south africa

Towards a pro-employment growth path

By **Anthony Black, Hein Gerwel and Reviva Hasson**

Black is a professor with the Policy Research in International Services and Manufacturing (PRISM) unit at the University of Cape Town's School of Economics, where Gerwel and Hasson are researchers. This paper draws on a full-length article by Black and Gerwel, "Shifting the growth path to achieve employment-intensive growth in South Africa"

Anthony Black

Hein Gerwel

Reviva Hasson

While more rapid economic growth is essential for South Africa to make progress in reducing unemployment, the economy also needs to become more "employment-intensive". But what does this actually mean in practice, and are policies leading us towards this objective? The paper argues that declining and ineffective state support has reduced the employment potential of agriculture, while there has been a bias towards heavy, capital-intensive industry in manufacturing. Pro-employment policies have to be placed at the centre of the policy agenda.

This implies that, at any given growth rate, the economy needs to increase labour demand at a more rapid pace than has hitherto been the case. After all, if GDP is growing at 4 percent per year, it makes a big difference whether employment is growing at 0 (jobless growth), 2 or 4 percent. Major recent policy documents, such as the National Development Plan (NDP), the New Growth Path (NGP), the various Industrial Policy Action Plans (IPAPs), as well as recent budget statements, implicitly or explicitly support the objective of "employment-intensive" growth. But they are not very explicit about how this could happen.

Raising the employment intensity of growth could be achieved in two main ways. Firstly, existing economic activities could become relatively more labour-demanding. Secondly, the composition of output could shift to relatively labour-intensive sectors. This point is made in the NGP, which indicates the growth rates required to achieve the target of five million new jobs by 2020 under various employment intensity scenarios. With an employment intensity of 0.8, a GDP growth rate of just over 4 percent will be sufficient to create 500 000 employment opportunities per year, while employment intensity of 0.5 would require GDP growth in excess of around 7 percent per annum to achieve the equivalent increase in employment (EDD, 2011:24).

We will briefly examine two sectoral policies that have impacted South Africa's growth path in a manner that has been negative for employment growth. The following section examines agriculture. We will then go on to consider the manufacturing sector and industrial policy. We conclude that more explicitly employment-centred policies are required.

AGRICULTURE: DECLINING SUPPORT AND EMPLOYMENT

Substantial international evidence shows that agriculture's contribution to raising the incomes of the poorest groups in low- and middle-income countries is substantially greater than the contribution of other sectors (Valdes and Foster, 2010; Ligon and Sadoulet, 2007). In South Africa, the sector now accounts for less than 3 percent of GDP, but, because it is so labour-intensive, it remains important for employment. Large-scale commercial agriculture remains an important employer. Hall and Aliber (2010)

estimate that there are 200 000 commercially oriented smallholder farmers, and 2.5 million households involved in agriculture, primarily for subsistence purposes.

There is no need to reiterate here the history of land and agricultural policies that led to the emergence of a large-scale, white-owned commercial agricultural sector alongside a dislocated, black, small-scale farming sector earning extremely low incomes. However, a key feature of agricultural policy over the last three decades has been a decline in support to commercial agriculture (Black and Gerwel, 2014). At the same time, rural development, especially in the former bantustans, has been stymied by limited capacity and resources.

Commercial agriculture has been through a major process of liberalisation that started in the 1980s and gathered pace during the 1990s. This included the deregulation of marketing and the liberalisation of pervasive price controls, as well as the partial removal of favourable tax treatment. The net effect is that South African agriculture went from being highly protected, prior to 1994, to levels of support that are among the lowest in the world. According to the OECD (2011), producer support in South Africa as a share of gross farm receipts has declined from approximately 15 percent in 1995 to 2 percent in 2010. Moreover, this decline has been much steeper than the average decline in OECD support levels, which in any event remained very high, at about 17 percent in 2010.

Agriculture depends heavily on the provision of public goods, especially infrastructure. Government support for infrastructure in the formerly white, commercial areas has declined sharply over the past three decades. In the former reserves, severe backlogs remain, and in some cases have become worse. Programmes such as the Community-Based Public Works Programme, the Consolidated Municipal Infrastructure Programme and the Poverty Relief and Infrastructure Investment Fund have had limited effect (Machethe, 2004). In addition, investments in irrigation schemes have been poorly maintained.

