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AN EMPLOYMENT-TARGETED ECONOMIC PROGRAM FOR SOUTH AFRICA

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COUNTRY STUDY PUBLISHED BY THE INTERNATIONAL POVERTY CENTRE

AN EMPLOYMENT-TARGETED ECONOMIC PROGRAMME FOR SOUTH AFRICA

SUMMARY OF THE STUDY

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This is an independent report produced by a team of international and national consultants supported by the International Poverty Centre in Brasilia (IPC). Initial support for this report was provided by the Poverty Group of the United Nations Development Programme in New York. This report is part of a wider global research programme encompassing several other countries. The views in this report are the authors' and not necessarily IPC's. However, the IPC regards this report as an important contribution to the debate on economic policies and employment programmes in South Africa as well as in other countries in Africa.

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This report outlines a pro-poor, employment-focused economic policy framework for South Africa. Its specific focus is the severe problem of mass unemployment in South Africa today. Unemployment was between 26.5 and 40.5 percent as of March 2005, depending on whether one uses the 'official' or 'expanded' definition of unemployment (with the expanded definition including so-called 'discouraged workers'). The paper's concentration on the problem of mass unemployment is fully consistent with the stated goals of the current African National Congress (ANC) government. At the Growth and Development Summit in 2003, President Thabo Mbeki singled out "more jobs, better jobs, and decent work for all" as one of the country's four key economic challenges. Currently, the preliminary presentations of the Government's new economic policy framework, the "Accelerated and Shared Growth Initiative for South Africa (ASGISA)—indicate that it affirms its commitment to cutting the unemployment rate by half by 2014.

This publication is a summary of the full report (which is on the website of the Political Economy Research Institute: www.umass.edu/peri). Following an introductory first section, the full report consists of two short sections that lay out basic concerns, then two substantially longer sections presenting the framework for policy analysis and specific policy proposals.

Section 2 presents evidence on the scope of the unemployment problem in South Africa today, considering the unemployed by gender, race, region, length of joblessness and age. It then examines how the country's problem of mass unemployment can be usefully conceptualized in simple accounting terms—namely, as the result of 1) insufficiency in the rate of output growth, i.e., the economy's production of goods and services, and 2) a declining number of jobs being created per unit of output.

Section 3 examines supply-side perspectives on employment expansion. The fact that the South African economy is experiencing both high unemployment and rising capital intensity of production suggests to some analysts both an explanation for high unemployment and a solution to the problem. For these analysts, the explanation for the problem is straightforward: businesses will not hire more workers because they are convinced that the costs of doing so will exceed the benefits. Businesses therefore choose to either 1) maintain their operations at a lower level than they would if the benefits of hiring more workers exceeded the costs or 2) increase the use of machines in their operations as a substitute for employing workers as their preferred means of expanding their operations. Seen from this perspective, the solution to the problem of unemployment is also straightforward: lower the costs that businesses face in hiring more workers.

In general, there are four possible ways in which the costs to businesses of hiring workers could fall: 1) workers receive lower overall compensation, including wages and benefits 2) the industrial relations system and labor market regulations—including laws and regulations regarding workers' rights to organize, conflict resolution, and hiring and firing—operate with more flexibility for business 3) workers perform their workplace operations at a higher level of productivity or 4) the government absorbs some portion of the costs of hiring workers. In most discussions that consider the sources of unemployment from this business cost-oriented perspective, the focus generally is on the first way to reduce business costs, i.e., to lower wages and benefits for workers relative to both other input costs for production and the prices at which businesses can sell their final products.

This study argues that the evidence linking mass unemployment to high labor costs is not persuasive. We also argue that wage cutting as a policy approach is certain to elicit strong resistance, which in turn will worsen the country's investment climate. At the same time, we do indeed support measures to maintain wage increases in line with productivity growth and to improve the efficiency of the industrial relations system. This report also introduces a proposal for a hybrid program of credit and employment subsidies as a means through which the Government can effectively absorb a share of businesses' labor costs.

