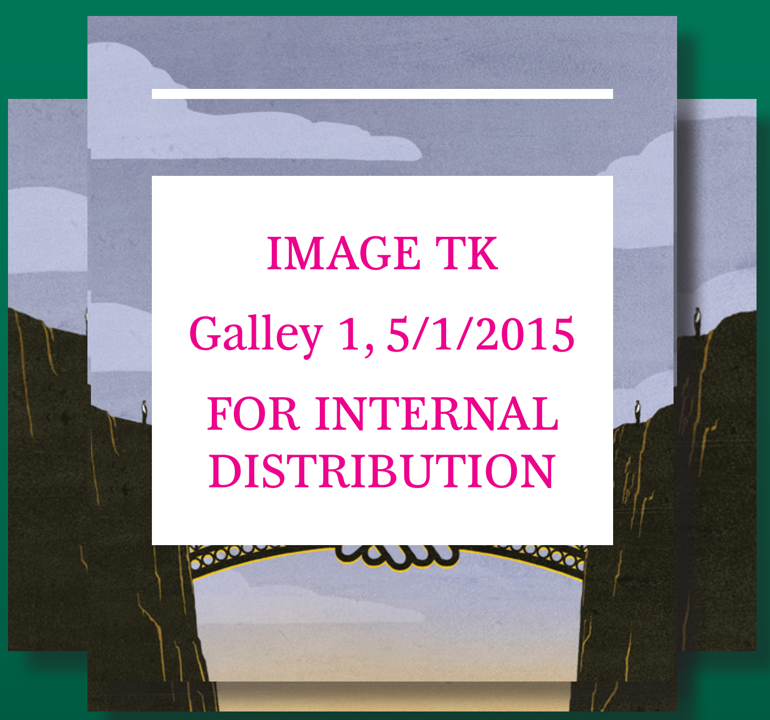
Four Priorities for South Africa's Future



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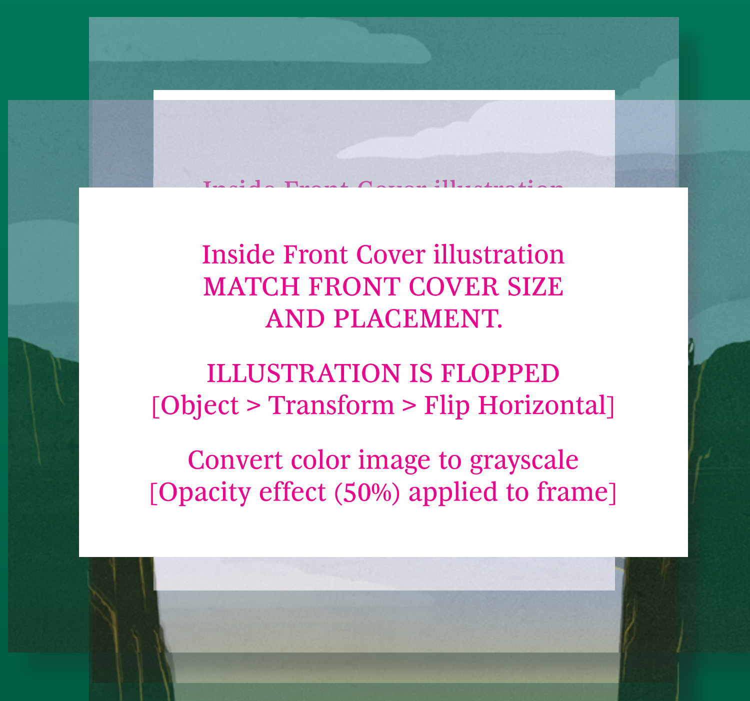

FOUR PRIORITIES FOR SOUTH AFRICA'S FUTURE

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May 2015 | The Boston Consulting Group

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FOREWORD

South Africa is now entering its third fully democratic decade, and the nation's progress across all sectors of society is cause for celebration. South Africa has successfully transitioned economically: once reliant on mining and agriculture, the nation now has a broad-based and sophisticated economy that encompasses vibrant finance and retail sectors, among others. According to the World Economic Forum, South Africa ranks thirty-sixth for strong institutions and is home to a particularly strong legal system and judiciary framework. And the country's outstanding natural beauty draws almost 10 million tourists a year, giving South Africa an increasing share of the global tourism market.

This report also recognizes, however, that South Africa faces a number of real challenges, including sustaining its economic growth, providing adequate education and skill development, addressing major health-care concerns, and reducing unemployment. These challenges will require effective leadership from both the public and the private sectors and will compel South Africa to draw on its considerable strengths and competitive advantages, including its proximity to the rest of the African continent.

As just one demonstration of our belief in South Africa's promise, The Boston Consulting Group is hosting its 2015 worldwide officers' meeting for BCG partners in Cape Town—the first meeting of this kind that we have held on the African continent.

South Africa is a beautiful, diverse, and exciting country, and we are proud to be a part of its long-term future through our flourishing office in Johannesburg. We are pleased to present this report, which is dedicated to South Africa, and hope it will serve as a guide to focus all stakeholders on the most critical challenges ahead and, more important, to accelerate solutions that will create a more prosperous future.

—Rich Lesser,
President and Chief Executive Officer

INTRODUCTION

South Africa has made tremendous progress in the 20 years since its first fully democratic election. What's even more impressive, the advances have occurred across multiple fronts: political, social, and economic. But as substantial as the progress has been, great challenges remain—complex issues of prosperity and well-being threaten to undermine South Africa's continued development. Addressing those challenges will require strong public- and private-sector leadership in the years to come.

One critical issue is sustaining economic growth, which has slowed in recent years. But reigniting growth is only a first step. Equally important is understanding how South Africa can translate growth into the broader well-being of its people. The Boston Consulting Group's proprietary Sustainable Economic Development Assessment (SEDA) methodology measures just that: how effectively a nation converts wealth into well-being along ten socioeconomic dimensions: income, economic stability, employment, income equality, civil society, governance, education, health, environment, and infrastructure.

