

**Provincial Government Western Cape
Provincial Treasury**

**PROVINCIAL ECONOMIC
REVIEW & OUTLOOK
2007**



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To obtain additional information and/or copies of this document, please contact:

Western Cape Provincial Treasury

Directorate Budget Office

Private Bag X9165

15 Wale Street

Cape Town

Tel: (021) 483-8683

Fax: (021) 483-3639

E-mail: gadaids@pgwc.gov.za

This publication is also available online at <http://www.capegateway.gov.za>

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Foreword

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

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

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

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

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

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

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

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

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

Cecilia Punt of the Western Cape Department of Agriculture authored *Chapter 3: Economic modelling and regional impact analysis*.

Jo Lorentzen of the Human Science Research Council (HSRC) wrote *Chapter 4: Regional innovation and growth*.

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

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

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

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

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

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



Lynne Brown
Minister of Finance and Tourism
July 2007

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Abbreviations

ABET	Adult basic education and training
ACSA	Airports Company of SA
ARC	Agricultural Research Council
AsgiSA	Accelerated and Shared Growth Initiative for South Africa
BEE	Black Economic Empowerment
BER	Bureau for Economic Research
BFAP	Bureau for Food and Agricultural Policy
BOP	Balance Of Payments
BPO	Business Process Outsourcing
Bric	Brazil, Russia, India and China
BRIC	Biotechnology Regional Innovations Centre
CBTI	Cape Town Boatbuilding and Technology Initiative
CETA	Construction Education and Training Authority
CGE	Computable general equilibrium
CPI	Consumer Price Index
CPIX	Consumer Price Index (excluding mortgage interest rates)
CS	Community Survey (Statistics South Africa)
Csgi	Cape Shared Growth Initiative
CSIR	Council for Scientific and Industrial Research
CSP	Community, social and other personal services
CTFR	Cape Town Functional Region
DBSA	Development Bank of Southern Africa
DEDT	Department of Economic Development and Tourism
DST	Department of Science and Technology (South Africa)
EA	Economic Analysis Unit
EAP	Economic Active Population
EAR	Employment Absorption Rate
ECB	European Central Bank
ECD	Early Childhood Development
EDI	Electricity Distribution Industry
EIU	Economist Intelligence Unit
EMIS	Education Management Information System
EPWP	Expanded Public Works Programme
EU	European Union
FDI	Foreign Direct Investment
FET	Further Education and Training

FIFA	Fédération Internationale de Footbal Association
FTA	Free Trade Agreement
GAMS	General Algebraic Modelling System
GDE	Gross Domestic Expenditure
GDFI	Gross Domestic Fixed Investment
GDP	Gross Domestic Product
GDPR	Regional Gross Domestic Product
GET	General Education and Training
GGP	Gross Geographic Product
GHS	General Household Survey (Stats SA)
GVA	Gross Value Added
HACCP	Hazard Analysis and Critical Control Points
HCDS	Human Capital Development Strategy
HDI	Human Development Index (UNDP)
HIV/AIDS	Human Immunodeficiency Virus/Acquired Immune Deficiency Syndrome
HMIS	Health Management Information System
HS	Harmonised Commodity Description and Coding System
HSRC	Human Sciences Research Council
ICS	Investment Climate Survey
ICT	Information and Communication Technology
IDP	Integrated Development Plan
IES	Income and Expenditure Survey
ILO	International Labour Organisation
IMF	International Monetary Fund
INCA	Infrastructure Finance Corporation Limited
IPSA	Institute of Purchasing and Supply (SA)
ISIC	International Standard Industrial Classification
ISM	Institute of Supply Management (US)
IT	Information Technology
ITAC	International Trade Administration Commission
ITC	International Trade Centre
KMP	Khayelitsha/Mitchell's Plain Survey
KS-III	Khayelitsha Survey Wave III
LES	Local Government Equitable Share
LFPR	Labour Force Participation Rate
LFS	Labour Force Survey (Stats SA)
LRA	Labour Relations Act
MEDS	Microeconomic Development Strategy
MERSETA	Manufacturing Sector Education and Training Authority
MICS	Micro-Enterprise Investment Climate Survey
MIDP	Motor Industry Development Programme (South Africa)
MIG	Municipal Infrastructure Grant
MPC	Monetary Policy Committee

