



CENTRE FOR DEVELOPMENT AND ENTERPRISE  
Informing South African Policy

# A FRESH LOOK AT UNEMPLOYMENT



A conversation among experts

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

Series editor: Ann Bernstein

This report summarises the proceedings of a workshop hosted by CDE in October 2010, as well as a series of post-workshop interactions with participants and a group of local and international experts. It was written by Antony Altbeker and edited by Riaan de Villiers.

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Cover: Sign on a building site in Sandton, Johannesburg.  
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## EXECUTIVE SUMMARY

LATE IN 2010, CDE convened a workshop of leading economists on South Africa's persistent and extremely high levels of unemployment. What, we asked, is preventing us from creating more jobs? Given the large and diverse body of theoretical work and empirical evidence, what do we know about the policy levers affecting employment? What do we still need to find out?

This report is a record of the proceedings, as well as of a series of post-workshop interactions with participants and a group of local and international experts. It sets out some of the key issues South Africa needs to address if it is to resolve its unemployment crisis. As with any controversial subject, participants disagreed on certain issues, and these perspectives have been recorded. The report should be read with this in mind.

### **Scale of crisis understated**

The official unemployment rate (the number of unemployed people expressed as a percentage of the labour force) is about 25 per cent. Although this is very high by international standards, it understates the magnitude of the crisis because it includes only those adults who are not employed and are actively looking for work. Given the poor state of the job market, millions of adults who want to work have given up looking for jobs, and are therefore not counted as unemployed.

A more revealing statistic is that only 41 per cent of the population of working age (everyone aged 16 to 64) have any kind of job – formal or informal. This rate (called the employment rate) is 30 percentage points lower than that of China, about 25 points lower than that of high-growth developing countries such as Brazil and Indonesia, and 20 points lower than the rate in the developed world. An employment rate of 60 per cent – roughly the global norm – would require 19 million jobs, nearly 50 per cent more than the 13 million formal and informal jobs that exist today.

### **Growth and employment**

Economic growth is essential for job creation. However the relationship between economic growth and employment growth in South Africa has weakened over time. In the 1970s, a percentage point of economic growth raised the number of people in jobs by a similar amount. Over the past decade, each percentage point of growth has increased employment by less than 0,4 per cent.

It is unclear why the employment intensity of growth has declined so rapidly. Part of the reason seems to be that employers prefer smaller workforces. This, in turn, is a consequence of economic, legislative and regulatory pressures which have driven employers towards industries and production techniques that rely on more skilled people and less labour-intensive production methods.

Unless the employment intensity of growth increases, even very rapid growth will have to be sustained for many years if South Africa is to raise its employment rate to international levels. Even if the population of working age were to remain unchanged at 32,1 million, the economy would need to grow at 7 per cent a year for almost 15 years to achieve this objective. If the population of working age continued to grow at its current rate of 1,9 per cent a year, it would take more than 40 years. This is a huge challenge. South Africa must find ways of increasing economic growth, sustaining this over many years, and ensuring that it is much more employment-intensive.

### *Underperforming exports*

Over the past 10 years, economic growth has relied heavily on rapid growth in government spending, which is unsustainable in the long term. Local markets are relatively small which means that accelerating economic growth will require a dramatic increase in exports. Export growth will not translate into rapid employment growth unless South Africa succeeds in producing labour-intensive goods for global

markets. The goods that make up our current basket of exports rely too heavily on skills and technology rather than unskilled labour.

There are many reasons for South Africa's poor performance in respect of labour-intensive manufacturing exports. The most commonly mentioned are the relatively high costs of doing business, the high cost of labour, and the exchange rate, which is said to be both too strong and too volatile.

Two other issues may also be important. Relatively high transport costs mean that businesses need to produce high-value goods to recover those costs. Typically, these require skilled workers and capital-intensive production methods. As a result, the manufactured goods we do export do not generate many jobs, especially for unskilled workers. Producing goods in labour-intensive ways at competitive prices requires economies of scale. Onerous employment equity and employment regulations that affect companies over a certain size may be persuading South African firms to remain small.

### **Labour market regulation and the cost of labour**

The number of people hired by firms is determined by their costs and productivity. Labour costs include the wage and non-wage costs of employment, such as the costs of dismissing and replacing unproductive or unsuitable workers. Low labour costs encourage firms to employ more people, while higher labour costs encourage them to adopt production methods relying on a smaller number of people, frequently with higher skills.

Comparing these costs across countries is not easy, but there is strong evidence that South Africa's labour costs are higher than those of many other developing countries. They can only be sustained if workers are very productive, which discourages businesses from hiring unskilled workers and encourages them to rely more heavily on capital-intensive production methods. These trends have accelerated in recent years as wage increases have outstripped gains in productivity.

One reason why labour is not more competitively priced may be that many agreements reached in wage bargaining councils by some employers and trade unions are extended to other businesses in those industries. This imposes higher costs on businesses which have to be offset by increased productivity. Since this usually requires firm-specific interventions, centralised bargaining can sever the link between negotiations over pay and improved productivity.

Another factor is the high cost of dismissing unsuitable or unproductive workers. Two thirds of all firms surveyed in a recent study had been taken to the Commission for Conciliation, Mediation and Arbitration (CCMA) by dismissed employees, with each episode typically requiring a week of a manager's time.

Many believe these procedures are justified because they help to protect employees. Unfortunately they also deter employers from hiring more people especially those whose productivity is unproven. This affects young, unskilled and inexperienced aspirant workers more than older ones, so it is they who are least likely to be employed. This effect might be mitigated if such workers could choose to work at lower wages than those earned by older, more experienced workers, but South African labour law does not allow this.

Another factor that may encourage employers to adopt capital-intensive production methods is that labour relations in South Africa are more adversarial than in many other countries. This increases business risk, especially when workforces are large, and may be adding significantly to the costs of doing business.

### *Labour market reform*

Three different arguments were made about the desirability and probable impact of significant reform of the labour market.

One view is that this would lower the cost of labour, boost employment, and provide a vital signal that government policy was becoming more business-friendly. This would help to raise business confidence,

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There is strong evidence that South Africa's labour costs are higher than those of other developing countries

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and boost investment levels. By raising the costs and ‘hassle factor’ of labour, the current labour market regime encouraged employers to hire smaller numbers of skilled workers. This works against the emergence of firms hiring large numbers of unskilled, inexperienced workers, making it more difficult to resolve the unemployment crisis.

A second view is that lowering the cost of labour would not measurably increase employment levels by very much and is undesirable because it jeopardises the incomes of millions of working South Africans.

A third group disputes this latter claim. Labour market reforms would not reduce the incomes of existing employees and this misconception makes reform a harder proposition to sell than it need be. Even though labour market regulations raised the cost of labour, existing businesses had compensated for this by selecting products and production methods that relied on skills and technology. These businesses were profitable, which means they have balanced relatively high wages with relatively high levels of productivity. Therefore, labour market reforms that allowed firms to hire less skilled workers at lower wages need not lead to large-scale job losses at high-productivity/high-wage firms. While the effect would be to lower *average* wages, existing workers’ salaries need not be affected.

### **Matching labour supply and demand**

Although most of the discussion revolved around the lack of demand for labour, important issues also arose in respect of the supply of labour:

- Why are so many adults of working age not looking for jobs? Is this an effect of South Africa’s social welfare net, of workers’ undue wage expectations or of other factors?
- To what extent can unemployment be explained by poor skills levels?

#### *Social grants and the labour market*

The international literature on welfare and dependency suggests that effective social safety nets can make beneficiaries more reluctant to work. This, and some South African research, has led to claims that South Africa’s rapidly expanding welfare state (including welfare grants, subsidies for housing and basic services etc) may be one reason for the low labour force participation rate, with many people choosing to stay home rather than looking for work.

The relationship between welfare and unemployment in South Africa is complicated. There is too little reliable national research. In rand terms, the bulk of welfare payments comprise old age pensions (60 per cent) and child support grants (35 per cent). Their effects on people of working age is unclear and it is not known whether they decrease labour force participation rates. Some recent research needs to be considered and investigated more thoroughly. For example labour force participation rates were lower in the mid-1990s when South Africa had a far less comprehensive or generous welfare system. And access to child support grants might make it easier for women to leave their children with caregivers and look for jobs.

#### *Reservation wages*

Some analysts argue that South Africa’s unemployment crisis can be explained by the reluctance of the unemployed to accept wages below a certain threshold – the ‘reservation wage’. Labour market surveys suggest that almost all jobless people say they are unemployed because they have not been offered any work, not because they have been offered work that pays too little.

However, while people may not be turning down poorly paying jobs, they may be looking only for jobs that pay above a certain rate. This situation is most likely to arise if there are large differences in the wages that equally (un)skilled people might earn in different sectors of the economy, different areas of the country, or different types of firm. The South African economy does exhibit these kinds of ‘wage cliffs’,

and the numbers of unemployed may be increased because some unemployed people are choosing not to look for certain kinds of jobs.

#### *Do poor skills explain unemployment?*

Many analysts regard poor skills levels as the most important cause of South Africa's high unemployment. This is certainly part of the explanation and a consequence of the country's education system which fails to equip millions of people with relevant skills. In addition many people do not get the chance to acquire the skills that can only be learnt on the job and they lack skills because they have been unemployed for so long. Resolving this aspect of our skills crisis requires getting people into jobs where they can gain some work experience and the skills that can only be learnt from regular work.

Unemployment is also affected by the shortage of people with managerial and other high-value skills sets – an issue that receives less attention in the discussion about unemployment than it should. South Africa's skills shortage – accentuated by its restrictive migration regime – inhibits the expansion of existing companies, and holds back new investors. While it is important to address the very low skills levels among the unemployed, it is equally important to increase the country's supply of skilled people.

#### **Concluding remarks**

If South Africa is to build a more employment-intensive growth path, we need to rethink some key assumptions. The most pervasive of these is that the country should move progressively up the value chain, producing export goods with skilled labour and advanced technology rather than emphasising goods made by large numbers of unskilled workers. Given the low skills and inexperience of most unemployed people, this approach will never create enough jobs. Instead, we should find and fill niches in the global supply chain for goods produced with more basic technology, and utilising relatively low-skilled workers.

In order to do so, we need to address the gap between the poor productivity of young, unskilled, inexperienced workers and their employment costs. This requires a fundamental re-examination of the labour market regime with a view to facilitating the emergence of lower-wage industries and businesses that have enabled other countries to drive high and sustained rates of economic growth, and employ very large numbers of people.

Labour market reforms of this kind would create opportunities for people who could not expect to find jobs in existing industries and firms. Without the development of low-wage companies, South Africa will not be able to create the millions of jobs we need, or achieve higher rates of economic growth.

South Africa needs to learn the lessons presented by Newcastle's clothing industry. In this town (with an unemployment rate of 60 per cent), workers have shown that they are willing to accept wages below the minimum levels prescribed by the industry's bargaining council, and have attracted more clothing factories as a result. By allowing firms to offer these sorts of wages, and workers to accept them, we could create new enterprises and industries with low and intermediate levels of wages and productivity. Events in the Newcastle clothing industry should be seen as a model for a new industrial structure rather than an affront to South Africa's self-image as a producer of high-value goods.

Directly or indirectly, unemployment is at the root of all of South Africa's most serious social, economic and political challenges. This publication reflects the results of a series of conversations in which CDE has engaged in recent months. Much more work is needed, and CDE will continue to explore the issues involved. One thing is clear: if rapid progress is to be made, some of the country's most important constituencies will need to rethink many of the policy positions to which they have committed themselves. Negotiating this will require strong and courageous leadership.

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We need to address the gap between the poor productivity of young, unskilled, inexperienced workers and the costs of employing them

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# Background

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ON 7 OCTOBER 2010, CDE convened a workshop of leading economists on South Africa's persistent and extremely high levels of unemployment. What, we asked, is preventing us from creating more jobs? Given the large and diverse body of theoretical work and empirical evidence, what do we know about the policy levers that affect employment? And what do we still need to find out?

We invited a number of experienced economists working on various aspects of the labour market to participate in the discussions. We then invited them to comment on earlier drafts of this report, and extended this invitation to other local and foreign experts. Their comments were taken into account in finalising this publication (see box, page 6).

