CHAPTER TWO: International and Domestic Trends

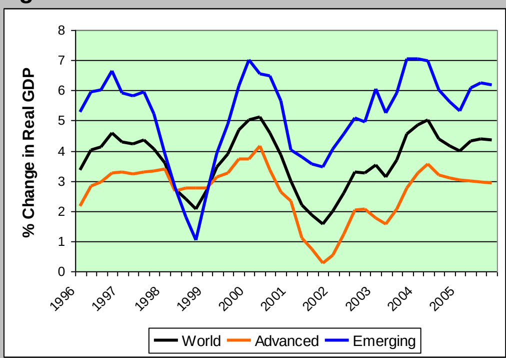
2.1. INTRODUCTION

The purpose of this chapter is to present a qualitative, and where justified, a quantitative discussion on international and domestic growth and development trends. This will provide the reader with a contextual understanding of development trends and the potential outlook for development in the Free State.

2.2. THE OUTLOOK FOR THE GLOBAL ECONOMY

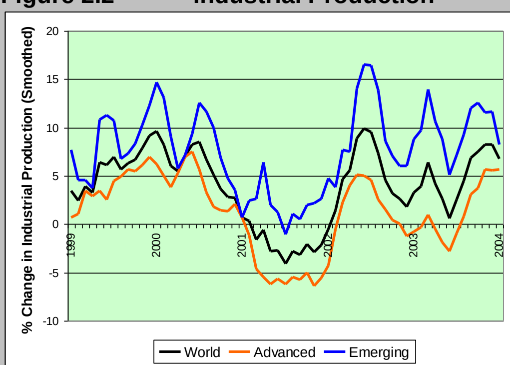
A strengthening and broadening of the global economic recovery in 2003 has resulted in an upward revision of anticipated growth rates for 2004 and 2005. The improvement in economic growth prospects is supported by sharp increases in industrial production and world trade, a strengthening of business and consumer confidence in most regions, and strong growth in investment. World gross domestic product (GDP) achieved average annualised growth of almost 6% in the second half of 2003 – due largely to tax-cut induced spending and mortgage refinancing in the United States and a post-SARS (Severe Acute Respiratory Syndrome) recovery in Asia.

Figure 2.1 Growth in Real GDP



Source: IMF World Economic Outlook 2004

Figure 2.2 Industrial Production

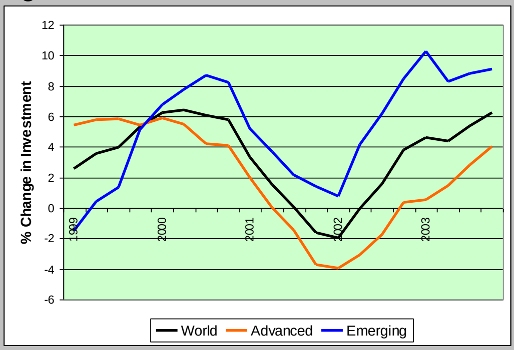


Source: IMF World Economic Outlook 2004

While this level of growth is unlikely to be sustained going forward, the improvements outlined above should support growth in world output of around 4.5% both this year, and in 2005.

However, the pace and nature of the upturn is likely to vary greatly between different regions. Despite rising concerns about "overheating" in China, the recovery is likely to be strongest in emerging Asia and the United States and weakest in the European Union. These regional differences are largely the result of variations in the strength of domestic consumption and investment spending which is – in many cases – exacerbating underlying trade and financial imbalances. Much of the latter has been due to uneven developments in world currency markets. While the US dollar has depreciated by around 18% on a trade-weighted basis from its peak of February 2002, the corresponding appreciation of other currencies has been patchy, and is focused mainly on the euro and the yen. Most emerging Asian economies have experienced some appreciation of their currencies against the US dollar, but substantial intervention and a build-up of official reserves have resulted in a depreciation of their currencies in trade-weighted terms. This has meant that large and rising current account surpluses are being sustained despite the strong growth in domestic demand.

Figure 2.3 Global Investment



Source: IMF World Economic Outlook 2004

According to the International Monetary Fund (IMF), emerging Asia has also been the biggest beneficiary of private net capital flows, receiving $84 billion of the world's total of $131 billion in 2003. They estimate this region's share of total world net private capital flows at around 72% in 2004, but anticipate a significant reduction in both the relative share and the absolute value of these inflows in 2005. In the absence of sustained intervention aimed at building up foreign reserves, the combination of these anticipated developments, and those in global trade suggest that emerging Asian economies' currencies should strengthen against those of the major capital exporting countries. By contrast, Africa's share of total world net private capital flows is expected to rise from $ 9.5 billion in 2003 to around $17 billion in 2005.

Developments in world currency markets and the pace of the global recovery have also had an impact on commodity prices – particularly oil, which has risen by around 36% in US dollar terms in the past year. According to *The Economist* "all items" commodity price index, commodity prices in US dollar terms were 23.3% higher in mid-July 2004 than a year earlier, and were up 6.4% in British sterling terms, 13.1% in Euro terms, and were 12% higher in Japanese yen terms. The strongest rise has been felt in metals prices – which are traditionally the most cyclically volatile of the commodities, and have increased by 43% in dollar terms in the year to July 2004.

In spite of the developments in commodity prices, inflation globally has remained reasonably subdued and is now in single digits in every major region of the world. Because of excess capacity, weak labour markets, and competitive pressures on producers in most industrialised markets, price increases are expected to remain at moderate levels in 2005/6, and there are no immediate fears about sustained, and significantly higher, rates of inflation beyond that. However, that picture could change if world oil prices remain beyond $50/barrel for an extended period.

As a group, the recovery in industrial economies is likely to be led by the United States, which is still benefiting from the fiscal and monetary stimuli of the past few years. However, the impact of these measures is waning and although the economy was estimated to grow at about 4.5% in 2004, sustaining such rates of expansion into the future will require significant investment and employment growth, combined with a continuation of the productivity improvements that have been a characteristic of the US economy for some time. In Europe household spending remains relatively weak even though there are some early signs of increased fixed capital formation. In the absence of significant policy stimulation – which seems unlikely – the recovery of European economies is likely to be driven from outside, and was estimated at an average about 1.8% growth in output in 2004, accelerating moderately to 2.5% in 2005. In contrast with Europe, the recovery in Japan is now well under way, with economic growth of about 3.5% estimated in 2004. This is the fastest rate of expansion that Japan has achieved since 1996, and has been driven in large part by strong external demand from China in particular. However, deflation, banking sector weaknesses and the potential for sharp currency appreciation remain as short-term risks.

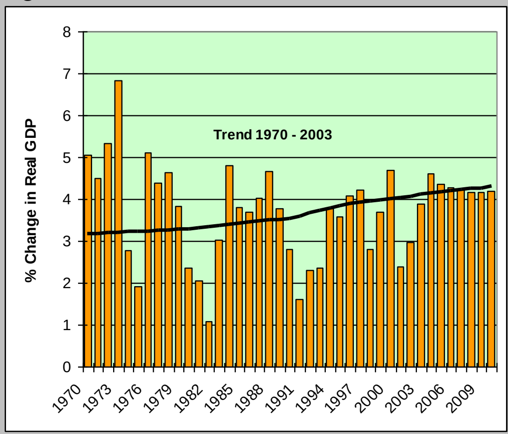
In **emerging and developing economies**, growth has been strongest in emerging Asia – which is expected to experience GDP growth in excess of 7% in 2004/5. If achieved, this would be the fastest rate of expansion since the 1997/98 Asian Crisis. The recovery has been supported by continued buoyant growth in China and higher than expected growth in India, which has contributed to rapid growth of investment and exports – particularly within the region. In Latin America, growth has been constrained by the performance of the Brazilian economy. However, the rate of expansion in output is expected to accelerate during 2004/5 on the back of higher commodity prices, the continued recovery of the global economy and stronger domestic demand. The fact that many countries within the region continue to be dependent on international borrowing increases the risks to the region of a significant increase in interest rates in the major capital exporting countries – but this is not expected to be a significant factor over the short-term future.

Elsewhere, strong expansions in Russia and Ukraine have raised GDP growth prospects in the Commonwealth of Independent States, but the performance of the rest of central and Eastern Europe is being constrained by their closer economic links to a European Union that is still struggling to gain momentum. While still relatively strong, growth in the Middle East is expected to slow from 2003 levels due to some decline in oil production. Although many of these economies are being boosted by current high oil prices, they could experience severe shocks in the event that global oil markets regain their balance and crude prices drop accordingly. In Africa, GDP growth was a fairly robust 4.4% in 2003, and is expected to strengthen further in 2004/5 because of rising oil and gas production, higher commodity prices, and general improvements in economic fundamentals. Political instability remains a major source of risk, however.