According to Liebenberg (2012), provincial funding for agricultural research has declined and even virtually ceased in the Eastern Cape. Since 1994, agricultural extension has changed to a single amalgamated service, which now focuses mainly on previously disadvantaged small-scale farmers. However, agricultural extension capacity is weak and the effectiveness of this spending has been questioned by a number of analysts (Hall and Aliber, 2010; Phuhlisani, 2009; Düvel, 2004). In spite of new measures to provide finance to small farmers, access to credit for this sector remains far from adequate.

A significant and growing portion of the overall support to agriculture has been devoted to land reform, but it is important to remember that this is taking place in a context of declining support to agriculture, which is placing substantial pressure even on established commercial farmers. The impact of land reform has been limited and the amount of actual land being transferred has not come close to meeting targets. New owners have received limited support and, as a result, output has fallen dramatically in many cases.

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South African agriculture has become increasingly integrated with world markets, and exports account for over a third of output. This is a significant increase from just more than 20 percent exported during the sanctions years from 1980 to 1994, but little higher than the share of output exported from 1970 to 1979. The share of agricultural exports as a share of world exports has been stagnant or declined, in sharp contrast to other middle-income developing countries, such as Brazil, Argentina, Mexico, China and Thailand (Sender, 2012). Agricultural imports, on the other hand, have increased very sharply, from 6.8 percent in 1975–79 to 26.2 percent in 2006–08 (Sandrey et al, 2011:15). Imports in this latter period almost reached parity with exports, while in 1975–79 they were only 20 percent of exports. Growing imports have been a contributory factor to stagnating gross incomes on farms, and the pressure on commercial agriculture is evident in the rapid rate of farm consolidation, with the number of farms declining from 58 000 in 1993 to 40 000 in 2007 (Liebenberg, 2012).

Agricultural output in the former reserves is very limited and has declined. Daniels et al (2013) found that agriculture accounts for only 6 percent of employment in these areas, according to Quarterly Labour Force Survey data, and for just 4 percent in the National Income Dynamics Survey (NIDS) data. There is also evidence, particularly in the Eastern Cape, that, in spite of overcrowding, increasing amounts of land are under-utilised.

Estimates of employment vary depending on the sources and definitions, especially with regard to small-scale agriculture. But all the data for commercial

and small-scale agriculture (for example, the Farm Survey, census data, the Labour Force Survey and World Bank estimates) show sharply declining trends. Liebenberg (2012) includes family labour and owners, and makes adjustments regarding seasonal workers. According to his estimates, there were 832 000 people employed on South African farms in 2010, a decline from 1 241 000 in the 1980s and 1 014 000 in the 1990s.

> The challenge for South African economic and social policy, therefore, is to tilt the playing field towards labour-absorbing growth in order to mobilise the huge potential of an under-employed and poorly skilled workforce.

MANUFACTURING: INDUSTRIAL POLICY AND EMPLOYMENT

While manufacturing is not a major source of employment expansion in most middle-income countries, the poor performance of the sector is a significant contributor to South Africa's employment problem. A striking feature has been a rapid increase in manufacturing capital intensity, in part due to the poor performance of labour-intensive sectors relative to the relatively rapid expansion of capital-intensive sectors. While manufactured exports have grown, it turns out that South Africa's "revealed" comparative advantage has, somewhat paradoxically, been in relatively capital-intensive products (e.g. steel, ferroalloys and basic chemicals). Labour-intensive sectors have struggled to compete against import competition. What are the implications of this for past and future industrial policy?

Assuming no large-scale state intervention, the (tradable) sectors that are likely to expand most rapidly will be those with a growing comparative advantage. But comparative advantage is obviously not simply a matter of initial endowments: it develops over time and is shaped, in part, by government policy, including industrial policy. Looking at South Africa's revealed comparative advantage, one could easily conclude that we cannot compete in more labour-demanding sectors – with the concomitant negative implications for our employment prospects. But before accepting this conclusion at face value, it is important to note that our revealed comparative advantage has been fundamentally distorted in three main ways.

