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Realising South Africa's Employment Potential

Geoff Barnard

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REALISING SOUTH AFRICA'S EMPLOYMENT POTENTIAL

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By

Geoff Barnard

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ABSTRACT/ RÉSUMÉ

Realising South Africa's employment potential

Unemployment in South Africa is extremely high and unevenly distributed, being concentrated among young less-skilled blacks. The legacies of apartheid can explain part of the increase in labour supply and inability of the economy to absorb it which produced the extreme levels of unemployment, but more could have been done to unwind those legacies and other policies and institutions have contributed to the dysfunction of the labour market. Notably, improvements in product market regulation to strengthen competition could help expand formal sector employment. Changes in municipal laws and regulations to ease migration and facilitate informal employment are also likely to be particularly important. Improving the implementation of employment protection legislation could also help reduce unemployment. Efforts to tackle crime could help reduce the brain drain and attract skilled immigrants, which would likely boost demand for less-skilled workers via complementarities. Over the longer term, improvements in basic education will be key to reducing the excess supply of less-skilled workers.

JEL classification: J11; J3; J5; J7

Keywords: Labour market; employment protection; employment; unemployment; working age population; labour force participation rates; education; training; union wage differentials; South Africa.

This Working Paper relates to the 2008 *OECD Economic Assessment of South Africa* (www.oecd.org/eco/surveys/southafrica).

* * * * *

Concrétiser le potentiel de l'Afrique du Sud en matière d'emploi

Le chômage en Afrique du Sud est extrêmement élevé et très inégalement réparti, étant concentré parmi les jeunes Noirs moins qualifiés. L'héritage de l'apartheid peut expliquer une partie de la hausse de l'offre de travail et l'incapacité de l'économie à l'absorber, ce qui a produit les niveaux extrêmes du chômage, mais on aurait pu faire plus pour contrer cet héritage, et d'autres politiques et institutions ont contribué au mauvais fonctionnement du marché du travail. Notamment, des améliorations de la réglementation du marché des produits afin de renforcer la concurrence pourraient aider à augmenter l'emploi dans le secteur formel. Des amendements des lois et règlements municipaux afin de faciliter la migration et l'emploi informel pourraient eux aussi aider à réduire le taux de chômage. L'amélioration de la mise en place de la législation de la protection de l'emploi pourrait également aider à réduire le chômage. Des efforts pour combattre la criminalité pourrait aider à diminuer la « fuite des cerveaux » et attirer des immigrants qualifiés, ce qui augmenterait probablement la demande des travailleurs moins qualifiés par le biais des complémentarités. À plus long terme, une amélioration de l'éducation de base sera déterminante pour la réduction de l'excédant des travailleurs moins qualifiés.

Classification JEL : J11; J3; J5; J7

Mots clés: le marché du travail; protection de l'emploi; emploi ; chômage ; population en âge de travailler ; taux d'activité; éducation ; formation professionnelle; primes syndicales ; Afrique du Sud.

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REALISING SOUTH AFRICA'S EMPLOYMENT POTENTIAL

Geoff Barnard¹

Diagnosing unemployment in South Africa

Unemployment is the most salient problem of post-apartheid South Africa. The lack of employment for a large share of those who want it not only implies a great loss of national income relative to potential, but is also an important factor in South Africa's extreme levels of inequality and widespread poverty. The failure to bring unemployment down decisively is probably the greatest source of popular discontent about the government's economic policies, despite numerous successes, and it naturally leads to pressures to try more radical and activist solutions which risk being wasteful and counterproductive. All this is of course recognised by the government, which under *AsgiSA* aims to halve unemployment (and poverty) by 2014, by removing a number of constraints on faster output and employment growth.

While some things are known about the causes of South Africa's very high unemployment rates and what can be done about them, a number of puzzles and uncertainties remain. For example, while it is clear that an important aspect of unemployment is mismatches between unskilled job-seekers and skill-intensive jobs, it is less clear why labour demand has evolved in such a skill-biased manner, and in particular why informal employment has not absorbed more of the workers excluded from the formal sector. Another important uncertainty relates to the evolution of real wages. While some observers see the increase in unemployment in the second half of the 1990s as proof of excessive real wages, some measures show real wages falling during that period. Analysis is complicated by the fact that data are often partial or missing and sometimes inconsistent.

A broad question of interest which is taken up in this paper, although no definitive answer is possible, is to what extent labour market policies themselves explain the emergence and persistence of extreme unemployment. One contribution to answering that question made here is the calculation of the OECD's employment protection legislation (EPL) indicator for South Africa, and the benchmarking of that indicator against OECD and selected non-OECD economies.

More broadly, the paper aims to add to the already extensive literature analysing the sharp rise in unemployment in South Africa in the post-apartheid era, and to suggest some policy priorities that would assist in meeting the government's goal of halving unemployment by 2014.

1. Geoff Barnard is head of the Russia/South Africa Desk in the Economics Department of the OECD. This paper is based largely on material from the *OECD Economic Assessment of South Africa*, which was discussed with the South African authorities in a meeting of the Economic and Development Review Committee in May 2008, and then published in July 2008 under the authority of the Secretary General. The authors would like to thank Andrew Dean, Andreas Wörgötter, Christian Gianella, and Tatyana Lysenko for valuable comments on earlier drafts. Special thanks go to Haroon Borat for essential background research prepared for the *Economic Assessment* and to Corinne Chanteloup for technical assistance. Kristina Jones provided excellent secretarial assistance

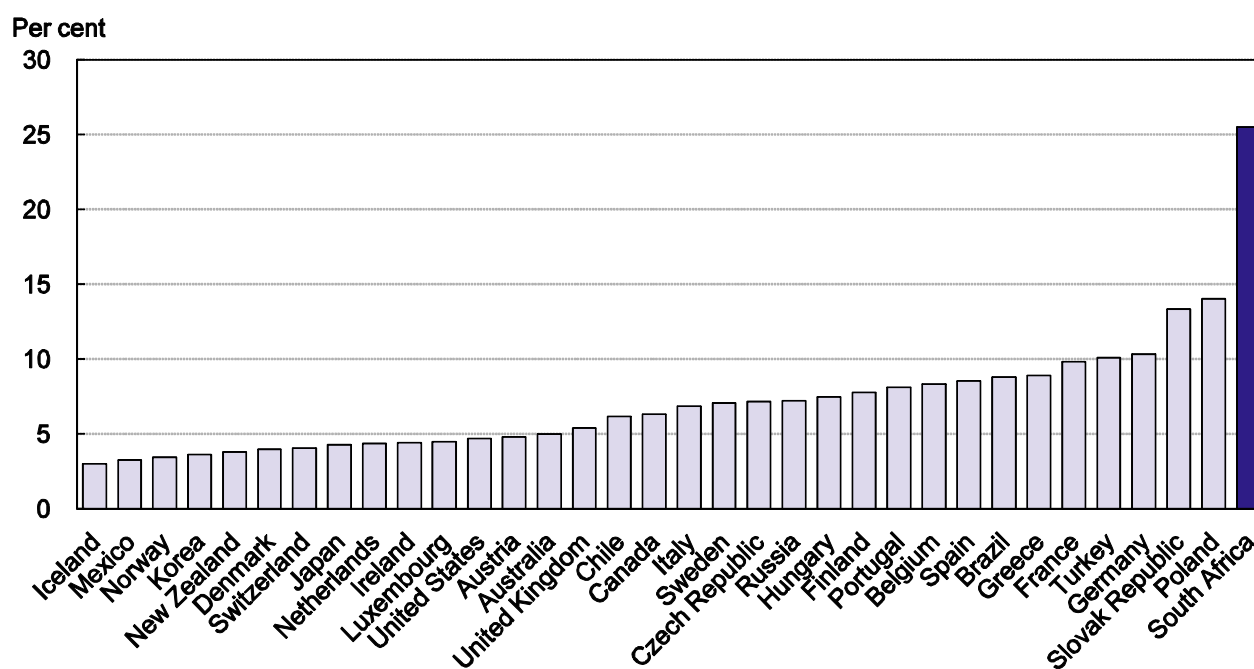
Labour market performance

Unemployment is extreme and persistent ...

The rate of unemployment in South Africa is extreme by virtually any standard, and it is certainly an outlier when compared to the OECD, notwithstanding the severe unemployment problem still seen in some advanced economies (Figure 1).

Figure 1. Unemployment rate, 2006

Persons aged 15-64 years¹



1. 15-65 for South Africa, 15-60 for Brazil, and 2005 data for Luxembourg.
Source: OECD, database on Labour Force Statistics; ILO, Laborstata database; and national statistical institutes.

The ramifications of the unemployment problem are severe and wide ranging. Achieving full employment (that is, a situation in which such unemployment as remains is only frictional) could add around USD 1 000 to GDP *per capita*, lift millions of South Africans out of poverty, and significantly reduce the extreme level of income inequality that currently characterises the country.

Given the scale of unemployment, it is inevitable that there be questions about the reliability of the official statistics. In particular, doubts are sometimes expressed about whether all those counted as unemployed are really actively seeking work.² Reviews of the data (*e.g.* Bhorat, 1999; Natrass, 2000) have not, however, uncovered any serious flaws. There is therefore no reason to think that the data are substantially overestimating true unemployment.

2. President Mbeki himself, writing in ANC Today (20-26 March 2005), questioned whether the ILO definition of job search was used as strictly as in other countries, giving rise to an overestimated unemployment rate for South Africa (cited in Meth, 2007).

It has also been argued that much of South Africa's measured unemployment may really be voluntary, in the sense that at the prevailing wage available to job-seekers, they are unwilling to work, preferring some alternative, whether that be public benefits, household agriculture, or continuing search for a better wage offer (Kantor, 1980; Gerson, 1981; and ILO, 1996). There is, however, considerable evidence to suggest that any such voluntary unemployment is at most a small part of the total. Kingdon and Knight (2004a) show that the unemployed are worse off in terms of income, expenditure, and well-being than those employed in either the formal or the informal sector, making it unlikely that they are to any significant extent choosing unemployment over undesirable jobs. To the extent that search for a well-paid formal sector job is more likely to be successful from unemployment than from informal employment, there would be some "wait" unemployment, but there is little evidence that this is an important feature of the overall unemployment picture.

... as well as unevenly distributed

Unemployment is not only high on average but also very unevenly distributed among age groups, genders, skill categories and ethnic groups. Unemployment rates are highest for youth, women, and blacks (Table 1). Regionally, unemployment is lowest in the provinces with the highest *per capita* incomes and containing the major metropolitan centres, being some 12 percentage points higher in largely-rural KwaZulu-Natal than in the Western Cape.³

Table 1. Unemployment rate, 15-65 years
September 2007

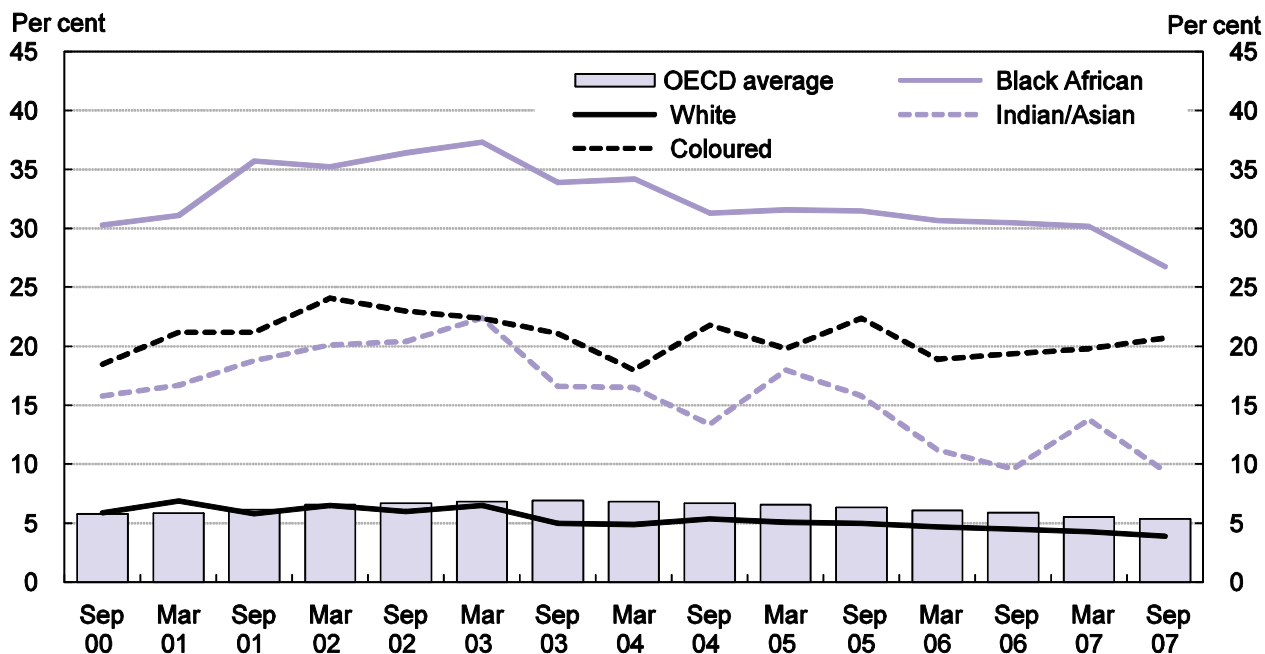
	Male	Female	Total
All population	20.0	26.7	23.0
<i>By population group:</i>			
Black African	23.1	31.2	26.8
Coloured	20.0	21.5	20.7
Indian / Asian	8.6	11.0	9.4
White	3.5	4.5	3.9
<i>By province:</i>			
Western Cape	16.3	17.6	17.0
Eastern Cape	19.9	26.9	23.1
Northern Cape	20.2	33.2	25.7
Free State	19.2	30.8	24.3
KwaZulu-Natal	27.8	30.6	29.1
North West	19.5	30.1	24.1
Gauteng	16.7	23.4	19.5
Mpumalanga	16.7	30.3	22.9
Limpopo	24.6	30.5	27.6
<i>By age (September 2006)</i>			
15-24			50.2
25-34			28.5
35-44			18.2
45-54			12.4
55-65			6.9

Source: Statistics South Africa (2007), Labour Force Survey, September 2007 and September 2006.

3. In addition to being generally higher, unemployment rates for the less-populous rural provinces are also more variable than urbanised provinces such as Gauteng or Western Cape, for instance: between March and September 2007 Limpopo and North West Provinces recorded falls in their recorded unemployment rate of 6 and 8 percentage points respectively.

