Ten Million and Rising

What it would take to address South Africa's jobs bloodbath

THE GROWTH AGENDA
Priorities for mass employment and inclusion

CDE

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This report is based on considerable research over the past five years, Roundtable discussions with South Africa's leading experts on growth and jobs, and a number of publications on these issues which are available on CDE's website, www.cde.org.za.

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- **CDE Report**
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Ten Million and Rising

What it would take to address South Africa's jobs bloodbath

Background Report

Introduction

South Africa has the deepest crisis of unemployment in the world. There is no other country where as large a proportion of the population has been without work for as long. Given its depth, along with its vast social and political consequences, joblessness is a crisis to which every policy document refers, and that is invoked by every politician. It is a crisis that has been the subject of Presidential summits, government initiatives, private sector and NGO projects, and one that is at the core of the National Development Plan. Despite all of this, and apart from a respite in the 2000s, the unemployment crisis has only grown deeper.

If the country is to turn this around, we need, first, to grasp how deep the crisis is; second, to understand what accounts for it; and, third, to draw up a set of proposals that could help address it. All three of these are provided in this report, which, having documented the scale of the crisis, argues that it is the result of two forces: 40 years of slow economic growth and a range of external forces and deliberate policy choices that have produced an economy that needs less and less unskilled labour – the one resource with which we are amply endowed. Given the depth of the crisis and the potency of the forces that have created and deepened it, there is little prospect of its being resolved quickly. There is, however, considerable scope for reforms that would improve the performance of the economy and, critically, deepen the inclusiveness of growth by increasing its employment-intensity.

Why is employment growth so important

Unless a large fraction of the members of a society is engaged in productive activities, it will not produce the goods and services needed to sustain high levels of consumption. High levels of employment in productive activities is a precondition for prosperity. Of course, every society has some members who are not employed. This population is generally made up of children and the elderly, whose needs are provided for largely by employed members of their families (supplemented by public assistance), with the majority of able-bodied, working-age adults working for themselves or for an employer. Some fraction of working age adults does not work, however: scholars, students, and home-makers, for example, are all deemed not to be economically active, and, again, their needs are provided for largely by members of their families who are employed.

Relative to the categories of people who are not working described already, a third category is by far the most challenging for policy-makers: able-bodied, working-age adults who want to work but can't find any. Again, this is a category of people that exists in every society, and which every society supports through some form of unemployment insurance whether provided by the state or by the families of the unemployed. The level at which this support can be provided depends on how many people require it and how much the rest of the society can afford to make available. When the numbers of unemployed are very large, as they are here, providing that support at any meaningful level quickly becomes unaffordable irrespective of whether such provision is public or private. The result is that high levels of unemployment impose significant costs on households and on society. Nor are the costs solely pecuniary: unemployment is highly correlated with a wide range of social malaises, from addiction and violence to depression and suicide, to say nothing of the political consequences of mass unemployment. Conversely, employment, by creating stability, structure, and order in employed people's lives, allows for much higher levels of inclusion and participation in the main currents of social and political life. Employed people have a greater stake in society and are able to be more engaged in the main currents of family, social, and political life.

This is the first and most important reason why employment is so important for development and prosperity: high levels of unemployment mean low levels of prosperity both because too little is

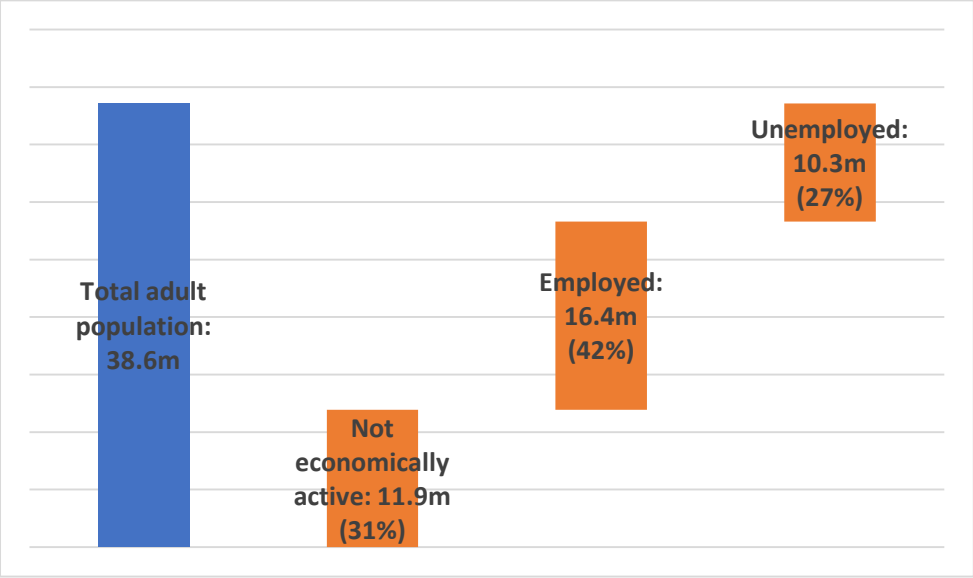
produced and because providing support to unemployed members of society and households makes everyone else poorer.

A critical second reason why employment is so important is less obvious and is, all too often, neglected. Employment is also a form of education and training, providing the employed person with knowledge, skills, disciplines, and capabilities that usually cannot be provided for in schooling and through chalk-and-talk post-school education. These skills are themselves needed to acquire further skills, discipline, and knowhow. Being in employment, in other words, is itself vital to becoming more employable. This is true of all jobs, including the most unskilled. This is not to say, of course, that even the most menial job can be thought of as a viable path to the most high-skilled of occupations. Increased levels of employability is a critical effect of employment. Conversely, high levels of unemployment, especially long-term unemployment, reduce employability and make unemployment something of a self-fulfilling prophecy. Tragically, this is one of the reasons why South Africa's unemployment crisis is as deep and persistent as it is. It is also a critical reason why addressing unemployment needs to be tackled with much more urgency than it has been.

How bad is it?

South Africa defines its working age population as those who are between the ages of 15 and 64 – some 38.6 million people. Of this, 16.4 million (42 per cent) are in work (Fig. 1). The rest are either not economically active –11.9 million people composed mostly of secondary school pupils and students, home-makers, and those not physically able to work – and 10.3 million unemployed people (i.e. adults who want a job but who are unable to find one).[1]

Figure 1: Working age adults by employment, (expanded) unemployment, NEA, Q3 2019



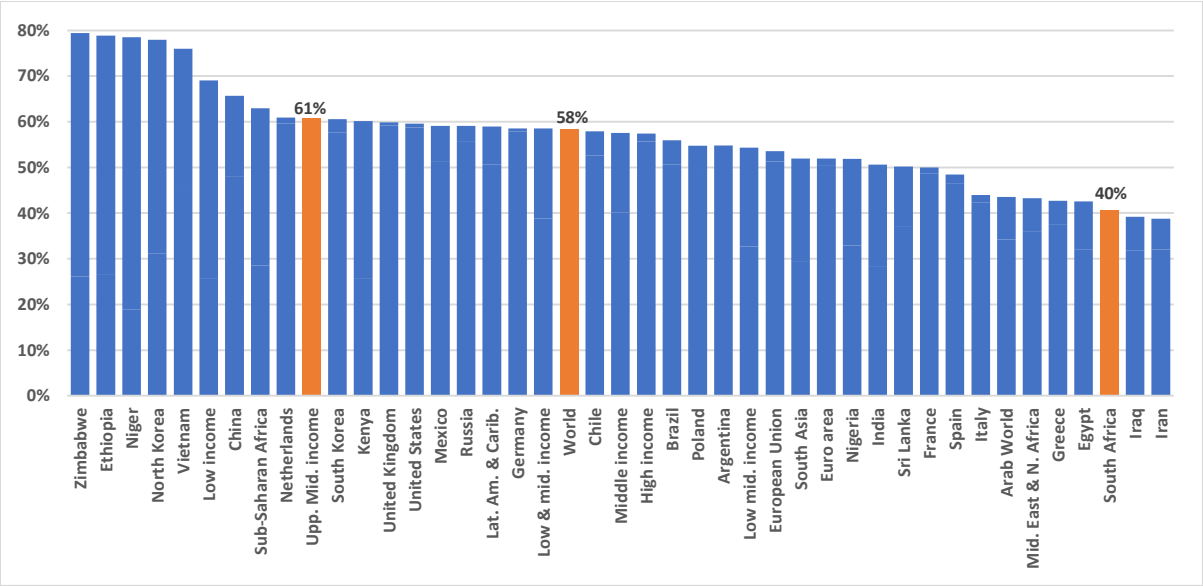
Source: Stats SA's quarterly labour force survey, Q3 2019

The 42 per cent of adults who are employed compares unfavourably with global norms, which is for about 60 per cent of adults to be in employment, with most countries recording employment rates between 55 and 70 per cent (Fig. 2).[2] In South Africa's case, even if we exclude from our calculations ±3 million people between the ages of 15 and 17 (on the basis that they should be in school), the employment rate still rises to only 46 per cent, still substantially below global norms.

[1] This report uses the expanded definition of unemployment, which includes people who are not actively looking for work but who would take a job if one were offered to them. This is a much more appropriate definition in South Africa, where the low probability of finding work is an important reason why significant numbers of people are not looking for a job. In any event, most people who are not actively looking for work, but who say they would take a job, are engaged in passive search: they are hoping that someone in their network will hear about an opportunity to which they might respond. This is why the chances of finding work of those who are not actively looking are not much smaller than those who are actively looking. There is, in short, little real difference between the two populations, and in this document we treat them as one.

[2] Note that the ILO's estimate of the percentage of adults in employment in South Africa, at 40 per cent, is a little lower than Stats SA's.

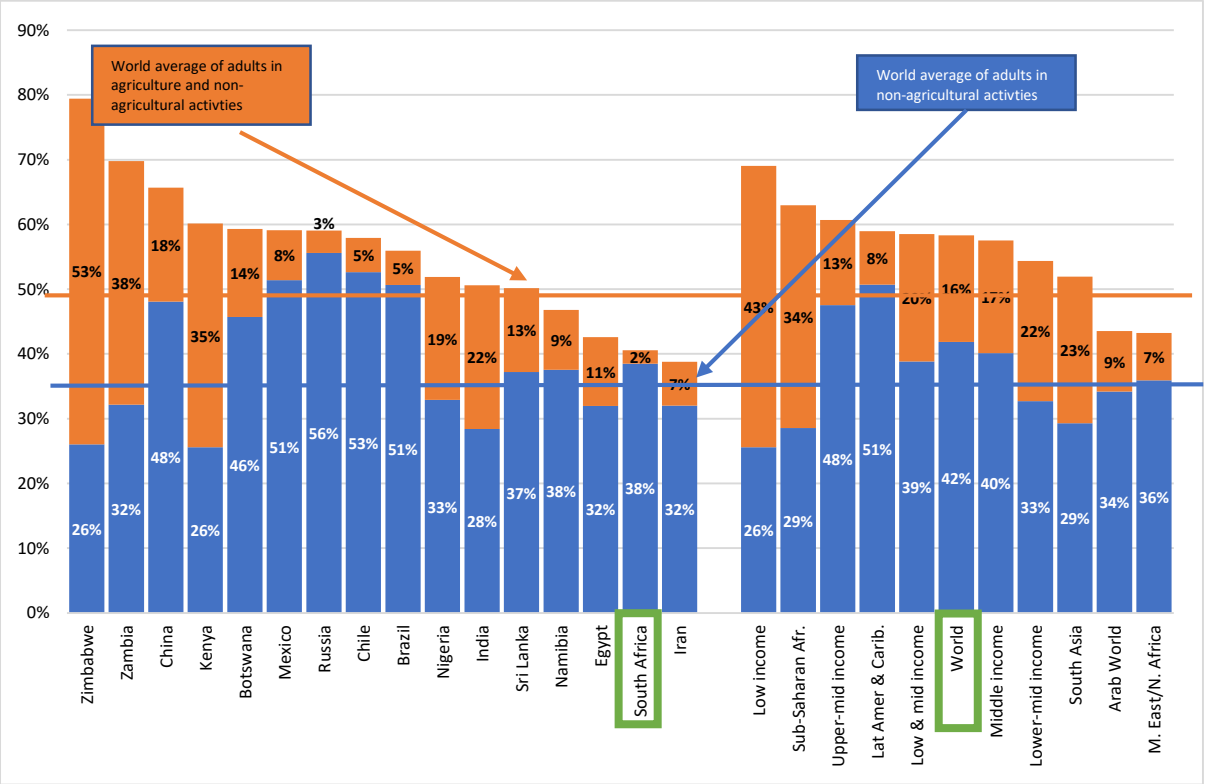
Figure 2: Percentage of adults in employment, 2018



Source: ILO estimates, World Bank database

A frequently forgotten fact about employment levels in South Africa is that the biggest differentiator between employment rates here and in the rest of the developing world is that we have extraordinarily low levels of employment in agriculture. Indeed, if one considers non-agricultural employment only, the performance of South Africa's labour market is much less exceptional than it initially appears.

