CDE
EXECUTIVE SUMMARY

A FRESH LOOK AT UNEMPLOYMENT

A conversation among experts

This is an executive summary of a **CDE workshop report** entitled *A fresh look at unemployment: A conversation among experts* (June 2011). The full-length publication is available from CDE, and can also be downloaded from www.cde.org.za.

INTRODUCTION

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 produc-

tion 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 sus-

tained 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, 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 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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