

# South Africa's economic development trajectory: implications for skills development

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This article argues that skills development in South Africa must be aligned to the economic and political imperatives of reducing unemployment and poverty, while fostering growth and international competitiveness. The legacy of a resource-based economy, overlaid by apartheid policies, has resulted in widespread poverty, inequality and unemployment existing alongside globally competitive industries. It is therefore necessary to foster employment through the provision of basic needs such as infrastructure, healthcare and education to the poor, while at the same time deepening linkages within the domestic economy to broaden economic participation and actively promoting international competitiveness to enhance exports. This analysis points to the need for a dual development trajectory. The first level requires a high skills trajectory to support the ongoing expansion of high-value traded goods and services. The second level requires the expansion of low productivity, non-traded goods and services to redress unemployment and must be underpinned by the provision of low and intermediate skills.

## Introduction

The purpose of this article is to frame the economic imperatives to which South Africa's skills development policies must be aligned. Just as policies to foster skills development differ vastly across different regions and countries because they are embedded in social and cultural institutions, so they must also be differentiated with respect to the specific patterns of economic growth and development that they seek to underpin.

In the case of the South African economy, the key issue with respect to skills development is that the economy's historical development trajectory has been inimical to the absorption of unskilled and semi-skilled labour. The path dependence of the minerals economy, overlaid by apartheid policies, has been exacerbated by South Africa's reintegration into the global economy in the democratic period. The consequence is an unemployment crisis of unprecedented proportions.

The central argument of this article is therefore not only that skills development should support measures to redress unemployment, but that the development of low and intermediate skills is an essential element of a broader policy framework to foster the expansion of labour-intensive industries.

### **South Africa's economic development trajectory**

Economic, social and educational institutions are embedded in historical, cultural and political contexts (Brown, 1999). It is therefore important to begin by outlining the character of South Africa's economic development trajectory, as this provides the context within which the demand for labour and its skill composition is determined.

Altman (2001) argues that resource extraction has been the central driver of South Africa's economic development. Indeed, as a 'minerals economy', South Africa's industrial development has been driven by all the attendant complications associated with a 'resource curse' (Auty, 1993, 1994a, 1994b; Davis, 1994; Ostensson & Uwizeye-Mapendano, 2000). In general, minerals economies tend to grow and to experience structural shifts more slowly than non-minerals exporters. They also tend to have a more capital-intensive structure of production. This is explained by a number of characteristics that are common to these economies.

Most developing countries go through a phase of low-wage, low-productivity manufacturing development that has the impact of mopping up the labour surplus (Syrquin & Chenery, 1989). The pattern of development experienced by labour surplus developing economies usually follows a familiar path, where underproductive labour moves off the farms and into labour-intensive manufacturing traded sectors. As there is a labour surplus, wages are low, and the sectors can therefore be highly competitive internationally. Only once there is a tighter labour market do wages begin to rise and the economy moves into the development of more capital and skill-intensive industries. The emphasis on labour-intensive traded sectors is a necessary step in an economy that is capital and foreign exchange constrained. Ultimately, the more successful newly industrialized countries are those that simultaneously invested in human capital development, so that the skills base developed alongside these structural shifts.

In contrast, minerals economies such as South Africa tend to leapfrog from the resource base into the development of heavy and chemicals industries, bypassing the development stage of labour intensive manufacturing. This is made possible by the large surpluses generated from resource extraction.

Consequently, the mass creation of jobs in labour-intensive traded sectors is less viable in a context of high domestic cost structures: overvalued exchange rates caused by minerals exports earnings render labour intensive agricultural and manufactured exports uncompetitive. Nor is job creation a requirement of manufacturing development, as it is in developing economies that do not have ready access to capital and foreign exchange. This means that the benefits of the minerals economy do not tend to spread widely and high levels of income inequality and unemployment result, since

heavy and chemicals industries are capital intensive. Moreover, domestic demand may not expand as much as in other economies.

In accordance with the experience of other minerals economies, South Africa bypassed the phase of development where large numbers of workers are absorbed into low-cost, low-skill, labour-intensive traded goods sectors (Altman, 2001). The low growth and high levels of unemployment that characterize the economy today are the consequence of a minerals economy.

The key features of South Africa's economic development trajectory during the apartheid period—import-substitution industrialization and a range of policies that discriminated against the majority of the population—are outlined below, as a background to the discussion of policy orientations and instruments in the post-1994 democratic period.

### **Import-substituting industrialization**

Conceptually, for developing countries (or late industrializers) there are two policy interventions that foster industrial development: import-substituting industrialization (ISI) and export-oriented industrialization (EOI). Trade policy is the primary instrument utilized by governments to implement these policies.

The ISI approach endeavours to develop industrial capacity within a developing economy by replacing imported goods with domestically produced manufactured goods. This is accomplished by erecting high tariff barriers to make imports more expensive than domestically produced goods. Tariff measures are often accompanied by subsidies to targeted industries.

In contrast, the EOI approach seeks to build an industrial base with production geared to external markets, since this enables scale economies to lower costs and foster international competitiveness. Industrial development does not take place behind protectionist tariff barriers, although targeted subsidies are often utilized.

In general, economies endowed with natural resources, (in particular minerals, for example, most Latin American economies) have followed an ISI path, while economies that have few natural resources (for example, East Asia) have followed an EOI path. The evidence strongly suggests that the EOI path has yielded better results, as evidenced by the spectacular industrial development of the newly industrialized countries, including Hong Kong, Korea, Singapore and Taiwan.

If the skill formation challenges currently facing South Africa are to be properly understood, it is essential to appreciate that South Africa's industrial development trajectory has been driven by ISI. From the 1920s, South Africa's industrial policy substantially relied on import protection and subsidization. In the first instance, there was an emphasis on solving the 'poor white problem' and absorbing white workers coming off the farms. In addition, there was also increasing interest from the private sector in import-replacement activities, particularly in relation to inputs for resource-based industries such as mining (Altman, 1997).

With the intensification of apartheid policies and increasing foreign isolation, industrial policy also turned to substantial subsidization of heavy industries such as

steel (ISCOR), synthetic fuels (SASOL, MOSSGAS), and the defence industry. In accordance with a 'minerals economy' trajectory, the main investments were largely directed to capital-intensive resource based projects in basic chemicals and metals.

Due to the small size of the domestic market, characterized by both a small economy and poor distribution of income, import substitution opportunities were largely exhausted by the late 1970s. This fact substantially contributed to poor productivity, high levels of industrial concentration and slow growth throughout the economy.

South Africa was a substantially open economy, even at the height of sanctions, but this applied primarily to its main exports of basic and slightly processed metals and minerals. As was the case in other 'minerals economies', the foreign exchange earnings from these exports enabled South Africa to pursue an import substitution industrialization strategy even after its efficacy as an instrument of industrial development became questionable and its cost to domestic consumers increasingly onerous.

