

Impediments on the labour absorption capacity of the South African economy

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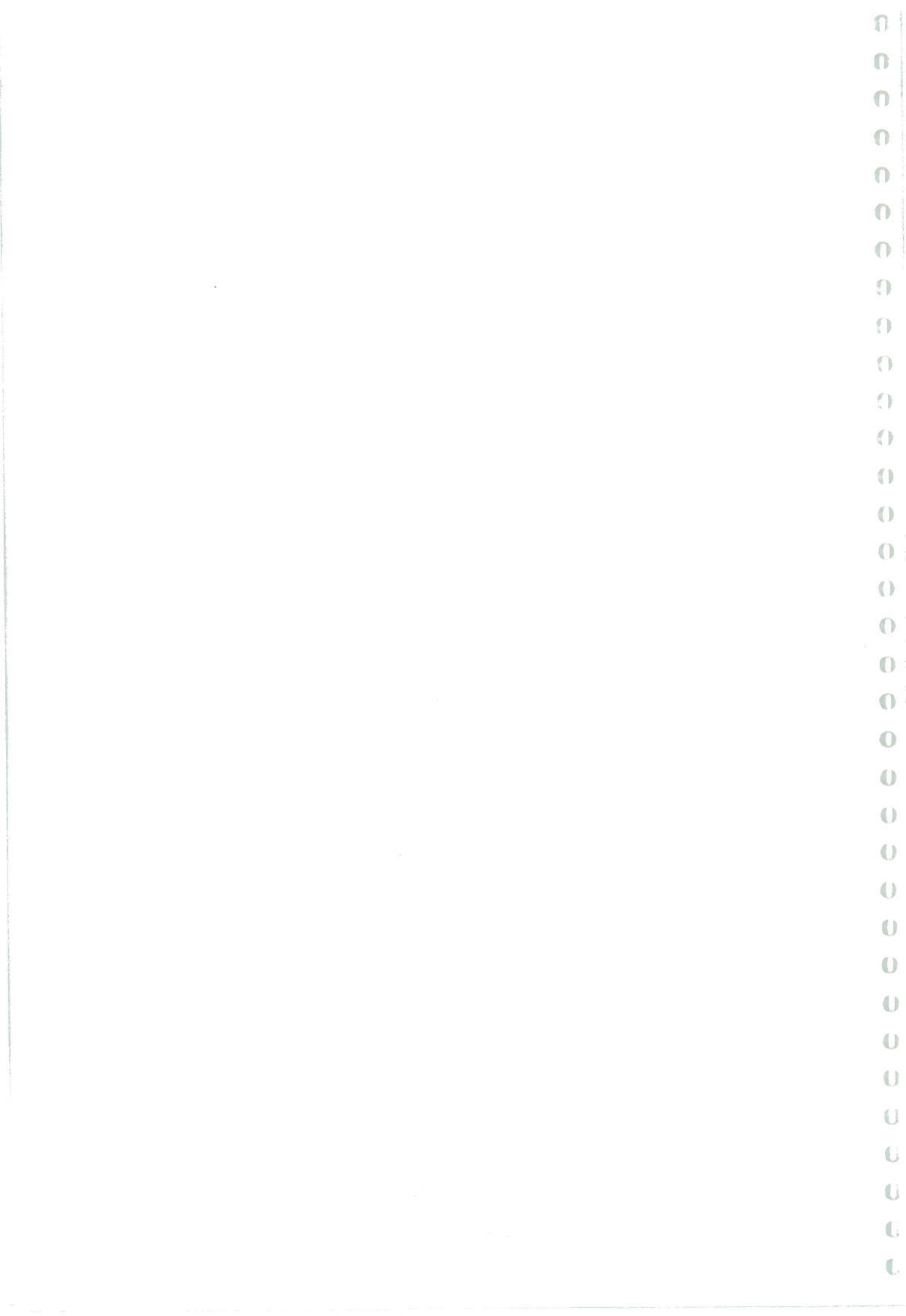
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IMPEDIMENTS ON THE LABOUR ABSORPTION CAPACITY OF THE SOUTH AFRICAN ECONOMY

1. INTRODUCTION

Much time and effort have recently been devoted to illustrating and highlighting one of the most alarming phenomena at present, viz. the growing inability of the SA economy to provide adequate employment opportunities to its relatively rapidly growing labour force. A number of measures have been employed to describe the intensity of the problem, for example marginal labour absorption capacity of the formal economy, an array of unemployment definitions and concepts, production elasticity of employment, and so forth. These yardsticks, however, only serve to exemplify the symptoms rather than the causes or contributing factors to this ailment. The seriousness of the condition, especially translated into the detrimental almost disastrous impact on the welfare of the economy - manifested in soaring poverty levels, political instability and uproar, rising crime rates, and so forth, demands immediate remedial action. Since a symptomatic approach to rectify the problem proved to be rather ineffective during the past two decades, a dire need developed for a proper analysis and identification of the determinants at the root of the malfunctioning of the labour market.

