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The Employment Problem in South Africa

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1. South Africa's Employment Problem

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 labor 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%. This is a serious matter, and is indeed the reason that this forum is being held today.

But as high as these numbers are, they capture only part of the problem. What South Africa has is an employment problem. It includes the unemployed but goes well beyond that to encompass 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. Unemployment is just the tip of the proverbial iceberg.

How large is South Africa's employment problem? Borat 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 labor 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 labor 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 South Africa do? In the balance of this address, I shall deal with a number of issues:

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

2. 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 labor market, this has two implications: other things equal, (1) higher wages lower employment and (2) lower wages raise employment. Not a pretty choice, 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 something else – perhaps how much labor is required to support a unit of capital. Those who hold this view say that you should just go for wage increases. Don't worry – employment won't 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 wouldn't hire any more workers from the target group than before. Rather, they would hire those who aren't 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 for any of this. What I have seen are several studies that have been done estimating wage elasticities of demand for labor. 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 you think that the problem is one of unemployment alone, then the implication of these employment elasticity estimates is clear: you can get more jobs by holding down real wages. But when you

conceive of the problem as an employment problem, you are 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 labor 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.

I would note too that 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 labor, to which we now turn.

3. Mitigating the Harsh Tradeoff: Increasing the Derived Demand for Labor in a Globalized 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 labor 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.

Much of the labor market research I have done has been on East Asia. 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 GDP grew at about a 7% annual rate for decades.

Successfully penetrating world markets was a major contributing factor. No wonder that 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 labor 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 labor with which they had begun came to be employed at virtually constant wage levels. But then, the labor surplus was exhausted and the labor 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.

What happened next? Let me share with you a personal experience with great relevance for contemporary South Africa. When I first went to East Asia in the early 1980s, I presented the then-current figures for the Asian Tigers on full employment, improved job mix, rapid real wage growth, low inequality, and falling poverty rates during the epoch of rapid export-led growth. The argument I made then (and make now) is that the trade and industrialization strategies they had followed had been good for workers and should be continued. One commentator reacted as follows: "That's all well and good for the past," he said, "but that won't work now. We live in a highly globalized world. We can't possibly succeed by exporting in the future. Today's world economy is too competitive for that." Well, 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 the 1980's and again in the 1990's, so too did real wages, and full employment was maintained except for crisis years at the end of the 1990's. (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.) My Korean friend and I now laugh at how wrong he was then.

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 labor. There is only so far you can go with metals, alloys, and precious stones.

The new niches need not be new products – can anybody think of a new product that was invented in Japan 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 this: the rest of the world doesn't need South Africa's working people, but South Africa's working people do need the rest of the world. Ask yourselves a question. 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 labor that anyone would want, plus a fair amount of skilled labor 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-maximizing enterprises must *want* to employ South Africa's labor. 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 labor practices. The labor 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, labor 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 labor 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, labor, 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 characterize South Africa.

Before concluding this address, I shall briefly mention two other aspects of South Africa's employment problem that deserve attention.

4. Confronting Structural Unemployment and Underemployment

Clearly the South African labor 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's how you can tell what kind of unemployment problem you have. 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 one is whether to focus on upgrading the skills of the currently unemployed and underemployed or, alternatively, emphasizing 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.

Permit me to offer another word of caution. 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 recognizing 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

5. Getting the Right Labor Market Model

A quite different need for South Africa is an analytical one. There does not yet seem to be a labor market model for South that properly incorporates the main stylized facts. Clearly, the right model is not the competitive labor market model – wages are not set by supply and demand. Nor is it an integrated labor market model – there is much too much labor 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 doesn't fully fit either because of South Africa's large volume of open unemployment. Thus, an

overall vision of how the South African labor 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 labor market model, coupled with policy experimentation, led to the conclusion that the solution to urban unemployment there is rural development – hardly an obvious conclusion. Absent similar in-depth analysis, the danger is that an intervention appropriate in one labor market context will make things worse in this one. For the poor and the unemployed in South Africa, that would be a great tragedy indeed.

6. Conclusions

So what are the main messages? I would leave you with five major challenges:

First, recognize 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 your 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, recognize that national policies to deal with the employment problem cannot be rationalized and designed well until choices are made about whom to try most to help. You need to decide whether the priority is to pursue higher wages for those employed or to seek fuller employment.

Third, recognize that you can't do it yourselves and that you need 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. If you want to make progress on the employment problem, your labor 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, recognize that in addition to deficient aggregate demand for labor, you also have a structural unemployment problem. Many if not most of the target workers do not possess the skills demanded by employers. You will have to seek efficient ways of marshalling the limited resources at your disposal to educate the young and train the others. It would be helpful to pose the question of opportunity cost – if we do this, what can we *not* do? – and prioritize your energies and your budgets accordingly.

Finally, we should all recognize that one barrier to formulating policies to combat the employment problem in South Africa is the lack of a guiding labor market model. The papers to be presented at this conference over the next three days promise to add information and understanding to the formulation of such a model. Pulling these insights together and developing an overarching framework for labor market analysis in South Africa 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 your choices. Best of luck in confronting them.