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Is South Africa's High-Productivity Growth Strategy Appropriate in a Labour-Surplus Economy?

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No one would disagree that economic growth in South Africa needs to be more labour-demanding. But what is the best way of achieving that end? On the face of it, the problem is simple: job creation depends crucially on investment growth, hence appropriate strategies are those which encourage capital accumulation and ensure that as many jobs as possible are created per unit of investment. But this apparently focussed answer raises two further fundamental questions: what drives the aggregate level of investment?; and what kind of investment is best suited to sustainable, labour-demanding growth?

Part 1 below considers some of the macroeconomic determinants of investment, and asks whether South Africa's macroeconomic growth strategy is 'investor-friendly'. Although the jury is still out, it seems that the architects of the government's Growth, Employment and Redistribution (GEAR) framework under-estimated the negative impact of constraining demand on private investment. But the determinants of growth extend beyond the macroeconomic policy stance and into the arena of the growth path itself. Part 2 considers the question of what broader growth strategies are good for growth. In doing so, it considers the key 'lessons' from international experience, namely that openness, education and low inequality are all good for growth. It also touches on the relative importance of state intervention (via industrial policy) and the market to growth. The South African experience is referred to where relevant.

Part 3 considers the narrower question as to what kind of investment is appropriate for a labour-demanding growth path. Is it better to go for maximising the number of jobs created now – in which case labour-intensive investment is preferable – or is there an argument in favour of capital- and skill-intensive investment as a catalyst for more dynamic and labour-demanding growth later? 'High productivity now' (HPN) strategies (which appear to inform South Africa's industrial and labour policies) opt for the latter. 'Hard HPN' strategies seek to discourage (or even eliminate) low-wage, low-productivity activities, whereas 'soft HPN' strategies seek merely to encourage greater productivity growth. It is argued that South Africa's industrial policy stance is consistent with soft HPN, but that labour market policy towards wage-setting is more in line with hard HPN thinking.

1. Investment and the Macroeconomic Environment

The question as to what drives investment is one of the most vexed in economics. Answers range from Keynes's 'animal spirits', to more specific determinants such as savings, the interest rate, and current and expected profit rates etc. Given that the search for profit underpins private investment, all of the above probably have a role to play: higher expected returns attract higher investment; and the lower the cost of borrowing (and higher the level of savings), the greater the range of profitable investment projects. But these variables only capture part of the picture. The range of profitable investment projects is also a function of the available infrastructure, the existence of support services and the supply of available inputs, market size etc. In other words, less easy-to-measure factors such as the level and pattern of development, and the nature of government support, are also important.

But the problem of trying to capture to determinants of investment ultimately flounders on the rock of investor expectations of the future. As Keynes pointed out long ago, the assumption of perfect information (so beloved of rational expectations theorists) has little purchase in the real world:

> "For Keynes, most of the things which go wrong – and right – in decentralised market economies stem from the central fact that human beings take decisions in ignorance of the future. Ignorance enters into all the motives for forward-looking action, investing them, at the limit, with the character of dreams and nightmares" (Skidelsky, 1992: 539).

In his review of empirical literature on the determinants of investment, Chirinko found that the most significant determinant was (lagged) demand: investment rose when economic growth was strong, and fell when it weakened (1993: 1883). This suggests that investors feel more confident about future streams of income when expenditure is rising, and hence are more prepared to make investments. But there is a clear limit on this relationship: if the rise in demand is so strong that it undermines macroeconomic balance (i.e. results in inflation and a depreciation of the exchange rate) then profitability may be threatened. The history of macroeconomic populism in Latin America shows very clearly that destabilising increases in demand undermine rather than induce investment. The message is thus that a stable, but growing, economy is probably the most suited to attracting high and sustained levels of investment.

In this regard, one of the lessons of the Asian growth path is that inflationary financing of budget deficits should be avoided. The eight highly performing Asian economies (HPAEs), namely Japan, Hong Kong, South Korea, Singapore, Taiwan, Indonesia, Malaysia and Thailand, chose either to keep budget deficits small (e.g. South Korea), or in the case of Malaysia and Thailand (which ran large deficits), took advantage of high domestic savings and the rapid increase in demand for financial assets which accompanied growth (Page 1997: 25). As a result, inflation was lower, and real interest rates far more stable, than in Latin America. Such an environment was ultimately more conducive to investment (Birdsall and Jaspersen, 1997).

Differences in savings may be one of the reasons for cross-country differences in investment. Whereas the HPAEs were able to mobilise a huge pool of domestic savings to finance investment, the Latin American countries (and South Africa) were characterised by relatively low rates of saving and investment (Jaspersen, 1997). However, as savings and investment tend to follow growth (Gavin *et al*, 1997), these savings and investment rates are probably more a result, than a cause, of differences in growth performance. One of the benefits, however, of a large pool of domestic savings was that the HPAEs were able to avoid the serious debt crises which beset most of Latin

America, were less prone to destabilising capital flight, and were better able to weather the external shocks of the early 1980s.

Is South Africa's macroeconomic policy stance conducive to investment? Yes and No. The GEAR strategy of reducing the fiscal deficit (and avoiding any inflationary financing thereof) ought to support investment in the sense that greater stability is being injected into the macroeconomic environment. But to the extent that this restrictive fiscal stance withdraws demand from the economy, investment demand is dampened accordingly. Thus, depending on which effect one imagines is more important, one can conclude that GEAR is either good or bad for investment.