South Africa's unemployment crisis is a controversial and politicised subject. We therefore ran the workshop according to Chatham House rules, which means that discussions could be reported but not attributed to particular participants. One consequence of this approach is that this report should not be read as implying that any of the participants in the original workshop, or any of those who offered comments on earlier drafts, endorses all aspects of it. And the same applies to CDE: because we have tried to reflect the views of all participants and commentators, this report should not be read as a comprehensive expression of CDE's views on South African unemployment, its causes, and its potential cures. It is intended, instead, to reflect the parameters of the debate, and to set out some key areas of agreement and disagreement within it. CDE is continuing its work on this vital subject, and will release more publications.

South Africa's unemployment rate of 25 per cent is among the highest in the world

## Introduction

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WHEN SOUTH AFRICANS talk about jobs, they usually bemoan the fact that our unemployment rate of 25 per cent (or 33 per cent, if a broader definition of unemployment is used) is among the highest in the world. However, a more significant – and even more alarming – statistic is that, at 41 per cent, the proportion of South African adults who are actually working is 25 or 30 percentage points lower than in developing countries such as China, Brazil, and Indonesia, and about 20 per cent lower than the international average. South Africa needs about six million more jobs – about 50 per cent more than the economy provides at present – to reach these international norms.

One way to get to grips with the scale of the challenge is to think about the implications for a sector such as manufacturing. According to the South African Revenue Service, there were about 34 000 manufacturing firms in the country in 2007.<sup>1</sup> By definition, increasing employment in this sector by 50 per cent would require many more firms and/or many more jobs per firm. Achieving this would require a dramatic increase in investment as well as in the number of skilled people available to the economy. It would also require vastly improved public infrastructure such as road and rail networks, water and electricity supplies, and port capacity.

Even this does not reflect the full extent of the challenge. Employment in mining and agriculture has declined, and neither sector is likely to recover the jobs lost over the past few decades. For this reason, other sectors, notably manufacturing and services, will have to create a disproportionate share of the new jobs we need. Given this, if the country is to create six million new jobs, the manufacturing sector may need to double in size instead of 'merely' growing by 50 per cent.

But the challenge is still understated. The estimate of six million jobs is premised on a population of about 32 million working age adults. This population will continue to grow, partly as a result of organic population growth and partly because our economy will continue to attract migrants from the region and further afield. Moreover, if South Africa starts creating jobs more rapidly, it would probably attract even more cross-border migrants. Therefore, we need to create more jobs over the next few decades than the six million we need now. We need to know where these jobs could come from, and what could be done to create them.

This report provides some data and analysis which we hope will help South Africans to find answers to these questions. It deals, in turn, with the scale of the unemployment crisis, the importance of raising the employment intensity of economic growth, the role of labour market regulation in South Africa's poor job creation record, and the way in which the behaviour of participants in the labour market exacerbates the unemployment crisis. Major insights gained are drawn together in a concluding section.

## The scale of South Africa's unemployment crisis

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WHILE ALL AGREE that levels of unemployment in South Africa are very high, there is room for debate about the way in which Statistics South Africa calculates the official unemployment rate (see box, page 9).

According to the Quarterly Labour Force Survey for the third quarter of 2010:<sup>3</sup>

- Of a population of working age of 32,1 million people, 14,7 million (or 46 per cent) are not economically active, and therefore not part of the labour force.
- Of the 17,4 million people in the labour force, 13 million (75 per cent) are employed, and 4,4 million (25 per cent) are unemployed.
- If discouraged workers are counted as unemployed (as opposed to counting them as not economically active, as is the norm), the size of the labour force increases to 19,4 million, and the ratio between employment and unemployment shifts from 75:25 to 67:33.

### EMPLOYMENT STATISTICS IN A NUTSHELL

Official employment and unemployment statistics can be confusing. Herewith a short guide to the latest figures, and how StatsSA compiles them. They are taken from the December 2010 issue of the Quarterly Labour Force Survey, which reports on the third quarter of 2010.<sup>2</sup>

As a first step, StatsSA defines a South African population of working age, namely everyone between the ages of 15 and 64. All employment statistics are compiled in respect of this sub-population.

Simply stated, unemployed people are people who want to work but cannot find a job. In line with this, StatsSA defines the *unemployed* as people who do not have a job, are not self-employed, and who actively looked for work in the month before the survey's reference week. On the other hand, people are *employed* if they did at least an hour's remunerated work (including self-employment) during the reference week. Together, the employed and the unemployed constitute the *labour force*, or the *economically active population*.

StatsSA then reports figures for *discouraged work-seekers*, defined as people who want to work but have given up looking for it. There are also figures for people who say they are not available to work. This category includes students, retired people and 'home-makers'. Together, these two categories make up the population of people who are *not participating in the labour market*, or who are *not economically active*.

According to the December 2010 figures, 13 million people are employed and 4,4 million are unemployed, yielding a labour force of 17,4 million. There are 2 million discouraged work-seekers, and 12,7 million who are not participating in the labour market, yielding an economically inactive population of 14,7 million.

These figures yield three important ratios. The *unemployment rate*, in which the number of unemployed is expressed as a percentage of the labour force. The current rate is 25 per cent. The second is the *employment rate*, in which the number of employed people is expressed as a percentage of the population of working age. The current rate is 41 per cent. The third is the *labour force participation rate*, in which the size of the labour force is expressed as a percentage of the population of working age. The current rate is 54 per cent.

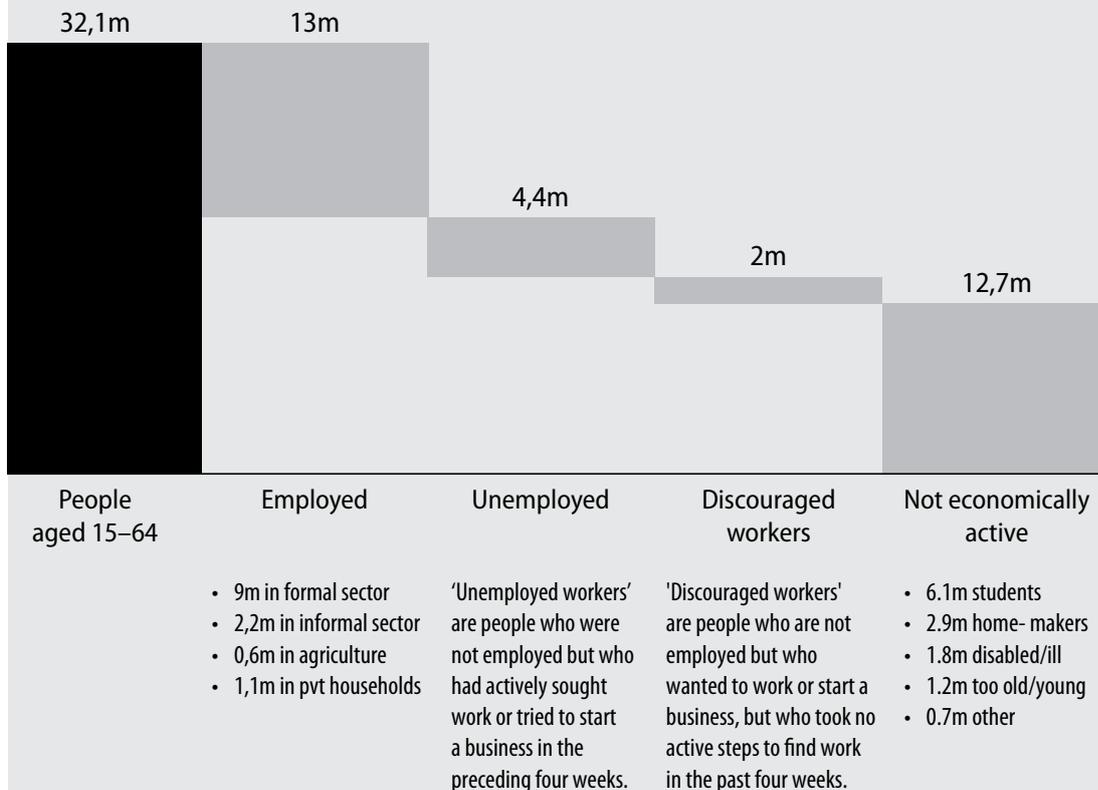
These calculations conform to standard international practice. Some people argue, however, that they do not provide a realistic picture of unemployment in a developing society such as South Africa. Notably, they argue that discouraged work-seekers should not be regarded as 'economically inactive' but as 'unemployed'. Similar sorts of issues also arise about other forms of economic activity prevalent in developing societies, such as subsistence farming.

These issues affect the overall ratios. Thus, if discouraged workers were to be counted as unemployed, the labour force increases to 19,4 million, the economically inactive population shrinks to 12,7 million, and the unemployment rate rises to 33 per cent.

**Figure 1: Population of working age, third quarter 2010**

**17,4 million** people were **in the labour force** because they either had jobs or had been actively looking for work.

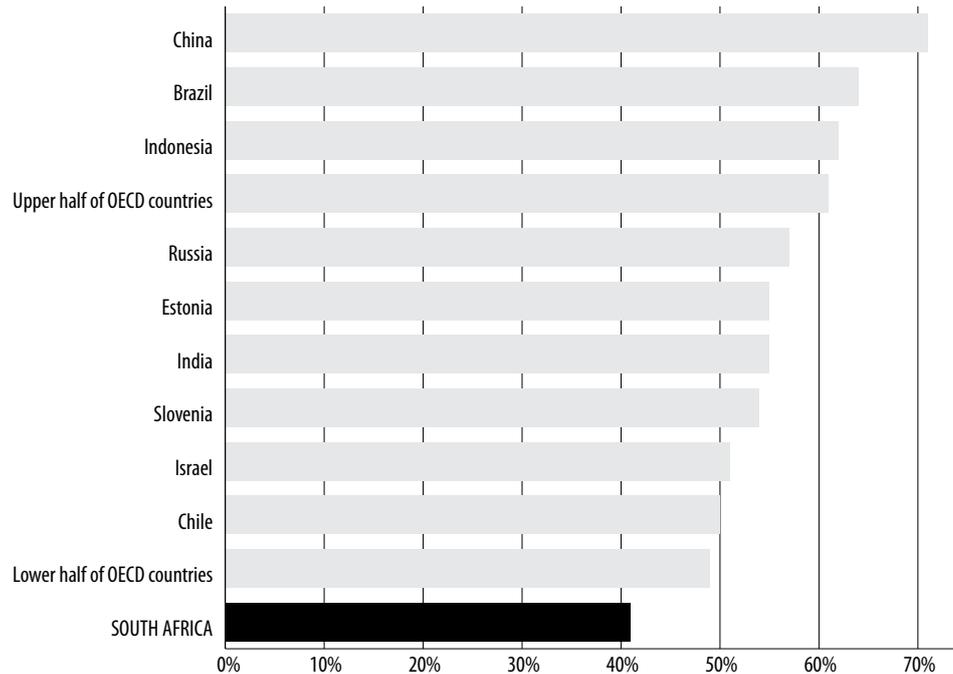
**14,7 million** people were defined as **not economically active** because they were not actively seeking work



StatSA data, as interpreted by CDE 2011

A qualification is in order. StatsSA’s definition of an employed person is anyone between the ages of 15 and 64 who worked for at least one hour during the reference week, or was temporarily absent from their job/business in that week. Here ‘work’ is defined as any activity carried out for pay, profit, or household gain (for instance, by participating in a household business). Thus, according to StatsSA, barely 41 per cent of South Africans aged between 15 and 64 did a minimum of one hour’s ‘work’ in the reference week. This is a very low level by international standards. It is, for example, 30 percentage points lower than the comparable rate in China, and more than 15 percentage points lower than the average of a set of countries including all OECD members as well as nine developing countries (see figure 2).

**Figure 2: The employment rate in SA and select countries, 2008**



Source: OECD, Economic Survey: South Africa, 2010.

