Provincial Government Western Cape
Provincial Treasury

PROVINCIAL ECONOMIC REVIEW & OUTLOOK
2007
Foreword

We present the 2007 Provincial Economic Review & Outlook (PER&O) as the fourth edition in the Western Cape’s series of provincial socio-economic reviews.

Focused on the strategic thrust of ‘Moving towards shared growth and integrated development in the Western Cape’, this year’s PER&O consolidates the research and analyses undertaken in the previous reviews as well as underpinning the Provincial Growth and Development Strategy (PGDS) and deepening the associated provincial policy debate.

The PGDS process and debate is happening amidst a broader national review of the appropriate governance model for provincial and local government that will best achieve higher levels of economic growth and social inclusion in SA over the medium- to longer term.

The fluid environment that we currently find ourselves in makes policy, strategy and budgetary decision-making at the provincial level complex. However, the business of governing must go on even at a time that government is reviewing its mode of governing itself.

As we initiate our journey of implementing the iKapa Elihlumayo lead strategies and interventions set out in the PGDS, we must continually examine our policy and implementation successes and failures. This is where an effective monitoring and evaluation system based on a credible provincial socio-economic analytical and information base, such as the PER&O, comes into play.

This part of the journey is not easy. It demands a sense of self-examination and realism in governing. Yet it is a critical step if we are intent on making a real difference in people’s lives throughout the Province.

Led by the Proovincial Treasury’s Economic Analysis (EA) unit, the 2007 PER&O is a team effort that draws on the knowledge, expertise and commitment of those in the broader academic community, Provincial Treasury and our partners in Provincial Government and local government.

I would like to give a special word of thanks to the core project management and research team. Provincial Treasury’s Shirley Robinson and Bulelwa Boqwana led the 2007 PER&O, supported by Wilbur van Niekerk, Mike Meyer and Russell Miller of TEMO Consulting as the project management and language editing team. 

Chapter 2: Economic Outlook: 2007/08 – 2009/10 was co-authored by Pieter Laubscher of the Bureau for Economic Research (BER) at the University of Stellenbosch and Wendy Mapira of Provincial Treasury’s EA team.

Cecilia Punt of the Western Cape Department of Agriculture authored Chapter 3: Economic modelling and regional impact analysis.
Jo Lorentzen of the Human Science Research Council (HSRC) wrote Chapter 4: Regional innovation and growth.

Chapter 5: Employment dynamics is the work of Provincial Treasury’s Esther Mohube and Mandla Gilimani.

Chapter 6: SMMEs and the informal sector was co-authored by Morné Oosthuizen and Liberty Mncube of the Development Policy Research Unit (DPRU) at the University of Cape Town.

Bulelwa Boqwana, Hassan Essop and Ashley Rasool of Provincial Treasury’s EA team revisit the high-level findings of the Socio-Economic Profiles of Local Government (SEP-LG) 2006 in Chapter 7: Socio-economic profiling of local government: An update.

An extensive team of external reviewers gave comment and critical insight into this year’s edition as well as making recommendations that may be taken into account in planning the research programme for the PER&O 2008. Our thanks in this regard go to David Kaplan, Graduate School of Business, University of Cape Town; Colin McCarthy, School of Economics, University of Stellenbosch; Wolfgang Thomas, independent consultant; Dirk Troskie, Western Cape Department of Agriculture; Carin Fouchè and Riefqah Jappie, Wesgro; Nigel Gwynne-Evans, Western Cape Department of Economic Development and Tourism; Nick Vink, Department of Agricultural Economics, University of Stellenbosch; Helena Barnard, Gordon Institute of Business Science, University of Pretoria, Debbie Budlender, Centre for Social Enquiry (Case); Caroline Skinner, School of Development Studies, University of Kwazulu-Natal, Durban; Carol White, Ross Harvey and Craig Haskins, City of Cape Town; Sigamoney Naicker and Fiona Lewis, Western Cape Department of Education and Faruz Dharsey, Western Cape Department of Local Government and Housing.

I wish to thank the entire team for the 2007 PER&O that engages an audience that over the past four years has matured and advanced in its debate on provincial socio-economic analyses.

This year’s edition marks an important consolidation of the work to date. Over the next year we will undertake an in-depth evaluation aimed at broadening debate on the role, scope and positioning of the PER&O so that future editions best support evidenced-based policy and decision making in the Province over the next few years.

Lynne Brown
Minister of Finance and Tourism
July 2007
Contents

Foreword

Chapter 1: Executive Summary
1. Moving ahead on shared growth and integrated development 1
2. 2007 Provincial Economic Review and Outlook (PER&O) 6
3. Western Cape’s economic outlook: 2007/08 – 2009/10 8
   3.1 Trends in the SA economy 8
   3.2 The Western Cape economy 10
4. Economic modelling and regional impact analysis 13
   4.1 Strategic micro and macro modelling 14
   4.2 General equilibrium analysis for the Western Cape 16
   4.3 The PROVIDE project SAMs and models 17
   4.4 Future initiatives 18
5. Regional innovation and growth 19
   5.1 A regional innovation system in the Western Cape 19
   5.2 Broad overview of sector development in the Western Cape 21
   5.3 Key sector performance: evidence from the MEDS 23
6. Employment dynamics 24
7. SMMEs and the informal sector 27
8. Socio-economic profiling of local government: An update 30
   8.1 The inter-relation of socio-economic findings 30
   8.2 Economic infrastructure 32
   8.3 Economic performance 33

1. Introduction

2. Trends in the South African economy
   2.1 Recent developments
   2.2 Global economic developments
   2.3 Business cycle prospects
   2.4 Towards more balanced domestic economic growth
   2.5 Short-term inflation and interest rate outlook
   2.6 Fixed investment and employment creation to drive growth

3. The Western Cape economy
   3.1 Introduction: recent developments
   3.2 The struggling manufacturing sector
   3.3 Trends in the sectoral pattern of GDPR growth
   3.4 Employment creation may have turned the corner
   3.5 Reviving export growth a key regional economic challenge
   3.6 Robust fixed investment spending
   3.7 Trends in direct investment into the Western Cape
      3.7.1 FDI trends in SA
      3.7.2 Direct investment trends in the Western Cape
      3.7.3 Sources of Western Cape direct investment
      3.7.4 Direct investment within the Western Cape
      3.7.5 Outlook

4. Outlook for the Western Cape economy: 2007/08 – 2009/10
Chapter 3: Economic Modelling and Regional Impact Analysis

1. Introduction 73
2. Explaining general equilibrium and related concepts 74
   2.1 Models and data 74
   2.2 General equilibrium or impact analysis modelling exercises 77
3. Strategic micro and macro modelling 78
4. General equilibrium analysis for the Western Cape 82
5. General equilibrium analysis for SA 84
   5.1 The PROVIDE project SAMs and models 84
   5.2 PROVIDE Project case studies 86
6. General equilibrium analysis and regional economic development 91
   6.1 International application of CGE analysis 92
7. Future initiatives 94
8. Summary and conclusion 95

Chapter 4: Regional Innovation and Growth

1. Introduction 99
2. The contemporary growth and development conundrum 99
   2.1 A regional innovation system in the Western Cape: Why bother? 102
      2.1.1 Innovation in the Western Cape 103
   2.2 Government policy and university-industry linkages (UILs) 109
   2.3 Broad overview of sector development 111
      2.3.1 Output growth 111
      2.3.2 Employment growth 112
   2.4 A detailed look at manufacturing 113
      2.4.1 Manufacturing output 113
      2.4.2 Manufacturing employment 114
      2.4.3 Manufacturing investment 115
      2.4.4 Manufacturing trade relative to total trade 116
2.5  A detailed look at services  
   2.5.1  Service sector output  
   2.5.2  Service sector employment  
   2.5.3  Service sector investment  
   2.5.4  Service sector exports  
2.6  Key sector performance: evidence from the MEDS  
   2.6.1  Boatbuilding  
   2.6.2  Food processing  
   2.6.3  Chemicals  
   2.6.4  Construction  
   2.6.5  Informal economy  
   2.6.6  Printing and publishing  
   2.6.7  Wholesale, retail, and franchising  
   2.6.8  Prioritisation  
   2.6.9  The 4th round of the MEDS: late 2007  
3.  Conclusion  

Chapter 5: Employment Dynamics  
1.  Introduction  
2.  The Western Cape labour market  
   2.1  Recent employment and unemployment trends  
   2.2  Provincial employment growth in demographic context  
   2.3  Labour force participation rates, 2000 and 2005  
   2.4  Composition of the Western Cape labour force, 2000 and 2005  
3.  Employment  
4.  Unemployment
Chapter 6: Small, Medium and Micro Enterprises and the Informal Sector

1. Introduction 153
2. SMMEs and the informal sector 153
   2.1 Descriptive overview of informal and small business sectors 153
   2.2 The informal sector in the Western Cape 154
      2.2.1 The informal sector in the Western Cape 154
   2.3 The small business sector in the Western Cape 160
   2.4 Constraints Facing the SMME and Informal Sectors 163
      2.4.1 Access to financial services 165
      2.4.2 Access to skills training 167
      2.4.3 Access to infrastructural and other services 168
      2.4.4 The regulatory environment 169
      2.4.5 Other constraints 170
   2.5 Constraints to self-employment in the Western Cape 171
3. Conclusion 173

Chapter 7: Socio-economic Profiling of Local Government: An Update

1. Introduction 177
2. The inter-relation of socio-economic findings 178
   2.1 Health indicators and access to health services 179
   2.2 Access to education and the employment link 180
3. Economic infrastructure 181
   3.1 Transport infrastructure 182
   3.2 Water 184
   3.3 Energy 184
   3.4 Housing 185
4. Economic performance 186
5. Municipal sustainability 188
6. Fiscal landscape and financial sustainability 189
   6.1 Municipal revenue sources 190
      6.1.1 Intergovernmental transfers 190
      6.1.2 Own revenue 191
      6.1.3 Borrowing 192
   6.2 Financial sustainability 194
      6.2.1 Municipal assessments 194
7. Responding to socio-economic challenges 196
8. Information management 196
9. Resource allocation 197
10. Conclusion 197

References 199
Tables

Chapter 1: Executive Summary
Table 1: Macro-economic outlook for SA 2007 to 2010 10
Table 2: Outlook for the Western Cape economy: 2007/08 – 2009/10 (%) 12
Table 3: Labour Market Aggregates, 2000 and 2005 25
Table 4: Social indicators by district 31
Table 5: City and district GDPR contribution, 2004 33

Table 1: Macro-economic outlook for SA: 2007 to 2010 53
Table 2: Real GDPR growth of the Western Cape economy: 2000 — 2005 58
Table 3: Western Cape real manufacturing export growth: 1995 to 2002 versus 2003 to 2005 60
Table 4: Composition of Western Cape exports: 2006 (constant 2000 prices) 61
Table 5: Top – 10 Sub-sectors of Direct Investment, 2006/07 66
Table 6: Direct Investment trends by Western Cape district 67
Table 7: Outlook for the Western Cape economy: 2007/08 – 2009/10 (%) 69

Chapter 3: Economic Modelling and Regional Impact Analysis
Table 1: Economic models and associated databases 75
Table 2: Increase in household income and labour payments as a result of productivity increase in agriculture (%) 81

Chapter 4: Regional Innovation and Growth
Table 1: Weighted specialisation indices for productive and knowledge-based activities, 2004 105
Table 2: Correspondences between specialisation indices 107
Chapter 5: Employment Dynamics

Table 1: Labour market aggregates, 2000 and 2005 134
Table 2: Main reason for not looking for work among discouraged workseekers, September 2005 135
Table 3: Composition of the Western Cape labour force, 2000 and 2005 141
Table 4: Composition of Western Cape employment, 2000 and 2005 142
Table 5: Sectoral distribution of Western Cape employment, 2000 and 2005 145
Table 6: Occupational structure of Western Cape employment, 2000 and 2005 146
Table 7: Broad unemployment rates in the Western Cape, 2000 and 2005 147
Table 8: Composition of Western Cape broad unemployment, 2000 and 2005 148

Chapter 6: Small, Medium and Micro Enterprises and the Informal Sector

Table 1: Formal and informal sector employment, 2000 and 2005 155
Table 2: Educational attainment of the employed, by sector excluding agricultural workers, Western Cape, 2005 159
Table 3: Employment by enterprise size and race, Western Cape, 2005 162

Chapter 7: Socio-economic Profiling of Local Government: An Update

Table 1: Social indicators by district, 2005 179
Table 2: Estimated housing backlogs, 2007 185
Table 3: Subsidised low-cost dwelling-houses completed by Province: 2005/06 186
Table 4: City and district GDPR contribution, 2004 186
Table 5: Selected regional growth rates, 1995 — 2004 187
Table 6: City and district sectoral contributions to Western Cape GDPR, 2004 188
Table 7: Budget size by province and municipality category, 2005/06 190
Table 8: Western Cape project consolidate municipalities, 2007 195
Figures

Chapter 1: Executive Summary

Figure 1: Sectoral contribution to Western Cape output, 2005  22


Figure 1: Imports and exports as a ratio of GDP  46
Figure 2: Manufacturing production capacity utilisation  49
Figure 3: Formal non-agricultural employment  50
Figure 4: Sectoral composition of Western Cape GDPR, 2005 (%)  54
Figure 5: Manufacturing business confidence  56
Figure 6: Western Cape real GDPR growth by sector: 2000 – 2005  57
Figure 7: Western Cape formal sector employment growth: 2000 – 2005  59
Figure 8: Western Cape real fixed investment growth by broad sector: 2000 – 2005  63

Chapter 3: Economic Modelling and Regional Impact Analysis

Figure 1: Change in welfare of Western Cape households as result of the introduction of a property rate on agricultural land  84
Figure 2: Changes in government revenue and expenditure following an increase in import tariffs on wheat  88
Figure 3: Changes in incomes of labour in the Western Cape for a 10% increase in international wine prices  90
Chapter 4: Regional Innovation and Growth

Figure 1: Sectoral contribution to Western Cape output, 2005  
Figure 2: Sectoral contribution to Western Cape employment, 2005  
Figure 3: Sub-sectoral contribution to manufacturing value added in the Western Cape, 2005  
Figure 4: Manufacturing employment in the Western Cape, 1995 – 2005  
Figure 5: Gross Provincial Fixed Investment in the Western Cape, 1995 – 2006  
Figure 6: Western Cape exports by sector, 1995 – 2006  
Figure 7: Western Cape trade balances by manufacturing sub-sector, 1995 – 2006  
Figure 8: Western Cape value added in services, 1995 – 2005  
Figure 9: Western Cape service sector employment, 1995 – 2005  
Figure 10: Western Cape gross provincial fixed investment in services, 1995 – 2006  
Figure 11: Western Cape service sector exports, 1995 – 2006

Chapter 5: Employment Dynamics

Figure 1: Employment target growth rates and employment absorption rates, 2000 and 2005  
Figure 2: Employment rates by demographic characteristics, 2000 and 2005  
Figure 3: Broad labour force participation rates, 2000 and 2005  
Figure 4: Time since last worked, expanded unemployed, 2005
Chapter 6: Small, Medium and Micro Enterprises and the Informal Sector

<table>
<thead>
<tr>
<th>Figure</th>
<th>Description</th>
<th>Page</th>
</tr>
</thead>
<tbody>
<tr>
<td>Figure 1</td>
<td>Characteristics of formal, informal and domestic work employment, excluding agricultural Sector, Western Cape, 2005</td>
<td>156</td>
</tr>
<tr>
<td>Figure 2</td>
<td>Cumulative distribution of formal and informal non-agricultural employment across income, 2005</td>
<td>158</td>
</tr>
<tr>
<td>Figure 3</td>
<td>Sectoral distribution of non-agricultural informal sector employment, 2005</td>
<td>160</td>
</tr>
<tr>
<td>Figure 4</td>
<td>Employment by enterprise size and sector, Western Cape, 2005</td>
<td>161</td>
</tr>
<tr>
<td>Figure 5</td>
<td>Employment by enterprise size and industrial sector, Western Cape, 2005</td>
<td>163</td>
</tr>
<tr>
<td>Figure 6</td>
<td>Perceived obstacles to business by firms in SA, 2004</td>
<td>166</td>
</tr>
</tbody>
</table>

Chapter 7: Socio-economic Profiling of Local Government: An Update

<table>
<thead>
<tr>
<th>Figure</th>
<th>Description</th>
<th>Page</th>
</tr>
</thead>
<tbody>
<tr>
<td>Figure 1</td>
<td>Provincial roads projects: 2006 – 2009</td>
<td>183</td>
</tr>
</tbody>
</table>
## Abbreviations

<table>
<thead>
<tr>
<th>Abbreviation</th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td>ABET</td>
<td>Adult basic education and training</td>
</tr>
<tr>
<td>ACSA</td>
<td>Airports Company of SA</td>
</tr>
<tr>
<td>ARC</td>
<td>Agricultural Research Council</td>
</tr>
<tr>
<td>AsgiSA</td>
<td>Accelerated and Shared Growth Initiative for South Africa</td>
</tr>
<tr>
<td>BEE</td>
<td>Black Economic Empowerment</td>
</tr>
<tr>
<td>BER</td>
<td>Bureau for Economic Research</td>
</tr>
<tr>
<td>BFAP</td>
<td>Bureau for Food and Agricultural Policy</td>
</tr>
<tr>
<td>BOP</td>
<td>Balance Of Payments</td>
</tr>
<tr>
<td>BPO</td>
<td>Business Process Outsourcing</td>
</tr>
<tr>
<td>Bric</td>
<td>Brazil, Russia, India and China</td>
</tr>
<tr>
<td>BRIC</td>
<td>Biotechnology Regional Innovations Centre</td>
</tr>
<tr>
<td>CBTI</td>
<td>Cape Town Boatbuilding and Technology Initiative</td>
</tr>
<tr>
<td>CETA</td>
<td>Construction Education and Training Authority</td>
</tr>
<tr>
<td>CGE</td>
<td>Computable general equilibrium</td>
</tr>
<tr>
<td>CPI</td>
<td>Consumer Price Index</td>
</tr>
<tr>
<td>CPIX</td>
<td>Consumer Price Index (excluding mortgage interest rates)</td>
</tr>
<tr>
<td>CS</td>
<td>Community Survey (Statistics South Africa)</td>
</tr>
<tr>
<td>CsGi</td>
<td>Cape Shared Growth Initiative</td>
</tr>
<tr>
<td>CSIR</td>
<td>Council for Scientific and Industrial Research</td>
</tr>
<tr>
<td>CSP</td>
<td>Community, social and other personal services</td>
</tr>
<tr>
<td>CTFR</td>
<td>Cape Town Functional Region</td>
</tr>
<tr>
<td>DBSA</td>
<td>Development Bank of Southern Africa</td>
</tr>
<tr>
<td>DEDT</td>
<td>Department of Economic Development and Tourism</td>
</tr>
<tr>
<td>DST</td>
<td>Department of Science and Technology (South Africa)</td>
</tr>
<tr>
<td>EA</td>
<td>Economic Analysis Unit</td>
</tr>
<tr>
<td>EAP</td>
<td>Economic Active Population</td>
</tr>
<tr>
<td>EAR</td>
<td>Employment Absorption Rate</td>
</tr>
<tr>
<td>ECB</td>
<td>European Central Bank</td>
</tr>
<tr>
<td>ECD</td>
<td>Early Childhood Development</td>
</tr>
<tr>
<td>EDI</td>
<td>Electricity Distribution Industry</td>
</tr>
<tr>
<td>EIU</td>
<td>Economist Intelligence Unit</td>
</tr>
<tr>
<td>EMIS</td>
<td>Education Management Information System</td>
</tr>
<tr>
<td>EPWP</td>
<td>Expanded Public Works Programme</td>
</tr>
<tr>
<td>EU</td>
<td>European Union</td>
</tr>
<tr>
<td>FDI</td>
<td>Foreign Direct Investment</td>
</tr>
<tr>
<td>FET</td>
<td>Further Education and Training</td>
</tr>
</tbody>
</table>
FIFA  Fédération Internationale de Footbal Association
FTA  Free Trade Agreement
GAMS  General Algebraic Modelling System
GDE  Gross Domestic Expenditure
GDFI  Gross Domestic Fixed Investment
GDP  Gross Domestic Product
GDPR  Regional Gross Domestic Product
GET  General Education and Training
GGP  Gross Geographic Product
GHS  General Household Survey (Stats SA)
GVA  Gross Value Added
HACCP  Hazard Analysis and Critical Control Points
HCDS  Human Capital Development Strategy
HDI  Human Development Index (UNDP)
HIV/AIDS  Human Immunodeficiency Virus/Acquired Immune Deficiency Syndrome
HMIS  Health Management Information System
HS  Harmonised Commodity Description and Coding System
HSRC  Human Sciences Research Council
ICS  Investment Climate Survey
ICT  Information and Communication Technology
IDP  Integrated Development Plan
IES  Income and Expenditure Survey
ILO  International Labour Organisation
IMF  International Monetary Fund
INCA  Infrastructure Finance Corporation Limited
IPSA  Institute of Purchasing and Supply (SA)
ISIC  International Standard Industrial Classification
ISM  Institute of Supply Management (US)
IT  Information Technology
ITAC  International Trade Administration Commission
ITC  International Trade Centre
KMP  Khayelitsha/Mitchell’s Plain Survey
KS-III  Khayelitsha Survey Wave III
LES  Local Government Equitable Share
LFPR  Labour Force Participation Rate
LFS  Labour Force Survey (Stats SA)
LRA  Labour Relations Act
MEDS  Microeconomic Development Strategy
MERSETA  Manufacturing Sector Education and Training Authority
MICS  Micro-Enterprise Investment Climate Survey
MIDP  Motor Industry Development Programme (South Africa)
MIG  Municipal Infrastructure Grant
MPC  Monetary Policy Committee
<table>
<thead>
<tr>
<th>Acronym</th>
<th>Full Form</th>
</tr>
</thead>
<tbody>
<tr>
<td>SITC</td>
<td>Standard International Trade Classification</td>
</tr>
<tr>
<td>SM3</td>
<td>Strategic Micro and Macro Modelling</td>
</tr>
<tr>
<td>SMME</td>
<td>Small, Medium and Micro Enterprise</td>
</tr>
<tr>
<td>STATS SA</td>
<td>Statistics South Africa</td>
</tr>
<tr>
<td>TB</td>
<td>Tuberculosis</td>
</tr>
<tr>
<td>TGR</td>
<td>Target Growth Rate</td>
</tr>
<tr>
<td>the dti</td>
<td>The Department of Trade and Industry (South Africa)</td>
</tr>
<tr>
<td>TRIPS</td>
<td>Trade-related Intellectual Property Rights</td>
</tr>
<tr>
<td>UCT</td>
<td>University of Cape Town</td>
</tr>
<tr>
<td>UIF</td>
<td>Unemployment Insurance Fund</td>
</tr>
<tr>
<td>UILs</td>
<td>University-industry linkages</td>
</tr>
<tr>
<td>UK</td>
<td>United Kingdom</td>
</tr>
<tr>
<td>UNCTAD</td>
<td>United Nations Conference on Trade and Development</td>
</tr>
<tr>
<td>UNDP</td>
<td>United Nations Development Programme</td>
</tr>
<tr>
<td>UNICEF</td>
<td>United Nations Children’s Fund</td>
</tr>
<tr>
<td>UNIDO</td>
<td>United Nations Industrial Development Organization</td>
</tr>
<tr>
<td>US</td>
<td>United States</td>
</tr>
<tr>
<td>VAT</td>
<td>Value-Added Tax</td>
</tr>
<tr>
<td>WCED</td>
<td>Western Cape Education Department</td>
</tr>
<tr>
<td>WCO</td>
<td>World Customs Organisation</td>
</tr>
<tr>
<td>W&amp;RSETA</td>
<td>Wholesale &amp; Retail SETA</td>
</tr>
<tr>
<td>WTO</td>
<td>World Trade Organisation</td>
</tr>
<tr>
<td>YTD</td>
<td>Year to date</td>
</tr>
</tbody>
</table>
Chapter 1: Executive Summary

1. Moving ahead on shared growth and integrated development

The 2007 Provincial Economic Review and Outlook (PER&O) presents at the pivotal interval of political and economic reflection as Government engages in its mid term review, just over three years after the April 2004 elections.

Recently released, the national Government's Development Indicators Mid-term Review invites the public to assess Government’s progress in meetings its socio-economic and governance commitments to its electorate. A key addition to Government’s toolkit for evidence-based policy and decision-making, the Review points to our considerable successes at the aggregate economic level, suggesting that the AsgiSA targets are well within reach.

However, scrolling through the indicators listed under the themes of ‘poverty and inequality’, ‘household and community assets’, ‘health’, ‘education’ and ‘safety and security’ in particular, raises sharp debate as sluggish progress distances us from broad development targets set for 20141.

Our economy is growing at higher levels than 10 years ago, but it is slow to share the benefits of growth to rich and poor alike. Hence the confirmation at the recent ruling party’s policy conference for a ‘developmental’ state; that is, a state that is more interventionist in its approach than at present in fast tracking economic development and transformation2.

---

1 The Presidency, 2007
2 ANC, 2007 (a)
Drawing lessons from East Asia where significant inroads into poverty were achieved through investments in equity, particular with regard to education and health\(^3\), the SA adaptation demands a particular mix of strategic, organisational and technical capacity that will ensure higher levels of broad-based economic growth and social inclusion.

A key part of the debate centres on the appropriate governance model for provincial and local government that is optimum for leading economic development and service delivery into a third democratic term\(^4\). This examination is valid and compelling, given Government’s imperative to improve both the pace and quality of service delivery if targets are to be achieved.

Unlike many other countries, SA’s mode of decentralisation did not evolve out of socio-economic considerations. Rather, our present intergovernmental system is the outcome of historical factors and a negotiated political settlement in the early 1990s. This does not mean that decentralisation has not borne socio-economic benefits over the past 13 years; rather, that the primary rationale for decentralisation, particularly at the provincial level, was based on political imperatives in the negotiation to democratic transition. Socio-economic considerations were secondary concerns at the time\(^5\).

After more than a decade of practice, the system surely does demand review to examine whether it is necessarily appropriate, even pragmatic in optimising Government’s stated economic growth and social inclusion imperatives and targets for 2014 and beyond.

This is not to say that the system has been static. Rather, the intergovernmental landscape has gained its own dynamism, evolving in response to local needs and circumstances. However, development has been uneven and asymmetric. Kaleidoscopic fragmentation has impeded coordinated and coherent progress and delivery.

Political concerns, usually short-term given five-year electoral cycles, have tended to over-ride longer term development interests. In many instances, they have moved in tangential direction to that demanded by longer-term visions and strategies, and tended not to engage key partnerships required for strategic, focused and coherent governance.

Yes, a review of provincial and local governance arrangements is most certainly on the cards. However, an array of vested interests in what is now deeply contested political terrain makes it difficult to discern succinct and focused solutions that are both credible and acceptable in view of SA’s longer term development challenges.

The fluid environment makes policy, strategy and budgetary decisions highly complex, most particularly at the provincial level. In what manner should a provincial government engage in developing long-term strategic vision, designing appropriate policy interventions, making complementary budgetary decisions and

\(^3\) World Bank, 2006  
\(^4\) ANC, 2007 (b)  
\(^5\) Momoniat, 1999
cohering with local government actions all while appreciating and anticipating significant institutional reform to its powers and functions?

Answers are not self-evident. Nevertheless, the business of governing must carry on even at a time that government reviews its very mode of governance itself.

The Western Cape has charted a unique course in this respect. Its Provincial Growth and Development Strategy (PGDS) – *iKapa Elihlumayo* – is a broad-based strategy aimed towards shifting the Western Cape onto a higher shared growth and integrated development path.

The PGDS is premised on a developmental role of the state that intervenes decisively to shape longer-term strategy based on economic and social inclusion. As such, a shared growth and integrated development approach recognises that environmental, spatial, social and institutional factors are key drivers to the economic development agenda for the Province.

A fundamental aim of *iKapa Elihlumayo* is to reconfigure spatial relations and implement spatial priorities in a manner that transforms the apartheid spatial economy, enhances regional performance, and ensures environmental integrity.

The strategy places particular emphasis on sustainable resource use, given regional environmental imperatives and trends. With the economic base of the Western Cape lying in tourism, agriculture and coast-based economic activities, constraints on the natural resource base, particularly energy and water, will define future economic growth paths.

While the broader SA economy’s fortunes are reliant on rich commodity resources, and associated industries and services, the Western Cape’s robust economic performance has been based on a more diverse array of agriculture, construction, wholesale & retail, financial & business services, niche manufacturing activities as well as property development and tourism. The Province’s unique economic structure calls for a particular blend of industrial policy under the broader national ambit, as proposed under its Microeconomic Development Strategy (MEDS).

While provincial unemployment is lower than the national rate, it has risen sharply over the past five years due to natural population growth and in-migration. Similar to the national picture, unemployment is particularly stark among the youth, contributing to fragmented social capital, and notably increased drug use, gang and criminal activities among young adults. Unemployment rates also continue to be higher among women than men.

Furthermore, structural shifts in the economy have contributed to a deepening mismatch between labour supply at the lower to medium skill levels and labour demand at the higher skill level, heightening the importance of investment in education and training among our youth.

Social stability and social cohesion hence form a key element of the Province’s development strategy. Demographic projections estimate that the coloured population will remain the dominant grouping by 2030 with an increasing proportion of african people and a relative decline in the number of white people living in the Western Cape.
The burden of poverty, unemployment, crime and violence is experienced disproportionately by African and coloured people, women and the youth. These aspects raise the importance of policies of social inclusion and addressing vulnerability as integral to a shared growth and integrated development approach.

Responding to the spatial, environmental, economic and social situational scan is a hierarchy of *iKapa Elithlumayo* lead policies and interventions. At the forefront is integrated transport which is identified as the core action required for shared growth and integrated development. The action is prime in realising urban agglomeration benefits and efficiencies as well as enhancing social mobility and spatial interconnectedness particularly within the City of Cape Town.

Bolstering the above are interventions aimed at unblocking binding constraints to enhanced regional growth and development. Key among these are World Cup 2010; energy and water (including sanitation) infrastructure projects; scarce skills development; and implementing the Western Cape’s Provincial Spatial Development Framework (PSDF) as the spatial lens on future growth and development in the Province.

Further base interventions aimed at underpinning the Province’s shift to a shared growth and integrated development trajectory include sustainable and integrated human settlements; implementation of the Province’s Strategic Infrastructure Plan (SIP) (particular, bulk infrastructure); economic sector support under the MEDS, rollout of the Social Capital Strategy and implementation of the Province’s Human Capital Development Strategy6 (HCDS).

The PGDS is broad and overarching in both form and function. It is ambitious in scope, although the real work lies in its implementation. This is where an effective monitoring and evaluation system based on a credible provincial socio-economic analytical and information base, such as the PER&O, comes into play. Examination of our successes and failures is important, as is engaging in further debate as to possible policy and implementation gaps and what interventions are required to bridge such gaps.

The PGDS therefore shapes and guides more detailed and focused policy discussions and interventions, mainly within the Provincial Government’s sphere of influence. Yet Province is only one player among a much broader team that is required to shift the Western Cape onto a shared growth and integrated development platform.

The PGDS calls for strengthened partnerships across the intergovernmental system and among its social dialogue associates. However, as the PGDS is firmly positioned as the Province’s primary policy framework for engagement, it is not the ideal tool to tailor such collaboration. That said, it supports and encourages collaborative processes that aim to lever resources and capabilities among partners, shaping interventions towards shared goals and targets.

---

6 Province of Western Cape, 2006
A key such initiative is the Cape Town Functional Region (CTFR) project. Recent global and national spatial development debates are emphasising the concept of functional regions as the drivers of economic competitiveness and social equity concerns. Internationally, regions are touted as the key economic space that supports successful cities, and cities as the drivers of flourishing functionally connected regions.

Such is also the thinking behind the latest iteration of the National Spatial Development Perspective (NSDP) that views district and metro governance structures as the “essential building blocks for a regional focus”. The NSDP suggests that district and metros should develop a “shared understanding of the social, growth and environment trends, processes and dynamics at play, providing strategic leadership and seeking to align the plans of all levels and departments of government, communities, labour & the private sector to maximize growth and development opportunities.”

Analysis of the Western Cape’s spatial dynamics highlights the socio-economic dominance of the City of Cape Town as the Province’s single major city and its surrounding municipalities, including the towns of Paarl, Stellenbosch and Wellington. The city-region is interwoven in respect of a wider set of economic connections, transport corridor links, social and institutional networks, bringing into play a new emphasis in respect of governance arrangements and partnerships.

The CTFR project is an exciting new process spearheading regional collaboration in the Western Cape. A broad range of partners, led by the City of Cape Town and the Provincial Government, have joined forces through the CTFR process to develop a regional development strategy for the Cape Town city region.

Branded as the Cape Shared Growth Initiative (Csgi), the move signals a new era of intergovernmental and broader stakeholder participation, including business, the community sector, state-owned enterprises and educational institutions, in an ongoing process aimed at positioning Cape Town and its supporting functional region for accelerated economic growth and inclusion in line with the stated objectives of iKapa Elihlumayo.

---

7 OECD, 2007
8 Pastor et al., 2007
9 Mohamed, 2006
10 Clark, 2007
11 ibid, p.3
12 Mohamed, 2006
11 The main drivers of the CTFR are the City of Cape Town and the Province. They are supported at the broader level by the Cape Winelands, Overstrand and West Coast district municipalities, and at a more focused level by the Stellenbosch, Drakenstein, Overberg, Theewaterskloof, Swartland and Saldahna local municipalities.
12 Csgi, 2007 (a)
At the nascent stage, the project is focusing on bringing all major stakeholders and roleplayers together in a series of seminars addressing key regional issues that require greater coordination and alignment for success. These include regional competitiveness and priority sector growth; increased social and economic inclusion; education for shared growth; research and innovation; transport, freight and logistics; climate change and sustainable resource use; and leadership and social capital.

Closely related to the CTFR project, but undertaken in a functionally separate process is the forthcoming Organisation for Economic Cooperation and Development (OECD) Territorial Review. The OECD has undertaken comparative territorial reviews in almost 80 of the largest metro regions in the OECD.

The resulting report, *Competitive Cities in the Global Economy*, draws on case studies to present policy recommendations that will guide city-regions to position themselves for greater economic success and improved socio-economic inclusion and equity in a globalised world.\(^1\)

The Western Cape Provincial Government has partnered with the OECD to undertake a Territorial Review of the Western Cape in the latter half of 2007 and 2008. This will focus primarily on the Cape Town functional region. The Review will be used to deepen the PGDS process, shaping a more sophisticated and nuanced policy debate at the intergovernmental level in respect of shared growth and integrated development in the Western Cape over the medium term.

### 2. 2007 Provincial Economic Review and Outlook (PER&O)

Positioning the Western Cape and the greater Cape Town functional region on a shared growth and integrated development trajectory requires a sophisticated level of evidenced-based policy debate and decision-making that is supported by extensive socio-economic research and analyses.

The Western Cape’s annual Provincial Economic Review & Outlook (PER&O) and its sister publication the Province’s Socio-economic Profile of Local Government (SEP-LG) provide critical socio-economic environmental scans at the provincial and local government level.

In its fourth edition, the 2007 PER&O builds on the analytical work completed in the Western Cape’s 2003 Socio-Economic Review and the 2005- and 2006 PER&Os.

---

\(^1\) OECD, 2007
The strategic focus of this year’s PER&O – Moving towards shared growth and integrated development in the Western Cape – consolidates the research and analyses undertaken in the previous reviews and provides a current socio-economic compendium that underpins the PGDS, deepening the debate and sharpening the associated iKapa Elihlumayo lead strategies and interventions. The 2007 PER&O also provides a critical analytical input to the CTFR process and the upcoming OECD Territorial Review of the Western Cape.

The edition consists of seven chapters. The first contextualises the broader policy environment in which the 2007 PER&O presents, and leads into an executive summary of the following six chapters.


Chapter 3: Economic modelling and regional impact analysis explains the concepts used in general equilibrium economic modelling techniques and illustrates their recent application in regional impact analyses focused on the Western Cape agricultural sector. The chapter shows how the modelling techniques may apply more broadly in the Western Cape policy debate in support of further PGDS engagement.

Chapter 4: Regional innovation and growth highlights how the integration of productive and knowledge-based activities in the Western Cape is critical to the regional economy’s competitive positioning over the medium to longer term.

Chapter 5: Employment dynamics examines the Western Cape’s labour market performance over the five year period 2000 to 2005.

Chapter 6: Small, medium and micro enterprises and the informal sector engages in a detailed analysis of the Province’s SMME and informal sector.

Chapter 7: Socio-economic profiling of local government: An update revisits some of SEP-LG 2006’s high-level findings, and shows evidence that financial sustainability is an important pre-condition for enhanced service delivery at the local level.

This year the focus has been to streamline the analyses, presenting the data and information in a manner that is more accessible to the reader without detracting from the depth of analytical rigor in support of evidenced-based policy debate and decision making in the Province.
3. Western Cape’s economic outlook: 2007/08 – 2009/10

The Accelerated and Shared Growth Initiative of South Africa (AsgiSA) has as its primary thrust moving the SA economy onto a significantly higher growth trajectory of 6 to 8 per cent by 2014, enhancing job creation, economic participation and inclusion over the medium to long term. The Western Cape shares this vision and strategic objective, encapsulated in the higher and shared growth thrust of iKapa Elihlumayo.

Recent trends evidence the feasibility of such objective. Both the national and the regional economies experienced robust growth over recent years. Revised national account statistics show that between 2004 and 2006 real GDP growth averaged around 5 per cent a year and the growth momentum remained at 5 per cent during the second half of 2006 and early 2007.

3.1 Trends in the SA economy

The SA economy registered a 5 per cent real GDP growth rate in 2006. The economy remained remarkably resilient towards the end of the year and early in 2007 in the face of higher interest rates. Domestic business and consumer confidence remained poised at elevated levels during the early part of 2007 suggesting the robust economic growth could continue. With robust fixed investment spending across many sectors, employment growth is taking place and this is boosting household financial positions, in turn underpinning household consumption spending.

Capacity constraints underpinning fixed investment spending, infrastructure investment and stronger net export growth are likely to be important countervailing forces to the slowdown in the domestic consumer market, ensuring a sustained 4.5 to 5 per cent level of growth in the economy overall.

The economy is therefore currently facing some typical business cycle pressures. Inflation has accelerated, the current account deficit (measured at the fourth quarter of 2006) is uncomfortably high at around 7 per cent of GDP and capacity utilisation pressures are evident across many sectors of the economy. The increase in inflation appears to be under control and the 200 basis points interest rate hike during the second half of 2006 should assist in this regard.

The current account deficit is appropriately financed through healthy capital inflows and prospects in this regard remain optimistic, albeit that the quantum of the portfolio investment component of these inflows is cause for alert. Finally, production capacity utilisation – in manufacturing, construction and the utilities – are at record highs, but fixed investment in all these areas is expanding to address capacity constraints.

While the above suggests a maturing business cycle upswing, macro-economic parameters are such that economic growth may be sustained. Following the interest rate hikes of last year, the economy is probably heading for some slowdown in 2007. It is important that economic growth becomes better balanced in terms of a reduced impetus from the consumer boom combined with a recovery in net exports.
Chapter 1: Executive Summary

The rand’s recent depreciation should be welcomed. While it will impact negatively on the favourable pricing environment of recent years, this impact could be manageable given the monetary policy credibility of the South African Reserve Bank (SARB) and hopefully a contained reaction in domestic inflation expectations. The latest available evidence supports this view. The current account of the balance of payments should improve as import demand cools down (on the back of higher import costs and slower domestic spending) and exports recover.

On the inflation front, CPI inflation has increased from 3.7 per cent in April 2006 to 5 per cent in August, remaining at this level for the remainder of 2006, but picking up further to 6.3 per cent in April 2007. CPI inflation is projected to trend slightly above the upper 6 per cent target range over the next 8 to 10 months, before moderating again closer to the 5 per cent level towards the end of 2008.

Looking at fixed investment trends, real gross domestic fixed investment growth averaged 10 per cent a year over the past four calendar years, that is, 2003 to 2006, while the momentum accelerated close to 16 per cent during the fourth quarter of 2006. Robust capital spending is led by the private sector and the public corporations expanding production capacity.

The cumulative growth of the SA economy over the past seven years has led to production capacity constraints across many industries. In a sustained 4.5 per cent to 5 per cent real GDP growth scenario, these production capacity constraints will continue to underpin fixed investment spending. It is expected that private fixed investment spending will remain robust over the short to medium term. Combined with the public sector infrastructure-spending programme this will increasingly drive economic growth.

The favourable fixed investment trend has also had a positive impact on employment creation. Statistics SA’s Labour Force Survey (LFS) and the Quarterly Employment Statistics (QES) reveal accelerating employment growth across most sectors of the economy. The LFS suggests an increase in economy-wide employment of 500 000 in the year to September 2006. The same survey suggests close to 400 000 of these employment opportunities were created in the formal non-agricultural sectors of the economy.

Improved income growth is boosting the financial positions of households, which in turn, buoys consumer confidence and spending. Real personal disposable income growth measured 6.6 per cent last year. While the new momentum in employment creation is encouraging, there is scope for further improvement, particularly in the tradable goods sectors.

Real GDP growth is projected to decelerate moderately from a 5 per cent tempo during 2004 to 2006 to 4.8 per cent during 2007 due to the impact of higher inflation and interest rates. However, the upbeat domestic economic growth outlook remains in place over the medium term. Growth is projected to accelerate again in 2008 and in the run-up to the 2010 FIFA World Cup.
Sustained fixed investment spending and associated employment growth are expected to compensate for the negative impact of higher interest rates on the interest rate sensitive components of household spending and private fixed investment, notably residential construction. The favourable fixed investment trend is also likely to be supported by a recovery in export growth.

### Table 1: Macro-economic outlook for SA 2007 to 2010

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Expenditure on GDP</strong> (real % change):</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Household consumption</td>
<td>5,1</td>
<td>7,3</td>
<td>4,8</td>
<td>4,3</td>
<td>4,5</td>
<td>4,9</td>
</tr>
<tr>
<td>Fixed investment</td>
<td>8,1</td>
<td>12,8</td>
<td>10,1</td>
<td>8,4</td>
<td>7,7</td>
<td>9,1</td>
</tr>
<tr>
<td><strong>Gross domestic expenditure (GDE)</strong></td>
<td>5,8</td>
<td>8,7</td>
<td>5,2</td>
<td>4,9</td>
<td>5,0</td>
<td>5,7</td>
</tr>
<tr>
<td>Exports</td>
<td>3,3</td>
<td>5,5</td>
<td>7,3</td>
<td>6,5</td>
<td>6,5</td>
<td>7,7</td>
</tr>
<tr>
<td><strong>Gross Domestic Product (GDP)</strong></td>
<td>4,1</td>
<td>5,0</td>
<td>4,8</td>
<td>5,0</td>
<td>4,9</td>
<td>5,4</td>
</tr>
</tbody>
</table>

**Inflation, interest & exchange rates**

|                      |                  |      |       |       |       |       |
| CPIX inflation       | 5,9              | 4,6  | 6,0   | 5,6   | 5,2   | 5,5   |
| PPI inflation        | 6,0              | 7,6  | 9,1   | 6,4   | 5,2   | 5,3   |
| Prime overdraft rate | 12,94            | 11,12| 12,97 | 13,31 | 12,50 | 12,50 |
| R/US$ exchange rate  | 7,71             | 6,77 | 7,44  | 7,93  | 8,41  | 8,89  |
| R/euro exchange rate | 8,44             | 8,50 | 9,94  | 10,44 | 10,71 | 10,96 |

**Source:** Bureau for Economic Research

### 3.2 The Western Cape economy

The revised real GDPR growth statistics indicate that the regional economy expanded by around 6 per cent a year during 2004 and 2005. According to current estimates, growth came in at 5,5 per cent last year.

The services industries (excluding government) continue to power the growth performance, growing by 6,5 per cent a year on average during calendar years 2004 and 2005 and an estimated 6 per cent during 2006. The construction sector is also expanding strongly, growing by a real 12 per cent a year during 2004 and 2005 and an estimated 15 per cent during 2006. The strong momentum in real domestic spending on the back of erstwhile low interest rates and inflation continue to benefit these sectors.

Overall formal sector regional employment growth improved during 2005 and 2006. However a number of sectors are continuing to retrench workers. These include the agriculture, clothing & textiles, wood & paper, furniture and communication sectors. The sectors that reported healthy employment growth are financial & business services, electricity & water, wholesale & retail trade, construction, transport & communication and general government.
Therefore, while the overall provincial economic growth picture remains upbeat, particularly in the leading services industries and in construction, there is scope for stronger and more broader-based employment growth. The unsatisfactory employment picture is influenced by the struggling manufacturing sector and large-scale retrenchments in the agricultural sector.

The evidence of an under-performing manufacturing sector in the Western Cape economy amounts to a key challenge to the Province. The manufacturing sector is best situated to absorb lower- and semi-skilled labour of which there is an oversupply. Furthermore, the sector’s contribution to exports is critical for sustainable high economic growth, both at the regional and national levels.

Looking ahead the regional retail sector will be exposed to the anticipated national slowdown, the impact on interest rate sensitive components of spending and the impact of higher food prices, particularly at the lower end of the market.

The changed financial environment is likely to impact negatively on the booming construction, property and financial services sectors. The property and financial services sectors may also be peaking, albeit that this is not yet so evident from the available statistics. However, the construction sector will also be underpinned by non-residential property development and civil engineering activity tied to infrastructure development. The anticipated slowdown is therefore expected to be of moderate proportions.

These factors all contribute to a likely change in the sectoral composition of the region’s growth. The momentum will in all likelihood slow in the retail, construction, financial services and property sectors, while that in the manufacturing and agricultural sectors should benefit from the depreciation of the rand exchange rate. Both the climatic conditions and the more competitive currency are bolstering the outlook for the Western Cape agricultural sector.

The recent recovery in provincial employment creation is led by the sectors that experienced job growth over the 2000 to 2005 period, notably financial & business services, community, social & other personal (CSP) services, and wholesale & retail trade, catering & accommodation. Strong fixed investment intentions, combined with the Government’s infrastructure fixed investment activities should underpin employment creation in the Western Cape going forward.

Reviving export growth is a key challenge for the Western Cape. Regional export growth performance deteriorated sharply in recent years, led by the downturn in manufacturing exports. Between 2003 and 2005 real manufacturing exports actually contracted by 2 per cent a year, explaining much of the problems in the lagging regional manufacturing sector. It is evident that regional export prospects will depend on how strong the recovery in manufacturing conditions will be over the short to medium term.

Between 2000 and 2005 real fixed investment spending in the Western Cape economy accelerated to 6,8 per cent a year compared to only 4 per cent a year over the decade from 1995. Fixed investment spending was particularly strong during 2004 (12,8%), 2005 (11,9%) and estimated at 10,7 per cent last year. This compares to an average annual growth rate of 10,3 per cent in real gross domestic fixed investment nationally.
The outlook for fixed investment remains bullish as production capacity constraints are expected to underpin capital spending. The Cape Town harbour will be expanded, the new owners of the Victoria & Alfred (V&A) Waterfront development are preparing for a major overhaul and expansion, construction of the World Cup soccer stadiums are in the offering, Eskom is building two new gas-fired power generation plants (scheduled for completion mid-2007) and planning a new nuclear power station, transport infrastructure will witness a major upgrade, to name a few. The rate of fixed investment growth in the Province should at least track that projected for national.

Table 2 below sets out the macroeconomic and sectoral outlook for the Western Cape for the fiscal years 2007/08 to 2009/10. Regional GDP growth is projected to soften from 5,7 per cent in 2005/06 and an estimated 5,3 per cent in 2006/07, to 4,9 per cent in 2007/08; thereafter growth is projected to re-accelerate in the run-up to the 2010 FIFA World Cup event to 5,7 per cent in 2009/10. The regional economic growth momentum is therefore expected to remain vigorous and exceed that of national.

Table 2: Outlook for the Western Cape economy: 2007/08 – 2009/10 (%)

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>GDPR (R billion; current prices):</strong></td>
<td>-</td>
<td>232,7</td>
<td>260,3</td>
<td>288,5</td>
<td>318,5</td>
<td>354,7</td>
</tr>
<tr>
<td>Real GDPR % growth</td>
<td>4,7</td>
<td>5,7</td>
<td>5,4</td>
<td>5,1</td>
<td>5,3</td>
<td>5,7</td>
</tr>
<tr>
<td>GDPR deflator</td>
<td>6,7</td>
<td>5,4</td>
<td>6,2</td>
<td>5,8</td>
<td>5,3</td>
<td>5,4</td>
</tr>
<tr>
<td>CPI inflation</td>
<td>5,2</td>
<td>4,6</td>
<td>4,8</td>
<td>5,8</td>
<td>5,2</td>
<td>4,9</td>
</tr>
<tr>
<td><strong>GDPR by sector (real % change):</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Agric, forestry &amp; fishing</td>
<td>1,6</td>
<td>4,4</td>
<td>2,7</td>
<td>1,9</td>
<td>2,4</td>
<td>2,8</td>
</tr>
<tr>
<td>Mining &amp; quarrying</td>
<td>-0,5</td>
<td>0,9</td>
<td>0,8</td>
<td>2,0</td>
<td>2,6</td>
<td>2,7</td>
</tr>
<tr>
<td>Manufacturing</td>
<td>3,1</td>
<td>4,9</td>
<td>3,7</td>
<td>3,5</td>
<td>3,5</td>
<td>3,6</td>
</tr>
<tr>
<td>Electricity, gas &amp; water</td>
<td>3,7</td>
<td>3,8</td>
<td>3,6</td>
<td>3,4</td>
<td>3,7</td>
<td>4,1</td>
</tr>
<tr>
<td>Construction</td>
<td>8,0</td>
<td>13,1</td>
<td>15,2</td>
<td>13,8</td>
<td>12,2</td>
<td>12,7</td>
</tr>
<tr>
<td>Wholesale &amp; retail trade, catering &amp; accommodation</td>
<td>6,0</td>
<td>6,6</td>
<td>7,0</td>
<td>5,5</td>
<td>6,1</td>
<td>6,4</td>
</tr>
<tr>
<td>Transport &amp; communication</td>
<td>6,4</td>
<td>6,3</td>
<td>5,6</td>
<td>6,3</td>
<td>6,6</td>
<td>7,0</td>
</tr>
<tr>
<td>Financial &amp; business services</td>
<td>6,6</td>
<td>5,9</td>
<td>5,6</td>
<td>5,7</td>
<td>5,9</td>
<td>6,3</td>
</tr>
<tr>
<td>CSP services</td>
<td>3,5</td>
<td>4,8</td>
<td>3,1</td>
<td>3,0</td>
<td>3,2</td>
<td>3,5</td>
</tr>
<tr>
<td>General government</td>
<td>1,0</td>
<td>3,0</td>
<td>3,3</td>
<td>2,9</td>
<td>2,9</td>
<td>3,2</td>
</tr>
<tr>
<td><strong>Western Cape GDP</strong></td>
<td><strong>4,7</strong></td>
<td><strong>5,7</strong></td>
<td><strong>5,4</strong></td>
<td><strong>5,1</strong></td>
<td><strong>5,3</strong></td>
<td><strong>5,7</strong></td>
</tr>
</tbody>
</table>

Source: Bureau for Economic Research

Note: Fiscal years ending 31 March

The projected growth rates are higher compared to those contained in the MTBPS compiled before the revisions of the GDP data by Statistics SA.
4. Economic modelling and regional impact analysis

Economic modelling is a critical tool in government policy, planning and budgeting processes at the national and regional level, and regional models have been developed specifically to increase understanding of the impact of changes, such as shifts in government policy or chance events, on a specific region. Regional models are also used for forecasting economic activity at the regional level, using large-scale econometric models based on time series data.