MRC	Medical Research Council (South Africa)
MTBPS	Medium Term Budget Policy Statement
MTEF	Medium Term Expenditure Framework
MVA	Manufacturing Value Added
NPA	National Ports Authority
NQF	National Qualifications Framework
NRF	National Research Foundation (South Africa)
NSDP	National Spatial Development Perspective
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
PAMTS	Provincial Advanced Manufacturing Technology Strategy
PAYE	Pay as you earn
PDI	Previously Disadvantaged Individual
PFMA	Public Finance Management Act
PGDS	Provincial Government and Development Strategy
PIMD	Provincial Index of Multiple Deprivation
PPI	Producer Price Index
PPP	Public Private Partnership
PPP	Purchasing Power Parity
PROVIDE	Provincial Decision-making Enabling
PSDF	Provincial Spatial Development Framework
QES	Quarterly Employment Statistics
R&D	Research and Development
RBT	Rapid Bus Transit
REDs	Regional Distributors
RED1	Regional Distribution One (RED1)
RIDS	Regional Industrial Development Strategy (RIDS)
ROI	Return on Investment
SA	South Africa
SALDRU	South African Labour Development Research Unit
SAM	Social accounting matrix
SAPO	South African Ports Authority
SAPS	South African Police Service
SARB	South African Reserve Bank
SDA	Service Delivery Agreement
SDF	Spatial Development Framework
SEE	Survey of Employment and Earnings (Stats SA)
SEP-LG	Socio-economic Profile of Local Government
SETA	Sector Education and Training Authority
SIC	Standard Industrial Classification
SIP	Strategic Infrastructure Plan

SITC	Standard International Trade Classification
SM3	Strategic Micro and Macro Modelling
SMME	Small, Medium and Micro Enterprise
STATS SA	Statistics South Africa
TB	Tuberculosis
TGR	Target Growth Rate
the dti	The Department of Trade and Industry (South Africa)
TRIPS	Trade-related Intellectual Property Rights
UCT	University of Cape Town
UIF	Unemployment Insurance Fund
UILs	University-industry linkages
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
WCED	Western Cape Education Department
WCO	World Customs Organisation
W&RSETA	Wholesale & Retail SETA
WTO	World Trade Organisation
YTD	Year to date

1

Executive Summary

1. Moving ahead on shared growth and integrated development

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

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

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

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

¹ The Presidency, 2007

² ANC, 2007 (a)

Drawing lessons from East Asia where significant inroads into poverty were achieved through investments in equity, particular with regard to education and health³, the SA adaptation demands a particular mix of strategic, organisational and technical capacity that will ensure higher levels of broad-based economic growth and social inclusion.

A key part of the debate centres on the appropriate governance model for provincial and local government that is optimum for leading economic development and service delivery into a third democratic term⁴. This examination is valid and compelling, given Government's imperative to improve both the pace and quality of service delivery if targets are to be achieved.

Unlike many other countries, SA's mode of decentralisation did not evolve out of socio-economic considerations. Rather, our present intergovernmental system is the outcome of historical factors and a negotiated political settlement in the early 1990s. This does not mean that decentralisation has not borne socio-economic benefits over the past 13 years; rather, that the primary rationale for decentralisation, particularly at the provincial level, was based on political imperatives in the negotiation to democratic transition. Socio-economic considerations were secondary concerns at the time⁵.

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

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

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

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

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

³ World Bank, 2006

⁴ ANC, 2007 (b)

⁵ Momoniat, 1999

cohering with local government actions all while appreciating and anticipating significant institutional reform to its powers and functions?

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

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

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

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

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

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

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

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

Social stability and social cohesion hence form a key element of the Province's development strategy. Demographic projections estimate that the coloured population will remain the dominant grouping by 2030 with an increasing proportion of african people and a relative decline in the number of white people living in the Western Cape.

The burden of poverty, unemployment, crime and violence is experienced disproportionately by african and coloured people, women and the youth. These aspects raise the importance of policies of social inclusion and addressing vulnerability as integral to a shared growth and integrated development approach.

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

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

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

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

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

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

⁶ Province of Western Cape, 2006

A key such initiative is the Cape Town Functional Region (CTFR) project. Recent global and national spatial development debates are emphasising the concept of functional regions as the drivers of economic competitiveness and social equity concerns⁷. Internationally, regions are touted as the key economic space that supports successful cities, and cities as the drivers of flourishing functionally connected regions⁸.

Such is also the thinking behind the latest iteration of the National Spatial Development Perspective (NSDP) that views district and metro governance structures as the “essential building blocks for a regional focus”. The NSDP suggests that district and metros should develop a “shared understanding of the social, growth and environment trends, processes and dynamics at play, providing strategic leadership and seeking to align the plans of all levels and departments of government, communities, labour & the private sector to maximize growth and development opportunities⁹.”

Analysis of the Western Cape’s spatial dynamics highlights the socio-economic dominance of the City of Cape Town as the Province’s single major city and its surrounding municipalities, including the towns of Paarl, Stellenbosch and Wellington. The city-region is interwoven in respect of a wider set of economic connections, transport corridor links, social and institutional networks, bringing into play a new emphasis in respect of governance arrangements and partnerships¹⁰.

