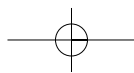
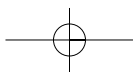
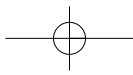
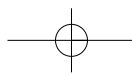


South Africa







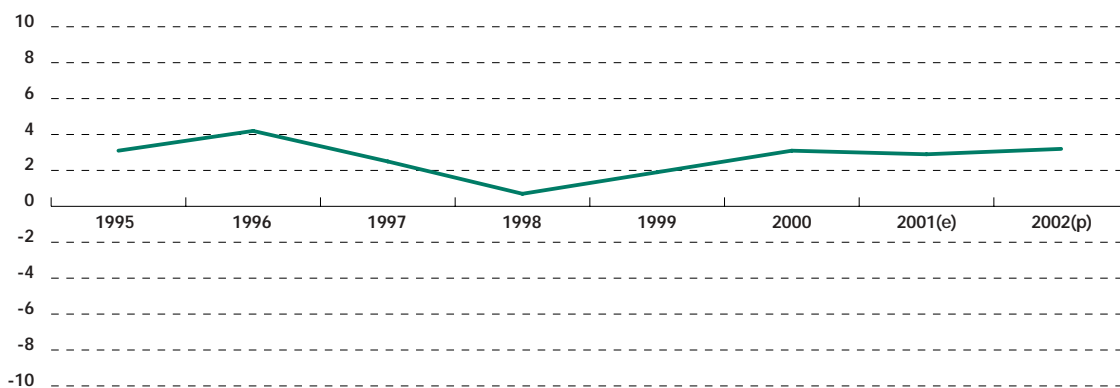
South Africa

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 is still rebounding from the 1998 slowdown with a growth rate at 3.1 per cent in 2000. The positive expectations remain precarious, however, as the downturn in economic activity during 2001 in the OECD area could have a negative impact on the South African economy. The rand is still depreciating but at a slower pace, which implies a

slowdown of export growth. Given somewhat enhanced public capital expenditure programmes but moderate consumption dynamism, growth expectations for 2001 and 2002 are at 2.9 and 3.2 per cent. Momentum gathered during the last two years of expansion remains fragile while social cohesion remains a highly sensitive issue. High unemployment persists while the formal labour market records further job losses and informal activities develop.

Ten years after apartheid ended, South Africa still faces the challenges of reducing inequality and enhancing growth

Figure 1 - Real GDP Growth



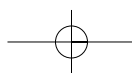
Source: Authors' estimates and predictions based on South Africa Reserve Bank data.

Recent Economic Developments

The South African economy has slowly recovered through 1999 and 2000 after the contagion effect of the Asian crisis and the turmoil in the financial markets that hit the country during 1997 and 1998. Growth performance of 2000 can be explained by the steady increases of both the manufacturing and services sectors. The ongoing depreciation of the rand has boosted the manufacturing output that grew by 3.6 per cent in 2000. The tertiary sector expanded throughout 2000 buoyed by continuous expansion of financial

intermediation and transport and communications sectors and by the sustained growth of retail trade after three years of moderate growth.

Output growth in the secondary sectors firmed in 2000. Manufacturing in particular has recovered thanks to net improvement in demand conditions, both at the domestic level and in terms of export demand. As a result of continuous rand depreciation in the last decade, the export oriented industries — mainly chemicals, basic metals and transport equipment — have gained momentum and in ten years their share in the manufacturing sector has risen by around 10 per cent.



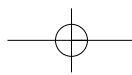
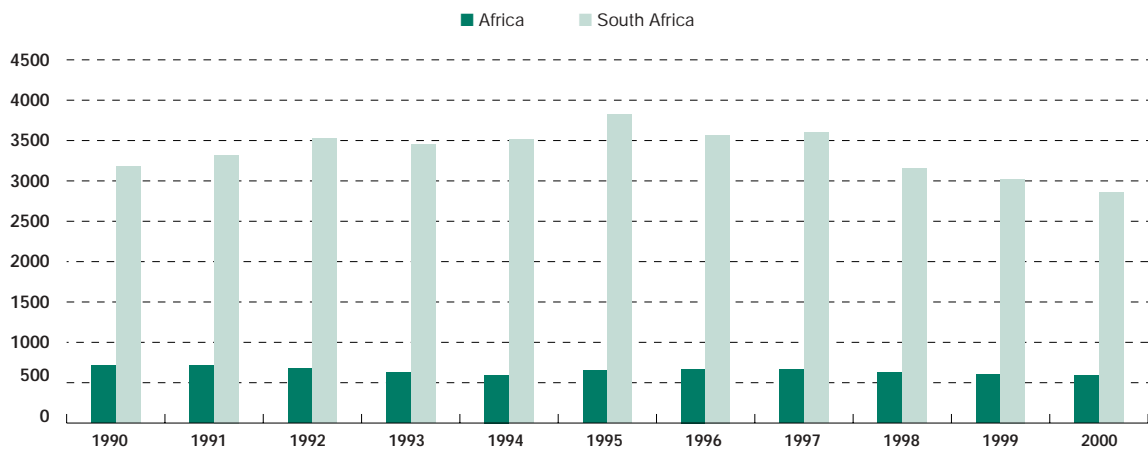


Figure 2 - GDP Per Capita in South Africa and in Africa (\$ current)



Source: Authors' estimates based on IMF data.

