

# The arms deal and employment creation

**T**his input explores the broader employment implications of the current arms procurement programme.

It focuses on the broader economic impact, rather than the specific implications of industrial participation programmes. To that end, it focuses on the opportunity costs – that is, the benefits of creating jobs through the arms procurement programme compared to expenditure on alternative projects. Specifically, it focuses on the opportunity costs of:

1. Expanding production in the defence industry, and
2. Increasing the share of arms procurement in total government spending.

In that context, we suggest that the developmental impact of defence spending can only be assessed realistically in the context of a more defined, sector-based development strategy

## The role of the state

Government spending can accelerate employment creation in four main ways:

- By supporting an effective economic development strategy that stimulates growth in relatively labour-intensive industries.
- By maintaining a social wage that sets a floor below living standards. Specifically, ensuring adequate health,

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education, housing and policing will create more stable and productive communities – an important factor facilitating job creation, expanding domestic demand and improving productivity overall

- By enhancing skills development – a particularly important consideration in South Africa. Broad-based training supports greater equity as well as rising productivity.
- By creating jobs within the state sector itself. This is particularly true where spending goes into the major social services – education, health and police – which are inherently labour intensive.

We can understand the opportunity costs of the defence procurement programme by looking at its implications in each of these areas.

### Economic growth

The main economic impact of the procurement programme is expected to take place through industrial participation programmes. Vague reporting on these programmes makes assessment of their impact difficult. By their nature, a substantial share of the benefits will accrue to the defence industry. That strategy seems likely to aggravate capital intensity; widen income inequalities by race, gender and region; do little to enhance skills development; and leave the economy even more vulnerable to international fluctuations for a number of reasons including:

- ❑ The capital intensive nature of the investment
- ❑ The location of the existing industry - about 80% of the industry is located in Gauteng - mainly in Johannesburg/Pretoria
- ❑ The sector is relatively skill intensive.
- ❑ The sector is dominated by white men in terms of employment.
- ❑ The depreciation of the rand against the dollar.

The published information on the industrial participation programmes is misleading at best. For instance, the 2000 Budget Review indicates that 'the supplier companies agreed to industrial participation commitments totalling R10.6-billion in investment, export and domestic sales in South Africa'. (Department of Finance 2000a, p 141) Yet the economic and employment implications of investment and sales are obviously very different, making the aggregate figure meaningless.

The nature of the defence industry means that, whatever their magnitude, the industrial participation programmes seem unlikely to optimise investment or economic structure from the standpoint of employment.

In the mid-1990s, the Defence Review estimated that direct and indirect employment in the defence industry came to around 70 000, or just under 5% of manufacturing employment. But, as the Review points out, the industry showed major shortcomings from a developmental perspective. To sum up, the Review argues that that defence industry is:

- ❑ relatively skill intensive, employing some 10% of engineers and scientists in the country in the late 1980s;
- ❑ relatively capital intensive, with a capital-labour ratio of almost R400 000 in the mid-'90s - that is, an average cost per job well above the national average;
- ❑ dominated by white men in terms of employment;
- ❑ very disproportionately located in the Gauteng metro areas;
- ❑ characterised by concentrated ownership, with four companies accounting for 90% of output.

The defence industrial participation projects will aggravate the dichotomies in the economy and not narrow them. Furthermore, to the extent they mobilise local capital into a fairly capital-intensive sector, they will actually limit employment creation.

In the event, reports suggest that the Industrial Participation programmes will actually increase the capital intensity of the sector. Estimates suggest that the cost will come to R1.7-million per job (Batchelor 1998) - this is about four times the current capital intensity of the defence sector and significantly higher than other highly labour intensive sectors where jobs can be created at considerably less than R100 000 per job.

Union shopstewards in the defence industry report that the development of industrial participation programmes at the political level makes planning difficult for both labour and management. As a result,



*The Department of Defence anticipates rationalising 30 000 personnel over the next three years.*

they cannot maximise positive spin-offs from the procurement programme.

Finally, the defence industry remains significantly export oriented. But military exports are obviously more subject to political and economic instability than most other products.

In sum, much of the benefits from industrial participation programmes are expected to go into a stronger defence industry. In the absence of a more explicit strategy for ensuring a diffusion of skills and growing backward and forward linkages to the civilian economy, this concentration is likely to aggravate economic and social divisions.

Furthermore, it exposes the economy as a whole to the risks associated with the defence industry. Finally, it seems likely to divert investment resources into a relatively capital-intensive sector.

#### *The impact on the social wage*

The arms procurement programme effectively shifts spending from the main social services and the criminal justice

system to defence. That change will affect the productivity of communities and the labour force in general, which will have significant implications for the long-term growth in employment. The implications for the social wage are aggravated by the exchange-rate risk.

According to the 2000 Medium-Term Budget Policy Statement, defence spending rose from 6,7% of total spending in 1999/2000 to 7,5% in 2000/1, and will stabilise at 7,7% for the next three years (Department of Finance 2000b, Table 5.2, p 66). Defence will grow by 8,5% a year over the period, compared to 7,6% for expenditure as a whole, and only 6,6% for the main social services and the criminal justice system (Calculated from, Finance 2000b, Table 5.1, p 65).

