

# Quarterly Research Report

JANUARY–APRIL 2016

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# Costs and profit declaration in a mining business: The basics that workers and other external stakeholders need to know

By Martin Kaggwa



The paper presents an investigation into the different types of costs that mining firms include in their profit calculations with the aim of getting insight into the storyline that profits in South Africa's mining sector are declining. Profitability of the mining business is of interest to both employers and mineworkers in terms of sustainability of business and beneficial employment, respectively. A review of international mining costs categorisation and profit calculation is done. Emphasis is put on understanding the different cost categories included in profit calculation in the mining business. It is revealed that there are 3 broad cost categories included: a) operation costs, b) costs related to royalties and production taxes, and c) accounting and miscellaneous costs. The accounting and miscellaneous costs category is particularly contentious because it includes costs that are discretionary and are not incurred in the period in which they are considered. It is pointed out that when mining businesses indicate that they are not profitable, it does not necessarily mean that they cannot cover their operation costs which includes payment of decent wages. It means rather that after taking into account the 3 cost categories, the businesses are not getting the desired profit margins. It is prudent, therefore, that workers representatives and other external stakeholders have access to information on costs included in profit calculations before they commit themselves to employers' decisions based on state of business profitability. Otherwise, declaration of low or no profits in the mining business may be unjustifiably used, or taken advantage of against interests of workers and other external stakeholders including government.

## Introduction

The storyline that mining in South Africa has become less and less profitable overtime has been cited so many times in the public media and various sector discussion forums recently. In making the assertion of low profits or lack of profits, the focus has tended to be on the revenue side of the profit equation. Decreased commodity prices due to decline in commodity demand by China is cited as the main reason for the price decline and the subsequent waning in profits (Evans, 2015). To a lesser extent, increasing labour costs has also been cited as a reason for the profit decline for mining businesses (Dodgson, 2016).

The PWC report of 2015 says that mining profits in South Africa were at their minimum in 2014, since 2008. According to the report, net profits for the 6 biggest mining companies registered at the JSE reduced from R27 billion in 2013 to R6 billion in 2014, a decrease of 78%. It further points out that net profit reduced by 78% despite Earnings Before Interest, Tax, Depreciation and

Amortisation (EBITDA) improvement of 10% in the same period (PWC, 2015).

The mining industry is quick to directly equate the low profit to job cuts without any qualification. The Chamber of Mines argues, for example, that if Eskom increases power tariff rates by 8% to bring the overall annual tariff increase to 16.6% in 2016, this will increase the overall operation costs of mining businesses. As a result, some 40,000 jobs may be lost in the gold and the platinum sectors (CoM, 2015).

An impression is created that profits in a mining business are dependent, exclusively, on commodity prices and operation costs. But this is not true. There are other cost categories that are included in a mining firm's profit calculation. These other costs are rarely mentioned, yet information on such is useful to all stakeholders in making strategic decisions, especially during low commodity price periods.



Broadly, profits are a function of costs and revenue. Whereas revenue figures can be estimated from sales information based on amount of mineral resource exported and world commodity prices, it is almost impossible to ascertain information on costs included in mining business profit calculation. There is a tendency to keep costs information other than operation costs of individual mining firms confidential, and when provided it is only in aggregated form.

Cost information is particularly important to all stakeholders in the mining business when cost cutting measures based on no or low profits margins are being proposed by the employer.

The paper uses the SNL Metals and Mining methodology of cost calculations to point out some important aspects of costs and costs calculation that all stakeholders, especially government and labour, should be aware of when it comes to adjudicating whether a mine business is profitable or not. SNL Metals and Mining is considered a trusted source of global mining information and analysis, providing global insights and intelligence on mining business. Information from SNL is neither contested nor disputed by the mining industry in South Africa. In fact, to make a case of reducing profits the mining sector in the country has often referred to SNL data.

### Importance of the mining sector in remaining profitable

The importance of mining remaining a profitable business in South Africa is acknowledged by all stakeholders. Business desires a profitable business environment because it enables a fair return to their investment in the sector; workers want it because it assures them, to some extent, that they will have work tomorrow, and the government needs it because it enables it to collect taxes thus contributing to the national fiscus. But how mining firms come to the conclusion that they are or are not making profits is a grey area characterised by lack of information and subjectivity.

The issue of incomplete disclosure of mining costs and subsequent obscurity, specific to gold mining, was highlighted by Brent Cook. He said:

*'Gold production costs as reported by mining companies have always consisted of a somewhat confusing, usually obscure, and often misleading set of metrics' (Cook, 2009).*

The cost analysis of mining firms in the context of profit declaration is important because it provides basis for negotiating interests of the different stakeholders in the industry, among other factors.

Specific to the mining sector in South Africa, apart from enabling mining business continuity and sustaining benefits therefrom, whether the sector is profitable or not is important for four other reasons:

- **Stagnation of wages and other workers' benefits:** Unqualified no or low profit declaration can be used as a reason to stagnate wages and freeze workers' benefits in the sector. This can in turn lead to more frequent strikes and work places stoppages that further dent the performance and contribution of the sector to national development. With the emerging tendency to politicise workers' strikes this may lead to social unrest among communities and general political instability.
- **Business seeking unjustified incentives:** It is a common phenomenon that the South African government comes up with a package of incentives for distressed sectors as a means of mitigating potential job losses. Improper diagnosing of the mining sector profitability may be used to earn unjustified incentives by business; in which case, national resources will be diverted from more deserving socio-economic programmes to the non-deserving business.
- **Discouraging transformation of the sector:** Transformation of the sector in terms of ownership and meaningful participation of previously disadvantaged blacks is a key objective for government. Understating the profitability of the sector may be used as another tool to frustrate previously disadvantaged black people in entering the sector. This can be due to the unfavourable terms under which financial institutions may be willing to fund them, or just being discouraged by the low profit prospects.
- **Perpetuating negative country ranking in terms of investment:** Of late, South Africa has been systematically downgraded as an investment destination. The ranking of the country has implication on attracting beneficial foreign direct investment in the country. The level of profits of the mining sector can contribute to the downgrading and resultant miss out of inward investment into the country.

Whether the mining sector in the country is making a profit or otherwise is not an issue of concern only for workers who are often the immediate victim of no-profit declaration, but an issue of national important. Hence, all stakeholders need to have some insight as to how the mining businesses come to the conclusion that they are making or not making profits.

