South Africa

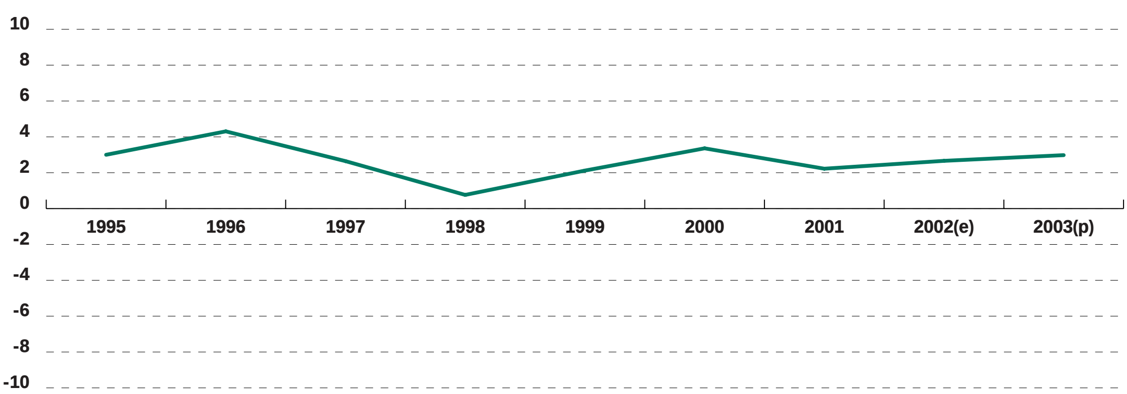
key figures

• Land area, thousands of km²	1 221
• Population, thousands (2001)	43 792
• GDP per capita, $ (2001)	2 587
• Life expectancy (2000-2005)	47.4
• Illiteracy rate (2001)	14.4

TEN YEARS AFTER APARTHEID ENDED, South Africa still faces the challenges of reducing inequality and enhancing growth performance. The policies implemented so far have had somewhat limited results. In terms of growth, South Africa, grew by 2.2 per cent in 2001, from 3.4 per cent in 2000, mainly on account of a contraction in overseas demand that lowered export prices and volumes. However, the sharp depreciation of the exchange rate at the end of 2001 mitigated the slowdown of the economy, and growth is expected to be about 2.7 per cent in 2002 and 3 per cent in 2003, supported by buoyant exports, domestic demand and higher public investments. The positive expectations are, however, precarious as uncertainty and lack of confidence in the economy remain, fuelled by the political instability in neighbouring Zimbabwe, the delay in the privatisation process, the high level of crime, and the handling of HIV/AIDS. These are among the main factors that determined the sharp depreciation of the rand in the second half of 2001 (when it depreciated by 34 per cent against the US dollar). Although this depreciation boosted exports in some manufacturing sectors, it was responsible for an upsurge in the inflation rate. The response has been to tighten monetary policy, moving in the opposite direction of the 2002/03 mildly expansionary budget. Against this background, the prospects for reducing the high unemployment, fighting poverty and promoting social cohesion remain low.

Despite the competitiveness gains reaped in 2002, South African growth prospects remain precarious

Figure 1 - Real GDP Growth



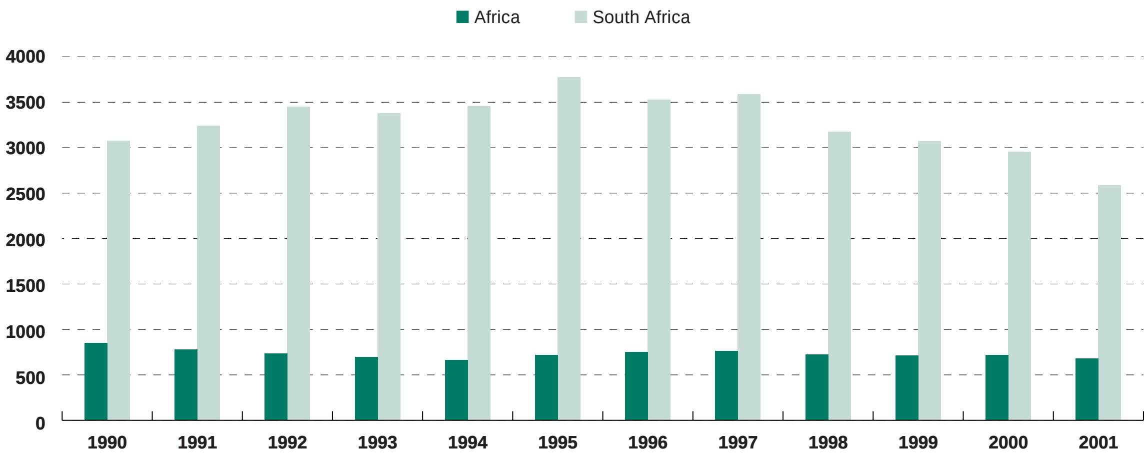
Source: Authors' estimates and prospects based on South African Reserve Bank data.

Recent Economic Developments

The South African economy has inevitably suffered from the slowing down of the global economy, but still succeeded in keeping growth at 2.2 per cent, aided by a strong export performance following the depreciation of the rand. Indeed, the second half of 2001 was characterised by sharp depreciation of the rand as a result of the confluence of economic, political and confidence factors built up during the year. This was responsible for an upsurge in inflation which has continued its upward trend since the last quarter of 2001, reaching 12.5 per cent in October 2002 from 5.8 per cent in September 2001.

The growth performance of 2001 can be explained by the steady increases in manufacturing, construction, and the tertiary sector. The ongoing depreciation of

Figure 2 - GDP Per Capita in South Africa and in Africa ($ current)



Source: Authors' estimates based on IMF data.

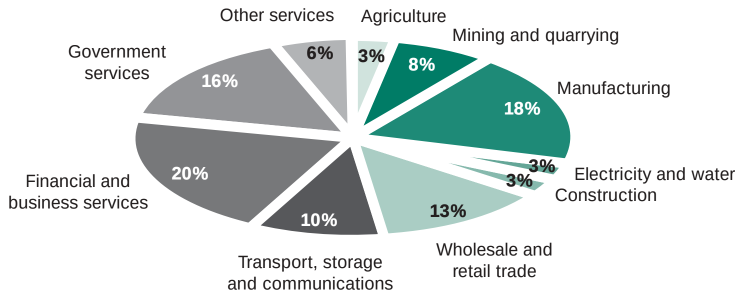
the rand has boosted manufacturing output which grew by 3.4 per cent in 2001, accelerating to 5.5 per cent in the last quarter of 2001 in tandem with the peak of the rand's depreciation. Construction grew by 5 per cent, backed by the lower interest rate that boosted the sales and construction of homes and buildings. The tertiary sector expanded throughout 2001, buoyed by continuous expansion of financial intermediation and transport and communications sectors and by the sustained growth of retail trade. Growth for 2002 is estimated at 2.7 per cent, rising to 3 per cent in 2003. In 2002, growth of the general economy was sustained by buoyant exports, a pick-up in the demand for goods produced by import-competing industries, and public investments.

