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# South Africa in the 21st Century: Some Key Socio-Economic Challenges

**Pundy Pillay**

## 1. Introduction

This paper provides a review of six key socio-economic challenges that face South Africa at the dawn of the 21st century. The paper is largely descriptive with its main purpose being to present the issues as objectively as possible with the focus being on how things have changed especially during the period of the first democratic government. No attempt is made here at providing policy prescriptions. Rather it is hoped that the information gathered can be the basis for informed discussion as well as providing the impetus for progress towards greater consensus in economic policy making.

From the perspective of government, the achievements of the past six years have been not inconsiderable especially in the areas of education, housing, health, water and sanitation, macro-economic policy and in establishing a new decentralized political framework. The recent NEDLAC report (NEDLAC 2000) has highlighted many of these achievements. However, the greatest achievement of the first democratic government has been probably in the arena of policy development. Nevertheless, huge challenges remain as government moves the emphasis from policy development to policy implementation and the delivery of services.

The analysis of the key socio-economic challenges facing the country should be considered within the context of the many encouraging signs emanating from government. Foremost amongst these are the following

- Government is clearly prepared to acknowledge that some mistakes have been made in policy development and implementation; note for instance, the Minister of Trade and Industry's recent comments on government's lack of success in small business development and Minister of Education's review of Curriculum 2005;
- There is now increased focus on development and implementation of co-ordinated, cross-cutting policies – e.g. on employment, spatial planning, rural development, human resource development, and crime – rather than focusing narrowly on departmental policy-making;
- In line with these objectives there has been a radical restructuring of the important decision-making structures, namely in the Cabinet Committees, and the Forum of Directors-General, to encourage co-ordinated policy-making;
- There is increasingly an emphasis on prioritisation through a cycle of policy planning and budgeting;
- Finally, there is increasing evidence of willingness to engage in partnerships in the implementation of policy, with civil society (especially in the social sector – e.g. education, social welfare, rural development); and with the business sector (privatization, crime, infrastructure).

We have to acknowledge however, that in spite of what has been achieved we still have a high incidence of absolute and relative poverty; new kinds of inequality are replacing racial manifestations of income and wealth inequality; there is a high and rising level of unemployment coupled with negative formal sector employment as well as high and increasing levels of crime, especially serious and violent crime. This is hardly an environment that is likely to be attractive to foreign direct investment and to be conducive to growth.

The six key socio-economic challenges described in this paper relate to:
1. Macroeconomic Policy;
2. The Labour Market;
3. Poverty and Inequality;
4. The Social Sector;
5. Globalisation and the South African economy; and
6. Fiscal Decentralisation.

## 2. Macroeconomic Policy

Nothing engenders more heated debate from various points on the political spectrum as does the government's macroeconomic policy, namely, the Growth, Employment and Redistribution Strategy (GEAR). Because GEAR is associated with such critical issues as job creation, economic growth, and inflation, discussions on it often tend to be emotional rather than rational.

From the left, GEAR is seen as a version of the IMF's Structural Adjustment Programme, a policy which has been blamed for increasing levels of poverty in many developing countries. For advocates of GEAR, the policy represents an attempt at providing essential macroeconomic stability in order to attract investment and stimulate growth.

GEAR was announced in February 1996. Its targets are:

- Economic growth of 6% per annum by the year 2000;
- Accelerated job creation, reaching 409 000 jobs annually after the year 2000;
- An inflation rate below 10% throughout the period;
- Average annual non-gold export growth of 8.4% during the five year period;
- A rise in gross domestic saving from 18% to 22% of GDP;
- Increased gross domestic investment from 20% to nearly 26% of GDP in 2000; with an average annual real private investment growth of 11.7%;
- Inflow of foreign investment equivalent to almost 4% of GDP; and
- Reducing the budget deficit to 3% of GDP.

**South African Economic Performance**

Table 1 provides a summary of the country's economic performance between 1970 and 1999.

**Table 1: Economic Performance, 1970-1999**

| Annual Average (%) | 1970-1999 | 1980-1989 | 1990-1999 | 1990-1994 | 1995-1999 |
|---|---|---|---|---|---|
| CPI Inflation | 9.9 | 14.6 | 9.9 | 12.5 | 7.4 |
| Real growth in: | | | | | |
| GDP | 3.3 | 2.2 | 1.3 | 0.2 | 2.3 |
| Gross fixed capital formation | 4.7 | 0.7 | 1.4 | -1.5 | 4.2 |

**Source: Budget Review 2000**

It is evident that the macroeconomic policy successes relate largely to reductions in the rate of inflation and in the budget deficit. As Table 1 shows CPI inflation fell from an annual average of 14.6 per cent during the period 1980-1989 to 9.9 per cent in 1990-1999. The period 1995-1999 was particularly impressive with an annual average of 7.4 per cent.

Second, the budget deficit as a percentage of the GDP has been reduced from 10.3 per cent in 1993 to 2.7 per cent in 1999.

The record on investment, both domestic and foreign, is at best, mixed. Table 1 shows that gross fixed capital formation increased by 4.2 per cent per annum between 1995-1999. Foreign direct investment increased three-fold, from $600m in 1996 to $2billion in 1997 – however, this was mainly due to the sale of part of Telkom. However, in 1998, there was a reversal of FDI inflows equal to $1.2bn or 0.9% of GDP.

The lowering of tariffs, the reduction of corporate tax from 48% to 30%, and the privatization programme of state assets were supposed to attract foreign investors. However, these measures have yet to achieve that aim. Most foreign investment remains in the form of short-term portfolio investment and not in real productive assets that can lead to the creation of jobs.

The policy has clearly failed in the attainment of targets relating to growth, savings and employment. With respect to economic growth, Table 1 shows that the annual average growth rate for the period 1995-1999 was 2.3 per cent, far short of the targeted 6 per cent in GEAR necessary for absorption of the unemployed and new entrants to the labour market. In fact, real GDP declined from 3.2% in 1994 to 0.5% in 1998. In its assessment of GEAR, the National Institute of Economic Policy (NIEP) found that since 1996, South Africa's real GDP has grown by only 1.8%, well below the rate of population growth – in effect, negative per capita growth. Moreover, the ratio of gross domestic saving fell from 16.9% in 1995 to 15.2% in 1997 and 14.2% in 1998, according to NIEP.

Employment in the formal sector has not been anywhere near expectations. In fact, employment in the formal sector of the economy has generally declined during this period and the ranks of the unemployed have swollen to at least 25 per cent of the economically active population (see section 3).

The key question in the macroeconomic policy debate is: What are the key constraints to growth? Low domestic savings, inadequate levels of foreign direct investment, crime, labour market rigidities, low skill levels, and restrictive monetary and fiscal policies are invariably put forward as causal factors by economists and other social commentators.