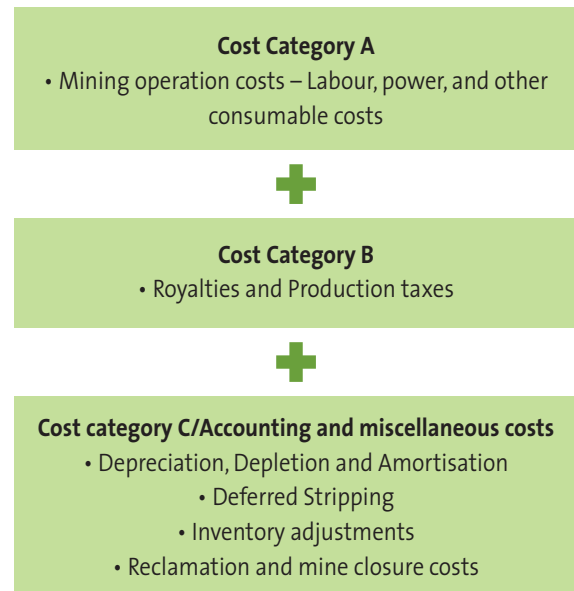
The following section examines the cost side of mining profit calculation, which is the focus for this paper.

**Cost categorisation in the mining business**

There are three broad categories of costs that are included in the profit calculation of mining operations: a) operation costs, b) royalties and production taxes, and c) accounting and miscellaneous costs (SNL, 2015).

- **Operation costs:** These include costs of all inputs and production supportive functions of mining. The cost of labour, power, and other consumables used in mining fall under the operation costs category. Normally when one talks about costs in mining, the tendency is to focus on the operation costs, yet they are just one of the costs within the business.
- **Royalties and production taxes:** The mining business includes royalties paid to third parties and direct production taxes paid to government as part of costs of doing business and as such deductible to total revenues before profits are declared. In practical terms it means a mining business can claim to be not profitable based on the amount paid through royalties and production taxes.
- **Accounting and miscellaneous costs:** This category of costs includes costs related to the accounting practices of calculation of depreciation, depletion and amortisation within a particular accounting period. Business practices relating to stripping and inventory management also influence costs included in this category. The other costs that may be included in the category are reclamation and mine closure costs, strikes costs, consultancy and head office costs.

**Figure 1: Cost categories the mining business profit calculation**



Source: Author's adoption from SNL

**Reflection on mining cost categories**

The operation costs category is fairly straight forward. Even under the situation of information asymmetry, it is possible for stakeholders to ascertain whether operation costs of a mining business are increasing or not. Being the most visible cost category, decision making tends to focus on reducing operation costs, particular labour costs, during the low profit periods. As a result, there is tendency

to equate low profits with retrenchments, without due acknowledgement that labour is just one of the many operation costs, and that operation costs are just one of the three mining business cost categories.

*Royalties and production taxes* cost category is fairly easy to understand too, and to get factual information on it for decision making whenever it is claimed that mining is not profitable. This cost category is specific and pre-determined. This means that its impact on the profits can be established and if found to be a major hindrance to sector profitability, it can be re-negotiated.

*The accounting and miscellaneous costs* category is the most complex and controversial yet a valid category. First, it is very technical in nature. Accounting systems and procedures of recording costs relating to depreciation and amortisation are determined by accounting and finance experts together with senior management. With depreciation and amortisation relating to costs that are not expensed in the period they were incurred, but recognized over a period of time, what portion of these costs should be considered in a specific period has an element of subjectivity. In addition, management can decide which other optional costs to include in a particular period. Costs relating to consultancy, and having more than one administrative office across the world, may be included in a particular financial period at the discretion of management.

The subjectivity of cost calculations and profit declaration, in general, is further exacerbated by the fact that mining companies can use costs in any way they want and often their calculations vary from one company to another (Hamilton, 2009). Interest costs, debt repayments, and head office costs are items that mining companies compile and are reported separately by auditors (Hamilton, 2009). They are not included as part of the operation costs yet at the end of the day, they impact on profit declaration by mining firms.

External stakeholders to the mining business cannot have a strong basis to contest these costs unless they

have access to full cost information. The challenge, though, is that it is unlikely that businesses will avail this information to the external stakeholders in a transparent and comprehensible way.

Ultimately the accounting and miscellaneous cost category, although valid, is contentious. If abused, it can lead to perpetual misrepresentation of the profit status of the mining business with far reaching implications to the sector's sustained and positive contribution to national development.

## Conclusion and recommendation

The paper highlights the fact that profits for a mining business, from the cost side, do not depend on operation costs alone, but a number of other costs, some of which are discretionary. Some of the costs included in the profit calculations have low bearing on immediate operating costs of the mines and their inclusion in profit determination may even be contested. Without knowing what costs are included in the profit calculations, a mere declaration that profits have declined should not be relied on in making strategic decisions such as determining the level of wages in the mining sector.

There is a need for workers' representatives and other external stakeholders to have specific information on costs included in profit calculations before they commit themselves to employers' decisions based on the state of business profitability in the mining sector.

From an employment perspective, recognition that there are other cost categories included in the profit calculation of mining businesses creates an opportunity for motivating for no retrenchments during the period of low commodity prices. Labour is just one cost aspect under operation costs. Efforts to cut costs in low commodity price cycles can be directed to other costs, especially those that are discretionary under the accounting and miscellaneous cost category.

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# The National Minimum Wage Debate in South Africa: Not a Question of Better Wages at the Expense of Fewer Jobs.

By Pulane Mafoea



This paper reviews the debate on the introduction of a National Minimum Wage (NMW) in South Africa. It considers the literature on the employment effects of introducing the minimum wage system. It reviews some of the most prominent successful cases of a minimum wage, and highlights the challenges thereof. Drawing from the literature and selected country experiences, the paper concludes that a NMW can only be effective if it is part of broader social and economic policies and efficient labour market system. Specific to South Africa, it proposes that employers should pay a wage amounting to the standard minimum living levels, and/or appendage with some basic needs of the workers, based on the sectors. These costs and subsidies are to be carried by the employers.

## Background

Wage inequality is one of the biggest challenges facing South Africa. With the rise in wage inequalities and uneven development, it has become essential to find viable alternatives for achieving a more equitable society. South Africa is ranked among the highest in the world in inequality, with co-efficient standing at 0.69 (StasSA). This has led to huge differences in life opportunities, particularly between different races as well as households with differences in income. A significant amount of evidence is now available to prove that if the increasing inequality continues, the cost will be even greater human suffering, and it will create even more serious and pervasive economic and social damage in the country. The effects of wage inequalities are varied, but the most affected are the poorest.