### **The role of apartheid policies**

Any account of South Africa's economic development trajectory would be incomplete without an analysis of the impact of apartheid policies that permeated every aspect of the economy, polity and society. Indeed, the apartheid legacy continues to act as a brake on growth and therefore on the alleviation of poverty.

Apartheid laws effectively repressed African entrepreneurship. Legal exclusion from vertical mobility severely limited the expansion of entrepreneurial or artisanal skills among the black population. African entrepreneurship was further stifled by exclusionary legislation, insufficient availability of credit, lack of market access and higher input costs.

African traders experienced discriminatory legislation from the early 1920s. These restrictions intensified from the mid-1950s with the evolution of the 'separate development' ideology. Fundamentally, Africans were regarded as temporary sojourners in white South Africa (Southall, 1980). These controls impacted on the ability of the African population to participate in the economy in a number of ways. First, the restrictions on black business raised the cost of inputs and hindered their access to markets. Inputs for black businesses had to be bought from the white centres; transport costs raised the price of these goods. Moreover, the majority of township dwellers worked and spent a large part of their day in white areas. Yet, the Group Areas Act stipulated that Africans could operate businesses in black residential areas only (Nattrass & Nattrass, 1988).

Second, the lack of access to credit constituted a major barrier to the development of African businesses. Moreover, the lack of freehold rights in urban areas precluded the possibility of using real estate as collateral against loans in a context where there were few alternatives (Southall, 1980).

Finally, an artisanal class was not developed during the period of industrialization as whites were moving out of industry into higher-paying jobs. This partly contributed to a concentration of production in large plants with relatively little subcontracting, thereby preventing small firms from developing the skills required to supply the

market. Moreover, the supply of skilled staff limited the ability of producers to expand horizontally.

From the perspective of skills development, the absence of effective labour market functions such as skills development, spatial and occupational mobility, affordable cost of job search, and circulation of market information for the disenfranchised part of the population continues to weigh heavily on the economy.

One legacy from this period is the severe gap in skills attainment: less than a third of 'African' men and women that work in the urban formal sector have completed high school (October Household Survey, 1999). Indeed, as a consequence of apartheid policies, South Africa is a highly distorted middle-income economy; it has a cost structure and domestic market-oriented production sectors that reflect this middle-income status but a skills level that is more reflective of a less developed country (Altman, 2001).

### **The democratic period**

On the eve of the demise of apartheid, the South African economy displayed stagnation in certain sectors and decline in others, double-digit inflation, growing unemployment, among the highest levels of inequality and poverty in the world, and isolation from a globalizing world economy.

After South Africa's first democratic elections in 1994, the African National Congress (ANC) led government was confronted with a dilemma: on the one hand there was an urgent need to reverse the legacy of apartheid by forcefully reducing poverty and inequality, while on the other hand there was enormous pressure to integrate with the global economy at a time when neo-liberalism reigned supreme.

In his discussion of the high skills thesis, Brown (1999) argues that the development paths of different countries depend critically on how their skills formation policies are adapted in response to globalization. This has been starkly illustrated in South Africa in the first decade of democracy. Ultimately, two policy interventions have set the tone for the economic growth trajectory over the next decade: a restrictive macroeconomic stance and substantial market liberalization accompanied by the introduction of supply-side measures.

#### *Macroeconomic reform*

The democratic government's macroeconomic policy stance (popularly known as GEAR—the growth employment and redistribution strategy) has been the subject of vociferous debate and criticism. The key objectives were to contain government expenditure, reduce debt and establish secure macroeconomic fundamentals, including low inflation. There is irrefutable evidence that these targets have been achieved (Bhorat & Cassim, 2004; McCord, 2004).

However, sustainable employment growth and low unemployment is also a macroeconomic fundamental, and this certainly was not achieved. South Africa achieved its first positive (albeit modest) economic growth rates, averaging 2.8% per annum,

between 1995 and 2002. Yet, over this period high rates of inequality do not appear to have been reduced (Bhorat & Cassim, 2004), and official unemployment rose to over 30%.

There is some controversy over the extent to which macroeconomic stabilization has created an enabling environment for growth. In other words, South Africa has experienced its first positive economic growth, but at rates that are much too low to sufficiently absorb its labour force or to substantially improve economic participation. It is believed by many economists that GDP growth rates exceeding 6% are required. The key factors that determine growth are the expansion of capital, skills formation and the accumulation of technology. None of these have expanded sufficiently to drive the kinds of growth rates needed.

Ultimately, low levels of private and public investment have resulted in high and growing levels of household poverty, largely as a consequence of exclusion from sources of livelihoods, including formal or non-formal employment and other forms of economic participation. Unemployment is a consequence of both low growth and weak labour absorption, which is itself related to the capital-intensive nature of a minerals economy and other forms of exclusion.

In the next section, we focus on elements related to formal wage employment, since this is the single most important source of income for poor households.

### *Trade orientation*

After many decades of import-substitution industrialization, plus sanctions and international isolation, the democratically elected government faced a formidable challenge in reversing the stagnation and poor international competitiveness of the economy. There were a number of elements in the government's strategy to promote global integration. Among these were the forging of bilateral and multilateral trade links (through the framing of trade arrangements, foreign offices and export councils) and the rationalization and reduction of the protectionist tariff regime.

South Africa's formal re-entry into the global economy came at precisely the time that policy instruments for industrial promotion were being circumscribed by the World Trade Organisation (WTO). Previously, member countries had the choice of signing the Subsidies Code which outlines allowable or restricted industry promotion incentives, such as export subsidies. From the early 1990s, the WTO arrangements automatically incorporated the Subsidies Code, allowing countries prescribed periods in which they were required to come into compliance, and prohibiting the introduction of new incentives that were not allowed under the terms of this Code.

In this context, the key challenge was to dismantle the protectionist tariff regime that had kept South Africa isolated from the global economy without bringing about deindustrialization. Thus, in 1994, the key objectives were to open up the economy, improve international competitiveness and improve access to economic opportunities. To that end, the ANC-led government undertook a process of far-reaching trade liberalization aimed at fostering South Africa's reintegration into the global economy

by reversing the psychology of protectionism and isolation that had permeated the economy. Trade liberalization was accompanied by the creation of a range of supply-side policy instruments—targeted at specific industries, spatial locations and exporting sectors—to replace demand-side interventions as the key instruments of industrial policy.

South Africa's offer of tariff bindings to the WTO in 1994 represented a decisive break with the highly protectionist nature of previous trade regimes. The key elements of South Africa's offer were to reduce average tariffs on industrial goods by one-third, reduce average tariffs for consumption goods by 50% and reduce tariff categories from more than 100 to 6 within a range of 0–30%, all within a five-year period. In the main, this had the effect of rationalizing the most trade-sensitive tariffs and reducing rent seeking by firms in their use of tariffs. For example, Altman (1997) shows how the tariff regime facing clothing and textiles had been undermined by firms since the late 1980s, so that the market had already been opened, albeit not intentionally. In other words, the average official tariff was more than 100%, but the actual average tariff paid was about 20%. Altman argues that the reduction of tariffs to a flat rate could have the effect of raising the actual tariff paid and improving protection for the most trade-sensitive products.