Regional economic modelling for impact analysis has evolved from simple input-output models with fixed relative prices to the more complex computable general equilibrium models that allow for flexible relative prices. More recent developments of input-output models also include the construction of models that integrate econometric and input-output approaches.

Since 1996, the Western Cape Department of Agriculture has had an active interest and participation in regional economic modelling, particularly impact simulation based on general equilibrium analysis.

While macroeconomic analysis makes use of economic aggregates in a top-down approach, general equilibrium analysis has its roots in microeconomics, giving an understanding of the whole economy using a bottom-up approach that starts at the basic level of individual markets and agents.

General equilibrium analysis therefore captures the interdependencies in a market economy where the prices and production of all goods are interrelated and shows that the different agents in the economy do not operate in isolation.

Both direct and indirect effects are relevant in the context of general equilibrium analysis and it is the capturing of indirect, or secondary, effects that makes general equilibrium analysis a powerful planning tool, distinguishing it from other analytical techniques.

General equilibrium analysis also allows for insight into the socio-economic impacts, including income, welfare, and employment, of policy decisions and economic shocks. These are particularly important when assessing the impact of policy decisions on different communities in the economy.

General equilibrium or impact-modelling exercises usually only simulate one or two policy changes simultaneously. When too many changes are incorporated into one simulation, the effects become intertwined and the model loses its power to extract from reality to improve the understanding of the economy.
General equilibrium analysis therefore has a macro-economic focus; making its applicability more suited to economy-wide analysis rather than detailed impact analysis where there are limited linkages. Despite such limitations, general equilibrium modelling has been carried out at various levels of the economy, from national, to regional or provincial level, as well as town level.

### 4.1 Strategic micro and macro modelling

During 1996 the Western Cape Department of Agriculture and the Agricultural Research Council (ARC) collaborated on a Strategic Micro and Macro Modelling (SM3) project to develop the necessary enabling framework for systematic quantitative decision-making.

The macro-modelling component of the SM3 project focused on the role of agriculture in the Western Cape identifying and quantifying the forward and backward linkages with the rest of the provincial economy. The model facilitated analysis of the impact of agricultural policy changes on the agriculture sector, the rest of the production sectors in the economy and households.

A key project output was the development of a Western Cape social accounting matrix (SAM) for 1993 that emphasised the agricultural sector. The SAM included 25 agricultural sectors and 23 non-agricultural sectors, distinguishing between farm-owner households and farm worker households. The SAM categorised non-farm households according to population group and per capita income.

The 1993 Western Cape SAM findings showed the dominance of horticultural enterprises in agriculture’s contributions to provincial value added, employment and employee remuneration. Viticulture, deciduous fruit, vegetables and table grapes were key contributors.

The livestock industry, in particular broiler production, was also a key contributor to provincial value-added and employment, although salary and wage payments to farm workers were particularly low in livestock enterprises relative to other industries.

The 1993 SAM for the Western Cape also indicated that while white households overall spent the largest total amount of money, the coloured population significantly dominated provincial spending on raw farm commodities as well as processed food.

In 1993 coloureds and africans accounted for 73.0 and 68.1 per cent, of household spending on unprocessed and processed agricultural commodities respectively. This suggests that growth of domestic demand for agricultural output is heavily dependent on income dynamics among those populations.

Initial research using the Western Cape SAM suggests that primary agriculture’s potential to contribute to employment and value added was found to significantly exceed those of the non-agricultural sectors in the Western Cape. Agribusiness showed substantially higher employment multipliers than other non-agricultural sectors.
The model results confirmed that spending by the poor tends to provide a much greater stimulus to SA’s agricultural and manufacturing industries than does spending by the rich. The poor devote a higher portion of their incomes to consumption spending, directly consume fewer imports and their spending tends to hire more people who are also poor, especially the agricultural labour force and persons involved in the informal sector.

Subsequent research evaluated implications of the World Trade Organisation (WTO) negotiations that would lead to a reduction in tariffs and hence an increase in agricultural prices on Western Cape economy.

The results confirmed expectations that food manufacturing sectors, including canning, dairy, beverage and tobacco, distilleries and wineries, grain products and animal feeds industries would be most affected by price increases in the agricultural sector.

Furthermore, an increase in the price of primary agricultural products would contribute to higher cost of living, particularly for coloured and african households in rural areas. The cost of living increased by 0.58 per cent, 0.47 per cent and 0.42 per cent for the low, medium and high income groups respectively. In contrast, households that experience the lowest increase in the cost of living ranging between 0.15 and 0.11 per cent include white and asian, rural and urban, middle and high income groups.

These results confirm that as low-income households spend a high percentage of their income on food, they are notably impacted by an increase in food prices (especially primary agricultural products). The analysis also shows that high income household are responsible for the greater part of repeated cycles of income expenditure (feedback) in the economy, and are therefore the greatest contributors to stimulation of economic activity.

The 1993 Western Cape SAM results were used to make a strong argument against certain proposed changes to the Liquor Bill. One of the less obvious implications of the proposed Bill would have been the unbundling of the liquor industry, as the Bill provided that enterprises would only have been able to register for one of six segments in the supply chain, including wholesale and combinations of retail and consumption on or off the premises.

The Bill would therefore have closed potential for vertical integration as an option for risk management to wine farmers, as the proposed changes undermined the concept of the wine farms and wine tourism due to their simultaneous engagement in production, wholesale and retail activities. The Liquor Bill was subsequently amended.
4.2 General equilibrium analysis for the Western Cape

While the SM3 project SAM for the Western Cape provided valuable information for decision-makers, it followed the structure used by earlier SAMs for SA, and consequently had certain structural characteristics that precluded its use as a database for computable general equilibrium (CGE) models.

In 2001 the Western Cape Department of Agriculture initiated the development of a CGE model for the Western Cape, which also required the revision of the 1993 SAM with detail on the agricultural sector.

The project was able to draw on a broader range of data than five years earlier. The revised SAM eventually formed the base for the Provincial Decision-making Enabling (PROVIDE) project SAMs.

Two case studies were conducted. The first analysed the potential of the basic income grant to alleviate poverty in rural areas. The results indicated that when funded exogenously a basic income grant could achieve substantial reductions in poverty and inequality.

The second study explored the socio-economic implications of a property tax on agricultural land. The study results were incorporated into the final Land Tax Committee report on a guideline framework for the implementation of property tax on agricultural land in the Western Cape. The property rate was subsequently introduced, with the Western Cape being one of the first provinces to implement.

The study showed that the tax would have only marginal impact on provincial GDP. If the revenue received from the tax were spent in the Province, there would be a slight increase in GDP.

Price changes, including those on food products, are insubstantial. Production in different agricultural regions is affected differently. The relatively rich white rural households lose out – inevitably since they are the primary recipients of income from land.

The only other representative household for which notable income losses were indicated is the coloured rural household, which is heavily dependent upon employment in agriculture and is regarded as one of the poorest household groups in the Province.

Benefits to other households from the introduction of a property rate on rural land would be negligible if Government were to spend the additional revenue according to existing government expenditure patterns.

The results therefore suggested that there is little benefit from the introduction of a property rate on agricultural land in the Western Cape.
4.3 The PROVIDE project SAMs and models

The PROVIDE project emerged from a desire to extend capacity in provincial level general equilibrium analysis from the Western Cape to other agricultural departments.

In 2001, the national Department of Agriculture and the nine provincial departments of agriculture co-funded the PROVIDE project, aiming to develop a series of SAMs that had a regional focus and detailed agricultural accounts as well as an associated CGE model and to use the latter for policy analysis and capacity building.

The project developed a national SAM, four regional SAMs and a multiregional SAM for the base year 2000. The SAMs all contain substantial detail on the agricultural industry. The inclusion of various different tax accounts allows for fiscal policy analysis. Detailed factor and household accounts capture the functional distribution of income to households, making the SAMs suitable to analyse the effects of policy changes on income redistribution.

A distinguishing feature of the national SAM is that it contains provincial level information on households and labour, providing critical insight into policy impact at a provincial level.

The PROVIDE regional SAMs are based on the four regions identified for purposes of the PROVIDE Project – the Northern Cape and Western Cape; the Eastern Cape and KwaZulu-Natal; the North West, Free State and Gauteng; and Mpumalanga and Limpopo.

**PROVIDE Project case studies**

Besides numerous background papers and technical documents, a series of working papers present the results of various studies conducted as part of the PROVIDE project.

Working Paper 2005:2 on the ‘Costs and benefits of higher tariffs on wheat imports to SA’ formed part of a report to Grain SA, after Grain SA commissioned a study on the implications of increasing the import tariff on wheat.

The report formed the basis for negotiations between Bureau for Food and Agricultural Policy (BFAP) and Grain SA, and the International Trade Administration Commission (ITAC). The latter is the international institution that administers import tariffs.

This study described and quantified the effects of increased tariffs on the local wheat industry. The results suggested that the benefits to the wheat industry are highly concentrated and smaller than the loss of income caused in other sectors.

Working Paper 2006:1 on the ‘Impact of increasing excise duties on the economy’ was completed on request from the SA Wine Industry Council. The results were used during negotiations between the SA Wine Council and Provincial Ministers of Finance and Tourism from the Northern and Western Cape and the National Minister of Finance to determine the desired level of increases in the excise duties on wine.
This study investigated the economic impact of a 10 per cent increase in excise duties on wine, focusing on the change in GDP, trade and prices, as well as changes in the factor market and the welfare of households of the Northern and Western Cape (the two major wine producing provinces in the country).

The results indicated that the majority of households in SA would be worse off in terms of real consumption expenditure, and that all households in the Northern and Western Cape would experience welfare losses. Lower-income households would be most affected, as they tend to spend a larger share of their income on beverages and tobacco.

The PROVIDE project also made inputs into the AsgiSA strategy, estimating the socio-economic impact of investment in irrigation schemes. The study described the results of preliminary investigations into the impact of technical progress (increased efficiency) in agricultural production through additional investments in irrigation systems and a general improvement in the efficiency in the use of primary factors of production, land, labour and capital.

The results confirmed that gains in the non-agricultural sector have the greatest impact on the economy, with efficiency gains in agriculture only adding to growth, employment and household welfare in proportion to its share of the economy.

General equilibrium analysis undertaken on a regional level therefore has a definite role to play in informing the policy debate on the Western Cape’s PGDS iKapa Elihlumayo.

The results give an indication as to which policy interventions will lead to an expansion of the regional economy and importantly, whether economic growth will be shared growth that will address poverty and inequality, or whether it will have the unintended effect of reinforcing the duality in the economy.

An advantage of general equilibrium analysis is that once there is a detailed SAM of the economy, the data and models may be used with relatively little adjustment to analyse any economic sector or industry.

### 4.4 Future initiatives

The PROVIDE project came to a contractual end during 2006. The stakeholders are negotiating the details of a follow-up initiative, which will most likely take the form of a Research Centre with five permanent researchers, hosted at the Western Cape Department of Agriculture.

An update of the SAMs from a base year of 2000 to a base year of 2005 is planned as part of the short term work programme of PROVIDE. Some revisions are envisaged to allow for gender-based research and further CGE model extensions including global modelling for trade issues, energy modelling and regional modelling.
The PROVIDE project provides evidence that the resulting analytical tools are particularly valued for the information they present on the socio-economic impacts of policy decisions and economic shocks, which are of importance from a political perspective in order to gain insight into who will be the potential winners and losers when certain policy changes are considered. A further advantage of CGE analysis is that it allows for systematic economic analysis, contributing to a more focused, disciplined and hence a more constructive policy debate.

5. Regional innovation and growth

In today’s globalised world knowledge and innovation are critical for economic growth and development. Institutions and networks that support innovation are indispensable building blocks of the knowledge economy.

Innovation is more likely to take place in an economy whose institutions encourage and support entrepreneurship (with its consequential risk-taking), and manage to shift resources from declining to rising activities.

However, as the relationship between knowledge and growth is not well enough understood, there is no simple guide that would provide a provincial government with a list of appropriate interventions. Initial work suggests that a macro perspective on the role of institutions becomes fruitful only to the extent that it is accompanied by micro-level investigations of the determinants of business behaviour, firm interactions with knowledge providers, the effectiveness of systemic support, and so on.

This is a key reason why it is important to discuss the knowledge economy in the Western Cape through an assessment of sectoral dynamics. Since the provincial government is responsible for a particular geographic space that can be distinguished from higher (national) and lower (local) levels of aggregation, it is necessary first to place the above discussion in its proper spatial context.

5.1 A regional innovation system in the Western Cape

At present there is considerable debate about the importance of realising a regional innovation system in the Western Cape. Businesses can benefit from agglomerations and they might also exploit the proximity of knowledge pools in universities or science institutions. But they need not.

It could be that championing the interaction between academics and entrepreneurs is very effective in some activities and not at all in others. Very likely, the determinants of innovation in businesses differ from sector to sector and the Provincial Government will have to engage in many different support activities, though not necessarily simultaneously.

For instance, although geographic proximity may undoubtedly facilitate learning, businesses can make use of other forms of proximity. Organisational, institutional, or social proximity may link actors that are geographically far apart.
The emergence of global innovation networks in which businesses from both advanced and developing countries engage in multidirectional knowledge flows is a key feature of contemporary capitalism. It is therefore important to distinguish between the mere existence of clusters, which is widely documented, and localised learning and innovation, about which less is known, especially in developing countries.

Much depends on the nature of the economic activity undertaken. To the extent that intra-industry spill-overs are more prevalent than inter-industry spill-overs, specialised local production structures favour innovative activity. Particularly in the case of R&D-intensive and small businesses, knowledge spill-overs have limited geographical reach and so proximity does matter.

By contrast, in industrially differentiated metropolitan areas, where much innovation is concentrated, higher technological intensity of an industrial activity is typically associated with higher diversity. So a policy for the City of Cape Town will likely have to be different from one aimed at an outlying area specialised in a few sectors with lower technological intensities; and the support provided for such an outlying area will have to change over time as it increases its technological sophistication.

Of interest is that the relative integration of productive and knowledge-based activities in the Province, as well as the relevance of geographic proximity between businesses and other knowledge users and producers for this relationship, appears to vary between sectors and technologies.

In 2004, the Province attracted 14 per cent of national R&D investment, including manufacturing, where it has a relatively weak productive base. R&D investments are much more diversified than productive activity, which is a possible indication that the knowledge sector in the Province is more sophisticated than the production sector.

Of note is that the provincial knowledge economy does not only manifest itself primarily or exclusively in advanced manufacturing or service sectors, or only in medium- or high-tech activities. In reality the primary sector with typically low R&D-intensive processes and with a very significant employment share in the Western Cape appears to be producing and making use of knowledge.

Fields in which specialisations in business sector R&D investments co-exist with specialisations in scientific output include biological sciences, electrical and electronic engineering, clinical sciences, and medical microbiology. Hence, the Western Cape has strengths in analytical, science-driven knowledge. This underlines the importance of university-industry linkages, which merits further investigation, especially for the four disciplines mentioned here.

Specialisations in investments in R&D co-exist with technological specialisations – in terms of producing or using patents, or both – in the areas of agriculture & fishing, including related downstream activities, plus textiles, rubber & plastics, ships & boats, and water transport.
In other words, we observe, for example, that some businesses in the Western Cape invest above average in nursery products and that some businesses – possibly the same – and other knowledge producers (such as the ARC in Stellenbosch) reap rewards in terms of technological achievement.

Regional linkages between businesses within the same value chain or even across value chains are therefore a distinct possibility. In addition, the Western Cape has a high number of correspondences where a specialisation in R&D investments is accompanied jointly by specialisations in patent production and use.

This could indicate spill-overs or even intended knowledge sharing at play. Although the bulk of SA’s technological knowledge is clearly not produced in the Western Cape, businesses based here may well be its most effective users.

Finally, the Western Cape distinguishes itself in that with the exception of textiles, all sectors with a specialisation in technology (that is, patent) output co-exist with specialisations in technology use. This applies to agricultural & fishing activities, paper & paper products, rubber & plastic products, ship & boat repairing and building.

Therefore businesses in the Western Cape are not only important producers or users of technological knowledge in these areas, but mostly both. Again, this suggests the possibility of regional dynamics that merit closer investigation, for example inter-business relationships between lead and laggard businesses.

### 5.2 Broad overview of sector development in the Western Cape

A broad overview of regional sector development highlights that the economy in the Western Cape is rather diversified, with important activities in the primary, secondary, and tertiary sectors. In 2005 the primary sector consisted predominantly of agriculture, fishing & forestry, which accounted for 4.3 per cent of provincial output, slightly lower than in 2004. The share of manufacturing was 17.6 per cent, also a little lower than in 2004.

The Western Cape is therefore mainly a service economy; over the past years between three quarters and four fifths of value added was generated here. The most important activities in 2005 included financial & business services (29.2%), wholesale & retail trade, catering & accommodation (17.7%), and transport & communication (11.1%), followed by government services (9.5%).
Over the 11-year period under review here, the activities with the highest average annual growth rates were transport & communication (6%), followed by wholesale & retail trade, catering & accommodation (5.4%), and financial & business services (4.7%). Sectors in long-term decline or stagnation included mining & quarrying (-11.0%) and government services (0%). All other activities grew between 1.5 and 3.7 per cent.

Turning to sectoral employment trends, in 2005, 12.1 per cent of the Western Cape’s work force was employed in agriculture, forestry & fishing. Manufacturing employed close to 15 per cent. Almost three-quarters (72.5%) were employed in service activities, led by financial & business services (18.3%), wholesale & retail trade, catering & accommodation (16.3%), government services (15%), and CSP services (11.8%).

Over the period 1995 to 2005 long-term growth rates were highest in financial & business services (5.3%). Wholesale & retail trade, catering & accommodation as well as CSP services grew by between 1.3 and 1.7 per cent. All other sectors declined, except manufacturing, which stagnated. Overall employment also stagnated which is obviously reason for concern because it means that output growth need not lead to job creation.
5.3 **Key sector performance: evidence from the MEDS**

The third phase of the Western Cape Microeconomic Development Strategy (MEDS) included seven new studies, namely of the informal sector, food processing, boatbuilding, construction, chemicals, printing & publishing and wholesale, retail & franchising.

**Boatbuilding** is a relatively new, dynamic industry in the Western Cape. More than half of SA’s boatbuilding businesses are based in the Western Cape, where they produce more than four fifths of the national boatbuilding output. More than two thirds of the value chain is domestic and under control of previously disadvantaged individual (PDI)-owned businesses. The most successful products of the sector are catamarans and monohulls, predominantly for sailing, where businesses based in the Western Cape successfully compete internationally. Strong global demand, especially for sailing catamarans, suggests that the sector could grow up to four times its current size.

The **food processing** sector accounts for a fifth of manufacturing value added, is the second largest employer in manufacturing, and the biggest exporter. It is linked to a strong local agricultural sector and to catering & accommodation activities. However, the sector has not been a strong growth performer over the last decade due to relatively stagnant but large, established activities and smaller but high-growth activities such as indigenous teas, speciality meats, and spices and condiments. Problems faced by smaller businesses include expensive inputs (such as packaging), barriers to entry to domestic retail, and entry into international markets. In addition, the whole industry faces more import competition.

Excluding petroleum, the **chemical** industry is not a sizeable sector in the Western Cape. It produces a small range of relatively low- to medium-technology products and imports most of the chemical products required by the Province. An interesting new idea is the development of chemicals out of compounds extracted from natural products. The unique patrimony of the Western Cape over its rich biodiversity lends itself to exploring the feasibility of developing pharmaceuticals, body care products, cosmetics, biofuels, and others.

The **construction** sector contributed some 3 to 4 per cent to regional GDP over the period 1999 to 2003. This is forecast to rise. The sector is affected by skills shortages in respect of skilled workers and management. Businesses interviewed complained about the lack of training in the sector. They reported having no financial incentives to offer training themselves, even though retraining their current workforces would allegedly go a long way toward addressing skills shortages.

About one in ten people working in the Western Cape are part of the **informal economy**. Compared to the rest of the country, people in the Western Cape’s informal economy tend to make more money and be more highly educated. However, there are barriers to enter the informal sector, blockages to improving incomes, and obstacles to taking advantage of emerging opportunities. Removal of these barriers relates to access to infrastructure and basic services, financial services, training, and local government regulations.
Printing & publishing employs some 30 500 people, providing one in seven jobs in manufacturing. The sector appears to be in the throes of a long-term decline. The sector suffers from skill shortages exerting upward pressures on wages and encouraging job-hopping. This has led to gradually more capital-intensive production processes, spelling trouble for job growth in this sector, including for semi-skilled workers.

The wholesale, retail & franchising sector is the largest employer in the Western Cape. Due to productivity increases of changing labour practices toward more flexible contracts, the considerable growth in the sector has not gone hand in hand with job creation. Leading businesses in the sector – essentially the large retailers – have played an important role in opening the supply chain both upstream and downstream to emerging businesses. But considerable obstacles continue to stand in the way of informal traders graduating into the formal economy, including lack of time and resources to attend training, and lack of access to credit, loans, tenure, infrastructure and bulk buying power to make their businesses more viable.

The fourth round of the MEDS deepens the analysis of two sectors it has taken on in previous rounds, namely the informal sector, and the cultural or creative industries. The focus will be on trade and construction, previously identified as activities with significant growth and job creation potential, and on music and the performing arts in the Western Cape. It aims to learn from international experiences of cities or regions that have used culture as a magnet for investment and tourism. In addition, the MEDS is exploring the opportunities of the 2010 World Cup, especially for small and medium-sized enterprises.

Finally, the work programme includes an ambitious attempt to improve the spatial understanding of economic opportunities in the Province by analysing the economic performance and growth potential of selected municipalities outside of the City of Cape Town. This will pay special attention to innovation in both urban and rural contexts, thus examining the presence of knowledge-based activities away from the Province’s major economic hub.

6. Employment dynamics

Unemployment and job creation present a key challenge to Government since it is only through equitable job creation that the problems of poverty and inequality can be addressed on a sustainable basis.

Table 3 below shows that between 2000 and 2005 the Western Cape’s working age population grew by 343 000 individuals – an average rate of 2,3 per cent a year – placing the Province under greater pressure in terms of job creation than the country as a whole. Over the same period, the number of individuals wanting work, but not necessarily actively seeking work, that is the broad labour force in the Province, rose by an average rate of 2,7 per cent a year.
Unfortunately, the measured net increase in employment in the Western Cape of 125,000 jobs – that is, the number of jobs created less the number of jobs lost – is not statistically significant. In contrast, broad unemployment in the Province is higher at 25.5 per cent in 2005 than it was in 2000, having risen at an average growth rate of 6.8 per cent a year. A similar, though less rapid, rate of growth in unemployment was observed nationally where broad unemployment in 2005 reached 38.8 per cent.

Unemployment trends are even starker when compared to buoyant economic growth rates at the provincial and national level. Therefore, despite the rapidly growing economy, both nationally and within the Province, the number of jobs created was insufficient to absorb new entrants into the labour market.

Of concern is the increase in the number of the discouraged workers in the Province, comprising those who want to work and are available to work, but who are not actively looking for work. Over the five-year period, the Western Cape experienced an increase in the number of the discouraged workseekers at an average rate of 12.1 per cent a year, contributing to a widening of the gap between the provincial broad or expanded rate of unemployment and the narrow rate of unemployment.

### Table 3: Labour Market Aggregates, 2000 and 2005

<table>
<thead>
<tr>
<th></th>
<th>2000 ('000s)</th>
<th>2005 ('000s)</th>
<th>Total change ('000s)</th>
<th>Total change (%)</th>
<th>Ave. ann. growth (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Western Cape</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Working age population</td>
<td>2,834</td>
<td>3,177</td>
<td>343</td>
<td>12.1</td>
<td>2.3</td>
</tr>
<tr>
<td>Employed</td>
<td>1,601</td>
<td>1,726</td>
<td>125</td>
<td>7.8</td>
<td>1.5</td>
</tr>
<tr>
<td>Broad unemployed</td>
<td>426</td>
<td>591</td>
<td>165</td>
<td>38.7</td>
<td>6.8 *</td>
</tr>
<tr>
<td>Broad labour force</td>
<td>2,027</td>
<td>2,317</td>
<td>290</td>
<td>14.3</td>
<td>2.7</td>
</tr>
<tr>
<td>Narrow unemployed</td>
<td>319</td>
<td>403</td>
<td>84</td>
<td>26.3</td>
<td>4.8</td>
</tr>
<tr>
<td>Narrow labour force</td>
<td>1,920</td>
<td>2,128</td>
<td>208</td>
<td>10.8</td>
<td>2.1</td>
</tr>
<tr>
<td>Discouraged work seekers</td>
<td>107</td>
<td>189</td>
<td>82</td>
<td>76.6</td>
<td>12.1 *</td>
</tr>
<tr>
<td><strong>GDP (2000 prices, R million)</strong></td>
<td>119,099</td>
<td>150,176</td>
<td>31,077</td>
<td>26.1</td>
<td>6.0</td>
</tr>
<tr>
<td><strong>SA</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Working age population</td>
<td>27,869</td>
<td>29,697</td>
<td>1,828</td>
<td>6.6</td>
<td>1.3</td>
</tr>
<tr>
<td>Employed</td>
<td>12,238</td>
<td>12,300</td>
<td>62</td>
<td>0.5</td>
<td>0.1</td>
</tr>
<tr>
<td>Broad unemployed</td>
<td>6,379</td>
<td>7,799</td>
<td>1,420</td>
<td>22.3</td>
<td>4.1 *</td>
</tr>
<tr>
<td>Broad labour force</td>
<td>18,618</td>
<td>20,100</td>
<td>1,482</td>
<td>8.0</td>
<td>1.5 *</td>
</tr>
<tr>
<td>Narrow unemployed</td>
<td>4,162</td>
<td>4,487</td>
<td>325</td>
<td>7.8</td>
<td>1.5</td>
</tr>
<tr>
<td>Narrow labour force</td>
<td>16,400</td>
<td>16,788</td>
<td>388</td>
<td>2.4</td>
<td>0.5</td>
</tr>
<tr>
<td>Discouraged work seekers</td>
<td>2,218</td>
<td>3,312</td>
<td>1,094</td>
<td>49.3</td>
<td>8.3 *</td>
</tr>
<tr>
<td><strong>GDP (2000 prices, R million)</strong></td>
<td>838,218</td>
<td>1,016,750</td>
<td>178,532</td>
<td>21.3</td>
<td>4.9</td>
</tr>
</tbody>
</table>


Note: Statistical significant changes at the 95 percent confidence level are indicated with an asterisk (*).
In total, in 2005 the employment rate in the Western Cape was 54.3 per cent, down marginally from 56.5 per cent in 2000. However, disaggregation reveals substantial inter-group variations. Although at a generally lower employment rate compared to other race groups, the proportion of the African working age population in the Province improved slightly from 45.4 per cent to 49.3 per cent between 2000 and 2005. This is in contrast to the coloured and white employment rates which declined marginally, falling to 54.3 per cent and 61.3 per cent respectively over the period.

Employment rates differ by gender, with 62.1 per cent of working-age males employed compared to only 47 per cent of females. Greater educational involvement amongst young people is evident in an employment rate of just 29.3 per cent amongst 15 to 24 year olds and 69.7 per cent amongst 25 to 34 year olds.

Having matric, a diploma or certificate, or a degree is associated with higher employment rates. In 2005, four-fifths of holders of diplomas or certificates of working age were engaged in employment in the Province. Approximately two-thirds (67.2%) of working-age holders of matric certificates were employed, while employment rates for those with no education, grade 0 to grade eight education, and grade nine to grade 11 education ranged were under 50 per cent.

Examining employment trends, we see that employment in the Western Cape expanded by around 1.5 per cent a year to about 1,73 million people by 2005. The African share of employment increased significantly from 17.2 per cent in 2000 to 25.5 per cent in 2005, while coloureds (50%) and whites (25%) accounted for approximately 75 per cent of provincial employment by 2005.

Provincial employment is dominated by the tertiary sector, accounting for 66.5 per cent of provincial employment in 2005, up from 59.7 per cent five years earlier. Key employers were wholesale & retail trade (24.3%), CSP services (17.8%) and financial & business services (12.7%).

Unemployment trends highlight the severity of the unemployment problems facing different groups and suggest stark labour market segmentation that feeds through into social and economic arenas. In 2005, broad unemployment in the Western Cape was highest amongst Africans at 35.9 per cent, compared to 26.1 per cent amongst coloureds and only 7.5 per cent amongst whites.

In line with the national pattern, unemployment is more severe among women than men, with broad unemployment rates of 30.6 per cent and 20.9 per cent respectively. The LFS surveys also confirm the trend observed nationally of higher unemployment rates amongst the youth. In 2005, the highest unemployment was in the 15 to 24 year old (49.1%) and 25 to 34 year olds (23.7%) age groups.

In 2005, unemployment amongst those who have not completed the General Education and Training (GET) phase of education (grades 0 to eight) and those who have not completed the Further Education and Training (FET) phase (grades nine to 11) was 31.7 per cent and 37.1 per cent, respectively. At 20.2 per cent unemployment among holders of matric certificates is still notably higher than that of 2.4 per cent among individuals with a diploma/certificate and 6.0 per cent among those with a degree.
Unemployment concentration patterns indicate that the Province’s unemployed are almost exclusively African (41.6%) and coloured (51.7%) with only 5.5 per cent being white. In terms of gender, women form 57.4 per cent and men 42.6 per cent of the unemployed, despite the fact that men account for 52 per cent of the labour force.

The most notable concern, however, is that the unemployed are concentrated in the younger age groups, an issue that is mirrored nationally. In 2005, 41.7 per cent of the unemployed individuals were between the ages of 15 and 24 years and a further 30.7 per cent were aged 25 to 34 years. In other words, seven out of every ten unemployed individuals was under the age of 35 years, even though this group accounted for only 55 per cent of the labour force. The reduction of unemployment rates amongst youth and the promotion of greater integration of the youth into the economy thus represent an important challenge, both provincially and nationally.

A defining characteristic of unemployment in SA is its long-term nature. Most of the unemployed have never worked before, the bulk of these being relatively young labour force participants. In 2005, more than two-thirds (69.2%) of broadly unemployed South Africans reported that they never worked before. This is a considerable proportion of the unemployed and is rooted in the large proportion of young people who have not worked before. Amongst unemployed 15 to 24 year olds, nearly 85 per cent reported never having worked before, while this was true of 68 per cent of those between the ages of 25 and 34 years. The Western Cape pattern is similar to that of SA as a whole. Such long-term unemployment has important consequences for the unemployed, not least of which is the rapid erosion of skills and familiarity with current technologies.

**7. SMMEs and the informal sector**

The informal sector in Western Cape is extremely small at 9.7 per cent of total provincial employment in 2005 compared to around 20 per cent for the country as a whole. The informal sector employed only around 174 000 individuals, while domestic workers, who are neither truly formal nor informal sector, accounted for under 6 per cent of employment.

In the five years between 2000 and 2005, the formal sector created 216 000 net new jobs, vastly outperformed the informal sector in the Province, the latter having shed around 16 000 jobs over the period.

Enthusiasm for the role and potential for the informal sector to provide employment and incomes to those unable to secure formal sector employment must, however, be tempered as formal and informal sector employment cannot be viewed as substitutes for each other.
In the Western Cape, informal sector workers find themselves inferior to both formal sector and domestic workers in terms of job security, legal protection and access to benefits. Informal sector workers have less legal recourse in the event of disputes with employers, while their lack of benefits in terms of pension/retirement and Unemployment Insurance Fund (UIF) contributions makes them particularly vulnerable to both sudden retrenchment and retirement.

For both SA as a whole and the Western Cape on its own, informal sector workers are more likely to be earning at a lower level. The educational profile of informal sector workers in the Province, as is the case nationally, is poorer than that of formal sector workers, with domestic workers being the least educated of the three groups.

Sectorally, both nationally (48,9%) and within the Province (40,7%) the informal sector employment is concentrated in the wholesale & retail trade sector. This is followed by employment in construction, which employs 15,4 per cent of the provincial informal workforce and 14,1 per cent nationally.

Small businesses are to be found in both the formal and informal sectors. Micro enterprises include survivalist enterprises that do not employ anyone, for hawkers, vendors and spaza shop owners, whereas non-survivalist enterprises employ no more than four regular workers. Both these types of enterprises tend to form part of the informal economy.

Very small enterprises operate in the formal economy and have access to modern technology. Small enterprises are likely to operate from business or industrial premises. In most cases, they are owner-managed or controlled directly by the owner-company, and are also likely to be registered with taxation authorities. Medium enterprises employ up to 200 people. Although still owner-controlled, the ownership and management structure is more complex and there is increased division of labour.

Unsurprisingly, small businesses are most prevalent in the informal sector. In 2005, 76,3 per cent of informal sector workers reported working in firms with fewer than five regular workers, while this was true of only 11,0 per cent of formal sector workers.

Very small (30,1%) and small enterprises (20,5%) tend to be more prevalent in the formal sector. In contrast, 16,8 per cent of informal sector workers worked in very small enterprises and only 3,2 per cent worked in small enterprises. More than nine in ten informal sector workers work in firms with fewer than 20 regular workers, compared to only four in ten in the formal sector.

Africans tend to dominate employment in the smallest firms, with 42,5 per cent of individuals engaged in micro-enterprises being african. Coloureds, on the other hand, account for a disproportionate share of employment in larger firms: 54,2 per cent of those working in small firms and 60,3 per cent of those in medium and large firms.
The bulk of micro enterprise activity is concentrated within private households (31.4%) and the wholesale & retail trade (26.9%) industrial sectors, with financial & business services and CSP services accounting for around 10 per cent of employment each. Wholesale & retail trade also accounts for the largest share of employment in very small enterprises: almost 28 per cent of those working in very small enterprises are engaged in wholesale & retail activity.

Small firms in general and informal firms in particular find it difficult or even impossible to access formal sector credit, due to perceptions of their higher risk. Informal sector firms are, therefore, often forced to cope without credit or must access credit from less reputable and significantly more expensive sources of credit, with negative consequences for the firms' sustainability. Access to credit for informal businesses should be promoted carefully, since credit is only useful if managed well.

Individuals engaged in informal sector activity tend to be less educated and have fewer marketable skills than their formal sector counterparts. A sustained increase in the utilisation of the learnership system on the part of informal and small businesses is possible if Sector Education and Training Authority’s (SETAs) ensure that their offerings are relevant and flexible. For instance, it is important that informal sector workers are able to access part-time learnerships, as their livelihoods would otherwise be seriously negatively impacted by full-time attendance.

Water, sanitation and refuse removal services, as well as access to electricity, are important municipal services that may support or constrain, in their absence, the informal business sector. However, given that most informal sector workers in the Western Cape work from home, it is important that these households have access to these services.

Transport infrastructure and services are also highly important, with historical settlement patterns resulting in large proportions of poor people living relatively distant from their places of employment. Those engaged in informal sector activity face high transport costs either getting themselves and their products to places of sale in markets, at intersections or on pavements in business districts, or getting stock or raw materials from distant suppliers to their places of work in their homes. Apart from high costs, poor accessibility of public transport on either end of a given journey will impede the ability of informal sector businesses to grow.

In respect of regulation, while some local municipalities have made great strides to liberalise the regulatory environment, many others still continue with restrictive land use legislation, business licensing legislation and by-laws which constrain SMME growth. The City of Cape Town, for example, has reduced legislation impacting on street trading. However, in most other municipalities in the Western Cape this is not the case.

Other constraints include a lack of access to business support services. The Western Cape, though, has a relatively strong platform from which to address these concerns, relative to other provinces, in the Red Doors.
While very few informal businesses are not in some way connected to the formal sector, these connections are not always very beneficial to informal businesses. Commonly, informal firms source their inputs and/or stock from formal sector businesses. However, very few are able to break into the market supplying larger formal enterprises. Being able to lock into formal sector supply chains can enable informal sector firms to grow more rapidly, access better technology and forge lasting business relationships that will ensure greater stability for the informal business and enhance sustainability. Through this, formal sector firms and government itself can help improve the fortunes of competitive informal businesses, with government specifically being able to promote formalisation through its procurement requirements.

8. Socio-economic profiling of local government: An update

Despite SA’s successful record of macroeconomic stability as a result of prudent fiscal and monetary policies, the record of basic service delivery by local government remains a key challenge.

In an attempt to unlock the reasons for non-delivery, this chapter explores some of the factors influencing the local sphere of government’s ability to deliver. The Western Cape’s first comprehensive Socio-Economic Profiles (SEP-LG) 2006 of the metropole, category B and category C municipalities in the Province were aimed at adopting an evidence-based approach to service delivery. The profiles juxtapose the uneven foundation of development, as shown by the Provincial Index of Multiple Deprivation, development indices and the utilization of social and economic infrastructure. These indicators confirm the existence of multifaceted deprivation within the Province.

On a positive note, the profiles have begun to yield good results as they set a platform for debate around findings that impact on sector departments within municipalities.

8.1 The inter-relation of socio-economic findings

This section highlights socio-economic findings by district with a greater emphasis on indicators that influence the quality of life and the potential pressures on service delivery. The indicators of socio-economic well-being are inter-related and therefore should not be read in isolation. This approach assists in identifying the type of required interventions and the target areas for such interventions.

For example, drug-related crimes might be linked to poverty and an ineffective education system, with major implications for the mental health system, social capital and investment. Meanwhile, unfavourable education indicators suggest the ineffectiveness of education programmes, poverty with adverse effects for social capital, skills, literacy and health in general.
Therefore, the indicators should be read mindful of the issues around the extent to which government programs address issues of access, affordability and relevance of the education system to the needs of the economy and the community.

### Table 4: Social indicators by district

<table>
<thead>
<tr>
<th>Indicator</th>
<th>Cape Town</th>
<th>Cape Winelands</th>
<th>Central Karoo</th>
<th>Eden</th>
<th>Overberg</th>
<th>West Coast</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Health</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Patient nurse ratio</td>
<td>54</td>
<td>32***</td>
<td>31</td>
<td>42</td>
<td>29,00</td>
<td>40</td>
</tr>
<tr>
<td>TB Prevalence/100 000 people</td>
<td>N/A</td>
<td>1 113</td>
<td>1 014</td>
<td>1 133</td>
<td>1 142</td>
<td>1 214</td>
</tr>
<tr>
<td>TB cure rate</td>
<td>71%</td>
<td>66%</td>
<td>71%</td>
<td>78%</td>
<td>74%</td>
<td>73%</td>
</tr>
<tr>
<td>Births under 2,5 kg (%)</td>
<td>2,40%</td>
<td>18%</td>
<td>26%</td>
<td>26%</td>
<td>16%</td>
<td>16%</td>
</tr>
<tr>
<td>Under 1 with 1st measles immunisation</td>
<td>83%</td>
<td>82%</td>
<td>80%</td>
<td>85%</td>
<td>75%</td>
<td>88%</td>
</tr>
<tr>
<td>HIV deaths (2010)</td>
<td>41 306</td>
<td>1 163</td>
<td>106</td>
<td>3 108</td>
<td>807</td>
<td></td>
</tr>
<tr>
<td>HIV prevalence rate (2010)</td>
<td>6,90%</td>
<td>4,70%</td>
<td>3,30%</td>
<td>4,60%</td>
<td>4,90%</td>
<td>4,30%</td>
</tr>
<tr>
<td><strong>Education</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Educator learner ratio</td>
<td>39</td>
<td>38</td>
<td>36</td>
<td>40</td>
<td>37,00</td>
<td>37</td>
</tr>
<tr>
<td>People over 14 illiterate</td>
<td>15%</td>
<td>28%</td>
<td>37%</td>
<td>26%</td>
<td>27%</td>
<td>29%</td>
</tr>
<tr>
<td>Enrolment rate</td>
<td>96%</td>
<td>99%</td>
<td>87%***</td>
<td>98%</td>
<td>94%***</td>
<td>97%</td>
</tr>
<tr>
<td>Unemployment rate</td>
<td>29,2%</td>
<td>18%</td>
<td>36%</td>
<td>27%</td>
<td>19%</td>
<td>14%</td>
</tr>
</tbody>
</table>

| **Note**                                       |           |                |               |      |          |            |
| **Source:** SEP-LG 2006                        |           |                |               |      |          |            |
| ***** utilisation of services/facilities not significant** |           |                |               |      |          |            |

In 2005, the general trend of health indicators trend across the Western Cape is uninspiring. Table 4 shows that tuberculosis (TB) cure rates for the City and the five districts were reported at levels well below the national target of 85 per cent. Eden district has the most favourable TB cure rate at 78 per cent, while the City had the worst cure rate at 71 per cent. The TB cure rate in Overberg has since improved to 85 per cent (2006).

Although the statistics are useful in highlighting where the pressures are, they conceal possible reasons for these patterns such as the efficiency of nurses, compliance of patients with the treatment programmes and accessibility of healthcare facilities.

Education is a primary influence in shaping the size and quality of skills available to support economic activity in an area. In addition, policy- (political and economic) related influences such as accessibility, relevance of the curriculum and affordability determine the availability of skills.

Table 4 also shows that illiteracy rates reported in the districts are relatively high when compared to that of 15 per cent reported for the City. Comparisons can be made between the shortage of schools, illiteracy rates and the eventual unemployment rates for the specific districts. In particular, a strong correlation exists between the illiteracy levels and the unemployment rate.
High levels of illiteracy are found in predominantly rural areas. The illiteracy levels are particularly high for the Central Karoo (37%), Cape Winelands (28%), Eden (26%), Overberg (27%) and West Coast (29%).

8.2 Economic infrastructure

Economic infrastructure is a key factor in economic growth performance, whether at the national, regional or local level. Within the growth framework, the role of government is to create an enabling environment to support the efforts of other economic agents.

At the local level, investment in transport, housing, water and electricity-reticulation infrastructure, sanitation and refuse-removal facilities, as well as municipal roads, pavements, bridges and storm-water drains are critical to advancing economic development at the local level.

Municipalities generally face a problem of ageing economic infrastructure coupled with bulk infrastructure backlogs. Chronic shortages were reported in the City. This is of great concern as the City accounts for 72 per cent of the Province’s municipal budgets and in 2004, approximately 76,5 per cent of Western Cape’s economic activity was within the City.

Furthermore, 65 per cent of the Western Cape population resides in the City. If left unattended, the infrastructure-related problems have the potential to hold growth plans hostage.

Transport infrastructure — road networks, airports, and harbours — play an important role in facilitating economic growth. The road networks in the Western Cape are continuously upgraded and there is a comprehensive network of primary (tarred) and secondary (gravel) roads.

More frequent maintenance is required on the gravel roads in order to improve the connectivity of the region’s economic network. In addition, SEP-LG 2006 highlighted that rural areas are under serviced and there are areas that need interventions to improve market access and reduce the cost of doing business for farmers.

The lack of efficient public transport services in the region is a major problem, particularly given the extremely dispersed settlement pattern. An efficient public transport system ensures that the amount of time people spend travelling is minimised. At a strategic level, the safety of the public transport system needs monitoring given its impacts on other department’s service delivery obligations.

Water availability is a contentious issue within the Western Cape region especially in major towns. The availability of water is also linked to the bulk infrastructure issues. A strong emphasis is placed on water infrastructure development in the major towns. Water network upgrading is in progress in some areas with the construction of reservoirs and upgrading of water pipes.

In relation to bulk infrastructure, sanitation and pipe blockages are a persistent problem. Many households in the Western Cape do not have access to water-borne sanitation. The proportion of households using the bucket system and without
sanitation facility is estimated at 3.4 per cent. The City has stopped approving new plans as a result of bulk infrastructure backlogs.

Recently, the energy crisis in the region has hindered economic activity and created problems in households as well as in leisure and daily living activities. Alternative sources of energy such as solar panels are being considered as an alternative. The greatest need for electricity exists with farm worker houses and a policy decision is required on whether farmers, Eskom or district municipalities are responsible for providing electricity to farm workers.

Housing is one of the problem areas for the Western Cape. Housing backlogs are widespread throughout the province. Most of the backlogs are in the City where there is a shortfall of about 300,000 housing units, followed by the Cape Winelands and Eden districts.

8.3 Economic performance

Contributing 76.5 per cent of the Western Cape’s GDP in 2004, the City of Cape Town forms the Province’s main economic growth engine. Two economic growth nodes flank the City: the Saldanha-Vredenburg node to the west and the South Cape to the east.

Table 5 below presents the City and district contribution to Provincial GDP in 2004, illustrating key economic contributions from the City (76.5%), Cape Winelands (10.5%) and Eden (6.2%) districts. In contrast, municipalities with a more rural and agricultural bias struggled to grow.

Table 5: City and district GDP contribution, 2004

<table>
<thead>
<tr>
<th>Region</th>
<th>Share of Western Cape (%)</th>
<th>Share of SA (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Central Karoo</td>
<td>0.50</td>
<td>0.07</td>
</tr>
<tr>
<td>Overberg</td>
<td>2.37</td>
<td>0.35</td>
</tr>
<tr>
<td>West Coast</td>
<td>4.00</td>
<td>0.58</td>
</tr>
<tr>
<td>Eden</td>
<td>6.15</td>
<td>0.90</td>
</tr>
<tr>
<td>Cape Winelands</td>
<td>10.49</td>
<td>1.54</td>
</tr>
<tr>
<td>City of Cape Town</td>
<td>76.49</td>
<td>11.19</td>
</tr>
<tr>
<td>Western Cape</td>
<td>100.00</td>
<td>14.63</td>
</tr>
</tbody>
</table>

Source: Own calculations based on Quantec Research, 2007

8.4 Municipal sustainability

Changes in political governance disrupt the implementation of strategies and programmes as political parties further party specific strategies. This was evident in a number of municipalities across the Western Cape although major changes were in specific local municipalities where some parties lost ward seats to others. Thus the continuity of governance and policy-making processes were not compromised.

Internal capacity in relation to staff appears to be healthy when assessed at a district level. However, the staffing situation within individual municipalities is less satisfactory with a strong correlation existing between staff shortages and problem in
basic service delivery. The City is an example of this correlation with less than 90 per cent of its posts filled. Staffing problems within the City are concentrated in critical areas such engineering, fire fighting and finance.

In 2005, the Cape Winelands district had four municipalities (Witzenberg, Breede Valley, Drakenstein and the Cape Winelands District Municipality) that had vacancy rates of less than 75 per cent. The Central Karoo had filled almost of their vacancies.

8.5 Fiscal landscape and financial sustainability

The fiscal landscape and financial sustainability are some of the key considerations in determining the speed of service delivery (assuming no skills constraint exists) in municipalities.

The size of the budget and the efficient execution of budget plans are important levers for accelerated development. The average budget size for Western Cape municipalities is estimated at R699 million with the bulk (72%) of the budget concentrated within the City. Category B and Category C municipalities account for 24 and 4 per cent respectively of the overall Provincial municipal budget.

As far as the fiscal landscape is concerned, SEP-LG 2006 found that municipalities continue to face an array of mounting challenges. Apart from poverty-induced revenue constraints, some challenges are largely associated with the combination of inefficient/ineffective debt collection, internal capacity (personnel and billing system), diminishing revenue due to legislative changes (abolition of the Regional Services Council (RSC) levy in 2005 and the proposed introduction of RED1) and limited use of external borrowing.

These factors collectively affect the fiscal landscape and have a strong influence on municipalities’ fiscal sustainability and could undermine the distributional goals of service delivery.

Municipalities can borrow using various funding instruments, ranging from project finance, short-term or long-term loans using either marketable or non-marketable debt to fund infrastructure projects. In the Western Cape there seems to be a weak appetite for long-term municipal debt, especially listed securities. Although municipalities are assessed from time to time, only three municipalities — the City, George and Breede Valley local municipalities — are assigned ratings by CA Ratings15.

The City is planning to tap the markets in 2007 to fund infrastructure. In the context of the growing need to accelerate economic growth and infrastructure backlogs, having all municipalities rated can be a valuable exercise to gauge their credit worthiness and investor sentiment.

15 CA Ratings (where ‘CA’ is drawn from the ‘Chartered Accountant’ profession) has been acquired by Moody’s Investor Service. CA Ratings for municipalities are currently being converted to Moody’s Ratings.
8.6 Financial sustainability

Financial sustainability is an important consideration in assessing municipalities’ ability to access capital and service delivery. Financial stability refers to the extent to which the municipalities enjoy healthy long-term financial performance in such a way that long-term service delivery, new infrastructure and maintenance plans are financed comfortably without resorting to drastic hikes in rates and deterioration of service delivery.

The recent audit report of 27 out of 30 municipalities in the Province, found that the majority (55%) of the municipalities’ annual financial statements for 2005/06 were qualified, 33 per cent unqualified with emphasis of matter, 8 per cent with adverse opinion and 4 per cent with disclaimer of opinion on debt service costs. In Witzenburg, external loans constitute 16,7 per cent of capital funding, reflecting an increase of 48,3 per cent from 2006/07 to 2007/08.

8.7 Responding to socio-economic challenges

It is evident from the SEP-LG 2006 analyses that an urgent response to socio-economic challenges is critical. Failure to do so will undermine Government’s socio-economic policies and strategic objectives, such as the PGDS iKapa Elihlumayo.