For most participants and readers, the exceptionally low proportion of South Africa’s adults that are in work is the most important indicator of South Africa’s unemployment crisis. This is because the unemployment rate is largely defined by how many people are actively looking for work. However, it is reasonable to assume that a very large proportion of people who are not actively looking for work have stopped looking because of the dire state of the jobs market. For this reason, official measures of unemployment understate matters because they do not count as unemployed anyone who has stayed out of the labour market because they believe they have no prospect of finding work. Therefore, some proportion of people who are not economically active, and not just those formally counted as ‘discouraged work-seekers,’ might be better thought of as unemployed.

According to one expert, to say that a 30-year-old was unemployed and had been unemployed for a long time implied one of two things. ‘Given that he hasn’t starved to death, either he is doing some work that is not being captured in the surveys, or he is obtaining some form of unemployment insurance.’

Since people are eligible for unemployment insurance only if they previously had a job (and then are entitled to benefits for only a short period), any unemployment insurance would probably be informal. This would include financial support received from family members, whose income might derive either from employment or from welfare grants. However, StatsSA’s definitions and methods could also exclude some forms of economic activity.

One example is crime, which provides an unknown number of individuals and households with some income. There are good reasons why crime is not classified as employment. Another more

debatable example of an activity that is not counted as employment, however, is subsistence agriculture, an activity in which, according to StatsSA, some 1,5 million people were engaged in mid-2010.

At present, and in contrast to previous practice, StatsSA categorises subsistence agriculture as a 'non-market activity', or an activity whose products are consumed exclusively in the household. Non-market activities currently recognised by StatsSA are listed in Table 1.

**Table 1: Non-market activities, July-September 2009 and 2010 (000s)**

Activities	July-Sept 2009	July-Sept 2010
Subsistence farming	1,248	1,529
Fetching water or collecting wood/dung	3,063	4,539
Produce other goods for household use	54	220
Construction or major repairs at own household	148	402
Hunting or fishing for household use	18	78
Total	3,746	4,331
Unemployed	553	665
Not economically active	3,193	3,667

Source: StatsSA, Quarterly Labour Force Survey, December 2010.

Note: The total number of people involved in all non-market activities is smaller than the sum of the various activities because some respondents gave multiple answers.

StatsSA classifies people engaged in these activities as either unemployed (if they are actively looking for work) or as economically inactive (if they are not actively look for work). In line with this, 15 per cent of subsistence farmers are currently deemed to be unemployed, while 85 per cent are deemed to be economically inactive. According to StatsSA, it would have classified subsistence farmers as employed if it had evidence that their activities made a 'significant contribution' to total household consumption levels, but at present they do not have the necessary data.

It could be argued that survivalist activities such as subsistence agriculture should be understood as a form of (informal) unemployment insurance rather than as employment, because this is what people fall back on when real employment opportunities are not available. However, subsistence agriculture could also be classified as self-employment. As one participant noted, subsistence agriculture has been a feature of economic activity throughout human history, making its exclusion as a form of employment from StatsSA's data rather incongruous.

Whatever the merits of these contending views, it seems likely that countries such as Brazil and China could not have achieved employment rates 30 percentage points higher than South Africa's without counting their tens of millions of subsistence farmers as employed. A simple calculation shows that if we were to count 1,5 million subsistence farmers as employed, our employment rate would rise to 45 per cent, and the unemployment rate would drop to about 23 per cent. This calculation assumes that the figure of 1,5 million subsistence farmers is accurate, but at least one participant believed it was implausibly low. According to StatsSA data, it appears that about a third of all households live in the former 'homelands'.<sup>4</sup> Even if the demographic profile in those areas is skewed towards children and the elderly, a conservative estimate of the number of working age adults living in the former Bantustans would be in the order of six million people. 'Why,' he asked, 'are only a quarter of them being captured as being engaged in subsistence farming? What else are they doing?'

Vigorous discussion ensued about whether or not subsistence farming should be counted as employment. Some participants agreed that classifying subsistence farmers as unemployed or economically inactive was problematic. Others said this kind of data was sometimes cited by 'unemployment denialists'

in and outside government, and might be used as an excuse to approach the issue with less urgency than it warranted. Others still argued that this kind of economic activity was intrinsically undesirable, and that South Africa's job aspirations needed to be higher. In line with this, one commentator even suggested that, as a matter of principle, South Africa should not count 'survivalist' strategies as employment.

Against this, one commentator argued forcefully that it was inappropriate to designate some kinds of work as 'desirable' and others as 'undesirable'. This, she said, tended to reinforce the sometimes problematic insistence that South Africans were interested only in 'decent work'. If peasant agriculture was defined as undesirable, one could just as easily say the same about other forms of low-wage, low-productivity work. Doing so might preclude the development of light manufacturing industries that could absorb hundreds of thousands of low-skilled and inexperienced workers.

However, other commentators insisted that there were important reasons to view formal sector wage employment as different from, and superior to, involvement in subsistence agriculture. For one, this was because formal sector employment – however badly paid – offered a route to modernity that subsistence agriculture could not. Another commentator argued that the experience of employment, as opposed to subsistence farming, generated skills and aptitudes which helped to transform human capabilities and raise the productivity of the economy. In other words, equating subsistence agriculture with low-wage employment missed the vital differences between them, particularly in relation to the life chances and income paths of individuals involved, with commensurate differences in the development trajectory of society as a whole.

Some participants raised concerns about the reliability and usefulness of the official statistics. One noted, however, that the figures for employment and unemployment were remarkably consistent over time, and moved in the expected direction when the economy grew or contracted. Even granting the difficulty of accurately enumerating part-time employees, subsistence farmers and the like, there was good reason to think that StatsSA's figures were broadly accurate. A more difficult question was whether the definition of employment – a minimum of one hour's work in the reference week – did not include many people who were grossly underemployed.

Participants agreed that more work should be done to assess StatsSA's definitions of employment, and whether or not the resultant data left gaps in our knowledge.

### **Points to note**

The workshop and subsequent comments raised important questions about how South Africa defines and records unemployment, with participants offering contrasting ideas that could either narrow or widen the definition of employment, and either worsen or improve the figures. While this debate is partly a technical one, a vital question does arise: what kind of activity should qualify as 'work'?

As much as anything else, this is a political question that cannot be answered in purely technical terms. At the same time, it is clear that far more debate is needed about the pros and cons of present approaches to defining employment and unemployment.

One point stands out. South Africa needs to be far more concerned about the employment rate (i.e., the proportion of the population of working age with jobs) than about the unemployment rate, since the latter is defined in part by whether people without work are actively looking for it. It seems likely that many people who want to work have become discouraged by the state of the jobs market (and are classified as economically inactive as a result). They would probably be looking for jobs more actively (and changing their formal classification in the process) if more openings existed

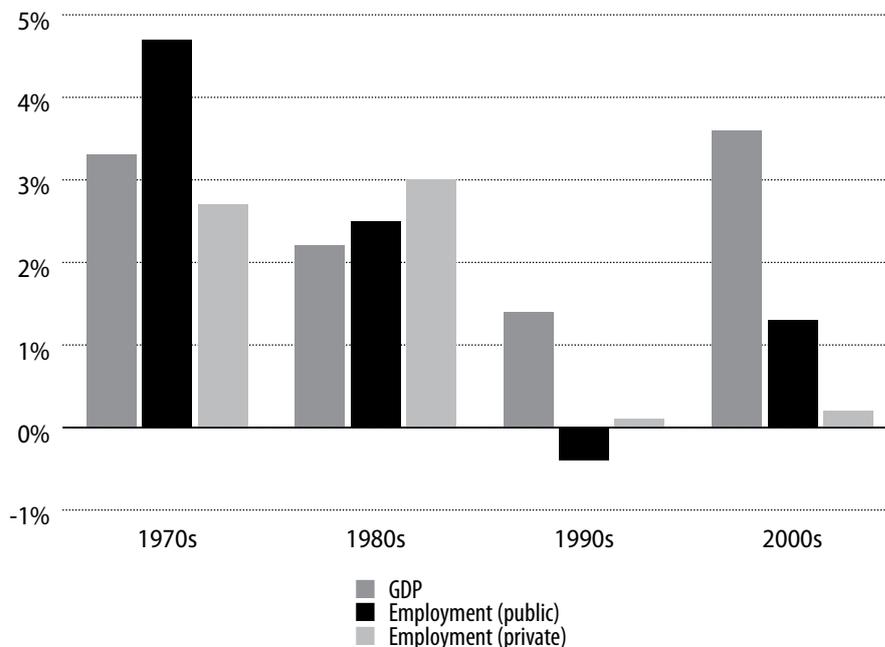
## The weakening link between growth and jobs

THERE IS NO doubt that economic growth is essential for creating jobs, and that the faster the economy grows, the more jobs will be created. Identifying the most effective and sustainable drivers of economic growth must form a large part of solving the unemployment crisis. But not all growth is equally employment-intensive – in fact, the link between economic growth and job creation in South Africa has been weakening over time. Reserve Bank figures show that, in the 1960s and 1970s, GDP growth of 1 per cent created a roughly similar increase in formal sector jobs. As figure 3 shows, however, that relationship has weakened dramatically in recent decades.

This was confirmed by one participant who showed that, in two periods of relatively rapid growth since 1990 (1994–6 and 2004–8), GDP growth averaged 4,4 per cent a year, but the number of jobs grew by only 1,8 per cent a year. One study suggests that, in the period 1990 to 2009, each percentage point of economic growth generated employment growth of only 0,35 per cent. Although one commentator expressed some doubt about the extent of the fall in the employment intensity of growth, this trend was viewed as enormously significant.

One possible reason for the declining employment intensity of growth is that most growth has taken place in relatively highly skilled economic sectors such as financial services. Another is that changes in labour legislation and other factors have driven employers towards methods of production that rely more heavily on skilled workers and automation. Some of these issues are sector-specific. In agriculture, for example, capital intensification has been driven by a range of factors including the consolidation of the farming sector (which has seen the number of farming units fall from 60 000 in 1996 to 40 000 in 2009),

**Figure 3: GDP growth versus job creation, 1970s—2000s**



Source: South African Reserve Bank, online database, <http://www.resbank.co.za/qbquery/timeseriesquery.aspx> (accessed on 16 November 2010).

heightened international competition, and technological change. In addition, a slew of legislation impacting on tenancy, land reform and other aspects of social relations in rural South Africa seems to have encouraged farmers to use less labour than they once did.

Another reason cited by a reader for the declining employment intensity of economic growth is the aggressive liberalisation of South Africa's trade regime in the mid and late 1990s. This, she noted, was not complemented by measures to make the labour market more flexible. The predictable consequence was that labour-intensive imports from low-wage countries resulted in job-shedding in industries that had previously employed large numbers of people. Thus, in the face of increased competition from abroad combined with relatively rigid labour laws, South Africa's labour force might have become increasingly uncompetitive.

Whatever the reason for the weakening relationship between economic growth and employment growth, simple mathematics shows that if economic growth of 4,4 per cent increases the number of jobs by only 1,8 per cent, it would take 22 years to create the six million jobs needed by people who are currently counted as unemployed or as 'discouraged work-seekers.' Moreover, the population of adults of working age is not static. If it continues to grow at 1,9 per cent a year (the rate between 2009 and 2010),<sup>5</sup> and the number of jobs grows at only 1,8 per cent a year, the employment rate will worsen instead of improve. If growth averages 7 per cent a year and the employment intensity of growth is not raised, it would take more than 40 years to create jobs for 60 per cent of the population of working age. Achieving this will be a challenge: the South African economy has achieved this rate of growth only four times since 1947, and never since 1967.<sup>6</sup>

The bottom line, then, is that we cannot grow our way out of the present unemployment crisis unless growth is very rapid. But growth must also be far more employment-intensive than it is at present.

## The sources of labour-intensive economic growth

The importance of GDP growth for employment raised numerous questions about the drivers of growth. Some participants argued that government spending – which currently amounts to about 28 per cent of GDP, and which has tended to be pro-cyclical – helped to accelerate economic growth in the boom years between 2000 and 2007. But this pattern is not sustainable, so if growth is to accelerate, the country will have to rely on the expansion of the private sector rather than continued growth in public spending.

Some participants said the most feasible way of accelerating private sector growth was via exports, both to Africa and to the rest of the world. One argued that a key reason why overall growth was lagging was that too many firms were not producing goods for export. But the domestic market is too small to support more rapid economic growth, the more so in the absence of pro-cyclical government spending. Therefore, South African firms needed to concentrate on producing goods for export.