Figure 3: Percentage of adults in employment, 2018, agricultural v non-agricultural activities



Source: ILO estimates, World Bank database

The implications of this are enormous: in many countries, access to land on which to engage in agricultural activities is an important source of income and/or subsistence, and is a critical safety net for poor households. This is why, for example, employment rates tend to be highest in the poorest countries: because there is so little surplus to distribute (whether through the state or through other familial and kinship networks), everyone is engaged in some form of economic activity, albeit at very low levels of productivity. In South Africa, this is not the case. The combination of a malign history of dispossession and the subsequent dumping of large portions of the population in underdeveloped rural areas in which the absence of property rights and physical infrastructure has inhibited the development of commercial agriculture. Together with geo-physical constraints on agriculture, this has meant that only about 2 per cent of adults are engaged in agricultural activities (see Figure 3). This is similar to that of the most developed countries in the world, and far lower than the average for the developing world, which runs from 43 per cent (for low income countries) to 13 per cent (for upper-middle income countries such as ours).

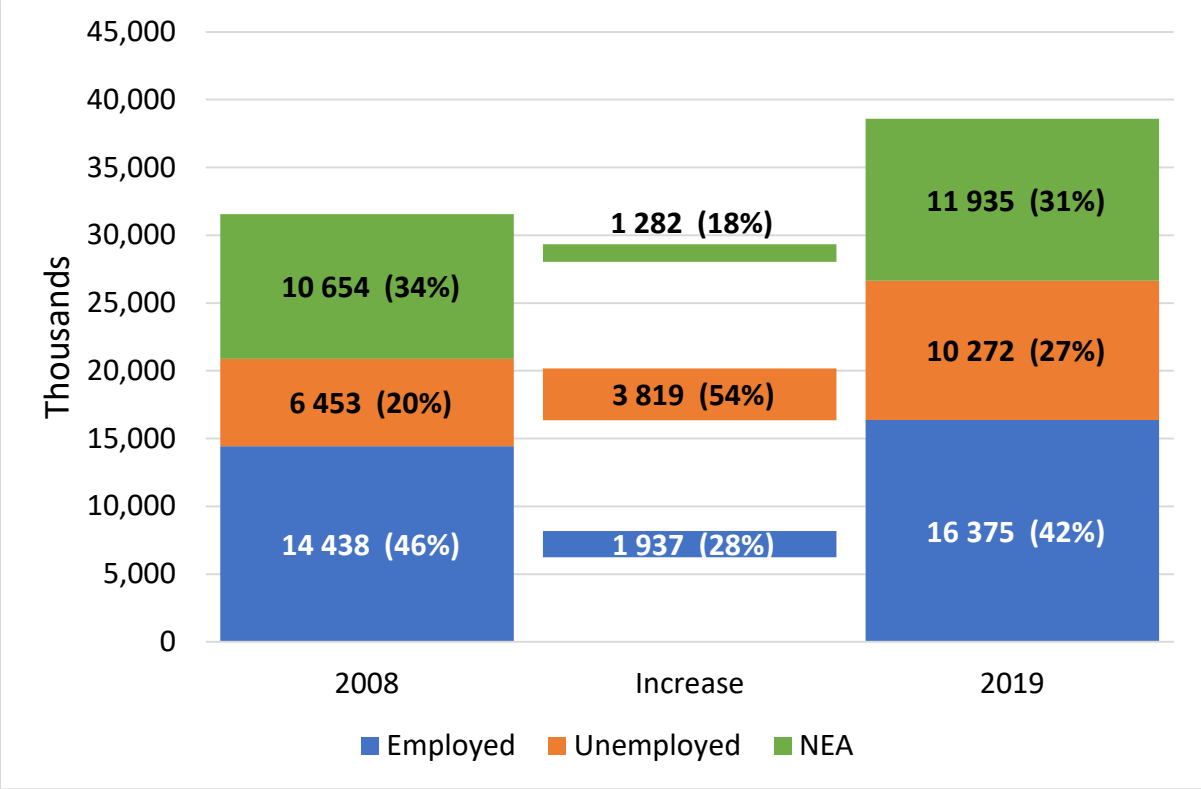
South Africa's unusually small agricultural sector has a number of important implications for how one conceives of the challenge of increasing unemployment. In this regard, much depends on how one thinks about the potential for expanding agricultural employment. On the one hand, the fact that employment levels in agriculture are so much lower than those of other developing countries means that one might think that there was a great deal of potential for growth in agricultural employment if the right set of institutions and policies could be developed. Alternatively, if one is sceptical of the capacity of land and agricultural policies to effect massive increases in employment, then the question becomes whether one believes that it is possible for South Africa to achieve much higher levels of non-agricultural employment, similar to those of countries like Russia, Chile and Brazil (where non-agricultural employment accounts for around 50 per cent of adults, compared to 38 per cent in South Africa).

One further implication is worth noting: in the absence of the implicit safety net that consists in access to land for agricultural activities, the importance for South Africa of the building of a state that redistributes a significant proportion of national income is much more obvious. If households cannot feed themselves or produce cash crops on land they work/own, then, in the absence of adequate numbers of non-agricultural jobs, a society simply has to redistribute income through the state if it is to avoid mass starvation.

Changes in employment since 2008

The labour market has performed particularly poorly over the past decade. In 2008, 46 per cent of the country's 31.5 million working-age adults had jobs, a figure that had fallen to 42 per cent by 2019. This is because, in the intervening years, the working age population had increased by 7 million, 3.8 million of whom (54 per cent) joined the unemployment queues, while the population that was not economically active increased by 1.3 million. Only 1.9 million new jobs were created in this time, which meant that fewer than one person in three (28 per cent) who came of age between 2008 and 2019 found work. So, between 2008 and 2019, not only did half the people coming into the working age population fail to find work, but the number of people in the unemployment queues rose by nearly 60 per cent.

Figure 4: Changes in the working age population, 2008 to 2019



Source: Stats SA's quarterly labour force survey, Q3 2019

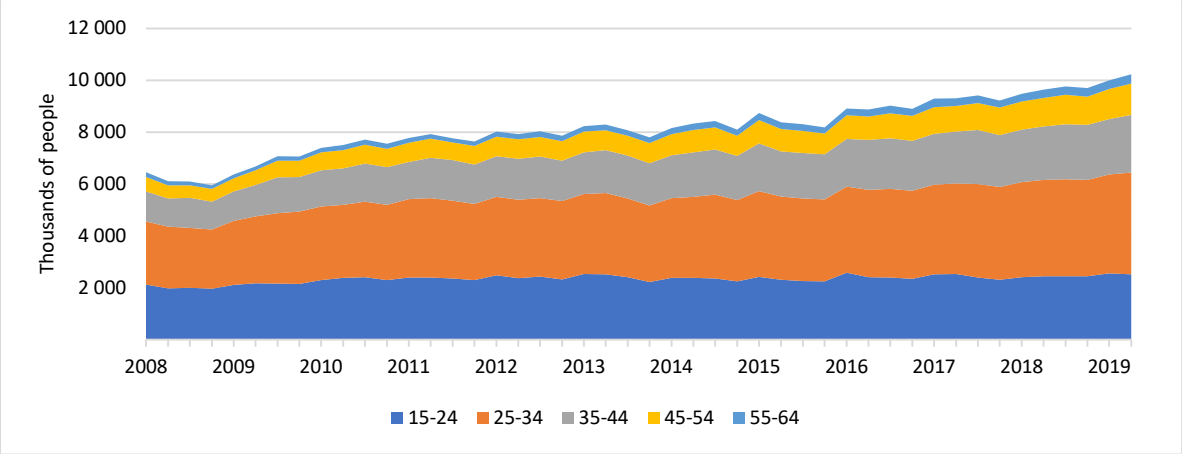
Cast in more immediately graspable terms, between 2008 and 2019, the size of the working age population increased by nearly 1 700 people per day. Of these, fewer than 500 found work, while nearly 900 joined the unemployment queues (the remaining are not economically active).

For young workers (15-34), the figures are even worse: between 2008 and 2019, the working population of young people increased by 2.2 million, but the number of young people who were employed actually fell by about 550 000. Thus, while the population of young people increased by more than 500 per day, the number of young people in work actually *fell* by more than 100 per day.

Profiling the unemployed

Overwhelmingly, the unemployed are young and relatively unskilled. Thus, of 6.4 million unemployed people in 2008, 4.6 million (71 per cent) were between the ages of 15 and 34. And, while the proportion of the unemployed who were young fell to 63 per cent by 2019, the number has increased to 6.5 million.

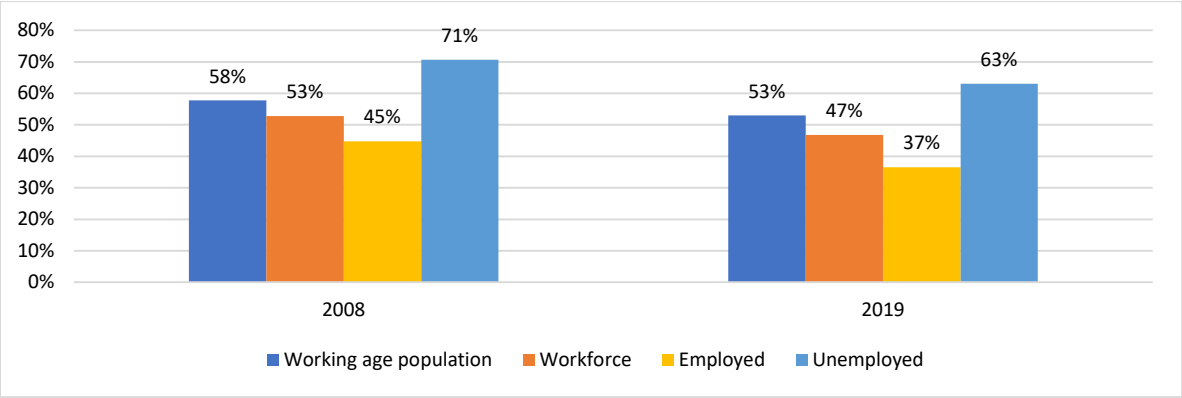
Figure 5: Age breakdown of the unemployed, Q3 2019



Source: Stats SA's quarterly labour force survey, Q3 2019

Young people constitute a disproportionate share of the unemployed: young people made up 53 per cent of the population that was working or looking for work 2008, but 71 per cent of the unemployed; by 2019, these figures were 47 per cent and 63 per cent, respectively.

