State must review priorities and step up performance

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Part One:

Late in 2003 the policy unit in the presidency distributed a preliminary assessment of the performance of the government during the first decade of freedom. While the overall assessment of Towards a Ten Year Review was that the government had performed reasonably well, the report suggested that for the next period, it had to review priorities and step up performance.

In the first 10 years achievements were considerable, notably macroeconomic stability and credibility. Inflation fell to the lowest level since 1959, and interest rates are at 20-year lows. 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 coherent system, and a comprehensive national skills development strategy was implemented. While social investment in health, education and training grew, the government was 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. Social expenditure rose from 44 percent of the budget in 1993 to 57 percent in 2002/03.

However, the performance of the economy is still not strong enough to effectively roll back the poverty, inequality and unemployment that has accumulated in decades of apartheid and centuries of colonialism. Unemployment is very high at 28 percent, and the average annual growth rate of 2.8 percent will not halve this by 2014, which is the government's target.

Poverty and inequality have resulted in about one-third of the population living below the poverty line. Many of these families are, in effect, trapped in poverty - parents lack the education and resources to enable their children to escape poverty.

Discussions focused on two questions: how to increase the rate of growth above an average of 2.8 percent 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 marginalised people who were unlikely to benefit from an improved rate of growth without the state and its partners reaching out to them.

The major reason for South Africa's relatively slow growth is the slow pace of capital formation, which has fallen from nearly 30 percent of gross domestic product (GDP) in the early 1980s to about 16 percent of GDP. The decline in investment in infrastructure, buildings and equipment stems partly from a drop in private sector investment, but the biggest decline in investment was by the state and public corporations.

Public sector capital formation declined from a peak level of about 16 percent of GDP in the late 1970s to 4 percent 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 percent 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 percent of GDP, while the Australian rate of capital formation has never fallen below 20 percent of GDP.

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

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 surged. If one combines direct and portfolio investment and loans, 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. But foreign direct investment, the most important 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 to build its productive base and competitiveness.

There are obvious exceptions in the mining and vehicle sectors, but not enough of the kind of investment designed to boost competitiveness. There are 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 judgments 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 advisers, of the perceived will and capacity of government.

Other factors include the high degree of concentration and centralisation of ownership in some sectors, and shareholder pressure for short-term returns. Some factors influencing investment are as much the product of mind-set and perceptions as objective facts. One is a concern about the crime rate and its effect on doing business in South Africa, though the per capita incidence of crime is decreasing. Another is a contrary view 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 affirmative action and employment prospects for whites.

The government will continue to address underlying factors that affect competitiveness and growth. Policies that focus on these conditions are collectively addressed in terms of the microeconomic reform strategy. There are three main elements:

* to address deficiencies in input sectors such as transport and communications, energy, telecommunications and water;

* to improve interventions in small business development, technology and research and development, access to capital, infrastructure, black economic empowerment 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, such as agriculture and agroprocessing, tourism, craft industries, information and communications technology, mining, sand, metals, clothing and textiles, chemicals and biotechnology, vehicle and transport and services.

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

Some sector-specific strategies have been well developed and successful - notably the vehicle manufacturing sector and the tourism industry. For other sectors, such as information and communications technology, clothing and textiles, agroprocessing and business services - especially business process outsourcing - the government believes there is potential for much faster growth if and when it gets the strategies right.

The concern is that among 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, 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.
A 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 jobs have been created since 1994, and a considerable proportion are 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 percent to about 28 percent.

The challenge of employment creation remains the key economic challenge of the government, a concern that is shared broadly across South African society. It was this challenge that led President Thabo Mbeki to call for a growth and development summit of 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 microeconomic reform strategy, but there were some additional elements, including a focus on higher investment in the productive sector and infrastructure.

Part Two: Government aims to unite two economies in one country

In his state of the nation address, President Thabo Mbeki set out targets for initiatives to increase the competitiveness of the first economy, the modern globalised economy, in contrast with the second economy of the marginalised. 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 commitment of 5 percent of institutional funds to infrastructure and productive investments;

* Completion of the medium-term investment plans of state-owned enterprises;

* Plans for the better use 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 an urgent task, the Coega port will be ready for use in September 2005, rail freight capacity will rise by 30 percent over the next 5 years, and the construction of the King Shaka Airport should begin soon after agreement is reached on the use of the land earmarked for it.

Other key interventions are: the launch of the first Regional Electricity Distributor 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 government's less successful areas of intervention in the past has been small business development. A review of small business policy is to be published by September 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. The government is also committed to a Co-operatives Bill by the same deadline. Another initiative expected to spark small business development is the establishment of a new agricultural credit scheme with R1 billion in starting capital.

Regarding skills development, commitments include an increase in the uptake of learnership candidates by the sector education and training authorities, investment in the technical colleges, the establishment of a database of graduates to help link up unemployed graduates with training programmes or employment opportunities, and the finalisation of immigration regulations to allow for the immigration of skilled people where needed. The importance of further expanding and diversifying exports keeps export support measures on the government's priority list. In addition to incentive programmes, multilateral and bilateral trade initiatives are central.

As well as 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 US, China and India, as well as with European countries outside the European Union. These deals will also improve the climate for direct investment into South Africa.

South Africa's performance in research and development is beginning to improve with research and development rising as a percentage of gross domestic product from 0.69 percent in 1997 to 0.76 percent in 2001. This is still well below the levels of our competitors, generally well over 2 percent, but our initial target is 1 percent of gross domestic product.
A final key strategy underpinning the sustained competitiveness of the "first economy" is the implementation of our broad-based black economic empowerment (BEE) strategy. The BEE law has been passed and the charter process is in full swing but Mbeki's BEE advisory council must soon be appointed, the National Empowerment Fund must become effectively operational and the funding arrangements for empowerment transactions need development.

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 shorthand 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.

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 Ten Year Review showed that our social security programmes are well targeted and are radically reducing poverty. But there are two concerns in the government about social security. One is that government does not want to build conditions of dependency or entitlement attitudes. South Africa cannot afford to become a granny state. The other is that the cost of social security transfers is rising rapidly, which is sounding a warning bell regarding the allocation of government' resources. South Africa cannot afford to address the challenge of the second economy through direct financial transfers alone.

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 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 five-year term of the current government is at least 1 million temporary jobs in a range of sectors.

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

One of the key skills development initiatives is a further extension of adult basic education and training. Achieving the goals of our path will require a higher level of co-operation among the spheres of the government, and between the government and civil society. The government does not have the capacity to achieve our objectives alone, and if we were to try to build all of them in the government, it would be 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.

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