

## CHAPTER 3

### THE SOUTH AFRICAN LABOUR MARKET

#### 3.1 INTRODUCTION

The unemployment rate in South Africa is exceptionally high and arguably the most pressing concern that faces policy makers. According to the conventional (narrow) definition of unemployment, which applies a job search test, one in every four adults in South Africa who wants work and is actively looking for work, is unemployed. Apart from this, there are also extreme wage inequalities and disparities in the incidence of unemployment between different race groups.

Given the importance of employment income in total household income, the varying incidence of unemployment across different groups has important implications for the distribution of income and for the incidence of poverty (Kingdon *et al*, 2001 (a), p1). Apart from this, high unemployment seems to coexist with comparatively low levels of labour force participation with the result that an even smaller proportion of the working age population is actually working (Klasen *et al*, 2000, p1).

There are therefore two major labour market issues that need to be addressed, these being how to create more jobs and thereby reduce unemployment in South Africa, and how to remove or at least reduce labor market inequalities. In this chapter the unemployment problem in South Africa is described and analysed. The analysis is done to determine the extent of South Africa's unemployment problem, and whether it is possible to design an environmental policy that will have the desired effect on the level of employment in South Africa.

Subsequent chapters that analyse the theory behind obtaining a double dividend will indicate that it is important to determine whether the unemployment problem is a labour demand-side, or a labour supply-side problem. Evidence from European markets indicates that the wage elasticities of both labour supply and demand play an important role in the possible attainment of a double dividend. If the wage elasticity of supply were relatively low (inelastic), an increase in the demand for labour could

result in an increase in wages, which would not have the desired effect on unemployment. In the event that the wage elasticity of supply were relatively high, an increase in the demand for labour would actually result in an increase in employment.

The South African labour market is analysed by reporting the results of previous studies that address the unemployment problem. The aim is to determine whether the current literature concerning the South African labour market indicates whether policies that address the demand for labour would result in a decrease in the unemployment rate. This is done by:

- i. describing the labour market by referring to the state of employment and unemployment in the country;
- ii. giving a review of some findings that argue that the unemployment problem in South Africa is involuntarily;
- iii. discussing reasons for the high rate of unemployment; and
- iv. reviewing solutions that have been suggested for solving the unemployment problem.

### **3.2 SOUTH AFRICAN UNEMPLOYMENT: A DESCRIPTION OF THE MARKET**

According to Fallon *et al* (1998) there are a number of features of the South African labour market that stand out as being rather unusual for a country at South Africa's present stage of development:

- i. The level of urbanisation is relatively high and agriculture accounts for a low share of the labour force;
- ii. Formal wage employment is by far the largest source of productive labour absorption;
- iii. The urban informal sector is a relatively small employer; and
- iv. Unemployment is extremely high.

Contrary to evidence for other developing countries, South Africa's labour force is mostly employed in urban areas, as only 38.5 percent of the labour force is found in rural areas. Apart from this, only 10.7 percent of the labour force is employed in the agriculture sector. This relatively low level of employment in agriculture is not surprising given the systematic encouragement of capital-intensive agriculture by previous governments and the eradication of subsistence farming in much of the country in earlier decades by policies such as the various Land Acts. These factors had a detrimental effect on the absorption capacity of the labour market, because agriculture acts as a valuable buffer in most developing countries as it absorbs what would otherwise be excess labour supply (Fallon *et al*, 1998, p3).

In contrast to the minimal role that the agricultural sector plays in the South African economy, the formal sector is the largest employer of South African labour. Estimates of the labour force in 1995 suggest that approximately 49.9 percent of the labour force in South Africa holds formal jobs, and although the proportion varies across racial groups, it remains true that the formal sector generates the most employment for every racial group. The formal employment sector is highly unionised with 35.1 percent of the formal workforce affiliated to a trade union. Despite the significant amount that this sector contributes towards total employment in South Africa, the employment performance of the formal sector has been disappointing. Formal employment growth peaked in the 1960s at an annual rate of 2.9 percent per year. This declined to 1.9 percent in the 1970s, and dropped further to 0.7 percent in the 1980s. The situation reached a critical stage in the 1990's and average employment growth during this period was negative and reached an all time low in 1996 at 6.9 percent below its average level of the 1990's. Within the formal sector the government has been the only consistent employer over the past 20 years, with a yearly employment growth rate of 4.5 percent in the 1970s and 3.4 percent in the 1980s. If not for the government, employment growth would have been negative in the period 1976-1990 (Fallon *et al*, 1998, p7).

