Making South Africa more labour intensive

CDE **SUMMARY REPORT**

January 2019

Introduction

On 13 June 2018 CDE hosted a roundtable discussion on the critical question of why economic activity is not more labour-intensive given the scale of our unemployment crisis. What prevents employers from employing more people? Why are industries that do use lots of labour in decline? What can be done to reset these trends and put South Africa on a more labour-intensive growth path?

To answer these questions, we gathered experts on the labour market from government and the academe, as well as senior businesspeople from a range of economic sectors (see participants list at the end of the report).

To what extent has public policy reduced employment?

A keynote address by **Prof. Haroon Bhorat** was premised on an empirical finding that, since 1997, real wages have grown strongly at the top of the wage distribution, have grown somewhat at the bottom of the distribution, but have actually fallen for a majority of workers in the middle. He argued that this was not all that surprising: the skills shortage has made it impossible for employers to avoid offering higher wages to skilled workers and changes to wage setting machinery have resulted in faster-than-inflation increases at the bottom. In order to moderate their costs, employers have kept wage growth in the middle of the distribution to rates lower than inflation.

The key policies most directly responsible for this are those that have had the effect of reducing employers' flexibility and those that have either strengthened collective bargaining or granted the Minister of Labour the power to raise minimum wages.

South African policy is continuing to drift towards increasing worker protection. This means reduced employment creation, with employers becoming increasingly reluctant to take on staff because

This Summary Report is based on a longer report, **Making South Africa more labour intensive**. The report is available on CDE's website (www.cde.org.za) or see here.

of rising wage and non-wage costs. Prof. Bhorat turned to the question of the national minimum wage (NMW) and argued that it was likely to reduce employment, especially in the most labour-intensive sectors like agriculture, domestic services and manufacturing. A critical problem was that advocates of the NMW had come to think of it as the critical tool for achieving a wide range of goals from poverty alleviation and inequality reduction to employment creation. He argued that it could not achieve all of this, and that there were more efficient approaches to reducing poverty and inequality that did not pose as direct a threat to employment creation.

Andrew Donaldson argued that the central economic ideas that shaped policy in the early 1990s were influenced by the ideas and thinking of the industrial unions. These focused strongly on the idea of a high-productivity, high-wage economy, and reflected a desire to avoid the kind of low-wage, low-skill, low-productivity strategy that the Asian tigers followed. High productivity was to be achieved through the opening up of the South African economy through trade liberalisation (to discipline firms) and the rebuilding of our skills systems (e.g. through the creation of the SETAs).

Much of this policy-making was naïve. In practice, it takes a long time to build the education and training capabilities needed to achieve high-skill and high productivity levels in an economy.

We have been, in other words, a low growth, low investment economy since the 1970s. And, there is no prospect of achieving higher productivity, high levels of skills, and high wages with a history of 40 years of under-investment.

He argued that this was a more important explanation of unemployment than labour market regulation. The fact that investment rates had been too low for so long had also undermined a critical link in government's strategy to enhance skills formation to assist with productivity growth: skills formation takes place most effectively in growing economies in which employment is growing, which also facilitates the formation of partnerships between business and institutions in the skills/education sector. Because of the lack of growth, these partnerships had never developed and skills formation had not been anywhere near as effective as had been expected.

Responding to these presentations, **Prof. Nicoli Nattrass** pointed out that although South Africa's unions reject the kinds of reforms needed to foster labour-intensive industries, this was not always the case. When she was on the Labour Commission in the 1990s, SACTWU rejected the idea of a NMW precisely because it understood that this would result in the loss of low-skill jobs. This attitude is not as obvious today, however, with unions and others committed to a strategy of higher-productivity, higher-wage jobs. She noted that the implementation of the NMW was bound to reduce employment even if the exemptions process worked well because the uncertainty associated with applying for exemption would itself reduce investment.

Key points from the discussion that followed these presentations, included that:

- The key deficit in South Arica's labour market relative to the rest of the developing world is that we have very few agricultural jobs, a fact that has enormous implications for social and economic policy;
- Notwithstanding some discussion about the difficulties of measuring income accurately, the data presented by Prof. Bhorat suggested that the proportion of the workforce that had seen real wage increases since 1995 was surprisingly small; and
- As the only significant demand-side intervention to support employment growth, the employment tax incentive might be usefully expanded (to other workers beyond only first time young employees) and extended (i.e. made applicable for longer periods of time).

