Western Cape

# PROVINCIAL ECONOMIC REVIEW & OUTLOOK 2006

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# Foreword

Our Provincial Growth and Development Strategy (PGDS) – *iKapa Elihlumayo* – sets out a clear vision that steers us towards shared growth and integrated development in the Western Cape by 2015.

Based on four key pillars: growth, equity, empowerment and environmental integrity, *iKapa Elihlumayo* recognises the need to fundamentally change the social, economic and human landscape of our Province if we are to realise a better life for all.

In line with the PGDS, the 2006 Provincial Economic Review & Outlook (PER&O) stresses the importance of defining the desired form of growth that Government seeks to stimulate. That is, the 2006 PER&O builds a deeper understanding of what shared growth and integrated development means for the Province.

The above draws on a complementary concept of *shared responsibility*, particularly in respect of *enhancing the provincial-local nexus.* Inter-linkages between provincial and local socio-economic trends and dynamics within the Western Cape, and how these contribute towards the Province's vision of shared growth and integrated development are important here.

The 2006 PER&O contains an executive summary of the detailed socio-economic profiles of 30 municipalities in the Western Cape that are set out in a separate publication, *2006 Socio-economic Profiling of Local Government in the Western Cape* (SEP-LG), to be published shortly after the 2006 PER&O.

Many may ask, 'what is new about shared growth and integrated development?'

First, it recognises that economic growth that is accompanied by improved social equity will have a greater impact on reducing poverty than growth that leaves distribution unchanged. This means that a shared growth and integrated development strategy, such as *iKapa Elihlumayo*, must constantly endeavour to balance growth and social equity concerns.

Secondly, it highlights that increased social inequality can offset the benefits of growth to the poor, reducing the poverty impact of future growth.

Thirdly, it emphasises that growth has to be environmentally sustainable, and particularly so in the Western Cape, in order to have medium- to long-term benefits for reduced poverty and improved livelihoods.

The Province's vision for shared growth and integrated development therefore proposes a fundamentally different trajectory that takes cognisance of these linkages between economic growth, social equity and environmental sustainability.

In his 2006 State of the Nation Address, President Thabo Mbeki drew on the words of his predecessor, former President Nelson Mandela in saying "*…we must seize the time to define for ourselves what we want to make of our shared destiny*".

As South Africa enters its age of hope, we choose a path of shared growth and integrated development that makes a better place for and brings a brighter future to all of those who live in the Western Cape.

Our choice is ambitious. At times it may be difficult to achieve. But it is our choice. It defines our future. With passion and realism, we will succeed!

The 2006 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 in 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 led the 2006 PER&O, supported by Lucille Gavera of Trade & Industrial Policy Strategies (TIPS) as the project manager. Input chapters were prepared by Pieter Laubscher, Bureau for Economic Research (BER), University of Stellenbosch; Jo Lorentzen of the Human Science Research Council (HSRC); and Mornè Oosthuizen and Carlene van der Westhuizen, Development Policy Research Unit (DPRU).

The 2006 SEP-LG and the executive summary presented in the 2006 PER&O are the work of Provincial Treasury's Economic Analysis team. Led by Bulelwa Boqwana, the team includes Wendy Mapira, Kim Engel, Hassan Essop and Esther Mohube, and was assisted by Alta Fölscher, an independent consultant.

The PER&O team held five focus group workshops that debated the technical form and content of the base analyses. The workshops drew on the technical expertise and experience of the research team and key academics, including Ben Smit, BER, University of Stellenbosch; David Kaplan, Graduate School of Business (GSB), University of Cape Town; Mike Morris and Charles Meth, School of Development Studies, University of KwaZulu-Natal; Haroon Bhorat, DPRU, University of Cape Town; and Ingrid Woolard and Anna McCord, South African Labour and Development Research Unit (SALDRU), University of Cape Town.

Other key partners that participated at the focus groups included Glynn Davies, Frank Mabuza and Nico Meyer, Development Bank of Southern Africa (DBSA); Simon Nicks, CNdV Africa; Claude van der Merwe, Quantec Research; Paul Lundall, independent consultant; Joyce Lestrade Jefferis and Yandiswa Mphetsheni, Statistics South Africa; Nicolette Burger and Karlien Chaplin, INCA; Carin Fouché and Riefqah Jappie, Wesgro; Theo van Rensburg, National Treasury; Gavin Miller, Department of Social Services; Fayruz Dharsey and Desi Angelis, Department of Economic Development and Planning;

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Sue Parnell, Environmental Planning, University of Cape Town; Jacqui Boulle, Rae Wolpe and Ken Briggs, independent consultants; and Carol White from the City of Cape Town provided further comments and inputs on the final document.

I wish to thank the entire team for the 2006 PER&O. Its excellence defines the impact that it will surely have on policy debate as we work together towards a better life for all in the Western Cape.

Lynne Brown
Minister of Finance and Tourism
March 2006

# Contents

## Foreword

## Chapter 1: Executive Summary



## Chapter 2: Economic Outlook 2006/07 – 2008/09

## Chapter 3: Sectoral Growth and Employment Prospects

## Chapter 4: Employment Dynamics

# Chapter 5: Socio-economic Profiling at the Local Level

# Chapter 6: Western Cape's Recent Growth Experience

1. Western Cape growth experience: shared or uneven?
2. Growth and poverty dynamics
3. Has growth in the Western Cape been pro-poor?
4. The impact of growth and equity on poverty in the Western Cape
5. Shifts in access to selected services in the Western Cape
6. Shared growth diagnostic for the Western Cape
7. Conclusion

# Abbreviations

| | |
|---|---|
| AGOA | African Growth and Opportunity Act |
| ASGISA | Accelerated and Shared Growth Initiative for South Africa |
| ASSA | Actuarial Society of South Africa |
| BEE | Black Economic Empowerment |
| BER | Bureau for Economic Research |
| BOP | Balance Of Payments |
| BPO | Business Process Outsourcing |
| BRIC | Biotechnology Regional Innovations Centre |
| CAPS | Cape Area Panel Study |
| CARE | Centre for Actuarial Research (University of Cape Town) |
| CDI | City Development Index |
| CPI | Consumer Price Index |
| CPIX | Consumer Price Index (excluding mortgage interest rates) |
| CS | Community Survey (Statistics South Africa) |
| CSP | Community, Social and Personal (Services) |
| CSSR | Centre for Social Science Research (University of Cape Town) |
| DBSA | Development Bank of Southern Africa |
| DST | Department of Science and Technology (South Africa) |
| EAP | Economic Active Population |
| EAR | Employment Absorption Rate |
| ECB | European Central Bank |
| ECD | Early Childhood Development |
| EU | European Union |
| FDI | Foreign Direct Investment |
| FET | Further Education and Training |
| FTA | Free Trade Agreement |
| GDE | Gross Domestic Expenditure |
| GDFI | Gross Domestic Fixed Investment |
| GDP | Gross Domestic Product |
| GDPR | Regional Gross Domestic Product |
| GGP | Gross Geographic Product |
| GHS | General Household Survey (Stats SA) |
| GVA | Gross Value Added |
| HSRC | Human Sciences Research Council |
| HDI | Human Development Index (UNDP) |
| HIV/AIDS | Human Immunodeficiency Virus/Acquired Immune Deficiency Syndrome |
| HS | Harmonised Commodity Description and Coding System |
| 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 |
| ITC | International Trade Centre |
| LFPR | Labour Force Participation Rate |
| LFS | Labour Force Survey (Stats SA) |
| MEDS | Microeconomic Development Strategy |
| MIDP | Motor Industry Development Programme (South Africa) |
| MIG | Municipal Infrastructure Grant |
| MPRS | Marginal Proportional Rate of Substitution |
| MRC | Medical Research Council (South Africa) |
| MVA | Manufacturing Value Added |
| NEPAD | New Partnership for Africa's Development |
| NIC | Newly Industrialised Country |
| NPA | National Ports Authority |
| NRF | National Research Foundation (South Africa) |
| NSI | National System of Innovation |
| OECD | Organisation for Economic Co-operation and Development |
| OHS | October Household Survey (Stats SA) |
| OPEC | Organisation of the Petroleum Exporting Countries |
| PGDS | Provincial Government and Development Strategy |
| PIMD | Provincial Index of Multiple Deprivation |
| PMI | Purchasing Managers Index |
| PPI | Producer Price Index |
| PPP | Public Private Partnership |
| PPP | Purchasing Power Parity |
| PSLSD | Project for Statistics on Living Standards and Development |
| R&D | Research and Development |
| ROI | Return on Investment |
| SA | South Africa |
| SALDRU | South African Labour Development Research Unit |
| SAPO | South African Ports Authority |
| SAPS | South African Police Service |
| SAR | Special Administrative Region (Hong Kong) |
| SARB | South African Reserve Bank |
| SDF | Spatial Development Framework |
| SEE | Survey of Employment and Earnings (Stats SA) |
| SIC | Standard Industrial Classification |

| | |
|---|---|
| SIP | Strategic Infrastructure Plan |
| SITC | Standard International Trade Classification |
| SMME | Small, Medium and Micro Enterprise |
| STATS SA | Statistics South Africa |
| TGR | Target Growth Rate |
| the dti | The Department of Trade and Industry (South Africa) |
| TIPS | Trade & Industrial Policy Strategies |
| TRIPS | Trade-related Intellectual Property Rights |
| UCT | University of Cape Town |
| UIF | Unemployment Insurance Fund |
| UK | United Kingdom |
| UNCTAD | United Nations Conference on Trade and Development |
| UNDP | United Nations Development Programme |
| UNICEF | United Nations Children's Fund |
| UNIDO | United Nations Industrial Development Organization |
| US | United States |
| VAT | Value-Added Tax |
| WATCP | Western African Trade Corridor Programme (Wesgro) |
| WCED | Western Cape Education Department |
| WCO | World Customs Organisation |
| WTO | World Trade Organisation |

# Tables

## Chapter 1: Executive Summary



## Chapter 2: Economic Outlook 2006/07 – 2008/09



## Chapter 3: Sectoral Growth and Employment Prospects



## Chapter 4: Employment Dynamics

## Chapter 5: Socioeconomic Profiling at the Local Level

## Chapter 6: Western Cape's Recent Growth Experience

# Figures

## Chapter 1: Executive summary



## Chapter 2: Economic Outlook 2006/07 – 2008/09



## Chapter 3: Sectoral Growth and Employment Prospects

## Chapter 4: Employment Dynamics



## Chapter 5: Socioeconomic Profiling at the Local Level



## Chapter 6: Western Cape's Recent Growth Experience

1

# Executive summary

## 1. Shared growth and integrated development

Three years ago, as part of its new vision, *iKapa Elihlumayo: A Home for All*, the Provincial Government charted a new course to fundamentally change the social, economic and human landscape of the Western Cape.

*iKapa Elihlumayo* recognises that South Africa (SA) has achieved considerable success in macroeconomic stabilisation at the national level, and closer to home, the Province has made important strides in the delivery of social and basic services.

However, high levels of unemployment and poverty persist, stretching the development chasm. Given present trends, we face retreating long-term sustainable gains; an outcome that the forthcoming Provincial Growth and Development Strategy (PGDS) aims to change.

Based on four key pillars – growth, equity, empowerment and environmental integrity – the Provincial Growth and Development Strategy: *iKapa Elihlumayo* sets out a vision for shared growth and integrated development in the Western Cape.

What is 'new' about the Province's shared growth and integrated development approach that sets it apart from other development strategies?

Said simply, shared growth is a development strategy that views poverty reduction and economic growth as being inter-dependent goals over the medium to long term. That is, that the fates of the poor and the wealthy are intertwined; that the only option is to find strength and unity in our diversity, and work together towards a shared future.

We know that higher levels of economic growth are critical to reducing unemployment and poverty over the medium to long term – it is only at higher levels of growth (the 6% to 8% band) that SA's economy will be able to generate sufficient investment, particularly in economic infrastructure, and stimulate the levels of economic activity that are conducive to the level of job creation and redistribution that we need.

So growth is not the ultimate aim. It is the means to the end – a better life for all.

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

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

Shared growth and integrated development recognises that growth alone is a necessary but not sufficient condition. That is, more than just high levels of growth are needed to reduce poverty. Social equity matters in growth and development.

High levels of equity enhance the impact of accelerated growth on poverty reduction. In turn, boosting the long-term growth potential of an economy depends on a more equitable distribution of income, capabilities and geographic location of communities and economic activity that enable the benefits of growth to be shared.

Enhanced sharing of economic yields boosts social and economic participation, which in turn feeds back to reinforce the economy's long-term growth potential, generating a virtuous cycle of growth and human development.

A shared growth and integrated development strategy must therefore be simultaneously pro-growth and pro-poor – a relationship that removes a false dichotomy in the debate and points to their inter-dependency.

Seen against empirical evidence drawn from a wide range of developing country experience, on average and over time, growth does result in the reduction of poverty. However, it is the quality of growth that matters for the extent of the impact of growth on poverty.

