POLICY BRIEF

Topic: Determinants of labour productivity in the Eastern Cape.

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Executive summary

Labour productivity has been stagnant in South Africa since 2011 which coincides with low levels of economic growth and employment. The purpose of this study is to examine the determinants of labour productivity in the Eastern Cape province. The performance of the Eastern Cape economy mirrors that of South Africa to a large extent. The focus on labour productivity as opposed to capital productivity is due to its close links with the socio-economic goals of reducing unemployment, alleviating poverty levels and inequality reduction, which are among the major targets of the province. The technique employed for the empirical analysis is the ARDL bounds test. The empirical results highlight that investment in ICT, health and GDP growth are the crucial determinants of total labour productivity in the Eastern Cape. The sectoral analysis shows that primary sector labour productivity is driven by human capital and investment in ICT. Trade is the most important factor explaining labour productivity in the secondary sector while the tertiary sector is driven by R&D expenditures and ICT investment. The industry analysis revealed results similar to those of the sectoral analysis to some extent. Agriculture labour productivity is determined by human capital variables while trade is the important driver of labour productivity in mining and quarrying. The manufacturing sector labour productivity is explained by ICT investments and human capital (similar to the overall secondary sector), while construction labour productivity is determined by capital stock. Wholesale and retail trade is impacted by capital, trade, and ICT investments while in the community and social services industry, R&D investments are vital.

There are a few policy recommendations that emanate from the study. Firstly, restructuring of the economy remains an area of paramount importance. The economy should be propelled towards the secondary sector with industries such as manufacturing and construction with more scope for labour productivity growth. Secondly, the results highlighted the disparities between the driver of labour productivity in different sectors and industries. The study recommends that interventions in different sector be tailor made to achieve the greatest impact. Thirdly, the results suggest that the shift to a knowledge-based economy is crucial for South Africa. ICT investments and human capital which are the cornerstone of knowledge-based economies appear to be major determinants of most labour productivity indicators.

Rationale for action on the problem

Economic growth in South Africa has failed to recover from the global financial crisis on 2008/09. Due to its close links with the United States of America and the European Union, the South African economy was not shielded from the crisis. In the last decade, the economy has recorded modest growth and job losses have been a regular occurrence. The slowdown in economic growth has been detrimental to employment creation which is crucial for the achievement of the major socio-economic goals of poverty and inequality reductions. One of the reasons for the slowdown in economic growth and the continued high unemployment rate is low levels of productivity.

This study examines the determinants of labour productivity in the Eastern Cape. The focus on labour productivity as opposed to capital productivity is due to its close links with the socio-economic goals of reducing unemployment, alleviating poverty levels and inequality reduction, which are among the major targets of the province. The decline in productivity is one explanation for the stagnant economic growth and stubbornly high unemployment rate. Labour productivity has been stagnant in South Africa since 2011 which coincides with low levels of economic growth and employment. The performance of the Eastern Cape economy mirrors that of South Africa to a large extent as labour productivity growth has averaged -0.25% during the period between 2011 – 2019.
The Eastern Cape is one of the hardest hit provinces in terms of the slowdown in labour productivity growth alongside Mpumalanga and North-West. The three mentioned provinces have recorded more years of negative labour productivity growth rate compared to other provinces. Average labour productivity in the primary sector has been in positive territory since 1994. However, since 2015 the sector’s output per worker has been on a downward trend with agriculture being the major contributor to the slump. This is a worrying trend as the Eastern Cape has a significant rural population and therefore agriculture should be contributing more to GDP and employment. The secondary sector which includes manufacturing and construction has been the best performing sector with regards to labour productivity growth since 1994.

Despite the labour productivity potential in the secondary sector, deindustrialisation has hindered growth in the contribution of manufacturing and construction to GDP and employment. Rapid employment growth has been recorded in the tertiary sector since the late 1990s, while employment growth in the secondary and primary sectors has been stagnant. The contribution of the primary sector to Eastern Cape GDP has averaged below 2% since 1995 while the secondary sector’s average contribution to GDP is roughly 17%. The tertiary sector contributes just over 70% to GDP, with the government being the highest contributor. Finance, real estate, and business services as well as the wholesale and retail trade industries which are in the tertiary sector, have recorded negative productivity growth despite their large contributions to GDP and employment.

The current trajectory of labour productivity in the Eastern Cape is insufficient to contribute to solving the socio-economic issues in the province. As such, it is necessary that policy makers enact policies that are conducive for the growth of labour productivity.