The unemployment rate for whites is under 4%, which compares favourably with OECD countries, while other groups all have elevated levels, with the most extreme problem being seen for blacks. The relative ranking and magnitudes of unemployment for different racial groupings (according to the apartheid era classifications) has remained very stable in recent years (Figure 2).

Figure 2. Unemployment rates for different racial groups, 2000-07

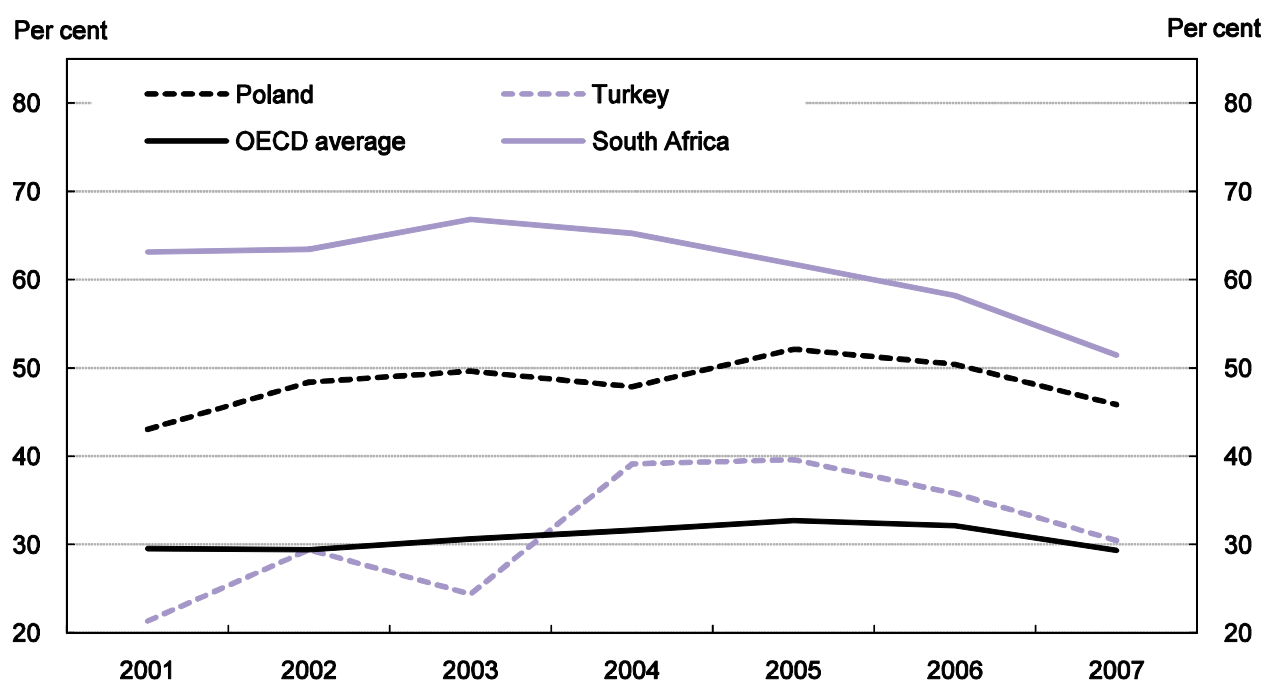


Source: Statistics South Africa, Labour force Survey; and OECD, Economic Outlook database No. 82.

Not surprisingly, in view of the high overall rate of unemployment and its concentration in certain groups, a high proportion of unemployment is of long duration (Figure 3). Many workers in the more privileged groups never experience unemployment, while approximately half of the unemployed report never having worked. This to a large extent reflects the heavy concentration of youth in total unemployment, but average spells of unemployment, particularly for rural blacks, are very long, and some less-skilled blacks may never experience anything but unemployment (Kingdon and Knight, 2004b).

Figure 3. Long-term unemployment

As a percentage of total unemployment



Note: Duration of job seeking > 1 year.

Source: Statistics South Africa, Labour Force Survey; and OECD, database on Labour Force Statistics.

Overall labour market flows are surprisingly large, but some flows appear to be blocked

Using the *Labour Force Survey* panel data, Banerjee *et al.* (2006) find a surprising amount of churning between different labour market states (formal employment, informal employment, unemployed, and not economically active). On the other hand, flows out of informal into formal employment are found to be rare, as are flows into employment for youth. Overall, the picture is of a group of people in the formal sector, who may move from job to job with relative ease, and a large excluded group who move only between unemployment, informal employment, and discouraged or not economically active status.

High unemployment has resulted from a surge in the supply of less-skilled labour ...

While discontinuities in data sources create difficulties of interpretation for a number of labour market variables (see Box 1), it is clear that the working age population, and especially the number of blacks of working age, has expanded substantially since the early 1990s (Table 2); the sharp increase in labour supply is in part a function of demographic trends.⁴

4. South Africa's rapidly growing population in the 1990s was a function of high fertility rates outweighing high mortality rates and net negative (recorded) immigration. It is widely thought that immigration from neighbouring countries has been far greater than the official figures (estimates of the foreign-born population are in the millions), and the recent anti-immigrant riots underline that foreign workers are perceived as aggravating the unemployment problem.

Box 1. Data constraints

A major difficulty in analysing South Africa's labour market performance (and indeed some other aspects of the economy) since the early 1990s is that there is no single consistent data source covering the entire period. One principal source of labour market data, the *October Household Survey (OHS)*, began in 1995, a year after the transition to democracy, and ended in 1999. Its successor, the *Labour Force Survey (LFS)*, conducted in March and September of each year, began in 2000. Censuses are conducted every 5 years, but the pre-democracy censuses are not fully comparable with the post-apartheid ones, and there are data for only two of the latter so far, 1996 and 2001. There have also been surveys of employers: the *Survey of Employment and Earnings*, discontinued in 2005, and the *Survey of Quarterly Employment*, which replaced it. The latter two provide measures only of formal sector non-agricultural employment, however, and these partial data tend to underestimate systematically overall employment growth.

A particular problem pertains to the year 2000, the first year of the LFS. An initial LFS (with a restricted sample) was conducted in February 2000, with a second in September/October. Of the measured employment growth of 3.08 million over the twelve-year period between October 1995 and September 2007, nearly half, 1.51 million, occurs in the 4-month interval between October 1999 and February 2000, when the changeover from the OHS to LFS takes place. It is not clear why such a sudden surge in employment would have taken place at that time. There was relatively strong real GDP growth (4.2%) in the year 2000 relative to previous years, though still only at about potential, and the LFS for September of that year actually shows slightly lower employment than in February. One statistical factor known to be at play is the improvement in coverage of employees in the informal sector. If all of the measured increase from October 1999 to February 2000 were an artefact of the statistical shift from the OHS to the LFS, then employment growth during 1995-2007 would have been not 2.2% a year but 1.2%. Probably the true value falls between the two, especially since 1995 also looks somewhat anomalous, giving rise to an 8.5% drop in employment between 1995 and 1996. The 1995 estimate uses weights derived from the 1991 Census.⁵ If weights from the 1996 Census are used instead, total employment in 1995 would be about 9.5 million, resulting in a smoother and more plausible trend over the period 1995-99.

A similar issue arises with labour force participation – indeed, the discontinuity is even more marked in this case. The OHS data show a gradual rise in the labour force participation rate from 46.0% to 51.5% between 1995 and 1999. The rate then jumps to 61.5% in the first LFS in February 2000, and is still 58.7% in the first full LFS conducted in September of that year. The jump between the two series is in fact almost equal to the whole of the measured rise in labour force participation between 1995 and 2007.

	October 1999 OHS	February 2000 LFS	% change	Average % change 1995-99
Employment (000s)	10 369	11 880	14.6	1.6
Economically active (000s)	13 527	16 213	19.9	3.5
Labour force participation rate (%)	51.5	58.7	14.0	2.3
Unemployment (narrow; 000s)	3 158	4 333	37.2	10.0

Source: Statistics South Africa.

Another important problem is the absence of a reliable time series for wage data. Both the OHS and the LFS only classified earnings in ranges, preventing the calculation of precise averages. And the 2000 discontinuity problem is again marked for wages, which are shown as dropping 38% in real terms between October 1999 to February 2000, then more than doubling between February and September 2000, before falling back almost to the same level in the following March. The September 2000 seem to have been affected by a problem of outliers which probably reflects misrecording (Burger and Yu, 2007), but overall, the picture that emerges from the OHS-LFS interface is that the latter captured a large number of low-paid, especially informal sector, workers (as well as unemployed individuals) not included in the former.

5. Another issue with the 1995 OHS was that security concerns prevented full sampling in KwaZulu-Natal, leading to a likely overestimation of employment (Banerjee *et al.*, 2006).

Table 2. Working-age population and labour force

	15-65 years ¹ , thousand		
	October 1995	September 2007	Annual growth
Population of working age	26 444	30 413	1.2
Male	12 766	14 682	1.2
Female	13 678	15 708	1.2
Black African	19 158	23 797	1.8
Coloured	2 444	2 767	1.0
Indian / Asian	745	808	0.7
White	4 097	2 986	-2.6

1. For 1995, 15+.

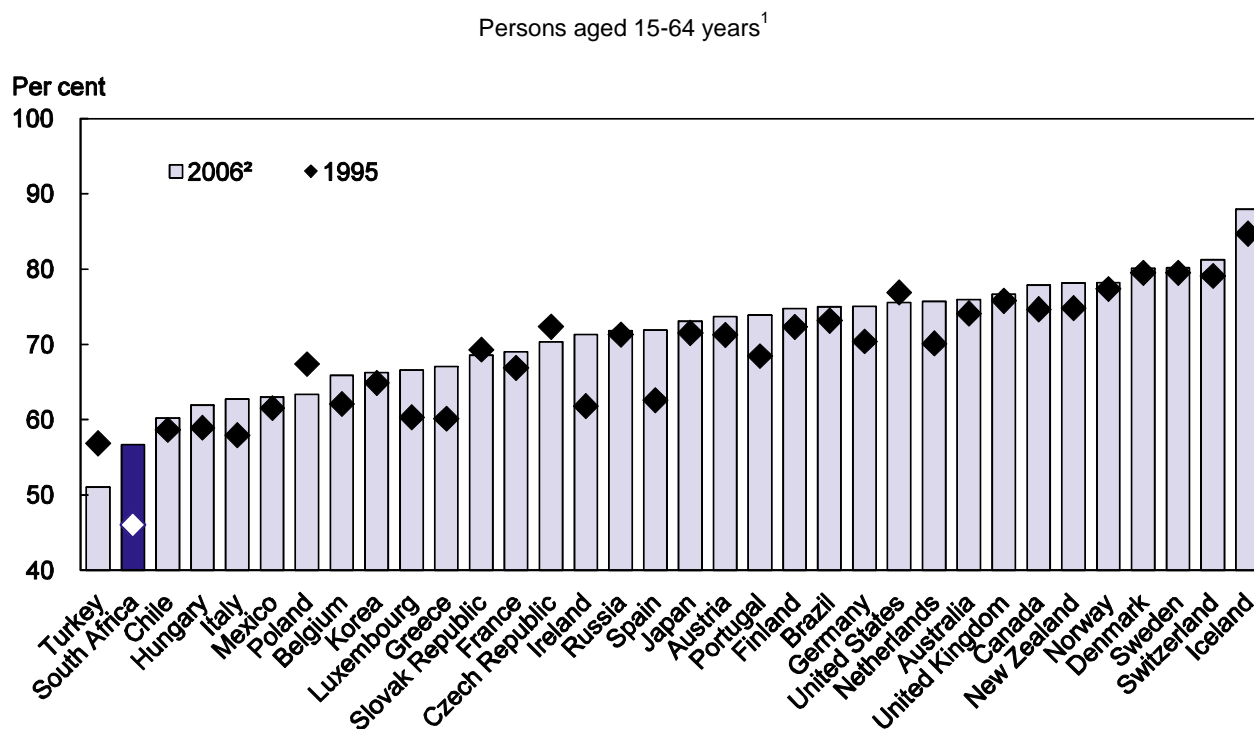
Source: Statistics South Africa, Labour Force Survey, September 2007, and Household Survey, October 1995.

Moreover, in some respects the composition of the working-age population has shifted in ways that are unfavourable from an unemployment perspective. While the age and gender structure of the population have not changed much since 1995, the racial composition has altered significantly. The black working-age population has increased faster than that for other racial groups since the early 1990s, and blacks in South Africa have by far the highest probability of being unemployed. Meanwhile, whites, who experience very low unemployment rates, have actually seen a reduction of about 25% in their working age population since the end of apartheid, with emigration playing an important role.⁶

Apart from demographic shifts, the share of the working-age population wanting employment also appears to have increased. The statistics certainly show a substantial rise in labour force participation rates since the mid-1990s: the official estimate of the participation rate (on a comparable basis, using the narrower, ILO definition for unemployment) was 46% in 1995 and 56.5% in 2007. There is a particular problem in interpreting these data, however, which is that, as noted in Box 1, the bulk in the rise in the labour force participation rate comes in 2000, at the break point between two discontinuous data sources. In any event, it is notable that participation rates remain low compared to OECD economies and most other middle-income countries (Figure 4). South Africa's high unemployment is not just an artefact of aberrantly high estimates of the participation rate; indeed, in the long-run, achieving labour utilisation rates typical of advanced countries, an important part of the process of raising living standards, will require substantial increases in labour force participation from current levels.

6. Gross self-identified emigration averaged about 10 000 people per year during the period 1994-2003. The numbers are not broken down by racial group, but emigrants are heavily skewed towards professional and skilled occupations, and have moved above all to the UK, the US, Australia, Canada, and Continental Europe (Statistics South Africa, 2005) – they are thought to have been predominantly white. Also, host country data on foreign residents suggests that self-identified white emigration is a substantial underestimate of the true amount.

Figure 4. Labour force participation rates, 1995 and 2006



1. 15-60 for Brazil, for South Africa 15-65 in 2006 and 15+ in 1995.

2. 2005 for Luxembourg.

Source: OECD, database on Labour Force Statistics; ILO, Laborsta database and national statistical institutes; and OECD calculations.

Moreover, the composition of the increase in participation rates has, like that of the growth of the working-age population, tended to push up unemployment. Participation rates have in particular risen for two groups, women and the young, which have a higher-than-average probability of being unemployed. Looking only at the latter factor, the unemployment rate in 2007 was about 2½ percentage points higher than it would have been if the age structure of the labour force had remained as it was in 1995, because the increase in participation rates has been most marked among the young. Overall, for the period 1995-2005, Banerjee *et al.* (2006) estimate that about 31% of the increase in unemployment can be explained purely by changes in the composition of the labour force in terms of gender, ethnicity, and age group.

