Youth Unemployment in South Africa and the Wage Subsidy 'Debate'

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By any conventional standard, unemployment in South Africa – and especially youth unemployment – is extreme. As measured by the employment ratio – the proportion of the working-age population with jobs – South Africa ranks far below other emerging markets, including its 'BRICS' partners. Whereas gainful employment absorbs 71% of the working-age population in China, 65% in Brazil, 57% in Russia and 55% in India, in South Africa it is 40.8%. The average ratio across 19 'emerging markets' is 56%. Among the 'youth' (15-24 year-olds), South Africa's employment ratio is 12.5% – only one in eight – compared with an emerging-market average of 36%.[1]

A second measure is the participation rate – the proportion of the population, including those not currently in employment but actively looking for or wanting to work, who regard themselves as part of the labour force. While South Africa's adult (over-25s) participation rate is on par with the emerging-market average of 67%, its youth participation rate of 24.4% compares very poorly with the emerging-market average of 42%. In short, three out of every four 15-24 year-olds do not currently regard themselves as part of the labour force.

These facts are reflected in the country's exceptionally high rates of unemployment. Even on the narrower definition, which excludes 'discouraged' workers[2], the total unemployment rate is currently around 25% of the labour force. On the more inclusive definition, it is close to 40%. Youth unemployment rates are significantly higher: even on the narrower definition, 35% for those aged 15-34, and 49% for 20-24 year-olds. Under-35s account for over 70% of total unemployment.[3]

Political failure

Employment represents the primary source of income for the overwhelming majority of the population. Gainful employment is also crucial to most people's sense of dignity, self-esteem, independence and social usefulness. Employment ('labour') is also an essential complement to capital for the production of all goods and services. The scale of South Africa's job-creation failure thus reflects a tragic loss of potential not only at the individual/household level, but – on account of the foregone contribution to national output and welfare – also at the wider societal level. The sheer magnitude of the wastage cries out for urgent attention and the adoption of appropriate remedies.

Given the evident social and political (as well as economic) dangers attendant upon marginalisation of the country's youth, much policy discussion in South Africa over recent years has indeed been devoted to the possibilities of at least stemming the growth of – if not actually reversing the tide towards – youth unemployment. However, although the issue has clearly risen much higher up the (rhetorical) political agenda, there is still no sign – in terms of practical policies – that government is seized with the urgency of the challenge.

This failure at the political level is not a recent phenomenon. Admittedly, unemployment in South Africa – as elsewhere in the world – has been exacerbated by the post-2008 global economic slowdown, with young people disproportionately affected: while overall employment fell by 6.4% between December 2008 and December 2010, employment of 18 to 24 year-olds fell by over 20 per cent.[4] However, the underlying causes of unemployment in South Africa, both youth and adult, are essentially structural and endemic, rather than merely cyclical, in nature. Consequently, profound policy-generated reforms directed at removing (or at least mitigating) the structural obstacles to employment creation are a prerequisite for fundamental resolution of the problem.

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Moreover, the policy failure has persisted – and worsened – over successive decades since the 1960s, with the economy showing itself increasingly unable to create enough new jobs to absorb even the new annual entrants to the labour force, let alone reduce pre-existing unemployment levels.[5] Indeed, the 1980s ushered in a period of sustained job destruction rather than job creation – a trend that has continued into the post-apartheid era. Consequently, total non-agricultural private formal sector employment is still 1.4 million below its 1980 level, and the total (narrowly defined) unemployment rate has now exceeded 20% for more than 15 years.

Sources of unemployment

The structural causes of unemployment are manifold and complex. It is common cause that the key obstacle on the supply-side is the general lack of skills within the workforce – itself largely the consequence of the deliberate exclusion of black people from the educational system and from skilled occupations under apartheid, and of failed educational and skills-training policies in the post-apartheid period. Although billions of rands of public funds have been poured into the educational and skills-development systems since 1994, it is still far from clear that these have significantly alleviated the underlying constraint: the great majority of new labour-force entrants still lack appropriate work-place skills and attitudes. Indeed, potential employers regard many of them as simply 'unemployable'. Even if current educational policies prove to be more appropriate, it will take at least two decades for them to bear fruit as the next generation of children makes its way through the system.