2. SYNOPSIS OF SYMPTOMS

The average **absorption capacity**¹ in SA has decreased rapidly during the past 14 years - in some provinces by well over 30 percentage points (see tables 1 and 2 and figure 1).

Table 1: Absorption capacity¹ of the formal economy per province; 1980, 1991 and 1994 (%)

Provinces	1980	1991	1994
Western Cape	86,2	67,4	63,8
Northern Cape	85,6	63,3	55,8
Free State	87,4	65,0	65,7
Eastern Cape	77,6	60,5	42,4
KwaZulu/Natal	77,4	55,9	52,4
Mpumalanga	86,0	62,1	51,0
Northern Province	80,5	57,4	42,1
Gauteng	84,2	62,7	56,9
North West	82,9	57,4	55,5
Total	82,7	61,1	53,9

Source: Development Information Business Unit, DBSA, 1997

¹The percentage of the labour force employed in the formal sector of the economy

Table 2: Labour absorption capacity: Average annual and incremental annual, 1960 - 1995

Period	Average annual	Incremental annual
1960 - 1965	88,6	107,6
1965 - 1970	89,7	85,3
1970 - 1975	88,2	80,2
1975 - 1980	84,4	45,4
1980 - 1985	78,1	18,5
1985 - 1990	68,6	15,9
1990 - 1995	56,9	*

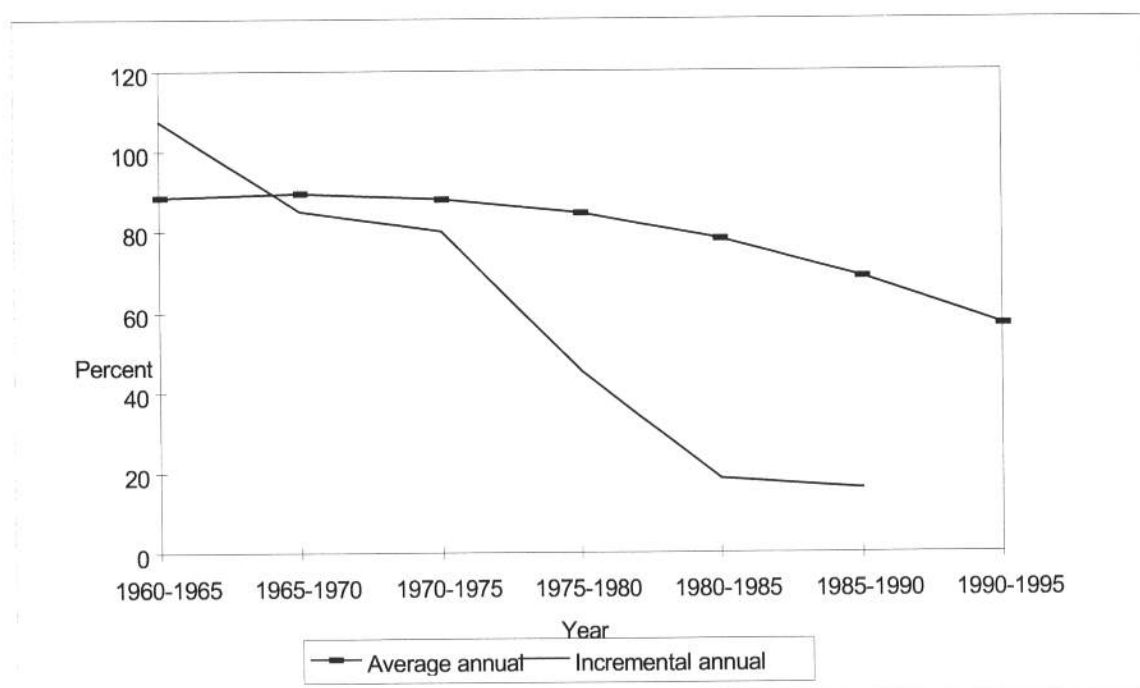
Note:

Average annual = $\frac{\text{Formal employment opportunities}}{\text{Labour force}}$
 - average for period

Incremental = $\frac{\text{Average annual increase in formal employment opportunities}}{\text{Average annual increase in labour force}}$

* During this period a nett number of 365 000 people entered the labour market p/a, while 82 000 job opportunities have been lost annually.

Source: Development Information Business Unit, DBSA, 1997.

Figure 1: Labour absorption capacity of the SA formal economy

For the period 1960 to 1995, the picture is even bleaker. The **marginal (incremental) absorption capacity**² of the formal economy of South Africa was 107,6% for the period 1960 to 1965. It subsequently declined to 85,3 over the next five years, and in 1980 it reached only 45%. Over the next decade it further declined to a dismal 15,9%.