The developments outlined above are expected to facilitate a growth in world GDP of around 4.5% in both 2005 and 2006, with the most significant risks being further terrorist attacks and geopolitical instabilities, and a significant increase in global oil prices. Beyond that, the performance of the global economy is likely to be influenced by the following factors:

- Significant global financial imbalances that are dominated by the large current account and fiscal deficits in the United States, and surpluses in emerging Asia. In 2004, the US fiscal deficit was estimated to reach 4.8% of GDP, and accumulated net government debt is expected to exceed 50% of GDP, and to rise to almost 55% of GDP by 2009. By contrast the newly industrialising economies of Asia were estimated to average current account surpluses of more than 6% of GDP in 2004, and 5.5% of GDP in 2005. The unwinding of these global trade and financial imbalances is likely to impact on economic growth in the medium term – particularly in the United States. It could also give rise to sharp exchange-rate-induced shocks and accompanying interest rate hikes that would disrupt the global economy, and rising protectionist pressures that run counter to the objectives of the Doha Round negotiations of the World Trade Organisation.

Figure 2.4 World Growth in Real GDP



Source: IMF World Economic Outlook 2004

- Many industrialised economies – particularly in Europe – face the problem of relatively high levels of accumulated fiscal debt combined with the challenge of aging populations that are increasing pressures on the fiscus. Addressing this problem will require unpopular decisions and actions –

particularly in relation to pension and health care systems – that will be hard to push through without strong political mandates and a widespread recognition on the part of the population of the need for change. A failure to do so will result in upward pressure on global interest rates in the future - as governments increasingly try to borrow their way out of trouble - or increases in tax rates in these countries that could serve to undermine their global competitiveness.

- Making the necessary adjustments to global fiscal imbalances is likely to be made harder in the medium term by the fact that interest rates in many markets are currently artificially low, and will be forced to rise significantly. This will impact on asset prices, such as house prices, which have risen sharply in recent years in response to the widespread access to cheap finance. Managing monetary policy in this environment will be difficult, and is likely to diverge significantly from region to region.

A key challenge in addressing present global imbalances will be achieving some element of global coordination of policy interventions that should – according to the IMF - encompass the following elements:

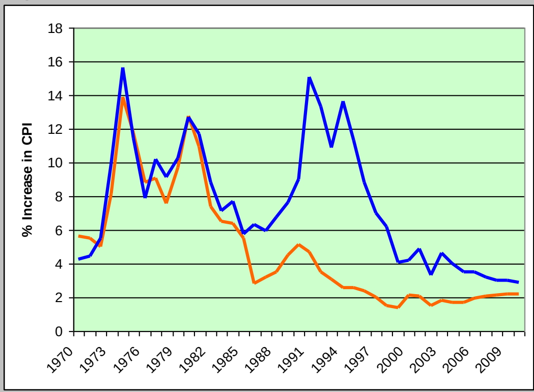
1. Adoption by the next term's leadership of the United States of a credible plan to restore budgetary balance;
2. Increasing the pace of structural reform in the Euro area, including increased labour market flexibility and pension and health care reforms;
3. Further reforms of the Japanese banking and corporate sector; and
4. Adoption of more flexible exchange rate systems in emerging Asia – particularly in those countries with very large current account surpluses and high levels of reserves.

The above actions also need to be set within the context of the Millennium Development goals, which aim – amongst other things - to halve world poverty (judged against its 1990 levels) by 2015.

In the light of the platform for global economic growth created by the consolidation of the upturn in 2004 and 2005, and the various factors listed above that are expected to impact on world growth trends between 2005 and 2010, the following broad medium-term economic environment is anticipated:

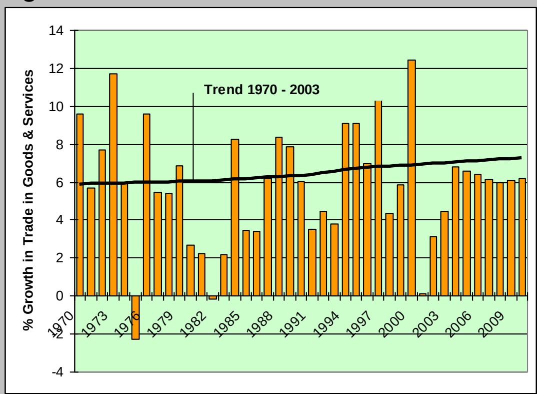
1. An average expansion of world output that is slightly lower than 2004/5 levels but which is nonetheless likely to be around 3.9% per annum;
2. An average annual growth in real per capita GDP of around 2.8% per annum;
3. A growth in world trade in goods and services that averages about 6% per annum between 2005 and 2010, but which slows from around 7% in 2004;
4. A moderate increase in consumer price inflation in advanced economies to average around 2.2% per annum between 2005 and 2010, accompanied by further declines in average inflation in developing economies – which is expected to average about 3% a year over the same period;
5. An increase in average world real long-term interest rates from current (2004/5) levels of about

Figure 2.5 Consumer Price Inflation



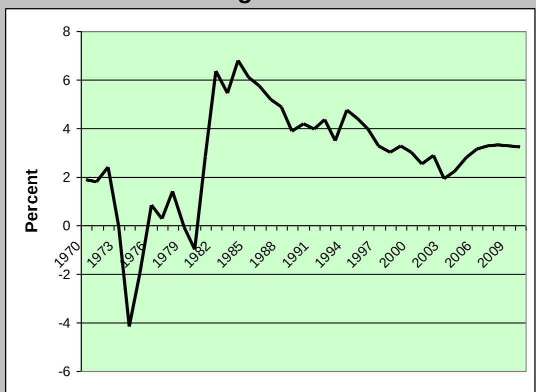
Source: IMF World Economic Outlook 2004

Figure 2.6 World Trade Volumes



Source: IMF World Economic Outlook 2004

Figure 2.7
World Real Long-term Interest Rates



Source: IMF World Economic Outlook 2004

1.6% to around 3%; and

6. A marginal decline in average non-oil commodity prices in real terms from 2004 levels back to those that existed in 2001/2.

2.3. LIKELY DRIVERS OF FUTURE INTERNATIONAL DEVELOPMENTS IN ECONOMIC SECTORS

The following likely (expected) sectoral economic drivers from an international perspective are highlighted here:

1. **Agriculture, Forestry and Fishing**
   a. Increased competition for SA from poorer countries with improved access to the world's main markets
   b. Positioning in relation to GM important strategic consideration
2. **Mining and Quarrying**
   a. PMG metals' demand likely to be strong going forward
   b. Strong growth in demand for coal – particularly from China and India
3. **Manufacturing**
   a. Significantly shorter product lifecycles in high-value-added products – implications for capital formation patterns (re-programming instead of re-tooling), and global marketing
   b. Doubling of silicon chip capacity every 2 years – new applications
   c. Greater "regionalisation" of trade and investment patterns
4. **Electricity, Gas and Water**
   a. Energy demand growth in developing world double that of developed world.
   b. Total electricity generation will double by 2025
5. **Construction**
   a. Energy-efficiency of materials and design will increase in importance

6. **Wholesale and Retail Trade and Accommodation**
    a. Technology to gradually change structure of trade through home/internet shopping
    b. Tourism growth will be stronger than global average growth (6% plus p.a. versus 4% p.a.)
7. **Transport, Storage and Communication**
    a. Greater regionalisation of international freight transport (in line with trade trends)
    b. Redundancy of traditional mass communication in favour of web-based medium
8. **Financial Intermediation, Insurance, Real Estate and Business Services**
    a. Stronger growth in international trade in commercial services (finance, insurance, transport, consulting) than global average growth
9. **Community, Social and Personal Services**
    a. Demographics and disease will sustain health care growth.
    b. Ongoing tensions with developing world over affordability, and "theft" of health care professionals.
    c. Developed world (EU) struggling to redefine government role in respect of pensions and health care

2.4. THE KNOWLEDGE BASED ECONOMY

For three decades or more, academics have been discussing the major transformations that are possible through harnessing electronic information-processing technologies to the social and economic priorities of industrialised and industrialising societies. In this context, the "knowledge economy" refers to an economy where knowledge (applied information) is used in all industries and sectors to improve productivity and to seek competitive advantage through commercial innovation and – in the public sector – to generate greater efficiency for government services and increased access to services for citizens. Such an economy is based on the production, distribution, and use of knowledge and information across the board, and is facilitated by ICT (Castells, 1996; Houghton & Sheehan, 2000).