In the mining sector, despite a sharp decline in gold production, mining output remained unchanged at the levels of 2000, owing to continued strong output of platinum and diamonds which also experienced robust growth in 2002. The mining industry is experiencing turmoil owing to the Minerals and Petroleum Development and Resource Bill passed in late June 2002. This is significant in so far as this is the first time in South Africa's 130-year mining history, that mineral rights are vested with the state. The main purpose of the Minerals and Petroleum Bill is to set out how South Africa can manage its mineral resources in a way that will bring about transformation in the mining industry. The new mining legislation, which should come into effect early next year, will grant mineral rights for 30 years, while the international average for mineral rights is 25 years.

The government Act, which is backed by black empowerment groups and trade unions, aims at creating better opportunities for black business, as well as small and medium enterprises. The law is strenuously opposed by the main mining conglomerates because it is seen as not providing the long-term security necessary to justify billion dollar investment decisions. Further discontent by the white-controlled mining companies has been caused by the leaking of the empowerment mining charter which states that at least 51 per cent of the mining industry must be transferred to black power entities within ten years. The leaked charter was understood as partial nationalisation, provoking a fall in the mining stocks.

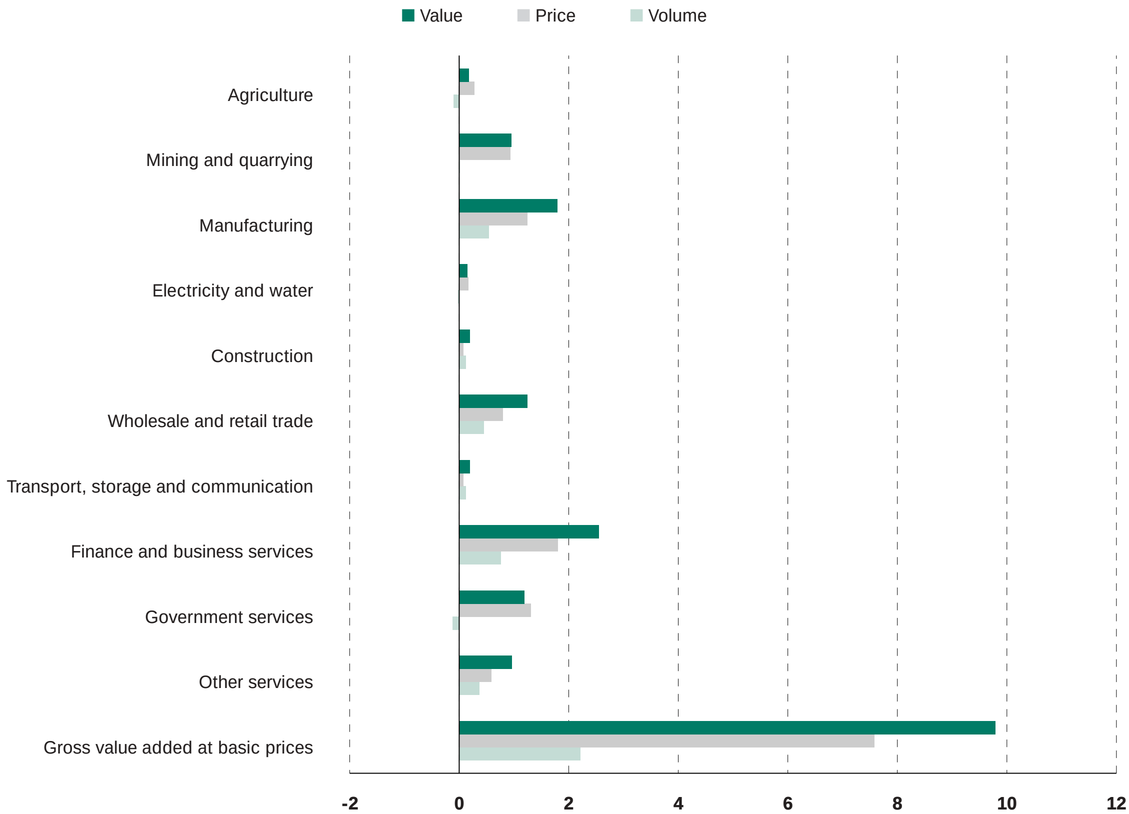
The government has therefore backtracked, pointing out the draft was still to be negotiated with the industry and labour force. A task force of the government, industry, black business and unions has been established with the scope of drawing up a new mining charter. The government ensured that the new mining charter would not measure empowerment by percentage targets and that any sale or transfer of ownership in the mining industry would be undertaken in a transparent manner at fair-market value.

Figure 3 - Structure of GDP in 2001



Source: Authors' estimates based on South African Reserve Bank data.

Figure 4 - Sectors' contribution to growth in 2001



Source: Authors' estimates based on South African Reserve Bank data.

The manufacturing sector has shown mixed results over the last five years. Following the continuous rand depreciation, some sub-sectors, such as chemicals, basic metals and motor vehicles manufacturing, and the related leather and rubber products, have raised output substantially. The growth rate of the motor vehicles parts and accessories averaged 4 per cent per annum from 1996 to 2001 and with the rand still at quite depreciated levels, it is expected to continue expanding in 2002 and 2003. Although small, the fastest growing manufacturing sub-sectors are plastic products, television, radio and communication equipment which grew on annual average by more than 8 per cent over the past five years. On the other hand, more labour-intensive sectors, such as textiles, clothing and footwear, have been hard hit by low domestic demand, tariff reductions and increased international competition. These sectors have experienced a slow growth, or in some cases negative growth, resulting in significant employment losses. It is important to emphasise that if we look at manufacturing performance in aggregate over the last 5 years (1996-2001) there has been a small growth in output hovering annually in real terms at around 2 per cent with a parallel average annual decline in employment of around 2 per cent. This partly explains increasing productivity growth in the last five years – where firms have become more productive but at the cost of jobs.

The tertiary sectors continued to expand significantly all through 2001. Wholesale and retail trade grew by an average rate of 3.5 per cent in 2001 and experienced an acceleration in the fourth quarter of the year, owing to pre-emptive buying by consumers in response to high inflation expectations. Over the same period, the transport, storage and communication sectors grew by an average of 3.7 per cent. Growth in these sectors was spurred by increased activity in the telecommunications industry, where a third cellular telephone operator – Cell C – started operations in 2001, an increase in harbour and docks traffic, and lively foreign tourism. Recent statistics show that foreign tourism increased substantially in 2002 (the number of non-residents visiting South Africa rose from 4.8 million in the first 10 months of 2001 to 5.3 million in the same period of 2002), boosted by the rand depreciation. A number of initiatives in environmental and tourism policy are expected to boost tourism even further. These include: the Transfrontier Conservation Area Program, World Heritage sites, and the Coastcare and the Wetlands Conservation programme. Although affected by the global downturn, the financial intermediation, insurance, real estate and business services sector maintained a growth rate of 4 per cent, compared with 6 per cent in 2000.