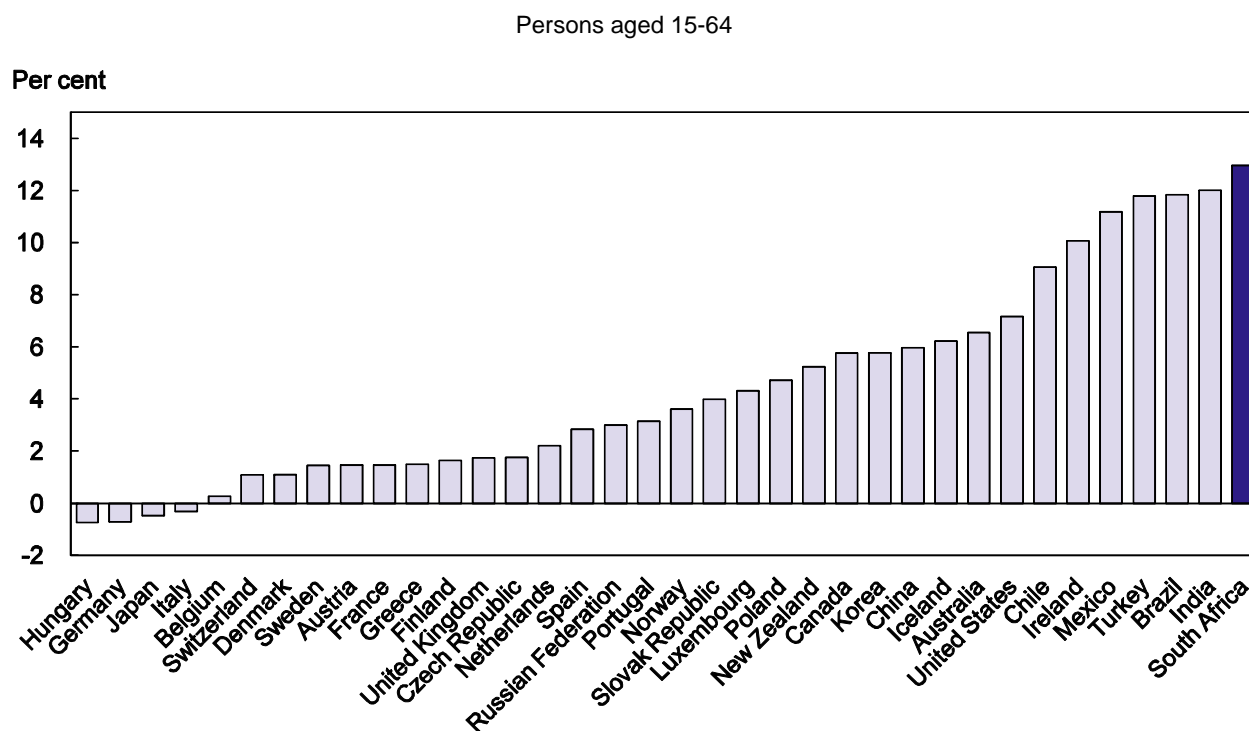
The significant increase in labour force participation, above all among blacks, and especially black women, is somewhat surprising given the high rates of unemployment, since given difficulties in finding employment one would expect, other things being equal, higher rates of discouraged job-seekers withdrawing from the labour force. One explanation may be that, with unemployment rising for males, a growing number of women joined the labour force to try to sustain family incomes.

... which was not fully absorbed into employment

Taking into account growth of the working-age population and rising participation rates, over the space of about 5 years South Africa saw an increase in the number of people of working age willing to work of nearly 40%. This sort of increase has few precedents, either in South Africa or elsewhere, and

there are many economies that would have trouble smoothly integrating such an increase in job-seekers into employment (Figure 5).⁷

Figure 5. Working-age population growth in selected countries, 1995-2000



Source: OECD, database on Labour Force Statistics; and United Nations (2006), World Population Prospects.

The success of the South African labour market in absorbing the surge was clearly limited, however. Whatever the precise increase in labour force participation rates, it is clear that of the roughly 5 million increase in the labour force that the data suggest occurred between 1995 and 2007, only about 3 million were absorbed into employment, with the remaining 2 million being reflected in the increase in unemployment.⁸ Employment growth has not been strong enough.

In fact, some data actually indicate a decline in formal employment up to 2002, which led to increasing talk of South Africa suffering from jobless growth (*e.g.* Wakeford 2003).⁹ In fact, however, the

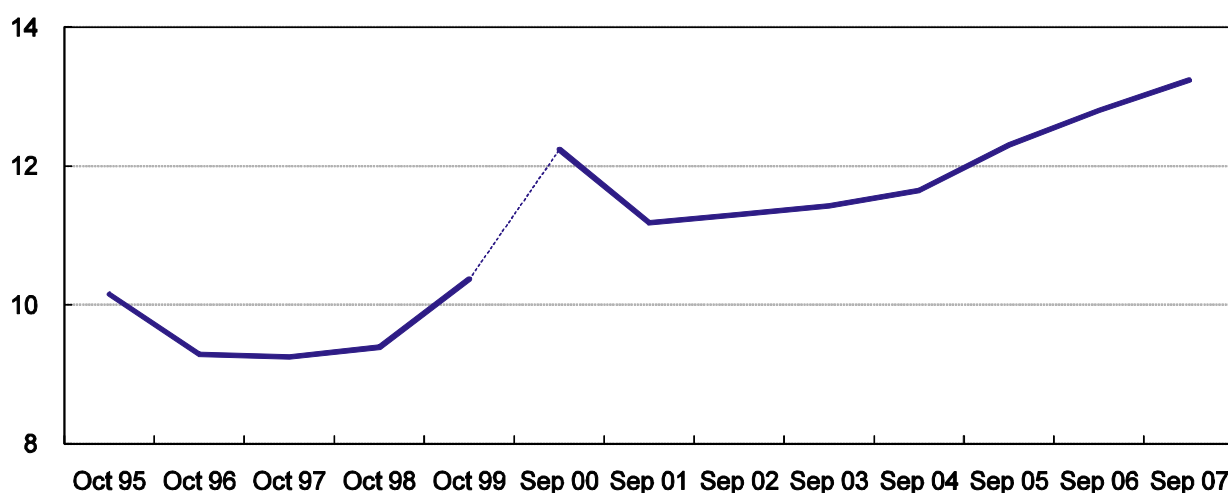
7. Israel is one such country having seen a similar increase in the labour force. For example, from 1990 to 1995 the growth in Israel's labour force was 27%, while unemployment, after initially rising, fell from 9.6% to 6.3%. In this case, however, the increase came mostly from immigration of relatively skilled workers, which were easier to absorb into employment, and there was no parallel to the negative labour demand shocks hitting South Africa (decline in mining, growing external competition in manufacturing).

8. As noted in Box 1, the employment estimate in 1995 may be too high by about 0.5 million, in which case true employment growth from 1995 to 2007 would be correspondingly greater. Estimated unemployment in 1995 suffers from the same problem, however, so that on a comparable basis, the growth in the number of unemployed would be somewhat larger than 2 million.

9. The *Survey of Employment and Earnings (SEE)*, discontinued in 2005, was a survey of formal sector businesses excluding agriculture and a range of other industries. Growth of employment in the informal sector and the excluded businesses, such as non-bank financial institutions, largely accounts for the

best available measures of total employment show some growth over the periods 1995-99 and 2000-07, with, as noted in Box 1, a break in the series in 2000, when employment is shown as jumping sharply (Figure 6). There have been significant losses of employment over the past 13 years in certain sectors, notably mining and agriculture, but these were outweighed by growth in other areas, especially construction, financial services, retail, and the state sector (especially community and social services and utilities). The size and persistence of the increase in unemployment since the early 1990s shows that the problem is not merely cyclical – on average, economic growth since 1994 has been roughly equal to estimated potential growth. Within that period, however, unemployment did rise strongly in the period 1995-2002, when growth was below potential, and has subsequently declined significantly (though much less than it had earlier risen) during the period in which actual growth has been above potential. The asymmetry in unemployment performance over the economic cycle indicates a substantial degree of hysteresis: the unemployment rate ratchets up sharply in cyclical downturns, but falls only slowly in cyclical upswings.

Figure 6. Employment, 1995-2007



Source: Statistics South Africa: October Household Survey 1995-99, September Labour Force Survey 2000-07.

This asymmetry between employment performance in strong and weak growth periods in South Africa means that, even if total employment has in fact risen, there may be something to the proposition that South Africa has had jobless growth, or more correctly insufficiently employment-intensive growth.

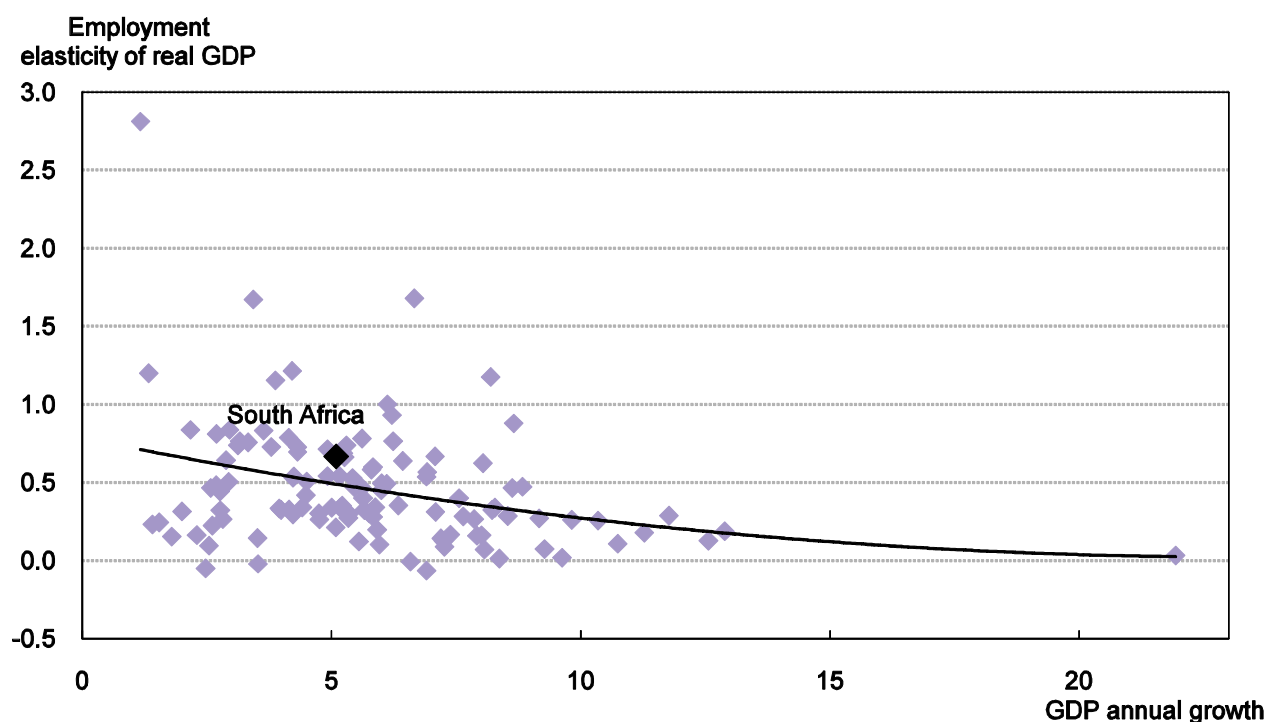
At least relative to other countries, however, the employment intensity of growth since 2003 does not in fact seem to have been a particular problem. South Africa's employment elasticity of real GDP growth during the period 2003-07 was somewhat better than average (Figure 7).¹⁰ On the other hand, international

discrepancy in the employment growth picture between the SEE and the *October Household Survey* and the latter's successor, the *Labour Force Survey* (Stryker *et al.* 2001).

10. Indeed, Figure 5 does not capture the acceleration in employment indicated in the *Labour Force Survey* for September 2007 – the employment intensity of growth has picked up latterly.

comparisons may be misleading, in that there appears to have been a widespread fall in the employment intensity of real GDP growth in recent years (IMF 2007; UNDP, 2006).¹¹

Figure 7. Employment intensity of growth, 2003-07



Source: OECD calculations based on WEO database, April 2008.

While in some sense the increase in unemployment must mean that real wages have moved upwards relative to the market-clearing level, it does not seem to be the case that excessive real wage increases have pushed employment leftwards along the labour demand curve, resulting in higher wages and lower employment. A good deal of evidence (*e.g.* Banerjee *et al.*; 2006; Burger and Yu, 2007; Woolard and Woolard, 2006) indicates that real wages have been stagnant or falling on average over most of the post-apartheid period.¹² The pattern, therefore, is rather that with labour supply increasing, real wages have not fallen by as much as would have been necessary to prevent unemployment from rising.¹³

11. There is a question of whether it is more appropriate to look at gross employment elasticities of growth or partial elasticities, taking into account other variables. Partial elasticities are potentially more appropriate for looking at causation (if the multivariate regression is well-specified), but as a measure of the overall employment-friendliness of growth, whatever the cause, gross elasticities are useful.

12. Burger and Yu (2007) estimate that overall real earnings in the formal sector declined until about 2000, were little changed until 2002, and began to rise thereafter, being slightly higher in 2005 than in 1995. Within that overall trend, skilled workers fared better than those with low skills. Woolard and Woolard (2006) find that real earnings for unskilled labour dropped by roughly a third between 1995 and 2003.

13. The few attempts to estimate the employment effects of changes in real wages in South Africa suggest that wage elasticities are fairly typical of estimates for other countries. Fields *et al.* (1999) found that the overall wage elasticity for formal sector private employment was about -0.53 in the period 1994-98, at the median of rates reported by Hamermesh (1993) for a large range of countries. This suggests that real wages would

Part of the sharp increase in unemployment in the 1990s may be attributable to unfavourable exogenous factors on the labour demand side. Employment growth, especially for less-skilled workers, was held back by the relatively poor growth performance of the mining and manufacturing sectors, two major employers of less-skilled labour. As concerns mining, until about 2003 prices of South Africa's key export commodities (precious metals, iron ore, coal, and diamonds) were low in historical terms. Moreover, the depletion of South Africa's gold reserves has meant that output and employment in that industry have remained on a long downtrend virtually regardless of price developments. Moreover, the need to go deeper to extract remaining reserves has required more capital-intensive methods, giving rise to another source of labour shedding. As to manufacturing, South Africa has been just one of many countries affected by the integration of China and India into the global economy in the past 20 years, exposing cost- and price-sensitive tradables industries to overwhelming competition from other emerging economies with a cheaper but better-suited labour force. On top of that, the reduction of trade barriers undertaken in the context of South Africa's accession to the WTO heightened this external competition in some sectors. Discontinuous data sources again make analysis over long periods difficult, but Statistics South Africa's Survey on Employment and Earnings indicates that between 1998 and 2001 formal employment in mining and manufacturing shrank by about 9%.