Although enormous progress has been made in the South African labour market (in terms of labour composition and average real wages) as we know it today, wage inequalities for many vulnerable workers remain largely unchanged. Over the past few years, there has been an upsurge of unprotected strikes and labour unrest over wages and conditions of work in different industries in South Africa. Workers have taken to the streets the issues of dissatisfaction with pay, risky and dangerous conditions of work and high levels of income inequalities. The 2012 Marikana strike and subsequent death of a number of miners is one example that has brought the issue of wages and conditions of work to the front of policy and economic discourses in the country

It is understandable, then, why recent social tensions and labour unrest on unfair wages have sparked debate around a national minimum wage system. The national minimum wage would play a key role in ensuring that workers are able to earn fair wages.

This paper examines the concept of a NMW, the challenges associated with it and the diverse views on the good and bad of introducing a NMW system. It submits that a NMW on its own will not be sufficient to address the wage inequalities in South Africa. The paper supports the view that it should include comprehensive social welfare benefits and that the NMW should be set at a level that will take forward the national plans of creating more jobs.

## What is a Minimum Wage?

The International Labour Organisation (ILO) defines the minimum wage as the:

*'minimum sum payable to a worker for work performed or services rendered, within a given period, whether calculated on the basis of time or output, which may not be reduced either by individual or collective agreement, which is guaranteed by law and which may be fixed in such a way as to cover the minimum needs of the workers and his or her family, in the light of national economic and social conditions.'*

Whilst this definition does not say how the minimum wage should be set, it highlights the significance of taking



into consideration the broader socio-economic needs of the worker.

The notion of the NMW dates as far back as the 1800s, with New Zealand being one of the first countries to have national minimum wage law endorsed. Other countries such as Australia and United States followed thereafter. It is, however, the growing inequality in many developing countries that has triggered the recent attention to minimum wages debates. Rani and Belser (2012:46) offer another reason to this change in perception: that a number of countries around the world began to experience positive changes after introducing the minimum wage. In the United Kingdom, for example, a survey by political experts identified the introduction of NWM in 1999 as the most successful government policy of the past 30 years. And in 1995 in Brazil, the reactivation of national minimum wages was widely welcomed.

### Minimum wage debates

Indeed, the interest and debates in minimum wages has increased among developing countries. The increased proliferation in minimum wages has been due to several reasons, one of which is that minimum wage policy can have a substantial impact on a range of economic

variables affecting economic performance and the growth rate. Of course, the discourse around the minimum wage is premised on two conflicting views. On the one hand is the perspective of the minimum wage as a social justice tool to provide socially acceptable wages to the most unskilled workers (Cunningham, 2007). The basis of this view is that an increase in minimum wage contributes to the overall redistribution of resources, thus enabling people to participate in economic activities. The other view is that minimum wages increase the cost of labour and therefore affect productivity, which may lead to job losses and subsequently affect the economic growth negatively.

The motivation for minimum wages has always been focused on the need to offer socially acceptable wages to vulnerable workers. The original proponents of the minimum wage argued that low wages impose substantially negative externalities on society, and that government had a responsibility to correct the market and serve as a collective bargaining proxy for poor workers without representation to ensure them a standard of living acceptable to society (Cunningham, 2007:8). Furthermore, the minimum wage system is believed to be critical in a number of ways, including being a poverty reduction tool. Another objective or motivation for minimum wages that

Starr (1993) cited in Cunningham points out is *Payment for inputs*. He highlights that early court cases in the United States argued that employers are obligated to pay for the production of the human energy required to supply the labour to their firms. As such, wages should be sufficient to cover the cost of food, shelter, leisure, clothing, and other inputs that create labour. A minimum wage should be equal to this cost, and it would be unjust for employers to pay a lower wage.

Belser and Sobeck (2012: 118) list these three criteria as critical in setting up a minimum wage:

- a minimum living wage threshold;
- the ratio of the minimum wage to the average (mean and median) wage;
- the number of employees directly affected by the minimum wage, and the impact on the country's total wage bill.

Different countries adopt different minimum wage levels and include or exclude various aspects and variables to determine the level of the minimum wage. What is important is that the minimum wage should address key aspects of what it aims to do. And so it is important to have clear objectives as they will help determine the approach as well as the level at which the minimum wage should be set. Experiences across the world show that the criteria to set the level of the minimum wage are often a combination of social needs, ability to pay, equity and economic development requirement (Cunningham, 2007: 66).

Critics of minimum wage systems argue that increasing the minimum wage can lead to job losses. This view is based on the understanding that higher minimum wages not only cut overall employment but also make it difficult for young workers to enter the labour force. The argument is that as the price of labour increases, the demand falls, causing job losses and making it difficult for young people to enter the labour market. For example, Cunningham (2007) argues that in Brazil an increase in the minimum wage led to greater job losses for women, youth, and low-skilled workers whose wages are clustered around the minimum wages. On the other hand, there were no significant job losses experienced by men, prime-aged or older workers, and the high-skilled. He points out that the same trend was widespread throughout the regions, despite the year or methods used for the analysis. An increase in the minimum wage resulted in higher unemployment and lower employment. Cunningham argues that depending on a country the (such as in Brazil), the effects may be very small or substantial (as in the case of Colombia), with most countries experiencing a job loss of 2 per cent for a 10 per cent increase in the minimum wage.

## National Minimum Wage developments in South Africa

In South Africa, sectoral minimum wages were introduced in 2002. However, the issue has long been on the agenda of the African National Congress (ANC). As an example, the 1955 Freedom Charter clearly states the need for a national minimum wage. On the issue of work, the Charter states that:

*'Men and women of all races shall receive equal pay for equal work; there shall be a forty-hour working week, a national minimum wage, paid annual leave, and sick leave for all workers, and maternity leave on full pay for all working mothers; Miners, domestic workers, farm workers and civil servants shall have the same rights as all others who work.'*

Indeed, when the ANC came into power, enormous efforts including shifts in policies were put in place to address the social and economic injustices of the past. As an example, the Basic Conditions of Employment Act (1997) gives the Minister of Labour power to set minimum wages in sectors that are believed to be vulnerable. The sectoral wage determination is one of the ANC-led government's strategies towards achieving the Charter aim of NMW.

