



Western Cape

PROVINCIAL ECONOMIC REVIEW & OUTLOOK

2005

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PR: 20/2005
ISBN: 0-621-35540-2

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Printed in the Republic of South Africa
for the Government Printers Cape
by Formaset Printers Cape



Foreword

Towards shared growth and development for the Western Cape is the key message that emanates from the 2005 Provincial Economic Review & Outlook (PER&O).

Building on 2003 Socio-Economic Review, 2005 PER&O deepens the economic analytical platform that informs and guides our annual budget decisions.

Wide-ranging in its scope, and probing in its rigour, the PER&O give all much to digest. It considers the economic outlook for the Western Cape over the next three years, examines the Province's sectoral growth and employment trends and prospects, reviews Provincial labour market and remuneration performance, and highlights the Province's challenges in respect of equity and development prospects.

From the above, it is clear that the Province has to take bold intervention to shift the present socio-economic trajectory towards a shared growth and development path that *does* build a 'Home for All' in the Western Cape.

In this respect, *iKapa Elihlumayo* is our strategic pathfinder. Its distinctive appeal builds partnerships and dialogues across society – uniting business, investors, government, workers and communities through a social contract that commits all to work together, creating a shared future.

Its vision and stance promotes *shared growth and development* in the Western Cape. In so doing, it endorses a strategy and policy-mix that views equity, development and economic growth as being *interdependent goals* over the medium to long term.

As such, *iKapa Elihlumayo* is a practical strategy for change. It describes how we will achieve shared growth and development through strategic interventions in the medium to long term.

The 2005 PER&O attempts to provide an overarching frame of reference as the lead strategies of *iKapa Elihlumayo* emerge in shape and form. Common reference points and parameters are useful in synthesising both debate and interaction towards a common goal – that of shared growth and development in our Province.

In the words of our Premier:

“We cannot afford to fail. We cannot afford to despair. Neither can we ever lose our way on the path to iKapa Elihlumayo. Nor can we ever lose sight of our vision of a better and shared life for all in the Western Cape.” – Ebrahim Rasool

The 2005 PER&O is a team effort that drew on expertise in the broader academic community, Provincial Treasury and our *iKapa Elihlumayo* partners in Provincial Government.

In particular, Lucille Gavera of Trade & Industrial Policy Strategies (TIPS) project managed the 2005 PER&O, while background documents were prepared by Pieter Laubscher, Bureau for Economic Research (BER), University of Stellenbosch; Laura Poswell and Morné Oosthuizen, Development Policy Research Unit (DPRU), University of Cape Town (UCT); and Simon Roberts, School of Economic and Business Sciences, Corporate Strategy & Industrial Development Research Project (CSID), University of the Witwatersrand. The latter drew from research commissioned in respect of the Province's Microeconomic Development Strategy.

The PER&O team held three workshops that debated the technical form and content of the base analyses. These drew on the technical expertise and experience of Murray Leibbrandt and Ingrid Woolard, Social and Labour Development Research Unit (SALDRU), University of Cape Town, Haroon Bhorat of the DPRU, and Servaas van der Berg, School of Economics, University of Stellenbosch.

Other participants included JC Stegmann, Shirley Robinson, Albert van Zyl, Gugu Shabalala and Shahieda Sechel of Provincial Treasury; Carin Fouché and Riefqah Jappie of Wesgro, Penelope Vinjevold of the Department of Education; Simon Nicks and Anton Lotz of CNdV africa planning & design (commissioned in respect of the Provincial Spatial Development Framework); and Jackie Gooch of Arcus Gibb (commissioned in respect of the Strategic Infrastructure Plan).

Fareed Abdullah, Department of Health; Gavin Miller, Department of Social Services and Poverty Alleviation; and David Kaplan, Graduate School of Business, UCT (commissioned in respect of the Microeconomic Development Strategy) provided further comments and inputs to the final document.

I wish to thank all who contributed to the 2005 PER&O for the hard work, effort and time that went into producing a quality publication.



Lynne Brown

Minister of Finance, Economic Development and Tourism

March 2005

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Abbreviations

AER	Annual Economic Report
AGOA	African Growth and Opportunity Act
AMI	Advanced Metals Initiative
AMTS	Advanced Manufacturing Technology Strategy
ATC	Agreement on Textiles and Clothing
BEE	Black Economic Empowerment
BER	Bureau for Economic Research
BPO	Business Process Outsourcing
BSF	Business Sample Frame
CBTi	Cape Town Boat-building and Technology initiative
CDF	Cumulative Distribution Function
CPI	Consumer Price Index
CPIX	Consumer Price Index (excluding mortgage interest rates)
CSIR	Council for Science and Industrial Research
CSP	Community, Social and Personal (Services)
DBSA	Development Bank of Southern Africa
DCCS	Duty Credit Certificate Scheme
DEAT	Department of Environmental Affairs and Tourism
DEDAT	Department of Economic Development and Tourism
EAP	Economic Active Population
EAR	Employment Absorption Rate
EU	European Union
GATT	General Agreement on Tariffs and Trade
GEAR	Growth, Employment and Redistribution
SA-EU FTA	South Africa-European Union Free Trade Agreement
FDI	Foreign Direct Investment
FET	Further Education and Training
GDFI	Gross Domestic Fixed Investment
GDP	Gross Domestic Product
GDPR	Regional Gross Domestic Product
GEM	Global Entrepreneurship Monitor
GGP	Gross Geographic Product
GHS	General Household Survey
GSP	Generalised System of Preferences
HDI	Human Development Index
HIV/AIDS	Human Immunodeficiency Virus/Acquired Immune Deficiency Syndrome
HRDS	Human Resource Development Strategy
ICT	Information and Communication Technology



IDC	Industrial Development Corporation
IES	Income and Expenditure Survey
ILO	International Labour Organisation
IMF	International Monetary Fund
IMR	Infant Mortality Rate
IMS	Integrated Manufacturing Strategy
LFS	Labour Force Survey
LFPR	Labour Force Participation Rate
LICUS	Low-Income Countries Under Stress
LMF	Labour Market Frontiers
MEDS	Microeconomic Development Strategy
MFA	Multi-Fibre Agreement
MTEF	Medium Term Expenditure Framework
NACI	National Council on Innovation
NEPAD	New Partnership for Africa's Development
NSDP	National Spatial Development Programme
OHS	October Household Survey
PMI	Purchasing Managers Index
PSDF	Provincial Spatial Development Framework
R&D	Research and Development
RDP	Reconstruction and Development Programme
RSA	Republic of South Africa
RSC	Regional Services Council
SA	South Africa
SAA	South African Airways
SACU	Southern Africa Customs Union
SAPC	South African Poverty Index for Cities
SARB	South African Reserve Bank
SARS	Severe Acute Respiratory Syndrome
SARS	South African Revenue Services
SEE	Survey of Employment and Earnings
SER	Socio Economic Review
SIC	Standard Industrial Classification
SMME	Small, Medium and Micro Enterprise
SSA	Sub-Saharan Africa
StatsSA	Statistics South Africa
TB	Tuberculosis
TDA	Trade and Development Accord
TFP	Total Factor Productivity
TGR	Target (Employment) Growth Rate
TIPS	Trade & Industrial Policy Strategies
the dti	The Department of Trade and Industry (South Africa)

UK	United Kingdom
UNDP	United Nations Development Programme
US	United States
VAT	Value-Added Tax
WC	Western Cape
WDR	World Development Report





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Introduction

1. The Road towards Shared Growth and Development

iKapa Elihlumayo is based on a strategy for shared or broad-based economic growth and development in the Province.

Having moved beyond the discourse of pro-growth and pro-poor orientations, *iKapa Elihlumayo's* approach and stance promotes *sharing growth and development* in the Western Cape. In so doing, it endorses a strategy and policy-mix that views poverty reduction and economic growth as being *interdependent goals* over the medium to long term.

It is generally accepted that growth on its own will not bring benefits to the wider community. The wealthy are able to capture economic rents, while poorer communities tend to have few resources or capabilities to respond to social and economic changes. Growth for its own sake most always results in higher levels of inequity and tends to exacerbate income distribution trends.

Yet growth also has the ability to make a significant contribution to reducing poverty and improving people's livelihoods and future opportunities.

In this sense, '*shared growth and development*' may be viewed as growth through broad-based spectacles or growth that is shared in respect of its strategic focus, policy stance and presentation, and most importantly, its rewards.

Today, understanding the links between equity, growth and development is integral to getting to grips with the process of shared development and the impact of different strategies and policy mixes in respect of long-term sustainable development goals.

Globally there is renewed interest in shared growth and development among policy-makers and development practitioners alike. The concept is attractive and holds the best prospects for enhancing development prospects in a sustainable manner.

More specifically, the shared growth and development approach recognises that the fates of rich and poor are intertwined, and that the only credible option is to find *unity in our diversity* and work together towards a shared growth and development path over the medium to long term.

Less well understood, however, are the possible strategy and policy mixes that Government should use in the targeting of a shared growth and development path.

This is the policy conundrum that the Western Cape faces, as does other national and sub-national governments – understanding that ‘one size’ does not fit all and that, while drawing from best practice, governments must take it on themselves to design and implement policy packages that are best suited to addressing local circumstances. This is what it means to create indigenous solutions to local challenges.

The Western Cape has done so. In *iKapa Elihlumayo*, it articulates the Province’s plan of action for shared growth and development over the medium term.

2. South Africa’s Development Challenges

iKapa Elihlumayo’s beauty and its value lie in its simultaneous connectivity and uniqueness. Positioned within the broader co-operative intergovernmental system, *iKapa Elihlumayo* builds on and shapes both vertical and horizontal relationships in a dynamic and fluid interaction, all whilst holding onto its distinctive appeal.

As such, *iKapa Elihlumayo* is embedded within National Government’s stated socio-economic policy priorities set out in the Medium Term Strategic Framework (MTSF) and the National Spatial Development Perspective (NSDP). It will ultimately draw together the integrated development plans (IDPs) of municipalities within the Western Cape, thereby enhancing economic development at the local level. And it builds on the President’s bold approach for raising South Africa’s development prospects into the third democratic term, outlined in his State of the Nation Address earlier this year.

More specifically, the President set out a programme of action to raise investment, growth and job creation in the ‘First Economy’, seen as the ‘engine’ driving South Africa’s development prospects. The stated policy interventions reflect a strong appreciation to achieve broad-based and inclusive shared growth and development in a manner that expands and deepens economic opportunities for all South Africans.

An equally expansive programme that responds to the challenges of the ‘Second Economy’ infuses a sense of realism and practicality, ensuring a social security net that provides

immediate poverty alleviation. Matched to the latter are interventions that improve people's capabilities and livelihoods, drawing them to participate in basic economic activities that reduce their dependency on welfare and raise their self empowerment in their own development agenda.

As said, the approach is bold and demanding. It sets an energetic pace for delivery in all spheres of government over the next 10 years. In doing so, it challenges interaction, cohesion and performance within our co-operative intergovernmental system – delivery depends on the whole rather than the sum of the parts. The scorecard is rigorous and demanding. Driven by acute reality, it measures improvements in the livelihoods and opportunities of South Africans by 2014. A tough development agenda, one may say. The stakes are high and our choices stark. Realism informs our options. Vision and passion guide our future.

“As Africans, we can neither be pessimistic nor skeptical about our future. Necessarily, we have to be firmly confident about the certainty of a better future for all our peoples. For us to be pessimistic or skeptical is to give up the fight and resign ourselves to lives of misery.” – Thabo Mbeki

3. The Changing Intergovernmental Landscape

As South Africans, our development agenda is clearly defined in many ways. In others, it is ambiguous. One that is most striking is the lack of clarity on the role and functions of the different spheres of government in effecting social and economic delivery programmes as the intergovernmental system evolves and matures over the next 10 years.

In this respect, the intergovernmental landscape is slowly changing. Like a kaleidoscope, the transition through fractal vision is often surprising yet pleasing; the end result still a distant uncertainty.

For provinces, broaching a greater recognition of the provincial development role demands that provinces build robust economic capacity that provides the analytical platform that may inform and guide annual provincial budget decisions.

Provinces need a better understanding as to how to describe provincial economies as distinct regional entities within the broader South African economy. They should be able to analyse key provincial economic variables and propose credible trend forecasts. Decomposing labour market structures and trends adds to an understanding of the provincial skill base and income distribution patterns. Finally, determining the sources, potential and constraints for enhanced provincial growth and employment is critical to ensure appropriate policy and/or co-ordination interventions that, at a meso level, link overarching macroeconomic policies and local economic development interventions.

Two years ago, in anticipation of the changing role of provinces, the Western Cape started embedding its actions in a clearer appreciation of its socio-economic environment. This led to the tabling of the 2003 Medium Term Budget Policy Statement and 2003 Socio-Economic Review.

Building on and deepening this analytical foundation, the 2005 Provincial Economic Review and Outlook (PER&O) is published alongside the 2005 Main Budget.

4. Western Cape's Economic Outlook

4.1 The South African economy

The Western Cape's economic fortunes are closely linked to those of the national economy. Following a decade of economic restructuring and prudent macro-economic policies, the outlook for the South African economy is the best in years.

In this respect, the South African economy has matured appreciably over the past decade and the economy is poised for higher growth. Fiscal policy has become more supportive of growth, prospects for lower and more stable inflation and interest rates are real, tariff reductions have for the most part run its course, the political climate is the most stable it has been in years and business and consumer confidence are on historically high levels reflecting an optimistic business mood intent on expanding production capacity. Exchange rate volatility remains a threat and currently places substantial pressure on the (higher value-added) export sectors, as well as import competing sectors.

The global economy is expected to remain supportive of domestic economic growth over the short term. The single biggest risk to the favourable global economic outlook is the high oil prices.

The South African economy is currently in its longest post-war economic upswing phase. Economic growth averaged a relatively pedestrian 2,8 per cent over the past decade; however, this is a big improvement and there are increasing signs of structurally higher growth prospects. Last year, economic growth was adversely affected by the strength of the currency; however, the affected production sectors are recovering as business adjusts to the macroeconomic forces.

Real gross domestic product (GDP)¹ growth is forecast to accelerate to 4,1 per cent during calendar year 2005 and to slow marginally to 3,6 per cent in 2006 and 3,0 per cent in 2007 under the weight of higher interest rates.

Job creation is expected to accompany robust fixed investment spending as firms contemplate expansion plans. There is already evidence of this. A more satisfactory rate of employment creation remains the single most important national economic challenge.

1 All GDP and regional GDP (GDPR) projections are those derived from work done by the BER.

The financial environment should remain supportive to economic growth over the short term, with inflation and inflation expectations adjusting to lower levels in a structural sense, creating the possibility of lower real interest rates and sustainable higher real economic growth.

While exchange rate volatility remains a threat, the improved balance of payments reserves and investor confidence could prevent a repeat of the 1998 and 2001 “rand events”. However, somewhat disconcerting is the composition of the capital inflows on the South African balance of payments over the past 18 months, revealing a lack of net foreign direct investment.

4.2 The Western Cape economy

The Western Cape regional economy displays a number of unique structural trends, giving rise to a dynamic process that has its own strengths and challenges for policy-makers.

Compared to the relatively small population share (10,2%), the Western Cape economy has a broad base with a multitude of sub-sectors or niches, many of which are growing well or have the potential to expand. With the exception of the mining sector, the Western Cape economy is well represented in each sector, with tourism as well as agriculture making up much of the mining deficit.

The Western Cape economy is well represented in the nationally fast-growing services industries such as financial & business services (on average, between 1999 and 2003 contributing 27,1% to the regional GDP), internal trade & catering (16%) and transport & communication (10%), as seen in Table 1 below. The tourism industry is an important source of growth in these and other sectors. The size of the Province's manufacturing sector is similar to that in the national economy, around 20 per cent of regional GDP (GDPR).

A salient feature of the Western Cape economy is the rapidly growing niche manufacturing and services industries, not always portrayed in the conventional national accounts statistics. Agriculture, construction and the government sectors are also important contributors to GDPR. The largest employers in the region are the government, internal trade & catering, manufacturing, agriculture and ‘other producers’ (mainly domestic servants). Combined, these sectors account for more than 75 per cent of the total regional employment opportunities in the Western Cape.

Table 1 Western Cape GDPR: sectoral composition, 1999 – 2003

Sector	1999 %	2000 %	2001 %	2002 %	2003 %	Average 1999 – 2003 %
Primary sector	5,9	5,3	5,7	6,7	5,7	5,9
Agriculture	5,7	5,1	5,5	6,4	5,4	5,6
Mining	0,3	0,3	0,3	0,3	0,3	0,3
Secondary sector	25,7	25,6	24,4	25,6	24,8	25,2
Manufacturing	19,9	20,2	20,0	20,6	19,9	20,1
Electricity & water	1,9	1,8	1,7	1,6	1,7	1,7
Construction	4,0	3,6	2,8	3,4	3,2	3,4
Tertiary sector	68,3	69,1	69,8	67,8	69,5	68,9
Internal trade & catering	15,1	16,1	16,1	15,6	15,8	15,7
Transport & communication	10,0	10,2	10,2	10,1	10,3	10,1
Financial & business services	26,4	26,3	27,7	27,0	28,0	27,1
CSP services ¹	5,1	5,3	5,3	5,2	5,3	5,3
Government	11,8	11,0	10,6	10,0	10,1	10,7
Total GDPR (basic prices)	100	100	100	100	100	100

¹ Including 'Other producers' (mainly domestic servants).

[Source: Statistics South Africa: Statistical Release P0441, 28 November 2004]

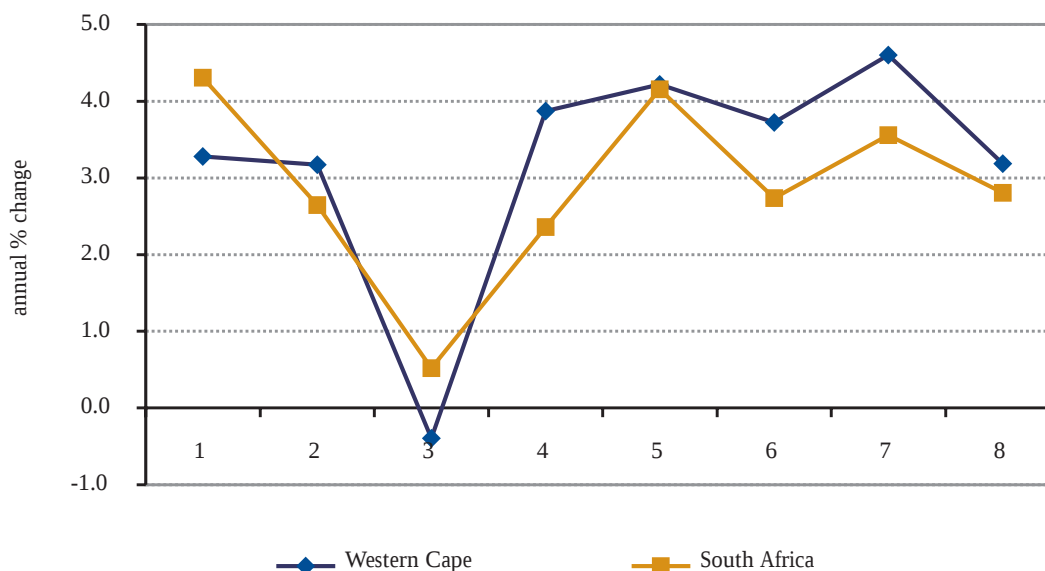
4.2.1 Economic growth trends

The Western Cape economy has out-performed the national economy over the period 1999 to 2003. Real GDPR growth for the Western Cape economy averaged 3,9 per cent over the period, compared to the national average of 3,1 per cent, as seen in Figure 1 below.

The appreciation of the Rand exchange rate, adverse climatic conditions and rationalisation activities in the financial services sector have had a disproportionately negative impact on the Western Cape economy in 2003. The region's real GDP growth rate decelerated to 1,6 per cent (compared to 1,9 % nationally) from 3,6 per cent in 2002.

On average, however, the superior growth of the Western Cape economy over the past five years is largely due to the strong growth of the region's services industries, such as transport & communication, financial & business services and internal trade & catering. While these are nationally fast-growing industries, the Western Cape out-performed national in these sectors, particularly in internal trade & catering (which grew by 6,6% per annum between 1999 and 2003 compared to 5,3% nationally) and financial & business services (6,3% versus 5,4%).

Figure 1 Real GDP growth Western Cape versus South Africa



[Source: Quantec Research]

The internal trade & catering sector benefited from tourism, which has been a fast-growing sector in the Western Cape. The proportionately larger financial & business services sector in the Western Cape benefited from the property boom and the recovery in asset markets following the 2000 global meltdown in the ICT sector.

In contrast, the growth of the Western Cape overall manufacturing industry has been disappointing. Real Western Cape manufacturing value-added grew at half the pace of the national average, or at 1,4 per cent per annum between 1999 and 2003 compared to 2,8 per cent nationally. The share of manufacturing in the regional GDP declined from 23 per cent in 1995 to 19,9 per cent in 2003. The decline in the sector's formal employment contribution was worse, dropping from 21 per cent in 1995 to 16 per cent in 2003.

Western Cape business confidence is currently measured on a lower level compared to the rest of South Africa. While the financial services and manufacturing sectors are recovering, the hostile climatic conditions and the strength of the rand persist, suggesting regional growth results for 2004 could be weaker compared to the rest of the country in 2004.

Provided the sustained buoyancy in domestic demand and a more robust recovery anticipated in exports, the lagging business confidence levels in the Western Cape should catch up over the short term. Generally, firms appear to be adopting a long-term view and are embarking on expansion plans.



The Western Cape economy's strong linkages with the national economy are reflected in a closely corresponding business cycle. The economy is also relatively open, that is external trade contributes a large share of the GDP, which renders the economy sensitive to changes in the exchange rate of the Rand and global demand.

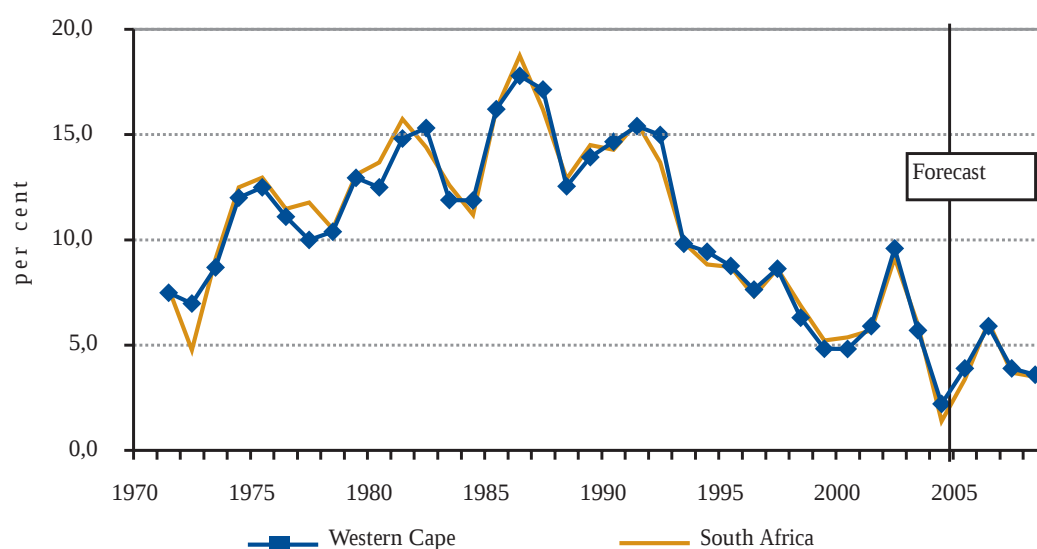
The regional economy is therefore expected to catch up with South Africa's economic recovery over the short term. Prospects vary, *inter alia*, depending on the direction of the rand exchange rate and/or business' adjustment to the new macro-economic parameters, as well as the regional policy support.

The growth in the Province's services industries is projected to equal or exceed the national performance and a more competitive exchange rate should allow for a firmer recovery in the Province's embattled manufacturing sector, as well as the agricultural sector on the assumption of normal climatic conditions.

4.2.2 Inflation

Regional inflation is highly correlated with that of the rest of the country. The inflation outlook is benign, apart from the crude oil price risk. Inflation is expected to accelerate to levels of five to six per cent during 2005/06 due to cyclical pressures and some depreciation in the exchange rate. Given the maturing anti-inflation process in South Africa, wage and price setting is expected to take account of competitive forces in the local and global arena.

Figure 2 CPI inflation Western Cape versus South Africa, 1970 – 2008



[Source: Statistics South Africa]

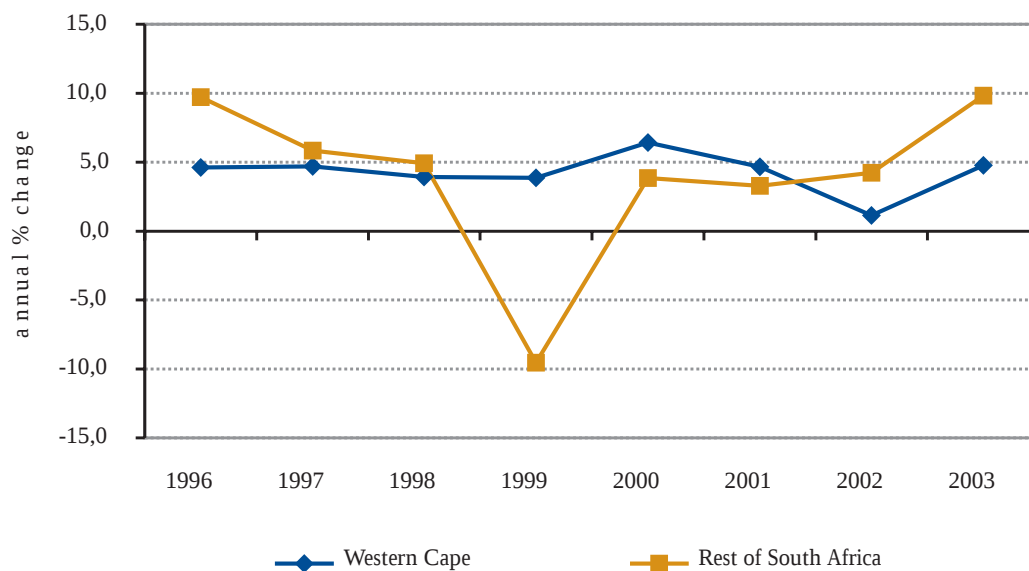
4.2.3 Fixed investment

The growth in Western Cape fixed investment spending has been very stable around a rate of four per cent per annum over the period 1999 to 2003. Due to the strong contribution by the less cyclical services industries, in particular, financial & business services (accounting for more than 45% of the cumulative growth in regional fixed investment, 1999 to 2003), transport and communication (18%) and internal trade and catering (13%), as well as autonomous mega investment projects, the Western Cape avoided the 1999 slump in general fixed investment. Manufacturing fixed investment has been lagging behind that of the tertiary sectors, however, the situation should improve over the short term.

The fixed investment outlook is positive. Following a period of strenuous macroeconomic policies and restructuring in the domestic economy, South Africa is entering a new era of more supportive fiscal policy, gradually lower real interest rates and firms generally having

adjusted to the lower level of import tariffs. Under these conditions, fixed investment spending can increasingly become of the capital-widening kind – being accompanied by expanding employment-rather than of the capital-deepening kind of the 1990s when formal employment contracted. There is already evidence that this is actually starting to happen.

Figure 3 Fixed investment Western Cape versus the rest of South Africa, 1996 – 2003



[Source: Quantec Research]

4.2.4 Exports

The Western Cape's exports have performed well over the past six to seven years, growing by eight per cent to nine per cent per annum in real terms. The region's established exports (ranging from fruit and processed foods & beverages, iron & steel and fish to clothing & textile products and electrical machinery) have performed well, even in the face of the stronger rand.

However, in a number of the smaller and fast growing ('non-core') export categories over the past five years, volumes have declined sharply in 2003 and probably in 2004. It is possible that the weakening trend in the rand exchange rate over the period 1996 to 2002 assisted many of these exporters entering the world markets, and the latter are currently finding the going tough.

While the outlook for the Province's agro-industrial and base metal exports is favourable, a broader recovery in manufacturing exports could be strongly influenced by the direction in the rand exchange rate, apart from the business response.

4.3 Outlook 2005/06 – 2007/08

In all, the Western Cape economy is expected to recover from the headwinds experienced in 2003 and 2004, and business is adjusting to the strong rand.

From a domestic demand perspective, the short-term outlook for the Western Cape economy is decidedly favourable, similar to the national situation. *Inflation* and *interest rates* are likely to remain *supportive* to final consumer spending. *Consumer confidence* is *high* and rising and consumers' ability to spend is likely to continue to improve due to above-inflation wage settlements and improving employment conditions.

The improvement in *employment* in the Western Cape could *lag* that of the rest of the country due to the problems in the labour-intensive clothing industry, as well as the other major employers in the manufacturing sector, in particular food processing, wood products, printing & publishing. The positive employment trend in the retail, tourism and business services sectors is likely to persist and this needs to be supported.

Export demand is also expected to be favourable over the projection period. While manufacturing exports are currently under pressure from the strong rand exchange rate, a more robust recovery should unfold once the rand depreciates, as is expected over the short term.

Provided that the buoyancy in domestic demand is sustained and the more robust recovery anticipated in exports materialises, the lagging business confidence levels in the Western Cape should continue to catch up over the short term.

The outlook for *fixed investment* is promising. Generally, firms appear to be adopting a long-term view and are increasingly embarking on expansion plans.

Given these demand conditions, *real GDP growth* is expected to continue *accelerating* in 2005 and over the short term. In all, real GDP is projected to accelerate from growth of 3,3 per cent in fiscal year 2003/04 to 4,1 per cent and 4,3 per cent during fiscal years 2004/05 and 2005/06 respectively, exceeding the projected national growth rate by a small margin.

In the outer years of the MTEF, real GDP growth is expected to decline slightly to 4,0 per cent and 3,9 per cent in fiscal years 2006/07 and 2007/08. These projections, however, remain above the national real GDP growth forecast of 3,9 per cent in 2005/06, 3,5 per cent in 2006/07 and 3,2 per cent in 2007/08.

Table 2 below therefore presents the Western Cape's macroeconomic outlook for the 2005 MTEF period.

Table 2 Western Cape macroeconomic outlook, 2004/05 – 2007/08¹

	2002/03	2003/04	2004/05F	2005/06F	2006/07F	2007/08F
GDPR (R-billion, current market prices)	168,8	185,4	203,0	222,5	244,4	263,4
Real GDPR growth (%)	4,3	3,3	4,1	4,3	4,0	3,9
GDPR inflation (%)	8,4	6,3	5,3	5,1	5,7	3,8
Western Cape CPI inflation (%)	9,0	4,6	2,3	4,5	5,5	3,7

¹ Fiscal years ending 31 March.

[Source: Bureau for Economic Research (BER)]

5. Sectoral growth and employment prospects

At a more detailed sectoral level, headlines point to the Western Cape economy outperforming the South African economy in GDP or value-added terms, largely due to strong growth and contribution of tertiary services sectors. But these sectors have not been creating jobs, and overall employment performance is much poorer than national. The latter result is a key risk factor, significantly jeopardising the Western Cape's chances of sharing economic benefits to a broader range of people and communities across the Province.

The aggregate picture, however, hides promising detail. The Western Cape's key attribute is its broad base and diversity of industry as well as up-and-coming or promising sub-sectors, industries or 'niches'. The Province's four core sectors – agriculture, manufacturing, trade and financial & business services – are each well diversified, reducing the risk of over-dependence on any single industry.

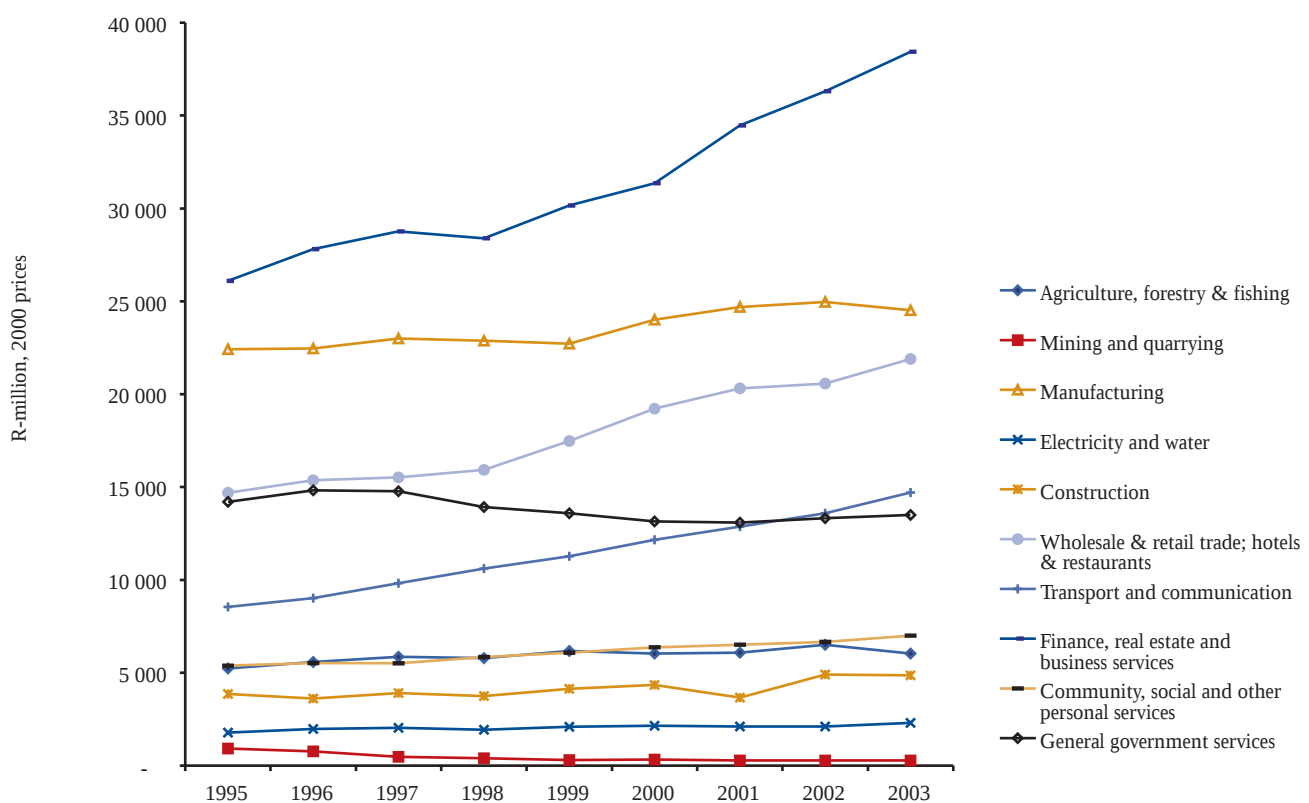
In addition, the region has a well-developed tourism sector, and reasonably strong and dynamic construction, fishing, professional services, higher education and transport sectors. A small mining base is mitigated by Saldanha's emergence as a major export harbour for minerals as well as a key base for the iron and steel industry.

The lack of any significant mining activity, capital-intensive mineral processing as well as attendant heavy industry accentuates the dominance of small and medium-sized enterprises in the Western Cape economy, and is likely also to contribute towards the shift towards a service economy.

5.1 Sectoral development

This means that Western Cape sector patterns are quite different from those at national level, although overall output and employment trends over time have been similar. As seen in Figure 4 below, the *eight-year period* between 1995 and 2003, the strongest average annual output growth rates in the Province have been recorded in transport & communications (7,0%), wholesale & retail trade and hotels (5,2%), and financial & business services (5,0%).

Figure 4 Western Cape sector contribution to GDPR, 1995 – 2003



[Source: Quantec Research]

Tertiary services together account for more than two-thirds (69,8%) of Provincial GDP, higher than the national average. Finance & insurance and business services, in particular, stand out with a share of 13,8 per cent and 15,0 per cent of GDPR respectively in 2003, compared to 9,7 per cent and 10,6 per cent of national GDP.

There has been strong growth across tertiary services, led by transport (8,6%), financial & insurance (6,2%) and wholesale & retail trade (5,2%), which all recorded average annual growth rates from 1995 to 2003 in excess of five per cent per annum.

The Province has recorded higher growth than the national average in catering & accommodation (4,9%), transport & storage (8,6%), business services (4,0%) and other producers (5,9%). This reflects the Western Cape's strengths in tourism, call centres and as a major port Province.

In the *secondary sector*, the performance of manufacturing has been very disappointing, with an average growth just half that of the national performance of 2,2 per cent per annum since 1995. In particular, the sector's performance reveals that in comparison with the national economy, industry in the Province is oriented towards food & beverages (a 21% share), clothing & textiles (8%), and wood, paper & publishing (12%) which together account for 41 per cent of output (measured as value-added). By comparison, metals & machinery and transport equipment are much less important in the Province (16%) than they are nationally (21%).

For firms to be able to compete internationally, and to expand and grow employment, it is important for them to increase their productive capacity and to upgrade equipment. Recent performance suggests that this is especially the case for employment growth in more labour-intensive sectors. But in very capital-intensive sectors, such as basic chemicals and basic iron & steel, increased investment has coincided with large reductions in employment

Similarly, in the *primary sector* the performance of agriculture, forestry and fishing in the Western Cape, with an average annual growth rate of 1,9 per cent since 1995, is also much poorer than the national growth rate of 3,5 per cent. However, more detailed sub-sector analysis reveals that the data do not necessarily reflect recent developments in the Province and that performance may have been better than the averages suggest. More specifically, there has been increased activity across a diverse range of agricultural activity, as well as increased output and employment in fishing and mariculture.

5.2 Employment patterns

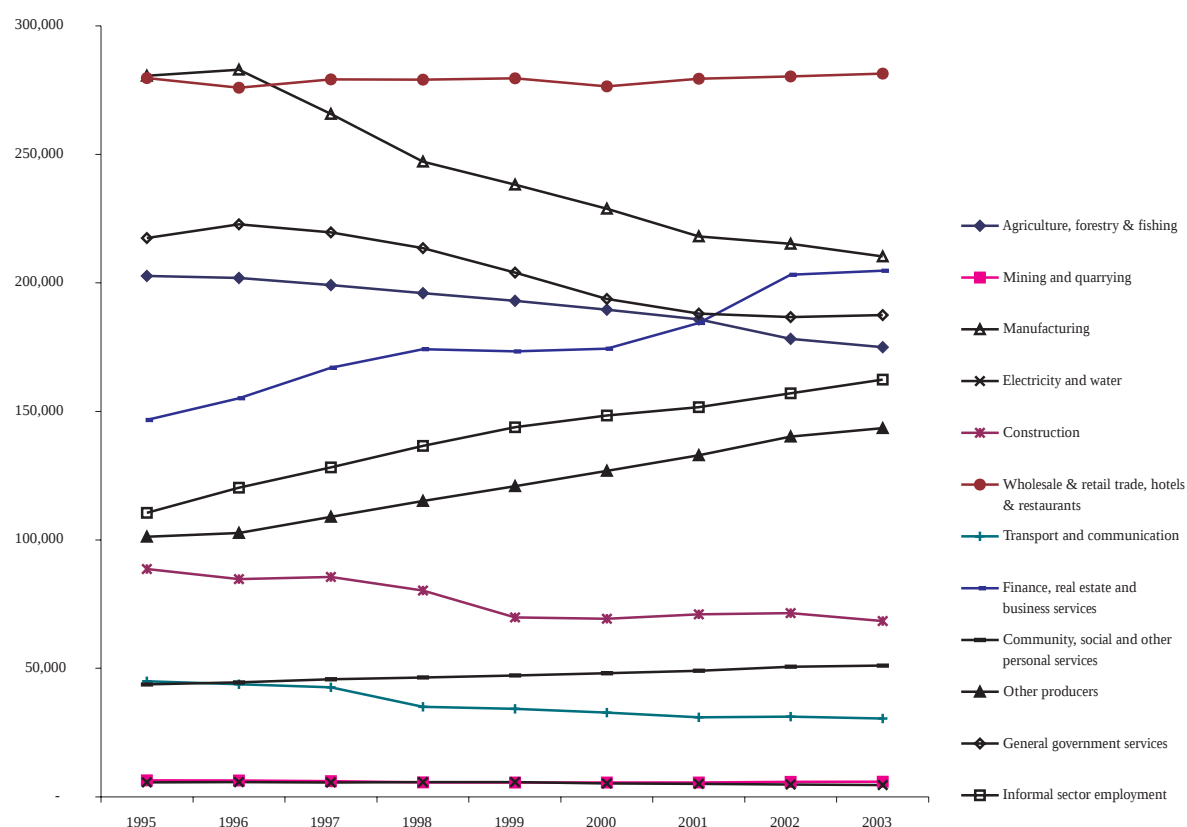
As seen in Figure 5 below, the most dramatic development has been a decline in manufacturing employment from 1995, and an increase in informal employment (the latter trend is discerned here using the Quantec database, and differs from the trends in chapter 4).

From being the largest employer, manufacturing has been overtaken by general government services and community & social services – in particular the major generators of formal sector employment – with employment almost doubling in a decade.

It is surprising, however, that there has not been net employment creation in finance & business services and transport & communication, nor in wholesale & retail trade and

hotels & restaurants, given the output growth of these sectors. Of perhaps greater concern is that there is little indication of increased employment resulting from tourism and other services such as telecommunications.

Figure 5 Western Cape sector employment, 1995 – 2003



[Source: Quantec Research]

It is evident from Figure 5 that all manufacturing sectors in the Province had lower employment in 2003 than in 1995, except for transport equipment (3,2% average annual growth), which has grown from a very small base, and furniture & other manufacturing (1,1%). The biggest proportionate declines were in electrical machinery (-11,9% per annum) and other non-metallic minerals (which includes cement and brick-making) (-10,3%), and the biggest absolute job losses were in the largest sector of clothing, textiles & leather (23 737 net jobs), closely followed by food, beverages & tobacco (18 321 net jobs).

In the last three years, the metals & machinery sector has shown signs of growth (3,2% growth per annum from 2000). This sector is linked to important areas of potential. Similarly, positive growth in employment in transport equipment in the Province reflects capabilities in auto components and in yacht- and ship-building.

Of more concern is that the Province's performance is generally much poorer than that of the country as a whole. In addition, while nationally the wood, paper & publishing and the petroleum & chemicals sectors have recorded employment growth from 2001 to 2003 of 0,7 per cent and 1,5 per cent per annum respectively, in the Province employment overall has continued to stagnate.

The growth at the national level in these broad groupings relates to the narrower sub-groupings of wood products (due mainly to increased processing of forestry products) and plastic products. Plastic product manufacture is both labour-intensive and at the national level is experiencing higher than average employment growth (of 2,1% per annum), as plastic products increasingly replace other materials. The Western Cape needs to ensure that it benefits from these developments.

A major concern is that the strong growth in services in respect of value-added or contribution to GDP is not reflected in employment patterns. Indeed, there have been contractions in employment in many service sectors. The largest contractions have been in communications (-4,8% per annum), transport (-4,3%) and catering & accommodation services (-4,2%).

The services sector's employment patterns have not seen the benefit from strong growth in services value-added. Indeed, there have been contractions in employment in many service sectors. The largest contractions have been in communications (-4,8% per annum), transport (-4,3%) and catering & accommodation services (-4,2%).

Given the substantial growth in tourism, it is surprising not to see this reflected in employment in catering & accommodation and transport. The communications sector shed almost 5 000 jobs between 1997 and 1998, probably reflecting major retrenchments by Telkom following its commercialisation and move to privatisation. Almost 4 000 jobs were also shed in transport between 1996 and 1998, reflecting retrenchments by Transnet across their operations as part of broad restructuring of the corporation.

By comparison, there have been high rates of employment growth in business services (average annual growth of 6,2%), wholesale & retail trade (3,2% growth) and other producers (4,5% growth). Business services reflect employment creation in call centres, while other producers may capture some of the effects of tourism. However, it is a little surprising that the Western Cape has not recorded as rapid increases in employment in business services as in the country as a whole.

5.3 Main drivers of provincial economic performance

To a large extent the drivers of provincial economic performance are national. The restructuring of industry in the past decade has been reflected in poor performance and

employment losses in the Province. Similarly, the improved national growth in the past year and the move to a more expansionary macroeconomic stance means the Province should plan for growth – in addressing training, infrastructure and investment by firms. The stimulus for growth is, however, primarily domestic demand.

Looking forward, a shared sustainable growth and employment path needs to rest on a broad foundation of agriculture, industrial regeneration, tourism and services such as business process outsourcing that grows in output and employment. The pattern of higher growth in financial & business services and tourism, with agriculture remaining very important, does not negate the need to further develop the manufacturing base.

A crucial dimension in the Western Cape is its coastal location and the opportunities that arise from it. These opportunities are not only in exports, but also in deepening international links around investment, technology and production networks. The challenge is to translate the opportunities into output growth and employment in relatively labour-intensive areas of manufacturing and other sectors.

Lessons from industrialising countries and regions indicate that government plays a crucial role in strategic repositioning by anticipating future developments together with local economic stakeholders, and co-ordinating the actions of local institutions to meet the dynamic needs of the global customer.

The 2005 PER&O suggests that the Province plays an important role in this respect. At the meso-economic level, Provincial actions focus on connectivity and integration, linking macro frameworks, institutions and interventions to local economic development, and, where necessary, designing appropriate Provincial interventions that stimulate broad-based economic activity and raise levels of economic participation.

Province's role is then to identify and address global and nation economy-wide as well as sector- and industry-specific opportunities and challenges. In particular, a key role rests in facilitating SMMEs and sector organisations to take full advantage of opportunities presented.

Initially, these opportunities are likely to be found in the tertiary rather than the primary and secondary sectors. A key challenge is to ensure that any further development of the tertiary sector does not entrench existing skill, capability and spatial patterns of inequality that exist in the Western Cape.

Repositioning to build and focus on the Province's dynamic competitive advantage therefore then calls for:

- Ongoing upgrading of the agriculture sector, with emphasis on a broader base of higher value-added products, that take account of climatic patterns and water usage

- in particular, and support for the research and standards necessary for exporting, complemented by support for smaller and historically disadvantaged farmers.
- Addressing cost competitiveness issues in industry (including steel prices), which impede the performance of labour-intensive, relatively basic products.
 - Ensuring that appropriate skills and training are implemented.
 - Monitoring the various technology initiatives and identifying where Provincial and local government facilitation can ensure the potential gains are realised. The Province needs to identify areas to develop local technological competency in tertiary education and other research institutions.
 - Facilitating ongoing growth in industries already performing well, such as yacht-building and film-making, with particular emphasis on quality and quantity of employment.
 - Selecting a small number of target areas where government action can facilitate significant expansion, including ship-building in medium and small vessels, herbal and natural products such as essential oils, furniture and BPO.
 - Implementing mechanisms to build inter-firm communication and co-operation, such as benchmarking (specifically proposed for foundries and clothing).

The above are critical in respect of enhancing the Province's growth and employment prospects over the medium term.

6. Employment and Remuneration Prospects

Turning to employment and remuneration prospects, many South Africans contend that economic restructuring has left many without work, and many more are convinced that our economic revival is about jobs, jobs and more jobs. A 'meso-cosm' of the national debate, the Western Cape picture is no different and the debate on the Provincial labour market performance no less contentious.

That said, it is important to get a better understanding of the Western Cape labour market, as it is the key mechanism through which individuals engage in the Provincial economy.

6.1 Demographic profile and migration trends

As other markets, the labour market functions through the interaction of supply and demand. A key determinant of labour supply is the size and structure of the population. As the Western Cape is a recipient of in-migration, the size and age profile of the present Provincial population, as well as the numbers and characteristics of individuals migrating into the province, are important factors that determine the present and future provincial labour supply.

The Provincial population is relatively young in that less than 15 per cent is older than 50 years. Conversely, approximately two-thirds (66%) of the population is between the ages of 16 and 65 and is therefore of working age.

The working age population in the Province is therefore likely to grow as these relatively large age-groups grow older and enter the working age population, while fewer older individuals exit the working age population. This change will filter through to the labour force, and the Provincial economy will therefore remain under significant pressure to create jobs for the foreseeable future.

Looking further ahead, unless migration affects the age distribution of the population significantly, the Western Cape is likely to face the prospect of an ageing population sooner than other provinces.

Substantial in-migration to the Province is a key factor influencing the Western Cape's changing demographic and labour market profile. It is estimated that the Province gains 48 000 individuals (net of out-migration) every year, with many of these motivated by perceived brighter employment prospects and higher incomes.

Although this may seem a relatively large number, particularly when summed up over time, annual in-migration represents only slightly more than one per cent of the Province's 2001 population (according to Census 2001).

In terms of the impact on the working age population, net in-migration constitutes an injection of young individuals into the Province's working age population (72,6% of in-migrants are under 36 years of age compared to 65,6 per cent of those Western Cape residents who did not move in the inter-census period).

In-migrants from the Eastern Cape differ significantly from other in-migrants in this regard, with 83,3 per cent being in this age-group. This difference is even more marked when one compares the proportions for individuals between 16 and 35 years of age: 48,9 per cent of other in-migrants fall into this age-group compared to 68,0 per cent of those from the Eastern Cape. Being younger, Coloured and African migration streams

represent an injection of young motivated workers, while the older White stream contributes few workers but brings in capital and skills.

In-migration may pose certain short-term challenges, particularly in the areas of service delivery and job creation where there are existing backlogs. It is essential that these challenges are identified, incorporated into current policy formulation and addressed proactively to ensure that potential future problems are avoided. Over the longer term, in-migration is a source of opportunity for increased labour. This depends significantly on strategies to upgrade and improve human resources and the Provincial skills base.

6.2 Employment and job creation

Assessing labour market performance often evokes contentious debate. At the technical level, debate is fraught in respect of the analytical measures and data used to assess labour market performance; their robustness and how analytical results should be interpreted, given many data and measurement uncertainties.

Labour market analysts need to tread carefully amidst assessments that either point to the expansion of employment opportunities since 1995, based on national household survey data; or raise that South African growth over the last decade has been 'jobless' due to economic restructuring.

At the national level, South Africa has witnessed notable growth in employment prior to 2000. But since then the aggregate national employment seems sticky at about 11,6 million jobs.

While the economy may be creating jobs, it may not be creating enough jobs given the rising numbers of new entrants into the labour market each year. If the annual job creation rate does not exceed or at least equal that of the labour force, then we will continue to see rising unemployment rates in South Africa.

This is the story that represents a more factual and realistic account of South African labour market performance over the last decade. By 2003, 8,3-million South Africans were unable to find work, up by more than four million individuals, with nearly 1,8-million of these becoming unemployed since 2000.

At the provincial level, the Western Cape's labour market performance holds brighter prospects when compared against its national counterpart. Since 2000, nearly 200 000 jobs were created in the Western Cape at a rate of 4 per cent per year. This has seen the Province raise its share of national employment from 13 per cent to 15 per cent.

Table 3 provides a comparative picture between the Province and South Africa as a whole.

Table 3 Labour force change in South Africa and the Western Cape, 2000 –2003

	2000 (‘000s)	2003 (‘000s)	‘000s	Change %	% p.a.	Target Growth Rate (%)	Emp. Absorp. Rate (%)
Western Cape							
Employment	1 537	1 730	194	12,6	4,0		
Expanded Unemployment	449	612	163	36,3	10,9	23,2	54,3
Expanded Labour Force	1 986	2 342	356	17,9	5,7		
Official Unemployment	317	448	131	41,5	12,3	21,1	59,6
Official Labour Force	1 853	2 178	325	17,5	5,5		
South Africa							
Employment	11 675	11 612	-63	-0,5	-0,2		
Expanded Unemployment	6 538	8 302	1 763	27,0	8,3	14,6	-3,7
Expanded Labour Force	18 214	19 914	1 700	9,3	3,0		
Official Unemployment	4 074	4 562	487	12,0	3,8	3,6	-14,9
Official Labour Force	15 750	16 174	424	2,7	0,9		

[Source: Statistics South Africa LFS, September 2000 and September 2003]

Unfortunately, although employment growth has been above the national average, unemployment in the Province, irrespective of definition, has also expanded at a more rapid rate. This trend sees the official (narrow) unemployment rate rising from 17,1 per cent in 2000 to 20,6 per cent in 2003, and that measured broadly rising from 22,6 per cent to 26,1 per cent respectively.

These aggregate unemployment measures hide important trends common to particular population and age groups. Reflecting the demographic profile of the Province, most jobs in 2003 were filled by Coloured individuals (58%), with Africans and Whites each constituting around one-fifth of employment. At the same time, more than one-half or 320 000 of the 612 000 Western Cape unemployed are Coloured. In contrast, at 41 per cent, Africans' share of unemployment is twice their employment share, indicating a substantial disadvantage for Africans in the provincial labour market. Conversely, Whites' unemployment share is around 6 per cent – less than one-third of their employment share.

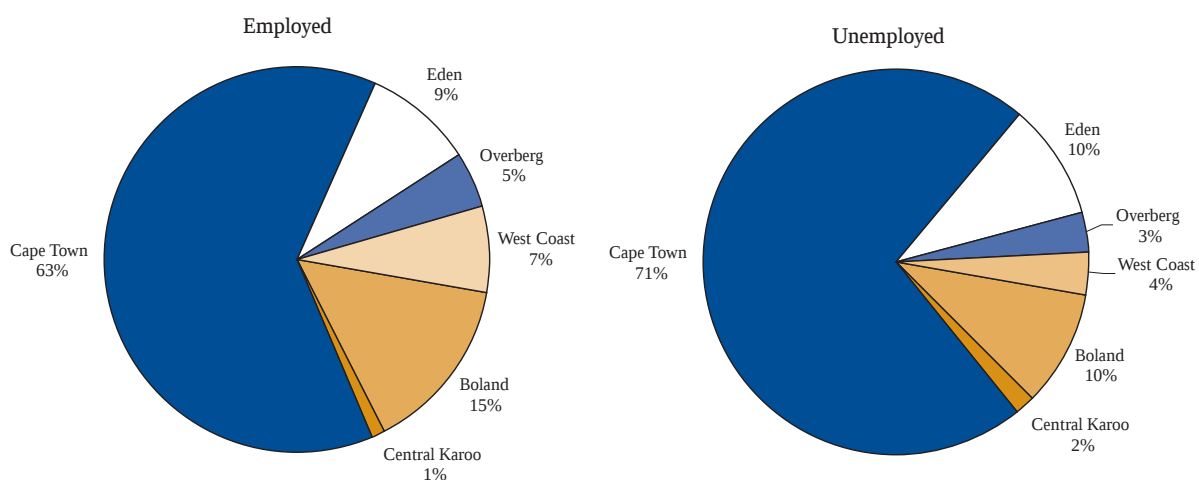
Perhaps most alarming, though, is the highly unequal age composition of employment and unemployment. In particular, the age group 16 and 25 years accounts for a mere 17 per cent of employment but 46 per cent of unemployment.

Based on these figures, the problem of youth unemployment in the Province appears, structurally, to be relatively more acute than it is in the rest of South Africa, where this group's share of unemployment was just under 40 per cent in 2003. Consequently, the Western Cape accounts for a relatively high share of the national number of unemployed

16 to 25 year olds, raising the importance of the youth focus of the *iKapa Elihlumayo* Social Capital and Human Resource Development strategies.

If we add a spatial perspective, we see that unemployment is concentrated in the City of Cape Town (unsurprisingly, given its dominance in economic and population terms) and the Boland and Eden regions, although the Central Karoo suffers from the highest unemployment rate.

Figure 6 Spatial Distribution of Employment and Unemployment, 2001



[Source: Statistics South Africa Census 2001]

Key Provincial challenges are therefore youth unemployment and the spatial dispersement of economic activity and hence employment patterns in the Province. A central political question is whether effort and hence resources should be concentrated on interventions that focus on the greater numbers of unemployed or on areas with higher rates (but lower aggregated numbers) of unemployed. Policy decisions in this respect have clear spatial consequences and pertain to the sustainability of development patterns in the Province.

6.3 Remuneration trends and the skills bias

Apartheid's legacy – decades of discrimination and unequal access to educational and unemployment opportunities – has left an indelible mark on the Western Cape's remuneration structure of formal employment across race groups.

Irrespective of what income level is used as reference, White formal sector workers are significantly better off than their Coloured counterparts, who in turn are better off than their African counterparts. At the top end of the income distribution, only 3,4 per cent of African formal sector workers earned more than

R6 000 per month in 2003, compared to 9,5 per cent of Coloureds and almost half of White formal sector workers. In 2003, therefore, the inequalities in the Western Cape in terms of formal sector remuneration were considerable, with White individuals accounting for 57 per cent of all workers earning over R6 000 per month and 64 per cent of those earning over R8 000.

An individual's income is closely related to his or her occupation or skill level, it is important to analyse skill distribution in a study of remuneration and inequality. Skills are highly unevenly distributed both nationally and within the Western Cape. Amongst those employed in the formal sector, Whites account for close to 54 per cent of the highly skilled, compared to their 22 per cent share of total formal sector employment. In contrast, while Africans constitute slightly more than 17 per cent of the employed in the Province, more than 28 per cent of low skilled persons employed are African. Coloureds are over-represented in the skilled and low-skilled occupations. Table 4 provides a breakdown of the skills category per major race group.

Table 4 Racial shares of formal sector employment by skill level, 2003

	African %	Coloured %	White %
High-Skilled	6,4	38,3	53,7
Skilled	15,2	64,4	19,7
Low-Skilled	28,4	69,4	2,2
Total	17,3	59,9	22,1

[Source: Statistics South Africa LFS, September 2003]

The skills bias of employment growth is central to the issue of income inequality within the Province, both across and within race groups. The current racial composition of formal employment by skills category indicates substantial educational inequalities and racial stratification of occupations. While a key focus of the Human Resource Development Strategy, this trend is not an easy one to address and one that takes time.

For the foreseeable future, then, the supply of skills is likely to reflect these racial imbalances, though less harshly as time elapses. As skill compositions begin to reflect a more desirable demographic representation, we are likely to see a transition in demographic representations in occupational classes. This will have a definite impact on income inequality in the Western Cape, although employment growth is required across the skills spectrum and particularly amongst less skilled occupations if inequality levels are to be reduced via the labour market.

6.4 Informal sector

The informal sector has been credited with creating a substantial proportion of all new jobs in the South African economy since the early 1990s.

Based on September 2003 Labour Force Survey data, it appears that around nine per cent of all Western Cape jobs were found in the informal sector, a proportion that was substantially lower than one-quarter of all jobs for the country as a whole. Although the proportion declined from around 14 per cent in 2000, the actual figures are not statistically different from each other and it is therefore not possible to say for certain that the informal sector has declined over the period.

However, this result is contrary to informal sector trends using Quantec data as highlighted in chapter 3. The only possible conclusion then is that the informal sector is a difficult sector to quantify, and demands urgent investigation at the Provincial level.

In terms of composition, informal sector activities are varied and range from manufacturing to roadside retail to subsistence agriculture. By 2003, the informal sector employed 2,2 million workers or roughly 20 per cent of total employment in South Africa. In the Western Cape, the informal sector is small relative to the rest of the country, accounting for only 9,3 per cent of Provincial employment or 161 000 workers.

Africans and Coloureds dominate the Provincial informal sector. Each group accounts for almost two-fifths of employment. Approximately 31 000 Whites are engaged in informal sector activities and in 2003 represented around 19 per cent of informal sector employment.

The nature of the activities engaged in seems differentiated by race if the skills distribution is considered. The bulk of African informal sector employment is low-skilled (57%) with one-third in skilled occupations. For Coloureds, skilled workers dominate the skills distribution (50%) with nearly two-fifths being low-skilled. In contrast, while the relatively few Whites are engaged in the informal sector, those who are tend to be engaged in high-skilled occupations: two-thirds of White informal sector workers are high-skilled. African and Coloured informal sector workers are, therefore, likely to be engaged in relatively low productivity, low paying activities.

Comparisons of the informal sector remuneration structure and that of the formal sector reveal, as expected, that informal sector employment is significantly lower paying than formal sector employment. For example, around 20 per cent of formal sector workers who reported their incomes in 2000 earned up to R12 000 per annum, compared to around 60 per cent of informal sector workers.

6.5 The small business sector

Looking at trends in the SMME sector, it is believed that there are between 1,8-million and 2,6-million actively trading small businesses in South Africa. Of the formal sector SMMEs, approximately 46 percent are located in Gauteng and 18 percent in the Western Cape.

It is estimated that there are around 336 000 owner-managers in the Western Cape in 2003, who are starting or running 189 000 businesses. Established businesses are in the minority (23 000), representing 12 per cent of businesses in the province, while 100 000 (53%) are start-ups and 67 000 (35%) are new businesses.

The contribution of SMMEs to overall employment is considerable and, excluding owner-managers, SMMEs account for 21 per cent of provincial employment. This proportion nearly doubles to 40 per cent if owner-managers are included. Apart from the owner-managers, new businesses employ 2,3 people on average nationally and 2,4 people on average in the Western Cape.

Key areas of policy concern in the SMME sector relate to the need to encourage individuals to establish small businesses and raise the rate of participation in this sector. The Province's Human Resource Development Strategy is critical in this regard, helping to foster entrepreneurial talents and help equip individuals to identify opportunities.

Secondly, the big difference between established businesses on the one hand and new and start-up businesses on the other in terms of employment illustrate the importance of ensuring that younger businesses reach the established phase of development.

Thirdly, not only is participation in the SMME sector uneven across gender and race groups, but females and Africans are more likely than others to engage in necessity-motivated business activities. Lower participation in the sector by females and Africans must be seen in the light of higher unemployment rates for these groups in the Province and their participation in small business activities ought to be promoted.

7. Equity and development scenarios

From the above, it is clear that, unless the Province takes bold intervention, the present economic trajectory, demographic and labour force performance, and sectoral growth and employment prospects do not hold a favourable outlook for improved equity and shared development scenarios in the Western Cape.

Similar trends in respect of demographic profile, labour force performance, mismatch in skills profile and the skills requirements of growing economic sectors may be seen at the

broader national level, and in fact, to many countries across the developing world. Such trends epitomise the development challenge that many governments face. In the Western Cape, understanding these trends is critical to formulating the most appropriate policy responses to meeting *iKapa Elihlumayo's* goal of shared growth and development in the Province.

Equity and development are powerful concepts. Understanding how equity is measured, the factors that drive changing distributions, and those public interventions that enhance such, is critical for understanding the dynamics of a shared growth and development path.

The challenge is particularly true for South Africa where inequality is particularly stark; the richest tenth of the South African population enjoy consumption per person almost 70 times that of the poorest tenth. The picture is alarmingly similar at provincial and local level.

The message – recent economic gains have not been equitably spread and have not made significant inroads into poverty for communities.

Striving for equity is not only laudable from a social justice view, it also makes good economic sense. Understanding how inequality is measured, the factors that drive inequality and those that reduce such are critical for policy and decision makers as they formulate the most appropriate policy interventions and set attainable targets with a medium term budgeting approach.

Moreover, lower levels of inequality have a marked impact on the level and spread of economic growth, and therefore the benefits of shared growth in terms of reduced poverty. That is, improved equity and enhanced growth tend to reinforce each other and translate into greater inroads into poverty reduction over time.

7.1 Equity and inequality

7.1.1 Measuring inequality

The *Gini coefficient* is the most commonly reported measure of inequality, and is often used to compare income inequality across regions, countries and over time. Measured between the value of zero (depicting a perfectly equal society) and one (complete inequality), Gini coefficients in the range of 0,40 to 0,45 are generally seen to represent intermediate levels of inequality and those exceeding 0,45 regarded as high.

Table 5 Comparison of selected middle-income countries

	Thailand	South Africa	Brazil	Malaysia	Venezuela	Poland
Gross National Income per capita US\$ (2002)	1 980	2 600	2 850	3 540	4 090	4 570
Gini Coefficient	0,414	+0,60*	0,607	0,492	0,495	0,316
Share of income of poorest 20%	6,1	2,8*	2,2	4,4	3,0	7,8

[Source: 2003 World Development Report and *from Borat et al., 2001: 22]

Gini coefficients move extremely slowly over time. Even fairly rapid change in the income ranking of certain individuals or households can coincide with surprisingly little change in the overall income distribution if these changes occur at both ends of the income distribution and hence cancel each other out. For instance, income distribution patterns will widen if those at the higher end of the income spectrum improve their prospects more than those at the lower end of the income scale.

7.1.2 Inequality in South Africa and the Western Cape

Inequality in South Africa is exceptionally high, and if anything, has worsened from 1995 to 2000¹. Use of Gini coefficient analysis in this respect, however should be interpreted with care.

Gini coefficients may be calculated according to different definitions using income or expenditure, at the household level or the individual level. It is essential comparisons of inequality are undertaken in respect of the identical definition, particularly if comparisons are to be made over time.

Table 6 shows the range of Gini coefficients calculated using the income and expenditure surveys of 1995 and 2000. The disparities between the different measures highlight the need for consistency in methodology. They also serve to emphasize that it is the general level and direction of change that should be interpreted, rather than the absolute values.

¹ The data used for the poverty and inequality analysis in this review comes from the Income and Expenditure Surveys of 1995 and 2000 (IES 1995 and IES 2000), carried out by Statistics South Africa.

Table 6 Gini coefficients calculated according to different parameters using the IES 1995 and 2000

Study	Gini Coefficients based on Total Household Income or Expenditure			
	1995		2000	
Household level	Income	Expenditure	Income	Expenditure
Fedderke, Manga & Pirouz (2003)	0,58	0,59	0,62	0,59
Statistics South Africa (2002)	0,56	-	0,57	-
Household level	Gini Coefficients based on Per Capita Household Income and Expenditure			
Lam & Leibbrandt (2003)*	0,64	-	0,67	-
Individual Level	Gini Coefficients based on Per Capita Income and Expenditure			
Fedderke, Manga & Pirouz (2003)	0,66	0,66	0,69	0,67
Poswell (2004)		0,639		0,682
Confidence Interval	-	[0,636; 0,642]	-	[0,675; 0,688]
Hoogeveen & Özler (2004) – “Core Consumption”	-	0,565	-	0,577

Note: * Household income per capita with one observation included per household

As can be seen, an array of Gini coefficients can be calculated with the same source data depending

The 2005 PER&O analysis considers individuals and uses disposable household per capita as the unit of analysis in computing Gini coefficients. In such analysis income inequality shows a large increase from 0,64 in 1995 to 0,68 in 2000. Irrespective of data concerns in such analysis, the trend (rather than the absolute value of the measure) is consistent with the majority of studies examining inequality in South Africa over the same time period.

Calculating Gini coefficients by province for 1995 and 2000 shows that inequality has increased across the board. In relation to other provinces, the Western Cape, in 1995, was the third least unequal province with a Gini coefficient of 0,584, following Mpumalanga (0,582) and Gauteng (0,545), and in 2000 the least unequal with a Gini coefficient of 0,616.

Table 7 Gini coefficients by province, 1995 and 2000

Province	Gini 1995	Gini 2000
Western Cape	0,584 [0,576; 0,591]	0,616 [0,597; 0,635]
Eastern Cape	0,648 [0,640; 0,657]	0,663 [0,653; 0,674]
Northern Cape	0,647 [0,630; 0,664]	0,658 [0,641; 0,675]
Free State	0,659 [0,649; 0,670]	0,696 [0,685; 0,707]
KwaZulu-Natal	0,625 [0,618; 0,633]	0,684 [0,673; 0,694]
North West	0,629 [0,621; 0,638]	0,658 [0,634; 0,683]
Gauteng*	0,545 [0,537; 0,552]	0,629 [0,617; 0,641]
Mpumalanga	0,582 [0,572; 0,592]	0,626 [0,615; 0,637]
Limpopo	0,625 [0,615 ; 0,636]	0,624 [0,607; 0,641]
National	0,639 [0,636; 0,642]	0,682 [0,675; 0,688]

[Source: IES 1995 and 2000. Author's calculations]

Note: Gini coefficients are not additive and therefore provincial Gini coefficients will not add up or average to the national Gini coefficient. Provincial Gini coefficients should not be compared to the national Gini coefficient but rather to Gini coefficients for the other provinces.

* The change in the Gini coefficient for Gauteng is implausibly high. There are extreme weighting issues with Gauteng data in the IES 2000 that are not apparent for the other provinces, and this data quality concern may be driving this result.

When considering within race inequality, the same pattern holds for the Province as for the nation as a whole, once again being one of rising inequality from 1995 to 2000. Inequality appears to have increased for all races, with Africans (a Gini coefficient of 0,515 in 1995 and 0,541 in 2000) and then Coloureds (0,439 in 1995 and 0,494 in 2000) experiencing the highest levels within race.

Complementary inequality measurement tools show an increase in the 'within race' contribution over the period for the Western Cape (the latter reading 52,9 % in 1995, compared to 58,8 % in 2000). These results infer that it is 'within race group' rather than 'between race group' inequality that is boosting inequality measurements both at the provincial level.

A deepening of poverty at the lower end and/or upward earnings mobility of those at the top end would serve to widen the distribution and is the likely reason for this result. Indeed, with labour market earnings being the key driver of inequality in South Africa, rising unemployment coupled with improvement in average real earnings in the Western Cape would be expected to lead to a widening of the income distribution.

This means that Gini coefficient and/or complementary inequality analysis should be carefully interpreted, as there are many causal factors to rising inequality that may or may not have to do with increased poverty levels.

7.1.3 Asset inequality in South Africa & the Western Cape

Turning to assets, we see that asset equality is attained in respect of access to good basic services & dwellings (water, sanitation, energy, refuse removal, and housing) and social services (health care, education, skill development and shelter).

These non-income dimensions of welfare are often notably correlated with income and consumption levels, drawing a link between income inequality and asset inequality concerns.

Most public services are therefore targeted at improving poor people's capabilities in respect of enhancing access to quality schooling and skill development, health care services, clean and safe water, sanitation facilities and housing. These are often called 'social wage goods'.

Looking at basic service access indicators, we see that the urban nature of the Western Cape facilitates extensive access to basic services with 95 per cent of households having access to piped water, 86 per cent to a flush toilet, 87 per cent to refuse removal and 87 per cent to electricity for lighting purposes. Our key failing is in respect of housing, where 80 per cent of dwellings are formal and 16 per cent are informal.

In respect of access to social services, we see that the Western Cape performs better than most provinces in terms of attendance rates and average educational attainment. Nationwide, attendance of seven- to 15-year olds is good, with 6,5 per cent of children in this age group not attending school in 2001. The Western Cape fares slightly better, with only 5,5 per cent of this age group not going to school, according to Census 2001 data.

The key area of concern, however, is the high rate of learner drop-out after Grade 8, reducing secondary school completion rates significantly. This trend is evident in respect of enrolment data by grade, indicating that only 45 per cent to 52 per cent of learners who enrol in Grade 1 reach Grade 12.

Table 8 Access to basic services for South African and Western Cape households, 1996 and 2001

	National		Western Cape	
	1996	2001	1996	2001
Urbanisation Rates	%	%	%	%
% of households in urban areas	59,9	62,4	88,8	90,3
Dwelling Types				
Formal	65,2	67,6	82,2	80,4
Informal	16,2	16,3	16,7	16,1
Traditional	18,3	14,6	0,9	2,1
*Water Access				
Piped	80,0	82,2	97,0	94,9
Borehole/tank/vendor	6,1	3,7	1,2	0,3
Spring/river/dam/pool	12,4	9,2	0,6	0,4
Energy Source Lighting				
Electricity	57,7	69,5	85,4	87,5
Paraffin	12,7	6,7	8,2	7,0
Candles	28,5	22,6	5,8	4,4
Energy Source Cooking				
Electricity	47,2	50,7	76,8	77,6
Paraffin	21,5	21,3	13,3	13,9
Wood	22,9	20,3	4,5	2,9
Sanitation				
Flush/ chemical toilet	50,3	53,4	85,8	85,8
Pit latrine	32,3	28,3	4,8	2,1
Bucket latrine	4,6	4,1	3,8	3,7
None	12,4	13,6	5,4	7,7
Refuse Removal				
Removed by local authority	53,5	55,7	84,9	87,2
Own refuse dump	32,2	32,0	7,7	7,2
Communal	3,2	1,7	3,7	2,1
No rubbish disposal	9,5	8,4	2,0	1,4
Telephone Access				
In this dwelling/ cellular phone	28,6	42,4	55,1	63,1
At a public telephone nearby	35,9	38,4	27,2	25,2
At another location	16,7	13,2	14,3	10,1
No access to telephone	18,3	6,0	3,0	1,7

[Source: Census 1996 and Census 2001, 10% Samples]

Nevertheless, better educational attainment does not mean that the education system is operating efficiently or that the population is acquiring the 'right set of skills' that will facilitate easy entry into the job market. Therefore, one of the greatest concerns with provincial and national education goes beyond issues of access to issues of quality of service delivery.

Access to other social services such as adequate healthcare and police services will also have important implications for quality of life and safety and security. Quality healthcare services within walking distance of communities facilitate preventative care, minimising ill health, particularly for children who are more vulnerable in this respect. Again, as for so many other access indicators, the Western Cape outperforms the national averages. This is true for doctors, professional nurses, nursing assistants, medical specialists and pharmacists.

However, the data shows a disturbing trend in terms of health personnel access, both for the Province and nationally. There have been declines in the number of personnel per person for all listed types of medical practitioners. This is a worrying trend, especially in light of the increased need for medical care with the spread of the HIV/Aids pandemic. Diminishing access to this very important resource is exacerbated by emigration of medical personnel, which is often encouraged by relatively good pay offers from other countries, and needs to be addressed.

Looking at census data and combining income and access to basic and social services data shows that, in most cases, it is the poorest who have experienced the greatest gains in terms of service delivery improvements in the Province. This provides an initial look at capturing some of the 'social wage' effects of service provision.

7.2 Poverty

Moving on, we see that there is an inextricable relationship between equity and inequalities in respect of income, assets and spatial or geographic location and poverty – the causal direction of which is intertwined.

This means that poverty has many faces and dimensions, which interface with income, asset and spatial inequality. As such, poverty describes a state of deprivation that prevents an individual from attaining some minimum "socially acceptable" standard of living. This 'state of deprivation' can therefore be measured in a number of ways and according to various approaches.

7.2.1 Measuring income poverty

That said, one of the most intractable ways to measure income poverty for a country is the use of a *national poverty line* – constructed to indicate the minimum amount of money

required to meet the cost of an individual's basic needs or that of a household. The monetary amount includes a food and non-food component. If an individual (or household) earns or spends less than the poverty line amount, s(he) (or the household) is deemed to be poor.

The extent of absolute poverty, or the *poverty rate*, is then measured as the proportion of the population that falls below the national poverty line. The measure is also referred to as the *poverty headcount*.

The depth of poverty may also be measured by summing the distance from the poverty line of all those who are poor, known as the *poverty gap*.

South Africa does not yet have an official national poverty line, although recent events suggest that Statistics South Africa is moving towards developing such in the near future. Despite the lack of an official national poverty line, recent academic efforts calculate a lower bound poverty line of R322 per capita per month and an upper bound of R593 per capita in 2000 prices. A further addition is the value of R174 per capita per month as equivalent to the internationally used 'Two (US) Dollar a day' poverty line.

7.2.2 Poverty in South African & the Western Cape

Measured in any way, income poverty in South Africa has not improved between 1995 and 2000²; it has in fact deteriorated. Taking a low poverty line of R174 per capita per month, 31 per cent of South Africans were poor in 1995. By 2000 this had risen to 38 per cent.

Table 9 National and Western Cape poverty levels, 1995 and 2000

	1995		2000	
	Headcount (Poverty Rate)	Poverty Gap	Headcount (Poverty Rate)	Poverty Gap
National				
R174 per month	0,31 [0,303; 0,309]	0,12 [0,115; 0,118]	0,38 [0,365; 0,393]	0,16 [0,153; 0,168]
R322 per month	0,52 [0,520; 0,5267]	0,26 [0,257; 0,260]	0,58 [0,565; 0,594]	0,31 [0,303; 0,323]
Western Cape				
R174 per month	0,09 [0,088; 0,099]	0,02 [0,022; 0,025]	0,08 [0,065; 0,103]	0,03 [0,018; 0,032]
R322 per month	0,29 [0,279; 0,296]	0,10 [0,096; 0,103]	0,28 [0,241; 0,318]	0,10 [0,083; 0,115]

[Source: IES 1995 and 2000. Author's calculations]

Note: The poverty line of R322 per capita per month in 2000 prices is the lower bound national poverty line calculated by Hoogeveen & Özler (2004). The R174 per month in 2000 prices is the value they compute as equivalent to the Two Dollar a day poverty line generally used for international comparisons.

² The data used is drawn from Statistics SA Income and Expenditure Survey (IES), the most recent of which is 2000.

Poverty gap measurement shows a similar picture. In 1995 the spending of the poor fell on average 12 per cent below the poverty line of R174 per capita per month. In 2000, this situation had further exacerbated, with spending of the poor falling on average 16 per cent below the poverty line. This message is a clear indictment for South Africa. Not only have the numbers of poor people risen, but the poor are faring worse in 2000 than they were in 1995!

The Western Cape's performance is pleasingly different, although the aggregate view masks worrying trends in poverty pockets. For example, if we take an extremely low poverty line of R100 per capita per month, poverty in the Province increased marginally from 1995 to 2000. Taking a poverty line of R174 per capita per month, we see that an improvement in the poverty rate from nine to eight per cent, although the poverty gap deteriorated from two to three per cent. At the upper bound of R322 per capita per month, there also seems to be a slight decline in the Western Cape's poverty rate from 29 to 28 per cent.

Notwithstanding the Western Cape's positive performance relative to the national picture, at 28 per cent of the population, poverty is still a pervasive problem for the Province, and given larger population numbers, this also means increased numbers of poor people despite the marginal rate improvement.

In terms of racial groupings, at the national level, Africans and Asians at the lower end of the income distribution are doing worse than in 1995, while the performance of Whites are stable. There has been little change in the welfare of the poorest Coloureds, who fare similarly in both periods at the low expenditure levels, but perform noticeable better above the R300 per capita per month level.

The racial pattern of dominance holds in the Western Cape, with Whites faring far better than Asians, who do better than Coloureds, who in turn outperform Africans. Looking at each group in turn, we see that Whites appear to be doing better in 2000 at nearly all levels of income, with their performance in the Western Cape surpassing the national trend. Interestingly, Africans in the Western Cape fare similarly in both periods – they are not experiencing increased poverty at the lower end, but are also not enjoying greater gains at the top end.

Groups of concern are Coloureds and Africans. Even at the extremely low poverty line of R174 per capita per month, 17 per cent of Africans in the Western Cape were poor in 2000. At the same level, 8 per cent of the Coloured population was said to be poor. At the R322 per capita per month mark, an alarmingly high 48 per cent of Africans were poor in 1995, rising to 53 per cent in 2000. At this level, one in three Coloured people in the Province was classified as poor in 1995. This ratio drops impressively over the five-year period to 2000, although at one in four, still remains of concern.

7.2.3 Access poverty

Taking a closer look at asset poverty, we draw attention to Provincial performance in respect of socio-economic or human development indicators.

As noted previously, although children have good schooling attendance up to age 15, more than half of children do not make it to grade 12 to write their final school leaving examinations. Furthermore, of those that do write their final exams, 12,5 per cent in the Province fail, and only 26 per cent pass with an endorsement as seen in table 8 below. Mathematics and science pass rates are even more dismal.

Table 10 Matric aggregate performance, Western Cape and South Africa, 2003

As% of age cohort	Western Cape		South Africa	
	Number	As % of age cohort	As % of age cohort	Number
Endorsement	10 158	12,2	82 384	8,4
Pass without endorsement	23 403	28,1	241 124	24,5
Fail	4 904	5,9	116 824	11,9
Total Matriculants	38 465	46,1	440 332	44,7
Drop-outs	44 935	5,9	544 668	55,3
No. of 18 year olds	83 400		985 000	

Looking at health indicators, we see that poor health performance is evident when looking at life expectancy at birth. At 59,3 years for men and 66,1 for women, the Western Cape performs above national but far below comparable middle-income developing countries. These trends are closely related to the impact of the HIV/Aids epidemic both nationally and Provincially.