The extent of the inability of the formal economy to provide jobs for new entrants to the labour market appears to be even worse when presented in actual numbers: the above-mentioned figures represent an annual increase of 365 000 new entrants. On a daily basis, this means more than 1 000 people currently enter the labour market. As indicated in table 3, the number of people entering the labour market not only exceeds the number of new job opportunities - the number of total job opportunities are in fact declining resulting in a "negative" absorption capacity.

Employment opportunities in the formal sectors of the economy have deteriorated considerably, especially during the current economic downswing because of, inter alia, a decrease in domestic demand and the rationalisation programmes which have been introduced in many sectors. From the beginning of the downswing in 1989 to the end of 1994, employment declined by 454 000 persons, wiping out nearly all the employment opportunity gains made in the formal economy from 1980 to 1994. Consequently, the net increase in formal employment opportunities from 1980 to 1994 was a dismal 142 000 while the labour force increased by about 5,1 million people.

The escalating "official" **unemployment rate**³ (based on the population censuses) supports the deteriorating situation reflected by the decreasing absorption capacity (see table 3). The unemployment rate increased from 8.4% in 1980 to 12,0% in 1985, 19,4% in **1991**⁴, and 29,3% in 1994.

² *The percentage of new labour market entrants able to find employment in the formal economy*

³ *People who are available for and willing to work and are actively looking for jobs, but who are not in any type of paid employment in the formal sector*

⁴ *Unadjusted 1991 census results*

Unemployment is, however, not readily measurable or unambiguously definable for South Africa because, especially among the black population, many are involved in peripheral activities. It is thus important to observe that the proportion of the total population which identified themselves as 'self-employed', almost doubled since 1980. For the coloured and black populations it more than doubled.

Unemployment figures, although alarmingly high - 4,7 million according to the preliminary 1994 CSS October Household Survey - are still under estimating the actual situation since no provision is made for hidden unemployment and underemployment and should rather serve the purpose of reflecting a certain trend (See table 3).

Table 3: Unemployment, 1980, 1991 and 1994

Year	Number of people unemployed million	Unemployed as percentage of labour force (%)
1980	0,8	8,4
1991	2,5	19,4
1994	4,7	32,6

Source: Development Information Business Unit, DBSA, 1997

The above-mentioned phenomena, i.e. declining absorption capacity and increasing unemployment rates (the one the inverse of the other), only serve to indicate an ever-widening gap between the aggregate supply of and demand for labour. Another phenomenon which not only highlights the symptom of the ailment but is also partially explanatory of the worsening situation, is the decline in the **production elasticity of employment**⁵ or **labour intensity**⁶ of the production process. The trend in the production elasticity of employment, viz:

1970 - 1980: 0,6; and

1980 - 1994: 0.12

is exemplified by the following employment/GDP figures:

⁵ *Percentage change in employment accompanied by a one percent change in gross domestic product (GDP)*

⁶ *Employment per R1 million GDP, i.e. the number of workers required to produce R1 million worth of final goods and services*

Table 4: Employment per R1 million GGP by kind of economic activity and province, 1980 and 1994

Province	Year	Agriculture, forestry, fishing	Mining, quarrying	Manufacturing	Electricity, water	Construction	Trade, catering	Transport, communication	Finance, real estate	Services	Total
Western Cape	1980	58	48	28	18	42	24	29	13	54	32
	1994	54	156	30	7	86	21	19	18	47	32
Northern Cape	1980	85	21	42	25	117	37	36	12	102	44
	1994	62	13	42	8	111	25	15	12	47	30
Free State	1980	64	29	19	14	58	41	35	11	121	42
	1994	77	31	25	5	70	44	17	13	73	40
Eastern Cape	1980	121	728	31	13	54	40	35	13	90	51
	1994	89	977	29	9	59	27	13	12	63	40
KwaZulu/Natal	1980	115	44	28	18	34	42	32	14	86	41
	1994	71	45	33	12	69	26	15	16	79	39
Mpumalanga	1980	97	27	29	6	155	61	50	13	121	43
	1994	50	21	15	3	68	34	20	18	64	22
Northern Province	1980	179	56	48	39	89	79	56	13	118	87
	1994	125	22	45	3	87	50	37	23	83	55
Gauteng	1980	74	26	19	16	17	21	25	12	61	24
	1994	48	22	18	9	31	18	17	16	34	21
North West	1980	76	34	38	24	73	65	70	14	133	53
	1994	71	26	51	17	69	58	39	18	99	46
Total	1980	90	31	24	12	3	32	31	12	78	36
	1994	69	26	25	6	57	25	18	16	55	31

Source: Development Information Business Unit, 1997

The decline is especially evident in the agricultural sector, where the number of workers per R1 million GGP have declined from 90 in 1980 to 69 in 1994. Other sectors exhibiting this tendency are mining, electricity, commerce, transport and community services, where substitution of capital for labour intensive processes occurred.

