



# THE GROWTH AGENDA

Priorities for mass employment and inclusion



## Making South Africa more labour intensive

## About CDE

The Centre for Development and Enterprise (CDE), an independent policy research and advocacy organisation, is South Africa's leading development think tank. Since its establishment in 1995, CDE has been consulting widely, gathering evidence and generating innovative policy recommendations on issues critical to economic growth and democratic consolidation. By examining South African and international experience, CDE formulates practical policy proposals outlining ways in which South Africa can tackle major social and economic challenges. CDE has a special focus on the role of business and markets in development.

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Series Editor: Ann Bernstein

This publication contains an overview of the proceedings of a workshop convened on 13 June 2018. This publication was written by Antony Altbeker and Thato Masiangoako.

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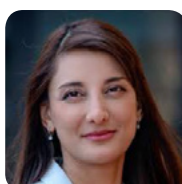
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# The Growth Agenda

## Making South Africa more labour intensive

### Proceedings of a workshop of experts on the South African labour market.

On 13 June 2018 CDE hosted a roundtable discussion on the critical questions of why economic activity in South Africa is not more labour-intensive given the vast number of jobless adults. What prevents employers from making use of the energies of more people? Why are industries that do use lots of labour in decline? What can be done to reset these trends and set the economy on a more labour-intensive growth path?

To answer these questions, we gathered experts on the labour market from government and the academe, as well as senior businesspeople from a range of economic sectors (see participants list). The conversation was organised into four sessions, with the first focusing on whether and to what extent public policy has pushed South Africa onto a less labour-intensive growth path. The second focused on specific sectors that have historically absorbed large numbers of workers – agriculture and clothing manufacturing – but which are now employing fewer people per unit of output, and asks why this might be so. The third looked at specific sectors that have the potential to employ more people, specifically the business process outsourcing industry, manufacturing and infrastructure investment. The final session asked to what extent stand-alone projects can help address the challenge, and focused on the Youth Employment Service (YES) and the Jobs Fund.

The format for each session was the same: presentations by one or two experts, a response from one or two other experts, and then general discussion. This report summarises the inputs, responses and discussion.

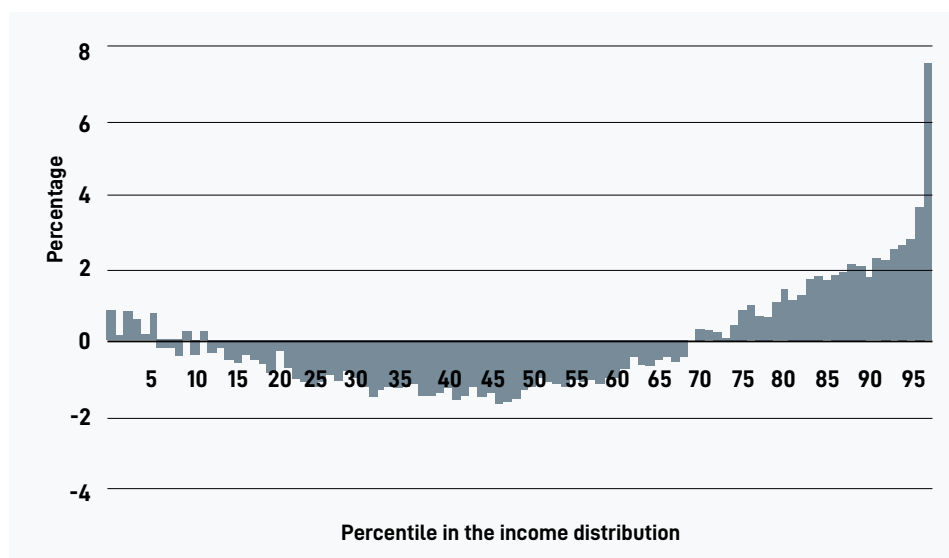
### Session 1: Has policy made South Africa less labour-intensive than it could have been?

The first session of the roundtable looks at some of the policy decisions South Africa has taken in the past and present that may have contributed to limiting South Africa's ability to become more labour intensive, with presentations by Haroon Borat (who explores how labour market policies have raised incomes at the bottom and top of the income distribution, but left a "missing middle" behind) and Andrew Donaldson (who looks at the effect of broader social policies on the performance of the labour market), and an initial response by Nicoli Nattrass (who describes important changes in the way South African policy makers have thought about labour market policy over the past two decades).

**“What prevents employers from making use of the energies of more people?”**

**“The middle strata of wage earners have seen their real incomes decline since the late-1990’s.”**

**Figure 1: Annual average real wage growth in SA, by percentile (1997-2015)**



### **The Labour Market Policy Environment: Current Context and Possible Future Trends**

**Haroon Borhat**, *Professor of Economics and Director, Development Policy Research Unit, University of Cape Town*

#### **Introduction**

I am going to talk about a number of related issues, all of which are, I think, implicated in the hollowing out of the middle strata of wage earners. This is a large group of people, who, in contrast to people at the bottom and the top of the income distribution (who have enjoyed real increases in their incomes), have seen their real incomes decline since the late-1990s (see Figure 1). The distribution of the benefits of labour market policies and the rest of our economic model, in other words, is distinctly u-shaped: people at the bottom (and we are excluding informal sector workers here) and the top have done much, much better than people in the middle. This suggests that there is something fundamentally flawed about our growth construct.

#### **Tightening the labour market**

The most important laws governing the labour market are the Labour Relations Act (LRA), the Basic Conditions of Employment Act (BCEA) and the Employment Equity Act. These were initially negotiated in the late 1990s in a spirit of give-and-take between business and labour, and the result was some well-crafted, carefully balanced legislation that had one eye on the “decent work agenda”, but which also gave employers a reasonable amount of flexibility in managing employees. The principal enforcement mechanism – the CCMA – also works reasonably well, although the Labour Court and Labour Appeals Court are notoriously slow and inefficient.

A key trend since 1996, however, is that amendments to these laws have tended to strengthen worker protection and reduce flexibility (see Table 1, where italics reflect amendments that increase worker protection).

There are a number of critical amendments here, but the latest is possibly the most significant, reflecting a significant move to limit the operation of temporary employment service providers and to regulate atypical employment, part-time contracts, etc. That is a massive move towards greater protection through the LRA. At the same time, provisions in the BCEA have been tightened to prohibit task-based work, piecework, home-based work and so on.

It is important to understand the implications of tightening in a labour-surplus economy, one of which is that it tends to push up wages (and the other costs of employing people) at the bottom end of the distribution. At best, this kind of regulatory tightening means that employment levels won't rise, but it is more likely that they will actually fall.

So one way to think of this is that we have increased protection, but at the expense of lower numbers of workers. And, to the extent that increased protection leads to reduced compliance, (for example, 45 per cent of employers do not fully comply with existing minimum wage rules), then the increase in protection is at the cost of even fewer workers who are actually protected.

#### **Wage setting processes**

South Africa has two main mechanisms for setting minimum wages: in most sectors, negotiations happen between organised labour and employers, and in some sectors, the minister makes determinations about wage levels. Aggressive minimum wage-setting by the minister is an important reason for real wage increases at the bottom of the distribution. In agriculture, for example, minimum wages have risen by 90 per cent in real terms, while the figure for domestic workers is about 40 per cent. There have also been substantial increases – over shorter periods – in the taxi industry, hospitality and private security.