However, with an average rate of growth of 2 per cent in the period 1995-2000 the manufacturing sector has not performed as expected. Structural issues such as the regulatory framework in the labour and product market have hampered the sector's growth. Moreover, skill shortages — fuelled by the brain drain that has hit the country in recent years — has constrained the expansion of the industrial sector.

The tertiary sectors continued to expand significantly all through 2000. The buoyancy of the commercial sector, helped by a boost in household disposable income, made a solid contribution to such growth. This trend was further enhanced by the dynamism in tourist activities and the expansion of telecommunications, the cellular telephone and Internet networks in particular. Services have been the major

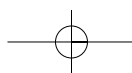
impetus of the modest growth that has taken place in the South African economy in the last five years. Average growth has been equal to 3.4 per cent and sub-sectors such as transport and communications as well as financial intermediation have expanded at a higher pace. Prospects for 2002 are encouraging since the government decision to allow a second fixed line operator for 2002 in the telecoms sector could further expand the dynamism of the sector.

Real output in the agriculture sector increased markedly during 2000 thanks both to a prolific (even though late) harvest of the maize crop, which amounted to one-third more than the previous year (10.9 million tons instead of 7.9), and to solid progress in livestock and horticultural farming. Wheat production contributed as well with a volume increase of 24 per

Table 1 - Demand Composition (percentage of GDP)

	1995	1998	1999	2000	2001 (e)	2002 (p)
Gross capital formation	18.1	15.8	14.8	15.3	17.0	18.5
Public	4.3	5.3	4.6	4.1	5.2	6.0
Private	13.8	10.4	10.3	11.2	11.8	12.5
Consumption	81.0	83.1	82.4	81.8	80.2	79.1
Public	18.4	19.8	19.2	18.3	17.1	16.3
Private	62.6	63.2	63.2	63.5	63.1	62.8
External sector	0.9	1.2	2.7	3.0	2.7	2.4
Exports	23.0	25.9	25.9	29.1	28.1	27.2
Imports	-22.1	-24.7	-23.1	-26.1	-25.4	-24.7

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



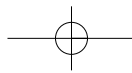
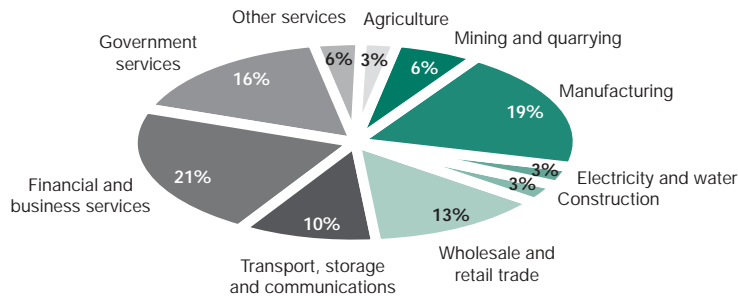
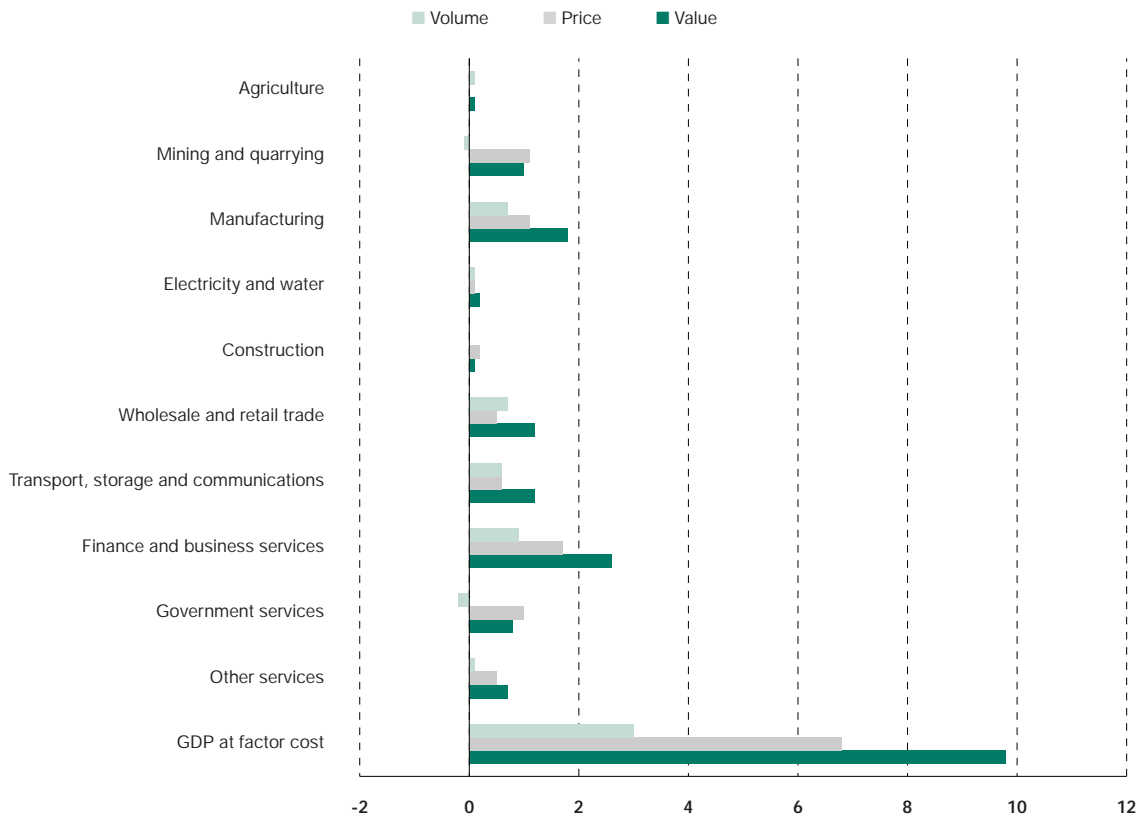


