

Second Economy Strategy: Addressing Inequality and Economic Marginalisation

A Strategic Framework
January 2009



1. What is the Second Economy Strategy Project?

The AsgiSA Annual Report presented in February 2007 identified a need for more focus on ‘the second economy’, and on mechanisms to ensure shared growth reaches the margins of the economy. It was in this context that the Second Economy Strategy Project was initiated; it reports to the AsgiSA High Level Task Team in the Presidency but is located outside government, in TIPS - a research NGO.

Phase 1 was to review the performance of existing government programmes targeting the second economy; this process was completed in early 2008; the outcomes are available at www.tips.org.za. The aim of Phase 2 was to develop an expanded strategy for the second economy, building on existing programmes where possible and innovating where necessary.

Research and policy proposals from the process were presented to a ‘Work in Progress’ workshop in May 2008 and to a conference entitled ‘Second Economy Strategy: Addressing Inequality and Economic Marginalisation’, held from 29 September – 1 October 2008. A framework and a set of ‘headline strategies’ resulting from these processes are presented here. These have been presented *inter alia* to the AsgiSA High Level Task Team, PCAS, the Economic and Social Clusters and FOSAD, before the framework was approved at the Cabinet *legotla* in January 2009.

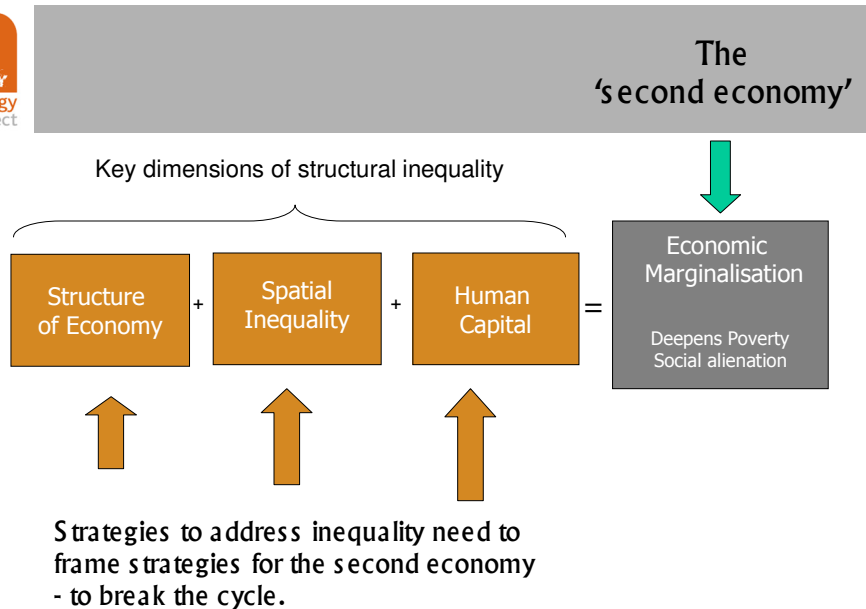
2. What is the ‘second economy’?

South Africa has a highly unequal economy in which people with access to wealth experience SA as a developed modern economy, while the poorest still struggle to access even the most basic services. The differences in conditions between the two are so stark they appear to be worlds apart – giving the notion of ‘two economies’ resonance. Yet these realities are in fact connected and interdependent in a range of complex ways, with certain common processes producing or reinforcing these extremes in access and opportunity. Analysing these processes has been a long-standing source of debate in SA – this debate necessarily also informs the development of a strategy for the second economy.

The approach taken in the second economy strategy process has been to use the terms ‘first’ and ‘second’ economy to describe the conditions at the two different ends of this spectrum: with wealth and resources concentrated at one end – and poverty and disadvantage at the other; with a strong focus on how certain key legacies of apartheid make this inequality deeply structural – in particular:

- The centralised, monopoly structure of SA’s core economy - including the labour market legacies of pass laws, as well as the highly skewed distribution of assets such as land and capital;
- The spatial legacy of bantustans and apartheid cities;
- The legacies of deep inequality in the development of human capital.

Despite the many changes in South African society since 1994, these forms of structural inequality continue to hamper the best efforts of development policy, reinforcing old forms of economic marginalisation at the same time as facilitating new ones. The concept of the ‘second economy’ is used to describe this economic marginalisation, and the poverty and social alienation that characterise it – in order to focus policy attention on the need to change it.