The two cases in which the Western Cape performs worse than national averages are prevalence of smoking amongst the youth and incidence of tuberculosis.

Crime statistics in the Western Cape are even more shocking. The murder rate of 59,9 per 100 000 people is exceptionally high and the worst of all the provinces. Burglaries at residential premises are almost double the national average, and reported child abuse is even more than twice the national average.

8. An appropriate backdrop to the 2005 Budget

An overview of the economic environment in the Province gives us much to digest. The next five chapters consider the economic outlook for the Western Cape over the next three years, examine the Province' sectoral growth and employment trends and prospects, review provincial labour market and remuneration performance, and highlight the Province's challenges in respect of equity and development prospects.

Given the analytical scope and depth covered in the 2005 PER&O, much of the succeeding analyses are drawn from analytical inputs that the Province commissioned earlier in the year, supported by research work being completed in respect of the iKapa Elihlumayo lead strategies.

Given limited resources, the 2005 Budget does not try to match resource allocations to all the challenges posed in the above analyses. Rather, it offers an allocation mix that aligns to the social and economic goals of iKapa Elihlumayo, thereby planting the seeds for shared growth and development in the Western Cape over time.

Economic Outlook

1. Introduction

The Western Cape economy grew by a respectable 3,2 per cent in 2003, albeit down on the buoyant growth of 4,6 per cent measured in calendar year 2002 in the wake of the rand exchange rate's depreciation. Economic growth slowed down in 2003 due to recessions in agriculture and manufacturing, which resulted from hostile climatic conditions as well as the strengthening rand exchange rate over this period (causing problems in the export and import-competing sectors). While the decline in real value-added in the regional agricultural and manufacturing sectors exceeded that of the national economy, overall growth in real Gross Domestic Product in the region (GDPR) still came in above the national average (that is, 2,8%) for 2003.

The Province's services industries compensated, growing by a strong 5,6 per cent in real terms, compared to the national average of 4,2 per cent. Real economic growth in the Western Cape Province averaged 3,9 per cent over the period 1999 to 2003, compared to 3,1 per cent nationally¹. It is estimated that real GDPR growth in the Western Cape economy again exceeded the national average in 2004; however, the manufacturing and agricultural sectors probably under-performed, with the overall out-performance explained by the region's services sector.

The Western Cape economy has therefore consistently out-performed the national economy over the past five years (this also applies over the 10-year period 1994 to 2003). Short-term economic prospects are favourable, as for the rest of the country. Whilst the sustained strength of the rand exchange rate inhibits growth and employment creation in the tradeable goods sectors (that is, goods that are exported and/or imported in

¹ Statistics South Africa revised the national accounts statistics, including the regional GDP data at the end of 2004 with its regular five-year rebasing and benchmarking exercise. Real GDPR growth for the Western Cape economy over the five-year period 1999 to 2003 was revised from 3,1% to 3,9%; the corresponding figures for the national economy are 2,7% and 3,1%.

international trade deals), business tends to adapt, and it is expected that the over-valuation of the exchange rate will ease over the short to medium term. Robust real economic growth is currently underway in the region as industry responds to the buoyancy in domestic spending, as well as a supportive world economy.

This chapter provides an analysis of the past performance and outlook for the Western Cape economy. As the Western Cape's prospects are closely linked to those of the South African economy, the first section provides an overview of the national economy's performance and outlook, discussing the global economic outlook, domestic economic growth, fixed investment, employment, inflation and interest rates, the balance of payments and the exchange rate.

The second section then provides a more in-depth discussion of the Western Cape economic performance and outlook. Both the past five years and the medium-term outlook (2005/06 – 2007/08) are assessed in respect of GDP growth, inflation, fixed investment, employment and exports.

2. Trends in the South African Economy

As mentioned, the Western Cape's economic fortunes are closely linked to those of the national economy. Following a decade of economic restructuring and prudent macroeconomic policies, the outlook for the South African economy is the best in years.

In this respect, the South African economy has matured appreciably over the past decade. Fiscal policy has become more supportive of growth, prospects for lower and more stable inflation and interest rates are real, tariff reductions have for the most part run its course, the political climate is the most stable in years, and business and consumer confidence are on historically high levels. This reflects an optimistic business mood intent on expanding production capacity. Exchange rate volatility remains a threat and currently places substantial pressure on the (higher value-added) export sectors, as well as import-competing sectors.

2.1. Global economic developments

World economic growth accelerated across a broad base during the second half of 2003 and early 2004. Initially growth was led by the United States (US) and the Chinese economies, but renewed vigour rapidly spread to Japan and the East Asian emerging economies, as well as the European, Latin American and African regions. The International Monetary Fund (IMF) estimates that the world economy expanded at an annualised rate of six per cent during the second half of 2003. This growth momentum continued during the first quarter of 2004. Some slowdown occurred during the middle quarters of the year as the headwinds from higher crude oil prices impacted and economic conditions weakened unexpectedly in Japan and the Euro area.

The current growth phase in the global economy reasserts the upswing phase of the global economic cycle that commenced around the end of 2001, when the US economy emerged from recession and the terrorist attacks in New York. However, subsequent wars in Afghanistan and Iraq introduced major uncertainty and higher oil prices, which led to temporary global economic weakness during the second half of 2002 and the first half of 2003. The Severe Acute Respiratory Syndrome (SARS) epidemic also impacted adversely on the Asian economies during the first half of 2003.

Deflation fears were the order of the day and globally, interest rates declined to historically low levels over this period. In addition, authorities in the US and Europe responded with expansionary fiscal policies. In the US, increased security and defence spending accounted for part of the fiscal stimulus. The US dollar also depreciated against the major global currencies as the strong capital inflows to that region over the 1996 to 2000 period decelerated, exposing the huge US current account deficit.

The macroeconomic stimulus, the end of the war in Iraq and the end of the SARS epidemic all contributed to the revival of global economic growth from the middle of 2003. Industrial commodity prices and precious metals prices rose strongly from the end of 2001; global industrial production growth has been exceptionally lively towards the end of 2003 and early 2004. These factors contribute towards driving global trade flows, expanding at year-on-year rates of 15 per cent to 20 per cent.

While this strong growth tapered off during the second half of 2004, the world economy registered the strongest real Gross Domestic Product (GDP) growth rate in 2004 since the four per cent expansion at the peak of the previous global economic cycle in 2000. This result is significant as the international upswing feeds strongly into national and regional economic performance and prospects.

While non-energy inflation rates are low globally, some acceleration occurred during 2004 (particularly in the US, China and the Euro area). Obviously, the sharp spike in international crude oil prices to above US\$50 a barrel played a role, and unexpected developments, in this regard continue to pose an inflationary risk. This has also been one of the major reasons for the slowdown in economic growth in the G3 (US, Japan and Germany) economies during the middle quarters of 2004.

The IMF estimates that a sustained US\$10 a barrel increase in the oil price leads to a 0,5 per cent reduction in the world real GDP growth rate in the subsequent 12 months. Oil prices declined towards the end of 2004, but spiked again early in 2005. The consensus view is that prices may subside following the Iraq election and stimulate global growth; however, this is no foregone conclusion. *Oil price volatility therefore remains a risk to the global, national and Western Cape economic outlook.*

The Federal Reserve (that is, the Reserve Bank of the US) has already commenced with increasing interest rates, following on similar moves by the Bank of England and the Reserve Banks of Australia and New Zealand. Interest rate levels in the major industrial countries are expected to normalise over the short term. This could have important implications for emerging market economies and currencies such as the South African rand. Higher interest rates abroad could stem the strong capital flows to emerging market countries currently in force due to a favourable interest rate differential.

Global economic growth should be relatively strong over the projection period. While the growth tempo has slowed closer to a trend rate (from the 5% to 6% pace registered during the early part of 2004), most analysts agree that growth will be sustained over the short term.

While the *US economy* is at risk to enter a sustained slowdown, renewed job growth could revive consumer spending in that economy (accounting for 70% of US GDP).

Following impressive levels of growth averaging 9,5 per cent during 2004, the Chinese economy is expected to experience a 'soft landing' as the authorities implement administrative interventions and monetary policy is tightened. A preview of this happened in 2004 (with real GDP growth coming in at 9,5% on average for the year).

In *Japan*, the domestic demand recovery disappointed in the latter part of 2004, but is still expected to replace export-led growth as the main driver of economic growth, which should render the Japanese economic recovery sustainable this time around. In fact, Japanese economic prospects are the brightest in a decade. Economic prospects in the region also remain the most robust in a global context.

Economic growth is lagging in the *Euro area* – South Africa's main trading partner – however, even there a steady economic recovery is underway.

The interconnectedness of global trade and capital markets has meant that improving growth in the major industrial countries and progress with internal macroeconomic policy reforms have also benefited the developing regions of the world.

Latin America has emerged from a deep recession and many *African* economies are benefiting from improved commodity prices. According to the IMF, the economic outlook for Sub-Saharan Africa (SSA) is the best in years, with real GDP growth estimated and projected to increase by five per cent to six per cent during both 2004 and 2005. However, progress across the developing world is uneven and often marred by socio-political instability (occurring, for example, in Venezuela and Central Africa). Table 1 shows more detailed projections in this regard.

Table 1 World economy real GDP growth outlook, 2004 – 2005

Country/ region	2003 (%)	2004F (%)	2005F (%)
US	3,0	4,3	3,5
Japan	2,5	4,4	2,3
Euro area	0,5	2,2	2,2
UK	2,2	3,4	2,5
China	9,1	9,0	7,5
Developing Asia ¹	5,1	5,6	5,5
Latin America	1,8	4,6	3,6
Africa	4,3	4,5	5,4
Sub-Saharan Africa	3,7	4,6	5,8
World	3,9	5,0	4,3

¹ Excluding China and India.

[Source: IMF World Economic Outlook, September 2004]

The main risk contained in the global outlook presented here is the possibility of the macroeconomic imbalances (*inter alia* reflected in the burgeoning US current account deficit, the sizeable G3-countries' growth differential, with sluggish domestic demand conditions in the Euro area and Japan comparing with the sustained buoyancy in the US) growing bigger and causing dislocations down the line.

The US dollar is particularly at risk of a more destabilising adjustment, including adverse implications for global interest rates and capital flows to developing countries. Furthermore, a volatile crude oil price remains a risk to the outlook, given the global economy's sensitivity in this regard.

South Africa's GDP revisions

Every five years, South Africa's GDP estimates are benchmarked and re-based. The latest revision of the GDP estimates involved the re-basing of the constant price series from 1995 to 2000, as well as new estimates for both the level of nominal GDP and the growth in real GDP. Statistics South Africa released the revised GDP estimates at the end of November 2004.

The level of nominal GDP was revised upwards for each calendar year from 1998 to 2003 by between 0,5 per cent and 3,9 per cent. The 2003 nominal GDP is currently estimated at R1 251-billion, that is 3,5 per cent (or R42-billion) higher than previously (R1 209-billion).

The six-year average real GDP growth rate has also been revised upwards, from 2,4 per cent to 2,7 per cent per annum over the period 1998 to 2003. Excluding 1998, real GDP growth averaged 3,1 per cent per annum over the past five years. This brings the average real GDP growth rate in the first decade of democracy closer to the three per cent level. The largest revisions were made to GDP growth in calendar years 2000 (3,6% to 4,2%) and 2003 (1,9% to 2,8%).

On a sectoral level, the largest upward revisions of the level of nominal GDP were made to mining (15,4% in 2000), internal trade (14,4%), manufacturing (5,9%), agriculture (5,3%) and personal services (4,9%). For two sectors – construction (11,5%) and financial & business services (2,9%) – the level of GDP was revised downwards.

In terms of real value-added growth (1998 to 2003), the largest revisions were made to the internal trade sector (including retail, wholesale, catering & accommodation, being revised from 2,1% to 4,6% per annum), manufacturing (from 1,8% to 2,3% per annum), mining (from -0,4% to 0,4% per annum) and personal services (from 2,6% to 4,1% per annum). In some sectors, the revisions have been quite radical, if not in terms of the level of growth then the pattern of growth.

On the demand side of the economy, the upward revision of overall GDP growth (from 2,4% to 2,7% per annum, 1998 – 2003) is explained by the upward revision of the growth in real domestic expenditure and a slightly higher contribution from net exports. The average annual growth (1998 – 2003) in real household consumption expenditure was revised from 2,6 per cent to three per cent per annum; real government consumption expenditure from 2,1 per cent to 2,5 per cent per annum and real gross fixed capital formation from 2,3 per cent to 2,9 per cent per annum. The growth in both real exports and imports was scaled down somewhat – for exports from 2,4 per cent to 2,2 per cent per annum and for imports from 2,4 per cent to 1,8 per cent per annum.

An important aspect of the revisions is the fact that the current growth tempo in the economy is significantly higher than previously estimated and anticipated by forecasters (including the Bureau for Economic Research, or BER). Real GDP growth could come in closer to four per cent in 2005 compared to a firm consensus earlier in the year that growth will struggle to reach three per cent. This is particularly true regarding consumption expenditure, both in respect of individuals and Government; the growth in real gross domestic fixed capital formation has in fact been revised downwards somewhat. This suggests a stronger consumption bias in the current economic growth performance than previously thought.

2.2. South Africa's economic growth: performance and outlook

South Africa's real economic growth performance has improved over the past decade. *Real GDP growth* averaged 2,9 per cent over the period 1994 to 2003 compared to 1,1 per cent over the preceding decade. A more revealing statistic may be the fact that real GDP *did not decline* in absolute terms in any of the calendar years since 1993. The growth performance has been more stable, and sound macroeconomic policies have contributed to sustainable growth. The current upswing phase of the business cycle, which commenced in September 1999, is the longest in the post-war history. Real GDP growth averaged 3,1 per cent over the five-year period since 1999.

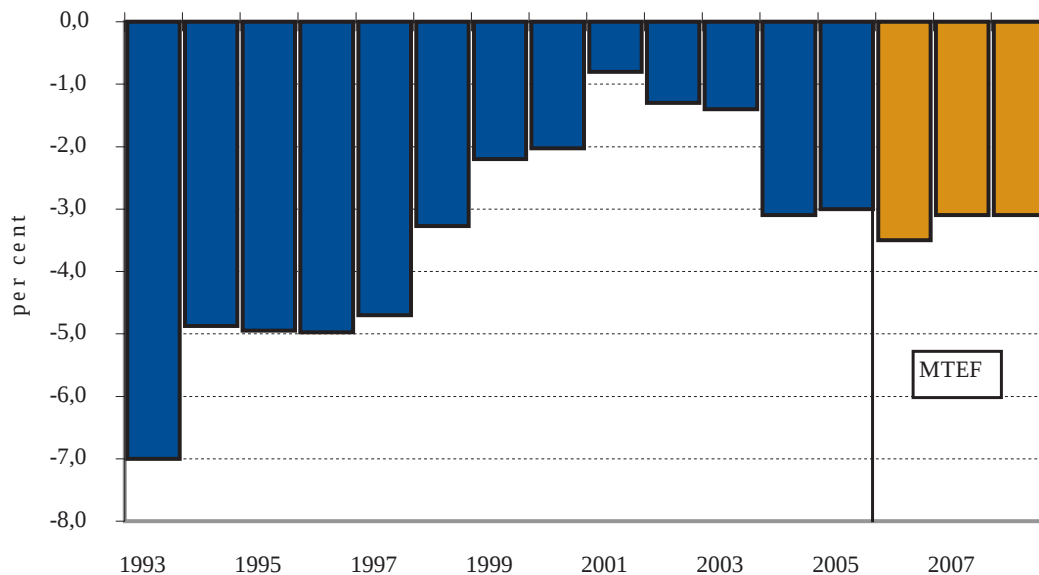
Both short- and long-term *nominal interest rates* have declined to 23-year lows on the back of lower inflation and lower inflation expectations. This is stimulating borrowing in the economy, particularly in respect of investment projects. Contrary to the 1970s and 1980s, real interest rates remain positive, rendering the current favourable monetary conditions sustainable.

While continued currency volatility represents some risk, chances are favourable that inflation expectations and actual inflation will become embedded well within the inflation targeting range. This, in turn, holds the promise of more accommodative monetary policy (that is, *lower real interest rates*), which should lift South Africa's fixed investment ratio further and stimulate employment growth.

Following some years of austerity between 1995 and 1999, *fiscal policy* has become more expansionary in recent years. A sound fiscal basis has been achieved upon which accelerated infrastructural development and social and welfare spending could be launched in a sustainable manner. The fiscal deficit widened to 2,3 per cent of GDP in the 2003/04 and 2004/5 fiscal years and is expected to deepen further to 3,1 per cent in 2005/06 before declining to 3,0 per cent in 2006/01 and further to 2,71 per cent in 2007/08 (see *Figure 1*). However, at these levels the budget balance remains consistent with prudent fiscal policies, which Government is determined to maintain over the next three to five years.

Business and consumer confidence are currently on historic highs. The swell in business and consumer confidence appears to be linked to fundamental economic factors – at this stage it is not a case of the 'over-optimism' that typically leads to over-investment and/or over-borrowing, spelling the final phases of an economic upswing. Overall household indebtedness is low, retail bad-debt problems are almost non-existent and South Africa's fixed investment ratio (16% of GDP in the second quarter of 2004) is increasing from a low base. These indicators suggest substantial further potential in the current historically long upswing phase of the South African business cycle.

Figure 1 General government budget deficit as % of GDP



[Source: SARB, Quarterly Bulletin, September 2004, Budget Review; 2005]

The demand side of the economy has responded strongly to the more stable financial conditions – real domestic expenditure accelerated to annualised growth of 6,5 per cent during the first half of 2004. While the growth tempo in real domestic expenditure slowed during the third quarter of last year, this slowdown is more technical than real, as real final demand continued to expand at a five per cent pace.

Both household consumption expenditure and business fixed investment have picked up sharply, and domestic spending is augmented by Government's social and welfare spending roll-out, as well as public sector fixed investment. Unfortunately the *over-valued* levels of the rand exchange rate have hampered the required supply response, particularly in terms of employment growth.

The strong appreciation of the rand exchange rate during 2003 and 2004 had a negative impact on South Africa's economic growth, which decelerated to 2,8 per cent in 2003.

The strong rand impacted negatively on the international price competitiveness of particularly manufacturing firms, and exports slumped. Manufacturing exports contribute more than 50 per cent of total exports. In contrast, mining companies benefited from higher commodity prices in foreign currency terms, shielding the negative impact of the appreciating currency. The latter enabled South Africa's commodity exports to recover strongly in 2004. However, simultaneously, imports accelerated sharply on the back of the strong currency and keen domestic spending, leading to deterioration on the trade account

of the balance of payments (that is, the balance between South Africa's earnings from the export of goods and its payments for imported goods).

While the manufacturing sector recovered firmly during the middle quarters of 2004, this occurred from a low base and appears to have run out of steam during the fourth quarter of 2004 and early 2005². While the private sector appears to be adjusting to the stronger level of the currency, reflected in high levels of business confidence, the manufacturing export and import-competing industries remain under pressure. The current account of the balance of payments (that is, the balance between South Africa's earnings from exports of goods and services and its payments for goods and services) deteriorated from a surplus in the first quarter of 2003 to a deficit measuring 2,7 per cent of GDP during the first half of 2004 (and 2,5% during the third quarter).

It is expected that the rand exchange rate will adjust to a 'fairer value' over the short term as interest rate levels in the major industrial countries normalise and the commodity cycle peaks. The progress South Africa has made in replenishing its balance of payments reserves and in generating greater domestic and foreign investor confidence should prevent a repeat of the 1998 and 2001 rand events. A healthier stock of foreign exchange reserves reduces South Africa's vulnerability to speculative currency attack, partly as it puts the South African Reserve Bank (SARB) in a stronger position to counter such an attack.

A contained depreciation of the currency (say to R7,00/US\$ by the end of 2005 and R7,50/US\$ by end-2006) should not destabilise the inflation and interest rate environments. Over the medium term, the policy of continued trade liberalisation, combined with a competitive exchange rate, should go a long way to nurture the required economic efficiencies to grow South Africa's exports off of a more diversified economic base, improve the balance of payments and render economic growth more sustainable.

It is expected that, overall, South African GDP growth will accelerate in the short term as the growth in real domestic expenditure is sustained and the rand exchange rate reverts to a 'fairer' value in 2006. Table 2 indicates that real GDP expanded by 3,7 per cent during 2004. Growth is projected to accelerate further to 4,1 per cent during calendar year 2005 and to slow marginally to 3,6 per cent in 2006 and 3,0 per cent in 2007 under the weight of higher interest rates.

²The Investec PMI declined from October 2004, falling to below the critical level of 50 in January 2005. This signals a mild contraction in manufacturing activity in January, the first such contraction in 15 months.

Table 2 South Africa real GDP growth outlook (expenditure components), 2004 – 2007³

%	Average 1999 – 2003	2003 actual	2004 estimate	2005F	2006F	2007F
Final household consumption	3,2	3,4	5,8	4,4	3,8	2,5
Government consumption	3,4	6,4	6,8	3,5	3,5	3,0
Gross fixed capital formation	2,6	9,0	8,0	9,2	8,8	4,3
Gross domestic expenditure	3,1	5,3	6,0	5,0	4,3	2,5
Exports	1,7	-2,3	4,9	5,9	5,8	5,4
Imports	1,7	7,3	13,5	9,2	7,9	3,3
Expenditure on GDP	3,1	2,8	3,7	4,1	3,6	3,0

[Source: BER, January 2005]

The baseline BER macroeconomic forecast adopted in this report is optimistic for the reasons explained above. In this regard, the BER does not deviate from the consensus view currently in force in South Africa (*see the Reuters consensus forecasts in respect of real GDP growth in Table 3*). However, as Table 3 also indicates, there is a significant outlook range, with some analysts being more pessimistic and others being even more optimistic. For the purpose of this report, it is important to be aware of the risks contained in the baseline outlook; these are highlighted throughout the report.

Table 3 Reuters consensus forecasts for South Africa, 2005 – 2007 (January 2005)

	2005	2006	2007
Real GDP growth (%)	4,0	3,6	4,0
Highest forecast	4,5	4,3	4,9
Lowest forecast	3,5	3,2	3,1

[Source: Reuters, January 2005]

It is important in this case to identify the *key risks* that are attached to the optimistic outlook adopted here. A particular risk concerns the *rand exchange rate*. The BER assumes some adjustment in the rand exchange rate to a more competitive level over the short term (*see section 2.6 below*). However, in the event of sustained currency strength, the outlook for economic growth may be notably different. The tradeable goods sectors (for example, mining and manufacturing) might be under greater pressure and South Africa's export performance might be weaker.

On the other hand, inflation and interest rates might be lower, fuelling the domestic boom further, without this benefiting domestic production to the desired extent. While growth could in the near term be higher in this scenario, it is also likely to be more unbalanced and less sustainable due to potential balance of payments problems.

³ The BER's macroeconomic forecasts do not necessarily agree with that of the National Treasury (*see the Budget Review 2005, 23 February 2005, p. 50*). The BER and the National Treasury use different econometric models and apply different assumptions. National Treasury upgraded its economic growth forecasts for the period 2005-07 compared to those contained in the 2004 Medium Term Budget Policy Statement (MTBPS) in respect of the period 2004-6. National Treasury's real GDP growth forecast for this period averages 4,2% compared to the BER's 3,6%. The BER anticipates a growth slowdown in 2006/07 due to higher interest rates in 2005/06, in turn related to business cycle pressures. The Treasury has slightly weaker growth in 2006 and a re-acceleration in 2007. The BER's economic forecast was also compiled before the release of the 2005 Budget, which is slightly more stimulatory to growth than expected. Regarding inflation, there is a greater correspondence between the BER's and the National Treasury's projections. The BER projects CPIX inflation to average 4,9% over the 2005-07 period compared to the Treasury's 4,8%.

Another important risk concerns the *performance of the global economy*. In the event of a stronger global economic slowdown (driven by problems in China and/or the US, for instance), the outlook for the South Africa economy could also be affected. A sharper deterioration in international non-oil commodity prices (such as platinum and gold) could cause a deterioration of South Africa's terms of trade. Including weaker demand for exports, South Africa's growth outlook could also be worse. However, the rand is also likely to depreciate in such a scenario, which should mitigate much of the decline in the terms of trade.

The economy's potential GDP growth – that is, trend real GDP growth – is estimated around three per cent currently (IMF, June 2004), up from 1,2 per cent over the period 1980 to 1994. This improvement occurred mainly due to higher total factor productivity (TFP) growth, that is, real economic growth related to factors other than increased growth of the capital and labour inputs *per se*, such as increased production efficiencies and technological advances (*see Table 4*). The improved TFP growth occurred mainly due to the range and stance of economic policies that were implemented. For instance, the opening of the economy to international trade, which drove increased production efficiencies, as well as an increased role of the private sector in the economy, reflected in a significantly higher share of private fixed investment in total fixed investment in 2002 compared to 1995.

Table 4 South Africa sources of economic growth, 1980 – 2002

	1980 – 1994	1995 – 2002	1980 – 2002
Annual real GDP growth (%)	1,2	2,8	1,7
Labour (including informal sector)	0,7	0,7	0,7
Capital	0,9	0,6	0,8
Total factor productivity	-0,5	1,5	0,2

[Source: IMF Country Report No. 04/178, June 2004]

The economy's potential GDP growth rate should improve gradually over the medium to longer term as the capacity of the economy to absorb labour improves and the fixed investment rate picks up. However, the potential GDP growth rate is likely to remain constrained by two key factors – *skilled labour* and the impact of the *HIV/Aids epidemic*.

Taking a closer look at the *sectoral* contribution to economic growth over the past decade, there has been a clear shift away from the *secondary* to the *tertiary sector*, while the contribution of the *primary sector* remained more or less unchanged between 11 per cent and 12 per cent of aggregate GDP (at current prices).

In the secondary sector, the contribution of *manufacturing* declined from 20,9 per cent in 1994 to 19,6 per cent in 2003, that of *electricity & water* from 3,6 per cent to 2,4 per cent and *construction* from 3,1 per cent to 2,4 per cent over the corresponding period.

In the tertiary sector, the contribution of the *general government* declined from 16,2 per cent in 1994 to 14,7 per cent in 2003, under the impact of the more austere fiscal policies. However, the other tertiary sectors more than compensated for this declining importance – the contribution of the *financial & business services* sector increased strongly from 16,0 per cent to 20,1 per cent, while that of the *transport & communications* sector increased from 8,7 per cent in 1994 to 9,7 per cent in 2003.

The opening up of the South African economy and the liberalisation of exchange controls, which spurred renewed growth, drove the strong growth in the financial services sector. The growth of the transport & communications sector was driven by the expansion of the taxi industry, as well as the development of cellular communications in South Africa and Telkom's expanded roll-out over the 1990s.

Table 5 highlights the five-year (1999 – 2003) sectoral growth performance, as well as the outlook for 2005 to 2007.

Table 5 South Africa: Real GDP growth outlook (sectors), 2004 – 2007

	Average 1999 – 2003 (%)	2003 (%)	2004 estimate (%)	2005F (%)	2006F (%)	2007F (%)
Agriculture	1,6	-6,0	2,6	3,0	2,0	1,5
Mining	0,5	4,3	4,4	4,0	-1,0	-1, 5
Manufacturing	2,8	-0,9	2,7	4,0	4,3	3,2
Electricity & water	-0,1	0,4	2,0	2,0	1,5	1,5
Construction	4,0	5,2	6,5	6,5	4,2	3,7
Internal trade & catering	5,3	6,7	6,5	5,4	4,2	3,2
Transport & communication	6,7	5,2	5,5	6,2	6,0	5,5
Financial & business services	5,4	4,1	3,7	4,9	5,1	4,5
CSP services	3,7	4,9	3,9	3,9	3,6	3,5
Government	-0,3	1,0	1,2	1,6	1,7	1,8
Total GDP	3,1	2,8	3,8	4,1	3,6	3,0

[Source: BER, January 2005]

2.3. Fixed investment: performance and outlook

Gross domestic fixed capital formation – that is, the total fixed investment spending by the private and public sectors – is currently expanding at a robust rate, both in the private and public sectors. Following growth of only 3,7 per cent in calendar year 2002, gross domestic fixed capital formation accelerated to growth of 9,0 per cent in 2003 and during the first half of 2004.

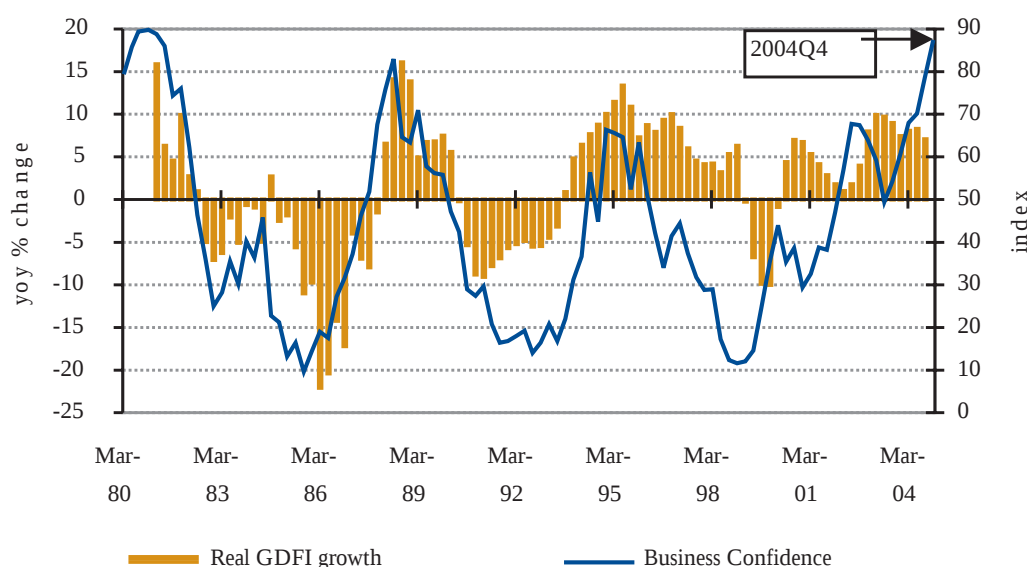
The recovery in fixed investment spending is broad-based. In the private sector, the momentum built gradually along with the general recovery in the economy since 1999. In

the public sector, calendar years 2002 and 2003 witnessed a reversal of the secular contraction in capital spending by the public corporations and government.

While the general fixed investment picture is decidedly bright at this stage, this does not conceal the more sombre fact that the fixed investment ratio only picked up to 16 per cent of GDP during the first half of 2004. This is well short of Government's 'unofficial' 25 per cent target and the historical picture of investment during the 1960s and 1970s.

The point about fixed investment, however, is that macroeconomic conditions – stable and lower inflation and interest rates – are favourable to nurture a higher fixed investment ratio over the medium to longer term on a sustainable basis. General socio-political stability is also a strong positive in this regard. While fixed investment has tended to be of the capital-deepening kind (substituting capital for labour) in recent years as firms rationalised and restructured to face fierce international competition, it is possible that job creation will become a stronger feature as firms contemplate expansion plans.

Figure 2 Business confidence versus fixed investment spending



[Source: SARB / BER]

It is important to note that the momentum in gross fixed capital formation *continued to strengthen* during 2002 and 2003 in the face of higher interest rates at the time and the volatility in the rand exchange rate. Firms appear to have taken a longer-term view in expanding production capacity because of the keen domestic demand conditions, the lower import costs (tied to the rand's appreciation) and what appeared to be a temporary hike in interest rates (in 2002).

Business confidence resumed an upward trend during the second half of 2003 as interest rates were lowered by a cumulative 5,5 per cent and a further 0,5 per cent in August 2004.

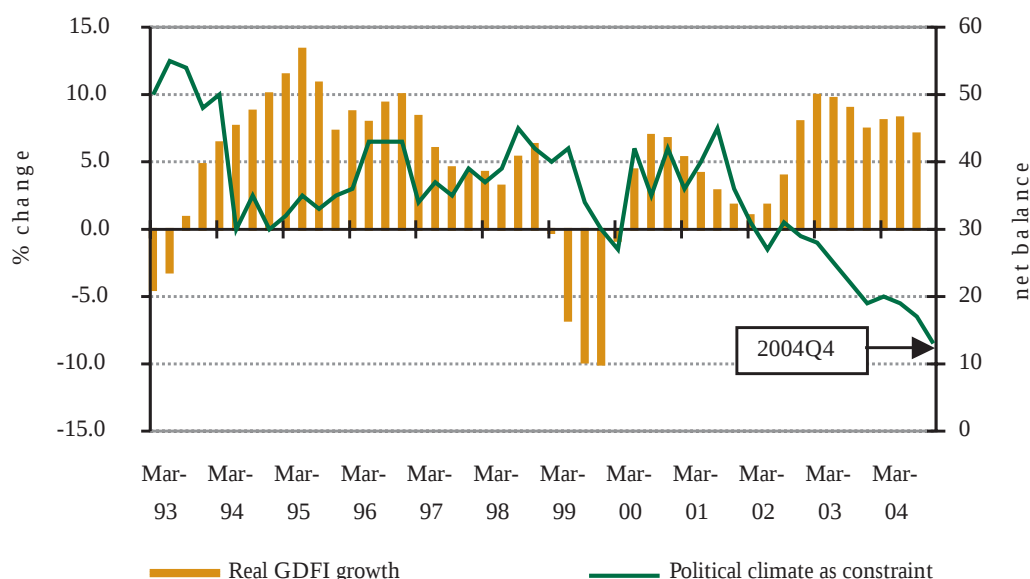
This reduces the cost of capital and boosts real domestic expenditure, both important drivers of business fixed investment. Business confidence reached a 23-year high during the fourth quarter of 2004. Figure 2 shows that a strong correlation exists between the levels of business confidence and changes in fixed investment spending.

The revised national accounts statistics show that private sector fixed investment remained strong during the first nine months of 2004 (growing by an annualised rate of 13% during the third quarter of 2004), despite the strength of the currency negatively impacting on mining and manufacturing firms' profitability.

It would appear that exporting firms are adopting a longer-term view, announcing major investment projects recently (Nedbank Capital Expenditure Project Listing, August 2004). The automotive and chemical sectors are embarking on big investment projects, while fixed investment spending in the retail, real estate and tourism sectors also appear to be robust – the consumer boom is spurring the development of new shopping space.

Fixed investment spending has also been particularly strong in recent years in the platinum mining sector and in the telecommunications sector due to the roll-out of cellular phone infrastructure, whereas robust fixed investment spending on transport equipment has largely been driven by the improvement in general economic conditions, as well as the general shift from rail to road transport and transport companies upgrading their vehicle fleets.

Figure 3 Political climate constraint versus fixed investment



[Source: SARB / BER]

Public corporations' fixed investment has been boosted strongly by South African Airways' (SAA's) aircraft acquisition programme, the Coega harbour development and other general infrastructure development. Technical factors related to SAA's aircraft acquisition programme resulted in a sharp decline in public corporations' fixed investment during the third quarter of 2004; however, the capital spending trend in this sector is set to rise strongly in the next five years with the R165-billion planned upgrading of Eskom and Transnet's infrastructure.

Unfortunately the growth in the general government's fixed investment spending has remained subdued in view of ambitious budget plans. It is expected that these plans will come to fruition. While the fiscal commitments in terms of the government's accelerated roll-out of social and welfare payments are expected to absorb the bulk of additional state spending in the current and 2005/06 fiscal years, government fixed investment spending is targeted to increase more meaningfully from the 2006/07 fiscal year in terms of the Medium Term Expenditure Framework (MTEF).

2.4. Employment: performance and outlook

Employment creation remains the most important vehicle to reduce poverty levels in South Africa. While an analysis of employment trends in the South African economy is severely hampered by discontinuities in the data, available analyses tend to show that the economy created jobs on a net basis over the 1990s, contrary to popular belief. However, it would appear that the job growth occurred in the informal sector, as formal sector employment generally declined. This implies a shift from the formal to the informal sectors and/or indirect labour (that is, outsourcing, subcontracting and other atypical forms of employment).

According to the SARB, the mining sector shed around 250 000 jobs during the 1990s compared to the 1980s, the manufacturing sector around 102 000 and the construction sector 100 000 jobs (SARB Labour Market Frontiers, June 2004: 3).

Employment also shrunk sharply in the public sector, particularly since 1995. The share of government & community services (excluding domestic servants) in total employment declined from 23 per cent in 1995 to 18 per cent in 2002 (Bhorat, 2003: 9).

On the other hand, job opportunities grew in the stronger growing services sectors, such as financial & business services and internal trade (including retail, wholesale, catering and accommodation). The financial & business services sector added around 100 000 jobs over the period 1991 to 2001, compared to the 1980s (SARB LMF, June 2004: 4)⁴. The employment share of the internal trade sector (mainly retail trade) grew from 17 per cent in 1995 to 20 per cent in 2002; however, close to 40 per cent of the employment

⁴ However, restructuring and rationalisation in the financial services sector have led to job losses recently. Data from Statistics South Africa's Survey of Employment and Earnings indicate a 7.4 per cent year-on-year decline in employment in the finance, insurance, real estate and business services sector in the first quarter of 2004 (SARB AER, 2004: 19).

opportunities in this sector reside in the informal sector (Labour Force Survey, September 2003: vii). This sector is also one of the few sectors for which the unskilled component of its workforce increased over the period between 1995 and 2002 (Bhorat, 2003: 11).

The broader trend in the economy is a higher demand for skilled and semi-skilled workers and a reduced demand for unskilled workers. This reflects the impact of changes in technology in the global arena and locally the structural shift in the economy from the primary to the services sectors. The share of unskilled labour in agriculture declined from 77 per cent in 1995 to 43 per cent in 2002; in mining it declined from 19 per cent to seven per cent and in manufacturing from 19 per cent to 15 per cent (Bhorat, 2003: 11).

On the other hand, the share of skilled labour in the financial & business services sector increased from 17 per cent to 25 per cent; in manufacturing it increased from six per cent to 10 per cent and in transport & communication from 15 per cent to 22 per cent. Sectors that tended to shed jobs over the period 1995 to 2002 experienced a movement away from unskilled labour towards semi-skilled and/or skilled employment.

From a cyclical point of view, the wave of formal sector worker retrenchments reached a peak in 1998, that is, at the trough of the previous economic downswing and in the wake of the East-Asian financial crisis. Since 1999, that is, with the onset of the current upswing phase of the business cycle, the rate of retrenchments tapered off and in calendar year 2002 firm formal sector job growth of 2,0 per cent was registered.

Unfortunately this positive trend in formal sector job growth was interrupted by the impact of the strengthening rand exchange rate over the period 2003 and 2004. The manufacturing sector experienced a recession in 2003 and the rate of retrenchments increased again in this sector. Employment in the mining sectors also came under pressure; however, the increase in commodity prices assisted to limit the damage, particularly in the non-gold mining sectors.

National account statistics showed that the supply side of the economy responded to the buoyant demand conditions locally and abroad during calendar 2004, which led to faster job creation. Statistics South Africa's *Survey of Employment & Earnings* (SEE) indicated that non-agricultural formal sector employment expanded by 3,1 per cent in year-on-year terms during the second quarter of 2004. The employment component of the Investec Purchasing Managers Index (PMI) reverted to a positive trend since the beginning of 2004 and a number of sectors, including retail & wholesale and construction, reported improving employment growth.

Unfortunately this positive broader trend in formal employment creation was affected by the impact of the sustained strength of the currency on the manufacturing sector. Should the rand exchange rate adjust to a more competitive level over the short term, as is expected, production conditions in the manufacturing sector should recover and revive

employment growth in the sector. Outside of manufacturing, the employment-intensive construction sector is booming, both in the residential and non-residential sectors. Employment in the retail, wholesale, catering & accommodation sectors is also expected to continue improving. Therefore, from a cyclical point of view, chances are good that formal sector job growth continued during the second half of 2004 and should strengthen further into 2005 and 2006.

From a structural point of view, however, employment prospects for the economy may be less than robust. First, economic growth is projected to be in the order of 3,5 per cent on average over the next three to five years, which may be not sufficient to absorb the new entrants to the labour market. This is explained in greater detail in chapter 4. Unemployment is therefore expected to continue increasing over the medium term⁵.

Secondly, labour demand is likely to remain skills-biased, that is, a stronger demand exists for semi-skilled and skilled labour at the expense of unskilled labour. The National Public Works Programme and the improved cyclical demand for unskilled labour in the retail and tourism sectors have a role to play in alleviating this problem. However, over the longer term, a concerted effort is required to educate and train the employable part of South Africa's unskilled labour force. Education, skills upgrading and further training are therefore key to raising longer-term growth potential.

2.5. Inflation and interest rate: performance and outlook

The strengthening rand exchange rate has been a strong disinflationary force in the domestic economy during 2003 and 2004. Actual CPIX inflation – the all-items Consumer Price Index (CPI) inflation rate, excluding mortgage interest rates – surprised on the low side in 2004, coming in at 4,3 per cent on average. This is close to the mid-point of the inflation targeting range. The upper band of the inflation target is unlikely to be breached over the short term. Moreover, inflation is expected to decelerate again towards the middle of 2005 before demand-pull factors are expected to begin to impact. *Overall, CPIX inflation is projected to average 4,5 per cent during 2005, accelerating to 5,4 per cent on average during 2006.*

Domestic inflation is currently adjusting to a lower level in a structural sense. The inflation-targeting monetary policy is driving this adjustment, as well as the complementing macroeconomic policies, in particular fiscal and trade policies, which are expected to persist over the longer term. As the South African society's inflation expectations adjust in response to the observed lower levels of actual inflation currently in force, the actual inflation outcome is also likely to be positively influenced.

The rand exchange rate remains a potential destabilising factor. While another 'rand event' (*a la* 1998 or 2001) is not entirely precluded, chances are that the replenishment of South Africa's balance of payments reserves (to US\$29-billion at the end of September 2004) and

⁵ The HIV/Aids epidemic is obviously going to have an impact in this regard. The growth in the labour force is already tapering off sharply due to the impact of Aids mortality. Consequently, improved economic growth and labour absorption are likely to ameliorate the unemployment trend.

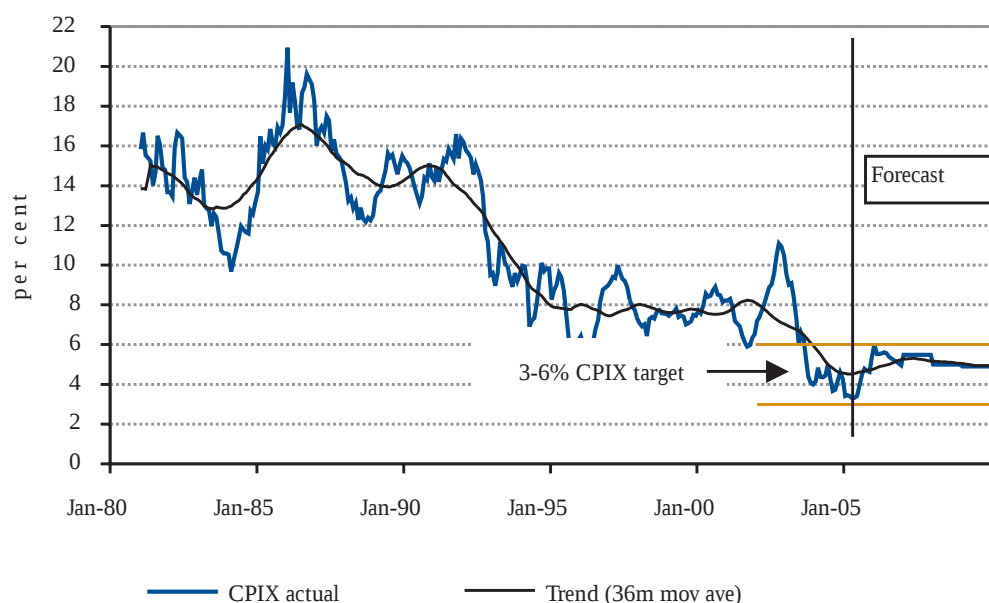
improved international investor sentiment could make a difference over the near term. The global inflation environment is also expected to be conducive to lower inflation in South Africa over the short to medium term, apart from the near-term oil price risk.

On a forward-looking basis, the SARB is not expected to tighten monetary policy well into 2005. In fact, the more benign inflation outlook allowed the SARB to cut interest rates in August 2004 (by 50 basis points or 0,5%) to counter the strength of the rand exchange rate; a similar cut is potentially possible later on in 2005, given the sustained strength of the rand.

However, the picture changes going into 2006 as the SARB becomes focused on inflation possibly accelerating towards the upper band of the inflation target in 2006 on the back of excess demand in the economy and a weaker currency. Interest rates are therefore expected to increase from the end of 2006. Bar unforeseen shocks, the total increase in interest rates could be on a limited scale in the current upward phase of the business cycle, should the favourable inflation outlook and the supporting sound economic fundamentals prevail.

Monetary policy will remain focused on driving inflation and inflation expectations lower until trend inflation stabilises within the targeting range. Once inflation has stabilised at these lower levels, there may be scope for a more accommodative monetary policy, which could increase trend growth and job creation in the economy.

Figure 4 CPIX inflation: the long-term trend



[Source: SARB / BER]

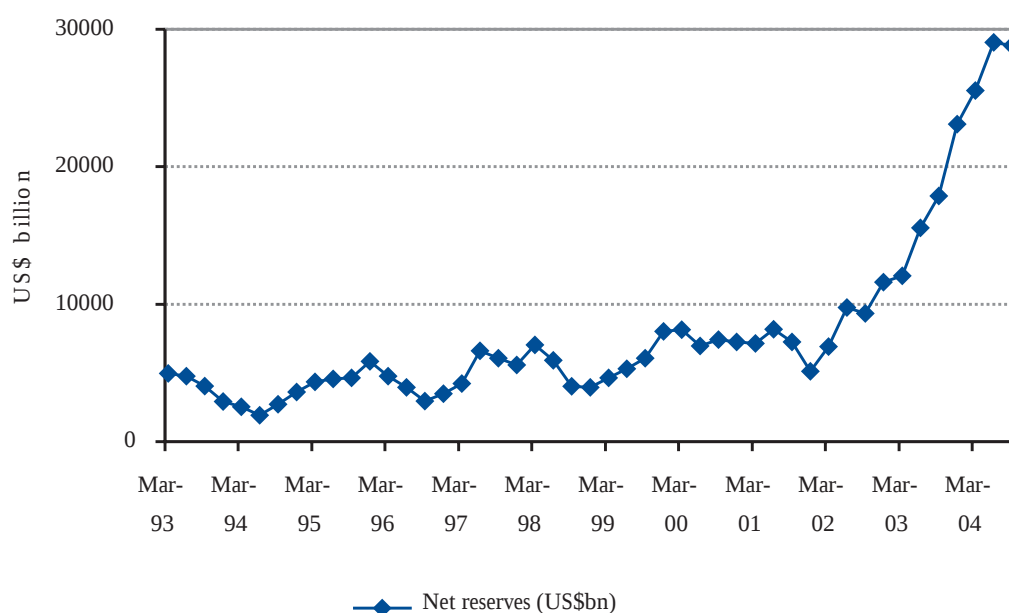
2.6. Balance of payments and the rand exchange rate: performance and outlook

Three key trends are discernable on the South African balance of payments since the end of 2001:

- *First*, the rising import to export ratio, which is closely correlated with the strengthening rand exchange rate. The result has been a deterioration of the trade balance into a deficit of R12-billion during calendar year 2004. The current account deficit measured 2,5 per cent of GDP during the third quarter of 2004, having been in a surplus during the first quarter of 2003.
- *Second*, the deterioration on the trade (and current) accounts was countered by the massive improvement in South Africa's terms of trade during 2003 and 2004. This resulted from the strong increase in international commodity prices over this period, exceeding the impact of higher crude oil and other import prices.
- *Third*, despite the deterioration in the trade balance (and the current account balance), net balance of payments reserves increased from around US\$5-billion at the end of 2001 to US\$29-billion at the end of September 2004 due to strong inflows on the financial account of the balance of payments (see Figure 5).

The higher level of reserves has been a direct result of the SARB's efforts to square off the open position of its forward book (that is, the balance between the SARB's forward foreign currency commitments and its forward currency receipts), which was achieved in February 2004. The subsequent replenishment of reserves, as well as the private banking sector's efforts to replenish foreign currency reserves to fulfil its role as the provider of forward exchange cover, have also been contributing factors.

Figure 5 Net balance of payments reserves (US\$-billion)



[Source: SARB]

While the global economy accelerated strongly since the middle of 2003, South Africa's export growth has been atypically subdued, largely as a result of reduced price competitiveness, as well as tepid growth in the economy of its largest trading partner, the Euro area. In particular, South Africa's manufactured exports came under pressure – the volume of manufacturing exports declined by 7,5 per cent in year-on-year terms during the first half of 2004 and manufacturers continued to report steep year-on-year declines in export volumes during the second half of 2004.

It is evident that the strong rand exchange rate is having a severe negative impact on South Africa's manufacturing exports and probably on export capacity. There is clear evidence that manufacturers are switching production to the lively local market. This is unfortunate in view of South Africa's longer-term export prospects and has negative implications for the balance of payments. The latter arises as South Africa's foreign currency earnings capacity could be compromised, in turn restraining real economic growth as higher rates of growth in domestic spending and import demand will not be sustainable.

South Africa's non-gold mining exports, in particular coal and platinum, fared better due to the strong increase in the dollar-based international prices – mining export volumes grew by 13 per cent year-on-year during the first half of 2004.

A broader recovery in exports is very dependent upon a more competitive currency. South Africa's export firms have improved production efficiencies during the 1990s; however, an overvalued currency could be very damaging to the country's export capacity. In South Africa's case, the overvalued status of the rand exchange rate is not sustainable and it is expected to adjust to a 'fairer value' over the short term.

Import demand, in turn, has accelerated strongly on the back of the strong currency and lively domestic spending on import-intensive consumer and capital goods. Import volumes grew by an average 14 per cent year-on-year during the first nine months of 2004. Imports were also boosted by special factors over this period, for example Government's acquisition of Navy corvettes, SAA's acquisition of new aircraft, and higher oil imports.

While these factors are expected to pass, the deteriorating trend on the current account of the balance of payments is unmistakable. As long as the wider current account deficit is financed by sufficient capital inflows, this should not present any problems; however, given South Africa's track record of volatile capital inflows, a large current account deficit is unsustainable in the event of a capital flow reversal. To restore balance on the current account, higher interest rates and/or a depreciation of the rand exchange rate will be required.

As noted, capital inflows on the financial account of the balance of payments have been sufficient to finance the current account deficit and a healthy increase in the balance of

payments reserves. Following a net inflow of R18,5-billion during the first half of 2003, the net inflow reached record proportions (an accumulated net inflow of R105,3-billion) during the subsequent 15 months. The bulk of these inflows were unrecorded transactions (one-third), other short-term investment inflows (47%) and portfolio investment inflows (one-quarter).

The stark reality is the fact that net direct investment has been negative during 2003 and the first half of 2004, that is, outward direct investment exceeded inward direct investment. Foreign direct investment (FDI) inflows are required to stabilise the capital inflow on the balance of payments to allow South Africa to sustain higher current account deficits which usually accompany higher real economic growth rates. Furthermore, increased inward FDI directly adds to domestic capital formation and employment generation, as well as facilitating the transfer of skills and technology, which all enhances South Africa's growth potential.

The recent portfolio inflows on the financial account of the balance of payments were very volatile, although the issuing of long-term debt abroad contributes to some stability. A large section of the other investment inflows appears to be related to trade financing, in turn related to the lower interest rates abroad and the strengthening rand exchange rate. These flows are sensitive to changing interest rates and movements in the exchange rate of the rand.

The rand exchange rate could therefore be vulnerable over the short term. The weak US dollar, the historical low interest rates abroad and the strong commodity cycle played a strong part in the rand's dramatic recovery during 2002 to 2004. The replenishment of South Africa's balance of payments reserves and increased foreign investor confidence reinforced the appreciating tendency of the rand.

However, as long as net FDI remains subdued, rand exchange rate volatility is likely to persist. At present the rand is particularly vulnerable to deterioration in South Africa's terms of trade (lower international commodity prices) and/or a reversal of short-term oriented capital inflows. Short-term investment capital inflows may be less forthcoming in an environment of higher interest rates abroad, a downturn in commodity prices and possibly a stronger US dollar.

3. The Western Cape Economy: Performance and Outlook, 2005 to 2007

In comparison to the other provinces of South Africa, the Western Cape regional economy displays a number of unique structural trends, giving rise to a dynamic process that has its own strengths and challenges for policy-makers.

Compared to the relatively small population share (10,2%), the Western Cape economy has an amazingly broad base with a multitude of sub-sectors or niches, many of which are growing well or have the potential to expand. With the exception of the mining sector, the Western Cape economy is well represented in each sector, with tourism as well as agriculture making up much of the mining deficit.

Table 6 Western Cape GDPR: Sectoral composition, 1999 – 2003

Sector	1999 %	2000 %	2001 %	2002 %	2003 %	Average 1999 – 2003 %
Primary sector	5,9	5,3	5,7	6,7	5,7	5,9
Agriculture	5,7	5,1	5,5	6,4	5,4	5,6
Mining	0,3	0,3	0,3	0,3	0,3	0,3
Secondary sector	25,7	25,6	24,4	25,6	24,8	25,2
Manufacturing	19,9	20,2	20,0	20,6	19,9	20,1
Electricity & water	1,9	1,8	1,7	1,6	1,7	1,7
Construction	4,0	3,6	2,8	3,4	3,2	3,4
Tertiary sector	68,3	69,1	69,8	67,8	69,5	68,9
Internal trade & catering	15,1	16,1	16,1	15,6	15,8	15,7
Transport & communication	10,0	10,2	10,2	10,1	10,3	10,1
Financial & business services	26,4	26,3	27,7	27,0	28,0	27,1
CSP services ¹	5,1	5,3	5,3	5,2	5,3	5,3
Government	11,8	11,0	10,6	10,0	10,1	10,7
Total GDPR (basic prices)	100	100	100	100	100	100

¹ Including 'Other producers' (mainly domestic servants).

[Source: Statistics South Africa: Statistical Release P0441, 28 November 2004]

Similar to the case nationally, the *tertiary sector* (comprising various services industries) produces the largest share of the GDPR, that is, *on average slightly more than two-thirds (68,9%) over the past five years (see Table 6)*. This is comparatively bigger than the tertiary sector's contribution to national GDP, which has been 64,3 per cent on average over the past five years.

The relative size of the *secondary sector* (manufacturing, electricity & water and construction) – 25 per cent of GDPR – is in line with the national situation, while the Western Cape has a much smaller *primary sector* (6% compared to 11,4% of national GDP, respectively) due to the absence of a meaningful mining industry in the Province.

Compared to the national economy and at a more disaggregated level, three sectors play a proportionately larger role in generating the regional GDP. These are:

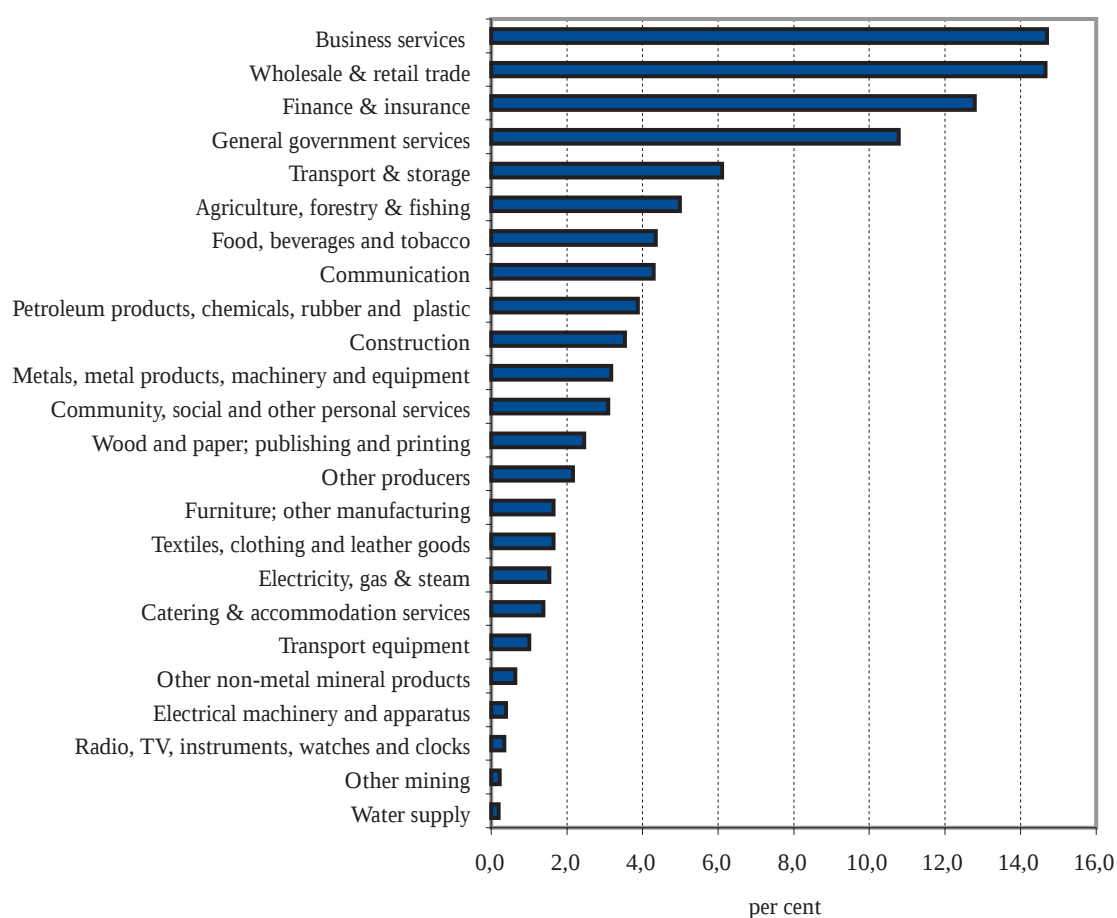
- *Financial & business services*, contributing 27,1 per cent of the GDPR on average over the five year period 1999 to 2003 compared to 19,2 per cent nationally. This sector

includes banking & insurance, real estate and business services, which in turn range from information and communication technology (ICT) services and engineering to accounting services, to name a few.

- *Agriculture*, contributing 5,6 per cent compared to 3,6 per cent nationally; and
- *Construction*, contributing 3,4 per cent compared to 2,5 per cent nationally.

These three broad sectors each accounts for around one-fifth of the respective national sectors.

Figure 6 Composition of the Western Cape GDP, 1999 – 2003



[Source: Quantec Research]

Contributions of the Province's *manufacturing* sector (20,1% of GDP on average over the period 1999 – 2003) and the *transport & communication* sector (10,1%) are very much in line with national contributions.

The Province's *internal trade sector* (including retail, wholesale, catering & accommodation) is larger in relation to GDP (15,7%) compared to the national situation (14%) due to the importance of the tourism industry in the Western Cape.

On the other hand, the Province has a number of smaller industries in a national perspective. The two that stand out most are:

- *Mining & quarrying* (contributing 0,3% of GDP compared to 7,8% nationally); and
- *General government* (10,7% compared to 15,5% nationally).

The Western Cape also has a relatively smaller *community & personal services* sector (5,3% compared to 6,2% nationally) and *electricity & water* sector (1,7% versus 2,6%, respectively).

The largest sectors of the Province are therefore:

- *Financial & business services* (banking & insurance 12,8% and real estate & business services 14,%) – 27% in total;
- *Manufacturing* (20%);
- *Internal trade & catering* (16%); and
- *Government* (11%).

These four broad sectors contribute more than 70 per cent of the regional GDP.

Within the manufacturing sector, *agro-processing* (food, beverages & tobacco), *metals processing & engineering*, *oil & petro-chemicals*, *clothing & textiles* and *furniture* are important activities.

In terms of GDP contribution, *transport & communication* (10%), *agriculture* (5,6%) and *construction* (3,4%) are also relatively large sectors in the Province.

However, conventional national accounts statistics do not always portray the growth of the more dynamic niche sectors. In this regard, an accurate representation of the tourism sector is a serious shortcoming in conventionally classified data. It is estimated that the tourism industry contributes between nine per cent and 10 per cent of national GDP, and the booming growth in the industry is reflected in the sharp growth in tourist arrivals in the Province (and nationally).

Within manufacturing and services, a diversity of growth niches is evident, which represent an important growth dynamic in the region. Included here are activities such as:

- *Mari- and aquaculture*;
- *Specialised agricultural niche products with a high value-added processing and marketing content*;
- *Boat building, repairs and upgrading*;
- *Commercial film production (particularly in the marketing sphere)*;
- *Specialised professional services*;
- *ICT services/software 'exports'*; and
- *The combination of health and tourism services*.

The Western Cape is also known for its booming 'retirement sector'. The proportionately larger presence of the financial & business services industry in the region is tied to the fact that these services are provided throughout South Africa (and even beyond the country's borders). The Western Cape clothing sector also services the higher end of the national clothing retail market and more manufacturing firms are moving this way. Apart from the local factors, national linkages are therefore an important aspect of the region's growth dynamic.

Regarding the structure of the region's economy, the picture is different from an employment perspective compared to a GDP perspective. The role of the more capital-intensive financial & business services sector (generating 10% of Western Cape employment in 2003) and transport & communications (5% to 7%) is reduced, while that of the more labour-intensive internal trade (20% when informal employment is included), agriculture (13% to 14%) and government (17%) sectors is increased.

The manufacturing sector's contribution to provincial employment (16% to 18%) is close to its GDP contribution (20%). Within the manufacturing sector, the clothing industry stands out as a labour-intensive industry, accounting for 25 per cent to 30 per cent of overall manufacturing employment in the Province.

From an employment perspective – and in order of importance – the government, internal trade & catering, manufacturing, agriculture and other producers (mainly domestic servants) are the most important sectors in the Province. Combined, these sectors account for more than 75 per cent of the total regional employment opportunities in the Western Cape⁶.

3.1. Western Cape Economic Growth (GDPR): Performance and Outlook

3.1.1. The past five years

Figure 7 shows that the Western Cape economy has out-performed the national economy over the past five years. Real GDPR growth for the Western Cape economy averaged 3,9 per cent over the period 1999 to 2003, compared to the national average of 3,1 per cent.

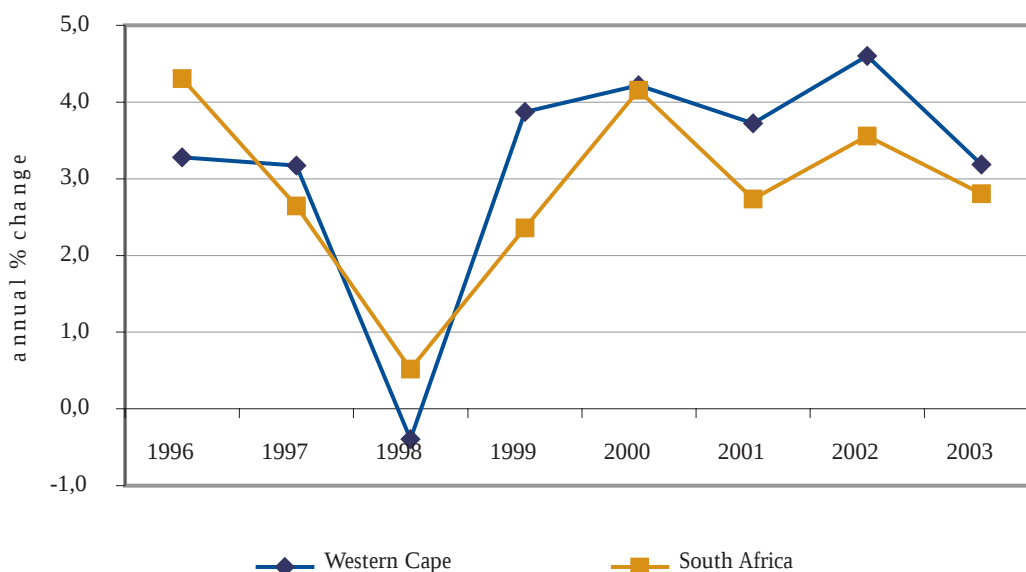
Even during 2003, when the appreciation of the rand exchange rate and the adverse climatic conditions had a proportionately larger negative impact on the regional agricultural and manufacturing sectors, the Western Cape real GDPR growth rate (3,2%) came in above the national real GDP growth rate (2,8%).

This performance is tied to robust growth in the region's services sectors, including a firm recovery in the financial sector. However, the recessions in agriculture and manufacturing

⁶ This is according to the Statistics South Africa September 2003 Labour Force Survey and Wesgro/Wolfgang Thomas' estimates of employment in the Western Cape in 2003.

caused a sharp deceleration in the region's real GDP growth rate from the buoyant 4,6 per cent registered in 2002 in the wake of the rand's sharp depreciation. It is estimated that regional growth again exceeded that of the rest of the country in 2004, albeit by a small margin due to the sustained strength of the rand and dry agricultural conditions. A number of the salient growth trends in the Western Cape economy are highlighted below.

Figure 7 Real GDP growth: Western Cape versus South Africa



[Source: Quantec Research]

The superior growth of the Western Cape economy over the past five years is largely due to the strong growth of the region's services industries, such as transport & communication, financial & business services and internal trade & catering. While these are nationally faster growing industries, Figure 8 shows that the Western Cape outperformed in these sectors, particularly in internal trade & catering (which grew by 6,6% per annum over the past five years compared to 5,3% nationally) and finance & business services (6,3% versus 5,4%).

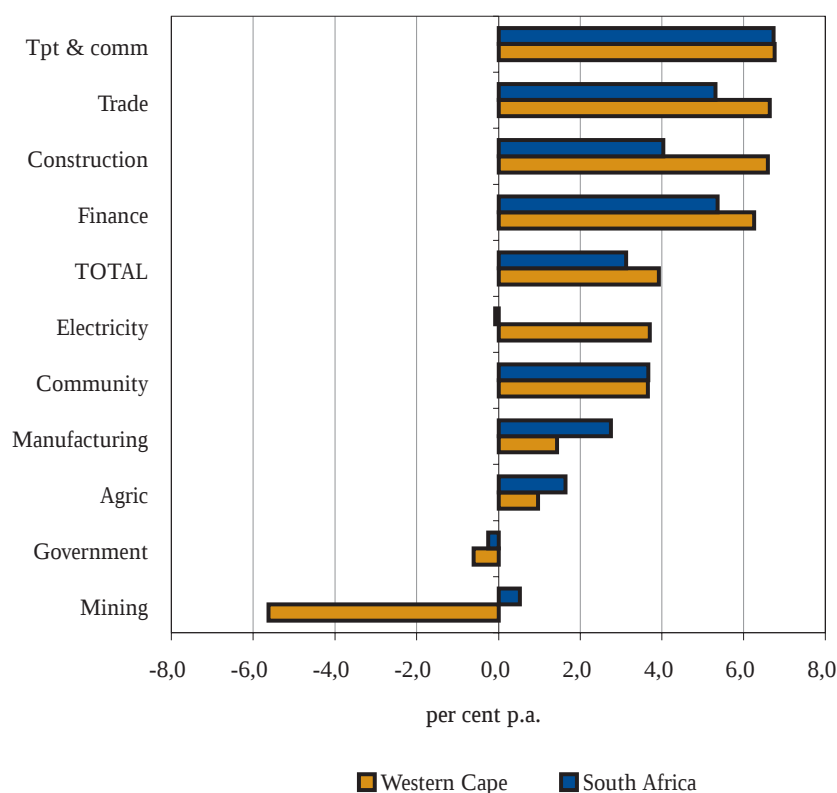
The internal trade & catering sector benefited from tourism, which has been a fast-growing sector in the Western Cape. The proportionately larger financial & business services sector in the Western Cape benefited from the property boom and the recovery in asset markets following the 2000 global meltdown in the ICT sector. The regional transport & communications sector kept up with the national growth tempo of this sector, growing by close to seven per cent per annum over the period 1999 to 2003. Therefore, the Western Cape economy is well represented in, and even outperforms, the faster growing national sectors.

Another sector well represented in the Western Cape (accounting for close to 20% of the national sector) and which outperformed the national sector, is the construction industry.

This sector grew by 6,6 per cent on average over the past five years compared to the national performance of only 4,0 per cent per annum.

This period witnessed the construction phases of a number of mega investment projects in the Western Cape, in particular the Century City shopping complex, the Grand West casino, the Cape Town International Convention Centre and Saldanha Steel, to name but a few. The hotel building boom of the mid-1990s in the Western Cape preceded these projects. The Western Cape construction industry shared in the general revival of the residential and non-residential building industries over the past five years.

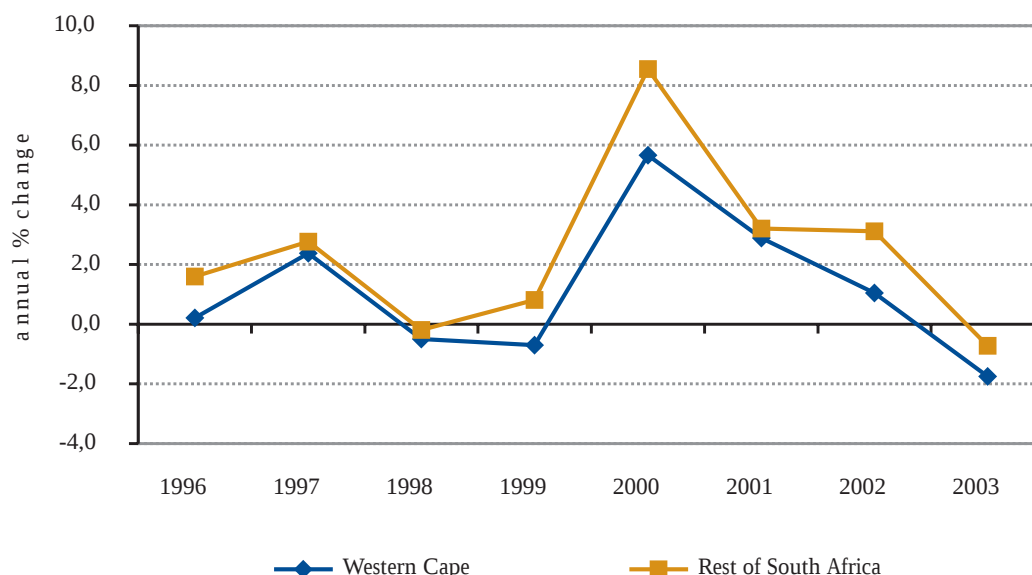
Figure 8 Average real GDP growth Western Cape versus South Africa (by sector), 1999 – 2003



[Source: Quantec Research]

In contrast, the growth of the Western Cape overall manufacturing industry has been disappointing. Real Western Cape manufacturing value-added grew at half the pace of the national average, or at 1,4 per cent per annum between 1999 and 2003 compared to 2,8 per cent nationally (see Figure 9). The share of manufacturing in the regional GDP declined from 23 per cent in 1995 to 19,9 per cent in 2003. The decline in the sector's formal employment contribution was worse, dropping from 21 per cent in 1995 to 16 per cent in 2003.

Figure 9 Manufacturing real value-added growth; Western Cape versus South Africa, 1996 – 2003



[Source: Quantec Research]

However, the sub-par growth performance of the Western Cape manufacturing industry needs to be put into perspective:

- The strong representation (35%) of the embattled national clothing & textile sector in the Western Cape has to explain an important part of the slow overall growth. Real value-added in this regional sector remained flat on average over the past five years, compared to marginal growth of 0,8 per cent per annum in the national sector outside of the Province.

This sector accounts for around 15 per cent of the Cape Metro's manufacturing Gross Geographic Product (GGP) and 25 per cent to 30 per cent of manufacturing employment (Barnes, 2004: 26)⁷. It contributes eight per cent of the Province's GDP. The number of clothing firms in the Province declined from more than 400 in 1995 to 324 in 2001 (Barnes, 2004: 15).

The shrinkage in the sector has been a result of restructuring, as clothing manufacturers have downsized to service the higher end of the clothing retail market in South Africa (Barnes, 2004: 16-17/ 27-28)⁸. Given this focus, the regional industry will be in a better position to withstand the expected increase in international competition in 2005 with the end of the Multi-Fibre Agreement. The latter restricted the major industrial countries' textile imports from countries such as China and India by way of import quotas.

However, the appreciation of the rand exchange rate during 2002 to 2004 has put substantial pressure on the sector and China remains a threat – witness the ratio of

⁷Quantec Research estimates that the clothing, textiles & leather sector contributes around 10 per cent to Western Cape real manufacturing value-added; however, the share is shrinking due to poor growth.

⁸The impact on employment may have been less serious as firms changed to indirect forms of labour (sub-contracting, etc.) and home industries developed in the wake of formal downsizing.

imports to exports in the clothing & textile sector in Figure 11. Business confidence is also currently measured at very low levels in this sector.

- The regional food processing and beverage sectors were also hard hit by the drought in agriculture in 2003 and 2004, adding to the exchange rate woes. However, it appears that food and beverage manufacturers are currently able to exploit the lively domestic market conditions to compensate for the decline in their exports; in fact, the sector has displayed remarkable resilience under the circumstances.

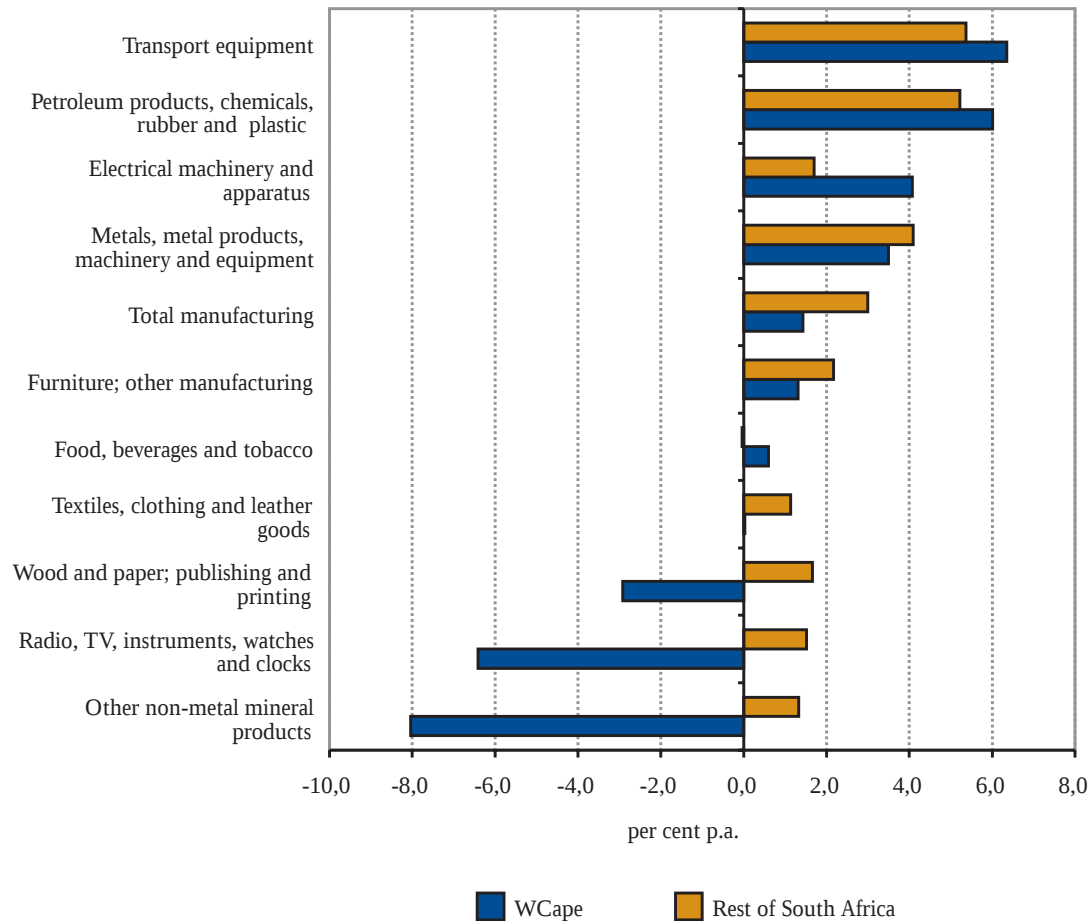
Real value-added in the food, beverages & tobacco sector tended to fluctuate around a flat trend over the past five years, both nationally and in the Western Cape. As this sector contributes 22 per cent to the Western Cape manufacturing real value-added (compared to 15% nationally), the lack of growth in this sector assists in explaining the sub-par growth performance of the Western Cape manufacturing sector.

- Other manufacturing sub-sectors showing weaker growth in a national context include wood & paper, printing & publishing, radio, television & instruments and non-metal minerals (*see Figure 10*). *These sectors tended to shrink in the Western Cape compared to positive growth in the rest of the country.*
- The Western Cape basic metals, metal products, machinery & equipment sector performed well (with real value-added growing by 3,5% per annum between 1999 and 2003); however, this was slightly below the performance of the same sector outside the Province, growing by an estimated four per cent per annum.
- The only manufacturing sub-sectors that outperformed their peers in the rest of the country are transport equipment (including automotive components and boat & ship building, with real value-added growing by 6,4% per annum over the period 1999 to 2003 compared to 5,4% nationally); electrical machinery (4,1% compared to 1,9%) and – to a lesser extent – petroleum products, chemicals, rubber & plastics (6% compared to 5,3%).
- Finally, the strong growth in some niche industries is not reflected in the aggregated statistics. As noted above, this represents an important aspect of the Western Cape's growth dynamic.

Real Western Cape manufacturing GDP declined by an estimated 1,7 per cent in 2003 compared to a one per cent decline nationally. A general recovery occurred in manufacturing since the end of 2003, driven mainly by keen domestic spending. Business is adjusting to the strong level of the exchange rate. However, in some sectors the pressure is immense, particularly the clothing & textile sector, as seen in Figure 11, due to the unrelenting strength of the rand.

The growth in the agriculture, forestry & fishing sector also fluctuated over the past five years, only growing by one per cent per annum in real terms compared to 1,6 per cent nationally. This is a labour-intensive sector, accounting for 13 per cent to 14 per cent of the Province's total employment. Production in this sector is very volatile, depending on climatic conditions. During 2003, real value-added in this sector declined by close to eight per cent due to the drought in the wheat- and fruit-producing areas. The 2004 wheat crop failed again. The wine industry is additionally struggling with global oversupply.

Figure 10 Western Cape manufacturing: real GDP growth, 1999 – 2003



[Source: Quantec Research]

In all, the net result of these growth trends has been that the bulk of the growth in the Western Cape economy over the past five years (and the analysis does not change over a 10-year history) has been contributed by the tertiary sector, at more than 85 per cent. Close to half of this growth originated from the financial & business services sector (42%), while the trade & catering sector contributed 25 per cent and the transport & communications sector 17 per cent.

The *secondary sector* only contributed 13 per cent of the accumulated growth. Within this sector, the contribution of the manufacturing industry did not exceed that of the construction sector by a large margin (6,8% compared to 4,6%). This juxtaposes the comparatively weak performance of the regional manufacturing sector (which contributes 20% to GDP) with the comparatively strong performance of the regional construction sector (contributing only 3,4% of GDP). The disappointing contribution from the regional manufacturing sector becomes more apparent when it is compared to the national

situation, where manufacturing accounted for close to 15 per cent of GDP growth over the corresponding period.

Finally, the *primary sector* has only been adding marginally to GDP growth over the past five to 10 years (0,5%), declining in some years and growing in others, depending on the climatic conditions.

Figure 11 Clothing & textile sector: ratio of imports to exports



[Source: SARS]

3.1.2. A business cycle perspective

The national economy has been in an upswing phase of the business cycle from September 1999, and the Western Cape shared in this revival. National economic growth was hard hit during 1998 and 1999 when prime overdraft rates increased to a level of 25,5 per cent in the wake of the East Asian currency crisis and the SARB's efforts to protect the value of the rand.

Sustained growth in the Western Cape's services sectors and the construction phases of large retail shopping and tourism facilities in the Province countered the slowdown in manufacturing. The national economy registered a real GDP growth rate of 2,4 per cent in 1999, only emerging from the growth slowdown towards the end of 1999. This compared with the Western Cape's growth rate of 3,9 per cent for the same year.