Issues relating to skills and the labour market are discussed elsewhere in the paper. This paper at this juncture raises two vital issues relating to the macroeconomic policy debate. The first concerns the linkages between domestic and foreign investment and the second, the impact of monetary policy on growth.

On the issue of foreign investment as the panacea for the South African economic crisis, Friedman (2000) has questioned the conventional wisdom in a persuasively-argued paper. He argues that mainstream thinking on South Africa's economic future is based on two misconceptions. The first is that the country’s prospects depend on its ability to attract foreign investment. However, the evidence shows clearly that 'developing' economies' growth is triggered by domestic investment; the growth which it generates attracts foreign investment which may then help sustain growth. The second is that growth depends on pursuing particular economic policy packages. This ignores the fact that different market economies have grown by applying very different policies. Here, the evidence suggests that the key to growth is a society's ability to resolve and manage conflict over economic resources. Investment, the key to growth, depends on confidence which in turn is the result of effective political management rather than policy recipes. This implies that our growth prospects depend on our ability to generate domestic investment - and that this will be achieved by effective political management rather than macro-economic formulae.

The second important issue on which this section focuses is the impact of restrictive monetary policy on growth. Specifically, what are the consequences for unemployment of reducing inflation to single digit figures?

There is general agreement among economists that the Phillips Curve which set out an inverse relationship between inflation and unemployment, no longer holds in the long run. What of the short run, however?

In the context of the recently-set inflation target (3-6 per cent), Barnardt (2000) in an elegant article argues that there is very little real world evidence to show “that reducing inflation from about 8% to about 4% would yield any meaningful growth benefits in any type of economy”.

He shows that IMF emerging-country research in 1996 found conclusively that reducing hyperinflation (of say, anything from 20% to 100% a year or more) to about 12% had major growth benefits. The research also suggested that reducing a country's inflation trend rate from 12% to 8% bore further moderate growth benefits, but that trying to push it down below 8% "yielded very little reward in relation to the pain such an exercise could involve".

Few economists and policy makers would argue with the notion that the reduction of South Africa's trend inflation rate from 15% in the 1980s to about 7.5% in the 1990s has brought about moderate growth benefits, by, among other things, enhancing investor perceptions of financial discipline. Barnadt argues, however, that "it is unnecessary – and quite risky at this point of our socio-political evolution – to launch a national campaign to target inflation at 4% or 5%, even if this is set over a three-year period".

Barnadt demonstrates also that some "high inflation" countries such as Mexico, have been the recipients of massive inflows of capital. If such countries could generate high economic growth rates with inflation rates around 10 per cent, he asks why South Africa is obsessed with pushing inflation to 5 per cent.

Moreover, he challenges several conventional wisdoms. The first concerns the usual Reserve Bank view that a lower inflation rate reduces the risks of capital outflow, emerging market "contagion" and general economic instability by showing that the worst currency crisis of the past decade - in Asia in late 1997 – occurred against the backdrop of inflation rates of mostly about 5%. Furthermore, in South Africa, the big currency crisis of 1996 occurred against the backdrop of 6% inflation, and the even bigger 1998 currency crisis occurred with inflation at 5%.

Second, he attacks the orthodox view that inflation hits the poor harder than the rich: "The argument that "an 8% inflation rate hits the poor harder than the rich" is so tortuous that no poor or unemployed person can be expected to follow or tolerate it. The opposite may well be the case. In any case, how does this argument help if sharp interest rate hikes – which probably hit the poor harder than the rich – are used as the main instrument to combat inflationary pressures?"

The compelling point he makes is that accelerating growth and job creation are much more important in the next five years than getting inflation down to 4% or 5%. He concludes by describing why it will be extremely difficult to keep inflation below 5% with more policy tightening and the consequent sacrifice of growth and jobs:

"For most of the past five years South Africa has endured harshly tight monetary policies. Their disinflationary effect was reinforced by applications of new technology, rising labour productivity, import tariff cuts, the abolition of import surcharges, a leakage of cheap imports through SA entry points, tightening of fiscal policy and noticeable global disinflation.

If despite all these simultaneous disinflationary forces, our underlying inflation rate stubbornly remains in the 6-9% range, what does this tell us? It tells us that at this stage SA inflation will "naturally" rest in a band about 5% or more above the inflation band of advanced economies. Why? Because the process of a financial deepening in a young population dictates that bank credit and money creation in SA will grow at a structural premium of 10% to that of advanced countries with ageing populations. The rand will tend to depreciate by 10% a year, on average, against advanced economies for an extended period. It will prove very difficult to keep inflation below 5% without severe bouts of policy tightening and the accompanying sacrifice of jobs, and under-utilisation of human and physical production capacity. A country that still requires considerable transformation should keep its monetary policy options as flexible and as open as possible. How draconian and obsessive will the policy makers' approach be to force successful achievement of sub-5% inflation?"

**Summary:**

1) Even the most fervent supporter of GEAR would concede that it has had limited success in attaining all its goals.
2) The successes it has endured related to reductions in the budget deficit and in the trend inflation rate have been crucial to providing and maintaining macroeconomic stability and enhancing investors' perceptions of financial confidence.
3) However, it is evident also that while macroeconomic stability is a necessary condition for investment, it is not sufficient.
4) Hence, the expected inflow of foreign direct investment has not materialized. One convincing argument made in regard to investment is that foreign investors follow domestic investors and that until the domestic private sector in South Africa shows confidence in the economy, foreign investors will not be induced here.
5) Allied to this issue of domestic investment and a key causal factor for growth and investment is a society's ability to resolve and manage conflict over the use of economic resources.
6) In summary then, the quest in the South African economy, after more than four years of tight macroeconomic policies, remains for sustainable economic growth and job creation.
7) This section focused finally on the potential costs of attaining the newly-set inflation target of 3-6% on economic growth and job creation.

## 3. The Labour Market

This section examines four sets of issues relating to the labour market:

a) Employment;
b) Unemployment;
c) Skills Shortages; and
d) Labour Market Flexibility.

### 3.1 Employment

Bhorat (1999) and Bhorat & Hodge (1999) have provided a lucid explanation of the trends in formal sector employment between 1970 and 1995. The key points of these analyses are described below.

Between 1970 and 1995, formal employment increased by 18.6% or from about 7.5 million employees to 8.9 million. The economically active population in 1970 was 8.1 million and in 1995, 12.7 million, which represents a 57% increase. This shows that the labour absorptive capacity of the formal economy has been inadequate in providing jobs for new entrants into the labour market. This is reflected in the growing numbers of the unemployed, from an estimate of about 570 000 in 1970 to approximately 4 million in 1995.

