LABOUR MARKET RIGIDITIES AND UNEMPLOYMENT: LESSONS FOR SOUTH AFRICA FROM THE EUROPEAN EXPERIENCE

By

Juliet Gael Archibald

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I hereby certify that, unless specifically indicated to the contrary in the text, this dissertation is the result of my own original work.

JJArchibald

Juliet Archibald

ABSTRACT

The aim of this thesis is to investigate the relationship between labour market rigidities and unemployment. The thesis does not attempt to undertake surveys, providing instead an overview of the literature and of South African works.

The unemployment – labour market rigidity debate is analysed with particular reference to the experiences of European countries belonging the Organisation of Economic Cooperation and Development (OECD). It appears that while adverse shocks acted in the direction of raising unemployment, they could not account for the considerable heterogeneity or the persistence in unemployment levels across countries. The possibility that labour market institutions or rigidities had a role to play in propagating the effects of adverse shocks on unemployment was then raised, leading to the emergence of a broad consensus that European unemployment has its sources in the interactions of adverse shocks and adverse labour market institutions.

Rigidities in the labour market have their source in trade union intransigence and in the legislation governing the labour market. Trade unions in South Africa are strong and in the past have been particularly militant in achieving their objectives of raising members' wages and improving conditions of employment. The regulatory environment in which the South African labour market operates was examined. South Africa's adoption of labour legislation that is very trade union friendly, and that introduces greater inflexibility into the market and affects business's abilities to adapt to change, which is particularly necessary within the context of globalisation, is against the trend observed internationally. The implementation of such legislation seems irresponsible in a country where conservatively 26,4 percent of the economically active population is unemployed.

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1 INTRODUCTION

The year 1994 saw the birth of democracy in South Africa. The new democratic government expressed a strong commitment to reducing poverty and unemployment, decreasing the disparities in the distribution of income and wealth, restructuring the economy and improving the economic growth rate. Legislation was reformed removing the racial biases that had formed the cornerstone of the apartheid policies. However the legacies of the apartheid era continue to affect the operation of the South African economy. The cycle of low investment leading to poor economic growth, which in turn results in higher levels of unemployment and the manifestation of various socio-economic ills, seems to be self-perpetuating. Jobless growth has come to characterise the economy. Unemployment standing at 26,4 percent and 36,2 percent in terms of the official and expanded definitions of unemployment respectively is high by any standard. Reducing unemployment and thereby improving the living standard of the South African people is a major challenge facing the country.

The importance of achieving macroeconomic stability, a necessary requirement for sustainable economic growth, has underpinned South African government policy. The government chose to adopt a gradualist approach to economic reform and followed largely the ideal policy sequence of reform that has come to be known as the Washington Consensus. The exception has been in the reform of the legislation governing the labour market. In this area the government has gone against the international trend and elected to adopt legislation that strongly favours the employed and that is particularly trade union friendly. Additional rigidities have been introduced into a labour market already plagued by an inability to create jobs. It is argued that rigidities or institutional arrangements prevent the free operation of the market mechanism in the labour market and are responsible for unemployment. This thesis seeks to determine the validity of the link between labour market rigidities and unemployment. The experience of European countries belonging to the Organisation for Economic Cooperation and Development (OECD) is considered and where possible lessons for South Africa are drawn. The thesis does not present the results of survey research, providing instead an overview of the relevant literature and South African works.

Chapter two reviews the extent and the nature of the unemployment problem that South Africa faces. It describes the change that has occurred in the output structure of the economy and identifies the areas in which employment is expanding.

Chapter three then examines with specific reference to the experience of European OECD countries, the possible causes of unemployment. Empirical evidence on the link between labour market rigidities and unemployment is examined. The chapter concludes with a brief comment on the policy responses to unemployment.

Chapter four presents a theoretical overview of the impacts of trade unions on the labour market. Trade unions as a source of labour market rigidity is of particular relevance to South Africa where organised labour has a significant voice in the political process and trade union density is very high by international standards.

Chapter five takes an in-depth look at the trade union organisations prevalent in the South African labour market. The impacts of trade unions on the labour market is analysed in terms of the labour market segmentation and the labour aristocracy theories.

Chapter six considers South Africa's progress in the liberalisation of trade in the context of globalisation. The effects of trade liberalisation and globalisation on the labour market and unemployment in particular, are examined.

Chapter seven analyses the effects of the recent labour legislation on employment. The legislation namely the Labour Relations Act, the Basic Conditions of Employment Act, the Employment Equity Act and the Skills Development Act, has created a new labour relations environment. The challenge is for business to operate as efficiently as possible within this new environment given the increasing pressures to become internationally competitive and then to maintain such a position. The labour relations system should promote a stable and productive work environment conducive to economic growth, investment and employment creation. Any aspects of the legislation that hinder the achievement of the aforementioned are identified.

Chapter eight concludes and presents any recommendations and / or lessons to be learnt from the European experience.

2 UNEMPLOYMENT: THE SOUTH AFRICAN SITUATION

2.1 INTRODUCTION

This chapter analyses the extent and the nature of unemployment in South Africa. Unemployment is one of the most serious and challenging socio-economic problems facing South Africa. Employment (including self-employment and employment in the formal sector) forms the primary link between economic growth and better living standards. The rising level of unemployment has thus become the greatest single cause of severe poverty with unemployment having replaced race as the major factor behind inequality. The fact that the Gini coefficient, which measures the extent to which the actual distribution of earnings in a country deviates from the perfectly equal distribution (that is, the degree of income inequality), would fall from 0,60 to 0,41 for the period 1985 - 1991 if the unemployed and informal sector participants were excluded from the data, is an indication of the extent to which job creation could reduce inequality (Barker, 1999b : 164).

Unemployment also contributes to, or is the source of a number of other socio-economic ills (Schlemmer and Levitz, 1998 : 1). It not only impacts negatively on the individual's dignity and self-respect, but its effects permeate the whole of society. The frustration and desperation caused by being unemployed often lead to lawlessness and violence.

Although employment creation is a policy priority not much success has been achieved in this direction. The high levels of unemployment are affecting perceptions among the populace of the success or failure of a market economy in South African context. Disadvantaged communities increasingly hold the view that the market economy at best cannot solve the problem, or at worst is cause of unemployment (Barker, 1999b : 164). Unless there is a significant increase in job creation there is the danger that South Africa will become an 'enclave economy', in which the formal, unionised and relatively well-paid sectors of the economy produce more while employing a smaller and smaller percentage of the labour force. The increasing numbers of unemployed and those in marginal employment are likely to have a destabilising effect, further damaging an already low level of confidence in the country (Schlemmer and Levitz, 1998 : 6).

2.2 MEASURING UNEMPLOYMENT

Controversy surrounds the real level of unemployment in South Africa. Available data concerning unemployment is unsatisfactory. Although this is to be expected in a developing country, the situation is exacerbated by additional shortcomings in the data. Firstly, no unemployment series for all population groups combined for any significant length of time exist; secondly, individual series are not always comparable over time due either to changes in statistical techniques and/or the exclusion in various years of certain geographical areas; and thirdly, definitions and survey methods have differed over time (Barker, 1999b : 168).

Prior to 2000 the official estimates of unemployment were based on the October Household Surveys (OHS) conducted by Statistics South Africa (Stats SA), previously known as the Central Statistical Service. However in early 2000 Statistics South Africa introduced the Labour Force Survey (LFS), which, like the OHS, is a household-based survey. The LFS assembles information twice yearly on the employed and the unemployed in the formal and informal sectors in greater detail than could be achieved using the OHS.

Statistics South Africa recently revised its definition of the official unemployment rate, bringing South Africa's definition in line with the main International Labour Organisation (ILO) definition. This definition is used by more than 80 percent of both developed and less developed countries among 114 countries, including South Africa's major trading partners (Stats SA, 1998 : 1). According to the official or strict unemployment rate, the unemployed are defined as those people who

a) did not work during the seven days prior to the interview;
b) wish to work and are available to begin working within a week of the interview; and
c) have taken active steps to look for work or to start some form of self-employment in the four weeks prior to the interview

(Stats SA, 1998 : 11).

This definition replaced as the official definition the so-called expanded unemployment rate which includes all persons who are not working but are willing to work, regardless of whether they actively sought employment during the month of reference.

The official or strict definition of unemployment, although in line with the International Labour Organisation's recommendations, is criticised in that the criterion of "have taken active steps to seek work" may be unrealistic and financially burdensome on the unemployed in a developing country. Discouraged job-seekers in the special retrospective survey of employment and unemployment, which was conducted by Statistics South Africa during September 1997 among a sample of 12 000 respondents drawn one per household, cited the following as the main reasons for having ceased searching for employment (Stats SA, 1998 : 12):

- a loss of hope of finding a job (33%);
- a shortage of jobs in the area in which they live (25%); and
- a lack of funds for transport to look for work (18%).

The low probability of finding a job, high transport costs and low incomes all contribute to a large pool of discouraged work seekers.

The official or strict definition of unemployment may thus understate South Africa's true unemployment position. Statistics South Africa therefore publishes both the expanded and the new official definition of the unemployment rate, for comparability with previous OHS reports, and also because, as stated by the International Labour Organisation (ILO), the expanded definition may be appropriate " in situations where the conventional means of seeking work are of limited relevance, where the labour market is unorganised or of limited scope, where labour absorption is at the time inadequate". These circumstances are applicable to a degree in South Africa (Stats SA, 1998 : 12).

In comparison with other countries South Africa has one of the highest levels of unemployment in the world. In 1994 according to comparative estimates by the International Labour Organisation (ILO), only Reunion (34%) and Macedonia (32%) had rates of unemployment as high or higher than South Africa. Spain and Algeria notorious for their high unemployment rates were well below the South African level with rates just above 20% (Schlemmer and Levitz, 1998 : 2). However caution needs to be sounded about these international comparisons. The ILO Yearbooks of Labour Statistics are incomplete since the numbers of unemployed are often not given as a proportion of the labour force. Furthermore the ILO data are derived from the official statistics submitted by countries and their validity is thus questionable, since some countries are known to rework their figures to project the desired national image (Schlemmer and Levitz, 1998 : 16).

Many third world countries have low levels of recorded unemployment because labour is absorbed by rural peasant or subsistence sectors and by the informal trading and craft sectors. The ILO attempted to calculate unemployment rates in the 'modern' sectors of the economies of a number of third world countries. These recalculated unemployment rates were much higher than the rates set out in the ILO's annual statistics (Schlemmer and Levitz, 1998 : 16). However underemployment also occurs in South Africa, so the contrasts between South Africa and the rest of the world are not fully explained.

The Labour Market Commission in a report released in June 1996 referred to a technical review undertaken by the ILO labour market policies branch which concluded that the unemployment problem was significantly overestimated (Schlemmer and Levitz, 1998 : 17). The ILO review team expressed concern over the use of the Central Statistical Service (now Statistics South Africa) household surveys in estimating unemployment since the surveys contained certain biases stemming from respondent mistrust. The team also found inconsistencies between the household survey results and other official estimates of sectoral employment derived from commercial and industrial surveys conducted by the Central Statistical Service and the South African Reserve Bank (Schlemmer and Levitz, 1998 : 17). However, the official sectoral estimates by the Central Statistical Service and the South African Reserve Bank are based on returns submitted to the relevant official agencies and normally no information is supplied on the level of response to questionnaires sent out or on the completeness of the agencies' enumeration frameworks. Hence Schlemmer and Levitz (1998 : 17) argue that biases exist on both sides of the comparisons, which the ILO team was making.

Statistics South Africa has carried out seven October Household Surveys[1] (OHSs) : in 1993, 1994, 1995, 1996,1997, 1998 and 1999. However the 1993 OHS is not comparable with the later surveys since it did not cover the former Transkei, Bophutathswana, Venda and Ciskei

[1] A household is defined by Statistics South Africa (1998 : 14) as consisting of a single person or a group of people who live together for at least four nights a week, who eat together and who share resources.

(TBVC states). The 1994 OHS covered the whole country and respondents in 30 000 households in a thousand enumeration areas (EAs) were interviewed with thirty households visited in each EA. In 1995, 30 000 households were covered, with 3 000 EAs being sampled and 10 households visited in each EA, that is, the sample was more widely dispersed throughout the country. In 1996, time and financial constraints meant that the survey took place in November with 16 000 households visited in 1 600 EAs. In 1997, 30 000 households were covered and visited as in 1995. In 1998, 20 000 households were selected from 2 000 EAs and 10 households visited per EA and in 1999, 30 000 households were covered and 10 households visited per EA (Statistical Release P0317, 2000).

In February 2000 Statistics South Africa conducted the first round of the Labour Force Survey, a twice-yearly rotating panel household survey, designed with the intention of measuring the dynamics of employment and unemployment in the country. This initial round was based on a probability sample of 10 000 dwelling units. The sample size was then increased to 30 000 dwelling units for the next two rounds conducted in September 2000 and February 2001 respectively.

Table 2.1 and Table 2.2 compare overall labour market trends over the period 1996 - 2001 based on the official and the expanded definitions of unemployment respectively. In 1996 and 1997 the sampling frame did not adequately cover mining hostels and thus those working in the mining sector were excluded from the calculations of labour force statistics. However in 1998 and 1999, the sampling frame was able to adequately include these mining hostels and Statistics South Africa has therefore included, where possible, those working in the mining sector in 1996 and 1997 to make the statistics comparable. The statistics on mining employment during these two years were obtained from the formal establishment based Survey of Total Employment and Earnings (STEE) (Statistical Release P0317, 2000).

Row a and row A of Table 2.1 and Table 2.2 respectively compare the number of employed in the formal sector according to the STEEs[2] of September 1996 to September 1999 with the

[2] The STEE collects data on formal employment in South Africa. However the following areas are excluded: a) agriculture, hunting, forestry and fishing; b) restaurants and other eating and drinking places, boarding houses, caravan parks, guest farms; c) water and air transport; financial institutions other than banks and insurance companies; d) real estate and business services; e) private educational services; f) medical,

number employed in other types of employment, across the four October Household Surveys. Only the total number of employed is given for 2000 and 2001 since the Labour Force Surveys do not give a comparable breakdown.

Table 2.1 Employment, Labour Force Participation And Absorption And Unemployment In The South African Economy Based On The Official Definition Of Unemployment, 1996 – 2001

	Labour market variables	**1996[1] N in '000s**	**1997[1] N in '000s**	**1998[1] N in '000s**	**1999[1] N in '000s**	**2000[2] N in '000s**	**2001[2] N in '000s**
A	Total employed	9 287	9 247	9 390	10 369	11 712	11 837
	Among the employed:						
	Employed in the formal sector STEE survey (excluding agriculture and certain activities not covered in STEE)	5 242	5 139	4 945	4 840		
	Employed in agriculture*	759	717	935	1 099		
	Employed in formal sector activities not covered in STEE**	1 550	1 587	1 445	1 724		
	Employed in the informal sector***	996	1 136	1 316	1 907		
	Employed in domestic service	740	668	749	799		
B	Total unemployed (official definition)	2 224	2 451	3 163	3 158	4 082	4 240
C	Total economically active = a +b	11 511	11 698	12 553	13 527	15 794	16 077
D	Total not economically active	13 146	13 414	13 157	12 753	11 100	11 044
E	Total aged 15 – 65 years = c + d	24 657	25 112	25 710	26 280	26 894	27 121
F	Labour absorption rate = a*100/e	37,7%	36,8%	36,5%	39,5%	43,5%	43,6%
G	Labour force participation rate = c*100/e	46,7%	46,7%	48,8%	51,5%	58,7%	59,3%
H	Official unemployment rate = b*100/c	19,3%	21,0%	25,2%	23,3%	25,8%	26,4%

The labour statistics include the mining sector.

Source: Statistics South Africa : 1 - Statistical Release P0317 (October Household Surveys)

2 - Statistical Release P0210 (Labour Force Surveys, September 2000 and February 2001

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dental and other health services; g) welfare and religious organisations; h) recreational and cultural services (Stats S.A. : Statistical Release P0317, 2000).

Table 2.2 Employment, Labour Force Participation And Absorption And Unemployment In The South African Economy Based On The Expanded Definition Of Unemployment, 1996 – 2001

	Labour market variables	1996[1] N in '000s	1997[1] N in '000s	1998[1] N in '000s	1999[1] N in '000s	2000[2] N in '000s	2001[2] N in '000s
A	Total employed	9 287	9 247	9 390	10 369	11 712	11 837
	Among the employed:						
	Employed in the formal sector STEE survey (excluding agriculture and certain activities not covered in STEE)	5 242	5 139	4 945	4 840		
	Employed in agriculture*	759	717	935	1 099		
	Employed in formal sector activities not covered in STEE**	1 550	1 587	1 445	1 724		
	Employed in the informal sector***	996	1 136	1 316	1 907		
	Employed in domestic service	740	668	749	799		
B	Total unemployed (expanded definition)	4 566	5 202	5 634	5 882	6 559	6 961
C	Total economically active = A + B	13 853	14 449	15 024	16 251	18 272	18 798
D	Total not economically active	10 804	10 663	10 686	10 028	8 623	8 323
E	Total aged 15 – 65 years = C + D	24 657	25 112	25 710	26 280	26 894	27 121
F	Labour absorption rate = A*100/E	37,7%	36,8%	36,5%	39,5%	43,5%	43,6%
G	Labour force participation rate = C*100/E	56,2%	57,5%	58,4%	61,8%	67,9%	69,3%
H	Expanded unemployment rate = B *100/C	33,0%	36,0%	37,5%	36,2%	35,9%	37,0%

*The 1996 sample size was smaller than for the other three years. Statistics by industry should therefore be interpreted with caution. Differences in sampling methodology may account for unstable employment measures in the agricultural sector.

** The formal industries not covered by STEE are given footnote 2

*** The 1996 survey did not distinguish between the formal and informal sectors with regard to employees. This distinction was made in 1997, 1998 and 1999 and thus the size of the informal sector in 1996 was estimated using the proportions of informal employers and employees in the aforementioned years.

Statistics include the mining sector.

Source: Statistics South Africa : 1 - Statistical Release P0317 (October Household Surveys)

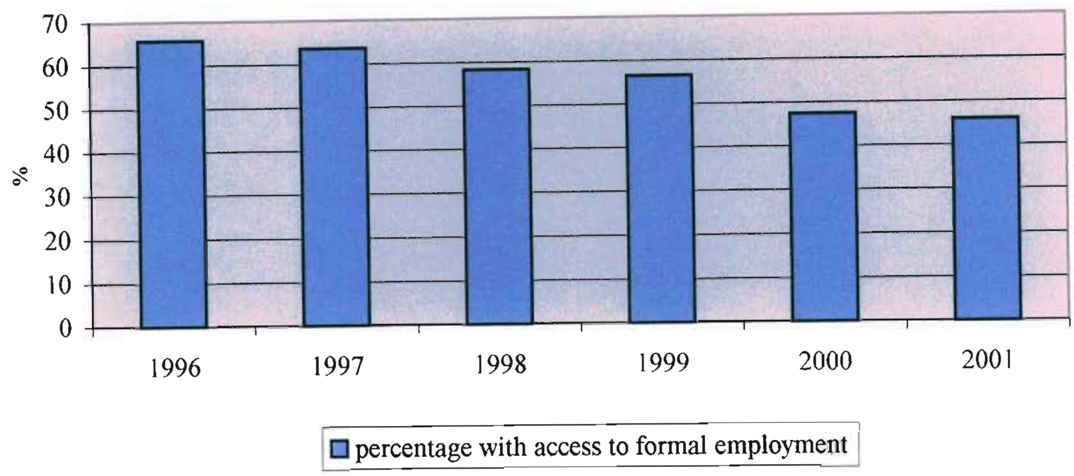
2 - Statistical Release P0210 (Labour Force Surveys, September 2000 and February 2001)

Referring to Table 2.1 and Table 2.2 it is evident that:

- The total number of employed has increased from 9,3 million in 1996 to 11,8 million as of February 2001. The labour absorption rate - the percentage of working age population which was employed - fell from 37,7% in 1996 to 36,8% in 1997 and 36,5% in 1998, increasing thereafter to 39,5%, 43,5% and 43,6% in 1999, September 2000 and February 2001 respectively.

- The number of jobs in the formal non-agricultural sectors of the economy declined from 6,8 million in September 1996 to approximately 6,7 million in September 1999, September 2000 and February 2001. The percentage of the labour force that has access to formal employment (including agriculture but excluding domestic service) has fallen steadily from 65,6% in 1996 to 45,9% in February 2001 as shown in Figure 2.1 This inability of the formal sector to generate sufficient employment is a major structural problem in the South African economy (SARB Quarterly Bulletin, September 2000).

Figure 2.1 Percentage Of The Labour Force With Access To Formal Employment Including Agriculture But Excluding Domestic Service



Source: Statistics South Africa :Statistical Releases P0317 and P0210

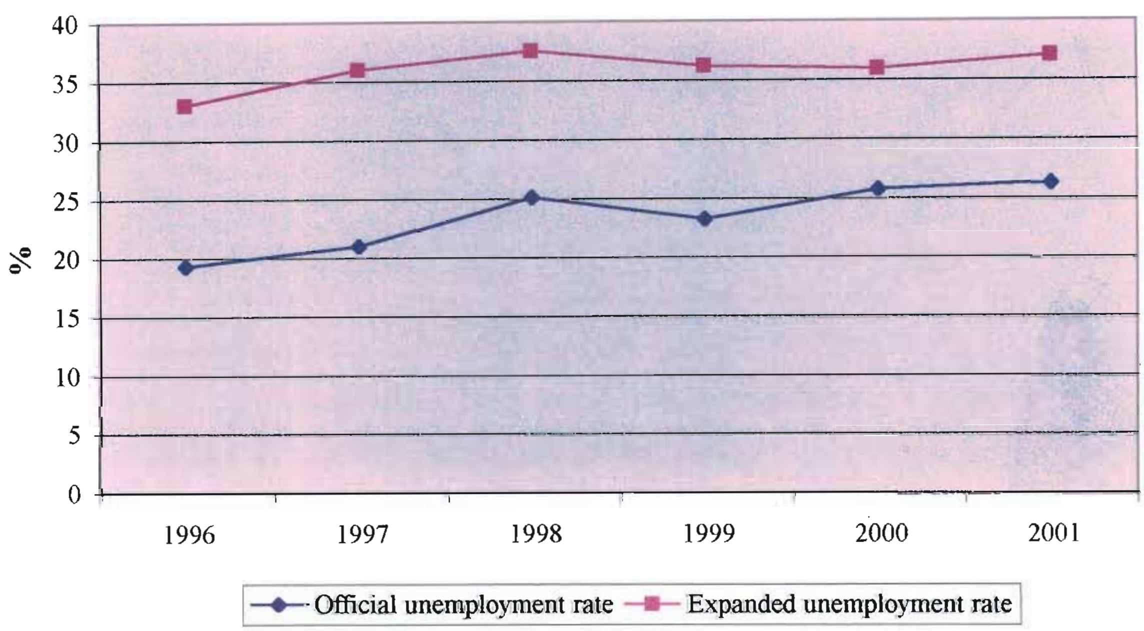
- The informal sector appears to have become an important job creator. The informal sector (excluding domestic service) has grown from 1 million in 1996 to 2,7 million in 2001. The February 2001 LFS alone indicates an increase of approximately 0,8 million jobs in the informal sector from the 1,9 million in September 2000. This is a significant increase and more data over a longer time frame will be required to determine whether the accuracy of the estimate has been affected by nonsampling error.

- Statistics South Africa (1998 : 12) defines the economically active population as those between the ages of 15 and 65 who are either employed or unemployed. This does not include full-time students, full-time homemakers, pensioners and disabled people. The size of the economically active population (labour force) will thus vary according to the definition of unemployment used. The total number of economically active people based on the official definition of unemployment increased from 11,5 million in 1996 to 16,077 million in 2001. Under the expanded definition the total number of economically active people increased from 13,9 million in 1996 to 18,8 million in 2001.

- The labour force participation rate - the percentage of the population aged 15 to 65 years which was economically active - remained constant at 46,7% in 1996 and 1997, increasing thereafter to 48,8%, 51,5%, 58,7% and 59,3% in 1998, 1999, 2000 and 2001 respectively. (The corresponding figures under the expanded definition are shown in row G of Table 2.2.)

- The number of unemployed has increased from 2,2 million in 1996 to 4,2 million in 2001. The official unemployment rate increased from 19,3% in 1996 to 26,4% in 2001 as shown in Figure 2.2. Although the number of unemployed remained constant between 1998 and 1999, the number of economically active people increased and hence the proportion of unemployed was slightly smaller in 1999. The expanded unemployment rate increased from 33% in 1996 to 37% in 2001.

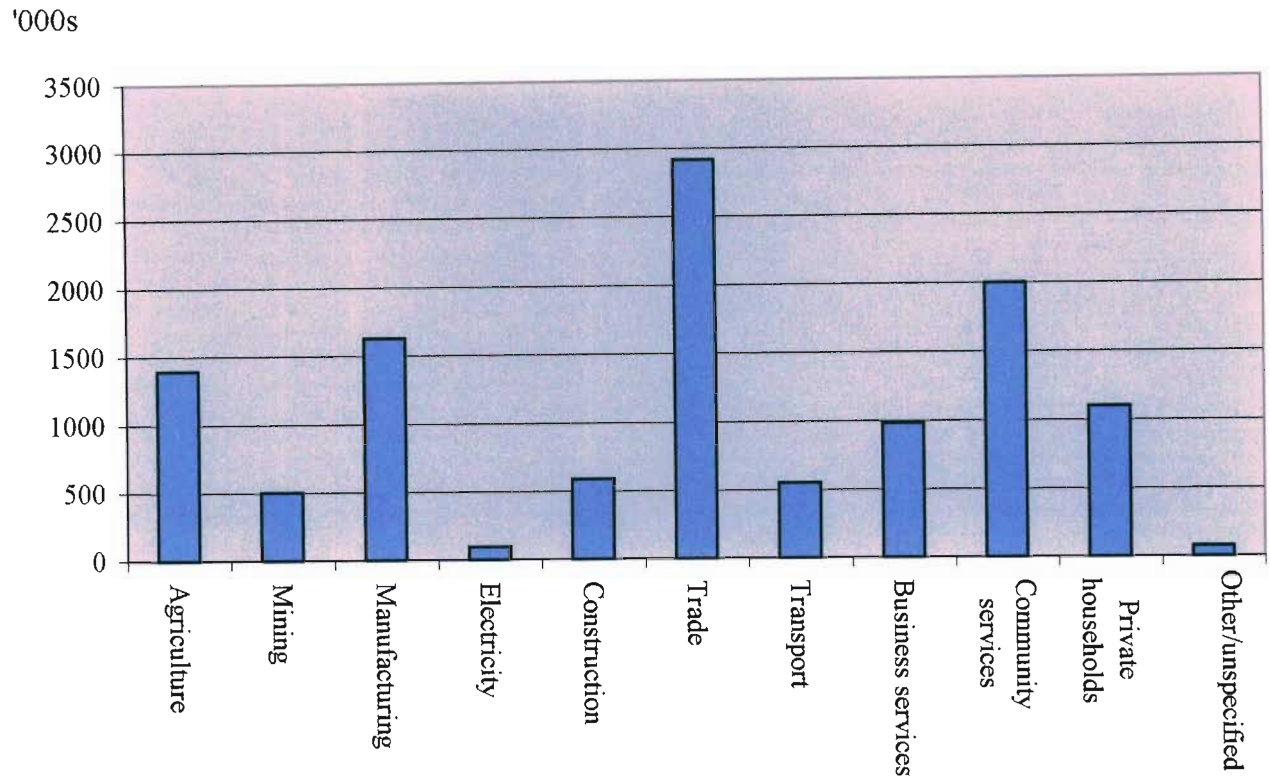
Figure 2.2 Official And Expanded Unemployment Rates In South Africa, 1996 - 2001



Source: Statistics South Africa: Statistical Releases P0317 and P0210

Figure 2.3 breaks those in employment down by industry. Wholesale, retail trade and catering and accommodation services employ the largest number of workers, followed by community, social and personal services, and manufacturing. The growing importance of the services sector as an employer is consistent with the trend observed in industrialised countries.

Figure 2.3 Employment by Industry, February 2001



Source: Statistics South Africa: Statistical Release P0210

2.2.1 BREAKDOWN OF UNEMPLOYMENT RATES BY URBAN AND NON-URBAN AREAS, GENDER, POPULATION GROUP AND LEVEL OF EDUCATION

It is important to consider the level of unemployment in terms of population group, gender, education and location. Table 2.3 shows the official unemployment rates over the period 1998 - 1999 by area of residence, population group and gender while Figure 2.4 shows the official unemployment rates by population group and gender for February 2001.