While the idea of focusing on exports to speed up economic growth is not new, participants suggested that even rapid export growth would not create many more jobs unless the products concerned could be produced by relatively unskilled workers. In this regard, trends in the export sector were discouraging, with few firms being globally competitive, especially in respect of labour-intensive manufacturing. A few reasons were offered for this.

Besides the frequently noted issues of the strong rand and the risk-inducing volatility of the exchange rate, participants suggested that the current regulatory environment imposed higher costs on larger manufacturing firms. For example, both employment equity legislation (which is more onerous for firms that employ more than 50 workers) and black economic empowerment rules (which requires far more detailed auditing of firms with turnovers above certain thresholds) could discourage

In the face of increased competition from abroad combined with relatively rigid labour laws, South Africa's labour force has become increasingly uncompetitive

firms from growing. As a result, firms remained too small to achieve the critical mass needed to export competitively.

In addition, firms that do export often produce goods and services that rely heavily on skilled labour or sophisticated production techniques. One reason for this is that transport and logistics costs are relatively high per unit of production, and producing high-value goods is the only way in which these costs can be recovered. These products typically create a smaller number of jobs for unskilled workers per unit of production than other types of goods.

The key implication is that South Africa needs to become much more competitive (by reducing transport costs to and through our ports, helping firms to raise productivity levels, and reducing other input costs). This may mean that, instead of supporting high-value, capital-intensive industries, policy-makers should create the infrastructural, economic, and regulatory conditions that would help South African manufacturers move down the value chain in order to produce more labour-intensive products. A key issue to consider is the extent to which some aspects of the business environment discourage firms from employing more people, and whether this might be inhibiting their ability to compete in world markets.

Such an approach demands a range of policy interventions aimed at lowering the price of manufactured goods, an issue which needs to be examined far more closely. In this regard, however, participants mentioned some key constraints, including the shortage of electricity, which could limit economic growth to 3 or 4 per cent a year. While investing in more generating capacity would add to economic growth in the short term, the rest of the economy would be held back until additional capacity became available.

Important as these issues are in shaping the growth and employment outlook, participants all recognised that the cost of labour remained a key issue in respect of international competitiveness.

### **Points to note**

Rapid and sustained economic growth is required to address South Africa's unemployment crisis. The employment intensity of growth must also improve. If this is not achieved, even very rapid growth will have to be sustained for decades before it raises employment rates to global norms. Raising the employment-intensity of growth will require the emergence of low-skilled, labour-intensive industries that serve global markets. There are significant obstacles to the emergence of such industries, particularly the emergence of companies with very large numbers of unskilled workers. Some of these inhibiting factors are infrastructural (roads, rail, electricity), but others are regulatory. Much more needs to be done to address them.

## The role of labour market regulations

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### Labour costs and productivity

EMPLOYMENT LEVELS ARE determined by two things: productivity levels and the cost of labour. Labour costs comprise not only direct costs (wages and benefits) but various indirect costs (including the costs of complying with health and safety rules, training workers, and, in some cases, providing benefits such as accommodation and transport). In addition, because there are costs associated with dismissing and replacing workers, a firm's decision to employ someone is also based on the risk that it will incur additional costs if it must replace him.

All of these costs help to determine the extent of employment: if the sum of these costs is high and/or rising, fewer jobs will be offered than if it is low and/or falling. In the face of rising employment costs, employers will tend to move towards products and production techniques that emphasise skilled labour and mechanisation.

Some labour costs are more easily quantified than others. Remuneration and the value of some benefits can be accurately priced. It is more difficult to calculate the costs of health and safety regulations, compliance with labour laws, employment equity, and so on. Imposing some or all of these costs on businesses may be appropriate in order to achieve certain social policy objectives. Health and safety regulations, for example, which impose costs on business, may be justified because they keep workers safe. However, to the extent that these and other kinds of regulations raise the costs of employment, they also work to reduce the number of jobs.

Over time, the impact of labour costs on employment will depend fundamentally on how they relate to workers' productivity. If rising labour costs are not offset by increased productivity, employers will retrench those workers whose productivity does not justify the costs of their employment.

Participants expressed concern about the relationship between remuneration trends and productivity trends in recent years. Because labour costs have risen faster than employment, it was argued, the relationship between the cost of capital and the cost of labour has changed. As one participant put it, labour was 'pricing itself out of the market.' This is evident in SA Reserve Bank data which shows that, since 2000, pay levels have risen far more than productivity, which, on average, has actually declined (see figure 4). It is also evident from a global remuneration survey conducted by a Swiss bank in 2010 which showed that, in dollar terms, Johannesburg's workers earned far more than workers in other cities in the developing world.

The fact that remuneration levels have risen more quickly than productivity in recent years has significant employment implications. One reader suggested that upward pressure on remuneration levels was appropriate and, to some extent, the consequence of deliberate social policy. Rising wages, especially for black workers, helped redress the inequalities in pay and remuneration inherited from apartheid, and should therefore be actively pursued. Whether or not this argument is correct – and it is widely held in government circles – understanding the sources and consequences of the divergence between remuneration and productivity over the past decade is vital if South Africa is to increase the demand for labour.

Some participants also noted that South African workers' take-home pay was affected by their having to absorb some costs associated with supplying their labour. A frequently cited example of this is the costs of getting to work which is said to be high because of inefficient spatial planning and poor public transport. While some participants doubted whether South African workers spent more on transport

If labour costs are not matched by productivity, employers will retrench those workers with the lowest productivity

**Figure 4: Average changes in productivity and real wages (non-agricultural sectors) per decade, 1970–2009**

Source: SARB on-line database, accessed on 16 November 2010.

than those in other countries, others argued that the spatial legacy of apartheid created a large gap between what firms paid their workers and workers' take-home pay. These kinds of costs could set limits to the salaries that workers would accept. What is clear is that the issue of safe and efficient public transport should be higher on the list of priority reforms.

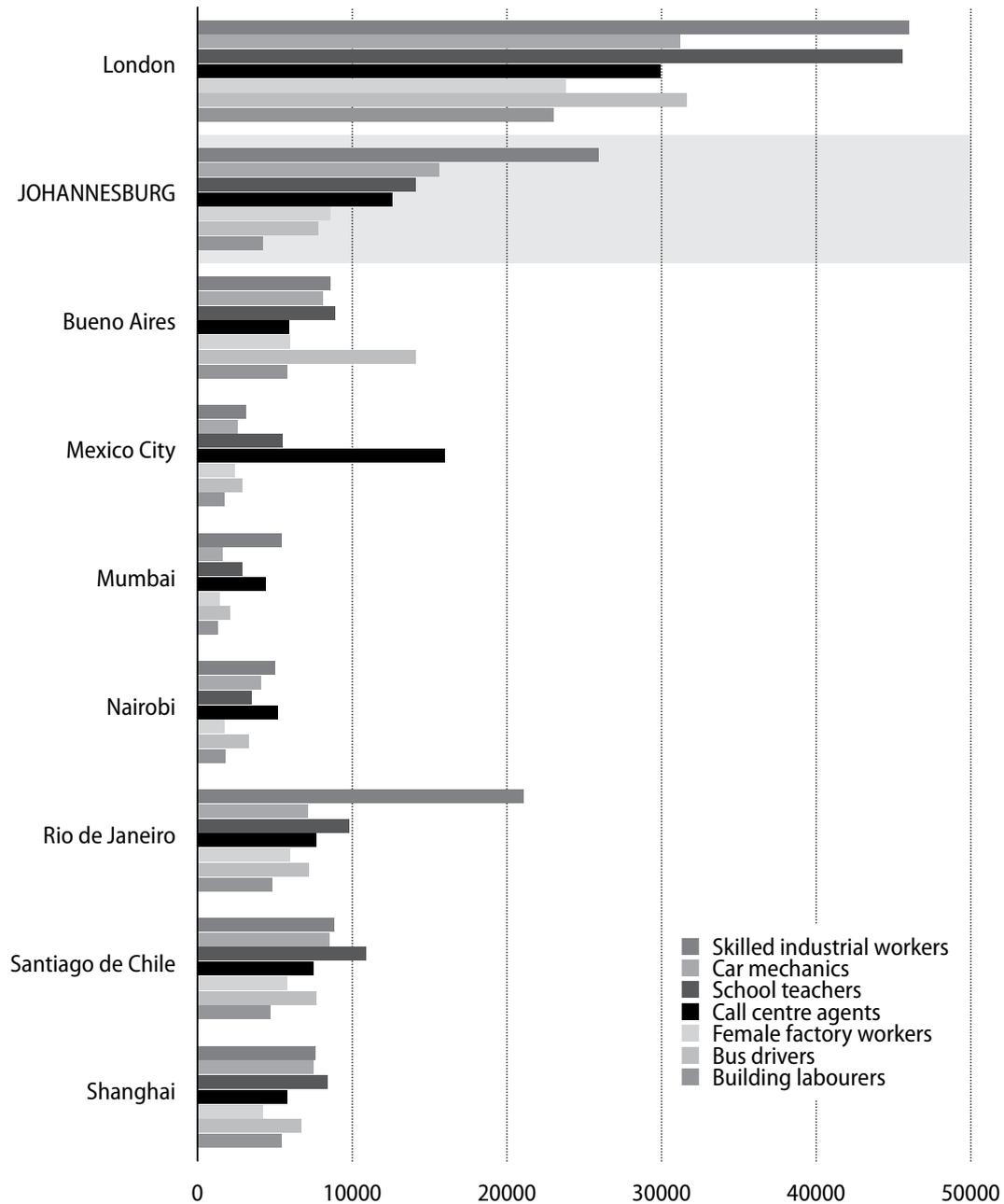
## Unions and collective bargaining

It is widely believed that South African wages are kept artificially high by trade unions, the system of collective bargaining, and other aspects of labour legislation. There is evidence that South Africa's unionised workers command a premium on wages relative to non-unionised workers. However, at about 10 to 20 per cent, this premium is not as large as many people believe. These premia exist even though unionised workers are often in relatively capital-intensive industries (mining and steel) or in skills-intensive professions (nursing and teaching). They exist, in other words, even if one takes into account the fact that unionised workers tend to be in industries and sectors where productivity levels and wages are relatively high. Even among unskilled workers, however, there is some evidence that the premium associated with unionisation is rising. One participant referred to a paper prepared for the National Treasury which showed that the union wage premium for skilled workers was falling, while the premium for unionised unskilled workers was rising.<sup>7</sup>

Participants referred to other features of labour market regulation which they regarded as problematic. One of these is that decisions made in wage negotiations are extended across industries even when not all employers (and employees) are formally represented at the talks, and can do little to obtain exemption from these decisions. Empirical research has found that firms covered by bargaining councils pay wages that are 10 to 21 per cent higher than those paid by similar firms in magisterial districts in which firms are not covered by bargaining councils. They also employ between 8 to 13 per cent fewer

people. Those industrial sectors also tend to be more dominated by larger firms and to comprise fewer small firms and entrepreneurs.<sup>8</sup>

**Figure 5: Gross earnings in various professions and various cities, 2009**



Source: UBS, Prices and earnings: A comparison of purchasing power around the globe, 2009.

Another participant noted that, while only a third of the formal economy was covered by centralised bargaining, the sectors concerned (including the public service) were among the most important. For that reason, they tended to provide a benchmark for increases in other sectors – in other words, they had knock-on effects on the rest of the economy. One reader disputed this, citing the fact that, while the public sector bargaining council had agreed to a 7,6 per cent pay rise in 2010, other sectors had agreed to significantly larger increases. Using a sample of 56 agreements reached by Cosatu affiliates

in 2010, he noted that the construction, transport, manufacturing, and retail sectors had all agreed to wage increases greater than 9 per cent. Their decisions, in other words, were not being guided by what happened in the public service. A question that could not be answered in full, however, was the extent to which these kinds of agreements impacted on sectors and employers that are not covered by centralised bargaining. To the extent that the premium associated with unionisation seems low, it may reflect the fact that wages in these sectors are pulled up by decisions taken elsewhere in the economy.