What of the demand side? Self-evidently, the pace of job creation has been regularly – and increasingly – far outstripped by the annual numbers of school-leavers (mostly 18 year-olds) looking to enter the labour market. Currently some 1.1 million young South Africans enter the labour market each year. Ordinarily, this annual accretion of human capital resources should represent a major national economic opportunity, providing a pool of talent from which to fuel economic growth and development. However, on average, only around 200,000 new formal-sector jobs are generated annually, with a further 100,000 or so existing jobs falling vacant through retirements. Consequently, some 800,000 youngsters in each annual cohort are currently destined to join the ranks of the unemployed, informally employed or welfare dependents. Moreover, South Africa's population is very young and getting younger: more than 40% are in the 15-34 years age cohort, which is also the fastest-growing group: 1.27% per year, compared with 1.12% for the total population. The problem is therefore set to worsen further for the foreseeable future.

Given the scale and complexity of South Africa's unemployment problem, and especially of youth unemployment, no single or easy policy solution exists. Stimulating faster growth in general, and employment creation in particular, requires the determined adoption of a broad package of long-term measures to address and resolve both the supply-side and demand-side constraints.

Again it is common cause that this yawning gap would be narrowed if the economy were to grow faster than it has done. Given South Africa's abundant resources, the potential for economic dynamism has always been present. However, despite repeated efforts – often seemingly more rhetorical than practical – on the government's part to accelerate economic growth to a sustainable 6% - 7% annual rate, the country's long-term annual growth rate has remained stubbornly around 3.5% since the transition to democracy.[6] This rate – again well below that exhibited by other emerging-market economies around the world – reflects the persistent post-1994 failure to raise the domestic savings rate above 14%-16% of GDP and to attract sufficient foreign direct investment to raise the fixed-capital investment rate decisively above 20% of GDP.[7]

Limited policy responses

Given the scale and complexity of South Africa's unemployment problem, and especially of youth unemployment, no single or easy policy solution exists. Stimulating faster growth in general, and employment creation in particular, requires the determined adoption of a broad package of long-term measures to address and resolve both the supply-side and demand-side constraints. These must include not only rectification of the deficiencies of the education and skills-development systems, but also the adoption of more business-friendly economic policies to restructure the economy, reform the general investment climate, and increase the incentives for private enterprises – which ultimately constitute the primary source of new jobs – to hire more labour. Indeed, as the World Bank's latest annual World Development Report reminds us, the private sector remains the source of almost nine out of every ten jobs in the world.[8] However, despite the growing rhetoric of reform, the government has repeatedly demonstrated an unwillingness or inability to embrace such policies in earnest.

Meanwhile, in the absence of faster private-sector-driven growth, the government's instincts have turned increasingly to more state-directed interventions. These have included the promotion of infrastructure developments, which certainly absorb some additional labour, especially during the construction phase, though few such jobs prove to be 'permanent'. Beyond this, there has been the inevitable recourse to public-sector hiring, both long-term through the continued expansion of the civil service, and shorter-term through 'public works' programmes. However, these interventions have arguably been targeted more at promoting further socio-economic 'transformation' than at large-scale job creation. Moreover, expansion of the public sector on this scale is not a sustainable long-term solution: by 2011, with over two million employees – some 24% of the total of around 8.3 million formal non-agricultural jobs – the public sector already accounted for about one-fifth more employees than mining and manufacturing combined.[9]

Role of real wages

From an economic perspective, aside from the low overall growth rate and the low investment rate, it is wage rates – especially the levels and growth rates of real wages (wage rates adjusted for the effects of inflation) – that lie at the immediate heart of the job creation issue. Whatever the broad parameters of economic activity, the relationship between the productivity of labour and its real cost is crucial in determining the willingness of private firms to hire additional workers.

In this respect, economic theories posit – and empirical evidence in most countries broadly supports – the existence of a strong positive relationship between growth in real wages and labour productivity, though the direction of causation can go either way.

Standard models predict that, other things being equal, higher output per worker (labour productivity) will increase the demand for workers and, hence, real wages.

Some models suggest that higher real wages lead to increased worker effort (and hence higher productivity).

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A recent working paper published by the International Monetary Fund (IMF) set out to examine the reasons for the high levels of job shedding in South Africa in 2008-2010.[10] Written by Nir Klein, the paper confirmed that a long-term link between real wages and labour productivity is also evident in South Africa. However, based on comparative evidence from other emerging-market economies, the link appears exceptionally weak. Although there are a number of caveats, the weakness of this link suggests that real-wage growth in South Africa is driven much less by productivity levels than by "other factors which delink it from labor market conditions".[11] The paper also found that, in the short run, real-wage growth in South Africa can persistently and substantially outpace labour-productivity growth, even when economic growth slows down and labour market conditions are 'soft'[12]. In particular, despite the large number of redundancies during the 2008-2010 slowdown – which the study deemed "disproportionate to the output path" – "the real wage continued to increase rapidly, outpacing the growth of labor productivity".[13]

Against this background, the paper's main finding was that the 'excess real wage' – the extent to which real-wage growth exceeds labour-productivity growth – played "an important role in suppressing job creation" during the crisis period[14], possibly accounting for as much as 25% of job losses[15]. This gap also appears to be positively correlated with growth in informal employment. Taken together with the job losses, this suggests that the excess real wage generates some substitution between formal and informal workers, thus contributing to the unemployment problem.