3. The Purpose of a 'second economy strategy'

A strategy for the second economy is intended to contribute to the following goals:

- Employment creation – widely recognized as South Africa's single biggest priority for addressing poverty, inequality and economic marginalisation.
- Improving the terms on which people participate in the economy – whether they are working for themselves or someone else – so that such participation lifts them out of poverty.
- Increasing poor people's ability to gain and secure assets;
- Ensuring basic needs are accessible and affordable;
- Improving the distribution of returns from economic activity more equitably across the society.

The strategy targets people who are willing and able to earn a living, but are either unemployed, or earn too little from economic activity to exit from poverty. This includes discouraged work-seekers, the working poor, many in the informal sector as well as subsistence or poor farmers. This comes to about 11.6 million people, almost all of whom are black; with women and youth most affected, particularly in rural areas – especially in former bantustan areas.

The second economy strategy is focused on the economic dimensions of the anti-poverty strategy; and is aligned with its key proposals and targets. Social policy and basic service delivery issues were excluded from the TOR's of the strategy process, but their crucial contribution to the livelihoods of poor people is recognised throughout.

4. Outcomes of the Review of Existing Second Economy Programmes

The Review of existing government programmes targeting the second economy was completed in January 2008 and is available at www.tips.org.za. Certain cross-cutting issues are highlighted here because of their implications for future strategies and programme design:

4.1. Challenges of achieving impacts at scale:

Most national programmes explicitly targeting the second economy are not designed to impact at the scale required to make a difference at a societal level – many have targets of below 50,000 people, with few actually reaching this level.

Instead, such programmes often focus on implementation at a project level, targeting a limited number of direct beneficiaries and leaving systems and structures unchanged. They are also often very management-intensive for government or its agents, limiting their scope to achieve the scale required.

Achieving impacts at scale cannot therefore rely simply on scaling-up existing approaches, but has to look at how to design and deliver programmes differently - in ways that achieve a more systemic, societal-level impact.

4.2. Weak impacts on market outcomes

Many second economy programmes are designed to achieve impacts that are measured as market-based outcomes - by creating more jobs, better jobs, more micro-enterprises or better returns to entrepreneurs, for example.

While government plays a crucial role in shaping markets, its ability to impact on market outcomes is nevertheless largely indirect – far more indirect, for example, than in relation to public goods or the social programmes, where the delivery of social grants or classrooms is primarily a function of government's own budget processes and delivery capacity.

The Review highlighted that so far, government has not had great success where outcomes depend on a market response, particularly in marginal economic contexts. This was attributed to two main factors:

- Insufficient account taken of the limits imposed by the structure of the economy and other forms of structural inequality (see below);
- Lack of clarity on how best to identify and wield the diverse instruments available to the state to achieve the market outcomes intended. Programmes that aim to impact on market outcomes too often miss the mark; they sometimes even cause unintended negative consequences that deepen market failures rather than supporting the kind of market development or market change processes intended.

4.3. Unwieldy budget and governance structures

The Review also highlighted that many second economy programmes have to secure budgets from within other existing allocations, and most require co-ordination between departments as well as between spheres of government – all notoriously difficult to achieve.

4.4. Lack of voice and advocacy from below

Finally, the lack of organisation or advocacy able to represent the interests of marginalised constituencies constrains government's effectiveness in targeting their needs.

5. Second Economy Strategy: Addressing Inequality and Economic Marginalisation

The Second Economy Strategy Project commissioned a range of research and engaged with practitioners and policy makers inside and outside government. The strategic framework proposed is based on the following core arguments arising from this process:

5.1. While the main target is to end poverty, inequality matters as an issue for the following key reasons:

- In South Africa, structural inequality plays a key role in sustaining diverse forms of economic marginalisation and limits the potential for growth and employment creation;
- Evidence suggests that highly unequal societies tend to grow more slowly, and that the effects of such growth tend not to be pro-poor (World Development Report 2006). Addressing inequality is therefore a necessary part of a strategy to achieve shared growth.
- In SA, the levels of growth required to impact significantly on poverty within current patterns of distribution are probably unattainable; shifts in the patterns of distribution are therefore a necessary part of an anti-poverty strategy.
- High levels of inequality can cause social conflict. This is undesirable on its own terms, but it has economic as well as social costs also.

5.2. The structure of the SA economy constrains employment creation in the core economy as well as in more marginal contexts:

In the core economy: The South African economy is highly centralised, capital intensive and dominated by a set of monopoly industries. Capital intensive industries tend to exclude SME participation and make employment creation expensive. While the focus of policy has been to try to address this within the core economy, through the introduction of effective competition policy, for example, such policies should also be seen as part of second economy strategy - because of the ways in which the structure of the economy also impacts on the scope for enterprise development and employment creation in more marginal contexts.

