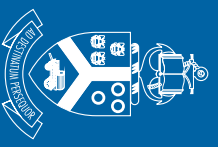


Integrated social development as the accelerator of shared growth

Focus on key economic issues, no. 55 – March 2007



University of Pretoria

Integrated social development as the accelerator of shared growth

Executive summary

South Africa has embarked on an initiative to accelerate economic growth in support of shared income (ASGI-SA), which succeeds the RDP and GEAR strategies. The latter policies, which focused on macroeconomic stabilisation and trade liberalisation, have contributed significantly in improving the economic growth performance in South Africa over the past decade. The recent momentum in GDP growth has been predominantly propelled by demand-side stimuli, like lower interest rates, reduced tax rates and enhanced accessibility to credit and financial markets.

However, despite the increases in GDP growth rates, economic growth has proven to be unsuccessful in making significant progress towards eradicating poverty by addressing the unemployment, redistribution and associated socio-economic problems in the economy. Focus 55 builds a case for the persistent prevalence of structural rather than cyclical impediments to employment and consequently shared output growth. Cyclical factors are contributing very little to the current high and unresponsive rates of unemployment. The inability of output growth to translate into significant employment creation and poverty reduction has created a dualistic economy. A "second economy" has consequently emerged with distinctly different features, based on unstable fundamentals and offering limited social protection to those forming part of this economy. The more stable and robust first economy represents the basis of the "era of hope" with high levels of output growth, low inflation and fiscal debt, buoyant financial markets and strong consumption spending. However, the crumbling foundation, or second economy, with high and sticky unemployment, unacceptable levels of extreme poverty associated with poor socio-economic conditions for the larger part of the population, have all contributed to a poverty trap – a situation that requires innovative and targeted external interventionist programmes. It is furthermore imperative that this poverty trap is eliminated in an effort to unlock South Africa's ability to grow sustainably at levels of 6 per cent.

Policy making in South Africa has to find a new paradigm - one where employment creation and resultant poverty alleviation is not merely accepted as a by-product of economic growth, but where employment creation is viewed as a key accelerator of economic growth. Social development targeted at mobilising and empowering the unemployed needs to constitute the backbone of any growth, employment and redistribution policy. This calls for an integrated strategy on social development to address the imbalances and structural impediments of the past facing the poverty stricken communities. The focus here should be on designing and implementing policies that truly empowers and mobilises this untapped potential of society towards spurring higher levels of future economic growth rather than merely awarding handouts.

The innovative and skilful redesign of existing policies will significantly impact on the returns of social spending on employment and growth. Focus provides empirical evidence that a 10 per cent improvement in the socio-economic environment would increase South Africa's growth potential to about 6.5 per cent, thereby generating sustainable levels of output and shared income growth. These results clearly highlight the importance of job creation through socio-economic development as a key accelerator of growth.

The proposed policy paradigm is based on an integrated national strategy for social development, where growth initiatives focus more intensively on employment creation. This broad based approach will ensure that any future accelerated income creation is truly "shared" by all levels of society. It also represents the only way to eradicate the growth and poverty trap once and for all and to realise goals envisaged in ASGI-SA.

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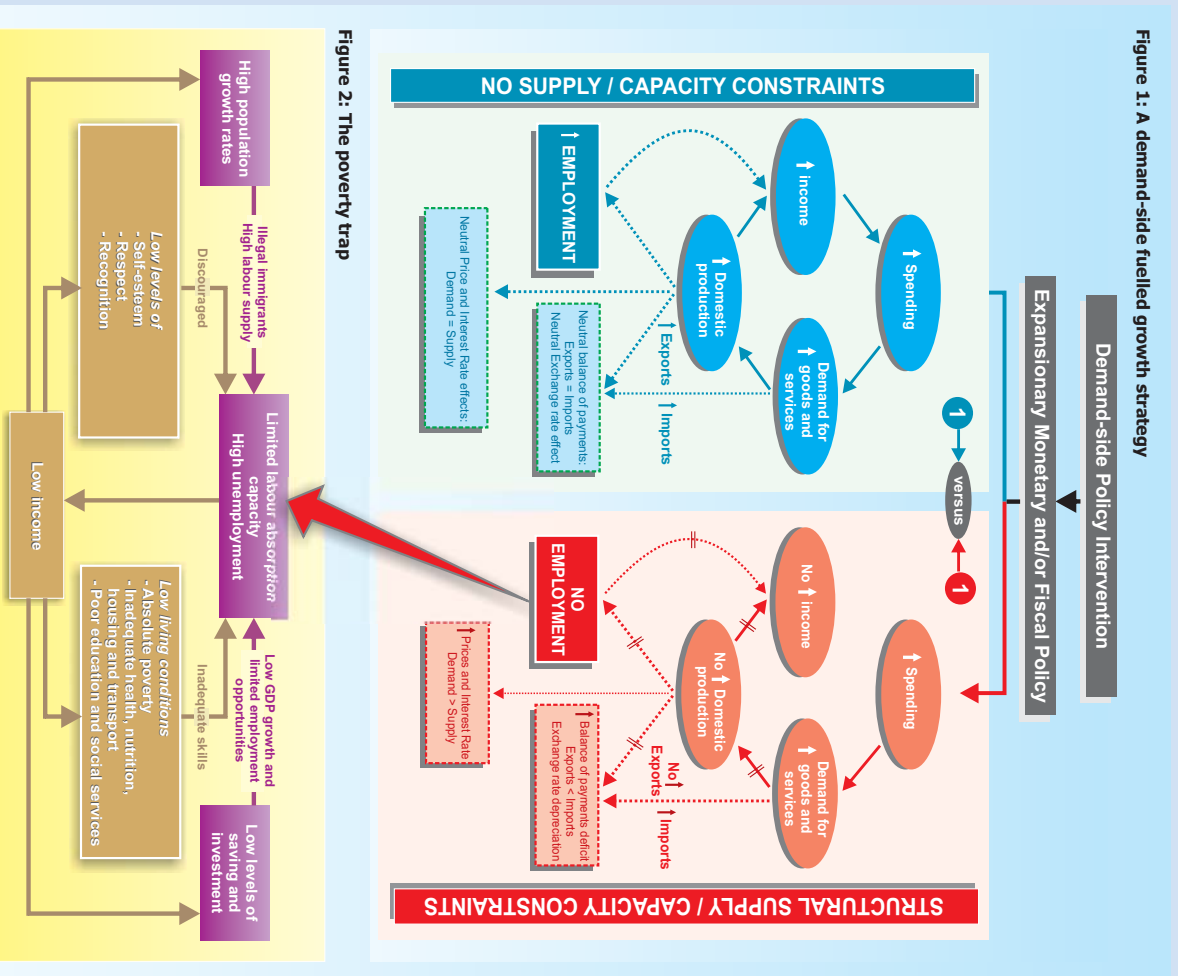


