Poverty, Inequality and the Labour Market: Evidence from South Africa

Abstract

The links between the changing composition of individual-level employment and unemployment in the labour market, and household-level poverty and inequality are complicated and context specific. This paper explores these relationships in South Africa over the post-apartheid period. It shows that the sluggish and skill-biased demand for labour alongside the large increase in the supply of relatively well-educated, young labour force participants led to sharply rising unemployment. Decomposition exercises show that these labour market dynamics have been central in driving increased household inequality and have prevented a positive role for the labour market in alleviating poverty. The measured improvements in poverty over the post-apartheid period have been the result of a massive expansion of social grants and not the labour market. In looking to reverse the negative role of the labour market, three labour market policy options dominate the contemporary agenda; namely, unemployment insurance, an expanded public works programme and a wage subsidy. The evidence on all three is presented and none of them appear to have the capacity to make a fundamental impact. The paper concludes by suggesting that programmes to assist job search might provide the most promising active labour market intervention. More fundamentally the growth of the informal sector needs to be facilitated in order to build a bridge into the labour market for the poor.

Key words: Unemployment, Inequality, Poverty
JEL codes: D31, D63, I32, J08, J68
Introduction

Creating jobs, reducing unemployment, and tackling persistent poverty and high levels of inequality in a context of weak economic growth and significant market failures are challenges faced by many developing countries. Against this backdrop, improving the performance of the labour market in terms of promoting employment is often a central tenet of government policy in the fight against poverty and inequality since unemployment not only constitutes a loss of productive capacity and output in the economy, but places tremendous pressure on formal and informal social assistance networks.

That said, there is little analytic work or specific evidence on the links between the performance of the labour market and poverty and inequality in developing economies. Recent work by Fields and Kanbur (2007), presenting a model that assesses the potential impacts of a minimum wage on poverty, provides a rare exception. In the spirit of their model, the following stylized set of connections can be established. Changing demand for labour patterns allocate jobs to specific individuals and drive changes to the distribution of individual labour market earnings. Linking these labour demand patterns to evolving household-level poverty and inequality trends requires that those who are and who are not getting employment can be linked back into their households and the activities and income flows of that household. Only in the case of government employment programmes that are formally targeted at members of poor households is there any direct connection between a household being poor and the labour demand process. Without such targeting the impacts of employment change on poverty and inequality are complicated and potentially contradictory. Fields and Kanbur (2007) conclude their paper by suggesting that the specific linkages that their model has highlighted are useful in demarcating what avenues to explore but that the nature of these linkages and their interactions will be different in each country context.

In this paper, we consider the link between labour markets and poverty and inequality, using the experience of post-apartheid South Africa as an example. Sluggish and skill-biased demand for labour alongside the large increase in the supply of relatively well-educated, young labour force participants has led to sharply rising unemployment over this period. It appears that inflexibility in the labour market has prevented adjustments to preserve or increase employment, but this is as much about the transactions costs of the employment relationships as about wage flexibility. Examining the empirical record of rising inequality and falling poverty over the post apartheid period, our analysis shows that the labour market has, in fact, been the driver of increasing inequality over time, and that social assistance in the form of government welfare grants have been primarily responsible for keeping rising poverty levels in check. As such, this suggests the complementary role for labour markets and social policies aimed at addressing poverty in developing countries. In looking to reverse the negative role of the labour market, three labour market policy options dominate the contemporary agenda; namely, unemployment insurance, an expanded public works programme and a wage subsidy. The evidence on all three is presented and none of them appear to have the capacity to make a fundamental
impact. The paper concludes by suggesting that programmes to assist job search might provide the most promising active labour market intervention. More fundamentally the growth of the informal sector needs to be facilitated in order to build a bridge into the labour market for the poor.

**The Post-Apartheid Labour Market**

Unemployment in South Africa, irrespective of whether one adopts a broad or a narrow definition, is high, and has increased during the post-apartheid era, from 15.6% in 1995 to 30.3% in 2002 (Banerjee et al., 2006), only beginning to fall in the latter part of the 2000’s. Similar trends can be observed in the data presented in Table 1 below. While unemployment has increased across all age cohorts during this period, youth have been particularly hard hit, with the most marked rise occurring in the 21 to 30 year age group. The legacy of unequal access to jobs and labour discrimination remains evident, with unemployment rates being significantly higher for women, and for African and Coloured workers. However, there has been a large increase in unemployment rates amongst Whites. The highest rates of unemployment were formerly reserved for those with only a primary school education, whereas more recently those who have attended high school but failed to attain their grade 12 certificate (thereby completing their schooling) are the most at risk. Even the better educated workforce appears to be having increasing difficulty with unemployment over time. As the younger generation become more educated than the older generation (particularly Africans) the increasing unemployment for the youth and the better educated are likely to be correlated, and related to increasing labour participation in these two categories. The relatively low rates of unemployment over time for those with little or no education are probably due to the exclusion of ‘discouraged’ workers and those who don’t want work from the official definition of unemployment.

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1 Nattrass (2000) reviews the official labour statistics and argues that these increases appear to be credible, and are not an artefact of mismeasurement.

2 Unemployment was formerly much more prevalent amongst the African and Coloured population while Whites enjoyed much higher levels of employment. One area where this race differential was most prominent was in the area of government administration, where all but the most menial jobs were reserved exclusively for Whites. In the economy in general, skilled jobs were reserved for the white population and the African labour force earned lower wages in relatively unskilled jobs. Thus the African population previously suffered not only relatively higher levels of unemployment, but lower wages for those that were employed.