Table 2.3 Official Unemployment Rates Amongst Males And Females Living In Urban And Non-Urban Areas By Population Group (Excluding The Mining Sector), October 1998 And 1999

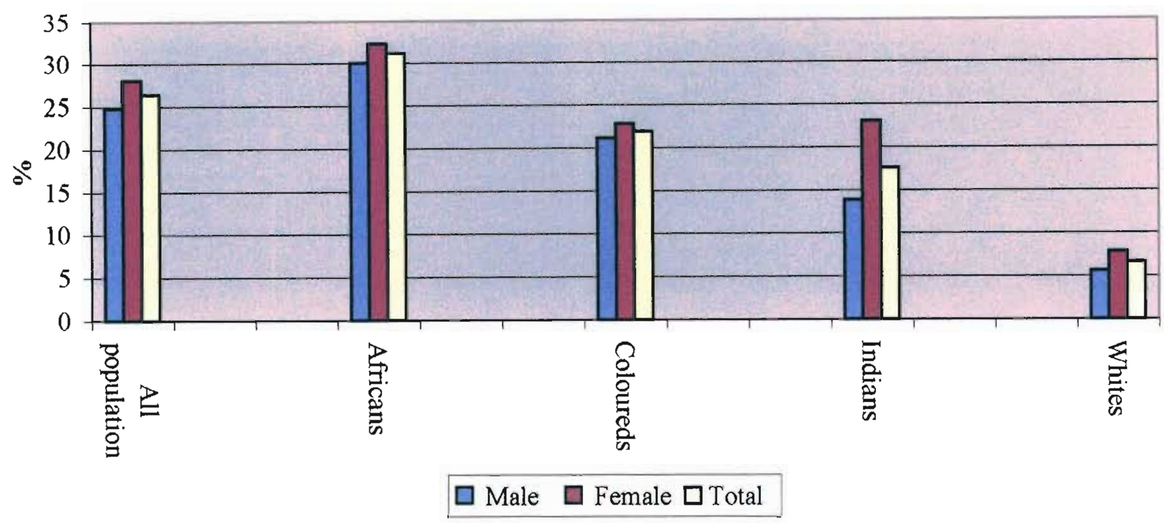
Population Group	Urban Male %	Urban Female %	Non-Urban Male %	Non-Urban Female %	Total Male %	Total Female %	Total %
All population groups:							
1998	19,4	27,1	26,1	36,9	21,5	30,1	25,2
1999	18,4	25,8	22,7	32,3	19,8	27,8	23,3
Africans:							
1998	26,6	37,3	28,4	39,8	27,3	38,3	32,0
1999	24,1	35,0	25,2	34,9	24,5	35,0	29,2
Coloureds:							
1998	15,5	20,8	-**	-**	13,3	18,9	15,8
1999	15,7	19,1	-**	-**	13,4	17,5	15,2
Indians:							
1998	13,6	17,2	-**	-**	13,6	16,9	14,7
1999	14,6	16,4	-**	-**	14,5	17,2	15,6
Whites:							
1998	4,0	5,1	-**	-**	3,9	5,0	4,4
1999	4,4	5,3	-**	-**	4,4	5,1	4,7

** number of responses too few for analysis

Each percentage is a percentage of all the people in that particular category

Source: Statistics South Africa : Statistical Release P0317, 1999

Figure 2.4 Official Unemployment Rates By Race And Gender, February 2001



Source: Statistics South Africa : Statistical Release P0210

As Table 2.3 and Figure 2.4 indicate, the official unemployment rates are highest for economically active Africans, followed by Coloureds, Indians and then Whites. This pattern holds for both economically active urban and non-urban males and females separately and when males and females were combined. For all population groups, unemployment was higher among women than among men. For example in 1998, among the African group 38,4% of women as opposed to 29,5% of men were unemployed.

Table 2.4 sets out the number of unemployed by level of education for 1999. The relationship between education and unemployment is curvilinear. In 1999 of those with no education 16,9% were unemployed, rising to 27,6% among those with some education, but no Grade 12 (matric), and dropping thereafter to 19,5% among those with Grade 12 (matric) or higher qualifications (unemployment rates calculated from Table 2.4). Although it is unusual to find higher unemployment rates among those with incomplete schooling than among those with no schooling, the World Bank /SALDRU study of poverty found the same association. Statistics South Africa (1998 : 26 - 27) suggests that a partial explanation for this is that a large proportion of people hold elementary occupations (about 18% of the employed), which are probably most suitable for people with no education. Table 2.5 breaks down the employed by occupation. The greatest number of employed are found in elementary occupations followed by craft and related trades, and service, shop and market sales.

Loots (1998 : 323) argues that the high incidence of unemployment among people with a grade 12 (matric) qualification (24,9% in 1999) indicates that the current school system is not geared to equip school leavers with the skills required by the labour market. Mathibela (cited in Loots, 1998 : 323) believes that the current education system is biased in that it produces job seekers and not job creators.

Table 2.4 Unemployment By Level Of Education, Based On The Official Definition Of Unemployment, October 1999

N in '000s				
Level of education	**Employed**	**Unemployed**	**Total economically active**	**Unemployment rate (official)**
Total	10 369	3 158	13 527	23,3
None	742	151	893	16,9
Grade 1- 3	475	133	608	21,9
Grade 4	334	109	443	24,6
Grade 5	416	129	545	23,7
Grade 6	528	183	711	25,7
Grade 7	697	258	955	27,0
Grade 8	829	304	1 133	26,8
Grade 9	597	282	879	32,0
Grade 10	908	328	1 236	26,5
Grade 11	575	312	887	35,0
Grade 12	2 340	775	3 115	24,9
NTC I	10*	3*	13*	23*
NTC II	15	2*	17*	11,8*
NTC III	68	8*	76*	10,5*
Diploma/certificate with G11 or lower	162	19	181	10,5
Diploma/certificate with G12	747	101	848	11,9
Degree/higher	677	33	710	4,6
Other	15	1*	16	6,3*
Unspecified	234	27	261	10,3

* sample size too small for reliable estimates. Due to rounding numbers do not necessarily add up to totals

Source: Statistics South Africa : Statistical Release P0317.

Table 2.5 The Employed By Occupation, October 1999

Main occupation group	Total (in '000s)		
	Total	**Male**	**Female**
Total	10 369	6 009	4 353
Legislators, senior officials and managers	684	511	171
Professionals	554	300	253
Technicians, and associated professionals	1 042	488	553
Clerks	1 071	371	699
Service workers and shop and market sales workers	1 225	684	541
Skilled agricultural and fishery workers	469	349	120
Craft and related trades workers	1 355	1 153	202
Plant and machine operators and assemblers	1 092	933	158
Elementary occupations	1 901	1 066	835
Domestic workers	799	36	763
Not elsewhere defined	0*	0*	0*
Occupation not adequately defined	138	96	43
Occupation unspecified	39	22	16

*sample size too small for reliable estimates. Due to rounding, numbers may not necessarily add up to totals

Source: Statistics South Africa , Statistical Release P0317.

Unemployment in South Africa tends to be a long-term phenomenon. In 1997, at least one-third of the unemployed had been unemployed for three years or more, and at least another quarter had been unemployed for between one and three years (Stats S.A., 1998 : 29). Long-term unemployment is equally common among men and women. In 1997 the proportions of men and women who had been looking for work for three or more years were much higher among Africans (41% and 43% respectively) than among coloured (17% and 21%), Indians (9% and 15%) and whites (6% and 17%) (Stats S.A., 1998 : 29).

2.3 ECONOMIC GROWTH, EMPLOYMENT AND UNEMPLOYMENT

Barker (1999b : 77) identifies low economic growth and high population growth rates as the primary reasons for the high levels of unemployment in South Africa. The notion exists that an improvement in material welfare and the standard of living can be attained through high-quality economic growth automatically leading to an expansion in income-generating employment opportunities (Loots, 1998 : 324). Typically, stronger economic activity gives rise to faster employment growth while weaker economic activity is accompanied by slower employment growth (Erasmus and Weideman, 1995 : 25).

Cyclical changes in employment levels in the late 1980s and 1990s differed significantly from those of the 1970s and the early 1980s. Erasmus and Weideman (1995 : 27-29) found that employment levels in the later years reacted less positively to changes in economic growth than previously. During the recessions of the 1970s employment continued to increase whereas the recessions of the late 1980s and early 1990s saw absolute declines in employment levels. Employment growth was also weaker during the upswings of the late 1980s and early 1990s. The contraction in private sector employment was much more rapid during recent economic slowdowns, whereas the expansion in private sector employment during economic upswings occurred much more slowly than previously (Erasmus and Weideman, 1995 : 27-29). This suggests that South Africa's unemployment problem is becoming increasingly structural. Even high economic growth cannot create sufficient employment opportunities to absorb the unemployed and first-time entrants to the labour force. The economy has experienced six successive years of positive real economic growth and yet remains unable to provide employment opportunities necessary for the growing population. South Africa has been experiencing the phenomenon of jobless growth, where employment falls even during periods of positive economic growth. Table 2.6 shows the growth in real gross domestic product and formal employment, and the employment coefficient in selected periods.

Table 2.6 Economic Growth And Growth Of Formal Employment

Growth rate (% p.a.) in period indicated

	1961-72[1]	**1973–78[1]**	**1979–84[1]**	**1985–93[1]**	**1994–97[1]**	**1997[2]**	**1998[2]**	**1999[2]**	**2000[2]**
Real GDP growth	5,3	2,9	3,1	0,6	2,8	2,5	0,7	1,9	3,1
Employment growth	2,6	2,2	1,4	-0,2	-0,18	-1,7*	-3,5*	-1,9*	-2,7*
Employment coefficient	0,49	0,76	0,45	-0,33	-0,06	-0,68	-5	-1	-0,87

* Growth of non-agricultural, formal employment

Source: 1 - Barker 1999b : 83

2 – calculated from SARB Quarterly Bulletin, September 2001

The employment coefficient (defined as the percentage change in employment divided by the percentage change in gross domestic product) is a crude indication of the responsiveness of employment to changes in economic growth. The lower the employment coefficient, the fewer jobs are created and the greater the level of real economic growth required to reduce the country's unemployment and underemployment problems. As Table 2.6 shows, the employment coefficient rose from 0,49 in the 1960s to 0,76 in the 1970s. However labour shortages caused partly by apartheid policies and partly by high economic growth, kept the employment coefficient lower than it would otherwise have been. The employment coefficient then fell sharply from 0,76 in 1973-78 period to 0,45 in 1979-84 period indicating that much less employment was being created for each percentage point of economic growth (Barker, 1999b : 83). Thereafter the employment coefficient turned negative. This trend has been maintained to date indicating that jobless growth has been occurring.

Structural unemployment arises as a result of skills or regional mismatches arising from workers being unemployable because their skills have become technologically redundant or there is no demand for them in the region where they live (Hargreaves-Heap, 1987 : 745). The South African economy has undergone a significant structural change since the 1970s as shown in Table 2.7.

Table 2.7 Share Of Economic Activity In GDP, 1970 – 1998 (%)

Period	Agr/ Forest/ Fishing	Min&Qrr	Manufact	Elec, Gas & water	Construt	Whols/ Retail/ Catr	Fin/RE/ Bus Svcs	Other Services
1970	8.3	10.3	24.2	2.6	4.3	15.1	11.1	24.1
1975	8.1	12.1	22.8	2.3	5.21	14.0	12.5	23.0
1980	6.9	21.7	22.2	3.6	3.5	11.3	10.8	20.0
1985	5.7	14.9	22.0	4.1	3.6	11.5	13.5	24.7
1990	5.1	9.4	24.7	4.2	3.4	14.6	14.0	24.6
1995	4.3	7.8	24.3	4.0	3.1	16.3	17.0	23.2
1998	4.3	7.8	23.7	3.9	2.8	15.9	18.6	22.8
Change 70-98	**-4.0**	**-2.4**	**-0.5**	**1.3**	**-1.5**	**0.8**	**7.6**	**-1.2**

Source: Stryker, Cassim, Rajaratnam, Bhorat, Leibrandt and Plunkett, 2001 : 27

This structural change has contributed to the rise in number of unskilled people who are unemployed. The primary sector, which includes agriculture, forestry and fishing, and mining and quarrying, has become a less significant contributor to real gross domestic product. The secondary sector's[3] share of GDP has remained relatively constant although the manufacturing and construction sectors' contribution to national output has grown gradually smaller. The tertiary or service sector[4] has grown significantly and currently contributes about 65 percent to the national income. However this sector is characterised by a low demand for less-skilled workers. The service sector's increasingly predominant role is in line with the experience of many of the developed countries where "[e]mployment in the industrial and manufacturing sectors typically shows a strong tendency to increase and then ultimately to decrease as capital substitutes for labour and services gain an increasing share of maturing economies" (Stryker *et al*, 2001 : 29).

The South African Reserve Bank identifies a number of other factors that have contributed to the weak labour absorption capacity of the South African economy. Firstly, since the early 1990s, firms have been restructuring with the aim of improving international competitiveness. The result has been a reduction in employment. Secondly, firms have exhibited a preference for capital-intensive as opposed to labour-intensive production processes. Thirdly, the introduction of new production technologies is most often accompanied by a greater demand for the small number of highly skilled workers and a lower demand for the country's abundant less-skilled workers. Fourthly, the domestic economy's capacity to create new jobs was negatively impacted by the decline in the investment ratio. Lastly, the government is in the process of restructuring the public service in order to improve the efficiency of service delivery.

2.4 SUMMARY

It is clear that South Africa has a serious unemployment problem by any standard. Unemployment is concentrated among the disadvantaged groups, particularly African females. A further legacy of Apartheid policies is that the majority of the unemployed are poorly educated and unskilled. Where the structure of the South African economy is in accordance

[3] The secondary sector includes manufacturing, electricity and other utilities, and construction.

[4] The tertiary sector includes trade, transport, financial and business services, and social, personal and community services.

with that of a developed country that of the labour force is not. Faster economic growth will thus be accompanied by more jobs for the highly skilled exacerbating inequalities already pervasive in the country. The challenge is to encourage growth that is labour-intensive with respect to less-skilled workers and to re-equip the labour force so that they increasingly possess the skills that are in demand.

3 UNEMPLOYMENT: THE POSSIBLE CAUSES

3.1 INTRODUCTION

Unemployment is a complex and far-reaching problem with a wide variety of potential causes and an equally wide variety of policy responses (Snower and de la Dehesa, 1997 : xxi). Unemployment is most often the result of several simultaneous causes, all interacting with each other. This chapter considers the possible causes of and comments briefly on the policy responses to the unemployment problem with particular reference to countries belonging to the Organisation for Economic Cooperation and Development (OECD).

3.2 SUPPLY SIDE SHOCKS

Unemployment started to rise in most OECD countries in the early 1970s. Bean (1994 : 574 – 575) plotted the rate of growth of the GNP / GDP deflator against the unemployment rate for four OECD regions namely the United States of America, the European Community, non-EC Europe and Japan over the 1967 – 1992 period. This revealed that the period of rising unemployment during the mid –1970s was accompanied by rising rather then falling inflation which he argues suggests the presence of supply rather than demand shocks. The disinflation process during the first half of the 1980s was accompanied by a much greater increase in unemployment in the United States of America and the European Community than elsewhere. Thereafter inflation stabilized at a low level, and while the unemployment rate in the United States of America returned to its former level that of the European Community did not, which suggests that the natural rate of unemployment itself must have risen over this period. Over the 1990s unemployment rates started to fall in certain European countries (Netherlands, Denmark and Ireland) and the United Kingdom. These falls in unemployment have generally occurred without any increase in inflation, which suggests that the improvements are structural (Elmeskov, 2000 : paragraph 6).

As unemployment started to rise in the 1970s, explanations focused on the role of adverse shocks. The adverse shocks identified by Fitoussi, Jestaz, Phelps, and Zoega (2000 : 238) were: 1) the productivity growth slowdown which became evident in the 1970s and led to increases in the effective cost of capital; 2) the increase in the expected world real rate of interest which took place in the early 1980s and once again raised the effective cost of capital; 3) the increases in income and services from workers' private assets; 4) the increase in the level and range of benefits from social entitlements relative to after-tax wage levels which arose from the productivity slowdown in the 1970s and the growth of equity considerations in the 1960s and 1970s; and 5) the oil price increases of the 1970s. These shocks were followed by sharp increases in unemployment. However, whereas unemployment levels in the United States of America had returned to pre-shock levels by the end of the 1980s, those in Europe had not.

These adverse shocks have contributed to unemployment (see Fitoussi *et al* (2000) and Blanchard and Wolfers (2000)), but as Blanchard and Wolfers (2000) found, they do not differ to the extent of being able to account for the cross-country variations evident in European unemployment. Furthermore, these adverse shocks cannot alone account for the persistence of high unemployment. The real price of oil had fallen back to its pre-shock level by the late 1980s. Furthermore, one would expect that by the 1990s workers' aspirations would have adjusted to lower levels of productivity growth. Both firms and workers take time to adjust to a slowdown in total factor productivity growth. During this adjustment process, wages will rise too fast relative to total factor productivity growth resulting in a decrease in employment, both directly and through lower profits and lower capital accumulation (Blanchard, 2000 : 297). This shifted the search for the causes of unemployment to labour market rigidities, hysteresis and skill-biased technological progress.

3.3 LABOUR MARKET RIGIDITIES

Conventionally, the following rigidities are considered the most important obstacles to the efficient operation of the labour market:

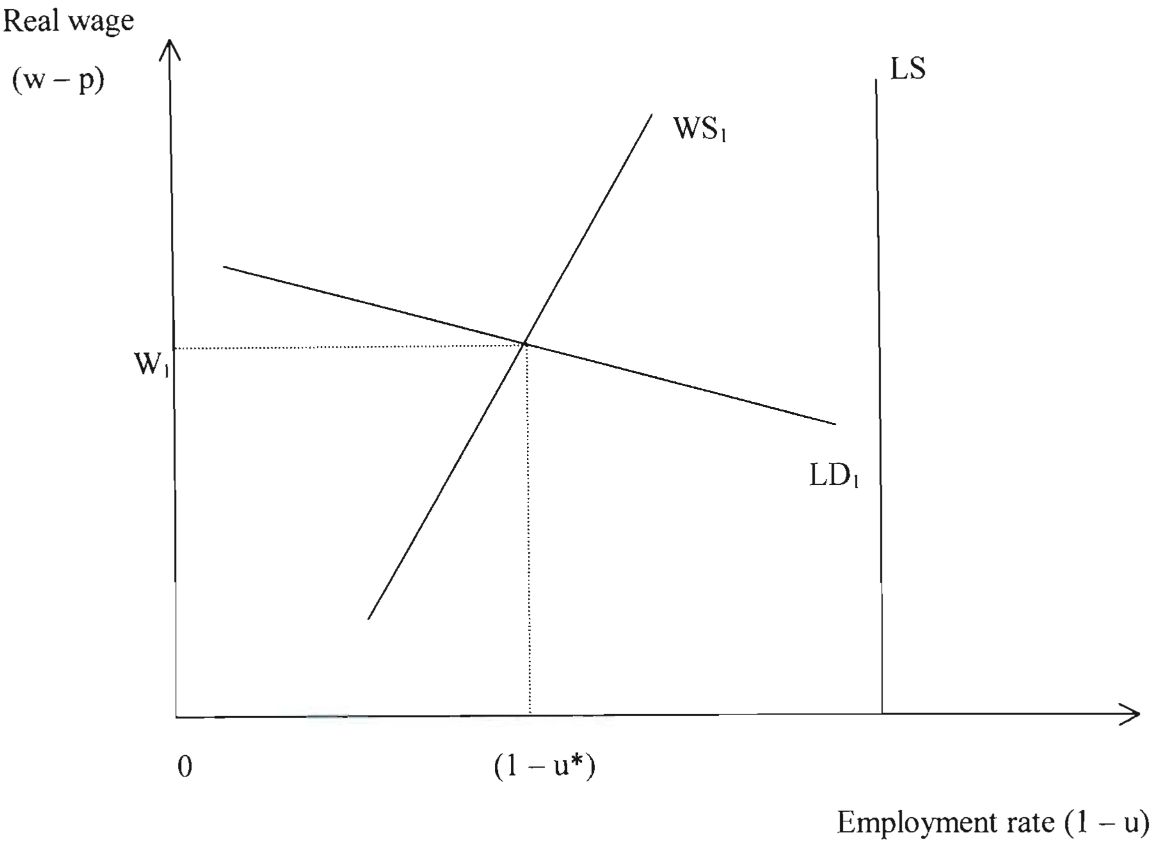
- Restrictions on hiring and firing, and other employment protection legislation that will increase the cost of labour, and lead to reduced flexibility and higher unemployment.
- Trade unions and the wage setting structure - it is argued that trade unions, in attempting to raise the wages of members and reduce the wage gap between the skilled and unskilled, destroy jobs and may reduce productive efficiency through restrictive practices.

- Benefit systems and the treatment of the unemployed - the purpose of such systems are to maintain or protect the standard of living of the unemployed. The gap in living standards between those out of work and those in work is reduced, but so are the incentives to finding or keeping a job. However active labour market policies will serve to offset the negative effect that generous unemployment benefits of long duration have on unemployment.
- Minimum wages - where minimum wages are set above the levels prevalent in the unregulated labour market, workers will be priced out of employment.
- Levels of labour taxation.

In assessing the role these factors play in determining unemployment rates it is useful to consider how they fit into an integrated framework. Figure 3.1 depicts Scarpetta's simple model of equilibrium in the labour market. Scarpetta (1996 : 45) assumed imperfectly competitive profit-maximizing firms, each facing exogenously determined product market conditions with a fixed stock of capital and technology. It is assumed that workers and firms bargain over wages and that once a wage agreement has been arrived at, firms unilaterally select a level of employment, output and prices. The model is static in that it ignores labour force growth and future trends in productivity.

The rate of structural unemployment (u*) is determined by the intersection of the labour demand and wage setting curves in the employment/real wage space (see Figure 3.1). The equilibrium rate of unemployment will be increased by any factor that exogenously increases any of the wage push variables or the variables that influence labour demand. The wage push factors include the following: employment protection, the relative strength of unions and the structure of the wage bargaining process, generosity of the unemployment benefit system, the effect of the tax wedge on the use of labour, and the degree of mismatch between the skills and geographical location of job seekers, and those of the unfilled job vacancies. Furthermore, any change in the factors influencing the decision to participate in the labour force will shift the full-employment curve (LS), thereby altering the measured level of structural unemployment. The speed with which the labour market responds to exogenous shocks may also be affected by the institutional and policy variables that enter the wage setting equation.

Figure 3.1 Labour Demand And Wage Setting Schedules



Source: Scarpetta, 1996 : 46

Persistence mechanisms may be incorporated into the bargaining model by permitting wages to be a function of both the level of and the change in unemployment. Scarpetta (1996 : 48) justifies this specification of the wage setting schedule in terms of the behaviour of both firms and workers. He argues, "High hiring and firing costs may introduce inertia in the firm's employment decisions. On the basis of the 'insider-outsider' hypothesis, it could also be argued that real wages may be more responsive to the threat of large-scale redundancy and rising unemployment than to the level of unemployment per se. Likewise, in the context of rising unemployment, the proportion of short-term unemployed (i.e. those most likely to compete directly with the unemployed) generally increases and this could put more downward pressure on wages than a stable level of unemployment".

The mechanisms by which labour market institutions and policy variables impact on unemployment are described in more detail below.

Employment Protection

The usual rationale behind legislating the labour market is to protect employees from arbitrary, unfair or discriminating actions on the part of employers. Legislation affecting the treatment of employees includes regulations on working hours, annual leave, health and safety, employee representation rights, workers' compensation insurance, fixed term contracts and employment security (Nickell and Layard, 1999 : 3039). Such legislation could raise the cost of employing workers and/or raise the actual cost of adjusting levels of employment (Nickell, 1997 : 66). The effect that the former has on unemployment hinges on the degree to which these additional costs are borne by the employees through wage adjustments.

Employment protection impacts on the functioning of the labour market in a variety of ways. The rate at which people leave unemployment is slowed, to the particular detriment of the less-skilled and the long-term unemployed, as firms become more prudent and selective about hiring. On the other hand employment protection legislation may result in more efficient job matching due to a more proficient human resources division. Hence the effect of such legislation on outflows from unemployment could go either way.

However employment protection also reduces involuntary dismissals thereby lowering the inflow into unemployment. Such legislation may also have a direct impact on wages paid since the increased job security enjoyed by "insiders" (i.e. the employed) may encourage them to demand higher pay increases (Nickell, Nunziata, Ochel and Quintini, 2001 : 7).

Trade Unions and the Wage Setting Structure

The structure of wage determination is a key factor affecting equilibrium unemployment. A variety of structures may exist within a particular country. Wages may be established in a largely competitive manner in certain sectors, while in others wages may be determined collectively at plant, firm, industry or national level. The overall impact of the wage setting structure on unemployment is dependent on union power in wage bargains, union coverage and the extent to which wage bargains are coordinated (Nickell and Layard, 1999 : 3041).

In general, greater union power and coverage will generate upward pressure on wages leading to an increase in equilibrium unemployment. However this increase can be offset if wage bargaining is coordinated. Common in decentralized, uncoordinated, union-dominated systems is 'leap-frogging' - each union identifies an earlier wage settlement in a related sector and aims to exceed this figure in its negotiations. 'Leap-frogging' is thus an additional source of inflationary pressure, requiring more unemployment to offset it. However, the coordination of wage bargaining activities by employers and unions will overcome the negative effects of 'leap-frogging' (Nickell, 1997 : 68). One should note that coordination is not synonymous with centralization which refers to the level (plant, firm, industry or national) at which collective bargaining occurs. Scarpetta (1996 : 54) explains coordination as "... the extent to which decisions taken by trade unions and employers' associations at the different bargaining levels... are concerted so as to foster a mutually beneficial strategy".

Minimum Wages

Minimum wages are widespread in the OECD (Nickell and Layard, 1999 : 3069). However, on surveying the evidence, Nickell and Layard (1999 : 3069) conclude that minimum wages are typically set low enough not to have a significant impact on adult male unemployment, although there is some evidence that youth unemployment rates are increased.

Benefit Systems and Active Labour Market Policies

Benefit systems impact on unemployment in two ways. First, they reduce the fear of unemployment thereby lowering the willingness of insiders to temper their wage claims in the face of unemployment pressure (Scarpetta, 1996 : 52). Second, benefits may be expected to raise beneficiaries' reservation wages, which will have a negative effect on their search efforts and their willingness to accept job offers. Generous and long-term benefits will therefore increase unemployment particularly in the long run. However, causality could run from unemployment to benefits rather than the other way round, with countries introducing more generous benefit systems when unemployment is high (Nickell, 1997 : 67).

Benefits systems also have important implications for the persistence of unemployment since the longer one is unemployed the less likely one is to be hired. As time passes the skills of the unemployed may deteriorate making them less desirable as job fillers. Furthermore, to the extent that firms use the length of workers' unemployment spells as an indication of their potential productivity, the long-term unemployed will have a lower probability of being hired (Lindbeck and Snower, 2001 : 174).

Active labour market policies include, *inter alia,* training and retraining programmes, job-search counselling, job brokerage services and various forms of subsidized employment, and are aimed at increasing the ability and willingness of the unemployed to acquire jobs. Active policies combined with benefits offered for relatively short period of time appear to be successful in lowering long-term unemployment while reducing the social distress that could accompany the discontinuation of benefits without active assistance toward finding employment.

Labour Taxes

Labour taxes affect the wage setting process and factor utilization (Scarpetta, 1996 : 53). Taxes on labour operate via the wedge between the real cost of a worker to an employer and the real consumption wage of the worker. Following Nickell and Layard (1999 : 3037), consider the case of a representative firm in a closed economy producing gross domestic product (GDP). The real labour cost per worker is W/P where W is the nominal labour cost per worker and P is the GDP deflator (at factor cost). The corresponding consumption wage, assuming workers consume GDP, is

$W(1 - t_1)(1 - t_2) / P(1 + t_3)$ where t_1 is the payroll tax, t_2 is the income tax rate and t_3 is the consumption tax rate. The tax wedge is $(1 - t_1)(1 - t_2) / (1 + t_3) \cong [1 - (t_1 + t_2 + t_3)]$. For example, if t_1, t_2 or t_3 increase, the real consumption wage will have to fall if firms' real labour costs per employee are not to increase. If this fall doesn't occur, unemployment will rise (Nickell *et al*, 2001 : 8).