Figure 1: A demand-side fuelled growth strategy

Accelerated economic growth may not necessarily be sustainable and translate into accelerated employment

Demand-side fiscal and monetary policy intervention aiming at accelerating gross domestic output will be effective in an economic environment without structural constraints impeding the capacity of the economy to absorb everyone willing and able to work. It will also serve to attract sufficient investment capital. In an environment unfettered by structural constraints, this course of action will achieve the goal of higher economic growth without putting pressure on the balance of payments, the exchange rate and domestic inflation. Figure 1 shows that a demand-side based strategy, such as the lowering of taxes and/or interest rates will cause increased demand/spending assuming little or no capacity constraints which will translate into higher domestic production and subsequent higher shared income for the owners of domestic production factors (labour, capital and land). However, in a scenario where the economy is faced with structural supply-side constraints, domestic production will fail to meet increased demand. In this case, accelerated growth represented by increased domestic expenditure on gross domestic product will not cause an equivalent increase in employment and hence fail to have everyone share in the higher income generated in the economy. The lack of domestic production to meet the increased domestic demand will merely be supplemented by increased imports, which, in turn will impact negatively on the balance of payments, the rand exchange rate and domestic inflation.

Unemployment in an environment subjected to capacity constraints will generate a poverty trap

The limited capacity of an economy to absorb labour will result in high and increasing levels of unemployment with depressing socio-economic and growth implications. Figure 2 indicates that high and rising levels of unemployment will cause a large portion of the population to be subjected to low income levels and poverty, thereby limiting their access to a range of economic and social services and which further diminishes their chances to be absorbed into the economy. The problem is further exacerbated by those who have become discouraged and have lost faith in the ability of the system to generate jobs, resulting in them remaining unemployed "by choice". In addition, low income and poverty-stricken groups have little financial manoeuvrability and make little to no contribution to savings, which in itself hampers investment, output growth and employment. While adverse socio-economic conditions contribute to the creation of only a limited amount of job opportunities, a high level of relatively unskilled labour supply, supplemented by the high influx of illegal immigrants, further exacerbates the unemployment problem. Unemployment and poverty thereby becomes a self-fulfilling prophecy – unemployment creates a poverty trap which requires innovative intervention targeted at eliminating the significant structural impediments.

South Africa's accelerated growth is diverging from its employment and development performance

There is a significant and sustained decrease in the employment rate as measured by the ratio of the total number of employed people, formal and informal sectors, to the economically active population. The declining trend in this ratio implies that the labour market has not sufficiently absorbed new job-market entrants, causing growth in the economically active population to outstrip the amount of new jobs created, resulting in increased unemployment. The most disconcerting about the overall employment rate is that even though GDP growth rates have recently been on the increase as indicated by the trend GDP in figure 3(a), the trend employment rate is still declining. This negative relationship between GDP growth and the employment rate suggests that the employment problem is not only a cyclical problem, but is structural in nature.

The problem is also evidenced by South Africa's unimpressive development performance. South Africa is ranked 55th in the world with regard to GDP per capita. However, as indicated by figure 3(b), the country's overall development performance in the UNDP's Human Development Index is 66 positions lower at 121. Even more alarming is the downward trend in South Africa's HDI ranking since 2000. This indicates that little of the new wealth generated in the country contributes to the socio-economic development of the country's poorest. South Africa's downward trend in its HDI ranking may be largely attributed to its poor health performance, but other indicators such as education show no significant improvement over the last decade. Whilst the rich are getting richer, the poor is caught in a poverty trap of which they are seemingly unable to escape. This is also illustrated by the high level of income inequality in the country. A new approach to achieving economic growth is required if South Africa are to reach its goal of halving poverty by 2014.

Lack of opportunity to participate in the accelerated economic activity has caused a lack of shared income and has exacerbated the extend of inequality

Households have secured progressively less of the income generated in South Africa. Figure 4(a) shows that the compensation of employees, or wage income, as a percentage of GDP has declined considerably in recent years. This has happened despite relatively high GDP growth and consumer expenditure growth. The relative strong growth in total household expenditure, whilst the compensation of employees has been declining, further emphasises the demand-side driven nature of South Africa's growth policies. This divergence can mainly be explained by credit to consumers, especially those in the growing middle income class. Consumers presented with new opportunities to borrow large amounts of money often spend more than they are able to repay, leading to a host of other socio-economic problems. In order to reduce poverty and inequality more of this potentially productive part of the population needs to be empowered to contribute to the economy, instead of being reliant on transfer payments from government or being lured into a false sense of prosperity by unsustainable demand-side driven growth policies.