This means that the way in which wealth is created (the quality of growth) is just as important as the level of growth.

Higher levels of economic growth have a larger impact on poverty in countries where there is a greater social equity, particularly with regard to assets. Conversely, widening inequality not only diminishes the impact that higher levels of growth have on reducing poverty; it also slows down the pace of economic growth, conflating the trend.

Said simply, higher levels of growth have a greater impact on reducing poverty when the poor are themselves empowered to participate in economic activity, acting as agents of growth through their own production.

When poor people have access to tangible assets, such as land, housing, water, energy, sanitation, transport and credit, or intangible assets, such as education, health and personal security, they hold the means to participate in economic activity and therefore are better placed to benefit from economic growth.

The quality of growth is also affected by environmental sustainability concerns. High levels of growth may have a short-term impact on reducing poverty. But if headed on a path that is environmentally unsustainable, medium- to long-term costs are likely to erode any short-term gains.

Environmental sustainability is critically important for the Western Cape. The Province is a bio-diverse economy that depends on agriculture, agro-processing and eco-tourism, and faces considerable risk from unrestrained urban sprawl and global climatic change, particularly in respect of water and energy use, and biodiversity protection.

The key message from recent climate change research is that global climatic change is likely to result in further warming and drying in the Western Cape. Already a water-scarce region, water availability in the Province is likely to worsen in future.

Climate change will have a significant negative impact on the Western Cape's agricultural productivity due to its dependence on irrigation, and potentially effect a decrease in rain-fed agriculture. Water scarcity may also affect the growth of the eco-tourism industry, and hence of coastal towns.

Furthermore, the ecological integrity of wetlands, rivers and estuaries will be significantly affected, contributing towards a reduction in biodiversity related to water bodies – notably affecting the fishing industry – while on land there is a likely increase in wildfire frequency and intensity. Threats to catchment integrity are reinforced by unsustainable and irresponsible settlement expansion.

Similar concerns are being raised in respect of energy. Higher economic growth and urbanisation pressures have placed considerable stress on current energy supplies to the Western Cape.

Recent power outages emphasise the importance of appropriate long-term planning for energy provision, a more competitive energy market and enhanced feasibility of alternative energy sources, particularly in respect of renewable energy (solar, wind, wave and biofuels), as well as managing and regulating energy demand.

The Province's vision for shared growth and integrated development therefore proposes a fundamentally different trajectory that takes cognisance of environmental sustainability concerns.

The key policy lessons to be learnt here are, first, that economic growth that is accompanied by improved social equity will have a greater impact on reducing poverty than growth that leaves distribution unchanged.

Secondly, increased social inequality can offset the benefits of growth to the poor, reducing the poverty impact of future growth.

Thirdly, growth has to be environmentally sustainable to have medium- to long-term benefits for reduced poverty and improved livelihoods.

It is precisely these conclusions that have shifted the Western Cape debate towards shared growth and integrated development. It is therefore important that we enhance our understanding of the interaction between growth, social equity and environmental sustainability, and how these impact on poverty over time.

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

## 2. 2006 Provincial Economic Review and Outlook (PER&O)

As provinces assert a stronger leadership role in regional economic development, it is critical that they build appropriate economic capacity to undertake research and analyses that inform and guide provincial planning and budgeting decisions.

Provinces need a better understanding of how to describe provincial economies as distinct regional entities within the broader SA economy. They should be able to analyse key provincial economic variables and propose credible trend forecasts.

Decomposing labour market structures and trends adds to an understanding of the provincial skill base and income distribution patterns.

Finally, determining the sources, potential and constraints to enhanced provincial growth and employment is critical to ensure appropriate policy and/or co-ordination interventions that, at a meso level, link overarching national macroeconomic policies and local economic development interventions.

Last year's Western Cape PER&O built on the 2003 Socio-Economic Review, taking it a significant step further.

The scope, depth, and rigour of the 2005 PER&O provides a critical overarching socio-economic environmental scan of the Western Cape, framing the *iKapa Elihlumayo* lead strategies, most of which are now complete.

This entails understanding what shared growth and integrated development means for the Western Cape in greater detail.

This year, in line with the PGDS, the 2006 PER&O stresses the importance of defining the desired form of growth that Government seeks to stimulate in the Western Cape.

The above draws on a complementary concept of shared responsibility, particularly in respect of enhancing the provincial-local nexus. Inter-linkages between provincial and local socio-economic trends and dynamics within the Western Cape, and how these contribute towards the Province's vision of shared growth and integrated development are important here.

The 2006 PER&O consists of six chapters. The introduction details the conceptual framework of shared growth and integrated development, leading into an executive summary of the following six chapters.

*Chapter 2: Economic Outlook* draws on global and national economic dynamics and the development of an integrated input-output econometric model for the Western Cape to provide a medium-term economic and sectoral outlook for the Province.

*Chapter 3: Sectoral Growth and Employment Prospects* describes salient features of sectoral activity in the global economy, complementing earlier work completed by the Province's Microeconomic Development Strategy (MEDS). These are then compared to national and Provincial sectoral trends in an effort to outline the complexities facing sectoral activity in the Western Cape.

*Chapter 4: Employment Dynamics* presents a closer analysis of the Western Cape labour market, providing both an historical review and a forward projection or outlook. This sets a credible analytical platform for debate of appropriate interventions aimed at improved Provincial labour market performance, enhanced job creation and reduced unemployment.

*Chapter 5: Socio-Economic Profiling at the Local Level* takes socio-economic environmental scanning to the municipal level. The constituent elements of the Provincial economy are metropolitan, district and local economies. Socio-economic profiling at the municipal level deepens our understanding of existing socio-economic patterns and dynamics at the local level, and enhances the provincial-local interface in the Province's shared growth and integrated development strategy.

*Chapter 6: Western Cape's Recent Growth Experience* explores the extent to which the economic growth experience of the Western Cape, and more broadly SA, has been biased toward or against the poor. Empirical estimates measure the extent to which growth was shared among groups in the Western Cape between 1995 and 2000, highlighting the challenge that the Province faces in steering a fundamentally new course for shared growth and integrated development over the next 10 years.

As the concluding chapter, chapter 6 then draws on growth diagnostic techniques to understand the dynamics of shared growth and integrated development, and the associated implications for public policy design and implementation.

In sum, the 2006 PER&O highlights that fostering shared growth and integrated development within the dynamics of intergovernmental interaction presents a challenge to all in the public sector.

Delivery depends on the whole rather than the sum of the parts. The scorecard is rigorous and demanding, measuring improvements in shared growth and future opportunities of South Africans, and more specifically those in the Western Cape, by 2015.

## 3. Western Cape's economic outlook

Economic growth in the Western Cape is closely tied to developments in the SA economy. In turn, the national economy is firmly embedded in the global economy. Global and national economic developments and outlooks therefore have important consequences for the Western Cape.

### 3.1. Global economic developments

Global growth continues as the upswing phase of the global business cycle entered its fifth year in November 2005. Following strong and synchronised growth in 2004 (around 5%), the global economy slowed down during the second half of 2004 and the early part of 2005. Growth also became more uneven. The Euro area and Japan lagged the strong performances of the United States (US) and Chinese economies.

Global economic indicators began turning upwards again from the middle of 2005, signalling a new leg of accelerated growth. However, hurricanes Katrina and Rita have had a material impact on the global economic outlook due to their effect on the US economy and the international crude oil price. Higher crude prices are pushing inflation higher, drawing the attention of central banks globally.

Expectations are that expansion in the global economy will be sustained. Corporate fixed investment spending and hiring, supportive interest rates and strong developing country economic performances – in particular that of China – underpin positive global growth prospects. However, the risks are loaded on the downside.

Led by the US Federal Bank, the normalisation of interest rate levels in the major industrial countries has implications for emerging market economies such as SA.

Emerging markets have been the beneficiaries of the period of low interest rates in the main industrial countries since the end of 2001. This has translated into strong capital inflows into emerging markets and appreciating exchange rates (depending on the host countries' currency regimes) as international investors sought higher yields.

The weak US dollar and the commodity boom compounded these flows to countries such as SA; the accumulated net capital inflow on the SA balance of payments (BoP) amounted to R184-billion during 2002 to 2005.

Wider interest rate spreads and increased international investor risk aversion, possibly compounded by softer commodity prices, could see a reversal, or at best, a sharp slowdown of these capital inflows, with the attendant risk for emerging market economies such as SA that are making use of capital inflows to finance widening current account deficits, the latter a casualty of weak export performance.

## 3.2. Trends in the SA economy

Turning to the domestic scene, the SA economy has been remarkably buoyant during 2005, in spite of a (temporary) global slowing during the first half of the year and high oil prices. Both business and consumer confidence levels scaled new heights during the second half of the year.

Growth remains remarkably broad-based, and following revision of national GDP statistics, came in close to 5 per cent in real terms for 2005.

On the demand side of the economy, final household consumption expenditure grew by 6,9 per cent in real terms in 2005 and government final consumption expenditure by an estimated 5,6 per cent.

However, growth is not entirely consumption-driven. Real private fixed investment grew by 8 per cent during 2005, including a particularly buoyant private residential construction sector. Public sector fixed investment spending is now taking off, with estimates suggesting strong growth of 10 per cent to 11 per cent during 2005.

On the external front, non-gold export growth has been stronger than expected, coming in at double-digit growth rates during the first half of the year. This growth is concentrated in the non-gold commodity sector, as manufacturing exports have been under pressure from the strong rand exchange rate.

Given sustained demand conditions, the production side of the economy is increasingly responding to keen demand conditions, with both mining and manufacturing showing signs of recovery and adjustment to the strong currency environment. During calendar year 2005, growth accelerated close to 4 per cent in the primary sector, 4,6 per cent in the secondary sector, and 6,2 per cent in the tertiary sector (excluding government).

The domestic market continues to boom. This is reflected in sustained high confidence levels in the retail sector, unprecedented car sales and keen overall credit demand. The strong currency environment (inducing lower inflation and interest rates) benefits the non-tradeable goods sectors, such as wholesale & retail trade, construction, transport & communication and – to a lesser extent – financial & business services.

Key to the sustainability of the spending momentum is income growth and a sustainable BoP position. Over the past five years, solid income growth has been driven by improved formal sector employment creation, enhanced productivity growth, personal tax cuts, a structural adjustment to lower levels of inflation and real interest rates, and higher levels of real economic growth.

The domestic spending momentum therefore has favourable structural characteristics. There is little sign of overspending and/or exorbitant general household indebtedness. Inflation and interest rates are at sustainable lower levels. There is sound fiscal stimulation and a higher fixed investment rate (both in the private and public sectors). Further, the BoP position is a function of external developments, the exchange rate and SA's competitiveness.

The strong spending momentum has been accompanied by the recovery of the rand exchange rate. However, the economic upswing is not dependent on the strong currency. In fact, it may be argued that the rand's overvaluation compromises improved economic growth performance due to the imbalances it is creating. These are best reflected in the widening current account deficit and an under-performing manufacturing sector.

Overall real GDP growth is estimated at 4,9 per cent during 2005 and is projected to slow somewhat to 4,6 per cent in 2006 and 4,1 per cent in 2007.

While inflation is likely to increase moderately over the medium term due to the high energy prices, demand-pull effects and some exchange rate depreciation, it is projected to remain within the 3 per cent to 6 per cent target range over the short term (CPIX inflation is estimated to reach 5,2% in 2007).

Given the solid basis of the domestic growth momentum, the SA economy is well positioned to weather any unexpected hostile external developments and sustain the current growth trajectory.

It is key that policy-makers and other stakeholders in the economy capitalise on this opportunity – termed SA's economic 'sweet-spot' by some – to implement the required microeconomic reforms that will enhance competitiveness and further elevate the economic growth and employment performance.

**Table 1: Macroeconomic outlook for SA: calendar 2006 – 2008**

| | Average '99-'04 | 2004 | 2005 | 2006 (forecast) | 2007 (forecast) | 2008 (forecast) |
|---|---|---|---|---|---|---|
| Expenditure on GDP (real % change): | | | | | | |
| Household consumption | 3,7 | 6,5 | 6,9 | 4,7 | 3,9 | 4,4 |
| Fixed investment | 3,5 | 8,8 | 8,0 | 8,3 | 9,5 | 10,5 |
| Gross domestic expenditure (GDE) | 3,8 | 7,5 | 5,9 | 5,2 | 5,0 | 5,3 |
| Exports | 2,4 | 2,5 | 6,7 | 7,0 | 4,7 | 5,9 |
| GDP | 3,4 | 4,5 | 4,9 | 4,6 | 4,1 | 4,7 |
| Inflation, interest and exchange rates: | | | | | | |
| CPIX inflation (%) | 6,9 | 4,3 | 3,9 | 4,5 | 5,2 | 4,9 |
| PPI inflation (%) | 6,7 | 0,7 | 3,1 | 5,0 | 4,9 | 5,0 |
| Prime overdraft rate (%) | 14,71 | 11,31 | 10,64 | 10,50 | 10,50 | 10,75 |
| R/US$ exchange rate | 7,70 | 6,45 | 6,36 | 6,35 | 6,92 | 7,54 |
| R/euro exchange rate | 7,85 | 8,02 | 7,93 | 7,79 | 8,66 | 9,28 |

*Source:* *BER*

## 3.3. The Western Cape economy

The Western Cape continues its strong economic growth performance. In 2004, the Provincial economy expanded by 5,3 per cent in real terms, compared to 4,5 per cent for SA. Strong performance continued in 2005, with estimated regional GDP growth rising to around 5 per cent in real terms.

