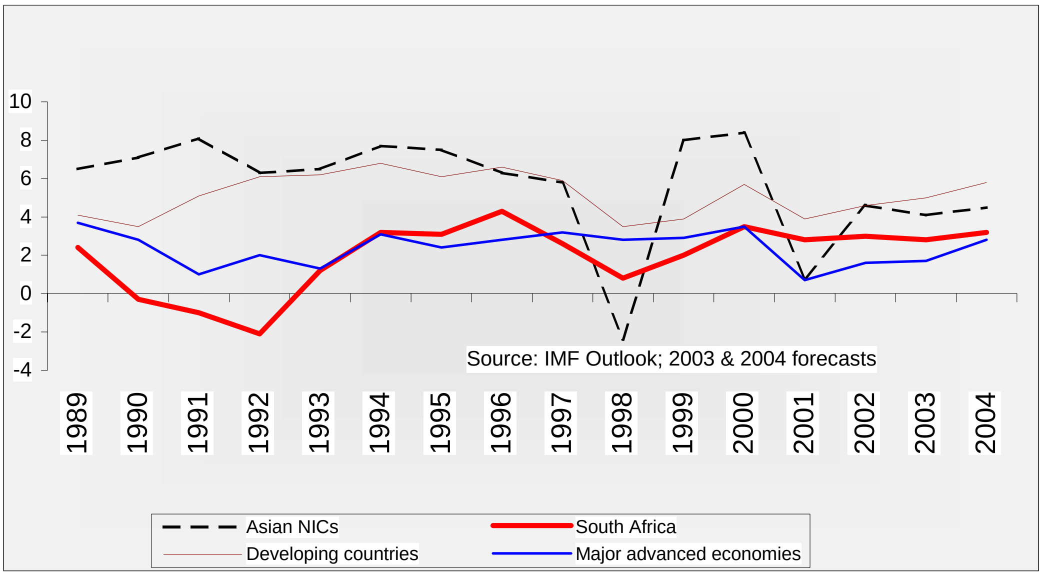
Education was unified into a single coherent system, and a comprehensive national skills development strategy was implemented. While social investments in health, education and training grew, we were also able to expand the social security system with the equalisation of social pensions, the improvement of disability payments, and the introduction of a child support grant. Overall, social expenditure rose from 44% of the national budget in 1993 to 57% in 2002/03.

However, the performance of the economy is still not strong enough to effectively roll back the poverty, inequality and unemployment that have accumulated for decades of apartheid, and centuries of colonialism. Unemployment is very high at 28 percent, and the current average growth rate of about 2.8% per year will not enable the unemployment rate to be halved by 2014. Poverty and inequality have resulted in about one third of the population living below the poverty line. Many of these families are, effectively, trapped in poverty—parents lack the education and resources to enable their children to escape poverty.

Trends in Capital Formation and Foreign Direct Investment

If we compare South Africa's growth rate to other parts of the world it becomes evident that our growth rate is relatively slow for a developing country. Figure 1 shows that South Africa's growth rate since 1994 has been below the rate of the Asian newly industrialised countries, and below the average for developing countries (bearing in mind that China and other Asian developing countries have a significant effect on this average too).