Agriculture's share of total output is about 3 per cent of real gross value added. However it remains an important sector in terms of employment creation, accounting for 11.2 per cent of the country's employment. The strong growth of agriculture in 2000 was followed in 2001 by a decline in output of an estimated 3 per cent. As a result of a substantial decrease in the production of summer crops, the volume of field crop production decreased by 15 per cent compared to the previous year. Horticultural production decreased by 4.5 per cent while animal production decreased by 4 per cent. Maize, which is the most important field crop (white maize, in particular, is the staple food for the major part of the population) experienced a decrease to 8 million tonnes in 2001 compared to 11.4 million tonnes in 2000, owing to less than normal rainfall at the beginning of 2001. The lower domestic production and the regional shortage (especially in Zimbabwe) coupled with the depreciation of the rand led to an increase in maize price - from R800 per ton in June 2001

Table 1 - Demand Composition (percentage of GDP)

	1995	1999	2000	2001	2002(e)	2003(p)
Gross capital formation	**18.1**	**16.0**	**16.1**	**15.6**	**16.1**	**16.8**
Public	4.3	4.8	4.1	3.8	4.0	4.4
Private	13.8	11.2	12.1	11.7	12.1	12.4
Consumption	**81.0**	**81.4**	**81.1**	**80.6**	**79.3**	**78.4**
Public	18.4	18.4	18.1	18.1	18.1	18.4
Private	62.6	63.0	63.0	62.5	61.2	60.0
External sector	**0.9**	**2.6**	**2.8**	**3.8**	**4.6**	**4.8**
Exports	23.0	25.6	28.6	31.0	32.8	34.0
Imports	-22.1	-23.0	-25.8	-27.1	-28.2	-29.2

Source: Authors' estimates and predictions based on South African Reserve Bank data.

to R1 500 per ton in June 2002. In the first half of 2002, the declining trend of agricultural output was reversed thanks to the good wheat crop, the second most important field crop of the country, which determined a growth of the sector of 4.5 per cent.

Compared to other emerging economies – South Africa is still characterised by relatively low levels of investment. Indeed, the investment/GDP ratio decreased from 18 per cent in 1995 to 15.6 per cent in 2001. Public sector investment, in particular, has not grown at a high pace in the last five years despite government emphasis on the need for public investment as a boost for economic growth. However, in 2002, it is estimated that gross fixed capital formation recorded an increase as a result of the higher level of government spending directed at improving the road network and at urban renewal and higher private investments in the cellular telephone industry, tourism and in platinum mining. The same trend is expected for 2003.

Although average growth in real private consumption slowed down from 3.5 per cent in 2000 to about 3 per cent in 2001, it accelerated in the fourth quarter of 2001, reflecting some pre-emptive buying of transport equipment by consumers to avoid further price rises. In 2002, the growth pattern of household consumption was mixed, underpinned on one side by nominal wage increases and tax cuts in the 2002/03 budget and constrained on the other side by monetary tightening, which raised the financing costs on instalment sale credit, compressing durable goods purchases. Real government consumption increased by 1.5 per cent in 2001 compared with 0.5 per cent in 2000, reflecting the expansionary stance of the 2001/02 budget. This increase, which continued in 2002, resulted from higher spending on intermediate goods and services and higher employee remuneration. Notwithstanding these developments, the ratio of final consumption expenditure by general government to gross domestic product has remained at about 18 per cent since 2000. In 2003, the public consumption ratio over GDP is expected to continue to increase mainly thanks to additional spending on targeted social welfare services. The external position is estimated to have improved in 2002 in line with the increase in competitiveness due to the rand's fall. The same trend is expected for 2003.

Macroeconomic Policy

Fiscal and Monetary Policies

The government's continued efforts to contain the deficit resulted in a deficit/GDP ratio of 1.4 per cent in the fiscal year 2001/02 (well below the official 2.5 per cent target). The low deficit partly reflects improvements in tax collection, owing to the increased efficiency of the South African Revenue Service. The increase in tax collection (by 15 billion rand more than budgeted) counteracted the lower than expected proceeds from privatisation (which were expected to be about R18 billion in 2001/02 and were limited to R2.3 billion). However, part of the reduced deficit stems from underspending by provinces and local governments, where much of the spending is channelled, owing to capacity constraints and lack of co-ordination. Recent official data indicate that provinces spent less than 47 per cent of their capital allocation between January and September 2001.

In line with the 2001/02 budget, which, against a background of improvement in the fiscal position, led to a transition from fiscal austerity to a growth-oriented policy, the 2002/03 budget is mildly expansionary. This policy has also been undertaken in response to the global slowdown and the sluggish domestic economy. The 2002/03 budget focuses on increasing spending on social services, (supporting an enhanced programme to address the impact of HIV/AIDS) and promoting tax cuts for individuals, further tax incentives for investment, and a more generous tax regime for small business. Government spending is budgeted to grow by 9.6 per cent to R287.9 billion ($33 billion at the 2001 average exchange rate of 8.6 Rand per $) in 2002/03, while revenue is expected to increase by 6.5 per cent to R265.2 billion($30.7 billion). Education, health and welfare expenditure accounts for about 57 per cent of non interest allocations in 2002/03 and are expected to grow by an average of 4.1 per cent a year in real terms for the next three years. Capital

Table 2 - Public Finances[a] (percentage of GDP)

	1995/96	1999/00	2000/01	2001/02	2002/03(e)	2003/04(p)
Total Revenue and grants[b]	**22.5**	**25.0**	**24.6**	**25.9**	**25.3**	**25.1**
Tax revenue	22.1	24.4	24.2	25.5	24.8	24.6
Total expenditure and net lending[b]	**27.5**	**27.0**	**26.6**	**27.4**	**26.6**	**27.1**
Current expenditure	25.3	26.4	26.2	26.5	25.8	25.7
excluding interest	*20.1*	*22.4*	*21.2*	*21.7*	*21.6*	*21.8*
Wages and salaries	10.3	10.4	10.1	10.0	9.8	9.8
Interest	5.2	4.0	5.1	4.8	4.1	3.9
Capital expenditure	2.4	1.4	1.4	1.8	1.8	2.0
Primary balance	**0.2**	**2.0**	**3.1**	**3.4**	**2.8**	**1.9**
Overall balance	**-5.0**	**-2.0**	**-2.0**	**-1.4**	**-1.4**	**-2.1**

Notes: a: Fiscal year begins 1 April.
b: Only major items are reported.
Source: Authors' estimates and predictions based on South African Reserve Bank and IMF data.

spending is budgeted to grow by 9 per cent a year in real terms for the next three years, including strong investment in both social infrastructures - such as schools, hospitals, and housing – and provision for investment in roads, water services and other economic assets. Moreover, 13 per cent of the expenditures will be devoted to expanding the country's police service and to reinforcing the administration of justice. However, such ambitious plans may be compromised by the strategy pursued by the government: 80 per cent of total expenditures will be channelled through provinces and local governments which have so far proved to be inefficient and unaccountable. In order to solve the problems linked to underspending and capacity constraints at the provincial and local levels, the government started to strengthen managerial capacity building programmes, upgrade information systems and enhance financial management training. However, it will take some time before the absorption capacity of the local entities improves.