The Western Cape was hard hit by the drought in agriculture as well as the adverse impact of the strong rand on manufacturing activity. A number of the rapidly growing niche manufacturing and services sectors have been affected by rand strength.

Strong growth performance has been led by sectors such as construction, wholesale & retail trade, financial & business services (including property development & real estate), and transport & communication.

The Western Cape economy is well represented in these nationally fast-growing industries, even exceeding its national counterpart. Excluding general government services, the estimated real value-added growth in the Province's tertiary sector is 6,2 per cent for 2004. This is in line with the 6,2 per cent average real growth rate registered between 1999 and 2004. The real value-added growth in construction is estimated at 9,4 per cent in 2005, and averaged 6,5 per cent over 1999 to 2004.

A number of niche manufacturing and services sectors have also contributed strongly to regional growth. These include agro-processing, automotive components, boat and ship-building, high-end clothing and furniture manufacturing, call centres and the film industry.

Unfortunately, the strong rand has dampened activity in a number of these emerging industries.

Western Cape economic performance has also been characterised by strong export growth over the period 1996 to 2002 (8% to 9% in real terms). This came under pressure in 2003 to 2005 due to the impact of the strong rand. While the Province's core exports to well-established markets (including fruit and alcoholic beverages, iron & steel and processed food) continued to grow in real terms, a number of the non-core export products contracted sharply in 2003 and 2004.

Nonetheless, as the Western Cape business cycle is closely linked to that of the national economy, the favourable outlook for the SA economy augurs well for the Province.

### 3.3.1. Western Cape economic outlook, 2006/07 – 2008/09

The short-term economic outlook for the Western Cape remains upbeat, despite the external risks. Nationally, SA should be in a favourable position to weather the impact of higher oil prices and/or other shocks. In the case of externally induced financial volatility, the currency is bound to act as a shock absorber, while the domestic spending cycle is built on sound foundations.

The rand is expected to continue trading at strong levels throughout 2006 and the national inflation outlook has improved, with positive implications for interest rates. While some slowdown in real domestic expenditure is likely in the absence of further interest rate stimulus and when the rand depreciates (particularly in durable goods retailing, construction and financial services), such a slowdown is likely to be relatively mild. Furthermore, Western Cape industry should benefit from a more competitive currency.

The robust growth in the Province's wholesale & retail sector (around 7% a year over the period 1999 to 2004), construction (6,5%) and transport & communication (around 6,3%) is expected to continue.

The sustained growth in domestic expenditure and a more stable financial environment should remain conducive to robust growth in excess of 5 per cent a year in the Western Cape's tertiary sectors (excluding government services). The property and financial services sectors are somewhat exposed to the risk of higher interest rates.

The manufacturing and agriculture sectors are expected to recover, the latter if climatic conditions remain favourable. The manufacturing sector did rebound in 2004 following the slump in 2003; however, this recovery petered out again during the second half of 2005 as the rand appreciated.

A more competitive currency is key to sustainable recovery in the manufacturing sector, stimulating growth via import replacement and accelerated exports. Real value-added growth in manufacturing is projected to accelerate close to 4 per cent over the medium term. This is heavily dependent on a decent recovery in the export sector.

Both the private and public sector agencies in the region have responded to the impact of the strong rand, embarking on marketing initiatives, capital investment and technological upgrading programmes, joint ventures with foreign firms, skills upgrading and improved management practices. These initiatives should enable the Province to regain the growth momentum.

Fixed investment trends in the Western Cape averaged 4,4 per cent a year in real terms over 1999 to 2004, slightly faster than the national performance of 3,5 per cent.

Looking ahead, the medium-term outlook for regional fixed investment spending is rosy. Projections estimate that the Western Cape's real fixed investment rate will grow by 9,1 per cent a year over the forecast period, more or less equivalent to the anticipated fixed investment growth nationally.

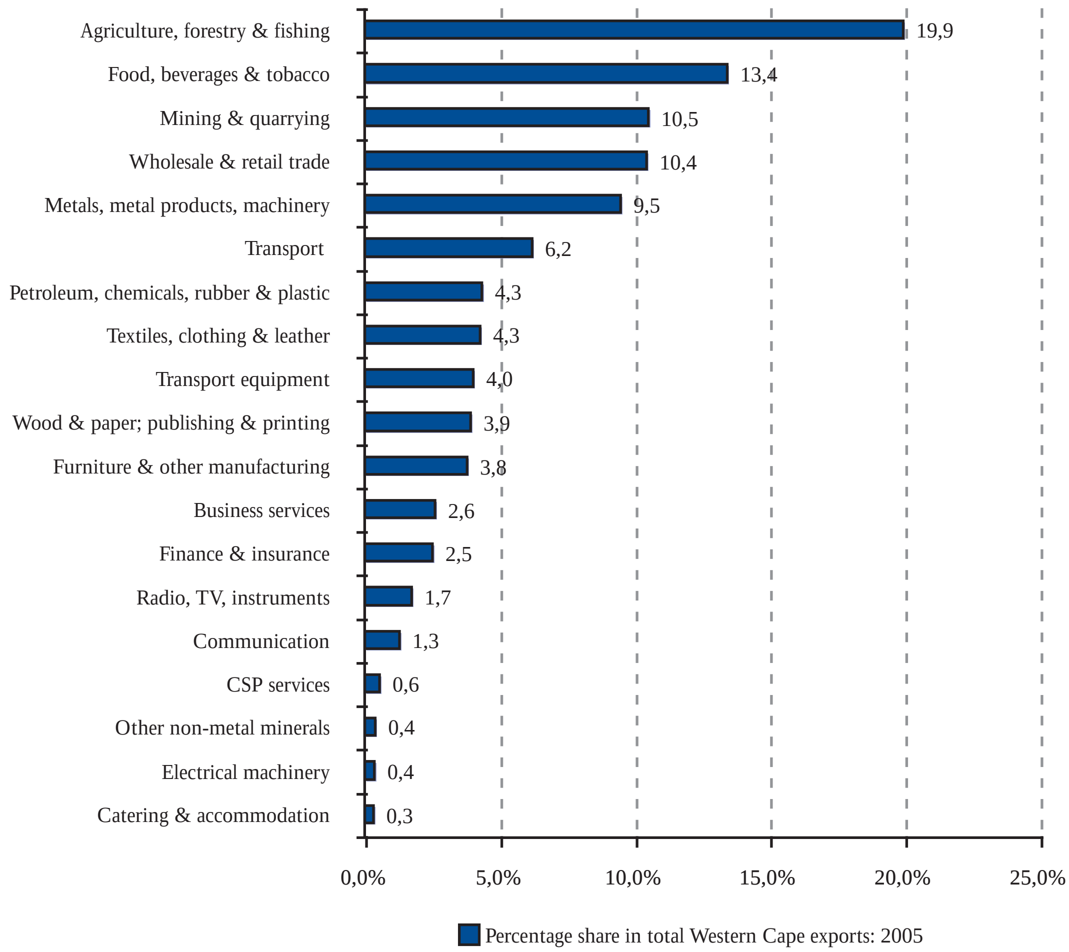
While private fixed investment spending is at risk of slowing over the short term, this is likely to be compensated for by public sector fixed investment spending. Aggregate fixed investment spending is projected to accelerate to 9,5 per cent in 2006 and 2007. This is strong growth and extends the favourable performance over the past three years.

Should this fixed investment growth materialise, the Western Cape's fixed investment rate could pick up further to 20 per cent of GDPR. Such a fixed investment environment should be conducive to Provincial employment creation and accelerated economic growth.

Turning to exports, while the general prospects for the Province's main exports remain favourable, third-country competition in the European market has intensified due to the weakness of the US dollar. The Western Cape's agricultural and processed food exports, which dominate the Province's exports (as seen in figure 1) are particularly exposed to this competition. In fact, contraction of food & beverage export volumes in 2003 and 2004 suggests that the price elasticity of Western Cape agro-processing exports to Europe may be on the increase.

Overall, the medium-term outlook for the Western Cape's agro-industrial and base metal exports is favourable. However, a broader recovery in manufacturing exports could be influenced strongly by the direction of the rand exchange rate. Global demand conditions are relatively favourable, and Western Cape manufacturers that have succeeded to maintain a foothold in the export market should be able to benefit from a more competitive currency.

**Figure 1: Composition of Western Cape exports, 2005**




*Source: Quantec Research*

The Western Cape economic performance is therefore expected to keep up with that of SA over the short term, and may continue to out-perform the national economy on average.

Table 2 shows that real GDPR growth is forecast to average 4,8 per cent a year over the medium term, slightly higher than the projected national average (4,4%). Growth is forecast to peak at 5,3 per cent in 2005/06.

## Table 2: Outlook for the Western Cape economy: 2006/07 – 2008/09[1]

| | Average '99-'04 | 2004/05 | 2005/06 (forecast) | 2006/07 (forecast) | 2007/08 (forecast) | 2008/09 (forecast) |
|---|---|---|---|---|---|---|
| **GDPR (Rbn; current prices):** | **–** | **186,3** | **205,3** | **225,1** | **247,6** | **271,5** |
| Real GDPR % growth | 4,1 | 5,3 | 5,3 | 4,7 | 4,5 | 4,8 |
| Real GDFI % growth | 4,4 | 7,8 | 8,6 | 9,3 | 9,5 | 9,5 |
| GDPR deflator | 6,8 | 4,5 | 4,1 | 4,2 | 5,4 | 4,6 |
| CPI inflation | 5,5 | 3,4 | 3,8 | 3,5 | 5,2 | 4,6 |
| **GDPR by sector (real % change):** | | | | | | |
| Agriculture, forestry & fishing | 1,7 | 3,6 | 7,4 | 2,3 | 1,0 | 0,8 |
| Mining & quarrying | -4,5 | 1,6 | 2,5 | 2,4 | 0,9 | 1,1 |
| Manufacturing | 2,1 | 5,1 | 3,5 | 4,1 | 3,4 | 3,8 |
| Electricity, gas & water | 5,1 | 6,9 | 6,1 | 6,0 | 5,1 | 5,0 |
| Construction | 6,5 | 5,8 | 8,8 | 7,3 | 8,2 | 8,6 |
| Wholesale & retail trade | 7,2 | 9,2 | 7,0 | 5,0 | 4,6 | 5,3 |
| Transport & communication | 6,3 | 5,4 | 6,2 | 6,0 | 5,8 | 6,2 |
| Financial & business services | 6,1 | 5,2 | 4,9 | 4,7 | 4,9 | 5,2 |
| CSP services | 3,1 | 1,8 | 3,3 | 3,6 | 3,5 | 3,6 |
| General government | -0,2 | 1,7 | 4,4 | 4,0 | 3,9 | 3,6 |
| **Western Cape GDPR** | **4,3** | **5,3** | **5,3** | **4,7** | **4,5** | **4,8** |

*Source:* *BER*

*Note:* [1] *Fiscal years ending 31 March*

## 4. Sectoral growth and employment prospects

Economic developments in the Western Cape are firmly linked to those in the SA and global economies. National and global economic events and trends therefore offer opportunities for, and pose constraints to, shared growth and integrated development in the Western Cape. Understanding these trends and the challenges they imply for firm-level growth and employment creation is critical.

Also important is understanding the role that government plays in accelerating and broad-basing economic growth and employment creation. This, in turn, requires insights into what has made catch-up of entire developing countries – and regions within them – successful in the past, and which factors are likely to be crucial for the accelerated development of the Western Cape in the years to come.

### 4.1. Knowledge, capabilities and catch-up

Countries – and regions within them – with above-average track records in economic development tend to have a sizeable skilled and knowledgeable labour force.

Such human capital accumulation is a result of considerable education and training planning and provision, whether public or private, through appropriate incentives.

Since the very definition of development 'latecomer' implies a certain distance to the technology frontier, it is important for the realisation of 'catch-up' that external, advanced knowledge is accessible and affordable. Local capabilities go only so far if the origins and sources of external knowledge remain barred because of prohibitively expensive patent regimes and the like.

The catch-up potential of a region depends prominently on three factors. The first is the absorptive capacities of individual firms that invest in technological learning and upgrading, and thus reduce the distance between themselves and their global competitors.

The second is the accumulation of these capacities over time – suggesting that one-off investments in research and development (R&D) are insufficient – and across firms, making for an increasingly knowledge-intensive industrial sector.

The third is the systemic character of the interactions with the institutional context without which firms are unlikely to thrive, namely the education system, the research infrastructure, input suppliers, financial institutions and the regulatory environment.