Whilst not decrying the benefits of promoting areas with greatest potential, strategies that are silent about the plight of the marginalized or under developed areas are harmful as they overlook issues that are potential causes of conflict (e.g. migration) that are constantly cited as sources of pressure for service delivery.

In addition to strategies, empirical evidence suggests that the ownership and customised interventions tend to be sustainable. The model of a successful approach to service delivery must be underpinned by strategies that are based on a methodology that addresses issues of gender, age, location, and social standing.

The 2007 PER&O consolidates work completed in the earlier reviews. The earlier reviews helped to initiate and catalyse debate on provincial socio-economic data, research and analyses, given the then dearth of provincial-level information. This year’s PER&O engages a matured and more sophisticated policy discourse.

It is now time to evaluate the form, content, applicability and positioning of the PER&O ahead of planning the 2008 edition. As a first step, external technical reviewers were invited both to comment on the technical content of this year’s PER&O prior to publication and to make recommendations that may be taken into account in planning the research programme for the PER&O 2008.

Inputs indicate that the PER&O readership holds a range of different views as to the role and scope of the publication. For instance, some see it primarily as a repository of provincial socio-economic data; others would like the PER&O to engage in more critical analysis and a few expressed their desire for analysis to extend beyond socio-economic scanning to more definitive policy statements, even targets.

A more in-depth evaluation will follow. This will help broaden debate on the role, scope and positioning of the PER&O, hence guiding the direction and scope of provincial socio-economic analysis in support of evidenced-based policy and decision making in the Province over the next few years.
Economic Outlook: 2007/08 – 2009/10

Key findings:

• Economic growth in the SA and the Western Cape economies continues to be buoyant, underpinned by robust global growth.

• SA experienced real GDP growth of about 5.0 per cent a year between 2004 and 2006.

• Western Cape economy registered even higher growth at 6 per cent a year during 2004 and 2005, and estimated at 5.5 per cent during 2006.

• It is expected that the real economy will experience some slowdown during 2007/08. The anticipated slowdown of the economy may be mild; however, the composition of that growth may change more significantly.

• The robust regional growth continued to be driven by the services industries (outside of government) and construction.

• Evidence points to the manufacturing sector underperforming, with results below anticipated levels.

• Higher inflation and interest rates are likely to cool down the household spending momentum in the national economy.
Regional business confidence recovered during the fourth quarter of 2006 and the first quarter of 2007. Business and consumer confidence remained poised at elevated levels during the early part of 2007 suggesting the robust economic growth could continue.

Broad fixed investment intentions remain strong, with the public sector infrastructure investment drive taking off, unlikely to be affected by interest rates.

The acceleration of economic growth to a higher level is exerting pressure on production capacities. Serious skilled labour constraints, production capacity constraints and infrastructure bottlenecks are developing, constraining the economy to elevate growth further.

There are some leading indications of the impact of higher interest rates on the consumer sector – the growth in household credit extension has turned the corner and new vehicle sales growth contracted towards the end of 2006 and early 2007.

Higher global interest rates are likely to cause tighter global liquidity conditions and higher risk aversion amongst international investors, affecting capital flows to developing countries.

Both fixed investment spending and household consumption expenditure accelerated strongly. The latter has been driven by the acceleration in employment creation in recent years.
1. Introduction

The AsgiSA has as its primary thrust moving the SA economy onto a significantly higher growth trajectory of 6 to 8 per cent by 2014. A higher broad-based growth path is critical for the creation of sufficient jobs, enhancing economic participation and inclusion over the medium to long term.

The Western Cape shares this vision and strategic objective, encapsulated in the higher and shared growth thrust of iKapa Elibhumayo. The latter aims to shift the Western Cape economic growth to the 6 to 8 per cent level over the next five years.

Recent trends evidence the feasibility of such objective. Both the national and the regional economies experienced robust growth over recent years. Revised national account statistics show that between 2004 and 2006 real GDP growth averaged around 5 per cent a year and the growth momentum remained at 5 per cent during the second half of 2006. The Western Cape economy registered even higher growth according to the revised statistics averaging 6 per cent a year during calendar years 2004 and 2005, and estimated at 5.5 per cent during 2006.

Economic growth in the region and the wider SA economy benefits from robust growth in the world economy. In fact, compared to the economic growth rates achieved in SA’s peers, SA’s current 5 per cent growth tempo continues to lag and needs to be elevated further, which will require that key growth constraints be alleviated through proper policy and other interventions.

Suffice to say, that the economic outlook in the region and the wider SA economy is looking more promising compared to any stage in the past 30 to 40 years. The growth acceleration has structural foundations and the potential to be sustained.

The available evidence shows that the robust regional growth continued to be driven by the services industries (outside of government) and construction. Regional manufacturing growth came in at an estimated and relatively disappointing 3.7 per cent in 2006 and the sector suffered a sharp decline in confidence contrary to the situation in the rest of the country.

The financial environment changed in a short space of time following developments on the global financial markets in May and June 2006, the rand’s depreciation since that time and the subsequent increase in inflation and interest rates.

The domestic real economic growth performance has proved to be remarkably resilient in the face of the increase in inflation and interest rates. Interest rates increased by a cumulative 200 basis points between June and December 2006, and the depreciation of the currency and high food and oil prices caused acceleration in inflation. The rand’s depreciation was capped as international investors’ risk appetite recovered towards the end of 2006.
It is still expected that the real economy will experience some slowdown during 2007 and 2008. The interest rate sensitive sectors – retail, construction and financial services – could in particular witness less vigorous growth. Manufacturing, on the other hand is benefiting from the more competitive currency. Broad fixed investment intentions also remain strong, with the public sector infrastructure investment drive taking off unlikely to be affected by interest rates. The anticipated slowdown of the economy may be mild; however, the composition of growth may change more significantly.

Higher inflation and interest rates are likely to cool down the 7 per cent household spending momentum in the economy, closer to 5 to 4.5 per cent but with the noted counterbalancing factors ensuring that national economic growth is sustained around a 5 per cent level.

The Western Cape economy business cycle broadly tracks that of the national economy. Therefore, the same factors currently affecting the national macro-economic climate will impact locally. The depreciation of the rand exchange rate and the increase in inflation and interest rates will impact both on the sectoral composition and level of growth in the Western Cape.

This having been said, the region suffered an unexpected decline in business confidence during the second and third quarters of 2006 to levels well below that in Gauteng, KwaZulu-Natal and the Eastern Cape where confidence still trended higher.

Regional business confidence recovered during the fourth quarter of 2006 and the first quarter of 2007. However, evidence points to an under performing manufacturing sector (see page 55).

The growth tempo remained exceptionally strong during calendar 2006 in the regional construction sector (estimated at close to 15%) and the services sectors, excluding government (growing by an estimated 6%).

This chapter discusses the short-term outlook for the SA economy (including global economic conditions) and the Western Cape economy. The first section briefly reviews the SA economic outlook. The second section takes a closer look at the regional economic outlook in its consideration of the regional economic linkages and the prospects for growth, employment and exports.
2. Trends in the South African economy

2.1 Recent developments

The SA economy registered a 5 per cent real GDP growth rate in 2006. This was the third consecutive calendar year of around 5 per cent growth. The economy remained remarkably resilient towards the end of the year and early in 2007 in the face of higher interest rates. Both the global and domestic financial markets have also shrugged off the jitters that surfaced in May and June 2006 and late February 2007.

Domestic business and consumer confidence remained poised at elevated levels during the early part of 2007 suggesting the robust economic growth could continue. With robust fixed investment spending across many sectors, employment growth is taking place and this is boosting household financial positions, in turn underpinning household consumption spending.

There are some leading indications of the impact of higher interest rates on the consumer sector – the growth in household credit extension has turned the corner and new vehicle sales growth contracted towards the end of 2006 and early 2007. PPI inflation\(^1\) accelerated to 10 per cent during October/November 2006 and further to 11,1 per cent in April 2007, reflecting strong pipeline price pressures. The pass through to CPI inflation has been contained thus far, aided by low inflation expectations. However, CPI inflation breached the upper 6 per cent boundary of the inflation target in April coming in at 6,3 per cent. After pausing with interest rate hikes in February 2007, the South African Reserve Bank (SARB) resumed tightening in June 2007.

The current account of the balance of payments, recording a deficit measuring 6,4 per cent of GDP during 2006, remains in a somewhat precarious position leaving the rand exchange rate vulnerable. The deficit on the current account continues to be handsomely financed by capital inflows, albeit that these inflows tend to be dominated by portfolio investments. This in turn results in an element of risk regarding the rand exchange rate. Between mid-May and mid-October 2006, the trade-weighted value of the rand exchange rate depreciated by 22 per cent; however the rand recovered back to a level of R7,00/US$.

Real domestic expenditure is projected to slow from an 8,7 per cent increase in 2006 to a 5 per cent pace during 2007, cooling down import growth, which will come under further pressure from the weaker rand exchange rate.

Furthermore, exports are expected to respond positively to the currency adjustment. These tendencies should benefit the current account of the balance of payments and render domestic growth more sustainable.

---

\(^1\) Inflation at the producer level is measured by the Producer Price Index (PPI). The PPI consists of two components, that is a domestic component capturing producer selling price increases ex factory and an import component capturing the increase in imported prices.
Capacity constraints underpinning fixed investment spending, infrastructure investment and stronger net export growth are likely to be important countervailing forces to the slowdown in the domestic consumer market, ensuring a sustained 4.5 to 5 per cent level of growth in the economy overall.

CPI, CPIX and PPI inflation

The Consumer Price Index (CPI) measures price increases of consumer goods at the retail level. The CPI is compiled by Statistics SA on a monthly basis from a survey of all consumer goods prices. The CPI is therefore a comprehensive measure of the prices of a basket of consumer goods.

The weights of the various components of the index are revised every five years along with changes in consumer spending patterns, that is each component of the index receives a weight equivalent to the share of household spending directed towards the particular item.

For the purpose of monetary policy, the interest cost on mortgages is excluded from the CPI in order to arrive at the CPIX inflation rate. CPIX is therefore also a broad measure of consumer goods inflation; however, mortgage interest cost is excluded as changes in interest rates (due to monetary policy decisions) will reflect directly in CPI.

The objective of monetary policy is to influence inflation levels and maintain the CPIX inflation rate within the 3 to 6 per cent target range. CPIX inflation is targeted as it excludes the direct impact of monetary policy decisions on CPI inflation.

Therefore, in a time of increasing interest rates, CPI inflation will typically be above CPIX inflation; during March 2007, CPI inflation stood at 6.1 per cent compared to CPIX inflation of 5.5 per cent following the 200 basis points increase in interest rates during the second half of 2006. The converse applies during periods of declining interest rates.

The Producer Price Index (PPI) measures price increases at the producer level; the index consists of a domestic production component (80%) and an import component (20%). The domestic component is determined by price increases at the factory gate level while the import component is determined by imported inflation, that is price increases abroad and changes in the exchange rate of the rand.

The PPI inflation rate was measured at 10.3 per cent in March 2007, well above the CPI and CPIX inflation rates. The recent increase in PPI inflation was mainly driven by the impact of the depreciating rand exchange rate (from R6/US$ early May 2006 to levels around R7/US$ currently), the increase in crude oil prices and food price increases (e.g. maize prices).

The current wide gap between CPI and PPI inflation suggests that retailers are absorbing much of the increased cost of goods procured from local producers. CPI inflation is not to the same extent exposed to the rand’s depreciation in a direct sense. It is also important to point out that the CPI contains the prices of household services, which are not measured in the PPI.

It is therefore possible that the PPI and CPI inflation rates could differ from time to time. Over the longer term there usually is a good correlation between inflation at the producer and consumer levels.

Economic growth has clearly accelerated to a higher level and this is exerting pressure on production capacities. Serious skilled labour constraints, production capacity constraints and infrastructure bottlenecks are constraining the economy to elevate growth further.
It is the main objective of the AsgiSA initiative to alleviate these constraints and in that way to accelerate the economic growth rate further. While the 5 per cent real economic growth rate achieved over the past three years is encouraging, there is clearly no room for complacency.

### 2.2 Global economic developments

There is widespread consensus that the world economy is heading for slower growth in 2007. The International Monetary Fund (IMF) expects global growth could ease to a still very strong 4.9 per cent in 2007 from an estimated 5.4 per cent in 2006. While the IMF is forecasting slower growth for the United States (US), Europe and Japan, it is of the opinion that any easing in growth will be mild.

There is a considerable variance of opinion amongst analysts on how sharp the slowdown in the US economy will be. A harder landing in the US economy is likely to lead to a weaker world economic growth environment compared to the IMF projections.

Chinese economic growth continues to surprise on the upside with most analysts believing that the country will continue to grow by 9 to 10 per cent during 2007. Sustained strong growth in China and the fast industrialising developing economies of the world should remain a key support for commodity prices.

The commodity picture is somewhat mixed with some base metal markets in surplus, whilst demand continues to exceed supply in others. Nonetheless, the general tendency in industrial commodity prices is likely to be downward over the short term.

Whilst the US Fed has paused with the tightening of monetary policy, interest rates are expected to increase further in Europe and Japan. Higher global interest rates are likely to cause tighter global liquidity conditions and higher risk aversion amongst international investors, affecting capital flows to developing countries.

### 2.3 Business cycle prospects

The current expansion of the SA economy is more than seven calendar years old. The durability of the cycle resides in the stabilised macro-economic climate, the (partial) lifting of the balance of payments constraint on economic growth (via the liberalisation of the capital account of the balance of payments) and the gradual and accelerating income growth in the household sector of the economy on the back of improved employment creation (in recent years), low inflation and personal tax relief.

Cumulative growth over the period 1999 to 2002 led to improved demand conditions in the domestic market, which in turn stimulated the private sector to expand investment. Fixed investment spending accelerated strongly from 2003 (at a rate consistently exceeding 9 per cent a year). The expanding fixed investment rate is feeding back to employment creation, supporting the growth in household consumption spending.
Consumption spending momentum has furthermore been boosted by healthy household credit utilisation on the back of lower interest rates. The latter trend during 2003 to 2005 contributed to capping the country’s debt service costs. The lower inflation environment is helping to make higher household indebtedness more sustainable.

Unfortunately the downside of the current expansion, particularly the period since 2002, is the poor export growth noted above, in turn related to the strong rand exchange rate and regulatory and infrastructure constraints in the mining sector. This has contributed to a sizeable current account deficit (6.4% of GDP in 2006).

The current economic expansion can be divided into two phases: the first phase, stretching from the third quarter in 1999 to 2002 and 2003 was characterised by moderate real GDP growth measuring 3.2 per cent a year. A key characteristic of this phase has been the poor formal sector employment record. This period was burdened by restrictive fiscal policy (implemented since 1996), rationalisation in the private sector as companies confronted the impact of trade liberalisation and globalisation pressures; and, finally, financial volatility in 2001 and 2002 (including a 400 basis point hike in domestic interest rates). However, the weaker rand exchange rate stimulated manufacturing exports and compressed imports (which were already restricted by the subdued growth in real domestic expenditure).

The moderate growth in real domestic expenditure over the first phase of the business cycle upswing should not be seen as a sign of economic weakness, but rather the impact of structural adjustment. The cumulative, steady growth introduced change, best reflected in an unrelenting increase in business confidence levels. In fact, the domestic economic resilience in the wake of the 2000 and 2001 global economic recession and the sustained increase in domestic business confidence suggested a newfound robustness in SA’s economic growth performance.

The typical business cycle pressure points were largely absent. That is, the current account of the balance of payments registered a surplus three years into the upswing (2002) and apart from the currency-induced (temporary) supply shock in 2002, inflation pressures were non-existent.

The track record since 2003 speaks for itself. During the ‘second phase’ of the expansion, real GDP growth accelerated notably to 4.5 per cent a year on average and reached 5 per cent on average in the period 2004 to 2006. Both fixed investment spending and household consumption expenditure accelerated strongly as noted above. Key was the acceleration in employment creation delivering the back bone of the growth in household consumption.

---

2 The household debt ratio increased from below 50 per cent at the end of 2002 to 73.8 per cent during the fourth quarter of 2006; however, the household debt service ratio has only increased to its long-term average of 9 per cent.
Credit utilisation also accelerated notably, driven by historically high consumer confidence on the back of deep interest rate cuts and low inflation. The financial impact of the strong inflows on the capital account of the balance of payments, driving a strong rand exchange rate and lower inflation has to be acknowledged in this regard.

However, this was not the primary driver of the growth. The roots of the expansion lay further back and acquired a sustainable momentum even in the face of the 2000 and 2001 global recession and domestic hike in interest rates in 2002.

The financial stimulus embodied in the strong capital inflows on the balance of payments upped the growth tempo. In the process, the current expansion became more typical for SA. That is, strong growth in real domestic spending, with a notable credit component, deteriorating net exports and current account and building inflationary pressure. The current account pressures were on the one hand relieved by the steady improvement in the terms of trade, but on the other hand exacerbated by a poor export performance (in turn related to the strong rand exchange rate and other factors noted above).

The economy is therefore currently facing some typical business cycle pressures. Inflation has accelerated, the current account deficit (measured at the fourth quarter of 2006) is uncomfortably high at around 7 per cent of GDP and capacity utilisation pressures are evident across many sectors of the economy. The increase in inflation appears to be under control and the 200 basis points interest rate hike during the second half of 2006 should assist in this regard.

The current account deficit is appropriately financed through healthy capital inflows and prospects in this regard remain optimistic, albeit that the quantum of the portfolio investment component of these inflows is cause for alert.

Finally, production capacity utilisation — in manufacturing, construction and the utilities — are at record highs, but fixed investment in all these areas is expanding to address capacity constraints.

All this evidence suggests a maturing business cycle upswing. Fortunately the macro-economic parameters are such that economic growth may be sustained. Following the interest rate hikes of last year, the economy is probably heading for some slowdown in 2007. It is important that economic growth becomes better balanced in terms of a reduced impetus from the consumer boom combined with a recovery in net exports.

SA’s fixed investment rate (that is, the ratio of fixed investment to GDP) has picked up from below 15 per cent at the end of 1999 close to 20 per cent by the end of 2006. This is still below that achieved in other developing economies (e.g. East Asia) and explains the lagging domestic real economic growth rate.

In order to elevate SA’s growth rate further the fixed investment rate needs to increase closer to 25 per cent; however, it will be critical to improve the national savings effort — national savings only measured 13,9 per cent of GDP in 2006. Some attention was accorded to savings in the 2007/08 national budget.
2.4 Towards more balanced domestic economic growth

The deficit on the current account of the balance of payments widened to 7.8 per cent of GDP during the fourth quarter of 2006, exacerbated by strong oil imports. It may not be so obvious that this level of the current account deficit is not sustainable provided the strong capital inflows that SA has been attracting in recent years, adequately financing the deficit. However, considering the trends in the export and import ratios, it is immediately evident that the large current account deficit is mainly due to an adverse trade performance and not sustainable.

The ratio of real exports to GDP declined by four percentage points (from 29 to 25%) between mid-2001 to mid-2006, while the ratio of imports to GDP increased by no less than nine percentage points (from 24 to 33%) over the corresponding period. This reflects a poor export performance particularly in view of the fact that the global economy experienced an upswing phase over this period (2002 to 2006), real export growth averaged 3.3 per cent a year and domestic import penetration skyrocketed over this period.

The strong rand exchange rate over the period 2003 to the first half of 2006 added fuel to the domestic spending boom (indirectly via lower inflation and interest rates) and import demand, whilst at the same time constraining the export effort, particularly in manufacturing.

Furthermore, infrastructure constraints and regulatory uncertainties, which impacted negatively on mining fixed investment spending, constrained SA’s export growth, preventing the mining sector from fully participating in the global commodities boom in recent years.

Figure 1: Imports and exports as a ratio of GDP

Source: SA Reserve Bank
The rand’s recent depreciation should be welcomed. While it will impact negatively on the favourable pricing environment of recent years, this impact could be manageable given the monetary policy credibility of the SARB and hopefully a contained reaction in domestic inflation expectations.

The latest available evidence supports this view. The current account of the balance of payments should improve as import demand cools down (on the back of higher import costs and slower domestic spending) and exports recover.

In fact the recovery in net exports (that is, exports minus imports) can to a large extent compensate for the projected slowdown in the interest rate sensitive components of real domestic spending. Therefore, while the composition of domestic economic growth may change, the level of growth could remain robust and better balanced.

**Inflation targeting**

SA adopted inflation targeting as its formal monetary policy framework in February 2000, after a range of industrial and developing countries adopted inflation targeting monetary policies during the 1990s (e.g. New Zealand, Australia, Brazil, Canada, Chile, Mexico, Sweden and the United Kingdom).

Before that, the SARB followed an essentially eclectic approach of ‘informal inflation targeting’ relying very much on the monetary aggregates as the anchor for policy decisions. However, much uncertainty arose as structural changes in the economy rendered the monetary aggregates inappropriate guides for monetary policy making.

Inflation targeting was then adopted, firstly, to improve the transparency of monetary policy decision making; secondly, to improve the co-ordination between the various economic policy departments in the pursuit of higher economic growth and lower unemployment; thirdly, to increase the accountability of the SARB; and, finally, to influence the level of inflation expectations as a means to reduce actual inflation in SA (Van der Merwe, July 2004: 1-2).

The latter-mentioned rationale for inflation targeting monetary policy is arguably its most important, that is through the setting of the inflation target the policy authorities aim to influence general inflation expectations and consequently the wage and price setting processes in the wider economy so as to reduce actual inflation.

Inflation targeting is more than just setting a numerical target for inflation to be attained over a specific time horizon; it is about co-ordination with other economic policy departments, accountability and transparency. While national practices differ, the SA government sets the inflation target in consultation with the SARB.

The SARB has the responsibility to attain the inflation target, but it has independence in choosing the instrument with which to do this. The key policy instrument used by the SARB is the repo interest rate, which determines the whole structure of short-term interest rates in the domestic financial markets.

While a whole range of options existed regarding the definition and time-specification of the inflation target, SA eventually (November 2003) opted for a continuous inflation target of 3 to 6 per cent for the CPIX inflation rate (that is, the overall CPI inflation rate, excluding mortgage interest costs), to be attained from 2006 onwards. This implies that the SARB should strive to maintain the year-on-year CPIX inflation rate within the 3 to 6 per cent target range for each month.
The SARB’s focus is on the expected rate of inflation as changes in interest rates only influence the actual inflation rate with a considerable time lag (up to 18 to 24 months). Interest rate decisions — taken by the Monetary Policy Committee (MPC) of the SARB — therefore have to be pre-emptive. Initially, four quarterly MPC meetings were scheduled; however, from June 2003, it was decided to change the frequency to six bi-annual meetings in order to facilitate more timely monetary policy decision making.

The Government and the SARB have from the onset been not too rigid in applying inflation targeting, that is they allowed for exceptional circumstances (e.g. supply shocks) to deviate from the set target, that is the so-called escape clause. From November 2003, the escape clause was replaced by an explanation clause, i.e. the SARB had to explain why the target may be missed in particular conditions and how the SARB intended to restore price stability.

Furthermore, whilst always at risk to damage credibility, the Government and the SARB appear to be sensitive to the attainment of other economic objectives such as the eradication of poverty, the reduction of unemployment, the stabilisation of output growth and the attainment of a competitive exchange rate.

However, the whole success of implementing inflation targeting monetary policy depended on the SARB’s success in generating the necessary credibility amongst business people, analysts, labour unions and the broader society; it follows that the lowering of inflation expectations and actual inflation required top priority during the initial phase of the policy.

During the years preceding the inflation targeting monetary policy, 1996 to 2000, core inflation averaged close to 8 per cent a year. Apart from the currency-induced spike in inflation during 2002, inflation expectations and actual inflation gradually declined to within the target range, with CPIX inflation for the first time measured below the 6 per cent upper range in September 2003.

CPIX inflation has since averaged well within the 3 to 6 per cent target range for 44 consecutive months (averaging 4,4%); general inflation expectations also remained within this target range (that is, slightly above 5%) at the time of writing.

One may therefore conclude that the SARB has largely been successful in establishing a high degree of anti-inflation credibility. Research also points to much weaker inflation pass-through from currency depreciation and other supply shocks to eventual CPI inflation, which could be, amongst other factors, a reflection of the measure of credibility attained by the SARB.

This success may provide a foundation for the SARB (and the Government) to embark on a more flexible approach to inflation targeting by giving increasing weight to the other economic policy objectives, such as output and exchange rate stabilisation, without damaging the Bank’s inflation fighting credentials.

2.5 Short-term inflation and interest rate outlook

CPIX inflation has increased from 3,7 per cent in April 2006 to 5 per cent in August and remaining at this level for the remainder of 2006, but picking up further to 6,3 per cent in April 2007. PPI inflation accelerated from 5,5 per cent in April 2006 to 10 per cent in October and November 2006 and 11,1 per cent in April 2007, mainly driven by higher food and energy prices, as well as the rand’s depreciation.

The pass-through from the currency depreciation and the high PPI inflation to CPI inflation has thus far therefore been contained. In a fiercely competitive global environment, pass-through has been moderated. Cost increases are rather absorbed in margins and/or via productivity improvements rather than to pass these through to consumers in order to retain market share. These structural changes will weigh up to domestic firms being eager to hike prices in order to catch-up with recent years’ price restraint and/or to insulate company earnings from lower sales volume growth.
Pressures emanating from producer prices indicate that some negative effects on inflation can be expected. CPIX inflation is projected to trend slightly above the upper 6 per cent target range over the next 8 to 10 months, before moderating again closer to the 5 per cent level towards the end of 2008.

The SARB decided to resume with interest rate hikes in June 2007. Fortunately, inflation expectations remain well-anchored, which could contain the increase in actual inflation and therefore any potential increases in interest rates.

There may be scope to reduce interest rates in 2008, but the magnitude of this will depend on the decline in actual inflation and the overall balance of payments position.

### 2.6 Fixed investment and employment creation to drive growth

The revised national account statistics show that real gross domestic fixed investment growth averaged 10 per cent a year over the past four calendar years, that is, 2003 to 2006, while the momentum accelerated close to 16 per cent during the fourth quarter of 2006.

The robust capital spending is led by the private sector and the public corporations expanding production capacity. The cumulative growth of the SA economy over the past seven years has led to production capacity constraints across many industries.

Figure 2 below points to the historical high rate of manufacturing capacity utilisation during the fourth quarter of 2006.

**Figure 2: Manufacturing production capacity utilisation**

![Graph showing historical manufacturing production capacity utilisation]  
*Source: SA Reserve Bank*
In a sustained 4.5 per cent to 5 per cent real GDP growth scenario, these production capacity constraints will continue to underpin fixed investment spending. In the private sector, healthy balance sheets may also make companies less sensitive to the higher level of interest rates. It is expected that private fixed investment spending will remain robust over the short to medium term. Combined with the public sector infrastructure spending programme this will increasingly drive economic growth.

The favourable fixed investment trend has also had a positive impact on employment creation. Figure 3 illustrates the extent to which formal sector employment creation has picked up over recent years, refuting concerns about ‘jobless growth’ in latter years.

Lower-income household consumer confidence has been boosted on the back of improved employment growth in the broader economy, both in the formal and informal sectors.

**Figure 3: Formal non-agricultural employment**

Statistics SA’s Labour Force Survey (LFS) and the Quarterly Employment Statistics (QES) reveal accelerating employment growth across most sectors of the economy.

The LFS suggests an increase in economy-wide employment of 500 000 in the year to September 2006. The same survey suggests close to 400 000 of these employment opportunities were created in the formal non-agricultural sectors of the economy.
Statistics SA is SA's primary source of labour market statistics. SA's employment statistics have been a source of much criticism due to discontinuities in the survey methods and samples. However, in recent years many of the problems have been attended to rendering the employment statistics more reliable.

Statistics SA conducts two surveys in order to measure the employment growth in the economy. The first of these surveys is the bi-annual Labour Force Survey (LFS), which is a survey of 30,000 households (that is, around 67,000 individuals of working age 15 to 65 years) and tracks the employment status of individual households over a broad front across the nine provinces.

This survey is a comprehensive survey of labour market trends measuring both formal and informal sector employment, the industrial and occupational structure of the labour force and it is the country's primary source of unemployment statistics.

According to the September 2006 release 25.5 per cent of the labour force is unemployed at the national level if the discouraged work seekers are excluded; including the latter, the broad definition of unemployment is closer to 38 per cent.

The second survey is the Quarterly Employment Statistics (QES) survey produced by Statistics SA. This is a survey of formal sector enterprises outside of the agricultural, forestry & fishing sectors and replaces the previous enterprise surveys which were more restricted in their coverage of the labour market (e.g. the Survey of Employment and Earnings).

As a survey of actual businesses, the sectoral data tend to be more stable to reveal trends in employment creation in the formal non-agricultural sector of the economy. However, the shortcoming of the survey is the fact that it does not keep track of employment in the informal sector of the economy and it does not track domestic workers.

The sample of businesses surveyed each quarter is drawn from Statistics SA’s Business Register, which has been expanded recently by including new information from the SA Revenue Service’s (SARS) PAYE records and the Department of Labour’s UIF databases.

According to the new estimates, based on the March 2006 Business Register the level of formal non-agricultural employment is 0.75 million bigger in June 2006 compared to the previous survey based on the June 2004 Business Register. The growth in the economy, the increased registration of previous informal businesses and improved data records are reported as reasons for the increased size of formal employment.

There are bound to be differences between a household-based survey of employment and a business-based survey, e.g. due to sampling errors, inaccuracies in household responses, different reference periods (the LFS refers to a week, while the QES refers to a quarter) and the differences in coverage.

It is therefore encouraging that both these surveys currently appear to be in agreement regarding the rate of formal non-agricultural employment growth in the economy, i.e. around 400,000 new jobs a year.

The QES reflect an increase of 107,000 formal non-agricultural job opportunities during the final quarter of 2006; annualised, this rate of employment growth corresponds to the LFS’ number; that employment creation is occurring across most sectors. Improved income growth is boosting the financial positions of households, which in turn, buoys consumer confidence and spending. Real personal disposable income growth measured 6.6 per cent last year. While the new momentum in employment creation is encouraging, there is scope for further improvement, particularly in the tradable goods sectors.
Real GDP growth is projected to decelerate moderately from a 5 per cent tempo during 2004 to 2006 to 4.8 per cent during 2007 due to the impact of higher inflation and interest rates. However, the upbeat domestic economic growth outlook remains in place over the medium term. Growth is projected to accelerate again in 2008 and in the run-up to the 2010 FIFA World Cup.

Sustained fixed investment spending and associated employment growth are expected to compensate for the negative impact of higher interest rates on the interest rate sensitive components of household spending and private fixed investment, notably residential construction. The favourable fixed investment trend is also likely to be supported by a recovery in export growth.

### Comparing the BER and National Treasury’s macro-economic forecasts

The BER's macro-economic forecast was used as a basis to generate the Western Cape regional economic forecast. It is therefore necessary to briefly highlight the differences between the BER's macro-economic forecast and that of National Treasury. The differences are relatively small and can be briefly summarized as follows:

- *The near-term real GDP growth forecasts are almost identical — both units see real GDP growth slowing from 5 per cent in 2006 to 4.8 per cent in 2007 and then re-accelerating to the 5 per cent level in 2008 (National Treasury, 5.1%). While the BER forecasts the 5 per cent growth tempo will persist in 2009, the National Treasury projects it to pick up to 5.4 per cent. The BER projects a similar growth rate in 2010. The slightly stronger growth momentum in the National Treasury forecast results from a stronger projected household spending and fixed investment momentum. The projected export growth rates are similar.*

- *A notable difference between the two sets of forecasts relates to the expected slowdown in household consumption expenditure over the short term. Interest rates were hiked by 200 basis points during the second half of 2006 and this is expected to have a delayed negative impact on the interest rate sensitive components of consumer spending in 2007. Whereas the BER forecasts real household spending to slow from 7.3 per cent in 2006 to 4.8 per cent and 4.3 per cent in 2007 and 2008 respectively, National Treasury projects growth of 5.7 per cent and 4.8 per cent, respectively.*

- *The BER is slightly more pessimistic regarding inflation. CPI inflation is projected to average 5.3 per cent over the period 2007 to 2009 in the BER forecast compared with the National Treasury forecast of 4.8 per cent. The BER sees CPI inflation tapering off from 5.6 per cent on average in 2007 to 5.2 per cent in 2009; the corresponding National Treasury numbers are 5.1 per cent and 4.5 per cent. While it is not possible to compare, the BER’s higher inflation forecast probably results from a weaker exchange rate assumption or simply a more negative evaluation of the inflation pressures foreseen over the short term.*

- *Both units see the deficit on the current account of the balance of payments averaging at 5.6 per cent of GDP over the 2007 to 2009 period.*

In all, the most prominent difference between the two sets of forecasts relates to the momentum in household consumption spending and fixed investment spending, which is projected at a faster rate in the National Treasury forecast. The BER anticipates more of a slowdown in these components of GDP over the short term. The BER is also slightly more pessimistic regarding the inflation outcome.

The April 2007 Reuters consensus forecast for real GDP growth in 2007 to 2009 is 4.8 per cent, 5 per cent and 5.2 per cent, i.e. in the middle of the BER and Treasury projections; the consensus outlook for CPI inflation was 5.4 per cent, 5 per cent and 4.7 per cent respectively over the corresponding period, i.e. closer to the National Treasury forecast.
Table 1: Macro-economic outlook for SA: 2007 to 2010

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Expenditure on GDP</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Household consumption</td>
<td>5.1</td>
<td>7.3</td>
<td>4.8</td>
<td>4.3</td>
<td>4.5</td>
<td>4.9</td>
</tr>
<tr>
<td>Fixed investment</td>
<td>8.1</td>
<td>12.8</td>
<td>10.1</td>
<td>8.4</td>
<td>7.7</td>
<td>9.1</td>
</tr>
<tr>
<td><strong>Gross domestic expenditure</strong></td>
<td>5.8</td>
<td>8.7</td>
<td>5.2</td>
<td>4.9</td>
<td>5.0</td>
<td>5.7</td>
</tr>
<tr>
<td>GDE</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Exports</td>
<td>3.3</td>
<td>5.5</td>
<td>7.3</td>
<td>6.5</td>
<td>6.5</td>
<td>7.7</td>
</tr>
<tr>
<td><strong>Gross Domestic Product (GDP)</strong></td>
<td>4.1</td>
<td>5.0</td>
<td>4.8</td>
<td>5.0</td>
<td>4.9</td>
<td>5.4</td>
</tr>
<tr>
<td><strong>Inflation, interest &amp; exchange rates</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>CPI inflation</td>
<td>5.9</td>
<td>4.6</td>
<td>6.0</td>
<td>5.6</td>
<td>5.2</td>
<td>5.5</td>
</tr>
<tr>
<td>PPI inflation</td>
<td>6.0</td>
<td>7.6</td>
<td>9.1</td>
<td>6.4</td>
<td>5.2</td>
<td>5.3</td>
</tr>
<tr>
<td>Prime overdraft rate</td>
<td>12.94</td>
<td>11.12</td>
<td>12.97</td>
<td>13.31</td>
<td>12.50</td>
<td>12.50</td>
</tr>
<tr>
<td>R/US$ exchange rate</td>
<td>7.71</td>
<td>6.77</td>
<td>7.44</td>
<td>7.93</td>
<td>8.41</td>
<td>8.89</td>
</tr>
<tr>
<td>R/euro exchange rate</td>
<td>8.44</td>
<td>8.50</td>
<td>9.94</td>
<td>10.44</td>
<td>10.71</td>
<td>10.96</td>
</tr>
</tbody>
</table>

Source: Bureau for Economic Research

3. The Western Cape economy

3.1 Introduction: recent developments

The revised real GDPR growth statistics indicate that the regional economy expanded by around 6 per cent a year during 2004 and 2005. According to current estimates, growth came in at 5.5 per cent last year.

The services industries (excluding government) continue to power the growth performance, growing by 6.5 per cent a year on average during calendar years 2004 and 2005 and an estimated 6 per cent during 2006. The construction sector is also expanding strongly, growing by a real 12 per cent a year during 2004 and 2005 and an estimated 15 per cent during 2006. The strong momentum in real domestic spending on the back of erstwhile low interest rates and inflation continue to benefit these sectors.
Figure 4: Sectoral composition of Western Cape GDPR, 2005 (%)

According to the revised GDPR statistics growth in the manufacturing sector came in at a respectable 5 per cent during 2004 and 2005; however, the sector suffered a substantial setback in business confidence in 2006 (see below). The high manufacturing growth in the regional manufacturing sector during 2004 and 2005 according to the revised GDPR statistics does not agree with the BER's business survey evidence in the sector and the available export data showing deep contractions in real exports from the region.

Regional manufacturers also reported continued employment cutbacks in 2006. Quantec Research estimates an annual contraction of 0,6 per cent in 2006. This tendency is borne out by the BER's regional manufacturing survey.

Overall formal sector regional employment growth did improve during 2005 and 2006 according to revised Quantec Research data. According to the data around 50 000 new jobs were created in the Province during both years, that is an average annual employment growth rate of 3 per cent. This compares to an average annual contraction of 0,1 per cent in regional formal sector employment over the 2000 to 2004 period. According to the latest LFS released by Statistics SA, the regional unemployment rate declined to 15 per cent in September 2006 from 18,9 per cent over the 2001 to 2005 period.

This is the lowest in the country; Gauteng has the second lowest unemployment rate, namely 23,2 per cent. However a number of sectors are continuing to retrench workers. These include the agriculture, clothing & textiles, wood & paper, furniture and communication sectors. The sectors that reported healthy employment growth are financial & business services, electricity & water, wholesale & retail trade, construction, transport & communication and general government.
Therefore, the overall economic growth picture remains upbeat, particularly in the leading services industries and in construction. However, there is scope for stronger and more broader-based employment growth. The unsatisfactory employment picture is influenced by the struggling manufacturing sector and the large-scale retrenchments in the agricultural sector.

3.2 The struggling manufacturing sector

While the revised GDPR statistics reveal a recovery in manufacturing and agricultural real value-added growth during 2004 to 2005, the five year average growth rates in these sectors (that is, 3% and 1.6% a year, respectively) reveal a disappointing growth performance.

It also appears that the manufacturing situation in the region deteriorated during 2006 – the estimated growth in real value-added came in at 3.5 per cent from above 5 per cent in 2004 and 2005.

Figure 5 shows that business confidence deteriorated sharply in the sector during 2006. Less than 40 per cent of the BER manufacturing respondents in the region reported satisfactory business conditions during the third quarter of 2006 compared to 76 per cent in Gauteng, 80 per cent in KwaZulu-Natal and 65 per cent in the Eastern Cape. This represented a decline of 30 index points in the Western Cape manufacturing business confidence index during 2006. Business confidence recovered during the final quarter of the year and the first quarter of 2007, but production volumes continued to contract on a year-on-year basis.

Analysing the pattern of business constraints reported by regional manufacturers in the BER’s manufacturing survey, it is clear that skilled labour constraints is a key issue – the constraint index value increased from 28 to 39 between the end of 2005 and the end of 2006 in respect of skilled labour and 20 to 30 in respect of semi-skilled labour. Skilled labour constraints are reported as the most binding constraint.

Furthermore, raw material shortages (17 to 31), higher interest rates (18 to 39) and a more constraining general political climate (16 to 28) are all areas that contributed to the deterioration in the business conditions.
Regional manufacturers’ short-term expectations are relatively upbeat. Hopefully the recovery in the national manufacturing sector will catch up with the Western Cape. The adverse export situation, which developed between 2003 and 2005 (see below) is slow to improve. We may have to look towards 2007 and 2008 to see a more meaningful recovery in this regard.

The evidence of an under-performing manufacturing sector in the Western Cape economy amounts to a key challenge to the regional policy authorities. The manufacturing sector is best situated to absorb lower- and semi-skilled labour of which there exists an oversupply. Furthermore, the sector’s contribution to exports is critical for sustainable high economic growth, both at the regional and national levels. It is necessary to investigate the region’s under-performance in manufacturing in order to gain a better understanding whether this is a short term or longer term trend.
3.3 Trends in the sectoral pattern of GDP growth

Table 2 shows that the Western Cape economy expanded by 4.7 per cent a year on average over the period 2000 to 2005. This compares to a national real GDP growth rate of 3.9 per cent over the corresponding period.

Table 2 below shows that the growth in the services industries (excluding the government) averaged 6.1 per cent over the corresponding period, with financial & business services (6.6%) and transport & communication (6.4%) performing strongest; internal trade, that is wholesale & retail trade, catering & accommodation, also performed strongly (6%).

The construction sector grew the fastest, with real value-added growth over the 2000 to 2005 period upgraded to 8 per cent a year. The electricity, gas & water sector grew by 3.7 per cent a year and CSP services by 3.5 per cent. The weakest performing sectors have been mining (contracting by 0.5% a year), general government (growing by 1% a year), agriculture (1.6%) and manufacturing (3.1%).

It remains to be seen what the impact of higher interest rates and inflation will be on the lively retail, construction and financial services sectors. Regional retailing business confidence tended to be somewhat volatile over recent years, falling below national during the first part of 2005, rising above national during the second half of 2005 and in 2006 declining sharply again. Over the past few quarters regional consumer confidence has been trending at slightly lower levels compared with national.
Looking ahead, the regional retail sector will be exposed to the anticipated national slowdown, the impact on interest rate sensitive components of spending and the impact of higher food prices, particularly at the lower end of the market.

Table 2: Real GDPR growth of the Western Cape economy: 2000 — 2005

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Agric, forestry &amp; fishing</td>
<td>-2,3</td>
<td>0,8</td>
<td>7,1</td>
<td>-3,6</td>
<td>3,0</td>
<td>4,8</td>
<td>1,6</td>
</tr>
<tr>
<td>Mining &amp; quarrying</td>
<td>7,5</td>
<td>-13,4</td>
<td>-1,3</td>
<td>1,8</td>
<td>1,2</td>
<td>1,0</td>
<td>-0,5</td>
</tr>
<tr>
<td>Manufacturing</td>
<td>5,7</td>
<td>2,9</td>
<td>1,1</td>
<td>-2,2</td>
<td>5,7</td>
<td>5,3</td>
<td>3,1</td>
</tr>
<tr>
<td>Electricity, gas &amp; water</td>
<td>2,8</td>
<td>-1,9</td>
<td>2,8</td>
<td>11,3</td>
<td>3,5</td>
<td>3,8</td>
<td>3,7</td>
</tr>
<tr>
<td>Construction</td>
<td>5,0</td>
<td>-15,8</td>
<td>34,1</td>
<td>0,7</td>
<td>11,8</td>
<td>12,3</td>
<td>8,0</td>
</tr>
<tr>
<td>Wholesale &amp; retail trade, catering &amp; accommodation</td>
<td>9,9</td>
<td>5,7</td>
<td>1,3</td>
<td>6,9</td>
<td>5,8</td>
<td>6,3</td>
<td>6,0</td>
</tr>
<tr>
<td>Transport &amp; communication</td>
<td>7,9</td>
<td>5,8</td>
<td>5,6</td>
<td>7,1</td>
<td>5,3</td>
<td>6,5</td>
<td>6,4</td>
</tr>
<tr>
<td>Financial &amp; business services</td>
<td>4,0</td>
<td>9,9</td>
<td>5,3</td>
<td>5,9</td>
<td>8,7</td>
<td>6,0</td>
<td>6,6</td>
</tr>
<tr>
<td>CSP services</td>
<td>4,8</td>
<td>2,2</td>
<td>2,4</td>
<td>4,1</td>
<td>2,1</td>
<td>5,3</td>
<td>3,5</td>
</tr>
<tr>
<td>General government</td>
<td>-3,2</td>
<td>0,5</td>
<td>0,8</td>
<td>2,2</td>
<td>3,6</td>
<td>2,9</td>
<td>1,0</td>
</tr>
<tr>
<td>Western Cape GDP</td>
<td>4,5</td>
<td>4,2</td>
<td>4,1</td>
<td>3,6</td>
<td>6,2</td>
<td>5,8</td>
<td>4,7</td>
</tr>
<tr>
<td>Services (excl. government)</td>
<td>6,3</td>
<td>7,3</td>
<td>4,0</td>
<td>6,2</td>
<td>6,7</td>
<td>6,1</td>
<td>6,1</td>
</tr>
</tbody>
</table>

Source: Quantec Research, 2007

The changed financial environment is likely to impact negatively on the booming construction, property and financial services sectors. An upper turning point is evident in the building and construction sector in line with the national situation. The property and financial services sectors may also be peaking, albeit that this is not yet so evident from the available statistics. However, the construction sector will also be underpinned by non-residential property development and civil engineering activity tied to infrastructure development. The anticipated slowdown is therefore expected to be of moderate proportions.

These factors all contribute to a likely change in the sectoral composition of the region’s growth. The momentum will in all likelihood slow in the retail, construction, financial services and property sectors, while that in the manufacturing and agricultural sectors should benefit from the depreciation of the rand exchange rate. Both the climatic conditions and the more competitive currency are bolstering the outlook for the Western Cape agricultural sector.

While the expected recovery in manufacturing has disappointed thus far, it is likely to happen. However, it is not expected that the growth in the manufacturing sector will surpass that in construction sector or the services industries over the forecast period.
3.4 Employment creation may have turned the corner

Formal sector employment creation in the Western Cape economy lagged behind the rest of the country in recent years. Between 2000 and 2005 formal sector employment grew by 0,3 per cent a year. This compares to positive formal sector employment growth of 0,6 per cent a year nationally over the corresponding period. However, in 2005 and 2006 the regional picture improved, along with the improving national trend, according to the latest data and estimates.

The regional sectors responsible for this disappointing employment trend over the 2000 to 2005 period are agriculture (-2,7% a year), electricity, gas & water (-2,6%), manufacturing (-2,3%), transport & communication (-1,5%), construction (-0,7%) and government (-0,3%).

Within the manufacturing sector, retrenchments have been the sharpest in clothing & textiles (employment declining by 6,1% a year), electrical machinery (-4,2%), food & beverages (-2,8%), radio, TV & instruments (-2,8%) and wood & paper products (-2,6%).

Figure 7: Western Cape formal sector employment growth: 2000 – 2005

Source: Quantec Research, 2007

3 The declining tendency in construction employment contradicts the robust growth this sector experienced over the period 2000 to 2005. The data probably reflect structural changes in employment practices, e.g. the rise of outsourcing and sub-contracting, rather than real retrenchments. It also appears that the declining tendency was arrested during 2005.
The sectors that experienced positive employment growth over the period 2000 to 2005 are financial & business services (5.2% a year), CSP services (2.5%), wholesale & retail trade, catering & accommodation (1.3%) and mining (1.7%). At a sub-sector level, the leading job creating sectors over this period were business services (6.7% a year), community services (2.5%) and wholesale & retail trade (2.1%). Within manufacturing, transport equipment (1.5%), metals & machinery (0.8%) and furniture & other manufacturing (0.4%) recorded positive employment creation over the period.

The 2005 data and estimates in respect of 2006 point to a recovery in employment creation in the region, with around 40 000 annual formal jobs being created in the province. The positive growth is being led by the sectors that experienced job growth over the 2000 to 2005 period. Strong fixed investment intentions, combined with the Government’s infrastructure fixed investment activities should underpin employment creation in the Province going forward.

3.5 Reviving export growth a key regional economic challenge

The regional export growth performance deteriorated sharply in recent years. Compared to double digit growth in total export volumes over the 1995 to 2002 period, growth decelerated to a meagre 2.9 per cent a year over the 2003 to 2005 period.

The deteriorating export tendency in the manufacturing sector led this reversal of the Provincial export buoyancy. In the period 2003 to 2005 real manufacturing exports actually contracted by 2 per cent a year. This compares to real growth of 12.5 per cent a year over the 1995 to 2002 period.

Table 3: Western Cape real manufacturing export growth: 1995 to 2002 versus 2003 to 2005

<table>
<thead>
<tr>
<th>Real % change a year</th>
<th>1995 – 2002</th>
<th>2003 – 2005</th>
</tr>
</thead>
<tbody>
<tr>
<td>Food, beverages &amp; tobacco</td>
<td>10.0</td>
<td>1.6</td>
</tr>
<tr>
<td>Textiles, clothing &amp; leather goods</td>
<td>8.1</td>
<td>-9.2</td>
</tr>
<tr>
<td>Wood &amp; paper; publishing &amp; printing</td>
<td>13.4</td>
<td>-3.0</td>
</tr>
<tr>
<td>Petroleum products, chemicals, rubber &amp; plastic</td>
<td>24.6</td>
<td>-0.2</td>
</tr>
<tr>
<td>Other non-metal mineral products</td>
<td>19.6</td>
<td>-4.8</td>
</tr>
<tr>
<td>Metals, metal products, machinery &amp; equipment</td>
<td>8.9</td>
<td>8.0</td>
</tr>
<tr>
<td>Electrical machinery &amp; apparatus</td>
<td>-6.3</td>
<td>7.7</td>
</tr>
<tr>
<td>Radio, TV, instruments, watches &amp; clocks</td>
<td>31.6</td>
<td>26.4</td>
</tr>
<tr>
<td>Transport equipment</td>
<td>39.3</td>
<td>-13.3</td>
</tr>
<tr>
<td>Furniture &amp; other manufacturing</td>
<td>25.3</td>
<td>1.9</td>
</tr>
<tr>
<td>Total manufacturing</td>
<td>12.5</td>
<td>-2.0</td>
</tr>
</tbody>
</table>

Source: Quantec Research, 2007
The sharpest reversal of export fortunes occurred in the transport equipment sector, declining from positive growth of close to 40 per cent a year over the period 1995 to 2002 to -13.3 per cent a year between 2003 and 2005; clothing & textiles (8.1% to -9.2%), non-metal minerals (19.6% to -4.8%) and wood & paper products (13.4% to -3%) and petro-chemicals (24.6% to -0.2%).

