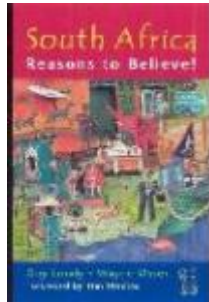


South Africa:

Reasons to Believe!

By Guy Lundy and Wayne Visser (Aardvark Press, 2003)



~ 4 LAUNCHPAD FOR PROSPERITY ~

Tourism is an industry that receives a good deal of attention when it grows, probably because we feel proud that people enjoy their experience and encourage others to come here. But tourism isn't the only sector that has been bucking gloomy world trends. The South African economy as a whole has been growing, and increasingly so, while the rest of the world has been faltering and struggling to come out of its latest downturn. While South Africans celebrated an increase in GDP growth to 3.1% in the second quarter of 2002, some economies, like Japan, have actually been shrinking. In fact, according to Iraj Abedian, Chief Economist at Standard Bank, South Africa is in the top seven best performing economies in the world.

This can be attributed to a number of developments, including the weakness of the rand that we mentioned earlier in this book. But, more than any one factor, it is a positive sign of the solid foundations that have been built upon by the country's economy aficionados over the past several years. In this chapter we take a closer look at those foundations and we investigate some of the economy's growth superstars. Out of necessity, this chapter maintains a relatively broad view. Things change so rapidly in the modern world, and while we are writing that the world is in recession today, it may be that it is well on its way towards recovery by the time that you are reading this.

Solid foundations

Most world governments that take over from an incumbent make some change to the status quo, especially those in the developing world. This is their prerogative, it is in expectation of such change that the population voted them in, and the feeling is that they have a limited period in which to make their mark so that they can be voted in again next time around. This happens to an even more radical degree when the take-over is affected by way of a revolution, or when the new regime's policies are fundamentally different to those of their predecessors. Traditionally there has usually been some form of mass nationalisation (as in many African countries in the 1960s and 70s) or conversely mass privatisation (as under Margaret Thatcher's rule in 1980s Britain).

And that is why everyone expected the new South African government under the ANC, which has long been aligned to the SA Communist Party (SACP) and the Congress of SA Trade Unions (COSATU), to go on a socialistic spree of nationalising the mines, the banks and pretty much everything else, using their revenues to spend like mad on inefficient

employment creation projects. And many are still convinced of it, despite the facts, waiting like prophets of doom for the government to make its move to seize farms, attach mines or some other dastardly deed because they believe that they are predisposed to doing so.

But what that attitude denies are several facts that we have in our favour. Firstly, we have a large number of highly educated and intelligent people in power. Many, if not most, of them have studied, lived or worked overseas. Those that have come back from exile, like President Thabo Mbeki, have lived and studied in Western Europe and the USA as well as Eastern Europe and Africa, and they have been able to experience first-hand and learn from the failures and successes of the policies in those countries. In addition, Thabo Mbeki has made some prudent appointments to his cabinet and to other areas of finance, in particular the "finance quartet" of Alec Erwin (Minister of Trade and Industry), Trevor Manuel (Minister of Finance), Maria Ramos (Director General of the Treasury) and Tito Mboweni (Governor of the Reserve Bank). In most cases these people have also had the ongoing help of the highly experienced professionals in their departments who were not simply kicked out and replaced after the change of government.

Prudent policies

Perhaps the ANC government has been in a position to avoid making massive and disruptive changes in a hurry, often in the face of criticism from the poorer sections of the population who expect more improvements faster, because it has not had to worry that it is in danger of losing the next election. And while it is certainly not a good thing for a government not to have an effective opposition, we are very lucky that they have used this breathing space wisely to lay the groundwork for growth so that greater social spending can take place responsibly.

The "finance quartet's" focus has been on following a prudent macroeconomic strategy in order to ensure that the rest of the world develops faith in our economy as being stable and positioned for growth. Once this has been achieved they can look further at opening the taps on public spending for employment creation and other poverty-alleviation programmes.

On the monetary policy side of things, the Treasury has set an ambitious target range for inflation for the next few years – 3-6% until 2003 and 3-5% in 2004-05. Although prior to November 2001 it looked very much like we would meet the targets, it looks like we are not going to make it in 2002 and possibly not in 2003. The reasons for this are unfortunately somewhat beyond our control – the price of oil increased dramatically after the September 11th attacks in the USA, and the rand had its big fall against the dollar. These factors help prices to rise here at home.

