SPECIAL REPORT

Development and under

Learning from the past how to overcome the

An ETC discussion document to stimulate debate on issues around the labour market has emerged from within the ANC. Some have attributed it to current deputy finance minister Jabu Moleketi. The **Labour Bulletin** reports on the main thrust of what has become known as the 'NGC discussion document'.

The government has achieved much over the last ten years , however, some critical challenges remain including:

- High unemployment, with continuing job losses in the formal sector and rising joblessness especially among the youth.
- Low growth, low savings and low levels of investment.
- Continued mass poverty and deep inequalities based on class, race, gender and region.

Addressing these challenges will require that we choose a broadly accepted development approach that will underpin sustained reform and transformation of major sectors, regions and key domestic economic markets. Our choice of approach must involve focused state-led interventions to ensure the integration of the two economies, poverty alleviation, job creation and, most importantly, sustained economic growth.

We believe that such an approach rests on a correct understanding of the successful efforts to defeat poverty and underdevelopment in the last half of the twentieth century, which we analyse below. In all these cases, a central component of success was the ability of government to act as a 'developmental state'. This means creating the capacity at every level of the state to mobilise and direct social, economic and political resources where they are needed most.

But government alone cannot resolve these challenges. They require that we unite our people in a People's Contract to Create Work and Fight Poverty. Building this united front will require us to continue to mobilise support for our economic policies and strategies. We must seek to reach consensus on our development approach in society in general.

LEARNING FROM EXPERIENCE

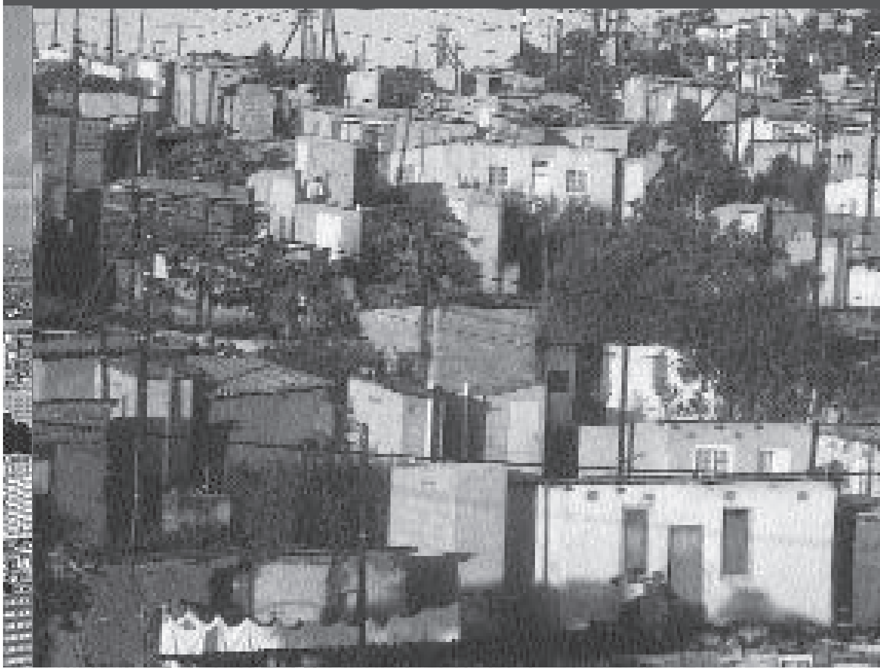
Since the Second World War, the world has experienced three successful development programmes specifically and consciously aimed at the eradication of poverty and underdevelopment. These were:

- The Marshall Plan
- The East Asian growth and development programme
- The European Union integration programme.

Each was successful. However, this success

COVER STORY

development
two-economy divide



required the political will on the part of the wealthy nations. Now it is commonly agreed that Africa constitutes the biggest challenge in the struggle against poverty. What can Africa, and South Africa in particular, learn from history?

