Media Briefing by Deputy President Phumzile Mlambo-Ngcuka
6 February 2006

BACKGROUND DOCUMENT

A CATALYST FOR
Accelerated and Shared Growth-South Africa (ASGISA)

A Summary

BACKGROUND

The core objective of this government as set out in 2004 is to halve poverty and unemployment by 2014. We believe that these objectives are feasible—indeed we would hope to surpass those objectives—because of the steady improvement in the performance and job creating capacity of the economy.

Growth averaged about 3 percent during the first decade of freedom. Since 2004 growth has tended to exceed 4% per year, reaching about 5% in 2005. Good economic policies, positive domestic sentiment, and a favourable international environment have created the opportunity to consolidate our recent gains, and prepare to take our performance to yet a higher level.

With the improvement in the growth rate has come rapidly improving employment creation, though unemployment remains high at over 26%. This is considerably better than the 32% unemployment rate reached a few years ago, but the challenge to reduce unemployment to below 15% and the challenge to halve the poverty rate will not be achieved without effective economic leadership from Government and effective partnerships between government and other key stakeholders such as organised labour and business.

In the course of exploring our opportunities, Government consulted with a range of stakeholders. The Deputy President's task force included the Ministers of Finance, Trade and Industry and Public Enterprises, the Premiers of Gauteng and Eastern Cape, and the Mayor of Johannesburg, representing SALGA. Many other ministers and their departments were included in the discussions, as well as organised business, labour, religious leaders, youth, and women in various groupings and forums. Government also consulted with domestic and international experts. Such consultations and discussions will continue during the course of the implementation of ASGISA. On the basis of these interactions, Government believes that South Africa is ready for ASGISA to be a **national shared growth initiative**, rather than "government's programme".

In Government's investigations, supported by some independent research, we found that the rate of growth needed to allow us to achieve our social objectives is around 5 percent on average between 2004 and 2014. Realistically assessing the capabilities and deficiencies of the economy and the international environment, we have set out a two phase target. In the first phase, between 2005 and 2009 we seek an annual growth rate that averages 4.5% or higher. In the second phase, between 2010 and 2014, we seek an average growth rate of at least 6% of GDP.

Even with this performance, to meet our social objectives we will have to ensure that the environment and opportunities for more labour-absorbing economic activities is considerably improved. More broadly, we need to ensure that the fruits of growth are shared in such a way that poverty comes as close as possible to being eliminated, and that the severe inequalities that still plague our country are considerably reduced. Our vision of our development path is a vigorous and inclusive economy where production products and services are diverse, more value is added to our products and services, costs of production and distribution are reduced, labour is readily absorbed into sustainable employment, and new businesses are encouraged to proliferate and expand.

Our recent growth, though welcome, has been unbalanced in two important respects. The growth is based on a combination of strong commodity prices, strong capital inflows and strong domestic consumer demand, rooted in anti-poverty measures, growing employment, and rising asset prices. The effect, however, of this combination has been to strengthen the currency making it difficult for exporters outside the commodity sector or those who compete with imports to remain competitive. That led to a trade deficit of nearly 4.5% of GDP in 2005, well financed by capital inflows, but demonstrating South Africa's challenge to compete effectively outside of the commodity sector. We perceive a risk of "hollowing out" or at least an unbalanced economy, compounded by the uncertainty of trends in commodity prices, capital flows, and the domestic consumption boom.

The second imbalance was that although the social grant programme has given some impetus to poverty reduction and income redistribution, there remain about a third of South African households not yet able to benefit **directly** from our relative economic success. Moreover, as long as a significant part of the population is excluded from the mainstream economy, our growth potential is considerably constrained.

Sustainable growth at a rate of around 6% would require that the two key imbalances are effectively countered. In developing a strategy for accelerated and shared growth, we adopted a growth diagnostic method of analysis which seeks to identify the "binding constraints" on achieving our objectives. The methodology holds that while all successful economies have certain characteristics in common such as well managed fiscal and monetary policy and competent government administration, each country faces specific challenges in its attempt to move from mediocre to successful. This contrasts with the Washington Consensus approach, widely advocated in the 1980s and 1990s, which posited a fairly long list of "virtuous" actions which would solve any country's economic problems.