But what we should be focussing on is the fact that we are in a position to set a target range like that in the first place. We very easily forget that for twenty years or more South Africa had double digit inflation, and a range of 3-6% was unthinkable. Also important is that Tito Mboweni, the man responsible (with the help of his monetary policy committee) for ensuring that the inflation targets are met, has stuck to his guns and raised interest rates 4 times during 2002 in order to beat inflation back down. This, despite upsetting consumers, has won him widespread respect from economists because of his consistency in sticking to his mandate.

It can't be easy managing an economy though, because increasing interest rates has the possible effect of dampening economic growth. It's a delicate balance, something that Trevor Manuel really wants to get right. He, too, has been given points for doing what he says he will do, like when he promised in 2001 that there would be tax cuts for lower- and

middle-income groups in 2002, and there were. These cuts, along with other fiscal policy measures like better tax collection and improved government spending, are amongst Manuel's economic tools which he hopes will help to lift growth to 3,7% by 2004. This growth through prudence will put us in a far better position to alleviate poverty and thus reduce the massive differences in income from which so many of our other problems stem.

Broadening our bases

The structure of the South African economy has changed dramatically over the past few decades. Many wistfully refer back to the days when one rand bought you more than one dollar, and it was so cheap to travel to the USA, but the point that they miss is that the rand was strong only because of the incredibly high gold price. In the early 1980s gold fetched over \$800 an ounce and South Africa produced over 70% of the Western world's gold. Today gold is considered to be doing very well at around \$320 an ounce. Unfortunately the revenues of those heady days did not help to change the economy on a macro level, and we continued to be almost entirely reliant on the export of primary goods – goods that come straight from the source, such as agricultural products or raw minerals, as opposed to goods that have had value added by being changed into useful items, like stainless steel from iron ore.

The economy is now far more diversified than it used to be and we are far less reliant on primary goods. Today only 30% of total exports are beneficiated primary goods, and the share of gold exports as a percentage of total exports fell from 22% in 1996 to 14% in 2000 while annual export growth of manufactured goods increased from 20% in 1996 to 24% in 2000. Our export markets are also far more diversified than they ever have been and more diverse than those of most other economies around the world. While Europe is still our biggest trading partner, we are not reliant on only one or two countries or even regions for our export earnings.

Prior to the eighties we were also very reliant on imports and foreign-owned companies for most of our manufactured goods. But that changed during the period of sanctions and disinvestment, when foreign governments forced their companies to stop supplying South Africa with imports and to get rid of their South African subsidiaries. Perversely, this actually did our economy some good in the long run, as companies like Barclays (now First National Bank) and Mobil (now Engen) were sold to local buyers, leading to a higher percentage of local ownership of already-strong companies. Although the period of isolation led to a lot of necessary but painful restructuring during reintegration into the world economy later on, it does mean that we now have more control over our own destiny and it helps to shield us to some degree from the ups and downs of foreign economies.

These locally-owned companies are often more adventurous than their former foreign owners, investing increasingly in the promising African market (South Africa, for example, is the biggest foreign investor in Mozambique, with some 250 companies present there). This is particularly true in the financial services sector. Our banks are the most powerful in Africa and are increasingly comparable to many of the larger banks elsewhere in the world. In fact, financial services companies like Old Mutual and Investec are expanding around the globe, and the JSE Securities Exchange, already the 15th largest stock exchange in the world, is forging alliances with exchanges in other countries, a sign of its strength and international standing.

Established infrastructure

For all the shortcomings of the old South African economy, there was at the very least significant development of the country's "developed world" infrastructure over several decades. This considerable transportation, energy and communications infrastructure has

not been broken down since the change of government; on the contrary it has been used as a platform for further development. This puts us in a far stronger position than virtually any of the former colonies in Africa, which were left devoid of tarred roads, airports, harbours, telecommunications, educational institutions, and so on. We can use our existing infrastructure and build on it to grow South Africa from a good economy into a great one.

