South African Reserve Bank

Employment and the economics of job creation

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Dr Erich Fromm, in his 1976 book "To have or to be?" provides an analysis of the crisis of modern civilisation and, when addressing the features of a new society, wrote: "*The first requirement in the possible creation of the new society is to be aware of the almost insurmountable difficulties that such an attempt must face … Those who have not given up hope can succeed only if they are hard-headed realists, shed all illusions and fully appreciate the difficulties … (the new society) would have to create work conditions and a general spirit in which not material gain but other, psychic satisfactions are effective motivations … "*

Akerlof and Shiller, in their book "*Animal Spirits*" (2009) write: "*We are facing the same problem today that we faced in the latter years of the Great Depression – business today is inhibited by uncertainty about the future, about the tolerance of an angry public, about a disaffected labour force and about what further government actions may be coming … We identified five psychological factors that we thought were of particular importance. They are confidence, fairness, corruption and bad faith, money illusion and stories …"*

It is almost twenty years into our young democracy, the past six of which have been seriously impacted by a global financial crisis to which there is no end in sight. And one of the hardest hitting impacts has been on ordinary people from all walks of life, who have seen their hopes for the future evaporate; millions will never work again; others will never know the dignity and independence that work brings. As the above quotes reflect, creating an inclusive society requires courage, foresight and the ability to make very tough choices. We also better understand our circumstances and challenges through stories, and it is imperative that we both tell and hear the many varied South African stories that make up the complex fabric of our society.

Each year, the World Bank publishes its World Development Report covering a particular theme of development. This year, it has titled its report "Jobs". This simple title says much about the most pressing economic issue facing the world today. The IMF, too, has released a substantive paper on Employment and Growth and recently the International Labour Organisation released its W**orld of Work** report with the theme of "*Repairing the Social and Economic Fabric"*. In recognition of the scale of the employment crisis and its impact on both social cohesion and longer term growth, several other global institutions and economists are focusing their attention on employment, seeking ways to tackle unemployment and underemployment.

These discussions on employment occur in a global context where unemployment has increased sharply since the onset of the financial crisis. Of great concern is the fact that the number of young people who are unemployed, and the length of time that people remain unemployed, are rising. South Africa has had an unemployment crisis for the better part of three decades. A few years ago South Africa was an outlier with an unemployment rate of around 25 percent. Today there are several countries in the periphery of Europe with unemployment rates at least as high as ours – not that this is any reason for complacency or comfort. The International Labour Organisation estimates that there are about 200 million unemployed people in the world today. This figure excludes the millions more who are either underemployed or are discouraged from seeking employment. The ILO estimates that the number of unemployed people in advanced economies is likely to remain above the pre-crisis level up to at least 2017, a full decade after the crisis first began. In South Africa, total employment is still about 400 000 below the peak reached in in 2008.

The unemployment crisis represents a massive waste of lives and resources. It has profound social implications and its effects will be with us for decades to come. Economists refer to the term hysteresis, which in this context describes the loss of skills and productivity when a person has been out of the workforce for a long period of time, thereby lowering future potential growth. Reducing unemployment on a sustainable basis is arguably the single most important economic objective at the present moment. In part, creating jobs is about raising the level of economic growth. However, it is also about addressing the structural factors that limit employment growth.

My address today will try to give you a sense of how central banks think about employment and how they factor employment issues into their reaction function. I will also explore broader structural and cyclical factors relating to employment. Before concluding, I will briefly make some observations about the future of work and the likely impact of technological change.

The policies of central banks are not often associated directly with employment creation. However, monetary and financial sector policies have a role to play in at least two respects. Firstly, the conventional view is that monetary policy can affect cyclical employment, but it cannot determine the longer run potential output of the economy. This is the basis for countercyclical monetary policy. However, in a recent paper, Phillipe Aghion and Enisse Kharoubbi, argue that better macroeconomic stability can actually contribute towards higher potential growth and that the absence of macroeconomic stability has a profound impact on employment rates.

