4

economic transformation

4.1 WHAT DEMOCRATIC SOUTH AFRICA INHERITED IN 1994

At the onset of democracy, the new government inherited an economy in crisis. The economy had been shaped by apartheid policies and by a dependence on mining exports. In 1994, 60 percent of exports were mineral products[1], although mining contributed only 10 percent of GDP. The apartheid economy was built on systematically enforced exclusion linked to racial division in every sphere[2]. The apartheid state deliberately excluded black people from opportunities in the labour market and direct ownership of businesses and land. It limited investment in infrastructure and services in black communities, and black entrepreneurs were denied access to industrial and retail sites, as well as credit. Furthermore, apartheid limited the residential rights of Africans in the economically developed areas of the country unless they had a white employer, creating a system of migrant labour and impoverished rural areas – the so-called "homelands" – that were characterised by extraordinarily high levels of poverty and joblessness.

Large, white-dominated conglomerates controlled large parts of commerce and industry[3]. There were high levels of concentration in most industries. Many industries were highly protected and spent little on investment, research, development or training. At the same time, small- and medium-sized enterprises were underdeveloped. International isolation, resulting from economic sanctions, import substitution industrial policies and a lack of investment in technological improvements, had reduced the relative competitiveness of South African industries and increased concentration.

From the late 1970s through to 1994, the results were high levels of poverty and inequality, slow economic growth and falling investment, accompanied by rising joblessness, a poorly educated workforce and skills shortages, high cost structures and an eroded manufacturing base. In the late 1970s, estimates based on the national census suggest that around 60 percent of the working-age population was employed – more or less the same as the international norm[i]. By the early 1990s, the figure had shrunk to under 40 percent, leaving South Africa with one of the lowest employment levels in the world[4]. In the former so-called "homelands", only 20 percent of adults were employed. Job-shedding occurred through the 1980s especially in agriculture and mining, while manufacturing and services did not expand enough to compensate for this loss.

In the 1980s, unemployment became a key factor behind the high level of inequality and poverty. In 1995, it was estimated that 28 percent of households and 48 percent of the population were living below the poverty line. Black women and youth, as well as black people living in the former "homeland" areas, were particularly likely to be poor and unemployed. There were also structural inequalities in the workplace. Under apartheid, a variety of measures effectively limited most skilled work to non-Africans, while entrenching hierarchical and oppressive management in many workplaces. Most black workers had virtually no prospect of promotion or reaching managerial levels, and would work in the same jobs for their entire lives, with no hope that their experience would be recognised or respected.

Between 1980 and 1994, the economy grew only 1.2 percent a year, around half the average for other middle-income economies, excluding China, and slower than the rate of population growth. This was compounded by negative growth in GDP between 1990 and 1992. The country's per capita GDP also declined in this period. The share of investment in GDP dropped from 27 percent in 1981 to 15 percent in 1993 (to achieve sustained growth, this figure should be between 20 and 25 percent). Investment by the public sector shrank from 12 percent to 4 percent of GDP between 1981 and 1993, while private-sector investment fell from 15 percent to 10 percent of GDP. The decline in public investment had a negative effect on economic infrastructure, such as rail, ports and power supply.

The apartheid state had run up substantial domestic debt, resulting in an unsustainable budget deficit. Throughout the 1980s, the deficit averaged just under 3 percent of GDP, which is considered a sustainable level. A combination of slow growth and higher spending meant that it rose sharply from 1990, reaching 7.3 percent in 1993[5]. Total public-sector debt stood at 69 percent of GDP in 1994. The need to bring the deficit back under control constrained the ability of the democratic state to address the backlogs in investment and services left by the apartheid state. Foreign exchange reserves and the domestic savings rate were also very low. Foreigners were disinvesting and there were large outflows of capital by South African residents.

4.2 DEVELOPMENTS SINCE 1994

Since the inception of democracy in 1994, the main economic objectives of government have been job creation, the elimination of poverty and the reduction of inequality. There has been a focus on sustainable and diversified economic growth – as underscored in the Ready to Govern and Reconstruction and Development Programme documents. These objectives have been reiterated in subsequent policy documents, from the Growth, Employment and Redistribution (GEAR) strategy of the late 1990s through the Accelerated and Shared Growth Initiative for South Africa (Asgi-SA) of 2006, the New Growth Path of 2010, and the NDP of 2012.

[i] The apartheid state did not collect data systematically on Africans, even for the Census. These figures therefore rely on estimates based on the available Census data, combined with interpretive work by the Development Bank of Southern African (DBSA).

Throughout this period, the challenge for the democratic state was to achieve the aims of eliminating poverty and reducing inequality, while simultaneously maintaining investment and growth. In essence, it adopted fiscal and monetary policies aimed at maintaining economic stability, while seeking to bring about economic transformation and increase productivity through micro-economic interventions.

The democratic government also had to respond to global trends and events that had a critical influence on the domestic economy. The economy was opened to global trade and investment, which increased competitive pressure on domestic manufacturing in particular, but also supported the growth of the financial sector. The agricultural sector was also severely affected by South Africa's re-entry into global markets and the associated reduction in protective tariffs. Other key global influences included the commodity boom from the early 2000s through to 2008, which fuelled economic and employment growth in South Africa, and the international recession in 2008/09, which was followed by a faltering global recovery up to 2013/14.

The democratic state has put in a place a range of policies and programmes to transform the economy. The RDP provided a broad framework for meeting basic social needs, reducing inequality and promoting investment and growth. Asgi-SA provided a framework for government's increased focus on economic infrastructure and skills development from the mid-2000s.

The National Industrial Policy Framework, published in 2007, and the Industrial Policy Action Plan (IPAP), which followed, provided frameworks for improving policy interventions to stimulate industrial development. The New Growth Path identified a number of key sectors to focus on in order to diversify and grow the economy and create jobs. The NDP provides long-term targets for investment, growth and employment creation, and provides a holistic plan for reaching these targets, drawing on other policies and programmes.

Core themes in these strategies have been an emphasis on the importance of infrastructure both to support growth and bring about greater equality, the need for sector strategies to encourage diversification of the economy into more employment-friendly sectors, the imperative of improving basic education and skills development, and the recognition that African development is critical for South Africa's own growth. All of these strategies stressed the introduction of labour rights and a new skills system, which were expected to bring about greater equality in the workplace and incomes, as well as address skills shortages. They also all involved efforts to broaden access to economic opportunity through support for emerging enterprises, land reform and incentives for increased representivity in management and ownership. Finally, all the strategies have emphasised the need for collaboration between government, business and labour.

4.2.1 Economic outcomes

The economy enjoyed a real recovery in growth and investment post-1994, with far more robust and stable growth than in the previous 30 years. Employment has also grown far faster than in the 1980s. As described in more detail in Chapter 3, higher pay for the working poor, social grants and improved government services have reduced poverty substantially.

South Africa has largely achieved and maintained macroeconomic stability, taking advantage of the country’s natural resource base and establishing a sound trade regime, while maintaining and broadening financial and physical infrastructure, strengthening property rights and the legal system, and establishing and maintaining strong financial, regulatory and business institutions, such as the South African Revenue Service, the South African Reserve Bank, the Competition Commission and the National Economic Development and Labour Council.

Achieving and maintaining macroeconomic stability has been a key achievement of the democratic government. Prudent fiscal management has turned around governmental balances, resulting in lower debt-servicing costs for the public sector and cheaper credit for the private sector. This created fiscal space for the country to weather the economic storm that followed the global financial crisis of 2008.

4.2.1.1 Economic growth

South Africa's economic growth improved dramatically with the transition to democracy and has been reasonably robust and stable throughout the democratic era. The South African economy grew at 3.2 percent a year on average from 1994 to 2012, the latest available full year. This has resulted in the transformation of the South African economy from a GDP of USD136 billion in 1994 to a GDP of USD384 billion in 2012[6].