The decrease in household's income share is intensifying the already skewed distribution of income in South Africa relative to other countries as shown in figure 4(b). The Gini index is a measure of the inequality of income in a country. A value of zero would indicate perfect income equality with every individual sharing equally to the income generated in the country. A value of one indicates perfect income inequality. Therefore, a lower Gini index value indicates a better or more equal distribution of income. South Africa's distribution of income is one of the major barriers to achieving a better life for all. According to the World Bank, South Africa has a Gini index value of 0,58, which again highlights the challenge the country faces in achieving a more equitable distribution of income and wealth. High levels of income inequality often lead to social instability and economic inefficiency within a country. The poorest 40 per cent of South Africa's population contributes very little to the GDP, and further highlights the need to mobilise and empower those currently excluded from economic activity.

Figure 3: South Africa's growth-poverty performance

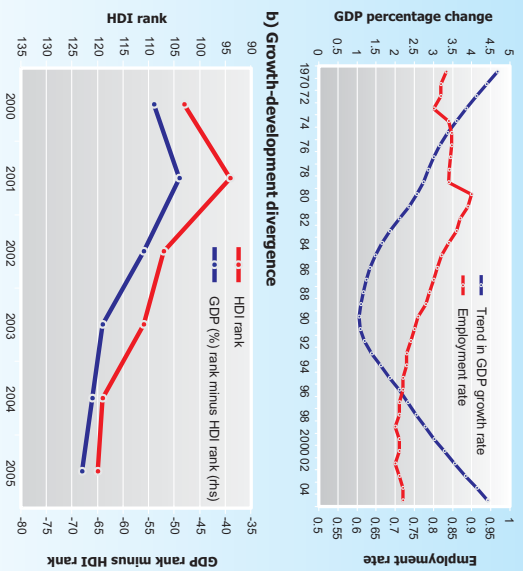
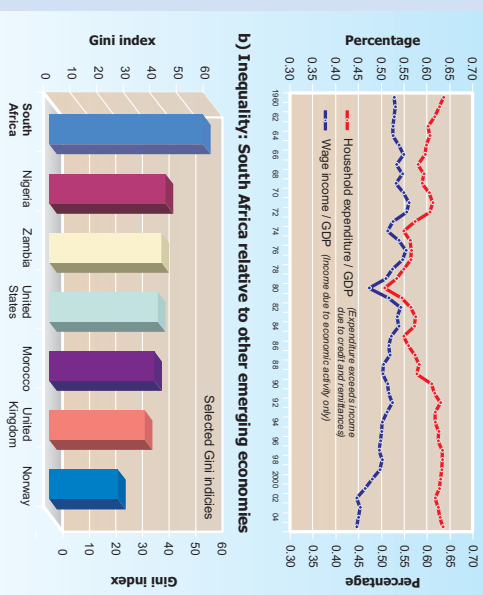


Figure 4: Lack of shared income and inequality



A large part of South Africa's potentially productive population is immobilised and incapacitated – a number of structural rigidities prevent them from being employed or participating in any form of income-generating economic activity

Structural unemployment may be crudely defined as that portion of unemployment that do not adjust with changes in wage rates and economic activity, and may be measured in terms of the "non-accelerating wage rate of unemployment" (NAWRU). Figure 5(a) demonstrates that the South African labour market has failed to reverse the increasing unemployment trends – depicted here by a decline in the employment rate.

Figure 5(b) not only indicates that structural unemployment in South Africa has been upward trending since the 1970s and has reached levels of 25 per cent, but the larger part of the official rate of unemployment is structural in nature – cyclical factors or the lack of sufficient GDP growth are contributing very little to the current high and unresponsive rates of unemployment.

The failure of output growth to translate into significant employment creation and poverty reduction has created a dualistic economy – two "sub-economies" with opposing fundamentals, causing potentially for severe instability. The stable and healthy "first economy" lays the foundation for an "era of hope" by exhibiting high levels of output growth, low inflation and fiscal debt, buoyant financial markets and strong consumption spending. However, the "second economy", with high and sticky unemployment, unacceptable levels of extreme poverty associated with poor socio-economic conditions for the larger part of the population demands innovative and targeted external interventionist programmes.

Figure 5: Structural impediments: A socio-economic dimension

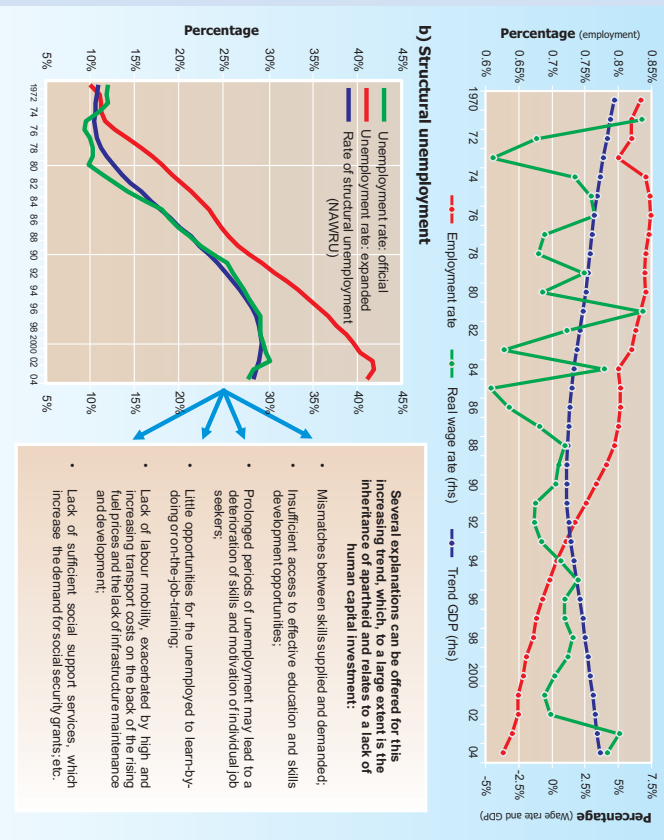
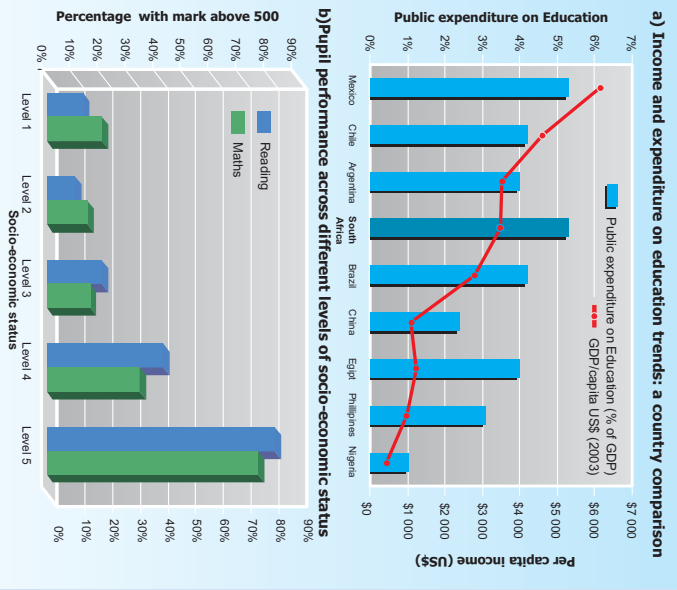


