

## Part 1: Understanding Basic Economics

The *economy* is about how wealth is created, distributed and consumed. It concerns the ways in which a country produces, distributes and consumes the tangible, material commodities of life. It is also about how the proceeds or income from these activities are distributed amongst those that contribute towards them: businesses, workers, the state and the whole of society. Every person affects the economy in some way and we are all affected by it.

Economics attempts to answer questions such as: What is produced and how? Why does a particular country produce particular goods and services? How are the natural resources used? How does a country earn and spend its money? How are its people employed, and what technology do they use in their work? What is the relationship between these things and the wealth and poverty of different communities?

### The size of the economy

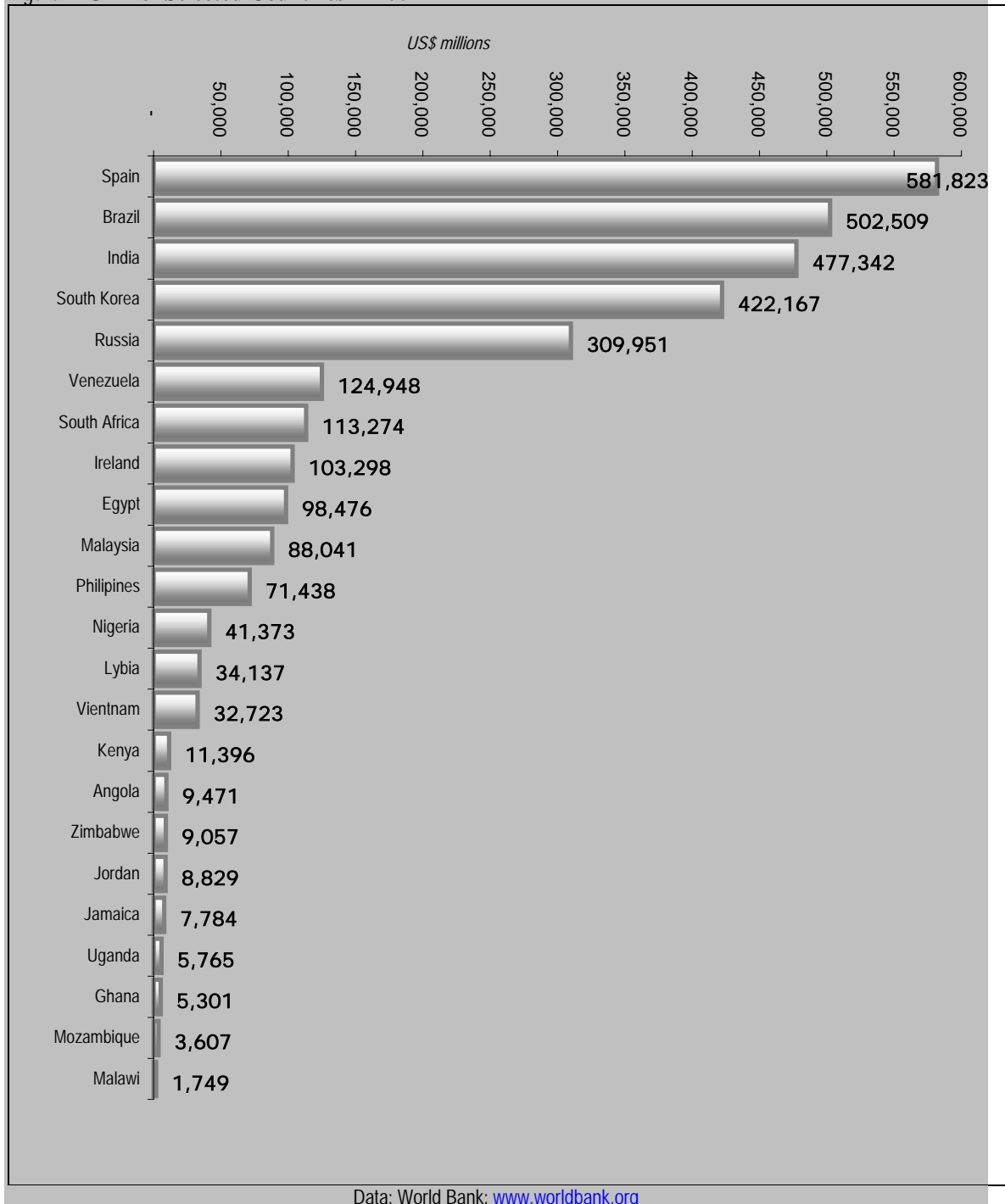
The way we usually measure the size of an economy is by its ***Gross Domestic Product*** (GDP). GDP is the value of all the goods and services produced within our borders in one year. This value is equal to the economic wealth of the country, all the things of economic value, which can be bought or sold, that have been produced in South Africa in one year. This includes all the *goods* like loaves of bread, mielies, cars and gold, as well as all the *services*, like taxi rides, telephone units, haircuts, hotel rooms or tickets to football matches. We add the prices of all these things together to get GDP.

