



# **UNDERSTANDING SOUTH AFRICA'S ECONOMIC PUZZLES**

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## UNEMPLOYMENT RATES

- ✘ Formal employment in manufacturing has declined from 1.6 million in 1990 to 1.2 million in 2004.
- ✘ Semi- and unskilled employment also decreased from 1.0 million to 0.7 million.
- ✘ **What is the reason for such high unemployment?**
- ✘ **What is behind South Africa's economic under performance?**



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Unemployment rate (%)

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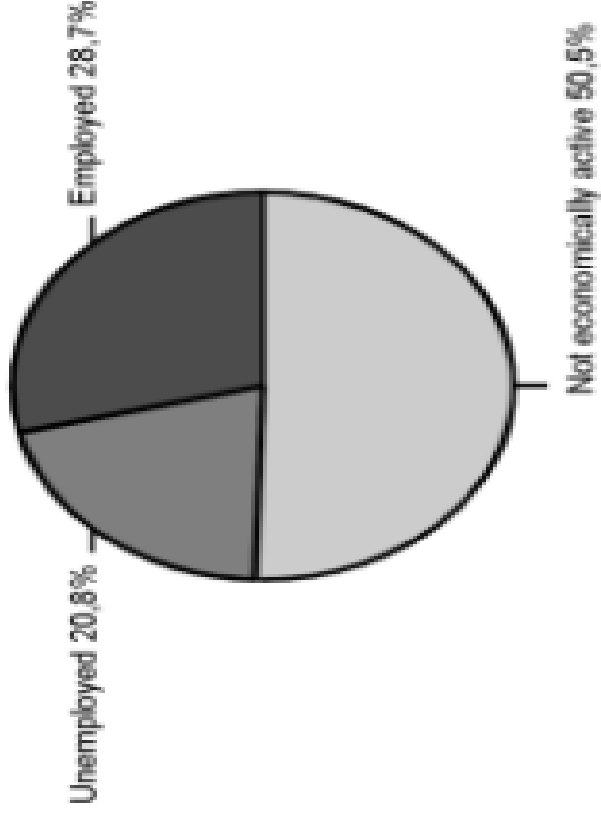
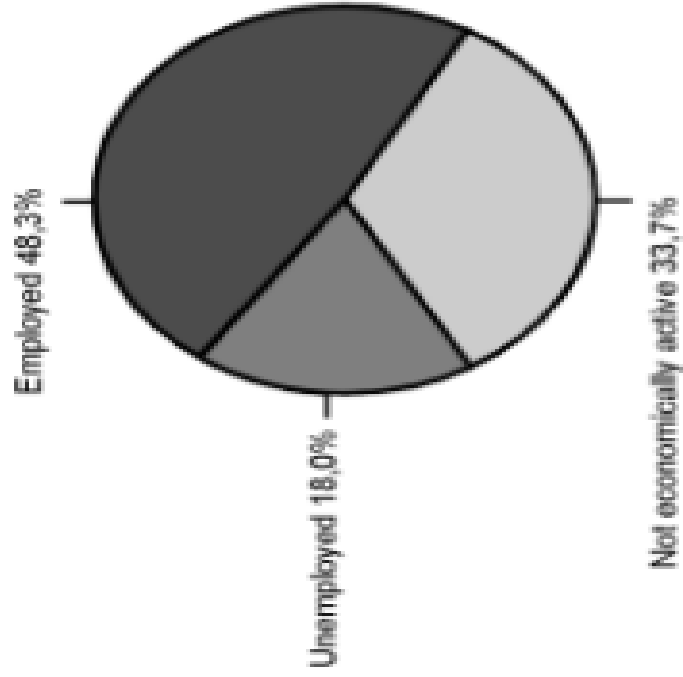
1960	6.7
1970	6.6
1980	8.4
1985	12.4
1991	19.4
1995	29.3