On the margins: In many developing countries, the informal sector provides easy access to livelihood opportunities for those unable to find formal employment. SA's relatively small micro-enterprise sector is often attributed to factors such as lack of skills, entrepreneurship or access to credit. Important as these are, this tends to overlook the way the structure of the economy constrains the scope for growth in this sector, for the following reasons:

- The scope for small manufacturing enterprises targeting poor consumers is small because most manufactured consumer goods bought by poor people are already mass-produced in the core economy and are available even in remote areas.
- Access to opportunities beyond the local economy, in higher volume and/or higher-value markets tends to require greater levels of formality. While this is where the

most scope for SME development and job creation exists, there are higher barriers to entry in these markets.

- While there is some scope in relation to fresh produce and services, these also tend to be relatively small in scale unless they're part of more formal value chains.
- The scope for small artisan-based enterprises is limited by the skills challenge and the high demand for such skills in the formal sector.
- As a result, SA's informal and/or micro-enterprise sector is unusually dominated by retail activity, often in a dependent relationship to the core economy. There are limits to the scope for this sector to expand, or for street traders or spazas to climb a 'ladder' into more formal enterprise: that space is taken, with 'big retail' also increasingly encroaching into markets currently served by this sector.

5.3. The small farming sector and subsistence agriculture perform a very limited employment and/or safety net function in South Africa

In many developing countries, such as India, China and Tanzania, the small farming sector is a dynamic part of food production and of rural local economies, and subsistence agriculture provides a form of safety net when employment opportunities fail. In SA, this role is severely constrained.

The coercive processes that forced black South Africans off the land and the men into labour markets in the early part of the last century destroyed the small-farming sector and led to the 'de-agrarianisation' of former Bantustan areas.

These processes stand in contrast to the active policies of support to white farmers over the same period. There have been decades of investment - including substantial subsidies - into the development of a 'big farm' model and the institutions required to support it: including access to land, water, inputs, credit, business services, infrastructure, and market access - as well as opportunities to share in the development of an increasingly vertically-integrated agro-processing sector.

In the former bantustans, however, these processes were mirrored by their opposites: those attempting to engage in agricultural production on increasingly small plots of land were not supported by the development of any of the institutions required to make a small-farm model viable. These two agricultural development paths still co-exist in an uneasy relationship, further complicated by different tenure arrangements - posing a challenge for the development of a unified agricultural strategy - and limiting the capacity of this sector to provide a safety-net function.

5.4. The former bantustans face a chronic development deficit

This skewed investment in agriculture was matched by the skewed investment in human capital, economic infrastructure, and access to basic services within the bantustans. This was coupled with coercive and patronage-based governance structures, including customary systems in which women's economic initiative was constrained - even though men were often absent. The former bantustans still have far to go to remedy these defects: they are also still home to the poorest people in SA, and the poorest women in particular.

5.5. Poor people are unusually dependent on wages and/or grants in SA; these in turn depend heavily on the performance of the core urban economy

The constraints on the micro-enterprise sector described above, coupled with the limited role played by smallholder or subsistence agriculture mean that poor people in SA are unusually dependent on wage income and/or grant income, relative to other developing economies. Both of these depend heavily on the performance of the core economy. Effective implementation of strategies to address the 'binding constraints' that limit economic dynamism at this level - the AsgiSA agenda – remains vital. In addition, the fact that this 'core economy' is mainly an urban economy also has implications for strategy.

5.6. Urban inefficiencies constrain growth and place a cost burden on workers and the poor

The high level of dependence on the core urban economy casts the spotlight onto the capacity of urban areas to support employment creation, access and opportunities at the scale required. But urban areas face a set of problems of their own.

Urban infrastructure is locked into the inefficient patterns created by apartheid - compounded since then by implementation choices and land market logics that continue to house poor people far away from economic opportunities, in poorly-planned, low-density housing settlements that have high service-costs, lack social-service infrastructure and do not facilitate local economic activity. For example, the decision to supply only two-phase electricity for lighting in many housing developments constrains the use of fridges, freezers, welding or other equipment used by home-based enterprise, in a context in which in Gauteng, for example, 69% of SME's are home-based (Finscope Small Business Survey Report, 2006).

