Critical Analyses of Trade Union Budget Proposals

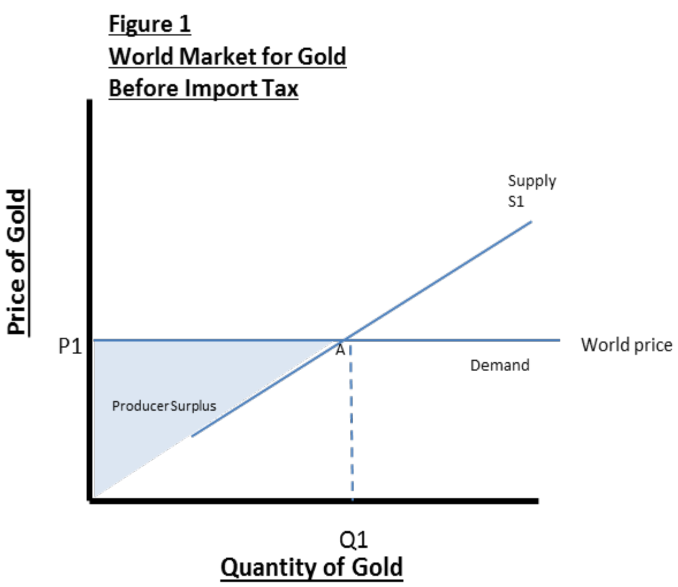
(2184)

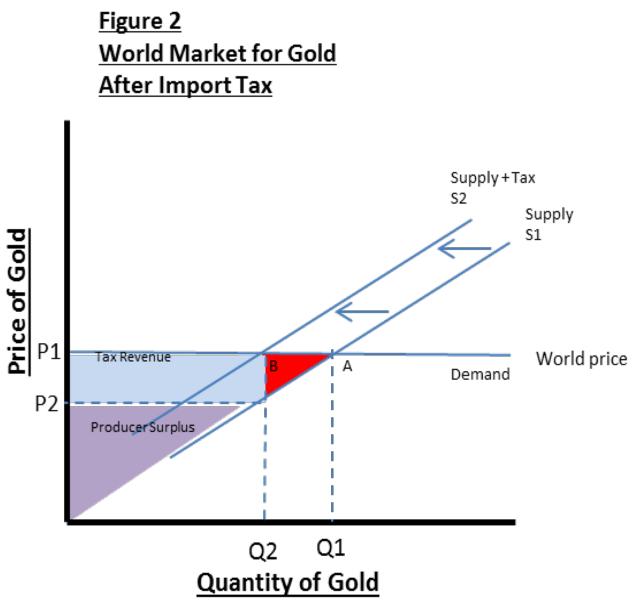
"Trade unions in South Africa play a significant role in the economy. Trade unions have been active in responding to the fiscal policies of government. Unions argue that their proposals for the budget will increase economic growth and support job creation. Criticism of trade union views on the budget has focused on the affordability of these proposals, and on their impacts on business growth. Your essay should review recent submissions from trade unions, and provide a critical analysis of their proposals. Will trade union alternatives on the budget support economic growth and economic inclusion?"

On the 26th February 2014, Finance Minister, Mr Pravin Gordan, delivered the national budget to Parliament. The budget aims at efficiently allocating state resources to facilitate the effective implementation of the Nation Development Plan (NDP) (National Treasury, 2014). The NDP seeks to eliminate poverty and reduce inequality by 2030 through the promotion of economic growth and job creation (National Treasury, 2014). The Congress of South African Trade Unions (COSATU) and the National Union of Metalworkers of South Africa (NUMSA) have been vocal in criticizing the government's fiscal policy and proposing alternative policies to address high unemployment and slow economic growth. This essay will analyse COSATU's proposed introduction of an export tax on strategic minerals, metals and other materials to boost the manufacturing sector. In light of union proposals to scrap the Employment Tax Incentive Act 26 of 2013, this essay will analyse its effectiveness and evaluate alternative solutions to address youth unemployment. These proposals will be critically analysed on the basis of whether they promote economic growth and inclusion.

