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# Labour market reform is needed
## for inclusive growth

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### Introduction

South Africa's unemployment problem is largely structural, in the sense that it is being driven by the decline of historically important employment sectors such as agriculture and mining. It is, however, being exacerbated by the country's labour and industrial policies. These are biased against labour-intensive industries and make labour-intensive growth impossible to achieve, while making the economy increasingly skill- and capital-intensive. This has led to higher labour productivity (along with higher average wages), but at the cost of a much weaker relationship between the growth of the economy and the creation of jobs. Job creation projects can help ameliorate this, but if we are to generate large numbers of new jobs, we have to confront the growth path itself.

Structural drivers of unemployment can be tough to address (and deliver benefits only in the medium term), but policy-related causes of declining labour-intensity can be addressed much more quickly, and can lead to much quicker responses. Attention should, therefore, focus on South Africa's industrial policies, which are unnecessarily biased in favour of larger, more capital-intensive projects and industries, and on South Africa's minimum wage setting machinery, which unnecessarily retards if not prevents entirely the expansion of lower-wage, labour-intensive enterprises.

South Africa's extremely high unemployment rate means that inclusive development is impossible without more labour-intensive growth. When nearly two adults in five is unemployed the expansion of jobs, even at relatively low wages, reduces poverty and inequality. This is all the more urgent when large proportions of the adult population have not completed secondary schooling and are unlikely to be absorbed in skill-intensive activities. We need, therefore, for labour-intensive firms to create jobs as quickly as possible. This requires a more supportive industrial policy, a more flexible minimum wage regime, and a targeted effort to attract foreign investment by

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firms and people with experience in labour-intensive activities. Export promotion is also essential because the small size of the domestic market means that substantial job creation would require competing in the larger international market.

It is impossible to say with any certainty what the impact of a more flexible minimum-wage-setting regime and more supportive industrial policy would mean for growth of labour-intensive sectors. What we do know is that the current strategy is not working and has worsened social and economic marginalisation.

## Bad policy based on bad assumptions

South Africa's development strategy rests on the erroneous assumption that encouraging the growth of labour-intensive firms that pay relatively low wages necessarily threatens higher-wage, higher productivity firms and hence creates a danger of spurring a 'race to the bottom' that will trap the country in a 'low road' to growth. This is erroneous because firms paying different wages can coexist in the same industry by using different technologies and targeting different product markets. It is possible, for example, to expand the production of work overalls in lower-wage, labour-intensive clothing factories without undermining jobs in relatively high-wage firms producing more expensive and sophisticated fashion items. Setting minimum wages at a level that only the sophisticated firm can afford, however, rules out the expansion of more labour-intensive employment elsewhere – and does so without providing meaningful protection to workers in high-end firms.

South Africa's development strategy also rests on what has been revealed to be the false hope that an increasingly skill- and capital-intensive economy can facilitate such rapid economic growth that employment would expand quickly enough to reduce unemployment. In fact, the economy has grown by an average of less than 3 per cent a year since 1994, resulting in the marginalisation of growing numbers of unemployed people. It is time for South Africa to change direction. This means learning from the experience of countries that have industrialised on the basis of labour-intensive manufacturing (e.g. Hong Kong, China, India, Mauritius) and inviting foreign investment from these countries to help South Africa develop the capacity to produce and export labour-intensive products such as clothing and light manufacturing.

The extent to which jobs might be created this way is unknowable, but with supportive industrial policies (including to attract foreign investors with suitable experience) and appropriate wages, there is significant potential for sustained job creation. By producing for the export market, China expanded the number of clothing jobs from 3.5 million in the mid-1990s to 5.5 million in the mid-2000s. Bangladesh increased the number of clothing jobs from 1 million in the mid-1990s to over 4 million today by taking advantage of the fact that, as wages rose in mainland China in the mid-2000s, Chinese manufacturers began looking for other places from which to operate. Clothing jobs are still leaving China and countries like Ethiopia and Madagascar are taking advantage of this. South Africa should start competing for these jobs too.