BINDING CONSTRAINTS

The list of binding constraints must be short enough and focused enough to allow for a coherent and consistent set of responses. After consultations and discussions we concluded on a set of binding constraints as follows:

- **The volatility and level of the currency.** In spite of major improvements in the administration of fiscal and monetary policy, currency volatility deters investors in tradable goods and services outside of the commodity sector. The rand remains somewhat volatile, though the degree of volatility might be reducing. At times such as the present, the relative volatility is accompanied by an overvalued currency—overvalued in the sense that economic resources are diverted into narrow areas of investment, laying an unsteady foundation for the future. This simply compounds the effects of volatility. A further area where macro-economic policies or implementation can be improved is in expenditure management, particularly in government capital investment, where several agencies budgets are considerably under spent and some run out of funds before the end of the financial year.

- **The cost, efficiency and capacity of the national logistics system.** Because of backlogs in infrastructure, investment, inadequate planning, and in some cases market structures that do not encourage competition, the price of moving goods and conveying services over distance is higher than it should be. In South Africa, which is a fairly large country, with considerable concentration of production inland, and which is some distance from all major industrial markets, deficiencies in logistics are keenly felt.

- **Shortage of suitably skilled labour amplified by the cost effects on labour of apartheid spatial patterns.** Those parts of the legacy of apartheid most difficult to unwind are the deliberately inferior system of education and the irrational patterns of population settlement. In a period of growth it is evident that we lack sufficient skilled professionals, managers and artisans, and that the uneven quality of education remains a contributory factor. In addition the price of labour of the poor is pushed up by the fact that many live a great distance from their places of work.

- **Barriers to entry, limits to competition and limited new investment opportunities.** The South African economy remains relatively concentrated, especially in upstream production sectors such as iron and steel, paper and chemicals and inputs such as telecommunications and energy. In some cases market structure negatively influences the possibilities of downstream production or service industry development. Competition law and industrial policies need to be strengthened to counteract these factors.

- **Regulatory environment and the burden on small and medium businesses.** The mediocre performance of the small, medium and micro business sector in terms of contribution to GDP and employment partly arises from the sub-optimal regulatory environment. The administration of tax, the planning system (including EIAs), municipal regulation, the administration of labour law, and in specific sectoral regulatory environments, regulation unnecessarily hampers the development of businesses.

- **Deficiencies in state organisation, capacity and leadership.** Certain weaknesses in the way government is organised, in the capacity of key institutions, including some of those providing economic services, and insufficiently decisive leadership in policy development and implementation all negatively impact on the country's growth potential .

Countering these constraints entails a series of decisive interventions. These interventions amount not to a shift in economic policy so much as a set of initiatives designed to achieve our objectives more effectively. In developing responses to the binding constraints, we have organised our initiatives into six categories:

- *Macroeconomic issues;*
- *Infrastructure programmes;*
- *Sector investment strategies (or industrial strategies);*
- *Skills and education initiatives,*
- *Second economy interventions; and*
- *Public administration issues.*

IN THE INFRASTRUCTURE INVESTMENT AREA

Government has already begun to ramp up public sector investment. Public sector investment fell below 4% of GDP. In recent years it rose above 6% of GDP. In order to roll-back the backlog that has emerged in the public infrastructure sector, public sector investment is planned to rise to a level of around 8% of GDP. As indicated in the Medium Term Budget Policy Statement in late 2005, government and public enterprise investment expenditure for the period April 2005 and March 2008 is planned to be about R370bn.

Of this about 40% will be spent by public enterprises, mostly Eskom (R84bn) and Transnet (R47bn, of which R40bn is "core"), and mostly on power generation, power distribution, rail transport, harbours and an oil pipeline. The general purpose is to improve the availability and reliability of infrastructure services in response to rapidly growing demand.

The three spheres of government are responsible for about half of the total public sector capital investment over the period through a range of programmes at national department level. The planned rate of growth of the capital budget of government at between 15% and 20% per year is unprecedented in South African history. Projects are distributed to provincial and local government through the municipal and provincial infrastructure grant programmes, while provinces and most municipalities have funds collected from their own revenue sources for capital expenditure. Key areas of expenditure, incorporating all these spheres of government are provincial and local roads, bulk water infrastructure and water supply networks, energy distribution, housing, schools and clinics, business centres, sports facilities, and multipurpose government service centres, including police stations, courts and correctional facilities.