One participant argued that the bargaining council system ‘severed the link between productivity and wages’ as centralised bargaining could not accommodate the specific negotiations needed to improve productivity, which usually have to happen at the level of individual firms and plants. For this reason, increased wages tended to be negotiated without considering whether corresponding productivity increases could be secured. The result was that new costs were imposed on firms which might not be able to secure the improvements in productivity needed to offset them. If they were unable to increase productivity, employers would have to eliminate the least productive workers from their payrolls.

In response, a reader argued that, to the extent that bargaining councils did increase wages faster than productivity gains, the problem lay less with the structure of the negotiations than with the substance of the wage agreements. Some employers had already put productivity and job retention on the collective bargaining agenda, and unions found it difficult to reject proposals that linked smaller wage increases with commitments to employ more people. Accepting that the structure of bargaining could make such holistic negotiations more difficult, he added that agreement on benefits such as provident funds or pensions, medical benefits, leave and training could often be more effectively negotiated centrally than at firm level. While the circumstances of individual firms, subsectors and geographic regions often merited differentiated wages, ‘smart councils’ could accommodate these differences. The big exception to this was the public service bargaining council which covered so many diverse sectors – policing, health, teachers, general workers – that it was far less capable of accommodating any kind of productivity-related negotiations.

The bargaining council system severs the link between productivity and wages

## The costs of dismissal

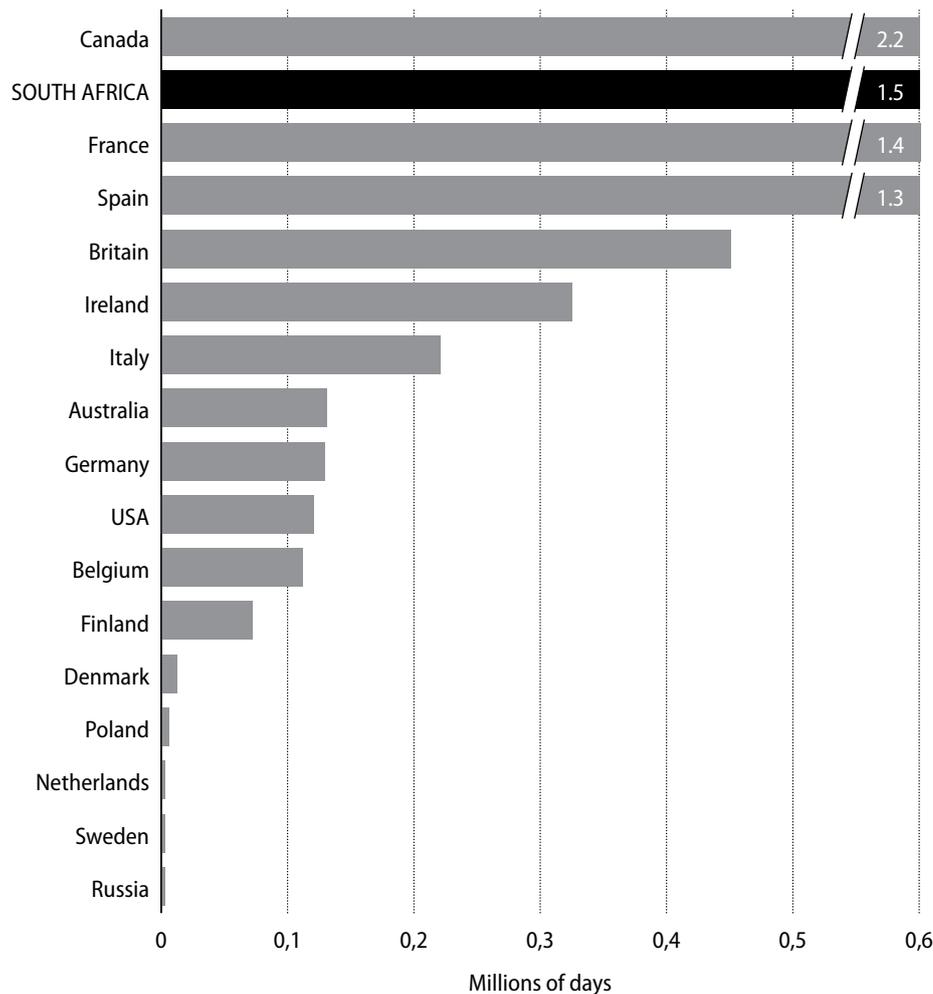
Another important effect of centralised wage bargaining, it was argued, is that it prevented entry-level workers, especially young workers with neither skills nor experience, from offering their labour to employers at a discount. Given that young, inexperienced workers were less productive than others, preventing them from offering their labour more cheaply meant that employers would be more reluctant to take them on. This was made worse by the non-wage costs and risks associated with their employment. Participants cited empirical studies which found that the procedural costs of dismissals had a significant inhibiting effect on employment growth. One study found that employees had taken two out of three firms in the survey sample to the Commission for Conciliation, Mediation and Arbitration (CCMA). On average, firms lost a week of a manager’s time as a result. The prospect of incurring costs of this kind implied that employers would require either exemption from the relevant labour legislation or a ‘wage discount’ to persuade them to hire riskier groups of potential employees. This applied particularly to young and inexperienced people: since they were more likely to turn out to be unsuitable, they were also more likely to be the source of costly dismissal procedures. In the absence of a wage discount or statutory exemptions, it was hard to see why firms would appoint them in the first place.

Some participants also felt that the system of regulating the labour market had become more onerous than justified by the legislation. This, it was argued, was partly due to the jurisprudence that had evolved around the legislation, and partly due to the roles of consultants, experts and labour lawyers in defining what was expected by the law. A reader, for example, noted a proposal which would have

instituted a wage cap on those who were entitled to use the CCMA, with people earning more than a certain level being denied access. In terms of this proposal, senior managers and other well-paid employees would be expected to secure their rights through contract law rather than labour law. These points aside, participants generally believed the regulatory system as a whole was discouraging employers from creating more jobs, and particularly from employing young people with limited formal qualifications and no prior work experience.

While participants generally viewed labour market rigidities arising from bargaining arrangements as a disincentive to greater employment, they also noted that factors other than labour law impeded the functioning of the labour market. One such factor is the ‘militancy’ of South African trade unions.

**Figure 6: Work days lost to industrial action in selected countries, 2009**



Source: *The Economist*, Striking facts: working days lost due to labour disputes, 6 September 2010, <http://www.economist.com/node/16976532>.

## The costs of strikes

An expert interviewed after the workshop noted that employment was not necessarily more strictly regulated in South Africa than elsewhere, especially in developed countries. The big difference in South Africa was greater trade union militancy, which made negotiations much more difficult and costly (see figure 6). While this might be the consequence of the historical role played by trade unions in the

struggle against apartheid, and struggles over collective bargaining, the effect was increased risks and costs to employers. Responding to this, one reader suggested that South Africa's unions had become less militant over time, and that, in terms of days lost to strikes, industrial action was in a long-term secular decline. However, recent data from the Department of Labour does not support this view. Given the strong likelihood that the public service strike of 2010 will result in a significant rise in the number of man-days lost to industrial action relative to 2009, the data actually suggests that spikes in the number of days lost to industrial action are relatively frequent (see figure 7).

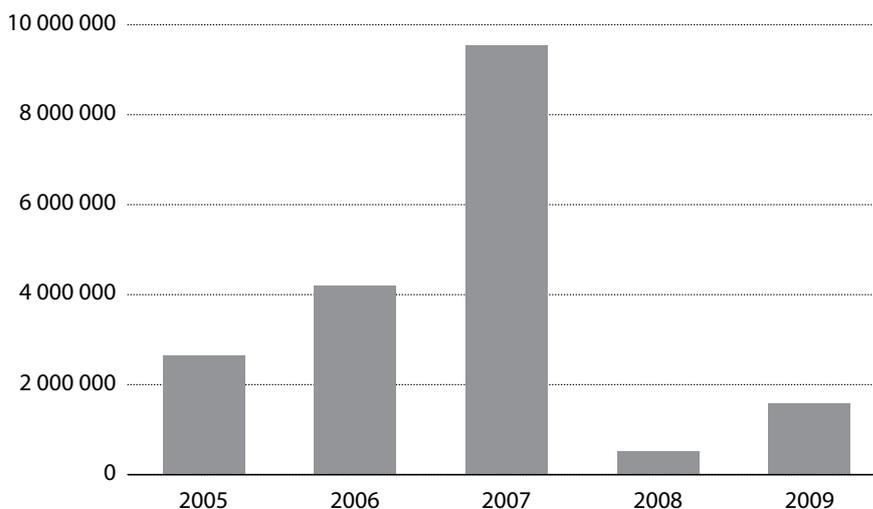
It is worth noting that more strike days are lost in the public sector than in the private sector, so this data may not reflect accurately what has happened in negotiations between unions and businesses. But Department of Labour statistics also suggest that the private sector is sometimes affected by strikes and other protest action that is not directly related to employer/worker negotiations. One example of this are the stay-aways called by Cosatu to protest against food price inflation and other non-workplace concerns.

## The role of labour market reform

While participants agreed that labour market institutions raised the risk-adjusted wage and non-wage costs of employment, they differed about the desirability, feasibility, and impact of labour market reforms. Some saw wholesale reform as a precondition for creating more jobs and as an essential signal to potential investors that government (and its constituencies) accepted the need to create a more business-friendly environment.

Others argued that this was not required. While no one suggested that the present legal regime was perfect, some argued that wholesale labour market reform was not politically feasible. Some also argued that reforms were unlikely to elicit the kind of response from employers that advocates of reform suggested. One reader noted that, irrespective of the feasibility or desirability of doing so, introducing reforms that would significantly lower the incomes of large numbers of workers would also result in a collapse in consumer demand and, therefore, a recession.

**Figure 7: Work days lost to industrial action in South Africa, 2005–09**



Source: Department of Labour, Annual Report, 2009-10.

Another participant argued for caution about labour market reform on the grounds that this was unlikely to increase employment. The price elasticity of demand for labour was so low, she argued, that creating millions of jobs would require a very dramatic reduction in wages. Apart from the negative macroeconomic consequences, equity considerations also militated against policies that would have these sorts of effects. ‘Would it be fair,’ one participant asked, ‘to expect people currently earning R3 000 or R4 000 a month to shoulder the full burden of policy reform?’

Other participants saw this argument as a significant misrepresentation of the likely effects of labour market reform, and, for that reason, as seriously misleading. This point was made strongly by a reader who suggested that labour market reform – even very aggressive reform – would not threaten the incomes of current workers, because their relatively high wages were matched and justified by relatively high productivity. Moreover, wages of existing workers almost never fell because of the likely impact on morale and productivity. Therefore, it was hard to conceive of plausible reforms that would reduce the wages of existing workers. Even implying that it might happen would make it politically far more difficult to reform the labour market. The key challenge, she argued, was to identify the reforms needed to stimulate the establishment of labour-intensive firms and industries. Reform, in other words,

had to set its sights on creating a situation in which South African industry no longer consisted exclusively of high-wage, high-productivity firms. Those firms were profitable today and would remain in business because the wages they paid reflected the capital and skills-intensity of their products and production techniques. However, South Africa needed far more medium and low-productivity firms where wages and non-wage costs of employment would also be lower. ‘Our manufacturing firms only create high-end products because labour costs are high,’ she noted. ‘If we allow lower-wage work to come into existence, our range of products will expand.’

A foreign expert concurred. He said an analysis of the distribution of productivity levels of South African firms revealed that there was a large gap – a ‘missing middle’ – between a group of firms (many of them informal) with very low levels of productivity and another group whose productivity levels were quite high. For obvious reasons, wages and incomes tended to be very low in the former, and relatively high in the latter. What was missing were firms with intermediate levels of productivity and wages. South Africa urgently needed to understand why this was the case, and what would be needed to make those firms grow. Addressing this gap, he felt, was the ‘single most important policy question facing South Africa in the medium term.’