On the revenue side, the sharp improvements in company tax receipts experienced in 2001/02 makes substantial relief to tax payers possible again in the 2002/03 budget. Tax cuts of R15 billion ($1.73 billion) are scheduled through a restructuring of personal income taxes affecting particularly the middle-income class. Moreover, a tax allowance is introduced to promote training, and tax relief for small businesses is extended [to those having a turnover of up to R3 million ($347 000) compared with R.1 million ($115 000) previously] to encourage emerging entrepreneurs.

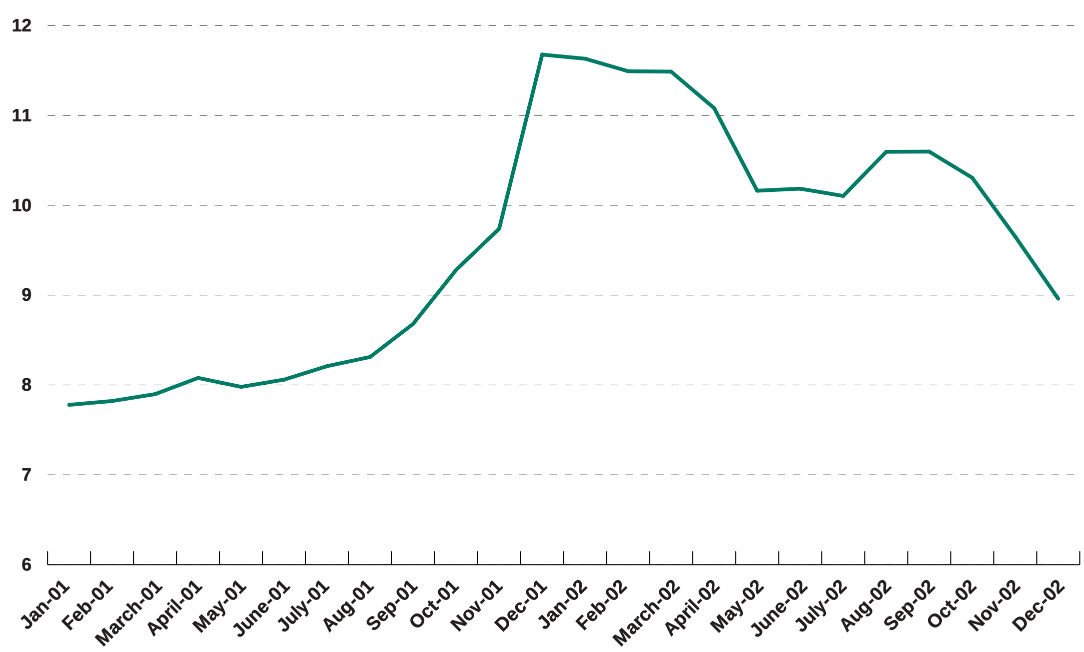
Despite a growth-oriented approach, it is estimated that, owing to underspending at provincial level, the overall deficit will be below target (which was set at 2.1 per cent of GDP) at about 1.4 per cent of GDP for the fiscal year 2002/03. Such a small government budget deficit also stems from the improved efficiency of the South Africa Revenue Service which, as mentioned earlier, allowed for higher than budgeted revenues in past years. However, problems will arise when the efficiency gains in revenue collection reach a ceiling and no longer compensate for poor privatisation proceeds. In 2003/04, the budget deficit to GDP ratio is forecast to increase to 2.1 per cent, owing to further tax relief measures and additional spending in targeted social welfare services, including HIV/AIDS prevention and treatment, and on economic infrastructure.

In South Africa, the exchange rate is flexible and therefore cannot be used by the national authorities for inflation control purposes. Since 2000, the South African Reserve Bank has adopted inflation targeting as its general monetary policy objective and uses interventions on the monetary market (i.e. indirect pressures on interest rates) to restrain inflationary trends. Inflation experienced a decline in the second half of 2000, reaching 5.8 per cent in September 2001, and the target for inflation was set by the Monetary

Policy Committee at between 3 to 6 per cent in 2002 and 2003. However, inflationary pressures increased dramatically in the first months of 2002 in response to the rand's depreciation, which moved from around R7.60 per US dollar at the beginning of 2001 to a new all time low of R13.84 to the US dollar on 21 December 2001. During the latter part of 2001, a combination of concurrent factors led to this rapid depreciation of the rand. These include the loss of confidence stemming from regional instability – particularly in Zimbabwe, perceptions about unemployment, HIV/AIDS, crime, and the lack of progress with privatisation. The rand consolidated in the first half of 2002 (reaching R9.74 per US dollar at the end of May), however from June until October it came under increased pressure, owing to the deteriorating political and economic situation of the region. Another crucial factor that contributed to the rand depreciation was the leaking of the draft mining charter which led to substantial net sales of securities in the bond and equity markets. As a consequence, the increase in CPIX, the consumer prices minus the interest cost on mortgage bonds, averaged 6.8 per cent in the last quarter of 2001 and continued its upward trend in 2002, reaching 12.5 per cent in October. The category that contributed most to the acceleration of CPIX was food, owing to the exchange rate depreciation coupled with the need to import grain into the Southern African region. According to the South African Reserve Bank, both at production and consumption level, food price inflation picked up dramatically, reaching maximum year-on-year levels of 30 and 20 per cent respectively.

The authorities' concern that the depreciation of the rand and expectation of higher inflation could result in higher wage demands and further price increases, led to the abandoning of the policy of non-intervention and the use of interest-rate policy to defend the currency directly. Since January 2002, the Monetary Policy Committee has increased the repurchase rate of the South African Reserve Bank four times already (by 100 basis points each time) leading to a rate of 13.5 per cent in September 2002. However, such tight monetary

Figure 5 - Average Monthly R:$ Exchange Rates 2001-2002



Source: South African Reserve Bank.

policy raises concerns about the negative short-term impact on the already low economic growth. Another reason that led to the Monetary Policy Committee's decision was the evidence of excessive increases in money supply and credit extension. The increase of the latter was mainly due to pre-emptive buying of durable consumer goods in anticipation of price increases. Despite these actions, CPIX inflation is estimated to have averaged 9.6 per cent in 2002 and is projected to decline to 7.7 per cent in 2003, still above the Central Bank's target. Major factors that may prevent the attainment of the inflation target for 2003 include the exchange rate of the rand, the continued high level of growth in money supply and credit extension, and the recently announced increase in salary and wages in the private and public sector.