Section 4 of the report considers the demand-side forces in South Africa's economy that will need to be mobilized to achieve faster economic growth and greater labor intensity. In terms of growth, the report discusses all four components of the conventional national income identity that, taken together, define economic growth—i.e., private investment, private consumption, net exports, and government spending. The report places particular stress in this section on the growth-enhancing effects of expanding public infrastructure investments. Indeed, public investment could expand both output and private sector productivity, and could correspondingly increase private investment and export competitiveness. It is significant that the ASGISA program also emphasizes the need for expanded public investment.

In considering ways to increase the labor intensity of growth, the report examines two basic approaches. The first is the Expanded Public Works Program (EPWP) now being implemented by the national government. The second approach is to encourage accelerated growth in business activities within South Africa that are capable of generating large increases in employment. The report examines the relative labor intensity of various industries in South Africa as well as the 'employment multipliers' of industries, i.e., their capacity to generate relatively large numbers of new jobs through their upstream links with other business firms in the country.

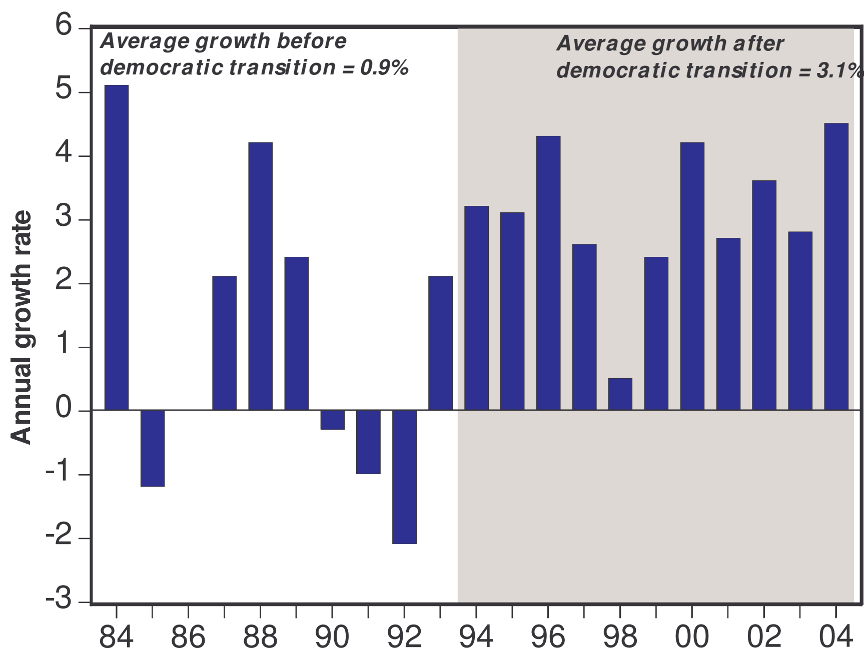
Section 5, which concludes the report, considers specific policy tools that can be deployed to promote faster growth, rising labor intensity and greater poverty reduction. It considers policy interventions in the following areas: fiscal policy, monetary policy, credit subsidies, and development banking; capital market and exchange rate controls; inflation control; and sectoral policies in the areas of a) monopolistic pricing and b) promoting growth of selected productivity-enhancing and import-substituting capital-intensive industries, on grounds other than employment benefits.

OUR MAJOR FINDINGS AND RECOMMENDATIONS ARE AS FOLLOWS:

1. Between 1994 and 2004—i.e., since the end of apartheid—the South African economy grew at an average annual rate slightly above three percent. As seen in Figure 1, this is a major improvement over the country's dismal 0.9 percent average growth rate over the last decade of apartheid. At the same time, a three percent growth rate is only about one percent faster than South Africa's average rate of population growth. As such, it will not, by itself, be adequate to deliver major improvements in average living standards.