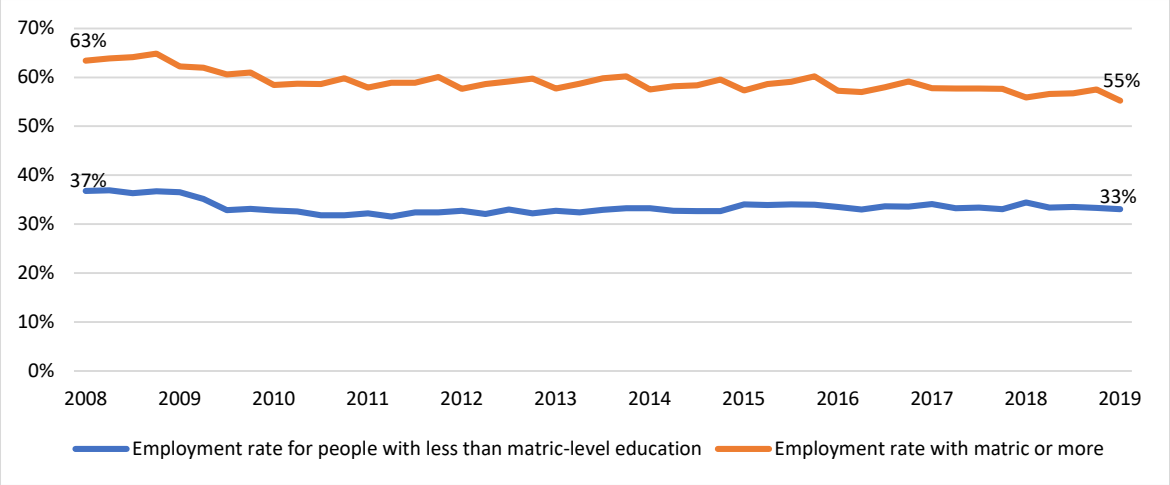
Figure 6: Young people as a % of the working age population, workforce, employed, unemployed, Q3 2019



Source: Stats SA's quarterly labour force survey, Q3 2019

South Africans who have completed secondary schooling or more are far more likely to be employed than those who have lower educational achievements. In 2019, 57 per cent of adults who had, at a minimum, completed their schooling were employed – the number rose to 74 per cent among those who had completed tertiary education. Among those who had not completed their matric, however, the employment rate was only 33 per cent. Employment rates for both subsets of the workforce – those *with* and those *without* a matric – fell between 2008 and 2018, but the gap between the two remains large (55 per cent versus 33 per cent).

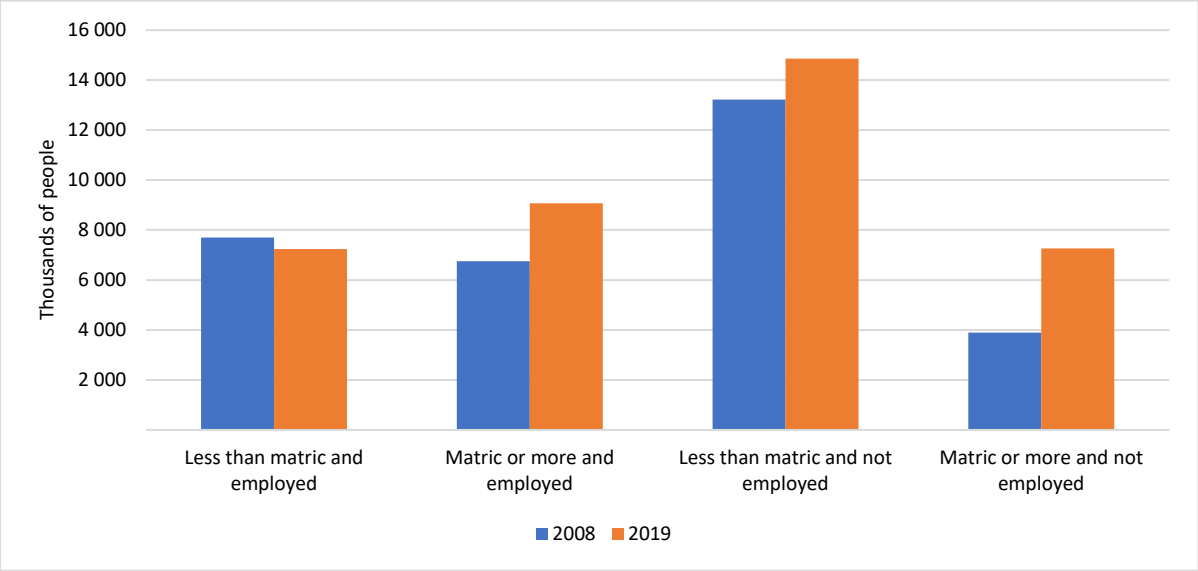
Figure 7: Employment rate for people with less than matric-level education and with matric or more, Q3 2019



Source: Stats SA's quarterly labour force survey, Q3 2019

Between 2008 and 2019, the number of people in the working age population who had not completed secondary schooling increased by 1.2 million, but the number of people in employment who had not completed matric *fell* by 450 000. Over the same period the number of people in the workforce who had completed their matric (at least) increased by 5.7 million, with about 2.3 million of this group finding work. This meant, of course, that the number of unemployed people with and without a matric both rose quickly over this period. Nevertheless, of those who did find work, overwhelmingly they were relatively well-educated.

Figure 8: Changes to population in and out of employment according to employment level, 2008 to 2019



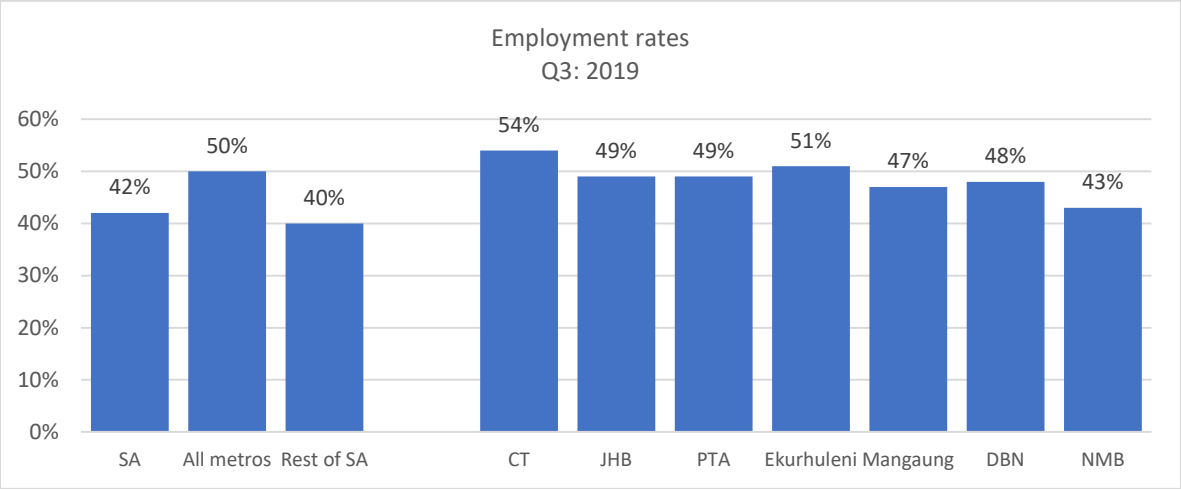
Source: Stats SA's quarterly labour force survey, Q3 2019

Urban versus rural employment levels

One of the features of South Africa's employment landscape is that there are profound differences in employment rates in urban and rural areas: although 42 per cent of all adults in South Africa are employed, the figure for adults who live in metros is 50 per cent (and ranges between 54 per cent in

Cape Town and 43 per cent in Nelson Mandela Bay). Indeed, South Africa's seven largest metros, though home to 42 per cent of the population, account for 48 per cent of all jobs.

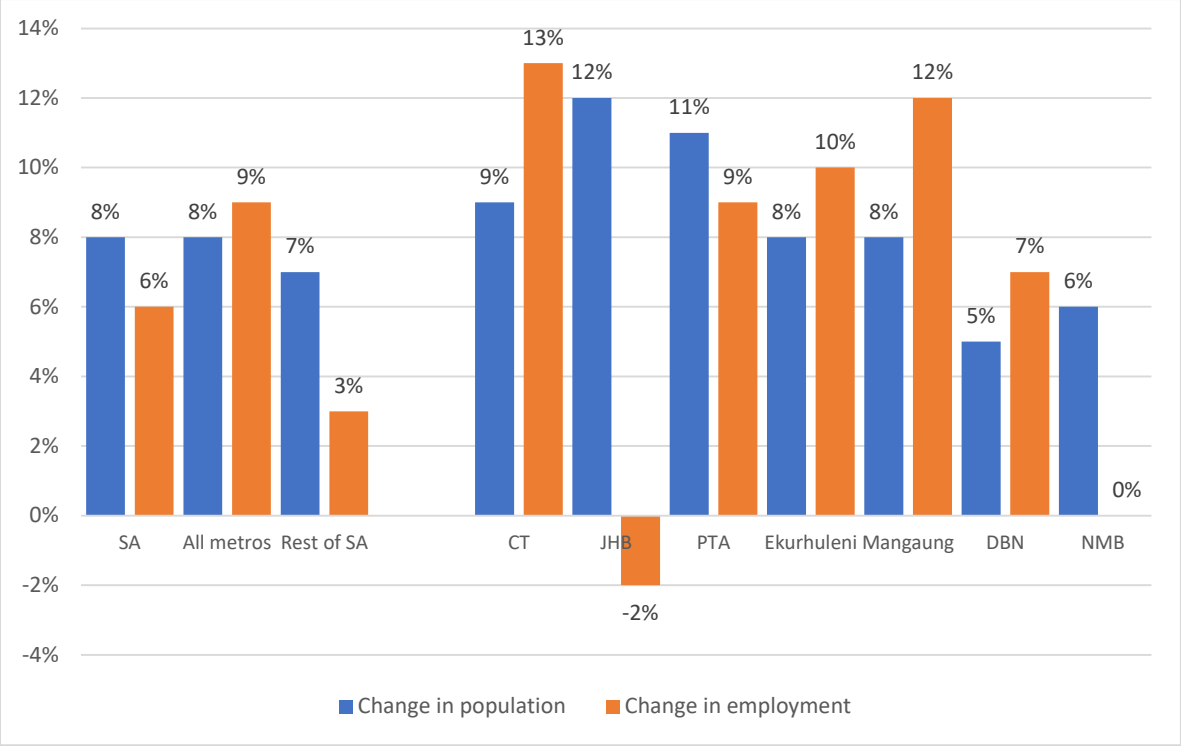
Figure 9: Employment rates according to total South African working age population, combined metro areas, combined non-metro areas, metro, Q3 2019



Source: Stats SA's quarterly labour force survey, Q3 2019

The comparative effectiveness of cities as platforms for employment creation is evident in the fact that between 2015 and 2019, employment in South Africa's metros rose by 9 per cent even as populations increased by 8 per cent. Outside the metros, on the other hand, the adult population increased by 7 per cent but employment increased by only 3 per cent.

Figure 10: Changes in adult population and number of employed people according to total South African working age population, combined metro areas, combined non-metro areas, metro, Q3 2019



Source: Stats SA's quarterly labour force survey, Q3 2019

Employability tends to be concentrated among the employed

One of the more insidious and damaging consequences of joblessness on the scale we have experienced and for the period we have experienced it, is a phenomenon known as hysteresis, the essence of which is that long-term unemployment reproduces itself as the economy becomes less and less employment-generative.

There are numerous mechanisms through which this phenomenon emerges. The first is that insiders use their insider-status and power to ensure that the benefits of economic growth are captured by them through higher incomes rather than by expanded employment. The second is that the long-term unemployed become increasingly ill-suited to the needs of the economy: their skills deteriorate, their training becomes less and less relevant, and their soft skills and workplace readiness deteriorate. Jobs, it turns out, are platforms for training and the acquisition of knowhow, the absence of which makes people even less employable than they might otherwise be. In South Africa's case, the effect of this is deepened by the large number of households in which no-one works in the formal sector. This makes it harder for their children to acquire the soft skills and competencies (punctuality, trainability, the ability to manage relationships with supervisors effectively, the ability to work in teams, etc.) needed to be effective employees. The result is that employment tends to be concentrated in households in which previous generations were employed, an effect that is magnified by the fact that existing employees often play a role in identifying new/replacement employees when their employers seek new staff.

