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BUILDING
SHARED PROSPERITY
IN SOUTH AFRICA

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The Challenge: Growing Jobs in a Tough World

We know that economic growth and job creation is not easy in the current global environment. Climate change targets entail painful and expensive transitions, and the direct costs of climate change are rising. The production of goods is increasingly automated, and it is even more difficult than before to match upskilled China in globally competitive manufacturing.

Value chain bottlenecks from Covid shutdowns and recent shocks caused by wars accelerated a trend towards nearshoring and onshoring. Technological changes which diminish labour costs as a competitive factor. Production is moving closer to the largest global markets. This inward-looking trend was accelerated by the Trump tariffs.

Dani Rodrik's recent book, Shared Prosperity in a Fractured World, recognises that growth and jobs are less likely to come through manufacturing than in the past and are increasingly likely to result from the development of the broad services sector. Now that the path to prosperity in manufacturing has been captured by East Asia, the very rapid growth of China and its astonishing rate of poverty reduction will be virtually impossible in the rest of the world.

The economic challenge can, however, be addressed with what Rodrik names **'productivism'**: 'moving an economy's resources – innovation, organisational capacity, entrepreneurship, capital and workers to activities that are more productive and achieve social, environmental and developmental goals in the process' (p.155). This requires active partnerships between government, business, and sometimes labour and communities.

What has been tried

There are initiatives to try to stimulate growth and employment, but they are not yet having the impact hoped for.

While President Ramaphosa's office has put a lot of energy and political capital into **'investment drives'**, these have had little impact.

Commendable public employment programmes have helped raise employment on the margins. Small business initiatives are fragmented and subject to the whims of a series of weakly supported ministers. Youth initiatives sometimes help, but also on the margins.

The government's latest Industrial Development Strategy (IDS) is better for not being solely focused on the manufacturing sector, but it remains oriented towards large- scale formal sector business and retains the top-down approach that has pervaded industrial policy for the last 20 years.

The most important reforms have been those driven by Operation Vulindela (OV) in the Presidency. They include liberalising the electricity sector which made progress for a while but may be stalling in mid-transformation. Freight logistics-rail and harbours-are improving, but slowly. Water and sanitation reform has proved difficult to pursue effectively from central government. Visa and immigration reform has had success, but weak systems and backlogs still plague the Department of Home Affairs.

Newer OV initiatives include local government reforms, efforts to drive spatial integration and housing and a drive to build digital public infrastructure, but the results of these initiatives are not yet visible.

Phase 3 of the partnership between business and government which gave rise to Operation Vulindlela focuses on economic growth and jobs, but, confusingly, not in the same way as the Industrial Development Strategy. (More on this in the next article in this series.)

To try plug the jobs/poverty gap South Africa built an elaborate system of social transfers that, while individually modest, are very widely applied. Social transfers assist a third of the population, but fiscal constraints prevent further expansion of the system. With central government debt at nearly 80% of GDP, debt servicing absorbing more than 20% of the budget, and taxpayers carrying a heavy load already, fiscal space is virtually non-existent.

Any further expenditure on social transfers or public employment programmes would be at the expense of social services or government capital expenditure, both of which have suffered through many years of austerity. Only economic growth can relieve the fiscal constraint.

Where next?

South Africa has a threefold economic challenge: to generate more growth; to create more jobs; and to strengthen the economy's largely missing productive middle sector-a dynamic smaller business sector that complements and supplements the large firms that dominate the formal sector.

Accelerated economic growth is necessary to address South Africa's three-fold challenge and it should be the central priority of government-but it is not sufficient.

Discussion within South Africa as to how best to address the three-fold challenge has often been bogged down in debate-should we focus on growth or inclusion? By contrast, we will argue that the way forward has three complementary strategies.

- Accelerate formal sector growth.
- Complement formal sector growth with far-reaching reforms to improve the enabling environment for **'survivalist'** micro- and small firms.
- Harness the ICT connective revolution to raise productivity and living standards in the now precarious middle of the economy.

Moving the discussion forward requires moving beyond general advocacy for one specific policy or another and anchoring the discussion in orders of magnitude.