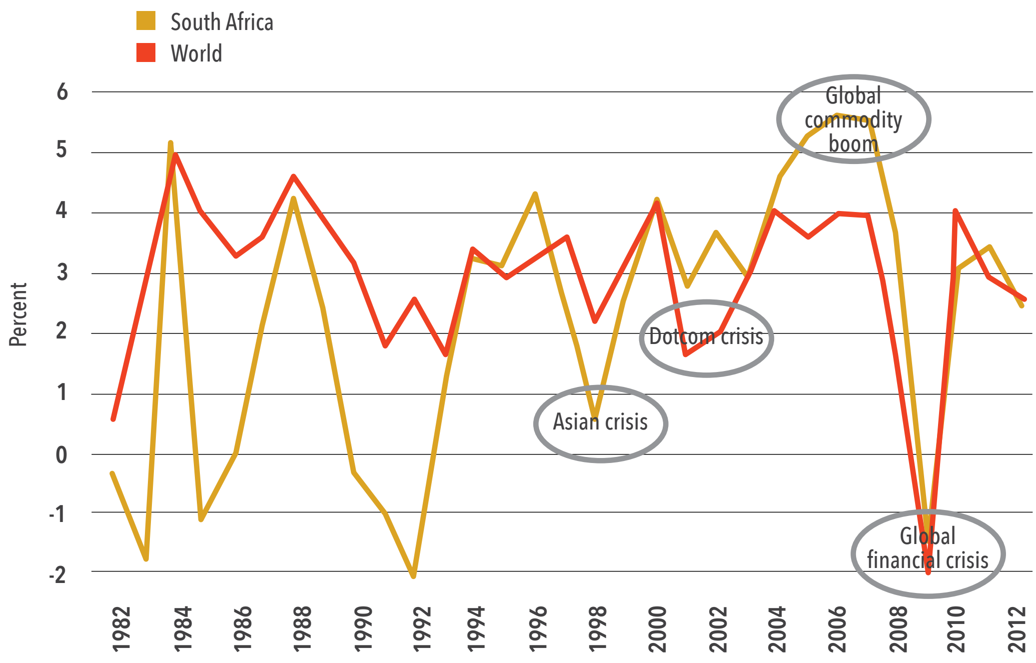
There were only four quarters of negative growth between 1994 and 2012, a far lower rate than in the years before democracy. From 1965 to the first quarter of 1994, the economy shrank in 36 quarters, or 32 percent of the time, compared with just 5 percent of the time from April 1994 to the third quarter of 2013. Moreover, the economy has enjoyed long periods of growth compared with the years before 1994. It grew for 40 quarters between the fourth quarter of 1998 and the third quarter of 2008, and has grown steadily from the third quarter of 2009 to the third quarter of 2013 – that is, for 17 quarters so far. In contrast, from 1965 to 1993, the economy never grew for more than 14 uninterrupted quarters[7].

In those quarters in which GDP fell after 1994, it was precipitated by international developments. In 1998, the East Asian financial crisis led to a significant slowdown in the world economy, while the international financial crisis that began in 2007 led to a global recession.

As illustrated in Figure 4.1 overleaf, by global standards, the economy performed reasonably well for most of the post-1994 period, although it has lagged behind other middle-income economies since 2008. From 1994 to 2008, GDP grew by 3.6 percent a year, which equalled the average for upper middle-income economies, excluding China. From 2009 to 2012, however, the South African economy grew by only 3.1 percent a year, while other upper middle-income economies averaged 4.3 percent a year. In the downturn, however, growth fell by 1.5 percent. A variety of factors such as a shortage in electricity supply and subsequent rising cost from late 2007 onwards, as well as increases in other administered costs, the uncertain global environment and other domestic issues contributed to slower growth.

Despite the recent deceleration in growth, GDP per capita growth (which averaged less

Figure 4.1: South African GDP compared to world GDP growth, 1982–2012



Source: IMF, World Economic Outlook, GDP growth data[8]

than 1 percent per year between 1994 and 2002) has averaged 2 percent since 2003. Gross national income per capita has risen even faster, at an average of 2.6 percent since 2003, increasing from R12 504 in 1994 to R60 505 in 2013. In constant 2005 prices, gross national income per capita increased from R28 536 to R37 423.

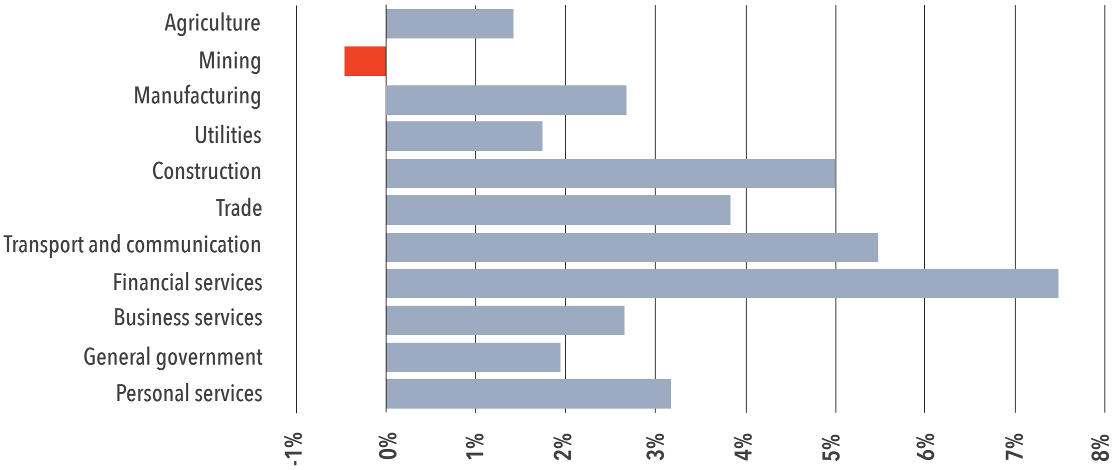
As illustrated in Figure 4.2, in sectoral terms[9], the fastest-growing activity has been telecommunications, with an annual growth rate of over 9 percent from 1994 to 2012, followed by financial services at 7.5 percent a year. Retail and mining also grew faster than the rest of GDP. The mining value chain has contributed over half of South Africa's exports throughout the democratic era.

The share of mining in the GDP climbed only because of booming global commodity prices, especially from around 2002 to 2011. From 1994 to 2012, mining production actually fell by 0.4 percent a year in volume terms, and the industry lost 80 000 jobs. The fall in mining production reflected, in part, a sharp decline in gold output as the industry matured. The share of gold in mining value add fell from 50 percent to 16 percent between 1994 and 2012, while platinum and coal each rose from around 15 percent to 25 percent, and other metal ores – mostly iron ore – climbed from 8 percent to 24 percent.

In contrast to the relatively dynamic sectors, such as financial services, transport and communication, sectors such as agriculture, manufacturing and government services tended to grow slowly. In real terms, agricultural value add rose by 1.4 percent a year from 1994 to 2012, manufacturing by 2.7 percent a year, and general government services by 1.9 percent a year.

