Briefing to the Portfolio Committee on Economic Development

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Outline of the presentation

1. Presentation of the OECD
2. The 2015 South Africa Economic Survey: Main lessons
3. Inequality and poverty in South Africa
4. Structural reforms to boost growth and jobs in South Africa
5. Education and skills
6. Setting a national minimum wage: lessons from OECD and partner countries
The OECD

• **Mission**: promote policies that will improve the economic and social well-being of people around the world.

• **Composition**: founded in 1961, 35 member countries; key partner countries (Brazil, China, India, Indonesia, South Africa).
OECD Functioning

Who drives the OECD’s work?

Council
Oversight and strategic direction
Representatives of member countries and of the European Commission; chaired by the Secretary-General; decisions taken by consensus

Committees
Discussion and implementation
Representatives of member countries and of countries with Observer status work with the OECD Secretariat on specific issues

Secretariat
Analysis and proposals
Secretary-General
Deputy Secretaries-General
Directorates
OECD: How we work

Publications
OECD publications are a prime vehicle for disseminating the Organisation's intellectual output. OECD publishes regular outlooks, annual overviews and comparative statistics. Among them: OECD Economic Outlook assesses prospects for member and major non-member economies. OECD Factbook is a key reference tool for everyone working on economic and policy issues. OECD Economic surveys provide individual national analyses and policy recommendations. Going for Growth presents comparative indicators and evaluations of national performance.
2015 OECD ECONOMIC SURVEY OF SOUTH AFRICA

For a strong and inclusive country

Social progress has been impressive

Services have been broadened and poverty has been alleviated through social grants

1. Access to piped water is mostly through a tap in a house but includes other infrastructure such as communal taps.
Source: Statistics South Africa; World Bank WDI Database
Growth is falling behind

GDP per capita over the past two decades

Source: World Bank WDI Database
Infrastructure bottlenecks must be tackled, especially in electricity

Source: Statistics South Africa
Wage negotiations are too confrontational

Working days lost to strike action

1. Working days lost are a function of the number of workers on strike and the duration of the strike. Source: Andrew Levy, Wage Settlement Survey, quarterly reports
Growth has not been inclusive enough

Source: World Bank WDI Database
Less than half of the working-age population has a job, driving inequality

Source: Statistics South Africa
SMEs face too many obstacles

Barriers to entrepreneurship

Source: OECD Product Market Regulation Database
Key Recommendations

• Use independent producers to increase electricity capacity, and ensure prices reflect costs.
• Increase the role of mediation and arbitration to make wage negotiations less confrontational.
• Establish a public employment service as a one-stop shop for job seekers.
• Expand affordable public transport.
• Build housing closer to economic centres.
• Support SMEs by reducing the regulatory burden and eliminating entry barriers and regulation that limits competition.
• Broaden key tax bases. Increase taxation of high income earners to make the tax system more progressive.
INEQUALITY AND THE SOUTH AFRICAN LABOUR MARKET
Deep labour market divides exist in South Africa

- By ethnic background
- By gender
- By age
- By education
Large and persistent disparities in unemployment by ethnic background

Unemployment rate, 15-64, Q1 2008 – Q1 2015
Fewer women than men are in paid work

Employment/population rate, 15-64, 2014 (or latest available year)
More than 1 in 2 young people in the labour force are unemployed

Youth unemployment rate (2012)
Percentage of the youth in the labour force
Nearly 1 in 3 young people are Neither in Employment, nor in Education or Training (NEET)
Informal employment is common (though not as high as in some other emerging economies)

Incidence of informality
As a share of total employment

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Labour market inequalities are reflected in earnings as well.

Median monthly earnings by gender, population group and skill
Rand, 2014

- Gender: Men, Women
- Population group: Black African, Coloured, Indian/Asian, White
- Skill: Skilled, Semi-skilled, Low-skilled

The chart shows the median monthly earnings across different categories.
To a large extent, LM inequalities reflect inequalities in skills
Extreme poverty is still very high

Poverty rates, two absolute poverty lines

Why do we care about rising inequality?

• Higher inequality lowers well-being and can mean hardship for those at the bottom of the distribution

• But OECD research shows it also lowers economic growth

• This is driven by disparities at the lower end of the distribution, involving lower middle classes, not just the poor

• At the same time, redistribution through taxes and transfers has *not* led to bad growth outcomes
How can labour market disparities be reduced?