3.3.1 EVIDENCE ON THE RELATIONSHIP BETWEEN LABOUR MARKET REGULATION AND UNEMPLOYMENT.

A large volume of econometric work aimed at ascertaining the determinants of unemployment exists. These studies usually involve regressing the unemployment rate on a set of variables thought to affect unemployment, or an estimation of a system of equations from which the determinants of unemployment may be deduced (Gregg and Manning, 1997 : 399 - 400).

In 1996 Layard, Jackman and Nickell attempted to determine whether the solution to lower unemployment is greater labour market flexibility. They investigated the effect that differences of labour market policy and institutions have on unemployment levels in the different OECD countries using annual data over the 1983 – 1994 period. They found that unemployment is strongly influenced by the treatment of the unemployed (i.e. unemployment benefit systems) and by the method of wage determination. *Ceteris paribus*, greater union coverage is found to have a negative effect on employment but greater coordination in the bargaining process tends to offset the effect. However they found no clear evidence that employment protection or employment taxes affect equilibrium unemployment.

Scarpetta (1996) performed a similar exercise for a group of OECD countries using an annual panel from 1983 – 1993. Scarpetta's results are similar in terms of the effects of unemployment benefits, unionisation, coordination in the wage bargaining process, and employment taxes on unemployment. However, although Scarpetta found that employment protection has a significant effect on unemployment, the effect disappears when an index of centralization is included. The impact of active labour market policies on unemployment is found to be small and negative as expected.

Gregg and Manning (1997 : 404 -407) carried out single variable regressions of a variety of measures of labour market performance, namely the unemployment rate in 1990; the change in unemployment rate given by the difference between the 1985-9 average and the 1960-4 average; and the percentage of unemployed who are considered long-term unemployed, on a variety of measures of labour market regulation using available data for 16 OECD countries. The benefit duration and the replacement ratio, trade union density and collective bargaining coverage rates, the minimum wage relative to the average wage, and average job tenure and the Bertola index of job security (an index of job security compiled by Bertola in 1990 from the rankings of Emerson (1988)), were used as measures of the generosity of the social security system, the bargaining power of workers, the strength of the minimum wage legislation, and the strength of employment protection legislation, respectively.

They note (1997 : 406) , " ...the most striking thing is that it is very rare to find any significant relationship at all." Gregg and Manning (1997 : 406) thus conclude, " There is simply no strong evidence for the conventional view that regulation is associated with poor unemployment performance". However their results are contrary to other findings and should be treated with caution since they are based on single variable regressions, a questionable technique given the acknowledged existence of complementary effects of labour market rigidities on unemployment (see Coe and Snower, 1997).

In 1999 Nickell and Layard produced an extensive summary of the theory and facts pertaining to the labour market rigidity debate. They looked at separate features of the labour market and attempted to identify those responsible for the high levels of unemployment[1] in many European countries. The following direct measures of labour market rigidities and statistics summarizing the treatment of the unemployed were considered[2] (Nickell and Layard, 1999 : 3037 - 3048):

1. The employment protection index, as drawn up by the OECD and based on the strength of the legal framework regulating hiring and firing. Countries are ranked from 1 to 20, with 20 indicating the strictest regulation.
2. The labour standards index which was drawn up by OECD and is based on the strength of the legislation governing certain aspects of the labour market. The index ranges from 0 to 10 and is the sum of each country's score on each of five factors. Each country is awarded points from 0, indicating weak or no legislation, to 2, indicating strict legislation, on each of the following factors: working hours, fixed-term contracts, employment protection, minimum wages and employees' rights to representation (on work councils, company boards etc.).
3. The benefit replacement rate which indicates what share (percentage) of income is replaced by unemployment benefits.
4. The duration of unemployment benefits.

[1] Table A1 in Appendix A sets out the total, short-term and long-term unemployment rates in the OECD member countries for the period under consideration.

[2] Data on the rigidities affecting the treatment of the unemployed are presented in Table A2 in Appendix A.

5. Active labour market policies which constitute expenditure on activities aimed at helping the unemployed back into work such as labour market training, assistance with job search, subsidised employment and special measures for the disabled. This measure is calculated by taking active labour market spending per unemployed person as a percentage of GDP per member of the labour force.
6. The percentage of households who are owner-occupiers is included as a measure of barriers to geographical mobility.

Nickell and Layard (1999 : 3038 - 3042) also included the following variables[3] as descriptors of the structure of wage determination systems:

7. The union density which gives the proportion of trade union members as a percentage of all wage and salary earners.
8. The union coverage index which indicates the share of workers actually covered by collective agreements. A value of 3 indicates that 70 percent are covered, 2 a coverage of 25 to 70 percent, and 1 represents below 25 percent.
9. The degree of union and employer coordination in wage bargaining ranked from a low of 1 to a high of 3.
10. Countries are also ranked following Calmfors and Driffill (cited in Nickell and Layard, 1999 : 3042) on the degree of centralization with the most centralized economy scoring 17 and the least 1.
11. The payroll tax rate (t_1) which is given by the ratio of labour costs to wages (less unity) and includes pension and other compulsory payments by employers.
12. The total tax rate which is the sum of the average payroll, income and consumption tax rates and provides a rough measure of the tax wedge between real labour costs and take-home pay.

In investigating the relationship between unemployment and labour market institutions, Nickell and Layard (1999) conducted three cross-country regressions. Each regression was based on two cross-sections dated 1983 - 1988 and 1989 - 1994. The dependent variables were the logs of the unemployment rate, the long-term and the short-term unemployment rates. This means that should the log unemployment increase by 0.1, then unemployment would rise by just over 10 percent. The independent variables were the direct measures of labour market rigidities and

[3] Data on the variables capturing the structure of the wage determination systems in OECD countries are presented in Table A3 in Appendix A.

statistics summarizing the treatment of the unemployed and the variables impacting the wage determination structure as outlined above. Six-year averages were used to smooth out the cycle and year-on-year noise. The standard generalized least squares procedure, which is in effect ordinary least squares corrected for the fact that the two successive observations for each country cannot be treated as independent and random, was used to estimate the regression coefficients. Given that the unemployment rates are the actual unemployment rates as opposed to the equilibrium unemployment rates which are influenced by the labour market institutions, Nickell and Layard (1999 : 3052) captured the difference between the two by including the rate of change of inflation. Results of the regressions are set out in Table 3.1. Only those variables that are reasonably significant are reported.

Table 3.1 Regressions To Explain Log Unemployment Rate (%)
(20 OECD Countries, 1983-88 And 1989-1994)

	1 Total Unemployment	2 Long-term Unemployment	3 Short-term Unemployment
Total Tax Rate (%)	0.027 (4.0)	0.023 (1.6)	0.028 (3.5)
Employment Protection (1-20)		0.052 (1.4)	-0.061 (2.8)
Replacement Rate (%)	0.013 (3.4)	0.011 (1.3)	0.013 (2.6)
Benefit Duration (years)	0.10 (2.2)	0.25 (2.7)	0.045 (0.8)
Active Labour Market Policies	-0.023 (3.3)	-0.039 (2.8)	-0.097 (1.2)
Union Density (%)	0.010 (2.3)	0.010 (1.0)	0.0031 (0.5)
Union Coverage Index (1–3)	0.38 (2.7)	0.83 (2.3)	0.45 (2.1)
Co-ordination (Union + Employer) (2-6)	-0.43 (6.1)	-0.54 (3.6)	-0.34 (3.8)
Change in Inflation (% pts. p.a.)	-0.21 (2.2)	-0.30 (1.6)	-0.29 (2.7)
Dummy for 1989-94	0.15 (1.5)	0.30 (1.8)	0.092 (1.0)
R^2	0.82	0.84	0.73
N (countries, time)	40 (20, 2)	38 (19, 2)	38 (19, 2)

t ratios in parentheses

Source: Nickell and Layard (1999 : 3053)

In the Nickell and Layard regressions high labour standards, for example minimum wages, are found to have no effect on unemployment. The coefficient of the labour standards variable in the unemployment regression is negligible and insignificant (the coefficient is 0.0011 with a t ratio of 0.02) and hence it is not reported in Table 3.1. Although there is no evidence that employment protection affects overall employment, this variable was found to increase long-term unemployment and to reduce short-term unemployment. They found that both the benefit replacement rate and the benefit duration have significant effects on unemployment. However the negative effects of a relatively generous benefit system could be neutralized by appropriate active policies aimed at encouraging the unemployed back to work. This does appear to be the case. Their regression analysis found that active policy measures do have a significant effect on reducing long-term unemployment (coefficient of -0.039 with a t ratio of (2.8)). Owner-occupation does appear to raise unemployment but Nickell and Layard (1999 : 3055) question its effectiveness as an indicator of the barriers to entry since no correlation was found between regional mobility and the percent of households who were owner-occupied.

Nickell and Layard (1999) identified the important aspects of a wage determination system as the degree to which wages are determined collectively, through union bargaining (union coverage), and the degree to which employers and unions coordinate their wage bargaining activities given that wages are determined collectively. The regressions showed that higher union density and union coverage in particular increase unemployment. However, unions and employers co-ordinating their bargaining activities offset this. The coordination variable has a coefficient of -0.43 (6.1), -0.54 (3.6) and –0.34 (3.8) in the total unemployment, long-term unemployment and short-term unemployment regressions respectively (t ratios in parentheses). The coefficient of the centralization variable is insignificant. Thus the negative impact unions have on employment will be neutralized when both unions and employers coordinate wage bargaining activities.

Evidence shows that the burden of payroll taxes is usually shifted onto workers in the long run, cancelling any impact on unemployment. The coefficient of the payroll tax rate was found to be negligible in the regressions, which is confirmation of existing evidence suggesting that reducing payroll taxes and increasing consumption taxes will have no long-term effect on unemployment (Nickell and Layard, 1999 : 3053). Including the total tax rate in the regressions indicates that the overall tax burden increases unemployment.

Nickell and Layard (1999) thus identified trade unions and benefit systems as the labour market institutions most germane to European unemployment, and conclude that "...time spent worrying about strict labour market regulations, employment protection and minimum wages is probably time largely wasted." This is consistent with the results of a cross-section study of OECD countries conducted by Nickell in 1997. He found that the following labour market features contributed to unemployment: "1) generous unemployment benefits that are allowed to run on indefinitely, combined with little or no pressure on the unemployed to obtain work and low levels of active intervention to increase the ability and willingness of the unemployed to work; 2) high unionisation with wages bargained collectively and no coordination between either unions or employers in wage bargaining; 3) high overall taxes impinging on labour or a combination of high minimum wages for young people associated with high payroll taxes; and 4) poor educational standards at the bottom end of the labour market" (Nickell, 1997 : 72).

However it is argued that these models could not convincingly attribute the rise in unemployment to greater labour market regulation. Gregg and Manning (1997 : 400) argue that policy makers were aware of the fact that labour regulation had been increased in most countries during the 1960s and 1970s and that unemployment had begun to rise from the late 1960s. Hence, in the 1980s policy makers adopted labour market policies that tended to support deregulation. However, unemployment continued to rise in spite of these measures. Blanchard and Wolfers (2000 : C2) also note that labour market institutions, while potentially able to account for the current heterogeneity of individual country experiences, are unable to explain the general evolution of unemployment over time since "...many of these institutions were already present when unemployment was low (and similar across countries), and, while many became less employment friendly in the 1970s, the movement since then has been mostly in the opposite direction." They suggest a shift in focus to the interaction of adverse shocks with adverse labour market institutions. Fitoussi *et al* (2000 : 254) agree that labour market institutions cannot account for the higher and higher levels of equilibrium unemployment experienced during the 1970s and 1980s. They argue that the role that labour market institutions may have played is to propagate the shocks that explain the rise in unemployment rather than to originate them.

3.3.2 THE INTERACTION OF SHOCKS AND LABOUR MARKET INSTITUTIONS

The current view on the interaction of shocks and labour market institutions is that labour market institutions shape the effects of shocks on unemployment in two ways: first, by affecting the impact of shocks on unemployment and second, by affecting the persistence of unemployment in response to shocks (Blanchard and Wolfers, 2000 : C17). Studies on the first concentrated on how the innate characteristics and the details of collective bargaining could determine the response of unemployment to various shocks. For example, centralized wage negotiations could make coordinating a slowdown in wages in response to a shock easier. However continued high unemployment shifted the focus to the second. In the normal course of events, higher unemployment caused by an adverse shock will exert downward pressure on wages until equilibrium unemployment has been re-established. However certain labour market institutions serve to weaken the effect of unemployment on wages, thereby increasing the persistence of unemployment in response to shocks (Blanchard and Wolfers, 2000 : C17). For example, generous benefit systems and employment protection tend to increase the duration of unemployment experienced by an individual. The longer an individual is unemployed, the greater the erosion of his/her skills and the greater the probability that he/she will cease searching for a job altogether. This unemployable nature of or the failure of the long-term unemployed to actively seek work will result in their becoming irrelevant to the wage setting process. The downward pressure of unemployment on wages will fall and the persistence of unemployment will increase.

Blanchard and Wolfers (2000) investigated the interaction between shocks and institutional variables, employing five-year averages of the data on a panel of shocks and institutions for 20 OECD countries since 1960. They identified the following shock variables as having played an important role in the increase in unemployment: the level of total factor productivity (TFP) growth, the real interest rate and labour demand shifts (essentially the log of the labour share purged of the effects of factor prices). The institutional variables employed correspond to those used by Nickell and Layard (1999) and Nickell (1997), namely measures of the replacement rate, the duration of unemployment benefits, active labour market policies, employment protection, the tax wedge, union coverage, union density and union and employer coordination of wage bargaining. Their empirical results lead them to conclude (C32) that "... an account of the evolution of unemployment based on the interaction of shocks and institutions can do a good job of fitting the evolution of European unemployment, both over time and across countries".

Nickell, Nunziata, Ochel and Quintini (2001) attempted to determine the extent to which the long- term shifts in unemployment experienced by 20 OECD countries over the last four decades could be explained by changes in labour market institutions over that time. They identified the following variables as affecting equilibrium unemployment: the unemployment benefit system, the real interest rate, employment protection legislation, barriers to mobility, active labour market policies, union structures and the extent of coordination in wage bargaining, labour taxes, terms of trade changes and shifts in trend productivity growth. The latter three variables influence unemployment through their impact on wages. Employment will fall if workers attempt to sustain recent wage growth when the rate consistent with stable unemployment shifts unexpectedly due to either an increase in labour taxes, adverse shifts in the terms of trade (increases in real import prices) or a fall in trend productivity growth (Nickell *et al*, 2001 : 8). The factors expected to explain the deviation in short-term unemployment from equilibrium unemployment included aggregate demand shocks, productivity shocks and wage shocks. They conclude that shifts in labour market institutions can account for broad movements in unemployment across OECD countries. However this result is dependent on high levels of endogenous persistence as reflected in a lagged dependent variable coefficient of around 0,86 (Nickell *et al*, 2001 : 38).

3.4 HYSTERESIS

Failure of movements in any exogenous factor to provide a probable explanation for the seemingly permanent increase in equilibrium unemployment led to a shift in focus away from the original source of the increase toward the question of how the effects of the shocks were propagated over time (Bean, 1994 : 603). Hence in the mid-1980s explanations based on hysteresis became popular.

Hysteresis is explained by Cross and Allen (1988 : 28) as follows, "If the behaviour of economic systems in such equilibrium positions [that is partial, general, local temporary, stationary, dynamic and spatial] can be explained by reference to present state variables alone the systems can be said to be ahysteretic; if reference to the history of the relevant explanatory variables is required as well, the systems are hysteretic". The hysteresis theory of unemployment thus holds that equilibrium unemployment is path-dependent, that is, it depends on the history of actual unemployment. A change in actual unemployment could have a long-lasting effect on equilibrium unemployment. High unemployment was held to be the outcome of a very slow adjustment to the high actual unemployment caused by temporary shocks such as the oil price increases of the 1970s and the tight monetary policies of the 1980s.

The behaviour of insiders, and the role played by the unemployed and particularly the long-term unemployed have been identified, *inter alia*, as potential channels for hysteresis in unemployment.

3.4.1 THE BEHAVIOUR OF INSIDERS

Involuntary unemployment means that there are individuals who are unemployed despite a preference and a desire to work at the wages (normalized for productivity differences) received by those currently in employment. In order to acquire employment, these individuals will offer to work for less than the prevailing wage. The fact that unemployment persists in these circumstances means that something or someone is able to prevent underbidding taking place (Lindbeck and Snower, 1988 : 61). Government intervention through say minimum wage laws, is a possible culprit as are firms and the employed.

In the insider-outsider theory, it is in the interests of the incumbent workers (insiders) to prevent the unemployed from offering to work for less than the prevailing wage. According to the theory workers have the ability to at least partially influence wage and employment decisions (Lindbeck and Snower, 1988 : 44). The theory is based on two fundamental assumptions: as a result of labour turnover costs insiders are able to exert market power in the wage setting process; and insiders apply this power in their own interests without giving full consideration to other workers.

An illustration of an insider/outsider model is provided by Lindbeck and Snower (1988 : 3) who see workers being divided into three groups:

1) The insiders who are the experienced incumbent employees. Labour turnover costs (i.e. costs arising when workers join or leave a firm) protect the jobs of incumbent workers, making it costly for firms to fire them and hire someone else in their place.

2) The entrants who are workers who have only recently been employed and whose positions are presently not characterised by significant labour costs but who may achieve insider status in the future.

3) The outsiders who have no protection and are either unemployed or participate in the informal sector which offers very little if any job security. They are prepared to work for less than insiders.

In this model hiring costs include the costs incurred in advertising for, screening, negotiating with and training outsiders to replace insiders. Firing costs may include the implementation of costly firing procedures, litigation, severance pay, and the possibility of strikes and low levels of morale among the remaining workforce (Lindbeck and Snower, 1988 : 1-2). Turnover costs create economic rent since firms would be willing to pay to prevent a given level of turnover. Insiders are assumed to have sufficient power to seize part of this rent in the form of higher wages.

Insiders and firms negotiate wages on an individual or a collective (through a union) basis and insiders plan their rent-seeking activities (if any), considering the employment response to these decisions. Firms then make the employment decision unilaterally, taking wages and rent-creating activities as given (Lindbeck and Snower, 1988 : 4). Insiders are able to push their wages above the entrant wage and still keep their jobs since labour turnover costs may neutralize any incentive firms may have to replace insiders with entrants. Furthermore, current workers will find it in their self-interest to push entrants' wages above the entrants' reservation wage thereby limiting the firms' employment of entrants (Lindbeck and Snower, 2001 : 170). Hence while labour turnover costs will raise the insider wage, the entrant wage – unlike the reservation wage – will not fall by an equivalent amount in present value terms. The labour turnover costs will increase the present value of firms' wage costs of the marginal worker causing firms to reduce employment (Lindbeck and Snower, 2001 : 170).

Labour turnover costs discourage firms from hiring when the demand for labour increases and from firing when the demand for labour decreases. Hence the consequence of an expansion in economic activity will be the tendency for employment to remain relatively high while a consequence of a recession is the tendency for employment to remain lower than it would otherwise have been. This raises employment inertia so that firms' current employment depends more strongly on past employment (Lindbeck and Snower, 2001 : 170).

The nature of macroeconomic fluctuations will also impact the influence that labour turnover costs have on employment and unemployment. When business cycles are long and deep (as was the case following the two oil price shocks in the 1970s and the adoption of restrictive monetary policy in the 1980s and early 1990s), labour costs may prove ineffective in preventing labour cutbacks during the recessions, but they will discourage hiring in booms because of the uncertainties surrounding the strength and the duration of the upswing (Lindbeck and Snower, 2001 : 172). The overall effect on employment will thus be negative.

3.4.2 OUTSIDER CHARACTERISTICS

The second source of persistent unemployment focuses on the role played by the unemployed and particularly the long-term unemployed in the wage determination process. Long periods of unemployment tend to render people less employable either because employers use the length of their unemployment as an indication of their potential as workers or because their skills deteriorate making them less attractive to employers. This in turn causes discouragement and eventually an end to the job search. When the demand for labour starts to increase again, it will be the short-term unemployed who will find employment first and hence one could consider the long-term unemployed as effectively no longer a part of the labour market. The long-term unemployed are not considered by firms or viewed as competition by employed workers, resulting in less downward pressure on wages than would be suggested by the over-supply of labour and thus to an increase in the equilibrium rate of unemployment (The Economist, 1994b : 74). Generous unemployment benefit systems will also contribute to the persistence of unemployment by encouraging or enabling people to remain unemployed for longer than they necessarily would in the absence of such systems.

3.5 SKILL-BIASED TECHNOLOGICAL PROGRESS

A popular explanation for the unemployment problem is that the opportunities for the less-skilled have been declining relative to those for the skilled. The inability to compete with low-wage labour in developing countries and technical progress that is biased against the unskilled have been identified as reasons for this shift in demand away from the less-skilled.

It is argued that all countries have experienced an increase in relative demand for skilled workers, as opposed to that of unskilled workers, that has exceeded the increase in their relative supply. Juhn, Murphy and Topel (1991 : 76) found that in the United States of America, "...the significant secular increases in unemployment, nonparticipation, and nonemployment are heavily concentrated among less skilled individuals". They conclude that these increases are the result of reduced demand for unskilled workers. Between 1970 and the late 1980s, real wages for workers in the bottom decile of the wage distribution fell by more than 30 percent, while those of workers in the top 40 percent of the distribution remained stable. The latter group experienced stable unemployment and participation rates while the former experienced the greatest secular rises in unemployment and nonparticipation (Juhn *et al*, 1991 : 100). This evidence lends support to this view; "(t)aken together, the evidence suggests that nonneutral changes in the long-run demand for labour, coupled with wages that are flexible in the long-run, may be the major factor explaining changing jobless rates" (Juhn *et al*, 1991 : 100).

This shift in demand is held to explain the majority of the increase in European unemployment relative to that in the United States of America. However while inflexibility of the labour market in Europe translated the shift in relative demand into greater unemployment, the flexible labour market in the United States of America, converted the shift into increased earnings inequality (Nickell, 1997 : 71).

The conclusion of this research is that although labour market regulation is not the fundamental cause of labour market problems it does determine the form these problems take. Countries that have institutions or measures in place (such as welfare grants, minimum wages and trade unions) which aim to prevent increasing inequalities in income distribution will hinder adjustments in relative wages and experience high unemployment particularly among the unskilled as a result (Gregg and Manning, 1997 : 402). On the other hand, countries with more flexible labour markets (for example the USA) have lower levels of unemployment, but the wage/income inequalities between less-skilled and skilled workers is much greater.

Following the argument that real wages did not adjust sufficiently because of labour market regulation, one would expect the divergence in the unemployment rates of the unskilled and the skilled to be larger in Europe than in the United States of America. However Gregg and Manning (1997: 402) point out that this is not in fact the case. They conclude that, "The relative deterioration in the employment prospects of the least skilled does not seem to be greater in the UK than the USA, which is a strong prediction of the theory that blames labour market regulation and skill-biased change for current labour market problems".

Layard, Jackman, Manacorda and Petrongola (1997) attempted to determine the extent to which changes in unemployment in Europe and the United States of America could be attributed to changes in the skills mismatch. They found that in both Britain and the United States of America imbalanced demand and supply changes had raised unskilled unemployment and lowered skilled unemployment, although shifts in relative wage behaviour offset part of the effect. Over the 1975 – 1992 period changes in the skills mismatch accounted for under a half a percentage point increase in total unemployment in Britain. The relevant figure for the United States of America over the period 1979 – 1988 was even smaller (Layard *et al*, 1997 : 216). In addition no significant increase in skills mismatch was found for the European countries studied. Over the 1980s wage differentials were found to have increased much less in Europe than in the United States of America. However they note that this is unsurprising given that the rate of skill formation was found to be much higher in Europe.

Furthermore history does not support the view that advances in technology lower the rate of labour absorption and increase unemployment - technology advanced rapidly over the past two centuries but unemployment did not rise (The Economist, 1995 : 21). In fact, accelerations in technological progress are accompanied by accelerations in growth, living standards and employment.

Two forms of technological advances exist. "Product innovation" is the introduction of entirely new items, the demand for which generates jobs where none existed previously. "Process innovation" involves the introduction of new machines and methods for more efficient production of existing goods and hence unemployment may increase in the short-run.

However the extra demand produced in the economy could offset the initial labour-reducing effects (The Economist, 1995 : 21). Increased productivity will lower costs, which will in turn result in lower prices, higher wages and larger profits. Lower prices and higher wages will raise real incomes and hence increase the demand for goods and workers. If higher profits are the outcome, the expansion in investment that results will also increase output and employment (The Economist, 1995 : 21). New technology could only lead to permanently higher unemployment in the improbable and more likely impossible event that all consumer desires have been fully satisfied and demand could not increase to match an increase in productive capacity. New technology may however cause unemployment to rise in certain occupations or regions. Technology does tend to destroy lower wage, lower productivity jobs and to create more productive, high-skill and better-paid jobs (OECD, 1994 : 33). The transition to new technologies can therefore lead to a mismatch between the skills people possess and those that are required. Lags between the destruction of old jobs and the creation of new ones may also exist.

It is true that the faster productivity grows, the fewer jobs are created by a given rate of growth. The demand for labour depends upon the relationship between productivity and wages. Say, for example, productivity growth was reduced because firms invested less in machinery. Then workers will have to accept smaller pay rises than before since if they do not, the cost of hiring the "marginal" worker would exceed the value of his extra output and unemployment would rise (The Economist, 1995 : 21).

The call for policies that increase labour market flexibility is challenged by an alternative view that holds that the absorption of labour may not necessarily be increased by low wages and low labour costs since factors, which make the use of labour-saving technology more profitable, might exist (Schlemmer and Levitz, 1998 : 54). As the use of technology increases, labour costs become a less significant proportion of operating costs, and wage levels may thus have relatively weak influences on business decisions. Policies advocated by proponents of this view tend to involve improving wages, employee benefits and job security, on the grounds that such measures are requisite for achieving improvements in labour productivity. The focus is on what the government can do to increase the demand for labour and it is argued that developing countries should follow expansionary fiscal policies despite the risk of higher inflation, thereby placing the economy on a growth path led by demand. It is assumed that the inflation rate will be checked as production catches up with demand (Schlemmer and Levitz, 1998 : 54).

Regardless of whether a high technology or a demand-driven growth path is followed, any labour market conditions and characteristics that inhibit labour absorption could exert upward pressure on unemployment. Schlemmer and Levitz (1998) therefore argue that labour market flexibility is imperative for either strategy. Labour market rigidities may, in the high technology path and despite expansion, result in employers putting off increasing their workforce for as long as possible, adopting instead better and better technology, perhaps even before it is cost-effective. In the demand-driven route, a rigid labour market may reduce industry profitability to the extent that production does not respond satisfactorily to the markets created by fiscal expansion.

3.6 A NOTE ON POLICY RESPONSE

The dominant view among economists is that the cause of the progressive rise in unemployment in countries over the past 25 years can be found in the supply side of the economy, particularly in the labour market (Gregg and Manning, 1997 : 395). It is held that deregulation will move the labour market towards the perfectly competitive ideal in which all can find employment, if they desire it, at a wage equal to the value of their contribution to society. Although a completely deregulated labour market will still have some involuntary unemployment possibly as a result of efficiency wage considerations or friction in the operation of the market, the economy will be closer to market clearing (Gregg and Manning, 1997 : 410). Any form of labour market regulation is thus seen to reduce the efficiency of the labour market and such regulation can only be vindicated on equity grounds.

However, Gregg and Manning (1997 : 396) believe that a more complex relationship exists between labour market regulation and unemployment. They argue that labour markets are not perfectly competitive and that a wholly unregulated labour market is unlikely to be efficient, largely because it is probable that the market will be monopsonistic in nature for those groups of workers most disposed to unemployment. Unskilled workers need to be granted or allowed a level of bargaining power to countervail the monopsony power of firms and "aristocracy workers". The challenge is to determine the optimal amount and the form that the regulation should take.

Gregg and Manning (1997 : 416 - 417) after studying a number of search and matching models in order to determine the optimal amount of power that workers should have in wage-setting, conclude, " The important point is that the optimal bargaining power of workers in search and matching models is not zero, so that complete labour market deregulation should not be expected to lead to efficiency". An optimal level of regulation needs to be adopted to minimise unemployment.