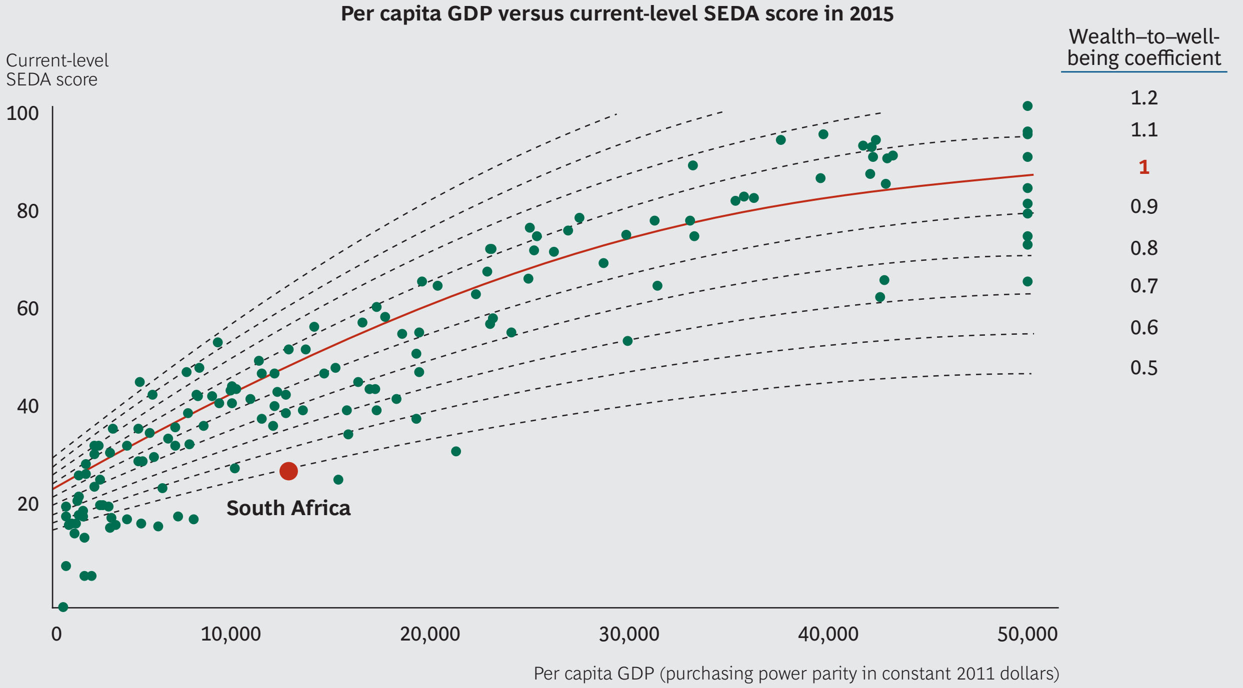
Our most recent SEDA analysis shows that South Africa still has work to do. South Africa ranks 138th out of 149 economies in our SEDA database in terms of converting its wealth to well-being. (See Exhibit 1.) Compared with global averages, South Africa underperforms many sub-Saharan neighbors, the BRIC countries (Brazil, Russia, India, and China), and other economies that made the transition to open-market democracy in the last two decades, such as Poland and Romania. (For an explanation of SEDA and these assessment tools, see the sidebar "How Well-Being Relates to Wealth and Growth.")

Delving deeper into the data on the ten SEDA dimensions and comparing a nation with peer groups of countries of similar size and economic and social characteristics exposes reasons for lagging performance. The SEDA analysis highlights areas where high-impact solutions can lead to outsize improvement in overall standing. (See the appendix.)

To this end, we compared South Africa with three groups of neighbors and peers:

- Sub-Saharan challengers: ten emerging economies from the region
- Global peers: eight countries with similar levels of development
- Advanced peers: six global economies that have had per capita growth at least double that of South Africa and have demonstrated

EXHIBIT 1 | South Africa Is 138th of 149 Surveyed Countries in Converting Wealth to Well-Being



Source: BCG analysis.
Note: The data is based on SEDA scores, and the line is based on regression (polynomial second order). The wealth–to–well-being coefficient compares a country's current-level SEDA score with the score that would be expected given its per capita GDP. The per capita GDPs of Kuwait ($84,188), Qatar ($127,562), Luxembourg ($86,442), Singapore ($76,236), Norway ($62,448), Saudi Arabia ($52,067), Switzerland ($51,733), the United Arab Emirates ($57,044), the U.S. ($51,450), and Hong Kong ($51,509) were adjusted to the maximum value of the matrix ($50,000).

HOW WELL-BEING RELATES TO WEALTH AND GROWTH

SEDA evaluates overall well-being by examining ten key dimensions: income, economic stability, employment, income equality, civil society, governance, education, health, environment, and infrastructure. (See the exhibit.) We look not only at a country's current level of well-being but also at the country improvement in well-being—what we call recent progress. Both the current level of well-being and recent progress are measured on a scale of 0 to 100, with 100 representing the highest level.

We analyze overall well-being and each of the ten dimensions in two ways:

- *Current Level.* This is a snapshot that uses the most recent data available (generally 2013).
- *Recent Progress.* This is a measure of change in current-level data for the most recent seven-year period for which data is available. For most indicators, the time frame we analyze to measure recent progress in this report starts in 2006. We have calculated recent progress through a least-squares best-fit approach.

On the basis of SEDA's measures of a country's current level of well-being and its recent progress, we are able to examine the relationships between wealth and current well-being and between growth and recent progress in well-being. We do this by calculating two coefficients in order to compare a country's performance—relative to its income level (or GDP per capita)—with the global average.

The wealth–to–well-being coefficient compares a country's current-level SEDA score with the score that would be expect-

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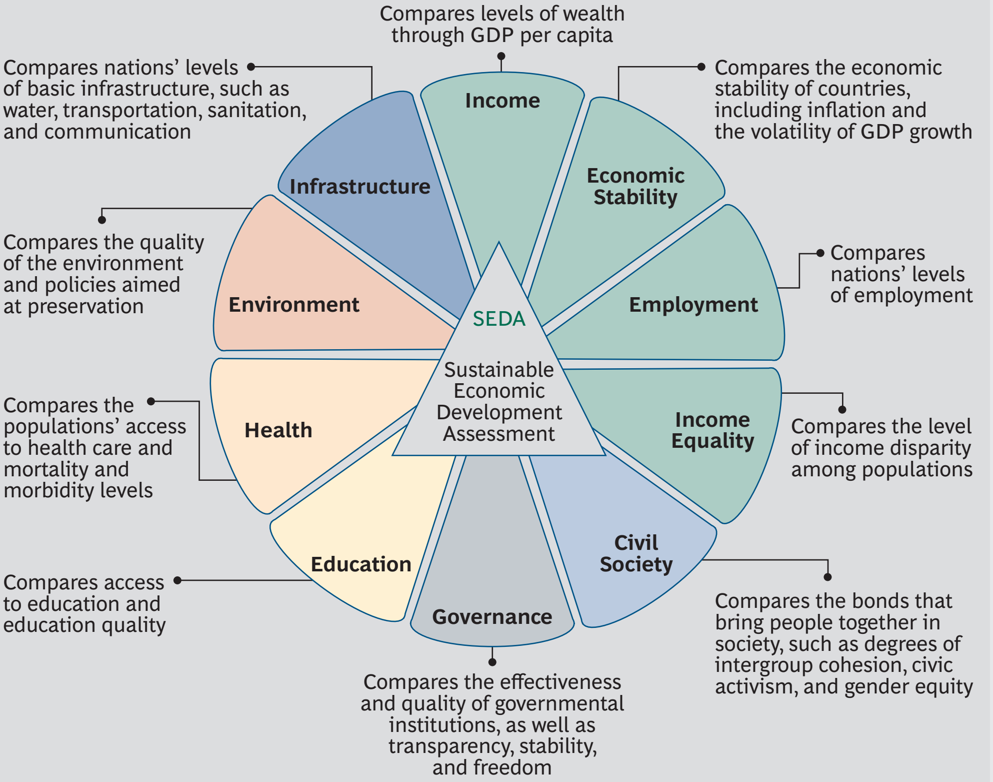
HOW WELL-BEING RELATES TO WEALTH AND GROWTH (continued)

BCG's Sustainable Economic Development Assessment Measures Well-Being Along Ten Dimensions



Source: BCG analysis.

ed given its per capita GDP. We use per capita GDP in purchasing-power-parity terms as the best basis for comparing countries at a given point in time. The expected score reflects the average world-wide relationship between well-being current-level scores and per capita GDP as estimated by the best-fit line, in this case a second-order polynomial regression. Countries with a coefficient greater than 1.0 deliver higher levels of well-being than would be expected given their GDP levels, and those with coefficients below 1.0 deliver lower levels of well-being than would be expected.