Some of these sectoral minimums will be superseded by the national minimum wage (NMW). In this regard, we did some work for the Department of Labour, and, depending on what you think the elasticity of demand with respect to wages is for labour, the NMW could result in significant declines in employment. And the effect will be greatest in the least capital-intensive sectors and in ones in which there are many small businesses. This is because big, capital-intensive industries already pay above the minimum wage. Consider the furniture industry, where the NMW could lead to an increase in minimum wages of something like 160 per cent. This creates the real threat of job losses.

**“Amendments to labour laws have tended to strengthen worker protection and reduce flexibility.”**



**“The NMW is not the right tool for solving all our socio-economic challenges.”**

**Table 1: Key amendments to labour legislation (1998-2014)**

1998
Provisions for pension and medical schemes. <i>Adjust requirements for extending collective agreements in bargaining council to non-parties.</i>
2000
Specified the laws around bargaining council registration, extension agreements, and council agents. Gave bargaining councils power to provide industrial support services to participating parties.
2002
<i>Enhance enforcement of collective bargaining agreements.</i> <i>Extend functions of bargaining councils to informal sector.</i> <i>Set sectoral determinations on minimum wages and increases.</i> Specify circumstances under which ordinary hours of work can be varied and regulate extension of overtime.
2013
Prohibit employers from requiring employees to pay to secure jobs, purchase goods & services. <i>Provision for minimum increases to wages in addition to minimum wage rate for vulnerable workers.</i> <i>Prohibit or regulate task-based work, piecework, home-based work, sub-contracting and contract work.</i> Provisions for increasing the penalties for certain offences of Act.
2014
<i>Provide greater protection for workers placed by temporary employment services by regulating employment of fixed term contracts and part-time employees, and specifying liability for employers' obligations.</i> <i>Limiting temporary employment to genuine temporary work that does not exceed six months.</i>

**The NMW cannot solve all our problems**

The NMW is not the right tool for solving all our socio-economic challenges. In particular, it can't be the only vehicle for solving the crises of poverty and inequality, for which we need rapid job creation and much more effective delivery of public goods and services. Absent this, we do not expect large improvements in poverty and inequality delivered by the NMW precisely because it will lead to some job losses. And, depending on how large you think the disemployment effects are, the level of inequality could be no lower after the NMW is implemented than it is now.

The minimum wage is also not the best tool for reducing poverty, which might be better countered through other instruments like free schooling, better access to health clinics and transport, housing subsidies, etc. These would all reduce poverty outcomes without affecting employment. Indeed, they could increase employment through a variety of supply and demand-side effects. At the moment, the employment tax incentive (ETI) is the only real demand-side intervention we have for the labour market, but it seems remarkably effective. Even if there may be a little displacement of older workers, it seems to have created a significant number of jobs at a relatively low net cost.

Some aspects of the NMW and its implementation that will affect its overall impact are unknown at this point. We do not know, for example, how the exemptions process will work, and this could be important for protecting jobs. We also do not know how the process of convergence of wages in agriculture and domestic work to the NMW will proceed. Finally, we do not know how the NMW will be adjusted over time in response to inflation, and this could have very important implications for the long-term effect of the NMW.

#### **Concluding remarks**

It seems to me that South African policy is continuing to drift towards increasing worker protection. This means reduced employment creation, with employers becoming increasingly reluctant to take on staff because of rising wage and non-wage costs. It has also resulted in a u-shape in the distribution of the benefits of wage growth: if employers have to raise minimum wages, and if wages at the top rise because skills and experience are scarce, firms can reconcile their total wage bill only by suppressing wage growth of people in the middle.

#### **Social policy and the labour market**

**Andrew Donaldson**, *Honorary Professor of Economics, Stellenbosch University and Former Acting Head Government Technical Advisory Centre, National Treasury*

The central economic ideas that shaped policy in the early 1990's were influenced by the ideas and thinking of the industrial unions. These focused strongly on the idea of a high-productivity, high-wage economy, and reflected a desire to avoid the kind of low-wage, low-skill, low-productivity strategy that the Asian tigers followed. High productivity was to be achieved through the opening up of the South African economy through trade liberalisation (to discipline firms) and the rebuilding of our skills systems (e.g. through the creation of the SETAs).

Much of this policy-making was naïve. In practice, it takes a long time to build the education and training capabilities needed to achieve high-skill and high productivity levels in an economy.

**“The NMW could result in significant declines in employment.”**

**“You cannot make progress in improving skills when there is limited job creation .”**

That is not the only problem. To raise productivity levels we would have had to have enjoyed higher levels of investment: Kenneth Arrow's learning-by-doing thesis suggests that investment drives higher growth and productivity improvements. It argues that improved productivity is a by-product of the accumulation of capital. That made the 1990s a poor time for a high-productivity strategy because that was the tail end of a decade of underinvestment.

In the 1980s, South Africa was negatively investing and was not even replacing the depreciating capital stock because of the political and economic uncertainties of the time. Investment levels were comparatively low. Although some progress was then made to raise investment to around 20 per cent and a bit higher in the early 2000s, these again fell back after 2007 to levels that are a bit lower than the early 1990s.

We have been, in other words, a low growth, low investment economy since the 1970s. And, there is no prospect of achieving higher productivity, high levels of skills, and high wages with a history of 40 years of under-investment.

This, I think, is more important than labour market policies for explaining high levels of unemployment and why we have made only limited socio-economic progress. The failure to achieve more investment has slowed growth, raised unemployment, and increased inequality.

Another key feature of the economic policies of the 1980s and 1990s was how much they relied on large, state-supported projects to drive investment, many of which were too-big-to-fail – Mossgas, aluminium smelters, Iscor, Saldanha Exports, the opening up of Richards Bay, as well as a vast water projects in the Lesotho highlands. The success of these was underwritten by the state, and generous export and tax incentives continued into the late 1990s. In the case of aluminium, concessions to them remain an unfortunate feature of our current electricity-pricing environment.

The direct and indirect fiscal costs, as well as the opportunity costs, of supporting large projects has been the hobbling of small businesses, labour-intensive manufacturing, and the services sector. In other words, South Africa has had a policy environment that has reinforced the concentration of our economy, supported large businesses, and slowed the opening up of opportunities.

This is a critical reason why education and training reform has had such limited effect: you cannot make progress in improving skills when there is limited job creation because it is difficult to create constructive relationships between business and training providers in slow-growing economies. This is why our low growth, low investment and high unemployment economy has become a self-reinforcing trap, one that is reinforced by the fact that policy-making processes dominated by stakeholders who do not represent the interests of small and family businesses.

## Response

**Nicoli Natrass**, *Professor of Economics and Director, AIDS and Society Research Unit within the Centre for Social Science Research, University of Cape Town*

I think the story that Haroon Borat tells is convincing. The changes we have seen to labour legislation have tended to reduce flexibility and increase worker protection, so it is not surprising that they have had the effect of raising wages at the bottom, though I would caution that the jobs at the bottom are not the same jobs in 2015 as they were in 1996. Structural changes in the economy have been significant, and the nature of work has changed, too.

I would want to make a broader point about how South Africans talk about our economic choices, the discourse we use and the narratives that generates. In particular, I want to talk about the way discussion about the labour market has been shaped by a growing insistence on the need to upgrade jobs, to raise productivity, and to increase wages, and that any reform that would increase labour-intensity is, it is argued, by definition, part of a "race to the bottom". That was not always the case.

