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Growth, employment and· economic policy in South Africa: a critical review

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International experience shows that labour-demanding growth is best pursued through stable, growth oriented macroeconomic policies, a trade regime that encourages exports, and a competitive labour market. Macroeconomic and labour market policies must be consistent with each other, especially during periods of adjustment.

Are South Africa's policies in line with these lessons?

The paper starts with an overview of South Africa's job crisis. It then moves on to consider whether the country's economic policies are conducive to labour-demanding growth. In so doing, it examines trade policies, labour market policies and macroeconomic strategies, considering their consistency, and whether they are conducive to sustainable job creation. Part 2 shows that increased exposure to international competition is undermining the labourintensive manufacturing sector. Part 3 looks critically at wage-setting institutions. The final section discusses tensions and areas of conflict between the government's macroeconomic strategy and its labour market policies.

The author addresses the international experience in a companion paper, *Labour-demanding growth: Lessons from international experience?* which is also available from CDE.

Part 1: Unemployment and employment

As economic growth fell from around 6% in the 1960s to less than 1 % in the 1980s and early 1990s, the capacity of the South African economy to create jobs decreased dramatically. During the 1960s, most new entrants into the labour force obtained formal employment, but by the late 1980s this had dropped to 15% and between 1990 and 1995 formal employment actually declined.

South Africa's job crisis stems ultimately from comparatively weak long-term growth and rising capital intensity. Almost two million jobs have been lost over the past two decades as a result of investment being channelled increasingly into capital-intensive sectors and technologies. South African manufacturing is now far more capital-intensive than in middleincome countries like Brazil, Mexico, Korea and Malaysia. Labour-intensive sectors have declined relative to more capital-intensive sectors, and there has been an economy-wide trend away from labour-intensive techniques. Unemployment is now a major determinant of poverty and inequality.

In contrast to most other middle-income economies in Latin America and South East Asia, almost all household income in South Africa now comes from participation in the labour market, mainly through wages, but also through remittances. Oldage pensions are the only other important source of income. This dependence on wage income points to the pressing need for job creation in South Africa. Employment in manufacturing and services has to be at the heart of any sustainable and significant antipoverty programme.

Official statistics for unemployment, as well as the contention that employment is contracting, have been disputed. The paper reviews this debate, and concludes that there are strong reasons for believing that the official statistics are broadly in line with reality. South African unemployment rates are indeed very high. There is little credible evidence of substantial hidden employment (in the informal sector or subsistence agriculture), nor that non-regular employment is widespread and under-recorded. There is no reason to believe that under-enumeration of employment is resulting in a significant over-estimation of unemployment. Recent work by Klasen and Woolard suggests a broad unemployment rate of 31,3% in 1994, and 28,3% in 1995, representing only

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minor adjustments to the October Household Survey (OHS) estimates.

The fall in unemployment between the 1994 and 1995 OHS was mainly due to a decline in labour force participation rates across all population groups, and for both men and women - probably because of people withdrawing from the labour force in the face of depressed economic conditions. Should they re-enter·the·labour· force when ·economic growth picks up, unemployment rates are likely to remain high even if employment grows.

In so far as 'flexibility' is making its presence felt in South Africa, it appears to be of the harsh, job-shedding, cost-reducing variety, rather than as part of a broader strategy entailing multi-skilling and the use of co-operative and incentive-based systems. Although the use of contract labour is the most common form of non-regular employment, there is little evidence to suggest that in the manufacturing sector this practice is widespread or growing significantly.

Part 2: South Africa's trade policy and employment

South Africa adopted an explicit policy of protectionism as far back as 1925, thus becoming one of the first developing countries to introduce an inward-looking industrial policy. Apart from the way in which this protectionism was linked to supporting white labour, South Africa's trade policy mirrored the Latin American path in other respects - though growing international isolation from the] 960s onwards exacerbated South Africa's inward orientation. However, in the 1970s and 1980s the government introduced export incentives in an attempt to neutralise the anti-export bias. These were rationalised into the General Export Incentive Scheme (GElS) in 1993.

