SOUTH AFRICA
2014

Wolassa Lawisso Kumo / w.kumo@afdb.org
Jan Rieländer / jan.rielaender@oecd.org
Babatunde Omilola / babatunde.omilola@undp.org

www.africaneconomicoutlook.org

SOUTH AFRICA

- **Labour unrest and the persistently sluggish environment in Europe and the United States impacted on growth, but the situation should improve in 2014 as the global economy improves and a cheaper rand boosts exports.**
- **With almost 25% of the population (and 65% of young people) without work, unemployment is South Africa's largest social challenge. The National Development Plan of 2012 stipulates crucial measures for the acceleration of structural and education reforms.**
- **South Africa is an important hub in the global mining value chain, a regional assembly hub in the global automotive value chain and a key player in the regional finance and retail value chains. It should capitalise on these links as engines of growth at home.**

Overview

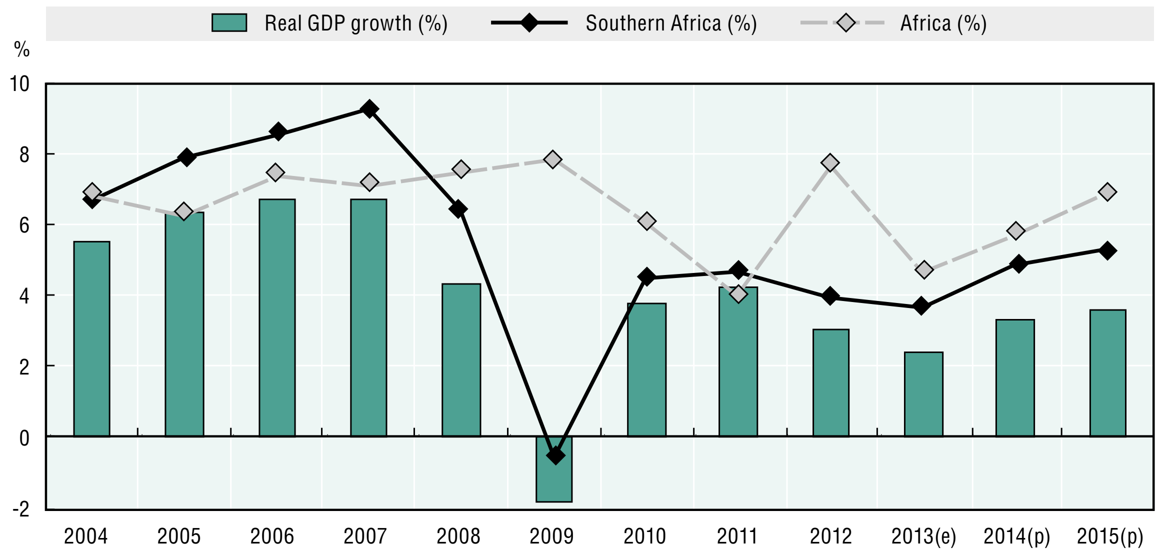
The labour unrest in South Africa that marked 2012 improved in 2013, proving to be less violent but more widespread, and it significantly affected output in the automotive and agricultural sectors. The slow pace of international economic growth also continued to limit South Africa's development. A year of low investment and ongoing efforts to reduce household debt have held this back further, with growth reaching 1.9% in 2013 compared with 2.5% in 2012. However, projections based on improvements to the global economy and the successful completion of major government projects (including the Medupi Power Station) suggest that growth could rise to 2.7% in 2014.

Unemployment and labour relations continue to pose challenges for the country. Unemployment remains high at 24.1% overall, and 64.8% for young people between the ages of 15 and 24. The government's newly launched employment tax incentive aims to address this challenge by encouraging private sector absorption of youth by subsidising the salaries of newly recruited workers aged between 18 and 29. However, the overall labour market remains constrained and labour unrest continued to reduce South Africa's output in 2013, especially in agriculture and manufacturing. Furthermore, output potential is constrained by a skills shortage, and calls are being made for further investment and reform of the poorly performing education system.

Broadly, the South African economy remained within the Reserve Bank's (SARB) target inflation range of 3%-6%, estimated at 5.7% in 2013. The South African rand (ZAR) remained under pressure in 2013, sliding 20% in value during the year. National government debt increased to 42.5% of gross domestic product (GDP) in 2012/13, up from 36.2% two years earlier.

In addition to functioning as an assembly hub for the automotive industry, South Africa has had some success in becoming a global supplier of components (seats and catalytic converters) capitalising on locally available skills and intermediate products. The Automotive Production Development Plan (APDP) that came into force in January 2013 is aimed at encouraging new investments in the industry, promoting use of local components and boosting annual production to 1.2 million vehicles by 2020. In the mining industry South Africa is an important global hub with deep backward vertical integration and a fully-fledged supply industry serving both South African and foreign companies that is an international player in its own right. Both South Africa's retail sector and its financial services industry are the most sophisticated on the continent and both have a significant regional presence.

Figure 1. **Real GDP growth**



Source: AfDB, Statistics Department AEO. Estimates (e); projections (p).