Whether growth is necessary but not sufficient to address South Africa's unemployment crisis is an empirical question. How much job creation can come from improvements in the enabling environment for survivalist micro and small firms is an empirical question. The extent to which an ICT- connective revolution can help South Africa overcome its longstanding curse of economic dualism and build a vibrant middle is an empirical question.

We need experimentation and flexible responses to outcomes to provide robust answers. To kickstart the conversation, we set out a simple argument through a heuristic, empirically anchored overview of our suggested three-part approach for addressing the challenge. In other words, we combine educated guesses with real-world evidence.

Indicative outcomes

Later posts will address each of the three components of the strategy in more detail. Our hope is that our evidence-informed guestimates of how things might unfold across a variety of scenarios can provide some empirically anchored sense of the possibilities.

What we have done, to underpin our argument, is to construct a simple model drawing on reasonably well- established simple statistical relationships. As a way of introduction, we want to set out what different policies-separately or in conjunction – could achieve. Future posts will elaborate on how these rough estimates were derived.

Scenario 1: The economy grows at 4% per annum without significant interventions in support of micro and small firms, including survivalist ones, or regarding ICT connectivity. This would likely result in the creation of about 4 to 5 million jobs which would be much better than current trends, but not sufficient to address the challenge of more than 12 million people out of work today.

Scenario 2: If there was no growth but there were effective reforms supporting small, micro and survivalist firms, we estimate an additional 1 to 2 million jobs over the 10-year period. The main reason the number is modest is that without growth the scope for expansion in this sector is limited. Also, success in the small firm sector would eat into formal sector jobs in the absence of economic growth.

Scenario 3: What if the reforms in scenarios 1 and 2 were combined? In this third scenario 4% growth was accompanied by effective reforms for smaller and survivalist firms, we'd expect around 7.5 million new jobs, a small improvement in the growth rate over the growth-only scenario, but a 50% improvement in job creation.

Scenario 4: If there were successful interventions supporting ICT capabilities enhancing productivity in smaller firms, but neither accelerated overall growth nor reforms supporting small, micro and survivalist firms , we estimate a small growth in GDP and a modest decrease in employment – the latter because, while the connective revolution increases productivity and creates some new jobs, it also outcompetes survivalist firms, resulting in significant declines in employment at the bottom of the labour market.

Scenario 5: This fifth scenario combines all three of the above reforms (formal sector growth, reform of environment for informal sector, and a connective revolution for small firms). If all three were implemented effectively, there would be a modest further increase in GDP over scenario 3, and very little change in aggregate employment – but a very large change in the composition of employment. The reason for the mixed employment effects is that the connective revolution can give a massive boost to firms with the potential to fill the 'missing middle' of South Africa's economic landscape. They increase jobs insofar as they bring new innovations into the market or substitute for formal firms – but where they substitute for survivalist firms, they enhance productivity but reduce jobs. Crucially, once all the labour market reshuffling is worked through, the result is a substantial increase in the share of jobs in the 'missing middle' -roughly 1-1.5 million more by our calculation. A labour market restructuring along these lines could be transformative in finally making real inroads into the extreme economic dualism that has long bedevilled South Africa's economy and society.

These are complex outcomes, and we will explain them, and how they were derived, in greater detail in forthcoming blogs.

Our model is a simple and partial one we haven't calculated other possible impacts, for example the impact of growth on government revenue and, in turn, the impact on social services, social transfers and infrastructure investment. In that sense our estimates could be considered conservative.

In our next three blogs we will explore each of the three elements in the strategy:-how to achieve higher growth, how to intervene in support of the smaller and informal sectors, including survivalists, and thirdly, what an ICT- driven productivity intervention could look like.

We also plan to consider the circumstances under which such reforms might be implemented:-where are the obstacles, where are the allies, and how can we build momentum in into a reform strategy?

Building Shared Prosperity in South Africa

A ive-part series brought to you by the New South Institute

Read the other articles in this series:

- **Blog 2** – Going for Growth
- **Blog 3** – Jobs and the Informal Sector
- **Blog 4** – Overcoming Dualism
- **Blog 5** – How Do We Get There?

Series page >>>