



## Collective Wage Bargaining in South Africa: What are the Implications for Lesotho's Economy?

*Industrial action in demand for higher wages.....*

### **Introduction**

Several industries were hit by a wave of industrial action in South Africa (SA) with the most violent strike at Lonmin's Marikana platinum mine in August 2012 and which is claimed to have sparked the spread to other mines and sectors including the agricultural, transport and fuel distribution sectors. The main trigger of the strikes was the demand for higher wages by the workers. The labor unrest over salary increases was not a new phenomenon in SA. Labor unrests have become an annual occurrence save for the

fatalities that characterized this year's strike. SA's labour is highly unionized and literally all sectors have flagship labor unions that are in turn affiliated to the national union federation. For example, the Chamber of Mines represents workers in the mining industry whether they are in platinum, gold, coal or any other mineral. Thus they are able to engage in collective bargaining, which, as a result, affects the entire industry not just one company or firm within an industry.

### ***The Link between Wages, Labor Productivity and Employment***

Economic theory indicates that labor demand would increase if productivity per unit of labor increased at given wages because further expansion of production would increase firms' profits. This is used as the basis for justifying that wage increases should be restrained below the productivity growth rate so that they do not hamper employment growth. The growth models, like some neoclassical models of the labor market, contend that under the assumptions of perfectly competitive labor and product markets, and perfect access and utilization of information, real wages will be equal to the value of the marginal product of labor at the price expected by the employer for its output. If this is the case then real wages should rise in proportion to marginal labor productivity. This implies that the real wage should equate to the marginal product of

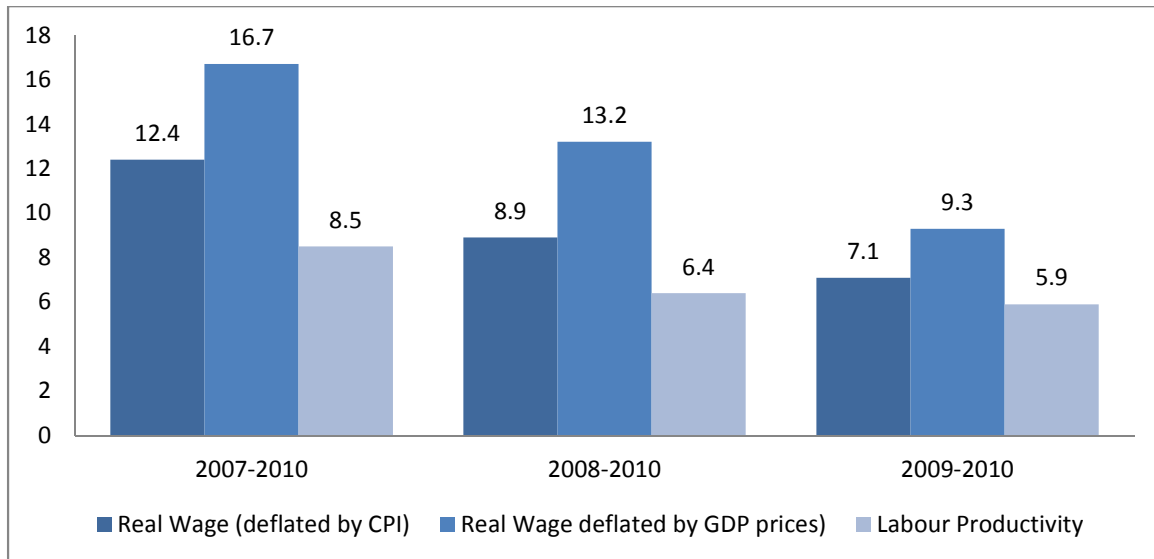
labor, and therefore wages should, at least in the long run, rise at the same rate as labor productivity.

In real life, real wages may not necessarily reflect labor productivity as the theoretical assertions are often disregarded by workers in their demand for wage increases and by international organizations when advocating for "decent wages". This is particularly an issue in economies and sectors where the labor unions have strong bargaining power. As depicted in Figure 1 below, the real wage has been increasing rapidly in SA, outstripping the growth of labor productivity over the years. In addition, Klein (2012) found that there exists a statistically weak long run relationship between labor productivity and the real wage in SA which suggests that there are other factors behind

the increase in the real wage other than labour productivity. One such factor could be the strong labor unions which have over

the years displayed pretty strong bargaining power.