The systemic character of capacity building suggests that having a first-class knowledge infrastructure is by itself not sufficient to generate a fruitful interaction between the worlds of science (in academia) and technology (in industry).

The public sector can play an important complementary role in providing incentives so that national investments in skills and competences, and the adoption of existing and the creation of new knowledge jointly involve training and research institutions and industry. In short, catch-up is unlikely to come about by itself; instead it requires a co-ordination effort.

The co-evolution of skills and technological learning, and the institutional context to combine them, is the key challenge to catching up, including at the regional level.

## 4.2. The global context of sectoral activity

Developing countries have become much more important in world industrial activity and trade over the last decades. Presently about a quarter of developed country and one half of developing country imports originate in developing countries.

Most of this is due to rapid industrial development and increased integration into the world economy of the East Asian tigers – Hong Kong, Singapore, Korea and Taiwan – and more recently also China.

Over the last two decades, a limited number of products originating in a limited number of countries accounted for a growing share of export dynamism. These products were mostly electrical and electronic goods, including parts and components; textiles and other labour-intensive manufactures, especially clothing; and finished products from R&D-intensive industries with high technological complexity and/or a high degree of economies of scale.

Most of these products originate in developed countries, but in a select few the developing-country share is rather substantial or even – as in knitted undergarments – higher.

For the world as a whole, high-skill and technology-intensive products registered the highest export value growth in the 1980s and 1990s. This is why the notion of the knowledge economy has become a widely used concept.

Perhaps surprisingly, trends in developing countries are very similar – products in the noted category, along with those in medium-skill and medium-technology-intensive activities, grew much above average. In contrast, labour- and resource-intensive sectors, along with low-skill and low-technology-intensive sectors, were close to the average, and primary commodities, except fuel, below average.

These trends hold a mixed message for resource-intensive regions. As the productivity potential and the income elasticity of demand for primary commodities are lower than for manufactures, especially for high-skill-intensive goods, the key challenge for primary commodity producers is to invest the returns from the commodity boom into activities associated with economic diversification and knowledge intensification.

Empirical comparisons of SA and the Western Cape against the global picture suggest that SA is overspecialised in traditional, declining industries and under-specialised in new, growing industries.

Not surprisingly, this assessment is borne out by the export performance of the country and the Western Cape in dynamic products. Only in perfumes does the share in Western Cape exports exceed the world average.

In all other dynamic products, the country and the Province are hardly present. The Western Cape has actually lost market share in the combined product list. Growth rates in electronic and electrical-related production are particularly sobering; for the latter they are actually negative. If one made a comparison not with the developing country average but that for the most important East and South East Asian exporters, the contrast would be starker still.

SA and the Western Cape are therefore under-represented in those skill- and technology-intensive economic activities that have accounted for much of the medium- to long-term dynamism in world output and trade.

### 4.3. A role for provincial government

Provincial government could make a difference in regional industrial policy. In the area of knowledge, skills and capabilities in catch-up, although the Province has no jurisdiction over the higher education institutions, it can help them to grow into a more important role for Provincial economic development by providing incentives and support over and above nationally funded mandates that bring the relevant role players together.

The second area concerns salient trends in the world economy, among which increasing knowledge intensity is particularly relevant. The Western Cape is not capitalising on the opportunities that globalisation presents in a similar way to those countries – like Korea – that are a model for SA's technological aspirations. This raises the question of positioning.

Provincial government has a role in respect of initiating dialogue with all concerned stakeholders that ultimately grapples with the Western Cape's commitment to capitalise onto opportunities presented by globalisation. These discussions require detailed understanding of the dynamic make-up of the Provincial economy, and the potential areas in which competitive advantage may be attained.

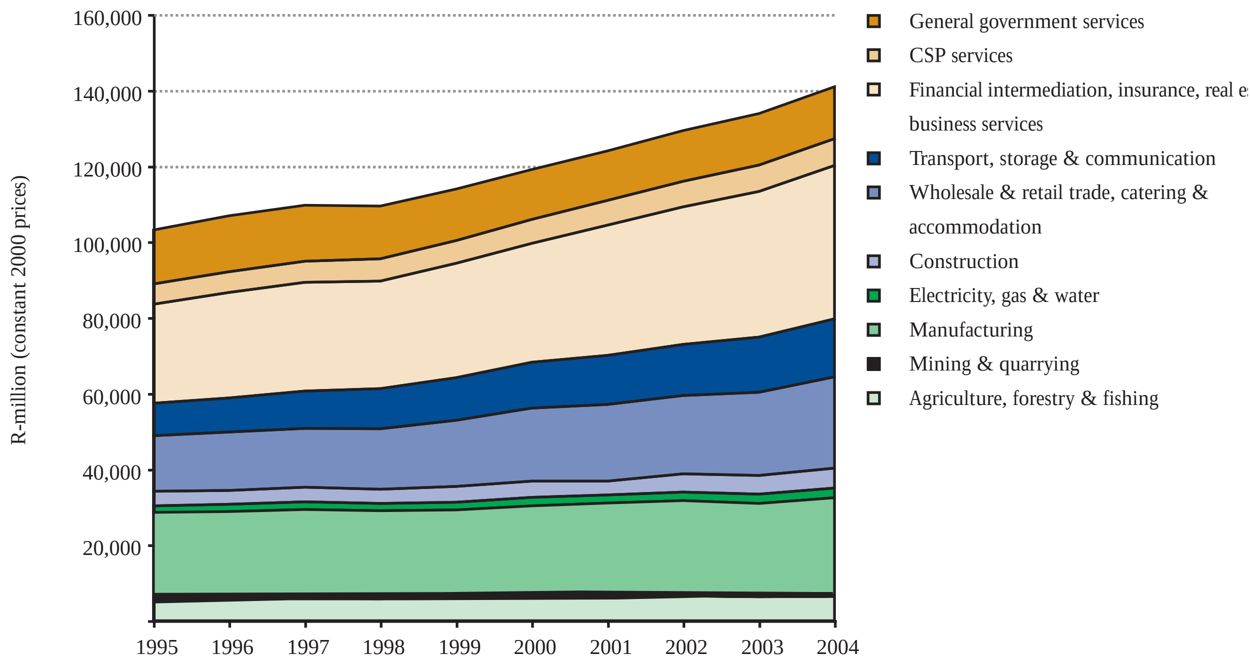
## 4.4. Broad overview of sector development

The Western Cape economy has traditionally been broad based. It supports sizeable and important activities in all sectors of the economy – primary, secondary and tertiary.

In the primary sector, agriculture, forestry, & fishing accounted for 4,5 per cent of Provincial output in 2004. The share of manufacturing was 18,3 per cent. Service sector activity had the lion's share; financial & business services and wholesale & retail trade alone made up 44,4 per cent of Provincial GDPR.

Figure 2 shows that over the 10-year period, 1995 to 2004, average annual growth rates were highest in transport & communication (6%), followed by wholesale & retail trade (5,1%), financial & business services (4,5%) and electricity, gas & water (3,8%). All other sectors grew at a rate below the Provincial average (3,2%). Thus, manufacturing as a whole grew by only 1,4 per cent.

**Figure 2: Western Cape sector contribution to GDPR, 1995 – 2004**




*Source: Quantec Research*

The recent strong currency environment has had definite impact on the non-tradeable goods sector and on the industrial base more generally. Within manufacturing, the only sectors with significant growth were petroleum products, chemicals, rubber & plastic (4,4%); transport equipment (3,2%); and metals, metal products, machinery and equipment (3%).

Market-dynamic products registered relatively low growth; in textiles, clothing & leather goods, it was slightly negative over the period under consideration. It remained below 1 per cent in radio, television, instruments, watches and clocks, as well as furniture, and reached only just over 2 per cent in electrical machinery and apparatus.

Structural change over the last 10 years has diminished the weight of primary and secondary activities in favour of growth in the tertiary sector. Although this secular trend has not been dramatic, it does suggest that the Western Cape economy is increasingly service-dominated.

At the same time, its broad base is likely to give way to more specialisation. Although this is therefore a positive development, it entails adjustment costs for those (sub-)sectors that contract – in particular, agriculture, forestry & fishing and manufacturing.

All spheres of economic activity can therefore rise to the challenge of sustained competitiveness through growing their knowledge and technological assets.

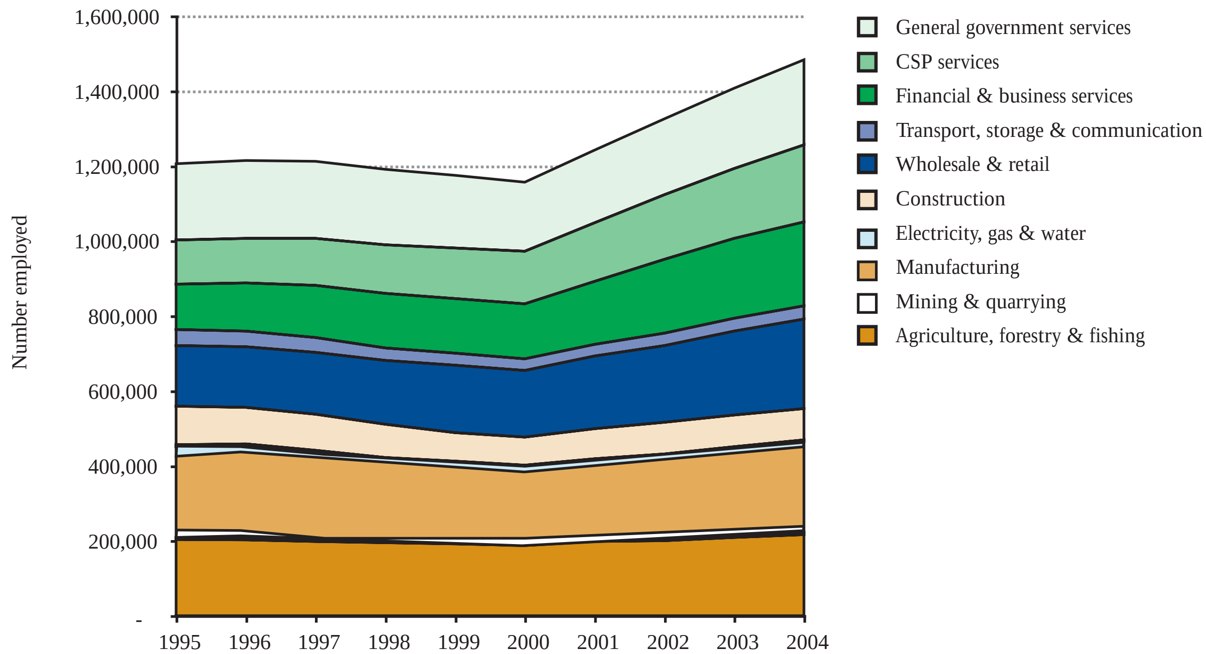
In terms of job creation, figure 3 highlights that over the same 10-year period, average annual growth in employment trailed output growth by roughly one point, at 2,1 per cent. Six sectors – manufacturing (16,3%); wholesale & retail trade (16,1%); government (15,3%); financial & business services (15,1%); agriculture, forestry & fishing (14,6%) and CSP services (13,9%) – account for more than 90 per cent of Provincial employment in the formal sector. Meanwhile, roughly one in 10 persons is employed in the informal economy.

Of these sectors, the only ones with above-average growth rates between 1995 and 2004 were CSP services and financial & business services (5,7 and 6,3%, respectively) and wholesale & retail trade (3,9%). Within manufacturing, only transport equipment (3,9%) and furniture (3,5%) grew at above-average growth rates.

Only in a few sectors did above-average output growth coincide with above-average employment growth. In financial & business services and transport equipment, employment growth outstripped output growth. In wholesale & retail trade, a 5 per cent output growth happened alongside a 4 per cent employment growth. In furniture, above-average employment growth coincided with below-average output growth.

Output growth therefore seems to have a positive impact on employment. Compared to the country as a whole, the Western Cape has been doing rather well. In sectors with generally declining employment, it registered lower negative growth rates, and in sector with generally expanding employment it registered higher growth rates than the rest of the country.

**Figure 3: Western Cape sector employment, 1995 – 2004**




*Source: Quantec Research*

## 4.5. Sectoral prospects for the Western Cape

The Western Cape faces three key challenges at the sector level:

- The comparison with industrial dynamics in the rest of the world has shows that the Province faces the risks of globalisation and is struggling to benefit from the opportunities that globalisation affords. Its industrial structure and export composition are not such that it will be easy for the Province to emulate the success of the catch-up economies in East Asia.

- The Western Cape is a relatively resource-poor region in a relatively resource-intensive country. This means that not only does the Province miss out somewhat on the windfall benefits from the current resource boom; it suffers the consequences of a real exchange rate appreciation.

- The Western Cape is very much exposed to challenges that are either partly or totally beyond its control. Global warming is a direct threat to its biodiversity. Water stress affects the prospects for agriculture, industry and livelihoods more generally.