Klein's paper does not formally investigate these 'other' factors – whether structural or policy-related – that have been driving the growth in real wages. However, he notes that, among others, they might include entry restrictions, employment protection legislation and the collective bargaining framework. Indeed, in his view, the last-mentioned factor was a principal cause of the "misalignment" between real wages and labour productivity.[16] In essence, Klein's analysis suggests that, at least in relation to its productivity, the cost of labour in South Africa is 'too high' and that this fact contributes to the slow pace of job creation.

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This implication was underlined earlier this year when the trade union UASA published its annual Employment Report. Compiled on UASA's behalf by prominent economist Mike Schussler, the report argued that unskilled and, to a lesser extent, semi-skilled workers in South Africa earn "too much" in both absolute and relative terms, and that they are becoming progressively more expensive.[17] In consequence, unskilled workers have become "unaffordable" to private sector employers, especially in manufacturing. In short, the unskilled unemployed, who dominate the ranks of the unemployed and who are also overwhelmingly young, have been priced out of the market. Schussler claims that this fact, more than any other, explains why total non-agricultural private formal sector employment is still so far below its 1980 level, and why more people in South Africa are now forced to rely on welfare rather than employment for their income[18].

Tackling youth unemployment

Governments have the power to 'create' more public sector jobs merely through the allocation of additional funding. However, they cannot – at least not without generating potentially severe adverse consequences – force private enterprises to employ significantly more people, especially if firms find the hiring of additional labour 'too expensive' (for whatever reason). In the longer term, resolution of the youth unemployment problem requires the meeting of two preconditions: on the supply side, the reduction – if not the elimination – of the gap between real wages and productivity by improving the quality of the potential labour force through education and training, so that young people seeking work will have the skills and attributes that meet firms' requirements; and, on the demand side, providing the incentives for profitable private-sector job creation on a significantly larger scale.

In the shorter term, a menu of other demand-side and supply-side policy options exists for motivating limited increases in recruitments of unemployed people, especially the young unemployed. Some of these involve subsidies that reduce employers' effective wage costs; others involve grants to work-seekers, intended to enhance their employability and/or reduce their job-search costs. These forms of assistance can be very general, or they can be fairly narrowly or closely targeted to specific groups or sub-groups of the young unemployed, for example, those with the highest educational qualifications. Alternatively, they can be used to promote the growth of particular sectors or industries. Such policies have been implemented in a number of countries around the world, including in other emerging economies such as Turkey, Chile and Colombia.[19]

Intuitively, where alleviation of general youth unemployment is the objective, and the (too high) cost of such labour is the obstacle, interventions that directly lower firm's hiring costs are likely to be most effective, at least in the short-to-medium term. However, in any country, the claim that national workers, especially unskilled workers, are paid 'too much' – or even just more relative to their counterparts in other countries – would be politically controversial. South Africa is no exception. As might be expected, such claims are aggressively resisted by the Confederation of South African Trade Unions (COSATU) – to which, it should be noted, UASA is not affiliated. COSATU also rejects any suggestion that further real-wage growth needs to be constrained in the interests of job creation. This opposition matters politically since COSATU is an influential member of the governing ANC-led tripartite alliance. Nowhere have these facts been more evident and more relevant than in the debate about the Treasury's proposal to undertake a (limited) programme of subsidisation of entry-level wages for young unemployed job-seekers.

Treasury proposal

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In February 2011, the South African Treasury published a substantial and wide-ranging discussion document on the policy options for confronting youth unemployment.[20] At the same time, President Jacob Zuma announced the government's intention to introduce a temporary youth employment subsidy with effect from April 2012. Subsequently, in its 2011-12 budget, the Treasury – which had consulted international experience and evidence about alternative forms of subsidy and their implementation – allocated R5 billion (600 million dollars) towards a three-year proposal to enable a number of young people to obtain credible work experience while reducing the risk to employers of taking on youngsters of unknown productivity. The scheme proposed that employers paying the full minimum wage to new hires aged 18 to 29 should be able to reclaim 50% of the cost in the first year and 20% in the second year.

