The cost of “doing business” and labour regulation: The case of South Africa

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Abstract. The “Employing Workers” indices compiled from the World Bank’s Doing Business (DB) survey for 2006 presented mixed results as to the nature and extent of labour regulation in South Africa. Arguing that these measures – with their narrow focus on legislation – provide only a partial picture, the authors suggest and investigate three possible extensions to the DB framework with the aim of achieving a more realistic representation of labour regulation in practice, namely: “micro-legislation”, labour market institutions and judicial interpretation. They conclude with a plea for taking account of the crucial importance of these features in the assessment of labour regulation frameworks.

The current, dominant approach to understanding and analysing the impact of regulation on economic growth relies on the use of multi-country surveys, whose core function is to provide measures of the costs of business regulation within an economy. These multi-country surveys have, over a fairly short space of time, come to dominate global, regional and country-level policy discussions around the potential economic consequences of labour market regulation. Two of these surveys loom large in analytical work on the developing world, namely the Investment Climate Assessment (ICA) surveys and the Doing Business (DB) surveys – both run under the auspices of the World Bank. The focus of this article is on the “Employing Workers” indicators of the DB framework, with a specific application to the South African economy.

In an attempt to mature the debate on labour regulation and worker protection, the article pursues two key objectives. The first is to use the “Employing Workers” indicators from the 2006 DB survey to provide more nuanced and empirically based measures of labour regulation and worker protection in the

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emerging market economy of South Africa, where much of the debate on labour regulation has been mired in rhetoric and perception-based evidence, with little recourse to empirical rigour. In this context, the DB survey offers a useful starting point – but by no means a complete framework – for a detailed analysis of labour regulation within an economy. Hence the second objective of the article, which is to suggest a set of possible extensions to the DB framework. We argue that the DB framework’s “Employing Workers” indices can and should be complemented in at least three areas of investigation, namely micro-legislation, recognition of the centrality of labour market institutions, and, finally, the relevance of how labour legislation is interpreted.

The remainder of the article is divided into three sections. The first provides an empirical overview of the labour regulation module of the DB survey framework, with a specific application to South Africa. The second suggests three possible extensions to the DB survey framework, and the third section concludes.

Labour regulation as a cost of doing business in South Africa

In April 1994, South Africa held its first democratic elections, bringing to an end the era of white minority rule, yet beset with significant welfare challenges. Whilst formally categorized as an upper middle-income country, the economy has one of the highest unemployment rates in the world – officially at 26.7 per cent, and 38.8 per cent when discouraged workers are included (Bhorat, 2004). This characteristic, more than any other, has placed labour market regulation high on the country’s policy agenda. The intrinsic nature of the issues at stake, coupled with the fact that South African society is characterized by strong, vocal trade unions and employers’ organizations, have meant that change to the regulatory and institutional framework is a highly contested policy issue. Influenced by these ongoing pressures, the South African Government enacted the Labour Relations Act (Act No. 66 of 1995), which comprehensively restructured the legal and institutional basis of collective labour law and unfair dismissal law and created for the first time a single legal framework for labour relations applicable to all sectors of the economy.

By the second democratic election of June 1999, the Labour Relations Act had been joined on the statute book by the Basic Conditions of Employment Act (Act No. 75 of 1997), the Employment Equity Act (Act No. 55 of 1998) and the Skills Development Act (Act No. 97 of 1998). All of these laws were subject to an intensive negotiation process between the Government, organized business and the major trade union federations, conducted under the auspices of the National Economic, Development and Labour Council, which had been established in 1994. The enactment of this quartet of laws is widely regarded as one of the most substantial legislative achievements of the country’s first five years of democracy – and this has arguably made South Africa’s labour regulatory regime a model for other developing countries around the world.
Using the World Bank’s Employing Workers indicators for 2006, we attempt here an overview of the evidence relating to the degree of actual and perceived rigidity within the South African labour market. The DB survey data – from which the indices are compiled – are used to provide a more detailed and more objective assessment of the labour regulatory environment in South Africa – and to put South Africa’s labour law regime into international perspective. The DB surveys have been conducted since 2004 and now cover some 180 countries. Their core function is to provide objective measures of the costs of business regulation – the “ease of doing business index” – within each economy. It is crucial to note, however, that the methodology used to compile the “Employing Workers” indices relies heavily on Botero et al. (2004).1 The broad areas of labour regulation covered thus relate to legislative provisions on hiring, firing, hours of work, and the employment relationship. In addition, legislative provisions for firing a worker and those concerning non-wage costs are converted into measures of the regulatory costs of hiring and firing workers. In contrast to the earlier study by Botero et al. (2004), however, the DB surveys rely on local firms of lawyers to glean the information on the labour regulatory regime.2

Despite the important advances made in the DB survey methodology to refine its measures of labour market regulation – two broad objections and concerns need to be noted at the outset. The first is that the range of different sub-indices used to capture hiring and firing may exclude important aspects of regulation. An obvious example for South Africa would be the extent to which employers can use employment agencies to provide employees for work of temporary or indefinite duration and the protection these employees receive. This is not covered by any of the measures intended to capture hiring regulation or cost, although it potentially impacts on the perceived or actual level of rigidity in an economy’s labour market. The generic point, however, is that the omission of certain features of the regulatory regime from the sub-index measures may result in biased aggregate measures of labour regulation.