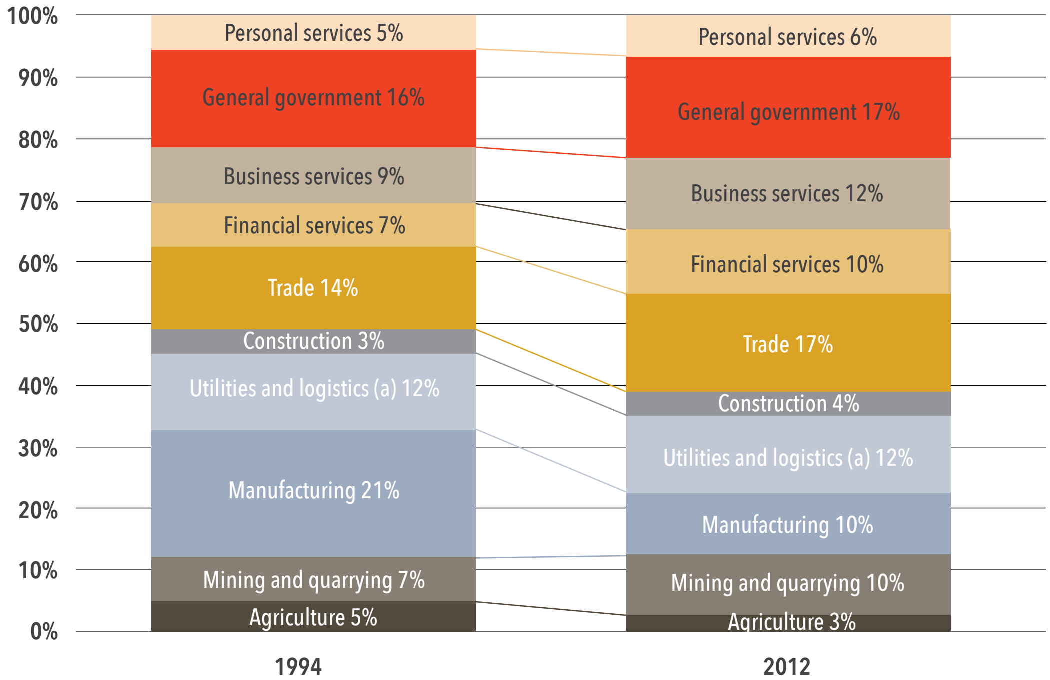
As illustrated in Figure 4.3, the share of manufacturing in GDP dropped from 21 percent in 1994 to 10 percent in 2012. The decline in manufacturing may be attributed to the impact of opening the economy to global competition post-1994 and the uncompetitive nature of many South African firms, among other reasons. In response, a number of interventions were developed in the New Growth Path and the IPAP with the aim of reversing this trend and stimulating development in sectors such as agriculture, mining, manufacturing and construction.

Figure 4.2: Average annual percentage change in value add in volume terms, 1994–2012, by sector



Source: Statistics South Africa, GDP data[10]

Figure 4.3: Composition of GDP by major industries, 1994 and 2012

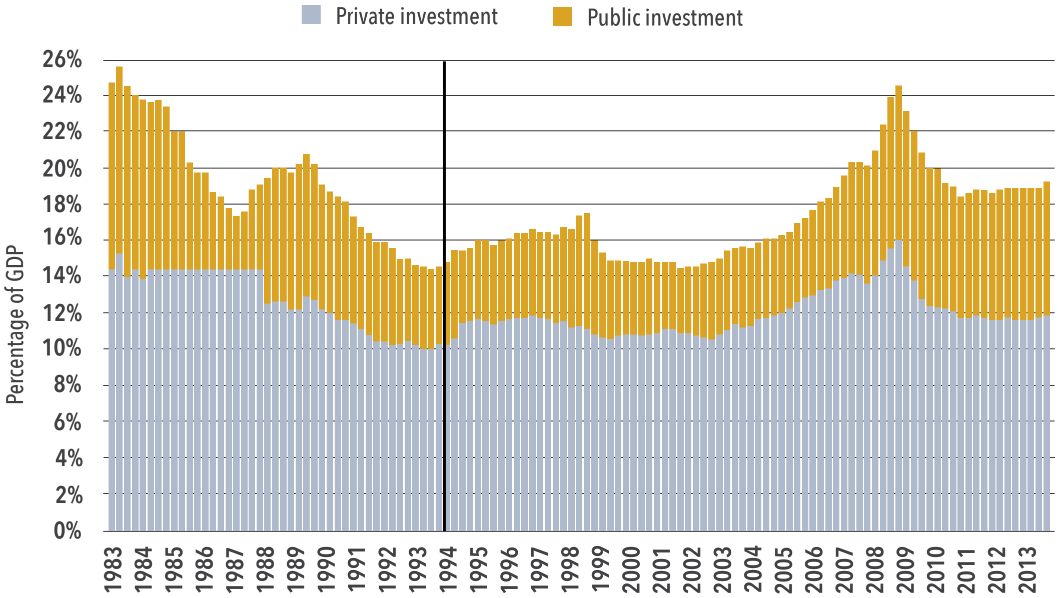


Source: Statistics South Africa, GDP data[11]

4.2.1.2 Investment and savings

Investment improved markedly after 1994, with public investment playing a growing role after the 2008 slump. As indicated earlier, investment needs to be between 20 percent and 25 percent of GDP to sustain growth. In 1993, investment had dropped to under 15 percent of GDP. As illustrated in Figure 4.4, it climbed fairly steadily from 1994 to reach 24.8 percent of GDP in the fourth quarter of 2008, just as the global downturn began. The slump brought a sharp decline, to below 19 percent. By 2013, investment had recovered to 19.2 percent of GDP, underpinned principally by the multibillion-rand expansion in public infrastructure.

Figure 4.4: Investment as a percentage of GDP, third quarter 1983 to third quarter 2013



Source: South African Reserve Bank[12]

Public investment has proven particularly important for economic transformation in South Africa because apartheid rested largely on depriving African households and enterprises of infrastructure, with deep backlogs especially in African urban and rural communities. At the same time, the state is responsible for maintaining adequate infrastructure to sustain growth in the formal economy.

The share of the public sector in overall fixed investment rose from under 30 percent in 1994 to 38 percent in 2013. State-owned companies – especially Eskom and Transnet – accounted for around half of public investment. Higher investment rates require financing, either through domestic or foreign savings. Throughout the democratic era, a relatively low level of domestic savings formed a structural constraint to future growth, inhibiting investment and increasing dependence on inflows of foreign funds. Household savings in South Africa have been declining steadily since the 1980s, and are worryingly low. The ratio of gross savings to GDP stood at 13.2 percent in 2012, compared with 19.1 percent in 1990 and 16.9 percent in 1994. That compares with the World Bank's estimate (based on the World Development Indicators) of 20 percent for middle-income countries excluding China in 2012, down from 24 percent in 2008.

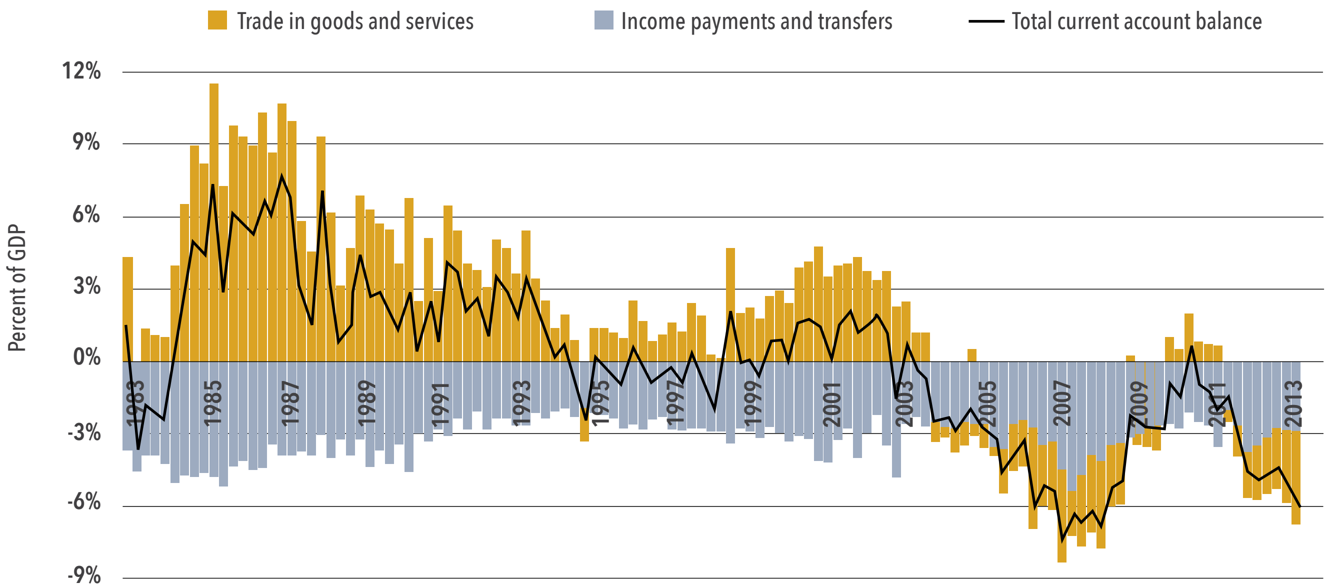
Estimates suggest that South Africa's gross fixed capital formation (that is, physical investment spending) will need to grow by 10 percent per year, with investment as a percentage of GDP rising to 30 percent by 2030, if the country is to meet the development goals set out in the NDP.