At the same time, South Africa gained preferential access to its main export markets in the European Union by securing a free trade agreement (FTA), and to the USA through the Africa Growth and Opportunities Act (AGOA).

Growing trade with the Southern African Development Community—with which an FTA was also secured—has been a critical new outlet for South African manufactured exports and investment. This has contributed to the growth in higher-value goods exports, but may also have contributed to the higher skill and capital intensity in average exports.

### *The impact of policy reform*

The central objective of the policy reform package introduced at the beginning of the democratic era was to restructure the economy in order to render it internationally competitive. This was expected to drive higher rates of growth and create sufficient employment to reverse the high levels of unemployment and poverty prevailing in 1994.

By 2000, only some of these objectives had been met. A notable success was the increasing export orientation of the economy as evidenced by a marked increase in exports. Growth and employment creation has, however, been disappointing. This outcome can be attributed to the fact that international competitiveness requires industry-level technological change that is biased towards skills and capital-intensive production processes.

As the central instruments of industrial policy, trade liberalization and promotion have induced a far-reaching structural change in the economy. Although there is some evidence of growing import penetration, (Cassim *et al.*, 2002), it has not caused deindustrialization. This may be partly explained by Altman's (1997) argument that

many of the most trade-sensitive sectors had already been opened up by virtue of the ability of firms to circumvent official tariffs.

As illustrated in Figure 1, exports have grown at an average of 5.5% per annum during the 1991–2000 period. A disaggregation of this data reveals that exports emanating from the primary sector (agriculture and minerals) declined by –1.5% per annum, while manufacturing and services exports increased by 11.2 and 9.9% per annum respectively. This represents a significant structural change in the composition of exports, reflecting more closely trends in other middle-income developing countries.

A positive outcome of the economic reform package introduced in the democratic period is that industrial policy has led to a more competitive environment. The unintended consequence—from an employment perspective—has been the role of policy reform in shifting the structure of the economy to one that is even more capital and skills absorbing. On the one hand, manufacturing industries have shifted towards more capital and skills-using technologies. On the other, many of the resource-based industries that had been the main employers of low and semi-skilled

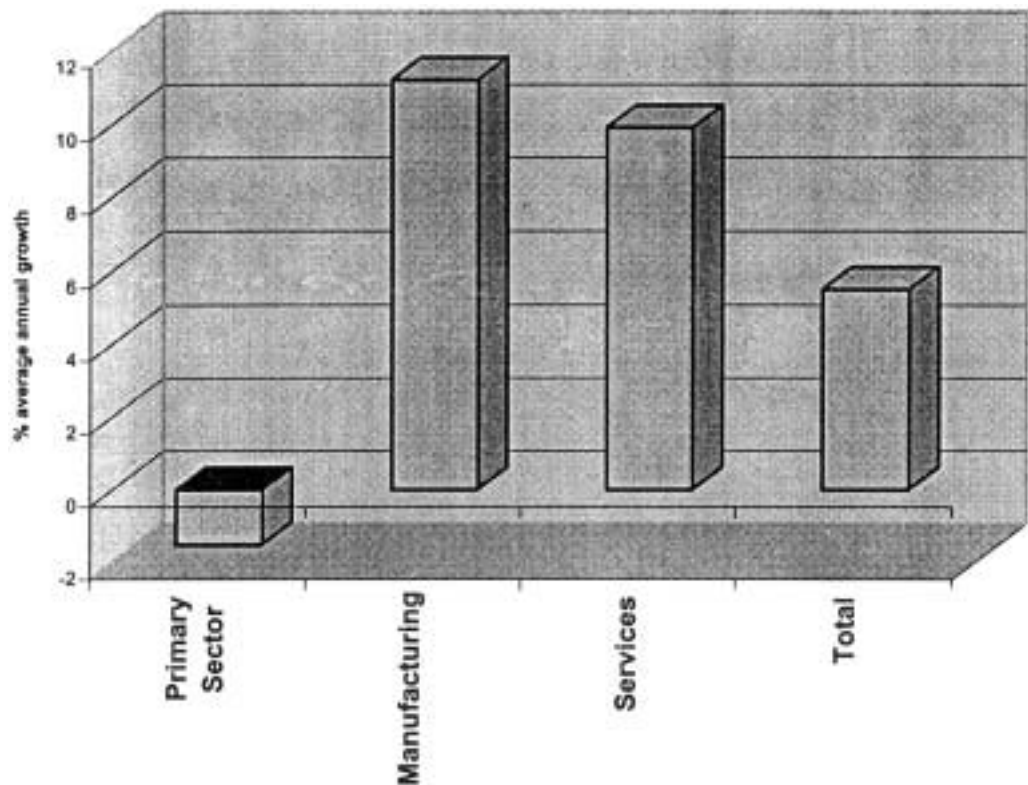


Figure 1. Growth in exports, 1991–2000 (weighted average annual growth rates, constant 1995 prices)

Source: TIPS Standard Industrial Database (2002).

labour, particularly mining and agriculture, shed substantial numbers of jobs, especially over the 1980s.

### **The post-2000 period**

The failure of policy reform to yield sufficient economic growth or investment to enable government to meet its aims of alleviating poverty, redistributing wealth or eradicating structural unemployment, led policy makers back to the drawing board after the first term of the democratic government. A critical review of the policies that had been implemented between 1994 and 2000 prompted government to augment and refine the instruments of economic policy. The new policy approach is articulated in government's overarching microeconomic reform strategy, which includes an integrated manufacturing strategy. This recognizes that the long-term development of the South African economy is contingent on a more thoroughgoing reform programme aimed at tackling its structural deficiencies. Government proposes to do this through a systemic approach to eliminating constraints in the economy and improving efficiency. Such constraints include inadequate appropriate and efficient economic and social infrastructure, inadequate access to finance for productive activities, inadequate investment in research and development, inadequate innovation and take-up of new technologies, inadequate investment in human capital and an insufficiently adaptive, flexible workforce. While eliminating these constraints has been a part of government policy since 1994, the microeconomic reform policies elevate these interventions to a higher status.

In the manufacturing sector, the integrated manufacturing strategy is premised on the view that reliance on traditional bases for competitiveness—in particular, abundant natural resources and cheap unskilled labour—will not create a modern, outward-looking economy that is essential for growth. Instead, it is argued that competitiveness should be built on increased knowledge intensity and value addition. Government believes that new sources of competitiveness are located in the development of the Information and Communication Technology (ITC) sector, the impact of technological change on production processes and the importance of time and efficiency to production costs. The emergence of integrated supply or value chains—in many cases transnational and influenced by the operations of multinational corporations—is seen as a hallmark of modern production processes.

