

# INCLUSIVE ECONOMIC GROWTH

In a series of op-eds in Business Day, Ann Bernstein has called for a new approach to making South Africa's economy more inclusive. With ultra-high levels of unemployment, the current approach is to compensate people for their exclusion rather than focus on more effective forms of inclusion, especially by making the policy changes needed to expand employment.

Instead of seeing redistributive policies as the heart of inclusion, we should see wider participation in the economy as the key to a more inclusive society. Raising the rate of growth while simultaneously encouraging production to become more labour intensive is the only way to achieve this in South Africa. This requires urgent policy reforms to make it more attractive to create jobs for unskilled and poorly educated workers. In particular, we need to review labour market policies that prevent the creation of the kinds of jobs that have been the point of entry for millions of unskilled workers into modernising economies in the rest of the developing world.



**OP-EDS**

## Winning strategies focus on bringing the jobless into cycle of production

By Ann Bernstein, 14 June 2017

*While capacity to redistribute is at full stretch, policies make it more difficult for excluded people to find work.*

A generation after the end of apartheid, SA remains a country characterised by mass social and economic exclusion, a country in which only a minority of people can be said to be effectively included.

Half the population lives below the poverty line; more than 9-million adults are unemployed — more than 35% of the workforce — and nearly half of those who work earn less than R3,500 a month; a third rely on social grants to make ends meet; and, by some calculations, 60% live in homes with uncertain and insecure forms of tenure.

With economic and employment growth hovering around zero, and with risks accumulating on the government's balance sheet, SA is going backwards. More of the same will only deepen levels of exclusion. How, then, should we think about inclusion?

Too often, when politicians and policy makers talk about inclusion, their ideas seem to be built on the assumption that the process of inclusion happens after the production of goods and services has been completed. For them, inclusive policies are those that redistribute value created during productive activities from those involved in those activities to those who were not. Redistribution is, from this perspective, the heart of inclusion.

Another way of thinking about inclusion is to see it as intrinsic to the productive process. It is the process of expanding the quantity, range and value of economic activities that drives the inclusion of people, because this is the outcome of expanding employment to millions more people and raising their incomes.

This approach has been successful in reducing poverty in the developing world's most successful economies, where rapid economic growth, driven

by industrialisation, has led hundreds of millions of people to move from low-productivity, low-income agricultural work to higher-productivity, better-paying manufacturing and service sector jobs.

While every society should provide for people through state-directed redistributive activities, engaging the unemployed in new productive activities has several advantages. The critical one is that getting people into work increases national income, in principle making everyone better off because society is richer and fewer people rely on fiscal transfers.

Employment is far more empowering than grants. Jobs can lead to rapid skill acquisition. Leading Harvard professor Ricardo Hausmann argues that SA compensates people for their exclusion; we should rather focus on more effective forms of inclusion.

One mistake is to focus too much attention on redistribution of the fruits of productive activities. A second is for policy makers to spend too much energy on those who already have jobs — in particular, on raising their incomes — rather than on finding ways to include people who are totally excluded.

Unfortunately, many of the strategies that improve the prospects of the employed have the unintended effect of reducing the likelihood of those without work ever finding any.

Increasing employment is always a desirable way of expanding inclusion. Most people would agree that employment is far superior to more inclusion through redistribution. This approach is also much more likely to be successful. Consider the enormous strides made in countries in East Asia — starting with Japan in the '50s and followed by Hong Kong, Taiwan, South Korea, China and Vietnam.

In these countries the primary driving force of prosperity and inclusion has been the considerable

growth of employment in the formal, nonagricultural sectors. Hundreds of millions of jobs have been created and drastic changes in poverty achieved.

Unfortunately, despite the stated commitment to more rapid economic and employment growth, SA's progress has been very poor. There are many reasons for this, and some are beyond the control of policy makers.

However, many of the other reasons involve SA's policy choices; and these are the most important factors why there has not been faster employment-driven inclusion. Many policies, conceived as an attempt to improve working conditions of the employed, have had the effect of making it more difficult for those who are excluded to find work. So how should we think about inclusion?

We need to recognise that, however desirable it might be to improve the conditions and security of those who have jobs, the national priority has to be finding ways to broaden inclusion to the unemployed.

We need also to acknowledge that we are at, or beyond, the limits of the economy's capacity to redistribute income efficiently and that attempts to push us much beyond where we are could drive us into fiscal crisis.

SA's subinvestment grade rating on sovereign debt means that the world's investors think this is a real possibility. We should therefore be especially wary of high-risk proposals aimed at redistributing assets and incomes in ways that are bound to choke off growth even more. Proposals in this category include making drastic changes to property rights, in land (there are calls for expropriation without compensation) or companies (some are advocating wholesale nationalisation of large parts of the private economy).

