CDE ROUND TABLE

Number 22 · June 2013

# RETHINKING SOUTH AFRICA'S LABOUR MARKET

## Lessons from Brazil, India and Malaysia

Edited proceedings of a Round Table convened
by the Centre for Development and Enterprise

The Centre for Development and Enterprise is a leading South African development think tank, focussing on vital national development issues and their relationship to economic growth and democratic consolidation. Through examining South African realities and international experience, CDE formulates practical policy proposals for addressing major social and economic challenges. It has a special interest in the role of business and markets in development.

Series editor: Ann Bernstein

This report summarises the proceedings of a Round Table hosted by CDE in November 2012 and the research papers that were presented. It was written by Prof David Kaplan and edited by Julia de Kadt and Antony Altbeker.

This document is available from CDE, and can be downloaded from www.cde.org.za.

The Round Table and this report were funded by the UK Foreign and Commonwealth Office Prosperity Fund. The funders do not necessarily agree with the contents of this publication.

Cover: Striking Lonmin mine workers gather at the Wonderkop Stadium on September 18, 2012 in Rustenburg. (Photo by Gallo Images / The Times / Lauren Mulligan)

Published in June 2013 by The Centre for Development and Enterprise
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ISBN: 978-1-920653-08-8

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# EXECUTIVE SUMMARY

## Introduction

In November 2012, CDE hosted experts from Brazil, India, Malaysia and South Africa at a Round Table discussion with an invited group of participants that included leaders from business, labour and government. Coming soon after the events at Marikana, the Round Table provided an excellent opportunity for discussion and debate about the experiences of labour market reform in four important developing countries and, most importantly, the lessons South Africa could draw from them.

This executive summary provides a brief overview of the full report on the roundtable, *RETHINKING SOUTH AFRICA'S LABOUR MARKET: Lessons from Brazil, India and Malaysia*. It covers the presentations by leading experts from each country on each of the labour markets, and draws out the key insights and lessons for South Africa.

## Labour market regulation and reform in South Africa

Even when narrowly defined, at 26 per cent (in 2012), unemployment in South Africa is exceptionally high and is the country's most pressing policy challenge. High unemployment is at least partially caused by South Africa's labour market institutions and regulations. These have their roots in the historical protections afforded to white workers, and their extension to all workers in the 1980s and 1990s. And the views and preferences of unions (especially Cosatu) and big business have dominated the process of consultation and decision-making in government with respect to the formulation of labour market policies.

Key policies include the Labour Relations Act (1995), the Basic Conditions of Employment Act (1997), the Employment Equity Act (1998), the Skills Development Act (1998) and the Skills Development Levies Act (1999). Together, this legislation protects rights to form unions and strike, provides guaranteed minimum conditions of employment, promotes redress for historical inequality of opportunity, and finances some skills development and training institutions. Key institutions created by these laws include the Commission for Conciliation, Mediation and Arbitration (CCMA; established 1995), which resolves disputes between workers and employers, bargaining councils, which govern working conditions for various sectors of the economy, and Sector Education and Training Authorities (SETAs; established 2000).

In 2012, South Africa had a working age population (16 to 65) of 33 million people, 18 million (56 per cent) of whom were either employed or actively seeking work. The level of labour market participation has been somewhat volatile but has risen since the mid-1990s, reflecting increasing entry of women into the labour market, growing urbanisation and a fall in temporary, circular labour migration.

Employment has risen since 2001, peaking at 13,7 million in 2008 (before the global recession), and hovering just below that at 13,6 million at the end of 2012. The private sector accounts for 86 per cent of all employment, with some 20 per cent of these employees working in the informal sector—a low proportion by international standards.

Unemployment has fallen from 30 per cent in 2001 to 26 per cent today. The broad unemployment rate, including those wanting work but not actively seeking it, was closer to 35 per cent. The high unemployment rate is despite the fact that during the boom years, South Africa's rate of employment growth per unit of economic growth (termed the employment elasticity of growth) was actually higher than that of emerging market peers including India and China. This was because in South Africa, the new jobs being created were pulling people out of unemployment, rather than simply moving them from one form of employment to another. High unemployment therefore reflects, in part, low economic growth, as well as the unusually rapid pace of job destruction during the global recession.

Overall, 41 per cent of adults are employed or self-employed, which is low by international standards. Youth employment—which is generally lower than employment for older people—is particularly low by global standards. Only around one young adult in eight is employed in South Africa, compared to two in five in other emerging economies.

There have been significant changes in the sectoral composition of the economy and employment over the past three decades. The most important change has been the rapid rise in employment in financial services since the late 1990s, and, more recently, in community, social and personal services. By contrast, there has been a fall in employment in manufacturing and construction.

These trends have driven and reflect a shift towards a more capital- and skills-intensive economy, with fewer new low-skill jobs being created. The proportion of all jobs defined as skilled rose from 20 to 25 per cent between 2001 and 2007. In the context of a poorly performing education system, this has exacerbated the challenge of finding work faced by young people. The declining proportion of employment provided by small firms, which tend to pay lower wages but are more likely to hire younger and less experienced workers, has also reduced labour market opportunities for this group. Levels of self-employment in South Africa are also extremely low by international standards.

Although labour productivity is rising in South Africa, this is driven by a process in which employers are shifting to higher productivity production techniques (relying on more skills and equipment) and through the letting go of firms' least productive employees. The first trend is a consequence of the relative costs of productivity of skilled and unskilled labour, while the second reflects the way firms and the economy have adapted to the recession. Importantly, there is evidence that South African wages are less responsive to productivity changes than in comparator countries, often rising at a greater rate than productivity, and encouraging firms to shed labour. In part, this is due to the extension of bargaining council agreements to non-parties.

Unless current trends change, the South African economy is unlikely to generate significant numbers of new jobs in the near future, especially not the unskilled jobs which the bulk of the unemployed have a reasonable prospect of securing. While not the sole cause of these trends, South Africa's labour market regime is a significant contributor to them. This can be seen in some key factors that differentiate the South African labour market from others. For example, international surveys such as the World Economic Forum's Global Competiveness Report suggest that South Africa performs poorly with regards to cooperation between employers and employees, the flexibility of wage determination, the nature of the rules governing hiring and firing, and the link between pay and productivity. Countries which have achieved rapid job creation have typically performed much better in these areas.

Particular concerns with respect to the current labour market regime relate to:

- *The Commission for Conciliation, Mediation and Arbitration*: This tends to be used disproportionately by lower-skilled workers, and cases tend to be found in their favour, making this institution relatively burdensome for employers of low-skill workers. The resolution of a case takes on average 1,4 days, imposing burdens on employers, particularly in smaller firms which lack specialised human resources staff.
- *Hiring and firing regulations*: In 2011, South Africa was ranked third last out of 142 countries in terms of its hiring and firing processes by the Global Competitiveness Report, and employers indicate that time, trouble and hassle of both these processes are obstacles to hiring new staff.
- *Collective bargaining, wage setting and bargaining council extensions*: Collective bargaining and unionisation are associated with higher wages and lower employment levels in South Africa. One study suggested that those who are both members of a union and covered by a bargaining council earn 16 per cent more than those who are neither. Bargaining councils are typically dominated by large firms and unions, but their agreements are often extended to all businesses in a sector. This practice is particularly damaging to small firms and entrepreneurs, and one estimate of its impact suggests that it may account for one percentage point of unemployment.

South African labour market policy has tended to focus on ensuring 'decent jobs', at the cost of lower rates of job creation. It favours 'insiders'—people who are already employed, members of established unions and big businesses—over 'outsiders'—lower-skilled workers in smaller firms, and the unemployed. Current trends, driven by rising real wages, onerous labour regulation and the extension of bargaining council agreements, are not compatible with the large-scale creation of new jobs required to combat the unemployment crisis.

The impact of South Africa's labour market policies on employment trends is reinforced by its approach to industrial development which has tended to target incentives and subsidies at relatively capital- and skill-intensive industries, sectors and firms. This lowers the cost of capital relative to unskilled labour, reducing the demand for the latter.

## Labour market regulation and reform in Brazil

Although Brazil's economy ($2,5 trillion in 2011) and labour force (86 million in 2010, with a participation rate of 70 per cent) are much larger than South Africa's, the two countries' economies have similar sectoral compositions and have had similar rates of growth over the past decade. However, Brazilian unemployment is low, and poverty has fallen substantially in recent years.

The regulation of Brazil's labour market has changed little since the 1930s, and provides high levels of protection for individual workers and collective rights. The union structure is particularly highly regulated, with a single union per occupational category, and compulsory union contributions required from all workers. Employers' associations (also known as 'unions') are also structured along sectoral lines and receive compulsory contributions. Most bargaining occurs on a regional, industry-wide level. Brazil funds many social and industrial programmes through extensive payroll taxes, which add over 50 per cent to the cost of wages. These have more recently been reduced for small businesses, the self-employed and those exposed to international competition.

Despite its otherwise highly-regulated labour market, Brazilian employees can be dismissed at any time and for any reason with 30 days' notice, introducing a high flexibility into the labour market. This has helped ensure low levels of unemployment. The institution of universal basic education, a modest income transfer programme and pension benefits for the informal sector, combined with the stabilisation of the economy and real increases to the national minimum wage, have reduced poverty and inequality even in the absence of sustained rapid economic growth. If growth continues to falter, however, questions about the sustainability of this approach will arise.

Both Presidents Cardoso and Lula attempted significant labour market reform, but both faced resistance to their efforts and neither achieved more than a few modest changes. There is some evidence that failure to reform the labour market has retarded economic growth in Brazil.

## Labour market regulation and reform in India

South Africa and India share a political history in which a national liberation movement, closely allied with organised labour, established comprehensive legal protections for workers on coming to power. Although India's population (1,2 billion in 2011), GDP ($1,8 trillion in 2011) and GDP growth rate (7 per cent in 2011) are all substantially greater than South Africa's, the labour force participation rate is similar, at 58 per cent. Unemployment, however, is below 4 per cent. (It is important to note that one reason India's unemployment rate is much lower than South Africa's is that subsistence farmers, who make up half of the workforce, are counted as employed. This is not the case in South Africa.)

India has a complex system of labour market regulation, largely designed to protect workers. With 54 central laws and 160 state laws, the system is complex and difficult to navigate. In reality, however, most of these laws apply only to the small minority of Indian workers who have jobs in the formal sector, a figure that accounts for under 10 per cent of the workforce. Complex labour regulation is one reason why employment growth, particularly in the formal sector, has been much slower than economic growth, and certainly slower than employment growth in the informal sector Thus, between 1991 and 2010, the number of employees in the 'organised sector' barely changed, rising from 26,7 million to 27,5 million. This is remarkable during a period in which growth rates averaged more than 6 per cent a year.

As the exposure of the Indian economy to global markets has grown in recent years, concerns about the impact of labour market regulation on larger firms, and those in the traded goods sector, have grown. Particular concerns relate to measures governing the retrenchment of workers and the closing of businesses, as well as those restricting the use of contract labour. Despite recognition that existing labour market regulation is problematic, efforts at reform have not led to any major legislative changes. Government has, instead, adopted an approach of minor changes, relaxed implementation and 'looking the other way'—sometimes termed 'reform by stealth'.

## Labour market regulation and reform in Malaysia

Malaysia is a development success story. While it now looks very different from South Africa, in the early 1980s the two countries had a great deal in common, with similar levels of poverty (around 50 per cent), output per head and total factor productivity, as well as a comparably heavy reliance on the export of minerals. After five decades of annual average GDP growth of over 3 per cent a year, its unemployment rate (4 per cent) and poverty rate (4 per cent) were very different from South Africa's. By 2011, its GDP was $287,9 billion, with an annual GDP growth rate of 5 per cent. Malaysia is, however, the smallest economy of the three comparator countries, with a population of 29 million, and a labour force of 12 million.

The Malaysian labour market is characterised by strong state controls, used largely to keep wages low in support of a shift from a resource driven economy to one focussed on large-scale, export-oriented manufacturing. For example, labour unions have very limited power, and until 2012, there was no statutory minimum wage. Also hiring and firing is largely unrestricted. In addition, tax and labour law exemptions are often provided to foreign companies to encourage investment. More recently, the entrance of large numbers of low-skill foreign workers who are not covered by minimum wage provisions or represented by unions, has also been encouraged. While efforts have been made to enhance the economic engagement of historically disadvantaged indigenous Malays since 1965, these have met with only limited success. Targets for indigenous ownership have not been met, and there are concerns that the benefits of indigenisation have accrued largely to a small and politically connected elite.

