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Trade and Uneven Development: Opportunities and Challenges



Micro-Economic Development Strategy for the
Western Cape
Synthesis Report - Extract

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NOTE: This is an extract from the recent report of the Department of Economic Development, Western Cape Province.

The first chapter sets the scene by outlining some of the challenges faced. Chapter 5 sets out the heart of the approach employed in identifying priority sectors and the broad policy approach followed.

The report itself provides the details on the recommendations - but these are not explored here.

Chapter 1

The Western Cape Economy: Performance and Prospects

Chapter 1 is a broad survey of the major structural features of the Western Cape economy¹ and the prospects for further development. Its sectoral strengths, as well as its challenges, are laid out, serving as the foundation for the more detailed industrial policy analysis that follows. The international dynamics governing globalisation in this current era, including opportunities and threats, are briefly explained, and the region's insertion into the global economy is particularly highlighted.

1.1 Structure

With a population of 4.6 million or 10% of the national populace, an area of about 10% (120 000 km) of South Africa, and a GDP share of 14%, the Western Cape falls into the middle range of the nine Provinces. Based on the Western Cape's estimated per capita Gross Regional Product (GRP) of about R40,800 in 2004, and a country-wide per capita GDP of approximately R28,800, the Western Cape (together with Gauteng) is at the top of the provincial development range.

¹In this Chapter, much of the data is drawn from the PERO (2005).

The Province's population increase is well above the national average (about 2.4% compared to the national average of 1.4%), signalling lower HIV/Aids mortality and a significant net population in-migration. Urbanisation is high at close to 90%, and the Western Cape rural areas do not have peasant agricultural settlements but well-established small towns.

The Western Cape is blessed with a solid, diversified resource base, even though it has no minerals of significance and its water supply is under some threat. These resources relate to the topography, coastline, rivers and diversified vegetation of the region, its extraordinary natural attractions (ranging from Table Mountain and the Garden Route to the Cederberg and the Winelands area) and its moderate climate. It also includes its strategic location along east-west and north-south sea routes, with two world-class harbours (Cape Town and Saldanha).

The Western Cape's infrastructure is relatively well-developed, compared to most of the other Provinces, but as outlined later, the infrastructure is much less impressive when compared on a global scale. In addition, deterioration and development gaps are becoming a serious concern for some sectors and places. Local education levels are on average much better than the national average; this is reflected in the significantly higher literacy levels and grade 12 pass rates.

1.2 Sectoral characteristics

Probably the most important characteristic of the Western Cape's economy and its economic development is the broad base and diversity of its more promising sub-sectors, industries or 'niches'. The four core sectors of the Western Cape's economy (agriculture, manufacturing, trade, and financial and business services) are each well diversified, thereby reducing the risk of over-dependence on any single industry. In addition, the region has a well-developed and diversified tourism sector, and relatively strong and dynamic construction, fishing, professional services, higher education and transport sectors. While it lacks a significant mining sector, Saldanha has become a major export harbour for minerals and a downstream iron and steel industry.

The broad services sector accounts for more than two-thirds of the regional economy. Within this sector, business services are particularly im-

portant, comprising 27% of the regional economy - considerably higher than the 19% nationally. Manufacturing makes up 20% of the regional economy - similar to the national figure. Within manufacturing, the major activities are agro-processing, metals and engineering, oil and petro-chemicals, and clothing and textiles. Agriculture (5.6%) and construction (3.4%) are also somewhat larger than the national average. Mining and quarrying (0.3%) is much lower than the national average (7.8%).

1.3 Size of enterprise

The absence of large mines and capital-intensive mineral processing as well as heavy industry complexes accentuates the dominance of small and medium-sized enterprises (SMEs) in the Western Cape's economy. As explained later, this dominance of SMEs in the regional economy also influences the role that falls upon the PGWC in the stimulation and orientation of economic growth and transformation in the region.

1.4 Socio-economic Factors

The following factors have an important impact on the regional economy:

- the particular location of the Western Cape within South Africa's spatial development framework (1 500 km away from the country's economic and metropolitan hub);
- its broad regional economic base; and
- the attractive living and working environment of the Western Cape.

Parallels to this locational impact on the structure of the regional economy can be found in countries like Canada (Vancouver as the far-western regional centre), Brazil (Rio de Janeiro as opposed to the capital Brasilia and the industrial centre Sao Paulo) and Turkey (Istanbul as opposed to the capital Ankara).

As far as socio-economic development indicators are concerned (e.g. the number of doctors, nurses and hospital beds per 10 000 of the population, access to water, electricity and communication services, etc.) the Western

Cape ranks either highest or second-highest after Gauteng. This also applies to skill levels of the labour force and, in the inverse, to unemployment levels. Yet, ‘relatively better off’ does not imply that development issues related to these indicators are not serious in the Western Cape, or that they do not demand attention from both the public and the private sector.

The relatively well off position of the Western Cape among South Africa’s nine Provinces can be linked to particular historical factors, which shaped the specific socio-demographic structure of the Western Cape. These forces, again, influence current trends with respect to net in-migration to the Western Cape from the Eastern Cape, and they also explain why the Western Cape receives a declining share of provincial transfers, most of which are directly linked to development needs.

1.5 Economic growth

For the period 1999-2003, economic growth in the Western Cape (3.9% per annum) considerably exceeded that of the national economy (3.1% per annum). This is largely due to the services sector – both because fast-growing services are over-represented in the region and because services grew faster in the region than they did nationally. This faster growth was particularly evident in internal trade and catering (reflecting tourism) and especially in financial and business services. By contrast, the manufacturing industry in the Western Cape grew at only half the rate of the national, 1.4% as compared to 2.8%. A number of manufacturing sectors of importance to the region saw overall declines – food and beverages; non-metallic minerals, clothing and textiles, and wood, paper and publishing.

