IS SOUTH AFRICAN LABOUR MARKET MORE RIGID COMPARED TO OTHER DEVELOPING COUNTRIES?

From the Public Servants Association's Perspective

Introduction

Questions regarding the South African labour market have always dominated policy discussions regarding growth strategies and industrial policies since the advent of democracy in 1994. The importance of this issue was clear as early as 1996 when the new democratic government commissioned a study on the development of a comprehensive labour market policy. The Presidential Commission that was appointed for this task was dominated, in the main, by trade unionists, members of the African National Congress, and also comprised academics.

The work of the Commission was largely occasioned by harsh realities that coincided with democratic change in South Africa, when job shedding in the formal sector accelerated. This was exacerbated by the rising tide of globalisation, with the domestic economic restructuring proceeding in tandem with pressure for greater global integration. The obvious manifestation of the structural problems in the economy was that of high level of unemployment, which was at 13% (and 30% in terms of expanded definition) at the dawn of democracy. This is currently at 25.5% (and 45% at expanded definition).

The Presidential Labour Market Commission of 1996 had as its preoccupation the social outcomes of policy, including the eradication of poverty through job creation as well as through improved remuneration for the working poor. It was aimed, essentially, at achieving better paying and decent jobs. The elimination of race- and gender-based inequality and discrimination was another goal. It had a social democratic intent – to ensure that workers are sufficiently covered – in a global economy that was unforgiving to countries that put in place labour market policies that were not perceived to be pro-business. It should be borne in mind that this came right in the midst of celebrations of a concluded Labour Relations Act (1996), with a slew of equity measures and those protecting the conditions of work following.

The starting point of the labour market policy was "the need to balance flexibility with security that justifies the constructive role that bargaining between workers (or their unions) and employers (or their associations) can play in the productive-enhancing redesign of the work processes, in training and skills development, in employment-equity planning and in many other aspects of the employment relationship."[i]

There were a number of assumptions that were made by the report of the Commissioners that were not borne out by reality, including the educational profile of the South African workers in the formal sector, the nature of labour-business relations, and the effects of international trade (or globalisation) in the structure of industry in the long run.

Indeed the dramatic rise in unemployment in the late 1990s showed that the commissioners (and policy makers) did not adequately prepare for the future.

Labour market inefficiencies would later feature as a major hurdle to job creation in South Africa. In this paper we look at various dimensions of this phenomenon. What is clear is that in comparison with its peers in the developing world, South Africa suffers from labour market rigidities. As we point out in the paper, this factor cannot be looked at in isolation from the social history of the country. First we offer an overview of the global perspective of South Africa's labour market, comparing this with its peer economies. Second, we look at the social context that foregrounds an assessment of South Africa's labour market. Third, we look at the peculiar structure of the South African economy, especially its duality. Finally, we conclude with some observation that contextualises the challenges faced by the South African labour market.

South Africa's labour market from a global perspective

At the core of subsequent economic debates about the South African economy was the issue of labour market rigidity as one of the binding constraints to growth. Indeed, in various World Economic Forum's (WEF) annual global competitiveness reports, labour market efficiency - which is the opposite of labour market rigidity - is identified as one of the 12 pillars of an economy's competitiveness. It is clustered with other efficiency enhancers such as higher education training; goods and market efficiency; financial market development; technological readiness; and market size.

These are dimensions of competitiveness that are seen as crucial in unlocking efficiencies, and in turn contribute to the overall competitiveness of the economy. Taken as a category on its own, labour market rigidity (or poor labour market efficiency) is one of South Africa's Achilles' Heels. The country ranks 116 out of 148 on measures of labour market efficiency in the Global Competitiveness Report.

Labour market efficiency, according to the WEF, is essentially about the allocation of workers to the most effective use in the economy and that they are provided with incentives to give their best effort in their jobs. This obviously assumes that there are no distortions in the labour market, such as, for example, discrimination or barriers to transitioning in the labour market. When an economy is said to be characterised by labour market efficiency this does not necessarily mean workers have flexibility to move within the economy, but rather that employers have a great deal of flexibility to fire and hire workers, uninhibited by a restrictive labour legislative framework. Factors that inhibit ease of movement within the labour market, for example, from the formal sector to the informal sector, are usually under-emphasised in analyses about labour market flexibility.