External Sector

Over the past two years, no major developments have taken place as far as South Africa's multilateral trade policy is concerned. However, with the success of the Doha Development Agenda at the WTO, the government may undertake some revision of the still-cumbersome tariff structure.

In general, South Africa's tariffs are low in agriculture, by international comparison. As far as industrial tariffs are concerned, these are relatively moderate. There are, however, peak tariffs above 20 per cent in products such as motor components and motor vehicles, and clothing and textiles. The major problem is that many tariff categories exist in the economy, meaning that South Africa's tariff structure is highly dispersed. As we can see from the table, the standard deviation is higher for manufacturing but has come down significantly from 18 per cent in 1997 to 9.4 per cent in 2001. A key priority for government is to reduce the level of dispersion of tariffs and make the tariff structure more uniform.

The effects of South Africa's free trade agreements are beginning to be felt in the external sector. However, movements in the external sectors have been significantly overshadowed by the substantial depreciation of the rand towards the end of 2001.

Table 3 - Tariff Structure for 1997, 2000 and 2001 with Imports for 2000

	# of lines	imports (R million curr pr)	imports %	weighted average	unweighted average	unweighted average	unweighted average	standard deviation	standard deviation	standard deviation
	2000	**2000**	**2000**	**2000**	**1997**	**2000**	**2001**	**1997**	**2000**	**2001**
Agriculture	295	1 459	0.8%	1.4%	5.6%	4.2%	4.0%	8.9%	7.5%	7.2%
Mining	107	25 559	14.5%	0.0%	1.4%	1.2%	1.4%	3.4%	3.2%	3.7%
Manufacturing	5 479	149 539	84.7%	8.6%	15.6%	6.7%	6.7%	18.0%	9.6%	9.4%
Total	5 883	176 564	100.0%	7.3%	15.1%	6.5%	6.5%	17.8%	9.4%	9.3%

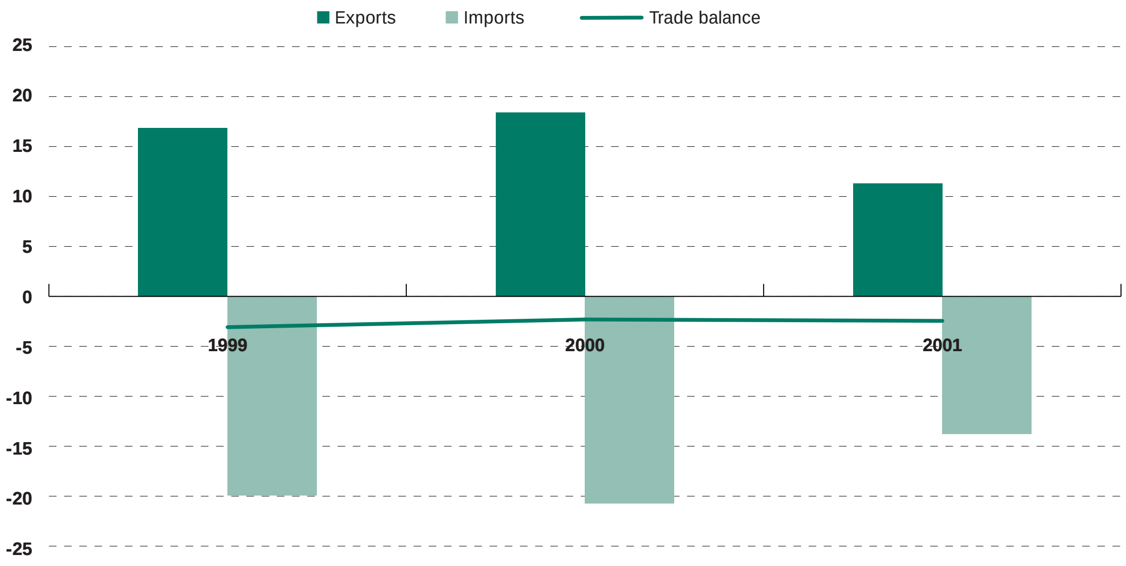
Source: Department Trade and Industry, Customs & Excise, Van Seventer 2002, Trade and Industrial Policy Strategies (TIPS).

The effects of South Africa's bilateral and regional trade agreements are difficult to gauge, in view of the fact that they have just been concluded in the last year or two. Some trends are, however, beginning to emerge.

Trade between the EU and South Africa has continued to grow, since the conclusion of the Free Trade Agreement (FTA) in January 2000. The EU is South Africa's largest trading partner, accounting for 31.3 per cent of exports and 39.7 per cent of imports in 2000. The EU agreement is heavily front-loaded in favour of South Africa. Some analysts show that there was a net increase in exports from South Africa for those products that were subjected to a tariff reduction of 2000. A more elaborate analysis is needed to isolate the impact of the FTA on South Africa/EU trade bearing in mind the depreciation of South Africa's exchange rate and other factors. Nevertheless, the trends below show a declining trade balance with the EU in 2000 with a marginal increase in 2001.

Regarding the Southern African Development Community (SADC) Free Trade Agreement, launched in 2000, South Africa has undertaken to fast track the

Figure 6 - South Africa's Exports to and from the EU



Source: Department Trade and Industry and Trade and Industrial Policy Strategies data (TIPS).

lifting on import tariffs on goods from the SADC region. Tariffs on 65 per cent of imports have been lifted in 2000 while 95 per cent of imports from the region would be duty free by 2005. However, South Africa still enjoys a significant trade surplus with the rest of the region, owing to the size of the economy. The trade ratio[1] between South Africa and the rest of the region has moved from 6:1 in 1999 to 9:1 in 2001.

In addition to the trade agreement, the South African government has concluded a new revenue-sharing formula with what is considered the oldest customs union in Africa, the Southern African Customs Union (SACU), which comprises Botswana, Lesotho, Namibia and Swaziland (BLNS). New proposals are coming into effect, which will change the SACU revenue-sharing formula. The main aim is to ensure that both revenue and development considerations are balanced. Currently, revenue sharing is based on implicit compensation to the BLNS for any cost-raising effect or loss of fiscal discretion resulting from the Customs Union. The new formula recommends moving from revenue based on imports to that based on excise taxes.

It is through this component that South Africa will receive most of its revenue, and can expect to retain around 80 per cent of total excise revenue collected. This will not only provide South Africa with improved revenue stability over time, but will ensure that most of the benefits accruing to SACU from excise policy decisions will flow into the South African treasury. Moreover, a development fund will be created from 15 per cent of total excise collections, and be distributed according to (the inverse of) each country's GDP/capita.