Table 1. **Macroeconomic indicators**

	2012	2013(e)	2014(p)	2015(p)
Real GDP growth	2.5	1.9	2.7	3.0
Real GDP per capita growth	1.7	1.2	2.0	2.3
CPI inflation	5.7	5.7	5.7	5.3
Budget balance % GDP	-4.2	-4.1	-4.1	-3.9
Current account balance % GDP	-5.2	-6.5	-6.4	-6.4

Source: Data from domestic authorities; estimates (e) and projections (p) based on authors' calculations.

Recent developments and prospects

After South Africa's initially promising recovery following the global economic crisis, real GDP growth peaked at 3.6% in 2011, sliding to 2.5% in 2012 and to 1.9% in 2013. Sluggish growth in South Africa's major European and North American trading partners combined with ongoing labour unrest and fading business and household confidence all underlay this performance. Nonetheless, the outlook for 2014 is more promising, but it hinges on the recovery in Europe gaining momentum and on the government's investment plans to address bottlenecks in electricity and transport being effectively implemented.

Despite progress, employment remains South Africa's most pressing social challenge. Official employment has recovered to its pre-recession level of 14 million full-time employees, with an unemployment rate of 24.1% (down from 25.5% in 2012), although youth unemployment remains high with 64.8% of those between the ages of 15 and 24 out of work (down from 66.3% in 2012). Job gains were largely driven by the public sector at local government level, although the service sector (retail and hospitality) also contributed.

Labour unrest continued to affect performance in the manufacturing, mining and agricultural sectors with the former being worst hit. The mining sector performed well despite union rivalries and the loss of 14 000 jobs at Amplats, the world's largest platinum producer. The sector expanded for the first time since 2011 posting 2.5% annual growth as iron ore and coal production largely offset platinum's decline. In the agricultural sector, violent strikes early in 2013 caused growth to collapse from 4% in 2012 to just 1.4% in 2013. It was on manufacturing however that labour unrest had the greatest impact. The automobile sector was worst hit with strikes in August and September resulting in a 75% quarterly fall in vehicle production and a 6.6% quarterly fall in total manufacturing output.

Services, which account for 25% of the South African economy, rose 2.6% in 2013, compared with 5% in 2012. Within services the finance and insurance, real estate and business sub-sectors lead with finance and retail in particular tapping into the more dynamic growth of the wider Southern African region.

The growth of gross fixed capital formation slowed to less than 3%, from its post-crisis peak of 5% in 2011 and pre-crisis average of 12% (2003-08). Sluggish public investment due to labour disputes at the Medupi power plant project and delays with spending on rail, road and port infrastructure accounted for some of this fall. However, the outlook for public investment is good. The new Medupi plant will boost electricity generation by 4 800 MW and another 3 725 MW is to be created by 2016 under the Department of Energy's Renewable Energy Independent Power Producers Programme (REIPP). Notably, with this programme private sector operators will be invited to participate in energy infrastructure, which is currently fully controlled by the state owned ESKOM. Higher electricity generation along with improved rail transportation capacities are crucial for overcoming the infrastructure bottlenecks that hamper the country's growth.

The private sector accounts for two-thirds of fixed capital formation. The bulk of the investments made target mechanisation and efficiency gains, expanding productive capacity, but limiting employment opportunities in a low growth environment. South African companies have significant cash reserves but report low confidence in both the current business cycle and political environment. The government replaced a number of bilateral investment treaties with general legislation with the intention of creating a level playing field for domestic and foreign investors. A much debated proposal for a new mining law that would have included export restrictions has been postponed until after the elections.

Under pressure from weaker growth, high unemployment and a significant debt burden, household consumption growth has slowed to less than 3%, posing a significant challenge to the consumption driven post-crisis recovery model. On the positive side, household indebtedness has decreased despite the challenging environment; debt-to-income ratios reached 75% in 2013, down from 82% in 2009. Unsecured lending remains low as a share of total bank assets, but continues to expand rapidly leading to fears about overleveraging of the poor.

The rand continued its downward trend reaching 11.1 rand to the US dollar at end January 2014, 20% lower than end 2012 and 66% below the peak in 2011. Despite this dramatic fall, the effect has been muted with importers and retailers absorbing much of the pressure and food and fuel prices increasing more slowly than could have been expected. However, the SARB increased the repo rate from 5% to 5.5% in late January 2014 in a bid to contain inflation. Exports might begin to benefit in 2014 if the exchange rate stabilises around current levels, replacing past volatility with the more stable environment firms prefer. Without such adjustment, the current account deficit is likely to widen somewhat.

The country's fifth national elections since democracy will take place in 2014. A victory by the African National Congress (ANC) led by President Jacob seems likely and no major policy changes are expected. Nevertheless some political fissures emerged in 2013 that may widen. First, tensions within the Tripartite Alliance, particularly between the labour unions (Congress of South African Trade Unions – COSATU) and the ANC have arisen over the planned youth employment subsidy programme and these are likely to intensify as unemployment continues to put pressure on politics. A more arm's length relationship between the ANC and labour seems likely. Second, Julius Malema's Economic Freedom Fighters (EFF) have emerged as a populist party proposing radical economic policies.