Given the industrial and export specialisation of the Western Cape, knowledge intensification must aim at reducing the vulnerability of economic activities in the Province to first-world protectionism, price volatility and elasticity, and other factors that negatively affect exporters of primary products or relatively simply processed manufactures. This means that it must be sector specific.

At the same time it must also reflect the existing skill profile of the Western Cape and the need to increase labour absorption rates. Knowledge intensification cannot mean an exclusive focus on very high-end competences in platform technologies such as information technology (IT) or biotechnology. Instead, the process must include people and firms in low- and medium-skill- and low- and medium-technology-intensive activities.

As such, the Western Cape could consider strategic positioning of its industrial competitiveness with ecological sustainability in respect of key interventions in respect of water and energy supply provision and demand management. This requires that knowledge intensity is enhanced in a way that promotes employment across the skill spectrum and takes account of the notable impact that climatic change will have on the Province's agricultural potential and biodiversity over the medium to long term.

# 5. Employment dynamics

Shared growth and integrated development in the Province depend critically on improved labour market performance and enhanced economic empowerment and participation, particularly among poorer communities.

The Western Cape faces important challenges in its efforts to ensure that there are sufficient employment opportunities for its population.

The first is that the working age population is expected to continue to grow over the next 10 years. More specifically, the number of individuals between the ages of 15 and 65 years is expected to expand by 287 000 between 2005 and 2015, with all the growth occurring within the 35-65 year age group. This means that the population is expected to become older over time.

Migration into the Province is expected to play an important role in terms of aggregate population growth over the period, thereby presenting both opportunities and challenges. Net in-migration between 1991 and 2000 is estimated to have added an average of between 38 000 to 41 000 people a year. This rate has slowed down from 2000. From 2001 to 2015, the Western Cape will gain only about 11 800 additional people a year.

By 2015, the working-age population is expected to account for 67,6 per cent of the population, while adults aged 65 years and older are expected to represent another 6,6 per cent of the population, up from 5,0 per cent of the population in 2000.

In terms of the geographical distribution of the population, the City of Cape Town continues to dominate the Province, accounting for about 65,0 per cent of the population.

## 5.1. Recent employment and unemployment trends

The labour force has grown rapidly since 2000, mainly as a result of an increase in the number of broadly unemployed individuals. This in turn can be linked to rapid growth in the number of discouraged workseekers living in the Province.

These are individuals who are unemployed but have given up actively looking for work. They are captured in the broad definition of unemployment, but not the narrow definition.

The number of discouraged workseekers in the Western Cape has been relatively small compared to the numbers in other provinces, although this is beginning to change. As a result, it is expected that the relatively narrow numerical gap between the narrow and broad definitions of unemployment will begin to widen.

Table 3 shows that both broad and narrow unemployment appear to have increased over the period 2000 to 2004. However, given the small provincial sample size, only the change in broadly unemployed individuals is statistically significant.

That said, the data suggests that in 2004 broad unemployment in the Western Cape has reached about 26,3 per cent and narrow unemployment 18,6 per cent. This compares favourably to the national situation where broad unemployment topped 41 per cent and narrow unemployment 26,2 per cent the same year. Nonetheless, Western Cape unemployment rates are rising over time, albeit off a lower base than nationally.

Looking more closely at employment data, in 2004 about 1,7 million people were employed in the Western Cape. Approximately one half (50,6%) are coloured, while 27,0 per cent are white and 21,1 per cent are african.

**Table 3: Labour market aggregates, 2000 – 2004**

| | 2000 ('000s) | 2004 ('000s) | Total change ('000s) | Total change (%) | Average annual growth (%) | |
|---|---|---|---|---|---|---|
| **Western Cape** | | | | | | |
| Working age population | 2 834 | 3 147 | 313 | 11,0 | 2,7 | |
| Employed | 1 601 | 1 691 | 90 | 5,6 | 1,4 | |
| Broad unemployed | 426 | 604 | 179 | 42,0 | 9,2 | * |
| Broad labour force | 2 027 | 2 296 | 269 | 13,3 | 3,2 | * |
| Narrow unemployed | 319 | 387 | 68 | 21,2 | 4,9 | |
| Narrow labour force | 1 920 | 2 078 | 158 | 8,2 | 2,0 | |
| Discouraged workseekers | 107 | 218 | 111 | 104,2 | 19,5 | * |
| GDPR (2000 prices, R-million) | 119 099 | 140 896 | 21 797 | 18,3 | 4,3 | |
| **South Africa** | | | | | | |
| Working age population | 27 869 | 29 305 | 1 436 | 5,2 | 1,3 | |
| Employed | 12 238 | 11 643 | -596 | -4,9 | -1,2 | |
| Broad unemployed | 6 379 | 8 083 | 1 704 | 26,7 | 6,1 | * |
| Broad labour force | 18 618 | 19 726 | 1 108 | 6,0 | 1,5 | * |
| Narrow unemployed | 4 162 | 4 135 | -26 | -0,6 | -0,2 | |
| Narrow labour force | 16 400 | 15 778 | -622 | -3,8 | -1,0 | |
| Discouraged workseekers | 2 218 | 3 948 | 1 731 | 78,0 | 15,5 | * |
| GDP (2000 prices, R-million) | 922 148 | 1 056 771 | 134 623 | 14,6 | 3,5 | |

*Source:* *Own calculations, September 2000 and September 2004 LFS (Stats SA), SARB (2005), BER*

*Note:* *Statistically significant changes at the 95 percent confidence level are indicated with an asterisk (*). GDP and GDPR growth rates are not subject to significance testing.*

While the coloured share of employment is largely in line with that of the broad labour force, the shares of africans and whites are not. Africans account for a smaller share of employment (21,1%) than of the labour force (27,8%), while the converse is true for whites.

The result of this misalignment of relative labour force and employment shares is that whites have the lowest unemployment rate, followed by coloureds and africans.

Perhaps the most encouraging trend is rapid employment growth amongst matriculants. In 2004, there were 151 000 more matriculants employed in the Western Cape than four years earlier. The same year, employed matriculants numbered more than half a million individuals, equivalent to 30,4 per cent of Provincial employment. This is clearly a good sign for the Western Cape.

The tertiary sector is by far the dominant sector of the Provincial economy in terms of employment. Almost 1,1 million workers representing 64,7 per cent of total employment were employed in the tertiary sector in 2004, compared to 441 000 in the secondary sector and 153 000 in the primary sector.

In 2004, the major employment sectors in the Western Cape were wholesale & retail trade (341 000 workers or 20,2% of employment), CSP services (322 000 workers, 19% of employment) and manufacturing (287 000 workers, 17% of employment).

These three sectors account for over 56 per cent of total Provincial employment. Agriculture, forestry & fishing was still the fifth-largest employer in 2004, despite its rapid decline from 2000 when it was the third-largest employer.

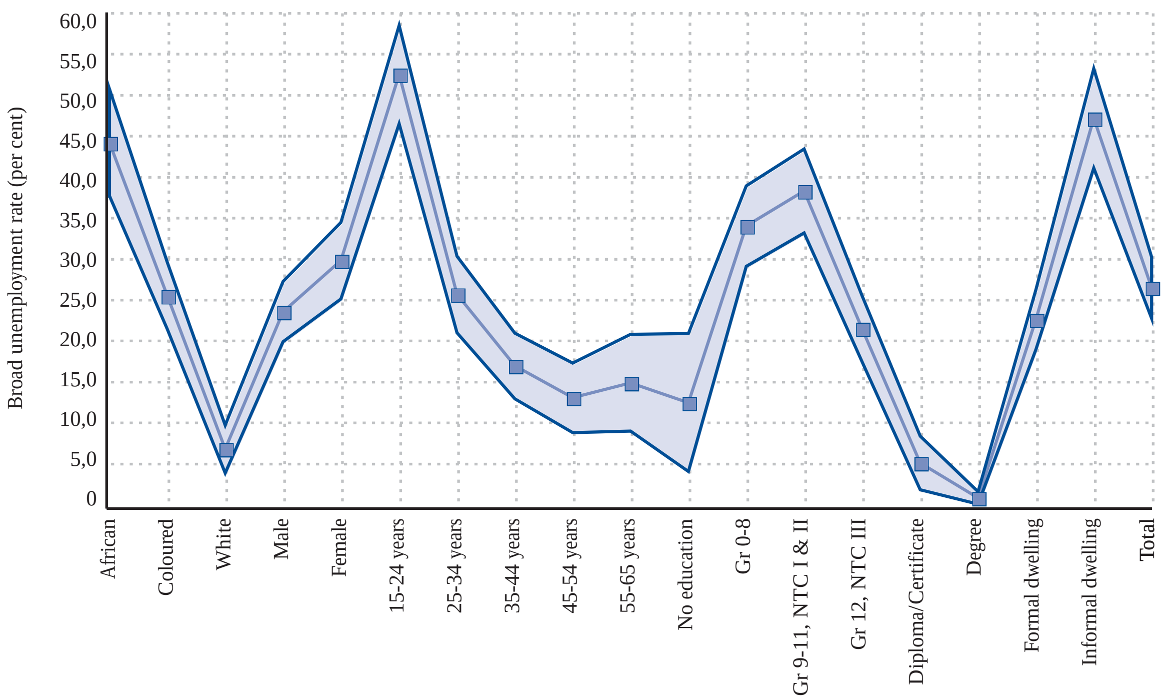
In 2004, the formal sector employed over 1,4 million individuals, equivalent to 84 per cent of total Provincial employment in that year. In contrast, the informal sector accounted for fewer than one in 10 jobs, employing 166 000 individuals.

Formal sector employment appears to have grown relatively rapidly. Between 2000 and 2004, the formal sector created 188 000 net new jobs. This translates into job creation growth of 3,6 per cent a year.

In contrast, informal sector employment continues to be lacklustre at best. It is apparent that this sector is flagging and therefore not making the contribution that it could to employment growth and the alleviation of poverty.

Turning to unemployment, figure 4 highlights that the aggregate estimates hide considerable distributional variation.

**Figure 4: Broad unemployment rates, 2004**




*Source:* *Own calculations, LFS September 2004 (Stats SA)*

*Notes:*
1. *Dark blue lines indicate upper and lower bounds of 95 per cent confidence intervals.*
2. *Formal dwellings comprise dwellings or brick structures on a separate stand or yard on a farm, flat or apartment in a block of flats, town/cluster/semi-detached house (simplex, duplex or triplex), unit in retirement village, dwelling/flat/room in backyard, and room/flatlet. Informal dwellings comprise traditional dwelling/hut/structure of traditional materials, informal dwelling/shack in backyard, informal dwelling/shack not in backyard, e.g. in an informal/squatter settlement or on farm, and caravan/tent.*

More specifically, the segmentation of the labour market is clear from the widely differing estimates of the broad unemployment rate for africans, coloureds and whites. In 2004, the broad unemployment rate amongst whites, at 6,6 percent, is substantially lower than the 25,3 per cent rate for coloureds and the 44,0 per cent rate for africans. Similar to the national pattern, female unemployment at 29,6 per cent exceeds that of male unemployment (23,4%).

The pattern of higher unemployment amongst younger age groups persists. Over 52 per cent of 15-24 year-olds are unemployed. Amongst 25-34 year-olds, the unemployment rate is substantially lower at 25,5 per cent, dropping to around 13 per cent amongst 45-54 year-olds.

These trends highlight the unemployment problem among the youth. Labour force members between the ages of 15 and 34 years are more likely to be unemployed than their older counterparts, even when controlling for education. Thus, the unemployment rate of matriculants between 15 and 34 years of age is more than 2,5 times higher than that of individuals between 35 and 65 years of age with the same level of education.

Furthermore, evidence is mounting that older people are tending to keep their jobs, while younger people are struggling to find employment. This has important implications for future economic growth, as long-term unemployment begins to erode the skills and knowledge that younger labour force members currently have but are unable to extend or even maintain through employment.

Generally, lower levels of education are associated with higher rates of unemployment. Unemployment amongst those with incomplete primary, complete primary and incomplete secondary education ranges between 32 per cent and 37 per cent, while holders of matriculation certificates experience a rate of 21,3 per cent. Less than three per cent of the Western Cape's tertiary educated labour force is unable to find work.

In many countries, unemployment is generally a temporary phenomenon. However, in SA, for many people unemployment is a long-term situation. Almost one quarter of the unemployed in SA have not worked for one year or more, with 14 per cent reporting that they have been without work for three years or more.

While the Western Cape finds itself in a slightly more favourable position in terms of the duration of unemployment, broad trends are similar. Such medium- and long-term unemployment is of considerable concern due to the deleterious impact on affected individuals and their households, and is therefore a key aspect of policy debate in respect of improving labour market performance, both at the Provincial and national level.

## 5.2. The future labour market to 2015

Policy debate on employment and unemployment at all levels is becoming more heated. Considerable attention is focused on interventions that may boost job creation and lower unemployment, a key tenet of shared growth and integrated development.