Summary

South Africa is a country that is labour-abundant: there is far more labour available than there are jobs, especially among unskilled work-seekers. The fact that more than 10 million people are either looking for work or would accept work if it were offered indicates that the key deficit lies in the demand for labour.

In the section that follows, the two main causes of this inadequacy of the demand for labour will be described and analysed: (i) the failure of the economy to grow sufficiently quickly to absorb new job seekers, and (ii) the forces and policy choices that have combined to raise the costs of employing unskilled workers above the value of the output they are likely to generate.

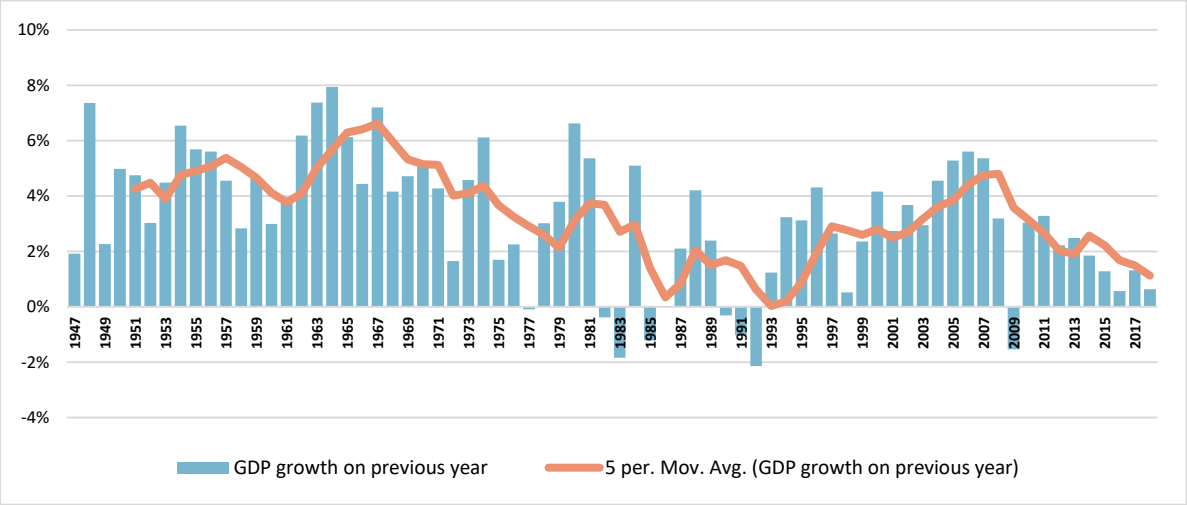
What explains the disappointing growth performance of the economy?

The principal reason that the South African economy employs so few people is that, since the late 1970s, it has almost never grown sufficiently quickly to create sufficient jobs for new workers. By one measure, the 22 years after 1982 are the second-longest period of below-normal growth for any developing country in the past 150 years.[3]

Much of the reason for this is political. Social and political instability in the 1970s, 1980s and early 1990s made South Africa an unattractive location for investment. During the same period, the apartheid government massively underinvested in the education of black learners and students. Combined with the crisis in South Africa's schools after 1976, this resulted in the stunting of the country's accumulation of human capital, which is a critical driver of growth in middle-income countries. Racist rules and norms prevented black people from acquiring significant experience in running successful companies, stunting the development of entrepreneurial and managerial talent.

The net effect was an economy, endowments of which were very poorly suited to driving rapid and sustained growth, except in the exceptionally favourable climate of the 2000s during which rapid global growth and an explosion of demand for South Africa's minerals generated fast growth for six or seven years. The rapacious looting and collapse in governance over the past decade, combined with the continuing failure to improve the quality of our education and skills systems, has been accompanied both by a decline in growth and, tragically, a decline in South Africa's potential for growth.

Figure 11: Annual GDP growth and 5-year moving average, 1947 to 2018



Source: SA Reserve Bank statistics

So, two persistent, multi-generational challenges that have held South Africa's economy back are: (i) seriously adverse political circumstances and (ii) the catastrophic failure to generate the skilled workforce needed for faster growth. To these two, a third is worth adding: slow growth over the last 40 years has something to do also with the incredibly inefficient spatial structure of the country and of its cities. These are among the deepest and most persistent legacies of apartheid, with a wide range of consequences, the most important of which are:

[3] Sharma, R. (2016) *The Rise and Fall of Nations: Ten rules of change in the post-crisis world* (Penguin Books: UK). The only longer period of below-normal growth was India's 23 years starting in 1930.

- The presence of deep poverty traps in rural areas that remain home to a very substantial fraction of the population, but in which there is very little prospect of meaningful economic development and prosperity; and
- An urban spatial structure that makes it exceptionally difficult for our cities to generate the kinds of productivity gains that economically more rational urbanisation generates, and which has been at the root of the growth processes of countries across the developed world, and, increasingly, the developing world.

Some of this effect has been moderated by post-apartheid policies. But these have, at best, failed to maximise the economic possibilities inherent in urbanisation, while some have actively set back the quest for more efficient cities with increasing access by the poor.

Bad policies, policy uncertainty and the rising cost of doing business

When the absence of growth is discussed in the media, a chief cause of this is often described as "policy uncertainty", with the argument (sometimes made only by implication) being that firms can't invest and grow unless and until they have a clear sense of the rules with which they will have to comply when they do business. There is something to this: businesses in sectors in which policies are changing or may still change face greater uncertainty in calculating expected returns on investment, and would, therefore, be expected to invest less and to wait longer before making critical decisions. Uncertainty, in other words, raises the relative value of not doing anything until the uncertainty is resolved.

However, the more fundamental problem facing South African business is not the absence of policy certainty, it is the presence of policies that increase the costs of doing business or which lower returns for doing so.

One set of issues relate to policies intended to accelerate the transformation of the economy through the redistribution of assets, income, and opportunity. These are critical goals for South Africa, essential both for justice and for creating the legitimacy needed for economic policies. Unfortunately, many of the policies that seek to do this actually achieve very little transformation. This is a tragedy: transforming the economy and massively expanding the opportunities for individuals from groups denied opportunities by the policies and practices of apartheid and its discriminatory workplaces, is one of the country's most important goals. It has been undermined, however, by policies whose design and implementation have imposed more costs than they have created benefits, and, critically, by policies that have concentrated the benefits of transformation in very few hands.

Important as are the goals of South Africa's various transformation-focused policies – black economic empowerment, employment equity – it seems unarguable that their impact on business growth as a whole must have been negative. This is partly because the quest for empowerment points must sometimes push firms to do things they would not otherwise do or to pay prices they would not otherwise accept, and partly because they must consume managerial time, energy, and resources. Thus, whether or not there have been offsetting positive effects of policies that promote transformation, it is hard to believe they could have been good for growth in the short term. Indeed, no-one has ever sought to make the case that transformation policies are good for short-term growth (though there are plausible arguments that they might raise the potential for growth in the long-run).

To say that transformation policies have cost the country some growth is not to say that they should not have been pursued. It is to say, however, that one of their costs has been reduced economic growth and, therefore, reduced employment growth. Assuming those costs could be quantified – to date, no one has done so – reasonable people might disagree about whether the benefits exceeded

the costs or vice versa. To pretend that there are no costs associated with transformation is, however, wishful thinking.

It is not just transformation-related policies with which business has had to contend, and which have absorbed firms' resources and the attention of their managers; a large number of other policy interventions have also raised the costs of doing business.

Some of these other policies are sensible responses to real challenges, while others are gratuitous and unlikely to achieve anything that might plausibly be described as an appropriate goal of public policy. There was never any good reason to require the children of tourists to arrive in South Africa with unabridged birth certificates, for example, or to impose onerous visa requirements on tourists from most countries. The real challenge for business, however, comes from policies the goals of which have some merit, but which are implemented abysmally.

There are, for example, reasonable arguments for a country with South Africa's many developmental challenges to have a large state sector and for the state to play a significant role in the economy. In practice, however, South Africa's state-owned corporations have been run horrendously and, as a group, the costs they have imposed on the economy have increased far more quickly than any benefits they deliver. Eskom, for example, now produces less electricity than it did in 2008, despite vast spending on new plants as well as a near tripling in the inflation-adjusted price of electricity.

In addition, the pitiful administration of vast swathes of legislation greatly undermines whatever merit they might have. Legislation and regulations governing the access to and use of water and the laws governing environmental impact assessments, for example, would be much less costly to business growth if approval processes were significantly reduced and handled much more efficiently, and if decisions were more predictable. The same could be said about business registration processes and a host of other licensing rules across swathes of the economy, all of which seem to cost far more in time, energy, and resources than is necessary, especially since many of these policies' goals are, in any event, undermined by corruption.

Nor is it just the weak implementation of policies of relatively recent vintage that imposes costs on business: declining levels of efficiency, predictability, and credibility in an array of institutions has reduced businesses' confidence that they know with whom they are contracting and that they can enforce contracts when and if disputes arise.

Among the most serious of the policy changes are those that change (or reflect an intention to change) existing property rights. To be sure, it is not the case that all rights in all forms of property must be cast in stone and that no changes to these are ever legitimate or justifiable. But even before the controversies over the possible expropriation of land without compensation, too many ill-conceived changes have been made or proposed, often with predictable-if-unintended consequences.[4]
Whatever their merits, all the policy changes and prospective changes are disruptive, and they increase costs (including legal costs), require changes to business plans and processes, can reduce actual and prospective income streams, and increase risk. They also help breed more generalised concerns about government's commitment to property rights, with implications for perceptions about the quality of South Africa's business environment. These concerns are only magnified by growing

[4] There are many examples of the kind of policy that has affected property rights for reasons that are potentially defensible and which, on its own, would not have delivered too significant a disruption to the flows of commerce and investment. Collectively, however, the effect of these policies – new BEE rules, changes to the ownership regime governing minerals, changes to riparian rights, new tenure rules for labour tenants, stronger protections of tenants vis-à-vis landlords, changes to intellectual property rules, mandated debt forgiveness for over-extended low-income consumers – has served to reduce certainty about the rights of those who own assets.

weaknesses in (and unpredictability of) the institutions charged with protecting property rights such as the sheriffs' offices, the courts, and the Companies and Intellectual Property Commission.

Industrial and commercial concentration and its origins

An argument that has gained traction in recent years is that a key reason for South Africa's poor growth performance has been the relatively high levels of concentration in the economy. The argument, in essence, is that high levels of concentration reduce competitive pressures and weaken the forces that would otherwise push firms to raise productivity. This is a view shared by many, including academic economists, policy-makers, organised labour, and international financial institutions like the World Bank.[5]

A critical question to ask, however, and one that is not properly addressed in the reports that have reached this conclusion, is whether concentration in product markets is a function of large companies abusing their positions of dominance or of the fact that a highly regulated business environment inevitably throws up obstacles over which new firms struggle to climb.

This is an issue around which reports like the World Bank's circle without ever finally offering a conclusion. They note numerous examples of abusive practices – many of them related to cartels – as well as the fact that many markets are dominated by large firms that are either state-owned or which were state-owned when they were established. They also note that some of the concentration evident in some markets has something to do with regulatory restrictions (which make it harder for new firms to compete) or by the cost and complexity of various regulations, including the provision of incentives, which are easier for large firms to navigate than for small ones.