Even if such idiosyncratic factors were creating obstacles to achieving full employment, especially of less-skilled workers, this cannot be a fully satisfactory explanation for the persistence of high unemployment over more than a decade. There have to be structural features of the South African economy which have prevented a better matching of labour demand and supply, contributing to the hysteresis in unemployment rates.

Reasons for the inability to absorb the increase in labour supply

The labour force surge and the inability to absorb it both owe something to the legacy of apartheid ...

Under apartheid, the majority black population was restricted in the choice of where to live. It was generally not possible to live in the main urban centres, and there were numerous episodes of forced relocations. Under the pass law system, urban blacks were concentrated in townships situated outside city centres, implying long commutes for workers with jobs in the cities. Others were restricted to black African "homelands" far from major cities and situated on low-productivity land. Blacks were also prevented from engaging in certain economic activities, even within homelands.¹⁴

It is therefore not surprising that the advent of democracy saw a release of pent-up labour supply. Restrictions on residency, accumulation of financial and human capital and choice of occupation were removed. Opportunities for job search increased, and blacks moved in large numbers to the cities, and began to seek jobs that had been closed to them in the past.

have had to fall substantially in the second half of the 1990s to prevent the rise in unemployment that occurred.

14. Apartheid legislation authorised the "reservation" of many skilled jobs and managerial positions for whites; qualified blacks could legally be excluded from most senior-level jobs. The Industrial Conciliation Act of 1924, which governed many aspects of labour relations, as amended by the Native Labour (Settlement of Disputes) Act (No. 48) of 1953 redefined the term "*employee*" to exclude all blacks, depriving them of any labour law protection. The Industrial Conciliation Act (No. 28) of 1956 enabled the minister of Labour to reserve categories of work for members of specified racial groups. In effect, if the minister felt that white workers were being pressured by "unfair competition" from blacks, he could recategorise jobs for whites only and increase their rates of pay. Moreover, apart from the formalised job discrimination, the separate educational system for blacks was designed to prepare blacks only for relatively low-skilled work.

Some aspects of the situation inherited from the apartheid era hampered the absorption into employment of the big increase of labour supply in the 1990s. One such aspect was the spatial allocation of the black population. As noted above, blacks were largely confined to remote agriculture-dominated “homelands” and segregated townships scattered around the main urban areas. The result was that at the beginning of the democratic era, blacks generally lived far from the main sources of employment growth and/or faced long (and dangerous) commutes to their place of work. South Africa was at that time much less urbanised than would have been expected for a country of its income level, and urban public transport was, and remains, underdeveloped.

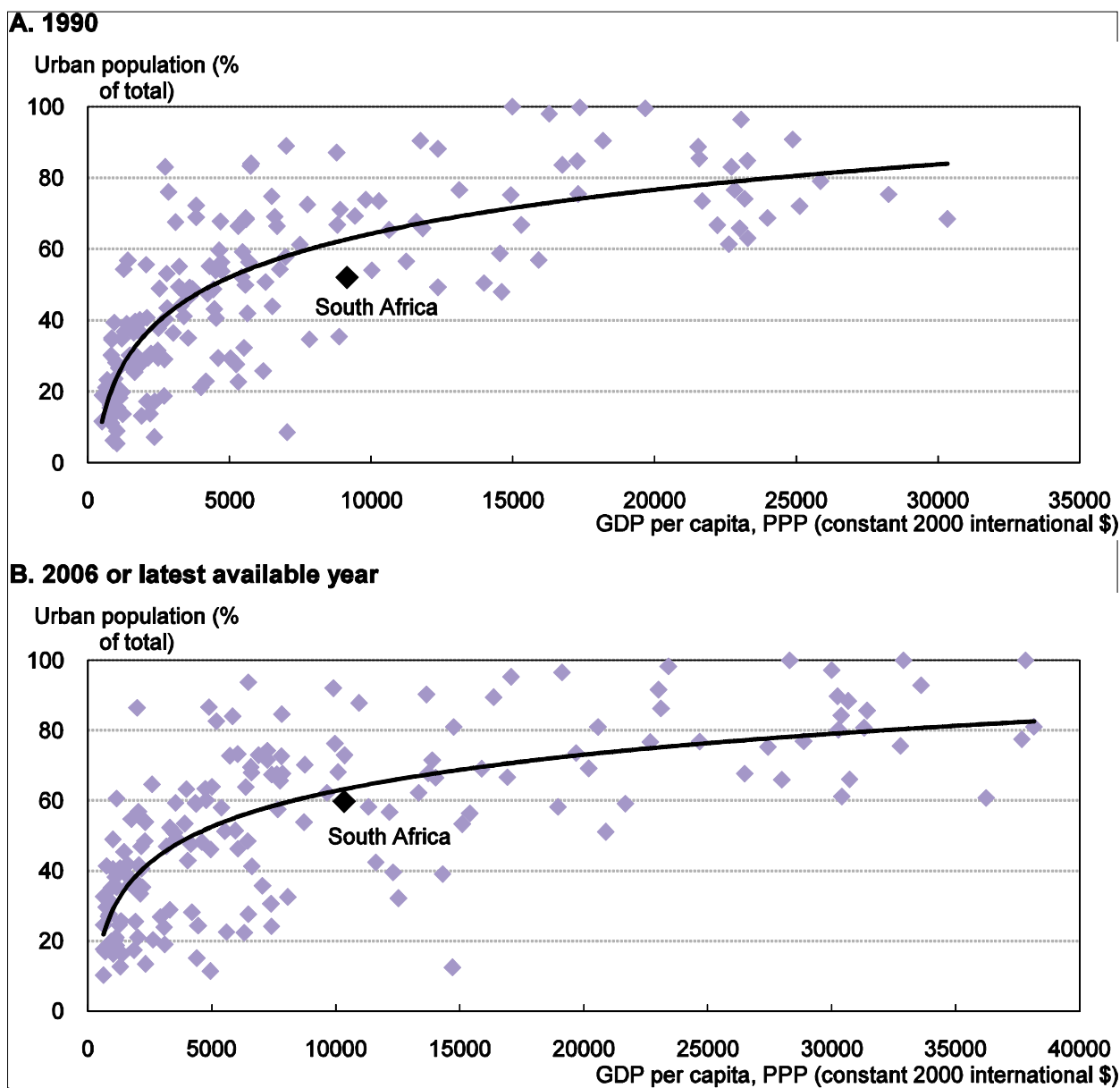
The implications for labour markets of this spatial pattern of settlement are that search costs and reservation wages are likely to be unusually high. This inhibits the efficient functioning of the labour market and raises the equilibrium unemployment rate, an effect aggravated by the existence of capital market imperfections – it will not generally be easy, for instance, for a poor unemployed job seeker to get a loan to travel from his or her rural dwelling to the city to search for work.

Since the mid-1990s there has been a gradual alleviation of the spatial misallocation problem. The pass laws were repealed, and urbanisation rates have increased significantly. One sign of the increased mobility of workers may be the inversion of the previous pattern in which rural unemployment rates were higher than urban rates.¹⁵ With people in rural areas increasingly able to move to the cities to seek employment, the extreme excess supply of labour outside the cities has eased somewhat. This may be taken as a sign that South Africa is becoming more normal in relation to the standard model for developing economies, in which in equilibrium potential rural migrants to cities are indifferent between low local incomes and the probability adjusted returns from either well-paid formal sector work in the city or urban unemployment.

Nonetheless, the internal migration process is still incomplete. Despite the increase in the past 14 years, the urbanisation rate in South Africa remains slightly below what would be expected given the country’s *per capita* income level (Figure 8). Regulations, especially at the municipal level, have hindered the provision of adequate housing in urban and peri-urban areas for working class blacks (World Bank, 2008). And while improvements are being made to transport infrastructure, these have not been targeted at enhancing the speed and safety of commutes from former townships to urban centres. A forthcoming OECD Territorial Review of the Western Cape region confirms that even for this relatively low-unemployment region, the problem of spatial misallocation is contributing to labour market dysfunction (OECD, 2008a).

15. The trend towards falling relative unemployment in rural areas *vis-à-vis* urban ones is noticeable until 2005, when Statistics South Africa stopped reporting urban/rural unemployment numbers.

Figure 8. Urbanisation



Source: World Bank, WDI database.

Another aspect of apartheid which may still be contributing to poor labour market outcomes is the suppression of entrepreneurialism among blacks. One dimension of this was the stifling of the informal economy through strict regulations. Attitudes towards the informal sector on the part both of government and of the population appear to bear the marks of that tradition. In many developing and middle-income countries, the informal economy plays an important role as an absorber of labour excluded from the formal sector. The extreme level of unemployment is partly a reflection of the fact that the informal sector does not play this role in South Africa to the same extent as elsewhere.

Another prominent aspect of the unemployment problem in South Africa is the mismatching of labour demand and supply by skill level. As already noted, unemployment is most extreme for the less-skilled,

while there is evidence of shortages of skilled labour. This tendency is far from unique to South Africa – in much of the OECD also, labour demand has shifted over the past two decades in favour of those with more skills, widening the wage gap between skill levels and resulting in a concentration of unemployment among the less-skilled. The pattern is, however, particularly marked in South Africa, and understanding why the economy has not evolved in a direction that uses abundant factors more intensively is one of the challenges in analysing the labour market dysfunction in South Africa.

Nonetheless, the prevailing skills mismatch can be attributed in part to the low skill level of a major part of the population, and that in turn is partly another legacy of the apartheid era. Although access to education began to improve – in part as a result of protests – in the latter years of the apartheid regime, the system was based on limiting the accumulation of human capital of the majority black population. Even for those blacks with access to schooling, resources were scarce and the quality of education was generally low. The strong excess supply of unskilled workers in the post-apartheid era is in part a function of that system.

... but little has happened to address the hindrances to employment arising from the apartheid era

One striking aspect of the unemployment problem in South Africa is that while it is overwhelmingly a problem for less-skilled blacks, and while this is a group which suffered the most from the apartheid-era legacies referred to above, surprisingly little has been done to unwind these legacies.

As regards the spatial allocation problem, for instance, the democratic governments since 1994 have tried to increase low-cost housing. To maximise the number of dwellings to be constructed from a limited budget and/or to offset the high costs of meeting infrastructure standards, however, this housing has to a large extent been built far from urban centres, and therefore has done relatively little to bring black workers closer to the source of jobs. Meanwhile, it remains difficult for blacks to settle in peri-urban areas to mix urban employment and informal agricultural activities (World Bank, 2008). In addition, urban public transport remains underdeveloped relative to other middle-income countries like Brazil or Chile. This may, however, be due in part to the relative absence of high-density urban centres in South Africa, itself partly a legacy of apartheid, under which the majority black population was largely excluded from living in the major cities. The biggest project currently underway, the Gautrain – linking Johannesburg, Pretoria, and Johannesburg airport, rather than the city centres and the surrounding townships – does not directly target the transport problems of the black working class.

Again, while black entrepreneurialism, including *via* the informal sector, was stifled during the apartheid era, there is little sign that the authorities see informal activities as an instrument for absorbing part of the excess supply of less-skilled labour. One aim of *AsgiSA* is the elimination of the “second economy”, and many restrictions (at the sub-federal level) persist making it hard for informal businesses to operate. While efforts to eliminate informality may be understandable in the sense that formal sector jobs on average have higher pay and better conditions, such efforts cut against the imperative of making rapid progress in reducing unemployment.¹⁶

... especially in the area of education

Probably the most important failure to erase labour market effects of the apartheid era relates to education. Concerning the tendency of the education system to fail blacks, some progress has been made, but serious problems remain. The democratically elected governments since 1994 made a major effort to

16. This is not to say that the authorities are making no effort to develop entrepreneurialism. *AsgiSA* does include potentially useful microfinance initiatives and an important emphasis on reducing the regulatory burden on SSMEs.

increase access to education, and enrolment rates did rise substantially. There are doubts, however, about the quality of the education being provided to the majority of students. In international tests of literacy and maths and science learning since the late 1990s, average scores for South Africa have trailed the pack – which included non-OECD as well as advanced countries, including some from Africa – by some distance (Figure 9). Moreover, the range of scores for South Africa was greater than for all other countries tested. Students from the best schools are performing at levels typical of OECD countries, while others are at or below the levels seen elsewhere in sub-Saharan Africa.