Underlying the debate are questions in respect of the number of new jobs required to reduce unemployment, the impact of population growth on employment and unemployment, and the level and quality of growth that is required to boost employment growth.

These questions are difficult to answer and depend on numerous variables, some less predictable than others.

The 2006 PER&O presents a few scenarios on the Western Cape's future labour market to 2015 as a first step to engage rigorous debate and catalyse appropriate policy solutions.

The scenarios presented are very simple approximations of some of the Province's labour market outcomes that are possible under various conditions and are by no means definitive, since they are unable to account for a wide variety of factors.

The scenarios show that, depending on differing assumptions about informal and domestic worker employment growth, by 2015 the broad unemployment rate is estimated to range between 19 per cent and 22 per cent, all other factors remaining constant.

They also show that in order to reduce broad unemployment in the Western Cape to 10 per cent by 2015, the Provincial economy would need to grow more than 8 per cent a year and/or sharply increase labour intensity in those jobs that are created, all other factors remaining constant.

Again, it is important to emphasise that these are merely technical scenarios and not intended to capture every factor possible. Rather, they highlight the massive challenge of making a significant impact on unemployment levels over short periods of time, requiring rates of economic growth and levels of employment intensity significantly higher than that presently experienced.

It is important to emphasise that the scenario exercise assumes all other factors constant, and therefore does not take account of recent announcements of economic stimuli packages under the national Accelerated and Shared Growth Initiative for SA (Asgisa) initiative and the upcoming Provincial Growth and Development Strategy.

# 6. Socio-economic profiling at the local level

Placing the Western Cape on a shared growth and integrated development trajectory requires a bold, coherent and co-ordinated public sector response to the Province's socio-economic opportunities and challenges.

At the regional and local level, good governance depends strongly on enhancing provincial and local performance and delivery. Shared growth demands shared responsibility. This means that provinces and local government must work closer together, and through their combined efforts, lever greater impact on regional and local economic development and poverty reduction.

It is critical that both provinces and local government undertake rigorous socio-economic research and analyses that profile the regional and local economies.

The chapter provides an executive summary of the detailed socio-economic profiles of 30 municipalities in the Western Cape: Cape Town as the Province's only metropole; five district municipalities – the Cape Winelands, Overberg, Central Karoo, Eden and the West Coast – and 24 local municipalities that are grouped within each of the five districts.

The detailed profiles are set out in a separate publication, *2006 Socio-Economic Profiling of Local Government in the Western Cape*, to be published shortly after the 2006 PER&O.

## 6.1. Opportunities and outlook

The local socio-economic profiles present six key areas of opportunity to achieving a shared growth and development outlook in the Province:

- Thriving regional growth sources;
- Competitive regional economies;
- Maturing demographic profiles;
- Reasonably skilled workers;
- Considerable infrastructure and settlement investment opportunities; and
- Relatively sound municipal finances.

### 6.6.1. Thriving regional growth sources

*Chapter 2: Economic Outlook* shows that the Western Cape is registering robust growth levels, buoyed by the continued momentum in the domestic spending-led boom on the back of historically low interest rates.

Economically, Cape Town is the Province's growth engine, generating R106,4bn, or 76,6 per cent of the Western Cape's total output of R138,9bn in 2004.

The city's dominance of the Provincial economy is clear. The Winelands district follows at a distant second, yielding 10,45 per cent of Provincial output, Eden 6,14 per cent and the West Coast 4 per cent.

The Province is fortunate to have two further regional growth motors – the Eden node, which includes Mossel Bay, George, Knysna and Plettenberg Bay – and that of Saldanha-Vredenburg.

Between Cape Town and the two regional growth nodes are emerging regional development corridors, based on transport (road and rail) corridors. These regional development corridors are key to enhancing economic linkages within the Western Cape, improving mobility for people and of freight, and boosting the economic potential of settlements along corridor routes.

The Cape Winelands locates in the development corridor between Eden and the city, so that while it is not a regional growth node, its significant contribution to the economy is fundamental to the corridor's development.

#### 6.6.2. Competitive regional economics

The structure of the Provincial economy has changed over time, becoming increasingly service dominated – financial & business services and retail & wholesale trade alone make up about 45,6 per cent of the Province's output, whereas agriculture, forestry, & fishing account for 4,4 per cent and manufacturing for 18,1 per cent.

Cape Town is the key driver behind the shift to services as the dominant sector of the Western Cape economy. Financial & business services comprise 30 per cent of the city's economy, followed by CSP services (21,31%), wholesale & retail trade (17,21%) and manufacturing (15,1%).

The Cape Winelands' economy is fairly well diversified, with the manufacturing industry (comprising largely of wine and agro-processing industries) remaining the largest contributor to GDP at 22,1 per cent, followed by financial & business services (20,3%), wholesale & retail trade (15%) and agriculture, forestry & fishing (14,2%).

Eden, an important economic growth area and eco-tourist hub for the Western Cape, is driven mainly by the expansion of the wholesale & retail trade sector. The latter comprises 18,58 per cent of the district's economy. Other growth sectors are financial & business services and manufacturing, which contribute 22,51 per cent and 16,65 per cent to economic activity, respectively.

The sectoral make-up and dynamics of these three regions indicate clearly the Province's structural shift towards a service-based economy.

### 6.6.3. Maturing demographic profiles

The Western Cape has both a growing and maturing population over the medium term. The working age population is expected to continue to grow over the next 10 years, driven by natural population growth and migration, although the latter has slowed down significantly since 2000.

The Western Cape therefore finds itself with a greater variety of workseekers that may also begin to help to alleviate labour supply constraints in particular sectors. However, the Province must ensure that workseekers are appropriately trained and skilled, particularly in technical areas such as science and engineering.

Workseekers would then be employable at intermediate to higher skill levels, matching demand from industries that are growing in the Province, and thereby alleviating skill constraints in the sectors over the medium to long term.

Spatially, Cape Town dominates the Province's demographic distribution, accounting for 65 per cent of the Western Cape's population. The working age population is expected to become more concentrated within Cape Town, which is not unexpected due to the concentration of economic activity within the city and the greater employment prospects that this implies.

### 6.6.4. Reasonably skilled workers

Western Cape has relatively higher education levels than the rest of SA, and is second only to Gauteng.

There has been a rapid increase in the number of Grade 9-11 graduates and matric certificate holders entering the Province' labour force. In 2004, matriculants comprised 28,5 per cent of the total Provincial labour force, compared to 26,2 per cent at the national level.

The Western Cape has also seen more rapid employment growth among matriculants than nationally. By 2004, employed matriculants numbered more than half a million individuals, equivalent to 30,4 per cent of Provincial employment.

These trends are clearly a good sign for the Province at a national comparative level.

### 6.6.5. Considerable transport infrastructure and settlement investment opportunities

The Western Cape is at a confluence where imminent investment decisions related to transport infrastructure and settlement patterns will shape the Province's development trajectory, potentially towards shared growth and integrated development.

Spatial and land use patterns that are characterised by urban sprawl tend to promote inefficient, costly and segregated settlement patterns.

Shared growth and integrated development demands a completely different spatial investment approach, requiring public transport solutions that increase access to mobility and promote higher density transport modalities. This requires a corresponding and supportive change in the land-use pattern.

In particular, low- and middle-income housing investments and zoning decisions should reflect higher densification and mixed-use development targets.

An average of 100 people per hectare has been identified as the critical threshold where good supportive neighbourhood facilities, public transport services and walking become convenient as people live, work and pursue recreational activities in nearby localities.

With the exception of high-density informal settlements, most settlements in the Western Cape, including the city, reflect low densities averaging just under 50 people per hectare.

Both the Province and local government are key players in making investment decisions related to public transport, housing and settlement patterns. For the most part, Province has regulatory oversight and funding responsibilities, while local government is the service delivery provider.

The role of provincial and local government needs to be considered carefully. It has been found more effective for government to take on a managing role where it ensures that its investments leverage greater multiples of private/community sector investment.

### 6.6.6. Financial health and sustainability of municipalities

Municipalities are expected to provide water, sanitation, electricity, refuse removal and other basic services. They finance operating expenditure from transfers from national and provincial government and from own revenue.

Capital expenditure is funded from national and provincial transfers, revolving asset financing reserve and medium- to long-term bonds raised on the capital market.

Currently, the DBSA and INCA are the main municipal lenders. However, commercial banks are also recent entrants into the municipal market as well.

Recent data from INCA shows a loan portfolio to 19 municipalities in the Western Cape. INCA's favourable report on its Western Cape municipal borrowers – 19 out of 30 municipalities in the Province – suggests that, generally, local government in the Western Cape is financially well placed to undertake capital financing for large infrastructure investments.

These investments, particularly in terms of water and sanitation infrastructure in local municipalities and public transport and human settlements in the larger urban centres, are critical for accelerating and broad-basing local economic growth in the Western Cape.

## 6.2 Risks and challenges

The detailed profiles raise five key risks and challenges to achieving shared growth and integrated development in the Western Cape:

- Demographic dynamics;
- Rising youth unemployment;
- Sectoral growth and employment trends;
- Skill constraints; and
- Social infrastructure pressures.

### 6.2.1. Demographic dynamics

The Province's rapid increase in the working-age population is already feeding through to the Province's labour force.

More potential workseekers translate into higher unemployment levels, particularly if individuals are not appropriately skilled and the economy is not able to generate sufficient numbers of jobs to absorb increasing new entrants at the lower end of the skill spectrum.

In 2004, broad unemployment in the Western Cape reached about 26,3 per cent and narrow unemployment 18,6 per cent. Rapid growth in the labour force due to increasing numbers of working-age people is contributing to increased unemployment in the Western Cape over the short to medium term, albeit off a lower base than national levels.

The city, the Central Karoo and Eden have high unemployment rates (29,2%, 36%, and 26,5%, respectively) while the West Coast, Cape Winelands and Overberg have relatively low unemployment rates (13,8%, 18,4% and 18,6%, respectively).

Cape Town, as the Province's only metropolitan area and dominant economic agglomeration, acts as a powerful magnet for workseekers from all over the Western Cape, as well as from the rest of the country. In contrast, the Central Karoo is a relatively sparsely populated, arid region with relatively little economic activity. Eden borders the Eastern Cape and may also attract workseekers from that province.

The West Coast, Cape Winelands and Overberg all border on Cape Town, which means migration to the city is relatively easy, relatively cheap and less daunting for migrants than is the case for prospective migrants from elsewhere in the Province and the rest of the country.

### 6.2.2 Rising youth unemployment

The problem of youth unemployment in the Western Cape is structural and more acute than in the rest of the country. In 2004, unemployment rates in excess of 52 per cent amongst 15-24 year-olds translated into one in two labour force members in this age group unable to find work.

Of the five districts, Eden and the Cape Winelands accounted for the largest proportion of the increase in unemployment amongst 15-34 year-olds (5,6% and 4,5%, respectively). However, compared to their shares of the labour force, the Central Karoo and Overberg contributed the most to increased unemployment, these regions' shares of unemployment change being 1,7 and 1,3 times their shares of the labour force respectively.

The increase in unemployment amongst 15-34 year-olds in Cape Town represented almost one half (49,6%) of the increase in unemployment over the period. This was due mainly to the fact that Cape Town africans 15-34 years of age represented 36,2 per cent of overall unemployment growth, followed by coloureds who accounted for 14,5 per cent.

The evidence is mounting that older people are tending to keep their jobs, while younger people are struggling to find employment. This has important implications for future economic growth, as long-term unemployment begins to erode the skills and knowledge that younger labour force members have but are unable to extend or even maintain through employment.

The problem of youth unemployment is becoming increasingly dire, despite the fact that the educational profile of young people is superior to that of their older counterparts. This suggests a disjuncture between education and skill levels and poses serious challenges to the education sector.

### 6.2.3. Sectoral growth and employment dynamics

Sectoral trends feed strongly into spatial economic development dynamics. How well a region or municipal district copes with economic change largely depends on the ability of its residents either to move from declining to growing sectors inside their region or to leave the district/region in search of better fortunes elsewhere.

While there are similarities in terms of employment structure across the Western Cape's municipal districts, there are also some important differences. Within wholesale & retail trade, the bulk of employment expansion occurred within Cape Town, accounting for 15,9 per cent of total Provincial employment growth over the period. Employment within this sector expanded in all districts, with growth in Eden representing 3 per cent of Provincial employment growth and that in the Cape Winelands representing 2,9 per cent.

In terms of agriculture, forestry & fishing, employment growth has been experienced in all districts but has been concentrated particularly in the West Coast and the Cape Winelands. Agriculture employment growth in these districts accounted for 5,2 per cent and 7,6 per cent respectively of overall employment expansion, with Cape Town accounting for a further 3,4 per cent.

CSP services contributed over one fifth of employment expansion over the period and was highly concentrated within Cape Town. In fact, the Cape Town CSP services sector alone accounted for 13,2 per cent of Provincial employment expansion amongst 35-65 year-olds. Eden's CSP services sector accounted for a further 3,2 per cent of Provincial employment growth. A similar pattern is observable in financial & business services employment growth.