FIGURE 1

Real Growth Rate of South Africa GDP, 1984 - 2004



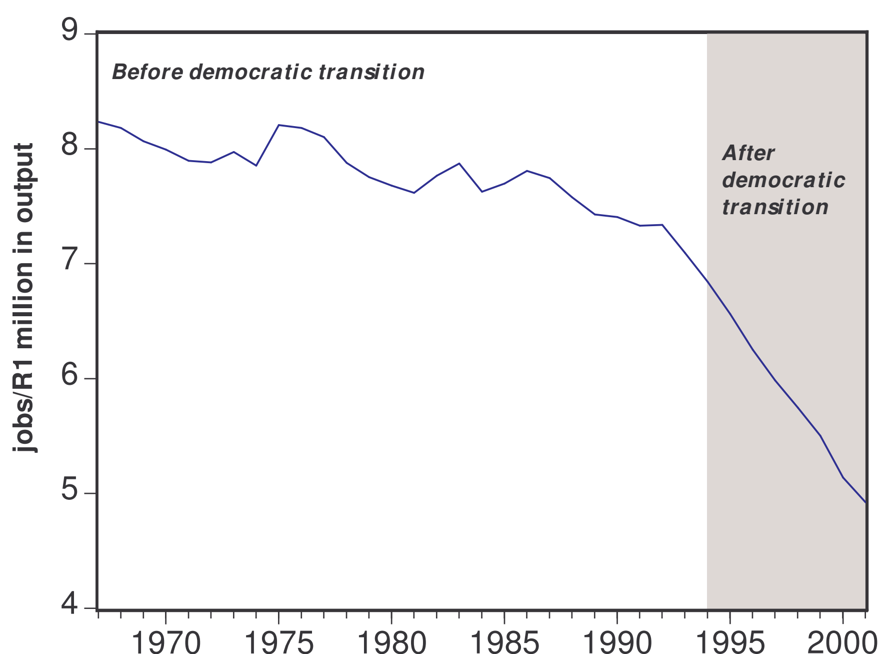
Source: South Africa National Accounts, 12/05 South African Reserve Bank Quartely Bulletin.

In addition, average labor intensity of production—as measured by the ratio of employment per R1 million in output—has been falling sharply in South Africa. The average decline between 1994 and 2001 was nearly four percent per year, a substantial acceleration over the longer trend decline of about one percent per year from 1967 to 2001. Figure 2 shows the long-term pattern. If the South African economy proceeded along approximately this growth path for the next decade, it would not be possible for the Government to achieve its stated goal of reducing unemployment by half by 2014. Making reasonable assumptions about labor force growth and the proportionate rise of informal versus formal employment, the report projects that continuing for the next decade at a three percent growth rate and a one percent annual decline in labor intensity would produce an official unemployment rate by 2014 in the range of 33 percent.

2. For the Government to achieve a 50 percent reduction in unemployment by 2014 will require an aggressive employment-targeted program that increases both the rate of economic growth and the labor intensity of growth. However, even under an aggressive program such as this report describes, the unemployment rate as of 2014 is still likely to be in the range of 15 percent. This means that other measures besides employment growth are needed to improve living conditions for the poor. We therefore support significant increases in government social expenditures and income transfers, even while recognizing the large fiscal commitments that the Government is already making in these areas. We show how increased spending in these areas can be achieved through only modest increases in the conventional sources of tax revenue.

FIGURE 2

Ratio of Formal Employment to GDP in South Africa, 1967 - 2001



Source: Reserve Bank of South Africa.