Figure 1: Comparative GDP Growth Rates

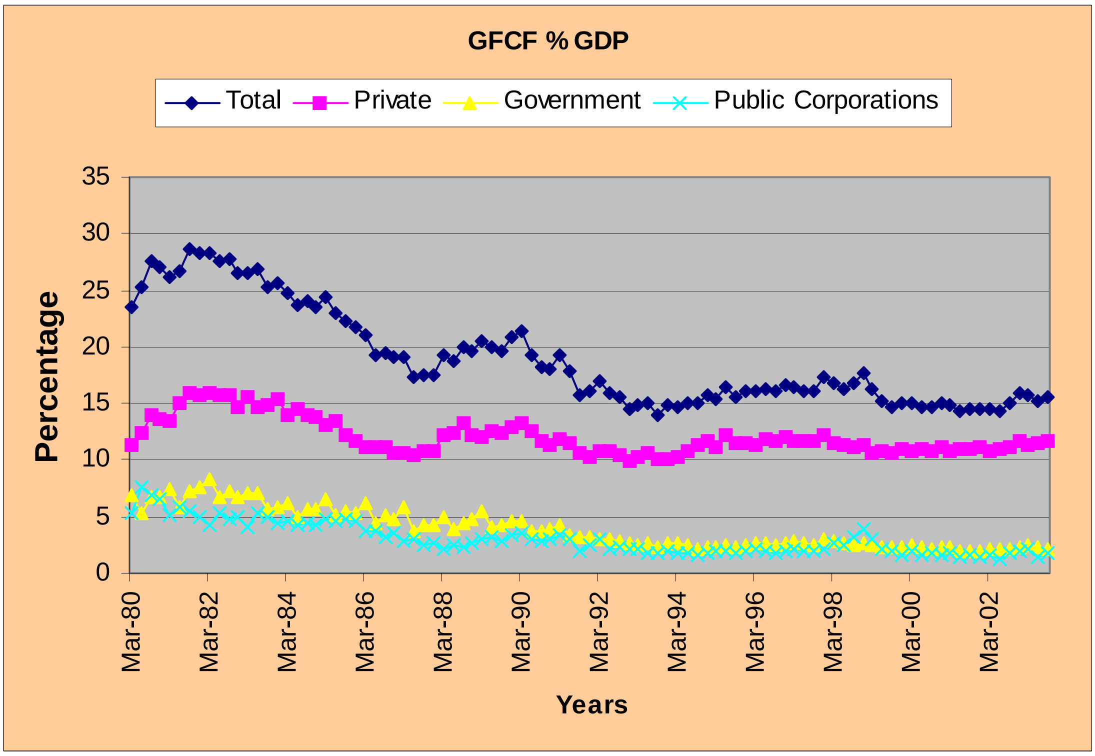


When we delve a little deeper into the economic data, the major reason for South Africa's relatively slow growth becomes obvious: the slow pace of capital formation. As Figure 2 shows, the overall rate of capital formation has fallen from nearly 30% of GDP in the early 1980s (and for considerable periods in the 1960s and 1970s) to about 16% of GDP. The decline in investment in infrastructure, buildings and equipment stems partly from a decline in private sector investment, but the biggest decline in investment was by government and the public corporations. Public sector capital formation declined from a peak level of about 16% of GDP in the late 1970s to 4% of GDP by the early 2000s, with most of the decline happening in the 1980s, with another dip in the late 1990s.

The current rate of capital formation, at about 16% of GDP, is low compared with successful developing countries. For example, since the mid-1970s, the rate of capital formation in South Korea has been consistently above 25% of GDP, while the Australian rate of capital formation has never fallen below 20% of GDP.

In South Africa, in broad terms the downward plunge of capital formation halted in 1994, but we do not yet have a powerful upward trend. The Minister of Finance recently indicated that South Africa's target is capital formation at 25% of GDP by 2014.

Figure 2: Gross fixed capital formation as a percentage of GDP



One factor limiting capital formation in South Africa is the low savings rate. Another has been the relatively slow rate of foreign investment. Certainly, foreign investment has grown very considerably. If one combines direct and portfolio investment and loans, South Africa's liabilities (inward investment) grew from R185 billion in 1994 to R736 billion by the end of 2002, in current rand. Outward investment grew at a similar rate. Though all three categories of investment grew significantly, foreign direct investment, the most important category, because it is long term and often adds to productive capacity, did not grow as quickly as hoped.

Moreover, much of the inward direct foreign investment was associated with companies entering South Africa to buy market share by neutralising domestic producers, or to participate in privatisation programmes, rather than investing in South Africa to build its productive base and its competitiveness. There are obvious exceptions in the mining sector and the automobile sector, but not enough of the kind of investment designed to boost competitiveness.

There are some objective reasons for the slow rate of investment. Both domestic and foreign investors are influenced by the relatively slow domestic growth rate, high interest rates (which encourage short-term flows), and the volatile exchange rate. More subjective judgements include the extent of inequality and the potential for social conflict, where decisions might be made by investors based on their assessment, or the assessment of their advisors, of the perceived will and capacity of government.