Figure 3 - GDP by Sector in 2000



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

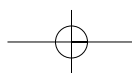
Figure 4 - Sectoral Contribution to GDP Growth in 2000

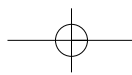


Source: Authors' estimates based on South Africa Reserve Bank data.

cent with respect to 1999. The shrinking of the mining output (-1.8 per cent in 2000) did not offset this good performance in agriculture. Gold production fell the most, counter-balancing increases in other sectors — notably platinum — of the mining industry.

After experiencing an almost flat trend in 1999, real gross domestic expenditure picked up again in 2000, taking over from exports to lead growth. All components of domestic expenditure contributed to this higher path.





Gross capital formation displayed a growth rate of 2.7 per cent during 2000 after a steep decline due to the 1998 slowdown. Both private and public sectors contributed to this moderate upsurge of investment. Nevertheless — compared to other emerging economies — South Africa is still characterised by relatively low levels of investment. Indeed, during the second half of the 1990s, investment languished at around 17 per cent of GDP. 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 to economic growth. Since 1995, the growth of general government investment has been on average 1.5 per cent and in 2000 it has been only 0.1 per cent (-7.4 if parastatals are included). The trend is again positive in 2001 and 2002, with public investment (including parastatals) growing at a higher pace in 2001 and 2002.

Private consumption continued to expand, recovering further from the 1998 downturn and reflecting the optimistic attitude of consumers. Even if all major categories contributed to this higher path, durable and semi-durable goods have been the liveliest components. The expansion in household spending was largely grounded by the tax cuts and the decline in bank lending rates that occurred all along 1999. As a consequence, debt-servicing cost of households has diminished and real disposable income has risen by 3.5 per cent in 2000 compared with 0.5 per cent in 1999. Real government consumption continues its negative trend started in 1998, reflecting the successful government policy to restrain spending and reduce the budget deficit. The reduction of government spending is nevertheless achieved through a decrease of spending for goods and non-labour services. Therefore, a proportional increase of compensation for employees has occurred.

Macroeconomic Policy

Fiscal and Monetary Policies

The macroeconomic policy of the South African government was first defined in the Growth,

Employment And Redistribution (GEAR) strategy that was adopted in June 1996. One of the major objectives of GEAR was to enhance the credibility of the South African government by signalling to the international investor community South Africa's commitment to a stable macro policy. Moreover, the fiscal policy was designed to solve the employment crisis through significant growth increases. Social and physical infrastructure was considered as a main pillar for boosting economic growth and employment. An integrated policy aiming at containing real increases in public salaries to 1 per cent per annum and increasing public capital expenditure by 7.4 per annum was envisaged in order to fund substantial housing, land reform and infrastructural development programmes. In contrast with the GEAR proposals, the government met its targets on fiscal deficit keeping a planned level of expenditure with increasing spending on the government wage bill at the expense of capital expenditure. Despite the fact that GEAR has been successful on fiscal balance target and inflation control, growth has remained low while unemployment has continued to grow.

This has led to a major re-evaluation of government growth strategy. In February 2001, President Thabo Mbeki argued in his state-of-the-nation address that major emphasis will be on creating the right environment to expand the economy. Over the next three years, government spending is presumed to grow in real terms. In particular, a R7.8 billion (\$1.1 billion at the average exchange rate of 7 Rand per \$) spending is expected on investment in infrastructure. Additional R16 billion (\$2.3 billion) will be spent in favour of people suffering from HIV/AIDS. R4 billion (\$576 million) will be devoted to improving efficiency of the criminal justice system. On revenues, a tax cut of R8.3 billion (\$1.2 billion) is scheduled through a restructuring of personal income taxes affecting particularly the middle income class. Nevertheless, the government has remained committed to fiscal discipline. Indeed, privatisation receipts — expected at R18 billion (\$2.6 billion) for 2001-02 — will be used to pay long-term domestic bond debt. Beside these budget measures, the government has renewed focus on microeconomic and structural reforms as a major tool to increase