The growth–to–well-being coefficient compares a country's recent progress score with the score that would be expected given its GDP growth rate. We use real GDP as the best comparable measure of economic expansion and calculate growth rates from the slope of the least-squares best-fit line for the seven-year period in the recent-progress analysis. The expected score reflects the average worldwide relationship between well-being recent-progress scores and GDP growth rates as estimated by the best-fit line, in this case a simple linear regression. Again, countries that have a coefficient greater than 1.0 are producing improvements in well-being beyond what would be expected given their GDP growth rate over the past seven years.

BCG's upcoming SEDA report, to be launched in May 2015, will shed more light on development in the region and other parts of the world.

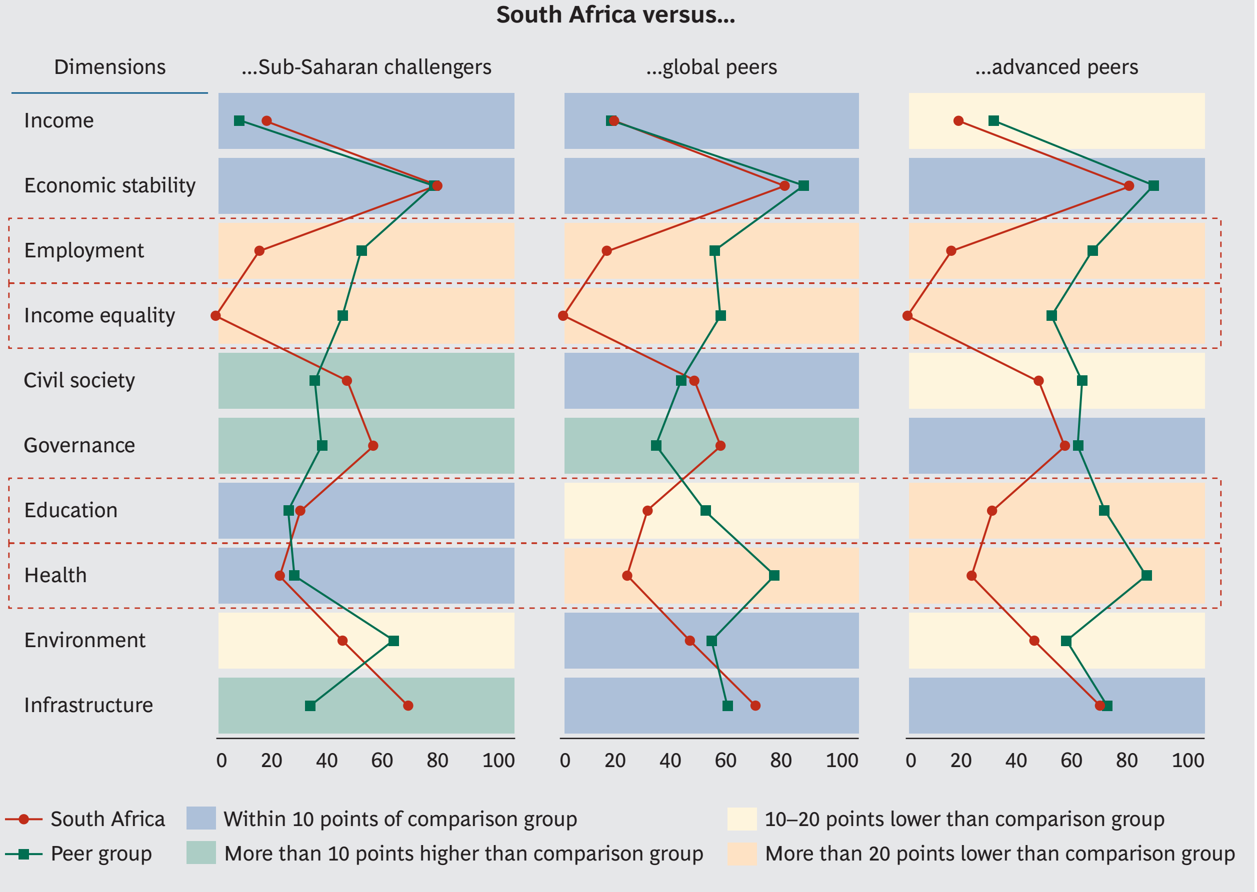
both consistent growth and a strong track record of translating growth into well-being

The SEDA analysis reveals four critical dimensions in which South Africa's performance impedes its ability to improve economic and social well-being: education, health care, employment, and income equality. South Africa is actually on par with, or slightly ahead of, its neighboring sub-Saharan Africa challengers on such dimensions as income, economic stability, civil society, governance, and infrastructure. It barely keeps pace with, or even significantly lags, the sub-Saharan challengers on education, health care, employment, and income equality. It trails its global and advanced peers on these latter dimensions by substantial margins. (See Exhibit 2.)

These four problem areas are linked. They are key components of a vicious circle that undermines prosperity and social well-being. For example, poor education results in a lack of skills, which contributes to high unemployment.

The overall unemployment rate in South Africa in 2013 was 25 percent, but unemployment ranged from 40 percent to 70 percent among those with only ninth- to eleventh-grade educations. And it's not that

Exhibit 2 | South Africa Lags Peers on Four Key Dimensions: Education, Health, Employment, and Income Equality



Source: BCG analysis.

jobs aren't available. In 2014, there were vacancies for 432,000 technicians, 216,000 managers, 178,000 professionals, and 19,000 teachers in South Africa.

These kinds of unemployment levels foster income inequality and slow economic growth, which in turn limits access to, and funding for, education; access to and funding for health care are similarly imperiled. Put another way, improving education is essential to breaking the circle in the long term, but improvement in employment, equality, and health care is necessary to improve well-being now.

In the remainder of this report, we look at the challenges that each of these areas presents for South Africa overall and the issues that South Africa must address to improve. We reflect on some significant strengths that South Africa can bring to bear, including positive initiatives that are already in the works, such as those contained in the government's ambitious National Development Plan 2030 (NDP). We have identified root causes behind the main problem areas and suggested priorities and solutions that can have an outsize impact in both the short and long terms.

THE PREREQUISITE OF ACCELERATING ECONOMIC GROWTH

To generate wealth sufficient to be transferred to well-being, an economy has to grow. However, growth has been a challenge for South Africa in recent years; its annual GDP growth rate has not exceeded 2.2 percent since 2012 and has lagged that of all peer groups almost every year since 2002. (See Exhibit 3.)

The outlook for the immediate future is not much better given the confluence of factors that conspire to hold back economic expansion.

One is that economic development in South Africa, as elsewhere, has shifted the composition of the economy more heavily to services—financial, real estate, and business services now represent more than a fifth of all economic activity. These sectors require educated and skilled workers—a need that South Africa's schools are not currently meeting. (See the next chapter.)

Another factor is high consumer debt. Retail spending is a big driver of growth, and in many countries, debt fuels this spending. But consumer debt levels in South Africa are becoming unsustainable. Almost half of all South Africans carry some debt, and nearly half of those people—or one-quarter of the country overall—have poor credit histories. The ratio of household debt to disposable income climbed from about 65 percent in 2005 to about 80 percent in 2014.

A third factor is government spending, which has been another big growth driver, but it too is not sustainable. The ratio of public debt to GDP rose from 27 percent in 2007 to 45 percent in 2014, causing S&P to downgrade South Africa's sovereign debt last year. Another possible downgrade—this time to junk status—looms in 2015.