LESSONS OF POST-WAR DEVELOPMENT AND THE FAILURE OF THE 'WASHINGTON CONSENSUS'

A summary of the three programmes reveals a number of common factors from which we need to draw lessons:

- Each grew out of a powerful strategic consensus, which translated into political will on the part of the affluent to act decisively to overcome poverty and underdevelopment. This political will resulted in a conscious, purposeful and determined response that involved the allocation of vast amounts of resources on the part of the affluent.
- Each was based on the understanding that the regions concerned were too poor to generate the savings and capital they required for their development, and that the extent of poverty and underdevelopment made it impossible to attract significant volumes of private capital.
- Accordingly, public sector grants, soft loans and other forms of aid constituted the bulk of the funds allocated for development in each case. This assistance was augmented, in one case or another, by preferential and asymmetric market access agreements, the deliberate engineering of undervalued currencies, the creation of rents linked to performance and other measures that required substantial government intervention.
- As such, each programme has been premised on the understanding that development could not be left to the market alone, and that it would be critical for the state to be directly involved in the planning and implementation of detailed and comprehensive development programmes.

In the 1990s the 'Washington Consensus' emerged as a shorthand for the package of policies that the richest and most powerful nations of the world had agreed would best address the problems of underdevelopment and poverty amongst the poorest. The measures proposed included fiscal discipline, reordering of public expenditure priorities, tax reform, liberalising interest rates, abolishing exchange-rate control, trade and capital market liberalisation, privatisation, deregulation and the entrenchment of property rights.

Despite all the efforts by developing countries to create the political, policy and other conditions that the developed countries set as pre-conditions for economic take off, it has not happened. This is because, rather than sincerely drawing on the lessons of the programmes stated above, the Washington Consensus was not primarily designed with the needs of the less-developed countries in mind. Rather, it was a response to the interests and needs of the developed countries themselves.

Through opening the markets of developing countries, but failing to reciprocate, and by a host of other measures, the developed countries have sought through the Washington Consensus to provide new outlets and investments for their own businesses.

Freed of any challenge equivalent to the perceived threat posed by 'communism', the developed capitalist countries will devote only such resources to meet the needs of the poor billions in the world as would ensure that these billions do not act in a manner that threatens their survival as prosperous

capitalist countries. Believing such a threat to be absent, the developed countries are ready to argue against substantial resource transfers to the poor, on the basis that their constituencies suffer from 'donor fatigue' and that, in any case, they have a responsibility to address the serious challenge of poverty within their own societies.

SOUTH AFRICA'S 'TWO ECONOMIES'

South Africa is fully integrated with the global economy. It is therefore open to the pressures imposed on all medium-sized middle-income countries of the South by the process of globalisation. At the same time, a large part of our population is caught in an underdeveloped sector, the Second Economy, which cannot escape the trap of poverty and underdevelopment through reliance on the market. Despite the impressive gains made in the First Economy over the last decade, the benefits of growth have yet to reach the Second Economy which risks falling further behind, if there is no decisive government intervention.

The Second Economy is linked to the First Economy by the extent to which it can still supply the cheap, unskilled labour this economy may require. It survives on money transfers sent by family members who have been able to secure regular or occasional employment within the First Economy, as well as social grants and elements of the social wage provided by the democratic state. It is also linked to the First Economy by the goods, equipment and services it purchases with the meagre resources at its disposal.

Such positive 'trickle-down' effects as would result from higher earnings of family members who would benefit from growth in the First Economy, as well as individual and social transfers by the state, would not be sufficient to raise the standard of living in the Second Economy, or close the ever widening wealth and development gap. The market economy, which encompasses both the First and the Second economies, is unable to solve the problem of poverty and underdevelopment that characterises the Second Economy. Neither can welfare grants and increases in the social wage. The level of underdevelopment of the Second Economy also makes it structurally inevitable that the bulk of such resources as flow into the Second Economy will inevitably leak back into the First Economy.

