

Youth unemployment in South Africa: causes and counter-measures

South Africa is currently struggling with large unemployment amongst the youth. The National Development Plan has identified a number of policy interventions to improve youth employment. In your view, what are the causes of youth unemployment and what should government do to improve the levels of youth employment? Identify the pros and cons of each of your proposals.

Word count: **2200 words**
(incl. footnotes, excl. headings, references, & in-text references)

1. Introduction

Unemployment is arguably the single most significant obstacle to poverty reduction in South Africa (Ligthelm, 2006:30). The incidence of unemployment falls most harshly on young South Africans, who are generally low-skilled and have little to no experience of formal employment (National Treasury, 2011:12). It is exceedingly difficult for one of these unemployed young people to exit unemployment, and it is expected that a significant number of today's unemployed youth will never achieve formal sector employment (National Planning Commission, 2012:106). The National Development Plan (NDP) (National Planning Commission, 2012) seeks to address this significant issue by suggesting a number of policies which may reduce youth unemployment. This paper will argue that one of the NDP's more controversial policies, that of a youth wage subsidy, is a worthwhile policy and should be implemented, but with a regulated dismissal period. It will also argue that the government should encourage the growth of the South African informal sector. Section 2 describes the nature of unemployment in South Africa, and section 3 goes on to analyse the causes of youth unemployment. Section 4.1 offers a broad approach within which unemployment-reduction policies should be theorised, and will then briefly outline the two most significant unemployment-reducing processes, education and economic growth, before explaining how intermediary policies are needed while these two processes develop. In section 4.2 the youth wage subsidy will be introduced and analysed, and the modified version put forward. The paper will end by discussing the role that South Africa's currently stunted informal sector could play in reducing youth unemployment.

2. Characterising unemployment in South Africa

The South African labour market is characterised by significantly high levels of unemployment compared to other emerging-market economies (National Planning Commission, 2011:12-13). The South African labour force makes up just 0.5% of the global labour force, but accounts for 2% of the world's unemployment (National Treasury, 2011:13). The local labour-force participation rate of 56.5% is significantly lower than the rates of comparable countries (National Planning Commission, 2011:13), and the labour absorption rate of the formal economy has steadily declined since 1985 (Ligthelm, 2006:37), as Table 1 shows.

However these broad pictures of unemployment do not reflect the sectional differentiation evident in the South African labour market. In particular, while the employment of non-

youths in South Africa is low compared to comparable emerging-market levels (8 percentage points lower), youth employment in South Africa is much lower still (24 percentage points lower), with further investigation emphasising this divergence (National Treasury, 2011:12). Less than 17% of people over age 30 are unemployed in South Africa, compared to 42% for people younger than 30 (National Treasury, 2011:5). Figure 1 illustrates that the incidence of unemployment falls largely on young people. Unemployed youth in South Africa are generally low-skilled and have little experience of employment, with two thirds of young people having never worked (National Treasury, 2011:5).

Youth unemployment is a particularly serious issue in South Africa because the country is experiencing a youth bulge (National Planning Commission, 2012:98), which presents opportunities for growth if young people are meaningfully employed (McKinsey Global Institute, 2010:3), and the potential for serious social instability if they are not (National Planning Commission, 2012:106). More generally there are a plethora of reasons as to why unemployment is a negative phenomenon, from simple welfare effects, to output effects and other social consequences (Yu, 2012b:13).

3. The causes of youth unemployment

Up until 1994, numerous market distortions were caused by the industrial and social policies of the Apartheid government, with the effects of these distortions remaining evident in South Africa today. Import Substitution Industrialisation induced an uncompetitive, capital-intensive economy, from which the majority of South Africans were excluded due to racial spatial policy and other measures (National Planning Commission, 2011:5). The relevant legacies of the Apartheid economy upon democratisation were uncompetitive primary and secondary industries which have consistently shed jobs since 1994¹ (National Planning Commission, 2011:13), and an unskilled, spatially misaligned labour force, with the majority of South Africans having been denied quality education (National Planning Commission, 2012:110, 114). South African economic growth has occurred largely in skills-intensive sectors, such as the financial and business services sector (Hausmann, 2008). It is generally accepted that the primary cause for South Africa's widespread unemployment today is a structural mismatch between the skills the modern South African economy demands, and the skills it supplies (Hausmann, 2008) (National Planning Commission, 2011:15), with the ratio

¹ 2004 mining employment was 29% lower than 1994 levels; 2004 agricultural employment was 12.1% lower, and manufacturing sector employment declined 11.2% (National Planning Commission, 2011:9)

of skilled to unskilled employment having changed from 35:65 between 1970 and 1975, to 53:46 between 2000 and 2002 (Ligthelm, 2005:42). The shortage of suitable jobs has been compounded by significant increases in labour force growth since 1994 (Hausmann, 2008).