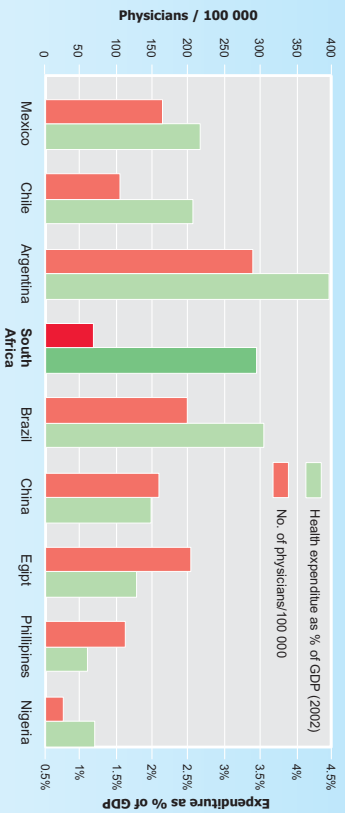
Figure 6: A socio-economic dimension: Human capital development



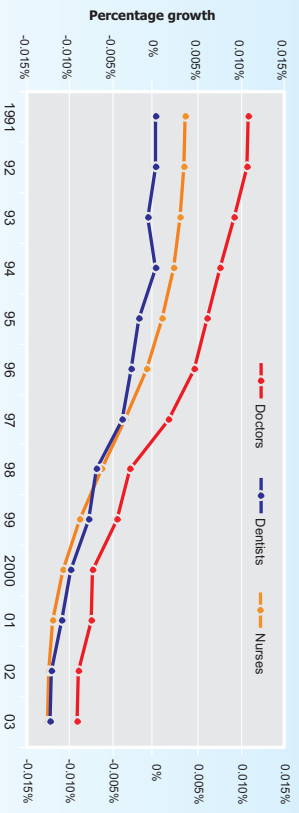
Building human capacity / Inter alia means good quality education ...

In Figure 6(a) a comparison is made of public expenditure on education as a percentage of GDP and GDP per capita. The figure shows that expenditure on education in South Africa compares favourably with that in other developing countries included in the selection. Although not a perfect match, there seems to be a correlation between per capita income and expenditure on education with higher levels of income in those countries where more is spent on education. However, Figure 6(b) shows that the quality of education as reflected in differences in reading and mathematical skills differs substantially between the various socio-economic groupings. Groupings at a lower level of socio-economic status (groupings 1-3) perform much worse than those in the highest status group (group 5). The figure indicates that the percentage of pupils in 2000 with a mark above the SACMEQ (Southern and East African Consortium for Monitoring Educational Quality) mean of 500 (see Van der Berg 7) ranges from an average of 14.3 per cent to 82.5 per cent in the case of reading and from 16.8 to 76.4 per cent in the case of mathematics between the various socio-economic status groups.

Figure 7: A socio-economic dimension: Health
a) Public health expenditure and the availability of doctors - a country comparison



b) Growth in the number of medical practitioners and nurses per 100 000 of the population

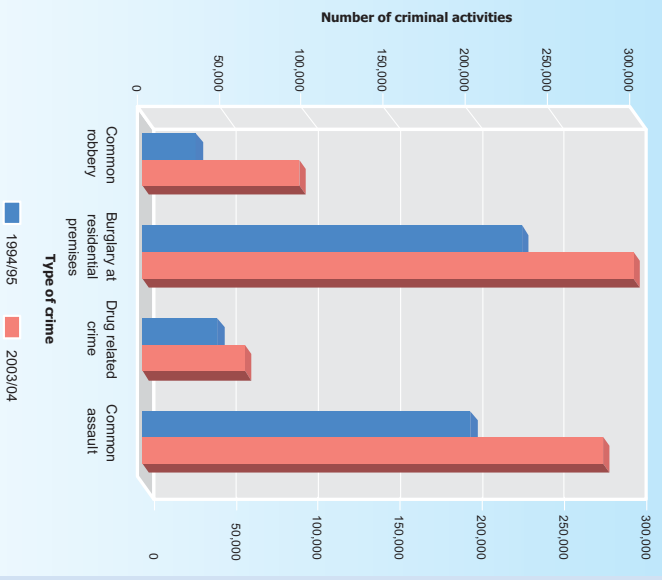


...as well as sufficient and quality health services...

While the percentage of government expenditure on health compares favourably with most other developing countries, the availability of medical practitioners and nurses is a concern especially given the prevalence of illnesses such as HIV (Aids), tuberculosis and malaria that affect labour productivity.