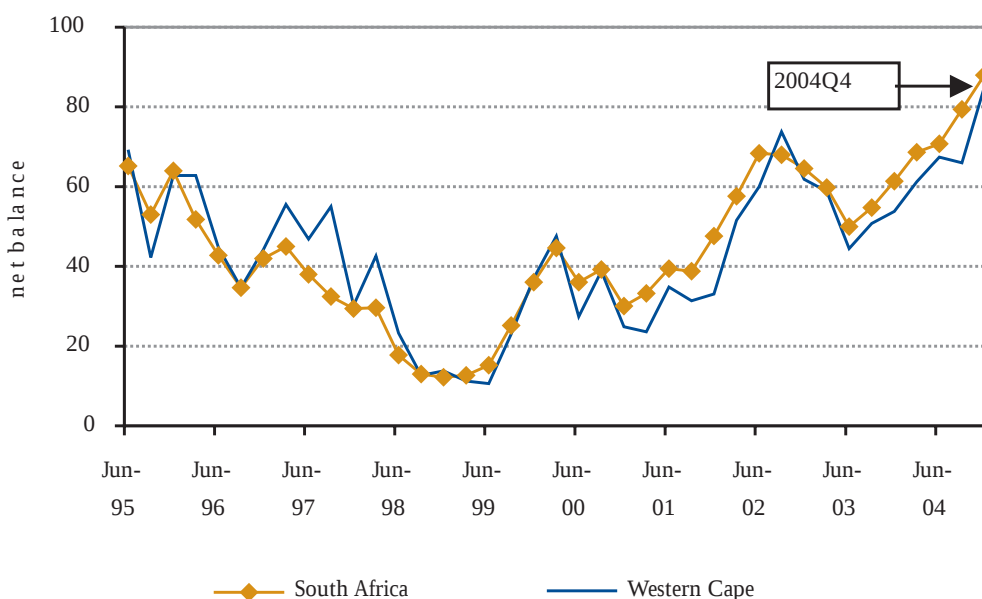
This economic revival has developed increased momentum over the past five years, despite heavy financial volatility. In 2001 and 2002, the economy weathered the sharp global

economic slowdown quite well as the sustained growth in real after-tax household incomes, improving employment conditions and higher consumer confidence levels fuelled a three per cent-odd sustained growth in final household consumption expenditure.

In this regard, the growth in the higher end of the retail market has been much healthier compared to the situation at the lower end of the income scale. Middle- to higher income earners benefited from tax cuts, lower interest rates, improving house prices, black economic empowerment (BEE) and more stable skilled employment conditions.

The more favourable growth of this market segment benefited the Western Cape retail sector. Exports also performed strongly on the back of the weaker currency (between 2000 and 2002). Real GDP growth averaged 4,2 per cent in 2000, both in the Western Cape and in South Africa. It accelerated further to 4,6 per cent in the Western Cape in 2002, while slowing nationally to 3,6 per cent. In calendar year 2002, positive formal sector employment growth was registered, both nationally and in the Western Cape (2,0% and 1,3% respectively).

Figure 12 Western Cape versus national business confidence (BER survey)



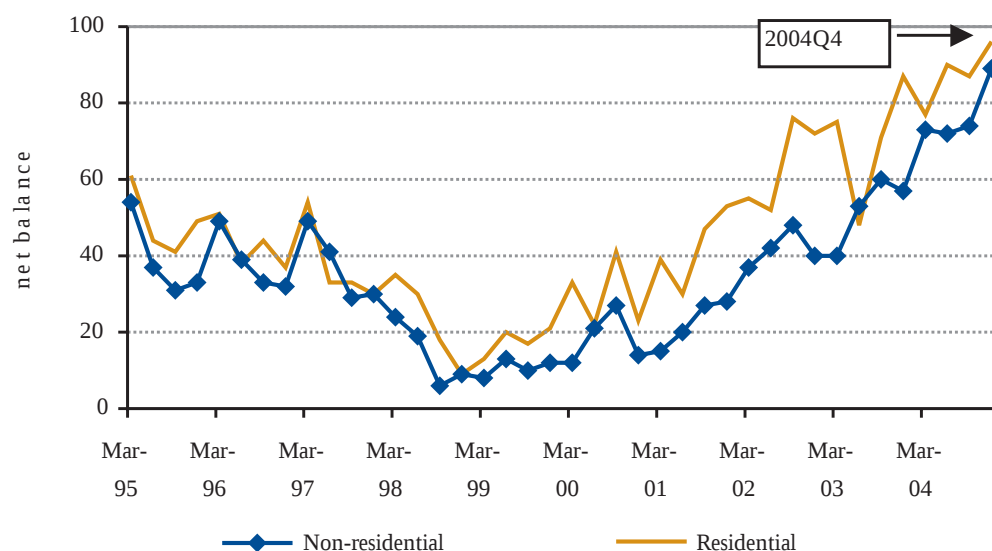
[Source: BER]

The combined impact of higher inflation and interest rates (2002/03), poor world economic growth and the strengthening of the rand exchange rate (between 2002 and 2004) was a significant deceleration in general economic growth to 2,8 per cent and 3,2 per cent nationally and in the Western Cape respectively during 2003. Manufacturing was particularly hard hit (clothing & textiles, food & beverages, metal products &

machinery, wood & paper and furniture). The adverse climatic conditions also had a negative impact on regional economic growth. The Western Cape employment situation deteriorated, reversing the improving tendency discernable since 2000.

In the first three quarters of 2004, Western Cape business confidence was measured on a lower level compared to the rest of South Africa (see Figure 12). Whereas around 80 per cent of the BER's respondents in the retail, wholesale, motor trade, manufacturing and building sectors reported satisfactory general business conditions nationally, only 61 per cent to 66 per cent did so in the Western Cape⁹. However, Western Cape business confidence recovered sharply during the fourth quarter of 2004, reverting to the historically close correlation in confidence trends between the region and nationally.

Figure 13 Building contractors' business confidence (BER survey)



[Source: BER]

Western Cape economic sectors that are fully sharing in the general improvement of economic activity in South Africa during 2004 include retail, wholesale and building & construction. National real retail sales grew at rate of close to 10 per cent year-on-year during the first 10 months of 2004. Consumer confidence was measured on a higher level during the second half of 2004 in the Western Cape compared to the other two large provinces in economic terms, Gauteng and KwaZulu-Natal.

Western Cape building contractors in both the residential and non-residential sectors also reported equally buoyant business conditions during the course of 2004 compared to the national situation. Building plans passed in the Western Cape, measured in square meters,

⁹ The BER measures business confidence nationally and on a geographical basis in the retail, wholesale, motor trade, manufacturing and building sectors. Whereas business confidence was measured on a higher level in the Western Cape compared to the whole country over the period 1995 to 1998/99, this has changed subsequently. Unfortunately, the BER's business confidence index does not include the rapidly growing services industries in the Western Cape (for example, financial services and transport & communication). This and the relative under-performance of the regional manufacturing industry probably explain the lower level of business confidence in the Western Cape compared to South Africa over the period 1999 to 2004.

are showing growth of 32 per cent year-on-year (for dwellings larger than 80 square metres); for flats and townhouses the growth is more than 100 per cent. Building plans for shopping space are also showing growth in excess of 100 per cent.

As seen in Figure 13, the BER's building business confidence index is currently on a 23-year high. The strong performance of the construction sector is likely to persist, boosted by the lively retailing conditions, the tourism industry and FDI.

The transport & communication sector is also likely to continue performing well, both in the region and nationally. Transport activity is closely driven by retail and manufacturing conditions, import and export activity, and tourism. The cell phone industry also remains in a strong growth phase as the number of mobile subscribers continues to grow.

In all, the current performance of the Western Cape economy is somewhat uneven, with real value-added growth not as strong in the agricultural and manufacturing sectors as in the services sectors.

Following the GDP revisions announced by Statistics South Africa at the end of 2004, it is estimated that real GDP growth came in close to the four per cent level in 2004, probably exceeding the national average by a small margin. The degree to which Western Cape economic growth exceeds that of the country may be a function of where the exchange rate is headed or, alternatively, how successful local business adapts to the changing macroeconomic parameters.

3.1.3. Economic growth outlook, 2005 to 2007

As seen above, the Western Cape economy's out-performance over the past five years has been tied to the strong presence of fast-growing services industries such as retail & wholesale trade, transport & communication and financial & business services in the Province. The flourishing tourism industry has been part and parcel of the growth story. Apart from these services industries, the construction sector also expanded strongly, although representing a relatively small part of the regional economy. Within manufacturing and services, a number of niche industries have also performed well and show promising potential.

However, the Western Cape agriculture and manufacturing sectors were hard hit in 2003 due to the negative impact of the strengthening rand exchange rate and adverse climatic conditions. The region's services sectors compensated, and growth came in above the national average. Indications are that the regional economy's relative out-performance continued during 2004, although the recoveries in the manufacturing and agricultural sectors probably lagged those in the rest of the country.

Considering the economic outlook for the region, the question is therefore whether the Western Cape will continue to out-perform in a national context.

From a domestic demand perspective, the short-term outlook for the Western Cape economy is decidedly favourable, similar to the national situation. As noted in the first section of the report, *inflation* and *interest rates* are likely to remain supportive to final consumer spending. *Consumer confidence* is *high* and rising and consumers' ability to spend is likely to continue to improve due to above-inflation wage settlements and improving employment conditions.

The improvement in *employment* in the Western Cape could *lag* that of the rest of the country due to the problems in the labour-intensive clothing industry, as well as the other major employers in the manufacturing sector, in particular food processing, wood products, printing & publishing. On the other hand, employment generation could be positive in the internal trade & catering, tourism and construction sectors.

Income growth is expected to continue improving and, combined with an increased propensity to utilise credit, consumer spending is expected to remain lively over the period 2005 to 2006. Western Cape industry is well positioned to service the strong-growing higher end of the retail market throughout the country, particularly should import competition be checked by some 'adjustment' in the rand exchange rate over the short term.

Export demand is also expected to be favourable over the projection period. While manufacturing exports are currently under pressure from the strong rand exchange rate, a more robust recovery should unfold once the rand depreciates, as is expected over the short term. Currently it is unknown to what extent export capacity has been affected more permanently by the exceptional strength of the rand. In a number of the smaller but faster-growing export categories over the past five years, volumes appear to have declined in 2003 and probably in 2004. Compensating for the decline in the region's manufacturing exports is the stable growth trend in the Province's agro-industrial exports and the favourable demand and prices for the Province's base metal exports.

Government is adding to the growth impetus via its accelerated roll-out of social welfare spending and infrastructure development, including the public works programme¹⁰.

Provided that the buoyancy in domestic demand is sustained and the more robust recovery anticipated in exports materialises, the lagging business confidence levels in the Western Cape should continue to catch up over the short term.

The outlook for *fixed investment* is promising. In this regard the regional situation corresponds to that in the rest of the country. Generally, firms appear to be adopting a long-term view and are increasingly embarking on expansion plans. Nationally, business confidence levels are on historical highs and the general political climate is rated as being the most stable in years.

¹⁰ The Western Cape's expanded public works programme aims to generate 120 000 jobs, and investment in infrastructure will be accelerated to 2,5 per cent of GDP (from one per cent currently) in terms of the agreements between government, business, labour and civil society reached at the Provincial Growth & Development Summit (November 2003).

Following a period of strenuous macroeconomic policies and restructuring in the domestic economy, we are entering an era of more supportive fiscal policy, gradually lower real interest rates and firms generally having adjusted to the lower level of import tariffs. Under these conditions, fixed investment spending can increasingly become of the capital-widening kind (being accompanied by expanding employment) rather than of the capital-deepening kind of the 1990s when formal employment contracted. That is the theory; however, there is already evidence that this is actually starting to happen.

Given these demand conditions, *real GDP growth* is expected to continue *accelerating* in 2005 and over the short term. The margin of growth above the national average may initially be relatively small due to the relatively weaker performing manufacturing and agricultural sectors. However, the internal trade & catering sector is projected to grow at a faster rate than nationally, being well positioned to service the fast-growing tourism sector and the higher end of the retail market. The growth in the financial & business services sector (including real estate) and in the transport & communication sector is also expected to keep up with the rest of the country, if not exceeding it. The construction sector should continue to benefit from the strong growth in both the residential and non-residential building sectors.

Identified growth sectors/opportunities in the Western Cape over the short to medium term include the following, to name only a few:

- The agriculture and food processing sector, including fishing & mariculture;
- Oil & gas developments, in particular the Kudu gas pipeline and downstream petrochemicals;
- The development of the downstream metals processing industry (Saldanha Steel/Duferco) linking into the Province's clothing/textile, food processing, beverages, automotive and fishing industries. Boat building & ship repair also show viable potential.
- High-value clothing, textiles and leather products (including the African Growth and Opportunity Act, or AGOA, opportunities), crafts and jewellery;
- Furniture – for household, office and industrial use;
- Tourism is expected to continue expanding in the Western Cape; the Provincial Government's own target is to increase the number of overseas tourists visiting the Western Cape from 790 000 in 1999 to four million by 2010. Domestic tourism is also targeted.
- The ICT sector is also earmarked for growth, particularly with the planned liberalisation of the communications market in 2005. ICT services show the strongest growth potential in the Province and also exhibit the strongest capabilities at this stage. Included here are call centres and business process outsourcing (BPO) centres.
- The film industry has also taken off in a big way and has growth potential, although this development is currently being constrained by the strength of the rand exchange rate.

In all, real GDP is projected to accelerate from growth of 3,3 per cent in fiscal year 2003/04 to 4,1 per cent and 4,3 per cent during fiscal years 2004/05 and 2005/06 respectively, exceeding the projected national growth rate by a small margin. In the outer years of the MTEF, real GDP growth is expected to decline slightly to 4,0 per cent and 3,9 per cent in fiscal years 2006/07 and 2007/08. These projections, however, remain above the national real GDP growth forecast of 3,9 per cent in 2005/06, 3,5 per cent in 2006/07 and 3,2 per cent in 2007/08.

The growth in the Province's services industries is projected to equal or exceed the national performance and a more competitive exchange rate (at around US\$7,00 to US\$7,50) should allow for a firmer recovery in the Province's embattled manufacturing sector, as well as the agricultural sector on the assumption of normal climatic conditions. *More detailed projections are provided in Table 7 and Table 8.*

Table 7 Western Cape macroeconomic outlook, 2004/05 – 2007/08¹

	2002/03	2003/04	2004/05F	2005/06F	2006/07F	2007/08F
GDP (R-billion, current market prices)	168,8	185,4	203,0	222,5	244,4	263,4
Real GDP growth (%)	4,3	3,3	4,1	4,3	4,0	3,9
GDP inflation (%)	8,4	6,3	5,3	5,1	5,7	3,8
Western Cape CPI inflation (%)	9,0	4,6	2,3	4,5	5,5	3,7

¹ Fiscal years ending 31 March.

[Source: BER]

Table 8 Western Cape: Sectoral real GDP growth outlook, 2004/05 – 2007/08¹

Sector (SIC)	Average 1999–03 %	2003/04 %	2004/05F %	2005/06F %	2006/07F %	2007/08F %
Agriculture	1,0	-6,4	1,7	2,4	2,4	1,8
Mining	-5,6	2,2	2,7	2,9	-1,5	-0,9
Manufacturing	1,4	-0,9	3,3	3,8	3,1	2,5
Electricity & water	3,7	7,5	-0,4	2,6	3,0	3,4
Construction	6,6	-0,3	8,3	8,5	6,6	6,4
Internal trade & catering	6,6	6,9	6,9	6,1	5,0	4,5
Transport & communication	6,8	7,6	5,3	6,0	5,6	5,3
Financial & business services	6,3	5,3	3,8	4,7	4,8	5,2
CSP services	3,7	4,8	3,9	3,8	3,6	3,5
Government	-0,6	1,2	1,3	1,6	1,7	1,8
Total GDP (market prices)	3,9	3,3	4,1	4,3	4,0	3,9

¹ Fiscal years ending 31 March.

[Source: Statistics South Africa / BER]

3.2. Western Cape inflation: performance and outlook

Figure 14 shows that price trends in the Western Cape economy correspond closely to those in the rest of the country. It follows that what has been said regarding inflation in the first section of the chapter also applies to the inflation performance of the Western Cape economy.

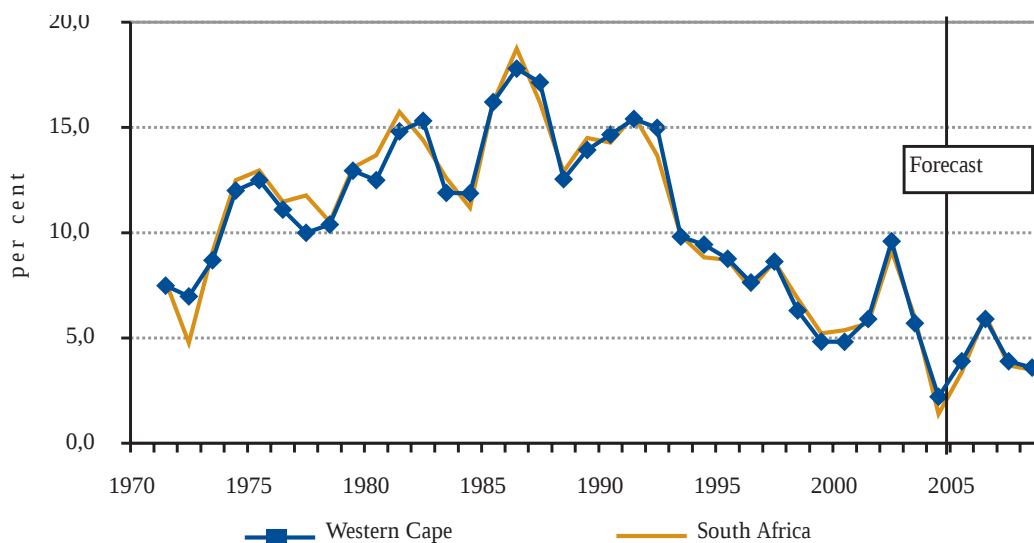
Inflation is currently well under control, benefiting from the strength of the rand as well as a structural adjustment in inflation expectations, which are responding to Government's inflation-targeting monetary policy framework. Food price inflation is also at exceptionally low levels, partly related to currency strength. CPIX inflation could come in below the four per cent level during the early months of 2005.

Having said that, ordinary cyclical forces and possibly the currency are likely to cause acceleration in domestic inflation over the short term. It is expected that surplus production capacity will disappear over the short term as the general economic growth momentum gathers steam; the production side of the economy has already responded to the lively domestic demand conditions.

Should the rand depreciate in addition, we could be faced with both demand-pull and cost-push inflationary forces later in the year. CPIX inflation is therefore projected to accelerate to between five per cent and six per cent during 2005/06.

It is expected that the lower level of inflation expectations and the maturing anti-inflation process in South Africa will curtail the price and wage responses in the private sector and keep inflation within the target range. Furthermore, with Government's renewed efforts to curtail administrative price adjustments, positive surprises in this regard could impact favourably.

Figure 14 CPI inflation: Western Cape versus South Africa, 1970 – 2008



[Source: Statistics South Africa / BER]

3.3. Western Cape fixed investment: performance and outlook

3.3.1. The past five years

As noted in the first section of the report, *gross fixed capital formation* is currently expanding at a rapid rate throughout South Africa. The growth is broad-based, involving both the private and public sectors. The Western Cape economy is sharing in the growth of fixed investment, although less robustly during 2003 and probably 2004.

Figure 15 reveals that the growth in fixed investment spending in the Western Cape has been more stable over the past number of years compared to the rest of the country. The more stable trend is linked to the fact that the less cyclical services industries contributed the bulk of the fixed investment growth over the past five to 10 years.

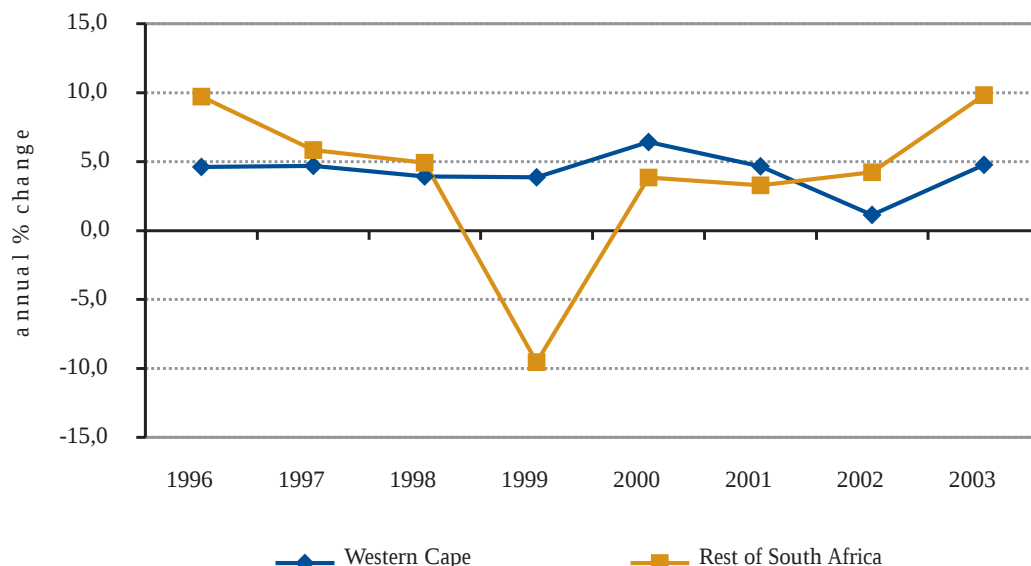
The general revival in fixed investment spending since 2000 is rooted in a gradual strengthening of domestic demand conditions over the past five years, lower and more stable interest rates, higher business confidence levels and a more favourable real economic growth outlook. It would appear that the stronger level of the exchange rate has stimulated capital expenditure further in 2003 and 2004, as firms exploit the opportunity to replace worn-out machinery and equipment and in some areas add to production capacity at the lower import costs.

Total gross domestic capital formation expanded at an annualised rate of nine per cent during the first half of 2004, similar to the growth rate registered in 2003. This could also be an indication that firms are taking a long-term view, and are not being discouraged by the deleterious effect the strong rand exchange rate has on profitability and export volumes.

Real fixed investment spending in the Western Cape grew by an average rate of 4,2 per cent per annum over the period 1999 to 2003, similar to the rate of expansion over the period 1995 to 2003. This compares favourably with the growth of only 2,3 per cent in the rest of the country over the corresponding period. However, the national five-year average is distorted by the sharp (9,5%) decline in 1999 outside the Western Cape. Fixed investment spending declined sharply in the wake of the spike in interest rates to 25 per cent in 1998.

In the Western Cape, strong investment spending at the time in the retail and tourism sectors, as well as the transport & communication and financial services sectors, countered the general cyclical decline in capital spending. Excluding 1999, real growth in gross fixed capital formation has averaged 5,1 per cent nationally since 2000 – slightly higher than the Western Cape's 4,2 per cent. However, the average growth rates over the whole period from 1995 to 2003 are similar around four per cent.

Figure 15 Fixed investment: Western Cape versus the rest of South Africa, 1996 – 2003



[Source: Quantec Research]

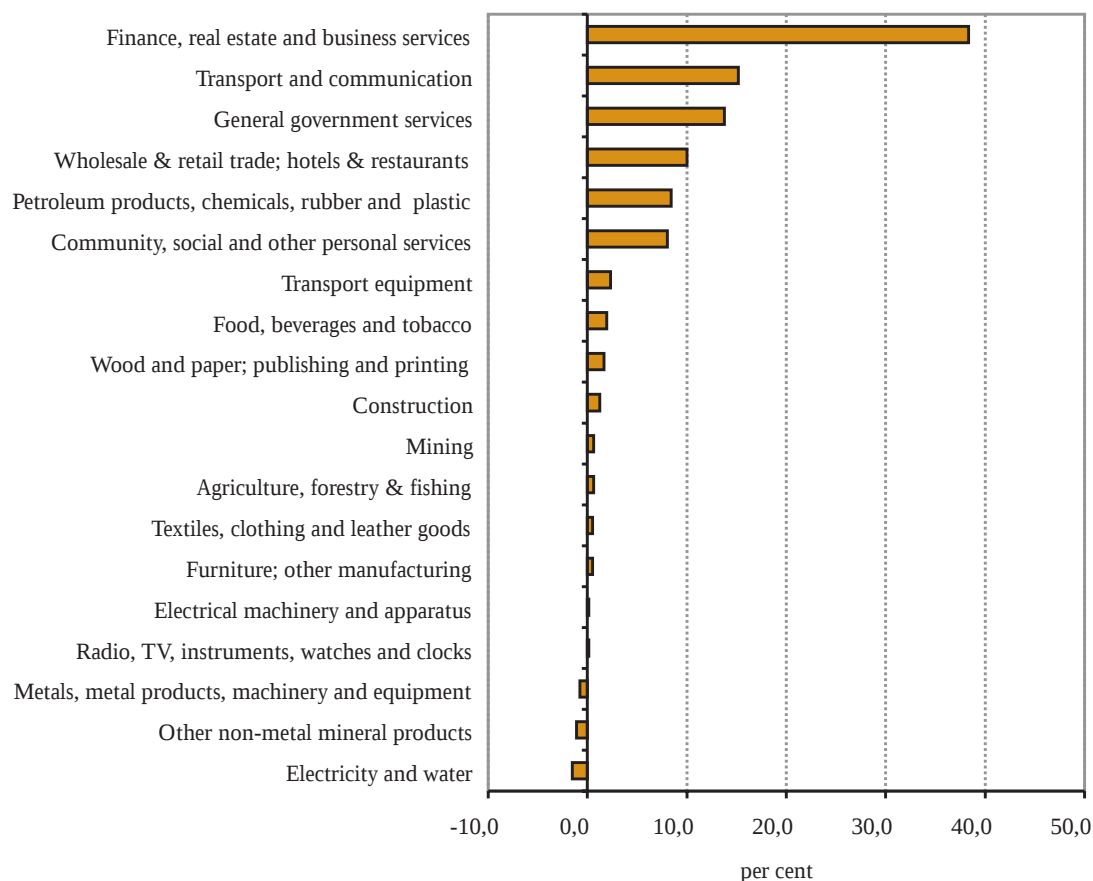
Considering the *sectoral contribution to the growth in fixed investment spending* in the Province, Figure 16 shows that the financial & business services sector has by far been the largest contributor. This sector accounted for close to 40 per cent of the growth in regional fixed investment spending over the past five years. Other sectors that contributed substantially to the growth in fixed investment spending include transport & communication (15%), the regional government (14%), internal trade & catering (10%) and the petro-chemical sector (8,4%). The community, social & personal services sector contributed eight per cent, while food & beverages and transport equipment contributed around two per cent each. Apart from wood & paper and printing & publishing, the other sectors contributed little to the real growth in fixed investment spending in the Province.

The strong fixed investment spending in the financial services (banking & insurance), transport & communication and the petro-chemical sectors was *not accompanied by net job growth* in these sectors, suggesting that *capital deepening* occurred.

This also appears to be the case in a number of manufacturing sub-sectors. Only the transport equipment sub-sector created meaningful employment over the past five years while contributing to fixed investment.

The strong fixed investment spending in the internal trade & catering and business services sectors was also accompanied by net job growth. These sectors are, however, the exception to the rule. In all, regional fixed investment spending increased by 4,2 per cent per annum over the past five years while formal sector employment *declined* by 0,4 per cent per annum over the corresponding period. The decline in formal sector employment is discussed in section 3.4.

Figure 16 Western Cape fixed investment growth: weighted sectoral contribution, 1999 – 2003



[Source: Quantec Research]

The Western Cape succeeded in attracting 17 per cent of national FDI inflows over the past decade (1994 to 2003) (Wesgro, 2004: 9) – the third-largest share of all nine provinces. The European Union (EU) and the US accounted for the bulk (84%) of FDI into the Province. While FDI inflows declined in the wake of the global economic slowdown in 2000 and 2001, it is expected to recover again over the short term. Intensifying global competition for lower-cost destinations, regional integration and improved and more open business environments in developing countries should be supportive of FDI flows.

3.3.2. Outlook, 2005 to 2007

Stability has been a hallmark of the Western Cape's fixed investment growth track record over the past decade. The strong investment by the less cyclical services industries contributed to this result, as well as large retail and tourism infrastructure developments at the time of the previous trough in the national fixed investment cycle – 1999 in particular.

The outlook for the financial & business service sector, transport & communication and retail, wholesale & catering is favourable, and these sectors have been the largest contributors to fixed investment spending in the Province over the past five years. The petroleum refineries are also expected to invest substantial amounts in new technology to comply with Government's new fuel emissions standards to be phased in from 2006. Furthermore, general prospects for the property development sector remain bullish, both in the residential and non-residential sectors.

Manufacturing fixed investment is lagging the tertiary sectors and needs to improve the labour absorption capacity of the regional economy. In this regard, new investment in the Province's more labour-intensive metals-processing industries shows promising potential, provided the required policy environment is created. The fixed investment rates in the food processing, clothing & textiles, furniture and a number of niche industries are also likely to be stepped up over the projection period.

3.4. Western Cape employment: performance and outlook

3.4.1. The past five years

Estimates of the Western Cape's labour force in 2003 vary from 1,9-million to 2,2-million, with 1,5-million to 1,7-million people in employment and 39 000 to 450 000 unemployed. Adding discouraged work seekers, the number of unemployed increases. While the Western Cape has the lowest official unemployment rate in the country (20% on the narrow, official definition), regional unemployment appears to be growing more rapidly. This could be due to a combination of relatively weaker employment absorption and a large migration influx of workers into the region and into the labour force*. The Quantec Research provincial database shows that the Western Cape's formal sector employment creation has been worse than that of the rest of South Africa over the period 1999 to 2003**.

** For the purpose of this report, the Quantec Research provincial database was used to deduct trends in regional and sectoral employment. Reference is also made to the results from the Statistics South Africa Labour Force Survey where useful.*

*** This is contradicted by the analysis in chapter 4 of this report. According to the Labour Force Survey, six out of every 10 job seekers in the province managed to find work over the period 2000 to 2003, which is much better than the national labour absorption rate of around 30 per cent. However, the regional employment performance over the recent past may be overstated in the Survey due to an improvement in the successive Labour Force Surveys, with the later Surveys more accurately measuring employment compared to the first 2000 Survey.*

According to this database, Western Cape formal sector employment (including domestic servants) showed an average annual decline measuring 0,4 per cent over the five-year period 1999 to 2003¹¹. Table 9 shows that in almost all the sectors, formal employment declined. Net job growth only occurred in the automotive sector, retail & wholesale trade,

¹¹ Excluding "other producers" (mainly domestic servants), the average annual contraction in formal sector employment amounts to 0,9 per cent.

business services, community, social & personal (CSP) services (including domestic servants) and in mining. Informal sector employment expanded by 3,5 per cent per annum over the corresponding period, resulting in a flat overall employment trend in the region.

The employment trend suggested by the Quantec Research database corresponds to the national picture highlighted in the first section of the report, that is, that a shift occurred from the formal sector of the economy to the informal sector and indirect forms of labour. It is possible that the jobs lost in the formal sector according to the Quantec database, at least to some degree, reflect the transition to indirect forms of labour, captured in the 'informal' component of overall job growth. This is also what Wesgro research indicates has occurred in some sectors (Barnes, 2004).

Quantec Research employment time series data

Any employment estimates in South Africa are fraught with difficulties and should be used with care. This is even more so at the regional level, and stems largely from the historical lack of consistent and comprehensive surveys based on both the enterprise and household populations. Quantec Research constructed an employment database with sectoral and provincial employment time series data (1970 – 2003) using the following sources:

Regional Statistics

- Labour Force Survey (LFS) (2000 – 2003) – Statistics South Africa
- October Household Survey/General Household Survey (OHS/GHS) (1995 – 2003) – Statistics South Africa
- Population Censuses (1970-2001) – Statistics South Africa
- Industry Censuses (various) – Statistics South Africa
- EasyData Standardised Provincial Demographic Database (1970 – 2003) – Quantec Research

National Statistics

- Survey of Employment and Earnings (SEE) (1972 – 2004) – Statistics South Africa
- Development Bank of South Africa (DBSA) Standardised Employment Series – DBSA (discontinued during the late 1990s)
- Manpower Survey – Statistics South Africa and Department of Labour (discontinued in 1996)
- South African Labour Statistics – Statistics South Africa (last published in 1996)
- EasyData Standardised Industry Database – Quantec Research (1970 – 2003)

Statistics South Africa's OHS (annually, 1995 – 1999), the LFS (replacing the OHS and surveyed bi-annually since 2000) and the GHS (replacing the OHS and surveyed annually, 2002 – 2003) are household-based surveys. The current LFS sample size is approximately 30 000 households (0,3% of all households). The actual households included in the samples change over time. The LFS and GHS are therefore not well suited for industry and/or provincial dissemination of employment data with any high degree of confidence. However, it is good at estimating overall employment and unemployment. The LFS and GHS also split employment between formal and informal employment, although the formal and informal employment and unemployment estimates vary considerably over time. Definitional changes also played a role in this.

In contrast to the LFS, the SEE is a quarterly enterprise-based survey covering a sample of approximately 10 200 employers, being both private sector companies and public institutions in the formal non-agricultural sector. Only national employment and earnings statistics are estimated from the survey information. The survey gives a good indication of formal employment by sector. The SEE was revamped during 2002 to cover the service industries comprehensively. The sample for the SEE is designed and drawn from Statistics South Africa's re-engineered Business Sample Frame (BSF), which excludes non-value-added tax (VAT) paying businesses (firms with a turnover smaller than R300 000 per annum and/or unregistered).

Two main shortcomings of the SEE therefore are:

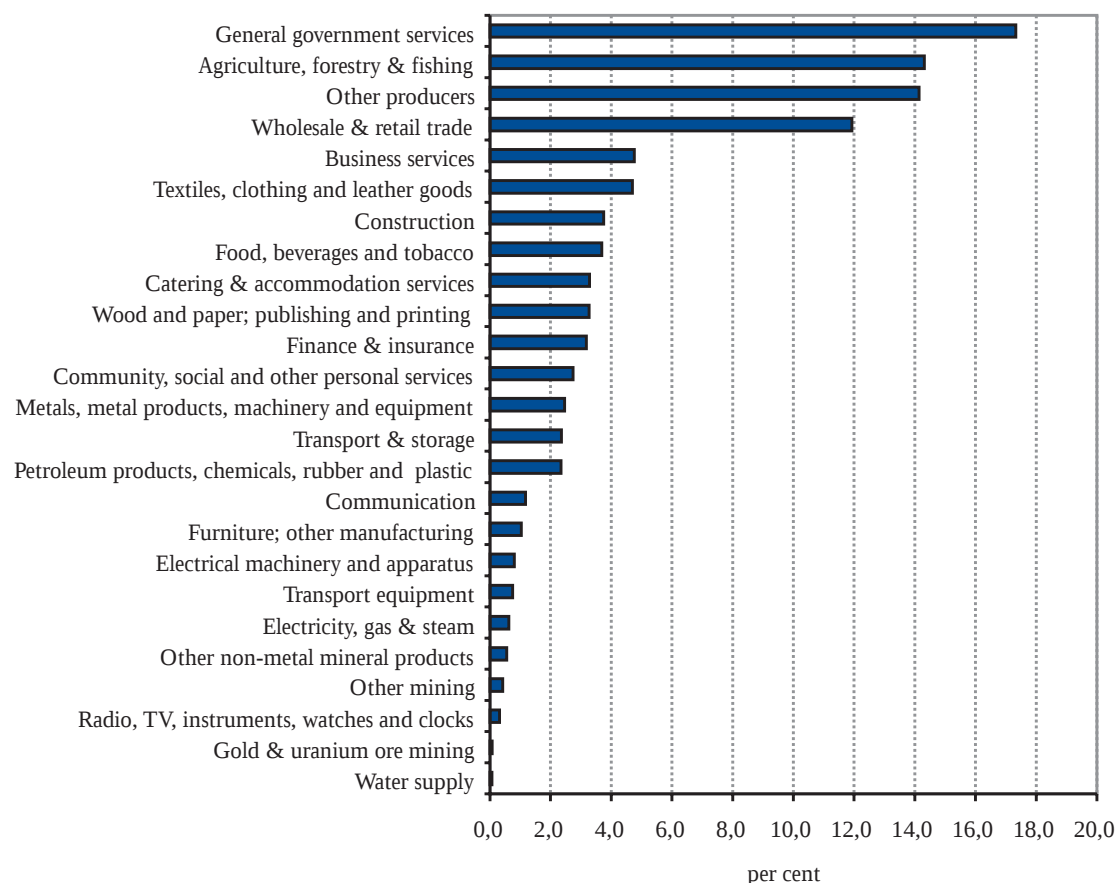
- First, the SEE's coverage is not comprehensive; both the agricultural and informal sectors are not surveyed. In addition, the coverage of the SMME sector is problematic due to the exclusion of non-VAT paying firms. In September 2003, for instance, the gap between the SEE number for formal non-agricultural employment (6,4-million) and the LFS overall employment (11,6-million) is explained by 1,2-million workers in agriculture, one million in domestic service, 1,9-million in the informal sector and 1,1-million employed in sectors/firms not covered by the SEE (SARB Quarterly Bulletin, June 2004, p.13).
- Secondly, major discontinuities exist in the SEE as certain sectors were alternately included and excluded from the survey's coverage. For instance, data before and from the first quarter of 1998 and data before and from the third quarter of 2002 are strictly not comparable. It is possible to circumvent this problem by statistically linking the time series in order to provide continuous (albeit imperfect) employment time series.

Quantec Research attempts to overcome these shortcomings by relying on most of the above sources to estimate regional employment for 26 industries. The various population censuses provide a benchmarking basis for estimating employment, unemployment and the labour force on a regional basis. The regional estimates are benchmarked on the national estimates from the EasyData Standardised Industry Database, which are compatible with the labour remuneration statistics in the national accounts. Regarding the discontinuities in the SEE, Quantec linked the new and old SEE (before the services industries were comprehensively covered) by phasing in the new SEE from 1985 onwards. Previously, the DBSA Standardised Employment Series was used as the basis to give estimates of the service industries.

Regional estimates of industry employment (formal and informal) as well as unemployment should be used as medium-term indicators. Short-term results from the LFS are problematic because of the high levels of variation caused by the sample size and definitional issues (the Western Cape LFS sample is normally based on approximately 4 000 households or 8 000 workers). The analysis regarding employment trends in the accompanying section relied upon the Quantec Research database.

While the data sources tend to be contradictory, it appears that employment growth in the Western Cape occurred in the fast-growing and more skills-intensive services industries and niche manufacturing sectors. In this respect, the Western Cape appears to share the national trend of skills-biased employment creation (Western Cape SER, 2003: 24). Even in the more unskilled and informal labour-intensive internal trade & catering sector (employing one-fifth of the Province's workforce), the share of unskilled workers has tended to decline over the past five years. Nonetheless, the strong growth in the retail and tourism sectors added to job growth in the region and probably softens the skills bias of employment creation in the region.

Figure 17 Sectoral composition of the Western Cape employment, 1999 – 2003



[Source: Quantec Research]

According to the Quantec database, many formal sector jobs were lost in the Western Cape manufacturing sector over the past five years, with jobs contracting at an average annual rate of 3,2 per cent as seen in Figure 17. This compares with an average annual decline in manufacturing employment outside of the Western Cape of only 0,8 per cent per annum. In almost all of the sub-sectors in Western Cape manufacturing, jobs were shed over the past five years.

A particular worrying trend is the large-scale retrenchment that occurred in the Province's largest manufacturing employment sectors, specifically food & beverages (employing around 19% of the regional manufacturing workforce), clothing & textiles (24%) and wood products, printing & publishing (14%)¹². It is possible that these jobs – or at least some of them – were replaced by informal jobs and home industries, such as the case appears to have been in the clothing sector (Barnes, 2004)¹³.

¹²The Quantec database shows that 26 000 jobs were lost in these three sectors over the past five years, or 12,5 per cent of the Western Cape manufacturing workforce.

¹³The Labour Force Survey shows net job growth in the manufacturing sector over the period 2000 to 2003, albeit less robust compared to the other sectors in the Western Cape.

As these three sectors employed 56 per cent of the regional manufacturing workforce in 2003, the employment trend here is likely to have a major bearing on the regional factory employment prospects. This may also help to explain why the region's employment creation has been weaker than nationally, despite the fact that the regional economy grew faster. Furthermore, the region's fast-growing services industries did not create many formal jobs in the process, with the exception of the retail & wholesale and business services sectors.

Table 9 Western Cape: Formal sector employment growth, 1999 – 2003

Sector	1999 %	2000 %	2001 %	2002 %	2003 %	Average 1999 – 2003 %
Primary sectors	-1,5	-1,8	-1,9	-3,8	-1,7	-2,1
Agriculture	-1,5	-1,8	-2,0	-4,1	-1,8	-2,2
Mining	-2,8	0,0	1,2	4,2	2,0	0,9
Secondary sectors	-5,8	-3,3	-3,1	-0,9	-2,8	-3,2
Manufacturing	-3,6	-3,9	-4,7	-1,3	-2,3	-3,2
Electricity & water	-0,1	-8,7	-3,6	-4,0	-4,5	-4,2
Construction	-13,0	-0,7	2,4	0,7	-4,3	-3,0
Tertiary sectors	0,8	-0,8	1,4	3,4	1,2	1,2
Internal trade & catering	5,6	-1,3	0,6	0,2	2,0	1,4
.....Retail & wholesale trade	11,3	0,1	2,1	1,0	1,7	3,2
Transport & communication	-2,4	-4,4	-5,5	0,9	-2,4	-2,7
Financial & business services	-0,5	0,6	5,7	10,2	0,8	3,4
.....Business services	1,6	2,0	8,8	16,5	0,2	5,8
CSP services ¹	4,0	4,1	4,0	4,9	1,9	3,8
Government	-4,5	-5,0	-2,9	-0,8	0,4	-2,6
Total formal employment	-1,2	-1,6	-0,2	1,3	-0,1	-0,4
Informal sector	5,3	3,2	2,1	3,5	3,4	3,5
Total employment	-0,6	-1,1	0,1	1,6	0,2	0,0

¹ Including domestic servants.

[Source: Quantec Research]

The Quantec database also shows strong employment losses in the Province's rapidly growing construction sector, which could also be a case of indirect forms of labour and/or home industries replacing formal employment. The BER's survey evidence in the Western Cape building & construction sector, on the other hand, indicates healthy employment growth in this labour-intensive sector at present.

3.4.2. Outlook, 2005 to 2007

Taking into account the negative trend in formal employment in the Western Cape economy in recent years, the outlook could be viewed as less than promising. The uncertain outlook for the clothing & textile sector is a negative for the Province's employment outlook. Considering the broader negative currency-induced tendency in the Province's manufacturing exports of late, manufacturing job growth could be under pressure. The positive employment trend in the automotive sector (mainly automotive components) is, for instance, at risk.

On the other hand, some sectors appear to be switching production for exports to the local market that is benefiting from the robust domestic spending¹⁷. Export-induced job losses in the food, beverage, furniture and wood products sectors may be limited in this way. These sectors also appear to be better able to stand up to import competition compared to the clothing & textile sector.

The BER's survey evidence in the national manufacturing sector indicates positive growth in factory employment in the food, wood and furniture sectors at present. Should the currency bring some relief, the current positive employment tendency in these industries should strengthen further over the short term¹⁸. The Western Cape is likely to share in this improvement as these industries have a strong presence in the Province. The same goes for the labour-intensive construction sector, which is booming currently and creating jobs (contrary to what the official data indicates).

Furthermore, the outlook for consumer spending is very favourable, and combined with a positive trend in tourist arrivals, the net job growth recorded in the retail & wholesale trade over recent years is likely to strengthen.

There appears to be a clear negative trend in agricultural employment in the Western Cape (as well as nationally), which is likely to persist. Furthermore, adverse climatic conditions have shattered earlier hopes of a better wheat crop in the Western Cape. Employment conditions may be better in the fruit-producing areas, where sustained export growth is proving an important support.

In all, the employment outlook for the Western Cape economy is mixed. Anecdotal (and survey-based) evidence of improvements in some sectors, combined with the favourable general economic outlook, contrasts with the adverse formal sector employment trend over the past number of years. Industry is currently adjusting to the new macroeconomic parameters, more specifically a stronger currency, a lively domestic market and lower and more stable inflation and interest rates.

¹⁴ Firms producing tradeable goods and able to do so (depending on the type of product involved) also switch production to the non-durable goods sector.

¹⁵ Data limitations make it difficult to say whether this represents a turnaround in the adverse structural trend in employment in these industries over recent years.

On balance, prospects may be favourable that the adverse employment trend of recent years will be arrested over the projection period, particularly should fixed investment grow as projected and change from a capital-deepening to the capital-widening kind.

3.5. Western Cape exports: performance and outlook

3.5.1. The past five years

The Western Cape export sector is well diversified, although the agriculture & fishing sector has a disproportionate share (close to one-third) in total exports¹⁶. When food-processing exports are added, this amounted to more than half of total Western Cape exports in 2003. The most important export products within this category are fruit (including processed) at 26 per cent of the total, wine, beer & spirits (13%) and fish (9%).

The Province's mining sector only contributes three per cent to four per cent of total exports. However, when iron & steel exports¹⁷, which have grown rapidly since the advent of Saldanha Steel, are added, the contribution of basic commodities increases to around 12 per cent.

The manufacturing sector accounts for the remainder of total exports. In fact, as food processing and basic metals are officially classified as manufacturing, this sector contributes close to two-thirds of total Western Cape exports. Excluding food processing and basic metals, manufactured exports amounted to 35 per cent of total exports in 2003.

The important manufacturing export products from the region are clothing & textiles (7% of total exports), machinery & equipment (including electrical & telecommunications equipment) (6%), precious & semi-precious stones & jewellery (3,5%), plastic products (2,2%), chemical products (including cosmetics) (2,1%), wood products (1,6%), and hides & leather products (1,4%).

Table 10 shows the 10 largest export products from the Western Cape in 2003, as well as the growth trends. The 10 listed product categories accounted for 75 per cent of total Western Cape exports in 2003, up from 65 per cent in 1996 to 1998, suggesting that the Province's largest export products have been growing at above-average rates.

The growth in the value of total Western Cape exports (excluding services exports and mineral fuels) averaged close to 19 per cent per annum over the period 1996 to 2003. Applying the SARB's non-gold export price deflator, this translates to eight per cent to nine per cent real export growth per annum over the past six to seven years¹⁸.

¹⁶ It needs to be pointed out that excluded from the export statistics discussed here is the foreign exchange earning contribution from services, including tourism, and the exports of engineering and financial services. Furthermore, due to the distorting effect of mineral fuel exports, this product category is also excluded from the analysis.

¹⁷ In terms of the Standard Industrial Classification (SIC), basic metals (including iron & steel) are classified in the manufacturing sector.

¹⁸ Quantec Research estimates a real growth rate of 11,4 per cent per annum over the period 1996 to 2003.

On the same basis, the growth of the 'core' export products listed in Table 10 amounted to 11 per cent per annum. Within this group, the Province's beverage, fish, iron & steel, clothing & textiles, precious stones & jewellery and plastic products exports performed particularly well, growing by more than 10 per cent per annum in real terms. This compares favourably to the real growth of South Africa's total goods exports measuring around five per cent per annum over the corresponding period.

Table 10 Western Cape exports, 1996 – 2003¹

Top 10 Product Categories	1996 Rm	2003 Rm	% Share		% Change			
			1996	2003	1996 – 2003		2002 – 2003	
					nominal	real	nominal	real
1 Fruit & veg (incl. processed)	2 690,0	6 852,7	28,0	25,7	16,9	6,6	8,1	18,5
2 Wine, beer & spirits	752,1	3 333,0	7,8	12,5	28,2	16,9	4,6	14,6
3 Iron & steel and minerals	546,7	2 635,5	5,7	9,9	30,0	18,6	10,7	21,3
4 Fish	697,8	2 311,9	7,3	8,7	22,1	11,4	-4,4	4,7
5 Machinery & appliances	406,5	1 090,3	4,2	4,1	17,9	7,6	-16,8	-8,9
6 Textile products	298,5	1 021,0	3,1	3,8	22,7	12,0	-16,0	-8,0
7 Precious & semi-precious stones & jewellery	228,6	943,8	2,4	3,5	26,7	15,6	-19,3	-11,6
8 Clothing	238,4	768,3	2,5	2,9	21,5	10,9	1,6	11,4
9 Plastic products	170,4	576,2	1,8	2,2	22,5	11,8	-15,6	-7,5
10 Electrical & telecom. machinery & equipment	226,7	564,3	2,4	2,1	16,4	6,2	-5,1	4,0
Total Exports	9 602,4	26 638,9	100,0	100,0	18,5	8,2	-5,8	3,2
..... Total above	6 255,7	20 097,0	65,1	75,4	21,5	10,8	0,2	9,8
..... Total 'non-core'	3 346,7	6 541,8	34,9	24,6	11,8	2,0	-20,6	-13,0

¹ Excluded from the statistics are mineral fuel & armaments exports.

[Source: Wesgro]

Wesgro points out that there are a number of 'non-core' export categories that also grew sharply from a low base in recent years, in particular ships & boats, furniture, chemical products (including cosmetics), wood products, automotive components, tobacco products and paper (Wesgro, 2003: 6).

However, closer inspection of the 2003 export statistics from the region indicates that the export performance deteriorated substantially, as particularly manufacturing exports, including a number of the 'non-core' export categories, came under pressure. The deterioration can be linked to poor world economic growth during the 12 months up to the middle of 2003, as well as the rand's strong appreciation during the year.

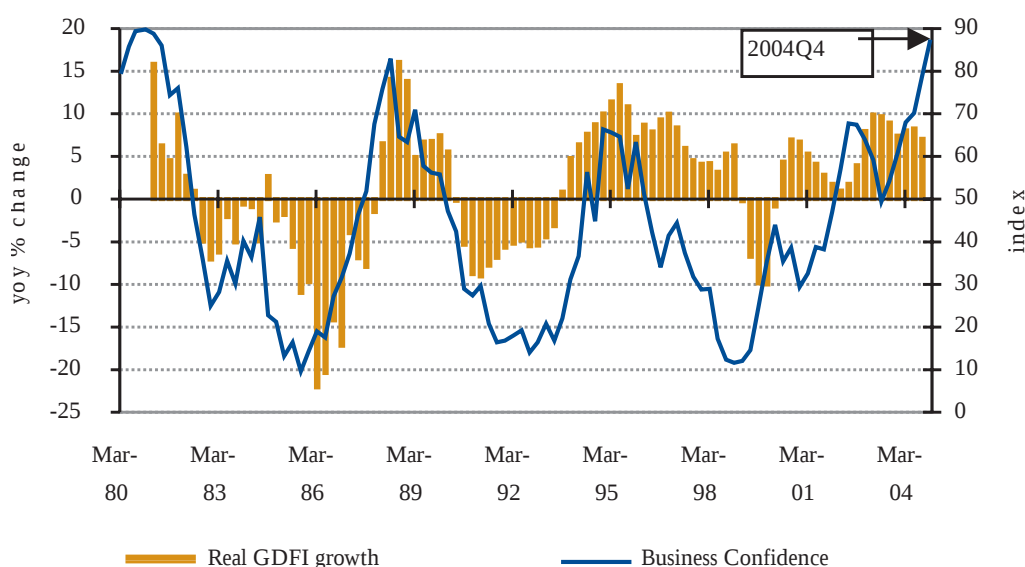
Considering volumes, total Western Cape exports increased by a moderate three per cent to five per cent in 2003 compared to 2002, as the decline in the value of exports (4% to 6%) was less than the decline in the non-gold price deflator (9%)¹⁹.

¹⁹ It is necessary to deflate the value of trade numbers in order to exclude the impact of currency and other price movements from the underlying trade flow.

The positive aggregate growth is mainly attributed to the sustained export growth of the Province's top three export categories – fruit, alcoholic beverages and iron & steel, which continued to register healthy growth of between eight per cent and 10 per cent in value terms. In real terms, growth was much higher (15% to 20%). Fruit and wine exports to the European market were sustained, and improving prices and keen global demand stimulated the region's basic metal exports. This compensated for the decline in the other manufacturing exports.

Excluding basic metals, the real Western Cape manufacturing exports declined by five per cent in 2003. In fact, table 10 shows that the decline in the 'non-core' export categories (including a number of late export bloomers) amounted to 13 per cent. Exports of processed food, textile products, machinery & equipment, automotive components and boat building, precious stones & jewellery and plastic products declined sharply. Clothing is an exception, with the volume of clothing exports continuing to increase at a rate similar to that achieved during the preceding five years. It is likely that the AGOA compensated for the impact of the strong rand on the clothing sector²⁰.

Figure 18 Manufacturing export volumes (BER survey), 1980 – 2004



[Source: BER]

It is possible that the weakening trend in the rand exchange rate over the period 1996 to 2002 assisted many of these exporters entering the world markets and who are currently finding the going tough at the strong levels of the rand exchange rate. The implication is that the sectors with well-established markets overseas might be able to survive the strength of the rand; however, those companies that ventured onto the world markets afforded by the weak rand may be faced with more permanent problems.

²⁰ The Western Cape clothing sector has a large export exposure to the US market (R230-million in 2002).

This has adverse implications for the region's export outlook. Export capacity may be lost in the process. It is not clear that any shelved export capacity will be revived, even in the event of an adjustment in the exchange rate over the short term. The BER's manufacturing survey in the Western Cape indicates that exports remained under pressure throughout 2004 (*see Figure 18*).

3.5.2. Outlook, 2005 to 2007

The global economic outlook is favourable; however, the strength of the rand exchange rate has prevented Western Cape exporters to benefit fully from the favourable global economic conditions. Regarding specific export markets, the following issues are of note:

- Real economic growth in the Western Cape's main export market, the Euro area, remains moderate. Consumer spending is particularly under pressure due to high unemployment levels in the region. While an improvement is underway and expected to continue, it is likely to lag that in the rest of the world.
- The European market absorbs 50 per cent of Western Cape exports (Wesgro, 2003: 7)²¹. However, as the 2003 export statistics reveal, exports to these well-established markets continued to grow and could survive the impact of the strong rand exchange rate – exports to Europe are known to be less price sensitive. The South Africa-EU Free Trade Agreement (SA-EU FTA) is likely to be a compensating factor. Furthermore, export potential to the accession EU countries (Poland, Bulgaria, Czech Republic, Slovenia and Estonia, to name but a few) is promising. The Western Cape's export exposure to these countries is small at this stage (Wesgro, 2003: 12).
- A positive factor in terms of the export outlook is the increasing diversification of the Western Cape's export market (Wesgro, 2003: 9-10). Exports to countries such as China, Nigeria and Mauritius have grown strongly from a low base in recent years. The short-term outlook for the SSA region is the best in years, which should stimulate Western Cape exports to the region.
- On the negative side, the Multi-Fibre Agreement (regulating international trade in clothing and textile products) expired at the beginning of 2005, which implies that the quotas, which effectively restricted large and low-cost producers such as China and India's exports of clothing and textile products to the major industrial countries, will come to an end.
- It is specifically expected that China will capture a large share of this market to the detriment of clothing and textile exporters in Africa and elsewhere. The AGOA is not expected to compensate, as China is likely to become the preferred supplier of apparel to the large US buyers.
- This is likely to be a significant negative factor for the domestic clothing & textile sector, although the Western Cape clothing industry could be less exposed than Gauteng and KwaZulu-Natal due to a lower export propensity and a different (more upmarket) focus. Nonetheless, it is evident that the Western Cape clothing & textile sector is confronted by the dual threat of an overvalued currency and import and

²¹ According to Wesgro, the UK, Netherlands, Belgium, Germany, Italy and Spain are the most important European trading partners. The most important export products to the region are fruit, wine, beer & spirits, processed foods and iron & steel.

export competition due to the changing clothing & textile international trade dispensation.

- A stronger than expected rand exchange rate could have a negative bearing on Western Cape industry. While the Western Cape is not well positioned to benefit from the commodity-intensive growth of the Chinese economy (apart from Saldanha Steel), favourable industrial commodity prices, driven by Chinese demand, could lead to a stronger rand exchange rate. There is a strong historical link between commodity prices and changes in the rand exchange rate. An uncompetitive currency, in turn, could impact negatively on Western Cape tourism, manufacturing (including clothing & textiles and metals processing) and agriculture.

The Western Cape region's export outlook therefore has to be qualified. The outlook for the Province's agro-industrial exports is positive, and this sector may survive the impact of the strong rand as markets are well established and not price sensitive. Although European economic growth is lagging that in the rest of the world, the SA-EU FTA could compensate, and new opportunities may be opening up in the accession EU countries and other regions. Exports of basic metals and other minerals from the Province should also fare well in view of strong global demand and favourable commodity prices.

On the other hand, the outlook for the Province's remaining manufacturing exports hinges on the outlook for the exchange rate. Should the rand exchange rate adjust closer to a 'fairer value' over the short term, as is expected (say R7,00/US\$ at the end of 2005), export growth should recover from 2003's slump (also if we assume that export capacity has not been lost permanently).

However, in the event of a stronger than expected rand exchange rate, prospects for the region's manufacturing exports may be less promising. While one should allow for some adjustment on the part of Western Cape manufacturers to adapt to the level of the currency, the recent export performance reveals that firms simply fail to compete at the current over-valued level of the exchange rate, particularly in the clothing & textile, machinery & equipment and other smaller ('non-core') sectors.

4. Conclusion

The Western Cape's agricultural and manufacturing sectors were hard hit by the strengthening rand exchange rate and adverse climatic conditions, which led to a deceleration of real economic growth from 4,6 per cent in 2002 to 3,2 per cent in 2003. The regional employment conditions also deteriorated as a result, but an improving tendency was observable since 2000.

However, GDPR growth still came in above the national average for 2003 (2,8%) as the region's services industries grew strongly, outperforming their national counterparts. A recovery is currently underway in the agricultural and manufacturing sectors, although constrained by the persisting strength of the rand and dry climatic conditions.

As a result, the margin of the region's economic out-performance (0,8% per annum over the period 1999 to 2003) shrunk. Real GDPR growth in calendar year 2004 is therefore estimated at 3,9 per cent – only 0,2 per cent above the national average.

In all, Western Cape real GDPR growth averaged higher compared to that of South Africa over the period 1999 to 2003. It is likely that this national out-performance will continue over the short term; however, this could be a function of where the exchange rate is headed and/or local industry's adaptation to the changed macroeconomic parameters. The following aspects include some of the more salient features of the region's economic performance:

- The Western Cape economy is well represented in the nationally faster growing services industries, such as financial & business services, transport & communication and retail trade & catering. The booming tourism industry has been part and parcel of the growth story. The regional construction and property development sector has also outperformed the remainder of the national sector by a wide margin, partly tied to the healthy 'retirement sector' in the region. The short-term outlook for these sectors is favourable.
- The regional economy also has strong linkages with the rest of the country, particularly in respect of financial & business services and parts of manufacturing. The higher end of the South African consumer market is growing strongly and general South African economic prospects are the best in a long time. National real GDP growth is projected to reach 4,1 per cent in 2006.
- A number of niche manufacturing and services industries, which have shown strong growth and/or potential, have emerged in the Western Cape. It is expected that these industries will continue to perform well given the required policy support.
- The region's exports have also grown strongly over the past number of years, with the established export sectors performing well, even in the face of the strong rand exchange rate in 2003 and 2004. The Province's coastal location has been a strong positive with the country's re-entry into the world economy over the 1990s. However,

it is evident that some export-oriented manufacturing industries, particularly those manufacturing 'non-core' export products, have suffered a strong negative impact from the rand's appreciation during 2003 and 2004. In this respect, the export outlook needs to be qualified.

- On the downside, the region's overall manufacturing performance has been disappointing, albeit remaining one of the largest sectors. The clothing & textile sector failed to grow over the past five years, the food, beverages & tobacco sector has added little to cumulative growth, and some other sub-sectors performed worse than their national peers, in particular wood & paper and printing & publishing. Problems were compounded by the strength of the rand. Likewise, the agricultural sector added little to cumulative growth, and also contracted sharply in 2004 due to adverse climatic conditions which persisted in 2004.

In all, the Western Cape economy is recovering from the headwinds experienced in 2003 and 2004. While business tends to adjust to the strong rand, the direction of the exchange rate could be an important determinant of the regional economic performance. A strong currency benefits the non-tradeable goods sectors and disadvantages the tradeable goods sectors.

Western Cape business confidence jumped sharply at the end of 2004, catching up with the rest of the country. The outlook for fixed investment and employment creation is positive following years of capital-deepening investment and formal sector retrenchment of workers. The challenge is to develop downstream and niche manufacturing and services industries which have more potential to create jobs.

The positive employment trend in the retail, tourism and business services sectors is likely to persist and this needs to be supported. With improved formal sector job growth, the chances are maximised to alleviate poverty in the Province in the medium term beyond Government's social welfare and infrastructure development spending.

Table 11 Summary of Western Cape's Economic Outlook 2005/06 – 2007/08¹

	2003/04	2004/05est	2005/06F	2006/07F	2007/08F	Ave2005/06 -2007/08
GDPR (R-billion, current market prices)	185,4	203,0	222,5	244,4	263,4	-
Real GDPR growth (%)	3,3	4,1	4,3	4,0	3,9	4,1
Primary sector	-6,0	1,7	2,5	2,2	1,7	2,1
Secondary sector	-0,2	3,8	4,5	3,7	3,2	3,8
Tertiary sector	5,4	4,4	4,8	4,5	4,5	4,6
GDPR inflation (%)	6,3	5,3	5,1	5,7	3,8	4,8
Western Cape CPI inflation (%)	4,6	2,3	4,5	5,5	3,7	4,6

¹ Fiscal years ending 31 March.

[Source: BER]

Sectoral Growth and Employment Prospects

1. Introduction

Formulating a realistic, forward-looking global, national or regional economic outlook requires robust insight into the key factors that drive economic performance, how these factors are likely to change and how they may be influenced by government action.

An important dimension of any national or regional development path is its sectoral nature. How much economic activity is concentrated in, for example, agriculture and related activities? This has important implications for the nature of employment, and the links to the livelihoods of local communities.

The Western Cape presents a mixed picture in this regard. While overall performance in the Province has been unsatisfactory, it has outperformed South Africa as a whole in recent years in value-added terms – largely due to the contribution of service sectors. But, these sectors have not been creating jobs. This means that workers, and their families and communities have not benefited from higher growth of the Province in recent years.

While tourism is undoubtedly an ‘engine’ for the Provincial economy, and there are opportunities in areas such as call centres, the Province has important strengths that need to be developed in industry and agriculture with broad-based employment potential. This in turn will stimulate activity in transport, communications, finance and construction.

Building productive capabilities across economic sectors is a key theme of this chapter. This requires upgrading skills across the labour force through the Province’s Human Resource Development Strategy (HRDS) and the National Skills Development Framework. It means improving the technological capabilities of firms through the national technology

and research and development (R&D) strategies. It calls the Province to draw on its strengths in tertiary institutions and apply knowledge, learning and technical excellence to the practical tasks of upgrading firms' capabilities, innovating and expanding new economic activity.

As mentioned in chapter 2, the Western Cape is open in respect of its marked integration into the international economy. This presents both opportunities and challenges. Trade flows reveal many industries are taking advantage of the possibilities through increased exports. Riding the globalisation wave requires that we preen our competitive advantage in international markets by developing strategic relations in areas such as design, R&D, technology and production operations.

This is the high road that will place Western Cape firms and industries in a stronger position to compete in the global marketplace. But it also means that the Province should move away from focused competition in respect of labour costs. Low-wage economies such as India and China are able to export labour-intensive products, such as low value-added clothing, at low prices, undercutting domestic producers, as their main input cost – wages – is much lower.

More particularly, the Province does not advocate wage reductions to match the input costs of such competitors. Instead, a strategic repositioning a restructuring of the Western Cape economy requires that the Province's firms ensure improved competitiveness in the new global sector.

Lessons from industrialising countries and regions indicate that government plays a crucial role in strategic repositioning by anticipating future developments together with local economic stakeholders, and co-ordinating the actions of local institutions to meet the dynamic needs of the global customer.

Yet economic development roles and responsibilities are not yet clarified in South Africa's evolving intergovernmental system. This chapter rises the debate on *provincial or regional developmental responsibilities*, identifying provincial economic sector opportunities and challenges, and going some way to opening the debate in respect of intergovernmental engagement on economic growth and development.

Offering an initial definition of provincial development responsibilities, the chapter moves on to outline sectoral growth and employment trends, opportunities and challenges for the Western Cape, drawing from research commissioned in respect of the Province's Microeconomic Development Strategy (MEDS) and additional data analysis of cross-sectoral trends in output, value-added contribution, trade and employment.

The following section then draws on a range of recent MEDS research to analyse the performance of key sectors in more detail. Using this analysis enables us to identify the

main drivers of provincial economic performance. This provides a foundation for identifying the key policy challenges facing Provincial Government, the response to which is discussed in greater detail in chapter 6.

2. A Provincial Role in Economic Development

Sector development goes straight to the heart of contested terrain in respect of economic development. Yet, what is sector or economic development facilitation and why is it contested at all, given the immensity of the broader social and economic development challenges that face South Africa?

Interestingly, looking to the international stage, economic development facilitation finds itself at the centre of intergovernmental debate in developing and developed countries across the world. What is the interplay between national, provincial (regional) and local government in this respect? Does each sphere have a unique, distinctive role? Do the different spheres engage, co-ordinate their actions and lever synergies in a single drive towards shared growth and development?

A broader perspective of economic development challenges the very interaction, cohesion and performance within any co-operative intergovernmental system. Most importantly, delivery depends on the whole rather than on the sum of the parts.

Closer to home, South Africa's first decade of democracy has seen the intergovernmental landscape slowly changing, maturing noticeably along the way. Introducing a unitary state with a decentralised flavour – nine provinces and 284 local municipalities – the first 10 years saw significant political consolidation. More specifically, overarching macroeconomic imbalances and concerns led national government to centralise economic development responsibilities, focusing singularly on macroeconomic reform, in particular prioritising the strengthening of fiscal discipline and market liberalisation.

For the most part, Provincial and Local Government were new or revamped entities that faced enormous challenges, first and foremost of which included structural and administrative redesign to respond to the social and basic service needs of democratic South Africa.

Economic development was therefore not yet within their viewfinder. At the time, their vision, capacities and energies focused most appropriately on social and basic service delivery.

Ten years on, South Africa's democratic governance gains are many and well documented. Looking ahead, the time is right now to advance debate on co-operative response to economic development challenges so that we may maximise future development gains in a shared and equitable way.

In a snapshot, macroeconomic stability has been achieved, and social and basic service delivery is on its way to a measure of cohesiveness. But at the intergovernmental level economic development is not quite streamlined or seamless, given limited debate and engagement on roles and responsibilities.

After 2000 it was clear that macroeconomic reform alone was not sufficient to mobilise higher levels of investment and spur economic growth and development in line with national policy objectives. In his 2002 State of the Nation Address, President Thabo Mbeki proposed a new direction to economic policy – an integrated action plan that, using macroeconomic stability as its foundation and springboard, was directed towards overcoming microeconomic constraints to growth.

Broadly, the Microeconomic Reform Strategy aims to enhance economic growth and job creation, reduce income inequality and promote a more even spread of economic activity. Its focus is three-fold:

- Targeting growth sectors in collaboration with other key players, including parastatals, provincial and local governments;
- Addressing cross-cutting areas of concern, including technology development and transfer, infrastructure development, improved access to finance and human resource development; and
- Improving the performance of key input sectors – transport, telecommunication and energy – which are key drivers in themselves of accelerated development.

Initially, national government identified five key growth sectors – exports, tourism, agriculture, ICT and cultural industries – on the basis of their potential for increased output, exports and employment.

These sectors were detailed further in the national Department of Trade and Industry's (**the dti's**) Integrated Manufacturing Strategy (IMS) released in 2002. The latter identified eight priority sectors for targeted facilitation and support – automotive & transport, clothing & textiles, agro-processing, metals & minerals, tourism, crafts, chemicals & biotechnology, and knowledge-intensive services. Since then three industries – aerospace, call centres and back-office operations – have been added.

The IMS is a broad, overarching industrial and sector policy strategy. It draws attention to the dwindling of South Africa's natural competitiveness in respect of cheap raw materials and energy. It highlights that protected markets are of the past. It focuses on building value-chains of related activities that cross sector boundaries. It stresses the importance of knowledge-intensive activities in enhancing a competitive edge in a rapidly globalising marketplace. It does not yet go as far as providing a detailed map for each sector, although a few sectors, notably auto and auto components, are significantly advanced in this regard.

While there is considerable movement at a national level in developing these sector strategies and developing sector-specific incentives, there is little discussion on roles and

responsibilities of collaborative players, in particular, provincial and local government (DEDAT, 2005: 28-32).

National strategies are exactly that – national, overarching development frameworks. Positioned at a higher, more aggregated level, their implementation on the ground needs to take into account regional differences, local implementation capacities, and provincial and local economic development strategies. The latter are necessary for effective implementation, but they too are not sufficient on their own.

Equally, provincial and local strategies should be developed under the broad rubric of national frameworks, ensuring cohesiveness, direction and co-ordination. This means that provinces need to ensure that national sector policies are appropriately adapted, generally known to local players, and effectively implemented at the local level.

An effective economic development strategy therefore demands government actions along a continuum within the co-operative intergovernmental system.

So a first play at economic development positioning places National Government at the macroeconomic level, providing overarching economic development guidance, incentives and support that defines broad parameters for cohesive engagement.

On the ground, Local Government is the ‘mover’, the ‘shaker’, and the ‘implementer’. Economic development happens at the local level, engaging people in economic activity in a real sense. Local Government therefore has a key role in economic development implementation.

National and local are drawn together through the actions of a ‘weaver’ that, at a *meso-economic level*, focuses on *connectivity and integration* and less on provision or implementation. Provinces occupy this dynamic meso-space, linking macro frameworks, institutions and interventions to local economic development.

A key element that is under-emphasised is the role of provinces in collecting *local knowledge* and in *representing* local needs.

A unique and stimulating responsibility, it spans activities that draw dissonant or fragmented pieces and/or players together. It catalyses, energises and synergises. It enhances and leverages. It lobbies key players at all levels. Most importantly, it facilitates economic development at the regional level, taking account of regional dimensions, peculiarities and preferences, and enhancing provincial economic growth and development over the medium to long term. Where necessary, provinces should design appropriate provincial interventions that stimulate broad-based economic activity and raise levels of economic participation.

Focusing at the industry and sector level, this is the realm of the Western Cape's MEDS, the overall goal of which is to guide the Province's actions to enhance, guide and support private sector activity in the Western Cape. This requires that the Province identify and respond to global and nation economy-wide as well as sector and industry-specific opportunities and challenges.

Many shifts in the sector make-up of the Provincial economy happened in response to global events or movements over which neither National nor Provincial Government has any leverage. Economic change, however, does not benefit all in equal proportions. There are winners and there are losers. The key challenge of the Province's MEDS is therefore to encourage, guide and support priority sectors to facilitate a better fit between what the Provincial economy has to offer and what global and domestic markets demand.

In the main, support should be targeted at industries or sectors that are likely to benefit from future global economic movements. This means identifying key growth sectors in the Province on the basis of employment as well as growth considerations. More detailed sector analysis allows the Province to identify useful 'meso-level' interventions in growth sectors that take account of global trends, technology transfer, and changes in exports and imports. The aim is to enhance the level of private sector activity and job creation in the Province, thereby stimulating shared growth and development over the medium to long term (DEDAT, 2005: 2).

3. A Broad Overview of Sector Development

Chapter 2 provides a succinct and robust review of the Western Cape's sector economic performance in its backdrop to the Province's economic outlook for 2005/06 to 2007/08, the detail of which is not repeated here.

This chapter takes a different tack, using sector trends analysis over the eight-year period 1995 to 2003 to develop strategic insight into sector trends and movements. Chapter 2 uses data in respect of a snapshot picture of the Provincial economy in 2003 and analyses trends in respect of the five-year period 1999 to 2003. The longer-term trends give a better picture of inter-sectoral shifts and industry restructuring.

Taking a broad sector sweep, the most important characteristic of the Western Cape economy is its broad base and diversity of base sectors as well as up-and-coming or promising sub-sectors, industries or 'niches'. The Province's four core sectors – agriculture, manufacturing, trade and financial & business services – are each well diversified, reducing the risk of over-dependence on any single industry or sub-sector.

In addition, the region has a well-developed tourism sector, and reasonably strong and dynamic construction, fishing, professional services, higher education and transport

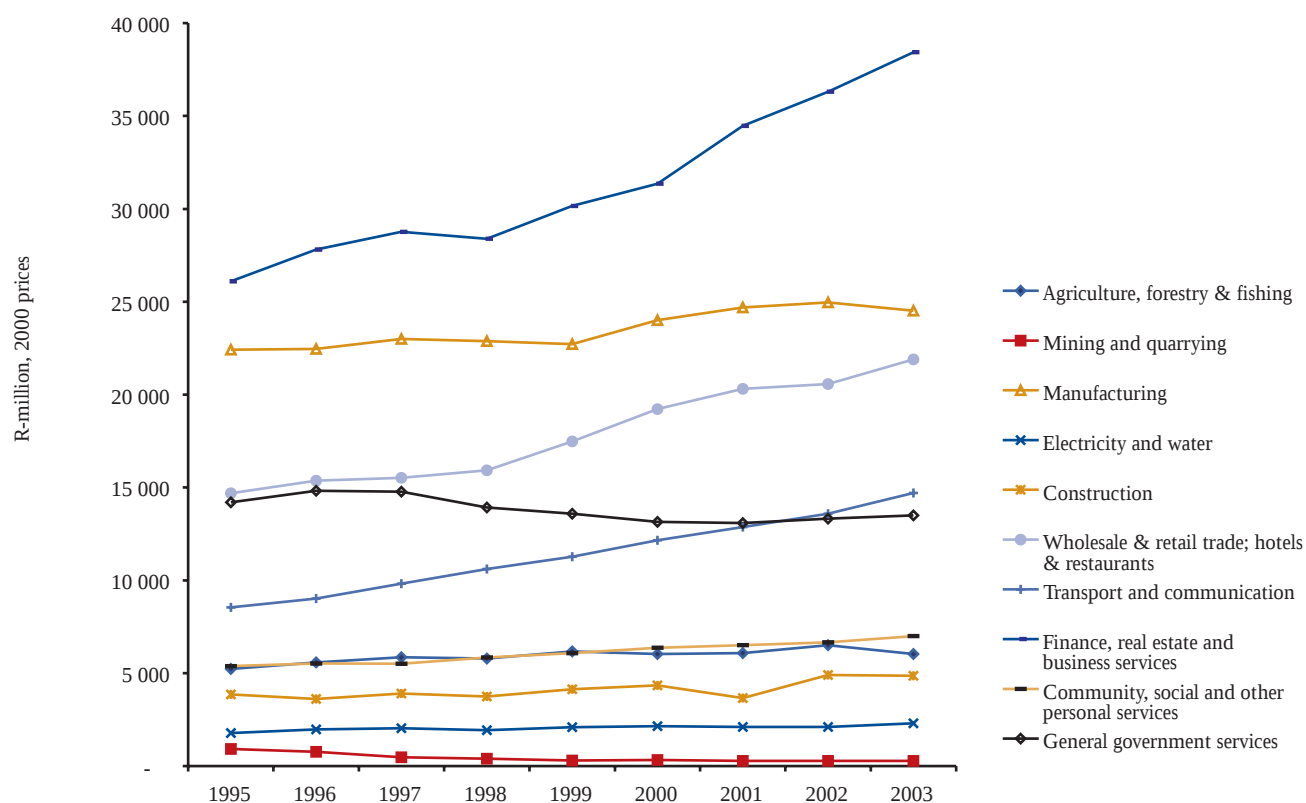
sectors. A small mining base is mitigated by Saldanha's emergence as a major export harbour for minerals as well as a key base for the iron and steel industry.

Apart from Saldanha and Namakwa Sands, there is limited mining activity and capital-intensive mineral processing, as well as attendant heavy industry. This accentuates the dominance of small and medium-sized enterprises in the Western Cape economy, and is likely also to contribute towards the shift to a service economy (DEDAT, 2005).

This means that Western Cape sector patterns are quite different from those at national level, although overall output and employment trends over time have been similar. Between 1995 and 2003, the strongest average annual output growth rates in the Province have been recorded in transport & communications (7,0%), wholesale & retail trade and hotels (5,2%), and financial & business services (5,0%). These are detailed graphically in Figure 1.

In the first two of these sectors, Provincial performance has outstripped national performance. This suggests the increased importance of *tertiary services*, as might be expected from a relatively developed economy. However, the employment performance is much poorer, and the disaggregated picture shows very different patterns across different sub-sectors of services.

Figure 1 Western Cape sector contribution to GDPR, 1995 – 2003



[Source: Quantec Research]

In the *secondary sector*, the performance of *manufacturing* has been very disappointing, with an average growth of just half the national performance of 2,2 per cent per annum since 1995.

Trade liberalisation and increased integration into the international economy would be expected to favour coastal locations such as the Western Cape. But the potential gains from these developments do not appear to have been realised in the Province. This suggests that a careful evaluation is needed of constraints to firms' performance and competitiveness.

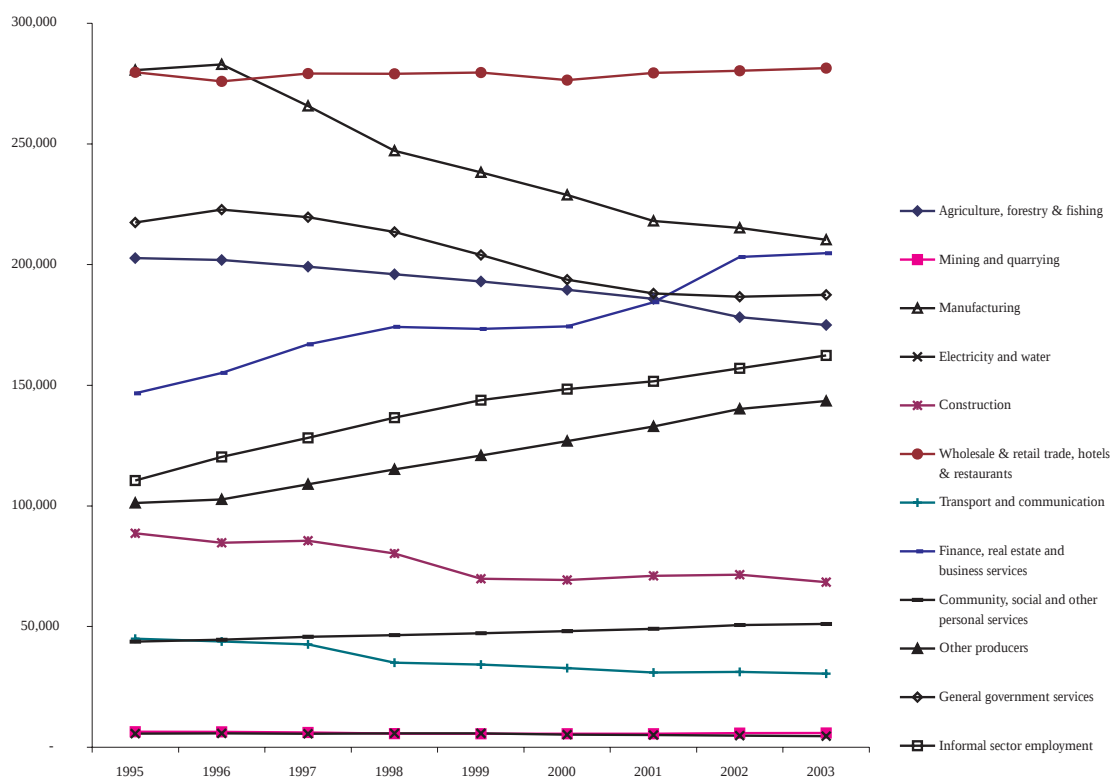
Similarly, in the *primary sector* the performance of *agriculture, forestry & fishing* in the Western Cape, with an average annual growth rate of 1,9 per cent since 1995, is also much poorer than the national growth rate of 3,5 per cent. Closer evaluation of sub-sectors reveals that the data do not reflect recent developments in the Province and that a generally low average performance hides significant growth and development in a number of areas.