However, a key structural shift has been the decline of the primary sectors and the growth of the services sector. In terms of occupational shifts, in each of the primary, secondary and service sectors, professional and managerial occupations showed the highest growth rate during the 1970-1995 period.

The analyses show also that total employment gains since 1970 had a differential impact on the four racial groups: the employment of non-Africans increased at a rate of between 48% and 108% while formal employment of African workers basically remained constant through this period. The poor employment performance of Africans is attributed to the high losses in the primary sectors. There were notable gains, however, for Africans in the service sectors, with the largest increase reported in Wholesale and Retail (156%) and Finance (450%).

Furthermore, the overall gain in employment was not evenly distributed by educational qualifications. The largest increase was for individuals with tertiary education This was followed by those with completed secondary education. For those individuals who had not attained a matriculation certificate, their employment rose by far less. Finally, for those individuals with primary or secondary schooling, the demand for their labour decreased substantially while those with no education have been the most severely disadvantaged in the labour market.

The analysis demonstrated also that labour demand patterns at the sectoral level can be explained in terms of two forces – within-sector shifts and between-sector shifts. Within-sector employment shifts are those changes in labour allocation that come from within the industry itself. Between-sector changes are relative employment shifts occurring between sectors in the economy. Sources of within-sector shifts include technological change in a sector that may create the need for a certain skill-type over another. Between-sector employment changes are largely explained through the altering shares in aggregate output of the sector under consideration. Through a growing or declining share in production of a sector, labour demand at different skill levels may change.

For the period under consideration, it is clear firstly that demand has shifted away from unskilled individuals to those in semi-skilled and skilled occupations. The key cause of these shifts appears to be technological change within the individual sectors. The rising capital intensity in sectors, coupled with greater computerization, has meant the need for more highly skilled workers. Interestingly though, the results suggest that when examining lower skilled workers, the importance of within-sector shifts remains, but diminishes. This suggests that for those at the bottom-end, the altering shares in national output of different sectors had a more significant role in understanding relative employment shifts, when compared with those at the top-end where employment shifts were overwhelmingly shaped by within-sector factors.

Between 1995 and 1998, total employment in the formal sector declined from 10,1 million to 9,4 million according to information gleaned from the October Household Surveys (OHS) for these two years. For males the decline was significantly greater at 10 per cent while for females it was 3.5 per cent.

The surveys show also that for the same period, the number of people employed in the informal sector increased from 996 000 in 1996 to 1 316 000 in 1998. However, no information is available about the quality of these jobs and the incomes earned.

A comparison of OHS information for the two years reveals the following:

- The decline in employment in the agricultural sector continues.
- Mining employment remained constant.
- Of concern is the decline in manufacturing employment even though it is slight.
- The sectors which increased their share of employment were electricity, gas and water; construction; wholesale retail trade, catering and accommodation; and financial services.
- The share of community, social and personal services (including ‘private households’) also declined during this period.
- Within the male population there were declines in the shares of agriculture and community, social and personal services; and increases in wholesale and retail trade, and financial services.
- For females, there were increases in most sectors but significantly in wholesale and retail trade, and financial services with a decline in community, social and personal services.

There were significant increases in the share of women in several higher level occupations including professionals (from 38% to 44%); technicians (from 52% to 55%); clerks (64% to 66%) and skilled agricultural workers (from 13% to 23%). However, at the other end of the occupational spectrum, there was also a significant increase in women's share of elementary occupations (from 47% to 54%).

With respect to race, there was somewhat surprisingly a decline in the proportion of African professionals (from 34% to 30%) and technicians (from 52% to 49%). Significant increases were recorded in the share of Africans as service workers (from 62% to 71%); as skilled agricultural workers (from 30% to 82%); and as craft related workers (53% to 68%).

For Coloured people, there were significant increases in the proportion of professionals, technicians and clerks and a decline in the share of service workers. For Indians, there was a decrease in the proportion of professionals and an increase in the share of technicians and for Whites, there was a decline in the share of legislators and senior officials; clerks; and service workers and an increase in the proportion of professionals.

According to the South African Reserve Bank (Quarterly Bulletin, 12/99), in 1999, employment in the private sector displayed a pattern that was broadly similar to total employment: it increased at a seasonally adjusted and annualized rate of 2.7% in the first quarter of 1999, but declined at a rate of 3.0% in the second quarter. Employment declined in five of the eight main sectors of economic activity during the second quarter of 1999, ranging in intensity from 16.2% in the construction sector to 1.7% in mining. Increases in employment were recorded in two main sectors of the economy: in the transport, storage and communication sector at an annualized rate of 24.1%, mainly due to the appointment of part-time workers; and in the financial intermediation and insurance sector at a rate of 4.3%.

Unlike private sector employment which had increased in the first quarter of 1999, employment by public authorities declined in both of the first two quarters: in the first quarter at a seasonally adjusted and annualized rate of 3.6% and in the second quarter at 5.3%. Decreases occurred at all tiers of government, except local governments where employment increased at 1.2% in the second quarter of 1999. Decreases varied from 14.0% in the transport, storage and communication sector to 2.9% in national government departments. All the declines are consistent with the overriding policy objective of a smaller public service but with a strong commitment to a better quality of service delivery.

## 3.2 Unemployment

Unemployment statistics in South Africa have long been a source of controversy. In recent years Statistics South Africa has gone some way towards addressing this contentious issue. It now provides two sets of unemployment data: one based on a 'narrow' definition of unemployment which is regarded as the official definition of unemployment; and one based on an 'expanded' definition of unemployment.

The <u>official</u> definition of unemployment is based on the definition of the International Labour Organisation (ILO): "the unemployed are those people within the economically active population who did not work during the seven days prior to the interview; want to and are available to start work within a week of the interview; and have taken active steps to look for work or to start some form of self-employment in the four weeks prior to the interview".

The <u>expanded</u> definition counts people as unemployed even if they have not sought work in the previous four weeks. This includes discouraged workers who may have given up hope or cannot afford to come to town to seek work.

According to these labour market statistics, the total number of unemployed according to the 'official' or 'narrow' definition of unemployment increased from 2.2 million to 3.2 million between 1996 and 1998. On these figures the unemployment rate increased from 19.3 per cent to 25.2 per cent.

On the 'expanded' definition, unemployment increased from 4.6 million to 5.6 million and the unemployment rate rose from 33.0 per cent to 37.5 per cent.

Unemployment rates showed some changes over the time frame from 1996 to 1998, not only by urban or non-urban place of residence, but also by gender and race, using either the official or the expanded definition of unemployment. Some key features include the following:

- The increase in unemployment affects both urban and non-urban areas. In 1998, for example, 20.5% of economically active males in urban areas and 28.0% in non-urban areas were unemployed, as against 15.1% of economically active males in urban and 20.7% economically active males in non-urban areas in 1996.
- The highest official unemployment rate in October 1998 was found among African economically active females living in non-urban areas (39.9%).
- The second highest rate in 1998 was found among African economically active females living in urban areas (37.4%).
- White economically active males were least likely to be unemployed in 1998 (4.1%).