3. The logic of the report's employment-targeted program is as follows. It divides the South African economy into two broad categories—subsidized and unsubsidized activities. The subsidized activities will be eligible to receive credit on concessionary terms, based on both a large expansion of the Government's current development banking activities and a large-scale program of loan guarantees administered by the private banking system. Overall, these subsidized activities should account for roughly 20–25 percent of all new investment spending in the South African economy. Small-scale agriculture, small and medium sized businesses, and cooperative businesses would all be eligible for this subsidy program. In addition, any other businesses could qualify for this subsidy if they could demonstrate their capacity either to raise the labor intensity of output or to generate large employment multipliers. Some of the activities that are likely to qualify for such subsidies are within the industries identified by the preliminary presentations of the ASGISA program as 'priority' areas. These include agro-processing (such as biofuels) and tourism. We estimate that sectors receiving large credit subsidies should be capable of growing at an average annual rate of about eight percent through 2014.

The idea of providing subsidies for activities that are either labor intensive or capable of generating large employment multipliers builds on the approach of the current EPWP program. But the EPWP in its current form is too modest in scale. According to one estimate, the public infrastructure component of the program that is scheduled to receive 75 percent of the program's total budget will generate roughly 80,000 net new jobs per year. As of March 2005, creating a net increase of 80,000 new jobs would have led to a reduction in the unemployment rate from 26.5 to 26.0 percent.

4. For the 75–80 percent of business activities in South Africa that would not receive credit subsidies, the report proposes that growth of output should be accelerated to an average annual rate of roughly 4.5 percent through 2014. This is a rate that could be achieved through a fairly small relaxation of the Government's fiscal and monetary stances—that is, a relaxation that will not create significant problems either in terms of inflation or the exchange rate. If we combine the eight percent growth rate for subsidized activities with a 4.5 percent growth rate for the remaining 75–80 percent of the economy, the result would be an overall average growth rate of 5.3 percent between 2005 and 2014. We note that this average growth path over 2005–2014 is nearly identical to that being projected in the preliminary presentations of the ASGISA initiative. Assuming this growth projection can be sustained over the next decade, and also making reasonable assumptions about labor market growth and the ratio of formal to informal economy jobs, this report estimates that South Africa's official unemployment rate could fall to roughly 15.4 percent by 2014. Table 1 below provides the basic assumptions, data and calculations upon which we generated our alternative estimates of the unemployment rate as of 2014.

TABLE 1

Total Employment and Unemployment Rate in 2014 under Alternative Scenarios For Economic Growth and Labor Intensity

	(1) Labor Force	(2) Formal Employment	(3) Informal Employment	(4) Total Employment	(5) Total Unemployment	(6) Unemployment Rate (= columns 5/1)
Scenario 1: Steady state from current economic trends 1) 3% annual growth rate 2) 1% annual decline in employment/output	19.5 million	9.8 million	3.2 million	13.0 million	6.5 million	33.3%
Scenario 2: Accelerated growth with credit subsidies to promote labor intensity 1) 4.5% growth for non-subsidized activities 2) 8% growth for subsidized activities 3) 5.3% combined average growth for all activities 4) Employment/output constant	19.5 million	12.4 million	4.1 million	16.5 million	3.0 million	15.4%

Source: Calculations based on data in full study.

Note: Additional Assumptions:. 1. Labor force growth is 1.9 percent per year and 2. Informal employment/total employment = 27 percent.

The report utilizes a series of conventional policy tools to achieve these objectives. These measures will promote growth, employment expansion and poverty reduction while maintaining stability of inflation and the exchange rate.

Fiscal Stimulus. Because of the high levels of government debt incurred during the apartheid era, the ANC government understandably chose to establish a tight fiscal stance in the initial years of post-apartheid democracy. The deficit as a share of GDP fell to a low of 1.1 percent in 2002. According to its 2005 Medium Term Budget Policy Statement (MTBPS), the National Treasury has projected a fiscal deficit in the range of two percent of GDP through 2008-09. However, in its 2004 MTBPS, the Treasury had projected a more relaxed fiscal stance, in the range of three percent of GDP through 2006/07, and somewhat higher figures still for the full Public Sector Borrowing Requirement. This earlier proposal for a more expansionary, but still prudent, fiscal stance would contribute positively to economic growth, since it would mean an additional injection into the economy of roughly R14 billion per year (in 2004 prices) relative to the baseline of a deficit at two percent of GDP. At the same time, even with a three percent deficit/GDP ratio, South Africa would still remain within the range of performance of other lower-middle income countries. The average fiscal deficit for these countries over 1990–2001 was 2.6 percent of GDP.