Malaysia has been enormously successful in creating economic growth and employment, and significantly reducing poverty. Poverty has fallen from 52 per cent in 1970 to under 4 per cent in 2009, and inequality has also declined, with the Gini coefficient falling from 0,51 to 0,44 over the same period. However, there is evidence that growth and job creation have started to decline in recent years. While the existing labour market regulations and institutions were designed to support export-oriented industrialisation and helped lift Malaysia to middle-income status, some analysts believe that the country may now be caught in a 'middle-income trap', a term usually used to describe the situation when a country's ability to compete against low-wage economies declines because of rising wages and incomes, and where it is also insufficiently skilled and productive to compete with the economies of the developed world. If this is so, a different set of labour market policies, focussing on skills development and productivity growth, may be needed in Malaysia to ensure further development.

## Brazil, India, Malaysia: what can South Africa learn?

Brazil

- *The sectoral composition of the South African economy does not necessarily need to change to generate large numbers of jobs*: Despite similar growth rates and economic structures, Brazil has substantially outperformed South Africa in job creation. This suggests that South African job creation could be significantly enhanced, even without potentially costly and disruptive changes to the sectoral composition of the economy.
- *Small firms and self-employment could play a role in increasing labour intensity*: South African policies often encourages capital-intensification and make small firms less competitive. Brazilian policy, by contrast, supports small firms by reducing payroll taxes.
- *Even in highly regulated labour markets, the ability to fire people easily facilitates more rapid job creation*: Despite otherwise intrusive regulation, the fact that Brazilian employers can hire and fire at will allows the labour market to perform more efficiently and increases labour intensity. By keeping the labour market tight, it also ensures that wages rise with productivity gains.

India

- *A poorly regulated labour market reduces job creation in the formal sector*: Although the Indian economy has grown dramatically, this has not translated into rapid employment growth, especially in the formal sector. This dynamic helps explain the extreme dualism of its labour market, where more than 90 per cent of employment is regarded as informal.
- *Prohibitions on contract labour are ineffective*: The use of contract labour in India has grown rapidly, despite legal prohibitions. With a Bill going through Parliament that would seek to regulate more tightly the terms on which employers can use temporary employees in South Africa, the Indian case suggests that some rethinking is in order.

Malaysia

- *Keeping labour costs from growing creates jobs for less skilled workers*: Malaysian labour market policies, which contained wage costs, limited collective rights and entrenched significant management prerogatives, helped produce rapid economic and employment growth. It is estimated that in South Africa every 1 per cent rise in labour costs that is not offset by productivity reduces employment by 0,7 per cent. This means that too rapid a rise in wages will choke off employment growth.
- *Is South Africa stuck in a middle income trap?* The National Development Plan characterises South Africa as being caught in a middle-income trap, suggesting it is unable to compete with low-income countries at the bottom end of the market, and unable to compete with high-income countries at the top end. Like Malaysia, South Africa needs to upgrade technology and skills to escape this trap. But unlike Malaysia, South Africa needs to do this while promoting rapid employment growth at the bottom end of the value chain.
- *The 'indigenisation' of an economy is hard to achieve, even in the context of high growth and employment*: Despite extensive policy efforts to increase indigenous ownership, programmes aimed at transforming Malaysia's economy have had limited success with most of the benefits accruing to a small elite. This was in a context of high and sustained economic growth for many years, an advantage South Africa does not have. Nonetheless, Malaysia did manage to implement a comprehensive indigenisation programme without compromising job creation or economic growth, but with unintended consequences including corruption and the large-scale emigration of non-Bumiputera Malaysians.

## General comparative findings

When all four countries are compared simultaneously, additional themes emerge.

- *The outcome of labour market policies depends on factors beyond the labour market*: Despite similarities in their economic structures, the four countries have very different labour market outcomes, with some of the differences deriving from factors beyond the labour market. Given the context-dependence of labour market policies and institutions, policy-makers need to be careful about what lessons they learn from other countries and different models of labour market reform and regulation. While countries can learn from each other's experiences, lessons need to be carefully adapted to local context.
- *Labour market reform is difficult*: Attempts to reform the labour market often run into opposition and resistance,

making the design and implementation of reforms difficult. This is inevitable because labour market institutions are a critical component in a society's social contract. Changes may be difficult to conceptualise and 'sell', and, importantly, will generate uncertainty and resistance from those who believe the reforms may worsen their circumstances and prospects. In this regard, the Brazilian experience, where reforms have proved to be elusive whether the country was ruled by the military or by political parties of both the Right and Left, is instructive. Nonetheless, some countries, such as Germany, have successfully achieved major labour market reform. Successful and meaningful reform requires high levels of trust as well as strong and committed leadership.

## Concluding remarks

Labour market regulations and institutions play a critical role in shaping the trajectory of a country's economic growth and development. The distinct choices made by Brazil, India, Malaysia and South Africa, together with their divergent circumstances, have generated quite distinct labour market outcomes, whether measured by unemployment, wage rates, inequality, or the size of the informal sector. The comparisons presented here have illustrated that, for various reasons, the South African labour market is the one in which unskilled and inexperienced workers struggle the most to gain purchase, and in which enterprise formation is most stunted. It is therefore the one in most need of reform.

If the South African economy is to grow in ways that enable it to absorb the millions of unskilled and inexperienced people who are unemployed, there are some general conclusions to be drawn from the experiences of Brazil, India and Malaysia.

- An excessive regulatory burden on employers hinders the growth of enterprises and formal sector employment.
- An excessive regulatory burden also contributes to growth in sub-contracted employment.
- High levels of payroll taxes help ensure the persistence of high levels of informality.
- Not all aspects of labour market reform need to be undertaken simultaneously to have an impact. Even with high levels of regulation and taxation, substantial employment can be generated—as in Brazil and Malaysia—when the employer's risks when taking on new staff is minimised, in particular, by allowing for easy dismissal.
- Low-wage strategies can generate mass employment and rising incomes. This strategy may need to change in time as tightening labour markets raise wages, in which case increased competitiveness in higher value-added activities needs to be generated.

Brazil, India and Malaysia illustrate that labour market reform is difficult, but in the South African context, where unemployment rates are far higher than in any of the comparator countries, it has become absolutely essential.

By driving up wages and making it difficult to dismiss unsuitable workers, our current labour market regime has helped put the economy on an increasingly skill- and capital-intensive growth path. South Africa needs to find ways to make it easier for employers to hire unskilled and inexperienced workers. This requires making dismissal of unsuitable workers easier, ensuring that pay increases are in line with productivity growth, and freeing up the environment for business, especially labour-intensive small and medium sized firms.

The imperative to reform the South African labour market derives from our very high unemployment rates, our low levels of new firm creation and relatively low levels of investment (foreign and domestic). We are not like Brazil (which has absorbed millions into its urban economy), India (where economic growth is rapid), or Malaysia (where employment levels are very high). The differences in our circumstances mean that labour market reform is a more urgent priority here than it is in India, Brazil and Malaysia. With millions of unskilled people without work, it is no exaggeration to say that South Africa's future depends on its ability to make the necessary changes. It is essential that South Africa acts decisively with respect to labour market reform. Vision and leadership from government are urgently required.

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Greg Lopez specialises in understanding the interaction between Malaysian society, its economy and its politics. He has spent more than a decade researching these issues in various capacities. He is currently pursuing a PhD in Economic Policy at the Crawford School of Public Policy, ANU. His thesis analyses how domestic institutions affect economic growth in Malaysia. He is also Editor of the New Mandala's Malaysia section at ANU. He has published extensively on topics related to Malaysian economic growth. He was previously a Senior Research Officer at the Malaysian Institute for Economic Research.

# Introduction

This report provides a summary of a roundtable hosted in Johannesburg by CDE on November 6, 2012. Experts from each of South Africa, Brazil, India and Malaysia presented papers detailing the labour markets and economies of their respective country, with a particular focus on the implications of labour market regulations, institutions and reforms. The event, attended by an invited group of participants with expertise and experience relating to labour markets and their regulation, provided an excellent opportunity for discussion and debate about the comparisons which could be drawn between South Africa and each of the other countries considered (*see page 8 for list of participants*).

This report summarises the expert presentations on each of South Africa, Brazil, India and Malaysia, and draws out key lessons that South Africa can learn from the experiences of labour market regulation and reform in each of these countries.

This report has five parts. The first summarises the paper on the South African labour market written by Professor Neil Rankin and presented by Mr Volker Schöer, the former from the economics department at the University of Stellenbosch, the latter from the School of Economic and Business Sciences at Wits.

The second section describes labour market regulations and outcomes in each of Brazil, India and Malaysia. A summary of the expert paper is presented for each country, along with some key information about that country's labour market and economy. The third and fourth sections contain comparisons between the different countries discussed, and provide an overview of key findings and issues. There is a particular focus on the lessons which South Africa can learn from the experiences of Brazil, India and Malaysia. Section five concludes.

The full country papers are available from CDE on request.

Unemployment is South Africa's most pressing policy challenge, with a narrow unemployment rate of 25,5 per cent in 2012

# Labour Market Regulation and Reform in South Africa

Unemployment is South Africa's most pressing policy challenge, with a narrow unemployment rate of 25,5 per cent in 2012.[1] Unemployment rates are particularly high amongst young people—half of whom are unemployed. The evidence suggests that labour market regulations and institutions have adversely affected employment levels.

## Labour Market Regulations and Institutions

Following the transition to democracy, South Africa passed a series of labour laws, to extend to all workers the rights that historically governed the market for white labour in South Africa, but which also granted all workers additional rights and protections. In part, this was due to the significant role of the trade union movement, and specifically the Congress of South African Trade Unions (Cosatu), in South Africa's transition to democracy, its subsequent alliance with the ruling ANC, and the entrenchment of organised labour in the legislative process.

The key policies and institutions that govern the labour market are:

- The *Labour Relations Act (1995)* protects the right of workers to form unions and to strike. It also established a number of key labour market institutions such as:
  - The *Commission for Conciliation, Mediation and Arbitration (CCMA)*, which resolves disputes between employers and individual employees who claim that their statutory employment rights have been infringed, especially their right not to be dismissed unfairly as defined in the law; and
  - A system of *bargaining councils* which entrench bargaining at a sectoral level, the agreements of which can, in certain circumstances, be extended to all participants in the sector even if they are not party to negotiations.
- The *Basic Conditions of Employment Act (1997)* sets out minimum standards for work, such as working hours, and overtime, as well as leave and health and safety standards across the economy.
- The *Employment Equity Act (1998)* seeks to compensate for historical inequality of opportunity by prohibiting discrimination and increasing opportunities for 'designated' groups, including women, black men, and disabled people.
- The *Skills Development Act (1998)* and the *Skills Development Levies Act (1999)* use a payroll levy distributed to *Sector Education and Training Authorities (SETAs)* to run skills development and training programmes within their sectors.

In the 1990s, labour market protections were extended because of the role of trade unions in the transition to democracy and the entrenchment of organised labour in the legislative process

While the revision of South African labour market regulations was essential, concerns were raised about potential impacts on the creation of employment even at the time of these revisions.[2]

## The performance of the labour marker

The proportion of the South African population which is of working age (15 to 64) has remained relatively constant since 2001—fluctuating between 62,4 and 64,6 per cent. In 2012, the working age population of South Africa was 33 million, of whom 16 million were men, and 17 million were women. The labour force participation rate (the proportion of working age people who are either employed or actively looking for work) has been more volatile. It fell in the early 2000s, rose between 2004 and 2008, fell again in 2009 and 2010, before rising again. In 2012 it settled at 55,5 per cent, or 18,3 million. In 2012, the labour force participation was 49 per cent for women, and 63 per cent for men. By contrast, in 2010, overall labour force participation was 70 per cent in Brazil, 58 per cent in India, and 63 per cent in Malaysia.