In line with its higher rates of economic growth, fixed investment spending in the region also grew more rapidly than nationally – 4.2% as compared to 2.2%. However, much of this difference occurred in 1999 when, following the Asian crisis, investment dipped far less in the Western Cape than in the rest of the country.² In terms of sectoral contribution, financial and business services played a major role in this increase – probably close to one-third of overall growth in investment spending being contributed by

²It is not clear why fixed investment in the Western Cape remained stable while it declined considerably at a national level. It is probably, in part, a consequence of investment in the service industries being less cyclical.

this sector.³ Transport and communication, government and internal trade and catering also contributed to the growth in fixed investment spending. The only manufacturing sectors that made any significant positive contribution were petroleum products, and chemicals and transport equipment.

1.6 Employment

For a number of sectors, there is something of a disjuncture between growth in fixed capital formation and employment creation. This is particularly evident in petro-chemicals, transport and communications, and, most importantly, financial services. In these sectors, significant increases in capital investment were not accompanied by any net employment growth.

Employment declined in almost all sectors – the major exceptions being automotive, retail and wholesale trade, and business and community services. Employment decline was particularly sharp in manufacturing at 3.2% per annum. Outside of the Western Cape, employment decline in manufacturing measured 0.8%. Employment in financial services grew by 1.1% per annum while output growth was 6.1% and investment growth 5%. Internal trade and catering, business services, and in manufacturing only transport equipment, contributed positively to both capital investment and employment.

The net result was that despite a healthy growth in investment spending of 4.2% per annum, aggregate employment in the Western Cape *declined* – by 0.4% per annum. In employment creation, the Western Cape performed poorly by comparison with national.

Rising fixed investment accompanied by falling employment is a clear indication of capital deepening and labour substitution. This is a national phenomenon. However, with fixed investment rising significantly faster and employment declining significantly faster than for the country as a whole, the Western Cape has been particularly prone to capital deepening and labour displacement.

In line with the strong tendency to capital deepening, employment cre-

³The PERO calculation of “..close to 40%..” (PERO, 2005: 76) included transfer costs. The MEDS researcher for financial and business services, after a considerable sifting of the data, concluded that the figure was accordingly considerably lower i.e. close to one-third. It is clear that the data for this very important sector are seriously deficient.

ation in the Western Cape is significantly skill-biased. In all sectors, even in the unskilled areas, the share of unskilled workers has tended to decline. Whereas unemployment has risen significantly for all other education levels, unemployment amongst those with tertiary education has declined since 1995 (Education Department, Western Cape 2004: Table 4).⁴ Between 2000 and 2003, two-thirds of the jobs created accrued to those with a matric certificate or higher.

The challenge for the Western Cape therefore is not solely to raise the rate of growth but also to foster growth that takes a more labour demanding path, and more especially to increase the demand of unskilled and semi-skilled labour.

However, this is a very difficult challenge. Our researchers were able to identify only a few productive sectors that hold promise for the direct creation of significant new unskilled and semi-skilled employment opportunities. Limitations in employment opportunities raise the importance of SME and entrepreneurial development. Training and education to equip more people with the skills that can command employment as well as interventions in other policy domains such as public works programmes is needed.

1.7 Future Growth and Employment Prospects

In line with expectations that the national growth rate is likely to be considerably higher over the next few years – at time of writing the consensus forecast for 2005 and 2006 is around 4% per annum⁵ – growth in the Western Cape is forecast to shift higher. The outlook for the rapidly growing sectors that is financial and business services, transport and communications, property and retail, and wholesale trade and catering is very favourable. Growth in these service industries is projected to equal or exceed the national performance. The strong representation of these sectors

⁴Other data suggest that while unemployment levels are considerably lower amongst those with tertiary education, in the period 2000-2003, the unemployment rate for those with tertiary education increased – from 4.3% to 7.3%. PERO (2005):162.

⁵National Treasury is forecasting a growth rate in excess of 4%. “Government forecast is for the economy to grow by an average of 4.2 % over the next few years.” PERO (2005):1

in the Western Cape is likely to result in the region exceeding the national growth rate.

The manufacturing sector is likely to be favourably affected by strong domestic demand. This will be of particular importance to the clothing and textiles industries. But, many sectors are currently experiencing both rising import penetration and declining exports on the back of an appreciating Rand. Accordingly, much will depend on the future strength of the Rand. The outlook for manufacturing is more uncertain and less expansive.

In the short-medium term therefore, the outlook is for a similar pattern of output growth - strong growth in the broad services sector and very slow growth in manufacturing with some sectors actually contracting. The trend for the Western Cape to become a service-based economy is likely to accelerate.

Table 1.1: Summary of Western Cape's Economic Outlook 2004/5 – 2007/8

	2004/5est	2005/6F	2006/7F	2007/8F	Av.
GDPR (R-Billion)	203,0	222,5	244,4	263,4	
Real GDPR growth (%)	4,1	4,3	4,0	3,9	4,1
Primary sector	1,7	2,5	2,2	1,7	2,1
Secondary sector	3,8	4,5	3,7	3,2	3,8
Tertiary sector	4,4	4,8	4,5	4,5	4,6

Source: BER in PERO 2005:90. "Av." refers to the average over 2005/6 - 2007/8.

The impact on employment is uncertain. Any substantive employment gains will depend heavily on the rapidly expanding sectors. If these sectors continue to resort to capital deepening, overall employment gains will be very limited and will be below the anticipated growth rate. Thus, even at the projected significantly higher growth rate, the prospects for any significant reduction in the unemployment rate do not look promising.

1.8 Further growth and employment opportunities

However, there are a number of significant opportunities for output and employment growth in the Western Cape. If it is able to capitalise on the opportunities presented, the Province may significantly exceed projections. There are also a number of other sectors that have prospects of more limited expansion in output and employment. These are identified and discussed in Chapter 5. In addition, there are a number of areas and activities in which provincial policies can have a more indirect but broader systemic impact on output growth and employment. Finally, there are sectors where output and employment are under considerable threat and policy may help to retain capacity.

1.9 Some factors constraining the Western Cape's economic performance

Notwithstanding the comparative strengths and 'above national average' performance of the Western Cape over the past two decades, important problems, limiting factors and potential threats cloud its socio-economic performance and future development path. A number of these are listed below to illustrate the range and seriousness of some of them.