Whether the broadening and reconfiguration of economic policy will accomplish the objectives of higher growth and lower levels of unemployment is uncertain. There is still an uneasy and unspecified relationship between the objective of creating a modern, outwardly focused economy and the imperative of reducing unemployment among the unskilled and semi-skilled. The former relies on a rapid increase in the skills base in order to meet the demands of a knowledge-intensive development trajectory. This begs the question as to where the unskilled and semi-skilled workers that currently comprise the vast majority of the unemployed will be absorbed. Moreover, how will the pool of skilled labour be exponentially expanded? The state (DTI, 2002a, 2002b) identifies this as a central challenge, and incorporates this into its National Skills Development Strategy, which was under review in 2004.

Table 1. Unemployment rates by region, 2003 (%)

Region	Total unemployment (%)
World	6.3
Industrialized economies	6.8
Transition economies	9.4
East Asia	3.1
South East Asia	7.1
South Asia	4.8
Latin America & Caribbean	9.0
Middle East & North Africa	11.9
Sub-Saharan Africa	10.8
South Africa*	30.5

*Notes:*

1. Different aggregation techniques and methodologies may lead to differences in aggregate figures. These should be used as indicative only.

2. These unemployment rates are the 'official' or 'strict' measures, which exclude 'discouraged' workers. They include those that are not employed, but are actively searching for work.

*Source:* Extracted from ILO (2004, Table 2) and \*South Africa's Labour Force Survey (September 2002).

### **The nature and magnitude of the unemployment crisis**

After a decade of democratic rule, the central economic problem currently confronting South Africa is an unemployment rate of crisis proportions and the concomitant deepening of poverty and inequality. As illustrated in Table 1, South Africa's official unemployment rate is currently higher than in any other economy for which data is available.

There is substantial agreement that poverty and inequality have increased in the democratic era (Whiteford & van Seventer, 1999; Borat and Cassim, 2004) and that this is caused primarily by growing unemployment among unskilled African workers (Leibbrandt & Woolard, 2001; McCord, 2004). For Leibbrandt and Woolard (2001) access to wage income is the main determinant of inequality in South Africa because the spatially fragmented labour market and underdeveloped informal and subsistence agricultural sectors inherited from the apartheid administration have left South Africa highly dependent on wage income. Consequently, the rise in unskilled employment and associated reduction in remittance transfers has a highly significant impact on household economic security.

The most distressing aspect of South Africa's unemployment crisis is the extent to which the unemployment rate has grown in the democratic period, as illustrated in Table 2. In terms of the broad definition, the unemployment rate has grown from 20% in 1994 to 30.5% in 2002. If the expanded definition (which includes discouraged workers) is used, the unemployment rate increased from 28.6% to 41.8% during the same period. The build up of unemployment in the democratic period is a consequence of new labour market entrants being unable to find jobs and the sheer number of these new entrants vastly outstripping those that exit the labour market.

Table 2. Unemployment trends, 1994–2002

	1994	1995	1996	1997	1998	1999	2000	2001	2002
Strict definition	20.0	16.9	19.3	21.0	25.2	23.3	25.8	29.5	30.5
Broad definition	28.6	26.5	34.9	38.9	37.5	36.2	35.9	41.5	41.8

Source: October Household Survey 1994–99 and Labour Force Survey, September 2000, 2001, 2002. Official employment was tracked by an annual household survey that took place in October each year during the 1994–99 period. From 2000 it was replaced by the labour force survey, which conducted twice annually: in March and September.

The demographic composition of the unemployed reveals that the overwhelming majority are African, with an unemployment rate of 37% in 2002, as compared to 6% for whites (Labour Force Survey, September 2002). Critically, the majority of the unemployed are young and recent entrants to the labour market as evidenced by the fact that 75% were younger than 35 in 2002 (Labour Force Survey, September 2002).

Broad trends in formal and informal employment in the 1995–2002 period are depicted in Figure 2. Notably, total employment has been stagnant between 2000 and 2002, largely because of a reduction in non-formal employment.

While the private formal non-agricultural sector—which is the main source of employment growth—has been absorbing labour since 1998, the rate of absorption has been disappointing, with 1.1 million jobs created between 1998 and 2002 against 4.3 million net new labour force entrants. The majority of new formal jobs were created (in order of importance) in finance, insurance and IT-related industries, retail and wholesale, community and social services and manufacturing.

Given that it is a middle-income developing country, two aspects of South Africa's employment trends are striking: the first relates to the small and declining proportion of public sector employment. Public sector employment has shrunk as a result of government's restrictive fiscal stance as well as its desire to improve efficiency in the public service. In terms of its fiscal stance, the South African government has sought to release funds from current to capital expenditure—that is, away from a very substantial personnel budget towards greater investment in infrastructure. In terms of improved efficiency, there has been a sense that some employees have been under-employed, or that there are 'ghost workers' (those that are not working or who are dead, but are still on the payroll with relatives collecting their cheques).

The second unusual feature is the small proportion of non-formal employment. The non-formal economy does appear to have grown quite substantially since the mid-1990s, but has stagnated since 2000. The dynamics underpinning the growth of the non-formal economy are poorly understood. It most likely grew during the 1990s as a result of a variety of liberalizations, and of reduced policing of trading by black business in 'white' areas, which had previously been illegal. We do not know to what extent this form of employment is part of a 'virtuous circle'—feeding off growth in the rest of the economy, or alternatively part of a 'vicious circle'—acting as survival strategies for the growing pool of unemployed.