Though this expert was more sanguine than others about the extent to which existing workers’ wages would be protected if the labour market were reformed, he agreed that stimulating a low-wage sector need not affect existing workers as long as the firms for which they worked were able to find a profitable balance between (relatively high) wages and (relatively high) productivity levels. New firms, even if they were paying lower wages, would produce different products or use different production techniques which would require lower productivity from their workers. Thus it could be argued that if one removed the extension of collective bargaining agreements to non-parties and lowered minimum wages, existing wages need not fall. However, average wages would come down as low-wage jobs came on stream.

Precisely how many jobs could be created in this way is uncertain. One way of estimating this, it was argued, was through authoritative studies of the wage elasticity of demand for labour. Historically, these studies have generated mixed results, with differences emerging between different industries and between workers of different skills levels. However, as one reader noted, studies of existing industries and firms were biased towards results which showed that demand for labour in South Africa was relatively inelastic precisely because of the low labour-intensity of the existing mix of products and production methods. Studies of the impact of lower wages on the demand for labour could therefore say very little about whether large numbers of workers might be employed in low-productivity, low-wage industries if such industries were allowed to develop.

South Africa needs far more medium and low-productivity firms where employment costs would also be lower

The relative ease with which the Expanded Public Works Programme attracted participants at low wages suggested that it might be possible to expand employment dramatically while paying relatively low wages. More important, the same is true of the clothing industry, where a significant proportion of registered employers pay less than the established minimum wages and easily attract workers. In the case of non-compliant clothing factories at Newcastle (recently targeted by the bargaining council and the Department of Labour), recipients of sub-minimum wages are working with employers to try to stave off government interventions that may lead to the closure of the firms.

Some experts said events in Newcastle also showed it might become politically possible to introduce major labour market reforms. These developments could change the political balance of forces simply because workers themselves had begun to resist the threatened closure of non-compliant firms. The result was an impasse which was making visible the high costs of the present system, and which might result in the creation of new, more extensive, exemptions to the labour market regime. However, recent proposals to amend labour laws might discourage employment even further (see box, page 24).

### Points to note

Employment levels are affected by the cost of labour, including wage and non-wage costs, all of which must be adjusted to the risk an employer runs in hiring an unsuitable person and incurring the consequent costs of dismissing and replacing him. The higher these costs, the fewer the jobs employers will create. While this point is not as widely recognised as it should be, a subsidiary point is even less well appreciated. In the face of high labour costs, employers have one of two options: (i) they can pass on the high costs of employment to consumers (which is increasingly difficult in globalised markets); or (ii) they can move to industries or adopt production techniques that rely on skills and technology. These are the only options, and South African firms have responded to the relatively high costs of labour in this country with a mix of these strategies.

What South Africa needs to develop is a mix of industries and production techniques that include the relatively high-productivity/high-wage sectors and firms we have now, as well as firms with low and intermediate levels of productivity and wages. Our existing labour market regime makes it difficult for these kinds of firms to emerge.

## FOUR DRAFT BILLS WHICH COULD IMPACT ON EMPLOYMENT

On 17 December 2010 government gazetted proposed amendments to the three principal laws governing South Africa's labour market: the Basic Conditions of Employment Act (BCEA), the Employment Equity Act (EEA), and the Labour Relations Act (LRA). It also gazetted an Employment Services Bill (ESB).

These four bills propose a vast array of changes to the regime regulating the labour market. What follows is a brief summary of some of the far-reaching consequences if they were to be enacted.

### *The amendments to the BCEA would:*

- Require that part-time and contract staff receive benefits of 'similar or equal value' to those received by permanent staff;
- Allow the minister to regulate not just minimum wages when sectoral determinations are made, but set minimum increases in remuneration as well; and
- Allow the minister to 'prohibit or regulate' the use of temporary employment services firms and of sub-contracting.

### *The amendments to the EEA would:*

- Define and prohibit, as a form of 'unfair discrimination' analogous to policies that discriminate on the basis of race, gender, language, etc., the differential remuneration of two employees who do 'the same work', 'substantially the same work' or 'work of equal value';
- Require employers with more than 50 employees or generating significant turnover to ensure their workforces are representative of the 'profile of the economically active population', a change from the previous requirement which was to be representative of the 'profile of the national and regional economically active population';
- Remove a variety of defences that employers who fail to achieve representivity can currently use, including that the relevant skills are not available among designated groups, that the business cannot afford to make such changes, and that similar employers are also struggling to achieve this goal; and
- Significantly increase the potential penalties that companies will pay for failing to comply with the law.

### *The amendments to the LRA would:*

- Introduce a wide range of technical changes that would affect institutions currently involved in regulating the labour market;
- Change the definition of 'employee' and 'employer' in ways that would have potentially far-reaching implications for workplace relationships and legal disputes;
- Make the client of a sub-contracting firm liable for unfair labour practices in sub-contracted firms; and
- Undercut the temporary employment services industry by defining all employees earning less than a threshold amount to be permanent employees, unless the employer can show a reasonable justification for using fixed term contracts.

### *The ESB would:*

- Create public employment services institutions to which employers would be obliged to provide information about any vacancies that arose, and about the filling of those vacancies;
- Create new obligations on employers seeking to employ foreign nationals to explain why they cannot employ South Africans and to create skills-transfer programmes; and

- Require the licensing of temporary employment services firms, prohibit them from charging work-seekers for any services rendered, and prohibit them from offering a variety of value-adding services such as training work-seekers or taking on any aspect of their clients' human resource management function.

All these changes would disrupt existing patterns of employment, and raise the costs and administrative burdens of employment. Unsurprisingly, business has sharply criticised the proposals.

Business Unity South Africa (BUSA), which represents 58 business organisations, has stated that the enactment of these proposals would result in increased costs of doing business, a more complex legal environment, more complex and expensive legal claims, and heightened uncertainty in conducting business. The changes would also 'result in employers pursuing alternative production and service options, technology, off-shoring, automation and mechanisation'. Moreover, the criminalisation of many aspects of employment law would make South Africa a more risky place to do business.<sup>9</sup>

According to Business Leadership South Africa (BLSA), which represents 80 of South Africa's largest companies, the Bills are 'legally wanting, potentially unconstitutional and dismissive of businesses' requirements for labour flexibility in order to compete in a globally competitive environment'. The results of the proposed amendments could already be felt, with some businesses choosing not to employ additional workers, choosing to automate and mechanise where the opportunity presented itself, and opting not to invest in new capacity until the proposals had been clarified.<sup>10</sup>

Both BUSA and BLSA have based their submissions on the contents of a regulatory impact assessment commissioned by the Department of Labour in 2010.<sup>11</sup> This independent assessment found that the Bills were likely to 'have seriously destabilising effects on the South African labour market', raise the cost of labour and of doing business, and put companies at risk of incurring penalties so great they would 'contribute to company contraction and retrenchments, and even company closure, resulting in job losses and negative impacts for economic growth'.

While some of the provisions might increase the number of permanent employees, a significant proportion of temporary jobs would not be converted into full-time jobs. This would result in higher levels of unemployment.

The Bills, coupled with the fact that the Department of Labour ignored the regulatory impact assessment it commissioned, is puzzling especially in light of the stated commitment by the President and the Minister of Finance to create far more jobs. It suggests that commitments made to organised labour may well trump promises to pursue a more job-intensive growth path.

**Update:** It was agreed in April 2011 that Nedlac would not debate the four bills as they had been gazetted. Instead, government agreed with organised business and labour to set up a process to review problematic aspects of labour market regulation, and to bring new legislation to Parliament. Precisely what will emerge from this process is unclear but reports suggest that revised amendment bills may go to parliament in 2012. It appears that some participants in this process remain committed to the substance of the bills.

**CDE 2011**

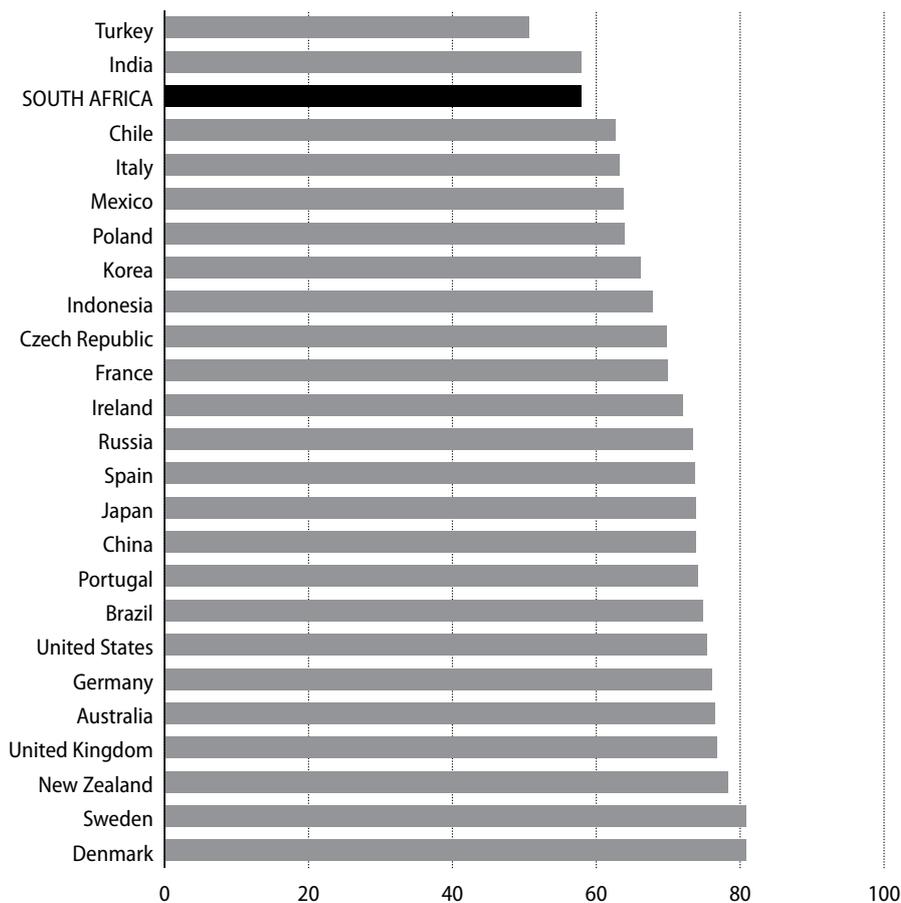
## Matching labour supply and demand

WHILE MUCH OF the discussion centred on cost-related factors affecting the demand for labour, supply-side constraints were also discussed. Two broad issues fell in this category. One was whether some unemployed people are choosing not to work. The other was the skills set of the unemployed, and the suggestion that the skills they have do not match employers' needs, resulting in low levels of employability.

### Do social grants keep people out of the labour market?

One of the most striking features of South Africa's labour market is the very low participation rate, i.e., the number of people who either have jobs or are looking for jobs expressed as a percentage of the population of working age. The current rate of about 54 per cent (which is down from 57 per cent in 2008) is significantly lower than in most developed and developing countries.<sup>12</sup> As figure 8 shows, countries with similar levels of participation to South Africa are ones in which social, cultural and religious norms keep large numbers of women out of the labour market.<sup>13</sup>

**Figure 8: Rates of labour market participation in 25 countries, 2008**



Source: OECD, Country Survey: South Africa and the OECD, 2010; Economic Policy Reforms 2010: Going for growth.

Some analysts believe South Africa's participation rate is so low because the social welfare net discourages people from seeking work. One participant noted empirical research which showed that the participation rates of adult men in households in which someone received an old age pension were lower than in households in which no one received a pension. More anecdotally, one participant noted that foreigners working in South Africa had told researchers that they worked harder and made more money because they could not rely on grant income received by their families, and that welfare had made South Africans 'lazy'.

While international literature on welfare dependency suggests that our welfare net may explain a portion of the low level of participation in the labour market, the discussion at the workshop showed that the relationship between labour force participation and South Africa's social safety net is quite complex.

Empirical work conducted by a participant showed that, for women, the expansion of social grants might actually have increased labour force participation rates. This, it was suggested, was because access to cash income in the household allowed women to leave their children with relatives more easily, freeing them up to look for work. Similarly, a reader noted that the finding cited earlier on labour participation rates in households which received or did not receive pensions might simply reflect the fact that income from pensions attracted dependents back to households. By this reading, households which include pensioners may have more dependants than those which do not, which would lower their participation rates. One participant made the point that housing grants – which are scored as a form of welfare in the national accounts – have helped to accelerate changes in household size, and may even have helped to raise participation rates. 'If people are living in their own houses rather than their parents' homes,' he said, 'perhaps they are forced to seek work.'