In other sectors, particularly where there is strong union presence, wages are negotiated through collective bargaining processes. In other sectors, such as the private sector, wages are determined by employers alone through individual contracts. Through the Department of Labour, an Employment Conditions Commission (ECC) was set up as an institution responsible for advising the minister on sectors minimum wage determinations, among other things. At present, there are nine sectors covered through sectoral determination. It is, however, important to note that there are currently 36 different minimum wages in South Africa (as per the table below). This is because in some instances minimum wages differ not only by sectors but also by occupation and regions.

Sector	Minimum wage per month ( in Rands)
Domestic Metro	1877.70
Domestic Non Metro	1618.37
2. Security Officer Grades D&E Area 1	2939.00
Security Officer Grades D&E Area 2	2688.00
Security Officer Grades D& E Area	2441.00
3. Forestry	2420.41
4. Farm	2420.41

<b>5. Contract Clearing Area A Metros ex KZN</b>	3051.35
<b>Contract Cleaning Area B all other ex KZN</b>	2764.92
<b>6. Hospitality 10 or &lt;workers</b>	2601.88
<b>Hospitality 10 or &gt;workers</b>	2900.08
<b>7. Taxi Driver and Admin Workers</b>	2847.01
<b>Taxi Rank Marshals</b>	2275.81
<b>8. Wholesale &amp;Retail shop assistant Area A</b>	3063.13
<b>Wholesale &amp;Retail shop assistant Area B</b>	2556.30
<b>Wholesale &amp;Retail sales Person Area A</b>	3866.20
<b>Wholesale &amp;Retail sales Person Area B</b>	3261.51
<b>9. EPWP (Ministerial Determination)</b>	

Source: Jane Barret in Coleman (2014)

One advantage of setting a minimum wage system at the sectoral level is that it is more considerate of the existence of sectoral and occupational differences. The key role of sectoral minimum wage is to safeguard certain groups of particularly vulnerable workers, who in most cases are lowly qualified. Although that is a crucial aspect, sectoral minimum wage systems are usually complex and require a large effort of coordination in terms of administration and monitoring (Foguel et.al, 2001:26). As it stands now, a study by Bhorat et.al (2010) on minimum wage violation in South Africa revealed that non-compliance levels of employers in the country with minimum wages are disturbingly high, with the security sector being the highest at 80%, followed by the farm and forestry sectors. The report is disheartening, especially when one looks at the initial expectations when sectoral minimum wages were introduced.

Furthermore, according to the DPRU report (2008:1), based on data from the Labour Force Survey (LFS) of September 2000, which was conducted prior to any of the sectoral minimum wages being enacted, it was estimated that all the sectoral determinations combined would eventually cover about one-third of formal and informal sector workers in South Africa. Over half of these workers that would eventually be covered by minimum wages reportedly earned less than what the stipulated minimum wage would eventually be (converted to 2000 prices) and were, therefore, set to benefit from the policy if their employers complied. And so the enforcement of sectoral minimum wages seems to be a challenge. Similarly, India introduced multiple minimum wage rates varying across states as well as across jobs within a state.

A study by Rani and Belser (2012:63) reported that in all of the states in India, there was no full compliance, and non-compliance seemed to be high in the highly developed and industrialised states.

The technical issues such as compliance and monitoring of minimum wage systems have not taken centre stage in the debate on NMW in South Africa. Most of the discussion has been centred around the issue of unemployment and wage inequality with regards to NMW. For instance, the paper assessing the income and non-income inequality in post-apartheid South Africa, Bhorat et.al (2009), indicates that wage inequality in the latter part of post-apartheid South Africa is explained by increasing wages for skilled workers, and particularly the gap between the wages of those at the top (90th percentile) and middle (50th percentile) of the distribution.

One peculiarity of the South African labour market is the huge unemployment rate, especially amongst the youth. In the first quarter of 2014, South Africa unemployment rate increased from 25.2% to 25.5% in the second quarter of 2014 — a loss of 87,000 jobs in three months according to the strict definition (Stats SA). But then again, these figures do not include the broad definition of unemployment, which includes discouraged job seekers. Taking the discouraged job seekers into consideration, the South African unemployment rate was 35%. There is a lot of work to be covered by policy makers, government, businesses and unions in addressing the unemployment problem in South Africa.

With the unemployment picture so glaringly depressing, it is understandable why the major concern around the NMW is whether it will not make the unemployment situation worse. The opponents of the NMW argue that minimum wages usually reduce employment opportunities, and that the NMW often presents challenges to people who normally would find employment in small enterprises. This is because these workers output is not sufficient to the level of the required minimum wages, thus leaving low skilled workers in a situation where it is difficult for them to find employment. In a labour surplus economy like South Africa's, where there are large numbers of semi-skilled and unskilled workers, there can be no other option — at the low end of the market — but to allow economic forces to function unhindered (Temba, 2014). However, Issacs and Fine (2015) slate such thinking by arguing that there is no mechanical link between raising wages and employment, that wages are not the only factor that determines the level of employment. Rather, there may be factors such as investment, output and many others that are critical in understanding wages and employment. This is another reason why unemployment exists even when the wages are low.



Brazil and the USA are often cited as examples of countries in which a rise in the national minimum wage did not affect employment levels; however, Seekings & Natrass argue that it is misleading to compare these countries with South Africa. The reason is that Brazil and USA are low-unemployment economies, while South Africa has a very high unemployment rate (Seekings & Natrass, 2015); but this view has been discarded by proponents of the national minimum wage (such as Coleman 2012: 2014, Isaacs and Fine 2014, 2015) as unfounded and misdirected. Coleman (2014) argues that as an example, in 2006, more than 650 US economists said that increasing the minimum wage would significantly improve the lives of low-income workers and their families 'without the adverse effects that critics have claimed.' The UK Low Pay Commission said its research found no evidence that minimum wages harm the economy or jobs. Brazil saw the creation of 17-million formal-sector jobs from 2002-11 coincide with large real increases in minimum wages. More remarkably, Uruguay increased its minimum wage from \$100 in 2003 to \$500 during the same year and unemployment is now at historically low levels.

Similar findings were reported with sectoral wage determinants in South Africa. In their research on the impact of sectoral minimum wage laws in South Africa, Bhorat and Mayet (2013) concluded that minimum wages in four out of five affected sectors in South Africa have not had a negative effect on employment despite real wages having increased after the minimum wage date. However, it is important to note that there were cases of reduced working hours reported, and the agriculture sector experienced job losses. Whilst it is true that unemployment can exist even when wages are low, it is worth noting that the level at which minimum wages are set is crucial.