Calaza (1997 : 425) supports this argument. The analytical framework of deregulation holds that the labour market is more important than the goods and services market in overcoming unemployment. He agrees that Keynesian measures are insufficient in counter-balancing structural change problems, but maintains that the importance granted to the labour market is over-estimated and leads to a bias in favour of certain economic policies which are advantageous to firms rather than workers, even despite an original intention to benefit workers. This bias would not be problematic if the outcomes reached were also accompanied by a drastic reduction in unskilled unemployment. However, Calaza (1997 : 425) holds little confidence in such a result since firms aim to maximise profits and not to generate employment, and profits are derived from producing goods and services, not hiring labour. He concludes (1997 : 425), "... the goods and services markets logically dominate the labour market in order to create employment, even if the satisfactory functioning of the latter is a necessary condition for full employment". The deregulation of monetary and financial markets following the globalisation of the world economy has meant that a causal relationship between profits and employment cannot be assumed. Profits generated by a decrease in salaries and wages may be reinvested in the country leading to job creation, but investment opportunities in financial markets outside the country may be equally or more attractive (Calaza, 1997 : 427). This is one of the reasons, Calaza (1997 : 427) argues, for the incomplete validity of the microeconomic conjecture that assumes a clear negative relationship between employment and wage costs in the macroeconomic framework.

Coe and Snower (1997) assert that labour market institutions have complementary effects on unemployment, that is, institutional rigidities reinforce each other, and hence policies aimed at reducing these rigidities will also be complementary. Unemployment policy complementarities are defined by Coe and Snower (1997 : 1) as follows, "...a group of policies is complementary when the unemployment effect of each policy is greater when it is implemented in conjunction with other policies than in isolation". European countries have been largely unsuccessful in reducing unemployment since they have been implementing diverse, piecemeal labour market reforms instead of undertaking "broad" and "deep" reforms. Coe and Snower (1997 : 22) do recognize that reducing unemployment is not the only objective of policy makers who must also provide support for the unemployed and job protection for the employed. The task facing policy makers is thus to "... find a set of complementary reforms that have a powerful joint effect on unemployment without creating a socially undesirable widening of the distribution of income" (Coe and Snower, 1997 : 22).

Coe and Snower (1997 : 32 – 33) identify the following as features that might be incorporated in a fundamental reform programme:

1. Replacing passive income support measures with a negative income tax conditional on employment or job search to achieve distributional objectives with fewer adverse effects on incentives and employment (Snower, 1995b), coupled with a substantial scaling back or elimination of existing measures of passive income support;
2. reducing payroll taxes, particularly for low-wage workers;
3. liberalising job security legislation;
4. reducing wage rigidities (such as those arising from minimum wages or broad coverage of union wage agreements) to allow wage differentials to better reflect productivity differences;
5. implementing measures to increase incentives for the acquisition and provision of training, including allowing unemployed workers to transfer benefits for training vouchers (Snower, 1995a);
6. introducing longer-run reforms to education systems to better prepare students for the transition to work; and
7. taking measures to lower search costs by increasing worker mobility, including reforms in the housing market and in the portability of pensions.

The Organisation for Economic Cooperation and Development (OECD) agrees that significant synergies exist between structural reforms in different areas; "(s)eeing structural reforms as part of an overall strategy is also important because reforms in one area produce better results if other areas are also reformed" (OECD, section IV, paragraph 1). For example, the full benefits of greater product market competition will only be achieved if labour markets are flexible enough to enable a prompt reallocation of labour.

A comprehensive policy reform may have a mitigating impact on some of the inherent policy trade-offs. The OECD (section VI, paragraph 1) notes,

> "By exposing wider segments of the population to structural reform, the process may be perceived as more fair, reducing strains on social cohesion. And reforms which negatively affect the real incomes of people without jobs will be perceived as less unfair if they are accompanied by other reforms aimed at getting these outsiders back into regular employment".

Consequently, the Job Strategy developed by the OECD involves a balanced and comprehensive set of reform recommendations that are best implemented in a coordinated manner. These recommendations were designed with the intention of improving countries' capacities to be innovative and to adapt to change, and hence to increase employment. The recommendations are as follows (OECD, 1994 : 43):

1. Set macroeconomic policy such that it will both encourage growth and, in conjunction with good structural policies, make it sustainable.
2. Enhance the creation and diffusion of technological know-how by improving frameworks for its development.
3. Increase flexibility of working-time (both short-term and lifetime) voluntarily sought by workers and employers.
4. Nurture an entrepreneurial climate by eliminating impediments to, and restrictions on, the creation and expansion of enterprises.
5. Make wage and labour costs more flexible by removing restrictions that prevent wages from reflecting local conditions and individual skill levels, in particular of younger workers.
6. Reform employment security provisions that inhibit the expansion of employment in the private sector.
7. Strengthen the emphasis on active labour market policies and reinforce their effectiveness.

8. Improve labour force skills and competences through wide-ranging changes in education and training systems.
9. Reform unemployment and related benefits systems – and their interaction with the tax system – such that societies' fundamental equity goals are achieved in ways that impinge far less on the efficient functioning of labour markets.

The success of the strategy is evidenced by the improved labour market outcomes in the countries that have been most vigorous and conscientious in implementing it. Developments in the United Kingdom, the Netherlands, New Zealand and Ireland have been encouraging (unemployment rates in the United Kingdom, the Netherlands and Ireland have fallen to their lowest levels since the 1970s); and support the view that a comprehensive approach to reform brings greater benefits, even though their experience suggests that a considerable time may elapse before the benefits are evident (OECD, section VI, paragraph 1).

3.7 SUMMARY

This chapter briefly considered the explanations of the European unemployment problem provided by the authorities in this field, but it appears from the vast literature on the subject that there is no single or easily identifiable cause of the rise in unemployment. While adverse shocks acted in the direction of raising unemployment, they could not account for the considerable heterogeneity or the persistence in unemployment levels across countries. The possibility that labour market institutions or rigidities had had a role to play in propagating the effects of adverse shocks on unemployment was then raised, leading to the emergence of a broad consensus that European unemployment had its source in the interactions of adverse shocks and adverse labour market institutions.

The policy response developed by the OECD's 1994 Jobs Study is cognizant of the existence of unemployment policy complementarities and suggests a balanced and comprehensive set of reforms designed to improve countries' capacities to be innovative and to adapt to change, and consequently to raise employment. Country experience indicates that this suggested comprehensive policy reform programme is associated with improved employment and unemployment performance, although the time taken for the positive effects to become evident may be considerable.

4 TRADE UNIONS: A THEORETICAL FRAMEWORK

4.1 INTRODUCTION

A trade union may be defined as an association of employees formed for the purpose of improving the material welfare of its members, chiefly by raising wages above the competitive level (Booth, 1995 : 51). Freeman and Medoff (1984 : 5-6) recognised trade unions as having two faces, each leading to a different view of unions:

1) A monopoly face, associated with their monopolistic power to achieve wage gains; and
2) A collective voice or institutional response face, associated with their role as agents of organised workers within firms.

The monopoly power of trade unions introduces an element of inflexibility into the labour market. This chapter examines the effects of trade unions in the setting of perfectly competitive product and labour markets. Two factors must be present if a trade union is to achieve a wage rate that is greater than the competitive level. Firstly, economic rents or a surplus must be available for sharing. Secondly, the union needs to possess a degree of bargaining power sufficient to persuade the firm to share the surplus with union members. The monopoly union model, which affords the simplest way of reconciling the objectives of the firm and trade union, is considered. The impact that trade unions have on non-union workers is then examined. Typically unions will attain a wage rate greater than the competitive level for its members and in the process wages in the non-union sector will be pushed below the competitive level. Provided the unionised labour market would have been competitive in the absence of a union, unionisation will result in an efficiency loss and it is shown that the impact on aggregate labour income in the economy will depend on whether the total wage bill after unionisation is greater or less than the total wage bill before unionisation. The impact of trade unions on productivity and employment is then analysed. Lastly, the effect of the wage bargaining structure on aggregate unemployment is considered.

4.2 THE ORTHODOX THEORETICAL VIEW OF TRADE UNIONS

4.2.1 TRADE UNIONS IN A PERFECTLY COMPETITIVE PRODUCT MARKET

The ability of a trade union to secure a wage rate higher than the non-union wage depends on the existence of economic rents or surplus in the product market, and on the extent to which the union is able to behave as a monopolist in the supply of labour. Therefore, if they are to be viable organisations, trade unions must either create a surplus, or be able to acquire a share of the surplus previously captured by the firm. Economic rents have a variety of sources with market imperfections or the regulation of the particular industry being the most likely. One would therefore expect the probability of unionisation to be higher in non-competitive industries than in competitive product markets, since where non-competitive firms or industries make surpluses, unions will be able to achieve higher wages without undermining the viability of the firm (Booth, 1995 : 53).

If a union is to capture any surplus in a perfectly competitive product market, the firm must be making abnormal profits when employing workers (n) at the perfectly competitive wage (W_c). In the equilibrium region the competitive firm's production function would have to be characterised by decreasing returns to labour. The firm's total revenue product curve is given by pq(n), where p is product price and q(n) is the production function. The firm's total factor outlay curve is given by W_cn where capital is assumed fixed in the short-run. W_c, the competitive wage rate is exogenously given to the firm (it is determined by the interaction of the industry labour demand and labour supply schedules). The firm's profits,π, are given by
$\pi = pq(n) - W_cn$.

The profits are greatest where the vertical distance between the total factor outlay curve and the total revenue product curve is at its greatest. The union will be able to capture some of the surplus if it can set wages at a rate greater than the competitive level. W* is the highest wage it can set without pushing the firm out of business.

In a perfectly competitive market, the firm will face an exogenously determined wage rate, W_c. The firm will hire labour until the marginal benefit of hiring an additional worker is equal to the marginal cost of doing so. If the firm chooses labour n to maximise profits, the first order condition from maximisation of the profit equation is given by

$$d\pi/dn = pq'(n) - W_c = 0$$

Therefore

$$pq'(n) = W_c$$

The firm will hire labour until the value of the marginal product of labour (VMPL) given by $pq'(n)$ is equal to the wage rate that must be paid to this worker (W_c). Unions, given the freedom of entry and exit of firms from the industry, may not be able to capture any surplus in the long-run since in the long-run one would expect only the firms with the lowest costs to survive, and abnormal profits would be eroded (Booth, 1995 : 55).

The existence of a surplus is a necessary, but not a sufficient condition for union existence. In addition unions must have sufficient power to force the firm to share the surplus with the workers, or the firm must be prepared to share part of the surplus with the union in exchange for behaviour that guarantees a larger surplus (with the consequence that the firm is not made worse off). Workers may struggle to gain sufficient power to persuade firms to grant them a share of the surplus. This is consistent with the Marxian analysis of the capitalist means of production which argues that the production process is specifically selected by capitalists to maintain their control over labour, and to ensure that labour as a class has no bargaining power (Booth, 1995 : 56). Given the inherent conflict between employers and workers over work effort and the costs involved in monitoring workers, employers find it in their interests to use unemployment as a means of encouraging work effort. If employees receive a wage rate greater than their next best alternative, there is some positive cost associated with being fired. The equilibrium wages in such a labour market are above the market-clearing wage since the market-clearing wage is associated with zero unemployment (this implies that the cost of job loss is zero). Such involuntary unemployment is associated with excess labour supply, which means that labour as a class fails to achieve a position of bargaining strength necessary to capture a share of any surplus (Booth, 1995 : 56).

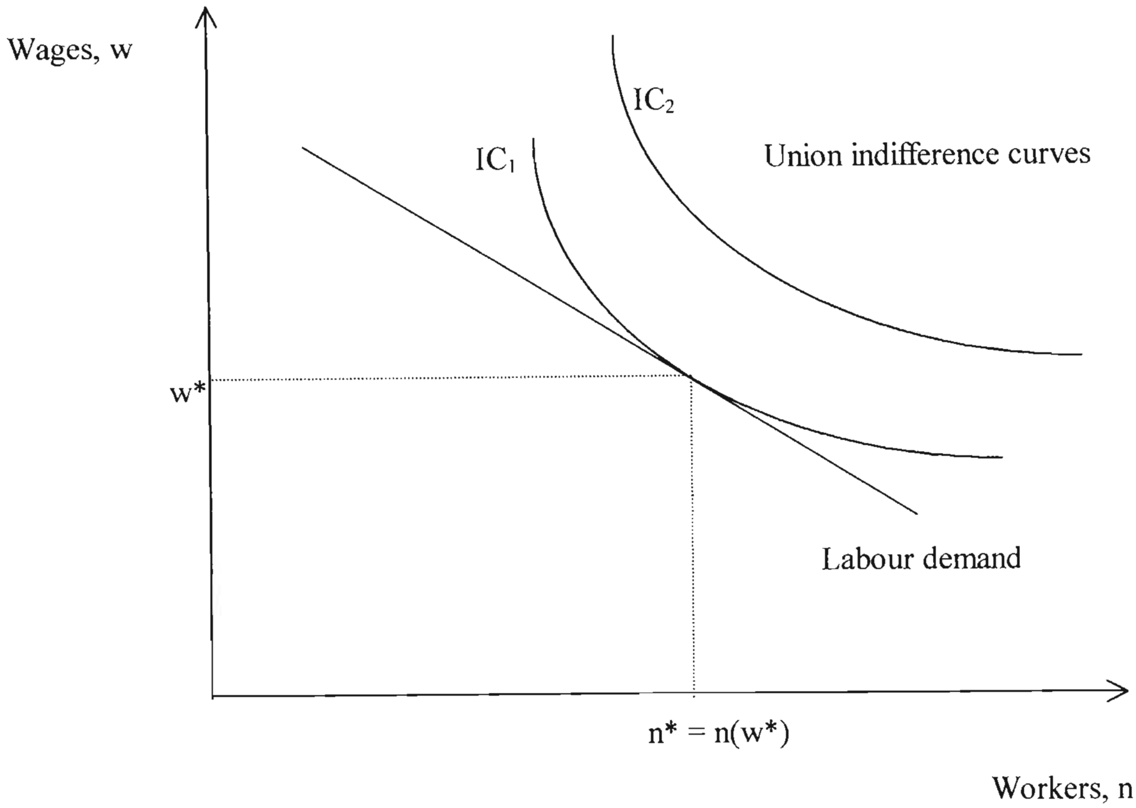
The question as to how the trade union acquires the monopoly power needed to capture a share of the surplus arises. Unions are able to gain power primarily, although not exclusively, through the threat of strikes provided that an alternative pool of substitute workers is unavailable. It is therefore essential that unions are able to prevent firms from hiring alternative workers in the event of a labour withdrawal. This can be achieved by organising all the workers, or most workers, in the industry, such that the union behaves as a monopolist in the supply of labour. In other words unions need to control labour supply either by imposing entry restrictions or, in the case of a fixed labour supply, by having high levels of membership relative to the size of the sector. It is also important to note that union power is likely to be closely related to the market power of the sector it organises. The ability of a union to negotiate a large wage increase relative to the competitive level depends on the wage elasticity of labour demand in that particular sector. Marshall's rules of derived demand describe the factors affecting the elasticity of labour demand in the long-run and where capital is variable. Firstly, the demand for labour will be influenced by changes in demand for the final product. Secondly, labour demand will be affected by the degree of substitutability in production between labour and other inputs. If the price of labour were to increase firms may be able to substitute other inputs for labour. Thirdly, the share of labour in total costs will affect the elasticity of labour demand. The smaller the share of labour costs in total costs, the smaller the impact of an increase in the price of labour on total costs. Fourthly, labour demand will be affected by the elasticity of supply of other inputs to the production process. (Booth, 1995 : 58)

4.2.2 THE MONOPOLY UNION MODEL

The monopoly union model provides the simplest method of reconciling the objectives of the firm and the trade union. Traditional theory views a union as a monopoly that tries to secure higher wages for its members. The union is assumed to set the wage unilaterally, subject to the firm's labour demand curve. Once the wage is set, the firm is free to adjust employment to the profit maximising level on the demand curve. The union knows how the firm will behave in response to the wage it has set (Booth, 1995 : 97).

The union selects the highest possible level of utility, given the constraint of the firm's labour demand curve. The optimum position (n*,w*) is thus achieved where the union equates its marginal rate of substitution of employment for wages with the slope of the labour demand curve. This is shown in Figure 4.1

Figure 4.1 The Monopoly Union Model



Source: Booth, 1995 : 98

Assume that the union maximises the expected utility of a representative worker:

$$\max EU = (n/t)u(w) + (1 - n/t)\, u(b) \qquad (1)$$

subject to

$$pq'(n) = w \qquad (2)$$

where n = employment in the union sector

t = total number of union workers in the sector

b = alternative sector wage or unemployment benefit

The first order condition of this maximisation problem can be determined by equating the slope of the union indifference curve with the slope of the labour demand curve. Alternatively, once the union has set its optimal wage, w*, equilibrium employment is found by equating w* with the firm's labour demand curve pq'(n). The union's constraint can thus be written as

$$n = n(w/p) \qquad (3)$$

Substituting (3) into (1) and maximising with respect to w, Booth (1995 : 99) obtained the following result (p is equal to 1 for simplicity):

> The union will set wages such that the percentage increase in a member's utility due to a percentage increase in wages is exactly equal to the elasticity of labour demand (that is, the percentage reduction in employment due to the percentage wage increase). This is given by:
>
> $$\varepsilon = wu'(w)/[u(w) - u(b)] \tag{4}$$
>
> where
>
> $$\varepsilon = -n'(w)\, w/n$$

The effect of the business cycle on the unionised sector of the economy is of particular interest. Both labour demand and alternative opportunities (represented by b) are likely to be affected by the business cycle. Since labour demand is a derived demand, an increase in product demand will increase the demand for labour at each wage rate, and the labour demand curve will shift to the right. However, the union wage remains unchanged provided that the elasticity of labour demand is unaffected. Equation (4) shows that if ε is fixed, the right-hand side of (4) must remain unchanged, and thus wages will not be altered. Hence it can be concluded that wages are rigid during fluctuations in product price, with all adjustments occurring through employment instead (Booth, 1995 : 99).

An improvement in alternative opportunities, that is an increase in b, will only affect union preferences, and not labour demand. The left-hand side of equation (4) remains unchanged by the increase in b, and thus in order to keep the right-hand side of (4) also unaltered, w must rise with an increase in b. This outcome suggests that if alternative opportunities worsen (b falls), the union will relax its wage claims, thus leading to an increase in employment in the unionised sector (Booth, 1995 : 100).

However, it is likely that the business cycle will have a simultaneous effect on labour demand and alternative opportunities, b. Should the economy enter a recession, product demand and alternative opportunities are both likely to decline. The decline in product demand will have no effect on the union wage but it will result in a fall in employment. The decrease in b, on the other hand, will reduce the union wage and raise employment. According to the monopoly union model, the net effect of a recession would be for union wages to fall with an ambiguous impact on employment. The effects of changes in alternative opportunities will be small if there exists little labour mobility between sectors in the short-run. In such a case one might expect the negative effect of a fall in product prices to dominate and wages to be sticky. The model therefore provides a microeconomic alternative to the implicit contract models of sticky wages and unemployment (Booth, 1995 : 100 -101).

4.2.3 SPILLOVER AND THREAT EFFECTS (UNION EFFECTS ON NON-UNION WORKERS)

Consideration of the impact of trade unions on relative wages requires the definition of two concepts of wage differentials. First, the wage gain refers to the difference between the wages paid to union members and the wages that these same workers would receive in the economy with no trade unions at all, which would be the competitive wage rate. Secondly, the wage gap refers to the difference in earnings between a union and non-union worker who are in every other respect identical. The wage gap may be smaller than the true wage gain due to the existence of threat effects, or larger due to the existence of spillover effects. Thus the 'true' effects of unionisation may be under or over-estimated by the wage gap (Elliot, 1990: 433).

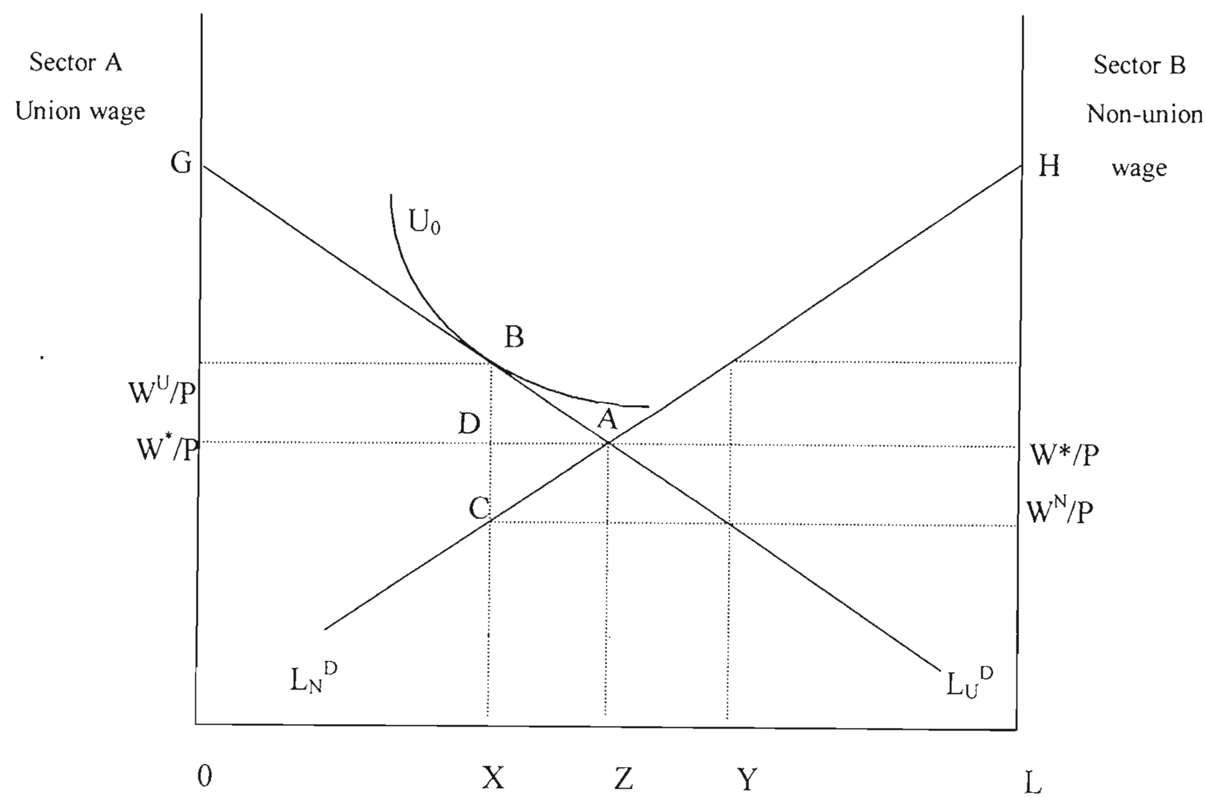
The spillover (or 'crowding') effect suggests that employers in the union sector will reduce employment given the successful negotiation of higher wages by unions, and that the demand for labour in the union sector is not perfectly inelastic or that unions fail to negotiate efficient contracts. Displaced workers 'crowd' into the non-union sector, and compete down wages in that sector subject to the floor imposed by the welfare or social minimum (Elliot, 1990 : 433).

A simple general equilibrium model can illustrate this (see figure 4.2). Suppose that there are only two sectors, A and B in the economy, and that initially there are no trade unions. The labour demand curves for these sectors are given by L_N^D and L_U^D in figure 4.2, and the length of the horizontal axis measures aggregate labour supply in this economy. If the labour market is competitive the wage rate will be W*/P and the labour supply will be fully employed. There will be no incentive for workers to relocate since wages are equal in both sectors. Now suppose that a union forms in sector A so that L_U^D represents the demand for labour in the unionised sector. Union preferences, as depicted by U_0, result in the negotiation of a union wage W^u/P. In consequence employment in the unionised sector is reduced, labour supply to the non-union sector is increased and the wage rate in that sector is driven down to W^N/P

(where the supply of workers to sector B given by LX is equal to demand, at point C). OX workers will be employed in the union sector and XL workers in the non-union sector. The estimated wage gap that results $(W^u - W^N)/W^N$ will overstate the wage gain, $(W^u - W^*)/W^*$, that results. Wages in the union sector will have risen while those in the non-union sector will have fallen relative to the competitive benchmark (Elliot, 1990 : 433).

The threat effect suggests that employers may, for a variety of reasons, try to match the union wages even though their labour force is not unionised. Employers may be forced to pay union wages to recruit labour but perhaps they are most likely to pay union wages to prevent or pre-empt unionisation, if they believe that the unions will impose additional costs, for example, strikes that halt operations, or reductions in the ease with which they may deploy labour. No wage gap will emerge, and the wage gains from unionisation accruing to union and non-union members who remain in employment, will be understated. However, XY workers will now be unemployed (Elliot, 1990 : 434).

Figure 4.2 Union Wage Gaps And Wage Gains In A Two-Sector Economy



Source: Booth, 1995 : 60

4.2.4 THE EFFECT OF TRADE UNIONS ON ALLOCATIVE EFFICIENCY AND SOCIAL WELFARE

The standard monopoly view of trade unions is that they distort factor prices resulting in allocative inefficiency. Following Booth (1995 : 60 - 61) in the absence of trade unions allocative efficiency is achieved when identical factor inputs are distributed so that their marginal products across sectors are equalised. Given a fixed capital stock in the short-run, union induced wage increases will change relative factor prices. Union firms will employ fewer workers - in equilibrium the higher wage must be set equal to marginal product, that is, union firms move up the negatively sloped labour demand curve. Those workers who have lost their jobs in the union sector will enter the non-union sector, driving non-union wages down.

Unionisation, provided the unionised labour market would otherwise have been competitive, results in an efficiency loss. The total deadweight loss determined by the loss in producers' surplus following unionisation, less the gain in the workers' surplus, is given by triangle ABC in Figure 4.2 (Booth, 1995 : 61). The impact on aggregate labour income (social welfare) in the economy depends on whether the total wage bill after unionisation is greater or less than the total wage bill prior to unionisation. Referring to figure 4.2, aggregate labour income will increase if (O W^U/PBX + XCW^N/PL) > (OW*/PAZ + ZAW*/PL). A fixed surplus is available for sharing and hence if labour as a class has gained the capitalists (employers) will have lost. Capitalists will gain (or lose), depending on whether the post-unionisation return to capital (given by the sum of triangles GBW^U/P and HCW^N/P) is greater than (or less than) the pre-unionisation return to capital (area GAW*/P and HAW*/P).

In the long-run, the capital stock is variable and an increase in the wage rate induced by a union will cause the union firm to substitute relatively cheaper capital for more expensive labour (the substitution effect). The higher price of labour will also affect the output produced by the firm - the ratio of factor input price (W/r where W = wage rate and r = return to capital) will increase and less output will be produced. The output effect may have either a positive or negative effect on the demand for labour. The net effect may therefore be an increase or decrease in labour demand depending on the relative strengths of the substitution and output effects, and the production technology (Booth, 1995 : 62 - 63).