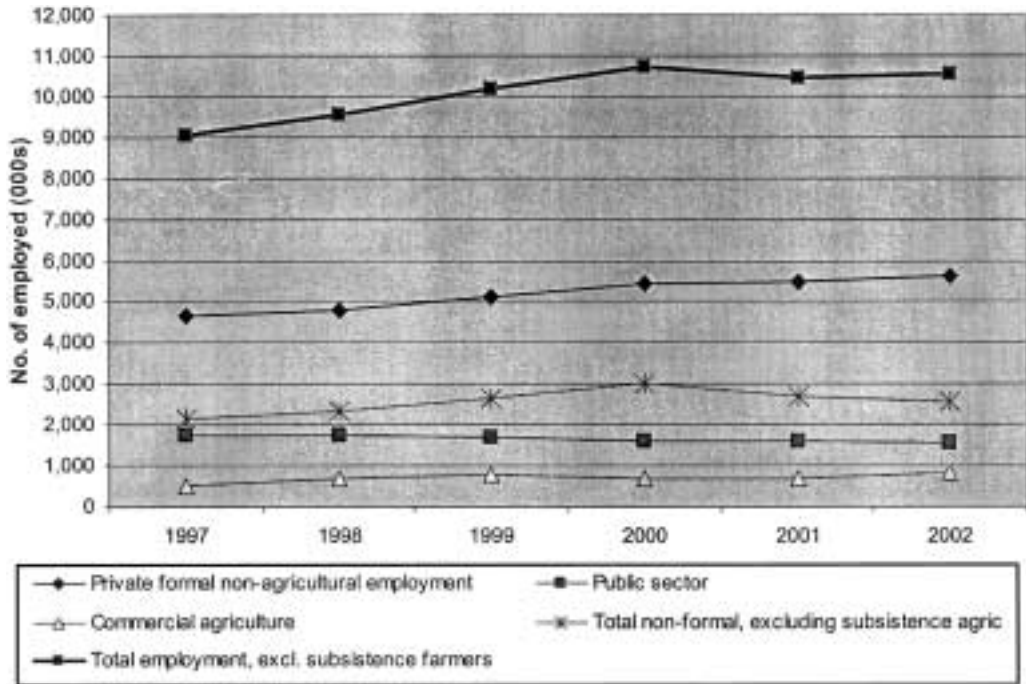


Figure 2. Employment in formal and non-formal sectors

Source: Calculated from electronic data made available by Statistics South Africa, from the October Household Survey (1997–99) and Labour Force Survey (September 2000–02).

Notes: These figures exclude subsistence agriculture unless specifically indicated and are adjusted, as explained in Altman and Woolard (2004).

Most authors currently argue that South Africa has experienced a development path in the 1990s which has been primarily skill absorbing, and low skill shedding. More updated figures show that this might not be the case. The Labour Force Survey shows that the proportions of workers employed in low, medium and high skill jobs remained about the same from 1997 to 2002, as illustrated in Figure 3. Therefore, in absolute terms, there have been more low skill jobs created than high skill jobs. This may represent a reversal of trends in the early 1990s, when many low and mid-skill jobs were lost in mining, agriculture and, to a lesser extent, in some manufacturing industries. Of course, the limited number of jobs created overall may indicate a shortage of high skills, as the hiring of lower skill workers often depends on the availability of higher skill employees; if there was a larger skills reservoir, there might have been more employment generally.

The South African economy has not been creating sufficient jobs to absorb even new labour market entrants on an annual basis. The scale of the problem is such that, while the labour force grows on average by 614,000 participants annually, the formal and informal sectors have jointly been generating an average of 183,000 jobs a year. This is equivalent to 30% of the number of jobs required to maintain the

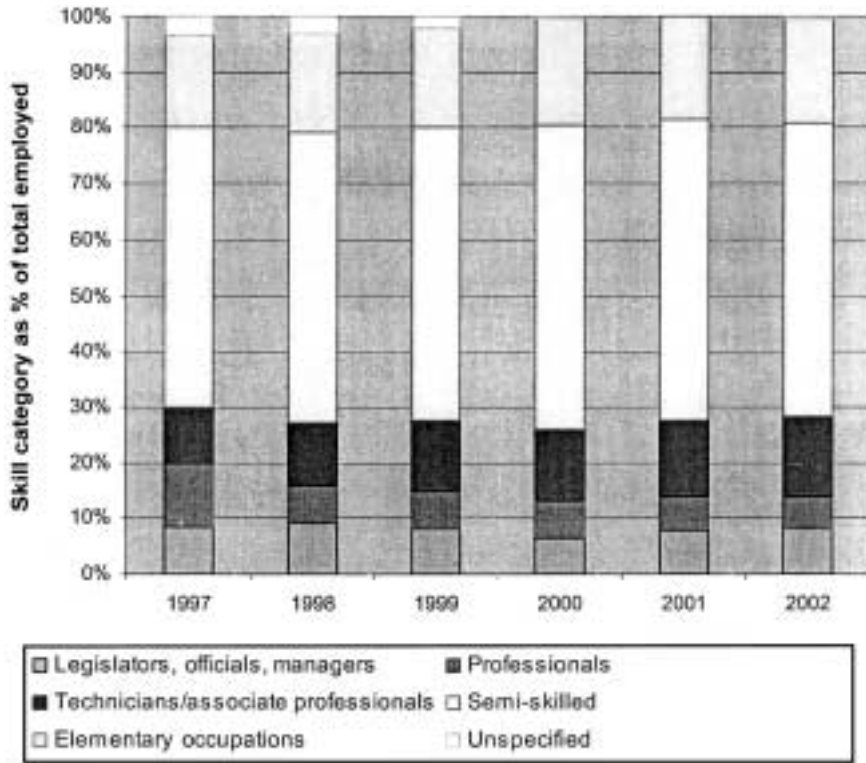


Figure 3. Formal employment by skill level

Source: Statistics South Africa, October Household Survey (1997–99); Labour Force Survey (September 2000–02).

prevailing unemployment rate. This means that to merely *maintain* an unemployment rate of 30.5% the number of jobs created annually would have to increase by a multiple of 2.4. A much higher multiple would be required to reduce the rate of unemployment by absorbing the ‘stock’ of unemployed people that has built up over the years.

### Causes of unemployment

The primary cause of unemployment in South Africa is the capital-intensity that historically characterized the minerals economy and globalization more recently. Apartheid policies and their persistent legacy serve to amplify this path dependence. The apartheid legacy also leaves low rates of economic participation and significant skills gaps in its wake. Unemployment continues to rise, despite the positive relation between GDP and employment. This is explained partly by the relatively slow rate of GDP growth, but also by the dramatic increase in the number of people seeking employment in the post-apartheid era. This has widened the gap between labour force entry and the ability of the economy to create jobs. Figure 4 compares total job

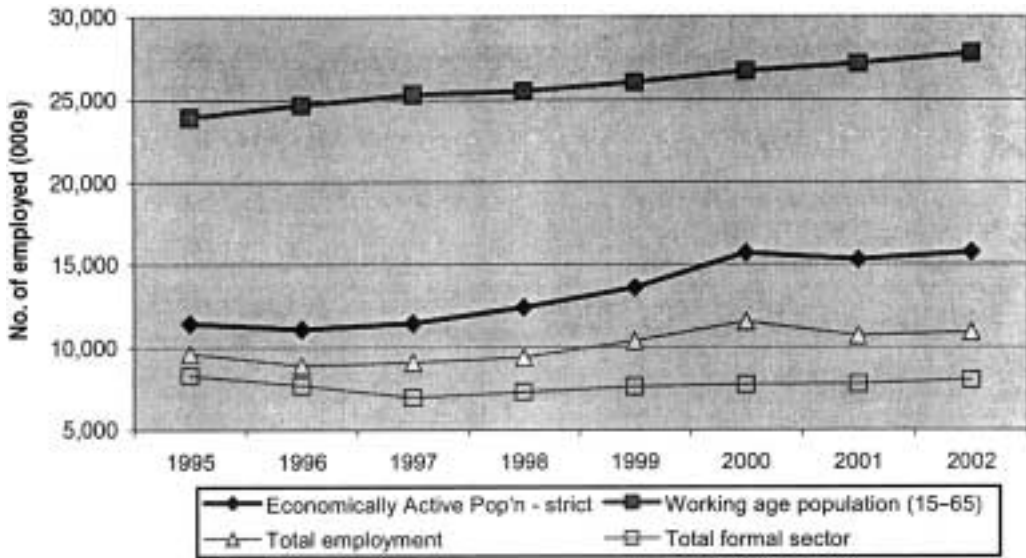


Figure 4. Growth in employment and the labour force, 1995–2002

Note: The strict definition of the labour force is used in this figure (i.e. discouraged job seekers are excluded).