Table 2. **GDP by sector (percentage)**

	2008	2012
Agriculture, hunting, forestry, fishing	3.0	2.5
of which fishing	0.1	0.1
Mining	9.7	9.6
of which oil		
Manufacturing	16.8	12.1
Electricity, gas and water	2.3	3.0
Construction	3.6	3.7
Wholesale and retail trade, hotels and restaurants	13.4	16.2
of which hotels and restaurants	1.1	1.0
Transport, storage and communication	9.4	9.1
Finance, real estate and business services	21.6	21.2
Public administration, education, health and social work, community, social and personal services	5.3	5.7
Other services	15.0	16.9
Gross domestic product at basic prices / factor cost	**100.0**	**100.0**

Source: Data from domestic authorities.

Macroeconomic policy

Fiscal policy

South Africa's fiscal position, though fundamentally sound, saw a slight deterioration in the 2012/13 fiscal year. The government budget deficit rose from 3.6% in 2011/12 to 4.2% in 2012/13. Reasons for this include a lower than expected growth in tax revenue and slow (but steady) increases in government spending, albeit within the government's expenditure ceiling, on initiatives targeting economic recovery and job creation, all set against a backdrop of domestic structural challenges and an ailing global economy. Domestic borrowing, through a combination of Treasury bills and both fixed-income and inflation-indexed bonds, remains the primary source of funding for the budget deficit. Public expenditure grew by 8.4%, totalling ZAR 962 billion (29.9% of GDP), compared to a 13.4% increase in 2011/2. Total spending on social grants for the poor, which cover approximately 16.1 million individuals, amounts to 3.4% of GDP; this figure is expected to remain stable for 2013/4.

Public revenue grew by 6.3% in 2012/13, reaching ZAR 787 billion, compared to a 10.5% increase in the previous year. The budget deficit is projected to remain at 4.2% in 2013/4, with a slight decline to 4.1% projected in 2014/5. The primary deficit increased from 0.9% in 2011/12 to 1.4% in 2012/13. The wage bill remains the largest component of spending, reaching almost 36% of consolidated government expenditure in both 2011/12 and 2012/13. Contingent liabilities are set to grow from an estimated ZAR 373.2 billion in 2012/13 to ZAR 399 billion in 2013/14, due mainly to investments in public infrastructure contained in the government's medium- and long-term development strategy. Approximately 52% of these projected contingent liabilities are set to come from guarantees given by the government to public enterprises to enable them to raise infrastructure investment funds from the debt market. Public sector spending on infrastructure accounted for almost 8% of GDP in 2012/13, and is projected to increase in the medium term with government plans for infrastructure investment and job creation. The government plans to invest more than ZAR 827 billion on infrastructure over the medium term, and approximately ZAR 4 trillion over the next 15 years to 2028.

Three principles continue to guide the design and implementation of fiscal policy: long-term public debt sustainability, counter cyclicality, and intergenerational equity. Budget support from foreign donors is not significant, with foreign aid accounting for less than 1% of South Africa's budget.

Table 3. **Public finances (percentage of GDP)**

	2005	2010	2011	2012	2013(e)	2014(p)	2015(p)
Total revenue and grants	**25.5**	**27.7**	**28.2**	**27.8**	**28.2**	**28.2**	**28.2**
Tax revenue	24.9	25.3	25.4	25.8	26.0	26.0	26.0
Grants	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Total expenditure and net lending (a)	**25.8**	**32.1**	**32.1**	**32.0**	**32.2**	**32.3**	**32.1**
Current expenditure	25.7	29.3	29.9	29.7	29.9	29.7	29.6
Excluding interest	22.6	26.8	27.4	27.0	27.2	27.1	27.0
Wages and salaries	8.7	11.3	11.6	11.7	11.5	11.2	11.0
Interest	3.2	2.4	2.6	2.8	2.6	2.6	2.6
Capital expenditure	1.3	2.0	2.1	2.2	2.3	2.4	2.4
Primary balance	**2.8**	**-2.0**	**-1.4**	**-1.4**	**-1.4**	**-1.4**	**-1.3**
Overall balance	**-0.3**	**-4.4**	**-3.9**	**-4.2**	**-4.1**	**-4.1**	**-3.9**

Note: a. Only major items are reported.
Source: Data from domestic authorities; estimates (e) and projections (p) based on authors' calculations.

Monetary policy

The primary objective of monetary policy in South Africa is achieving price stability. The South African Reserve Bank (SARB) increased the discount rate by 50 basis points to 5.5% at the end of January 2014, following the tapering of the US Federal Reserve's (FED) quantitative easing programme. The rate hike was the first in six years, and came as something of a shock to the economy. In spite of the historically low interest rate, private sector demand for credit remains subdued, increasing by 8.2% in August 2013 from 7.8% in August 2012. At the end of 2013 the private sector (including households) accounted for approximately 98% of total domestic credit (ZAR 2.6 trillion). Growth in broad money (M3) declined from 7.8% in August 2012 to 6.9% in August 2013.

The private sector has good access to credit, and South Africa was ranked 1st out of 185 countries in the World Bank's report *Doing Business 2013* with regards to obtaining credit. South Africa also possesses a developed stock market and the 18th largest stock exchange in the world, the Johannesburg Stock Exchange (JSE), which anchors private sector investment and growth both within South Africa and across the region.