The estimated value of all goods and services produced in South Africa in 2001 amounts to about one hundred and fifteen thousand million US dollars or US\$115 billion. We use dollars because this makes it easy to compare our GDP with other countries.

One of the drawbacks of the GDP number is that it excludes unrecorded economic activity. Any exchange of money that is not reported to the government in some way goes unmentioned in the GDP figure, although Stats SA does attempt to estimate the size of the 'informal economy'. Unrecorded transactions would include the informal sector, subsistence production (i.e. growing mielies or tomatoes to eat them yourself), the criminal economy and white-collar crime or other means in which the wealthy evade the notice of governments. Also unrecorded in total GDP is the work done by members of society that contributes to production but which is not sold for money. The classic example is housework mainly performed by women. Cooking, raising children and housework are all economic activities essential for producing wealth, but none find their way into GDP, unless they are done for money and registered with government, such as formal domestic work.

Figure one shows how South Africa compared with some other countries in 2001. Which countries on the graph do you think should be compared to South Africa economically or for other reasons? Explain why?

Figure 1: GDP of Selected Countries in 2001



As you can see South Africa is in the middle of this selection of countries. Many of our neighbours have very small economies compared to us. The country on our continent with a GDP closest to South Africa is Nigeria. On the other hand South Africa has an economy that is much smaller than many in the world. If you add together the GDP of all the countries listed in the graph it amounts to more than US\$3 thousand billion (which is called three trillion). Japan in 2001 produced goods and services alone valued at more

than \$4 trillion. And the value of goods and services produced in 2001 in the USA, the wealth it created that year, is worth more than US\$10 trillion.