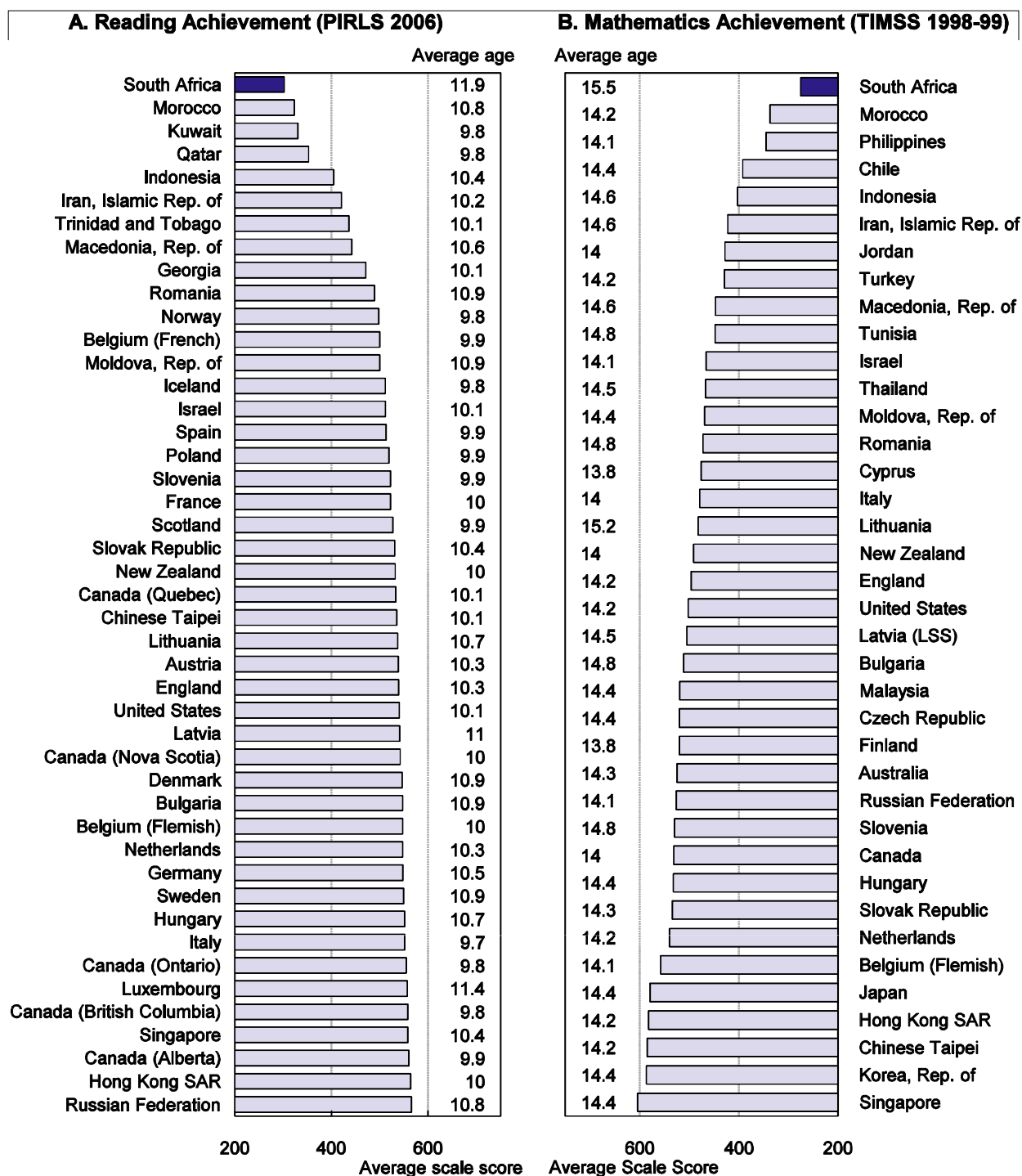
In the crucial area of mathematics and science, the government has set itself ambitious goals for increasing exam pass rates, but the goals are not being met, and the number of passes even fell between 2005 and 2006. Moreover, some 70% of exam passes are accounted for by just 11% of schools, the former white, coloured, and Asian schools (Centre for Development and Enterprise, 2007).

The generally poor (and not clearly improving) results in the post-apartheid education system may be in part a by-product of the understandable effort to make the system more democratic. One factor was the expansion in the number of teachers in the 1990s, in order to deliver greater access to schooling for black children. The certification of a large number of new teachers appears to have been associated with a relaxation of standards, given the shortage of experienced and well-qualified teachers. In some cases, individuals having themselves just received their high-school diploma (the “matric”) were employed to teach that same curriculum. At the same time, in order to rebalance the teaching corps in favour of the majority black population, there were efforts to encourage white teachers to quit or retire, which worsened the shortage of trained teachers. Despite the acute shortage of well-trained teachers, anecdotal evidence suggests that it can be difficult for qualified teachers from abroad to get work visas to teach in South Africa.

Key problems in the education system include the lack of training of teachers; a shortage of texts and basic infrastructure (school buildings, windows, running water, electricity); teacher absenteeism; the impact of HIV/AIDs; and the continued disparity between the former white schools and others, especially the former black schools. On this last point, the mixed public-private system, in which individual schools in the state-funded system can charge fees and supplement the numbers and/or pay of teachers, is an important element maintaining the disparities in outcomes and opportunities between different parts of the schooling system. Public spending per pupil has been broadly equalised across the system, an important step towards addressing pre-existing disadvantages (Department of Education, 2003), but disparities in total (*i.e.* public plus private) spending remain very large.¹⁷

17. In former white schools, about 40% of total teacher salaries on average are paid by fees, against an average of only 5% in former black schools. Fees at the upper end of the scale – for former white schools in wealthy areas – are in the region of median annual incomes for black adults.

Figure 9. International Tests of Scholastic Achievement



Source: IEA, Progress in International Reading Literacy Study (PIRLS 2006); and IEA, Third International Mathematics and Science Study (TIMSS), 1998-99.

A possible reflection of a deterioration in the quality of education since the mid-1990s is that, according to a probit analysis of the chances of finding employment, completing high school apparently conveys less of an advantage than it did before. Whereas in 1995 the impact of gaining the matric was

significant, by 2005 that was no longer the case – in the later year, to get a significant boost to the probability of getting a job, a post-secondary qualification was needed (Table 3).^{18 19}

Table 3. An employment equation for South Africa, 1995 and 2005

Dependent variable: probability of being employed

Independent Variable	1995			2005		
	Marginal Effects		x-bar	Marginal Effects		x-bar
Coloured	0.146	***	0.113	0.082	***	0.0948
Asian	0.218	***	0.031	0.2202	***	0.0279
White	0.281	***	0.140	0.3037	***	0.1074
No education to incomplete GET	-0.011	***	6.602	-0.0030		7.0179
Complete GET	-0.012	***	1.416	0.0110	*	1.7300
Matric	0.031	***	0.319	0.0167		0.3830
Diploma	0.163	***	0.103	0.2123	***	0.1034
Degree	-0.001		0.067	0.0646	**	0.0821
Observed probability			0.698			0.400
Predicted probability (at x-bar)			0.751			0.380
Number of observations (unweighted)			42 166			43 631
Chi ²			5 068.6			3 398.3 ***
Pseudo R ²			0.184			0.167

1. *** significant at the 1% level; ** significant at the 5% level; and * significant at the 10% level.
2. Other independent variables included region, age group, gender, and urban or rural.
3. Estimates are based on the expanded definition of unemployment.
4. The education variable is a set of splines, where Incomplete GET refers to those with a Grade 8 or less. Complete GET refers to individuals who have completed either Grade 9, 10 or 11 and Matric refers to those who have successfully completed Grade 12.

Source: Statistics South Africa, October Household Survey (1995), September Labour Force Survey (2005); and OECD calculations.

... and other factors are also contributing to the unemployment problem

While the failure to unwind patterns of disadvantage carried over from the apartheid era has contributed to the rise and persistence of unemployment, the failure of unemployment to fall more decisively, especially in the context of several years of robust economic growth, suggests a lack of labour market flexibility. Among OECD countries there is considerable evidence on the role of several sources of rigidity in explaining variations in employment performance. Factors which have been found to play a significant role in at least some cases include the generosity of unemployment insurance, tax wedges, the level of minimum wages, and union power.

18. The equation reported represents the second stage of a two stage model. First, a participation probability model was estimated using a full sample of potential labour market participants. Then, for the reduced sample of labour market participants an employment probability model was estimated. The equations were estimated for 1995 (using the *October Household Survey*) and 2005 (with the *September 2005 Labour Force Survey*) an attempt to yield a temporal analysis of labour market changes in the post-*apartheid* period. Independent variables are race, gender, age, and education, as well as a location dummy and a set of province dummies.
19. It is also notable that the penalty for having incomplete high-school education, which is statistically significant in 1995, becomes less so in 2005. Combined with the results for the matric, one interpretation of this pattern is that the strength of the signal of the matric as reflecting human capital has weakened over time.

Of these factors, some appear to have limited relevance for South Africa. Unemployment insurance was only introduced in 2001, after the big surge in unemployment, and replacement rates are not particularly high from an international perspective. Tax wedges are likewise modest by comparison to most OECD countries.

Employment protection legislation (EPL)

One factor that is frequently mentioned as a problem for business in South Africa, however, is employment protection regulation. Evidence from surveys such as the World Bank's *Doing Business* or the World Economic Forum's *Competitiveness Index* suggest that firms see South Africa's labour market as highly regulated, especially as regards firing. These findings helped motivate the decision to compute the OECD's Employment Protection (EPL) indicator for South Africa.

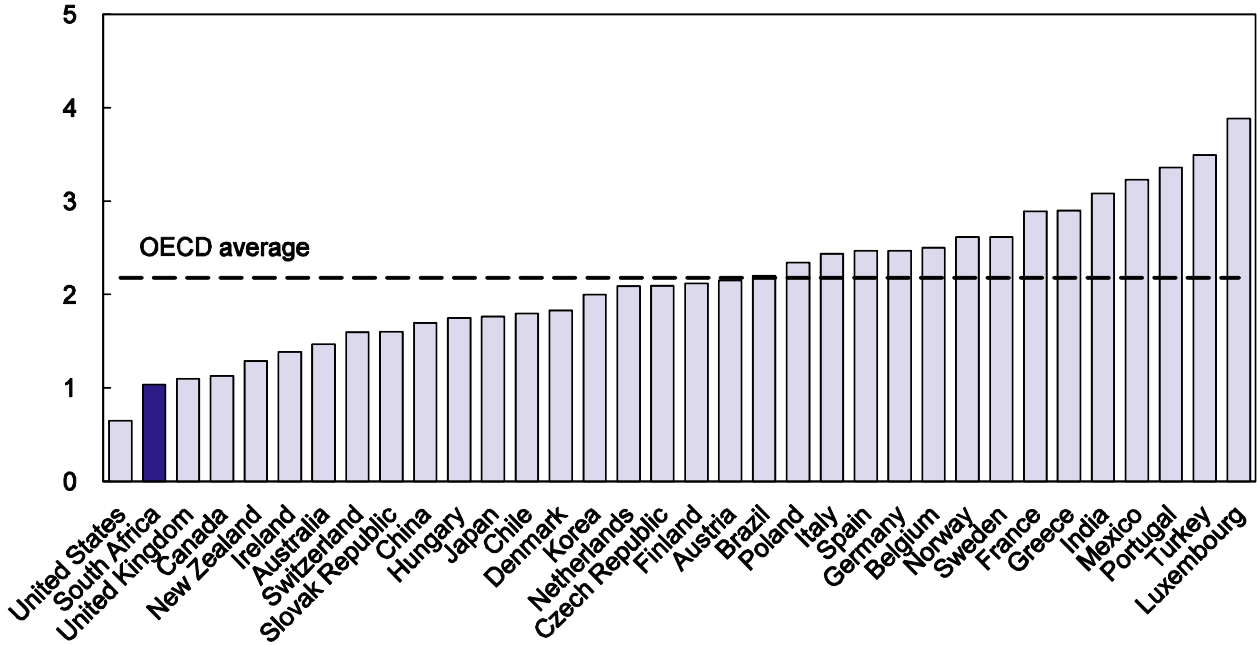
OECD research on the effect of EPL seems to suggest that it generally reduces the flows into and out of unemployment, with little effect on the level of the unemployment rate, but with a positive impact on the average duration of unemployment spells (OECD, 2004). There is also some evidence that restrictive EPL may hinder resilience to shocks (see Blanchard and Wolfers, 2000). Excessively restrictive EPL can also create a distortion favouring greater use of non-standard jobs, short-term contracts and inefficiently low levels of training. Also, while EPL is generally found to have little effect on the employment rates of prime-age men in OECD economies, a number of studies suggest that stricter EPL tends to decrease the employment rates of both youth and women. Since South Africa is characterised by a very high average length of unemployment spells, extensive use of short-term contracts, inadequate training, susceptibility to shocks (commodity prices, real exchange rate swings, etc.), and extreme levels of youth and female unemployment, inspection of the EPL regime is worthwhile, even if it is probably an exacerbating factor and only a relatively small part of the explanation for the elevated level of the overall unemployment rate.

The nature of the EPL indicator and the components and weights are set out in the annex. In brief, the EPL indicator describes employment protection legislation *via* 18 questions gathered into three main groups: employment protection of regular workers against individual dismissal; regulation of temporary forms of employment; and specific requirements for collective dismissals. Compared to other available survey measures of employment regulation, it is more focused on legislative provisions than implementation, and attempts to capture the statutory facts rather than business (or other) perceptions of the EPL environment.

Overall, EPL in South Africa appears to be relatively flexible, with respect both to the average of OECD countries and to those other non-OECD member economies (Brazil, Chile, China, and India) for which the indicator has been calculated (Figure 10). South Africa's labour legislation seems to live up to its creators' aim of providing for "regulated flexibility" (Cheadle, 2006). Within the overall indicator, it is true that ease of firing is one area where South Africa shows up as being less flexible, but even in this case, the score is below the average for OECD economies (Figure 11).

Figure 10. Employment protection legislation

Overall score, indicator scale of 0-6 from least to most restrictive, 2006¹

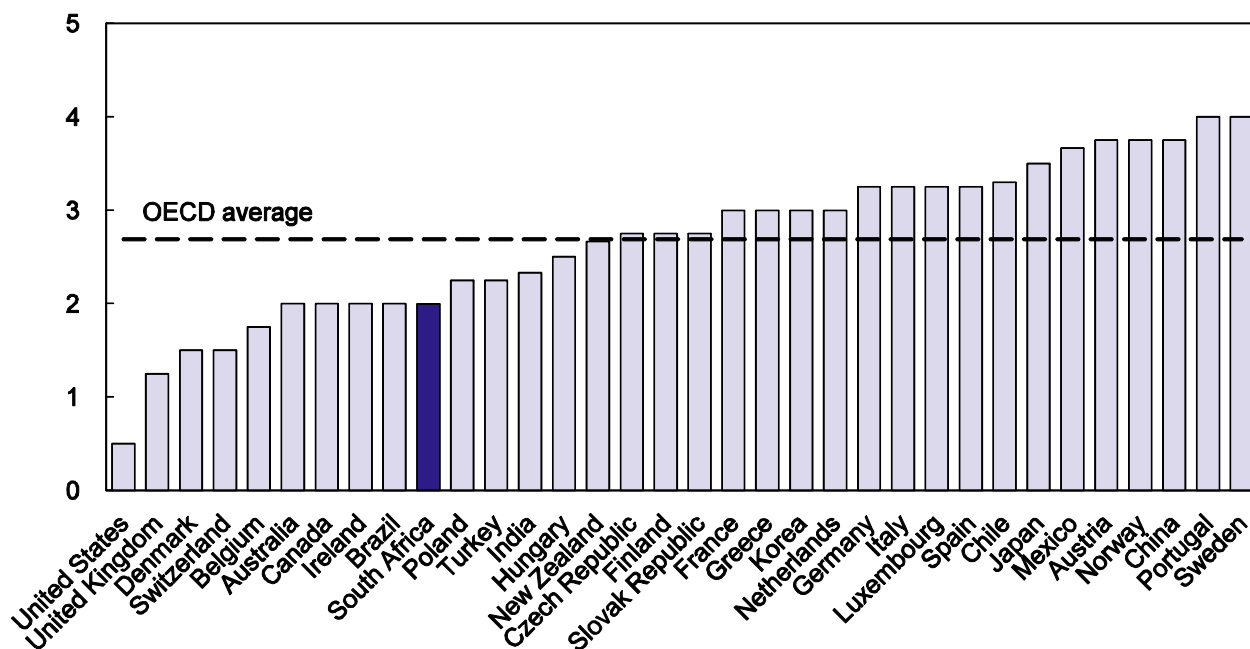


1. 2007 for South Africa, 2003 for Chile and 2004 for Brazil.