The notion of labour market efficiency or flexibility takes as given the inherent power relations between the employer and the employee, and gives primacy to the latter. This explains why countries where trade unions are a strong political constituency, for example, in Germany and France, have low scores on labour market efficiency amongst developed country peers. There is a particular social history that explains this: Germans have a tradition where trade unions co-determine work place policies and practices with management; and in France, unions historically received government support for their right to block retrenchments and call for large settlements for retrenched workers.[ii] Factors such as highly skilled labour force, productivity, and innovation, temper these countries' labour market rigidity.

Apart from being informed by ideologically driven concerns, labour market rigidities, especially in countries with the abundance of unskilled labour and trade dependence contribute to high levels of unemployment. In such contexts, a push for some efficiency in the labour market, without eroding the protective cover of labour regulation framework in the formal sector is a progressive one.

Rigidity in the labour market can create a fertile ground for social tensions in a manner similar to what happened in countries such as Tunisia in 2011, where the unemployed youth set in motion a cauldron of social uprising that removed President Zine El-Abidine Ben Ali from power. In its methodology, the WEF is clear that there is no singular pillar or dimension that is responsible for competitiveness. The different factors have to be seen as inter-related and co-reinforcing.

The WEF cautions that comparing countries at different stages of development on measures of competitiveness may not be helpful. These considerations should be kept in mind when analysing the South African labour market. There are rigidities that are standard, and could be traced to wage bargaining processes; but these are usually derived from the history of low wages amongst African workers compared to their White counterparts.

Broadly, there are three stages of development that countries measured for their competitiveness fall into: first stage, which is factor-driven, and where competition is largely based on the price structure of commodities rather than efficiencies. Such countries tend to be resource abundant, have abundance of unskilled labour, and located in poor regions of the world. They compete mostly on price. Efficiency dimensions such as quality of education or flexibility of the labour market are secondary to the level at which commodities are priced.

The second stage: efficiency-driven economies, is where countries such as South Africa fall. At this stage, efficiency drivers such as labour cost, higher education, goods market efficiency, and market size are important enablers of competitiveness.

At this stage, labour markets are characterised by relatively higher wages, and creating flexibilities in the labour market, managing efficiencies in the production process, and increasing product quality to boost competitiveness.

The third stage is innovation-driven economies. Many developed countries, characterised by the high quality of education, labour market efficiencies, including high productivity levels, and on the cutting edge of innovation fall under this category. Rigidities in the labour market that are present in some of the countries in this category are compensated for by other factors such as educated work force, productivity gains, well-developed infrastructure, large domestic or regional markets, and capacity to innovate. This is where countries such as Switzerland (and Scandinavian countries) are located. These countries have highly skilled labour force and their industrial relations are marked by alignment of employee protection and the interests of employers, and with conflict resolution resting on the strength of a thriving social dialogue.

The relevant category within which to examine South Africa are the efficiency-driven economies. This is where a number of middle-income, and other developing countries with diverse industrial structure, would be placed. Here what matters the most are efficient production processes, including the cost structure of production. Combination of product quality and low wages is a crucial indicator of competitiveness alongside improvements in higher education training, large domestic or foreign markets, and well-developed financial markets. Further, there is ease of transition between the formal sector and the informal sector in these economies.

South Africa's peers in this category are countries such as Egypt, with high levels of labour market rigidities (poor labour market efficiency), which rank at unenviable 146 out of 148 countries; Indonesia (103); Mauritius (55); Guyana (63); Namibia (59); Paraguay (117); and China (34). Quite clearly, South Africa compares poorly against many of these countries as it ranks 116, ahead of only Egypt and Paraguay. In other words, its labour market inefficiency is a competitive disadvantage relative to these countries. A look at South Africa's BRICS partners (except China), reveal poor positioning on labour market efficiency. Brazil is ranked at 92, India 99, and Russia 72.