4.2.1.3 The balance of payments, trade and tourism

The opening of the economy associated with the transition to democracy saw a substantial increase in both exports and imports, as well as a rapid rise in portfolio investments. From the early 2000s, the result was an increase in the trade and current account deficit, with a particularly sharp rise in imports outstripping increased exports. The 2008 global recession led to a marked decline in both exports and imports in volume terms; thereafter, imports climbed much faster than exports, leading to a worsening current account balance (see Figure 4.5).

As a percentage of GDP, exports fell from 31 percent in mid-1985 to 21 percent in mid-1994. For most of the next 20 years, exports climbed on the back of the global commodity boom, growing auto sales and

Figure 4.5: The balance of trade, payments and transfers and the total current account deficit as a percentage of GDP, third quarter 1983 to third quarter 2013



Source: South African Reserve Bank[13]

opening of the economy in general. The mining value chain consistently contributed over half of exports, but shifted from gold to platinum and iron ore. In 2008, exports again reached 31 percent of the GDP. The crisis brought a 23 percent fall in the volume of exports, with the volume of exports in 2013 still below the 2008 peak. Exports were hampered by falling world mineral prices from 2011, major strike action in mining and auto, and the rising cost of electricity, amongst others.

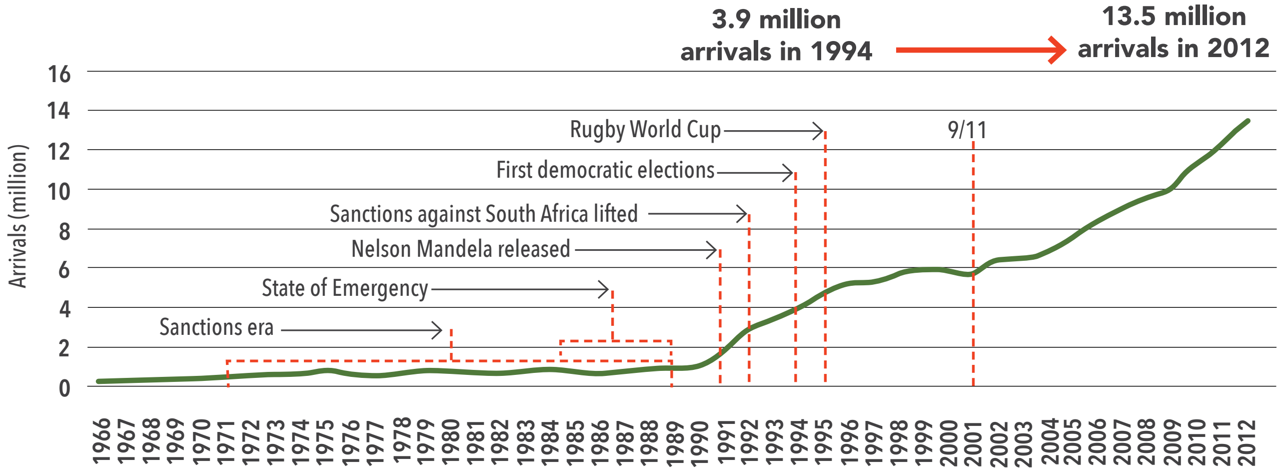
Imports were around 20 percent of GDP through the 1980s. They then rose fairly steeply, increasing from 19 percent in mid-1994 to 41 percent in mid-2008. Like exports, imports fell from 2008 to 2009 by 23 percent, but then they recovered strongly, growing by some 47 percent to reach 36 percent of the GDP. The biggest factor behind rising imports was petroleum, which climbed from 10 percent of imports in 1995 to 22 percent in 2013, accounting for almost a quarter of the total increase in imports and rising from 2 percent of the GDP to 6 percent. Machinery and equipment, personal cars and medical equipment and medicines were the most important imports following fuels.

The current account deficit has been largely financed by foreign portfolio investment in South African equities and bonds. This was influenced by South Africa's comparatively high interest rates as a result of developed countries deliberately keeping interest rates extraordinarily low in order to stimulate growth. Increasing international portfolio inflows led to a stronger currency for much of the second decade of freedom. The downside of this was a loss of competitiveness for local producers.

There is a risk that foreign investors could withdraw or withhold their investments, which would result in a severe constraint on the current account, as well as a fall in the relative value of the rand. In late 2013 and early 2014, as prospects for higher interest rates emerged in the USA and Europe, capital has started to flow out of South Africa, leading to a substantial depreciation in the rand.

Tourism has grown dramatically since 1994. As illustrated in Figure 4.6, foreign arrivals (including tourists) to South Africa grew from fewer than 1 million per year in the late 1980s to 13.5 million in 2012.

Figure 4.6: Foreign tourist arrivals, 1966–2012



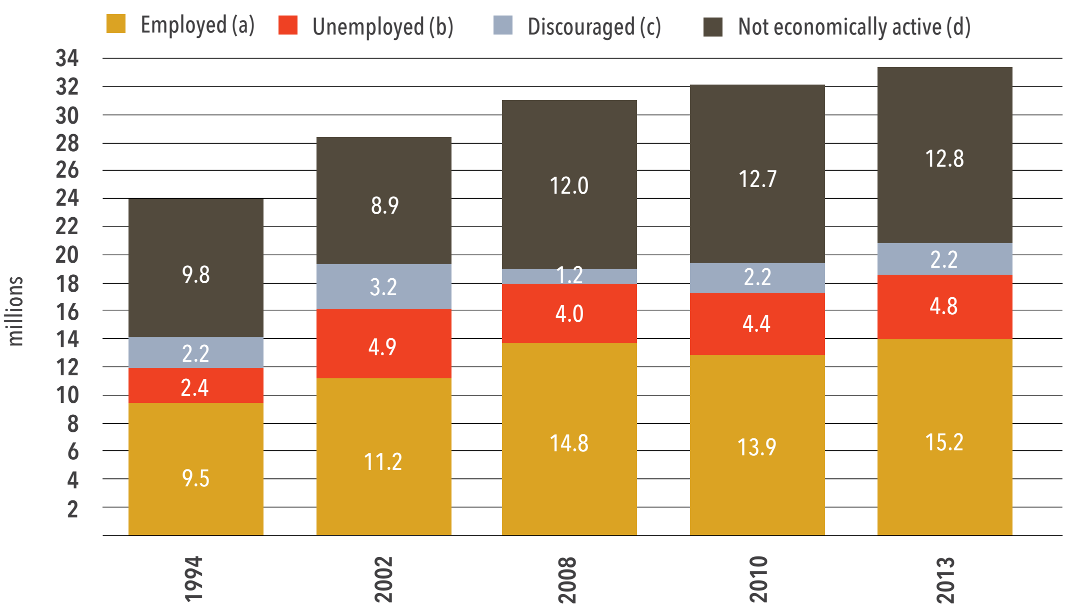
Source: South African Tourism

4.2.1.4 Employment

Over the past 20 years, employment (both formal and informal) has grown by around 5.6 million, or by 60 percent, far faster than previously. As illustrated in Figure 4.7, the number of employed people rose from 9.5 million in 1994 to 15.2 million in 2013, despite the loss of almost a million jobs from 2008 to 2010 as a result of the global downturn.