- Complacency about past achievements and 'satisfactory life-styles' among the middle and higher socio-economic strata of society is a factor (sometimes) limiting initiatives and the tenacity to tackle the more fundamental issues.
- Short-to-medium-term implications of the strong Rand, which directly impact on a wide range of Western Cape exports and dampen the opening up of new export niches (e.g. yacht building and film production).
- Stark, and increasing, income and wealth inequality in the region, which potentially threatens the social cohesion of society.

- Relatively slow (visible) progress with black economic empowerment, especially with respect to the steadily rising share of the Western Cape's African population.
- Sizeable net in-migration, with about two-thirds of the 50 000 net in-migrants per year coming from poor, rural communities in the Eastern Cape, and with the (currently still low) level of foreign African in-migration also accelerating.
- Steady annual out-migration of relatively well-skilled (young) people to the northern hub as well as other centres of the country and overseas.
- A large and highly visible number of poor, unemployed and often destitute people, predominantly in or near the urban areas (in particular metropolitan Cape Town).
- Steadily increasing competition from other regions and centres of South Africa in areas where the Western Cape in the past had either a comparative advantage or was the first with projects or sectors (e.g. competition for the V & A Waterfront, for the hosting of world-class conferences, for export grapes, designer furniture, etc.).
- The challenge of quota removals and other global trade liberalisation measures on hitherto relatively protected local industries (such as clothing).
- An understandable reluctance at national and inter-provincial levels to support or subsidise Western Cape developments, seeing that the region is comparatively so much better off than other developing regions (e.g. in the allocation of capital funds for infrastructure development or mega-projects).

These limiting factors have a major influence on shaping the future growth and unfolding of the Western Cape's sector structure. Some of the factors and forces can be addressed directly (e.g. bottlenecks developed in certain infrastructure segments) while others suggest a lower future presence of some sectors (e.g. clothing). A thorough understanding of these problems and underlying forces is critical for the shaping of effective sector strategies.

1.10 The Western Cape in the global economy

One of the most significant spatial dimensions of global growth is that coastal economies have tended to grow significantly faster than hinterland economies. This is true globally, for fast-growing Asia, and also for Africa. Coastal regions have grown far more rapidly in Africa than the hinterland, albeit at significantly slower rates than for coastal regions elsewhere (Collier and O'Connell 2005).

The principal factor underlying the enhanced economic performance of coastal regions is that their location allows for easier engagement in the global economy, particularly if, as in the case of the Western Cape, it sits astride established trading routes. Global trade and commerce have consistently expanded at much more rapid rates than growth in global GDP. Similarly, the growth in South Africa's exports significantly exceeds its growth in GDP.

For the Western Cape, the rise in exports has exceeded the growth rate of the regional economy by a significant margin. The growth in Western Cape exports in the period 1996-2003 has been estimated as being between 8% and 11.4% per annum (PERO, 2005:84).⁶ This compares to a provincial growth rate of 3.9% over the same period.

Much of this export growth comes from the Western Cape's top 3 export categories – fruit, alcoholic beverages (wine) and iron and steel – the first two are based on local inputs, while iron and steel is based on the beneficiation of inputs from outside of the Province. These 3 categories account for a little under half of all Western Cape exports. However, export growth is very widespread – notably in boats and ships, furniture, chemicals, wood products, automotive components, tobacco and paper (PERO, 2005:85).

While the Rand's appreciation considerably slowed export growth in 2003, growth is likely to resume, more particularly if, as is forecast, the value of the Rand declines. Clearly, the performance of the global economy will have a critical impact on the prospects for the Western Cape.

⁶The discrepancies arise from the use of different deflators necessary to exclude the impact of currency and price movements from the underlying flows.

1.11 International dimensions impacting on Western Cape Industry

We have isolated a number of key dimensions impacting on the Western Cape economy:

- The global dispersion of production and the opportunities this offers to regions (such as the Western Cape) within developing countries.
- The global importance of knowledge intensive processes as high rent yielding activities – implications for fostering specific knowledge activities/sectors, and attracting skilled high income earning and spending personnel into the Province.
- The segmented nature of global tourism and the advantages the Western Cape has in facilitating the synergies between natural and cultural resources.
- The impact of globalisation on poverty and inequality.

1.11.1 The global dispersion of production - opportunities and constraints

From the perspective of developing countries this new era of globalisation – roughly the last three decades of the 20th century - is characterised by two processes. Firstly, a rapid expansion of global trade in manufacturing and services fuelled by the systematic reduction in international barriers to trading, and secondly, a major shift in the global dispersion of industrial production towards locally owned and/or managed firms in developing countries, especially in respect of products with high labour intensive components. Manufactured exports grew rapidly from developing countries, accounting for more than 70% of all their merchandise exports by 2000, as compared to 20% in the 1970s and 1980s (UNCTAD, 2002:51). Even in sub-Saharan Africa, exports of manufactured products exceed agricultural exports. Throughout the developing world there has been a pervasive shift away from resource-based manufactured products to low-tech manufactured products.

Firms in these (often, but not exclusively, middle income) developing countries are not simply engaging in trading of final product commodities as independent producers, but are locked into global value chains often producing components (semi-manufactured goods) for links further up the supply chain. In these global value chains the buyers or intermediate agents exercise enormous power over the characteristics of the sourcing arrangement: *what* is produced, *how* it is manufactured, *where* it is sourced from, and *how much* it is sold for. Competing on the basis of price is important, but so are a host of other factors such as quality, time to market, etc. Hence sourcing buyers constantly compare the operational efficiency of different competitor suppliers. This imposes the need for producers to continuously upgrade their operating performance in line with world class manufacturing techniques and radically ratchet up their competitiveness.

A new layer of dynamic Asian economies (principally China and India) has emerged, impacting on the manufacturing sectors of other developing economies, especially Africa. These Asian economies have a cheap labour advantage but are also highly competent in production performance; hence their export drives are carving out a huge global terrain especially in lower-end manufactured goods (e.g. clothing). A major reason has been their ability to not only meet the production standards dictated by the global value chain drivers, but also to continuously cut prices for low technology products, hence cutting other developing country producers' global market share. This has been reflected in a general global fall in prices of low tech manufactured products since the 1990s (Kaplinsky 2005). Hence, for developing country firms, competing globally simply on the basis of price is a very risky business indeed. Local manufacturers that wish to maintain some degree of domestic and export shares are having to radically upgrade their production capabilities, resulting in a concerted drive towards internalising manufacturing excellence principles and achieving world class manufacturing standards.