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

Branded as the Cape Shared Growth Initiative (Csgi), the move signals a new era of intergovernmental¹¹ and broader stakeholder participation, including business, the community sector, state-owned enterprises and educational institutions, in an ongoing process aimed at positioning Cape Town and its supporting functional region for accelerated economic growth and inclusion¹² in line with the stated objectives of *iKapa Elihlumayo*.

⁷ OECD, 2007
Pastor et al., 2007
Mohamed, 2006

⁸ Clark, 2007

⁹ *ibid*, p.3

¹⁰ Mohamed, 2006

¹¹ The main drivers of the CTFR are the City of Cape Town and the Province. They are supported at the broader level by the Cape Winelands, Overstrand and West Coast district municipalities, and at a more focused level by the Stellenbosch, Drakenstein, Overberg, Theewaterskloof, Swartland and Saldanha local municipalities.

¹² Csgi, 2007 (a)

At the nascent stage, the project is focusing on bringing all major stakeholders and roleplayers together in a series of seminars addressing key regional issues that require greater coordination and alignment for success. These include regional competitiveness and priority sector growth; increased social and economic inclusion; education for shared growth; research and innovation; transport, freight and logistics; climate change and sustainable resource use; and leadership and social capital.

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

The resulting report, *Competitive Cities in the Global Economy*, draws on case studies to present policy recommendations that will guide city-regions to position themselves for greater economic success and improved socio-economic inclusion and equity in a globalised world¹³.

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

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

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

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

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

¹³ OECD, 2007

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

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

Chapter 2: Economic Outlook: 2007/08 – 2009/10 draws on global and national economic dynamics in presenting a macroeconomic outlook for the Western Cape for the medium term period 2007/08 to 2009/10.

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

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

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

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

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

This year the focus has been to streamline the analyses, presenting the data and information in a manner that is more accessible to the reader without detracting from the depth of analytical rigor in support of evidenced-based policy debate and decision making in the Province.

3. Western Cape's economic outlook: 2007/08 – 2009/10

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

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

3.1 Trends in the SA economy

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

Capacity constraints underpinning fixed investment spending, infrastructure investment and stronger net export growth are likely to be important countervailing forces to the slowdown in the domestic consumer market, ensuring a sustained 4,5 to 5 per cent level of growth in the economy overall.

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

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

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

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

On the inflation front, CPIX inflation has increased from 3,7 per cent in April 2006 to 5 per cent in August, remaining at this level for the remainder of 2006, but picking up further to 6,3 per cent in April 2007. CPIX inflation is projected to trend slightly above the upper 6 per cent target range over the next 8 to 10 months, before moderating again closer to the 5 per cent level towards the end of 2008.

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

The cumulative growth of the SA economy over the past seven years has led to production capacity constraints across many industries. In a sustained 4,5 per cent to 5 per cent real GDP growth scenario, these production capacity constraints will continue to underpin fixed investment spending. It is expected that private fixed investment spending will remain robust over the short to medium term. Combined with the public sector infrastructure-spending programme this will increasingly drive economic growth.

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

Improved income growth is boosting the financial positions of households, which in turn, buoys consumer confidence and spending. Real personal disposable income growth measured 6,6 per cent last year. While the new momentum in employment creation is encouraging, there is scope for further improvement, particularly in the tradable goods sectors.

Real GDP growth is projected to decelerate moderately from a 5 per cent tempo during 2004 to 2006 to 4,8 per cent during 2007 due to the impact of higher inflation and interest rates. However, the upbeat domestic economic growth outlook remains in place over the medium term. Growth is projected to accelerate again in 2008 and in the run-up to the 2010 FIFA World Cup.

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

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

	Ave 2001 — 2006	2006	2007F	2008F	2009F	2010F
<u>Expenditure on GDP</u> (real % change):						
Household consumption	5,1	7,3	4,8	4,3	4,5	4,9
Fixed investment	8,1	12,8	10,1	8,4	7,7	9,1
Gross domestic expenditure (GDE)	5,8	8,7	5,2	4,9	5,0	5,7
Exports	3,3	5,5	7,3	6,5	6,5	7,7
Gross Domestic Product (GDP)	4,1	5,0	4,8	5,0	4,9	5,4
<u>Inflation, interest & exchange rates</u>						
CPIX inflation	5,9	4,6	6,0	5,6	5,2	5,5
PPI inflation	6,0	7,6	9,1	6,4	5,2	5,3
Prime overdraft rate	12,94	11,12	12,97	13,31	12,50	12,50
R/US\$ exchange rate	7,71	6,77	7,44	7,93	8,41	8,89
R/euro exchange rate	8,44	8,50	9,94	10,44	10,71	10,96

Source: Bureau for Economic Research

3.2 The Western Cape economy

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

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

Overall formal sector regional employment growth improved during 2005 and 2006. However a number of sectors are continuing to retrench workers. These include the agriculture, clothing & textiles, wood & paper, furniture and communication sectors. The sectors that reported healthy employment growth are financial & business services, electricity & water, wholesale & retail trade, construction, transport & communication and general government.