South Africa operates a floating exchange rate system but the SARB intervenes in the foreign exchange market by relaxing exchange controls and increasing foreign currency reserves in an effort to minimise the adverse impact of excess short-term capital flows and currency volatility. SARB uses reserve accumulation as an instrument to manage international liquidity, rather than employing it as an instrument in exchange rate policy.

Headline inflation breached the upper limit of the policy range in July and August 2013, reaching 6.3% and 6.4% respectively, but fell back to 5.5% in October 2013. Core inflation also increased to 5.1% in August 2013, compared to 4.7% in August 2012. In order to contain these inflationary pressures the SARB increased the repo rate from 5% to 5.5% in late January 2014.

Between March and June 2013 the rand depreciated by 8.9% against the euro and 7.2% against the US dollar, whilst the nominal effective exchange rate (NEER) depreciated by 6.8% during the same period. The rand remained volatile during the third quarter due to a widening current account deficit, domestic labour disputes and capital flight from emerging markets. However, the decline in the rand's real effective exchange rate (REER) of 12% between June 2012 and June 2013 served to enhance South Africa's external price competitiveness.

Economic co-operation, regional integration and trade

South Africa is a member of various regional and sub-regional groupings including the Common Monetary Area, Southern African Customs Union, Southern African Development Community (SADC), and the African Union. South Africa dominates the region economically, accounting for 41% of all SADC trade and about 63% of its combined GDP. It is also a member of BRICS (Brazil, Russia, India, China and South Africa), an association of five fast-growing and emerging economics, which accounts for 25% of global GDP and 40% of global population.

In the first 11 months of 2013, exports rose to the value of ZAR 846 billion over ZAR 817 billion in 2012 boosted by the rand's deterioration (of 15.2% in the 18 months to September 2013), while imports increased to ZAR 921 billion up from ZAR 852 billion. As a result the trade deficit almost doubled, going from ZAR 40 billion in 2012 to over ZAR 74 billion in 2013. The current account deficit is estimated to reach 6.5% in 2013, compared to 5.2% in 2012. For the first 11 months of 2013 the top four export commodities were gold, iron ores and concentrates, coal, and platinum. The primary imports were petroleum, original equipment components, electrical machinery, equipment, vehicles and accessories. Emerging markets and the Euro area economies are the key drivers in the demand for commodities. Foreign direct investment (FDI) revenues increased from ZAR 37.5 billion in 2012 to ZAR 47.4 billion in the third quarter of 2013. The key recipient sectors included mining, pharmaceuticals, automotive equipment, financial services and, most recently, renewable energy. Investments originated from BRICS (China and India in particular), as well as Europe and the United States. Despite South Africa's poor economic performance in recent years, short-term capital flows also remained strong, reaching ZAR 95 billion in 2012. Aid remains insignificant, amounting to less than 0.8% of South Africa's budget.

Table 4. **Table 4 - Current account (percentage of GDP)**

	2005	2010	2011	2012	2013(e)	2014(p)	2015(p)
Trade balance	-0.1	1.9	1.6	-1.3	-2.5	-3.1	-3.4
Exports of goods (f.o.b.)	22.8	24.6	26.9	26.0	28.1	30.0	26.5
Imports of goods (f.o.b.)	22.9	22.7	25.3	27.2	30.6	33.1	29.8
Services	-0.3	-1.2	-1.2	-1.5	-0.7	-0.5	-0.2
Factor income	-2.0	-2.0	-2.3	-1.8	-2.2	-1.9	-1.9
Current transfers	-1.0	-0.6	-0.5	-0.7	-1.0	-0.9	-0.8
Current account balance	**-3.5**	**-2.0**	**-2.3**	**-5.2**	**-6.5**	**-6.4**	**-6.4**

Source: Data from the Central Bank and domestic authorities; estimates (e) and projections (p) based on authors' calculations.

Debt policy

Between March and June 2013, the government's domestic debt increased by ZAR 70 billion, from ZAR 1.24 trillion to ZAR 1.31 trillion. Domestic debt continued to contribute overwhelmingly to the government's debt portfolio, accounting for 92% of total debt at the end of June 2013. Foreign debt fell from USD 140.6 billion to USD 130.4 billion in the second quarter of 2013, chiefly due to the increase in rand-denominated debt. At the end of June 2013, external debt amounted to 35.4% of GDP, or 111.5% of export earnings. Total gross loans (domestic and foreign) increased from ZAR 1.36 trillion to ZAR 1.49 trillion between March and September 2013, rising from 42.7% to 44.7% of GDP.

The government's debt management strategy forms part of broader fiscal sustainability policy and net borrowing targets for foreign and domestic borrowing are set with a three-year perspective. This strategy aims to keep the cost of debt as low as possible, ensure access to domestic and international financial markets, diversify funding instruments, and encourage the continued development of liquid capital markets in South Africa.