It is, in our view, quite plausible that it is easier for large firms with deep pockets and the capacity to hire the requisite expertise to navigate the complexities of South Africa's vast and complex regulatory regime than it is for small firms to do so. The costs and complexities of these systems, their lack of alignment, and the frustrations that they generate, all serve to protect incumbent firms' market share from new entrants. This applies at least as strongly to the provision of incentives and industrial support by government: the World Bank identified nearly 100 separate incentive schemes available to South African firms, but most were used by only a tiny minority of firms, often because accessing the support was too complex and costly for small firms to contemplate.[6]

Supply constraints and high administered prices

Perhaps the most significant reason for the near-stagnant growth of recent years is the hard constraints that firms face in seeking to grow, especially the absence (or high price) of key inputs. Key amongst these is the scarcity of skills, especially technical and managerial skills needed for expanding business operations. This may be the single largest constraint on the economy's growth prospects: having experienced two generations of mass unemployment and considerable skilled emigration, there may now be too few people in the country with the entrepreneurial, managerial, and technical skills needed to start and run enough firms to create the quantity of employment needed.

This is a deficit that cannot be filled merely through improved, more widely accessible education and skills training because the skills needed to start and manage firms are, to a large extent, learnt through experience and observation. It is what Ricardo Hausmann calls "knowhow" – a set of implicit skills that

[5] World Bank, 2018, *An Incomplete Transition Overcoming the Legacy of Exclusion in South Africa*, World Bank: Washington DC.
[6] Ibid. p.68.

are imprinted on their bearers' brains through experience, through the replication and repetition of practices they encounter at work, and that cannot readily be transferred from one brain to another in any other way. A society in need of something like a million new firms if it is to create 10 million jobs needs a comparably large cohort of people who are able to start those firms and make them prosper. This is not a resource that we have.

While the scarcity of skills (which is, or course, an artefact of apartheid and which has been reinforced by the weaknesses of post-apartheid South Africa's education and skills training system and the slow pace of economic growth) is a widely recognised constraint on growth, too often the implication of this for the cost of skilled labour fails to attract the attention it deserves.

Skilled labour in South Africa is expensive in comparison with skilled workers in other parts of the developing world. And this has implications for the costs of doing business, because skilled workers salaries make up a substantial fraction of the wage costs of any enterprise, no matter how intensive it is in the use of unskilled labour. Thus, the high costs of skilled labour make it harder for South African businesses to be competitive. By way of example: in an analysis of the reasons why South African manufacturing is less labour-intensive than is the case elsewhere, Black and Hasson show that, while a typical unskilled worker in South Africa was about 2.8 times more expensive than comparable workers in Thailand, the ratio for supervisors was more than 4:1 and for professionals was nearly 6:1.[7]

One confounding question, of course, is whether the fact that unskilled workers in South Africa earn less than three times the equivalent of their Thai counterparts in this example, while skilled workers earn four to six times what such workers earn, reflects differences in comparative levels of productivity, rather than differences in the relative supply of skilled and unskilled workers. This seems doubtful, however. Much of South Africa's economic history can be understood as a series of measures aimed at increasing the incomes of skilled workers (who, under apartheid, were almost exclusively white) relative to unskilled workers (who were overwhelmingly black). While the end of apartheid has moderated some of this, the scarcity of skills (together with a series of embedded norms about pay) mean that skilled workers earn significant wage premia in South Africa today. Even if one only considers people who earn income from work and exclude the unemployed, South Africa has among the highest levels of inequality in the world.[8] However much employers may worry about the level of wages at the bottom of the distribution, in other words, incomes at the top are also high and have significant implications for firms' international competitiveness.

Human capital deficits are not the only challenges that businesses face in sourcing essential inputs: physical constraints on the supply of electricity combined with high and rising prices for what electricity that is available, high port charges, and the high costs of data, all constrain businesses' capacity to increase output.

What growth we have had is creating less and less employment

Apart from the slow pace of economic growth since the early 1980s, what growth we have had has become increasingly skill- and capital-intensive, absorbing less and less labour (especially unskilled labour). In part, this is a consequence of universal trends: as technology advances, less and less labour is required to produce any given quantum of output, investment in labour-saving equipment increases, and the demand for labour shifts towards skilled workers. Overall, this is a positive force for human progress, but in a labour-abundant country in which there has been too little economic growth and in which too few new activities have emerged to absorb unskilled workers, the result is higher levels of unemployment.

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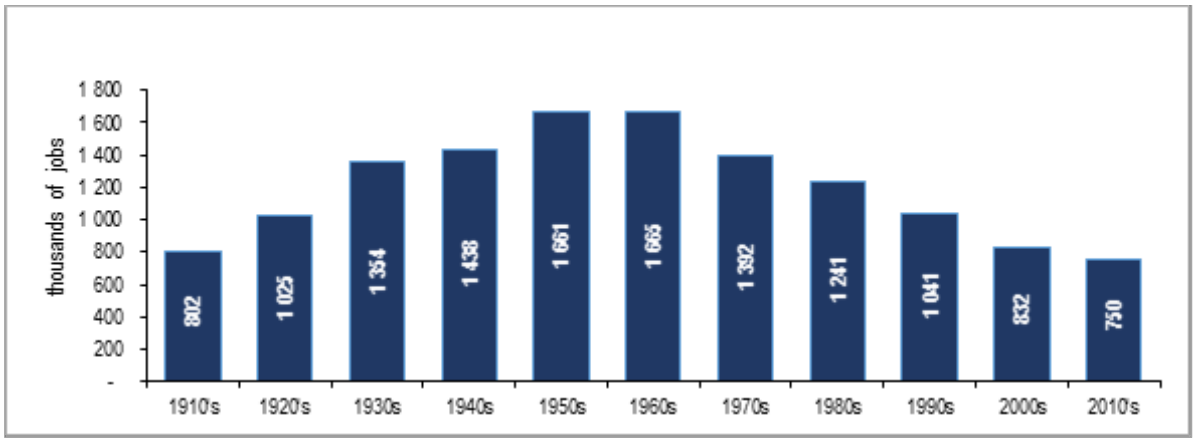
[7] Black, A and Hasson, R. (2012) "Capital intensive industrialisation and comparative advantage: Can South Africa do better in labour demanding manufacturing?".

[8] ILO, 2018, *Global Wage Report 2018/19* (ILO: Geneva).

To make up the gap in demand for unskilled labour per unit of output, even faster growth is needed in labour-intensive sectors. This has not happened. Sectors – such as agriculture and mining – that have historically absorbed large numbers have grown too slowly (if at all) to increase the demand for labour in the face of productivity growth. The result is a big decline in unskilled employment: agriculture, for example, now employs fewer than half the number of people it did in the 1960s, while mining and manufacturing have also shed large numbers of jobs. The decline in employment in agriculture and mining are among the key reasons why employment creation outside of the metros has been so much slower than employment creation in the metros.

Figure 12: Employment in the South African agricultural sector



Source: Presentation by Wandile Sihlobo at CDE, 13 June 2018

There are many reasons for these losses: manufacturing employment in South Africa has always been driven by conditions in the mining industry, and the latter has declined partly because it is a very mature industry already and partly because the regulation of the industry has discouraged investment while cost pressures – notably for labour and energy – have squeezed margins. Manufacturing employment has also declined for other reasons, the most important being that regulation of South Africa's labour market has made it much more difficult for local firms to adapt to the vast new opportunities presented by globalisation and the explosion of trade over the past 30 years. Instead of gaining from this (as might have happened in other circumstances), local firms have lost out to more competitive, lower-cost producers in East Asia.

The services sector has seen employment growth that, in the context of stagnation in employment and reversals in the rest of the economy, has been relatively robust. This growth – driven by retailing, community services (which includes government), and financial services – has provided some support to employment levels. There are, however, significant limitations on a strategy that relies heavily on services to provide employment: the vast majority of services are not tradeable, so, unlike mining, manufacturing, and agriculture, demand for them is limited by the size of the domestic economy. That means that slow economic growth implies slow employment growth in services.

The second problem is that services activities tend to have very divergent outcomes for individual income: "hamburger flippers", subsistence-level retailers, lawyers, and hedge fund managers all work in services sectors, but their earnings are very different. Importantly, it is very hard to see how productivity in low-end services (subsistence retailing, for example, or waitering) rises sufficiently quickly to support sustainable increases in incomes across large swathes of the services sector. Inequality in productivity and incomes is particularly acute in services industries, in other words, and the result is that if employment growth is driven by services, it is more likely to result in increasing inequality. It is hard to see how this limitation might be overcome.

Summary

The bottom line, then, is that the most important reason why South Africa faces as deep and persistent a crisis of unemployment as it does, is that economic growth since the early 1980s has been inadequate to absorb new entrants into the labour market. The result is ever-growing numbers of people who want to work but who are unable to find anyone willing to employ them.

The lack of growth over this period has many causes, but the most significant are political (although the nature of the political constraint has changed considerably over time from the near civil war conditions of the 1980s to the looting and governance collapse of the 2010s), the failure to produce a skilled workforce, and the malign spatial legacy of apartheid. Other factors have included the passage of growth-unfriendly policies combined with significant policy uncertainty (especially in relation to the commitment of government to protecting property rights), the regulation-induced over-concentration of business activities, structural changes in the global and domestic economies, and unnecessarily high costs of doing business (many of which have their roots in policy choices and administered prices).

This is a formidable set of challenges, but the performance of the labour market has been weakened further by a set of policies that are ill-suited to the needs of an economy in which there is a surplus of unskilled labour and in which there is an overwhelming social interest in fostering much faster employment growth.

Making employment unaffordable

Although the absence of growth is by far the most significant driver of the abysmal performance of the labour market, policy has helped worsen that performance, most obviously through labour market norms, rules, and institutions that ensure that the balance between productivity growth and the cost of employment in South Africa is more adverse than in peer group countries. This makes it difficult for local firms to produce goods and services at prices that are competitive with firms in other countries.

There are three distinguishable forces driving the relatively high cost of labour in the domestic economy:

- the scarcity of skills and the high cost of skilled labour,
- a variety of non-wage costs of employment and of compliance with employment law, and
- the establishment of wage-setting processes that have the effect of pushing up wages at the bottom of the skill distribution even in the presence of vast unemployment.

There is little more that need be said about the first of the three, the essentials of which were discussed in a previous section. Suffice it to say, that in the context of an economy that is increasingly skill-intensive, the scarcity of skills means that those with skills are able to command large wage premia. This can be counteracted only through the accumulation over time (through training and experience) of skills and knowhow, or its acquisition from beyond our borders through skilled immigration.

The commonality between the second and third forces driving up the cost of employment (and a partial contrast with the first), is that each raises the costs of employment directly through policy intervention. The goal is to ensure higher incomes for employed workers and greater protection for their jobs, but the effect is that firms face increased employment costs. On the reasonable assumption that, after some point, the additional output that each worker adds to a firm is smaller than the average output of all the other workers, raising the cost of employment means that firms will employ fewer people than they might otherwise have done and/or that the firm's managers will change the way they do things in order to raise productivity to match higher employment costs (e.g. by increasing the use of skilled workers and labour-saving equipment). By way of example: over the past 15 years, some of South Africa's paper and pulp manufacturers have replaced thousands of workers who had been employed on very low wages stripping bark from trees, with more skilled workers operating mechanical bark-strippers. These workers earn as much as ten times more than the unskilled workers they replaced, but can easily do the work that ten labourers might have done.

One might debate whether or not the reduction in employment is worth the additional benefits earned by those who do have jobs, but claims that higher costs of employment are irrelevant to the quantum of jobs should be treated with scepticism (a point to which we will return in a moment). Before looking at the policies that affect the costs of employment directly, we should, however, pause to recognise a further perversity (in relation to the fostering of employment growth) of South Africa's policy mix. Even as our labour market policies have the effect of raising the cost of employment, our industrial policies seek to lower the cost of investing in industrial upgrading, which often has the effect of reducing firms' demand for unskilled labour.