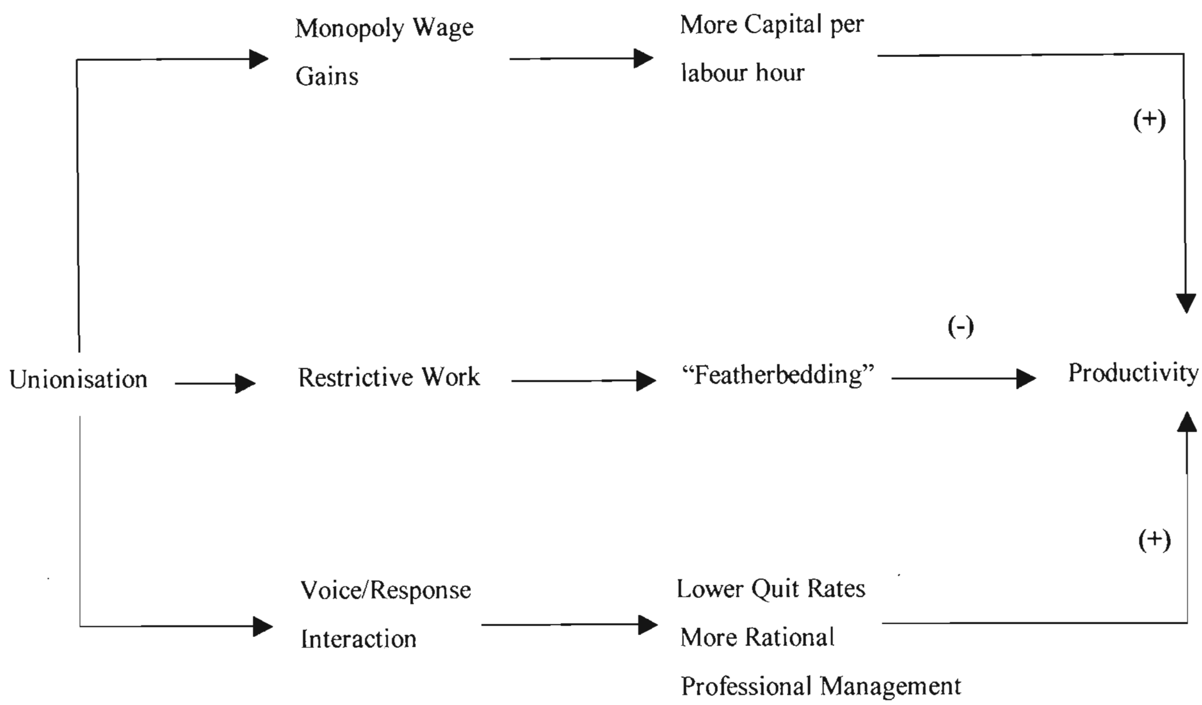
4.3 THE IMPACT OF TRADE UNIONS ON PRODUCTIVITY

The orthodox view of monopoly trade unions is that any monopoly wage gain they secure is at the expense of one or more parties: non-union workers who may be paid lower wages; consumers if any increase in costs is passed on as higher prices; or employers (capitalists) whose profits may be reduced (Booth, 1995 : 183).

Trade unions may have positive or negative effects in the economy depending upon the incentives faced and the regulatory environment within which they operate. Opponents of trade unions see unions as monopolists, limiting employment in order to raise the wages of members. Alternatively, unions may be viewed as efficiency enhancing in certain situations, in the sense that the existence of a union may serve to improve the organisation of the work place and the productivity of the work force (Booth, 1995 : 183).

Two popular views exist in the literature as to how this improved productivity is achieved. Unionisation may affect the organisation of production and workers' incentives, and hence both views fall under the broad heading of organisation theories. The first organisation theory is the so-called "shock" effect, whereby the advent of unionisation, with its associated higher labour costs, "shock" management into operating the enterprises more efficiently. This view presumes pre-union inefficiency. According to the monopoly view, firms respond to unionisation by changing capital (and other inputs) per worker and improving the quality of labour until the contribution of the last unit of labour just equals the union wage rate. Although unions may be able to use their monopoly power to lower productivity through restrictive work practices, competition in the product markets is unlikely to allow such behaviour to persist for very long (except in markets protected from competition). Figure 4.3 illustrates the effects of unionisation on productivity.

Figure 4.3 Unionisation and Productivity



Source: Freeman and Medoff, 1984 : 163

It is important to note that while the monopoly model predicts higher productivity in unionised firms than in comparable non-union firms, the monopoly-wage increase in productivity is socially harmful (Freeman and Medoff, 1984 : 164). The union wage premium distorts factor prices and causes a misallocation of resources - unionisation induces firms to substitute toward capital and higher quality labour. In turn, efficiency in consumption will be reduced if the cost increases are passed on so that the relative prices consumers face fail to reflect social opportunity costs. The private cost of union labour will exceed its social opportunity costs. Ultimately, too few workers/goods will be employed/produced in the union sector, and conversely in the non-union sector (Hirsch and Addison, 1986 : 181).

The first organisational theory follows Leibenstein (1966) in supposing that a firm's output depends not only on capital and labour inputs, but also on "X-efficiency" which includes such factors as the firm's motivational structure, managerial supervision, organisational variables and working conditions. Having to pay higher wages with the advent of unionisation "shocks" management into searching for cost savings elsewhere and consequently into more efficient practices (Booth, 1995 : 183).

The second organisational theory is the view that the advent of unionisation is associated with changes in procedural arrangements and improvements in worker morale and co-operation. Many aspects of labour contracts, and workplace characteristics are collective in native (i.e. public goods), for example, promotions, grievance procedures and safety provisions, and are therefore subject to the usual problems associated with preference revelation for public goods. According to Freeman and Medoff (1984) unions collect information about the preferences of all workers and enable firms to choose a more efficient mix of wage and personnel policies. In providing a means of expressing discontent other than through quitting, collective voice, that is the union, is said to reduce exit behaviour, lower hiring and training costs, and raise firm-specific investments (Hirsch and Addison, 1986 : 190). Thus, while unions may force up wages in the union sector, neither employment nor the firm's profitability need necessarily be greatly affected because higher labour cost may be offset by improved labour productivity. However, the Freeman and Medoff voice/response view has been criticised as logically inconsistent, since if unions did raise labour productivity by an amount sufficient to offset the union mark-up, unit labour costs would fall, and firms should be observed exhibiting an eagerness for unionisation (Polachek and Siebert, 1993 : 320).

Conversely, unions may be viewed as reducing worker morale and motivation, and obstructing the efficient organisation of capital and labour through the constraints they impose on management's choice set. The voice/response analysis identifies the "state of industrial relations" in a sector as a key factor in either raising or reducing productivity. Unions may have an adverse effect on productivity through industrial action (strikes), and in some cases the adoption of an adversarial rather than a co-operative approach to industrial relations. Therefore, whether the organisational effects of unions enhance or retard productivity is ultimately an empirical question (Booth, 1995 : 186).

Hirsch and Addison (1986 : 215) surveyed the American literature and concluded that ".. the longer-term effects of unionism are not encouraging". Booth (1995 : 223) states that ".. unionisation in both Britain and the USA appears, on average, to have a negative impact on productivity and productivity growth". Consequently without an accompanying productivity increase, profits will fall as trade unions induce firms to share their surplus (Booth, 1995 : 223). In South Africa wage demands have tended to exceed productivity increases, which has had the effect of eroding South Africa's international competitiveness. Excessive wage demands also tend to be inflationary thus impacting negatively on the economy.

4.4 THE IMPACT OF TRADE UNIONS ON EMPLOYMENT

The standard model of labour demand indicates that if a union sets a wage rate above the competitive level, the firm will move up its labour demand curve, cutting back employment to the point where the new union wage is equal to the (higher) value marginal product of labour (VMPL). The model predicts that the fall in employment is given by the product of the wage elasticity of labour demand and the union wage differential (Booth, 1995 : 216). However this prediction is problematic since if unions achieve sufficient productivity increases, employment may be unaffected. Given a union wage rate of W^U and a non-union wage rate W^N, an increase in the value of the marginal product of labour (VMPL) caused by unionisation will result in a small or even no net impact on employment for the competitive firm despite a union induced increase in wages (Booth, 1995 : 186). Furthermore, where unionisation of an imperfectly competitive firm occurs, a higher wage will redistribute some of the firm's abnormal profits to the workers and need not impact employment (Booth, 1995 : 216).

The potential problems are captured by the following model of labour demand outlined by Booth (1995 : 216 - 217). Consider a simple constant elasticity labour demand curve, written as

$$n = w^a x^b \tag{5}$$

where

n = the labour demanded

w = wage rate

x = exogenous factors affecting labour demand

a and b = constants

Taking the natural logarithms of (5) gives

$$\ln n = a \ln w + b \ln x \tag{6}$$

The labour demand of a union (n^U) and a non-union (n^N) sector will thus be given by

$$\ln n^U = a^U \ln w^U + b^U \ln x^U \tag{7}$$

and

$$\ln n^N = a^N \ln w^N + b^N \ln x^N \tag{8}$$

respectively.

The elasticity of demand in the union and non-union sector is given by $d\ln n^U / d\ln w^U = a^U$ and $d\ln n^N / d\ln w^N = a^N$ respectively. The union - non-union employment differential ($\ln n^U - \ln n^N \equiv d$) is obtained by subtracting (8) from (7):

$$d = a^U(\ln w^U - \ln w^N) + (a^U - a^N) \ln w^N + b^U \ln x^U - b^N \ln x^N \qquad (9)$$

The union - non-union wage differential is given by ($\ln w^U - \ln w^N$). The first term on the right-hand side of (9) is the product of the wage elasticity of labour demand in the union sector (a^U) and the union - non-union wage differential ($\ln w^U - \ln w^N$). The union - non-union employment differential will only be given by the product of wage elasticity of labour demand and the union - non-union differential if all other terms in (9) are equal to zero. Booth notes that it is unlikely *a priori* that $a^U = a^N$ or that $x^u = x^N$.

4.4.1 AGGREGATE UNEMPLOYMENT AND THE WAGE BARGAINING STRUCTURE

Over the 1980s the argument that the institutional structure of wage bargaining may have a significant effect on macroeconomic performance was proposed (Booth, 1995 : 243). Wage bargaining structures can be broadly divided into three groups. At the one extreme wage bargaining is decentralised, taking place at individual firm level. This type of bargaining occurs in the United States of America, Canada and Switzerland. At the other extreme, wage bargaining is centralised at the economy level - trade union coalitions and employers' federations negotiate wage settlements. Austria, Denmark, Finland, Norway and Sweden fall into this group. The third wage bargaining structure, intermediate bargaining at the industry level, falls in between these two extremes and characterises bargaining in countries such as the United Kingdom, France, Italy, Germany, the Netherlands, Australia and Belgium (Booth, 1995 : 244).

By the late 1980s, empirical evidence suggested a hump-shaped relationship between the degree of centralisation of wage bargaining and the maintenance of low unemployment given aggregate supply shocks (Booth, 1995 : 244). Countries with wage bargaining structures at the extremes of the spectrum seemed to experience smaller disturbances in unemployment after major supply shocks.

The theory underlying the effect of bargaining structure on economic performance follows the Calmfors and Driffill approach as put forward by Booth (1995 : 245-246). The basis of this approach is the elasticity of product substitution. Assuming that union utility is a function of both the real consumption wage, $w_i = W_i/P$, and employment, unions will know that higher wages translate into lower employment in the centralised and decentralised cases. The wage-employment trade-off effectively curbs the power of the unions.

In the decentralised bargaining case, the firm will try to pass the high money wage set by the union on to the consumer as a higher price for its product. Given that the firm is one of many in the industry, its product will have many close substitutes. If the firm passes the higher nominal wage costs onto the consumer, demand for its higher priced product will drop as will employment. The firm will produce less output and hence its demand for factor inputs including labour will be reduced. The demand for labour is derived from the demand for the product and following Marshall, wage elasticity of labour demand is greater the more elastic is the demand for the firm's product. The union leaders, knowing that a real wage gain can only be achieved at the cost of greater unemployment, will not press their employer for too high a money wage increase. Given that the economy consists of many firms, equilibrium aggregate unemployment will be low. Other reasons may exist for the wage moderation. For example, where firms impose sanctions on any firm in the industry that agrees to pay too large a wage increase, employer coordination as opposed to a very elastic product demand may restrict wage increases.

In the centralised case, all the firms in the economy will pass on as higher product prices any increase in the nominal wage achieved by the union coalition. Real wages will not rise. Should the monetary authorities elect to follow a non-accommodation policy, the real money supply will contract, reducing aggregate demand and leading to an increase in aggregate unemployment. The union coalition, aware of the trade-off, will set wages consistent with low equilibrium unemployment.

Booth (1995 : 246) identifies two potential problems with centralised wage bargaining. The first is wage drift. This is the tendency for certain sectors in strong bargaining positions to negotiate for themselves wage increases significantly greater than the increase determined centrally. Hence the ability of the central union coalition to coordinate its constituent unions and minimize wage drift will affect the wage constraint that a centralised bargaining structure can achieve. Second, centralised wage bargaining results in fixed wage relativities across sectors and may therefore be linked with allocative inefficiencies since fluctuations in relative wages cannot be used to signal shortages or surpluses of labour in sectors.

In the case of an intermediate-level bargaining structure, and in an economy of many industries, the nominal wage W_i will be set at the level of the ith industry. Substitutability between products of different industries will be low, and the industry union will be aware that the high nominal wage, W_i, can be passed on as higher prices for the product of the ith industry, P_i. The demand for industry output will not fall too much since industry demand is relatively inelastic (i.e. no close substitutes). Furthermore, given the many industries in the economy, the union is of the belief that the consumer price index P will not be affected by the price increase in the ith industry. Real wages, $w_i = W_i/P$, will rise with little effect on unemployment. If all industry unions follow the same pattern, P will increase, and real wages will be unaffected, but nominal wages and prices will have increased. Given a fixed nominal money supply, the real money supply will contract, leading to a fall in aggregate demand and an increase in aggregate unemployment. However, this will not be taken into account by the industry union in its wage setting.

Booth (1995), after reviewing the literature, finds that in both Britain and North America there is some evidence that unions are associated with a negative effect on employment growth.
Neo-liberal analysts consider trade unions ultimately responsible for distortions in the labour market which give rise to negative economic consequences, including bidding labour costs above market clearing levels, reducing both competitiveness and employment; establishing hindrances to flexible adjustment within firms that would increase productivity and reduce costs; undermining macro-economic stability through excessive (inflationary) wage settlements; and disturbing industrial peace (Lee, 1998 : 314). As well as these economic efficiency arguments, there exists an equity-based argument that holds that trade unions increase income inequality between members and non-members directly through the union wage premium and indirectly through the adverse impact they have on the employment prospects of non-members (Lee, 1998 : 314).

However it is argued by some that there is no clear-cut empirical evidence to support the neo-liberal view that trade unions produce damaging effects. The assertion that more flexibility in the labour market (i.e. limited involvement by trade unions and thus less union-inspired market regulation) is linked to better economic performance is unproven (Lee, 1998 : 315). Neo-liberals in support of their argument that rigidities in the labour market negatively impact on employment performance refer to the better employment performance since 1973 of the United States of America (depicting flexible labour markets) compared with that of Europe (seen to have rigid labour markets). They maintain that unless Europeans want permanent double-digit unemployment, they need to take steps to achieve greater flexibility in their labour markets.

Nickell (1997) and Nickell and Layard (1999) contend that while labour market features, some of which could be considered rigidities, do help sustain high levels of unemployment in certain European countries, there are numerous other so-called rigidities that do not result in high unemployment. Using data for the period 1983 to 1996, Nickell (1997 : 59) found that provided a high degree of coordination between unions and employers exists in the wage bargaining process, high levels of unionisation and union coverage will not have a significant impact on average levels of unemployment. He states, "...unions are bad for jobs, but these bad effects can be nullified if both the unions and the employers can coordinate their wage bargaining activities" (1997 : 68).

4.5 SUMMARY

Trade unions have both positive and negative effects. Freedom of association and the right to organise, which are closely linked to the basic political rights of freedom of expression, of assembly and from arbitrary arrest, are recognised as fundamental human rights. Such rights enable workers to mobilise a degree of bargaining power significant enough to curb employer behaviour that may be arbitrary, exploitative or retaliatory. Workers are able to share in the economic rents that result from imperfect competition and their involvement in the firm may boost productivity through improvements in worker morale, co-operation and the operation of the collective voice. Higher labour costs resulting from union wage demands will thus be offset by improved labour productivity.

However the negative effects of trade unions include the obstruction of the efficient organisation of capital and labour which impinges on management's choice set. Employment is adversely affected as employers seek to substitute relatively cheaper capital for the more expensive labour and its attendant hassles. Trade unions also impact on equity in the economy. Income inequality between union members and non-members is increased as a result of the wage premium enjoyed by union members and the consequent negative effect of this premium on employment in the union sector, which in turn induces "spillover" effects in the non-union sector. The supply of labour to the non-union sector is increased causing wages in the non-union sector to be bid down to levels below the prevailing union sector wage and increasing the level of unemployment in this sector.

The structure of the wage bargaining process is also important. It is argued that in centralised and decentralised wage bargaining processes trade unions take the effect of their wage demands on aggregate unemployment into account and set wages that are consistent with low equilibrium unemployment. This does not occur in the case of an intermediate-level bargaining structure. The impact of trade unions on aggregate unemployment is thus dependent on the wage bargaining structure, which is in turn affected by the country's labour market legislation.

5 TRADE UNIONS IN SOUTH AFRICA

5.1 INTRODUCTION

Although the economic consequences of the apartheid system were all pervasive, the principal implication for the labour market was severe segmentation, mainly between Africans and the other races. Black South Africans were effectively excluded from union membership until the early 1980s. This chapter looks at trade unionism in South Africa and the effects that trade unions have had on the country's wages. The validity of the segmented labour market and the labour aristocracy theories in the context of South Africa is then evaluated. A brief overview of the history of South Africa's trade union movement is provided in Appendix B.

5.2 TRADE UNION ORGANISATIONS

Trade unions in South Africa are relatively strong. In 1997, registered unions claimed a membership of 3,4 million, representing 46 percent of those in formal employment. This rose to 64 percent when domestic and agricultural workers were excluded (Barker 1999b : 280). In 1998 union membership stood at 3,8 million (an 11 percent increase from the previous year). This is high by international standards and very high by developing country standards, particularly given South Africa's high level of unemployment. However, it is argued that union density may be exaggerated since statistics do rely on union self-reporting, and are based on employment figures that exclude many unregistered enterprises and employees (which have low levels of unionisation), and on underestimates of employment (Barker, 1999b : 280). Nevertheless, evidence does point to trade unions playing and having played an influential and at times a militant role in the operation of the labour market.

The threat of a strike is the primary means by which unions are able to acquire power and is only credible if firms cannot immediately replace the workforce. It is therefore in the union's interest to achieve a monopoly over the supply of labour by organising all or the majority of the workers in the industry. Table 5.1 shows the cumulative number of man-days lost in South

Africa over the last decade due to strike action. It is clear from these figures that South African trade unions are prepared to exert their right to strike to achieve their objectives.

Table 5.1 Cumulative Number Of Man-Days Lost Due To Strike Action (In Millions)

1990	1991	1992	1993	1994	1995	1996	1997	1998	1999
4,0	3,8	4,2	3,6	3,9	1,6	1,7	0,65	2,3	3,1

Source: Andrew Levy & Associates, 2000 : 19

Andrew Levy & Associates (2000 : 19) note that most of the strike action in 1999 was high profile in nature, wage related, and highly emotional. Wages remained the major strike trigger, accounting for 97,2 percent of the total number of man-days lost or 80 percent of the number of strikes. The increase in strike activity can be attributed to employers who were moved by the weakening economy and the impacts of globalisation to assume a tougher position during wage negotiations, and on the country's second democratic election, which created a degree of instability in the bargaining environment (Andrew Levy & Associates, 2000 : 19).

Over the long-term union membership is expected to stagnate or even decline for the following reasons (Barker, 1999b : 283):

1) Over the last decade a significant drop in trade union membership has occurred across the world. Although membership growth in South Africa was the highest of the 92 countries surveyed by the International Labour Organisation in 1997, there are concerns about the future of trade unionism in South Africa. Sectors that traditionally have had a high union density are experiencing a decline in membership. Union membership in manufacturing has fallen and employment in mining, the sector with the highest union density, will probably continue to fall as the industry restructures and rationalises. Furthermore, future downscaling, outsourcing and privatisation could negatively impact the growth of unions in the public sector.

2) The labour force has been experiencing structural changes. A long-term trend away from unskilled, manual jobs to higher skilled, white-collar and service jobs, which have lower levels of unionisation, has been observed and this may negatively impact union membership. Most trade unions in South Africa are craft or industry unions and since workers are increasingly changing sectors and occupational categories, support for these types of unions will be weakened.

3) Employers, in attempting to keep their labour costs down, may try to bypass the unions. South Africa's accelerated integration into the global economy has meant that capital has become increasingly mobile. Labour costs now play a critical role in businesses' achieving competitive status and maintaining this position.

4) The growing popularity of employing atypical workers (temporary, part-time and contract workers) and outsourcing will affect unions as such workers are less likely to join unions. The growth of the informal sector and other small enterprises will also affect union density since these traditionally have low union membership.

5) Andrew Levy & Associates, consultants in the labour relations field, hypothesise that the influence and power unions possess will fall " and that this with other mega trends such as the application of technology, and the outsourcing revolution, will lead to a rethink, a restructuring and a re-definition of the conduct of employment relations" (2000 : 50).

Currently there are three major union federations in South Africa, namely:

1) The Congress of South African Trade Unions (Cosatu)
2) The National Council of Trade Unions (Nactu)
3) The Federation of Unions of South Africa (Fedusa)

These three federations form the labour constituency at the National Economic Development and Labour Council (NEDLAC). NEDLAC was established in 1995 as a means of facilitating cooperation and seeking agreement between organised business, organised labour, a development constituency and government on issues of economic, labour and development policy. In 1999, Cosatu held four seats and Nactu and Fedusa one each; government, labour and business hold six seats each at NEDLAC.

1) Cosatu

Cosatu was founded in 1985 and has since more than trebled its membership. It currently has a claimed membership of approximately 1,8 million and is the country's largest and most powerful union federation with 17 affiliates as of 1999. The federation was founded on principles of non-racialism and non-sexism; one industry, one union; worker control of the union; paid-up membership; one country, one federation and international worker solidarity (Andrew Levy & Associates, 2000 : 12 – 13). It is committed to a socialist economic system.

Cosatu adopted the Freedom Charter and is in a formal alliance with the African National Congress (ANC) and the South African Communist Party (SACP). However, Cosatu continues to confront the government on issues it feels strongly about (for example, its opposition to the government's macroeconomic policy, Growth, Employment And Redistribution (GEAR)).

Current growth is taking place in the public sector unions while unions in the private sector have been losing members due to ongoing retrenchments and rationalisation. The mining industry has been particularly affected. The continuing decline in formal sector job levels is expected to reduce its overall membership, ultimately affecting Cosatu's overall influence and effectiveness. To counteract this Cosatu is looking to organize the growing informal sector with the two-fold purpose of bringing these workers under the protection of the Labour Relations Act and increasing its membership (Andrew Levy & Associates, 2000 : 12 –13).

2) Nactu

Nactu, formerly a black consciousness movement with an Africanist leadership stance, now supports leadership by the working class. As of 1999 it had 19 affiliates and an estimated membership of 300 000 (Andrew Levy & Associates, 2000 : 14). The federation believes in non-affiliation to political parties; otherwise philosophies and principles correspond to those of Cosatu.

3) Fedusa

Fedusa was formed in 1997 when the Federation of South African Labour Unions (Fedsal) amalgamated with the Federation of Organisations Representing Civil Employees (Force) and it is the second largest trade union federation. Initially it had a predominantly white membership base representing skilled workers; now it has a majority of black members. As of 1999 membership stood at approximately 555 000 covering 27 affiliates (Andrew Levy & Associates, 2000 : 16).

FEDUSA has a policy of not aligning itself politically and it expresses support for "balanced" economic policies. It is founded on principles of equal opportunities and non-discrimination, professionalism and disciplined action (Andrew Levy & Associates, 2000 : 16).

5.3 WAGES AND TRADE UNIONS IN SOUTH AFRICA

The Second World War resulted in a labour shortage in South African cities. Urbanisation of Africans increased as the jobs vacated by white soldiers were filled by people of other races (Hofmeyer, 1998 : 3). However, demobilisation at the end of the Second World War and the defeat of the Smuts government in 1948, saw a substantial number of Africans lose their jobs. A surplus of labour developed and the real wage levels for Africans in the modern sector stagnated after having rapidly risen during the war (Hofmeyer, 1996 : 234). White wages continued to rise over this period partly as a result of apartheid policies that protected the white monopoly on skilled jobs. However the economy grew at a pace substantially faster than the population and by 1960 a shortage of skilled labour had developed causing the Nationalist government of the time to adjust its policies on immigration. Although the flow of skilled immigrants increased, the shortages continued to the extent that employers started to resist the law by training and promoting black workers to fill more skilled positions. The government finally accepted the need for a more skilled black worker and began to rapidly expand education from the early 1970s (Hofmeyer, 1996 : 234).

In the late 1960s shortages of unskilled labour (at least as far as males were concerned) had also arisen in wide areas of the country. Despite the presence of influx control and a policy discouraging the urbanisation of Africans, farmers had to approximately double real wages between the late 1960s and the late 1970s in order to attract and keep their workers (Hofmeyer, 1996 : 234).

An internationally fixed gold price meant that the mining industry had to keep costs in check. African wages were thus held at levels much lower than other industrial employees. This was made possible by the mining industry's access to foreign labour that was willing to accept lower wages than local labour because of greater poverty and a dearth of income-earning alternatives in their home countries. However the low wages paid during the 1960s made it increasingly difficult for the mining industry to attract South African labour. Hence it became clear that the continuation of this low wage policy would result in the mining industry's complete dependence on foreign labour. The increase in the gold price from the early 1970s combined with the political risks inherent in a dependence on foreign labour as emphasised by Malawi's withdrawal of labour following the crash of an aeroplane carrying migrant workers, and the coming into power of the hostile Frelimo government in Mozambique, caused the mines to revise their policy. (Hofmeyer, 1996 : 235) The decision was made to increase the proportion of local Africans, and to achieve this, a more competitive wage had to be paid. Thus average wages trebled in real terms and the proportion of local African workers increased from 25 percent to over 60 percent between 1971 and 1977. (Hofmeyer, 1996 : 235) Improvements in the conditions of employment in the urban areas resulted in labour shortages in the rural areas thereby forcing traditionally low wage employers to raise wages substantially in order to compete (Hofmeyer, 1996 : 235). However, after 1975 economic growth and employment growth collapsed with only a brief recovery at the end of the 1970s.

The Wiehahn Commission, appointed by the government to examine all aspects of labour relations, presented its first report in 1979 in which it recommended that Africans be given full trade union rights, and that existing trade unions be recognised and fully incorporated into the official industrial relations system. The government elected to adopt the recommendations in stages and by 1984 all restrictions had been removed. Thus with the recognition of full trade union rights for black workers, legislated apartheid in the labour market largely disappeared (Hofmeyer, 1996 : 235).

The relationship between unemployment and the wage changes that occurred in the post-war period can be divided into three phases. The first phase is characterised by a developing scarcity of African labour, even at the unskilled level for prime-age males. The labour market conditions were thus a cause and not a consequence of the increases in overall real wages. The wage increases enjoyed by African workers could be viewed as one of the natural consequences of economic growth, and thus would have no adverse effects on employment. Any mechanisation that took place because of the rising relative price of labour would have been entirely appropriate, since the rising price correctly indicated an increasing scarcity of labour (Hofmeyer, 1996 : 238).

The second phase began in the mid-1970s when the economy entered a severe recession. Pressure for higher wages dissipated and wage rates for large sections of the labour force, especially the less skilled, fell. Hofmeyer (1996 : 236) found that most occupational wage rates for males decreased in real terms between 1975 and 1985, particularly for the least skilled, and that occupational differentials increased. Unemployment and underemployment grew as labour supply exceeded demand. The development of a labour surplus is confirmed by the stagnation of agricultural and domestic wages after the mid-1970s, and the growing gap between them and industrial wages (Hofmeyer, 1998: 5). He notes that this growth in unemployment seemed to have been more a cause than a consequence of the wage changes. Unemployment rose as population growth outpaced the growth in overall modern sector prime employment.

The third phase began in the early 1980s when wage rates started to increase for large parts of the labour force. However, the increases seemed to be in inverse proportion to the level of skill. After 1985, occupational wage rates in the manufacturing sector began to rise but rising most for the least skilled (Hofmeyer, 1996 : 237). In the early eighties the mining sector also saw wage rates for unskilled Africans rising more rapidly than those of the skilled. The growing unionisation of African workers is identified as the most probable underlying cause of such wage movements since a narrowing of the skilled-unskilled wage gap is an important objective of trade unions. It thus appears that institutional factors played a more important role than market forces in sectors where such wage patterns were evident (Hofmeyer, 1996 : 237). The gap between industrial wages and agricultural and domestic wages continued growing which, as noted, is an indication of the absence of any labour shortage which would drive wages up (Hofmeyer, 1996 : 237). A study conducted by Moll (1993) showed that by 1985 black unions in South Africa had made wage gains similar to those made by unions in developed countries. The union wage effect for black male and female blue-collar workers in 1985 was about 24%, which is within the range of effects found in studies of unions in the United States of America but above those found for the European unions. As is typical of union action in developing countries, the black unions tended to reduce wage differentials across skill levels, raising the minimum wages for the unskilled. Employment actually started to decline after 1989. The net decline over the period 1985 to 1993 was 148 000 persons, or 0,2 percent per year (Barker, 1999 : 81). However in spite of growing unemployment real wages continued to rise as wage increases were consistently negotiated above levels of inflation.