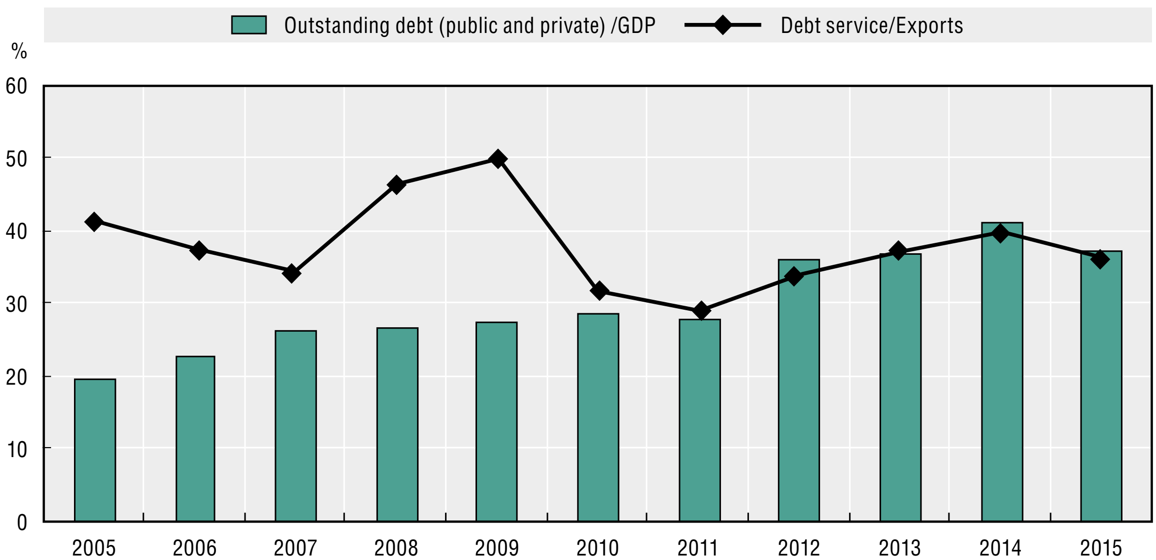
The National Treasury monitors debt sustainability with a benchmark range of 20-25% of GDP, and an interest rate risk benchmark of 70% versus 30% for fixed versus floating domestic debt.

Other risk factors it assesses include the currency composition of the debt, contingent liabilities, and the sovereign rating by credit rating agencies.

According to the 2013 International Monetary Fund's (IMF) Article IV report, South Africa's high bond spread, budgeting requirements and significant non-resident bond holdings pose risks to an otherwise manageable debt level. Public debt is expected to stabilise at around 47%

of GDP in 2018/19, up from its current 2012/13 level of 42.5%. In addition, debts held by state-owned enterprises are expected to continue increasing. These and rising deficits will raise gross financing requirements. In light of this, the IMF has advised the government to reduce its debt-to-GDP ratio to 40% by 2020.

Figure 2. **Stock of total external debt (percentage of GDP) and debt service (percentage of exports of goods and services)**



Source: IMF (WEO & Article IV).

Economic and political governance

Private sector

South Africa's regulatory climate is regarded as one of the most conducive to business in Africa and the country ranked 41st out of 189 countries in the World Bank report *Doing Business 2014*. In Africa, only Mauritius and Rwanda ranked higher. However, it remains one of the most difficult countries in the region for conducting cross-border trade (ranking 106th out of 189) but ranks 24th in terms of ease of paying taxes with a burden of 200 hours and 7 tax payments. The same report states that South Africa ranks 10th globally and 1st in the Southern African region in terms of protecting investors.

In 2013, the Department of Trade and Industry introduced a new business licencing bill repealing the Business Act of 1991 and aiming to establish national norms and simplify procedures for obtaining business licences. The bill calls for businesses to obtain licences from local municipalities, a stipulation which is a cause of concern for some, who point out that the limited capacities and high levels of red tape amongst local governments may create further challenges for businesses.

Competition in the private sector goods market remains weak. The 2013/14 *Global Competitiveness Report* ranked South Africa 45th out of 148 countries in terms of the intensity of local competition, and 8th for the effectiveness of its anti-monopoly policy. The report also stated that the six most problematic factors for doing business in South Africa are: *i*) an inadequately educated labour force; *ii*) restrictive labour regulations; *iii*) inefficient government bureaucracy; *iv*) corruption; *v*) a poor work ethic in the national labour force; and *vi*) inadequate infrastructure.

Financial sector

South Africa has a well-developed financial sector with assets worth over ZAR 6 trillion that contributes 10.5% of GDP. The sector employs 3.9% of the labour force and is responsible for 15% of the corporate income tax bill. Within this measured in August 2013, the banking sector accounted for ZAR 3.8 trillion. Year-on-year, return on equity rose by 16.23% to August 2013 with gross loans also up 10.6% from ZAR 2.6 trillion in August 2012 to ZAR 2.9 trillion in August 2013. Deposits increased by 8.5% over the same period from ZAR 2.7 trillion to ZAR 3 trillion. The loans-to-deposit ratio therefore remained stable at about 96% in both 2012 and 2013.

The non-banking financial sector, including long- and short-term insurance, public and private pension funds, and unit trusts (amongst other services) is also well developed. By third-quarter 2013, this sector's assets increased by 19% year on year.