These kinds of initiatives might improve the lot of a tiny number of beneficiaries, but there is absolutely no reason to expect them to have anything but the most disastrous effects on economic and employment growth. Proponents might think that outcomes cannot be worse than what is being experienced now, but that is far from true. Very bad things can happen to economies run by poorly informed policy makers. Even if they are well-intentioned. And too many of SA's policy makers are not well-intentioned.

Instead of focusing on high-risk policy changes, the government and opposition parties should be looking closely at the kinds of reforms needed if millions of new jobs are to come on line in the next decade.

A large majority of those who are unemployed have very little education — 60% have less than a matric —

so SA needs to create jobs for the workforce it actually has. Millions of new jobs are needed for those with few skills and little or no work experience. Our labour market policies result in a system where the creation of these jobs is very unattractive.

Creating an environment in which companies are able (and encouraged) to create large numbers of low-skill jobs is the single most important step SA could take to make its growth path more inclusive. This can be done. Millions of low-skill jobs are leaving China, automation is not yet taking place in these sectors, and with the right policies, SA could be competitive in these industries.

Too many of SA's industrial sectors are marked by high levels of concentration, with a small number of dominant companies. Much of this is not the result of abusive and anticompetitive practices but of policies that lower the cost of capital in relation to the cost of labour, combined (in retailing) with urban structures that make it very hard for small businesses to find niches.

Given the top-heavy character of our business sector, we need to focus on assisting smaller companies. We need a better understanding of the regulations and practices that prevent small businesses from being formed and prospering. In particular, we should be looking at exempting smaller businesses from onerous regulations, although we need to prevent such exemptions from reducing companies' incentives to grow.

In the cities, apartheid's spatial legacies cut many small companies off from markets: businesses that can only service relatively poor customers face constraints. The goal should be to tackle spatial legacies and to provide support to companies seeking new markets.

A focus on production-driven inclusion does not imply that SA should not use its state, tax and social security systems to redistribute income. The country's relative prosperity means that, unlike very poor developing countries, we can afford to ameliorate the effects of a low-skill, low-wage growth path using our already relatively large social security system, along with the provision of a range of free or near-free public services.

We should, however, insist that the efficacy of redistributive programmes is improved: providing free education to the poor is of limited benefit if

the education is all but worthless. Affordable, safe and efficient public transport must become a much higher priority.

Embracing a growth path of this kind — the rapid expansion of employment in low-productivity

sectors combined with smart and decent social security programmes — is at the heart of what a programme of inclusive growth should look like. It is entirely achievable.



## Country's first goal should be fast, labour-intensive growth

By Ann Bernstein, 31 May 2016

STATISTICS SA reported in May that nearly 9-million South Africans want work but cannot find it. Of these, 3-million have given up looking. This grim scenario is getting worse: in the first three months of 2016, the economy lost more than 350,000 jobs.

To put this number in context, the economy lost 1-million jobs in the course of the 2008-10 global financial crisis. In that period, there was only one quarter during the largest global downturn in modern history in which more South Africans lost their jobs than were lost in the first three months of this year.

These cold figures represent tragedies of unfulfilled human promise, whose effects are transmitted across generations. SA, the country with arguably the worst employment record in the world, simply cannot afford it. Yet despite its persistence and scale, the devastation caused by unemployment has not resulted in a fundamental rethinking of the assumptions underpinning SA's economic strategy. Mass unemployment signifies a clear failure of policy.

Among these assumptions, the most damaging is that, despite the sheer numbers of unskilled people who are without work, the economy should be pushed onto a skill-intensive and capital-intensive growth path. Equally serious is the assumption that those who are left behind by our failing education system can be adequately and sustainably included through social grants and the social wage, or employment of last resort in the public sector.

Policy-making guided by these assumptions has led the country in the wrong direction and has locked

unskilled and inexperienced workers out of the economy. A new framework is essential. Enormous effort should be put into fixing the education and training system, and equipping all South Africans with the skills to enter the modern economy at as high a level as possible. At the same time, we need urgently to make it more attractive to create jobs for unskilled and poorly educated workers.

Evidence of what is going wrong can be found in some of the trends noted in Statistics SA's report. These show that the economy generates far fewer opportunities for unskilled than for skilled workers. In the past quarter, more than 250,000 elementary and domestic workers lost their jobs, while the ranks of the professional classes swelled by almost 110,000 people. This underlying dynamic has existed for many years: employment rates are much higher for those with tertiary education than those without. The problem is huge: about 19-million adults do not have a matric.