Source: OECD (2007), Going for Growth; OECD (2005); Economic Surveys: Brazil; and OECD (2007), OECD Economic Surveys: India.

Figure 11. EPL – ease of firing

Indicator scale of 0-6 from least to most restrictive, 20061



1. 2007 for South Africa, 2003 for Chile and 2004 for Brazil.

Source: OECD, Going for Growth (2007), OECD Economic Surveys: Brazil (2005), OECD Economic Surveys: India (2007).

Notwithstanding the scoring of South Africa's employment protection legislation as relatively flexible, there is, as noted above, a widespread perception that the labour market is highly regulated and that firing in particular tends to be difficult and costly. The primary explanation for this apparent discrepancy most likely lies in the way EPL is implemented. The main institutions arbitrating cases relating to dismissals, the CCMA and the labour courts, are both seen as slow and cumbersome.

To some extent, these perceptions have a clear basis in reality. Although most cases are heard quickly by the CCMA, the institution is overburdened. The growing use of combined conciliation and arbitration ("conarb") hearings has helped speed up resolution, but for most dismissals conarb cannot be imposed on the parties, and one or other party often has an incentive to delay.²⁰ Conarb proceedings currently make up about a quarter of total wrongful dismissal cases settled by the CCMA. The pattern of reviews of CCMA decisions suggests that employers seek to string out the process to exert pressure on dismissed employees to give up rather than going to the end of the process. In addition, a common complaint is that CCMA arbitrators are formalistic in their approach, preferring to apply mechanically the Codes of Practice (which set guidelines on fair procedures, but allow for exceptions) rather than judging the substance of the case.

Another possibility is that, even in implementation, the South African system is not particularly overburdened by labour market regulation, and that business perceptions to the contrary are distorted. There have been a few high-profile cases of wrongful dismissal challenges going through numerous stages and taking years to resolve. The ultimate judgement may even be to reinstate a worker fired years earlier.

20. The legislation currently mandates compulsory conarb hearings only in relation to unfair dismissal or unfair labour practices while on probation.

Such cases attract a disproportionate amount of attention and concern. For the most part, cases taken to the CCMA are heard and resolved fairly quickly. The average time for achieving a judgement in CCMA arbitration cases is about 7 weeks. Even if it is true, however, that perceptions are distorted by a few highly visible but atypical cases, such misperceptions would remain important, since hiring strategies will be affected by beliefs about ease of firing if the need arises.

Union wage differentials are large, suggesting a sharing of product market rents

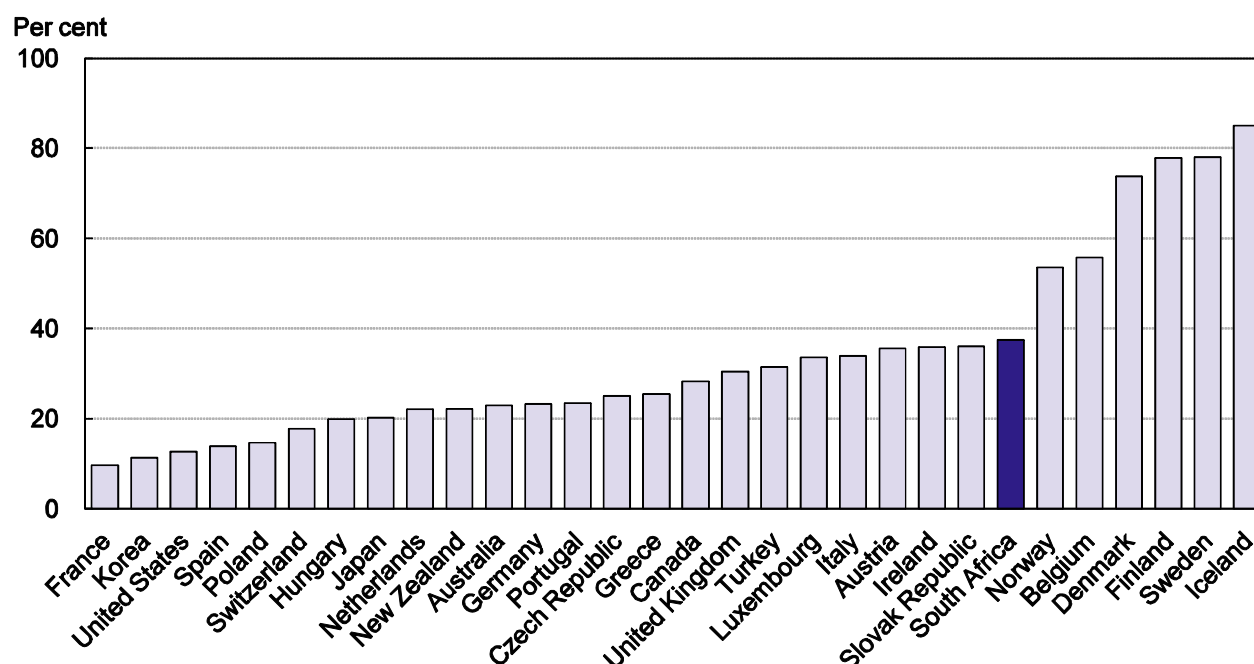
Another institutional feature which is widely seen as playing an important role in South Africa's labour market outcomes is the trade unions. The vast literature on unions finds a range of effects on labour markets. Unions generally raise the relative wages of unionised workers, which other things being equal reduces economic efficiency. Union wage premia were estimated for the United States by Gregg Lewis (1963), and subsequently for a wide range of countries and periods (*e.g.* Blanchflower and Bryson, 2003 and 2004). Apart from this well-documented monopoly role, however, Freeman and Medoff (1984) note that unions also serve as an instrument for collective voice.²¹ The collective voice role allows worker discontent to be articulated and channelled into improved working conditions and productivity. A good deal of evidence suggests that unions are associated with lower quits, higher training, and greater pension savings. Relatedly, despite the union wage premium effect, the empirical evidence of the impact of unions on profits is mixed.²² The net welfare impact of unions is therefore ambiguous, and can vary across time in given places and among countries.

Unionisation rates in South Africa are not particularly high, being about average both in comparison to OECD countries and relative to other large middle-income countries (Figure 12). Union density grew considerably starting in the 1970s, but has been little changed since the mid-1990s.

21 Unions may also, of course, play other roles which are not primarily economic, but which are significant in assessing their overall effects on social welfare. In South Africa, for example, unions have a historical role as a locus for resistance against the former apartheid regime.

22 While the empirical evidence on the effect of unions on profits is mixed, the downtrend in private sector unionisation rates in recent decades may suggest that indeed unionised firms are driven out of business or pushed to deunionise, which would indicate that the wage-raising effect of unions dominates any productivity-raising effects.

Figure 12. Trade union density



Note: 1999 for Turkey. 2001 for Austria, Belgium, Denmark, Finland, France, Greece, Hungary, Iceland, Ireland, Luxembourg, Norway, Poland, Portugal, Spain and Switzerland. 2002 for Australia, Canada, Czech Republic, Germany, Italy, Japan, Korea, Netherlands, New Zealand, Slovak Republic, Sweden, United Kingdom and United States. 2005 for South Africa.
Source: OECD and Statistics South Africa.

One institutional feature which could allow unions in South Africa to play a more important monopoly role than elsewhere, however, is the system of bargaining councils. In industries with bargaining councils, collective bargaining agreements between firms and unions are extended across the rest of the sector. In principle, this is a powerful instrument for increasing the power of unions and magnifying their effect on wages and other labour market outcomes, with a possible amplification of insider-outsider problems.

In practice, however, there is some doubt about the extent to which collectively bargained wages are transmitted to non-union workers *via* the bargaining councils. A multivariate analysis of wage determination reported in Table 4 indicates a strong union wage premium, especially for lower-paid workers. The impact of membership of a bargaining council is found to be insignificant in the private sector.²³

²³

Part of the explanation of this pattern may be that in practice unions bargain both at the sectoral level, setting wage minima for the sector, and at the firm level, negotiating premia for workers in unionized companies. This would suggest that the measured union wage differential is in fact an underestimate of the power of unions to raise wages.

Table 4. Union and bargaining council wage premia earnings function estimates

Dependent variable: log of monthly earnings

Variable	OLS	Quantile:				
		0.1	0.25	0.5	0.75	0.9
Private sector bargaining council (BC) member	0.03	0.05	0.01	0.02	0.02	-0.01
Public sector BC member	0.28**	0.32**	0.33**	0.26**	0.26**	0.19**
Union	0.23**	0.35**	0.31**	0.27**	0.21**	0.15**
Number of observations	14 746	14 746	14 746	14 746	14 746	14 746
Adjusted R ²	0.543	0.230	0.332	0.393	0.406	0.394

** Significant at the 1% level.

Note: Variables not shown here are race, gender, experience, education, occupation, sector, location and a set of province dummies.
Source: Statistics South Africa (2005), Labour Force Survey, September.

Nonetheless, even if union wages are not in fact being extended across sectors with bargaining councils, the fact that about a third of workers are unionised and receiving substantial wage premia has significant implications for economic efficiency. Other things being equal, employment in unionised firms will be less than otherwise. The impact on unemployment is less straightforward, since there could be a competitive secondary labour market which absorbs workers excluded from unionised firms (by having a lower wage than otherwise), but clearly this does not happen to the full extent in South Africa. Indeed, to some extent the problem of unemployment in South Africa can be seen as the product of an unwillingness to allow real wages to fall far enough to clear the labour market. To that extent, having a part of the primary labour market paying large union wage differentials decreases the wage that would clear the secondary market, and probably results in more unemployment than would be the case if the union premium were smaller.

Again, some part of the large union wage premium is likely to be linked to the existence of substantial product market rents. While data limitations prevented an examination of this proposition, studies of other countries suggest that the existence of product market rents tends to permit labour to extract a share of those rents – wages are higher (controlling for quality of worker and other relevant characteristics) where firms can earn excess profits.²⁴ Such rents not only make it possible for firms to pay wages above the competitive level without going out of business, but also make strikes or other forms of withheld effort more costly, making firms more willing to pay a premium over the market-clearing wage rate.

In this context, product market regulation can have significant labour market effects. Rent-sharing between firms and insiders may explain the finding that highly restrictive product markets have negative employment impacts (Nicoletti and Scarpetta, 2005; Fedderke and Naumann, 2005). As detailed in OECD (2008b), South Africa's product market is characterised by high mark-ups and concentration in many sectors, and relatively extensive state involvement.

24. The absence of micro datasets with worker and job characteristics and precise wage information prevents a rigorous study of such inter-industry wage differentials, but some fragmentary evidence exists. For example, the cement company PPC, a firm with substantial monopoly power, is a past winner and perennial leader in surveys of best company to work for in South Africa. Other winners, including the large banks, have similarly tended to come from highly concentrated industries with elevated mark-ups.

Another factor related to the high degree of product market regulation is the government's drive to develop and expand industrial policies. Already, industrial policy, such as the support for the chemicals and auto industries, has contributed to the capital- and skill-intensive nature of growth, to the detriment of employment of less-skilled labour.²⁵

Sectoral minimum wages probably have little impact on employment overall

Even in OECD economies with national minimum wages, the impact on unemployment is a matter of dispute (OECD, 2004). It is clear both theoretically and empirically that minimum wages that are set too high in relation to average wages will reduce demand for less skilled workers. But the empirical magnitude of this employment-depressing effect is unclear, with some studies finding no significant impact (*e.g.* Card and Krueger, 1997), while others finding strong effects (*e.g.* Deere *et al.*, 1995; Neumark and Wascher, 1995). Overall, the literature for OECD countries suggests small effects.

South Africa has no national minimum wages. Beginning in 2003, minimum wages at a sectoral level came into effect for sectors with no bargaining council. This covers a relatively small number of employees – notable examples of sectors with minimum wages include domestic workers, agriculture, and retail trade.

To date there has been little work on the employment effects of the sectoral minimum wages. But there is no discernible break in the relative employment performance of these sectors relative to others since the introduction of the minimum wages, and no sign that wages for those earning the minima have increased much in relation to average wages. Moreover, the number of workers covered by the sectoral minima is relatively small. It is therefore not surprising that minimum wages are not generally cited as an important factor in restraining overall employment and sustaining the high unemployment rates.

Social benefits are increasingly important, but their impact on unemployment is uncertain

A final feature of the South African context which is sometimes seen as a significant explanatory factor in the high overall rate of unemployment is the large number of recipients of social grants, especially for pensions. There has been a rapid increase in the incidence of such benefits, with some 12 million South Africans now receiving them. Moreover, some are generous, with pensions paying up to twice the average wage. To the extent that such benefits allow individuals to survive without working (historically, the alternative to employment was certainly extreme hardship, and sometimes starvation), they may discourage search and raise reservation wages. Some research (*e.g.* Bertrand *et al.*, 2003) suggests that this effect is important. As against that, other studies (*e.g.* Posel *et al.*, 2004; Edmonds *et al.*, 2003) find that the payment of pensions to an elderly family member is actually associated with greater job search by younger family members. More research is needed on the net effects on search and reservation wages. In any case, social benefits were not important in the 1990s, and so cannot plausibly explain the big increase in unemployment since the mid-1990s. Moreover, they have more than just a labour market impact, playing an important direct role in alleviating poverty. It is possible, however, that their greater importance in recent years has had some role in hindering the reduction of unemployment since 2000, by making it possible to choose to remain unemployed and still survive in a household supported by grants. The fact that the number of discouraged workers – that is, those reporting that they want work but are not actively

25. It could be argued that if for one reason or another the labour market is not competitive, then state support for an industry could make the difference between there being some (albeit capital-intensive) jobs or none, so that assistance to capital-intensive industries could have been employment-enhancing. But even then, it would then need to be established that given amounts of assistance could not have had a bigger employment impact by being targeted at industries making more intensive use of less-skilled labour.

seeking a job – has risen even as the pace of decline of the narrow definition of unemployment has quickened may be one sign of such an effect.