Electronic communications is a key commercial and social infrastructure. Plans to be implemented in this sector include:

- The implementation of a strategy to rapidly grow South Africa's broadband network;
- Implementation of a plan to reduce telephony costs more rapidly;
- The completion of a submarine cable project that will provide competitive and reliable international access, especially to Africa and Asia; and
- The provision of subsidies to encourage the establishment of telecommunications- and labour-intensive business in poor areas.

Another key challenge in the infrastructure sector is preparations for the 2010 FIFA World Cup. This includes building or improving the 10 stadiums to be used, and investment in the environs and access to the stadiums.

Other strategic interventions in the infrastructure arena include further development of the country's research and development infrastructure, and further improvement in the modalities for public-private-partnerships in the development and maintenance of public infrastructure.

Public sector infrastructure spending has considerable potential spin-offs in terms of the generation or regeneration of domestic supply industries, small business development and empowerment. Government is seeking to maximise the positive impact of these spin-offs on the domestic economy.

In addition to the general infrastructure programmes, **provinces were asked to propose special projects that would have a major impact on accelerating and sharing growth.** A set of projects has been selected for finalisation of implementation plans. Some of these projects are already underway. They are:

- The Umzimvubu Catchment and Timber Industries Development Initiative in the Eastern Cape;
- A diamond and gemstone jewellery project in the Northern Cape;
- A biofuels initiative that will cover at least Northern Cape, Free State, KZN, Eastern Cape and Mpumalanga;
- A water reticulation project for Mokopane-Vaalwater-Marken in Limpopo;
- A Moloto Corridor Rail Project, mostly in Mpumalanga;
- The Johannesburg International Airport Logistics Hub and Industrial Development Zone in Gauteng;
- The Makhathini Cassava and Sugar Project in KZN;
- A National Livestock Project that would particularly focus on the Northern Cape and North West;
- The Dilokong Platinum Corridor to integrate development located around the planned De Hoop Dam in Limpopo;
- The proposed Square Kilometre Array and linked projects in Northern Cape; and
- The Cape Flats Infrastructure Project in the Western Cape.

SECTOR STRATEGIES

In order to promote private sector investment, sector strategies are being prepared, and some are in the implementation stage. A broader **National Industrial Policy** framework is in the final stages of preparation and is expected to be submitted to Cabinet in the first quarter of 2006.

Part of the purpose of ASGISA is to focus the energy of government and its partners. For this reason, two sectors were identified for special priority attention: business process outsourcing and tourism, and a third which is at a less advanced stage of development, biofuels. What all of these industries have in common is that they are labour intensive, rapidly growing sectors world wide, suited to South African circumstances, and open to opportunities for Broad Based Black Economic Empowerment (BBBEE) and small business development.

The trend of business world wide, especially in countries where labour is costly, is to locate back-office activities such as accounts or claims processing or front office activities like call centres in cheaper centres, even in other countries, is called *business process outsourcing* (BPO). South Africa has attracted about 5 000 of such jobs from the rest of the world so far. The sector has the potential for 100 000 additional direct and indirect jobs by 2009. Government and business have a joint project, supported by the Business Trust, led by the Minister of Trade and Industry and the Chair of Standard Bank to remove obstacles and refine incentives to achieve this goal.

The other high immediate priority sector is *tourism*. This sector has already grown rapidly in South Africa but is ready for a second phase of growth that could take its contribution to GDP from about 8% to about 12%, and increase employment by up to 400 000 people. Key issues are: marketing, air access, safety, and skills development. This industry also entails a strong government/private sector partnership, which was established during the first phase of growth.

The other high priority industries but less advanced in preparation which are to follow are in the *agriculture and agro-processing* field and include biofuels, referred to above. They have similar advantages and opportunities as tourism and BPO. The 3rd priority sectors which are less advanced in development include:

- Chemicals;
- Metals beneficiation including the capital goods sector;
- Creative industries (Crafts, Film & T.V. Content and Music);
- Clothing and textiles;
- Durable consumer goods; and
- Wood, pulp and paper (as mentioned in provincial projects).