3 This relative increase in unemployment for the better educated does not indicate a shift in the demand for labour towards the less educated. Rather, the less educated groups make up declining shares of the labour force and sharply declining shares of new entrants.
Table 1: Unemployment rates by category

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<tbody>
<tr>
<td>Total (narrow defn)</td>
<td>13.6</td>
<td>20.5</td>
<td>29.6</td>
<td>26.4</td>
<td>23.4</td>
<td>9.8</td>
</tr>
<tr>
<td>Total (broad defn)</td>
<td>31.2</td>
<td>36.1</td>
<td>41.3</td>
<td>38.3</td>
<td>28.9</td>
<td>-2.3</td>
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**Age**

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<tbody>
<tr>
<td>16-20</td>
<td>39.2</td>
<td>44.4</td>
<td>58.3</td>
<td>58.9</td>
<td>41.3</td>
<td>2.1</td>
</tr>
<tr>
<td>21-30</td>
<td>20.3</td>
<td>31.4</td>
<td>43.3</td>
<td>39.7</td>
<td>33.2</td>
<td>12.9</td>
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<tr>
<td>31-40</td>
<td>10.5</td>
<td>18</td>
<td>23.4</td>
<td>21</td>
<td>19.8</td>
<td>9.3</td>
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<tr>
<td>41-50</td>
<td>7.4</td>
<td>13.1</td>
<td>16.7</td>
<td>14.9</td>
<td>16.9</td>
<td>9.5</td>
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<tr>
<td>51-60</td>
<td>6.2</td>
<td>8.5</td>
<td>12.3</td>
<td>9.8</td>
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<tr>
<td>61-65</td>
<td>5.3</td>
<td>7.2</td>
<td>8.1</td>
<td>6.1</td>
<td>8.1</td>
<td>2.7</td>
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**Race**

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<tbody>
<tr>
<td>African</td>
<td>17</td>
<td>27.1</td>
<td>36</td>
<td>31.1</td>
<td>27</td>
<td>10</td>
</tr>
<tr>
<td>Coloured</td>
<td>15.7</td>
<td>15.2</td>
<td>21.6</td>
<td>22.3</td>
<td>17.3</td>
<td>1.5</td>
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<tr>
<td>Indian</td>
<td>8.3</td>
<td>9.8</td>
<td>18.9</td>
<td>15.6</td>
<td>6.6</td>
<td>-1.7</td>
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<tr>
<td>White</td>
<td>3.2</td>
<td>3.9</td>
<td>6</td>
<td>4.9</td>
<td>10.3</td>
<td>7.1</td>
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**Gender**

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<tbody>
<tr>
<td>Male</td>
<td>11.9</td>
<td>17.3</td>
<td>26</td>
<td>22.2</td>
<td>17.1</td>
<td>5.2</td>
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<td>Female</td>
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<td>26.5</td>
<td>34.1</td>
<td>31.3</td>
<td>30.1</td>
<td>14.2</td>
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**Education**

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<tbody>
<tr>
<td>None</td>
<td>10.5</td>
<td>18.3</td>
<td>21.8</td>
<td>17.1</td>
<td>16.9</td>
<td>6.5</td>
</tr>
<tr>
<td>Primary</td>
<td>17</td>
<td>25.6</td>
<td>29.9</td>
<td>26.4</td>
<td>20.7</td>
<td>3.8</td>
</tr>
<tr>
<td>Secondary (incomplete)</td>
<td>16.2</td>
<td>24.2</td>
<td>36.9</td>
<td>33.3</td>
<td>30.2</td>
<td>14.1</td>
</tr>
<tr>
<td>Secondary (Grade 12)</td>
<td>12.7</td>
<td>21.5</td>
<td>30.8</td>
<td>28</td>
<td>25</td>
<td>12.3</td>
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<tr>
<td>Tertiary</td>
<td>2</td>
<td>6.3</td>
<td>11.4</td>
<td>7.7</td>
<td>12.5</td>
<td>10.4</td>
</tr>
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Importantly, South Africa exhibits high levels of long-term unemployment; that is, unemployment duration longer than a year. In 2004, 67% of South Africa’s unemployed were unemployed on a long-term basis as opposed to only 0.8% in Mexico (Department of Trade and Industry, 2004). This figure had dropped to 58.5% by 2008 (Portfolio Committee on Finance, 2008). The fact that in South Africa many skilled sectors are having difficulty in filling certain positions and unemployment is structural in nature, also contributes to long-term unemployment (Department of Trade and Industry, 2004).

The causes underlying South Africa’s high unemployment rates are multiple and varied, but parallel the experiences of many developing countries. Arguably, a key factor influencing employment in the long run is economic growth. Comparatively, South Africa’s GDP per capita growth has been poor, averaging 0.3% over the period 1980 to 2008, compared to 1.15% for other upper middle income countries. While economic
growth has increased steadily both in real and per capita terms during the post-apartheid era, this growth has been less than was expected. Structural shifts in production from the employment intensive primary sector to the tertiary sector have also contributed to sectoral changes in employment, causing the relative demand for labour, and unskilled labour in particular, to decline. Banerjee et al (2008) emphasise that due to the structural nature of unemployment it is unlikely to improve in the future without policy interventions.

At the same time, labour force participation has increased rapidly since 1993, especially amongst youth\(^4\) and African women\(^5\) (Branson, 2006; Posel & Casale, 2002; Kingdon and Knight, 2008). Available evidence from the October Household Survey (OHS) and Labour Force Survey (LFS) suggests that between 1995 and 2002 (a period of particularly high unemployment growth) employment growth was actually higher than growth of the working age population, suggesting that labour force growth is indeed responsible for growing unemployment (Burger & Woolard, 2005). Almost a third of the increase in unemployment experienced between 1995 and 2005 can be attributed to the change in the composition of the labour force brought about by the influx of these new entrants (Banerjee et al, 2006). This increased labour force participation has coincided with a relatively static demand for labour (although sectors such as mining and agriculture have experienced a decline in the demand for labour), inevitably resulting in rising unemployment.