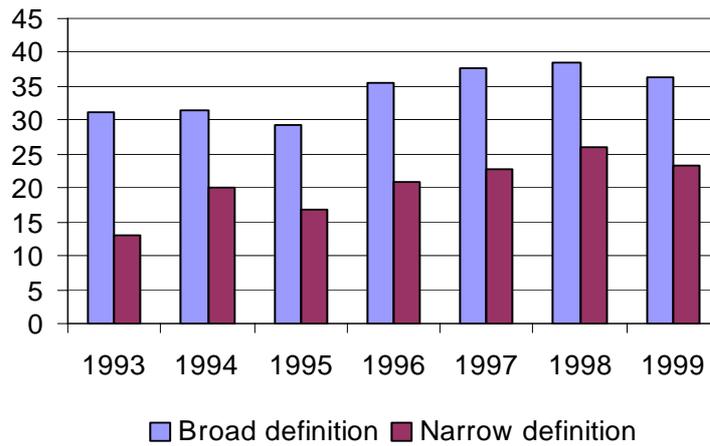
Informal sector employment such as casual work, and self-employment in agriculture and other activities, comprises only a minor part of the labour market and absorbs only 14.6 percent of the labour force. Urban informal activities are heavily based

upon trade, while the rise of black taxi services in the 1980s is estimated to have employed nearly 300 000 workers by the end of the decade (Fallon *et al*, 1998, p5).

The slowdown in employment over the past three decades was not matched by a reduction in labour supply growth. This caused an increasing imbalance in recent years between levels of labour supply and formal sector employment. Labour supply estimates indicate that African labour force growth increased from about 2.5 percent per year in the early 1960s to about 2.8 percent in the 1980s, while growth of other Black groups declined from 2.8 percent to 2.6 percent. The imbalance between black labour supply and formal sector demand grew substantially in 1970-1994, and now stands at over 50 percent. In contrast to this, the proportion of Whites without formal jobs remained reasonably constant in the 1970's and the 1980's, although it increased significantly in the 1990's (Fallon *et al*, 1998, p8).

A distinction must be made between the two definitions of unemployment that are commonly utilized, these being the broad and the narrow definitions. The narrowly defined unemployed are those individuals who are currently not employed, but who have looked for work in the past four weeks. The broadly defined unemployed consist of the narrow unemployed plus those who say they want to work but have not looked for work in the past four weeks (Kingdon *et al*, 2001 (a), p4). South Africa had a narrow unemployment rate of 24 percent and a broad-based rate of 38 percent in 1999 (Klasen *et al*, 2000, p1). Although some improvement in employment is evident due to a broad-based expansion in employment in the private sector, unemployment remains very high, and the lack of job creation in the formal sector continues to be a major concern for the government. The significant difference between the broad and narrow unemployment rates indicates that there is a large proportion of jobless people who say they want to work, but are not actively looking for work. The reason for this discrepancy is a topic of some controversy as some analysts argue that many of these unemployed are not labour force participants. However, others have persuasively argued that the broad definition is the more relevant, because tests suggests that non-searching people are discouraged workers who have given up on the search for employment opportunities (Kingdon *et al*, 2001 (a), p4).