This global dispersion of production offers new export opportunities to manufacturers in the Western Cape, but only if they can meet the exact technical requirements, operational parameters, and pricing structures specified by their global value chains. However, those firms who supply the domestic market have no room for complacency, for the other side of export opportunities is the threat of cheaper imports into the country wip-

ing out domestic market share. This is most evident in the clothing and textile sectors, traditionally more oriented towards the domestic market, which are large employers of semi-skilled workers. The domestic upsurge in the economy may well provide numerous opportunities for stabilising employment but there is no room for local manufacturing to hide from international competition. The demands to strive for manufacturing excellence and upgrade to world class manufacturing standards applies in all markets. Strategies to rapidly upgrade the operational performance of the firms to compete internationally is noted as an urgent provincial policy lever.

1.11.2 The global shift to knowledge intensive activities

Within global value chains knowledge intensive functions and activities are increasingly important – ‘branding’, ‘marketing’, ‘design’, ‘research and product development’, ‘logistics’, ‘organising sourcing’, ‘managerial skills’, ‘financial services’. The further up the value chain or more knowledge intensive (hence complex) the activities, or meeting specialist standards, or producing branded country of origin products, the greater the financial gains and wage income returns. Within value chains where the manufacturing process is relatively labour intensive and low technology products are being produced (e.g. clothing and footwear) the highest income and rent yields revert to those who own and control brand names, design, marketing or who control the organisational outsourcing and logistics functions.

Value chain transactions require sourcing arrangements involving obligatory relationships.. There is a major organisational/logistics function between the various chain links, ensuring adequate sourcing, meeting technical parameters and achieving chain competitiveness. Those firms who organise relationships (a knowledge intensive function) are hence in an extremely good position to appropriate high rents and income.

This has impacted on the geographical location of these functions. There has also been a simultaneous re-concentration of these knowledge intensive functions in the industrialised countries or in newly emerging middle income countries or even regions within countries. Furthermore, middle income developing countries who have acquired highly developed process manufacturing competence (a form of knowledge intensive skills) are able to meet the technical demands of world class manufacturing and

therefore do not only compete on price and low wages. Moreover, there are other benefits to having control over and access to such knowledge intensive intangible functions and activities. For knowledge intensive intangibles create their own specific barriers to entry, thus reproducing the tendency to concentrate them in higher income countries and regions.

Industrial development is increasingly more dependent on the transmission and acquisition of appropriate knowledge. Information communication technology (ICT) is transforming business – enabling customers to access information about new products and suppliers, revolutionising distribution and supply chain management, and enabling a much tighter integration in the management of inputs and design to marketing and sales. Continuous innovation in design, manufacturing processes, and marketing has become the driving force of successful economies – and innovation requires accelerating knowledge intensity. Increasingly economists argue that countries specialising in technologically rich (i.e. based in knowledge-intensive) industries or labour intensive industries based on making available advanced levels of information technology (e.g. call centres) will experience faster growth than those that do not. This is particularly important for developing countries and regions unable to compete using cheap labour. International competitiveness is therefore increasingly based on the capacity to master information technology, to exploit all of the knowledge resources available, and to innovate.

Furthermore, in many instances where geographical regions or cities have managed to create a hub of knowledge creativity this has resulted in attracting high income skilled personnel, with potential spin offs for economic growth and economic spillovers into rising demand for a myriad of labour intensive services. In a major study of contemporary successful knowledge valuing cities, Kotkin and DeVol (2001:97) observe, “there are several basic premises that are critical for urban success in the digital age. Perhaps the most important regards lifestyle concerns. In the digital economy, where people want to live becomes the paramount concern. Thus, reducing crime, creating new arts districts, refurbishing historic structures, encouraging new restaurants and clubs have become primary economic development tools.” Citing recent studies, they go on to conclude “that investments in skill development are far more effective than traditional economic development incentives. If lifestyle factors lure new workers, training

initiatives can go far in keeping employers in a particular geographic area.”

The Western Cape has major advantages, insofar as it already exhibits a concentration of many of these knowledge intensive characteristics, innovation activities and services. A significant number of highly skilled personnel have chosen to live there, and learning and innovation has become coupled with life style choices. These processes should be encouraged and fostered as much as possible. The industrial policy implications for the Western Cape government are:

- encouraging knowledge intensive functions within value chains, such as design, both in general and with respect to particular sectors;
- assisting management in industrial sectors, to acquire the operational knowledge to attain world class manufacturing excellence in the production process through fostering clusters focused on continuous improvement and knowledge acquisition;
- facilitating the generic business management upgrading for SMMEs;
- encouraging stable representative sector stakeholder forums to ensure rapid communication between industry and provincial/local government;
- facilitating the widespread diffusion of ICT to allow enterprises and skilled self employed individuals achieve the knowledge based productivities these can yield;
- supporting the expansion of the general ‘call centre’ business process outsourcing (BPO) industry in the Western Cape, as well as niche oriented high quality services focused in specific knowledge intensive areas (e.g. financial services), thus providing employment opportunities for large numbers of recently matriculated youth; and
- investigating how in some areas organisational/logistic functions have the potential to attract other activities that are labour absorbing, as in the servicing of oil/gas activities in Africa.

1.11.3 Globalisation and Tourism

Globalisation has also produced a massive movement of people across national boundaries. Leaving aside work migrants, its most far-reaching expression is to be found in the rapid growth of global tourism. Between 1990 and 2001, global tourists doubled from 325m to 688m, and the value of earnings from tourism rose from US\$256bn to US\$426bn (Kaplinsky 2005). International and domestic tourism combined is estimated to generate up to 10% of the world's GDP and international tourism is the world's largest export earner. Globally, international tourism outstripped exports of petroleum products, motor vehicles, telecommunications equipment, textiles or any other product or service. Travel and tourism are also important job creators, employing an estimated 100m people globally. Globally, employment in tourism is growing $1\frac{1}{2}$ times faster than any other industrial sector - mostly in SME sized, family-owned enterprises. (WTO, 2003).