Why have employment-intensive industries declined?

Wandile Sihlobo presented data on the long-term decline in agricultural employment, arguing that it was a function of increased farm sizes, mechanisation and capital-intensity. This, he argued, was a result of the liberalisation of the agricultural market and the withdrawal of public support to farmers, especially small farmers that the apartheid government had previously offered. This wiped out smaller and less efficient farms, but also had the effect of reducing employment in the sector.

Looking to the future, he noted that, while adverse trends in employment in some of the large agricultural sub-sectors were likely to continue, there were some sub-sectors that had growth potential and were also highly labour-intensive (e.g. nuts, avocados, table grapes and vegetables). Addressing land claims was a prerequisite for exploiting these opportunities in commercial areas, while opportunities that existed in the former Bantustans could be realized only with more extensive reform.

South Africa's clothing sector was the subject of a presentation by **Prof. Jeremy Seekings**, who argued that South Africa had failed to take advantage of the opportunities that existed in this sector for mass employment creation, a failure that dated back to apartheid. Recent trends had worsened this: employment in the sector halved between 2002 and 2012. The upshot is that South Africa has only a tiny fraction of the world's 18 million clothing jobs.

This compares poorly with other countries' experiences. In 1987, Hong Kong had 300 000 clothing workers. Employment in China grew from about 3.5 million to 5.5 million in ten years. Bangladesh (4 million workers today) has seen explosive growth in clothing sector employment, while Vietnam (1.3 million), Turkey (over 300 000), Madagascar (120 000) and even Lesotho (53 000 in 2004) have all had periods of rapid employment growth.

Clothing offers countries extraordinary development opportunities. But South Africa has never taken advantage of these. When global trade in clothing increased 25-fold between 1963 and 1976, South Africa was producing almost exclusively for the domestic market, and accounted for 0.1 per cent of global exports. The key reasons South Africa had failed to tap into these jobs were:

- Taken as a whole, South African labour has never been cheap (even under apartheid, employers faced high costs for skilled labour);
- High tariff barriers and adverse locational decisions made it expensive to run clothing factories in apartheid South Africa, while the strong Rand made exporting difficult; and
- Rising costs of unskilled labour has priced South Africa out of the global market for many kinds of clothing.

Prof. Seekings concluded by arguing that, because the unions have recruited members from non-compliant firms in Newcastle, they have become increasingly flexible in their pursuit of high wage settlements. This, however, might be threatened by the implementation of a NMW. This is important because the only way that South Africa could expand employment in this sector significantly is if we exported far more clothing, which depends on the competitiveness of input costs. Realistically, however, we probably need to establish export-processing zones in which there would be more wage flexibility if we are to achieve this.

Responding to the presentations, **Prof. Anthony Black** disagreed with Prof. Seekings's assertion that trade liberalisation was not a key driver of employment losses in the clothing sector, and agreed with Wandile Sihlobo that the withdrawal of support from commercial farming had led to consolidation in the sector and a loss of jobs. This was accentuated by the ineffective support offered to small farmers since 1994. He pointed out that, unlike the Asian Tigers, South Africa's neighbours did not provide either large markets for our goods or sophisticated firms seeking to outsource some of their production to South Africa. **Gilad Isaacs** argued that too much emphasis on the challenges firms might have with the labour market detracted from many other potential sources of competitive gains such as better logistics, a more predictable exchange rate, and improved access to finance.

In the **discussion** that followed these inputs, debate turned on the extent to which a depreciated Rand might offer prospects of competitive advantage, with some participants noting that the pass through to higher inflation rendered this strategy largely ineffective, though others insisted it could facilitate expansion in some manufacturing sectors, especially the most labour-intensive, such as clothing.

A number of speakers pointed out that, in the absence of a recovery of manufacturing, it might be harder to build a viable growth and development strategy, since services seemed much less effective a vehicle for fostering economic prosperity.

Which industries could absorb large numbers of workers?