In deriving their predictions for future trends, the architects of GEAR (RSA, 1996) assumed that investors would respond quickly and well to the lower deficit (and to the government's commitment to continued deficit reduction). The assumption was that the positive impact of increased investor confidence on investment would outweigh the negative impact of tighter fiscal policy on demand – and hence investment. In other words, they assumed that investors were more anxious about the prospect of macroeconomic instability brought about by an over-rapid increase in demand, than they were about sluggish spending and poor sales. Despite international experience indicating that most countries which cut their deficits experienced slower growth for at least two years as a result (McDermott and Wescott, 1996), the GEAR model accordingly predicted a mild slowdown and quick recovery (see Table 1).

Table 1. GEAR vs. Reality

Annual Growth Rates	*Predicted Results of GEAR*			
	1996	1997	1998	1999
Real GDP	3,5	2,9	3,8	4,9
Real Bank Rate	7	5	4	3
Private Investment	9,3	9,1	9,3	13,9
Employment (non-agricultural)	1,3	3,0	2,7	3,5
Inflation	8,4	10,9	9,6	7,7
Real Wage Growth (Private)	-0,5	1,0	1,0	1,0
Change in Real Effective Exchange Rate	-8,5	-0,3	0,0	0,0
Conventional Deficit/GDP	-5,1	-4,0	-3,5	-3,0
	Actual Performance			
Real GDP	4,2	2,5	0,6	1,2
Real Bank Rate*	8,8	7,4	8,1	7,3
Private Investment	6,1	4,7	-2,9	-4,4
Employment (non-agricultural)	-0,7	-1,7	-3,7	-3,2
Inflation (CPI)	7,4	8,6	6,9	5,2
Real Wage Growth (Private)	1,7	2,3	8,6	3,0
Change in (average) Real Effective Exchange Rate	-6,3	6,4	-9,2	–

Conventional deficit/GDP (31 December)	-4,9	-4,6	-3,3	-2,6

Source: SARB Quarterly Bulletin, March 2000. *This is equal to the bank rate – CPI for 1996-1998, and the repo rate – CPI for 1999

Has it worked? On the 'positive' side, the fiscal deficit target was reached, and inflation fell to lower levels than predicted. However, the drop in the deficit was not accompanied by lower interest rates – indeed, the real bank rate rose sharply – and private investment has remained sluggish. As can be seen in Table 1, South Africa's investment, output and employment growth was way below target during the 1990s. This is consistent with the warnings of economists across the ideological spectrum that GEAR would reduce demand, and that private investment would follow demand downwards, rather than compensating for it.[1] It is also consistent with evidence that aggressively anti-inflationary components of stabilisation packages have undermined, rather than supported, growth (Stiglitz 1998: 7-9). The GEAR modellers were almost certainly unrealistic in their assumption that business confidence would rise (drawing investment up with it) once the GEAR policies had been announced to the business community.

But not all of South Africa's poor growth performance can be laid at the door of GEAR. From early 1998, the economy suffered from the contagion effects of the Asian crisis that affected growth in ways that could not reasonably have been predicted. However, even as early as 1996 and 1997, differences emerged between the GEAR projections and actual economic trends. Furthermore, it appears that South Africa's growth performance was significantly worse than that of other middle-income countries, and worse than that which would have been predicted solely on the basis of changing world market conditions (Weeks, 1999: 804-808). This implies that the GEAR strategy exercised a major, and independently negative impact on growth and investment.

Another reason why the GEAR targets were not met may have been because the GEAR strategy was not implemented consistently, particularly with regard to labour-market policy. In sharp contrast to the labour-market vision outlined in GEAR, the government passed various pieces of legislation that increased the costs of employing labour[2] and extended minimum wage floors. Promised reforms to existing labour laws – such as amendments to the mandatory extension of collectively bargained agreements to non-parties – did not materialise.[3]

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[1] See e.g. Gibson and van Seventer, 1995; Nattrass, 1996; NIEP, 1996; Standing *et al*, 1996: 33; NLC, 1996, Samson, 1997.

[2] The Basic Conditions of Employment Act provided for longer annual and family leave (thus increasing the indirect cost of employing labour) and reduced hours of work (thus increasing hourly fixed costs). The over-time premium was also increased, with the result that over-time labour is now paid over two and a half times that of workers in comparable middle-income countries (Barker, 1999: 19).

[3] Both the Ministry of Finance's GEAR strategy (RSA, 1996) and the Ministry of Labour's Employment Strategy Framework (RSA, 1998: 44) recommend that amendments be made to the extension of collectively bargained wage agreements to non-parties. Soon after the Labour Market Commission

According to evidence from the OECD (1999: 156-9), countries that have undergone macroeconomic stabilisation without addressing labour market rigidity have found the experience costly in terms of unemployment. South Africa is unlikely to be an exception. As can be seen in Table 1, instead of generating jobs, GEAR has presided over significant job losses. Although much of the decrease in employment in mining and agriculture cannot be blamed directly on GEAR, it is nevertheless feasible that co-ordination failures between fiscal, monetary and labour-market policy could be exacerbating unemployment (Nattrass, 1998). And, even with regard to short-term poverty-relief employment programmes, the government appears not to be able to deliver on the jobs front. Although great plans were trumpeted about short-term job creation for the unemployed in public works programmes and the like (e.g. RSA, 1998), the government (with the exception of the Department of Water Affairs) has had little success in deploying what little funds were actually allocated for such purposes.[4]

The macroeconomic policy stance is only one aspect of the growth path. Given that growth itself drives investment, it is thus necessary to consider the broader question of the growth path in order to gain a fuller picture of what drives investment. This is the task of Part 2 which looks at the international experience of successful growth.

2. The Determinants of Growth: Lessons from International Experience?

The international literature on economic growth is vast and varied. If there is a broad consensus on the 'lessons' of successful economic growth it is probably this: openness, education and low inequality is good for growth. The relative importance of state versus the market in development remains a subject of great debate. This part of the paper briefly reviews each of these issues.