To arrest and reverse this trend, attention will have to be given to, inter alia, technology that takes into consideration the relative shortage of capital and the relative oversupply of semi-skilled and unskilled labour in South Africa.

3. CAUSES OF UNEMPLOYMENT

A decline in the absorption capacity and consequential increase in unemployment does not provide for a differentiation between cyclical, secular and structural unemployment. The fact that the unemployment rate remained high and has shown a persistent upward trend since the 1970's, throughout intermittent upswing periods of the business cycle, indicates that a significant component of unemployment is not sensitive to the rate of economic growth. It thus seems as if too much emphasis had been placed on the existence of an imbalance between the relatively rapid population growth and the meagre growth in economic activity.

Although the causes of unemployment in South Africa are many and varied, ranging from negative effects of macro-economic strategies on employment creation to political complications, incompatibility between the structures of the labour force and the structure of economic activity, sanctions and capital flight and institutional factors such as overregulation of the economy, the complexity can be reduced to factors distorting the ratio between the cost of labour and the cost of other inputs, mainly capital. The continuing drift towards capital-intensive production processes is clearly the result of an attempt by firms to counter the twin problems of rising labour cost and lagging labour productivity. The change in the production function can be illustrated in many ways, that is a changing capital-labour ratio, a changing labour-output ratio, and so forth. Suffice it to say, however, that the labour intensity (production elasticity of employment) has been declining since the 1970's, as indicated above.

When reference is made to the cost of labour, it is imperative to emphasise that cost does not only entail remuneration (direct cost) but is also influenced by other determinants (indirect cost), especially in South Africa:

- (i) Since the 1970's, considerable social and political pressures were brought to bear on companies operating in South Africa to increase wage rates. Some of these, for example, the Sullivan-code, had a direct impact on labour cost. In the final analysis, however, all these pressures, whether directly or indirectly, affected the social conscience of employers in South Africa. Unfortunately and ironically, although the intentions of politicians were unquestionably (?) noble, it had and still has a detrimental impact on employment in South Africa. In an attempt to avoid confrontation and to subdue their own conscience employers retrenched large numbers of workers to enable them to pay the required wages to the fortunate few remaining employees. This set a process in motion resulting in an increase in capital intensity, decline in capital productivity, erosion of gross operating surpluses, a decline in investment, and eventually, another round of retrenchments as a consequence of a decline in economic activity.

The above mentioned decline in capital productivity can, to a large extent, be ascribed to a shortage of entrepreneurs and appropriately skilled labour required for the development and maintenance of modern and mechanised technology.

- (ii) The substitution of capital for labour is to be in accordance with the price of labour, relative to the price of capital, which ideally should be related to the relative abundance of the two factors of production. During the sixties the real rate of interest had been positive every year and in the seventies six out of ten years experienced negative rates. After a few years of positive real rates in the eighties, it has again become negative.

Since 1989, the SA economy experienced positive real interest rates. As pointed out above, real wages and labour costs increased due to, amongst others, the philosophy of the "social responsibility of employers". These disparate movements are at variance with the relative scarcity of labour (excluding the highly skilled) and capital. The abundant factor is being employed as if scarce, and the scarce factor used as if in abundant supply. Employment thus suffered and capital intensification increased.

- (iii) The mix of subsectors within manufacturing is an important determinant of overall capital-intensity, since relative capital-intensive subsectors have, on average, 8,5 times the stock of capital per workers as the relative labour-intensive subsectors. (See Table 5).

Table 5: Manufacturing: Annual growth, percentage contribution and capital-labour ratios of subsectors, 1972 - 1990

Year	Relative capital-intensive industries			Relative labour-intensive industries			Total manufacturing		
	Contribution to:		Capital-labour ratio (R000/worker)*	Contribution to:		Capital-labour ratio (R000/worker)*	Contribution to:		Capital-labour ratio (R000/worker)*
	Value-added	Employment		Value-added	Employment		Value-added	Employment	
	%	%	%	%	%	%	%	%	
1972	29,1	16,9	113	70,9	83,1	21	100	100	37
1975	28,9	17,0	136	71,1	83,0	21	100	100	41
1980	32,4	17,8	205	67,6	82,8	22	100	100	55
1985	38,0	18,3	239	62,0	81,7	30	100	100	69
1990	40,0	17,6	239	60,0	82,4	28	100	100	66
Annual growth rate (1972 - 1990)	4,2		4,2	1,5		1,6	2,4		3,2

* Values at constant (1985) prices

Basic source: IDC, 1992

An analysis of 76 subsectors within manufacturing revealed that the relative capital-intensive industries grew at a much higher rate (4,2 % per annum) than the relative labour-intensive industries (1,5 % per annum) from 1972 - 1990. Examples of the first-mentioned group are the petrochemical and iron and steel basic industries whereby the expansion can mainly be ascribed to an emphasis on capital-intensive strategic investments.