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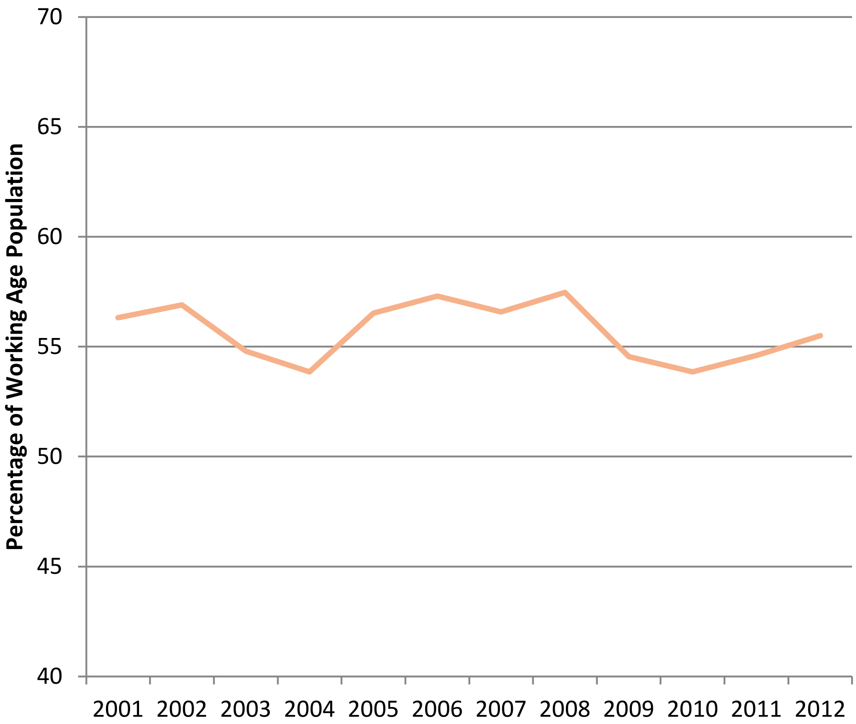
**Figure 1: Labour force participation rate in South Africa, 2001-2012**




Source: Data from September LFS for 2001—2007, and Q3 QLFS for 2008—2012

Participation rates vary across South Africa, and are much lower in rural areas (where the lack of opportunities mean that most of the unemployed do not look for work) than they are in urban areas with the differential appearing to grow over time. In 2010, the participation rate in urban areas was about 60 per cent, compared with 33 per cent in rural areas.

Participation rates are much lower in rural than in urban areas, with the differential appearing to grow over time

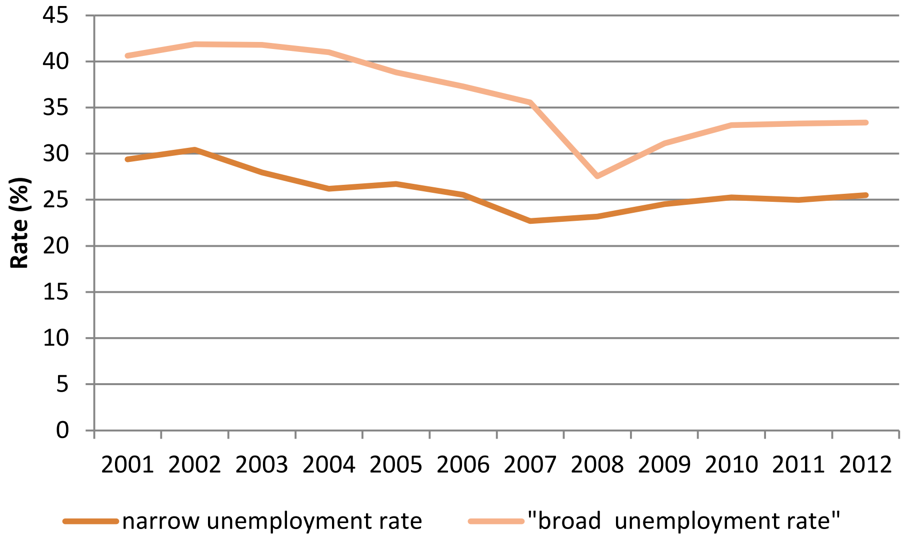
Changing levels of labour market participation in South Africa reflect a number of processes, among the most important of which have been the entry of large numbers of women into the labour market, as well as increasing levels of urbanisation which has also become less transitory and more permanent.[3] International migration has also played a role, with foreign migrants, who typically move to urban areas, being more likely to be active in the labour market. Although data on the number of international migrants is of dubious quality, this population was estimated to be about 1,2 million in 2007, or just less than 3 per cent of the total population.[4] The labour force has also been affected by emigration, particularly of skilled whites, with estimates of the number of émigrés ranging up to 1 million.

## Employment and Unemployment

Between 2001 and 2012, employment increased by 2,4 million, from 11,2 million to 13,6 million. This is still just below the peak in 2008, when 13,7 million people were in jobs. The narrow unemployment rate, which includes only those actively looking for a job, fell by nearly 4 percentage points between 2001 and 2012, from 29,6 per cent to 25,5 per cent. In absolute terms, this means that there were 4,7 million people actively looking for a job in 2012. The broad unemployment rate, including those who have given up looking for a job, fell by 7,2 points, to 33,4 per cent, or 6,8 million people. For more information on how unemployment is measured in South Africa, see the box on page 15.

Currently, 86 per cent of employment is in the private sector, although the share of the public sector has been increasing. Levels of informal employment are generally considered to be fairly low in South Africa, constituting less than 20 per cent of private sector employment. Even using a fairly broad definition, Statistics South Africa estimates that in 2012, only 2,2 million people, or 16 per cent of the employed, worked in informal sector firms.

**Figure 2: South African unemployment, 2001-2012**



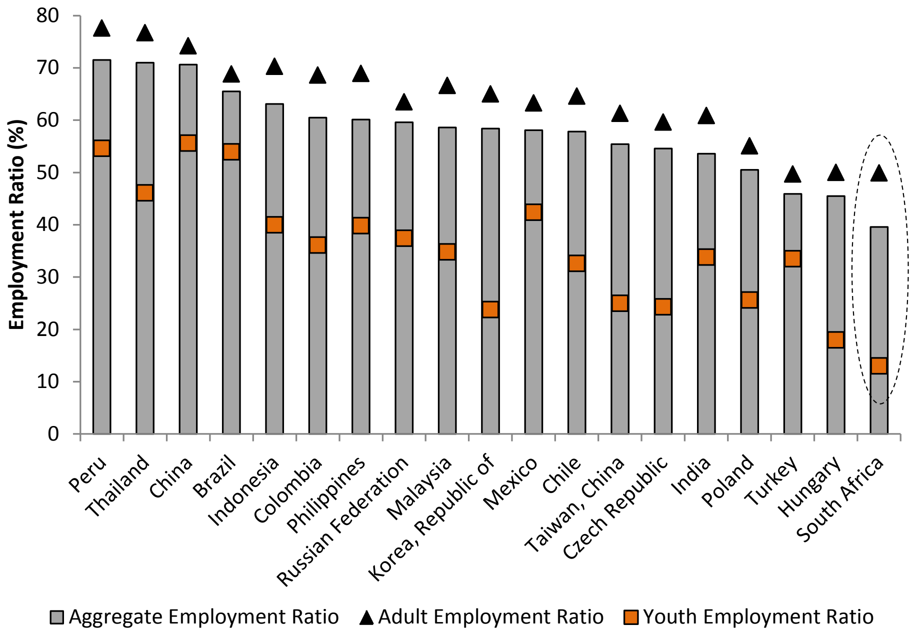

Data from September LFS for 2001-2007, and QLFS Q3 from 2008-2012

Currently, 86 per cent of employment is in the private sector, although the share of the public sector has been rising

By international standards, levels of employment in South Africa are exceptionally low. During the boom years, South Africa's rate of employment growth per unit of economic growth (termed the employment elasticity of growth) was actually higher than that of emerging country peers, including India and China. This was because in South Africa, the new jobs being created were pulling people out of unemployment, rather than simply moving them from one form of employment to another. Despite this, job creation has been slower in South Africa than elsewhere, with the country ranking 17th out of 20 comparable countries over the period 2001 to 2011. This reflects, in part, low economic growth. But it also reflects the unusually rapid pace of job destruction during the global recession.

In addition to its high overall unemployment rate, South Africa's youth unemployment is significantly higher than in comparable countries, with only one in eight young adults having a job, compared with two in five in many other emerging countries (see Figure 3). Partly as a result, youth labour force participation in South Africa is also very low.

**Figure 3: Youth and adult employment ratios in South Africa and selected emerging economies**




Source: Data from ILO (Key Indicators of the Labour Market, 7th Edition)[5]

It is common internationally for youth unemployment to be considerably higher than unemployment rates for older people. This is partly because employers know that young people, who lack work experience, tend to be less productive than equally qualified but more experienced older workers. To offset this, young workers in other economies offer their labour to employers at discounts to the wages that older workers receive. In South Africa, however, relatively high wages for entry level positions make this impossible, so employers are reluctant to incur these costs on young and untested employees. There is also evidence that jobs for young people are especially sensitive to the growth rate of the economy, with young workers often being the first to lose their jobs if the economy slows.

Jobs for young people are especially sensitive to the growth rate of the economy, with young workers often being the first to lose their jobs

### Box: Defining Unemployment in South Africa

Although the extent of unemployment in South Africa often seems implausibly high to those from other countries, recent evidence supports the argument that South African unemployment may actually be under-estimated.

South Africa uses the standard ILO definition of unemployment, which regards as unemployed only those without jobs who are actively looking for work. This definition, also termed 'narrow unemployment', is distinguished from 'broad unemployment' which includes people who are in the labour market and have no job, but who have not actively looked for work in the recent past. Recent research casts some doubt on the stability of the distinction between broad and narrow unemployment.[6]

Data from the National Income Dynamics Survey (NIDS) were used to explore whether people who were not actively looking for work ('non-searchers') were any less committed to finding a job than active job searchers. As it turns out, members of both groups had similar chances of actually finding a job. This, it is thought, is because it is quite hard to determine who is looking for a job when many of those who find work do so through social networks. It may be that 'non-searchers' are really looking for work, but using the relatively passive strategy of waiting for information about job openings from people in their social networks.

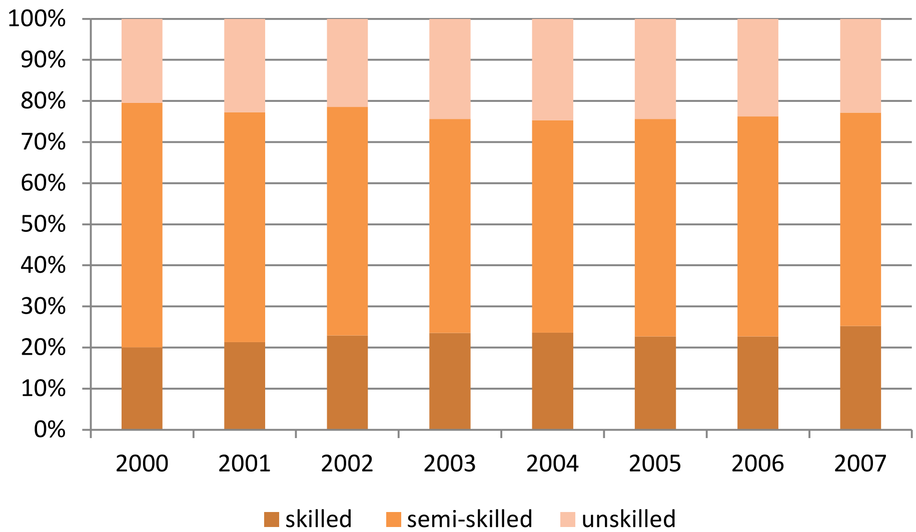
Given the persistently high unemployment rate and the low probability of finding work, these types of passive job search strategies are widespread, and it may be that the most significant difference between 'searchers' and 'non-searchers' is that the latter are simply less optimistic about the likelihood of finding a job. In this context, the broad unemployment rate may be the more relevant measure of unemployment in South Africa.

The economy has become increasingly skill-intensive over time

## Employment and Skills

The economy has become increasingly skill-intensive over time. This is reflected in an increase in the proportion of skilled jobs from 20 per cent in 2000 to 25 per cent in 2007.