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In addition, growth is highly correlated with business confidence, and with confidence declining, numerous industries—particularly, manufacturing, construction, and retail—are suffering. Confidence concerns are rooted in entrenched causes: overly stringent regulation, the need for fiscal-income increases to achieve financial stability, rigid labor rules, uncertainty over policy direction in critical sectors such as telecommunications and mining, and, lately, unstable electricity supply. "Stringent regulations create a compliance environment reinforced by the fear of criminal sanctions as opposed to an enterprise environment reinforced by trust and confidence," says Mervyn King, chairman of the International Integrated Reporting Council, a

Exhibit 3 | South Africa's GDP Growth Rate Lags All Peer Groups

Source: EIU country data.

global coalition of regulators, investors, companies, and nongovernmental organizations.

Accelerating growth will require improvement in the country's fiscal position and business confidence. Austerity measures are necessary to reverse the credit decline and instill confidence in the economy's financial standing. The regulatory environment needs reform to improve cross-border trade and flexibility in the labor market.

One more area has the potential to hold back progress and prosperity: energy. Owing to delays in the completion of the new Kusile and Medupi power stations and maintenance-related problems at existing power plants, South Africa is already experiencing countrywide load shedding. Without urgent action, the electricity shortage will persist for the next three years or more, until new sources of supply come on line. (See the sidebar "Meeting South Africa's Energy Challenge.")

Economic growth is a prerequisite, but South Africa is unlikely to achieve sustainable growth—or to materially improve the well-being of its people—without mounting aggressive, concerted efforts to address the four key problem areas of education, health, unemployment, and income inequality. Time is of the essence, if only because these issues will take years to resolve. The right actions can result in measurable progress in the near term and help pave the way for longer-term solutions.

MEETING SOUTH AFRICA'S ENERGY CHALLENGE

Various near-term solutions can be used to address South Africa's electricity shortage, but rapid implementation and the collaboration of multiple parties are essential.

Supply can be increased in several ways. One is to adjust the bidding criteria in the government's Renewable Energy Independent Power Producer Procurement Programme. More power-generation capacity should be specified, and faster construction schedules should be mandated for successful bidders. The government can also explore alternative, independent power-procurement platforms, such as floating power stations. The cost of leasing such units is high, but they are designed expressly to fill temporary supply shortfalls such as the one that South Africa faces.

One smart supply solution that could have long-term as well as immediate benefits is the decentralized installation of photovoltaic (PV) panels—basically, individual rooftop solar panels—in homes and businesses nationwide. Each panel could serve two purposes: powering the building where it is installed and generating excess power that can be sold back to the central grid for distribution elsewhere. The second is key to addressing the broader electric power shortage. Thanks to South Africa's abundance of sunshine and the low cost of PV panels, the power generated by these small-scale installations will be far less expensive than that from big coal-fired stations. Installation, cost, price, and impact on municipal governments that participate in the current electricity distribution chain are issues to be addressed, but we believe these hurdles are all surmountable. We estimate that it would take no more than six months to draft the necessary policies and regulations and start implementation.

On the demand side, Eskom, the South African public-electric utility, and others have been aggressively promoting efficiency and conservation through such initiatives as free distribution of low-power-consumption LED lightbulbs, promoting energy-conscious behavior, and a program to shift usage away from peak hours. These undertakings have helped, but rolling blackouts are still necessary. These are not only inconvenient (and sometimes dangerous), they also have a big negative effect on economic activity. Hence the urgency of achieving a near-term balance of supply and demand.

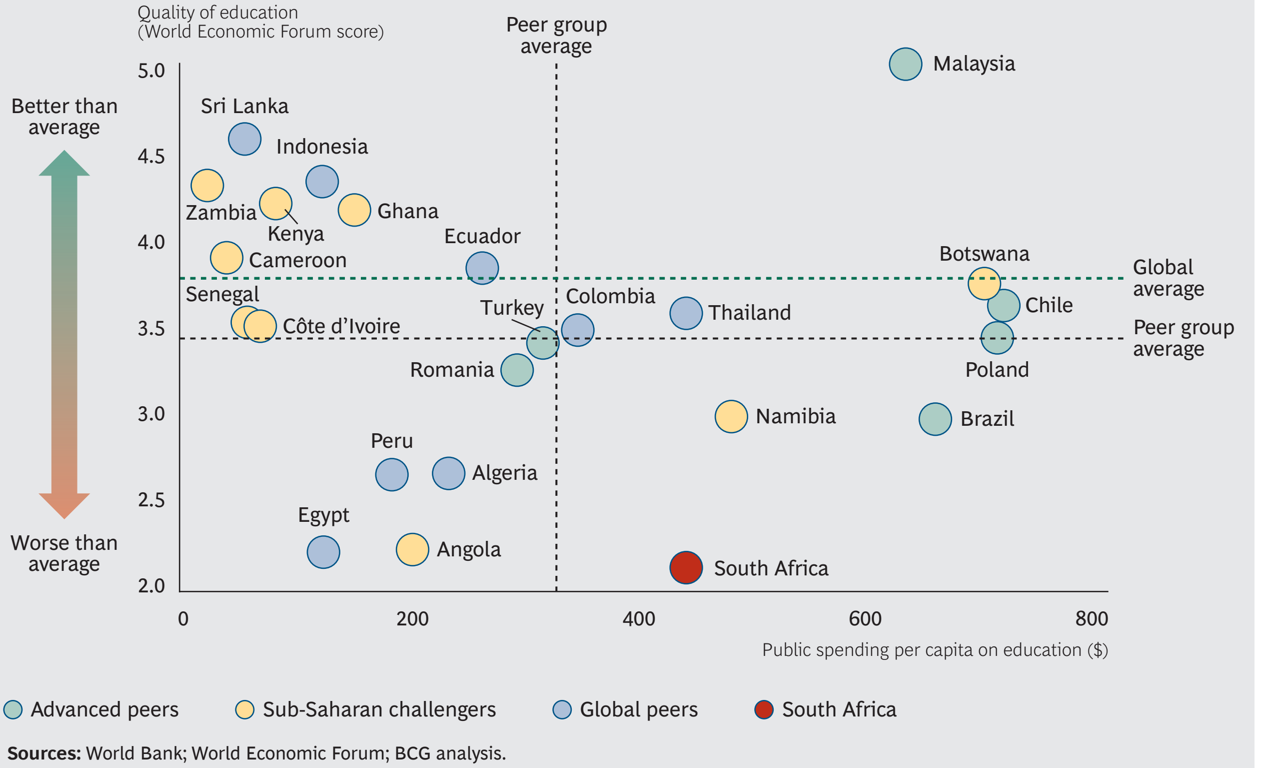
We are optimistic about the near- and long-term potential. South Africa has the fundamentals to become a leader in renewable energy, even though the transition from fossil fuels will, inevitably, be disruptive. The country is already taking the right steps to manage the transition by, for example, including capacity payments in current Eskom contracts.

EDUCATION

TEACH YOUR CHILDREN WELL

ALTHOUGH THE PROBLEMS AFFLICTING education in South Africa are serious and systemic, the experiences of peer nations show that significant improvement is possible, even in the near term, and that targeted policies make a difference. Money is not the issue: South Africa already spends more per capita on education than most of its peers. (See Exhibit 4.) Setting the right priorities is a much bigger imperative. Previous efforts at

EXHIBIT 4 | South Africa Spends More Than Most Peers on Education but Achieves Worse Outcomes



Sources: World Bank; World Economic Forum; BCG analysis.
Note: The data on quality of education is for 2013/2014, the GDP data is for 2013, and the percentage of GDP spending on public education is the latest available from the on World Bank. No education spending data is available for Nigeria.

reform—there have been three since 1994—focused on issues that did need tackling, such as infrastructure, enrollment, and access, but did not address other long-standing problem areas that now demand priority attention.

