

Bhorat, Haroon; Lilenstein, Kezia; Oosthuizen, Morné; Thornton, Amy

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Structural transformation, inequality, and inclusive growth in South Africa

Haroon Bhorat, Kezia Lilenstein, Morné Oosthuizen, and Amy Thornton*

April 2020

Abstract: This paper evaluates structural change, inequality dynamics, and industrial policy in South Africa between 1960 and the present day. We find that South Africa experienced growth-enhancing structural transformation until the early 1970s, before entering a period of premature deindustrialization. Today, the services sector has become the primary driver of growth and employment in the country, while the agriculture, mining, and manufacturing sectors have declined in relative importance. While the post-apartheid government has systematically strengthened its pro-poor policies, the high levels of poverty, unemployment, and inequality forged under the past race-based colonial and apartheid regimes remain stagnant. The future of South Africa's structural transformation and inclusive growth path rests on the ability of the country to move into more skills-intensive and higher value-added manufacturing, while also promoting employment-enhancing services subsectors.

Key words: structural transformation, inclusive growth, South Africa, industrial policy, inequality

JEL classification: H00, I38, O14, O25

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*All authors: University of Cape Town, South Africa; corresponding author: kezia.lilenstein@uct.ac.za.

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Katajanokanlaituri 6 B, 00160 Helsinki, Finland

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1 Introduction

This paper evaluates structural change and inequality dynamics in South Africa. The first half of the paper focuses on the economic history prior to the 1960s, before discussing structural transformation in three distinct periods: (1) 1960–80, the period of industrialization; (2) 1981–93, the period of decline; and (3) 1994–present, the post-apartheid period. The analysis shows that South Africa enjoyed growth-enhancing structural transformation until about the early 1970s. This period of rapid economic growth and industrialization saw industry overtaking the combined share of agriculture and mining. Following this, South Africa went through a period of premature deindustrialization and low growth, driven by poor global economic conditions that were compounded by growing political turmoil within the country. In the post-apartheid period, South Africa has experienced services-led structural transformation. The services sector has become the primary driver of growth and employment, while agriculture, mining, and manufacturing have declined.

The second half of the paper examines South Africa's outcomes in these three periods in terms of inclusive growth, poverty, and employment. The origin of the high inequality in South Africa can be traced back to race-based policies under colonialization and apartheid, which sought to promote high living standards for white South Africans by limiting the economic prospects of black¹ South Africans through their forced removal from urban centres and discriminatory employment and education policies. Inequality was further exacerbated in the first half of period I as the economic boom disproportionately benefited high-skilled, white workers. The combination of growth-enhancing structural transformation in the presence of growing inequality indicates a *strong* Kuznetsian tension in South Africa, at least until about 1975. Thereafter, growth faltered while inequality continued to grow throughout both the period of decline and the post-apartheid period. This indicates a *weak* Kuznetsian tension in South Africa during the latter two periods.

The post-apartheid state has progressively intensified its pro-poor policies through increased spending on education, an expansion of social security provisions, an expansion of basic services, the implementation of Black Economic Empowerment programme policies, and a number of labour market policies, including minimum wages and public works programmes. However, while there has been an expansion in policies aimed at improving the livelihoods of the most vulnerable in South Africa, poverty, unemployment, and inequality remain stagnant. Today, the inclusive growth path is not straightforward for South Africa. The skills-intensive services industry, as the primary driver of GDP growth, is not equipped to generate the number of jobs needed to combat the country's severe unemployment problem. While there are subsectors of the service industry with the capacity to absorb low- and medium-skilled workers, the potential of the manufacturing industry to promote employment-enhancing growth cannot be ignored. However, the obstacles to increasing the growth of South African manufacturing industry are formidable in today's global conditions. The challenge facing South Africa is that of climbing the international ladder of industrial production to more high-tech, more skills-intensive, and higher value-added manufacturing activities. The balance of these strategies around revitalization of the flagging manufacturing industry and promotion of employment-enhancing services subsectors is critical, as establishing a successful pro-poor growth path is essential to creating sustainable livelihoods for marginalized South Africans.

¹ 'Black' in this context is a generic term referring to previously disadvantaged individuals, including African, Asian, and coloured South Africans.

2 Economic history to 1960

During the late nineteenth and early twentieth centuries, South African economic development was well on the conventional track of structural transformation. In the 1870s and 1890s, black African farmers enjoyed a viable peasant agriculture which was able to compete with large-scale white-owned farms. However, this had shifted substantially by the early twentieth century through the economic marginalization of the black peasantry. Bundy (1979) describes the government regulations—driven by political alliance with white farmers—which restricted black South Africans' access to land. This all but eliminated the black African agriculture sector and created a mass of workers whose only option in terms of livelihood was to labour on white farms or in white mines (Bundy 1979). In particular, the Natives Land Act of 1913 legalized territorial segregation, prohibiting black Africans from owning land in white-owned areas, and demarcating only 7 per cent of South Africa's land for their use. This, in conjunction with the discovery of first diamonds and then particularly gold on the Witwatersrand in 1886, was to transform what was an agriculture-dominated economy to one that was minerals-driven (Nattrass and Seekings 2010).

The first three decades of the twentieth century saw relatively stagnant growth. The economy grew but GDP per capita lagged behind that of similar settler colonies such as Australia, New Zealand, Canada, and Argentina (Maddison 2001). Major exports were agricultural: wool, ostrich feathers, maize, and sugar. Pockets of economic activity existed along the strip of gold mines that emerged along the Witwatersrand, in the city of Johannesburg, and to a lesser extent in Cape Town. In 1911, agriculture accounted for 22 per cent of South African national income, and mining for just less than 27 per cent (Feinstein 2005). By 1930, though, gold accounted for 50 per cent of all exports from the Union and a third of world supply at the time, and was undoubtedly the most important industry in South Africa. The mines were critical in attracting capital and stimulating growth in other industrializing sectors, such as timber, food, and transport (Nattrass and Seekings 2010).

Recession hit the economy in the early 1930s with the onset of the Great Depression, but the South African economy was cushioned by relatively inelastic global demand for gold and an agricultural sector that was, by then, producing mainly for the domestic market. South Africa belatedly abandoned the gold standard in 1932 and devalued the currency, raising the income of the gold mines by 45 per cent (Terblanche 2002) and unleashing a period of enrichment and three decades of strong sustained growth. Depreciation of the exchange rate, combined with an increase in the dollar price of gold, led to a 30-year boom in gold production revenue, tax revenues, and employment growth. South Africa was still responsible for about one-third of the global gold supply in 1939, which rose further during the Second World War despite severe labour shortages. This allowed South Africa to weather the war period relatively well. During this time, the country ran a budget surplus, accumulated gold reserves, and managed to repay government and private debt (Nattrass 2005). Total factor productivity between 1939 and 1945 grew faster than in any other period in South African history (Moll 1991).

The importance of the mines meant that their labour dynamics were cause for policy intervention. Most of the gold was buried in reefs deep underground and deep-level mining activity was required to extract the ore. Gold mining therefore came with high fixed capital costs, and the easiest way to make the industry profitable was by keeping the cost of labour low. There is general consensus that the mines would not have been profitable if it were not for low-skilled black African migrant labourers, whose wages were kept low despite chronic labour shortages at the time (Feinstein 2005; Wilson 1972). When the mines sought to adjust their labour mix to one that was more profitable—by increasing employment of skilled black African labour at the expense of costly white workers—white workers resisted with industrial action and violence in the 1922 Rand Revolt. Government

wanted to maintain the profitability of the mines due to the industry's importance for the economy as a whole, but was also concerned with the living standards of the white population, which demanded a 'living' or 'civilized' wage in line with their Australian and other settler counterparts (Nattrass and Seekings 2010). To balance these two priorities, the government sought to find other sectors of the economy in which to employ white workers at high wages.

Government set up a series of incentives to stimulate industrialization, and in 1925 the Customs Tariff and Excise Duty Amendment Act increased and expanded tariffs. With strong state support, high wartime demand, and protection from foreign competition, the manufacturing sector thrived. Manufacturing output tripled between 1924 and 1939, despite the depression, and its share of GDP increased from 12 per cent in 1939 to 19 per cent in 1949 (Richards 1940). The tariffs helped employers to cope with the high cost of white labour, even if this brought about a cost in terms of efficiency. Just before the war, manufacturing overtook agriculture's share of value added, and soon after it overtook mining. A consequence of the state incentives to increase the share of capital was that farms also started intensifying their use of capital, and soon small farms were being absorbed by bigger, more efficient capital-intensive ones. During the war period and while the more organized elements of white labour were absent, employers in most sectors took the opportunity to mechanize and deskill, a precursor to a trend that would continue into the twenty-first century.

In 1948, the National Party was elected and swiftly introduced a slew of legislation that structured apartheid. O'Meara (1983) describes this system as *volkskapitalisme*, a politically led system of Afrikaner capitalism which took the form of vigorous state support for burgeoning Afrikaner business. During its first decade in power, the National Party set up a series of exclusionary labour market institutions that protected white workers' jobs and wages, to the cost of black South Africans and also, potentially at the cost of future growth (Nattrass and Seekings 2010). Carried by the beginning of the boom in the late 1930s, this was a period of strong growth until about the early 1970s. Real GDP tripled and real GDP per capita almost doubled between 1948 and 1970. Industrialization gained momentum as the share of industry (including construction, electricity, and manufacturing) came to exceed the combined share of agriculture and mining in the 1950s.

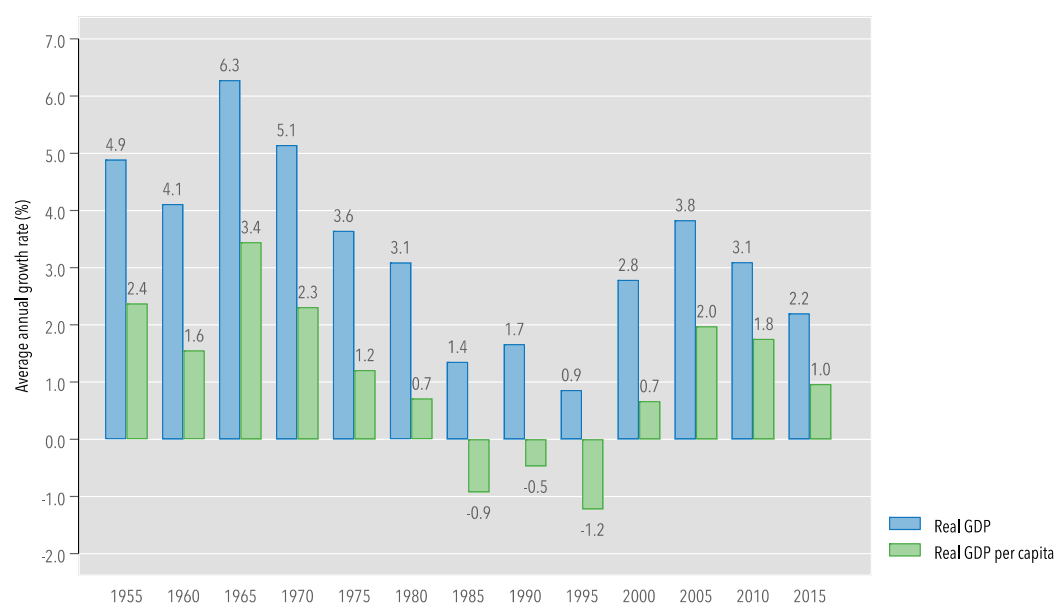
However, this institutional structure rendered the economy less efficient and less competitive internationally and undermined the buying power of the domestic population. The economic consequences of these institutions dovetailed during the apartheid period and were reinforced well into the post-apartheid era to preclude inclusive growth, and they have proven to be highly persistent and difficult to uproot. While overall the period saw a transition from agriculture towards manufacturing, the extent to which the apartheid government's race-based strategies played a role in this is unclear. In other words, it is uncertain whether South Africa would have organically followed this pattern of structural transformation in the absence of the oppression of the black African agriculture peasantry and state-supported Afrikaner industrialization. It may therefore be the case that South Africa's growth path follows a unique 'race-based' pattern of structural transformation, rather than one which would have naturally occurred in the absence of these policies.