**Figure 1: Cumulative Growth of the Real Wage and Labor Productivity of the Non-Agriculture Sector in SA**



Source: Borrowed from Klein (2012)<sup>1</sup>

This does not augur well for employment growth especially given the current jittery global economic environment. Microeconomic theory indicates that labor demand would increase if productivity per unit of labor input increased at a given wage as a further extension of production would increase firms' profits. This is the basis of the perspective that wage increases should be restrained below the productivity growth rate so as to stimulate an increase in employment levels. Policy debates on employment, following the recent recession, apply this argument saying that in the medium and long run, the combination of productivity growth and moderate wage increases may stimulate output growth and employment generation. In addition, according to the neoclassical labor market view, involuntary unemployment in an

economy could be wiped out by reducing the real wage in the labor market provided that nominal wage variations do not affect the price level thus resulting in real wage variations and also provided that effective demand by households and firms in the goods market is always sufficient to take up the goods produced and supplied by firms.

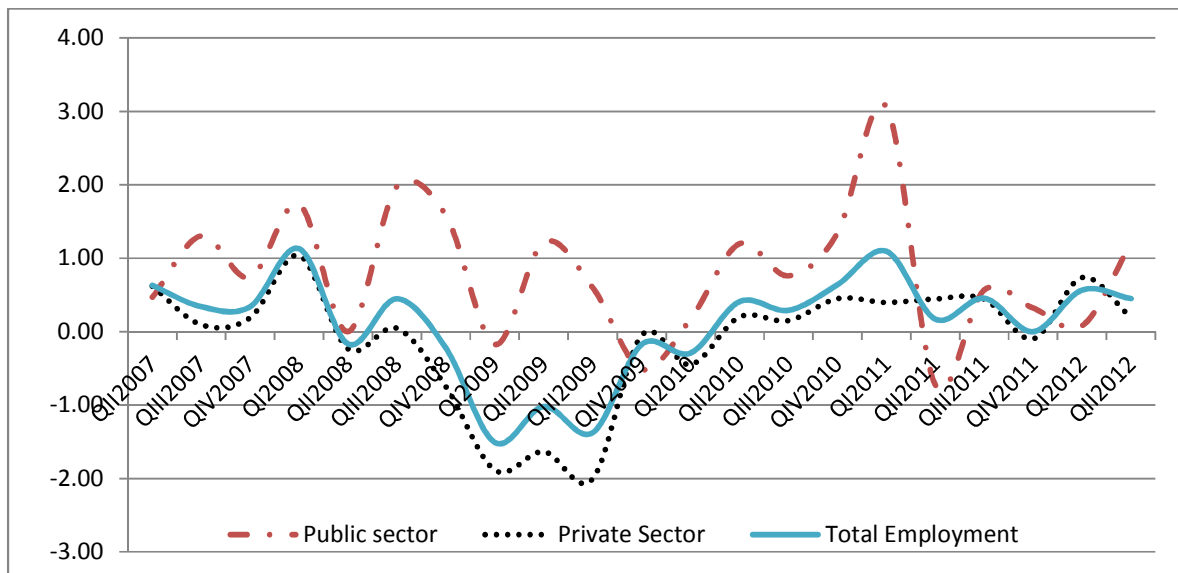
SA has one of the world's very high unemployment rates estimated at 25.5 per cent in the third quarter of 2012 on the basis of the narrow definition of unemployment and around 40.0 per cent on the basis of the broader definition. As depicted in figure 2 below, private sector employment was stable since the second quarter of 2010 until it declined in the fourth quarter of 2011. This was followed by another decline in the second quarter of 2012. For the large part of this period, public employment was increasing, thus offsetting some of the loss in private employment. Klein (2012) found that the rapid increase in the real wage has had a significant negative impact on formal

<sup>1</sup> Klein, N., 2012, "Real wage, labour productivity and employment trends in South Africa: A closer look," IMF Working Paper WP/12/92 (Washington D.C)

employment, accounting for around 25 per cent of employment loss during 2008 – 2010. The recent labor unrest over the wages is expected to perpetuate this situation. The SA mining sector, one of the major supporters of SA's economy, was hit very hard by the recent labor unrest, which has resulted in a renewed surge in wage costs for the sector. Consequently, the sector could soon reduce employment. Although SA's manufacturing sector was not affected as much as the mining sector by the recent labor unrest it continued to shed jobs. SARB's September 2012 Quarterly Bulletin has reported that employment had

been declining since the onset of the global recession in the mining and manufacturing sectors with job shedding continuing in both sectors in the second quarter of 2012. Steeper declines in SA's employment since the advent of the global recession have been prevented by the counter-cyclical fiscal policy, which translated into significant increase in public sector's employment. Nonetheless, according to the 2012 Medium Term Budget Policy Statement, the SA Government plans to reduce public sector employment and wage growth in the years ahead.