South Africa has resources – infrastructure, businesses, people with knowledge and skills, institutions at many levels that contribute to building the country, and significant financial resources. However, the current usage of its resources is not producing the annual growth rates needed to move large numbers of people out of poverty and unemployment. Provinces such as the Free State, North West and Mpumalanga – traditionally reliant on mining and agriculture – are rethinking their economic options and priorities to better position themselves for growth and development.

In the past eight years, South African policy-makers have introduced a number of policy and strategy measures aimed at preparing South African economic sectors and institutions for participation in the global knowledge economy. These include, but are not limited to:

- The White Paper on Science and Technology – "Preparing for the 21st Century" (1996)
- The National Research and Technology Foresight Project (1998)
- A Human Resource Development Strategy for South Africa – "A Nation at Work for a Better Life for All" (2001)
- The South African Information Technology Industry Strategy (2001)
- The National Biotechnology Strategy for South Africa (2001)
- The Department of Trade and Industry's (DTI) Integrated Manufacturing and Industrial Strategy (2001)
- The National Research and Development Strategy (2002)
- The National Plan for Higher Education (2002)
- DTI's ICT Cluster Strategic Plan (2002)
- DTI Vision 2014
- The Advanced Manufacturing Technology Strategy (2003)

While limited progress has thus far been made in implementing these strategies, early benefits can be seen in, for example, the establishment and achievements of the Science Park and Technology Station at the Central University of Technology (CUT) and the contribution of the Automotive Industry Development Centre (AIDC) in Gauteng to building competitiveness in the global automotive sector.

Based on this composition, the Free State has a number of institutions that function within the broader South African NSI. They include the Department of Sport, Arts, Culture, Science and Technology, the HSRC, the University of the Free State, the Central University of Technology, FARMOVS – PAREXEL, and others. R&D capacity also exists at the Free State Botanical Gardens in Bloemfontein and at the Small Grain Institute, the Agricultural Research Council at Bethlehem and the National Cooperative Dairies at Heilbron. However, science councils such as the CSIR with their focus on a broad range of fields in science, engineering, technology and innovation, have limited presence in the province.

In the Free State, the Centre for Rapid Prototyping and Manufacturing (CRPM) and the Science Park based at the Central University of Technology, have collaborated with the community of the Basotho Cultural Village in the Golden Gate National Park to develop high quality clay pots for export. The pots bear local patterns and are made using indigenous materials and firing methods. The project, bringing together engineers, arts people and the community, aims to combine indigenous knowledge and new technology and to apply indigenous knowledge for economic competitiveness and LED.

The Centre offers a commercial service to conduct R&D that will support the commercialisation of innovations for individuals and groups who do not have the resources and specialised technologies to test their ideas and translate them into patented inventions. Successful R&D enables the CRPM to match contract income from clients with government funding through THRIP[1], thus expanding their R&D funding base. Successful commercialisation of the inventions and innovations opens up new income streams for the 'clients', who may become long-term supporters of the Centre.

2.4.1. Recommendations for the Free State

The following recommendations concerning the development of a knowledge-based economy in the Free State, as concluded by the PEAC reports, are listed here:

Recommendation 1: Economic development and innovation focus – Free State Growth and Development Agreement 2014

To build on the Growth and Development Agreement 2003, the Free State Provincial Government should pursue the establishment of a formal multi-stakeholder structure bringing in all the major economic players from the five districts that have the capacity, resources and desire to foster innovation – including industry partners, further and higher education institutions, science councils and provincial and local government players – and pursue their backing for a Free State Growth Agreement aimed at shifting the economic base towards high-value-add manufacturing and local innovation, initially on a small scale, but with plans to grow the size and scope of innovation output over the next ten years.

Recommendation 2: Science, engineering, technology and innovation focus – collaborative networks of science councils, local industry and other agencies

The Free State provincial government should encourage, foster and directly facilitate the establishment of strong collaborative networks among

[1] Technology Human Resource Investment Programme, DTI and NRF.

knowledge-based institutions across South Africa, in particular with the institutions in the National System of Innovation.

<u>The key objectives of these collaborative networks should be to:</u>
(1) produce significant numbers of high quality graduates in the disciplines of science, engineering, technology, social science, innovation management and entrepreneurship, with the curriculum and key outputs being focused towards building the knowledge and skills base to foster local innovation and to resource the partner institutions.

(2) encourage the growth of multi-disciplinary academic programmes that bring together the scientific, analytical and managerial disciplines in order to develop cohorts of science and technology researchers and entrepreneurs.

(3) promote R&D in the higher education environment in support of early innovation initiatives and in particular invest resources in postgraduate programmes at Masters, doctoral and post-doctoral level to supply a new generation of young researchers and thus replenish the declining pool of R&D workers.

(4) promote R&D across the institutions engaged in the system of innovation in the Free State Province for mutual benefit and put together collaborative bids for R&D and innovation funding flows, e.g. the Technology Human Resource Investment Programme (THRIP) and the Innovation Fund.

(5) collaborate on, and foster, the production of research outputs including patents, licences, prototypes and articles in local and international accredited journals.

Recommendation 3: LED and small towns

A “Small Towns Research Project” should be conducted on an ongoing basis to identify the particular activities that will best promote increased economic activity in each small town. Generalised recommendations applicable to many small towns are not appropriate or meaningful.

In addition, a “Small Towns Investment Fund” could be established, possibly in collaboration with the development financing sector including the Development Bank of Southern Africa, the Land Bank, the Industrial Development Corporatation, Khula and Ntsika to support local entrepreneurs in infrastructure development, agriculture and agro-processing, small-scale industry development and SMME development.

Recommendation 4: Human Capital focus – collaboration of provincial and other South African institutions

Given the low levels of access to further and higher education for many people and communities in the province, special efforts should be made to strengthen the availability of FET (Further Education and Training) and HET (Higher Education and Training) infrastructure in the province. For example, communities in the northern Free State rely largely on institutions in the provinces of North West and Gauteng for access to higher education. In reality, there is limited access to these campuses, which, although nearer than UFS or CUT (Central University of Technology), do not necessarily offer courses tailored to local needs. This access is in any event generally unaffordable to the majority of the Free State’s population.

Recommendation 5: Social Development focus – advances in telemedicine, e-government and ICT for development

The early work of the Free State Department of Health in promoting general health services and in particular tele-radiology services is highly commendable. Given the high levels of knowledge and expertise in the medical field in the Free State, detailed plans should be developed to promote the development of a hybrid face-to-face/telemedicine network over the next ten years to reach out to communities in towns and rural areas that currently have access to only the most basic health services.

The extension of mobile services to communities on farms, on mines, in small towns and in national parks can support the growth of a rurally biased tele-health approach. The combination of mobile tele-health services and the further establishment of multi-purpose community centres in collaboration with the Department of Public Service and Administration and the Centre for Public Service Innovation can provide the necessary infrastructure to promote the rural focus of the Department of Health in terms of health education, disease prevention, referrals and a more extensive range of health services.

Recommendation 6: ICT focus – ICT and e-government strategy

The Free State provincial government should work with local and district municipalities to design an e-government strategy that will, over time, ensure that every citizen and every business can interact with government online. This infrastructure base could, within a period of ten years, create an environment whereby citizens, government and business are fully interactive – using ICT as a functional tool to support learning, communication, entrepreneurship, trade and innovation. The CapeOnline initiative (provincial government) and the SmartCape initiative (local government) provide interesting models for a possible future.

Recommendation 7: Public service innovation focus – partnership with CPSI, SA Cities Network and DPSA Learning Network

The focus on public service innovation, (with key institutions being the CPSI, SA Cities Network and the DPSA Learning Network), covers a wide range – most notably the area of integrated service delivery. Both Free State provincial and local government should participate in these activities to contribute to and benefit from the general innovation drive occurring in the public service.

The introduction of innovations, such as those proposed in recommendations 1 to 5 are by definition high risk. Participation in innovation and learning networks can help to minimise the risks as the participants share their experiences and can learn what works and what does not from those who have taken earlier initiatives. Risk is spread throughout the group as not all participants will take on risk on the same issues at the same time.

2.5. MACRO ECONOMIC OVERVIEW OF THE SOUTH AFRICAN ECONOMY

This section provides insight into the South African economy. The focus is future orientated and serves as the contextual economic growth framework for the Free State PGDS.

It is important to recognise that South Africa's successful transition to democracy in 1994 has been accompanied by a dramatic reversal of the country's economic fortunes. Between 1981 and 1993, the economy had experienced three extended periods of recession and living standards declined throughout this period.