More specifically, there has been increased activity across a diverse range of agricultural activity, as well as increased output and employment in fishing and mariculture.

As noted in chapter 2, the picture in terms of *employment* is much more worrying. The most dramatic development has been the decline in manufacturing employment from 1996 (-3,5% average annual growth between 1995 to 2003), while employment has increased rapidly in financial & business services (4,3%), the informal sector (4,9%) and 'other producers' (including domestic workers) (4,5%).

Comprising 18 per cent of total Provincial employment, the broad wholesale & retail trade, hotels & restaurants sector is now by far the largest employer, but it is surprising that this sector has not registered significant net employment creation (only 0,1% per annum over the period) given the output growth of this sector (5,2%). The decline in employment in transport & communication (-4,6%) is also quite out of line with the output performance. An increase in atypical forms of employment and the contracting out of service provision are possible factors here.

Figure 2 Western Cape sector employment, 1995 – 2003



[Source: Quantec Research]

The Western Cape differs markedly from the national picture in employment. Nationally, informal employment has been the largest grouping throughout the period, with a share of 27,9 per cent in 2003 compared to a share of just 11,1 per cent in the Western Cape.

While manufacturing employment has declined in South Africa as a whole (at -1,6% per annum on average), it is at a much lower rate than the decline in the Province (of -3,5% per annum). These comparisons show a shift in emphasis to the areas of services in which the Western Cape has led the country, and away from manufacturing. As will be explored in more detail below, different sub-sectors of manufacturing perform quite differently, and generalisations can be misleading.

Of perhaps even greater concern is that there is little indication of increased *employment* resulting from tourism and transport & telecommunications, either in the Province or nationally. Financial & business services have recorded strong employment growth at both the Provincial (4,3%) and national level (5,6%, due mainly to business services).

Data problems, and needs

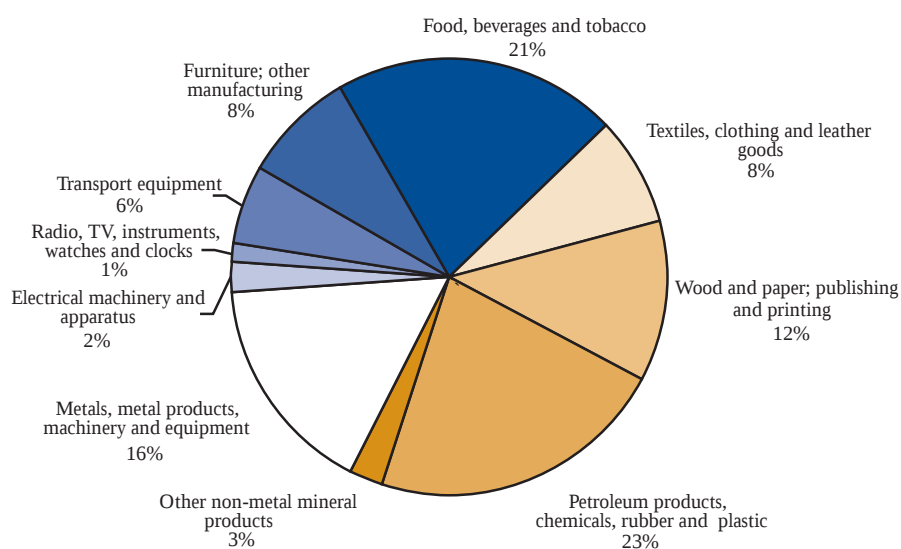
Critical to economic policy and implementation is the ability to collect information and undertake analysis. Such analysis enables Government to understand the Provincial economy and to anticipate economic outcomes under different scenarios and policy choices. This relies on economic data at a provincial level. Unfortunately, the available data is not always reliable when examined at the provincial level, due to considerations such as the size of the samples used and changes occurring in the economy, for example, the increasing importance of ICT which is not picked up, as well as the more traditional industries.

This increases the importance of local research and information gathering to ensure that Provincial Government has a well-founded basis from which to make decisions. It also increases the importance of being responsive to stakeholders, in particular, those who do not have the loudest voices.

3.1. Manufacturing

Focusing on the performance of manufacturing in the Western Cape reveals that, in comparison with the national economy, industry in the Province is oriented towards food & beverages (a 21% share), clothing & textiles (8%), and wood, paper & publishing (12%), which together account for 41 per cent of output (measured as value-added). By comparison, metals & machinery and transport equipment are much less important in the Province (16%) than they are nationally (21%) (see Figure 3).

Figure 3a Shares of sectors in manufacturing value-added, 2003: Western Cape



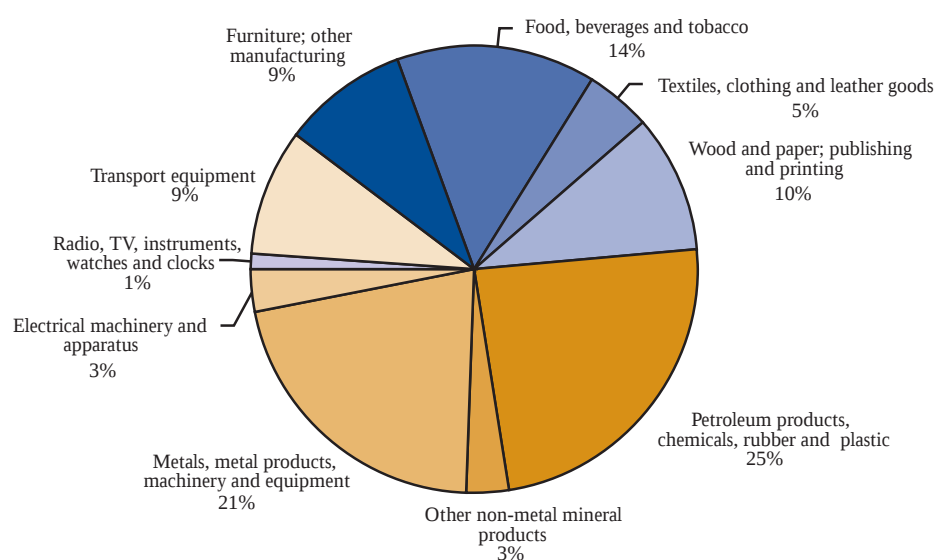
Source: Quantec Research]

However, the sectors in which the Province is relatively under-represented have been performing better. Figure 4 shows that over the eight-year period 1995 to 2003, relatively strong average annual growth of output was recorded for transport equipment (7,4%); petroleum, chemicals & plastics (4,3%); electrical machinery (3,7%); and metals & machinery (3,3%). And in transport equipment and electrical machinery, the Province has far out-performed the national economy, which recorded output growth of 3,2 per cent for transport equipment and 2,4 per cent for electrical machinery.

But food & beverages (at -0,4% per annum); non-metallic minerals (-5,9%); radio & TV (-4,6%); clothing & textiles (0,2%); and wood, paper & publishing (-1,4%) have either stagnated or recorded contractions in output, and have generally performed more poorly than the national economy over the period.

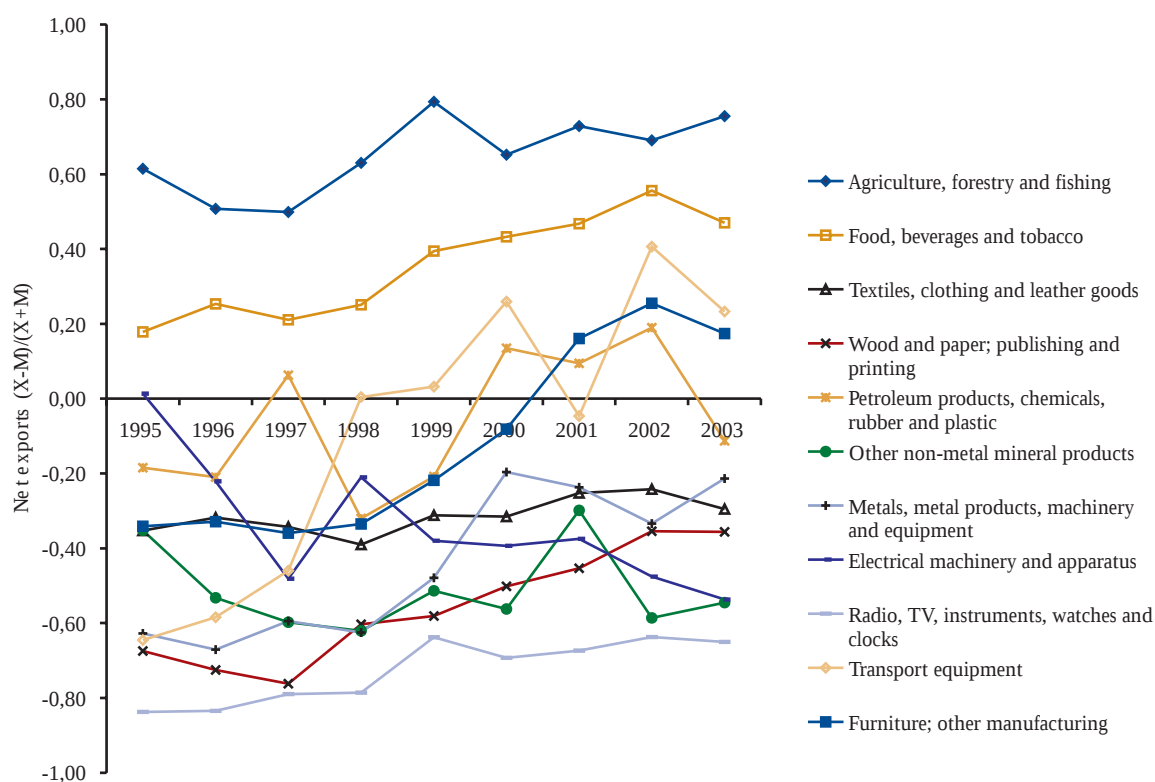
Figure 5 shows that all manufacturing sectors in the Province had lower employment in 2003 than in 1995, except for transport equipment (3,2% average annual growth) (which has grown from a very small base, and furniture & other manufacturing (1,1%). The biggest proportionate declines were in electrical machinery (-11,9% per annum) and other non-metallic minerals (which includes cement and brick-making) (-10,3%). The biggest absolute job losses were in the largest sector of clothing, textiles & leather (23 737 net jobs), closely followed by food, beverages & tobacco (18 321 net jobs).

Figure 3b Shares of sectors in manufacturing value-added, 2003: South Africa



[Source: Quantech Research]

Figure 4 Western Cape manufacturing value-added, 1995 – 2003



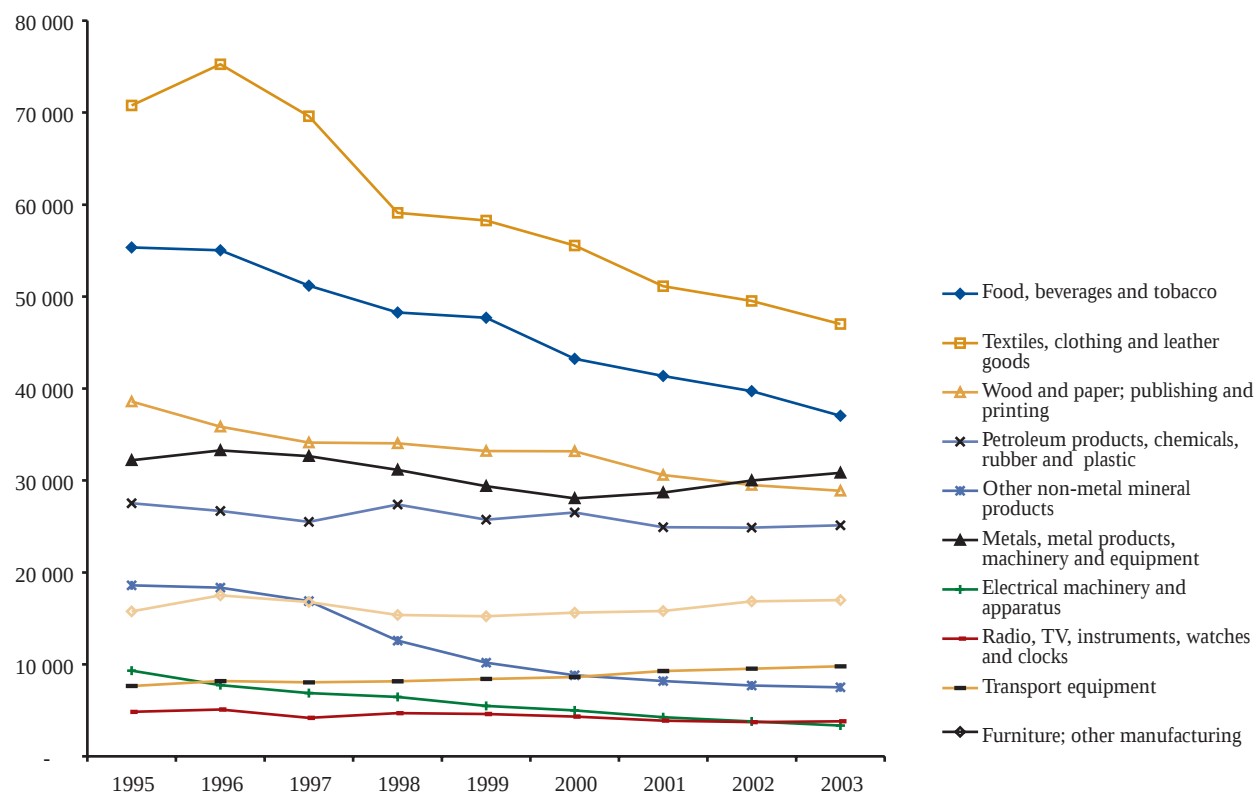
[Source: Quantec Research]

In the last three years, the metals and machinery sector has shown signs of growth (3,2% growth per annum from 2000). This sector is linked to important areas of potential. Similarly, positive growth in employment in transport equipment in the Province reflects capabilities in auto components and in yacht- & ship-building.

Of more concern is that the Province's performance is generally much poorer than that of the country as a whole. In addition, while nationally the wood, paper & publishing and the petroleum & chemicals sectors have recorded employment growth from 2001 to 2003 of 0,7 per cent and 1,5 per cent per annum respectively, employment in the Province overall has continued to stagnate.

Growth at national level in these broad groupings relates to the narrower sub-groupings of wood products (due mainly to increased processing of forestry products) and plastic products. Plastic product manufacture is both labour intensive and experiencing higher than average employment growth (of 2,1% per annum) at the national level, as plastic products increasingly replace other materials. The Western Cape needs to ensure that it benefits from these developments.

Figure 5 Western Cape manufacturing employment, 1995 – 2003

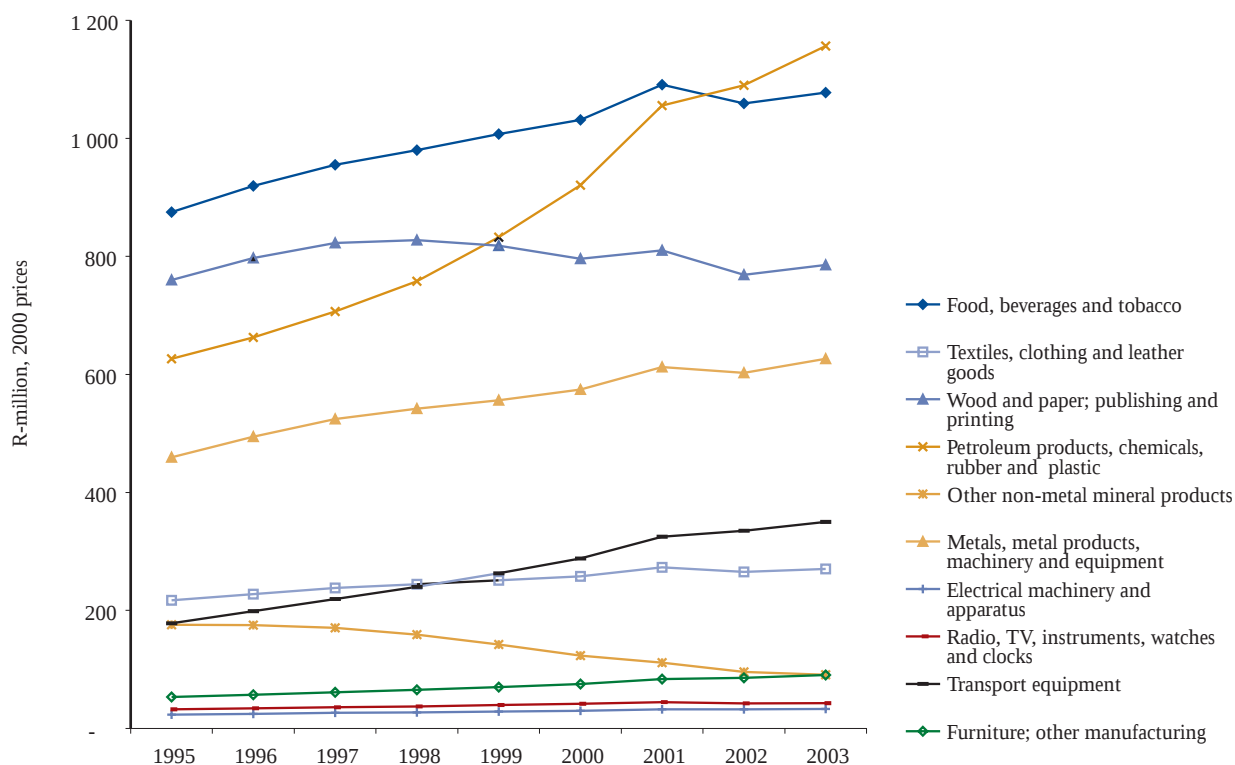


[Source: Quantec Research]

Figure 6 indicates that while manufacturing firms have not increased employment, they have increased investment. Particularly strong increases in investment in the Province have occurred in petroleum, chemicals, rubber & plastic products (8,0% per annum), as well as in transport equipment (8,9% per annum).

For firms to be able to compete internationally and to expand and grow employment, it is important that they increase their productive capacity and upgrade equipment. Recent performance suggests that this is especially the case for employment growth in more labour-intensive sectors. But in very capital-intensive sectors, such as basic chemicals and basic iron & steel, increased investment has coincided with large reductions in employment.

Figure 6 Western Cape gross manufacturing domestic fixed investment, 1995 – 2003



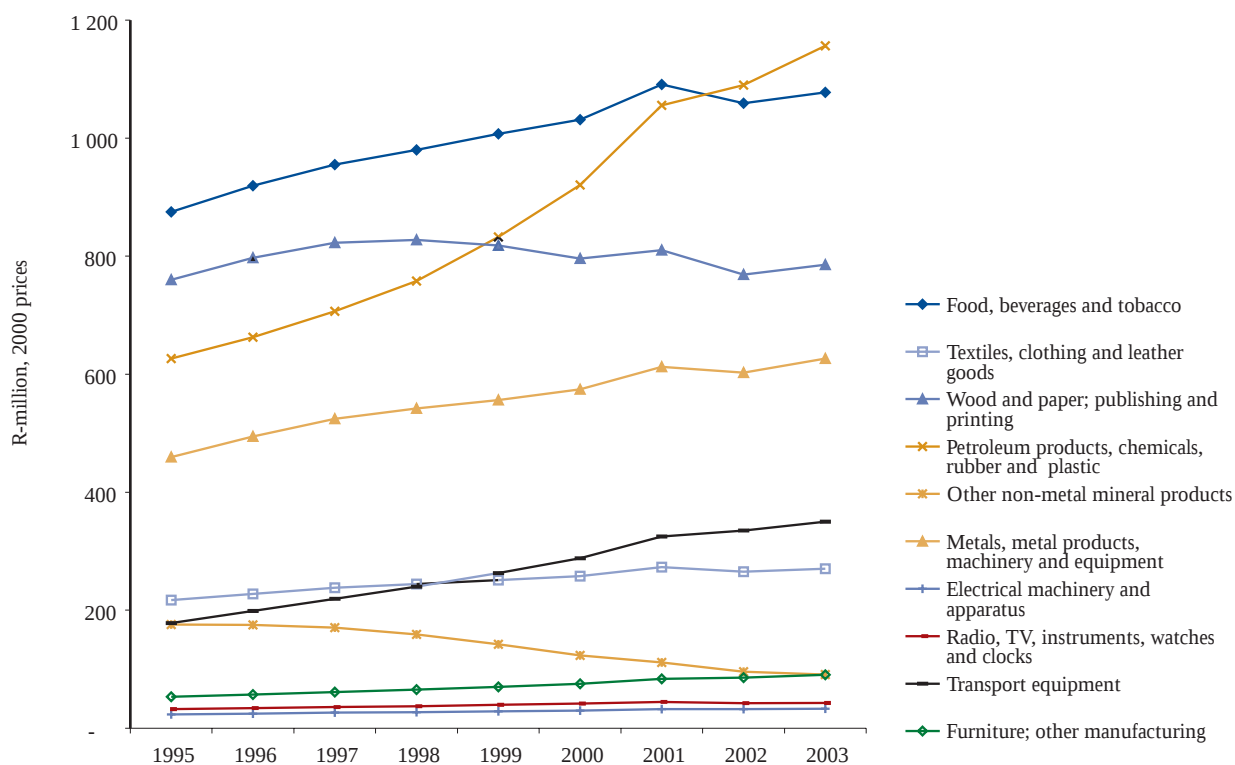
[Source: Quantec Research]

The trade data provides a more accurate indication of changing patterns of competitiveness. Figure 7 shows that Western Cape firms have increased competitiveness strongly in almost all sectors, with the largest growth recorded in petroleum, chemicals, rubber & plastics (24,5% per annum). The exports of this industry are dominated by petroleum products (76,4% of the total), which are mainly exported to other African countries. However, exports of other chemicals, fibres & plastics have all increased too. Strong growth has also been recorded in exports of agriculture, food & beverages (14,6%) and in metals & machinery (14,6%).

A more disaggregated analysis in Table 1 reveals the importance of agricultural products, fishing, and food and beverage products in the Province's exports. These account for four of the top five exports categories in 2003. Iron & steel is in fourth place, due largely to exports of steel from Saldanha, while the Western Cape's strengths in metals and machinery is reflected by the sixth-place export category, as well as exports of electrical machinery (12th), vehicles & parts (17th) and ships & boats (18th).

The strengthening of the rand had a major impact on the value of exports in rand terms in 2003. The total value of exports from the Province declined by 6,3 per cent. But, if one considers the longer-term period of 2001 to 2003, high rates of increase are recorded

Figure 7 Western Cape Sector Exports, 1995 – 2003



[Source: Quantec Research]

across most categories. Reduced trade barriers in the domestic market and the impact of trade agreements such as the EU-South Africa Trade and Development Agreement (EU-SA TDA) and the AGOA are key contributing factors to the Province's export success.

Of further interest is that the top four exports – fruit, wine, fish and iron & steel – make up 54 per cent of exports. All are based on 'local' raw materials that are subject to fluctuations in global markets and in supply, as a result of weather or other natural factors. Further detailed time series analysis is therefore required to see whether the Western Cape export performance is subject to a high degree of volatility in comparison to national trends.

Table 1 Top 20 Western Cape exports and growth (HS2), 2001 – 2003

Products	Value, 2003 (R-million)	% of Total Exports	% Increase 2002 – 2003	% Increase 2001 – 2003
1. Fruit	5 168,0	19,4	17,6	75,0
2. Wine, beer & spirits	3 333,0	12,5	4,6	58,0
3. Fish, crustaceans & molluscs	2 311,9	8,7	-4,4	28,5
4. Iron & Steel	1 777,8	6,7	-13,3	50,5
5. Processed food	1 684,0	6,3	-16,8	-2,4
6. Machinery, boilers & appliances	1 090,3	4,1	38,7	79,4
7. Precious & semi-precious stones	943,8	3,6	-19,3	74,5
8. Ores, slag, ash	857,7	3,2	-22,0	19,1
9. Clothing	768,2	2,9	1,65	50,8
10. Man-made filaments	614,3	2,3	-12,4	8,2
11. Plastic products	576,2	2,2	-15,6	14,6
12. Elec & telecom. Mach & equipmt	564,3	2,1	-5,1	40,8
13. Railway equipment & stock	559,4	2,1	-5,0	12,9
14. Wood and wood products	429,7	1,6	4,7	75,5
15. Raw hides, skins & leather	371,3	1,4	-42,0	-15,7
16. Furniture, lamps, soft furnishings	356,6	1,3	-24,5	21,5
17. Vehicles, parts & accessories	346,7	1,3	-8,5	23,1
18. Ships & boats	268,9	1,0	-52,8	23,9
19. Other chemical products	262,0	1,0	-36,5	136,5
20. Meat	227,7	0,9	-26,5	-12,5
Total Top 20 Exports	22 512,8	84,5	-3,5	43,6
Other Exports	4 126,1	15,5	-19,0	18,9
Total Exports	26 638,9	100,0	-6,3	39,1

[Source: Customs and Excise]

Note: Excludes mineral oils and arms

African Growth and Opportunity Act

AGOA is an arrangement between the US and Sub-Saharan African (SSA) countries that was entered into in 2000 and will be in operation until September 2008. AGOA liberalises access to the US for 37 SSA countries.

AGOA builds on existing US trade programmes by expanding the (duty-free) benefits previously available only under the Generalised System of Preferences (GSP) programme. Duty-free access to the US market under the combined AGOA/GSP programme now stands at approximately 7 000 product tariff lines, including the roughly 1 800 product tariff lines that were added to the GSP by the AGOA legislation.

Items such as apparel, footwear, wine, motor vehicle components, a variety of agricultural products, chemicals, steel etc. can be exported to the US duty free. (www.tralac.org)

European Union-South Africa Trade and Development Agreement

The EU-SA trade agreement has been in operation since 2000. South Africa is supposed to open its market to 86 per cent of EU goods over a 12-year period, while EU will open 15 of its economies to 95 per cent of South African goods over a 10-year period.

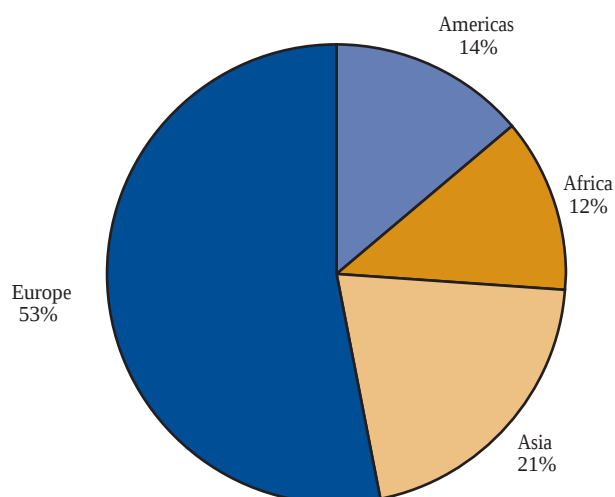
The EU has always been a market destination for South Africa and this agreement will help domestic exporters to supply more to this market if they can compete with EU firms. The EU pledged to drop average duties on South African goods from 2,7 per cent to 1,5 per cent while South Africa agreed to cut average duties on EU goods from 10 percent to 4,3 percent (UN Department of Public Information 1999: 1)

The EU-SA agreement is notable because it includes agriculture in a bilateral free trade. South Africa is granted a sizeable zero-tariff quota, which allows the country to export volumes of goods in agriculture duty free. South Africa, in contrast, is obliged to scrap tariffs on 95 per cent of agricultural imports from the EU over a 10-year period.

Complementary analysis in respect of export products focuses on trade partners, in particularly export destinations.

Figure 8 shows that Europe is that the main destination for Western Cape exports, with 54 per cent of the total in 2003. This is followed by Asia (21%) and the Americas (14%).

Figure 8 Western Cape exports by region, 2003

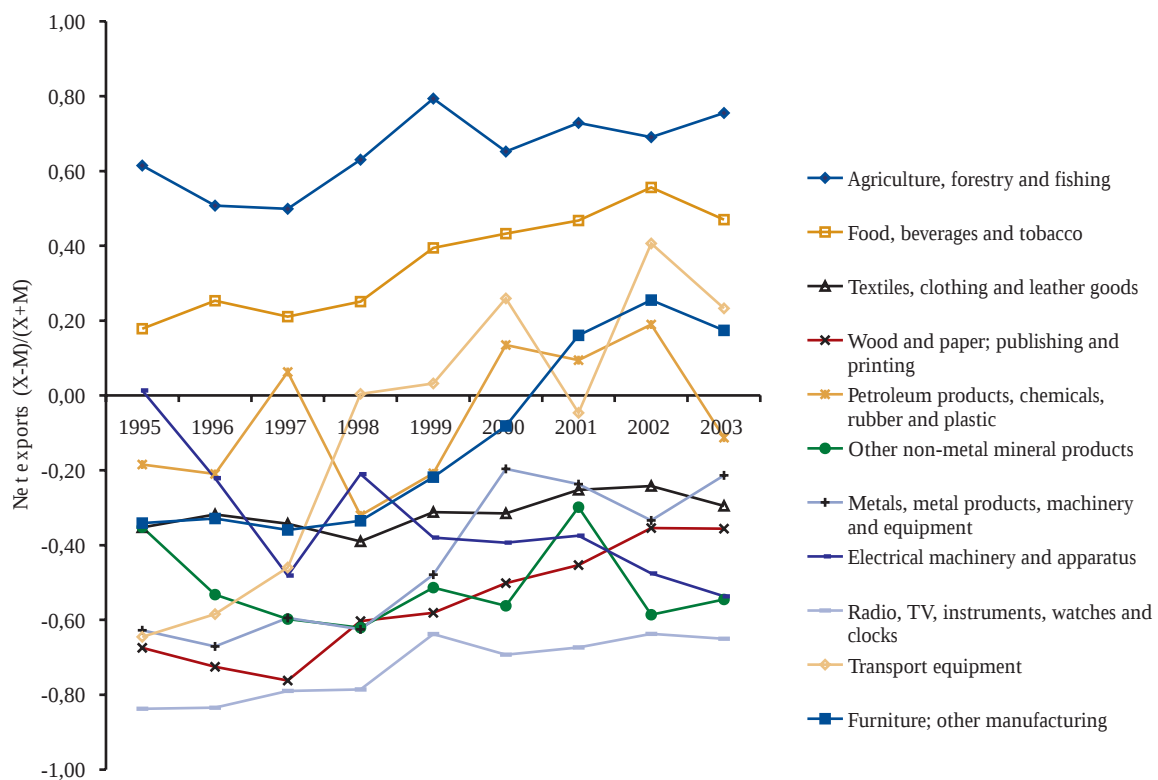


[Source: Customs and Excise]

The *net trade ratio* expresses the trade balance of exports relative to imports as a ratio of total trade flows. This indicates that competitiveness has improved greatly across industries. A positive value indicates a trade surplus, while a negative value reflects a trade deficit. A positive change over time reflects improved trade performance, either because the ratio becoming less negative means the trade deficit has narrowed, or because the ratio has an increasing positive value, reflecting an increased surplus.

Figure 9 illustrates the growing trade surplus in agriculture & fishing, food & beverages, transport equipment, and furniture & other manufacturing. Moreover, the trade deficits in most other industries have been declining over the past eight years, with the notable exception of electrical machinery. Of concern is the poorer performance in many groupings in 2003, reflecting the effects of the stronger currency.

Figure 9 Net export ratio, Western Cape, 1995 – 2003



[Source: Quantec Research]

Note: Excludes mining, electricity & gas and unspecified

The improved trade performance over the longer term strongly suggests that, while a process of restructuring has taken place, Western Cape industries have gained from increased exports in particular. The coastal nature of the Province has enabled it to take advantage of opportunities offered by greater international integration to a certain degree. The latter offers significant potential for further expansion.

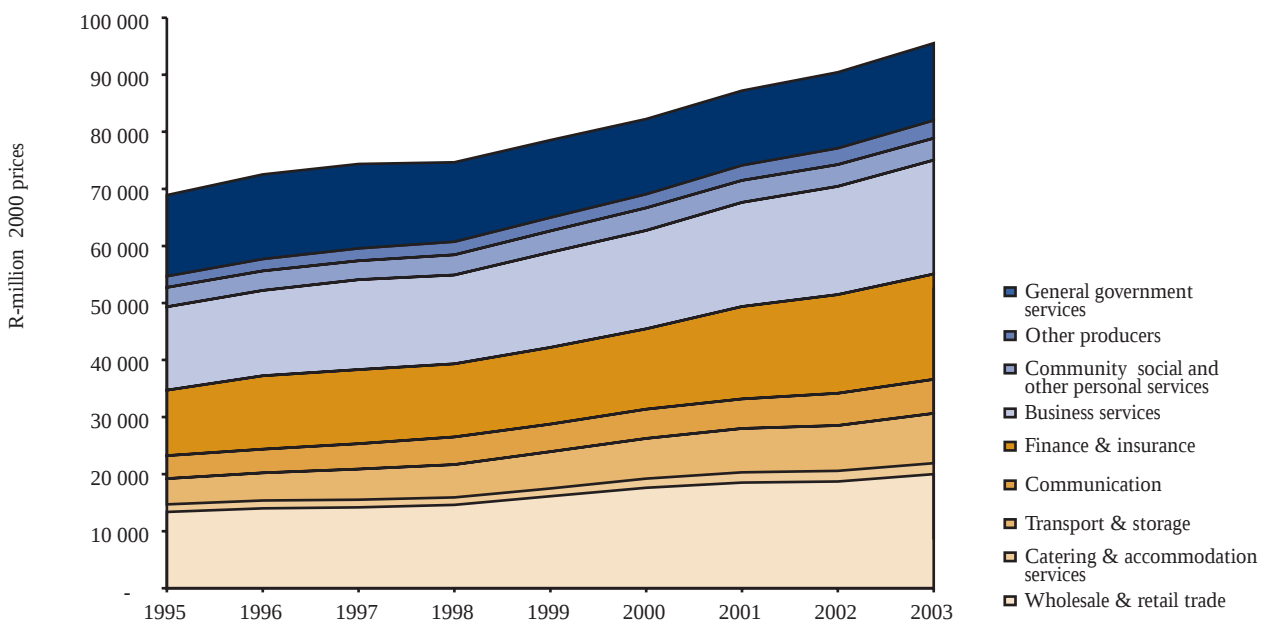
3.2. Services

Services together account for over more than two-thirds of Provincial GDP, higher than the national average. Financial & insurance and business services, in particular, stand out, with a share of 13,8 per cent and 15,0 per cent of GDPR respectively in 2003, compared to 9,7 per cent and 10,6 per cent of national GDP.

There has been strong growth across services, led by transport (8,6%), finance & insurance (6,2%) and wholesale & retail trade (5,2%), which all recorded average annual growth rates from 1995 to 2003 in excess of five per cent per annum (*see Figure 10*). This is similar to national patterns of growth.

The Province has recorded higher growth than the national average in catering & accommodation (4,9%), transport & storage (8,6%), business services (4,0%) and other producers (5,9%). This reflects strengths in tourism and call centres, as well as having the advantage of a major port.

Figure 10 Value-added in services, Western Cape, 1995 – 2003

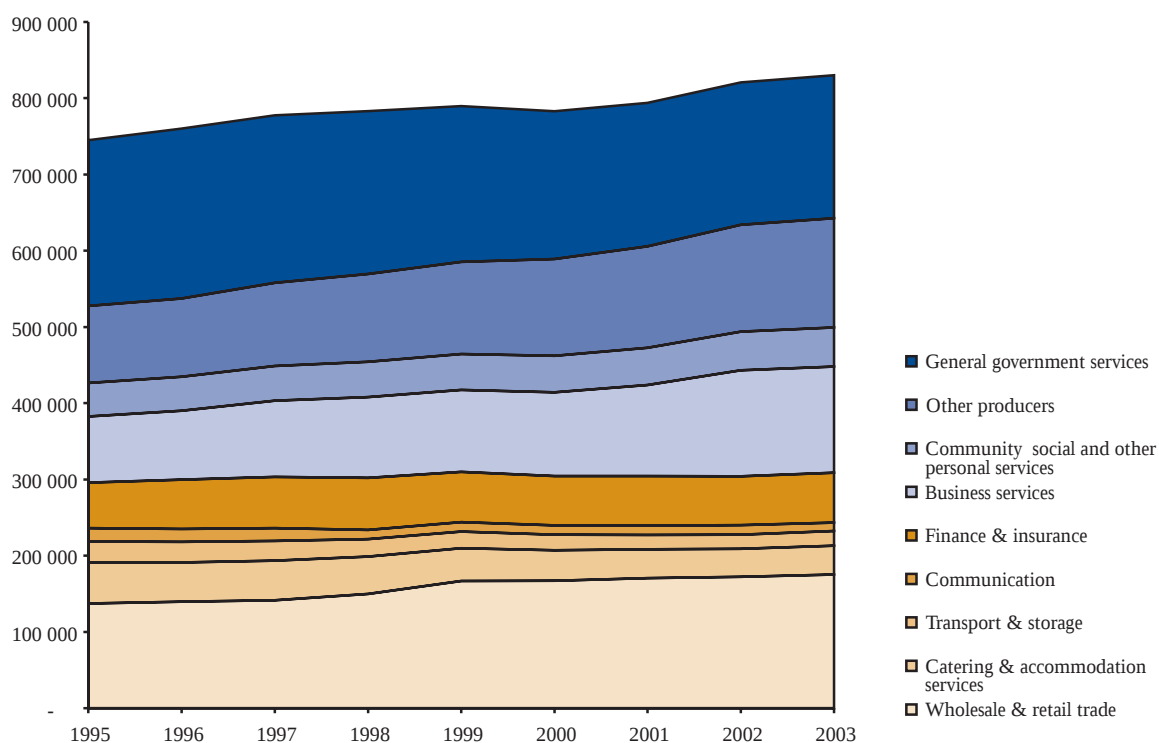


[Source: Quantec Research]

A major concern is that the strong growth in services value-added is not reflected in employment patterns. Indeed, as seen in Figure 11, contractions in employment have occurred in many service sectors. The largest contractions have been in communications (-4,8% per annum), transport (-4,3%) and catering & accommodation services (-4,2%).

It is surprising not to see the substantial growth in tourism reflected in employment in catering & accommodation and transport. The communications sector shed almost 5 000 jobs between 1997 and 1998, probably reflecting major retrenchments by Telkom following its commercialisation and move to privatisation. Almost 4 000 jobs were also shed in transport between 1996 and 1998, reflecting retrenchments by Transnet across their operations as part of broad restructuring of the corporation.

Figure 11 Formal employment in services, Western Cape, 1995 – 2003



[Source: Quantec Research]

By comparison there have been high rates of employment growth in business services (average annual growth of 6,2%), wholesale & retail trade (3,2% growth) and other producers (4,5% growth). Business services reflect employment creation in call centres, while other producers may capture some of the effects of tourism. However, it is quite surprising that the Western Cape has not recorded as rapid increases in employment in business services as in the country as a whole.

The fluctuations in employment in the financial & insurance sector, alongside rapid growth in value-added, reflect the increased use of information technology, which entails increased capital intensity. The Province has also seen the expansion of international banks such as Citibank and Barclays, as well as niche financial services aimed at the wealthy, which are not significant generators of employment. In contrast, the roll out of retail banking services to low- and middle-income consumers do create significant employment opportunities.

4 Demands of Provincial/Regional Economic Development

Despite international trends towards liberalisation and increased international flows of goods and capital, industrial activity remains highly concentrated in local regions or districts. The main reasons for this are:

- The importance of local *agglomeration effects* in skills, specialist services and inputs, and knowledge and information flows, which entail the benefits firms reap from locating where skills, inputs and services are available, and the ongoing development of such services where the demand for them exists.
- *Collective learning* by firms to develop competencies within and across groups of firms.
- The development of common services, effective business associations and industrial policy frameworks all require *effective governance* at the local and regional level. This is one of the key reasons underpinning the growth of successful industrial clusters.

The potential gains from shared learning, a wide skills pool and sharing of appropriate institutions supporting research, training and development are important in explaining why production is increasingly concentrated in specific locations. For example, while firms in the auto industry sell into international production chains, their competitiveness depends on the existence of design capabilities, skilled labour and effective logistics in the local region. The presence of these conditions will attract other auto component firms, which in turn will enhance the pool of services provided, and local skills and knowledge. These factors mean that there is a strong path-dependency driving agglomeration effects (see, for example, Helmsing, 2001 and Dunning, 2000).

Locations and countries that were first-movers derive an initial advantage, which is compounded over time. For late-industrialisers the clear implication is that co-ordinated and purposive action is very important in the development of more sophisticated industrial activities. Analyses of the East Asian experience of industrialisation have highlighted the importance of co-ordination across R&D, investment, training and product-development activities within selected sectors.

Technological capabilities are a central element of firms' overall capabilities. Indeed, a major body of literature argues that how enterprises manage the process of mastering, adapting and improving upon existing technologies – better known as 'innovation' – is the single most important determinant of industrial development. This in turn is an outcome of firms' decisions and wider strategic orientation. It reflects deliberate actions and the evolution of firms in the context of their environment and incentives.

R&D activities and firms' development of production capabilities more broadly are areas in which collective action by government and firms has an important role. Such action can

establish institutions that provide services and training, so enabling positive externality effects (or 'spill-overs') on which to build. For example, there may be common elements in the development of a process technology by two firms in different sectors. And investment in training by firms contributes to a pool of skilled labour from which all may draw. This role for the public sector is an important feature of developing production systems and more dynamic business models.

International experience of the development of industrial districts and local industrial clusters demonstrates the importance of the public sector in creating appropriate institutions. These institutions may be developed in conjunction with business associations and represent collective action responses to market failure.

In the celebrated case of Emilia-Romagna in Italy, the regional development agency established a network of general, sector-specific and function-specific centres to provide services to targeted industries. The centres were jointly managed with business associations. Important areas for institutional actions are education and training, and support for research and development. The institutional framework is, however, broader than this. Taken as a whole, it is effectively the means through which information and integration are achieved.

Value-chain frameworks (such as those that underpin **the dti's IMS**) highlight the importance of linkages and raise questions of governance by firms at different levels in the chain. Governance also relates to the organisation of inter-firm relations and which firms ultimately drive the value chain. If the role-players driving the value chain are only interested in maximising their returns in the short-term through optional extraction of economic rents, it is unlikely that firms will develop their capabilities and co-operate to improve products. Business and industry associations may be effective groups to address the challenges of upgrading production capabilities, but they may also be ineffective social clubs.

4.1. Industrial and technology policy in South Africa

Historically, industrial and technology policies both focused on the strategic concerns of the *apartheid* government, such as defence and liquid fuels, and the needs of resource extraction and processing industries. By comparison, recent industrial and technology policy frameworks aim to encourage downstream value-addition and employment creation. In 2003, the Department of Science and Technology, through the National Council on Innovation, released its *Advanced Manufacturing Technology Strategy* (AMTS). The AMTS and **the dti's IMS** complement each other and emphasise the need to develop production capabilities, the need for firms and public institutions to work together effectively, and that knowledge and technology should be the foundation for growth of output and employment. Many of these areas require action at the local level.

The *IMS* places increased value-addition downstream and the strengthening of vertical and horizontal linkages at its centre. The strategy identifies a range of broad issues to be taken forward through specific policy measures. These issues include the pricing of inputs, and improving skills and technological capabilities.

The *AMTS* also establishes a framework for government action to support industrial development, specifically as it relates to research, technology and productive capacities. This strategy is to be given effect in specific programmes, such as a *National Tooling Initiative* launched by the Council for Science and Industrial Research's (CSIR's) National Product Development Centre. This was initially driven by the auto industry but has now grown to be much broader. The *Advanced Metals Initiative* (AMI) has also grown out of the *AMTS*, and is aimed specifically at light metals. A key target area is the application of technologies to aerospace.

Much of the actual programmes, such as technical centres or innovation networks, envisaged under the *AMTS* have concrete locations as part of growth clusters. This is evident in the Automotive Industry Development Centre, which is linked to a supplier park in Rosslyn, Tshwane, and a chair in automotive engineering at the University of Pretoria. In these initiatives champions are needed from the different stakeholders, and particularly from government and business.

5. Key Sector Performance 1995 – 2003

Understanding the performance of different economic activities requires assessment of the factors influencing firms' decisions – from developments in input costs, through employment and investment decisions, to demand patterns and growth of markets. Producers' ability to grow output depends on their competitiveness in existing and new markets. This relates to the positioning of firms in terms of the types of products they supply and their strategies in product development.

The broad sectors are far from homogeneous, which makes it necessary to examine the composition of economic activity and developments at a disaggregated level. From this we can identify the impacts on employment and the key challenges in the reorientation and growth of the economy.

Our review of development in key sectors draws heavily on the base sector research reports completed as part of the first phase of the Province's MEDS. Looking ahead, this enables us to identify major cross-cutting issues in respect of the drivers of Provincial economic performance.

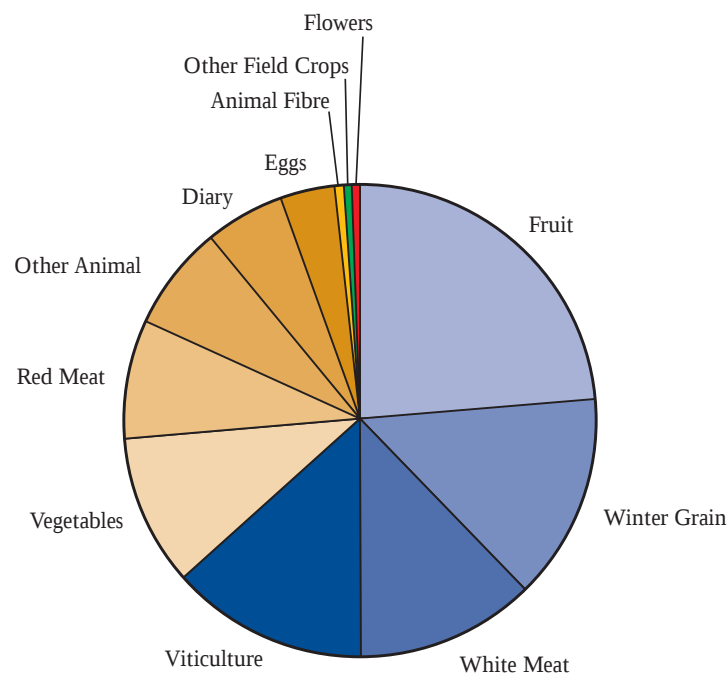
5.1. Agriculture and food & beverages

Agriculture, together with food and beverages production, is one of the main pillars of the Western Cape economy. And, while the share of agriculture in the economy overall is declining from 5,1 per cent of GDP in 1995 to 4,5 per cent in 2003, the sector continues to grow in absolute size and offers many opportunities for further growth, especially around higher-value exports.

Agriculture is a significant exporter and has been a primary contributor to the export boom of recent years. The two largest categories of exports of the Province are agricultural – fresh, dried and processed fruit (19,4% of total Provincial exports) and wine, beer & spirits (12,5%) – both of which have strong growth potential.

There is also growth potential in a whole range of diverse *fynbos* products, ranging from flowers through *rooibos* and a variety of herbal teas. A distinctive feature of these products is that their production is often associated with poor communities living in distant rural areas.

Figure 12 Agricultural production in the Western Cape, 2002



[Source: Wesgro]

The diversity of agricultural production reflects the mix of conditions in the Province's sub-regions. Figure 12 illustrates that major products include deciduous and citrus fruit (20%), vegetables (12%), viticulture (12%), white meat (14%) and winter grain (15%). As is well known, South Africa is the world's sixth-largest wine producer, due to the Western Cape, and is also a major exporter of canned fruit. There are thus strong linkages from agriculture into processed exports.

Agriculture is an important employer in the Western Cape, providing jobs to 13 to 14 per cent of total Provincial employed as opposed to eight per cent nationally. Production processes are also more labour-intensive than is the case nationally, and worker remuneration is higher (farm workers in the Province earn 24 per cent of all farm wages yet account for only 18 per cent of all farm workers in South Africa). Farmers' incomes are also higher.

Within the total employment picture, key trends are the substitution of labour by technology (in line with global shifts), replacement of permanent labour by seasonal or part-time labour, increased use of contract labour and an increase in the number of women employed as farm workers (DEDAT, 2005:84).

While the strong currency has impacted on the sector, especially on the fruit and wine producers, there have also been indications of improved capabilities. For example, in viticulture (wine), the technology and production systems mean the industry is very competitive. There have also been new entrants to the industry and a number of joint ventures have been established with farm workers. The advancement of black farmers requires Government to play a role in advisory services, and in ensuring effective and appropriate institutions that are open to all.

Continuing to grow agricultural exports requires ongoing development of research and standards, including in food safety and in organic production. It also requires training for farmers. In addition, the development of a mix of agricultural production – for the local market and for export – necessitates that decisions be taken with a view to scarce resources, including water.

The rapid growth of China, in particular, means greatly increased demand for the agricultural products of the Western Cape. This represents the greatest possible gains for South Africa from the proposed Southern African Customs Union (SACU)-China trade agreement.

Biotechnology

The Western Cape has important advantages in the establishment of a biotechnology hub. These include a strong research community and institutions, long-established firms in the fields of agricultural, medical and industrial biotechnology, and an ecosystem (or biome) with the richest plant diversity on earth.

It is estimated that more than a third of South Africa's biotechnology companies are in the Western Cape. However, the transfer of technology from research institutions to commercial applications is slow, with only two start-up companies being created for every 100 patents granted in South Africa, compared to a global norm of 10 to 15 start-ups.

A special-purpose vehicle, Cape Biotech, was established in 2003 and is tasked with developing and promoting biotechnology capacity in the Western Cape, including through investing in promising projects and creating capacity and support networks in the industry. Cape Biotech is also responsible for running one of three national Biotechnology Regional Innovation Centres. As a relatively new industry, the initiative represents an investment in the future.

Looking forward, there are a number of constraints that could impact negatively on the sector. First and foremost is resource availability, particularly in respect of water. Here both reduced rainfall patterns arising from climatic change and increased competition for irrigation water from the Province's continued urban growth should be taken into account.

Second, there has been slow progress in land reform and overall transformation in the Province's agricultural sector. Only 0,8 per cent of available agricultural land was transferred in the period between 1997 and 2002. Given national and Provincial targets, it is critical that the pace of transfer accelerates over the medium term. Concern, however, has been raised that most land transferred is used for settlement rather than agricultural purposes. And when land is used for the latter, there is limited capacity to advise and support new farmers effectively.

Finally, there is increased competition in agricultural exports from southern-hemisphere producers, mainly Chile, Brazil, Argentina and New Zealand. Exchange rate competitiveness is key here, but equally important is product quality control, supply-chain logistics and marketing.

Looking beyond these constraints, there is undoubtedly potential for growth of the sector, although the latter requires further strategic repositioning and diversification in response to climatic and global competitive trends (DEDAT, 2005: 85-86).

Rooibos tea

The export-oriented growth of *rooibos* tea is one of the agricultural success stories of the Province. It is cultivated almost exclusively in the Clanwilliam-Cederberg region and now sells more than three-million kilogrammes per year.

Competition initially meant lower margins, but it has also brought more vigorous exploration of new markets and variations on the product and its use. In 2000, more than 4 500 tons of *rooibos* was exported to 31 countries, up on 1 800 tons in 1999. Currently, Germany imports as much *rooibos* as is consumed in the whole of South Africa. Other importers include Switzerland, Israel, US, Holland, the UK and Japan.

Together with similar herbal products such as honey bush tea, there is significant employment opportunities have been created by the *rooibos* industry, particularly in historically poorer rural areas of the Province. Export and marketing also provides employment in packaging and processing. According to Wesgro (2000: 2), in 2000 the *rooibos* industry in the Western Cape employed 4 000 people and earned an annual income of between R60-million and R70-million a year.

Maximising the potential from natural herbal products, such as essential oils, requires attention to the organisation of production, harvesting, processing and marketing to ensure that both effective market entry and positive effects for communities, including employment, are attained.

In this respect, a number of institutions – the Agricultural Research Council, the Medical Research Council, and the Universities of Stellenbosch and the Free State – assist in *rooibos* research that focuses on production, cultivation and health properties.

Certification is crucial to food products, and includes certification as organic produce. However, the costs of certification are potentially a barrier to small farmers.

[Source: Wesgro, 2000]

5.2. Fishing and aquaculture/mariculture

5.2.1. Fishing

The fishing industry is a major employer and income generator in the Western Cape. The Province accounts for 70 per cent of national employment and 71 per cent of income earned from fishing in South Africa. In total, approximately 27 000 people are employed in the industry in the Western Cape, predominantly from historically disadvantaged groups and in jobs of a semi-skilled nature.

As with agriculture, the importance of the industry extends to the processing, packaging and export of the product. For example, the pilchard and anchovy catch supports eight fish-meal plants, six canning factories and more than 40 bait-packing facilities. Employment in secondary and tertiary activities is roughly equivalent to primary activities (on vessels and on-shore support).

The key market for fishing is exports, and the industry is the third-largest exporter in the Province after fruit and wine, representing 8,5 per cent of total Western Cape exports. Exports have been growing in both mass and value terms in recent years. The most important products are frozen fish and fish fillets and cutlets. The main export destinations are Europe, Asia, Canada and Australia, and several African countries such as Angola.

The two main dynamics in recent years have been the transformation of the industry and the need to manage fish stocks in a sustainable way. Transformation is primarily the result of a change in the number and size of fishing rights allocated. Some 2 625 rights (or quotas) were allocated in 2001, of which at least 2 000 qualify as SMMEs. Historically disadvantaged persons now own approximately 60 per cent of quotas, enhancing income generation in poor fishing communities. Despite such progress, there is still much to be done in respect of employment, income generation, skills development and distribution, as well as livelihoods in these communities.

Looking ahead, the fishing industry faces a number of key constraints. These include natural resources limitations with increased demand for resource access, the continued marginalisation of small fishers, limited access to capital for new entrants and poor fishers, destabilising livelihoods in a seasonal industry, and skills composition among traditional fishers and small operators. Poaching and corrupt behaviour in certain sub-sectors and poor resource conditions in line fish and abalone also pose risks.

There are, however, equally important opportunities for future growth. These include local beneficiation and value addition, improving the infrastructure and enhancing the status of women in the industry (DEDAT, 2005: 89).

5.2.2. Aquaculture and mariculture

Aquaculture (freshwater cultivation of trout, crocodiles, ornamental fish, catfish and tilapia) and mariculture (marine cultivation of abalone, prawns, oysters, seaweed and mussels) are small but have been growing rapidly, with growth rates of up to 25 per cent per annum in the late 1990s. Mariculture, in particular, has shown great potential, with the majority of activities taking place in the Western Cape.

Mariculture encompasses abalone of which South Africa is a net exporter with 15 commercial farms, as well as mussels and oysters in which the country is a net importer. Cultivation has increased in each of these, with potential for further expansion. In addition, there is potential for growing the kelp and seaweed industries, with expanded employment opportunities.

While prospects for the sub-sector are extremely promising, a critical concern is the location of suitable sites along the south and west coast for farming purposes. Furthermore, the industry is capital intensive and involves imported technology and

expertise. There is therefore need for technological adaptations towards smaller-scale models that are technologically more effective, hold lower risk and could have an enhanced impact on poverty alleviation in poor communities (DEDAT, 2005: 91).

5.3. Tourism

Tourism has been identified as a major growth impetus for the Province, with ambitious targets set for 2010 in the Provincial White Paper of 2001. However, the lack of good statistics means it is difficult to evaluate performance. Information on overseas tourist arrivals indicates there was an increase of 30 per cent in 2002 following the rand's depreciation. While this growth was not maintained in 2003 as the rand strengthened, it is encouraging that numbers did not decline.

Recent reports suggest that tourism-related revenues are increasing once more in 2004. Of concern is that the foreign visitor's average length of stay in the Province appears to have declined. Moreover, the affordability of Cape Town in particular has come under increasing scrutiny.

Even less is known about local tourism and visitors from other African countries. Encouraging these visitors to the Province is also an important goal. Cheaper domestic airfares with increased competition has undoubtedly made it much more affordable to travel to Cape Town from destinations such as Johannesburg, and increased flights suggest the numbers of visitors has increased, but assessing the impact is difficult.

South Africa Tourism has identified local tourism as a high-potential growth area, further development of which requires greater local promotion as well as products suited to local tourism consumers. These include packages linked to local events, off-season specials, and cost-effective group travel packages.

Of critical importance is the management of tourism as a system, with infrastructure provision, marketing, skill development and improved service all part of the package. In addition, there has been relatively little integration of tourism to link the City of Cape Town to regional centres elsewhere in the Province. The vast majority of tourists stay in the City of Cape Town with day trips outside, but do not extend their stay with longer excursions throughout the Province.

A further priority identified by the Province is to increase the involvement of previously disadvantaged individuals through their role in providing services and through increased township tourism. Low barriers to entry into tourism-related activities mean there are great opportunities, but without clear strategies these will not be realised. The developing policy framework sets out an integrated approach; the challenge is to design and implement concrete actions.

Two new transformation initiatives are also proposed – the facilitation of the set-up of craft, jewellery and cabinet-making co-operatives in the Province, and initiating research into extended beach tourism. The latter would explore the costs, benefits and feasibility of the Province positioning itself as an international destination for beach tourism. Of necessity, this would have to explore the environmental implications as well as attitudes of local residents to extended beach tourism initiatives (DEDAT, 2005: 117).

Co-operatives development in South Africa

Government has recognized the value that co-operatives development may play in promoting entrepreneurship and SMMEs, and contribute to enhanced employment, black economic empowerment and reduced inequality in South Africa over time.

In brief, a co-operative is a type of ownership that members form to combine skill or capital to achieve a specific objective, such as profit. Co-operatives differ from other forms of ownership due to few formalities required to register the enterprise, as well as its independence from its founders. Furthermore, there is no limit to the number of people who may join a co-operative.

At present, co-operatives in South Africa do not have legal capacity to perform juristic acts, making it difficult for them to acquire financial assistance. Government is now introducing enabling legislation – the Co-operatives Bill – that enables co-operatives to operate as legal entities, facilitating their development and sustainability.

The dti is leading the formulation of government policy to incorporate co-operatives in the mainstream economy, and is currently designing a grant that will enable co-operative members to access finance with fewer legal requirements. National Treasury is also involved in the process by developing tax incentives and other enabling regulations, such as the Co-operatives Banks Bill, which will enable financial services co-operatives to operate as banks and offer their services to unbanked communities. These co-operatives will be exempted from the requirements of the Bank Act, and fewer legal requirements will apply to institutions.

[Source: Shabalala, 2005]

5.4. Clothing and textiles

The clothing & textiles industries account for the single largest share of manufacturing employment in the Western Cape. However, in line with national trends, employment levels have been falling sharply. There have been huge job losses – in the 18 months from January 2003 to June 2004 it is estimated that 27 000 jobs have been lost nationally.

The clothing & textile industries are driven by the demands of the main international retailers. The latter expect low prices, high quality and rapid delivery on designs. Retailers such as Walmart in the US govern the clothing and textile ‘value chain’ around the world,

dictating standards of design, delivery, quality and price to the different levels of production, from yarn through to fabric and the making-up of the garments. Their control ensures delivery to their specifications and enables the retailer to capture the largest share of the value that is created.

Value in the clothing industries derives less from the production capabilities than from the branding and distribution of the product to consumers in industrialised markets. It is very difficult for South African firms to have any influence over major brands; instead they are made to compete against other manufacturers for the same customer located in different countries around the world. There are, however, product niches where firms can develop their own brand identities. South Africa has also been more successful in non-clothing parts of textiles.

The biggest development in the last five years has been China's ability to compete on the delivery, design and quality criteria at very large volumes, which means they are highly price competitive. To compete entails investing in up-to-date machinery and having very efficient work organisation. China does not have the lowest clothing labour costs but has been investing heavily in machinery and equipment for its textile and clothing industries.

The South African industry has not, in most cases, made the changes necessary to lay the foundation for sustained improvements in competitiveness. There has been some investment in new machinery and equipment, but on average the machinery being used is quite old.

Of greater importance appears to be a very slow adjustment to new ways of working – to improve throughput time, ensure quality at every level of production and broadly be able to respond to the demands of international, and increasingly also of local, buyers. Recent benchmarking of Western Cape firms against best practice internationally and locally reveals great room for efficiency improvements.

The removal of quota restrictions under the Multi-Fibre Agreement (MFA) as of 1 January 2005 further threatens the South African industry. The MFA meant that countries were subject to maximum limits on their exports of clothing and textiles. This originally protected the clothing industries in countries such as the UK, but recently the biggest effect has been to limit South Africa's exposure to competition from countries such as China for these markets.

Asian firms in particular have a long history of 'quota hopping': moving production facilities to developing countries with low labour costs that have not fulfilled their quotas. With the ending of restrictions, there is likely to be greatly increased concentration of clothing and textiles production in countries such as China, India and Pakistan.

An advantage for clothing and textiles in African countries has been the AGOA, which provided for duty-free access to the US market – a significant advantage given that US

tariffs average 17 per cent on apparel imports. South Africa (along with Mauritius) is at a disadvantage, however, as it is required to use local fabric and yarn (or to import from the US). Other countries, such as Lesotho, are not subject to this triple-stage transformation requirement and have rapidly increased exports to the US of garments, generally of low-price basic items. Recently, investments have also been made in textiles factories in Lesotho, which entails more stages of processing.

Multi Fibre Agreement (MFA)

Clothing & textiles were excluded in 1947 under the General Agreement on Tariffs and Trade (GATT), which was the forerunner of the World Trade Organisation (WTO). In 1974, the MFA was signed, ratifying countries' rights to impose tariffs on clothing and textile imports. The MFA's objective was to allow developed countries time to restructure their clothing & textile industries before opening up to competition from developing countries. Although meant to be temporary, the MFA was frequently renewed. In 1994, the GATT signatories signed the Agreement on Textiles and Clothing (ATC), committing to phasing out the MFA by 1 January 2005.

One of the major concerns is how countries such as China and India, which have become major threats to clothing and textile-producing countries across the developed and developing world, will behave now that quotas have been removed.

Experts predict that in a quota-free world, China's share of world clothing exports will double in less than five years and that more than 80 per cent of clothing production may move to China.

Low wages are often attributed to China's success. However, while wages in China are competitive, they are not the lowest in the world. There are other reasons for China's export success. The most noted is China's maintenance of at least a 15 per cent under-valuation of its currency as it pegs the Yuan to the US dollar. This currency under-valuation has the effect of acting as an export subsidy to the industry.

Second, the Chinese government has a 52 per cent ownership interest in textiles and 25 per cent in clothing. It subsidises output by providing these industries with access to cheap capital, thereby allowing firms to undercut the prices of their competitors and increase their market share.

Clothing and textiles are important industries and export earners for both developed and developing countries. China's increasing dominance is therefore a concern – not only for the US and the EU but also for Mexico, the Caribbean and SSA.

Despite risks to the global outlook, there is substantial scope for export growth in the sector, particularly to growing middle-income countries. This may require repositioning and restructuring of domestic industry to ensure improved competitiveness in the new global order.

[Source: Morris, Barnes and Esselaar, 2004: 7]

The Western Cape clothing & textiles industries are strongest in niche areas where there is a quality or design advantage, such as in worsted woollen suits to the UK market primarily. There are also firms making high-quality household textiles, again targeted to the EU market.

Following international trends, local retailers have also become much more demanding in terms of price, quality, flexibility and variety. As a result, Western Cape firms have become more design-oriented and focused on serving the upper end of the market, which has also led to formal factory downsizing and increasing outsourcing of garment manufacturing to cut-make-trim operations.

Future performance of the industry requires going further to build firms' competitive capabilities in high quality and design niches. In this regard, high-quality fabrics are very important. This requires co-operation between firms in the industry, and the development of appropriate local institutions oriented to technological development and design.

The strategies at a Provincial level need to link with a coherent national industrial policy for the sector. Important revisions include changes to the workings of the duty credit certificate scheme (DCCS). At present, retailers use the DCCS credits from clothing exports to import duty-free products rather than clothing firms using them to import inputs at internationally competitive prices.

Duty Credit Certificate Scheme

The DCCS is an export incentive programme for the clothing & textile industries in South Africa and is aimed at encouraging the outward orientation of the two related industries.

Set to expire on 31 March 2005, the DCCS permits firms to claim a remission of duty for proven exports. Alternatively, rebates may be sold to any other importer of clothing and textiles. The level of support depends on the product exported. Relief granted ranges from a minimum of eight per cent of the export sales value for yarn exporters whose export sales represent 15 per cent of total sales, to 35 per cent for clothing exporters whose sales represent more than 15 per cent of total sales.

As a result of restrictions on the use of the DCCS as well as its tradeability, the majority of the DCCS is sold, benefiting major retailers. The latter pay as much as a 30 per cent to 40 per cent discount on the DCCS which they then use to import clothing and textiles, thereby decompressing local industry.

The dti has indicated that the DCCS would not be extended past 31 March 2005. In response, the industries submitted a joint proposal requesting that a two-year Interim Development Programme be implemented for both industries, allowing them time to restructure before phasing the programme out completely. The DCCS has now been extended and made more powerful. Smaller firms that used to get 15 per cent now get the full allowance. There are further possible changes in the pipeline.

[Source: Morris, Barnes and Esselaar, 2004:7]

5.5. Metals and machinery

The metals and machinery industry grouping is at the heart of the manufacturing industry. It encompasses the basic manufacture of metals through to the working of metal to make machinery and equipment – the capital equipment which is used across industries to

transform materials into manufactured products through successive stages of processing. The Western Cape has the advantages of availability of basic metals, a relatively good skills base, developed infrastructure and a coastal location.

While the industries in the Province have suffered from the same slump as the country as a whole, there has been growth of output and employment over the last three years. Employment in 2003 was nine per cent higher than in 2000.

The better performance of the sector in the Western Cape is reflected in its trade performance. There have been big improvements of exports from the Province relative to imports in most product categories, except for electrical machinery & appliances. Increasing international integration means that the Western Cape has the opportunity to benefit from improved opportunities to export – if the appropriate environment is in place.

In addition, there are three key recent developments which point to much-improved performance in the next decade:

- The expansion of basic steel production in the Province at Saldanha and the negotiation of a developmental pricing arrangement to ensure that local buyers of steel benefit from competitive steel prices holds a huge opportunity to increase local beneficiation for export.
- The growth of cast components for the auto sector. These are strongly export-oriented and have developed without the presence of a major auto assembly operation in the Western Cape, reflecting the competitiveness of the Western Cape industry.
- Increased investment spending by National Government on infrastructure. This will have important demand effects for metals and machinery industries.

The key challenge for broad-based employment creation is to grow downstream industries. Fabrication of metal products is a relatively labour-intensive operation and requires mainly low-skilled labour. While labour-intensive, firm competitiveness also requires competitively priced material inputs and investment in up-to-date machinery to be able to ensure quality and reliable on-time delivery, and the necessary skills in areas such as design and tool-making. For example, 37 per cent of direct material inputs for fabricated metal products are basic iron & steel and even for the more sophisticated general machinery products, iron & steel accounts for one-quarter of all material inputs when the iron & steel content of components is taken into account. Competitively priced steel inputs (as opposed to the import-parity pricing charged by Ispat-Iscor and other metals producers) will fundamentally alter the competitiveness of downstream labour-intensive industry in the Province.

Metal fabrication industries are well-established in the Western Cape, with specific links into markets for marine equipment, tank containers and food packaging (ship-building and repair is addressed separately below). Internationally, industry growth is characterised

by clusters of firms developing niche capabilities and drawing on shared services, including technical and design services, skills development and R&D facilities.

The importance of quality, design and delivery has been emphasised by recent studies of the sector. This points to the importance of ongoing upgrading of skills, and the increasing use of computer-aided design and computer numerically-controlled machining, which enables greater precision. A sustainable growth strategy therefore requires attention to the network of shared facilities, in addition to vertical linkages from material inputs through to markets. The Western Cape is fortunate in this regard in having well-established tertiary education institutions.

The Western Cape foundry industry has undergone something of a renaissance with the growth of small and medium firms supplying a range of diverse markets. The auto industry has been the main source of growth, however, firms also supply castings for the general engineering and machinery, electrical machinery, railway equipment, medical equipment, ICT, defence and shipbuilding industries.

The ability of transnational corporations to source castings from anywhere in the world means that continued improvements in technological capabilities are crucial alongside cost-competitiveness. The majority of foundries in the Western Cape have introduced technologically improved castings, with both incremental improvements and radical developments in the production process.

Crucially, the industry has started to reap the economic gains that derive from agglomeration and clustering. Firms in the Province share knowledge and expertise and have devised a common training programme, even before this has been done at the national level.

Two important national initiatives are directly relevant to metals and machinery – the AMI and the National Tooling Initiative. The AMI's light-metals focus is particularly relevant for firms supplying the aerospace and automobile industries. The National Tooling Initiative has been launched by the CSIR's National Product Development Centre and is initially being driven by the auto sector. However, improved tooling capabilities are important for many industries, including plastics. Without good local tool-making firms, South African manufacturers often have to source their tooling and moulds from overseas countries, such as Italy.

Steel pricing developments and beneficiation

The Western Cape is a major producer of primary steel at Saldanha. From originally being orientated 100 per cent towards export, it is the intention of both National Government and of Ispat-Iscor that there is increased local beneficiation. To an extent this has already occurred, although local beneficiation in the Western Cape has largely been limited to galvanising and re-rolling. Ispat-Iscor's intention is also to double the production of Saldanha Steel in the very near future.

The main obstacle to local beneficiation is the current import parity pricing practised by Ispat-Iscor. This means charging prices equal to those that a local buyer would have to pay to import the product, including the notional costs of shipping, tariffs, wharfage and port charges.

However, in the case of steel there is a very large trade surplus, reflecting South Africa's competitive and comparative advantage in steel, and there is no need to import. In such conditions, additional local consumption means exporting less. But, while South Africa has low production costs for steel – certainly below the international average – it has much higher than average local prices for steel, placing steel using industries at an immediate competitive disadvantage. The prices charged to local buyers of steel are between 30 per cent and 50 per cent higher than the prices received for exported steel.

Indeed, the size of the notional costs added in depends on geographical accident, as the price mark-up is due partly to the distance of the local market from the sources of imports. In flat-steel products, the market power of the main producers is such that they maintain their prices just at the level at which it is not worth it for a local buyer actually to import.

Current negotiations of a developmental pricing framework to replace the import parity pricing being practised by Ispat-Iscor pose a major opportunity for growth of industries around Saldanha.

The establishment of a service centre already means that steel can be cut and slit for use by fabricators, and there are several firms engaged in manufacture of products, such as palisade fencing, for export. It should be emphasised that there are very large employment creation opportunities of a mainly low-skilled nature in metal fabrication.

A Saldanha steel beneficiation cluster requires:

- Provincial Government to facilitate beneficial pricing for local firms as part of the wider pricing framework.
- An industrial development plan for the area, the current lack of which apparently is holding up further industrial growth (despite the location of heavy industries in the area).
- Provision of infrastructure for firms making 'greenfield' investments (that is, establishing new factories or production sites).
- A commitment to provide the appropriate training support – essentially to ensure that firms can use the skills development framework.
- Support for small firms, for example in accessing export markets and financing investments in new capital, to name a few.

5.5.1. Motor vehicles

The South African motor vehicle sector has recorded one of the highest rates of output growth over the past decade. This has been largely due to the Motor Industry Development Programme (MIDP) which provides a structured plan to encourage the local production and export of motor vehicles and components. This allows the main auto firms to obtain duty-free import licences for car models not made in South Africa. Although the Western Cape does not have a major motor vehicle assembler, there has been growth in auto components in the Province.

Catalytic converters is by far the largest single category of auto components exports, with exports of R8,1-billion in 2003 (a share in total components exports of 38%), followed by seat leather with exports of R2,9-billion and tyre exports of R1,3-billion. Of importance for the Western Cape is the increasing diversification of components exports, and particularly the increased exports of engine parts, which rose to fourth place in 2003, with exports of R0,8 billion, with exports of engines and auto tooling not far behind.

Exports of motor vehicles and components from the Western Cape are still relatively small at R347-million in 2003, but have increased strongly. For example, in 1998 they totalled just R99-million. However, the stronger rand in 2003 impacted negatively on the local currency value of exports, and has placed increased pressure on firms to improve their international competitiveness.

5.6. Ship- and yacht-building

The Western Cape has long been a base of ship-building and repair, and has recently developed into a major boat-building location for yachts. While all related to water-born craft, these industries operate on quite different bases. Ship-building and repair have an engineering base, and are predominantly concerned with metal-working – mainly steel. Making yachts is a very sophisticated activity, with a range of materials.

The international ship-building industry is currently booming as increased freight drives global demand. The major players are Asian countries and, in particular, Japan, South Korea and China. After a major slump in ship-building in the Western Cape, with only one major ship-building firm left, there is now potential for growth, particularly in small and medium vessels in which the Western Cape has a geographical advantage over the big Asian producers in the African market.

Ship-building potential

There is a major opportunity for the Western Cape to develop a ship-building industry focused on smaller vessels, such as tugs and harbour craft, targeted at the west coast of Africa. The only current producer is performing well, and there is interest from new entrants. A key obstacle is the financing provided by European countries for exports of ships. A competitive financing package is therefore required, and would be consistent with the New Economic Plan for African Development objectives, where South Africa becomes a major supplier of ships to the other African countries.

Local ship-building essentially requires steel and labour. The important design activities and engine components are sourced internationally and this would continue in the early stages. Partnerships with international ship-builders are important for design and technology. Ship engines are sourced from a small number of manufacturers globally and provision should be made for their duty-free importation.

A Western Cape ship-building initiative requires:

- Identification of sites for major new ship-builders and appropriate infrastructure provision.
- Identification of potential investors – foreign and local. (Reportedly, major foreign concerns have already shown interest.)
- Development of a 'package'; including export financing in conjunction with national agencies such as the Industrial Development Corporation (IDC). In the medium term, the package would include development of local design and research capacities ,with universities building on what already exists.
- A steel pricing deal for ship-building firms (such as the current auto industry currently deal).
- An industry development body (again, the Auto Industry Development Council provides one possible model).

Ship repair is labour-intensive and provides between 1 700 to 2 000 direct jobs nationally, with 1 000 being in the Western Cape. Moreover, the employment in related activities is also significant.

The Province has always been the main repair location in South Africa, benefiting from well-developed facilities and its ideal location. The development of offshore oil and gas fields off the west coast of Africa have added to the demand for services, while foreign fishing fleets also use the Port of Cape Town's facilities.

The main bottleneck to the expansion of the sector is the available port infrastructure and its management. The facilities in Cape Town include two dry docks and a shiplift facility; however, these are sometimes fully utilised, which means ships move elsewhere, to East London or to other countries altogether. It is estimated that the Western Cape loses an average of R14-million annually for vessels turned away due to lack of quay and repair space. A new shiplift facility is planned, which will increase repair capacity considerably; however, the huge increases in international shipping traffic suggests that demand for repair services will continue to rise.

Oil & gas

The oil & gas supply sector in the Western Cape is extremely diverse, and includes ship and rig maintenance and repair, logistics, marine construction and engineering, sea and air freight, and personnel transport. It is a specific niche within the broader activities in ship-building and repair, benefiting from the Western Cape's unique position and infrastructure.

The industry initially took off to meet the need of exploration and production by companies off the South African coast, but now the major opportunities lie with offshore exploration and production up the west coast of Africa. In 2003, 80 wells were drilled off the west African coast, with exploration and production spending of over US\$10-billion. It is estimated that despite South African firms supplying less than one per cent of the needs in this market, the activity in 2003 supported 5 000 jobs in South Africa.

The Cape Oil and Gas Supply Initiative aims to position the Western Cape as the preferred oil and gas service and supply hub for exploration and production off the African west coast. To do this requires addressing a range of obstacles, including:

- Price and availability of specialist steel products;
- Infrastructure and port inefficiencies;
- Skills and training needs;
- Technology transfer and the attraction of foreign players to the Western Cape; and
- Improved visibility and marketing.

It has already succeeded in facilitating several large deals bringing business to the Western Cape, but much needs to be done to address the core issues impeding broad-based growth of the sector.

5.6.1. Yacht manufacture

Boat-building, which accounts for approximately 70 per cent of activity in South Africa, has been long-established in the Western Cape. The manufacture of yachts for cruising and racing has recently underpinned a rapid expansion of the industry in the Province, notwithstanding the poor performance in 2003 with the strengthening of the rand (when export earnings in rand terms fell 50%).

Exports of ships and boats from the Western Cape increased from just R45-million in 1997 to R569-million in 2002, before falling back to R269-million in 2003. The indications are that, after some painful adjustment, the industry is growing once more.

The Western Cape has the important pre-requisites for boat-building, namely a network of the various suppliers required (including sail-makers, composites and metal fabricators), a tradition of boat-building and the skills base that accompanies it, as well as a relatively good business environment for manufacture and export.

The competencies required for boat-building can be broken-down into:

- Boat construction;
- Supply industries of related products and services, such as sail-making, mast builders and riggers, and naval architecture;
- Outsourced manufacturing of component parts; and
- Post-production services.

Some firms specialise in making products and systems for one boat-builder, while others make components for many firms, including those outside boat-building, for example, in making stainless steel fittings. The competitiveness of the whole depends on the performance of each of the parts, as high-specification boats are reliant on all the parts working together. The Western Cape has also tended to make small numbers of boats, often custom designed, which differs from the trajectory followed in, for example, New Zealand, which has firms engaged in mass production.

Of critical importance for ongoing growth of the industry is attention to the pricing of material inputs, improved training and skills development, support for product development and research, and appropriate support for exporters. Together this suggests a framework for collective action by the industry, which has recently led to the launch of the Cape Town Boat-building and Technology initiative (CTBi).

Cape Town Boat-building and Technology initiative

Following studies commissioned by Wesgro and **the dti**, which identified key constraints in the future growth of the industry in the Western Cape, the CTBi was launched in mid-2004 with the following objectives:

- To identify the key industry bottlenecks restricting further growth and development;
- To develop a three- to five-year strategic business plan with programmes to unlock this potential; and
- To implement and manage the strategic business plan.

Initiatives are underway to address issues of skills training, suitable financial products for boat-building, increased international exposure, improved co-operation within the industry and regulatory and legislative issues. A generic one-year boat-building qualification is currently being designed for introduction in 2005.

5.7. Information and communication technology

The ICT sector provides a range of goods and services that support electronic display, processing, storage and transmission of information. With ongoing developments in technology, this sector is growing strongly. One key area of employment is in the business process outsourcing and contact centre sector – this is reviewed separately below due to its importance.

Total information technology spending nationally was estimated to reach R37,8-billion by the end of 2002 and to grow by 10,9 per cent per annum to R57,1-billion by 2006. The majority of the turnover is estimated to be in software design and development, and IT services. Gauteng has the largest shares of the 6 400 firms and 212 000 employees nationally. The Western Cape is in second place with 16 per cent of firms and an estimated 27 000 employees (13%).

The main strengths of the Western Cape are in the good skills, infrastructure, communications network, and the Cape IT initiative. These have underpinned the growth of the foreign client base.

The main challenges are, however, the small local market and an effective response to BEE. Much of the software development is for local clients, which entails that growth depends on the developments of sectors such as financial services which demand ICT solutions.

5.7.1. Contact centre and business process outsourcing industry (BPO)

The BPO and contact centre industry was identified in 2003 as one of five key growth sectors to drive employment in the Province, and the government has targeted it to create 5 000 new jobs by 2008. The industry is well developed in the Western Cape, with a broad base of management and service provider expertise.

There are now more than 105 active operations in Cape Town, with over 11 000 employees. Offshore outsourcing is a key area, and the main driver of industry growth. Approximately 55 per cent of the revenue of BPO operators came from international clients in 2004, with seven foreign languages offered.

Key strengths of the Western Cape industry include the depth of financial services expertise, particularly in insurance, mortgage and loan processing. Financial services operations account for more than half of the employees in the industry. Coupled with this are the excellent skills base, good technology and infrastructure, and the sophistication of the local industry. Productivity measures such as first-call resolution are high by international comparisons, and the attrition rates of employees are low. Wages are not high by international comparisons and are around one-third of those in the UK.