Policies that lower the cost of mechanising

One of the peculiarities of South Africa's economic policies is that, with the lone exception of the employment tax incentive (which provides firms with a subsidy when they employ young, low-wage workers), the incentives and subsidies offered by government are designed to help reduce the cost to firms of investing in plant and capital equipment. These lower the relative cost of capital equipment

and raise the relative cost of employing workers (especially unskilled workers who are least likely to benefit from firms' upgrading their machinery and equipment).

Historically, the most important of these subsidies came in the form of ultra-low costs of energy, the price of which was well below the long-run marginal cost of its production. This is one of the key reasons Eskom ran out of generating capacity in the 2000s. The most important effect of low energy prices was to set South Africa's industrialisation on a path dominated by heavy, energy-intensive industries that are, in the nature of things, highly capital-intensive, rather than labour-intensive. This implicit subsidy is now a thing of the past, of course, and the adjustment to the new realities has been extremely painful and disruptive, not least because Eskom's attempts to build new generating capacity have been so appallingly managed.

But low electricity costs were not the only policies that have pushed South African industry in more capital-intensive directions. Others include:

- The provision of enormous subsidies and incentives to vehicle manufacturers (and their protection from foreign competition);
- The tax treatment of investment in plant and machinery, and
- The design and application of various incentive schemes aimed at different industrial sectors, the effect of which is often to support (a) more capital-intensive activities, and (b) more capital-intensive firms.

The net effect of all of this may be to increase average productivity in the economy and in those sectors that receive support, but it also encourages the private sector to invest in activities that are less labour-intensive. This is the opposite approach to what we should be encouraging if we are to create the jobs we need for millions of unskilled work-seekers.

Important as these issues are, they pale in significance against policies the effect of which has been to raise the costs of employment directly and indirectly.

The non-wage costs of employment

One of the ways in which policy increases the cost of employment is through the imposition of complex, often onerous, employment-related rules with which firm owners and managers must comply. As a consequence, firm owners and managers must factor the risks and costs (in time, money, and energy) of compliance with these rules into the cost-benefit calculations they make when employing people.

It would be absurd to claim that all these rules are inappropriate. It is equally implausible, however, to argue that these "hassle factors" are costless, or that they do not increase employers' reluctance to employ people. For many business owners, the greater the risk that they will have to engage with difficult, time-consuming rules and bureaucracies, the more likely they are to find ways to avoid employing people whom they regard as most likely to be the source of this kind of non-wage cost and whose employment is of least financial benefit to the firm. If the non-wage costs, risks, and "hassle factors" associated with all this are equal for all employees, the impact on employment will be greatest for low-productivity, low-wage workers. This is because the costs of these factors will be proportionately greater relative to the productivity of unskilled workers than they will be for more skilled, more productive workers. Onerous employment laws, in other words, have more negative effects on the employment of lower wage workers.

It is striking that much of the relevant legislation seems to presume that employers will generally act in bad faith in relation to their employees. While it may be true that some employers may do this, and

while it is certainly true that suspicions about employers that developed under apartheid are not unfounded, the tenor of the current legislation seems unduly suspicious of employers, their motives, and their incentives. As a result, the legislation, particularly those sections that relate to the termination of an employment relationship (especially through dismissal) tends to err on the side of shifting the risk of employing the wrong person too far onto employers' shoulders. Inevitably, the consequence is that employers will be more reluctant to take that risk than they might otherwise be.

One example is illustrative. The law makes provision for probationary periods at the outset of an employment relationship. The proper application of the law is actually quite onerous, placing considerable responsibility on employers to give newly appointed staff every opportunity to acquire the skills and competencies needed before allowing for the dismissal of someone who turns out not to be suited to a particular position.[9] The result is that, even as the legislation recognises the possibility that an employer might appoint someone who is poorly suited to the job and can terminate their appointment after a suitable probationary period, it also makes it unnecessarily difficult for an employer, acting in good faith, to make use of that provision.

This is not the only example of this kind. The result is that employers, who, because of the poor quality of South Africa's education system cannot rely on school qualifications as a signal about the qualities of applicants, must bear risks in appointing someone, which make it less likely that they will hire in the first place.

Important as the costs of skilled workers and the non-wage costs of employment are, the key to understanding how labour market policy has helped reduce employment growth is to focus on the way in which it has raised the costs of employing unskilled workers. As we showed earlier, these are precisely the people who are most likely to be unemployed.

High minimum wages and unemployment in South Africa

A key goal of the rules governing the labour market is to increase the relative bargaining power of workers in order to ensure that wages rise, especially at the bottom of the distribution. This is done:

- *indirectly* by strengthening collective bargaining and empowering unions, and
- *directly* by allowing the Minister of Labour to issue minimum wage directives for sectors in which collective bargaining is infeasible and by permitting him to extend agreements reached by bargaining councils deemed to be representative of a sector to all firms in a sector irrespective of whether those firms participate or are represented in those negotiations.

There are critiques from the left about the extent to which some sectors have managed to avoid these effects and further critiques to the effect that the power balance has not been shifted sufficiently to ensure that wages rise enough. It is, nevertheless, plain that this is a core goal of the labour market regime. The real questions are whether seeking to achieve this is justifiable, on what grounds, and whether the benefits of pursuing this goal in this way are worth the costs that accrue.

Two distinguishable arguments have been made for increasing workers' bargaining power to increase their wages. The first, and less plausible, is developmental: by raising wages, so the argument goes, aggregate demand shifts to workers, raising their incomes relative to other stake-holders, and, in the process, shifting aggregate demand towards higher levels of consumption and, in particular, towards the consumption of more locally produced goods and services. This is the core argument for "wage-

[9] See s8, which deals with the requirements probation, of the Code of Good Practice: Dismissal, Schedule 8 of the LRA.

led growth", and, if it were true, a society would be foolish not to pursue it. Unfortunately, it is completely implausible as a development strategy.

The second argument for facilitating faster wage growth at the bottom is much more plausible, though not without problems of its own. This argument is that higher wages reduce poverty and inequality, and the institutions that help ensure that this happens need no further justification than that.

Before discussing these arguments in more detail, it is worth making a prior point that sometimes goes unremarked. The right way to think about the fact that there are more than 10 million people in South Africa who want work (or who would take it if it were offered), is to remember that they want work *at current wages*. There is, in other words, clear evidence that those who are unemployed and who understand what the labour market offers are, nevertheless, keen to work under current conditions. It is important to remember this when people say that current wages are too low: in fact, there are many millions of people who are willing to work at current wages.[10]

The implausibility of wage-led growth

The idea that higher wages are the key to unlocking faster growth in South Africa is a view that, while seldom explicitly articulated, does surface occasionally. Indeed, it did so – albeit in passing – in the Framework Agreement adopted at President Ramaphosa's Jobs Summit, where it is explicitly linked to the idea that higher wages will increase aggregate demand and accelerate growth.

The essence of the argument is that if wages go up, demand for goods and services will rise because the working classes save a smaller proportion of their incomes than do the rich. In addition, the increase in demand will disproportionately favour locally produced goods and services because the poor devote a larger share of their consumption spending to local goods. The net result would be an increase in demand for domestic goods and services, and, therefore, a rise in growth.

While it is true that the poor tend to consume a higher proportion of their incomes than the rich, it is not obviously true that the share of locally produced goods and services in their consumption basket is greater. This is an empirical question, but we are not aware of definitive studies answering it. What is true is that imported food (e.g. chicken), fuel, clothing, and technology (e.g. cell phones) make up a substantial portion of poor households' consumption, just as they do in richer households. It cannot be presumed, therefore, that even if consumer demand did increase as a result of higher wages, the impact would not be felt in higher imports. Indeed, there is good reason to think this is inevitable.

A cursory glance at South Africa's national accounts will show that it already runs a current account deficit (i.e. it imports more than it exports, which is another way of saying that it consumes more than it produces). This is an important factor to bear in mind when advocating for a growth strategy that is premised on reducing savings rates and increasing consumption.

What is being proposed is that higher wages for lower-income workers will increase consumption precisely because the rich save more than the poor. Thus, wage-led growth could work only to the extent that it reduces the national savings rate. In an economy with a current account deficit (i.e. one that already spends more than it produces), falling savings must – as a matter of mathematical

[10] This point is cast into some relief if one considers the changes in the labour market in 2019, when the number of people actively looking for work suddenly increased markedly despite the fact that there was no greater likelihood of their finding work, raising the unemployment rate and reducing the number of discouraged workers in the survey. One plausible explanation for why this happened is the introduction of the national minimum wage. By increasing the wages work-seekers understood they might receive should they find work, the NMW increased the number of people actively looking for work.

certainty – lead to one of two possible effects: a decline in investment (to match the decline in savings) or an increase in the current account deficit (because spending now exceeds production by even more than it did previously). It is, in other words, inevitable that the successful implementation of a strategy of wage-led growth would lead either to less investment (and, therefore, less growth in the future) or to higher imports.

Another fundamental problem with this approach, is that the only way that higher wages could translate into greater spending power is if the increase in wages were not eroded by higher prices. But higher prices are an entirely plausible consequence of higher wages, irrespective of whether firms operate in uncompetitive markets (in which case they have pricing power and can raise prices if and when they need to) or competitive markets (in which case firms' margins must be tight, and higher wages will inevitably be passed on to consumers). Given that an economy-wide push for higher wages must lead to higher prices, the net result on workers' standards of living might not be anywhere near as positive as advocates for higher wages assume.

Higher wages, poverty and inequality

A more plausible, though not unproblematic, justification for a policy approach that seeks to push up workers' wages is that this reduces poverty and inequality.

There are a number of strands to this argument, but the core claim is entirely straightforward and superficially common-sensical: households in South Africa are poor because too few people work, and many of those who do work earn incomes that are too low to lift the household out of poverty. Raising wages would, therefore, reduce household poverty. In addition, it is sometimes argued that higher wages at the bottom – especially, if these were "paid for" by lower incomes at the top (whether through lower wages or reduced profits) – would help reduce inequality, too.

All this is true. But it is true if and only if the positive effect on poverty and inequality of higher wages is not offset by the negative effects on poverty and inequality of the disemployment effects of those higher wages. If higher wages lead to slower job creation – or, worse, to job destruction – then there is no guarantee that those higher wages will translate to lower levels of poverty and inequality overall even if they do reduce poverty in the households in which wage-earners enjoy higher incomes. If one assumes that higher wages do have adverse effects on employment, in other words, they could actually increase both poverty and inequality. Higher wages' effect on poverty and inequality is, therefore, ambiguous. They may make the recipients of those wages better off and reduce the gap between their wages and those of people who earn more than them, but if those higher wages leave more people unemployed, then their aggregate effect could be quite different.

This is why the debate about whether a national minimum wage increases unemployment is critical for understanding its effects. To the extent that advocates for a high minimum are right when they say that raising wages at the bottom of the formal sector has no effect on employment (either now or in the future), they are also right that it will reduce poverty (but only if it does not increase inflation). This, however, seems highly unlikely, and there is compelling evidence in some sectors – clothing, furniture manufacture, agriculture and domestic work – that higher wages do have disemployment effects.[11]

If it is true that higher wages can increase poverty by reducing employment, the converse is also true: lower wages that lead to an increase in employment might not reduce overall levels of poverty and

[11] See CDE's work on the national minimum wage.

inequality if the poverty-increasing effects on households of a fall in wages exceeds the poverty-reducing effects on households of the expansion of employment.

If it is true that both higher wages and lower wages have potentially adverse effects on poverty and inequality overall, it is reasonable to ask why policy-makers should favour one approach over the other and whether it is justifiable to expect workers to accept lower wages if there is no way to be sure that this would not reduce the overall level of poverty. In this regard, it is worth pointing out that higher wages are much more likely to result in higher prices for consumers reducing everyone's real income, including those of the unemployed. The adverse effects of high wages on poverty, in other words, are not confined to their disemployment effects because they can raise prices for everyone, and there is no symmetrical impact on poverty of lower wages. Indeed, if lower wages were accompanied by consumer price moderation, then this would help reduce poverty.