Government and unions agree that economic growth and economic inclusion is required to reduce the high levels of poverty and inequality. The Government's growth plan is centred on the private sector, focusing on small, medium and micro-sized enterprises (SMME) and encouraging mass entrepreneurship (National Treasury, 2014). The NDP states that SMME's will be the main creators of employment with approximately 90% of new jobs being created in small and expanding firms (National Development Plan, 2011). In contrast, COSATU perceives the country's potential economic growth as being driven by the manufacturing sector. COSATU proposes to increase investment and diversification of the manufacturing sector to enable the greater beneficiation of the country's raw materials, create employment, reduce import dependency and diversify exports (COSATU, 2013). The Union has submitted proposals on fiscal policy pertaining to the realisation of their proposed growth plan. One such fiscal policy is an export tax on strategic minerals, metals and other resources to support downstream industries and to promote value-addition (COSATU(a), 2014).

Figure 1, 2, 3 and 4 make use of the demand and supply framework to determine the effect of an export tax on the gold industry. The assumption is made that in the short term production is fixed and is either sold locally or on the world market. It is also assumed that the purchaser pays the shipping costs. Shipping costs include all additional costs involved in delivering gold from one market to another. Figure 1 and 2 shows the demand for and supply of South African gold on the world market. South Africa contributes 6.5% of the world's total gold production and is therefore assumed a 'price taker' in the world market; exerting no influence over the price (miningtechnology, 2013). Figure 1 shows the volume of South African exports of gold to the world market without an export tax. World price is fixed at P1 and the market is in equilibrium at point A, with a quantity of Q1 sold on the world market. Figure 2 shows the effect of the introduction of an export tax to the world market. The supply curve shift inwards from S1 to S2 and the new equilibrium is at point B. The quantity of gold sold on the world market decreases from Q1 to Q2. Due to the export tax, the world price is P1 but producers only receive P2 as P1-P2 is tax. Tax revenue is therefore represented by the blue rectangle. As short term gold production is fixed and is either sold locally or on the world market, the drop of quantity sold on the world market must be offset by increasing the amount sold locally.





Source: (de Villiers & Frank, 2011)

Figure 3 and 4 show the demand and supply of gold on the domestic market. Figure 3 shows the market before the implementation of an export tax. Local mines are not willing to accept a price below the world price, as any price lower than world price would make it more profitable to export gold. Similarly, domestic gold manufactures are not willing to pay a price higher than world price plus shipping costs (Purchaser pays shipping costs). Any higher price than that would make it more worthwhile for gold manufactures to import gold. The local market is therefore at equilibrium at point A. Figure 4 shows the resultant change in the domestic market due to the rate at which export tax is imposed. As determined from figures 1 and 2, the imposition of export taxes results in an increased local supply of gold, shifting the supply curve from S1 to S2. Mines will now be willing to accept a minimum price equal to world price less export tax. The resultant change to the market is a decrease in the local price, an increase in the amount of gold sold domestically and therefore, the establishment of a new equilibrium at point B.

Source: (de Villiers & Frank, 2011)

Figure 1, 2, 3 and 4 illustrate that the introduction of an export tax will be effective in discouraging exports of raw materials in sectors where South Africa is a price taker. The tax