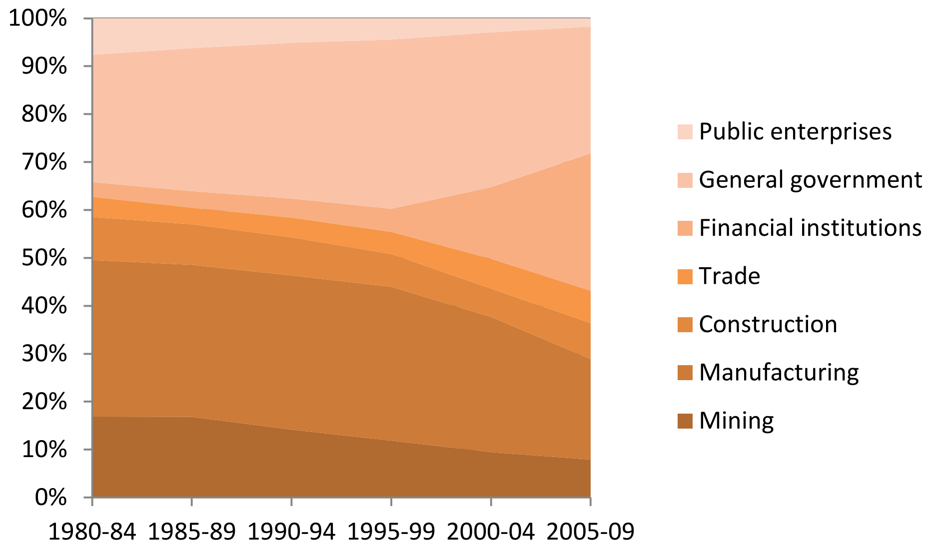
**Figure 4: Skills breakdown of employment in South Africa, 2000-2007**




Source: Rankin et al (2012)[7]

One process driving the increasing skill-intensity of the economy is the changing sectoral composition of the economy and employment over the past three decades, with a rapid rise in employment in financial services since the late 1990s and a fall in employment in manufacturing being the dominant trends. This has been replicated since 2006, a period which has seen a net increase in non-agricultural formal sector jobs of 366 000. The largest number of new jobs was created was in community, social and personal services (a category which includes government). Another sector with substantial increases in employment was electricity, gas and water, which is also a government-dominated sector. Importantly, these sectors are also among those which have the lowest ratio of lower to higher skilled employees. This means that as long as growth is restricted to these areas, few new lower-skilled jobs are being created.

**Figure 5: Employment shares in South Africa's non-agricultural economy, 1980-2009**




Source: Fedderke (2012)[8]

Furthermore, since 2006, the number of jobs in manufacturing fell by 185 000, while jobs in construction also fell. Relative to other non-agricultural sectors, both these sectors tend to rely less on high skilled workers. Thus, even though jobs were created in the lower-skill intensive areas of mining and quarrying, as well as wholesale and retail, the overall trend remains towards a greater increase in employment in sectors with higher proportions of skilled employees.

A second trend that has exacerbated the increasing difficulty that young, relatively unskilled and inexperienced workers have in finding work has been the decline in the share of employment provided by small firms. While these firms tend to pay lower wages than bigger businesses, they are more likely to be entry points to employment for those with the skill and experience profiles of the unemployed in South Africa. Across all industries, the share of employment in firms with fewer than ten employees fell from 47 per cent in 2000 (already low by international standards) to 35 per cent in 2010. There were particularly large falls in agriculture, mining, and community, social and personal services. In addition, levels of self-employment in South Africa are strikingly low, at 6 and 8 per cent of total employment respectively for females and males. By contrast, the figures for Brazil are 24 and 27 per cent.[9]

The overall trend remains towards a greater increase in employment in sectors with higher proportions of skilled employees

## Remuneration and Productivity

Between 2006 and 2012, real wages rose about 18 per cent (or about 2,8 per cent per year) across the economy. This increase has been driven primarily by above-inflation increases in the salaries of skilled employees, along with the shift towards increasingly skill-intensive patterns of employment. Having said that, real wage growth has been particularly high in some of the sectors which employ large numbers of less-skilled workers, for example in construction (35 per cent over the period), mining and quarrying (30 per cent), and manufacturing (20 per cent).

Unit labour costs (the average cost of labour per unit of output) are also higher in South Africa than in comparable countries. This is both a cause and an effect of the fact that South African firms employ more capital per worker.[10] Overall, industries which have had the fastest real wage growth have either lost jobs or added fewer new jobs than industries with lower real wage growth, and rising wages are associated with lower levels of employment.[11]

A World Bank study found that South African real wages in the manufacturing sector are higher and have risen faster than wages in comparable countries.[12] While labour productivity in South Africa is also higher than in other developing countries (largely because of greater capital-intensity), the study found that changes in South African wages are not driven as directly by changes in productivity as is the case in other countries. One factor that may be contributing to this is the structure of the labour market, and, in particular the extension of bargaining council agreements to non-parties. This can have the effect of raising wages even in firms in which productivity does not rise as fast.

Unit labour costs (the average cost of labour per unit of output) are higher in South Africa than in comparable countries

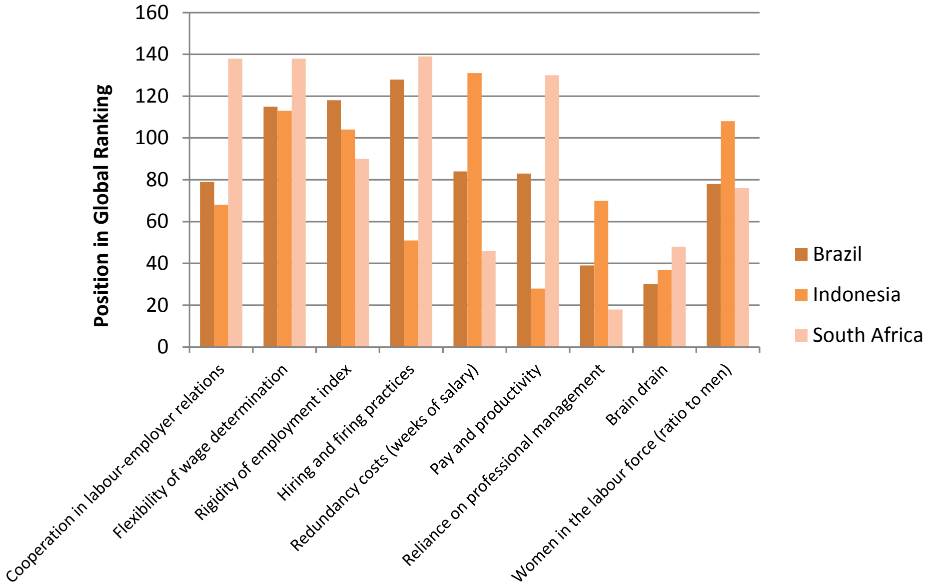
Thus, South Africa's high and rising labour productivity, while an apparently positive feature, is driven largely by rising capital- and skill-intensity. Because employers can generally replace unskilled workers with more highly-skilled people by changing production techniques and by relying more heavily on machines and technology, the consequences are reduced employment per unit of output and lower demand for unskilled workers. This trend has been reinforced by declining real interest rates since the 1990s, which have reduced the cost of capital just as the real costs of labour have been increasing, and by a variety of industrial policy incentives the design of which further reduces the cost of capital.

The immediate consequence of all of this is that the South African economy is unlikely to create a substantial number of new jobs in the near future, and particularly not the type of unskilled jobs that are most accessible to those who are currently unemployed. Much of the responsibility for these patterns lies with South African labour regulations and institutions, which have been identified as barriers to the creation of employment. This is explored in the following section.

## The impact of labour regulations and institutions

South African labour market regulations are generally perceived by business as burdensome.[13] A recent survey reported that 25 per cent of small manufacturing firms identified inflexible labour regulations as a critical barrier to employment,[14] while the World Bank has found up to 30 per cent of firms describe the regulations as a major or severe obstacle to business expansion.[15] South Africa's institutional processes around the dismissal of employees are amongst the most onerous in the world. In addition, when compared to peer group countries, South Africa performs poorly with regards to cooperation between employers and employees, flexibility of wage determination, hiring and firing practices, and the link between pay and productivity. Countries which have achieved rapid job creation tend to perform much better in these areas, which are all heavily influenced by labour market institutions.

**Figure 6: Ranking in terms of labour market competitiveness**




Source: World Economic Forum's Global Competitiveness Report (2011-12)

South African labour market regulations are generally perceived by business as burdensome

## Collective bargaining and wage setting

Collective bargaining and unionisation are associated with higher wages, and as a consequence, lower employment levels in South Africa. Union members were estimated to earn a wage premium of approximately 7 per cent over non-unionised workers in 2005, while workers covered by bargaining councils earned 9 per cent more than non-covered workers.[16] For those both unionised and covered, the premium was 16,4 per cent. When only the public sector was considered, this premium was even higher, at 22 per cent. In addition, in sectors covered by bargaining councils, there were 7 to 16 per cent fewer employees in small firms and 7 to 15 per cent fewer entrepreneurs.[17] This effect is estimated to add at least one percentage point to unemployment.

South Africa's collective bargaining framework has also been shown to contribute to the misalignment between real wages and labour productivity, again with implications for employment levels. Excess real wage growth is estimated to have accounted for at least one-quarter of employment loss between 2008 and 2010 (or close to 200 000 jobs).[18]

## Key areas of concern

Although South African labour regulations and institutions are generally perceived as burdensome,[19] employer dissatisfaction is particularly focused around a few areas, as identified by the World Economic Forum's Global Competitiveness Report—cooperation between employers and employees, the flexibility of wage determination, the link between pay and productivity, and hiring and firing practice.[20] These areas of dissatisfaction are clustered around three particular sets of regulations and institutions, which are perceived to have a particularly negative impact on employment.

1) *The Commission for Conciliation, Mediation and Arbitration (CCMA).* Firms find the CCMA process onerous and costly. The CCMA is more widely used by lower skilled (45 per cent) or semi-skilled (31 per cent) workers, and disputes are more often resolved in favour of the employee. This is particularly so in the case of less-skilled employees (72 per cent as opposed to 60 to 65 per cent for others).[21] Thus the costs of the CCMA process are proportionately greater for firms that employ less-skilled workers, once again encouraging a shift towards more skill-intensive processes. In addition, while the efficiency of the CCMA is highly variable by province, the average time taken in the arbitration process is nearly 1,5 days.[22] Surveys undertaken by the African Micro-Economic Research Unit (AMERU) indicate that firms without dedicated human resources staff find the CCMA processes especially burdensome, spending approximately a week of staff time on a typical case.
2) *Hiring and firing regulations.* In a survey of firms, 71 per cent regarded firing procedures as a moderate or serious obstacle to hiring new employees, and 57 per cent regarded hiring procedures as an obstacle to hiring.[23] While the survey is dated, hiring and firing regulations have not changed a great deal since that time, and, as of 2011, South Africa was ranked third last out of 142 countries in terms of its hiring and firing processes.[24]
3) *Bargaining council extensions.* The extension of agreements reached at bargaining councils (which are often dominated by large firms and their unions) raise employment costs for small business and encourage them to hire fewer comparatively expensive less-skilled workers, and also to become more capital-intensive in order to reduce the wage bill. There is evidence that bargaining council extensions reduce employment in small firms.[25] In the absence of these extensions, it has been estimated that employment could increase by 1,5 per cent.

In a survey of firms, 71 per cent regarded firing procedures as a moderate or serious obstacle to hiring new employees

One response to this by small firms is to invest in more capital- and skill-intensive production processes. However, this is economical only if firms increase their scale of production. Small firms that are unable to do so may go out of business. The trends evident in the South African labour market—higher real wages, increasing skill- and capital-intensity and a declining share of small firms—all accord with this explanation.

The extension of bargaining council agreements has recently been subject to a number of legal challenges. For more information on these, see the box on page 20.

## Legal challenges to the sectoral extension of bargaining council agreements

South African courts have seen two recent challenges to critical aspects of the country's labour legislation, and, in particular, the sectoral extension of bargaining council agreements to non-parties.

The first challenge was brought by a number of clothing factories in Newcastle, to whom a 2010 bargaining council agreement on higher minimum wages had been extended. This threatened the viability of about 450 non-compliant firms employing over 16 500 people.[26] The second challenge, brought by the Free Market Foundation (FMF) against the Ministers of Labour and of Justice and Constitutional Development, as well as 48 individual bargaining councils, argues that the legal provisions that allow (and, in some cases, compel) the Minister of Labour to extend bargaining council agreements to other firms in a sector, are not constitutional.

With regards to the first challenge, the High Court in Pietermaritzburg found on 13 March 2013 that the extension of the 2010 bargaining council agreement on wages was invalid because the Minister of Labour had not ensured that more than 50 per cent of the employees in the industry were employed by employers whose representatives at the bargaining council signed the agreement. In fact, the true figure was only 48,6 per cent of employees. The decision is a very narrow one, though it does have implications for the Minister of Labour, who can no longer rely on a certificate provided by the Registrar of Bargaining Councils to the effect that the bargaining council is representative, and must actually make sure that this is the case. If the provisions of the relevant section of the LRA are met, however, the Minister of Labour would still be compelled to extend agreements to non-parties.