With the fall in telecommunications costs, expected competition from a second national operator and liberalisation in February 2005 allowing voice services to be carried over the Internet, there is great potential for growth.

To meet the potential demand, the industry is working together with government to grow and develop the skills pool. A non-profit organisation, CallingtheCape was established in 2001 as a partnership between industry and Local and Provincial Government to promote and develop the industry.

Small Enterprises

In many industries, small enterprises are at the heart of growth and dynamism. In South Africa, recent survey research has estimated that there are 4,9-million people in the 'small business sector' (in firms with 10 or fewer employees). Often small enterprises dominate in the more labour-intensive downstream sectors, as well as in industries based on design and craft skills such as boat-building. The level of entrepreneurial activity is thus clearly important for the growth of provincial and local economies.

The Global Entrepreneurship Monitor (GEM) is an international research project which examines new business formation in more than 30 countries. Its findings indicate that entrepreneurial activity in South Africa is generally low by international comparisons. However, the Western Cape, along with Gauteng, has significantly higher levels of activity than the rest of the country.

Importantly, the survey distinguishes between entrepreneurial activity driven by 'opportunity' (where an attractive opportunity stimulates the entrepreneur to set up) rather than 'necessity' (where the entrepreneurial activity is because of the lack of alternative income-generating activities). The Western Cape scores higher on opportunity than any other province. The Western Cape (and Gauteng) also has a high rate of start-ups and new firms. (Start-ups are firms that have not paid wages or salaries for more than three months, while new firms are those that have paid wages or salaries for between three months and three and a half years.)

In the Western Cape, all owner-managed businesses were estimated to employ approximately 542 000 people, excluding the owner-managers. Of these, 103 000 were in start-ups, 146 000 were in new firms, and 292 000 were in established firms. Opportunity-motivated owner-manager businesses employed 312 000 people, compared with 53 000 in necessity-based owner-manager enterprises. The main sector in which entrepreneurial activity occurs is the retail, restaurants and hotel industry. thirty nine per cent of established and new firms are in this sector, and 47 per cent of start-ups.

Perhaps surprisingly, firms in the Western Cape are not more export-oriented than those nationally, although entrepreneurial firms in South Africa are more export-oriented than in other countries.

While entrepreneurial activity is important for the growth of the Provincial economy, it is important to distinguish entrepreneurial drive (which may underpin the growth of established firms) from the establishment of new firms as such. While new firms have an important impact in creating new employment, increased employment still derives to a greater extent from the growth of established firms. The key challenge is the survival rates of firms once established. This depends on the entrepreneurs, but also on the environment in which entrepreneurs operate.

6. Drivers of Provincial Economic Performance

To a large extent, the drivers of provincial economic performance are national. The restructuring of industry in the past decade has been reflected in poor performance and employment losses in the Province. Similarly, the improved national growth in the past year and the move to a more expansionary macroeconomic stance means the Province should plan for growth – in addressing training, infrastructure and investment by firms. The stimulus for growth is, however, primarily domestic demand.

At the sectoral level, Provincial growth and employment need to rest on a broad foundation of agriculture, industrial regeneration, tourism and services, such as BPO. The pattern of higher growth in financial & business services and tourism, with agriculture remaining very important, does not negate the need to further develop the manufacturing base further.

The far-reaching economic restructuring brought about by policy reforms in the past 10 years means that now is a crucial time to plan for expansion – both regeneration of some of the more traditional industries and new growth. The liberalisation of the economy entailed tough adaptation to increased international competition and a tightening of macroeconomic policies, including high real interest rates. This period is over, or at least for the time being. The tariff reductions are essentially complete, and Government is expanding capital spending, while real interest rates are expected to decline gradually.

A crucial dimension in the Western Cape is its coastal location and the opportunities that arise from it. These opportunities are not only in exports, but also in deepening international links around investment, technology and production networks. The trade data reveals that some sectors have made major gains, led by agriculture, food & beverages and transport equipment. The challenge is to translate the opportunities into output growth and employment in relatively labour-intensive areas of manufacturing.

The way in which increased international integration impacts on the Provincial economy, and the impacts on different groups such as low-skilled and high-skilled workers and different economic sectors, depend to an important extent on actions by Government, in respect of integration and incentivising programmes and interventions.

Broad-based manufacturing growth depends on the patterns of competitiveness in the Provincial economy. Competitiveness in the context of being able to deliver on design, quality and delivery dimensions requires vibrant firm clusters and effective local institutions. For example, in the absence of an appropriate framework, the Province will continue with exports of unbeneficiated metals and in niches such as yacht-building, with relatively limited returns to the wider economy. Interventions around the pricing of steel and the needs of downstream metals products and machinery firms are areas of possible concrete action.

The broad approach here is in line with the thrust of National Government's industrial, trade, technology and skills policies. The challenge is to ensure *effective implementation*. This relates to building/developing effective local institutions and to information gathering, analysis and dissemination. Together this will mean that Provincial Government is able to play a crucial co-ordinating role – building linkages between different programmes, ensuring coherence and consistency, and identifying and removing bottlenecks. This is also very important if government attention is to be directed to less high-profile sectors and industries, which may have much greater potential to absorb low-skilled labour and thereby contribute to poverty alleviation.

From the sector analysis, the following main priorities in building competitive capabilities of producers emerge:

- Ongoing upgrading of agriculture, with emphasis on a broader base of higher value-added products, and support for the research and standards necessary for exporting. This needs to be complemented by support for smaller and historically disadvantaged farmers.
- Addressing cost competitiveness issues in industry (including steel prices); which are impeding the performance of labour-intensive, relatively basic products.
- Developing and implementing action-oriented plans to ensure that policies for skills and training are being implemented effectively. This requires addressing the use of the skills levy, the administration involved, and the provision of appropriate courses by local institutions. These measures will be employment generating in themselves, as increased training activities will lead to the growth of local educational and training institutions.
- Monitoring the various technology initiatives and identifying where Provincial and Local Government facilitation can ensure the potential gains are realised (including the National Tooling Initiative and the AMI). The Province needs to proactively identify areas to develop local technological competency in tertiary education and other research institutions.
- Facilitating of ongoing growth in industries already performing well, such as yacht-building and film-making, with particular emphasis on the quality and quantity of employment.
- Selection of a small number of target areas where Government action can facilitate significant expansion. These include:
 - Ship-building in medium and small vessels;
 - Herbal and natural products such as essential oils;
 - Furniture; and
 - BPO.
- Mechanisms to build inter-firm communication and co-operation, such as benchmarking (which is specifically proposed for foundries and clothing).

Government support should be linked to clear performance criteria and expectations within specified time frames. In this way, the interventions influence firm behaviour, and firms are provided certainty as to what government will provide.

The prospects are good for sustained employment generation as part of a dynamic and diversified growth path.

Benchmarking and cluster development

The development of local clusters is premised on the collective gains from shared services, suppliers and skills development in localised areas, as discussed above. However, collections of firms do not necessarily become clusters. *Benchmarking* relates to a process of inter-firm learning and upgrading to improve operational performance.

Initially, benchmarking – exemplified in South Africa by those in the auto industry – compares firm performance across a range of criteria related to cost control, quality, flexibility and capacity to change. This enables firms to see clearly how far they are from best performance amongst their peers, and naturally leads to a desire to improve and to learn from other firms.

Improved relationships between firms can then graduate to a process of continuous improvement and the development of clusters where firms co-operate to improve competitiveness. Firms may be reluctant to participate together with those they regard as their competitors; however, it is important to distinguish the dynamic development of competitive capabilities from the static competition between firms for a given market. Increased international integration means it is important to view competitiveness in international terms, and related to the development of new markets and product niches.

Benchmarking initiatives are particularly useful where a need for upgrading of firms' competitiveness in terms of quality and delivery has been identified, which points to the importance of examining the organisation of production within firms.

This is relevant for many manufacturing sectors in South Africa, given the environment of a typically ageing management locked into 'ways of working' developed in a relatively protected local market. To achieve firm commitment to an initiative, however, requires analysis to demonstrate to firms the basis of their poor performance and to highlight the future development path in the absence of purposive action.



Employment and Remuneration Trends

1. Introduction

Turning to employment and remuneration prospects, many South Africans contend that economic restructuring has left many without work. Many more are convinced that our economic revival is about jobs, jobs and more jobs. A 'meso-cosm' of the national debate, the Western Cape picture is no different, and the debate on Provincial labour market performance no less contentious.

That said, it is important to get a better understanding of the Western Cape labour market, as it is the key mechanism through which individuals engage with the economy. Through the labour market, individuals sell their labour, earning incomes that enable them to purchase the goods and services they require.

Any exchange offers winners and losers, and so in many countries, the labour market is not entirely free from the state's hand in regulating market forces. But state intervention is not always without fault. Too much intervention or the wrong type of intervention causes 'government failure', which could distort markets to the extent that winners and losers are determined by the state's regulatory hand itself.

Decades of direct state intervention through labour legislation and indirect influence through a range of other government policies related to population movements, education and the cost of capital, amongst others, have shaped the South African labour market into a distinctive milieu.

Today, national, provincial and local government are challenged to address the systemic scars that *apartheid* etched into the labour market, as well as concerns such as alleviating

poverty, reducing inequality and advancing social cohesion that both influence and are influenced by the labour market itself.

Like other provinces, the Western Cape is faced with a daunting and critical task in reshaping, even reconstructing, the Provincial labour market. This is not an easy task and involves difficult public policy choices. Direct tools are not necessarily effective, as they tend to induce too many distortions of their own. Indirect tools offer a better chance of success, as the labour market is interdependent on other key areas of the economy – education, health, investment promotion and infrastructure policies and interventions that impact directly on labour market performance.

At the same time, the Province has to address the myriad issues surrounding internal migration, which may blur the many commonly used indicators to measure Provincial labour market performance. Dealing with the reality of ‘porous borders’ in our evolving intergovernmental system raises the interdependence of the system. One part of the system cannot succeed on its own. Individual provincial employment, economic growth and poverty reduction strategies depend on enabling complementary national, provincial and local policies and strategies. The whole is greater than the sum of the parts.

Chapter 4 investigates trends in the Western Cape’s labour market based on data from two rounds of the Labour Force Survey, conducted in September 2000 and September 2003. An analysis of Provincial demographic trends and future prospects aids understanding of the labour market profile. This section takes a step further, considering the possible effects of migration on the composition of labour supply.

A closer look at the Provincial labour force enables a better understanding of recent changes and their causes. Employment and unemployment are the main focus areas here, highlighting the critical labour market concerns that the Western Cape faces over the medium term.

The third section of this chapter focuses on provincial remuneration trends in the formal sector. Wages and salaries form a major part of the average household’s income, and as such they are main factors driving inequality patterns and trends in the Province. The section investigates pertinent aspects of these trends and looking ahead, teases out their implications for income inequality prospects in the Province.

The chapter closes with an analysis of the Province’s small, medium and micro enterprise (SMME) sector and the informal sector, both of which hold opportunity and improved life prospects for many at the lower end of the income distribution. For many people here, life is not easy. Every moment is spent making sure that the next holds better prospects. If not for themselves, then for their children, for whom life and life’s prospects lie ahead. Therein lies Government’s challenge.

2. Demographic Trends

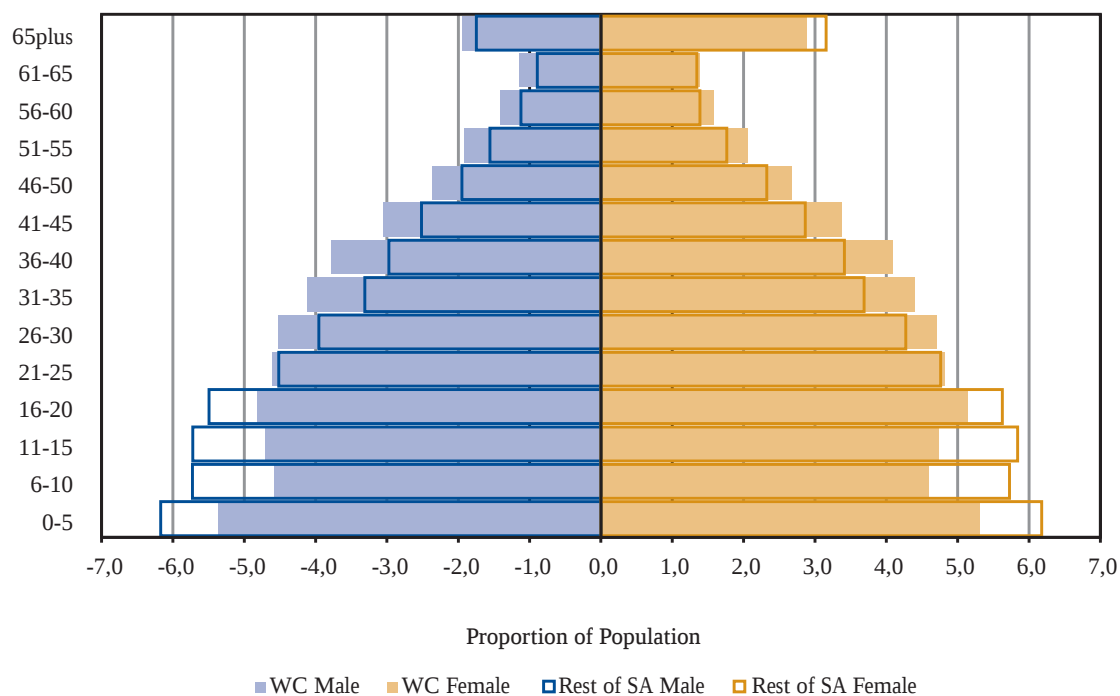
2.1. Demographic profile

Like other markets, the labour market functions through the interaction of supply and demand. Individuals supply or offer their labour to the market. Firms and other potential employers source or demand labour from the market.

A key determinant of labour supply is the size and structure of the population. As the Western Cape is a recipient of in-migration, the size and age profile of the present Provincial population, as well as the numbers and characteristics of individuals migrating into the Province, are important factors that determine the present and future Provincial labour supply.

Those that supply labour on the market constitute the labour force. As only individuals between the ages of 16 and 65 years are legally eligible for the labour force, the size of this age-group or cohort plays an important role in determining the size of the labour force. It is useful to think of the labour force as a dam. The dam becomes fuller as individuals enter the labour force and becomes smaller as they exit the labour force.

Figure 1 Age pyramid for Western Cape and South Africa, 2001



[Source: Statistics South Africa Census 2001]

Although Figure 1 shows that the Provincial population is relatively young in that less than 15 per cent is older than 50 years, relative to the country as a whole the Province's population is slightly older. With higher proportions of the population under 20 years of age, the age pyramid for the rest of South Africa is significantly more bottom-heavy than that of the Western Cape.

Conversely, the Western Cape pyramid is broader at higher age-groups, particularly between the ages of 26 and 45 years. Approximately two-thirds (66%) of the population is between the ages of 16 and 65 and is therefore of working age. Children aged 15 years or younger constitute 29 per cent of the Province's population.

Interestingly, the five age-groups between six and 30 years of age are very similar in size, indicating that the working age population in the Province is likely to grow as these relatively large age-groups grow older and enter the working age population, while fewer older individuals exit the working age population. This change will filter through to the labour force, and the Provincial economy will therefore remain under significant pressure to create jobs for the foreseeable future.

In other words, the inflow of younger people into the 16- to 65-year age group and by implication the labour force 'dam' is likely to be greater than the outflow of older individuals, with the result that the 'dam level' will rise and the labour force will grow.

Looking further ahead, unless migration affects the age distribution of the population significantly, the Western Cape is likely to face the prospect of an ageing population sooner than other provinces.

Across regions within the Province, the Overberg and Eden District Municipalities are relatively old, with 6,2 per cent and 6,0 per cent of their populations respectively over 65 years of age. In contrast, the Central Karoo has the largest proportion of children under 15 years of age (36%) and the City of Cape Town, not surprisingly, has the largest proportion of working age residents.

2.2. Migration trends

Aside from natural population increase, migration can constitute an important root cause of demographic change in South Africa's provinces. The Western Cape is a net receiving province, gaining an estimated *48 000 individuals net of out-migration annually*, according to the *2002 Migration Study in the Western Cape 2001* commissioned by the Western Cape Provincial Government.

Although this may seem a relatively large number, particularly when summed up over time, annual in-migration represents only slightly more than one per cent of the Province's

2001 population (according to Census 2001). Further, the flow of individuals to the Province from other provinces appears to be motivated primarily by brighter employment prospects and higher incomes in the Western Cape relative to the sending provinces, with the largest single stream of migrants originating in the Eastern Cape.

The flow of African in-migrants into the Western Cape has been described as “powerful and fast... probably [representing] the largest and most rapid demographic flow in South Africa” (Western Cape, 2003: 10). Most African in-migrants originate in the southern Transkei region and from Eastern Cape farms and cities, and migrate to Cape Town as well as those regions *en route*, particularly the eastern and southern districts of the Western Cape. About 44 per cent of in-migrants entering the Province originate in the Eastern Cape.

This, though, is likely to represent an underestimate of the true extent of in-migration, as migration information in the 2001 Census relates to the individual’s last move if the individual moved more than once in the five year inter-census period. The situation is compounded by the fact that much migration from the Eastern Cape is, in fact, step-wise migration. Individuals tend not to migrate directly from their place of origin to Cape Town. Rather, they make multiple moves *en route*. A further 18 per cent of in-migrants between the ages of 20 and 65 years arrive from Gauteng and eight per cent from KwaZulu-Natal.

Each in-migrant has a unique set of characteristics. This means that individuals and/or groups both enrich and place demands on the Province in different ways. Closer monitoring of migration patterns and the characteristics of in-migrants offers considerable value, informing Provincial policy- and decision-makers in respect of future demographic and labour force profiles as well as expected demand for provincial infrastructure, social, education and health services.

The 2001 Census allows some investigation of migration, although the data is clouded by certain issues. The most important is the fact that only the information about an individual’s most recent move (between 1996 and 2001) is recorded in the Census, thereby distorting the data where individuals have moved more than once in the inter-census period.

Table 1 presents the age structure of the Province’s population in 2001, according to whether or not they moved in the inter-census period and, if they did move, according to their province of previous residence. Row 8 (Total) of the table shows that in-migrants account for a relatively small size of the population. While 81,7 per cent of the Province’s population did not move in the inter-census period, in-migration accounted for only 7,1 per cent and movement within the Province for 11,2 per cent. As mentioned earlier, migrants from the Eastern Cape constitute the largest group of total in-migration.

Table 1 Age structure of Western Cape residents by recent migration status, 2001

	Moved Within WC (%)	Moved from Eastern Cape (%)	Moved from Rest of SA (%)	Moved from Foreign Country (%)	Did Not Move Since Census '96 (%)	Total In- Migration (%)
0 to 15 years	7,9	1,7	1,8	0,2	88,4	3,7
16 to 25 years	11,9	7,0	4,2	0,6	76,3	11,8
26 to 35 years	17,0	4,5	4,8	0,8	72,9	10,1
36 to 45 years	12,4	2,1	3,7	0,5	81,4	6,2
46 to 55 years	9,4	1,4	3,5	0,5	85,1	5,5
56 to 65 years	8,8	1,1	4,1	0,5	85,4	5,8
Over 65 years	10,1	0,9	3,7	0,5	84,7	5,2
Total	11,2	3,2	3,5	0,5	81,7	7,1

[Source: Statistics South Africa Census 2001]

Note: The zero to 15-year age group actually refers to five- to 15-year olds, as younger children had not been born at the time of the 1996 Census.

In-migration to the Western Cape is most common amongst younger individuals between the ages of 16 and 35 years. In 2001, almost 12 per cent of 16- to 25-year olds in the Province and 10 per cent of 26- to 35-year olds had migrated from outside the Western Cape since 1996. The bulk of the former group originated in the Eastern Cape (around three-fifths), while this was true of slightly less than half of the latter group. Interestingly, in-migration from the rest of South Africa (excluding the Eastern Cape) and from other countries to the Western Cape is spread relatively evenly as a proportion of the Province's population across the age-groups, while in-migration from the Eastern Cape tapers off significantly as age rises. Thus, while 7,0 per cent of 16- to 25-year olds in the Western Cape are recent in-migrants from the Eastern Cape, this is true of only about one per cent of 56- to 65-year olds and those over 65 years of age.

In terms of the impact on the working age population, net in-migration constitutes an injection of young individuals into the Province's working age population (72,6% of in-migrants are under 36 years of age compared to 65,6% of those Western Cape residents who did not move in the inter-census period).

In-migrants from the Eastern Cape differ significantly from other in-migrants in this regard, with 83,3 per cent being in the under 36 years of age group. This difference is even more marked when one compares the proportions for individuals between 16 and 35 years of age: 48,9 per cent of other in-migrants fall into this age-group compared to 68,0 per cent of those from the Eastern Cape. *The Migration Study* found that, being younger, the Coloured and African migration streams represent an injection of young motivated workers, while the older White stream "contributes few workers but brings in economic resources of capital and skills" from geographically diverse origins (Western Cape, 2003: 11).

Since in-migrants add to the working age population and, by extension, the labour force, it is useful to investigate what level of education this addition represents. In Table 2, in-migrants between the ages of 20 and 65 years are classified according to their migration status and their highest educational attainment. The 20- to 65-year age-group is chosen as we are interested in the working age population; the inclusion of individuals younger than 20 would provide a false impression of average education levels since many of them are likely to be attending educational institutions.

Column 8 (Total Western Cape Population) of the table provides a breakdown of the Provincial population for comparison purposes and indicates that over 28 per cent of the population have a primary education or less, while 30,2 per cent have a matric certificate. Just less than five per cent of the population have a tertiary qualification. In-migration as a whole represents a boost to the Provincial educational profile, since almost 41 per cent of all in-migrants have a matric while a further 10 per cent have a tertiary qualification.

By origin, in-migrants differ in their educational attainment. Thus, for example, in-migrants from other countries are substantially better educated than the general Provincial population: 33 per cent have tertiary qualifications and almost 50 per cent have completed secondary education.

However, the main stream of in-migrants (that from the Eastern Cape) has a lower educational profile than the stream of in-migrants from the rest of the country. Only 29 per cent of in-migrants from the Eastern Cape in this age-group have completed secondary school and 2,7 per cent have tertiary qualifications, while 27,7 per cent have a primary education or less. Amongst in-migrants from the rest of the country, these proportions are 50,0 per cent, 13,6 per cent and 12,9 per cent respectively.

Although these figures may seem to indicate that in-migrants from the Eastern Cape are lowering the educational profile of the Province, this is an incorrect assumption. In the first place, although in-migrants from the Eastern Cape represent the largest stream entering the Province, it is still relatively small compared to the Provincial population. This means that the lower educational attainment of in-migrants from the Eastern Cape is unable to make a major difference to the educational breakdown of the broader population.

Secondly, in-migrants from the Eastern Cape tend to be younger than in-migrants from other regions; consequently a greater proportion of the former is likely to be in the process of improving their educational status. Thirdly, comparing columns three (Moved from Eastern Cape) and six (Did not Move Since Census '96) in Table 2 makes it clear that the educational attainment of in-migrants from the Eastern Cape is, in fact, not significantly different to the profile of the Province's non-migrant population, nor is it substantially different to the profile of the overall Provincial population.

Table 2 Educational attainment of the Western Cape population aged 20 to 65 years by migrant status, 2001

	Moved Within WC (%)	Moved Eastern Cape (%)	Moved from Rest of SA (%)	Moved from Foreign Country (%)	Did Not Move Since Census '96 (%)	Total In- Migration (%)	Total WC Population (%)
No Education	3,4	6,0	3,0	1,9	5,6	4,2	5,2
Incomplete Primary	11,1	15,0	6,5	1,4	16,5	9,9	15,2
Complete Primary	6,0	6,6	3,4	0,9	8,8	4,7	8,0
Incomplete Secondary	32,9	40,2	23,6	12,8	38,1	30,2	36,7
Complete Secondary	39,3	29,4	50,0	49,7	27,5	40,8	30,2
Tertiary	7,4	2,7	13,6	33,2	3,5	10,2	4,6
Total	100,0	100,0	100,0	100,0	100,0	100,0	100,0

[Source: Statistics South Africa Census 2001]

Note: The zero to 15 year age-group actually refers to five- to 15-year olds, as younger children had not been born at the time of the 1996 Census.

The fact that recent in-migrants from the Eastern Cape are generally not as well educated as other in-migrants poses specific challenges to Government. Recent research by Van der Berg *et al.* (2004) drawn from the 1996 Census finds that the Western Cape seems to be attracting less educated in-migrants from the Eastern Cape and, specifically, that better educated African migrants from the Transkei region tend not to migrate to the Western Cape but rather move to Gauteng or Eastern Cape cities (Port Elizabeth in particular).

This means that many Eastern Cape in-migrants find themselves slotted in at the lower end of the labour market, where unemployment is greatest, and their relatively weaker social networks mean that they are more likely to struggle to find employment. This is certainly not good from the affected individuals' point of view, but neither is it from society's point of view.

Internationally, migration is often seen as a threat or a negative phenomenon by both receiving and sending regions. Receiving regions tend to feel that in-migrants represent a burden to their economies and government budgets, while sending regions often feel that they are losing precious skills and expertise in the short term.

The Western Cape, along with Gauteng, are major receiving regions for internal migration. It is important, however, not to exaggerate the magnitude of the phenomenon, nor its impact on the aggregate Provincial profile. Nevertheless, in-migration may pose certain challenges, particularly in the areas of service delivery and job creation where there are existing backlogs. It is essential that these challenges are identified, incorporated into

current policy formulation and addressed proactively to ensure that potential future problems are avoided.

3. Labour Market Trends

3.1 Analysing labour market performance

Assessing labour market performance is often a contentious debate. At the political level, contending voices clamour that economic restructuring has left many without work. Many more are convinced that economic revival is purely about jobs. At the technical level, debate is fraught in respect of the analytical measures and data used to assess labour market performance, their robustness and how analytical results should be interpreted, given many data and measurement uncertainties.

Labour market analysts therefore need to tread carefully amidst assessments that either tout the expansion of employment opportunities since 1995, based on national household survey data, or denote South African growth over the last decade as the 'jobless' result to economic restructuring.

The stakes are high. Earning an income is the best tool to lift a family out of poverty. This means that 'getting the story right' on labour market performance is critical in the present political and policy terrain. To do so, it is important to understand the potential and limits of labour market data and the available analytical assessment tools.

Data used in employment analysis

Employment analysis based on nationally representative household surveys commonly uses three groups of datasets:

- The October Household Surveys (OHSs);
- The Labour Force Surveys (LFSs);
- The subsequent LFS of September 2003; and
- The 10% Sample of the national population Census of 2001.

The OHSs were Statistics South Africa's first major household surveys conducted on a national level that included the former homelands and self-governing territories. These surveys were conducted annually in October between 1995 and 1999. The surveys collected a variety of information, including demographic, living conditions, education, health, social security, migration and labour market information.

In 2000, the OHS was discontinued and subsumed into the new LFS, which provides the most comprehensive household-based look at the labour force of any survey of its magnitude currently undertaken by Statistics South Africa. Unlike its predecessor, the LFS is conducted twice each year in February/March and September. As its name suggests, the LFS has as its primary focus the labour market, although it also collects much of the

information previously collected in the OHSs. The first LFS was piloted in February 2000 with a relatively small number of households (9 705) and, as a result, is generally not useful for analysis. Consequently, the first usable LFS is that of September 2000. Most LFSs sample between 26 000 and 29 000 households, representing over 100 000 individuals. The sample is constructed in such a way as to be representative of the national 'picture' by 'inflating' the results derived from the sample.

For a number of reasons, this chapter uses the September 2000 and 2003 LFSs. Most importantly, it provides the longest period for analysis based on the LFSs – three years, between September 2000 and September 2003. (Unfortunately, the September 2004 LFS was not yet available at the time of writing.) It also made more sense to use September LFSs because the Census is conducted in October, which implies that seasonal changes in the labour market would not be too much of an issue. Finally, seasonal influences on the labour market make comparisons of February and September LFSs more difficult and prone to error.

The Census, on the other hand, is not a very good source of labour market information (not all questions key to labour market analysis can be asked due to questionnaire space limitations). As a result, the Census tends to underestimate employment and over-estimate unemployment when compared to the LFS.

A further concern is that the frequency of the Census, previously at five-year intervals and now at 10-year intervals, complicates inter-temporal labour market analysis, or how labour market trends change over time.

However, the major advantage of the Census is its ability to provide information at a relatively low level of geographic aggregation, a feature that does not pertain to the LFS. In other words, the Census 10% Sample is able to provide accurate information at a district council or magisterial district level. Consequently, in an effort to provide a spatial 'flavour' to this chapter, the 2001 Census is used as a secondary data source.

As Census estimates of labour market variables are not totally accurate, too much emphasis should not be placed on the actual derived figures. Instead, these estimates should be used to place regions in the appropriate context relative to one other and to the Province as a whole.

Neither the LFSs nor the Census 10% Sample are able to provide exact numbers for variables such as employment or even, for example, the number of males or females in the population. Instead, they provide only estimates and 'bands' in which the true value of the variable is expected to lie. Therefore, when estimates from two different surveys are compared, it is important to test whether changes are real, rather than related to issues associated with the sample itself. Such changes are said to be statistically significant, which means one can be reasonably certain that these changes did occur. If a change is statistically insignificant, there is not enough certainty that the variation in the estimates is real.

A closer look at the national household surveys (the LFSs) in Table 3 shows that South Africa has witnessed significant employment growth, although such growth appears to have occurred prior to 2000. Between 2000 and 2003, aggregate national employment seems static at about 11,6-million jobs.

What is often forgotten is that these net results mask dynamic movement within and between economic sectors and occupational classes or skill levels. 'Sunrise' or stressed

Table 3 Labour force change in South Africa and the Western Cape, 2000 – 2003

	2000 (‘000s)	2003 (‘000s)	‘000s	Change %	% p.a.	Target Growth Rate (%)	Emp. Absorp. Rate (%)
Western Cape							
Employment	1 537	1 730	194	12,6	4,0		
Expanded Unemployment	449	612	163	36,3	10,9		
Expanded Labour Force	1 986	2 342	356	17,9	5,7	23,2	54,3
Official Unemployment	317	448	131	41,5	12,3		
Official Labour Force	1 853	2 178	325	17,5	5,5	21,1	59,6
South Africa							
Employment	11 675	11 612	-63	-0,5	-0,2		
Expanded Unemployment	6 538	8 302	1 763	27,0	8,3		
Expanded Labour Force	18 214	19 914	1 700	9,3	3,0	14,6	-3,7
Official Unemployment	4 074	4 562	487	12,0	3,8		
Official Labour Force	15 750	16 174	424	2,7	0,9	3,6	-14,9

[Source: Statistics South Africa LFS, September 2000 and September 2003]

sectors will shed employment, while rising or booming sectors will create employment. And there are always winners and losers in this game.

Another key factor to take into account is that while the economy may be creating jobs, it may not be creating enough jobs given the rising number of new entrants into the labour market each year. If annual job growth does not exceed or at least equal the growth in the labour force, rising unemployment rates will continue to be a defining feature of the South African society and economy.

This is the story that represents a more realistic and factual account of South African labour market performance over the last decade. Table 3 shows that the numbers of unemployed and the rates of unemployment have risen dramatically since 1995, irrespective of whether one uses the narrow or expanded definition of unemployment. By 2003, 8,3-million South Africans were unable to find work, up by more than four million individuals, with nearly 1,8-million of these becoming unemployed since 2000.

Definitions of unemployment

Translating the layperson's concept of being unemployed ('not having a job') into a technical and measurable form is a relatively difficult task.

Following that used by the International Labour Organisation (ILO), South Africa's official (or narrow) definition of unemployment classifies individuals as being unemployed if they "(a) did not work during the seven days prior to the interview, (b) want to work and are available to start work within a week of the interview, and (c) have taken active steps to look for work or to start some form of self-employment in the four weeks prior to the interview" (Statistics South Africa *Statistical Release* P0210, 2002: xv). This places the 'burden of proof' on the shoulders of non-employed individuals: they need to demonstrate that they have made some attempt at finding or creating a job for themselves. The expanded (or broad) definition of unemployment, on the other hand, does not include criterion (c).

Although the narrow definition is the official definition in South Africa, the evidence suggests that the broad definition is better able to identify the unemployed accurately in countries like South Africa where unemployment rates are very high and many individuals give up looking for work, becoming what is termed 'discouraged workers' (see Kingdon and Knight, 2001: 84-87, for a complete discussion). As a result, the analysis in this paper is based on the expanded definition of unemployment. That is, simply stated, if you have not worked in the last week, but you want to work and would, if offered a job, be able to start working within a week, then you are classified as unemployed according to the expanded definition.

3.1.1. Western Cape labour market performance

At the provincial level, the Western Cape's labour market performance holds brighter prospects than its national counterpart.

The Western Cape's superior employment performance and its faster unemployment growth therefore translate into labour force growth that is significantly higher than is the case nationally. The problems of rapidly growing numbers of unemployed individuals and of a rapidly growing labour force are interlinked, but it is possible to begin to separate out the various forces involved. Because the unemployed are part of the labour force, rapid unemployment growth often, but not always, translates into labour force growth and *vice versa*.

Since 2000, though, about 194 000 jobs were created in the Western Cape at a rate of 4,0 per cent per year. This has seen the Province raise its share of national employment from 13 per cent to 15 per cent. Unfortunately, although employment growth has been above the national average, unemployment in the Province, irrespective of definition, has also expanded at a more rapid rate. The Province is now home to 7,4 per cent of the country's broadly unemployed.

Calculating *target employment growth rates* (TGRs) and *employment absorption rates* (EARs) are useful measures to assess and explain labour market performance and trends in the context of an expanding labour force.

The *TGR* represents the rate of employment growth that would absorb all net new jobseekers into employment, and is defined as the *change (growth) in the labour force relative to the level of employment in the base year* (Bhorat, 2003)¹. For example, if there are 100 000 employed people in the Province, and the labour force grows by 10 000 people, then the target growth rate (which would see *all* net new jobseekers finding a job) would be 10 000 divided by 100 000, which equals 10 per cent. So, the number of jobs would have to grow by 10 per cent for all new jobseekers to find employment.

Interestingly, the target growth rate is a rather high target, because it means that the unemployment rate amongst the cohort of new jobseekers would be zero per cent. What this means is that if employment growth equalled the target employment growth rate, the overall unemployment rate would fall relatively rapidly.

Even though it may not seem so – representing, as it were, a ‘treading water’ level of employment growth – achievement of this target rate of employment growth would be a major success for the economy and policy-makers, as it provides a benchmark rate of employment growth that starts to stabilise unemployment levels in the context of an expanding labour force, pointing to the possibility of lower unemployment rates over the medium to long term.

The *employment absorption rate*, on the other hand, answers the question, “By how much did employment growth miss the target growth rate?”, thereby *comparing the actual growth of employment to the target growth rate*². Where actual employment growth equals the target growth rate, all net new jobseekers would have been absorbed into employment and the employment absorption rate will equal 100 per cent.

Any employment absorption rate below the current unemployment rate will entail an increase in overall unemployment rates. If the employment absorption rate were to improve (rise towards 100, or even more), it would mean that a greater proportion of new labour force participants would be absorbed into employment than before, while a smaller proportion would become unemployed. In contrast, if the employment absorption rate were to worsen (fall towards zero or lower), a smaller proportion of labour force participants would be absorbed into employment than before, while a larger proportion would become unemployed.

The relatively rapid expansion of the Provincial labour force is evident from the Province’s higher target growth rates when compared to national data. To absorb the net increase in

¹ Mathematically, the TGR equals $\frac{EAP_{k,t+1} - EAP_{k,t}}{L_{k,t}} \times 100$, where EAP is the economically active population (or the labour force) and L is the employment level. The subscript k denotes any given subpopulation and t the period.

² The EAR is represented mathematically by $\frac{L_{k,t+1} - L_{k,t}}{EAP_{k,t+1} - EAP_{k,t}} \times 100$, where EAP is the economically active population (or the labour force) and L is the employment level. The subscript k denotes any given subpopulation and t the period.

the Province's labour force between 2000 and 2003, the Western Cape would have needed to achieve employment growth in excess of 20 per cent. This is equivalent to an average of about seven per cent a year.

As seen earlier, actual Provincial employment growth reached just 12,6 per cent over the period – half of the required rate, resulting in an employment absorption rate of 54,3 per cent according to the expanded definition of unemployment. Despite the fact that almost one in two net labour market entrants in the province was unable to find employment, these rates compare favourably with national rates (-0,5% employment growth between 2000 and 2003, and a -3,7% employment absorption rate), which indicates an inability on the part of the national economy to absorb the growing labour force³.

The usefulness of the target employment growth rate and employment absorption rate measures is that they can be calculated for specific groups within the labour force, for example, for Coloureds or for females or for Cape Town residents. This allows one to identify areas of success and progress as well as areas of concern that need further policy attention.

Figure 2 presents the relationship between desired employment growth and actual employment growth in the Province. The three columns in the figure represent the target growth rate of employment, the actual growth rate of employment and the employment absorption rate. The relationship between the target growth rate and the employment absorption rate is clarified through the inclusion of the actual employment growth rate. Thus, in the figure, the TGR (first) row divided by the actual employment growth (second) row (and multiplied by 100) gives the employment absorption rate (third) row.

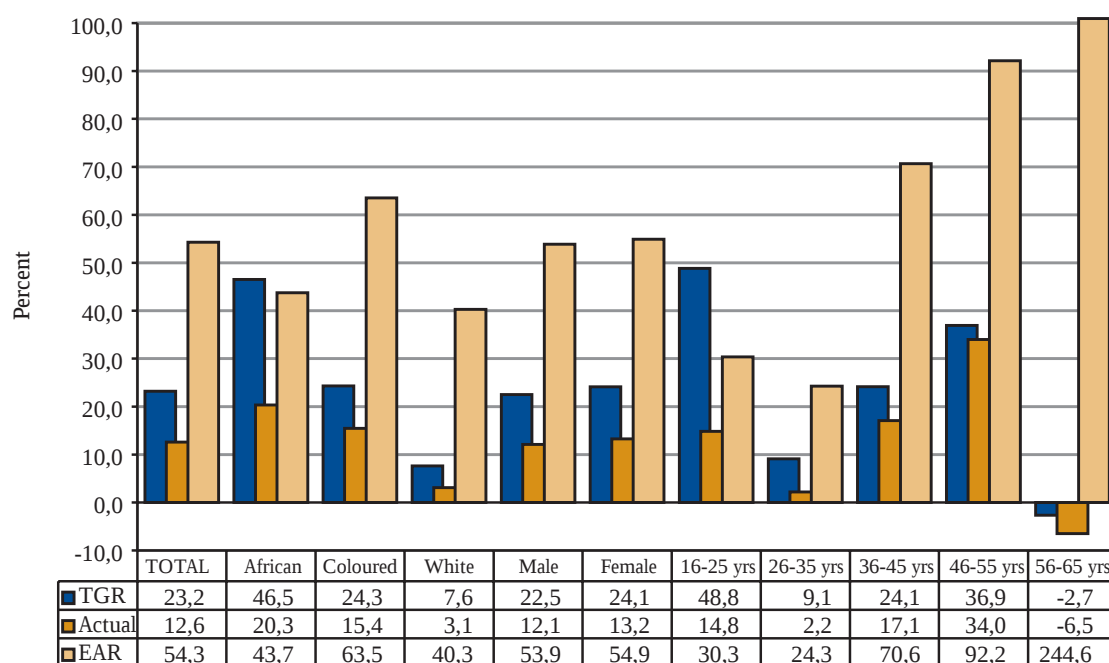
A number of interesting changes are evident. For example, the African labour force has grown rapidly, requiring employment among this group to grow by almost half to absorb new labour force entrants (the TGR is 46,5%), but the economy has been able to absorb only two-fifths of these new entrants (the EAR is 43,7%). This growth is at least in part related to the continued in-migration of Africans to the Western Cape, which is adding younger, relatively less skilled individuals to the labour force. In comparison, nearly two-thirds of Coloured net labour force entrants were absorbed into employment, while amongst Whites, employment absorption was only around 40 per cent.

While there are differences amongst the races, the experience of males and females has been virtually identical. Perhaps the most alarming trend relates to the youth as opposed to other age-groups. The youngest group within the labour force – 16- to 25-year olds – has seen relatively rapid labour force growth, but only three in 10 new entrants in this age-group were able to secure employment. At the other extreme, labour force growth amongst the oldest has been slower, with very high levels of absorption being recorded for those over

³ Although the employment absorption rates for the South African economy are negative in the table, the decline in employment is statistically insignificant, which would render employment absorption rates of zero per cent.

35 years and, in particular, for those over 46 years of age. Even amongst 26- to 35-year olds, fewer than one in four of net new labour market entrants found employment despite a low target growth rate of just over nine per cent. Clearly, therefore, there are important issues that need to be dealt with in this regard and the emphasis placed by the *iKapa Elihlumayo* strategy on the youth is not misplaced.

Figure 2 Required and actual labour market performance for the Western Cape, 2000 – 2003



[Source: Statistics South Africa LFS, September 2000 and September 2003]

As mentioned earlier, the size of the labour force is related to the size of the population between the ages of 16 and 64 years. The size of the labour force is also affected by the propensity of individuals to enter the labour market. This is essentially a behavioural change, with individuals deciding whether or not to enter the labour force based on innumerable factors, some relevant to the general population and others personal. Recent evidence from national household surveys shows that, nationally, there has been a significant increase in the propensity of individuals, particularly African females, to enter the labour force, as reflected by the labour force participation rate (LFPR) (Casale and Posel, 2002; Bhorat and Oosthuizen, 2004).

Rising labour force participation rates have been observed internationally; in South Africa, this phenomenon is the result of numerous forces acting on society. One of the key reasons is certainly the opening up of the South African labour market and the elimination of racially-based restrictions on access to jobs and geographical mobility, allowing all

individuals the opportunity to engage in the labour market. The changing structure of the South African economy, with the growth of the services sectors, has both created space and stimulated demand for greater female employment. Other issues may include rising poverty that has forced individuals into the labour market in order for them to survive and support their households.

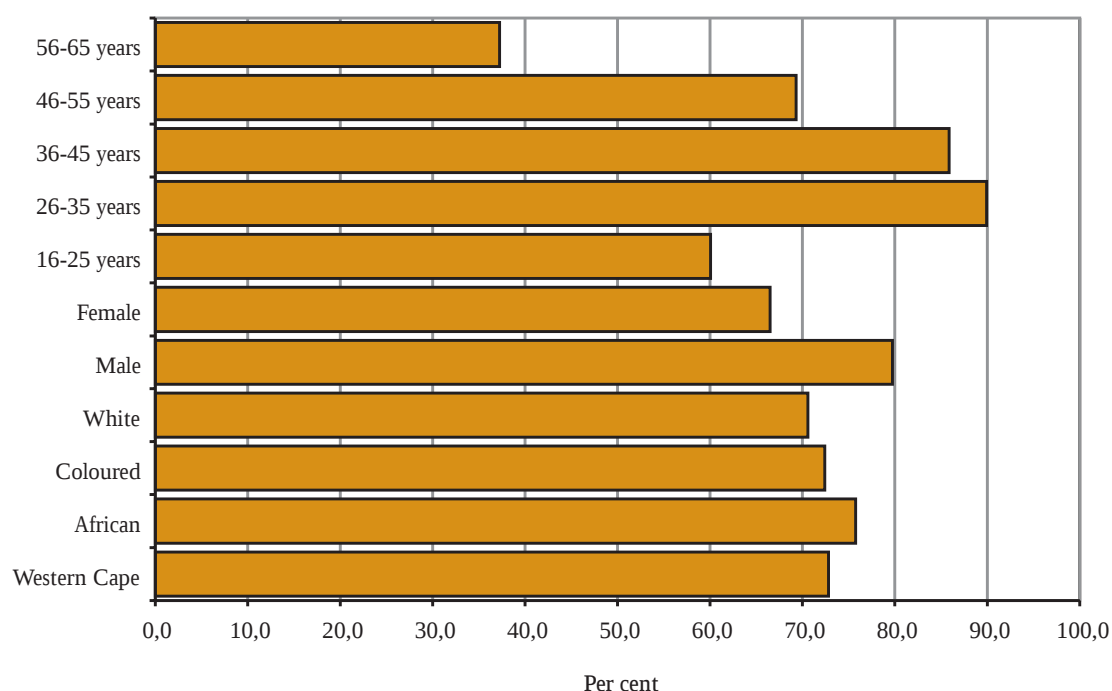
The labour force participation rate is calculated as the size of the labour force as a proportion of the number of people in the working age population (16 to 65 years). For example, if there are 17 000 employed people of working age and 13 000 unemployed people of working age, then the labour force consists of 30 000 people. If there are another 20 000 people who are outside of the labour force (neither employed nor unemployed), the labour force participation rate is $(17\,000 + 13\,000)$ divided by $(17\,000 + 13\,000 + 20\,000)$, which equals 60 per cent.

Higher LFPR rates contribute to rapidly growing numbers of unemployed individuals, particularly in the context of the broader economy's inability to absorb new labour market entrants. At the national level, the most marked increase in participation was amongst African females (up 17 percentage points to 64%). Large increases were also recorded over the period in rural areas (up 13 percentage points to 62 per cent), largely related to the change observed amongst African females, and for 15- to 24-year olds (up 12 percentage points to 41%) (Oosthuizen and Bhorat, 2004).

In the Western Cape, however, labour force growth of 17,9 per cent between 2000 and 2003 is attributable to the rapid growth of the 16- to 64-year age-group, averaging 5,7 per cent per annum, more than 1,5 percentage points higher than the provincial population growth rate, with LFPR not contributing to labour force growth at all.

Figure 3 shows that almost three in four individuals (72,8%) in the Western Cape between the ages of 16 and 64 years form part of the labour force, the rest being classified as not economically active. There is relatively little difference across race groups, with African participation marginally higher than that of Coloureds and Whites. This is likely a result of differences in household incomes that allow members of wealthier households the opportunity of withdrawing from the labour force without significant deleterious impacts on their households, but it may also stem from differences in these groups' age and gender profiles.

Figure 3 Western Cape labour force participation rates, 2003



[Source: Statistics South Africa LFS, September 2000 and September 2003]

As one would expect, men are more likely to enter the labour force than women. About 80 per cent of males are labour force members, being either employed or unemployed, compared to two-thirds of females. The usual pattern of greatest engagement with the labour market amongst the middle age-groups is confirmed, with labour force participation at 85 per cent to 90 per cent amongst 26- to 45-year olds. LFPRs are lower amongst the very young (due to participation in the further and higher education system) and the very old (incidence of retirement increasing with age).

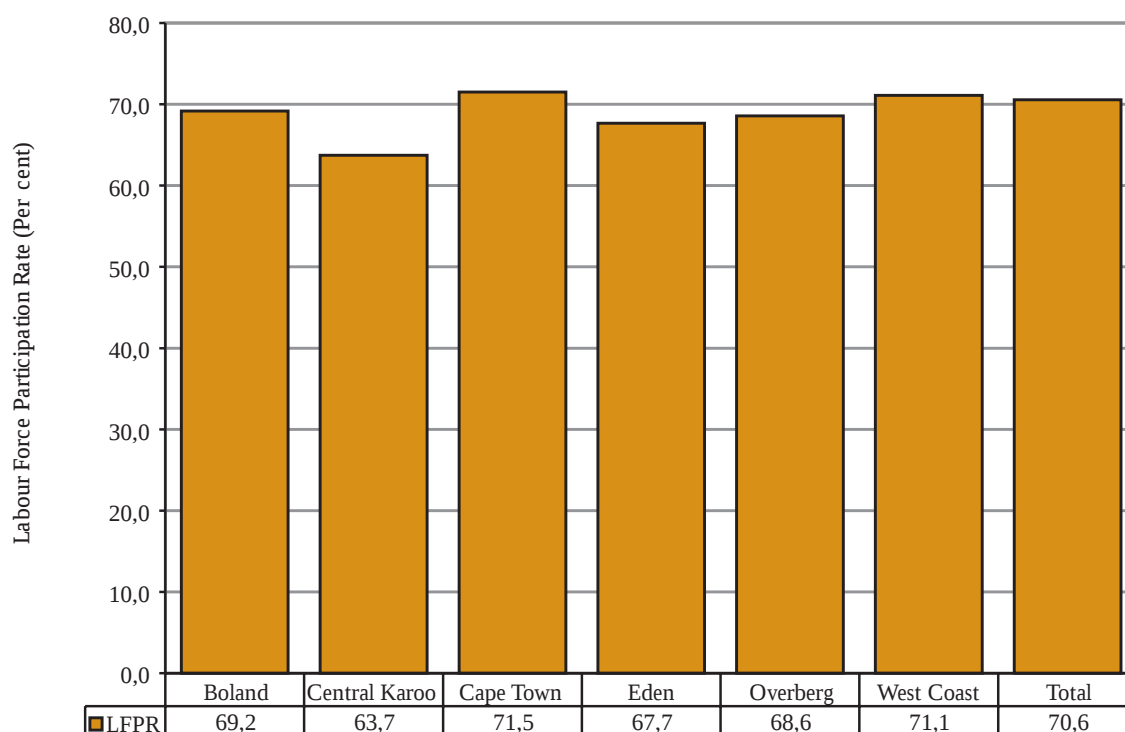
As one moves higher through the age-groups, growing proportions of individuals tend to exit the labour force due to, *inter alia*, family responsibilities or retirement. For instance, a mere 37 per cent of 56- to 65-year olds are labour force members. This result may be related to the Western Cape being a recipient of older, often retired, migrants.

In the broader national context, Gauteng and the Western Cape have the highest provincial labour force participation rates, due most likely to their urbanised nature. The only large difference observed is for 16- to 25-year olds, where the Western Cape's LFPR is more than 10 percentage points higher than the national figure. This result is somewhat concerning, given that non-participants in this age-group are most likely to be engaged in education, and therefore corresponds to the high drop-out rate in secondary schooling from Grade 10 onwards, pointing to the critical importance of the Human Resource

Development Strategy focus on improving school through-put and further education and training provision through the Western Cape.

Just as the Province differs from the rest of the country in terms of individuals' decisions to enter the labour force, so regions within the Province differ from one other. The Western Cape's five district councils – the Boland, the Central Karoo, Eden, Overberg and the West Coast – and the Province's only metropolitan area, the City of Cape Town, are each distinctive in their demographic and economic characteristics. It is therefore not surprising that labour force participation varies across regions.

Figure 4 Labour force participation rates by district council, 2001



[Source: Statistics South Africa Census 2001]

Figure 4 provides rough estimates of labour force participation rates by district council in 2001. For the Western Cape as a whole, labour force participation is estimated at just over 70 per cent. Labour force participation rates in the six regions vary between 63 per cent and 72 per cent, with participation highest in Cape Town (71,5%) and the West Coast (71,1%). In contrast, less than two-thirds of adults between the ages of 16 and 64 years in the Central Karoo are economically active, rising to 67,7 per cent in Eden. (For information by magisterial district, refer to Appendix B).

The broad outlines of the Western Cape labour market sketched above reveal a mixed performance that stands in contrast to the national picture. On the positive side, Provincial employment has grown at a fairly rapid pace since 2000 and employment absorption has

been relatively good by South African standards. In both instances, the Provincial performance has exceeded the national average. However, the fact that rapid labour force growth has been significantly higher than the national average means that unemployment growth in the Province has far exceeded national unemployment growth. On average, this indicates an increasing burden on employed individuals to provide for those without employment, and points to the prospect of increased inequality and a greater burden on Provincial social spending if this trend continues.

3.2. Employment and unemployment

A detailed walk through Provincial demographic and labour market trends and the performance of the Provincial labour market provides an essential backdrop against which Provincial employment and unemployment may be analysed.

3.2.1. Employment and unemployment: a national priority

Unemployment remains one of the most pressing socio-economic problems facing South Africa and one that has a myriad of linkages to other issues and problems, such as poverty, inequality and crime. Unemployment continued to increase steadily over the entire post-*apartheid* era. Nationally, in 1995, the official unemployment rate was around 17 per cent of the labour force and expanded unemployment stood at 30 per cent (Oosthuizen and Bhorat, 2004). By 2000, these rates stood at 26 per cent and 36 per cent respectively, rising further to 28 per cent and 42 per cent respectively in 2003.

Recent evidence from the LFSs, though, suggests that national unemployment rates are stabilising, if not declining slightly. Rising unemployment does not preclude the expansion of employment and, as mentioned earlier, the period 1995 to 2002 saw the number of jobs nationally grow by around 1,6-million. At the same time, employment in the Western Cape expanded by 177 000 jobs at a rate slightly slower than nationally (Western Cape, 2003: 18). In 2003, the Provincial unemployment rate was 26 per cent according to the expanded definition and 21 per cent according to the official definition.

That unemployment is not as severe in the Western Cape as it is nationally is evident from the relatively small proportion of the broadly unemployed who can be classified as discouraged work-seekers (around 5% of the labour force). In contrast, nationally, discouraged work-seekers constitute around 13,5 per cent of the labour force.

3.2.2. Composition of the employed and unemployed

Unemployment problems are typically identified through investigations of unemployment rates, with higher rates indicating the most serious problems. However, unemployment rates, although important to our understanding of labour market conditions, tend to

provide only part of the picture. In common with poverty analyses, while it is important to know which group is most often afflicted by unemployment, policy must also be informed by the knowledge of which group constitutes the largest *share* of unemployment.

Analysis in respect of *unemployment rates* and *unemployment shares* provides critical information to policy- and decision-makers in respect of government interventions to assist the unemployed. In essence, the question is whether it is preferable to focus on helping the group most often afflicted by unemployment (the group with the highest unemployment rate) or on helping the largest group of unemployed individuals (the group with the highest unemployment share). Given a stratified labour market at the national and provincial levels, this question impacts on race, gender, age and geographic or spatial area variance in employment and unemployment trends.

Probably one of the simplest ways to identify problems in terms of employment and unemployment is to compare their composition. So, groups that constitute inordinately large proportions of the unemployed relative to the employed can easily be seen to be disadvantaged, for whatever reason. The further benefit of this approach is that it gives an idea of a group's unemployment share, as well as its unemployment rate relative to the average (*national and provincial unemployment rates by race, gender and age-group can be found in Appendix A*). In situations where a group's unemployment share exceeds its employment share, that group's unemployment rate is above the average for the overall population, while the opposite is true where the unemployment share is lower than the employment share.

Figure 5 presents comparisons in respect of Western Cape employment and unemployment according to race, gender, age and education, immediately highlighting concerns in respect of Africans, females, the youth and the less educated.

Given that the Western Cape's demographic profile differs markedly from the broader national demographic profile, so too do the Province's employment and unemployment profiles differ from those at the national level, where nine in 10 unemployed individuals are African.

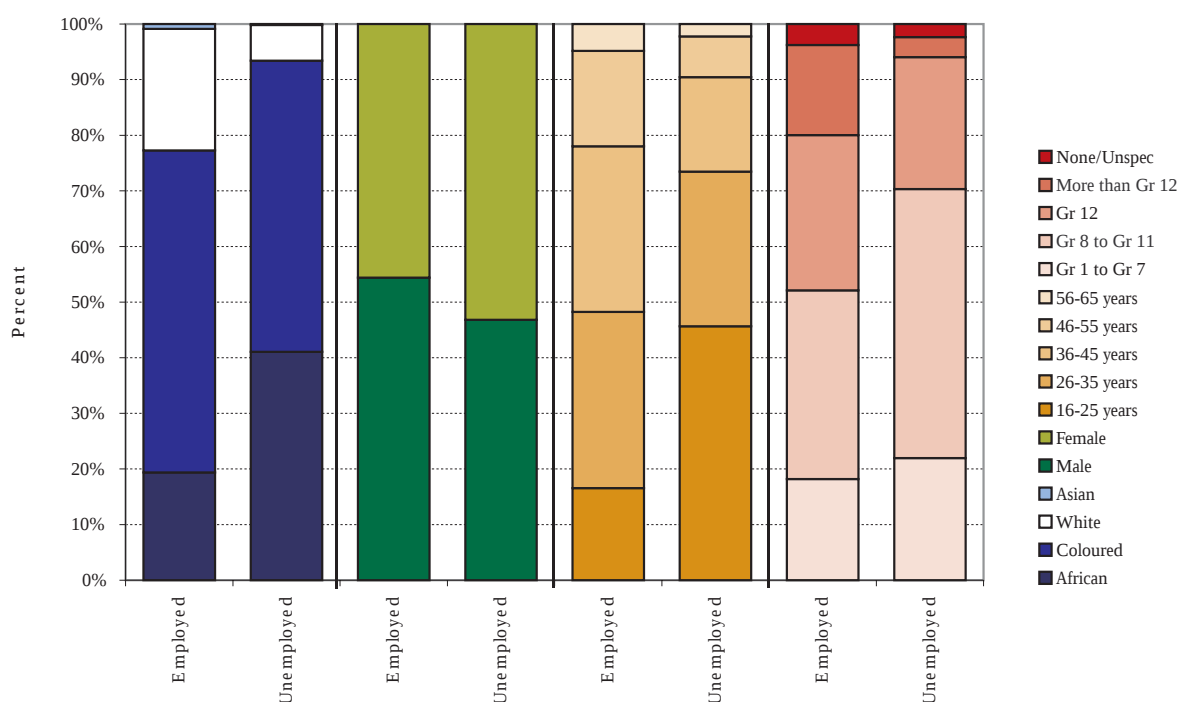
In 2003, most jobs (58%) in the Western Cape were filled by Coloureds, reflecting their demographic dominance in the Province. In contrast, Africans and Whites each constitute around one-fifth of Provincial employment.

At the same time, more than half, or 320 000, of the 612 000 Western Cape unemployed are Coloured. In contrast, at 41 per cent, Africans' share of unemployment is twice their employment share (19,4%) indicating a substantial disadvantage for Africans in the Provincial labour market. Conversely, Whites' unemployment share is around six per cent and less than one-third of their employment share (21,8%).

These patterns suggest a higher unemployment rate amongst Africans than is the case nationally, pointing to inequitable access to the Provincial labour market. Such inference is confirmed by data analysis, which shows that the Provincial unemployment rate amongst Africans was 43 per cent in 2003, compared to 48,7 per cent nationally. Within the Province, this compares to 24 per cent for Coloureds and only nine per cent for Whites. However, the rise in the African unemployment rate was, relative to the 2000 rate, slowest amongst the three race groups, at less than 10 per cent. On the other hand, the unemployment rate for Whites increased by 62 per cent off a low base (less than 6%).

Not only is employment unevenly distributed across individuals of different race groups, but it also appears that the new jobs created since 2000 were not evenly distributed. Approximately 70 per cent of net employment growth was attributable to Coloured individuals, resulting in this group slightly increasing its share of total employment. Growth in African and Coloured employment exceeded the Provincial average (around 6% off a relatively low base and 5% off a much higher base, respectively), while White employment remained constant at around 370 000.

Figure 5 Composition of the employed and unemployed in the Western Cape, 2003



[Source: Statistics South Africa LFS, September 2003]

The relatively high proportion of Africans amongst the unemployed is related to this group's skills profile and rate of in-migration. Given historical inequities in educational provision, African in-migrants tend to have a lower skills profile than other in-migrants. This trend is compounded by the fact, noted above, that the Western Cape is attracting 44 per cent of its in-migrants from the Eastern Cape, but at the lower end of the skills

spectrum, while those of a higher skills dispensation tend to migrate to Gauteng or to cities in the Eastern Cape, in particular Port Elizabeth.

These trends exacerbate already high levels of Provincial unskilled and semi-skilled labour supply at the same time that those economic sectors most dependent on such labour profile, for instance agriculture and clothing & textiles, are in decline. (*Please refer to Chapter 3 for more detail on Provincial economic sectoral performance*). The conflation of demographic factors, increased supply of low-skilled labour and reduced demand for such labour in the Western Cape has therefore led to relatively high unemployment amongst Africans in the Province.

Turning to gender considerations, more than half of all jobs (54,4%) in the Province is filled by men, but the latter constitute only 46,8 per cent of the unemployed. This employment share pattern is not unique to the Western Cape but reflects the national gender employment profile, although the Provincial gender bias is slightly less than nationally where females account for 57 per cent of the unemployed.

Recently, though, female employment growth in the Province has been marginally higher than that of males. Approximately 92 000 net new jobs accrued to women, although this is less than half the overall increase in Provincial employment. This has meant that the gap in unemployment rates between males and females has narrowed slightly. The unemployment rate for men in the Province remains lower than the Provincial average at 23 per cent, while nearly 30 per cent of women in the Province were unable to secure employment in 2003.

Perhaps the most alarming trend observed in Figure 5 is the highly unequal age composition of the employed and the unemployed. The largest groups by age within the employed are the 26- to 35-year olds and the 36- to 45-year olds, who account for 32 per cent and 30 per cent of employment respectively, approximately 62 per cent in total. These two age-groups, however, represent only 28 per cent and 17 per cent of unemployment, or around 45 per cent in total.

Of considerable concern is the dominance of young people aged between 16 and 25 years among the unemployed. Their *employment share* stands at a mere 17 per cent, whilst accounting for 46 per cent of unemployment. Viewed differently, while one in every six employed people is between 16 and 25 years old, nearly every second unemployed person is in the same age-group.

The problem of youth unemployment in the Western Cape therefore seems structural in nature and relatively more acute than it is in the rest of the country, where this group's share of unemployment was just under 40 per cent in 2003. Consequently, the Province accounts for a relatively high share of the national number of unemployed 16- to 25-year olds.

This pattern, as mentioned earlier, manifests itself in significantly higher *unemployment rates* amongst the youth. The youth labour force is split quite evenly between employed and unemployed. The unemployment rate for this group stood at 49 per cent in 2003, almost twice the Provincial average and more than twice the rate for 26- to 35-year olds (24%), which is the age-group with the second-highest unemployment rate. All other age-groups have unemployment rates below the Provincial average (23%), with the rates declining as age increases.

It should not be surprising that the general pattern of falling unemployment rates as age increases characterises the Western Cape economy, given that younger people are more likely to be experiencing frictional unemployment as they move out of the education system and into the labour market. This pattern is likely to hold to varying degrees in most economies. Younger people are also disadvantaged in securing employment in that they have little, if any, experience, a characteristic that is highly valued by potential employers. At the same time, older unemployed individuals tend to retire or exit the labour force rather than remain unemployed. What is somewhat surprising, though, is the extent of the difference across age-groups.

Recent work on the national labour market reveals the same pattern, with some evidence suggesting that the phenomenon may be at least partially driven by employment retention by older individuals, thereby making entry by younger individuals more difficult (Oosthuizen and Bhorat, 2004). In line with this, unemployment rates amongst 46- to 55-year olds have declined slightly, although the oldest members of the labour force – 56- to 65-year-olds, – have seen surging unemployment rates (up by more than one-third on the 2000 rate). Amongst other factors, this may be related partly to older individuals increasingly needing to enter the labour force, seeking work to avert looming poverty, and partly to restructuring by firms and government where older workers are targeted for retrenchment. However, more information is required before either of these can be confirmed.

Although 26-to 35-year olds constitute the largest group within the employed, they have lost ground to older age-groups. Between 2000 and 2003, more than three-quarters of overall employment growth in the Province – 150 000 jobs – accrued to 36- to 55-year olds, increasing their employment share from 43 per cent to 47 per cent. While almost 50 000 jobs accrued to 16- to 35-year olds, most went to 16- to 25-year olds, with 26- to 35-year olds faring second-worst of the five age-groups. Employment amongst 56- to 65-year olds was, at best, stagnant. This pattern of employment change is consistent with the changes seen nationally, except for 16- to 25-year olds who, nationally, experienced the most rapid contraction of employment of all age-groups.

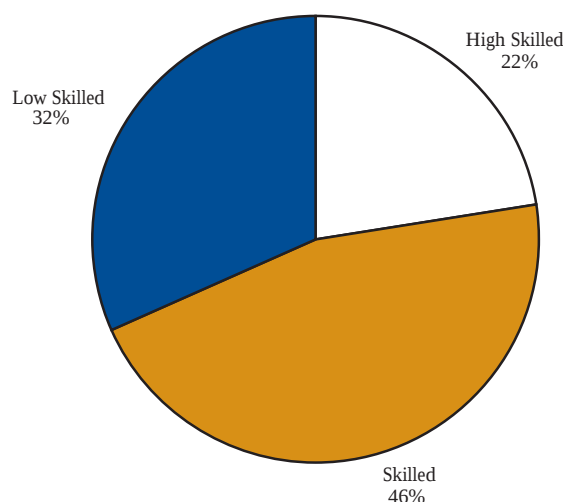
The fourth area of concern in terms of employment and unemployment trends relates to high unemployment amongst those without complete secondary education. The issues surrounding education, employment and unemployment in the Western Cape are not straightforward, though, with individuals with primary or less education seemingly not

worst off in terms of securing employment. Since an individual's level of education is a key determinant of the individual's occupation and therefore skill classification, issues surrounding these three variables are discussed together.

The long-term trend in the South African economy has been one biased towards high-skilled employment and against low-skilled employment. Nationally, the last three decades have seen skill-biased employment expansion, with more skilled workers experiencing the most rapid rates of employment expansion. This trend is evidenced in national household survey data since 1995 (Bhorat and Hodge, 1999; Oosthuizen and Bhorat, 2004).

The current distribution of employment in the Western Cape across both educational and skill categories confirms the above trend. Approximately 44 per cent of the Province's employed have at least a matric certificate and 16 per cent a post-matric qualification. A further 34 per cent have incomplete secondary education and 18 per cent have completed only primary grades (Grades 1 to 7).

Figure 6 Skill composition of Western Cape total employment, 2003



[Source: Statistics South Africa LFS, September 2003]

Figure 6 shows that 22 per cent of Western Cape employment is in high-skilled occupations, 46 per cent in skilled occupations and 32 per cent in low-skilled occupations⁴. Interestingly, the skills profile of employment in the Province is virtually identical to the national profile, although the educational profile is slightly better, with the Province having a lower proportion of workers with less than Grade 7 education (14% of Provincial employment versus 21% nationally).

Between 2000 and 2003, most of the growth in Provincial employment – two-thirds of 194 000 jobs – accrued to those with matric certificates. In the broader South African context, employment expanded rapidly amongst those with matric certificates, at an average annual rate of 9,6 per cent, representing 728 000 new jobs. Here, the Western

The skills categories used are as follows. High-skilled occupations include Managers (and Legislators), Professionals and Technicians, skilled occupations are Clerks, Service and Sales workers, Crafts workers, Operators and Skilled Agricultural workers, while low-skilled occupations include Elementary occupants and Domestic Workers. It is important to note that the skill categories do not necessarily coincide with specific educational categories, or with general perceptions of skill and education levels.

Cape created more jobs than would be expected, given its share of total and matriculant employment in 2000, accounting for 18 per cent of these new jobs. Unfortunately, the LFSs do not point to unambiguous increases in employment in any of the skill categories.

A natural assumption is to expect that individuals with the least education would be most often unemployed, given the bias towards more skilled employment. This assumption does not play out in practice. In fact, those with no education are the least often unemployed, after tertiary-educated individuals. This result is linked in particular to employment in the agriculture sector, where, according to Census 2001, more than 10 per cent of the employed lack any formal education. Those with no education also accounted for around five per cent of employment in construction, but for all other sectors the proportion ranged from one per cent to three per cent. The relative decline in the fortunes of the agriculture sector, noted in Chapter 3, is likely to hold particularly negative implications for the least educated workers in the Province, posing an important challenge to efforts potentially aimed at reskilling retrenched agricultural workers.

An important characteristic of those with no education is that they are generally older than average. For example, one-third of individuals over 15 years of age with no formal education are over the age of 55 years, although this group represents only 15 per cent of all individuals over 15 years old. In contrast, 16- to 25-year olds account for only ten per cent of those with no formal education while representing 27 per cent of those over 15 years of age. Consequently, it is likely that employment of those without formal education will decline over time as these individuals gradually exit the labour market, while education policies continue to limit the supply of uneducated and very low educated workers.

Lower rates of unemployment amongst those without formal education may also be related to the fact that better educated individuals may be more likely to hold out for a job that pays an 'acceptable' wage. Further, because the least educated individuals tend to be older, they may be more likely to exit the labour force if they are not employed than younger individuals, particularly where the individual is eligible to receive an old-age pension.

Table 4 demonstrates that both Provincial and national unemployment rates, in 2000 and 2003, are lowest amongst those with the highest educational levels, in line with the structure of labour demand that is biased in favour of higher-level skills. Amongst those with tertiary education, unemployment is just over seven per cent in the Western Cape, compared to around 13 per cent nationally. Holders of matric certificates and those with incomplete secondary education are significantly more often unemployed, with Provincial unemployment rates for these two groups at 23 per cent and 34 per cent respectively in 2003.

Although unemployment rates by educational attainment in the Province cannot be said to have changed over the period, the data does show that, in absolute terms, unemployment has increased amongst those with complete and incomplete secondary

Table 4 Unemployment rates by education level, 2000 and 2003

	2000		2003	
	WC	SA	WC	SA
None	19,5 [11,0; 28,1]	30,3 [28,4; 32,3]	19,8 [8,8; 30,7]	36,7 [34,1; 39,3]
Incomplete Primary	31,2 [26,7; 35,8]	36,6 [35,2; 38,0]	28,3 [23,5; 33,2]	43,8 [42,2; 45,4]
Complete Primary	27,6 [22,8; 32,4]	40,3 [38,4; 42,3]	32,5 [26,9; 38,0]	47,2 [45,1; 49,4]
Incomplete Secondary	27,6 [24,6; 30,6]	42,1 [41,0; 43,2]	33,5 [30,3; 36,7]	50,0 [48,8; 51,2]
Complete Secondary	19,6 [16,2; 23,0]	38,8 [37,3; 40,4]	23,1 [19,5; 26,7]	40,9 [39,4; 42,3]
Tertiary	4,3 [2,3; 6,3]	13,1 [11,7; 14,5]	7,3 [4,5; 10,2]	13,1 [11,8; 14,4]

[Source: Statistics South Africa LFS, September 2000 and September 2003]

Note: Figures in square brackets are the 95 per cent confidence intervals. Where changes over the period are statistically significant, the relevant cells are shaded.

education, a trend that is not unique to the Province. In 1995, the national unemployment rate for tertiary-educated labour market participants was seven per cent and four per cent for degreed individuals. By 2002, unemployment had risen to 15 per cent and eight per cent respectively (Oosthuizen and Bhorat, 2004). Although the table suggests that unemployment amongst tertiary-educated individuals has risen, overlapping confidence intervals on both unemployment rates and absolute numbers mean that these changes are not statistically significant.

Although the Western Cape numbers are too small to discern real changes in unemployment within these groups, it is likely that tertiary-educated individuals in the Province have seen similar changes, particularly as it seems that Provincial high-skilled employment has not expanded significantly since 2000.

Although the labour market is often quickly blamed for not producing highly educated and skilled workers in sufficient quantities, the excess supply of tertiary- and secondary-educated labour force participants seems to suggest that at least part of the problem is related to deficient labour demand – although, admittedly, there is evidence to suggest that many individuals are obtaining qualifications in ‘incorrect’ fields where labour demand is low (Bhorat, 2003).

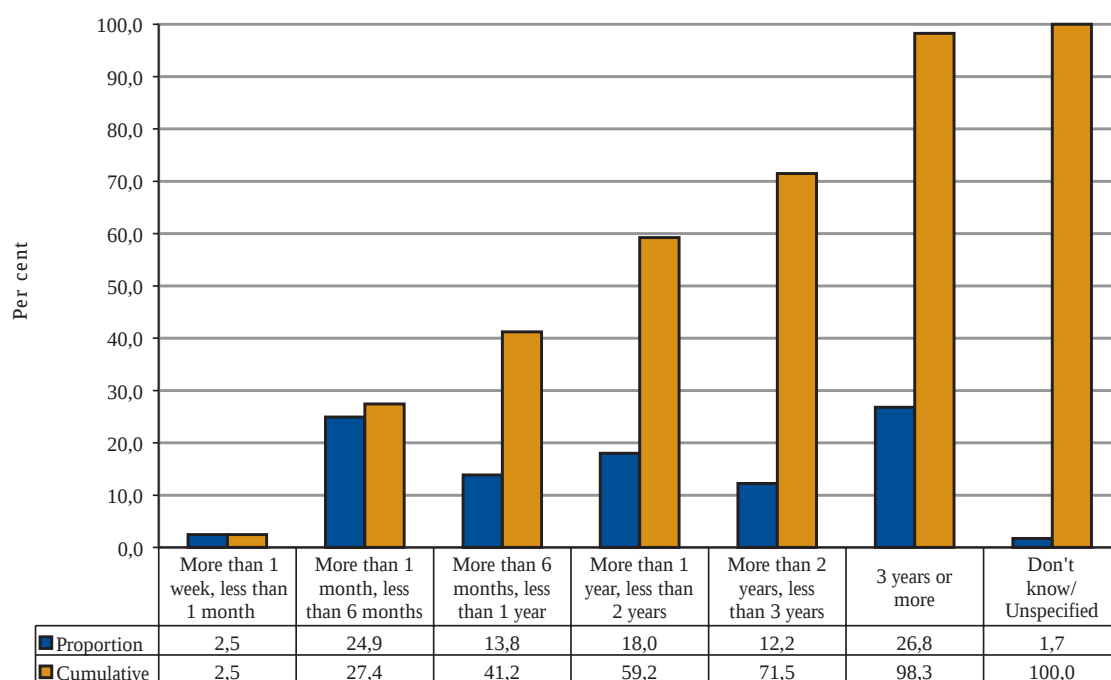
In the Western Cape, as is the case nationally, a large proportion of the unemployed who have worked before have been unemployed for long periods of time. Of the

612 000 unemployed residents of the Province (according to the expanded definition), 41 per cent or 251 000 have never worked before.

The bulk of the unemployed who have never worked before are young: 61,5 per cent are between 16 and 25 years of age, while 11,0 per cent are between 25 and 36 years. The majority (three-fifths) of the unemployed who have worked before have been unemployed for more than a year (*refer to Figure 7*). More than one-quarter (26,8%) have not worked for three years or more, while a similar proportion (27,4%) has not worked for up to six months.

This large proportion of individuals who have been unemployed for extended periods of time should be of significant concern to Government. The longer individuals remain unemployed, the more likely they are to experience an erosion of their skills and the more difficult it becomes for them to keep abreast of the latest technologies and techniques, thereby reducing their chances of finding employment even further. Long-term unemployment eventually renders individuals 'unemployable', as employers become increasingly reluctant to take them on.

Figure 7 Time since last worked, expanded unemployed who have worked before, 2003



[Source: Statistics South Africa LFS, September 2003]

Overall, total unemployment in the Western Cape measured according to the expanded definition has risen in absolute terms (the increase being statistically significant). Although

it is not possible to say with certainty that unemployment *rates* in the Province have changed between 2000 and 2003 (*please refer to Appendix A*), this should be viewed in light of the fact that, for the country as a whole, the change in the expanded unemployment rate has been upward and statistically significant, pointing to an overall superior labour market performance for the Province relative to the country as a whole.

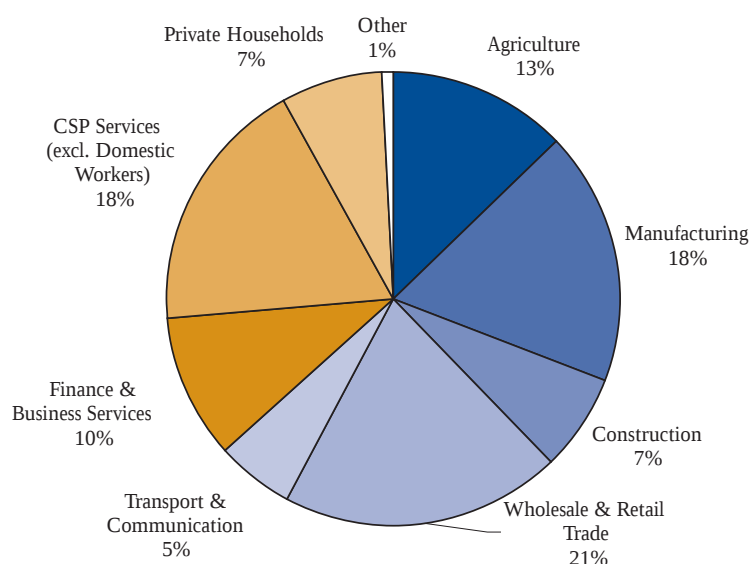
3.2.3. Sector distribution of employment

Employment (formal) in the Western Cape is dominated by four sectors – internal trade (21%); manufacturing (18%); community, social & personal (CSP) services (18%); and agriculture (13%).

Figure 8 shows that, together, these sectors account for nearly 70 per cent of total employment in 2003. Internal trade, which includes the hospitality industry, is the largest sector in employment terms, comprising one-fifth of total employment in 2003, while manufacturing and CSP services each provide 18 per cent of the Province's jobs. Future economic conditions and employment changes in these sectors, as well as in agriculture, are likely to have a large impact on aggregate Provincial employment.

It is important to note that Figure 8 uses LFS, September, 2003 data, which is not comparable to Chapter 2's sector employment analysis which draws on the Quatec Research database.

Figure 8 Total employment by sector, 2003



[Source: Statistics South Africa LFS, September 2003]

⁵ Economic sectors are classified as primary, secondary or tertiary according to the type of activities they represent. Primary sectors are the resource-extraction sectors, such as Agriculture and Mining. The secondary sectors are the industrial and manufacturing sectors and include Manufacturing, Electricity, Gas & Water, and Construction. The services sectors, namely Internal Trade, Transport & Communications, Finance, Community, Social & Personal Services, and Private Households, comprise the tertiary sector.

The bulk of the remaining jobs are located within three tertiary sectors⁵ – finance (10%), private households (7%) and transport & communication (5%). Provincial employment is therefore clearly dominated by tertiary (service) sectors, which account for 61 per cent of all jobs, while the secondary and primary sectors account for 26 per cent and 13 per cent of employment respectively. The distribution of Western Cape employment differs from the national distribution in that it is relatively more concentrated within the secondary sector (one-fifth of national employment as opposed to one-quarter of Provincial employment).

Unfortunately, the LFS data does not allow for an accurate sectoral breakdown of employment growth within the Western Cape. However, indications are that the tertiary sector is responsible for the generation of around two out of three net new jobs, with this growth likely to be concentrated in the internal trade and CSP services sectors. Internal trade is characterised by a relatively high level of informality, as many informal sector ‘retail’ activities are classified within this sector. As such, an important question, but one that is unanswerable with national household surveys due to the small sample sizes, is to what extent employment growth in this sector is derived from its informal component.

By far the largest formal sector in the Western Cape in terms of employment is the tertiary sector, which in 2003 employed over one million people (*Table 5*). The secondary sector employed approximately 441 000 people and the primary sector 224 000 people. However, the small sample size in the LFSs means that it is not possible to be certain that the estimated changes in sectoral employment found in the surveys is an accurate representation of reality. This is due to the fact that the 95 per cent confidence intervals for the two years for each sector overlap.

Table 5 Aggregate sectoral composition of formal employment, 2000 and 2003

	2000	2003
Primary Sector	194,4 [160,0; 228,7]	223,9 [189,4; 258,3]
Secondary Sector	401,6 [356,7; 446,6]	441,5 [399,6; 483,4]
Tertiary Sector	933,0 [863,2; 1 002,7]	1 064,1 [998,0; 1 130,3]
Total	1 536,8 [1 446,8; 1 626,8]	1 730,3 [1 649,4; 1 811]

[Source: Statistics South Africa LFS, September 2000 and September 2003]

Note: Figures in square brackets are the 95 per cent confidence intervals. Where changes over the period are statistically significant, the relevant cells are shaded.

Although the Provincial tertiary sector has been able to expand employment since 2000, it has not always been able to keep pace with expansion in the national economy. Provincial employment expansion has far outpaced national employment expansion in the internal trade sector (averaging 4,6% per annum, compared to 0,4% per annum nationally), but employment in the finance sector grew slightly slower in the Western Cape than it did nationally (4,6% per annum versus 5,2% per annum).

Generally, though, in the tertiary sectors that are less skills intensive (such as private households and CSP services), employment growth in the Western Cape has equalled or surpassed that of the country as a whole. Employment change in the remaining sectors, though, has been too low to be statistically significant.