Firstly, the historical, systematic undermining of black education has limited the supply of skills and, therefore, hugely raised costs for manufacturing. Since 1994, the lack of progress in the rehabilitation of black education and artisanal training has continued to militate against competitiveness in more labour-demanding sectors (Black and Gerwel, 2014). A striking feature about the labour market in South Africa is not so much that the wages of production workers are higher than competitors (although in many cases they are), but the high costs of managers and skilled staff, including artisans (Clarke et al, 2007).

Secondly, the market power of large upstream producers in sectors such as steel and chemicals (e.g. Arcelor-Mittal and Sasol) has profoundly disadvantaged more labour-intensive downstream production. The lack of competition has enabled them to use import parity pricing, meaning that local fabricators of metal and plastic products have derived no advantage from low domestic production costs of key inputs, such as steel, aluminium and basic chemicals.

The third distortion has been that, while the rapid development of heavy industry partly reflects South Africa's rich mineral endowment, these sectors have historically benefited enormously from very substantial direct and indirect state support. The growth of resource-based manufacturing sectors has been on the back of cheap coal-based energy and government support. For example, aluminium production is based entirely on low-priced electricity to process imported bauxite. Cheap electricity has been a function, not just of abundant coal resources, but also of the extraordinary electricity pricing policy. Eskom's heavy over-investment in electricity capacity in the 1970s and early 1980s led government to set extremely low tariffs to attract huge investments in a series of metal processing plants. Such plants create little direct employment and tend to export the bulk of their output. The long history of artificially low electricity prices has led the economy to its current predicament: electricity supply is inadequate and prices have risen sharply as Eskom battles to fund massive expansion in new capacity.

While the clearly stated objective of industrial policy is to restructure the economy to promote growth and jobs, some of the very substantial support programmes provided by government have reinforced, rather than altered, the industrial development path. In the 1990s, an accelerated depreciation allowance (under the 37E incentive) was given to major resource-based projects such as Columbus Stainless Steel and Saldanha Steel. The Strategic Industrial Projects (SIP) programme provided tax relief equivalent to R7.7 billion from 2002 to 2005 for large capital-intensive projects, mostly in sectors such as steel, ferroalloys, aluminium and basic chemicals. Support for mega projects and industrial development zones has, until recently, been aimed

mainly at large scale capital- and energy-intensive projects. The state-owned Industrial Development Corporation (IDC) has provided further direct state support for heavy industry.

Industrial policy and IDC strategy have increasingly sought to shift industrial development onto a different trajectory, which includes greater emphasis on smaller scale firms and downstream manufacturing. But this is proving difficult, not least because of the powerful interests that have coalesced around this capital- and energy-intensive growth path.

POLICY IMPLICATIONS

Economic policy should be concerned with promoting structural change in order to improve economy wide efficiency. Unemployed human resources on this scale represent the most glaring "inefficiency" afflicting the South African economy. It follows that economic policy has to be centrally concerned with the trajectory of South Africa's growth path, which, in turn, means the promotion of employment-intensive growth. The bulk of South Africa's unemployed labour is unskilled or semi-skilled, and can most easily be absorbed into labour-intensive activities. Intuitively, it should be much easier (require less capital resources) to raise the productivity of an unemployed worker from zero to a low number than to achieve an equivalent productivity gain in, say, a car assembly plant, where labour productivity is already relatively high.

Promoting employment-intensive growth could take many forms – greater support for agriculture is one. Commercial farming is being squeezed between the hammer of international competition and the anvil of rising wages. Small-scale agriculture has to compete in this milieu and suffers from a lack of dedicated and effective public sector support. In the manufacturing sector, placing employment at the centre of industrial policy means support for small firms and training, particularly at a basic level, and an examination of the regulatory environment. Incentives should subsidise labour and training rather than capital investment, electricity and infrastructure for capital-intensive firms. It does not necessarily mean that wages should be driven down, although policy-makers do need to address labour market rigidities in certain areas.

This does not mean protecting and subsidising unsustainable labour-intensive activities, but it does require active intervention that goes beyond a "levelling" of the playing field. The historical destruction of peasant farming, generous (but now much reduced) support for large-scale, commercial agriculture, the skills deficit and apartheid-era industrial policy support for heavy industry have created conditions inimical to labour-intensive employment in agriculture and light manufacturing. The challenge for South African economic and social policy, therefore, is to tilt the playing field towards labour-absorbing growth in order to mobilise the huge potential of an under-employed and poorly skilled workforce.

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