Policies to tackle unemployment

South Africa's extreme levels of unemployment are above all the product of an excess supply of unskilled labour (at prevailing wage rates). Achieving the government's goal of halving unemployment from 2004 levels would involve moving something like 2 million low-skilled individuals off the unemployment rolls. This will require a substantial increase in the demand for unskilled labour, a major reduction in the supply of such labour, or some combination of the two.

To some degree *AsgiSA* recognises the need for such a combination. Some of the language on industrial policy suggests that one motivation is stimulating labour-intensive activities, and the concern with the volatility and level of the exchange rate indicates a recognition of the danger of macroeconomic conditions holding back demand for unskilled labour. But since another thrust of the industrial policy thinking is to encourage capital- and skill-intensive sectors, and since no clear interventions are identified to address exchange rate volatility or misalignment, it is not clear, overall, that there is much in *AsgiSA* that would have a significant positive impact on the labour demand side of the unemployment problem.

The policy directions that follow represent tentative suggestions of actions that seem to warrant consideration and further discussion, based on the main factors identified as explaining the scale of unemployment in South Africa and the experience of OECD countries in this area. The persistence of very high unemployment, concentrated in one segment of the population, even in the face of several years of robust economic growth, suggests that a range of policy actions may be needed to meet the *AsgiSA* goals.

Upgrading human capital

There are many problems in the education system: undertrained and demotivated teachers; severe shortages of books and computers in most schools; poor school infrastructure; the impact of HIV/AIDS; and the fragmentation of the school system along ethnic/language lines. Most of these will take a long time to be addressed.

Some solutions are relatively straightforward, if costly and gradual: for example, increasing and reorienting education expenditures *via* increased numbers of books and computers in schools and improved infrastructure. Increased efforts could be made to attract trained teachers and/or teacher trainers from abroad (especially from low-income countries with a relative abundance of individuals with the necessary skills, such as India).

Other more difficult reforms may also be warranted. For example, the mixed public-private state system, in which individual schools can charge fees and hire more or better teachers, has meant that the huge disparities in outcomes between different regions and ethnic groups have continued. It may be worth considering moving to compulsory education to age 18 with free public education and no private co-funding of public schools. This would facilitate the evening out of teacher-pupil ratios and quality of teaching within the public system and reduce the number of unskilled school-leavers. It might also facilitate moving trained teachers to where they are most needed. All this would address the relegation of so much of the majority black population to unemployment, low-paid informal employment, or unskilled manual labour in the formal sector.

The low performance in international reading and maths and science tests of students in African language schools suggests that teaching of English may need to be strengthened, at least at secondary school level, and perhaps that objectives other than cultural identity should be considered in deciding on the language of instruction.

Concerning public training schemes, there is no doubt a role for them to play in raising the human capital of the workforce. Given the size of the unemployment problem, the fact that so many of the unemployed have been out of work for a long time, and the track record of these programmes to date, it is doubtful they can be counted on to contribute much to meeting the government's goal of halving unemployment by 2014. Existing training initiatives like the Joint Initiative for Priority Skills Acquisition (JIPSA) and the National Skills Development Programme (the NSDP, which funds the SETAs) are relatively small-scale and/or beset with implementation problems.²⁶ In the case of the NSDP, there appears to be scope to increase its flexibility and reduce administrative costs. Public training schemes could perhaps play a more important role as an active labour market programme, by offering training to the unemployed, but with the acceptance of such training being a condition for receipt of state benefits (including any new forms of assistance with search or mobility, as below).

Encouraging mobility

A number of measures may be possible to ease capital market constraints on rural-urban migrants/jobseekers, including subsidised education/training loans or job search loans (maybe like student loans in some places, with repayment only if employed).

There may be a need to attach a higher priority to the development of infrastructure aimed at addressing the residual problem of spatial misallocation of workers. Shorter safer commutes for workers would help to reduce reservation wages, and an increased availability of urban housing for working class blacks would reduce search costs and improve job matches.

Better implementation of employment protection legislation

While South Africa's EPL appears to be relatively flexible, it seems that implementation of the laws is fuelling perceptions that the system is in fact quite rigid, especially as regards firing. There are actions that could be considered to address such perceptions, which may have restrained hiring (especially in the cyclical upturn since 2003).

The overburdening of the CCMA appears to have contributed to the use of formalistic judgements and long delays in some cases. Measures to streamline the case load of CCMA may merit consideration. For instance, access to the CCMA could be restricted to non-managerial workers. Managers are typically better protected by their employment contracts, and can have recourse to the courts if needed.

Ways might also be found to shorten and simplify arbitration procedures for wrongful dismissal at the CCMA. For example, greater use of "conarb" procedures, perhaps expanding the provisions for compulsory conarb hearings, might help to reduce average times for resolution of cases. Also, employers, who most often apply for review of CCMA rulings, could be charged a significant fee to appeal.²⁷

It may also be useful to look for ways to restrict the number of reviews of wrongful dismissal cases by the Labour Courts. The large number of cases and long processing times to some extent frustrate the original rationale for establishing the CCMA: to provide quick and simple judgements on wrongful dismissal and unfair labour practices. Reforms might also be possible to help speed up the functioning of

26. Criticisms of the SETAs have been legion since their inception. Some of the problems with the administration of the SETAs, including low take-up by firms, low learnership completion rates, and mismanagement are discussed in Grawitsky (2007).

27. From April 2006 through January 2008, nearly 98% of objections to CCMA awards were filed by employers.

the labour courts, which can be a major source of delay in some cases. For example, increased computer resources for the courts could pay dividends in faster processing times.

Improving competition and product market regulation

One promising avenue on the labour demand side may well be to foster more competition throughout the economy. Not only is this associated with greater innovation and productivity growth over the long term, but the shrinkage of product market rents accruing to a few large entrenched incumbent firms would weaken the power of labour market insiders, and would be expected to lead to increased employment in these sectors, as well as in other sectors using the output of industries with weak competition (such as monopolised network industries) as inputs. Moreover, such an initiative would go in the same direction of creating new opportunities for historically disadvantaged groups, and would thus be consistent with the democratisation of South Africa.

Other measures to boost demand for less-skilled labour

Another possibility for reducing the segregation of the labour market and increasing demand for less-skilled workers would be to develop further the system of wage subsidies for young or first-time workers, called *learnerships* in South Africa. A similar idea that could be explored would be to lengthen the maximum allowable probation period, during which normal labour regulations do not apply. Certainly the calamitous unemployment rates for youth and less-skilled blacks suggest that more could be done to give such marginal workers a foothold in the job market.

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ANNEX: THE ASSESSMENT OF EPL IN SOUTH AFRICA

Labour market rigidities are often cited in surveys as an important obstacle to business in South Africa. In this context, the application of the OECD's indicator of employment protection legislation (EPL) is of interest. The EPL indicator has been applied to all OECD member countries (first in 1998, and then again in 2003), and a number of non-members (Brazil, Chile, China, and India). Computing the indicator for South Africa thus allows its EPL to be benchmarked against a range of advanced, middle-income, and developing countries.

Overview of the construction of the EPL indicator

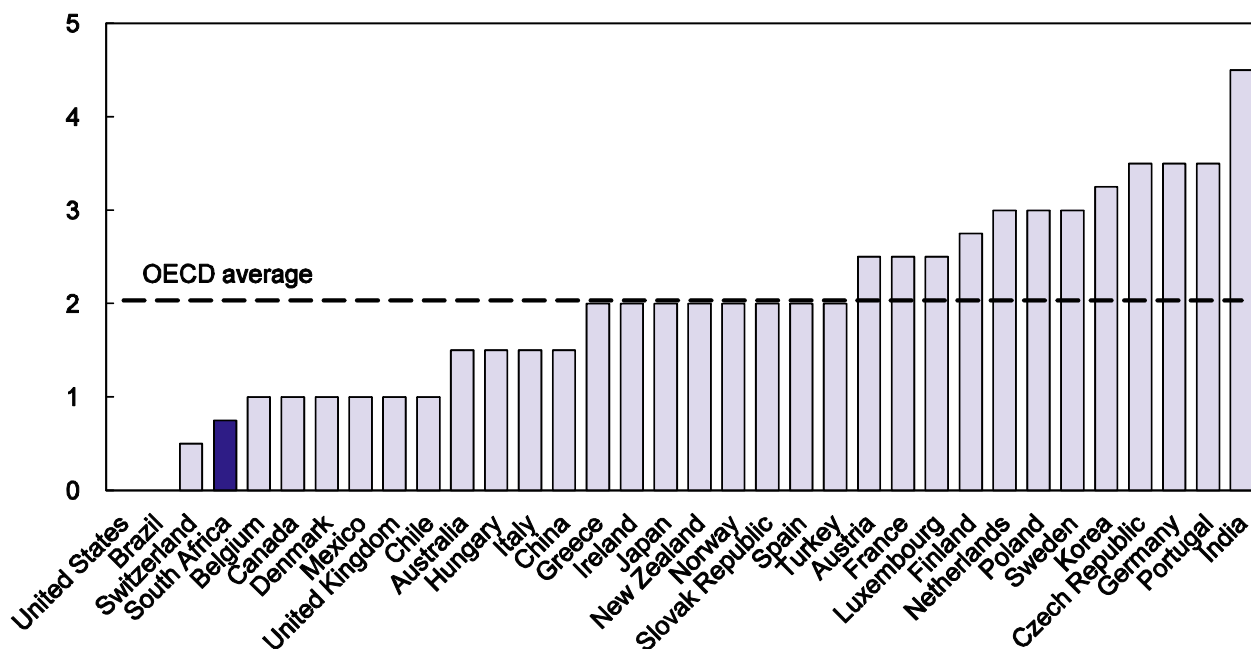
The EPL indicator has a pyramidal form, with 22 detailed items at the bottom and an overall score at the top. The 22 basic items can be classified in three main areas: *i*) protection of regular workers against individual dismissal; *ii*) regulation of temporary forms of employment; and *iii*) specific requirements for collective dismissals. Scoring is based primarily on labour legislation, but also tries to take into account judicial practices and court interpretations of legal and contractual provisions. A four-step procedure is used to construct summary indicators of EPL strictness that allow meaningful international and intertemporal comparisons to be made, (see OECD, 1999, Chapter 2, Annex 2.B for details). The 22 first-digit inputs are initially expressed either in units of time (*e.g.* delays before notice can start, or months of notice and severance pay), as a number (*e.g.* maximum number of successive fixed-term contracts allowed), or as a score on an ordinal scale specific to each item (0 to 2, 3, 4 or simply yes/no). These first-level measures of EPL are first converted into cardinal scores normalised to range from 0 to 6, with higher scores representing stricter regulation. The three remaining steps consists in forming successive weighted averages, thus constructing three sets of summary indicators that correspond to successively more aggregated measures of EPL strictness. The last step of the procedure involves computing, for each country, an overall summary indicator based on the three highest-level subcomponents: strictness of regulation for regular contracts, temporary contracts and collective dismissals. The summary measure for collective dismissals was assigned a lower weight than those for regular and temporary contracts, as the collective dismissals indicator only reflects *additional* employment protection triggered by the collective nature of the dismissal. In most countries, these additional requirements are quite modest.

Results of the EPL assessment of South Africa

The *procedural inconveniences* sub-component is designed to capture how burdensome the procedures for dismissal are for firms. The two items comprising this sub-component relate to the nature of the required procedures (for example, whether notice has to be given in writing or only orally) and delays before the notice period may begin. South Africa shows up as having very flexible arrangements in this area compared both to most OECD and other non-OECD countries (Figure A.1).

Figure A.1. Procedural Inconveniences

Indicator scale of 0-6 from least to most restrictive, 20061



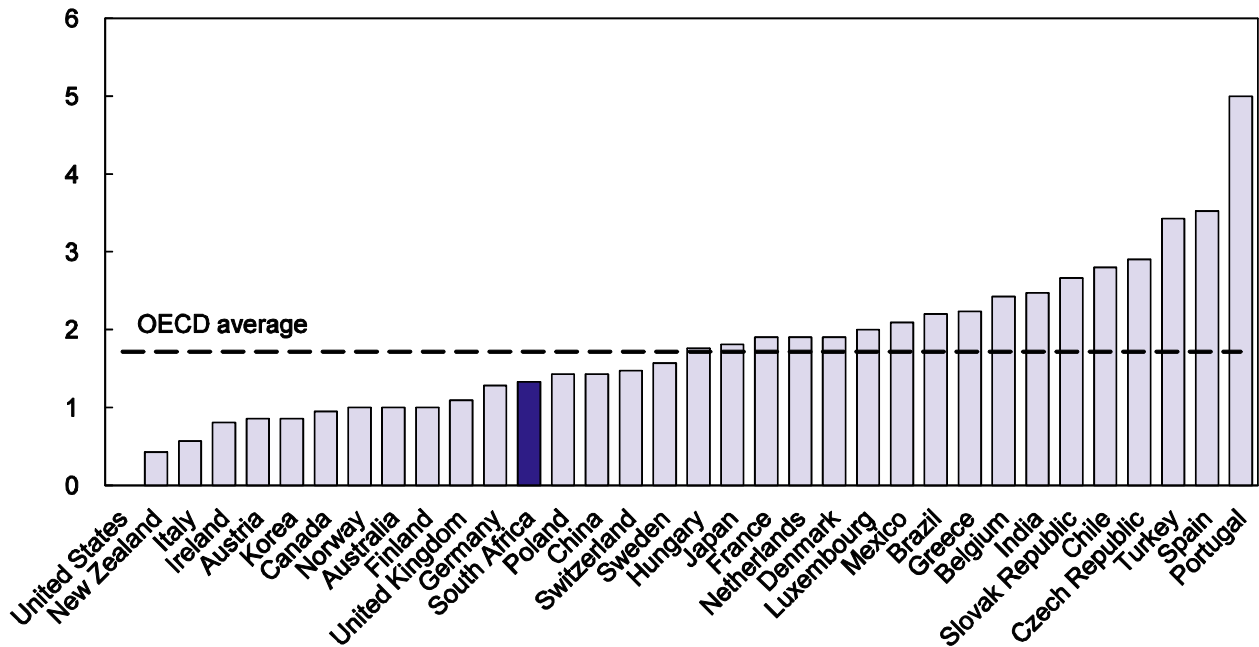
1. 2007 for South Africa, 2003 for Chile and 2004 for Brazil.