INTERVENING FOR DEVELOPMENT AND GROWTH

These problems make decisive government intervention imperative. This intervention would set the preconditions for market-led economic growth. Fortunately, South Africa can draw on a wide range of experiences, including the examples we have discussed above, to learn the lessons of successful government intervention to overcome conditions of poverty and underdevelopment. One is that we should, as far as possible finance the transformation of the Second Economy through domestic resources. These should be made available through the state in the form of grants. This does not rule out accessing commercial loans by the state, or equity participation funds to finance economically viable projects.

Therefore, decisive government intervention in the Second Economy requires that the government should have the resources to make this intervention. The successful management of the macro-economy, coupled with policies that have resulted in the growth of the First Economy, have enabled the government to generate these resources. Now our interventions must focus on:

- Productive investment to create and safeguard sustainable jobs;
- Investment in infrastructure which contributes to development, structural adjustment and the creation and maintenance of sustainable jobs, or, in eligible regions, to diversification, revitalisation, improved access and regeneration of economic sites and industrial areas suffering from decline, depressed urban areas, rural areas and areas dependent on fisheries. Such investment may also target the development of trans-Southern African networks in the areas of transport, telecommunications and energy;
- Development of internal potential by measures which support local development and employment initiatives and the activities of small and medium sized enterprises. Such assistance should be aimed at services for enterprises and cooperatives, transfer of technology, development of financing institutions, direct aid to investment, provision of local infrastructure, and aid for structures providing neighbourhood services;
- Investment in education and training and health.

As was the objective of the Marshall Plan, those currently caught within the Second Economy should be able to grow and develop without the need for exceptional outside interventions. We must fully understand that the success of our own vigorous and targeted interventions in the Second Economy are dependent on the success of the First Economy and building the structural links between these two economies.

South Africa's strategy has to be to raise the level of investment and economic activity while at the same time, reforming the labour market so that more labour is absorbed, the fruits of economic growth are spread more evenly and that the Second Economy is empowered to generate higher levels of growth internally and in collaboration with the First Economy. The two elements of this strategy entail reducing the cost of capital and allowing for a more competitive currency aimed at raising investment and exports, while at the same time allowing for labour demand to be expanded through more flexible and appropriate labour market policies. Because of the duality of our economy the methods and strategies to achieve a reduction in the cost of capital and a more appropriate labour regime for the First and Second economies will differ.

THE COST OF CAPITAL

Within the First Economy a policy aimed at reducing the cost of capital should not be based on artificial reduction of real interest rates. Lower real interest rates must come from prudent fiscal policy, a more nuanced inflation targeting policy, deeper capital markets, more efficient use of capital in the state owned enterprises and the achievement of a more competitive unit labour cost. Government can also pursue a more competitive currency through the accumulation of reserves and through freer foreign exchange markets.

It must be noted that lowering the cost of capital on its own may raise investment but will not necessarily achieve our objective of raising employment. Cheaper capital without reforms to reduce the relative cost of labour is likely to result in higher investment that displaces labour. An increase in investment is only likely to result in an increase in employment if the cost of labour is reduced relative to capital. A difficult issue to broach, but one that must be confronted is the capital requirements of financing black economic empowerment.

While these policies aimed at the First Economy will naturally reach the cost of capital faced by the Second Economy, additional measures will be required to address the specific issues relating to the cost of capital in the Second Economy. Ultimately, reducing the cost of capital in the Second Economy can only be achieved by the state carrying the cost of this price reduction, which adds to fiscal pressure. It is however possible that this burden could be limited by the government seeking soft monies from international institutions as well as leveraging 'under-utilised' domestic assets. Also critical is the role of South Africa's development finance institutions and parastatals.