Therefore, while the overall provincial economic growth picture remains upbeat, particularly in the leading services industries and in construction, there is scope for stronger and more broader-based employment growth. The unsatisfactory employment picture is influenced by the struggling manufacturing sector and large-scale retrenchments in the agricultural sector.

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

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

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

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

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

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

Between 2000 and 2005 real fixed investment spending in the Western Cape economy accelerated to 6,8 per cent a year compared to only 4 per cent a year over the decade from 1995. Fixed investment spending was particularly strong during 2004 (12,8%), 2005 (11,9%) and estimated at 10,7 per cent last year. This compares to an average annual growth rate of 10,3 per cent in real gross domestic fixed investment nationally.

The outlook for fixed investment remains bullish as production capacity constraints are expected to underpin capital spending. The Cape Town harbour will be expanded, the new owners of the Victoria & Alfred (V&A) Waterfront development are preparing for a major overhaul and expansion, construction of the World Cup soccer stadiums are in the offering, Eskom is building two new gas-fired power generation plants (scheduled for completion mid-2007) and planning a new nuclear power station, transport infrastructure will witness a major upgrade, to name a few. The rate of fixed investment growth in the Province should at least track that projected for national.

Table 2 below sets out the macroeconomic and sectoral outlook for the Western Cape for the fiscal years 2007/08 to 2009/10. Regional GDP growth is projected to soften from 5,7 per cent in 2005/06 and an estimated 5,3 per cent in 2006/07, to 4,9 per cent in 2007/08; thereafter growth is projected to re-accelerate in the run-up to the 2010 FIFA World Cup event to 5,7 per cent in 2009/10¹⁴. The regional economic growth momentum is therefore expected to remain vigorous and exceed that of national.

Table 2: Outlook for the Western Cape economy: 2007/08 – 2009/10¹ (%)

	Ave 2000 – 2005	2005/06	2006/07 ^e	MTEF		
				2007/08F	2008/09F	2009/10F
GDPR (R billion; current prices):	-	232,7	260,3	288,5	318,5	354,7
Real GDPR % growth	4,7	5,7	5,4	5,1	5,3	5,7
GDPR deflator	6,7	5,4	6,2	5,8	5,3	5,4
CPI inflation	5,2	4,6	4,8	5,8	5,2	4,9
GDPR by sector (real % change):						
Agric, forestry & fishing	1,6	4,4	2,7	1,9	2,4	2,8
Mining & quarrying	-0,5	0,9	0,8	2,0	2,6	2,7
Manufacturing	3,1	4,9	3,7	3,5	3,5	3,6
Electricity, gas & water	3,7	3,8	3,6	3,4	3,7	4,1
Construction	8,0	13,1	15,2	13,8	12,2	12,7
Wholesale & retail trade, catering & accommodation	6,0	6,6	7,0	5,5	6,1	6,4
Transport & communication	6,4	6,3	5,6	6,3	6,6	7,0
Financial & business services	6,6	5,9	5,6	5,7	5,9	6,3
CSP services	3,5	4,8	3,1	3,0	3,2	3,5
General government	1,0	3,0	3,3	2,9	2,9	3,2
Western Cape GDPR	4,7	5,7	5,4	5,1	5,3	5,7

Source: Bureau for Economic Research

Note: ¹ Fiscal years ending 31 March

¹⁴ The projected growth rates are higher compared to those contained in the MTBPS compiled before the revisions of the GDPR data by Statistics SA.

4. Economic modelling and regional impact analysis

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

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

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

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

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

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

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

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

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

General equilibrium analysis therefore has a macro-economic focus; making its applicability more suited to economy-wide analysis rather than detailed impact analysis where there are limited linkages. Despite such limitations, general equilibrium modelling has been carried out at various levels of the economy, from national, to regional or provincial level, as well as town level.

4.1 Strategic micro and macro modelling

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

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

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

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

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

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

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

Initial research using the Western Cape SAM suggests that primary agriculture's potential to contribute to employment and value added was found to significantly exceed those of the non-agricultural sectors in the Western Cape. Agribusiness showed substantially higher employment multipliers than other non-agricultural sectors.

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

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

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

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

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

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

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

4.2 General equilibrium analysis for the Western Cape

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

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

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

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

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

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

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

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

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

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

4.3 The PROVIDE project SAMs and models

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

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

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

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

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

PROVIDE Project case studies

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

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

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

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

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

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

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

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

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

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

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

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

4.4 Future initiatives

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

An update of the SAMs from a base year of 2000 to a base year of 2005 is planned as part of the short term work programme of PROVIDE. Some revisions are envisaged to allow for gender-based research and further CGE model extensions including global modelling for trade issues, energy modelling and regional modelling.