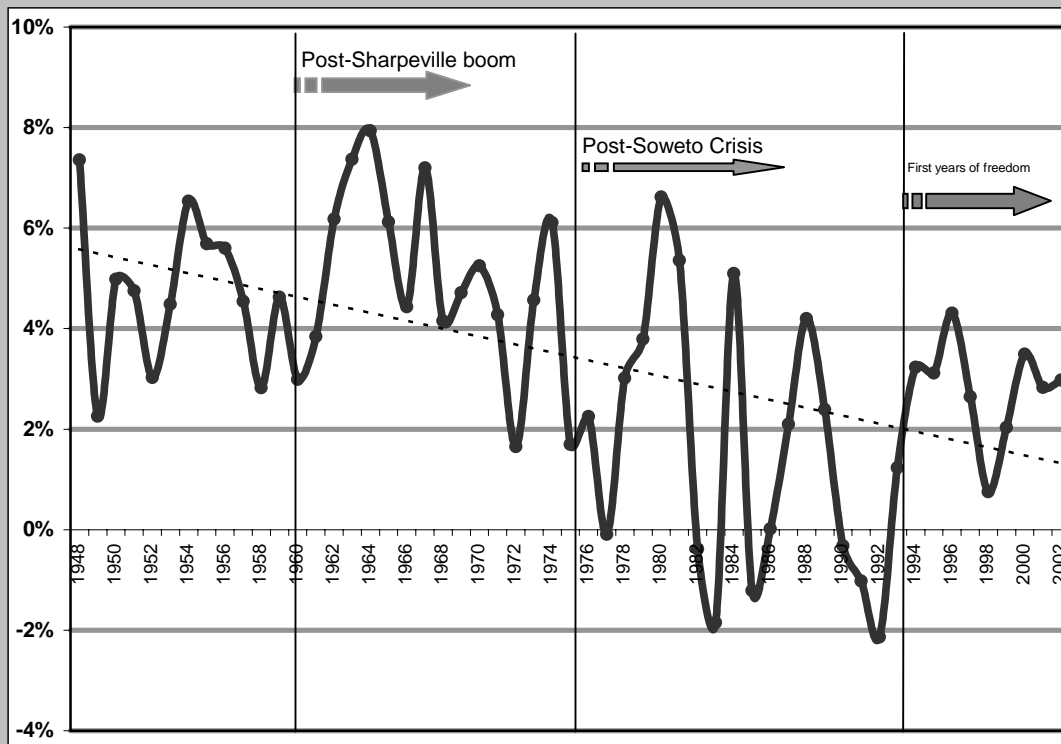
## Economic growth

The GDP figure gives you a snapshot of how large an economy is in any particular year. But the GDP of all countries is changing all the time. If there are more goods and services produced this year than last year we say there has been growth in South Africa's GDP.

We measure *GDP growth* using *percentage change*. For example if GDP is \$100billion this year and next year it is \$110billion, we say that GDP has grown by ten percent (because \$10billion is 10% of \$100billion).

The graph below shows growth of our GDP from 1948 until 2002

Figure 2: **South African Real GDP Growth (1948 - 2002)**



Data: South African Reserve Bank [% Change in KBP6006Y: Gross domestic product at market prices Yearly/RMILL/Constant 1995 prices, [1946 -2002]  
See: [www.resbank.co.za](http://www.resbank.co.za)

There are a huge variety of factors that influence GDP growth over the long run. These include economic factors, but also all kinds of social, political and even cultural conditions. This can be seen by observing the graph of South Africa's GDP. Even without analysing the economic conditions in the country of the period, we can see how various political conditions affected growth.

The Sharpeville massacre led to the first state of emergency and the banning of the ANC and the PAC. After the Rivonia Trial all resistance to the state was incarcerated, exiled or forced underground. The regime successfully restored the racist order and to a large extent pacified the masses. Once they had completed these tasks, there was an investment boom, with foreign investors pouring millions into the country.

This *Post-Sharpeville boom* can be seen in the fact that in 1962 GDP grew by almost 4%. The next year growth was up to 6% and two years later GDP grew by a massive 8%, the highest level of growth seen in the post-war era. Even after this high point there is not a single year in which growth was below 4% of GDP from 1962 until 1972 – a decade long boom in the South African economy.

In the period following the Soweto uprising, when the future of the system of apartheid was in constant doubt, GDP growth became very volatile (jumping up and down). In 1977 GDP did not grow at all (i.e. 0% growth). In 1980, it reached almost seven percent, boosted by the high international gold price. Two years later it grew smaller, or contracted, by 2%.

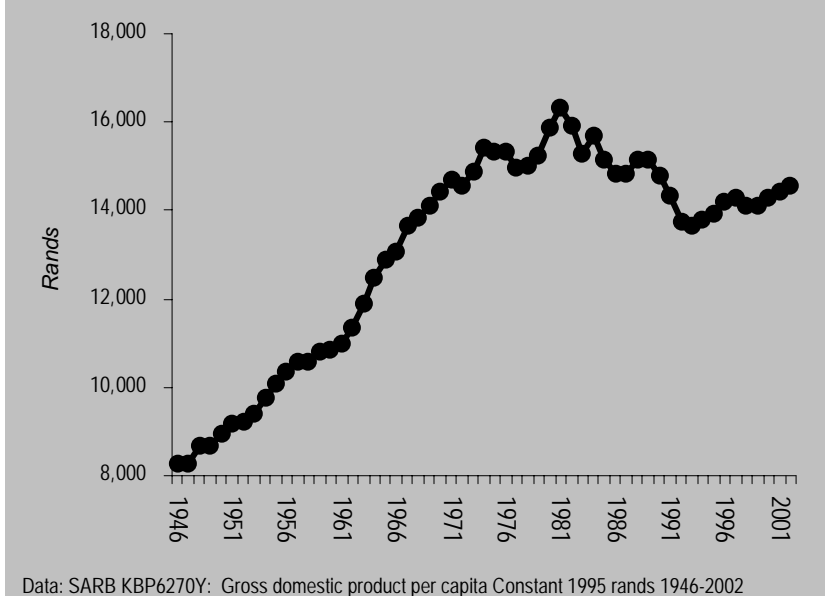
You can see that more recently, in the first decade of freedom, growth has been far less volatile, but has not reached levels we are satisfied with. If you consider the dotted line in the graph, which is called the trend line, perhaps you'll agree that this is not surprising. The trend-line gives the average of all the movements up and down over the whole period. As you can see it has moved consistently down.