In Figure 11(a) - presented later in Focus 55 - it is shown that government expenditure on health as a percentage of total expenditure remained fairly constant between 1983 and 2003 (9.4%) and Figure 7(a) shows that the level of expenditure compares favourably with that in other countries at similar levels of development. However, despite this tendency, the number of medical practitioners available per 100 000 of the population is disproportionately lower. Also, Figure 7(b) shows a downward trend in the numbers of doctors, dentists and nurses over the past 15 years. Given the prevalence of life threatening illnesses and the impact of these illnesses on quality of life and labour productivity, this trend is a cause for concern.

Figure 8: Growth in selected criminal activities between 1994/95 and 2003/04

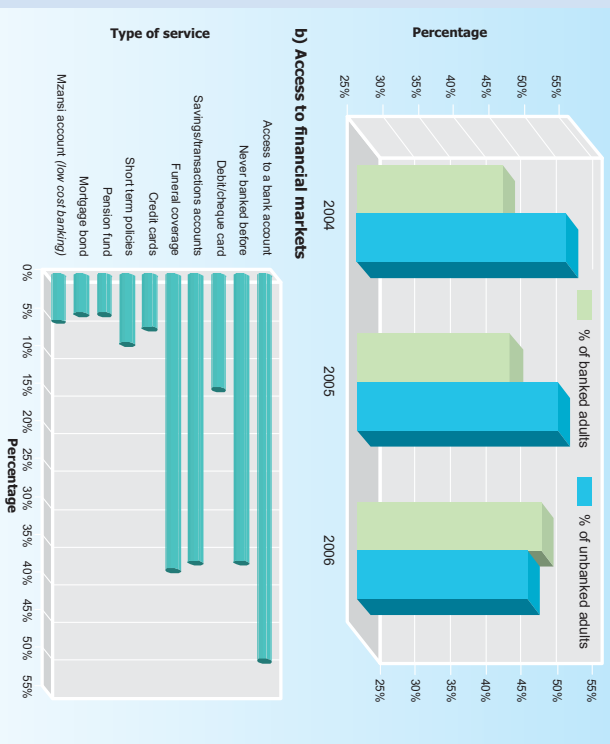


...a stable and crime free environment...

The weakening in the social welfare of a large part of the population and the massive inflow of work seekers from neighbouring countries of which many live in precarious conditions have contributed to an increase in various criminal activities – a concern to investors and entrepreneurs.

Despite figures released by the Commissioner of Police at the end of September 2006 that indicate a marginal decline in some crime-related events, the South African society is still subjected to rampant criminal activity. Of particular concern is the high and increasing level of violent crime associated with organised crime. Figure 8 shows that between 1994/95 and 2003/04, common assault increased from approximately 200 000 cases to more than 270 000 cases while burglary at residential premises increased from about 230 000 to 300 000 cases. In a lead story in Business Day, one of South Africa's leading entrepreneurs said that crime is beginning to affect business negatively. This leads both directly and indirectly, to job losses and social misery.

Figure 9: A socio-economic dimension: Access to financial resources and markets
a) Growth in access to financial markets (2004 - 2006)

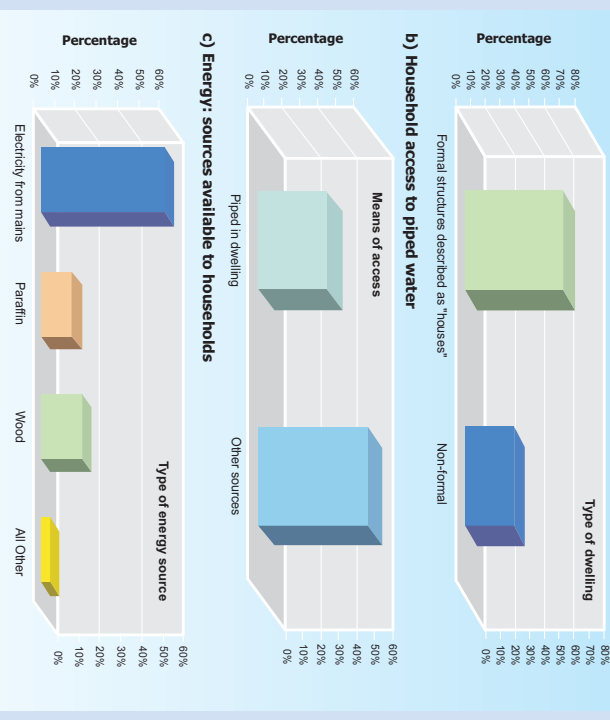


... access to financial markets ...

Those in the lower income groups have limited access to financial markets – a barrier that prevents them from developing entrepreneurial skills and therefore from sharing in the wealth of the economy. Numbers revealed by Finscope South Africa (Figure 9(a)) show that more than 48 per cent of the adult population in South Africa are not using any formal financial service but the number has declined from more than 54 per cent in 2004. The number of banked adults increased sharply from 2005 to 2006 (about 5 per cent) which mirrors the growth in consumer spending over the past year. Of those using financial services provided by the formal financial sector, most use saving/transaction accounts while a relatively large number also have funeral coverage (see Figure 9(b)). Only a limited number of adults use financial services such as insurance policies, pension schemes and mortgage bonds. In October 2004 a special low cost banking scheme was introduced (Mzansi), but its current membership is still limited to about 6 per cent of all adults. On the question in the Finscope survey why people do not bank, most indicated that they simply cannot afford it.

Thus, the poor community in South Africa is largely excluded from the country's relatively sophisticated financial sector. For them to have access to financial intermediation, innovative informal mechanisms will have to be devised in addition to the formal structures with supplementary financial literacy programs. Microfinance institutions that provide basic credit, saving and a range of financial services to the very poor such as transfer payments, insurance and even pension schemes could be a powerful tool in reducing the poverty problem and allow those who have been locked out of formal financing to be financially sustainable, provided that such services are affordable.

Figure 10: A socio-economic dimension: Infrastructure and support services
a) Housing Infrastructure



... adequate infrastructure and support services ...