It is instructive to compare this pattern of expenditure with the priorities officially set in the Budget Policy Statement. 'As part of the 2001 Budget process, the Ministers' Committee on the Budget, the Budget Council and Cabinet have given in-depth consideration to government priorities

and medium term spending options...

This review identified the following critical areas:

- ❑ Maintenance, rehabilitation and investment in economic and social public infrastructure
- ❑ Targeted interventions aimed at improving the efficiency of the criminal justice system.
- ❑ Continued emphasis in the social services on improving the effectiveness of service delivery and strengthening the distributional impact of spending, while targeting additional expenditure at critical maintenance and operational needs.
- ❑ Provision for the impact of HIV/AIDS in welfare expenditure, public health and other services.
- ❑ Programmes aimed at accelerating employment creation. (p 63)

In short, it appears that one of the fastest-growing areas of the Budget, namely defence, was not identified as a priority.

To illustrate the distortions introduced into government development strategies by the procurement programme, and the implications for job growth, consider the figures provided in the 2000 Budget Review on expenditure for 'poverty relief and job creation'. According to Table 6.2, total spending on these programmes will come to R5-billion between 1999/2000 and 2002/3, as compared to R43-million for arms procurement. (Department of Finance 2000a, p 144)

An unexpected deterioration in the exchange rate could lead to even more severe implications for the social wage. Some 85% of the package is denominated in foreign currencies. The divergence in estimates of costs for the arms package - ranging from R30 billion in real terms to R43-billion in current rand - underscores the resulting importance of the exchange rate in determining the cost in rand. But

the Medium-Term Budget Policy Statement allows an annual increase of only around 1% over inflation for the next three years. That is far less than the depreciation of the rand in the recent past.

The risk of depreciation is underlined by some of the cost estimates produced in 1998, when the package was first explored. Cilliers then came up with exchange-rate estimates based on a long-term depreciation of 5% a year - leading to a rate of R7,76 to the dollar in 2006. (Cilliers 1998)

Even at current cost estimates, it is clear that the armaments programme is absorbing enough of the Budget to place strict limits on developmental spending. Looking at the medium term framework (MTF), the budget has protected infrastructure and economic spending, to a degree. But the big social services, which are crucial for development, will grow less than the population for the coming three years. That will have long-term effects on the broader social and economic conditions required for employment creation.

### *Skills development*

As noted above, the defence industry absorbs a disproportionate share of high-skilled labour. It is alleged that the industrial participation programmes do not include training or employment-equity requirements. (Batchelor 1998) There is no overall training programme for the defence industry, which is split amongst several Skills Education and Training Authorities (SETAs). Furthermore, the secrecy surrounding the defence industrial participation plans makes it difficult for SETAs to include projects in their planning exercises.

This situation will presumably limit the extent of broad-based training in the industrial participation programmes. Currently, however, the skills in the

defence sector are monopolised by white men. In the absence of systematic and coherent training and employment equity programmes, this situation will persist for the foreseeable future.

### ***Employment in the state sector***

Agreements reached recently at the Public Service Jobs Summit note the importance of the public service as a source of employment. It accounts for 20% of formal employment. To the extent expenditure goes into the labour-intensive social services – especially education, health and policing – it will increase employment substantially. In contrast, the current arms package shifts expenditure away from personnel expenditure. This shift comes at a cost in terms of public-service jobs.

The loss is clear within defence itself. The procurement programme forms part of a plan to raise the share of expenditure on equipment to 30% of defence spending. The Department of Defence anticipated that the increase in the capital budget would be achieved through the rationalisation of 30 000 personnel over three years. In effect, the procurement project in itself marks a shift toward a more capital-intensive defence force. While this may be appropriate from a security standpoint, it cuts formal jobs at a time of extraordinarily high unemployment.

It is also unclear how many jobs will be created in industries other than defence, the nature of the investment in those sectors, and the nature of the jobs created. How these investments link into a new growth path and industrial policy are unclear.

### **Summary and conclusions**

Government has stated that the decision to procure arms on the current scale arises primarily from strategic considerations, not from a desire to

maximise employment. COSATU feels that this decision did not adequately look at the broader economic, social and employment costs. It takes an inappropriately narrow view of national security, underestimating the importance of ensuring greater employment and equity as the basis for a more peaceful and dynamic society. It also fails to appropriately assess the opportunity costs against the objectives of a developmental state, which include reducing poverty and inequality, and meeting developmental targets.

In any case, whatever the security

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considerations, in light of the opportunity costs, it is clearly inappropriate to justify the arms deals in terms of job creation. If we as a nation are serious about employment, we must look much harder at ways to ensure growth in relatively labour-intensive sectors, such as food and food processing, clothing and textiles, tourism and other services. We hope that the Sector Job Summits, planned to take place in the course of the coming year, will contribute substantially to the development of such a development strategy. That should obviate the current, misguided dependence on risky arms procurement packages as a driver for job creation. ★

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*The full version of this submission, including COSATU's recommendations, can be obtained on COSATU's website: <http://www.cosatu.org.za>*