South Africa's financial stability indicators remain strong. Nonetheless the rapid expansion of non-secured lending to households which currently accounts for about 12% of total banking exposure has increased credit risk, although bank capital is well above the regulatory minimum and profitability remains strong. Domestic banks are already capitalised above the new Basel III levels and are currently operating with an average capital adequacy ratio of 15.9%, above the minimum prudential requirement of 9.5%. Total capital adequacy was 14.75%, while Tier 1 capital adequacy was 11.74% in August 2013. South Africa was amongst the first ten of the 27 Basel Committee member countries to have adopted Basel III on schedule by January 2013. Due to the sluggish economic recovery the ratio of Non-Performing Loans (NPLs) reached 4.6% in 2012. The liquidity ratio of banks also declined from 197.8% in August 2012 to 184.7% in August 2013.

South Africa was ranked 3rd out of 148 countries in terms of financial market development by the 2013/14 *Global Competiveness Report*. In spite of this, about one-third of the adult population does not have a bank account, and millions more have only limited access to formal financial services.

Public sector management, institutions and reform

According to the 2012 Open Budget Survey, South Africa has the second most transparent budget system in the world with consistent, transparent and detailed budget documents. The 2013 budget was fully aligned with the National Development Plan adopted in August 2012 that aims to address the triple challenges of poverty, inequality and unemployment. However laudable this transparency, it has not translated into improvements in service delivery in rural areas and informal settlements.

Guided by the Public Finance Management Act, public accounts are prepared, audited and submitted to the legislature in a timely fashion. There is a sound internal audit and control system in government departments, which is closely co-ordinated by the audit committee, the national treasury and the auditor-general. Due to improved controls, the 2012/13 audits of national and provincial departments and public bodies resulted in 81 public entities and 24 departments – 22% of the 450 departments and public entities for which audits were finalised by 31 August – being given clean audit reports. This was up from 17% in 2011/12 and 20% in 2010/11.

Nonetheless, the perception of corruption has deteriorated in recent years. South Africa is ranked 72nd out of 177 countries in the 2013 Transparency International *Corruption Perceptions Index*, compared to 69th out of 176 countries in the 2012 index. South Africa now ranks as the 9th least corrupt country in Africa, below Lesotho and Rwanda. The government has put mechanisms in place to fight corruption, including the creation of the independent Public Protector Office, which has investigated a number of high profile corruption cases in recent years, leading to effective sanctions.

Natural resource management and environment

South Africa adopted a National Climate Change Response Policy (NCCRP) at the end of 2011. The main objectives of the policy are: *i*) to effectively manage the impact of climate change through interventions that build and sustain South Africa's social, economic and environmental resilience and emergency response capacity; and *ii*) to make a fair contribution to the global effort to stabilise greenhouse gas emissions within a timeframe that enables economic, social and environmental development to proceed in a sustainable manner. The NCCRP envisages cutting CO_2 emissions by 34% over the next decade by introducing emission caps on the major polluters.

Although South Africa made some progress in achieving the targets of Millennium Development Goal (MDG) 7 pertaining to environmental sustainability, most notably by halving the proportion of people without sustainable access to safe water, it is unlikely to achieve all of its indicators on schedule by 2015. The country is lagging behind in a number of areas including reducing CO_2 emissions, protecting fish stocks, increasing access to basic sanitation and reducing the number of people living in informal dwellings. Currently an estimated 1.2 million households exist in informal settlements. The proportion of forested surfaces, a key indicator for environmental sustainability, is 36.6%. South Africa is a water-stressed country and equitable water conservation remains crucial.

In 2011 the South African Revenue Service (SARS) assessed income tax from mining and quarrying to be approximately ZAR 15 billion, or 11% of total tax revenue. Mining and petroleum royalties remain recent additions to SARS' revenue stream as they were only introduced in March 2010 following the adoption of the Mineral and Petroleum Resources Royalty Act of 2008.

Political context

The passing of former president and national icon Nelson Mandela on 5 December 2013 brought together South Africans and the international community in an impressive show of tribute and mourning. It also served as a moment of national reflection on the mounting challenges facing the political leadership as unemployment runs high, labour relations have turned increasingly violent and reports of graft and corruption in the political class have been mounting.

Tensions have emerged in the tripartite alliance between the ANC, COSATU and the South African Communist Party (SACP). In December 2013, the president signed the employment tax incentive bill into law amid stiff opposition from the trade unions. Tensions will likely increase as the challenge of unemployment continues to exert great pressure on politics and the labour movements continue to fragment, as seen in the mining sector.

Current predictions see the ANC winning the election in May 2014, against a strengthening opposition. The Economic Freedom Fighters, founded by Julius Malema following his expulsion from the ANC, have emerged as a populist party. Agang, on the other hand, a party led by former World Bank Managing Director and successful businesswoman Mamphela Ramphele, seemed to flounder shortly after its establishment in February 2013. While the main opposition party, the Democratic Alliance won 17% of the vote in the last election, it still struggles to shed its image as a party for "white" interests, a major political handicap.

Social context and human development

Building human resources

South Africa's performance in addressing under-five mortality and ensuring universal access to reproductive healthcare remains weak. According to the November 2011 Department of Health report, the maternal mortality ratio and under-five mortality were 310 per 100 000 and 56 per 1 000, respectively. These figures compare poorly with the MDG 5 target to reduce maternal mortality and under-five mortality to under 38 per 100 000 and 20 per 1 000 by 2015. The national incidence of severe malnutrition averaged 7.8% and studies indicate a rising trend in child mortality in recent years. Health service coverage is about 70.7%, whilst only 17.9% of the population belonged to a medical aid scheme in 2012. South Africa therefore is unlikely to achieve the MDG 4 and 5 goals by 2015.