Other factors influencing investment include the high degree of concentration and centralisation of ownership in some market segments in South Africa, and shareholder pressure for short-term and certain returns.

Some factors influencing investment are as much the product of mindset and perceptions as objective facts. One is a concern about the crime rate and its impact on doing business in South Africa, though the per capita incidence of crime is decreasing, and is no higher than in many of South Africa's competitors, which are often less open about their crime statistics. Another is a contrary view or misunderstanding of South Africa's role or potential role in Zimbabwe. Some potential investors believe that the labour market regime inhibits investments, while others are concerned about the expected or imagined effects of affirmative action on the employment prospects for whites.

For a few there is an underlying pessimistic view that interprets every possible event as a sign of South Africa's inevitable failure. This in turn often derives from a lack of understanding and trust between the potential investors of capital and the political rulers. For unavoidable historical reasons, the cultural gap between political and economic leaders is unusually large in South Africa at this time.

The MERS and the GDS

While government is working to improve the level of understanding and trust between business and political leaders, it will continue to address some underlying factors which affect South Africa's competitiveness and its growth potential. Policies that focus on these microeconomic conditions are collectively addressed in terms of the Microeconomic Reform Strategy or MERS. There are three main elements of the MERS: to address deficiencies in *input sectors* such as transport and communications; to exploit opportunities to improve *crosscutting interventions* such as small business development and the performance of state-owned enterprises; and to develop and improve *sector specific strategies* for sectors which have significant potential for growth and/or employment creation and/or exports. The MERS targets are:

Input sectors/utilities:

- Transport and Logistics
- Energy
- Telecommunications
- Water

Crosscutting interventions:

- HRD
- Technology and R&D
- Access to capital
- Infrastructure
- Management of State Owned Enterprises
- Economic Development Capacity of Local Government
- Geographic spread
- Small enterprises
- Investor Perceptions
- BEE
- Africa

Priority growth and employment sectors:

- Agriculture/agro-processing
- Tourism
- Cultural and Craft
- ICTs
- Mining & metals
- Clothing & textiles
- Chemicals & biotech
- Auto & transport
- Services

Amongst the input sectors, government believes that the most urgent challenge is the freight transport and logistics sector, particularly the operations of the rail and port sectors. Public transport has emerged as another key challenge, especially in light of South Africa's successful bid for the 2010 FIFA World Cup. Telecommunications services have grown well, especially the cell phone sector, but costs of high volume international voice calls and data transmission remain unacceptably high, and an obstacle to investment in telecommunications intensive businesses.

There have been notable improvements in some crosscutting sectors: the new skills development programme, the National Research and Development Strategy, the International Marketing Council and the maturation of a broad-based black economic empowerment policy are all major steps forward. However, major challenges remain in local government economic management outside of the metros, in micro-business development and in the governance of the state-owned enterprises.

Some sector strategies have been well developed and successful—notably the automobile manufacturing sector and the tourism industry. For others such as the information and communications technology sector, the clothing and textile sector, the agro-processing sector and the business services sector, especially business process outsourcing, we believe that the potential exists for much faster growth if and when we get the sector strategies right.

We are concerned that amongst manufacturing sectors, the most successful continue to be largely relatively capital-intensive industries such as metals processing, chemicals, and pulp and paper manufacture. Potentially labour absorbing sectors such as clothing and textiles, footwear, food processing, and wood and wood products are not reaching their potential, and are weak competitors against cheap imports. This suggests a systemic problem, such as inappropriate prices of the factors of production in these sectors.

Another concern is that while local government is generally the key interface between the private sector and the state, many of South Africa's 284 municipalities are not equipped to accomplish this task successfully.

While employment has grown strongly in some sectors like business services and tourism, overall employment growth is not high enough. About 2 million net new jobs have been created since 1994, and a considerable proportion of these in the formal sector. However, the even more rapid growth in the labour force, partly as a result of the incorporation of African women into the economy, has meant that the rate of unemployment has grown from about 16% to about 28%.