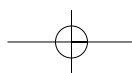


Table 2 - Public Finances^a (percentage of GDP)

	1995/96	1998/99	1999/00	2000/01	2001/02(e)	2002/03(p)
Total revenue and grants^b	22.5	25.1	25.9	25.1	25.0	24.9
Tax revenue	22.0	24.5	24.6	24.5	24.3	24.3
Total expenditure and net lending^b	27.5	27.6	27.7	27.1		
Current expenditure	25.4	26.8	26.5	26.1		
<i>Excluding interest</i>	<i>20.1</i>	<i>21.1</i>	<i>21.1</i>	<i>21.0</i>	<i>21.3</i>	<i>21.7</i>
Wages and salaries	10.3	11.0	10.6	9.9 ^c	9.9	9.9
Interest on public debt	5.2	5.7	5.4	5.2		
Capital expenditure	2.4	1.2	1.3	1.0	1.3	1.5
Primary balance	0.2	3.2	3.7	3.1	2.4	1.7
Overall balance	-5.0	-2.5	-1.8	-2.0		

a. Fiscal year begins 1 April.

b. Only major items are reported.

c. OECD estimates.

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

competitiveness and a managed liberalisation for the energy, transport and telecommunications sectors is expected. However, it should be stressed that a potential problem arises with the strategy proposed by the government: much of the spending — R16 billion (\$2.3 billion) for social deliveries and investment on infrastructure — will be channelled through provincial and municipal governments that have not been efficient and accountable so far.

The primary surplus may decline in 2001 and 2002 as a result of increased capital expenditure. Such an increase is not compensated on the revenue side owing to the lack of dynamism of domestic demand.

In South Africa, the exchange rate is flexible and therefore cannot be used by the national authorities for inflation control purposes. Instead, 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.

South Africa is slowly emerging from a high interest rate period. Only improved market conditions developing since the fourth quarter of 1998 have allowed the authorities to relax significantly their tight monetary policy through 1999. However, South African yields, money aggregates and interest rates remain highly sensitive to international circumstances. Events in sub-Saharan Africa, variations in crude oil prices and

evolution of the rand against the US dollar are all likely to affect the general perception, which prompts the Reserve Bank to remain cautious. Thus, after a year of constant decrease in interest rates in 1999, the Reserve Bank's Monetary Policy Committee decided to exert pressure on the money market to keep interest rates stable. In October 2000, the Committee even chose to invert the trend and allowed a rise in the repurchase rate from 11.75 to 12 per cent. The policy was aimed at restraining potential effects of the depreciation of the rand and the impact of increasing oil prices that had already generated a new acceleration in the rise of M3.

After the lowest growth rate of CPIX in 30 years displayed in 1999 (5.2 per cent), the steep rise in the price of imported crude oil and the depreciation of the rand that developed through 1999 and 2000 reactivated fear of potential inflation. Inflation has nevertheless been contained to 9.2 per cent largely as a result of the tight monetary policy carried out by the South African Reserve Bank in 2000. Indeed, according to the South Africa Reserve Bank, taking aside the rise in food and oil prices, the annual rate of inflation for the past three years would have been unchanged at 4.9 per cent. This trend should be further enhanced by the net decrease in crude oil prices from December 2000. In 2001 and 2002, inflation should slow down to a pace of 5.4 per cent.

Considering the real effective exchange rate (REER) as calculated by the Reserve Bank, it has been observed

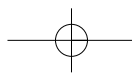
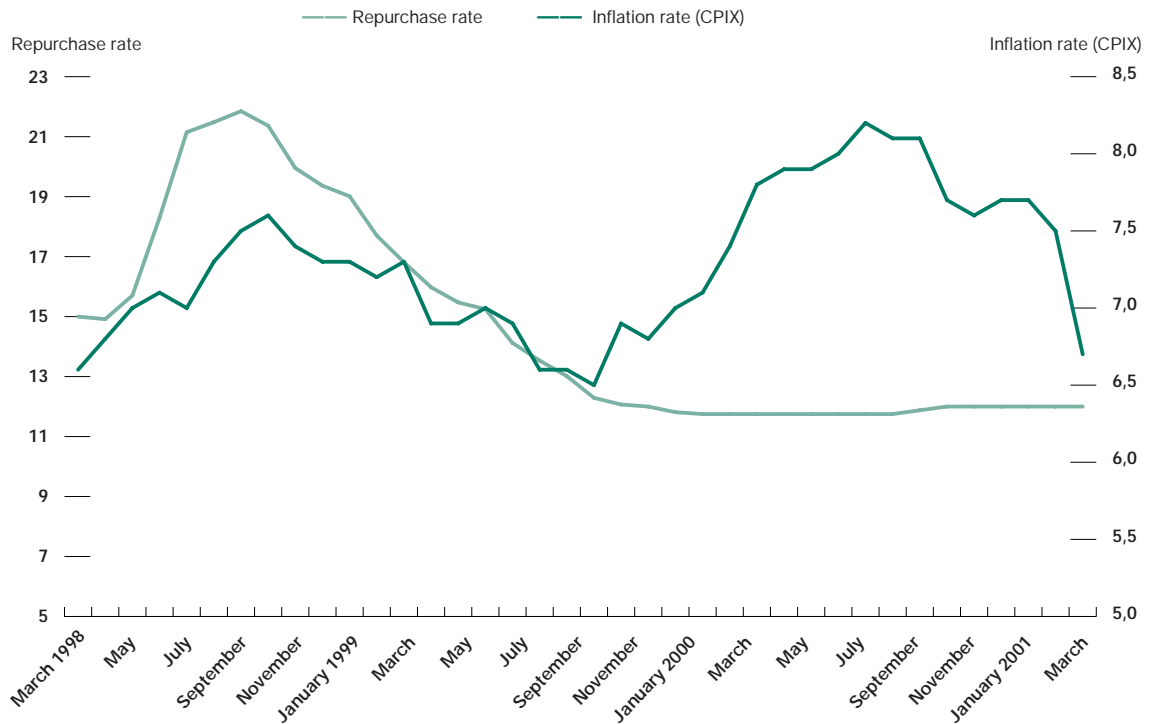