Moreover, about a quarter of the unemployed have no education or incomplete primary education. Seventy two percent of those unemployed have an educational qualification less than matric. There are no significant differences between males and females.

However, the possession of a matric does not preclude unemployment. Twenty two percent of those who were unemployed in October 1998 had a matric. This astoundingly high figure poses some serious research/policy questions about the inability of such individuals to find employment and indeed about the quality of their education.

### 3.3 Skills Shortages and the Demand for High-Level Human Resources

Co-existing with high levels of unemployment is a huge skills shortage. The dimensions of this skills shortage have been highlighted in two recent studies (DBSA, 1995; HSRC, 1999).

The DBSA study projected skill requirements at all levels up to 2020. All four depicted scenarios ( in which the GDP growth rate and the employment elasticity are varied) show that demand would be highest for professional occupations. Interestingly, semi-skilled occupations come consistently second in all four scenarios followed by highly skilled and skilled occupations. No explanation is provided for any of the findings but the unexpected finding on the semi-skilled occupations should surely be researched further because of its important education policy implications. Unfortunately these findings cannot be correlated with those of the HSRC study (described below) or with the official statistics cited for the period 1970-1995 because of the different occupational definitions.

The HSRC study examines past and likely future employment trends (1998-2003), together with the likely medium-term demand for labour in high-level occupations. The methodology involved a combination of estimates based on the 1998 level and structure of employment and an annual growth rate of around 2.7% per annum, and employer interviews.

According to this study total employment is expected to increase by about 45 000 between 1998 and 2003. However, growth varies considerably by occupation. The highest growth rates are expected among professionals (9.6%) and managers (6.2%), followed by artisans (3.9%). Little change is expected at the level of clerical/sales/service and a substantial decline in employment is expected at the level of semi-skilled and unskilled workers (-3.4%).

The highest rate of growth of professional employment is expected in the finance sector especially in banking (almost 50%). This is ascribed to three factors all of which increase the need for high-level personnel: (1) the rapid advance of technology in the industry; (2) the increasing complexity of financial services offered by the financial institutions; and (3) increasing globalisation.

The business services sub-sector of finance is expected to show a growth rate for professionals of almost 31%. This high rate of growth, coupled with the fact that this sector employs 75 000, or almost 8% of all professionals, means that this sector is expected to be the second largest contributor to professional employment growth (almost 25% of total growth).

Strong growth (11.3%) in professional employment is expected in the community and social services sector, which is dominated by private health care and non-government education. This growth is largely in the categories of teachers, nurses and medical practitioners. Growth in this sector is expected to account for more than 12% of total growth in professional employment, which makes it the third largest contributor to professional employment growth. Slow growth (5.6%) in professional employment is expected in government, mainly due to the low growth in the employment of nurses and teachers.

Although managers were classified as high-level human resources along with professionals, they are expected to show very different growth patterns over the period 1998-2003. The number of managers employed is expected to grow by 6.4% over the period under review which is lower than the expected growth in professionals. The highest growth rate is expected to be in the trade sector.

The HSRC classified future demand for professional occupations into 'super-growth' occupations (forecasted rate of growth in excess of 40% - includes computer programmers, analysts and other computer science occupations, chartered accountants), 'high-growth' occupations (15-40% - economic and financial occupations, electrical engineers, etc.), 'moderate-growth' occupations (10-15% - electrical and related engineering technicians), medical occupations, etc.), and 'low-growth' occupations (5-10%).

The study draws attention to the fact that ranking of occupations by expected total number of vacancies over the next five years shows some differences compared to a ranking of occupations by expected growth in demand. The major reason for this is that many occupations have high absolute replacement demand since they are numerically large occupations, yet do not necessarily show high growth rates. By far the most positions (40 000+) are expected to need filling in the teaching occupation, just less than half of which need filling due to replacement. Next are nurses, which are expected to have between 15000 and 20000 vacancies. Again, the majority of nurse vacancies are expected to arise from replacement needs. Both teachers and nurses are expected to show only moderate growth in demand over the next five years.

The study shows further that a number of occupations show both high growth in new demand and are ranked high in terms of the number of vacancies which need filling. These include the IT professions, accountants, economic and financial occupations and electrical engineering technicians and technologists. It is probable that these high-ranking occupations offer the best employment prospects for new entrants to the labour market.

A number of occupations show high growth in new demand but the absolute number of positions that need filling are relatively low. These occupations include actuarial occupations, chemical engineers, mathematical and related occupations and industrial/production engineers.

### 3.4 Labour Market Flexibility

Between 1994 and 1999 the new democratic government passed various pieces of legislation with the primary purpose of safeguarding worker rights and conditions of work. Employers claim, however, that these laws increase the costs of employing labour and the ensuing labour market rigidity deters foreign investment .

These costs are said to derive from the following existing labour laws:

- The Labour Relations Act (LRA) of 1995, amended in 1996, obliges the Labour Minister to extend agreements reached at bargaining council level to an entire sector, including companies that are not party to the agreement. It is claimed by employers that the LRA makes it difficult to dismiss workers, because dismissal procedures are so unwieldy.
- The Basic Conditions of Employment Act, 1997, reduced maximum work hours from 46 to 45 hours a week. Overtime was restricted to 10 hours a week at a rate of time and a half. Hours worked could be averaged over a period of up to four months but only through collective agreement.
- The Employment Equity Act, 1998, pushed up the costs of recruitment and human resources, because managers must make equity plans, monitor their implementation and submit annual audits to the Labour Department.
- The Skills Development Act, 1999, imposes a training levy of 0.5% of payroll increasing to 1% in the second year.

Thus the South African Chamber of Commerce (Sacob), commenting on labour regulations, states: "Perhaps the main reason advanced for the need to develop the small business sector in South Africa is the perceived superior ability of such businesses to create employment. However, it is clear from official employment figures that the sector has thus far not been able to absorb all jobs shed by large-scale enterprises – much less assist in reducing the overall level of unemployment in this country."

According to Sacob, the situation is that many small business owners believed labour regulations to be too onerous, and were in fact themselves looking to shed jobs. Under these circumstances, many small businesses are reluctant to let their labour forces grow beyond levels which allow them exemption from certain provisions of legislation. This results in an artificial constraint on their growth and development.

In sum, the three main problems cited by employers with the new labour regulations are:

- It imposes significant additional direct costs on business;
- There is a high "hassle factor" associated with compliance; and
- The legislation "robs" owners and managers of some of the control and flexibility which they perceive as being both desirable and necessary to the effective running of their businesses.