3.2.4. Spatial distribution of employment and unemployment

Identifying specific race, gender and age-groups amongst which unemployment is a pressing problem is not sufficient for policy to make a real and sustainable impact on unemployment numbers or rates, nor is the identification of skill requirements and shortages. Perhaps one of the most critical variables to consider, around which many policies should be anchored, is the spatial dimension.

The unequal distribution of economic activity is not necessarily undesirable, in that it provides firms and workers with a range of advantages that promote competitiveness and continued employment respectively. However, where there is an improper match between economic and population concentrations, at whatever geographic level, whether it be local, provincial, national or international level, major problems and inequalities are sure to arise.

Figure 9 shows that the City of Cape Town is the dominant urban and economic agglomeration in the Province, accounting for 64 per cent of the Province's population in 2001. One would therefore expect a similar proportion of employment to be located in the City, or even a slightly higher proportion, depending on the extent of the metropolitan area's economic dominance. Cape Town is home to 63 per cent of the Province's employed, according to Census 2001, a proportion that may be an underestimate, given the Census' relative poor capturing of the informal sector. A further 15 per cent of employment is located within the borders of the Boland District Council and nine per cent in the Eden region. The Central Karoo accounts for the smallest proportion of employment at only one per cent in 2001.

Unemployment, however, is relatively more concentrated in the City of Cape Town (71%) as only 29 per cent of the Province's unemployed residents live outside of the metropolitan area. The Boland and Eden regions each account for 10 per cent of the unemployed. The differences in the employment and unemployment shares mean that unemployment is higher than the Provincial average in three of the six regions, namely the City of Cape

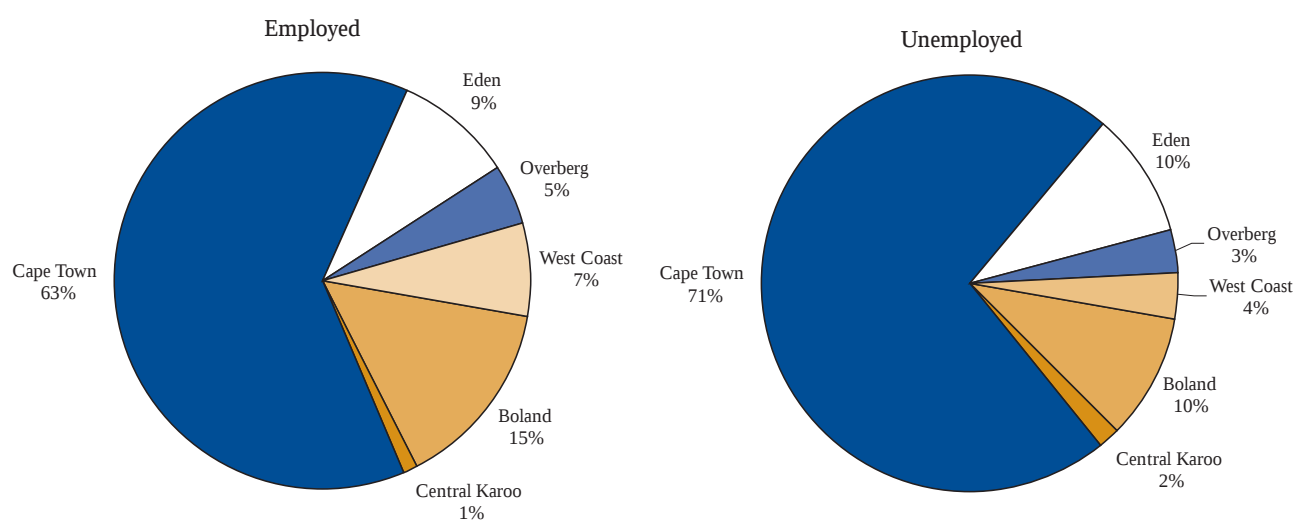
⁶ Note that, due to the less detailed questions on labour market status in the Census, the broad unemployment figures reported here are strictly not comparable with those derived from the CFSs. However, they do provide an indication of relative performance across regions.

Town, and the Eden and Central Karoo regions. The highest rates of unemployment are to be found in the Central Karoo and the City of Cape Town, where approximately 42 per cent and 31 per cent of the workforce are broadly unemployed respectively⁶. The lowest unemployment rates in the Province are to be found in the West Coast (17%), Boland (21%) and Overberg (22%) regions.

These comparisons are interesting, particularly given that labour force participation rates in the West Coast, the Boland and the Overberg regions are above or close to the Provincial average, indicating that the lower unemployment rates are not due to the withdrawal of unemployed individuals from the labour market, which would result in lower labour force participation rates.

At a further level of disaggregation, using Census 2001, three magisterial districts are home to two-fifths of the unemployed: Kuils River (16%), Mitchell's Plain (14%) and Wynberg (10%), all three of which fall within the City of Cape Town and contain the city's largest townships and informal settlements. A more detailed geographical presentation of unemployment rates by magisterial district can be found in Appendix B.

Figure 9 Spatial distribution of employment and unemployment, 2001



[Source: Statistics South Africa Census 2001]

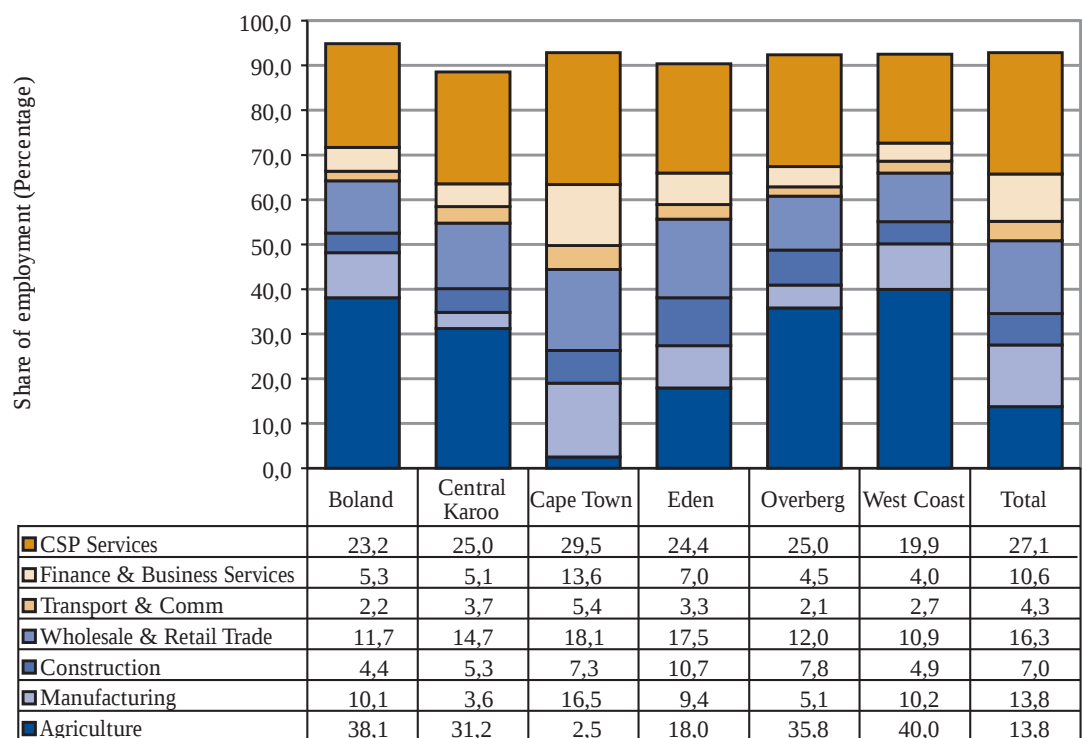
3.2.5. District economic structures

Relative employment and unemployment performances are likely to be related in some way to the economic structures of the various districts. So, for example, a district that is dominated by a declining sector or that lacks dynamic growing sectors may have higher unemployment rates than average. On a district level, the different economic structures are clearly discernible from the distribution of employment across industries as estimated from the 2001 Census and illustrated in Figure 10.

Agriculture is the main employer in four districts, namely the West Coast (employing 40% of the workforce), Boland (38%), Overberg (36%) and Central Karoo (31%). In Cape Town and the Eden district, the largest sector in terms of employment is community, social & personal services, employing 30 per cent and 25 per cent of the workforce respectively.

Each of the regions are reliant on a relatively narrow sectoral employment base. The two largest sectors in terms of employment account for three-fifths or more of total employment in the Boland, Overberg and West Coast district councils, while the three largest sectors account for 70 per cent to 73 per cent of employment in the Boland, Central Karoo, Overberg and West Coast.

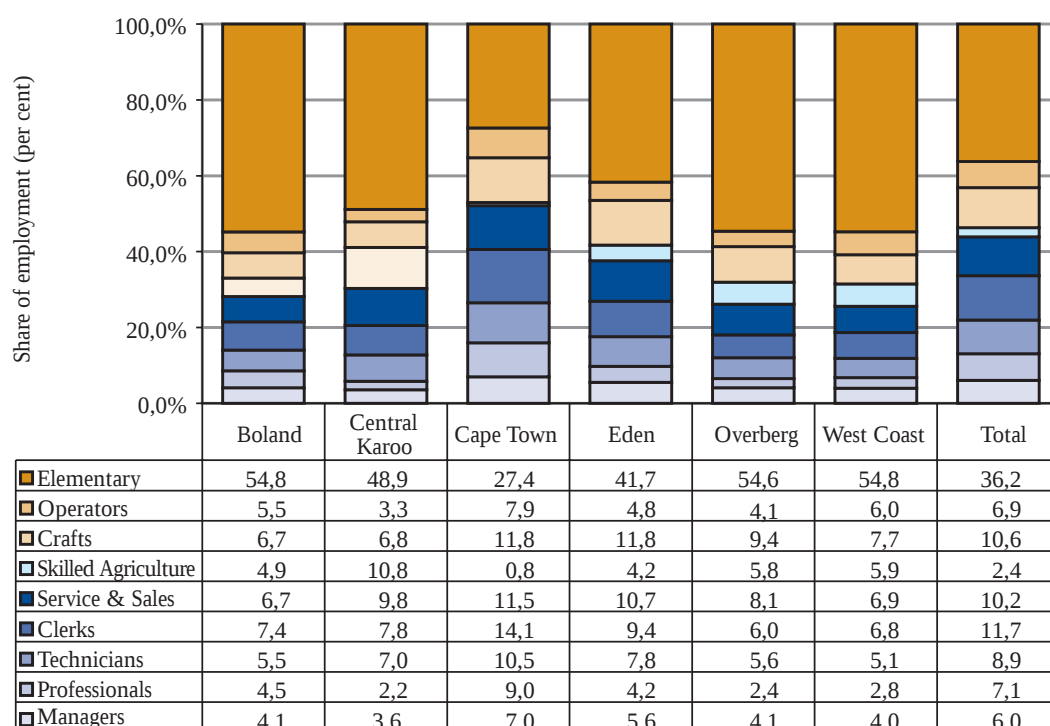
Figure 10 Sectoral distribution of total employment by district, 2001



[Source: Statistics South Africa Census 2001]

Interestingly, the district with the broadest sectoral employment base is Eden, with 42 per cent of total employment concentrated in the two largest sectors and 60 per cent in the three largest sectors. A narrow sectoral employment base means that overall employment is particularly susceptible to employment problems in these key sectors and, where the employment base is particularly narrow, concerted policy effort may be required to diversify employment where appropriate. This, however, is likely to more of a problem on a smaller geographical level than that of district council.

Figure 11 Occupational distribution of total employment by district, 2001



[Source: Statistics South Africa Census 2001]

Evidence from the 2001 Census points to the fact that the City of Cape Town has, relative to the rest of Province, a more skilled workforce (*refer to Figure 11*). Elementary occupations account for only 27 per cent of the City's total employment, compared to 36 per cent Provincially⁷. The City's urban nature means that there are virtually no workers employed in skilled agriculture occupations, while the proportions of managers, professionals, technicians, clerks, service and sales workers, crafts workers and operators are higher than for the Province as a whole.

Overall, high-skilled occupations account for 27 per cent, skilled occupations (excluding skilled agriculture) for 45 per cent and low-skilled occupations for 27 per cent of total employment. This compares very favourably to the 14 per cent, 29 per cent and 51 per cent for high-skilled, skilled and low-skilled employment in the rest of the Province.

At a district council level, therefore, it is clear that the varying performances of the economic sectors, as well as the changing profile of skills demand, will impact on employment differently. For example, if the

⁷ Note that these figures are strictly speaking not comparable to those derived from the Labour Force Survey.

agricultural sector were struggling, overall employment in the City of Cape Town would be far less affected than overall employment, say, in the Overberg region.

3.2.6. Racial distribution of employment by sector and skill level

It is important to note that employment expansion in a given sector will not impact evenly across race, gender, educational or geographic groupings. Of particular interest is the differential impact of expanding employment on the employment fortunes across races. These differences are exacerbated due to the skills inequalities between Africans, Coloureds and Whites, although the data does not allow adequate and accurate disaggregation to investigate the sectoral and occupational interactions.

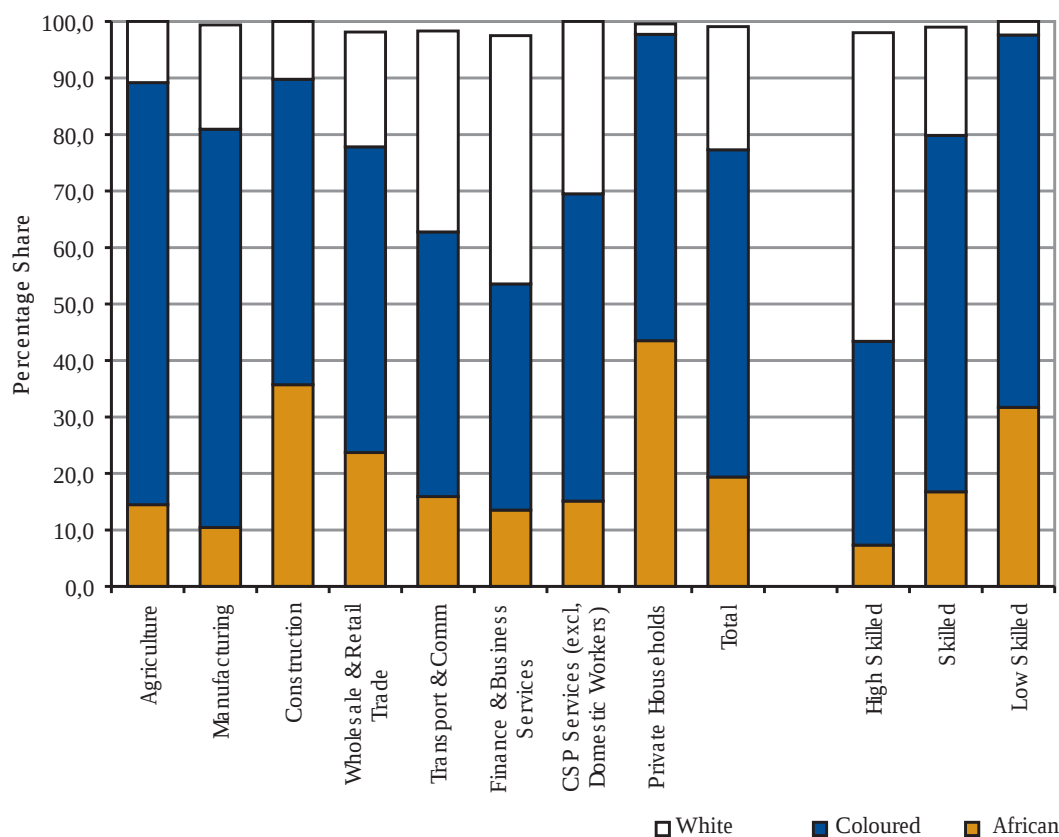
Figure 12 shows that in terms of skill, the racial composition of the workforce varied substantially in 2003. Coloureds dominate employment in all but one sector, namely finance, and constitute more than half of the workforce in six of the eight sectors. The preponderance of Coloureds within the workforce is particularly marked in agriculture and manufacturing, where they represent in excess of 70 per cent of employment.

Given the racial structure of employment by skill level, it is clear that Africans and Whites are concentrated in those sectors characterised by relatively low- and relatively high-skill requirements respectively. Africans account for the largest proportions of employment in private households (43%) and construction (36%), and represent 24 per cent of the workforce in the internal trade sector. Conversely, Whites constitute 44 per cent of the finance sector workforce, 36 per cent of employment in transport & communication and 30 per cent in CSP services.

The offshoot of this is that rapid employment growth in a given sector is likely to impact differently on the employment fortunes of the Province's three major race groups. The predicted impact becomes particularly certain over short periods in instances where there is no change in the given sector's desired skills mix of employment.

If, for example, one looks at the finance sector which expanded employment relatively rapidly over the period, it is clear that, given a stable skills mix, high-skilled workers in general and Whites in particular are likely to have benefited disproportionately. Agricultural employment growth, on the other hand, is likely to have been concentrated within low-skilled and skilled occupations, thereby expanding, disproportionately, employment amongst Coloureds disproportionately. The differential skills and, consequently, racial impacts that sectoral employment expansion often has, have important implications for inequality within the Province, an issue that is explored in greater detail below.

Figure 12 Racial distribution of total employment by sector and skill, 2003



[Source: Statistics South Africa LFS, September 2003]

3.2.7. Provincial employment and unemployment summarised

In summary, Western Cape employment growth between 2000 and 2003 has been relatively rapid but has not been high enough to absorb all new labour market entrants. Irrespective, the Province has one of the lowest provincial unemployment rates in the country at 26 per cent compared to almost 42 per cent nationally in 2003, although the pattern of unemployment reflects rather accurately the national pattern, being highest amongst Africans, females and the youth (Oosthuizen and Bhorat, 2004).

Employment growth has been most rapid amongst Africans, females and older age-groups (36 to 55 years), although Coloureds, males and older individuals filled most jobs. The Province is also experiencing a clear trend towards a more educated workforce, with two-thirds of net employment expansion occurring amongst holders of matric certificates and the share and levels of employment of individuals with no education, or incomplete or complete primary education, declining.

Despite this trend, in occupational and broad skill-level terms, most employment growth has occurred at the middle and lower end of the skills ladder. The tertiary (services) sector

has been the main driver of employment expansion in the Province, accounting for more than two-thirds of the provincial total increase, with internal trade and community, social & personal services the key sectors. At the same time, employment in the Province has become more formal as the informal sector shed jobs and formal sector employment grew rapidly.

Although the Western Cape is characterised by less severe unemployment rates relative to the rest of South Africa, the problem is intensifying, with 612 000 unemployed individuals living in the Province. Unemployment is most severe amongst Africans and females, while there is a very strong youth dimension to the problem, with 16- to 25-year olds accounting for close to half of all the unemployed in the Province. At the same time, the evidence suggests that, although unemployment does not necessarily decline as individuals' educational attainment rises, completing secondary and tertiary education is related to lower unemployment rates, a pattern that is also evident nationally.

Geographically, unemployment is concentrated in the City of Cape Town (unsurprisingly, given its dominance in economic and population terms) and the Boland and Eden regions, although the Central Karoo suffers from the highest unemployment rate.

The key challenges for Government are clearly addressing youth unemployment and the uneven distribution of economic activity, which results in a wide dispersion of unemployment rates on a sub-provincial regional basis.

4. Formal Sector Remuneration and Inequality

As mentioned earlier, the labour market is the key mechanism through which individuals interact with the economy. However, it is through remuneration that labour market outcomes are translated into socio-economic reality and impact on poverty and inequality within a society. By looking at formal sector remuneration, it is possible to judge different kinds of employment growth. Therefore, if all formal sector employment growth comprised of low-paying employment, we would judge it less beneficial to society than a similar level of employment growth within better paying occupations. This is because, generally, the latter will improve inequality and poverty levels, while relieving some of the pressure on Government from a welfare perspective.

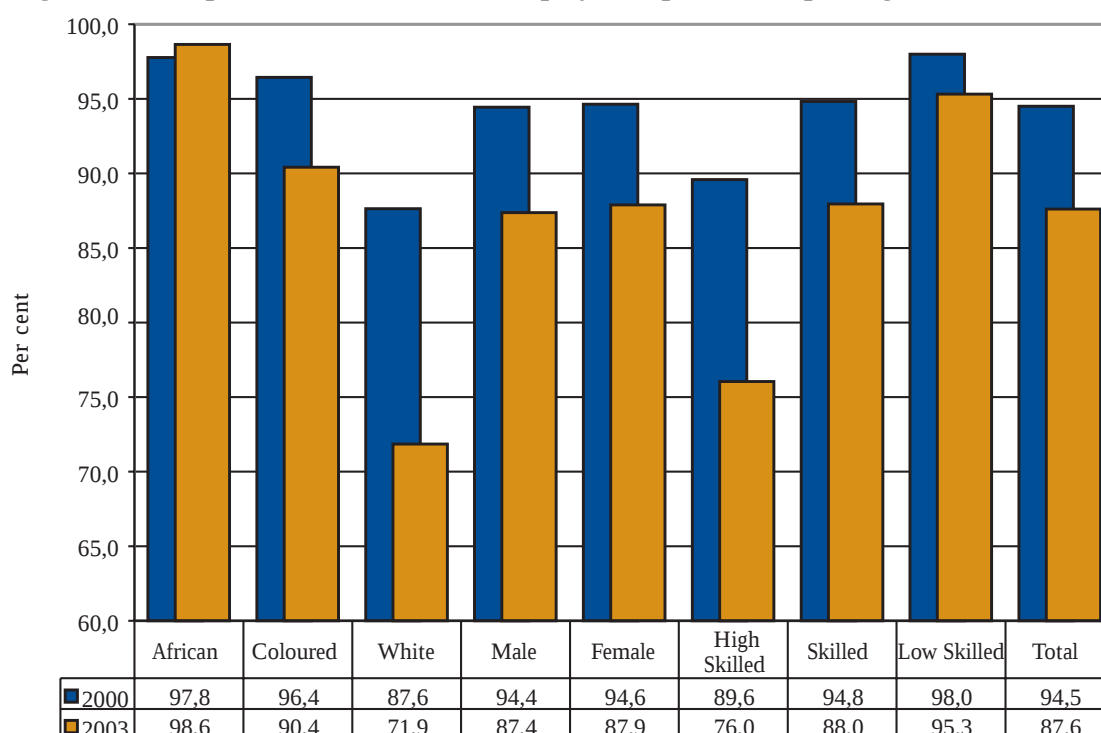
Incomes are, for various reasons, notoriously difficult to capture accurately, particularly when the survey requires individuals to provide an actual number without giving them the option of rather indicating an income band. Fortunately, though, the LFSs have allowed respondents to indicate either an actual income figure or the band in which their incomes fall. Consequently in 2000, as seen in Figure 13, only 5,5 per cent of employed individuals did not report their incomes, while in 2003 there is income data for almost 88 per cent of employed individuals.

However, closer investigation of the income data reveals that those who did not reveal their incomes were not always randomly distributed across the various categories used. Although the dispersion in the proportions of people revealing their incomes was relatively small across race, gender, skill, occupation and industry in 2000 (between six and 12 percentage points), the dispersion ranged from 19 to 29 percentage points in 2003.

The decline in response rate to the income questions was particularly marked amongst Whites, with only 72 per cent reporting incomes in 2003 compared to 88 per cent in 2000. The response rate for Coloureds also fell by more than five percentage points. On aggregate, gender seems not to influence the decision to report one's income to the survey enumerators, with response rates falling from around 94,5 per cent to 87,5 per cent for both males and females over the period.

In contrast, the skill level is negatively related to the response rate (individuals in higher-skilled occupations being less likely to report their incomes) and higher-skilled individuals have become relatively less likely to report their incomes over the period. The fall in the response rate for high skilled workers was 13,5 percentage points, compared to declines of seven and three percentage points for skilled and low-skilled workers respectively.

Figure 13 Proportion of formal sector employed respondents reporting incomes



[Source: Statistics South Africa LFS, September 2000 and September 2003]

The discernment of remuneration trends is complicated by the apparently uneven incidence of non-responses across groups. However, skill levels and remuneration are closely related and it is therefore possible to identify the likely impact that the non-responses will have on the distribution of workers across the income categories.

In general, higher income categories are likely to be under-represented relative to lower income categories, given that non-responses are most common amongst high-skilled workers. This fits in with the fact that non-responses are lowest, and have fallen most, amongst Whites. Keeping this in mind, remuneration trends of formal sector workers are investigated below.

An individual's income is closely related to his or her occupation or skill level and it is therefore important, in the analysis of remuneration trends and inequality, to investigate the distribution of skills within the population.

Skills are highly unevenly distributed both nationally and within the Western Cape. Amongst those employed in the formal sector, Whites account for close to 54 per cent of the high-skilled, compared to their 22 per cent share of total formal sector employment. In contrast, while Africans constitute slightly more than 17 per cent of the employed in the Province, more than 28 per cent of the low-skilled are African. Coloureds are over-represented in the skilled and low-skilled occupations.

This distribution, however, is likely to be less biased than the overall distribution if one includes both formal and informal sector employment and unemployment, the latter two being characterised by larger proportions of lower-skilled Africans and Coloureds.

Table 6 Racial shares of formal sector employment by skill level, 2003

	African	Coloured	White
High-Skilled	6,4	38,3	53,7
Skilled	15,2	64,4	19,7
Low-Skilled	28,4	69,4	2,2
Total	17,3	59,9	22,1

[Source: Statistics South Africa LFS, September 2003]

The effect of *apartheid* and decades of discrimination and unequal access to educational and employment opportunities have left a clear mark on the remuneration structure of formal sector employment across the race groups.

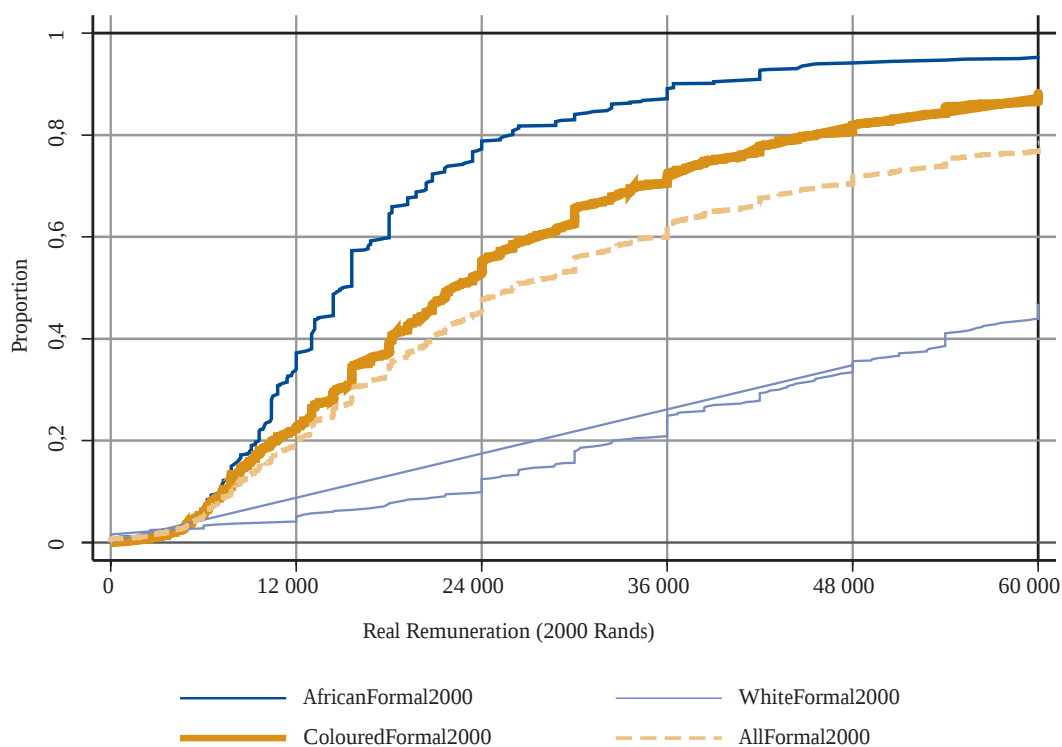
Figure 14 presents cumulative real income distributions for formal sector workers by race in 2000, and includes only those formal sector workers who reported incomes.

Interpretation of these lines is relatively straightforward. Each line indicates the proportion of people that earn less than a given amount, the amount being displayed on the horizontal axis and the proportion on the vertical axis. So, for example, approximately 20 per cent of formal sector workers (who reported their incomes) earned no more than R12 000 per year (or R1 000 per month) in 2000. Amongst African formal sector workers, this proportion was almost twice as high at around 35 per cent, while only around five per cent of White formal sector workers earned this amount.

Taking another income level as a reference point, close to 90 per cent of African formal sector workers earn no more than R36 000 per annum, compared to around 25 per cent of White workers. In fact, this is true of all income levels: the proportion of African workers earning less than a given amount in 2000 is always less than the proportion of White workers earning less than that amount.

Graphically, what this means is that the line for Africans in 2000 is always above that of Whites for 2000. Generalising this, if one group's line is always above another group's line, the first group is worse off (in terms of income) than the second group. Therefore, irrespective of what income level is used as reference, White formal sector workers are significantly better off than their Coloured counterparts, who in turn are better off than their African counterparts.

Figure 14 Cumulative real income distributions for formal sector workers, by race, 2000

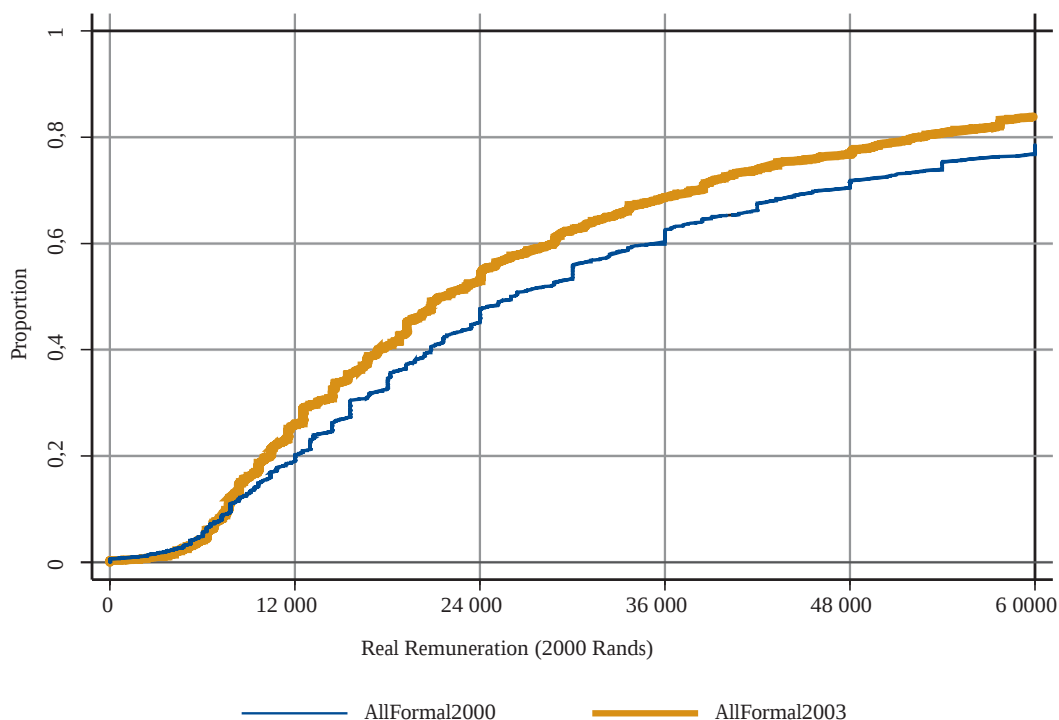


[Source: Statistics South Africa LFS, September 2000.]

At the top end of the formal sector remuneration distribution, only 5,5 per cent of Africans earned more than R60 000 per annum in 2003 (in 2000 rands), compared to 18,6 per cent of Coloureds and 62,0 per cent of Whites. Given that higher skilled workers and Whites have been found to not report their incomes more often than other workers, it is likely that the proportion of Whites earning over R60 000 per annum is even higher. In 2003, therefore, the inequalities in the Western Cape in terms of formal sector remuneration are large, with White individuals accounting for 54,6 per cent of all formal sector workers earning over R60 000 per annum and 55,7 per cent of those earning over R100 000 per annum.

Just as it is possible to compare race groups, it is also to compare skill categories or groups over time. In Figure 15, the cumulative real income distributions for formal sector workers in 2000 and 2003 are presented. Incomes for 2003 were deflated by the consumer price index for this period. What the figure shows is that the line for 2003 is below that of 2000, which, if we compare it with what has been said about the race groups in Figure 14, seems to indicate that formal sector workers are worse off in 2003 than in 2000. Unfortunately, it is impossible to tell whether this is an actual upward movement of the curve, or whether it has been caused, at least partially, by the increase in the number of individuals who did not report their incomes in 2003 and are likely to be located near the top of the income distribution (as mentioned, in 2003, more than 12% of formal sector workers did not report their incomes as opposed to 5,5% in 2000).

Figure 15 Cumulative real income distributions for formal sector workers, 2000 and 2003



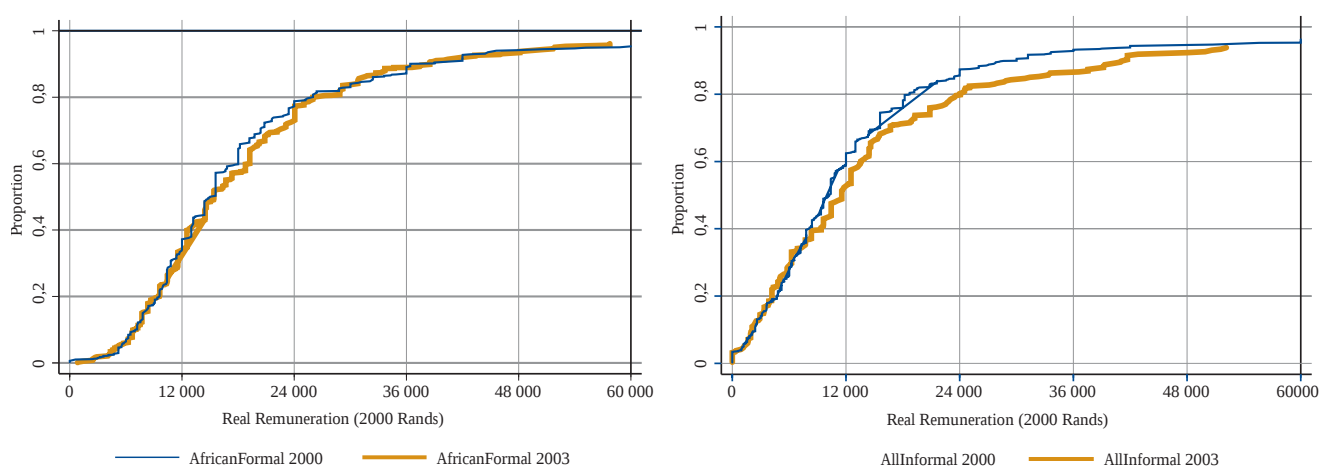
[Source: Statistics South Africa LFS, September 2000.]

Nevertheless, certain groups were relatively less affected by the rise in non-reporting of income, and comparisons of the 2000 and 2003 cumulative income distributions will therefore be more reliable. Specifically, Africans were actually more likely to report their incomes in 2003 than in 2000, and non-reporting amongst non-skilled workers fell by less than three percentage points.

In the left-hand panel of Figure 16, it is clear that the distribution of formal sector real remuneration amongst Africans has hardly changed over the period at all, indicating that they are neither better nor worse off as a group in 2003. In contrast, however, amongst low-skilled workers (the right-hand panel), there appears to have been a deterioration in the real earnings profile between 2000 and 2003.

Most interesting, though, is the fact that the distributions are almost identical at the lowest income levels. This means that the lowest paying low-skilled jobs in the formal sector have been relatively successful in warding off decreases in their real incomes, while others have not. This may be related to minimum wage legislation and the regular inflation adjustments made by government. However, the figure indicates a significant worsening in the plight of low-skilled formal sector workers generally, with a particularly substantial increase in the proportion of workers earning between R6 000 and R12 000 per annum (R500 to R1 000 per month).

Figure 16 Cumulative real income distributions for African and low-skilled formal sector workers, 2000 and 2003



[Source: Statistics South Africa LFS, September 2000.]

Although cumulative income distributions can be powerful tools in the analysis of differing income distributions across time periods, they are rendered relatively useless by the systematic changes in non-response rates in the surveys.

One alternative is to look at the actual numbers of formal sector workers in specific remuneration categories. That way, at least, it is possible to see the changed distribution of workers across remuneration categories over time.

This data is presented in Table 7 and suggests a rapid increase in the number of workers in the lowest remuneration categories. However, there are only two categories where the confidence intervals do not overlap, allowing a high degree of certainty as to the change experienced. First, there has been a substantial increase in the number of formal sector workers earning up to R6 000 per annum (or up to R500 per month). Secondly, there has been, as was mentioned, a large increase in the proportion of non-reporters.

Improvements in remuneration are of greatest concern amongst those earning the least and who are most often low-skilled workers. Fortunately, the remuneration situation amongst the workers with the lowest skill levels is the most clear-cut, given that almost all low-skilled workers provided remuneration information for 2003. Unfortunately, the data

Table 7 Remuneration of formal sector workers, 2000 and 2003

Remuneration (2000 Rands)	Number of workers	
	2000	2003
Up to R6000	214 948 [183 243; 246 653]	320 337 [280 486; 360 188]
R6001-R12000	153 326 [127 682; 178 969]	195 490 [169 953; 221 027]
R12001-R24000	233 056 [205 362; 260 751]	279 031 [245 612; 312 449]
R24001-R48000	231 545 [194 836; 268 254]	230 130 [199 645; 260 614]
R48001-R96000	181 685 [146 453; 216 917]	158 511 [129 954; 187 069]
R96001 +	114 086 [81 719; 146 454]	82 629 [61 160; 104 098]
Unspecified	62 248 [41 259; 83 238]	192 335 [157 590; 227 080]
Total	1 190 895 [1 108 890; 1 272 899]	1 458 462 [1 376 517; 1 540 407]

[Source: Statistics South Africa LFS, September 2000]

Note: Figures in square brackets are the 95 per cent confidence interval

points to a worsening in the distribution of formal sector remuneration in real terms amongst low-skilled workers between 2000 and 2003, and although the proportions of individuals earning incomes of up to about R6 000 per annum have remained stable, the absolute number of formal sector workers earning below R6 000 has increased substantially, and this change is statistically significant.

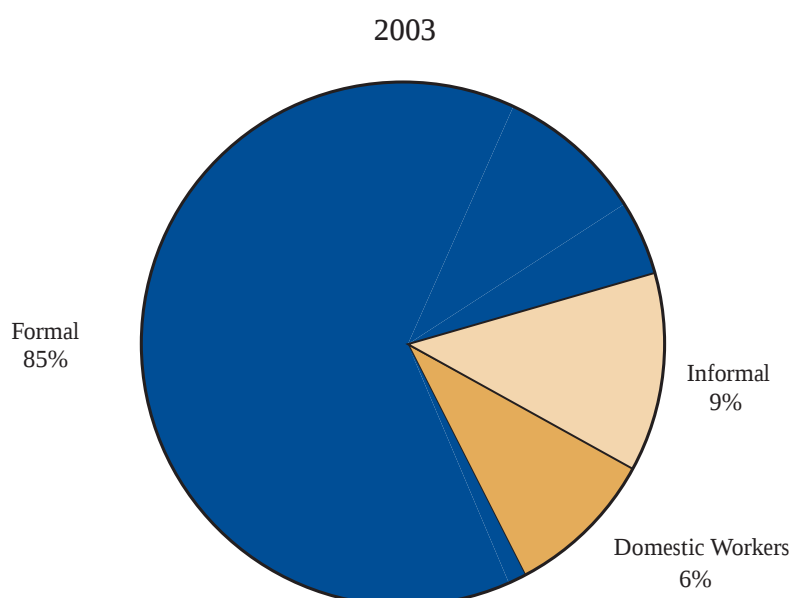
5. Informal Sector

5.1. Employment in the informal sector

The informal sector has been credited with creating a substantial proportion of all new jobs in the South African economy since the early 1990s. Unfortunately, apart from the informal sector being notoriously difficult to quantify, the OHS of 1995 was not structured in such a way as to allow the derivation of informal sector employment levels in that year. Later OHSs were increasingly well designed, allowing them to identify informal sector employment better.

This means that comparisons are very difficult, because it is impossible to quantify how much of the rise in the estimates of informal sector employment was due to the better questionnaire, and how much was real growth of the sector. The advent of the LFSs has facilitated the analysis of employment change in this sector, and conclusions reached are more reliable than in the past.

Figure 17 Composition of Western Cape Total Employment, 2003



[Source: Statistics South Africa LFS, September 2000 and September 2003]

Table 8 provides estimates of the relative sizes of Western Cape's formal and informal sectors in 2003. Domestic workers are neither truly formal sector nor informal sector and they are therefore presented separately, totalling 100 000, or six per cent, of all Provincial jobs.

Based on these figures, it appears that around nine per cent of all Western Cape jobs were found in the informal sector, a proportion that was substantially lower than one-quarter of all jobs for the country as a whole. Although the proportion declined from around 14 per cent in 2000, the actual figures are not statistically different from each other and it is therefore not possible to say for certain that the informal sector has declined over the period. The Province's formal sector, on the other hand, has performed extremely well according to the LFSs, creating 268 000 net new jobs at an average annual rate of 7,0 per cent, raising the formal sector's share of total employment. While a similar pattern of formal sector growth is evident on a national scale, it has been less rapid at 3,4 per cent per annum.

The informal sector, as mentioned, is a difficult sector to quantify. Its activities are varied and range from manufacturing to roadside retail to subsistence agriculture. Technically, the informal sector even includes illegal activities such as prostitution and the illegal drug trade, although these are unlikely to be picked up in household surveys. By 2003, the informal sector employed 2,2-million workers or roughly 20 per cent of total employment in South Africa. In the Western Cape, the informal sector is small relative to the rest of the country, accounting for only 9,3 per cent of Provincial employment, or 161 000 workers.

Africans and Coloureds dominate the Provincial informal sector. Each group accounts for almost two-fifths of employment. Approximately 31 000 Whites are engaged in informal sector activities and in 2003 represented around 19 per cent of informal sector employment. The nature of the activities engaged in seems differentiated by race if the skills distribution is considered. The bulk of African informal sector employment is low-skilled (57%) with one-third in skilled occupations. For Coloureds, skilled workers dominate the skills distribution (50%), with nearly two-fifths being low-skilled. In contrast, while relatively few Whites are engaged in the informal sector, those who are tend to be engaged in high-skilled occupations: two-thirds of White informal sector workers are high-skilled. African and Coloured informal sector workers are, therefore, likely to be engaged in relatively low-productivity, low-paying activities.

In-depth analysis of the Provincial informal sector using the national household surveys is very difficult due to the small number of observations, and Figure 18 presents the cumulative informal sector real remuneration distribution for the Western Cape. Once again, the picture is clouded by the increase in the number of individuals who did not report their incomes – 6,6 per cent in 2000 and 11,5 per cent in 2003.

Table 8 Racial distribution of informal sector employment, 2003

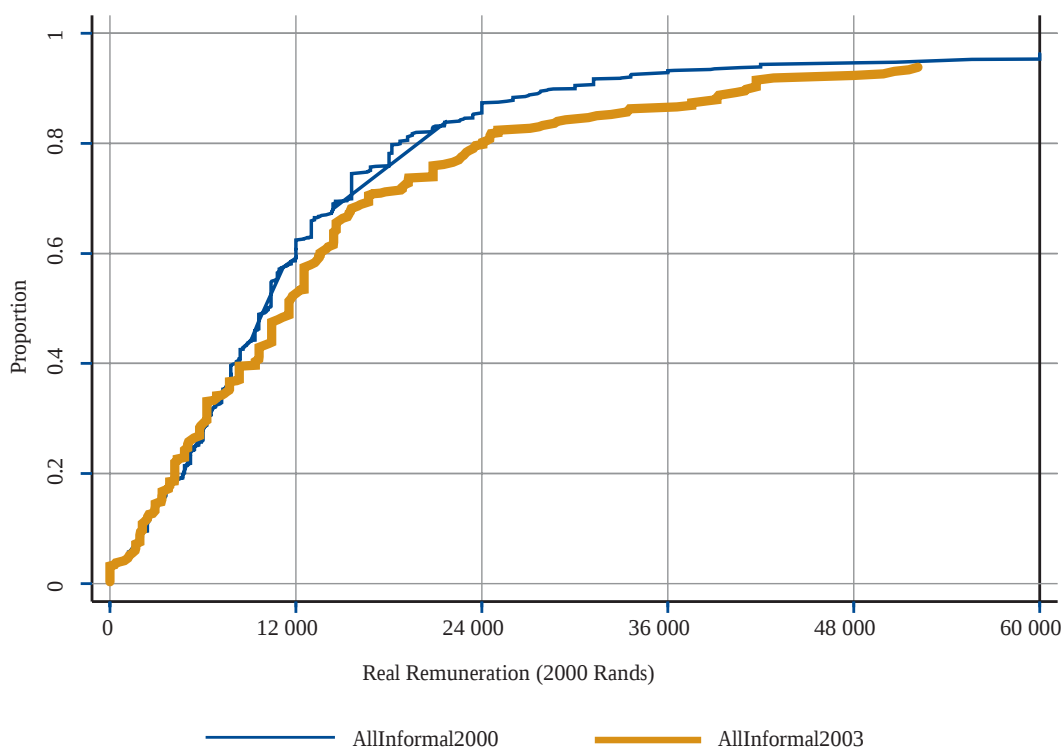
	African		Coloured		White	
	Number (’000s)	Share (%)	Number (’000s)	Share (%)	Number (’000s)	Share (%)
High Skilled	5,1*	18,4*	2,1*	7,6*	18,8	66,7
Skilled	23,1	32,7	35,2	49,8	9,6*	13,5*
Low Skilled	35,4	57,3	24,0	38,9	2,4*	3,8*
Total	63,8	39,7	61,5	38,2	30,8	19,1

[Source: Statistics South Africa LFS, September 2003.]

Note: Figures marked by an asterisk (*) are too small to draw conclusions from.

Figure 18 appears to provide some evidence that informal sector incomes are somewhat higher in 2003: the proportion of workers earning up to R12 000 per annum (R1 000 per month) has decreased and the curve as a whole for 2003 seems to have moved lower, indicating an improvement. Comparisons of the informal sector remuneration structure and that of the formal sector reveal, as expected, that informal sector employment is significantly lower paying than formal sector employment. For example, around 20 per cent of formal sector workers who reported their incomes in 2000 earned up to R12 000 per annum, compared to around 60 per cent of informal sector workers.

Figure 18 Cumulative Real Income Distributions for Informal Sector Workers, 2000 and 2003

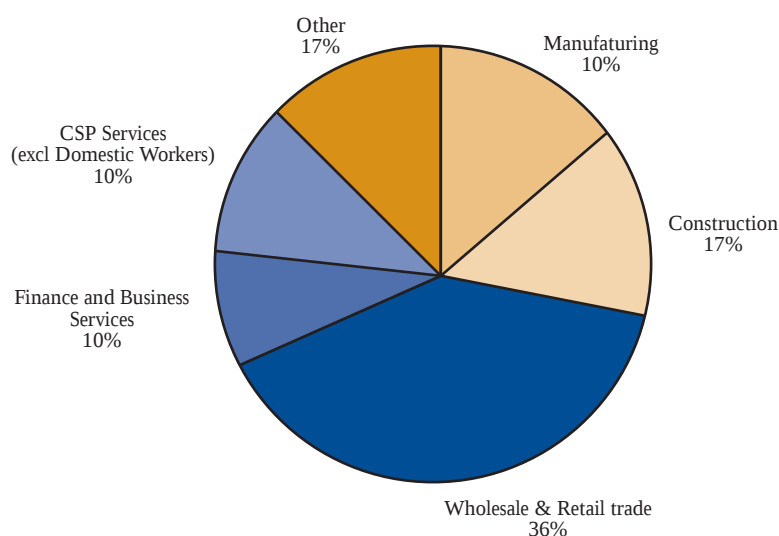


[Source: Statistics South Africa Labour Force Survey, September 2000 and September 2003]

It appears that more than half of informal sector employment is concentrated in two economic sectors, namely internal trade (36%) and construction (17%). Three other sectors account for 10 per cent of informal sector employment each, namely manufacturing, finance and CSP services. Of these five major sectors, three are services sectors, while the other two are secondary sectors.

The fact that a large proportion of informal sector employment is located in the services sectors is encouraging, since it is these kinds of sectors that are most accessible to women. It is clear that further study of the Province's informal sector is required, particularly on issues surrounding the longevity of informal sector businesses, the extent to which informal businesses make the transition to the formal sector, and the factors promoting and retarding the process of formalisation.

Figure 19 Sectoral distribution of informal sector employment, 2003



[Source: Statistics South Africa LFS, September 2003.]

Although the informal sector appears to have shrunk in both absolute terms and relative to the rest of the Provincial economy if one looks at employment, the LFS are unable to provide conclusive evidence of this. On the surface, such a decline, if real, may seem to be a positive development in that there are fewer individuals employed in low-paying, unprotected informal sector jobs. However, it is essential that the processes underlying this change be better understood. Is there a process of formalisation underway, with informal businesses moving into the formal sector, thereby creating the illusion of a shrinking informal sector? Or is the formal sector growing while the informal sector is being throttled?

Whatever the situation, one of the most important considerations is the impact of these changes at individual and household levels. In this regard, it is important to ascertain whether individuals previously employed in informal businesses are being re-employed in the formal sector or whether they merely become unemployed while others are employed in the formal sector. The answer to this question has important implications for poverty levels and inequality in the Province.

In terms of the structure of informal sector remuneration, the bias is, unsurprisingly, towards lower income categories, and it is particularly pronounced when compared to the structure of formal sector remuneration. Such a distribution is likely to have negative consequences for inequality within the Province. Further, although it is not possible to accurately gauge directly, the racial and skills composition of informal sector employment points to the likelihood that Africans are most likely to be earning incomes at the lower end of the informal sector remuneration distribution, while Whites are likely to be earning incomes at the top end of the distribution, with Coloureds to be found somewhere in between. Clearly, this situation can only compound past inequalities.

Small, Medium and Micro Enterprises (SMMEs) ⁸

A sector that has received much attention recently is that of smaller businesses, referred to as small, medium and micro enterprises, or SMMEs. This sector is a highly heterogeneous group, cutting across industries and the formal-informal sector divide, and varying in size, turnover and purpose, amongst other things. SMMEs are relatively difficult to accurately quantify accurately due to the fact that many registered firms are not actively trading and many active firms are not required to register for VAT purposes (for example, firms with VAT turnover of less than R300 000. However, it is believed that there are between 1,8-million and 2,6-million trading small businesses in South Africa.

Of the formal sector SMMEs, approximately 46 per cent are located in Gauteng and 18 per cent in the Western Cape. It is estimated that there are around 336 000 owner-managers in the Western Cape in 2003, who are starting or running 189 000 businesses. Established businesses are in the minority (23 000) representing 12 per cent of businesses in the Province, while 100 000 (53%) are start-ups and 67 000 (35%) are new businesses⁹. Compared to the national figures, small businesses in the Western Cape are less likely to be established businesses.

Table 8 shows that the contribution of SMMEs to overall employment is considerable. Excluding owner-managers, SMMEs account for 21 per cent of total Provincial employment and this proportion nearly doubles to 40 per cent if owner-managers are included. Apart from the owner-managers, new businesses employ 2,3 people on average nationally and 2,4 people on average in the Western Cape.

⁸ This section draws heavily on Orford and Wood (2004).

⁹ The GEM survey classifies businesses into three categories according to their level of development. Start-up businesses have paid wages/salaries for less than three months, new businesses have paid wages/salaries for three to 42 months and established businesses have been paying wages/salaries for more than 42 months.

For established businesses, the gap between the national and Western Cape is substantial, with 4,5 and 8,1 additional people employed respectively. The low propensity of start-up businesses to employ additional workers apart from the owner-manager is clear from Table 9, with one additional worker employed for every 10 owner-managers. However, older businesses employ significantly more additional workers, with each owner-manager of an established business employing about 19 additional workers on average, a clear indication of the importance of setting up a policy framework that will promote the development of businesses from start-ups to established businesses. In fact, “welfare gains will be maximised by increasing survival rates amongst businesses rather than by increasing the start-up rate” (Orford and Wood, 2004).

Table 9 SMMEs’ contribution to provincial employment, 2003

	Excluding Owner-Managers		Including Owner-Managers	
	Number	%	Number	%
Start-ups	21 000	6	229 000	33
New businesses	157 000	43	249 000	36
Established businesses	183 000	51	221 000	31
Total	362 000	100	698 000	100
Proportion of 2003 total employment	21 %		40 %	

[Source: Orford and Wood, 2004, and own calculations.]

There are two main reasons for starting up a small business: first, a business may be started to take advantage of some opportunity that exists in the market or, secondly, an individual may have no other option but to start some kind of business in order to support themselves and their families. Accordingly, SMMEs are either opportunity-motivated or necessity-motivated, and these two groups of businesses are likely to be quite dissimilar in their characteristics and requirements.

Intuitively, though, necessity-motivated businesses are likely to be engaged in less productive, lower remunerating activities than opportunity-motivated businesses. Necessity is more likely to motivate women in the Western Cape than men when starting businesses, while Whites and Coloureds most often found opportunity-motivated businesses. Amongst businesses started by African entrepreneurs, though, necessity and opportunity motives are equally prevalent. As a result, one can expect that the returns on their businesses for Africans and females will be lower than for Whites, Coloureds and males. In terms of income inequalities in the Province, this pattern is likely to reinforce the inequalities inherited from the *apartheid* era.

Efficiently targeted policy requires the identification of entrepreneurs: who starts businesses? Men are 1,4 times more likely than women to be self-employed, with the September 2003 LFS estimating that 6,8 per cent of men between the ages of 15 and 65 years are self-employed. However, this average is biased by the gender profile of African entrepreneurs, amongst whom women are just as likely as men to be self-employed. Amongst Coloureds, Asians and Whites, males are three times more likely than females to be self-employed, on average.

According to the GEM survey, in South Africa approximately eight per cent of men between the ages of 16 and 64 years are either starting up or operating existing businesses, as are 5,5 per cent of women, making men 1,5 times more likely than women to be doing so. The difference in propensity to start up or operate a

business between men and women is slightly more pronounced in the Western Cape than it is nationally, with men's likelihood being 1,7 times that of women. Provincially, in terms of race, Whites are most likely to be owner-managers than other groups (16% of individuals aged 16 to 64 years), compared to less than six per cent of Africans and nine per cent of Coloureds.

The gap between Whites and non-Whites seems to be related to the age of the business: the ratio in the Province rises from 2,0 times in start-ups to 5,1 times in new businesses and 5,7 times in established businesses. At the same time, individuals in possession of matric certificates are more likely to be owner-managers than individuals without. The former are twice as likely as the latter to be involved in start-ups, and this ratio rises to 2,3 times in new businesses and 20,7 times in established businesses.

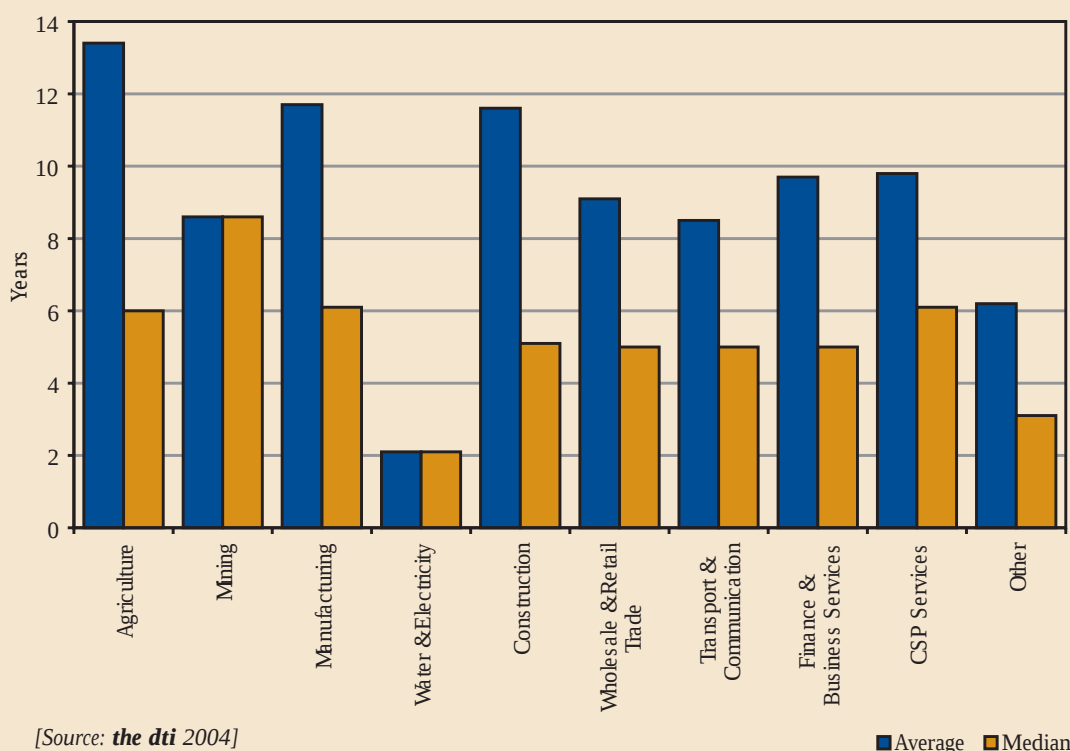
Owner-managers with matric certificates also tend to employ more additional workers than those without (**the dti**, 2004). Finally, 25- to 34-year olds in the Province are most likely to be involved in start-up and new businesses, while 45- to 54-year olds are most likely to be engaged in established business activities.

The survival of small businesses is to be seen as a key criterion according to which pro-SMME policy can be judged, as well as being crucial to the expansion of employment in this sector. Although it is not possible to track small businesses accurately over time at a national level, the Western Cape is fortunate to have a relatively good source of information on small business survival in the form of the Regional Services Council (RSC) Levy data for the Cape Town Unicity, containing 40 000 accounts of businesses and institutions paying the levy. While almost 4 000 new levy-payers are added to the database annually, equivalent to about one-tenth of the total, a similar number is dropped due to de-registrations, liquidations or dormancy (**the dti**, 2004). On average, though, the database grows by between one per cent and four per cent per year, a range that may be under-estimated due to the inclusion of low turnover institutions such as schools and hospitals.

The RSC Levy data is also able to provide information on the ages of around 2 500 de-registered or dormant firms, as seen in Figure 20 below. Those firms with the longest lifespans are generally found in agriculture (13,4 years), manufacturing (11,7 years) and construction (11,6 years). At the other end of the scale, firms that do not survive for very long tend to operate in transport & communication (8,5 years), internal trade (9,1 years) and finance (9,7 years). **The dti** (2004) finds that the most vulnerable firms, as defined by being those with the shortest average lifespans, are restaurants and businesses operating in the leisure and information technology sub-sectors, where the average lifespan is, at most, between four and five years.

What seems to be clear from **the dti**'s analysis is that, irrespective of age, small businesses face an important challenge in the instability of their turnover from year to year. In fact, "[stability] is the least probable scenario [and] even older enterprises rarely maintain their turnover in a +/- 5% range". This is identified as one of the major differences between SMMEs and large businesses. The evidence suggests that while younger firms tend to grow fastest (possibly related to low bases), older firms are often able to grow their turnover by more than 25 per cent. Similarly, a firm's age does not seem impact on likelihood that it would experience significant declines in turnover.

Figure 20 Average lifespan of deactivated accounts by main sector, Cape Town



This brief overview of SMMEs points to several focus areas for policy. First, it is evident that steps need to be taken to encourage individuals to establish small businesses and raise the rate of participation in this sector. Clearly, though, quality should not be sacrificed for quantity, and policy should seek to promote the most viable and sustainable forms of small business activities where possible. The Province's Human Resource Development Strategy is also key in this regard, as it should help to foster entrepreneurial talents and help to equip individuals to identify opportunities.

Secondly, the differences between established businesses on the one hand and new and start-up businesses on the other in terms of employment are substantial, and this clearly illustrates the importance of ensuring that younger businesses reach the established phase of development. In order to do so, it is essential that policy-makers are informed of the key factors that lead to the failure of younger businesses, as well as those factors that act as constraints on employment expansion amongst established businesses.

Thirdly, not only is participation in the SMME sector uneven across gender and race groups, but females and Africans are more likely than others to engage in necessity-motivated business activities. Lower participation in the sector by females and Africans must be seen in the light of higher unemployment rates for these groups in the Province, and their participation in small business activities ought to be promoted. The fact that female and African participation in this sector is more often motivated by necessity has important implications for the SMME sector's impact on overall income inequality within the Province, and likely services to exacerbate the existing income inequalities.

6. Conclusion

The labour market challenges facing the Western Cape labour market are clear. The labour force is likely to experience continued growth as the number of young individuals joining the working age population exceeds the number of older individuals leaving this group. Further, migration is likely to continue to play an important role by impacting on the demographic composition of the population, as well as the skills distribution of the labour force.

The main areas from which working-age migrants come to the Western Cape are the Eastern Cape, Gauteng and KwaZulu-Natal. The stream from the Eastern Cape is the dominant stream and does not exhibit as proficient an educational profile as the other migrant streams. Conversely, better-educated in-migrants to the Western Cape tend to be older and therefore often do not represent a long-term addition of skilled labour to the Provincial labour market.

Migration is one of the important challenges facing policy-makers, particularly since a large proportion of migrants slot in at the 'lower end' of the socio-economic distribution of the population, making the absorption and re-skilling of lower skilled labour key to the realisation of Government's ideals for the Province.

Although unemployment in the Western Cape is less severe than in the rest of the country, it is growing rapidly and this is likely to continue for as long as there are perceptions of superior economic opportunity in the Western Cape relative to neighbouring provinces.

The uneven distribution of employment and unemployment across various socio-economically defined groups has highlighted a number of key focus areas for policy consideration:

Africans do not enjoy the same level of access to employment opportunities enjoyed by Coloureds and especially Whites in the Province, and around 43 per cent of African labour force members are unemployed. This is at least partially related to the relatively lower education levels of Africans in the Province, as well as the fact that, largely due to historical reasons, agricultural employment is dominated by Coloureds. Women also appear to find it more difficult than men to secure employment.

Crucially, though, the youth appear to be marginalised from the growth in job opportunities in the Province, as is the case nationally. This is cause for great concern, not least because young labour force members are not able to use the skills they have, leading to an erosion of skills and preventing a transfer of knowledge and expertise from older workers through employment experience. Further research is required as to the exact reasons for this phenomenon, particularly given that the South African economy is

claimed to be skills constrained and young people today are arguably better educated on average than they were in the past.

Throughout the policy formulation and implementation aimed at addressing these key issues, it is important that the spatial aspects of economic concentrations and population concentrations are kept in mind. The City of Cape Town's dominant position within the Provincial economy is illustrated by its almost two-thirds share of Provincial employment. The Central Karoo and the City of Cape Town have the highest unemployment rates in the Province and it is clear that different sets of policies need to be used in these two very different regions.

It is here where Provincial Government also needs to make important decisions as to its focus: does it want to spend more time, energy and resources on addressing the highest unemployment rates or the highest unemployment shares? If the latter is the case, then clearly Cape Town in general, and Kuils River, Mitchell's Plain and Wynberg in particular, should be the focus for policy. If the former is true, then unemployment in the Central Karoo should receive highest priority. At the same time, policy needs to be alert to the spatial consequences of changes in sectoral economic and employment experiences.

It appears to have been little change in the distribution of formal sector workers across remuneration categories since 2000, with what little change there has been occurring at the lowest income categories. However, racially, there appears to have been significant change amongst Africans and Whites employed in the formal sector, possibly due to the extension of minimum wage legislation in the case of the former and improvements in remuneration in high-skilled occupations in the case of the latter, although each race group appears to be better off in 2003 than they were in 2000.

Geographically, income inequality amongst formal sector workers appears to be less in Cape Town than it is in the other five districts in the Province. It is difficult to predict with certainty the future trends in inequality as influenced via the labour market. However, in general, employment growth is required across the skills spectrum and particularly amongst less skilled occupations if inequality levels are to be reduced via the labour market. What is clear, is that disproportionate involvement in the informal sector by Africans in particular is likely to exacerbate existing income inequalities. Further, as long as Provincial unemployment increases and disproportionately afflicts Africans, the upward pressure on inequality will continue.

Appendix A

Broad unemployment rates in the Western Cape and South Africa, 2000 and 2003

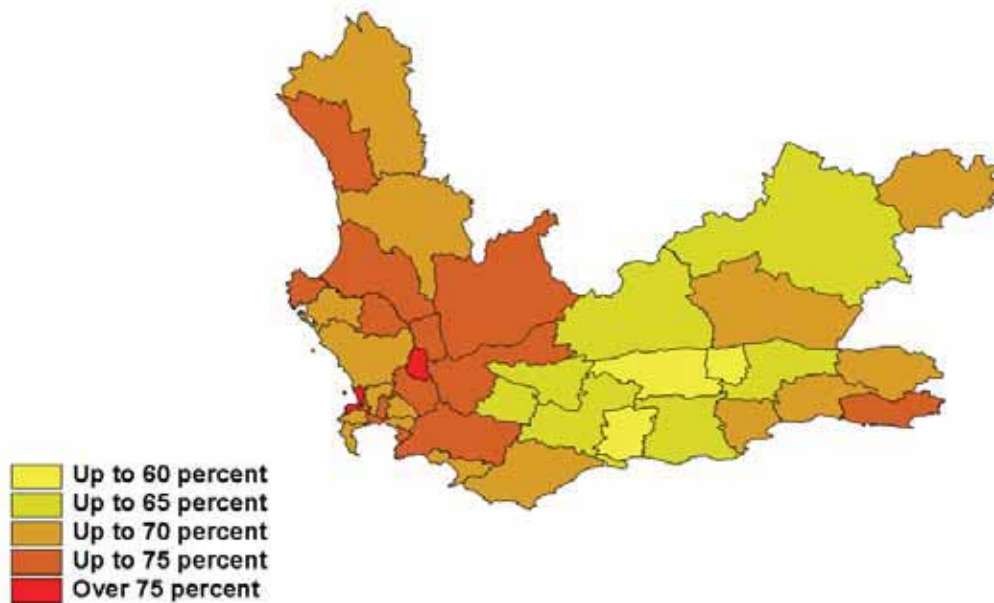
	2000 Western Cape	2003 South Africa	Western Cape	South Africa
Total	22,6 [20,2; 25]	35,9 [35,0; 36,8]	26,1 [23,6; 28,7]	41,7 [40,8; 42,6]
- African	39,1 [35,0; 43,1]	41,9 [41,1; 42,8]	42,9 [38,6; 47,2]	48,7 [47,8; 49,7]
- Coloured	21,9 [19,4; 24,4]	27,5 [25,5; 29,5]	24,2 [21,5; 27,0]	29,3 [27,0; 31,7]
- Asian	5,9 [-5,9; 17,6]	20,0 [17,1; 23,0]	6,5 [-2,2; 15,3]	20,7 [17,3; 24,1]
- White	5,8 [3,3; 8,2]	8,3 [6,9; 9,7]	9,4 [6,8; 12,0]	7,6 [6,6; 8,5]
- Male	19,2 [16,6; 21,8]	30,8 [29,8; 31,8]	23,3 [20,5; 26,2]	35,7 [34,6; 36,8]
- Female	26,4 [23,4; 29,4]	41,1 [40,1; 42,1]	29,2 [26,3; 32,2]	47,7 [46,7; 48,8]
- 16-25 years	43,8 [39,2; 48,4]	59,3 [57,9; 60,8]	49,4 [45; 53,7]	69,2 [67,8; 70,6]
- 26-35 years	19,9 [17,1; 22,7]	38,7 [37,5; 39,9]	23,7 [20,2; 27,2]	43,1 [41,9; 44,4]
- 36-45 years	14,2 [11,7; 16,7]	24,2 [23,1; 25,3]	16,8 [14,1; 19,5]	28,3 [27,1; 29,5]
- 46-55 years	14,8 [11,2; 18,3]	19,4 [18,1; 20,7]	13,1 [10,3; 15,9]	23,4 [22,0; 24,7]
- 56-64 years	10,3 [5,6; 15,0]	13,2 [11,7; 14,8]	14,1 [9,2; 19,0]	15,5 [13,7; 17,3]

[Source: Statistics South Africa LFS, September 2000 and September 2003]

Note: Figures in square brackets are the 95 per cent confidence intervals. Where changes over the period are statistically significant, the relevant cells are shaded.

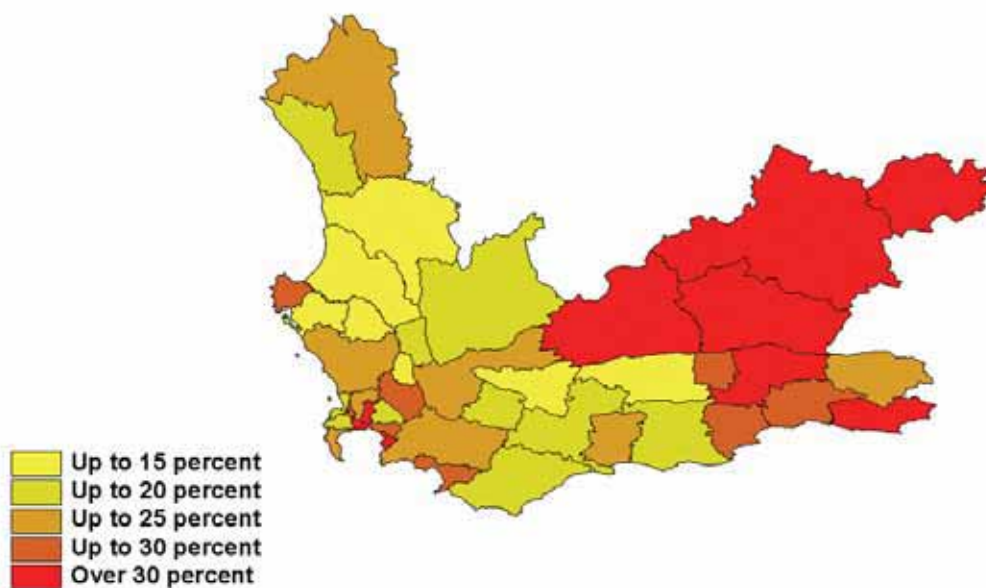
Appendix B

Labour force participation rates by magisterial district, 2001



[Source: Statistics South Africa Census 2001]

Expanded unemployment rates by magisterial district, 2001



[Source: Statistics South Africa Census 2001]

Equity and Development Scenarios

1. Introduction

Equity *and* development – these are powerful concepts that lie at the centre of global, national and sub-national economic debate. Many argue that equity and development are driven from fundamentally opposing ideologies, the former from a ‘rights’ or social justice perspective and the latter from an economic perspective. Others suggest that they are interdependent in respect of philosophy, approach and development interventions; that interlinked, they hold greater potential for success; that separated, they offer limited progress.

Drawing on fundamental beliefs and ideologies, debate on equity and development is almost always contentious. Less well understood, however, is that most often tension derives from the dynamism of the relationship. There is no *status quo*. There is no fulcrum. There is only fluidity and interdependency. This is the very nature of the challenge.

Government’s response, therefore, must be equally creative and dynamic. It must anticipate, even counter. Drawing on all resources, it must pose credible solutions that ‘talk’ to the development challenge that lies beyond today – 20, even 50, years hence.

Understanding how equity is measured, the factors that drive changing distributions and those public interventions that enhance such are therefore critical for policy- and decision-makers as they formulate the most appropriate policy responses that enhance shared or broad-based economic growth and development.

This challenge is especially true for South Africa where inequality is particularly stark – the richest tenth of the country’s population enjoy consumption per person of almost 70 times that of the poorest tenth. The picture is alarmingly similar at provincial and local level.

These trends point to the fact that recent economic growth gains are not equitably spread and have not made significant contributions to poverty reduction for communities who depend on such to better their daily lives and improve their future opportunities.

Analyses in the preceding chapters in the 2005 PER&O underscore that, unless the Province makes bold interventions, the present economic trajectory, demographic and labour force performance, and sectoral growth and employment prospects of the Western Cape do not hold a favourable outlook for equity and development in the Province over the medium to long term.

Our situation is not unique. Similar trends in terms of demographic profile, labour force performance, mismatch in skills profile and the skills requirements of growing economic sectors may be seen at the broader national level, and in fact, in many countries across the developing world. Such trends epitomise the development challenge facing many governments today.

This means that, like every other government, the Province has to come to grips with these trends in order to formulate appropriate provincial responses and set attainable targets under its growth and development strategy, *iKapa Elihlumayo*.

This chapter probes the political and technical intricacies that shroud the equity and development debate. The opening section poses tough questions, asking whether policy- and decision-makers have reached consensus on a conceptual understanding of 'equity', as the latter is the bedrock of the Province's shared growth and development commitment.

A more detailed explanation of a heightened appreciation of the linkages between poverty, inequality and growth then moves to the premise that such interdependent development goals are best pursued simultaneously.

The body of the chapter focuses on decomposing and measuring equity (and inequality) in terms of its base elements – income, assets and spatial or geographic location – paying special attention to trends in respect of South Africa and the Western Cape.

Analysis then talks to the interrelationship between equity (or inequality) and poverty, as their interaction both conflates and reinforces systemic trends. Again, poverty is decomposed into base elements in terms of income, asset and spatial or geographic location, and trends examined for South Africa and the Western Cape.

These engagements frame the socio-economic context and challenge posed to Government as the five lead strategies that spearhead its response framed under the broader *iKapa Elihlumayo* banner are sharpened, poised for implementation in the coming year.

In its conclusion, the chapter queries how analytical boundaries may be broadened, responding to the challenge for robust scenarios that provide an outlook on equity and development for the Province over the medium to long term.

2. Equity and Development

2.1. Consensus on equity

What is meant by ‘equity’? The forthcoming 2006 World Development Report on *Equity and Development* defines equity as that which is about “normative concerns of social fairness and social justice”. In this sense, equity is organised around:

“a conception of equality of opportunities, or, more broadly, equality in the capability (or freedom) of different individuals to pursue a life of their choosing. This... also consider[s] inequalities in recognition, where different groups... face different opportunities owing to differences in their status, power and influence within a society. Equity in this sense generally does not imply equality in outcomes (such as in incomes or consumption). Even an exclusive concern with equity would lead to differences among individuals, since individuals differ in needs, preferences, efforts and talents. Moreover, a concern with equity and the means to achieve it has to be balanced against other objectives, such as respect for personal freedoms or the provision of incentives for efficient resource use, entrepreneurship, innovation, saving and investment, [within the public and private spheres] with which there may or may not be trade-offs.” (WDR 2006 Outline)

The above definition is only one of many perspectives on equity. Notions of equity may differ due to different historical legacies, religious or moral concerns and/or political objectives. Different frames of references and different starting blocks mean consensus is not easily reachable. It demands thorough debate. Yet conceptual agreement is critical as ‘equity’ lies at the core of every development strategy.

For the Province, this means that reaching a common understanding on the definition of equity in the Western Cape and on what degree of inequity is politically and socially tolerable, is an important building block and one that is likely to be fundamental to the success of a number of interlinking objectives, policies and interventions in Government’s strategic development response.

2.2. Equity and shared/broad-based development

Reaching a common perspective on equity is the first step. The next is to understand why equity is central to shared or broad-based growth and development.



Recent evolution in poverty measurement and analysis suggests that inequalities in opportunity or capabilities may be fundamental drivers of poverty. Poor people are poor not only due to insufficient income, but also due to inadequate access to quality schooling, health care, shelter, safe and clean water, energy, roads and mobility means, market opportunities, financial credit, effective financial and risk management, and entrepreneurship, to name a few.

This approach represents a clear departure from conventional poverty measurement that focused on a lack of income available to obtain a certain socially acceptable standard of living. In this respect, Sen's seminal contributions (1981, 1984) led the evolution on broadening poverty analysis towards an understanding of capability deprivation.

Capabilities refer to the substantive freedoms that people enjoy that enable them to lead the kind of life that they have reason to value (Sen, 1999: 87). Capability deprivation therefore goes beyond a lack of income. It includes health concerns (relating to premature mortality, morbidity and insufficient nourishment), education and literacy, safety and security in respect of physical vulnerability, and social exclusion (in respect of the impact of negative social capital within and between communities).

More recent further analysis through participatory poverty assessments has emphasised the importance of social exclusion, vulnerability and risk in contributing to a lack of voice and to disempowerment, depriving people of full societal participation.

The broader capability approach to poverty measurement emphasises the interrelatedness of capability deprivation. Lack of income, for example, might lead to malnutrition, which diminishes cognitive ability and may lead to poor educational outcomes. In turn, poor educational attainment may limit opportunities in the labour market and reduce income-earning capacity. Furthermore, intergenerational dynamics often mean that poverty might also perpetuate over time.

From a policy perspective, identifying various aspects of capability deprivation is important, focusing consideration, resources and effort on those areas where benefits from development interventions could have multiplier effects in respect of poverty reduction and, at the aggregate level, economic growth.

The capability approach may easily be extended to inequality analysis, where initial work on income inequality expands to include that on capabilities and opportunities, and further to encompass inequality in respect of outcomes.

Distribution of income, consumption and health status are typical measures of inequality of outcomes, whereas discrepancies in access to basic services, such as an acceptable level of education and health care, would serve as indicators of inequality of assets (or opportunities). Multiple interactions between the drivers and resulting outcomes will, as

in the case of poverty, impact on the effectiveness of both development interventions and economic growth.

Yet, in turn, efforts to reduce poverty in communities depend on aggregate economic growth and its distribution, the latter determined by equity concerns. In essence, then, both equity AND growth contribute towards a shared or growth and development path.

For the Province, this means that a central challenge is to understand how improved equity contributes towards reducing poverty and enhancing development gains and processes, particularly in respect of efforts to realise *iKapa Elihlumayo*. In this respect, it is essential to understand the interaction of key factors, the directions in which they may move and the trade-offs that are involved.

2.3. Equity, growth and poverty reduction debate

The third conceptual link involves examining why and how some forms of inequality matter. In this respect, it is important to take note of the significant interdependencies and interactions between economic performance, inequalities and poverty, often referred to as the growth-poverty-inequality triangle.

Empirically, for a given growth rate, higher relative inequality often implies a slower rate of reduction in absolute income poverty. This said, there are two important caveats in respect of growth processes. First, the incidence of growth may vary considerably, across countries [or regions] and over time. Similar rates of growth in mean income are consistent with large gains for the poor as well as absolute losses. Second, distributional dynamics are often characterised by substantial churning or mobility, that is, as an economy develops over time, people move up and down the equity distribution with considerable frequency.

Moreover, there are important relationships between inequalities and both efficiencies and growth that may work in positive and/or negative directions. In a capitalist or mixed economy system, some level of economic inequality is necessary to provide incentives for investment and effort (whether in education or in work). Yet some forms of inequality may be detrimental to economic efficiency and growth in an aggregate sense as they may negate contribution to a shared development path (WDR 2006 Outline).

On a more practical level, the South African development debate and policy agenda have moved from the RDP¹-style 'growth through development' to the GEAR²-style 'development through growth' to the present policy dialogue, which appears to favour an explicit combination of policies aimed specifically at growth and those directed at redistribution.

Bourguignon (2004) highlights the continual dilemma countries face of whether development strategies should focus mainly on growth, poverty, inequality or some

¹ Reconstruction and Development Programme

² Growth, Employment and Redistribution

combination of the three. He emphasises: “First, the rapid elimination of *absolute* poverty, under all forms, is a meaningful goal for development. Second, to achieve the goal of rapidly reducing absolute poverty requires strong, country-specific *combinations* of growth and distribution policies.”