The second key objection is more qualitative in nature. This is the fact that some legislative provisions which are implicitly regulatory are not generally regarded as such by legal practitioners. Perhaps the most powerful example of this is the collective rights index featured in the study by Botero et al. (2004). From a legal perspective, the right to freedom of association and the right to join a union are universally recognized rights entrenched in public international law and in most, if not all, democratic constitutions. They are fundamental human rights and therefore cannot qualify as a form of regulation. Indeed, from

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1 Indeed, the explanatory note on the “Employing Workers” methodology points out that: “This methodology was developed in Botero and others (2004) and is adopted here with minor changes” (http://www.doingbusiness.org/MethodologySurveys/EmployingWorkers.aspx). See appendix.

2 The 2008 Report of the World Bank’s Independent Evaluation Group has criticized the DB surveys for being too reliant on a small number of informants and for the inaccurate nomenclature in certain questions (World Bank, 2008). Benjamin and Theron (2007) argue that the ambiguous phrasing of questions in the survey leads to countries receiving incorrect ratings.
a jurisprudential point of view the notion of a continuum ranging from “flexible”
to “rigid” to characterize labour market regulation is problematic.

Such concerns and broader critiques (see Lee, McCann and Torm, 2008)
eventually led the World Bank in 2009 to suspend the use of the Employing
Workers indicators as a basis for policy advice.

“Doing Business” estimates for labour regulation
in South Africa

Table 1 presents the key aggregated measures of the “Employing workers” in-
dices by country income level. The “Difficulty of Hiring Index” measures
restrictions on part-time and temporary contracts, together with the wages of
trainees relative to worker value-added. The “Rigidity of Hours Index” meas-
ures the various restrictions around weekend, Sunday and public holiday work,
limits on overtime, etc. The “Difficulty of Firing Index” assesses and ranks spe-
cific legislative provisions on dismissal. “Non-wage labour costs” are in effect
social protection costs and measure all social security and health costs associated
with hiring a worker. Finally, the “firing cost” measures the costs of terminating
the employment of an individual in terms of legislated prior notice requirements,
severance pay, etc.

The aggregate cross-country data suggest an interesting contrast in the
prevalence of regulation and protection: the highest scores for any area of rigid-
ity relating to regulation in hiring, firing and hours of work are found in low-
income economies. The highest firing costs also occur amongst low-income
countries, although non-wage labour costs are the highest in non-OECD high-
income economies.

While South Africa’s indices for firing costs, non-wage labour costs, and
rigidity of hours are below the world means, the measures of hiring and firing
difficulty are noticeably above the respective means. Those aspects of legisla-
tion which could be deemed problematic – or having unintended consequences
– within these latter two areas will be examined in detail below. Meanwhile, fig-
ures 1 and 2 show South Africa’s specific position in the global percentile distri-

3 The detailed measures which together aggregate up to the five indices presented in table 1,
are explained in the note on methodology reproduced in the appendix to this article, but they are not
available for download in their raw form. They are obtainable by special request from the World
Bank. These more textured data are in fact essential for a detailed analysis of regulation and pro-
tection at the country and cross-country levels. Importantly for our purposes here, a close examin-
ation of the sub-indices that make up each overall index reveals a fairly accurate estimation of South
African legislation by the law firms contracted by the World Bank.

4 Herein lies another concern regarding the choice of the sub-indices used to derive an aggre-
gate index. We thus find that for the difficulty of hiring index, South Africa scores 0 on the first sub-
indicator (there is no limitation on the use of fixed-term contracts) and 0 on the second (there is no
maximum cumulative duration for fixed-term contracts). That leaves the ratio of an apprentice’s
wages to average added value per worker as the third sub-indicator. In essence, therefore, the meas-
ure of difficulty of hiring for South Africa is a measure of entry-level wages relative labour pro-
ductivity – an inadequate representation of hiring difficulty. As discussed below, South Africa thus
displays fairly low levels of regulation around contractual employment.
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Figure 1 presents the distribution for difficulty of hiring, rigidity of hours and difficulty of firing across 175 countries. Corroborating the results shown in Table 1, South Africa’s indices for difficulty of hiring and firing are positioned fairly high in the distribution – specifically at the 65th percentile for difficulty of hiring and around the 60th percentile for difficulty of firing. Within the upper-middle income sample, South Africa ranks at the 73rd percentile for difficulty of hiring, and at the 63rd percentile for difficulty of firing. It must be noted, however, that despite its position in relation to the global mean in terms of rigidity of hours of work, South Africa ranks at about the 40th percentile in global terms on this index.