Back in the 1990s, I sat on government's Labour Commission. We had a long debate about minimum wages. SACTWU was firmly against them, and was very clear that the clothing sector needed to have low minimum wages, and that the priority should be the strengthening of collective bargaining. The RDP, too, was clear that we should engage in labour-intensive activities, including in the provision of infrastructure and housing. Back then, the notion of labour-intensity was not dismissed out of hand.

This has obviously changed: nobody seems to be in favour of labour-intensive activities any more, seeing them as something to be avoided unless you want to be like Bangladesh or want to go back to apartheid-era employment practices. Instead, our emphasis is on labour upgrading and increased productivity. This makes it impossible to add low-productivity jobs to the economy, which is a mistake in a labour surplus economy with so many unskilled and inexperienced workers.

A couple of other points:

- Even if the NMW's rules permit exemptions, any uncertainty about whether an exemption will be granted must have a chilling effect on investment.
- The NMW may rule out the possibility of attracting labour-intensive firms to an export processing zone unless exemptions can be granted for it.

**"Nobody seems to be in favour of labour-intensive activities any more."**

**“Only  
43 per cent of  
adults are in  
employment,  
compared to a  
global norm of  
60-65 per cent.”**

## Discussion

### The extent of the challenge

One speaker noted that South Africa has a low employment ratio: only 43 per cent of adults are in employment, compared to a global norm of 60-65 per cent. A critical reason for this is the absence of significant employment in agriculture, which is responsible for a lot of jobs in other developing countries. This was unlikely to change, so South Africa needs to have an exceptionally large number of non-agricultural jobs if it was to achieve an employment-to-population ratio similar to other countries'. It was hard to see, however, what interventions could be made to put South Africa in that position.

It was pointed out also that two other factors impact on the difficulty of improving South Africa's employment performance. The first is that, given the low level of investment over the past decade, any acceleration in investment might involve the accumulation of labour-saving capital goods. In addition, and more generally, the advent of the fourth industrial revolution made new technologies available that would reduce the need for labour.

### The underlying data

There was some discussion about what Haroon Borhat's data reflected, during which he confirmed that the data were for wages paid to employees in the formal sector and excluded other sources of income as well as informal sector workers. The estimates of wages come from surveys, though these may be biased downwards. In light of this, it was suggested that one interpretation is that very few people at the bottom of the distribution of wages had done very well out of the labour market, a fact that probably reflected the destruction of low-wage jobs. It remained striking, however, how few workers had seen real wage increases in two decades.

### The Employment Tax Incentive (ETI)

There was some discussion about the ETI and its effectiveness, with some participants questioning whether it was appropriate to characterise it as a success: wouldn't many of the jobs that are being supported have been created anyway? In response, Haroon Borhat said that the low cost of the created jobs included the deadweight costs of the jobs that would have been created anyway. Another participant noted that the ETI reflected a substantial subsidy for young workers. If it did not generate employment growth, then this might have implications for the argument of those who claim that wage levels matter for employment levels.

Another kind of response suggested that the ETI was ill-designed because it supported too few jobs, and that it would have had more impact, especially on poverty, if it had been designed along the lines of the earned income tax credit in the US, which works as a kind of negative income tax for all low-wage workers. This would have made it an easier sell to the unions. It was also suggested that

focusing on young workers and offering a temporary subsidy was a mistake: to create much more demand for unskilled workers, a generalised subsidy was needed, as this would change its price relative to capital and to skilled workers.

## Session 2: Why are sectors that use the most unskilled labour doing so badly in creating employment?

The second session turns to the various dynamics that have impacted on labour intensity in the agricultural and clothing sectors. Wandile Sihlobo shows that employment in the agricultural sector has declined over the past four decades, but suggests that there are sectors in which employment growth is possible. Jeremy Seekings argues that employment in the clothing sector has been especially low particularly in comparison to the experiences of other developing countries. Anthony Black and Gilad Isaacs critically reflect on the poor performance of both sectors and as well as the potential they both still hold.

### Reflections on SA's agricultural labour market in the context of changing farm structures

**Wandile Sihlobo**, *Head of Agribusiness Research, Agricultural Business Chamber (Agbiz) and Columnist, Business Day and Farmers Weekly*

The main point about employment in agriculture is that it has declined every decade since the 1970s. The main reasons for this are the consolidation of farms and the mechanisation of production. Having said that, there are sub-sectors of agriculture that are more labour-intensive and in which employment has been growing.

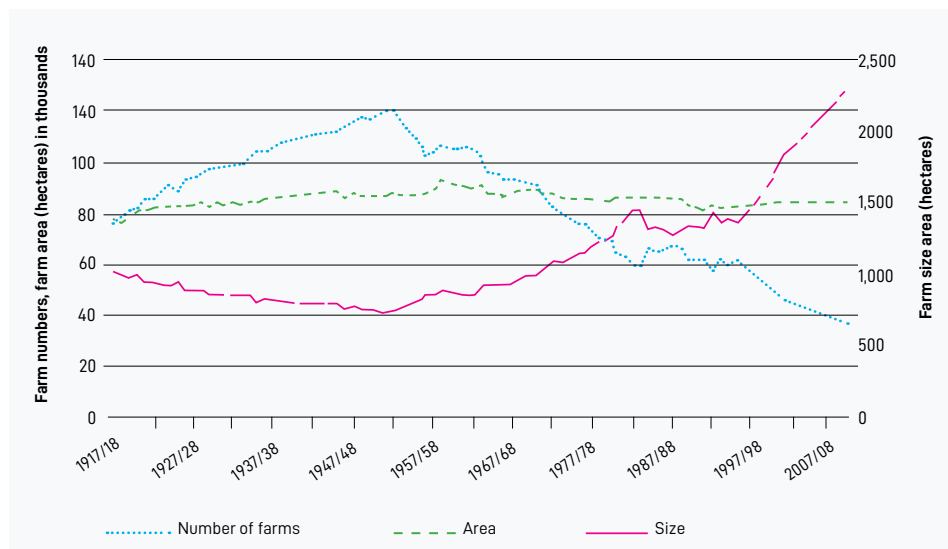
In the 1960s, about 14 per cent of workers were employed in agriculture, a figure that has fallen to 5 per cent today. The downward trajectory of agricultural employment is common across the world. For example, in the US in the 1970s 4 per cent of workers were in agriculture; now it's 1.5 per cent.

A hundred years ago, the amount of land being farmed in South Africa was not very different from what it is now: 79 million hectares compared to about 82 million hectares that we plant now. What has changed a lot, however, is the number of farms (Figure 2).

The main reason that farms were so much smaller in the middle of the twentieth century is that the government provided significant protection and subsidies in order to keep as many white folk on the land as they could. Fast forward to 1997/98, and agriculture goes through considerable deregulation, so less productive farms start to fail and get bought up by more successful farmers.

**“Employment in agriculture has declined every decade since the 1970s.”**

**Figure 2: Title of the chart should be: Changes to farm numbers and size in SA**



**“A hundred years ago, the amount of land being farmed in South Africa was not very different from what it is now.”**

This consolidation was accompanied by increased output, partly because of significant mechanisation over the same period, during which we saw much more investment in capital equipment. And that, ultimately, explains the decline in the number of people employed in agriculture – from 1.7 million in the 1960s to 800,000 now. It is also why you see such a big decline in owners, family members and domestic workers employed on farms. The other trend you see is the decline in the number of permanent workers on farms after the start of democracy, which was a response to changes in tenure laws that affected farm labourers. (Table 2).