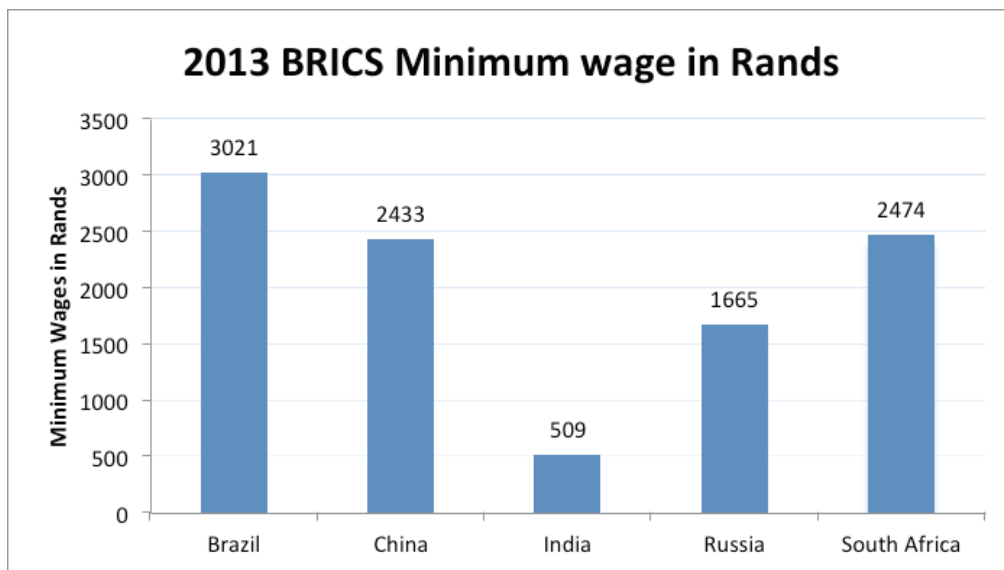
The general wage level in the country is an important aspect that needs to be taken into consideration when fixing minimum wages level. In Brazil, the consumer price index was taken into consideration when setting up a minimum wage level, but more importantly, the workers' needs which the minimum wage must satisfy are to be specified (ILO Global wage Report, 2014:124). Another important factor as per the ILO's *Global Wage Report 2008/09* is that most countries frequently set their minimum wages at between 35 per cent and 45 per cent of mean wages. It is on this basis that the ILO *Global Wage Report (2008/09: 47)* recommended that 40 per cent of a country's average wages represented a useful reference point when considering the level for the minimum wage. The ILO, however, also highlighted the need to extend the analysis beyond this rough approximate reference number.

Local business has reacted negatively towards using the 40% of country average wage as a reference point. For example, The Business Unity South Africa warned against using 40% of average wage, they argued that 40% would indicate the minimum wage should be set at around R8 087. Busa argued that the 40% model is not relevant to South Africa as it does not take into consideration the wage disparities in South Africa and is also distorted towards the wealthy and hence provides a skewed 'average wage'. Considering this, it is vital to note that a minimum wage that is not calculated properly can create huge problems in the economy as well as the society at large. This level would be too high even when compared with other countries in the world.

Currently, the average minimum wage (based on the average sectoral wage determinants) in South Africa is at R2 474, as per figure below. It is, therefore, clear that the 40% of average wage level (R8 087) model as a NMW level determinant will be too high even in comparison with the BRICS counterparts.

It is generally agreed that a minimum wage should amount to a living wage; however, what is not so easily agreed upon is how to measure and quantify a living wage. While it is largely recognised that a minimum living wage should provide workers and families with a decent standard of living, opinions differ on the specific quantities of goods and services needed to afford a decent living. The exact valuation of the needs with which a minimum wage would be equated is difficult to determine because of subjectivity in the determination of the composition of the basic basket, and whom to include in the definition of the family. The difficulty becomes even greater when putting a monetary value on the more abstract concepts such as a living wage (Cunningham, 2007:66). As an example, Stats SA reported that minimum living levels for a family of five in 2014 was R946 pp/pm, requiring the breadwinner to earn a minimum of R4, 730 to survive. And so, many

Figure 1: Brics minimum wages



Source: ILOSTAT Database 31/12/2013 (2013), US Dollar Exchange Rates for 31/12/2013 (2013)

supporters of the NMW argue that the minimum living levels should be used to benchmark the NMW level.

Furthermore, Stats SA reported that more than one-fifth of SA's total workforce lives in households which are not capable of meeting their basic minimum needs. In such cases, workers are often forced to turn to loan sharks to survive. This keeps them in a vicious circle of debt, and trapped in poverty. The plight facing these workers is often overlooked when discussing the unemployment problem in South Africa. Thus there is a need for an inclusive strategy of how the South African labour market works, and the need to understand how several factors of the economy can work together to improve the labour market.

Raising the minimum wage to the level of the living wage can be a tool that can address the wage gaps and help workers out of poverty. It is, therefore, understandable why workers in South Africa have received President Jacob Zuma's call for a NMW debate with fervent support, a sentiment endorsed by powerful labour unions including COSATU. The federation insists that it is crucial to set basic minimum and sustainable living standards through an array of key social wage interventions such as access to education, access to health care through NHSP, access to cheap reliable public transport and national retirement or saving schemes (Cosatu/Naledi, 2011). However, there has also been concerns that NMW may weaken the role of unions in collective bargaining. The concern is that NMW has a potential to come between the wage level agreements between employers and unions. But this can be avoided if the introduction of the NMW is decided by all social partners and connected to strengthening workers' power through collective bargaining.

This understanding is but one of the main issues highlighted by the ILO in the Convention 131; that countries must take their own socio-economic needs into consideration when setting up a minimum wage. For example, in Brazil the minimum wage was driven by the need to reduce poverty and inequality; hence it serves as a benchmark for social security benefits such as pensions, welfare, and unemployment insurance. It is, therefore, not shocking that the minimum wage had a positive effect on redistribution of most vulnerable groups in society. Berg (2009:3) argues that the increase of the minimum wage (between the years 1995 to 2005) accounted for 73% of the improvement in income distribution among workers with an income, and in terms of family income, the minimum wage was responsible for 64% of income distribution improvements, as measured by the Gini Index.

Countries that have had successful introduction of the minimum wage system have mostly incorporated the social and economic aspects in their wage policies. In South Africa, for instance, government can require employers to cover the transport costs of their employees. If transport is taken out of workers budget and monthly equation, it gives a bit of relieve and workers can have extra money to spend on other family expenses such as food and education. This would be particularly helpful to workers in the vulnerable sectors such as on the farms, in domestic work and in the security services.