These new housing developments have not, however, managed to keep up with the influx to urban areas, where ongoing growth in informal settlements and backyard shacks provide the most visible manifestation of the 'second economy' in urban areas – and where the lack of basic services and tenure security further constrains the scope for local economic dynamism.

5.7. Reliance on the wage mechanism to cover what are in fact wider social and economic costs raises the costs of labour and disincentivises labour-intensity.

Many of the social and economic costs of poor urban planning as described above are carried directly and indirectly by the poor, and impact on the costs of labour – through the high cost of transport, for example.

In addition, in the absence of forms of social protection targeting the unemployed (apart from those eligible - for a limited period – to UIF), households with unemployed members rely to a large extent on the wage income of those who are employed; as well as on the contribution of social grants actually intended to target other needs. This in turn dilutes the impact of these grants on the needs they are intended to address - such as child support.

This level of reliance on the wage mechanism to cover wider social and economic costs - rather than using the social wage to do so – strengthens wage pressures and impacts on labour costs and the costs of production in general – strengthening existing biases against labour-intensive production.

5.8. High costs of living and high dependency ratios mean low-wage jobs do not lift people out of poverty.

These factors also mean that low-wage employment currently has limited impacts on poverty. While growth since 2004 has become increasingly labour-absorptive, most new jobs have been in the retail and construction sectors: poorly paid and highly insecure. Casualisation and externalization have affected labour standards in other sectors also. These workers as well as many who are self-employed form part of the 'working poor' with income earned insufficient to lift them or their households out of poverty.

5.9. Youth, women and rural dwellers carry the highest burden of unemployment

While unemployment is a structural problem, additional factors skew its distribution, with unemployment levels for black youth, women and rural dwellers disproportionately high. A combination of factors influences this: poor work-search information systems, lack of access to employment networks, the poor correlation of certification with competencies, and the high costs of work search. All of these factors are compounded for work-seekers from rural areas.

6. A Strategic Framework for Second Economy Strategy

The analysis above has a range of implications which inform the framework for second economy strategy, outlined below:

6.1. A wider focus on inequality is needed and should be taken forward as a more formal part of AsgiSA's focus on shared growth.

While this agenda should address each of the key areas of structural inequality identified, two clear cross-cutting priorities can be highlighted, based on international experience and our own:

- **Human capital development:** Within the wider framework of existing policy in this area, particular attention needs to be given to the 'points of no return' – childhood nutrition and early childhood development. Where these fail, policies are forced to focus on mitigation for another generation.
- **The social wage:** of all existing policies, it is the contribution to the social wage – including grants and access to basic services - that has had the greatest impacts on poverty and inequality. Strategies need to build on this strength, with a focus on gaps in coverage, such as access to basic services in rural areas and informal settlements, and access to affordable public transport.

6.2. Employment creation on decent terms is the single biggest priority for addressing poverty, economic marginalisation and inequality.

Employment policy needs to be an over-riding policy priority, at the heart of all economic policy, with particular attention paid to the ways in which the current structure of the economy constrains these outcomes.

6.3. Employment creation ‘from below’ – through micro-enterprise or self employment - faces significant constraints and is a poverty trap for many.

- The structure of the economy constrains the scope for significant or sustainable expansion in this sector – but the scope that does exist must be supported.
- Evidence shows that those least likely to get a job are unfortunately also least likely to succeed in becoming self-employed;
- Employment strategy cannot therefore rely on the poorest and most economically-marginalised people in the economy ‘self-employing’ their way out of poverty.

6.4. Increasing the contribution from micro-enterprise and self-employment requires ‘patient support’ and improved conditions:

- Support to this sector needs to be designed within a more realistic set of expectations of its scope for growth. This means more focus on the ‘patient support’ required to turn ‘start-ups’ into ‘stay-ups’, and more caution in promoting self-employment as a solution for all.
- This needs to go hand in hand with providing greater recognition and legitimacy to the sector, to improve conditions and returns in these often marginal economic activities. For street traders (the largest sub-component of the sector) this includes clear ‘rules of the game’ to reduce their risks and vulnerability to abuse; access to storage and ablution facilities, as well as services such as electricity supply where feasible; and support to forms of co-operation and organisation to reduce their costs and increase their ‘voice’.
- The current skills development framework does not enable access by this sector, and relies on supply-driven approaches that are often inappropriate. This needs to be addressed in the skills strategy.
- New technology creates opportunities to fast-track increased access to financial services for the sector: including savings products, cash transfers, access to micro-credit, and to incremental housing finance to enable home-based enterprise activity. In a sector financed mainly by family and friends, tax credits for ‘angel finance’ (currently under design) need special adaptation to ensure access by more marginal enterprises.