2.1. Openness and Growth

(LMC, 1996) presented its report, the Minister of Labour announced that changes to the mandatory extension provision were immanent – yet nothing came of it. The State President made a similar announcement in early 2000, but this too appears to have been empty.

[4] South Africa's new democratic institutions have been plagued with capacity problems which have undermined various development and poverty alleviation initiatives (Nattrass and Seekings 1998). The Welfare Department and the Department of Public Works appear to be particularly incapable of spending money on job creation and poverty alleviation programmes (see "Now Public Works Betrays the Poor" ,in *Sunday Independent*, 11 June 2000).

Perhaps the most oft-cited 'lesson' from international experience is that openness (or at least producing for the export market) is good for growth.[5] Openness appears to improve efficiency (through increased competition), boost productivity growth (Edwards, 1998) and provide a market for rapidly expanding output. Most notably, the HPAEs were able to expand output and employment dramatically (particularly in the manufacturing sector) through producing for the rapidly expanding external market. Between 1965 and 1990, *per capita* GDP averaged 5,6 percent p.a. in the HPAEs, whereas *per capita* incomes grew by a mere 1,2 percent p.a. in the major (inwardly-oriented) Latin American economies over the same period (Birdsall and Jaspersen, 1997).

In the 1960s and 1970s, the HPAEs dominated the low-wage, labour-intensive end of international trade. As manufacturing exports expanded rapidly, labour was increasing drawn out of lower-value added sectors and into manufacturing. Over time, the manufacturing sector itself started moving into higher value-added product lines – a process aided by targeted industrial policies (Weiss, 1998) and the fact that most workers had a basic education (Wood, 1994). Wage flexibility appears to have kept unemployment low and steady, and a more rapid rise in productivity than wages (up until at least the mid-1980s) helped fuel investment and growth (World Bank, 1993). Strong growth in output and employment ensured that wages and living standards rose. Growth, to an important extent, was thus shared growth.

South Africa followed the Latin American route, becoming one of the first developing countries to opt for inward-industrialisation (McCarthy, 1998: 66). And, having out-performed most similar developing countries during the first part of the twentieth century, the South African economy, like its Latin American counterparts, ran out of steam in the 1970s and 1980s. Whereas other countries benefited tremendously from the ideal external economic conditions of 1950-73, South Africa's 'post-war leap' was the 'lowest on record' (Moll, 1993: 5). Like Latin America, South Africa started removing protective barriers in the 1980s. This process was given further impetus through renewed trade liberalisation in the 1990s (see over-views in Edwards 2000 and Fedderke *et al*, 2000). Current trade policy is strongly committed to increased openness (RSA, 1996), and in this regard, South Africa's growth strategy is in line with the prevailing international opinion on what constitutes sound policy.

But has increased openness in the 1980s and 1990s brought with it the same benefits enjoyed by the HPAEs two decades earlier? It would seem not. By the time that South Africa and Latin America started liberalising their trade regimes, low-wage countries like Bangladesh, Indonesia, Pakistan and China, had moved into the lower-value added end of the international market.[6] There are now

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[5] Some 'revisionist' economists have used cross-country growth regressions to question the assumed link between openness and growth (e.g. Rodriguez and Rodrik (1999). However, such methodology has been questioned by others, who argue that case studies are more meaningful and that they show a clear correlation between openness and growth (Srinivasan and Bhagwati, 1999).

[6] Between 1987 and 1993, developed country imports from low-income countries rose nearly four times to comprise nearly one-third of all manufactured imports from developing countries (Wood 1997: 48-9).

established and strong competitors at all levels of the value-chain. To compete in any sector or niche-market means ensuring that the ratio of costs to productivity is better than the international standard. With regard to low-wage, labour-intensive production, the option is often only one of constraining wage increases (because wages account for a substantial part of costs). Alternatively, competitiveness can be forged through changes in work-place organisation, improving relations between firms, and changes in technology. The cost, however, is a shift away from labour-intensive production, and rising demand for skilled labour, and falling demand for unskilled labour.

There is evidence that trade with low-wage developing countries has reduced the demand for relatively less-skilled labour in high- and middle-income countries (Wood 1994, 1995, 1997; OECD, 1997). Although there is still controversy regarding how much of the decline in demand can be placed at the door of international trade, there is widespread agreement that trade with low-wage countries is at least one contributing factor. As Wood observes, "the debate is now over the *magnitude* of the effects, with their *direction* – adverse to unskilled workers – being largely agreed" (1997: 33).

This has unfortunate implications for growth in middle-income countries. In contrast to the East-Asian growth path followed two decades earlier, increased openness and trade liberalisation in Latin America appears to have been accompanied by slower employment growth and widening inequality (Morley 1995). Latin America, with its relatively developed industrial structure, found itself entering global markets with intermediate ratios of skilled to unskilled labour (Wood, 1997) and unable to compete in low-wage labour-intensive product lines. This problem, as manifested by a general decline in the demand for unskilled labour, appears also to have been experienced by other middle-income countries (Dirwan and Walton, 1997).

Similar trends are evident in South Africa. Manufacturing exports have grown, but mostly in capital- and skill-intensive product lines (Bell and Cattaneo 1997: 6-7, ILO, 1999: 14-6; Edwards, 2000), and increased import-penetration has had a significantly negative effect on employment in ultra-labour-intensive sectors. According to Edwards (2000: 6), import penetration reduced employment by 9,1 percent in ultra-labour intensive industries, and by 2,4 percent overall between 1993 and 1997. However, once the positive impact of export expansion on employment (in export and related industries) is taken into account, Edwards estimates that the net impact of international trade on employment was to raise employment by 1 percent over the period (2000: 13). Fedderke *et al* (2000) also found that the net measurable impact of trade was to increase employment rather than reduce it.