3 Trends in structural transformation

The post-1960 period is known as the 'winds of change' period, when the process of decolonization and the separation of Britain from its Southern African colonies was formalized. However, this process stalled at the South African borders as separate development took over in the form of formal apartheid systems. Overall, the post-1960 period has been a turbulent period

both politically and economically in South Africa. Considering growth trends and economic structure, the period can be divided into three. The first period was characterized by relatively rapid GDP and GDP per capita growth (Figure 1), and a growing manufacturing sector, ending in 1981. The second period was characterized by a combination of challenges—including the after-effects of the oil crisis, the gold boom and bust, and increasing internal and external opposition to apartheid—and culminated in the 1994 democratic elections. The third period, the post-apartheid era, has seen the reintegration of South Africa into the global economy and a recovery in economic growth.

Figure 1: Five-year real GDP and GDP per capita growth rates in South Africa



Note: figures are for preceding five-year period in each case.

Source: authors' illustration based on South African Reserve Bank (2019).

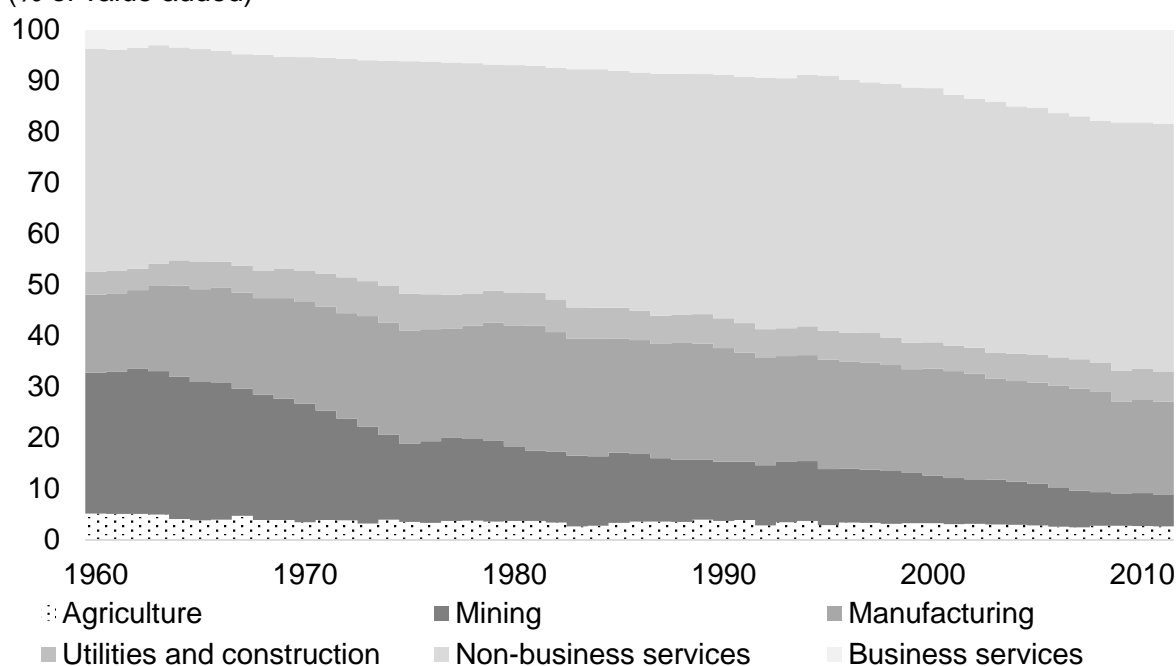
3.1 Period I: industrialization (pre-1981)

Real GDP growth was at its highest since the Second World War during the 1960s, averaging 6.3 per cent per annum over the 1960–65 period, often referred to as the ‘golden age of growth’ in South Africa. Growth lost momentum in the 1970s, as manufacturing went into decline and the effects of the oil crisis were felt, and would only really recover after apartheid was dismantled in the mid-1990s. Both real GDP and GDP per capita growth decelerated throughout the 1960s and 1970s, averaging 3.1 per cent and 0.7 per cent per annum in 1975–80.

The period to 1981 was characterized by growth in the share of value added and employment accounted for by manufacturing. At its peak in 1981, manufacturing accounted for 24.5 per cent of value added and 16.8 per cent of employment (Figure 2). At the same time, there was a steep decline in the non-manufacturing industry share and a very slight decline in the agricultural share of value added. In employment terms, agriculture collapsed from 48.8 per cent of total employment in 1960 to 25.9 per cent in 1981, while non-manufacturing industry employment was marginally higher over the period (Figure 4). The growth in services was also substantial, with the share in value added increasing from 47.4 to 51.6 per cent and the share of employment increasing from 28.7 to 42.0 per cent over the period. While in 1960 the agriculture sector dominated in terms of employment, by 1980 the services sector was the largest employer in the South African economy.

Figure 2: Composition of value added, South Africa, 1960–2011

(% of value added)

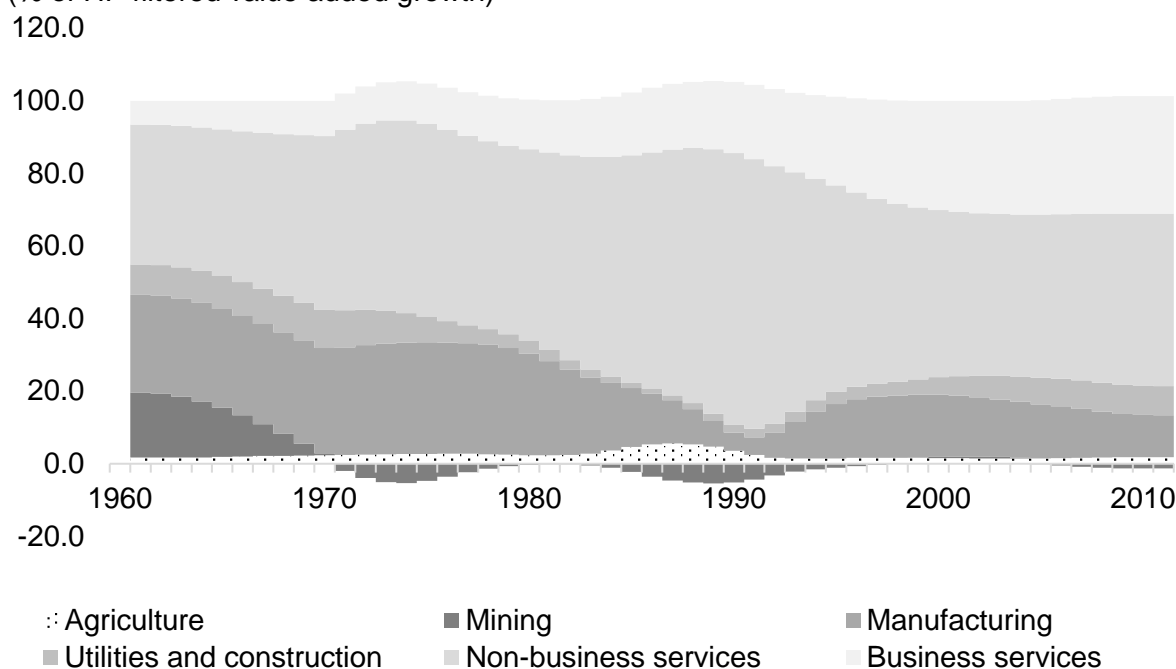


Notes: business services are financial intermediation, renting, business activities. Non-business services are (a) wholesale and retail trade, repair of motor vehicles, motorcycles, and personal and household goods, hotels and restaurants, (b) transport, storage, communications, (c) public administration, defence, education, health, social work, and (d) other community, social, and personal service activities, activities of private households.

Source: authors' calculations based on GGDC (Groningen Growth and Development Centre) 10-Sector Database Version 2015 (Timmer et al. 2015).

Figure 3: Growth decomposition by sector, South Africa, 1961–2011

(% of HP filtered value added growth)

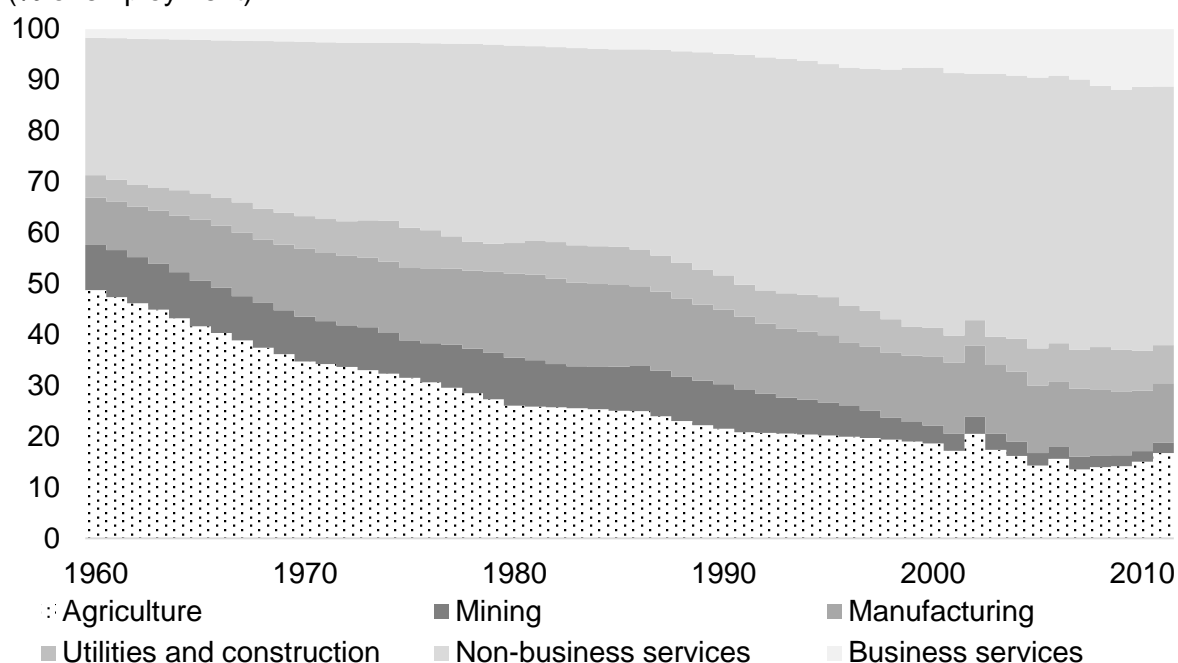


Source: authors' calculations based on GGDC 10-Sector Database Version 2015 (Timmer et al. 2015).

By the 1970s, a combination of investment subsidies, tax breaks, and negative real interest rates encouraged capital intensification even though the productivity of capital was declining: from the 1960s to the 1980s, the cost of capital relative to labour fell by 50 per cent, as wages for all population groups increased (Nattrass and Seekings 2010). Terblanche (2002) further argues that the trend towards greater capital intensity of production had its roots in the experience of state-owned enterprises in the 1920s and 1930s. These were initially unable to compete with foreign-owned companies which had access to cheap European capital, and had to compensate by using ‘highly mechanised production methods, a small elite of skilled white workers, and large numbers of unskilled, disenfranchised, and cheap African workers’ (Terblanche 2002). This represented a continuation of the existing approach of the gold mines and served to further entrench this approach in the rest of the economy.