High labour costs and labour market rigidities have also been advanced as an explanation for unemployment in South Africa. Fedderke (2006) argues that increasing labour militancy combined with the structural changes in the economy that favoured skilled workers resulted in rising labour costs that exceeded labour productivity improvements. These trends impacted negatively on employment in sectors with strong negative elasticities of labour demand, that typically relied on unskilled labour, such as mining and agriculture. However, Banerjee et al (2007) find no evidence to support the claim that unemployment has been driven by upward wage pressure, and argue that even though the estimated wage union premium increased between 1995 and 2005, especially for skilled and semi-skilled workers, this premium simply kept these wages from falling as fast as

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\(^4\) Globally, there has been a trend of decreasing labour force participation of the youth as more people stay in school longer and delay their entrance into the labour market (ILO, 2008). In South Africa grade attainment for the youth, particularly Africans, has increased markedly since 1994, while years in school has only increased marginally. Therefore there has been little change in the delay in labour market entrance due to increased education. The large increase in youth participation suggests instead that either the youth are becoming less ‘discouraged’ and actively seeking employment (perhaps due to their increased education levels), or youth who previously did not enter the job market are increasingly choosing to do so. Thus the labour force is not only growing, it is also becoming younger and better educated.

\(^5\) Kingdon and Knight (2008) argue that the higher rates of female participation in the labour market are a result of higher education levels, loss of male income through unemployment and HIV/AIDS mortality and greater number of female headed households. Globally, particularly in developing countries, there has been a trend towards increased female labour force participation due to increased human capital in the form of educational attainment (ILO, 2008).
they would have otherwise. In fact, real wages for youth and unskilled workers have been falling.

There is some evidence though that employers have turned to part-time or casual labour in order to avoid the ‘hassle factor’ of permanent employment (Bhorat et al, 2002), owing to strict labour legislation and an inflexible labour market. There has been a sharp increase in casual and part-time work between 1993 and 2008, most notably after 1997, which coincides with the implementation of the Labour Relations Act of 1995, and the Employment Equity Act of 1998 and the Skills Development Act of the same year. This ultimately means that fewer workers are protected by legislation, and thus are likely to fall into unemployment far more easily. According to Schultz and Mwabu (1998), not only do firms substitute capital for labour, but a reduction in working hours may also be a direct result of an increase in the cost of labour. This may provoke workers to seek employment in sectors not covered by collective bargaining agreements, thereby reducing wages in uncovered sectors. Using the Labour Flexibility Survey, Standing (1997) found that the preferred means by which to avoid escalating labour costs was to introduce technological changes. This not only decreases the demand for labour overall, but increases the demand for skilled relative to unskilled labour. This is a shift in demand away from a pool of labour in which South Africa is abundant to a pool of skilled labour that is scarce. Aron et al (2008) argue that South Africa’s labour legislation is far too rigid for a country with the kinds of unemployment conditions and the state of labour market segmentation, as they currently exist. As such, they argue that the lack of flexibility is contributing to exacerbating income inequalities and hampering employment creation (Aron et al, 2008).

Poverty, Inequality and the Labour Market

Poverty and inequality in South Africa are inextricably linked with the labour market. This is because strong positive employment and real wage responses by the private sector to economic growth are a key mechanism to alleviate poverty. Census-based analyses reaching as far back as 1917 indicate that average real incomes have been steadily increasing for all population groups. This trend has also persisted over the last 15 years according to work carried out on four household surveys, namely the Project for Statistics on Living Standards and Development (PSLSD), the Labour Force Survey (LFS), the

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6 These inflexibilities include the difficulty of hiring and firing labour as well as adhering to bargaining council agreements, labour laws which only cover permanent workers.

7 The rise in casual labour is predominantly among the African population, where the share of part-time employment more than doubled, as opposed to a mere increase of only 22% among the white population. This may be explained by the fact that part-time labour generally comprises of workers with lower levels of education. In short, the proportion of the African employed population that is fully utilising their productive capacity and also enjoying the benefits of protective labour legislation is falling rapidly.
Income and Expenditure Survey (IES), and the National Income Dynamics Study (NIDS). This, however, has not resulted in a decline in South Africa’s historically high inequality. In fact aggregate inequality measures have shown an increase in inequality over the post-apartheid years. The rising aggregate Gini coefficients for 1993, 2000 and 2008 presented in Table 2 illustrate this point and the evidence reviewed in Leibbrandt et al. (2009) shows the same trend using other data sets for other years.

Table 2: Gini coefficients for 1993, 2000 and 2008, aggregate and by race

<table>
<thead>
<tr>
<th>Year</th>
<th>1993</th>
<th>2000</th>
<th>2008</th>
</tr>
</thead>
<tbody>
<tr>
<td>African</td>
<td>0.55</td>
<td>0.61</td>
<td>0.62</td>
</tr>
<tr>
<td>Coloured</td>
<td>0.43</td>
<td>0.53</td>
<td>0.54</td>
</tr>
<tr>
<td>Indian</td>
<td>0.46</td>
<td>0.50</td>
<td>0.61</td>
</tr>
<tr>
<td>White</td>
<td>0.42</td>
<td>0.47</td>
<td>0.50</td>
</tr>
<tr>
<td>Aggregate</td>
<td>0.66</td>
<td>0.68</td>
<td>0.70</td>
</tr>
</tbody>
</table>

*Source: Own calculations using PSLSD (1993), LFS (2000) and NIDS (2008)*

For a country with a racially discriminatory past such as South Africa’s, it is only natural that the large and increasing income disparities bear a strong racial footprint and there is a tendency to attribute the country’s unusually high aggregate inequality measures to strong between race income disparities. However, while the between race component of inequality remains very high, within-race inequality has increased markedly for all racial groups. In fact, within racial group dynamics have become more important and within African dynamics have become especially important in driving aggregate changes in inequality (Leibbrandt et al, 2009).