### Table 4: Composition of Western Cape exports: 2006 (constant 2000 prices)

<table>
<thead>
<tr>
<th>Sector</th>
<th>R million</th>
<th>% share</th>
</tr>
</thead>
<tbody>
<tr>
<td>Agriculture, forestry &amp; fishing</td>
<td>7 456,5</td>
<td>20.2</td>
</tr>
<tr>
<td>Food, beverages &amp; tobacco</td>
<td>7 004,7</td>
<td>18.9</td>
</tr>
<tr>
<td>Petroleum products, chemicals, rubber &amp; plastic</td>
<td>6 618,8</td>
<td>17.9</td>
</tr>
<tr>
<td>Metals, metal products, machinery &amp; equipment</td>
<td>1 440,2</td>
<td>3.9</td>
</tr>
<tr>
<td>Textiles, clothing &amp; leather goods</td>
<td>1 068,6</td>
<td>2.9</td>
</tr>
<tr>
<td>Radio, TV, instruments, watches &amp; clocks</td>
<td>980,4</td>
<td>2.7</td>
</tr>
<tr>
<td>Furniture &amp; other manufacturing</td>
<td>977,3</td>
<td>2.6</td>
</tr>
<tr>
<td>Transport equipment</td>
<td>962,6</td>
<td>2.6</td>
</tr>
<tr>
<td>Mining</td>
<td>612,5</td>
<td>1.7</td>
</tr>
<tr>
<td>Wood &amp; paper; publishing &amp; printing</td>
<td>355,1</td>
<td>1.0</td>
</tr>
<tr>
<td>Electrical machinery &amp; apparatus</td>
<td>175,5</td>
<td>0.5</td>
</tr>
<tr>
<td>Other non-metal mineral products</td>
<td>147,4</td>
<td>0.4</td>
</tr>
<tr>
<td>Other</td>
<td>9 166,0</td>
<td>24.8</td>
</tr>
<tr>
<td><strong>Total Western Cape exports</strong></td>
<td><strong>36 965,9</strong></td>
<td><strong>100</strong></td>
</tr>
</tbody>
</table>

Source: Quantec Research, 2007

In the period 2003 to 2005 all the manufacturing sub-sectors experienced a substantial deterioration in export performance. The sole exception was the electronics industry – the electrical machinery and radio, TV & instrument sectors either improved or maintained their export growth; however, growth is from a low base. Basic metal exports were also sustained at a robust rate.

The poor export growth can explain much of the problems in the lagging regional manufacturing sector. It can also explain why the Province’s manufacturing sector is not responding positively to the competitive boost provided by the rand’s depreciation since May 2006. It is possible that local manufacturers are focussing more on the buoyant domestic market and neglecting exports, a tendency that is picked up nationally in particularly the consumer goods manufacturing industries.

Nationally, the export response has proved to be slow. However, whereas Western Cape manufacturers were previously more dependent on export growth and less on domestic demand, they may be in a more serious predicament compared to their regional counterparts. It is evident that regional export prospects will depend on how strong the recovery in manufacturing conditions will be over the short to medium term.
3.6 Robust fixed investment spending

Over the period 2000 to 2005 real fixed investment spending in the Western Cape economy accelerated to 6.8 per cent a year compared to only 4 per cent a year over the decade from 1995. Fixed investment spending was particularly strong during 2004 (up 12.8%), 2005 (up 11.9%) and estimated at 10.7 per cent last year. This compares to an average growth rate of 10.3 per cent a year in real gross domestic fixed investment nationally.

Over the same period, fixed investment grew strongly in construction (13.7% a year), electricity, gas & water (10.1%), financial & business services (9.5%), CSP services (9.4%), wholesale & retail trade (8.2%), transport & communication (5.8%) and general government (5.4%); whereas manufacturing fixed investment grew by a slower 4.3 per cent a year.

Infrastructure fixed investment spending in the Western Cape

Investment in infrastructure is anticipated to be a major driver of economic growth in the Western Cape. The AsgiSA has infrastructure investment as one of its key interventions for growing the economy and creating employment.

Better infrastructure helps poor communities connect to the mainstream economy. By building roads, improving the public transport system and providing other critical infrastructure, more people are able to take advantage of economic opportunities and the cost of doing business drops significantly.

Over the Medium Term Expenditure Framework (MTEF) period, the Provincial Government of the Western Cape budgeted R6,629 billion for building and maintaining roads, public transport, social services and administrative infrastructure.

The 2010 FIFA World Cup is also set to have a major influence on the level of infrastructure investment activity in the Western Cape. A multi-purpose stadium, which can be used for ball sport, major events and concerts, will be constructed at Green Point at a cost of R2.85 billion.

The City of Cape Town is contributing R400 million towards the construction of the stadium and an additional R100 million for contingency funds. The Provincial Government will contribute R212 million in 2008/09 to support the construction of the Green Point Stadium.

The supporting infrastructure for hosting this event, including transport infrastructure, accommodation projects and the upgrading of the Athlone Stadium will also have an impact on infrastructure development in the Province.

Cape Town’s poor and working class people live furthest from their places of work, as a result of the apartheid planning system. Many of these people rely heavily on public transport. The Province has also developed a mobility strategy to revitalise the public transport system and address some of the problems created by the existing infrastructure.

The first phase of this extensive project will be the introduction of a rapid bus transit (RBT) system along the Klipfontein corridor. This will entail a dedicated bus route from Khayelitsha to Mowbray, along with improved cycling and pedestrian paths. It is expected that the development of Klipfontein Road into a transport corridor will result in many advantages for businesses, communities and public transport operators. The estimated cost of this transport initiative is R300 million.
The Western Cape will also benefit from infrastructure interventions under the AsgiSA programme. About 37 per cent of the R409.7 billion budgeted for infrastructure investment by national government over the MTEF period will be spent by State-Owned Enterprises across the country mainly for power generation, transmission and distribution investments by Eskom and municipal distributors and also for port, rail and pipeline infrastructure investments by Transnet.

The Airports Company of SA (ACSA) is embarking on a capital expenditure programme to address 2010 needs, which will entail the expansion and upgrading of the Cape Town International airport. ACSA will spend a total of R1.3 billion at Cape Town International airport, of which R900 million will be spent on a new terminal building. The remainder will be spent on projects such as a multi-storey parkade and construction of an elevated road above the existing ring road.

In addition, Transnet will spend R3.2 billion on the expansion of Cape Town's container terminal. This project is aimed at increasing the turnaround time for ships and also at giving better support to refrigerated cargo.

Figure 8: Western Cape real fixed investment growth by broad sector: 2000 – 2005

The outlook for fixed investment remains bullish as production capacity constraints are expected to underpin capital spending. The Cape Town harbour will be expanded, the new owners of the Victoria & Alfred (V&A) Waterfront development are preparing for a major overhaul and expansion, construction of the World Cup soccer stadiums are in the offing, Eskom is building two new gas-fired power generation plants (scheduled for completion mid-2007) and planning a new nuclear power station, transport infrastructure will witness a major upgrade, to name a few.
Both public and private sector fixed investment spending are projected to continue growing strongly over the projection period. The rate of fixed investment growth in the Province should at least track that projected for national as the trend has been over the past five to six years, i.e. around 8 per cent a year.

3.7 Trends in direct investment into the Western Cape

At the international level, the United States, European Union and Japan (also known as the “Triad”) were the dominant sources of foreign direct investment (FDI) for many developing countries in 2005. Global FDI inflows registered a nominal increase of 22 per cent in the period 2004 to 2005 (US$955 billion in 2005).

In 2005, the primary source of investment into SA was from European countries constituting 89 per cent of investment inflows. Of all countries in Africa, SA had the largest inflow of FDI in 2005 largely driven by the acquisition of ABSA bank by the UK’s Barclays’ Bank. Emerging markets have led the recovery in global FDI inflows accounting for the bulk of the increase in global FDI inflows.

Global FDI inflows, as forecasted by the Economist Intelligence Unit (EIU), are projected to grow at an annual average rate of 8 per cent over the medium term, exceeding the projected rate of growth in global output and lagging growth in global trade.

This forecast is underpinned by assumptions that world economic growth is set to remain buoyant; the trend towards better business environment continues; progress is made with regional integration; technological change and overall sharper competition. It is expected that the services sector will continue to maintain its majority shareholding in global FDI flows and that South-South FDI will be of greater importance.

3.7.1 FDI trends in SA

The main source of FDI into SA is primarily the European countries, which contributed 89 per cent of FDI inflows in 2005. Among the top three contributors were the United Kingdom, Germany and the Netherlands. The Americas (with a share of nearly 7 per cent) is the second largest source of FDI. Germany is another major source of FDI for SA, having increased its contribution by 36 per cent since 2002. The Bric countries are also emerging as important sources of FDI for developing countries in the form of South-South investment.

FDI into SA have largely been in the services or tertiary sectors. On a sub-sectoral level the commercial services followed by mining and manufacturing attract the most foreign investment. These three sectors accounted for 91 per cent of all FDI in SA in 2005. The Barclays/ABSA deal dominated FDI inflows into SA in 2005. Apart from this, FDI inflows have generally been disappointing. According to Reserve Bank figures, outward FDI exceeded inward FDI in SA over the period 2002 to 2006.

4 Brazil, Russia, India and China.
Whilst the improved real economic growth performance is stimulating foreign investor interest capital inflows have been dominated by portfolio investments. However, an improved real economic growth performance should in time stimulate inward direct investment.

As noted above, AsgiSA has as its main objective to increase the real GDP growth rate to an average of 6 per cent by 2010 to 2014. Central to this strategy is a strong focus on infrastructure investments.

The 2010 FIFA World Cup is also set to have a major influence on the level of investment activity in SA as new projects arise in preparation for this event.

### 3.7.2 Direct investment trends in the Western Cape

Since 2004, Wesgro attracted total investments amounting to R2.2 billion into the Western Cape, largely following the national trend of investment being concentrated in the services sectors. The Western Cape’s real fixed investment growth has averaged 6.6 per cent a year over the period 2000 to 2005, in line with the national performance.

### 3.7.3 Sources of Western Cape direct investment

Prior to 2005, the primary source of direct investment in the Western Cape has been from elsewhere in SA, indicative of marked investor confidence by SA businesses. In 2005 and 2006, about 43 per cent of all foreign direct investment facilitated by Wesgro was from the UK. Germany was the second most significant source at 27 per cent.

The Western Cape’s investment links with other developing countries are quite low, albeit that there is potential for expansion. Despite being an increasingly important outward investor, the Asian economies have not featured prominently as source markets for the Western Cape, hence the need for more proactive investment targeting of the emerging Asian markets. The recent V&A Waterfront acquisition by a Saudi-Arabian-based consortium and optimistic prospects in terms of future interest by Middle Eastern countries may be indicative of the potential in this regard.

---

5 Detailed statistics on the Western Cape FDI performance are not readily available. For the purpose of this analysis, Wesgro’s investment performance is used as a proxy for the Western Cape FDI performance. Wesgro is the official trade and investment promotion agency for the Western Cape Province.

6 Wesgro reports on total committed investments. Committed investments are classified as those projects where the investor has already incurred substantial expenditure towards the implementation of the investment project. Furthermore, all of Wesgro’s committed investments are direct investments defined as investments in fixed assets that are used over a number of years to produce goods and/or services. Wesgro’s committed (direct) investment figures are periodically reviewed to update any changes in investor plans. Wesgro’s definition of FDI also complies with the SARB standards.
The services sector attracted a considerable amount of direct investment; a trend that reflects the Province’s economic structure whereby the services accounts for 70 per cent of the GDP. Table 5 below shows that almost three quarters of direct investment into the Western Cape occurred in the film & media and accommodation sub-sectors. The socio-economic impact of these investments is substantial, contributing to an estimated additional 6 288 jobs in the Western Cape since 2004.

Table 5: Top – 10 Sub-sectors of Direct Investment, 2006/07

<table>
<thead>
<tr>
<th>Sub-sector</th>
<th>Investment (R million)</th>
<th>Share of total investment (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Film &amp; media</td>
<td>433,2</td>
<td>34</td>
</tr>
<tr>
<td>Accommodation</td>
<td>268,2</td>
<td>21</td>
</tr>
<tr>
<td>Call centre</td>
<td>164,9</td>
<td>13</td>
</tr>
<tr>
<td>Metals &amp; engineering</td>
<td>55,0</td>
<td>4</td>
</tr>
<tr>
<td>Tourism</td>
<td>52,4</td>
<td>4</td>
</tr>
<tr>
<td>Biotechnology</td>
<td>44,0</td>
<td>4</td>
</tr>
<tr>
<td>Catering</td>
<td>31,7</td>
<td>4</td>
</tr>
<tr>
<td>Medical &amp; dental &amp; veterinary services</td>
<td>31,6</td>
<td>3</td>
</tr>
<tr>
<td>Other manufacturing</td>
<td>25,2</td>
<td>2</td>
</tr>
<tr>
<td>Clothing &amp; textile</td>
<td>20,2</td>
<td>2</td>
</tr>
</tbody>
</table>


3.7.4 Direct investment within the Western Cape

Cape Town is regarded as the financial and business hub of the Western Cape, contributing about 76 per cent of the Western Cape’s GDP in 2005. The largest proportion of direct investment is directed towards business services, call centres, BPO and ICT within the City of Cape Town.

Table 6 below shows that the level of direct investment facilitated by Wesgro in the other districts is relatively low. These investments are directed largely towards tourist activities, accommodation, catering and agriculture.

A most notable trend is that the Central Karoo did not attract any investments for two consecutive financial years. Also the share of agriculture in the Western Cape’s total inward investment portfolio is very low.
Table 6: Direct Investment trends by Western Cape district

<table>
<thead>
<tr>
<th>District</th>
<th>2004/2005 R'000</th>
<th>2005/2006 R'000</th>
<th>2006/2007 R'000</th>
</tr>
</thead>
<tbody>
<tr>
<td>City of Cape Town</td>
<td>430,3</td>
<td>520,3</td>
<td>1 196,90</td>
</tr>
<tr>
<td>Overberg</td>
<td>30,7</td>
<td>12,3</td>
<td>5,6</td>
</tr>
<tr>
<td>West Coast</td>
<td>31,5</td>
<td>72,9</td>
<td>3,8</td>
</tr>
<tr>
<td>Cape Winelands</td>
<td>313,4</td>
<td>23,8</td>
<td>333</td>
</tr>
<tr>
<td>Eden</td>
<td>34,1</td>
<td>78,4</td>
<td>18,3</td>
</tr>
<tr>
<td>Central Karoo</td>
<td>-</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>Total</td>
<td>840,0</td>
<td>707,7</td>
<td>1 256,9</td>
</tr>
</tbody>
</table>


3.7.5 Outlook

Projecting forward, the medium-term outlook for the Western Cape’s fixed investment spending is favourable.

As indicated in the 2007 national Budget, Government and public enterprises infrastructure fixed investment expenditure for the period from April 2007 to March 2010 is planned to be about R416 billion (US $57 billion).

This investment is expected to not only raise current growth, but will also allow for sustained growth through better transport, communication and electricity provision to ultimately attract further foreign and domestic investment.

4. Outlook for the Western Cape economy: 2007/08 – 2009/10

The broader economic conditions in the national economy remained robust through the end of last year and early in 2007 despite the changed financial climate, that is higher inflation and interest rates. However, leading indications of the impact of higher interest rates are evident and economic growth is projected to moderate during the second half of 2007 and next year, albeit only mildly so.

The global economy is also expected to register slower growth during 2007, leading to lower commodity prices, but is expected to remain supportive to domestic growth.

The Western Cape economic performance is currently characterised by sterling growth (5 to 6%). While the employment creation trend has been unsatisfactory, the latest data and estimates point to a recovery, which is projected to be sustained.

There is continued evidence of an under-performing manufacturing sector, with a weak export performance being an important drag. It is not expected that the manufacturing sector will attain the projected growth rates of the construction and leading services industries in the Province, but growth in the sector should improve.
While the booming retail, construction and financial services sectors are exposed to the higher level of interest rates, the projected slowdowns in these sectors are of moderate proportions. In manufacturing, much will depend on the incumbent export recovery in the region to sustain growth and employment creation at a satisfactory pace.

Table 7 below sets out the macro-economic and sectoral outlook for the Western Cape for the fiscal years 2007/08 to 2009/10. Regional GDP growth is projected to soften from 5.7 per cent in 2005/06 and an estimated 5.3 per cent in 2006/07, to 4.9 per cent in 2007/08; thereafter growth is projected to re-accelerate in the run-up to the 2010 FIFA World Cup event to 5.7 per cent in 2009/10.

The regional economic growth momentum is therefore expected to remain vigorous and exceed that of national. From the accompanying table it is evident that the region’s services sectors are projected to continue making a strong contribution to aggregate GDP growth.

Excluding the general government, the region’s tertiary sectors are projected to grow at a rate of 6 per cent a year over the projection period, which compares to the 5.3 per cent average for aggregate GDP. Financial & business services, wholesale & retail trade, tourism, transport & communication are the key growth sectors in this regard. Furthermore, the forecast suggests that the growth in manufacturing is likely to accelerate somewhat.

The construction sector is also expected to accelerate substantially, from an average 8 per cent real growth over the 2000 to 2005 period closer to 13 per cent over the forecast period. The growth in this sector will be driven by robust infrastructure development and the buoyant conditions in the residential and non-residential building sectors. Such growth is bound to create substantial challenges for the construction industry in terms of skills training and fixed investment spending in order to implement the required capacity.

Should it be assumed that the labour intensity of regional GDP growth (measured by the employment coefficient) remains around 0.53 per cent (i.e. an estimated 3.1 per cent formal sector employment growth compared to 5.8 per cent real GDP growth during 2005/6) over the forecast period, the projected growth should translate into between 40 000 to 50 000 new formal sector jobs a year. This will be a big improvement compared to the previous five years and will be key in sustaining the growth momentum and spreading the benefits of growth wider.

---

7 The projected growth rates are higher compared to those contained in the MTBPS compiled before the revisions of the GDP data by Statistics SA.
### Table 7: Outlook for the Western Cape economy: 2007/08 – 2009/10\(^1\) (%)

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>GDPR</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>R billion (current prices)</td>
<td>-</td>
<td>232,7</td>
<td>260,3</td>
<td>288,5</td>
<td>318,5</td>
<td>354,7</td>
</tr>
<tr>
<td>Real GDPR % growth</td>
<td>4,7</td>
<td>5,7</td>
<td>5,4</td>
<td>5,1</td>
<td>5,3</td>
<td>5,7</td>
</tr>
<tr>
<td>GDP deflator</td>
<td>6,7</td>
<td>5,4</td>
<td>6,2</td>
<td>5,8</td>
<td>5,3</td>
<td>5,4</td>
</tr>
<tr>
<td>CPI inflation</td>
<td>5,2</td>
<td>4,6</td>
<td>4,8</td>
<td>5,8</td>
<td>5,2</td>
<td>4,9</td>
</tr>
<tr>
<td><strong>GDPR by sector</strong> (real % change)</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Agric, forestry &amp; fishing</td>
<td>1,6</td>
<td>4,4</td>
<td>2,7</td>
<td>1,9</td>
<td>2,4</td>
<td>2,8</td>
</tr>
<tr>
<td>Mining &amp; quarrying</td>
<td>-0,5</td>
<td>0,9</td>
<td>0,8</td>
<td>2,0</td>
<td>2,6</td>
<td>2,7</td>
</tr>
<tr>
<td>Manufacturing</td>
<td>3,1</td>
<td>4,9</td>
<td>3,7</td>
<td>3,5</td>
<td>3,5</td>
<td>3,6</td>
</tr>
<tr>
<td>Electricity, gas &amp; water</td>
<td>3,7</td>
<td>3,8</td>
<td>3,6</td>
<td>3,4</td>
<td>3,7</td>
<td>4,1</td>
</tr>
<tr>
<td>Construction</td>
<td>8,0</td>
<td>13,1</td>
<td>15,2</td>
<td>13,8</td>
<td>12,2</td>
<td>12,7</td>
</tr>
<tr>
<td>Wholesale &amp; retail trade, catering and accommodation</td>
<td>6,0</td>
<td>6,6</td>
<td>7,0</td>
<td>5,5</td>
<td>6,1</td>
<td>6,4</td>
</tr>
<tr>
<td>Transport &amp; communication</td>
<td>6,4</td>
<td>6,3</td>
<td>5,6</td>
<td>6,3</td>
<td>6,6</td>
<td>7,0</td>
</tr>
<tr>
<td>Financial &amp; business services</td>
<td>6,6</td>
<td>5,9</td>
<td>5,6</td>
<td>5,7</td>
<td>5,9</td>
<td>6,3</td>
</tr>
<tr>
<td>CSP services</td>
<td>3,5</td>
<td>4,8</td>
<td>3,1</td>
<td>3,0</td>
<td>3,2</td>
<td>3,5</td>
</tr>
<tr>
<td>General government</td>
<td>1,0</td>
<td>3,0</td>
<td>3,3</td>
<td>2,9</td>
<td>2,9</td>
<td>3,2</td>
</tr>
<tr>
<td><strong>Western Cape GDPR</strong></td>
<td>4,7</td>
<td>5,7</td>
<td>5,4</td>
<td>5,1</td>
<td>5,3</td>
<td>5,7</td>
</tr>
</tbody>
</table>

*Source: Bureau for Economic Research*

*Note: \(^1\) Fiscal years ending 31 March*
This page was left blank intentionally.
Economic Modelling and Regional Impact Analysis

Key findings:

- Regional economic modelling based on general equilibrium analysis is often used in impact simulation analyses.

- The techniques are useful as general equilibrium analysis captures the interdependencies in a market economy and shows that the different agents in the economy do not operate in isolation.

- There are different types of models, including:
  - Input-output models – used for short term analysis of small policy changes.
  - SAM-Leontief models which are a statistical representation of the economic and social structure of a country or region.
  - Computable general equilibrium (CGE) models which are powerful with regard to issues such as fiscal policy and trade policy interventions.

- The Western Cape Department of Agriculture and ARC developed the first Western Cape Social Accounting Matrix (SAM) for 1993 as part of the SM3 project.

- The Western Cape SAM showed that horticultural enterprises dominate agriculture’s contribution to provincial value added and employment.
• In 2001 the PROVIDE project developed national and regional SAMs and presented results in a series of working papers which showed, for example:
  – Higher tariffs on wheat exports would negatively impact most industries.
  – A 10 per cent increase in the international wine price can create 5 824 additional jobs.

• General equilibrium analysis can be used in the Western Cape’s PGDS iKapa Elihlumayo as the results give an indication as to which policy interventions will lead to an expansion of the regional economy and whether economic growth will address poverty and inequality.
1. Introduction

Economic modelling is a critical tool in government policy, planning and budgeting processes at the national and regional level, and regional models have been developed specifically to increase understanding of the impact of changes, such as shifts in government policy or chance events, on a specific region. Regional models are also used for forecasting economic activity at the regional level, using large-scale econometric models based on time series data.

Chapter 2: Economic Outlook: 2007/08 — 2009/10 makes use of such forecasting techniques in presenting a regional economic outlook for the Western Cape for the period 2007/08 to 2009/10.

Regional economic modelling has evolved from simple input-output models with fixed relative prices to the more complex computable general equilibrium models that allow for flexible relative prices. More recent developments of input-output models also include the construction of integrated models that combine econometric and input-output approaches models.

Since 1996, the Western Cape Department of Agriculture has had an active interest and participation in regional economic modelling; particularly impact simulation based on general equilibrium analysis.

While macroeconomic analysis makes use of economic aggregates in a top-down approach, general equilibrium analysis has its roots in microeconomics, giving an understanding of the whole economy using a bottom-up approach that starts at the basic level of individual markets and agents.

General equilibrium analysis therefore captures the interdependencies in a market economy where the prices and production of all goods are interrelated and shows that the different agents in the economy do not operate in isolation. For example an increase in the price of crude oil affects all industries, some to a greater extent than others, depending on the reliance on petroleum product as an input in the production and transport processes.

Both direct and indirect effects are relevant in the context of general equilibrium analysis and it is the capturing of indirect, or secondary, effects that makes general equilibrium analysis a powerful planning tool, distinguishing it from other analytical techniques.

General equilibrium analysis also allows for insight into the socio-economic impacts, including income, welfare, and employment, of policy decisions and economic shocks. These are particularly important when assessing the impact of policy decisions on different communities in the economy.

This chapter introduces key concepts related to general equilibrium analysis before discussing some of the key outputs that have emerged from the Western Cape Department of Agriculture’s economic modelling projects, showing how these have informed the regional policy debate. The chapter then concludes in suggesting further possibilities for general equilibrium analysis in the Western Cape.
2. Explaining general equilibrium and related concepts

The term ‘general equilibrium’ conveys two concepts. First, ‘general’ indicates that the entire economy is taken into account, not only one economic sector, based on the knowledge that no economic sector or economic agent operates in isolation.

Second, ‘equilibrium’ suggests that the starting point of the analysis assumes that the economy is in equilibrium. General equilibrium analysis assumes that the equilibrium in the economy is disturbed as a result of an economic shock, such as drought, or change in policy, which can include fiscal policy related to available tax instruments, investment decisions, social transfers, to name a few.

This will trigger an adjustment period in the economy because policy that influences one market causes changes in behaviour of households and firms, leading to changes in other markets, commonly referred to as the ripple effects throughout the economy. The assumption is that the economy will attempt to revert back to a new equilibrium.

General equilibrium analysis aims to estimate the magnitude of changes between the original and the new equilibrium. The time frame for the model is therefore the time it takes to move from one state of equilibrium to another. In dynamic models, as opposed to static models, a time dimension is introduced and this is particularly useful when the timing or sequencing of implementation of policies is of importance.

2.1 Models and data

Models and associated databases are functionally separate. The datasets for general equilibrium models, such as input-output tables and social accounting matrices (SAMs), capture the circular flow of funds (which move in the opposite direction to goods and services) through the economy.

The models consist of several equations that capture the economic relationships based on economic theory. In applied research the data from a specific type of dataset is used together with the model to quantify estimates. Hence one database can support several variants of a model, with each variant producing potentially different results.

Table 1 presents the broad model types and associated data commonly used in general equilibrium analysis. The list is not exhaustive because many variants of these models have been developed over time, but the list is simplified for explanatory purposes.
Table 1: Economic models and associated databases

<table>
<thead>
<tr>
<th>Models</th>
<th>Data</th>
</tr>
</thead>
<tbody>
<tr>
<td>Input-output models</td>
<td>Input-output tables</td>
</tr>
<tr>
<td>SAM-Leontief models</td>
<td>SAMs</td>
</tr>
<tr>
<td>Computable General Equilibrium (CGE) models</td>
<td>SAMs plus range of elasticities¹</td>
</tr>
</tbody>
</table>

*Input-output models* can be regarded as simplified general equilibrium models and are suitable only for short-term analyses of small policy changes.

These models are based on the key assumption that relative prices remain fixed, making them unsuitable for analysis when changes in relative prices become important. The latter are particularly important in the case of exchange rate changes or fiscal policy considerations.

Fiscal policy interventions tend to cause relative prices to change. For instance, a decrease in the tariff rate on textile imports will decrease the price of imported textiles relative to the price of domestically produced textiles, resulting in consumers buying relatively more imported textiles than domestically produced textiles.

The results from input-output models typically include multipliers², which are useful for structural analyses of an economy and for comparisons between economic sectors with regard to the potential for employment creation and growth in gross domestic product.

These models are also well suited to analyses of the impact of capital investment, social transfers, and increases in demand for exports.

Input-output models use data from *input-output* tables. These are rectangular arrays of rows and columns that depict transaction flows in terms of money payments (Rand value for a given period, usually a year) between various industries or sectors for goods and services transferred. Input-output tables place emphasis on inter-industry transactions and usually distinguish between intermediate, household, government, outside world (region) and capital formation sectors. However, they do not capture the full circular flow of transactions in the economy because transactions between households and factor markets and between factor markets and international markets (the rest of the world) are not fully captured.

*SAM-Leontief models* are similar to input-output models, but use social accounting matrices as the underlying data, instead of input-output tables. A *social accounting matrix (SAM)* is an extension of an input-output table and includes more detailed information on institutions and production factors.

---

¹ Elasticities measure responsiveness of various variables. For example the price elasticity of demand measures the responsiveness of the quantity demanded of a good to a change in its price.

² Fixed price multipliers reflect the expected change in basic model results that arise from an exogenous economic stimulus such as a change in final demand through exports. For example an employment multiplier of 80 for industry X would indicate that 80 employment opportunities are created for a unit increase in final demand of the product produced by industry X.
**SAM-Leontief models** represent flows of all economic transactions that take place within an economy (regional or national) and is therefore a statistical representation of the economic and social structure of a country or region. SAMs conventionally refer to a single year, providing a static picture of the economy.

A SAM is a data set presented in the form of a square matrix (columns equal rows) in the sense that all institutional agents are represented as buyers and sellers. The SAM captures not only the value of transactions, but also between which two agents in the economy these transactions take place.

Columns represent expenditures and rows represent receipts, and there is a row and column for each agent. Following accounting principles, the total of the row and column account for each agent must equate, otherwise all incomes and expenditures are not taken into account.

Because a SAM reflects the whole economy, it also forms a useful basis to check the consistency of statistics from the various sources, thus identifying inconsistencies in the data quality.

There are six main groups of agents – products; producers; factors of production including capital, labour and land; institutions including households, incorporated enterprises and government; capital including savings and investment; and trade.

For example, a SAM captures the total value of intermediate consumption in the economy as the payments from the producers to the commodity market, while household income tax is captured as a payment from households to government.

The level of detail within the broad aggregates can vary greatly. For instance, the aggregate commodity account can be disaggregated in any desired number of commodity groups, depending on the focus of the study and availability of data.

The multipliers calculated with SAM-Leontief models tend to be larger than those calculated with input-output models because a SAM captures the full circular flow, as opposed to input-output tables, which do not allow for the feedback of factor incomes to households for consumption expenditures.

The range of issues suitable for analysis with SAM-Leontief models is similar to those suitable for input-output models and model assumptions are also comparable to those of input-output models. Examples of applications are presented in section 3: Strategic micro and macro modelling.

**Computable general equilibrium (CGE)** models differ from input-output models in that they allow for changes in relative prices. CGE models therefore have wider application possibilities and are particularly powerful with regard to issues involving relative price changes, such as fiscal policy and trade policy interventions.

Induced changes in relative prices provide the economic incentives for changes in production and consumption patterns. Changes in relative prices imply substitution possibilities, the magnitude of which is determined by an elasticity of substitution. For instance, if the export price of goods increases relative to the price that producers can obtain in the domestic market, then producers will divert a greater proportion of their produce towards the export market relative to the domestic market.
Similarly, an income elasticity of demand indicates the change in quantity of goods or services demanded as a result of a unit change in income. The number of elasticities required for a CGE model depends on the functions included in the model.

Despite the fact that indirect effects in the economy are also captured with CGE models, there are typically no multipliers explicitly calculated with CGE models and therefore these models are not as frequently used for sectoral comparisons as the input-output models and SAM-Leontief models.

CGE models are used for impact analysis, such as estimating the effect of a particular shock or policy change. The results derived can be reported as either changes in quantities or relative prices because the model has an explicit price system and a quantity system.

For instance, results could indicate the impact on consumer prices, producer prices and import prices, as well as quantities of goods and services produced and traded. Estimates on factor incomes, employment and household welfare can also be obtained.

Examples of applications are presented in section 4: General equilibrium for SA, which also presents a description of the SAMs developed as part of the PROVIDE project.

2.2 General equilibrium or impact analysis modelling exercises

General equilibrium or impact-modelling exercises usually only simulate one or two policy changes simultaneously. When too many changes are incorporated into one simulation, then the effects become intertwined and the model loses its power to extract from reality to improve the understanding of the economy.

Results are therefore seldom viewed in reality. Rather they are used to interpret the direction in which the economy may tend to move, given an economic shock.

Furthermore, general equilibrium analysis has a macro-economic focus; making its applicability more suited to economy-wide analysis rather than detailed impact analysis where there are limited linkages. For instance the socio-economic impact of an outbreak of swine fever on one farm in the Western Cape is not suitable for analysis with a CGE model, even though this might have important implications for the owner involved.

A more suitable analysis for CGE techniques would be to determine the implications of animal disease in general, through the potential ramifications on imposed trade bans, food prices and household welfare.

However, it is worth mentioning that general equilibrium modelling has been carried out at various levels of the economy, from national, to regional or provincial level, as well as town level.
3. Strategic micro and macro modelling

During 1996 the Western Cape Department of Agriculture and the Agricultural Research Council (ARC) collaborated on a Strategic Micro and Macro Modelling (SM3) project to develop the necessary enabling framework for systematic quantitative decision-making.

The macro-modelling component of the SM3 project focused on the role of agriculture in the Western Cape, identifying and quantifying the forward and backward linkages with the rest of the provincial economy. The model facilitated analysis of the impact of agricultural policy changes on the agriculture sector, the rest of the production sectors in the economy, and households.

A key project output³ was the development of a Western Cape SAM for 1993 that emphasised the agricultural sector. The SAM included 25 agricultural sectors and 23 non-agricultural sectors, distinguishing between farm-owner households and farm worker households. The SAM categorised non-farm households according to population group and per capita income.

The 1993 Western Cape SAM findings showed the dominance of horticultural enterprises in agriculture’s contributions to provincial value added, employment and employee remuneration. Viticulture, deciduous fruit, vegetables and table grapes were key contributors.

The livestock industry, in particular broiler production, was also a key contributor to provincial value-added and employment, although salary and wage payments to farm workers were particularly low in livestock enterprises relative to other industries.

The 1993 SAM for the Western Cape also indicated that while white households overall spent the largest total amount of money, the coloured population significantly dominated provincial spending on raw farm commodities as well as processed food.

In 1993 coloureds accounted for 73,0 per cent of household spending and africans accounted for 68,1 per cent of household spending on unprocessed and processed agricultural commodities. This suggests that growth of domestic demand for agricultural output is heavily dependent on income dynamics among those populations.

Initial research⁴ using the Western Cape SAM suggests that R1,00 of additional demand for agricultural output will increase Provincial value added by R1,29, requiring R0,21 of additional international imports and will contribute R0,26 to government revenue.

³ Eckert et al., 1997 (a)
⁴ Eckert et al., 1997 (b), and Eckert and Liebenberg, 1997
Primary agriculture’s potential to contribute to employment and value added was found to significantly exceed those of the non-agricultural sectors in the Western Cape. Agribusiness showed substantially higher employment multipliers than other non-agricultural sectors.

Within agriculture itself, the horticultural sub-sector ranked first, followed by livestock. Furthermore, agricultural production tends to make greater contributions to household income and in a more redistributive manner than other sectors.

The model results confirmed that spending by the poor tends to provide a much greater stimulus to SA’s agricultural and manufacturing industries than does spending by the rich. The poor devote a higher portion of their incomes to consumption spending, directly consume fewer imports and their spending tends to hire more people who are also poor, especially the agricultural labour force and persons involved in the informal sector.

Subsequent research evaluated the implications of the World Trade Organisation (WTO) negotiations on the Western Cape economy.

The first scenario estimated the effect of a partial reduction in trade tariffs, assuming that world prices of various (primary) agricultural commodities would on average increase by 2 to 3 per cent as a result.

As the Western Cape economy is comparatively small in size, it is regarded as a price taker in world markets. This means that the increase in world prices would lead to an increase in domestic prices.

The results confirmed expectations that food manufacturing sectors, including canning, dairy, beverage and tobacco, distilleries and wineries, grain products and animal feeds industries would be most affected by price increases in the agricultural sector.

Furthermore, an increase in the price of primary agricultural products would contribute to higher cost of living, particularly for coloured and african households in rural areas. The cost of living increased for the low (0,58%), medium (0,47%) and high (0,42%) income groups. In contrast, households that experience the lowest increase in the cost of living, ranging between 0,15 and 0,11 per cent include white and asian, rural and urban, middle and high income groups.

These results confirm that low-income households, who spend a high percentage of their income on food, are notably impacted by an increase in food prices (especially primary agricultural products). The analysis also shows that high income households are responsible for the greater part of repeated cycles of income expenditure (feedback) in the economy, and are therefore the greatest contributors to stimulation of economic activity.

 Bernie et al., 1999
The second scenario estimated the impact of an increase in international exports on the Western Cape economy, assuming that there will be a greater market for products from SA in general and from the Western Cape in particular due to a reduction in trade tariff rates and the shift of production from protected to unprotected economies.

The analysis identified several key provincial agricultural and food processing industries as potential growth sectors that were likely to increase production, taking advantage of greater international market access.

Simulations in export demand showed that a 2.5 to 5 per cent expansion in identified industries could create about 9 500 additional employment opportunities.

The SAM employment multipliers are a function of inter-industry dependencies, the manner in which factor payments are distributed from production sectors to institutions and the pattern of institutional demand.

While a standard modelling assumption presumes that all production sectors have capacity to increase output, such is not always the case in agriculture. The research therefore progressed into quantifying the implications of supply side constraints in agriculture in the Western Cape.

Although the Western Cape has benefited from the increased export opportunities that followed political reform in the early 1990s it is important to recognise that the ability of agriculture to respond to the liberalisation of trade is dependent upon the rigidity of supply-side constraints, especially the availability of land resources.

The study demonstrated that the economic benefits accruing from expanded export opportunities are not only influenced by these capacity constraints but also by the patterns of interdependence within an economy, particularly for the food processing industries.

Results indicated that, despite supply constraints, increases in exports of wine, table grapes and other deciduous fruits have contributed positively to increases in employment and rural incomes, especially among farm worker households and reductions in income inequalities.

Furthermore, future benefits are likely to rise from relaxing the constraints via increases in agricultural production through increased productivity, as this will influence the extent to which capacity constraints can be released and consequently will determine the magnitude of the benefits, as shown in Table 2 below. Results suggest that trade opportunities accompanied by productivity growth are likely to be complementary in the search for shared growth and reduced inequality.

---

6 Berning and McDonald, 2000
### Table 2: Increase in household income and labour payments as a result of productivity increase in agriculture (%)

<table>
<thead>
<tr>
<th>Household accounts</th>
<th>Increase in productivity for crops</th>
<th>Increase in productivity for fruits</th>
<th>Increase in productivity for livestock</th>
<th>Increase in productivity for agriculture</th>
</tr>
</thead>
<tbody>
<tr>
<td>White and asian bottom 40</td>
<td>0.20</td>
<td>0.31</td>
<td>0.27</td>
<td>0.79</td>
</tr>
<tr>
<td>White and asian middle 40</td>
<td>0.21</td>
<td>0.32</td>
<td>0.27</td>
<td>0.80</td>
</tr>
<tr>
<td>White and asian top 20</td>
<td>0.19</td>
<td>0.29</td>
<td>0.26</td>
<td>0.74</td>
</tr>
<tr>
<td>Coloured bottom 40</td>
<td>0.13</td>
<td>0.22</td>
<td>0.16</td>
<td>0.51</td>
</tr>
<tr>
<td>Coloured middle 40</td>
<td>0.15</td>
<td>0.25</td>
<td>0.18</td>
<td>0.58</td>
</tr>
<tr>
<td>Coloured top 20</td>
<td>0.14</td>
<td>0.23</td>
<td>0.17</td>
<td>0.54</td>
</tr>
<tr>
<td>African bottom 40</td>
<td>0.18</td>
<td>0.29</td>
<td>0.22</td>
<td>0.69</td>
</tr>
<tr>
<td>African middle 40</td>
<td>0.19</td>
<td>0.31</td>
<td>0.23</td>
<td>0.73</td>
</tr>
<tr>
<td>African top 20</td>
<td>0.18</td>
<td>0.30</td>
<td>0.23</td>
<td>0.71</td>
</tr>
<tr>
<td>White and asian farm h’hold bottom 40</td>
<td>0.36</td>
<td>0.59</td>
<td>0.48</td>
<td>1.43</td>
</tr>
<tr>
<td>White and asian farm h’hold middle 40</td>
<td>0.35</td>
<td>0.57</td>
<td>0.45</td>
<td>1.37</td>
</tr>
<tr>
<td>White and asian farm h’hold top 20</td>
<td>0.43</td>
<td>0.67</td>
<td>0.55</td>
<td>1.65</td>
</tr>
<tr>
<td>Coloured and african farm h’hold bottom 40</td>
<td>1.58</td>
<td>3.11</td>
<td>1.18</td>
<td>5.87</td>
</tr>
<tr>
<td>Coloured and african farm h’hold middle 40</td>
<td>1.53</td>
<td>2.99</td>
<td>1.14</td>
<td>5.67</td>
</tr>
<tr>
<td>Coloured and african farm h’hold top 20</td>
<td>1.42</td>
<td>2.77</td>
<td>1.07</td>
<td>5.26</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Factor accounts</th>
<th>Increase in factor payments</th>
</tr>
</thead>
<tbody>
<tr>
<td>Average white labour</td>
<td>0.19</td>
</tr>
<tr>
<td>Average coloured labour</td>
<td>0.22</td>
</tr>
<tr>
<td>Average african labour</td>
<td>0.24</td>
</tr>
</tbody>
</table>

Source: Berning and McDonald, 2000

The 1993 Western Cape SAM results were used to make a strong argument against certain proposed changes to the Liquor Bill. One of the less obvious implications of the proposed Bill would have been the unbundling of the liquor industry, as the Bill provided that enterprises would have been able to register for only one of six segments in the supply chain, including wholesale and combinations of retail and consumption on or off the premises.

The Bill would therefore have closed the potential for vertical integration as one option for risk management to wine farmers, as the proposed changes undermined the concept of the wine farms and wine tourism due to their simultaneous engagement in production, wholesale and retail activities. The Liquor Bill was subsequently amended.
4. General equilibrium analysis for the Western Cape

While the SM3 project SAM for the Western Cape provided valuable information for decision-makers, it followed the structure used by earlier SAMs for SA, and consequently had certain structural characteristics that precluded its use as a database for CGE models.

In 2001 the Western Cape Department of Agriculture initiated the development of a CGE model for the Western Cape, which also required the revision of the 1993 SAM with detail on the agricultural sector.

The project was able to draw on a broader range of data than five years. Available data included the 1993 supply and use tables that provided data on domestic production and imports, and intermediate and final demand respectively, the 1993 Census of Agriculture, the 1995 October Household Survey, the 1995 Income and Expenditure Survey and the 1996 Census of Manufacturing.

The revised SAM was developed following a modular approach, which facilitated any subsequent updates. The general structure of this SAM eventually formed the base for the Provincial Decision-making Enabling (PROVIDE) project SAMs.

Two case studies were conducted. The first analysed the potential of the basic income grant to alleviate poverty in rural areas. The results indicated that when funded exogenously a basic income grant could achieve substantial reductions in poverty and inequality.

However, a universal basic income grant would be only marginally superior to a targeted basic income grant and would achieve a lower degree of poverty alleviation than an enhanced but targeted basic income grant.

If the basic income transfers were funded by increases in tax rates, the degrees of poverty alleviation achieved were greatly reduced, particularly if the transfers were funded by an increase in the value added tax rate.

When a basic income grant was assumed to be funded from tax revenues the degrees of poverty alleviation from targeting increased enormously such that under certain scenarios targeting could nearly double the estimated extent of poverty alleviation.

The second study explored the socio-economic implications of a property tax on agricultural land. The study results were incorporated into the Land Tax Committee final report on a guideline framework for the implementation of property tax on agricultural land in the Western Cape. The property rate was subsequently introduced, with the Western Cape being one of the first provinces to implement.

---

7 The research project was initiated in conjunction with the University of Sheffield, UK, a collaborative link that is still ongoing.
8 McDonald and Punt, 2003
9 McDonald and Punt, 2004
The study showed that the tax would have only a marginal impact on provincial GDPR. If the revenue received from the tax were spent in the Province, there would be a slight increase in GDPR.

Price changes, including those on food products, are insubstantial. Production in different agricultural regions is affected differently. The relatively rich white rural households lose out – inevitably since they are the primary recipients of income from land.

The only other representative household for which notable income losses were indicated is the coloured rural household, which is heavily dependent upon employment in agriculture and is regarded as one of the poorest household groups in the Province.

Figure 1 below shows that the benefits to other households from the introduction of a property rate on rural land would be negligible if Government were to spend the additional revenue according to existing government expenditure patterns.

The results suggested that there is little benefit from the introduction of a property rate on agricultural land in the Western Cape.

Furthermore, the CGE model does not capture implications related to the extent to which farm debt is secured against the asset value of agricultural land. Any property rate on agricultural land will reduce the returns to agricultural land as an investment; consequently the value of agricultural land will inevitably decline as a result of the introduction of a property rate on agricultural land.

One likely result is that a number of farmers will be placed in a position of holding negative equity, while all land owning farmers will experience a reduction in income. Such events are likely to produce a series of adjustment problems for a number of years. The model does not explore such adjustment concerns as it only refers to the long-run equilibrium outcomes of the introduction of property rates on agricultural land.
Figure 1: Change in welfare of Western Cape households as result of the introduction of a property rate on agricultural land

Source: McDonald and Punt, 2004

5. General equilibrium analysis for SA

5.1 The PROVIDE project SAMs and models

The PROVIDE project emerged from a desire to extend capacity in provincial level general equilibrium analysis from the Western Cape to other agricultural departments.

In 2001, the national Department of Agriculture and the nine provincial departments of agriculture co-funded the PROVIDE project, aiming to develop a series of social accounting matrices that had a regional focus and detailed agricultural accounts and an associated CGE model and to use the latter for policy analysis and capacity building.\(^{10}\)

The project developed a national SAM, four regional SAMs and a multiregional SAM for the base year 2000.\(^{11}\) The SAMs all contain substantial detail on the agricultural industry. The inclusion of various different tax accounts allows for fiscal policy analysis. Detailed factor and household accounts capture the functional distribution of income to households, making the SAMs suitable to analyse the effects of policy changes on income redistribution.

\(^{10}\) An emphasis on capacity building in the project saw extensive training of the research team as well as representatives from other stakeholder departments. Furthermore, industry leaders and even politicians were exposed to the results of the analyses, illustrating the project’s significant contribution to policy debates.

\(^{11}\) PROVIDE, 2006
The PROVIDE SAM for SA has 558 accounts, which can be grouped into seven broad aggregates — commodities (116, of which 20 are for agriculture), activities/industries (166, of which 70 are for agriculture), margins (2), factors (98), institutions (173), capital (2) and international trade (1). The institutions consist of sub-aggregates — households (162), incorporated enterprises (1) and government (10).

The commodity and activity accounts are largely based upon the account classification scheme used in Statistics SA’s supply and use tables. A distinguishing feature of the national SAM is that it contains provincial level information on households and labour, providing critical insight into policy impact at a provincial level.

The factor and household categories are identified firstly by province of residence, then by population group and then by other selected criteria such as gender and education level of head of household, and skill level of factor group.

Government tax accounts include commodity taxes (value added tax, excise duties and import duties) and subsidies, production taxes and subsidies and direct taxes on households and enterprises.

The agricultural commodity accounts reflect the pattern of commodity production in SA, while the agricultural activity accounts classify farms by regions within provinces.

The PROVIDE regional SAMs are based on the four regions identified for purposes of the PROVIDE Project – the Northern Cape and Western Cape; the Eastern Cape and KwaZulu-Natal; the North West, Free State and Gauteng; and Mpumalanga and Limpopo.

Each regional SAM contains detailed accounts for the particular region and accounts for the other three regions are aggregated and appear as an account called “Rest of SA”.

The commodity accounts (48 accounts) and non-agricultural activity accounts (approximately 33 accounts) in the regional SAMs are derived from aggregations of the commodity and activity accounts in the national SAM and are consistent for each of the regional SAMs, except for selected industries that are not found in a particular region.

The number of accounts in each of the regional SAMs varies between 143 and 173 depending mainly on the number of agricultural activity, household and factor accounts in each. The household and factor accounts in the regional SAMs correspond to those for the particular region in the national SAM.

Compared to the national SAM, a distinction is made between provincial government and the consolidated government in the regional SAM. With regard to trade a distinction is made between interregional trade within SA and international trade.
In the multiregional SAM detailed accounts for each of the four regions appear and, compared to the regional SAM, there is therefore no need for a “Rest of SA” account. The interregional trade flows depict between which two regions the trade is taking place. The multiregional SAM has 624 accounts. Information from the regional SAMs is retained for the commodity, activity, factor, household and provincial government accounts. The accounts for enterprises, consolidated government, capital and stock changes present national level information.

The PROVIDE CGE model\(^\text{12}\) allows for a generalised treatment of trade relationships by incorporating provisions for non-traded exports and imports, and competitive and non-competitive imports. It also permits the relaxation of the small country assumption for exported commodities. The model encompasses multiple product activities by differentiating between commodities by the activities that produce them, using a range of production technologies that can be selected by the user. The model runs in General Algebraic Modelling System (GAMS) software.

### 5.2 PROVIDE Project case studies

Besides numerous background papers and technical documents, a series of working papers present the results of various studies conducted as part of the PROVIDE project.

<table>
<thead>
<tr>
<th>PROVIDE Project Working Papers</th>
</tr>
</thead>
<tbody>
<tr>
<td>The PROVIDE project working papers are posted on the PROVIDE website (<a href="http://www.elsenburg.com/PROVIDE">www.elsenburg.com/PROVIDE</a>). Feedback indicates that the research analyses have been widely utilised. The working paper series includes the following:</td>
</tr>
<tr>
<td>WP2004:1 Trade liberalisation, efficiency and SA’s sugar industry</td>
</tr>
<tr>
<td>WP2004:2 The welfare impacts of national and international agricultural efficiency gains — a SA case study</td>
</tr>
<tr>
<td>WP2005:1 A Computable General Equilibrium (CGE) analysis of the impact of an oil price increase in SA</td>
</tr>
<tr>
<td>WP2005:2 Costs and benefits of higher tariffs on wheat imports to SA — a general equilibrium analysis</td>
</tr>
<tr>
<td>WP2005:3 Quantifying the economic divide in SA Agriculture: An income-side analysis</td>
</tr>
<tr>
<td>WP2005:4 The impact of a higher fuel levy on the Western Cape</td>
</tr>
<tr>
<td>WP2005:5 General equilibrium effects in the SA maize market: International trade simulations</td>
</tr>
<tr>
<td>WP2005:6 The welfare impacts of targeted transfers to poor households</td>
</tr>
<tr>
<td>WP2006:1 The impact of increasing excise duties on the economy</td>
</tr>
<tr>
<td>WP2006:2(1)to(9) The impact of property rates on agricultural land, focusing on each individual province</td>
</tr>
<tr>
<td>WP2006:3 The impact of an increase in wine industry exports on the SA economy, focusing on the Western Cape</td>
</tr>
</tbody>
</table>

\(^{12}\) PROVIDE, 2005 (a)
Working Paper 2005:2 on the ‘Costs and benefits of higher tariffs on wheat imports’ to SA\textsuperscript{13} formed part of a report to Grain SA, after Grain SA commissioned a study on the implications of increasing the import tariff on wheat.

The report formed the basis for negotiations between the Bureau for Food and Agricultural Policy (BFAP) and Grain SA, and the International Trade Administration Commission (ITAC). ITAC is the international institution that administers import tariffs.

This study described and quantified the effects of increased tariffs on the local wheat industry. The results showed that the benefits to the wheat industry are highly concentrated and smaller than the loss of income caused in other sectors.