In addition, a couple of important points should be made in favour of an approach to development that supports the fastest possible expansion of employment for unskilled workers, even if that is at low wages. The most important of these relate to the argument made in the introduction that employment is critical for both human and social development: because high levels of unemployment impose pecuniary and non-pecuniary costs on others and on the wider community, and because being in employment helps make possible the accumulation of capabilities and skills that cannot be acquired through other means, ensuring the maximum possible growth or employment is good for society even if it cannot be shown definitively that doing so will reduce aggregate levels of poverty if achieving this requires some reduction of wages.

More importantly, however, it is possible to design policy reforms that would largely protect the incomes of existing workers while introducing reforms that make possible the expansion of employment at wages that are lower than those currently mandated through collective bargaining. The recommendations we make in the next section seek to do exactly this.

Summary

The absence of growth is the principal reason for failure of the South African labour market to generate the jobs needed for the population. However, policies that raise the cost of unskilled labour both in absolute terms and relative to the cost of skilled labour/capital make it even harder to create the jobs we need for the millions of people who do not have qualifications or workplace-derived skills and knowhow.

Arguments that policies that drive up wages will spark growth and development by shifting demand from rich households (who tend to save a larger proportion of their incomes) to poor households are implausible. On the other hand, it is possible that these policies do reduce poverty and inequality, but this is true if, and only if, the increase in benefits enjoyed by those who have jobs and whose wages are higher than they might otherwise have been exceed the costs paid by those who are unable to find work as a result of the higher wages. The fact that there are sectors in which we have evidence that higher wages lead to lower levels of employment should give pause to those who advocate unconditionally for higher wages: what is their answer to those who lose their jobs? The critical question, however, is whether a package of reforms can be designed that both maximises employment growth and minimises any negative effects on the wages of existing employees.

What should be done?

The range, complexity, and severity of the sources of labour market dysfunction in South Africa mean that there are no silver bullets that would resolve the crisis of unemployment in short order. It is in this context that we should recall the point made earlier in this report to the effect that the critical differentiator between South Africa and other developing countries is the marked absence of agricultural jobs, and that, if one looked only at non-agricultural activities, employment rates in South Africa are similar to those that prevail in middle income countries. Framed as starkly as possible, this means that if South Africa is ever to see 60 per cent of adults in employment, either employment in agriculture will have to grow enormously (reversing a decades' long downward trend that is essentially universal) or we will have to create unusually large numbers of non-agricultural jobs. Neither task appears especially propitious.

While there are many advocates for extensive land reform, there is little evidence that there are millions of people both willing and able to farm, and certainly not that number willing and able to generate meaningful income in this way. Apart from anything else, South Africa is not an easy country in which to create vastly expanded opportunities for small-scale, resource-poor farmers. Nor is it easy to imagine our overcoming all of the many obstacles confronting the growth of tradeable goods and services industries (the lack of skills and knowhow, our many infrastructural challenges, etc.) except over an extended period of time.

Given this, it is vital to think incrementally and to define success carefully. We need also, as noted earlier, to seek solutions that do not rely unduly on reducing the incomes of those whose current incomes mean that they and their families are vulnerable to slipping back into poverty. We cannot protect every person from every change that a dynamic economy will experience (because doing so would make it impossible to achieve the requisite level of dynamism), but a strategy that reduces the incomes of large numbers of people is both politically infeasible and economically undesirable.

Acknowledging that the challenge is vast is not the same thing as saying that there is no point in doing anything or that everything we try is bound to disappoint. Nor is it to say that we have no good options. None of this is true, and with clarity of thought, determination to do what is necessary, and the political leadership to take people along with them, there is plenty that could be achieved. CDE's key recommendations would include the following priorities.

Go for growth

The absence of growth is the main reason that the economy has failed to generate enough employment for people entering the labour market. For this reason, accelerating growth is key to generating the jobs we need.

Here, the NDP has exaggerated how much growth is needed to make meaningful inroads into unemployment. The NDP calculated that annual growth of 5.4 per cent between 2012 and 2030 would have been needed to ensure that 60 per cent of adults were in employment by the end of that period. But that calculation is premised on an employment elasticity of growth of 0.6 (i.e. the assumption that employment increases by 0.6 per cent for every percentage point of growth). This assumption is almost certainly flawed. If you assume that the firms and industries that will drive employment growth will be substantially more labour-intensive than is the norm in South Africa's excessively capital- and skill-intensive economy today, then it is possible for employment growth to exceed economic growth. It may not be necessary, in other words, for the economy to grow as quickly as the NDP calculated to absorb all of South Africa's unemployed workers, although this is only true so long as employment growth is concentrated in labour-intensive firms and industries rather than merely replicating the levels of capital and skill-intensity of the existing economy (see below). This is good news because it

is exceptionally unlikely that South Africa can grow at more than 5 per cent a year for an extended period of time. Very, very few countries have ever done so, and the number of countries that have done so after achieving upper-middle income status is even smaller.[12]

But even if South Africa doesn't need growth in excess of 5 per cent a year to bring down unemployment, we do need much more growth than the less than 1 or 2 per cent we have been achieving recently. So, an absolute prerequisite for improving employment outcomes is faster growth. Happily, our experience in the 2000s shows that it is possible for the economy to grow quickly. This was a period in which the global economy was exceptionally benign, but the fact remains that South Africa was able to sustain more rapid growth. If the right circumstances prevailed, there is no reason to think that this could not be replicated. Nor is there much secret about what it would take to get faster growth: a business environment more conducive to investment and entrepreneurialism. To get that we need government to:

- Rethink the role of business and markets in development, and to adopt, at the minimum, a much less hostile and sceptical attitude to business and its oft-expressed needs:
- Undo and rollback bad policies (especially in relation to the undermining of property rights);
- Deal with our unsustainable fiscal trajectory because it is undermining confidence in long-term economic prosperity, increasing risk, and raising the cost of capital (and, in this way, slowing growth);
- Fix the failing SOCs that are necessary for economic activity, especially Eskom and Prasa, while restructuring and selling or closing the bulk of the rest of them; and
- Revive and restore a reasonably high level of governance, defenestrate the corrupt, and ensure that our institutions – especially those involved in maintaining the rule of law – are revivified.

And, given that the scarcity of skilled workers (a term we would define as included workers with managerial, professional, and entrepreneurial experience) is the economy's most serious constraint, serious attention needs also to be focused on improving education and training systems in South Africa, and, in the immediate term, opening the economy to skilled migrants. Apart from engineers and managers, statisticians and teachers, doctors and lecturers whose skills are needed to supplement our own, if there were 50 000 people capable of starting small businesses willing to come to South Africa, we should welcome them with open arms. A new and enthusiastic approach to foreign skills would raise the overall quality of the workforce, and provide an easily grasped signal of government's seriousness in tackling our challenges.

If more growth can be achieved, more employment is sure to follow, irrespective of other changes we might make to the functioning of the labour market. But the implementation of some key reforms would help the economy create more jobs per unit of economic growth. And if we do that, the rate of employment growth could increase substantially.

The critical role of urbanisation

One of the most challenging legacies of apartheid is the adverse spatial distribution of people and economic opportunity. Far too many people live in rural areas in which there is little prospect of

[12] Having said that, the elasticity of demand for labour with respect to growth would fall if employment levels rose because, as they did so, more and more of the growth would result in shifting people from relatively low productivity activities to higher productivity activities, and less and less of it would be achieved by drawing the unemployed into employment. This would be very good for those who move, and is extremely desirable, but it does mean that one would expect growth rates to have to rise to maintain the same level of employment growth. We are, however, a very long way away from the happy day when this becomes a problem.

meaningful economic development, while many more live in denser settlements that are deemed urban, but which lack the diversity of skills and economic activities that are essential for producing the kinds of productivity accelerations that cities might otherwise make possible. Unless official attitudes to urbanisation change, and unless that change in attitude is supported by changes in policy that support densification, improved public transport, and better urban management, South Africa will miss out on the faster and more inclusive growth that is possible as populations urbanise.

Better urban policies are desirable because they will boost growth. They are also desirable because, by making cities more attractive, they will draw in more people who currently live in places in which there is no plausible path to prosperity. This is critical to jobs and unemployment precisely because the low levels of employment in rural South Africa, and the absence of substantial agricultural employment, are among the most important features of our labour market.

Critical labour market reforms

No-one should doubt the political difficulty entailed in seeking to reform the labour market. This is for good reasons (worker rights form part of the social contract, which should not be too easily changed) and for bad reasons (unions wield *de facto* veto power over large swathes of public policy, and don't exercise this power with sufficient consideration of interests other than their own). Nor, as we have stressed, are proposals to radically restructure the terms governing the labour market desirable if the effect would be to reduce the incomes of a large fraction of existing workers who are vulnerable to slipping back into poverty. For this reason, the most important changes we need should focus on making possible the emergence of new, more labour-intensive activities rather than prioritising the lowering of employment costs of current workers.

Whatever the reason, the difficulties confronting would-be labour market reformers are real. Nevertheless, if the economy is to become more intensive in its use of labour, it will do so only if some of the rules governing the labour market are recalibrated to facilitate the entry and prosperity of smaller, younger, and more labour-intensive firms. Achieving this doesn't require root-and-branch reform to the rules governing the labour market, but it does require the creation of a range of exemptions from some requirements of the Labour Relations Act (LRA) for small firms and newly formed firms (firms that employ fewer than 100 people or which have been formed within the last five years), both of which should have a more accommodative labour market regime as a competitive edge in the marketplace. Specific exemptions/reforms that should be implemented would include:

- A legal exemption from agreements reached at collective bargaining councils for small and newly formed firms that are not party to the agreement (a recommendation that is also contained in President Kgalema Motlanthe's High Level Panel report to Parliament[13]); and
- Provisions in the LRA to ensure greater representation by small and medium-sized firms' employers at bargaining councils, together with provisions ensuring that procedures for exempting small and medium-sized businesses from bargaining council agreements are more sympathetic to the needs of those businesses.

Changes could also be made to provisions of the LRA governing the dismissal of workers, particularly during probationary periods. These should seek to de-risk the employment decision, something that could be achieved by providing employers with the unfettered right to dismiss workers during their probationary period unless it can be shown that the employer is acting in bad faith (e.g. by abusing

[13] Parliament, 2017, *Report of the High Level Panel on the Assessment of Key Legislation and the Acceleration of Fundamental Change*, available at www.gov.za.

the probationary period or acting unreasonably). A potential "sweetener" here might be a much more generous treatment by the UIF of workers who lose their jobs during probation
In addition, a different kind of reform might also help: by international standards, an unusually large proportion of dismissals is contested through the CCMA. This is largely because workers who lose their jobs are unlikely to find alternatives, giving them a significant incentive to seek redress or compensation of some kind. They lose the vast majority of these cases, but the costs of this are borne exclusively by the employer. The imposition of a penalty on the bringing of frivolous cases to the CCMA might discourage some of these abuses.

Apart from these kinds of changes, a more subtle kind of change would also be helpful. Policy-makers need to signal that the constant ratcheting up of labour rights is no longer a foregone conclusion and, ideally, that the burden of evidence is now on labour to show why some rights should not be weakened in light of the poor performance of the labour market.

This would represent an important shift in policy direction and, critically, mitigate employers' concerns about ever-hardening rules governing employment leading to ever-increasing risks and ever-rising costs of employment. One way of doing this would be to reconsider some of the provisions restricting employers' use of temporary employment services firms (commonly known as "labour brokers"). While not all uses of these firms are defensible, the temporary employment services industry emerged largely as a result of the increasing challenges that employers had in complying with all the provisions of labour law.

Reduce the relative price of labour

Giving smaller, newer firms some exemptions from some of the rules governing the labour market, while signalling that any further reforms to the labour market will be towards liberalisation rather than further tightening of rules, would help lower the cost (and expected future cost) of labour. The absolute value of this reduction in cost is important, but it is important also because it lowers the cost of unskilled labour relative to the costs of both skilled labour and of capital. This will increase firms' incentives to take on new workers.