This judgement, then, does not speak at all to the broader issues surrounding the extension of bargaining council agreements to non-parties. It does, however, highlight the fact that the current legislation is extremely sensitive to the way in which a sector is defined. Had the sector been defined differently, the judgement might have been very different.

The second challenge—filed by the FMF with the Gauteng North High Court—addresses the constitutionality of the principle of the extension of bargaining council agreements to non-parties. This is challenged on two grounds: (i) that because the members of bargaining councils are private actors, the state cannot delegate substantive powers of statutory regulation to them without violating the constitution; and (ii) that the wording of the LRA distorts the provisions of majority rule, allowing a minority to coerce a majority into complying with terms and conditions of employment that they define.

The FMF argues that these provisions of the LRA have the effect of erecting barriers to entry which negatively affect small firms and the unemployed by preventing effective competition in the labour market. This results in fewer jobs, higher unemployment, fewer opportunities for entrepreneurs, and less economic growth for South Africa.

While the FMF opposes the extension of bargaining council agreements to non-parties, it does not take issue with representative collective bargaining relating to terms of employment. Furthermore, it acknowledges that the state has a right to impose conditions around employment, and to be guided by experts and interest groups, including bargaining councils. It argues, however, that in doing so, the state must be motivated by a genuine understanding of the public interest, and must follow due process. They argue for the amendment of the LRA to ensure that the minster is given greater discretion, and to ensure that the principle of majority rule is respected.

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## Conclusions

South Africa has a set of labour market regulations and institutions that centralise bargaining and provide extensive statutory protections to workers. Government policy has focused on ensuring 'decent jobs'—those with better conditions of employment and remuneration—which has come at the cost of lower levels of job creation, especially for unskilled workers.

Current trends in the South African labour market include the increasing skills-intensification of employment, the decrease in employment by small firms, and the fact that the bulk of new job creation in recent years has been coming from government. These trends follow from the high cost of labour relative to capital, which is driven by rising real wages, falling real interest rates, onerous labour regulations, and the extension of bargaining council agreements. These trends and patterns are not compatible with the large-scale creation of new jobs required to combat the unemployment crisis in South Africa. Proposed amendments which would extend the coverage of labour regulations and the reach of labour market institutions are only likely to reinforce existing trends, worsening the prospects for the sustainable creation of jobs.

South Africa's policy has focused on ensuring 'decent jobs,' which has come at the cost of lower levels of job creation

# Brazil, India, Malaysia: Labour market regulation and reform

Brazil, India and Malaysia are developing countries with more-or-less democratic polities. Their labour markets exhibit both some important differences from, and some similarities to, South Africa's. Brazil, for example, has experienced similar rates of GDP growth to South Africa over the past decade. In addition, while Brazil's economy and labour market are far larger than South Africa, the sectoral composition of its economy is much like that of South Africa's. The Brazilian economy, has, nevertheless, been much more successful in creating employment.

Similarly, two decades ago Malaysia had an economic structure that was very similar to South Africa's. While sustained rapid economic growth has changed this a great deal, at the time output per head and total factor productivity were very similar in the two countries, and both economies relied on the export of minerals.[27] India is very different from South Africa in many ways, but like this country, it has a political history of a national liberation movement closely allied with labour which, after independence, established a comprehensive set of laws to protect workers.

This section provides a summary of the expert papers documenting each country's labour market and its performance, and highlights issues with particular salience for the South African labour market.

## Brazil

Brazil had a population of nearly 200 million people, and an economy worth $2,5 trillion in 2011. The total labour force was 86 million in 2010, with a labour force participation rate of 70 per cent. Unemployment is fairly low, at 8 per cent in 2009 (although half of all workers are in the informal economy), and GDP growth was 2,7 per cent in 2011.

The Brazilian labour market is highly regulated, but, paradoxically, very flexible. The labour market has performed well, with near full employment in recent years and significant reductions in poverty rates. In light of falling economic growth over the past two years, there is concern, however, about the sustainability of Brazil's success.

### The labour market

Labour market regulation in Brazil was inspired by a fascist-style, corporatist model. It has always included extensive worker rights, and a very state-focused approach to labour regulation. Adopted in the 1930s and 1940s, the model has changed little, despite several changes in government. In 1985, following 21 years of military rule, the country inaugurated a new democratic regime, which resulted in a new constitution in 1988. This included an extensive list of the rights of individual workers, such as working time, minimum wages, bonuses and holiday leave. It also provided for collective rights, union rights, union structures and funding. Throughout the first ten years of democracy, chronic high inflation was the major macroeconomic challenge, and during this period, a major aim of labour legislation was to provide employees with income protection. Price stability was finally achieved in 1994, following the success of the *Real* plan.

The Brazilian labour market is highly regulated, but, paradoxically, very flexible

While workers in Brazil enjoy extensive and constitutionally protected individual rights, employers are able to dismiss workers at any time with 30 days' notice. They are, however, required to compensate dismissed workers at the rate of one month's pay per year worked. In addition, while unions are protected by law, and while their funding is guaranteed by compulsory fees collected from workers by the state, union representation at plant level does not exist, meaning that there is no collective representation for workers in the workplace.

In broad terms, Brazil has a highly-regulated labour market, which is simultaneously very flexible, with high rates of labour turnover. During the 1990s and early 2000s there were several efforts at reforming labour market regulation, particularly those aspects relating to the rights of individual employees. These efforts were, however, largely unsuccessful, with the exception of the institution of an hours bank, and profit-and gain-sharing. In both cases, implementation is subject to negotiation between unions and industry.

Brazil's union structure is particularly highly regulated. A single union represents workers in each occupational category, and all workers make compulsory payments to their union to the value of one day's wages per annum. Despite this, unionisation levels are low, under 20 per cent, though unions collect compulsory fees even from non-members.

Unions represent workers at the municipal, regional and national levels, but not at the plant level. Employers' associations (also, as in the fascist model, termed 'unions') are organised along the same lines as the workers' unions. There are five sectorally-structured employers' associations, with all employers required to make a contribution to their representative association. Most bargaining takes place at the regional, industry-wide level, with very little occurring at the national level. President Lula's efforts at labour market reform were focused at the level of unions and collective bargaining, but like president Cardoso's efforts in the late 1990s, were largely ineffective.

Brazil has an extensive system of payroll taxes to fund social security, workers' compensation, training, education, small business support and agrarian reform. Payroll taxes, excluding income tax, add over 50 per cent of net wages to the wage bill. This is high, particularly because Brazil has had periods in which employment levels were low, and given the size of the informal sector. In response to these concerns, payroll taxes have been substantially simplified and reduced for small businesses and the self-employed over the past 15 years. More recently, employer contributions to social security have also been reduced in sectors exposed to international competition.

## Labour market outcomes

Despite concerns about excessive regulation and the challenges faced by reform efforts to date, Brazil's labour market has had several significant achievements to date. These include:

- *Substantial increases in employment:* Brazil is now a full-employment economy despite a rapid rate of growth in the labour supply;
- *Significant increases in real wages:* between 2003 and 2012, real wages increased by 25 per cent;
- *A noteworthy reduction in inequality*: based on increasing employment and rising wages, the Gini coefficient has fallen steadily from 0,6 to near 0,5 over the last 15 years; and
- *A dramatic reduction in informality:* the percentage of informal sector jobs declined from 64 per cent in 1992 to a little over 50 per cent in 2011.

Brazil is now a full-employment economy despite a rapid rate of growth in the labour supply

In addition, Brazil has adopted policies that have resulted in important gains for poorer Brazilians, including universal access to basic education, a well-designed income transfer programme, and non-contributory pension benefits in the informal sector and agriculture. In addition, the taming of hyper-inflation and a continuous real increase in the national minimum wage have also helped to reduce income inequality in the country.

These achievements have been realised despite economic difficulties. In terms of economic growth, Brazil's performance has not been particularly strong (3,5 per cent per year between 2001 and 2012), and growth has been volatile. More recently, there has been a sharp fall-off in the growth rate—just 0,9 per cent for 2012. Brazilian successes, despite these constraints, result from several factors, such as increases in the incomes of poor families, which have been transformed into consumption and raised aggregate demand; demographic changes that have started to reduce the growth rate of the labour supply; and shifts in the economy towards more labour-intensive production. Given recent declines in the growth rate, however, there are now questions about the sustainability of Brazil's achievements in employment, and in the improvements to its social indicators.

Additional questions are currently being asked about whether Brazil might not be performing even better if efforts at labour reform had been more successful. There is currently an active agenda for labour reform, with particular focus on three industries—ethanol and sugarcane, construction, and metal. If successful, this type of voluntary labour reform may provide a new model for labour relations in Brazil.

## India

In 2011, the Indian population stood at 1,2 billion. Its GDP was worth nearly $1,9 trillion, and was growing at the rate of nearly 7 per cent a year. There were over 470 million in the labour force, while the labour force participation rate among those in the 15-59 age group was 57,7 per cent. As of 2010, the unemployment rate was only 3,6 per cent, and the Gini coefficient was 0,33.

### Defining unemployment in India and South Africa

Many people are surprised that unemployment in India is so much lower than in South Africa despite the fact that poverty rates are considerably higher. This is not because unemployment is defined differently in both countries: in both cases, a person is considered unemployed if he has no work and is actively looking for work. A key difference, however, lies in how people living in rural areas who work the land are counted. In South Africa state transfers and remittances from family members are thought to make up a considerable proportion of the incomes of rural people and for this reason their farming activities are not considered a form of employment.)

South Africa's unemployment rate would still be higher than India's even if every member of the rural workforce were considered employed, but a significant proportion of the gap between the two countries' measured levels of unemployment is related to the treatment of low level farming.

Labour market regulation in India is extremely complex, but applies mainly to the very small proportion of the Indian workforce in formal employment. Despite low coverage, there are concerns that labour regulation is preventing faster growth in employment, which has been very slow for an economy growing as quickly as India's. There are also concerns that it may create incentives for firms to stay outside the formal sector. To date, however, efforts to reform labour regulation have been largely unsuccessful, resulting in only piecemeal changes.

Labour market regulation in India is extremely complex, but applies mainly to the very small proportion of the Indian workforce in formal employment

### The labour market

Labour regulation in India began under the colonial government. The labour unions were important members of the movement for national independence, and, after independence, helped to shape new labour laws passed at both central and state levels. India now has a complex system of laws governing the labour market—54 laws at the central level and 160 at the state level. Most of these are designed to protect workers, with laws regulating working conditions and wages, and providing some measure of social security. There are also laws, however, that protect employers from worker ill-discipline or misconduct, and which impose obligations on workers in the exercise of their rights. As a result, India has a comprehensive and elaborate labour market regulatory regime. Given the extent of legislation, it is unsurprising that laws often have overlapping scope and coverage, and that there is a fair degree of confusion around concepts and definitions.

The most salient feature of the Indian labour market, however, is that this elaborate system is applicable to only a small minority of the Indian workforce. This is because it does not apply to the over 50 per cent of Indian workers who are self-employed, those engaged in agriculture, and those employed in the informal sector (a category that includes all private establishments employing fewer than 10 workers). This is despite the fact that together these groups constitute the large majority of those working for wages in India. In addition, some regulations do not apply to workers employed on a non-regular, casual or contract basis in larger formal establishments. While there are a few labour laws which do apply to workers in the informal sector, these are poorly implemented. As a result, most important labour regulations apply to fewer than 10 per cent of wage-earners. In fact, actual coverage by any particular piece of legislation is even smaller—often less than 5 per cent of the workforce.

Despite these low levels of coverage, in recent years industry, international financial institutions and investors have argued that the labour market is excessively regulated and that it provides employers too little freedom to make adjustments in their workforces. The resulting labour market rigidities are believed to have adversely affected industrial growth, investment and employment. Although the empirical evidence is ambiguous, it has been observed that employment growth is slower in the formal sector than in the informal sector, and faster in areas with relatively lighter regulatory burdens on employers. These concerns have become particularly prominent since 1991, when India launched economic reforms and sought to open its economy to international trade and investment, and have also been recognised by government. There are particular concerns about the costs imposed by labour market regulation on larger firms, and especially those in the traded goods sector. Two provisions have been particularly criticised.