Figure 4: Composition of employment, South Africa, 1960–2011

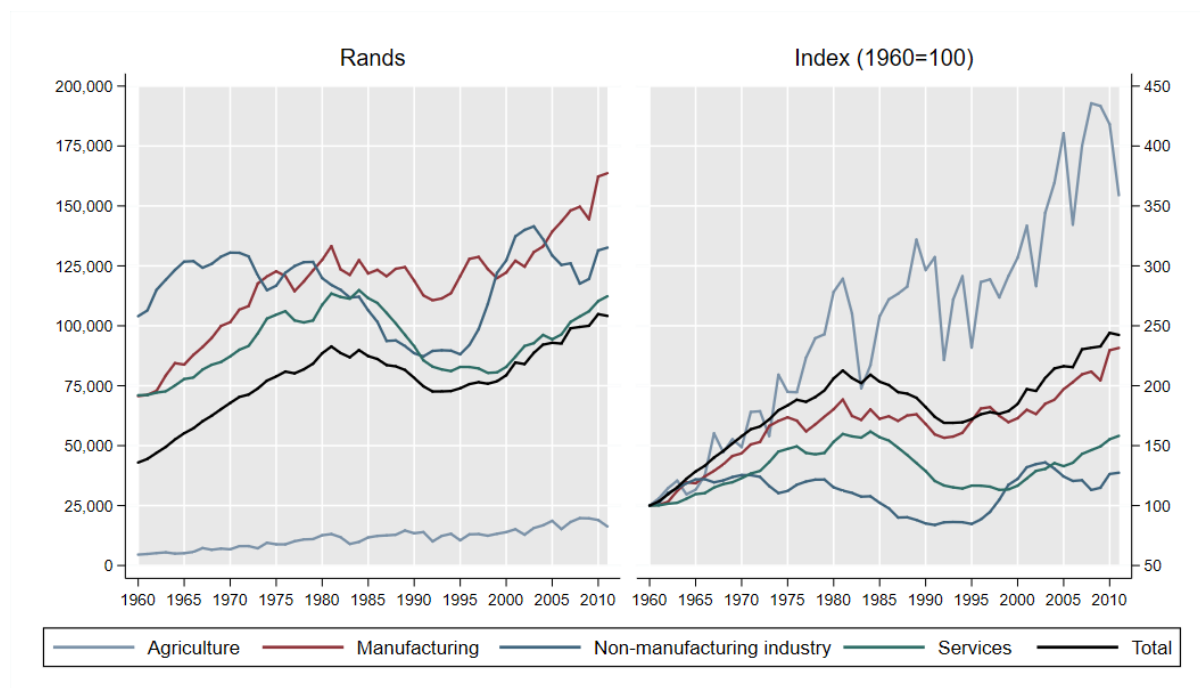
(% of employment)



Source: authors' calculations based on GGDC 10-Sector Database Version 2015 (Timmer et al. 2015).

Between 1960 and 1981, overall labour productivity more than doubled from an index value of 100 to 212.7, equivalent to an average annual growth rate of 3.6 per cent (Figure 5). The most rapid increase was observed in agriculture, where labour productivity almost tripled to an index value of 289.2 in 1981, primarily driven by a large decrease in employment in the sector over the period. Increases in labour productivity were weakest in non-manufacturing industry (a 12.5 per cent increase over the period) and services (an increase of 59.8 per cent). Nevertheless, in absolute terms, agricultural labour productivity remained only a fraction of that in other sectors.

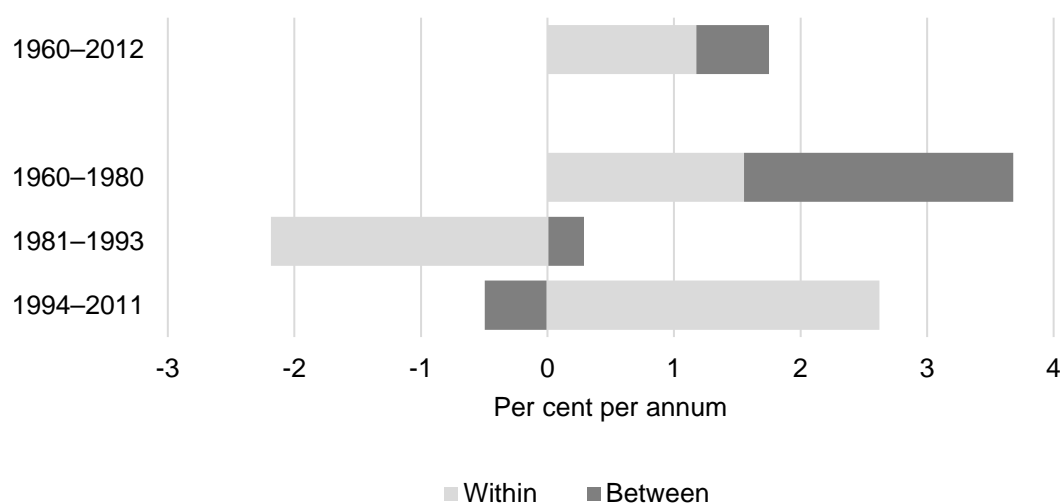
Figure 5: Labour productivity by sector since 1960



Source: authors' calculations based on GGDC 10-Sector Database Version 2015 (Timmer et al. 2015).

Despite these shifts in sectoral labour productivity, Figure 6 indicates that growth in labour productivity was primarily driven by between-sector rather than within-sector changes in this period. Figure 7 gives the ratio of sectoral to economy-wide labour productivity against employment share. The industries in bold are those sectors with higher than economy-wide average labour productivity that also experienced an increase in employment share. It is clear that in this period the manufacturing, mining, and services sectors all experienced higher than economy-wide labour productivity growth coupled with growing employment. This is indicative of the increasing importance of the manufacturing and services sectors in driving structural transformation.

Figure 6: Decomposition of labour productivity growth, South Africa, 1960–2011



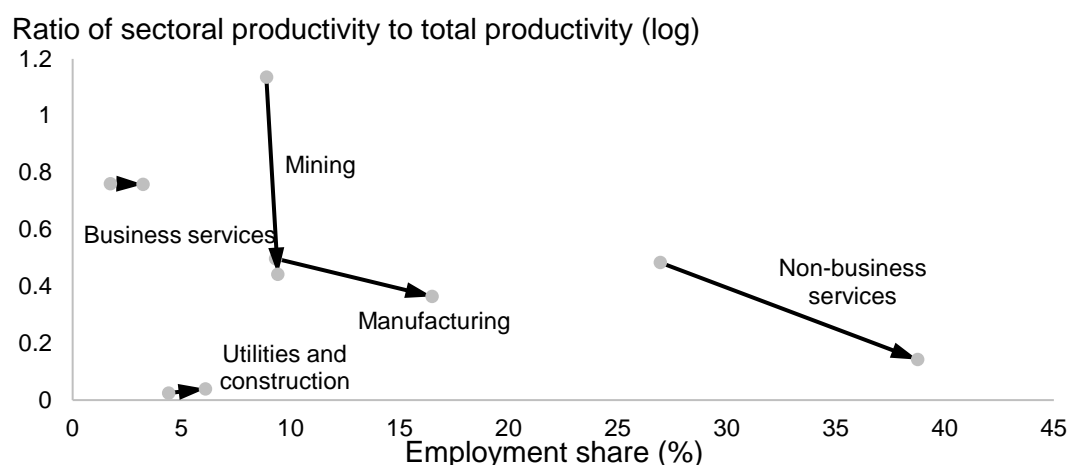
Note: decomposition uses the methodology of McMillan and Rodrik (2011).

Source: authors' calculations based on GGDC 10-Sector Database Version 2015 (Timmer et al. 2015).

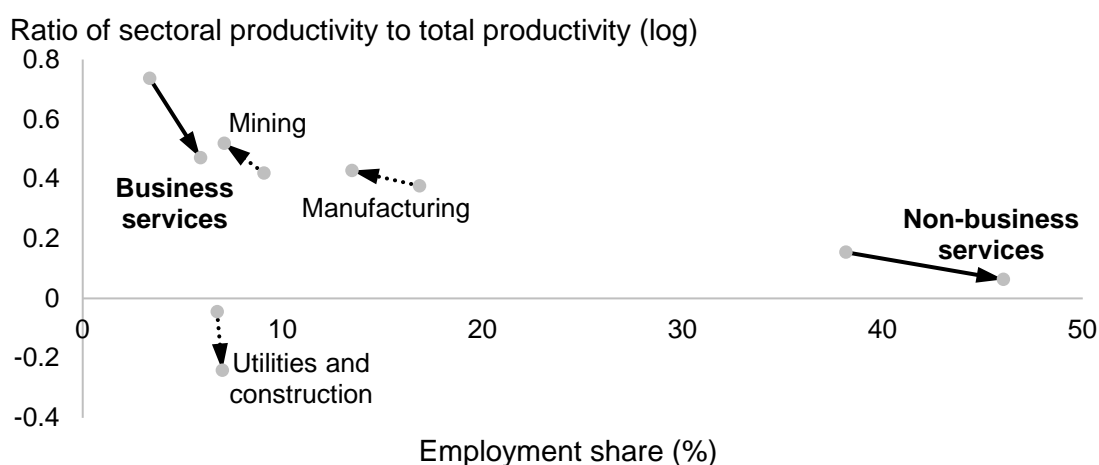
The gold-led commodity price boom of the 1970s also played a substantial role in the changing structure of exports of the period. The dollar price of total exports grew by 5 per cent per year between 1965 and 1970, but between 1970 and 1980 this had increased to 12.4 per cent (Bell and Madula 2002), led by an increase in the price of gold and other mined goods. With the influx of foreign exchange came a substantial real appreciation of the rand and a change in the relative prices of manufactured goods. The result was a considerable change in the composition of manufacturing exports. The shares of light manufacturing such as food, beverages, and tobacco were in decline as the competitiveness of downstream manufactured goods declined with the increase in the exchange rate. There was a simultaneous growth in natural-resource-based manufacturing such as iron and steel, machinery, and paper. With natural-resource-based manufacturing exports protected by high international prices for commodity-based goods, the share of these goods in manufactured exports grew from 24.3 per cent to 37.1 per cent between 1970 and 1980 (Bell and Madula 2001).

Figure 7: Changes in labour productivity and employment share, South Africa, 1960–2011

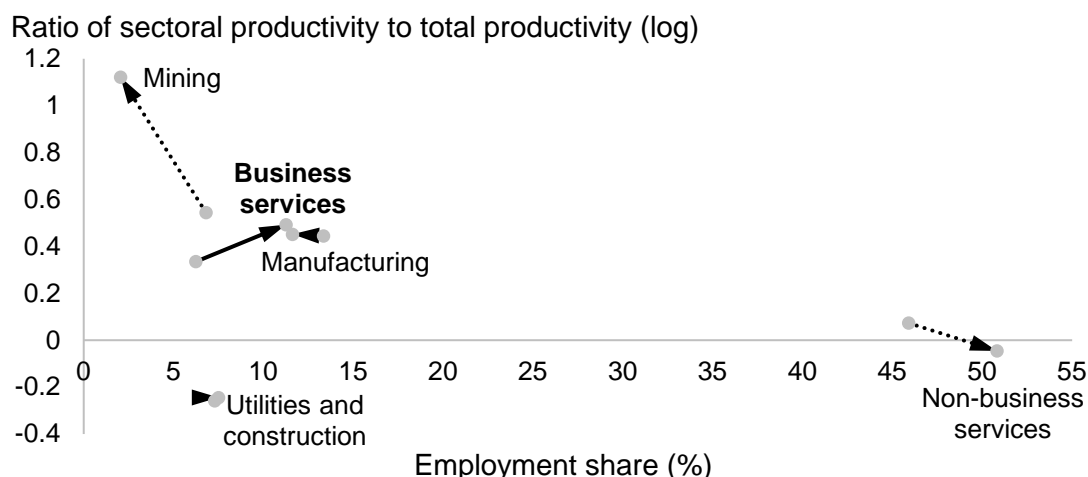
7a: 1960–80



7b: 1981–93



7c: 1994–2011



Note: sectors with higher than economy-wide average labour productivity that experienced an increase in employment share are in bold.

Source: authors' calculations based on GGDC 10-Sector Database Version 2015 (Timmer et al. 2015).