It is meaningless to deal with the cost of capital without addressing access to capital. Three possible policy options exist. First, it could be possible to create a set of measures that improve the creditworthiness of potential borrowers in the periphery. For example, a lower tax rate applicable to second economy businesses and lower effective labour costs would improve their profitability and improve their likelihood of accessing credit. A second policy, which does exist, but has been largely unsuccessful, is to re-look at the financial intermediaries and their ability to penetrate this under-serviced market.

In this regard it is necessary to investigate how the state-backed substitute intermediaries operate as well as to consider how more appropriately existing private sector intermediaries can be incentivised to expand their coverage. A final intervention to improve access to capital is the formal and legal recognition of assets that are currently unregistered and cannot be used as collateral (especially rural land and township houses).

THE LABOUR MARKET AND SMALL BUSINESS

Without wanting to deregulate labour markets or erode the gains of the democratic order, a number of small adjustments to the current regulation of the labour market could produce substantial returns for job creation. Some of these apply to the First Economy and some to the Second Economy. Government should consider adapting the present bargaining arrangements to limit the effect of agreements on parties outside of the agreement such as smaller firms. In amending this policy, government must aim to support increased employment in small businesses. Policy must also aim to support increases in employment in labour intensive sectors as well as high value added sectors that are able to export. These measures may include investment incentives such as the present strategic investment incentive and the critical infrastructure programme as well as the possibility of a special labour dispensation for labour-intensive sectors.

A sensitive point, which must be raised here, is that often we refer to labour-intensive and capital-intensive activities when in reality with respect to absorbing labour we are talking about skilled and unskilled activities. Similarly we often characterise a sector in isolation of the value chain to which it belongs. For example: while high value added manufacturing in the motor vehicle or ICT industry may not be labour intensive, but the inputs, packaging and distribution of these final goods may give rise to increased levels of activity which are more labour intensive. So there is also much to be gained from supporting non-labour intensive industries whose inputs in the total value chain may indirectly create jobs.

From a policy perspective, the unintended consequences of the Labour Relations Act and the Basic Conditions of Employment Act need to be properly understood and unpacked, and a strategy to address this needs to be developed. The solution to this problem lies in reducing the hassle factor associated with employing workers. While the legislation has good intentions, the effect is higher costs for companies and the alienation of these protective rights from the employees they were designed to protect. Other unintended consequences include the use of short-term contracts and consultancies, which distort jobs that in the absence of the legislation might be permanent positions.

Government must increase the employment opportunities for unskilled people. The Expanded Public Works Programme is a good example of how labour-based techniques can be used to achieve the same output in the same time with the same financial resources. We need to explore other sectors where this is possible. Home-based and community based care services also have the potential to increase employment. Simultaneously we must ensure that the different spheres of government are not placed in a situation where they are contributing to unemployment or moving staff from their own services into the expanded public works programme. For example a metro council recently invested in new capital and technology, which made refuse removal less labour intensive. They did this for sound economic reasons from a company perspective but it was contrary to the larger job creation strategy. Numerous examples of these apparent contradictions exist for example, government garages and fleet management.

Increasing the limit of the size of companies that must comply with certain aspects of the labour legislation from 50 to 200 may stimulate more small business development. Government must look at reducing the compliance burden from the tax

system and the regulatory environment to stimulate the informal sector. A strengthened land reform programme and supportive subsistence agriculture programme as well as better access to credit for small businesses (including agricultural businesses) would stimulate the informal economy and increase employment. The application of the minimum wage in sectors that potentially could employ more people must be examined. High transport costs and high reservation wages in the South African economy (the wage rate at which people will not work) already places a floor in the labour market. Addressing high transport costs and the spatial pattern of apartheid's 'location' policy is a more effective way of increasing real incomes to poorer people.

Some European countries with similar generous labour regimes to our own, have experimented with accommodating some amount of duality in the labour market as a means of raising employment prospects. The model looks something like this: One set of labour laws (the existing ones normally) are used to govern one set of employees and more flexible labour laws apply to another set of people. This is often done informally through policy rather than legislation.