Sectoral economic development policies and interventions must bear in mind that there are important spatial differences within the Western Cape and that this is true even within the district municipalities. Policy formulation must therefore cater for local conditions.

### 6.2.4. Skill constraints

Global competitive advantage is increasingly driven by skill- and technology-intensive products and services. However, the Western Cape is under-represented in these economic activities that have accounted for much of the medium- to long-term dynamism in world output and trade.

This means that skill upgrading is critical to match appropriately skilled labour supply with demand from industries that are growing in the Province, and thereby alleviating skills constraints in the sectors over the medium to long term.

For the education sector, evidence of a critical mismatch between levels of educational attainment and skills level of school-leavers and young graduates and those demanded by the workplace pose serious challenges. These are evident in education participation and success rates, particularly in respect of numeracy and literacy. The Western Cape data point to a dramatic drop-off in enrolment after Grade 8 and more recently Grade 10. Recent research suggests that only 45 per cent to 52 per cent of learners who enrol in Grade 1 reach Grade 12.

Improving education retention, throughput and attainment rates, particularly in terms of numeracy and literacy, is critical to support the skill requirements of a growing, globally competitive regional economy.

### 6.2.5. Social infrastructure pressures

As the Western Cape's population has grown rapidly over recent years, more stress has been placed on the utilisation of social infrastructure and services, particularly in terms of education, healthcare and policing.

Social infrastructure backlogs are more pronounced in Cape Town – especially in the high population density areas such as Mitchell's Plain, Khayelitsha, Gugulethu and Langa – than in any other district in the Province.

Eden and the Cape Winelands need to prioritise the provision of healthcare facilities and police stations, while the West Coast needs an additional police station. Overberg needs more healthcare services and the Central Karoo more schools.

In education, although Cape Town accounts for about 63 per cent of the Province's learners, the schools available account for only 50 per cent learners, even though the city's schools are larger, accommodating an average of 842 learners per school.

Almost all the districts have backlogs in the provision of healthcare services, with Cape Town showing the highest need. There is a strong positive correlation between shortage of hospitals and workload in the health sector, especially in the context of high prevalence of tuberculosis and HIV/Aids.

In respect of policing, overall in the Western Cape, reported crime statistics from 2001 to 2005 suggest mixed results. The only clear trend is a dramatic increase in drug-related crimes across all districts. There are more reported criminal cases in highly dense areas, where more policing resources need to be deployed.

## 6.3. Enhancing the provincial-local government interface

Closer working relationships between the Province and local government are increasing important. Understanding the dynamics of local economic growth and employment is key to policy interventions that aim towards achieving shared growth and integrated development in the Western Cape.

Furthermore, local government has to ensure that it 'gets the basics right' and addresses fundamental service delivery issues that pose key risks and challenges to a shared growth and integrated development future.

# 7. Western Cape's recent growth experience

Moving the Western Cape towards shared growth and integrated development signals a notable shift away from 'business as usual' towards a more strategic approach to regional economic development.

As shared growth and integrated development balances a pro-growth and pro-poor agenda, an empirical analysis of the Western Cape's recent growth experience places the challenges that the Province faces into stark relief.

## 7.1. Has growth in the Western Cape been pro-poor?

In a broad sense, pro-poor growth is economic growth that leads to significant reduction in poverty. This means that shared growth and integrated development is aimed at both accelerating sustained growth and ensuring that resultant higher levels of growth contribute to reducing poverty.

Using the 1995 and 2000 Income and Expenditure Survey (IES) to compare the growth of expenditures of the poor to those in the upper expenditure echelon highlights the acute contrast in the average growth experience of the wealthy compared to that for lower expenditure deciles.

At the national level, average per capita expenditure increased at about 6 per cent a year in nominal terms.

In turn, the average of nominal growth rates of all the percentiles of the expenditure distribution – that is, the mean percentile growth rate – was only 3,3 per cent over the same period.

Expenditure growth was concentrated in the upper income echelons, as only individuals from around the 70th percentile upwards experienced growth in their expenditure above 3,3 per cent.

Individuals below this mark saw their expenditures grow relatively slowly over the period, while those at the base of the distribution faced the lowest increase.

All individuals, including those in the lowest expenditure percentiles experienced an increase in their per capita expenditure over the five-year period, highlighting that while the relative comparison depicts national growth biased against the poor, absolute pro-poor growth occurred.

**Table 4: Measures of pro-poor growth by race, 1995 – 2000 (%)**

| Growth rate in: | African National | African Western Cape | Coloured National | Coloured Western Cape | White National | White Western Cape | Asians National | Asians Western Cape |
|---|---|---|---|---|---|---|---|---|
| Mean per capita expenditure | 5,26 | 7,45 | 11,01 | 13,51 | 9,82 | 13,05 | 3,96 | 18,44 |
| Median | 2,91 | 5,12 | 9,16 | 10,65 | 7,30 | 11,42 | 2,49 | 20,53 |
| Mean | 3,23 | 6,34 | 9,13 | 11,42 | 7,84 | 11,76 | 3,04 | 17,36 |
| **Growth at percentile:** | | | | | | | | |
| 10 | 0,85 | 6,18 | 4,05 | 5,46 | 4,17 | 11,84 | 0,00 | 4,50 |
| 15 | 1,34 | 7,12 | 4,76 | 6,44 | 4,66 | 11,20 | 0,57 | 7,74 |
| 20 | 1,59 | 7,72 | 5,22 | 6,97 | 5,03 | 10,88 | 0,86 | 9,22 |
| 25 | 1,79 | 7,64 | 5,60 | 7,39 | 5,25 | 10,80 | 0,98 | 9,94 |
| 30 | 1,93 | 7,23 | 5,89 | 7,67 | 5,50 | 10,72 | 0,94 | 10,49 |
| **Rate of pro-poor growth** | **2,48** | **6,36** | **6,14** | **7,49** | **-3,21** | **2,3** | **-0,32** | **0,11** |
| **Rate of ultra-poor growth** | **2,22** | **7,37** | **4,68** | **4,79** | **-2,26** | **0,95** | **-5,59** | **–** |

*Source:* *Stats SA (1995 and 2000) and own calculations*

*Notes:* *1. Frequency weights are assumed with the populations in both datasets weighted according to the 1996 Census.*
*2. The pro-poor growth rate is based on a poverty line of R322 per capita per month in 2000 prices, while the ultra-poor rate of growth is based on a poverty line of R174 per capita per month, also in 2000 prices.*
*3. Figures are annualised growth rates.*

Turning to the Western Cape's growth performance, between 1995 and 2000, average per capita expenditure rose at 11 per cent a year in nominal terms. This is double the national annual increase.

Average of growth rates at all the percentiles of the expenditure distribution reached just under 9 per cent a year. This is almost three times the national average.

Individuals around the 50th percentile upwards – about half of the population – experienced spending growth above 9 per cent.

Looking at the base of the distribution, the poor in the Western Cape experienced higher spending growth than the poor at the national level, with average percentile growth in the Western Cape not dipping below 4 per cent a year.

In fact, even the poorest households in the Western Cape experienced higher spending growth that the national average.

However, while the poor in the Province benefited in absolute terms (rising per capita expenditure), they did not benefit in relative terms. Looking at the poorest 30 per cent, at 6,7 per cent, their average spending growth rate was less than that of 8,98 per cent for all income groups.

Disaggregating by population group, those in the Western Cape experienced higher average per capita spending growth rates than their national counterparts.

At national level, at 5,2 per cent the average growth in african per capita expenditure between 1995 and 2000 was slightly below the national average for all groups (6,14%).

Over the same period, at 11,01 per cent and 9,92 per cent, respectively, both coloured and white nominal expenditure increased at rates of more than double the aggregate national average.

In the Western Cape, at 7,45 per cent, the increase in per capita expenditure for africans was also lower than the aggregate Provincial average (11,01%). In contrast, coloured and white nominal per capita expenditure increased by 13,51 per cent and 13,05 per cent, respectively.

Definite key messages emerge. The period 1995 to 2000 saw pro-poor growth at an absolute level in SA and the Western Cape, as poor individuals experienced absolute growth in expenditure over this period.

However, relative pro-poor growth did not take place, as poor individuals experienced spending growth at rates below the national and provincial average. That means that expenditure growth over this period was biased against the poor.

Of note, however, is that the Western Cape's performance surpassed that of national. That is, the Western Cape experienced higher growth rates in nominal per capita expenditure at the aggregate level, and in terms of population group, gender and urban-rural disaggregation.

## 7.2. The impact of growth and equity on poverty in the Western Cape

Understanding how growth and equity interact to impact on poverty is important. The process and quality of growth itself may induce equity shifts that erode some or all of the growth-associated poverty reduction gains  Empirical analysis of the growth-poverty-inequality triangle therefore provides key information to policy- and decision-makers, helping to shape policies and interventions that are appropriate to local circumstances.

Using the 1995 and 2000 IESs, changes in poverty in SA and the Western Cape may be decomposed into a growth effect and an equity effect. These are proxied by increases in average income and income distribution, respectively, and have separate effects on poverty. An increase in average income reduces poverty, while an increase in income inequality increases it.

Looking first at the growth-poverty elasticities, there is a positive relationship between an increase in average per capita expenditure (as a proxy for economic growth) and the reduction of poverty both nationally and in the Western Cape.

In 1995, using the R322 per month poverty line, a 1 per cent increase in SA's economic growth (as measured by per capita expenditure) would have resulted in a 1 per cent decrease in the national poverty gap.

All the elasticity measures were higher for the Western Cape. This meant that economic growth had a larger impact on the poor in the Western Cape. In 1995, using the R322 poverty line, a 1 per cent increase in Provincial economic growth would have resulted in an almost 2 per cent decrease in the Province's poverty gap.

However, all elasticity estimates decreased between 1995 and 2000. This indicates that the economic growth path has become less pro-poor over the period. In 2000, a 1 per cent increase in the Western Cape's economic growth would only have led to a 1,83 per cent decline in the Province's poverty gap.

Poverty-inequality elasticity estimates show how sensitive poverty is to changes in inequality (as measured by the Gini coefficient).

Both SA and the Western Cape show a positive relationship between poverty and inequality. Using the R322 poverty line, in 1995 a 1 per cent increase in the Gini coefficient would have resulted in a 3,83 per cent increase in SA's poverty gap.

Again, the elasticities are much larger for the Western Cape. In 1995, using the R322 poverty line, a 1 per cent increase in the Provincial Gini coefficient would have resulted in an increase of more than 8,5 per cent in the Province's poverty gap.

The third measure, the marginal proportional rate of substitution (MPRS), indicates the magnitude of economic growth that is required to negate the effect of increasing inequality in order to reduce poverty.

In 1995, SA's MPRS was 3,74. This means that the economy had to grow by 3,74 per cent in nominal terms (as measured by per capita expenditure) to compensate for an increase of 1 per cent in the Gini coefficient.

The higher MPRS for the Western Cape means that the Provincial economy needed to grow at a higher rate of 4,52 per cent in nominal terms to compensate for a 1 per cent increase in the Provincial Gini coefficient.

Further growth-poverty-inequality measures probe the combined effect of changes in growth and changes in inequality on poverty levels. These estimates decompose the change in measured poverty into a growth component and a redistribution component.

At the R322 per capita per month poverty line, national poverty increased by 5,3 per cent between 1995 and 2000. The growth component reduced poverty levels by 9,4 per cent. But, the redistribution component increased poverty by 14,6 per cent.

The increase in inequality over the period therefore completely eroded the gains realised from the growth in nominal per capita expenditure. The resulting increase in poverty levels was solely due to rising inequality over the period.

The same result appears for all population groups at the national level, except coloureds. Coloured poverty decreased by almost 3 per cent as a result of the 21 per cent growth contribution of the growth component cancelling out the 18 per cent increase in poverty due to the redistribution component.

Between 1995 and 2000 Western Cape poverty decreased by almost 1 per cent due to the growth component at 18 per cent, outweighing the accompanying increase in inequality.

Disaggregating by population group, with the exception of whites and africans, poverty declined for all other groups over the period. White poverty levels remained unchanged with the contributions of the two components cancelling each other out perfectly. The increase in african poverty was due to increased inequality outweighing the contribution of the growth component.

Although illuminating, the above analysis has its limitations, due in a large part to data limitations and credibility, given concerns raised about the 2000 IES in particular.

In addition, the above measures do not capture the changes in the non-income measures of poverty, such as asset and spatial poverty, also important in understanding the impact of shared growth and development.

## 7.3. Shifts in access to selected services in the Western Cape

Asset equality focuses on accumulation of personal assets that provide people the capabilities and/or opportunities to improve their daily lives and their future social and economic opportunities.

Asset equality is attained in respect of access to good basic services (water, sanitation, energy and refuse removal) and social services (health care, education and skill development, and shelter).

Typically, those at the higher end of the income spectrum have better access to quality services, ensuring that their capabilities and opportunities are broadened and deepened to their fullest potential.