The impact of a 25 percentage point increase in the tariff rate on wheat on the economy translates into a net decline of 0,03 per cent in GDP, after accounting for the benefits to winter cereals farmers and farm workers. This represented a cost of R257,4 million (2000 values) to the economy.

The tariff increase would negatively affect most industries, except the winter cereal producers. The main winter cereal producing agricultural regions would likely expand, causing a net increase in value added in agriculture as a whole.

There is a reallocation of scarce factors from other sectors towards winter cereal production. This is an important consideration in terms of allocative efficiency in the economy because the returns from winter cereal production are raised “artificially” when tariff rates are increased.

The reallocation of resources towards winter cereal production is also reflected in the results for factors and households, where only those closely involved in winter cereal production benefit. This is especially the case in the Free State and Northern Cape.

However in the Western Cape, despite the fact that there are two main winter cereal producing areas, it was found that the anticipated benefits as a result of the increased tariff on wheat imports are not sufficient to outweigh the negative impacts on employment and factor incomes as a result of the general contraction in the economy.

The effects are also mildly regressive, that is they tend to harm low-income households more than higher-income households. This is largely explained by the increase in some food prices.

Figure 2 below shows that when the import tariff on wheat increases by more than 20 per cent, government revenue from import tariffs on wheat starts to decline due to the decline in wheat imports.

\textsuperscript{13} Working Paper 2005:2 was undertaken in collaboration with the BFAP and Free State University.
Western Cape Provincial Economic Review & Outlook 2007

Figure 2: Changes in government revenue and expenditure following an increase in import tariffs on wheat

![Graph showing changes in government revenue and expenditure following an increase in import tariffs on wheat.](image)

Source: PROVIDE working paper, 2005:2

Working paper 2006:1 on the ‘Impact of increasing excise duties on the economy’ was completed on request from the SA Wine Industry Council. The results were used during negotiations between the SA Wine Council and Provincial Ministers of Finance and Tourism from the Northern and Western Cape and the National Minister of Finance to determine the desired level of increases in the excise duties on wine.

This study investigated the economic impact of a 10 per cent increase in excise duties on wine, focusing on the change in GDP, trade and prices, as well as changes in the factor market and the welfare of households of the Northern and Western Cape (the two major wine producing provinces in the country).

The results indicated that the majority of households in SA would be worse off in terms of real consumption expenditure, and that all households in the Northern and Western Cape would experience welfare losses. Lower-income households would be most affected, as they tend to spend a larger share of their income on beverages and tobacco.
However, these results do not capture the benefits from any reduction in negative externalities following the decline in demand due to a price increase in alcoholic beverages, and hence are likely to represent an upper bound of any welfare losses. Likely negative externalities include continuation of high levels of foetal alcohol syndrome among children, high levels of traffic accidents, and high levels of violence, including domestic violence. Additional analyses indicated that the gain in productivity required to offset the negative impact of increasing excise duties is rather small.

Further analysis was undertaken for the SA Wine Industry Council in respect of the economic impact of changing labels on wine bottles, following proposed legislation on mandatory health warning labels on wine products. The results contributed to more in-depth discussion and investigation into the viability of this legislation, the financial implications for the wine industry and the potential socio-economic implications for the Western Cape, thus avoiding hasty decisions that might have unintended consequences.

The SA Wine Industry Council requested additional analysis on the economic impact of an increase in wine industry exports to inform the process of development of a new marketing strategy for the wine industry\textsuperscript{14}.

The increase in wine exports would result from heightened awareness of and demand for SA wines.

A 10 per cent increase in the international wine price would lead to an increase of 0.1 per cent in GDP and the creation of an additional 5,824 employment opportunities, of which 20 per cent would be located in the Western Cape.

Figure 3 below shows that factor incomes showed varied results, but were positive (ranging between 0.11\% and 0.16\%) for all five labour groups identified in the Western Cape.

Domestic production of wine increased by 4.5 per cent, while the volume of exports increased by 26.7 per cent and the volume of domestic sales by 1.45 per cent.

The simulation showed that capital might be a binding constraint over the short run. However, as the increase in the international wine price would be a gradual trend, short-term capital constraints may prove less of an obstacle. Furthermore, a successful marketing strategy would likely cause additional investment in the industry.

\textsuperscript{14} Working Paper 2006:3
Figure 3: Changes in incomes of labour in the Western Cape for a 10% increase in international wine prices

![Bar chart showing the percentage change in incomes of labour in the Western Cape for a 10% increase in international wine prices.](chart.png)


The PROVIDE project also made inputs into the AsgiSA strategy, estimating the socio-economic impact of investment in irrigation schemes.

The study described the results of preliminary investigations into the impact of technical progress (increased efficiency) in agricultural production through additional investments in irrigation systems and a general improvement in the efficiency in the use of primary factors of production, land, labour and capital.

The results confirmed that gains in the non-agricultural sector have the greatest impact on the economy, with efficiency gains in agriculture only adding to growth, employment and household welfare in proportion to its share of the economy.

The model assumed that the scheme was funded through government borrowing on the external financial market. While debt interest payments had a negative indirect effect, the net effect was still positive.

In fact the investment strategy benefits all households in the model, and there was no net cost to the non-agricultural sectors. This would seem to support a strategy of large-scale public investments in agricultural infrastructure.

However, it could be expected that any acceleration of growth in SA, including in agriculture, would lead to increased inequality due to disparities in ownership patterns, particularly skills. At the very least, this suggests that investment in human capital becomes even more important as part of a programme of public investment to accelerated and shared economic growth.
Real increases in wage rates of unskilled labourers were assumed, which seemed appropriate given an emphasis on equity as well as on growth. However, a separate simulation that excluded real wage increases for unskilled labour, obtained higher economic growth results, particularly in sectors employing relatively more unskilled labour, such as agriculture.

6. General equilibrium analysis and regional economic development

General equilibrium analysis undertaken on a regional level has a definite role to play in the policy debate on the Western Cape’s PGDS iKapa Elinhulumayo. The results give an indication as to which policy interventions will lead to an expansion of the regional economy and importantly, whether economic growth take the form of shared growth, i.e., whether it that will address poverty and inequality, or whether it will have the unintended effect of reinforcing the duality in the economy.

For instance, a study\(^{15}\) on the dualistic nature of the agricultural sector in SA showed that inequalities within agriculture may be explained to a large extent by differences in the ownership of income-generating assets, such as land and productive capital. Given the high poverty rates and meagre incomes among African subsistence and small-scale farmer households, the returns to non-commercial agriculture would have to increase before land ownership \textit{per se} will become a solution to poverty reduction.

An advantage of general equilibrium analysis is that once there is a detailed SAM of the economy, the data and models may be used with relatively little adjustment to analyse any economic sector or industry.

For example, the PROVIDE project undertook studies on the wine, sugar, maize and wheat industries. Although the agricultural sector has been the focus of the Western Cape Department of Agriculture, the model and data could just as easily be used to investigate sectoral policies of the textile or film industries or the impact of fiscal or trade policy on the manufacturing industry.

The level of detail in the SAM database usually dictates the possible focus areas for analysis. For instance, a highly aggregated SAM, which distinguishes only between food and non-food manufacturing, will not be suitable for analysis of the textile industry. However, if the textile industry is identified separately in the data, the SAM becomes suitable for a more detailed analysis of the industry.

\(^{15}\) PROVIDE, 2005 (b)
The number of accounts included in SAMs varies greatly. The PROVIDE SAM for SA was constructed with the aim of retaining as much detail as possible, allowing researchers to form suitable aggregations for modelling depending on the focus of the analysis\textsuperscript{16}.

A key area of applicability of general equilibrium analysis is to international trade. As the latter is an important driver of economic growth, it is essential to understand how international trade agreements and national trade policies affect the Western Cape.

This area of research is high on the agenda of the Western Cape Department of Agriculture. Analysis of the impacts of trade with China and India on the Western Cape economy is scheduled for the second half of 2007. Linkages with global models, which concentrate on inter-country rather than intra-country relations has been used extensively as part of the Global Trade Analysis Project run from Purdue University in the US. A similar global model, but based on SAM data, has been developed at the University of Sheffield. Links between this global model and the SA country model are in progress.

6.1 International application of CGE analysis

A scan of international literature on CGE model applications indicates that the approach is commonly used in policy making, particularly in developed economies.

Several examples exist in the literature of CGE studies on broader issues related to the tourism industry, environmental issues, including climate change, as well as energy issues such as biofuels and CO$_2$ emissions.

General equilibrium analysis, when using dynamic models (models with a time dimension), could also be used for analysis of large investment projects to identify the expected impact on employment and changes in household incomes and welfare.

Multiplier analysis using regional datasets could be employed to conduct sectoral analyses in an attempt to identify industries with large linkage effects in the economy, where investment and growth would have the greatest overall impact for the regional economy.

In the context of spatial development within the Western Cape, standard CGE models using standard national SAMs are less suitable, as these models do not typically capture a true spatial dimension. In this case the potential role of CGE analysis would be to determine whether a certain investment project, such as a biofuels plant, has net benefits to the economy as a whole, rather than deciding the location of the plant.

\textsuperscript{16} For a full list of accounts included in the SAM see PROVIDE, 2006
Incorporation of provincial level information in the SAMs allows a certain degree of assessment of provincial level implications. A distinguishing feature of the PROVIDE SAMs is that they contain household and labour information on a provincial level, therefore obtaining a sense of the spatial distribution of socio-economic impacts. These effects are driven by the differences in consumption patterns by households in different provinces, as well as by factor use in the economy and the patterns of factor ownership by households.

Examples of more sophisticated integrated models exist for detailed spatial analysis. For example, an integrated transport-multiregional CGE model was developed to assess the spatial economic effects of four highways out of the proposed national highway network on economic growth and regional income inequality in Korea17.

The transport model measured a change in inter-regional shortest distances and accessibility due to the highway project. The CGE model estimated the spatial economic effects of the project on GDP, prices, exports and the regional distribution of wages and population.

A spatial structural decomposition analysis, based on input-output tables, has also been used to measure the effects of the changes in intra-and inter-country linkages on energy demand18.

In Denmark spatial accounting methods were used to construct spatial SAMs19, which are an extension of the more general regional SAMs, driven by growing interest in regional and local economic performance and interactions with other regions and localities.

A key benefit of CGE analysis is that it allows for systematic economic analysis, taking a wide variety of issues into account. It also stimulates thought and careful consideration about the driving forces behind the economic changes, as required when deciding how to implement an experiment for simulation.

For example, an issue often neglected in the policy debate is the source of funding. If the source of funding is not explicitly accounted for, almost all investment projects or social transfers will have positive net benefits to the economy. A study on welfare transfers indicated that if the transfer is funded from increases in income tax, poverty of some household groups may actually increase due to the increased tax burden and the associated linkage effects20.

---

17 Kim et al., 2004
18 Kagawa and Inamura, 2004
19 Madsen and Jensen-Butler, 2005
20 PROVIDE, 2005 (c)
7. Future initiatives

The PROVIDE project came to a contractual end during 2006. The stakeholders are negotiating the details of a follow-up initiative, which will most likely take the form of a Research Centre with five permanent researchers, hosted at the Western Cape Department of Agriculture.

The Agricultural Economics Standing Committee, comprising representatives of the ten departments of agriculture, the Agricultural Research Council (ARC), the National Agricultural Marketing Council (NAMC) and the Land Bank, will prioritise the research agenda.

An update of the SAMs from a base year of 2000 to a base year of 2005 is planned as part of the short term work programme of PROVIDE. Some revisions with regard to the household and factor accounts are envisaged to allow for gender-based research, as well as a revision of the treatment of value added tax in the SAM. Envisaged CGE model extensions include global modelling for trade issues, energy modelling and regional modelling, but these extensions are dependent on securing funding for a follow-up initiative.

The network of CGE modellers is slowly growing and it is essential for researchers and modellers in specialised areas of expertise to collaborate in order to exchange information and to ensure that no duplication takes place. During April 2007 the NAMC convened the first meeting of a trade reference group to ensure synchronised efforts related to economic modelling of trade issues of importance to agriculture. The modellers included in this group use various, but complementary, modelling techniques.

Although general equilibrium analysis provides informative answers to policy makers, it has a specific focus and should therefore be regarded as a key tool among a range of analytical techniques that are an important part of evidence-based policy decision-making.

The CGE analysis conducted as part of the PROVIDE project appears to be a natural extension of the industry and farm level research conducted by the BFAP. The latter has largely focused on partial equilibrium (industry level) econometric projection models, as well as farm level models to assess financial risk. The results derived with the industry models provide limited information on indirect effects, impacts on consumers, welfare and employment; issues that are specifically addressed in general equilibrium analysis.

The joint study on wheat import tariffs confirmed synergy, and close collaboration is maintained. The partial equilibrium and farm level models used for the study on the import tariffs on wheat gave detailed results on the industry, and farm level risk profiles for different scenarios, whereas the CGE analysis presents the wider economic implications, indicating implications for welfare and employment.
8. Summary and conclusion

This chapter presented an overview of the involvement of the Western Cape Department of Agriculture in general equilibrium analysis over the past decade. General equilibrium analysis captures the interdependencies in the economy and as such provides insight into the direct and indirect effects of policy changes, or other macro-economic shocks to the economy.

The techniques used in general equilibrium analysis include input-output models, SAM-Leontief models and CGE models. The underlying databases include input-output tables and SAMs.

Three main projects have been initiated by the Western Cape Department of Agriculture in the field of general equilibrium modelling and the studies that emanated from these projects cover a wide range of issues.

The most recent project, the PROVIDE project, was a collaborative project by the nine provincial departments of agriculture and the national Department of Agriculture. The project developed a national SAM, four regional SAMs and a multiregional SAM and conducted various CGE case studies.

Case studies include impact studies on issues such as the introduction of property rates and the fuel levy, increases in import tariffs or excise duties, and increases in the price of crude oil, issues related to basic grants and social transfers, to name a few.

The PROVIDE project has not embarked on dynamic CGE models, but these models are suitable for analysis of, for example, the impact of large investment projects and HIV/Aids.

When provincial level data are included in the underlying dataset, general equilibrium models may be used to inform decision-makers of the implications of policy decisions and economic shocks on the provincial economy. Results may illustrate the impact on different prices in the economy, including consumer prices, producer prices, import prices, etc., as well as quantities of goods and services produced and traded. Estimates of the impact on factor incomes, employment, and household welfare may also be obtained.

These macro-economic tools are particularly valued for the information they present on the socio-economic impacts of policy decisions and economic shocks, which are of importance from a political perspective in order to gain insight into who will be the potential winners and losers when certain policy changes are considered.

A further advantage of CGE analysis is that it allows for systematic economic analysis, contributing towards a focused, disciplined and hence a more constructive policy debate.
This page was left blank intentionally.
Regional Innovation & Growth

Key findings:

- Knowledge and innovation are key elements of economic competitiveness in today’s globalised world.

- Debate is heightening about the importance of realising a regional innovation system in the Western Cape to enhance regional economic competitiveness.

- The Western Cape knowledge economy manifests not only in advanced manufacturing and service sectors; the primary sector is producing and making use of knowledge.

- The Western Cape economy has key strengths in analytical, science-driven knowledge, underlying the importance of university-industry linkages.

- Both regional and sectoral dynamics appear to be important to growth in the Province.

- In terms of sectoral dynamics, updated trend analysis between 1995 and 2005 shows that the Western Cape is mainly a service economy; over the past years between three-quarters and four fifths of value added was generated here.

- Key activities in 2005 included financial & business services (29.2%), wholesale & retail trade, catering and accommodation (17.7%), and transport & communication (11.1%).

- The fastest growing sectors over the past 11-years were transport & communication (6%), wholesale & retail trade, catering & accommodation (5.4%) and financial & business services (4.7%).
• In 2005 almost three-quarters (72.5%) of the Western Cape’s workforce were employed in service activities, led by financial & business services (18.3%), wholesale & retail trade, catering & accommodation (16.3%), government services (15%) and community, social and other personal services (11.8%).

• This year’s PER&O briefly reviews evidence from the third phase of the MEDS, which included seven new studies – the informal sector, food processing, boatbuilding, construction, chemicals, printing & publishing and wholesale, retail & franchising.

• The MEDS recommended that the informal sector be accorded priority status within the MEDS strategy, based on its potentially large impact with respect to output and equity.

• The fourth round of the MEDS, undertaken in 2007, extends analyses to the informal sector and the cultural or creative industries.
1. Introduction

The PER&O 2006 chapter titled “Sectoral growth and employment prospects” focused on the global context of sectoral activity, comparing conditions for knowledge intensification of economic activities in the Western Cape with those elsewhere in SA and in other parts of the world. The chapter concluded that while the Western Cape is an advanced province in SA, it is at the same time a very marginal player compared to other catch-up regions, especially in Asia.

Furthermore, the chapter argued that it was important to gain a better understanding of the knowledge infrastructure and the dynamics of innovation in the Province, in order to be able to design policies in support of higher and shared growth and job creation.

Chapter 4: Regional innovation and growth in this year’s PER&O extends the above analysis, reflecting on the reasons why the knowledge economy matters to the Western Cape and how it does so. The chapter thereafter reports recent research that shows linkages between productive and knowledge-based activities in the Western Cape.


Finally, the chapter outlines the implications for policy research and for policy formulation.

2. The contemporary growth and development conundrum

If knowledge is considered the opposite of ignorance and if innovation is considered the alternative to a business-as-usual approach, it is surprising that there is the level of hype surrounding the knowledge economy. Perhaps those who feel part of it draw comfort from the belief that they have moved into a new era and therefore disdain those that do not appreciate the merits of the knowledge economy.

But precisely such distinction between worlds traditional and modern not only illustrates a fair amount of arrogance vis-à-vis past generations and their achievements, but also a colossal misunderstanding of what the knowledge economy is about and which role innovation plays in it.

Much like the terms “globalisation” and “competitiveness” in the last two decades of the past century, “knowledge” and “innovation” are terms that frequently obfuscate more than they explain; often they are used by people who struggle, and fail, to understand the complexities of economic change in today’s world.

1 cf. Mokyr, 2002
To be sure, knowledge and innovation are important for economic growth and development. While “institutions” and “networks” are fashionable terms in their own right, at the same time they are indispensable building blocks of the knowledge economy as well.

Although each of these terms has a widely agreed definition attached to it, there is much less consensus about how they are causally related to growth. It is far from clear how exactly “knowing” (what?) and “learning about” (from whom?) or “making new things” (under which conditions?) help a society grapple with the challenges of late or with underdevelopment.

Sober academic assessments of the state of the art admit as much. In a recent paper, Richard Nelson, a pioneer of evolutionary economic theory, argues that it is early days in the endeavour to unravel the mystery of economic growth and understand the role institutions play in it: “This diversity of meanings, and analytic foci, makes coherent discussion about the nature and role of institutions difficult. Indeed, it can lead to some rather bizarre arguments”².

There is, of course, general agreement that innovation is more likely to take place in an economy whose institutions encourage and support entrepreneurship (with its consequential risk-taking), and manage to shift resources from declining to rising activities. But this is so general as to lose the insights that really matter, namely the sector-specific and time-bound details of which specific institutions support or hinder productivity growth³.

More recent work explores the higher-order complexities of what is termed “network alignment”, that is, the extent of fit between the heterogeneity and rising number of networks, in which all actors (notably businesses, governments, science and training institutions) in transition or catch-up economies are simultaneously involved, and that of the developmental goals of productivity increases, growth, and poverty reduction that inform the behaviour of those networks ⁴.

The analysis argues that it is hard to assess the extent of network (mis)alignment precisely because concepts such as knowledge and innovation largely elude measurement, and that the analytical tools at our disposal are currently rather blunt.

For example, in a regional context such as the Western Cape, businesses invariably seek new markets, try to improve efficiencies, or aim to master new technologies; universities pursue teaching and research in an environment in which external funding is becoming more important; and provincial, metropolitan, and local governments aim to harness resources for higher and shared growth.

² Nelson n.d., 2006, 11
³ ibid, 31
⁴ von Tunzelmann, 2007
The heterogeneity of these goals raises the question of how the various (possibly conflicting) underlying aims and objectives can be reconciled for a collective purpose or, in other words, how network alignment becomes the visible expression of a somehow coordinated “network of networks” located in a “system of systems”\(^5\).

Institutions and networks have, of course, always played a role in catch-up and, thus, in innovation. But a generation ago, when Taiwan and Korea surprised the world through their rapid economic advances, much of their progress was based on learning how to master a few key technologies in capital-intensive industries such as electronics.

Today Taiwan, Korea and later-generation catch-up economies need to have a much wider range of competencies, both because development has proceeded and because there is more of it, due to the progress made by large economies such as China and India.

This means that it is no longer sufficient to send academically gifted young learners abroad to obtain a degree in engineering at a reputable institution of higher learning, and then expect them to return home and apply their skills for national development.

The knowledge economy demands much larger numbers of highly skilled people who need to be trained primarily at domestic universities in a wide range of competencies, including frontier activities such as bio- and nanotechnology. Therefore, while the complexity (or science base) of key technologies has increased, so have the challenges in ensuring that a country’s or a region’s stock of talent contributes meaningfully to mastering the multitude of applications that ensue\(^6\).

The good news about all this is that the role of institutions and networks for innovation, and knowledge for development, appear to be receiving attention from more academic quarters than was the case not so long ago.

Although research such as that referred to above implicitly warns against premature policy conclusions, much of this literature has an activist leaning in that it seeks to inform public interventions in favour of upgrading and learning. Linkages between research communities and policy makers are alive and well; this very publication is a case in point.

The bad news is that because the relationship between knowledge and growth is not well enough understood, there is no simple guide that would provide a provincial government with a list of appropriate interventions.

What the state of the art suggests is that a macro perspective on the role of institutions or network alignment becomes fruitful only to the extent that it is accompanied by micro-level investigations of the determinants of business behaviour, their interactions with knowledge providers, the effectiveness of systemic support, and so on.

---

\(^5\) ibid
\(^6\) cf. Nelson, 2006
This is but one reason why it is important to discuss the knowledge economy in the Western Cape through an assessment of sectoral dynamics as is done in this edition of the PER&O. Since the Provincial Government is responsible for a particular geographic space that can be distinguished from higher (national) and lower (local) levels of aggregation, it is necessary first to place the above discussion in its proper spatial context.

2.1 A regional innovation system in the Western Cape: Why bother?

This is an important question. Businesses can benefit from agglomerations and they might also exploit the proximity of knowledge pools in universities or science institutions. But they need not. In fact, their most important source of knowledge may be other businesses half way round the world, perhaps their mother companies, or the internet. Possibly they buy their key technological assets on the open market.

In brief, if there is nothing intrinsically regional about the determinants of innovation in the Western Cape, the role the Provincial Government plays in helping to build a knowledge economy is obviously different.

For example, rather than concentrating on flows of knowledge between information technology (IT) and biotechnology businesses in and around Cape Town or between food processors in Bellville and ostrich farmers in Oudtshoorn, it may have to facilitate communication between businesses in the same sector, but geographically far apart.

It could be that championing the interaction between academics and entrepreneurs is very effective in some activities and not at all in others. Reasons might include the relative strengths of local knowledge producing institutions in specific fields, the ease of transferability of the knowledge involved, the state of technological upgrading achieved in a particular sector relative to the rest of the world, and so on.

Very likely, the determinants of innovation in businesses differ from sector to sector and the Provincial Government will have to engage in all of the above, though not necessarily simultaneously. Economists have acknowledged the role of proximity since Marshall in 1890 systematically thought about the benefits arising from the co-location of businesses specialised in similar products.

The fragmentation of production from the late 1970s implied that emerging parts and components producers needed to agglomerate so as to organise the supply chain. Porter, in 2003, simply transferred his competitive diamond to the local level arguing that it was equally as relevant in a regional context.

But although geographic proximity – and the cognitive dimension that often accompanies it – may undoubtedly facilitate learning, businesses can make use of other forms of proximity. Organisational, institutional, or social proximity may link actors that are geographically far apart.

7 See also Simmie, 2005
8 Piore and Sabel 1984, Storper, 1997; for a critical review, see Markusen, 1999
The emergence of global innovation networks in which businesses from both advanced and developing countries engage in multidirectional knowledge flows, belongs to the most fascinating features of contemporary capitalism. It is therefore important to distinguish between the mere existence of clusters, which is widely documented, and localised learning and innovation, about which less is known, especially in developing countries. The existence of studies underlining the importance of geographic proximity both in Europe and in North America merely confirms that the proof lies in empirical analysis.

Much depends on the nature of the economic activity undertaken. To the extent that intra-industry spill-overs are more prevalent than inter-industry spill-overs, specialised local production structures favour innovative activity. Particularly in the case of R&D-intensive and small businesses, knowledge spill-overs have limited geographical reach and so proximity does matter.

By contrast, in industrially differentiated metropolitan areas, where much innovation is concentrated, higher technological intensity of an industrial activity is typically associated with higher diversity. So a policy for the City of Cape Town will likely have to be different from one aimed at an outlying area specialised in a few sectors with lower technological intensities; and the support provided for such an outlying area will have to change over time as it increases its technological sophistication.

2.1.1 Innovation in the Western Cape

The literature on the relationship between knowledge and growth is therefore not such that regional authorities with a developmental agenda can easily derive a list of recommendations from it, to help them pursue their growth strategies more convincingly. The current state of the art is better at suggesting some general principles, but ultimately of course specific plans of action are needed.

It doesn't help that SA has not produced much scholarship on the role of spatial agglomeration, various dimensions of proximity, and the nature of inter-firm relationships in innovative activities. In the mid-1990s, the Foundation for Research Development assessed the competitive strengths of the nine provinces. Ten years later a team from the national Department of Science and Technology (DST) calculated provincial Technology Achievement Indices. But these reports did not probe causal links between the various dimensions of the composite indicators they used, or factors within them. Hence they reported an outcome without really understanding the processes that led to it.

10 UNCTAD, 2005
11 Helmsing, 2001
12 For example, Greunz, 2003, Audretech and Lehmann, 2005, Asheim and Coenen, 2005, Rondé and Hussler, 2005
13 Van der Panne, 2004
14 Greunz, 2004, Lim 2004
15 FRD, 1995
16 DST, 2005, see also UNDP, 2001
Fortunately our understanding of the knowledge economy in the Western Cape is more advanced than what is known about it in the rest of the country. This is thanks to background work over the past three years commissioned by the PER&O itself, analyses undertaken in the context of the MEDS, the Council for Scientific and Industrial Research’s (CSIR) Provincial Advanced Manufacturing Technology Strategy (PAMTS), and an ongoing project at the Human Science Research Council (HSRC) on the provincial knowledge infrastructure and dynamics of learning\textsuperscript{17}.

Of interest to this chapter is that the relative integration of productive and knowledge-based activities in the Province, as well as the relevance of geographic proximity between businesses and other knowledge users and producers for this relationship, appears to vary between sectors and technologies. This is illustrated in the following analysis.

Table 1 below, shows the economic, R&D, scientific, and technological profile of the Western Cape in 2004. Data sources include value added by sector supplied by Quantec, R&D investments by sector as well as research field, publications in peer-reviewed journals, and patent applications, all supplied by the HSRC. Activities are reported in Table 1 only if the Western Cape compared to the rest of the country is specialised in them and accounts for a sizeable proportion of the national total (at least 20%).

Productive activity is concentrated in agriculture, forestry, & fishing; food & beverages, textiles, as well as in financial & business services.

In 2004, the Province attracted 14 per cent of national R&D investment, including manufacturing, where it has a relatively weak productive base. R&D investments are much more diversified than productive activity, which is a possible indication that the knowledge sector in the Province is more sophisticated than the production sector. At first sight, “knowledge” (proxied by scientific output) also seems to be much more at home in the Western Cape than “technology” (proxied by patent applications).

\textsuperscript{17} Lorentzen, 2006
### Table 1: Weighted specialisation indices for productive and knowledge-based activities, 2004

<table>
<thead>
<tr>
<th>Production</th>
<th>R&amp;D investment</th>
<th>Technology (patents)</th>
<th>Science (publications)</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
<td>Produced by</td>
<td>Used by</td>
</tr>
<tr>
<td><strong>Primary</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Agriculture, fishing</td>
<td>Vegetables, horticultural specialties, nursery products</td>
<td>Agriculture</td>
<td>Vegetables, horticultural specialties, nursery products</td>
</tr>
<tr>
<td></td>
<td>Fishing, fish hatcheries, and fish farms</td>
<td>Fishing, fish hatcheries and fish farms</td>
<td>Fruits, nuts, beverage and spice crops</td>
</tr>
<tr>
<td><strong>Secondary</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Food, beverages</td>
<td>Food products, beverages</td>
<td>Food, beverages</td>
<td>Food, beverages</td>
</tr>
<tr>
<td>Textiles, clothing, leather</td>
<td>Textiles</td>
<td>Wearing apparel</td>
<td>Wearing apparel</td>
</tr>
<tr>
<td></td>
<td>Publishing, printing, media</td>
<td>Paper, paper products</td>
<td>Paper, paper products</td>
</tr>
<tr>
<td></td>
<td>Pesticides</td>
<td>Rubber and plastics products</td>
<td>Rubber and plastics products</td>
</tr>
<tr>
<td></td>
<td>Machinery, equipment</td>
<td>Ships, boats</td>
<td>Ships, boats</td>
</tr>
<tr>
<td></td>
<td>Electronic valves, tubes</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>TV and radio transmitters</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>Medical and surgical equipment</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>Instruments, appliances</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>Aircraft, spacecraft</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>Transport equipment</td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Tertiary</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Finance, business</td>
<td>Trade and repair of motor vehicles</td>
<td>Water transport</td>
<td>Sewage and refuse disposal</td>
</tr>
<tr>
<td></td>
<td>Retail trade</td>
<td></td>
<td>Private households</td>
</tr>
<tr>
<td></td>
<td>Land transport</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>Water transport</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>Air transport</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>Financial intermediation</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>Insurance and pension funding</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>Other business activities</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>Advertising</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>Public administration, defence, social security</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>Health, social work</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

*Source: Lorentzen, 2007*

*Note: Weighted specialisation indices resemble revealed comparative advantages in that they are obtained by calculating the relative share of a particular activity (by SIC code or research field) in the national total which is reported only if the absolute weight in the national total reaches 20 per cent.*
The question then is how, and if, knowledge inputs relate to knowledge outputs. The definitive answer relies on further analysis. But preliminary conjectures may help in answering the following questions:

- In which sectors that are key to the regional economy do successful businesses appear also to invest in R&D and obtain technological innovations that in turn might make them more successful?
- What science and technology output is yielded by R&D input?
- What evidence exists for spill-overs between knowledge production and use?

The establishment of correspondences between the Western Cape’s specialisation indices is not equivalent to attributing causality in the sense that, for example, R&D investment in a specific sector or research field leads to a scientific publication or technological innovation in the same fields.

It merely suggests that, where there is co-existence of knowledge inputs and outputs, the underlying production function is possibly knowledge-intensive, which then justifies probing the role of regional dynamics that make this possible. In turn, if such correspondences do not exist, it is safe to conclude that regional innovation dynamics do not play an important role in the provincial industrial profile.

Table 2 shows the results of this exercise. A productive specialisation in agriculture, forestry, & fishing co-exists with an R&D specialisation in crop growing, gardening, and horticulture. Patents emanate from agriculture, hunting, and related service activities while producers in horticultural, fruit, forestry and related activities make use of them.

A very important insight is that these data yield contrasts with the often un-reflected notion that the knowledge economy manifests itself primarily or exclusively in advanced manufacturing or service sectors, and that it occurs only in medium- or high-tech activities.

In reality – and this is good news – a primary sector, agriculture, with typically low R&D-intensive processes and with a very significant employment share in the Western Cape appears to be producing and making use of knowledge.

Fields in which specialisations in business sector R&D investments co-exist with specialisations in scientific output include biological sciences, electrical and electronic engineering, clinical sciences, and medical microbiology.

Hence, the Western Cape has strengths in analytical, science-driven knowledge. This underlines the importance of university-industry linkages, which merits further investigation, especially for the four disciplines mentioned here.
Table 2: Correspondences between specialisation indices

<table>
<thead>
<tr>
<th>Production</th>
<th>R&amp;D: SIC code</th>
<th>R&amp;D: research field</th>
<th>Patents: producers</th>
<th>Patents: users</th>
<th>Science: publications</th>
</tr>
</thead>
<tbody>
<tr>
<td>Agriculture, forestry/fishing</td>
<td>SIC code</td>
<td>Growing of crops, market gardening, horticulture</td>
<td>Agriculture and related service activities</td>
<td>Growing of vegetables, horticultural specialties, nursery products; growing of fruit, nuts, beverage and spice crops; forestry, logging and related service activities</td>
<td></td>
</tr>
</tbody>
</table>

Production, R&D, and technology

R&D and science

R&D and technology (production and use)

Source: Lorentzen, 2007
Specialisations in investments in R&D co-exist with technological specialisations – in terms of producing or using patents, or both – in the areas of agriculture & fishing, including related downstream activities, plus textiles, rubber & plastics, ships & boats, and water transport.

In other words, we observe, for example, that some businesses in the Western Cape invest above average in nursery products and that some businesses – possibly the same – and other knowledge producers (such as the ARC in Stellenbosch) reap rewards in terms of technological achievement.

We cannot be sure that knowledge flows link these two groups. But the information certainly suggests that regional linkages between businesses within the same value chain or even across value chains are a distinct possibility.

In addition, the Western Cape has a high number of correspondences where a specialisation in R&D investments is accompanied jointly by specialisations in patent production and use.

This could indicate spill-overs or even intended knowledge sharing at play. Although the bulk of SA’s technological knowledge is clearly not produced in the Western Cape, businesses based here may well be its most effective users.

Finally, in the Western Cape, with the exception of textiles, all sectors with a specialisation in technology (that is, patent) output co-exist with specialisations in technology use. This applies to agricultural & fishing activities, paper & paper products, rubber & plastic products, ship & boat repairing and building.

Therefore businesses in the Western Cape are not only important producers or users of technological knowledge in these areas, but mostly both. Again, this suggests the possibility of regional dynamics that merit closer investigation, for example inter-business relationships between lead and laggard businesses.

On the basis of this evidence, the textile sector appears to be rather fragmented. For the time being it remains an open question whether improving interactions between producers and users of knowledge in the sector could allay the competitive challenges with which it has been battling rather unsuccessfully of late.

In summary, in the Western Cape both regional and sectoral dynamics appear to be important. We now need to establish if these dynamics are determined merely by economies of scale and scope, superior infrastructure, a high demand for innovative products, and so on, or if businesses actually enjoy agglomeration advantages and the benefits of joint action (or suffer from their absence) in dealing with technological change.

The difference is important for the role of the Provincial Government. If businesses operate in Cape Town because of, say, the City’s international airport and related logistics and nothing else, it would not be appropriate to speak of a regional innovation system.
By contrast, if innovative activities in the Province do hinge on some or all of the relationships hinted at in this section – in other words if what goes on in the Province has a systemic quality to it, articulated in the interactions between businesses, science and training institutions, and governance agencies – then proximity would indeed matter.

In the first instance, the Provincial Government could limit itself to basic service provision. In the second, it would need to understand, and try to overcome, network failures that hold back the advance of the province.

2.2 Government policy and university-industry linkages (UILs)

Insights from international empirical studies confirm the potential importance of university-industry linkages (UILs) for the knowledge economy in the Western Cape, gleaned from the data presented here. For example, in the European Union (EU), regional geographical and technological proximities matter for the creation of new knowledge. Knowledge spill-overs become less evident over longer distances. This is especially true for UILs which are largely limited to directly adjacent regions.\textsuperscript{18}

In Germany, universities with a greater investment in knowledge that are located in regions that also invest above average in knowledge, create opportunities for entrepreneurship through the associated spill-overs. Especially for small businesses, these externalities are easier to capture from close by, so therefore the rate of creation of technological start-ups has a distinct spatial dimension\textsuperscript{19}.

In France, a highly skilled labour force and productive universities do not per se make much of a difference to innovative activity unless they are part of a system; just “being there” is not sufficient\textsuperscript{20}. In Spain, businesses located in regions with higher R&D investment and more scientific output make greater use of science in patented technology.

What matters here is not so much R&D investment in itself, but rather the back-and-forth movement of people between industry and academia.

In sum, the increase in the use of science by local industry rises concomitantly with larger allocations to local universities, in terms of both money and people, and with the production of more scientific research results plus the human resources capable of generating and applying this knowledge\textsuperscript{21}. The situation in the UK is similar\textsuperscript{22}.

However, what works in Europe or the United States need of course not apply in SA. A recent, very comprehensive review of the last ten years of academic writing on university-industry linkages raised a number of concerns with this literature\textsuperscript{23}.

\textsuperscript{18} Greunz, 2003  
\textsuperscript{19} Audretsch and Lehmann, 2005  
\textsuperscript{20} Rondé and Hussler, 2005  
\textsuperscript{21} Coronado and Acosta, 2005  
\textsuperscript{22} Faggian and McCann, 2006; see also Kim, Lee, and Marschke, 2005  
\textsuperscript{23} Klitkou, Gulbrandsen, Patel, von Ledebur, 2007
First, this work is largely a-theoretical. At best, there are “frameworks”, none of which enjoy much currency outside their small group of supporters. What is lacking is an approach that conceives of UILs as a particular articulation of economic, institutional, and organisational relationships.

In view of the fact that these relationships differ considerably between advanced and latecomer economies, it would be spurious simply to transfer insights from a highly sophisticated developed economy to the Western Cape.

Second, there is a prevailing disciplinary bias in favour of biotechnology and related fields. Since UILs are likely to differ substantially across sectors and disciplines – especially with respect to their research intensity – the available research has not really captured the expected variance in the nature and mode of these interactions.

In the context of developing countries that rely predominantly on low research-intensive activities, this means that not only is there little appropriate data available to compare like with like, but key research questions have not even been asked yet24.

In sum, conceptual questions such as those raised by various researchers referred to above25 must be pursued alongside empirical investigations of regional knowledge flows in order to understand how a regional innovation system works, and where and why it underperforms.

Having briefly reviewed the role of regional innovation in growth and having illustrated preliminary evidence of linkages between productive and knowledge-based activities in the Western Cape, it would be desirable to include innovation indicators or other evidence of firm-based technological learning into the sections that follow.

This combination would ideally allow us to begin to understand how the presence and strength of these linkages affect economic performance. Unfortunately, available data do not yet allow us to do that which is why sections 2.3 do not quite live up to the expectations generated by the material reviewed here.

In the future it might be possible to rely on data such as those generated by the HSRC’s Innovation Survey, suitably disaggregated to the provincial level, in order to do so. A more realistic strategy, certainly in the short term, would be to mandate the MEDS to incorporate innovative activities explicitly in its sectoral reviews.

To date, the sector research commissioned by the MEDS has employed a standard industry analysis methodology and thus largely neglected innovation. If this were changed, it would contribute to the emerging knowledge base on innovation in the province.

Due to data limitations, a certain disjuncture between the previous and the following sections is therefore inevitable. All one can do at this point is venture some conjectures based on where sectoral trends suggest that linkages between productive and knowledge-based activities may influence economic performance. This is done in the conclusion of this chapter.

2.3 Broad overview of sector development

This section builds on and extends the sectoral description in the 2006 PER&O. It covers data for the period from 1995 to 2005 or 1995 to 2006.

2.3.1 Output growth

The economy in the Western Cape is rather diversified, with activities in the primary, secondary, and tertiary sectors. In 2005 the primary sector consisted predominantly of agriculture, forestry & fishing, which accounted for 4.3 per cent of provincial output, slightly lower than in 2004. The share of manufacturing was 17.6 per cent, also a little lower than in 2004.

The Western Cape is therefore mainly a service economy; over the past years between three quarters and four fifths of value added was generated here. The most important activities in 2005 included financial & business services (29.2%), wholesale & retail trade, catering & accommodation (17.7%), and transport & communication (11.1%), followed by government services (9.5%).

Figure 1: Sectoral contribution to Western Cape output, 2005

[Diagram showing sectoral contributions]

Source: Quantec Research, 2007

Over the 11-year period under review here, the activities with the highest average annual growth rates were transport & communication (6%), followed by wholesale & retail trade, catering & accommodation (5.4%), and financial & business services (4.7%). Sectors in long-term decline or stagnation included mining & quarrying (-11.0%) and government services (0%). All other activities grew between 1.5 and 3.7 per cent.
From 2004 to 2005, the Western Cape economy grew 5,5 per cent. Above average growth materialised in construction (10,3%), wholesale & retail trade, catering & accommodation (8,2%), financial & business services (7,1%), and marginally in transport & communication (5,7%). The only sector in absolute decline was mining (-12%).

**2.3.2 Employment growth**

In 2005, 12,1 per cent of the Western Cape’s work force was employed in agriculture, forestry & fishing. Manufacturing employed close to 15 per cent. Almost three-quarters (72,5%) were employed in service activities, led by financial & business services (18,3%), wholesale & retail trade, catering & accommodation (16,3%), government services (15%), and CSP services (11,8%).

Over the period 1995 to 2005 long-term growth rates were highest in financial & business services (5,3%). Wholesale & retail trade, catering & accommodation as well as community, social & other services grew by between 1,3 and 1,7 per cent. All other sectors declined, except manufacturing, which stagnated.

Overall employment also stagnated which is obviously reason for concern because it means that output growth need not lead to job creation.

**Figure 2: Sectoral contribution to Western Cape employment, 2005**

Fortunately, the more recent picture looks considerably brighter. While from 2004 to 2005 employment fell in manufacturing (-10,6%), as well as in agriculture, fishing & forestry (-18,6%), and in CSP services (-9,8%), overall job growth picked up by 3,2 per cent, more than a point higher than in the previous year.
Job creation was especially vibrant in transport & communications (52.1%), financial & business services (27.1%), construction (23.7%), electricity & water (17.4%).

In summary, job gains in the service sector more than compensated for job losses in the primary and secondary sectors. This means that at a macro level the economy is realising a shift toward activities in the tertiary sector.

It does not mean, however, that farm workers, fishermen, and textile workers who are being retrenched successfully establish themselves as, say, data entry operators in the financial sector. Some of these workers will need retraining, while others, for reasons of age, may in the longer term be unemployable and will therefore have to rely on forms of social security to avoid hardship.

2.4 A detailed look at manufacturing

2.4.1 Manufacturing output

Within the manufacturing sector, in 2005 the most important activities were wood & paper, publishing & printing, and food & beverages, each accounting for a fifth of manufacturing value added; followed by petroleum products, chemicals, rubber & plastic, as well as other non-metal mineral products (28.8%). Textiles, clothing & leather goods continue to play a role (9.6%), as does the furniture industry (8.9%).

Figure 3: Sub-sectoral contribution to manufacturing value added in the Western Cape, 2005

Source: Quantec Research, 2007
Average annual growth from 1995 to 2005 was highest in transport equipment (4.2%) and petroleum products, chemicals, rubber & plastic (3.8%). It was also above average in metals, metal products, machinery & equipment (2.8%) and electrical machinery & apparatus (2.6%). All other sectors were affected by below average growth, while the textile sector actually shrunk slightly.

From 2004 to 2005, manufacturing output growth was generally higher (2.4%). Transport equipment (14.3%), other non-metal mineral products (12.8%), radio, TV, instruments, and watches & clocks (10.7%) were the most dynamic activities. The only sector in absolute decline was wood & paper, publishing & printing (-4.8%).

Although small, developments in transport equipment and the instrument sector merit closer attention since they possibly constitute promising forays by Western Cape businesses into activities that are among the most dynamic areas of global trade.

### 2.4.2 Manufacturing employment

In 2005 about one in five workers in manufacturing was still employed in textiles, clothing & leather goods. Employment in the food processing sub-sector followed at 18.5 per cent, then in metals, metal products, machinery & equipment (15.8%), and wood & paper, publishing & printing (12.18%). Taken together, petroleum products, chemicals, rubber & plastics (9.52%), furniture (8.16%), and transport equipment (7.19%) employed another quarter of the manufacturing work force.

**Figure 4: Manufacturing employment in the Western Cape, 1995 – 2005**

![Graph showing manufacturing employment in the Western Cape, 1995 – 2005](image-url)

*Source: Quantec Research, 2007*
The long-term decline in manufacturing employment was reflected in all sectors except transport equipment, which grew at an average rate of 3 per cent in the period 1995 to 2005, thus combining a successful output growth with a promising job creation performance.

Jobs in the furniture and metals industries stagnated, while job losses in both old sectors (textiles) and new sectors (electronic devices) amounted on average to as much as 5 to 6 per cent per year.

Unlike in the previous year, manufacturing employment also dropped in 2005, by 10,6 per cent. Sectors that moved against the trend include transport equipment (28,1%), electrical machinery & apparatus (15,5%), and food processing (4,0%).

2.4.3 Manufacturing investment

In 2006, the share of the manufacturing sector in provincial investment exceeded its weight in the regional economy, while the picture was reversed for the service and primary sectors. Manufacturing contributed 21,4 per cent to total outlays. The most important activities were petroleum products, chemicals, rubber & plastics (5,6%), transport equipment (3,2%), furniture (2,4%), and wood & paper, publishing & printing (2,3%).

Figure 5: Gross Provincial Fixed Investment in the Western Cape, 1995 – 2006

Source: Quantec Research, 2007
Gross fixed investment in the provincial economy grew 10.7 per cent from 2005 to 2006. Within manufacturing, furniture (35.5%) realised the highest growth rate. Over the 12-year period from 1995, average annual growth for all sectors was 4.8 per cent.

Over the long term, the service sector had the leading growth rates on average — CSP services (14.6%), construction (13.3%), communication (12.8%) — although the two top investing sectors were furniture (24.5%) and transport equipment (15.7%).

2.4.4 Manufacturing trade relative to total trade

The primary sector contributed 21.9 per cent to Western Cape exports in 2006. Agriculture, forestry & fishing are thus roughly five to six times as important for Provincial exports as for output. More than half (53.4%) of the Western Cape’s exports originated in manufacturing, about three times as much as its contribution to output. Services contributed a quarter of exports, about three times less than their share in output.

Figure 6: Western Cape exports by sector, 1995 – 2006

According to Quantec data used in this report, average annual growth of manufacturing exports totaled 16.6 per cent from 1995 to 2006. If true, this would not only be world-class performance but nearly four times as much as that reported in the 2006 PER&O for the period 1995 to 2004, thus raising questions about the reliability of data at the provincial level.

In 2006, more than half of Western Cape manufacturing exports was in coke and refined petroleum products (16.1%), food (14.2%), beverages (12.9%), and basic chemicals (8.7%).

Another quarter came from basic iron & steel (6.9%), machinery & equipment (6.5%), other chemicals & man-made fibres (4.8%), TV, radio & communication equipment (3.3%), and non-automotive transport equipment (3.3%).
The sectors registering average annual growth rates over the 12-year period of 20 per cent or higher included tobacco (53.6%), TV, radio & communication equipment (42.5%), basic chemicals (30.7%), non-automotive transport equipment (30.1%), glass (28.5%), basic iron & steel (23.8%), beverages (22.8%), professional & scientific equipment (19.9%), and machinery & equipment (19.7%).

From 2005 to 2006, growth was most dynamic in tobacco (262.5%), basic chemicals (244.8%), rubber products (61.5%), basic non-ferrous metals (37.0%), metal products (32.9%), machinery & equipment (24.8%), and non-automotive transport equipment (22.7%).

From 1995 to 2006, the Western Cape’s manufacturing trade balance registered a surplus only twice, in 2001 and 2002. In the other years, the value of imports exceeded exports by a factor of up to two; in 2006 export values represented 62 per cent of import values.

Activities with consistent surpluses included food; beverages; tobacco, leather & leather products; coke & refined petroleum products; basic iron & steel; and motor vehicle parts & accessories.

Trade deficits accrued in textiles; wearing apparel; footwear; wood & wood products; paper & paper products; printing, publishing & recorded media; chemicals, rubber, plastic & glass products; non-metallic minerals; basic non-ferrous metals; metal products; machinery & equipment; electrical machinery; television, radio & communication equipment; professional & scientific equipment; and, more recently, furniture.

**Figure 7: Western Cape trade balances by manufacturing sub-sector, 1995 – 2006**

*Source: Quantec Research, 2007*
2.5 A detailed look at services

2.5.1 Service sector output

In 2005, service activities contributed 78 per cent to provincial output. The most important activities were financial & business services (29,2%), trade, catering & accommodation (17,7%), transport & communication (11,1%), and government services (9,5%).

From 1995 to 2005, average annual growth was highest in transport & communication (6,0%), trade, catering & accommodation (5,4%), and financial & business services (4,7%). From 2004 to 2005, growth was most dynamic in construction (10,3%), trade, catering & accommodation (8,2%), and financial & business services (71%).

Figure 8: Western Cape value added in services, 1995 – 2005

2.5.2 Service sector employment

In 2005, the service sector employed some 943 000 people, or 72 per cent of the workforce. Employment was highest in financial & banking (18,3%), wholesale & retail trade, catering & accommodation (16,3%), government services (15%), and CSP services (11,8%).

The sector with the highest employment growth rate from 1995 to 2005 was financial & business services (5,3%), followed by wholesale & retail trade (1,7%) and community services (1,3%). All other activities shed jobs. However, from 2004 to 2005, there was dynamic growth in transport & communication (52,1%), financial & business services (27,1%), and construction (23,7%).
Figure 9: Western Cape service sector employment, 1995 – 2005

Source: Quantec Research, 2007

2.5.3 Service sector investment

In 2006, business services represented 16,3 per cent of investment in the Western Cape economy, closely followed by financial & insurance services (15,4%), and government services (10,3%). Transport, trade, and communication each accounted for 7 to 8 per cent. In total, three quarters of investment in the Province originated in the service sector.

Figure 10: Western Cape gross provincial fixed investment in services, 1995 – 2006

Source: Quantec Research, 2007
From 1995 to 2006, average annual growth was highest in community services (14,6%), construction (13,3%), communication (12,8%), catering & accommodation (8,1%), and trade (7,3%). From 2005 to 2006, investment growth was highest in construction (39,7%), community services (18,8%), communication (14,4%), and trade (14,1%).

2.5.4 Service sector exports

The service sector in 2006 contributed roughly a quarter to exports from the Western Cape, led by transport (6,3%) and trade (5,8%), followed by financial & insurance services (3,6%), business services (3,1%), and catering & accommodation (3,0%).