The relationship that exists between union-driven wage increases and unemployment is complex. One cannot simply conclude that these union-driven wage increases directly caused the unemployment. However union pressure would have indirectly exacerbated any existing unemployment problem (Hofmeyer, 1996 : 239). Significant wage differences between similar jobs in different sectors and regions are a consequence of unionisation. Unionisation will therefore lead to an increasingly fragmented labour market.

5.3.1 LABOUR MARKET SEGMENTATION

The segmented labour market theory was developed to explain certain phenomena, such as the existence of large variations in the individual earnings of workers that differences in education and training levels could not satisfactorily account for. Segmentation involves the compartmentalisation of a market into non-competing segments. Each segment has its own characteristics, method of operation and little if no mobility takes place between them (Barker, 1999 : 24). Apartheid induced labour legislation prevented competition between races, between urban and rural Africans, and between Africans in different urban areas. The skilled jobs were reserved for the Whites while the Africans were restricted to employment in the unskilled sectors in the industrial and commercial centres and the Coloureds and Indians fell somewhere in between. In addition, Africans could not move freely between urban and rural areas, or between urban areas (Hofmeyer, 1998 : 6). The South African labour market was thus initially segmented along racial lines, but it is now argued that labour market is increasingly taking the form of a dual labour market.

A dual labour market is a special case of the segmented labour market and comprises two non-competing markets, namely the primary and the secondary labour markets. The primary sector consists of those in formal sector employment in large enterprises or under regulated conditions. In addition, employment in the formal sector is likely to be further segmented between those who have unionised jobs and those who do not. Employees in the primary market enjoy high earnings, good working conditions, upward mobility and stable employment (Barker, 1999 : 24). The secondary market is characterised by low paying low-skill jobs, limited upward mobility, unstable employment and low levels of unionisation. The secondary market includes the informal sector and firms that are typically over-competitive, small-scale and labour intensive (Barker, 1999 : 25). The feature distinguishing the primary and secondary markets is the extent to which the conditions in that segment are determined by market forces. The connection is very loose in the primary market and much more direct in the secondary labour market (Hofmeyer, 1996 : 240). Wage levels in the primary sector are determined under union pressure and by taking seniority, career scales etc. into consideration and tend to be significantly higher than the market-determined or market-clearing levels. This is particularly true if working conditions, job security and promotional prospects are included (Hofmeyer, 1996 : 240). Wages (or earnings in self-employment) in the secondary sector are generally close to market-clearing levels. Individuals employed in the primary sector become part of the privileged elite or 'insiders' while those employed in the secondary sector are 'outsiders'. Jobs in the primary sector are thus in demand. Although an oversimplification, Hofmeyer (1996 : 240) holds that this model captures the essential aspects of the South African situation.

Unions can exacerbate segmentation and Hofmeyer (1996 : 240 - 241) illustrates this using the example of the one-off costs associated with the hiring and firing of labour. The existence of these costs is one cause of segmentation. To reduce such costs, firms will attempt to minimise labour turnover and create long-term employment relationships. If employees share this cost by, for example, accepting a lower wage during training, they will also prefer a long-lasting employment relationship. Effectively both employer and employees undertake an investment the returns of which will be increased by ensuring that the employment relationship lasts as long as possible. A bilateral monopoly is created to a degree thereby allowing bargaining over the size of the return received by each party. Unions can use this power to extract the maximum possible wage and thus maximise the wage differences that characterise the segmentation of the labour market (Hofmeyer, 1996 : 241). These wages may lead to additional mechanisation. As mechanisation takes place employment will contract or expand at a slower rate than would otherwise be the case, forcing a larger proportion of the labour force to enter the secondary labour market, depressing earnings in this sector and further exacerbating segmentation (Hofmeyer, 1996 : 241).

5.3.2 THE LABOUR ARISTOCRACY THEORY

The idea of a labour aristocracy was developed in the late-nineteenth century by Socialists in an attempt to explain workers' failure to rise against capital. They argued that a section of the working class had abandoned their revolutionary destiny – the artisans due to their skills were interested in maintaining the status quo. Hostile to the changes sought by the working mass, the artisans behaved like the old aristocracy, undermining efforts at a revolutionary reconstitution of society (Adler and O'Sullivan, 1996 : 166). This "new" labour aristocracy was seen as benefiting directly from, or co-conspiring in, the capitalist exploitation.

The development of nationalist independence movements at the end of the colonial era saw the labour aristocracy theory redeployed to explain the gap between the small and seemingly privileged urban wage force and the mass of poor peasants, and the inability of the former to lead a progressive movement in the interests of the latter. For this reason African Marxists preferred national liberation led by the peasants (Adler and O'Sullivan, 1996 : 167).

In the 1960s and 1970s liberal analysts adopted the view that projects aimed at national development constituted a type of class domination in which the urban elite - owners and workers - created policies that intentionally favoured the cities and manufacturing at the expense of agriculture (Adler and O'Sullivan, 1996 : 167). This neo-liberal formulation of the labour aristocracy thesis became very influential with the onset of the debt crisis in the 1980s. The World Bank and the neo-liberal analysts held that the urban elite played a central role in the debt-based development projects that were blamed for the crisis. Structural Adjustment Programmes (SAPs) consisting of budget cuts, privatisation, currency devaluation and price and tariff liberalisation, *inter alia*, were introduced to reverse policies that favoured the urban elite (Adler and O'Sullivan, 1996 : 167).

The use of the labour aristocracy thesis in Africa in both its Marxist and neo-liberal form has been criticised. Adler and O'Sullivan (1996 : 168) argue that the real income levels of urban workers and the extent of the difference between African workers and peasants (urban and rural workers) are exaggerated, while the more significant inconsistencies between property and non-property owners are ignored. They claim that the division of the labour force into urban insiders and rural outsiders disregards the interdependence and support available between urban and rural life. The second criticism of the thesis is its failure to correctly interpret the political orientation of African workers who are much more likely to oppose rather than act in agreement with the elite group (Adesina, 1992 cited in Adler and O'Sullivan, 1996 : 168). Despite these criticisms the labour aristocracy thesis continues to form part of the World Bank and International Monetary Fund (IMF) orthodoxy. After 1990 the renewed involvement of the World Bank and the IMF in South African development policy debates led to the revival of the labour aristocracy thesis in the country (Adler and O'Sullivan, 1996 : 168).

In the past in South Africa, Marxists and neo-Marxists referred to the labour aristocracy thesis to explain the characteristics associated with a labour market distorted along racial lines, and the high wages, good living conditions and the political behaviour of white workers (Adler and O'Sullivan, 1996 : 169). Current supporters of the labour aristocracy thesis grant less attention to the political and racial aspects, emphasising instead organisational factors in the labour market that place unionised formal sector workers in positions of unfair advantage (Adler and O'Sullivan, 1996 : 169).

Following the general neo-liberal view, the strong trade unions in South Africa drive the price of labour up beyond workers' contributions to productivity improvements and the current supply of labour. The high relative cost of labour encourages mechanisation as opposed to labour-absorbing production processes which would be more appropriate for an economy with a labour surplus. Industry thus becomes too capital intensive and investment is drawn away from other important areas. Growth provides high incomes for union members while little occurs to reduce unemployment (Adler and O'Sullivan, 1996 : 169). Unions are blamed for the gap between the high wage sector, and low-wage earners and the unemployed because of the emphasis they place on increases based on a living wage for their members (as opposed to productivity-linked increases), and it is argued that the centralised bargaining favoured by unions, leads to wage gains throughout the economy, even where firms are not in a position to pay and where workers are not particularly productive (Adler and O'Sullivan, 1996 : 169).

In South Africa the labour aristocracy thesis has thus come to characterise the differences between unionised workers and non-unionised workers, informal sector workers, the unemployed and rural people (Adler and O'Sullivan, 1996 : 170). Union members in the formal sector are seen as a rent-seeking special interest group whose behaviour benefits union members at the expense of job creation, non-members and the unemployed. The solutions suggested by the neo-liberals vary but the common points are deregulation of the labour market and the weakening of the unions' ability to achieve generalised wage gains through collective bargaining. Adler and O'Sullivan (1996 : 170) believe that this would involve restricting bargaining councils' abilities to extend wage and working condition agreements to non-parties, developing a second deregulated tier in the formal labour market, and/or creating incentives for the development of the informal sector.

The labour aristocracy thesis is based on the assertion that union members experience a considerably better standard of living (measured in terms of income) than non-union workers and the unemployed. A tyrannical relationship is held to exist between these two groups with unionised workers benefiting at the expense of non-union members. However Adler and O'Sullivan (1996) showed using data from the Central Statistical Service's 1994 October Household Survey, that South African unionised workers do not enjoy a substantially improved standard of living compared to their non-unionised counterparts. They found that although African workers benefited from union membership, enjoying income levels higher than non-unionised workers with similar education levels, the differences were not statistically significant. Furthermore, the gap between unionised African workers and non-unionised African workers is smaller than that which exists between all African workers whether unionised or not, whether well educated or not, and white workers with very limited education (Adler and O'Sullivan, 1996 : 178). The aristocracy revealed by their data is one based on race or education.

5.4 SUMMARY

Trade unions play a major role in the South African labour market as evidenced by the high levels of trade union membership particularly in the formal non-agricultural sector. The South African labour market is characterised by elements of both the labour market segmentation and labour aristocracy theories in that the unionised sector of the labour force has successfully used its bargaining power derived largely from the threat to strike, to achieve wage increases in excess of contributions to greater productivity and the wage increases enjoyed by non-unionised workers. The extension of bargaining council wage and conditions of employment agreements to include non-party employers and employees within the jurisdiction of the council has further served to standardise these high wages and worker-friendly conditions of employment across sectors. High relative labour costs have encouraged the replacement of labour by capital increasing unemployment and discouraging job creation in the formal sector of the economy.

6 GLOBALISATION AND TRADE LIBERALISATION

6.1 INTRODUCTION

The establishment of a democracy in 1994 brought an end to South Africa's apartheid-related isolation. Globalisation, that is " ... the accelerated integration of economies throughout the world through trade, financial flows, the exchange of technology, information and ideas, and the movement of people" (Calitz 2000 : 1), is thus a fairly recent challenge for the country.

Globalisation "... is driven by firm strategies to exploit competitive advantages internationally, use favourable local inputs and infrastructure, and locate in final markets" (OECD, 1994 : 26). Therefore a consequence of globalisation is business' preference of certain countries based on their assessment of the country's ability to satisfy their requirements and to provide a hospitable and supportive environment. The ability of a country to grow and create opportunities will thus depend to a large degree on whether or not the assessment of its business environment is favourable. The factors that influence a country's attractiveness as a location for business comprise labour legislation, the extent of trade unionisation, the educational and skills profile of the labour force, and the presence of infrastructural prerequisites, including social stability and predictable and honest government (Andrew Levy & Associates, 2000 : 52).

South Africa's potential for economic growth is affected by international conditions, the most influential being the terms and availability of international investment and the growth in exports (Sellars, 2000 : 487). Calitz (1997 : 323) notes, "The welfare benefits to be derived from [globalisation] are strongly correlated with the extent to which effect is given to the principles, policies and practices which ensure that the growth in the world economy benefits the South African economy maximally *via* foreign trade and investment".

This chapter considers the effects of globalisation on labour markets, and the impact that globalisation has on a country's comparative advantage. The chapter then looks at trade liberalisation in South Africa and the impact that this has had and is having on the labour market in the context of increasing integration in the global economy.

6.2 GLOBALISATION AND THE LABOUR MARKET

Increasing globalisation has meant that capital is no longer a fixed factor of production, rather it moves around the world, taking advantage of profitable investment opportunities. Labour, on the other hand, is less mobile and hence labour costs play an increasingly determinant role in a country's comparative advantage (Nattrass, 1998 : 72- 73). As trade barriers and transport costs fall, firms in developed countries, who pay wages inconsistent with productivity, will be out-competed by lower-wage developing countries. Low productivity sectors will end up situated in low-wage developing countries, and the more skill-intensive sectors will be situated in developed countries where higher wages are accompanied by higher productivity (Nattrass, 1998 : 72-73). This will affect labour markets. As cheaper, less-skill-intensive imports enter a country, the wages of workers in the import-competing sector of the economy will fall or the import-competing part of the industry will go out of business. In the latter case, the displaced workers will enter other sectors, bringing down wages for all the unskilled, or if they are unable to find alternative employment, they will enter the pool of unskilled unemployed. On the other hand, the movement of capital into skill-intensive sectors and the upgrading of technologies by existing enterprises as they implement 'defensive innovation' will cause the wages of skilled workers to rise (Nattrass, 1998 : 73). Economic theory thus predicts that a decrease in the demand for unskilled labour will lead to a fall in the equilibrium real wage and a reduction in unskilled manufacturing employment, particularly where labour market regulation provides a wage floor (Nattrass, 1998 : 74).

This theory is supported by trends in advanced capitalist countries. The growth of low-skill-intensive manufactured imports from developing countries was followed by a fall in demand for less-skilled workers and an increase in manufacturing productivity (Nattrass, 1998 : 73). Given data deficiencies and disputes over methodology, the exact effect that international trade has on developed country labour markets cannot be determined. However, there is consensus that international trade does have some effect. Wood (1997 : 33) states that "...the debate over trade and inequality in *developed* countries is now over the *magnitude* of the effects, with their *direction* - adverse to unskilled workers - being largely agreed".

6.3 TRADE LIBERALISATION IN SOUTH AFRICA

At the beginning of the 1900s agriculture and the newly emerging mining industry formed the basis of the South African economy. Jones and Muller (1992 : 15) note, "In 1910 the mines were the source of capital, the engine of growth and the lubricating oil that made the whole system work smoothly". In 1898 South Africa had become the largest gold producer in the world and has remained such ever since (with only one small exception during World War I). This emergence of a powerful mining industry facilitated South Africa's transformation from a poor agricultural economy into Africa's industrial leader and an important force among the world's emerging markets (Innes, 1999 : 9).

During the early 1900s the manufacturing industry was virtually non-existent and most of the country's manufactured goods were imported, largely from Britain. The First World War disrupted the production of civilian manufactures in England and Europe, providing an important boost for South Africa's manufacturing industries.

In 1922, political leaders started to take the development of the country's economic infrastructure seriously. The Smuts government established the Electricity Supply Commission (Escom) in 1922 and the Pact government (a National Party and Labour Party alliance which had come to power in 1924), formed the South African Iron and Steel Corporation (Iscor) in 1928. The Pact government felt it important that South Africa become economically independent and in 1925, a policy of import-substituting industrialization was adopted. This was implemented by means of import controls and the establishment of parastatals in key industries. Rapid industrial growth and diversification resulted initially. However, the import substitutes produced primarily met the demand from the narrow middle- and upper-income group and hence the potential for long-run growth was constrained. South Africa was thus in a position to take advantage of the growth opportunities provided by the outbreak of the Second World War in 1939 (Innes, 1999 : 12).

In the post-war period, world trade normalised and South African industries were open to foreign competition. However, the Sharpeville riot in 1960 initiated a sudden and sharp capital outflow leading to the introduction of foreign exchange controls and the decision to leave the Commonwealth by the National Party. Import controls and tariff barriers were extended with the aim of establishing a protected environment in which South Africa's industries could grow.

At this time the Free State gold fields produced huge revenues and due to the foreign exchange controls, the mining houses had little choice but to invest a large part of their revenue in South Africa's manufacturing and financial industries. Over the period 1961 to 1972 South Africa experienced an economic boom with economic growth rates averaging 5,3% per annum (Barker, 1999b : 80). However the small size of the domestic market, the foreign exchange controls, the dead weight of state regulation and controls, the inefficiency of many state enterprises, the negative effect of poor education and skills development on productivity, and the political instability following the Soweto uprising in 1976, all made South African industry less efficient and the investment environment more risky (Innes, 1999 : 12).

By the 1970s the limitations of an import-substituting industrialization policy were becoming evident. The protection of import-substituting industries had created an anti-export bias in the manufacturing sector. This led to a shift in the emphasis of the country's trade policy to export promotion and the adoption of export incentives, although they were initially limited in scope and largely unsuccessful. The export drive culminated in 1990 with the introduction of the General Export Incentive Scheme (GEIS). GEIS applied mainly to industrial or processed products and producers qualified for a tax-free subsidy of a percentage of the Rand value of their exports with the percentage depending on the degree of processing and local content (ILO, 1999: paragraph 7 – 11). GEIS promoted natural-resource-intensive manufacturing exports relatively successfully. Labour-intensive sectors on the other hand, took less advantage of the scheme (Belli, Finger and Ballevan, 1993 and Jenkins, Bleaney and Holden, 1995 cited in ILO, 1999 : paragraph 11). After the 1985 foreign debt crisis, South Africa began to exhibit the typical developing country pattern, tending towards a debt trap, accompanied by falling raw material prices and capital outflows (Barker, 1999b : 81). The average economic growth rate for the period 1985 to 1993 was a mere 0,6% per annum - a consequence of political uncertainty, disinvestment and sanctions experienced in the country (Barker, 1999b : 81).

The year 1994 saw the birth of democracy in South Africa and while the new government has made progress in opening South Africa's economy to global trends, the results of 40 years of protectionism could not be instantaneously reversed. Economic growth continued to be disappointing. Although growth in real gross domestic product picked up in 1995 and 1996 growing at 3,1% and 4,2% respectively, it fell thereafter recovering to 3,1% in 2000.

In the environment of globalisation, macroeconomic stability forms the platform for economic liberalisation. South Africa has, in line with the international trend, expanded the importance awarded to a macroeconomic stabilization policy to include structural reform or development of the economy (Calitz, 1997 : 323). Macroeconomic stability is considered a necessary condition for sustained economic growth, which in turn is considered a necessary, but not a sufficient, condition for income redistribution and poverty alleviation in developing countries (Calitz, 2000 : 3).

South Africa has pursued a gradualist approach to economic reform following largely (with the exception of the labour legislation and certain tax measures) the ideal policy sequence of reform that has come to be known as the Washington Consensus. Such a reform process involves, in chronological order, as outlined by Weiss (1995, cited in Calitz 2000 : 6):

a) Macroeconomic stabilisation - particularly in terms of expenditure restriction and exchange rate adjustment.

b) Reform of domestic commodity and labour markets - removing price and wage controls and phasing out subsidies.

c) Tax reform - broadening the tax base and rationalising many taxes.

d) Trade reform - removing quotas and reducing tariffs plus further exchange rate adjustment.

e) Domestic financial liberalisation - removing or raising interest rate ceilings and relaxing restrictions on commercial bank activity.

f) External financial liberalisation - removing controls on capital inflows and outflows.

A trade liberalisation program was initiated and an agreement with the World Trade Organisation (WTO) was signed in January 1994. This agreement involved reducing the general level of tariff protection from a weighted average of 30 to 15 percent over a 5 year period, rationalising the tariff structure and replacing import quotas with tariff measures in respect of agricultural imports (Calitz, 2000 : 5). In 1994, the decision was taken to phase out GEIS since such a scheme is not allowed under the General Agreement of Trade and Tariffs and World Trade Organisation rules, and by mid-1997, the programme had been terminated entirely. Liberalising trade is a significant structural change, the benefits of which can be expected once the anti-export bias created by the previous import-substitution policy has been removed and "...the country enters a path of higher, export-led growth benefiting from the dynamic gains from foreign trade" (Coetzee, Gwarada, Naude and Swanepoel, 1997 : 165).

The government also implemented a process of external and domestic financial liberalisation and adopted a conservative fiscal and monetary stance.

The export-oriented industrialization policies adopted in Latin America and South Africa in the 1980s and 1990s did not achieve the eminent success of similar policies adopted earlier by East Asian countries. Conventional wisdom holds that as developing countries adopt more outward-oriented policies (i.e. become more open to trade) efficiency will increase and wage inequality will fall. This argument is based on the fact that the relative supply of unskilled labour to skilled labour is greater in developing than in developed countries, and on the Heckscher-Ohlin theory of trade which asserts that countries export goods that use relatively abundant factors of production intensively and import goods that use relatively scarce factors intensively (Wood, 1997 : 34). Given the abundance of unskilled workers in developing countries, increased trade will push the relative demand for unskilled workers upwards, reducing the gap between unskilled and skilled workers' wages and unemployment rates (Wood, 1997 : 34).

The experience of East Asian countries in the 1960s and 1970s supports the conventional wisdom but that of Latin America and South Africa in the late 1980s and early 1990s does not (Wood, 1997 : 42 – 46). One explanation lies in the differences between East Asia, and Latin America and South Africa. The other, and considered by Wood (1997 : 55) as the more likely explanation for the reasons mentioned below, is that the international environment faced by Latin America and South Africa differed greatly from that encountered by the Asian tigers when they entered the international market and adopted export-oriented industrialisation policies. Firstly, the volume of international trade as a proportion of total output has greatly increased (Nattrass, 1998 : 72). Secondly, low-income countries such as Bangladesh, China, India, Indonesia and Pakistan, which were closed to trade in the 1960s and 1970s, now dominate low-wage, labour-intensive (and relatively unskilled) export production (Nattrass, 1998 : 72). Indonesia and China lead the move and by the mid-1980s all five countries were opening to trade. Half the world's population and an even greater proportion of the world's unskilled workers live in these five countries. During the period 1987 to 1993, manufactures imported by developed countries from these countries nearly quadrupled from $28 billion to $110 billion (about one-third of all manufactured imports from developing countries) while developed countries' imports from middle-income countries increased by less than 50 percent (Wood, 1997 : 48 -49).

Wood (1997 : 49) notes that the opening to trade of these low-income countries is likely to have changed the comparative advantage of middle-income countries which have intermediate ratios of skilled to unskilled labour, that is, above the global average but below that of developed countries. In the 1960s and 1970s, developed and middle-income countries effectively made up the economic world, and hence the comparative advantage in low-skill-intensive goods fell to the middle-income countries. In the 1980s, low-income Asia began to establish its own comparative advantage in low-skill-intensive goods. This shifted the comparative advantage of middle- income countries to goods of intermediate skill intensity (Wood, 1997 : 49). The East Asian economies that had opened to trade in the 1960s (Hong Kong, the Republic of Korea, Singapore and Taiwan) experienced rapid skills growth, facilitating a shift in their comparative advantage towards goods of intermediate skill intensity (Wood, 1997 : 49).

He concludes that it is likely that the effect on relative wages in a middle-income country as it opens to trade has changed over time. In the 1960s, greater openness would have increased the relative wage of unskilled workers, since given a comparative advantage in goods of low skill intensity, sectors of above-average and below-average skill intensity would have shrunk and expanded respectively. However, opening to trade in the 1980s resulted in discrepancies in the effects on relative wages. Contraction occurred in sectors of both high skill intensity (replaced by imports from developed countries) and low skill intensity (replaced by imports from low-income countries). The overall effect could be in either direction. The middle-income countries of Latin America experienced a widening of the gap between skilled and unskilled workers in this period (Wood, 1997 : 49).

The argument that globalisation results in net job losses has the support of Cosatu workers despite assurances from the Minister of Trade and Industry, Alec Erwin, that export expansion will create more jobs than will be lost through greater import penetration (Nattrass, 1998 : 79). Bhorat and Hodge (1999 : 378) found that domestic firms responded to trade liberalization by increasing their capital-labour ratios "in a bid to remain competitive through higher productivity and more efficient methods of production". They conclude that the structure of labour demand in firms today is characterized by a rising demand for skilled and semi-skilled workers and the rationalization of workers "at the bottom-end of the occupational ladder". Bell and Cattaneo (cited by Nattrass,1998 : 79) found that between 1985 and 1993 employment in manufacturing fell, but employment associated with manufactured exports increased by 3,1 percent per annum. However, the fall in the labour intensity of manufactured exports relative to that of imports and the manufacturing sector as a whole elicits concern. Bell and Cattaneo (1997) calculated that a shift in the sectoral composition of exports accounted for 36 percent of the decline in average labour intensity. They also noted sectoral shifts away from relatively black labour-intensive industries and towards white labour-intensive industries, which, to the extent that race is a proxy for skill, indicates that exports have become more skill intensive. Nattrass (1998 : 80) draws on Tsikata (1998) for confirmation of this trend, ".. South Africa has a "paradoxical" export structure with a remarkably low and declining share of exports that use unskilled labour, and a relatively high share that use more skilled labour." Tsikata (1998) identifies comparatively high wage levels (relative to productivity), which place South Africa at a competitive disadvantage in low-wage, unskilled-labour-intensive activities, as a cause of this trend.

Hayter (cited in Sellars, 2000 : 493), in a study of more recent data, found that while capital-intensive products made up 51 percent of exports in 1993, rising to 52 percent in 1997, labour-intensive products fell from 49 percent of imports in 1993 to 48 percent in 1997. Both Hayter (1998) and Edwards (2000, cited in Sellars, 2000 : 493) found that over the 1993 – 1997 period employment in the capital-intensive manufacturing sectors fell by more than in the labour-intensive sectors. Studies by Bhorat (1999) and Edwards (2000) and cited by Sellars (2000 : 493) show that the fall in employment occurred among the unskilled, the fall being attributed by the authors to tariff liberalization and technological change respectively.

The increase in the demand for skilled labour in the export sector is troubling, particularly in light of the negative impact skilled labour shortages have on economic growth. Furthermore ultra-labour-intensive imports, such as clothing, wood and wood products, from low wage countries are rising whereas South African exports in these categories are falling (Nattrass, 1998 : 84). The fall in the demand for unskilled labour, at least in the export sector, is not encouraging with regards to the ability of the economy to provide jobs for the unskilled unemployed. Furthermore, the current labour market legislation characterised by rigidity is likely to bring about job losses as opposed to a considerable fall in wages, particularly in the import-competing sectors.

Sellars (2000 : 495) concludes that, "...international competitive forces appear to be the decisive factor driving changes in the structure of manufacturing". This is unsurprising given the accelerated integration of South Africa into the global economy. If South African industries are to succeed, they must rationalize. However Sellars (2000 : 496) argues against slowing down the trade liberalisation process since in the medium- to long-term free trade will contribute to growth and employment creation.

6.4 SUMMARY

It appears that trade liberalisation, particularly in the current context of increasing globalisation, has a negative effect on employment in the short term as firms are forced to rationalise so as to become and remain internationally competitive. The development and implementation of a labour-demanding growth strategy rests on the successful coordination of a growth-oriented macroeconomic policy, a labour market policy that is conducive to competition in the labour market, and a trade policy that promotes exports and encourages greater investment in the economy.

7 LABOUR MARKET REGULATION IN SOUTH AFRICA

7.1 INTRODUCTION

The dominant view is that rigidities in the labour market inhibit the efficient functioning of the market. The basic assumption, therefore, is that anything that prevents wages and other employee benefits from falling to market clearing levels will slow down job creation (Schlemmer and Levitz, 1998 : 52). This chapter considers the regulatory environment in which the South African labour market operates and analyses the consequences this environment has for employment.

7.2 SOUTH AFRICAN LABOUR LEGISLATION

South Africa has moved from being a relatively closed and protected economy to greater integration with international markets. In becoming more competitive, unviable jobs must be eliminated and new jobs will be created more gradually, at least in the initial stages of trade liberalisation. The argument that trade liberalisation and other economic reforms should be accompanied by greater labour market flexibility is supported by international evidence (Nattrass, 1998 cited by Barker, 1999a : 11). A more market oriented labour market, that is, greater flexibility in the labour market, is an element of the fundamental reform process, which has come to be known as the Washington Consensus, and forms the development strategy suggested by the World Bank, the International Monetary Fund, and the government of the United States of America (Calitz, 2000 : 3).

The demand for labour is a derived demand, that is, it is derived from the demand for the product or service provided by the employer. The demand for labour is thus indirectly affected by economic conditions, for example, expansionary or tight fiscal and monetary policies, and domestic and foreign competitive conditions (Barker, 1999b : 77). The demand for labour is also directly affected by the cost of labour and the productivity of labour. The price at which the firm's output can be sold is influenced by labour costs and the productivity of labour. The price charged impacts in turn the demand for the product and hence the demand for labour.