The PROVIDE project provides evidence that the resulting analytical tools are particularly valued for the information they present on the socio-economic impacts of policy decisions and economic shocks, which are of importance from a political perspective in order to gain insight into who will be the potential winners and losers when certain policy changes are considered. A further advantage of CGE analysis is that it allows for systematic economic analysis, contributing to a more focused, disciplined and hence a more constructive policy debate.

5. Regional innovation and growth

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

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

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

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

5.1 A regional innovation system in the Western Cape

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

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

For instance, although geographic proximity may undoubtedly facilitate learning, businesses can make use of other forms of proximity. Organisational, institutional, or social proximity may link actors that are geographically far apart.

The emergence of *global* innovation networks in which businesses from both advanced and developing countries engage in multidirectional knowledge flows is a key feature of contemporary capitalism. It is therefore important to distinguish between the mere existence of clusters, which is widely documented, and localised learning and innovation, about which less is known, especially in developing countries.

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

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

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

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

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

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

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

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

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

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

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

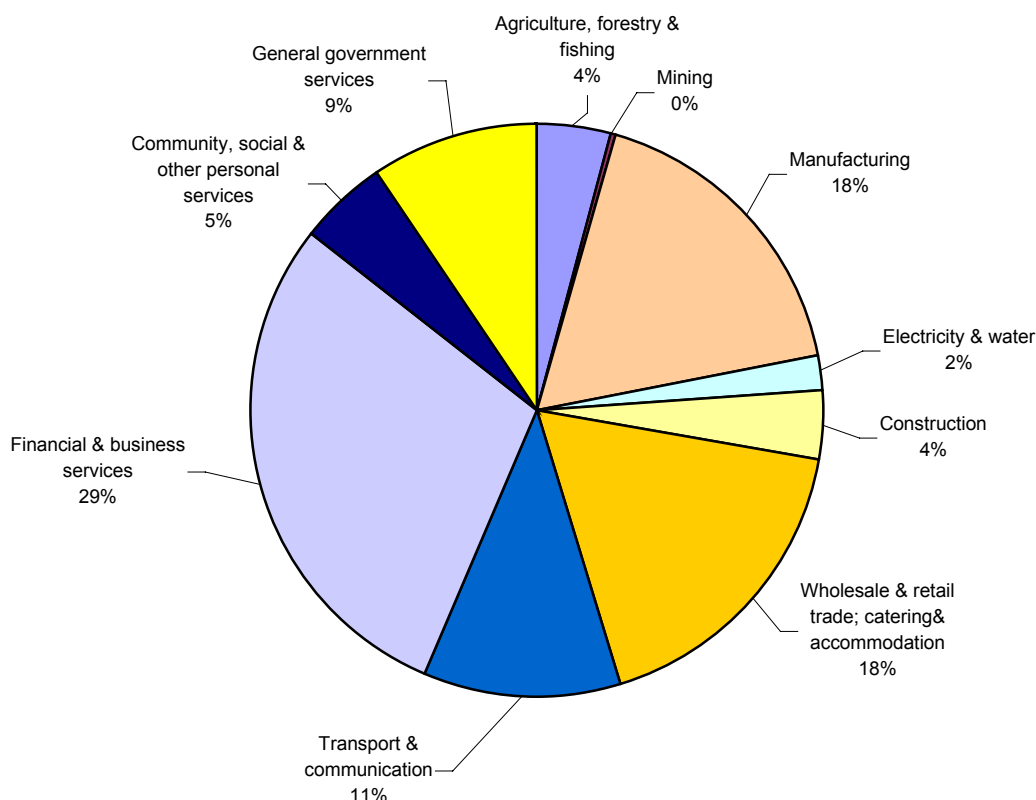
Therefore businesses in the Western Cape are not only important producers or users of technological knowledge in these areas, but mostly both. Again, this suggests the possibility of regional dynamics that merit closer investigation, for example inter-business relationships between lead and laggard businesses.

5.2 Broad overview of sector development in the Western Cape

A broad overview of regional sector development highlights that the economy in the Western Cape is rather diversified, with important activities in the primary, secondary, and tertiary sectors. In 2005 the primary sector consisted predominantly of agriculture, fishing & forestry, which accounted for 4,3 per cent of provincial output, slightly lower than in 2004. The share of manufacturing was 17,6 per cent, also a little lower than in 2004.

The Western Cape is therefore mainly a service economy; over the past years between three quarters and four fifths of value added was generated here. The most important activities in 2005 included financial & business services (29,2%), wholesale & retail trade, catering & accommodation (17,7%), and transport & communication (11,1%), followed by government services (9,5%).

Figure 1: Sectoral contribution to Western Cape output, 2005



Source: Quantec Research, 2007

Over the 11-year period under review here, the activities with the highest average annual growth rates were transport & communication (6%), followed by wholesale & retail trade, catering & accommodation (5,4%), and financial & business services (4,7%). Sectors in long-term decline or stagnation included mining & quarrying (-11,0%) and government services (0%). All other activities grew between 1,5 and 3,7 per cent.