As already described, South African youth are low-skilled, and the skills mismatch that applies to the broader South African economy applies particularly to them. The principal reason given by employers for their low youth employment is that with schooling not accurately indicating skill levels (National Treasury, 2011:16), unskilled inexperienced workers are seen as risky to employ, thus increasing their real cost (National Treasury, 2011:5-6). The causes of South African youth unemployment then, are a combination of deficient demand for labour, due to the increasingly skills-intensive orientation of the South African economy, and substandard supply, caused by the emergence of risky low-skilled youth.

4.1 Approaching remedies: broad focus

Godfrey (2003:1) proposes an analytical framework which sorts unemployment-reducing policy interventions into being either preventative or curative. Preventative measures are those which aim to address the causes of a problem, whereas curative measures address symptoms, and he argues that preventative solutions are generally superior (Godfrey, 2003:1). With the principal cause of youth unemployment being a structural mismatch of skills, it follows that preventative measures would aim to address this.

In looking to address the fundamental issue of unskilled, deficient labour supply, the key preventative reform is instituting higher quality, more widely accessible education (National Treasury, 2011:19). This has been recognised by the National Planning Commission (2012:70-71) and the South African Government, with a number of policies having been formulated (National Treasury, 2011:9) and more than 20% of national expenditure being allocated towards education, including R23 billion towards infrastructure development (Gordhan, 2013:25, 33). However a number of issues in education remain unresolved, and a long-term reduction of youth unemployment requires that they be better addressed (Equal Education, 2013).

The second preventative development required is rapid and sustained inclusive economic growth, which would address deficiencies in the demand for young low-skilled labour. Sustained inclusive growth between 2003 and 2008 created in excess of 2 million jobs, and

lowered the strict unemployment rate from 27.1% to 21.9% (National Treasury, 2011:10). The employment growth of this period was higher than in most other emerging economies and was highly labour-absorbing (National Treasury, 2011:18), as can be seen in Figure 2. The importance of growth for employment was emphasised in a negative fashion after the 2008 global recession, which resulted in the loss of 1 million South African jobs and disproportionately affected young people (National Planning Commission, 2011:6).

It is important to note that while the above two preventative measures do address the underlying causes of youth unemployment, the realisation of their aims will occur only in the long-run. There is therefore a need for policy which will address at least the symptoms of youth unemployment in the short-term (Levinsohn, 2007:22). These curative measures, called active labour market policies (ALMPs), aim to quickly improve the employability of the youth and increase demand for labour (National Treasury, 2011:19-20). The ALMP this paper focuses on is the youth wage subsidy as proposed by the National Treasury (2011) and the Democratic Alliance (2012).²

4.2 Narrow focus: youth wage subsidy

The youth wage subsidy suggested by the National Treasury (2011:7) is a tax rebate awarded to employers when they employ low-skilled workers between the ages of 18 and 29 who earn below the income tax threshold. The maximum value of the rebate per worker per year is R12 000, and it will be available for a maximum of two years, with a number of factors determining the size of the grant in specific cases (Yu, 2012b:11).

The purpose of the subsidy is to boost labour demand, and in doing so increase employment (National Treasury, 2011:24). The mechanism through which this occurs is by reducing the cost of employing a young person, and therefore mitigating the financial risk associated with hiring inexperienced low-skilled youth (Yu, 2012b:12). This reduces the gap between the cost of employing a worker and that worker's productivity, while leaving wages unaffected (Yu, 2012b:12). In addition to achieving short-term employment, it is hoped that young people will develop on-the-job skills, and will be productive enough by the end of the subsidised period to retain employment, or find unsubsidised employment elsewhere (National Treasury, 2011:10). Even in the absence of significant human capital development, young workers will likely be more employable after subsidised employment, as an unemployed young person in

² In the absence of space constraints other ALMPs deserve attention, such as training programmes, entrepreneurship schemes, job-matching initiatives and public sector employment creation.

South Africa is three times more likely to find work if they have prior work experience (National Treasury, 2011:7). The National Treasury (2011:7) estimates that its proposed subsidy would result in a net increase of 178 000 jobs at a cost of R28 000 per job.

However youth wage subsidies may be associated with a number of negative effects. Deadweight loss occurs when a subsidy is paid for a worker who would have found that employment without subsidisation (Yu, 2012b:13), and must be included in the total cost when evaluating the cost per new job.

