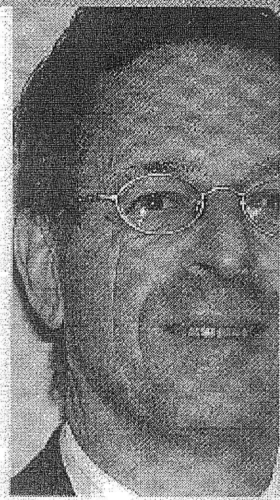
Marise Taljaard /Hsrc
03/25/2008 10:12 AM

To All HSRC Offices
cc
bcc
Subject Financial Mail, 20-03-2008: Out of service

ON MY MIND

MICHAEL KA



Out of service

What sector contributes the largest share to SA's GDP? It is not mining or manufacturing but — at 69% — services. Services also dominate the GDP of the industrialised countries of the OECD and account for much of employment growth.

They are both important and underestimated.

There are two salient differences between SA and the average OECD country. One is that from productivity and growth perspectives, the World Economic Forum classes most OECD countries as "innovation-driven", while it assesses the SA economy as "efficiency-driven". Many countries of the South are in a third category: "resource-driven".

The second difference is that our income and distribution inequalities set us in a class of our own, evidenced by our high Gini coefficient or, more graphically, as two economies in one country.

The department of science & technology's (DST) 10-year plan, "innovation toward a knowledge-based economy", says innovation is the key to economic growth. It identifies five challenges through which innovation will be driven: space science, energy, climate change, the "farmer to pharma" value chain, and human and social dynamics.

Given the economic dominance of services, what will the role of innovation in services be?

Service industries provide intangibles such as transport systems, retailing, ICT and health care. They are the part of the economy beyond agriculture, mining and manufacturing. They include financial intermediation as well as all the ancillary scientific, consulting and testing companies that depend on the mining industry. Innovation involves the implementation of a new or improved product, marketing method, organisational form or service.

A key finding of the HSRC's innovation survey 2005 is that services firms are not technological laggards — 50% of them declare innovative activity compared with 55% of manufacturing firms. Services enterprises

hand services firms interact less with science councils and universities for innovation.

Research and development (R&D) is an important input for innovation. SA services firms account for 27% of all business expenditure on R&D compared with 41% in Australia and 21% for Hungary and Italy. We are not out of line here. The bulk of R&D in the services sector is in system and software development, followed by mathematics and statistics, customer behaviour and organisational psychology, to name a few. Econometric modelling is an important field of such inquiry. Much of this R&D falls within the domain of the social sciences and humanities.

Being innovative and willing to invest in R&D are characteristics of our leading firms in retail, banking, logistics and insurance, and the levels of R&D expenditure in relation to company revenue are in line with international averages. This investment in knowledge goes some way toward explaining how it is that these firms compete globally and engage in mergers and acquisitions.

The DST's plan does not really address the importance of the services sector, as a sector. There is a gap that warrants further thought.

An important policy instrument is the new incentive that allows companies to deduct 150% of R&D expenditure in their tax returns. But R&D in the social sciences and humanities is excluded from the regulations on deductibility. And it is an area where the services sector spends much of its R&D.

This suggests that some fine-tuning may be necessary to include the services sector. Services have the potential to grow further; they should be enabled, not short-changed. Firms could do it themselves by rebranding cus-

R&D in the social scienc should not b excluded fro the current regulations that allow companies tc tax-deduct 150% of R&D expenditure give more attention to organisational and marketing innovations than is the case for manufacturing industry; but on the other

tomer modelling as mathematical modelling, which is deductible. Perish the thought. ■

Kahn is an executive director of the HSRC

Marise Taljaard

Corporate Communications
Human Sciences Research Council
Private Bag X41
Pretoria
0001

Tel: 27 12 302 2026
Fax: 27 12 302 2027