There are several crosscutting industrial policy challenges being addressed too, including:

- Inadequate competition and import parity pricing;
- Capacity for trade negotiations;
- A more coordinated Africa development strategy;

- Better incentives for private R&D investment; and
- Better use of BBBEE to encourage industry transformation, beyond the transfer of equity.

EDUCATION AND SKILLS DEVELOPMENT

For both the public infrastructure and the private investment programmes, the single greatest impediment is the shortage of skills—including professional skills such as engineers and scientists, managers such as financial, personnel and project managers; and skilled technical employees such as artisans and IT technicians. The shortfall is due to the policies of the apartheid era and the slowness of our education and skills development institutions to catch up with the current acceleration of economic growth.

Key measures to address the skills challenge in the educational sphere are:

- The QUIDS UP programme aimed at achieving high levels of literacy and numeracy in the lowest grades;
- The Maths and Science (Dinaledi) programme for 529 high schools to double maths and science high school graduates to 50 000 by 2008;
- An upgraded career guidance programme; and
- A huge upgrading of the Further Education and Training colleges. In addition, the Adult Basic and Education Training programme is to be ramped up, based on a model developed in Cuba and New Zealand.

Other key interventions in the skills sphere include the development of an Employment Services System (to close the gap between potential employers and employees), and Phase 2 of the National Skills Development Strategy. A short-term project is the development of a scarce skills database based directly on the expected needs of the over **100 individual projects** included in ASGISA.

Other key skills projects include the **deployment of experienced professionals and managers** to local governments to improve project development implementation and maintenance capabilities. The project managed by the Development Bank of Southern Africa will deploy an estimated total of 150 expert staff, with the first 30 to be deployed in April 2006. The project will also include skills transfer to **new graduates**. **The DBSA is compiling a database of "retired experts"** for this and further possible deployments.

The Umsobomvu Youth Trust is driving a number of initiatives, many of which entail youth volunteers, to support a range of skills development programmes.

A new institution is the **Joint Initiative for Priority Skills Acquisition (JIPSA).** This is a structure led by a committee of key ministers, business leaders, trade unionists and education and training providers or experts. Its job will be to identify urgent skills needs and quick and effective solutions. Solutions may include special training programmes, bringing back retirees or South Africans and Africans working out of Africa, and drawing in new immigrants where necessary. It may also include mentoring and overseas placement of trainees to fast track their development. JIPSA will have an initial timetable of 18 months, starting in March 2006, after which its future will be reviewed.

ELIMINATING THE SECOND ECONOMY

Without interventions directly addressed at reducing South Africa's historical inequalities, growth is unsustainable. Interventions to address deep-seated inequalities and that target the marginalised poor are interventions to bridge the gap with the second economy, ultimately eliminating the second economy. ASGISA is not the only response to the 2nd Economy challenges.

One of the key mechanisms is to use the **leverage of the first economy** to address the second economy. There are two key examples in ASGISA.

The first is to leverage the **increased levels of public expenditure**, especially **investment expenditure**, to develop **small businesses and broad based empowerment** addressing such issues as: Access to finance, Preferential Procurement, Sectors that are labour intensive and review of regulations impact on this sector**.** For public enterprises, the State Owned Enterprise Procurement Forum is codifying and spreading best practices for affirmative procurement. For the government, the DTI is developing a procedure through which 10 products will be set aside for procurement through smaller black owned business.

Linking small businesses to opportunities deriving from the 2010 FIFA World Cup is another task for government. Private companies will also be persuaded to engage in affirmative procurement and the implementation of the relevant provisions of the BEE Codes of Good Practice and the relevant sector BBBEE charters will be closely monitored. Timely payment by government will also be monitored by the DTI. Infrastructure projects will be labour-intensive where feasible.

We are convinced that to achieve ASGISA's goal of halving unemployment and poverty by 2014, we will have to work more closely with women and the youth. With regard to women the focus will be on:

- Human resource training;
- Ensuring they have access to finance (micro to mega bucks);
- Fast tracking them out of the 2nd economy;
- Ensure their significant participation in agriculture and creative industries;
- Improve their access to basic services; and
- Increase their participation in expanded public works programme.