- (iv) Until the mid-1950's, South Africa's Industrial and trade policy followed the pattern typical of most developing countries, for example, the replacement of imports of final consumer goods with domestic production encouraged by government via the use of protection from import competition. These downstream activities tended to be relatively labour intensive in their use of resources.

Once this phase of import-substitution was completed, a fundamental choice arose as to how to proceed with industrial development. East and South-East Asian countries chose to move toward outward-oriented industrial policies, and to penetrate export markets in downstream labour-demanding subsectors. By contrast, aggregate data and case studies suggest (Levy, Brian, 1992) that South Africa chose to deepen import replacement by progressively extending protection to upstream, relatively capital-intensive subsectors of manufacturing.

Table 6: Manufacturing: Comparison of growth (1972 - 1990) between "up-stream" and "down-stream" activities - certain examples

Up-stream activities	Capital-labour ratio (R000/worker)*	Growth rate (%)	Down-stream activities	Capital labour ratio (R000/worker)*	Growth rate (%)
Wood and wood products	17	2,1	Furniture	6	1,1
Paper and paper products	83	4,2	Printing and publishing	24	1,8
Iron and steel basic industries	208	3,7	-	-	-
Basic metal industries	97	6,0	Metal products	18	0,7

* Values at constant (1985) prices

Basic Source: IDC, 1992

- (v) An increase in capital-intensity can also be attributed to a change in the production function (technology) - markedly more so in certain sectors of the economy than in others. A major employment shift away, for example, from one of the most labour-intensive sector in the economy, i.e. agriculture, occurred since the 1960's. Much technology in South Africa resulted from research and development in advanced Western countries where labour is scarce and expensive relative to capital (Van Zyl, et al, 1987). "The adverse effects of labour substitution, in the light of the relative scarcity of capital, are especially acute in

South Africa, given the dualistic nature of the agriculture sector". (Van Zyl, et al, loc cit). Factors contributing to the displacement of labour in the case of the agricultural sector, specifically, resulted from the distortion of production factors relative to their scarcity. Some of the measures contributing to the distortion were, amongst others subsidisation of interest rates and tax concessions on capital investment.

- (vi) A similar trend is evident in the other sectors of the economy (tables 4 and 5). The capital-labour ratio, in case of the relative capital-intensive industries, for instance, increased at an annual rate of 4,2 %. Thus contrary, to what could be expected from the trends in both the relative factor prices and relative availability of capital and labour in the economy, more use was made of the relative scarce and more expensive (particular since 1987) factor of production, i.e. capital. If real gross domestic investment (i.e. gross domestic savings after adjustment for net capital influx from the rest of the world and change in gold and other foreign reserves) is taken as a proxy for the availability of capital in the economy, Table 7 indicates that the supply of capital decreased on average by 0,9 per cent per annum from 1980 to 1996.

Table 7: Real gross domestic investment at 1990 prices

Year	Rm	Annual growth rate
1980	71 896	31,9
1981	79 524	10,6
1982	62 238	-21,7
1983	64 118	3,0
1984	65 299	1,8
1985	52 743	-19,2
1986	45 850	-13,1
1987	46 637	1,7
1988	54 984	17,9
1989	56 463	2,7
1990	48 634	-13,9
1991	46 832	-3,7
1992	44 615	-4,7
1993	46 446	4,1
1994	54 401	17,1
1995	61 639	13,3
1996	61 925	0,5

Basic source: SA Reserve Bank, 1997

With the change in fixed capital stock taken as a proxy for demand for capital, Table 8 indicates that the demand for capital increased by an average annual rate of 1,9 percent over the same period.

Table 8: Fixed capital stock at constant 1990 prices

Year	Rm	Annual growth rate
1980	635 665	5,1
1981	670 085	5,4
1982	700 863	4,6
1983	727 493	3,8
1984	751 482	3,3
1985	770 076	2,5
1986	777 8 40	1,0
1987	784 050	0,8
1988	793 625	1,2
1989	806 298	1,6
1990	817 455	1,4
1991	824 932	0,9
1992	830 087	0,6
1993	833 998	0,5
1994	841 155	0,9
1995	852 034	1,3
1996	865 196	1,5

Basic source: SA Reserve Bank, 1997

Figure 2 and table 9 indicate the relative price of capital to labour - the average annual user cost of capital increased by 25,5 per cent and the wage rate in manufacturing by 15,2 per cent over the period 1979 - 1991. The user cost of capital increased due to the positive-real-interest-rate policy adopted by the monetary authorities as well as the devaluation of the exchange rate since the mid-1980's. Despite the rising trend in the user cost of capital relative to wage rate since 1979 and the relative abundance of labour (the supply of labour increased by an average annual rate of 3,2 per cent), the demand for this factor of production increased by only 0,1 per cent from 1980 to 1994.