This trend could be strengthened by shifting the balance of policy from supporting capital-intensive firms and investment in plant and equipment to supporting employment, especially of unskilled workers. This would require a reversal of the historic pattern, which for generations has seen industrial policy that is biased towards capital-intensive firms and sectors rather than labour-intensive firms and sectors. This has been through direct subsidies and various forms of protectionism (e.g. in support of motor vehicle assembly), through the accounting treatment of and incentives for capital investment, and, critically, through a long history of under-priced, heavily subsidised electricity that encouraged the emergence and growth of energy-intensive firms and industries. The last of these factors – under-priced electricity – is now a thing of the past, of course, but there is a high degree of path-dependency that shapes an economy's trajectory, so unless active measures are put in place to undo the bias towards capital-intensive activities, we are unlikely to see the kind of rapid growth of labour-intensive activities that we need.

One measure that achieves this and which should receive more attention and resourcing is the employment tax incentive (ETI), the 10-year extension of which was announced at the 2018 Jobs Summit. In our view, the ETI should not only be extended through time, but its provisions should be extended to render many more workers eligible and for longer periods. A R12,000 a year subsidy to employers for employing unskilled workers would cost around 1 per cent of GDP even if as many as 5 million workers qualified.

Apart from this, it is critical that the annual review of the national minimum wage that is required by the law engage seriously with its disemployment effects in labour-intensive industries, and that great care is taken to:

- Ensure that the system for evaluating requests for exemption from its provisions works, especially for smaller firms;
- That exemptions are for a reasonable period of time; and
- That any upward revisions to the level of the NMW are made with exceptional care, and are not simply indexed to inflation or, worse, to some level that is above inflation.

Fix the regulatory regime to increase competition

The extent to which South Africa's economy is dominated by large firms has attracted attention from commentators from very different ideological persuasions. And, indeed, there is enough evidence of the outsize role of large firms for policy-makers to pay attention. It is important, however, to properly diagnose the sources of these firms' market power. It is not, in the first instance, a result of anti-competitive practices or the abuse of monopoly positions, but is, instead, an artefact of the substantial regulatory hurdles that bar new firms from competing effectively by raising compliance costs. Reducing the regulatory burden on firms – especially, smaller, newer firms – would help them get a foothold in the marketplace and give them a competitive advantage over larger and more heavily regulated competitors.

The advantage that larger firms have over smaller ones is among the key reasons that South Africa's business environment is unusually heavily dominated by larger firms, for the fact is that, whatever the shape of the regulatory environment, if all regulations apply more or less equally to all firms, their costs will fall disproportionately heavily on smaller firms. And this is the case in South Africa where the best evidence suggests that the main regulatory challenges that businesses face arise from three factors:

1) legitimate and necessary regulatory functions that are administered too slowly and too inconsistently, including tax administration, registering property, obtaining municipal clearance certificates, zoning approvals and construction permits, and securing connections to power and water networks;
2) complex and onerous labour laws and regulations (see above); and
3) the complex and costly requirements of various requirements of legislation relating to economic empowerment and transformation.

In relation to the first issue, much more attention needs to be paid to ensuring faster, more predictable approvals, and, critically, faster and more predictable resolution of disputes so that businesses are not held back indefinitely by bureaucratic decision-making. Problems at the South African Revenue Service have clearly worsened performance in relation to this, and, while the new leadership there is making progress in some of the more problematic areas (e.g. VAT repayments), government needs to recognise that the costs businesses bear in trying to resolve issues in dispute with SARS are paid for through slower growth and less employment. Many of the other issues about which businesses complain relate to the functions of local government, where governance and administrative deficiencies are common, and where the infrastructure for which they are responsible increasingly seems to be on the point of collapse. A new approach to how the country deals with the collapsing state of many municipalities is vital, if they are not to act as a brake on business activity.

In relation to transformation-related regulations, there is almost universal consensus that these provisions have not achieved the goals their proponents set for them. There is, of course, considerable

debate about why this is the case. It is our assessment, as noted earlier, that the key issue is the unwillingness to recognise the inevitable costs of these policies on firm growth. Their reformulation needs to minimise the impact of these requirements on growth. Particular attention should be paid to minimising the requirements imposed on small and new firms since these generally require considerable "sweat equity" from their owners, who are, in the nature of things, heavily involved in the day-to-day running of the business. Imposing ownership-intensive transformation requirements on firms of this kind greatly weakens these owners' incentives, and makes it far less likely that these firms will either come into existence, prosper, and create employment.

An export processing zone for Nelson Mandela Bay

One way to test the potential impact of the changes proposed above would be to establish an export processing zone (EPZ) in the Coega facility. This would be aimed at attracting labour-intensive, lower-wage manufacturing firms, the output of which would be for sale exclusively to export markets. Examples of the kinds of goods that might be made in such a zone include clothing, agro-processing, and other light assembly and manufacturing. The firms would receive exemptions to key aspects of South Africa's labour laws, especially in relation to the outcomes of collective bargaining in their respective industries. The firms would, however, receive no incentives other than the ETI. Given the limited experience of South African entrepreneurs in global value chains of this kind, concessions would also be made to immigration rules so that foreigners might invest in and manage these firms and/or so that firms could attract the managers they might need.

The informal sector

South Africa's informal sector is, by global standards, small. Why this is the case is something of a mystery, but it clearly has something to do with the fact that the formal economy generates sufficient income to provide for the consumption of poor households through intra- and inter-household redistributive activities, social welfare payments, and the fact that returns on activities in the informal sector are low. The reason that returns are low probably has roots in the effectiveness of South Africa's formal sector firms in finding ways to offer goods and services across all market niches and to consumers of all income levels, making it difficult for all but a fraction of informal firms to achieve returns above bare subsistence.

In this context, proposals relating to the informal sector often focus on how to increase returns by offering entrepreneurship training/support, providing more suitable infrastructure (e.g. markets), or seeking to lower the cost of finance. While there may be merit to all of these, it seems likely that the most useful policy intervention in support of informal activities would be to ensure that public institutions did less harm to these businesses, many of whom are routinely harassed or extorted out of business by overzealous or corrupt officials. If municipalities chose, instead, to ignore all but the most problematic of informal activities, more people might be able to generate livelihoods in this sector.

None of which is to say that growth of the informal sector should ever be seen as anything but distant second-best to growth of the formal sector, which offers all stake-holders far better prospects than does informality. At the same time, in a society in which over 30 per cent of the population is unemployed, government action to restrict legitimate – albeit informal – activities is perverse.

Education and training

Getting the most out of the resources South Africa commits to education and training every year is desirable for many reasons: not only is a quality education a good in itself, those who pass their matric

and who obtain post-matric qualifications are far more likely to find work than those who do not. Add to that the fact that economic growth is constrained by the lack of skills, and there is every reason to think that we should invest heavily in education and training (as we do) and ensure that the funds are used effectively and efficiently (as we do not).

It is important, however, not to see investment in education and training, however effective and efficient it might be, as a panacea for South Africa's employment challenges. One reason for saying so is that economic take-off has, historically, not been confined only to countries in which education levels have already risen: some of the East Asian miracles (including China's) took place in countries in which something like half the population were illiterate. This is good news because if growth required high levels of education, it would (a) have to wait for the effects of successful education reform (which would, in any event, take a generation to fundamentally affect the workforce) and (b) would leave behind millions of people who have already aged-out of their educations and cannot plausibly be re-educated now.

That said, education and training are key vehicles for inclusion and for increasing the human capital endowment of the economy, and we need to get much more out of these systems than we currently do.

Precisely because South Africa has one of the least efficient education systems in the world, significant improvements could be achieved if some of the constraints that stand in the way of raising the quality of teaching could be removed. There is also widespread agreement that our post-school skills and vocational education system is delivering very little value for money. Those who drop out of school have almost no access to training that would make them more employable, and the TVET colleges and SETA system are underperforming.

Finally, it is worth noting that, despite the apparent popularity with both government and some large corporate donors of training programmes aimed at building entrepreneurship, there is little evidence anywhere in the world that these programmes achieve very much. It is not the case that some people are born entrepreneurs and others are not, but it is also not the case that entrepreneurship can be taught in the classroom. It is, instead, overwhelming produced through direct experience of the workplace and of the functioning of markets. If we wish to see greater levels of successful entrepreneurship, we should be pushing for faster economic growth and the kind of education and training that will get people into formal sector jobs.

Public employment programmes

With the best will in the world, there is no realistic prospect of employment growing so quickly as to obviate the need for public employment programmes like the Expanded Public Work Programme and Community Works Programme. This is especially true in areas in which there is little prospect of private sector-led economic growth creating large numbers of new jobs.

That said, we need to get much more out of the investment we put into these enterprises: there is too much evidence of maladministration and (possibly) corruption in the awarding of some of the CWP contracts, for example, for anyone to feel assured that these programmes are generating as much employment as they should be. Add to that the strong suspicion that the number of "work opportunities" claimed by the EPWP may be exaggerated or may not represent jobs that would not have existed in the absence of the EPWP, and there is every reason for optimism that much more impact might be obtained from these programmes than we have seen so far. Having said that, to the extent that fiscal resources allow for it, expanding these programmes should be a priority of government's.

Concluding remarks

South Africa's unemployment crisis is the consequence of decades of inadequate growth coupled with globalisation, technological change, poor governance, and bad policy choices. There are limits to the pace at which the effects of this can be rolled back, so a certain amount of realism about how quickly the crisis can be resolved – and, indeed, what "resolved" means – is needed.

At the same time, mass unemployment has been greatly magnified by policies that have increased the cost of labour, especially unskilled labour, both in absolute terms and in comparison with the costs of mechanising firms' operations. The result has been not just slow growth, but growth that has absorbed less and less unskilled labour. Unless these policies are changed, ever more rapid economic growth will not generate the adequate growth of the kind of employment that we need.

Determined action on this front, whatever the political costs and risks, is essential if we are to have any chance of building a more inclusive economy.

Reforming labour markets is always politically difficult, South Africa has, however, no real choices: even if growth were to accelerate, it is unlikely to generate enough jobs to absorb new entrants into the labour market and the 10 million who currently want work, unless that growth can be made substantially more labour-intensive, especially in the use of unskilled labour, than is the norm today. The reforms suggested here are not politically easy, but they are also not so implausible as to make it unreasonable to think that they might be implemented.

Although a rapid resolution of the unemployment crisis is not possible, real progress is. To achieve it, government has to grasp that politically difficult decisions will have to be taken. Were that done, and were the recommendations made here implemented, South Africa would stand a much greater chance of faster economic and employment growth.

How these reforms are implemented matters, of course, and the greater the level of consensus among "social partners" about their desirability, the better. It is, however, abundantly clear that significant portions of the ruling alliance, especially members of the trade unions and the Communist Party, are deeply sceptical of making any of these changes. If government allows this scepticism to continue to act as a veto over all progress, then there is no prospect of our changing the dire trajectory along which we are currently going.

Avoiding these essential reforms and focussing attention on ad hoc projects or special initiatives is not the answer. These can never reach the scale required to move the dial on our unemployment numbers and they divert energy, focus, and resources away from designing, implementing, and successfully managing a policy reform process. Similarly, exhorting business not to retrench in the face of deepening economic difficulties is not sustainable. At best, such calls distract from the need for reform; at worst, they may store up costs that will slow any future recovery should that ever occur.

South Africa cannot afford to allow the number of unemployed to continue to rise. The costs of this to political stability will be increasingly severe. Moving the dial and starting to reduce unemployment significantly will help move the country onto a new track of hope and possibility. Action must be taken and this means vital policy reforms. Designing and implementing an effective reform process with respect to growth and employment intensity has to be at the top of the national agenda in 2020 and beyond.

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