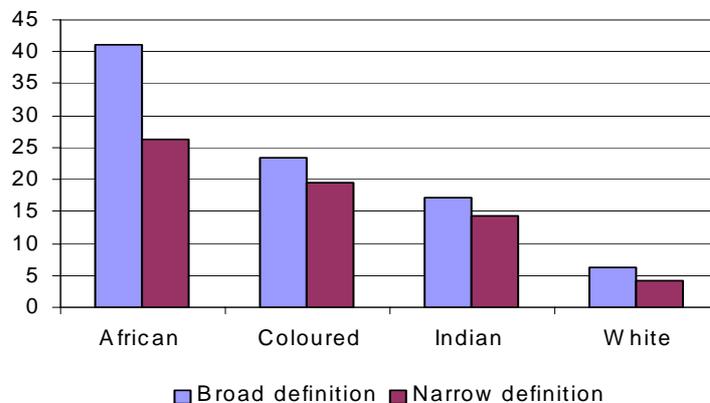
**Figure 3.1: Unemployment rates in South Africa: 1993-1999**



Source: Kingdon *et al*, 2001 (a)

Apart from the high differential between the broad and narrow unemployed, there is a significant difference in the incidence of unemployment between different race groups, regions, and based on gender and levels of education in the country. While Africans face unemployment rates of 41 percent (broad definition), the rate for whites is only 6 percent. The high level of unemployment among Africans is one of the highest in the world, and could be the highest if compared with rates of countries of similar, or larger, population size. In general, women are more susceptible to unemployment than men. This is a common phenomenon in developing countries, as women are often more restricted to work at or near their homes and may face negative discrimination when looking for work (Fallon *et al*, 1998, p5-6).

**Figure 3.2: Unemployment rates by race in South Africa 1994**



Source: Kingdon *et al*, 2001(a)

People with higher education face an unemployment rate of 6 percent, but those with primary education or less suffer a rate close to 40 percent. This could partially explain the labour allocation by race, because there is a big gap between education and level of skills between racial groups, with whites having much greater education and skills than other groups, and Africans lagging well behind Asians and Coloureds (Kingdon *et al*, 2001 (a), p5).

As discussed above, rural unemployment rates are higher than unemployment rates in urban areas. This regional discrepancy seems to be the result of the segregation policies of the apartheid era in which millions of Africans were consigned to live in rural areas of poor land quality and with few employment opportunities. The result of this policy was that much of the unemployment in rural South Africa took the form of people waiting in the homelands for a formal sector job opportunity (Kingdon *et al*, 2001 (a), p5).

### **3.3 SOUTH AFRICAN UNEMPLOYMENT: VOLUNTARY OR INVOLUNTARY?**

The chapters that describe the theory behind the double dividend hypothesis indicate that the construction of a policy that addresses both environmental, as well as unemployment problems will depend, among other factors, on whether the unemployed are voluntarily or involuntarily unemployed. If the unemployed prefer to be unemployed because of a high premium attached to leisure, the unemployment problem will have to be approached in a different way than it would be if there were barriers to entry into the labour market. It is therefore necessary to determine whether unemployment can be attributed to the supply side or to the demand side of the labour market. Although a considerable amount of research has been performed on the reasons for unemployment, little attention has been directed towards determining whether unemployment in South Africa is voluntary or involuntary. For this reason much importance is attached to a paper by Geeta Kingdon and John Knight (2001 (a)) in which an attempt is made to answer the latter question.

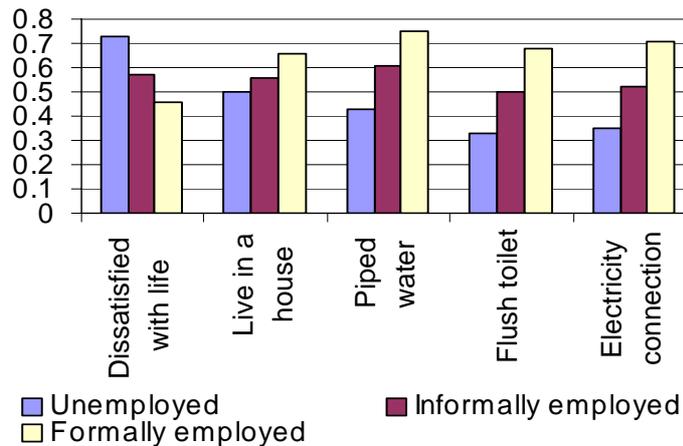
In their research Kingdon and Knight (2001 (a)) distinguish between two broad questions:

- i. Why do the unemployed not enter into self-employment (informal sector);  
and
  - ii. Why do the unemployed not enter into wage-employment (formal sector)?
- (Kingdon *et al*, 2001 (b), p5)

In answering the first question they distinguish between the supply and demand functions of labour. If it can be shown that the unemployed do not enter the labour market, because they prefer leisure and can afford it, the unemployment problem is one of voluntary unemployment and should be a labour supply-side problem. If, however, barriers to entry into the labour market exist, then the problem is a demand-side problem.