**Table 2: Changing profile of agricultural employment**

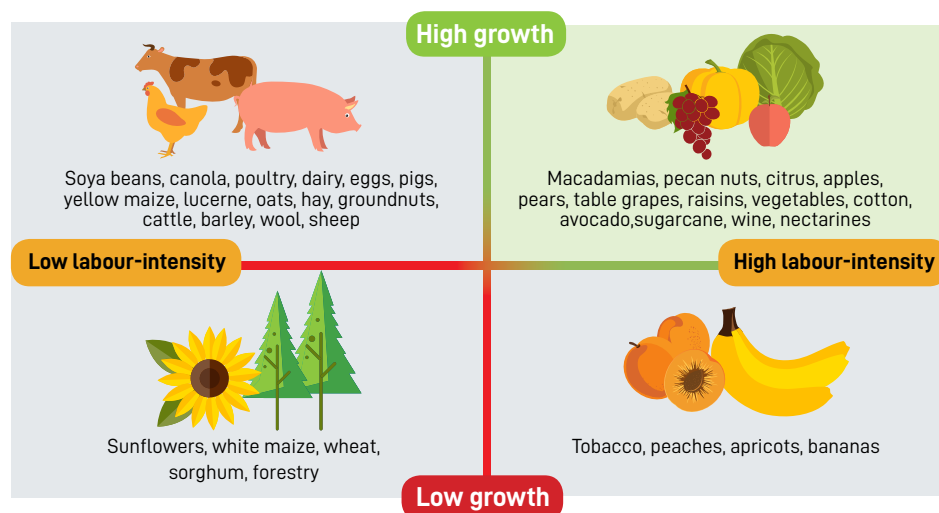
	1910s	1920s	1930s	1940s	1950s	1960s	1970s	1980s	1990s	2000s
<b>Decade averages (thousands)</b>										
Family	78	83	80	61	56	57	40	24	17	11
Regular	411	523	730	699	773	806	704	677	603	411
Casual	265	354	467	583	738	716	584	485	349	417
Domestic	8	0	0	28	137	123	94	61	20	0
Owners	48	65	76	94	93	86	64	54	46	37
<b>Total (excl. Domestic)</b>	<b>802</b>	<b>1,025</b>	<b>1,354</b>	<b>1,438</b>	<b>1,661</b>	<b>1,665</b>	<b>1,392</b>	<b>1,241</b>	<b>1,014</b>	<b>896</b>

There is little employment creation in livestock, including milk production. However, today, the agricultural sector is creating some jobs, but only in some specific sub-sectors, especially field crops and horticulture. Some of these sub-sectors have considerable potential for both economic and employment growth.

Climate change puts a question mark over job creation in the Western Cape in the medium and long term. The same is true about the debate about land reform and expropriation without compensation, which poses a risk to the

sector. This is a pity because there are parts of the country, especially in the former homelands, where land and tenure reform of the right sort could really help grow employment and output. In the meantime, there has been a big knock to confidence in commercial agriculture, and that will affect investment, employment and output.

**Figure 3: Sectors indicating growth potential and labour-intensity**



“South Africa has only a tiny fraction of the world’s 18 million clothing jobs.”

**Can jobs be created in the clothing manufacturing sector?**

**Jeremy Seekings**, *Professor of Economics and Director, Centre for Social Science Research, University of Cape Town*

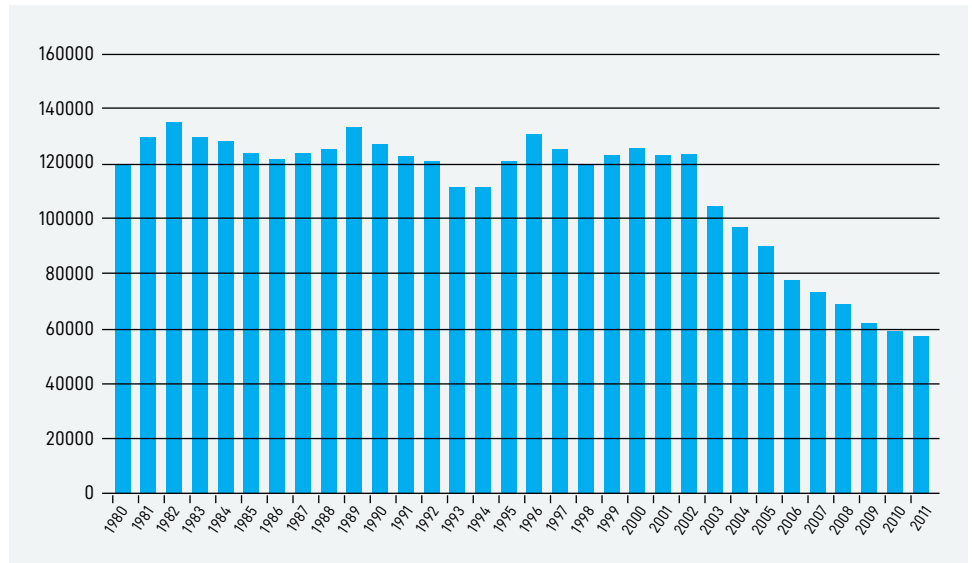
The recent history of employment in the clothing sector in South Africa is horrific: we saw the number of workers in the sector halve between 2002 and 2012 (Figure 4). This is not a history of job creation, but of job destruction. The result is that South Africa has only a tiny fraction of the world's 18 million clothing jobs – a figure that shows just how much potential there is for creating clothing jobs. It is a potential that South Africa has never really tapped. The challenge is to understand why this is so.

It is worth comparing South Africa's experience to that of other developing countries, many of which had periods of spectacular growth in the clothing sector. In 1987, Hong Kong had 300 000 clothing workers. Employment in China grew from about 3.5 million to 5.5 million in ten years. Bangladesh (4 million workers today) has seen explosive growth in clothing sector employment, while Vietnam (1.3 million), Turkey (over 300 000), Madagascar (120 000) and even Lesotho (53 000 in 2004) have all had periods of rapid employment growth.

In some of these cases, job creation in clothing was fundamental to the industrialisation process and there are no serious cases of industrialisation in the last 60 years that have not gone through a phase of labour-intensive employment creation in sectors like clothing.



Figure 4: Employment in the clothing sector



**“Clothing offers countries extraordinary development opportunities. But South Africa has never taken advantage of these.”**

So clothing offers countries extraordinary development opportunities. But South Africa has never taken advantage of these. When global trade in clothing increased 25-fold between 1963 and 1976, South Africa was producing almost exclusively for the domestic market, and accounted for 0.1 per cent of global exports. This, despite the fact that the apartheid government's Tomlinson Commission had made the creation of tens of thousands of industrial jobs an explicit goal.

If a place as small as Hong Kong's has exports of clothing that are 100 times greater than South Africa's, then you must say that even under apartheid, clothing was a spectacular failure. Why? Well, the cost of textiles (because of steep tariffs) held things up, as did the elevated value of the rand (which made our exports uncompetitive). Another factor is that even if wages at the bottom were low, that does not mean that South Africa was a low-wage economy: in fact, wages for skilled workers, managers and entrepreneurs were high, so overall wage costs were not competitive. This is why South Africans were outcompeted by Chinese and Taiwanese immigrants in Newcastle. Then there were the locational decisions of the apartheid state, which put all its industrial zones in the homelands, far from the ports.