Figure 5 - Interest and Inflation Rates



Source: South Africa Reserve Bank.

that the REER has — since the mid-1980s — been declining, especially after 1992, implying that competitiveness has been enhanced. This decline is expected to slow down in 2002. Since export performance generally moves in line with the REER, this decline had translated into improved competitiveness and hence exports performance. For 2000 the relationship between REER and exports has been confirmed since a real effective depreciation of 3 per cent has been associated with export increases in real terms.

External Position

South Africa is a relatively open economy and its trade relationships are characterised by the high concentration of trade with high-income countries (the United Kingdom, Germany, Italy, the United States and Japan). Only Zimbabwe among low-income economies has a sizeable trade relationship — for exports only though — with South Africa. Recently South Africa has been diversifying its trade establishing

relationships with new markets (such as China). Export earnings are still dominated by gold, notwithstanding the declining trend of its international price and the internal shrinking of production. Indeed, gold accounted for 15 per cent of total goods exports in 2000.

Although trade policy in recent years has been largely characterised by a gradual liberalisation process, there is some scope for faster reduction of tariffs in some areas. South Africa began liberalising its economy in the early 1990s and in the context of the multilateral liberalisation the country made a tariff offer phased over five years that took effect in January 1995. It consisted mainly of: *a)* a reduction in the number of tariff lines; *b)* a conversion of all quantitative restrictions on agricultural imports to bound ad valorem rates; *c)* a simplification of the tariff regime for industrial products; *d)* the liberalisation of the sensitive industries within eight years. Moreover, South Africa has committed itself to a reduction of its import-weighted average tariffs in manufacturing of five percentage points. Average tariffs fell from 28 per cent to 10 per cent, the

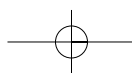




Table 3 - Current Account (percentage of GDP)

	1995	1998	1999	2000	2001 (e)	2002 (p)
Trade balance	1.8	1.4	3.2	3.4	3.2	2.9
Exports of goods (f.o.b.)	19.9	21.9	22.0	25.0	24.2	23.4
Imports of goods (f.o.b.)	-18.1	-20.5	-18.8	-21.6	-21.1	-20.5
Services	-0.9	-0.3	-0.4	-0.4		
Factor income	-1.9	-2.4	-2.5	-2.6		
Current transfers	-0.4	-0.6	-0.7	-0.7		
Current account balance	-1.5	-1.8	-0.4	-0.3		

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

average manufacturing tariff dropped from 30 per cent to 16 per cent in the 1990s. Despite these developments, South Africa's tariff system still remains cumbersome with over 7 000 tariff lines. Tariff peaks still exist for a number of broad categories of commodities such as processed foods, vehicles and components, rubber products and clothing and textiles.

Beside a trade policy oriented at simplifying and enhancing multilateral trade, South Africa has strengthened its role in regional and bilateral agreements motivated not only by economic considerations but by traditional, political and cultural links with partner countries. So far, the main trade agreements involve the EU and southern African countries (SADC and SACU). The EU-SA agreement was enforced in January 2000, setting a principle of asymmetry in bilateral liberalisation, with the EU liberalising at a faster pace (three years compared to 12 years for South Africa) and more broadly in terms of coverage (95 per cent of all imports with respect of 86 per cent for SA). In 1994 South Africa joined the SADC, which was officially relaunched on 1 September 2000. The agreement covers all SADC members except Angola, Democratic Republic of Congo and Seychelles. South Africa offered its partners asymmetric liberalisation: according to the Trade and Industry Minister, by 2005, 99 per cent of tariff lines should qualify for duty-free access.