Many in the business sector are of the view that a fundamental problem with the existing labour law is that it was based on the premise that low wage competition should – as far as possible – be eliminated from the South African labour market, and that business should instead compete on the basis of other costs and "intangibles" such as quality, reliability and service. However, according to this view government in developing such legislation does not take into account the fact that producers and suppliers in many developing and developed economies are not constrained to the same degree in their ability to compete. There is also a view in the business sector that some small businesses did not have the expertise to deal with the legal procedures for dismissals and were "intimidated" by mediation proceedings.

In a recent paper Nattrass and Seekings (2000) suggest also that the labour regulations may account for the lack of success of the government's employment strategy. They cite a recent review of labour market and macroeconomic reforms in the OECD which showed that those countries which tightened their fiscal policies without accompanying this with broader reforms, found this to be very costly in terms of unemployment – especially in countries with rigid labour markets. They state that "co-ordination failures between fiscal, monetary and labour-market policy in South Africa may be evoking a high cost in terms of unemployment. However, there are other forces also at work to exacerbate the situation. The interplay between international competition and protective labour market institutions has exacerbated the reduction in the demand for unskilled labour, and has boosted the demand for skilled labour. This has contributed to rising inequality through widening wage inequality and rising (unskilled) unemployment."

Whether the adverse effects on unskilled labour take the form of lower wages or rising unemployment appears to depend in part on labour-market institutions and the wage-setting machinery. Where labour markets allow sufficient wage flexibility, international trade with low-wage countries is likely to result in a relative decline in unskilled wages. Where labour-market institutions provide a wage-floor, then unskilled unemployment is likely to rise (unless compensating job creation occurs in other sectors, such as services).

Nattrass and Seekings go on to argue that there appears to be a strong case that increased openness and trade with low-wage countries is reducing the demand for less-skilled workers in middle-income as well as industrialized economies. In the absence of a large and vibrant informal sector, this suggest that countries that use labour market policies to narrow the wage distribution by raising unskilled wages are likely to experience higher unemployment (among the less-skilled) than those that allow the wages of less-skilled workers to fall.

Increased international competition is likely to reduce the demand for unskilled labour yet further, while boosting the demand for more skilled labour. Rising unemployment and wage inequality will serve to widen overall inequality (as appears to have been the case during the 1990s). Nattrass and Seekings point out that if poverty and inequality are to be reduced significantly, this could then be achieved only thorough the welfare system. However, given the fiscal constraints, this is unlikely to happen. They state: "If no welfare is provided, then the decrease in demand for unskilled labour will translate into rising inequality and poverty. South Africa is in the difficult position of having 'European-style' labour market regulations, but without European levels of welfare support for the unemployed and poor. Whereas the unemployed are picked up by the welfare net in Europe, they fall through it in South Africa. The net result is that labour market institutions which act to narrow the wage distribution, contribute to rising inequality in SA (in so far as they exacerbate unemployment)."

They argue further that as South Africa cannot afford a ‘European’ level of welfare support, there is clearly an urgent need to address poverty and inequality by boosting employment, rather than relying solely on welfare transfers. For this to happen, labour market reform is a necessary component of such a strategy. There is an important caveat to their recommendations and that is that even in the context of substantial labour market reform, the employment effects are likely to be muted in the short-run. The international experience suggests that employment appears to response slowly to labour market reform. This suggests then that labour market reforms should be but one component of a broader economic reform strategy.

**Summary**

1) Between 1970 and 1995, there were key structural and occupational shifts in the composition of formal sector employment with the former characterized by a decline in the primary sector and growth in the service sector and the latter by high growth in the professional and managerial occupations.
2) Labour demand during this period was characterized further by a discernible shift away from unskilled occupations to semi-skilled and skilled occupations. The principal cause of these shifts appears to be technological change.
3) It is evident also that employment in the formal sector has been declining in absolute terms in the last years of the ‘90s with significant job losses in the agricultural, mining and manufacturing sectors.
4) As a consequence of declining formal sector employment and increasing numbers of new work seekers, unemployment in the late 1990s increased substantially to at least 1 in 4 of the economically active population.
5) Unemployment is affecting both urban and rural residents with the most severe impact on African females.
6) Co-existing with high-levels of unemployment is a huge skills shortage. The DBSA study of 1995 projected high growth in demand for professional and semi-skilled occupations.
7) The HSRC study of 1999 confirms the high growth in demand for professional occupations, particularly for computer personnel, chartered accountants and other financial occupations and engineers.
8) Although not showing high growth in demand, there will be a need for approximately 40 000 teachers and 20 000 nurses in the next five years because of the high ‘replacement’ demand in these occupations.
9) A contentious labour market issue relates to the extent to which the new labour market regulations increase the cost of employing labour. South African business and some academics argue forcefully that these regulations are seriously restricting the capacity of the economy to create jobs.

### 3.4 Poverty and Inequality

The first democratic government inherited a nation which was characterized by high levels of poverty reflected in its racial and regional dimensions. According to a 1993 World Bank/UCT household survey, between 30 and 50 per cent of households could be regarded as poor, depending on the definition used (see Tables 2 and 3. Source: World Bank, 1995). Moreover, 75 per cent of the poor lived in rural areas.

**Table 2: Poverty Levels: 1993 - Comparison of selected poverty lines**

| Type of poverty line | Month cut-off in rand | Population below the poverty line |
|---|---|---|
| Population cut-offs at the:<br>a) 40th percentile of households ranked by adult equivalence<br>b) 20th percentile of households ranked by adult equivalence | <br>301.0<br><br>177.6 | <br>52.8<br><br>28.8 |
| Minimum per capita caloric intake (at 2500 Kcal per day) | 143.2 | 39.3 |
| Minimum caloric-adjusted per capita intake (at 2500 Kcal per day) | 185.4 | 42.3 |
| Minimum Living Level<br>Supplemented Living Level | 164.2<br>220.1 | 44.7<br>56.7 |

**Table 3: Distribution of poverty, 1993**

| Location | Share of Pop. (millions) | % of Pop. | Poverty Share (%) | Poverty rate (%) |
|---|---|---|---|---|
| Rural | 20.3 | 53.4 | 74.6 | 73.7 |
| Metropolitan | 9.9 | 26.1 | 9.8 | 19.7 |
| Urban | 7.8 | 20.5 | 15.7 | 40.5 |
| All | 38.0 | 100.0 | 100.0 | 52.8 |

Co-existing with these high levels of poverty are extreme levels of inequality of income and wealth. South Africa has long been at the top of the inequality league with measured Gini coefficients up until the 1980s being second only to that of Brazil.

How are poverty and inequality changing since the advent of the country's first democratic government?