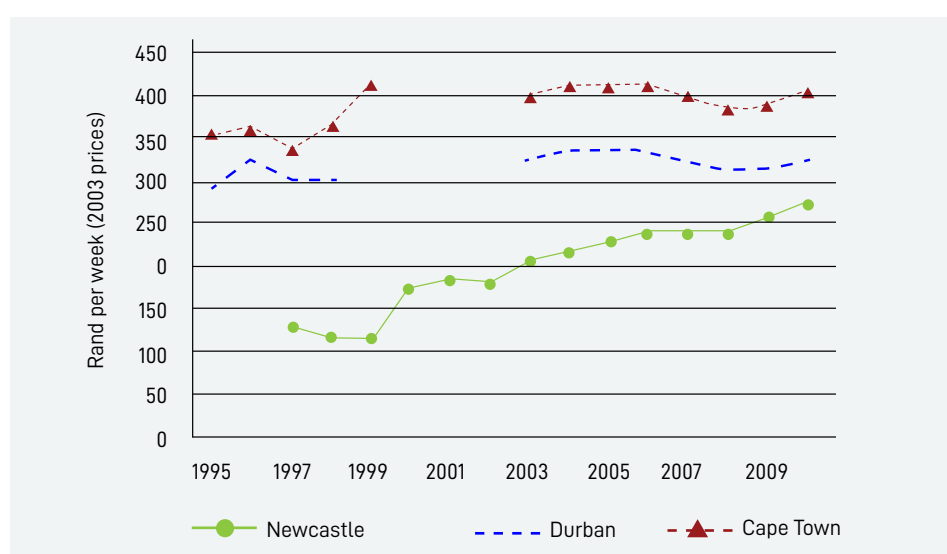
From an employment and growth point of view, this was all a colossal failure.

Of course, there have been changes: trade liberalisation opened our markets to imports. Many people say this drove job destruction. But that is unlikely: firstly, the timing is wrong because job destruction comes well after trade liberalisation. Secondly, liberalisation could just as easily have helped the sector grow because it would have lowered the cost of textiles. Thirdly, declining protection was offset by the depreciating rand.

More generally, liberalisation cannot tell us anything about why we have been unable to expand our exports.

Then there is the critical question of wages: this is a highly labour-intensive sector, so if wages are high then it will be hard to grow and to increase employment. Higher wages can also be expected to lead to job destruction. And SACTWU – the main union – understand this well. Until 2012, SACTWU seemed happy to destroy jobs in those parts of the industry in which it had no members, i.e. in places like Newcastle. So for a long time, what you saw is no real increase in wages in Durban and Cape Town, but a lot of pressure to push up wages in Newcastle (Figure 5).

**Figure 5: Minimum wage for trainee machinist (in 2003 prices)**



**“It is unlikely that trade liberalisation drove job destruction in the clothing sector.”**

Then, in the 2010s, SACTWU recruited workers in Newcastle's factories. And this has changed the dynamic. For example, SACTWU recently agreed that qualified machinists in Newcastle would have a minimum wage that was 75 per cent of the wage in Cape Town, but that machinists in firms that are (supposedly) transitioning to full compliance, could be paid 80 per cent of that wage. So, Newcastle's machinists, now organised by SACTWU, will have minimum wages that are 40 per cent lower than machinists in Cape Town.

Why the change? Because SACTWU is pretty shrewd about what firms can afford, and, now that it has members in Newcastle, it does not want to price them out of work. This interpretation is reinforced by the fact that despite very high levels of non-compliance in the industry, SACTWU has not pushed hard for greater enforcement. It is hard not to think that it knows that higher wages will mean job losses.

So what would it take for South Africa to see rapid job growth in this sector? Well, we would do so only if we were exporting substantial volumes of clothing, and we can only do that if we are priced competitively. That probably requires establishing export-processing zones where you can have more wage flexibility. It is actually reasonably simple.

### Response

**Anthony Black**, *Professor of Economics, University of Cape Town*

Many people say that South Africa cannot compete in labour-intensive manufacturing. They also say that small-scale farming cannot compete in globalised markets, so we need large-scale farming.

It is important to note, however, that many countries have much larger agricultural sectors than South Africa's and that we employ a lot fewer people in agriculture than most comparable countries. South Africa does have some subsistence farming and some small farms, but, again, much less than comparable countries. An important reason for this is that there has been a massive decline in state support for producers since the late 1980s. Add to that a shift – albeit an ineffective one – in support to smaller farmers, and our agricultural sector receives very little meaningful support.

Then we have also made things worse through a land reform programme that has transferred very little land, but which has been accompanied by rhetoric that has deterred investment. The outcome is that South Africa's agricultural sector is not creating as many jobs as it should.

Nor is the clothing sector creating jobs. However, compared to Jeremy, I think that trade liberalisation has had a big effect, if only because we have seen an increase in import penetration rising from 8 per cent in 1980 to 45 per cent in 2013.

We cannot address this by focusing on labour regulations alone. If we look at the Chinese model, for example, we see that wages were low, but that the cost of living was also reduced through the provision of subsidised housing and transport, cheap training, etc. We should be trying that in addition to paying attention to labour regulation. Also, because the cost of living is quite high, the wage subsidies should cover all workers and not just young ones.

Having said that, the development trajectory of countries like Bangladesh, Cambodia, and Pakistan etc. is greatly assisted by their proximity to Asian countries that have already industrialised. We do not have that advantage. We could, nevertheless, do a lot better in manufacturing. Although we cannot compete with the likes of China or Bangladesh, we can and should do better and a modest improvement in exporting competitiveness could make a

**“We have a land reform programme that has transferred very little land, but which has been accompanied by rhetoric that has deterred investment.”**

**“Integration on the African continent has been slow. South Africa has played a foot-dragging role in regional integration.”**

relatively big difference. In light of that, we should favour a weaker rand, which would benefit exports, especially labour-intensive ones, where a lot of the costs are local.

### **Response**

**Gilad Isaacs**, *Lecturer School of Economic & Business Sciences, University of the Witwatersrand*

I do not think that the only factors that have driven poor employment performance are mechanisation and wages. The relationship between wages and employment is not mechanical, and other macroeconomic factors can retard or facilitate sectoral strategies. In any event, the social and political climate in South Africa will not accept an ultra-low-wage growth path whatever the claims made to justify it. So the question becomes two-fold: which sectors can be labour absorbing but are not ultra-low-wage and are there other means of supporting those labour absorbing sectors by, for example, subsidizing transport costs?

But even in relation to labour-intensive sectors, it is important to say that, while wages are important, they are not the only factor.

Another factor, for example, is access to finance, and the way that the financial sector has reduced lending to non-financial firms, which has fallen steeply in recent years. What are the implications of this decline on a sectoral level? In what ways does it impact the textile industry, agricultural firms, and other sectors? The volatility of the exchange rate is also important, and it is driven by excess trading.

The Map to a Million report by the Manufacturing Circle draws attention to the linkages across sectors within the South African economy. However, our historic growth path has been centred around the mining and manufacturing sectors. So what does sectoral integration mean in a heavily concentrated economy with large monopolies? In terms of infrastructure, what would the impact on agriculture be if all the roads in rural Eastern Cape were tarred?