In India, firms with more than 100 workers cannot lay-off or retrench any worker without the prior permission of government

The first relates to restrictions on the employer's right to retrench and lay off workers and even to close their business. As stipulated by the Industrial Disputes Act, employers are required to give long notice periods and compensation to workers in the event of a retrenchment, lay-off or a closure. Establishments employing 50 to 99 workers are required to notify government at least 60 days in advance, while firms with more than 100 workers cannot lay-off or retrench any worker without the prior permission of government. A number of studies suggest that these provisions have impacted negatively on both economic growth and employment levels in the formal sector. Not all of this evidence is conclusive, but government has accepted that the law has created a 'psychological block' against expansion in the formal sector.

The second provision which has attracted particular criticism relates to restrictions placed on the employment of contract labour. The Contract Labour Act prohibits the use of contract labour in the 'core' activities of a business where labour is required on a regular basis, even when demand is seasonal or fluctuates regularly. It also provides that where contract labour is employed, workers must be paid at the same rate as the regular employees. This poses a particular constraint on those enterprises which are geared to responding to bulk orders, the regularity of which may fluctuate, such as in the garments and leather sectors.

Although no major changes have been made to labour legislation, steps to ease problematic restrictions have been taken, particularly at the level of state governments. Permission to retrench workers or close enterprises tends to be more readily granted, and exemptions and rule changes have made the use of contract labour more permissible. The implementation of labour laws in general tends to be fairly relaxed, with limited inspection, extensive reliance on self-certification, and a tendency for enforcers to look the other way when non-compliance is identified. This limited enforcement means that India's complex and restrictive labour legislation has become somewhat less important.

## Labour market outcomes

India's labour force of nearly 500 million people is the second largest in the world, after China. Over 70 per cent of the labour force is rural, however, and 92 per cent of workers are self-employed or in informal employment. Of those in the formal sector, only 15 per cent are employed in establishments with 10 or more workers. The labour force participation rate, at about 57 per cent, is low and has been declining. It is particularly low for women, who make up only 27 per cent of the labour force.

Employment grew at 2 per cent per annum from 1981 to 1994, but this growth rate has since fallen to 1,7 per cent per annum. Thus, between 1991 and 2010, the number of employees in the formal sector barely changed, rising from 26,7 million to 27,5 million. This has occurred despite the acceleration in GDP growth—averaging over 6 per cent per year during this period. This implies a pronounced decline in the employment elasticity of growth—the extent to which economic growth translates into additional employment—from 0,52 in the 1970s, to 0,2 in the decade starting in 2000. It is possible, however, that many of those who are employed are working longer hours or, if self-employed, for higher rewards. It is also likely that growth has created opportunities for people to move from one sector to a better-paying job in another.

Over the last decade, employment growth has been highest in industry, at 4,6 per cent per annum. The major contributor to this growth, however, was construction. Employment growth in manufacturing has been much slower. Within manufacturing, there is a sharp discrepancy between formal sector manufacturing, with a growth rate of 0,7 per cent per annum, and manufacturing as a whole, with a growth rate of 2,6 to 3 per cent. The far slower growth of employment in formal sector manufacturing held across almost all sectors of manufacturing, and may be due, at least in part, to higher costs (including wage costs). In addition, the Industrial Disputes Act is thought to have encouraged formal sector firms to outsource some of their production to the informal sector rather than to increase their own workforces affected firms' decisions to expand their workforce or to outsource production to the informal sector. Limited enforcement of the Contract Labour Act seems to have encouraged the employment of more contract labour.

Between 1991 and 2010, the number of employees in the Indian formal sector barely changed, rising from 26,7 million to 27,5 million

## Malaysia

Malaysia is a development success story. Since independence from the British in 1957, per capita income has increased eightfold, and absolute poverty is now below 5 per cent. In 2011, GDP was $288 billion, and the growth rate was 5,1 per cent. Malaysia has a population of 29 million, and a labour force of about 12 million. The labour force participation rate is 63 per cent, and unemployment is very low, at only 3,7 per cent (2009).

Malaysia's labour market has historically been strongly controlled by the state, which worked to keep the costs of labour down in the interest of promoting economic growth. While this approach has resulted in high levels of economic growth and job creation, these now appear to be levelling off.

There is some concern that Malaysia is caught in a middle-income trap, finding itself unable to generate sufficient growth in either the supply of, or the demand for, skilled labour, and that a different set of labour market policies will be needed to develop the country further.

### The labour market

Malaysia's labour market has historically had extensive state controls, and was used by the state to pursue a strategy of low-wage industrialisation. While this meant lower wages and limited rights for employees, it resulted in enhanced economic growth, and a substantial reduction in poverty levels. The labour market and its institutions were used by the state for a number of purposes alongside economic development, such as ensuring national security, promoting political, social and industrial harmony, and protecting the political hegemony of the ruling party.

From 1957 to 1970, Malaysia followed a policy of import substitution industrialisation. This had mixed results because, while the economy grew at over 5 per cent a year, the integration of the Malay community into the formal sector was limited, while the economic benefits accrued largely to foreign investors as well as local Indian and Chinese elites. This sparked communal violence in 1969, which led to greater state involvement in the economy, and growing efforts to increase the economic engagement of the indigenous Malays. During the 1980s, there was a shift towards export oriented industrialisation, and state policies shifted their focus towards encouraging investment, particularly by keeping labour costs low.

A key component of Malaysian labour regulation is severe limits on the power of unions, which ensures that the Malay-dominated government has control over labour. Unions are not permitted to demand better terms of employment than those available under law, their existence was subject to state approval, the extent of their bargaining power was controlled by the state, and political strikes were prohibited. At the level of the firm, areas such as transfers, layoffs, retrenchments and job assignments are deemed to be outside of the scope of bargaining. Unions are weak and fragmented, with divisions along racial lines. These divisions are reinforced by government policy.

An additional goal of labour policy has been to maintain Malaysia's comparative advantage of cheap and disciplined labour

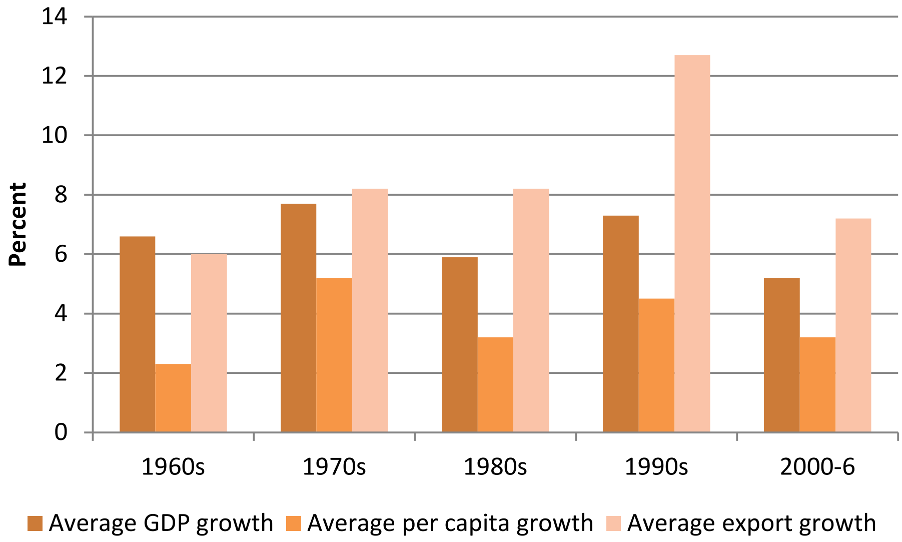
As Malaysia's economic growth, and by extension the creation of employment, has been concentrated in labour-intensive activities, and, since the 1980s, particularly in exporting manufactures, an additional goal of labour policy has been to maintain Malaysia's comparative advantage of cheap and disciplined labour. To this end government has pursued a number of policies to keep wages down, including, until April 2012, the absence of a minimum wage. Employers have also been able to hire and fire with very few restrictions, except in the public sector and at the professional and managerial levels in the private sector. Tax and labour law exemptions were available to foreign companies, to encourage investment, and government refused to enact policies prescribing equal pay for equal work in the export oriented sector where women workers predominate.

A more recent development in the Malaysian labour market has been the entry of a large number of foreign workers. These now make up a quarter of workers in agriculture, and over a third in manufacturing, and most are semi-skilled or unskilled. Foreigners are only able to work in Malaysia for five years, and cannot access the training and human resource development funds available to Malaysians. In addition, they have no union representation and are not protected by any minimum wage provisions. There are concerns that the availability of this type of foreign labour has reduced the pressure on industry to invest in upgrading technology, and shifting away from labour-intensive methods of production.

## Labour market outcomes

Malaysia experienced rapid and sustained economic growth for over five decades. In the 1970s, per capita GDP growth was over 5 per cent per annum, and it has consistently been well above 3 per cent until 2000. Since then it has been more volatile, but has typically remained over 3 per cent (see Figure 7). There has been a pronounced shift from a resource-based economy, focused primarily on rubber and tin, to one centred around large-scale, manufacturing. Agriculture and mining have declined in economic significance since 1970, while manufacturing has more than doubled. Manufacturing's share of total exports rose from 6 per cent in 1970 to over 70 per cent in 2009.

**Figure 7: Malaysian economic performance, 1960-2006**



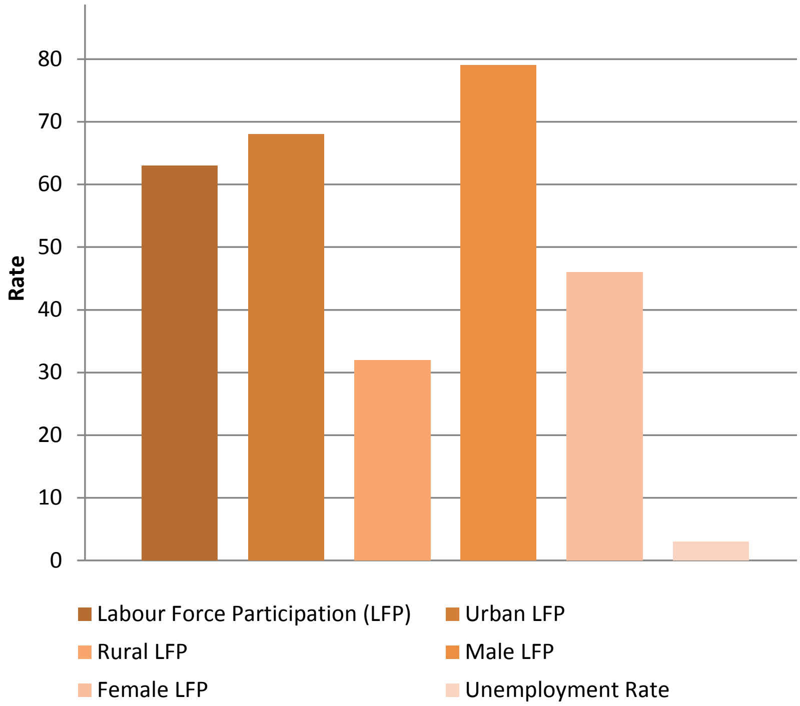

Source: Yusuf and Nabeshima (2009)[28]

From 1980 to 2000, Malaysia had employment growth that was consistently over 3 per cent per year. Between 2001 and 2007, however, annual employment growth slowed to only 1,7 per cent—somewhat below the growth in the labour force. The unemployment rate declined from 7,1 per cent in the late 1980s to 3 per cent in the late 1990s, but by 2007 it had risen to 3,5 per cent, where it has since remained.

Although labour force participation is fairly high (63 per cent), this masks a large discrepancy between urban and rural participation rates, with participation rates of only 32 per cent in rural areas. There is also a marked gender difference, with male labour force participation at 79 per cent, while female labour force participation is only 46 per cent (see Figure 8). Malaysia also faces some challenges in youth unemployment, with 90 per cent of registered job-seekers being younger than 30 years of age. Unemployment appears to particularly affect young job-seekers with tertiary education, as 70 per cent of available jobs involve routine or manual work.

From 1980 to 2000, Malaysia had employment growth that was consistently over 3 per cent per year

**Figure 8: Labour market characteristics, 2010**




Source: World Bank, World Development Indicators

The incidence of poverty in Malaysia has declined dramatically, from 52 per cent in 1970 to 4 per cent in 2009.