These results are in line with most decomposition analyses in the international literature which estimate the impact of international trade on employment to be small relative to that of technology (see overview in OECD 1997: 112-119). However, one's choice of model[7] and decomposition

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[7] The theoretical model underpinning empirical explorations of the impact of trade on domestic labour markets fundamentally influences the results. In terms of a Stolper-Samuelson model, unskilled employment will fall in the ACCs if the relative price of unskilled labour-intensive products fall (as a

technique profoundly influences the results. Measuring the impact of technology is particularly difficult, and often relegated in an unsatisfactory manner to the unexplained residual in a regression equation. Furthermore, the effects of trade and technology may be inter-related, and hence it is almost impossible to untangle their relative impacts. If firms undergo what Wood calls 'defensive innovation' in the face of international competition, then the impact of globalisation on employment will be substantially greater than that indicated by the decomposition analyses. In recognition of this problem, Edwards checked to see if there was a statistically significant relationship between trade and technology, and found there was. This suggests that the impact of trade on employment was greater than suggested by the conventional decomposition methodologies (Edwards, 2000: 15-6). As Edwards points out, his regression result 'lends support to Wood's (1994) contention that increased import competition forces firms to restructure through the shedding of labour in order to remain competitive. However this relationship is suggestive and requires more detailed interrogation using firm level data" (2000: 15). The ILO has also made the connection between trade and technological by attributing employment losses to "a process of rationalisation or downsizing which might occur as a reaction to increased international competition" (1999:21).

The contraction in ultra-labour-intensive sectors and increase in skill-intensive exports suggests that the forces Wood hypothesised were acting on Latin America are probably making their presence felt in South Africa. There is evidence that South Africa is moving towards more (intermediate) skill-intensive product lines, with technological change in manufacturing resulting in an increased demand for skilled labour (Standing 1997). The demand for skilled workers (particularly in the information technology sector) has been rising, and the general shift towards capital-intensity has further increased the demand for skilled workers, and reduced the demand for unskilled workers (Bhorat and Hodge, 1999). This does not bode well for the prospects of expanding low-wage employment for currently unskilled unemployed people – at least not in the short-term.

In sum, it thus appears that openness is probably still a useful component of any growth strategy. However, for middle-income countries like South Africa, there is a great deal of competition in all product lines. The dramatic export-driven path of structural adjustment achieved by the HPAEs is unlikely to be replicable in the near future.

2.2. State versus Market

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result of increased trade with developing countries). The fact that the relative price of such goods has fallen only slightly (Sachs and Shatz, 1994), has thus been interpreted as indicating that international trade has had a relatively small impact on the demand for less-skilled labour (e.g. Deardoff and Hakura, 1994: 80). However, if one adopts a Shumpeterian model where trade is driven by differences in knowledge between countries (Dinopoulos and Segerstrom, 1999), then trade liberalisation can account not only for the observed rise in wage inequality, but also for intra-industry skill upgrading and accelerating technological change.

Except for Hong Kong (and to a lesser extent Singapore), the state played a highly interventionist role in the HPAEs with regard to the direction of investment and industrial policy. The developmental states of East Asia mobilised resources (in Korea's case by nationalising the financial sector), acted entrepreneurially where necessary (in Taiwan's case through state-owned enterprises) and otherwise coerced and disciplined capital (see e.g. White 1988). Indeed, the coexistence of rapid economic growth, selective protection and targeted support of key industries in South Korea, Japan and Taiwan lead some analysts to conclude that industrial policies were central to the growth of total factor productivity and technological catch-up (e.g. Amsden 1989; Wade 1990, Weiss, 1998).

A corollary of this argument is that efficient bureaucracies and performance-related support measures enabled East Asian industrial policies to avoid the pitfalls of rent-seeking, corruption etc. that characterised Latin American support of industry with tariff barriers. Any policy of strategic intervention is risky in the sense that state officials have to make educated guesses about which industries or firms will turn out to be winners. Tying support to clear performance criteria – most notably measurable trends such as export performance – and being willing to drop support in cases of clear failure – helps limit the potential for wasting resources. According to Evans (1995), the success of interventionist states like Japan lay in the fact that they were both 'embedded', in the sense that information flowed easily and well between bureaucrats and firms, and 'autonomous', in that they were able to withstand pressure from firms to maintain support where it was not efficient to do so. This helped facilitate the development of specific state capacities geared around industrial policy (Weiss, 1998).

Other analyses (e.g. World Bank 1993; Page 1997), however, play down the role of strategic intervention and attribute the success of the HPAEs to the business environment common to all of them, i.e. stable macroeconomic policies, stable and competitive exchange rates and high savings rates. Page, for example, points out that productivity growth in Korea and Taiwan was high by international standards, but not higher in sectors targeted for special attention by such industrial policies (1997: 46-7). He thus concludes that export-orientation – rather than industrial policy – was the main reason behind productivity growth (1997: 48). However, aggregate industrial statistics can easily hide the impact of industrial policy targeted at firm (rather than industry) level, so to an important extent, this debate remains moot.

The debate over state intervention and market signals recently resurfaced again as a result of the 1998 Asian crisis which started in Thailand and reverberated across the globe. The IMF adjustment packages for Thailand, South Korea and Japan (which placed strong emphasis on liberalisation and deregulation) implicitly blamed government intervention in large part for the crisis. Others, however, attributed the crisis to the financial deregulation which occurred in East Asia during the 1990s, and predict that IMF policies are pushing Asian economies in precisely the wrong direction (see e.g. Chang 1998, Stiglitz 1998). The debate about the role of state and market in East Asia is clearly far from over.