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

Over the period 1995 to 2005 long-term growth rates were highest in financial & business services (5,3%). Wholesale & retail trade, catering & accommodation as well as CSP services grew by between 1,3 and 1,7 per cent. All other sectors declined, except manufacturing, which stagnated. Overall employment also stagnated which is obviously reason for concern because it means that output growth need not lead to job creation.

5.3 Key sector performance: evidence from the MEDS

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

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

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

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

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

About one in ten people working in the Western Cape are part of the *informal economy*. Compared to the rest of the country, people in the Western Cape's informal economy tend to make more money and be more highly educated. However, there are barriers to enter the informal sector, blockages to improving incomes, and obstacles to taking advantage of emerging opportunities. Removal of these barriers relates to access to infrastructure and basic services, financial services, training, and local government regulations.

Printing & publishing employs some 30 500 people, providing one in seven jobs in manufacturing. The sector appears to be in the throes of a long-term decline. The sector suffers from skill shortages exerting upward pressures on wages and encouraging job-hopping. This has led to gradually more capital-intensive production processes, spelling trouble for job growth in this sector, including for semi-skilled workers.

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

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

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

6. Employment dynamics

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

Table 3 below shows that between 2000 and 2005 the Western Cape's working age population grew by 343 000 individuals – an average rate of 2,3 per cent a year – placing the Province under greater pressure in terms of job creation than the country as a whole. Over the same period, the number of individuals wanting work, but not necessarily actively seeking work, that is the broad labour force in the Province, rose by an average rate of 2,7 per cent a year.

Unfortunately, the measured net increase in employment in the Western Cape of 125 000 jobs – that is, the number of jobs created less the number of jobs lost – is not statistically significant. In contrast, broad unemployment in the Province is higher at 25,5 per cent in 2005 than it was in 2000, having risen at an average growth rate of 6,8 per cent a year. A similar, though less rapid, rate of growth in unemployment was observed nationally where broad unemployment in 2005 reached 38,8 per cent.

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

Of concern is the increase in the number of the discouraged workers in the Province, comprising those who want to work and are available to work, but who are not actively looking for work. Over the five-year period, the Western Cape experienced an increase in the number of the discouraged workseekers at an average rate of 12,1 per cent a year, contributing to a widening of the gap between the provincial broad or expanded rate of unemployment and the narrow rate of unemployment.

Table 3: Labour Market Aggregates, 2000 and 2005

	2000 (‘000s)	2005 (‘000s)	Total change		Ave. ann. growth (%)
			(‘000s)	(%)	
Western Cape					
Working age population	2 834	3 177	343	12,1	2,3
Employed	1 601	1 726	125	7,8	1,5
Broad unemployed	426	591	165	38,7	6,8 *
Broad labour force	2 027	2 317	290	14,3	2,7
Narrow unemployed	319	403	84	26,3	4,8
Narrow labour force	1 920	2 128	208	10,8	2,1
Discouraged work seekers	107	189	82	76,6	12,1 *
GDPR (2000 prices, R million)	119 099	150 176	31 077	26,1	6,0
SA					
Working age population	27 869	29 697	1 828	6,6	1,3
Employed	12 238	12 300	62	0,5	0,1
Broad unemployed	6 379	7 799	1 420	22,3	4,1 *
Broad labour force	18 618	20 100	1 482	8,0	1,5 *
Narrow unemployed	4 162	4 487	325	7,8	1,5
Narrow labour force	16 400	16 788	388	2,4	0,5
Discouraged work seekers	2 218	3 312	1 094	49,3	8,3 *
GDP (2000 prices, R million)	838 218	1 016 750	178 532	21,3	4,9

Source: Provincial Treasury calculations, September 2000 and 2005 LFS, Statistics SA 2001 and 2006, Bureau for Economic Research, 2006

Note: Statistical significant changes at the 95 percent confidence level are indicated with an asterisk (*).

In total, in 2005 the employment rate in the Western Cape was 54,3 per cent, down marginally from 56,5 per cent in 2000. However, disaggregation reveals substantial inter-group variations. Although at a generally lower employment rate compared to other race groups, the proportion of the african working age population in the Province improved slightly from 45,4 per cent to 49,3 per cent between 2000 and 2005. This is in contrast to the coloured and white employment rates which declined marginally, falling to 54,3 per cent and 61,3 per cent respectively over the period.

Employment rates differ by gender, with 62,1 per cent of working-age males employed compared to only 47 per cent of females. Greater educational involvement amongst young people is evident in an employment rate of just 29,3 per cent amongst 15 to 24 year olds and 69,7 per cent amongst 25 to 34 year olds.