**Source:** Loots, 1997, p. 2

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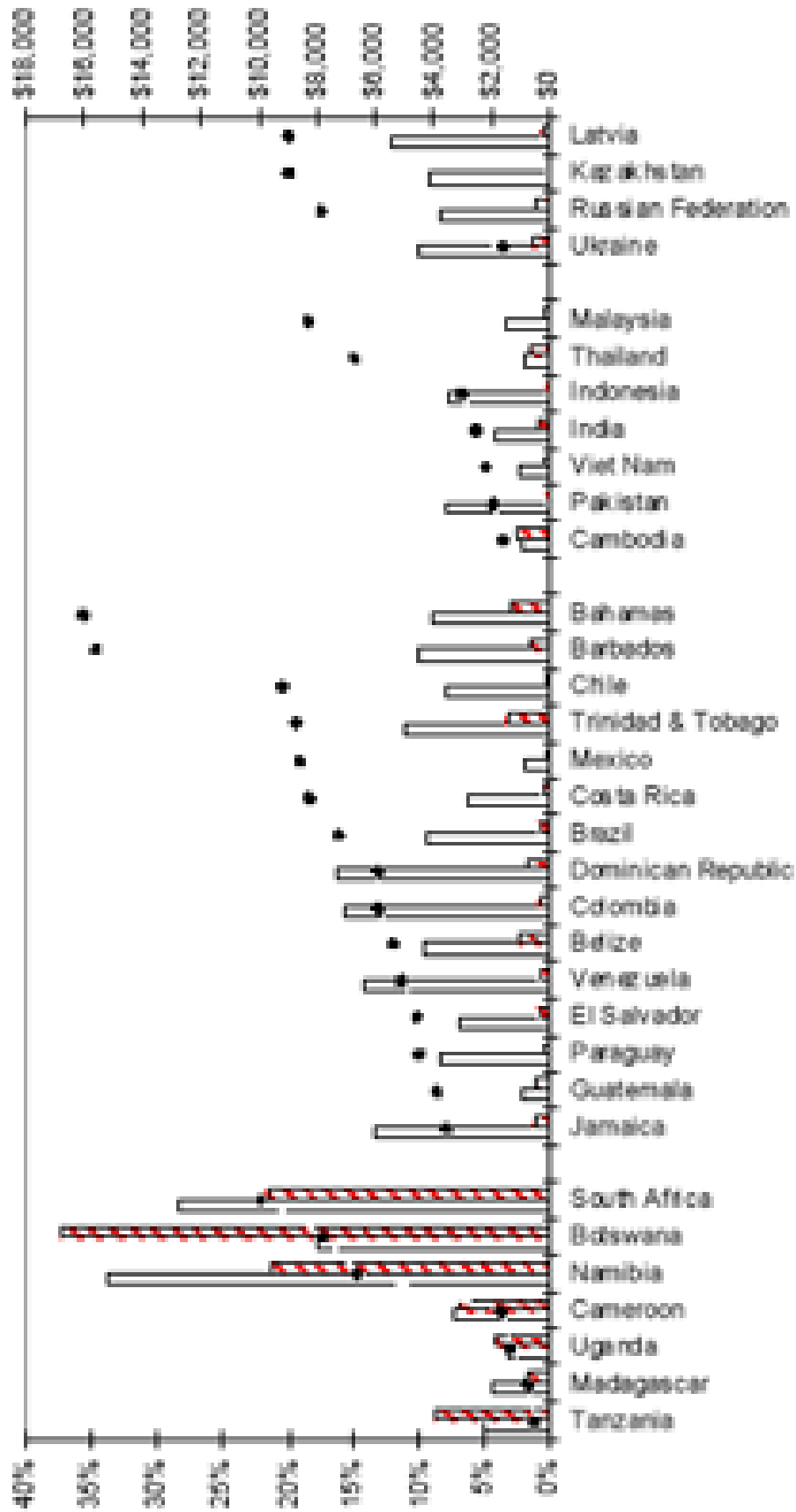
**Male: 11 341 143**

**Female: 12 645 463**



**Source: Census '96**

**Unemployment, HIV Prevalence and per capita income for those countries with HIV Prevalence of 0.1% or more, and for which adequate data exists (source: ILO, World Bank, UNAIDS)**



Legend: Average unemployment rate (2000-2004) Adult HIV Prevalence GNP per capita (PPP) 2002

# AGENDA

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- ✘ political democratic transition
- ✘ Malaysia comparison
- ✘ Issues with growth
- ✘ Patterns of employment and structural change

## **POLITICAL TRANSITION**

- ✘ South Africa underwent a democratic transformation in 1994 with the end of the Apartheid regime.
- ✘ Prior to 1994, the South African economy and polity were dominated by white minority.
- ✘ The democratic transition helped redistribute income throughout the economy.
- ✘ Is it possible that the prior regime delayed the creation of social and other networks needed to maintain large-scale informality?



# COMPARISON WITH MALAYSIA

- ✘ Why compare South Africa to Malaysia?
- ✘ Well, both share many similar economic features in the 1980s:
  - 1.) Both medium sized economies, with deep racial cleavages.
  - 2.) Ethnic majority controls the polity but economic power lies with ethnic minority.
  - 3.) Similar economic structures.
  - 4.) Output per head and TFP were almost identical at some point.
  - 5.) Human capital levels close.
  - 6.) Both economies have similar dependencies on mining.