## Conclusion

The current debate on the introduction of a national minimum wage has been divided between two different views. The first view is whether national minimum wages will not lead to job losses. On the other hand is the view

that raised national minimum wages will not lead to job losses but will improve economic well-being of vulnerable workers as well as affect other sectors positively. It is the view of this paper that other initiatives that ensure that various sectors in the economy are able to absorb low-skilled and middle-skilled labour are developed, and increased social welfare security should be part and parcel of the national minimum wage debate. And lastly, the

level at which the national minimum wage is set should be carefully determined based on the socio-economic conditions of South Africa. But more importantly, the level at which the national minimum wage is set should take into cognizance the minimum levels of living; and so employers should take some of the socio-economic needs of the workers as part of their responsibility.

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# What is the likelihood that the Labour Relations Amendment Act (6 of 2014) will increase permanent employment in the construction sector?

By Zolisa Bavuyise Mpange



The South African government introduced the Labour Relations Amendment Act (6 of 2014), which came into effect on 1 January 2015. The aim of this paper is to review the likelihood that the Amended Act will increase permanent employment in the construction sector of South Africa. First, an analysis of the changing nature of employment in the construction sector is done and the factors responsible for the change are explored. It is specifically highlighted that permanent employment in the sector has persistently been lower than non-permanent employment, predominately due to sub-contracting. In addition, the bulk of the construction workforce is now recruited on short-term contracts through sub-contractors. As a result, the sector has low rates of organised labour. Close scrutiny of the Amended Act reveals significant changes pertaining to the regulation of non-permanent employment in the sector. The Amended Act introduces a clause that stipulates that fixed-term or temporary employees must be employed permanently after three months of employment, unless the employer can justify the temporary nature of their employment. Although this clause is meant to increase permanent employment in the sector, the likelihood of its success is low because of the cyclical and project-based nature of the construction industry. Employers will continue to have a justifiable reason for not offering permanent employment under the Amended Act. This paper recommends that there be a clause in the Amended Act that limits the extent of sub-contracting to specialist services not covered by the main contractor.

## 1 Introduction

Outsourcing of labour through sub-contracting is now the predominant form of employment in the construction industry. This has rendered regulation of employment and the standard of employment more difficult. Various types of employment which differ from full-time protected regular wage and salary employment have emerged. Such employment can be temporary or short term. The umbrella term 'non-standard employment' is used to refer to such employment. There are more people in these kinds of non-standard work and more working with non-permanent contracts than in permanent employment. These changes in the labour market have been accompanied by a general decline in security of work in the sector.

This suggests that there are many advantages in sub-contracting from the employer's point of view. At individual firm level, they include a preference for increased flexibility

in staffing arrangements, a response to cyclical or project-related changes in staffing needs, and sub-contracting of labour to increase efficiencies (CIDB, 2013). However, the practice of sub-contracting is widely condemned on the grounds that it is exploitative; and has been criticised on the grounds that it poses a barrier to the unionisation of labour.

The terms under which construction workers are employed can affect the achievement of promotion of social and economic security. The need to adapt labour legislation in response to the increased scale of non-permanent workers was identified by the South African government and subsequently the Labour Relations Amendment Act (6 of 2014) was introduced.

This paper seeks to review the likelihood that the Amended Act will increase permanent employment in the construction sector of South Africa. The focus of the paper



is the analysis of the changing nature of employment in the construction sector and the factors responsible for the change. The paper is divided into five sections. In Section 2, selected literature is reviewed to get insight into the changing nature of employment in the construction sector, predominantly due to sub-contracting. The advantages offered by this particular labour system from the viewpoint of the employers are discussed. The third section focuses on problems associated with non-permanent employment on organised labour. The fourth section presents the response of the South African government to the increasing non-standard work through the Labour Relations Amendment Act. Next, the paper explores the likelihood that the Act will increase permanent employment in the construction sector. The concluding section summarises the arguments and highlights recommendations.

## **2 Nature of employment in the construction sector**

The construction sector is an important employer in South Africa, with approximately 1 438 000 people employed in the sector (Stats SA, 2016). The CIDB report of 2015 further states that the sector accounts for around 8% of total formal employment and around 17% of total informal

employment. In addition, permanent employment in the construction sector has persistently been lower than non-permanent employment predominately due to sub-contracting (CIDB, 2015).

Sub-contracting is very prevalent in the South African construction industry, with up to 80% of building and 30% of civil construction projects sub-contracted. The duration of typical sub-contracts in the building industry is between three and six months, with the civil sector industry having longer duration sub-contracts of about twelve months on average (CIDB, 2015). Construction workers may spend only a few weeks or months at any one project. Moreover, in the course of the year, workers may have several employers on short term employment, and there will be periods spent out of work.

Traditionally, construction companies employed all their labourers on permanent contracts (CIDB, 2015). With the flexible labour market, and cyclical and project-based nature of the construction industry, most construction companies now only retain core workforce and outsource their labour through sub-contractors. Indeed, the bulk of the construction workforce is now recruited through sub-contractors on short-term contracts as outsourcing of labour has become the norm.

## 2.1 Sub-contracting

According to the CIDB (2013), main contractors use sub-contracting as a business strategy to deal with uncertainties in the construction market and to transfer risks, such as financial risks, completion risks and responsibility for employees. An advantage of sub-contracting is that it reduces direct costs and overheads. Sub-contracting also allows main contractors to use more competitive local firms with their lower overhead costs and better knowledge of the local market conditions, practices and procedures. In addition, sub-contracting facilitates quality work through the use of specialist sub-contractors with the necessary knowledge and skills in specialised trades. In general, sub-contracting allows the main contractor to reduce operating costs and thereby enhance competitiveness. Overall, the main contractor remains liable to the party with whom it has contracted for the performance of all aspects of the contract. This includes the work performed by sub-contractors.

Sub-contracting offers an important area of opportunity for small businesses. A number of innovative business linkage programmes strongly advocate sub-contracting. This is specifically aimed at encouraging large corporations to expand their value chains to include local and, particularly, small businesses. Similarly, government tender requirements may stipulate that a portion of the contract value is sub-contracted to Black Economic Empowerment (BEE) contractors. Hereby, small businesses with specialised skills are able to access the supply chains of big businesses and create employment opportunities in the local area (Benjamin, 2010).

