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# The Employment Problem in South Africa

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**Abstract**
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# The Employment Problem in South Africa

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## Introduction

That South Africa has an unemployment problem is unquestioned. By the narrow definition of unemployment (did not work in the last seven days but actively looked for work), the unemployment rate is 12-20% of the labour force. By a broader definition of unemployment, which includes the narrowly unemployed, plus those who were not working but would accept a suitable job if one were offered even though they are not now looking for work (and in some cases includes seasonal workers and contract workers as well), the unemployment rate rises to 27-34%.

As high as these numbers are, they capture only part of the problem. What South Africa has is an employment problem that includes not only the unemployed but also those with very low hourly wages, those with inadequate monthly or yearly work hours, and those who have to work too long just to be able to eke out a meager livelihood.

How large is South Africa's employment problem? Bhorat and Leibbrandt have estimated a low-earnings line, defined as the wage required to enable an average household to escape poverty, given the mean number of employed plus unemployed workers in a household. This amounts to R650 per month in 1995 rand. According to their calculations from October Household Survey data, 46% of the labour force - about seven million people - earn less than this amount. The unemployed, defined broadly, make up about half this group, and the working poor make up the other half.

Once the issue is defined as an employment problem - comprising not only those who are unemployed by standard international definitions but also those with low labour market earnings by South African standards - different policy analysis and prescriptions follow. The goal is no longer merely to create jobs. The goal is to create good jobs. It is as important to raise the earnings of the working poor as it is to get the poor working.

What, then, should be done to alleviate South Africa's employment problem? This article will examine a number of issues:

- Facing employment and wages simultaneously
- Increasing the derived demand for labour in a globalised world economy
- Confronting the structurally unemployed and underemployed; and
- Getting the right labour market model.

## Wages and Employment: The Need to Confront Both

First-year economics students are taught that demand curves are downward-sloping but not vertical. In the labour market, this has two implications: other things equal, (1) higher wages lower employment and (2) lower wages raise employment. These are not easy choices to make, but then again, economics has been called "the dismal science" for good reason.

But in contemporary South Africa, there are those who say that there is no such tradeoff. I've heard at least three arguments to this effect.

The first concerns wage increases. It has been said that if wages are raised, firms will hire just as many workers as before, because employment is determined by other factors - perhaps by how much labour is required to support a unit of capital. Those who hold this view support wage increases and do not contend that employment will suffer.

The second argument goes in the opposite direction. Suppose that to try to create more jobs, wages were to be lowered. According to this argument, firms would not hire any more workers from the target group than before. Rather, they would hire those who are not part of the problem to begin with - namely, the skilled. By this line of thinking, the social challenge of employing the poor would remain unmet.

And third, one sometimes hears the macroeconomic argument that pushing wages up raises purchasing power and, through multiplier effects, leads to more jobs than are lost.

I have seen no evidence that supports these arguments. Several studies have estimated wage elasticities of demand for labour. These studies - by Bowles and Heintz, Fallon and Lucas, and Fields, Leibbrandt, and Wakeford - have derived estimates of -0.5 to -0.7. That is, each percentage point increase in wages would lead to a half-point reduction in employment or more. As with anything else, there is a confidence interval surrounding these point estimates. But what comes out of this literature is that nobody has found anything like a zero wage elasticity of employment, let alone a positive one. To maintain this in light of the evidence is wishful thinking.

We come back now to the definition of the problem. If South Africa's problem is conceived of as only an unemployment problem, then the implication of these employment elasticity estimates is clear: create more jobs by holding down real wages. But when one conceives of the problem as an employment problem, one is led to ask not only whether people are working but also how much they earn when they work. South Africa must choose carefully between policies aimed at raising the labour market earnings of the employed and policies that would raise employment by holding down the growth of real wages. Would it be socially desirable to have lower real wages but more jobs? What about higher real wages for those employed but fewer jobs? The answers can only be resolved through a continued society-wide debate.

The tripartite approach to social negotiations in South Africa, as in the rest of the world, leaves out a very important group: those workers who are not employed in the formal sector, who do not belong to trade unions, and who do not have representatives at the bargaining table. Extending collectively negotiated contracts is not helpful to the millions of South Africans who are out of work and the millions more who cannot possibly be covered because there is no employer who can be made to meet the agreed-upon terms. What promotes the interests of the unemployed and underemployed is shifting the demand for their labour, to which we now turn.

## Mitigating the Harsh Tradeoff: Increasing the Derived Demand for Labour in a Globalised World Economy

The tradeoff posed in the last section can be softened, though not eliminated, by bringing another element into the discussion: the possibility of shifting the derived demand for labour curve so that more workers are demanded at any given wage than before. To see how this might be done, a look at some success cases in other parts of the world can be fruitful.