Source: Statistics South Africa: October Household Survey and September Labour Force Survey.

creation to labour force growth between 1996 and 2000. It starkly illustrates the extent to which labour force growth outstripped employment expansion.

The inability of the economy to absorb labour at the required scale has been attributed partly to government's limited capital spending. Adelzadeh *et al.* (1998) and Samson (2000) argue that in light of the relatively large output and employment multipliers associated with government capital expenditure, limited growth in actual and planned expenditure has dampened potential growth and employment creation.

Trade liberalization, already discussed in this chapter, may be another aspect of government's policy that may have slowed aggregate employment growth. However, its stated purpose is to put the economy in a better competitive position with respect to global trade, thereby enabling longer-term growth and employment. The economy has definitely felt the effects of both jobs losses in some sectors, and jobs growth in others. Recent studies have shown that the jobs losses have been less a result of import penetration and more related to technology and process adaptation and changing forms of work organization leading to subcontracting of non-core activities (Edwards, 1999, 2001; Borat & Cassim, 2004).

Growing trade has also had the impact of shifting the economy towards a higher skills composition in the demand for labour. In the traded sectors, the demand for lower skill labour has fallen in the context of a very large oversupply. In contrast, the demand for higher skill labour has risen, in the context of a severe skills shortage (Bell & Cattaneo, 1997; Borat & Hodge, 1999; HSRC, 1999; Edwards, 2001).

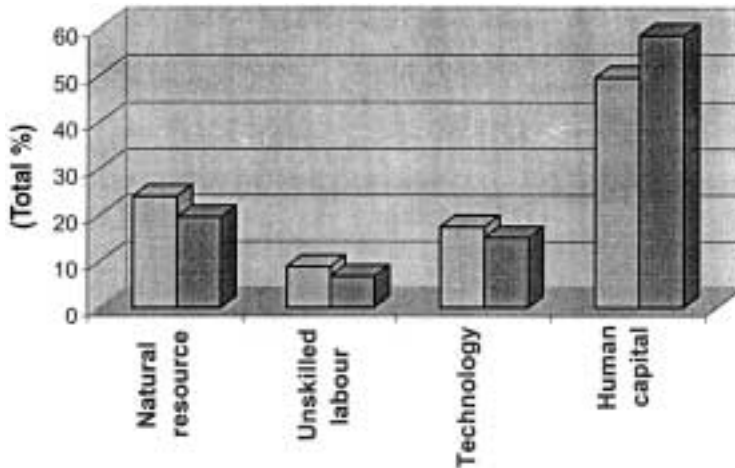


Figure 5. Factor-intensity of South Africa's exports, 1992 and 1999  
 Source: Lewis (2002).

As illustrated in Figure 5, unskilled labour-intensive exports declined from 8.9% to 6.8% of total exports between 1992 and 1999, while human capital-intensive exports increased from 49.5% to 58.5% during the same period (Lewis, 2001). Moreover, an analysis of factor intensity in exports finds that South Africa has a remarkably low, and declining, share of exports that use unskilled labour, and a relatively high share of exports using more skilled labour (Lewis, 2002). This explains why the manufacturing sector has not been a source of employment creation despite the rapid growth in exports.

Government acknowledges that there is a correlation between industries that have become increasingly export-oriented and high rates of investment in capital equipment and capital and skills-intensive technology (DTI, 2002a). This is seen as a necessary structural change in order to gear up for international competition and partly accounts for the 26% increase in labour productivity that has occurred since 1994. Moreover, many of the sectors that have rapidly increased their output are less labour intensive than the manufacturing sector in aggregate. Strangely, this rising skills intensity may partly be the result of growing exports into the African continent, which is an increasingly important outlet for South African manufactured goods.

### **The future economic development path: implications for skill formation**

The South African government has made a commitment to halving unemployment by 2014. This will require that many millions of jobs be created over the next decade. We therefore examine the possible paths to achieving this objective. The imperative is clearly to simultaneously provide avenues for the absorption of low skilled labour and more forcefully enhance the skills base of the labour force. The success of the latter approach to fostering labour absorption rests on aligning the skill formation

strategy with the demand for labour arising from policy interventions aimed at stimulating the expansion of specific sectors and industries.

While the buoyant growth of exports in the latter part of the 1990s created an expectation that global demand would drive labour absorption, the evidence suggests that the potential for mass employment expansion through labour-intensive exports is quite limited. Although jobs can be generated through exports, expectations that large unemployment problems can be directly addressed in this way may be unrealistic for middle and high-income economies. In this context, export sectors can create some jobs but will be more important for growth, incomes, foreign exchange, productivity and technological learning. This feeds fiscal and intra-household transfers that support greater employment generation and a wider distribution of income.

Reliance on a labour-intensive exports strategy is unrealistic in a middle-income economy as it depends on low wage competition. To maintain this as a *dominant* employment-generating strategy for any length of time, it would be necessary to continuously reduce the cost of living (through, for example, price controls on wage goods and the generous provision of a social wage as a proportion of incomes) or reduce real wages (either through exchange rate devaluations or some sort of wage control). Otherwise, it is unlikely that these goods would be competitive in international markets (Altman, 2001).

Workers in a middle-income country must earn wages that reflect the cost of living. Otherwise, human resources are undermined. In a country with a small domestic market, this requires that the production structure and the export profile reflect this cost structure. High productivity industries generally pay workers with the same educational attainment more than lower productivity sectors. A greater reliance on higher value-added exports should raise national income and reduce business cycle volatility, with important knock-on effects for domestic firms generally. A longer-term strategy can focus on expanding the number of investments that fall within this category. However, with high productivity and strong local linkages, these sectors are unlikely to generate substantial net new employment in the medium term.

Altman (2001) argues that the demand-side drivers that would make the South African economy more labour absorbing depend on two interconnected legs: the expansion of both higher-value traded sectors and low productivity non-traded subsectors. Ultimately, deeper linkages are required. It is often forgotten that employment is about all the linkages that occur in response to an investment. The more credible and sustained a programme is, the more the private sector will respond, not only by delivering the procured service, but also by mobilizing investable resources to provide inputs, logistics, and related goods and services. These are the desired spin-offs that are required to enhance the ability of the economy to create more jobs.