As the WEF points out, South Africa lacks scale in its domestic market, and can thus not use this as a compensatory factor for labour market inefficiencies. A country like Turkey, for example, lags behind South Africa on labour market efficiency (130), but the size of its economy (and internal market) is much larger (ranked 16th) than that of South Africa (25). Further, Turkey possesses a reasonably developed infrastructure, ranked at 49 compared to South Africa's, which is ranked at 66.

So, across the dimensions of education and training, market size, and infrastructure, South Africa does not have the requisite depth and quality to reduce the effects of its labour market rigidities on the economy. In addition, in many developing countries and emerging economies, the informal sector plays a role of a buffer for those who leak from the formal sector; and those in the informal sector have a chance to get back to the formal sector. This is not so in South Africa, where the informal sector represents less than 20% of total employment.[iii]

The social context

Looking at the structure of South Africa's labour market, it is important to take into account the socio-historical factors that shape it, including the racialised wage inequalities; the historical low wages amongst the black working class in agriculture and manufacturing; the rural-urban divide entrenched by apartheid; the apartheid laws that restricted the expansion of the informal sector in the urban centres; the varying levels of access to quality education between different races; and the distance from places of residence and work, which contribute significantly to the cost of transport. These factors have been surveyed in various government policy statements as well as in the literature of the trade unions. Some economists have referred to these challenges as the "inertial consequences of *apartheid*".[iv]

Barnejee et.al (2008) suggest that job search appears to be less effective for African job seekers compared to whites, due to spatial separation between places of potential employment and where job seekers reside. The cost of public transport becomes an inhibiting factor for searching for jobs. One would thus expect that the informal sector would have, as a result, a significant absorptive capacity in a way that reduces unemployment figures.

However, as Kingdon and Knight (2007) and Barnejee (2008) note, entry barriers to the informal sector, including high start-up costs, and compounded by high crime rates, have reduced growth potential, and by implications the labour-absorbing potential, of this sector.[v] Further, unlike in other countries, those who are in the informal sector find it difficult to make a transition to the formal sector, a hoopla too high to jump, especially for African labour.[vi] One of the impediments to greater labour absorption in the labour market in general are both educational attainment levels, a point that a number of economists have alluded to, as well as the quality of education, in particular the mismatch between the output of the education system and demands of the economy. South Africa's labour absorption rate is very low at 42.8% - which is employment to population ratio or a percentage of working age population that is employed. Similarly, South Africa's labour force participation ratio[vii] at 54% is well below that of its peers in the developing world or emerging economies.

It has long been recognised that good education increases the chances of finding employment, relative to those who are without education. Even if the country were to significantly shift the employment profile where services would potentially make a dent on unemployment, this would require much better performance of our education system, especially at higher levels. In any case, unlike manufacturing, services are generally not a labour-intensive sector. For the services sector to be the engine of job creation that would mean a radical improvement in the education profile of South Africans, and that South Africa is on a post-industrial curve and with significant technological upgrading and innovation in its economy. It would also require greater improvements in the enrolment and throughput rates of black South Africans who make up the bulk of the economically active youth.

Yet rates of higher education enrolment amongst Africans of the age group 18 – 29 remains very low in comparison with the other groups (with the exception of Coloureds). Only 3.2% of Africans in this group is enrolled at a higher education institution. The proportions for Whites are 18.7%; 9.2% for Indians; and 3.1% for the Coloureds. Functional illiteracy remains very high in South Africa at 16.2%. So, from the standpoint of South Africa's social legacy, the labour market has inherited rigidities. Given the existing patterns of relationship between the education system and the labour market, South Africa's labour market, and by implication, competitiveness woes are likely to persist for the foreseeable future.