Monetary Stimulus. The South African Reserve Bank and ANC-led Government have been committed to tight monetary policies since assuming office in the historic transition of 1994. This commitment was strengthened through the adoption, in two stages between 1998 and 2000, of an inflation-targeting regime, with the CPIX inflation target being set at 3–6 percent per year.[1] The preliminary presentations of the ASGISA program confirm continued support for a 3–6 percent inflation target. The primary policy instrument that the Government utilizes to control inflation is adjusting interest rates and, more precisely, raising interest rates to dampen the inflationary pressures that might result from more rapid economic growth. However, the South African economy has been paying a significant price in terms of slower growth of output and employment through its commitment to high interest rates. Both business investment and household consumption could increase if interest rates were allowed to fall.

Considering these and other channels of influence in a vector autoregression econometric model, the report finds, overall, that lowering the nominal prime lending rate by one percentage point and holding it at that lower level for five years would increase GDP growth by about 0.15 percentage points per year. For example, starting from a GDP growth rate of 3.0 percent and a nominal prime rate of 11 percent, if the prime rate fell to 10 percent and were held at that level for five years, the average rate of GDP growth over the five-year period would rise to 3.15 percent. At the same time, the corresponding rise in inflation would be relatively modest, increasing inflation from, say, a base rate of 5 percent to 5.2 percent. The rand would also depreciate over this five year period but, again, only by a modest amount, namely, falling on average by about 0.6 percent per year relative to the dollar.

Based on these rough estimates, the report proposes that the Reserve Bank maintain lending rates at four percentage points below their current levels, which would then raise the average GDP growth rate from the base of three percent to somewhere around 3.6 percent over a five year policy timeframe. The resulting effects on inflation and the exchange rate would remain relatively modest.

However, the four percentage point decline in lending rates would not, by itself, induce an adequate increase in economic growth for the 75–80 percent of the economy that is not receiving credit subsidies. But in our judgment, allowing the fiscal deficit to rise to roughly three percent of GDP should provide the remaining stimulus to move the unsubsidized segments of the South African economy to the target 4.5 percent growth path.

Public Credit Allocation and Development Banking. The key mechanism through which the report proposes to generate an eight percent growth stimulus for 20–25 percent of the economy is to provide credit on a subsidized basis. We develop a formula for establishing an appropriate subsidized interest rate, based on 1) the proportion of a loan that the Government is guaranteeing and 2) the difference between market interest rates and government bond rates that have no default risk.

The report proposes three main policy tools to channel credit to the targeted industries at concessionary rates.

1. *A major expansion in the lending activity and developmental focus of the country's currently operating development banks.* The Industrial Development Corporation is South Africa's largest development bank. Its 2005 Annual Report reported that through its lending activity over 2004-05, it anticipated creating 16,700 jobs. But this is far too modest a contribution for such an important institution, given that the official statistic of 4.3 million unemployed people in 2005 is 257 times larger than this 16,700 figure. The capitalization of these banks therefore needs to increase and they should be allowed to assume a higher level of risk on behalf of an employment-targeted growth agenda.