Figure 2 shows the percentile distributions for the aggregate “rigidity of employment index”, and for the firing cost and non-wage labour cost estimates. Clearly, in terms of these last two estimates, South Africa remains both fairly “flexible” and relatively unprotected. Indeed, worker protection – in the form of social security – positions South Africa at the 10th percentile of the global distribution. Firing costs, which in effect measure prior notice and severance pay for a worker with specific characteristics, are also fairly low in international terms. The index value of 24, thus places South Africa in the bottom third of the distribution – specifically at the 30th percentile.

In short, South Africa’s legislative provisions for termination of employment translate into a labour market that is comparatively flexible in terms of firing costs according to the data for 2006. The relatively high values for difficulty of hiring and firing, however, ultimately result in an overall employment rigidity index that stands in contrast to the low levels of firing costs and non-wage labour costs. On the employment rigidity index, South Africa thus ranks at the 58th percentile of the global distribution. It is worth reiterating that this employment

<table>
<thead>
<tr>
<th>Area of regulation</th>
<th>Low income</th>
<th>LMI</th>
<th>UMI</th>
<th>HI – non-OECD</th>
<th>HI – OECD</th>
<th>South Africa</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>Difficulty of hiring</td>
<td>44.28</td>
<td>33.68</td>
<td>29.91</td>
<td>27.00</td>
<td>20.60</td>
<td>44.00</td>
<td>34.33</td>
</tr>
<tr>
<td>Rigidity of hours</td>
<td>47.60</td>
<td>39.64</td>
<td>40.57</td>
<td>45.22</td>
<td>32.00</td>
<td>40.00</td>
<td>42.40</td>
</tr>
<tr>
<td>Difficulty of firing</td>
<td>40.00</td>
<td>33.04</td>
<td>33.43</td>
<td>27.39</td>
<td>14.00</td>
<td>40.00</td>
<td>33.26</td>
</tr>
<tr>
<td>Aggregate rigidity of employment</td>
<td>43.96</td>
<td>35.45</td>
<td>34.64</td>
<td>33.20</td>
<td>22.20</td>
<td>41.33</td>
<td>36.66</td>
</tr>
<tr>
<td>Non-wage labour costs</td>
<td>12.40</td>
<td>16.01</td>
<td>17.31</td>
<td>21.43</td>
<td>10.17</td>
<td>2.40</td>
<td>15.62</td>
</tr>
<tr>
<td>Firing costs</td>
<td>65.32</td>
<td>50.91</td>
<td>44.63</td>
<td>31.32</td>
<td>54.64</td>
<td>24.00</td>
<td>51.34</td>
</tr>
</tbody>
</table>

Notes: 1. LMI refers to Lower-Middle Income countries; UMI to Upper-Middle Income countries, and HI to High-Income economies either within the OECD or not. These are standard classifications drawn from the World Bank’s World Development Report (2005). 2. All indices are normalized to one hundred.

Source: World Bank (2006) and authors’ calculations.
International Labour Review

regulation index measures legislative provisions on work arrangements such as temporary tasks, the maximum duration of short-term contracts, whether an employer needs to notify a third party prior to retrenchment or reassignment, retraining rules during retrenchment, etc. In this context, these measures are very specific about which components of the legislative environment are considered to be detrimental to employment creation.

The above analysis of South Africa’s labour market regulation – based on combined measures of employment inflexibility and social protection – reflects an overall level of hiring and firing costs that is low by world standards. However, South Africa possesses a relatively high level of regulation in terms of legislative provisions for firing workers and (due to the problems with the measure noted above) for hiring, albeit to a lesser extent. This is an important addition to previous research on South Africa in this field, in that it suggests for the first time where the reported rigidity within the domestic labour market may lie. Specifically, according to the empirical evidence considered here, any lack of flexibility within the South African labour market lies in legislative provisions on hiring and firing. The legislation that currently governs fixed-term contracts and the clauses governing dismissals and unfair labour practices are indeed at the heart of the labour market flexibility debate in South Africa.

In more general terms, the foregoing also provides at least one possible analytical framework for estimating the extent of labour regulation within an economy. Indeed, in the case of South Africa, the DB estimates have for the first time allowed for a more robust and empirically informed policy debate around labour market regulation. We would argue, however, that the DB approach also has significant limitations. In one conception of these limitations, whilst the ap-

Figure 1. Difficulty of hiring, rigidity of hours and difficulty of firing: Cross-country percentile distribution and South Africa

Source: World Bank (2006) and authors' calculations.
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Adjusting the DB approach: Legislation, institutions and judicial interpretation

The above analysis was conducted at a level of generality which is in most instances inadequate for legal practitioners and indeed policy implementers seeking formal advice and suggestions for intervention. Specifically, the DB survey – as an instrument for evaluating an economy’s labour regulatory regime – will, by its very design, ignore those elements of the regulation which may be harder to measure empirically and thus make it difficult to provide robust country comparisons. We argue below that there are at least three broad categories of omission, as it were, within the DB framework which, together, result in an inadequate and ultimately incomplete assessment and evaluation of labour regulation within a country. First, we consider the relevance of what we have termed “micro-legislation” – those sub-clauses within a piece of legislation which may not be picked up by the “Employing workers” indicators, but may in fact have significant consequences for employment creation and worker protection. Second, we look at the institutional environment of regulation – particularly labour market institutions – which remains critical to any understanding and appreciation of labour regulation in operation. Third, the DB approach cannot offer any guidance on how the law is interpreted by the different courts.
within a country, and this remains another drawback of this approach in assessing the labour regulatory environment within an economy. Each of these issues will now be taken up in turn, with specific reference to the South African labour market.