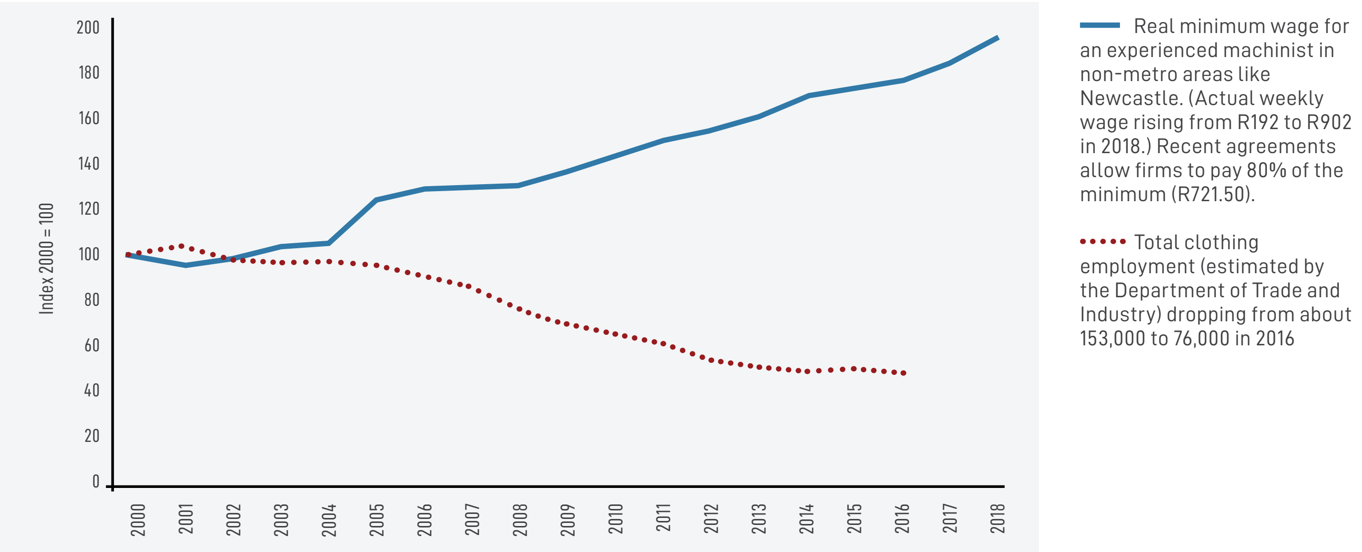
It would obviously be helpful, in this regard, if South Africa had preferential access to big export markets. South Africa already benefits from the African Growth and Opportunities Act (AGOA) which provides duty free access to the United States. But to grow exports South Africa would ideally also need duty free access to European Union (EU) markets. Policy-makers should consider a co-ordinated submission (along with Namibia, Botswana and Swaziland) to the EU for inclusion in the 'Everything But Arms' programme that is aimed at low-income countries. South Africa, Namibia and Botswana are unique amongst middle income countries for their exceptionally high unemployment rates and an argument could be mounted to facilitate access to EU markets as part of a labour-intensive development effort to provide jobs to the unemployed poor.

## Wages and employment

The international evidence on the relationship between changes in minimum wages and employment shows that the direct, short-term effects of changes in wages are typically small. However, some important qualifications are in order. One is that most countries set minimum wages at modest levels and adjust them by modest amounts. Another is that labour-market reforms are not typically implemented when the economy is performing badly, which means that most estimates of the negative effect of labour market reforms on employment are biased downwards. These circumstances do not apply in South Africa, where rising wages do seem to correlate with falling employment, at least in the clothing sector (see Figure 1), and where the implementation of the national minimum wage will increase wages in some firms by over 20 per cent.

or R900 per week for a 45 hour week) already makes exemptions for agriculture and domestic work – and allows an exception for the government's Expanded Public Works Programme (EPWP) of R11 an hour. This exemption could become the effective minimum wage floor across the economy – with subsequent adjustments being made to it by the Employment Conditions Commission after due consideration of any potential employment effects.

**Figure 1: Minimum wages and employment in the clothing sector: 2000-2018**




Source: Authors' calculations

Wages matter for employment. In post-apartheid South Africa, rapidly rising minimum wages in clothing (and in agriculture) have demonstrably destroyed jobs and the new NMW effectively rules out any significant labour-intensive growth. For example, it is higher than the current dispensation that allows clothing firms in non-metro areas to pay 80 per cent of the bargained minimum if they are otherwise compliant with the collective agreement.

The experience of countries like Mauritius and Ethiopia, both of whom were able to grow clothing employment quickly by encouraging Asian manufacturers to set up factories there, suggests that with appropriate wage rates and investment climate, a dramatic increase in labour-intensive growth is possible. To achieve this in South Africa, some adaptations are necessary to the minimum wage setting regime. The new National Minimum Wage (of R20 an hour –

Labour-intensive industries like the clothing industry should rather have the same minimum wage floor as the government's EPWP. It makes little if any sense to allow an exemption for the government's employment creation program without exempting private sector efforts to generate jobs suitable for relatively unskilled people on a large scale.