The real value of the country's fixed capital formation in 1993 was 30% lower than the figure for 1982 and inflation persisted at levels of between 10% and 20% for most of the 1980s and the early 1990s. During the period 1985 to 1993, South Africa was forced to maintain a surplus on the current account of its balance of payments, due to the capital flight instigated by the debt standstill agreements with foreign creditors. It had become clear by the end of the 1980s that domestic socio-political unrest, combined with international embargoes on trade with South Africa, was destabilising the country.

Democracy, attained in 1994, signalled an abrupt end to negative trends in virtually all of the major economic indicators. The changes in these trends are, by and large, dramatic, both in terms of directional shifts and sustainability, a fact that is not fully appreciated by the broad business community.

Between 1988 and 1992, real GDP in South Africa contracted by an average annual rate of 0.3%. Between 1993 and 2003 the South African economy managed an average annual rate of real economic growth of 2.6%. To place this change into perspective, this sustained growth performance has witnessed a three-fold increase in the nominal GDP (from R370 billion in 1992 to R1.2 trillion in 2003). The South African economy has, in fact, not witnessed a technical recession (two successive quarters of negative GDP growth) since the advent of democracy, and growth rates of between 3% and 4%, respectively, are being forecast for 2004 and 2006 by most economists.

The following macro-economic trends have been observed in South Africa since democracy (1994):

- Eleven successive years of positive real GDP growth
- The lowest inflation in 40 years
- A cumulative net inflow on the capital account of the balance of payments of more than R170 billion
- Average annual positive growth in capital formation of 4.6% (in real terms) between 1993 and 2003
- Average annual labour productivity growth of more than 4%
- A lowering of the budget deficit/GDP ratio from 9.1% in the 1993/94 fiscal year to 3% for 2004/2005
- A lowering of the public debt/GDP ratio from 50% to 40% over the past four years
- A decrease in the ratio of personal income and wealth taxes to gross salaries and wages
- An increase in the trade/GDP ratio from 38% to above 55%

A large degree of consensus exists amongst economists that South Africa has returned to a position of fundamental macroeconomic stability. Since 1998, every national budget prepared by the Department of Finance has provided measurable relief to low-income earners. The cost of mortgage credit is 30% lower today than during mid-2002 and interest rate levels are expected to remain at their current levels for many years to come.

It should be fairly obvious that such a state of affairs calls for renewed vigour in the quest to relieve poverty, particularly amongst rural communities. It is no surprise, therefore, that the State President himself has committed government to strict deadlines and ambitious targets with regard to projects aimed at large-scale job creation, expanding social welfare and establishing new infrastructure.

The link between infrastructure, on the one hand, and growth and development, on the other hand, is quite strong and transgresses direct effects via increased demand in the economy. Input-output table analysis shows that transport, telecommunications, electricity and water are used in the production processes of nearly all sectors of economic activity. Infrastructure services are not only demanded for direct consumption needs, but also indirectly, by reducing the costs associated with production or involvement in gainful employment.

Furthermore, the awarding of the 2010 Soccer World Cup bid should be viewed as an event that promises to act as a catalyst for future economic growth. In addition to boosting the national morale, every sector of economic activity stands to gain from a host of activities that will surround the preparation for the World's largest single event of whatever nature. Construction activity will be in the foreground, but the preparations for the tournament will impact on a multitude of linked industries, particularly tourism and hospitality.

2.5.1. Sectoral Outlook for the South African economy

This section outlines the outlook for the South African economy according to the nine formal sectors as defined by the Standard Industrial Classification.

<u>Agriculture</u>

Since 1998, the sector comprising agriculture, hunting, forestry and fishing, has underperformed relative to the aggregate economy. The sector's Gross Value Added (GVA) amounted to R41.9 billion in 2003 (SARB). The average annual real growth in GVA between 1998 and 2003 amounted to 1.8%, compared to 2.8% for the economy as a whole.

Within the three subsectors, the dominant subsector for agriculture and hunting outperformed the other two by a substantial margin. From the perspective of capital formation, agriculture has not performed well, with an average annual growth rate of less than one per cent.

The following key expectations in the agricultural sector are listed here:

- Recognition in the Strategic Plan for Agriculture that agriculture holds strategic importance with regard to food security, foreign exchange earnings and employment creation.
- Land reform aimed at increasing the utilisation levels of arable land as well as BEE considerations are to be stepped up.
- New water schemes that will also enhance land utilisation levels.
- Due to the prevalence of primary workers in most agricultural subsectors, skills development initiatives will prove to be relatively cost effective.
- A growing population will lead to an ever-increasing demand for food products. The latter constitutes the bulk of household consumption expenditure for lower income groups, and the demand for food products is destined to continue growing.
- High levels of protection for farmers in Europe continue to act as a deterrent to increased agricultural output in developing countries.

Mining

The mining sector has been the worst performing key sector of the economy over the past five years, and has, in fact, contracted in terms of real GVA between 1998 and 2003. Despite this negative trend, the sector seems to be optimistic over future prospects and has recorded the highest capital formation growth rate in the economy since 1998.

The South African mining sector experienced a period of significant expansion during the 1970s and early 1980s, raising its contribution to the country's total GVA from 11% in 1952 to more than 20% in 1980. Since then, however, the sector has consistently shrunk in terms of its relative contribution to the total economy, namely to a level of only 7.1% in 2003.

These trends do not necessarily equate to an industry in demise, but rather reflect the substantial degree of economic development that has taken place with regard to increasing domestic value added in the secondary and tertiary sector of economic activity. Unfortunately, increased international competitiveness and enhanced output capacity in other mining countries have necessitated a switch in mining techniques toward more technologically advanced methods, resulting in an inevitable decline in employment levels. Table 2.1 illustrates trends with regard to mining production volumes between 1998 and 2003, clearly indicating the existence of mixed fortunes within the different subsectors of mining.

Table 2.1 - Mining Production volumes (Index - 2000 = 100)

Mining products	1998	1999	2000	2001	2002	2003	Avg. annual growth
Platinum group metals	96.7	104.7	100	110.6	115.9	129.0	5.9%
Building materials (mining)	79.2	75.6	100	97.9	99.2	97.5	4.2%
Manganese ore	79.5	83.4	100	89.3	92.3	93.4	3.3%
Diamonds	101.2	92.4	100	115.9	100.6	117.9	3.1%
Iron ore	98.8	87.9	100	103.5	109.2	114.6	3.0%
Chrome	97.3	102.3	100	82.6	96.6	111.1	2.7%
Nickel	100.2	98.9	100	99.5	105.3	112.0	2.2%
Coal	99.8	99.2	100	99.1	99.8	105.9	1.2%
Other non-metallic minerals	106.8	96.2	100	93.9	90.6	85.8	-4.3%
Gold	108.0	104.8	100	91.7	92.4	86.6	-4.3%
Other metallic minerals	107.0	93.4	100	97.3	99.6	83.8	-4.8%
Copper	121.0	105.8	100	104.0	94.7	88.3	-6.1%
Total, gold excluded	**100.8**	**99.5**	**100**	**104.8**	**105.6**	**113.7**	**2.4%**
Total, gold included	**103.6**	**101.5**	**100**	**101.4**	**102.2**	**106.7**	**0.6%**

Source: Quantec Research

It is clear from these figures that the subsectors for platinum group metals, manganese ore, diamonds, iron ore and chrome have performed well over the past five years, but that gold and a variety of other mining activities have not grown at positive real rates.

In its latest overview of the South African economy, the Department of Finance has warned that the current strength of the rand exchange rate may impact negatively on mining output in the medium term.

The following key expectations in the mining sector are listed here:

- The mining sector has recorded the highest capital formation growth of all sectors in the economy since 1998.
- In terms of its contribution to foreign exchange earnings, no other sector remotely matches the performance of mining.
- Future research & development initiatives supported by the industry, particularly at Mintek and the CSIR, are expected to lead to an improvement in the beneficiation chain within the mining sector.
- Improved economies of scale within SADC, as a result of the democratisation initiatives in Angola and DR Congo, will in future also provide impetus for beneficiation and the realisation of resource potential. The latter has been declared a policy imperative of NEPAD.
- The subsectors for iron platinum, diamonds, iron ore, and coal are expected to record relatively strong growth.

<u>Manufacturing</u>

The manufacturing sector has performed reasonably well over the past five years, recording average annual GDP growth of 2.5%, in real terms (SARB). This figure is marginally below the growth rate for the economy as a whole between 1998 and 2003.

Although manufacturing has been surpassed by the sector for financial & business services as the largest contributor to GVA, its role in the economy remains strategically important by virtue of the multifarious linkages between the primary and tertiary sectors. Strong backward linkages exist to the agriculture, mining and energy sectors, with significant forward linkages to the construction, trade, transport and financial services sectors, and it enjoys the status as the largest non-government sector employer. A particular issue that needs to be considered in any future evaluation of employment trends within the manufacturing sector is the role that it is expected to play in further primary sector beneficiation initiatives, as well as exports to Sub-Saharan Africa.