Micro-legislation: The case of probation in South Africa

The 2006 DB survey results suggest that difficulty of hiring is an area where South Africa is above the median of the global distribution. In other words, while overall non-wage labour costs and firing costs may not be an issue, regulation at the point of labour market entry may be problematic. Unfortunately, this observation, although useful, may be too crude to serve as a basis for any specific policy intervention. Indeed, such a broad assessment of hiring legislation “as a whole” may lead to an inappropriate policy response. Probation offers a specific example of how the DB framework could overlook the nuances of micro-components of a country’s legislation.

Probation has always been a vexed issue. Employers need it in order to assess the suitability of the employee in the work situation. On the one hand, if an employer is unable to dismiss an employee who proves unsuitable with relative ease during probation, the purpose of probation is undermined and may become a barrier to employment. On the other hand, there is the concern that unscrupulous employers will use the reduced level of protection during probation to dismiss workers at the end of the probationary period and replace them with new employees. Within the context of this article, the specific clauses governing probation may thus be the only obstacle to unlocking “difficulty of hiring” within an economy. The DB approach, however, is ill-equipped to deal with such a nuance.

In South Africa, there are Codes of Good Practice which guide adjudicators and other practitioners as to how the law should be interpreted. However, the Code of Good Practice on dismissal contained in Schedule 8 to the 1995 Labour Relations Act initially said nothing about probation and, although this was changed in 1998, the revised Code failed to provide a coherent set of guidelines on this point, so that legal practitioners continued to treat employees on probation no differently from employees accepted into long-term employment. In 2002, the Code of Good Practice was again amended – by the Labour Relations Amendment Act. While the amendment appeared to lower the threshold for substantive fairness in respect of performance-related dismissals during probation, it included a range of obligations in respect of evaluation, instruction, training, guidance and counselling. Part of the package also aimed to make unfair conduct short of dismissal relating to probation an “unfair labour practice” by including it in the definition of the latter.

A detailed legal analysis of this specific component of what the DB survey refers to as “difficulty of hiring” suggests that there are several problems with the approach adopted in the above amendment process in South Africa. The first is that the less compelling standard for assessing the fairness of dismissal
during probation applies only to performance. But probation is also about testing the employee's suitability in the workplace, which is a more difficult dimension of discretion to review effectively. Restricting the lower standard to performance is an example of a policy driven by concerns related to the efficacy of enforcement rather than the efficacy of the selection process. The trade-off arises because the wrong regulatory mechanism is chosen. The second problem is the inclusion of unfair conduct relating to probation (other than dismissal) in the definition of unfair labour practice. This change was driven by the fear that the introduction of a less stringent standard would lead employers to extend the probationary period repeatedly. The third problem is that the whole construct of regulation is easily avoided. Specifically, the employer can avoid a probationary period of employment by entering into a fixed-term contract of a few weeks or months to determine whether the employee is suitable. If the employee is not suitable, the contract terminates automatically at the end of the period. If the employee is suitable, the employee remains in employment. Alternatively, the employer can circumvent this by contracting with an agency to supply an employee for an effective “trial” period.

It has been argued that the solution to probation lies in the approach taken in many other jurisdictions, namely, that the ordinary protections against unfair dismissal (except in regard to automatically unfair dismissals) do not apply to employees with less than six months’ service (Cheadle, 2006). In order to prevent the abuse of terminating and re-employing just before the expiry of the six-month period, the said period of service should include all previous service with the employer or a related employer. Provision should also be made for the possibility of shortening or lengthening the six-month period through sectoral collective agreements, sectoral determination or ministerial discretion in order to cater for the special needs of institutions such as universities or banks that can justify the need for a longer probationary period.

The crucial point from the above, however, is that what the DB approach can, within its empirical confines, only refer to as hiring clauses and their associated country ranking runs the risk of ignoring significant nuance and detail in regard to the challenges and policy debates around a very specific, micro-component of the legislation. In the case of South Africa, the DB survey thus fundamentally overlooked one of the key features of the labour regulatory environment, namely, the recasting of the country’s Code of Good Practice in regard to probation.

The importance of institutions: Dispute settlement mechanisms and the labour courts

The extent to which the institutional environment reinforces or weakens the effectiveness of legislative provisions is often underestimated in debates around labour market regulation. In most economies, the labour market is governed and managed by institutions. These include organizations of employers and workers; the courts of law, including specialist courts; dispute resolution institutions;
ministries of labour or employment; collective bargaining institutions; tripartite institutions and so on. These institutions are differentially resourced in human and physical terms; they yield contrasting performances according to pre-set objectives; they have different governance structures, parameters of influence and, ultimately, power within society. Simply put, this range of factors – all of which are time- and context-dependent – can and do fundamentally affect the manner in which labour regulatory provisions impact on the economy. For example, a sectoral minimum wage mandated by government will have little impact on either wages or employment if enforcement and oversight of this regulation through the relevant institutions are of poor quality. In such a case, economic outcomes could potentially be relatively benign if the institutional oversight is weak and of poor quality. To give another example: in many developing countries, the judicial system is poorly resourced and inefficient. As a result, the rule of law takes a long time to be implemented. For labour law cases, this could mean that rigidity in the labour market is more about an inefficient judiciary than any aspect of wages, union power or indeed labour legislation itself.