## MALAYSIA COMPARISON CONT...

- ✘ The main differences between these two countries are:
  - a.) Malaysia was able to pull an increasing share of its workforce into manufacturing (the sector with the highest labor productivity in the economy), in the process of becoming an economic “tiger,” while in S.A. manufacturing has lost ground to the tertiary sector.
  - b.) S.A. non-mineral tradable (including manufacturing) are intensive in low-skilled labor compared to services.

## **MALAYSIA COMPARISON...**

- ✘ However, the biggest difference between these two countries is that Malaysia began experiencing industrialization, while S.A began to de-industrialize.
- ✘ Why did South Africa de-industrialize prematurely?

## POSSIBLE EXPLANATIONS

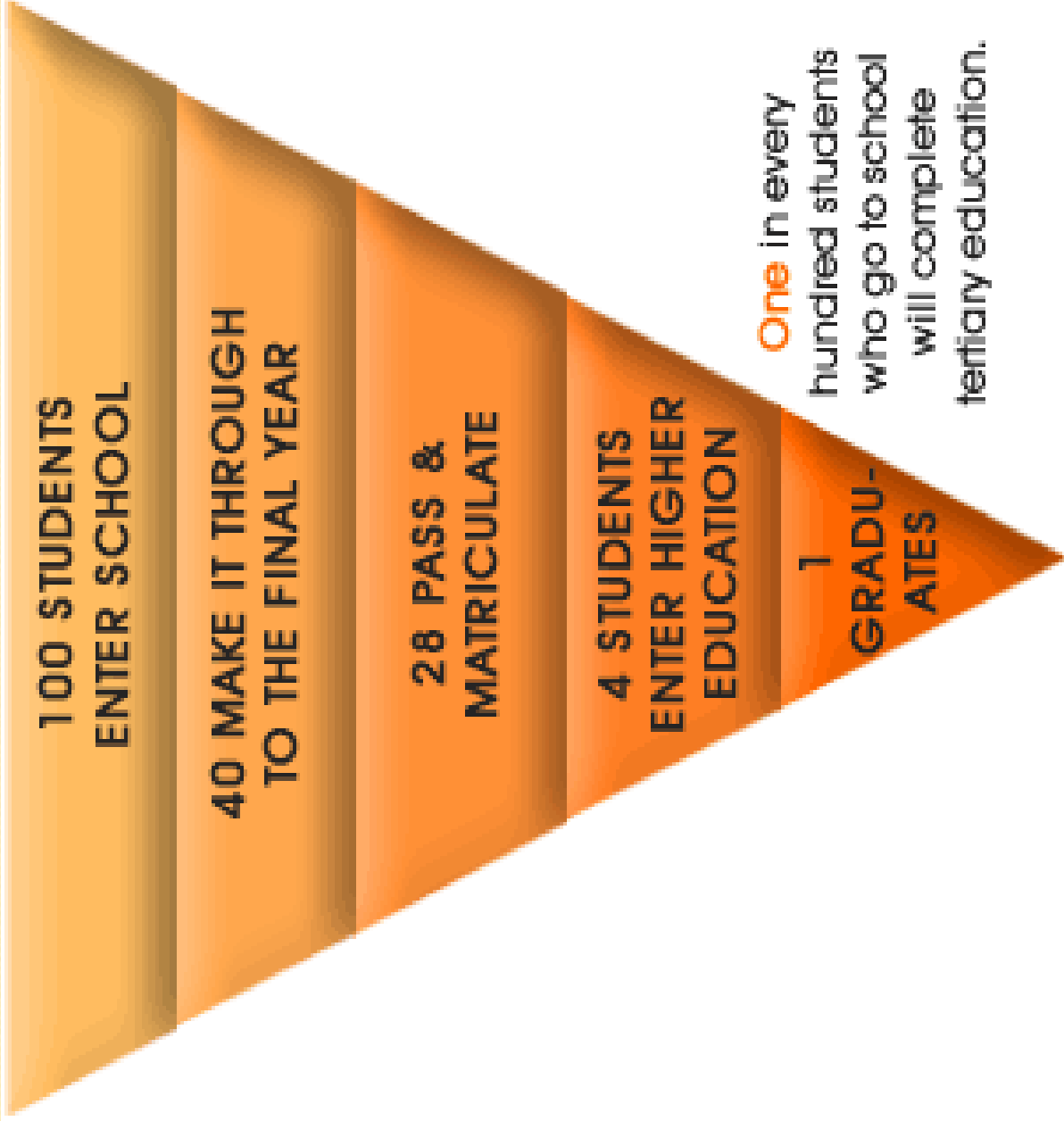
- ✘ Malaysia has a more advantageous geographical location.
- ✘ Malaysia government actively promoted manufacturing. Their goal was to expand and diversify the industrial base of the economy.
- ✘ South Africa had to contend with heavy defense spending and the devastating effects of trade embargo.