3.2 Period II: decline (1981–93)

Economic growth decelerated even further during the 1980s, to the extent that real GDP per capita growth contracted in each of the five-year periods between 1980 and 1995. This was a result of both internal and external factors. Slow growth was not unique to South Africa, with the Western world only just emerging from the recession of the early 1970s, which was at least partially driven by the oil crises in the same period. The mid-1980s also saw a decline in gold exports and a depreciation of the rand after the collapse of the commodity price boom (Bell and Madula 2001), which resulted directly in a declining level of output. At the same time, there was growing international opposition to apartheid as well as rising political instability in South Africa. This contributed to a substantial increase in debt and a sharp fall in foreign direct investment (FDI) inflows. By the 1985–1992 period, foreign capital outflows were equivalent to 4.1 per cent of GDP per annum on average (Terblanche 2002).

This period of decline also saw a significant weakening of the manufacturing sector relative to the rest of the economy. The sector's share of value added declined by more than six percentage points to 18.3 per cent in 2011, and its share of employment by more than five percentage points to 11.6 per cent (Figure 2). Manufacturing's share of total employment also declined, from 16.5 per cent to 13.5 per cent between 1981 and 1993 (Figure 4). Only the utilities and services sector saw a growth in employment share over this period of decline. In 1980, the combined business and non-business services sector contributed 42 per cent to overall employment. By 1993, this had increased to 51.9 per cent.

Labour productivity suffered too, falling from an index value of 212.7 in 1981 to 169.4 in 1994—a level previously seen prior to the oil crisis—representing a decline of more than one-fifth (Figure 5). This weakness in labour productivity was observed across sectors: it fell by roughly 15 per cent in manufacturing, 24 per cent in non-manufacturing industry, and 29 per cent in services. While labour productivity fell over the period, only the services sector experienced growth and employment-enhancing structural transformation in the period (Figure 7). Figure 6 indicates that there was very little change in sector labour productivity growth between 1981 and 1993. However, the services sector continued on its pre-1981 trajectory as the only sector experiencing higher than average sectoral productivity coupled with an increase in employment. Non-manufacturing

industry began to move more or less in tandem with manufacturing, losing ground in both value added and employment.

This decline in manufacturing and general collapse of the economy is related to the deterioration of economy-wide investment, as downstream manufacturing goods are particularly sensitive to levels of investment in the economy (Bell and Madula 2001). Manufacturing in general is an import-intensive industry and was particularly badly hit by the increase in the price of imports that accompanied the deterioration of the exchange rate over the period (Bell and Madula 2001). This collapse in the manufacturing sector was mirrored in South Africa's dismal performance in the export markets. By the mid-1980s, manufactures accounted for less than one-fifth of exports, with over half of exports in the 'unclassified' category, which would have included gold (Figure 8). Between 1960 and 2004, South Africa's manufacturing exports grew by only 34 per cent, compared with 169 per cent in Argentina, 385 per cent in Brazil, and 1,887 per cent in Botswana (Hausman, 2008). This decline in manufacturing exports can also be linked to increased competition in the market coming from the intrusion of Asian newly industrialized countries (NICs) into the world market. Furthermore, South Africa had become increasingly globally isolated in the face of stringent economic sanctions put in place in opposition to the apartheid government.

Overall, this period can be described as one in which South Africa experienced premature deindustrialization, as growth in the industrial sectors declined before the full benefit of such structural transformation could be gained. Hausmann (2008) explains that this had two key consequences. The failure to diversify and grow exports meant that later in the post-apartheid period, when growth did improve, the current account went into deficit because growth was largely stimulated by the business and financial services sector—which used, rather than generated, foreign exchange. The result was a foreign exchange constraint, which severely undermined the ability of import-reliant sectors to grow. In addition, this resulted in inflationary pressure, which led to restrictive economic policies in general. The second key consequence of an underperforming export sector was an inhibitive effect on employment because the sectors leading growth were relatively more skills-intensive.

3.3 Period III: the post-apartheid period (1994–present)

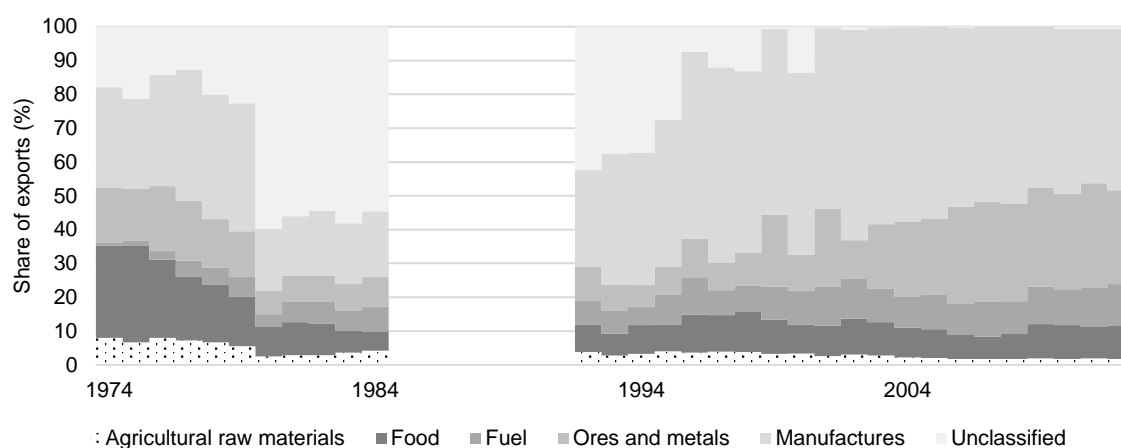
With the end of apartheid in 1994, the economy went through important changes as the country underwent a process of state-building to dismantle the existing discriminatory legal framework and rebuild one that would reflect the new democratic and inclusive constitution. Economic sanctions were removed, FDI surged, and tariffs were slashed in most sectors in the late 1990s (Bhorat and Rooney 2017). Economic growth was relatively robust, at least until the global financial crisis. From a low of 0.9 per cent per annum in 1990–95, GDP growth averaged above 3 per cent in the 2000–05 and 2005–10 periods, before moderating during the 2010s (Figure 1). However, the structure of the economy inherited from the apartheid era was such that the gains of growth largely accrued to a small already-privileged segment of the population, compounding their advantage.

After decades of isolation, it was not a surprise that the industrial sector struggled to cope with the onslaught of foreign competition and quickly contracted (Bhorat and Rooney 2017; Edwards 2005). Adjustments in labour market institutions soon led to similar trends in agriculture and mining, as the benefits and comparatively high wages previously only enjoyed by white workers were extended to all (Nattrass and Seekings 2010). Mining and manufacturing contracted by a third and a fifth, respectively, between 2001 and 2014 in terms of value added; the finance sector, in contrast, expanded by 30 per cent. Figure 3 shows that the services sector contributed 84 per cent to GDP growth in 1994, and the majority of movement was seen in the business services sector in particular. While this subsector contributed 21.9 per cent to the growth of value added in 1993, this increased to 32.3 per cent in 2011 (Figure 3). Employment changes moved in tandem: the

employment share of the tertiary sector soared, while employment in the secondary sector remained stable and employment in the primary sector halved (Bhorat and Rooney 2017). Financial services and community, social, and personal (CSP) services together accounted for almost 80 per cent of the change in employment between 2001 and 2014.

At the same time, labour productivity began to recover (Figure 5). At the national level, labour productivity rose by 43.1 per cent between 1994 and 2011, surpassing the 1981 peak in 2004. Improvements have been observed across all sectors, particularly in non-manufacturing industry (47.9 per cent), manufacturing (44.1 per cent), and services (38.5 per cent), although non-manufacturing industry has shown weakness since around 2000. However, unlike in period I, increases in labour productivity during this period have been driven by *within*- rather than *between*-sector changes (Figure 6). There was also a shift in the structure of exports over the period, with manufactures gaining ground during the 1990s but then being crowded out to some extent by ores and metals (Figure 8).

Figure 8: Export composition, South Africa, 1974–2012



Source: authors' calculations based on World Development Indicators, Version June 2019 (World Bank 2019b).

In the post-apartheid period, the productivity of capital has increased and employers have resumed the process of capital intensification, though for reasons different to those in the 1960s and 1970s. After 1995, this process was stimulated less by state incentives (e.g. negative interest rates) than by the high cost of labour and skills shortages. Given weaker international competitiveness, employers have struggled to cope with rising labour costs without concomitant increases in labour productivity (Nattrass and Seekings 2010). As such, incentives to mechanize and intensify capital remain, and South African industry has become increasingly mechanized even in a context of high open unemployment. Low-wage informal work, by contrast, constitutes a relatively small share of total employment.

Overall, there has been a general inability of the manufacturing sector to drive substantial increases in output and employment. The reasons for this may be numerous. Bell and Madula (2001) argue that the manufacturing sector's general inability to recover as a key driver of growth in South Africa is related to the foreign exchange constraint generated by the falling price of commodities and generally adverse conditions for investment over the period, which is an important factor in this important intensive industry. In addition, there has been continual downward pressure on manufacturing output prices due to increased global competition. Furthermore, South Africa is experiencing a scarcity of high-skilled workers directly related to its race-based policies enacted during apartheid. Bhorat (2001) shows that there have been substantial increases in the demand

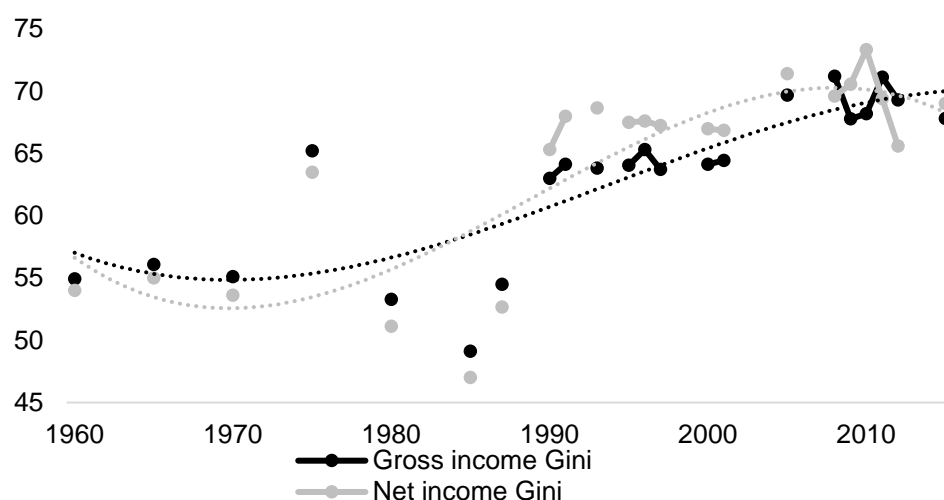
for highly skilled workers in the manufacturing sector, coupled with a decline in demand for skilled and unskilled workers. With the services sector also demanding more relatively highly skilled workers, the manufacturing sector is struggling to compete with these skills-intensive industries for workers. This has contributed to an inability to penetrate skills-intensive, high-tech manufacturing subsectors. This inability of manufacturing to contribute meaningfully to growth in recent decades has seen South Africa transition to a services-led economy, and this sector is now the dominant source of output and employment growth.

4 Income inequality, employment, and inclusive growth

4.1 Period I: industrialization (pre-1981)

Inequality at the start of period I was high in South Africa, with the Gini estimated at 54.9 (Figure 9). Over the next two decades the Gini fluctuated, rising to 65.2 in 1975 before falling to 53.3 in 1980, its lowest level over the period. Overall, inequality in this period was unstable. It appears that inequality was increasing in the beginning of the period when real GDP was growing fastest. During this period, white South Africans were the primary beneficiaries of this boom due to the growing need for skilled workers. Higher export prices associated with the commodity boom also disproportionately benefited white capital. This is also the period of the most concentrated industrialization, with growth in the manufacturing share of value added at its highest. Inequality therefore appears to have been positively related to manufacturing-led structural transformation until about 1975 (Figure 10 and Figure 11).