In addition to racial inequality, in South Africa inequality by geotype (urban versus rural) has proven to be a leading theme in inequality studies. This bears a strong link to racial inequality, as zoning policies under the country’s apartheid government forced Africans, and thus predominantly poor people to live in allocated rural homelands. Survey data reveals that urban inequality has in fact increased since 1993, whereas rural inequality seems to have fallen. This is generally linked to the prolific migration of rural dwellers to urban centres, thus increasing urban income discrepancies.

While inequality has remained stubbornly high, there is substantial evidence that poverty has fallen over time (Hoogeveen and Ozler, 2006; Leibbrandt et al, 2006; van den Berg et al, 2006). All literature shows that African poverty incidence was and remains a lot higher than Coloured, which in turn is a lot higher than Indians/Asians and then whites. Combining this relative incidence with population shares, Africans account for more than 90% of the country’s poverty share, with Coloureds making up the remaining share. In

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8 One notable difference between the picture of Table 2 and this literature is that other studies seem to indicate an improvement in poverty levels only after 2000. Thus, there is some contention over the timing of the poverty declines. There is no such contention with regard to changes in non money-metric well-being. In all analyses, access to services, formal dwellings and private assets are shown to improve in the period from 1996 to 2001 and then on through to 2008.
accordance with the change in urban/rural Gini coefficients pointed out earlier, rural poverty incidence barely changed over the last 15 years, whereas an increase in poverty was seen in urban centres.

Table 3: Poverty headcount ratios

<table>
<thead>
<tr>
<th>Population</th>
<th>Poverty headcount: $1.25 per day</th>
<th>Poverty headcount: $2 per day</th>
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<tbody>
<tr>
<td>1993</td>
<td>40,002,316</td>
<td>0.21</td>
</tr>
<tr>
<td>2000</td>
<td>45,134,247</td>
<td>0.17</td>
</tr>
<tr>
<td>2005</td>
<td>46,971,312</td>
<td>0.17</td>
</tr>
<tr>
<td>2008</td>
<td>48,687,036</td>
<td>0.18</td>
</tr>
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</table>


The labour market connection to poverty and inequality can be explored by examining the share of income sources in total household income by income decile in 2008. Figure 1 demonstrates that the proportion of income derived from wages increases linearly by income decile. If a person is a member of a household situated in the poorest five deciles they are likely to receive relatively little wage income and depend quite heavily on government grants\(^9\) and subsidies. There has been a rapid expansion in spending on social assistance between 2000/01 and 2006/07. While spending on most budget items (e.g. education and health) have remained fairly constant in real terms, consolidated expenditure on welfare and social assistance has increased 3.2 per cent of GDP in 2000/01 to 4.4 per cent of GDP in 2008/09 (National Treasury, 2002 and 2009).\(^10\) Social grants have thus been central to poverty alleviation over the post-apartheid years.

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\(^9\) There are several kinds of Social Assistance Grants in South Africa, namely, the State Old Age Pension, the Disability Grant, the Child Support Grant, the Care Dependency Grant and the Foster Care Grant.

\(^10\) In April 2009, 13.4 million people were benefiting from social grants. Of these, 2.3 million were receiving old age pensions, 1.4 million were receiving disability grants and 9.1 million children were benefiting from Child Support Grants. These grants are means-tested unconditional cash transfers.
Figure 1. Income decomposition by decile, 2008

Source: NIDS (2008)

Figure 2 complements this picture by showing South African unemployment rates by decile for 1993, 2000 and 2008. This figure shows very high unemployment rates in the lower deciles that fall as one moves to higher deciles. This unemployment situation has worsened between 1993 and 2008; especially in the lower deciles. In a country with unemployment levels as high as those in South Africa, one would expect to find a far larger informal sector. In addition, the difficulty in finding employment by those with a moderate level of education should theoretically result in a high national self-employment level. However, the share of informal employment has only increased slightly despite more rapidly increasing levels of unemployment. Furthermore, the self-employment rate has declined substantially (Leibbrandt et al, 2009).
Table 4 examines the labour market connection to poverty further by looking at the relationship between the poverty status of individuals given the labour market status of their household’s. In 2008, just under half of the unemployed were living in households that contained at least one employed person. Another 13% were living in households that received some indirect labour market income in the form of remittances. Most pertinently, about one quarter of the unemployed were living in households that were receiving social assistance grants and have no access to labour market income. The share of households with no link to the labour market has risen sharply, from 30% in 1997 to 42% in 2008, escalating the number of households relying on grants, child grants in particular (Leibbrandt et al, 2009).

Some of these grants involve large cash transfers and there is some concern about negative labour supply effects from these transfers. The empirical evidence to support this concern is mixed. Bertrand et al (2005) use cross-sectional data to demonstrate that household members in pension-eligible households work less than their counterparts in non-eligible households. Ranchod (2007) finds similar results using LFS data, demonstrating that when a household loses a pensioner, employment rates increase, especially amongst adult women. This accords with the notion that young people only engage in serious job search once their parents die, which translates into higher employment rates amongst cohorts aged 30 and above. Age also correlates with changes in other life events, such as marriage and child bearing, which may also make it more difficult to continue to rely on parental income. A key caveat to this body of evidence is that the results focus only on the behaviour of resident household members, giving rise to sample selection bias in the results. Work by Posel et al (2004) demonstrates that once one expands the definition of the household to include non-resident household members, pension receipt facilitates the departure of prime age women from the household in order to search for work. Edmonds et al (2003) and Ardington et al (2009) confirm this result. Thus, it seems that these grants may, in fact, play an important indirect role in reducing unemployment: through funding job search or migration or the establishment of a business.
Table 4: Household labour market attachment and access to grants of the unemployed (%)