Speaking about manufacturing, **André de Ruyter** noted that manufacturing employed somewhere between 800 000 and a million fewer workers than a country at our level of development should. He ascribed the deficit to a lack of demand for local goods as well as the hurdles that local manufactures face. It was, he said far more expensive to transport iron ore to the Vaal Triangle for smelting than it was to export it to China, while local manufactures had to deal with some of the world's highest port charges. He argued that trade and investment policy had to be better aligned because investment decisions often depended on the extent to which local firms would face the threat of foreign dumping, but pre-emptive protection could not be obtained before investment was done because our trade regime requires firms to show actual harm before restrictions are placed on foreign firms' dumping goods in South Africa.

Sean Phillips argued that a lot of emphasis was often put on infrastructure projects to support employment creation, but as a general rule, most infrastructure projects are not all that labour-intensive when one measures jobs created per rand spent. The Expanded Public Works Programme (EPWP) had been designed to reverse engineer increased labour intensity into existing infrastructure spending by government, but this had not really been successful, and most of the jobs reported by the EPWP were jobs that would in all likelihood have existed in any event. The EPWP was not, therefore, creating a large net increase in employment in comparison to what would have happened in its absence.

According to **Andy Searle**, employment creation in the Business Process Outsourcing sector initially disappointed those who thought the sector would grow rapidly, but in recent years it has increased by 22 per cent year-on-year. The sector has the potential to add as many as 100 000 new jobs. (International BPO activities already employ 40 000 people in South Africa.) He said that South Africa's BPO offering was highly competitive globally, and that this was a result of strong collaboration by stakeholders within the industry as well as with government, which also provides significant employment-based subsidies to BPO firms.

Do stand-alone projects help?

A critical question that policy-makers confront is the value of stand-alone projects and whether these have the capacity to make a meaningful difference to employment creation or are more of a distraction from fundamental changes that need to be made.

Addressing this, **Najwah Allie-Edries** of the Jobs Fund argued that context matters, and that in an environment more conducive to investment and growth (e.g. more anti-corruption enforcement, regulatory reforms to encourage new firm entry, and educational reforms to stimulate better skills acquisition), stand-alone projects would have a wider and deeper impact. At the same time, the Jobs Fund, which was consciously designed to encourage experimentation had the capacity to help build the knowledge and trust needed to spark further initiatives.

Tashmia Ismail-Saville described the approach that the Youth Employment Service (YES) has taken to ensure that its initiatives are integrated into wider economic activities in order to avoid becoming stand-alone activities. These included significant efforts to identify the sectoral and spatial profile of South Africa's job-creation potential: where would these jobs be and what would they look like? They intended to use this to ensure that YES initiatives help exploit these opportunities.

According to **Tumelo Chipfupa**, special economic zones (SEZs) have shown enormous potential to spark economic and employment growth in countries all around the world. The redefinition of South Africa's industrial development zones (IDZs) as SEZs is a result largely of the disappointing performance of the IDZs. This he ascribed to the absence of incentives provided to firms locating in IDZs, something that the new legal framework addresses by making provision for lower corporate tax rates and enhanced access to the employment tax incentive. It was likely, however, that administrative challenges would persist in ensuring better coordination between regulatory agencies and lower regulatory burdens for firms.

Reflecting on the conversation, **Catherine MacLeod** noted that, while there were real limits to what stand-alone projects could achieve, in a low-growth, low-trust society they offered some prospect of progress that might not be achievable otherwise. Critically, however, maximising their impact required learning lessons from them, which requires a much deeper commitment to monitoring and analysing the projects and their impact, and being prepared to close down those projects that did not seem to be working.

Key themes

The day concluded with **Prof. Haroon Bhorat** offering some thoughts on the discussion, a key theme of which had been that there was often a tendency to load too many objectives onto individual initiatives and policies. This was evident, too, in the discussion of the NMW, which some think can solve poverty, inequality and unemployment. This, he said was, unrealistic, and there were usually more efficient ways to achieve multiple objectives than expecting a single tool to achieve them all. In the same spirit, it was unrealistic to expect that any single sector – or even a small group of sectors – would make meaningful progress in reducing unemployment by itself. We need all sectors to grow. It was, however, important to understand the on-going importance of manufacturing in helping to build the capabilities a society needed to address many of the challenges it faces. In light of this, on-going weaknesses in manufacturing growth were something that South Africa needed to address seriously.

Participants

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