Absolute poverty refers to the proportion of people who fall below some predetermined poverty line that should be calculated to reflect the income level that satisfies the basic needs of a person in the society in question. “Poverty reduction in a given country and at a given point in time is fully determined by the rate of growth of mean income of the population and the change in the distribution of income” (Bourguignon, 2004:2). Therefore, understanding the interaction between growth and distribution is critical to efforts to reduce poverty.

In this respect, there is consensus that, given a stable income distribution, growth is necessary to reduce income poverty. But the span of the income distribution itself and how this changes will also have a marked impact on both the levels of growth that are attained and the consequent reduction in poverty that can be expected. Indeed, both growth and changes in inequality are extremely important in reducing poverty – their effects are interrelated and should be considered simultaneously (Bourguignon, 2004; Adams, 2003).

This means that improving distribution and growth should reinforce each other and have a sizeable impact on poverty reduction. Furthermore, small changes in inequality can result in large changes in the rate of poverty. However, the effects of growth, together with a worsening distribution, will work in opposite directions, counteracting the impacts on poverty reduction. The degree to which these changes impact on poverty depends on the initial level of development (or income) of a country and initial inequality. High initial inequality is generally associated with lower growth rates (*see, for example, Galor and Zeira, 1993*).

In fact, one recent study finds that for a given rate of economic growth, low-income and low-middle income countries with an initial Gini coefficient below 0,40 will on average experience twice the poverty reduction of countries at a similar level of development with an initial Gini coefficient greater than 0,40 (Adams, 2003: 19). As Bourguignon (2004: 10) notes, in the quest for reduction in absolute poverty, “changing distribution is probably more important for middle-income and inegalitarian countries, while growth is probably more important in relative terms for low-income egalitarian countries.” Furthermore, he emphasises that wealth-based (not income-based) redistributive policies could have a reinforcing effect of reducing poverty immediately and facilitating faster poverty reduction in the future.

For these economic reasons, the reduction of high levels of inequality such as those experienced in South Africa should have positive implications for growth, which should then translate into greater inroads into poverty reduction. The links between growth and

inequality are clear when one considers the example of crime rates. The evidence suggests that the most unequal regions in the world (Sub-Saharan Africa (SSA) and Latin America) have experienced rapidly increasing levels of violence (measured as murder rates) in recent years (Bourguignon, 2004: 17). Such high reported crime rates adversely affect the economy through increasing the risk profile of these countries in terms of investment decisions as well as the loss of lives, use of medical resources and the direction of resources towards fighting crime, away from other productive activities (Bourguignon, 1998, cited in Bourguignon, 2004).

Previous chapters of this review have considered macroeconomic and sector-specific performance within the Province – factors which are used to measure economic growth directly. This chapter addresses the relationship between equality and development, the success of which is largely measured in terms of marked reduction in poverty.

2.4. Decomposing and measuring equity and inequality

Equity is a broad-based concept. Decomposing the overarching notion into more practical elements and taking a closer look at how they are measured, analysed and interpreted, yields a greater degree of tangibility to the debate on the relationship between equity, and shared growth and development.

Broadly speaking, equity or inequity (inequality) may be measured in respect of income, assets and/or opportunities, and spatial elements.

The first gives a money-metric insight into equity and inequality, and is often used in complementary impact analysis in terms of money-metric poverty measurements such as poverty rates and gaps that are calculated in relation to an income poverty line.

The second – asset equity or inequality – refers to people's capability and opportunity to develop themselves to their fullest potential through access to various assets (health status, educational attainment, financial, land or property, to name a few), gained largely in respect of access to quality services. In the main, asset equity is concerned about access to good basic services (water, sanitation, energy and refuse removal) and social services (health care, education and skill development, and shelter). Many of these variables refer to the asset distribution within a population and therefore will have an influence on the distribution of capabilities and the opportunity to live a life of people's choosing.

Lastly, spatial equity or inequality talks to spatial divergence or convergence across regions and their correlates in patterns of individual and community assets. Particular aspects of spatial inequality relate to the dislocation of living, working and recreational spaces that add further environmental (broadly used) adversities, exacerbating poor living conditions.

2.4.1. Income inequality

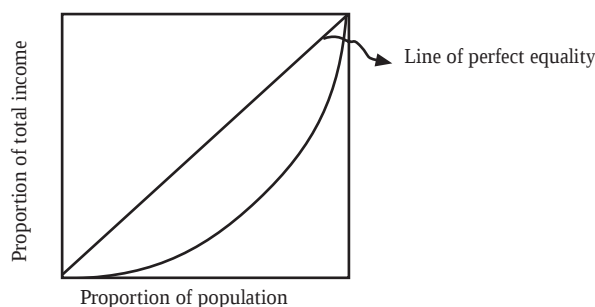
Understanding measures of income inequality³

The most commonly reported measure of inequality is the *Gini coefficient*, which is often used in comparisons of inequality between defined groups in respect of countries and sub-national regions, and over time. Ginis will always lie between the value of zero (perfect equality) and one (perfect inequality). This means that a high and/or increasing Gini points to increasing income inequality between groups, whereas a low or declining value illustrates improved equity.

The power of the Gini as a measure of income inequality is that it takes every pair of income differences across the entire population into account. Furthermore, a transfer from a rich person to a poor person will always lower the Gini.

The Gini coefficient may be represented in graphic form using the Lorenz curve. The Lorenz Curve plots the population share on the horizontal axis of the graph and the corresponding proportion of total income on the vertical axis. The population is ordered from lowest to highest income. The Gini coefficient essentially reflects the area between the line of perfect equality and the Lorenz curve as a proportion of area that would exist under conditions of perfect income equality.

Figure 1 Graphical representation of a Lorenz Curve



If everyone in society has the identical income, perfect equality prevails, and the Lorenz Curve is the straight (45-degree) line. In such an instance, for example, the 'poorest' 20 per cent of the population receive 20 per cent of total income and the 'richest' 20 per cent also receive 20 per cent of total income. In this case, the Gini coefficient is 0,0.

If, however, perfect equality does not prevail, *poorer members of the population* will receive a *smaller than proportionate share of income* and the curve will dip below the 45-degree line. The more unequal the society, the larger the gap that exists between the Lorenz curve and the diagonal.

³ Please note that to assist layperson understanding of economic concepts and not to introduce unnecessary technical jargon, the terms income and expenditure are used interchangeable in this analysis.

Less common, but notable in their use in income inequality analyses, are the *Theil index* and the *share of total income* received by quintiles of the population.

Like the Gini coefficient, the *Theil index* lies between zero and one and has the property that a transfer from the richest person to the poorest person always decreases the index. The advantage of the Theil over and above the Gini is that it is decomposable into mutually exclusive and exhaustive sub-groups, with the between- and within-group contribution measurable. Such decomposition becomes particularly useful in South Africa where there is an obvious racial division. The Theil index allows us to explore the relative contributions of 'within-race' and 'between-race' inequality and how these change over time.

Finally, considering the share of total income across income quintiles is another, intuitively appealing, indicator of inequality, and also aids to highlight movements along the income distribution which may be masked by an aggregate such as the Gini coefficient or Theil index. Gini coefficients, Theil indices and income shares are therefore complementary measures or tools that can be used in income inequality measurement and analysis⁴.

International comparisons

Equity and development are global challenges. As such, they manifest as a worldwide phenomenon between the developed world and the developing world, with low-income countries under stress (LICUS) at the critical fringe. For people living in Scandinavia, life often seems light years away from the daily experience of urbanising Chinese, and is certain far removed from life in much of SSA.

Global inequality is therefore at a much larger and more politically contentious scale than inequality at the country and sub-national regions level. The former frames and permeates inequality patterns that prevail at the latter. Whilst harnessing considerable potential and opportunity for reducing inequality at the national and sub-national levels, the character, prevalence and accentuation of global inequality often serve to temper and limit scope for change. This frames global development patterns and 'catch-up' potential, bringing to the fore the pervasiveness and impact of globalisation on societies and economies.

Closer to home, it is a well-known fact that income inequality in South Africa is amongst the most severe in the world and most comparable with the also highly skewed income distribution of Brazil. Our infamous ranking is evident from a comparison of diverse Gini coefficients for a selection of middle-income countries set out in Table 1.

⁴ All three measures are sensitive to the quality of survey data collected, but considering quintile shares by province or race requires data to be as representative as possible along these lines. That said, analytical results and interpretations are only as robust as the underlying official data, the availability and credibility of which are subject to considerable debate.

Table 1 Comparison of selected middle-income countries

	Thailand	South Africa	Brazil	Malaysia	Venezuela	Poland
Gross National Income						
per capita US\$ (2002)	1 980	2 600	2 850	3 540	4 090	4 570
Gini Coefficient	0,414	±0,60*	0,607	0,492	0,495	0,316
Share of income of poorest 20%	6,1	2,8*	2,2	4,4	3,0	7,8

[Source: 2003 World Development Report and *from Borat et al., 2001: 22]

It is useful to note that Gini coefficients in the range of 0,40 to 0,45 are generally seen to represent intermediate levels of income inequality, with those below this range considered as relatively low and those exceeding 0,45 regarded as high. At a level in excess of 0,60, South Africa's Gini coefficient is extremely high in comparison, pointing to prohibitive income inequality within our country – a fact well known but which is driven home in respect of the numerical comparisons.

Furthermore, given that Gini coefficients move extremely slowly over time, reducing South Africa's income inequality poses a substantial challenge. Even fairly rapid change in the ranking of individuals or households can coincide with surprisingly little change in the overall income distribution, as many of these changes in rank cancel out. Furthermore, factors contributing to changes in income inequality, such as changes in returns to education in the labour market and changes in educational attainment, may also work in opposite directions. For example, progress may be made in terms of educational attainment, with more persons obtaining higher educational qualifications; however, if the returns to that education decline – perhaps due to changes in prices – then a better-educated workforce may not enjoy an increase in earnings. This would in all likelihood be reflected as static inequality.

This means that overall movements in Gini coefficients over time tend to mask shifts in the underlying elements. Such complexity in interrelated shifts is illustrated in the examples and trends in Gini coefficients for certain countries over time set out in the text box below.

The pace and complexity of Gini coefficient movements over time

How and why do Gini coefficients move?

A number of cross-country studies have assessed the extent and likelihood of Gini coefficients moving over time. The much-cited paper by Deininger and Squire (1996)* finds that the average annual growth for their sample of 108 countries spanning the 1960s to the 1990s experienced an annual growth rate in income per capita of 2,16 per cent, while the Gini moved on average only 0,28 percentage points.

Even countries with impressive growth saw very little movement in their Ginis:

- The case of Taiwan from 1964 to 1990 shows that real per capita income increased five times, from US\$1 540 to US\$8 063, while the Gini coefficient only declined from 32,2 to 30,1 (Deiningering & Squire: 587).
- The US saw an increase in real income per capita from US\$8 772 in 1950 to US\$17 594 in 1991, with the Gini moving only from 0,360 to 0,379.
- Brazil's real income per capita increased from US\$1 784 in 1960 to US\$4 271 in 1989, with its Gini moving from 0,530 to 0,596 (Deiningering and Squire: 587).

Only Eastern Europe and Central Asia have seen particularly large changes, but these have been negative and due to massive economic restructuring (Deiningering and Squire; Adams, 2003).

Although they move slowly, Ginis do move. A recent study by Ravallion (2002) finds evidence of a trend, in that inequality tends to converge around the 0,40 level, with low-inequality countries experiencing increases in their Ginis and high-inequality countries experiencing declines.

Emphasis is again placed on the fact that movements are slow over time, and country-specific examples may well differ from the trend. An example from Ravallion's work uses two countries, one with an initial Gini of 0,60 and one with an initial Gini of 0,30. The calculated expected trend movements in these Ginis is -0,57 per annum for the first country and 0,31 per annum for the second. In 15 years, the first would see a decline in its Gini from 0,60 to 0,51, while the second country would see an increase to 0,35 over the equivalent time period. (Ravallion: 11)

** Deiningering and Squire (1996) uses a carefully compiled dataset of 682 high-quality, cross-country observations covering the above-mentioned 108 countries and 1960s to 1990s time period.*

Income inequality in South Africa and the Western Cape

Closer to home, considerable work has been done in examining the levels and changes in income inequality in South Africa. This is unsurprising, given the fact that income inequality in South Africa is amongst the worst in the world. Therefore, even though Gini coefficients move slowly over time, the level of the coefficient is a key way to benchmark performance, specifically in terms of identifying the direction of trends, that is, whether income inequality is increasing or declining.

This section details the changes in income inequality for South Africa and the Western Cape for the period 1995 to 2000. It is critically important to note that the resulting analysis is only as robust as the underlying data, and that comparative analysis is only as meaningful as the underlying data and methodologies allow. For instance, Gini coefficients compared over time must be calculated using the same definition – either income or expenditure - and the same statistical unit of analysis – at the individual or household level. Data concerns and choices for the 2005 PER&O analysis are explained below.

Data concerns and units of analysis

The data used for the income inequality and poverty analyses in this chapter comes from the Income and Expenditure Surveys (IESs) of 1995 and 2000, carried out by Statistics South Africa. The IES is a household sample survey, undertaken every five years with the primary purpose of determining weights for the CPI. As such, the survey collects detailed data on the earning and spending capacity, as well as consumption patterns, of South African households.

The IES 1995 was undertaken at the same time as the OHS 1995 and interviewed mostly the same households, a similar case holding for the IES 2000 and the September 2000 LFS. The final data used in this review comes from the merged versions of the IES 1995 with the OHS 1995, and the IES 2000 with the LFS 2000. The datasets should be nationally representative and reflect a fairly accurate breakdown of the demographic characteristics of the population at the provincial level.

As the survey is sample-based, weights based on Census data are used to impute the population size and relevant proportions. The weights used for the 1995 data are those released by Statistics South Africa after the initial release of the survey and based on the Census 1996. These accurately reflect the population size and proportion of the country in 1995. The weights released with the IES 2000 are more problematic. The two sets of weights currently available with the dataset are not representative of the population at the provincial level. The weights used in this analysis are the re-calibrated weights released with the LFS 2000. Although imperfect, there is more consistency in the ranking of populations by provinces with these weights.

The quality of the data in the 1995 surveys has always appeared adequate although errors do occur. In using expenditure data, this report's research team aggregated all categories from the bottom up, and recalculated all totals so as to avoid computational errors that exist in the released dataset. The data quality of the IES 2000 is much more contentious. It appears that there are a range of problems which most likely occurred during all stages of the data collection process – fieldwork, data capture and data manipulation – prior to the dataset being released. Little can be done about the queries surrounding the data quality at this stage other than to wait for comment from Statistics South Africa. As with the IES 1995, the PER&O research team again aggregated all data up from the lowest units and recalculated all totals. In addition, all observations for which there was no expenditure indicated for food items (about 500) were dropped.

The representivity of the final samples used in this report is shown in Table 2. It is clear that the population proportions in the IES/OHS 1995 lie very close to those of the Census 1996. The actual numbers for the population by race for the Province are also very similar to the Census figures. This is not the case for the 2000 data, in which the racial proportions are different and the absolute numbers of the people in the Western Cape are largely under-estimated. As is evident from the Table, the proportion of Coloureds is overstated and the proportion of Africans understated in the 2000 data. This will have an impact on some of the results discussed here; the likely direction of the effect, where applicable, is pointed to in the report.

When considering the unit of analysis, the choice must be made between gross or net income, income or expenditure, and whether the focus should be at the household or person level. Using the household as the

unit of analysis as opposed to the individual can have a sizeable impact on inequity/inequality and/or poverty measures, as poorer households generally have more members than richer households. Inequity/inequality and/or poverty measures based on the household will therefore be lower than when based on individuals, and may in fact understate the extent of the problem.

Table 2 Census proportions and weighted IES sample for the Western Cape

	Proportion of Population		Proportion of Population	
	Census 1996	IES/OHS 1995	Census 2001	IES/LFS 2000
	(%)	(%)	(%)	(%)
African	21	21	27	22
Coloured	54	56	54	59
White	21	21	18	18

[Source: IES, 1995 and 2000; Census 1996 and 2000; author's calculations]

Note: The totals do not add up to 100 as Asians and 'unspecified' are excluded due to their small numbers.

To reflect more truly the differences in potential living standards across the population, income less of income tax would be the preferred measure, as taxes are not actually available for use by those who pay them and in fact are often redistributive.

Table 3 shows the range of Gini coefficients calculated using the IESs of 1995 and 2000. The disparities between the different measures highlight the need for consistency in methodology. They also serve to emphasise that it is the general level and direction of change that should be interpreted, rather than the absolute values.

Table 3 Gini coefficients calculated according to different parameters using the IES 1995 and 2000

Study	Gini Coefficients based on Total Household Income or Expenditure			
	1995		2000	
Household level	Income	Expenditure	Income	Expenditure
Fedderke, Manga & Pirouz (2003)	0,58	0,59	0,62	0,59
Statistics South Africa (2002)	0,56	-	0,57	-
Household level	Gini Coefficients based on Per Capita Household Income and Expenditure			
Lam & Leibbrandt (2003)*	0,64	-	0,67	-
Individual level	Gini Coefficients based on Per Capita Income and Expenditure			
Fedderke, Manga & Pirouz (2003)	0,66	0,66	0,69	0,67
Poswell (2004)		0,639		0,682
Confidence Interval	-	[0,636; 0,642]	-	[0,675; 0,688]
Hoozevee & Özler (2004) – “Core Consumption”	-	0,565	-	0,577

Note: * Household income per capita with one observation included per household



As can be seen, an array of Gini coefficients can be calculated with the same source data depending on the unit of analysis chosen. First, it is evident that in the South African case, Gini coefficients calculated with total *household expenditure/income* are much lower than those calculated at the household level, but based on *per capita household expenditure or income*. This is to be expected as poorer households have on average more people, so that taking household size into account will 'stretch' the distribution of income or expenditure further apart.

Second, the Gini coefficients for the population (individuals) based on *household per capita income or expenditure* are slightly higher than the household level Gini using (household) per capita income or expenditure, but only one observation per household. Once again, this is unsurprising as each household is counted only once in the latter measure.

It is also apparent that income-based and expenditure-based measures calculated for the same groupings are quite similar in magnitude. It would be expected that the income measure be higher than the expenditure measure, as people generally smooth consumption (expenditure) over time, whereas income is likely to be much more volatile. This is borne out in most instances above (and own calculations using the income data not reported here).

Finally, differing income or expenditure bundles that are used as the unit of analysis will yield very different results. Hoogeveen and Özler's (2004) substantially lower figures based on a narrowly defined 'core consumption' bundle reflect this result. As a substantial number of consumption categories, especially many of those with large spending potential for some, are 'culled', much variation in the income distribution is lost. For any comparisons over time, the reader must be sure to understand the method used so as to be aware of whether the values are comparable or not.

Caveats aside, the remaining analysis focuses on individuals (rather than households) and uses disposable expenditure per capita as the unit of analysis.

First, it is plain to see from Table 3 that income inequality in South Africa is exceptionally high, and if anything, has worsened from 1995 to 2000. For the purposes of the 2005 PER&O analyses, Poswell's (2004) calculation in respect of South African income inequality across individuals shows an exceptionally large increase, from 0,64 to 0,68⁵. In fact, irrespective of the unit of analysis chosen, an increase in income inequality is the one consistent result to emerge from the majority of studies examining inequality with the IESs and the Censuses from 1996 and 2001⁶.

It is important to note the aggregate level of the Gini coefficient and the direction in which it moves over time. However, it is also critical to be aware that underlying data quality concerns (particularly in respect of the IES 2000) will impact on the precision of the

⁵ This increase is statistically significant at the five per cent significance level.

⁶ See Hoogeveen and Özler (2004), Lam and Leibbrandt (2003) and Leibbrandt et al. (2004).

statistical point estimates as well as relevant confidence intervals, the latter determining whether statistically significant change has in fact occurred.

The increase we see in the Gini coefficient from 0,64 to 0,68 is notable. Part of the rise is most certainly due to underlying data quality concerns, and therefore full confidence cannot be placed in the absolute value. That said, statistical testing suggests that the general upward drift in respect of income/expenditure inequality at the national level is robust.

This finding is confirmed when analysing Gini coefficients calculated according to different assumptions about the income variables in the Censuses of 1996 and 2001, as set out in Table 4. The latter illustrates that, using Census data, Gini coefficient absolute values rise to exceptionally high values of around 0,80. Such absolute values are clearly unrealistic and obviously relate to underlying data concerns as well as to missing values in respect of the income variable. However, statistical robustness of the upward trend permits the inference that income inequality is extremely high, and that there appears to have been an increase.

Use of confidence intervals in statistical analysis

These intervals are calculated because the datasets are from sample surveys and there is thus a certain probability that the estimates generated will not be truly representative of the entire population. The confidence intervals indicate the likely range within which the estimate should fall, if one was to resample the same population and calculate these estimates with the new data*. This range is therefore a valuable marker and should be given as much attention as the point estimate.

The confidence intervals become particularly useful when making comparisons across data points. If the intervals overlap, one cannot say with any precision that there has been a change. If they do not overlap, one can say with a certain degree of confidence that a statistically significant change has occurred. Although the confidence intervals are useful in that they provide us with the likely range, these too are affected by the data quality concerns already mentioned, and are only as 'precise' as the data upon which they are based.

** The confidence interval is generally calculated according to a specified probability of the interval containing the true population value. The most common level is at the 95 per cent level, which means that, statistically, the true value has a 0,95 probability of falling within this range.*

All Gini coefficients here are listed with their confidence intervals below. The confidence intervals around the national level Gini coefficients for 1995 are [0,636; 0,642] and for 2000 are [0,675; 0,688]. As these bands do not overlap, we can say that the data indicates an increase in income inequality over the period.

Table 4 Gini coefficients across a number of different data assumptions, 1996 and 2001

	1996	2001 Unconstrained	2001 Constrained
National	0,74	0,82	0,79
Race			
African	0,71	0,78	0,75
Coloured	0,55	0,66	0,63
Indian	0,50	0,62	0,58
White	0,46	0,60	0,53
Province			
Western Cape	0,62	0,74	0,70
Eastern Cape	0,78	0,83	0,81
Northern Cape	0,69	0,77	0,74
Free State	0,73	0,81	0,78
KwaZulu-Natal	0,75	0,82	0,80
North West	0,71	0,79	0,76
Gauteng	0,65	0,78	0,74
Mpumalanga	0,73	0,81	0,78
Limpopo	0,77	0,81	0,79

[Source: Leibbrandt et al. (2004) using Census 1996 and 2001]

Note: All estimates include zero incomes

In the two censuses, income is captured in categories rather than as actual values. The 1996 and 2001 categories are inconsistent, with the top band in 1996 being significantly lower than the top bands in 2001. Constrained income in 2001 in this table refers to a variable in which the top categories for income earners in 2001 were constrained to the upper 1996 values in real terms.

Given that income inequality is so high at the national level and that inequality is detrimental to society in so many ways, it is important that we understand how income inequality within the Western Cape compares to other provinces, how this has changed over the period under review and whether the Province's patterns of 'within-group' racial income inequality mirror those of the other provinces, or deviate in some specific way.

Table 5 shows the results for Gini coefficients calculated by province for 1995 and 2000.

Table 5 Gini coefficients by province, 1995 and 2000

Province	Gini 1995	Gini 2000
Western Cape	0,584 [0,576; 0,591]	0,616 [0,597; 0,635]
Eastern Cape	0,648 [0,640; 0,657]	0,663 [0,653; 0,674]
Northern Cape	0,647 [0,630; 0,664]	0,658 [0,641; 0,675]
Free State	0,659 [0,649; 0,670]	0,696 [0,685; 0,707]
KwaZulu-Natal	0,625 [0,618; 0,633]	0,684 [0,673; 0,694]
North West	0,629 [0,621; 0,638]	0,658 [0,634; 0,683]
Gauteng*	0,545 [0,537; 0,552]	0,629 [0,617; 0,641]
Mpumalanga	0,582 [0,572; 0,592]	0,626 [0,615; 0,637]
Limpopo	0,625 [0,615; 0,636]	0,624 [0,607; 0,641]
National	0,639 [0,636; 0,642]	0,682 [0,675; 0,688]

[Source: IES 1995 and 2000. Author's calculations]

Note: Gini coefficients are not additive and therefore provincial Gini coefficients will not add up or average to the national Gini coefficient. Provincial Gini coefficients should not be compared to the national Gini coefficient but rather to Gini coefficients for the other provinces.

** The change in the Gini coefficient for Gauteng is implausibly high. There are extreme weighting issues with Gauteng data in the IES 2000 that are not apparent for the other provinces, and this data quality concern may be driving this result.*

First, it is important to note that Gini coefficients calculated at the provincial level are often lower than those calculated at national level (using the same data). This is to be expected, as there will be factors within geographical areas that have meant the distribution of people characterised in this way is more similar than if we consider both within and across all these groups.

Looking at each province individually, the Gini coefficients indicate increases in income inequality across the board from extremely high to even higher. These changes are only statistically significant for the Western Cape, Free State, KwaZulu-Natal, Gauteng and Mpumalanga. In the other provinces, we cannot say with confidence whether an increase has occurred.

Considering how the Western Cape fares in relation to other provinces, it *appears* to have been the third-least unequal province in 1995, with a Gini coefficient of 0,584, and the

least unequal in 2000 with a Gini coefficient of 0,616. From a comparative perspective, the Western Cape is performing well in relation to the other provinces, if only in the sense that its inequality is marginally lower. This finding of relatively lower income inequality in the Western Cape is corroborated by Leibbrandt *et al.* (2004) who, using Census data, find the Western Cape to have the lowest Gini coefficients of the provinces in both 1996 and 2001 across various measures of income.

In terms of the pace of the Gini movements for the Western Cape, the change may be much lower than the point estimates would indicate (an almost three percentage point increase. This can be seen by the very *closeness of the confidence intervals*, with 1995's upper limit being 0,591 and 2000's lower limit 0,597 – a very small difference indeed.

When considering 'within-race' inequality, the same pattern holds for the Province as for the nation as a whole, with Africans experiencing the highest 'within-race' income inequality, followed by Coloureds and then Whites.

Table 6 Income inequity/inequality measures by race, 1995 and 2000

Race	National	Western Cape		
	Gini coefficients			
	1995	2000	1995	2000
African	0,546 [0,543; 0,550]	0,589 [0,585; 0,594]	0,515 [0,479; 0,550]	0,541 [0,464; 0,617]
Coloured	0,488 [0,482; 0,495]	0,528 [0,517; 0,540]	0,439 [0,429; 0,449]	0,494 [0,479; 0,509]
Asian	0,449 [0,434; 0,464]	0,474 [0,449; 0,498]	Sample size too small for useful estimates	
White	0,393 [0,386; 0,400]	0,455 [0,440; 0,469]	0,404 [0,389; 0,418]	0,446 [0,405; 0,487]
Theil contributions (%)				
Within Race Inequality	53,1	55,7	52,9	58,8
Between Race Inequality	46,9	44,3	47,1	41,2
Total Inequality	100,0	100,0	1000	100,0

[Source: IES 1995 and 2000. Author's calculations]

Note: Confidence intervals in square brackets below Gini Coefficients

In terms of changes in income inequality over the period, Table 6 shows that at the national level, income inequality appears to have increased for Africans, Coloureds and Whites. (The confidence intervals for Asians overlap, resulting in an indeterminate result in respect of the direction of change for this group). In terms of the Western Cape, *small sample sizes* for the *African* and *White* groups lead to estimates where *confidence intervals overlap*. However, stronger statements can be made about income inequality amongst Coloureds, which does seem to have increased over the period.

Turning to complementary analysis, the use of *Theil contributions* enables analysis in respect of the share of inequality attributable to 'within-race' group income inequality and the share attributable to 'between-group' inequality. There appears to be a slight increase in the 'within-race' contribution over the period, inferring that it is more 'within-race' than 'between-race' inequality that is driving the income inequality measures upwards.

It is interesting that the Western Cape, with its quite different racial profile, still has a similar income inequality profile to the rest of the country in terms of having extremely high income inequality at the Provincial level and in terms of the 'within-race' patterns.

Higher or deeper rates of poverty at the lower end and/or upward earnings mobility of those at the top end would serve to widen the distribution and is the likely reason for the rise in inequality seen here. Indeed, with labour market earnings being the key driver of inequality in South Africa⁷, the workings of this market become central to measured income inequity/inequality.

Determining the main contributors to the changes in inequality shown above is made difficult by data constraints. Statistically significant increases in unemployment rates at the national level would likely explain part of the inequality increase. Uncertainty as to the trends in remuneration paid to the employed, however, prevents comment on this potential impact. In terms of provincial drivers, the analysis in chapter 4 revealed that little can be said regarding the direction of unemployment or remuneration changes in the Western Cape, making it extremely difficult to comment on the apparent aggregate increase in inequality shown here.

Improved equality in access to education and educational attainment, and the commensurate structure of returns to education of the formally employed, may be other key reasons that explain the changes in inequality and potentially the slight decrease in the inter-racial contribution to income inequality shown in Table 6⁸.

From 2000 to 2003, mean years of completed education for Africans in the Western Cape aged 20 and above increased from 8,2 to 9,1 years over the period. The Coloured population aged 20 and above showed a slight increase in mean years of education from 8,9 in 2000 to 9,2 in 2003, whilst the White mean years of schooling remained stable at around 12,6 years. We therefore see a narrowing in the distribution of educational attainment between the races. The divide, once again, will be largely between those who manage to find work and those who do not, and how the additional education is rewarded in the labour market.

⁷ See Leibbrandt, Murray; Woolard, Ingrid and Borat, Haroon. "Understanding Contemporary Household Inequality in South Africa," Ch. 1 in H. Borat, M. Leibbrandt, M. Maziya and S. Van der Berg, *Fighting Poverty: Labour Markets and Inequality in South Africa*. Cape Town: University of Cape Town Press, 2001: 32.

⁸ There is an unfortunate disjuncture between the time periods used for labour market analysis and those for poverty and inequality. This was driven by data considerations. Using the labour market findings to reflect on the changes in poverty and inequality here assumes similar processes at work over the two periods.

The story of increasing income inequality in the Western Cape, and indeed in South Africa as a whole, is the outcome of many complex factors that interact and move in a myriad of different directions. It mirrors the narration in respect of employment and unemployment changes that lead from Provincial labour market performance.

On the one hand, increased employment and remuneration opportunities for some, albeit insufficient, mean that part of the Province's population is progressing, reflecting a positive strand to the Western Cape's growth and development story.

However, this gratifying note is somewhat dampened as the rumblings of structural unemployment in the Province grow stronger. While the Province is not experiencing jobless growth, it certainly is not absorbing sufficient numbers of additional people entering the labour force (in respect of normal demographic transition, migration and increased labour force participation rates). This has contributed notably to high unemployment rates and a possible deepening of poverty rates, or at a minimum, an increase in the number of poor in the Province itself.

These trends are occurring despite increased access to education, therefore reflecting that improved equality in access has not yet translated into positive labour market outcomes for many. This emphasises the complexity and interdependency of the Province's development challenges. Here concerns in respect of the quality of education and training and the health status of the population come to the fore.

Understanding the reasons behind this rising income inequality and the impact of the underlying factor movements is essential if appropriate policies are to be formulated with an aim of reversing the upward trend. Isolating and examining the dynamics of these forces are a key area for future research, some considerations of which are discussed in the final section of this chapter.

That said, it is also critical to understand the implications of rising income inequality for deepening or entrenched poverty at the lower end of the income distribution, and therefore the intransigency of systemic poverty that is the face and heart of South Africa's development challenge.

2.4.2. Asset inequality

This section continues the discussion on inequality by looking more closely at what may be termed *asset inequality*, which concerns the accumulation of personal assets that affords people the capabilities and/or opportunities to improve their daily living circumstances and their future social and economic opportunities.

Usually 'assets' refer to financial or physical assets (such as land or buildings). But viewed in a broader sense, a person's asset portfolio stretches beyond her or his accumulation of

financial wealth or physical collateral; it also encompasses her or his health status, literacy, educational attainment and entrepreneurial ability, to name a few.

These non-income dimensions of welfare are often notably correlated with income and consumption levels, drawing a link between income inequality and asset inequality concerns. More specifically, asset equality is attained in respect of access to good basic services (water, sanitation, energy and refuse removal) and social services (health care, education and skill development, and shelter). Typically, those at the higher end of the income spectrum have more extensive access to quality services, ensuring that their capabilities and opportunities are broadened and deepened to their fullest potential.

Many government interventions therefore focus on improving poor people's capabilities in respect of enhancing access to quality schooling and skill development, health care services, clean and safe water, sanitation facilities and housing. These types of public service provision are often termed the 'social wage' or 'social wage goods'.

Asset inequality in South Africa and the Western Cape

A credible assessment of the relationship between equity and development should augment income inequality analysis with an explicit focus on access to basic and social services, and the disparities in these that exist both nationally and at sub-national level. These simple measures serve as powerful indicators of living standards and can help to provide a more nuanced understanding of areas of need of the population. In instances in which Government is providing many of these basic services free of charge to the poor, the extent of income inequality may be overstated.

The initial part of this section focuses on access to *basic services and dwelling types* of those in the Western Cape, and compares these to national data in an attempt to further our understanding of welfare levels in the province. The unit of analysis in this case is the household (rather than individual people as households share in access to such services).

Key access indicators considered here in respect of basic services include type of dwelling, water supply, energy source, type of sanitation, refuse removal and telephone access. The nature of access to these basic goods and services will have a strong influence on standards of living and quality of life. Type or quality of housing, for example, besides providing a space in which to live, may offer opportunities as either a place of work or – if the dwelling is owned – as collateral for a loan. Sanitation, water supply and refuse removal will have impacts on the health of the population, while access to energy and water will also determine time spent in obtaining these resources. Finally, telephone access is a key indicator of household engagement with the economy, and will reflect on opportunities to engage with the formal labour market.

It is important to note that, as the population of the Western Cape lives mostly in urban areas, extensive access to basic services should be achievable. The data in Table 7 attests to this, with 95 per cent of Provincial households in 2001 having access to piped water, 86 per cent to a flush toilet, 87 per cent to refuse removal and 87 per cent to electricity for lighting purposes. On aggregate, the Western Cape once again performs well above the national averages.

The one instance in which this is not the case is in terms of dwelling type. Although 80 per cent of dwellings are classified as formal, far exceeding the national average of 68 per cent, a similar proportion of dwellings to the national average (16%) is classified as informal. Informal dwellings are generally constructed with walls and roofs of corrugated iron or other materials such as cardboard and plastics. They are often less secure than even traditional dwellings, are found in densely populated areas and are more vulnerable to shocks such as fires and floods. In the Western Cape in 2001, Census data indicates that approximately 188 000 dwellings were informal and in excess of 600 000 people were living in these sub-standard structures. Furthermore, the majority of households indicating that they have no toilet are classified as informal. Province and City of Cape Town plans to upgrade the N2 corridor should help to address some of these housing and associated problems in the Province.

Finally, telephone access is also well above the national average, with 63 per cent of households having access to a landline telephone within the home or to a cellular telephone. Public telephones remain important, with a further one-quarter of households using them as their main telephonic source.

Table 7 also shows *changes* in basic service access indicators over the 1996 to 2001 period. At the national level, small improvements have been made across all services categories, most notably in the increase in electricity for lighting purposes and telephone access. This is an important point, as it reveals that even though income inequality appears to have increased across South Africa, improvements in access to basic services have been made.

In terms of basic service access levels, the Western Cape once again performs well above the national averages, however, *improvement* in access is less impressive for the Province. In fact, the proportion of dwellings classified as formal has seen a drop, and the share of households that do not have a toilet has increased.

It is interesting to note that in terms of expenditure levels, the Western Cape has shown improvements well in excess of the national trend, but in terms of *improving* access to basic services and housing types, the Province is actually performing relatively poorly.

Table 7 Access to basic services for South African and Western Cape households, 1996 and 2001

	National		Western Cape	
	1996	2001	1996	2001
Urbanisation Rates	%	%	%	%
% of households in urban areas	59,9	62,4	88,8	90,3
Dwelling Types				
Formal	65,2	67,6	82,2	80,4
Informal	16,2	16,3	16,7	16,1
Traditional	18,3	14,6	0,9	2,1
Water Access				
Piped	80,0	82,2	97,0	94,9
Borehole/tank/vendor	6,1	3,7	1,2	0,3
Spring/river/dam/pool	12,4	9,2	0,6	0,4
Energy Source Lighting				
Electricity	57,7	69,5	85,4	87,5
Paraffin	12,7	6,7	8,2	7,0
Candles	28,5	22,6	5,8	4,4
Energy Source Cooking				
Electricity	47,2	50,7	76,8	77,6
Paraffin	21,5	21,3	13,3	13,9
Wood	22,9	20,3	4,5	2,9
Sanitation				
Flush/ chemical toilet	50,3	53,4	85,8	85,8
Pit latrine	32,3	28,3	4,8	2,1
Bucket latrine	4,6	4,1	3,8	3,7
None	12,4	13,6	5,4	7,7
Refuse Removal				
Removed by local authority	53,5	55,7	84,9	87,2
Own refuse dump	32,2	32,0	7,7	7,2
Communal	3,2	1,7	3,7	2,1
No rubbish disposal	9,5	8,4	2,0	1,4
Telephone Access				
In this dwelling/ cellular phone	28,6	42,4	55,1	63,1
At a public telephone nearby	35,9	38,4	27,2	25,2
At another location	16,7	13,2	14,3	10,1
No access to telephone	18,3	6,0	3,0	1,7

[Source: Census 1996 and Census 2001, 10% Samples]



It is also important to recognise that the large increase in the population of the Western Cape over this period means that, even if the proportions stay constant, the absolute numbers may increase substantially. For example, if one considers informal dwellings, although the proportion has been fairly stable (in the 16% to 17% range over the period), the actual number of informal dwellings has risen from 162 873 in 1995 to 188 209 in 2001, an increase of 25 000 dwellings.

Taking the analysis further, we examine access to *social services* – education, healthcare services, social welfare services and policing. This facilitates a comparison of access data in the Western Cape to national data, drawing a more complete picture of opportunities for future development and areas of explicit need. In terms of targeting inequality of opportunities, widespread access to many of these services forms the foundation of a more equitable society, in which people are better equipped to participate more fully in the economy. This time the unit of analysis is the individual, as access to social services is predominantly in respect of individual access.

Key access indicators in terms of social services include, amongst others, education participation and completion rates; enrolment numbers and rates at Grade R, primary, secondary and further education and training (FET) colleges; numbers of health personnel (doctors, nurses, pharmacists) for every 1 000 people; percentage access to a primary healthcare facility within 5km walking distance, acceptable patient waiting and service times; numbers of social workers for every 1 000 people; numbers of police personnel for every 1 000 people and percentage access to a police station/mobile unit within 5km walking distance.

Again, as with basic services, the nature of access to these social services has a fundamental impact on improving people's capabilities, and therefore their present and future quality of life and opportunities.

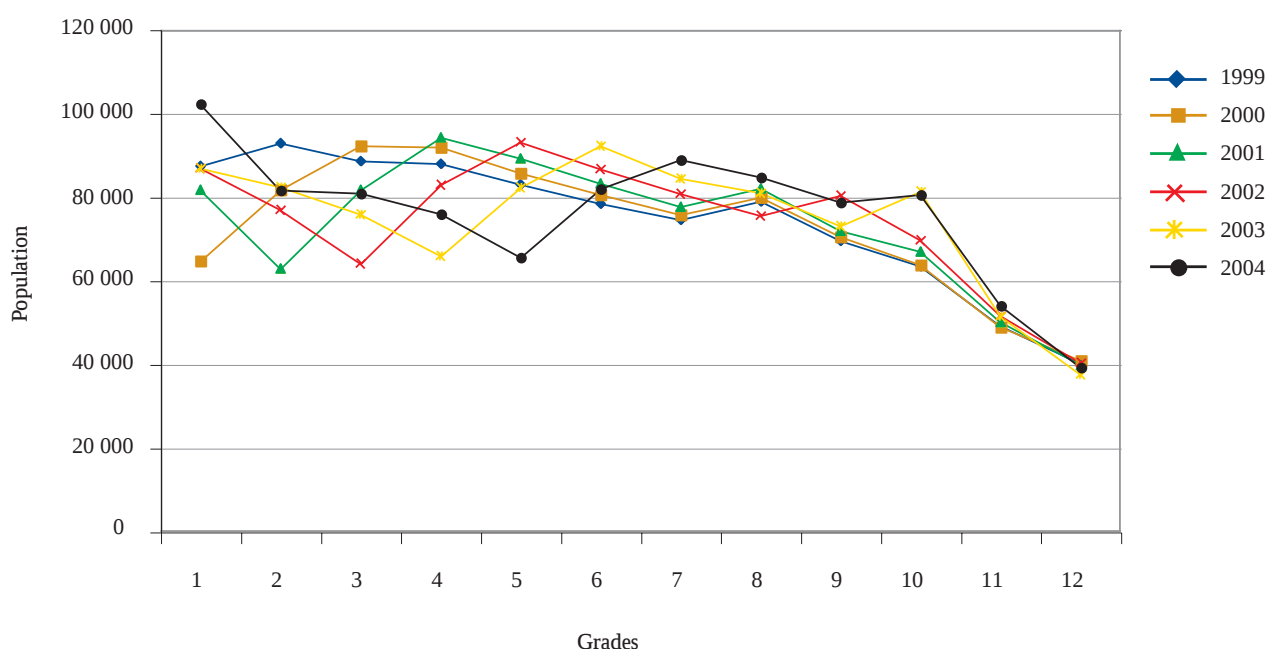
Taking a closer look at a few of the above indicators, we note that access to quality education is the foundation of skill development, opening access to further education and training and hence to skilled, well-remunerated employment opportunities. Education has already been discussed in the context of the labour market, with the employment and unemployment profiles of the Provincial labour force as well as Provincial migrant status mapped out by educational attainment. As with many other indicators, the Western Cape performs better than most provinces in terms of attendance rates and average educational attainment. Nationwide, attendance of seven- to 15-year olds is good, with 6,5 per cent of children in this age group not attending school in 2001. The Western Cape fares slightly better, with only 5,5 per cent of this age group not going to school, according to Census 2001 data.

According to 2001 Census figures, the Western Cape also had the lowest proportion of those aged 20 and above with no schooling. It had the second-highest proportion of its

provincial population in this age group with a completed Grade 12 or higher education, with only Gauteng performing better. In addition, it exhibits the highest adult literacy at 91 per cent (measured as those aged 20 and above with at least four years of schooling) compared to a national average of 77 per cent.

The key area of concern, however, is the high rate of learner drop-out after Grade 8, reducing secondary school completion rates significantly. This trend is evident in respect of enrolment data by grade, indicating that only 45 per cent to 52 per cent of learners who enrol in Grade 1 reach Grade 12.

Figure 2 Enrolment in public ordinary schools in Western Cape, 1999 – 2004



[Source: WCED, 2005]

Nevertheless, better educational attainment does not mean that the education system is operating efficiently or that the population is acquiring the 'right set of skills' that will facilitate easy entry into the job market. In fact, chapter 4 shows that there is widespread unemployment across the skills spectrum. Therefore, one of the greatest concerns with provincial and national education goes beyond issues of access to issues of quality of service delivery.

Access to other social services such as adequate health care and police services will also have important implications for quality of life and safety and security. Quality health care services within walking distance of communities facilitate preventative care and minimise ill health, particularly for children who are more vulnerable in this respect.

Table 8 shows the numbers per 100 000 population of selected health personnel for 2000, 2002 and 2003. (For doctors and professional nurses, only the figures for 2000 and 2002 are comparable and therefore 2002's figures are included here.) Again, as for so many other access indicators, the Western Cape out-performs the national averages. This is true

Table 8 Public sector health personnel per 100 000 population for South Africa and the Western Cape – 2000, 2002 and 2003

	2000	National 2002	2003	2000	Western Cape 2002	2003
Doctors*	21,9	19,3	19,7	39,7	33,1	31,9
Professional nurses *	120,3	106,8	107,1	139,9	130	113,9
Nursing Assistants	81,3	75,9	74,8	131,2	134,9	118,2
Medical Specialists	11,2	9,8	8,9	42,7	39,3	32,6
Pharmacists	3,1	3,3	3,1	6,1	7,3	6,4

[Source: PERSAL Personnel Administration System (<http://www.hst.org.za/>)]

Note: * Proportion calculated excluding medical aid members so as to approximate the public sector-dependent population.

for doctors, professional nurses, nursing assistants, medical specialists and pharmacists. However, the data shows a disturbing trend in terms of health personnel access, both for the Province and nationally. There have been declines in the number of personnel per person for all listed types of medical practitioners. This is a worrying trend, especially in light of the increased need for medical care with the spread of the HIV/Aids pandemic. Diminishing access to this very important resource is exacerbated by emigration of medical personnel, which is often encouraged by relatively good pay offers from other countries, and needs to be addressed.

Access to medical aid

As many as 35 per cent of people living within the boundaries of the City of Cape Town buy medical insurance and use private health providers for their health care needs. This number of medically insured population is twice as high as the national average, which has declined over the last 10 years to a new low of 16 per cent. It is also higher than the estimated average rate of 20 per cent amongst rural persons in the Western Cape (including big towns such as George, Paarl and Worcester).

The medical aid coverage rates for urban (metro) and rural coverage mask inequalities between sub-district areas. For instance, Khayelitsha sub-district in the metro has only one per cent of its population on medical aids, compared to Mitchell's Plain (14%) and Tygerberg (51%) sub-districts.

Medical aid coverage and the inequality of access to private health care that it generates are linked to the patterns of unemployment and income. There are also geographic inequalities related to the lack of access to

private hospital care in some areas. Medically insured persons in Khayelitsha or Delft have to travel to other areas, as private hospital groups have been reluctant to set up shop in these areas or have failed due to a lack of demand in these areas (for example, Eerste Rivier Private Hospital).

Within the public sector, more money is spent per capita on primary health care services in the metro than in rural areas. It appears that the number of health professionals and health facilities per 1 000 population in the metro is higher than that in rural districts. This has not translated into better primary health care within the metro. Anecdotal information points to a paradox - rural private health care provision is reported to be of a higher quality than the metro's. The reverse is true for secondary and tertiary hospital services. As expected, people who live closer to the secondary and tertiary hospitals have better access than those living further away, favouring the Metro population over the rural.

Inequity on a sub-district level presents itself in morbidity and mortality outcomes. The rates for antenatal HIV prevalence (27%), tuberculosis incidence (1 500 / 100 000) and infant mortality (44 per 1 000 live births) are all higher in Khayelitsha than in any other sub-district in the Western Cape, reflecting the same images described in other parts of this review on inequality. No systematic policy exists to address these inequalities in the health sphere.

Lastly, good coverage of police and social work personnel enhances people's safety and security, providing a safety net for many in respect of physical and emotional vulnerability. In terms of access to safety and security services, the Province is, on average, better equipped than the rest of the country, as can be seen from Table 9. This, however, does not mean that the Province is performing better in terms of outcomes. Crime statistics shown in section 3.2.2 indicate that greater policing and social services may, in fact, be the result of direct need, as the Province appears to suffer from severe social problems – in many instances, crime rates are relatively worse than nationally. Although the Province provides

Table 9 Social workers and police for South Africa and the Western Cape

	National		Western Cape	
	Number	Per 100 000 People	Number	Per 100 000 People
Social workers (2001)	10 231	22,8	2 139	47,3
Police (2004)	112 168	240,8	14 613	319,7

[Source: Council for Social Work and <http://www.saps.gov.za>]

better access to these resources, it would seem that even greater assistance is required.

An exercise performed with Census data and which combines income and access to basic and social services data shows that, in most cases, the poorest in society have experienced the greatest gains in terms of improvements in service delivery⁹. This provides an initial look at capturing some of the 'social wage' effects of service provision. A similar exercise is undertaken here using the IES expenditure and access to services data for the Western

⁹ Leibbrandt, et al. (2004).

¹⁰ Unfortunately, weighting issues across the surveys and sample sizes prohibit a comparison being made between 95 and 99.



Table 10 Western Cape expenditure quintiles, 2000

Quintile	Number of HHs	Cumulative %	Mean Annual Per Capita Income	Min	Max	Share of Population
1	198 839	20	2 523	190	3 821	27,5
2	198 282	40	5 288	3 835	6 961	21,9
3	198 495	60	9 772	6 967	13 308	18,5
4	198 247	80	20 355	13 364	29 480	17,5
5	198 394	100	73 387	29 492	1 590 331	14,6
Total	992 257	100	22 257	190	1 590 331	100,0

[Source: *Income and Expenditure Surveys 2000*. Author's calculations]

Cape¹⁰. An association between income and access inequality is drawn through examination of service access rates in respect of income quintiles.

Table 10 shows descriptive statistics relating to the household income quintiles for 2000. Importantly, using the household as the unit of analysis means that there are many more people attached to the bottom quintiles, reflecting once again that poorer households have, on average, larger household sizes. It is clear that 27,5 per cent of the Provincial population lived in the poorest 20 per cent of households in 2000, while only 14,6 per cent of the population lived in the richest 20 per cent of households.

Table 11 surveys household service access by income quintile, linking income inequality with access inequality. A quick glance at the data reveals, as is to be expected, that access rates improve as we move up the income quintiles, which means households with higher income are more likely to have better access to better quality services.

In terms of basic services and dwellings, of note is the very high level of informal dwellings for the poorest 20 per cent, with more than one in three of these households living in a 'vulnerable' structure. In fact, on average 23 per cent of the poorest 60 per cent of households lived in informal dwellings in 2000.

Regarding water access, the data shows that only 44 per cent of the poorest quintile has access to piped water in the dwelling, with 32,5 per cent having water piped on site and a further 21 per cent making use of a public tap as their primary source. Less than half of the poorest quintile use electricity for cooking, with paraffin the main fuel for one in three. In excess of 70 per cent use electricity as the main energy source for lighting, up marginally from 1995. The differences in sanitation access are particularly stark across quintiles, with one in five of the poorest 20 per cent of households having only off-site access or indicating that they make use of no toilet at all. Telephone access is also substantially skewed.

Table 11 Western Cape household services access by income quintile, 2000

Quintiles 2000	20%	40%	60%	80%	100%	Total 2000	Total 2003
Dwelling Types							
Formal	61,4	77,2	84,0	93,6	98,4	82,9	84,8
Informal	35,9	19,6	14,6	6,2	1,3	15,5	14,3
Water Access							
Piped in dwelling	44,1	60,0	75,8	90,9	97,6	73,7	75,8
Piped on site	32,5	25,8	14,9	5,2	1,3	15,9	15,4
Public Tap	21,3	11,8	8,9	3,9	0,5	9,3	7,6
Other	2,2	2,4	0,4	0,0	0,6	1,1	1,2
Energy Source: Lighting							
Electricity	72,1	81,9	90,1	96,3	98,8	87,8	92,1
Paraffin	12,3	7,0	3,9	1,7	0,1	5,0	2,4
Candles	15,2	10,1	5,4	1,7	0,5	6,6	5,5
Energy Source: Cooking							
Electricity	48,7	68,2	79,8	93,8	94,8	77,0	83,3
Paraffin	34,8	18,7	12,5	4,7	0,7	14,3	9,9
Wood	10,8	6,4	1,9	0,2	0,0	3,9	3,4
Sanitation							
Flush in dwelling	37,4	54,6	71,9	89,3	98,5	70,3	72,4
Flush/ chemical on site	34,6	26,6	16,9	7,2	1,0	17,3	17,4
Pit on site	2,0	4,1	1,4	1,1	0,1	1,7	1,4
Bucket on site	4,2	1,9	1,9	0,9	0,0	1,8	1,4
Any offsite	16,7	8,3	4,6	1,3	0,5	6,3	2,7
None	5,0	4,4	3,4	0,2	0,0	2,6	4,7
Refuse Removal							
Local authority 1 x week	73,6	75,9	85,6	92,1	95,2	84,5	86,2
Local authority < 1x week	3,5	2,1	3,1	0,8	0,8	2,1	0,8
Communal dump	4,4	6,1	2,8	2,1	0,3	3,1	7,0
Own dump	12,8	10,8	4,8	4,1	2,1	6,9	4,1
None	2,3	1,1	2,1	0,3	0,4	1,2	0,5
Telephone							
Cell only	2,5	5,2	5,7	9,3	11,9	6,9	20,7
Landline only	17,4	30,1	44,6	45,3	20,2	31,5	15,3
Cell & landline	1,3	3,8	9,2	30,6	62,3	21,5	32,8
Other	78,6	60,5	40,4	14,2	4,9	39,7	31,2

[Source: IES 2000 & General Household Survey 2003. Author's calculations]



Considering the range of access indicators by income quintile reveals notable differences between the poorest 40 per cent of households and the rest, indicating that it is these households that are marginalised in terms of *both* income and service delivery, and it is these households that must be targeted in future development programmes.

In terms of trying to capture the 'social wage' effects of publicly provided goods/services, although the poorest two quintiles (or 40%) are markedly worse off, many do in fact have access to adequate services. In this sense, income inequality estimates may be somewhat overstated.

Included in Table 11 are also the more recent 2003 estimates for the Province. These show mostly small but encouraging improvements for all indicators considered. Given that the top 40 per cent of households have practically full service provision, we can assume that the improvements that have been made – notwithstanding the fact that of most them were quite small – are probably flowing to the poorer in the Province. Of particular interest is the change in telephone access, with an additional eight per cent of households obtaining access to a telephone in only three years. This can largely be attributed to the exceptional uptake rates of cellular phones.

A useful exercise for future research would be to try to value this 'social wage', and thus gauge how the population is being assisted through poverty reduction strategies such as service delivery. From another perspective, however, there may be a high level of services cut-offs for water and electricity. This would also need to be incorporated into future analyses.

2.4.3. Spatial inequality

The third key form of inequality is that of *spatial or geographic inequality*. Spatial patterns of inequality within countries and sub-national regions are often of importance in their own rights, as well as being key to the political economy of policy-making.

Spatial inequality is a key dimension of inequality profiling in respect of national or sub-national socio-economic analysis. In many instances, spatially disaggregated information can be used to investigate patterns of spatial divergence or convergence across regions, and their correlation to patterns of individual and community income and asset portfolios.

Spatial profiling throws into relief the confluence of income, asset and spatial inequality, drawing attention to stark inequalities on multiple levels. Targeted intervention therefore requires service delivery that is co-ordinated in terms of audience, complementing outputs (goods and services), geographic area and time. It is at this point that spatial mapping of income and asset inequalities becomes necessary, so that the most marginalised within the Province may be identified and targeted in respect of service delivery.

Spatial inequality in South Africa and the Western Cape

Spatial inequality patterns are most commonly understood in respect of the natural environment, socio-economic concerns and the built environment.

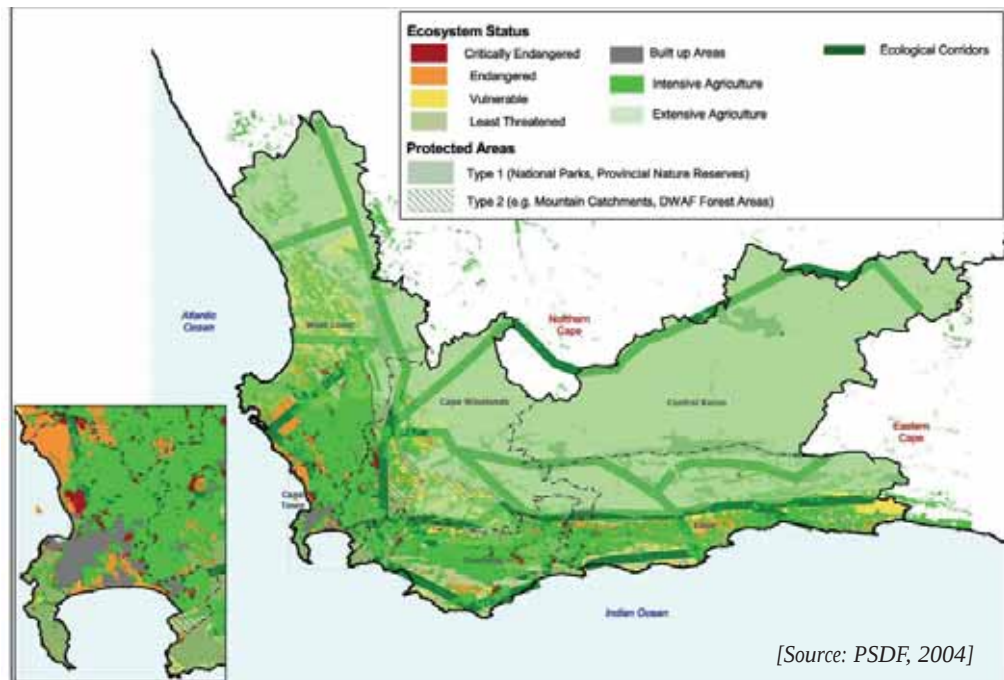
In respect of the natural environment, biodiversity conservation is a key concern. The Provincial Spatial Development Framework (PSDF) has used spatial mapping (GIS) techniques to map the critically endangered and endangered areas of biodiversity in the Province. Of interest is that the least-endangered areas correspond with protected areas.

Further maps then overlay the extent of intensive and extensive agriculture in the Province, as there are critical trade-offs happening in respect of biodiversity. More specifically, areas of intensive agriculture plough the land and are therefore destructive of biodiversity. Extensive agricultural areas comprise the small and large stock farming occurring in the Karoo and the northern part of the West Coast. This activity occurs on natural veld and so, theoretically, there is a complementary relationship between extensive farming and biodiversity if grazing is properly managed.

There are two major implications for land-use planning and biodiversity conservation in the Province. First, the critically endangered and endangered remnants that are left are very important. This means that the competition between agriculture and biodiversity should be well understood.

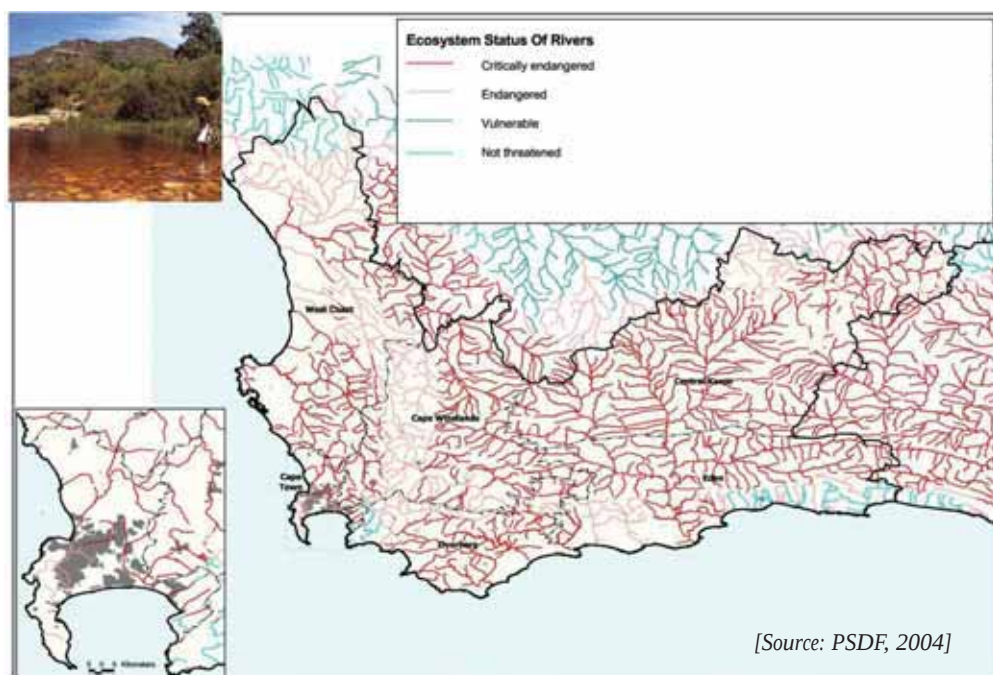
Second, there is a major overlap between extensive farming in the Karoo and areas of least threatened biodiversity. This suggests the potential of veld management to manage veld-carrying capacity and biodiversity conservation.

Figure 3 Western Cape biodiversity conservation



Looking at the ecosystem status of rivers, alarming trends point to the extremely poor ecosystem status of most of the Province's rivers, 90 per cent of which are either critically endangered or endangered. These shocking results are due both to urban development pressures and extensive and intensive farming practices. This suggests that river conservation should be a major area of policy focus going forward.

Figure 4 Ecosystem status of Western Cape rivers



Turning to socio-economic trends, broader demographic profiles for both South Africa and the Western Cape are discussed in detail in chapter 4. This section draws from these discussions, taking a closer look at the human settlement and built environment patterns in relation to income and asset distributions.

Analysis of human settlement patterns investigates urbanisation trends, the form and distribution of the built environment, growth and urban sprawl, and human needs versus development potential.

In respect of urbanisation, more than 50 per cent of South Africans already live and work in fast-growing urban areas. The percentage of South Africa's population resident in urban areas has increased from 47 per cent in 1980 to about 56 per cent in 2004, representing an increase of nearly 10 percentage points.

Table 12 below shows that, at the provincial level, the Western Cape is highly urbanised – 90 per cent of the population lives in urban areas, compared to 38 per cent in the Eastern Cape and 45 per cent in KwaZulu-Natal. However, the percentages of people in rural areas vary over the various districts: 35 per cent in the Overberg district, 33 per cent in Eden, 35 per cent in the West Coast, 19,9 per cent in the Boland and 33 per cent in the Central Karoo district.

Table 12 South African urban population, 2001

Province	% of Population	Population (no.)	% urban	Urban
Eastern Cape	14,4	6 436 763	38,1	2 453 120
Free State	6,0	2 706 775	74,8	2 023 545
Gauteng	19,7	8 837 178	96,2	8 505 744
KwaZulu-Natal	21,0	9 426 017	45,2	4 261 504
Limpopo	11,8	5 273 642	10,5	551 836
Mpumalanga	7,0	3 122 990	39,1	1 222 224
Northern Cape	1,8	822 727	80,2	660 092
North West	8,2	3 669 349	41,0	1 505 211
Western Cape	10,1	4 524 335	89,7	4 058 783
National	100	44 819 776	56,3	2 5247 736

[Source: Census 2001 and Census 2001 10% Sample]

Note: Urban-rural classification based on definitions used in Census 1996 and previously.

Broadly speaking, 64,8 per cent of the Province's population is located in the City of Cape Town (metropolitan area) and 36 per cent are collectively located in the five district municipalities. The split between the Province's urban and rural populations is shown in Table 13.



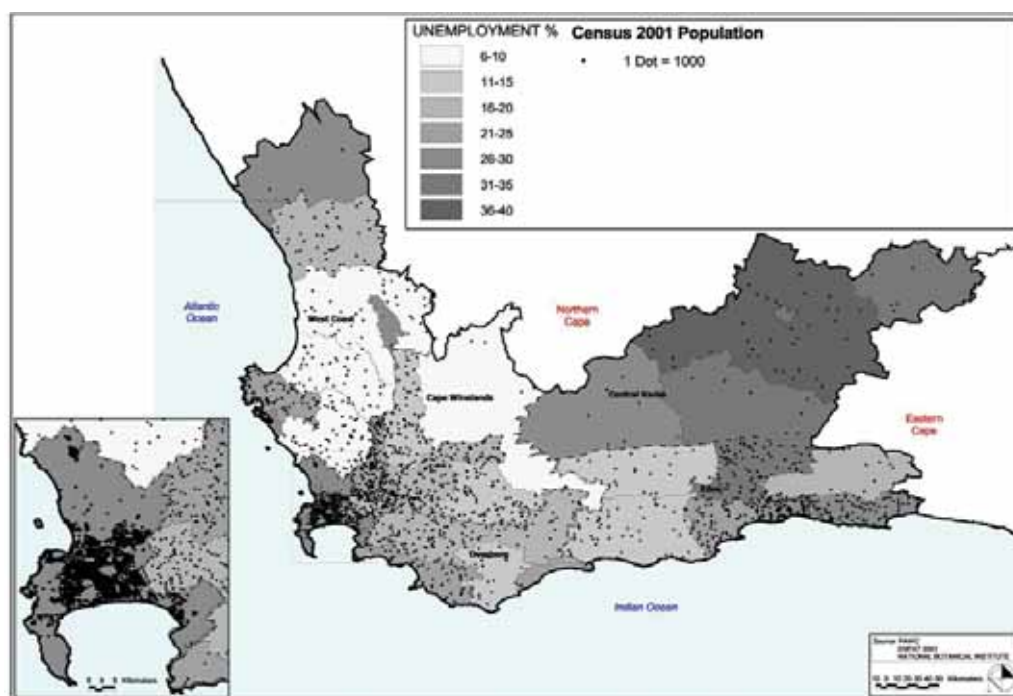
Table 13 Western Cape urban populations, 2001

	% of Provincial population	Population (no.)	% Urban	% Rural	Urban	Rural
Cape Metro	64,8	2 492 000	99,0	1	2 913 000	29 000
Boland	14,0	636 000	81	19	515 000	121 000
Eden	9,7	440 000	67,2	32,8	296 000	144 000
West Coast	6,0	272 000	64,7	35,3	176 000	96 000
Overberg	4,2	191 000	64,7	35,3	124 000	67 000
Central Karoo	1,4	636 000	67,0	33,0	42 600	21 000
Total	32,5	4 544 600	90,0	10,0	4 066 600	478 000

[Source: Census 1996 for urban percentage and Census 2001 for population]

Moving from demographic to socio-economic spatial trends, previous chapters discuss concerns in respect of unemployment, education, health and crime in considerable detail. This chapter does not replicate such analyses, but points out that socio-economic trends mapped out spatially highlight the confluence of many socio-economic trends with certain settlement areas. An example of unemployment GIS mapping is seen in Figure 5.

Figure 5 Socio-economic spatial trends: unemployment in the Western Cape



[Source: PSDF, 2004]

In respect of the *built environment*, the majority of South African towns are essentially a system of settlements, consisting of a ‘White’ core, which contains the economic centre and most social services, and surrounded by a number of disparate, racially discrete dormitory areas or locations, often of considerable size.

South African settlements, including those in the Western Cape, may be classified or understood in the light of their original reason for existence – some originally were missionary towns, other performed an administrative function, while others still served a transport (railway) function. The sizes of these settlements vary from small towns in the Karoo to secondary cities (for example George) and the primary metropolitan area (for example, Cape Town).

Turning to urban growth and sprawl, for the most part, newer residential developments have led to extensions of the existing urban footprint outside of the previous urban edge. This pattern of growth leads to the perpetuation of the *apartheid* town structure where poorer people are located further away from town, with the accompanying inefficiencies for infrastructure, transport and other services. This takes place despite policies promoting the contrary, as a result of other contradictory policies such as large-scale transport subsidies that encourage sprawl by reducing the cost effect of distance.

Over time, however, smaller towns decline relative to larger cities due to factors including consolidation of commercial farming, de-densification of the rural periphery and increased accessibility to a large town.

For the Western Cape, most of the stagnating and declining settlements cover the larger portion of the Province’s land area and are located in the inland arid areas with the highest moisture loss (Central Karoo, northern Boland and the northern parts of the West Coast).

Understanding the balance and dichotomy between human need and development potential is essential for spatial development planning. Table 14 shows that most towns in the Western Cape have either high development potential and low need, or inversely high development need and low development potential.

Table 14 Comparison between Western Cape development potential and need

Potential & Need	Development Potential	Need
Metro	High	High
Coastal town	<i>High</i>	<i>Low</i>
Large inland town	<i>Low</i>	<i>High</i>
Small inland town	<i>Low</i>	<i>High</i>

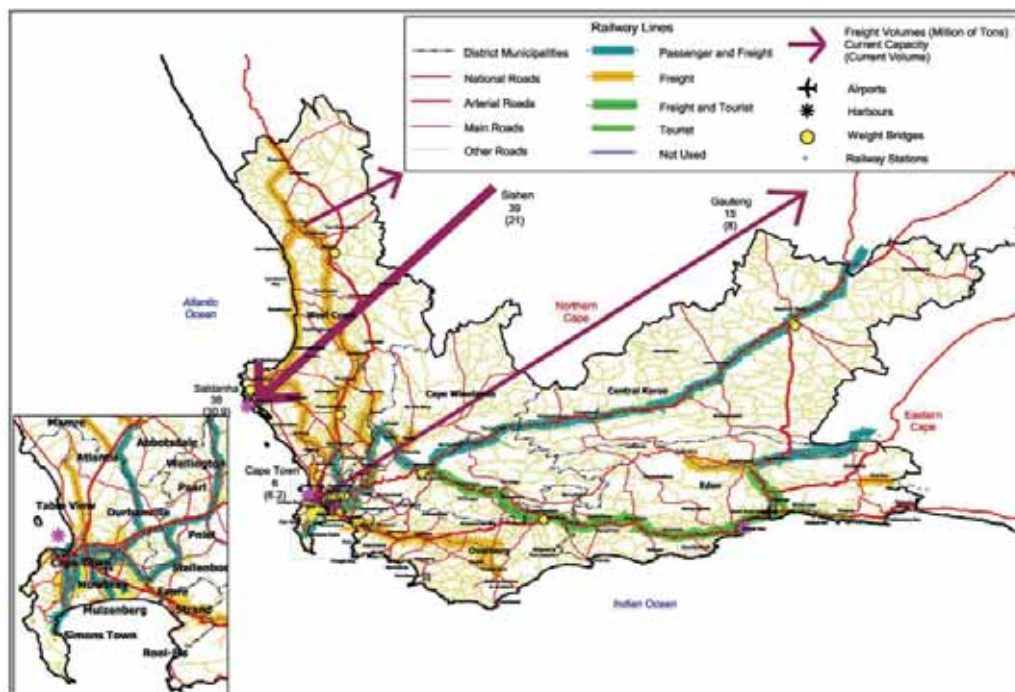
Source: [Van der Merwe, 2005]

In respect of transportation concerns, there are four main aspects to be considered – public transport, non-motorised transport, freight and private motor vehicles. These are carried on two infrastructure networks: road and rail. In respect of road, three well-developed transport axes (north, northeast and east) converge on the Metropolitan area and offer opportunities for settlement in the form of the West Coast Investment Initiative consolidation. The West Coast Corridor – a national development goal – offers similar development opportunities.

Given large distances, public transport is a basic need for a very large proportion of the Western Cape's population in both urban and rural areas. In the City of Cape Town, the car ownership rate, combined with the need to use other means of transport for work trips mean that 56 per cent of the population depend on public transport use.

Historic settlement patterns and the separation of work and residence have resulted in an urban transport system which compels the urban poor to commute long distances to employment centres. This discrepancy has resulted in an inefficient and heavily subsidised public transport system and the need for investment in road infrastructure due to the reliance on private vehicle ownership as well as road infrastructure's high maintenance costs.

Figure 6 Western Cape transportation infrastructure



[Source: PSD, 2004]

3. Poverty: The Face of Inequality

Our earlier review of the relationship between equity (or inequality) and shared or broad-based development suggests that inequalities in respect of income, assets and spatial or geographic location may be fundamental drivers of poverty.

Yet equally poverty, has in its many faces and dimensions that interface with income, asset and spatial inequality. However, the causal direction of this relationship is undefined. As such, poverty describes a state of deprivation that prevents an individual from attaining some minimum 'socially acceptable' standard of living. This 'state of deprivation' can therefore be measured in a number of ways and according to various approaches.

3.1. Poverty measurement and analysis

The poverty measurement debate follows on the sequence of inequality analysis above, in respect of considering poverty in terms of income, asset and geographic space.

In respect of *income poverty*, one of the most tractable ways to measure income poverty for a country is through the use of a *national [income] poverty line*. Poverty lines are constructed so as to indicate the minimum amount of money required to meet the cost of an individual's (or household's) basic needs and include a food and non-food component. If an individual earns or spends less than the poverty line amount, she or he is deemed to be poor.

The extent of *absolute poverty*, or the *poverty rate* is then measured as the proportion of the population that fall below the predetermined national poverty line. This is referred to as the *poverty headcount measure*. A measure of the *depth of poverty* can also be calculated, by summing the distance from the poverty line of all those who are poor. This is known as the poverty gap and indicates how far on average the poor are from the *poverty line*.

The most recent attempt at establishing a poverty line for South Africa has been undertaken by Hoogeveen and Ozler (2004). They calculate a lower bound poverty line of R322 per capita per month and an upper bound line of R593 per capita in 2000 prices. In addition, they use the value of R174 per capita per month as equivalent to the internationally used Two Dollar a day 'poverty line'¹¹. These figures will be used as the basis for poverty estimates in this review.

Poverty lines are notoriously difficult to measure and the choice of line often imprecise. Another way of comparing relative well-being of pre-defined groups is the poverty dominance approach. In this type of analysis, no single poverty line is used, but groups are measured against each other in terms of chosen indicators such as income levels or access

¹¹ The value of R174 per month is somewhat arbitrary given that it is based on imprecise Purchasing Parity estimates. Leibbrandt et al. (2004), attempting to find a rand value for the US\$2 a day line, obtain an estimate of R124 per month in 2001 prices.



to certain assets or services. Using income as an example, the dominance method graphically depicts the cumulative proportion of those with access to each and every income level, for each group being considered. If it is shown that one group's cumulative distribution always falls above/ or below another's, strong statements can be made about relative wellbeing. For example, in the case of income, it could then be stated that one group is better off than another for each and every income poverty line chosen.

Moving towards *asset poverty*, the latter may be measured in terms of key indicators of people's socio-economic outcome or human development status. These often include analysis in respect of indicators of attainment in education – literacy and numeracy rates, and matriculation pass rates, etc.; and in health – life expectancy at birth, infant and/or child mortality, infectious disease prevalence, morbidity and mortality rates. Other key indicators commonly used are those that reflect economic participation in respect of employment and unemployment rates, and community safety in respect of crime rates.

An alternative approach that might more fully include various dimensions of deprivation into a single measure is to combine chosen indicators into a *poverty index*. A well-known example of an index used to reflect differences in wellbeing is the United Nations Development Programme's *Human Development Index* (HDI), discussed later on in greater detail.

Finally, *spatial poverty* may be measured using a single-dimension or a composite poverty index to identify the most deprived communities within national or sub-national boundaries. As poverty is multi-dimensional and encompasses deprivation in various forms, the development of a composite poverty index is a useful way to isolate the regions that score worst according to a range factors. Once the most deprived areas have been identified, the index can be unpacked to ascertain the key drivers of deprivation.

Using a combination of measures in assessing poverty and inequality should allow us to develop a more nuanced understanding of the development needs of the Province. In the empirical analysis, one must move beyond the choice of measure to a decision on the unit of analysis that will often be guided by data considerations.

3.2. Poverty in South Africa and the Western Cape

As highlighted in earlier sections, the primary concern with such high levels of income, asset and spatial inequality is that even in a growing regional economy, returns may then not flow to the poorest in the society and the potential positive impacts of poverty alleviation through growth could be lost. In a low-growth economy, the chances for poverty reduction are further diminished.

While South Africa's and the Western Cape's growth record has been stronger over recent years and holds notable optimism over the 2005 MTEF period, lacklustre growth of the

period 1995 to 2000, the economy's inability to sufficiently absorb its growing labour force, as well as the extremely skewed distribution of income, it would not be surprising to find that the more economically marginalised in society have become poorer over the period.

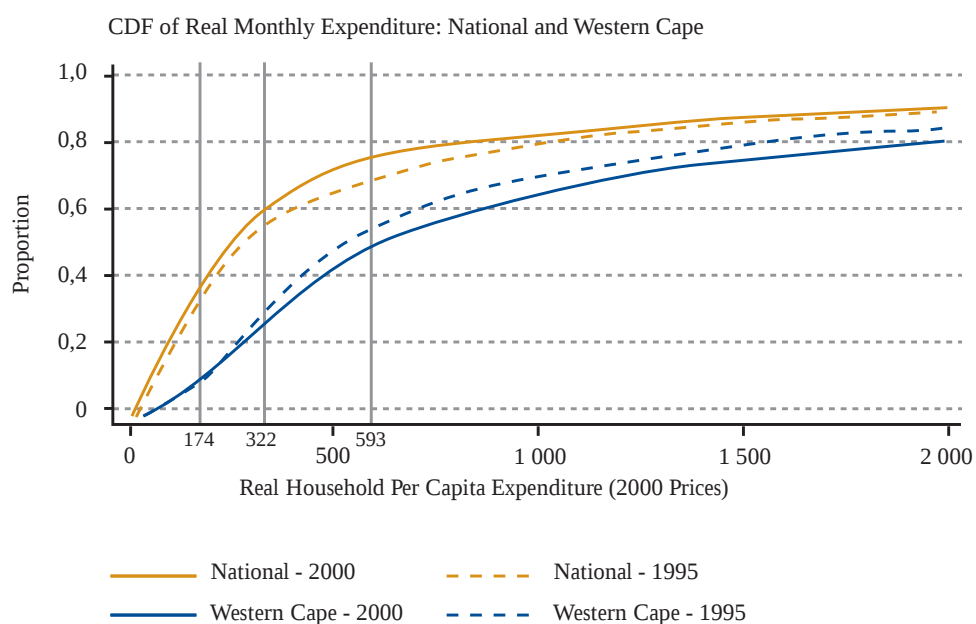
This means that understanding the patterns and trends in respect of poverty magnitude and incidence at the national and provincial level is essential to the development debate. Following on the sequence of inequality analysis above, we move on to examining poverty in respect of income, asset and spatial considerations.

3.2.1. Income poverty

An extremely useful way to consider changes in income poverty is with the *cumulative distribution function* or CDF. The CDF orders the population from poorest to richest along the income distribution. It then graphs the proportion of the population on the vertical axis with less than or equal to a corresponding value of real expenditure which is shown on the horizontal axis. The value in this approach is that one can see if a particular group of people is doing better or worse on average at different levels of expenditure. If the CDF for one group lies always above another, then dominance is said to hold, with the group whose line always lies above doing worse at every level of expenditure, or being poorer at every poverty line.

Figure 7 shows the cumulative distribution functions for South Africa and for the Western Cape depicting shares of real expenditure for 1995 and 2000, in 2000 prices.

Figure 7 Cumulative distribution function of real per capita expenditure, South Africa and the Western Cape, 1995 and 2000



[Source: IES 1995 and 2000. Author's calculations]

Figure 7 above shows that, in respect of the graphs for South Africa, the income per capita line for 2000 lies everywhere above that for 1995 – at least up to the R1 500 per capita per month level, below which approximately 85 per cent of the population falls. This indicates that a higher proportion of people in 2000 spend below every equivalent level of expenditure in 1995.

For example, considering a low poverty line of R174 per person per month the proportion of the national population calculated as poor according to this poverty line is 31 per cent in 1995. In 2000 this proportion has increased to 38 per cent¹².

If one considers a measure of the depth of income poverty for these two years, reported here as the poverty gap in Table 15, it can be seen that this, too, has worsened over the period. The poverty gap of 0,12 in 1995 indicates that the income of the poor fell on average 12 per cent below the poverty line of R174. In 2000, this situation has worsened, with the poor's income now falling on average 16 per cent below the R174 level. This is an important point as it shows not only that the number of poor increased, but also that the poor are faring even worse (that is, are relatively poorer) in 2000 than they were in 1995.

The higher poverty line of R322 per month shows the same patterns of greater incidence and depth of poverty over the period with the national poverty rates significantly higher at 52 per cent of the population in 1995 and 58 percent in 2000.

Table 15 National and Western Cape poverty levels, 1995 and 2000

	1995		2000	
	Headcount (Poverty Rate)	Poverty Gap	Headcount (Poverty Rate)	Poverty Gap
National				
R174 per month	0,31 [0,303; 0,309]	0,12 [0,115; 0,118]	0,38 [0,365; 0,393]	0,16 [0,153; 0,168]
R322 per month	0,52 [0,520; 0,5267]	0,26 [0,257; 0,260]	0,58 [0,565; 0,594]	0,31 [0,303; 0,323]
Western Cape				
R174 per month	0,09 [0,088; 0,099]	0,02 [0,022; 0,025]	0,08 [0,065; 0,103]	0,03 [0,018; 0,032]
R322 per month	0,29 [0,279; 0,296]	0,10 [0,096; 0,103]	0,28 [0,241; 0,318]	0,10 [0,083; 0,115]

[Source: IES 1995 and 2000. Author's calculations]

Note: The poverty line of R322 per capita per month in 2000 prices is the lower bound national poverty line calculated by Hoogeveen & Özler (2004). The R174 per month in 2000 prices is the value they compute as equivalent to the Two Dollar a day poverty line generally used for international comparisons.