The history of government intervention in industry in South Africa is not an edifying one. Although massive government investments in electricity (ESCOM) and steel (ISCOR) arguably helped create a basis for the expansion of the manufacturing sector, the focus on mega projects and armaments production tended to inject a strong bias towards capital-intensity in industry (Kaplinsky, 1995). So too did restrictions on the employment of African labour in metropolitan areas, subsidies to producers, accelerated depreciation allowances, negative real interest rates and racial discrimination in skills acquisition.

In addition, the state wasted vast sums of money in attracting industry to the 'border' areas of homelands and to low-wage 'decentralised' areas (Haines, 1996). Incentives of 100% of the wage bill were offered along with transport and rent subsidies. While labour-intensive forms of production were indeed attracted to poor areas, many of the industries (particularly in clothing) were decentralising anyway because of wage pressure in metropolitan areas (Bell, 1997). Many of these firms stayed on after the withdrawal of incentives (Sharp and Spiegel, 1996) and are now being threatened by the minimum wage determinations – from which they had previously been exempt (Nattrass, 2000).

During the 1990s, the decentralisation strategy was restructured and simplified and now consists of a tax holiday scheme, spatial development initiatives and industrial development zones (DTI, 1998: 23-36). The idea is to create industrial dusters in key areas in order to promote agglomeration economies, co-operative relations between firms, and backward and forward linkages. It is too early to tell if this approach will in fact deliver dynamic, labour-demanding growth. So far, the investment costs have been very high in relation to the number of jobs created. The spatial development initiative (which the DTI regards as "one of its most successful programmes" has so far created 10 000 jobs at an investment cost of R17 billion and a further 400 programmes are in the pipeline promising to create 68 00 jobs at a cost of R83 billion (DTI, 1998: 28). At between R1,2 million and R1,7 million a job, this is a very capital intensive outcome! Industrial policy likewise nods in the direction of supporting labour-intensive sectors, but in practice has failed to do so. Even the tax holiday scheme, which was aimed in part at encouraging labour-intensive manufacturing, has succeeded only in creating jobs at a cost of R237 000 each (DTI, 1998: 26). The record relating to the Industrial Development Zones is similarly uninspiring. Rather than initiate large-scale job creation, the DTI has succeeded mainly in attracting large capital-intensive mega projects (ILO, 1999: 25) – which is not surprising given that existing labour regulations and standards are enforced in these areas.

2.3. Education and Growth

As emphasised by the new "endogenous growth" theory, higher levels of accumulation of both physical and human capital are vital contributing factors to *per capita* income growth as it is the interaction between ideas and accumulation which results in increasing returns to scale of physical and human capital (Romer 1986). This literature suggests that if human to physical capital ratios are initially high, then a country's subsequent economic performance will be characterised by faster investment and *per capita* income growth. Empirical work by Barro (1991) – which shows that for a given quantity of initial human capital, a poor country tends to grow faster than a rich country, so that incomes converge over the period among countries with similar levels of education – supports this hypothesis. According to Barro (1991), growth in Korea and Japan was raised by as much as 1,5 percent per year due to their above-average initial levels of schooling. This analysis is suggestive of the costs, in terms of the waste of human potential and lost growth, of apartheid education and training policies on South African development. It also supports the emphasis that South Africa is placing on improving education and skills development.

An increase in the supply of educated labour is only beneficial for growth if it is matched by a similar increase in demand. The growth pay-off in East Asia of human capital accumulation appears to have greater because the development path was more demanding of workers with basic education:

> "In East Asia, the stimulus that human capital has given to economic growth appears to have been augmented by the economies' export orientation and the resulting labour- and skill-demanding growth paths they followed. Latin American countries, following a more inward-looking, capital-intensive growth path, failed to benefit from this positive interaction between human capital and the demand for skilled labour" (Birdsall *et al* 1997: 103-4).

In other words, there appears to have been important feed-back effects between growth, investment, education, export-orientation and job creation. Increasing education on its own, is not a sufficient condition for growth, and rapid growth is required to finance education and to boost the creation of both skilled and relatively unskilled jobs. The provision of health and educational services is a necessary condition for the creation of a 'virtuous cycle' between human development and growth (Ramirez, Ranis and Stewart (1997). But it is not a sufficient condition.

2.4. Inequality and Growth

With economic development, the share of wage employment in total employment rises, and hence wage inequality accounts for an increasing share of overall inequality (Knight and Sabot 1991). Wage differentials thus have an increasingly important impact on overall inequality. According to Wood, the major factor behind narrowing wage differentials in the HPAEs was the increase in the demand for workers with basic education relative to unskilled and skilled labour (1994: Chapter 6). The adoption of more outward-oriented policies increased the demand for workers with only a basic general education relative to the demand for workers with more education and skills. Subsequent expansion of higher education further compressed wage differentials (see also Fields 1994).

Birdsall *et al* argue that lower income inequality itself boosted growth in East Asia (1997: 108-112). They suggest, *inter alia*, that the higher the absolute incomes of the poor, the greater will be their opportunity to save and invest in human capital. When income-earning opportunities are expanding rapidly at the same time as poor people are given better access to education, the behaviour of poor households is likely to change in ways which foster greater investment in human capital and entrepreneurial activity. Furthermore, a society in which the benefits of growth are shared, is less likely to suffer political upheaval and macroeconomic populism. High inequality creates pressure for exchange rate overvaluation and public spending on favoured groups (such as university education for the children of elites – as happened in Latin America) at the cost of more sensible strategies (such as the expansion of basic education for all). Other benefits of a more equal income distribution include the development of vibrant internal markets, and if equity is fostered by rising agricultural incomes, a smaller gap between urban and rural incomes. Using Barro-style growth equations, Birdsall *et al* find that:

> "If, in 1960, Korea had had Brazil's level of inequality, Korea's predicted growth rate over the following 25 years would have been reduced by 0,66 percentage points each year, implying that, after 25 years, *per capita* GDP in Korea would have been 15 percent lower" (1997: 116).