Our task as monetary authorities is to provide a stable environment for balanced and sustainable economic growth to occur; to ensure that investors can take a longer term perspective and that the value of earnings and savings are not eroded by inflation. Price stability is an important contribution to this environment because inflation is a regressive tax, impacting on the earnings and wealth of poor people far more than on the rich, who often have the means to protect themselves. In South Africa, high inflation contributed significantly to widening inequality in the 1970s and 1980s.

Secondly, central banks also play an important role as regulators of the financial sector in a manner that contributes to the efficient allocation of resources in the economy, to prevent financial crises from occurring and to ensure that that money and credit is flowing to those who seek it. A key lesson from the financial crisis is that when the financial sector implodes, when confidence in the banking sector evaporates, the real economy is seriously affected because if money and credit are unavailable, the economy grinds to a halt. And one of the consequences is that people lose their jobs.

One of the measures taken as part of a global move to create a safer and more accountable financial sector has been a series of regulatory reforms, including what is known as Basel III, which creates a framework for regulating the conduct and risk-taking of banks. South Africa sees these measures as critically important, and is in the process of introducing the so-called twin peaks model to regulate the financial sector in a more holistic manner.

Beyond these important contributions to the broader economic environment, which are essential for job creation, central banks do not have the policy instruments to create jobs directly. Central banks also do not usually have the institutional authority or tools to undertake the structural reforms required to ensure that an economy grows faster or that unemployment is reduced at a faster pace. Furthermore, the room for central banks to direct credit to one sector over another or to one firm over another is limited. Fiscal policy, industrial policy and quasi-fiscal institutions such as development finance institutions are more suited to implementing such policies, which also fall within their areas of responsibility.

The on-going global crisis has, since inception, mutated from a sub-prime crisis to a systemic banking crisis, a fiscal deficit and sovereign debt crisis to one that has seen countries and regions move in and out of recessions. Some measures taken to address these issues, including in some instances the introduction of extreme fiscal austerity policies, exacerbated the adverse effects of the crisis on unemployment. The latest mutation appears to be one that has impacted on emerging market economies, which are experiencing significant capital outflows, depreciating currencies, slowing growth and rising inflation. All of this impacts on local economies and jobs.

Some of the rise in global unemployment is due to cyclical factors, including the austerity measures introduced following the crisis, and part of the rise is due to structural changes to the economy. It is often difficult to differentiate one from the other, especially when unemployment has been so high for so long. In the South African context, a relatively small proportion of our unemployment is cyclical; the bulk of it is structural with deep and long historical underpinnings.

Drawing on reports by the IMF, World Bank, ILO and other institutions, several themes emerge. The key ones include:

- What is the appropriate fiscal and monetary response to unemployment or more generally to the present state of poor economic growth?
- What labour market reforms are required to support economic efficiency and productivity growth?
- What labour market and other social policies can protect workers?
- What other microeconomic or structural reforms are needed to raise the level of growth and employment going forward?

There is general support for strong fiscal and monetary responses to cyclical downturns. Countercyclical monetary and fiscal policy can stimulate investment and employment when the private sector and households are less inclined to spend or to invest. On the fiscal side, there is strong support for investment in infrastructure and for subsidies to firms to train people rather than retrench workers. There is also increasing evidence that greater public support for research and development can contribute towards economic development and productivity growth, especially at a time when private firms are spending less on investment. Monetary policy in much of the globe has been supportive of credit extension and consumption. In most countries, including our own, interest rates are at historic lows and have been for some time. In some jurisdictions, central bank purchases of a broader range of assets, also known as quantitative easing, has provided further stimulus, enabling banks to improve their balance sheets. In general, central banks in advanced countries have tried to assure economic participants that interest rates will be kept low for some time in order to encourage investment. But there are limits to what monetary policy can achieve in this respect. As indicated earlier, monetary policy can only provide short to medium term relief and is not a substitute for necessary structural reforms.

On both the fiscal and monetary fronts there are debates about the sustainability of these measures and the debate has shifted to the timing of the normalisation of such unconventional policies, and a concern about the possible unintended consequences as has been seen over the past few weeks.