Figure 9: Gross and net income Gini, South Africa, 1960–2015

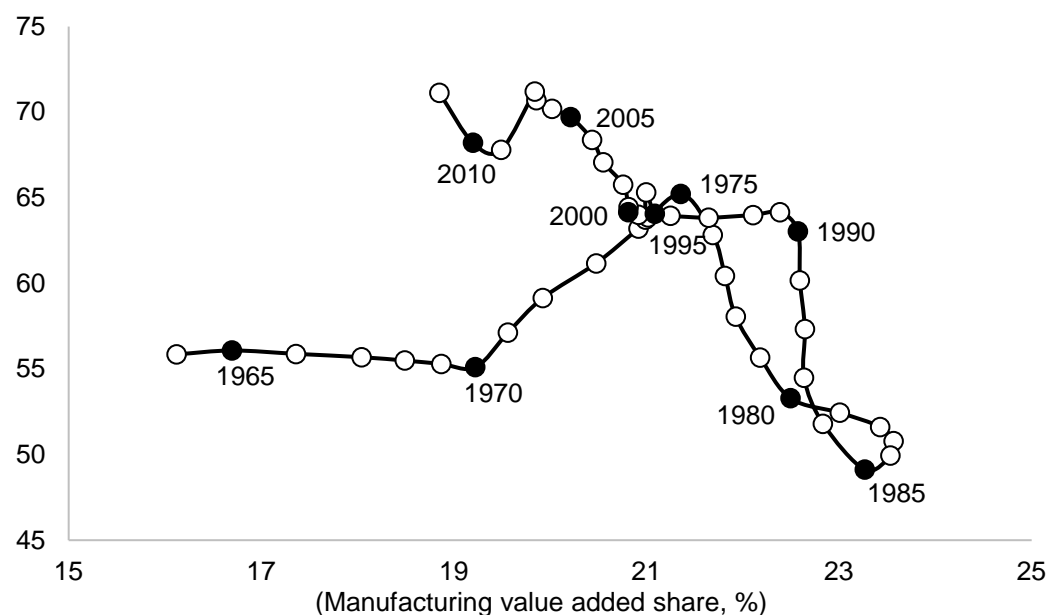


Source: authors' calculations based on UNU-WIDER's World Income Inequality Database (WIID).

Inequality underwent a large decline towards the end of the period (Figure 9). Van der Berg and Bhorat (1999) relate this to the unprecedented decrease in the racial wage gap in the 1970s. Between 1972 and 1980, average black African wages in mining almost tripled (a 184 per cent increase), while wages in manufacturing and construction also saw a large increase (van der Berg and Bhorat 1999). Higher levels of education and the rise of powerful black trade unions are both contributing factors to the narrowing of the racial wage gap (van der Berg and Bhorat 1999), and are both related in turn to the changing political landscape of the period, discussed in the following section.

Figure 10: Gross income Gini and manufacturing value added share, South Africa, 1964–2011

(Gross income Gini)

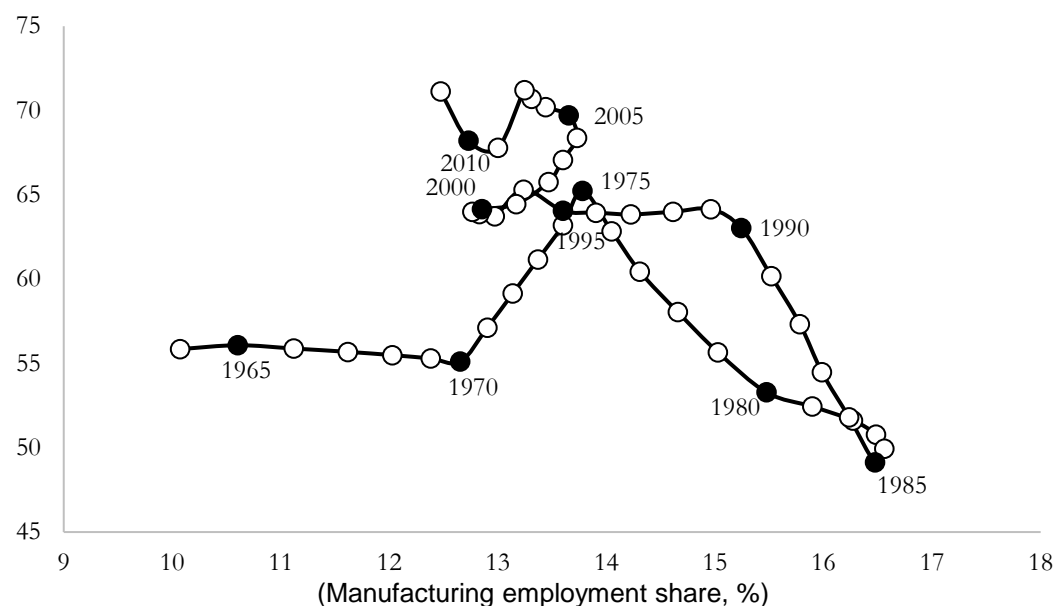


Notes: (i) the missing Gini coefficients were calculated using linear interpolation (see Figure 12 for the original data); (ii) manufacturing value added and employment shares are five-year moving averages: for example, the data for 1975 is an average of data for 1971–75 (see Figures 1 and 2 for the original data). These notes apply to Figures 7, 8, 9, and 10.

Source: authors' calculations based on GGDC 10-Sector Database Version 2015 (Timmer et al. 2015) and WIID (UNU-WIDER).

Figure 11: Gross income Gini and manufacturing employment share, South Africa, 1964–2011

(Gross income Gini)



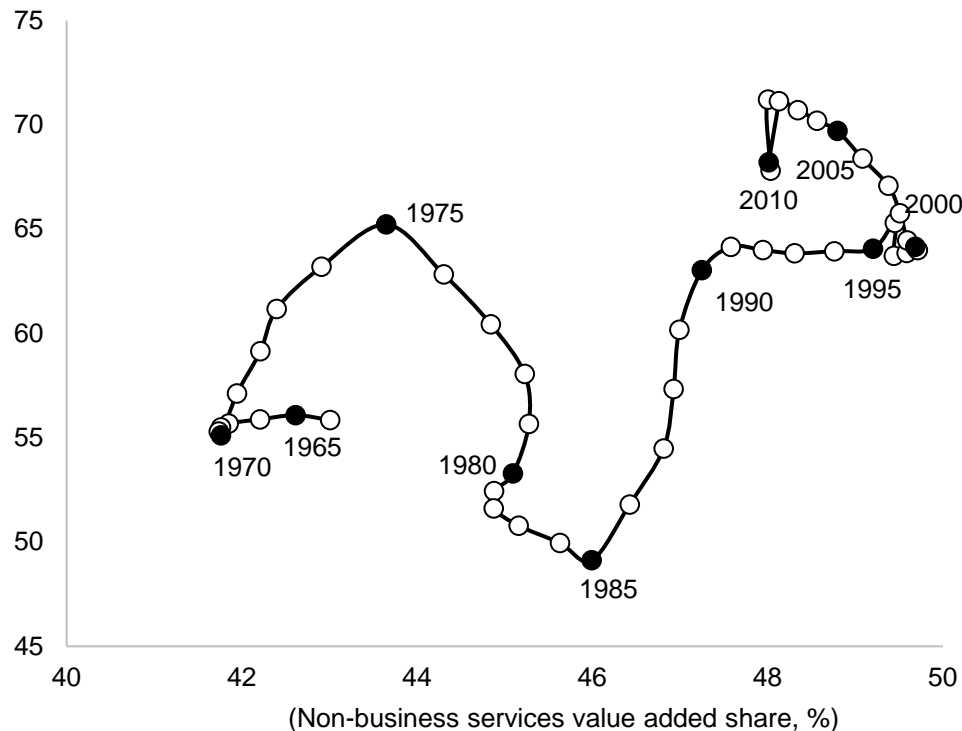
Source: authors' calculations based on GGDC 10-Sector Database Version 2015 (Timmer et al. 2015) and WIID (UNU-WIDER).

4.2 Period II: decline (1981–93)

Inequality almost unequivocally rose during this period of deindustrialization, with the Gini moving from 53.3 in 1980 to 63.8 in 1993 (Figure 9). The relationship between inequality and manufacturing-led structural transformation is also less ambiguous in this period. Figure 10 and Figure 11 indicate a clear inverse relationship, with inequality rising throughout the period as the manufacturing share of value added and employment declined. Conversely, the relationship with changes in the services sector is positive. Figure 12 and Figure 13 indicate a clear increase in the services share of value added and employment during this period of rising inequality.

Figure 12: Gross income Gini and non-business services value added share, South Africa, 1964–2011

(Gross income Gini)

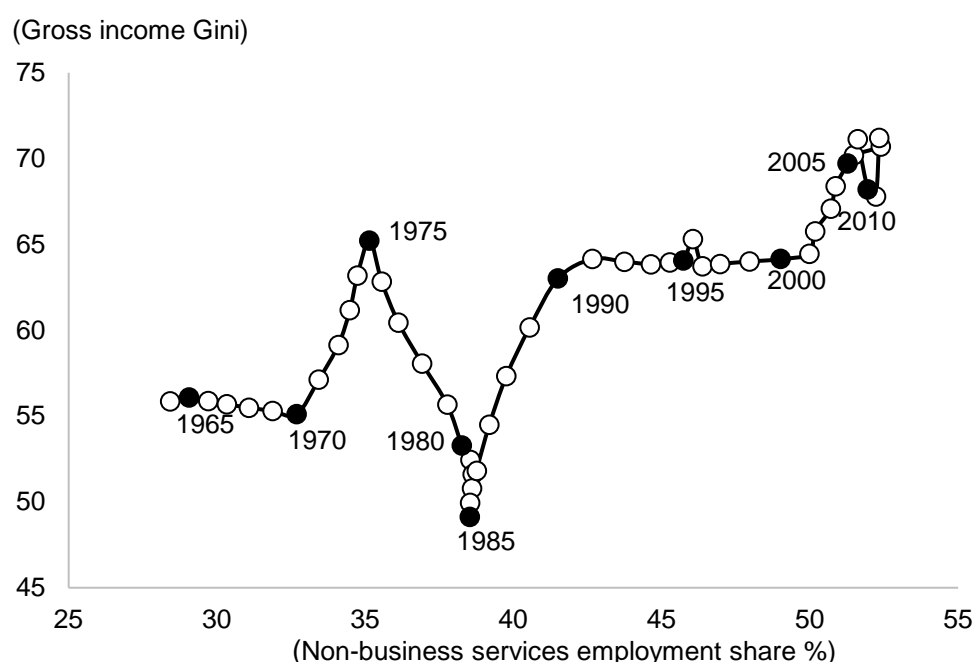


Source: authors' calculations based on GGDC 10-Sector Database Version 2015 (Timmer et al. 2015) and WIID (UNU-WIDER).

At the same time, the racial wage gap in South Africa continued to narrow. In manufacturing, for example, black African wages increased from 23 per cent of white wages in 1980, to 29 per cent in 1994 (van der Berg and Bhorat 1999). This was mirrored in overall income, with black African per capita income as a percentage of white income rising from 8.5 per cent in 1980 to 13.5 per cent in 1995 (van der Berg et al. 2001). Accompanying this was an increase in the occupational mobility for black South Africans, as the need to promote economic growth increased. However, employment growth lagged labour market growth, leading to rising unemployment in the period. By 1994, about half of all economically active South Africans were unable to find formal sector employment (van der Berg and Bhorat 1999). These shifting dynamics contributed to the structure of inequality in South Africa changing over time. Whiteford and van Seventer (2000) show that the driver of income inequality in South Africa shifted over the period: in 1975, 62 per cent of inequality was driven by between-group inequality, while in 1996 within-group inequality contributed 67 per cent to overall inequality (groups defined here according to race). Overall, these patterns of changing inequality, unemployment, and poverty have been persistent in the post-

apartheid years. While poverty has decreased and wages for black South Africans have increased, inequality and unemployment continue to rise.