2. *The establishment of so-called 'asset reserve requirements' for private banks and other financial institutions.* Asset reserve requirements require that financial institutions hold a designated proportion of their assets in loans to priority areas or else hold the same proportion of their total assets in a sterile cash reserve account. For example, applying our subsidy policy would stipulate that banks should hold 25 percent of their loan portfolio in designated subsidized activities. If the subsidized activities did not account for at least 25 percent of the banks' total loan portfolio, the banks would then need to cover this gap by holding cash. Features of this proposal are comparable to the system of 'prescribed assets' that operated in South Africa from 1956 to1989. However, this report proposes measures to operate this system more flexibly—for example, through allowing banks that hold more than 25 percent of their loans in subsidized activities to sell permits to institutions whose targeted industries account for below the 25 percent minimum of subsidized loans.

3. *A major expansion of the Government's system of loan guarantees.* For the Government's current loan guarantee program, the accruals on its contingent liabilities—i.e., the amounts that the Government actually pays when loans default—have been a trivial cost, amounting, on average, to 1/100 of one percent or less over the recent past. This report proposes the following program: the Government underwrites about R40 billion per year in loans, i.e., a figure approximately equal to 25 percent of fixed capital formation as of 2004. The report assumes a default rate on these loans of 15 percent and loan guarantees that cover 75 percent of the principal on defaulted debts. Under this scenario, it follows that the accruals to the Government would amount to R4.5 billion/year (i.e., R40 billion x .15 x .75). This is a crucial result. It shows that the Government has the capacity to underwrite a major loan guarantee program, equivalent to roughly 25 percent of productive investment in the economy, with a financial commitment of no more than 1-2 percent of its fiscal budget.

Controls on Exchange Rates and Capital Flows. Exchange rate variability can create significant problems for monetary policy. Excessive depreciations could raise inflation rates, while excessive appreciations could generate lost output, profits and employment in some industries. Variability itself can also be harmful by generating more uncertainty and thereby possibly discouraging private investors.

All of these issues will become central if South Africa commits itself to a more expansionary set of fiscal, monetary and credit allocation policies—i.e., a set of measures that could effectively support an employment-targeted program. Policymakers will of course have to take seriously the possibility that financial market investors might react negatively to such a program, and might sell-off their holdings of rand. Such a reaction could occur entirely as a result of a shift in investors' perceptions, regardless of whether the fundamental indicators of economic stability—such as fiscal deficits and the inflation rate—may change by only the relatively modest amounts that this report is projecting.

Capital controls, exchange controls and other capital management techniques have been utilized as mechanisms for reducing the sensitivity of domestic financial markets, including sensitivity of exchange rates, to macroeconomic policy. For South Africa, such measures could potentially serve, at least, to partially insulate the economy against any negative reactions by financial markets to an employment-targeted economic program. The key question for South Africa then is: to what extent and under what conditions can capital management interventions enhance the autonomy of macroeconomic policy, including by helping to manage exchange rates?

In our view, such measures are capable, at least, of supporting efforts by the Reserve Bank to lower nominal interest rates within the range of about four percentage points that we are proposing. In addition, severe bouts of exchange rate volatility will be less likely when capital management policies are deployed to prevent such episodes. The fact that South Africa has a long history of operating exchange and capital controls enhances the prospect that such measures could be used effectively to support a more expansionary set of fiscal, monetary, and credit allocation policies. At the same time, in part because such measures are again becoming increasingly common as a form of macroeconomic management, they would not suggest that South Africa is moving away from its generally open interactions with global markets.

Inflation Control and Economic Growth. The Government clearly appears committed to the idea that maintaining a low inflation environment is a necessary foundation for attacking poverty and unemployment in a sustainable way. We certainly do not advocate a high inflation rate or a relaxation of the inflation-targeting regime as ends in themselves. However, the primary tool that the Government utilizes to control inflation is to maintain high interest rates. By contrast, we have advanced measures to lower interest rates—both across the board, and also through providing concessionary borrowing rates for industries with high employment multipliers. This report anticipates that a likely effect of such measures will be for inflationary pressures to develop beyond the recent levels common under the inflation-targeting regime.