From 1995 to 2006, service sector activities with above-average annual growth included communication (17,1%), business services (11,0%), and catering & accommodation (9,2%). From 2005 to 2006, service sector investment growth trailed that in manufacturing and remained below the provincial average of 5,6 per cent in all activities.

Figure 11: Western Cape service sector exports, 1995 – 2006

Source: Quantec Research, 2007

2.6 Key sector performance: evidence from the MEDS

The Western Cape Microeconomic Development Strategy (MEDS) is one of a set of interactive strategies developed on behalf of the Provincial Government to stimulate economic development and transformation in the Western Cape. It is based on a multi-annual review of sectoral developments in the provincial economy, currently in its fourth phase.

The 2006 PER&O reported on the results of the first two phases of the MEDS, amounting to 14 sectors and four cross-cutting activities. This edition summarises the deliberations of the MEDS’s third phase, which was concluded in July 2006.

The third phase included seven new studies, namely that of the informal sector, food processing, boatbuilding, construction, chemicals, printing & publishing, and retail, wholesale & franchising.
2.6.1 Boatbuilding

Boatbuilding is a relatively new, dynamic industry in the Western Cape. The Province has managed to establish itself as the principal national location for boatbuilding. More than half of South Africa’s boatbuilding businesses are based in the Western Cape, where they produce more than four fifths of the national boatbuilding output. More than two thirds of the value chain is domestic and under control of PDI-owned businesses.

The most successful products of the sector are catamarans and monohulls, predominantly for sailing, where businesses based in the Western Cape successfully compete internationally. Strong global demand, especially for sailing catamarans, suggests that the sector could grow up to four times its current size.

Constraints to growth relate to production efficiency and quality on the one hand, and to the absence of intra-sectoral cooperation in the interest of joint technological learning and upgrading, and the lack of reduction in logistics costs on the other hand.

These challenges are not primarily steeped in market failures but are the result of the highly individualistic nature of the industry, particularly its manager-owners.

The absence of sector-wide quality assurance mechanisms has had an adverse effect when specific products of individual yards performed badly and were noticed as such by the world yachting community.

Collective problems such as quality might best be addressed through collective measures, but the small size of the industry militates against this in that no yard managers could afford to devote a lot of time to issues that affect the sector at large.

This is why government needs to keep a watching brief over the sector. Unfortunately, even if the sector were to grow, due to its traditionally high labour intensity, the job creation elasticity to demand growth is low because yard owners will likely invest in new technology.

The Boatbuilding Academy

The Boatbuilding Academy was established in early 2006 as a joint initiative between the Cape Town Boatbuilding and Technology Initiative (CBTI), the education and training authority for the Manufacturing sector (Merseta), and False Bay College. It opened its door to the first 12 students in January 2006.

The main objective of the Academy is to train young people for employment within the industry by providing a recognised quality qualification. The programme targets existing employees within the industry as well as unemployed and school leavers.

The entrance requirement is a NQF 1 or equivalent qualification (grade 9). The qualification will be offered at NQF levels 2 to 4. The objective is to give students first a broad knowledge of boatbuilding up to NQF Level 2. Specialisation is then possible in the various categories at NQF Levels 3 and 4. The total course lasts 3 years, one year for each of the three NQF Levels.

The training consists of a mix of training at the College and on-the-job training in companies. The response from the boatbuilding companies has been positive; some of the larger companies have each offered to accommodate all of the trainees.

The training at False Bay Collegel will not immediately alleviate the skills bottlenecks within the industry, but is a very important initiative in this direction, reflecting a recognition of formal training in relation to the needs of this niche industry.
2.6.2 Food processing

Food processing is internationally a large, complex industry with high degrees of vertical integration. This poses challenges for smaller producers in developing countries. At the same time, growth in demand for healthy products and renewed interest in niche foods, including lifestyle foods, offer opportunities to small-scale producers, especially if they can exploit location-specific advantages and differentiate themselves through Made in the Cape.

The food processing sector contributes in important ways to the Western Cape economy. Provincial demand for food is higher than in the rest of the country. It accounts for a fifth of manufacturing value added, is the second largest employer in manufacturing, and the biggest exporter. It is linked to a strong local agricultural sector and to catering and accommodation activities. Intra-sectoral links are important as well.

On the whole, however, the food processing sector has not been a strong growth performer over the last decade. This is the result of relatively stagnant but large, established activities and smaller but high-growth activities such as indigenous teas, speciality meats, and spices & condiments.

Problems faced by smaller businesses which are often associated with the high-growth activities include expensive inputs (such as packaging), barriers to entry to domestic retail, and entry into international markets. In addition, the whole industry faces more import competition.

In a series of activities combining large and fast growing international demand and low concentration levels (that is, with lower barriers to entry for SMMEs), major obstacles faced by Western Cape producers include certification, access to distribution networks, and skills.

The Cape Herb & Spice Company

The Cape Herb & Spice Company, started in Cape Town in 1994, has grown into an internationally recognised company with a global reach.

The Cape Herb & Spice Company produces mainly innovative spice mixtures and blends packaged in grinders. Rubs, salts, and sugars also form part of the product range, in packaging such as tins and shakers. The company produces few primarily chilli products and chillies are present only in small amounts in some items of their product range.

The Cape Herb & Spice Company buys inputs locally where possible, due in part to cost considerations. Products not available in SA are imported in bulk purchases where there are significant cost savings. Sourcing from local suppliers has distinct advantages in that the logistics are more manageable and no up-front payment is required, whereas that is the case with international spice purchases.

Furthermore, samples from international suppliers are often vastly different from the actual product purchased. Unsatisfactory products are difficult to return and obtaining refunds can be problematic. Raw spices are purchased internationally through spice traders and locally from farmers.
The company is planning to expand its capacity. It currently has two lines at its factory, and a new factory will be built in 2008, which would add one line to their production capacity. The company currently employs approximately 50 people.

The success of the company thus far has been driven by the quality of its products and by innovative marketing. The company distinguishes itself from larger competitors, such as Robertson’s, by emphasising certain product qualities (products have no colourants, flavourants, preservatives, etc.) as well as the quality of the actual mixing, blending, and packaging processes. Therefore, the company targets higher-income customers who are more quality conscious.

The Cape Herb & Spice Company is the own label supplier for Woolworths’ range of herbs and spices and supplies into the “President’s” range of Loblaws in Canada. Through their listing in this range the company gains a near automatic listing with other retailers. An international retailer recently commented that the Cape Herb and Spice Company’s products are “known as the best in the world”.

The company is extensively certified to export into foreign markets with HACCP and British Retailers Consortium certifications, amongst others. Only two farms in South Africa are sufficiently certified to supply the company with organic products.

Innovative marketing that differentiates their products includes glass grinders and innovative/trendy names such as “Earth’s Energy” and “Spirit of Fire”. They also hold the worldwide rights for the manufacture (not distribution) of the Jamie Oliver-branded range of rubs, flavoured salts, and sugars.

The majority of their business is derived from the export market. Products are distributed globally, and destinations include the UK and Europe, the US, Canada, South America, Japan, New Zealand and Australia.

The route into the international food market started at trade shows, which play an important role in accessing the international food market. The Cape Herb & Spice Company still participates in these trade shows in order to open up new opportunities and markets.

2.6.3 Chemicals

Excluding petroleum, the chemical industry is not a sizeable sector in the Western Cape. It produces a small range of relatively low- to medium-technology products and imports most of the chemical products required by the Province.

In some sense, the state of the sector in the Western Cape broadly reflects the state of the chemical industry in the country, namely an industry that has hardly grown in the past decade and has lost critical manufacturing capacity and skills.

An interesting new idea is the development of chemicals out of compounds extracted from natural products. The unique patrimony of the Western Cape over its rich biodiversity lends itself to exploring the feasibility of developing pharmaceuticals, body care products, cosmetics, biofuels, and others.
2.6.4 Construction

The construction sector contributed some 3 to 4 per cent to regional GDP over the period 1999 to 2003. With annual sector growth to 2008 projected at seven per cent, this is forecast to rise. Planned public infrastructure investments under the AsgiSA play a major role in this.

Over the last decade the output employment elasticity has fallen in this sector, confirming that even in sectors with opportunities for unskilled workers, growth does not necessarily go hand-in-hand with job creation.

The sector is affected by skills shortages. This concerns skilled workers and management. Businesses interviewed in the course of the MEDS sector study complained about the lack of training in the sector. They reported having no financial incentives to offer training themselves, even though retraining their current workforces would allegedly go a long way toward addressing skills shortages.

This suggests that the Construction Education and Training Authority (CETA) is failing in its mandate to facilitate appropriate training.

2.6.5 Informal economy

About one in ten people working in the Western Cape are part of the informal economy. This alone shows that the sector is important, albeit not as much as in other Provinces. Compared to the rest of the country, people in the Western Cape’s informal economy tend to make more money and be more highly educated.

But this does not mean that all is well. There are barriers to enter the informal sector, blockages to improving incomes, and obstacles to taking advantage of emerging opportunities. Removal of these barriers relates to access to infrastructure and basic services, financial services, training, and local government regulations.

Further analysis on the informal sector is presented in Chapter 6: Small, Medium and Micro Enterprises and the Informal Sector.

2.6.6 Printing and publishing

Printing & publishing employs some 30 500 people, providing one in seven jobs in manufacturing. The sector appears to be in the throes of a long-term decline.

First, it has not weathered the emerging competition from producers in the Far East well. Lower wages, high levels of efficiency, large scale economies, and significant government support characterise the industry in countries such as the Philippines.

Second, the sector suffers from skill shortages not only in printing and publishing but also in wood and paper. This exerts upward pressures on wages and encourages job-hopping. This has led to gradually more capital-intensive production processes, spelling trouble for job growth in this sector, including for semi-skilled workers.

Managers interviewed for this MEDS study had a poor opinion of the sector SETA and recommended the creation of a provincial training centre along the lines of its existing counterpart in Gauteng. This could be organised in a public-private partnership.
2.6.7 Wholesale, retail, and franchising

This sector is the largest employer in the Western Cape. Due to productivity increases of changing labour practices toward more flexible contracts, the considerable growth in the sector has not gone hand in hand with job creation.

Leading businesses in the sector – essentially the large retailers – have played an important role in opening the supply chain both upstream and downstream to emerging businesses. The training authority, the Wholesale & Retail SETA (W&RSETA), has organised successful learnership programmes, allowing unemployed people to gain valuable work experience.

But considerable obstacles continue to stand in the way of informal traders graduating into the formal economy. These obstacles include lack of time and resources to attend training, and lack of access to credit, loans, tenure, infrastructure and bulk buying power to make their businesses more viable.

2.6.8 Prioritisation

The MEDS recommended that the informal sector be accorded priority status within the MEDS strategy. This is based on its potentially large impact with respect to output and equity. Resource costs are limited. In addition, the relatively high education levels of a significant portion of the people working in the informal sector suggest that training programmes are likely be effective.

Food processing, boatbuilding, and construction were identified as important within the Western Cape’s development strategy, albeit not needing or justifying comprehensive government intervention at this stage.

The recommendation is to keep a watching brief on these sectors in order to monitor whether in future their growth potential is likely to be matched by high impact, which might then change the rationale for support policy.

Finally, chemicals, printing & publishing, and retail, wholesale & franchising each warrant minor support.

2.6.9 The 4th round of the MEDS: late 2007

The current round of the MEDS deepens the analysis of two sectors it has taken on in previous rounds, namely the informal sector, and the cultural or creative industries. The focus in the informal sector will be on trade and construction, previously identified as activities with significant growth and job creation potential.

The other study concentrates on music and the performing arts in the Western Cape. Next to a profile of attendant activities, it aims to learn from international experiences of cities or regions that have used culture as a magnet for investment and tourism.

In addition, the MEDS is exploring the opportunities of the 2010 World Cup, especially for small and medium-sized enterprises.
Finally, the work programme includes an ambitious attempt to improve the spatial understanding of economic opportunities in the Province by analysing the economic performance and growth potential of selected municipalities outside of the Cape Metropole.

This will pay special attention to innovation in both urban and rural contexts, thus examining the presence of knowledge-based activities away from the Province’s major economic hub.

3. Conclusion

This chapter has embedded a detailed summary of sectoral and employment trends up to 2005 or 2006 in a preliminary analysis of the integration of productive and knowledge-based activities in the Western Cape. It attempts to relate trend data about output, employment, investment, and international trade (which are well established and widely used), with data that loosely describe aspects of the Western Cape’s knowledge economy (which are much less easily available).

It is critical for policymakers to understand the contribution knowledge-based activities are making to the performance of a particular sector. Such analysis is at least as interesting as the growth in output, employment, or exports itself.

For instance, the agriculture and fishing sectors have traditionally provided livelihoods for many people in the Western Cape. They are prominent surplus items on the provincial trade balance. Yet due to changing weather patterns, scarcer water, pressure on fish stocks, and continuing protectionism in international markets, these two industries are on the whole in decline.

However, this trend is not applicable for every activity in these sectors. In fact, despite the general malaise, some agricultural producers thrive. The analysis in this chapter suggests that this difference may have to do with the degree of integration between what businesses do and what knowledge-producing institutions do²⁶.

The existence of possible areas of interaction between productive and knowledge-based activities in low research-intensive industries, such as agriculture and fishing, is one of the most interesting findings of this kind of work. It is also a finding that could make the gains from the knowledge economy accessible to a wider group of people.

Given the documented strengths in natural sciences, including biotechnology, it is worth investigating where UILs exist, if they are exploited to the fullest and, in the likely case that they are not, what sort of incentives a provincial government could provide to create networks or overcome network failures.

²⁶ cf. Lorentzen, 2006 for the Western Cape wine industry.
Another question worth pursuing is whether the dynamic performance of sectors such as transport equipment (including boats) and instruments, with its positive consequences for job creation documented in this chapter, owes anything to the investment into R&D and production or the usage of technology undertaken by some businesses in these sectors.

This requires in-depth case work: Which businesses have invested in R&D, for what reason, and what is the history of learning behind a patent that these businesses apply for or license? And further, are R&D and technology (use or production) the determinants of differential performance within a sector?

This same question can also be asked across sectors. The analysis showed, for example, that as far as technology is concerned, user-producer relationships in textiles seem to be much less developed than in all other sectors in which Western Cape businesses possess technological competences.

To the extent that the sorry state of the textile industry in the Western Cape is due to a lack of appreciation or understanding of key technological changes behind world-class manufacturing in the textile sector, the absence of networks might in the same way doom even those producers that would have a chance at survival if they could benefit from collective strategies to overcome sector-wide shortcomings.

If these suggestions sound like exhortations to fund further research into these matters, that’s exactly what they are meant to convey. Yet this is not the usual academic litany. The Western Cape Provincial Government has been remarkably willing to create the space in which questions like these can be pursued. And although we will not learn all answers subito, we know today a lot more about what makes the Western Cape economy tick than we did in 2005, the year the first PER&O was published.
This page was left blank intentionally.
Employment Dynamics

Key Findings

- Between 2000 and 2005, the Western Cape’s working-age population grew at a rate of 2.3 per cent a year, placing the Province under greater pressure to create jobs than the rest of SA.

- Despite buoyant economic growth, provincial employment creation is not growing rapidly enough and as a result broad unemployment in the Western Cape is growing faster than nationally.

- Employment in the Province expanded by 1.5 per cent a year to about 1.73 million people in 2005. The African share of employment increased to 25.5 per cent, while coloureds and whites accounted for approximately 50 per cent and 25 per cent, respectively.

- The number of employed matriculants continues to grow rapidly, although at a slightly reduced rate.

- The bulk of employment expansion has occurred in the tertiary sector, driven largely by the rapid growth in wholesale & retail trade.

- The increase in the number of the discouraged workseekers in the Province is concerning and is contributing to a widening of the gap between the Provincial broad and narrow rate of unemployment.

- In 2005, broad unemployment in the Western Cape reached 25.5 per cent in comparison to 38.8 per cent nationally.
Unemployment is concentrated among coloureds (51.7%) and Africans (41.6%), as well as in younger age-groups – in 2005 41.7% per cent of unemployed in the Province were between the ages of 15 and 24 years and a further 30.7% per cent were aged 25 to 24 years.

A key feature of both SA and Western Cape unemployment is its long-term nature – most of the unemployed have never worked before, contributing to rapid erosion of skills and familiarity of current technologies.
1. Introduction

One of the key challenges facing all levels of government is the challenge of unemployment and job creation, since it is only through equitable job creation that the problems of poverty and inequality can be addressed on a sustainable basis.

It is also an important aspect of ensuring that all groups within society are able to engage with the economy and enjoy the benefits of economic growth and increased prosperity. However, creating jobs and ensuring that all groups within society are able to access these jobs is no simple task.

This chapter presents a closer analysis of the labour market over the first half of this decade. The next section presents recent labour market performance in the Western Cape and, where appropriate, contextualises this performance nationally.

Important questions revolve around whether jobs have been created in the Province over the period and whether unemployment has continued to rise. Sections three and four take a closer look at employment and unemployment respectively.

2. The Western Cape labour market

2.1 Recent employment and unemployment trends

The bi-annual Labour Force Survey (LFS), conducted by Statistics SA, is the most comprehensive source of labour market data in the country, with a wealth of individual and household level data. This nationally representative dataset provides insights into a range of labour market and other issues.

The analysis below draws on the September 2000 and the September 2005\(^1\) LFSs, the latter based on information from nearly 110 000 individuals living in around 28 400 households. The Western Cape sample in this dataset consists of just under 11 600 individuals in 3 230 households.

Table 1 below shows labour market aggregates for the periods 2000 and 2005. The working population, defined as those individuals between the ages of 15 and 65 years inclusive, forms the group from which the labour force may potentially be drawn.

In the period 2000 to 2005 the Western Cape’s working age population grew by 343 000 individuals due to natural population growth coupled with net in-migration. This represents an average growth rate of 2,3 per cent a year, and is a full percentage point above growth in the national working age population.

This means that, given labour force participation rates, the Province has faced relatively greater pressure in terms of job creation than the country as a whole.

\(^1\) The 2005 LFS is used for this analysis as the raw datasets for the September 2006 LFS were not yet available.
Use of confidence intervals in statistical analysis

Confidence intervals are calculated because the datasets used are from sample surveys and the possibility therefore exists 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, they are affected by data quality concerns, and are only as ‘precise’ as the data upon which they are based.

Source: PER&O 2005

Over the same period, the number of individuals wanting work, but not necessarily actively seeking work, that is the broad labour force in the Province, rose by 290 000 individuals, equivalent to an average rate of 2,7 per cent a year, but this change is only statistically significant at the 90 per cent level. This compares to the national broad labour force expansion of 1,5 million individuals or average growth rate of 1,5 per cent a year over the same period, which is also statistically significant.

Similarly, the number of individuals wanting work and actively seeking work, that is the narrow labour force, in the Province increased by 208 000 individuals, at an average rate of 2,1 per cent a year. In contrast, the national narrow labour force increased by 388 000 individuals, or an average rate of 0,5 per cent a year. These trends highlight the significantly faster labour force growth at the provincial level.

Unfortunately, the measured net increase in employment in the Western Cape of 125 000 jobs – that is, the number of jobs created less the number of jobs lost – is not statistically significant. This is similar to the national situation: employment appears to have risen marginally but this change is not significant.

In contrast, broad unemployment in the Province is higher in 2005 than it was in 2000, having risen to 591 000 from 426 000. This is equivalent to an average growth rate of 6,8 per cent a year. A similar, though less rapid, rate of growth was observed nationally, where the number of broadly unemployed individuals rose by 1,4 million\(^2\). In contrast, narrow unemployment is not statistically different in 2005 than it was five years earlier, both nationally and provincially.

\(^2\) Western Cape Provincial Treasury
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), SA’s official (narrow) definition of unemployment classifies individuals as being unemployed if they did not have a job or business in the seven days prior to the survey interview but had looked for work or taken steps to start a business in the four weeks prior to the interview and were able to take up work within two weeks of the interview.

This definition is slightly different from the 2000 definition, the change having occurred in 2004, in that the 2000 definition requires individuals to be able to take up a job within one week of the interview. Although this may impact on the estimates of unemployment, it is unlikely to have a major impact on the estimates.

This definition 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 the criterion of having taken active steps to find work or start a business.

Although the narrow definition is the official definition in SA, the evidence suggests that the broad definition is better able to accurately identify the unemployed in countries, like SA, where unemployment rates are very high and many individuals give up looking for work, becoming what is termed ‘discouraged workers’.

Thus, although details of narrow unemployment are provided, most of the analysis in this chapter uses the expanded definition of unemployment. That is, simply stated, if you have not worked in the last week but want to work and would, if offered a job, be able to start working within two weeks, you are classified as unemployed according to the expanded definition.

Unemployment trends are even starker when compared to buoyant economic growth rates at the provincial and national level. In the period 2000 to 2005 the Western Cape economy grew at an average annual rate of 6,0 per cent, significantly faster than the average national growth of 4,9 per cent.

In 2005, total output for the Western Cape was R150 billion, or 14,8 per cent of SA’s GDP, while the Province accounted for 14,0 per cent of total employment in the country. Therefore, despite the rapidly growing economy, both nationally and within the Province, the number of jobs created was insufficient to absorb new entrants into the labour market.

---

3 This figure is calculated based on annual production accounts by industry at constant 2000 prices.
Table 1: Labour market aggregates, 2000 and 2005

<table>
<thead>
<tr>
<th>Western Cape</th>
<th>2000</th>
<th>2005</th>
<th>Total change</th>
<th>Ave. ann. growth</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>‘000s</td>
<td>‘000s</td>
<td>‘000s</td>
<td>%</td>
</tr>
<tr>
<td>Ave. ann. growth</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Working age population</td>
<td>2 834</td>
<td>3 177</td>
<td>343</td>
<td>12,1</td>
</tr>
<tr>
<td>Employed</td>
<td>1 601</td>
<td>1 726</td>
<td>125</td>
<td>7,8</td>
</tr>
<tr>
<td>Broad unemployment</td>
<td>426</td>
<td>591</td>
<td>165</td>
<td>38,7</td>
</tr>
<tr>
<td>Broad labour force</td>
<td>2 027</td>
<td>2 317</td>
<td>290</td>
<td>14,3</td>
</tr>
<tr>
<td>Narrow unemployment</td>
<td>319</td>
<td>403</td>
<td>84</td>
<td>26,3</td>
</tr>
<tr>
<td>Narrow labour force</td>
<td>1 920</td>
<td>2 128</td>
<td>208</td>
<td>10,8</td>
</tr>
<tr>
<td>Discouraged workseekers</td>
<td>107</td>
<td>189</td>
<td>82</td>
<td>76,6</td>
</tr>
<tr>
<td>GDPR (2000 prices, R million)</td>
<td>119 099</td>
<td>150 176</td>
<td>31 077</td>
<td>26,1</td>
</tr>
</tbody>
</table>

| SA | 2000 | 2005 | Total change | Ave. ann. growth |
|    | ‘000s | ‘000s | ‘000s | % |
|    |      |      |       |    |
| Working age population | 27 869 | 29 697 | 1 828 | 6,6 |
| Employed | 12 238 | 12 300 | 62 | 0,5 |
| Broad unemployment | 6 379 | 7 799 | 1 420 | 22,3 |
| Broad labour force | 18 618 | 20 100 | 1 482 | 8,0 |
| Narrow unemployment | 4 162 | 4 487 | 325 | 7,8 |
| Narrow labour force | 16 400 | 16 788 | 388 | 2,4 |
| Discouraged workseekers | 2 218 | 3 122 | 1 094 | 49,3 |
| GDP (2000 prices, R million) | 838 218 | 1 016 750 | 178 532 | 21,3 |


Note: Statistically significant changes at the 95 per cent confidence level are indicated with an asterisk (*).

Of concern is the increase in the number of the discouraged workers in the Province, rising from 107 000 in 2000 to 189 000 in 2005. Discouraged workseekers are those who want to work and are available to work, but who are not actively looking for work, and constitute the difference between the narrow and broad definitions of the labour force.

Over the five-year period, the Western Cape experienced an increase in the number of the discouraged workers at an average rate of 12,1 per cent a year, contributing to a widening of the gap between the provincial broad or expanded rate of unemployment and the narrow rate of unemployment.

At the national level, growth in the number of discouraged workseekers was more muted, but still rapid, at 8,3 per cent a year. Nationally and provincially, the change in the number of discouraged workers was statistically significant at 95 per cent confidence interval. The rapid rate of growth in the number of discouraged workseekers requires further investigation and understanding, as do their reasons for not actively seeking work. Table 2 shows a breakdown of reasons why discouraged workseekers in the Province did not take steps to find employment or start a business.
Chapter 5: Employment Dynamics

More than one-third (35.3%) of discouraged workseekers in the Province mentioned the fact that there were no jobs in their area as the main reason for not looking for work. This is compared to more than one-half (55.9%) for the country as a whole. Family concerns were cited as a main reason for not looking for work by 14.0 per cent of discouraged in the Western Cape, while lack of transport money, the loss of hope of finding work, and poor health or disability were also relatively commonly cited problems. Nationally, lack of transport money was the second most commonly cited reason for not looking for work, with the loss of hope of finding work and family concerns also cited as preventing discouraged workseekers from actively seeking employment.

Table 2: Main reason for not looking for work among discouraged workseekers, September 2005

<table>
<thead>
<tr>
<th>Reason</th>
<th>Western Cape '000s</th>
<th>Share (%)</th>
<th>SA '000s</th>
<th>Share (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>No jobs available in the area</td>
<td>67</td>
<td>35.3</td>
<td>1 852</td>
<td>55.9</td>
</tr>
<tr>
<td>Family concerns</td>
<td>26</td>
<td>14.0</td>
<td>196</td>
<td>5.9</td>
</tr>
<tr>
<td>Lack of transport money</td>
<td>15</td>
<td>7.9</td>
<td>504</td>
<td>15.2</td>
</tr>
<tr>
<td>Lost hope of finding work</td>
<td>12</td>
<td>6.6</td>
<td>329</td>
<td>9.9</td>
</tr>
<tr>
<td>Ill health/physical disability</td>
<td>12</td>
<td>6.2</td>
<td>40</td>
<td>1.2</td>
</tr>
<tr>
<td>Undergoing training</td>
<td>6</td>
<td>3.2</td>
<td>37</td>
<td>1.1</td>
</tr>
<tr>
<td>Unable to find work</td>
<td>6</td>
<td>3.1</td>
<td>102</td>
<td>3.1</td>
</tr>
<tr>
<td>Pregnancy</td>
<td>5</td>
<td>2.7</td>
<td>73</td>
<td>2.2</td>
</tr>
<tr>
<td>Temporarily laid off</td>
<td>2</td>
<td>1.0</td>
<td>9</td>
<td>0.3</td>
</tr>
<tr>
<td>No transport available</td>
<td>1</td>
<td>0.6</td>
<td>12</td>
<td>0.4</td>
</tr>
<tr>
<td>Other reason</td>
<td>36</td>
<td>18.9</td>
<td>105</td>
<td>3.2</td>
</tr>
<tr>
<td>Unspecified</td>
<td>1</td>
<td>0.3</td>
<td>53</td>
<td>1.6</td>
</tr>
<tr>
<td>Total</td>
<td>189</td>
<td>100.0</td>
<td>3 312</td>
<td>100.0</td>
</tr>
</tbody>
</table>


The second most commonly cited reason in the Province was ‘other reason’, which cannot be disaggregated in the LFS. This may point to an area of future investigation in the Province, to ascertain why some unemployed individuals do not actively look for jobs.

2.2 Provincial employment growth in demographic context

The rate of employment growth requires some degree of contextualisation before judgement can be passed on its sufficiency. In particular, employment growth should be viewed in the context of changes in the working age population, the labour force and unemployment.

Calculating target employment growth rates (TGRs) and employment absorption rates (EARs) are useful measures to assess and explain employment and unemployment growth in the context of an expanding working age population and labour force.
The target growth rate measures the rate at which employment should have expanded over a certain period in order to absorb all the new entrants in the labour force. On the other hand, the employment absorption rate quantifies the difference between TGR and actual growth rate of employment. The higher the EAR, the better the actual relative to desired employment performance. An EAR of 100 per cent indicates that all net labour force entrants were absorbed into employment, while an EAR of over 100 per cent is associated with an absolute decline in the number of unemployed individuals.

Figure 1 below shows that for the period 2000 to 2005 the Western Cape’s TGR measured 18,1 per cent according to the broad labour force definition and 13 per cent according to the narrow labour force definition. This compares to actual average employment growth of only 7,8 per cent a year over the period. This implies that the economy fell short of creating sufficient jobs for new entrants in the labour market by 10,3 percentage points.

As a result, the Province’s EAR amounted to only 43,1 per cent according to the expanded definition and 60,1 per cent using the narrow definition. This implies that around 57 per cent of net new labour force entrants were broadly unemployed, thereby indicating upward pressure on the broad unemployment rate.

A similar, but slightly more favourable, pattern is observed using the narrow definition of unemployment. Around 40 per cent of the net increase in the narrow labour force was not absorbed into employment, resulting in upward pressure on the narrow unemployment rate.

**Figure 1: Employment target growth rates and employment absorption rates, 2000 and 2005**

<table>
<thead>
<tr>
<th>Definition</th>
<th>TGR(%)</th>
<th>EAR(%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Expanded definition</td>
<td>18,1</td>
<td>43,1</td>
</tr>
<tr>
<td>Official definition</td>
<td>13,0</td>
<td>60,1</td>
</tr>
</tbody>
</table>

Figure 2 below shows that, in total, the employment rate – technically defined as the proportion of the working age population with jobs – in the Western Cape was 54,3 per cent in 2005, down marginally from 56,5 per cent in 2000.

A high employment rate means that a large proportion of the Province’s population is employed, while a low rate means that a large share of the population is not involved directly in employment activities, as they are either unemployed or not economically active.

However, disaggregation of the employment rate by race, gender, age or education levels reveals substantial inter-group variations. Although at a generally lower employment rate compared to other race groups, the proportion of the African working age population in the Province improved slightly from 45,4 per cent to 49,3 per cent between 2000 and 2005. This is in contrast to the coloured and white employment rates declined marginally, falling to 54,3 per cent and 61,3 per cent respectively over the period.

It is unsurprising that employment rates differ by gender, with 62,1 per cent of working-age males employed compared to only 47 per cent of females. This gap between the employment rates of genders may decrease in future as the labour market policies of gender equality and affirmative action, for example, are implemented more effectively and widely. However, an equalisation of the rates is unlikely without significant social change, given females’ greater involvement in child-rearing and other family and households support activities.

The highest employment ratios are to be found amongst 25 to 54 year olds, averaging just under 70 per cent of the working age population in 2005. Since, for many, involvement in education precludes employment, it is not unexpected that employment rates amongst the youth, specifically those under the age of 25 years, would be lower than for the non-youth. This is evident in an employment rate of just 29,3 per cent amongst 15 to 24 year olds and 69,7 per cent amongst 25 to 34 year olds. Similarly, older individuals are more likely to have retired from active employment and thus the employment rate amongst 55 to 65 year olds is around one-third (32,8%).
Having matric, a diploma or certificate, or a degree is associated with higher employment rates. In 2005, four-fifths of holders of diplomas or certificates of working age were engaged in employment in the Province. This was true of individuals that have a degree in 2000, although the 2005 value is much lower due to a decline in degreed employment that is not statistically significant. It is unlikely, therefore, that this fall occurred in reality.

Approximately two-thirds (67.2%) of working-age holders of matric certificates were employed, while employment rates for those with no education, grade 0 to grade eight education, and grade nine to grade 11 education were under 50 per cent. The employment rate of those individuals without education declined over the period, although, as was the case with individuals with a degree, a statistically insignificant decline in employment in this group underlies this fall.

### 2.3 Labour force participation rates, 2000 and 2005

The Labour Force Participation Rate (LFPR) measures the proportion of the working age population that is in the labour force – whether employed or unemployed. This rate is useful to determine the willingness and the ability of the people to participate in the labour market and how that changes over time.

Moreover, the LFPR gives an indication of the capacity of a region to produce goods and services, which in turn indirectly determines the standard of living of the residents of a region or country.
Figure 3 below shows that in the Western Cape, the LFPR was barely changed over the period, rising marginally from 71.5 per cent to 72.9 per cent in 2005. Amongst africans, participation stood at 77 per cent, compared to 73.4 per cent amongst coloureds and 66.2 per cent amongst whites. For all three groups, the LFPR did not change significantly over the period.

**Figure 3: Broad labour force participation rates, 2000 and 2005**

<table>
<thead>
<tr>
<th>Per cent</th>
<th>2000 (%)</th>
<th>2005 (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Afr 15-24 years</td>
<td>75.5</td>
<td>77.0</td>
</tr>
<tr>
<td>Afr 25-34 years</td>
<td>71.7</td>
<td>73.4</td>
</tr>
<tr>
<td>Afr 35-44 years</td>
<td>67.7</td>
<td>66.2</td>
</tr>
<tr>
<td>Afr 45-54 years</td>
<td>65.8</td>
<td>78.5</td>
</tr>
<tr>
<td>Afr 55-65 years</td>
<td>52.9</td>
<td>78.5</td>
</tr>
<tr>
<td>Afr No Educ</td>
<td>87.0</td>
<td>78.5</td>
</tr>
<tr>
<td>Afr Gr 0-8</td>
<td>85.4</td>
<td>67.7</td>
</tr>
<tr>
<td>Afr Gr 9-11</td>
<td>74.1</td>
<td>75.7</td>
</tr>
<tr>
<td>Afr Gr 12</td>
<td>41.8</td>
<td>19.2</td>
</tr>
<tr>
<td>Afr Depr Cert</td>
<td>52.9</td>
<td>65.8</td>
</tr>
<tr>
<td>Afr Degr</td>
<td>65.4</td>
<td>79.9</td>
</tr>
<tr>
<td>Afr Total</td>
<td>67.5</td>
<td>84.2</td>
</tr>
</tbody>
</table>


Both male and female participation rates increased marginally in the period 2000 to 2005, and were 78.5 per cent and 67.7 per cent respectively in 2005. An increase in the female LFPR is often, amongst other trends, associated with employment growth in services industries, which are relatively important in the Western Cape as detailed below.

Further, SA as a whole has seen a rapid increase in participation in the labour force of women since the mid-1990s, which has served to narrow the gap in participation between males and females. However, for the same reasons that employment rates will differ by gender, the LFPR for women remains below that of men. Generally, an increase in female education levels is also positively related to an increase in the female LFPR.

In the Western Cape, female employment grew by 1.9 per cent on average between 2000 and 2005. The increase is more prominent amongst females with grade 12 and those with grades nine – 11, NTC1 and II. This shows an annual average employment growth rate of 16.5 and 4.9 per cent, respectively, over the period analysed.
In the Western Cape, youth labour force participation remained unchanged over the period. In line with the relatively low employment rate for 15 to 24 year olds, this group’s LFPR is only 58 per cent. Labour force participation is highest amongst those aged 25 to 44 years, peaking at around 91 per cent. Thereafter, it declines gradually amongst 45 to 54 year olds and quite dramatically amongst 55 to 65 year olds, to 80 per cent and 38 per cent respectively in 2005. The steep decline is primarily due to retirement prior to the recognised retirement age of 65 years, particularly amongst women who tend to retire earlier than men.

As evident from figure 3, labour force participation is lower than average amongst those without matric certificates. Labour force participation amongst individuals who have no education declined from 65 per cent in 2000 to 48 per cent in 2005, while the LFPR is highest amongst those with matric certificates and those with diplomas or certificates, at over four-fifths. The changes were not statistically significant for the former observation. Again, the fall in the LFPR of individuals with a degree would be related to the statistically insignificant fall in employment for this group over the period.

### 2.4 Composition of the Western Cape labour force, 2000 and 2005

The labour force is made up of employed and unemployed individuals of working age. It, however, excludes students, retirees, those with childcare responsibilities, and those who are not available for work.

In the Western Cape, the broad labour force increased by approximately 290 000 individuals in the period 2000 to 2005, growing at an average rate of 2,7 per cent a year. Africans and coloureds alone accounted for the full increase in the labour force over the period. By 2005, africans constituted 29,6 per cent of the labour force, coloureds 50,6 per cent and whites 18,8 per cent.
Table 3: Composition of the Western Cape labour force, 2000 and 2005

<table>
<thead>
<tr>
<th></th>
<th>2000 '000s</th>
<th>Share (%)</th>
<th>2005 '000s</th>
<th>Share (%)</th>
<th>Change share (%)</th>
<th>Ave. ann. growth (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>African</td>
<td>458</td>
<td>22,6</td>
<td>685</td>
<td>29,6</td>
<td>227</td>
<td>78,3</td>
</tr>
<tr>
<td>Coloured</td>
<td>1 105</td>
<td>54,5</td>
<td>1 172</td>
<td>50,6</td>
<td>67</td>
<td>23,3</td>
</tr>
<tr>
<td>White</td>
<td>436</td>
<td>21,5</td>
<td>436</td>
<td>18,8</td>
<td>0</td>
<td>-0,1</td>
</tr>
<tr>
<td>Male</td>
<td>1 087</td>
<td>53,6</td>
<td>1 207</td>
<td>52,1</td>
<td>120</td>
<td>41,4</td>
</tr>
<tr>
<td>Female</td>
<td>939</td>
<td>46,3</td>
<td>1 109</td>
<td>47,9</td>
<td>170</td>
<td>58,6</td>
</tr>
<tr>
<td>15-24 years</td>
<td>399</td>
<td>19,7</td>
<td>493</td>
<td>21,3</td>
<td>94</td>
<td>32,5</td>
</tr>
<tr>
<td>25-34 years</td>
<td>716</td>
<td>35,3</td>
<td>767</td>
<td>33,1</td>
<td>50</td>
<td>17,3</td>
</tr>
<tr>
<td>35-44 years</td>
<td>481</td>
<td>23,7</td>
<td>518</td>
<td>22,4</td>
<td>38</td>
<td>12,9</td>
</tr>
<tr>
<td>45-54 years</td>
<td>314</td>
<td>15,5</td>
<td>391</td>
<td>16,9</td>
<td>77</td>
<td>26,5</td>
</tr>
<tr>
<td>55-65 years</td>
<td>116</td>
<td>5,7</td>
<td>139</td>
<td>6,0</td>
<td>23</td>
<td>7,8</td>
</tr>
<tr>
<td>No education</td>
<td>58</td>
<td>2,9</td>
<td>38</td>
<td>1,6</td>
<td>-20</td>
<td>-7,0</td>
</tr>
<tr>
<td>Grades 0-8</td>
<td>668</td>
<td>32,9</td>
<td>611</td>
<td>26,4</td>
<td>-57</td>
<td>-19,5</td>
</tr>
<tr>
<td>Grades 9-11, NTC I &amp; II</td>
<td>486</td>
<td>24,0</td>
<td>623</td>
<td>26,9</td>
<td>138</td>
<td>47,5</td>
</tr>
<tr>
<td>Grade 12, NTC III</td>
<td>443</td>
<td>21,9</td>
<td>678</td>
<td>29,3</td>
<td>234</td>
<td>80,8</td>
</tr>
<tr>
<td>Diploma/certificate</td>
<td>186</td>
<td>9,2</td>
<td>195</td>
<td>8,4</td>
<td>9</td>
<td>3,2</td>
</tr>
<tr>
<td>Degree</td>
<td>169</td>
<td>8,3</td>
<td>125</td>
<td>5,4</td>
<td>-44</td>
<td>-15,1</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td>2 027</td>
<td>100,0</td>
<td>2 317</td>
<td>100,0</td>
<td>290</td>
<td>100,0</td>
</tr>
</tbody>
</table>


Note: Statistically significant changes at the 95 per cent confidence level are indicated with an asterisk (*).

Table 3 above indicates a gradual evening out of the gender balance within the labour force, with the female share increasing slightly to 47,9 per cent by 2005. The net entry of 170 000 females into the labour market surpasses that of males, which was statistically insignificant. On average, the female labour force grew by 3,4 per cent a year, underpinning the bulk of labour force expansion over the period.

Labour force growth, however, cannot be allocated with confidence to a specific age-group, despite appearing to have originated predominantly amongst the youth. Three-quarters of the labour force were under the age of 45 years in 2005, with around one-third aged 25 to 34 years.

In terms of educational qualifications, the bulk of labour force growth is attributable to individuals with incomplete Further Education and Training (FET) education (grades nine through 11) and those with matric certificates. Together, these groups account for around 370 000 extra labour force members, considerably more than the net increase of 290 000. These groups within the labour force expanded at average annual rates of 5,1 per cent and 8,9 per cent respectively.
3. Employment

Employment in the Western Cape expanded by around 1.5 per cent a year in the period 2000 to 2005 to about 1.73 million people by 2005. However, this increase in employment did not accrue evenly to all groups, for example, African share of employment increased significantly from 17.2 per cent in 2000 to 25.5 per cent in 2005.

This is in stark contrast to the marginal decline in coloured and white employment, both in absolute and relative terms. By 2005, coloureds (50%) and whites (25%) accounted for approximately 75 per cent of provincial employment.

The bulk of employment expansion in the period 2000 to 2005 accrued to females. Women saw their employment increase by around 68 000 jobs, while that of men increased by around 56 000 jobs. However, in 2005 males still made up 55 per cent of the employed population.

There was no single age-group that saw a significant increase in employment over the period. The bulk of the employed were between the ages of 25 and 54 years.

Table 4: Composition of Western Cape employment, 2000 and 2005

<table>
<thead>
<tr>
<th></th>
<th>2000</th>
<th>2005</th>
<th>Total change</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>'000s</td>
<td>Share (%)</td>
<td>'000s</td>
</tr>
<tr>
<td>African</td>
<td>275</td>
<td>17.2</td>
<td>439</td>
</tr>
<tr>
<td>Coloured</td>
<td>885</td>
<td>55.3</td>
<td>867</td>
</tr>
<tr>
<td>White</td>
<td>417</td>
<td>26.0</td>
<td>403</td>
</tr>
<tr>
<td>Male</td>
<td>899</td>
<td>56.2</td>
<td>955</td>
</tr>
<tr>
<td>Female</td>
<td>702</td>
<td>43.8</td>
<td>770</td>
</tr>
<tr>
<td>15-24 years</td>
<td>225</td>
<td>14.0</td>
<td>255</td>
</tr>
<tr>
<td>25-34 years</td>
<td>582</td>
<td>36.4</td>
<td>585</td>
</tr>
<tr>
<td>35-44 years</td>
<td>414</td>
<td>25.9</td>
<td>424</td>
</tr>
<tr>
<td>45-54 years</td>
<td>275</td>
<td>17.1</td>
<td>340</td>
</tr>
<tr>
<td>55-65 years</td>
<td>106</td>
<td>6.6</td>
<td>120</td>
</tr>
<tr>
<td>No education</td>
<td>48</td>
<td>3.0</td>
<td>27</td>
</tr>
<tr>
<td>Grades 0-8</td>
<td>478</td>
<td>29.9</td>
<td>417</td>
</tr>
<tr>
<td>Grades 9-11, NTC I &amp; II</td>
<td>358</td>
<td>22.4</td>
<td>392</td>
</tr>
<tr>
<td>Grade 12 NTC III</td>
<td>363</td>
<td>22.7</td>
<td>541</td>
</tr>
<tr>
<td>Diploma/certificate</td>
<td>172</td>
<td>10.7</td>
<td>190</td>
</tr>
<tr>
<td>Degree</td>
<td>166</td>
<td>10.3</td>
<td>118</td>
</tr>
<tr>
<td>Total</td>
<td>1 601</td>
<td>100.0</td>
<td>1 726</td>
</tr>
</tbody>
</table>


Note: Statistically significant changes at the 95 per cent confidence level are indicated with an asterisk (*).

The Western Cape has seen a slight improvement in the educational profile of its workforce over the past five years. The bulk of employment expansion in the Province accrued to those with matric certificates.

By 2005, this educational category accounted for 31.3 per cent of employment, having grown at an average rate of 8.3 per cent a year. No other educational category experienced statistically significant changes in employment over the period.
By 2005, close to 18 per cent of the employed had a diploma, certificate or tertiary degree, 31.3 per cent had a matric certificate, and 22.7 per cent had incomplete FET education. SA also has a higher share of employed without any education (5.6%) than the Western Cape.

### Matric pass rates and skills mismatch in the Western Cape

The issue of scarce skills is one of the key measures identified by the AsgiSA to the problem of skills mismatch. One of the proposed interventions in the educational arena is to double mathematics and science students by 2008. The Western Cape Education Department, through its Human Capital Development Strategy (HCDS) has aligned its strategy in concert with measures identified by AsgiSA. A closer look at the historical trends of the matric results suggest that the extent of skills mismatch is the most significant constraint to higher economic growth.

**Figure 1. Western Cape Matric results: 2004 — 2006**

The Western Cape Province’s matric pass rate though relatively higher than the rest of the country has been gradually declining for the period 2004 to 2006. Of the total 39,824 candidates that sat for matriculation exams in 2006, 33,316 passed, representing an 83.7 per cent pass rate.

Nevertheless, the number of matric candidates that wrote matric exams has increased for the period 2004 to 2006. The annual growth rate for the matric candidates for this period has increased by 1.2 per cent simultaneously, the matric pass rate decreased by 1.3 per cent. Consequently, in real terms this means that an increase of an additional 251 matriculants have been added to the supply of labour force.
Western Cape matric endorsement results in 2006 (1,059) improved with 195 endorsements. Comparably, the matric distinction results in 2006 (6,594) have increased with 79 distinctions. Nonetheless the average annual growth rates for period 2004 to 2006 for endorsement and distinction results were 0,3 per cent and 1,7 per cent, respectively. Furthermore, 26,6 per cent of the candidates that wrote the matric exam in 2006 will be eligible for university compared with the national figure of 5 per cent.

The HCDS intends to double the number of matric candidates passing Maths on the Higher Grade (HG) to 8000 by the year 2008. That means, the number of Maths HG passes will have to increase from 4,137 (2006) by an average of 1,931,5 passes a year over next two years. Given the decreased pass rate of 2,2 per cent for Maths HG over the same period, more is needed to achieve the steep target the Department has set.

The contrary is true for Science Higher Grade HG pass rate, which has a positive trend and an increase of 4,9 per cent for the period 2004 to 2006. The supply of relatively skilled labour as regarding science over this period has improved for the Province. Also the supply to tertiary institutions will increase with individuals who seek to improve their future employment prospects.

The 5 per cent drop in the Western Cape Maths HG in 2006 together with the fact that even though more candidates wrote Maths HG exams does not bode well for the Province in view of the target of 8000 for 2008. The implication for employability as regards the issue of scarce skills involving Maths HG as a prerequisite for 2008 appears to be unfavourable.

The scenario painted by the matric pass rates and the need to accelerate skills shed some light on the extent of the problems facing education. While the economy is growing and demanding more skills, these figures translate to a potential decline to the supply of relatively skilled labour force in the Western Cape. Similarly the declining pass rates will have an adverse effect on the supply of potential students entering institutions of higher learning.

**Figure 2. Matric 2004 to 2006 Western Cape Maths Higher Grade and Science Higher Grade pass rate**
Table 5 indicates that provincial employment is dominated by the tertiary sector, which comprises the various services sectors. This sector accounted for 66,5 per cent of provincial employment in 2005, up from 59,7 per cent five years earlier.

The key tertiary sector employers in the Province were wholesale & retail trade (24,3%), CSP services (17,8%) and financial & business services (12,7%). These three sectors collectively accounted for nine in ten of the net new jobs in the tertiary sector, exceeding the net overall increase in employment.

Tertiary sector employment grew at an average rate of 3,7 per cent a year, driven largely by the rapid growth in wholesale & retail trade of 6,6 per cent a year. The provincial economy’s vibrant tourism industry could explain the labour-absorptive nature of this sector. This sector also contributes towards employing the less-educated youth of the region as these jobs do not necessarily require formal qualifications.

The CSP services sector includes employment created mainly by the municipalities and Provincial Government’s personnel, educational institutions and health facilities service providers, which explains why employment in this sector has not grown over the period.

The bulk of the secondary sector jobs are in manufacturing (279 000 jobs). However, employment growth in this sector was not statistically significant over the period.

The agricultural sector, however, saw rapid decline over the period, with employment falling by almost 50 per cent. Thus, having accounted for 15,0 per cent of overall employment in 2000, the primary sector now accounts for just 7,4 per cent.
Table 6 indicates that employment in the Province is dominated by occupations of mid-range skill levels, which accounted for 55,1 per cent of employment in 2005. Within this category, the major occupational categories are clerks (13,4%), service and sales workers (12,3%) and crafts workers (13%).

**Table 6: Occupational structure of Western Cape employment, 2000 and 2005**

<table>
<thead>
<tr>
<th>2000</th>
<th>2005</th>
<th>Total change</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>000s</td>
<td>Share (%)</td>
</tr>
<tr>
<td>Managers</td>
<td>117</td>
<td>7,3</td>
</tr>
<tr>
<td>Professionals</td>
<td>110</td>
<td>6,9</td>
</tr>
<tr>
<td>High skilled</td>
<td>227</td>
<td>14,2</td>
</tr>
<tr>
<td>Technicians</td>
<td>167</td>
<td>10,5</td>
</tr>
<tr>
<td>Clerks</td>
<td>162</td>
<td>10,1</td>
</tr>
<tr>
<td>Services &amp; sales</td>
<td>191</td>
<td>12,0</td>
</tr>
<tr>
<td>Crafts</td>
<td>193</td>
<td>12,0</td>
</tr>
<tr>
<td>Operators</td>
<td>118</td>
<td>7,3</td>
</tr>
<tr>
<td>Skilled</td>
<td>831</td>
<td>51,9</td>
</tr>
<tr>
<td>Elementary</td>
<td>394</td>
<td>24,6</td>
</tr>
<tr>
<td>Domestic workers</td>
<td>85</td>
<td>5,3</td>
</tr>
<tr>
<td>Low skilled</td>
<td>480</td>
<td>30,0</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>1 601</strong></td>
<td><strong>100,0</strong></td>
</tr>
</tbody>
</table>


*Notes: Total figures include employment in skilled agricultural occupations, which have been excluded from the table due to their instability. Figures for other and unspecified occupations have also been omitted from the table. Subtotals do not include omitted figures.*

Low skilled occupations account for 28,2 per cent of provincial employment, while high skilled occupations account for 15,7 per cent. The single most important occupational category is elementary occupations, which accounts for 22,5 per cent of all employment in the Province. The dominance of elementary occupations may be partially attributed to the importance of the agricultural sector in the Province. The bulk of employment expansion appears to have occurred within the secondary sector, although this growth is not statistically significant.
4. Unemployment

Broad unemployment in SA in September 2005 was 38,8 per cent, significantly higher than the 25,5 per cent unemployment rate experienced in the Western Cape. The provincial unemployment rate increased by 4,5 per cent in the period 2000 to 2005.