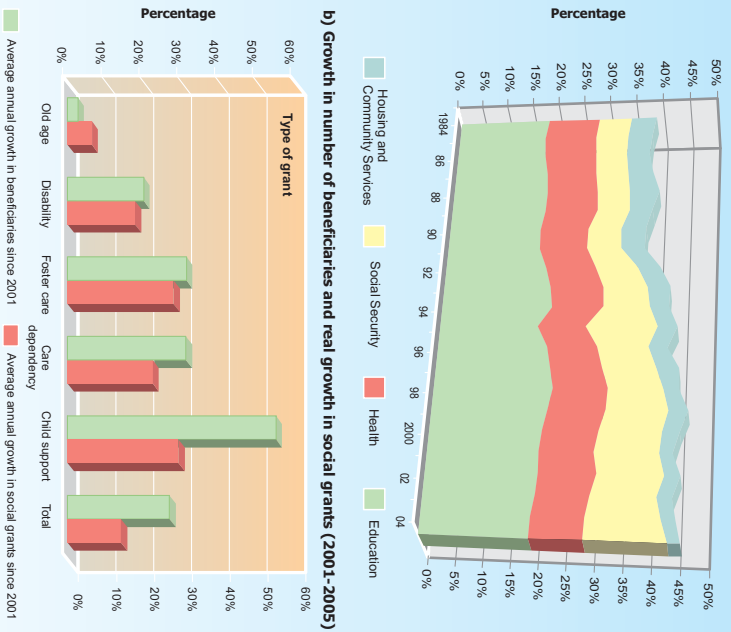
Poverty reduction does not only mean the eradication of extreme poverty but also relative poverty i.e. all the factors that prevent an individual from reaching his/her full potential to contribute to the economy in a more meaningful way. The supply-side constraints severely impeding the realisation of South Africa's true growth potential of the economy need to be addressed. Factors such as inadequate transport infrastructure, housing, piped water, electricity, etc. all impact on living conditions and as such negatively affect productivity and access to available opportunities. Structural impediments in accessing these basic facilities cause wider inequalities, further constraining not only human capacity building but also the fundamental principle of equal opportunity.

Figure 10(a) shows that of the estimated 12.2 million households in South Africa, approximately one third still live in housing structures that can be described as "non-formal". Of the latter group 2.5 million households live in structures that can be described as "not suitable for families". Figure 10(b) indicates the means of access to household water. Piped water inside the dwelling is only available to about 38 per cent of households while the rest have to fetch water from community taps, boreholes, dams, etc. Electricity as energy source is only available to close to 60 per cent of households (Figure 10(c)). The other 40 per cent mainly use wood or paraffin.

... and a comprehensive and targeted social security net

Figure 11(a) shows the composition of socio-economic expenditure as a percentage of total government expenditure. Since the beginning of the nineties there has been a marginal increase in the share of expenditure on education but a substantial increase in social security (14.4 per cent in 2004 compared to only 6.3 per cent in 1990). However, despite this increase, poverty as measured in terms of individuals eligible for grants has also increased, which could be interpreted as an increase in poverty amongst the poorest (Figure 11(b)). Attempts at reducing poverty through grants exclusively is overly unsustainable and should be complemented by an extended and comprehensive socio-economic agenda to develop and enhance human capacity. When scrutinising the dependency on grants, growth in child support grants tops the list of increases in grants, followed by foster care and care dependency. The actual overall amounts spent on the above-stated grants, are however far below that of old age pensions, disability and child support (R20 billion, R15 billion and R14.5 billion, respectively).

Figure 11: A socio-economic dimension: social security safety net



While accelerated demand-driven economic growth is not translating into significant employment and poverty reduction ("well-being" of all), lack of shared well-being inhibits the growth potential of the economy, thereby exacerbating the problem

In the preceding analysis it was shown that South Africa's higher economic growth rates have not been effective in significantly lowering unemployment and poverty. Figure 12(a) depicts the flipside of the "growth-to-employment" coin: unemployed South Africans do not share in the income generated by the economy, caused by their inability to participate in significant income-generating economic activity. The economy is therefore under-utilising its labour resources – the high and sticky levels of unemployment hamper South Africa's ability to grow sustainable at levels of 6 per cent.

An analysis of South Africa's growth potential by Du Toit (2005) indicates that South Africa's growth potential is limited to approximately 4 per cent. The implication thereof is that if actual GDP growth rates exceed 4 per cent (figure 12(b)), that is, if actual output exceeds the potential of the economy, the economy is "overheated" and production prices and wages will start rising. Given the subsequent impact on consumer prices and the balance of payments, monetary policy will ultimately have to intervene by deflating the economy through increased interest rates. A growth potential of 4 per cent does not imply that the economy can indeed grow at levels exceeding this rate, but actual growth rates in excess of 4 per cent will be unsustainable in the medium and longer run. If growth in "supply" through employment, productivity and investment growth, does not meet the growth in "demand" mainly fuelled by lower tax and interest rates, it will jeopardise the balance of payments position, destabilise the exchange rate and ultimately give rise to increased domestic inflation.