Figure 13: Gross income Gini and non-business services employment share, South Africa, 1964–2011

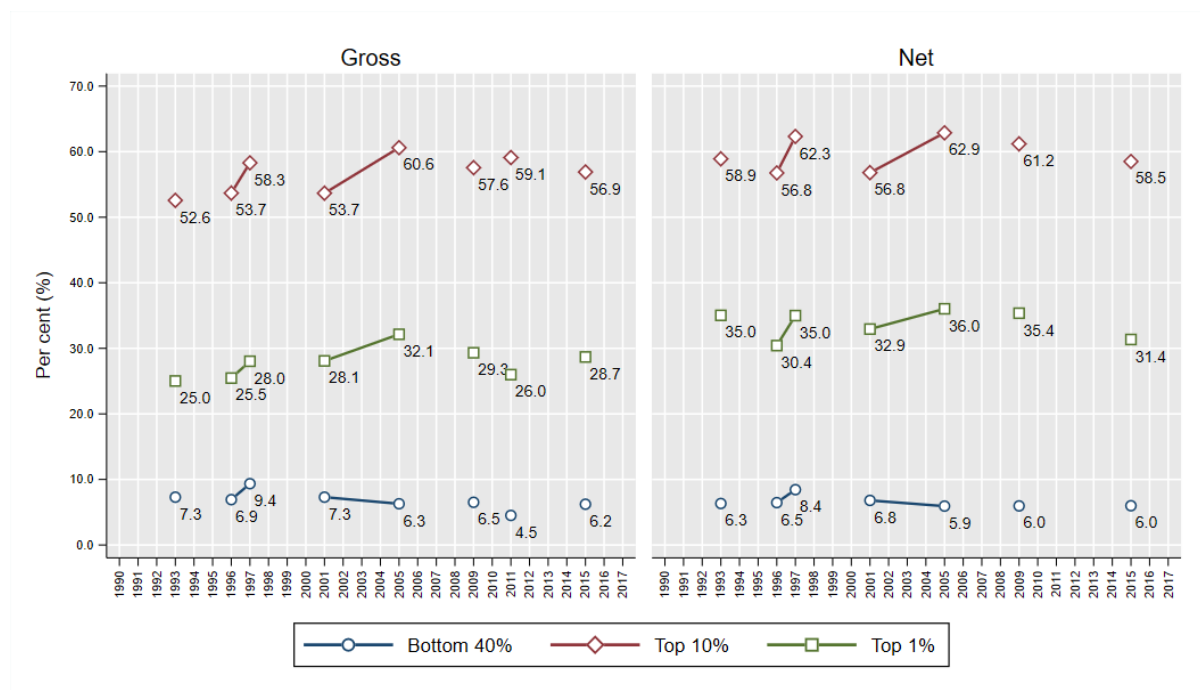


Source: authors' calculations based on GGDC 10-Sector Database Version 2015 (Timmer et al. 2015) and WIID (UNU-WIDER).

4.3 Period III: the post-apartheid period (1994–present)

The high levels of inequality faced by South Africa during apartheid were persistent in the post-apartheid era. While there have been some fluctuations, inequality has remained almost unchanged between 1993 and the present day, with a Gini of 69.3 in 2015 (Figure 9). Overall, the consensus is that inequality either has not changed or has increased since 1994, despite the dismantling of discriminatory legislation (Wittenberg 2017). This increase comes mainly from a rise in within-race inequality among black Africans, as some members of the population have succeeded in advancing economically (Wittenberg 2017). Today South Africa has what may be the highest level of income inequality in the world (Statistics South Africa 2017). From the perspective of income shares, a similar pattern emerges: Figure 14 shows that in both 1993 and 2015, the bottom 40 per cent of the distribution had around a 6 per cent share of net income. In contrast, the top 1 per cent of income earners accounted for 35.0 per cent of total net income in 1993 and 31.4 per cent in 2015.

Figure 14: Estimated income shares by income group since 1993



Source: authors' calculations based on WIID (UNU-WIDER).

The relationship between structural transformation and inequality follows that of the preceding period. Figure 10 and Figure 11 indicate rising inequality in this continued period of deindustrialization. At the same time, Figure 12 and Figure 13 show continued services-led structural transformation. The increase in inequality associated with the expanding services sector may be related to existing inequalities within that sector, as well as a shifting skills profile of the employed. A large proportion of employment generated by the services sector is in the form of temporary employment services (TES) (Bhorat et al. 2016b). TES workers are employed through third-party companies and perform activities such as cleaning or security services at formal sector firms. Bhorat et al. (2016c) find that TES employment has risen substantially in the post-apartheid period and that in 2014, TES employment made up 61 per cent of total business services employment. This type of employment, as well as that of other low-skilled service sector workers, is associated with negative earnings premiums (Bhorat et al. 2015). Simultaneously, there has been growth in skilled employment in the sector. Between 2001 and 2012, more than 70 per cent of the increase in tertiary sector employment came from medium- and high-skilled workers, with high-skilled workers accounting for almost 30 per cent of services sector employment in 2012 (Bhorat et al. 2015). These workers are likely to be located in more modern subsectors of the services sector—namely business, finance, and communications services—and are able to garner a substantial wage premium (Bhorat et al. 2016b).

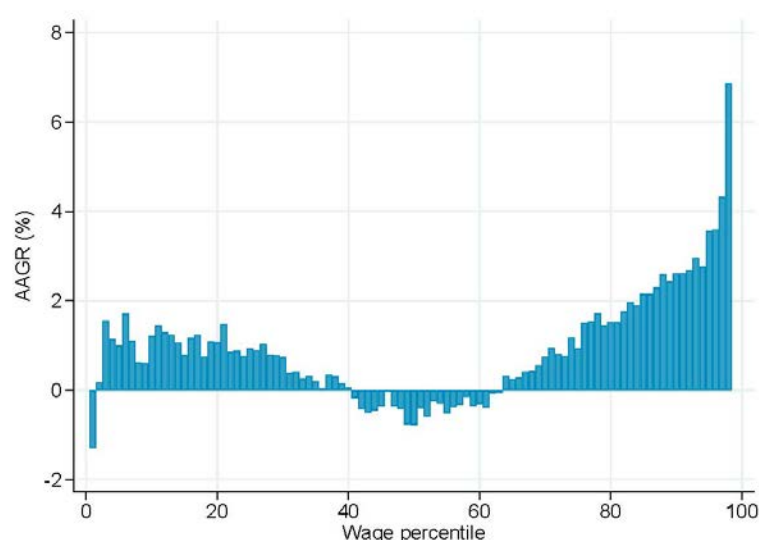
While overall income inequality has increased, inequality in the years of schooling obtained has decreased: in 1994 only 15 per cent of Africans over the age of 25 had completed high school, while in 2017 this figure had increased to 34 per cent (own calculations, data from Kerr et al. 2017). However, it will take a significant amount of time to undo centuries of racially discriminatory education policies. Despite some improvement, South Africa still has the worst education system of all middle-income countries that participate in cross-national assessments of educational achievement, and also performs worse than many low-income countries (Spaull 2013). Only 50 per cent of pupils entering the school system make it to grade 12, only 40 per cent pass grade 12, and only 12 per cent qualify for university. Regardless of the metric used, South African students

persistently test below where they should be in terms of the curriculum and have not reached a host of normal numeracy and literacy milestones (Spaull 2013).

This has led to a severe skills shortage in the economy, which hampers South Africa's ability to drive economic growth in general and inclusive growth more specifically. The combination of the sluggish transformation of the education system and increasing demand for high-skilled workers associated with services-led structural transformation has only exacerbated South Africa's unemployment problem, with the unemployment rate estimated at 29.1 per cent in 2019 (Statistics South Africa 2020). The overall result is a shortage of highly educated, high-skilled workers and insufficient demand for low-skilled workers. Unemployment in South Africa is also racially delineated: the unemployment rate of 7.6 per cent for whites is a quarter of that for black Africans (32.4 per cent) (Statistics South Africa 2020).

The relationship between structural transformation and inequality can also be viewed in terms of changes in wage income across the distribution. Figure 15 gives the average annualized growth rate of real monthly earnings between 2000 and 2015 plotted against wage percentiles. The change in wages in this period is clearly U-shaped, with wages at the bottom and top of the distribution increasing overall, and wages in the middle of the distribution remaining stagnant or decreasing. Growth at the bottom of the distribution can be linked to the implementation of and increases in minimum wages over the period, discussed in the following section. There has also been a proliferation of low-paid jobs associated with the burgeoning services sector (Bhorat et al. forthcoming).

Figure 15: Annual average growth rate (AAGR) of real earnings for employees in South Africa, 2000–15



Note: calculations adjusted using sampling weights; sample consists of all employees of working age with non-missing wage and hours of work data.

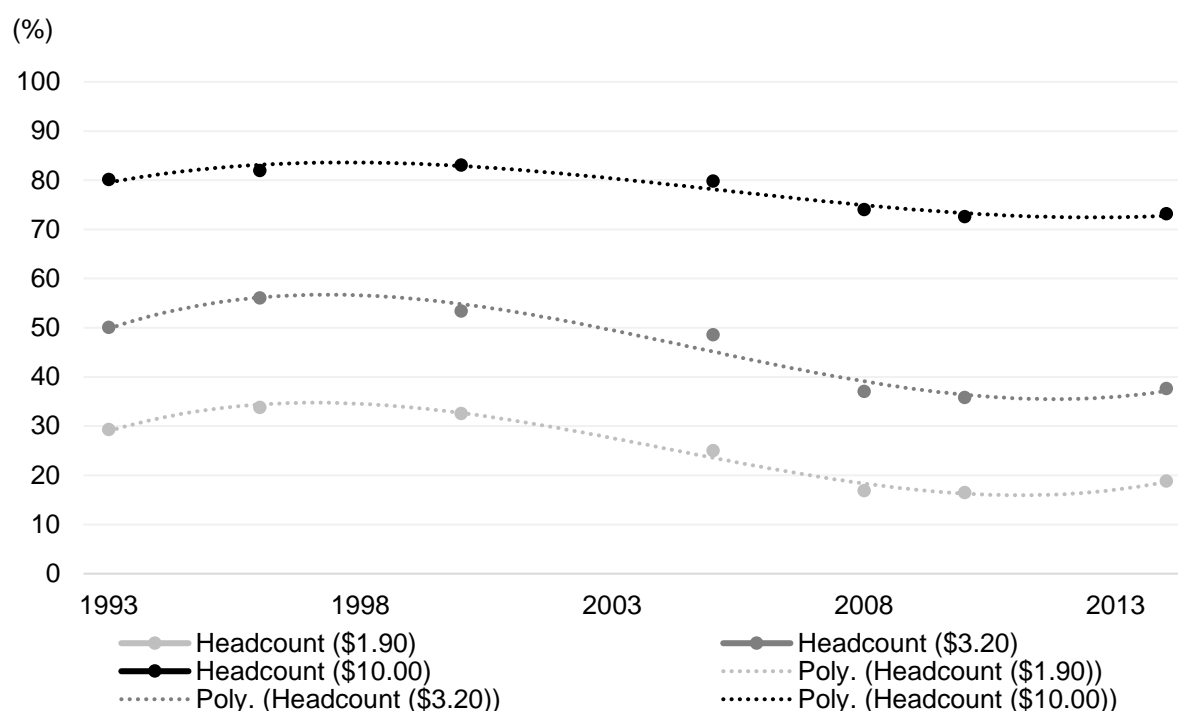
Source: authors' calculations based on Post-Apartheid Labour Market Series (Kerr et al. 2017).