Source: OECD (2007), Going for Growth; OECD (2005), OECD Economic Surveys: Brazil; and OECD (2007), OECD Economic Surveys: India.

The indicator on *notice and severance pay for no-fault dismissals* measures the required notice period and severance pay for different levels of tenure (9 months, 4 years, and 20 years). Especially on account of having no mandatory severance pay for tenure of less than one year, and having only 4 weeks notice for workers with as much as 20 years tenure, South Africa again is among the countries with relatively high flexibility in this area (Figure A.2).

Figure A.2. Notice and severance pay for no-fault individual dismissals

Indicator scale of 0-6 from least to most restrictive, 20061



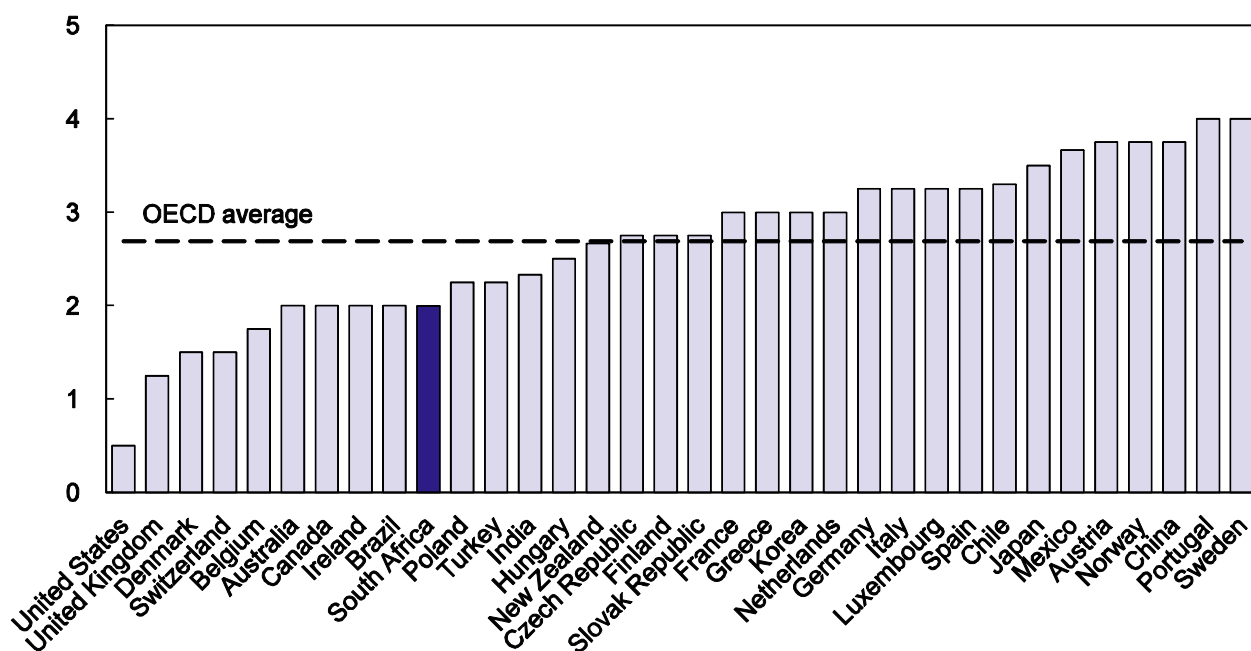
1. 2007 for South Africa, 2003 for Chile and 2004 for Brazil.

Source: OECD (2007), Going for Growth; OECD (2005), OECD Economic Surveys: Brazil; and OECD (2007), OECD Economic Surveys: India.

A third sub-component relates to *difficulty of dismissal*. It is built up from measures of the restrictiveness of the definition of unfair dismissal, trial periods, compensation for unfair dismissal, and the possibility of reinstatement in the case of a finding of unfair dismissal. Largely on account of the last two elements, South Africa is found to be relatively less flexible as regards ease of dismissal than it is in other areas of the overall indicator. Even here, however, it is still less restrictive than the OECD average, and at or below the level for other non-OECD economies for which the data are available (Figure A.3).

Figure A.3. Employment protection legislation, difficulty of dismissal

Indicator scale of 0-6 from least to most restrictive, 20061



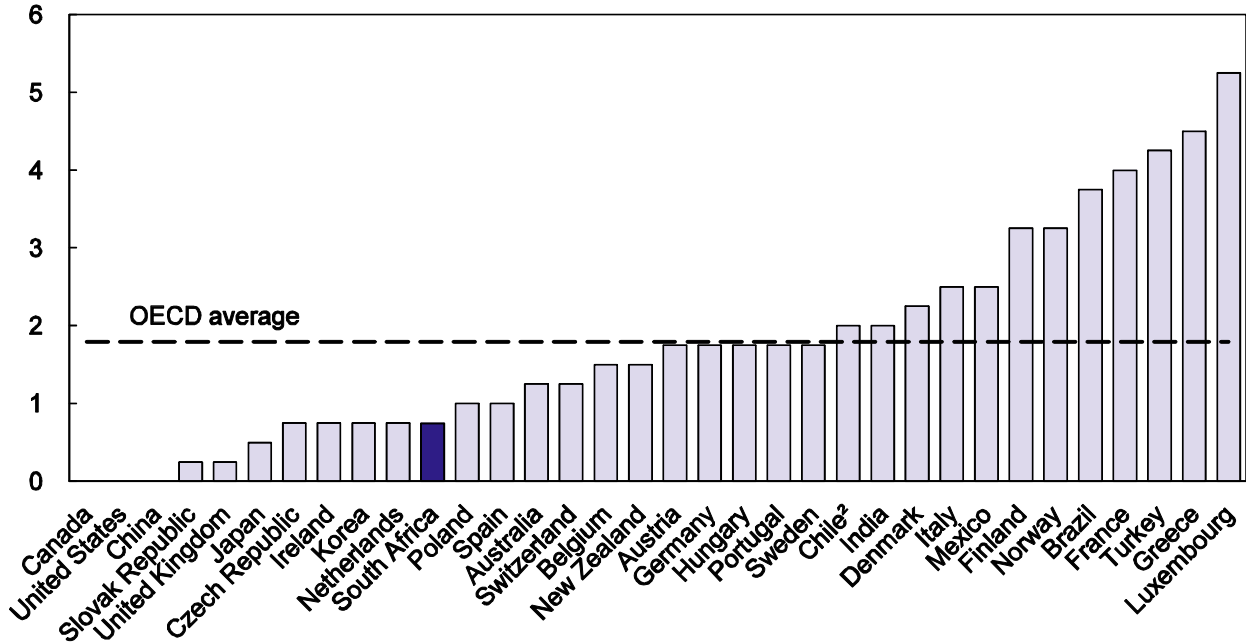
1. 2007 for South Africa, 2003 for Chile and 2004 for Brazil.

Source: OECD (2007), Going for Growth, OECD (2005), OECD Economic Surveys: Brazil; and OECD (2007), OECD Economic Surveys: India.

Flexibility as regards temporary employment is assessed *via* sub-components on *fixed term contracts* and *temporary work agencies*. South Africa does not require specific reasons for using fixed term contracts, and does not impose limitations on the number of contract renewals. The main restrictive element arises from the provision that workers who have had several successive fixed term contracts and who had a reasonable expectation of further renewal may interpret the non-renewal of the contract as dismissal. Overall, however, South Africa again scores as relatively flexible in this area (Figure A.4).

Figure A.4. Employment Protection Legislation, fixed term contracts

Overall score, indicator scale of 0-6 from least to most restrictive, 20061



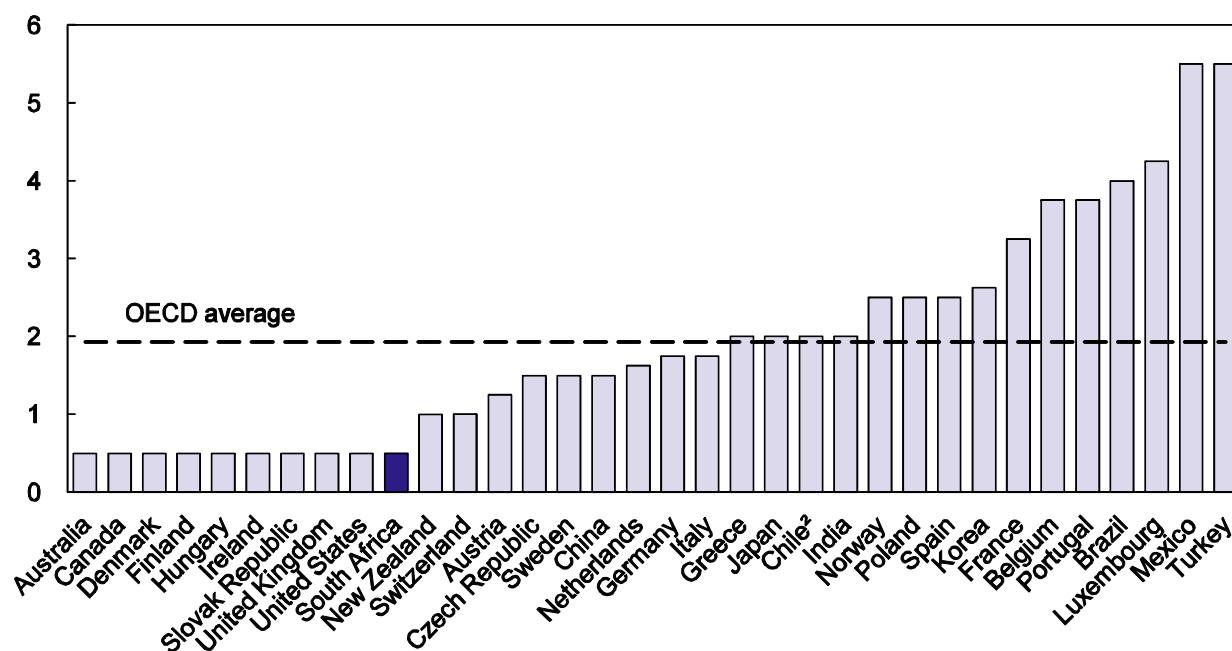
1. 2007 for South Africa, 2003 for Chile and 2004 for Brazil.

2. The scores estimated for fixed-term contracts are taken to apply to temporary-work agencies as well.

Source: OECD (2007), Going for Growth; OECD (2005), OECD Economic Surveys: Brazil; and OECD (2007), OECD Economic Surveys: India.

The use of temporary work agencies is widespread in South Africa, and the legal restrictions in this area are minimal, making South Africa particularly liberal in comparison with many OECD and non-OECD countries (Figure A.5).

Figure A.5. Temporary work agency employment

Overall score, indicator scale of 0-6 from least to most restrictive, 2006¹

1. 2007 for South Africa, 2003 for Chile and 2004 for Brazil.

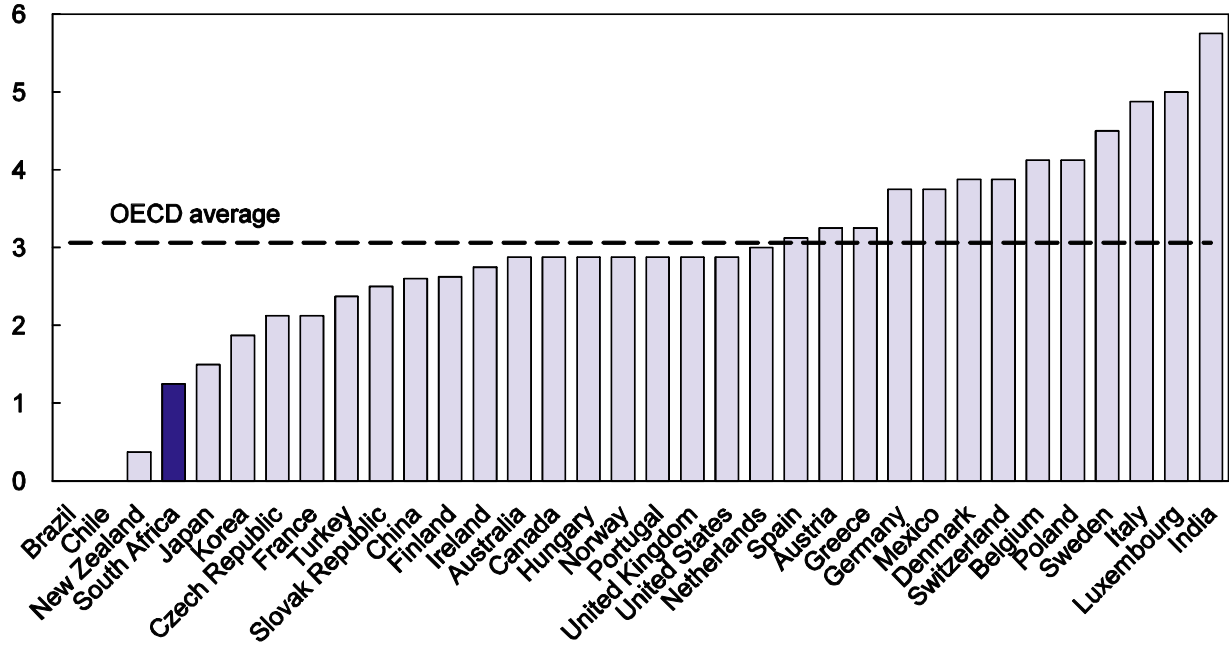
2. The scores estimated for fixed-term contracts are taken to apply to temporary-work agencies as well.

Source: OECD (2007), Going for Growth; OECD (2005), OECD Economic Surveys: Brazil; and OECD (2007), OECD Economic Surveys: India.

The final sub-component of the overall indicator concerns *collective dismissals*. In South Africa EPL imposes no additional delays for collective relative to individual dismissals, but representatives of unions with workers employed in the organisation must be notified. Also, in enterprises owned by or linked to the state, the negotiation of social plans is common, which restricts the possibility for collective dismissal in that sector. Again, however, overall South Africa emerges as less restrictive than all but one OECD country in this area, though less liberal than middle-income peers Brazil and Chile (Figure A.6).

Figure A.6. Employment Protection Legislation, collective dismissals

Overall score, indicator scale of 0-6 from least to most restrictive, 20061



1. 2007 for South Africa, 2003 for Chile and 2004 for Brazil.

Source: OECD (2007), Going for Growth; OECD (2005), OECD Economic Surveys: Brazil; and OECD (2007), OECD Economic Surveys: India.

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