Four Critical Issues

Radical improvement is needed in four areas.

Teacher Quality. In Statistics South Africa's 2013 General Household Survey, teacher-related issues were cited as the top challenge facing public schools. With good reason. Studies by the Southern and Eastern Africa Consortium for Monitoring Educational Quality, among others, have found that some 60 percent of people teaching math to grades one through six failed to pass tests for math at the grade level taught.

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Basic Skills. South Africa's students perform poorly at math, science, and reading. Only 35 percent of sixth graders are numerate at an acceptable level (defined as answering 50 percent of the questions correctly on standardized math tests) and only 3 percent of ninth graders are numerate. According to the World Economic Forum's Global Information Technology Report 2014, South Africa ranks last (144th out of 144) in terms of the quality of math and science education. Reading results are not much better. The results of the 2014 South African Annual National Assessment showed that only 48 percent of ninth-grade test takers achieved scores of 50 percent or better for "home language" literacy and only 18 percent achieved 50 percent or better scores for their first additional language.

Dropout Rates. High secondary-school dropout rates undermine skill building and employability. According to the Department of Basic Education's 2014 Country Progress Report, although 86 percent of 16- to 18-year-olds are in school, only 5 percent complete grade 12. Other research shows that students completing grade 10 face only a 52 percent chance of employment. Completing grade 12 raises the probability of finding a job to 67 percent, but going on to postsecondary education improves one's job-finding chances enormously—completing just one additional year increases the probability to 86 percent.

Vocational Training and Higher Education. High dropout rates are exacerbated by the lack of training for vocational and practical skills. Further Education and Training (FET) colleges—schools that should provide vocational and practical-skill training—enroll about 200,000 students a year, but this is far from sufficient to compensate for current dropout rates. Moreover, FET colleges tend to provide theoretical training rather than practical, hands-on skill building, which makes them both less attractive to, and less helpful for, young dropouts. Also, communication and collaboration between employers and colleges are insufficient; as a result, colleges are not necessarily providing training in market-relevant skills and it is more difficult than it should be for students to find internships and apprenticeships.

Four Priorities for Reform

The latest education-reform program (Action Plan 2014) addresses all of the critical issues, and its goals have been confirmed in the government's NDP. Numerous initiatives, with goals that include increasing teacher number and quality and improving reading, math, and science learning, are under way. The intentions are good, but the four problem areas are intractable. We believe the impact of reform can be heightened by focusing on four priorities: achieving a mind-set shift with respect to education, making teacher quality measurable, strengthening vocational-training opportunities, and reducing dropout rates.

Achieving a Mind-Set Shift. Nelson Mandela famously said, "Education is the most important weapon which you can use to change the world." Unfortunately, his message seems largely forgotten in the South Africa of today. South Africans need to recalibrate their appreciation for the value of education and combine that newfound respect with a corresponding show of appreciation for teachers.

This will happen only with leadership—from both government officials and role models in other areas of society. Leaders need to start a drumbeat of recognition for the critical role that educators play. Sri Lanka and Kenya are two examples of what can be achieved (at very little cost) by demonstrating publicly the value that a society places on education and the people who deliver it. As Taddy Blecher, a cofounder of the Maharishi Institute and the chairperson of the government task force on entrepreneurship in the Human Resource Development Council, puts it, "Infrastructure is not as important as the mind-set. If the mind-set is right, people can achieve anything, even by learning under a tree."

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Making Teaching Quality Measurable. Good teachers are central to turning around the educational system; they help improve learning and stem the dropout rate. Several poorly resourced schools in some of South Africa's poorest communities achieve matric (university-qualifying) graduate rates of 90 percent of more, thanks to the quality and commitment of their teachers. They do this despite student-to-teacher ratios on the order of 30 to 1. In one instance, a school in Diepsloot that uses mobile containers as classrooms was able to lift matric pass rates from 27 percent in 2002 to 90 percent in 2004, thanks primarily to a strong principal who was able to efficiently manage teachers and material resources for maximum impact.

Teacher quality today is a hit-or-miss proposition. There is no consistent, systemic means of measuring performance; therefore, there is no systemic way to reward good teachers, identify underperformers, and make improvements. The experience of other countries and cities shows that good teacher performance depends on being able to train, develop, and incentivize teachers properly. Japan, where the education meritocracy places a high priority on teacher quality and performance, is one example. Its results in math and reading as measured by the Programme for International Student Assessment (PISA) far outdistance averages in Organisation for Economic Co-operation and Development countries and continue to improve. Shanghai is another example. It focuses on training new teachers and assigning good teachers to assist low-performing schools; the city's system achieved the top PISA math scores in 2012. Finland has increased the percentage of students who complete secondary and higher education by 7 percent and 10 percent, respectively, since 1990 by improving teacher training and support.

Given the strong role that the teachers' union plays in the education system in South Africa, union involvement and cooperation are essential if the nation is to improve teacher quality. This will be tough. At the moment, unions do not allow teacher evaluations (even to identify areas in need of improvement), union rules do not permit teachers to be available after hours to participate in training, and the impact of training cannot be measured, owing to the lack of evaluations.

Teachers and the department of education do have common goals, however, and improving student performance and enhancing the reputation of teachers are two of the most important. The government needs to facilitate dialogue among relevant stakeholders, including teachers, unions, school administrators, students, and parents. The future of a whole generation is at stake.

Ann Bernstein, executive director of the Centre for Development and Enterprise, a leading independent development-policy research organization, puts it this way, "A performance management system must be put in place to evaluate both teachers and principals. Creating accountability among teachers and principals is key to improving the state of education in the country."

Strengthening Vocational-Training Opportunities. South Africa should consider establishing a tiered education system that includes a clear potential route after grade nine into vocational training. This training should be financed by the government and allow students who choose this path to learn a skill that is geared to both their talents and the needs of the economy.

In Germany, students can choose to enter vocational school at age 16, and approximately half do so. These students spend one to two days a week in school and three to four days receiving practical, on-the-job training. They select vocations on the basis of market demand for given skills. Germany reduced youth unemployment from 15.6 percent in 2004 to 7.2 percent in February 2015 (compared with 22.1 percent for European Union as a whole).

In the words of Azar Jammine, chief economist at the consultancy Econometrix, "We need a tiered education to ensure that learners who are less comfortable with theoretical knowledge can exit our education system with a strong skill set under their belts. It is only through education that we will achieve long-term transformation and growth in our economy."

Reducing Dropout Rates. Quick action can help reduce the dropout rate in the near term, and that, in turn, can significantly improve the employability of youths entering the workforce. Research shows that the three main reasons that 60 percent of men leave school early are lack of money for fees, poor academic performance, and a view that there is little value in continuing. The top three reasons for women, accounting for 62 percent of female dropouts, are lack of funds, family commitments, and poor academic performance. Better instruction on the link between education and employment, highlighting particularly the importance of math, science, and reading for most career options, can help. South Africa should also provide financial incentives, such as conditional grants to low-income families based on attendance, to help keep kids in school. (See the chapter on welfare and well-being.)

South Africa needs to start today. Leadership cannot allow various stakeholders to continue find reasons why change can't happen. This jeopardizes the future of an entire generation.

HEALTH CARE

ADVANCING PREVENTION, ACCELERATING CURES

Life expectancy in South Africa lags that in other countries. Despite marked improvement since 2005, South Africa is only moderately ahead of its sub-Saharan peers and trails its global peers by a wide margin on this critical health measure. The infant mortality rate in South Africa is the lowest among the sub-Saharan African peers but still far higher than that of peer countries in other parts of the world.