The question that the report therefore examines is: how severe would be the costs to the South African economy of allowing the inflation rate to rise above its current target range of 3–6 percent? Recent research on this general issue had been pioneered by the late Michael Bruno, who had served both as Governor of the Bank of Israel and Chief Economist of the World Bank. In his 1995 World Bank study, Bruno analyzed the relationship between inflation and economic growth for 127 countries between 1960 and 1992. He found that average growth rates fell only slightly as inflation rates moved up to 20–25 percent. Of particular importance for policymaking in South Africa, Bruno found that during 1960–72, economic growth on average increased as inflation rose from negative or low rates to the 15–20 percent

range. This is because, as Bruno explained, "in the 1950s and 1960s, low-to-moderate inflation went hand in hand with very rapid growth because of investment demand pressures in an expanding economy," (1995, p. 35). That is, demand-pull inflation, resulting from a process of economic expansion, was positively associated with growth as long as the inflation rate remained moderate.

Many researchers have subsequently examined the issue, a minority challenging Bruno's findings. This study developed its own model of the growth-inflation relationship, whose results broadly affirm Bruno's. And while a consensus has not been established on the issue, a few basic conclusions from the range of studies, including the one for this report, do seem warranted. One is that, regardless of whether researchers observe a negative growth-inflation relationship emerging in the *double-digit* range for developing countries, there is only negligible evidence showing a negative relationship between growth and *single-digit* inflation. In addition, no researcher has challenged Bruno's point that the relationship between inflation and growth will be different depending on *what is causing* the economy's inflationary pressures. Thus, if South Africa pursues an aggressive employment-targeted program, one would expect that the inflationary pressures that might then emerge would not be harmful to growth, as long as policies maintain inflation at a moderate level.

But what happens if inflation accumulates momentum, such that a rise to, say, a 10 percent inflation rate leads to still greater inflationary pressures? Should South Africa then revert to raising interest rates, i.e., its standard policy tool at present for controlling inflation? In fact, two other policy tools are available for use. The first tool would be to pursue measures that weaken the monopolistic pricing power that now characterizes some sectors of the economy. The second tool would be to pursue so-called 'incomes policies'. Incomes policies have been developed in various ways across countries, but the basic idea is straightforward: wage and price increases are negotiated over an economy–wide basis between the organized sectors of labor and business. Incomes policies can also be beneficial more generally in improving the efficiency of the country's industrial relations system and the implementation of its labor-law regulations.

The most basic critique of incomes policies is that in order for the approach to have any chance of success, it is necessary that workers achieve a high level of organization and that there be some reasonable degree of common ground for negotiations between workers and business. Otherwise, there would be no realistic prospect for economy-wide bargaining that could yield results that would be honored widely. In the case of South Africa, a high degree of organization does exist both among sectors of the working class and among business interests. However, the relationship between unions and business is highly contentious. This could possibly diminish to the extent that both sides recognize the obvious benefits of a program of accelerated economic growth and employment expansion.

Government Spending Programs and Tax Policy. Beyond providing a fiscal stimulus, the Government obviously would play a crucial role in an employment-targeted program through its spending priorities and tax programs. The programs that this report is advocating would entail annual expenditures of R20-30 (in 2004 prices), broken down as follows:

1. Public investment in infrastructure: R5–7.5 billion
2. Income transfers and social support: R10–20 billion
3. Credit subsidies to businesses to promote accelerated employment growth: R5–7.5 billion

This report supports the idea of raising the structural fiscal deficit from two percent to three percent of GDP. If the Treasury did operate with this higher deficit, that alone would cover about R14 billion/year, i.e., roughly half of the total spending increase implied by our high end figure of R30 billion. Raising the additional R16 billion would have to come primarily from more revenue. This would raise South Africa's tax revenue/GDP ratio from the 2004 rate of 24.7 percent to roughly 25.8 of GDP.