## **ISSUES WITH GROWTH**

- ✘ A decreasing non-mineral tradable sector.
- ✘ Weak export-oriented manufacturing sector.
- ✘ Decreasing relative price and profitability in the manufacturing sector.
- ✘ Weak composition of export basket.
- ✘ In general, higher wages.
- ✘ An increasing wage in (informal sector).

## WHY HAS THE DEMAND FOR LOW-SKILLED WORKERS DECREASED?

- ✘ Three important trends in the economy imply:
  - ✘ 1.) there has been significant substitution toward skilled workers within each economic activity.
  - ✘ 2.) significant structural change away from most low-skill intensive parts of economy.
  - ✘ 3.) Now, within those tradable goods, production is more capital intensive.
- ✘ All of these shifts in demand, help explain why unemployment levels have increased.



Statistics: Ministry of Education South Africa

# **PATTERNS OF EMPLOYMENT AND STRUCTURAL CHANGE 1**

- ✘ 1.) Decline in the relative demand for low skill labor.
- ✘ 2.) There have been across-the board skill upgrading.
- ✘ 3.) The tradable sector still remains the most low-skill intensive part of the economy.



## PATTERNS OF EMPLOYMENT AND STRUCTURAL CHANGE 2

- ✘ Formal employment in South Africa stagnated in 1990s.
- ✘ Semi-and low-skilled workers only contribute around 42% of those employed.
- ✘ S.A. unemployment rate today is at 40% if you include discouraged workers, and 30% without.
- ✘ The end of the Apartheid era in 1994 helped pick-up economic growth to a certain extent. With the implementation of outward-oriented GEAR (Growth, Employment and Redistribution) strategy, has shift S.A. toward greater integration into the global economy.
- ✘ Agriculture and mining jobs have declined and it has not been compensated for by an increase in manufacturing employment.

**TABLE 4 Workers by highest level of education and sector in South Africa, 2003**

Highest level of education	Formal workers	Informal workers
None	4.1%	12.3%
Grade 0-3	2.8	7.4
Grade 4-6	8.7	16.8
Grade 7-9	17.4	29.1
Grade 10-12	43.4	29.3
Diploma	12.8	2.4
Degree	8.9	1.2
<i>Total*</i>	98.1	98.5

\* Totals do not add to 100 because of rounding errors and a small portion of the sample whose education levels were not reported.

Source: Adapted from research by Braude in chapter 5 (South Africa).

# **PATTERNS OF EMPLOYMENT AND STRUCTURAL CHANGE 3**

- ✘ There has been a dramatic increase in the employment share of private non-tradables at the expense of tradable.
- ✘ Among expanding sectors: financial intermediation, insurance, real estate and business services.
- ✘ In the tradables sector, employment has decreased by 10 percent.
- ✘ South Africa puts a premium on skills and human capital.
- ✘ However to achieve higher levels of growth, an expansion of low-skill intensive manufacture at the expense of skill-intensive non-tradables is needed.
- ✘ Manufacture-led growth would on balance reduce the relative demand for skilled workers.

## **PATTERNS...POLICIES**

- ✘ Education policy
- ✘ Technology policy
- ✘ Employment policy
- ✘ Social Security policy
- ✘ Labor Market policy
- ✘ What do you guys think?

## WHAT DOES THIS IMPLY?

- ✘ So far, how do you think this relates to South Africa's underperformance?
- ✘ Why did relative profitability in manufacturing decline in the 1990s?
- ✘ What do you think?