While all employees experienced rising real earnings of about 2 per cent per annum from 1995 to 1999, between 1999 and 2004 the real earning of managers and professionals rose far more quickly than those lower on the earnings scale. Nonetheless, the incidence of poverty has declined dramatically, from 52 per cent in 1970 to 4 per cent in 2009. Inequality has also declined, with the Gini coefficient falling from 0,51 in 1970 to 0,44 in 2009.

Malaysia has been enormously successful in creating both employment and economic growth. Rising employment, combined with higher earnings, has led to a substantial reduction of the number of people living in poverty. Increases in GDP have been sustained over a long period, and the structure of the economy has shifted away from raw materials. At the same time, the evidence indicates that while Malaysia's performance in both employment and economic growth is still positive, in recent years it has started to decline. Some analysts believe that the country may now be caught in a 'middle-income trap,' a term used to describe the situation when a country's ability to compete against low-wage economies declines because of rising wages and incomes, but when it also remains insufficiently skilled and productive to compete with the economies of the developed world. If this is so, it suggests that while the country's labour market policies may have helped lift the country to middle-income status, a different approach focussing on skills development and productivity growth may be needed to ensure further development.

# Comparative Insights for South African Labour Market Reform

The great value of comparative research is that it is possible to extract insights for South Africa from the experience of other countries. The insights one draws depend, of course, on the comparator countries that are chosen. In our case, the reasons for selecting each of the comparator countries differed. For example, while Brazil was chosen for its similar economic trends and sectoral composition, India was chosen primarily for reasons of historical political similarities, and Malaysia was chosen because, despite economic and social similarities to South Africa in the 1980s, economic development and employment patterns have followed a very different path since that time.

These similarities and differences are not strong enough to support a claim that any one experience should be thought of as decisive in framing the way South Africa tackles the challenges of reforming its labour market. They do, however, suggest a number of insights—some broad, some more specific—about how to think about the challenge of labour market reform. In this section, we draw together some of these insights derived from the background reports and from the discussions at the Round Table in November 2012.

> Faster growth will clearly lead to more employment, but much can be done to enhance employment growth even without this

## Brazil

### The sectoral composition of the South African economy does not necessarily need to change to generate large numbers of jobs

Brazil's rate of economic growth has been similar to South Africa's since the 1990s. The sectoral composition of its economy is also reasonably similar to South Africa's, and has been changing in similar ways. For example, manufacturing makes up a similar share of the two economies—about 15 per cent on Brazil, and 13 per cent in South Africa. Moreover, the share of each has been declining at a similar rate over time, while the share made up by the services sector has been rising in both economies.[29]

There is an important difference between the two economies, however. While the trends in manufacturing have been broadly similar in the two countries, their implications for employment have been very different: employment in manufacturing has grown in Brazil, but has fallen significantly in South Africa. During this same period, Brazil has also attained a steady increase in equality, as well as improving other social indicators.

This has important implications for South Africa for it suggests that rising employment and increasing equality in South Africa are not necessarily predicated on more rapid economic growth. Nor, as some would claim, need they be dependent on driving a potentially—disruptive transformation of the sectoral composition of the economy. While faster growth will clearly lead to more employment, much can be done to enhance employment growth even at existing growth rates and without significant changes to the sectoral composition of the economy. What is needed, however, is to ensure economic growth is driven by the growth of labour-intensive firms.

## Small firms and self-employment could play a role in increasing labour intensity

One sharp contrast between Brazil and South Africa, and perhaps one of the reasons that Brazil has been so much more successful than South Africa in creating jobs (and reducing poverty and inequality), is the share of employees to be found in self-employment or in small firms.

In South Africa, 8 per cent of males and 6 per cent of females are self-employed, while in Brazil the figures are 27 and 24 per cent respectively. In South Africa, 24 per cent of males and 33 per cent of females are employed in firms with between one and four employees, while in Brazil the figures are 37 and 56 per cent respectively. In South Africa, small firms tend to be far more labour-intensive than their larger counterparts, and are therefore more likely to employ workers with the characteristics of the South African unemployed. This means that they raise overall employment intensity, while providing natural entry points into employment for the unemployed, and particularly the less skilled and the young.

The fact that there are so few people working in South African small firms suggests that these firms are offering only limited employment opportunities, which disadvantages young people with few skills and little experience. This seems likely to be an effect—at least, in part—of the constraints the South African labour market regime places on the growth and development of small firms. By contrast, the Brazilian labour market regime seems to encourage small firms, which pay lower payroll taxes than larger firms do. Bargaining councils, and the extension of their agreements, which helps constrain employment in small firms in South Africa, are also absent in Brazil. In the Brazilian context, small firms are not pushed towards more capital-intensive production processes, which means they are likely to hire larger numbers of employees with lower skill levels than in South Africa. The Brazilian experience suggests that South Africa should find ways to encourage the emergence and development of small and labour-intensive firms.

The power of the employer to fire may be the most critical component of labour market flexibility

## Even in highly regulated labour markets, the ability to fire people easily facilitates more rapid job creation

It is remarkable that Brazil has been able to achieve rapid employment growth despite its labour market's being heavily regulated. A variety of policies and institutions—like the high level of payroll taxes—which would usually fuel the growth of the informal sector and discourage the creation of formal sector jobs do not seem to have had this effect in Brazil over the past decade.

Off-setting these policies and institutions is the fact that employers are able to dismiss workers very easily and at little cost. Thus, while the labour market is highly regulated and imposes considerable additional costs on wages through payroll taxes, it is also very flexible. Indeed, employers make significant use of their firing powers, resulting in considerable rates of labour turnover. This suggests that the power of the employer to fire may be the most critical component of labour market flexibility. Even in a labour market that otherwise appears to militate against employment creation, significant employment gains can be realised if there is flexibility in respect of firing.

## India

### A poorly regulated labour market reduces job creation in the formal sector

The most prominent feature of the Indian labour market is the very large proportion of workers—over 90 per cent—working under largely unregulated conditions. The dualism between the large and unregulated informal sector, and the small and highly-regulated formal sector may have been an important factor limiting the growth of formal sector employment. While it is not possible to eliminate all differences between the informal and the formal segments of the labour market, India has moved to reduce the duality by defining basic working conditions, minimum wages and social security covering injury, sickness, maternity and old age. However, as long as the formal sector remains over-regulated, incentives for the growth of the informal sector will persist.

South Africa's informal sector is much smaller than India's, but it is marked by wages and incomes that are considerably lower from those received by many workers in the formal sector. In some areas, such as clothing, informal employment appears to be growing rapidly, while formal employment shrinks as a result of reduced competitiveness of formal sector business in these industries. This is likely to continue for as long as formal businesses' competitiveness declines. Allowing an informal sector to grow in response to the over-regulation of the formal sector is an outcome that ought to be resisted by all constituencies: the unemployed, organised labour, business and government. It is, therefore, important to avoid creating excessive disincentives to operating in the formal sector.

Prohibiting contract labour is likely to cause more problems than it solves, particularly for firms where demand is volatile

### Prohibitions on contract labour are ineffective

Contract labour is particularly important for firms in the traded sectors in India, especially manufacturing, because these experience fluctuating demand for their product. As a result, and despite legal restrictions that have sought to limit the use of contract labour to non-core activities, firms in India are increasingly resorting to the use of contract labour. In the formal manufacturing sector, contract labour comprised 13 per cent of the labour force in 1993, but rose to one-third by 2009. Over 60 per cent of new jobs created in the past decade were for contract labour. This has been facilitated by amending laws, granting exemptions and by 'looking the other way'.

Different approaches to this challenge have been proposed, including the suggestion that contract labour should be broadly permitted irrespective of the nature of the work undertaken, but providing contract workers with the same wages and benefits as regular workers. Under this approach, social security benefits, such as health insurance and provident fund contributions, should be provided on the basis of 'portable' eligibility, with responsibility falling on both employers and contractors. This would provide contract workers with wage and social security, but not job security. Employers would therefore have no incentive to substitute casual workers for permanent workers, but would be able to utilise contract labour unhindered to adjust to fluctuating demand for their product.

The use of contract labour in South Africa is currently a hotly-contested policy issue, with government moving to regulate more closely the use of contract labour. The ostensible grounds for this is the exploitation of contract workers, and the pressure that the use of contract workers places on those in regular employment. The case of India suggests that there may be other ways of dealing with this issue, and that prohibiting contract labour is likely to cause more problems than it solves, particularly for firms, including critically those in export, where demand is volatile.

## Malaysia

### Keeping labour costs from growing creates jobs for less skilled workers

The outstanding feature of Malaysia's development has been its success in sustaining economic growth and the creation of employment, and the accompanying reductions in inequality and poverty. It is worth emphasising that Malaysia's success in employment creation and economic growth was achieved on the basis of an economic structure that closely resembled South Africa's in the 1980s, in terms of productivity, levels of human capital development and dependence on primary products. Key elements of the Malaysian labour market policies which enabled extensive job creation and economic gains were contained wage costs, severely limited collective rights for workers and high levels of management prerogatives with respect to employees.

In South Africa, it is estimated that for every 1 per cent rise in labour costs that is not offset by productivity increases, employment is reduced by 0,7 per cent. This means that a rapid rise in wages will choke off employment growth. While there are limits—political and constitutional—to which South Africa can proceed with implementing a low-wage employment strategy, the broader lesson to recognise is that managing labour costs can play an important role in ensuring employment growth.

Managing labour costs can play an important role in ensuring employment growth

### Is South Africa stuck in a middle income trap?

The recent slowing of economic growth and employment creation in Malaysia has been interpreted by some as evidence that Malaysia is caught in a middle income trap. Malaysia's earlier success in creating employment resulted in lower unemployment and less underemployment in the labour force, which in turn led to a relatively rapid increase in wages compared to those in other low cost producers. Malaysia's competitive position in labour-intensive industries has, therefore, declined. At the same time, Malaysia has not been able to develop significant competitive advantages in the production of higher value goods and services through innovation and skills development. The result is that Malaysia now struggles to remain competitive compared to other low cost producers of labour-intensive products, while also being unable to compete effectively with technologically superior producers.

South Africa's National Development Plan (NDP) characterises South Africa as caught in a similar middle income trap, arguing that, along with Malaysia and many other middle income countries, it is currently unable to compete at the 'bottom end' with low-income countries, but is also unable to compete at the 'upper end' and break into the higher value products and markets that are dominated by high-income countries.[30]

The Malaysian government has recognised that its low cost labour strategy, which was so successful in the past, is now hindering efforts to upgrade skills and technology. Beginning in the early 1990s, the Malaysian government has introduced several active labour market policies to enhance innovation and technological upgrading, and to equip workers with new skills. It has mandated the training of workers in the workplace, and provided fiscal and financial incentives for training.

The Malaysian experience suggests that low wage strategies allied to export-orientated policies can result in significant increases in employment for those with limited skills. It suggests also, however, that it can be difficult to transition from a low-wage strategy to one premised on higher wages and productivity. It is important to recognise, however, that Malaysia's challenge is different from South Africa's, where mass unemployment of low-skill workers is the dominant policy challenge. The high-productivity sectors in South Africa need to remain competitive and continue to grow. At the same time, however, our national strategy cannot be premised on the assumption that achieving growth in these sectors will solve the wider challenges of unemployment.

## The 'indigenisation' of an economy is hard to achieve, even in the context of high growth and employment

In 1975, Malaysia passed the Industrial Coordination Act (ICA), with a stated goal of raising the Bumiputera (Malay and other indigenous Malaysian) ownership of productive assets from 2,4 per cent to 30 per cent by 1990. The ICA required Chinese business owners to have minority Bumiputera partners, and quotas were established for all aspects of economic life, including debt and equity financing, home ownership, education and public assistance. One example of this is that for a firm to qualify for import protection and tax holidays, 30 per cent of its work force would have to be Malay (though MNCs manufacturing for export were exempted from ICA policies).

Despite these efforts, by 2012 the target of 30 per cent Bumiputera ownership had still not been reached. Instead, a limited number of politically connected Bumiputera have been the primary beneficiaries of these policies, while the Bumiputera entrepreneurial class are clustered around state enterprises and equity stakes in businesses owned by other ethnic groups. As a result, the Bumiputera remain among the poorest ethnic groups in Malaysia, with the highest level of intra-ethnic inequality. Unintended consequences of Malaysian indigenisation policies include a growth in corruption, and the large-scale emigration of skilled non-Bumiputera Malaysians.