Ultimately, however, the obvious point is that institutions matter – and nowhere more so than within the labour regulatory environment. One of South Africa’s key labour market institutions is the Commission for Conciliation, Mediation and Arbitration (CCMA), which serves as the institutional anchor for the resolution of all labour disputes across the country. The following discussion of this institution and its centrality to understanding labour regulation within the economy indirectly reflects the limitations of the DB approach.

Efficient dispute resolution bodies in South Africa

In 1997 South Africa established two new institutions for dispute resolution and adjudication: the CCMA and a specialist system of labour courts with an exclusive labour law jurisdiction. The CCMA is an independent institution governed by a tripartite Governing Body. Its functions include dispute resolution, dispute management, institution-building within the labour arena and the provision of education, training and information to employers and employees and their organizations. The Labour Courts are specialist courts with national jurisdiction, having the same status as a division of the High Court of South Africa. Appeals lie from the Labour Court to the Labour Appeal Court, to the Supreme Court of Appeal5 and, on constitutional issues, to the Constitutional Court.

All disputes must be referred to conciliation, and there is a statutory requirement for a conciliation meeting to be held within 30 days. Dismissal cases must be referred to conciliation within 30 days of the dismissal, although late referrals are occasionally accepted. Unresolved disputes about dismissals on grounds related to the employee’s conduct or capacity (and, since 2002, individ-

5 The Supreme Court of Appeal, which is the highest court of appeal in all matters except constitutional issues, has ruled that it will only entertain appeals from the Labour Appeal Court if “there are special considerations relating to issues of constitutional or legislative construction or important issues of principle” [National Union of Mineworkers v. Mazista Tiles (Pty) Ltd (2006) 27 Indus. L.J. (SA) 471 (SCA); [2003] 7 BLLR 631 (SCA) at para 12].
ual redundancies) may be referred to arbitration. As a court of first instance, the Labour Court hears cases involving dismissals for operational requirements and strike-related dismissals, as well as cases concerning discrimination.

Arbitration may be conducted under the auspices of the CCMA, a bargaining council, or a private arbitrator appointed in terms of a collective or other agreement. Arbitration is intended to provide cheap, accessible, quick and informal dispute resolution. The arbitrator has discretion to determine a dispute fairly and quickly while dealing with the substantial merits of the dispute. The right to legal representation in arbitration is restricted. There is no appeal against the arbitrator’s decisions, although such decisions are subject to review by the Labour Court.

The CCMA operates an electronic Case Management System which allows for its case-load, the efficiency of dispute resolution and the outcome of cases to be tracked over time. Approximately 80,000 to 90,000 dismissal cases are referred to the CCMA each year, accounting for 80 per cent of its referrals (Benjamin, 2009). The majority of cases are referred by low-paid workers who are classified as being low-skilled or semi-skilled. All disputes must be referred to conciliation, and the average time taken for conciliation is approximately 28 days. Over 60 per cent of disputes are settled in this way. In the merged conciliation-arbitration process (“con-arb”) introduced in 2002, arbitration can start immediately after conciliation has failed to resolve the dispute, unless one of the parties objects. This has significantly reduced the time it takes to resolve disputes, and almost 50 per cent of disputes are heard in this manner (Bhorat, Pauw and Mncube, 2009). A very high proportion (roughly 80 per cent) of “con-arbs” are finalized in a single “event”. However, in roughly one-third of the cases enrolled for this expedited process, one of the parties, almost always the employer, objects and the ordinary process applies.

The high number of referrals for conciliation reflects the accessibility and legitimacy of this institution; and the high number of referrals settled through conciliation demonstrates that, despite criticism of the manner in which settlements are leveraged, this particular institution has played an important role in the South African labour market in reducing the number of disputes going into the more drawn-out process of arbitration or adjudication. Even if there is no settlement, arbitrations are completed on average seven months after the initial referral to the CCMA. Factors which contribute to reducing the time and costs of adjudicating these cases, include the absence of pre-hearing pleadings, the informal nature of arbitration hearings and restrictions on the right of legal representation. Approximately, 25 per cent of the dismissal disputes that are referred to the CCMA are settled by an arbitration award, indicating that a large number of them are resolved by consensus.

Ultimately, though, the above suggests that the South African economy’s key dispute resolution body, the CCMA, has not only ensured a highly efficient system of resolving disputes, it has also effectively provided recourse to legal protection to those workers who are un- or under-represented by trade unions. Yet, while optimally functioning labour market institutions are arguably crucial
to the overall efficiency and effectiveness of any system of labour regulation, the efficient operation of this component of South Africa’s labour regulatory architecture cannot be measured through the DB survey approach.