Integration on the African continent has been slow. South Africa has played a foot-dragging role in regional integration. What would happen if we took this more seriously?

### **Discussion**

Following the inputs and the responses, the discussion around the table focused on a few big issues, in particular the role of a depreciating exchange rate in promoting export and output growth. One strong view was that the depreciation of the Rand was not a plausible strategy for promoting exports, with a number of speakers noting that the absence of evidence that increased output follows a depreciation. The main reasons advanced for this were:

**“South Africa's prospects for expanding employment were limited both by its history and by the geographical and climatic realities.”**

- A weaker Rand translates to higher domestic inflation, undermining competitive advantage;
- Many industries import many of their inputs, so a weaker currency raises costs; and
- Many corporates have foreign currency debt, the costs of which rise with depreciations.

Against this, other speakers noted that while the overall effect of a depreciation on exports as a whole might be weak, this may not be true for labour-intensive manufacturers. This is partly because of their lower import-intensity, but it was also because some of these industries – like clothing – engage in constant pricing and repricing activities as order-flow is rapid, so they can react quickly to changing prices relative to imports. Jeremy Seekings also noted a distinct pattern in which official enforcement actions in the clothing industry pick up when the Rand depreciates and non-compliant firms become that much more competitive.

Another theme of discussion related to whether the “fourth industrial revolution” was weakening the relationship between manufacturing output growth and employment growth. Most felt that even if this were true in aggregate, some industries – such as clothing – had not yet seen a level of robotization that would threaten employment levels, and were unlikely to do so in the near future. That said, speakers felt it was likely that manufacturing is becoming a less potent motor of growth and development, and that this created a significant challenge for developing countries because there is little evidence that the service sector could do this as effectively.

Asked about the efficacy of the incentives offered by government to protect jobs in the clothing sector, Jeremy Seekings said that his impression was that these were overwhelmingly capital subsidies and offered to help firms upgrade their technologies. As such, they probably had the effect of reducing employment intensity by helping firms replace workers with machines.

In relation to agriculture, some speakers noted that South Africa's prospects for expanding employment were limited both by its history and by the geographical and climatic realities of the country, in which there is not all that much land on which labour-intensive agriculture is viable.

### **Session 3: Growing labour-intensive sectors**

The third session of the roundtable focused on some of the sectors that could grow and deliver more jobs. André de Ruyter shared his perspective of the challenges faced by the manufacturing sector as well as the Manufacturing Circle's proposals to stimulate demand. Sean Phillips provided an analysis of

**“South Africa's manufacturing sector underperforms both in comparison to our level of GDP per capita and in comparison with other countries.”**

the Expanded Public Works Programme's (EPWP) underwhelming contribution to labour intensive job creation while Andy Searle shared an optimistic overview of the Business Process Outsourcing sector and the potential that it has for South Africa.

### **Manufacturing as an engine of job creation**

**André de Ruyter**, *Chief Executive Officer, Nampak*

South Africa's manufacturing sector underperforms both in comparison to our level of GDP per capita and in comparison with other countries, and we have lost 500,000 jobs since 1989. However, if the sector were to perform at the appropriate level, it could add 800,000 to 1 million more jobs.

We are suffering from what Dani Rodrik calls premature deindustrialization, and we are struggling because of a lack of demand which makes companies reluctant to invest in additional manufacturing capacity because we already have low capacity utilization. The result is a lack of new projects, fewer shifts, and ultimately less income in the pockets of potential consumers, holding back demand.

A case in point is the Vaal Triangle: the Emfuleni Municipality has a very high level of unemployment, with all the social, economic and political effects that implies. It really needs revitalization, which is one reason I am a bit skeptical about calls for special economic zones: why invest in new places when there is existing physical infrastructure (pipelines, roads, electricity) as well as social infrastructure (training colleges, schools and housing)? We could potentially recapitalize and rebuild on the foundations of what we have, especially as there is a large pool of labour available.

However, it is really hard to revitalize the Vaal Triangle under current circumstances. About 60 per cent of South Africa's exports are raw materials and government encourages this in the way logistics are priced. It costs 250 per cent more to transport iron ore from Sishen to Vanderbiljpark to convert into steel in South Africa than it does to transport iron to Saldana for export to China. The result is we buy more and more steel from China.

The Manufacturing Circle has proposals to increase demand through simple fixes. These include reducing port tariffs, which are currently 88 per cent higher than the global average. Implementing export incentives and enhancing road and rail infrastructure are also demand-stimulating measures. These measures are relatively low impact but help create a policy environment for more investment.

If South Africa is to turn this vicious cycle into a virtuous one, we must stimulate demand for local goods and preferential procurement. But that is

**“If South Africa is to turn this vicious cycle into a virtuous one, we must stimulate demand for local goods.”**

not enough: trade policy also needs to be more aggressive. An example is how the International Trade Administration Council of South Africa has caused the deferral of two major chemical projects because it refuses to consider protecting producers from dumping until they can show that harm is being done. But you can't show harm until after you have built your factory and started to produce. Industrial and trade policy needs to be much more proactive if we are to get new investment.

### **Growing labour-intensive sectors: Infrastructure Development**

**Sean Phillips**, *Former Director-General, Department of Performance Monitoring and Evaluation, Presidency*

There are three basic kinds of infrastructure spending: civils (roads, water pipes, dams and bridges), buildings (e.g. stadia) and heavy machinery (e.g. power stations). None of these is especially labour intensive:

- Civil engineering projects have the most potential for increased use of unskilled labour, but this is true only in some kinds of projects because, for the most part, labour costs are only about 5 per cent of project costs. Some kinds of civil engineering, however, can be made more labour intensive, with labour reaching up to 20 or 40 per cent of costs.
- Building projects also tend not to use a lot of unskilled labour, though they do use lots of artisans and semi-skilled labour. Here, there is little potential for reverse substitution of manual labour for machines.
- Machinery is the least labour-intensive infrastructure spend. Ironically, this is what has absorbed most infrastructure spending because most of the spending goes on imported turbines and boilers and so on. There may be some potential for greater localisation, but this spending does not really create many jobs.

This is the context in which we designed the EPWP, the main goal of which was to reverse-engineer greater labour-intensity into infrastructure projects in the full recognition that many of these projects can never be very labour intensive. We also wanted to avoid creating a separate, dedicated infrastructure programme because we knew that when infrastructure spending is separated from the ordinary business of government, departments tend not to budget for the staffing and maintenance costs that they will incur when they use the infrastructure. Besides, dedicated infrastructure programmes often end up duplicating projects. Finally, we thought it would be much more efficient to create jobs by leveraging existing infrastructure programmes aimed at dealing with our huge infrastructure backlogs and helping them become more labour intensive than creating what would be a very expensive stand-alone programme.

Ultimately, however, the results have been disappointing and the EPWP has been unable to effect a reverse substitution of labour for machinery. Instead,

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the programme has largely relabelled jobs in infrastructure projects as EPWP jobs for reporting purposes, and most of these jobs would have existed even without the EPWP.

There are many reasons for this disappointment. It is hard to implement a programme of this kind in a highly decentralised government system, especially when there are such large capacity weaknesses in relation to management of contracting. That many of these contracts also specify all kinds of other goals – small business development, training, BEE – makes it even harder to make sure job creation is prioritised.