On 1 April 2013 South Africa launched a new one pill, single dose ARV treatment for HIV/AIDS patients. Currently, about 2 million of the 6.4 million people who live with HIV/AIDS in South Africa have access to ARV treatment and the government plans to expand access to 2.5 million patients by 2014 and an additional 1.5 million by 2017.

South Africa has cut the mortality rate from malaria by 85% during the past 12 years through the use of a controversial pesticide, DDT. The risk of infection had fallen to less than 1 per 1 000 by 2012. In spite of the reported side effects of DDT, the country aims to continue on course and fully eradicate malaria by 2018.

The Early Childhood Development (ECD) programme remains a very important educational priority in South Africa. In 2012, 37% of children under the age of four attended ECD institutions compared to 34.5% in 2011. South Africa has in effect achieved MDG 2 pertaining to universal access to primary education in advance of the 2015 deadline, a considerable accomplishment given that almost 30% of the population is of primary school age (under 13 years of age). School attendance for those aged 7-13 had reached 98.4% for boys and 98.8% for girls in 2009. The primary school gross enrolment rate in 2009 was 102%. However, only 2.8% of black Africans aged 18 to 28 were studying at tertiary institutions in 2012 compared to 17.2% of white South Africans in the same age group.

Education outcomes continue to improve, with greater access to educational facilities and services. Nevertheless, the quality of education still remains poor, particularly in disadvantaged black schools. The World Economic Forum in its *Global Information Technology Report 2013*, ranked South Africa 143rd out of 144 countries for the quality of maths and science education, and 139th for the overall education system below several low-income African countries.

Poverty reduction, social protection and labour

The South African government has adopted a comprehensive safety net programme to target extreme poverty and hunger. By 2012, 29.6% of the population received a social grant (up from 12.7% in 2003) with children accounting for 70% of these individuals. In 2011, over 10.4 million children under the age of 18 received a child support grant, which in total accounts for 36% of total grant expenditure. In 2012, approximately 15 million people and 37.4% of black Africans received grants. Social spending is estimated to account for 58% of government expenditure in 2012, increased from 49% a decade ago. In addition to social grants, the government funds largely free services such as public health facilities, free schools (provided for approximately 60% of students in 2011), and housing, water and electricity in poorer communities. The average value of a social grant for a family of four in 2012/13 was ZAR 3 940 per month. Social support thus marks a substantial contribution to household budgets and is financed and informed by a progressive tax system. The government had built 1.5 million free homes to house the poor since 2012.

The correlation between unemployment and poverty persists in South Africa. At 41%, the country has one of the lowest labour force participation rates in the world, and unemployment is currently at 24.7% (or 34% including 'discouraged workers' who are unemployed but not seeking work), with youth unemployment (15-34 year olds) at 50%[1]. In spite of a 3% increase in GDP employment only rose by 0.8% during the 2010-12 period. Since 2009, net job creation has been primarily in the public sector, whilst the private sector has only managed to recover around two-thirds of jobs lost during the financial crisis. The disparity between the skills provided by education and job requirements continues to be a primary cause of unemployment. The Labour Relations Amendment Bill was adopted by parliament on 20 August 2013 in a bid to introduce major changes to labour relations.

The main instrument of the government's effort to boost employment is the Expanded Public Works Program (EPWP). By the end of the 2012/13 financial year more than 3 million work opportunities had been created by the EPWP since the start of the second phase in 2009/10. Additionally since 2012 the incentive grant model was revised, giving rural municipalities easier access to grants in order to increase labour-intensive work opportunities through EPWP projects. The programme surpassed its targets, aiming for a 55% participation rate for women and 40% for youths, it achieved 60% and 50%, respectively. The EPWP has near comprehensive reach, with 277/278 municipalities implementing the programme by 2012/3.

Gender equality

South Africa has made significant progress in addressing gender disparities in health and education. A tremendous improvement has been made with regard to girls' participation in secondary school, with the ratio of female to male enrolment reaching 104.8% in 2009. Around 63.3% of women aged 25 years or older had received at least secondary education.

In September 2013, 51% of the 4.6 million unemployed were women, putting the unemployment rate amongst women at 26.7% (and 23.1% for men). Figures in 2012 suggested that 61% of women were living in poverty, and 31% in destitution, compared to 39% and 18% of men, respectively.

Perhaps the most visible facet of the country's success in improving gender equality is that of politics. In 2012, women held 45% of seats in the national parliament, making South Africa the second best country in Africa for female political representation after Rwanda. Moreover, figures from 2012 show that 39% of cabinet ministers were female. Female representation currently stands at 42.4% in provincial legislatures and 40% in local government. However, more needs to be done to improve the lives of rural black women, and violence against women remains very high.

Thematic analysis: Global value chains and industrialisation in Africa

South Africa is integrated into several global value chains (GVCs), particularly in the automobile, mining, finance and agriculture industries. It may be unique in Africa in possessing the efficiency and scale to drive a global value chain. As the largest African economy it is also an important regional hub, and South Africa increasingly capitalises on regional value chains, especially in retail, finance and telecommunications.