The challenge of employment creation remains the key economic challenge of government, a concern that is shared broadly across South African society. It was this challenge that led the President to call for a Growth and Development Summit between the major economic stakeholders in June 2003. The meeting resulted in a detailed agreement constructed around the central agreement: "The constituencies [labour, business, government and the community] commit themselves to a common vision for promoting rising levels of growth, investment, job creation and people centred development."

Much of the agreement coincided with the main elements of the micro-economic reform strategy, but there were some additional elements including a focus on higher levels of investment in the productive sector and infrastructure.

Macroeconomic Challenges

Reducing the public sector deficit from 9% of GDP in 1993 to 1% of GDP in 2003 meant that government was borrowing considerably less (proportionate to GDP), which put considerable downward pressure on interest rates. This in turn encouraged private sector spending, unfortunately more on consumption than on investment. But it also had the short-term negative effect of reducing the capacity of the public sector (government and the public corporations) to invest. A major goal of macroeconomic policy in the current era is to increase the rate of gross fixed capital formation to over 20% by 2009 and to 25% of GDP by 2014, without significantly destabilising macroeconomic balances.

The other key elements of macroeconomic policy, in addition to the maintenance of price stability, are the stabilisation of the currency as far as possible at a suitable competitive level, and effective support for raising the level of investment in fixed capital, including infrastructure.

Growth of the First Economy

In his State of the Nation Address, the President set out a set of targets for initiatives to increase the competitiveness of the first economy—i.e. the modern globalised economy, in contrast with the "second economy" of the marginalized. In respect of the goal of raising the investment rate, some key targets are:

- The completion of the Growth and Development Summit discussion on the meaning of the commitment for 5% of institutional funds to be committed to infrastructure and productive investments;
- Completion of the medium term investment plans of state-owned enterprises;
- Plans for the better utilisation of the Isibaya Fund—an instrument to invest a small portion of the funds of the Public Investment Commission;
- Finalisation of the Enterprise Development bill to improve the system of incentives for investment;
- And better international marketing of South Africa and its investment opportunities.

Another area of focus is the reduction of input costs. In the transport and logistics sector the restructuring of the ports is a very urgent task, the Coega port will be ready for use in September 2005, rail freight capacity will rise by 30% over the next 5 years, and construction of the King Shaka Airport should begin soon after agreement is reached on the use of the land earmarked for it.

Other key expected input sector interventions are: the launch of the first Regional Electricity Distributor (RED) by June 2005, with the sixth and last in place by January 2007; investment decisions on new generating capacity for electricity by the middle of 2005; urgent movement on the establishment of a second network operator to compete with Telkom; and the announcement of the policy to combat persistent inflation in administered prices by October 2004.

One of the key commitments regarding small business development, one of the governments less successful areas of intervention in the past, are the publication of a comprehensive review of small business policy by September 2004 and a review of the regulatory framework for small businesses. A key reform is the establishment of a single unified small business support agency by the end of 2004. Government is also committed to a Cooperatives Bill by the same deadline, which is intended to ease the regulatory conditions for the establishment and development of cooperatives. Another initiative expected to spark small business development is the establishment of a new Agricultural Credit Scheme with R1 billion in starting capital.

Some key commitments regarding skills development are:

- Sector Education and Training Authorities (SETAs) should further increase their uptake of learnership candidates and participants in other skills development programmes;
- Considerable investment in the technical colleges ("further education and training"), and their realignment, as appropriate, with the needs of the first and second economies;
- The establishment of a database of all graduates to help link up unemployed graduates with training programmes or employment opportunities;
- And the finalisation of immigration regulations in order to allow for the immigration of skilled people where needed.

The importance of further expanding and diversifying exports keeps export support measures on government's priority list. In addition to incentive programmes, multilateral and bilateral trade initiatives are central. Addition to expanding access to the major international markets and deepening links in Africa, South Africa will aim to close agreements with Mercosur in Latin America, the United States, China and India, as well as with the non-EU European countries in EFTA. These will add to the EU trade and development agreement and the South African trade protocol. These agreements will also improve the climate for direct investment into South Africa.