A limited number of politically connected Bumiputera have been the primary beneficiaries of these policies

The experience of Malaysia underlines the difficulties entailed in changing ethnically-based patterns of ownership and economic participation, as well as the economic distortions that tend to arise when efforts are made to do so. Moreover, Malaysia's attempt to alter its ethnic patterns of ownership occurred in the context of very high and sustained levels of economic growth, an advantage which South Africa does not have. From a different angle, however, Malaysia did manage to implement a comprehensive indigenisation programme without significantly compromising employment creation or economic growth, although not without increasing corruption and skilled emigration.

# Key Findings

The Round Table discussion and the research we commissioned provided a number of important insights for South Africa, with each comparator country providing a somewhat different angle onto labour market institutions and policies. There are a number of key insights which emerge from looking at all four countries as a group.

## The outcome of labour market policies depends on factors beyond the labour market

Despite some similarities to each other and to South Africa, the four countries considered have very different labour markets. The most striking differences are with respect to the size of the labour markets and in relation to a number of critical indicators. Key indicators for each country are summarised in Table 1 below. The figures highlight the size of the Brazilian economy, and of the Indian population, but also the high level of unemployment and inequality in South Africa (driven by the very low level of employment). Additional differences are found in the size of the informal sector, the quality of infrastructure, and the availability of technology and human capital.

Despite some similarities to each other and to South Africa, the four countries considered have very different labour markets

**Table 1: Critical indicators for Brazil, India, Malaysia and South Africa (most recent data)**

| | Brazil | India | Malaysia | South Africa |
|---|---|---|---|---|
| **Population (2011)** | 197 million | 1 241 million | 29 million | 51 million |
| **Labour force (2010)** | 80 million | 473 million | 12 million | 18 million |
| **Proportion of adult population in the labour force (2011)** | 70% | 56% | 60% | 52% |
| **Proportion of adult population in employment (2011)** | 65% | 54% | 59% | 39% |
| **Unemployment rate (narrow; 2009)** | 8% | 4% | 4% | 24% |
| **Size of economy (2011)** | $2,5 trillion | $1,8 trillion | $290 billion | $420 billion |
| **GDP growth rate (2011)** | 3% | 7% | 5% | 3% |
| **Gini coefficient (2010)** | 0,54 | 0,33 | 0,46 | 0,63 |

**CDE 2013**

Source: Data from World Bank datasets and country paper authors

These differences both shape and are shaped by the four countries' divergent labour market policies and institutions. For example, Brazil is characterized by a highly regulated labour market, but one in which employers have considerable freedom to dismiss workers at low cost. This flexibility appears to be important, resulting in high levels of employment despite the unfavourable sectoral composition of the economy and economic growth rates that are not especially high.

The Indian labour market is also highly regulated, but the vast majority of provisions apply only to a small proportion of the Indian workforce. They are, nevertheless, thought to be one of the reasons why the informal sector remains so large, job creation in the formal sector remains low, and the differences in employment conditions between the formal and informal sectors is so stark. By contrast, the Malaysian labour market is characterised by lower levels of statutory protection for employees and, historically at least, a policy commitment to try to keep labour costs down the better to compete in global markets for low-end manufactured goods. In this regard, it has been extremely successful. However, it is proving less successful in supporting Malaysia's transition from a middle- to high-income status.

The most prominent feature of South Africa's labour market, by contrast, is the high level of unemployment. The high costs of hiring and firing employees, barriers to the survival and growth of small firms, and regulations which hinder firm expansion and ensure entry level wages are high, all constrain job creation and make it particularly difficult for new entrants to the labour market to find employment. An important question, given high unemployment and regulation in South Africa, is whether the informal sector is genuinely as small as it appears to be. If so, why has excessive regulation of the formal sector had such different outcomes for the informal sector in the two countries?

Given the context dependence of labour market institutions, and the labour market itself, it is clear that solutions from one environment cannot simply be transplanted into another. While countries can learn from each other's experiences, these lessons need to be adapted carefully to the local context.

## Labour market reform is difficult

Even if transplanting labour market policies and institutions from one country to another was desirable, it is unlikely that it would be feasible. In each of the countries examined, efforts at labour market reform have taken place, but significant reform has proved remarkably elusive. One reason for this is the extent to which labour market institutions are shaped by the societies in which they occur. Labour market institutions form a critical part of a society's social contract, making reform difficult. This is especially so when people believe that the reforms in question will reduce their protection, make their employment less secure and reduce lifetime earnings.

In each of the countries efforts at labour market reform have taken place, but significant reform has proved elusive

The Brazilian labour market regime is based on a fascist-style, corporatist model, developed during the dictatorship of the 1930s and 1940s. Subsequently, with the transition to democracy, various presidents have attempted to reform it. President Cardoso attempted reform at the level of individual workers' rights, while President Lula's efforts addressed union rights and collective bargaining. Although each managed to make some changes, the logic of the underlying system remains unchanged, and no fundamental reform has been achieved.

Similarly, successive Indian governments have made repeated efforts to reform its labour market regime. Despite the complexity and impracticality of the laws, most efforts at reform have been unsuccessful, and government has now largely resorted to 'looking the other way', granting some exemptions, and making minor changes to laws.

In Malaysia, the pressure for reform has been more recent—largely since the country identified the need to escape its middle-income trap. Although some reforms, such as the introduction of a minimum wage, have been successfully implemented, progress has been extremely slow. Other changes which have been widely advocated, such as providing labour representation with a more opportunities to engage with business and government, have not yet been successfully implemented.

As is the case with Brazil, India and Malaysia, South Africa's current set of labour market policies and institutions is in large part shaped by history. They are essentially those which were developed during the apartheid era to protect white workers, but deracialised and extended to all workers. In the process we have created a highly protected and relatively highly-paid formal workforce, but with such high barriers to entry that we have also created one of the world's largest groups of unemployed.

# Concluding Remarks

South Africa's labour market is the one in which unskilled and inexperienced workers struggle most to gain purchase

The way a society regulates its labour market, and the institutions it erects to govern that market, play a critical role in shaping the trajectory of economic growth and development. The distinctive choices made by Brazil, India, Malaysia and South Africa have generated quite distinct labour outcomes, whether measured by levels of employment and unemployment, wage rates, inequality, or formality/informality.

The interaction between labour market rules and institutions and the variables that measure the performance of the labour market is complex, and affected by a wide range of other contextual factors. These include the rate of economic growth, the state of the global economy, the sectoral composition of the economy, the quality of education, the quality of governance and regulation in the rest of the economy, the quality of infrastructure, the availability of skills and technology, and the non-labour costs of doing business. It would, therefore, be a mistake to draw unqualified conclusions about the impact and effect of any particular institution or set of institutions in one labour market, or about the likely impact of replicating those in the labour market of another society.

Having said that, a comparison between the experiences of the four countries under review suggests that, for a range of reasons, South Africa's labour market is the one in which unskilled and inexperienced workers struggle most to gain purchase. This is reflected, most obviously, in the vastly higher levels of unemployment in South Africa relative to the other economies, but it is also reflected in the lower levels of participation in the labour force and even in the much smaller size of the informal sector. Against all these metrics, South Africa's labour market performs worst of the four countries', with one not unrelated exception. This is that levels of remuneration for unskilled people who do get work in South Africa are higher (and even far higher) than those of Malaysia and India.

If South Africa is to begin to absorb the millions of people who need work, most of whom are unskilled and inexperienced, there are some general conclusions to draw from the experiences of the other three countries. These include:

- Creating excessive regulatory burdens on employers (as India, for example, has done) can help ensure that even rapid economic growth generates only very modest gains in formal sector employment, with employers seeking to avoid these regulatory burdens by using contract labour or by outsourcing some of their operations to firms working in the informal sector;

- Excessive regulatory burdens also contribute to the rapid growth in the use of contract labour that is seen in all four of the countries;
- High levels of payroll taxes create incentives for both employers and employees to work 'off the books' and can ensure the persistence of a high level of informality;
- Not all labour market reform needs to be undertaken simultaneously. Even highly-regulated labour markets, like Brazil's, can generate considerable employment growth if the employment decision is 'de-risked' by not unduly restricting the circumstances in which employers can dismiss employees and keeping the costs of that process as low as possible. Similarly, the de-risking of the employment decision in Malaysia also helped to spur employment growth;
- A low-wage manufacture and export strategy such as Malaysia's can run into problems as wages rise and the country loses competitiveness if it cannot generate off-setting competitiveness in higher value-add activities, but it can also generate mass employment and rising incomes for millions of people; and
- It is possible to provide exemptions from labour market regulations for firms operating in particular sectors or in particular spatial areas, as has been done in both Malaysia and India.

These are important insights, and offer clues about the direction that South Africa might explore in an effort to address some of the many weaknesses built into the architecture of the institutions governing the labour market. These, surely, revolve around finding ways to make it easier for employers and would-be employers to hire unskilled and inexperienced workers by reducing the set of disincentives that employers currently face. The two most critical of these are the difficulties and costs associated with dismissing unsuitable workers and the need to ensure that wage costs (and the growth rate of those costs) reflect productivity as closely as possible. Addressing these concerns will also assist in making labour markets more conducive to the growth of labour-intensive small and medium size firms, which have a particularly important role to play in job creation.

South Africa's labour market is the one in which unskilled and inexperienced workers struggle most to gain purchase

Identifying these priorities is relatively straight forward. Much more complicated is devising a plausible path to reform given the difficulties that many, though not all, societies experience in seeking effective reform of their labour markets.

Societies both shape and are shaped by their labour market institutions, which create winners and losers and which also constrain the way social actors think about the labour market and imagine alternatives. As a result, it is generally quite difficult to reform labour markets, particularly when vested interests are strong. This is not a counsel of despair, but recognition that the experiences of Brazil, India and Malaysia in attempting to reform their labour market illustrate just how difficult this can be.

As mentioned previously, however, South Africa's labour market outcomes are markedly worse than those in Brazil, India or Malaysia. It is the economy in which young, inexperienced and unskilled people face the greatest challenges in finding employment, or a way in which to generate income for themselves. While the size of India's informal economy makes comparisons more complicated, in both Brazil and Malaysia, levels of labour market participation are higher than in South Africa, and unemployment is substantially lower. Thus, while concerns about the harmful impact of current labour regulation have been raised in each country, and labour market reform has been advocated, the need for reform in those countries may not have been as urgent as it is in South Africa.

While labour market reform is rarely popular, and while even popular, labour-friendly governments such as President Lula's in Brazil have struggled to implement it, it can be done. But it requires a government that is both strong and committed. In the South African context, labour market reform is particularly unpopular because of the failure of other institutions whose purpose is to resolve socio-economic conflict and improve the lives of South Africans. This places extra pressure on labour market institutions. It is probable, for example, that the poor living conditions of miners contributed substantially to recent labour problems partially manifest of Marikana. In the absence of functioning local government, unmet needs and expectations have increased pressure on wage negotiations and have exacerbated tension in the workplace. Addressing failures in other institutions, and improving the provision of basic services by the state, would go a long way to making labour market reform more palatable.

But if it is difficult to conceive a path to root-and-branch reform of the labour market, it is necessary to recognise the malign effects of the status quo. We need to effect reforms that make it easier for employers to hire unskilled, inexperienced workers at a cost that reflects their productivity. By driving up wages and making it difficult to dismiss unsuitable workers, our current labour market regime has helped put the economy on an increasingly skill- and capital-intensive growth path. South Africa needs to find ways to make it easier for potential employers to hire unskilled and inexperienced workers. This requires making dismissal of unsuitable workers easier, ensuring that pay increases are in line with productivity growth, and freeing up the environment for business, especially labour-intensive small and medium sized firms.

The differences in South Africa's circumstances mean that labour market reform is a more urgent priority here than India, Brazil or Malaysia

The imperative to reform the South African labour market derives from our very high unemployment rates, our very low levels of new firm creation and our lack of greenfields foreign investment. We are not like Brazil (which has absorbed millions into its urban economy), India (where economic growth is rapid), or Malaysia (where employment levels are very high). The differences in our circumstances mean that labour market reform may be a more urgent priority here than it is in the other countries we have looked at. With millions of unskilled people without work, it is no exaggeration to say that South Africa's future depends on its ability to overcome this. It is essential South Africa acts decisively with respect to labour market reform. Vision and leadership from government are urgently required.

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This CDE Round Table was funded by
the UK Foreign and Commonwealth Office Prosperity Fund

British High Commission Pretoria