Policies aimed at overcoming the apartheid-induced deficiencies such as weak labour coverage and low wages have come against the reality of an open global economy where South African labour in the formal sector has to compete with peers in the developing world, where there are much greater flexibilities. It thus tends to be politically incorrect to make reference to the labour market as lacking flexibility. At the extreme end, labour market flexibility is associated with labour exploitation.

In one of the authoritative papers on labour market, Haroon Bhorat looks at trends over the period 1995 to 2002, and makes a link between the official policy of racial exclusion, on the one hand, and poverty and inequality on the other hand.[viii] Past inequalities of incomes, unequal access to education, and imbalances in the provision of welfare have all served to distort South Africa's labour market over time.

These distortions have continued, and in some ways altered on the margins by post-apartheid equity policies aimed at growing the African middle class, a reformist process that has perversely accentuated intra-racial class divisions. Parallel to a growing proportion of the educated and relatively skilled middle class, there is a burgeoning army of unemployed, uneducated, and unskilled African workers. It is important, though, to place the historical trends in perspective: in 1994, unemployment was 13%, and much lower than the years following the inauguration of democratic rule.[ix]

What compounds South Africa's reality is the fact that the structure of the labour market is highly fragmented and the profile of the economy is diverse, and with evidence of capital intensity without adequate skills upgrading. As such, South Africa is sandwiched between advanced industrial economies (in the skills-sensitive services sectors) and middle-income countries with abundant cheap labour and natural resources. Moreover, the comparably poor output of South Africa's economy, with a GDP that has barely touched 5% since democracy, means that it would be harder at current levels of rigidity to create new jobs. Yet, as Bhorat points out: "A well-performing, job generating labour market remains the key long run mechanism for reducing the poverty and inequality levels in the domestic economy."[x]

Structural shifts

Apart from the legacy of apartheid, structural shifts and technological changes in the economy are said to contribute to difficulties in the labour market. These dynamics manifest themselves in the form of the shift in output away from the primary sector to the services sectors; and the growing capital intensity in the economy. This capital intensity, especially, affects the mining and the agricultural sectors, which have been either shedding jobs or do not contribute much to job creation.

The meaning of this reality is that labour is under-employed, as it is perceived to be more costly, relative to capital. Reinforcing this view, when asked recently about his thoughts on the relationship between high wages and growing unemployment, Pali Lehohla, the head of Statistics South Africa, responded: "Theory suggests that people tend to mechanise if the cost of labour is high, so they become capital intensive."[xi] In short, labour market rigidities in South Africa remain a policy conundrum that has a dizzying effect even on the country's chief stastician.

The structural shift in South Africa's economy is borne out, for example, in the fact that over the period 1970 – 2005, agriculture and mining shed labour, while sectors characterised by skill demand or high degree of flexibilisation – finance, wholesale and retail sales, and community, social and personal services have grown remarkably. In 1970, agriculture and mining contributed 33% and 9%, respectively, to employment. In 1995, this declined to 14% and 5%, respectively. In 2005, agriculture shed more jobs and was contributing only 8% to employment, while mining remained constant.[xii] Currently, agriculture (670 000 jobs) is at 4.5%, while the mining sector (419 000 jobs) has declined further.

According to one of South Africa's leading macro-economist, Johannes Fedderke, even when looked at from the perspective of gross value added at basic prices over a much longer period of time (1960 – 2009), the primary sector (agriculture, forestry, fishing and mining) have witnessed severe declines, from contributing 22.05% to 7.42% of gross value added; while manufacturing peaked in the early 1980s at

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17.38%, before declining to 14.7% in the 2005 – 2009.[xiii] Sectors such as construction and community, social and personal services have maintained a constant share.