Although the CCMA thus provides for a fair degree of labour market efficiency, the same cannot be said of another set of institutions within the South African labour market – the courts of law.

Judicial reviews and institutional inefficiency in South Africa

Roughly one in ten arbitration awards from the CCMA is taken to a Labour Court for judicial review. During the CCMA’s first decade of operation, a total of 1,700 review applications were thus made each year. The Labour Courts of South Africa are therefore a key part of the dispute resolution process, and their efficient operation is critical to the effectiveness of the country’s labour regulatory regime. While inconsistent decision-making by CCMA commissioners undoubtedly contributes to the number of reviews, there is no doubt that many employers use the institution of judicial review as a strategy to delay the enforcement of arbitration awards against them. Indeed, only 20 per cent of the reviews lodged with the country’s Labour Courts in the first ten years of the CCMA’s operation had been finalized (Benjamin, 2009).

A recent Constitutional Court judgment has clarified both the tests that arbitrators should apply when deciding on the fairness of dismissals and the circumstances in which arbitral awards can be reviewed. This is likely to reduce the number of reviews. However, almost 80 per cent of the employees who receive an award in their favour have to take further legal action in order to obtain payment. It will take additional institutional reform to prevent the review process from being abused with the aim of frustrating the enforcement of awards.

It takes an average of 24 months for a review application to be heard in the Labour Court (Benjamin, 2009). The factors contributing to these delays include uncertainty concerning the restructuring of the Labour Courts, which has discouraged lawyers from seeking appointment as judges, and an excessive reliance on acting judges. This has had a negative effect on the efficacy of South Africa’s Labour Courts and has undermined one of the reasons for establishing specialist labour courts in the first place, namely, expedition. In the Labour Appeal Court, delays of 12 to 18 months between date of hearing and date of judgment are not uncommon. The Supreme Court of Appeal, by contrast, hands down judgments within three months of the hearing despite a very heavy case-load. Ultimately, though, the suggestion here is that any notion of labour market rigidity in South Africa may in fact derive not from the legislative framework, but from the suboptimal performance of labour market institutions such as the Labour Courts and Labour Appeals Court. While delays at this level may affect a relatively small proportion of cases, these cases are often highly publicized and disproportionately influence perception.

Although the malfunction of this component of the labour regulatory regime may feed employers’ perceptions of labour market rigidity, it cannot in fact be measured by the DB surveys. The inability to provide an accurate indica-
tion of this aspect of regulatory frameworks weakens the predictive power of such surveys immensely. Indeed, in order to generate a more robust, representative measure of labour regulation across countries, it would be fairly easy to introduce standardized indicators of institutional efficiency covering both the courts and dispute resolution bodies across countries. The DB surveys could certainly be modified to include such non-legislative variables.

**Interpretation of legislation by the courts**

The standard measures of regulation found in the DB “Employing workers” indices are, as noted above, numeric codings for country-level legislative provisions. The DB approach does not claim to do any more than that. However, it is worth reiterating the importance of how legislation is interpreted by the courts of law and other relevant institutions, including dispute resolution bodies. Indeed, legislative provisions are, more often than not, subject to interpretation by the relevant legal authority. For example, how judges interpret the notion of “fair dismissal” is influenced by a range of variables including the subjective opinion of the judge; the merits of each particular case; the evolution of jurisprudence on the issues at stake; the resources available to the parties, and so on. The combined effects of these variables thus lead to a specific interpretation of the law. The outcome may be over-regulation or indeed under-regulation of specific labour market activities in terms of reasons for dismissal, unfair labour practices, probation rights, etc.

In other words, the interpretation of labour legislation by the authorities responsible for applying it may in fact yield a measure of regulation that is at odds with the findings of the DB surveys and the ICAs. While it would be almost impossible to extend the DB framework to include a measure of judicial interpretation, it is essential to take account of this variable in any discussion on measures of labour regulation within a country. Legislative provisions and country rankings based thereon are therefore implicitly incomplete indicators because they ultimately provide an inadequate representation of labour regulation in an economy.

There is another layer to understanding the legislative environment in relation to the labour market: in many cases a country’s labour law architecture is intricately and deliberately linked to its international and complementary domestic legal obligations. Policy interventions designed to deregulate the labour market may therefore require due recognition of the ILO Conventions that the country has already ratified. In addition, individual rights enshrined in the country’s constitution serve as the bedrock on which specific labour law provisions are made. Tampering with such rights in a substantive manner may indeed be unconstitutional. The generic point, however, is that deregulating a labour market through significant legislative changes will critically impact on the broader legal environment in most countries. What the notion of deregulating a labour market means to economists may indeed have significant and possibly intractable legal implications.
The significance of both judicial interpretation and the manner in which key interest groups respond to changes in legislation is well illustrated in South Africa by the practical application of changes in the approach to employers’ pre-dismissal procedural obligations under the 1995 Labour Relations Act.