**Figure 2: SA's Employment Growth**



Source: Statistics SA

### **Wages and Inflation**

According to the Keynes and Post-Keynesian views, an increase (fall) in the growth rate of nominal wages/compensation per worker is associated with rising (declining) inflation rates. This is because firms will pass the increase in their costs of production, resulting from the wage increases, to consumers by raising the prices of goods and services they provide so as to preserve their profit margins.

However, it may not always be the case that the rise in the nominal wage causes inflation. On the one hand, if nominal wages were to increase at the same rate or less than labor productivity, a firm would be able to pay that wage increase without incurring a squeeze on profits. On the other hand, an increase in wages that is higher than an increase in productivity would mean higher production costs for firms to which they

would react by increasing their prices or reducing employment to preserve their profits. As indicated above, the real wage increase in SA has over the years exceeded the growth rate of labour productivity. The wage demands in the recent wave of labour

unrests were above the inflation rate resulting in wage settlements well above inflation. This risks raising aggregate demand and prices though the likely job losses could moderate the impact somewhat.

### ***Implications for Lesotho's Economy***

The faster increase in the real wages than in labour productivity does not bode well for employment growth and inflation in SA. This has implications for Lesotho due to the economic relationship between these two countries. The possible consequent increase in SA's unemployment could affect Lesotho in several ways. SA is an important market for Lesotho's exports. As such should SA's unemployment rate increase further, demand for Lesotho's exports could dwindle and this poses further risks for Lesotho's balance of payments position, employment and the exchange rate peg.

The eminent job shedding by the labour unrest-hit industries, particularly the mining

industry in SA implies further and possibly steeper declines in the number of Basotho mineworkers in SA. This has far reaching implications for poverty in Lesotho.

The upside risk on inflation, posed by the eminent above inflation wage settlements and the probable impact of higher-than-productivity real wage increases implies higher imported inflation, hence upward pressure on Lesotho's consumer inflation. This is because Lesotho follows a fixed exchange rate regime under which the Lesotho currency is pegged one to one to the SA Rand. In addition, Lesotho is highly dependent on imports from SA.

## **2. South African National Development Plan (NDP) 2030: What are the Implications for Lesotho's Economy?**

*South Africa launched its NDP in August 2012.....*

### **Introduction**

The South African Planning Commission's Diagnostic Report, released in June 2011, set out South Africa's achievements and shortcomings since 1994. It identified a failure to implement policies and absence of broad partnerships as the main reasons for slow progress and set out the following challenges amongst others: too few people work, infrastructure is poorly located, inadequate and under maintained, the economy is unsustainably resource intensive and SA remains a divided society. In an endeavour to kick start the process of addressing these challenges the Draft National Development Plan was developed and released in November 2011. Thereafter

it was revised and finally launched in August 2012 as the NDP 2030. The NDP outlines strategies for eliminating poverty, raising living standards to the acceptable level and reducing inequality by 2030. These strategies arose from the fact that too many South Africans live in poverty, only a few work and the society remains highly unequal. What appears to be the general point of departure towards achievement of the overarching objectives of the NDP is the idea that the economy must grow faster and generate employment on a sustainable basis.

This article provides an overview of the salient features of the NDP and the possible implications of its successful implementation on Lesotho's economy. The second part of

the article is a selection of 'plan areas' that have immediate implications for Lesotho's economy while such implications form the concluding discussion of the article.

### **South Africa's National Development Plan 2030**

The NDP 2030 outlines a strategic framework that SA envisages to follow in addressing poverty and inequality. The approach to achieving the ultimate targets of the plan is based on six priority areas of (i) uniting South Africans around a common program; (ii) citizens should actively engage in their own development; (iii) promoting faster and more inclusive economic growth;

(iv) building the critical capabilities; (v) building a capable and developmental state; and (vi) fostering strong leadership and a high level of responsibility throughout society. An overview of the most relevant strategies for purposes of this article amongst the six is provided below focusing on issues that have implications for Lesotho's economy.