As noted in the previous chapter, South African trade flows are characterised by capital-intensive exports and labour-intensive imports. Given South Africa's abundance of labour (as evidenced by the high rate of unemployment) and trade liberalisation, which has involved the removal of industrial incentives that created a bias towards capital-intensive sectors, one would expect a shift towards labour-intensive specialisation (ILO, 1999 : paragraph 68). This has not occurred; instead, the economy continues to follow a path of capital-intensive specialisation. The popular explanation for this pattern, confirmed by research[1], is that South Africa's unit labour costs are not competitive.

Where labour market institutions and policies raise the costs of labour, whether direct or indirect, employment will be discouraged and where possible employers will switch to the use of capital-intensive technology. This means that appropriate labour policies have a crucial role to play in determining a country's ability to adjust to and face international competition. Furthermore, globalisation is having a significant impact on domestic economies. Capital has become more mobile, and the cost of labour increasingly more important as a factor influencing a country's competitive standing in the international market.

Labour market rigidities have their sources in the laws and regulations, the institutions created by these laws and regulations, and union intransigence. Siebert (1997 : 43) identifies three ways that institutional arrangements can affect the clearing function of the labour market:

> "by weakening the demand for labour, making it less attractive to hire a worker by explicitly pushing up the wage costs or by introducing a negative shadow price for labor; by distorting the labor supply; and by impairing the equilibrating function of the market mechanism (for instance, by influencing bargaining behavior)".

In 1995 the Department of Labour decided to restructure the South African labour market by introducing a series of legislative reforms which were aimed at improving labour relations,

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[1] A SRI International study (1998) found that of all the countries taken into account, South Africa had the highest productivity adjusted cost of labour. Nattrass (1998) found that in a sample of eighteen developed and developing countries, only the United Kingdom had a higher wage to productivity ratio than South Africa. The World Economic Forum in their *Global Competitiveness Report* place South Africa in 46th position out of 58 countries on the basis of wage adjusted productivity levels. (All cited in Sellars, 2000 : 497)

securing worker rights, balancing the requirements for flexibility with the need for employment security and redressing inequality and discrimination (ILO, 1999 : paragraph 112).

The National Economic Development and Labour Council (NEDLAC) was formed to facilitate co-operation and seek consensus between organised business, organised labour, the development constituency and government on economic, labour and development issues (Barker, 1999b : 275) The following legislative reforms resulted from the tripartite negotiation process:

1) The Labour Relations Act of 1995
2) The Basic Conditions of Employment Act of 1997
3) The Employment Equity Act of 1998
4) The Skills Development Act of 1998

These pieces of labour legislation have had and are having a negative effect on the cost of labour (direct and indirect) and on workplace flexibility (Barker, 1999a : 13).

7.2.1 THE LABOUR RELATIONS ACT

The Labour Relations Act (LRA) formalizes and codifies union organisational rights; establishes a basis for economic democracy at the workplace; grants workers the right to strike (without fear of dismissal); introduces speedy dispute resolution; and extends the law to all workers (Baskin and Satgar, 1995 : 46). The LRA has improved job security; most employees, including agricultural, domestic and public sector employees, are now covered by a single set of laws. The new LRA is substantially more union friendly than its predecessor and it recognises trade unions as an integral part of economic decision making (Baskin and Satgar, 1995 : 47).

Job security rules do however make employers reluctant to hire new workers on indefinite period contracts. A survey of firms employing 50 or more workers in eight manufacturing industries in the Greater Johannesburg metropolitan area conducted in 1999 found that the average time taken to retrench an entry level worker is 2.7 months, costing R2 160 – 2 900 for a worker in the least skilled occupational category (Stryker, Cassim, Rajaratnam, Bhorat, Leibrandt, Plunkett, 2001 : 67). The result is an increasing tendency to substitute capital for labour or make use of atypical employment (subcontractors, casual and temporary workers) or to only engage workers on fixed-term contracts (Barker, 1999b : 38). It is very likely that unemployment would increase.

On the other hand, increased job security could lead to employers being more selective in their recruitment, thereby ensuring better job matching. Employers may also be encouraged to invest more in training workers. Workers may also become less resistant to change as the fear of losing their jobs is reduced. Although little evidence to prove either the negative or positive effect of high job security exists, many countries have in fact relaxed or are in the process of relaxing job security regulations (Barker, 1999b : 38).

7.2.1.1 TRADE UNIONS, COLLECTIVE BARGAINING AND THE LABOUR RELATIONS ACT

W. H. Hutt considered labour unions in their current form as impediments to improving the welfare and prosperity of workers in general (Baird, 1998 : 197). Instead he advocated trade unions that are compatible with the principles of classical liberalism. Hutt's labour economics influenced Britain's labour law reforms conducted during the 1980s under Margaret Thatcher's government, and New Zealand's 1991 Employment Contracts Act (Baird, 1998 : 197) According to Hutt, labour relations institutions should be founded on (i) voluntarism for all parties, (ii) equality before the law for all parties and (iii) universal human rights (Baird, 1998 : 198).

Voluntarism requires that individuals have the right to choose, that is, workers can decide whether to join a union, be represented by a union or become a union fees payer; and employers can elect whether they wish to bargain with unions and then select the issues that will be bargained over (Baird, 1998 : 198). Equality before the law requires that all parties be governed by the same rules, and that no party to the labour process be granted special advantage or placed under special obligation (Baird, 1998 : 198). To be a universal human right, the right must be, according to classical liberal thought, non-rivalrous. This means that one person's exercising the right has no effect on the ability of another individual to do the same. Following this reasoning, no individual has a right to a job since guaranteeing an individual a job requires that another individual provide this employment regardless of his/her own preferences (Baird, 1998 : 199). The only logically admissible human right with respect to employment is the offer to buy or sell labour on one's own terms. Everyone is then free to accept attractive offers and turn down unattractive ones. Hutt argued that unions demand and governments often concede many illegitimate job-related rights (Baird, 1998 : 199).

The Labour Relations Act (1995) is not consistent with Hutt's labour unionism. Individual workers cannot elect the representatives they consider appropriate, workers' rights to full freedom of association are violated, and collective bargaining is more than encouraged (Baird, 1998 : 200). Under the LRA, workers are required to accept representation by any union that has a majority of the employer's workers as members. Furthermore, unions that do not have the majority of workers as members may, under certain conditions, achieve monopoly representation of an employer's employees provided they are "sufficiently representative" (Baird, 1998 : 201).

The LRA impinges upon an individual's right to freedom of association. In terms of the LRA, a majority union and an employer can agree to establish a closed shop. A closed shop agreement must have the vote of two-thirds of the workers and requires that all workers become union members (Baird, 1998 : 201). An alternative option is the formation of an agency shop. Under an agency shop agreement, workers need not join the majority union, but the payment of union dues and fees is made compulsory. Workers cannot vote on agency shops (Baird, 1998 : 202). Unions put forward the free-rider argument as justification for forcing workers to join unions or pay union dues and fees. The law provides the opportunity for workers other than the union's own voluntary members to benefit from representation. Unions argue that all workers who receive representation services must therefore pay an appropriate share of the union's costs of supplying these services, or workers would have the incentive to become free riders, and the union's bargaining power would be undermined (Baird, 1998 : 202). However, it is argued that unions themselves are responsible for the free-rider problem since they fought for legislation giving them bargaining rights (privileges) over dissenting workers. The free-rider problem would not exist had unions confined representation to their voluntary members (Baird, 1998 : 202).

The LRA makes collective bargaining mandatory on employers. An employer must meet with a majority or a representational union within thirty days of the union's demand for organisational or recognition privileges, and a "collective agreement" must be attained (Baird, 1998 : 203).

Collective bargaining refers to the joint regulation of the employment relationship by employer and employee representatives (Brown, 1987 : 478). By participating in the collective bargaining process, the employer recognises the right of employees' independent representatives, behaving as a collective, to argue their view on issues affecting their interests (Brown, 1987 : 478). Wage and working conditions usually form the central issues of the collective bargaining process. The effect that collective bargaining has on the employer, and its success on the part of trade union members, is dependent on the collective strength possessed by the employees. This bargaining power is dependent on the country's legislative framework since this sets out the limits of rights to strike, the employment contract status, the extent to which trade unions enjoy protection, and the legally responsible agents on each side (Brown, 1987 : 481).

Although Brown (1987 : 479) holds that collective bargaining is best viewed as a political institution - the interests of employers and employees each capable of harming the other, are temporarily reconciled through collective bargaining - he acknowledges that the relative bargaining power of each party is largely influenced by their respective labour and product markets. The bargaining result will also affect the wages and productivity of labour. The role played by trade unions is thus best summed up " … as one of constant opposition, acting to modify management actions in the light of members' interests insofar as their organised power permits" (Brown, 1987 : 481).

Most industrialised countries regard a commitment to collective bargaining as an essential part of democracy, and Convention 84 (1947) of the International Labour Organisation (ILO) states that "all practical measures shall be taken to assure to trade unions which are representative of the workers concerned the right to conclude collective agreements with employers and employers' associations" (Brown, 1987 : 481).

Employment conditions can be regulated on four different levels, namely:

1) individual employment contracts;
2) collective bargaining within the firm;
3) collective bargaining within a bargaining council; or
4) legislative or regulatory fiat (Barker, 1999a : 17).

While the Labour Relations Act (LRA) explicitly encourages collective bargaining, the new Basic Conditions of Employment Act (BCEA) favours collective bargaining at levels (3) and (4), that is collective bargaining within a bargaining council, and legislative or regulatory fiat. Very little provision is made in the BCEA for altering conditions of employment through collective bargaining within a firm or through agreement between an employer and employee (Barker, 1999a : 17). This goes against the trend that in the presence of globalisation collective bargaining should be decentralised – collective bargaining at the enterprise level is considered an increase in labour market flexibility. The main argument supporting this trend is that "the increased competition enhances the interest of employers to take measures concerning their internal labour market without being bound by rules and standards imposed on them from higher levels" (ILO, 1999 : paragraph 126).

In South Africa, collective bargaining at the industry-, sector- and even economy-wide-levels is encouraged through the provisions made in the legislation for the establishment of bargaining councils and statutory councils.

A bargaining council is made up of one or more trade unions representing employees in one or more sectors and an organisation representing the relevant employers. The union or unions together must have as members, the majority of workers in the sector or sectors to be party to the bargaining council. The union or unions together form one bargaining agent, and bargain with the employers' organisation over the wages and conditions of employment for the whole sector or the sectors covered (Baird, 1998 : 205). Bargaining council agreements have the same force and effect as parliamentary legislation. The Minister of Labour is required by law to extend the bargaining council agreement to all employers falling under the scope of the bargaining council (Barker, 1999a : 14). However, the Minister must be requested to extend the bargaining council agreement by the trade union representing the majority of employees in the particular sector and the employers' organisation employing the majority of employees in that sector (Barker, 1999a : 14). An amendment requiring that councils allow non-parties to make representations to the councils concerning collective agreements that the Minister has been asked to extend to non-parties has been proposed. The proposed amendment will give smaller businesses better opportunities for lobbying for the exclusion from industry agreements (Financial Mail, 2000 : 39). Anecdotal evidence suggests that smaller businesses only apply for an exemption when a complaint is lodged with the bargaining council, preferring non-compliance and the evasion of registration instead (ILO, 1999 : paragraph 127).

The extension of bargaining council agreements results in wages and conditions of employment that are standardised throughout all branches of the industry. This prevents the employer parties (usually the larger and more profitable firms) from being under-cut by non-party employers. Furthermore, the agreed wage rate is likely to be lower than that which the larger, more profitable firms (which are normally members of the council) might have had to face under a decentralised system (Barker, 1999a : 15). On the other hand, the smaller, less profitable and more labour-intensive firms, which are usually not bargaining council members, may find the agreed wage rate higher than that which they would otherwise have to pay. This could undermine the viability of businesses, forcing them at best to downsize their labour forces or at worst to shutdown entirely.

If all employers face an increase in labour costs, the likelihood of the increase being passed on to the consumers is much higher. Competition on the basis of wages is eliminated, and the incentive to member employers to fight wage demands is reduced. The bilateral monopoly resulting from the bargaining council is considered by some economists as being anti-competitive and anti-consumer; employer and unions tacitly collude to control the labour and product markets (Barker, 1999a : 15). The resultant wage and price increases will negatively impact the consumer, the non-party employer and the unemployed worker (Barker, 1999 : 15). However South Africa's integration into the global economy has meant that a number of industries covered by bargaining councils now face greater competitive forces. Employers are thus under pressure to cut costs and increase productivity. The consequences for employment are generally negative as firms rationalise (Barker, 1999a : 16).

Sellars (2000 : 501) states,

> "It is difficult to say anything positive about employment effects of industry level wage setting. Certainly, the argument that industry bargaining serves only to remove labour costs as a basis for competition is very difficult to sustain in an open economy. It is far more likely that firms, particularly those that are small scale and labour intensive, will bow to pressure from more efficient large-scale domestic competitors and imports, and will close down".

It is incomprehensible that a country experiencing high levels of unemployment largely among the unskilled, should support an industrial relations system that is based on the elimination of low wage competition (Nattrass, 1998 : 85 - 86).

The suitability of the bargaining council system for South Africa has been questioned. Highly centralised and highly decentralised bargaining systems are held to produce better results than intermediate systems, such as bargaining councils, which contain elements of both centralisation and decentralisation. Uncoordinated industry-level bargaining (such as occurs in South Africa) could contribute to inflation and unemployment since the exposure of wage bargainers at industry-level to direct competitive pressures is more remote in comparison to that of plant-level wage bargainers, and they are less cognisant of the implications of their wage agreements on the macro economy than would be the case of central-level bargainers (Nattrass, 2000 : 133). However a highly centralised bargaining system involving the successful coordination of wage agreements between employer associations and trade unions is unlikely in South Africa at present since there is little incentive for the two groups to negotiate at national level and it is questionable whether they even possess the capacity to impose such an agreement on their members at industry level (Nattrass, 2000 : 133).

7.2.2 THE BASIC CONDITIONS OF EMPLOYMENT ACT

The Basic Conditions of Employment Act (BCEA) provides a floor of rights for all workers on issues relating to working time, leave, termination of employment and employer obligations. It is argued that this Act reflects the voice of insiders (i.e. the employed), strengthening their bargaining positions and raising their real wages while largely ignoring the plight of the unemployed (Stryker *et al*, 2001 : 53).

As already mentioned employment conditions can be regulated on four different levels, namely:

1) individual employment contracts;
2) collective bargaining within the firm;
3) collective bargaining within a bargaining council; or
4) legislative or regulatory fiat.

While the LRA encourages collective bargaining, the new BCEA favours collective bargaining at levels (3) and (4), that is, collective bargaining within a bargaining council, and legislative or regulatory fiat (Sectoral determinations). Very little provision is made in the BCEA for altering conditions of employment through collective bargaining within a firm or through an agreement between an employer and employee (Barker, 1999a : 17).

The BCEA significantly increases the direct and indirect costs of labour. The Act reduces hours of work from 46 to 45 hours, and further reductions (to 40 hours) are expected in the future. This will increase the unit cost of labour and production costs in general because of the impact on fixed and variable labour cost and capital cost. The fixed cost of labour (leave pay, welfare services, office space, severance pay, training costs) and capital costs do not vary in proportion with hours of work. If employees work less, the hourly fixed costs will increase. The variable cost of labour depends on what happens to the hourly wage rate. If workers are paid by the hour, a reduced workweek will not impact the hourly cost of labour. However, most workers are paid either weekly or monthly and if the weekly/monthly rates remain unchanged, reduced hours will increase the hourly cost of labour. Given the effect of increased labour costs on price levels (inflation), international competition and the substitution of capital for labour, reduced hours have been found by most researchers to negatively affect employment creation (Barker, 1999a : 18).

Reducing hours of work and early retirement have been suggested as solutions to unemployment. Supporters of these measures appear to assume that the output of an economy is fixed and that there exists an exogenously given level of available work. This is known as the lump of labour fallacy. The amount of work to be done is not fixed; rather, evidence indicates that for a given institutional structure, the quantity of work to be done tends to change in line with the available supply of labour, leaving equilibrium unemployment unaltered (Nickell, 1997 : 70). Cutting hours of work or reducing the labour force will increase wage pressure in such a way that an equivalent cut in jobs will be required to offset it (Nickell, 1997 : 70).

An increase in the percentage of non-wage costs means that total remuneration to an increasing extent does not reflect workers' productivity or even demand and supply conditions. It increases the fixed-cost component of total labour costs. Provisions in the BCEA regarding annual leave (increased from 2 to 3 weeks), maternity leave (from 3 to 4 months), the provision of suitable alternative employment for pregnant employees, and three-days paid family responsibility leave will all raise non-wage costs significantly. Schlemmer and Levitz (1998 : 5) assert that the "...the effects on labour absorption of any legislated upgrading of conditions of employment or further limitations on the flexibility of the use of labour are likely to be severe".

The following amendments to the BCEA have been proposed:

- The scrapping of the premium for Sunday work
- The introduction of greater flexibility in working hours. Bargaining councils will be able to increase the number of ordinary hours per week to above 45 hours by collective agreement. Trade unions and employers can increase the number of overtime hours worked per week from 10 to 15 hours by collective agreement. The Minister will be able to vary all the conditions of employment through Ministerial or Sectoral Determinations after taking advice from the Employment Conditions Commission. (Labour Law Review, 2000 : 6)
- A tightening of the law on independent contractors. A series of rebuttable presumptions will be created to determine whether or not an employment relationship exists. The effect of these is that where a particular factor exists, the worker is presumed to be an employee unless the contrary is proved (Labour Law Review, 2000 : 7). Employers will thus be required to prove that independent contractors are truly independent. The decision is made by considering whether there is supervision of the contractor, controlled working hours and whether the person forms part of the organization or is economically dependent on the employer (Financial Mail, 2000: 39).

7.2.2.1 WAGE FLEXIBILITY

Wage flexibility means that wages should be responsive to market and economic conditions in the country, the economic sector or in the individual enterprise. Wage adjustment is one of the primary mechanisms through which individuals and jobs are matched.

The wage-setting process is affected by labour market pressures, social perceptions, legislation and the industrial relations system (OECD, 1994 : 22). The levels of collective bargaining and the extent to which provision is made at such levels for flexibility arrangements will directly influence wage flexibility. The South African industrial relations system has been identified as one of the factors preventing wage rates falling to market clearing levels, at least in the highly unionised larger corporate sectors (Schlemner and Levitz, 1998 : 58). Furthermore, the promotion of industry-level bargaining in South Africa contradicts the global trend of decentralisation in wage determination (Standing *et al*, 1996; Baskin,1998a; Hayter,1998 cited in Sellars, 2000 : 500).

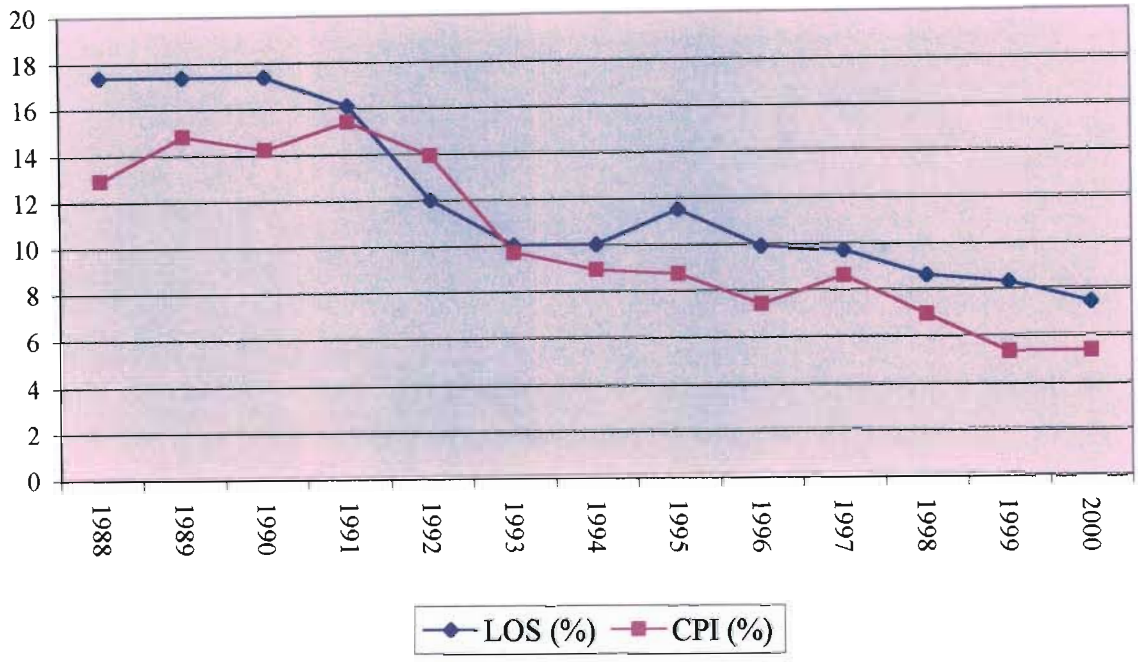
Given the inadequate social security system, Nattrass (1998 : 87) argues that there is a moral responsibility to assist the unemployed either by slowing the pace of trade liberalization (this suggestion is heavily criticized, see Sellars, 2000; Coetzee, Gwarada, Naude, and Swanepoel, 1997), or by introducing greater flexibility into the wage determination process through, for example, decentralising wage determination to the enterprise level, thereby granting workers the choice of working for a low wage or becoming unemployed.

Minimum wages appear to be a major cause of unemployment among the groups they attempt to protect, namely the young and the unskilled. In South Africa, minimum wages set by the previous Wage Board were conservative and would have had little, if any, effect on labour market flexibility (Barker, 1999b : 36). In the new BCEA minimum wages can be determined by bargaining councils or sectoral determinations, either way, both institutions "act to narrow the wage distribution by protecting unskilled wages" (Nattrass, 1998 : 87).

In sectors where proper collective bargaining does not occur, the Employment Conditions Commission, which has replaced the Wage Board, may be requested by the Minister to investigate the industry and then make recommendations in terms of wages and other conditions of employment. Although the making of sectoral determinations for a particular sector and area could introduce a degree of flexibility, they are more likely to bring about more demanding or additional provisions than greater flexibility (Barker, 1999b : 34). The new BCEA allows the Minister more discretion in relation to the powers of the Employment Conditions Commission than was the case of the Wage Board - the Minister has the authority to change the Commission's recommendation whereas under the previous Act he could only accept or reject a recommendation of the Wage Board (Barker, 1999b : 34). The scope of sectoral determination is also much wider than wage determinations under the previous Act. This may introduce greater rigidity in the labour market and thereby reduce employment creation among lower-skilled and younger workers particularly given that South African wages are relatively high in international terms.

Wages tend to be rigid downwards and flexible upward, in other words they are responsive to price increases and unresponsive to unemployment. Figure 7.1 shows that wage increases or the level of settlement (LOS) in South Africa tend to be fairly consistently above the level of inflation as given by the consumer price index (CPI) – this is contrary to normal expectations of supply and demand in an economy where jobs are being lost. Wage employment elasticities in South Africa have been found to be relatively high, ranging between –0,5 and –1,5, which suggests that a 10% increase in real wages will result in a drop in employment of between 5% and 15% (Standing *et al*,1996; Baskin,1998a; Fields, Leibrandt and Wakeford,1999 all cited in Sellars, 2000 : 501).

Figure 7.1 Average Level Of Settlement In Relation To The Consumer Price Index, 1988 - 2000



Source: Andrew Levy & Associates, 2000 : 37 ; South African Reserve Bank Quarterly Bulletin, September 2001

7.2.3 THE EMPLOYMENT EQUITY ACT

The purpose of the Employment Equity Act (EEA) is to achieve equity in the workplace primarily through the prohibition of discrimination, which applies to all employers regardless of size; and the implementation of affirmative action measures, which apply only to "designated employers" , that is, an employer with 50 or more workers or an annual turnover equal to or higher than the applicable minimum turnover as defined in the Act (Barker, 1999a : 20).

In terms of the EEA employers are required to reduce disproportionate income differentials. The Employment Conditions Commission will set acceptable proportionate differentials. The Minister of Labour may also establish guidelines for employers to follow in reducing income differentials (Barker, 1999a : 20). Employers could decide to increase the wages for less skilled workers but if this increase is not accompanied by an increase in productivity it would negatively impact the enterprise's competitiveness. Furthermore such legislation could discourage the employment of less skilled workers thereby exacerbating our already serious unemployment problem (Barker, 1999a : 20). On the other hand, employers could decide to freeze the pay of executives but this brings the risk of losing executives to domestic and foreign competitors.

The EEA will have a positive effect on the Growth, Employment and Redistribution (GEAR) objective of redistribution but the extent of this effect is as yet unknown. The drafters of the Act also claim that productivity will be positively affected; over the longer term the EEA will result in better utilization of human resources (Barker, 1999a : 28). However affirmative action policies may have a demotivating effect on white males. Barker (1999a : 28) notes "…this legislation sacrifices the principle of 'the best person for the job' in favour of a lesser concept of suitably qualified, which refers simply to the ability to do the job".

The Act will be demanding in respect of managerial time. All "designated" employers are required to draft and implement employment equity plans, carry out employment analyses; implement affirmative action and report regularly to the Department of Labour. Implementing and applying the new labour legislation will take a lot of managerial time as well as increasing the real cost of doing business (Barker, 1999a : 22).

7.2.4 THE SKILLS DEVELOPMENT ACT

Karl Wohlmuth, in a comprehensive review of employment and labour policies in South Africa (cited in Schlemmer and Levitz, 1998 : 61), concluded that:

> "South Africa is prototypical for a country where the quality of the labour force is not in conformity with the level of development and the importance of the capital stock…..Scarcity of skills leads in the upswing [in the economic cycle] to sharp wage increases for the skilled ….. leading quickly to successive wage demands from the less skilled".

This wage leverage of the scarce skilled workers also causes employers to compensate by cutting-back their less-skilled staff. In addition, the emphasis that unions place on wage inequality tends to sustain (foster) the relatively high wage expectations of unskilled workers.

The former Labour Minister, Tito Mboweni, (cited in Schlemmer and Levitz, 1998 : 61) has argued that the weak educational and training systems in South Africa introduce inherent rigidities in the labour market. Functional adaptability (redeployment of workers in different tasks within the same enterprise and skills upgrading) is hindered by skill shortages coupled with inadequate organisation of work on management's part (ILO, 1999 : paragraph 124).

Competitiveness should be based not only on cost, but also on the effective and efficient utilisation of productive resources. This includes the labour force - a highly skilled labour force providing quality work and possessing the ability to adjust to changing conditions will greatly increase the flexibility and competitiveness of an enterprise (Barker, 1999b : 37), particularly in today's environment of globalisation. The existence of large numbers of unemployed is an indication of wasted and under-utilised resources.

The Skills Development Act creates a partnership between public and private sectors. It establishes a centralised funding mechanism and industry level institutions to direct the development of occupational skills (Sellars, 2000 : 502). A payroll levy will be placed on all firms but only those firms who train will qualify for a grant. The training strategy will have a sectoral focus and will be aimed at providing generic skills.

The payroll training levy will be advantageous to the extent that it increases productivity but it will also serve to raise the costs of production. Whether the gains form increased productivity exceed the costs will depend on how efficiently and effectively the government uses the revenues raised at the sectoral and national level (Financial Mail, 1999 : 16).

It is also argued that the Act is not very well targeted. It is most likely to be effective in upgrading the skills of already skilled workers, while not being of much help to workers at the lower end of the job ladder since it would be difficult to reach the unskilled, large numbers of whom are unemployed, and then extremely costly and time-consuming to upgrade their skills to the level that is in demand (Bhorat, Deiden and Hodge, 1998 cited in ILO, 1998 : paragraph 108).

7.3 ASSESSMENT OF THE LABOUR LEGISLATION

Labour market reform was certainly overdue but unfortunately the form that the reform has taken has not always been the most appropriate in the South African context. The Financial Mail (1999 : 16) notes that, "(t)he result is a body of legislation that protects jobs instead of creating them" . Given the extent of South Africa's unemployment problem this is not an outcome that should be tolerated particularly when the government supposedly holds job creation as a priority. The labour legislation is not conducive to the establishment of a competitive labour market considered a necessary part of any labour-demanding growth strategy.

The new legislation does not have the same impact on the major corporate sector that it does on small- and medium-sized enterprises. The former largely meet the employment standards set out in the legislation and they can afford "the burden of red tape that the laws impose" (The Economist, 2001 : 11). In addition, it is this sector that has been restructuring and shedding labour. Of the latter group, the small-sized business (employing less than 10 workers) is exempt from the new laws but the medium-sized business is not. The effect of the new legislation has thus been to increase the rigidity of the labour market in which medium-sized businesses operate. Given that any increase in labour absorption is anticipated to come from the medium-sized business sector, one would have to argue that introducing additional rigidities in the labour market is self-defeating and perverse.