¹² All national changes in this paragraph are statistically significant at the five per cent significance level, with no overlapping of confidence intervals.

The cumulative distribution functions for the Western Cape Province look quite different to the national lines in two noticeable ways. First, the Province's lines fall far below the national lines, indicating that the Western Cape is considerably less poor on average than the nation as a whole in both 1995 and 2000. Secondly, the lines appear to overlap up to around the R300 level, after which the line for 2000 lies below the 1995 line for every poverty line / expenditure level.

When cumulative distribution functions cross, it means the change in poverty is indeterminate, or specifically, that the group faring better will be sensitive to the poverty line chosen. For example, if we chose an extremely low poverty line of R100 per month and read the values off the vertical axis, poverty, although minimal, will seem to have worsened from 1995 to 2000. Taking a poverty line of R174 per month shows an improvement in the headcount ratio from nine per cent to eight per cent, although the poverty gap has worsened slightly from two per cent to three per cent. At the R322 per capita per month line, there also appears to have been a slight decline in the rate of poverty from 29 per cent to 28 per cent of the population.

These differences, however, are not statistically significant at the five per cent level. Taking a higher poverty line of R593 per capita per month shows a greater difference between the poverty incidence for 1995 and 2000 that is statistically significant. The graphical depiction of the CDF, showing the overlaps and sensitivities of poverty rate measures to the poverty line chosen, is what makes this method of analysis so useful.

We can sum up the changes in poverty that occurred in the Western Cape between 1995 and 2000 as follows: According to the data, poverty and extreme poverty appear to be fairly stable with the best-off 60 per cent of the Western Cape population seemingly doing better in 2000 than they were in 1995. This is a very different picture than for the nation as a whole.

Notwithstanding the Western Cape's relatively positive performance, the actual poverty rate for the Province at the poverty line of R322 per capita per month (a fairly low poverty line) is still an extremely high 28 per cent in 2000. Applying this percentage to Statistics South Africa's mid-year population estimate for the Western Cape in 2000¹³, which stands at 4 178 598, puts the number of poor at approximately 1,2-million, indicating that poverty is a pervasive problem in the Province that calls for urgent attention.

If one had to assume that the poverty rate had remained fairly stable at this poverty line to 2004, the number of poor in the Province would be in the region of 1,3-million at present¹⁴.

We now look more closely at the experience of the different racial groups in the Province. We also show the CDFs for the country by race, as a reference point for Provincial performance.

¹³ See Statistics South Africa (2000). The 2000 figures are used as they enable comparison in respect of the income and expenditure data used.

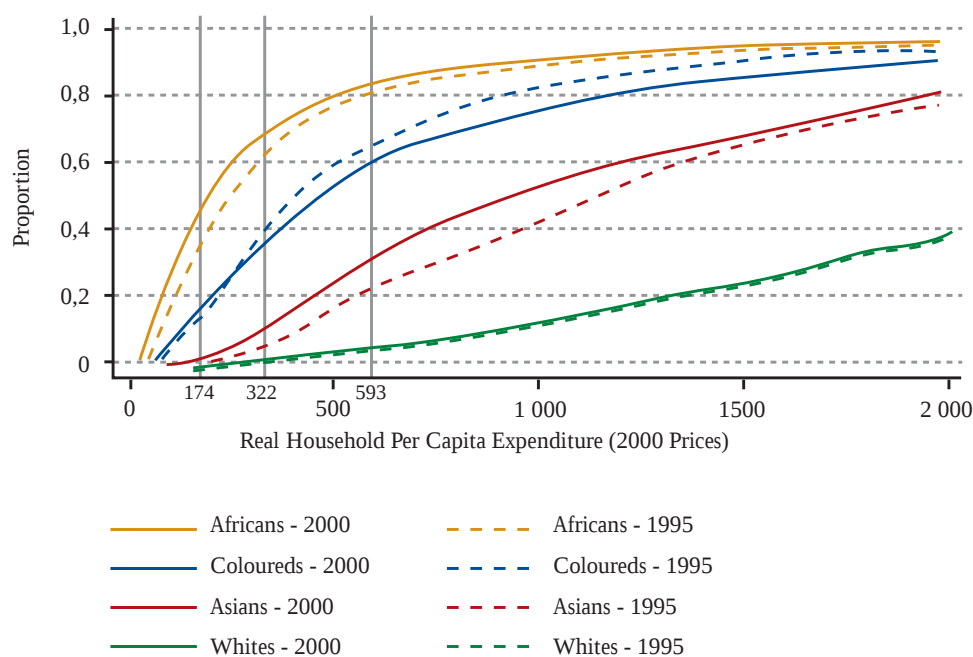
¹⁴ Based on the 2004 mid-year population estimate for the Western Cape of 4 570 696 (Statistics South Africa (2004))

Figure 8 shows that at the national level, Africans and Asians at the lower expenditure levels are doing worse in 2000 than in 1995, with the performance of Whites stable. There has been little change in the welfare of the poorest Coloureds, who fare similarly in both years at the very low expenditure levels, but perform noticeably better above the R300 per capita per month mark.

As with the national picture, the racial pattern of dominance holds in the Western Cape with Whites faring far better than Asians, who do far better than Coloureds, who in turn out-perform Africans, as can be seen in Figure 9. Apart from this feature, the Western Cape graph paints a different view to the national picture for the three races depicted, and lends interesting insight into how the different race groups are faring within the regional economy.

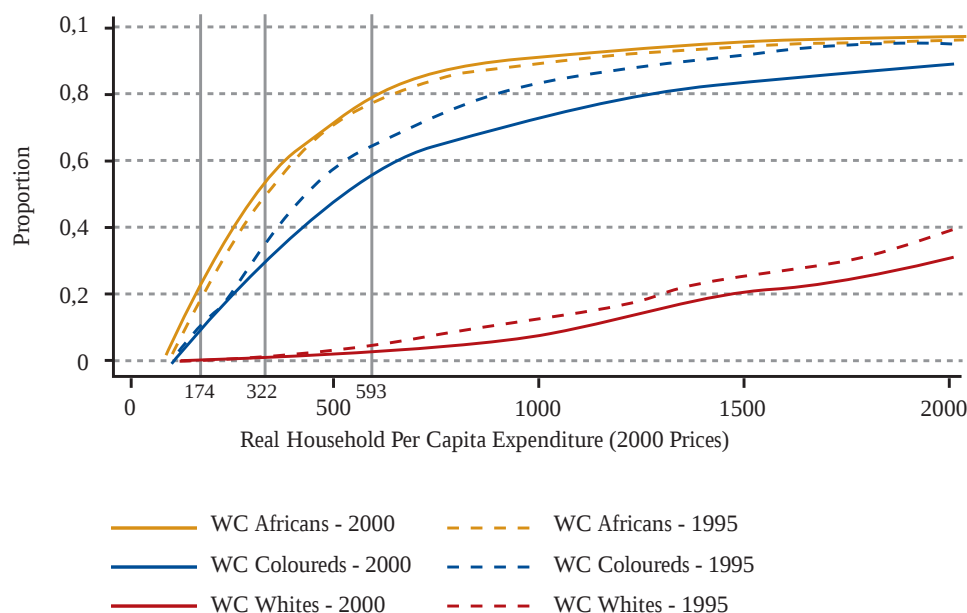
First, Whites appear to be doing better in 2000 at nearly all levels of income, with their performance in the Western Cape surpassing the national trend. Interestingly, Africans in the Western Cape exhibit overlapping graphs for 1995 and 2000, indicating that they appear to be faring similarly in both years – that is, they are not experiencing discernable increases in poverty at the bottom end, but are also not enjoying greater gains at the top end. Once again, the graphs for the Coloured population in the Province overlap, but at a lower level of expenditure than the national figure of approximately R175. Furthermore, the graph for Coloureds is moving away from that of Africans in 2000.

Figure 8 Cumulative distribution function of real per capita expenditure by race, South Africa, 1995 and 2000



[Source: IES 1995 and 2000. Author's calculations]

Figure 9 Cumulative distribution function of real per capita expenditure by race, Western Cape, 1995 and 2000



[Source: Income and Expenditure Surveys 1995 and 2000. Author's calculations]

Note: Asians are excluded due to the sample size being too small

Considering the actual poverty rates for the Western Cape in Table 16 shows that the groups of concern are Coloureds and Africans. Even at the extremely low poverty line of R174 per month, between 15 per cent and 18 per cent of Africans in the Western Cape were poor in 2000. At this same level, approximately eight per cent of the Coloured population was also poor. At the R322 per capita per month poverty line we see an alarmingly high 45 per cent to 50 per cent of Africans poor in 1995 with the range rising to 50 per cent to 56 per cent in 2000. An extremely high one in three Coloureds was also classified as poor in 1995, by this standard, and although this number drops impressively in 2000, it is still a high one in four. These estimates put the number of poor in 2000 at almost 600 000 Africans and 610 000 Coloureds.

(Note the effect of crossing CDFs on the changes in poverty reported for different poverty lines. Africans in the Western Cape is a good example, showing a decline in poverty at the R174 line, but an almost equivalent increase when using the higher R322 line. Such differences warn at using a single poverty line approach).

Table 16 Western Cape poverty levels by race, 1995 and 2000

Western Cape	1995		2000		Number of Poor*
	Headcount	Poverty Gap	Headcount	Poverty Gap	
R174 per month					
African	0,21	0,06	0,17	0,05	191 798
	[0,187; 0,223]	[0,056; 0,070]	[0,149; 0,183]	[0,048; 0,062]	
Coloured	0,09	0,02	0,08	0,02	180 515
	[0,081; 0,094]	[0,016; 0,019]	[0,067; 0,084]	[0,019; 0,024]	
White	0,00	0,00	0,01	0,00	7 521
	[0,000; 0,003]	[0,000; 0,000]	[0,001; 0,009]	[0,000; 0,001]	
R322 per month					
African	0,48	0,19	0,53	0,20	597 957
	[0,454; 0,500]	[0,177; 0,200]	[0,50; 0,556]	[0,186; 0,209]	
Coloured	0,33	0,10	0,27	0,09	609 240
	[0,317; 0,338]	[0,100; 0,109]	[0,259; 0,283]	[0,086; 0,097]	
White	0,01	0,00	0,01	0,00	7 521
	[0,005; 0,012]	[0,001; 0,003]	[0,004; 0,013]	[0,001; 0,005]	

[Source: IES 1995 and 2000. Author's calculations]

*Note: Number of poor are calculated using the Mid-year Population Estimates for 2000 from Statistics South Africa and the Racial Shares from the Census 2001

At this point, we draw attention to the previously mentioned problem with the weights for the 2000 IES. As Africans are under-weighted for the Western Cape in this survey and these are the poorest group in the Province, it is likely that absolute poverty is higher than the levels indicated above, and that the African share of the poor, too, is higher. The relatively promising economic performance of the Province will further act as a pull factor for people from provinces with fewer economic opportunities, and it can be expected that in-migration will continue at a rapid pace. If a large enough share of in-migrants is relatively poor, one might expect to see increases in poverty in future.

The logical next step in this analysis would be to consider poverty shares by province, with a particular focus on changes over time. If we expect many poorer people from the Eastern Cape to migrate to the Western Cape, we should detect this in changes in the share of national poor found in each province.

The weighting problems in the IES 2000 preclude such an analysis with the figures used in this review this far. The Census should be better for a 'shares' analysis, but suffers great problems with its income variable for which there are 18,2 per cent zero values in 1996 and 21,3 per cent in 2001, with a further 3,6 per cent missing in 1996 and 4,8 per cent missing in 2001.

Table 17 below sets out the results from a preliminary analysis of Provincial poverty shares, using the Census data by Leibbrandt *et al.* (2004). It shows a slight increase in the share of national poverty of the Western Cape, an equivalent increase for KwaZulu-Natal and a larger increase for Gauteng. Unsurprisingly, it is these three provinces that have seen the greatest population growth over the period, with in-migration of often relatively worse-off people resulting in increased population shares. A small decline in the national poverty share of the Eastern Cape, one of the main feeder provinces, is also evident. Although this particular study is in its infant stages and the income variables used require more refining, the need for accurate data to undertake this type of analysis in the future should be clear. A release of representative weights for the IES 2000 would be a first step in this direction.

Table 17 Poverty shares by province for different income measures including zero-income entries, 1996 and 2001

Poverty Line R125 per capita per month (2001 Prices)	Head Count	Poverty Gap Ratio	Head Count	Poverty Gap Ratio
	1996		2001	
Western Cape	0,03	0,03	0,04	0,04
Eastern Cape	0,22	0,23	0,19	0,19
Northern Cape	0,02	0,01	0,01	0,01
Free State	0,07	0,06	0,07	0,06
KwaZulu-Natal	0,24	0,24	0,25	0,25
North West	0,09	0,09	0,09	0,09
Gauteng	0,08	0,08	0,12	0,12
Mpumalanga	0,07	0,07	0,08	0,07
Limpopo	0,18	0,19	0,16	0,16

[Sources: Own calculations, Census 1996 2001, Statistics South Africa (Leibbrandt *et al.* (2004))]

Note: This table is part of a preliminary analysis using census data. The income variable reported here refers to a per capita income variable that includes income recorded as zeros. See Leibbrandt *et al.* (2004) for a detailed explanation.

R125 (2001 prices) per capita per month is an extremely low poverty line. Using a line of R400 per capita (2001 prices) shows the Western Cape accounting for six percent of the poor in 1996 and seven percent in 2001, according to the headcount measure.

The income or consumption measures of poverty and inequality have shown an increase in inequality within the Province and within race groups. The poverty dynamics are less clear-cut, with gains appearing to have been made for the top 60 per cent of the Coloured population and losses for the African population if one chooses a poverty line of R322. But the changes in poverty rates are sensitive to the poverty line chosen, and how the most poor have been affected is less clear. Once again it is not apparent whether the poor have shared sufficiently in the returns to growth that have been experienced in the Province, especially at the very low end.



3.2.2. Asset poverty

Taking a closer look at asset poverty for South Africa and the Western Cape, we draw attention to national and Province-specific performance in respect of socio-economic outcome or human development indicators, including matriculation pass rates, literacy and numeracy rates, life expectancy at birth, infant mortality, infectious disease prevalence, morbidity and mortality rates, and crime rates.

In terms of educational attainment, it is important to note that better educational attainment does not mean that the education system is operating efficiently or that the population is acquiring the 'right set of skills' that will facilitate easy entry into the job market. In fact, the chapter on the Provincial labour market shows that there is widespread unemployment across the skills spectrum. One of the greatest concerns with provincial and national education goes beyond issues of access to issues of quality of service delivery.

Looking more closely at educational attainment, Table 18 reveals some harsh facts about the performance of those in high school. First, it can be seen that although children have good attendance up to age 15, more than half of children do not make it to Grade 12 (Matric) to write their final examinations. The figures for drop-outs are disconcerting at the national level and likewise for the Western Cape. Furthermore, of those who do write their final exams, 12,5 percent in the Province fail, and disturbingly, only 26 per cent pass with an endorsement. Mathematics and Science pass rates are even more dismal (Van der Berg, 2004) for the Western Cape, as reflected in Table 19.

Table 18 Matric aggregate performance, Western Cape and South Africa, 2003

	Western Cape		South Africa	
	Number	As % of age cohort	Number	As % of age cohort
Endorsement	10 158	12,2	82 384	8,4
Pass without endorsement	23 403	28,1	241 124	24,5
Fail	4 904	5,9	116 824	11,9
Total Matriculants	38 465	46,1	440 332	44,7
Drop-outs	44 935	5,9	544 668	55,3
No. of 18-year olds	83 400		985 000	

[Source: 2003 examination dataset in Van der Berg (2004)]

Note: One should, however, take into account students who write Matric part-time. Because such students are not enrolled in 'formal' schools, but rather in education and training programmes – either at adult centres of private or public FET's, the data on drop-out rates could be problematic.

Table 19 Results in Western Cape Senior Certificate maths and science by race, 2003

Exam	Black	Coloured	White	Indian & Asian	Total
Maths HG	220	853	2 663	153 + 49	3 938
Maths SG	2 338	4 802	3 773	168 + 29	11 070
Science HG	268	908	2 516	154 + 46	3 892
Science SG	1 747	2 947	1 246	60 + 25	6 025

[Source: WCED, 2005]

The drop-out and success rates at the Grade 12 level can be traced back to foundational learning in the first years of the schooling system. Table 20 below shows that in a study of a representative sample of Grade 3 learners from all Western Cape schools (over 30 000 learners), 37 per cent were reading at the Grade 3 level; 41 per cent at the Grade 2 level, 12 per cent at Grade 1 level and 10 per cent at below grade 1. In the same sample, 37 per cent of children were found to have numerical abilities at the Grade 3 level, 11 per cent at the Grade 2 level; 37 per cent at the Grade 1 level and 15% at below grade 1. Similar trends are found in respect of Grade 6 test results of 2003. These results are highly correlated with income poverty (*as in Table 21 and Figure 10*).

Table 20 Results of reading and numeracy for Grade 3 and Grade 6

2002	Below Grade 1 %	Grade 1 %	Grade 2 %	Grade 3 %
Grade 3 numeracy	15	37	11	37
Grade 3 reading	10	12	41	37

2003	Below Grade 3 %	Grade 3 %	Grade 4 %	Grade 5 %	Grade 6 %
Grade 6 numeracy	60	40	29	24	15
Grade 6 reading	18	82	67	78	35

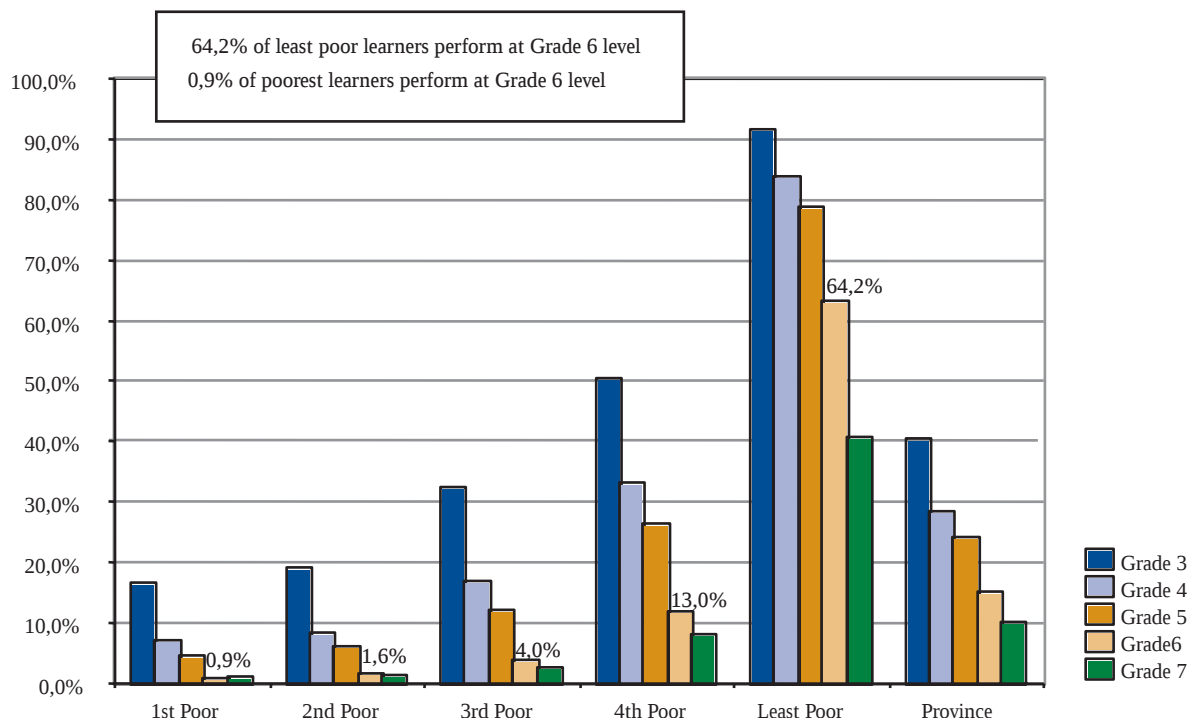
[Source: WCED, 2005]

Table 21 Literacy: pass rates by poverty index and grade, Western Cape (%)

Poverty Index	Grade 3	Grade 4	Grade 5	Grade 6
1st Poor	75,8	51,2	67,9	16,8
2nd Poor	75,0	52,0	65,9	16,2
3rd Poor	81,9	65,0	77,9	24,3
4th Poor	85,8	76,9	85,0	41,1
Least Poor	97,9	97,4	98,0	82,9
Total Province	82,8	67,4	78,3	35,0

[Source: WCED, 2005]

Figure 10 Numeracy: results by poverty, Western Cape



[Source: WCED, 2005]

Although inequalities in access to education and educational attainment have declined within the Province, the challenge is now to improve the quality of the schooling children receive to promote retention of children in schools and the capabilities and opportunities to reap real returns from the education they receive.

Turning to health attainment, Table 22 shows a handful of key health indicators for the Western Cape and South Africa and, where available, as comparators for middle-income countries. The latter is particularly important as the World Bank classifies South Africa as an upper-middle income country in terms of its GDP. However, due to the extremely high levels of income, asset and spatial inequality, we often perform much more poorly on other living standards indicators.

Our poor health performance is apparent in terms of many of our health indicators, and probably most starkly when looking at life expectancy at birth. In this instance, even though the Western Cape yet again does significantly better than the national average, if we compare Provincial performance with the average for middle-income countries, it can be seen that the figures of 59,3 for males and 66,1 for females are low. These figures, which are declining rather than increasing for South Africa, are closely related to the HIV/Aids pandemic, which will be discussed in more detail later.

Infant mortality rates (IMR) are much lower than those of the national average and are more in line with other middle- income countries. The IMR is more closely related to

Table 22 Health indicators for South Africa, Western Cape and comparator middle-income countries

	Western Cape	South Africa	Middle Income Countries
Life expectancy at birth			70
Life expectancy at birth: males (years) ¹ , 2002	59,3	49,9	
Life expectancy at birth: females (years) ¹ , 2002	66,1	55,0	
Infant mortality rate (per 1 000 infants aged less than 1), 2002	30,0 ²	59,0	31
Child mortality (per 1 000 children aged 1-4), 1998	9,0 ³	15,4	39
Children under 5 with diarrhoea in past two weeks	9,4% ⁴	13,3%	
Total fertility rate (The average number of children that a woman gives birth to in her lifetime, assuming that the prevailing fertility rates remain unchanged.), 2004	2,5 ⁵	2,8	2,2
Incidence of TB (PTB new Sm+) (per 100 000). Number of cases of tuberculosis (pulmonary TB, new smear positive cases) reported to the Department of Health per 100 000 population, 2002	430,1 ⁶	218,7	104
Prevalence of smoking (%) : Youth – males, 2002			
The definition of current smokers used in this source was: Percentage of people who smoked on one or more of the 30 days preceding the survey. These data are for use of any tobacco product.	46,9 ⁷	34,3	
Prevalence of smoking (%) : Youth – females, 2002	38,4	21,6	

[Source: Data for South Africa from Health Systems Trust website <http://www.hst.org.za/> and Data for Middle-Income Countries from World Bank (2002)]

1. Ref: Dorrington RE, Bradshaw D, Budlender D. HIV/Aids profile of the provinces of South Africa indicators for 2002. Centre for Actuarial Research, Medical Research Council and the Actuarial Society of South Africa 2002.

<http://www.mrc.ac.za/bod/Aidsindicators2002.pdf> AidsIndicators2002.pdf

2. Dorrington RE, Bradshaw D, Budlender D. HIV/Aids profile of the provinces of South Africa indicators for 2002. Centre for Actuarial Research, Medical Research Council and the Actuarial Society of South Africa 2002.

<http://www.mrc.ac.za/bod/Aidsindicators2002.pdf> AidsIndicators2002.pdf

3. Department of Health, Medical Research Council & Measure DHS+. South Africa Demographic and Health Survey 1998, Full Report. Pretoria: Department of Health 2002.

South Africa Demographic and Health Survey 1998. Preliminary Report. <http://www.doh.gov.za/facts/1998/sadhs98/>

5. Statistics South Africa: Statistical release P0302 Mid-year estimates. (various years) <http://www.statssa.gov.za/> A new feature of the 2000 mid year estimates was that two population estimates were provided, one taking into account the estimated additional deaths that might have occurred due to HIV/Aids (With Aids) and one that does not attempt to model the impact of Aids (Without Aids). The assumptions that underpinned these estimates are outlined in the relevant P0302 Statistical release.

2004 mid-year estimates. TFR assumptions used in development of the current mid-year estimates. Source includes comparison of values to other estimates.

6. Department of Health (TB section). Pretoria. <http://www.doh.gov.za/tb/>

7. Swart D, Reddy SP, Panday S, Philip JL, Naidoo N, Ngobeni N. The 2002 Global Youth Tobacco Survey (GYTS): The 2nd GYTS in South Africa (SA) – A comparison between GYTS (SA) 1999 and GYTS (SA) 2002. Cape Town: South African Medical Research Council 2004. <http://www.mrc.ac.za/healthpromotion/healthpromotion.htm>

<http://www.cdc.gov/tobacco/global/GYTS/reports/SouthAfrica2002.pdf> (Preliminary Report)



adequacy of health care services and in this case indicates that health care services, in the Western Cape are most likely superior to those in the rest of the country.

The two cases in which the Western Cape actually performs worse than the national averages is for prevalence of smoking amongst the youth, and incidence of tuberculosis (TB). Both of these have important implications for health care provision and productivity in the work place, although smoking may have more long-term impacts, whereas TB is an immediate problem.

Dorrington *et al's* *HIV/Aids Profile of the Provinces of South Africa – Indicators for 2002* uses the ASSA 2000 HIV/Aids projection model to project the prevalence, incidence and spread of the disease for each of the provinces in South Africa and for the country as a whole. Although all such projections are sensitive to a wide range of assumptions, the figures here will give some indication of the spread of the disease in terms of the number of people it might impact on, as well as the spatial dimension.

Table 23 shows that the ASSA 2000 model estimates that 6,5-million South Africans were living with HIV or Aids in 2002. In the Western Cape, the estimate is at 193 000. Ninety seven per cent of these are adults aged 18 to 64. The prevalence rate refers to the percentage of a group of people infected at a point in time. It can be seen that the 2002 prevalence estimates are well below that of South Africa as a whole, with a 4,2 per cent rate for the Province compared to a 14,2 per cent rate for the country. Prevalence is substantially lower across the age spectrum, but highest for adult women.

Table 23 ASSA 2000 estimates (and selected Department of Health estimates) of people living with HIV/Aids and HIV/Aids Prevalence in 2002, Western Cape and South Africa

	People living with HIV/Aids		Prevalence %	
	Western Cape	South Africa	Western Cape	South Africa
Total HIV infections	192 946	6 461 372	4,2	14,2
Adults (18-64)	187 073	6 141 578	6,7	23,4
Adult men (18-64)	79 604	3 016 080	5,8	23,3
Adult women (18-64)	107 469	3 125 498	7,6	23,5
Youth (15-24)	24 754	1 210 749	3,3	13,7
Male youth (15-24)	4 144	263 069	1,1	5,8
Female youth (15-24)	20 610	947 680	5,5	21,6
Children (0-14)	4 327	205 134		
Antenatal clinics	-	-	11,4	29,0
Department of Health Estimates for 2002 and 2003				
Antenatal clinics			13,1	27,9
Total HIV infections		5 300 000		

[Source: Dorrington *et al.* (2002), Department of Health (2003) and the Western Cape Department of Health (2003)]

Prevalence rates for antenatal clinic attendees are also reported by the Department of Health. The figures are included in the table above for comparative purposes and show that the Department of Health's estimates (based on the National HIV and Syphilis Antenatal Sero-Prevalence Survey 2002) and the ASSA model source data correspond relatively well. We also include the Department of Health's projection of number of people infected, which is lower at 5,3-million.

Even though prevalence is substantially lower than for the rest of the country, having potentially 187 000 working-aged adults living with HIV/Aids has large implications for health care requirements on the one hand and productivity in the work environment, spending power and economic growth on the other. Furthermore, these numbers are projected to increase to approximately 275 000 by 2010. It is estimated that 45 000 of these will be Aids sick, thus requiring high levels of care and anti-retrovirals. In addition, it is estimated that there will be 44 000 maternal Aids orphans under 15 years by 2010. Increased dependency and need of care for both children and adults should be incorporated into any Provincial development strategy. Those directly impacted by HIV/Aids are some of the most vulnerable in society and if their plight is not addressed, we are likely to witness increases in our poverty rates and in the depth of poverty, regardless of economic performance.

Turning towards safety and security aspects, links between income and asset inequality and crime means that given our notable levels of income and asset inequality, the high incidence of crime experienced in South Africa is unsurprising. Being at vulnerable to crime can have personal impacts such as reducing quality of life and economic impacts such as reducing investment and therefore growth. Once again the forces impacting on well-being impact on the performance of the economy as well. Resulting high levels of social conflict from extreme inequality, provides a clear reason of why the inequities in our society need to be reduced. The Western Cape performs particularly poorly when it comes to reported crime statistics as can be seen in Table 24 below.

Table 24 Selected Crime Statistics: Western Cape and South Africa, 2003/2004

	Western Cape 2003/2004	South Africa 2003/2004
Murder (ratio per 100 000 population)	59,9	42,7
Percentage increase/decrease 1994/1995 to 2003/2004	3,9%	-23,7%
Burglary at residential premises (Ratio per 100 000 population)	1 141,6	645,2
Percentage increase/decrease 1994/1995 to 2003/2004	55,8%	29,4%
Child Abuse (ratio per 100 000 population)	37,2	14,0
Percentage increase/decrease 1994/1995 to 2003/2004	83,5%	111,9%

[Source: www.SAPS.gov.za]



Table 24 shows that the Western Cape performs much more poorly than the country as a whole for the three selected crime statistics listed. The murder rate of 59,9 per 100 000 people is exceptionally high and the worst of all the provinces. Burglaries at residential premises are almost double the national average for 2003/2004 and also highest of all the provinces. Reported child abuse is more than twice the national average, and is second-highest of all the provinces, behind only the Northern Cape.

It is clear from the above that social conflict and crime are major problems in the Western Cape. Thus vulnerability and insecurity will rank highly in terms of key provincial poverty factors. The relationship between crime and poverty is circular in that poverty often leads to crime and crime then leads to poverty. Once again, the links between inequality reduction, poverty reduction and growth are evident. Although crime is widespread, there are areas of especially high incidence – reflected as spatial inequality. In fact, one of the key ways inequality and poverty can be delineated and persist is through space. The next section considers this spatial dimension of poverty.

3.2.3. Spatial poverty

As mentioned above, spatial poverty may be measured using a single-dimension or a composite poverty index to identify the most deprived communities within national or sub-national boundaries.

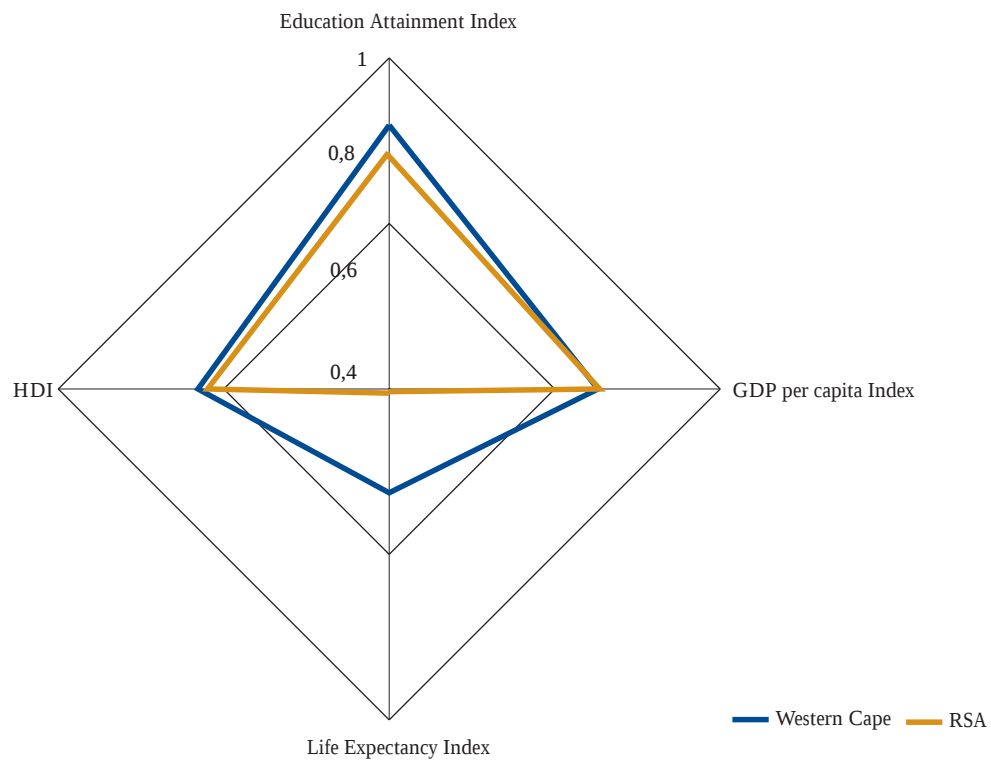
As mentioned, a composite poverty index is a useful way to isolate the regions that score worst according to a range factors. Once the most deprived areas have been identified, the index can be disaggregated to ascertain the key factors resulting in deprivation.

Three composite poverty indices currently exist for the Western Cape. The most recent is the Office of the Premier's development of a provincial Human Development Index for the Western Cape, disaggregated to municipal level.

The results are stark in absolute value and in terms of trend movements. Over the period 1990 to 2003, the national HDI fell from 0,7201 to 0,6675. While performing better than the national HDI, the Western Cape HDI also shows a marked decline from 0,7869 to 0,7708 over the same period.

Table 25 below sets out the full detail for values for each element of the HDI for both South Africa and the Western Cape over the period 1990 to 2003. This data is also depicted graphically in the attendant 'radar diagram' (Figure 11), which points to alarmingly low life expectancy indices, a decline in the economic indices and a fall in the overall HDI indices rates for both South Africa and the Western Cape over this period.

Figure 11 Human Development Index for Western Cape and South Africa 2003.



[Source: Department of the Premier, Western Cape. "Measuring the state of development in the Province of the Western Cape". (February 2005)]

Table 25 HDI for South Africa and Western Cape, 1990 – 2003

Life Expectancy at birth	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003
Western Cape	64,2000	64,4000	64,5000	64,5000	64,5000	64,5000	64,4000	64,3000	64,0000	63,8000	63,4000	62,9000	62,2000	61,5000
South Africa	61,6000	61,6000	61,7000	61,6000	61,5000	61,4000	60,8000	59,9000	58,5000	57,3000	55,5000	53,5000	51,4000	49,2000
Adult Literacy Index	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003
Western Cape	0,9401	0,9381	0,9353	0,9327	0,9303	0,9278	0,9249	0,9267	0,9288	0,9311	0,9336	0,9377	0,9419	0,9426
South Africa	0,8124	0,8166	0,8207	0,8249	0,8291	0,8333	0,8371	0,8409	0,8447	0,8486	0,8526	0,8580	0,8634	0,8688
Gross Enrolment Index	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003
Western Cape	0,7607	0,7801	0,7945	0,8164	0,8404	0,8528	0,8454	0,8402	0,8344	0,7697	0,7446	0,7477	0,7518	0,7552
South Africa	0,7583	0,7829	0,8030	0,8302	0,8599	0,8788	0,8770	0,8769	0,8781	0,8319	0,7948	0,7937	0,7995	0,8016
Education Attainment Index	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003
Western Cape	0,8803	0,8854	0,8883	0,8939	0,9003	0,9028	0,8984	0,8979	0,8973	0,8773	0,8706	0,8744	0,8785	0,8825
South Africa	0,7944	0,8054	0,8148	0,8267	0,8394	0,8485	0,8504	0,8529	0,8558	0,8430	0,8333	0,8377	0,8421	0,8464
GDP per capita Index	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003
Western Cape	0,8274	0,8231	0,8135	0,8107	0,8116	0,8125	0,8153	0,8148	0,8124	0,8133	0,8166	0,8178	0,8201	0,8223
South Africa	0,7565	0,7514	0,7433	0,7414	0,7422	0,7432	0,7465	0,7466	0,7442	0,7445	0,7470	0,7479	0,7508	0,7535
Life Expectancy Index	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003
Western Cape	0,6531	0,6563	0,6575	0,6562	0,6586	0,6590	0,6571	0,6545	0,6495	0,6459	0,6396	0,6312	0,6204	0,6076
South Africa	0,6095	0,6106	0,6110	0,6102	0,6085	0,6062	0,5959	0,5810	0,5580	0,5380	0,5090	0,4756	0,4394	0,4026
Human Development Index (HDI)	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003
Western Cape	0,7869	0,7883	0,7865	0,7876	0,7902	0,7914	0,7903	0,7891	0,7864	0,7788	0,7756	0,7744	0,7730	0,7708
South Africa	0,7201	0,7225	0,7230	0,7261	0,7300	0,7326	0,7309	0,7236	0,7193	0,7085	0,6964	0,6871	0,6774	0,6675
Difference	0,0668	0,0658	0,0635	0,0615	0,0602	0,0588	0,0594	0,0655	0,0671	0,0703	0,0792	0,0873	0,0956	0,1033

[Source: UNDP, 2003]

The South African Cities Network is exploring the use of the 'South African Poverty Index for Cities' (SAPIC), which includes as components measures for mean household income, education, health, infrastructure and services. At present this index is most useful in comparing the relative performance of cities.

The Western Cape Provincial Population Unit located in the Department of Social Services and Poverty Alleviation has developed what it terms the 'provincial poverty index' which uses similar inputs as the SAPIC, but has been calculated down to the sub-place name level captured in the Census 2001.

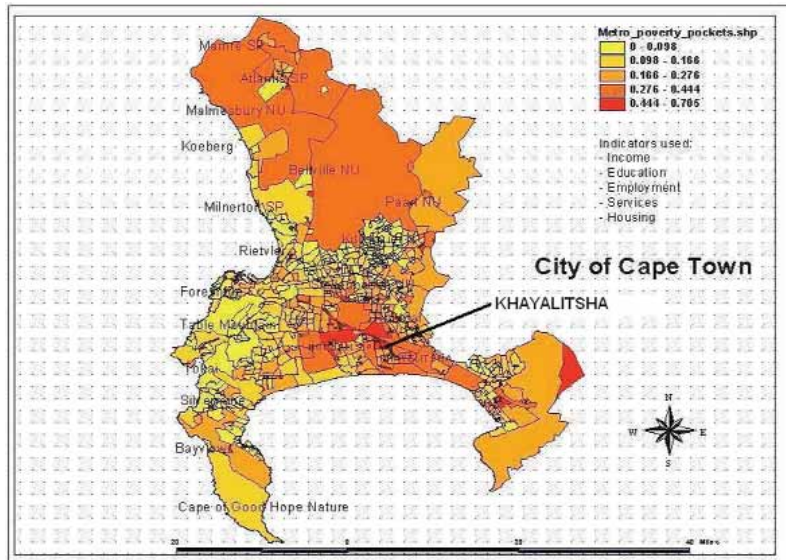
The five components of the provincial poverty index are measures for household income, knowledge (literacy and school attendance), unemployment and economic dependence, services (water supply, electricity, refuse removal and sanitation), and housing type.

Various weightings apply for measures within each category, the five of which are then given equal weight in the final index. This index ranges from zero to one, with zero representing no poverty and one indicating 'full' poverty. Although all indices are subjective to an extent, necessitating that the user has a clear understanding of how they have been computed, they can prove extremely useful.

Part of the power of the provincial poverty index as it is presently calculated lies in the small regional units for which it has been computed. Having data at such a disaggregated level allows for precise mapping with the greatest areas of need easily identified.

Figure 12 is an example of a map generated of the Cape Metropolitan Area, with the provincial poverty index shown at the sub-place name level. The regional discrepancies measured by the index are clearly apparent, with the most deprived areas evident in the north of the metropole as well as some severe poverty pockets in the south and south east.

Figure 12 Map of City of Cape Town showing Provincial Poverty Index of 2001

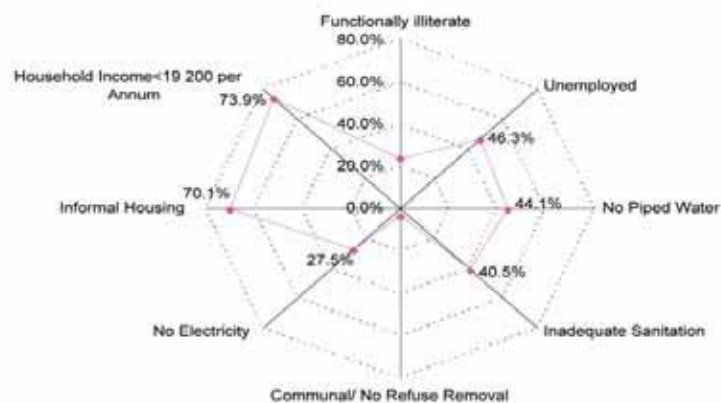


[Source: Department of Social Services and Poverty Alleviation in the Western Cape Provincial Population Unit, Western Cape Government. Source data – Census 2001]

One of the most severely disadvantaged areas identified through the index mapping approach is Khayelitsha. This area also has a very high population density with 276 334 residents recorded in Census 2001.

We can now unpack the index to reveal the key features of deprivation characterising this local population. Some of these are shown in Figure 13.

Figure 13 Selected components of the Provincial Poverty Index for Khayelitsha



[Source: Census 2001]

The radar diagram in Figure 13 shows clearly that Khayelitsha performs relatively well in terms of refuse removal, functional illiteracy (calculated here as the proportion of those aged 14 and above who have not attained grade 6¹⁴) and electricity access. Key drivers of poverty in this area are the excessively high proportion of homes classified as informal, (70,1% compared with a Provincial average of 16,1% percent), without piped water (44,1% compared to a Provincial average of 5,1%) and inadequate sanitation (40,5% compared to a Provincial average of 14,2%). High unemployment rates and the majority of households with household income of less than R19 200 per month are also major concerns.

The above exercise can be performed for all sub-regions to assist with the targeting of the most deprived areas in terms of their most pressing needs. Contrasting the picture for Khayelitsha with that of a suburb like Claremont reveals the stark contrasts between these areas. There is not much use in graphing Claremont's deprivation levels, as most score at zero. Interestingly, unemployment sits at a mere six percent for this relatively well-off suburb. Overlaying this type of map with population density figures would further enhance the poverty targeting process and emphasises, yet again, the value of the spatial approach in assisting with poverty alleviation strategies.

4. Moving Forward: Targeting Poverty and Inequality

Decomposing and measuring poverty in respect of income, asset and spatial dimensions for South Africa and the Western Cape highlight the intractability of systemic poverty in our communities. In many senses, the scale and magnitude of the challenge are overwhelming, and the trends alarming, to say the least.

Identification of prime areas of need is key in the fight against poverty and in attempts to reduce inequalities. Furthermore, planning to contain and lessen the poverty and inequality problems in the Province in the future warrants careful attention.

The ability to project changes in poverty and inequality would be an invaluable tool in planning a response to reduce these phenomena. However, given the complex nature of the forces driving measured income inequality, particularly forecasting changes in the inequality and poverty and especially on a provincial level, is a demanding task. Essentially it would mean having to forecast economic growth, employment growth, the impact of greater access to services and potential improvements, population growth given the impact of HIV/Aids, provincial migration and more.

Two attempts at systematic long-run forecasts of racial income distribution have been undertaken in the past few decades. The first – Van der Berg (1989) – decomposed personal income into its main components (the functional shares of income), and then

14 This definition differs from that used when discussing education, as it was taken from the manipulated Census dataset provided by the Department of Social Development

forecast wage income (the product of the average wage and employment) based on certain scenarios and non-wage incomes separately, based on past trends and alternative economic growth scenarios.

The second – Simkins (1991) – forecast income distribution for the Urban Foundation Income Distribution Model using a similar model, but without separating the forces of employment and wage growth. The emphasis was rather on projecting the functional distribution of income and then breaking these into racial shares. Thereafter distribution across income classes was obtained by assuming a constant distribution in each region/settlement type, with the overall distribution then largely being affected by population shifts between region/settlement types.

Forecasting the overall income distribution, however, requires more assumptions about distribution throughout the income range. At the provincial level, moreover, forecasting becomes even more complex because of some forces that are difficult to predict, and could substantially influence inter-regional distribution, such as migration to the Western Cape from other provinces, particularly the Eastern Cape.

Linking income distribution to the performance of the economy could be accomplished, for instance, by linking employment generation forecasts to economic growth and modelling the effect on income distribution. However, the probability of more rapid immigration into the Western Cape in response to an acceleration in its economic growth makes population size endogenous (that is, determined within the model), thus making such modelling very sensitive to the correct assumptions about population inflow.

That said, even if income distribution modelling were feasible at the provincial level, targeting inequality through use of Gini coefficient analysis is not advisable from a policy perspective for a number of reasons. First, Gini coefficients move slowly and therefore are not conducive to monitoring policy response or impact in the short to medium term. Second, sharp movements in Gini coefficients are usually downwards in response to massive structural change. But the reverse is not always as easily attributable. Third, various elements that comprise the Gini coefficient may tend to move in different directions in response to different circumstances or policy incentives. This may lead to a stagnant Gini coefficient that does not reflect underlying dynamics. Lastly, Gini coefficients are notably sensitive to underlying data availability and quality. Movements then have to be interpreted in light of data robustness.

Having established that forecasting and targeting poverty and/or inequality at the provincial level is a daunting task, even when it allows for different scenarios, another route has to be found.

An alternative, which may be more predictable, would be to forecast *income adequacy*, that is, the number (*not the proportion*) of people with an income above a particular level, which

may be regarded as clearly demarcating non-poverty in terms of money-metric poverty. This also provides a more concrete goal for policy.

Most migrants to the Western Cape are economic migrants – they arrive with resources and often without immediate job prospects. Studies based on both the Census (Van der Berg, Leibbrandt, Burger & Mlatsheni, 2004) and on a survey conducted in Khayelitsha and Mitchells' Plain (Nieftagodien *et al.*, 2004) show that black migrants are far worse off than long-term residents. This being the case, setting targets in terms of the number of people above an income adequacy line is a form of concrete quantification of poverty targets. Given the achievement of these targets, poverty is then a residual, the size of which is determined by the magnitude of population influx, a factor out of control of the Provincial Government.

To make this more concrete: A specific income level can be set as a target income. If, say, 2,5-million presently have incomes which place them in this income-adequate bracket, and another 2,0-million below it, the target could be to increase the number with adequate incomes by four per cent per year. Reaching this target would then depend on the combination of growth and redistribution, with the former probably the major driver over a longer-term time horizon. The number in poverty would then be the residual population, whose magnitude would itself be affected by the inflow of population, which may even have responded to economic growth.

The approach suggested here is a variant of poverty and/or inequality targeting, in respect of a positive dimension using adequacy considerations. The income aspect detailed above may be broadened to include assets and spatial or geographic location. Government's policy response would therefore comprise a basket of interventions and associated targets to decrease inequality of assets and spatial location, with income inequality an indirect outcome through improved labour market performance.

Equity forecasting and scenario planning is both challenging and an exciting innovation for the policy debate. It certainly demands further development. A better understanding of poverty, distribution and migration is a prerequisite, and research currently undertaken in this regard nationally and in the Western Cape provides an important potential source of information. However, data quality is still a concern, given deficiencies in survey data and its inadequate coverage at the provincial and particularly at the regional level. For this purpose, further work on data from the Census may be an important further tool.

In broad outlines, it would appear that the Western Cape's ability to provide adequate incomes to its population is growing, in that economic growth in the Province has been above that at the national level, but further acceleration is required to make larger inroads in the present pool of poor people, not even to mention national population growth (which has slowed) and in-migration from poorer provinces. This challenge remains.

5. Conclusion

Equity and development are powerful concepts. Understanding how equity is measured, the factors that drive changing distributions and those public interventions that enhance such, is critical for understanding the dynamics of a shared growth and development path.

This chapter decomposes equity in respect of income, assets, and spatial or geographical location. Looking at income inequality, we see that both South Africa and the Western Cape have high and rising levels of inequality, measured by a rise in the respective Gini coefficients from 0,64 to 0,68 and 0,584 to 0,616. Data accuracy and credibility mean that the absolute number should not hold focus; rather the high level and rising trend are important here.

These trends highlight the importance of understanding labour market performance, as a greater number of poor at the lower end an/or upward earnings mobility of those at the top end would serve to widen the distribution, and is the likely reason for rising inequality trends.

Turning to assets, we see that asset equality is attained in respect of access to good basic services and dwellings (water, sanitation, energy, refuse removal and housing) and social services (health care, education, skill development and shelter).

Most public services are therefore targeted at improving poor people's capabilities in respect of enhancing access to quality schooling and skill development, health care services, clean and safe water, sanitation facilities and housing. These are often called 'social wage goods'.

Looking at basic service access indicators, we see that the urban nature of the Western Cape facilitates extensive access to basic services, with 95 per cent of households having access to piped water, 86 per cent to a flush toilet, 87 per cent to refuse removal and 87 per cent to electricity for lighting purposes. Our key failing is in respect of housing, where 80 per cent of dwellings are formal and 16 per cent informal.

In respect of access to social services, the Western Cape performs well in terms of school attendance rates and average educational attainment. The key concern, however, is the high rate of drop-out of learners after Grade 8, reducing secondary school completion rates. Only 45 per cent to 52 per cent of learners who enrol in Grade 1 reach Grade 12. The employment data presented above highlighted the importance of matriculation in gaining access to the labour market.

Looking at Census data, and combining income and access to basic and social services data, shows that it is the poorest who have experienced the greatest gains in terms of service delivery improvements in the Province.

Spatial inequality is the third dimension – Key in profiling inequality – it throws into stark relief the confluence of income, asset and spatial inequality.

Most commonly understood in respect of the natural environment, socio-economic concerns and the built environment, key concerns in respect of the trade-off between biodiversity and agricultural land use, and the ecological status of rivers in the Province are highlighted.

Looking at demographics, we see that the Western Cape is highly urbanised at 90 per cent. However, percentages of people in rural areas vary over the various districts: 35 per cent in the Overberg district, 33 per cent in Eden, 35 per cent in the West Coast, 19,9 per cent in the Boland and 33 per cent in the Central Karoo district.

In respect of the built environment, the majority of South African towns and cities are essentially a system of settlements, consisting of a 'White' core, which contains the economic centre and most social services, surrounded by a number of disparate, racially discrete, dormitory areas or locations of considerable size.

These settlement patterns are the extraordinary spatial legacy of apartheid, and extremely difficult to change, requiring considerable public spatial planning and intervention in the line of the NSDP and the PSDF.

Moving on, we see that there is an inextricable relationship between equity and inequalities in respect of income, assets and spatial or geographic location and poverty – the causal direction of which is intertwined.

Measured in any way, income poverty in South Africa has not improved between 1995 and 2000; it has in fact deteriorated. Taking a low poverty line of R174 per capita per month, 31 per cent of South Africans were poor in 1995. By 2000 this had risen to 38 per cent. Not only have the numbers of poor people risen, but the poor are faring worse in 2000 than they were in 1995!

The Western Cape's performance is notably different, although the aggregate view masks worrying trends in poverty. If we take a low poverty line of R174 per capita per month, we see a slight improvement in the poverty rate from 9 per cent to 8 per cent. At the upper bound of R322 per capita per month, there is a slight decline from 29 per cent to 28 per cent.

Groups of concern are Coloureds and Africans. Even at the extremely low level of R174 per capita per month, 17 per cent of Africans in the Western Cape were poor in 2000. At the same level, eight per cent of Coloureds were said to be poor. At the R322 per capita per month level, an alarmingly high 48 per cent of Africans were poor in 1995, rising to

53 per cent in 2000. At this, level, one in three Coloureds were poor in 1995; this drops to one in four in 2000, although at such levels this remains a concern.

Taking a closer look at asset poverty, we draw attention to Provincial performance in respect of socio-economic or human development indicators. As noted previously, although children have good schooling attendance up to age 15, more than half of children do not make it to Grade 12 to write their final school-leaving examinations. Furthermore, of those that do write their final exams, 12,5 per cent in the Province fail, and only 26 per cent pass with an endorsement. Mathematic and science pass rates are even more dismal.

Looking at health indicators, we see that poor health performance is evident when looking at life expectancy at birth. At 59,3 years for men and 66,1 for women, the Western Cape performs above national but far below comparable middle-income developing countries. These trends are closely related to the impact of the HIV/Aids epidemic, both nationally and Provincially.

The two cases in which the Western Cape performs worse than national averages are prevalence of smoking amongst the youth and incidence of tuberculosis.

Crime statistics in the Western Cape are even more shocking. The murder rate of 59,9 per 100 000 people is exceptionally high and the worst of all the provinces. Burglaries at residential premises are almost double the national average, and reported child abuse is more than twice the national average.

Lastly, spatial poverty may be measured using a single-dimension or a composite poverty index to identify the most deprived communities within the national or regional boundaries. This is a useful tool for providing greater insight into the areas of greatest need. Decomposing the index then allows for streamlining and increasing efficiency of targeted interventions.

Three composite poverty indices currently exist for the Western Cape. The most recent is the Office of the Premier's development of a provincial Human Development Index or HDI for the Western Cape, disaggregated to municipal level.

The results are stark in absolute value and in terms of trend movements. Between 1990 and 2003 the Western Cape's HDI fell from 0,7869 to 0,7708.

Similar results may be obtained from the South African Cities Network poverty index and the Provincial poverty index recently developed by the Western Cape Social Services and Poverty Alleviation Department., highlighting the importance of spatial poverty mapping tools for prioritising areas of greatest need in social service planning, budgeting and delivery.

In conclusion, then, this chapter highlights the clear relationship between equity and shared development goals for the Western Cape. Moving forward, the ability to project changes in poverty and inequality would be an invaluable tool in planning a response to reduce these phenomena. However, given the complex nature of the underlying driving forces, modelling (income) distributions at the provincial level is almost impossible and has many pitfalls. So too does pursuing a Gini coefficient target.

The focus should fall on mapping and targeting poverty and inequality in respect of a positive dimension that focuses on adequacy considerations, such as the number (not proportion) of people with an income above a certain level. This may be done for asset poverty and inequality, and spatial poverty and inequality, providing more concrete goals for policy interventions over the medium to long term.



Conclusion

The preceding five chapters in the 2005 PER&O cover a wealth of information and analyses. The resultant overview of the economic environment in the Province gives us much to digest.

The expanse and volume can be overwhelming, and requires that we step back from the detail so that we are able to draw out key messages and thematic thrusts. This allows us to gain perspective on the value and contribution of the 2005 PER&O to the further development of the *iKapa Elihlumayo* lead strategies and the 2005 Budget itself.

Perspective often enhances insight. Given such, we make various suggestions on how the 2005 PER&O should be used and taken further, strengthening the Province's economic analytical base and capacity over the medium term.

The 2005 PER&O endeavours to do justice to the economic discipline from which it emanates. As such, it aims to raise the hue and level of analytical sophistication, posing further questions, probing the rigour of present analyses and extending both the reach and depth of the latter as we move forward into planning PER&O 2006.

1. Key Messages of the 2005 PER&O

The 2005 PER&O chapters 2 and 3 provide a detailed overview of the Western Cape's economic trends and outlook, focusing on broad macro- and sector-level performance.

1.1 Chapter 2 – Economic Outlook

At the macro-level, the key 'sound-bite' is that the Western Cape economy has consistently out-performed the national economy over the last five to 10 years, and is recovering from the headwinds experienced in 2003 and 2004.

Looking ahead, short-term economic prospects are as favourable as for the rest of the country. While business tends to adjust to the strong rand, the direction of the exchange rate could be an important determinant of the regional economic performance and therefore a key risk to the Province's optimistic macroeconomic outlook. A strong currency benefits the non-tradeable goods sectors and disadvantages the tradeable goods sectors.

Nevertheless, robust real economic growth is currently underway in the region as industry responds to buoyancy in domestic spending, as well as a supportive world economy. In this respect, the Western Cape business confidence jumped sharply at the end of 2004, catching up with the rest of the country.

The outlook for fixed investment and employment creation is positive, following years of capital-deepening investment and formal sector retrenchment of workers. The challenge is to develop downstream and niche manufacturing and services industries, which have more potential to create jobs.

The positive employment trend in the retail, tourism and business services sectors is likely to persist and this needs to be supported. With improved formal sector job (and therefore wage earner) growth, the chances for enhancing poverty reduction in the Province in the medium term, beyond Government's social welfare and infrastructure development spending, are looking better.

In all, the *macroeconomic outlook* for the Western Cape predicts that real GDPR¹ will accelerate from 4,1 per cent in 2004/05 to 4,3 per cent in 2005/06, exceeding the national GDP growth rate of 3,9 per cent. This reflects sustained growth in real domestic expenditure and a 'fairer' value of the rand.

In the outer years of the MTEF, real GDPR growth is expected to decline slightly to 4,0 per cent and 3,9 per cent in 2006/07 and 2007/08, respectively, responding to the weight of higher interest rates. The latter arises as the SARB becomes focused on inflation possibly accelerating to the upper band of the inflation target in 2006 on the back of excess demand in the economy and a weaker currency.

¹ All GDP and GDPR projections are those derived from work done by the BER.

While the outlook reflects a strong and vibrant Provincial economy, we must *attain higher levels of economic growth in the Western Cape, in the region of five to six percent per annum. The latter is essential if we are to raise the Province's employment performance and improving the long-term growth potential of the Provincial economy.*

1.2 Chapter 3 – Sectoral growth & employment prospects

At a sectoral level, headlines point to the Western Cape economy out-performing the South African economy in GDP or value-added terms, largely due to strong growth and contribution of tertiary services sectors. But these sectors have not been creating jobs, and overall employment performance is poorer than national. The latter result is a key risk factor, significantly jeopardising the Western Cape's chances of sharing economic benefits to a broader range of people and communities across the Province.

The aggregate picture, however, hides promising detail. The Western Cape's key attribute is its broad base and diversity of base sectors as well as up-and-coming or promising sub-sectors, industries or 'niches'. The Province's four core sectors – agriculture, manufacturing, trade and financial & business services – are each well diversified, reducing the risk of over-dependence on any single industry or sub-sector.

In addition, the region has a well-developed tourism sector, and reasonably strong and dynamic construction, fishing, professional services, higher education and transport sectors. A small mining base is mitigated by Saldanha's emergence as a major export harbour for minerals, as well as a key base for the iron and steel industry.

Apart from Saldanha and Namakwa Sands, limited mining activity, capital-intensive mineral processing and attendant heavy industry accentuates the dominance of small and medium-sized enterprises in the Western Cape economy, and is also likely to contribute towards the shift towards a service economy.

At a more detailed level, then, the tertiary sector (comprising various service industry) produces the largest share of GDP at slightly more than two-thirds (69,8%) on average over the past five years. The secondary sector (manufacturing, electricity & water and construction) comes a distant second (25,2%), and the much smaller primary sector (6%) trails due to the absence of a meaningful mining industry in the Province.

Between 1999 and 2003, on average, the financial & business services sector contributed 27,1 per cent of GDP. This sector includes banking & insurance, real estate and business services (ICT, engineering, accounting services). Also notable are the Province's manufacturing sector (20,1%), transport & communication (10,1%), and internal trade sector (including retail, wholesale, catering & accommodation) (15,7%). In contrast, agriculture comprises 5,6 per cent and construction 3,4 per cent.

Of note, however, is the decline of the manufacturing industry in the Western Cape. Once, a manufacturing 'heartland', the Province has now shifted the emphasis towards tertiary services. This has had a particularly severe impact on manufacturing employment in the Province, particularly in the clothing & textile industry.

Looking forward, a shared sustainable growth and employment path needs to rest on a broad foundation of agriculture, industrial regeneration, tourism and services, such as that grows in output and employment. The pattern of higher growth in financial and business services and tourism, with agriculture remaining very important, does not negate the need to develop the manufacturing base further.

A crucial dimension in the Western Cape is its coastal location and the opportunities that arise from it. These opportunities are not only in exports, but also in deepening international links around investment, technology and production networks. The challenge is to translate the opportunities into output growth and employment in relatively labour-intensive areas of manufacturing and other sectors.

Lessons from industrialising countries and regions indicate that government plays a crucial role in strategic repositioning by anticipating future development together with local economic stakeholders, and co-ordinating the actions of local institutions to meet the dynamic needs of the global customer.

The 2005 PER&O suggests that provincial government plays an important role in this respect. At the meso-economic level, provincial actions should focus on connectivity and integration, linking macro frameworks, institutions and interventions to local economic development, and where necessary designing appropriate provincial interventions that stimulate broad-based economic activity and raise levels of economic participation.

Province's role is then to identify and respond to global and national economy-wide as well as sector- and industry-specific opportunities and challenges. In particular, a key role rests in facilitating SMMEs and sector organisations to take full advantage of opportunities presented.

Initially, these opportunities are likely to be found in the tertiary rather than the primary and secondary sectors. A key challenge is to ensure that any further development of the tertiary sector does not entrench existing skill, capability and spatial patterns of inequality that exist in the Western Cape.

We must improve both the growth (value-added) AND labour performance of tertiary, secondary and primary sectors in the Provincial economy.

In doing so we must understand that while much of the growth impetus will come from the tertiary sector, the secondary and primary sectors should not be left behind, as they are

employment intensive and absorb skills at the lower to middle of the skill spectrum where much of the Province's labour supply currently rests.

1.3 Chapter 4 – Employment and remuneration trends

Turning to employment and remuneration prospects, like the national debate, the Provincial debate contends that economic restructuring has left many without work and that our economic revival is about more jobs.

Nowhere is this contention clearer than in the clothing & textile industry, which in the 18 months between January 2003 and June 2004 lost 27 000 jobs nationally, most of which were lost in the Western Cape.

Chapter 4 draws attention to the stark labour market challenges that the Western Cape faces over the next few years.

Most importantly, while the Provincial economy is generating jobs, it is not generating enough jobs to absorb new entrants into the labour market.

In particular, the labour force is growing as the number of young individuals joining the working age population exceeds the number of older people leaving this group. Migration acts as a further source of expansion, impacting on the Province's demographic composition as well as the skills distribution of the labour force.

The result is that unemployment, while less severe than in the rest of the country, is likely to grow rapidly over the next few years. And this trend is likely to continue for as long as people living outside of the Western Cape perceive that they have a greater chance of being employed in the Province, given our better than average economic performance.

It is imperative that we develop a better understanding of the Western Cape labour market, as it is the key mechanism through which individuals engage with the Provincial economy, and its performance is therefore a key determinant of Provincial income distribution and equity profiles.

More specifically, between 2000 and 2003, about 194 000 jobs were created in the Western Cape at a rate of 4,0 per cent per annum. This has seen the Province raise its share of national employment from 13 per cent to 15 per cent.

Unfortunately, although employment growth has been above the national average, unemployment has also expanded at an even more rapid rate. The Province is now home to 7,4 per cent of the country's broadly unemployed. Within the Western Cape, broad unemployment has risen from 22,6 per cent in 2000 to 26,1 per cent in 2003.

Of key concern is the lower level of employment and higher share of unemployment among Africans, women and most acutely, the youth.

More specifically, Africans do not enjoy the same level of access to employment opportunities enjoyed by Coloureds and especially Whites in the Province, and around 43 per cent of African labour force members are unemployed. This is mainly due to historical reasons that relate both to the relatively lower education levels of Africans in the Province and the Coloured domination of agricultural employment.

Women also appear to find it more difficult than men to secure employment, as men fill more than half of all jobs (54,4%) in the Province, but constitute only 46,8 per cent of the unemployed.

Most alarming, though, is the dominance of young people aged between 16 and 25 years among the unemployed. Their employment share stands at a mere 17 per cent, whilst accounting for 46 per cent of the unemployed. These trends contribute to higher unemployment rates of around 49 per cent among the youth – a more acute picture than national trends, pointing to the structural nature of youth unemployment in the Province.

The marginalisation of the youth is of further concern as they are not able to use the skills they have, leading to an erosion of such skills and preventing a transfer of knowledge and experience from older workers through employment.

A further concern relates to high unemployment amongst those that have not completed their secondary education.

In this respect, the long-term trend in the South African and Provincial economy has been one of a bias towards high-skilled employment and against low-skilled employment. About 22 per cent of Western Cape employment is in high-skilled occupations, 46 per cent in skilled occupations and 32 per cent in low-skilled occupations.

Between 2000 and 2003, most of the growth in Provincial employment – two-thirds of 194 000 jobs – accrued to those with matriculation certificates, whilst unemployment rates are lowest amongst those with the highest educational levels.

Since an individual's level of education is a key determinant of the individual's occupation and therefore skills classification and attendant remuneration level, these trends highlight the importance of improving throughput in the schooling system, particularly from grade 10 to 12, and upgrading skills across the spectrum, specifically for lower skilled labour. Strategies to address unemployment concerns, however, should keep in mind the spatial aspects of economic and population concentrations. Its two-thirds share of Provincial employment illustrates the City of Cape Town's urban and economic dominance. Yet the City is also home to 71 per cent of the Province's unemployed.

This means that graphically, unemployment is concentrated in the City of Cape Town, the Boland and Eden regions, although the Central Karoo suffers from the *highest unemployment rate* (although *lower numbers of unemployed* people), raising the importance of spatial planning tools, such as the National Spatial Development Perspective (NSDP) and the Provincial Spatial Development Framework (PSDF) in addressing conflicting unemployment concerns.

Turning to remuneration patterns, there appears to have been little change in the distribution of formal sector workers across remuneration categories since 2000, with traditional patterns of racial dominance – White formal workers are significantly better off than their Coloured counterparts, who in turn are better off than their African counterparts.

There is however, positive remuneration change amongst Africans employed in the formal sector, possible due to the extension of minimum wage legislation and improvements in remuneration for Whites mainly related to increases in respect of high-skilled occupations.

Entrenched patterns point to the indelible mark decades of discrimination and unequal access to educational and employment opportunities have left on the remuneration structure of formal sector employment, and, in fact, on formal employment performance itself, across race groups.

We must improve the Western Cape's ability to create more jobs and absorb new entrants into the labour market. Rising unemployment, particularly amongst the youth, is the single biggest risk to the Province's goal of shared growth and development. We also need to alter the racial profile of the labour force in respect of skill and remuneration distribution.

The answer lies predominantly in upgrading skills across the spectrum and enhancing economic stimulation, improving economic participation and therefore labour market performance over the medium to long term.

Expressed more technically, over the medium term we need to reach, and improve on, our target Provincial employment growth rate – that is, the rate at which employment growth would absorb all new job seekers onto the market.

1.4 Chapter 5 – Equity and Development Scenarios

Equity and development are powerful concepts. Understanding how equity is measured, the factors that drive changing distributions, and those public interventions that enhance such, is critical for understanding the dynamics of a shared growth and development path.

The challenge is particularly true for South Africa where inequality is particularly stark – the richest one tenth of the South African population enjoy consumption per person of almost 70 times that of the poorest one tenth. The picture is alarmingly similar at provincial and local level.

It is clear that recent economic gains have not been equitably spread and have not made significant inroads into poverty for communities.

It is now commonly agreed that economic growth is necessary to reduce poverty. But equity concerns are also a critical factor. That is, improving distribution and enhancing growth should reinforce each other, having a greater impact on poverty reduction.

Equity can be decomposed in respect of income, assets and spatial or geographical location. Looking at income inequality, we see that both South Africa and the Western Cape have high and rising levels of inequality, measured by a rise in the respective Gini coefficients from 0,64 to 0,68 and 0,584 to 0,616. Data accuracy and credibility mean that the absolute number should not hold focus; rather the *high level* and *rising trend* are important here.

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Looking at Census data and combining income and access to basic and social services data shows that it is the poorest who have experienced the greatest gains in terms of service delivery improvements in the Province.

Spatial inequality is the third dimension. It is a key aspect of inequality profiling and throws into stark relief the confluence of other elements of income and asset inequality.

Most commonly understood in respect of demographic and human settlement patterns and linked to income and asset distributions, we see that the Western Cape is highly urbanised at 90 per cent. However, percentages of people in rural areas vary over the various districts: 35 per cent in the Overberg district, 33 per cent in Eden, 35 per cent in the West Coast, 19,9 per cent in the Boland and 33 per cent in the Central Karoo district.

In respect of the built environment, the majority of South African towns and cities are essentially a system of settlements, consisting of a 'White' core, which contains the economic centre and most social services, surrounded by a number of disparate, racially discrete, dormitory areas or locations of considerable size.

These settlement patterns are the extraordinary spatial legacy of *apartheid*, and extremely difficult to change, requiring considerable public spatial planning and intervention in the line of the NSDP and the PSDF.

Moving on, we see that there is an inextricable relationship between equity and inequalities in respect of income, assets and spatial or geographic location and poverty – the causal direction of which is intertwined.

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Groups of concern are Coloureds and Africans. Even at the extremely low level of R174 per capita per month, 17 per cent of Africans in the Western Cape were poor in 2000. At the same level, eight per cent of Coloureds were said to be poor. At the R322 per capita per month level, an alarmingly high 48 per cent of Africans were poor in 1995, rising to 53 per cent in 2000. At this, level, one in three Coloureds were poor in 1995; this drops to one in four in 2000, although at such levels this trend remain a concern.

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The results are stark in absolute value and in terms of trend movements. Between 1990 and 2003, the Western Cape's HDI fell from 0,7869 to 0,7708.

Similar results may be obtained from the South African Cities Network poverty index and the Provincial poverty index recently developed by the Western Cape Social Services and Poverty Alleviation Department.

The end result – there is a clear symbiotic relationship between equity and development goals.

The ideal would be to model and target Provincial equity distributions. But modelling (income) distributions at the provincial level is almost impossible and has many pitfalls. So too does pursuing a Gini coefficient target.

The focus should fall on mapping and targeting poverty and inequality in respect of a positive dimension that focuses on adequacy considerations, such as the number (not proportion) of people with an income above a certain level. This may be done for asset poverty and inequality, and spatial poverty and inequality, providing more concrete goals for policy interventions over the medium to long term.

2. Value & Contribution of the 2005 PER&O

As we stand back then and evaluate the main messages emanating from the 2005 PER&O, we see that the latter is a socio-economic compendium reflecting an analytical journey that has been exhausting yet empowering. We now have emerging answers in one form or another to many of the questions raised in respect of the Western Cape's socio-economic environment and development challenges. Equally, the PER&O analyses have elicited yet further questions and debate. The latter, however, sparks a positive and creative energy that the Province welcomes and encourages.

Debate that is dynamic in character builds on an analytical foundation to ask further questions and seek innovative solutions. It continues probing the rigour of alternatives proposed and refines and tempers the skill of the players.

What is notable is that all players involved are committed to achieving the best in terms of the end goal; that is, shared growth and development for all in the Western Cape.

3. iKapa Elihlumyao – towards Shared Growth and Development

As said before, our response is embodied within *iKapa Elihlumayo* – the Province's shared growth and development strategy. Its beauty and value lie in its simultaneous connectivity and uniqueness as a shared development approach. Its distinctive appeal builds

partnerships and dialogues across society – uniting business, investors, government, workers and communities through a social contract that commits all to work together for a ‘Home for All’.

Having moved beyond the discourse of pro-growth and pro-poor orientations, *iKapa Elihlumayo’s* approach and stance promote sharing growth and development in the Western Cape. In so doing, it endorses a strategy and policy-mix that views poverty reduction and economic growth as being interdependent goals over the medium to long term.

Higher levels of economic growth are the most powerful of tools to reduce poverty over the medium to long term. But greater impact on poverty depends on high levels of equity. Equally, improving the long-term growth potential of an economy in turn depends on a more equitable distribution of income, capabilities and geographic location of communities and economic activity that ‘shares’ the benefits of growth. This ‘sharing’ of economic yields enhances social and economic participation, which in turn feeds back into raising the economy’s long-term growth potential.

Shared growth and development therefore describes a strategy and policy mix that has a ‘win-win’ orientation over the medium to long term.

Many query whether the definition matters. The 2005 PER&O suggests an affirmative answer in this respect. Pro-poor growth is growth that is good for the poor. Under the relative definition, growth is pro-poor if the incomes of poorer people grow faster than those of the population as a whole, leading to lower levels of income inequality. Under the absolute definition, growth is considered pro-poor if, and only if, poor people benefit in absolute terms according to a pre-defined measure of poverty.

Pro-poor growth policies have contributed to national and sub-national (regional) public expenditure strategies that emphasise poverty reduction and social expenditures in a sharpened focus on poverty and human development. The latter is best defined in the Millennium Development Goals, which provided an international benchmark for compared development performance.

However, pro-poor growth strategies risk ignoring the overall economic performance and fortunes of those that are not poor. Yet, without enhanced levels of economic growth, poverty cannot be reduced. Improving growth levels is therefore a *necessary*, but not yet *sufficient*, condition for advancing development gains.

Pro-growth strategies are those that tend to ignore the needs of the poor, creaming off economic rents for the better-off in society and ignoring the development needs and challenges of low-income and poor communities. This creates a development chasm that strips away gains, contributing to a long-term slide in development opportunities for the poor and wealthy alike.

The fates of the poor and the wealthy are therefore intertwined over the long term. This means that the only credible option is to find *unity in our diversity* and work together towards a shared growth and development path over the medium to long term.

But as always, simplicity has its origins in complexity. In this sense, the detail of the eight *iKapa Elihumayo* lead strategies is now emerging. Almost all of the strategies have completed their initial analytical phase and will be ready to table proposals in June 2005.

The 2005 PER&O tries to provide an overarching frame of reference that may be used to assess the interfacing of the lead strategies. In particular, it is important to examine whether the lead strategies' design and sequencing are compatible, that is, whether they 'talk' to each other, deriving synergies in an interdependent way, and, whether they are targeting common goals for shared growth and development under the rubric of *iKapa Elihlumayo*.

As the strategies begin to engage, the 2005 PER&O may be used to facilitate common reference points and parameters for all, synthesising both debate and interaction towards a common goal – that of shared growth and development in the Western Cape.

This goal is shared at the conceptual level by the eight lead strategies. Practically, however, each has to date focused on its own detail and does not as yet effectively interface with the other strategies.

We therefore need a linking and/or organising tool that will help to merge conceptual and practical understanding of shared growth and development in the Province.

Development indicator frameworks have proven very successful in this regard, creating structure and schematic organisation that provides direction and purpose in a logical manner.

Taking the 2005 PER&O a step further could therefore see the development of an *iKapa Elihlumyo* indicator framework. The latter would identify, formulate, target and monitor progress towards an agreed set of indicators that describes a state of shared growth and development in the Province.

For instance, initial brainstorming suggests that an indicator framework might target the following objectives through initial proposed measures as follows:

- Improving human development status and potential measured in terms of an HDI, targeting an X% improved to Y by year Z. This may be extended to target specific income, asset and spatial inequality and poverty indicators that focus on adequacy considerations, assessing whether trends over time reflect better access to the economy.

- Enhancing Provincial economic growth by increasing growth in real GDP per annum towards a target rate of X % by year Y.
- Advancing broad-based Provincial economic participation measured in respect of targets for BEE employment, procurement contracts, SMME owners & turnover.
- Increasing Provincial employment by X jobs a year, or reducing Provincial unemployment by X% to Y% by year Z.
- Reducing transaction & input costs of doing business in the Province, especially for SMMEs measured in terms of reducing regulation & compliance costs by X% by year Y.
- Improving the growth & employment performance of tertiary, secondary and primary economic sectors, as well as their intergration and restructuring towards the global economy, measured in terms of increased annual take-up of national, provincial or local sector incentives to X% by Y year.
- Strengthening social inclusion & cohesion (social capital) measured in terms of increasing voter participation in local and/ or Provincial elections to X% by Y year.
- Enhancing environmental & resource sustainability measured in respect of reducing Provincial fuel consumption, or carbon emissions by X% to Y level by year Z.

Equally, an attendant risk framework might target the following risks or gambles:

- Limited urban restructuring, which serves to entrench existing apartheid spatial legacies;
- Reduced biodiversity, particularly in relation to water and energy.
- Increased competition in respect of land use strategies and management.
- Narrow skills development, decreasing the Provincial skill base in the face of expanding labour supply.
- Separation and impoverishment of the second economy due to diminished links with the first economy

These are just suggestions for a framework and do not as yet constitute a comprehensive indicator framework. The latter would need to be developed over the next year over the next three to five months and to be incorporated into our nascent monitoring and evaluation framework. They do, however, get us thinking and planning as to the thematic focus and structure of the 2006 PER&O.

4. On to PER&O 2006

As always, the first step starts a journey. The 2005 PER&O builds on the 2003 Socio-Economic Review and takes it a significant step further. The scope, depth and rigor of analyses poses further analytical challenges and questions that demand investigation as we move to strengthen the Province's economic capacity and analytical base.

Developing an indicator framework with which to frame *iKapa Elihlumayo* is just one thought. Others emerge from a range of unanswered questions that arise from the 2005 PER&O detailed analyses.

More specifically, the Western Cape's development of a provincial economic outlook – a first among the provinces – uses macroeconomic parameters and techniques and applies these to the provincial economy. This allows us to describe the Western Cape economic as a distinct entity within the broader South African economy through analyzing key provincial economic variables and proposing credible trend forecasts for the coming MTEF period.

However, as Statistics South Africa has only released official data on regional GDP or GDPR since 2002, there are insufficient historical data to ensure robust provincial econometric forecasts in respect of GDPR. The macroeconomic outlook of chapter 2 is therefore based on 'soft' initial macroeconomic forecasts. These forecasts will be strengthened over the next couple of years as the Province develops its own provincial macroeconomic model and builds capacity to undertake credible, robust econometric trend and forecasting analysis.

Taking a closer look at the sectoral level, further work on the Microeconomic Development Strategy will expand the present scope to include, amongst others, call centers & business process outsourcing, the film industry, oil and gas exploration, biotechnology, furniture; cultural industries; crafts & jewelry as well as cross-cutting sectors like transport, energy, and R&D.

Sectoral reviews should be matched by overarching analysis that examines generic and sector-specific enablers and constraints to growth and employment, in particular picking up on provincial-level levers and bottlenecks. It would also be interesting to see whether, data permitting, sectoral analysis could also extend to growth and employment sensitivity analysis that facilitates testing of different policy and environment scenarios.

At a more academic level, supporting analysis will take a closer look at Provincial sectoral growth and employment performance in respect of endogenous growth sources. Disaggregated to magisterial district level, this analysis will aid in providing a critical link between local and provincial economic performance. The latter will become increasingly important as the Province assumes oversight responsibilities in respect of municipal level

economic analysis contained in local integrated development plans (IDPs) under the ambit of the Municipal Finance Management Act (MFMA), 2003.

Contradictory informal sector employment trends using different data source point to the urgency of more detailed analysis, even survey work, on the Western Cape's informal sector. This is a priority given worrying employment trends and prospects in the face of increasing labour surplus in the Province's economy.

Turning to equity concerns, provincial demographic and income distribution modeling analysis hold considerable, if daunting appeal. The former is already underway, but the latter poses considerable challenge given migration movements across porous provincial borders.

Despite such, the exercise does have merit, if not for Gini coefficient targeting (the risks of which are highlighted in chapter 5), then for forecasting derived demand for Provincial services, in particular, health, education and housing. The latter would be extremely beneficial for medium- to long-term planning and budgeting for Provincial service delivery.

Modeling and targeting Provincial equity distributions requires a different tack. As noted, above, recent proposals suggest that we should focus on mapping and targeting poverty and inequality in respect of a positive dimension that focuses on adequacy considerations, such as the number (not proportion) of people with an income above a certain level. This may be done for asset poverty & inequality and spatial poverty & inequality, providing more concrete goals for policy interventions over the medium to long term.

Each of these analytical areas poses exciting and challenging promise for extending and deepening the Western Cape's analytical economic base and capacity over the next few years.

Onto the 2006 PER&O....

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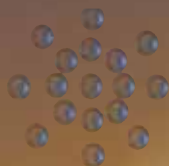
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