6.5. New work, decent work is likely to come mainly from growth in the more developed, formal, core economy: including the more formal end of the SME sector;

- The employment focus in industrial policy needs to address issues of market access and the spread of power and benefits in value chains, to enable greater SME participation and employment creation.
- This means transformation cannot focus on changes in ownership alone, but needs to address issues of power and distribution in value chains also;
- Achieving this also requires stronger advocacy capacity and ‘voice’ from small producers and new entrants within sectors.
- In certain contexts (eg agro-processing) access to wider markets may require co-ordination and co-operation between small producers in order to create economies of scale, or to reach the necessary volume and quality requirements. This creates opportunities for forms of business association and co-operative development.
- There is often a wide gulf in expectations between small producers who are currently excluded from wider markets, and the practices and expectations in existing value chains. Intermediary entities are often needed to bridge the gap or facilitate access.

Such intermediation can take a range of forms, but needs to be supported as a critical part of strategies for the sector.

6.6. New market-based employment is likely to be largely urban, where ‘urban’ includes small towns and dense settlements.

This requires the following:

- Efficient and inclusive cities and towns;
- Alignment of social, economic, infrastructure and land use planning to increase efficiency, ‘crowd in’ economic opportunities and promote dynamism; including within residential neighbourhoods.
- Upgrading and transforming informal settlements is vital to social and economic inclusion in urban areas;
- The release of well-located land and planned development to ensure access to services is necessary to ‘get ahead’ of the ongoing influx into urban areas and facilitate such entry.

6.7. Creating rural employment will require a stronger catalytic role from the state to achieve results, as part of a wider strategy for rural development and agrarian reform.

- Strategies to develop a smallholder sector and strengthen subsistence agriculture face many challenges and start off a low base: but their potential impact on poverty and on rural employment makes this investment - and the associated risk - imperative.
 - Success in this area requires a strong focus on institutional support that creates economies of scale, and access to business services and markets.
 - Redistributive land reform needs to promote greater access for smallholders, and opportunities for successful black farmers to expand beyond former bantustans, where they have not yet managed to do so;
 - Increases in the use of arable land in former bantustan areas will be assisted by support to rental markets for land while longer-term tenure issues are resolved;
 - A new generation of water harvesting and irrigation support is needed.
 - Incentivise co-ordination, co-operation and facilitation of access to value chains and markets eg through commodity associations and other forms of economic co-operation;
- Employment in the existing commercial agricultural sector also matters. Land claims that affect whole value chains – including jobs across the chain - need to be urgently resolved, and advantage taken of the scope to take transformation of ownership and access beyond land alone in this process.
- Human capital development and the provision of basic services in rural areas need to form a key part of a rural employment strategy.
- In a context of increasing constraints on natural resources, these take on new value. This in turn introduces potentially significant new opportunities for rural employment, from the implementation of payment systems for environmental services. This wide heading includes strategies related to water, waste, energy and the scope to earn carbon credits from action in these areas; realizing this potential depends strongly on government playing a catalytic role – or the role of a developmental state.
- All of the above link to and can support increased household food production and smallholder activity. The critical constraints facing such integrated approaches are institutional.

- The health of rural economies depends on the dynamism of the small towns that service them; these linkages need stronger focus.

6.8. The significant expansion of public employment is required, with an ‘employment safety net’ – providing a minimum level of secure employment – to target the most marginalised.

All of the above contributions to employment strategy will take time to impact. Meanwhile, there is a need to address a key social protection gap in SA – working age people who are willing and able to work, but unable to find opportunities to do so.

While employment solutions are clearly the priority, there is a need to provide a form of employment safety net until such solutions are able to deliver: to strengthen people’s capacity to work, and to provide access not only to income, but also to work experience and the enhanced dignity and social inclusion that comes with it.

Public employment is an area of significant and continued innovation in SA, as reflected in the design of EPWP 2 - which is fully supported. To achieve the impacts required, however, it will have to scale up even further than currently projected. Within that process, it is proposed that the concept of a minimum employment guarantee be adapted to South Africa, to target the most marginalised, in ways that ensure that those least able to find other forms of employment have access to a minimum level of regular work, building on the approach demonstrated in the Community Work Programme – an approach enabled as part of EPWP Phase 2.