The introduction of a development component raises the revenue shares of the poorer SACU member states and should help to stabilise future flows to the BLNS. The size of this component will be reviewed and possibly adjusted over time if the revenue share accruing to any one country falls significantly.

South Africa has also benefited from the Africa Growth and Opportunity Act (AGOA), passed by the US legislature in 2000. Some of the major sectors that have benefited from AGOA are clothing and textiles as well as some agricultural and mining sectors.

1. Exports relative to imports.

South Africa's clothing and textile exports to the US rose by 28 per cent to $356 million in 2001 while there was a 17 per cent overall increase in exports to the US. An emerging problem with this agreement is that the US government has discretionary powers to change the tariff margins as South Africa's exports in certain products to the US grow dramatically.

FDI, which contributes about 10 per cent to gross domestic investment, changed from an inflow of R3.6 billion in the third quarter of 2001 ($418 million at the 2001 average exchange rate of R.8.6:$1) to an outflow of R7.3 billion ($847 million) in the fourth quarter, thus contributing to the weakness of the rand. As far as portfolio investment is concerned, the net outward movement of portfolio capital totalled R3.4 billion ($394 million) in the fourth quarter of 2001. This raised the total net value of international portfolio outflows to R67.6 billion ($7.85 billion) for the calendar year 2001 as a whole, compared to net outflows of R13.8 billion ($1.6 billion) in 2000.

Manufacturing exports growth has been quite robust in the last five years from 1996 to 2001 with over 6 per cent average annual growth in constant rands for the period. Moreover, the share of exports in manufacturing output has more than doubled in seven years (from 14 per cent in 1996 to 28 per cent in 2001). Manufacturing's share in total exports has risen from 35 per cent in 1994 to over 50 per cent at the end of the 1990s. The balance of trade for manufactures, while still negative, improved further in 2001 to a little under R31 billion ($3.6 billion) from R33.6 billion ($3.9 billion) in 2000. Capital goods, motor vehicles and transport equipment are the large net importers while metal products are the large net exporters.

Table 4 - Current Account Balance (percentage of GDP)

	1995	1999	2000	2001	2002(e)	2003(p)
Trade balance	1.8	3.1	3.4	4.3	5.3	5.6
Exports of goods (f.o.b.)	19.9	21.8	24.8	26.9	28.7	29.9
Imports of goods (f.o.b.)	-18.1	-18.7	-21.4	-22.6	-23.4	-24.3
Services	-0.9	-0.5	-0.6	-0.5		
Factor income	-1.9	-2.4	-2.4	-3.4		
Current transfers	-0.4	-0.7	-0.7	-0.6		
Balance on current account	**-1.5**	**-0.5**	**-0.4**	**-0.2**		

Source: Authors' estimates and predictions based on South African Reserve Bank data.

On account of the rand depreciation, trade performance has been strong in 2001, and the current account deficit narrowed to 0.2 per cent of GDP. South Africa's trade performance remained robust in 2002, boosted by manufacturing exports –especially vehicles, transport equipment, machinery and electrical equipment and by gold exports, spurred by a rise in the average price of gold. The 2002 trade surplus is estimated to have been around 5.3 per cent. The trade balance is projected to improve further in 2003 thanks to the continued strong performance of exports.

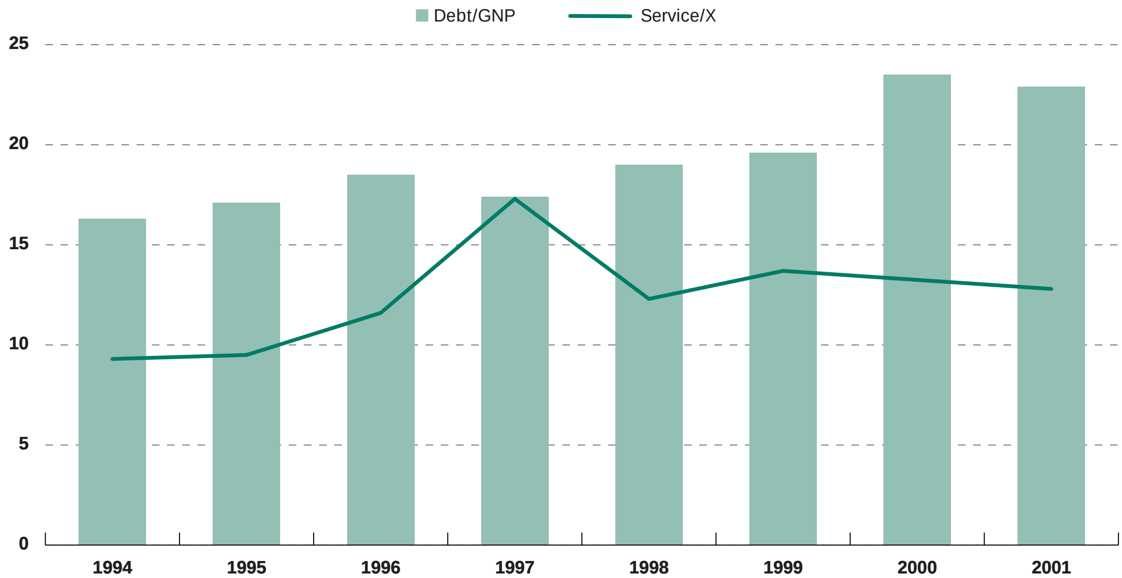
According to the World Bank's *Global Development Finance*, South Africa's total external debt fell to 22.9 per cent of GNP at the end of 2001 from 23.5 per cent in 2000 owing to the reduction in the dollar value of the rand denominated debt held by non-residents and a decrease in short-term foreign currency denominated debt.

Structural Issues

The privatisation programme in South Africa was embarked upon in 1996. There were no clearly defined time frames or "waves" as various government departments were involved in these processes, depending on the industry concerned (for instance the Departments of Public Enterprises; Communications; Transport; Electricity etc).

The process is currently on-going: some state-owned enterprises (SOEs) are fully privatised

Figure 7 - Stock of Total External Debt (percentage of GNP) and Debt Service (percentage of exports of goods and services)



Source: World Bank.

(e.g. broadcasting stations); others are currently due for the listing of a second *tranche* (e.g. the telecommunications utility); and in some cases little or no progress has been made (the sale of a chain of resorts to a Black Economic Empowerment (BEE) partner was abandoned in 1999 when the company was unable to raise the funds required. Three years later approximately 20 per cent has been sold in the first leg of a three-step process).

The privatisation process in South Africa has been largely focused on divestiture of "non-core businesses", such as resorts, broadcasting stations and related services in the transport sector, as well as the restructuring of utilities by selling minority stakes to so-called strategic equity partners and BEE groupings. Owing to the slow pace of privatisation, the government has not been able to expedite as much revenue as that set out in the 2001 budget, which was committed to raising R18 billion from privatisation, but in fact raised an estimated R2.3 billion.