Figure 3
Local Market For Gold
Before Export Tax

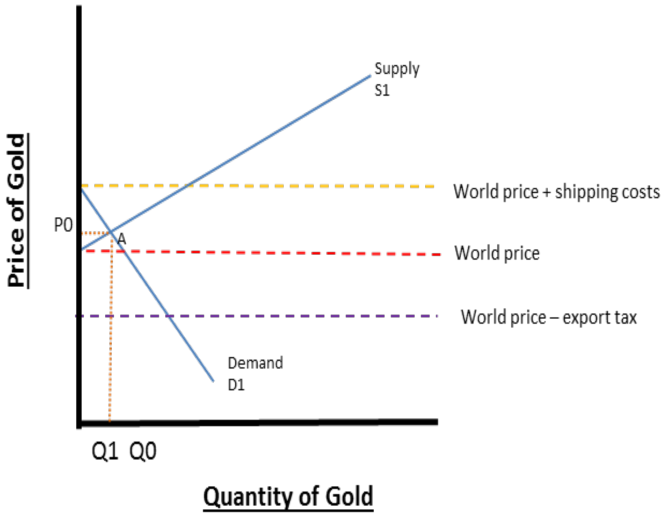
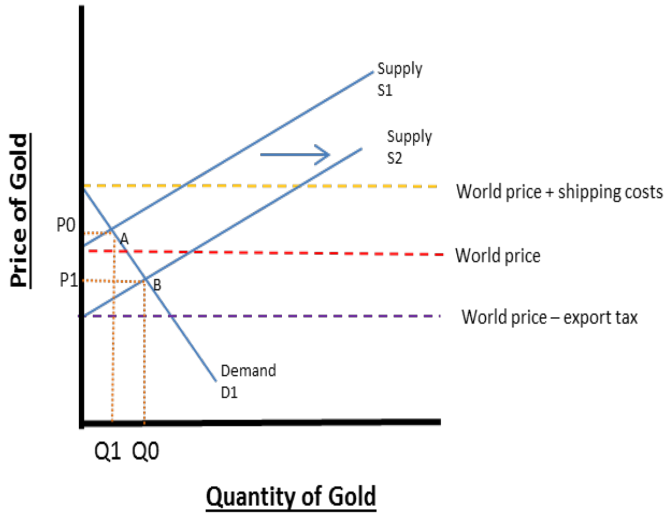


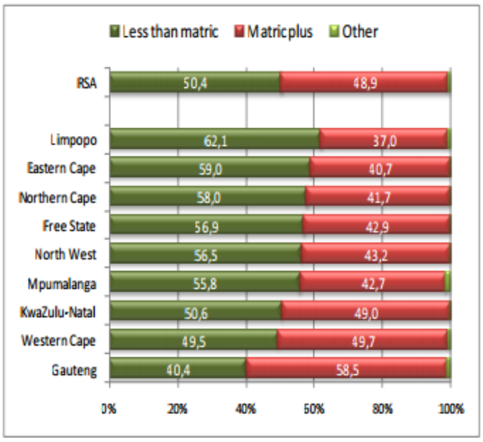
Figure 4
Local Market For Gold
After Export Tax



will in effect lower local prices and increase the quantity of locally mined raw material sold in the domestic market. Lower input costs will boost the relevant manufacturing sector and encourage further growth in the sector. In the long term, an increase in the domestic market demand is essential to discourage mines from reducing their production levels. Reduced input costs will grow the sector demand; however growth can be accelerated by increasing state expenditure on manufacturing infrastructure. The manufacturing sector is traditionally labour intensive and therefore inclusivity will be realised as well as growth.

The manufacturing sector is vital to South Africa's economy as both an employer and a source of growth. An export tax would serve as a boost to the sector, which would in turn stimulate growth. However, the financial investment and resources required to restructure the economy as a whole so as to implement a manufacturing centred growth plan would be enormous. Furthermore, a diverse and dominant manufacturing sector requires a highly skilled labour force (Masuku, 2008). South Africa has a largely unskilled labour force (in 2013, over half thereof were reported as having not completed their high school education) and it is therefore unrealistic to centre the country's growth plan on manufacturing (Statistics South Africa, 2013).

Table 1: labour force Education level by province (2013)



Source: (Statistics South Africa, 2013)

In December 2013, the Employment Tax Incentive Act 26 of 2013 was passed. The Act took effect as of 1 January 2014. The Act aims to reduce high levels of youth unemployment in South Africa, the reality of which presents a threat to the stability of the economy. Youth unemployment between the ages of 15 and 24 years is estimated to be in excess of 50%, the third highest rate in the world (WEF, 2014). The Act aims to stimulate youth employment through incentivising employers by way of a 'youth wage subsidy' (Employment Tax Incentive, 26 of 2013, 2013: Part 1). The high youth unemployment rate is perceived as being the result of an unnaturally high entry-level wage which has handicapped the youth (Hassen, 2011). A high entry-level wage disadvantages the youth as employers are faced with the choice of hiring either experienced workers or unexperienced workers for the same wage (Hassen, 2011). In order to counter this, the youth wage subsidy lowers the cost of youth labour, making these employees more attractive candidates.