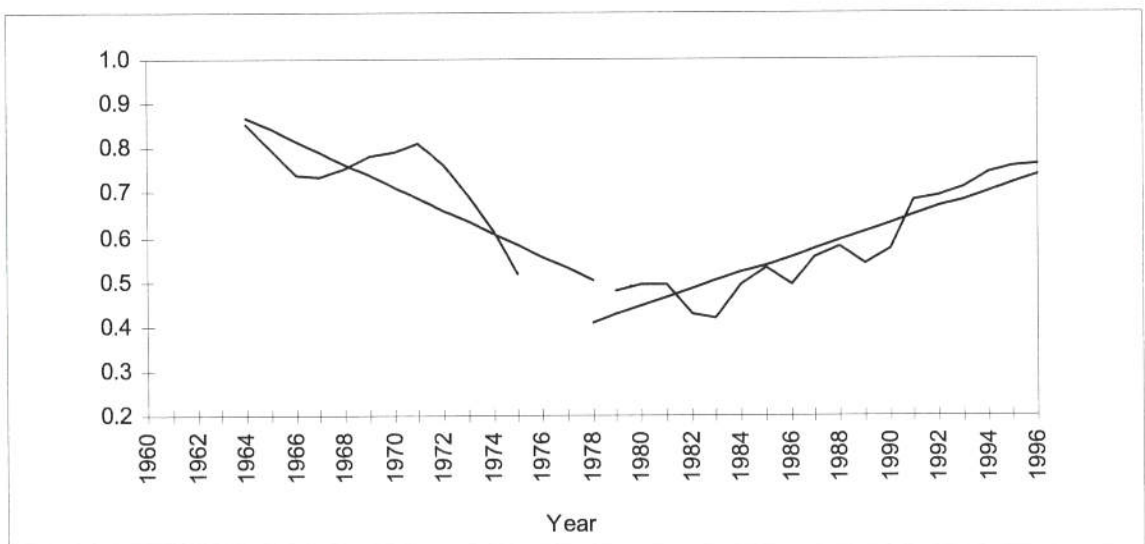
Figure 2: User cost of capital relative to wage rate: 1960 - 1996: South African Manufacturing

Table 9: Relative price of capital labour

Year	User cost	Wage rate	User cost of capital relative to wage rate	
			Actual	Five year moving average
1960	1.000	1.000	1.000	n.a
1961	1.015	1.047	0.970	n.a
1962	0.892	1.081	0.826	n.a.
1963	0.872	1.160	0.752	n.a.
1964	0.922	1,265	0.729	0.855
1965	0.952	1.349	0.706	0.796
1966	0.972	1.419	0.685	0.740
1967	1.208	1.496	0.808	0.736
1968	1.366	1.598	0.855	0.756
1969	1.410	1,648	0.855	0.782
1970	1.371	1.782	0.769	0.794
1971	1.483	1.950	0.760	0.809
1972	1.226	2.088	0,587	0.765
1973	1.145	2.316	0.494	0.693
1974	1.200	2.673	0.449	0.612
1975	0.886	3.113	0.285	0.515
1976	1.635	3.575	0.457	0.454
1977	2.918	3.977	0.734	0.484
1978	2.535	4.443	0.571	0.499
1979	1.813	5.088	0.356	0.480
1980	2.061	5.991	0.344	0.492
1981	3.328	7.129	0.467	0.494
1982	3.395	8.478	0.400	0.428
1983	4.873	9.519	0.512	0.416
1984	8.080	10.909	0.741	0.493
1985	6.400	12.224	0.524	0.529
1986	4.117	13.910	0.296	0.495
1987	11.239	16.064	0.700	0.554
1988	11.732	18.772	0.625	0.577
1989	12.118	22.030	0.550	0.539
1990	17.629	25.181	0.700	0.574
1991	23.809	28.348	0.840	0.683
1992	24.868	32.430	0.748	0.693
1993	25.921	35.951	0.721	0.712
1994	28.216	39.614	0.712	0.744
1995	34.032	43.818	0.777	0.760
1996	40.487	47.594	0.851	0.762

Source: South African Reserve Bank (Economic Department)

The main conclusion of the analysis is that, while movements in factor prices, (in particular, upward movement in black wages as a result of union activity since 1980), have had a depressing effect on employment growth, much of the decline seems to arise from other sources. A study conducted by Welcher (1991), based upon a survey of employers in the manufacturing sector, found that 'labour problems' were indicated as the most common cause of the continuing drift towards greater capital intensity. A possible interpretation of this is that industrial conflict widened the margin between perceived cost of employing