On youth front, one of the interventions is to target unemployed graduate for jobs or learnerships. We support the Umsobomvu youth fund initiative to register unemployment graduates on their database. We shall ensure that the focus on youth development is intensified in all spheres of government. Among other things during the next financial year, we wil:

- Set 100 new Youth Advisory Centres,
- Enrol at least 10 000 young people in the National Youth Service, and
- We will enrol 5 000 volunteers to act as mentors to vulnerable children
- We will also expand the reach of our business support system to young people and
- Intensify the Youth Cooperative Programme.
- We will closely monitor the impact of our programmes on youth skills training and business empowerment as an integral part of our National Effort.

The other form of leverage will be that all of the sector strategies, such as the strategies for tourism or BPO, will have elements addressing development goals in the second economy. For example, the economic cluster of government is committed to ensure that at least 5 BPO operations are established in poor areas with relatively little economic activity. The targeted beneficiaries are youth and women.

There are several other components of BBBEE which will be leveraged to support shared growth. These include{

- Provisions for access to finance for women and youths,
- Funding commitments for housing and small business loans,
- Skills development commitments,
- Social responsibility commitments, and
- Other commitments to enterprise development. In addition,
- BBBEE charters will be assessed from time to time to establish how broad based their impact has been.

There are several other interventions designed to support small businesses. Nafcoc's commitment to establish 100 000 new SMEs per year is laudable, and Government will support Nafcoc's efforts. A key challenge is to address the gap in loans between R10 000 and R250 000.

One such effort is a new partnership between Khula and Business Partners in a R150 million fund for business loans of this size. Another is a planned fund for women entrepreneurs which is the result of a collaboration between the DTI, Eskom, Umsobomvu and the Women's Development Bank.

The Financial Services Charter R5 billion commitment to small business loans is still be finalised as a programme, but we expect progress shortly under the new leadership of the FSC implementation process. We also plan to accelerate the rollout of the Apex (SAMAF) and Mafisa programmes of loans under R10 000.

For the next stage of business development venture funding is key, and Government is supporting efforts to establish new venture funds for SMMEs. The R1 billion programme recently announced by the IDC and the National Empowerment Fund's venture fund will make a considerable impact on the growth of small businesses. These large interventions will be supported by the development of the Small Enterprise Development Agency based at the DTI, which is rolling out its services, making a stronger operational distinction between small and medium business and micro businesses, and adding to its capacity to take small businesses into manufacturing.

A further key small business initiative will be to pursue the recommendations made to Cabinet on the regulatory environment for small businesses. These recommendations include:

- That the Minister of Labour will lead a review of labour laws, including their impact on small businesses;
- That the reforms in tax administration affecting small businesses will continue;
- That the DTI and DPLG will prepare recommendations on how to improve the regulatory environment for small businesses in municipalities; and
- That sector departments will review the impact of their laws and regulations on small businesses.

In respect of municipalities, the ASGISA process has also mandated the **DPLG, in consultation with the DTI, to improve the capacity of local government to support local economic development.**

Another key Second Economy **intervention is the Expanded Public Works Programme.** This programme will be expanded beyond its original targets in terms of ASGISA.

Firstly, its mandate has been extended to a larger number of roads and some larger road projects. This will entail about R4.5 billion additional funds over the coming Medium Term Expenditure Framework period, about 63 000 more people maintaining roads, and about 100 000 additional people in jobs averaging 6 months in roads building and training.

In addition, 1 000 more small black contractors will be developed. New access roads will have a significant impact on conditions and opportunities in some poor and rural areas.

Other new elements of the EPWP will be a concerted roll-out of its **Early Childhood Development component, home based care** and the finalisation of a process to support local governments in developing larger EPWP projects.

A final set of second economy interventions is centred on the challenge of realising the value of dead assets—land, houses, livestock, skills, indigenous knowledge and other assets that have intrinsic value not currently realised. These include:

- More rapid movement towards the formalisation of land tenure,
- The livestock improvement programme mentioned amongst the provincial projects,
- Efforts to ensure that the financial services charter commitment on housing finance is effectively implemented,
- Improvements in planning and zoning capacities, and
- support for the development of cooperatives.