HIV/AIDS: Still the Main Cause of Death for Adults

In the adult population, HIV/AIDS and its immune-system effects, which open the door to other killers such as tuberculosis (TB), influenza, and pneumonia, remain the leading cause of death. About one-third of all deaths can be tied directly to these causes.

Overall, the country is on the right track in addressing the HIV epidemic. South Africa has reduced HIV incidence since 1999 by more than 50 percent, and overall prevalence remains stable. Better education and prevention as well as the availability of improved antiretroviral treatments have increased overall life expectancy by four years since 2007. (See Exhibit 5.) “The South African government has made tremendous progress in slowing down HIV infection rates and, in some cases, reversing infection trends,” says Stavros Nicolaou, senior executive, strategic trade at Aspen, South Africa’s largest generic-drug manufacturer.

South Africa’s progressive approach to HIV and TB treatment has often exceeded World Health Organization recommendations. For example, South Africa has implemented the WHO-endorsed Xpert MTB/RIF testing method for TB. It is also the only country to conduct a trial, called HVTN 100, to assess a new HIV vaccine in 2015. It began a trial on the use of microbicides to prevent transmission of HIV in 2011 and another trial to treat patients with multi-drug-resistant TB in 2014. The government has spent significantly—and successfully—on preventive measures—particularly, encouraging condom use through education and availability at no charge.

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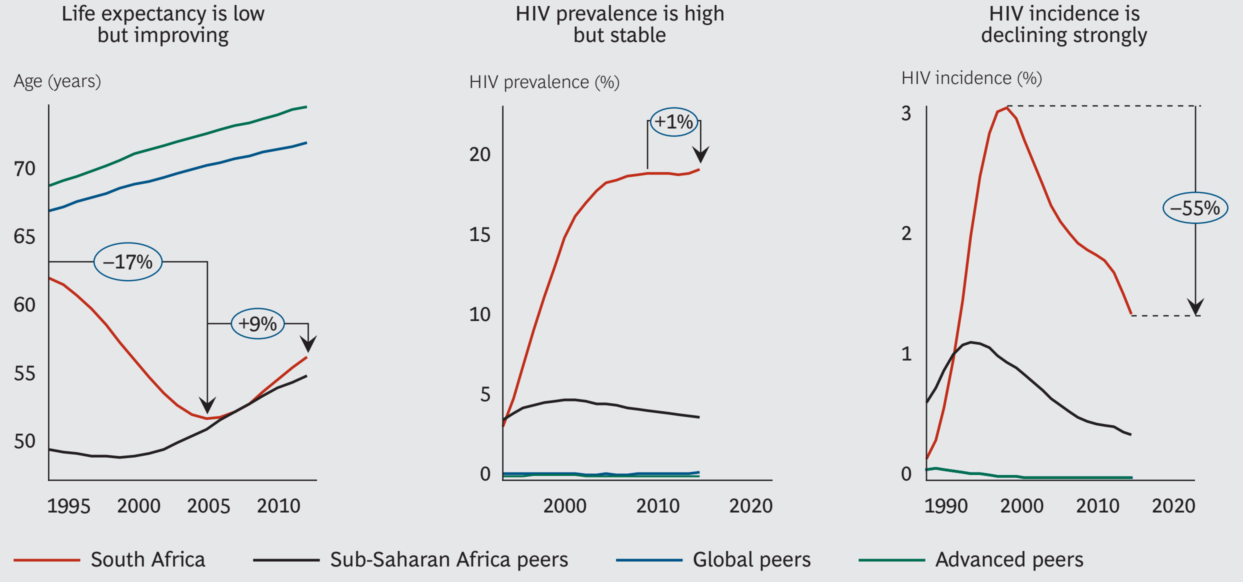
Still, the war against HIV/AIDS is far from over. A key issue is the lack of integration of primary health-care facilities into rural communities, a shortcoming that leads to low rates of diagnosis and treatment and undermines South Africa’s integrated prevention, testing, and treatment approach to reducing

Exhibit 5 | Progress in Addressing HIV/AIDS Is Evident in Better Life Expectancy and Disease Prevalence and Incidence



Sources: World Bank ; Millennium Development Goals Indicators.

HIV and TB incidence and coinfection. Community health workers should be used to address the gap by providing targeted health services and education in rural areas. Also, South Africa can focus more on reducing HIV incidence among high-risk groups, such as teenage girls. Additionally, South Africa should also accelerate its adoption of new treatments; the Medicines Control Council's accreditation process can be improved to increase the speed of new-treatment adoption. The country can also expand coverage of TB prevention for people already infected with HIV and distribution of antiretroviral drugs for those infected with HIV.

Reducing Child Mortality

The main causes of death among South African children younger than five are related to poor hygiene and infectious diseases; one-third of deaths in this age-group are attributed to these root causes. Vaccinations are available to counter the impact of poor hygiene and infectious diseases, but South Africa has low immunization rates. For example, the immunization rates for measles and diphtheria are the lowest among all of the country's peers. Low immunization rates do not currently lead to many deaths but do make South Africa susceptible to a major epidemic. Vaccinations are free in South Africa, so awareness and education are the principal issues that need to be addressed to reduce infection-related child mortality.

South Africa needs to focus on child mortality in the same way that it has attacked HIV/AIDS. Although substantial progress has been made in providing potable water nationwide (access to potable water increased from 60 percent in 1994 to 96 percent in 2012), lack of clean water and proper nutrition are still major problems in some areas and could worsen as a consequence of deteriorating water infrastructure.

Improving maternal care is another priority. Both the number of health care workers able to deliver maternal care and the level of their training can be increased. Ethiopia, where 83 percent of the population lives in rural areas, provides a useful model. That country has developed a program to train young women as health extension workers (HEWs) and provide a host of basic health-care services, including education and health promotion, testing and screening, and select clinical interventions. HEWs help reach almost 90 percent of communities throughout the country. "Even with good health-care infrastructure, many pregnant women do not receive antenatal checkups," says former deputy president (and current United Nations undersecretary general) Phumzile Mlambo-Ngcuka. "More public education is required to encourage women to use medical facilities."

In South Africa, community health workers are being used to provide various key health services, including maternal care. Teams are active across all 52 of the country's administrative districts. However, there is neither a standardized approach to training these workers nor a common mandate based on the health care priorities of the country. Collection of clinical health data by health workers is also lacking. These issues limit the effectiveness of the health workers. A recent pilot launched by the Institute for Healthcare Improvement and the University of KwaZulu-Natal used a systematic and data-driven approach to identify gaps in local health care and then provide targeted training to community health workers. Community members treated by these workers were found to be more knowledgeable about their ailments and more confident in the treatment they received relative to those treated by standard community health workers.

South Africa also needs to expand immunization and vaccination coverage. Community health workers should be trained to communicate the importance of vaccinations for infants and children and to administer vaccines in remote areas.

UNEMPLOYMENT

THE TOUGH JOB AHEAD

Unemployment is a structural, long-term problem in South Africa. At 25 percent, the country's unemployment rate is significantly higher than that of its peers (a range of 7 to 13 percent), and there has been no material improvement in South Africa in recent years, while the nation's peers have shown improvement.