Table 7 presents the expanded unemployment rates for various demographic groups in the Western Cape for 2000 and 2005. The trends highlight the severity of the unemployment problems facing different groups and suggest stark labour market segmentation that feeds through into social and economic arenas.

In 2005, broad unemployment in the Western Cape was highest amongst africans at 35,9 per cent, compared to 26,1 per cent amongst coloureds and only 7,5 per cent amongst whites. None of these measured changes in unemployment rates are statistically significant, although the increase in coloured unemployment is significant at a 90 per cent level.

<table>
<thead>
<tr>
<th>Table 7: Broad unemployment rates in the Western Cape, 2000 and 2005</th>
</tr>
</thead>
<tbody>
<tr>
<td>2000 (%)</td>
</tr>
<tr>
<td>----------</td>
</tr>
<tr>
<td>African</td>
</tr>
<tr>
<td>Coloured</td>
</tr>
<tr>
<td>White</td>
</tr>
<tr>
<td>Male</td>
</tr>
<tr>
<td>Female</td>
</tr>
<tr>
<td>15-24 years</td>
</tr>
<tr>
<td>25-34 years</td>
</tr>
<tr>
<td>35-44 years</td>
</tr>
<tr>
<td>45-54 years</td>
</tr>
<tr>
<td>55-65 years</td>
</tr>
<tr>
<td>No education</td>
</tr>
<tr>
<td>Grade 0 – 8</td>
</tr>
<tr>
<td>Grade 9 – 11, NTC I &amp; II</td>
</tr>
<tr>
<td>Grade 12/NTC III</td>
</tr>
<tr>
<td>Diplomas/certificates</td>
</tr>
<tr>
<td>Degrees</td>
</tr>
<tr>
<td>Total</td>
</tr>
</tbody>
</table>


In line with the national pattern, unemployment is more severe among women than men, with broad unemployment rates of 30,6 per cent and 20,9 per cent respectively. The LFS surveys also confirm the trend observed nationally of higher unemployment rates amongst the youth. In 2005, the highest unemployment rates were in the 15 to 24 year-old (49,1%) and 25 to 34 year olds (23,7%) age groups.

In 2005, unemployment amongst those who have not completed the General and Education Training (GET) phase of education (grade 0 to eight) and those who have not completed the FET phase (grades nine to 11) was 31,7 per cent and 37,1 per cent, respectively.
Unemployment among holders of matric certificates (20.2%) is still notably higher than that of 2.4 per cent among individuals with a diploma/certificate and 6.0 per cent among those with a degree.

The only change in unemployment rates that is statistically significant at the 95 per cent level, is the surge in the rate of unemployment amongst those with grade nine to 11 education, which rose by 10.8 per cent in the period. These trends verify the excess supply of labour at mid- to low education levels, highlighting the need for the Province’s Human Capital Development strategy’s interventions in raising the Western Cape’s economic growth potential over the medium to long term.

Table 8 indicates that the Province’s unemployed are almost exclusively african (41.6%) and coloured (51.7%) with only 5.5 per cent being white. The much larger coloured population results in the lower employment rate for coloureds seen in Table 7 above.

In terms of gender, women form 57.4 per cent and men 42.6 per cent of the unemployed, despite the fact that men account for 52 per cent of the labour force.

Table 8: Composition of Western Cape broad unemployment, 2000 and 2005

<table>
<thead>
<tr>
<th></th>
<th>2000</th>
<th>2005</th>
<th>Total change</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Share (%)</td>
<td>Share (%)</td>
<td>Change share (%)</td>
</tr>
<tr>
<td>African</td>
<td>183 42.9</td>
<td>246 41.6</td>
<td>64 38.3</td>
</tr>
<tr>
<td>Coloured</td>
<td>220 51.8</td>
<td>306 51.7</td>
<td>85 51.6</td>
</tr>
<tr>
<td>White</td>
<td>19 4.5</td>
<td>33 5.5</td>
<td>13 8.0</td>
</tr>
<tr>
<td>Male</td>
<td>188 44.2</td>
<td>252 42.6</td>
<td>64 38.7</td>
</tr>
<tr>
<td>Female</td>
<td>238 55.8</td>
<td>339 57.4</td>
<td>102 61.3</td>
</tr>
<tr>
<td>15-24 years</td>
<td>174 40.9</td>
<td>246 41.7</td>
<td>72 43.6</td>
</tr>
<tr>
<td>25-34 years</td>
<td>134 31.5</td>
<td>181 30.7</td>
<td>47 28.5</td>
</tr>
<tr>
<td>35-44 years</td>
<td>67 15.8</td>
<td>94 15.9</td>
<td>27 16.3</td>
</tr>
<tr>
<td>45-54 years</td>
<td>40 9.3</td>
<td>51 8.6</td>
<td>11 6.8</td>
</tr>
<tr>
<td>55-65 years</td>
<td>10 2.4</td>
<td>18 3.1</td>
<td>8 4.8</td>
</tr>
<tr>
<td>No education</td>
<td>10 2.3</td>
<td>8 1.4</td>
<td>-2 -1.0</td>
</tr>
<tr>
<td>Grades 0-8</td>
<td>189 44.4</td>
<td>194 32.8</td>
<td>5 2.8</td>
</tr>
<tr>
<td>Grades 9-11, NTC I&amp;II</td>
<td>128 30.0</td>
<td>231 39.1</td>
<td>104 62.6</td>
</tr>
<tr>
<td>Grade 12 NTC III</td>
<td>80 18.8</td>
<td>137 23.2</td>
<td>57 34.4</td>
</tr>
<tr>
<td>Diploma/certificate</td>
<td>14 3.2</td>
<td>5 0.8</td>
<td>-9 -5.3</td>
</tr>
<tr>
<td>Degree</td>
<td>4 0.8</td>
<td>8 1.3</td>
<td>4 2.4</td>
</tr>
<tr>
<td>Total</td>
<td>426 100.0</td>
<td>591 100.0</td>
<td>166 100.0</td>
</tr>
</tbody>
</table>

Note: Statistically significant changes at the 95 per cent confidence level are indicated with an asterisk (*).

The most notable concern, however, is that the unemployed are concentrated in the younger age groups, an issue that is mirrored nationally. In 2005, 41.7 per cent of the unemployed individuals were between the ages of 15 and 24 years and a further 30.7 per cent were aged 25 to 34 years.
In other words, seven out of every ten unemployed individuals was under the age of 35 years, even though this group accounted for only 55 per cent of the labour force. The reduction of unemployment rates amongst youth and the promotion of greater integration of the youth into the economy thus represent an important challenge, both provincially and nationally.

The oversupply of less well educated individuals is reflected in the large contributions to broad unemployment made by lower educational categories. Over 70 per cent of the unemployed have no more than grade 11. Although this proportion is slightly lower in 2005 than it was five years earlier, the number of unemployed individuals with grade nine to 11 education rose dramatically over the period, by a statistically significant 12.6 per cent a year. A similar rate of growth is observed in the number of unemployed individuals with matric certificates.

Apart from the direct loss to society in terms of lost productivity and lost tax revenues that unemployment represents, there are various other costs and negative consequences associated with youth unemployment. For example, young migrants to urban areas have poor social networks, which makes finding work and even everyday survival that much more difficult. Youth unemployment is also associated with crime, violence, commercial sexual exploitation of young people, particularly young women, and drug abuse.

There are also costs at the individual level, with lost earnings during unemployment the most immediate. However, in terms of the impact on youth, research in the United Kingdom has found that individuals bear long-lasting negative ‘scars’ from youth unemployment in the form of lower wages, particularly if unemployment episodes continue beyond youth.

A defining characteristic of unemployment in SA is its long-term nature. Most of the unemployed have never worked before, the bulk of these being relatively young labour force participants. In 2005, more than two-thirds (69.2%) of broadly unemployed South Africans reported that they never worked before, although it must be remembered that many people defined by the Labour Force Surveys as being employed would not classify themselves as being employed.

Nevertheless, this is a considerable proportion of the unemployed and is rooted in the large proportion of young people who have not worked before. Amongst unemployed 15 to 24 year olds, nearly 85 per cent reported never having worked before, while this was true of 68 per cent of those between the ages of 25 and 34 years.
Figure 4: Time since last worked, expanded unemployed, 2005

<table>
<thead>
<tr>
<th>Time Since Last Worked</th>
<th>South Africa (Share) (%)</th>
<th>Western Cape (Share) (%)</th>
<th>South Africa (Cum. Share) (%)</th>
<th>Western Cape (Cum. Share) (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Never worked</td>
<td>1,2</td>
<td>3,97</td>
<td>1,2</td>
<td>3,97</td>
</tr>
<tr>
<td>More than 1 year, less than 2 years</td>
<td>6,19</td>
<td>16,0</td>
<td>7,39</td>
<td>20,02</td>
</tr>
<tr>
<td>More than 2 years, less than 3 years</td>
<td>3,43</td>
<td>7,84</td>
<td>10,8</td>
<td>15,86</td>
</tr>
<tr>
<td>More than 3 years or more</td>
<td>4,86</td>
<td>10,3</td>
<td>15,6</td>
<td>27,88</td>
</tr>
<tr>
<td>More than 1 month, less than 6 months</td>
<td>3,59</td>
<td>5,79</td>
<td>19,2</td>
<td>38,24</td>
</tr>
<tr>
<td>More than 6 months, less than 1 year</td>
<td>3,59</td>
<td>5,79</td>
<td>19,2</td>
<td>44,03</td>
</tr>
</tbody>
</table>


In the Western Cape, the proportion of the unemployed who never worked before is considerably lower at 40,8 per cent. However, long-term unemployment (unemployment spells in excess of three years amongst those who have worked before) is more severe in the Western Cape than is the case nationally: 11,6 per cent of unemployed South Africans have not worked for three years or more, compared to 15,1 per cent in the Western Cape. In each category in Figure 4, the Western Cape pattern is similar to that of SA as a whole. Such long-term unemployment has important consequences for the unemployed, not least of which is the rapid erosion of skills and familiarity with current technologies.
Small, Medium and Micro Enterprises and the Informal Sector

Key findings

• SA’s informal sector, estimated at 23 per cent of total employment, is small in comparison to the rest of Sub-Saharan Africa.

• At 10.1 per cent of total provincial employment, the Western Cape has an even smaller informal sector than the national average.

• While provincial formal sector employment has grown significantly between 2000 to 2005, informal sector employment has contracted, thus not contributing to total provincial employment growth and leaving more of the labour force with no income at all.

• Formal sector employment is significantly superior to informal sector employment in respect of job permanency, written contracts, paid leave, pension and retirement funding, UIF provision as well as remuneration levels.

• Informal sector employees forgo a wide range of benefits because a large number of informal sector firms are not incorporated into the regulatory framework that governs employment relations.

• Small businesses are found in the formal and informal sector, but are more prevalent in the latter in the Western Cape.
• Africans tend to dominate employment in the smallest firms, with 42.5 per cent of individuals engaged in micro-enterprises being African.

• The bulk of micro-enterprise activity is concentrated within private households (31.4%) and the wholesale & retail trade (26.9%) sectors.

• Several key issues inhibit the performance of SMME and informal sector firms. These include access to financial services, skills training, physical infrastructure and basic services, business-related infrastructure, and the impact of regulations.

• Understanding these constraints and their underlying causes may help policymakers understand some of the mechanisms by which poverty traps persist over time.
1. Introduction

PER&O 2006 identified an important issue related to employment growth namely that, while the formal sector appeared to be growing, the informal sector was lacklustre and did not appear to be generating new employment. In fact, informal sector employment appeared to be stagnant at best, preventing the sector from making a greater contribution to the provincial economy.

This year, we take a closer look at the informal sector and Small, Medium and Micro Enterprises (SMMEs) in the Province. This section presents some descriptive statistics of informal sector and SMME employment.

The section continues by looking at some of the factors that may hinder growth, employment expansion and rising incomes in these sectors. It is hoped that this section raises some important issues for further debate and investigation.

2. SMMEs and the informal sector

In PER&O 2006, it was noted that the informal sector was not performing well, that it was in fact flagging and therefore not making the contribution it could to employment growth and the alleviation of poverty.

Informal sector employment was, at best, stagnant and, at worst, falling between 2000 and 2004. While greater formal sector employment should, arguably, be the primary focus of policy in this area, the informal sector should not be neglected.

In this section, we look at some of the characteristics of the informal and SMME sectors and some of the issues and challenges facing them.

2.1 Descriptive overview of informal and small business sectors

The dividing line between the informal sector and the formal sector is not always a clear one, with varying definitions being used in different countries attempting to categorise economic activity that essentially falls on a (multi-dimensional) continuum.

Further, classifying businesses according to size can be done in more than one way, thus leading to situations where firms identified as small using one criterion are not necessarily small according to another.

Although there is no universally accepted definition of what constitutes an informal enterprise, there is consensus that they are small scale, and operate outside registration, tax and social security frameworks, and health and safety rules for workers, with informal economic activity being defined by its ‘precarious’ nature.
Nevertheless, the formal-informal distinction is not simple. For example, analysis has shown that more than 45 per cent of formal sector workers are similar to their informal sector counterparts because they do not have written contracts, permanent positions or paid leave.

2.2 The informal sector in the Western Cape

2.2.1 The informal sector in the Western Cape

The informal sector in SA is relatively small by international standards. The International Labour Organisation (ILO) (2002: 7) estimates that approximately 78 per cent of non-agricultural jobs in sub-Saharan Africa, excluding SA, are located in the informal sector, with the figures for Asia and Latin America being 65 per cent and 51 per cent respectively.

In contrast, in SA it is estimated that the informal sector comprises 51 per cent of non-agricultural employment.

While international comparisons reveal SA’s informal sector to be relatively small, inter-provincial comparisons reveal that the Western Cape’s informal sector is even smaller. According to the LFS of September 2005, approximately 9.7 per cent of total employment in the Province is in the informal sector, compared to around 20 per cent for the country as a whole see Table 1.

The formal sector dominates total employment in both periods in the Province. In 2005, the formal sector employed over 1.3 million individuals, equivalent to 77 per cent of total employment. In contrast, the informal economy employed only around 168,000 individuals, while domestic workers, who are neither truly formal nor informal sector, accounted for under 6.0 per cent of employment.

In the five years between 2000 and 2005, the formal sector created 226,000 net new jobs, a result which is statistically significant. This reflects a rapid rate of job creation at 4.9 per cent a year, compared to 1.5 per cent a year overall. Thus, the formal sector has vastly outperformed the informal sector in the Province, the latter having shed around 16,000 jobs over the five years.

Contraction in the informal sector occurred at 1.8 per cent a year was, however, only statistically significant at a slightly lower level of confidence. This is worrying as the informal sector is not contributing to employment growth, leaving more labour force members without any form of income whatsoever.

---

1 International Labour Organisation, 2002, 19
2 Own calculations, Statistics SA 2006
In SA, as a whole, the informal sector accounted for 20,0 per cent of aggregate employment in 2005, while domestic workers accounted for a further 7,0 per cent. Consequently, just fewer than two in three workers in SA were employed in the formal sector. The Western Cape, therefore, has a small informal sector and large formal sector relative to the rest of the country.

Interestingly, the absolute and relative decline in the size of the Western Cape’s informal sector is not mirrored nationally, with the informal sector expanding by around 430 000 jobs in the first half of the decade. The expansion in both formal and informal sector employment nationally is found to be statistically significant.

Enthusiasm for the role and potential for the informal sector to provide employment and incomes to those unable to secure formal sector employment must, however, be tempered by the fact that formal and informal sector employment cannot be viewed as substitutes for each other.

In terms of the quality of employment, formal sector employment is significantly superior to that in the informal sector, with formal sector workers being significantly better off than their informal and domestic workers counterparts on a number of counts.

### Table 1: Formal and informal sector employment, 2000 and 2005

<table>
<thead>
<tr>
<th></th>
<th>2000 '000s</th>
<th>Share (%)</th>
<th>2005 '000s</th>
<th>Share (%)</th>
<th>Change '000s</th>
<th>Ave. ann. growth (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Western Cape</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Formal</td>
<td>1 047</td>
<td>65,4</td>
<td>1 327</td>
<td>76,9</td>
<td>281</td>
<td>225,6</td>
</tr>
<tr>
<td>Informal</td>
<td>183</td>
<td>11,4</td>
<td>168</td>
<td>9,7</td>
<td>-16</td>
<td>-12,5</td>
</tr>
<tr>
<td>Domestic workers</td>
<td>85</td>
<td>5,3</td>
<td>98</td>
<td>5,7</td>
<td>13</td>
<td>10,6</td>
</tr>
<tr>
<td><strong>Subtotal</strong></td>
<td>1 315</td>
<td>82,1</td>
<td>1 593</td>
<td>92,3</td>
<td>278</td>
<td>223,7</td>
</tr>
<tr>
<td>Agricultural workers</td>
<td>235</td>
<td>14,7</td>
<td>127</td>
<td>7,3</td>
<td>-108</td>
<td>-86,8</td>
</tr>
<tr>
<td>Unspecified</td>
<td>52</td>
<td>3,2</td>
<td>6</td>
<td>0,3</td>
<td>-46</td>
<td>-36,9</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td>1 601</td>
<td>100,0</td>
<td>1 726</td>
<td>100,0</td>
<td>124</td>
<td>100,0</td>
</tr>
<tr>
<td><strong>SA</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Formal</td>
<td>7 091</td>
<td>57,9</td>
<td>7 987</td>
<td>64,9</td>
<td>896</td>
<td>1 436,4</td>
</tr>
<tr>
<td>Informal</td>
<td>2 032</td>
<td>16,6</td>
<td>2 462</td>
<td>20,0</td>
<td>430</td>
<td>690,0</td>
</tr>
<tr>
<td>Domestic workers</td>
<td>930</td>
<td>7,6</td>
<td>859</td>
<td>7,0</td>
<td>-71</td>
<td>-114,1</td>
</tr>
<tr>
<td><strong>Subtotal</strong></td>
<td>10 054</td>
<td>82,1</td>
<td>11 309</td>
<td>91,9</td>
<td>1 255</td>
<td>2 012,3</td>
</tr>
<tr>
<td>Agricultural workers</td>
<td>1 914</td>
<td>15,6</td>
<td>925</td>
<td>7,5</td>
<td>-989</td>
<td>-1 585,5</td>
</tr>
<tr>
<td>Unspecified</td>
<td>271</td>
<td>2,2</td>
<td>67</td>
<td>0,5</td>
<td>-204</td>
<td>-326,8</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td>12 238</td>
<td>100,0</td>
<td>12 301</td>
<td>100,0</td>
<td>62</td>
<td>100,0</td>
</tr>
</tbody>
</table>


Notes: Statistically significant changes at the 95 per cent confidence level are indicated with a double asterisk (**). Statistically significant changes at the 90 per cent confidence level are indicated with a single asterisk (*).
Figure 1 illustrates the differences between the ‘quality’ of (non-agricultural) formal, informal and domestic work employment in the Province in 2005. Formal sector workers are better off than their informal counterparts in terms of job permanence. In 2005, more than three-quarters of the formal sector employed had permanent jobs, compared to only 21,4 per cent of informal sector workers and about 62,4 per cent of domestic workers.

Labour market protections, such the right to written contract were extended to domestic workers in 2002. It is interesting to note that, to a certain extent, domestic workers have benefited as a result, with informal sector workers (11%) being least and formal sector workers (71,5%) the most likely to have written contracts.

**Figure 1: Characteristics of formal, informal and domestic work employment, excluding agricultural Sector, Western Cape, 2005**

The incidence of paid leave is far higher amongst those employed in the formal sector (71%), as is the incidence of deductions for pensions and retirement funding (53,7%), and the UIF (77%). This is compared to the informal sector where the incidence rates reach 12,8 per cent, 6,6 per cent and 13,7 per cent, respectively.

Unionisation rates in the formal sector are also significantly higher (more than ten times higher) than in both the informal and domestic work sectors. Informal sector employees forgo a wide range of benefits because a large number of firms in the informal sector are not incorporated into the regulatory framework that governs employment relations.
The evidence suggests that formal sector employment is far superior to other forms of employment in terms of remuneration. In 2005, about 67 per cent of domestic workers earned less than R1 000 per month, 42 per cent of informal sector workers earned no more than R1 000 per month, compared to 9,5 per cent of formal sector workers.

Conversely, 35 per cent of the formal sector earned more than R4 500 per month, compared to 4,1 per cent of informal sector workers and virtually no domestic workers (0,3%). Informal sector workers tended to work longer hours on average compared to both domestic and formal sector workers.

Thus, in the Western Cape, informal sector workers find themselves inferior to both formal sector and domestic workers in terms of job security, legal protection and access to benefits. Informal sector workers have less legal recourse in the event of disputes with employers, while their lack of benefits in terms of pension/retirement and UIF contributions makes them particularly vulnerable to both sudden retrenchment and retirement.

The fact that there is virtually no union membership amongst the informally employed means that this group of workers has very little voice in terms of policymaking and very little bargaining power vis-à-vis employers, a fact that is confirmed by the low levels of access to the various benefits and the relatively longer working hours.

The inferior position of informal sector workers in terms of remuneration is clear from Figure 2 below, which indicates the proportion of workers in a given sector that earn below a given level of income. For both SA as a whole and the Western Cape on its own, informal sector workers are more likely to be earning low wages.

For example, 64,4 per cent of informal sector workers in SA report earning no more than R1 000 per month, compared to 14,9 per cent of formal workers. Similarly, for the Western Cape, the respective proportions are 41,9 per cent and 9,5 per cent.

At the other end of the remuneration scale, less than 5 per cent of informal sector workers in the Western Cape and in SA earn more than R4 500 per month, while this is true of around one-third of their formal sector counterparts (35,0% and 31,8%, respectively).
Informal sector workers in the Province, however, find themselves in a superior position to informal sector workers nationally. Only 15,4 per cent of informal sector workers in the Western Cape report earning no more than R500 per month, while 58,6 per cent earn no more than R1 500 per month. In contrast, 39,7 per cent and 77,9 per cent, respectively, of informal sector workers nationally report earnings below these thresholds.

It is only above incomes of R3 500 per month where the gap is reduced to around four percentage points and less. Although this figure does exclude individuals who refused or omitted to answer the income question, including these would not improve the relative situation of informal sector workers. Since higher income earners are most likely to refuse to detail their incomes, their omission actually underestimates the gap between the earnings profiles of informal and formal sector workers.

The educational profile of informal sector workers in the Province, as is the case nationally, is poorer than that of formal sector workers, with domestic workers being the least educated of the three groups (Table 2). In the formal sector, 36,1 per cent have matric certificates, while 13,3 per cent have diplomas or certificates and 8,6 per cent have a degree.
Only 12,1 per cent of the formal sector employed have no secondary education at all. In contrast, only 21,8 per cent of those employed in the informal sector have matric certificates, while less than seven per cent of workers have post-secondary educations (diplomas, certificates or degrees), and 26,2 per cent have no secondary education.

Amongst domestic workers, the profile is even more biased towards lower educational attainment, with 81,1 per cent of domestic workers not having completed matric.

Table 2: Educational attainment of the employed, by sector excluding agricultural workers, Western Cape, 2005

<table>
<thead>
<tr>
<th></th>
<th>Formal</th>
<th>Informal</th>
<th>Domestic</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>No education</td>
<td>0,6</td>
<td>4,8</td>
<td>2,2</td>
<td>1,5</td>
</tr>
<tr>
<td>Grades 0-7</td>
<td>11,5</td>
<td>21,3</td>
<td>29,2</td>
<td>15,8</td>
</tr>
<tr>
<td>No secondary education</td>
<td>12,1</td>
<td>26,2</td>
<td>31,4</td>
<td>17,3</td>
</tr>
<tr>
<td>Grades 8-11</td>
<td>28,0</td>
<td>40,2</td>
<td>49,8</td>
<td>31,1</td>
</tr>
<tr>
<td>Grade 12</td>
<td>36,1</td>
<td>21,8</td>
<td>13,4</td>
<td>31,3</td>
</tr>
<tr>
<td>At least some secondary education</td>
<td>64,1</td>
<td>62,0</td>
<td>63,1</td>
<td>62,5</td>
</tr>
<tr>
<td>Diploma</td>
<td>13,3</td>
<td>6,0</td>
<td>0,0</td>
<td>11,0</td>
</tr>
<tr>
<td>Degree</td>
<td>8,6</td>
<td>0,7</td>
<td>0,0</td>
<td>6,8</td>
</tr>
<tr>
<td>Post secondary education</td>
<td>21,9</td>
<td>6,7</td>
<td>0,0</td>
<td>17,8</td>
</tr>
<tr>
<td>Total</td>
<td>100,0</td>
<td>100,0</td>
<td>100,0</td>
<td>100,0</td>
</tr>
</tbody>
</table>

Source: Own calculations, September 2005 LFS, Statistics SA 2006

Sectorally, both nationally (48,9%) and within the Province (40,7%) the informal sector employment is concentrated in the wholesale & retail trade sector. This is followed by employment in construction, which employs 15,4 per cent of the provincial informal workforce and 14,1 per cent nationally.

The provincial and national sectoral distributions of informal employment, however, diverge here. In the Western Cape, private households (14,6%) and CSP services (13,4%) are the next most important sectors for informal employment. In contrast, nationally, manufacturing (10,3%) and CSP services (9,3%) complete the four most important informal sector employers.
2.3 The small business sector in the Western Cape

Small businesses are to be found in both the formal and informal sectors and the small business sector can, therefore, not be discussed by contrasting it with the informal sector. Small businesses are categorised as such according to the number of employees.

Micro enterprises have no more than four regular workers, very small businesses have fewer than 20 regular workers, and small businesses have fewer than 50 workers. Medium enterprises employ up to 200 people.

Micro enterprises can be classified as survivalist or non-survivalist enterprises. Survivalist enterprises do not employ anyone and examples of such enterprises include hawkers, vendors and spaza shop owners. Non-survivalist enterprises employ no more than four regular workers. Both these types of enterprises tend to form part of the informal economy. They typically do not pay any tax and are usually not registered. Very small enterprises operate in the formal economy and have access to modern technology.
Small businesses are highly heterogeneous cutting across industries and the formal-informal sector divide. They vary in size, turnover and purpose, amongst other things and are likely to operate from business or industrial premises. In most cases, they are owner-managed or controlled directly by the owner company, and are also likely to be registered with taxation authorities. Medium enterprises, although still owner-controlled, have more complex ownership and management structures and there is increased division of labour.

Unsurprisingly, small businesses are most prevalent in the informal sector (see Figure 4 below). In 2005, 76,3 per cent of informal sector workers reported working in firms with fewer than five regular workers, while this was true of only 11,0 per cent of formal sector workers.

Very small (30,1%) and small enterprises (20,5%) tend to be more prevalent in the formal sector. In contrast, 16,8 per cent of informal sector workers worked in very small enterprises and only 3,2 per cent worked in small enterprises. More than nine in ten informal sector workers work in firms with fewer than 20 regular workers, compared to only four in ten in the formal sector.

**Figure 4: Employment by enterprise size and sector, Western Cape, 2005**

In 2005, half of the employed in the Province were coloured (50,2%), while 25,5 per cent were african and 23,4 per cent were white (see Table 3 below). However, this pattern does not hold across firms categorised by number of employees.

Africans tend to dominate employment in the smallest firms, with 42,5 per cent of individuals engaged in micro-enterprises being african.
Table 3: Employment by enterprise size and race, Western Cape, 2005

<table>
<thead>
<tr>
<th>African</th>
<th>Coloured</th>
<th>White</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>'000s</td>
<td>'000s</td>
<td>'000s</td>
<td>'000s</td>
</tr>
<tr>
<td>Share of race (%)</td>
<td>Share of firm size (%)</td>
<td>Share of race (%)</td>
<td>Share of firm size (%)</td>
</tr>
<tr>
<td>Micro</td>
<td>163</td>
<td>37,1</td>
<td>42,5</td>
</tr>
<tr>
<td>Very small</td>
<td>126</td>
<td>28,7</td>
<td>27,8</td>
</tr>
<tr>
<td>Small</td>
<td>62</td>
<td>14,1</td>
<td>21,0</td>
</tr>
<tr>
<td>Medium &amp; large</td>
<td>80</td>
<td>18,1</td>
<td>14,6</td>
</tr>
<tr>
<td>Total</td>
<td>439</td>
<td>100,0</td>
<td>25,5</td>
</tr>
</tbody>
</table>

Source: Own calculations, September 2005 LFS, Statistics SA 2006

Notes: Totals may not tally due to the omission of the Don’t Know and Unspecified categories, as well as the omission of Asian employment, which total less than one per cent of employment.

Coloureds, on the other hand, account for a disproportionate share of employment in larger firms: 54,2 per cent of those working in small firms and 60,3 per cent of those in medium and large firms are coloured. Interestingly, whites account for a consistent share of around 23 to 25 per cent of employment, across all firm sizes.

Most africans work in the smallest firms – 37,1 per cent in micro-enterprises and 28,7 per cent in very small firms. In contrast, 37,9 per cent of coloureds and 31,9 per cent of whites are employed in medium and large firms, while 24,9 per cent of coloureds and 26,6 per cent of whites are employed in very small firms.

These differences are rooted in the differential rates of engagement in the informal sector by race, where one-fifth of employed africans are employed in the informal sector in 2005, compared to 7,5 per cent of coloureds and 4,2 per cent of whites.

Figure 5 illustrates the pattern of enterprise size in specific industries in the Western Cape. The bulk of micro enterprise activity is concentrated within private households (31,4%) and the wholesale & retail trade (26,9%) sectors, with financial & business services and CSP services accounting for around 10 per cent of employment each.
Wholesale & retail trade also accounts for the largest share of employment in very small enterprises: almost 28 per cent of those working in very small enterprises are engaged in wholesale & retail activity. Four other sectors make up the bulk of very small enterprise employment, namely CSP services (18.1%), construction (15.5%), manufacturing (13.3%) and financial & business services (12.6%), collectively accounting for around 60 per cent of employment.

### 2.4 Constraints Facing the SMME and Informal Sectors

The literature on micro, very small, small and medium enterprises points to two reasons for engaging in these entrepreneurial activities. An individual may start a business in order to take advantage of an opportunity that exits in the market. Alternatively, individuals may start a business as a way of supporting themselves and their families.

Necessity is more likely to motivate women than men to start a small business and such a business is likely to operate in the informal sector while men are more likely to engage in opportunity motivated small businesses.

The informal sector is therefore often viewed as a type of ‘safety net’, in that it provides employment and income-earning opportunities for those excluded from formal sector employment. Many of those engaged in the informal sector would, in its absence, be unemployed and unable to access any alternative form of income, including state grants. However, employment in the informal sector is clearly inferior to that in the formal sector (see section 5.2.1 above).
Putting the size of the informal sector into context, it is estimated that the labour component of the informal sector alone contributes over R5.5 billion annually to Western Cape Gross Geographic Product. While the informal sector may be small, labour productivity in SA micro-enterprises is high relative to other African and other middle-income countries.

Like any part of the private sector, firms in the informal sector require an enabling environment that will encourage growth and expansion, which in turn will hopefully benefit workers in this sector in terms of better incomes. There is also the hope and, in some quarters, the expectation that growth in the informal sector will spill over into the formal sector through the ‘formalisation’ of informal sector firms.

This enabling environment, however, is more than simply a generally favourable (macro)economic environment, but extends to local crime levels, prospects for small-scale or micro-finance and the ability of informal sector firms to engage with formal sector businesses. Many of the issues surrounding the performance of the informal sector are very much micro-economic, with especially local government playing a critical role in providing the infrastructure and environment that growth requires.

The informal sector in SA has been the subject of research focussing on the reason for its small size compared to other countries. The key question is why the informal sector is so small in the face of such high rates of unemployment.

In the 1993 SALDRU and various October Household Surveys, it was found that the unemployed are substantially disadvantaged in relation to the informally employed in terms of income and expenditure.

The fact that the percentage of unemployed people in the Western Cape is growing suggests that there are barriers which prevent many of the unemployed from entering the informal sector.

The barriers to entry in the informal sector limit its attractiveness to the unemployed and this sector may be unable to absorb significantly more of the currently unemployed.

One of the important questions that must be asked in the SA context is why do so many people ‘choose’ to remain unemployed rather than moving into self-employment. In other words, what are the issues that constrain expansion of the informal and SMME sectors?

Identifying these constraints and their underlying causes may help policymakers understand some of the mechanisms by which poverty traps persist over time. It is plausible that many individuals and households are classified as poor today due to the exclusion from profitable opportunities in the labour market of first or second earners in the household.

This is a potential outcome not just from exclusion of the chance to work in the formal sector but also a result of constraints that exclude individuals from opening spaza shops, entering street trading, and engaging in other informal sector activities.
International and SA research have identified several issues that inhibit the performance of informal sector firms and keep incomes in this sector low. The key issues are access to financial services, access to skills training, access to physical infrastructure and basic services, access to business-related infrastructure, the impact of regulations, sector-specific constraints, and poor collective action amongst the informally employed.

### 2.4.1 Access to financial services

Access to financial services, specifically savings and credit facilities, is seen by many to be critical to the success of private enterprise, whether located in the formal or informal sector. Such facilities help firms and their owners purchase equipment and stock; cope with irregular and often unpredictable cash flow problems; and make larger scale investments required to expand the business.

However, small firms in general and informal firms in particular find it difficult or even impossible to access formal sector credit, due to perceptions of their higher risk. Informal sector firms are, therefore, often forced to cope without credit or must access credit from less reputable and significantly more expensive sources of credit, with negative consequences for the firms’ sustainability.

Capital constraints are important to the SMME sector for two reasons. First, they may keep individuals from engaging in SMME activities and second, they may impact negatively on the growth rates of existing small enterprises.

A 2003 Micro-Enterprise Investment Climate (MICA) Survey conducted in Tshwane, Ekurhuleni and Stellenbosch found that 43 per cent of manufacturing micro-enterprises cited access to finance as a serious concern.

The contrast with larger firms is stark. Based on interviews conducted with 800 formal sector firms, the SA Investment Climate Survey found that fewer than one-fifth of firms cited either access to or cost of financing as major or very severe obstacles, which is considerably lower than in most comparable middle income countries. However, the World Bank findings suggest that the divide here is more an issue of formal versus informal rather than large versus small.

Out of about 600 firms interviewed in the Investment Climate (ICA) survey, 21.7 per cent were from the Western Cape. The size breakdown of the Western Cape firms was as follows: 60 had less than 50 employees, 36 employed between 50 and 199 employees and only 33 employed more than 200 employees.

The survey asked firms if a set of issues were seen as constraining the operation and growth of their businesses and to rank the severity of the constraint on a four a point scale. The focus was on the perceived constraints, which are likely to be highly correlated with actual constraints.

Figure 6 presents some of the results from the ICA survey sorted by the percentage of firms that related an obstacle as major. Interestingly, capital constraints are not identified as most important constraints to business, although they are identified as major obstacles by a substantial proportion of firms.
Two types of capital constraints hinder small business growth. The cost of financing (for example, interest rates) is mentioned as an obstacle by 16.4 per cent of firms while access to financing (for example, collateral) is identified as a constraint by 12.6 per cent of firms.

Capital constraints lead the majority of new small businesses to rely on their own savings or assistance from relatives or friends for start-up capital because costs of financing are too high and many entrepreneurs lack of the required collateral.

Financial institutions do not serve small business owners and the poor efficiently. Adopting a microfinance framework which has proved to be successful in other developing countries such as Bangladesh may be a welcome tool in the fight against poverty and unemployment.

Since 1995 the national Government has actively promoted the SMME sector because of its potential to contribute to innovation and its ability to impact on economic growth. Institutions such as the National Small Business Council and Ntsika Enterprise Promotion Agency and recently the Small Enterprise Development Agency form part of the national government’s on-going initiatives.

However, as international evidence shows many of the SMME firms do not survive for more than five years and fewer develop into high growth firms.

Access to credit for informal businesses should be promoted carefully, since credit is only useful if managed well. As shown above, individuals operating in the informal sector tend to be less educated than those in the formal sector, while arguably bearing greater responsibility than their formal sector counterparts of similar educational attainment.

---

3 Micro-finance is the provision of a range of the poor’s financial service needs, including credit, savings, insurance, remittance management while micro-credit is the provision of small-scale loans to the poor.
Thus, facilitating access to credit without providing informal sector entrepreneurs with financial skills may have serious negative consequences for the enterprise, its employees and its owner(s). Focus is therefore shifting towards the savings ability of micro-entrepreneurs, rather than encouraging the accumulation of debt.

2.4.2 Access to skills training

Individuals engaged in informal sector activity tend to be less educated and have fewer marketable skills than their formal sector counterparts. In the Western Cape in 2005, 18.1 per cent of formal sector workers have been trained in skills that can be used for work, compared to 12.5 per cent of informal workers.

One way in which to boost the performance of informal sector firms and improve incomes is through skills training. However, informal sector workers and entrepreneurs are constrained in their access to skills training. Surveys of Johannesburg and Durban that indicated that very few people working in the informal sector have ever accessed training.

The skills required, however, are not uniform across activities or individuals and include varying business skills, life skills and even literacy, numeracy and communication skills.

According to the MICA survey, approximately 21 per cent of micro-enterprises had managers with post-secondary or vocational training, while in manufacturing micro-enterprises, managers were less educated and those in black-owned businesses most often did not have any secondary education at all.

This contrasts starkly with the four-fifths of managers of larger enterprises surveyed in the Investment Climate Survey having university qualifications. It is also clear from Figure 6 that skills and education are the top constraint facing firms surveyed in the ICA survey, with more than one-third (35.5%) of firms citing it as a major constraint.

Although training is available via the SETA system, informal sector firms as well as small formal sector firms do not necessarily find this training to be accessible. Large corporations, for example, find the administrative and other requirements of the SETA system to be onerous, hindering the expansion of learnerships. It is therefore not surprising that this would apply even more so to smaller firms who are less able to dedicate the resources and expertise to this issue.

A sustained increase in the utilisation of the learnership system on the part of informal and small businesses is possible if SETAs ensure that their offerings are relevant and flexible. Specifically, for example, it is important that informal sector workers are able to access part-time learnerships, as their livelihoods would otherwise be negatively impacted by full-time attendance.

Learnerships need also to be accessible in terms of the level of education required by participants, particularly since the educational profile of informal sector workers is relatively low.
2.4.3 Access to infrastructural and other services

All businesses require access to infrastructural and other services in order to thrive. Water, sanitation and refuse removal services, as well as access to electricity, are important municipal services that may support or constrain, in their absence, the informal business sector.

Consequently, given that most informal sector workers in the Western Cape work from home, it is important that these households have access to these services.

Further, the provision of formal housing and the general upgrading of informal settlement are important interventions in this regard. Thus, service delivery and the provision of formal housing are not just important from a societal or welfare point of view, but also from an economic point of view.

Transport infrastructure and services are also highly important, with historical settlement patterns resulting in large proportions of poor people living relatively distant from their places of employment, in many cities and towns across the country. Cape Town and other Western Cape towns are not different in this regard, with many of the poorest workers having to travel long distances to work.

Those engaged in informal sector activity, even when working from home, are not unaffected, facing high transport costs either getting themselves and their products to places of sale in markets, at intersections or on pavements in business districts, or getting stock or raw materials from distant suppliers to their places of work in their homes.

Apart from high costs, poor accessibility of public transport on either end of a given journey will impede the ability of informal sector businesses to grow.

Safety and security are important to ensure that economic activity thrives. Crime, theft and disorder ranked fourth amongst firms in the ICA survey, with 29 per cent of firms identifying it as a major hindrance (see Figure 6). Crime negatively affects informal sector operators, perhaps even more than it does formal businesses, since the former are unlikely to have insurance against stock and property losses.

Informal sector businesses are typically more exposed to criminal activity due to less security at their premises and, particularly for traders, the exposed nature of their activities. Further, informal sector operators may be less forthcoming in terms of reporting crimes, due to greater fear of retribution or a less favourable relationship or perception of police.

This may be particularly important where informal businesses do not operate fully within the bounds of the law and police involvement may hold negative consequences for the business itself. The imperative for local government to facilitate informal sector activity also impacts on informal sector exposure to crime.

The creation of more favourable conditions for the informal sector, such as improved provision of infrastructure, services and storage facilities, while reducing the exposure to crime inherent in many informal sector activities, may also help foster greater trust between informal sector operators and the police.
2.4.4 The regulatory environment

The regulatory environment in SA has come under much investigation over the past decade. In particular, various studies have claimed that regulation in SA is stifling the growth of businesses, particularly smaller businesses, although this view is not held by all.

According to the ICA survey, one-third of firms identified labour regulations as a major constraint, making it the third most important constraint after education and skills, and macroeconomic stability (see Figure 6).

The Labour Relations Act (LRA) (Act no. 66 of 1995) has made the dispute resolution system cheaper and more accessible to vulnerable workers but the more personal relationship between the employer and employee in small businesses may lead the dispute resolution system to operate as a disincentive to employment creation in the SMME sector.

In addition, labour legislation provisions impose a burden of high labour costs on small firms, which may inhibit the entry and growth of these firms.

Tax rates are mentioned by 18.6 per cent of firms as an obstacle in the Investment Climate Survey (see Figure 6). Micro and very small businesses, though, would typically not identify tax rates as impeding their formation or growth.

According to LFS data, point out, nine in ten informal workers reported earnings below the personal income tax threshold in 2001, therefore nullifying the argument that individuals turn to informal sector employment to escape paying tax.

However, for better established SMMEs, high tax rates would, as expected, impact on profit margins and may be viewed more negatively. Another regulatory constraint as mentioned by 10.6 per cent of the firms in the ICA survey is tax administration (see Figure 6).

The time and effort required for tax administration is costly to small businesses. However a large component of tax compliance costs can be ascribed to firm-level inefficiencies.

Inefficient firm-level choices are also often motivated by firms’ perception of the risks associated with accidental non-compliance, for example, penalties that could result from losing a tax submission in the e-filing process. A reduction in the tax compliance burden may help to create a more enabling environment for small businesses.

However, where the regulatory environment is of particular concern for informal businesses is in the area of local government regulations. It is estimated that around 10 per cent of informal sector workers in the Western Cape work in public spaces, making street trading licences an important issue, while those selling alcohol are affected by provincially-issued liquor licences.

While some local municipalities have made great strides to liberalise the regulatory environment, many others continue with restrictive land use legislation, business licensing legislation and by-laws which constrain SMME growth.
The City of Cape Town, for example, has reduced legislation impacting on street trading. However, in most other municipalities in the Western Cape this is not the case especially as far as street trading, business hours and operating from home are concerned.

In some municipalities, although these restrictions exist, a lack of political will or capacity results in a lack of enforcement and thus explains the low impact of business licensing and operating regulations on SMMEs.

A recent study on the impacts of sector specific policies and regulations on the growth of SMMEs found that sector specific regulations create some significant costs for SMMEs, particularly in the automotive, pharmaceutical and tourism sectors.

In contrast, however, the study suggests that sector-specific regulations have very little impact on the behaviours and costs of SMMEs in agri-processing and in the clothing and textiles sectors, and that ICT and financial services SMMEs are simply unaware of sector-specific regulations.

Almost by definition, however, informal sector firms do not adhere to the various regulations, such as VAT and UIF registration, and compliance with labour and minimum wage legislation, and as a result it is unlikely that informal businesses are hindered by legislation.

Of the 240 enterprises surveyed in the MICA survey, only 38 per cent were registered for VAT, while about 70 per cent of firms who were not registered with any government agency being identified as informal businesses.

### 2.4.5 Other constraints

Informal and small businesses face various other constraints, which are specific to the industry in which the business operates, or may vary according to the individual business’ location, customer profile or product or service.

A spaza shop owner in Khayelitsha, an informal sector trader in Cape Town city centre selling curios to tourists and a vegetable seller trading at Cape Town station are likely to face different issues. This requires more nuanced policymaking based on a greater, more detailed understanding of the various types of informal businesses.

A lack of access to business support services is an important constraint on the growth and development of small and informal businesses. The Western Cape, though, has a relatively strong platform from which to address these concerns in the Red Doors (local business service centres established as part of the Real Enterprise Development Initiative).

While few informal businesses are not in some way connected to the formal sector, these connections are not always beneficial to informal businesses. Informal firms source their inputs and/or stock from formal sector businesses, however, very few are able to break into the market supplying larger formal enterprises.
Micro-enterprises are often poorly integrated into supply chains, with no more than 2.0 per cent of their sales going to firms with more than 100 employees. Being involved in formal sector supply chains can enable informal sector firms to grow more rapidly, access better technology and forge lasting business relationships that will ensure greater stability for the informal business and enhance sustainability.

In this way, formal sector firms can help improve the fortunes of competitive informal businesses, and government can promote formalisation through its procurement requirements.

Employees in informal sector and small businesses are less likely to be organised in terms of belonging to unions. This lack of bargaining power means that workers are more likely to be exploited and less able to negotiate for higher wages and better working conditions.

While there is much to gain through collective action in terms of working and living conditions, attempts at organising informal sector workers in SA have not generally been very successful.

2.5 Constraints to self-employment in the Western Cape

Various studies have been undertaken in SA, investigating the informal sector and attempting to identify those factors that constrain the sector’s growth, thereby preventing it from providing employment and incomes to those who would otherwise be unemployed.

Unfortunately, attention paid to the informal sector has been somewhat lacking in the Western Cape, in terms of both research and policymaking. Some investigations that have been done focus on the issues surrounding hindrances to self-employment in the Western Cape.

These hindrances to self-employment are classified as profit barriers where individuals do not view an activity as being able to generate profit, capital barriers that limit individuals’ access to funds, skill barriers in terms of technical or entrepreneurial skills, future-limiting barriers which arise when informal work today limits an individual’s opportunity to access formal employment in the future, and hidden cost barriers that include formal or informal restrictions and other costs.

This analysis is based on the responses of self-employed and unemployed individuals from a representative sample of the Mitchell’s Plain magisterial district, meaning that although it is not representative of the province or even the City of Cape Town, it is representative of the magisterial district and provides important insights that are arguably of relevance elsewhere in the province.

Relative to the rest of the City and the Province, unemployment in the Mitchell’s Plain magisterial district is extremely high. In fact, unemployment rates in the area mirror the national rates more closely than they do the provincial rates. In 2000, the official unemployment rate was estimated at 28,4 per cent, compared to 16,6 per cent for the Province as a whole, while the expanded unemployment rates were 46,3 per cent and 21 per cent respectively.
When asked why they did not choose self-employment as a means of escaping unemployment, broadly unemployed respondents in the Khayelitsha/Mitchell’s Plain (KMP) survey of 2000 identified a lack of capital or money to start a business as the reason, with a further 5.0 per cent of respondents giving alternative answers that were classed as capital barriers.

Given the dominance of capital barriers as a deterrent to entering self-employment, other reasons were relatively unimportant, with skill barriers (4.5% of respondents), future-limiting barriers (3.9%) and profit barriers (2.4%) the most commonly mentioned.

Previously self-employed individuals in the survey were identified and were asked the why they terminated their self-employment. Two in five individuals identified a lack of profits as the reason for ending self-employment, while 15 per cent said they did not have money to buy stock. Crime and violence was another important reason for ending self-employment, cited by 6.0 per cent of respondents.

However, few individuals left self-employment for paid employment (6.5%). Recent work suggests that there may be a significant degree of churning in the SA labour market, with large proportions of workers changing labour market status over relatively short periods of time. With the recent construction of the LFS panel, this issue can hopefully be investigated in more detail.

In a later study, using the 2005 Khayelitsha Survey Wave III (KS-III) data hindrances to self-employment in Khayelitsha were investigated. The KS-III survey tried to return to those individuals in Khayelitsha who had been surveyed in the original KMP Survey of 2000.

This study looked at individuals’ perceptions of factors that prevent them from entering self-employment. Respondents were asked to identify the extent to which each of 17 hindrances prevented them from entering a given type of self-employment.

Crime was perceived to be the dominant hindrance keeping the unemployed from entering self-employment, with other hindrances including the risk of business failure, a lack of access to start-up capital and high transport costs.

These findings from the Khayelitsha surveys are important steps in reaching a better understanding of the issues that prevent engagement in self-employment activities.

As the various issues are identified and better understood through consultation with those affected, policy can begin to reduce and eliminate those obstacles preventing particularly poor people from full engagement in the provincial economy.
3. Conclusion

While overall employment growth has been relatively slow, this has been because of the divergent performances of the formal and informal sectors. The formal sector performance has been good, with employment expanding at an average rate of 3.3 per cent per annum, adding approximately 216 000 jobs over the first half of the decade.

In contrast, the informal sector has performed poorly, shedding one in 20 jobs each year, with employment falling from 225 000 in 2000 to 174 000 in 2005. This pattern of employment change mirrors closely the overall SA experience.

However, the informal sector should not bear the burden of absorbing labour force participants into employment. Despite being viewed as a type of safety net, informal sector employment is of inferior quality relative to that in the formal sector. Lack of compliance with labour, safety and minimum wage legislation, combined with very little bargaining power on the part of informal sector workers, means that they often have inferior employed conditions.

Worker are employed on a temporary, casual or seasonal basis, are less likely to have written contracts or paid leave, and are less likely to have their employers pay pension or retirement contributions or UIF deductions. This leaves informal sector workers open to exploitation while they work and vulnerable to poverty once they no longer are able to work. Organising informal sector workers may not be easy, however, government should encourage and facilitate the process where possible. It is also important that informal sector workers are able to access and be heard by these organisations.

Promoting the small business sector is important for economic development and tackling the negative effects of unemployment and poverty in the Western Cape. There is therefore a need to distinguish between categories of small businesses that operate locally in order to develop strategies to support them.

The informal and the SMME sectors face various constraints to their growth and prosperity. Problems in terms of access to finance, training, infrastructure and services, as well as the regulatory environment all work to limit enterprises’ growth and performance.

Advisory support centres could target micro and very small enterprises and facilitate technical support and training of business owners. The administrative burden as a result of regulatory compliance could be reduced for start up small businesses through direct assistance in applying for licences and permits.

The unbundling of big contracts to involve small businesses, incentives to larger businesses to sub-contract to small businesses and shorter payment cycles, since small businesses have limited credit and rely heavily on regular payments for their cash flow management, could benefit small businesses greatly.
One of the most important issues is the low skills and educational levels that characterise these sectors. The skills lacked by workers in these enterprises range from basic literacy and numeracy to assertiveness, and to general and specific business skills, including basic accounting concepts.