So in conclusion, looking at infrastructure as a job creator particularly for manual unskilled labour through a Public Works type of a program or approach is attractive, but in reality, it has been very difficult to achieve results. Nevertheless, our infrastructure needs remain enormous, so the potential to get this right remains.

### **Business process outsourcing**

**Andy Searle**, *Interim Chief Executive Officer and Human Capital Portfolio, Business Process Enabling SA*

Growing jobs in mature sectors alone won't work; we need to look at the jobs of the future, too. Business process outsourcing is one of the jobs families where there is room for future growth.

The BPO sector is very people intensive, though the industry also depends on technology. That same technology makes it relatively easy to expand into global markets. We already have 210 000 people working in the sector, and the international market has grown from zero in 2004 to 40 000 today, and there is still potential for 100 000 more jobs. We have over 45 good international brands operating. Achieving this has taken 15 years of the government and industry working together.

According to the 2018 survey amongst buyers by Ryan Strategic Advisory, South Africa is the second most preferred location for offshore servicing, below the Philippines, a position we share with Malaysia. We are ahead of India for the kind of services it offers. India and the Philippines each employ in excess of 1.3 million people in their BPO/ICT Sectors.

South Africa's competitive advantages in this sector include:

- Good infrastructure and enabling environment
- Being an English-speaking country
- Being third least expensive country for operating costs balanced relative to quality of service



**“The success of the sector is owed to the industry collaborating in a non-competitive way.”**

- Good competencies and analytics
- Significant existing capacity and capacity to acquire core skills (math competency, empathy, understanding, emotional maturity, accountability, problem solving/critical thinking).

The success of the sector is owed to the industry collaborating in a non-competitive way to synergize, leverage resources and share information. It has been important for the industry to collaborate on the demand side, to strategize and create a single country value proposition that government and industry can use to communicate to the international market. That said, incentives played a big role in the sector's development. They started off as combined capex/opex incentives but these were later changed to an opex incentive after review. The second iteration of incentive is demand driven, with between R124 000 and R184 000 being paid to each employer per worker (depending on the sophistication of the job) over a five-year period on the basis of an annual drawdown if the job is sustained.

Although the industry has enjoyed support from government interventions on skills initiatives, we have failed to bring together a synchronized pathway from high school into the workplace for those who are moving into the sector. We could make better use of the private sector work readiness academies, TVET colleges, universities and other training providers to supply skilled people.

At formal inception of the BPO Sector in 2005, the aspiration was that the sector would create 100 000 jobs over five years, but everybody underestimated how difficult it would be to establish South Africa as a destination for offshore and outsourced services in such a competitive global market. However, over the past five years, the industry has seen compounded growth of 22 per cent. And, if South Africa continues on this growth path, the sector could expand to create 50 000 new direct jobs and 200 000 new work opportunities over the next three to five years.

## **Session 4: How much do stand-alone projects help?**

The final session reflected on the extent to which stand-alone projects help to create jobs and reduce unemployment in South Africa. Najwah Allie-Endries talked about the work of the Jobs Fund, managed by the National Treasury, and tasked with funding projects that might increase employment. Tashmia Ismail-Saville described what the Youth Employment Service (YES) plans to do, while Tumelo Chipfuba analysed the poor performance of special economic zones in South Africa.

## The Jobs Fund

**Najwah Allie-Endries**, *Head of the Jobs Fund, Government Technical Advisory Centre, National Treasury*

When the Jobs Fund and Harambee organised a recent event in Athlone, we were almost overwhelmed by the number of people who came. That is how desperate people are for work. So what must we do different to create more jobs?

One thing that I think is important is that we need more than just stand-alone, firm level projects; we need a much better investment climate: a real anti-corruption strategy is needed; some regulatory reform to facilitate more firms entering the economy, especially in relation to registration, access to finance, access to land, better contract enforcement and better-targeted incentives. We should also focus on raising productivity in priority sectors to get growth rates up. This means striking a balance between policies to increase labour intensity and policies to increase productivity. In both cases, though, we need the appropriate education and skills institutions, along with more on-the-job training and apprenticeship opportunities.

We need to think hard about the barriers – legal, cultural and economic – confronting women, and what we can do to reduce those.

So it is within an ecosystem of this kind that standalone projects will be most effective. This is not the current reality, however, and it is in a different ecosystem that the Jobs Fund operates. Within it, we have two mandates: to create jobs and to learn what works and what does not. This gives the Fund a framework for experimentation and innovation in trying to find sustainable solutions for job creation. Therefore, we are not like the EPWP, the ETI, or the YES. We are more experimental in nature and we try to share risk with the private sector, helping to crowd in other resources from outside government and facilitating partnerships. Basically, we use grant funding to de-risk investments, to demonstrate value of investing in SME development, and to provide opportunities for successful social impact investment.

All of this offers practical lessons for achieving jobs at scale, effective SMME development, successfully transitioning unemployed youth into employment, leveraging technology in the provision of services enter township economies.

Stand-alone programs can provide a useful safety net and the kind of experience that might offer new ways to tackle unemployment sustainably, but their impact would be greater if we had a more conducive, better-coordinated policy environment.

**“We need more than just stand-alone, firm level projects; we need a much better investment climate.”**

**“Our conception of a job, characterised by full-time work for a minimum of R3 500 a month, is stunting the number of jobs that can be created.”**

## **The Youth Employment Service**

**Tashmia Ismail-Saville**, *Chief Executive Officer, Youth Employment Services (YES)*

I have a different view. This is that stand-alone projects are not going to work because the impact of a project is very limited. That is why the Youth Employment Service (YES) has had to be quite pragmatic. The President set the target of 1 million jobs and the idea has been that money for the project has to come from BEE funding. The challenge has been that many companies do not invest in BEE anymore because it is an extremely complex and costly exercise. This has left a small pool of companies and has reduced the project's capacity to function as an incentive.

YES has had to look at how to best leverage money which was previously spent in a fragmented and siloed manner, so we are working hard to make sure that it is not a standalone project. Everything about YES is a platform business and the task is about how existing opportunities, like the BPO industry, can be amplified.

When thinking about which sectors have the potential to grow, it is important to see things in the light of modern technology. Six years ago, for example, the level of productivity for smallholder farmers Kenya has been ramped up by simple SMS technology. Today, even more is possible.

Together with the World Bank and Prof. Borat, YES is trying to think through where new jobs might be created and how the fourth industrial revolution is shaping the future of work. Many of the new jobs will be in consumer facing industries and were unimaginable ten years ago. We are also finding that our conception of a job, characterised by full-time work for a minimum of R3 500 a month, is stunting the number of jobs that can be created, even if this is the main aspiration of job-seekers.

Another division of the World Bank is doing value mapping with YES and it draws upon Ricardo Hausmann's work on economic complexity. This is to help our understanding regions' differing potential by mapping the existing businesses and looking at how new businesses can be created. How do we drive tourism and hospitality in Mpumalanga, for example?

When there is a value chain that can be identified and there is a range of corporate partners who are interested in investing in that value chain, a hub is developed. This brings together global pipelines, local buzz and best practice around how this industry has developed in other areas and lock it into what the local economy needs and what people need to be able to do that job.