Like Latin American countries, South Africa has been engaged in substantial trade liberalisation since the early 1980s, with a steady lowering of tariffs and a tarriffication of other quantitative controls. The process was given a new impetus in 1995, which saw the beginning of the implementation of comprehensive tariff cuts and the phasing out of GElS as agreed in the Uruguay Round of GATT negotiations. GElS was replaced in 1996 by the package of supply-side measures contained in the new democratic government's Growth, Employment and Redistribution macroeconomic framework (GEAR).

International evidence suggests that producing for the export market is good for output and productivity growth, and that the trade regime should therefore not be biased against export production. Liberalisation of the trade regime must however be co-ordinated with other reforms. The challenge is not only to remove an anti-export bias, but also to manage structural adjustment and co-ordinate this with other policies, including labour market policy.

There are some grounds for concern that there is still an anti-export bias in South Africa, since nominal.exchange rate depreciation raises. the price of both exportables and importables relative to non-tradeables. This suggests that a greater tariff reduction is needed. However, some analysts argue that by reducing tariffs more quickly than required under the WTO agreement, the government is contributing to a contraction in employment. In other words, there is a conflict between removing the anti-export bias through tariff cuts, and protecting jobs - especially in labour-intensive sectors.

To the extent that trade liberalisation results in structural adjustment, short-term job losses are inevitable. Ideally, liberalisation should facilitate rapid structural adjustment so that those workers who lose jobs obtain new ones in rapidly expanding industries. The Minister of Trade and Industry pins his hopes on this process when he assures the public that his trade strategy will create more jobs than it destroys. But there is little evidence for rapid and significant short- or medium-term job creation as a result of trade Iiberalisation. On the contrary, the Industrial Development Corporation's multi-sectoral general equilibrium model predicts that by 2002 trade Iiberalisation will have resulted in a net loss (of 1,7%) in manufacturing employment and a fall in output.

South African manufacturing wages are high in relation to productivity. This is evident from a sample of 18 countries for which comparative data exist for 1993, even when allowance is made for the fact that statistics for international comparisons are uneven and fraught with measurement errors. South Africa ranked seventh highest in terms of wages and tenth in terms of productivity. South. Africa's ratio of wages to productivity was 35% higher than that of the USA. Only Japan had a less competitive ratio (largely because the Yen was over-valued at the time). All developing countries in the sample had lower wage : productivity ratios than South Africa.

In the period since South Africa embarked on trade Iiberalisation, it has become apparent that exports are becoming relatively less labour-intensive, and more capital-intensive. At the same time, imports are rising across the spectrum, but especially in highly labour-intensive sectors.

Labour-intensive imports from low-wage countries are growing sharply, whereas South African

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exports in these categories are contracting. Increased labour-intensive import penetration from low-wage countries is likely to put further pressure on South Africa's labour-intensive industries. It appears that South Africa can't compete in these sectors, and is moving instead to more intermediate skill-intensive product lines. Technological changes in manufacturing associated with defensive innovation are also leading to an increased demand for skilled labour.

This does not bode well for the chances of expanding low-wage employment for the very large number of people who are currently unskilled, and unemployed.

Part 3: Wage-setting institutions in South Africa

Are South Africa's wage-setting institutions promoting employment growth?

The three main labour market institutions in South Africa are the National Economic Development and Labour Council (NED LAC), bargaining councils, and the Wage Board (soon to be replaced by the Employment Conditions Commission).

Although there has been some speculation about NEDLAC's becoming involved in influencing wages (by way of a social accord or incomes policy), it is questionable whether organised labour and business are really in a position to start negotiating ambitious accords at national level. There is little evidence that organised labour is interested in wage restraint. It is also a moot point whether either of the 'social partners' - COSATU and business - is sufficiently strongly and comprehensively organised to articulate a coherent position and deliver its members' support. The existence of industrial-level wage bargaining further constrains the range of feasible agreements that could be negotiated in NEDLAC.

Internationally, successful wage co-ordination is associated with lower unemployment; but unless labour and business have the incentive to negotiate at national level - and the capacity to impose agreements on their members at industry level - the chances of successful wage co-ordination are slim.

Collective bargaining at industrial level in South Africa takes place in bargaining councils (which used to be called industrial councils). For a bargaining council (BC) to be recognised, the relevant trade unions must show that they represent, and employers associations must show that their members employ, over 50% of workers in the industry concerned. All firms that fall under the scope of the BC must register with it and are covered by its provisions. Recent survey work indicates that BCs covered some 65% of manufacturing workers in 1996. Coverage was expected to rise further as a result of the new Labour Relations Act (LRA).