Labour market reforms that enable more efficient movement of workers from one sector to another are necessary because they help economies adjust to changing circumstances. They are also controversial because they reduce job security. Drawing on the work of the Spence Commission (the Growth Commission), policymakers are focusing more on protecting workers than on protecting jobs. This is a subtle distinction, but a significant one. Policies such as unemployment insurance, training vouchers and placement assistance can help workers who have lost their jobs find alternative opportunities. Policies that limit the ability to downsize or restructure are seen as inefficient and are being adjusted.

Some countries have introduced innovative programmes to enable firms to keep people on their payroll, albeit at lower wages, instead of retrenching workers. These programmes are generally tied to training and re-skilling of workers. The most successful of these programmes is in Germany where a significant proportion of the workforce chose lower pay and the chance to be retrained rather than retrenchment. Many countries, including developed ones, have public employment programmes not too dissimilar to our public works programme. Other active labour market policies include matching activities for both people and firms. Several jurisdictions offer tax credits to employers to take on specific categories of workers.

There is also recognition that structural reforms aimed at improving economic efficiency are needed to raise the level of employment. These policies include tougher anti-competition policies and microeconomic reforms aimed at lowering costs in key network industries.

Education, training and the retraining of workers are essential to maintain long-run competitiveness and ensure higher levels of employment. After declining for decades, many advanced economies are spending more on education and training since the financial crisis, despite significant pressure to reduce public spending.

South Africa's high level of unemployment is not a new phenomenon. According to Haroon Bhorat, a labour market economist at UCT, in 1970 the number of African people in formal employment was 5.3 million. This number increased in the 1970s and early 1980s but by 1995, 25 years later, it was exactly the same at 5.3 million. This is despite the working age population almost doubling. While we cannot simply look backwards and blame our past, we also cannot simply wipe away its terrible and enduring legacy. The deep structural features of apartheid - in the form of poor quality education for black people, job reservation, curbs on trading and owning businesses, forced removals, land dispossession, dormitory townships and the homeland system - have all contributed to the situation where we have one of the highest levels of inequality in the world and over a third of adults are out of work.

Since 1994, we have made steady progress in creating jobs, but clearly the rate of job creation has been too low to absorb the bulk of people seeking work. Sound macroeconomic performance combined with higher growth has contributed to rising employment since 1995. The problem has been that the increase in the labour force has outpaced the number of jobs created. South Africa's official unemployment rate increased from 17.6 percent in 1996 to 30.4 percent in 2002, before declining to 22 percent in 2007.

The legacy of apartheid has clearly resulted in a high level of unemployment, but growth since 1994 has not been as high as we would like. The rate at which an economy grows consistently is critical. While we all recognise that jobs are not automatically created when countries grow, we do know that if a country is not growing then it is extremely difficult to create new jobs, or even sustain existing ones. Government has frequently mentioned the desire to grow the economy at 7 percent a year. It takes decades for countries to make the transition from poor to advanced economies. Michael Spence, when examining this matter in his book "The Next Convergence", says that "at a 7 percent rate of growth income doubles every decade, and that is very fast ... And even at such very high growth rates it takes well over half a century to make the full transition. What matters is sustained growth over a long period of time. Little growth spurts followed by stagnation simply lowers the average growth and prolongs the process." It is in this context that we need to frankly assess our long term growth average, and our current growth rates, as while we are creating new jobs, they are not sufficient to absorb new entrants into the labour market, and therefore unemployment continues to rise.

We also have to acknowledge that there remain deep structural weaknesses in our economy that prevent faster growth and higher labour absorption. These structural weaknesses, notwithstanding the legacy issues mentioned earlier, also include uncompetitive product markets, low levels of fixed capital investment, a low savings rate, inadequate progress in improving education and training and poor public services.

Of particular concern has been the fact that the two sectors in the economy most intensive in low skilled workers, mining and agriculture, have shed jobs for much of the past twenty years. While there has been some job creation in low skill sectors such as the private security industry and the retail sector, in general most jobs have been created in skills-intensive sectors, locking out low skilled workers. Given the shortage of skilled workers, this trend has also pushed up the salaries of skilled people, contributing to rising inequality.