Will promoting exports be good for equality? Although there is a negative correlation between outward-orientation and inequality in the HPAEs, it does not follow that trade liberalisation will have egalitarian consequences in other developing countries. Countries with low ratios of human to natural resources are unlikely to achieve significant increases in manufactured exports, and employment and output may well contract (Wood 1995: 25). Furthermore, even in countries where manufactured exports increase, inequality will not necessarily decline. Greater demand for relatively unskilled but literate workers narrows the wage gap between them and skilled workers, but widens the wage gap between literate and illiterate workers. The overall impact on inequality thus depends on the relative demand for and shares of skilled, less-skilled but literate, and illiterate workers.

In South Africa's case, two forces appear to be acting on the wage distribution. On the one hand, the demand for skilled labour is putting upward pressure on the top end of the wage distribution. On the other hand, trade union pressure appears to be favouring lower paid workers (Schultz and Mbawu, 1998), thus contributing to a narrowing of wage inequality. But wage inequality is not the only factor driving inequality in South Africa. The gap between employed and unemployed households is also a significant driving factor (Leibbrandt *et al*, 2000; Seekings, 2000). To the extent that higher unskilled wages restrains job creation, a narrower wage distribution may be associated with higher overall inequality.

In general, improving the productivity of the poor through education and training should help reduce inequality, as it allows them to participate more fruitfully in the economy and obtain a bigger share of the growth dividend. However, this must be matched by an increase in income-earning opportunities – particularly jobs – if inequality is to fall. Where large pools of surplus-labour exist, creating jobs (even low-wage, low-productivity jobs) is almost certainly a necessary first step. In South Africa's case, where unemployment is a major determinant of inequality, job creation for the unskilled is a necessary condition for any significant and sustained reduction in inequality. This means that either capital accumulation has to so rapid that employment and incomes rise along with an increase in capital-intensity, or that more labour-intensive sectors expand significantly alongside higher productivity activities.

3. Dilemmas of the High Productivity Now (HPN) Growth Path

This brings us to the question of a potential trade-off between short-term job creation, and laying the basis for sustainable growth and higher future job creation. Is it better to go for maximising the number of jobs created now – in which case labour-intensive investment is preferable – or is there an argument in favour of capital- and skill-intensive investment as a catalyst for more dynamic and labour-demanding growth later?

In the case of the HPAEs, there was no tension between these objectives because the growth path was labour-demanding, although not, in the main, labour-intensive (Birdsall 1997: 101-2; Jaspersen, 1997: 75-82). To be sure, workers were initially drawn into labour-intensive sectors and activities, but as economic growth gathered pace, the production structure shifted steadily towards higher productivity activities. Labour productivity rose, but so did employment because of the even faster (export-driven) increase in output (Galenson, 1992).

There appears to be little chance of replicating this growth path. Firstly, the international conditions facing South Africa are very different to those enjoyed by the HPAEs in the post-war boom. Secondly, the South African growth strategy is *not* premised on the notion that labour should first be drawn into low-wage, low-productivity activities, and then only subsequently be drawn up the value-chain. Indeed, the very opposite notion appears to be driving labour and industrial policies, namely, that high value-added, high (labour) productivity[8] – and hence high-wage – activities should be promoted *now* in order to transform South African manufacturing into a dynamic and competitive lead sector.

On one level, it seems absurd given South Africa's massive labour-surplus, to be engaging in any form of increase in labour productivity. Indeed, in a relatively capital-scarce and labour-abundant economy, there is a strong argument to be made that it is capital productivity that should be maximised, even if this implies falling labour productivity.[9] However the implication of a low wage labour path is unpalatable to organised labour, and to proponents of HPN who populate the corridors of the Ministry of Labour and the Department of Trade and Industry (DTI).

This 'high productivity now' (HPN) strategy assumes that even in a labour-surplus middle income economy like South Africa, it is necessary to increase productivity today in order to project the economy onto a more dynamic (and ultimately more labour-demanding) growth path tomorrow. It belongs in the class of growth strategies which assume that competitiveness rests primarily (if not solely) on the adoption of cutting-edge technologies, on nurturing firms and segments of the

[8] Labour productivity refers to the ratio of employment to total output. For convenience, labour productivity is simply referred to as 'productivity'.

[9] This argument was made by Sam Bowles in the Labour Market Commission, but to no effect.

economy that demonstrate competitive advantage,[10] and otherwise generally encouraging structural change in favour of higher value-added activities. Proponents of such views point to the success of government industrial policies in the HPAEs, and locate themselves within the theoretical ambit of endogenous growth theory, highlighting the dynamic benefits of human capital, learning-by-doing, the spill-over effects of technology etc. South Africa's Industrial Strategy Project (ISP) is an example of this genre (Joffe *et al*, 1995), and much of this thinking is evident in DTI documents (DTI, 1995, 1998).

The message is attractive: invest in people, technology, infrastructure, work-place re-organisation, inter-firm co-operation etc, and achieve the win-win scenario of greater competitiveness, a better-paid workforce, and faster, sustainable growth. But behind the lure and glamour lurks the cost: significant employment creation is relegated to second- or third-round effects. HPN is, in other words, a reincarnation of the old 'trickle-down' story: increases in productivity drives the rising tide of growth; the unemployed must go to night school and training programmes whilst waiting for the employment waters to rise.