As illustrated in Figure 4.8, the percentage of working-aged adults in employment decreased during the last two decades of apartheid, as a result of slow economic growth, international sanctions and mechanisation, amongst other reasons. Only 39.8 percent of working-age adults had a job in 1994. By the third quarter of 2013, 43.3 percent

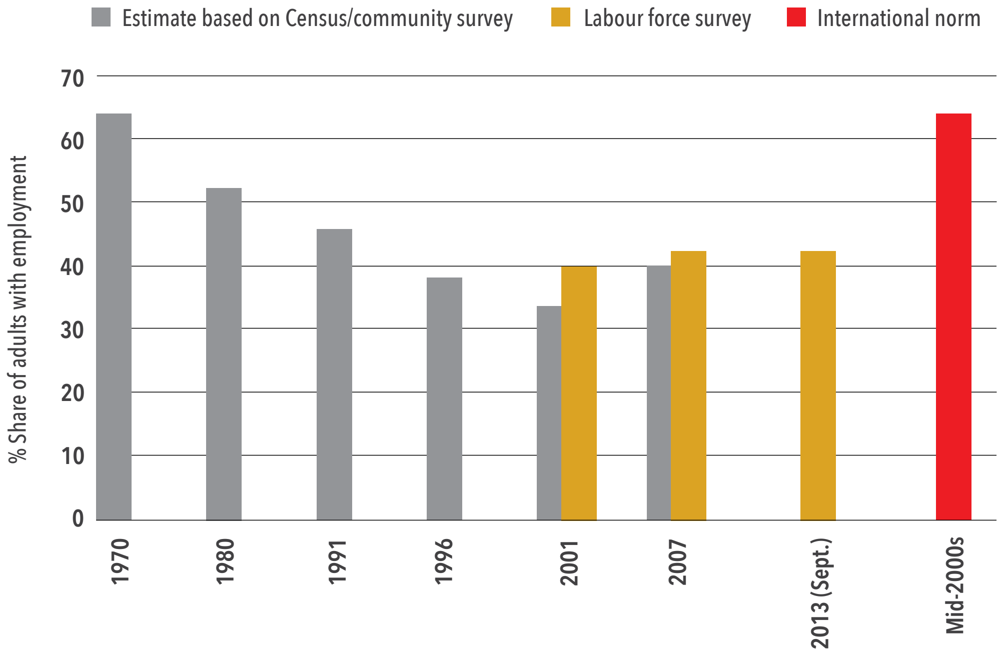
Figure 4.7: Labour force status of working-age population, 1994–2013, in millions



Source: Statistics South Africa[14]

Notes: (a) Includes employed and self-employed. (b) People who have actively looked for work in the previous week. (c) People who have not looked for work but would take a job if offered one. (d) People who are not looking for work and do not want a paid job.

Figure 4.8: Percentage of working-age adults in employment



Source: Statistics South Africa[15]

of working-age adults had a job. While the employment ratio has improved slightly since 1994, it is still far short of the international norm, which is around 60 percent.

Official data put the formal unemployment rate in 1994 at 20 percent, although only 39.8 percent of working-age adults had a job. This means that many working-age adults were not being included in the employment statistics, and were viewed as not economically active. The apartheid state did not fully count the African population before 1994, and its statisticians assumed that all jobless Africans were subsistence farmers rather than work-seekers – something that was blatantly untrue. Consequently, pre-1994 figures on the unemployment rate were highly unreliable, because the expulsion of unemployed Africans to rural areas meant that work-seekers were systematically undercounted. After 1994, it took almost a decade, to the introduction of the Labour Force Survey in 2002, to establish more accurate labour statistics.

In 2013, the unemployment rate was approximately 25 percent. The reasons why the unemployment rate has increased between 1994 and 2013, despite the large growth in employment over the period, are that the number of people entering the labour market as well as the number of people being counted in the labour market has increased. As illustrated in Figure 4.7, the number of people actively seeking work was estimated at 2.4 million in the mid-90s, rising to 4.8 million in 2013.

The number of people entering the labour market has increased both due to population growth and due to the ending of apartheid. More people began actively seeking work, particularly in urban areas, as the restrictions placed on black people, especially women, were removed. As a result, the share of working age adults who were neither employed nor looking for work – the "economically inactive population" – fell from 41 percent in 1994 to 37 percent in 2013. In addition, immigration from neighbouring countries increased in the 2000s, adding to the demand for employment.

Youth unemployment is a particular concern. In 1994, the percentage of young people aged 18 to 29 who were not in employment, training or education was 37 percent. It was 44 percent in 2013. The estimated unemployment rate for youth in this age group rose from 30 percent in 1994 to 40 percent in

2013 and the number of unemployed youth doubled from 1.3 million to 2.6 million.

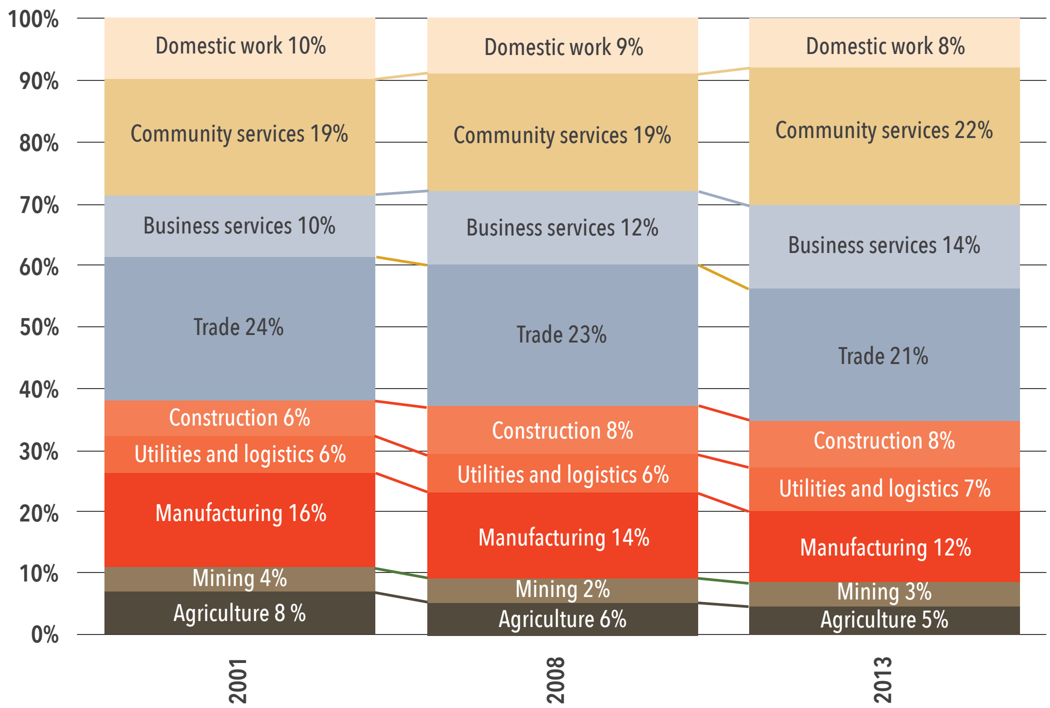
Joblessness is worst in the former so-called "homelands", where about a third of the population lived in 2013. In September 2013, only a quarter of adults in these regions were employed, compared with half in the rest of the country[16]. As a result, 55 percent of households in the former "homelands" indicated that they survived mainly from social grants and family remittances, compared with 17 percent in the rest of the country. The median household income in the former "homelands" was just R1 700 a month, compared with R3 800 in the rest of the country[17].