Having matric, a diploma or certificate, or a degree is associated with higher employment rates. In 2005, four-fifths of holders of diplomas or certificates of working age were engaged in employment in the Province. Approximately two-thirds (67,2%) of working-age holders of matric certificates were employed, while employment rates for those with no education, grade 0 to grade eight education, and grade nine to grade 11 education ranged were under 50 per cent.

Examining employment trends, we see that employment in the Western Cape expanded by around 1,5 per cent a year to about 1,73 million people by 2005. The african share of employment increased significantly from 17,2 per cent in 2000 to 25,5 per cent in 2005, while coloureds (50%) and whites (25%) accounted for approximately 75 per cent of provincial employment by 2005.

Provincial employment is dominated by the tertiary sector, accounting for 66,5 per cent of provincial employment in 2005, up from 59,7 per cent five years earlier. Key employers were wholesale & retail trade (24,3%), CSP services (17,8%) and financial & business services (12,7%).

Unemployment trends highlight the severity of the unemployment problems facing different groups and suggest stark labour market segmentation that feeds through into social and economic arenas. In 2005, broad unemployment in the Western Cape was highest amongst africans at 35,9 per cent, compared to 26,1 per cent amongst coloureds and only 7,5 per cent amongst whites.

In line with the national pattern, unemployment is more severe among women than men, with broad unemployment rates of 30,6 per cent and 20,9 per cent respectively. The LFS surveys also confirm the trend observed nationally of higher unemployment rates amongst the youth. In 2005, the highest unemployment was in the 15 to 24 year old (49,1%) and 25 to 34 year olds (23,7%) age groups.

In 2005, unemployment amongst those who have not completed the General Education and Training (GET) phase of education (grades 0 to eight) and those who have not completed the Further Education and Training (FET) phase (grades nine to 11) was 31,7 per cent and 37,1 per cent, respectively. At 20,2 per cent unemployment among holders of matric certificates is still notably higher than that of 2,4 per cent among individuals with a diploma/certificate and 6,0 per cent among those with a degree.

Unemployment concentration patterns indicate that the Province's unemployed are almost exclusively african (41,6%) and coloured (51,7%) with only 5,5 per cent being white. In terms of gender, women form 57,4 per cent and men 42,6 per cent of the unemployed, despite the fact that men account for 52 per cent of the labour force.

The most notable concern, however, is that the unemployed are concentrated in the younger age groups, an issue that is mirrored nationally. In 2005, 41,7 per cent of the unemployed individuals were between the ages of 15 and 24 years and a further 30,7 per cent were aged 25 to 34 years. In other words, seven out of every ten unemployed individuals was under the age of 35 years, even though this group accounted for only 55 per cent of the labour force. The reduction of unemployment rates amongst youth and the promotion of greater integration of the youth into the economy thus represent an important challenge, both provincially and nationally.

A defining characteristic of unemployment in SA is its long-term nature. Most of the unemployed have never worked before, the bulk of these being relatively young labour force participants. In 2005, more than two-thirds (69,2%) of broadly unemployed South Africans reported that they never worked before. This is a considerable proportion of the unemployed and is rooted in the large proportion of young people who have not worked before. Amongst unemployed 15 to 24 year olds, nearly 85 per cent reported never having worked before, while this was true of 68 per cent of those between the ages of 25 and 34 years. The Western Cape pattern is similar to that of SA as a whole. Such long-term unemployment has important consequences for the unemployed, not least of which is the rapid erosion of skills and familiarity with current technologies.

7. SMMEs and the informal sector

The informal sector in Western Cape is extremely small at 9,7 per cent of total provincial employment in 2005 compared to around 20 per cent for the country as a whole. The informal sector employed only around 174 000 individuals, while domestic workers, who are neither truly formal nor informal sector, accounted for under 6 per cent of employment.

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

Enthusiasm for the role and potential for the informal sector to provide employment and incomes to those unable to secure formal sector employment must, however, be tempered as formal and informal sector employment cannot be viewed as substitutes for each other.

In the Western Cape, informal sector workers find themselves inferior to both formal sector and domestic workers in terms of job security, legal protection and access to benefits. Informal sector workers have less legal recourse in the event of disputes with employers, while their lack of benefits in terms of pension/retirement and Unemployment Insurance Fund (UIF) contributions makes them particularly vulnerable to both sudden retrenchment and retirement.

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

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

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

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

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

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

Africans tend to dominate employment in the smallest firms, with 42,5 per cent of individuals engaged in micro-enterprises being african. Coloureds, on the other hand, account for a disproportionate share of employment in larger firms: 54,2 per cent of those working in small firms and 60,3 per cent of those in medium and large firms.

The bulk of micro enterprise activity is concentrated within private households (31,4%) and the wholesale & retail trade (26,9%) industrial sectors, with financial & business services and CSP services accounting for around 10 per cent of employment each. Wholesale & retail trade also accounts for the largest share of employment in very small enterprises: almost 28 per cent of those working in very small enterprises are engaged in wholesale & retail activity.