Globalisation has focused attention on competitiveness, as destination countries fight for market share, while tourists have become more sophisticated in their destination choice and expectations of a more complex 'tourist product.' The structure and operation of the global industry consists of tour operators, travel agents and transport services selling integrated "packages" to tourists, containing complex linkages to various tourist activities. The more diversified a destination's portfolio of tourism products, services and experiences, the greater its ability to attract different tourist segments. This portfolio includes the natural resources, heritage and culture available, and created resources such as infrastructure, and special events. In surveying the literature, Dwyer and Kim (2003:381) point out that, "the heritage and culture of a destination, its history, institutions, customs, architectural features, cuisine, traditions, artwork, music, handicrafts, dance, etc., provide a basic and powerful attracting force for the prospective visitor."

Two recent tourism studies of Africa show this. "Clearly tourists to Africa are not solely interested in sun, sea and beach holidays, but are travelling to experience Africa's culture, wildlife and diversity." (Naude and Saayman, 2004:18). Whilst a recent KZN Tourism (2004) survey revealed that, apart from the usual visits to bars, restaurants and beaches, 81% of air borne tourists visited a shopping mall, 60% a craft market, 59% a game reserve, 54% a nature reserve/park, 36% an art gallery or cultural museum,

and 33% a wine farm.

The availability of Internet and IT tools play an increasingly important role, both for the visitor and tourist business. Availability of Internet access in Africa plays an increasingly important role for international tourists' destination choice (Naude and Saayman, 2004). Furthermore, in respect of tourist enterprises, "the new IT tools enable smaller players, to compete on an equal footing with larger players thereby increasing their competitiveness." (Dwyer and Kim, 2003:397).

Finally a major development governing destination competitiveness and sustainability is establishing broad community participation, effective co-ordination and support between all stakeholders. These tourism forums enable the many parts of the industry to work together, compete more effectively, and design and implement public consultation so as to ensure that stakeholders are involved in making tourism-related decisions. (Dwyer and Kim, 2003).

It is for this reason that our strategy proposals for the Western Cape emphasise the importance of leveraging the tourism sector's ability to create a holistic tourist 'experience'. The region has a unique ability in this respect, if it facilitates the synergies between the tourist market and the complementary craft, film, heritage, cultural and creative sectors in the Province. The Department of Economic Development can play a significant role in encouraging and facilitating this linkage.

1.11.4 Poverty, Inequality and Strategies for Global Participation

Having outlined the growing importance of the global economy for the development of the Western Cape, it is important to stress that deeper engagement in the global economy is not without its costs and pitfalls.

Deeper engagement in the global economy does not necessarily increase employment opportunities or reduce poverty and inequality. Simply participating in price based global markets - and hence continually faced with having to reduce prices through lowering wages - or participating in the wrong markets and being forced out by more competitive countries can result in a deepening of poverty. The clothing sector's recent experience is indicative. What is critical is how countries and regions participate in the global economy. The policy issue is therefore not *whether* to participate

in globalisation but rather *how* to do so in a way which produces sustainable income growth and spreads the gains throughout income groups. The policy challenge is devising appropriate strategy levers so that firms and sectors do not rely on low wages as the basis for a competitive position, but rather seek to leverage the region's capacities in dynamic knowledge intensive activities. This will be critical to safeguarding and enhancing employment.

Chapter 5

Prioritisation and Selection: Identifying Key Sectors and Activities

We begin by making the case for prioritising sectors. We then outline what is envisaged in regard to policy support for selected sectors. A series of possible tools for identifying policy priorities – what we have termed a decision-making matrix - are detailed. Finally, utilising the tools outlined, we identify what we regard as the key priority sectors. We emphasise the contestability of our selection, more particularly in the light of data limitations and the number of areas that are still to be researched.

This first phase of the MEDS has examined a large number of sectors and themes. However, a number of sectors and themes have not been addressed and will need to be the subject of future phases. In Chapter 7, we outline what we see to be the priority areas for further research.

This “wide canvas” of the MEDS research is a reflection of a provincial economy that is very diversified. This is not an economy in which only a few sectors stand out and account for the overwhelming proportion of economic activity. There are a very wide range of sectors and sub-sectors that have significance. Similarly, there are currently a very wide range of sectors and sub-sectors that are growing and that have prospects of future growth. Looking at the economy in dynamic terms, growth is likely to occur across a very broad front and not be confined to a few sectors.

Given the wide field, and one in which so many have real prospects, how are we to make choices so as to prioritise certain sectors and activities? Given that resources are not infinite and this involves trade offs, what is the basis for prioritisation? How do we decide between sectors that have possible growth potential and others that do not but need rescuing from a process of decline? To compound the problem, how are we to do this given that much research is still to be done?

Before addressing these questions, there are a set of prior questions that are more fundamental; why should we prioritise; how do we ensure that we do not squander resources; and what precisely is entailed in prioritisation? We address each of these questions in turn.

5.1 Why Prioritise?

There are three main inter-related reasons why we believe that the PGWC should prioritise in deciding which sectors and activities to support.

The first is that in a situation where resources are scarce – financial, and just as critically, personnel - the absence of clear priorities very easily leads to an ad hoc opportunistic allocation of resources. Governmental programmes of sectoral support must have credibility amongst its “consumers,” the productive enterprises who are its recipients. Enterprises must be secure in the knowledge of government’s commitment over the applicable time period. Otherwise the desired impact on firm level behaviour, to raise investment or to improve productivity for example, will not result.

The second is that where the governmental personnel are stretched too thinly, choices will inevitably be made on the basis of very limited knowledge and engagement and will tend to follow no clear path or logic. This will significantly increase the likelihood of poor and inconsistent resource allocation.

The third is that in a situation where some individuals and enterprises clearly benefit from the allocation of resources, setting out clear priorities, the basis for making them, and the mechanism to prioritise, is very important to maintaining control over the potential corruption in decision-making.