Informal workers are those workers that are not in regular employment but engage themselves in casual wage employment, domestic services or agricultural/non-agricultural self-employment. Based on surveys conducted by the South African Labour Research Unit and Statistics South Africa, the research conducted by Kingdon *et al* (2001 (b)) indicates that the unemployed are substantially worse-off than the informally employed, when measured by virtually every indicator of well-being. This includes indicators such as per capita income, living space, access to drinking water and the availability of sanitation and electricity. The surveys also show that the predicted earnings of informally employed are 1.44–2.35 times higher than those of the unemployed (Kingdon *et al*, 2001 (b), p11).

**Figure 3.3: Measures of well-being of the unemployed, informally and formally employed (% of each sector).**



Source: Kingdon *et al*, 2001(b)

The hypothesis of voluntary unemployment was further tested by the question: “Are unemployed people any happier than informally employed people?” If they are, it might be possible to argue that their unemployment is the result of choice and therefore voluntary rather than being the result of limited opportunities for informal sector work. The research tests this hypothesis by using an ordered probit model by means of which it is shown that happiness increases with income and education and that the unemployed are substantially disadvantaged in terms of happiness. This indicates that the unemployed do not “voluntarily” remain unemployed and that the informal sector is not necessarily a free-entry sector in South Africa (Kingdon *et al*, 2001, p11).

With regards to barriers of entry into the formal sector work force, Kingdon *et al* (2001 (b)) test whether the wage expectations of the unemployed are too high by making use of the voluntary wage aspiration hypothesis. This hypothesis indicates that persons whose reservation wages are greater than their predicted wages may be considered to be voluntarily unemployed. Interestingly, the research indicates that more than 50 percent of the unemployed have higher reservation wages than their predicted wages. A closer look at the formation of reservation wages indicates that these figures are, however, not very reliable. Reasons for this include:

- i. labour market ignorance to such an extent that the unemployed in rural areas do not know current labour market conditions;
- ii. workers may actually be reporting their expected wages, rather than their reservation wages;
- iii. workers may actually be taking a bargaining stance when they report their reservation wage;
- iv. the participants could be reporting a reservation wage for work in a certain geographical area, other than the one that they live in.

(Kingdon *et al*, 2001 (b), p15–17)

The research concludes that the need for policies that would reduce unemployment in South Africa is compelling, as it is very likely that most of the currently unemployed workers are involuntarily unemployed in the sense that they would accept formal sector jobs at the going wages. For as long as barriers to entry continue to restrict opportunities in much of the informal sector, this sector will be unable to significantly absorb those currently jobless. It would also be remarkable if the unemployed in South Africa chose to remain deprived and it appears as if limited opportunities for entering the informal sector provide no real alternative but high levels of unemployment (Kingdon *et al*, 2001 (b), p20).

### **3.4 SOUTH AFRICAN UNEMPLOYMENT: THE REASONS**

Given South Africa's high unemployment rate, it seems as if some labour market rigidities exist which do not allow the market to clear. Although Fallon *et al* (1998) state that most of the decline in employment growth can be attributed to factors other than wage growth, they analyse its contribution towards unemployment in some detail, because the sensitivity of employment to wages is a very important issue. Its importance is due to it being central to virtually every question regarding wage policies. In their study, Fallon *et al* (1998) make the assumption that Black employment represents the unskilled labour force, while White employed represents the skilled employment force in South Africa. Despite the growing problem of unemployment among black workers, average real wages rose considerably in the 1970s and the 1980s, which means that real wages paid by employers also increased. This increase can be contributed to an improvement in earnings-related characteristics

of Blacks such as educational and occupational attainment. However, factors such as reduced discrimination, the abolition of influx control and pressures of growing African trade unionism also contributed to this increase. According to Fallon *et al* (1998) the most striking feature of real wage behaviour since 1970 was that White wages were near stationary while Black wages grew in a somewhat erratic manner which caused wage differentials between White workers and other groups to narrow considerably.