• Unemployment is a key driver to inequality
• Need to promote stronger and more inclusive labour markets
• This means :
  o Getting more people in to work
  o Improving job quality
• In other words, need to promote more and better jobs through
  o Appropriate macroeconomic policies
  o Tackling barriers to creation of permanent, formal jobs
Underpin low wages: earnings quality is low in South Africa

Improve job quality: through policies to
Reduce labour market insecurity

Overall labour market insecurity is high
3 arrows for tackling income inequality more broadly

- **Build stronger and more inclusive labour markets**
- **Potential instruments**
  - Government transfers (cash and in-kind) have an important role to play to safeguard low-income households
  - There is also scope for reviewing some tax provisions in light of increased “tax capacity” among top-income households
- **Invest in human capital**
  - Promote up-skilling of the workforce, better training and education for the low-skilled
Policy reforms to boost growth and jobs in South Africa
Channels of transmission of policies to per capita GDP

- GDP per capita
  - multi-factor productivity
  - capital stock / investment
  - employment rate

Channel specific policies:
- Innovation
- Trade policies
- Labour market policies for older workers/women/youth

Framework condition policies:
- Product market regulation, competition law & policy, bankruptcy legislation, labour market institutions

Legal infrastructure policies and institutions:
- Rule of law, enforcement of contracts, intellectual property rights
Policy variables

**Product market**
- Regulation (stance)
- Barriers to entrepreneurship
- State control
- Barriers to trade and investment

**Labour market**
- Regulation
- Employment protection
- Minimum wage

**Tax and benefit system**
- (Dis-)incentives to work embedded in tax and benefit system
- Labour tax wedges

**Institutions**
- Collective bargaining system

**Other areas**
- Various measures
  - Education
  - Innovation (R&D tax credit and grants)
  - Agriculture and energy (subsidies)
  - Infrastructure spending

**Taxation and subsidies**
- Tax structure
- Corporate taxation
- R&D Incentives

**Labour market**
- Regulation
- Employment protection
- Minimum wage

**Tax and benefit system**
- (Dis-)incentives to work embedded in tax and benefit system
- Labour tax wedges

**Institutions**
- Collective bargaining system
The OECD indicator of employment protection legislation allows for comparing LMKT regulation across countries

- **Collective dismissals**
  - Definition of collective dismissals
  - Additional notification requirements
  - Additional delays

- **Regular contracts**
  - Procedural inconvenience
    - Notification procedures
    - Delays to start a notice
  - Notice and severance pay
    - Notice period
      - After 9 months
      - After 4 years
      - After 20 years
    - Severance pay
      - After 9 months
      - After 4 years
      - After 20 years
  - Difficulty of dismissals
    - Definition of unfair dismissals
    - Trial period
    - Compensation
    - Re-instatement rules

- **Temporary contracts**
  - Fixed-term contracts
  - Temporary work agencies

- **Types of work for which it is legal**
  - Valid cases for Uses of F.T. contracts
  - Maximum Number of Successive contracts
  - Maximum Cumulated duration

- **Difficulty of dismissals**
  - Maximum Number of renewals
  - Restrictions on number of renewals
  - Maximum cumulated duration
The OECD PMR indicator covers aspects of regulation that can result in barriers to entry and competition.
Regulatory barriers to competition are relatively high
Policy reforms

• **Labour market policies**
  - Higher **tax wedge** and **unemployment benefits** and lower spending on **active labour market policies** tend to have **negative** effects. Even more so:
    - on the elderly and the youth
    - on the low educated

• **Framework conditions and institutions**
  - **Positive** effects: **rule of law; judicial independence; competition law** and **policy; financial development**
  - **Negative** effects: **barriers to trade, investment and entrepreneurship; housing market regulations**
Effects of reforms in South Africa

• The *product market reforms* with important effects on growth would be through reduced administrative burden and reducing government involvement, including ownership of state-owned companies and in network sectors.

• The *labour market reform* with important effects on growth is reducing the automatic extension of wage agreements to firms not covered by the agreement. The effect of additional spending to expand active labour market policies could also be very large, depending on the size of the reform.
For further information


Education and skills
The role of education and training

- Key OECD Reviews of South Africa’s system:
  - 2013 *Economic Survey* special chapter
  - 2014 *Skills Beyond School Review*
- Improving basic education is critical for achieving the government’s development objectives.
- Yet education quality remains poor on average and uneven across regions and population groups.
- Quality can be improved by making better use of available resources.
- More teachers and more capital are needed.
- Expenditure should be distributed in a more equitable way and increased in specific areas.
Substantial gaps prevail in average levels of education but EMEs have been catching up over the past 20 years.