This approach uses public employment as a catalyst for community development. ‘Useful work’ is prioritised at the local level, through structures such as ward committees and local development fora. This helps energise such structures, and deepens the mechanisms for local participation in setting development priorities.

6.9. Prioritise approaches that target the most marginalised directly.

Many of the actions required by government are intended to achieve market-based outcomes, and will achieve these in ways that take time and are indirect. Crucial as it is to do this and to get it right, the outcomes of these processes will tend to reach the most marginalised last. For this reason, strategies that target the most marginalised first need to be prioritised in a second economy strategy. These need to be designed to impact at scale, to build on government’s strengths, and to facilitate economic participation for those affected.

The argument is therefore for a ‘first level’ of intervention that aims to strengthen the incomes and assets of poor people in ways that do not depend on markets to achieve their intended impacts (although they will certainly have market effects).

While it will take time to overcome the structural factors, there is no time to lose in building people’s sense of economic agency – of their capacity to change their material conditions through their own actions, to be productive members of their household, their community and their society. This requires that we find ways to facilitate their economic participation and scope to impact on their economic conditions even where markets do not do so.

It is in this context that the following programmes are motivated:

1. The significant expansion of public employment, including the adaptation of the concept of a minimum employment guarantee, as motivated above;
2. Investment in the transformation of informal settlements into sustainable, serviced neighborhoods (where safe and practically feasible); adapt current funding mechanisms to unlock greater scale and scope for self-build options;
3. A focus on reducing hunger through incentives for home-based food production, integrated where possible to programmes targeting basic services in off-grid areas: water harvesting, energy, sanitation and waste management.

These strategies do not depend on markets to deliver the outcomes, but they will have market effects – and should be designed to do so:

- They have the potential to stimulate local demand and scope for local enterprise activity: ie help to ‘thicken’ local markets;
- They engage people in economic activity that builds assets and/or incomes, access to services, networks and social capital;
- They need to be designed to strengthen rather than undermine local market development, to help enable the next level of strategies required - and that do entail a greater level of participation in markets.

6.10. And last but not least - there’s just no alternative but to address the challenge of restructuring the economy as a whole – and not just ‘fixing’ the second economy.

7. Translation into Headline Strategies and Programmes:

The challenge is to translate this framework into a limited number of headline strategies and programmes, rather than providing a long 'to-do list' for government. These are the proposed headline areas: programme development is at different stages, working in partnership with departments to take design and implementation processes into the next stage in 2009.

7.1. An agenda to address structural inequality

Develop an agenda to address the key areas of structural inequality as identified, as part of AsgiSA.

7.2. A social compact to place employment at the heart of economic policy:

- a. In sector strategies, focus on employment, market access, and the spread of power and benefits in value chains.
- b. Promote forms of intermediation to facilitate access by those enterprises that have the potential to enter into wider value chains and markets;
- c. Provide the 'patient support' required to turn start-ups into 'stay-ups';
- d. Develop strategies for rural employment (see further below).
- e. Improve job placement and labour market information systems, with a focus on labour market entry for youth.

7.3. Strengthen livelihoods and improve conditions for the working poor – employed or self-employed;

- a. For micro-enterprise, address conditions that would make the most impact on reducing poverty, with a special focus on street traders;
- b. Adapt the skills development framework to reach the sector more effectively;
- c. Improve access to a spectrum of financial services;
- d. Strengthen access to decent working conditions, rights at work and social protection for the most vulnerable workers.

7.4. Address the development deficit in rural areas:

As part of a wider rural development strategy, prioritise support to rural employment and livelihoods:

- a. Develop a smallholder support strategy, with a focus on subsistence agriculture.
- b. Prioritise land-claims affecting whole value chains in ways that give priority to job retention and expanded employment, as part of a wider focus on these goals in the agriculture sector;
- c. Implement payment systems for environmental services; create the institutions necessary to convert environmental and climate-change challenges into opportunities for development.
- d. Use human capital development and the delivery of basic services as part of rural employment strategy;
- e. Develop the service capacity of small towns.

7.5. Build efficient and inclusive cities and towns

- Secure, service and release land close to economic opportunities for poor people to live in cities and towns.
- Make sure that in any planned housing developments, social, economic and recreational services and spaces are integrated
- Prioritise affordable public transport.
- Plan for continued urbanisation.

7.6. Target the most marginalised directly:

- a. Massively expand public employment, including the introduction of a form of minimum employment guarantee;
 - b. Upgrade informal settlements and release serviced land;
 - c. Incentivise household food production in both rural and urban areas to reduce hunger.
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