Provision of training to workers in this sector in a way that is flexible and responsive to the trainees’ needs is critical for improved performance and incomes.

Provincial and local governments have important roles to play in creating an enabling, small business-friendly environment. Local government can ensure that registration, licensing and other regulations relating to informal enterprises do not stifle growth.

Experiences of other SA cities reveal that policymaking must be proactive, with active steps being taken to identify, understand and eliminate problems that constrain this sector and limit its contribution to the achievement of our society’s ideals.
Socio-economic Profiling at the Local Level: An Update

Key Findings

- Service delivery within local government is the most important link for SA regional development.
- Financial sustainability is an important consideration and a precondition for service delivery.
- There are still some challenges facing local government and some of those are structural.
- Internal capacity in relation to staff appears to be healthy at a district level. However, the staffing situation within individual municipalities is less satisfactory, which is linked to problems in basic service delivery.
- There are municipalities in the Western Cape which serve as best practice cases within the province and nationally.
- There is multi-faceted deprivation (infra-structure, education, employment & environment) across the Province.
- Service delivery can be improved by implementing a model that is efficient and cost effective.
- The City is planning to tap the markets in 2007 to fund infrastructure.
• Integration of information systems through harmonising the co-ordination between different spheres of government and streamlining interventions.

• Resource allocation and distribution can be targeted to reflect both the potential and the developmental needs of regions targeted, using correct interventions to address the problem areas.
1. Introduction

Despite SA’s successful record of macroeconomic stability as a result of prudent fiscal and monetary policies the record of basic service delivery by local government remains a key challenge.

SA has in 2007, for the first time since the democratic government was elected in 1994, reported a budget surplus. This record is in stark contrast with the financial performance seen in the sphere of local government.

The magnitude of challenges facing the local sphere of government puts the country’s structural problems into perspective. When disaggregated by locality, the challenges are more acute than seen through the national picture, and reveal the realities of poverty and inequality.

This scenario suggests that funding is not a problem for government, but it is rather the manifestation of inefficiencies and imbalances in planning, co-ordination and implementation. In particular, the inefficiencies limit the capacity of local government to spend capital budgets in order to facilitate the fast tracking of capital projects.

These problems are a reflection of missed opportunities to take advantage of the favourable environment at the macro level as well as the degree to which inefficiencies compromises service delivery.

In an attempt to unlock the reasons for non-delivery, this chapter explores some of the factors influencing the local sphere of government’s ability to deliver. The Western Cape’s first comprehensive Socio-Economic Profiles (SEP-LG) 2006 of the metropole, category B and category C municipalities in the Province were aimed at adopting an evidence-based approach to service delivery.

The profiles juxtapose the uneven foundation of development, as shown by the Provincial Index of Multiple Deprivation, development indices and the utilisation of social and economic infrastructure. These indicators confirm the existence of multifaceted deprivation within the Province.

The developmental disparities are to some degree influenced by unfavourable indicators of socio-economic status within households, access to infrastructure, markets, internal staffing and systems, political and financial stability.

On a positive note, the profiles have begun to yield good results as they set a platform for debate around findings related to sector departments & service delivery plan within municipalities. The Department of Education has notably been pro-active and has engaged stakeholders on the findings to formulate appropriate responses to challenges, in concert with the Province’s iKapa Elihlumayo lead strategies.

---

1 Fiscal and monetary policies are determined at the national level of government.
2 In SA municipalities are categorised as A, B and C. A Category A municipality is a metropole and a Category B municipality is a district municipality. A Category B is defined as a municipality that shares executive and legislative authority with a category C municipality within whose area they fall.
Going forward, efficiency-related issues should be targeted in a way that addresses service-delivery in areas that provide quicker payoff. At the same time it should be acknowledged that some challenges will take longer to address.

This chapter revisits some of SEP-LG 2006’s high-level findings, and the evidence that financial sustainability is an important consideration and a pre-condition for service delivery and access to capital, where necessary.

Case studies are presented to illustrate the intra-district dynamics influencing various municipalities and some municipalities that have won national recognition as models for best practice in the Western Cape. These factors when combined influence quality of service delivery and ability to access alternative sources of funding.

2. The inter-relation of socio-economic findings

This section highlights findings by district with a greater emphasis on indicators that influence quality of life and potential pressures on service delivery. The indicators of socio-economic well-being are inter-related and must therefore be contextualised and should not be read in isolation.

This approach assists in identifying the type of required interventions and the target areas for such interventions. For example, drug-related crimes might be linked to poverty and an ineffective education system, with major implications for the mental health system, social capital and investment.

Meanwhile, unfavourable education indicators suggest that the education programmes are ineffective, with adverse effects for social capital, skills, literacy and health in general.

Therefore, the indicators should be read mindful of the issues around the extent to which government programmes address issues of access, affordability and relevance of the education system to the needs of the economy and the community.
### Table 1: Social indicators by district, 2005

<table>
<thead>
<tr>
<th>Indicator</th>
<th>Cape Town</th>
<th>Cape Winelands</th>
<th>Central Karoo</th>
<th>Eden</th>
<th>Overberg</th>
<th>West Coast</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Health</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Patient nurse ratio</td>
<td>54</td>
<td>32***</td>
<td>31</td>
<td>42</td>
<td>29</td>
<td>40</td>
</tr>
<tr>
<td>TB prevalence/100 000 people</td>
<td>N/A</td>
<td>1 113</td>
<td>1 014</td>
<td>1 133</td>
<td>1 142</td>
<td>1 214</td>
</tr>
<tr>
<td>TB cure rate</td>
<td>71%</td>
<td>66%</td>
<td>71%</td>
<td>78%</td>
<td>74%</td>
<td>73%</td>
</tr>
<tr>
<td>Births under 2,5 kg (%)</td>
<td>2.40%</td>
<td>18%</td>
<td>26%</td>
<td>26%</td>
<td>16%</td>
<td>16%</td>
</tr>
<tr>
<td>Under 1 with 1st measles immunisation</td>
<td>83%</td>
<td>82%</td>
<td>80%</td>
<td>85%</td>
<td>75%</td>
<td>88%</td>
</tr>
<tr>
<td>HIV deaths (2010)</td>
<td>41 306</td>
<td>1 163</td>
<td>106</td>
<td>3 108</td>
<td>807</td>
<td></td>
</tr>
<tr>
<td>HIV prevalence rate (2010)</td>
<td>6.90%</td>
<td>4.70%</td>
<td>3.30%</td>
<td>4.60%</td>
<td>4.90%</td>
<td>4.30%</td>
</tr>
<tr>
<td><strong>Education</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Educator learner ratio</td>
<td>39</td>
<td>38</td>
<td>36</td>
<td>40</td>
<td>37.00</td>
<td>37</td>
</tr>
<tr>
<td>People over 14 illiterate</td>
<td>15%</td>
<td>28%</td>
<td>37%</td>
<td>26%</td>
<td>27%</td>
<td>29%</td>
</tr>
<tr>
<td>Enrolment rate</td>
<td>96%</td>
<td>99%</td>
<td>87%***</td>
<td>98%</td>
<td>94%***</td>
<td>97%</td>
</tr>
<tr>
<td>Unemployment rate</td>
<td>29.2%</td>
<td>18%</td>
<td>36%</td>
<td>27%</td>
<td>19%</td>
<td>14%</td>
</tr>
</tbody>
</table>

Source: SEP-LG, 2006

*** Although the healthcare workload is within acceptable benchmark in Cape Winelands, the outcomes as reflected in other health indicators suggests that the interventions are not yielding positive results. For education related issues, high illiteracy and unemployment rates are a problem. Low enrolment rates in schools suggests the need to intensify interventions in Central Karoo and Overberg.

Table 1 above shows health and education indicators by district. When read together, these indicators reflect the extent of development or under development by district using education and health-related indicators as proxy (see footnote). It is worth noting that these are not the latest indicators and might have changed since publication.

In Cape Winelands the workload of nurses is relatively low (32 patients to 1 nurse) compared to other.

### 2.1 Health indicators and access to health services

In 2005, the general trend of health indicators trend across the Western Cape was disappointing. Table 1 shows that tuberculosis (TB) cure rates for the City and the five districts were reported at levels well below the national target of 85 per cent.

Eden district had the most favourable TB cure rate at 78 per cent, while the City had the worst cure rate at 71 per cent. The TB cure rate in Overberg has since improved to 85 per cent (2006).

The provincial average for percentage of new-born babies (under 1 year old) with first measles immunisation is marginally below the national target of 90 per cent but the Overberg district has a figure of 75 per cent.
The workload in the health care system is generally high within the City, Eden and the West Coast districts. The high workload can be attributed to the burden of disease and the accessibility of facilities.

The City, Eden and the West Coast districts reported high patient nurse ratios of 54:1, 42.1, and 40:1, respectively. These compare unfavourably with the national target of 34:1.

Although the statistics are useful in highlighting where the pressures are, they conceal issues such as the efficiency of nurses, compliance of patients with the treatment programmes and accessibility of healthcare facilities.

2.2 Access to education and the employment link

Education is a primary influence in shaping the size and quality of skills available to support economic activity in an area. In addition, policy-(political and economic) related influences such as accessibility, relevance of the curriculum and affordability determine the availability of skills.

Table 1 also shows that illiteracy rates reported in the districts are relatively high when compared to that of 15 per cent reported for the City. Comparisons can be made between the shortage of schools, illiteracy rates and the eventual unemployment rates for the specific districts.

In particular, a strong correlation exists between the illiteracy levels and the unemployment rate. High levels of illiteracy are found in predominantly rural areas. The illiteracy levels are particularly high for the Central Karoo (37%), Cape Winelands (28%), Eden (26%), Overberg (27%) and West Coast (29%).

Central Karoo has the highest need for the Department of Education to deepen interventions that encourage a culture of learning to address problems related to unemployment and illiteracy. It had the most unfavourable indicators with regard to unemployment, illiteracy and school enrolment rates. According to Census 2001 the unemployment rate was the highest (36%), the illiteracy rate, with 37 per cent of the population over 14 illiterate, was the highest and enrolment rate (87%) was the lowest.

The recent engagements with the Western Cape Department of Education and stakeholders (local government, Further Education and Training (FET) institutions and adult basic education and training (ABET) providers) revealed that the ABET centres were not used as effectively as possible.

At the same time the FET representatives expressed concerns about the co-ordination and communication of FET programmes in order to ensure that the FET curriculum is relevant for different regions and needs of district economies.

There is a strong link between education and skills development. It is therefore important that employment creation initiatives take into consideration the fundamental importance of education in unlocking the socio-economic potential of local economies. There is a strong need to strengthen ties with the private sector and the sector education training authorities (SETAs) on board.
3. Economic infrastructure

Economic infrastructure is a key factor in economic growth performance, whether at the national, regional or local level.

At a regional level, the rate of economic growth is generally premised on:
- Regional economic infrastructure;
- Inward investment;
- Labour intensity and productivity amongst regional industries;
- Income earning potential of residents;
- Possession of tangible assets, the ability of the region to retain and/or circulate the income earned within the region; and
- The ability to retain, increase and attract the skills base.

All these factors, amongst others, when combined determine the speed of growth and development. Within the growth framework, the role of government is to create an enabling environment to support the efforts of other economic agents.

At the local level, investment in transport, housing, water and electricity-reticulation infrastructure, sanitation and refuse-removal facilities, as well as municipal roads, pavements, bridges and storm-water drains are critical to advancing economic development.

Municipalities generally face a problem of ageing economic infrastructure coupled with bulk infrastructure backlogs. Chronic shortages were notably reported in the City. This is of great concern as the City accounts for 72 per cent of the Province’s municipal budgets and the fact that, in 2004, approximately 76,5 per cent of Western Cape’s economic activity was within the City. Furthermore, 65 per cent of the Western Cape population resides in the City. If left unattended, the infrastructure-related problems have the potential to hold growth plans hostage.
Strategic Focus Area: Sustainable Urban Infrastructure and Services, City of Cape Town

The City of Cape Town has, in light of the widespread infrastructure backlogs, unveiled an Integrated Development Plan (IDP) that addresses these concerns, focusing on universal access to basic services, conservation of natural resources and effective management of the City’s infrastructure and resources.

Universal access to basic services
• Reduce backlogs in line with national objectives for basic services.
• Large or bulk infrastructure programmes that are essential must receive priority.

Conservation of natural resources
• Develop demand management programmes for water, electricity, waste and transport and reduce attendant pollutants.
• Conserve biodiversity and improve quality living environments through greening, education and access.
• Reduce impact of flooding on community livelihoods and regional economies.

Effective management of the City’s infrastructure and resources
• Develop an ‘integrated programme’ approach to infrastructure and service planning and budgeting.
• Safeguard human health, protect natural aquatic environments, and improve and maintain recreational water quality.

Source: City of Cape Town IDP 2007—2008, draft 2.3 to Council

3.1 Transport infrastructure

Transport infrastructure — road networks, airports, harbours, etc. — play an important role in facilitating economic growth. The road networks in the Western Cape are continuously upgraded and there is a comprehensive network of primary (tarred) and secondary (gravel) roads.

More frequent maintenance is required on the gravel roads in order to improve the connectivity of the region’s economic network. In addition, SEP-LG 2006 highlighted that rural areas are under serviced and that there are areas that need interventions to improve market access and reduce the cost of doing business for farmers. The expanded public works program (EPWP) in roads maintenance play an important role not only for poverty reduction program, but also for long term viability to maintain roads in rural areas.

The Strategic Infrastructure Plan (SIP) estimates that between 2006 and 2009, the Province will invest R17.6 billion of capital expenditure on road infrastructure. However, the allocation of funds and timing does not reflect the priority given to the projects and risk consideration.

Approximately 92 per cent of the total allocation is allocated to a single project (which the department of transport and public works classified as a medium priority project) over a period of one year which makes the project prone to concentration risk.
The lack of efficient public transport services in the region is a major problem, particularly given the extremely dispersed settlement pattern. An efficient public transport system ensures that the amount of time people spend travelling is minimised. At a strategic level, the safety of the public transport system needs monitoring given its impacts on other department’s service delivery obligations.

**City’s public transport plan**

- Improve public transport system and services
- Promote use of public transport. Creation of a unified road-based public transport system utilising the optimum mode for a particular route/corridor. Promote use of public transport to access all facilities and services and reduce the need to use private cars.
- Reduce demand for travel and create conditions for all day public transport services.
- Integration of land use and transport.
- Ensure that freight moves efficiently and safely within the City.
- Develop and implement a transport asset management plan for the City.

*Source: City of Cape Town IDP 2007 — 2008, draft 2.3 to Council*

The infrastructure-led growth in provinces is mainly driven by activities in the built environment. The transport sector has received a major boost as a result of the preparations for the 2010 FIFA World Cup.

In a context of a growing economy, those provinces with large transport network (road, rail, air and ports) need to work closer with the state owned enterprises to influence the planning and executing infrastructure delivery.
3.2 Water

Water availability is a contentious issue within the Western Cape region especially in major towns. The availability of water is also linked to the bulk infrastructure issues.

A strong emphasis is placed on water infrastructure development in the major towns. Water network upgrading is in progress in some areas with the construction of reservoirs and upgrading of water pipes.

In the area of bulk infrastructure, sanitation and pipe blockages are a persistent problem. Many households in the Western Cape do not have access to water-borne sanitation. The City has stopped approving new plans in certain areas as a result of bulk infrastructure backlogs.

3.3 Energy

Recently, the energy crisis in the region has hindered economic activity and created problems in households as well as in leisure and daily living activities. It also added to the challenges of doing business in the Western Cape. Alternative sources of energy such as solar panels are being considered.

The greatest need for electricity exists with farm worker houses and a policy decision is required on whether farmers, Eskom or the district municipalities are responsible for providing electricity to farm workers.

RED 1: Recent developments

In 1997, the national Cabinet approved the restructuring of the electricity distribution industry to a model of Regional Distributors (REDS). The REDs are aimed at fast tracking access to electricity to all of SA's households, while providing low-cost, reliable and quality electricity with equitable tariffs to all.

The Regional Distribution One (RED1) is one of six REDs, which form part of Government's restructuring of the Electricity Distribution Industry (EDI).

The Cape Town based RED1 was launched in July 2005 and includes 40 municipalities, sixteen district councils and the metropolitan area of Cape Town. However, some players contested the establishment of the REDs.

Municipalities feel that the REDs will have a negative effect on their revenues as they generate most of their income from electricity distribution. In the operating revenue estimate for 2007/08 for the City of Cape Town, electricity accounts for 19.1 per cent of the revenue.

In the latest developments, the National Energy Regulator of South Africa (NERSA) declined the application from RED1 for the extension of its license period that terminated on 31 December 2006. The previous RED1 license was issued subject to conditions, which currently have not been satisfied. These conditions comprise the following:

- All electricity customers, assets and staff belonging to the City of Cape Town are transferred to RED1.
- All non-contestable electricity customers, assets and staff belonging to the Eskom distribution business in the RED1 end-state-area are transferred to RED1.
• All electricity customers, assets and staff belonging to the majority of the remaining municipalities in the RED1 end-state-area to be transferred to RED or Service Delivery Agreement (SDA) be concluded with RED1.

Consequently the board of RED1 has placed the entity under voluntary liquidation. NERSA issued to the City of Cape Town the electricity distribution and supply license for a term of six months commencing from 1 January 2007. One of the reasons for the decision by NERSA was that the City of Cape Town indicated unequivocally that it would not renew any new agreements. The reason for this is that Cabinet amended the original conditions on 25 October 2006 to state that REDs would be a public entity and not a municipal entity. As a result, the City of Cape Town will have to reapply to NERSA to extend its license at the end of June 2007.

Concurrently, the national Government has commenced the development of the enabling legislation to smooth the process of implementation of six REDs as public entities as recognised by Cabinet on 25 October 2006. According to EDI Holdings, the country is losing between R2.6 billion and R8 billion a year because of inefficiencies in the current fragmented electricity distribution.

3.4 Housing

Housing is one of the problem areas for the Western Cape. Housing backlogs are widespread throughout the Province. Most of the backlogs are in the City with a shortfall of housing unit of about 300 thousand, followed by the Cape Winelands and Eden Districts.

Affordability and location are the major problems facing the black middle class that has been driving SA’s economy. Buying a house in the Western Cape, especially Cape Town is expensive compared to elsewhere in the country. A large proportion of black people remain inadequately housed with consequent negative impact on the burden of diseases, crime and social capital.

Table 2: Estimated housing backlogs, 2007

<table>
<thead>
<tr>
<th>Metropole/district</th>
<th>Housing units</th>
</tr>
</thead>
<tbody>
<tr>
<td>City of Cape Town</td>
<td>300 100</td>
</tr>
<tr>
<td>Cape Winelands</td>
<td>38 522</td>
</tr>
<tr>
<td>Eden</td>
<td>35 380</td>
</tr>
<tr>
<td>West Coast</td>
<td>15 876</td>
</tr>
<tr>
<td>Overberg</td>
<td>17 427</td>
</tr>
<tr>
<td>Central Karoo</td>
<td>2 522</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>409 827</strong></td>
</tr>
</tbody>
</table>

Source: Western Cape Department of Local Government and Housing, 2007

On the supply side, the most cited problems are lack of land for development of housing projects and lack of skills. This leads to a slower pace in providing bulk infrastructure for new developments. The greatest supply side problem in the construction sector is actually capacity constraints. In other words, there is a shortage of formally recognised skills and huge demand in the industry along with anomalously large inflation cost of building materials. The situation, in turn, exacerbates the budgetary constraints for government.
The Western Cape compares unfavourably with the rest of SA in the delivery of low cost housing. The rate of delivery of the subsidised low cost housing in 2005/06 was far below the national average of 15 295 units, making the Province an outlier on the national scale.

Table 3: Subsidised low-cost dwelling-houses completed by Province: 2005/06

<table>
<thead>
<tr>
<th>Province</th>
<th>Number¹</th>
<th>Square metres²</th>
<th>Value (R’000)²</th>
</tr>
</thead>
<tbody>
<tr>
<td>Western Cape</td>
<td>2 040</td>
<td>61 200</td>
<td>52 877</td>
</tr>
<tr>
<td>Eastern Cape</td>
<td>16 874</td>
<td>506 220</td>
<td>437 374</td>
</tr>
<tr>
<td>Northern Cape</td>
<td>5 293</td>
<td>158 790</td>
<td>137 195</td>
</tr>
<tr>
<td>Free State</td>
<td>17 635</td>
<td>529 050</td>
<td>457 099</td>
</tr>
<tr>
<td>KwaZulu-Natal</td>
<td>21 601</td>
<td>648 030</td>
<td>559 898</td>
</tr>
<tr>
<td>North West</td>
<td>14 445</td>
<td>433 350</td>
<td>374 414</td>
</tr>
<tr>
<td>Gauteng</td>
<td>23 409</td>
<td>702 270</td>
<td>606 761</td>
</tr>
<tr>
<td>Mpumalanga</td>
<td>14 389</td>
<td>431 670</td>
<td>372 963</td>
</tr>
<tr>
<td>Limpopo</td>
<td>21 973</td>
<td>659 190</td>
<td>569 540</td>
</tr>
<tr>
<td>SA</td>
<td>137 659</td>
<td>4 129 770</td>
<td>3 568 121</td>
</tr>
</tbody>
</table>

Source: Statistics SA

Notes: ¹ Units completed during the financial year, 1 April 2005 to 31 March 2006
² Estimates by the National Department of Housing

4. Economic performance

The City of Cape Town forms the Province’s main economic growth engine contributing 76,5 per cent of the Western Cape’s GDP in 2004. Two economic growth nodes flank the City: the Saldanha-Vredenburg node to the west and the South Cape to the east.

Table 4 below presents the City and district contribution to Provincial GDP in 2004, illustrating key economic contributions from the City (76,5%), Cape Winelands (10,5%) and Eden (6,2%) districts. In contrast, municipalities with a more rural and agricultural bias struggled to grow.

Table 4: City and district GDP contribution, 2004

<table>
<thead>
<tr>
<th>Region</th>
<th>Share of WC (%)</th>
<th>Share of SA (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Central Karoo</td>
<td>0,50</td>
<td>0,07</td>
</tr>
<tr>
<td>Overberg</td>
<td>2,37</td>
<td>0,35</td>
</tr>
<tr>
<td>West Coast</td>
<td>4,00</td>
<td>0,58</td>
</tr>
<tr>
<td>Eden</td>
<td>6,5</td>
<td>0,90</td>
</tr>
<tr>
<td>Cape Winelands</td>
<td>10,49</td>
<td>1,54</td>
</tr>
<tr>
<td>City of Cape Town</td>
<td>76,49</td>
<td>11,19</td>
</tr>
<tr>
<td>Western Cape</td>
<td>100,00</td>
<td>14,63</td>
</tr>
</tbody>
</table>

Source: Western Cape Provincial Treasury calculations based on Quantec Research, 2007
Furthermore, in addition to economic resources, to become a top performing municipality sound leadership is a required.

In the period 1995 to 2004, the Western Cape economy grew at an average rate of 3,5 per cent a year, marginally higher than the average for SA over the same period (see Table 5 below). The Western Cape’s growth rate has increased, and is expected to remain steady.

**Table 5: Selected regional growth rates, 1995 — 2004**

<table>
<thead>
<tr>
<th>Region</th>
<th>Average annual growth rate, 1995 — 2004 (%)</th>
<th>Growth rate, 2003 — 2004 (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Central Karoo</td>
<td>4,23</td>
<td>5,26</td>
</tr>
<tr>
<td>Overberg</td>
<td>2,58</td>
<td>4,26</td>
</tr>
<tr>
<td>West Coast</td>
<td>2,38</td>
<td>4,33</td>
</tr>
<tr>
<td>Eden</td>
<td>3,34</td>
<td>5,38</td>
</tr>
<tr>
<td>Cape Winelands</td>
<td>3,34</td>
<td>5,33</td>
</tr>
<tr>
<td>City of Cape Town</td>
<td>3,73</td>
<td>5,38</td>
</tr>
<tr>
<td>Western Cape</td>
<td>3,53</td>
<td>5,27</td>
</tr>
<tr>
<td>SA</td>
<td>3,13</td>
<td>4,43</td>
</tr>
</tbody>
</table>

*Source: Western Cape Provincial Treasury calculations based on Quantece Research, 2007*

The fastest growing region within the Western Cape for the period 1995 to 2004 was the Central Karoo (albeit off a low base), followed by the City of Cape Town. The interpretation of the growth rates in the Central Karoo should be treated with caution given its relative size compared to other districts in the Province. Despite its faster growth rate, Central Karoo remains the poorest district.

In 2004, the main sectors driving robust provincial economic performance were construction (4,5%), financial & business services (5,3%), wholesale & retail trade (9,7%), and transport & communication (5,2%).

Table 6 disaggregates the sectoral contribution of the City and the districts to the Province’s GDP. The City plays a dominant role in the Province’s economic activity with all sectors accounting for more than 55 per cent, with the exception of agriculture (23%).

The Cape Winelands district is the largest contributor to the Province’s agriculture forestry & fishing sector, accounting for 33,9 per cent of the agricultural output, followed by the City at 27,2 per cent. The contribution from the construction sector is significant in Eden, contributing 10,3 per cent to the Province.
Table 6: City and district sectoral contributions to Western Cape GDPR, 2004

<table>
<thead>
<tr>
<th>Sectors</th>
<th>Central Karoo</th>
<th>Overberg</th>
<th>West Coast</th>
<th>Eden District</th>
<th>Cape Winelands</th>
<th>City of Cape Town</th>
</tr>
</thead>
<tbody>
<tr>
<td>Agriculture, forestry &amp; fishing</td>
<td>1,2</td>
<td>11,0</td>
<td>17,1</td>
<td>9,6</td>
<td>33,9</td>
<td>27,2</td>
</tr>
<tr>
<td>Mining</td>
<td>0,2</td>
<td>0,7</td>
<td>18,5</td>
<td>13,5</td>
<td>10,4</td>
<td>56,8</td>
</tr>
<tr>
<td>Manufacturing</td>
<td>0,2</td>
<td>2,0</td>
<td>4,5</td>
<td>5,6</td>
<td>12,7</td>
<td>75,0</td>
</tr>
<tr>
<td>Electricity &amp; water</td>
<td>0,4</td>
<td>2,5</td>
<td>4,1</td>
<td>11,5</td>
<td>5,4</td>
<td>78,1</td>
</tr>
<tr>
<td>Construction</td>
<td>0,7</td>
<td>3,5</td>
<td>4,4</td>
<td>10,3</td>
<td>9,3</td>
<td>71,8</td>
</tr>
<tr>
<td>Wholesale &amp; retail trade; catering &amp;</td>
<td>0,5</td>
<td>2,6</td>
<td>3,8</td>
<td>6,8</td>
<td>9,3</td>
<td>77,1</td>
</tr>
<tr>
<td>accommodation</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Transport &amp; communication</td>
<td>1,0</td>
<td>1,6</td>
<td>3,4</td>
<td>4,8</td>
<td>7,7</td>
<td>81,5</td>
</tr>
<tr>
<td>Financial &amp; business services</td>
<td>0,3</td>
<td>1,2</td>
<td>1,9</td>
<td>4,8</td>
<td>7,4</td>
<td>84,4</td>
</tr>
<tr>
<td>CSP services</td>
<td>0,5</td>
<td>2,7</td>
<td>4,5</td>
<td>6,3</td>
<td>9,3</td>
<td>76,6</td>
</tr>
<tr>
<td>General government services</td>
<td>0,6</td>
<td>2,3</td>
<td>3,7</td>
<td>7,2</td>
<td>12,1</td>
<td>74,2</td>
</tr>
<tr>
<td>Overall contribution to Western Cape GDPR</td>
<td>0,5</td>
<td>2,4</td>
<td>4,0</td>
<td>6,2</td>
<td>10,5</td>
<td>76,5</td>
</tr>
</tbody>
</table>

Source: Western Cape Provincial Treasury calculations based on Quantec Research, 2007

5. Municipal sustainability

Changes in political governance disrupt the implementation of strategies and programmes as political parties further party specific strategies. This was evident in a number of municipalities across the Western Cape during the period although the major changes were in specific local municipalities where some parties lost ward seats to others. Thus the continuity of governance and policy-making processes were not compromised.

Internal capacity in relation to staff appears to be healthy when assessed at a district level. However, the staffing situation within individual municipalities is less satisfactory with a strong correlation existing between staff shortages and problem in basic service delivery.

The City is an example of this correlation with less than 90 per cent of its posts filled. Staffing problems within the City are concentrated in critical areas such as engineering, fire fighting and finance. The impact of a protracted restructuring and realignment process within the organisational structure of the City of Cape Town has also had a negative effect on human resources and service delivery.
In 2005, the Cape Winelands district had four local municipalities (Witzenberg, Breede Valley, Drakenstein and the Cape Winelands District Municipality) that had vacancy rates of less than 75 per cent. The Central Karoo had filled almost all of their vacancies.

6. Fiscal landscape and financial sustainability

Understanding the fiscal landscape and the limitations to financial sustainability is key to unlocking the resources of municipalities. In addition to the fiscal landscape, efficiency gains can be realised through internal controls, information management and innovative models of service delivery that encourage local responses directed at maximising the impact of service delivery.

The fiscal landscape and financial sustainability are some of the key considerations in determining the speed of service delivery in municipalities, assuming no skills constraint exists.

The size of the budget and the efficient execution of budget plans are important levers for accelerated development. Table 7 below compares the size and composition of SA’s municipal budgets.

The Western Cape has the second largest municipal budget (R21.6 billion) after Gauteng (R41.2 billion). The average budget size for Western Cape municipalities is estimated at R6993 million with the bulk (72%) of the budget concentrated within the City.

Category B and Category C municipalities account for 24 and 4 per cent respectively of the overall provincial municipal budget. In other words, the overall budget of the City amounted to R15.6 billion and the Category B and Category C municipalities received R5.2 billion and R866 million respectively.

Municipalities drive the developmental agenda of the country. The size of the budget should therefore be linked to its execution. More is needed to test the alignment of the municipal budgets and expenditure to national priorities.

3 The figure includes the budget of the Metro
Table 7: Budget size by province and municipality category, 2005/06

<table>
<thead>
<tr>
<th>Province</th>
<th>Overall Budget R million</th>
<th>Average budget size per municipality R million</th>
<th>Category A %</th>
<th>Category B %</th>
<th>Category C %</th>
</tr>
</thead>
<tbody>
<tr>
<td>Eastern Cape</td>
<td>10 780</td>
<td>234</td>
<td>34</td>
<td>46</td>
<td>20</td>
</tr>
<tr>
<td>Free State</td>
<td>5 480</td>
<td>219</td>
<td>0</td>
<td>94</td>
<td>6</td>
</tr>
<tr>
<td>Gauteng</td>
<td>41 230</td>
<td>2425</td>
<td>90</td>
<td>9</td>
<td>1</td>
</tr>
<tr>
<td>KwaZulu-Natal</td>
<td>20 433</td>
<td>330</td>
<td>59</td>
<td>30</td>
<td>11</td>
</tr>
<tr>
<td>Limpopo</td>
<td>5 828</td>
<td>194</td>
<td>0</td>
<td>67</td>
<td>33</td>
</tr>
<tr>
<td>Mpumalanga</td>
<td>5 395</td>
<td>257</td>
<td>0</td>
<td>83</td>
<td>17</td>
</tr>
<tr>
<td>Northern Cape</td>
<td>2 314</td>
<td>72</td>
<td>0</td>
<td>84</td>
<td>16</td>
</tr>
<tr>
<td>North West</td>
<td>6 513</td>
<td>261</td>
<td>0</td>
<td>86</td>
<td>14</td>
</tr>
<tr>
<td>Western Cape</td>
<td>21 670</td>
<td>699</td>
<td>72</td>
<td>24</td>
<td>4</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>119 642</strong></td>
<td><strong>521</strong></td>
<td><strong>57</strong></td>
<td><strong>34</strong></td>
<td><strong>9</strong></td>
</tr>
</tbody>
</table>

Source: National Treasury 2007

6.1 Municipal revenue sources

Municipalities source revenue mainly from:

- Intergovernmental transfers — local equitable share and conditional grants from national and provincial government;
- Own source of revenue (property taxes, water, electricity, sanitation, refuse removal and other sources);
- Donor funding — though not on a large scale; and
- Borrowing (excluding recurrent deficits).

6.1.1 Intergovernmental transfers

According to section 214 of the Public Finance Management Act (PFMA), the size of the equitable share to a sphere is based on expenditure (service delivery) responsibilities, and fiscal capacity and efficiency. In addition to intergovernmental transfers, municipalities are expected to raise revenues on their own and borrow on the strength of their balance sheets to supplement transfers.

**The local government ‘equitable share’**

The local government equitable share (LES) was introduced in 1998. It is the lump sum transfer made to local government, among a system of transfers, by national government. Local government is also able to generate its own revenue, which is an additional revenue stream.

The Division of Revenue Act governs the Local Government Equitable Share, and allocations are made by national government in terms of a complex range of considerations.

6.1.2 Own revenue

Findings from SEP-LG 2006 highlighted the degree to which various municipalities are able to raise revenue. The main determinants of the municipalities’ ability to raise revenue are wealth and poverty patterns amongst the populations. Wealth and poverty amongst municipalities are assessed on the basis of geographic location, the level of economic activity, income levels and access to social and economic infrastructure.

Wealthier areas tend to be in good geographical locations that attract investment (e.g. infrastructure) an in turn influences economic activity which then informs the socio-economic status of households.

As far as the fiscal landscape is concerned, the SEP-LG 2006 found that municipalities continue to face an array of mounting challenges. Apart from poverty-induced revenue constraints, some challenges are largely associated with the combination of inefficient/ineffective debt collection, internal capacity (personnel and billing system), diminishing revenue due to legislative changes (abolition of the Regional Services Council (RSC) levy in 2005 and the proposed introduction of RED1) and limited use of external borrowing. It is not clear whether the equitable share sufficiently compensates municipalities for loss of revenue and whether the REDs would do so as well.

These factors collectively affect the fiscal landscape and have a strong influence on municipalities’ fiscal sustainability and could undermine the distributional goals of service delivery.

Charges for electricity and water are also important sources of finance. Of the 30 municipalities of the Western Cape, 22 municipalities collect at least 35 per cent of their own revenue from electricity. Revenue generation and collection varies across districts and municipalities alike. The number of municipalities reflecting revenue receipts above the notional benchmark for February 2007 has also increased.

Of the 30 municipalities, 21 (70%) reflected year-to-date (YTD) figures above the 66,7 per cent benchmark (for the first eight months) as compared to January 2007, when 19 out of the 30 municipalities (63,3%) reflected YTD figures above the notional benchmark of 58,3 per cent (for the first seven months).

Only two municipalities have collected less than 50 per cent of their budgeted operating revenue namely: Kannaland (39%) and Drakenstein (49,3%).
Vuna Awards: Rewarding service excellence in municipalities

In December 2006, Overstrand Municipality received a financial boost totalling R3 million from the national Vuna Awards, in recognition of their performance in areas of governance and financial management. It was the country’s best category B municipality for the financial year ended 2004/05.

The Vuna Award is a national competition, which recognises and rewards excellent municipal performance. The following five key performance areas are used to assess municipalities:

- Infrastructure development and service delivery;
- Local economic development;
- Municipal transformation and institutional development;
- Financial viability; and
- Good governance.

The Vuna Award aims to cultivate a culture of performance and productivity in South African local government. The improvement in the performance of municipalities is measured and the top three in each province are short listed for the annual ministerial awards.

Overstrand municipality was nominated alongside Swartland and Breede River/Winelands municipalities to represent the Western Cape for the competition.

Overstrand also received a favourable assessment from the Provincial Treasury’s SEP-LG 2006.

"Overstrand’s financial health is commendable, with marked improvement in the recovery of bad debt. It is more reliant on own-revenue resources rather than government grants" Socio Economic Profile: Overberg District page 61.

Source: National Department of Provincial and Local Government, Development Bank of Southern Africa

6.1.3 Borrowing

Borrowing is another source of funding for municipalities. Municipalities can borrow using various funding instruments, ranging from project finance, short-term or long-term loans using either marketable or non-marketable debt to fund infrastructure projects.

The choice of funding instruments amongst municipalities differs, some motivated by extent of required disclosure, costs, flexibility and relative complexity of sourcing funds.

Traditionally, the objectives of accessing the municipal bond market, amongst others, include:

- Improve credit worthiness
- Diversify funding instruments
- Build liquid benchmarks
- Reduce debt-service costs
- Increase investor base and encourage regional investment flows
- Benchmark opportunities amongst municipalities
- Build price tension in the municipal bond market.

SA’s municipal debt market has been depressed — until the City of Johannesburg’s first issuance in 2004 — and remains largely untapped, despite the deep and liquid capital market that is of world standard. For borrowers to access the bond market, a credit rating is a prerequisite.
In the Western Cape there seems to be a weak appetite for long-term municipal debt, especially listed securities. Although municipalities are assessed from time to time, only three municipalities — the City, George and Breede Valley local municipalities — are assigned ratings by CA Ratings.

The City is planning to tap the markets in 2007 to fund infrastructure. In the context of the growing need to accelerate economic growth and infrastructure backlogs, having all municipalities rated can be a valuable exercise to gauge their credit worthiness and investor sentiment.

**Case study: The SA Municipal Bond Market — City of Johannesburg leads the way**

The City of Johannesburg has emerged as one of the pioneers in reviving SA’s listed municipal bond market to become the benchmark issuer in this tier of securities. The City of Johannesburg has built liquid benchmarks and they have four bonds listed on the Bond Exchange.

Their investment story began in 2002 when the Egoli 2002 team pioneered a financial sustainability benchmarking exercise by approaching international credit rating agencies. The evolution of the City of Johannesburg investment story is reflected in its ratings. Since their first rating in 2002 the ratings reflect a significant turnaround in credit worthiness and ability to service debt. In 2002, Fitch Ratings assigned the City of Johannesburg an investment grade rating of BBB+ in the long-term, which was upgraded to A- in 2003, and that rating was affirmed in 2004.

<table>
<thead>
<tr>
<th>Year</th>
<th>Short-term</th>
<th>Long-term</th>
<th>Agency</th>
</tr>
</thead>
<tbody>
<tr>
<td>2002</td>
<td>F2+</td>
<td>BBB+</td>
<td>Fitch Ratings</td>
</tr>
<tr>
<td>2003</td>
<td>F2+</td>
<td>A-</td>
<td>Fitch Ratings</td>
</tr>
<tr>
<td>2004</td>
<td>F2+</td>
<td>A-</td>
<td>Fitch Ratings</td>
</tr>
<tr>
<td>2004</td>
<td>ZaA2</td>
<td>ZaA</td>
<td>CA-Ratings</td>
</tr>
</tbody>
</table>

The benefits of the improved credit story are evident in the spreads at which the Municipality borrowed and the gradual reduction in its coupon rate. Another way of gauging the success of the issuance is the over subscription and the secondary market performance. There is evidence of growing appetite for the City of Johannesburg’s paper.

<table>
<thead>
<tr>
<th>Stock Code</th>
<th>Issue Date</th>
<th>Amount</th>
<th>Coupon</th>
<th>Maturity</th>
<th>Issue Spread</th>
<th>Spread (22/05/2007)</th>
</tr>
</thead>
<tbody>
<tr>
<td>COJ01</td>
<td>13 April 2004</td>
<td>R1bn</td>
<td>11.95%</td>
<td>13 April 2010</td>
<td>230 bps</td>
<td>90 bps</td>
</tr>
<tr>
<td>COJ02</td>
<td>30 June 2004</td>
<td>R1bn</td>
<td>11.9%</td>
<td>15 September 2016</td>
<td>164 bps</td>
<td>120 bps</td>
</tr>
<tr>
<td>COJ03</td>
<td>26 April 2005</td>
<td>R700m</td>
<td>9.7%</td>
<td>26 April 2013</td>
<td>154 bps</td>
<td>100 bps</td>
</tr>
<tr>
<td>COJ04</td>
<td>05 June 2006</td>
<td>R1.2 bn</td>
<td>9%</td>
<td>5 June 2018</td>
<td>120 bps</td>
<td>103 bps</td>
</tr>
</tbody>
</table>

The first bond issued (COJ 01) was 1.5 times over-subscribed and the second bond was 2.3 times over-subscribed. The spreads also continued to tighten, signalling the market conditions and to some extent the improved credit quality. The City of Johannesburg’s O1 bond was issued at a spread of 230 basis points above the Government R153 bond. As at 22 May 2007 the spread was quoted at 90 basis points (bps). A spread is the difference between the underlying instruments and the benchmark bond of similar maturity. A tighter spread implies the narrowing gap between the COJ bond and the government bond while the wider spread is the opposite.

---

4 CA Ratings (where ‘CA’ is drawn from the ‘Chartered Accountant’ profession) has been acquired by Moody’s Investor Service. CA Ratings for municipalities are currently being converted to Moody’s Ratings.
6.2 Financial sustainability

Financial sustainability is an important consideration in assessing municipalities’ ability to access capital and service delivery. Financial stability refers to the extent to which the municipalities enjoy healthy long-term financial performance in such a way that long-term service delivery, new infrastructure and maintenance plans are financed comfortably without resorting to drastic hikes in rates and deterioration of service delivery.

In other words, for the municipality to be on a sustainable path, current economic and consumption patterns should not reduce opportunities for future generations by impairing or depleting existing resources (financial and environmental).

The municipalities’ financial sustainability is measured by a matrix of indicators focused on financial issues (both revenue and expenditure), operating, and debt indicators. All these indicators have a series of subsets, which, when analysed together with the economic consideration of municipalities, inform the municipalities’ ability to deliver and source funding from external loans.

6.2.1 Municipal assessments

Independent assessments on municipalities’ financial standing are also important sources of financial disclosure used to assist prospective investors and lenders in making decisions. Such reports also complement the Provincial Treasury’s oversight role. These include audit reports and rating reports from credit rating agencies.

The recent audit report of 27\(^5\) out of 30 municipalities in the Province, found that the majority (55\%) of the municipalities’ annual financial statements for 2005/06 were qualified, 33 per cent unqualified with emphasis of matter, 8 per cent with adverse opinion and 4 per cent with disclaimer of opinion.

Most of the municipalities with unqualified annual financial statements with ‘emphasis of matter’ are medium to low capacity municipalities and only one high capacity municipality fell in this category.

In line with the SEP LG 2006 the 2005/06 audit report also emphasised weak debtors control as one of the areas that requires urgent corrective action. Other areas mentioned were non-compliance with the laws and regulation, supply chain management related issues, internal control weaknesses, asset management and financial statement items.

In the Western Cape, most Project Consolidate municipalities have a large rural component. The ability of some of these municipalities to fast track service delivery is undermined by exposure to external loans, thus diverting funds away from service delivery towards servicing debt. Cederberg, Witzenberg, Matzikama and Kannaland municipalities have the largest rural component.

\(^5\) The District Management Areas report to the district municipalities and are not considered.
Since 2004 Witzenberg and Kannaland were two municipalities with severe cash flow problems. Kannaland’s revenue growth is compromised by high interest payments (18.5% a year) for external loans with the Development Bank of Southern Africa (DBSA).

Kannaland spends about R2 million on debt service costs\(^6\). In Witzenburg, external loans constitute 16.7% per cent of capital funding, reflecting an increase of 48.3 per cent from 2006/07 to 2007/08.

**Table 8: Western Cape project consolidate municipalities, 2007\(^7\)**

<table>
<thead>
<tr>
<th>Municipality</th>
<th>Urban: rural split (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cape Town (Khayelitsha &amp; Mitchells Plain)</td>
<td>N/A</td>
</tr>
<tr>
<td>West Coast District Municipality (DMA area)</td>
<td>69,9:30,1</td>
</tr>
<tr>
<td>Matzikama</td>
<td>60,7:39,3</td>
</tr>
<tr>
<td>Cederberg</td>
<td>48,8:51,2</td>
</tr>
<tr>
<td>Cape Winelands District</td>
<td>70,3:29,7</td>
</tr>
<tr>
<td>Witzenberg</td>
<td>58,5:41,6</td>
</tr>
<tr>
<td>Overberg District</td>
<td>75,7:24,2</td>
</tr>
<tr>
<td>Theewaterskloof</td>
<td>64,2:35,8</td>
</tr>
<tr>
<td>Eden District</td>
<td>79,8:20,2</td>
</tr>
<tr>
<td>Kannaland</td>
<td>38,9:61,1</td>
</tr>
<tr>
<td>Central Karoo District (DMA: Murraysburg)</td>
<td>75,0:25,0</td>
</tr>
<tr>
<td>Laingsburg</td>
<td>6,3:0,37,0</td>
</tr>
<tr>
<td>Beaufort West</td>
<td>82,0:18,0</td>
</tr>
<tr>
<td>Prince Albert</td>
<td>65,0:35,0</td>
</tr>
</tbody>
</table>

*Source: Western Cape Department of Local Government and Housing, Demarcation Board*

\(^6\) Kannaland’s financial statements were qualified due to the misallocation of R1.7 million worth of interest payment. The municipality included the amount to the trust fund instead of interest.

\(^7\) Project Consolidate Municipalities are those identified to be in greater need of hands on support. The project is aimed at strengthening the performance of municipalities through support systems focusing on capacity building, economic development to support service delivery in the targeted municipalities. Only the district municipalities are not Project Consolidate municipalities.
7. Responding to socio-economic challenges

It is evident from the SEP-LG 2006 analysis that an urgent response to socio-economic challenges is critical. Failure to do so will undermine Government’s socio-economic policies and strategic objectives, such as the Western Cape’s iKapa Elihlumayo.

The skills and human resources issues in municipalities are the most fundamental issues that need urgent attention. With such skills in place, it will be easier to implement policy priorities that are evidence-based to ensure that the distribution of resources is equitable.

Whilst not decrying the benefits of promoting areas with greatest potential, strategies that are silent about the plight of the marginalised or under developed areas are harmful. This is as a result of overlooking issues that are potential causes of conflict (e.g. migration) that are constantly cited as sources of pressure for service delivery.

8. Information management

The benefits of good information gathering and dissemination are enormous for policy makers. However, it is not only the availability of information that is beneficial, but also understanding the implications of the data and formulating policy responses.

In the absence of harmonised information management systems, SEP-LG 2006 bridges the information gap by consolidating disparate information from different management systems, such as the Education Management Information System (EMIS) and Health Management Information System (HMIS) to reduce the extent of isolated policy responses.

SEP-LG 2006 revealed that there are regional imbalances in the developmental trajectory within the Province, suggesting the need to devise local solutions given the unique and complex nature of problems facing various municipalities.
9. Resource allocation

Municipalities provide several of the most crucial services to households and businesses — water, sanitation, storm water drainage, roads and electricity. Resource allocation (financial and non-financial) therefore needs to intentionally influence the quality of service delivery and the access of basic services to the under serviced areas to maximise the impact of service delivery.

The findings of the SEP-LG 2006 support the need for a targeted allocation of resources given the inequitable allocation of resources. Resource allocation and distribution can be targeted to reflect both the potential and the developmental needs of regions targeted, using correct interventions to address the problem areas (e.g. literacy, accessibility and relevance of curriculum to influence the skills need).

In addition to strategies, empirical evidence suggests that the ownership and customised interventions tend to be sustainable. The model of a successful approach to service delivery is underpinned by strategies that are based on a methodology that addresses issues of gender, age, location and social standing.

10. Conclusion

The rate of service delivery within the local sphere of government is the most important link for SA’s regional development. The outcome of the 2006 national Budget suggests that financial resources are not a major problem in the improvement of service delivery at the local sphere of government.

The problems encountered are a reflection of lack of efficiency, innovation and capacity (staffing, systems and other exogenous issues) to enhance service delivery.

Financial sustainability, however, remains one of the significant influences on municipal performance. The path to the “ideal” route to development has been marred by structural challenges that manifest in “missed” opportunities for economic development and growth. These deficiencies also make it a mammoth task for policy makers to craft effective strategies timeously.

Although the fiscal landscape has changed, interventions do not necessarily imply that financial injection is always a solution. Instead, identifying opportunities and efficiency gains through local solutions can result in positive spin offs.

This can be achieved through building business/government’ intelligence from the wide range of available data. Despite the data availability and concerted efforts to deepen compliance, monitoring and evaluation tools currently in place have not improved outcomes.
One of the main challenges in accelerating an effective model of service delivery is the lack of harmonised co-ordination between the different spheres of government and streamlining of interventions. In the Western Cape, information management systems are stand-alone tools within departments and have not been utilised in a way that assists clusters within government.

The disintegrated fashion of service delivery from time to time lends itself to bottlenecks and unnecessary inefficiencies. Empirical evidence suggests that debt collection is an area of weakness among municipalities. This area of weakness means that municipalities forego revenue that could have otherwise been used for service delivery.

There is also room to access under utilised sources of funding (borrowing and donor finance). Relatively poor municipalities are limited by their capacity to access these sources of funding.
References

Chapter 1: Executive Summary


Cape Shared Growth Initiative (Csgi), 2007 (a), Newsletter 1, http://www.capecrowth.org.za


Mohamed, H., 2006, District and metro IDPs: A framework for contextualising and applying the NSDP, draft discussion paper.


Pastor, M. (Jnr.), Benner, C., Matuoka, M., 2007, This could be the start of something big: Regional equity organising and the future of metropolitan America, draft.


Province of Western Cape, 2006, Provincial Gazette Extraordinary, No. 6385, The Provincial Growth and Development Strategy (PGDS) which serves as a Green Paper for the Western Cape.


South African Reserve Bank (SARB). Various Quarterly Bulletins.


Chapter 3: Economic Modelling and Regional Impact Analysis


Berning, C. and McDonald, S., (2000). ‘Supply Constraints, Export Opportunities and Agriculture in the Western Cape of South Africa’, Agricultural Economics Society Annual Conference, University of Manchester, April.


**Chapter 4: Regional Innovation and Growth**


Lorentzen, Jo. 2007. The Geography of Innovation in South Africa: A First Cut. HSRC-ESSD, Cape Town [mimeo].


Von Tunzelmann, Nick. 2007. Approaching network alignment. SPRU, University of Sussex [mimeo].


Chapter 5: Employment Dynamics


Chapter 6: Small, Medium and Micro Enterprises and the Informal Sector


**Chapter 7: Socio-economic Profiling at the Local Level: An Update**

Bond Exchange of South Africa, [http://www.bondexchange.co.za](http://www.bondexchange.co.za)