Perhaps our policies are turning it around, taking our nation out of the crisis of declining growth and moving us into a new era sustained growth and development. But that is a matter for speculating the future: something which economists are notoriously bad at!

## **Population**

One of the reasons why it is important for us to generate growth every year is that every year our population also grows.

Figure 3: **South African GDP per Capita (1946 – 2002)**



If our GDP was to remain the same while our population grew, this would mean there would be fewer goods and services produced per person on average.

This can be easily shown using GDP per capita, which is simply GDP divided by the number of people in the country. This gives us average production, or average wealth produced, per person.

As you can see in

Figure 3, while our GDP has grown consistently over the last fifty years, since the 1970s this growth has become more volatile and declined from its peak in 1983.

GDP per capita is a useful measure of how the economy is doing. However, it is important to remember the following problems with this figure. First, GDP per capita is an average: it tells us how much each South African would have if all the wealth in the country were divided equally amongst the whole population. From the graph we can see this is at the moment around R14,000 a year. As we know, wealth is highly uneven. In South Africa the vast majority earn much less than the R14,000, while a tiny minority earn a great deal more than this average.

The second thing to remember is that *GDP per capita*, by definition, depends on two estimates: (a) GDP and (b) population. If either of these is wrong for any reason then the GDP per capita figure will itself be wrong. In South Africa, as in most developing countries, population figures must be viewed with some circumspection. If we look at the graph below, for example, we may want to ask questions such as: Are the TBVC states included in the calculation of population and/or the GDP figures? If they are added at a certain stage, when does this happen? Before we can answer these questions the figures can be viewed with the healthy suspicion that is due to all statistics.

## **How the South African Economy Developed**

**Early Economy** : From the arrival of the colonialists to the discovery of gold and diamonds in the late 1800's, South Africa's economy was based on farming. There was almost no industry. The development of big mines led to the growth of big business which needed lots of cheap labour.

**Early Development 1880s to 1940s**: The government introduced land and tax laws which limited the African people to the reserves and forced them to earn a money wage. Cheap black labour was directed to the mines and farms which were owned by white capitalists. Mining was key to generating a modern economy. The profits from mining were used to set up finance houses which set up factories. The government budget was used to favour the white minority and the capitalists. The African people suffered a great deal.

**Rapid Growth 1950s 1970s**: From the 1950s onwards, the South African economy grew much faster than the population. South Africans began to produce goods which previously could only be obtained from abroad through imports. This model that guided South Africa through its boom years was called Import Substitution and Industrialisation (ISI). In order to produce these goods machinery was imported from other countries. Gold was sold at an internationally fixed price so that South Africa had a stable income (foreign exchange money that we received from foreign countries buying our gold). As a result of these policies rapid growth did occur, but this growth did not benefit people equally. White people, in general, became richer while the black working class in particular continued to be exploited. Capitalists produced more and more luxury goods that only the white and rich sections of society could afford. Huge profits were made as the government's policies at the time ensured a supply of cheap labour. This model relied on three factors for its success: the fixed gold price, the cheap import of machinery and a cheap and stable workforce.

### **Economic Crisis 1970s 1990s**

From 1970 onward the rapid growth rate began to decline. This was because the Import Substitution and Industrialisation model broke down. It did so for the following reasons:

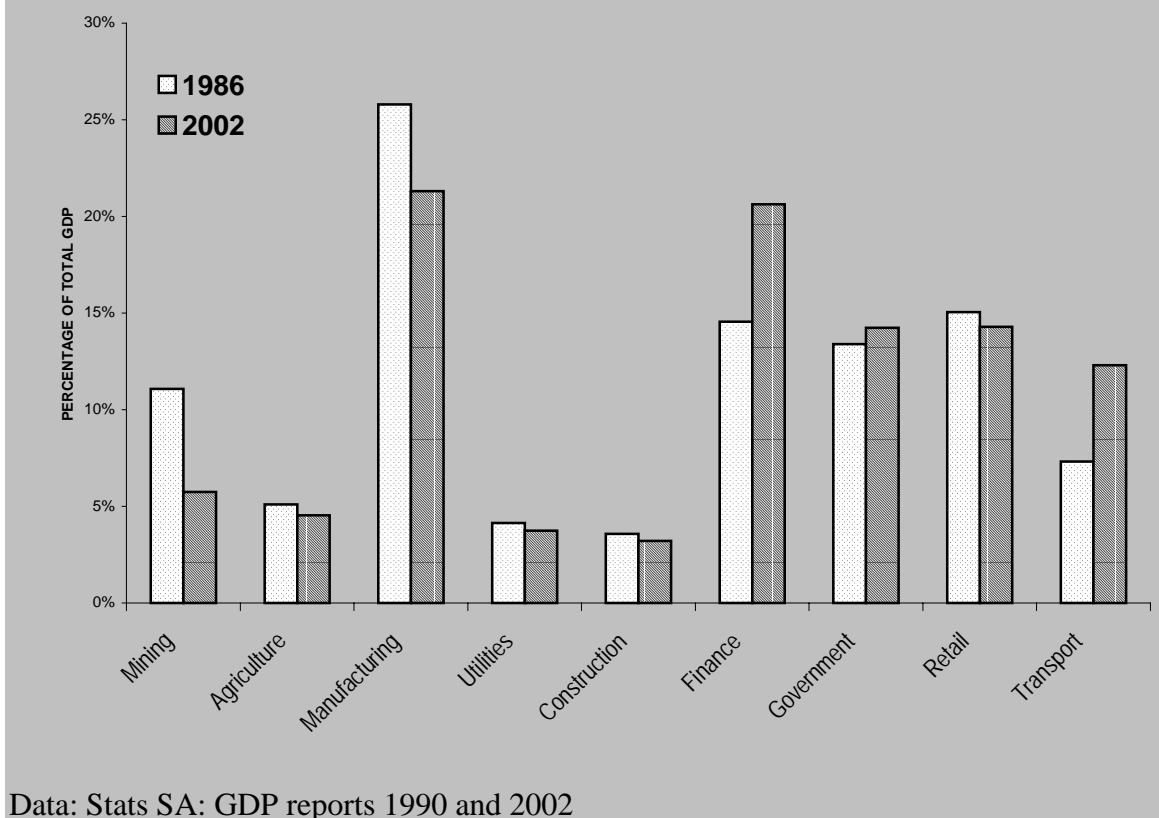
1. In 1971, the gold price was no longer fixed and started going up and down according to how much people in the world markets wanted to buy and how much was available to be sold. This meant that South Africa no longer had a stable income of foreign exchange.
2. An international oil crisis hit the world economy in 1973 and the oil price shot up. One of the results of this crisis was that South Africa had to pay much higher prices for oil and all other imports. So while we got less income from our gold, we had more expenses.
3. From 1973 stronger union organisations were built and there was a huge increase in strikes and other labour action. This meant that employers could no longer get away with paying such low wages. Mass political activity such as the Soweto Uprising of 1976 also led to increased instability. Sanctions meant that many foreign capitalists took their investments out of South Africa. Many big South African businesses also took a lot of their money to other countries.
4. The issue of racial fordism is also linked to the failures of ISI. Racial fordism means that the domestic South African market was divided upon racial lines with black people not having the same access to the economy as white people. This meant that the domestic market for goods and services was limited and quite small.

We started spending more than we were earning. In the 1980s and 1990s the downward movement of the economy continued and South Africa faced a recession and negative growth. A recession occurs when the population is growing faster than the economy. This was the economy that we inherited in 1994.

## The Structure of the Economy

The economy can be broken down, or classified, in various ways. The classifications in the chart below are taken from Stats SA methodology.

Figure 4: Percentage of GDP by Economic Sector in 1986 and 2002



The chart compares the percentage of total South African GDP produced in various sectors of the economy in 1986 and in 2002. Which sectors produce relatively more GDP than in 1986? Remember that all sectors have grown larger in GDP since 1986. But some have grown faster than others and therefore account for a larger proportion of GDP. Can you discern any relationship between those sectors that have grown and those that have got relatively smaller?