<table>
<thead>
<tr>
<th></th>
<th>1997</th>
<th>2006</th>
<th>2008</th>
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<tbody>
<tr>
<td>No-one employed, no remittances, no social grants</td>
<td>11.8</td>
<td>13.2</td>
<td>16.9</td>
</tr>
<tr>
<td>No-one employed, no remittances, social grants</td>
<td>17.5</td>
<td>24.7</td>
<td>24.9</td>
</tr>
<tr>
<td>No-one employed, remittances</td>
<td>21.3</td>
<td>11.2</td>
<td>12.9</td>
</tr>
<tr>
<td>1 employed</td>
<td>35.8</td>
<td>39.4</td>
<td>36.6</td>
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<tr>
<td>2 or more employed</td>
<td>13.5</td>
<td>11.5</td>
<td>9.4</td>
</tr>
<tr>
<td>Total</td>
<td>100.0</td>
<td>100.0</td>
<td>100.0</td>
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</table>

Source: 1997 October Household Survey; September 2006 Labour Force Survey, Statistics South Africa and 2008 NIDS data  Note: This table presents only selected years owing to the absence of data on either remittances or labour market status in other surveys

The major findings concerning poverty and the labour market are easy to discern from these figures and tables. While the presence of an employed person in one’s household is not a guarantee that one will not be poor, lack of access to employment is a very strong marker of poverty. The labour market has not had a positive impact on poverty because of the failure to pull unemployed individuals from poor households into employment.

Aside from the kind of within-race and between-race decomposition exercises that were reported on earlier in this paper, the dominant decomposition exercise that has been undertaken on post-Apartheid national survey data follows Shorrocks (1984) in partitioning aggregate income inequality (as measured by the Gini coefficient) into contributions from various income sources (Leibbrandt et al., 2000, Bhorat et al., 2000, Leibbrandt et al., 2009). Such exercises are important in formally establishing the importance of the labour market and social grants in understanding South African inequality.

For the purposes of this paper, it makes sense to decompose income into four sources; namely, remittances, wage income (including self-employment), social assistance (“grants”) and capital income (such as dividends, interest, rent income, imputed rent from residing in own dwelling and private pensions). Leibbrandt et al (2009) do this for 1993, 2000 and 2008. The decomposition analyses find that, across all years, wage income (including self-employment income) has a dominant share of income (around 70%) but makes an even larger contribution to inequality (around 85%). The reasons for this are the high inequality of wage income itself and then the high correlation between wage income and total household income (a rank correlation of over 0.9), implying that a household's rank in the distribution of wage income is strongly correlated with that households rank in the distribution of total income. All in all, the labour market is shown to sit centre-stage as the driver of South African income inequality.

A useful extension to this decomposition, derived by Lerman and Yitzhaki (1994), has been applied in South Africa. This extension allows the inequality contribution of wage income (or any income source) to be further decomposed into a contribution due to inequality among those earning income from that source and the proportion of households who have no access to a particular income source. Thus, this takes the analysis part of the way to apportioning the "blame" for Gini inequality into two parts; the inequality amongst earners
and the inequality driven by those with some wage income and those with none. From such exercises it appears that at least one-third of the dominant contribution of "wage inequality" is attributable to the large percentage of households with zero wage income. Thus, low labour force participation and lack of access to employment are an important component of the dominance of the labour market in driving South African inequality.

In contrast to wages, state transfers are shown to account for up to 10% of income but to make almost no contribution to inequality. This very low contribution arises because of the low correlation between the rank ordering of transfer income and total income as well as the low Gini coefficient for state transfers. In 1993 and even more so by 2000, state transfers were heavily concentrated in the middle of the distribution as access to a State Old Age Pension or Disability Grant was sufficient to lift most households out of the bottom quintile, while the means tests for these grants excluded households at the upper end of the income distribution. This is a promising outcome in that it suggests that the low contribution of these transfers to inequality is because they are well targeted and making a significant contribution.

In order to better understand the mechanism whereby employment affects inequality, Leibbrandt, Woolard and Woolard (2009) make use of a decomposition technique to unpack the earned (i.e. wage and self-employment) income component of household income. They begin by recognizing that household labour market income depends on three factors, namely, the number of “potential workers” (that is, household members of working age), the number of household members that are actually employed and the earnings of these workers. They slightly modify Glewwe (1986) in order to decompose the log-variance of household labour market earnings into these three components:

\[
\frac{W}{hhs} = \frac{L_p}{hhs} \cdot \frac{L_w}{L_p} \cdot \frac{W}{L_w}
\]

where \(W\) is labour market income from both wage and self-employment (for simplicity we call it merely ‘wage income’), \(hhs\) is household size, \(L_p\) is the potential number of workers (defined here as the number of persons aged 15-64) and \(L_w\) is the number of people actually employed.

Taking the natural logarithm of both sides of the equation above and calculating the variance gives:

\[
\text{var} \left[ \ln \left( \frac{W}{hhs} \right) \right] = \text{var} \left[ \ln \left( \frac{L_p}{hhs} \right) \right] + \text{var} \left[ \ln \left( \frac{L_w}{L_p} \right) \right] + \text{var} \left[ \ln \left( \frac{W}{L_w} \right) \right] + 2 \times \text{cov} \left[ \ln \left( \frac{L_p}{hhs} \right), \ln \left( \frac{L_w}{L_p} \right) \right] \\
+ 2 \times \text{cov} \left[ \ln \left( \frac{L_p}{hhs} \right), \ln \left( \frac{W}{L_w} \right) \right] + 2 \times \text{cov} \left[ \ln \left( \frac{L_w}{L_p} \right), \ln \left( \frac{W}{L_w} \right) \right]
\]

The contribution of each of the first three terms on the right-hand-side can be thought of as the contribution of household composition (the number of persons of working age), access to employment and wage inequality, respectively.
Table 5 reports on the results of this technique. It reveals that most of the inequality in shared household earnings is the result of unequal wage incomes, rather than the fraction of household members that are of working age or who are actually working. Nevertheless, joblessness has a significant effect on household wage inequality. This is particularly true in African households.