### **Stimulating basic needs industries**

The most likely avenue for creating more employment is by increasing effective domestic demand for more employment-absorbing, low labour productivity non-traded

goods and services (Altman, 2001). 'Non-traded' is distinct from non-tradable: most goods and services can practically be traded, but some, such as construction or social services, are more oriented towards the local market. The promotion of non-traded goods and services, such as housing or social and economic infrastructure, and social services, such as early childhood development, home community-based care for those afflicted with HIV/AIDS, school feeding schemes and community development programmes, represents an orthodox Keynesian employment creation programme. Generally, these measures are designed to kick-start the economy by stimulating domestic demand. Indeed, this was a central part of the ANC's programme prior to entering government (MERG, 1993).

In a context where investment overwhelmingly favours capital-intensive production, and in the absence of sufficient market-related inducements, government expenditure should aim to more forcefully push investment towards sectors with higher employment coefficients. Until recently, government's ability to significantly expand the provision of basic needs has been constrained by both fiscal austerity and capacity constraints at all its tiers. During the 1996–2001 period, fiscal policy was characterized by expenditure moderation and a shrinking deficit. In the 2001/02 fiscal year, however, government signalled a change in its macroeconomic policy stance towards a more expansionary fiscal policy.

Alongside increased expenditure on basic needs, government has endeavoured to enhance its capacity to deliver a range of services. Until recently, government has not attempted to utilize the provision of infrastructure and social services as an instrument of employment creation. Instead, the approach to employment creation has hitherto focused on short-term opportunities created through community based public works projects, which do not generate sustainable employment opportunities.

At the Growth and Development Summit held in June 2003, however, employment creation through the provision of basic needs was brought back into the policy arena. Indeed, this strategy is central to the agreement reached between government, organized labour and business, as evidenced by government's commitment to creating jobs through public investment initiatives and expanded public works programmes. The focus of public investment initiatives is to utilize the construction and maintenance of economic and social infrastructure by government, state-owned enterprises and development institutions to create employment.

Central to the commitments made by government in relation to the expanded public works programme is the imperative to implement programmes aimed at *meeting basic needs*. In particular, the following government programmes are targeted (NEDLAC, 2003, p. 4):

- Integrated community home-based care for people living with HIV/AIDS;
- Early childhood development (ECD) and integrated community home-based care for children of working mothers;
- Integrated community home-based care for the aged;
- Food distribution;
- School feeding;

- Feeding at clinics; and
- Food vouchers.

Hence the expansion of the construction and social services sectors are the central strategy for employment creation. The scale of government expenditure on basic needs in the construction and social services sectors, both of which are non-tradable, has significant potential for job creation among unskilled and semi-skilled workers. Non-traded sectors offer an opportunity for employment creation for three reasons. Foremost is the great unmet demand for basic goods and services within South Africa. Vast backlogs in social and economic infrastructure, dramatic social and economic dislocation, weak community care for children, the aged, the disabled and HIV/AIDS sufferers, and limited basic services in waste collection, education, health and welfare among others, characterize the South African situation. It is therefore easy to justify the expansion of community goods and services. It serves not only to provide community services but also long-term jobs, skill formation and social cohesion.

Critically, civil construction and social and personal services have by far the highest employment coefficients. In the former, the use of labour-intensive construction technologies can increase the number of jobs created per million rand of expenditure from 17 to 50. In social services, 47 jobs are generated for every figure 1 million rand invested, with a large portion of these jobs accruing to low and semi-skilled workers (Lewis, 2002b).

Second, in contrast to the manufactured goods sector, it is possible to provide a range of incentives to foster the expansion of these industries without concern for WTO regulations. This is because they do not yet fall within the framework of WTO regulations, as services provided by government are excluded from the General Agreement on Trade in Services (GATS).

Third, government expenditure is a central lever to influence the nature and pace of the expansion of employment in industries where it provides and procures services. This lever has recently become more meaningful as government commenced with an expansionary fiscal policy in 2001.

While a detailed analysis of the means by which basic needs industries will be stimulated lies beyond the scope of this article, its success in creating sustainable employment rests on the development of an *industrial strategy* for each of the affected industries, rather than a public works framework which emphasizes the creation of short-term jobs. This would require supply-side policies aimed at expanding the capacity of these industries, including policy measures aimed at expanding the whole spectrum of skills in these industries and increasing formal accreditations.

### *Strengthening domestic linkages*

The three tiers of government in South Africa<sup>1</sup> together with state-owned enterprises, procure a substantial amount of goods and services, as do large corporations in the

private sector. This is an important lever for promoting employment creation. Until recently, however, this has largely been unexplored.

Import substitution can be encouraged through substantial linkages programmes that leverage off existing demand by the state, public enterprises and large corporations, without abrogating WTO rules. To date, the linkages programmes have focused on low-skills services such as catering or gardening. There are three levers for fostering such linkages: industry-level charters to promote black economic empowerment, the 'proudly South Africa' strategy and government procurement through public works programmes.

Through a process initiated by government, the private sector has recently made significant progress in developing such domestic linkages through the adoption of a number of industry charters. The charters provide a framework for fostering black economic empowerment, i.e. the inclusion of the historically disadvantaged portion of the population in core business activities. These industry-specific charters require large corporations to meet specific targets in terms of shareholding, management and procurement from historically disadvantaged individuals and companies. The Liquid Fuels Charter (which applies to South Africa's synthetic fuels industry) and the Minerals Charter (which applies to the mining sector) were the forerunners and exemplify the impact of promoting linkages in this way. Both require firms in the respective industries to meet a target of 25% with respect to procurement from black empowered enterprises.

Black empowerment involves a combination of equity held, board representation and senior management by black South Africans. Given that there are few firms that meet the criteria to qualify as black empowered within the existing group of firms supplying goods and services, many large corporations have put in place measures to facilitate their development. Such measures include the provision of finance in the form of both debt and equity for start-ups and support services such as training and mentoring. Although these initiatives are relatively new, the preliminary evidence suggests that if the targets are met, they will provide a substantial stimulus not only to the achievement of black economic empowerment targets, but also to domestic linkages and therefore to employment and output.

A further initiative that emerged from the Jobs Summit between government, organized business and labour in 1998 is the 'Proudly South African' campaign. The campaign is supported by the three parties as well as community organizations and actively promotes South African companies, products and services—in favour of those that are imported—as a means of creating employment.

Companies that meet the campaign's criteria—which include substantial value-added in South Africa, high quality, fair labour and employment practices and sound environmental practices—are permitted to use the Proudly South Africa logo, which has proven to be important for marketing goods and services.

Aside from promoting the equity charters, government's main foci since 2003 have been on improving infrastructure, underpinning free basic services, addressing shortcomings in small business promotion, promoting the use of labour-intensive methods in civil construction, and expanding environmental projects and social services within

the framework of an expanded public works programme. Government has also been exploring improvements to its procurement framework.