The resources available to PGWC are very limited. In terms of financial resources, we have understood the figure to be in the realm of R100 million

per annum over the next three years. In terms of personnel, while there is some flexibility as to the precise staff complement, this too will be very limited.

5.2 Government Failure and the Misallocation of Resources

The issue of whether or not government should actively select and support a number of key sectors and/or themes continues to be the subject of heated debate. We do not enter this debate here. We take as our initial starting point the position that the PGWC has decided on the pursuit of an active sectoral or industrial policy and that the task of the MEDS is to give this optimal form.

However, we note three things in passing. The first is that there is increasing support for such policies at a national level (see Chapter 3) and that such policies are rendered more effective where there is provincial engagement in both design and implementation (see Chapter 2). The second is that the major ground for opposition to an active sectoral or industrial policy rests in the view that governments are unable to read the market and as such government policy action is likely to fail, where failure is understood as a misallocation and squandering of public resources. This criticism indeed has considerable weight and informs the design of our strategy. Thirdly, we note the criticism that government often lacks the capacity to deliver on overly ambitious sectoral interventions. Government is often plagued by capacity skill deficits and we are mindful of the need to create partnerships as a way of overcoming this problem.

It is essential that the PGWC works very closely with the private sector. In our view, the identification of new opportunities and the design and implementation of policies must be a joint endeavour of the Province working together with the private sector. Indeed, it should often be the private sector rather than government that plays the leading role in this process – this is more so at an early stage of policy development as is characteristic of the current situation in the Western Cape. We accordingly place considerable emphasis on the need for the PGWC to facilitate the development of industry and sector level associations, or independent bodies that are institutionally embedded within sectors and can play the role of

representation, where no or only limited organisation exist. Furthermore, we have also emphasised the importance of creating ‘forums’ – bodies of dialogue between government and the private sector in the various sectors – to ensure that a healthy working relationship is sustained and decisions are neither ad hoc nor arbitrary. On grounds of both efficiency and equity, it will be very important for the PGWC to facilitate and incentivise organisations that clearly have the buy-in, commitment and participation of the core of the industry, but which are also broadly representative and have clear programmes for the development of smaller businesses (including black- and women-owned and managed).

Working with, and indeed taking a lead from the private sector, will result in a considerably reduced risk of government squandering scarce public resources. This risk can be further mitigated if government engages only in part funding of new opportunities and programmes. Where other funders, who have access to information and who are able to exercise considerable expertise and information, also commit resources, government can have fair confidence that its resources will be used effectively.

Finally, we propose that firm and frequent monitoring and evaluation of all government programmes and funding arrangements be implemented (see Chapter 6).

Working in tandem with the private sector, committing only limited resources in partnership with others and ensuring regular monitoring and evaluation will not eliminate, but it will considerably reduce, the risk of squandering public resources.

Accordingly, what may be termed “an ideal scenario” is the following:

Government support is offered in a sector or sub-sector where there is a broadly representative and legitimate organisational body that is committed to the development of the sector as a whole and especially small and black- and women-owned and managed enterprises. This representative organisation, in consultation with government, identifies programmes and actions that will serve to raise output and employment through the sector. Government possesses the critical facility and autonomy to evaluate such programmes and actions. It responds by offering part-funding. The organisation raises the additional resources required from amongst its membership and/or other (private) funders. The programmes and actions are subjected to regular external processes of monitoring and evaluation.

5.3 What is Entailed in Prioritisation?

The MEDS research has identified a number of sectors where prospects for further development are particularly promising and where government policy support has the clear potential to considerably enhance performance in accord with the stated goals in terms of growth and equity. These sectors would be clear candidates for priority attention. We provide more detail on the specification of priority sectors below.

With respect to priority sectors, the precise characteristics of government attention and support would clearly vary so as to accord with the requirements of that sector, but the following broad outlines would pertain:

- Clear and consistent multi-annual policies and programmes entailing allocation of financial resources committed in advance and applicable over a period of time, typically 3-5 years .
- Allocation of dedicated personnel government whose sole function rests with that sector.
- Publicly declared high-level political support for “flagship” sectors.

This combination will send a clear message to the private sector as to government’s seriousness of intent and give credibility to policy support. Even the best designed policies will fail if they lack credibility and consistency.

As outlined above, government’s capacity to provide this level of support is limited. It is therefore critical that government select only a few priority sectors. This is more particularly so at the early stages of policy development as is currently the case in the Western Cape. With time, government will learn from successes and failures and will generally get better at designing and implementing policy support. It may then take on a larger load and extend its support to across more sectors and activities.

But what of the other sectors? Here we have divided the remaining sectors into two categories. Firstly, “important sectors” which are currently of social and economic significance to the Western Cape for a variety of reasons – e.g. employment, output, linkages to priority sectors, etc. – but which do not display the same growth prospects as our priority sectors.

Secondly, sectors that have very uncertain future prospects or are declining sectors or lack a significant presence in the regional economy.

In a well diversified economy where a number of sectors have the capacity for growth, government cannot ignore developments and opportunities presented. With respect to the ‘important sectors’, the PGWC would identify limited but critical interventions, allocate defined but relatively minimal resources to specific projects, and allocate personnel (with expertise) to cover a number of them at one time.

This is different from the approach to the ‘non-priority sectors’ where the role of Province might best be described as “keeping a watching brief.” This would entail assessing major developments and supporting favourable developments as and when they arise. But, support would be ad hoc and very limited. There would be no dedicated personnel or “desks” relating to single non-priority sectors. Rather personnel would be responsible for a number of non-priority sectors.

One of the most difficult tasks is to achieve “the right balance” between significant support for the identified priority sectors, limited support for the important sectors and the remainder. The principle should be to first ensure that the priority sectors receive sufficient support and that the others are thereafter accommodated within the budget constraint. We turn now to the selection of priorities.

5.4 How Do We Prioritise?

Our approach to this critical issue is that the Province develops an explicit tool in order to identify priorities. We call this tool a decision-making matrix. This tool must fulfil the following requirements:¹

- Workable – possible given the availability of information.
- Defensible – open to scrutiny from both a technical and a political perspective.
- Realistic – results in prioritisation that makes sense to all the parties involved.