The South African bargaining system has been described as involving a growing 'compulsory centralisation'. Under the previous LRA, parties to a BCcould *request* the Minister to declare the terms oftheir agreement binding on non~party firms. In terms of the new LRA, the Minister of Labour is now *obliged* to extend agreements.

According to the most recent available data from the Department of Labour, there are 76 BCs. Four of these are concerned with local government. Of the 71 private sector BCs, only two do not extend their agreements to non-parties - and that is because they regulate single-firm industries. By extending collective agreements to non-parties, the BCs effectively set minimum wages for workers in the industry. Even where the parties are not representative, the Minister may choose to extend agreements to non-parties if he believes that the practice of industry-level bargaining would be threatened by not doing so. Firms can apply for exemptions; but in 1994/5 only 8% of firms covered by BC agreements were operating under full or partial exemptions. The exemption process itself appears to be very arbitrary.

Larger, more profitable firms have a strong incentive to participate in the BC system. A centrally negotiated wage is likely to be lower than profitable firms might have to pay under decentralised bargaining. Smaller, less profitable firms fmd themselves having to pay higher than optimal wages as a result of the extension mechanism. By forcing up wages in such firms, larger firms can eliminate 'unfair competition'.

Faced with higher minimum wages, non-party firms can reduce employment; externalise the labour function (for example, through increased use of subcontracting); or raise labour productivity to justify the higher wage. Alternatively they can apply for exemption; ignore the minimum wage; or go out of business. The effects of extending minimum wages on non-party firms have not been studied systematically - but it is disturbing that if the system were to be enforced with any vigour it could destroy jobs in small labour-intensive firms. It is extremely inappropriate for an economy with high unemployment like South Africa to operate within an industrial relations system predicated on eliminating low-wage competition.

Minimum wages are also enforced in trades and industries not covered by bargaining councils. This has been the function of the Wage Board. Historically, the Wage Board operated with a

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IDcome countries like Brazil, Mexico, Korea and Malaysia.

measure of autonomy; and the Minister could not tamper with its recommendations, but only accept or reject them. By contrast, the new Employment Conditions Commission will no longer conduct independent investigations, but instead only comment on investigations conducted by officials in the Department of Labour.

While there are good reasons for decentralising minimum wage setting, the-opposite is taking place as power becomes centralised in the Ministry of Labour, with mandatory extensions of collective agreements to non-parties, as well as greater geographic coverage.

International evidence suggests that labour policies and institutions that protect the wages of lowpaid workers are likely to lead to job losses as international competition increases. It is cause for concern that the Ministry of Labour is injecting greater rigidity into minimum wage determination at a time when South Africa's trade barriers are coming down rapidly.

Given the extent of unskilled unemployment, opting for a 'high road', 'up-the value-chain' strategy premised on the destruction of low-productivity employment seems highly undesirable from both employment and equity perspectives. Furthermore, since between 40% and 60% of the workforce is functionally illiterate, increasing the demand for skilled labour may itself be unsustainable.

The indications are that South African policy has not got the balance right between productivity enhancement and job creation.

Part 4: Conflicts between South Africa's macroeconomic strategy and labour market policies

According to GEAR, South Africa is pursuing a set of 'integrated', 'coherent' and 'technically sound' policies which add up to a consistent and investor-friendly framework. Labour-intensive growth is a central tenet of GEAR - as is greater labour market flexibility.

Although it was claimed that GEAR represented the government's integrated growth strategy, in reality it represented the vision of the Department of Finance and a small band of economists. One of the problems in evaluating GEAR is that in some crucial respects it was neither implemented as proposed, nor was it as 'integrated' as its proponents claimed. The most dramatic example concerns labour market policy, where the vision outlined in GEAR is very different to the policies followed by the Department of Labour. This makes it difficult to apportion blame for GEAR's most striking failure- that instead of generating jobs, GEAR has presided over significant job losses.

In projecting strong employment growth, GEAR not only assumes strong output growth but also rising labour intensity. GEAR assumes that the labour policies it identifies (coupled with government support for labour-intensive job creation) will help to ensure that more jobs are created for every unit of output. The GEAR modellersuassume that labour-intensive sectors will grow faster than other sectors, and/or that labour-intensive technologies will become generally more important than capitalintensive technologies.