COSATU, NUMSA and various other unions propose to abolish the Employment Tax Incentive Act (COSATU(a), 2014). The Act has received criticism primarily on the basis that employers would be incentivised to replace older, more expensive labour with young labour. Other reasons for opposing the Act include ineffective enforcement of legislation to protect existing workers, no guarantee of training and skill development and recycling of youth labour to continually benefit from subsidies (COSATU(b), 2014).

Figure 5 uses the isocost-isoquant approach to illustrate the effect of a youth wage subsidy on the labour market. The Isocost show different combinations of youth labour and other labour that can be hired for the same amount. The isoquant curves show the different combinations of youth labour and other labour needed to produce a given output. The point at which the isocost forms a tanget to the isoquant is equal to the optimal input combination. At this point the producer produces the maximum possible output for a given expenditure on inputs (de Villiers & Frank, 2011). Before the introduction of the youth wage subsidy, businesses' labour budgets can purchase the combinations represented by isoquant 1. The optimal combinations of other labour and youth labour is represented by point A. The introduction of the youth wage subsidy decreases the cost of youth labour(the 'other labour' wage remains the same), resulting in the isocost pivoting outward to isocoast 2. Isocost 2 forms a tangent to isoquant 2, representing an output greater than isoquant 1, at point B. One can see from the blue arrows that other labour decreased from Q1 to Q2 while youth labour employment increases from Q1 to Q2.

Figure 5
Labour Market

Source: (de Villiers & Frank, 2011)

The introduction of the youth wage subsidy is simplified in Figure 5. However, it illustrates that a youth wage subsidy can be effective at simultaneously increasing youth employment and promoting economic growth. It is however critical to limit the substitution of youth for skilled labour, represented by the slipping down of isoquant 2 on isocost 2.

The Labour Relations Act 66 of 1995 and the Basic Conditions of Employment Act 75 of 1997 empowers workers with certain rights, stipulate grounds for unfair dismissal and provide procedures for dispute resolution. To ensure labour rights are upheld, the state has facilitated the implementation of bargaining councils, statutory councils and the Council for Conciliation, Mediation and Arbitration (CCMA) to deal with labour disputes (Labour Relations, 66 of 1995, 1995: chapter 7). The state has also established specialised Labour Courts and Labour Appeal Courts to handle unresolved disputes. The presence of comprehensive labour laws and procedures protecting existing employees' rights will dampen labour substitution.

To further discourage substitution, the Employment Tax Incentive Act 26 of 2013 includes penalties on employees who are found guilty of replacing existing employees in order to benefit from the incentive. The penalties include a fine of R30 000 per employee unfairly replaced and the possibility of being disqualified from receiving the employment tax incentive (Employment Tax Incentive Act, 66 of 2013, 2013: section 5). These measures will minimise the substitution of existing employees for youth employees. For these reasons, the Employment Tax Incentive Act 26 of 2013 offers a promising measure to address youth unemployment and thereby promote economic growth.

COSATU, offering counter arguments to the measures adopted in the above-outlines legislation, proposes to rather address youth unemployment by extending their stay in the education and training system (COSATU(b), 2014). COSATU calls for the expansion of the Further Education and Training (FET) sector's annual intake from 400 000 learners to 1 million (COSATU(b), 2014). This proposal links to COSATU's growth plan as these graduates would form the backbone of the skilled labour required in a large manufacturing sector. COSATU suggests that the R5 billion budgeted for the youth wage subsidy could rather be used to supplement a stipend fund to encourage young people to further their studies (COSATU(b), 2014). COSATU also proposes that the FET sector can be funded by the skills levy collected by Sector Education and Training Authority (SETA) (COSATU(b), 2014).