The key reason for this is that the government's policy regime leads to the mispricing of unskilled labour. It does this directly, through a system of wage-setting institutions that are geared to raising minimum wages and, indirectly, by overempowering unions and imposing onerous and cumbersome protections against dismissal.

Mispricing is an important reason for the failure to generate jobs for unskilled workers. It is, therefore, possible that the likelihood of a high national minimum wage being implemented soon is contributing to the destruction of jobs at the bottom end of the labour market right now.

The government should resist the political temptations of setting a high minimum wage. And big business should strongly resist a minimum wage that large corporates might be able to live with by raising prices or extending automation, but which will further weaken job creation.

Nor is there much prospect that some of the slack can or should be taken up by the expansion of low-wage public sector jobs like those offered by the expanded public works and the community work programmes. Our shrinking economy simply does not produce the tax revenues needed to finance an expansion of public service jobs. Besides, public works jobs are mostly a dead end, with the vast majority offering neither training nor promotion prospects. All are temporary, most lasting less than three months.

In the context of slow and uncertain global growth, SA needs to improve the domestic policy environment considerably. The case for a new growth agenda is urgent and compelling. What should such an agenda for inclusion of the low-skilled through employment consist of? SA's policy makers need to make a determined choice to go for rapid, job-rich growth. This requires prioritisation. Policies that encourage rapid, labour-intensive growth must come first, and all other goals and policies need to adapt to this. The government has to stop undermining the prospects for growth in its pursuit of other goals.

By their nature, labour-intensive activities require less capital. The only way employers and new investors will move into more labour-intensive activities is if unskilled labour is competitively priced compared with machines and the cost of capital. Today, much of our policy raises the cost of employing unskilled workers and subsidises the use of capital equipment. Unless we reverse these trends, growth will continue to be less and less labour-intensive.

Lowering the relative cost of employing unskilled labour doesn't necessarily require lowering existing wages. What is essential is a set of reforms that would slow their rise until the labour market tightens. One way to do this is by changing some of our wage-setting institutions by:

- Reducing the scope of the labour minister's authority to set minimum wages in some sectors and to extend bargaining council agreements to nonparties;

- Widening the grounds for exemption from sectoral determinations and bargaining council agreements, especially for new and small firms (while also avoiding the imposition of a high minimum wage);
- Assisting young workers to enter the labour market by allowing below-minimum wages for young workers, and, if the current experiment in subsidising employment of young workers is effective, looking to expand this in sensible ways.

Critics that label internationally competitive, low-skill employment as "a race to the bottom" are wrong. They assume that low wages are forever. This ignores employment effects at both individual and industry level. Individuals can take advantage of opportunities for mobility through employment experience and training.

At industry level, the effects of employment growth and a tightening labour market raise wages. In China, the average annual increase has been 15% in recent years.

In addition to correcting the mispricing of unskilled labour, the country needs to reconfigure the balance of power in labour relations. Current rules strengthen the hand of workers in negotiations with their employers, enabling them to ensure higher wages and extract concessions. Some of the quick fixes include linking wage increases to productivity; new rules requiring secrecy in strike ballots; requiring unions to pay for damage to property caused by violent strikers; and implementing rules that would make it possible for employers to get the protected status of strikes lifted.

Most importantly, SA needs to create a competitive environment for the establishment and expansion of economic activities that are much more intensive in their use of unskilled labour. That means embracing an approach to economic growth and inclusion that is realistic.

SA must create work for the unskilled labour force we have, not the highly skilled workforce we wish to have. Only in this way will we make sustainable inroads into unemployment and, therefore, poverty and inequality. The continued failure to grasp this essential point is the key reason millions of people face the dignity-sapping prospect of never being productively employed.

## Crisis demands we ditch our aversion to lowly paid jobs

By Ann Bernstein, 30 June 2015

It is time SA had a realistic jobs strategy with the potential to create millions of new jobs for the workforce we actually have. The roots of SA's overlapping economic, social and political crises can be found in the failure of our economy to create jobs. It is time to stop the wishful thinking and grand but empty promises. SA needs to make some bold new choices and change course.

By some measures, SA's unemployment crisis is the deepest in the world: in a country of about 30-million working-age adults, about 7.3-million people are unemployed.

SA is exceptionally bad at creating jobs. There is virtually no other country in the world that has anything like as few adults in productive employment or self-employment as SA does. The norm is for about 60% of adults to be employed in most developing countries (Cambodia, Mexico, India, Poland, Thailand). In SA, it is a little more than 40%.