The following four tables provide a ranking of manufacturing subsectors in terms of four different norms, namely production volume growth, sales value growth, sales values in absolute terms and export earnings. In combination, these methods of ranking provide a concise overview of the sectors that are important to the national economy in terms of their size, their recent growth performance and their contribution to foreign exchange earnings.

Table 2.2 - Top manufacturing sectors by volume growth (index, 2000 = 100)

Manufacturing sectors	**1998**	**2003**	**Avg. growth**
Motor vehicle parts & accessories	78.5	119.2	8.7%
Electricity distribution and control apparatus	88.0	129.7	8.1%
Motor vehicles	71.4	101.5	7.3%
Basic iron and steel	83.5	109.4	5.6%
Professional equipment	97.8	122.9	4.7%
Products of wood	86.7	107.3	4.3%
Other fabricated metal products	94.7	116.9	4.3%
Basic precious and non-ferrous metals	82.3	100.9	4.1%
Wood and wood products	90.5	109.2	3.8%
Plastic products	101.3	121.4	3.7%
Basic chemicals	88.7	105.7	3.6%
Special purpose machinery	111.1	131.8	3.5%
Meat, fish, fruit, vegetables, oils and fats	97.6	115.5	3.4%
Sawmilling and planing of wood	96.1	112.2	3.1%
Glass and glass products	101.3	117.9	3.1%
Household appliances	91.2	104.2	2.7%
Machinery and equipment	104.6	118.5	2.5%
Paper and paper products	89.2	99.1	2.1%
Total manufacturing	**96.9**	**105.7**	**1.8%**

Source: Quantec Research

Table 2.3 - Manufacturing sales growth - top performers

Manufacturing products	1998	2003	Avg. growth
Jewellery and related articles	2,518	4,753	13.5%
Parts and accessories for motor vehicles	12,656	22,005	11.7%
Motor vehicles	32,866	53,853	10.4%
Electricity distribution and control apparatus	2,400	3,856	9.9%
Petroleum refinery products and nuclear fuel	22,846	35,584	9.3%
Basic iron and steel products	32,064	48,542	8.6%
Cement, lime and plaster	3,149	4,664	8.2%
Basic chemicals	8,465	12,525	8.2%
Other wood products, e.g. builders' carpentry	4,959	7,260	7.9%
Coke oven products	1,138	1,611	7.2%
Slaughtering, preparing and preserving of meat	6,955	9,707	6.9%
Products of wood	7,150	9,654	6.2%
Processing of fresh milk (pasteurising)	2,713	3,647	6.1%
Cutlery, hand tools, general hardware	2,273	3,046	6.0%
Soap, perfumes, cosmetics	8,888	11,733	5.7%
Steel pipe and tube mills	2,886	3,807	5.7%
Medical, precision and optical instruments	1,624	2,111	5.4%
Metal containers, e.g. cans and tins	4,657	6,047	5.4%
Metal fasteners	868	1,115	5.1%
Stationery and other paper products	4,318	5,513	5.0%
Tyres, tubes and rethreading of tyres	4,096	5,213	4.9%
Distilleries and wineries	7,735	9,627	4.5%
Plastic products	12,913	15,979	4.4%
Flour and grain mill products	12,857	15,726	4.1%
Manufacturing sales: Total	**505,699**	**613,630**	**3.9%**

Source: Quantec Research

Table 2.4 - Key manufacturing subsectors by sales values (Rm at constant 2003 prices)

Manufacturing sector	1998	2003	Avg. annual growth
Motor vehicles	32,866	53,853	10.4%
Basic iron and steel products	32,064	48,542	8.6%
Other chemical products and man-made fibres	32,183	36,429	2.5%
Petroleum refinery products and nuclear fuel	22,846	35,584	9.3%
Fabricated metal products	33,319	35,249	1.1%
Beverages	26,179	30,006	2.8%
Paper and paper products	24,832	29,650	3.6%
Machinery and equipment	25,314	28,624	2.5%
Meat, fish, fruit, vegetables, oils and fats	22,216	26,899	3.9%
Grain mill products and starches	19,358	23,473	3.9%
Other food products	23,388	23,066	-0.3%
Parts and accessories for motor vehicles	12,656	22,005	11.7%
Basic precious and non-ferrous metals	15,783	18,982	3.8%
Electrical machinery and apparatus	15,702	17,329	2.0%

Manufacturing sector	1998	2003	Avg. annual growth
Plastic products	12,913	15,979	4.4%
Flour and grain mill products	12,857	15,726	4.1%
Printing and publishing	15,121	15,208	0.1%

Source: Quantec Research

Table 2.5 - Key manufacturing exports by subsector (Rm at constant 2003 prices)

Manufacturing subsector	1998	2003	Avg. annual growth
Base metals	30,705	43,373	7.2%
Transport equipment	10,861	24,916	18.1%
Machinery & equipment	13,903	24,248	11.8%
Chemicals	12,563	15,724	4.6%
Food	8,027	10,953	6.4%
Paper	5,615	6,748	3.7%
Textiles & clothing	4,360	6,100	6.9%
Plastics & rubber	4,146	5,091	4.2%
Other products	3,679	4,562	4.4%
Wood products	1,919	3,345	11.7%
Articles of stone & cement	1,257	1,670	5.8%
Professional equipment	1,122	1,597	7.3%
Leather products	1,576	1,426	-2.0%
Footwear	194	271	7.0%
Art & antiques	126	164	5.4%

Source: SARS Customs & Excise

The following key expectations in the manufacturing sector are listed here:

- The sector has experienced positive GVA growth over the past five years, namely 3.6%
- Strong export growth has occurred since 1998 in the sectors for transport equipment, machinery & equipment, wood products, base metals, professional equipment, food, and textiles & clothing. Several of these sectors benefited from AGOA.
- In terms of total sales value, the key subsectors are transport equipment, iron and steel products, chemicals, petroleum refinery products, beverages, paper, machinery & equipment and a variety of food subsectors. Several of the largest manufacturing sub-sectors possess strong linkages with the primary sectors.
- Volume growth trends over the past five years reflect a ranking that corresponds closely to that for total GVA contribution.

- The sector represents a key baseline economic structure with a multitude of high-technology linkages with all other sectors of economic activity. Several subsectors possess high-value-added and employment multipliers.
- In terms of sales value growth, it is significant that several sectors seem to be benefiting from specific incentives introduced by the DTI. These include motor vehicles and jewellery.
- Government's strategic investment incentive programme has supported capital expenditure of more than R27.3 billion over the past decade.
- Technological advancement and increased international competitiveness will continue to change the skills profile in this sector towards higher competency levels.

Electricity and water

Impending capacity constraints faced by Eskom have prompted the announcement of plans for large-scale capital expenditure on new **electricity** generating capacity.

Since 1993, the total nominal power capacity of power stations has grown by only 5.7%, whilst the peak demand on Eskom's integrated system has grown by 36%. As a result, a number of previously mothballed power stations are expected to be refurbished and made operational again within the next two to four years. They are:

- Camden (Ermelo);
- Grootvlei (Balfour); and
- Komati (Middelburg, Mpumalanga).

It is envisaged that South Africa would require at least one more power station with a 3,600 MegaWatt capacity before the end of the decade, and thereafter another one every three years. According to price estimates conducted by Eskom, the new capacity will cost eight times as much as the existing capacity.

Government's declared commitment to supply poor families with 50kW of free electricity a month will undoubtedly hasten the need to create new electricity generating capacity. Although plans have been mooted to seek intra-regional solutions through, inter alia, the restoration of and development of new hydroelectric generators in the Democratic Republic of Congo, the civil war in this country, combined with the long-term nature of such programmes, will place significant pressure on Eskom and the stakeholders in the new institutionalised electricity supply chain to act quickly.

An indicator of growth trends in the water sector is the storage capacity of major South African dams. According to the Department of Water Affairs and Forestry (DWAF), total capacity at the beginning of 2001 stood at almost 30 billion cubic metres with dams, on average, more than 90% full. Between 1960 and 1990, South Africa's ground water resource capacity was expanded from a capacity of 5 billion cubic metres to almost 28 billion cubic metres.

Between 1990 and 2000, however, the average annual growth in capacity expansion has been less than one per cent. In the future perspective of water requirements contained in the National Water Resource Strategy (NWRS), it is acknowledged that water deficits in the Water Management Areas (WMAs) are likely to increase and surpluses are likely to diminish. It is not surprising, therefore, that the DWAF intends to construct a number of new water schemes, the completion dates of which are projected to run until 2015.