South Africa's performance in research and development is beginning to improve with R&D rising as a percentage of GDP from 0.69% in 1997 to 0.76 in 2001. This is still well below the levels of our competitors, generally well over 2%, but our initial target is 1% of GDP. Some current initiatives are the establishment of a new governance system for the science councils, a strategy to develop South and Southern Africa as a regional hub for astronomy and space science and technology, and a range of strategies to more effectively diffuse new technologies across the economy.

A final key strategy underpinning the sustained competitiveness of the “first economy” is the implementation of our broad-based black economic empowerment strategy. The BEE law has been passed and the charter process is in full swing, but the President’s BEE advisory council must soon be appointed, the National Empowerment Fund must become effectively operational, and the funding arrangements for empowerment transactions need further development. Also still at an early stage are the implementation of the other aspects of empowerment including skills development, developmental procurement, other forms of small business support, and the empowerment of women, people with disabilities and the youth.

The Paradigm of Two Economies

Even if we do succeed in raising the rate of growth and employment creation in the first economy, we will still be left with a significant proportion of our people trapped in a vicious cycle of poverty in the second economy. The two economies concept is short hand for a situation where one part of the population is included in the global economy, and another part through lack of education, relevant skills, and other exploitable assets is excluded. The second economy is not in a geographic place—there are people in the second economy living in and on the fringes of cities and towns, as well as in different types of rural areas. Being in the second economy is not defined in class terms—many members of the working class are fully part of the first economy. Being part of the informal sector does not necessarily place one in the second economy, as many informal sector businesses are reasonably successful. The second economy is a condition of exclusion that tends, on its own, to be self-perpetuating, as parents often do not have the skills to elevate their children out of the second economy.

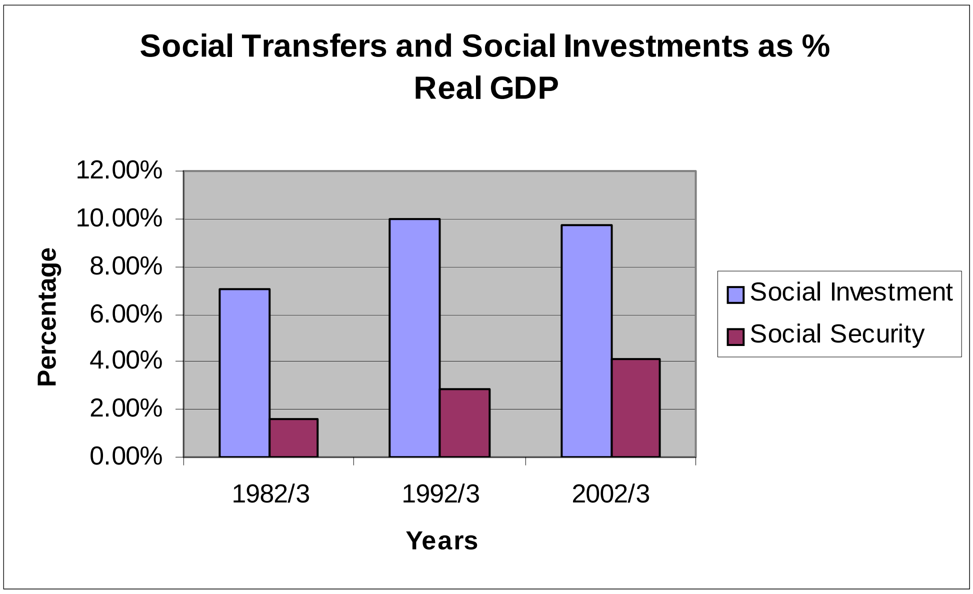
International studies have shown that highly unequal societies are generally not able to roll back inequality without some significant interventions by the state. They have also shown that where inequality in reduced, risks of instability are reduced and the economies tend to grow faster. The case for carefully designed and properly managed interventions to build a staircase between the two economies, and to meld them together, really is a no-brainer.

Social Services and Social Investment

One form of intervention is through direct transfers to the needy. South Africa has developed a substantial social security system, with a social pension, a disability pension, and a child support grant for children under 15 living in indigent households. Work undertaken for the 10 Year Review showed that our social security programmes are well targeted, are radically reducing poverty and may soon virtually eliminate extreme poverty.