Pre-dismissal procedures

On this point, the CCMA’s practice has continued to impose the rigid and formalistic approach adopted by the courts under the old Labour Relations Act by overemphasizing pre-dismissal procedures and, in doing so, imposing an unnecessary burden on employers without advancing the protection of workers.

There are various reasons for this. Firstly, the Industrial Court had developed a jurisprudence under the old Labour Relations Act that imposed strict procedural requirements on pre-dismissal hearings and, although the new Act endeavoured to break away from this approach, lawyers, arbitrators and judges schooled under the old legislation continued to apply the same exacting technical requirements in developing their new jurisprudence. Secondly, employers had established complex disciplinary procedures under the old Labour Relations Act, which they did not alter with the introduction of the 1995 Act. Thirdly, faced with the arbitrators’ and judges’ decisions continuing the old jurisprudence, lawyers and consultants gave advice that protected the interests of their clients (which happily happened to coincide with their own). Finally, the model of disciplinary hearings developed under the apartheid-era Act of 1956, premised as it was on an analogy with criminal proceedings, did not die out and give way to the model advanced under the 1995 Act, which is more analogous to administrative law procedures that are more flexible and based on the Code of Good Practice. Both van Niekerk (2007) and Roskam (2007) regard the requirements for pre-dismissal procedural fairness imposed by the arbitrators and the courts as having contributed more than any other factor to perceptions about the inflexibility of South African labour law.

However, subsequent rulings by the Labour Courts have clarified that the “criminal model” of procedural fairness is not consistent with the 1995 Labour Relations Act, and arbitrators are now required to follow a less technical approach on this issue.6 This shift has occurred without legislative change and has been the result of judicial reinterpretation. Coupled with the administrative efficiencies described previously, this has significantly reduced the cost of dismissal protections to employers, without significant loss of protection for employees.

Ultimately, however, the manner in which pre-dismissal procedures were interpreted by legal practitioners and indeed the courts in South Africa arguably resulted in a significant dissonance between the legislation on the statute books and its application. It follows that interpretations of the legislation measured by

the DB surveys can and often do have inputs and outcomes at odds with the intentions of the drafters of the legislation.

Conclusion

This article has attempted to engage in two distinct, yet inter-linked, analytical exercises on South Africa’s labour regulation environment. At the outset, we sought to establish that examining regulatory issues as a binary policy alternative – flexibility versus regulation – is conceptually and empirically wrong. Indeed, an approach that brings together the thinking, concerns and approaches both of legal experts and economists underlies the core message of this article.

The empirical evidence on the international ranking of South Africa’s labour regulation regime yields three key results. Firstly, on most of the measures of labour regulation produced by the 2006 DB survey, South Africa’s labour market is neither exceptionally over-regulated nor, indeed, under-regulated. This holds true both globally and in relation to the sample of middle-income economies. This result reinforces our view that labour market policy debates in South Africa should be about nuance, rather than substance. Secondly, within the global distribution of labour regulation rankings, South Africa displays a fairly benign level of regulation in terms of non-wage labour costs and firing costs. And thirdly, the legislative source of any actual or perceived rigidity in the South African labour market therefore centres on provisions for the hiring and dismissal of workers, as international comparisons based on the DB surveys place South Africa above the sample mean on the indices for “difficulty of hiring” and “difficulty of firing”.

The second part of the article, however, draws on contemporary South African labour law debates to illustrate the limitations of the DB surveys as an instrument for evaluating an economy’s labour regulation regime. This part examined three aspects of law: what we have termed “micro-legislation”, the institutional environment within which regulation operates, and judicial interpretation of legislative provisions. That the DB framework does not offer any insights into these aspects is a significant drawback when using it to assess the labour regulation environment within an economy. In 2009, the World Bank announced that it would be “adjusting the scoring in the Doing Business 2010 report … in order to accord favourable scores to worker protection policies that comply with … the spirit of the relevant ILO Conventions”. It also suspended the use of the “Employing Workers” indices as a basis for both its Country Policy and Institutional Assessments and its policy advice.7 This provides a timely opportunity for wider consideration of their design to incorporate measures that better capture the operation of labour legislation in practice.

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References


Appendix – 2006 “Employing Workers” methodology and indices*

Doing Business measures the regulation of employment, specifically as it affects the hiring and firing of workers and the rigidity of working hours. The data on employing workers are based on a detailed survey of employment regulations that is completed by local law firms. The employment laws of most countries are available online in the NATLEX database, published by the International Labour Organization. Laws and regulations as well as secondary sources are reviewed to ensure accuracy. Conflicting answers are further checked against two additional sources, including a local legal treatise on employment regulation.

To make the data comparable across countries, several assumptions about the worker and the business are used.

Assumptions about the worker

The worker:
- is a non-executive, full-time male employee who has worked in the same company for 20 years;
- earns a salary plus benefits equal to the country’s average wage during the entire period of his employment;
- is a lawful citizen with a wife and two children. The family resides in the country’s most populous city;
- is not a member of a labour union, unless membership is mandatory.