As is well-known, the so-called "East Asian Miracle" produced rapid economic growth, first in Japan, then in Hong Kong and Singapore, then in Korea and Taiwan. In each of these economies, real per capita Gross Domestic Product (GDP) grew at about a 7% annual rate for decades. Successfully penetrating world markets was a major contributing factor. No wonder these so-called "Asian Tigers" continue their export drive and that the "Asian Cubs" (Thailand, the Philippines, Indonesia, Malaysia, and, more recently, China) seek to become tigers themselves.

Much less-known is the labour market record that accompanied this growth. When the process first got started around 1960, real wages barely rose - wages in Taiwan were only 2% higher in real terms in 1970 than they had been in 1960. What did grow was employment. Thus, in the first phase of the Asian Tigers' growth, the surplus labour with which they had begun came to be employed at virtually constant wage levels. But then, the labour surplus was exhausted and the labour market tightened to the point where employers needed to raise wages in order to retain existing workers and attract new ones. In each of the Asian Tigers, real wages grew apace of per capita GDP growth and unemployment rates of 2-4% were maintained throughout the decade of the 1970s.

During the epoch of rapid export-led growth in the early 1980s, East Asia experienced full employment, improved job mix, rapid real wage growth, low inequality, and falling poverty rates. Despite several objections, the argument I made then (and make now) is that the trade and industrialisation strategies they had followed had been good for workers and should be continued. Real exports from the East Asian and Pacific countries grew by 164% in the 1980s and by 187% in the first eight years of the 1990s, real GDP per capita continued to double in the1980s and again in the 1990s, so too did real wages, and full employment was maintained except for crisis years at the end of the 1990s. (At the time of this writing, South Korea's unemployment rate is back down to 3.6% and real wages are 11% higher than they were a year ago.)

Coming back to South Africa, what can work here is what worked in East Asia: producing things that those who have the purchasing power elsewhere in the world will want to buy. A fundamental truth is sometimes forgotten: if you're poor, you can't get rich by selling to yourself.

The challenge for South Africa is to find new niches in which South African producers can become world class, and thereby increase the derived demand for the nation's labour. There is only so far you can go with metals, alloys, and precious stones.

The new niches need not be new products - did Japan invent anything other than the Walkman? They are likely instead to be existing products: footwear, furniture, ball-point pens, or whatever. Government cannot determine what these products are (or at least can do only a little of it) - the energies of South Africa's private sector must be harnessed.

Take the example of computers. None of us demands an American-made computer or a Japanese-made computer or a South African-made computer. What we do demand is a computer with the right features, with high reliability, with good service facilities, and with a reasonable price for the features it has. Most of us will buy such a computer from wherever in the world it comes, and may perhaps not even know its origin when we buy it. And the computers themselves can be freely exported and freely imported, subject only to relatively modest transportation costs and, in some countries, import duties. The people of East Asia benefited by manufacturing computers not because they could buy them cheaply when they produce them (Asians still find it cheaper to buy computers and other major electronics items in the United States and ship them home) but because they could use their wages from producing world class products to buy what they most wanted.

This model can work today. In fact, one may argue that for South Africa to prosper, such a model must work today. Why? Because the harsh fact is that the rest of the world does not need South Africa's working people, but South Africa's working people do need the rest of the world. There are 1,300 million Chinese and 1,000 million Indians compared with 40 million South Africans. These two Asian countries alone offer all the unskilled labour that anyone would want, plus a fair amount of skilled labour as well. If a business is thinking of producing someplace in the world, why would it not want to produce in China or India? Why should it want to produce in South Africa? Profit-maximising enterprises must want to employ South Africa's labour. This implies that if businesses are going to want to invest in the country, building factories and offices and creating jobs, they must find South Africa an attractive place in which to operate.

What promotes this? High productivity of workers, a cooperative work environment, the opportunity to make money. What impedes this? Excessively restrictive labour practices, the labour hassle factor, an unsafe living environment for the business executives and their families. According to research just now being completed by the Greater Johannesburg Metropolitan Council and the World Bank, corporate CEOs identify the leading constraints to business growth in South Africa as crime and violence, labour regulations, interest rates, exchange rates, corruption in government, skills shortage, and tax rates. The leading priorities for remedying this situation, according to these CEOs, are for the national government to promote an efficient and flexible wage policy in the labour market, maintain macroeconomic policy stability, and promote an efficient and flexible interest rate policy.

In Europe, they use the term "social partners" to describe the ways in which business, labour, and government get together to try to advance their common interests. South Africa has NEDLAC, workplace forums, sectoral bargaining councils, and skills training boards. Still, the overall attitude is conflictual and confrontational. "Partnership" is about the last word one would think to use to characterise South Africa.