¹This section is an edited version of an input commissioned from Kaiser and Associates.

Various options are possible. These are sketched below with their associated advantages (pros) and disadvantages (cons).

5.4.1 Relatively unstructured “expert opinion” based on available evidence

The least structured and “matrix-like” approach would involve assessment on the basis of expert opinion, based on one or two criteria, using the available data as “evidence” to motivate for decisions. Examples of criteria are:

- Initiatives most likely to succeed based on expert understanding of sector dynamics and sustainable competitiveness.
- Likelihood of stakeholder buy-in to implement and champion initiatives.
- Initiatives with synergies across sectors that could provide the best “economies of scale” for government investment.
- Initiatives that are well aligned to national policy and therefore likely to generate greater shared return on investment through intergovernmental coordination.

Pros

- This is a very workable approach, as it allows decisions to be made based on a simple set of criteria and whatever information is available.

Cons

- The approach can be open to contestation as it can be perceived as subjective.
- The degree to which it can be defended is dependent on the manner of communication of findings and the perceived credibility of the experts involved.

5.4.2 Relative assessment against two main criteria

A slightly more structured approach would involve relative ranking based on the potential scale of significance or impact consequent upon policy support and the cost or investment required. Priorities would depend therefore on a relative weighting of potential impact and cost – the greater the potential impact and the lower the cost, the higher the priority.

Pros

- The approach is workable in that it is not overly complex.
- It is easy to demonstrate visually and therefore creates scope for debate of the relative positioning of initiatives.
- It is relatively easy to re-assess inclusion or exclusion by adjusting the “inclusion/exclusion” line.

Cons

- Assessment can be considered arbitrary if not based on accurate data.

5.4.3 Hierarchical filtering applying levels of screening

In this approach, a series of filters would be applied, narrowing down options after each filter. Examples of potential filtering criteria are:

- Importance of sectors to the provincial economy first, then impact assessment of initiatives.
- Relevance to the Department of Economic Development’s mandate, then impact assessment of initiatives.
- Cut-off in terms of cost or available capacity for initiatives, then balance across sectors.

Pros

- Allows for a workable assessment of a large number of options.
- Can provide a realistic assessment that makes sense to role players (if appropriate filtering criteria are selected).

Cons

- Rationale for hierarchy of filtering is subject to scrutiny and challenge.
- Can be seen as arbitrary if not based on accurate data.

5.4.4 Qualitative matrix

In this approach, qualitative assessments of a series of factors are set out in a matrix, often using a “High / Medium / Low” or similar qualitative categorisation. Options can then be ranked based on the number of “Highs” against these factors.

A variation on this approach would be to give numerical scores and calculate a total at the end. The Department of Economic Development has in fact drawn up such a matrix whereby the sectors were scored on the following criteria: potential clustering; job or growth potential; export potential; investment potential; skills potential; competitiveness and technology potential; and empowerment potential. Priority sectors were those with the highest scores. It would seem though that this matrix was not actually operationalised.

Pros

- Can be used even where quantitative data is not available in all cases.
- Is relatively transparent, and can therefore be debated.
- Relatively accessible to role players, in particular if supported by a motivation using available evidence.

Cons

- Not a very nuanced form of assessment.
- Difficult to assess a large number of items with this system, as it becomes hard to make relative assessment and provide visual representation.
- Does not easily accommodate weighting of the importance of some factors more than others.

- Makes no resource costs.
- Can be seen as arbitrary if not based on accurate data.

5.4.5 Matrix Utilising a Weighted ranking based on quantitative assessment

This approach would involve allocating quantitative figures to a range of factors, applying a weighting to each of these factors and then calculating a summary score for each sector or initiative, which could then be ranked by score.

Pros

- Can allow for nuanced assessment.
- Can readily accommodate multiple factors.
- Enables weighting of importance of criteria.

Cons

- Requires extensive, reliable quantitative data.
- Can result in a false sense of accuracy if based on quantitative rankings of qualitative assessments (e.g. giving scores from 1 to 10 for factors).
- Relative weighting of factors is open to contestation.
- Approach can be inaccessible to non-technical role players and officials involved in implementation.

5.4.6 Additional Observations

Three important observations should be noted. Firstly, whichever decision-making tool is selected, the result is indicative and not final. It is not to be seen as akin to a formulaic modelling exercise. The results are only one, albeit an important, input into the decision-making process. Thus, this should not be applied in a mechanistic fashion.

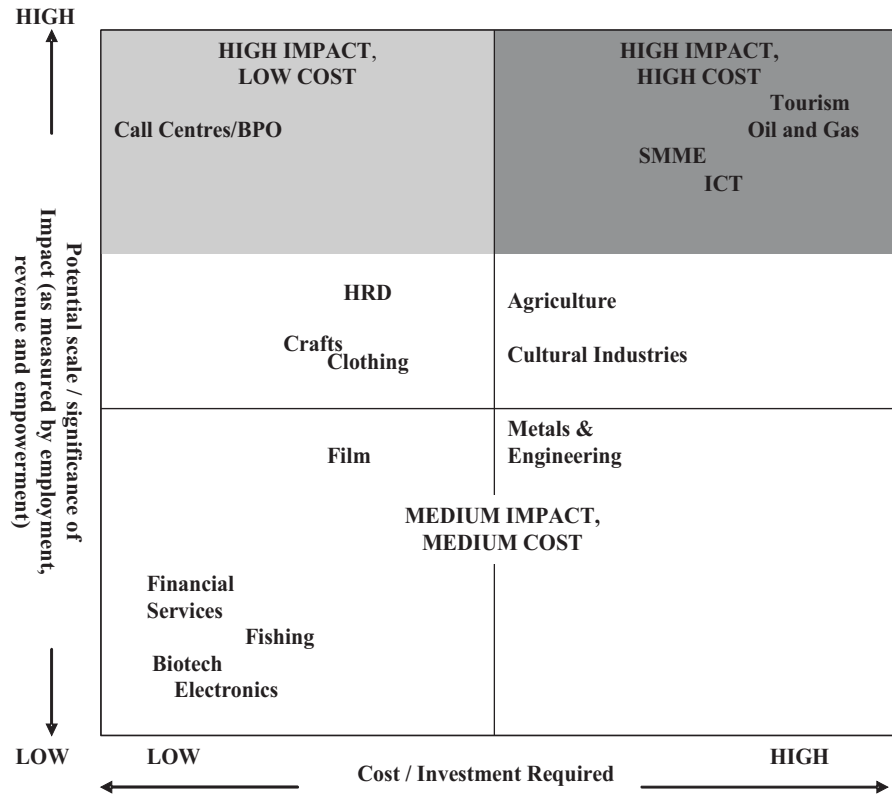
Secondly, the criteria for selection will always be multi-faceted. This will include critically an assessment of potential impact of policy – where impact could be measured along many dimensions such as output, investment, employment, impact on other sectors, etc. The first task is to agree on the criteria for selection. The second task is to agree on the relative weighting of these criteria. The criteria and their respective weightings will depend heavily on the economic and social goals to be pursued.