As illustrated in Figure 4.9, the structure of employment by industry shifted substantially between 1994 and 2013. From September 2001 to September 2013, many new jobs were created in the public service, as indicated in the growth of employment in community services, primarily in health, education and policing. Employment growth in the private sector is largely the result of expansion in business services, mostly private security services and cleaning. There was also employment growth in construction, transport and communications.

In contrast, key productive sectors such as mining and manufacturing saw much slower growth in employment and a decline as a percentage of total employment in the economy over the same period. Similarly, domestic services – still a major employer for African women – saw some growth but fell as a percentage of total employment. The agriculture sector saw a decline in both jobs and as a share of total employment in the economy between 2001 and 2012, despite some growth in 2012/13.

The democratic era has seen rising education levels in the labour force. In 1994, 8 percent of workers had no education while 36 percent had matric or more. Just 5 percent had a university degree. By the third quarter of 2013, the share of workers with no education had fallen to 2 percent, most of whom were relatively old, while the share with matric or more had reached 52 percent and university graduates, 12 percent[18]. The quality of education and limited access to in-depth vocational training remain a challenge, however.

Figure 4.9: Employment by industry, September 2001 and third quarter 2008 and 2013



Source: Statistics South Africa[19]

Higher levels of education have gone hand in hand with changes in the structure of employment. Employment of workers classed as managerial, professional or semi-professional increased most rapidly, followed by clerical and sales work, which typically requires matric. These occupations climbed around 3 percent a year from 1994 to 2013, while employment of elementary and semi-skilled workers rose by just over 1.5 percent a year. Employment of elementary workers was affected by the decline in domestic and agricultural work through the 1990s and early 2000s, although both occupations saw job growth from the mid 2000s. Finally, skilled production workers (including artisans) dropped from 12 percent of total employment in 1994 to 11 percent in 2013. This appeared to result from inadequate training outcomes rather than from a lack of demand, with persistent reports of skills shortages in this regard.

Considerable progress has been made in ensuring greater equality in employment in terms of race and gender, although challenges persist. In 1994, just 34 percent of working-age Africans were employed, and only 26 percent of African women. In contrast, 66 percent of whites and 51 percent of Coloured and Asians were employed. By 2013, African employment had climbed to 43 percent, and 38 percent of African women had paid work. The share of whites, Coloureds and Asians with work remained virtually unchanged.

Progress toward equality in employment also emerged in greater representivity in more skilled and high-level occupations. In 1994, 19 percent of managers, 48 percent of professionals and 51 percent of skilled production workers were African, although Africans made up 61 percent of all employed people and 73 percent of the working-age population. Moreover, just 4 percent of managers were African women. By 2013, Africans made up 41 percent of managers and 77 percent of skilled production workers, although their share amongst professionals was virtually unchanged. African women were 13 percent of managers. The share of Africans in total employment had climbed to 73 percent, and they made up 79 percent of the working-age population[20].

The increase in representivity has been disproportionately due to state employment, which makes up about a fifth of total employment. In the public sector, 67 percent of managers of larger organisations (with over 50 employees) were African in 2013, compared with 29 percent in the private sector. Similarly, 62 percent of public-sector professionals were African, compared with 43 percent in larger private companies.

Income differentials by race and gender declined significantly from 1994 to 2012, but in 2012 the median earnings for a white man was still six times as high as for an African woman[21].

4.2.2 Fiscal and monetary policy

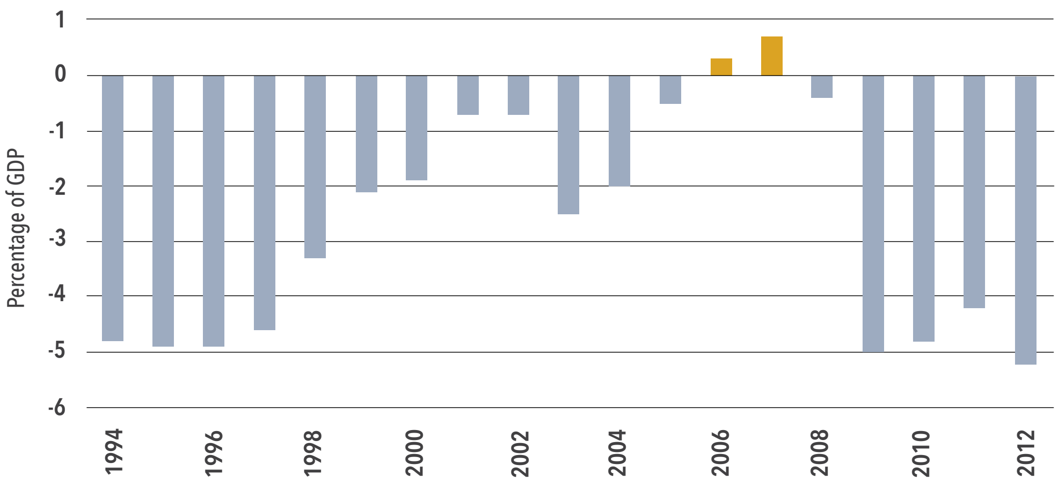
4.2.2.1 Fiscal policy

As described above, the democratic government inherited a historically high budget deficit in 1994. An unsustainable budget deficit meant increasing borrowing costs with less funding for core government programmes.

Figure 4.10 indicates that the budget balance improved dramatically from a deficit of 4.8 percent of GDP in 1994 to 0.5 percent by 2005. The budget surplus that followed over the subsequent two years allowed government to increase expenditure without having to increase borrowing. In part, this was due to an increase in the tax revenue collected. Relative to the size of the economy, government's net loan debt declined sharply from 48 percent of GDP 1996/97 to 22.8 percent in 2008/09. The budget ran into a deficit after 2008/09 and the debt-to-GDP ratio had reached 36.3 percent by 2012/13. Foreign debt remains relatively low.

From the early 2000s, government has adopted a counter-cyclical stance. In that context, it has seen investment in infrastructure, education and health, combined with growing local procurement of inputs, as critical for stimulating growth, while bringing about more equitable and inclusive economic outcomes. The counter-cyclical stance involves stabilising spending in downturns, so as to support growth and employment creation, and avoiding massive spending increases when the economy is doing well. That said, the deep inequalities and unemployment that remain from apartheid, including in core government services, such as health, education and municipal services, mean that there will be pressure on spending for the foreseeable future.

Figure 4.10: Trend in the budget balance since 1994



Source: Industrial Development Corporation, compiled from Reserve Bank data

The counter-cyclical fiscal policy stance means that government continued to run a higher budget deficit since the 2008 global economic and financial crisis. Current debt levels remain sustainable with ongoing measures to ensure that the country's debt-to-GDP ratio remains stable.

Compensation for public servants, as a percentage of non-interest expenditure, declined from around 50 percent in 1996/97 to about 33 percent in 2008/09, then rose to almost 40 percent in 2012/13[22]. The main reasons for the rise since 2008/09 are an increase in the number of public servants employed and relatively large salary increases. This may result in fewer resources being available for social spending, infrastructure, and other priorities. This means that a sustainable approach to public sector wage costs is needed in the medium- to long-term, without having to reduce spending on the core and critical skills that are needed for public service delivery.

4.2.2.2 Monetary policy

Since 1994, the main objective of monetary policy has been price stability with the view of achieving balanced and sustainable growth. In 2002, South Africa adopted an inflation-targeting framework approach to ensure that inflation remains between 3 percent and 6 percent. The framework has been flexibly applied by the South African Reserve Bank, whose operational independence is enshrined in the 1996 Constitution.