An increase to a roughly 26 percent ratio would still place South Africa well below the ratios for lower-income OECD countries, such as Greece (45.1 percent) and Poland (41.8). It would also put South Africa roughly in line with a group of rapidly growing Asian economies, including Singapore (29.0 percent), Republic of Korea (28.4 percent) and Malaysia (22.2 percent). None of these other countries necessarily provides a particularly appropriate comparison to South Africa. But the key point is that neither the nearly 25 percent ratio at which South Africa currently operates nor an increase to 26 percent would establish South Africa as a significant outlier either among the OECD or Asian comparison groups.

Of the R16 billion/year that would need to be raised through additional revenue, the report argues that about R6 billion could be raised through increasing rates modestly on the Government's three major revenue sources, the personal income tax, the corporate profit tax and the VAT. However, the other R10 billion could be raised through three other sources. The first would be to extend the current Uncertified Securities Tax, which now applies only to stock trading, to the bond market as well. This is done in several comparison countries such as Brazil, Chile, Malaysia, and Morocco. We conservatively estimate that such a tax could raise roughly R6 billion per year. A second source would be enacting the Mineral and Petroleum Royalty bill that was drafted by the Treasury in 2003. We estimate that this royalty would generate another R2.5 billion.

Finally, assuming that the economy's growth would rise from a three percent trend to a 5.3 percent trend through an employment-targeted program, we conclude that tax revenues of about R6.5 billion would result because of higher incomes. Such a rise in incomes will also bring reductions in the Government's expenditures on income support payments, given that employment will increase and poverty will decline. But in our calculations we allow for only a modest net fiscal contribution since the Treasury has already factored in a significant growth dividend in its fiscal projections through 2008-09.

Policies for Productive Sectors. In addition to subsidizing activities for the expressed purpose of accelerating employment growth, this report considers two other concerns within the realm of sectoral policy. The first deals with the costs incurred through monopolistic pricing power and the administrative determination of prices. The administrated prices of the parastatals – the publicly-owned utilities and economic services industries – are a case in point. Enterprises such as Eskom (electricity), Transnet (transportation), and Telkom (telecommunications) provide essential inputs and services to sectors throughout the South African economy. However, prices are poorly regulated and are not effectively coordinated with national policy objectives. Prices are often the outcome of a process of negotiation rather than an integrated regulatory framework. For example, large industrial users of electricity are able to negotiate more favorable rates than smaller commercial enterprises. This effectively subsidizes the costs of production for larger firms, at the expense of smaller-scale users.

Such pricing practices therefore act to counter efforts to promote small enterprises and cooperatives. Similar problems with administered prices exist for other critical segments of the economy. For example, the practice of 'import parity pricing' enables steel producers to set prices at the international price plus tariff and transportation costs rather than at the price that would reflect domestic production conditions. Such practices raise barriers to the success of an employment-targeted program. At the same time, common blanket solutions, such as privatization, are not likely to resolve these problems. Many of these industries are 'natural monopolies' that require regulation regardless of who owns the assets. Thus, establishing a coherent set of such regulations will be critical to the long-term viability of an employment-targeted program.

The second concern that the report addresses is that of promoting some industries even when their employment multipliers are weak. Such measures relate to both the motor vehicles industry and the capital goods industry. While neither industry should be targeted for accelerated expansion on the basis of its employment multipliers, there are other grounds on which they should be promoted. In particular, it would clearly be crucial over the next decade for the South African economy to continue enhancing productivity and the capacity to produce import-competing capital goods. This is so even if policymakers remain focused on employment creation as their primary objective. Indeed, implementing an effective employment-targeted program should indeed enhance the capacity of policymakers to advance a broader economic policy agenda, since they can pursue other objectives—such as building a competitive capital goods industry—without neglecting the imperatives of job creation and poverty reduction.

NOTE

1. The CPIX consumer price index excludes interest rates on mortgage bonds, which are included in the CPI measure. The CPI measure is the so-called 'headline' inflation rate.

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