Water shortages act as major impediments to social and economic development, particularly in arid regions with increasing populations. In appreciation of the fact that South Africa is a semi-arid country and that 11 of the 19 WMAs are facing a water deficit, the South African government has recently completed a thorough overhaul of legislation pertaining to the country's water resources.

Other key characteristics of the water sector in South Africa are:

- a high level of dependency on surface water in most of the developed regions;

- ground water plays a major role in rural water supply, but large porous aquifers occur only in a few areas;
- the four rivers that collectively drain almost 70% of the land area are shared with other countries (Limpopo, Inkomati, Pongola and Orange);
- the natural availability of water across the country is uneven and is compounded by a strong seasonality of rainfall;

Construction

Construction activity in South Africa was adversely affected by the sharp increase in interest rates that occurred towards the end of 1998, and no growth occurred over the period 1998 to 2000. Since then, the sector has started to recover, and the 2003 real rate of increase in GVA amounted to 5%. Average annual growth over the past five years was 2.5%, marginally below the figure for the economy as a whole. In terms of its contribution to the country's total GDP, construction has diminished marginally from a level of 2.7% in 1998 to 2.6% in 2003.

The following key expectations in the construction sector are listed here:

- An expansion of government infrastructure projects, particularly in the area of Water Management Areas (WMAs).
- Increased budgetary support for the Expanded Public Works Programme (EPWP).
- The installation of facilities to support the industrial development zones, especially Coega.
- An imminent upgrading of the facilities at the Durban container terminal and Durban Harbour.
- The announcement by Transnet that it intends spending R14 billion over the next decade to upgrade the country's rail transport facilities.
- Preparations for the Soccer World Cup in 2010, which will witness the upgrading of existing sports stadiums and the building of several new ones
- The Gautrain project, which is due to commence during September 2005.
- An expansion of public/private partnerships in the area of construction activity, which promises to introduce innovating funding ideas to future infrastructure projects.

- A clear indication by various research reports confirming the need for a higher output of suitably qualified construction sector workers (at virtually all levels). This conclusion is supported by the Construction Industry Development Board
- Increased budget allocations have been made towards housing infrastructure. Since 1994, approximately 500 new houses have been built for poor people every working day under the housing subsidy scheme and 22 000 emerging contractors have been established. These figures are expected to accelerate over the next five years.
- The total number of 1.6 million houses that have been completed under this programme has created an asset base of R50 billion for historically marginalised people. Future access to credit via collateral based on intrinsic property values will stimulate construction activity through incremental home improvements.
- Increased occupancy levels for office space suggest that the medium-term prospects for the construction of commercial office parks are improving.

Wholesale & retail trade, catering & accommodation

The sector comprising wholesale & retail trade and activities relating to hotel and restaurants, has maintained its 13.3% contribution to the country's total GVA over the 1998 to 2003 period. Average annual real GDP growth over the past five years has been identical to the figure for the economy as a whole, namely 2.8%.

In terms of capital formation, however, the sector has performed exceptionally well, recording average annual real growth of 5.6%, which is more than double the figure for the economy as a whole.

The second key component of the sector comprising trade, catering and accommodation, is closely related to tourism activities. South Africa is in the process of consolidating its new status as one of the world's preferred international tourist destinations. Official statistics indicate that overseas tourist arrivals in South Africa increased at an average annual rate of 5.8% between 1996 and 2003, which is virtually double the real growth rate for the economy as a whole. In 2002 the rate of growth of overseas holiday visitors was 12.8% - a year in which world tourism activity declined marginally.

The events of September 11, 2001 started a slowdown in global tourism. Since then, matters have not improved, mainly as a result of the war on Iraq, a deepening of the Middle East crisis, a continuation of anti-American terrorism, the outbreak of the Serious Acute Respiratory Syndrome disease, and sluggish world economic growth.

The result has been manifested in the first decline in the global tourism industry in more than two decades. Quoted in a recent international survey of tourism trends, a spokesperson for the World Tourism Organisation has referred to the current climate as “the worst in living memory”.

Until 2001, international tourism had enjoyed a 20-year period of uninterrupted growth, averaging more than 4% per annum. The last two years, however, had witnessed negative growth and the World Travel and Tourism Council is predicting a paltry 1% growth for 2003.

The United Kingdom remains South Africa’s foremost source of overseas tourist arrivals, accounting for almost one quarter of total arrivals as indicated in Tables 2.6 and 2.7.

Table 2.6 - Arrivals of foreign visitors (holiday)

Year	No ('000)	Growth
1996	3,938	n/a
1997	4,002	1.6%
1998	4,731	18.2%
1999	4,991	5.5%
2000	4,989	0.0%
2001	4,962	-0.5%
2002	5,596	12.8%
2003	5,853	4.6%
Average annual growth = 5.8%		

Source: Statistics South Africa

Table 2.7: Foreign arrivals by country of residence - 2003

Country of residence	Arrivals
Country	no ('000)
UK	463
Germany	261
US	193
France	130
Netherlands	123
Australia	73
Italy	50
Belgium	44
India	43
Switzerland	36
Canada	36
China	33

Source: Statistics South Africa
Note: Excludes Africa

The accompanying tables list South Africa's top twelve sources of overseas tourist arrivals (in terms of the total for 2003), as well as the total number of foreign travellers arriving in South Africa for holiday purposes over the past seven years.

The following expectations regarding this sector are highlighted:

- Sustained economic growth and the development of many new retail complexes since 1994 have assisted the growth performance of the wholesale & retail trading sectors.
- Exceptionally high capital formation growth rates over the past five years are likely to provide further momentum to the sector's future growth performance.
- Further diversification of motor vehicle brands in South Africa will boost employment growth within this subsector.
- International tourist arrivals are set to continue growing as a result of socio-political stability in South Africa, the high retention rates applicable to foreign tourists, and the Soccer World Cup 2010. Fact-finding and preparatory missions from the soccer fraternity of countries that expect to qualify for 2010 may start arriving several years in advance of the event itself.

- The heightening of international terrorism since September 11, 2001 has benefited the South African tourism industry through an international perception of the country's relatively safe geographical location, as well as the neutrality of South Africa's foreign policy stance.
- Total employment in the hospitality industry is estimated at more than 1.1 million, and the ratio of hospitality industry employment to aggregate employment in the economy has increased from 19% in 1997 to 24% in 2003.
- Continued tax relief for low- and middle-income earners has contributed to a lowering of the personal tax/gross salary ratio for the economy as a whole. This trend is expected to continue for several years to come and will provide further impetus to retail sales growth.

Transport, storage & communication

The sector comprising activities related to transport and communication has been the best performer in the economy, recording average annual GVA growth of 6.9% between 1998 and 2003. Although the sector has experienced negative capital formation growth since 1998, this trend should be seen against the background of the substantial capital outlays prior to 1998, during which time SA Airways expanded its fleet of passenger jets and cellular telephone operators were establishing networks.

As a result of the sustained strong growth of the past five years, the sector has increased its contribution to the country's total GVA from 8.3% to 10.1%.

Over the past five years, the subsector for posts & telecommunications posted the largest average annual growth rate of all the two-digit SIC sub-sectors in the economy, namely 12.1%. Air transport growth was also above-average (3.7%), but storage and land transport activities have been more subdued, with growth rates below the national average.

The South African government fully recognises the cardinal importance of a thriving communications sector within a world economy that is systematically shifting the composition of GVA towards tertiary economic activity. It has provided the institutional statutory environment for the development of cellular telephone operators.

An estimated 3.3 million South Africans enjoyed access to the internet by the end of 2003, and this figure is set to grow strongly in future. The Department of Communications is in the process of establishing Public Internet Terminals (PITs) throughout the country and 300 of these terminals were in operation by the end of 2003. The total number of fixed phone lines in South Africa is estimated at 5 million, and the number of cellular telephone users is estimated at 13 million.

The following expectations regarding the Transport and Communications sector are noted here:

- The establishment of three cellular telephone networks in South Africa has resulted in the sector for transport, storage and communication outperforming all other sectors over the past five years. Its real average annual GVA growth has been more than double the figure for the economy as a whole between 1998 and 2003.
- Capital formation in the sector has declined in real terms since 1998, but this was partly due to the completion of the capital expenditure programmes associated with the cellular telephone networks.
- The rates of GVA growth within the different components of the sector differ substantially, with the subsector for posts and telecommunications recording average annual real growth of 12.1% between 1998 and 2003. This is more than four times higher than the growth rate for the economy as a whole. Air transport managed above-average growth of 3.7%, but the key subsectors of land transport and storage only recorded growth of 1.7% and 1.8%, respectively.
- Capacity constraints within rail transport have become an impediment to economic growth, and Transnet has announced its intention to spend more than R14 billion as part of an upgrading programme.
- The cellular telephone operators will continue to experience an increase in subscribers and are also expanding their networks into several African countries.