Average number of years of schooling of the adult population

EMEs also lag in terms of educational outcomes based on PISA scores.
Key recommendations on vocational training

• Simplify vocational pathways
• Build partnership between vocational training and the economy
• Reform the funding schemes
  – The levy grant system
  – The TVET college funding formula
• Strengthen professional development for vocational teachers and college leaders
• Support completion and transition
Key recommendations on basic education

• Improve teacher training, enhance accountability and monitoring of school leadership.
  – E.g. Expand the Funza Lushaka bursary programme and provide more school leadership training and staff support in exchange for stricter accountability

• Teach English as a second language earlier, while maintaining mother-tongue instruction for longer.
  – Also allow more immigration of English teachers

• Upgrade infrastructure.
  – E.g. expanding the Accelerated Schools Infrastructure Development Initiative programme

• Gradually phase out school fees in the public school system.
Skills beyond School: key messages

- South Africa’s strengths:
  - The creation of DHET in 2009 was a major step forward in integrating VET policy.
  - South Africa’s well established qualifications framework provides a helpful structure.
  - Consolidation of the TVET college sector was helpful.
  - In response to the challenge of young people outside the labour market, there are bold plans to expand the college system.
  - A ‘turnaround strategy’ addresses quality in the college sector.
  - South Africa has a strong capacity for analysis.
For further information


Minimum wage
Key factors in setting a minimum wage

• Objective
  – Primary goal: helping workers with low bargaining power in the labour market.
  – Often many others: labour standard, reducing inequality or poverty, strengthening work incentives, increasing tax collection.

• Key trade-off: insiders vs outsiders

• Key factors in setting up the system:
  – Level
  – Variation
  – Coverage
  – Method and frequency of adjustment
  – Transition arrangements
Key factors (cont.)

• Level
  – In OECD countries typically half of the median full-time wage
  – In Indonesia and Colombia concerns about high minimum wage pushing workers into informality (including youth, low-skilled workers and workers in some regions).

• Variation
  – Around half of the OECD countries with minimum wages set lower rates (or no minimum) for youth.
  – Other workers with lower rates: workers on apprenticeships/training, long-term unemployed, disabled workers
  – Regional differentiation is more common in emerging economies.

• Coverage
  – E.g. Self-employed excluded. Other groups may also be excluded (e.g. agricultural sector)

• Method and frequency of adjustment
  – Independent expert commissions can play an important role (e.g. AUS, FRA, GRC, IRL, GBR)
  – In most OECD countries adjusted annually or almost annually

• Transition arrangements
  – Germany introduced a minimum wage in 2015 but exempted some branches until 2017
Countries’ minimum wages vary considerably

Minimum wages levels in OECD, key partner and accession countries, 2013

Tax and transfer policies affect net earnings of minimum wage earners

Employer and employee taxes on minimum wage earners
2013, percentage of gross earnings

- Net earnings
- Employee income taxes and contributions
- Employer payroll taxes and contributions

Mexican low-wage earners have negative income taxes (they receive a wage supplement in the form of a tax credit)

Minimum-wage policies must pay special attention to disadvantages groups

Percentage of workers with hourly wage at the statutory minimum
By education, age and contract type, 2010

Source: OECD (2015), Minimum wages after the crisis: making them pay.
Countries’ experience with minimum wages has varied over time

Minimum wage as % of median full-time wage

Source: OECD Earnings Database
Statutory minima have a role in tackling wage inequality and in-work poverty
  – Other policies are also used: e.g. benefit systems, in-work tax credits for low income earners, rebates on payroll tax for hiring minimum wage workers

Setting and adjusting a minimum wage:
  – Focus on most affected groups, notably youth
    • But be careful about how these are defined. E.g. 18 years, even 23 years.
  – Make changes in small steps
  – Institutionalise frequent reviews
  – Important role for independent minimum wage commissions
  – Account for links with tax and transfer system, non-wage related labour costs and regulations and co-ordinate policy reforms.

But more information is still needed:
  – Effects on training and education choices
  – Impact on wage adjustments in a downturn
Even at relatively low levels, a large number of people could be affected, with positive and negative consequences.