According to the joint OECD-World Trade Organization (WTO) Trade in Value Added database, South Africa ranks 2nd amongst the BRICS countries in terms of the content of foreign value added to exports. China's exports contain 37% of foreign value added, whilst South Africa's contain 16%, ahead of those coming from Brazil, India and Russia with 15% or below. In terms of specific industries, in South Africa, the automotive industry adds the most value to exports at 40%, whilst finance, retail and mining are the lowest at less than 10%.

These data reflect the position of South African operations in global value chains. In the automobile value chain, South Africa serves as an assembly hub for Africa and for right-hand steering. Some of the models produced in South Africa are also exported to the US market. The large assembly presence has also come to attract component manufacturers too that produce parts alongside the automobile plants. These component and car manufacturers are large international firms that own the core elements of the value chain all the way from research and development through assembly, marketing, distribution and after-sales services. Consequently, many intermediary products are imported for assembling in South Africa. Experience working with the local assembly lines has enabled local firms to become exporters of several components, of which catalytic converters and leather seats have been prominent in the recent past. South Africa's automotive industry accounts for more than 6% of its GDP and 12% of its manufacturing exports.

The high value of domestic content in mining exports reflects the industry's long history, local ownership and extensive backward integration into the wider South African economy. In 2012, mining contributed ZAR 468 billion to South Africa's economy. The impact of the mining industry on other sectors (steel, timber and rail, for example) is close to 19% of South Africa's GDP. Additionally, mining accounts for over 16% of formal sector employment. Recent cost figures from the mining industry indicate that of the ZAR 437 billion spent in 2011, purchases and operating costs for steel, timber, electricty, rail, etc. accounted for the largest proportion of total expenditure, followed by wages at ZAR 89 billion and capital expenditure at ZAR 47 billion.

The finance from mining circulates throughout the economy, affecting sectors as diverse as financial services and housing. The mining services and equipment sectors have developed into important exporters in their own right. Indeed, South African suppliers are global leaders in numerous areas, particularly the provision of washing spirals, underground locomotives, submersible pumps, hydropower equipment and mining fans. South African firms are also leaders in some of the vast mining services including geological services, prospecting, shaft sinking, turnkey solutions to the mining and mineral processing industries, and operation services. They are also competitive on a global scale when it comes to the four vital areas of mine safety, tracked mining, shaft sinking and ventilation. Development in these areas is strong and considered much greater than in comparable countries such as Chile or Australia. According to the South African Capital Equipment Export Council (SACEEC), one of South Africa's largest exports is mining equipment, accounting for 8.5% of total exports from 2005-09, and 55% of capital equipment exports during the same period. It is estimated that 90% of the exports of the mining equipment and specialist services are local content. Mining houses are clustered around Johannesburg and supply industries around East Rand. Mining equipment and specialist services have not received any direct government subsidy at any stage in their development.

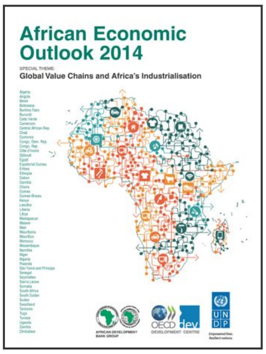
South Africa's finance and retail industries also have deep value chains, and have an expanding presence in other African countries. The four major banks are well established, offering a full and comprehensive range of banking services and are amongst the top players on the continent. South African retailers are similarly branching out into neighbouring countries leading the supermarketisation of retail there. These regional value chains offer important opportunities to create value in key industries, boost employment opportunities, and improve economic growth.

South Africa's advantages in global value chains pertain to skills (especially experiential skills), well established companies with leading products and competencies, public research linked to firms, sophisticated customers, well-developed and dense networks of local supply industries and services and geographical clustering. However, these advantages must be maintained and some are not being further developed. There are skills shortages at every level, particularly amongst engineers and artisans, with many firms stating that standards are declining. Publicly funded research has fallen significantly. Global value chain-related activities are ignored in South Africa's innovation policies and there is less research and declining links between firms and science councils. Companies increasingly see their major areas of operation outside the country, and regard South Africa as a less attractive place from which to direct and administer global value chain investments. The lack of new investments in global value chains in South Africa is reducing the overall size and impeding the prospects for technological advancement for local suppliers.

Improving the capacity of specific value chains, and on a globally competitive scale, is a critical part of an important diversification strategy. South Africa would stand to benefit from the diversification promoted by linkages and spillovers between industries. In order to increase the depth of value chains, measures that target skills development, expansion of technological capabilities and access to capital are essential.

Note

1. South Africa defines young people as 15-34 years. The international definition of young people is 15-24 years. The unemployment rate for this group is almost 65%.



From:

African Economic Outlook 2014

Global Value Chains and Africa's Industrialisation

Access the complete publication at:

https://doi.org/10.1787/aeo-2014-en

Please cite this chapter as:

African Development Bank/OECD/United Nations Development Programme (2014), “South Africa”, in *African Economic Outlook 2014: Global Value Chains and Africa's Industrialisation*, OECD Publishing, Paris.

DOI: https://doi.org/10.1787/aeo-2014-57-en