**Proposed policy options**

One of the goals of the Eastern Cape outlined in the Provincial Development Plan (PDP) is to build an inclusive, equitable and growing economy for the province. The strategic actions for this goal include developing the quality of infrastructure, economic development including rural areas, industry, and enterprise support, accelerated, and completed land reform process and the promotion of high-potential economic sectors. These sectors are agriculture, mining and energy, construction, manufacturing, tourism, the social economy, ocean economy and knowledge-based services. Enhancing labour productivity is crucial for the development of an inclusive, equitable and growing economy. Furthermore, promoting the most productive industries such as manufacturing and construction is of paramount importance.

The study highlighted the instruments required to promote labour productivity in the high-potential economic sectors. Investments in ICT technologies, R&D and human capital are the major determinants of labour productivity and therefore require significant expenditures from the policy makers. Furthermore, the creation of an environment conducive for private sector investments is of paramount importance. Policy makers should play an active role in efforts to reverse the process of premature de-industrialisation through infrastructure improvements, elimination of barriers to entry and promoting financial access.

**Policy recommendations**

There are a few policy recommendations that emanate from the study. Firstly, restructuring of the economy remains an area of paramount importance. Average labour productivity in the secondary sector has been the highest since 1994, however, the contribution of the sector to GDP and employment has declined/or remains stagnant. The tertiary sector with low scope for high labour productivity growth has been the major contributor to GDP and employment. The economy should be propelled towards the secondary sector with industries such as manufacturing and construction. The Eastern Cape Provincial Industrial Development Strategy (PIDS) proposed a “state-led industrialisation path towards a robust, resilient and sustainable industrial base by 2025”. Despite the...
relative success of the Special Economic Zones (SEZ) in attracting investments especially in automotive manufacturing in the Eastern Cape, the overall manufacturing industry output remains stagnant. Eastern Cape manufacturing output as a percentage of total manufacturing output in South Africa averages over 8% compared to 14%, 21% and 40% in Western Cape, KZN and Gauteng. Efforts to diversify the manufacturing and enhance agro-processing and petrochemicals industries as outlined in PIDS should be increased through the creation of an environment inducive for investments. Furthermore, labour productivity in the tertiary sector should be enhanced due its contribution to employment and GDP. The Eastern Cape province should follow the case of Asian countries that restructured their economies more to services which in turn contributed significantly to the growth of labour productivity. Enhancing human capital and skills levels is vital in this regard.

The second recommendation is drawn from the empirical results which highlighted the disparities between the driver of labour productivity growth in different sectors and industries. The study recommends that interventions in different sector be tailor made to achieve the greatest impact. To promote labour productivity growth in the primary sector policy makers ought to invest more in ICT, encourage trade in goods and services and promote skills development. Secondary sector labour productivity requires investment in ICT and capital, and the promotion of trade. Tertiary sector labour productivity is mostly driven by capital stock, investment in R&D and ICT as well as trade in goods and services.

Thirdly, the results suggest that the shift to a knowledge-based economy is crucial for South Africa. ICT investments and human capital which are the cornerstone of knowledge-based economies appear to be major determinants of most labour productivity indicators. The reliance on the traditional drivers of economic growth such as capital should be minimised. As shown in the results, capital stock is negatively related to total labour productivity and is only an important determinant of labour productivity in construction and wholesale and retail trade. This is in line with the observations from literature that capital productivity has been on a decline in South Africa. Furthermore, the effect of the “old technology” involving the usage of computers and the internet may be reaching a peak. Therefore, adoption of latest technologies such as artificial intelligence and 3D technologies is crucial. ICT investments in the manufacturing sector involving 3D manufacturing and artificial intelligence may be instrumental in promoting industrialisation in the Eastern Cape.

Investment in ICT in the Eastern Cape in 2019 was the fourth highest in South Africa from a provincial perspective below that of KZN, Western Cape and Gauteng. However, when examining the actual investments amounts, it is clear that the Eastern Cape lags behind the three provinces with just over R5 billion invested compared to R10 billion, R11 billion and R27.5 billion for the Western Cape, KZN and Gauteng respectively. Investments in R&D are also crucial for technological advancements and labour productivity. Khanna and Sharma (2018) found that R&D and ICT are complementary in promoting labour productivity. Investment in R&D should be enhanced in the province as they continue to lag behind the bigger provinces similar to ICT investments. An environment conducive for the promotion of private sector investments in ICT and R&D is of paramount importance. The Eastern Cape PIDS identified R&D expenditures and innovation as the vital determinants of the achievement of industrialisation goals and set a target of increasing such expenditures to 1% of GDP in line with plans at national level. However, investments in ICT and R&D continue to be slightly below the target.