The external position of South Africa has been largely influenced by historical developments. Before 1994, the balance of payments was managed mainly with the objective of compensating for the weakness of financial inflows due to a hostile international environment. As a result, South Africa was led to

produce trade surpluses in order to generate foreign currency. After 1994, the turnaround of capital flows changed dramatically the need for a positive current account. The positive trade balance consequently narrowed and the service, income and current account transfer balance increased its negative impact on the current account.

Since 1999, thanks to the rand depreciation, the trade balance has improved to an average 3.2 per cent of GDP, with both trade volumes increasing markedly. In 2000, the 9.1 per cent increase in exports reflected the good performance of the agriculture sector coupled with the output growth of the secondary sector. Platinum exports within the mining sector have been boosted by strong price increases and car manufacturers have particularly benefited from the rise of global demand in the latter part of the year. Imports increased by 10.1 per cent in response to stronger growth and rising international oil prices. Consequently, the trade balance has remained roughly stable through 1999 and 2000 (at 3.2 and 3.4 per cent of GDP) and should be comparable in 2001 and 2002.

The capital flows were nearly in balance in 2000, amounting to a \$1.4 billion deficit. This is rather different from the capital flows of the previous years where large portfolio inflows dominated the balance on financial account generating large capital surpluses.

Foreign direct investment in South Africa represents a small share of the financial account and more importantly is less than 10 per cent of total gross investment. In 2000, both inflows and outflows have retrenched in volumes and the turnaround from net

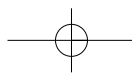
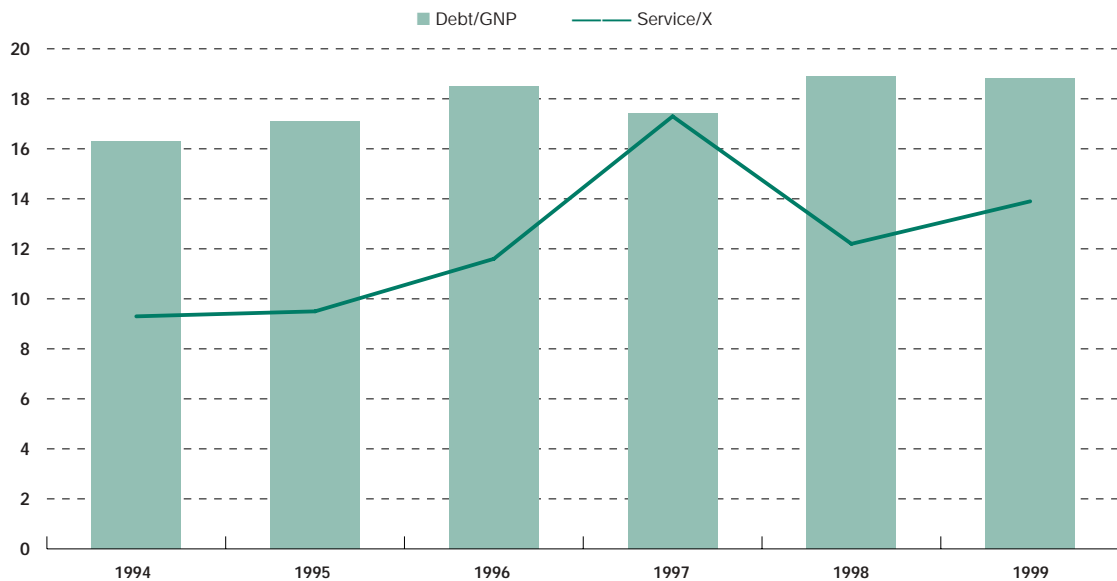


Figure 6 - Stock of Total External Debt (percentage of GNP) and Debt Service (percentage of exports of goods and services)



Source: World Bank (2001), *Global Development Finance*.

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outflows to inflows can be considered as an outcome of net assets' divestiture of South African companies abroad.

The portfolio investment flows in 2000 were dominated by a sharp contraction of inflows which passed from \$12.1 billion to \$1.7 billion. As a result in 2000 portfolio net flows were negative after a long period of portfolio inflows, a change in the attitudes by international investors towards risk-taking in South Africa.

Total foreign debt in 2000 totalled nearly \$38 billion (29.6 per cent of GNP). Foreign currency denominated debt has slightly increased *vis-à-vis* rand-denominated share and in 1999 account for \$24.1 billion.

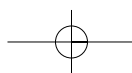
Structural Issues

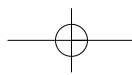
Issues of corporate governance and regulation have gained increasing prominence in policy discussions in South Africa today. The government has emphasised that a major area of focus is that of microeconomic reforms specifically creating more accountability in economic institutions as well as more competition in

the economy. Specific attention is given to privatisation and deregulation of services and utilities, and to competition policy.

The South African financial sector is the most developed in sub-Saharan Africa. Considerable regulatory changes have taken place in South Africa's financial sector, particularly in opening up the sector to foreign investment. The banking system is facing increasing competition with international banks settling down locally (e.g. Citibank) in specific market segments. With gradual exchange rate liberalisation, domestic institutions are now allowed to invest up to 15 per cent of their balance sheet assets offshore. The Insider Trading Act came into force in January 1999 as the legal infrastructure dealing with insider trading. It was enforced by the Financial Services Board (FSB), which has the investigative power and access to surveillance information, as well as the right to pursue civil actions against suspected insider dealers.