Figure 12: Poverty - a self-fulfilling prophesy

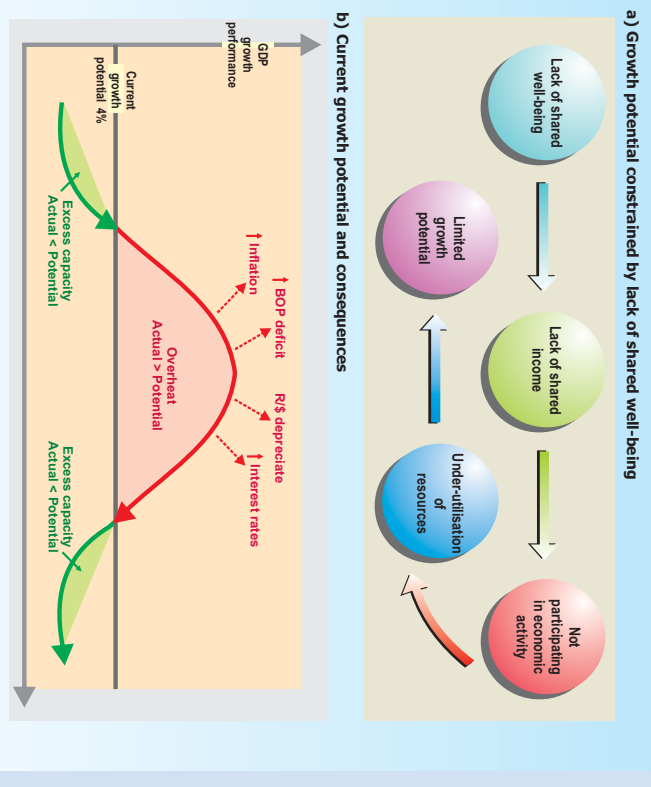
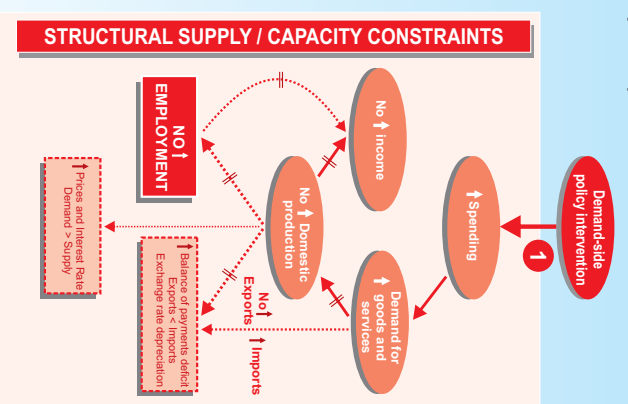
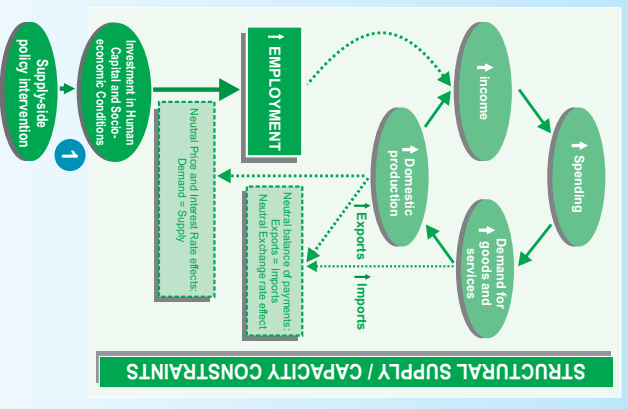


Figure 13: Adjusting the growth strategy
a) Status quo



b) New paradigm



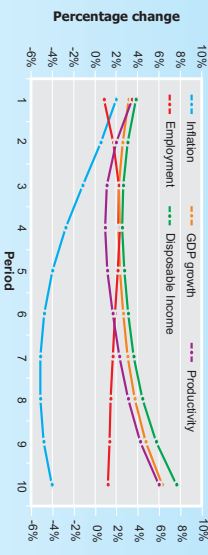
Policy making in South Africa has to enter a new paradigm, where employment creation and resultant poverty alleviation is not considered to be a mere consequence of growth, but where employment creation and shared well-being through addressing the socio-economic impediments is targeted as a key accelerator of economic growth.

Figure 13(a) depicts the current policy and growth performance of the South African economy; where demand-fueled economic growth in an economy subjected to structural impediments has failed to make significant inroads into the alleviation of unemployment and associated poverty (refer to the discussion of figure 1).

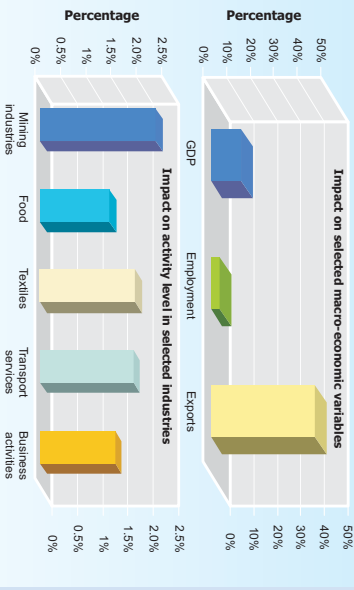
However, figure 13(b) represents a new paradigm for the role and contribution, but more specifically the design and implementation of social security practices to ensure the sustainability of these programmes by facilitating employment creation as the main thrust in poverty reduction and output growth. Policy intervention should aim at fuelling economic growth from the supply side by mobilising and empowering the potentially productive population. This calls for a strategy to address the imbalances and structural impediments of the past; however, designed and implemented to focus on the development of an untapped and poverty stricken workforce. The notion of social spending as an expense item needs to be replaced by significant investment in the development of human capital. Only then will external programmes of intervention be successful in achieving their objectives and become sustainable by contributing to GDP growth through employment creation. This approach also demands a new philosophy regarding the expanded role of social development, which is much broader than the traditional reactionist/interventionist/survival strategy aiming at providing security to the most vulnerable. Social development needs to be pro-active and needs to be perceived as an essential investment in human capital.

Figure 14: Model evidence

a) Results from the Macro-econometric model



b) Results from the Computable General Equilibrium (CGE) model



Modelling evidence support the view that an improvement in the socio-economic environment will benefit the economy on various levels

Simulations by the research team using both a macro-econometric and a computable general equilibrium (CGE) model of the South African economy show that the productivity increases resulting from an improvement in the socio-economic environment holds significant benefits for the domestic economy. In the macro-econometric model, a scenario was created assuming a 10 per cent improvement in the socio-economic environment through the socio-economic index included in the model. The socio-economic index captures elements of education, energy, health, crime and various government transfers to households. Figure 14(a) indicates that an improvement in the socio-economic conditions significantly contribute to employment growth (an additional 2 per cent over the sample period); productivity, output and income growth (additional growth of between 4 to 7 per cent), as well as a substantial reduction in inflation (2 to 4 percentage points lower), which again supports the sustainability of output and income growth.