Consumer price inflation has been generally declining since 1994. Initially, inflation exceeded 6 percent due to the rand weakening in 2001 and 2002. However, the rand exchange rate has recovered substantially and continued currency strength between 2003 and 2006 resulted in overall consumer inflation moderating over this period. Having reached a 20-year peak of 9.9 percent in 2008, consumer inflation declined in subsequent years, averaging about 5.5 percent per year over the period 2009 to 2012. Managing increasing oil, food and administered prices will be important in continuing to keep inflation in check.

In line with the long-term declining trend in consumer price inflation, the repo rate had declined to reach its lowest level (a nominal level of 5 percent) in almost 40 years after July 2012. Policy-makers continue to adopt a monetary policy stance that supports economic recovery. In real terms, the repo rate entered negative territory on a number of occasions over the past five years.

4.2.3 Trade and industrial policy and industrial restructuring

4.2.3.1 Trade policy

South Africa embarked on an ambitious set of trade and tariff policy reforms after the mid-1990s. Work in this area included supporting and promoting multilateral rules-based global trading regimes and using general and targeted supply-side measures. Initially, trade policy emphasised reintegrating South Africa on a more equal basis with the global economy, following the years of isolation brought about by the global rejection of apartheid.

From the late 2000s, trade reforms shifted to more targeted efforts, with considered use of safeguard measures, local procurement and other interventions geared to fostering industrialisation and job creation. In collaboration with the BRICS grouping, South Africa became a leading proponent of ensuring that international trade rules do more to support development.

4.2.3.2 Industrial policy

Over the past two decades, South Africa's core industrial policy goals have been as follows:

- Target labour-intensive sectors and enhance the competitiveness of capital-intensive sectors.
- Ensure that our rich natural resources are increasingly used in local industry so as to ensure that they stimulate employment creation and value added.
- Promote competition by limiting the abuse of dominant market power and encouraging smaller and emergent enterprise and new forms of ownership, including through broad-based black economic empowerment (B-BBEE).
- Strengthen industrial finance as central to catalysing new industries and activities so as to diversify the economy and deepen industrialisation.
- Strengthen trade relationships with fast-growing developing economies, notably in

the context of BRICS, while contributing to development in the African region.

- Enhance technology and innovation.

- Increase skills development and target it to meet emerging skill needs.

The National Industrial Policy Framework was published in 2007, followed by a series of rolling three-year implementation plans known as the IPAP. Since then, the automotive, clothing and textiles, film and television, business-process services, and metals and engineering industries have registered some progress.

In line with the rollout of IPAP, government modified and strengthened sectoral incentives, including those that had been in existence for some time, such as the Motor Industry Development Programme (MIDP). In 2011, the Manufacturing Competitiveness Enhancement Programme was developed. Regulations stemming from the Preferential Procurement Policy Framework Act of 2000 were revised. As a result, public procurement commitments for local content, such as rail rolling stock, buses, textiles and renewable energy, have increased. The quantum of financial support available to firms has also increased in the past five years, with new tax-based incentives and revised grant-based incentives in place.

There have been significant recent structural changes in industrial policy implementation. In 2010, the Industrial Development Corporation (IDC) doubled its financing envelope to over R100 billion for the subsequent five years. By 2012, the IDC had accounted for almost 2.5 percent of total investment directly and had leveraged around 6.5 percent. Moreover, its projects supported over 15 percent of all new jobs created.

Industrial policy initiatives must continue to address many of the constraints faced from apartheid policies in the productive sectors of the economy. These include a lack of skills, improving policy alignment and reorientating exports to new markets in Africa and other developing markets.

4.2.3.3 Competition policy

Democratic South Africa inherited a highly concentrated economy characterised by corporate and industrial monopolies. Government introduced a more robust Competition Act in 1998, which informed the establishment of the Competition Commission and the Competition Tribunal. The rationale for the new legislation was that competition policy should address anti-competitive behaviour flowing from over-concentration in the South African economy, while facilitating the entry and growth of small and emerging firms, as well as foreign direct investment.

South Africa's competition policy framework is robust by world standards and includes innovative elements, such as a public-interest clause to protect vulnerable workers. Its institutions have won global acclaim for the technical quality and nuance of their decisions. The 2013 Global Competition Report by the World Economic Forum rated the effectiveness of South African competition policy 53 out of 148 countries. This ranking is above other emerging countries, such as Brazil, Mexico and Nigeria[23]. The Competition Act also set new standards in transparency by opening up large parts of the Competition Commission's processes to the public and the media.

The Competition Commission has adopted a strategic approach that involved focusing on key intermediate inputs and consumer basics. It has uncovered extensive collusion in critical industries, including construction services, bread, poultry and fertilisers. In addition, in regulating mergers, it has increasingly used its powers to ensure more developmental outcomes. For instance, when the U.S. giant Walmart took over a South African retail chain, Massmart, in 2011/12, the Competition Tribunal swiftly moved towards ensuring Massmart set up a development fund of R240 million for the next five years with a programme aimed at the development of local suppliers, including small, micro and medium-sized enterprises (SMMEs)[24].

4.2.3.4 Small, micro and medium enterprise support

Apartheid systematically denied Africans opportunities to develop their own businesses. The result was, on the one hand, inadequate market institutions and infrastructure to support emerging producers, and, on the other, a widespread lack of experience in starting and running enterprises.

Overcoming these historic obstacles has proven difficult. Since 1994, the democratic government has implemented various approaches to supporting SMMEs: measures to reduce the tax compliance burden for small enterprises, providing dedicated credit facilities, establishing support and extension agencies and incubators, and diversifying procurement towards emerging enterprises where possible. In 2012, the various national small business finance agencies were consolidated into the Small Enterprise Financing Agency (sefa), which was housed in the IDC. In the process, sefa saw a doubling of its resources.

Despite these measures, the 2009 Global Entrepreneurship Monitor Report ranked South Africa 15th out of 37 countries for start-up activity and 29th in new firm activity. Only 2 percent of the adult population worked in new companies. This placed South Africa in the lowest quartile of all the countries involved in the study in two key measures: opportunity entrepreneurship and new firm activity. Total early-stage entrepreneurial activity is particularly low – about half of that of other developing countries. Going forward, there needs to be continued focus on improving mentoring and other support programmes for small businesses, as well as reducing the regulatory burden for small businesses.

4.2.3.5 Broad-based black economic empowerment

To overcome apartheid's legacy and ensure that historically disadvantaged people are empowered, government implemented various policies and programmes to facilitate B-BBEE. This included establishing the National Empowerment Fund to support and facilitate increased participation of black South Africans in the economy by providing financial and non-financial support. The B-BBEE Act of 2003 was also promulgated, followed by the phased release of the B-BBEE Codes of Good Practice. This spurred the development of a number of sector charters aimed at ensuring transformation in specific sectors of the economy. Together with affirmative procurement in both the public and private sectors, this has resulted in a large increase in the number of small and medium-sized black-owned companies operating in a range of industries, such as construction, private security, catering and transport.

Initially, the Codes had an emphasis on ownership and senior management, which had unintended consequences, such as fronting, speculation and tender abuse. There was also more scope for B-BBEE to incentivise large companies to create jobs

and support small and local enterprises. To ensure a more broad-based approach, there is now a stronger focus on the broad-based elements, support for small enterprises and cooperatives, and procurement from local producers in the B-BBEE Codes.

4.2.3.6 Labour market policy and institutions

In 1994, the labour market was characterised by deep segmentation and oppressive workplace relations. The labour laws contributed to this situation through a long history of promoting negotiations between white workers and employers, while largely excluding black workers. As reflected in the RDP, the transition to democracy required a profound shift in the labour market regime.

From 1994, the democratic government sought to ensure improved workplace relations. The National Economic Development and Labour Council (NEDLAC) was formed to enable consultation between key social partners on key legislation, including the labour laws. Despite challenges, NEDLAC has helped to develop a culture of participatory democracy on economic issues, and build trust and constructive working relationships between the main constituencies.