The Treasury estimated that, over the three-year period, the subsidy would create a net 178,000 new jobs, at a cost-per-job of R28,000 – significantly more cost-effective than the current public works programmes. Importantly, the document made no claim that these jobs would be permanent. On the contrary, it explicitly recognised that – like those jobs 'created' by public works programmes – they would likely be temporary. The document also acknowledged that there would be hidden costs. In particular, since the subsidy would accrue to employers for all new minimum-wage-level hirings of 18-29 year-olds, it would unavoidably also cover those new hires that would have been made in the absence of the subsidy. Indeed, the Treasury's estimate was that a total of 423,000 jobs would qualify for the subsidy. This 'deadweight loss' (as the phenomenon is technically known) was included in the Treasury's cost estimates.

The document also recognised that any policy of this nature inevitably would carry risks, including possibilities of abuse by the employer beneficiaries. For example, some employers may take advantage of a subsidy by using it to displace older and more costly employees with young subsidised workers. There would be no obligation on employers to extend the jobs beyond the two-year period of subsidisation. There was also no obligation on employers to provide the new employees with any substantial or specific on-the-job training beyond the subsidised work-experience period itself, but the subsidised workers would otherwise enjoy standard conditions of employment. Moreover, the imposition of the three-year time limit for implementation was intended to avoid the potential danger of creating a 'two-tier' labour market that would effectively lower average real wages. In short, the

objective was simply to lift a limited but non-trivial number of young persons out of unemployment for a limited period of time, and this was a modest proposal directed at temporarily alleviating a major socio-economic blight, pending the implementation of more substantive longer-term measures.

Political responses

The proposal garnered impressively wide support from both national and international organisations, the former including the government's own National Planning Commission, the National Youth Development Agency, the main business bodies (including the Black Business Council and Business Unity South Africa), and FEDUSA (the second largest national trade union association, to which UASA is federated).

Fears abounded that the government was indeed intent on creating a two-tier labour market.

However, the scheme was fiercely – indeed wildly – opposed from the outset, not only by COSATU but also by other left-leaning organisations, including the Young Communist League, the ANC Youth League and the Democratic Left Front. The level of hyperbole and vitriol was exceptionally high: COSATU argued that the subsidy would "entrench slavery", and all the opponents viewed it as potentially harmful to worker interests and advantageous only to business profits.[21] Fears abounded that the government was indeed intent on creating a two-tier labour market. This opposition was instrumental in stalling the passage of the proposal through the multi-stakeholder National Economic Development and Labour Council (NEDLAC), despite the passing of the intended April 2012 implementation date.

Opposition to the measure attained worryingly new levels of fury when the main national opposition party, the Democratic Alliance (DA), which controls the Western Cape province, began to implement its own youth-wage subsidy in a pilot project. A breakdown of public order was threatened in May this year, when the DA legitimately – albeit controversially – organised a pro-subsidy march to COSATU's Johannesburg headquarters, provoking a disproportionate and brutally violent response from COSATU members.

Prospects for nationwide implementation of the Treasury scheme were further dimmed in June when President Zuma, whose recent comments had remained strongly supportive of the scheme, endorsed an alternative – but as yet unspecified – COSATU proposal for a 'job-seeker's grant' at the opening of the ANC's five-yearly policy conference. The virtual abandonment of the wage subsidy was subsequently confirmed by conference decision. The implication is that no substantive policy will emerge at least until the ANC's forthcoming electoral conference in December – and possibly much later.

It is also noteworthy that one of the main reasons why COSATU opposes the subsidy is that it "does not contribute in addressing the underlying causes of the youth unemployment problem".

COSATU rejoinder

It was not until late June this year – 16 months after the publication of the Treasury proposal – that COSATU sought to engage in reasoned and rational discussion of the issue. In a substantial, but anonymously authored, document circulated by its national spokesperson, Patrick Craven, COSATU has sought to discredit the Treasury's analysis, and particularly its reading of the international evidence regarding youth wage subsidy programmes.[22] The document claims that the literature referred to by the Treasury "does not support" the use of such subsidies and that "they (Treasury) have not carefully read the literature, and neither have they bothered to analyse the strict, extremely limited and more often than not irrelevant, conditions under which wage subsidies appeared to have had extremely small positive results, at huge cost to the public purse".[23]