However, there are two concerns in government about social security. One is that government does not want to build conditions of dependency, or entitlement attitudes. South Africa can't afford to become a granny state. The other is that the cost of social security transfers is rising rapidly as the child support grant and disability payment systems roll out, which is sounding a warning bell regarding the allocation of government resources. Figure 3 shows that while social investments, education and health, have plateau-ed as a percentage of GDP, social transfers—the grants—are rising rapidly as a percentage of GDP. The rate of growth should moderate when the grants are fully rolled out around 2006.

Figure 3: Social Transfers and Investments as % of GDP



Interventions in the Second Economy

South Africa cannot afford to address the challenge of the second economy through direct financial transfers alone. These are palliatives, and though they may help some households develop effective sustainability strategies, for most very poor households, the grants alone will not lead to major changes.

Hence the need for carefully designed interventions. The main objectives of interventions in the second economy are to eliminate conditions of extreme poverty, to create conditions for sustainable livelihoods, to reduce the dependence on social grants, and to open up paths for mobility to the first economy.

The major themes of the programmes are temporary work opportunities, skills development, the two-way flow of information and access to finance for poor households and micro-enterprises. The Expanded Public Works Programme is the major national initiative to create temporary jobs. Its target for the 5-year term of the current government is at least one million temporary jobs in a range of sectors including labour intensive construction, home- and community-based health care, and conservation programmes.

Another major initiative is the establishment of a new Apex Fund as a wholesale supplier of credit to NGOs and cooperatives that on lend to very small businesses and very poor households. A set of rural land based initiatives include the Agriculture Credit Scheme, the Comprehensive Agricultural Support Programme, and the BEE framework for agriculture, all aim at assisting emerging black farmers.

The flow of information to and from the second economy will be facilitated through the establishment of a corps of community development workers, the building of more multipurpose community centres linked up to information and communication networks, and through the extended use of the Imbizo programme as a form of communication between communities and government.

One the key skills development initiatives is a further extension of adult basic education and training (ABET) as we now understand that the extent of education of parents, especially their literacy and numeracy, has a major impact on the life chances of their children. Other interventions are the strengthening and refocusing of the Further Education and Training system (technical colleges), and greater support for early childhood development programmes. This is not to forget, however, the importance of continuing to improve the quality of the general education system, which is at the centre of it all.

Monitoring and Evaluation

It is not possible to cover all the initiatives of government—first or second economy—in this article. There is an ambitious programme of action announced by government, including accelerating infrastructure development, building the health and crime fighting systems, and reviewing the effectiveness and focus of the housing programme. The President introduced and set targets for some of the major interventions in his State of the Nation Address on May 21st 2004. The full set of national government programmes, with lead agencies and deadlines is available on the web at www.info.gov.za/issues/poa/.

It is a very unusual step, possibly unprecedented, for a government to put its detailed work programme, with details of responsible organisations and deadlines, into the public arena. This symbolises a desire for intense scrutiny of our programme and our implementation performance. The invitation to the public and NGOs, not to mention the Parliamentary Opposition, to act as informal monitors of government performance is matched by the introduction of new internal systems of monitoring and evaluation within government.

One element is the establishment of a evaluation and monitoring system within the Presidency, where the implementation of all cabinet decisions will be monitored. In addition, each of the five clusters of directors general (economic, social, justice and crime prevention, governance and administration and international relations) is required to report in detail to the relevant cabinet committee at two monthly intervals on progress in the implementation of decisions. To a significant extent, the role of the executive and of Cabinet itself has shifted in emphasis from policy development to the monitoring of implementation.

Government has delivered effectively in the past—the response to the Ten Year Review showed that the government has credibility as an effective agent of implementation. But, as the Ten Year Review itself indicated, the performance of government has been uneven, and there are many areas where improvements are urgently necessary.

Achieving the goals of our development path will require a higher level of cooperation amongst the spheres of government, and between government and civil society. Government does not have the capacity to achieve our objectives alone, and if we were to try to build all of them in government, it would be very costly. We are confident that there is a very high level of agreement about where the nation should be going and how to get there. The challenge is to unite the nation in our efforts to get there.