Besides it being unlikely that the FET sector can increase its intake by 150%, COSATU's strategy does not address the fundamental problem: the lack of jobs in the economy. Trapping youth in education is a short term solution to youth unemployment; when these youths begin to graduate from FET institutions, they will be presented with a labour market that still lacks the capacity to absorb them. The youth wage subsidy offers a preferable solution by boosting the capacity of the economy to offer jobs to the youth. Once employed, youths gain practical experience through performing their work duties. Furthermore, the Skills Development Act 66 of 1998 incentivises employers to provide on-the-job training which will increase youth productivity and facilitate the graduation of youths from unskilled labourers to semi-skilled and skilled labourers. In this way it offers a more sustainable solution to the problem posed by youth unemployment and addresses the needs of a growing economy insofar as it creates a source of skilled workers.

In conclusion, economic growth and inclusion is fundamental to South Africa's goal of poverty and inequality reduction. COSATU's proposed introduction of an export tax on raw materials will encourage the expansion of the manufacturing sector and promote value addition**.** Shifting the stage at which metals are exported, from raw materials to manufactured goods will boost employment in the labour absorptive manufacturing industry and promote economic growth. COSATU's proposal to address youth unemployment through FET expansion, however, will not address the shortage of jobs in the labour market. In contrast, the recent enactment of the Employment Tax Incentive Act will increase youth employment and simultaneously improve economic growth by enabling firms to increase production levels. The Act offers a solution to high entry wage levels by reducing the cost of youth labour while not affecting the wage received by other labourers. South Africa's rigid labour laws will deter labour substitution between existing labour and youth labour, increasing the overall effectiveness of the Act. Furthermore, the Skills Development Act 67 of 1998 will complement the youth wage subsidy by promoting on-the-job training and skills development thereby improving the overall productivity of labourers.

Word Count including references 2284

Less referencing (98 words) = 2186

Bibliography

Employment Tax Incentive Act. [Online]
Available at: http://jutalaw.co.za/media/filestore/2013/10/b_46_-_2013_-_Employment_Tax_Incentive_Bill.pdf
[Accessed 16 Aril 2014].

Labour Relations Act No. 66 of 1995. [Online]
Available at: http://www.labour.gov.za/DOL/legislation/acts/labour-relations/read-online/amended-labour-relations-act
[Accessed 17 April 2014].

a) COSATU, 2014. *COSATU Statement on the 2014 Budget Speech.* [Online]
Available at: http://www.cosatu.org.za/show.php?ID=8479
[Accessed 14 April 2014].

b) COSATU, 2014. *The Youth Wage Subsidy in South Africa.* [Online]
Available at:
http://www.politicsweb.co.za/politicsweb/view/politicsweb/en/page71656?oid=308054&sn=Detail&pid=71656
[Accessed 15 Aripl 2014].

Gordan, P., 2014. *Budget Speech.* [Online]
Available at:
http://www.treasury.gov.za/documents/national%20budget/2014/speech/speech.pdf
[Accessed 15 Aril 2014].

Hassen, E.-K., 2011. *Transformational Audit: From Inequality to Inclusive Growth.* s.l.:s.n.

Masuku, S. D., 2008. *The importance of human capital in the manufacturing sector of the South African economy.* [Online]
Available at: https://ujdigispace.uj.ac.za/handle/10210/649
[Accessed 17 Aril 2014].

miningtechnology, 2013. *Mining Technology.* [Online]
Available at: http://www.mining-technology.com/features/feature-ten-largest-gold-producing-countries-china/
[Accessed 16 April 2014].

National Development Plan, 2011. [Online]
Available at:
http://www.npconline.co.za/medialib/downloads/home/NPC%20National%20Development%20Plan%20Vision%202030%20-lo-res.pdf
[Accessed 14 April 2014].

Pierre de Villiers, R. F., 2011. *Microeconomics and Behaviour.* 1st ed. Berkshire: McGraw-Hill Education.

Statistics South Africa, 2013. *National and provincial labour market 2003-2013.* [Online]
Available at: http://www.statssa.gov.za/Publications2/P02114/P021142013.pdf
[Accessed 15 Aril 2014].

WEF, 2014. *Global Risks 2014,* Geneva: World Economic Forum.