Another reason why sub-contracting of labour is prevalent in the construction sector is specific to construction and relates to the nature of the construction process, which has not changed over time. Sub-contracting offers main contractors flexibility in the recruitment of labour. It enables main contractors to get the labour they need, when they need it and pay for it only when it is needed. And because of fluctuating labour requirements, flexibility is particularly important in the construction sector. These stem partly from variations in total output, but it is important to note that neither construction products nor skills are homogeneous (ILO, 2001). Building construction, in particular, requires a variable mix of skills. Additional complications arise from the widespread use of the contracting system. Here, production is achieved through discrete contracts let to contractors through a process of competitive bidding. The labour requirements of any one contractor will change with the portfolio of projects, and contractors cannot plan for labour requirements ahead of bidding. The contractor is, therefore, not able to adapt the portfolio of projects to suit the skill mix of employees. Sub-contracting offers an easy way of adapting to the changing labour requirements.

Sub-contracting is now an integral part of the construction industry, especially in building construction where the production process is divided into numerous discrete activities. These tasks or activities may require specialised labour and it, therefore, often makes sense in technical and economic terms for main contractors to subcontract some tasks to independent, specialised sub-contractors.

Another benefit of sub-contracted labour in construction is that the responsibility of supervision can be delegated. This is important in an industry where supervision is a challenge because of the dispersed location of sites and the craft nature of the production process. Therefore, sub-contracting enables main contractors to both get the flexibility they need and pass the problem of labour control to the sub-contractor. Sub-contracting can, therefore, contribute substantially to reducing costs, even if all labour regulations are adhered to for the sub-contracted labour.

Sub-contracting has also been applied to minimise or avoid employer obligations under labour legislation and/or to lower wage bills and benefit entitlements. However, these temporary employees are left insecure and exposed to risk without the provision of benefits such as provident funds and medical aid cover, and increases the burden on the state of providing social and health protection (Benjamin, 2010). This opportunity is very appealing in construction, as in other sectors. This is particularly so in countries where the on-costs of labour are extremely high or where regulations are complex and therefore costly to implement. In these situations, there is a strong incentive to recruit labour through sub-contractors, who are more able or more willing to evade legislation. Therefore, there is evidence that sub-contracting is not only restricted to specialised tasks but is also used as a vehicle for exploitation of temporary workers.

## 3 Implications of non-permanent employment on organised labour

Outsourcing of labour through sub-contracting, which is now the norm in the construction industry of South Africa, has a profound effect on organised labour. Although it is possible for any group of workers to organise and make their voice heard, voice representation is generally more difficult for workers in temporary employment. In general, there is little evidence that temporary workers are members of trade unions, or have any other form of representation associations. Temporary employees do not see any long-term benefits in union affiliation. Worldwide, these workers are liable to temperamental employment, lower wages and more precarious working conditions. They rarely receive social benefits and are regularly denied the right to join a union. Even when they have the right to unionise, workers are apprehensive about joining a union if they know they are easily replaceable. There is general fragmentation, and large construction companies are



reporting an increase in the number of unions with which they have recognition agreements, despite declining union membership (CIDB, 2015). Unionisation levels are, however, very low in cyclical and project-based sectors.

Temporary workers without union representation have no bargaining power to negotiate for severance pay or different safeguards when dismissals occur. These workers face challenges in exercising their freedom of association rights and engaging in collective bargaining. This is because, in most cases, they are employed through outsourcing and are required to engage with the sub-contractor as their employer, rather than with the main contractor.

By definition, temporary employment means that there will be frequent changes in jobs. Most temporary contracts are for the duration of a project. As sub-contracting increases, such projects correspond to even smaller units of work, which means that most temporary contracts are now very short. In Spain, the average number of contracts per worker per year was almost eight in 1998 (Byrne & Van der Meer, 2000). With this rate of turnover, it is almost inevitable that there will be periods spent unemployed. The length and frequency of unemployment depend primarily on demand and supply in the labour market and, ultimately, on the state of the economy.

Representing workers and creating effective labour standards in areas where temporary employment is used widely have been major challenges for unions. Unions find it difficult to recruit temporary workers to union membership and retain them during periods of non-placement, while they are not earning money and cannot pay membership fees. It is difficult for unions to represent these workers and bargain on their behalf.

However, in South Africa, all employees have a right to join a union and participate in the union's lawful activities. Registered trade unions are able to obtain statutory organisational rights, provided they obtain sufficient representation among employees in a particular workplace. In the construction industry, trade union affiliation is important as the unions deal with issues such as wages, working hours, job allocations, terms of termination or redundancy as well as the provision of a safe working environment and personal protective clothing. Unfortunately, most temporary employees do not belong to a trade union and may be subjected to unsafe and unsecure employment practices.

Globally, there are unions representing construction workers, but the number of paid-up members has declined sharply in the past few decades (CIDB, 2015; Benjamin, 2010; ILO, 2001). This is attributed to an increase in the practice of employing labour through sub-contractors and a consequent decline in the proportion of the permanent labour force employed in large firms. In Kenya, for example, construction workers are represented by the Kenya Building, Construction, Timber, Furniture and Allied Industries Employees Union. In 2000, the union had 15,000 members from the construction division on its books, but official data show that paid-up membership was only 3,719 (Kenya, 2000). Union officials point to the Trade Union Act, which requires union members to have a contract of employment, as the cause of the problem, arguing that this disqualifies most construction workers who operate in the informal sector. However, although a change in the law may be appropriate, it seems unlikely that this is the real deterrent. The underlying reason for low union membership is undoubtedly the same factor prevailing elsewhere, namely the high turnover of temporary employment (ILO, 2001).

It may be concluded that in the construction sector, collective bargaining has been undermined and collective agreements, where they exist, are applied to a diminishing permanent workforce. Collective agreements have special significance in the construction industry because of the specific circumstances of construction, notably the high mobility of labour between employers. Collective bargaining provides a mechanism for the provision of socio-economic benefits. The increase in flexible working practices and the proliferation of sub-contracting that is occurring in the industry has intensified the need for collective action, while reducing the chances of achieving it. How unions respond to the challenges presented by the changing nature of employment will be decisive in determining their level of influence within the workplace in the coming years.

## 4 Legislative framework: Labour Relations Amendment Act (6 of 2014)

Against this background, the South African government introduced the Labour Relations Amendment Act (6 of 2014), which came into effect on 1 January 2015. The amendments reflect the government's determination to regulate more closely, though not ban, the use of the most common forms of non-standard employment. The main objective of the Amended Act is to regulate non-standard work in a way that recognises its legitimate role in a modern economy, but seeks to prevent it from being used as a vehicle for exploitation.