In April 2001 a further 3 per cent of Telkom, South Africa's only fixed-line telecoms operator, was sold to the BEE grouping, Ucingo. A public listing of the second *tranche* of Telkom shares (which is estimated to be around 20 per cent) was due in 2000/2001 but was delayed due to adverse market conditions. The listing is expected to take place in the current financial year (2002/2003) and will involve a primary listing on the Johannesburg Stock Exchange and a secondary listing on the New York Stock Exchange.

In 2001, much of the debate on telecommunications services in South Africa centred on the licensing of a second, and possibly even third, network operator. Eventually, it was decided, in the Department of Telecommunications' policy for the post-exclusivity period, to limit the number of national network operators to one additional operator, whose licensing conditions include a BEE partner and to absorb the telecommunication subsidiaries of two parastatals: Eskom and Transnet.

Policy credibility, or at least, policy predictability have suffered from the wrangling over a second or third national operator as well as from the postponement of Telkom's listing.

Transnet, South Africa's largest parastatal, dominates the South African transportation sector, controlling

13 companies involved in transport and allied services, including the railway parastatal, Spoornet, which is its largest division. Transnet was incorporated in 1990.

The South African government is aiming for a deep-level restructuring of the railway industry, involving corporatisation of different divisions of the parastatal, sale of equity and concessioning. Spoornet's corporatisation will involve the creation of several autonomous corporate entities, which will be operated as concessions, sold through an Initial Public Offering (IPO) or transformed into a joint venture with a strategic equity partner. Eligible for concessioning are two dedicated heavy-haul links for coal and iron ore (Coallink and Orex), luxury passenger services (LuxRail) and branch lines (Link Rail). Eligible for IPO or joint venture are the general freight business (GFB) and the network operator (Rail & Terminal Services).

These changes are aimed at general commercialisation of the freight services, whilst the use of the concession vehicle is specifically aimed at attracting expertise and private capital required for restructuring. Once again, the emphasis has been placed on privatisation and strategic equity partners in lieu of the introduction of (intra-modal) competition, thereby further reducing the efficiency incentives to pressures from inter-modal competition.

In the case of aviation, a 20 per cent equity stake in the national airline, South African Airways, was sold to Swissair in 1999, but due to its financial collapse was bought back by Transnet in 2002. A stake in the Airports Company of South Africa (ACSA) has been sold to *Aeroporti di Roma* and a further "Initial Public Offering" of shares is planned to advance privatisation.

Spoornet has met stiff competition from road hauliers since the road transport industry was deregulated in 1988. The limit on truck haulage is currently among the highest in the world (56 tonnes) and as a result of uncompetitive railway tariffs, road transport accounts for 80 per cent – compared to rail at 20 per cent – of the overland freight transport market.

In a bid to shift freight and passengers back from the road onto the rail network, the government intends to impose stricter controls on all road transport (in particular weight restrictions) to support its restructuring of the rail industry. Officially, mounting maintenance costs to South African roads resulting from heavy cargo has inspired this policy but the general view is that it is an ill-disguised attempt to boost the volumes carried by Spoornet. Toll road concessions have been sold for sections of major routes.

As far as maritime transport is concerned, Portnet, the Transnet division for the ports in South Africa, will be split into two separate entities, one responsible for port operations and one responsible for licensing and infrastructure (the National Ports Authority of South Africa). The National Ports Authority will be responsible for changing the tariff structure in years to come, under the supervision of an independent ports regulatory body, which is yet to be established.

The restructuring of Portnet is aimed at leveraging private investment for port infrastructure backlogs and efficiency improvements required for increased trade. The private sector's involvement is further increased by the introduction of long-term concessions on certain operations such as cargo handling.

In the case of energy, the government aims to sell approximately 30 per cent of Eskom's generation capacity in its privatisation drive. As a first step, Eskom was converted from a public enterprise, led by an electricity council, into a public company with a share capital, liable for taxes and dividends in 2002 (Eskom was henceforth known as Eskom Holdings). The disposal of 10 per cent of Eskom's capacity to BEE players is due in financial year 2002/2003 and soon after an additional 20 per cent would be sold to a strategic equity partner to secure foreign direct investment in Eskom.

Apart from the big utilities, the government is also moving ahead with transferring other assets that it owns to the private sector. It signed a deal with a BEE company called Zama Resouces to sell off some of its state-owned forestry deals to the value of R335 million

($38.9 million). (This is currently shrouded in controversy, especially after a failed attempt to sell off Aventura Resorts.)

The improvement, maintenance and expansion of infrastructure remain an important cornerstone of government policy, as highlighted by the 2002/03 budget.

The policy of providing universal access to telecommunications, especially the provision of entrepreneurial opportunities to rural communities, has only partially succeeded. Approximately 2 million of the 2.67 million new telephone lines have been disconnected because poor households could not afford line rentals and call charges, or they had switched to cellular phones.

Another important development is the Afrilink initiative, which involved installing undersea cables linking South Africa (and West Africa) with Europe and Malaysia in order to improve Internet access and bandwidth. Indeed, the Afrilink initiative launched in June 2002, consists of two major projects: a South Africa/Far East connection from southern Africa to Mauritius, India and Malaysia, and a west African one northwards to Portugal and Europe. The European-South African component of the massive international project has a capacity of 120 GB, taking 5.8 million simultaneous telephone calls.

Notwithstanding South Africa's highly developed financial sector, some important developments have taken place that have begun to create vulnerability and instability in parts of the financial sector. Moreover, as a consequence of these mini crises, the government has reviewed its approach to financial regulation.

Financial instability was induced by the collapse of a few banks, beginning with Saambou. This has created some focus on the approach of the South African Reserve Bank (SARB) to bank bailouts. Although placing banks under curatorship is not new to the financial sector in South Africa, Saambou was unusual in the sense that it represents a bank with a fairly large depositor and home-loan base, and was considered the biggest banking collapse in SA. At around the same time, one of South Africa's largest banks, Absa, saw its micro-lending arm, Unifer collapse.

Developments in the financial sector this year have put financial regulation in the spotlight again. Banks are currently regulated by the South African Reserve Bank while an independent Financial Services Board (FSB) regulates non-banking financial services. The South African Minister of Finance, Trevor Manuel, announced the need for a single regulator. It is envisaged that these institutions will merge before 2003. The fact that the situation at Saambou reached crisis proportions was, according to some analysts, because of split regulation. This led to some contagion, as another bank, the Board of Executors (BoE), also started showing signs of collapse. The recent strife in the micro-lending industry partially stemmed from micro-lending disasters.