For example, our existing communications and IT infrastructure is being expanded to develop a competitive advantage for South Africa. A new 'Jo'burg 2030' initiative has been launched that aims to set the city up as the IT and service-oriented hub of Africa. For any global player wanting a piece of the African pie, Johannesburg will be the entry point. The Gauteng government has also started the Blue IQ project, aiming to spend R3,5 billion over the next three years to set up the infrastructure required by modern knowledge-based sectors. It expects to generate R100 billion and 100 000 new jobs for the province over the next 15 to 20 years. At the same time Cape Town is vying to do the same and better. The Cape IT Initiative (CITI) aims to make Cape Town the IT development hub of choice for organisations around the world. CITI recently launched a new forum called The Cape Lab, aimed at helping entrepreneurs break into the global market.

The importance of the sector has not been lost on the national government, which has been seeking the guidance of global IT masters who serve on the President's International Advisory Council on Information Society and Development; players such as Larry Ellison (CEO of Oracle), Carly Fiorina (CEO of HP), Reza Mahdavi (CEO of Cisco), local boy Mark Shuttleworth and others. This is aimed at ensuring that South Africa uses technology to develop and transform, and that it becomes increasingly competitive internationally.

The government has also committed to selling a large stake in Telkom and introducing a second fixed line operator soon. This privatisation and opening up of the market will help to make our communications infrastructure even more advanced. South Africa already has the highest number of internet users in Africa, at 2.5 million currently, and we are leading the way in the mobile phone industry on the continent with some 7 million subscribers. South African companies are taking the experience gained here and spreading it around Africa, with investments by MTN in Nigeria, Vodacom in Tanzania and others too numerous to mention. The opportunities are huge. The UN's International Telecommunication Union recently reported that the number of cellphone users in Africa has vaulted up from two million in 1997 to 30 million in 2001, and that number is growing fast.

But it isn't only in the high tech areas where we are benefiting from our existing infrastructure. Eskom, which generates around 200,000 GWh of the world's cheapest electricity, is bringing electricity to millions of South Africans, while also investing in significant projects all over the rest of Africa. Eskom already generates 70% of Africa's electricity, and it is leading a campaign to light up the continent with a continent-wide grid by 2010, possibly exporting surplus electricity to Europe and the Middle East.

We have seven good deep water ports, which are busier than ever and increasingly so, and plans are underway to build another one at Coega in the Eastern Cape. Coega, which is estimated to be the largest single long-term investment in our history, is expected to create 10 000 jobs directly during the building of the port and when multi-billion rand investments from European companies are completed in the building of stainless steel works and a hoped-for aluminium smelter, among others.

We have 34000 km of well-maintained railway lines to get goods from those ports to pretty much anywhere else in the country and vice versa. This rail network connects into the networks of other African countries, enabling us to move products throughout the continent. We also have over 6000 km of tarred highways and main roads to cover the rest

of the country. Transport Minister Dullah Omar, as the person ultimately responsible for this network, recognises that "there is clearly room for improvement and we need to make it more efficient", and that is what he is working towards. Already the existing airports are being put through massive upgrades by the Airports Company, which is planning for a tremendous increase in the movement of both people and cargo over the next ten years.

Let's talk

Our developed infrastructure provides us with another indirect advantage. Developed countries are feeling increasingly pressured to help developing countries improve by offering them preferential trade agreements. An example of this is the Africa Growth and Opportunities Act (AGOA) in the United States, which provides a number of African countries with the opportunity to export certain products at a significant reduction in import duties. But of these countries, South Africa is undoubtedly best positioned to take advantage of this benefit because of our more-developed industries and superior infrastructure. To illustrate, 20,8% of our exports to the US are duty free, while that figure is only 8,1% for the rest of the AGOA countries. Some industries, like the automotive industry, have seen major benefits from AGOA. BMW has switched its production of 3-series cars destined for America from Germany to South Africa in order to take advantage of the lower tariffs on cars made in South Africa.

The European Union has also opted to work out an agreement with South Africa in its drive to support developing nations. This trade, development and cooperation agreement removes barriers on 90% of all trade between South Africa and the countries of the EU. The benefits of this are obvious when one considers how much cheaper our goods are than goods of the same quality built in Europe and exports have already grown as a direct result.

Our government is committed to developing a free trade area between the fourteen member countries of the Southern African Development Community, which will further assist the growth of exports to our African neighbours. And South Africa is in talks with the countries of Mercosur (the group of countries in the South American free trade association), China, Australia and various others about preferential trade agreements. After November 2002 it is hoped that Russia will re-classify South Africa as a developing country. This is significant because until now we have been classified as "developed", and the change will allow our products to be subjected to significantly less in import duties.