#### ***Faster and More Inclusive Economic Growth***

The evolution of SA's economy over the last 150 years has left it with high levels of unemployment and inequality, and low levels of investment. The economy needs to grow faster for SA to be able to address these inefficiencies. The NDP proposes to accelerate growth by enhancing human capital, productive capacity and infrastructure to raise exports, which will in turn increase resources for investment and reduce SA's high reliance on foreign capital inflows. Improved public infrastructure and skills will support higher investment, thus enabling the economy to grow faster. The resultant rise in employment and productivity will stimulate a rise in incomes and living standards hence reduce inequality.

The needed economic growth rate of more than 5.0 per cent per annum will be attained by addressing a number of challenges. SA's high value-added and labour-intensive exports are decelerating. For this trend to be reversed competitiveness and investment in high value added industries will have to be bolstered and the volume of mineral exports increased. This will be achieved through greater policy focus, effective implementation of industrial

policies and improved skills development. In addition, greater focus will be geared to areas where SA has endowments and comparative advantage such as mining, construction, mid-skill manufacturing, agriculture and agro-processing, higher education, tourism and business services to **increase exports**.

Poor infrastructure together with regulatory and policy frameworks that hinder investment have halted growth of SA's mineral exports. The necessary **infrastructure** will be developed to strengthen services such as commercial transportation, energy, telecommunications and water supply so as to facilitate economic activity. Both private and public investment spending in SA have fallen considerably over the years. Government will prioritize investment over consumption expenditure with the objective of crowding in private investment over time. Wherever necessary, challenges will be addressed through regional cooperation. For example, electricity will be imported from the region to supplement SA's production. The NDP points out that SA should invest in and help exploit the wide range of opportunities for low carbon energy from hydroelectric and

other clean energy sources in southern Africa. In addition, to address its water scarcity, SA will resort to neighbouring countries that have abundant water supply.

**Financial services** will also be strengthened with a view to reduce their costs and improve access for small and medium sized enterprises.

### ***Fostering Strong Leadership and a High Level of Responsibility throughout Society***

SA has a strong and vibrant trade union movement that protects the interests of its members and gives voice to vulnerable workers. However, the strong bargaining power of the union results in bargaining processes that leave little room for employment growth because it results in wage increases that are above productivity growth. The NDP recognises that

extraordinary measures will need to be undertaken to address high levels of unemployment and that the labour union leadership will have to ensure that members' income increases are sustainable in the long term. For sustainable progress to be made in raising incomes and the living standards, productivity and employment should rise on a sustained basis.

### ***Immediate Measures to Reduce Poverty***

The NDP recognises that most of the strategies are long term in nature and hence will take time to have a significant effect on reducing poverty. Thus it also proposes some measures for reducing the acute effects of poverty on the majority of South Africans over the short term. The short-term strategies include, amongst other things, introducing labour market policies aimed at

stimulating employment growth, particularly for young people and in sectors that employ low-skilled people. In addition, public employment programmes will be expanded to 1 million participants in 2015 and 2 million by 2020 with the expectation that they will be scaled down later on as the number of private formal and informal sector jobs increase.

### ***Implications of the Plan on Lesotho's Economy***

The NDP is the South African government's blueprint to transform the economy through rapid economic growth, employment generation and increased investment. For the overarching targets of the plan to be achieved policy choices have to be made and implemented. Successful implementation thereof has a number of implications for Lesotho's economy that arise mainly as a result of Lesotho's proximity to SA, the regional integration arrangements to which both Lesotho and SA are part and the macroeconomic relationship between the two countries. It also presents some opportunities which Lesotho could exploit to develop itself.

The plan envisages raising exports and investment with a view to stimulate rapid economic growth. This will, in all likelihood, necessitate a surge in imports of machinery and other capital goods which will bode well for the Southern African Customs Union (SACU) revenue. This could have positive effects on Lesotho, notwithstanding the general global move towards free trade areas which implies future declines in customs revenue. Resultant rise in employment, incomes and living standards ushered by the accelerated growth of the SA's economy, together with envisaged rises in investment and exports and the expansion of public employment programmes imply future increases in

aggregate demand. This can only be a positive development for Lesotho's exports. It presents an opportunity for Lesotho to expand and diversify its manufacturing sector and create the much needed employment. The plan identifies the mining sector as one of the areas where SA has comparative advantage and indicates that a conducive environment should be created for the mining industry to deploy skills and resources with a view to increasing the volume of mineral exports. In principle this could halt the job shedding by the mining sector and by extension the retrenchment of Basotho mineworkers in SA.