Assumptions about the business

The business:
- is a limited liability company;
- operates in the country’s most populous city;
- is 100 per cent domestically owned;
- operates in the manufacturing sector;
- has 201 employees;
- abides by every law and regulation but does not grant workers more benefits than what is legally mandated;
- is subject to collective bargaining agreements in countries where such bargaining covers more than half the manufacturing sector.

Rigidity of employment index

The rigidity of employment index is the average of three sub-indices: a difficulty of hiring index, a rigidity of hours index and a difficulty of firing index. All the sub-indices

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have several components. And all take values between 0 and 100, with higher values indicating more rigid regulation.

The difficulty of hiring index measures (i) whether fixed-term contracts can be used only for temporary tasks; (ii) the maximum cumulative duration of fixed-term contracts; and (iii) the ratio of the minimum wage for a trainee or first-time employee to the average value added per worker. A country is assigned a score of 1 if fixed-term contracts can be used only for temporary tasks and a score of 0 if they can be used for any task. A score of 1 is assigned if the maximum cumulative duration of fixed-term contracts is less than three years; 0.5 if it is between three and five years; and 0 if fixed-term contracts can last five years or more. Finally, a score of 1 is assigned if the ratio of the minimum wage to the average value added per worker is higher than 0.75; 0.67 for a ratio greater than 0.50 and less than or equal to 0.75; 0.33 for a ratio greater than 0.25 and less than or equal to 0.50; and 0 for a ratio less than or equal to 0.25. In the Central African Republic, for example, fixed-term contracts are allowed only for temporary tasks (a score of 1), and they can be used for a maximum of two years (a score of 1). The ratio of the mandated minimum wage to the value added per worker is 0.66 (a score of 0.67). Averaging the three sub-indices and scaling the index to 100 gives the Central African Republic a score of 89.

The rigidity of hours index has five components: (i) whether night work is unrestricted; (ii) whether weekend work is unrestricted; (iii) whether the workweek can consist of 5.5 days; (iv) whether the workweek can extend to 50 hours or more (including overtime) for two months a year; and (v) whether paid annual vacation is 21 working days or fewer. For each of these questions, if the answer is no, the country is assigned a score of 1; otherwise a score of 0 is assigned. For example, Montenegro imposes restrictions on night work (a score of 1) and weekend work (a score of 1), allows 5.5-day workweeks (a score of 0), permits 50-hour workweeks for two months (a score of 0) and requires paid vacation of 20 working days (a score of 0). Averaging the scores and scaling the result to 100 gives a final index of 40 for Montenegro.

The difficulty of firing index has eight components: (i) whether redundancy is disallowed as a basis for terminating workers; (ii) whether the employer needs to notify a third party (such as a government agency) to terminate one redundant worker; (iii) whether the employer needs to notify a third party to terminate a group of more than 20 redundant workers; (iv) whether the employer needs approval from a third party to terminate one redundant worker; (v) whether the employer needs approval from a third party to terminate a group of more than 20 redundant workers; (vi) whether the law requires the employer to consider reassignment or retraining options before redundancy termination; (vii) whether priority rules apply for redundancies; and (viii) whether priority rules apply for re-employment. For the first question, an answer of yes for workers of any income level gives a score of 10 and means that the rest of the questions do not apply. An answer of yes to question (iv) gives a score of 2. For every other question, if the answer is yes, a score of 1 is assigned; otherwise a score of 0 is given. Questions (i) and (iv), as the most restrictive regulations, have greater weight in the construction of the index.

In Tunisia, for example, redundancy is allowed as grounds for termination (a score of 0). An employer has to both notify a third party (a score of 1) and obtain its approval (a score of 2) to terminate a single redundant worker, and has to both notify a third party (a score of 1) and obtain its approval (a score of 1) to terminate a group of redundant workers. The law mandates consideration of retraining or alternative placement before termination (a score of 1). There are priority rules for termination (a score
of 1) and re-employment (a score of 1). Adding up the scores and scaling to 100 gives a final index of 80 for Tunisia.

**Non-wage labour cost**

The non-wage labour cost indicator measures all social security payments (including retirement fund; sickness, maternity and health insurance; workplace injury; family allowance; and other obligatory contributions) and payroll taxes associated with hiring an employee in fiscal year 2005. The cost is expressed as a percentage of the worker’s salary. In Bolivia, for example, the taxes paid by the employer amount to 13.7 per cent of the worker’s wages and include 10 per cent for sickness, maternity and temporary disability benefits; 1.7 per cent for permanent disability and survivor benefits; and 2 per cent for housing.

**Firing cost**

The firing cost indicator measures the cost of advance notice requirements, severance payments and penalties due when terminating a redundant worker, expressed in weekly wages. One month is recorded as 4 and 1/3 weeks. In Mozambique, for example, an employer is required to give 90 days’ notice before a redundancy termination, and the severance pay for workers with 20 years of service equals 30 months of wages. No penalty is levied. Altogether, the employer pays the equivalent of 143 weeks of salary to dismiss the worker.

This methodology was developed in Botero and others (2004) and is adopted here with minor changes.