The Unemployment Landscape

Several factors shape South Africa's unemployment landscape, starting with education. The causal relationship between South Africa's education situation and the inability of individuals to attain employment cannot be overstated. Jobs go unfilled because there are not enough educated or skilled workers to meet demand. It's a problem rooted in the lack of education and skills rather than worker availability. The unemployment rate is only 2 to 5 percent for those with university degrees. Companies consistently say that finding workers with the right skills is the single biggest constraint to growth.

Constraints on small businesses are a second problem. Although small, medium, and micro enterprises (SMMEs) provide more than half of all jobs, their potential for growth and job creation is constricted. SMME owners and executives pointing to factors that hold back the growth of their businesses frequently cite such factors as poor access to credit, bureaucratic red tape, and policies that discourage entrepreneurship.

The rigidity of the labor market also constrains employment growth. South Africa's labor-market efficiency (a combination of market flexibility and efficient use of talent) ranks 113th out of 144 countries, according to the World Economic Forum—a decline from 76th in 2006. South Africa has the lowest score among all its peers for relations between labor and employers. Rigid rules that limit employer flexibility with respect to hiring, firing, and wages are exacerbated by low labor productivity and frequent unrest.

A large number of people are employed in community and social services as well as other government jobs—and that is not an economic strength. The government has been the country's largest employer since 2012, and government employment has grown at an annual rate of 7 percent since 2000 while employment across all other sectors has grown at 3 percent annually. The base and midcase scenarios presented in the NDP imply continued high public-services employment through expanded public-works programs—and commensurate strain on the public purse.

Far better, in our judgment, is to pursue the path articulated by Iraj Abedian, CEO at the equity firm Pan-African Investment & Research Services: "The public sector is being used as a source of empowerment by employing a limited number of previously disadvantaged South Africans, while actually it should be used as a source of empowerment by delivering excellent basic services as well as good-quality education and health care to all South Africans."

Callout style: heniam dolo re euis magnibh elesed exer senim ent iuscing euiscidunt.

All of these factors combine to make South Africa a very expensive place to do business (often prohibitively so) and therefore less attractive to investors in labor-intensive industries—which are exactly the kind of businesses South Africa needs to attract to maximize employment. As independent development expert Ann Bernstein says, "South Africa needs to focus on growing low-skill, labor-intensive jobs. This will take a fundamental rethinking of government's approach. Reforms to labor market regulation, competition policy, and other areas are needed."

NDP Mostly on Target

The NDP sets high ambitions for improving the employment picture, with goals of reducing the unemployment rate to 14 percent in 2020 and 6 percent in 2030. It also sets a goal of increasing workforce participation from 54 percent in 2010 to 65 percent in 2030. To achieve these objectives, the economy needs to add some 9 million jobs (to the current base of 15 million) by 2030.

The government is focusing on the right areas. The NDP cites four priorities: transforming the economy (including creating an environment in which SMMEs can thrive); stimulating SMME growth by addressing the regulatory environment and skills gap, among other measures; reforming the labor market; and providing postschool skill development for workers.

Reforming the labor market is a particularly important priority, and the NDP sets out several useful initiatives. One is to revisit the dismissal process, which currently ties employers' hands, with the goal of making employee dismissals much simpler and thus reducing a big impediment to hiring.

The NDP also proposes proper enforcement of probation periods, which allow employers to evaluate new hires for up to six months and to dismiss them during this period without unfair-dismissal protections coming into play. Proper enforcement would further incentivize hiring.

In another positive step, the government has attempted to address South Africa's skills gap through the dedicated Skills Education and Training Authorities (SETA), which consists of 21 agencies, each with the primary objective of developing the skills needed to fill jobs in its economic sector (such as agriculture, banking, and information and communications technology). To date, the SETA agencies have struggled with poor corporate governance and have lacked the strategic focus necessary to build demand-led skill development. It does not help that, in the words of Moeletsi Mbeki, deputy chairman of the South African Institute of International Affairs, "South Africans have a very poor attitude to artisan and skill-based work, as a result of the stigma attached to it through the Bantu Education system during the apartheid regime." This mindset needs to change.

SETA also needs to provide employers and employees with greater incentives to engage with the labor market. The SETA agencies should focus on promoting training for high-demand skills while incentivizing (or even requiring) large companies to take on interns and apprentices. The NDP suggests relaxing immigration requirements in fields in which homegrown skills are scarce, such as health care, education, and financial services, which would be a positive step for businesses, giving them better access to people with scarce skills and facilitating growth.

The experience of other countries shows that the kinds of efforts outlined in the NDP can bear substantial fruit. Brazil has cut unemployment to record lows, creating some 5 million jobs from 2011 through 2013. Chile added 817,000 jobs (good progress toward a goal of 1 million) from 2010 through 2014. Turkey increased employment by 4.3 million jobs from 2008 through 2013. Saudi Arabia has embarked on a major program to tackle its significant youth-unemployment problem; key measures include incentivizing businesses to employ young workers, supporting on-the-job and vocational training, coaching current employees to help train new staff, improving workplace standards, and providing career counseling and guidance.

With the initiatives outlined in the NDP, South Africa is on the right employment track and, if anything, needs to intensify its efforts. Execution is key, and ultimately the scale of success will also depend on stimulating growth.

WELFARE AND WELL-BEING

THE BEST OF "FRENEMIES"

Despite strong improvements in standards of living, South Africa continues to suffer from severe income inequality. The percentage of people living in the three poorest groups (designated by living-standard measure, or LSM) has dropped from 42 percent in 1994 to 11 percent in 2013, but South Africa still ranks 148th out of 149 countries on the World Bank's income-equality scale, ahead of only Haiti.

Bad—and Not Getting Better

The black middle class grew from 1.7 million in 2004 to 4.2 million in 2012, but 31 million South Africans—almost 60 percent of the population—still live in the marginalized class, which has annual incomes of less than R7,428 ($617). A typical consumer in this class has an income of about R619 a month and basic expenses—food, rent, utilities, and transportation—of R1,102, a shortfall of R483. Debt is a recourse for many, and going without is the only "choice" for many more. The number of people on social grants disbursed through the government's welfare system has increased from 2.7 million in 1994 to more than 17 million (some 30 percent of the population) in 2014.

The situation is not expected to improve substantially going forward, at least not in the near future. The number of marginalized South Africans is projected to decrease only modestly, to 28 million (about 50 percent of the population) by 2024, according to analytics company Canback & Company.

Welfare: A Flawed but Necessary Tool

More than 17 million South Africans are supported by welfare, which takes up almost a third of all money paid in income tax. Welfare is an enormous transferor of wealth—the 80,000 highest tax contributors contribute about R90 billion in income tax annually and the 17 million poorest people receive about R120 billion in welfare payments —a flawed situation that healthier economies avoid.

This is a necessary evil for South Africa, at least in the near term. Discontinuing welfare, or substantially reducing the amount paid out, would cause another 3.3 million or more households to fall into poverty. As Azar Jammine puts it, "Without the current level of welfare and support to the poorest, people would have starved to death. We have and will in the near future need welfare in this country to avoid people falling into extreme poverty."

The longer-term risk, however, is that welfare will create long-term dependencies that recipients will have a hard time shaking. A key long-term goal for South Africa must be to vastly reduce the role that welfare plays in the economy and in supporting people's lives. The means of doing so, of course, is to strengthen the economy overall, particularly through the recommendations presented earlier in this report, in the chapters on education and employment. In the near term, South Africa can take steps to make the welfare system more efficient and to use it to support long-term goals. Most significantly, welfare payments should be made conditional and tied to broader social and economic goals, such as incentivizing education, skill acquisition, and regular health checkups and testing. "We need to ensure that the welfare is channelled into building capacity in the next generation of people so that they can contribute to the economy in the future and thereby become independent of the welfare system," says Iraj Abedian.