Finally, it was pointed out that labour force participation rates were significantly higher today than in the mid-1990s (see figure 9). This suggests that the increase in access to, and the value of, social grants has coincided with rising participation rates. This makes it harder to sustain the argument that social welfare has kept people out of the labour force. In addition, because most welfare payments are not made to people likely to participate in the labour market – 58 per cent of the value of the grants is paid to the elderly and the disabled, while 35 per cent is paid to parents of poor children (see box) – the welfare net in South Africa is unlikely to have the same effect as universal unemployment insurance in the developed world.

One possible explanation of South Africa's low participation rates is that, prior to 1994, apartheid kept labour force participation rates exceptionally low. To some extent, this changed after 1994, when expectations rose because apartheid ended and average wages rose. This encouraged more people, many of them women, to look for work. Often they migrated to cities to do so. This was reflected in a rapid rise in the participation rate (from about 45 per cent in the mid-1990s to nearly 60 per cent in 2000). The failure of these new entrants to find work explains why the official measure of unemployment rose at the same time. This failure may also explain why participation rates did not continue to climb, and actually began to fall: had people moving to the cities to look for work been more successful, many more might have left the former 'homelands' (where employment rates can be below 20 per cent, and labour force participation rates below 30 per cent).

By this argument, the fact that so many people did not move to the cities and are today overwhelmingly measured as 'not economically active' does not reflect their dependence on welfare, and their choice to remain unemployed, but rather an appreciation that their chances of finding work in the urban areas are very slight. Under these circumstances, it is not surprising that people are less likely to give up access to land for subsistence agriculture and incur the costs associated with moving to cities where they face the unattractive prospect of living among strangers in crime-ridden informal settlements.

Some analysts believe South Africa's participation rate is so low because the social welfare net discourages people from looking for work

## SOUTH AFRICA'S SOCIAL WELFARE NET

Public expenditure in South Africa is extremely progressive by developing country standards, with government providing free or highly subsidised education and health care. The price of bus and train tickets are also subsidised. For the most part, however, when people refer to the social welfare net, they have in mind a variety of payments made directly to individuals and households. The principal components of this are the grants managed by the South African Social Services Agency on behalf of the Department of Social development. These include:

- The old age pension, valued at R1 080 a month in 2010, are paid to 2,6 million recipients, accounting for 40 per cent of all grant expenditure and 18 per cent of all recipients.
- Child support grants, valued at R250 a month in 2010, are paid to the caregivers of 10 million children under the age of 16. It accounted for 69 per cent of all grant beneficiaries, and 35 per cent of all grant expenditure.
- Disability grants, valued at R1 080 a month in 2010, are paid to 1,2 million recipients (8 per cent of all beneficiaries) and accounted for 18 per cent of expenditure on welfare grants.
- A variety of other grants, including grants for war veterans, foster child grants, etc, valued between R250 and R1 100 a month, accounted for the balance of all recipients and spending.<sup>15</sup>

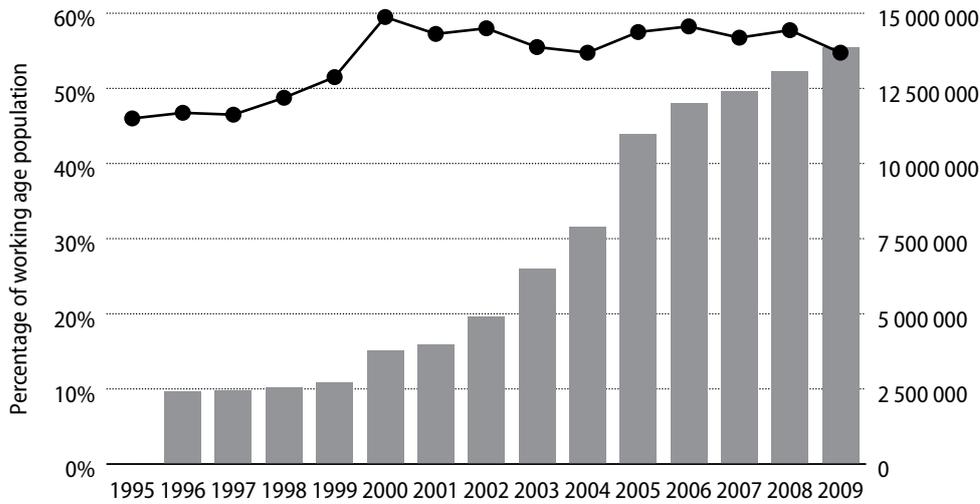
Besides these grants, government also provides housing subsidies for people earning less than R3 500 a month. These are used to develop and purchase low-cost, 40 square metre houses. These are once-off grants valued, in 2010, at about R55 000 per household, and have been used to finance the building of nearly 3 million RDP houses.<sup>16</sup>

Poor households also qualify for free basic services such as electricity, sanitation and refuse removal. These subsidies are paid to municipalities which provide free basic services to poor households. Accurate data on the value of these grants and the number of recipients does not exist, but National Treasury estimates of the likely numbers and associated benefits are:<sup>17</sup>

	Served households		Unserved households	
	Qualifying households	Value of monthly subsidy in 2011/12	Qualifying households	Value of monthly subsidy in 2011/12 (used for alternative services)
Electricity	3 079 340	R188	2 456 443	R85
Water	3 322 295	R125	2 213 488	R56
Sanitation	3 260 814	R125	3 274 969	R56
Refuse	2 176 923	R125	3 358 860	R56

Depending on which services a qualifying household receives, the value of the basic services provided could range up to about R563 a month.

CDE 2011

**Figure 9: Social grants versus labour force participation rates, 1995–2009**

Sources: OECD, Country survey: South Africa, 2010, The Presidency, Development indicators,; Mid-term review, 2008; SASSA, Statistical report on social grants, 31 October 2010.

One important implication of this is that, if job creation accelerates, many people who are currently not actively seeking work would join the labour market. If that happens, employment rates will rise, but unemployment rates may not fall.

It is not completely clear how the welfare net is affecting labour market participation or whether different components of the net are having different kinds of effect. More research is needed, as well as a greater willingness to question long-entrenched views.

## Reservation wages and wage cliffs

A key issue for policy is whether unemployed people have high ‘reservation wages’ – i.e., wage expectations below which they are reluctant to accept low-wage work or engage in low-income self-employment activities. Put differently: do people choose not to work when their expected earnings fall below a particular threshold? And if so, why?

Empirical work on these issues has generated contradictory findings. For example, a 2005 study in Khayelitsha and Mitchells Plain found that the wage expectations of unemployed people were 15 per cent *lower* than those generally earned by people with the same skills and demographic profile as the respondents.<sup>18</sup>

The fact that so many people queue for jobs outside factory gates also seems to disprove that the unemployed remain unemployed because their wage expectations are too high. Given the length of these queues, the more likely reason for unemployment is not that jobless people are unwilling to accept the wages they may realistically be offered, but the fact that too few jobs are available at those wages. This is confirmed by the fact that, despite its low daily wages, the Expanded Public Works Programme sources labour relatively easily. However, a participant pointed out that this might be partly because those jobs ‘came to the workers’, whose transport costs were lower than they would otherwise be. If transport costs were higher, the programme might not attract participants as easily.

In addition, survey data tends to show that most people are out of work because they had not been offered any, not because they had turned down work at wages they regarded as being too low. Thus, in the 2007 Labour Force Survey, 85 per cent of unemployed respondents said they were unemployed

because they had not been able to find any work at all, while less than 2 per cent said they were unemployed because they could not find 'suitable work' – a phrase explicitly defined to include jobs in which wages were deemed to be too low.

On the other hand, another study has found that many younger people base their wage expectations on the higher rates paid by larger firms rather than the lower wages paid by smaller ones.<sup>19</sup> Thus, if young people expect to earn the kinds of salaries paid to workers in large firms, or even the average of the wages paid by large and small firms, their expectations may exceed the wages actually paid by smaller firms. If that is the case, they may turn down work offered by small firms. More frequently, the divergence in potential earnings between different kinds of firms might result in unemployed people choosing to look for openings only at larger firms where wages are relatively high. This might help to explain why migrants appeared more likely to secure certain kinds of jobs: if they were not looking only for better-paying jobs at larger firms, they might be more likely to secure jobs at lower wages in smaller businesses. They may also be much more amenable to engaging in informal work, where returns might be low and volatile.

While participants differed on whether or not undue wage expectations were preventing workers from taking jobs, none felt that mass unemployment was caused by millions of people turning down job offers because the wages on offer were too low.

Despite this, some felt that reservation wages, their causes, and the resultant job search practices and strategies should be researched in greater depth. More specifically, it may be valuable to examine whether job search strategies are affected by 'wage cliffs': is it possible that unemployed people are only looking for jobs at employers known to pay relatively high wages?

## Wage cliffs

A 'wage cliff' is said to exist when two workers with similar skills levels receive different salaries because they work in different industries, different firms, firms of different sizes, or firms located in different parts of the country. Significant wage differentials may encourage unemployed people to look for work with firms paying higher wages rather than looking for (or accepting) lower-paying work in other economic sectors. Thus, the fact that larger South African firms typically pay far higher wages than smaller ones may be encouraging some young people to spurn low-paying jobs in the hope of finding better-paying ones. One participant pointed out that the differences in wages paid by small and large firms meant that workers at large firms enjoyed far higher lifetime earnings than employees of smaller firms. These differences were so large that it could be regarded as economically rational to wait as long as 2,5 years for a job in a larger firm than to take a job in a small one.<sup>20</sup>

Gaps between wages paid by small and large firms were not the only cliffs identified. Using data from the September 2006 Labour Force Survey, a participant pointed to large variations in wages among 'elementary workers' (i.e., the least skilled workers), depending on the sectors in which they worked. Thus the expected monthly salary of an elementary worker in the mining sector (a category that did not include miners themselves, since they were relatively skilled) was about R3 400. This was almost three times the R1 260 an elementary worker might earn on a farm. Expected wages were R2 170 in the manufacturing sector, and about R1 430 in the trade and domestic service sectors. Given these differences, it would hardly be surprising if many unskilled farm workers looked for jobs in other sectors.

Another participant pointed out that people's career earnings tended to solidify by age 30. For that reason, accepting wages in a low-paying sector or firm in one's early or mid-20s might have considerable implications for one's lifetime's earnings. Empirical evidence showed that there was little or no correlation between wage levels and workers' age, and that older workers only earned more than younger ones if they were more skilled and assumed greater responsibilities. Seen in this light, it is

economically rational for workers to try to be in the best possible job at age 25 or 30, which may be encouraging younger people to search for jobs in higher-paying firms and economic sectors rather than lower-paying ones. This, in turn, means that significant wage cliffs will help ensure that unemployment persists even as the economy grows, and that significant numbers of people will continue to look for relatively high-paying jobs and avoid the low-paying informal sector.

If this analysis is correct, the existence of significant wage cliffs may explain a part of the unemployment problem: because the unemployed are looking for certain kinds of work, they are, to some extent at least, also choosing to remain unemployed. Since this appears to be economically rational, it is worth asking whether it is possible (and desirable) to find ways to moderate the wide differences in potential income among industries, firms, and areas. This may make it easier for people in poorly paid jobs to move to better-paying sectors, regions or firms. By changing the incentives for the unemployed, policy measures of this kind could change job search strategies and encourage individuals to look for (and accept) those jobs that are actually on offer. It may be, however, that little can be done to smooth out South Africa's wage cliffs, and that attention should rather be paid to facilitating the emergence of firms employing large numbers of inexperienced and unskilled workers.

## Recruitment practices

If job search patterns can affect unemployment levels, firms' recruitment practices can affect the distribution of employment between individuals and households.

When firms hire new people, they rely on signals about a worker's suitability such as previous work experience, references, or school-leaving certificates. Much of government policy is also premised on the idea that raising skills levels and formalising qualifications will help to persuade employers to hire more people. In practice, however, firms faced with an abundance of candidates for low-skill and entry-level jobs may use other selection methods. One of these is to prefer applicants with previous work experience. Another is to rely on existing staff to recruit new employees.