It seems that now, in stark contrast to the way things were, everyone wants to talk. Well, why should we complain? It's great not being a pariah state anymore!

Africa awakes

We're playing an important role in talks and negotiations closer to home too; an increasingly important role as a regional power in Africa. The face of African politics has changed since the end of the Cold War, as a few figures can demonstrate. From 1985 to 1989, only nine sub-Saharan countries held 'competitive' (free and fair) elections. In the five years that followed, that number more than quadrupled to 38. The average share of legislative seats won by opposition parties rose from 10% in 1989 to 31% in 1994. And of these 38 elections, 29 were founding elections that broke the monopoly on politics held by authoritarian regimes.

Now the Organisation of African Unity (OAU) has metamorphosed into the African Union (AU), in 2002. But this is more than just a name change; it represents a significant change in attitudes on the continent. While the OAU defined itself in terms of what it stood against – colonialism, racism and Cold War-era foreign interference, the new legal framework of the AU defines it by what it stands for – democracy, good governance and

respect for human rights. The AU's structure and responsibilities are now in line with international legal trends, and it is loosely modelled along the lines of the European Union and the UN.

The 1990s also saw the rise of a new generation of African leaders. Before 1990 more than nine out of 10 incoming national leaders were appointed by military or party elites. Between 1990 and 1994, democratic leadership transitions took place in 11 countries. It is these new leaders, including South Africa's President Mbeki, Nigeria's President Obasanjo and Senegal's President Wade, who have begun taking responsibility for Africa's economic recovery through initiatives like NEPAD (New Partnership for Africa's Development).

Officially, NEPAD is the AU's economic and development plan. In a broader sense, it is a strategy to make Africa's renaissance happen, similar to the Marshall Plan that helped to rejuvenate Europe and Japan after the Second World War. Thabo Mbeki came up with this idea of a rebirth that rids the world of Afro-pessimism, develops the African economy and instils peace, security and democracy. NEPAD's codes of conduct will commit each member state to multi-party democracy, sensible economic and financial policies, the sanctity of private property and the rule of law.

Rejuvenation will be achieved on three levels. Firstly, NEPAD will negotiate on behalf of member countries for things such as better trade access and debt relief. Secondly, practical programmes will ensure pressing social problems such as health and education are addressed. Thirdly, NEPAD will set standards for good governance and implement a peer review system designed to put pressure on undemocratic states to change their ways. A committee will assess compliance with these standards every three years.

It may seem like the AU and NEPAD have some lofty goals, and certainly there are many sceptics who will wait to see positive changes before believing in them, but what they are doing is setting an agenda which has the potential to change negative sentiment about Africa and prepare the ground for a sustained economic boom on the continent. And South Africa, as a key regional player, stands to gain enormously from any such boom.

Increased confidence

Some of this good news and economic potential seems to finally be filtering through. International agencies like Moody's, which produces economic ratings that are widely used as a measure of a country's investment attractiveness, have consistently been offering votes of confidence in South Africa's economic future by upgrading our ratings. Positive spin-offs include the fact that during the first seven months of 2002, foreigners bought a net R6,147 billion of South African bonds. And when the treasury issued South Africa's biggest bond ever in the form of a \$1 billion with a ten year maturity and the lowest-ever coupon for a dollar-denominated bond of 7,375% in April 2002, it attracted orders of more than \$2 billion from 120 international investors. This demand, along with the fact that Standard & Poor's assigned a favourable BBB-minus debt rating to the bond, was seen as a clear signal of confidence in South Africa's solid economic fundamentals and consistent economic policies by foreign investors.

Locally, too, business confidence hit an eight year high in the second quarter of 2002, despite the prospect of missing the inflation target, despite the low rand, and despite the problems in the rest of the world economy. It reached 68 points, the highest since the previous high of 67 points in the fourth quarter of 1994 when the euphoria of the peaceful transition to democracy was at its peak.

While we still have a very long way to go in changing the negative perceptions that exist about South Africa, especially abroad, these are positive signs that the road ahead might just be smoother than it has been over the past few decades and that we could be in for

some good growth in the future. The more confidence foreigners and locals have in our economy, the more likely they are to invest and contribute to economic development.