Several countries, particularly in Latin America, have used welfare reduction programs to positive effect. A program tying conditional cash transfers to school attendance and health checkups in Honduras resulted in a 1 to 2 percent increase in school enrollment and a 2 to 3 percent reduction in the dropout rate. In Ecuador, a voucher program intended to improve education and health outcomes has helped to reduce the proportion of the population living in poverty from 37 percent in 2007 to 26 percent in 2013.

South Africa needs to shift the strategic focus of its welfare system. What is now a means of combating poverty must also become a tool that can help to remove recipients from the welfare rolls over time.

FUTURE PROSPERITY DEPENDS ON LEADERSHIP NOW

What will South Africa look like in 20 years' time? Will the potential to translate the country's enormous wealth and potential into pervasive well-being have been realized? Will success be evidenced by a widespread middle class, a healthier population, and a growing economy, with good jobs for a skilled workforce? Or will the anchors of poor education, disease, unemployment, and inequality still weigh heavily on the nation?

Leveraging Strengths to Improve Well-Being

There is ample reason for hope. South Africa has significant strengths. These include a good transportation infrastructure (roads, airports, seaports, rail), highly developed financial markets, a sound banking system, strong capital market regulation, and generally good (if sometimes difficult for small businesses) access to financing for businesses. South Africa is a large domestic market, with strong local suppliers of basic goods and services, and the business environment is competitive. The country's geographic proximity to high-growth African markets is a plus. Many South African companies have taken advantage of the location by building significant businesses on the continent from a South African base.

South Africa's enormous mineral resources earn foreign currency and attract investment for growth. The country's outstanding natural beauty draws almost 10 million tourists a year as South Africa claims an increasing share of the global tourism market. South Africa has access to relatively affordable and stable electricity, assuming the current shortages are addressed.

The digital economy can play a big role in South Africa's future. Smartphone penetration has grown rapidly, from 16 percent in 2011 to 47 percent in 2014. Our research shows that the size of the digital economy is already on par with that of the electricity, gas and water, and agriculture, forestry, and fisheries sectors. The digital economy will contribute $14 billion, or 2.5 percent, to national GDP in 2016 (double its contribution in 2010). Fast-rising Internet penetration and use can have a further substantial impact in such areas as health care, education, and provision of government services.

South Africa ranks 36th out of 144 countries for strong institutions, with a particularly strong legal system and judiciary framework, according to the World Economic Forum. Growing corruption, if left unchecked, is a threat—South Africa's ethics and corruption rank worsened from forty-second out of 144 countries in 2006 to seventy-third in 2014. In addition, the burden of government regulation weighs heavily on corporate entities and is making South Africa less attractive for investment. On this measure, South Africa has lost substantial ground, falling from 59th to 120th out of 144 countries since 2006 in the Forum's rankings. Still, at number 56 worldwide in competitiveness, South Africa ranks in the top 40 percent of countries.

Who Will Lead?

The solutions to the problems we have detailed in this report are straightforward and proven. They have been shown to work time and again in countries around the world. South Africa should not permit itself to be left behind.

But—and this is a big but—a concerted program of execution is essential. In many instances this will mean putting the greater good ahead of individual or institutional interests. Those engaged in "public service" need to put the public first without exception. Business and labor leaders have their own constituencies to answer to, but they should also remember that a rising economic tide lifts all boats.

South Africa's NDP provides a roadmap to follow, even if everyone does not agree with every detail. There are also plenty of solutions to particular problems being developed by companies, government agencies, not-for-profits, and even individual South Africans—sometimes because they aren't willing to wait for the government to act. The solutions that are working need to be identified and rolled out more widely—without regard for where or how they were initiated.

Leadership must come from both the public and private sectors—and from all levels of society. Political leadership is essential, of course, at the national, regional, and local levels. In the words of former deputy president Phumzile Mlambo-Ngcuka, "Leaders must be impeccable role models. Only then can they be credible in asking South Africans to sacrifice for the greater good."

But leadership needs to extend beyond the government. Leaders in business and labor must look to the future and work together toward common goals. Parents can lead by getting involved in the education of their children; teachers, by committing to do their jobs better; communities, by conferring the respect that these professionals deserve. Everyday citizens can demonstrate their commitment by taking care of their health and taking advantage of the resources that are, and will become, available to help them acquire skills and jobs.

Hope for a better future has carried South Africa a great distance. Hope can continue to shoulder this burden, but hope is fueled by progress, and the rate of progress needs to pick up. During the transition from apartheid to a full multiracial democracy, South Africa demonstrated that it has the capacity for the kind of extraordinary leadership that inspires the world. It is time to reach deep into that reservoir again.

APPENDIX

Comparing South Africa with groups of peers helps identify the SEDA dimensions that need improvement. We examined three distinct peer sets for South Africa: sub-Saharan challengers, global peers, and advanced peers.

Sub-Saharan Challengers

These are emerging economies from the same region. They share several characteristics: GDP per capita of less more than $2,000, population of more than 2 million, and democratic governments. These countries are Angola, Botswana, Cameroon, Côte d'Ivoire, Ghana, Kenya, Namibia, Nigeria, Senegal, and Zambia. They have an average population of 34 million, an average GDP per capita of $5,413, and an average real GDP of $38 billion.

Global Peers

Global peers are at a level of development similar to that of South Africa. They have a GDP per capita that ranges from 75 percent to 125 percent of South Africa's. Their populations range from 15 million to 250 million. (South Africa's population is 53 million.) These countries are Algeria, Colombia, Ecuador, Egypt, Indonesia, Peru, Sri Lanka, and Thailand. They have an average population of 69 million, an average GDP per capita of $11,217, and an average real GDP of $172 billion.

Advanced Peers

These are global economies that have up to 200 percent of South Africa's GDP per capita and that have exhibited consistent growth over two decades. Their GDP per capita ranges from 125 percent to 200 percent of South Africa's. Their GDP per capita growth rates have exceeded 60 percent over 20 years. The population of these countries ranges from 15 million to 250 million. They all have a high SEDA wealth-to-well-being coefficient. These countries are Chile, Brazil, Malaysia, Poland, Romania, and Turkey. (Technically, the GDP per capita places Brazil among the global peers by a narrow margin, but we have included Brazil as an advanced peer because of its very high GDP growth rate.)

FOR FURTHER READING

BCG has published widely on issues of interest to companies doing business in Africa. Some recent publications include those listed here.

What Every Leader Needs to Know About Converting Wealth into Well-Being: Sustainable Economic Development Assessment 2015
A report by The Boston Consulting Group, May 2015

Africa Blazes a Trail in Mobile Money: Time for Banks and Mobile Operators to Devise Strategies
A report by The Boston Consulting Group, February 2015

Understanding Consumers in the "Many Africas"
A Focus by The Boston Consulting Group, March 2014

Winning in Africa: From Trading Posts to Ecosystems
A report by The Boston Consulting Group, January 2014

Strategic Infrastructure in Africa: A Business Approach to Project Acceleration
A report by the World Economic Forum in collaboration with The Boston Consulting Group, May 2013

Ten Things to Know About African Consumers: Capturing the Emerging Consumer Class
An article by The Boston Consulting Group, January 2013

The New Prosperity: Strategies for Improving Well-Being in Sub-Saharan Africa
A Focus by The Boston Consulting Group, May 2013

Whither the Internet in Africa?
An article by The Boston Consulting Group, November 2012

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