The stagnation of wages in the middle of the distribution can be attributed at least partially to the changing structure of the economy, specifically through the collapse of the manufacturing industry. At the same time, education shares of the employed have shifted over time, and increases in the general level of education in South Africa have been undermined by changes in the way in which education is remunerated. The period has seen a rapid increase in medium-skilled workers who are qualified to do the types of routine and manual work commonly found in the manufacturing sector,

which are easily offshored by technology. The top of the distribution saw the biggest real increase in wages, which grew at about 3 per cent per annum in the top decile. This dramatic increase in wages for the top earners is associated with increasing returns to high-skilled work as well as more analytical, decision-making, and creative tasks being required by the high-skilled business and finance services sector (Bhorat et al. forthcoming). Therefore, the skills-biased wage structure in place today has undermined some of South Africa's post-apartheid advances.

Despite this, there have been overall decreases in poverty levels in South Africa over the period. Figure 16 indicates that South Africa has seen declining poverty since 1993. While headcount poverty at the US\$1.90 line was 29.3 per cent in 1993, this had declined to 18.8 per cent by 2014. Additionally, while poverty rates remain high, asset-based poverty has been steadily falling. The percentage of households living in a formal dwelling increased from 68 per cent in 1993 to 77 per cent in 2011, while access rates for piped water, electricity, and flush toilets have increased from 59 per cent, 45 per cent, and 53 per cent to 72 per cent, 73 per cent, and 61 per cent, respectively (Bhorat et al. 2014). Overall, asset poverty halved between 1993 and 2011. The profile of the poor has evolved over time in accordance with changes in the labour market structure. Labour shortages at the beginning of the twentieth century meant that African poverty was usually associated with the inability to work or a lack of access to wage labour and was concentrated among the elderly or those without access to remittance income. By the end of the twentieth century, many of the poor were of working age but without access to social grant income.

Figure 16: Poverty rates, South Africa, 1993–2014



Source: authors' calculations based on PovcalNet, Version March 2019 (World Bank 2019a).

In summary, South Africa entered the post-apartheid period with a socially engineered high level of inequality and poverty established along racial lines. Today, whites are more educated, earn more in the labour market, and are much less likely to be poor or unemployed than black Africans (Statistics South Africa 2017; DPRU 2018). The inability to substantially shift poverty and inequality levels is linked to a failure of the economy to generate inclusive pro-poor growth, in part due to the generally tepid performance of the economy. Economic growth rates peaked at about 5.6 per cent in 2006 and have been lacklustre since the global financial crisis. The past five years have seen growth falter at less than 2 per cent. Although similar to Latin America, South Africa

has lagged far behind South-East Asia (Rodrik 2008). As growth has continued to be weak, the economy has failed to create jobs even close to the rate needed to employ all active labour market participants. A critical economic policy debate in South Africa revolves around the wage level, which is often argued to be high relative to productivity. While organized labour is committed to a 'living or 'decent' wage, the economy does not appear to be sufficiently competitive or dynamic to employ everyone searching for work at such a wage level. High unemployment rates coexist with skills shortages, and continued capital intensification by employers and the concentration of ownership by powerful business interests have led to the persistence of income inequality and poverty, as the poor have been unable to benefit from the current growth path.

5 Political economy and policies shaping structural transformation, inequality, and inclusive growth

5.1 Period I: industrialization (pre-1981)

The origin and character of inequality in South Africa can be traced back to its colonial roots, which were further entrenched after the discovery of gold at the end of the nineteenth century. Keeping labour costs low was a critical way in which the profit of the mines was sustained. A series of sophisticated labour market institutions were set up between 1910 and 1930 to preserve a 'civilized' standard of living in order to secure the socioeconomic privilege of the white population over other groups. This involved reserving jobs and skilled work for whites as well as a bargaining council set-up where employers and white unions could jointly determine white minimum wages. Thus, the ratio of earnings of white to black African workers was about 10:1 during the inter-war period. The government also set up a white welfare state (Nattrass and Seekings 2010), including the introduction of a state non-contributory pension and other social assistance, as well as generous state investment in white public education.

In order to establish an black African labour base to supply the white economic centres with labour, the apartheid government spatially segregated the country, establishing ten nominally self-governing territories ('homelands') where black African people were expected to live. Africans living in the cities were evicted and forcibly relocated to the homelands, which were rural and marginalized from economic opportunities. Apartheid policies served to keep the black African population landless, largely unskilled, and, while concentrated far from work opportunities, dependent on wage labour (Nattrass and Seekings 2010). As discussed, this spatial dislocation, through the destruction of the black African peasantry, may have uniquely contributed to the onset of the period of industrialization in South Africa.

A key factor contributing to South Africa's period of industrialization was the import-substituting policies pursued by the government between 1925 to 1973, the aim of which was to stimulate domestic manufacturing and state investment (Schneider 2000). This, as well the development of a 'mineral energy complex'—the extraction of raw materials coupled with state support, including low-cost energy—was a driving factor in the growth of the manufacturing industry (Black et al. 2016). Indeed, the period was one of direct and indirect state support for industry, in the form of cheap energy and other incentives, with the state-owned Industrial Development Corporation (IDC) playing a central role in promoting the development of heavy industry (Black et al. 2016). Other large state-owned corporations were run with the aim of stimulating domestic manufacturing and providing cheap imports for the mining industry. By the 1960s, for example, the state-run steel-producing industry (ISCOR) had prices which were substantially lower than in the leading iron- and steel-producing countries (Norval 1962).

The period of unprecedented economic growth and manufacturing-led industrialization initially resulted in a period of increasing inequality, as the returns to skilled workers exacerbated the existing wage gap between white and black African workers. However, it was also associated with at least a partial weakening of some of South Africa's race-based labour market policies. The ongoing need to promote economic growth eventually led to shifts in occupational mobility and increased wages for black workers. With industry booming, it was increasingly difficult to rely solely on white employees (van der Berg et al. 2001). This resulted in a reclassification of jobs which allowed for restricted movement of black South Africans into jobs which were previously demarcated for white workers. This increase in bargaining power was mirrored in the marked increase in unionization after black unions were legalized in 1979 (van der Berg et al. 2001). Thus, the political landscape was inextricably linked to the movements of structural transformation and inequality at the time.

5.2 Period II: decline (1981–93)

While the growth in the manufacturing sector in period I has been attributed to the government's policy of import substitution, its continued pursuit of this and other protectionist policies contributed to its period of decline. These policies weakened the efficiency of South African producers (Edwards 2005; Hausman 2008), and the manufacturing sector's competitiveness vis-à-vis foreign manufacturers was undermined. This led to a shift towards a policy of export-orientated industrialization in what were essentially the conditions of an economic crisis. In 1983, a deliberate process of import liberalization was instituted, and in 1989 systems of duty-free imports-for-exports were instilled in downstream manufacturing subsectors such as textiles and clothing (Bell and Madula 2001). Between 1990 and 1995, export subsidies were introduced and import surcharges were removed. However, Edwards and Lawrence (2008) argue that, overall, there was a strong shift towards protectionism in the mid- to late 1980s. Regardless, the outcome was that the economy did not recover and growth in real GDP per capita was negative over the period.

While the economy struggled due to poor economic conditions globally, South Africa's specific history also exacerbated this period of poor growth and deindustrialization. This was a period of growing opposition to the apartheid government, and South Africa became increasingly economically isolated. Political turmoil was increasing in the form of both violent and non-violent active resistance such as mass strikes, boycotts, and protests. This culminated in the government declaring a state of emergency in 1986 and detaining thousands of its political opponents without trial. In the same year, the Comprehensive Anti-Apartheid Act was passed by the US Congress, imposing sanctions on South Africa and bolstering an ongoing disinvestment campaign.

The combination of factors external and internal to South Africa contributed to the economic stagnation of the economy. This period of decline also saw an increase in levels of inequality. Despite this, there was an increase in social spending for black Africans. In 1975 black African social expenditure was 12 per cent of white levels, but this had increased to 51 per cent in 1993 (van der Berg and Bhorat 1999). Social grant allocations in particular were equalized before the political transition in 1994 (van der Berg 2011). Similarly, in 1975 spending on black African education per potential student was 4 per cent of white spending but by 1991 this had increased to 19 per cent (De Villiers 1996). The racial wage gap also continued to decline, albeit slowly. However, fiscal redistribution and the modest decrease in the racial wage gap were not able to compensate for the socially engineered, severely unequal distribution of wage income.

5.3 Period III: the post-apartheid period (1994–present)

The post-apartheid government was faced with severe structural complexities and the triad of high open unemployment, severe income inequality, and widespread poverty. In order to address the apartheid-era policies which led to these conditions, in 1994 the newly elected African National Congress (ANC) implemented a comprehensive development strategy termed the Reconstruction and Development Programme (RDP), through a consultative process with key non-governmental organizations and research organizations. The RDP was an idealistic and transformative plan aiming to promote sustainable growth and development. In order to address unemployment, inequality, and poverty, it outlined key strategies including land reform, industrialization, and the provision of basic social services such as housing, education, and health care (Mamobolo and Moyo 2014). More recently, the National Development Plan (NDP) was implemented in 2013. The NDP lays out a panoptical, long-term vision for South Africa. It includes a comprehensive range of development goals for 2030, including growing the economy at 5 per cent per annum, universal access to broadband internet, an elimination of poverty, a reduction of inequality, and an almost doubling of the number of people in employment in order to achieve an economy at virtually full employment (National Planning Commission 2012).

In order to address the racial inequalities specifically, the ANC implemented Broad-Based Black Economic Empowerment (B-BBEE) in 2003 as a key component of dismantling the white stranglehold on the South African economy. B-BBEE is a direct intervention aimed at redistributing assets and opportunities in order to pursue an economy representative of the racial demographics in the country. However, the government relied on white-owned corporations to stimulate the rapid economic growth that was a key policy goal, leading to a focus on business-friendly policies and a fear that radical de-racialization of corporations would be detrimental to growth and investment (Tangri and Southall 2008). Twenty-five years after the end of apartheid, corporate South Africa continues to be managed and owned primarily by the minority white population and the distribution of B-BBEE-related benefits has led to the personal enrichment of prominent, well-connected figures. Overall, both the scope of the policy and its outcomes remain unclear, and controversy surrounding the effectiveness of the policy is growing.

The post-apartheid growth strategy sought to promote international competitiveness, trade liberalization, and support for non-mineral-based subsectors with high value added activities (Black and Roberts 2009). The Industrial Policy Action Plan (IPAP) outlines a number of policy interventions aiming to achieve structural change by encouraging the growth of the manufacturing sector. Despite this, South Africa has experienced continued deindustrialization with concurrent growth in the services sector, which is the dominant contributor to both GDP and employment. In recent years, trade liberalization has hit import-competing industries hard and there has been a striking collapse in exports in a number of subsectors of the manufacturing industry, particularly downstream durable goods. For example, the clothing, textiles, and footwear subsector contributed 5.7 per cent of manufacturing exports in 1995, but this proportion had decreased to only 0.8 per cent in 2013 (Black et al. 2016).

Given that the sectors currently driving growth are skills-intensive, this has contributed to the phenomenon of ‘job-poor growth’. In other words, economic growth (as low as it is) has generated an insufficient number of jobs relative to the large increase in new labour market entrants. Persistently high unemployment rates have therefore necessitated the design of appropriate labour market policies to increase labour market access for marginalized South Africans. To this end, South Africa has implemented active labour market policies in the form of a job retraining scheme, two variants of a public employment scheme, and a firm-based wage subsidy intervention. While these schemes have seen some success, they have had limited impact on the pervasive unemployment levels in the economy.

One of the more prominent pro-poor policies has been the widening and deepening of social security in the post-apartheid period. In 2018, 18 million people were covered by social security (National Treasury 2019), up from 4 million in 1994. There are seven government grants available, including the Old Age Grant, the Child Support Grant, and the Disability Grant. The most prominent in terms of access is the Child Support Grant, which was expected to cover 13 million people in 2019 (National Treasury 2019). The Old Age Grant covers 3.5 million people over the age of 60 and accounts for 43 per cent of total government spending on social grants (National Treasury 2019). At ZAR1,780 per month in 2019, it has a value equivalent to 63 per cent of the median wage (own calculations, data from Kerr et al. 2017). The expansion of government grants has therefore been a crucial component of the promotion of sustainable livelihoods for the poor. Leibbrandt et al. (2012) find that in 1993, government grants comprised 15 per cent of income in the poorest income decile. By 2008, this had increased to 73 per cent.