Some recent evidence suggests that the gulf between South Africa's rich and poor has widened since1994. This has been ascribed by some analysts to the growth in inequality stemming from world trends, including industrial restructuring in the face of fierce international competition, combined with a decreased demand for unskilled labour and rising demand for professional skills.

A study on income distribution undertaken between 1991 and 1996 by an economic consultancy, WEFA Southern Africa, shows that the rich continued to grow richer, while the poor lost further ground, especially within the black community. The study shows that Africans' share of national income rose to 35.7% in 1996 from 29.9% in 1991, while the white share fell from 59.5% to 51.9%. According to a 1998 revision of the 1996 census, Africans make up 76.7% of the population while whites comprise 10.9%.

The study showed also that more than 90% of the increase in the income of blacks stemmed from economic growth with less than 10% attributable to a redistribution away from whites.

This changing face of wealth has mostly benefited the emerging black middle class, with the proportion of black households in the richest 10% of households increasing from a mere 2% in 1975 to 9% in 1991 and 22% in 1996. However, the poorest 40% of black households saw a 20% fall in their incomes from 1991 to 1996.

Some analysts (e.g. Nattrass & Seekings, 2000) suggest that poverty and inequality in South Africa are rooted in the labour market: in part in low wages, and in part in very high rates of unemployment. Whereas inequality until the 1970s was determined largely by the gap between white and black incomes, inequality is now primarily driven by (a) inequality within the distribution of wages, and (b) by the fact that at least 25 per cent of households have no wage income at all.

One of the main factors driving these patterns is the loss of formal sector jobs and the shift towards higher skills. Between 1991 and 1996, there was an 80% increase in blacks employed in highly skilled occupations. Over the same period, the total number of blacks employed fell by 2%, with the unskilled and semi-skilled bearing the brunt.

The gold mining industry has shed more than 200 000 jobs from a peak of 530 000 in 1987. Companies that enjoyed state protection during the apartheid era now find themselves exposed to global competition. Even though the economy has grown, jobs continue to be lost and newcomers to the shrinking job market are forced to join the swelling ranks of the unemployed.

According to another WEFA study on employment prospects in SA, at least 142 000 jobs were lost in 1997, when the economy grew by 1.7% - and the labour force grew by about 320 000.

A recent report by UNISA's Bureau of Market Research highlights persistent regional inequalities. The report points to the sharply differing levels of the human development index for the various provinces. The HDI is an indicator of life expectancy, educational attainment and income used by the UNDP. The relative standing of the provinces has changed slightly with small gains being made by Mpumalanga and the Western Cape over the past five years. Gauteng and the Western Cape have the same ranking in terms of the HDI at 0.73. That is similar to a middle-income country like Turkey. By contrast, the Northern Province – the poorest province – has a HDI of 0.57, close to that of Zimbabwe, which ranks 130th in the index. Personal disposable income in Gauteng is more than three times that of the Northern Province. Overall, South Africa has a HDI of 0.67, which means that it is well short of the 0.8 which the UNDP considers necessary for a high level of human development. These provincial inequalities are reflected also in the huge differences in personal per capita income (Table 4).

**Table 4: Provincial Inequalities: personal disposable income per capita, 2000**

| Province | PDI (Rand) |
|---|---|
| Northern Province | 6 021 |
| Eastern Cape | 7 792 |
| North West | 9 693 |
| KZN | 10 592 |
| Mpumalanga | 11 088 |
| Free State | 12 334 |
| Northern Cape | 12 481 |
| Western Cape | 20 777 |
| Gauteng | 25 988 |
| SA | 13 502 |

Source: Business Day, 01.03.2000

**Summary**

1) There is little doubt that there are many chronically poor people in South Africa today and that this country is still one of the most inequitable in its distribution of income and wealth.
2) The limited evidence suggests that absolute poverty may be declining since 1994 not because of employment creation (because this is not happening) but primarily because of the extension of social security grant provision to the previously-excluded African population.
3) However, new forms of inequality may be replacing the ‘traditional’ white:black division of income and wealth. It is likely, for instance, that intra-racial and urban-rural differences have been exacerbated in the first years of the new dispensation.
4) The correct answer to the question about what has been happening to poverty and inequality since 1994 is that “we do not know”. This is because there is not yet in place an appropriate poverty monitoring system which would enable government to track the changes in poverty and inequality in the country as a whole. We know that there is poverty, but we know less about who the poor are precisely and where they are specifically located.

5) To obtain answers to these questions, government has to put in place, through Statistics South Africa, appropriate data collection instruments that would enable government to obtain the necessary information about the poor.

### 3.5 The Social Sector

The provision of social services (education, health, housing and welfare services) to the historically-disadvantaged sections of the population was deemed to be a high priority in the government's Reconstruction and Development Programme (RDP) introduced in 1994.

Government has attempted to ensure increased access to these services through substantial increases in the Social Sector budget even within the context of a tight fiscal policy. For instance, education expenditure increased from R34 billion in 1995/96 to R45 billion in 1998/99, an average annual increase of 2 per cent. Total education expenditure is expected to reach R52 billion in 2001/02. Health expenditure, on the other hand, is expected to increase from R17 billion in 1995/96 to R27 billion in 2001/02 and welfare expenditure from R14 billion to R21 billion during the same period.

In spite of increased expenditure, serious questions remain, particularly in regard to access and quality of provision in all three sectors of education health and welfare. In education, the issues of concern relate primarily to the increases in personnel costs, the ability of the state to provide classrooms and learning materials, attaining qualitative improvements in education and improving teacher productivity. Similarly in health, in spite of increased expenditure, many poor people are still denied access to primary health care and urban hospitals are grossly overcrowded. In the welfare sector, welfare services appear to be seriously neglected and the Department has shown itself to be incapable to effectively perform its poverty alleviation role. Moreover, there is a question mark hanging over the sustainability of social security expenditure.

As de Bruyn et al (1997) have shown, while expenditure on Education and Health in particular have increased substantially, the key issues relate still to the efficiency and incidence of public expenditure.

Furthermore, on the financing of education itself, Government responds to criticism about the perceived lack of progress in Education by pointing to the high level of expenditure in this sector in international terms both in respect of its share of the total budget and as a proportion of GDP. No one has yet challenged this conventional wisdom by questioning whether these benchmarks are appropriate in the context of the inherited inequalities in education provision.

On the efficiency of expenditure question, in education it is evident that the most important task is to improve quality of provision. As de Bruyn et al (1997) have shown, amongst the factors impeding the improvement of student achievement are the inadequate provision of facilities and the distribution of expenditure between its current and capital components. On the incidence of expenditure side, it is clear from the limited data available, that there is a need to strengthen the commitment to distributing education funds through a system that explicitly favours schools in disadvantaged communities. Similar arguments can be made about the efficiency and incidence of health expenditure.