## Confronting Structural Unemployment and Underemployment

Clearly the South African labour market has a deficient-aggregate demand problem. But in addition, part of the problem in South Africa is structural unemployment: employers are demanding workers with certain types of high-level skills which the unemployed and the working poor do not possess.

Here is how one can tell what kind of unemployment problem exists. If you have 20 people seeking 10 new jobs and employment increases by 10, then you have a deficient aggregate demand problem. But if 20 people are seeking 10 new jobs and employment increases by 5, because the other 15 are deemed unqualified, then you also have a structural unemployment problem.

South Africa's structural unemployment problem is thought to be a skills problem. The nation can selectively aim to improve the quality of its human resources through a kind of Say's law: supply creates its own demand. Thus, if more highly-qualified people are educated and trained in the right kinds of areas, South African employers will want to hire them. People with computer skills, for example, are said to be in very short supply, and if there were more of them, one would expect that they would be employed.

The skills gap is vast, far exceeding the available resources, and difficult choices will have to be made. One particularly crucial choice is whether to focus on upgrading the skills of the currently unemployed and underemployed or, alternatively, emphasising the education of the next generation of workers. Too many budgetary allocations are based on the rule, "doing some of this and some of that is better than doing just one thing alone," and South Africa would do well to avoid such politically attractive but economically unwarranted kinds of decisions.

The basis for policy formation ought not to be, "It's good for the unemployed if . . ." The needs are too great and the resources too limited for that. Hard-headed decisions need to be made, confronting opportunity costs, fully recognising that to do more of one thing means to do less of another, and weighing the social and economic benefits and costs as carefully as possible

## Getting the Right Labour Market Model

A quite different need for South Africa is an analytical one. There does not yet seem to be a labour market model for South Africa that properly incorporates the main stylised facts. Clearly, the right model is not the competitive labour market model - wages are not set by supply and demand. Nor is it an integrated labour market model - there is much too much labour market segmentation for that. Nor does the Harris-Todaro model fit - the cities are not uniformly high-wage vis-à-vis the rural areas. The least bad fit comes from the crowding model - those who cannot get formal sector jobs crowd into the informal sector, depressing earnings levels there - but that does not fully fit either because of South Africa's large volume of open unemployment. Thus, an overall vision of how the South African labour market works and how the various components link together remains both a puzzle and a challenge.

Researchers always like to call for more research, but this is a case where it is really needed. Policies to combat South Africa's employment problem can be designed better once an overarching structure is in place. In East Africa, a new labour market model, coupled with policy experimentation, led to the conclusion that the solution to urban unemployment was rural development - hardly an obvious conclusion. Absent similar in-depth analysis in South Africa runs the risk of implementing an intervention appropriate in one labour market context that makes things worse in another. For the poor and the unemployed in South Africa, that would be a great tragedy indeed.

## Conclusion

The employment problem in South Africa faces five major challenges:

First, it is important to recognise that the problem goes far beyond the several million openly unemployed by broad definitions and includes also several million others who are employed by standard international definitions but are not earning enough by South African standards. Then formulate policies so that the number one goal is to improve the lives of as many of these people as possible through better earning opportunities.

Second, recognise that national policies to deal with the employment problem cannot be rationalised and designed well until choices are made about whom to try most to help. Decisions need to be made about whether the priority is to pursue higher wages for those employed or to seek fuller employment.

Third, recognise that alleviating South Africa's employment problem requires the involvement of the rest of the world. You can only get so far with products that your own businesspeople are able to produce and that your own consumers want and can afford to buy. South Africa has to be an attractive place for South African entrepreneurs to do business and for foreign firms to do business as well. Labour policies, human resource policies, and even cultural policies must be coordinated toward achieving this end. The road to success is to produce goods that those with the purchasing power in South Africa and in the rest of the world will want to buy. South African businesses and workers need to join forces to achieve this. Changing from a confrontational to a cooperative approach will not be easy.

Fourth, recognise that in addition to deficient aggregate demand for labour, South Africa also has a structural unemployment problem. Many if not most of the target workers do not possess the skills demanded by employers. Efficient ways of marshalling limited resources to educate the young and train the others need to be found. It would be helpful to pose the question of opportunity cost - if we do this, what can we not do? - in order to prioritise energies and budgets accordingly.

Finally, recognise that one barrier to formulating policies to combat the employment problem in South Africa is the lack of a guiding labour market model. It is therefore imperative to pull research findings and insights together in order to develop an overarching framework for labour market analysis in South Africa. This is the highest priority for researchers and policy-makers in the months and years ahead.

Meeting these challenges is of vital importance. The economic well-being of literally millions of South Africans hinges on the wisdom of these choices.

### Endnote

This article is based on a keynote address prepared for presentation at the TIPS Forum on "*Paths to Growth and Employment in South Africa*," Johannesburg, South Africa, September 18, 2000.

### Bibliographical Note

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