Generally, structural shifts in the economy tend to be attributed to the technology-bias nature of globalisation, something that tends to have a bigger impact on countries that are highly integrated into the global structures of production and trade, as is the case with South Africa. This is usually borne out in the growth of the services sector, especially finance, insurance, real estate, and business service sectors. It is often a dominant feature of advanced industrial or post-industrial economies rather than poor or middle-income economies. Looked at over a long period of time (1960 – 2009), the value-added contribution of these tertiary sectors in the economy has increased from 25.53% to 39.86%.[xiv]

As such, South Africa's formal sector, especially the low employment share of industry and primary sector in employment, looks more like that found in advanced industrial countries than in developing or emerging economies, yet its high levels of unemployment underline its developing country credentials. The reason for this has to do with structural impediments to a much higher labour absorptive capacity of agriculture and manufacturing, causes of which are associated with the perceived cost of labour and wage setting rigidities.

Some of the rigidities that have contributed specifically to labour market rigidities and constrained growth in the economy include those that exist in the output market. These output market rigidities are expressed in the pricing monopoly of the manufacturing sector, which yields high price mark-ups over the marginal cost of production. Research suggests that this is two to three times higher than those found in advanced industrial economies. The effect of high mark-ups on labour market rigidities is mediated by lower productivity growth rates. Fedderke points out that a ten percent increase in mark-ups, lower productivity growth rate in South Africa by 1.6% to 2.5% per year. This has an effect on the overall output growth in the economy, and thus negatively affects employment creation. The essential narrative here is that rigidities in the labour markets are partly influenced by the behavior of the output market rather than only arising directly from the labour markets.

Other economists such as Haroon Bhorat have pointed out that the major explanatory factor to weak employment response (labour market dynamic) in the economy has to do with growth. According to him, employment is a *derivation* of growth, and therefore to have higher employment requires higher levels of growth. Seen in this way, South Africa does not have a serious problem of unemployment since long-term employment trends (1995 – 2002) have tracked our growth trajectory, at a lower profile, averaging 2.1%.

There are a number of caveats that Bhorat proposes, including sectoral differentials, the role of the informal sector in job expansion, and labour market bias towards skilled and semi-skilled workers (perhaps less for reasons to do with technology but for productivity gains), amongst others. As a consequence, demand has shifted away from unskilled labour to skilled workers, leading to job losses at the bottom of the labour market, a factor that has been compounded by weak output expansion.[xv]

The latter factor is likely to be felt acutely still, given the downward adjustments in economic growth projections for 2014, from 2.8% at the beginning of the year to 1.4% (at the second quarter of 2014 the economy has been growing at a mere 0.68%). If, as suggested by Fedderke (2012), the pricing structure in the output market has an effect on growth, it would make sense that growth would be flat and thus employment constant or in decline.

The duality of the economy and labour market Segmentation

A particularly salient factor complicating the analysis of South Africa's labour market is its dualistic nature.[xvi] On the one hand, there is the formal sector that is protected by a labour legislative framework, and with a clear industrial relations mechanism. This sector exhibits characteristics that are found in advanced middle-income countries and developed economies. On the other hand, there is the informal sector that is deprived of any form of protection. In this sphere there are small-scale activities that are unregistered, and there is no system of industrial bargaining or laws that protect workers in the sector. The labour force in this sector is excluded from the determination of wages, yet they are affected by it. The informal sector in South Africa is a sector that operates in ways similar to many less developed countries, but smaller in proportion to the labour force.[xvii]

Others have suggested that South Africa's labour market is rather segmented into three dimensions, marked by segmentation between formal and informal labour market, with a substantial wage differential of between 1.75 – 3.5: 1; and that which exists between unionised and non-unionised labour market.[xviii] Accordingly, we have a three-tier structure in the labour market: formal unionised; the formal non-unionised; and the informal sector. Sometimes those who are unionized are gratuitously referred to as a "labour aristocracy".

In this scenario there are significant wage differentials in favour of the unionised sector, and there are also attendant intra-labour income inequalities. There are a number of other factors that have been cited as accentuating the intensity of this reality. These include the role of social welfare provisions, which reduce appetite for job seeking, especially because of the already high cost associated with job seeking; and the mismatch between education output and the demands of the labour market.