Major developments have taken root in the stock market as well. The Johannesburg Securities Exchange (JSE) — the largest and the most sophisticated African equity market — has sharply increased its foreign





participation since 1994. Consequently, non-residents own about 9 per cent of the market and account for 30 per cent of trading. Furthermore, electronic trading was introduced in March 1996.

In a document published at the end of August 2000 the government indicated its willingness to push ahead on privatisation. It is seen as both an essential source of income for government and a tool of competition policy aimed at improving productivity in the former state-owned enterprises (SOEs). The major SOEs are still today ESKOM (energy sector), TRANSNET (transport sector), TELKOM (telecommunications sector) and DENEL (defence industry) with each dominating its sector. They also comprise 91 per cent of estimated total state assets and 77 per cent of all employees in the top 30 SOEs. To date, none of these institutions has been privatised, nor has market structure in these sectors changed in any significant way. Some enterprises like Telkom and South African Airways have, however, opened up to minority equity stakes.

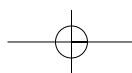
Privatisation should be implemented on a four-year basis according to the following patterns (given by the government blueprint): in 2001, transport companies should be under focus. In 2002, it will be the turn of telecommunications. The government has taken a decision to allow a second fixed line operator to enter the industry in May 2002 effectively constituting a duopoly. The positive spin-offs of a duopoly relative to the case of a monopoly will depend on the effectiveness of the regulator, the Independent Communications Authority of South Africa (ICASA). By the end of 2003, PORTNET — a TRANSNET subsidiary — which controls South African harbours and ports, will be partly sold. In May 2002, ESKOM's exclusivity agreement will end, and in 2004 the company will in turn be for sale. However, the pace of the privatisation programme will be influenced by two factors. The first is political opposition, specifically from the African National Council's (ANC's) key ally, the Congress of South African Trade Unions (COSATU). The second is the concern that government should ensure that it has sufficient regulatory capacity in the post-privatisation environment.

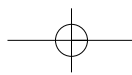
South Africa has made considerable progress in competition policy. Indeed the country has embraced an interventionist approach similar to that of the United States. It relies on the outlawing of three core practices: monopolisation, attempts to monopolise and conspiracies to monopolise as opposed to the European models based on restrictive practices and abuses of dominance. The legal framework is given by the Competition Act No. 89 of 1998, which came into effect on 1 September 1999. There are three institutional bodies established by the Act: the Competition Commission, the Competition Tribunal, and the Competition Appeal Court. This represents an important departure from the past where the government is now more accountable for rulings or decisions made.

Communications infrastructure, as the general economic and social structures in South Africa, has largely been inherited from apartheid and are therefore characterised by marked inequalities. Thus, although the South African transport infrastructure is certainly the best in Africa, its distribution is highly unequal across regions. On the one hand, international and inter-city connections are good; on the other, rural networks as well as links with former black homelands areas are largely insufficient. Telecommunications follow the same patterns, with 60 per cent of the white population having access to telephones compared with only 1 per cent of blacks.

In order to remedy such a situation, the government has undertaken a programme of Spatial Development Initiatives (SDIs) within GEAR. The programme consists of initiatives and industrial development zones that aim at improving the infrastructure and the institutional environment in order to attract local and international investors. By the end of June 2000, 12 SDIs had been listed by the Department of Trade and Industry (DTI). Most advanced was the Maputo Development Corridor, which comprised a toll road between Witbank and Maputo entirely financed by private funds.

Land reform is seen in South Africa as both a necessity and a serious potential risk for social cohesion.





South Africa has inherited an unequal agricultural system, with 67 000 white farmers owning 86 per cent of farmland and 12 million Africans living on the remaining 14 per cent (the homelands) in 1991. In 1994, the ANC aimed to transfer 30 per cent of farmland to black farmers by 1999 as one of its priorities. However, as a result of the market-led policy adopted by the government, the redistribution evolved far more slowly than expected. The government rejected the use of expropriation and relied on three pillars: redistribution (mainly reallocation of state-owned land and sales of indebted white farmers' land), land restitution (through land claims that had to be addressed before the end of 1998) and land tenure reform. Even though a significant number of projects have emerged since 1997, the target of 30 per cent set by ANC is far from being reached and only 1 per cent of white-owned land is believed to have changed hands.

Furthermore, the relations on farms deteriorated when the government introduced the Security of Tenure bill in order to guarantee the rights of farm workers. Many farmers reacted by replacing their workers with illegal foreign labourers, inducing a dramatic fall in registered farm workers from 1.4 million in 1994 to 600 000 in 1997.

Political and Social Context

The local government elections on 5 December 2000 suggest that democracy has taken root in South Africa. The African National Congress (ANC) won 62 per cent of the vote but the Democratic Alliance (DA) still managed to secure 22.5 per cent of the polls. However it is highly unlikely that the DA will ever become a serious threat to the ANC given the whites-only orientation of this party. The danger is more likely to come from within the coalition with tensions intensifying between the Congress of South African Trade Unions (COSATU) and the South African Communist Party (SACP), or from outside with social and political conflict spilling over from Zimbabwe.