- Telecommunications sector growth will be boosted by the introduction of a second fixed line operator.

Finance, insurance and business services

In 1999, the sector comprising financial intermediation, insurance, real estate and business services overtook manufacturing as the largest private sector contributor to GVA. Between 1998 and 2003, this sector recorded the second highest real GVA growth rate in the economy, namely 4.7% (annual average).

A measure of the growing importance of financial and business services as a generator of value added and employment in the economy is the fact that in 1994, its contribution to GDP stood at 16% and it represented 75% of the GVA of the government and other services sector. By 2003, these ratios had increased to 21% and 98%, respectively.

Capital formation growth in the sector has been sluggish since 1998, with an average annual real growth rate of only 1.8%. One explanation for this trend is the consolidation that has taken place in the industry, which has resulted in a degree of excess capacity.

For the growth indicator, all eight of the two-digit codes were ranked in the country's top-20 performers, whilst two subsectors (other business activities and financial intermediation) are in the country's top five with regard to GVA.

A further indication of the increasing significance of this sector is illustrated by the systematic increase in the ratio of total bank assets to the country's GDP, which reached a new record high of 114% at the end of 2003. This trend is depicted by Table 2.8.

A relatively low interest rate environment continues to bolster the earnings of local banks, and results announced by the big four (ABSA, Standard Bank, First Rand and Nedbank) continued to be supported by strong growth in retail lending.

Table 2.8 - Total assets of banks and GDP at current prices

Year	Bank assets Rb	GDP Rb	Bank assets/ GDP ratio
1993	295	382	77%
1994	344	431	80%
1995	399	485	82%
1996	471	618	76%
1997	550	686	80%
1998	654	739	88%
1999	726	801	91%
2000	821	888	92%
2001	1050	983	107%
2002	1103	1121	98%
2003	1381	1209	114%

Source: Quantec Research

The following expectations regarding the finance sector are noted here:

- This sector constitutes the largest single sector of economic activity in South Africa. Its strong growth has been reflected in an increasing ratio of bank assets to GDP, which is currently at a level of 14% above parity.
- Several subsectors are ranked amongst the top GVA sectors (two-digit classification).
- Average annual growth between 1998 and 2003 has been second only to the sector for transport and communication, namely 4.7%.
- The broad-based nature of GVA in this sector is illustrated by the fact that none of the subsectors feature prominently in the weighting of goods and services upon which the CPI is based.
- Consolidation in the banking and insurance subsectors has resulted in net employment losses over the past five years.
- Government has proposed new banking legislation that aims to significantly expand the range of financial services available to low-income earners.
- Sustained growth in the number of middle-income earners over the next five years is likely to stimulate the demand for insurance services.
- A sustained increase in the number of homeowners in South Africa has resulted in a significant increase in household assets. Access to collateral

finance is destined to be expanded into the area of low-income property ownership during the next decade.

Government, community and social services

Public sector expenditure dominates the sector for government, community, social and other services. Due to the long-standing policy of fiscal restraint, which was necessitated by a high deficit/GDP ratio, government expenditure trends have been lagging for most of the post-democracy era. In this process, government's contribution to total GVA has shrunk. Average annual growth in GVA for this sector amounted to only 0.6% between 1998 and 2003, and its contribution to GVA dropped from 23.6% to 21.1% over this period.

Growth in activities included in this sector has been well below average in every subsector, despite the fact that three of these subsectors are ranked in the country's top six in terms of their contribution to GVA (education, public administration & defence and health & social work). A reduction in the relative share of capital expenditure proved to be one of the negative side-effects of strict fiscal policy.

As a result of having lowered the budget deficit/GDP ratio to fundamentally sound levels over the past five years, government has indicated a change in its policy stance towards a more expansionary role.

Infrastructure

The first indication of government's commitment to increasing public expenditure on infrastructure and service delivery was provided in the National Budget for the fiscal year 2004/2005. In the chapter dealing with policy priorities for the decade ahead, the National Treasury has identified the following four key areas:

- Improvements in the quality of education and promotion of training opportunities, to ensure that skills development and productivity enhancement contribute to expanding participation in social and economic development.

- A poverty reduction strategy that includes promotion of work opportunities, creating sustainable communities and safe neighbourhoods and consolidation of the social security system.
- Development of markets, support for emerging entrepreneurs, better governance and regulation of private and public sector institutions and rigorous monitoring and measurement of public service delivery.

Since the tabling of the budget in Parliament in February 2004 and in particular, since the completion of the country's third round of democratic elections in April 2004, more specific details have been made public on the type of programmes that government intends to implement in pursuance of the infrastructure drive.

On 21 May 2004, President Thabo Mbeki unveiled a fair degree of detail about these programmes during his first keynote address to the new Parliament. In his address, he distinguished between two different sets of policy measures, namely those that would serve to encourage growth, development and job creation in South Africa's formal economy and a programme to address the challenges of the informal economy - representing the poor (or South Africa's "second economy", as referred to by the President). One of the key components of the latter programme would be the building of a social security net to alleviate poverty, whilst several cross cutting measures were also announced to deal with the high crime rate. These include an increase, by 2006, of police officers on active duty to 152,000 and the establishment of Special Joint Teams with the immediate objective of apprehending the top 200 criminals in the country.

Specific programmes of action were announced to grow the formal economy. These include the following:

- Raise the rate of investment.
- Work to reduce the cost of doing business in the country.
- Particular attention to SMMEs.
- Speed up the process of skills development, focusing on the shortfalls that had already been identified.

- Enhance the country's export performance, focusing on services and manufactured goods.
- Increase spending on scientific research and development.

Key programmes of action to grow the informal economy are:

- The Expanded Public Works Programme was launched in all provinces during 2004.
- A Financing Protocol was finalised during 2004 relating to the Urban Renewal and Rural Development Programmes.
- The Apex Fund (dedicated to the extension of micro credit) that came into operation in 2004.
- The Department of Agriculture to increase its support to agricultural activities in the communal land areas as well as other small-scale agriculture.
- During the 2005 financial year, finalise the strategy for the development and extension of financial and non-financial support to cooperative enterprises.
- The Department of Education would expand the reach of the Adult Basic Education and Training programme.
- Work with provincial and local governments to ensure that Community Development Workers are deployed by the end of 2004 in the 21 identified urban and rural nodes.
- Ensure that modern information and communications technologies were introduced in the development nodes as quickly as possible to assist in all their developmental and governance efforts.

The significance of the new infrastructure acceleration strategy in terms of both the fiscal expenditure commitment and its anticipated impact on job creation, warrants closer scrutiny of the key components of the programme.

<u>Health</u>

Healthcare as a topic has been at the forefront of public opinion ever since the 1994 elections, with a high prevalence of HIV and tuberculosis having been singled out as the two most urgent areas that require policy intervention.

Despite the high media and public profile afforded to the HIV situation, many difficulties have been experienced in providing effective treatment. These difficulties relate to the sensitivity surrounding the disease, as well as costs (within the ambit of budget constraints).

South Africa ranks fifth within southern Africa in terms of HIV and AIDS prevalence, a region that is viewed as the epicentre of the epidemic. It is estimated that the highest prevalence rates in the region in 2003 were in Swaziland (38.2%), followed closely by Botswana (38.0%), Lesotho (28.9%), Zimbabwe (24.9%), South Africa (20.9%), Zambia (16.7%) and Malawi (14.3%). HIV and AIDS is particularly hard hitting in that it directly affects the sexually active section of the population, which is also the core of the workforce. The recently released report by the International Labour Organisation (ILO) reveals that over 70% of the world's labour force living with either HIV or full-blown AIDS is found in Africa. South Africa (3.7 million), Zimbabwe (1.3 million) and Mozambique (1.1 million) are ranked among the African countries that have crossed the one million "threshold" of labour force participants infected with HIV. The ILO's projections of labour force losses due to HIV and AIDS for 2005 and 2020 estimate that labour supply in Botswana, Zimbabwe and South Africa will be the hardest hit over the next fifteen years. South Africa's estimated losses due to HIV/Aids are expected to rise from one in ten workers to one in four over the coming fifteen years. With the well-recorded indications that HIV and AIDS prevalence among females tends to be higher than that of males, the faster decline in labour force participation among women is possibly due to this epidemic.