MACROECONOMIC ISSUES

Regarding macroeconomic issues, one challenge is to find strategies to reduce the volatility and overvaluation of the currency; another is to ensure that within an inflation targeting regime fiscal and monetary policy can work together to produce sustained and shared growth.

A further challenge is to improve budgeting in government, particularly at a macro level where we tend to underestimate revenue and overestimate expenditure, which results in the budget appearing more expansionary than it is, which in turn sends misleading signals to other players in the economic arena.

A fourth area where macroeconomic policies or implementation can be improved is in expenditure management, particularly in government capital investment, where several agencies' budgets are considerably under-spent and some run out of funds before the end of the financial year. One innovation to be introduced in 2006 is the development of a new capital expenditure management information system by the National Treasury.

GOVERNANCE AND INSTITUTIONAL INTERVENTIONS

We have planned on the principle that institutional interventions are costly and should be kept to a minimum, and that, where possible, existing institutions should be levered into new functions and responsibilities.

One issue of concern has been the relatively slow progress made on the implementation of some aspects of the Growth and Development Summit. We believe that the social partners should seek, the context of ASGISA, to make progress towards realization of a people's contract on economic matters – as discussed in the President's Joint Working Group, and referred to as a social contract. The other issue we will focus on is the effective implementation of agreed BEE Charters, and leveraging benefits from offsets.

On Local Government and Service delivery we are focusing on addressing the skills problems identified in Project Consolidate. The skills interventions include the deployment of experienced professionals and managers to local governments to improve project development implementation and maintenance capabilities. The project managed by the Development Bank of Southern Africa (DBSA) will deploy an estimated total of 150 expert staff, with the first 90 to be deployed in May 2006. The project will also include skills transfer to new graduates. The DBSA is compiling as database of "retired experts" for this and further deployments.

For ASGISA implementation, monitoring and evaluation of bottlenecks by the Presidency, it has been decided in Cabinet that the Cabinet Committee for

Investment and Employment would now have ASGISA as a standing item for regular reports and problem-solving at its monthly meetings

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The DPSA has made proposals on improving the quality of economic services, initially through a study of the DTI. This effort will be extended to other relevant areas, including provincial and local government.

Government is committed to reviewing the functioning of the Development Finance Institutions, which include the IDC, the Land Bank, the DBSA and the NDA. These are powerful institutions that should be effectively employed in our developmental efforts and support social mobilisation and active participation of civil society.

There are reports that some investment projects have been held up by unnecessary bureaucratic delays. Government will ensure that investors have access to a one-stop trouble-shooting centre, probably located at Trade and Investment South Africa (TISA).

A new institution, mentioned earlier, will be the Joint Initiative on Priority Skills Acquisition (JIPSA). JIPSA will be lead by a committee headed by the Deputy President, and will include key leaders from government, business, labour and the education and training fields. The National Business Initiative will be providing support services for JIPSA.

A further innovation will be the institution, after finalisation by cabinet, of a system of regulatory impact analysis. The RIA will add well-designed procedures (first developed in the United Kingdom) to reduce or eliminate the negative unintended consequences of laws and regulations, especially on job creation.

A final key area requiring institutional reform is the framework for the planning and management of land use. Many investment projects are unnecessarily held up by the weakness of local or provincial planning and zoning systems, or the cumbersome Environmental Impact Assessment system. The EIA system is being reformed so that it will reduce unnecessary delays, without sacrificing environmental standards. A complimentary activity must be improvements in the planning and zoning systems of provincial and local governments.

CONCLUSION

The implementation of ASGISA which must still be adjusted and fine tuned in the context of ongoing consultations has already begun. Government will regularly review progress in the implementation of ASGSA, and will draw its social partners into such evaluations from time to time. The programme will also be subjected to expert review, such as from the team of economists and social scientists based at Harvard and other universities. Where necessary, the programme will be amended or supplemented.

We believe that we have built the basis for a national programme of shared economic growth. With this programme we can achieve our social objectives, and we can more than meet the Millennium Development Goals. Our second decade of freedom will be the decade in which we radically reduce inequality, and virtually eliminate poverty. We know now that we can do it, working together around an initiative which has the support of the nation.