The policies that GEAR identifies as supportive of greater labour-intensity include supply-side measures (such as tax holidays for targeted projects) and labour market reforms. Although the section on labour market policy is thin, there are clear policy recommendations. Chief among these are:

- greater Ministerial discretion in extending collective agreements to non-parties
- the promotion of 'regulated flexibility' - that is, greater wage variation within the existing wage determination system.

According to GEAR, wage agreements must be sensitive to regional labour market conditions; the diversity of skills levels in firms of varying size, location or capital intensity; and the need to foster training opportunities for new entrants to the labour market.

Removing mandatory extensions, and narrowing the geographical scope of bargaining councils and Wage Board determinations would be consistent with this strategy. However, the Ministry of Labour is moving in the opposite direction. Clearly, two different approaches to labour market regulation and job creation are at work.

There is a fundamental inconsistency between the policies pursued by the Ministry of Labour and the vision embedded in GEAR.

GEAR's vision is in line with international evidence that trade liberalisation and other economic reforms should be accompanied by greater labour market flexibility. It is premised on the relative expansion of labour-intensive production. The beneficiaries of this strategy would be the currently unemployed who would gain employment as the number of unskilled jobs rise.

The economic strategy implicit in the Ministry of Labour's policies is based on productivity-enhancement. A rise in average labour-productivity can occur in two ways: proactively, through measures to improve skills and encourage greater cooperation (for example, through work-place forums); and destructively, through forcing lowwage, low-productivity firms and sectors out of

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business. The beneficiaries of this strategy would be predominantly skilled workers who manage to keep their jobs in expanding, relatively capitalintensive industries, or else have skills that are sufficiently in demand for them to keep their jobs in contracting industries or fmd new jobs. Inequality will rise, because relatively few unskilled people will benefit, at least in the short term.

Productivity growth is obviously desirable - but to the extent that it is premised on the destruction of relatively low-productivity jobs, it conflicts with the goal of providing employment for relatively unskilled and unemployed people.

As unemployment is a major cause of poverty and inequality, job creation ought to be a central concern, for both equity and growth:

- in advanced capitalist countries low-wage job creation and equality move in opposite directions; but in South Africa low-wage job creation is likely to enhance equity; and
- given the extent of unemployment and limited fiscal resources for income-support to the unemployed, South Africa cannot opt for unemployment coupled with high levels of social security, and must ensure an expansion of incomeearning opportunities as rapidly as possible. The challenge facing South Africa is to boost

economic growth, and to increase productivity at the level of the firm through policies which promote skills development, co-operation and flexibility within the enterprise - without harming the capacity of the economy to create relatively low-wage, labour-intensive jobs in the short-term.

This requires more appropriate macroeconomic and labour market policies, and better co-ordination in government.

- There must be a greater strategic synergy between fiscal and monetary policy to promote growth
- Trade policy must beware of excessively fast tariff reductions
- Labour market policies must be more flexible
- There must be greater co-ordination between the Ministry of Trade and Industry and the Ministry of Labour.

Removing the mandatory extension of collectively bargained agreements would allow for the expansion of relatively small-scale labour-intensive firms without undermining productivity-enhancing changes in the.larger, unionised firms •.. Itwould not undermine gains made by workers in unionised sectors nor the development of more constructive and co-operative forms of flexibility at the level of the firm. This strategy would rely on competitive pressures together with other productivity-enhancing policies (such as skills development) to encourage productivity growth in the relatively high-wage firms.

Wage Board intervention could be adjusted similarly. Making wage determinations more responsive to local labour market conditions would introduce a greater variation in minimum wages. Ideally, the Wage Board should devolve its functions to regional level where potential trade-offs between wages and jobs can be a local decision involving representatives from all constituencies.

However, rather than moving towards a greater decentralisation of power and responsibility, the government has been centralising power in the hands of the Ministry of Labour. If the Ministry uses its new powers to raise minimum wages significantly, this will exacerbate the current contradictions within the government's growth framework.

There are good reasons for decentralising minimum wage setting, but the **opposite is taking place.**

The full paper, with tables, appendix and references, is 57 pages long. Copies are obtainable from CDE at R30 each.

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