In sum, an important stimulus to employment creation over the next decade is likely to be the enhancement of linkages to the domestic economy. It is therefore imperative that skills development is aligned to plans to stimulate specific sectors.

*The promotion of small, medium and micro enterprises (SMMEs)*

The promotion of the SMME sector is a critical dimension of a broader employment creation strategy because the creation of new firms is essential if the development of stronger linkages through procurement is to materialize. Critically, SMMEs are generally more labour-intensive than larger firms and hence have a higher labour-absorption capacity. Moreover, the majority of SMMEs operate in the non-traded sector (Berry *et al.*, 2002).

A myriad of complex regulations effectively prevented the entry of firms of this scale into many industries during the apartheid era. More to the point, the apartheid government made most forms of black business ownership illegal. In a bid to reverse this legacy, government has dismantled these regulations and provided a range of financial and non-financial instruments to promote this sector. Indeed, the SMME sector is viewed as a panacea. It is expected to fulfil a number of roles, ranging from poverty alleviation and employment creation to international competitiveness. Despite the creation of an array of policy instruments and institutions to promote SMMEs, the Department of Trade and Industry (DTI) has acknowledged that

the survival rate of small business remains low by international standards, and we have failed to develop a vibrant critical mass of small entrepreneurs that are effectively integrated into the mainstream operations of all sectors. (DTI 2002a, p. 18)

Unfortunately, there is currently little clarity on how SMMEs fit within the industrial policy framework and other objectives of government (Berry *et al.*, 2002). The National Small Business Act legalized the establishment of new institutions to promote the SMME sector, in particular Khula (to provide wholesale finance), and Ntsika Enterprise Promotion Agency (NEPA), to provide non-financial support. In addition, the DTI and Industrial Development Corporation (IDC) have a range of specific programmes to encourage the competitiveness of SMMEs.

These policies have not achieved their objectives if judged against the number of SMMEs that utilize them. Berry *et al.* (2002, p. 34), estimate that a mere 6% of SMMEs utilize support programmes and argue that this is 'due to distrust of external agencies among SMMEs and incapacity to raise awareness about their existence and efficiency'. Moreover, the poor coordination of service providers results in a replication of services and clustering of institutions in urban areas (Ntsika, 1999).

Berry *et al.* (2002, p. 91) argue that 'South Africa's SMME economy suffers from poor implementation of policy initiatives, which are in turn woefully inadequate'. Clearly, a more effective set of policy interventions are required to enhance the

development of this sector. Significantly, a survey of SMMEs in Gauteng and the Western Cape found that skills development was identified as the second priority after market development (Bloch & Kesper, 2002a, 2002b).

### **Implications for skills development**

The pattern of labour demand generated by South Africa's economic development trajectory, both in the apartheid era and the first decade of democracy, has not been aligned to the skill composition of the labour force. Together with stagnation and decline in the latter part of the apartheid era and tepid growth rates in the democratic period, this has resulted in an unemployment rate of crisis proportions.

Policy interventions to halve the rate of unemployment by 2014 are likely to focus on both the expansion of the export sector as well as a more explicit strategy to absorb labour in non-traded sectors. In particular, government has significant leverage as the main source of demand for goods and services aimed at meeting basic needs, together with import replacement by strengthening backward and forward linkages across a range of industries in the domestic economy. These policy imperatives will be unattainable if they are not aligned to the policy framework for skills development. This is because the sustained expansion of output and employment through both the growth of existing firms and the establishment of new firms is contingent on the supply of specific low, medium and high-level skills at the scale demanded by expanding industries.

It is clear that high-level skills are a requirement for the expansion of export-oriented industries and the development of a knowledge-intensive economy. However, it is also clear that the supply of middle-level skills and access points for lower skill labour are also essential. Generally, some proportion of high skill labour is required to generate employment for low skill labour. Therefore a shortage of high skill labour will inhibit the expansion of employment opportunities for low skill labour.

Clearly, the creation of mass employment opportunities for low and medium skilled workers will require more forceful interventions from government in the area of skills development, but other social support mechanisms will also be required to facilitate economic participation. For example, the sustained expansion of basic needs industries relies on the supply of very specific skills. If these goods and services are to be of the desired quality, these skills must be accredited within formally defined career paths. The provision of social services such as early childhood development and home community-based care for those afflicted by HIV/AIDS requires the providers of these services to be trained in these specific areas. At present, the wide range of actors—government, non-governmental organisations (NGOs), faith based and private institutions—that provide these services have different training programmes and standards. If these services are to be procured at a much larger scale by government, the development of unit standards and the improved accreditation of service providers (workers and agencies) will be necessary to facilitate mobility of workers within this

sector. Clearly, a considerable number of new labour market entrants will have to be trained and accredited if these programmes are to be taken to scale.

Likewise, if the construction industry is to be stimulated through a substantial increase in government expenditure on infrastructure (estimated at 33 billion rand between the 2003/04 and 2005/06 financial years in the 2003 Budget Review), it is imperative that there be an adequate supply of low, medium and high skills to support its expansion. At present, the evidence suggests that management and supervisory skills at the contractor level need to be enhanced. There is also a scarcity of artisans, particularly machine operators.

The fragmented nature of the construction industry poses particular challenges for skills development: four large construction companies dominate the management of construction projects and the supply of professional skills, while semi-skilled and unskilled labour is supplied by a large number of small, informal contractors. Recognition of prior learning, accreditation and training of unskilled and semi-skilled workers will therefore require initiatives that may not be accommodated within the current framework for skills development. For example, learnerships are unlikely to prove effective within the current framework.

This account of the social services and construction industries exemplifies the fact that skills development must be aligned to the particular circumstances and dynamics of specific industries and must be embedded in the characteristics of their labour markets.

Finally, the stimulation of the SMME sector relies on the development of entrepreneurial skills that not only provide new entrants to this sector with the skills to engage in specific types of activities, but also provides them with the skill and knowhow to identify opportunities and access the financial and non-financial support provided by government to establish new firms.

## **Conclusion**

This article has contextualized the debate about the most appropriate skills development path for South Africa by locating it within the economic development trajectory of both the apartheid and democratic periods. The central argument is that the economy's inability to absorb unskilled and semi-skilled labour, particularly in the democratic period, has created an unemployment crisis. The resolution of this crisis will be a policy imperative for the next decade. It is therefore essential that policies to foster skills development are aligned to this imperative.

Indeed, the prospects for mass labour-absorption through stimulating basic needs industries, strengthening linkages within the domestic economy and promoting the SMME sector all rely on skills development if they are to create sustainable employment opportunities. While there is considerable emphasis on the shortage of high-skill labour, it is the more forceful development of low and intermediate skills that will also make an equally essential contribution to breaking the back of South Africa's deepening unemployment crisis.

## Notes

1. South Africa has three tiers of government: national, provincial and municipal.

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