Lets look closer at how Stats SA defines these sectors:

- **Mining:** Includes both mining and quarrying: the extraction of our natural mineral wealth such as gold, coal, iron and diamonds. Mining was the first industrial sector in the economy and the whole structure of our economy has grown up around mining.
- **Agriculture:** Farming to produce foods like maize, wheat, meat, fruit and vegetables.
- **Manufacturing:** The production of goods in factories. This includes a wide range of products such as food, beverages, tobacco, textiles and clothing, wood and paper and their products, petroleum products, metals like steel as well as machinery and metal

equipment, electrical goods, transport equipment and furniture. South Africa's largest manufactured products are.

- **Utilities:** This category includes electricity, gas and water supplies to the community and to industry. This infrastructure and services are usually provided by the state.
- **Construction:** The building of houses, roads, bridges, factories, office blocks, shopping malls and other buildings.
- **Finance:** The institutions that hold the savings, or surplus wealth, such as banks, pension funds and the insurance industry. The products these institutions sell to the public (such as life insurance, bank accounts, etc) account for a significant proportion of the goods and services produced in the country. Indeed, South Africa is distinguished from most other developing countries by the size, sophistication and global integration of its financial sector.
- **Government:** All government taxation and spending is part and parcel of the economic interactions in society. Government contribution to GDP can be divided into the following types of economic interaction: (a) *transfers*: where the government takes money from one sector of the economy and gives it to another, e.g. child support grant; (b) *consumption*: the paying of salaries and other recurring costs that keeps the system of government moving; (c) *investment*: where the government builds new infrastructure.
- **Retail:** The official name for this category is *Wholesale, retail, and motor trade; catering and accommodation*. It includes the shops, the restaurants, the hotels and other services that consumers use every day. (Do you think *spaza* shops are included in this figure? How much would you guess they are accounted for in the economy as a whole? )
- **Transport:** This is actually both transport and communications. The moving of goods and people throughout the country by rail, road and air. The communications sector includes Telkom and the new cellular operators.

Each sector is interlinked with other sectors in various ways. A factory could not operate without electricity, which may be generated from coal, while from its profits the government takes taxes and may, for example, transfer these through a child support grant.

Another way of looking at the economy is to define it according to primary, secondary and tertiary sectors. These are terms you should be familiar with from the education system. Look at these classifications as given in table one and try to explain the logic that underpins them.

Table 1: **Classifying Economic Sectors**

Primary	Mining and Quarrying
	Agriculture, Forestry and Fishing
Secondary	Manufacturing
	Electricity, Gas and Water (utilities)
	Construction
Tertiary	Finance, insurance, real estate and business services
	General Government
	Wholesale, retail, and motor trade; catering and accommodation
	Transport and communications

The *primary* sector is the closest to natural resources. Both mining and agriculture work directly on the products of nature found on, or under, our soil. The *secondary* sector is a step away from this: it consists of activities that process raw materials into manufactured products or material goods that are used by consumers. While growing mielies is part of the primary sector, the production of mielie meal is a manufacturing process.

The *tertiary* sector is even farther removed from natural resources. This is where the mielie meal is sold to the consumer and marketed under a particular brand identity. Most of its

activities can be said to belong to the service sector.

Having defined our sectors better, and grouped them into broader economic categories, let's go back to the questions we posed at the beginning of this section: what is the general trend with respect to the growth of various economic sectors? Looking at the data you can see that those falling into the tertiary sector account for a greater proportion of our total GDP than they did in 1986. Conversely, those that fall into the primary sector account for a much lower proportion of our total GDP. In fact, using the same data we did in figure 4 we can say that in 1986 the primary sector accounted for 16% of production, while in 2002 it was worth only 10%. In 1986 the secondary sector made up 34%, while in 2002 it had gone down to 28%. And the tertiary sector, which means essentially services, had grown from 50% of GDP in 1986 to 61% in 2002.

This relative growth of services and relative decline of primary and secondary sectors is not confined to South Africa. In fact, it is a worldwide trend that is observable in all of the advanced capitalist economies throughout the twentieth century. These developments pose important challenges to all varieties of economic theory.

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In Part 2 of the UMRABULO POLITICAL EDUCATION SERIES we will look at *Globalisation and the South African Economy*.