More flexibility is accommodated (sometimes temporarily) rather than formally legislated. There are many ways in which the criteria for splitting the labour market can be determined. Under apartheid, race was used to differentiate the applicability of labour laws. In some countries, geographic area is used, where more flexible labour laws are allowed in a specific geographic area, sometimes associated with industrial development zones or export processing zones. China is a good example of this.

Age has also been used as differentiating criteria to break the insider-outsider problem. Companies are allowed to employ younger people under more flexible arrangements. They often fall outside of the collective bargaining and minimum wage arrangements and it's easier to dismiss people for non-performance. The theory is that young workers are able to get their foot into the door of the labour market, get some experience and then they are able to break into the labour market permanently.

A fourth approach to labour market segregation is by industry. You have one set of rules for certain industries, typically the financial services, government etc and another set of rules for specific labour-intensive industries that government wants to boost. These usually include textiles and clothing, tourism and many of the personal services sectors. A fifth way of segregating the market is by size of business.

Perhaps South Africa should consider accommodating some flexibility in its labour regime by considering the following:

- Allow younger people to be regulated under a more flexible regime. That is, waive the minimum wage and other collective bargaining arrangements (including limits on overtime work) and make it easier (less costly) to dismiss non-performers. The advantage of this option is that it might help break the very high rates of youth unemployment. On the other hand, the criticism of possible displacement of older workers with younger workers will be immense.
- Use the present industrial development zones as geographic areas where labour laws will be made more flexible. This will encourage investment and employment growth in poorer provinces such as the Eastern Cape and KwaZulu-Natal.
- Allow for greater labour flexibility in the tourism, textile and clothing, household and child-care and agricultural sectors. These are all labour-intensive industries, which can attract investment and will create jobs if investment rises. Is this approach politically feasible?
- Have much more flexible labour laws for companies that employ less than 200 people. While the present legislation does have some flexibility for companies that employ less than 50 people, this flexibility is very limited and the threshold is too low.

Aside from these changes to labour market regulation, we also need to streamline our efforts to promote small business. Already, budget 2005 has announced a number of tax reforms designed to benefit small businesses. Further discussion on how to promote small business is required.

CONCLUSION

The ANC's vision has always been one of a prosperous, equitable, stable and democratic society. In the economy, our vision has been one of decent work and living standards for all, in the context of qualitatively improved equity in ownership, management skills and access to opportunities. It is imperative that we mobilise the ANC's core constituencies - the poor, workers, women, youth and black business - around our economic strategies.

Decisive government intervention requires that the government should have the resources to make this intervention. Our growth strategy must aim to balance the need to raise investment and increase economic growth with the need to meaningfully share the benefits of economic growth with a wider group of people. This strategy requires policies that will increase investment while allowing for a strong state to direct the dividends of growth towards raising the human capital potential of the poor.

It is a strategy aimed at growing the First Economy, growing the value addition of the Second Economy while building staircases between the two economies.

The growth strategy must seek to reduce the contradictions present in policy. You cannot aim for small business development while imposing such a high regulatory burden on small businesses. You cannot provide a comprehensive social security system, invest in economic infrastructure, the criminal justice sector and keep the tax and debt burdens stable. You cannot extend wage agreements to non-parties and expect geographic concentration on investment to be diversified.

South Africa should pursue a policy that allows for a more competitive exchange rate without abandoning the inflation-targeting model. South Africa should also pursue policies aimed at lowering domestic real interest rates through prudent fiscal policy, encouraging savings, making progress in reducing the cost of utility services and encouraging competitiveness in the economy.

As a country with a 40% unemployment rate and a youth unemployment rate of almost 60%, the insider-outsider model of our labour market must be examined carefully. We have to introduce elements of flexibility in the labour market. LB

This is an edited version of the paper discussed at the ETC meeting.