### Table 5: Decomposition of shared household earnings

<table>
<thead>
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<th>Variances</th>
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<tr>
<td></td>
<td>Variances</td>
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<tr>
<td></td>
<td>ln(\frac{L_p}{hhsize})</td>
<td>ln(\frac{L_w}{L_p})</td>
</tr>
<tr>
<td>All Households</td>
<td>7.4% 12.6% 69.4%</td>
<td>2.4% 4.4% 3.6%</td>
</tr>
<tr>
<td>White Households</td>
<td>9.5% 12.6% 90.7%</td>
<td>-1.2% -1.6% -10.0%</td>
</tr>
<tr>
<td>African Households</td>
<td>8.7% 15.0% 64.8%</td>
<td>3.8% 5.2% 2.6%</td>
</tr>
</tbody>
</table>

Source: Own calculations based on September 2006 Labour Force Survey, Statistics South Africa. The percentage contribution to earnings inequality is shown in parentheses.

In sum then, available evidence suggests that the labour market plays a dominant role in driving inequality. This large labour market contribution is driven both by the large and rising number of households with no wage income as well as the highly unequal distribution of wage income in households with positive wage income\(^{12}\). In contrast, while state transfers have increased their importance as an income source, they appear to be neutral in respect of changes in inequality. This is partly because they are providing support that is significant enough to pull beneficiary households into the lower-middle deciles of the distribution.

### Reducing poverty and inequality: What role for the Labour Market?

Since the unemployed are excluded from direct targeting of grants, it remains key to explore labour market interventions that might directly assist the unemployed. In light of the poor performance of the post-apartheid labour market, the state implemented two interventions in the form of the provision of unemployment insurance, and public works programmes, both of which were aimed at directly assisting the unemployed.

\(^{12}\) There is evidence to suggest that wage inequality is high and increasing. Available data in the OHS and LFS show that decile 9 earned on average 20 times more than decile 1 in 1997 and this has almost doubled between 1997 and 2008. The ratios between the wealthy and the middle class and the poor and the middle class are fairly stable, although both have seen increases in inequality since 1997. This increase in wage inequality has been largely fuelled by the fact that between 1997 and 2008 deciles 9 and 10 were the only ones to experience any growth in real wages, all other deciles suffered a decrease in real wages (see table 2.4 below). During this period average real wages in decile 1 almost halved, while real wages in decile 9 increased by 12%. Ultimately the highest decile enjoyed the highest increase in real wages while the lowest decile suffered the highest decrease, further entrenching wage inequality.
Unemployment Insurance Fund (UIF) aims to provide relief for the short-term (frictional) unemployed and is financed out of employer and employee contributions made while employed. This meshes poorly with the circumstances of most of South Africa’s unemployed, many of whom have never been employed and who are unemployed for long periods of time, and thus ineligible for UIF benefits. Hence, not only are most of the unemployed unable to access unemployment benefits, but they are not provided for in the social assistance system which remains premised on the notion that unemployment is a temporary condition. Consequently, there are many that argue that the social grant system should be extended to focus directly on the unemployed. While strong economic growth supported the growth in the grants in the first fifteen years of democracy, we would argue that it is imprudent to argue for permanent income support for the unemployed. Many of the unemployed are young school leavers and while they clearly need some sort of social safety net or temporary social insurance, the longer-term goal has to be directed at assimilation into the labour market.

Government employment in the form of the expanded public works programme (EPWP) also appears to be limited in terms of what can be achieved. According to Altman and Hemson (2007), approximately 716,400 work opportunities have been created through the EPWP in three years, to be measured against a target of one million jobs over five years. Moreover, if these work opportunities are translated into full-time job equivalents, then only 220,000 full-time jobs have been created as opposed to the targeted 650,000. Significant job creation has been hindered by a multiplicity of competing goals and objectives set for PWPs to achieve (including poverty reduction, job creation and infrastructure development), as well as inadequate budgetary allocations in this regard, amounting to less than one percent of the annual social welfare budget (McCord, 2003). Even under the most optimistic growth scenarios (economic growth of 6%), Altman and Hemson (2007) estimate that almost 600,000 EPWP jobs (more than four times the number of jobs created through EPWP in 2004) would be needed to make a significant contribution in reducing unemployment, and that by 2014, R8-billion would be needed to cover the cost of social sector EPWP in particular (Altman and Hemson, 2007). Even if significant increases in budgetary allocations to PWPs were forthcoming, this might not be enough.

Available evidence suggests that PWPs have not been that successful at improving the ex-post employment prospects of PWP participants, with many workers returning to the pool of unemployed after completing work in short-term public works projects, rather than being absorbed into the labour market. Hence, the implementation of multiple short-term public works projects may simply result in churning amongst the unemployed, removing them temporarily from the pool of unemployed labour, rather than addressing the underlying causes of high unemployment (McCord, 2003 and 2009). In addition, the relatively low wages and limited duration of employment offered under public works makes it likely that wages are consumed rather than invested in productive activity that might improve employment outcomes in the long-run. This problem is compounded by the lack of access to microfinance and entrepreneurial training amongst work-seekers.

Other than government employment, there are a range of policy options that merit serious
consideration and debate. For example, strategies to assist the unemployed in obtaining their first job might include a wage subsidy, a search subsidy and reduced regulations for first jobs. Such policies received endorsement from the Harvard Group report (Banerjee et al, (2008), Levinsohn, (2008)) and a number of these options are under consideration in the country with specific reference to youth unemployment. All of these policies are premised on some kind of market failure in the market for employment and as such will require careful design.

A wage subsidy can be paid to the firm or to the worker, and theoretically, it makes no difference to the outcome. The provision of a wage subsidy should improve the incentives for workers to invest in training since there is a payoff to acquiring skills, and should also encourage firms to experiment with labour-intensive hiring practices (Levinsohn, 2008). Firm-side wage subsidies lower employment costs faced by employers. These costs include wages costs, but also non-wage costs such as the risk associated with employing workers who lack experience, such as youth. The wage subsidy therefore provides an incentive to firms to raise employment levels of those types of workers targeted by the policy, who, having gained some work experience, may improve their subsequent employment outcomes. Importantly, to the extent that such a policy is successful at bringing previously unemployed individuals into the formal labour market, it will begin to address that portion of income inequality being driven by the presence of zero wage earners. Finally, by lowering the average unit cost of production, firms may be able to reduce output prices and raise profitability, thereby improving consumer welfare and inducing additional investment in the targeted industries over time.