Thirdly, quantitative assessments in relation to the criteria specified are important in reducing the level of subjectivity in assessments. However, many magnitudes cannot be readily quantified e.g. the quality of sector organisation. In addition, at this stage, very few clear and definitive quantitative assessments could be made. Of particular importance here are the measurements of the employment magnitudes (especially indirect employment) and backward and forward linkages that might result from the further development of particular sectors. This underlines the importance of developing the modalities whereby such quantitative assessments can be made – most critically here would be a provincial economic model. We accordingly recommend that serious attention be given to this exercise. At this stage though, assessment and selection of priorities will rely heavily on qualitative criteria.

5.5 What Should be Prioritised?

Over the course of the MEDS process, the Oversight Committee spent much time deliberating the choice of priorities. Our view is that if, as we propose, the PGWC selects only a few priority sectors, these should be sectors in which policy could have a significant impact. In our schema therefore, “significant impact” understood in terms of both output and equity objectives became a necessary criteria for selection. This had to be weighed against the necessary resource commitments understood both in terms of finance and human resources. Where a sector had significant potential and the resource costs were likely to be limited, it would qualify as a priority sector. Our categorisation is illustrated in the diagram below.

The precise positioning of all of the different sectors and cross-cutting issues can be debated and disputed. However, 5 areas stand out from the pack in terms of the potential impact of policy – Call Centres/BPO;



Oil and Gas, Tourism, ICT, and SMMEs. We saw little to challenge this assessment.

In addition, given the considerable stress that we place on the importance of organisation, the existence of an effective and representative sector body, was also given considerable weight. It is of significance that, with the exception of SMMEs, all the sectors also have significant and legitimate organisation. SMMEs is clearly a cross-cutting issue and no single organisational form will result or is required.

While our researchers were able to provide fairly precise estimates on the magnitude of the resource costs in respect of the policies and programmes that they advanced in respect of ICT, Call Centres/BPO and SMMEs, the resources required in the other areas are less clear. However, it is likely

that all could be accommodated working within a budget envelope of R100 million per annum (see above) and still allow fair allocation of resources to the other sectors. However, this assessment will require further analysis and we would recommend that before the listing of priority sectors be adopted, an exercise be undertaken to ensure that the financial resources are indeed adequate. In terms of personnel, again this would appear to be manageable, but some further investigation by the Department will be in order. It may be that support for the sectors will need to be phased in over some time period.

As the diagram indicates, we have also identified a number of sectors that fall in the middle range and hence are regarded as having an important status. Although not high priority, they warrant governmental attention, particularly since the resource implications are limited. The evidence marshalled from the sectoral research does not indicate that they are likely to achieve substantial growth in terms of output or employment. However, other factors bring them to the fore as warranting some medium level prioritisation. In addition they have the capacity to contribute to equity. They also have representative organisations. In some cases the social implications (e.g. loss of employment in clothing) of not assisting them are substantial. In other cases they clearly provide important linkages to the five prioritised sectors, and bolstering them would have a significant spin off for these sectors – e.g. craft, cultural industries and film have direct linkages to the tourism sector.

5.6 Summary

As in every prioritisation exercise, our view is open to challenge – both as to the criteria selected and on the assessment of the different sectors and activities in terms of those criteria. This is more particularly so, given the paucity of hard data. However, whatever decision tool we employed, the same priorities emerged. We accordingly recommend the adoption of these priorities. This would entail commitment by PGWC as we outlined above. However, these priorities should be periodically reviewed, especially as research into other sectors is completed and as new data becomes available.

As Rodrik (2004) reminds us, development is a voyage of discovery. At its core lies a more or less intelligent attempt to make informed choices

about resource allocation in the context of relative uncertainty about where economies, especially in advanced, knowledge-intensive activities go. The point of departure for the voyage in this instance is the MEDS which sets a vision of growth and equity, identifies key priority sectors, commits to industrial policy and strategy levers, promises to facilitate institutional mechanisms to link the private and the public actors, and sets realisable targets.

A voyage of discovery implies setting sail from the security of the harbour with inadequate, incomplete and imperfect navigational equipment. The captain and crew may well have been blessed by a vision of the promised land, but have only rough maps and coarse guides to show the way. They know this is no reason to stay fast to their moorings and have to set off with imperfect charts plotting the way forward. They understand that they have no choice but to augment their knowledge with insights from others.

The analogy holds for the task of setting up and implementing industrial policy, which is why the MEDS stresses the importance of representative stakeholder forums and partnerships between the private and the public sectors as a way of acquiring and improving information. In setting out an industrial policy this is all the more so in conditions of rapid and profound economic change. Moreover, as one proceeds there is an imperative to update information, revise it, and consider different conclusions from those originally advanced. Only the most foolhardy will regard this as a mark of inconsistency. The more realistic will appreciate that in a voyage of discovery mistakes will always be made, and if they do not learn, they risk floundering on the rocks ahead.

A knowledge-intensive province knows that learning from mistakes can be just as instructive as celebrating successes. This is precisely the task of monitoring and evaluation to which we now turn.