Growth sectors

As we mentioned earlier, South African exports are already doing well. South Africa currently has the third highest export growth rate in the world. In the 44 months up to July 2002, there was a trade surplus in 39 of those months, which basically means that we sold more to foreigners than we bought from them. Certain specific examples stand out, such as the fact that in 1994 trade with Nigeria was worth \$12 million, and this had grown to \$400 million by 2001. But there are undoubtedly some shining stars amongst exporting industries that are beating all records and experiencing unprecedented growth.

Motoring ahead

Probably the most notable of South Africa's export growth areas is the motor industry. This industry, which during the 1980s was inefficient, uncompetitive, over-protected and beset by industrial unrest, has proved to be an example of how business and government can work together to develop a world class industry.

A good deal of the industry's success has been attributed to the Motor Industry Development Plan (MIDP), introduced in 1995, which allows manufacturers to offset import duties with export credits. The MIDP has encouraged motor manufacturers to concentrate on producing only a few models of vehicles locally for export and import other models. In this way they have been able to increase their production runs of certain models, thus reducing unit costs, increasing productivity and improving competitiveness. When it was first introduced, the industry predicted that it would not be able to compete internationally and that there would be thousands of jobs lost. But in fact the opposite has happened, with billions being invested in undertaking rapid structural change to the industry in a relatively short time and exports increasing beyond the wildest expectations. The current MIDP is due to end in 2007, but Trade Minister Alec Erwin has stated that it will continue with a few amendments to further increase competitiveness.

The results of the programme speak for themselves. In 1995 the automotive industry generated R4,2 billion in exports, just 4.1% of South Africa's total exports. In 2001 automotive exports reached R30 billion, 12% of total exports. The industry expects this amount to increase to R75 billion by 2005. In terms of units, 10500 cars were exported in 1997 and this grew to 97300 in 2001. It is expected that this will grow further to 153,000 in 2003. That's roughly an average of 39% growth per year.

Efficiency has increased too. In 1994 it took 112 hours to assemble a typical vehicle in South Africa, whereas in 1999 this had been reduced to 60 hours. This unfortunately still isn't good enough, since the European benchmark is 20 hours, but it is still improving. The improved efficiency hasn't been at the expense of quality, though. In 2002 a US-based global marketing information services company awarded BMW's plant outside Pretoria the European Gold Plant Quality Award, ranking it first among European plants for quality. BMW's plant in Germany only received a Silver award, while Daimler Chrysler's German plant got a Bronze award.

BMW, Daimler Chrysler and Volkswagen export cars all over the world and they continue to look for new markets. While these three companies build about 97% of South Africa's car exports to the US, Japan, Europe and Australasia, Toyota is also getting in on the act. Toyota is planning to invest R3,5 billion in its South African operations over the next four years, and will start exporting 15,000 to 20,000 Corollas to Australia from March 2003.

The export of automotive components has also grown rapidly, with an average annual growth of 33% being maintained over the past six years. The growth has been mainly in catalytic converters, which incidentally are only fitted to about 50% of new cars in South Africa. They increased in exports from R4.7 billion in 2000 to R9 billion in 2001. Delta Motor Corporation, which does not export whole vehicles at all, increased its export turnover from R304m in 1997 to R2.05bn in 2001 through components alone.

Shootings of a good sort

The film industry has also experienced dramatic growth since 1994. The estimated value of the industry to metropolitan Cape Town alone, which is where most of the growth is being experienced, is R2 billion a year. In 2000 Cape Town issued permits for about 820 film shooting days, which compared well with San Francisco's 980 shooting days, and which is growing fast. Much of this boom has been experienced in the making of advertisements for British, German and US companies, but South Africa is also being discovered by some of the bigger film companies now, and superstars Bruce Willis, Val Kilmer and LL Cool J will be in Cape Town during the 2002-03 season to work on their latest movies.

Foreigners are attracted by the Cape's beauty and diversity – it is possible to film in a variety of locations from beaches to mountains to vineyards to city centre all within an hour of each other. It is also very easy to disguise Cape Town as a European or American city. Producers, of course, are very mindful of the fact that filming in Cape Town is 20% cheaper than in Australia and 30-40% cheaper than in Europe or the USA. Plus we have a growing number of state-of-the-art production studios as well as a pool of well-trained and experienced film crews.