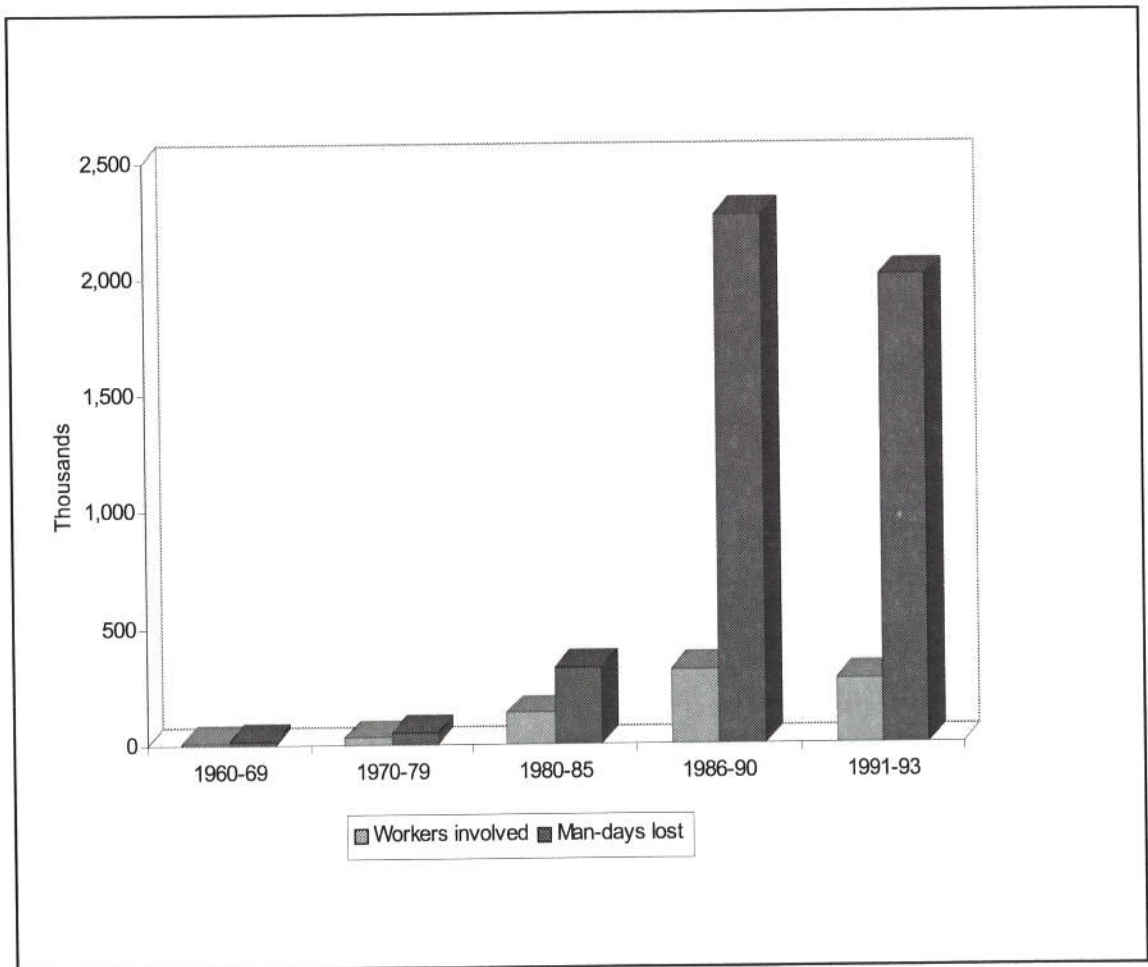
labour and the wage rate. (Fallon, 1992). If strike activity is taken as a proxy of industrial conflict, Table 10 indicates the exponential growth in, inter alia, number of strikes, man-days lost and number of workers involved since 1979, the year of legalisation of Black trade unions.

Table 10: Strike activity in South Africa (Annual averages)

	1960 - 1969	1970 - 1979	1980 - 1985	1986 - 1985	1986 - 1993
Number of strikes	73	179	356	897	863
Workers involved	4 235	27 906	130 404	314 700	271 383
Man-days lost	13 300	52 169	324 848	2 271 542	2 007 714