First round effects:
- Workers currently earning below the minimum may:
  - Keep their job and earn the higher wage → income gain
  - Keep their job but see their hours reduced → unclear income effect
  - Lose their jobs → income loss.
- “Outsiders” – those without a job – will face a higher barrier to employment and must be taken into account
  - These workers are likely to have lower productivity and therefore are most vulnerable

Second (and later) round effects
- Also positive and negative
- South Africa’s economists have produced papers on these effects...
Key issues in South Africa’s context (cont.)

• Interaction with other workers’ wages:
  – Existing sectoral minimum wages, collective bargaining and the potential for ripple effects further up the income distribution

• Effect on youth unemployment and employment probability of low-skilled workers
  – Opt-outs are one solution e.g. for youth, for youth in training programmes, or SMEs (taking the potential effects of using thresholds into account)

• Current economic conditions and difficulties already facing SMEs
  – Sensitivity of the economy and therefore fragility of some existing jobs (it is easier to adjust up than down).
  – Should there be a transitional period for some sectors?

• Differences in living costs across the country
  – Stats SA estimate the (upper-bound) poverty line in Mpumalanga is 55% higher than in Limpopo.

• Enforcement
  – More difficult in emerging economies and where the minimum wage is high and/or complex.

• Other policy instruments need to also support the fight against poverty
Thank You
Additional Materials
A divided labour market has contributed to high and rising income inequality in South Africa

Distribution of household disposable income (Gini coefficient)

Note: Gini coefficients are based on equivalised incomes for OECD countries, Colombia, Latvia and Russian Federation and per capita incomes for other countries except India and Indonesia for which per capita consumption was used.

EPL on permanent contracts does not appear to be overly strict

Employment protection legislation on regular employment (individual dismissal), 2013
But protection for temporary workers is particularly low.

Employment protection legislation on temporary employment, 2013

OECD average=2.08
There has been a rapid rise in the use of temporary employment agencies in SA.

Private temporary agency work penetration rate, 2005-2013

Source: ILO national federations; ILO - ILOSTAT Database, 2013.
Some lessons from Brazil

• Large increases in funding (oil royalties)
• More equitable allocation of funding (*Fundef* and *Fundeb*)
• Conditional Cash Transfers (*Bolsa Família*) provide incentives for school enrolment
• Increases in teacher quality
• Better monitoring and more accountability (including national tests)
• Important push on VET and apprenticeships (*PRONATEC* programme)

⇒ Tremendous progress on the education front has been made
Connect schools to external services to provide better support for at-risk students (Portugal)

• “Domains for Priority Intervention”
  – Creates **partnerships** between ‘priority schools’ and other public and private entities (e.g. health centres, associations, various agencies) in disadvantaged areas to provide alternatives to traditional school
  – Includes a mandatory **educational project** for each school, agreed with central administration, periodical assessment of results, and qualified consultancy by experts
  – **School failure rates progressively declined** after implementation of the programme and, after 4 years, they were practically identical to national rates
An alternative apprenticeship arrangement whereby a Group Training Organisation (GTO) recruits apprentices (new or existing) under a training contract and places them with ‘host’ employers during their training.

The GTO is the employer of the apprentice, reducing red-tape especially for SME’s who otherwise would not employ an apprentice.

It also creates quality employment and training opportunities for the apprentice and provides a breadth of experience gained in a number of different enterprises.
Countries’ minimum wages vary considerably

Minimum wage as % of median full-time wage in OECD countries
CLOSING THE LARGE PRODUCTIVITY GAP REMAINS THE PRIORITY FOR BRAZIL, CHILE, MEXICO AND SOUTH AFRICA

**Main challenges:**
- Labour utilisation generally high but so is informality
- Low quality and inclusiveness of education systems
- Inefficient allocation of resource – weak competition

**Policy areas:**
- Easing employment protection legislation while extending the coverage of social protection to reduce informality (MEX, CHL, IDN, TUR, ZAF)
- Reduce state control and regulatory barriers to business start-up and to foreign trade and investment (All except CHL)
- Raise capacity, access and efficiency of compulsory education (All)
- Improve the efficiency of the financial system or rule of law (BRA, MEX, CHN, RUS)
- Promote more effective infrastructure related regulation (BRA, IDN, ZAF)
Overview of OECD work on youth

- Regular monitoring of labour market situation of youth and youth policies (OECD Employment Outlook)

- Country reviews on:
  - Jobs for Youth
  - Learning for Jobs
  - Skills beyond School
  - Investing in Youth in Emerging Economies