Conclusion

It is clear from the analysis above, as well as by looking at the assessment of the World Economic Forum's Global Competitiveness Report, that South Africa's labour market is rigid compared to other developing countries with similar economic profile. This is accounted for largely by South Africa's unique social history, especially, the relationship between the evolution of capitalism under the social conditions and strictures of apartheid. Strong measures to protect workers and wage setting process have emerged as a response to this historical reality, but also as an important aspect of South Africa's political values – to defend workers' rights in the context of historical injustices and systematic exploitation of black wage labour under apartheid.

Yet still, there is a need to recast labour market policies in ways that balance the interests of both workers and employers. The appropriate response to labour market rigidities is not necessarily blanket deregulation and eroding the gains of labour legislative framework. Effective responses lie in developing dynamic industrial and social policies that are both growth enhancing and poverty alleviating (including through income support and extending asset ownership by the poor). Further, the binding constraints or entry barriers that impede the labour absorptive capacity of the informal sector will also need to be target of policy.

Finally, South Africa will not be able to escape the reality of globalisation. The labour-intensive primary sectors of the economy, agriculture and mining, have been shedding jobs over time. Mechanisation is a reality that seems to have permanency. The manufacturing sector is also countenancing its own competitive pressures. Ongoing strikes in mining and manufacturing do have an adverse effect on economic output, and thus on the fate of the unemployed. These macro-economic challenges will require much more than tinkering with policy; they call for a serious rethinking of South Africa's social dialogue, and the values that underpin it.

The prevailing mood in South Africa's labour market is that of adversariality, a reality that signifies a reversal in gains made in the early years of democracy. The broken triangle between the state, business and labour would need to be fixed on new terms. Alongside other contributors to labour market rigidities – such as the wage structure – there also needs to be a dialogue on high levels of income inequalities between the bosses and the workers.

End Notes

[i] Report of the Presidential Commission (1996). *Restructuring the South Africa Labour Market* . RP 83/1996. June 1996. Pretoria: Government Printer, 1996, p.3.
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[iii] OECD Economic Surveys: South Africa (2013). http://www.oecd.org/eco/surveys/South%20Africa%202013%20Overview%20FINAL.pdf [Accessed: 28 October 2014].
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[v] Banerjee et.al (2008), p.717.
[vi] See Banerjee et.al (2008), p.731.
[vii] This refers to the proportion of the population ages 15 and older that is economically active or of working age.
[viii] Bhorat, Haroon (2004). "Labour Market Challenges in the Post-Apartheid South Africa", *Development Policy Research Unit.* http://dspace.africaportal.org/jspui/bitstream/123456789/33484/3/DPRU%20WP05-093.pdf?1 [Accessed: 21 October 2014].
[ix] See discussion of the reasons for unemployment in Banerjee, Abhijit et.al. "Why has unemployment risen in the New South Africa?". *Economics of Transition,* Volume 16(4), pp.715-740.
[x] Bhorat, Haroon, pp.5-6.
[xi] Bloomberg (2014), *South Africa Unemployment Rate Climbs As Factories Shed Jobs*. 29 July 2014. http://www.bloomberg.com/news/2014-07-29/south-africa-jobless-rate-climbs-to-25-5-as-factories-shed-jobs.html [Accessed: 20 October 2014].
[xii] Banerjee et.al, p.724.
[xiii] Federke, Johannes (2012). "The Cost of Rigidity: The Case of the South African Labour Market". *Economic Research of Southern Africa Working Paper 290.* June 2012, p.3. http://www.econrsa.org/publications/working-papers/cost-rigidity-case-south-african-labor-market [Accessed: 22 October 2014].
[xiv] Fedderke, Johannes, p.4.
[xv] Bhorat, Haroon, p.6.
[xvi] Kingdon, Geeta and John Knight (2007). "Unemployment in South Africa, 1995 – 2003: Causes, Problems and Policies". *Journal of African Economies*, Volume 16 (5), pp.813-848.
[xvii] Kingdon, Geeta and John Knight (2007), p.820.
[xviii] Fedderke, Johannes, p.11.