**Summary**

1) Social sector expenditure (Education, Health, Housing and Welfare) increased substantially during the first term of the democratic government.
2) In spite of this increased expenditure, serious questions remain with regard to access and quality of provision in education, health and welfare.
3) Moreover, there are key unresolved issues relating to the efficiency and incidence of public expenditure on the social services.
4) Education and training, and human resource development in general, is the key to economic success and development. We need to ask also whether the levels of expenditure (although high) are adequate in the light of the magnitude of the inherited inequalities.

### 3.6 The Challenge of Globalisation

Globalisation has ensured that the world has become a smaller place especially during the past decade. The constraints of geography on economies, polities and societies have been gradually receding as intensification of worldwide social interactions are shaping events within boundaries beyond the nation state.

Most countries have privatized state assets, have opened their economies to foreign investment, and have export-led strategies for economic growth. This combination was supposed to spur growth, employment and an overall improvement in the living conditions of citizens around the world.

However, the financial crisis of 1997/98 has demonstrated the vulnerabilities of the process of globalisation and the growing inequality gap between the haves and the have-nots within societies and between countries that have participated in this globalisation process.

Even in the United States, the growth economy of the 1990s, the income of the poorest 20% of households has declined steadily since the 1970s, while the richest 1% has increased its income by more than 100%. At the global level, the ratio of average income of the richest country in the world to that of the poorest has risen from about 9:1 at the end of the $19^{th}$ century to at least 60:1 today.

The most recent Human Development Report of the UNDP further highlights today's global inequalities by stating that "differences in income and living standards have reached grotesque proportions….with the (gap between) the richest fifth of the world's people and those of the poorest fifth (widening) from 30:1 in 1960 to 74:1 in 1995".

There is an ensuing debate among economists and other social commentators regarding the causes of the widening gap between rich and poor, and the extension of poverty in some parts of the world. Slow or no growth in a national economy, limited educational and technological skills, restricted markets in the north for exports from the developing world, corruption and bad management, and the absence of "sound" macroeconomic policies are some of the main reasons put forward by experts on the subject.

Comparative research shows that countries which have sound macroeconomic policies and that have gradually opened up their economies to global competition fare better than those less integrated into global markets. The same research shows that growth by itself, though necessary to combat poverty, does not guarantee that the least-protected sectors of a given society will benefit from a growing gross national product, even in the long term. In fact, as the US and other cases show, it is even possible for an economy to thrive and at the same time leave important segments of the population on the margins of economic development.

Historic evidence shows that the most successful nations and regions of the world have been those able to strike a balance between revamping their economies to compete in a global world and providing "safety nets" and opportunities for the less skilled to adapt to the new environment created by globalisation's dynamics.

In South Africa the challenge is to ensure that globalisation benefits the many and not the few. There are many aspects to this challenge. For instance, how do we respond to the challenges posed by free trade? How do we ensure that our workers possess the necessary skills that are needed in the globalising world? And finally how do we develop an economy that can be competitive in this global economy?

### 3.7 The Challenge of Fiscal Decentralisation

The first democratic government has presided over significant political, economic and social transformation. The creation of nine provincial governments with considerably expanded responsibilities, the establishment of over 800 municipalities and the related set of intergovernmental institutions and fiscal arrangements posed enormous challenges.

Some of the major achievements in the development of the intergovernmental system are summarized below:

1) The Constitutional Framework, including the establishment of three "distinctive, interdependent and interrelated" spheres of government and the explicit designation of expenditure responsibilities and tax revenue assignment for each sphere;
2) The legislative framework and appropriate institutional mechanisms for the successful functioning of the intergovernmental fiscal system. Prominent amongst the former are the Intergovernmental Fiscal Relations Act establishing the Budget Council, comprising the Minister of Finance and provincial MECs for Finance, which oversees the division of revenue between the provinces and other finacial matters relating to the provinces. In addition, the Act established the Budget Forum, the analogous body for financial matters relating to local government. The Financial and Fiscal Commission (FFC) established by the Constitution is an independent body which makes recommendations to Parliament on the division of revenue between the three spheres of government. A significant development in the legislative framework is the recent introduction of the Public Finance Management Act which is designed to produce more effective management of finances in all three spheres, including promoting greater accountability by spending agencies.
3) A major development in the development of fiscal decentralization relates to the changes introduced to the budget process in order to take account of the Constitutional provisions relating particularly to autonomy for the sub-national governments. Allied to these developments in the budget process has been the introduction of the Medium Term Expenditure Framework (MTEF), a three-year rolling expenditure plan, which both enhances financial planning through providing certainty of revenue and promotes financial discipline.
4) An innovative feature of the budgeting process has been the development of revenue sharing formulae, based on the recommendations of the FFC, for the division of nationally-collected revenue amongst the provinces on the one hand and amongst the municipalities. These formulae are driven by criteria to reduce inter-jurisdictional poverty and inequalities.

There is little doubt then that significant progress has been made in the development and implementation of the intergovernmental fiscal system during the past six years. Nevertheless, several challenges remain. Foremost amongst these are the following:

1) **Persistent inter-jurisdictional and intra-jurisdictional inequalities**: Although the revenue-sharing formulae and the national government's conditional grants go some way towards addressing regional inequalities, between provinces and between municipalities, developmental needs are still enormous, especially in provinces that inherited the Bantustans.
2) **Institutional and human resource constraints**: development in the sub-national government spheres (provinces, municipalities) is hampered by serious institutional and human resource constraints relating particularly to budgeting and financial management, information technology and monitoring and evaluation. This in turn, affects their capacity to deliver services efficiently.

3) **Absence of an effective policy co-ordination framework,** to align the policy development activities of the national government and the policy implementation activities of the sub-national governments. There are currently weak and/or ineffective structures to enhance co-ordination between the three spheres as well as weak linkages between co-ordinating Ministries such as Finance, Provincial and Local Government and Public Service and Administration.