## IT IMPLIES...

- ✘ This could explain S.A. concern with “skill shortage.”
- ✘ Could also explain why S.A. has underperformed in tradable sector, manufacturing in particular.
- ✘ Lack of job creation because labor costs are too high. Unit labor costs in manufacturing (labor cost per unit of output) capture a key underlying determinant of competitiveness in an important subset of traded goods. Labor costs are less subject to exchange-rate effects than traded-goods prices (Stephen Golub’s “South African Real Exchange Rates and Manufacturing Competitiveness,” p. 17)

# COULD HAVE BEEN AVOIDED... USING INFORMAL SECTOR

- ✘ S.A. could avoid high rates of unemployment if utilizes young, unskilled job seekers and direct them into the informal sector.
- ✘ It seems they are trying this method but still remain way below Africa, Latin America, and Asia.
- ✘ Why?
- ✘ Maybe the social grants have worked in the opposite direction- decreasing incentives to work and setting higher reservation wage levels
- ✘ In addition, many households viewed paid employment and social grants issued by new democratic government, as close substitutes.
- ✘ Or perhaps the history of the Apartheid regime has left its legacy...

## WHY THE APARTHEID REGIME

- ✘ The legacy of the Apartheid regime was to confine blacks who did not already have a job to separate townships and prevent unemployment to migrate into the urban areas.
- ✘ Could it be possible that this history delayed the creation of social and other networks needed to maintain large-scale informality.



## IMPORTANCE OF LABOR UNIONS

- ✘ Labor Unions memberships among African male workers in 1993 are 145 percent higher than comparable nonunion workers.
- ✘ Inequality in wage rates is among the highest in the world for South Africa, with African and white workers receiving wages that differ by a factor of five.

## OTHER IMPLICATIONS

- ✘ South Africa's economy is now more open to international trade, and thus the manufacturing sector faces higher competition in imports.
- ✘ Rodrik (2006) believes increases in import competition is one of the reasons behind the decline in manufacturing's relative prices.
- ✘ What do you think?

## OTHER PATTERNS

- ✘ Capital deepening. The substitution of capital for labor has been particularly marked in tradable activities (including manufacturing). Now each worker has higher levels of total factor productivity.
- ✘ Tradable activities have considerably higher capital per worker than non-tradable activities.

## **BRIEF SUMMARY**

- 1.) Apparent fall in relative price of the manufacturing sector.
- 2.) International trade openness has increased import competition and export-oriented competition.
- 3.) Wage pressures have increased since 1990s.

## QUESTIONS

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- ✘ The big question is, what are possible ways to address the unemployment issue?

# HOW CAN WE SOLVE S.A. UNEMPLOYMENT PROBLEM?

- ✘ Both Macro and Micro policies are clearly needed.
- ✘ Macro level: a combination of monetary and fiscal policy that will allow S.A. Reserve Bank to work on improving equilibrium exchange rate.
- ✘ The success of South Africa's export-led growth strategy and shift towards manufacturing exports away from primary products is dependent on maintaining a competitive real exchange rate as well as on the growth of the world economy.
- ✘ Manufactured exports and imports are strongly influenced by cost competitiveness, therefore working to improve the levers price, cost and productivity will boost growth.

## **POSSIBLE SOLUTIONS CONT...**

- ✘ Encourage private investment and entrepreneurship in new areas where South Africa can develop comparative advantage.
- ✘ Micro front: S.A. need more coherent and better coordinated industrial policies.
- ✘ To ensure the above strategy will become a success:
- ✘ (1) greater discipline in targeting policy intervention on probable
- ✘ (2) improve institutional structure to ensure (a.) political leadership and coordination at the top, and (b) strategic collaboration at the bottom with businesses and stakeholders.

## **SOLUTIONS THAT WON'T WORK**

- ✘ Rising high employment could have been avoided by a subsequent decline in real wages for low-skilled workers.
- ✘ However, the above response would have been politically impossible given that South Africa was undergoing a democratic transformation.



## **SOUTH AFRICA'S POVERTY LEVELS**

- ✘ The number of people in poverty in South Africa is roughly 23.8 million. Of which, 11.8 live in households that receive no social assistance (2002 data).
- ✘ This translates to over half of the population in South Africa live in poverty. An average of R144 per person per month. (Poverty benchmark is \$1 a day.)
- ✘ Poverty heavily concentrated among its ethnic group with 61% African, 38% of mixed race, 5% of Indians and 1% whites.

## **BIGGEST THREAT**

- ✘ Consequently, poverty and income inequality pose the biggest threat to South Africa's young democracy.

## ADDITIONAL INSIGHT

- ✘ South Africa has a large percentage of its population infected with AIDS:
  - ✘ 31% of pregnant women are HIV positive
  - ✘ 20% of adults
  - ✘ 1.1 million orphans from AIDS
  - ✘ The impact of AIDS and HIV on the population are important factors to consider when addressing S.A. economic growth.
- ✘ (source: South Africa AID and HIV Statistics)