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

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

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

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

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

Other constraints include a lack of access to business support services. The Western Cape, though, has a relatively strong platform from which to address these concerns, relative to other provinces, in the Red Doors.

While very few informal businesses are not in some way connected to the formal sector, these connections are not always very beneficial to informal businesses. Commonly, informal firms source their inputs and/or stock from formal sector businesses. However, very few are able to break into the market supplying larger formal enterprises. Being able to lock into formal sector supply chains can enable informal sector firms to grow more rapidly, access better technology and forge lasting business relationships that will ensure greater stability for the informal business and enhance sustainability. Through this, formal sector firms and government itself can help improve the fortunes of competitive informal businesses, with government specifically being able to promote formalisation through its procurement requirements.

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

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

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

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

8.1 The inter-relation of socio-economic findings

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

For example, drug-related crimes might be linked to poverty and an ineffective education system, with major implications for the mental health system, social capital and investment. Meanwhile, unfavourable education indicators suggest the ineffectiveness of education programmes, poverty with adverse effects for social capital, skills, literacy and health in general.

Therefore, the indicators should be read mindful of the issues around the extent to which government programs address issues of access, affordability and relevance of the education system to the needs of the economy and the community.

Table 4: Social indicators by district

Indicator	Cape Town	Cape Winelands	Central Karoo	Eden	Overberg	West Coast
Health						
Patient nurse ratio	54	32***	31	42	29,00	40
TB Prevalance/100 000 people	N/A	1 113	1 014	1 133	1 142	1 214
TB cure rate	71%	66%	71%	78%	74%	73%
Births under 2,5 kg (%)	2,40%	18%	26%	26%	16%	16%
Under 1 with 1 st measles immunisation	83%	82%	80%	85%	75%	88%
HIV deaths (2010)	41 306	1 163	106		3 108	807
HIV prevalence rate (2010)	6,90%	4,70%	3,30%	4,60%	4,90%	4,30%
Education						
Educator learner ratio	39	38	36	40	37,00	37
People over 14 illiterate	15%	28%	37%	26%	27%	29%
Enrolment rate	96%	99%	87%***	98%	94%***	97%
Unemployment rate	29,2%					
	23,4% (2004)	18%	36%	27%	19%	14%

Source: SEP-LG 2006

*** utilisation of services/facilities not significant

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

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

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

Table 4 also shows that illiteracy rates reported in the districts are relatively high when compared to that of 15 per cent reported for the City. Comparisons can be made between the shortage of schools, illiteracy rates and the eventual unemployment rates for the specific districts. In particular, a strong correlation exists between the illiteracy levels and the unemployment rate.

High levels of illiteracy are found in predominantly rural areas. The illiteracy levels are particularly high for the Central Karoo (37%), Cape Winelands (28%), Eden (26%), Overberg (27%) and West Coast (29%).

8.2 Economic infrastructure

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

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

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

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

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

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

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

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

In relation to bulk infrastructure, sanitation and pipe blockages are a persistent problem. Many households in the Western Cape do not have access to water-borne sanitation. The proportion of households using the bucket system and without

sanitation facility is estimated at 3,4 per cent. The City has stopped approving new plans as a result of bulk infrastructure backlogs.

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

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

8.3 Economic performance

Contributing 76,5 per cent of the Western Cape's GDP in 2004, the City of Cape Town forms the Province's main economic growth engine. Two economic growth nodes flank the City: the Saldanha-Vredenburg node to the west and the South Cape to the east.

Table 5 below presents the City and district contribution to Provincial GDP in 2004, illustrating key economic contributions from the City (76,5%), Cape Winelands (10,5%) and Eden (6,2%) districts. In contrast, municipalities with a more rural and agricultural bias struggled to grow.

Table 5: City and district GDP contribution, 2004

Region	Share of Western Cape (%)	Share of SA (%)
Central Karoo	0,50	0,07
Overberg	2,37	0,35
West Coast	4,00	0,58
Eden	6,15	0,90
Cape Winelands	10,49	1,54
City of Cape Town	76,49	11,19
Western Cape	100,00	14,63

Source: Own calculations based on Quantec Research, 2007

8.4 Municipal sustainability

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

Internal capacity in relation to staff appears to be healthy when assessed at a district level. However, the staffing situation within individual municipalities is less satisfactory with a strong correlation existing between staff shortages and problem in

basic service delivery. The City is an example of this correlation with less than 90 per cent of its posts filled. Staffing problems within the City are concentrated in critical areas such as engineering, fire fighting and finance.

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

8.5 Fiscal landscape and financial sustainability

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

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

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

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

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

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

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

8.6 Financial sustainability

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

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

8.7 Responding to socio-economic challenges

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

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

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

9. Next steps: PER&O 2008

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

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

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

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