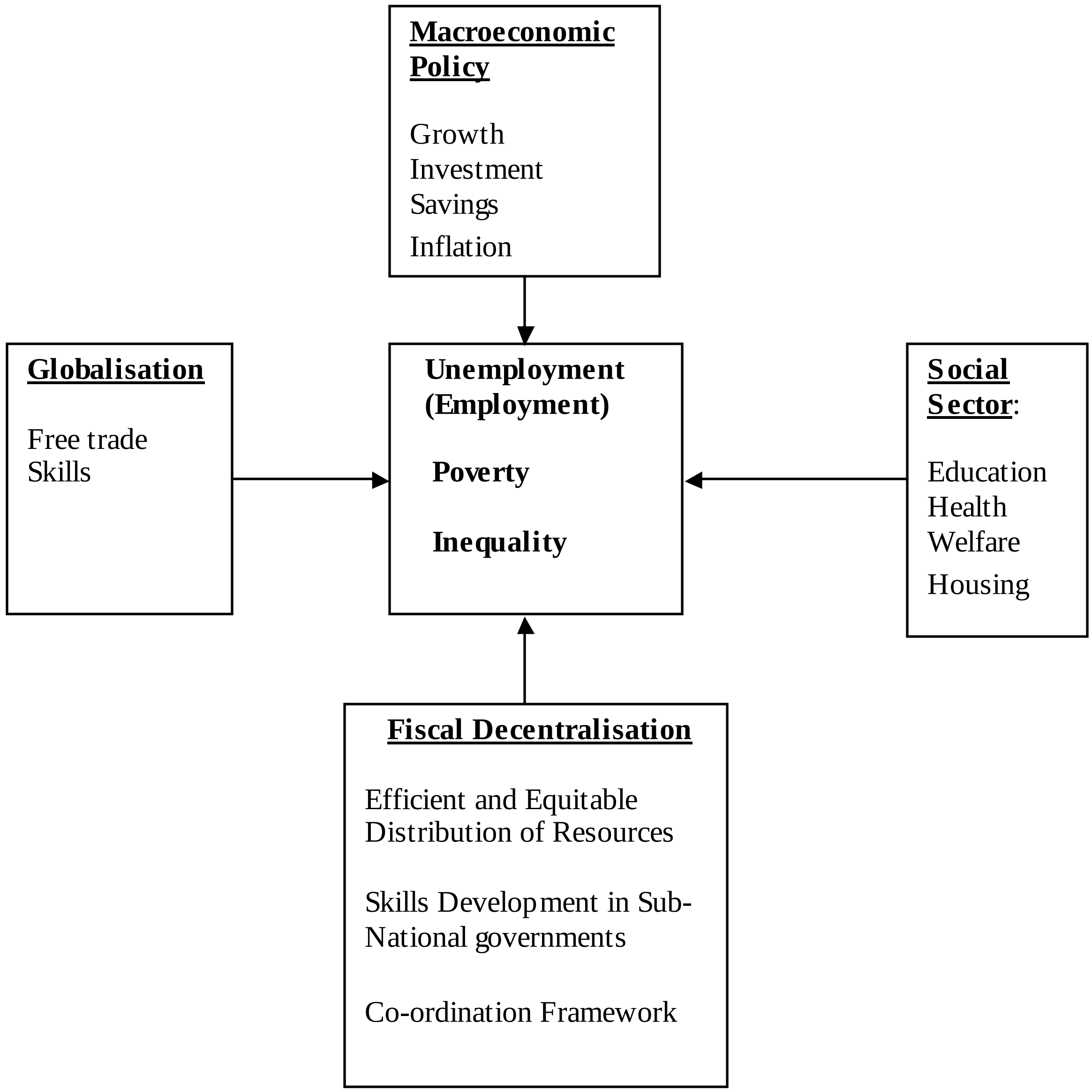
A serious gap in the Policy Co-ordination framework also is the absence of a Medium Term Strategic Framework (MTSF) to complement the Budget and the Medium Term Expenditure Framework. The consequences of this are two fold: first, all policy development is given equal priority; second, the budget is seen as the main policy making instrument.

## 4. Conclusion

This paper has served to document six key socio-economic challenges that face South Africa. This concluding section makes two broad points. The first is that it is necessary for policy makers to recognize the linkages between these challenges and to think seriously about how we can develop policy in a consensual fashion to address the challenges of unemployment, poverty and inequality.

One of the most important lessons from the emerging market crises of the past two years is that there is more to life than macroeconomics. Sound monetary and fiscal policies may be vital to economic success, but good government, robust financial systems and effective social provision also matter.

The diagram below attempts to illustrate rather crudely the inter-relationships referred to above. The nature and direction of policy making will determine whether these relationships will have a positive or negative dimension.


Macroeconomic Policy
Growth
Investment
Savings
Inflation
Globalisation
Free trade
Skills
Unemployment (Employment)
Poverty
Inequality
Social Sector:
Education
Health
Welfare
Housing
Fiscal Decentralisation
Efficient and Equitable Distribution of Resources
Skills Development in Sub-National governments
Co-ordination Framework

The second point made here (and which is related to the first) is about the need for a comprehensive approach to development. The virtues of a “holistic” approach to promoting development have been recognized for years, but the complex mix of national governments, international institutions, private sector players and civil society has for too long been seen as ill-equipped to deliver.

The President of the World Bank, for instance, sees the development framework for a country as a balance sheet with two sides. On the left hand side is the familiar macroeconomic presentation. On the right hand side is an analytical framework that presents the structural, social and human aspects. This second side will help to ensure that these issues are given equal status to the macroeconomic ones.

The basic idea is to set up a matrix for each country that lays down overall objectives and describes what various players are doing in a number of policy areas, thereby preventing duplication and conflict.

There are many different dimensions of policy to consider. The World Bank blueprint has identified a number of them:

a) **Structural**: good government, including transparent regulation and strong anti-corruption measures; an effective legal system, including impartially administered contract and property rights; a financial system that is well informed; and a social safety net, with social programmes for the elderly, children, the disadvantaged and the unemployed.

b) **Human**: education, with girls enjoying equal access; health, including support for mothers and children, plus action to restrain population growth.

c) **Physical**: water and sewerage; widespread access to energy; communications, including an adequate road system and telecommunications; environment protection and cultural heritage preservation; and

d) **Specific strategies** for rural areas, cities and the private sector, plus action to address special national needs (for example, eliminating illegal drug production).

As we ponder such a holistic approach we have to ask ourselves some difficult questions. Is it realistic to hope for a national consensus over a development strategy in an often fractious society such as ours? Will donors and other development players co-operate and specialize, or will they see the structure as the battleground for an institutionalized turf war? And will the laudable objectives of the right-hand side of the World Bank’s balance sheet be blown off course by the restrictive macroeconomic measures?

It is early days yet in the development of such holistic development strategies. However, we may want to look at the experience of Bolivia, which has already pioneered a similar framework. Its President has shown that it is possible to develop a national consensus through what he called a “Dialogo National”.

Bolivia's development framework has the overall objective of poverty alleviation, with the subsidiary objectives of boosting sustainable economic growth, promoting greater equality, improving government and extricating the country from the cocaine industry. A matrix describes what the government, the multi-lateral institutions, the private sector and non-governmental organizations are trying to do in each area.

It is conventional wisdom now that efforts should be measured by outputs rather than inputs, but the holistic approach moves a step further to outcomes. Looking at the development challenge as a whole will make it easier to identify policy problems that may be tougher to address in the short term but which, if solved, will break a log-jam and allow success in other areas.

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