Similarly, factor productivity was increased by 10 per cent in the CGE model to simulate this scenario. As indicated in figure 14(b), the CGE model shows the impact of this shock could increase the GDP by up to 12 per cent in the medium term. This increase would be driven by higher exports as a result of the increased competitiveness of the South African economy. On a sectoral level, the biggest winners are the mining and textile industries, but a number of other industries employing many primary factors also show significant gains.

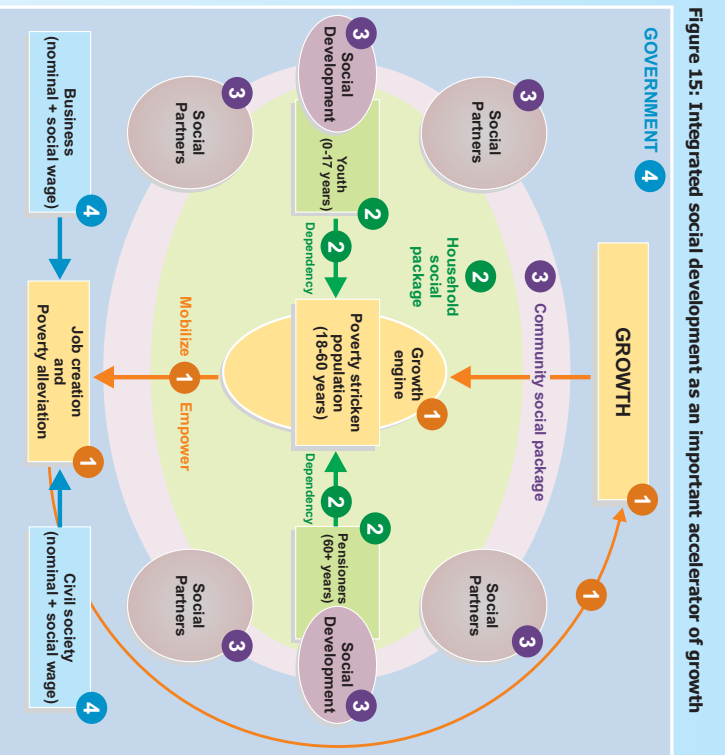


Figure 15: Integrated social development as an important accelerator of growth

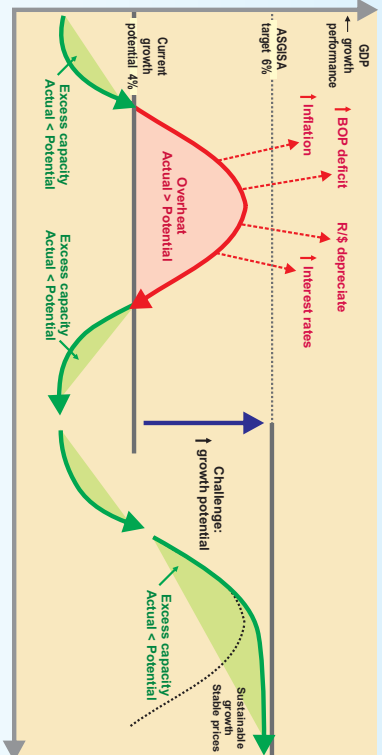


Figure 16: Realising the ASGI-SA ideals

This new paradigm demands an integrated national strategy on social development as a key accelerator of employment and shared growth...

As government embarks on the Accelerated and Shared Growth Initiative (ASGI-SA), expectations arise that more jobs will be created. However, based on the preceding analysis, little evidence exists that the employment opportunities created through the normal course of expansionary economic policy will be sufficient. Furthermore, no guarantees exist that the most destitute will share in the growth benefits nor that the most vulnerable will gain opportunities to engage in meaningful and sustainable economic activity. Social development must therefore step in to build human capital with the aim to ensure inclusivity for all.

An integrated social development strategy proposes the expansion of the social safety net. In a sustainable fashion, while deliberate efforts are made by all stakeholders to mobilise beneficiaries to enjoy the dignity and benefits of work and not become dependent on the state. The poor needs to be given the necessary support either to pursue self-employment or to secure the adequate skills and/or other employment in the "first economy".

The conceptual framework (figure 15) is presented in four phases:

1. Strategies need to focus on mobilising and empowering the potentially employable, thereby enabling them to move from poverty and welfare support to gainful employment, which again will support higher, sustainable and shared economic growth.
2. The target needs to be broader than the individual – it needs to consider the households as an economic unit. In an attempt to lower the dependency and subsequent impediments or constraints that children and pensioners may pose on the economically active poor.
3. Based on the specific needs and characteristics of the community, which will directly be linked to their geographical location, attempts need to be made to identify socio-economic packages, consisting of nominal wages, social wages, *in kind* compensation, infrastructure and services needs. This again requires an integrated national strategy from all social partners such as health, education, etc.
4. A "shared" initiative between government (policy), business, labour and civil society, with government providing clear guidelines and incentives in support of clearly defined social development objectives. This initiative should however be sufficiently flexible to allow for industry and society specific interventions.

... with such an investment in the well-being of all breaking the growth and poverty trap to realise the ASGI-SA goals.

Focus 55 proclaims that the impediments on the country's growth and poverty alleviating potential are predominantly supply side in nature. This finding critically affects policy decisions regarding a concerted effort to increase the productive capacity and future growth path of the South African economy, hence effectively translating into employment creation and poverty alleviation.

Notably, the most important challenge for government is a redesign and redirection of its budget allocation priorities away from operational expenses towards investment in human capital and the socio-economic environment. Such a strategic intervention will improve productivity levels, increase the labour absorption capacity of the economy and raise its growth potential to ensure higher sustainable output growth and shared income. A policy change whereby investment in integrated socio-economic development, will act as a key accelerator of shared future economic growth.

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