HPN comes in soft and hard versions. The soft version argues that active support should be given to higher productivity firms and sectors, and productivity improvements should be sought wherever possible. Such a strategy only harms low-wage, low-productivity activities in the sense that resources are not channelled in their direction. DTI policies appear to be supportive of this soft HPN position. Hard HPN, by contrast, not only promotes high productivity through supportive measures, but engineers an economy-wide shift in favour of higher productivity firms and sectors by actively undermining (even destroying) low-wage, low-productivity sectors. Using wage increases to force low-productivity activities out of business would constitute part of a hard HPN strategy.

The ISP, for example, comments favourably on the German system of wage determination which "keeps wages higher, and differentials lower than would be determined by a freely-functioning labour market" and thus "encourages investment in training and retraining as a mechanism to enhance productivity to match these wages" (Joffe *et al*, 1995: 213). A highly regulated labour market, argues the ISP, will "encourage restructuring up the value chain rather than restructuring towards low-wage, low-productivity forms of production" (*loc. cit*). The ISP situates COSATUs approach to industrial restructuring within this particularly logic, pointing out that it is "premised on the need to move South African firms out of their low-wage, low-skill, low-productivity vicious circle in which they are out-competed by the second-tier Newly Industrialising countries" (*ibid*, p.214).

The presentation of binary opposites – a low-wage, low-productivity 'vicious circle' versus a dynamic high-wage, high-productivity nirvana – is typical of hard HPN. The notion that one can have high-wage, high-productivity firms and sectors alongside lower-wage, lower-productivity

[10] Michael Porter's *The Competitive Advantage of Nations* (1990) is a popular bible for this set of beliefs. Monitor, an international consultancy which operates in a Porter-framework, has had a lot of influence on the formulation of industrial policy thinking in South Africa (Haines, 1996: 14-16).

activities is an anathema to hard HPN thinking. The ruling assumption appears to be that low-wage, low-productivity firms will undermine high-wage, high productivity activities (although there is no logical reason why this should be so). Talk of 'vicious circles' implies that there will be a race to the bottom of the value-chain unless a policy of zero tolerance is adopted towards low-wage, low-productivity activities.

The notion of using the wage as an instrument of restructuring is discussed in more detail in Part 3.1 below.

3.1. Using the Wage to Force Restructuring Up the Value-Chain (Hard HPN)

Increasing the costs of employing labour can be a deliberate part of a high productivity growth strategy (see e.g. Lee, 1996: 495). It was, for example, an integral part of the philosophy behind the post-war 'Scandinavian model.' Centralised wage bargaining set wages across all firms, regardless of productivity performance, thus putting pressure on low-productivity firms and sectors (Henley and Tsakalotos 1993). Workers who lost their jobs as a result of such restructuring received generous welfare benefits whilst being retrained for employment. The strategy worked well in Sweden until it fell apart under the combined impact of productivity slowdown, unemployment, and fiscal crisis (Lindbeck, 1997). The apartheid wage-setting machinery was used to similar effect in South Africa, except with the more limited aim of providing full-employment for white workers (Nattrass and Seekings, 1997). Once African workers were incorporated into the wage-setting machinery in a context of rising unemployment and inadequate labour-market welfare provision, the system manifestly became incapable of supporting full-employment for any group, and instead probably contributed to falling labour absorption.

As Moll has argued (1996), larger firms use more capital-intensive techniques, achieve higher labour-productivity, and hence pay higher wages than smaller firms. Data from the South African Manufacturing Survey supports this supposition: value-added per worker rises with size of firm, thus indicating that larger firms tend to manifest higher labour productivity; and larger firms tend to be more capital-intensive and pay higher wages.[11] As bargaining councils are dominated by large firms (where it is easier to organise workers)[12] the bargained wage is more likely to suit capital- rather than labour-intensive activities. Compulsory extensions of collectively bargained agreements to non-parties thus probably harms labour-intensive firms and activities, and hence reduces labour-absorption in manufacturing (see also Nattrass, 2000b).

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[11] See the 1993 Manufacturing Survey (Report no. 30-01-01 1993).

[12] Survey evidence indicates that the average party firm is between 2 and 4 times larger than non-party firms (Boccara and Moll, 1997; Du Toit *et al* 1995). In the largest national bargaining council (for iron, steel, engineering and metallurgical industries), less than a third of the firms (employing 65 percent of the workers) set wages for the entire industry (Standing *et al* 1996: 143).

As noted earlier, the Ministry of Labour has not yet acted to amend the provision pertaining to compulsory extensions of collective bargains to non parties – this, despite various government policy documents and statements in support of reform. Perhaps the Ministry of Labour buys into a hard HPN view of restructuring, and is thus resisting such changes. (The fact that the current Minister of Labour was drawn from trade union ranks lends credibility to this speculation). And, despite calls for greater lenience for small business with regard to minimum wages and labour standards, very little concrete has been done. Exemptions to bargained agreements remain largely in the hands of the parties to the agreement, and wage exemptions are rarely given (see review in Nattrass 2000b). All of this is consistent with a hard HPN strategy and flies in the face of the Ministry of Labour's stated commitment to job creation and support for small business (RSA, 1998).

Hard HPN appears to be the corner-stone of the South African trade union movement's approach to economic restructuring and growth. This is evident in the report of COSATU's 'September Commission' (1997) – an internal commission set up to reflect critically on whether COSATU strategies and policies were appropriate in the new South Africa. Five strategic themes are evident: a continued commitment to tri-partism/corporatism; support for an active, interventionist (developmental) state plus active trade union involvement in industrial policy; socialisation of capital (to create the foundation for a potential socialist transformation in the future); greater decision-making power for labour at firm and industry levels; expansionary redistributive macroeconomic policies; and a commitment to narrowing wage differentials in the economy.