Based on an examination of the relationship between wages and employment at the sectoral level, Fallon *et al* (1998) conclude that employment is more sensitive to wages than previously believed. By fitting labour demand equations to time series data of all the sectors of the economy, they obtained an average long-run wage elasticity of  $-0.71$ , which is in line with estimates obtained from other countries. A sectoral analysis indicates that mining has a rather low elasticity of  $-0.15$ , while the elasticity of the services sector is much higher at  $-0.95$ . Another interesting result from this study is that employment takes a significant period of time to adjust to wage changes and that the impact elasticities are mostly much lower in the short run than in the long run. This means that the employment gains from real wage reductions would take a number of years to be realized fully (Fallon *et al*, 1998, p11).

Although Kingdon *et al* (2001 (c)) do not state that the high unemployment rate is the direct result of high real wages in the South African economy, they do mention some wage-related issues that keep unemployment at high levels. These include labour market institutions such as Industrial Councils (Bargaining Councils) and Wage Boards. These institutions set sectoral minimum wages and stipulate working conditions in many industries. These minimum wages are then applied to all firms in the industry and region, irrespective of the size of the firm. Such provisions impose a burden of high labour costs on small firms and it is likely that it seriously inhibits the entry and growth of such firms into the formal economy (Kingdon *et al* (2001 (c), p7). These sentiments are shared by Black *et al* (1998), who use a labour demand and supply schedule to show that the “new” labour laws, passed in 1995 to reduce social imbalances, give rise to higher unemployment. They argue that the laws result in a loss of productivity, an increase in shirking (from both the employer as well as the employee) and an increase in wages and other costs attached to employment. This

will either cause a movement upward along, or a shift leftward of, the labour demand schedule and subsequently cause a higher unemployment rate (Black *et al*, 1998, p460).

Jackson (2001) investigates the role that the unemployed are allowed to play in finding a solution to their plight. He mentions that unemployment is mostly the result of labour market rigidities. These rigidities include the high transaction costs for hiring and firing workers, downwardly sticky wages and institutional wage setting arrangements across industries. The aforementioned factors can be blamed on organized labour, South Africa's apartheid past and the current labour-friendly legislation. Apart from labour market rigidities, mechanization due to labour unrest and access to cheap capital in the past has also had a negative impact on employment. Although capital is far more expensive today, there are still a number of firms that prefer to invest in "non-unionised" machinery instead of a vast workforce. South Africa also suffers from a lack of sufficient skilled labour and the current educational system provides matriculants with few marketable and relevant skills. Jackson (2001) also refers to high real wages, which have not reflected the decrease in the demand for labour or a declining economy. The increases were mostly the result of institutional arrangements. Jackson concludes his section on the causes of unemployment by referring to the "insider-outsider" phenomenon. The labour market segmentation of the 1970s and 1980s has resulted in a sector of "insiders" and "outsiders". The "insiders" in formal sector employment have tended to exert upward pressure on wages and greatly influenced employment practice. The result has been increasing numbers of people who are willing to work at reduced wages or the "outsiders", who have been prevented from doing so by those already in employment.

In summary, factors that have been identified as contributing towards the unemployment rate are:

- i. Rising capital-intensity linked to major parastatal investments (Fallon *et al*, 1998 and Jackson, 2001).
- ii. Increasing real wages that do not reflect the decrease in demand for labour (Fallon *et al*, 1998, Kingdon *et al*, 2001, and Jackson, 2001).

- iii. Insufficient skill acquisition by the work force that acts as a constraint on growth and employment (Fallon *et al*, 1998, and Jackson, 2001).
- iv. Declining private investment that leads to slow growth in the non-governmental capital stock (Fallon *et al*, 1998).
- v. The apartheid system that repressed the informal sector activities of black South Africans through licensing and zoning regulations (Kingdon *et al*, 2001).