Bargaining Councils can continue to set minimum wages above this floor, but these should not be automatically extended to non-parties, which tend to be smaller, less capital-intensive firms that cannot afford the wages paid at the larger firms that dominate decision-making at the bargaining council. The Labour Relations Act should be amended (along the lines proposed by the Labour Market Commission in 1996) to require that the Minister of Labour consider potentially adverse employment consequences for labour-intensive firms before extending collective agreements to non-parties. Alternatively, industrial development zones (or an export processing zone) should be created outside of the scope of bargaining councils so that labour-intensive firms could locate there.

### Supporting the expansion of labour-intensive sectors

South Africa needs a change in development strategy. There are no simple solutions to development, but where wages are appropriate and an effort is made to attract investors from countries with experience in labour-intensive development, significant job creation has resulted. Newcastle (in the KwaZulu-Natal midlands) is a case in point.

In the early 1980s, the municipality sent representatives to Taiwan (and subsequently Hong Kong and mainland China) to encourage entrepreneurs to relocate to Newcastle, efforts that were supported by industrial policy incentives. Ten years later, Newcastle had about 1 000 Chinese residents and 54 large Chinese-owned factories providing thousands of jobs. The industry contracted in the 1990s and 2000s in response to trade liberalisation, currency volatility and rising minimum wages. However, a tough back-bone of Chinese-owned labour-intensive firms continue to compete successfully against imports from low-wage countries, but only by paying below the bargained minimum wages. Rather than harassing these firms, the minimum wage setting machinery should explicitly allow lower wages in these labour-intensive firms. Industrial policy should support them to compete against imports and grow into export markets – something that some firms in Newcastle were able to do at one point in their history.

The key challenge such a proposal faces is political: organised labour is opposed to greater wage flexibility and is suspicious of development approaches based on labour-intensive growth (seeing this as encouraging sweatshops and a supposed 'race to the bottom'). This is both an ideological preference and a self-interested position (because trade unions in South Africa represent relatively well-paid workers, mostly in non-traded sectors and have no direct interest in expanding low-wage jobs).

A commission of inquiry might be set up to investigate how best to promote labour-intensive development (either through amending wage-setting machinery at a national level or restricting downward flexibility to special economic zones). It is essential to include the voice of the unemployed who are marginalised from bargaining councils, NEDLAC and political structures. In addition, it is at least conceivable that, properly informed, communities might be mobilised to help overcome unions' opposition, especially communities in areas that would benefit from the expansion of labour-intensive sectors.

Municipalities in poor areas that stand to benefit from the expansion of labour-intensive sectors (possibly through the creation of special economic zones) are another important constituency. Industrial policy support for the creation of economic zones could include the construction of houses, schools, clinics, transport – all of which would improve the standard of living of workers in lower-wage labour intensive jobs. It would improve the local infrastructure and rates base. Municipal officials and provincial level politicians should be part of the discussion.

Another important constituency is employers from labour-intensive firms and sectors, especially those with experience in labour-intensive exports. Engaging with potential foreign investors is important as it is essential that we understand what services and support they need to enable them to compete internationally if minimum wages were set at EPWP levels.

### Conclusion

Greater minimum wage flexibility is not a necessary or sufficient solution to South Africa's growth crisis. It is essential that it be achieved, however, if the South African economy is to have any chance of becoming significantly more labour-intensive.

Our key recommendation is to provide additional exemptions from the NMW (of R3,500 a month) and to set an effective wage floor at the level of the EPWP. This is more than twice as high in dollar terms as clothing wages in Ethiopia, but, given higher levels of productivity in South Africa and our superior infrastructure, and with appropriate industrial policy support, South Africa could generate significant employment growth through exports and by competing with imports.

This is not an argument against minimum wages in general or against health and safety regulations – all are important. Rather, it is an argument that we need to set minimum wages at different levels for different sectors and to allow wages that are appropriate for the expansion of labour-intensive sectors. Additional support could also be provided for the growing numbers of worker-owned co-operatives in the clothing industry to ensure that workers are properly empowered.

Given inadequate welfare support for the unemployed, the expansion of lower-wage, labour-intensive sectors will have a significant impact in terms of reducing poverty and inequality. Where the expansion of labour-intensive sectors is linked to special economic zones, non-wage benefits could potentially include better housing, schooling and access to clinics. There is no reason why a special economic zone could not be set up in the Eastern Cape (taking advantage of the spare capacity in Coega) to provide lower-wage, labour-intensive sectors to unemployed people in the area (many of whom have experience working in the clothing industry) – and to provide additional schools, houses and clinics for the employed workforce.

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