## Special Economic Zones (SEZs)

**Tumelo Chipfupa**, *Director, Cova Advisory Services*

SEZs are defined geographical areas in which firms receive regulatory or other concessions of various different kinds, from free trade zones, export processing zones, free zones and single-factory zones, each of which is different in size and other characteristics. They are introduced for many different reasons: to support a reform strategy; to help exporters by offering them lower import tariffs; and to reduce unemployment. They have existed since the 16th century but took off in the 20th century: there were 79 SEZs in 1975, and by 2015, there may have been 4 500 of them – though this figure includes single-factory SEZs like those in Mauritius and Mexico.

Countries like China have used zones to introduce policies would have been too disruptive if introduced in the country as a whole, often as experiments and generally in places far from Beijing.

South Africa got its first industrial development zones in 2000. These were little more than industrial estates linked to air or seaports to facilitate exports, and no IDZ-specific incentives were offered. So the main benefits were locational and we tried to offer some reduction in red tape, especially in handling duties and taxes to speed up logistics.

By 2010, however, it became clear that the IDZs had attracted less investment than we had hoped. There were many reasons for this: issues of who owned and was responsible for funding the IDZs created many inefficiencies, for example. That is why the programme was reviewed and new legislation was introduced.

Part of the motivation for this was that we did not want only export processing activities in the zones. However, we also wanted to experiment with location and with funding structures and ownership and governance. We are also introducing specific incentives like a 15 per cent corporate income tax, accelerated depreciation, qualification for an expanded ETI that is not restricted to young workers alone, etc.

So the SEZs will not all be export focused, but they will help exploit the latent economic potential of the areas in which they are located.

One area we could be doing better is in attracting private sector involvement in the establishment and running of zones. We also need more skills in the zone authorities. Another area we need to improve in is how we deliver on the promise of reducing red tape. Coordinating across different departments with different mandates has been difficult, and it is difficult to establish a one-stop-shop that does not become a one-more-stop-shop.

**“The SEZs will not all be export focused, but will help exploit the latent economic potential of the areas in which they are located.”**

## Response

**Catherine MacLeod**, *Chief Director, Macroeconomic Policy, National Treasury*

What is the value of stand-alone projects? I think that, while it is correct to say that every project is too small to make a big difference, they're still important initiatives in a context of fiscal constraints and low levels of social trust. Sometimes they're the only way to get the space to try something new. However, if you really want to make an impact, it is really important that you are prepared to monitor and evaluate those projects, and to learn lessons that can be applied elsewhere. This is not something we are always good at in government, and I think the SEZs might have been designed differently, for example, if we had really tried to understand the experience of the IDZs.

It is also important not to overburden every project with all of our policy objectives. None of them can achieve everything, and if we insist on measuring them all against the full menu of objectives, none will ever succeed. So we have to be really clear about what the objectives of a project are, and how we will measure them. It is really important, for example, to agree about what will count as a job created by a project when we evaluate them.

## Reflections on the day

**Haroon Borat**

The first big point to make is that there is no silver bullet, no easy solutions to our challenges. It also means that everything must be in play; we can't just debate whether we think a minimum wage is a good idea or a bad one, and need to think about how the NMW might articulate with other policies and interventions, what the trade-offs might be, and how we could make different options work.

We also cannot be too particular about sectors: no one sector, whether its infrastructure or manufacturing or BPO is going to be sufficient. We need all of them to grow.

But we do need to be smart. We need to know how we tailor solutions to the micro constraints in each industry, but also how we end subsidies that are not working well enough. Fine-tuning our policies is not something we are good at. This ties in with another theme: that we must be willing to experiment, to try things out, and to dump things that don't work. This is not our mind-set, though.

We also need to be aware of the differential impact of policies. A BPO strategy might work in urban areas, but do nothing in rural areas. So, we need to be aware of what we are failing to do, even when we achieve some success.

We also need to be very careful not to overload policy instruments with too many separate goals. The NMW can't solve all our challenges of poverty and

**“There is no silver bullet, no easy solutions to our challenges.”**

**“Tinkering will  
only get us so  
far.”**

inequality, and we shouldn't expect it to; our industrial policies need to balance competitiveness and transformation goals. And not every intervention will create lots of jobs: some will deliver growth in industries that don't employ lots of people but which generate lots of value. That's okay: not every intervention needs to have the same set of goals.

Some other points:

- The academic literature on the fourth industrial revolution suggests that its impact on jobs is going to vary across sectors and activities. There might be more delivery and logistics jobs, for example, and fewer jobs in retailing. Clerical jobs and repetitive jobs in finance may be digitised, but call centre jobs might grow because they involve a degree of human interaction that machines can't duplicate. Robots won't come for everyone's job. But they might take over some tasks in every occupation.
- We need to remember the critical importance of manufacturing. It is very hard to see how an economy moves from middle-income to upper-income without developing the capabilities that you can get only in manufacturing. Rwanda, for example, thinks it can get ahead of the fourth industrial revolution and develop jobs in IT and telecoms. But it can't get milk from one side of the country to the other because it has never developed the capabilities that industrial manufacturing creates. Manufacturing is the heartbeat of a thriving economy.
- Finally, we need to remember that, "It's the political-economy, stupid." What I mean is that tinkering will only get us so far because there is a great deal of path-dependency in how our economy and society develop. So, if our politics is dominated by a party that relies heavily on an increasingly urban group of organised workers who are increasingly concentrated in the public sector, then that will shape what happens. Our economy is also characterised by what the World Bank has called "a rambunctious struggle for rents" between big business, labour and government. For as long as that is the case, it will also set constraints on how it evolves because so many stakeholders are excluded.

### **Discussion**

A key issue that emerged in the discussion was the extent to which it might be said that efforts to promote employment through support for the BPO sector and through the EPWP had been successful. In relation to the latter, some speakers felt that the revelation that the EPWP had done little to increase employment in public infrastructure projects was deeply disappointing, though it was emphasised that the jobs were real, even if they would have been created even in the absence of the EPWP. Some speakers, however, expressed some doubt that that conclusion could be correct, because, in the absence of the

**“Significant growth could be achieved by fostering the productivity gains attendant on expanding infrastructure.”**

EPWP, municipalities would not have been able to afford at least some of the employment created in their infrastructural activities.

In relation to the BPO sector, a number of speakers argued that, at 40 000 jobs, the export sector of the BPO industry had not achieved the level of success that its advocates in business and government had hoped for, especially given the fact that India and Indonesia had created millions of BPO jobs. This was generally agreed, though it was also emphasised that both government and industry had underestimated how difficult it would be to break into the global value chain, but that, having done so, there was room for considerable growth.

A different kind of issue related to understanding the cost of jobs, the creation of which is subsidised by government. One participant reported an understanding that the average subsidy for a job created by the Jobs Fund was R500 000, but this was contested by others. More generally, the point was made that policy can create costly distortions, such as when SEZs are located in places that are not otherwise well suited for job creation.

It was suggested by one speaker that an under-acknowledged constraint on growth in South Africa is the scarcity of entrepreneurial skill and, in particular, the scarcity of skills needed to manage labour-intensive activities. This was why so many clothing firms were run by Chinese owners, and might also be a reason why it is difficult to increase the labour-intensity of public works activities.

One speaker noted that it is not just exports that stimulate growth. Citing Robert Gordon's work on productivity growth in the 19th and 20th centuries, he noted that the most rapid gains in output in the US were in the 19th and early 20th century and were driven by the rollout of public infrastructure – water and sanitation, roads, electricity. In a country in which there are vast deficits in this infrastructure, that suggests significant growth could be achieved by fostering the productivity gains attendant on expanding infrastructure.



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