The Amended Act is expected to increase permanent employment of temporary workers who will become permanent employees as a result of the amendment. Hereby, the Act declares indefinite employment unless the employer can establish a justification for the use of temporary employment. Furthermore, the clause only applies to employees who are earning below Basic Conditions of Employment Act threshold to protect the most vulnerable workers against possible abuse of temporary appointments by employers. The intention here is that the amendment would not impact on the use of fixed-term contracts in respect of managerial and other senior employees.

Overall, the purpose of these additional provisions is to counter practices by employers, such as using a fixed-term contract when a position is not really temporary; similarly, to try out an employee and, if it does not work out, appoint someone else on the same basis upon expiry of the contract. Another example is where the employer prefers temporary employees simply because the cost of employment is less, mostly because of the lack of benefits.

### 4.1 Fixed-term employment

According to the Amended Act, a fixed-term contract of employment is entered for a temporary period. It terminates on:

- a) the occurrence of a specified event;
- b) the completion of a specified task or project; or
- c) a fixed date, other than normal or agreed retirement age.

The new provisions make it much less attractive and more difficult for employers to get away with using temporary employees where the position is not truly a temporary one. There are a number of risks for employers who make use of temporary employment. Some of these risks have always existed; however, specific statutory protection has now been added in respect of certain categories of employees. These additional provisions do not apply to:

- a) employees who earn above the Basic Conditions of Employment Act threshold, which is currently R205,433 per year;

b) an employer who employs less than 10 employees, or who employs less than 50 employees and whose business has been in operation for less than two years, unless:

- i) the employer conducts more than one business; or
  - ii) the business was formed by the division or dissolution for any reason of an existing business.
- c) an employee employed in terms of a fixed-term contract which is permitted by any statute, sectoral determination or collective agreement.

### 4.2 Fixed-term employment exceeding three months

The Amended Act introduces a clause that stipulates that fixed-term employees must be employed permanently after three months of employment, unless the employer can justify the temporary nature of their employment. An employer cannot circumvent this provision by using successive fixed-term contracts limited to three months each. It is not the current contract period but the total period of employment that must not exceed three months. An employer may hire an employee on a fixed-term contract or successive fixed-term contracts for longer than three months of employment only if:

- a) the nature of the work for which the employee is employed is of a limited or definite duration; or
- b) the employer can demonstrate any other justifiable reason for fixing the term of the contract.

The conclusion of a fixed-term contract will be justifiable if the employee:

- a) is replacing another employee who is temporarily absent from work;
- b) is employed on account of a temporary increase in the volume of work which is not expected to endure beyond 12 months;
- c) is a student or recent graduate who is employed for the purpose of being trained or gaining work experience in order to enter a job or profession;
- d) is employed to work exclusively on a specific project that has a limited or defined duration;
- e) is a non-citizen who has been granted a work permit for a defined period;
- f) is employed to perform seasonal work;
- g) is employed for the purpose of an official public works scheme or similar public job creation scheme;
- h) is employed in a position which is funded by an external source for a limited period; or
- i) has reached the normal or agreed retirement age applicable in the employer's business.

### 4.3 Treating fixed-term employees no less favourably than permanent employees

A temporary employee (even if the reason for the temporary status is justified) may, after three months' employment with the employer, not be treated less favourably than a permanent employee performing the same or similar work, unless there is a justifiable reason



for different treatment. This provision started applying from 1 April 2015 to fixed-term contracts concluded prior to the commencement of the Amendment Act on 1 January 2015. A justifiable reason includes when the different treatment is a result of the application of a system that takes into account:

- a) seniority, experience or length of service;
- b) merit;
- c) the quality or quantity of work performed; or
- d) any other criteria of a similar nature, and such reason is not prohibited by Section 6(1) of the Employment Equity (these refer to human rights-type grounds such as race, gender, religion, etc.).

#### **4.4 Other relevant provisions relating to fixed-term employment**

Since the commencement of the Amended Act, an employer must provide an employee employed in terms of a fixed-term contract and an employee employed on a permanent basis with equal access to opportunities to apply for vacancies. The contract of a temporary employee must be in writing, must specify the reason why the appointment is only temporary and must contain the employee's agreement to the temporary appointment and the agreed duration. If the contract needs to be extended, a full new contract should be signed in the same way, instead of simply giving an extension letter. It is also recommended that the employer sit down with the employee whenever a fixed-term contract might be renewed to discuss all these issues before the new contract is signed. This may also clear up any issues around future expectations on the part of the employee. Lastly, a temporary employee who is employed for longer than 24 months on a specific project will be entitled to severance pay of at least one week's remuneration for each completed year of service.

#### **4.5 Likelihood of permanent employment increase in the construction sector**

The Amended Act declares permanent work after three months of employment for temporary employees earning below Basic Conditions of Employment Act threshold set by the Minister of Labour. It also states that an employer who wishes to engage these employees on a fixed-term contract longer than three months has to demonstrate a justification for doing so. The purpose of this clause is to prevent the use of a fixed-term contract as a basis for depriving employees who are engaged in work for indefinite duration. Although this clause is meant to increase permanent employment in the sector, the likelihood of its success in doing so is low because of the cyclical and project-based nature of the construction sector. This explains the widespread use of sub-contracting as a mechanism to provide flexibility and responsiveness to changing labour force requirements, particularly on project work. Therefore, employers in the construction sector will continue to have a justifiable reason for not offering permanent employment under the Amended Act.

For this reason, the majority of construction workers will not be affected by the Amended Act. Workers will continue to move from place to place as the work moves around, and move from contractor to contractor, depending on who bids successfully for work. They will still be subjected to unstable and insecure non-permanent employment.

### **5 Conclusion and recommendation**

The paper reviewed the likelihood that the Amended Act will increase permanent employment in the construction sector of South Africa. It analysed the changing nature of employment in the construction sector, and factors responsible for the change were explored from the perspective of the employer and the employee. It has shown that the likelihood is low that the Amended Act will increase permanent employment in the construction industry of South Africa. The case for the use of sub-contracted labour in construction is simply too compelling. Some limited return to permanent employment is possible, but it is not imminent or expected to be extensive. However, evidence was provided to prove that sub-contracting is not only restricted to specialist tasks but is also used as a vehicle for exploitation of temporary workers. This paper recommends that there be a clause in the Amended Act that limits the extent of sub-contracting to specialist services not covered by the main contractor. This is a call for a change in the law with clear implications for the productive structure and employment practices of the industry.

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