Infrastructure development is a necessary condition for investment growth. The NDP has indicated that SA will, wherever necessary, engage its neighbours to ensure that it has adequate and reliable electricity and water supply. Lesotho could benefit from cooperating with SA in these areas. Lesotho has water in abundance and is already exporting some to SA. Expansion of capacity to export more is on the way through implementation of Phase II of the Lesotho Highlands Water Project (LHWP).

The plan envisages strengthening and reducing the costs of financial services with

the objective of improving access for small and medium enterprises. Interest rates in Lesotho generally move in line with interest rates developments in SA because of the Common Monetary Area (CMA) arrangement and the fixed exchange rate regime that Lesotho is operating under, though there is a significant interest rate differential between the two economies. The reduction of financial costs in SA could stimulate Lesotho's to move in the same direction and stimulate further growth in credit extension to the private sector. Nevertheless, Lesotho may have to address structural bottlenecks and implement other reforms to enhance commercial institutions' confidence and facilitate extension of credit.

Fostering strong leadership and responsibility is identified as key for the achievement of the plan's goals. Leaders should work together towards achievement of common goals. Employment creation is one of the major goals of the NDP. This could stimulate an increase in SA's employment and in turn impact positively on Lesotho's exports, employment and economic growth.

### **3. Monetary Policy Operations for August 2012**

The Central Bank of Lesotho (CBL) conducts open market operations (OMOs), which influence the discount rate on Treasury bills (TBs) in line with developments in SA. The OMOs help the Bank to attain the desired level of the NIR, which is determined and set quarterly by the Monetary Policy Committee (MPC) of the Bank. In addition, the Government of Lesotho is currently under a program with the International Monetary Fund (IMF) under the Extended Credit Facility (ECF). This program is intended to assist Lesotho to pursue policies that could reduce its balance of payments (BOP) risks including achieving a program NIR target, which was set at US\$917 million for the review period.

To determine the amounts of TBs to be auctioned the CBL assesses the liquidity conditions in the economy. Liquidity levels largely depend on how government finances its excess expenditures over its revenue, transactions with the rest of the world and the maturity of securities.

The OMOs are used as an instrument of Monetary Policy, which influences the discount rate on treasury bills (intermediate target) in line with developments in South Africa. Competitive discount rates are set to enhance the attractiveness of the Government of Lesotho's securities relative to foreign securities to encourage investment in Lesotho. The securities are

sold in a competitive auction system to allow the TB rate to be market determined. A Dutch auction system is used where all successful bids are awarded at a uniform interest rate that clears the market to eliminate winner's obscenity.

Three TB auctions were held during the review month. As depicted in Table 1 below, during these auctions the amount of bids

was higher than the auction amounts indicating oversubscription in all the tenures. The demand for TB has historically exceeded the amount on offer and this continued during the review period. The minimum NIR level of US\$917.0 as determined under the IMF-ECF program was attained throughout the month of August with a positive deviation of US\$86.2 million at the end of the month.

**Table1: Treasury Bills Auctions**

Type of Security	Auction Date	Maturity Date	Auction Amount (million)	Amount Issued (million)	Over/Under Subscription (Million)	Discount Rate	RSA Discount Rate
91-day TBs	8-Aug	7-Nov	M9.0	M9.0	M21.6	5.50%	5.15%
	22-Aug	21-Nov	M8.0	M8.0	M14.8	5.50%	5.11%
	29-Aug	28-Nov	M10.0	M10.0	M15.5	5.50%	5.08%
182-day TBs	8-Aug	6-Feb	M9.0	M9.0	M15.5	5.62%	5.15%
	22-Aug	20-Jan	M8.0	M8.0	M9.57	5.62%	5.18%
	29-Aug	27-Feb	M10.0	M10.0	M15.3	5.61%	5.14%
273 day TBs	8-Aug	8-May	M6.0	M6.0	M16.4	5.90%	5.17%
	22-Aug	22-Apr	M6.0	M6.0	M9.4	5.90%	5.21%
	29-Aug	29-Apr	M6.0	M6.0	M7.0	5.90%	5.11%
<b>Total for the reporting period</b>			<b>M72.0</b>	<b>M72.0</b>	<b>M125.07</b>		