COSATU's belated recourse to reasoned discussion of an issue that warrants serious contemplation, rather than virulent abuse, is to be welcomed. However, whether its interpretation of the evidence is more valid than the Treasury's is arguable, and should be subject to further independent scrutiny, especially since it is not apparent that the Treasury was invoking 'extremely large' – as opposed to 'extremely small' – positive results. Moreover, several of the criticisms made by COSATU of the effects of a wage subsidy were clearly taken on board in the Treasury document, albeit possibly to a lesser extent. It is also noteworthy that one of the main reasons why COSATU opposes the subsidy is that it "does not contribute in addressing the underlying causes of the youth unemployment problem".[24] However, this is decidedly not a claim that the Treasury document makes.

It is further noteworthy that COSATU's own – solitary – policy proposal is to use "the National Skills Development Strategy III as a point of departure, by calling for expansion of the FET (Further Education and Training) sector to accept 1 million learners per annum by 2014, compared to the current 400 000 per annum. This will in turn reduce the youth labour force, by extending their stay in the education and training system, so that they acquire basic and high-level cognitive skills".[25] This is an interesting proposal, worthy of further discussion, though whether it is practically feasible and financially affordable also requires further discussion. However, it only addresses the supply-side problem, and not the demand-side policy requirement.

Conclusion.

Barring (further) policy reversals, and despite COSATU's belated engagement with the issue, recent political developments have probably now ruled out the implementation of any wage-subsidy scheme for alleviating youth unemployment. In any event, such a scheme could only be one – relatively short-term – component of a multi-pronged approach to unemployment. Sadly, however, the ANC-led government currently shows no inclination to confront either the political or the implementation risks inherent in the adoption of any coherent policies – either short- or long-term – that might effectively begin to address the problem.

NOTES

1 See National Treasury Discussion Paper, "Confronting Youth Unemployment: Policy Options for South Africa", Pretoria, February 2011, Fig 1. Youth employment ratios are typically lower than adult ratios, because many in the age group are still in full-time education.
2 The 'discouraged' unemployed are those who would prefer to be in employment, but have given up on their job searches because they believe the search to be futile.
3 See National Treasury, op cit, Section 3.
4 ibid, p 9.
5 See, for example, Charles Feinstein, An Economic History of South Africa, Cambridge University Press, Cambridge 2005, Fig 10.4; and Jill Nattrass, The South African Economy: Its Growth and Change, 2nd edn, Oxford University Press, Cape Town, 1988, pp 56-7.
6 There have been four major government-led economic initiatives in the post-apartheid period: the Reconstruction and Development Programme (RDP, 1994); the Growth, Employment and Redistribution Programme (GEAR, 1996); the Accelerated and Shared Growth Initiative for South Africa (ASGISA, 2006; and the New Growth Path (NGP, 2010). None has yet succeeded in raising the sustainable annual growth rate above its historic level.
7 See South African Reserve Bank (SARB), Quarterly Bulletin, September 2012, Table S-150.
8 [..]
9 Estimated from SARB, op cit, Table S-132.
10 Nir Klein, "Real Wage, Labor Productivity, and Employment Trends in South Africa: A Closer Look", Working Paper WP/12/92, IMF African Department, April 2012.
11 Klein, op cit, p 20.
12 ibid, p 4.
13 ibid.
14 ibid, p 20.
15 ibid, p 5
16 ibid, p 4. Interestingly, the large number of redundancies during the crisis period arguably raises some questions about the frequent claim from South African businesses that the restrictions on firing workers contribute to the reluctance to hire them. However, the claim is probably more valid for small rather than for large businesses, the latter being better able to afford high redundancy costs.
17 Schussler, 2012 UASA South African Employment Report Can South Africa afford itself?
18 [..]
19 A summary of the measures undertaken in 13 countries, and of their outcomes, is provided in the National Treasury document, op cit, Table 2
20 National Treasury, op cit.
21 See for example, "South African youth wage subsidy a false solution"
Democratic Left Front press statement, 9-11 June 2012, accessed online at http://pambazuka.org/en/category/features/82929 on 14 October, 2012; COSATU https://groups.google.com/forum/#!msg/cosatu-press/lvzNDc3j4lQ/n8KfebFl1a4J
22 "The Youth Wage Subsidy in South Africa: Response of the Congress of South African Trade Unions", accessed at https://groups.google.com/forum/#!msg/cosatu-press/lvzNDc3j4lQ/n8KfebFl1a4J on 14 October 2012
23 P 18
24 p 24
25 ibid