No other area of acknowledged public sector intervention has remotely witnessed as much activism in the democratic era than health and some of the demonstrations have been reminiscent of the political upheavals of the 1980s.

It is to no surprise therefore, that government has approved a dramatic increase in the budget allocation to the Strategic Health Programme (SHP), namely from R510 million in 2001 to more than R1.6 billion in 2005. The increase in the 2005 fiscal year alone is more than 37%. The subprogramme for HIV & Aids and Tuberculosis will receive three-quarters of the amount budgeted for in 2005. The objectives of the SHP are:

- Continuously strengthen policies and programmes for: HIV & Aids prevention, treatment and care, sexually transmitted diseases; tuberculosis; child health; reproductive and women's health; occupational and environmental health; and nutrition.
- Ensure that all medicines used are safe and affordable, and that essential medicines are available at all times in the public health sector.
- Monitor and evaluate health trends, through relevant research and epidemiological surveillance, to ensure that national health policies and programmatic interventions are having their desired impact.
- Support the development of the district health system as the vehicle for delivering primary health care services.

Table 2.9 - Expenditure on the Strategic Health Programme

Subprogramme	Expenditure (Rm)				
	2001	2002	2003	2004	2005
District Health Systems	3.6	2.5	2.5	3.2	2.8
International Health Liaison	20.5	35.8	31.4	46.8	41.7
SADC	1.8	2	2.4	~	~
Health Monitoring and Evaluation	121.5	145.4	161.8	183.6	176
Maternal, Child and Women's Health	142.2	103.7	103.2	132.3	135.7
Medicines Regulatory Affairs	15.1	15.8	21.3	23	23.5
Mental Health & Substance Abuse	4.6	6	5	6.2	7
HIV/Aids and Tuberculosis	181.1	265.8	460	766.3	1,212
Pharmaceutical Policy and Planning	11	49.2	17.3	23.9	27.7
Medical Schemes	8.8	2.6	~	2.7	2.8
Total	**510.2**	**628.8**	**804.9**	**1188**	**1629.2**

Source: Department of Finance

Other indications of the higher budget priority, which has been afforded to health, include the following:

- During 2003, the SA Government approved the Operational Plan for Comprehensive HIV & Aids Care, Management and Treatment for South Africa, which will be translated into significant national expenditure increases for HIV & Aids related programmes. The total HIV & Aids related budget over the next three fiscal years has been estimated at R12.3 billion.

- Health grants to South Africa’s nine provinces have received a higher fiscal priority. In the most recent National Budget, the amount allocated to conditional health sector grants is set to increase by 37% over the next three fiscal years (FYs), namely from R6.7 billion in FY 2004 to R9.2 billion in FY 2007.
- DoH expenditure on transfers and subsidies, which entail some degree of consulting work, is also being increased at a rapid rate, namely from R209 million in FY 2001 to more than R1 billion in FY 2005.

The following table provides a concise overview of expenditure trends relating to transfers and subsidies funded by the DoH. It is clear from these trends that the SA Government regards such expenditures as high priority status, with the total figure increasing by an annual average of more than 50% between the fiscal years 2001 and 2005.

The bulk of these transfers will go to the Provincial Governments, but the increase in transfers to NGOs that are involved in the area of HIV & AIDS, is also significant (from R5 million in 2001 to more than R40 million in 2005). In the area of health sector skills, serious concerns have been raised over the ability of the health authorities to meet the demand-side commitments embodied in the latest National Health Budget.

An annual health survey conducted by the Health Systems Trust (HST) has found that 31.1% of all professional health posts in the public sector were vacant at the end of 2003. In the Free State, this figure is as high as 40.7%. Apparently, 45% of professional health sector workers have indicated their intention to work abroad once their community service term has expired.

Table 2.10 - Expenditure on Health Transfer Payments and Subsidies

Beneficiary	Expenditure (Rm)				
	2001	2002	2003	2004	2005
Provinces					
Integrated Nutrition Programme	69.9	69.9	71.1	97	112.2
HIV/Aids Conditional Grant	16.8	54.4	210.2	333.6	781.6
Research					
Medical Research Council	108.7	127.2	145.5	156.7	154.4
Medical Scheme Council	8.8	2.6	2.7	2.7	2.8
Non-profit Institutions					
HIV/Aids - NGOs	5	5	31.3	53.8	40.3
Tuberculosis - NGOs	~	~	2.5	2.6	3
Total	**209.2**	**259.1**	**463.3**	**646.4**	**1094.1**

Source: Department of Finance

A further negative trend is the fact that the number of South Africans belonging to a medical aid schemes has declined from 17% in 1997 to 15.2% in 2002.

The huge responsibility that awaits government in the area of health is also evident from the increase since 1994 in the infant mortality rate, combined with a decrease in the life expectancy rate amongst South Africans.

<u>Education</u>

The consolidated education budgets of the nine provinces showed an increase of 8.4% for the 2005 fiscal year. This strong growth is the result of a renewed commitment by government to sustain the delivery of inputs, such as learner support materials and school infrastructure.

The grant for the school nutrition programme has been transferred to the education department, and the budget allocation is set to rise to more than R1 billion over the next three fiscal years. It is generally recognised that the South African education system requires substantial policy intervention in the following key areas:

- Teacher shortages in certain disciplines, particularly in science and mathematics

- A relatively low pass rate for matriculants
- High levels of adult illiteracy
- Inadequate facilities at many schools, particularly in the rural areas.

In addition to these direct issues, the South African education authorities are also aware of the need to focus on quality education, as a result of the pressures emanating from globalisation and the ever-increasing level of international competitiveness, as well as the continuous introduction of new technologies in the workplace.

Testimony to the challenges that lie ahead for the South African education sector (directly and indirectly) may also be found in the following rankings of South Africa's international competitiveness by the Institute for Management Development (IMD) in Table 2.11:

Table 2.11 - Rankings of South Africa's international competitiveness (out of 60 countries) in areas related to education and training

Indicator	Rank
Unemployment rate	60
Pupil/teacher ratio (secondary education)	57
Pupil/teacher ratio (primary education)	57
Illiteracy	57
Secondary school enrolment	55
Availability of qualified engineers	55
Availability of competent managers	54
Internet users	48

Source: IMD World Competitiveness Yearbook 2004

Progress has, nevertheless, been achieved in the field of education since democracy, as witnessed in the following indicators:

- Sustained improvements in pass rates (from below 50% in 1996 to above 60% in 2003)
- A decline in the pupil/classroom ratio from 43 in 1996 to 30 in 2003
- An increase in access to water (for schools) from 60% to 70% between 1996 and 2003
- An increase in access to a fixed telephone line from 41% to 69% between 1996 and 2003

- In 2001, a total of R248 million was spent on adult education. This figure rose to about R1.2 billion in 2004.

The following expectations regarding the Public sector are noted:

- In terms of its contribution to the country's economy, this sector remains crucial, with three subsectors that are ranked in the country's top six in terms of their contribution to GVA (education, public administration & defence and health & social work). In combination, these three subsectors accounted for almost one-fifth of South Africa's total GVA in 2003 and education is the single largest two-digit SIC sector in the economy (GVA of more than R86 billion in 2003).
- Lower budget commitments towards infrastructure proved one of the means through which fiscal stability was restored. A change to government's policy stance in this regard was announced by both the Minister of Finance and the State President earlier in 2004, and the new infrastructure acceleration programme will stimulate employment growth within both the public and the private sectors.
- Capacity constraints with regard to skilled labour in the public sector will necessitate significant training interventions. In the short to medium term, these capacity constraints may be overcome through public/private partnerships, which will facilitate skills transfer and training initiatives within a practical environment.
- Exceptionally high levels of public sector funds will be allocated to health programmes over the next five years and beyond.
- Education's importance for the future development of the country, as well as the advancement of individuals, are being recognised by government in the policy environment of fiscal expansion (post-2002), and are being translated in significantly higher budget allocations than for total government expenditure.
- Research by Dr Jane Hofmeyr of the Independent Schools Association of Southern Africa indicates that the sector consists of a total of 12 million pupils, 28 000 schools and 350 000 educators. Demographic and economic indicators suggest that all of these figures will experience strong growth over the next five years.

- Government has re-committed itself to the National Crime Prevention Strategy, and President Mbeki has made a personal promise to substantially increase the number of active police officers.
- The country's high crime rate is an embarrassment to its humanitarian constitution and stellar achievements in the area of constitutional and economic reform, and government will undoubtedly do everything in its power to lower the level of criminality in society.
- The private security industry has become a major generator of employment and the prospects for further wealth creation and higher levels of economic growth will allow a growing number of citizens to afford the luxury of increased expenditure on private security systems.