Many government interventions therefore focus on improving poor people's capabilities in respect of enhancing access to quality school and skill development, health care services, clean and safe water, sanitation facilities and housing. These types of public service provision are often term the 'social wage' or 'social wage goods'.

Assessing how government has performed in improving poor people's access to quality services is another way to assess whether the poor have shared in the benefits of economic growth through increased access to services such as formal housing, piped water, electricity and proper sanitation.

Total access to formal housing increased by 2 per cent in the Western Cape between 1993 and 2004. The bottom two household expenditure deciles, however, experienced a decline in the share of households living in formal dwellings. Deciles three to five saw their access to formal housing increase at a much faster rate than the average growth rate.

However, the poorest of the poor (as presented by the bottom two per capita household expenditure deciles) did not benefit from the increased delivery of formal housing in the Province. In fact, the bottom ten per cent of poor households saw a decline of 31 per cent in their access to formal housing.

Total access to piped water decreased by 1 per cent over the period. In addition, the performance by decile is quite uneven, with households in the bottom of the distribution experiencing a 16 per cent increase in access to piped water, while households in the second decile experienced a 12 per cent drop in their access rate.

There is however, a much clearer pro-poor growth path in the use of electricity for lighting and access to flush/chemical toilets. The bottom six deciles all experienced growth in the use of electricity for lighting above the average growth rate of 11 per cent. Absolute and relative pro-poor growth took place, with access rates for the bottom four deciles increasing between 32 per cent and 78 per cent.

All households up to the fifth expenditure decile experienced a growth in access to flush/chemical toilets above the mean growth rate of 4 per cent. Households in the bottom household expenditure decile saw their access to flush/chemical toilets more than double over the period. The second decile, however, only experienced a 5 per cent increase. The third, fourth and fifth deciles experienced an increase in access of around 20 per cent.

Empirical analysis therefore points to mixed evidence of shared growth and integrated development in the Western Cape, as measured by increased access to the above four household services for the period 1993 to 2004. Poor households only genuinely shared in the increased access to electricity for lighting and flush/chemical toilets.

These results highlight the challenge that the Province faces in shifting to a shared growth and integrated development trajectory over the medium- to long term.

## 7.4. Shared growth diagnostic for the Western Cape

Given mixed evidence of shared growth over the last 10 years, the Western Cape faces a considerable challenge in moving the Province onto a shared growth and integrated development trajectory.

Recent comparative international shared growth experiences show that the rate and quality of growth is determined, at the aggregate level, by a country's ability to integrate into the global economy, its capacity to maintain sustainable government finances, and its ability to put into place an institutional environment in which contracts can be enforced and property rights established.

At a regional and local level, efficient and effective governance is critical in providing an enabling environment for competitive, thriving businesses and strong social communities and networks.

The key message here is that the quality of government institutional capacity matters for accelerated shared growth and development.

In most developing countries, financial, human and administrative institutional capacity at all levels or spheres of government is a limited, scarce resource. As such, it needs to be prioritised and focused on removing those obstacles or economic distortions that are binding constraints on shared growth and will have the biggest direct impact if removed.

At the national level, the Asgisa task team has identified six key obstacles or binding constraints to accelerated and shared growth. Decisive responses in terms of macroeconomic concerns, infrastructure programmes, sector investment or industrial strategies, skills and education initiatives and public administration issues are currently being developed.

The changing intergovernmental landscape compels provinces to undertake similar shared growth diagnostic analyses. Proactive shaping of the regional economic development agenda demands that provinces identify key obstacles or binding constraints to shared growth and integrated development within an intergovernmental context.

The diagnostic entails identifying key obstacles or binding constraints through rigorous, empirical research and matching these to appropriate national, provincial and local policy levers.

Where policy levers are within the provincial domain, they will be subject to provincial political and resource prioritisation within the annual budget process. National and local policy levers demand a different approach, requiring provinces to work closely with national, local and other partners, notably public entities, in order to lever policy, programmatic and budgetary resources to address key obstacles or constraints to shared growth and integrated development at the regional level.

The Western Cape has initiated work on a growth diagnostic scan as part of the PGDS process. Drawn from the Asgisa approach, the base framework has been modified to be more appropriate to an exercise at the provincial level.

Further research and analysis on the diagnostic will feed into the Western Cape's policy and resource allocation processes, facilitating informed, evidence-based decision-making, and supporting intergovernmental co-ordination processes.

# 8. Key Messages of the 2006 PER&O

Framing the Province's strategic vision for shared growth and integrated development, key messages and imperatives that flow from the 2006 PER&O include the following:

## 8.1. Economic outlook

The Western Cape's medium-term economic outlook is favourable. Growth is expected to keep up with that of SA over the short term, and may continue to out-perform the national economy on average.

Peaking at 5,3 per cent in 2005/06, real GDPR growth is forecast to average 4,8 per cent a year over the medium term, slightly higher than the projected national average (4,4%).

While the outlook reflects a strong and vibrant Provincial economy, we must accelerate economic growth to the 6 to 8 per cent a year band in order to boost employment performance and improve the long-term growth potential of the Provincial economy.

This requires stepping up fixed investment performance and implementing key micro-economic reforms, key among which is skill deepening and enhancement. These are critical to enhancing economic competitiveness and further elevating economic growth and employment performance.

## 8.2. Sectoral growth and employment prospects

The Western Cape economy is increasingly service-dominated – financial & business services and retail & wholesale trade alone make up about 44,4 per cent of the Province's output, whereas agriculture, forestry, & fishing account for 4,5 per cent and manufacturing 18,3 per cent, respectively.

However, the Western Cape, and SA more broadly, are under-represented in skill- and technology-intensive economic activities that have accounted for much of the medium- to long-term dynamism in world output and trade.

Given the industrial and export specialisation of the Western Cape, knowledge intensification must aim at reducing the vulnerability of economic activities in the Province to first-world protectionism, price volatility and elasticity, and other factors that negatively affect exporters of primary products or relatively simply processed manufactures. This means that it must be sector specific.

At the same time it must also reflect the existing skill profile of the Western Cape and the need to increase labour absorption rates. Knowledge intensification cannot mean an exclusive focus on very high-end competences in platform technologies such as information technology or biotechnology. Instead the process must include people and firms in low- and medium-skill- and –technology-intensive activities.

## 8.3. Employment dynamics

The Western Cape faces important challenges in its efforts to ensure that there are sufficient employment opportunities for its growing labour force.

At 26,3 per cent broad unemployment is lower than the national level (41%) but rising rapidly, due to rapid growth of the Province's working-age population.

Older people are tending to keep their jobs, while younger people are struggling to find employment. This has important implications for future economic growth, as long-term unemployment begins to erode the skills and knowledge that younger labour force members currently have but are unable to extend or even maintain through employment.

We must improve the Western Cape's ability to create more jobs and absorb new entrants into the labour market. Rising unemployment, particularly for young people, is the single biggest risk to the Province's goal of shared growth and integrated development. We also need to alter the racial and gender profile of the workforce in respect of skill and remuneration.

This will require upgrading skills across the spectrum, enhancing economic stimulation and improving economic participation, and thereby employment performance over the medium- to long term.

Reducing unemployment is not a short-term concern. It requires a multi-faceted approach that accelerates Provincial economic growth and boosts labour intensity to raise labour demand as well as enhancing skill profile and improving economic participation of the Province's labour force; these key interventions will realise benefits over the medium- to long term.

## 8.4. Socio-economic profiling of municipalities

Socio-economic profiling at the local level provides an essential evidence-based platform to inform and guide provincial and local planning, budgeting and service delivery decisions. Closer working relationships between the Province and local government are increasingly important. Understanding the dynamics of local economic growth and employment is key to policy interventions that aim to achieve shared growth and integrated development in the Western Cape.

Shared growth demands shared responsibility. Province and local government must work closer together, and through their combined efforts

Greater alignment in provincial and local planning, budgeting and service delivery will enable government to lever greater impact on regional and local economic development and poverty reduction.

## 8.5. Western Cape's recent growth experience

Shared growth and integrated development balances pro-growth and pro-poor elements. However, the Western Cape's recent growth experience suggests that the Province's growth path has yielded mixed results for poor people and has become less pro-poor over time

These results highlight the challenge that the Province faces in shifting to a shared growth and integrated development trajectory over the medium to long term.

We must focus our efforts on both accelerating growth in the Western Cape and ensuring that growth is more broad based and shared amongst a wider range of people.

This is why shared growth and integrated development – based on four key pillars: growth, equity, empowerment and environmental integrity – is the key strategic, thrust of the Provincial Growth and Development Strategy: *iKapa Elihlumayo*, and the common objective of its lead strategies: the Microeconomic Development Strategy, the Strategic Infrastructure Plan, the Provincial Spatial Development Framework, the Human Capital Development Strategic, and the Social Capital Strategy.

## 9. …Onto PER&O 2007

The 2006 PER&O marks another step forward in developing rigorous economic analytical capacity in the Western Cape, and serves to deepen the socio-economic scan that frames the Provincial Growth and Development Strategy: iKapa Elihlumayo and the Province's annual budget decisions.

The next stage of analysis that will present in the 2007 PER&O draws from longer term research projects in each of the key PER&O areas, as well as new projects that will be initiated to close research and analytical gaps identified in both the 2005 and 2006 PER&Os.

More specifically, in respect of the Western Cape's Economic Outlook, forecasts in the 2007 PER&O will be based on the development of two Western Cape economic models, drawing on integrated econometric and input-output techniques.

The first is intended as a pure forecasting model, estimating key provincial economic variables, in particular GDPR, investment, exports, imports, and inflation. It will combine a national econometric front end with a regional input-output back end. Initially built on the Bureau for Economic Research's national model, it will be linked to National Treasury's model over the next year, ensuring consistency between national and Western Cape econometric forecasts.

The second model is intended as an impact analysis model. That is, it will enable the Province to estimate the impact of key policy interventions on the Western Cape economy. Also developed as an integrated econometric and input-output model, this model will combine a newly developed Western Cape econometric front end with the regional input-output back end. As it is a more complex model to develop, it is likely to be operational only in 2007.

Turning to Sectoral Growth and Employment Prospects, the 2005 PER&O and 2006 PER&O have covered considerable ground in respect of sectoral growth and employment trends and possibilities for competitive positioning within a dynamic global economy.

The key concern in this area of research is the paucity of good economic data at the provincial level to undertake further more detailed and disaggregated analysis. The lack of data draws not only from the limited number of economic surveys that Statistics SA conducts within its mandate as the official government statistical agency, but also due to the limited sample size at the provincial level. The latter, in particular, reduces analytical accuracy as sectoral and smaller area (municipal-level) disaggregations are undertaken.

Given the critical importance of further economic research as provinces' position their industrial competitiveness in an ever-changing global context, innovative and creative solutions are required. More specifically, the Province may wish to undertake firm-level and other surveys in order to collate and analyse data from primary sources. This is both costly and time-consuming. However, it may be a necessity if the Western Cape is to make further strides in economic analysis.

Other solutions may see the Province partnering Statistics SA in terms of funding and/or capacity to ensure that the latter is able to extend the sample size of its Western Cape surveys.

These data concerns also raise their head in further Employment Dynamic studies. This year, the Western Cape made use of commissioned demographic modelling projections in order to gain a better understanding of demographic profile dynamics that are key to labour market analysis.

As the model was developed outside of the government sector, it is categorised as a non-official data source. That said, the model is a significant boost to the Province's labour market research and forms a key element of initial labour market modelling.

The latter is a critical step in understanding future labour market scenarios for the Western Cape. The simple model will be further developed in 2007 and initial efforts made to integrate with the Province's economic forecasting model, aiding integrated economic and employment projections.

This year's socio-economic profiling at the local level was a major achievement in extending the PER&O's reach to the local level. The analysis will feed into municipal integrated development plans for 2007, laying the basis for evidence-based municipal planning, budgeting and service delivery going forward.

The next stage in this area of work is to partner with municipalities themselves, building local economic analysis capacity and deepening the resultant analysis with local socio-economic surveys that complement the structured, comparative approach taken in the 2006 PER&O.

Finally, research into the Western Cape's recent growth experience highlights the challenge of moving the Province onto a shared growth and integrated development path.

Feeding into the Provincial Growth and Development Strategy is initial work on a Western Cape growth diagnostic that enables the Province to identify key binding constraints to shared growth and integrated development within an intergovernmental context.

Further work in this area aims to identify specific provincial policy levers, and where possible rates of return on investment. Such analysis will feed into Provincial policy and resource prioritisation processes, facilitating informed, evidence-based decision-making. National and local policy levers demand a different approach, testing intergovernmental coordination, coherence and integration to the full.

A tough agenda ahead, but one that poses exciting and challenging promise for extending and deepening the Western Cape's analytical economic base and capacity over the medium-term.

The PER&O work has also raised considerable interest in other provinces, encouraging the Western Cape to share its experiences and engage its provincial colleagues in partnership, building a broader base to provincial economic research and analysis across SA.

…that said, onto PER&O 2007…