### **3.5 SOUTH AFRICAN UNEMPLOYMENT: SUGGESTED SOLUTIONS**

Fallon *et al* (1998) suggest the following policy initiatives to decrease unemployment:

- i. Increasing human capital. Expansion of the skills base would increase growth, and would result in welfare redistribution. This is reflected in the high returns to education received by all racial groups at almost all levels of education. By concentrating government efforts on basic education, a solid base is laid for the whole of the system. This means that access to primary and secondary education must be extended along with an improvement in the quality of instruction. The planning and management capacity of the education sector will also have to be strengthened (Fallon *et al*, 1998, p29).
- ii. Creation of a more competitive environment. A more competitive environment would serve to lessen labor market discrimination, as discrimination against workers with non-productive characteristics tends to decrease in a strongly competitive industry, as employers who discriminate less, gain an advantage over those who do (Fallon *et al*, 1998, p30).
- iii. Encouragement of the positive aspects of trade unions. The positive aspects of trade unions should be allowed to develop fully. These aspects include their ability to raise productivity by countering arbitrary and unwise employer decisions, and their provision of an information channel through which employers learn of production floor problems. Unions also reduce costs by limiting voluntary worker turnover through increased job satisfaction (Fallon *et al*, 1998, p31).
- iv. Creation of public works programs and labour-intensive construction. By creating productive jobs in the form of public works programs, or the

- v. adoption of more labour-intensive methods in the construction of public infrastructure, the government can increase employment. It is, however, important that such schemes be located in areas where there are substantial concentrations of surplus labour, otherwise local wage rates may be bid up, to the detriment of employment outside the schemes. Care should also be taken to ensure that the burden on public expenditure is eased by paying wages below prevailing levels. As unskilled labour is in excess supply in South Africa, it is appropriate that such labour is valued at its social opportunity cost. The informal sector wage may be taken as a rough guide (Fallon *et al*, 1998, p32).
- vi. Facilitation of national agreement. Given the current labour environment, it would be difficult for unions and employers to agree on a national social pact in which unions forego their power to increase wages in return for job-creating investment and training supplied by employers (Fallon *et al*, 1998, p32).
- vii. Avoidance of excessive wage increases. Further high wage increases would have a serious dampening effect on formal employment in the country. However, the government only has a few policy instruments with which to intervene directly in wage setting. Current structures would have to take responsibility for not merely setting minimum wages and other labor standards to protect existing workers, but would also have to ensure that wage increases do not increase unemployment. Under the present circumstances of high unemployment, protection against increases in unemployment would suggest that real wages should be allowed to fall. If this option seems politically unfeasible, labour costs should not rise more quickly than national productivity (Fallon *et al*, 1998, p30).
- viii. There are two concerns with regard to the wages that government employees receive. On the one hand, it is important that the government pay its skilled employees similar wages to those received by employees in competing sectors, because other sectors are already starting to attract skilled labour. On the other hand, unskilled labour is in excess supply in South Africa and there is little doubt that the government is actually paying wages well above the supply price (Fallon *et al*, 1998, p31).

### 3.6 CONCLUSION

The current literature that describes the South African labour market seems to indicate that the unemployment problem definitely stems from the demand side of the labour market in that there are structural restraints that inhibit an increase in the demand for labour. Apart from these structural problems, high real wages also seem to contribute to the unemployment problem, especially for the unskilled labour force.

A very important result that arose from analysing the supply side of the South African labour force is that most of the unemployed are not voluntarily employed and do not obtain a higher level of utility because less labour is supplied. In fact, most studies indicate that the unemployed will be willing to work at real wages that are lower than the current wages within the labour market.

Because unemployment seems to be a phenomenon that is prevalent among the unskilled labour force, it seems plausible to assume that the elasticity of labour supply for unskilled labour is very elastic, and could verge on perfect elasticity. The studies undertaken by Kingdon *et al* (2001) also indicate that unemployment in the skilled labour force is low and it is therefore plausible to assume that the wage elasticity of demand for the skilled labour force is inelastic.