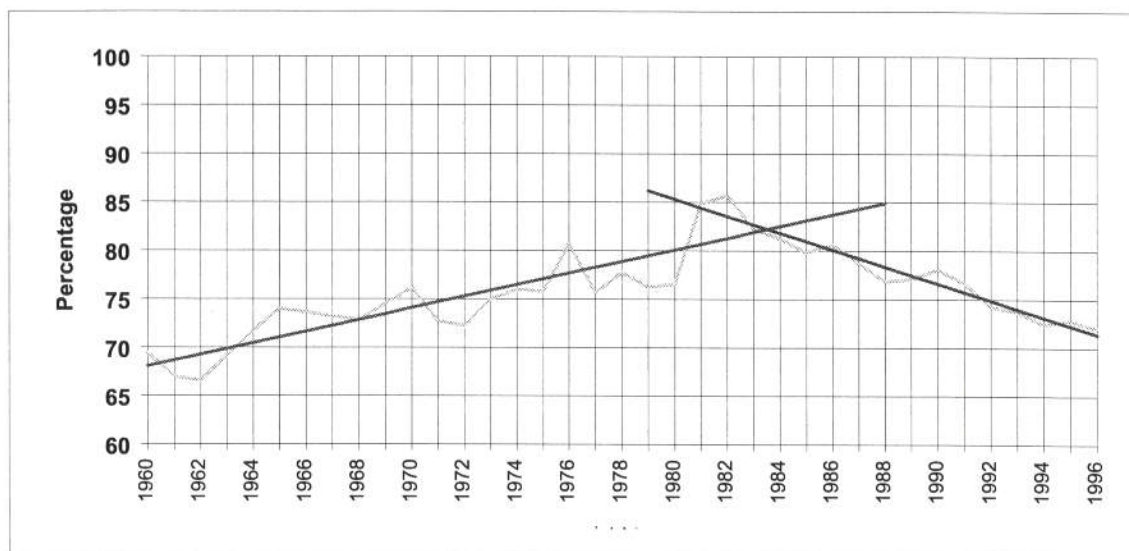
Source: Department of Labour

Figure 3: Strike activity in South Africa (Annual average)



The impact of trade union activities and concomitant wage pressures at the beginning of the 1980's is clearly indicated by the sharp increase in labour remuneration as percentage of personal income. This increase could to a certain extent also be explained by the increase in wages and salaries in the mining sector in response to the gold price bonanza at the time (see Figure 4).

Figure 4: Salaries and wages as percentage of personal income; 1960 - 1996



Ironically, however, since 1982 the labour remuneration : personal income ratio has steadily declined and reached 72,0 per cent in 1996, the lowest level since 1972. In view of the remuneration per workers, this decline is ostensibly the result of a relative sharp decrease in employment.

- (vii) As far as the labour market is concerned, a series of reforms culminated in the Labour Relations Act of 1981, and a new labour dispensation came into existence providing for, inter alia, a revised set of rules and a reform of collective bargaining structures. The primary objective of this was the defusion and management of conflict which characterises the work environment in any society. The mere existence of structures, however, does not ensure labour market stability and industrial peace and the political, economical and social aspirations coinciding with the current transitional period serve to exacerbate conflict.

A well established trade union system is in many instances used by groupings as a vehicle to lobby for political change instead of, by collective action, to strive to defend and advance the interests of their workers. Trade unions' ability to orchestrate the power of their members in their roles as workers and consumers resulted in alliances between federations/confederations of unions on the one hand and political groups on the other.

The structure devised for resolving the inherent conflict thus faces an increasingly complex challenge since the environmental influences (economic, social and political) impinging on industrial relations are diffuse and dynamic.

Despite the current beleaguered state of the SA economy (high inflation and unacceptable unemployment levels), the need for political change seems to overshadow economic debate. Basic realities may, however, prevent conflict from becoming destructive, compelling unions and employers to reach consensus to the benefit of both parties.

An optimistic scenario would entail that the process of collective bargaining, which is the preferred means of accommodating differences, be conducted at the level of the enterprise rather than the industry or national level. Negotiation confined to this level is the rule in industrialised countries such as Japan and the United States since it is targeted at the actual parties involved. A move in this direction could result in enhancing the negotiation process regarding real labour market issues, for example remuneration, hours of work, fringe benefits, and so forth rather than employing the existing structures to obtain objectives completely outside the labour market forum to the detriment of the country as a whole. Although no blueprint exists to be applied to the complex domestic situation, lessons learned in countries preceding SA in this regard could prove valuable.

4. CONCLUDING REMARKS

The key to success in raising the ability of the SA economy to create employment opportunities for its growing number of job-seekers lies in the ability to break out of the web of structural constraints and limitations. The resilience of the economic system has suffered from external shocks as well as excessive intervention from within. Unless the shackles of rigidities and undue interference are removed, recovery itself will be endangered. It would be wrong to postpone the necessary rectifying actions until a high economic growth rate is assured. If action is postponed the conditions may never be right.

Much work by government in adhering to prudent monetary and fiscal policies will be thwarted if at the same time policies are pursued which impede adjustments to change or which distort the allocation of resources. More consensus needs to be developed so as to make the market work. Nowhere are questions of social values, income distribution and efficiency more closely linked than in the area of employment and unemployment. The very notion of the labour market suggests that quantity and prices are determined by supply and demand conditions. Yet it is obvious that human consideration, and not only supply and demand, enter into the social choices that are made with regard to employment policies.

Structural policies to strengthen the capacity of our economy to create new jobs should cover a broad range of action. Against the background of the issues raised earlier, such policies must be build upon:

- * Confidence in the future, restored by a steady socio-economic and collective bargaining environment;
- * Consensus about the basic goals and values to be achieved; and
- * An equitable sharing of the costs of adjustment.

In the various areas embraced by these considerations, it is necessary to make the outcome socially and politically acceptable and to deepen consensus building.

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