This shift to more skills-intensive jobs is not a uniquely South African phenomenon. Globally, work has become more skills-intensive and the rates of return to education have been rising in most countries (IMF, 2013), meaning that skilled workers are capturing a larger and larger share of wages in the economy. This trend, referred to as skills-biased technological change, is also impacted by the introduction of China into the global trading system. Low skilled work has been outsourced to lower cost economies. When countries have highly skilled populations, this trend is a positive one for both productivity and employment. When workforces are insufficiently skilled to move up the value chain, then these workers get left behind. Even some developed countries, such as the US, are confronted by this problem.

One of the most controversial aspects of post-apartheid policies has been the labour regime and the institutional structure of the labour market. The labour regime we have has sound intentions. Its aims are to balance the power of employers and employees following a history where workers, black workers in particular, were exploited and subjected to arbitrary dismissal. The labour regime aimed to reduce tensions in the workplace by setting up complex quasi-legal dispute resolution mechanisms. Policy has also sought to broaden access to unemployment insurance, health insurance, workmen's compensation, maternity leave as well as training opportunities through the establishment of sectoral education and training authorities.

Following the enactment of the Labour Relations Act, the number of days lost to strike action fell sharply with about one million strike days a year on average from 1996 to 2007. Since 2007 however, the number of strike days lost have increased sharply and strike activity has also become more violent. More recently, there has been a sharp increase in illegal or unprocedural strikes. Today, many labour intensive sectors are characterised by high levels of tension which are not conducive to investment, job security or employment creation.

In other respects too, the labour regime has not lived up to expectations. We have not seen the dynamic growth of small and medium sized firms as one would have expected in a country at the level of development of South Africa. While collective bargaining has contributed to labour peace, it has also favoured big firms at the expense of smaller ones. New labour entrants also find it difficult to break into the labour market. While in general salaries are not high relative to other countries with a similar level of productivity, starting salaries are higher than other countries, discouraging employers from hiring inexperienced workers (OECD, 2010). Firing costs, especially for smaller firms, are also high by international standards (WEF, 2012).

A major feature of the labour market regime has been the inability to more closely link pay to productivity growth. This was not what was intended. When the Labour Relations Act of 1996 was passed, the intention was for collective agreements to serve as framework agreements, covering minimum pay and basic benefits. The intention was that within these framework agreements, firms would negotiate firm-specific agreements linking salary increases to productivity gains. In practice, this is the exception rather than the rule. To introduce greater links to performance one does not have to change the law. Within the existing legal framework such agreements are possible.

South Africa’s youth unemployment rate is particularly high, now above 50 percent. Programmes to encourage firms to hire young people have so far not yielded the desired results. Our view is that it is possible to incentivise firms to hire younger people without the threat of displacing more experienced workers. Several OECD and developing countries have some variant of incentive, including tax breaks, to firms to hire inexperienced workers and young people while protecting the existing workforce and older workers.

Given the scale of unemployment in South Africa and the fact that most of the unemployed lack the skills to fit into most of the skills-intensive parts of the economy, it is critical that we focus on growing labour intensive sectors, including mining and agriculture. It is also critical that government expands and strengthens the quality of its public services, including the social wage, to enable low skilled workers to live meaningful lives. This requires an implicit understanding that wages on their own may not meet the desired living standards for newer workers, a controversial question given the high levels of inequality in our society.

While South Africa has made praiseworthy progress in expanding access to early childhood education, school education, further education and training and university education, the quality of outcomes in the education system remains below international averages. Education provides the single most-effective route to breaking the intergenerational cycle of poverty. Lack of education is also the greatest exclusion a person can experience. It is also critical to obtaining a job and to higher productivity. Given that the economy is short of skills, importing skilled workers can be a sensible strategy because of the multiplier effects for low skilled employment. It is estimated that for each high skilled immigrant that comes into the country, between four and eight low skilled jobs are created.