The labour laws were deracialised and extended equally to all workers. The Labour Relations Act of 1995 introduced organisational rights for workers, set a framework for bargaining structures, provided for alternative dispute settlement in labour relations and the Commission for Conciliation, Mediation and Arbitration (CCMA), and regulated dismissals for operational reasons, as well as for poor productivity and disciplinary offences. The Labour Relations Act sought to protect workers from the kind of arbitrary and unfair dismissals that many had experienced under apartheid.

Specifically, the Labour Relations Act aimed to do the following:

- Minimise costs and delays, and reduce the legal costs of settling disputes.
- Encourage sectoral bargaining councils to respond to sectoral needs, which includes setting minimum pay and benefits, and settling disputes, within the framework of national law.
- Promote collaboration between employers and workers at the workplace level by providing for workplace forums.
- Avoid the highly legal and procedural approach to dismissals.
- Protect workers' organisations as crucial for fair and effective bargaining.

The CCMA has improved the lives of many workers and employers through the provision of free, accessible and speedy dispute resolution services. Settlement rates under the pre-1994 Industrial Court averaged only 17 percent, compared with the CCMA's rate of over 70 percent in 2013.

There are negative investor perceptions about some aspects of the regulatory frameworks for labour relations. For example, in 2013/14, the World Economic Forum's Global Competitiveness Report – a survey of employers – ranked South Africa 132nd out of 148 countries in terms of labour market flexibility.

The 1997 Basic Conditions of Employment Act (BCEA) set minimum standards to prevent unacceptable working conditions that impose social, economic and healthcare costs on society as a whole. The main beneficiaries of wage determinations in terms of income and benefits were domestic workers and farmworkers. With the introduction of the BCEA, the number of workers covered by minimum wages through sectoral determinations expanded substantially, covering 4.6 million workers in 2012.

Deeply inequitable access to education and workplace training formed a pillar of the apartheid workplace and the Skills Development Act of 1998 sought to address these legacies. It resulted in the formation of the National Skills Authority, the establishment of Sector Education Training Authorities (SETAs) for individual industries, the introduction of workplace learnerships combined with modular qualifications, and a requirement that the Department of Labour strengthen its employment and placement services. Overall, the Skills Development Act managed to desegregate training, but it has not yet resulted in a sufficient increase in the number of skilled production workers. This is discussed in more detail in Chapter 3.

The Employment Equity Act of 1998 aimed to improve career mobility for black workers, especially women, at all levels. This has contributed to much improved levels of representivity in the public sector and in some private companies.

Changes in the Occupational Health and Safety legislation post-1994 have resulted in important improvements in health and safety standards in the workplace, and a reduction in workplace injuries and deaths. The establishment of workplace health and safety committees, as well as strengthened inspectorates, particularly in the mining sector, has been an important step in reducing occupational health and safety risks for employees.

The new legal framework for the labour market led to lower workplace conflict for many years, but contestation surged after 2008. From the late 2000s, strike levels reached heights previously only seen before the transition to democracy. The biggest strikes emerged in relatively well-paid industries – the public service, mining and the automotive industry. This implies that the strikes may reflect dissatisfaction with inequality and divisions in the workplace rather than with low pay alone. In the World Economic Forum's survey of employer perceptions in 2012, South Africa ranked last out of 144 countries for workplace conflict. This situation points to a need to do more to create more collaborative and equitable workplaces. Critical steps include improving management and communication, reducing unfair inequalities in pay, conditions and amenities, and reviewing workplace organisation to promote career paths for more workers.

4.2.3.7 Innovation, research and development

South Africa's research and development (R&D) environment before 1994 was fairly well developed for a middle-income country, despite its isolation, but there were significant racial and gender disparities in human capital as well as a focus on the needs of large formal companies. Over the past 20 years the National Research and Development Strategy and the Ten-Year Innovation Plan have seen several positive developments. There has been some growth in R&D investment. Through the South African Research Chairs Initiative (SARCHi), there has also been growth in high-level human capital (more black people and women) employed. There has also been an increase in R&D output (research publications); innovation output (innovation activities at firm level, patents and royalties) and the development of a number of Centres of Excellence and Centres of Competencies. Nevertheless, R&D expenditure growth in South Africa has been slower than in comparable middle-income countries such as Brazil, China and India, and South Africa's share of global R&D output, citations and patents has declined.

South Africa has embarked on a number of key innovation projects. A major achievement for the country was the awarding of the Square Kilometre Array (SKA) in partnership with eight African countries. The SKA is one of biggest scientific projects the world has ever seen.

A further important project over the past 20 years has been the development of the Southern African Large Telescope (SALT). SALT is the largest telescope in the Southern hemisphere and was launched in 2005, contributing significantly to the field of astronomy.

Government-funded research into the development of hydrogen and fuel cell products for local application has resulted in a government-business partnership that could potentially contribute to exports and increased use of renewable energy. Another international government-business partnership related to titanium is intended to contribute towards major efficiency improvements in the aviation industry.

In 2013 the Council for Scientific and Industrial Research (CSIR) developed the world's first digital laser. This discovery presents a new way of thinking about laser technology and could assist in healthcare applications, communication and supporting new emerging industries.

South Africa has also made contributions towards space science over the past 20 years. In 2009 the first government-funded satellite, Sumbandila, was launched. In 2013 the Cape Peninsula University of Technology made history with the launch of ZACUBE-1, a type of nano-satellite.

4.3 CONCLUSION AND WAY FORWARD

From an economy in crisis, the democratic government has made enormous strides in addressing the legacies of apartheid. In the past 20 years, growth and employment have improved markedly, despite the global setback of the 2008 recession, while investment has improved. The state has taken bold steps to diversify the economy and build our industrial base with a greater emphasis on labour-absorbing employment. In addition, positions of power in the economy have become more representative. More work is required to increase equity in ownership, work organisation and pay, to reduce unemployment, especially in the former so-called "homelands", and to increase the number of small and medium enterprises.

From the late 2000s, three major new challenges emerged. First, workplace conflict began to threaten production and investment. Second, the rising price of electricity and the need to address climate change posed far-reaching questions about South Africa's traditional heavy dependence on coal-based energy. Finally, the dependence on short-term portfolio capital flows to finance investment, with the associated high deficit on the current account, led to increasing instability after 2008, reflected in the highly volatile exchange rate.

The key challenge is to ensure that the country accelerates its drive towards higher levels of economic growth and employment absorption, and towards a more inclusive economy. The NDP, supported by the New Growth Path and IPAP, identifies what needs to be done to move towards a new trajectory. Key actions include:

- Maintaining large-scale but sustainable public investment in infrastructure to facilitate economic growth, with improved maintenance and a well-defined financing strategy
- Improving the quality of basic education and substantially expanding higher and further education, linked to stronger ties between enterprises and Further Education and Training in particular, to provide the skills required by a growing economy
- Ensuring that regulations are implemented as efficiently and cost-effectively as possible, without imposing unnecessary delays or red tape, to create a business-friendly environment
- Continuing to increase financing for industrial development and small and micro enterprise in the context of a strong industrial policy focused on bolstering employment and growth
- Improving energy security including through development of shale gas, while continuing more generally to take advantage of opportunities and minimise the costs from greening the economy
- Maintaining a counter-cyclical fiscal and monetary stance, bolstered by innovative approaches such as stronger local procurement and investment by state-owned enterprises
- Enhancing regional development through increased investment in logistics combined with the establishment of regional value chains, to facilitate regional economic growth and integration
- Stronger measures to address workplace conflict, above all by working with stakeholders to address unfair inequalities and improve communication and career pathing, to create a more stable workplace environment for growth.

The NDP further states that it is only through effective partnerships across society that a virtuous cycle of rising confidence, rising investment, higher employment, and increased productivity and income can be generated. This requires greater trust between the state, labour and business.

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