The implications of this are devastating. SA's mass unemployment is the key cause of poverty and inequality, contributing immeasurably to social dysfunction and political instability. Worst of all, unemployment is a terrible waste of human potential and an assault on human dignity. Almost every unemployed person should be doing remunerated work that improves their lives and develops the country.

There is nothing inevitable about SA's scandalously high unemployment rate. While it is true SA must deal with the unique and terrible legacy of apartheid, we could be doing considerably better. One reason for the unemployment crisis is that policy makers have been driven by a set of ideas about employment and the labour market that are completely unsuited

to the challenges we face. In essence, SA has chosen an approach to employment that says it will accept only jobs that are "decent". In other words, all South African employees must receive relatively high minimum wages, enjoy considerable legal protection from dismissal and enjoy a high level of basic conditions of employment. Jobs that do not meet these requirements are not the kind of jobs employers should be allowed to offer, and not the kind of jobs the unemployed should be allowed to accept.

In practice, what this means is labour market policy has prevented the creation of the kinds of jobs that were the first point of entry for unskilled workers into modernising economies in the rest of the developing world. These jobs — mainly in light manufacturing and assembly as well as low-end services — represent a real step forward for hundreds of millions of workers in the developing world (think Hong Kong 50 years ago, Vietnam, Thailand, Malaysia and, of course, China). But these kinds of jobs are deemed by policy makers as insufficiently "decent".

This aversion is disastrous for unskilled work seekers, particularly those who lack experience. It is also in direct contravention of the advice of many international experts. Time and again these experts have said SA must create jobs for the workforce that we actually have and not the workforce policy makers wish we had. Creating the kinds of jobs that could be offered to the undereducated and inexperienced workers who are unemployed is a far more plausible development strategy than one that seeks to create jobs for the workforce that policy makers hope to create in time.

Compared with the alternatives they actually have (unemployment, rural or urban misery and hopelessness, dependence long into adulthood on

support from parents and grandparents), working in a factory for low wages and often long hours would be attractive to many hundreds of thousands of people. And these basic jobs are not an endpoint, they can lead — as they have in almost every other country — to better jobs in time.

For those who have them, there are big advantages to having a “decent” job. But the cost of setting high minimum standards all employers must meet is that very few jobs are created. The key questions advocates of the “decent work” agenda fail to tackle include: what do they offer all those people whose skills levels are too low to have any real prospect of securing a “decent job”? Where should they go? To whom should they turn? What do we offer them today and tomorrow if our policy is to prevent low-skill and inevitably low-wage jobs from being created? Why do we want those jobs to go to other countries? For many years now, all we have offered is growing unemployment, exclusion from the modern economy, and no way to find a ladder into work and all the learning and personal self-worth benefits of regular employment.

Ironically, given the supposed sanctity of the “decent work” agenda, there is one area in which the government exempts itself from some of its more aspirational goals — and boasts about doing so.

The Expanded Public Works Programme is the main driver behind the government’s plan to offer 6-million “work opportunities” between last year and 2019. The programme offers only short-term, contractor work, with a minimum wage of less than R80 a day. The jobs offer little training and no opportunities to progress. And, as many consist of little more than picking up litter or waving red flags at passing motorists, they’re not exactly dignity enhancing. Why is it acceptable for the state to employ people on these terms but not for private employers to do so?

The kinds of jobs private sector employers would create — if the environment were right — are almost certainly better than those that the government boasts about in the Expanded Public Works Programme. The experience of almost every country that has ever emerged from poverty has shown it is these kinds of jobs that help put a society and millions of poorer people on the escalator to modernity.

It would be unprecedented for a country to move from mass unemployment to seeing millions of unskilled, inexperienced workers entering global supply chains at a position of their choosing.

Ever since the 18th century, newly industrialising countries, from the UK and Sweden in the past to Vietnam and Bangladesh today, have added most jobs, initially, at the bottom of the value chain, not the top.

SA’s approach has resulted in the worst possible option: mass unemployment. It is time to acknowledge these policies have failed. Siphon Pityana, former labour and foreign affairs director-general and now a leading businessman, says: “SA is an economy in deep trouble ... (the) transformation project has become increasingly superficial and separated from the growth imperative we so desperately need ... we need to start a proper and honest conversation.”

One place to start that honest conversation is around our approach to mass unemployment. If you are truly interested in broad-based black economic empowerment, getting a job is the most effective and quickest form of empowerment there is.



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5 Eton Road, Parktown, Johannesburg 2193, South Africa | P O Box 1936, Johannesburg 2000, South Africa  
Tel +27 11 482 5140 | Fax +27 11 482 5089 | [info@cde.org.za](mailto:info@cde.org.za) | [www.cde.org.za](http://www.cde.org.za)