South Africa is faced with a difficult set of trade-offs. In general, countries get rich by moving up the value chain, by becoming more skills-intensive. South Africa lacks the skills to compete with advanced economies such as Germany and the US. On the other hand, our cost structure does not allow us to compete with poorer economies. South Africa has to therefore adopt a dual strategy of promoting growth in advanced sectors that can compete globally while also creating jobs in lower productivity sectors. Both legs of this strategy should focus on the need to raise exports in general which is the only realistic strategy to address our inequality problem on a sustainable basis. While mining will remain critical to our development prospects, the economy has to diversify to be able to create more jobs going forward.

Since the industrial revolution, there have been many debates about the impact of technology on employment. The general consensus is that while technology may displace workers in some firms or industries, the productivity gains and resulting welfare benefits imply that new industries emerge and overall employment continues to rise. There could of course be huge inter-temporal factors that complicate the picture with long delays and lags between the destruction of a job in one sector and the emergence of new jobs in other sectors. There are also distributional effects which have to be considered. Well-paying jobs in the auto industry in the US, for example, may be destroyed through outsourcing or mechanisation while the jobs created in the growing services sector may offer lower pay. Furthermore, the returns that go to the developers and designers of technology now far exceed the returns to the people who assemble the products or even the people who extract the raw materials for the product.

These distributional challenges arise in a global context. With a rising share of profits going to the design companies who are generally located in advanced economies, less of the value addition occurs in poorer countries. To put it differently, more of the value of the product accrues from the research, development, marketing, logistics and intelligence of the product than in any other part of the supply chain.

The pace of technological change appears to be accelerating exponentially. The internet, mobile telephony, networked computing and more recently artificial intelligence have implications for the world of work and for our lives that are difficult to comprehend. Joseph Stiglitz in his 2010 book *Freefall*, argues that the jobs lost in agriculture at the end of the 19th

century contributed to lower aggregate demand, leading to the Great Depression. This catastrophe was only resolved through the rise of manufacturing, initially prompted by the demands arising from the outbreak of Second World War. Is the unemployment we are witnessing today a result of a great dislocation of workers from manufacturing to services, or a replacement of workers – both skilled and unskilled - by artificial intelligence, or are there new work opportunities that are yet to be identified that could absorb the growing army of unemployed across the globe?

These trends pose complex questions for policymakers. Should we protect certain sectors, and if so, how? Does protecting certain sectors or firms weaken the ability of the economy to transform or to innovate? Again referring to the Growth Commission report, the preferred approach is to protect people through sensible welfare safety nets and retraining opportunities rather than protecting specific jobs. It also brings back into focus the role of the public sector not only as provider of public goods such as education and research and development but also as employer in labour intensive services such as health care, transport, crime prevention and education. Does this level of unemployment not require all of us to reconsider the role and responsibility of the state in filling the gaps in services to all citizens that the private sector is not adequately meeting?

Conclusion

South Africa and the world face difficult challenges in reviving economic growth and creating jobs. Sensible counter-cyclical policies combined with longer term structural reforms aimed at promoting growth, employment and a more equitable distribution of incomes are the way to navigate out of this crisis. For South Africa, there is also a need to improve the functioning of the labour market, to strengthen its institutions and to walk that careful balance between hard-won rights of workers and the need to promote inclusive growth through encouraging new entrants into the workplace.

From our perspective at the Reserve Bank, we will continue to contribute towards an environment conducive to creating jobs and encouraging long term investment. This implies a continued focus on price stability and the prevention of financial sector crises. It also implies policies aimed at reducing the volatility of the business cycle and of ensuring as little disruption to the macroeconomy from external shocks as we can manage.

I leave you with a quote from the World Development Report on jobs: “In today’s global economy the world of work is rapidly evolving. Demographic shifts, technological progress, and the lasting effects of the international financial crisis are reshaping the employment landscape in countries around the world. Countries that successfully adapt to these changes and meet their jobs challenges can achieve dramatic gains in living standards, productivity growth, and more cohesive societies. Those that do not will miss out on the transformational effects of economic and social development."

Thank you

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