The NDP outlines multiple areas for improvement of the education system, including the need for a high-quality, universal early childhood education and globally competitive literacy and numeracy standards (National Planning Commission 2012). The proportion of government spending allocated to education has been steadily rising. In 2019, the government allocated 15 per cent of its overall budget to basic education (i.e. up to the equivalent of grade 12), and 5 per cent to higher education (National Treasury 2019). However, this increasing in spending has not translated into a significant narrowing of the skills gap, and the labour market continues to be a major driver of overall inequality. Lack of access to labour market income and inequality of income earned accounts for more than 80 per cent of total inequality in 1993 and 2008 (Leibbrandt et al. 2012). In order to combat wage inequality, the government introduced the first minimum wage in the contract cleaning sector in 1999. By 2015, there were nine sectoral minimum wages which covered 31 per cent of the formal sector (ILO 2015). Most of these sectors experienced annual real increases in their wages with the onset of a minimum wage (Bhorat et al. 2016a); the impact of minimum wages in propping the wages of the poorest deciles has been illustrated in Section 4.

In January 2019, the government implemented a National Minimum Wage (NMW) of ZAR20 an hour. The NMW is higher than the median hourly wage, with 58 per cent of workers earning below this wage (own calculations, data from Kerr et al. 2017). The strength of the collective bargaining mechanism in South Africa can be directly attributed to the influence of its powerful trade unions, which have had powerful alliances with the ruling party since democracy. However, unions have increasingly been argued to serve the labour elite. Private sector unionization rates have fallen, from 35.6 per cent in 1997 to 24.4 per cent in 2013 (Bhorat et al. 2015). At the same time, public sector union membership rose by over half a million, with 70 per cent of the sector unionized by 2013 (Bhorat et al. 2015). This shift has also coincided with a rapid increase in the public sector wage bill.

This discussion highlights the fact that the government is committed to the idea of South Africa becoming a ‘developmental state’. Overall, however, the country’s turbulent and complex history has had a long-lasting effect on its ability to actualize pro-poor and inclusive growth. The alignment of the colonial and apartheid state with the business sector and the centrality of the labour movement in mobilizing resistance to apartheid have resulted in deep-seated antipathy between labour and business that persists today. This has meant that it has been extremely difficult to generate a national consensus on the country’s future development path. At the same time, a rising public sector wage bill, corruption, and weak economic and employment growth have considerably limited the state’s ability to make the appropriate investments required to direct or facilitate economic transformation.

6 The future trajectory of structural transformation, inequality, and inclusive growth

The post-apartheid era has been characterized by the failure of South African society to adequately address inequality and achieve a more equitable distribution of the benefits of economic growth. This failure has been the result of various factors, including the entrenched inequalities and distorted economy inherited from the apartheid era, the difficult relationship between the social partners, and sometimes simply a failure to make appropriate but difficult policy choices. The urgency is clear: the country's working-age population continues to grow and unemployment continues to rise, a problem that would be compounded should labour force participation rates rise in the future.

South Africa's future trajectory of structural transformation, inequality, and inclusive growth is very much dependent on the policy regime. Critically, in several key areas—land reform, the public sector wage bill, state-owned enterprises, and skills shortages—policymakers will need to be prepared to make and follow through on difficult choices, where the costs and benefits extend across multiple electoral cycles.

The labour market remains one of the most important channels through which the benefits of structural transformation and economic growth can reach ordinary citizens. While employment growth has been positive over the past decade, it remains too slow to absorb the growing labour force. While many other developing countries have dynamic informal sectors that act as a sponge to absorb 'excess labour', this is not true in South Africa. The result is that unemployment continues to rise. From the perspective of policy, it seems that an emphasis on supporting this sector would be appropriate, with the intention of facilitating the establishment of sustainable income-earning opportunities and linkages between the formal and informal sectors.

In the last four decades, East Asia has experienced rapid economic growth, employment absorption, and decreased poverty, driven by the process of industrialization. However, South Africa—along with much of the rest of Africa—has been following a process of deindustrialization, with the post-apartheid period witnessing the declining importance of manufacturing. As a result, structural transformation in South Africa has not followed the conventional path observed in East Asian countries. As South Asia starts to match the growth performance of East Asia, a new path for sustained economic growth has been laid, one less dependent on manufacturing-driven growth and more dependent on the services sector.

If South Africa can grow and structurally transform through the services sector, the nuances within this sector in terms of growth, productivity, and employment must be explored. The complication of following a services-led growth path is that the more productive and growing subsectors of the services industry tend to require highly skilled labour—something which is in scarce supply in South Africa, despite its substantial unemployment problem. Indeed, skills portability gaps are more easily navigated when moving between agriculture and manufacturing than when moving between agriculture and high-end services (Bhorat et al. 2016b). The concern is that South Africa will struggle to utilize its growing working-age population, the majority of whom are semi- or low-skilled, if it attempts to follow a growth path predicated on an abundance of high-skilled labour.

However, there are subsectors of the services industry which are fast-growing, tradeable industries that benefit from productivity growth and have the capacity to absorb huge numbers of moderately skilled workers. In South Africa, subsectors such as wholesale and retail trade, transport and storage, and catering and accommodation have a higher proportion of semi-skilled workers than manufacturing (Bhorat et al. 2016b). The tourism sector in particular has the potential to promote inclusive growth through the absorption of women and young people into the labour market (Bhorat et al. 2016b).

While manufacturing and industrialization remain the focus of South Africa's policy landscape, there has been increased attention on the potential of the services industry in recent years. The most recent IPAP emphasized the potential of business process services to support economic growth, highlighting an incentive structure aimed at promoting South Africa as a major offshoring destination. The NDP highlights the importance of low-wage, domestic-orientated services as a pro-poor driver of economic growth. However, it is not certain that these industries will contribute substantially to growth and development and be able to support a mass of decent work for low-skilled individuals.

Despite the potential of the services sector, South Africa cannot ignore the potential of the manufacturing sector in promoting labour-intensive economic growth. The manufacturing sector has the highest indirect employment multiplier (Dessus and Hanusch 2017), highlighting the importance of a multi-pronged approach in tackling the unemployment and growth problem in South Africa. In this regard, there are tradeable non-manufacturing sectors which overlap with manufacturing in terms of the policy requirements to facilitate growth—for example, agro-processing. Policies aimed at improving the manufacturing sector, such as improving transport links and export promotion, will apply equally to these sectors. The key to promoting effective structural transformation coupled with substantial job creation will therefore be to develop a strategy promoting the development of industries with and without smokestacks—specifically those industries with the scope for high growth levels, coupled with the potential for low and medium-skilled employment creation.

South African governments through the twentieth century saw themselves as capable of generating jobs in significant numbers. This has also been true of the post-apartheid government and, over the past decade or more, public sector employment has grown significantly. However, the economic sustainability of an expanding public sector is cause for concern, particularly within the current context of slow economic growth and weak revenue collection growth. It is estimated, for example, that employee compensation in public spending accounted for 14.0 per cent of GDP in South Africa in 2016 (Ortiz-Ospina and Roser 2019). According to the National Treasury (2019), compensation of public service workers 'accounts for more than 35 per cent of consolidated public spending and has been a major driver of the fiscal deficit', with negative consequences for service delivery. It seems increasingly urgent that the government take action to trim the bloated civil service.

The obstacles to significantly faster growth of South African manufacturing industry, however, are formidable in today's global conditions. The challenge facing South Africa is that of climbing the international ladder of industrial production to more high-tech, more skills-intensive, and higher value-added manufacturing activities. This is in some respects particularly difficult for a natural-resource-abundant economy such as South Africa's. As Findlay and Lundahl (1999: 36) observe, there is 'the possibility that under certain circumstances pursuing a pattern of primary specialisation makes it difficult to switch at all' to a more diversified export pattern. And, as we have seen above, it can be yet more difficult to sustain a rapid rate of growth of output while transforming the export pattern, especially in unfavourable world economic conditions such as have prevailed for the past 30 years.

7 Conclusion

During the 1960s, South Africa experienced unprecedented levels of growth in a period of industrialization. While policies such as import substitution and state support for heavy manufacturing nurtured South Africa's manufacturing sector, it can be argued that the shift from

agriculture to manufacturing was uniquely influenced by the destruction of the black African peasantry, particularly through legalized racial segregation and restrictive land ownership laws. What followed was a period of decline, with sluggish GDP growth rates and premature deindustrialization, driven both by poor global conditions and growing economic isolation due to South Africa's ongoing political system of legalized racial oppression.

Today, South Africa has completed the transition from an economy based on agriculture to one based on services, although this has arguably been 'premature' (Cattaneo 2011; Imbs 2013). The financial and business services sector has become the main growth driver of the economy expanding in terms of value added and employment, while agriculture, mining, and manufacturing have collapsed (Bhorat and Rooney 2017). This pattern could fit a profile of premature deindustrialization where the full benefits of manufacturing-led growth are not extracted before transitioning to service-led growth (Cattaneo 2011; Imbs 2013). The result is a service-heavy economy struggling to maintain growth in currently restrictive global conditions. With employment opportunities increasingly found in this skill-intensive sector, this has contributed to 'job-poor growth', whereby the growth in the economy cannot absorb the growing labour force. This has contributed to exceedingly high levels of unemployment, and particularly an oversupply of labour among the low-skilled majority.

This pattern of structural transformation experienced by South Africa can be visualized as in Figure 17, which plots inequality vertically and growth-enhancing structural transformation horizontally. For the Kuznetsian tension to play out, a country should experience rising inequality in the context of growth-enhancing structural transformation. In South Africa, the only period of strong growth (period I) was accompanied by an ambiguous outcome in the rates of inequality. However, it appears that the Kuznetsian tension held in South Africa at the beginning of period I, or up until about 1975. Thereafter, the period was typified by a *weak* Kuznetsian tension, which continued into periods II and III, where increasing inequality was accompanied by sluggish growth.

Figure 17: Kuznetsian tension through the three periods

Inequality	Increasing	<i>Kuznetsian tension: Weak</i> Period II: 1981–93 Period III: 1994–present	<i>Kuznetsian tension: Strong</i> Period I: 1960–80
	Decreasing	<i>Kuznetsian tension: Ambiguous</i>	<i>Kuznetsian tension: Weak</i>
		Weak	Strong
		Growth-enhancing structural transformation	

Source: authors' illustration.

In terms of the inclusivity of its growth, the post-apartheid era has been characterized by high and stagnant rates of unemployment, poverty, and inequality. The origin of this can be traced back to historical discriminatory raced-based policies that sought to promote high living standards for white South Africans by limiting the economic prospects of black South Africans. This was effected through forced removal from urban centres and discriminatory employment and education policies. Today, South Africa faces severe structural complexities which were socially engineered to be starkly demarcated across racial lines. The post-apartheid government has implemented a series of comprehensive development strategies in order to address this, with

varying levels of success. While poverty and unemployment have remained high, the livelihoods of the most vulnerable South Africans have improved through an expansion of the social grant and service delivery systems.

The structural transformation pathway laid out in this paper has left South Africa in a similar position to that of many African countries—where the inclusive growth path is not straightforward, and the historical road map of industrialization as the growth and employment driver in the economy is no longer applicable. South Africa will therefore need to strategize around attempting to revitalize a flagging manufacturing sector which has thus far failed to be competitive, or attempt a services-led growth path, with the aim of absorbing the country's large supply of low-skilled unemployed into employment. Establishing a successful pro-poor growth path is essential to combat the persistently high levels of inequality in the economy and to create sustainable livelihoods for those previously excluded from economic opportunities.

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