Second-tier players, Brait and CorpCapital, have abandoned their banking licenses, and BoE and Saambou are to be absorbed by two of the four big banks. Once these are taken over, ABSA, FirstRand, Nedcor and Stanbic will own 85 per cent of the industry's capital and reserves.

The consolidation of regulatory capacity culminating in a single regulator, as well other factors such as the introduction of a Deposit Insurance Scheme (currently under consideration) would contribute to the long-term financial stability of the SA financial sector. The close of smaller banks has raised some concerns that lack of competition does remain a problem – signalling that financial stability or consolidation may come at some cost to consumers.

The collapse of major international firms as well as the failure of organisations in South Africa, such as Leisure Net, Regal Treasury Private Bank, Saambou and Unifer, highlighted the need for good corporate governance. The release of the King II Report on Corporate Governance is an important development. It focuses additionally on some other issues such as enforcement of better financial reporting over a period of time and others. A major emphasis of the King II report is to balance performance and compliance. King II follows King 1 released in 1996.

The government has also introduced the Strategic Industrial Projects (SIP) Incentive Programme, in an attempt to raise the levels of private sector investment in innovative, profitable and wealth-creating business enterprises, while at the same time creating employment opportunities in the industrial sector. At the heart of the SIP programme is an amount of R3 billion in the form of tax allowances, effective for a 4-year period from 1 August 2001. These allowances are aimed at lowering the cost of investing in critical industrial projects, bearing in mind the specific requirements of prospective investors.

Political and Social Context

The African National Congress (ANC) continues to enjoy popular support in South Africa. A major challenge is to ensure that a significant opposition develops beyond the current primarily white opposition party. The current government continues to balance the interests of its alliances, against the backdrop of a still fragile democracy and high levels of inequality in the economy.

Formidable challenges face South Africa as unemployment continues to rise with increases in HIV infection rates and an increasing widening of income inequality. However, some positive developments are beginning to address these problems.

Unemployment in the formal sector is still rising with a 1.4 per cent (65 000 workers) decline in formal sector employment in 2001, and continued signs of decline in 2002. Since 1990, an estimated 1 million jobs have been lost. One concern has been the increase in unit labour costs owing to increasing wages, without corresponding increases in productivity. However, the major reasons behind unemployment are skills constraints and low demand in the economy. The upward pressure on wages continues. This is partly a response to increasing food prices, which rose to 14 per cent, compared with 7 per cent for other goods and services. One of the major concerns of the labour movement about wage moderation in the economy when food prices rise is that it is likely to worsen poverty and inequality.

After almost eight years of democratic government, major pressures for distribution in favour of the poor in the economy still exist, as exemplified by a range of policy initiatives to promote BEE, such as the minerals bill, new wage legislation to introduce minimum wages for domestic workers, as well as new developments in agriculture. One topic under discussion is whether targets should be set for the distribution of land during the next 10 to 20 years to poor previously disadvantaged people. Although some progress has been made, change is still very slow.

One of the most important political developments, not only in South Africa, but for Africa as a whole, is the birth of the New Partnership for Africa's Development (NEPAD), born on 23 October 2001 in Abuja, Nigeria. In essence, NEPAD is an initiative by African leaders to bring peace, democracy, and good governance to the continent with the objective of promoting development, foreign aid and investment and thereby securing the integration of the African economy into the world economic order. It is based on the preconditions for development that, in addition to regional integration and democracy, also include political, economic and corporate governance. The priority sectors that need to be addressed are the infrastructure, information and communication technology, human development and poverty reduction, agriculture and diversification of exports.

NEPAD has specific importance for South Africa, as the country and its president are central to the conception and sustainability of the initiative. This also has an important bearing on South African politics. Core to the NEPAD initiative are the concepts of accountability and good governance. What this means is increased pressure on governments in Africa to address a multitude of issues that need to be resolved when the mechanisms that will drive implementation of the initiative get underway. One of these mechanisms is a peer review that will allow other states to put pressure on members of NEPAD to adhere to objective criteria.

The NEPAD initiative presents an interesting dilemma for the South African President in view of South Africa's tempered position on Zimbabwe, as well as increasing concerns about governance and corruption.

It is estimated that some 5 million people are HIV-positive in South Africa. Twenty-five per cent of pregnant women testing at government facilities are HIV-positive. There have been important developments in the last year in response to the Aids crisis. Firstly, the South African government confronted international pharmaceutical companies in a court battle in order to get access to cheap aids drugs in contravention of an intellectual property rights agreement in mid-2001.

At the end of 2001, the government lost a high court case on antiretroviral provision against a civil lobby group. Indeed, President Mbeki's position was that there was no cure for HIV/AIDS and emphasised that the key to preventing Aids lay in poverty eradication policies. The Constitutional Court in South Africa ruled in favour of the Treatment Action Campaign (TAC), compelling the government to provide Nevirapine to HIV-positive pregnant women. Moreover, a report released in February 2002 stated the non-toxicity of the drug Nevrapine and raised the necessity of the use of antiretroviral treatments to pregnant women as part of government's prevention programme. Such a position, which was supported by the former President Nelson Mandela, further weakened the government's antiretroviral stance. The government is now obliged to uphold the court ruling - this partly reflects the robustness of South African democratic and constitutional processes. This landmark case demonstrates how the Constitutional Court can become both a significant opposition to government as well as make governments more accountable to the public. It should be noted, however, that since the Constitutional Court's judgement, the government has been slow in meeting its obligations. Nevirapine and counselling were available only in 18 test areas in September 2002.

Education expenditures in South Africa currently comprise approximately 8 per cent of GDP. This partly reflects the government's commitment to addressing the apartheid education backlog. The government has taken major initiatives to improve the efficiency of expenditure on education. For example, a bill has been passed to merge tertiary institutions in South Africa, based on the fact that the country has too many institutions. This has led to the merger of universities, reducing their number from 36 to 22. Some initiatives have been taken to improve pass rates at secondary level too.

Notwithstanding attempts to improve the efficiency of educational expenditure – some formidable challenges remain, specifically the effective redistribution of resources to poverty-stricken areas. Close to 40 per cent of schools in the country have no electricity, 25 per cent lack clean water, 60 per cent have inadequate sanitation and 40 per cent are without telephones.

As mentioned earlier, the major challenge faced by the country remains the development of the country's skill base. An important initiative taken to deal with the daunting problem of skills is the launch of the Skills Development Act. However, the relatively bureaucratic structure of Sector Education and Training Authorities (SETAs) is reducing their potential effectiveness. It is important that while the skills development strategies are being implemented, the need for access to skills from abroad should not be encumbered. However, amendments to the Aliens Control Act, which governs the movement of persons into South Africa, have not been without controversy. Given the difficulty regarding the employment of skilled foreigners in South Africa, amendments to this Act were proposed, but it remains to be seen whether the new Immigration Act will facilitate the movement of skilled persons to South Africa.