This kind of response by employers has several implications, one of them being that firms may not advertise jobs. Instead, because of the perceived risks of hiring strangers, they may rely on the social networks of existing employees for recruitment. While this may not affect the number of jobs on offer, it makes access to employment more exclusive and restrictive than it might be, perpetuating and reinforcing the division between insiders and outsiders.

Participants suggested that employers might do all of this for various reasons. One is that firms may believe existing employees are most likely to identify good new ones. Apart from helping to select new workers more efficiently, this approach also has the benefit of using existing employees to 'police' and 'discipline' new workers. It also provides non-wage incentives to existing employees who might want to be first in the queue to suggest new recruits. This helps to explain why, in terms of research cited by a participant, an individual is far more likely to have a job if someone else in his or her family already has one.

A reader noted that the fear of crime, and the resulting increase in security, might also be making it more difficult for people to present themselves to potential employers. Suspicious of strangers, employers might seek to minimise their exposure to them, in the process further locking 'outsiders' out of the formal economy.

Getting a better grasp on reservation wages, as well as on job search and recruitment patterns, would help those concerned about unemployment to distinguish between structural unemployment, frictional unemployment and voluntary unemployment. It would also help the country to reach a better understanding of what employers are looking for, and whether existing policies address the deficiencies

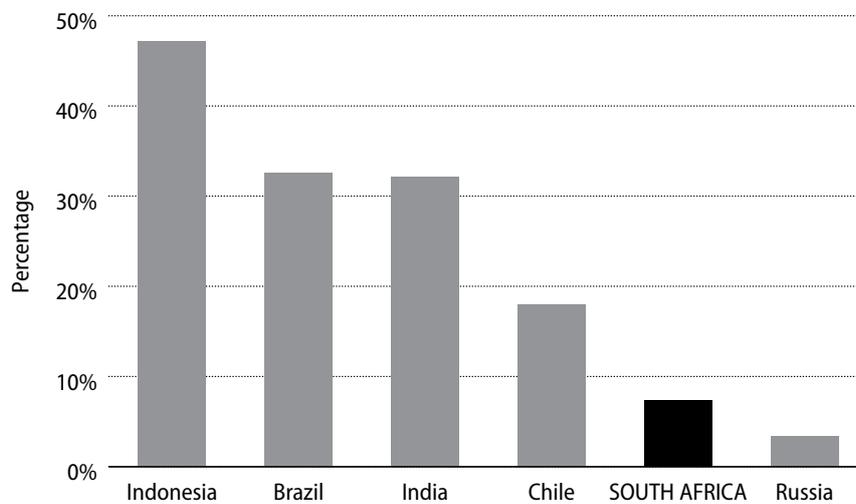
Firms faced with an abundance of candidates for low-skill and entry-level jobs prefer applicants with previous work experience

employers see in the pool of potential recruits. In the meantime, however, we need to understand what the risk mitigation strategies used by employers in recruiting new employees imply about the risk-adjusted costs of employment.

## Why doesn't the informal sector create more jobs?

When labour demand in the formal sector is low, some economies compensate with large and growing informal sectors. In South Africa this has not been the case. Compared to other developing countries, it has very high levels of unemployment as well as a relatively small informal sector, as shown in figure 10.

**Figure 10: Share of working age adults employed in the informal sector in SA and selected developing countries, latest data**



Source: OECD, Going for growth, 2010.

Understanding the constraints to entering the informal sector was identified as an important area for further work. A participant cited a study which had found that entry into self-employment in the Western Cape was constrained by insufficient start-up capital and the threat of crime.<sup>21</sup> On the other hand, some participants argued that the absence of a strong informal sector might simply reflect the overall lack of competition in the South African economy, in which most industrial sectors are dominated by relatively few firms, and incumbents felt little competition from new-comers. One manifestation of this is the decline of corner cafés in suburban areas, and the corresponding emergence of franchised outlets and chain stores as a consequence of the difficulties facing small entrepreneurs. Probable causes included the regulatory burden on small businesses, and their lack of economies of scale.

The uneven spatial distribution of spending power across the economy may also help explain the paucity of informal businesses in poor areas.

Many areas in which unemployed people live have very low economic densities in that individuals are poor and the areas have low population densities. Research for the Business Trust had shown, for example, that it was far more viable to open a street stall in Alexandra than in Motherwell simply because there were more people in the streets of the former.<sup>22</sup> Low economic densities in poor areas also helps to explain why incomes from informal trade are very low. And this, in turn, might explain why so few unemployed South Africans engage in informal economic activities, and continue to seek formal jobs instead. This, it was suggested by one participant, increased the value of and return on developing and implementing policies that encourage urbanisation and effective urban management.

However, participants warned that because cross border migrants (often irregular) engaging in informal activities were not well captured by surveys, the economy might be creating more informal jobs than was generally believed. CDE research, as well as that of other organisations, suggests this, but more empirical work is required.

## Do poor skills explain unemployment?

One explanation frequently offered for South Africa's high levels of unemployment is the shortage of skills. It is argued that employers are reluctant to expand their operations because they doubt whether they will find suitable employees.

In order to test this assertion, a participant examined the data about the relationship between skills and employment growth. Analysing total wage employment in South Africa from 2000 to 2007 by skills levels, she argued that most jobs were medium-skilled. However, wage employment in high-skilled jobs increased by the largest number in absolute terms (about 480 000 jobs), or 53 per cent. Over the same period, low-skilled jobs increased by only 340 000, or 12 per cent. So, although there was clearly a 'skills bias' in employment growth, the difference in the number of jobs created for low-skilled and high-skilled workers was not as large as was sometimes believed.

Given the large numbers of unskilled people who are unemployed, a new growth path that creates work for which they are suited is highly desirable. This is particularly so because 59 per cent of the unemployed have never worked<sup>23</sup> and have not had the opportunity to acquire the kinds of skill that can only be learnt on the job, and which might have offset their poor schooling. Thus many participants agreed that the vital factor the unemployed lacked were the skills and aptitudes acquired in actual employment. Certainly, survey evidence shows that employers prefer to employ people who have been employed before.

A number of implications flow from this. First, employers' preference for people with work experience negates some of the downward pressure on wages that high levels of unemployment may otherwise be expected to exert. If unskilled workers with jobs (or who have lost their jobs only recently) are more sought after than those who have never worked, they can command higher salaries. The point is that unskilled workers are not all alike, and employers prefer recruiting in the (relatively small) pool of workers with previous experience rather than the (much larger) pool of all unemployed people. This reduces competition for jobs by those who have never worked, and helps prevent the unemployed undercutting the wages of the employed.

The relative desirability of people with previous experience must exist in all economies. The result may be particularly pernicious in South Africa, however, because our labour laws make it harder for inexperienced workers to offer their labour at a discount to more experienced workers. This raises the risks and costs of hiring the wrong person. If this is so, it means that a vicious circle may have been created in which (i) our labour legislation and economic policies drive the economy towards high-productivity, high-wage industries; (ii) high wages and the high costs of retrenchment mean that employers prefer to employ less risky groups, and use previous employment as a key signal of an individual's potential productivity; and (iii) having work experience protects would-be employees from competition from those who do not have that experience. It is the definition of a division between insiders and outsiders.

Flowing from this, a participant argued that 'the skills shortage is really nothing more than a jobs shortage'. This, he said, was because employers really wanted people with skills acquired from job experience. It also implied that what the country really lacked was more jobs rather than more people with formal qualifications. In fact, he argued, the prominence given to the 'skills shortage' detracted from the real problems in the labour market such as trade union militancy, the effect of collective bargaining on remuneration, and the unintended consequences of government regulations.

Some 59 per cent of the unemployed have never worked and have not had the opportunity to acquire the skills that can only be learnt on the job

Some commentators thought this argument went too far, if only because addressing the crisis of unemployment would be easier if our schools were producing larger numbers of well-qualified matriculants. At the same time, most agreed the main problem was that our labour market regime, along with our trade and industrial policies, forced employers to adopt high-wage, high-productivity production methods, and that South Africa simply did not have enough skilled people to make such a strategy work. If the country produced hundreds of thousands of well-taught learners with credible certification, it could deal with unemployment in very different ways.

However, the absence of skills impacts on unemployment in another way: the scarcity of people with managerial and other high-value skills sets. This issue receives less attention in the discussion about unemployment than it should. It is highly likely that South Africa's shortage of skills - accentuated by its restrictive migration regime - is inhibiting the expansion of existing companies, and holding back new investment. Thus, while it is important to address the very low levels of skills among the unemployed, it is equally important to greatly increase the supply of skilled people.

### **Points to note**

This section has examined whether the unemployed are choosing to stay out of the labour market, and if so, why. Questions raised include whether welfare dependency is contributing towards the low labour force participation rate, and whether significant wage cliffs are preventing some unemployed people from looking for low-wage work (or engaging in poorly paying informal trade). These are thorny and controversial issues which need to be more intensively researched and debated. If more people are to be employed, the country needs to reach a far better understanding of why so many people who do not have work are also not seeking work.

## Concluding remarks

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GIVEN THE LARGE body of literature and empirical research on South Africa's unemployment crisis, the workshop covered some familiar territory. It also broke new ground.

The single most important point to emerge was the need to accelerate the growth of labour-intensive industries. At current rates of employment intensity, it would take more than 40 years of growth at 7 per cent a year to raise the employment rate from the current 40 per cent to the global norm of 60 per cent. Since the South African economy has only achieved this level of growth in four years since 1947, doing so will be an enormous challenge. It will require a new approach to shaping the business environment, as well as significant labour market reform. It is essential for South Africa to raise the employment intensity of economic growth so that each additional percentage point of economic activity generates more jobs than is currently the case.

If South Africa is to build a more employment-intensive growth path, we need to rethink some key assumptions. Many people in and around government argue that the country should move progressively up the value chain, producing export goods with skilled labour and advanced technology. Given the low skills and inexperience of most unemployed people, this approach will never create enough jobs for the millions of South Africans who have few skills.

Instead, South Africa should seek to create and/or fill niches in the global supply chain for goods produced with larger numbers of lesser skilled workers, and utilising basic technologies. To achieve this requires addressing the gap between the low productivity of young, unskilled and inexperienced workers and the costs of their employment.

South Africa's regulatory regime has pushed the costs of South African labour higher than in other developing countries. This, together with a variety of other labour-related costs (including the relatively high incidence of strikes) has encouraged firms to produce goods that rely on skilled workers or automated production systems rather than on unskilled labour.

In order to absorb more unskilled and inexperienced workers, South Africa needs to create industries and businesses that would fill the current 'missing middle' between low productivity informal sector companies and high productivity firms in the formal sector. To do this, we must craft a new social compact that permits much greater flexibility at the bottom end of the formal employment spectrum, thus allowing the creation of low-wage jobs that use technology that is not skill or capital intensive. We need to create the kind of lower-wage industries and businesses that have enabled other countries to employ very large numbers of people and drive high and sustained rates of economic growth.

Doing this need not necessarily impact negatively on existing workers, as their higher wages are matched by higher levels of productivity. However, it would create opportunities for people who are unlikely to find jobs in existing (high-wage/high-productivity) industries and firms. However severe the political constraints on reforming the labour market may be, reforms must be introduced that will enable the employment of unskilled and inexperienced people at costs commensurate with their low levels of productivity.

This is the most important lesson to be learnt from developments in Newcastle, a town with unemployment levels of nearly 60 per cent, but whose relatively large garment industry can be explained by the willingness of large numbers of workers to accept wages below the minimum established by the industry's bargaining council. Having recognised that compliance with the bargaining council's minimum wages would probably result in the closure of companies and the loss of jobs, they are working with their employers to try to obtain exemptions. By allowing firms to offer these sorts of wages, and workers to accept them, South Africa could create new enterprises and industries with low and

South Africa's regulatory regime has pushed the costs of South African labour higher than in other developing countries

intermediate levels of wages and productivity. This should be seen as a model for an emerging industrial structure appropriate to the country's needs and realities, rather than an affront to South Africa's image of itself as a producer of high-value goods.

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