The perception that the labour market is over-regulated is held internationally as well as locally. A survey published in The Financial Mail (2000 : 38) showed that foreign investors identify the following as labour market obstacles: the inflexible labour market (54 percent), the unskilled labour force (31 percent), labour disputes (8 percent) and the brain drain (7 percent).

In 1996 Schlemmer and Levitz, in order to determine the local response to conditions in the labour market, conducted a random sample survey of 300 businesses, primarily small- and medium-sized, in Gauteng. Although not representative of South Africa as a whole, Gauteng is the location of about 40 percent of economic activity and was considered adequate as a basis for useful generalisations.

The firms showed an increase in labour absorption - between 1991 and 1996 the sample on average was found to have increased its labour force by 21 percent. However over this same period, real turnover and real salary bills increased by 65 and 59 percent respectively (Schlemmer and Levitz, 1998 : 45). However it was found that the opportunities for the less skilled were decreasing rapidly.

Table 7.1 indicates the concerns of business with respect to labour problems and productivity. The table lists the sample's response to firstly, factors considered bad for business and secondly, to the most powerful factors which had damaged business prospects.

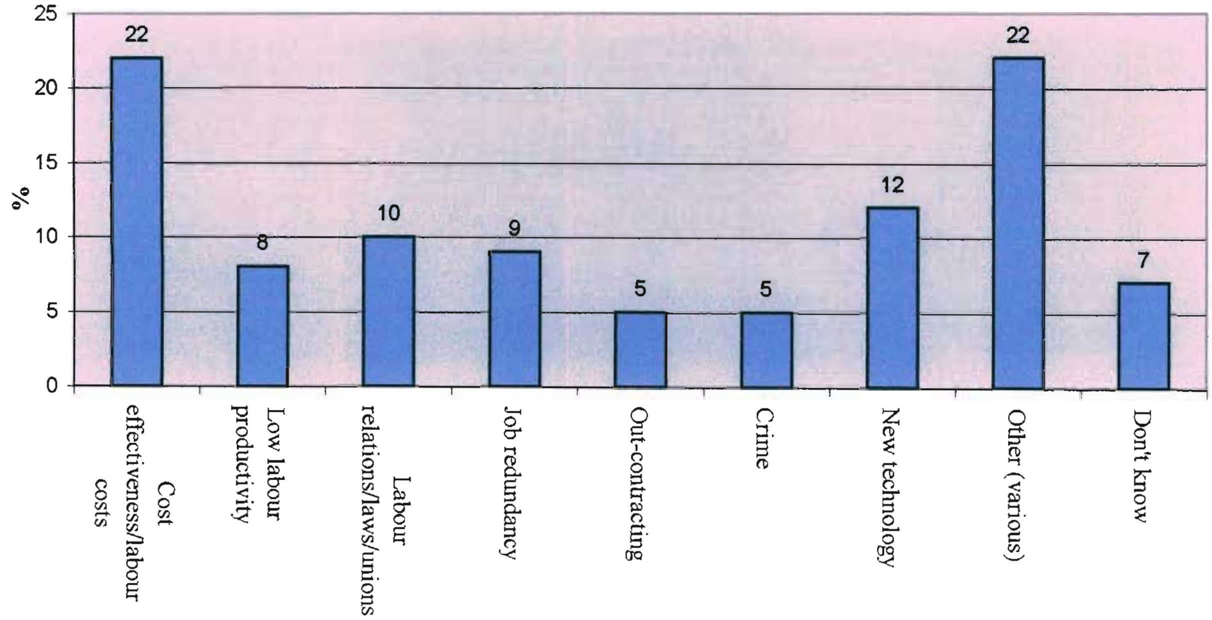
Table 7.1 Percentage Mentions Of Labour Problems According To Size Of Labour Force

	Number of employees				
	<10	11-50	51-150	151-300	300+
Factors bad for business					
Low productivity	4%	11%	13%	21%	10%
Labour demands	31%	34%	42%	42%	52%
Most powerful negative factors					
Low productivity	7%	6%	4%	8%	19%
Labour demands	18%	18%	26%	29%	19%

Source: Schlemmer and Levitz, 1998 : 44

Figure 7.2 depicts the reasons given for decreases in employment over the period 1991 -1996. Approximately 40 percent of the firms identified the difficulties of dealing with trade unions, poor labour productivity and labour costs as reasons for reducing employment.

Figure 7.2 Reasons Given For Employment Decrease, 1991 - 1996



Source: Schlemmer and Levitz, 1998 : 47

Table 7.2 summarises firms' responses to identifying the main factors that make it difficult to employ more labour. Once again labour factors emerged as significant influences on firms' behaviour.

Table 7.2 Difficulties Faced In Employing More Labour By Size Of Company*

	Number of employees					
	<10	11-50	51-150	151-300	300+	All
Trade union activity	16%	17%	26%	20%	19%	19%
Minimum wage	21%	17%	25%	32%	48%	23%
Unqualified workforce	30%	24%	21%	36%	19%	26%
Labour laws	3%	6%	11%	4%	5%	6%
Labour relations	6%	8%	12%	0%	10%	7%
Low productivity	8%	13%	13%	16%	19%	12%
(All labour factors)	(84%)	(85%)	(100%)	(100%)	(100%)	(93%)
Economic factors	22%	34%	26%	36%	19%	29%
Crime	13%	15%	8%	4%	0%	11%
Illegal immigrants	5%	2%	6%	5%	0%	3%
Imported goods	3%	2%	0%	0%	5%	2%
Automation	1%	2%	0%	4%	5%	2%
Other factors combined	40%	31%	32%	24%	29%	32%
No difficulties	5%	1%	2%	0%	5%	2%

* Multiple answers: percentages exceed 100.

Source: Schlemmer and Levitz, 1998 : 48

Schlemmer and Levitz (1998 : 49) concluded from the survey, "It is quite clear, therefore, that the factors of quality of labour - its productivity and skill level, the labour relations or hassle factor and the factors of labour cost combine to form a rather massive disincentive to increased labour absorption".

In late 1999, the World Bank in partnership with the Greater Johannesburg Metropolitan Council conducted an enterprise survey of both SMMEs and large firms (i.e. firms employing more than 50 workers) in the Greater Johannesburg metropolitan area. The SMMEs identified insufficient demand, the high cost and non-availability of capital, crime and a lack of infrastructure as the four most important constraints on business expansion (Stryker *et al*, 2001 : 66). In turn the large enterprises identified, in order of importance, crime and violence, and then equally ranked, labour regulations, interest rates and exchange rates as factors inhibiting growth (Stryker *et al*, 2001 : 67).

The challenge to South Africa thus involves more than simply deregulating the labour market. Although the efforts being made to reduce unemployment are being hindered by an overly rigid labour market, the Minister of Labour points out that the high unemployment that South Africa is experiencing has not been created by the new labour laws, instead its causes lie in, *inter alia*, the structural nature of the economy, the process of globalisation and inherited rigidities (Mdladlana, 2000 : 1).

The government is aware that under circumstances of accelerated international integration, excessively protective regulations could have unintended negative effects on employment creation and on enterprises' abilities to adapt (ILO, 1999 : paragraph 131). The government is therefore committed to improve the application of the laws; address the unintended consequences of the legislation; align and re-align the laws to the ever-changing nature of the labour market; and ensure that the laws are sensitive to the imperative to create jobs and attract investment (Mdladlana, 2000 : 5).

The New Zealand labour relations model, which recognises the importance of an unregulated and competitive labour market, is a model from which South Africa could learn much.

7.4 THE NEW ZEALAND LABOUR RELATIONS MODEL

Baird (1998 : 206) argues that New Zealand's Employment Contracts Act (ECA) is the labour relations model that the rest of the world should consider and adopt. Coe and Snower (1997 : 33) also identify New Zealand as perhaps the best example of fundamental reform. They argue that European policies aimed at reducing unemployment have not been very successful because governments did not always take the complementarities that exist among labour market policies into account. In the presence of complementarities, incremental reforms (comprising small changes in policy instruments) and partial reforms (affecting only a subset of institutional rigidities) will have very little effect. Instead Coe and Snower (1997 : 2) argue for reforms that are both "broad" (covering a wide range of complementary policies) and "deep" (of substantial magnitude).

The introduction of flexibility into the labour market constituted an important part of the reform process undertaken in New Zealand's economic and political environment (Honeybone, 1997 : 493). Government policy in New Zealand throughout the 1960s and 1970s established a highly regulated and protected economy, with the country having one of the highest levels of effective protection amongst OECD countries (Honeybone, 1997 : 493). By the early 1980s, the economy was no longer sustainable. Critical analysis of economic and social policy was followed by wide-ranging structural and institutional reforms. Wage, price, interest rate, credit and foreign exchange controls were abolished in 1984. The reforms were based on the "New Right" ideology (founded on neo-classical economics). The neo-classical approach adopted by the New Zealand government " ...saw the market as being a superior means of restoring democracy, individual liberty and the efficient distribution of resources. It was highly intolerant of those pressure groups, such as trade unions, which argue for constraints on the unfettered operation of the market" (Honeybone, 1997 : 494).

Historically, the New Zealand labour market was based on a collective ideology that implied a role for the State in ensuring effective and efficient labour relations (Honeybone, 1997 : 494). Pressure on the government to deregulate the labour market resulted in the revocation of the Industrial Relations Act 1973 and the adoption of the Labour Relations Act 1987. The Labour Relations Act 1987 aimed to reduce government intervention in the labour market by creating a setting in which employers and workers could voluntarily and as equal partners agree on employment contracts. However, the basic concepts of the previous legislation remained. The New Zealand Business Roundtable (NZBR), which represented the chief executives of most of New Zealand's large enterprises, and other pro-market groups, argued that the labour market remained rigid and inflexible, and that more radical reform was required (Honeybone, 1997 : 495-496). In October 1990 a National Party Government replaced the Labour Government, and further deregulation of the labour market was initiated. This introduction of flexibility into the labour market and the move away from collectivism was formalised in the Employment Contracts Act 1991 (Honeybone, 1997 : 496).

Free market principles form the basis of the Employment Contracts Act and it adopts the libertarian notion that employers and workers are free agents, able to agree with each other on the wage and conditions of employment (Honeybone, 1997 : 496). The Act was designed to encourage individual or collective arrangements at the enterprise or sub-enterprise level. Furthermore, whether or not bargaining for an individual or collective employment contract is to occur, is itself negotiable (Honeybone, 1997 : 496-497). The individual employee and employer are the primary parties to the bargaining process, but each can elect another person, group or organisation to represent them in the bargaining process (Honeybone, 1997 : 497). Trade unions or trade unionism are not mentioned in the Act, and unions no longer play a statutory role in the labour market (Honeybone, 1997 : 497). Exclusive bargaining rights or automatic rights in the workplace have been removed, and compulsory union membership and compulsory dues and fees payments are not allowed (Baird, 1997 : 207).

Employers and employees select the form and level of bargaining, allowing the enterprise the flexibility to adopt labour relations consistent with its specific requirements (Honeybone, 1997 : 501). The Employment Contracts Act (1991) focused on the enterprise/firm, effectively ending centralised bargaining. Honeybone (1997 : 498) states

> "Arguably, the emergence of the enterprise as the predominant bargaining level (with various laws on minimum conditions used as guidelines), has been the most important development in fostering flexibility in enterprises, whether by way of collective or individual employment contracts".

Prior to the Employment Contracts Act 1991, settlements most often occurred through industry or occupational bargaining, coordinated at the national level. Multi-employer negotiations were held annually and many of the settlements were extended to cover those not directly involved in the negotiation process, thereby creating "blanket coverage" of the industry or occupational group (Honeybone, 1997 : 500).

Where the decentralisation process has resulted in individual employment contracts, concern has been expressed about workers' rights and the imbalance of power in the employment relationship (Honeybone, 1997 : 501). The tentative argument is that the Act is more likely to negatively impact the more vulnerable worker (young, female, less skilled, or a combination of the three) who is most in need of a collective approach (Honeybone, 1997 : 501).

The New Zealand labour market has been shaped by the perception that increased flexibility in the enterprise is an essential given greater global competition in product and service markets (Honeybone, 1997 : 505). The greater scope given to managerial prerogative and unilateral managerial action has been used by managers to make labour relations as flexible as product and service markets are thought to demand (Honeybone, 1997 : 502,505).

7.5 SUMMARY

The South African labour market is not as competitive as one would like, given the challenge of combating a seriously high and seemingly persistent level of unemployment. On balance the labour legislation favours "insiders" , that is, those already in employment. Bargaining councils play a dominant role in the wage setting process where their effect is to reduce low wage competition. South Africa does not have the social security system to assist the unemployed and it is therefore a duty of government to ensure that the unemployed have the opportunity to accept low wage employment should they desire it. Protecting those in employment to the detriment of the unemployed, who in all probability are already experiencing severe impoverishment, suggests a disregard of an individual's right to decide whether or not to work at a particular wage and to provide for himself/herself and family.

Fundamental reform of the labour market along the lines of that undertaken in New Zealand would introduce more flexibility into the labour market and would contribute to lowering the unemployment rate as firms through improved competitiveness are able to capture a greater share of and grow the export market for their products.

8 CONCLUSION

Currently the broad consensus is that labour market rigidities or institutional arrangements played a role in propagating the effects of adverse shocks on unemployment in Europe over the past three decades. A number of studies conducted by experts in the field of labour economics have found support for a relationship between certain labour market rigidities and unemployment. Nickell and Layard (1999) found that the labour market institutions on which policy should be focussed are social security systems and trade unions.

The thesis showed that since South Africa does not have a social security system to speak of and attention could be directed to the trade unions. Trade union density in South Africa is high by international standards and the unions have through the labour legislation been granted a significant role in the operation of the labour market. The existence of unions serves to raise unemployment and reduce growth rates. However these negative effects can be counterbalanced if there is central coordination between unions and firms in the wage bargaining process. This does not occur in South Africa where the legislation allows, through the establishment of bargaining councils, for wage bargaining at an intermediate-level. Little incentive exists for the coordination of wage bargaining between employer associations and unions. Furthermore, whether these organisations possess the capacity to impose such agreements on their members at industry level is doubtful.

The review of the legislation concluded that both the direct and the indirect costs of labour have been raised, but perhaps the most significant outcome has been the perception by many employers of a "hassle factor" associated with employing workers. This has resulted in less hiring, and where possible the substitution of capital for labour or the outsourcing of non-essential tasks. Complex legislation, the implementation of which is time-consuming and costly, is not appropriate in South Africa.

It was found that as trade has been liberalised, firms have had to restructure in order to achieve a competitive standing internationally. In the short run this results in more unemployment particularly among the less skilled. This is exacerbated by the fact that South Africa's comparative advantage appears to be in the production of less labour-intensive and more skill-intensive goods and services. Specialisation in the production and exportation of labour-intensive goods and services is precluded by South Africa's relatively expensive unskilled and semi-skilled labour. The demand for labour thus appears to be following the worldwide trend with growth taking place in the higher skill levels while the demand for the less skilled contracts.

Proposed as a possible solution is to identify the skills that are in demand and upgrade the skills of the labour force to that level. Failure to do so will push the wages for skilled workers up as demand exceeds supply. In turn, the emphasis placed by trade unions on reducing income inequalities will serve to sustain the relatively high wage expectations of the unskilled workers. The intention of the Skills Development Act is to do just this but it is argued that it is most likely to be effective in upgrading the skills of already skilled workers, while not being of much help to workers at the lower end of the job ladder since it would be difficult to reach the unskilled, large numbers of whom are unemployed, and then extremely costly and time-consuming to upgrade their skills to the level that is in demand (Bhorat *et al*, cited in ILO, 1998 : paragraph 108). More attention needs to be paid to the skills and training provided by the country's secondary and tertiary educational institutions. This presents a more permanent solution since at least those entering the labour force for the first time will be equipped with the skills that are in demand in the economy.

Reversing the trade liberalisation process is not a solution and doing so would severely set back and hinder the growth of the South African economy. Globalisation is a reality and to survive requires change and adaptation. Greater flexibility in the labour market is one requirement of doing so.

In light of international experience the policy which seems most appropriate is the OECD Jobs Strategy, which is a balanced and comprehensive set of reforms designed to improve countries' capacities to be innovative and to adapt to change and consequently to raise employment. Its adoption and conscientious implementation has produced positive results for countries. The strategy has at its centre the creation of more flexible labour markets. However, South Africa by adopting the current legislation has gone against the international trend and has chose to ignore an unemployment strategy that has proved successful. This seems irresponsible in a country where conservatively 26,4 percent of the economically active population is unemployed. Furthermore this unemployment is concentrated among those groups of the population who are already impoverished and hence least able to afford it. South Africa is at risk of marginalizing large numbers of its population.

APPENDIX A NICKELL AND LAYARD DATA

Table A1 Unemployment Rates In The OECD (%)

	1983 - 1996	1983 – 1988			1989 – 1994		
	Total	Total	Short-term	Long-term	Total	Short-term	Long-term
Austria	3.8	3.6	Na	Na	3.7	Na	Na
Belgium	9.7	11.3	3.3	8.0	8.1	2.9	5.1
Denmark	9.9	9.0	6.0	3.0	10.8	7.9	3.0
Finland	9.1	5.1	4.0	1.0	10.5	8.9	1.7
France	10.4	9.8	5.4	4.4	10.4	6.5	3.9
Germany (W)	6.2	6.8	3.7	3.1	5.4	3.2	2.2
Ireland	15.1	16.1	6.9	9.2	14.8	5.4	9.4
Italy	7.6	6.9	3.1	3.8	8.2	2.9	5.3
Netherlands	8.4	10.5	5.0	5.5	7.0	3.5	3.5
Norway	4.2	2.7	2.5	0.2	5.5	4.3	1.2
Portugal	6.4	7.6	3.5	4.2	5.0	3.0	2.0
Spain	19.7	19.6	8.3	11.3	18.9	9.1	9.7
Sweden	4.3	2.6	2.3	0.3	4.4	4.0	0.4
Switzerland	1.8	0.8	0.7	0.1	2.3	1.8	0.5
U.K.	9.7	10.9	5.8	5.1	8.9	5.5	3.4
Canada	9.8	9.9	9.0	0.9	9.8	8.9	0.9
U.S.	6.5	7.1	6.4	0.7	6.2	5.6	0.6
Japan	2.6	2.7	2.2	0.5	2.3	1.9	0.4
Australia	8.7	8.4	5.9	2.4	9.0	6.2	2.7
New Zealand	6.8	4.9	4.3	0.6	8.9	6.6	2.3

Source: Nickell and Layard, 1999 : 3033

Table A2 Characteristics Of OECD Labour Markets I, 1989 – 1994

	Direct Rigidities		Treatment of the Unemployed			
	1 Employment Protection	2 Labour Standards	3 Benefit Replacement Rate (%)	4 Benefit Duration (years)	5 Active Labour Market Policies	6 % households who are owner-occupiers
Austria	16	5	50	2	8.3	54
Belgium	17	4	60	4	14.6	65
Denmark	5	2	90	2.5	10.3	55
Finland	10	5	63	2	16.4	78
France	14	6	57	3	8.8	56
Germany(W)	15	6	63	4	25.7	42
Ireland	12	4	37	4	9.1	76
Italy	20	7	20	0.5	10.3	68
Netherlands	9	5	70	2	6.9	45
Norway	11	5	65	1.5	14.7	78
Portugal	18	4	65	0.8	18.8	58
Spain	19	7	70	3.5	4.7	75
Sweden	13	7	80	1.2	59.3	56
Switzerland	6	3	70	1	8.2	28
U.K.	7	0	38	4	6.4	65
Canada	3	2	59	1	5.9	63
U.S.	1	0	50	0.5	3.0	64
Japan	8	1	60	0.5	4.3	59
Australia	4	3	36	4	3.2	70
New Zealand	2	3	30	4	6.8	71

Source: Nickell and Layard, 1999 : 3040, 3045

Table A3 Characteristics Of OECD Labour Markets II, 1989 – 1994

	7 Union Density (%)	8 Union Coverage Index	9a Union Coordination	9b Employer Coordination	10 Centralization	11 Payroll Tax Rate (%)	12 Total Tax Rate (%)
Austria	46.2	3	3	3	17	22.6	53.7
Belgium	51.2	3	2	2	10	21.5	49.8
Denmark	71.4	3	3	3	14	0.6	46.3
Finland	72.0	3	2	3	13	25.5	65.9
France	9.8	3	2	2	7	38.8	63.8
Germany (W)	32.9	3	2	3	12	23.0	53.0
Ireland	49.7	3	1	1	6	7.1	34.3
Italy	38.8	3	2	2	5	40.2	62.9
Netherlands	25.5	3	2	2	11	27.5	56.5
Norway	56.0	3	3	3	16	17.5	48.6
Portugal	31.8	3	2	2	7	14.5	37.6
Spain	11.0	3	2	1	7	33.2	54.2
Sweden	82.5	3	3	3	15	37.8	70.7
Switzerland	26.6	2	1	3	3	14.5	38.6
U.K.	39.1	2	1	1	6	13.8	40.8
Canada	35.8	2	1	1	1	13.0	42.7
U.S.	15.6	1	1	1	2	20.9	43.8
Japan	25.4	2	2	2	4	16.5	36.3
Australia	40.4	3	2	1	8	2.5	28.7
New Zealand	44.8	2	1	1	9	-	34.8

Source: Nickell and Layard, 1999 : 3038, 3041

APPENDIX B A BRIEF OVERVIEW OF THE SOUTH AFRICAN TRADE UNION MOVEMENT

The first trade unions in South Africa were formed by the skilled European workers who had come to work mainly on the mines. These workers followed the European trade union ideology of socialism and the use of industrial action. The first quarter of the twentieth century saw a number of strikes taking place primarily in the mining industry, and although led by the white workers, these strikes enjoyed to a certain extent the support of the black migrant workers. In 1912 the government had introduced War Measure 145 that made strikes illegal and imposed severe sanctions on strikes. This proved ineffective and the number of illegal strikes increased to 60 over the subsequent two-year period (Innes, 1999 : 17).

In February 1920, 71 000 black workers (out of a total labour force of 173 000) went on strike on 22 of the 35 mines on the Rand. This strike won few reforms but elicited concern among the mine owners which led to the adoption of a strategy by the Chamber of Mines aimed at allowing black workers into white miners' semi-skilled jobs. In November 1921 the Chamber of Mines made known its intention to break the 'conventional colour bar' that protected 19 job categories in which 4020 whites were employed, and to rearrange underground work (Innes, 1999 : 15). This triggered the 1922 Rand Revolt - white coal miners went in strike on 2 January 1922 and on 12 January, they were joined by white gold miners. The revolt ended on 16 March but only after the government had declared martial law, 250 people had been killed and 4 758 people arrested (Innes, 1999 : 15).

The Smuts government's response to the Rand Revolt proved its downfall. In the 1924 general elections Smuts was replaced by a Nationalist-Labour Party coalition (known as the Pact government). In 1924, the Pact government passed the Industrial Conciliation Act which legalised trade unions and collective bargaining for white, coloured and Indian workers. The Wage Act of 1925 provided for statutory wage determinations for non-African, non-unionised workers, and the Job Reservation Act of 1926 secured jobs for white workers, further extending white worker rights and leading to the establishment of a racially segmented labour market with white workers enjoying superiority (Innes, 1999 : 16).

South Africa's first major black trade union, the Industrial and Commercial Workers' Union (ICU) was formed in 1919. The ICU was a general union, representing a loosely organised association of workers across industries. The union grew rapidly reaching a peak membership of 100 000 in 1926. The Pact government was in power at this time and in 1927 they launched a 'campaign of terror' against the ICU, the Communist Party and union federations such as the non-racial South African Trade Union Congress (Satuc) and the black South African Federation of Non- European Trade Unions. By 1932 the government had succeeded in destroying the ICU and the Communist Party and the two union federations mentioned above had been forced into submission (Innes, 1999 : 16).

The African Mine Workers' Union (AMWU) aimed at organising black mine workers, was established in 1941 and had acquired a membership of 44 000 by 1944. In August 1946 AMWU organised the biggest strike South Africa had ever experienced up to that date. About 100 000 black mine workers went on strike demanding a minimum wage of ten shillings per day. The government reacted quickly and forcefully, and within six days the strike was crushed without any of their demands being met.

By 1948, the African National Congress (ANC), which had been founded in 1912, was in the process of being transformed by its Youth League. A more militant approach had been adopted and on 1 May 1950 the ANC's new strategy of mass action and mass mobilisation was launched with a one-day work stoppage called in protest against the Suppression of Communism Bill, which sought to ban the Communist Party and to grant the government new powers (Innes, 1999 : 17). In 1952 the ANC initiated its Defiance Campaign of civil disobedience. In 1955 the ANC together with other allied organisations, including the South African Congress of Trade Unions (Sactu), which had only been formed in March of that year, adopted the Freedom Charter at the Congress of the People held in Kliptown in the Transvaal. However, after the ANC and PAC were banned in 1960, Sactu collapsed, the reason being that after the formal alliance between the ANC and Sactu in 1955, most of Sactu's leaders had come from within the ANC; thus once the ANC was banned, Sactu's leaders were either arrested, or forced underground and exiled (Innes, 1999 : 18).

In 1973 black workers in Durban went on strike demanding better wages. The strike spread to other parts of Natal and even the Transvaal, and led to the formation of a number of new unions, such as the Metal and Allied Workers Union (now Numsa), the Chemical Workers

Industrial Union (now Ceppwawu), the National Union of Textile Workers (now Sactwu), and the Transport and General Workers Union. These unions had a combined membership of 14 000 by 1975 and in 1979 the Federation of South African Trade Unions (Fosatu) bringing together the newly formed black unions, was launched. By 1983 Fosatu had a membership of 106 000 workers (Innes, 1999 : 19).

The growth of these new unions led to the government adopting the recommendations of the Wiehahn Commission. In 1981 the government passed the Labour Relations Act which effectively legalised the African union movement. Following legal recognition, the unions entered into an expansion phase, although black unions continued to be the subject of state repression and employer hostility (Baskin, 1996 : 22).

Granting industrial citizenship without political citizenship was a fundamentally unstable arrangement and resulted in the use of the black union movement as a vehicle in the anti-apartheid struggle. The African unions gave a previously powerless people a chance to have their voices heard. Union demands were thus of a socio-political nature as well as of the bread-and-butter variety (Baskin, 1996 : 22). In November 1985 Fosatu combined with the National Union of Mineworkers (Num), the South African Allied Workers Union (Saawu), the General Workers' Union (Gwu), and the General and Allied Workers Union (Gawu) *inter alia*, to form the Congress of South African Trade Unions (Cosatu). Cosatu adopted non-racialism, held both capitalism and apartheid in contempt and called for the revolutionary overthrow of the apartheid state (Baskin, 1996 : 22). These new more militant unions quickly displaced the more conservative unions and within months of Cosatu's launch the conservative union Trade Union Council of South Africa (TUCSA) had collapsed. Cosatu supported the ANC thus giving the ANC a considerable power base among the black working class. Cosatu adopted the Freedom Charter and formed an alliance with the ANC and the South African Communist Party. To avoid the mistake made by Sactu, Cosatu ensured that the union movement retained some autonomy and kept its leadership separate from that of the ANC (Innes, 1999 : 20). By 1991 Cosatu had a claimed membership of 1.2 million growing to approximately 1.8 million by 1999.

After the ANC was elected to power in April 1994, they enacted legislation (the Labour Relations Act 1995) that strengthened the position of employees and their unions within the new South Africa. The ANC and Cosatu also decided to allow Cosatu's leaders and the leaders of its affiliates to join the ANC as part of the three tiers of government (national, regional and local). Unions experienced a substantial 'brain drain' as many of their most qualified and experienced leaders left to enter electoral politics, business or the civil service. During 1994, Cosatu and its affiliates lost an estimated 80 experienced unionists out of a staff of 1 450. Replacements tended to be much younger and less experienced. Furthermore as racial barriers fell and pressures to implement affirmative action grew, many talented shop-stewards were promoted to supervisory and management positions, weakening union representation at enterprise level (Baskin, 1996 : 34). Salary levels, job satisfaction, career prospects, uncertainty about the future and a desire to 'move on' are identified as reasons for the high level of staff turnover among unions (Baskin, 1996 : 35).

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