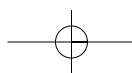
Although South Africa enjoys an increasing respectability at the international level, the crisis in

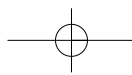
Zimbabwe has had a bad effect on its image for two reasons. First it has driven the international community to picture the whole region as highly unstable. The economic consequences were serious, starting from damaged foreign investor confidence that did not help the already poor FDI record of the country. It also directly affected President Mbeki's reputation, as he seemed indecisive on whether to support his neighbour.

South Africa has inherited from apartheid a highly unequal economic and social system that threatens social cohesion. Both education and health profiles reflect the impact of segregation. While the white population displays life expectancy and education statistics close to those recorded in OECD countries, the African population is characterised by both poor records on education and high mortality rates. Simultaneously, South Africa exhibits one of the most unequal income distributions in the world. According to the World Development Report 2000, South Africa displayed a Gini index of 59.3 in 1994, which put it in line with Brazil, Central African Republic, Guatemala, Namibia and Sierra Leone at the forefront in terms of inequalities.

In 1994, the government chose to address the aftermath of segregation through the Reconstruction and Development Programme. The results were however disappointing, or at least slow to reveal themselves. It generated discontent in the population and threatened the initial aura brought by the ANC's accession to power. As a result of segregation and discontent, South Africa has faced intensification in crime and reached one of the highest murder rates in the World (WHO). It has also recently experienced a massive emigration of skilled workers, impeding economic activity in the long run. Both characteristics constitute major deterrents to potential investors. They also have serious consequences on the labour market.

Despite economic recovery, employment growth remains the Achilles heel of South Africa. According to Statistics South Africa, employment in the formal private non-agricultural sector fell by 10.5 per cent between 1995 and 1999 while in the public sector it shrank by a further 1.9 per cent. Both low growth and





structural problems account for this pattern. South Africa has more of a skilled-labour supply problem. There are jobs in the economy that cannot be filled by the current unemployed because of lack of skills.

Between 1995 and 1998 most of the labour laws were rewritten in order to correct the segregation orientation. They were designed as such to stimulate employment as well as to redress obvious anomalies on the labour market. However, job conditions have remained highly different across race, gender and regions in South Africa. The changes in the sectoral composition of the South African economy, with the decrease in primary and secondary sectors and the stark rise of tertiary and more knowledge-intensive activities, have emphasised the skills shortage which was fuelled by segregation. As a consequence, the capital-to-labour ratio — particularly in the secondary sector — has increased, leading to both falls in employment levels and increases in labour productivity.

Moreover the predictions concerning employment are rather bleak. South Africa displays a strikingly low ratio of employed to total population (21 per cent), reflecting both a high level of unemployment and a skewed age distribution towards the young. A key challenge is, how can government stimulate job creation for unskilled labour? The one area that requires attention is that of labour regulation, specifically simplifying procedures around the cost of hiring and firing. Positive development have been the nominal wage restraint and declining real unit labour costs occurred in recent years.

In the last ten years South Africa has also been seriously struck by a new worry, which has put the economy and the society under serious strains: HIV/AIDS. According to UNAIDS, South Africa displayed in 2000 one of the largest infected populations in the world (after Botswana, Swaziland and Zimbabwe) with almost 20 per cent of adults (defined as 15-49 years olds) carrying the disease. Unfortunately, the South African economic structure is also particularly conducive to rapid contagion with many workers engaging in seasonal work (agriculture, mining) or in the transport sector, implying long-distance commuting.

The disease is a threat for social cohesion and economic performance for several reasons. Aside from the human aspects, AIDS entails dramatic demographic and labour market costs. Between 2000 and 2005, life expectancy will decrease from 65.8 years to 47.4 years as a result of HIV/AIDS. The loss in terms of human capital will be equally serious, especially with skilled workers being the most affected by the virus.

The profile of education in South Africa is highly influenced by the legacy of apartheid. The school system, divided along racial lines during the apartheid regime, has produced a society where 24 per cent of African adults (over 20 years) have had no access to schooling compared to 1.4 per cent of the white population. As a result 7.9 million adults — 29 per cent of the adult population — is functionally illiterate. World Bank data suggest that, with primary and secondary gross enrolment ratios of 131 per cent and 94 per cent respectively, school attainment is remarkable compared to most African countries. Since 1994 education policy has been at the top of the government agenda and in 2000 it was the largest spending category with 21.5 per cent of total expenditure. A national policy bill was published in 1995 setting out a unitary education system. So far the achievements are mixed: according to a joint 2000 UNESCO-UNICEF survey, nine-year-old children in South Africa have among the worst literacy and numeracy skills in Africa. Alongside the rather bleak picture of the primary and secondary school system due to its poor quality, tertiary education — with 36 universities and *techikons* — is the best developed on the African continent.