The weight of available evidence suggests that firm-side subsidies may be not be that effective at stimulating employment (Smith, 2007; Dar and Tzannatos, 1999), particularly in developing and transitional economies (Betcherman et al, 2004). The relative lack of success in this regard may be attributable to a high administrative burden that is borne by the firm, both in applying for the subsidy and in verifying the eligibility of the potential new hire in the case of a targeted subsidy. This is likely to be exacerbated where subsidy amounts are low, and where eligibility may be difficult or time-consuming to verify, as in the case of subsidies targeted towards “disadvantaged” youth, requiring verification of socio-economic circumstances. Consequently, firms may either ignore the eligibility criteria in their hiring decisions altogether, thereby undermining the programme effect, or may simply go ahead and make their hiring decisions irrespective, and claim any available subsidy ex-post as a bonus (Dar and Tzannatos, 1999).

This latter case raises doubts about the efficacy of the intended subsidy, since it does not affect strategic decisions on the part of the firm, but is rather claimed as a windfall gain. Moreover, if subsidy amounts are perceived to be low, this will act further to reduce the incentive of firms to undertake the administrative burden involved with the scheme, especially if the risk of hiring a worker from a designated group is seen to be large. This risk may be deemed even larger if firms are required to retain the new hire for a specified period beyond the subsidised employment period, or where the regulatory framework governing labour market hiring and firing is perceived to be onerous. These factors together all serve to undermine the take-up rates of firms of the wage subsidy scheme.
However, to the extent that a wage subsidy is based on age criteria alone, as would be the case with the proposed youth subsidy in South Africa, the verification requirements would be substantially lessened. Finally, even with a well-designed targeted subsidy scheme, it is difficult to know whether or not some of the new employment of workers from the target group might have occurred in the absence of the subsidy. These concerns are minimized with a marginal as opposed to a general subsidy.

An alternative is to pay the subsidy directly to the worker. The principle underlying a worker-side subsidy is to increase employment by stimulating an increase in the aggregate supply of labour to the economy, since larger numbers of workers are now willing to work for the pre-subsidy wage rate. An additional benefit of worker-side subsidy schemes over firm-side subsidy schemes is that since the subsidies are paid/administered directly by the government, potential employers do not face significant administrative burdens in this regard. However, key to the successful implementation of a worker-side scheme is the state’s capacity to administer such a system. Even though worker-side subsidy schemes may be more successful at improving employment outcomes than firm side-schemes, it is still worth noting that the employment effects may be quite small.

While it is true that theoretically it makes no difference which party receives the subsidy (Smith 2007), the mechanism through which employment outcomes are affected under these subsidy schemes differs, and this is important for the applicability of a (youth) wage subsidy to the South African context. If the subsidy is awarded to the firm, employment increases via increased aggregate demand for labour on the part of firms who now face lower labour costs. Hence, if the primary cause of high unemployment in South Africa is considered to be high labour costs and extensive labour regulations, then a firm-side wage subsidy scheme may be an appropriate response. Levinsohn (2007) argues that the design of any wage-subsidy scheme for youth work seekers should consider the provision of a risk-free probationary period, during which the subsidised worker could be fired at will, as part of the scheme. Under such a scenario, the risk is borne by the worker not the firm, thereby promoting experimentation on the part of the firm. While the possibility exists that such provisions might be abused by unscrupulous firms, the risk should be minimal since firing a productive worker simply to exploit the provisions of the probationary period does not make good business sense, and the firm in question would face additional hiring and training costs associated with subsequent hires.

Concerning worker-side subsidy schemes, here the mechanism for reduced unemployment appears to operate by inducing greater labour force participation on the part of work-seekers. However, part of the problem of high unemployment in South Africa is attributable to the large influx of young work-seekers into the labour market against a context of static labour demand (Branson, 2007). Hence, it is not clear whether a worker-side youth subsidy would be an appropriate response either, since if this stimulates greater labour supply on the part of youth without affecting aggregate demand conditions, it may simply exacerbate the problem, especially if careful thought is not given to the way in which the target youth population is defined (Levinsohn, 2008).
Linking subsidy receipt to educational attainment may be an important component of the design of the subsidy design.

Finally, wage-subsidy schemes are best targeted at formal sector employment outcomes, since verification of eligibility status, and payment details require well-functioning administrative structures to be in place, coupled with effective monitoring and verification procedures (Smith, 2007). Imposing audit requirements in this regard is significantly easier to achieve in the formal sector than the informal sector, again limiting the scope for such programmes to impact on employment outcomes more broadly.

One of the difficulties in trying to assess the impact that a wage subsidy might have on employment outcomes, and more indirectly on poverty and inequality, stems from the fact that very few wage subsidy schemes have been rigorously evaluated, in part because of the difficulty of randomising at the firm level. Computable general equilibrium models (CGE) have been used to model the impact of a hypothetical wage subsidy scheme on employment, production, household income and poverty in South Africa. Pauw et al (2008) model a temporary non-targeted general firm-side subsidy where the firm receives a subsidy equal to 50% of the wage. While the model suggests positive short-run employment effects of such a subsidy, increasing employment by 6.5%, unemployment still remains high. Moreover, a micro simulation exercise suggests that reductions in poverty arising from this intervention are small when the wage elasticity is low, and the associated cost per job is high. Similarly, Go et al (2009) argue on the basis of their CGE results that a wage subsidy only has its intended impact on reducing unemployment and reducing poverty and inequality in the medium elasticity case. In a context of labour market rigidities and structural unemployment, which is typically associated with low elasticities, Go et al (2009) argue that the impact of a wage subsidy on employment, poverty and inequality would be modest at best.