COSATU rejects the idea that wage restraint or wage flexibility is necessary for job creation: "Jobs must be created and economic opportunities expanded, but not at the price of lower wages" (1997, Chapter 4, p.18). The more moderate version of wage restraint, i.e. tying wage increases to productivity is also rejected: "Increases in basic wages should not be linked to productivity increases since the major portion of productivity improvements are the responsibility of management" (*ibid*, p.21).

COSATU's reluctance to countenance keeping wage growth in line with productivity plus an inflation adjustment drastically limits the potential for a social accord. The September Commission says as much:

> "The Labour Market Commission advocates a social accord between government, labour and business on wages, prices and investment with the aim of promoting job-creating growth. COSATU has tended to reject this idea because, to the extent that it is based on a policy of wage moderation for labour, it would entrench existing inequalities. COSATU needs to explain to its alliance partners why this approach to an accord is doomed to failure" (ibid, p.22-3).

This places the ANC in a difficult position. On the one hand, organised labour is a powerful constituency, and there is a significant overlap between ANC and trade union activists. On the other hand, the ANC must be increasingly sensitive to the fact that many of its voters are unemployed, or living in households with unemployed members. Opinion polls consistently find that voters regard the ANC as having failed with regard to job creation. So far, the ANC government has pinned its hopes on macroeconomic policy as the prime means of boosting investment and employment. However it is becoming increasingly clear that unless labour market reforms accompany broader processes of adjustment, there will be no significant reduction in unemployment in the short or medium term. This means grasping the nettle of trade union disapproval – and the ANC has yet to do that in any meaningful way.

For example, in October 1998, the government held the long awaited 'Jobs Summit.' The idea of a Jobs Summit had first been mooted by the Presidential Labour Market Commission (LMC, 1996) as a means of bringing various interest groups together to discuss an employment accord. The Commission envisaged that macroeconomic policy, labour legislation and incomes policies would all be on the agenda. However, in light of Cosatu's refusal to discuss labour legislation and wages, and the ANC's reluctance to open up a debate on macroeconomic policy, none of these issues made the agenda. Instead, the Jobs Summit degenerated into a talk shop, providing a platform for the government to announce a set of minor initiatives, such as further support for small business, the tourism industry, regional development etc, and increased funding to public works programmes (most notably the Working for Water initiative).[13] While most of the proposals were sensible, they did not add up to a significant job creating strategy.

The problem is that most union members and employers have an interest in maintaining the present system which protects them (as insiders) from lower wage competition. The labour movement is likely to keep labour market reform off the agenda for as long as possible. Given the ANC's reluctance to challenge this vested interest directly, it seems as if movement will only occur once a national consensus builds up in favour of labour market reform. Given the serious nature of the unemployment problem, it is possible that such national consensus may not be impossible to achieve.

3.2. The Distributional Dilemma of HPN

The HPN strategy essentially asks the currently unemployed generation to make a sacrifice for the sake of the employed and better skilled amongst them, and for the next generation which will (supposedly) enjoy the fruits of a more dynamic economy. In the case of soft HPN, the sacrifice being asked of the less-skilled is time, and in the case of hard HPN it may be loss of income (as low-productivity jobs are destroyed) and time.

One way of addressing this distributional dilemma would be if those who gained from HPN (high-tech industry and the better educated, skilled and currently employed workforce) were taxed sufficiently to finance adequate welfare grants and training programs for the unemployed. This was the implicit 'social contract' behind the Scandinavian model – but it only held together while growth was rapid and unemployment relatively low. In a labour-surplus middle-income country like South Africa, such a scenario seems highly unlikely. Although there is talk about a 'basic income grant' the

[13] See Summary of Jobs Summit Declaration, October 30, 1998, at http://www.polity.org.za/govdocs/summit/summit.html

numbers being bandied about are tiny (R100 a month), and it is questionable whether the political will exists to pay the associated tax bill.[14]

Those who favouring HPN strategies have to make an ethical judgement about the costs involved. Not only do they have to be sure that a HPN strategy will actually deliver more labour-demanding growth in the future, but they have to be sure that the benefits to future generations are worth the costs (most notably unemployment) borne by many in the present. As Sen has pointed out, it is worth considering that the cost of unemployment reach beyond welfare payments: "The penalties of unemployment include not only income loss, but also far-reaching effects on self-confidence, work motivation, basic competence, social integration, racial harmony, gender justice and the appreciation and use of individual freedom and responsibility" (1997: 169).

Ultimately the decision as to which strategy is optimal depends on the prevailing social ethics and on the level of development. For a middle-income economy like South Africa with high unemployment and limited fiscal resources for providing adequate welfare, opting for a hard HPN strategy is fraught with danger. Such a path would exclude too many (relatively poor) people from sharing in the fruits in growth. Wage inequality may fall, but overall inequality could rise if unemployment increases significantly. And, as the international evidence on growth suggests, rising inequality has costs in terms of growth itself.

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[14] According to estimates by Samson *et al* (2000), it would cost R52 billion to provide every person in South Africa with a grant of R100 a month. This comes to about 21 percent of total government spending – i.e well over twice the amount currently spent on welfare. They argue that R24 billion can be reclaimed from higher earners through the income tax system through adjustments to marginal tax rates and income thresholds. This leaves the net cost of transfer at R28 billion to be financed through further increases in taxation. Given that South Africa's top income earners are already highly burdened, it is thus likely that significant and sustainable increases in tax revenues could only come about through either adding to the income tax burden of households in, especially, the seventh and eighth income deciles (i.e. the labour movement's chief constituency) or increasing value-added tax. If the burden falls mainly on value-added tax, then the redistributive impact of the basic income grant will be reduced, as the poor will be paying for part of it every time they spend it on goods and services. At present both the trade union movement and the Democratic Party (representing most of the rich) profess support for a basic income grant, but both seem to anticipate that their constituencies will not shoulder the financial burden.

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