The growth of the film industry in Cape Town is already on a par with the growth in tourism. This growth has been achieved with virtually no government support, unlike competitive locations like Canada, Australia and India, which give their industry very favourable incentives. Imagine what can be achieved with government incentives, not only for the film industry and its supporting structures like car hire and catering, but for the spin-offs in the form of increased exposure and tourism to the locations seen in movies around the globe.

Winning wines

The South African wine industry has established a proud tradition since the embryonic introduction of vines by Dutch and French immigrants more than 300 years ago. The 19th century Cape Constantia white wines were mentioned by Victorian author Jane Austen and Vin de Constance from Klein Constantia was reputed to be the favourite drink of Napoleon. More recently, since the end of South Africa's isolation period, our wines are once again enjoying global recognition. For example, at Queen Elizabeth's jubilee celebrations in June 2002, VIP guests attending the garden party outside Buckingham Palace all received dinky bottles of Nederburg wine in their prepared gourmet picnic hampers. Our wines are also regularly winning international awards and once again finding their way into the best restaurants around the world.

This newfound success is no coincidence. The South African wine industry has literally been reinvented. Thirty years ago, there were 23 wine estates and 30 wholesale wine producers in the Western Cape. The 2002 John Platter Guide, widely regarded as the bible of the Cape wine industry, lists around 4 000 wines from 70 wine cooperates, and reviews nearly 150 wine cellars, exporters and wholesalers. Included are 16 wines classified in the five-star 'superlative' category. Simply put, the industry has gone world-class. South African wine makers have studied and practised in France, California and Australia. New, often

foreign, owners have taken over estates and invested in new technologies, cultivars and expertise. And wine-makers have changed their habits, becoming more innovative and using local cultivars like pinotage in dazzling new ways.

As a result of all this, exports of South African wines grew by 24% in 2001 – three times the average annual growth rate of the previous four years. KWV, the co-operative that used to be the industry regulator but which is now an unlisted public company, almost doubled its earnings in 2001-02. This has largely been attributed to a 40% increase in its foreign sales, about half of which came through increased volume and the rest through the depreciation of the rand.

And so on...

Exports of other agricultural products are also growing by the year. Exports of South African fruit to Russia more than doubled between 2000 and 2001, and they are expected to almost double again in 2002. Assuming the Russians decide to re-classify South Africa as a developing country, the sky is the limit.

Minerals continue to be a big money-spinner for our economy. For example, South Africa is now the largest shipper of unfinished diamonds (regardless of where they were found) to the USA, growing by 60% in 2001. We have now outstripped our major competitors in this market, the UK and Belgium, who used to have an equal market share to us. Platinum is another mining success story, with an 80% increase in export sales in 2001.

And let's not forget the smaller guys, like the winner of the 2002 Cape Town Regional Chamber of Commerce and Industry's Maersk Sealand Exporter of the Year competition, Blue Bay Concepts, which has doubled its turnover every year for seven years mainly through exports of its Rogz for Dogz pet products that make up 80% of its production.

Challenges ahead

So it looks like we may have things pretty sorted out on the economic front. The government's prudent policies are helping to grow the economy responsibly, other countries want to trade with us, confidence is increasing, and our exports are booming. But we must not forget that there are important challenges that lie ahead.

Chief among these is HIV/AIDS. We must address this problem and companies must plan for it so that we can prevent some of the worst predictions from coming true. Other challenges also include unemployment, which is still unacceptably high at around 24% and the massive disparity in incomes (Brazil is the only country in the world that has worse distribution of income than South Africa). These need to be addressed to avoid any greater opposition to the government's commitment to liberal economics. Skilled resources will also be needed to take the economy to the next level, and there may be a need to encourage immigration of skilled professionals while we train up more of our own.

We must also never become complacent about our international competition and forget that the countries of South-East Asia, like China and India, are vying for the same foreign investment that we are. We need to keep an eye on what they are doing to attract investment and do it better. The government would do well to look closer at the removal of foreign exchange controls to attract further foreign direct investment.

We have the potential to further grow our economy to the benefit of all our people. Let's show the world that we recognise that and remain positive in the face of whatever challenges lie ahead, so that foreign investors can feel the confidence that we feel ourselves.