Conclusion

Creating jobs and reducing unemployment are key economic and social challenges in developing countries generally, and is explicitly recognized by the South African government, which, under their policy framework known as the “Accelerated and Shared Growth Initiative for South Africa” (ASGISA), aims to halve unemployment by 2014 by removing a number of constraints on faster output and employment growth. To date, labour market performance has been central in the worsening of aggregate inequality and also in dampening the poverty reducing impacts of economic growth. Labour market institutions have not promoted effective adjustments in the labour market or facilitated a reduction in inequality. It is the expansion of social grants that has been central to poverty alleviation, alongside steady improvements in access to services such as electricity, water and housing.

13 These estimates are sensitive to assumptions made about the elasticity of employment with respect to wages.
A number of policies have been proposed to facilitate a better matching of the demand for labour and the supply of labour. The unemployed often live far from jobs and transport is expensive. This raises the costs of job search for those least able to afford it. Improvements in housing and transport will clearly generate a high return. The fact remains though that the many of the unemployed are unlikely to be absorbed into formal sector jobs at the going wage even if their arrival at the factory gate was costless.

The paper assesses three of the major labour market interventions proposed by the government to relieve the burden of unemployment. An unemployment insurance fund and an expanded public works programmes are already in place and the central debates revolved around whether either of these policies can be reformed or scaled up in order to make a serious dent on South Africa’s unemployment problem. The available evidence is firmly of the view that this will not be possible. Thirdly, a form of wage subsidy that lowers the costs to employers of hiring new entrants has been proposed and is enjoying a wide airing. In some versions of this wage subsidy policy, it is tied to easier hiring and firing regulations than are the legislated norm (Levinsohn, 2008).

Government has shown a willingness to test out such policies on a small scale through policy trials. This willingness to experiment is to be endorsed. However, our assessment of the evidence implies that a wage subsidy scheme is unlikely to be the primary or dominant policy instrument to reduce unemployment in South Africa. Wage subsidies are not the best instrument to deal with, for example, poor employment growth arising from weak output growth, technological change and structural changes in the composition of production. Wage subsidies, at best, can be considered as a targeted intervention dealing with specific sectors or workers where employment will be responsive to lower costs of labour. In addition, a wage subsidy may need to be complemented with additional policies that directly target the market failure leading to high unemployment.

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14 This may especially be the case for programmes that target youth. Betcherman et al. (2007) assess the success of youth employment programmes, especially those relating to training programmes, finding positive impacts in developing economies when training is offered as part of a comprehensive package that includes interventions to reduce school dropout rates and improve educational attainment. Heckman et al. (1999) review evidence from a series of evaluation studies in the USA and Europe concerning the impact of job training, job search assistance and wage subsidies on employment prospects. They find mixed success by intervention type, and outcomes for youth to be moderate at best. Kluve and Schmidt (2002) analyse results from a sample of 53 European labour market programmes, and find that while training and job search assistance may improve employment prospects, direct job creation programmes in the public sector may have negative consequences for employment prospects. Again, young workers were the most difficult to assist amongst the unemployed. Kluve (2006) finds that across categories of interventions, training programmes have relatively modest impacts on employability, with private sector incentive programmes having larger success. Conversely, public sector employment programmes are 30–40% less likely to yield positive impacts than training programmes. Once again, the results indicate that unemployed youth are the most difficult target group to assist in terms of improved employment outcomes. Finally, empirical results from a sample of 172 studies evaluated in a meta-analysis of the Youth Employment Inventory (Puerto, 2007) suggests that the success of a particular programme intervention is not determined by the type of intervention, but rather by the programme’s targeting strategies toward disadvantaged youth, the flexibility of labour market regulations, and the country level of development.
Thus, our review is rather negative about the alternatives that are dominating the policy agenda at the moment. Are there other alternatives that warrant consideration? An alternative way to intervene to improve the labour market outcomes of youth work-seekers is via the provision of job search assistance programmes, one of the most common forms of active labour market policies (Smith 2007). The bulk of available evidence concerning job search assistance programmes suggests that provision of job search assistance programmes not only improves the labour market outcomes of participants relative to non-participants, but that these kinds of programmes may be more effective than other ALMPs such as subsidy schemes. Typically, job search assistance programmes are shown to have significant short-run effects in reducing unemployment, with the added bonus that they are relatively cost-effective to implement (particularly since success implies a reduction in the amounts being paid out by the state in unemployment insurance).

Facilitating the growth of the informal sector represents a further employment strategy. Although there has been some growth of the informal sector in South Africa, it has not been particularly responsive to growing unemployment. This seems to suggest that there are impediments preventing the participation of more of the unemployed in informal activity. Thus, potentially, the removal of these impediments through policy interventions could result in relatively quick results. It is clear that informal employment is associated with wages that are lower and working conditions that are worse than in the formal sector. However such employment would no doubt improve the lives of those without work and earning no wage income. Finally, since an increasing number of South African households currently have no connection to the labour market, a key requirement for any labour market policy that is directed at promoting a virtuous linkage between employment creation and lowering inequality is that it reverses this trend and builds a bridge for the poor and those in the lower deciles into productive employment.

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15 As with subsidy programmes, there is considerable variation in the way these programmes are actually implemented. Possibilities include the provision of personalized job-search assistance and counseling to work-seekers on a regular basis (where participation by the work-seeker is mandatory), including job counseling, re-skilling workshops and training workshops on interview skills, job search techniques and CV presentation, or may take the less-intensive form of the provision of job search resources at the local labour office which job seekers can elect to take advantage of. The provision of transportation subsidies to facilitate job search, or the provision of relocation subsidies, as was the case with the Moving-to-Opportunity programme, may also form part of a job search assistance intervention.
References


*Presentation at the Labour Market and Enterprise Performance in South Africa Conference.*