Substitution effects³ are a commonly objected to aspect of wage subsidies. In South Africa substitution effects are minimised via strict labour laws and because young inexperienced workers are not suitable substitutes for productive older workers (National Treasury, 2011). However COSATU (2012) argues that increasing labour casualisation and the expansion of labour brokers works in the opposite direction, increasing to some extent the probability of labour substitution taking place.

Because costs associated with dismissing workers are relatively high in South Africa, writers such as Levinsohn (2007:11) argue that they limit employment by increasing risk for employers, and consequently decreasing demand for labour. In order to mitigate this effect, Hausmann (2008) argues that the first 10 weeks of subsidised employment should be a probationary period, during which subsidised employees can be fired without reasons being given. In defence of the above proposal, Levinsohn (2011:13) argues that the potential for harmful destructive churning⁴ is mitigated by training costs and increased worker productivity which comes with experience.

Puerto (2007:8-9) finds clear empirical evidence which suggests that wage subsidies have better than average efficacy in increasing employment compared to other ALMPs, and that ALMPs generally are particularly effective in developing countries. This finding is supported by Davies and Thurlow (2010:453-454), who determine that youth subsidies are effective at increasing youth employment probabilities. This pattern is emphasised by evidence of wage subsidy programs increasing employment in Australia, Denmark and Turkey (National Treasury, 2011:31-32). COSATU (2012) provides an example in Poland of

³ These occur when already-employed non-subsidised workers are fired so employers can hire subsidised workers and extract the subsidy rent (Yu, 2012b:13).

⁴ The process whereby employers keep subsidised employees only for the duration of the dismissal period and then fire them for other subsidised workers, so as to extract subsidy rents without committing to sustained employment (Yu, 2012b:14).

subsidies decreasing long-term employment prospects, but this appears in context to be the exception rather than the rule.

It seems clear that youth wage subsidies are effective and useful labour market interventions. They are not a panacea for youth unemployment, but address its symptoms relatively successfully, though on a small scale. This paper would adjust the National Treasury's proposal by instituting a probationary dismissal period as suggested by Hausmann, in order to increase the subsidy's employment effect. This would be complemented with a requirement that firms report their dismissals of subsidised workers to the subsidising authority, with firms found to be abusing the dismissal period being penalised.

4.3 Narrow focus: the potential of informal markets

Apart from ALMPs, this paper argues that there is another space in which to expand youth employment. Because of South Africa's significant formal sector unemployment, it is expected that the country would have a relatively large informal sector (Yu, 2012a:158). However, the opposite is true, and as Table 2 shows, the South African informal sector is exceptionally small relative to other developing countries (Kingdon & Knight, 2003:391).

An informal sector has significant capacity to absorb employment, and is traditionally seen as an alternative to limited opportunities available in the formal sector (Wellings & Sutcliffe, 1984:520). In addition, it is generally more labour intensive than the formal sector, and low-skilled people without experience of formal employment make up a significant part of the informal working population (Kingdon & Knight, 2003:403). It has been empirically shown that people are better off working in the informal economy than they are when unemployed (Ligthelm, 2006:45), and Fasanya & Onakoya (2012) find that informal market activities have had a positive impact on employment generation in Nigeria.

It is important to recognise that informal employment is not ideal, and is a poor substitute for formal sector jobs (Aliber, 2003:487). However it is an improvement upon unemployment, and for young unemployed South Africans it can serve in the short-term. Recent moves by national government to increase informal sector regulation through the Licencing of Businesses Bill seem ill-advised, as they are likely to increase the costs of informal traders and further stunt the sector (SAITA, 2013). Significant potential can be unlocked if restrictive regulations are removed (Yu, 2012a:158), and this low-cost, high-potential area deserves greater development.

5. Concluding remarks

It is clear that South Africa faces a serious problem of very high unemployment amongst young people. It has been shown that this is primarily due to the structure of the South African economy, which is moving towards becoming more skills-intensive while a significant number of its participants have little to no hard skills. It was argued that ultimately remedies for these structural difficulties are in education development and inclusive economic growth, but it was realised that these are long-term solutions, and more immediately appreciable policies are required. From here the paper recommended a youth wage subsidy with a regulated dismissal period, and then proposed that government should stimulate growth in South Africa's informal markets, which have significant employment absorption potential.

6. Tables and figures

TABLE 1: Labour absorption rate of formal economy, 1980 – 2005

Year	People of working age (15-64 years) ('000)	Formal employment ('000)	Labour absorption rate of the formal sector (%)
1980	16 254	7 429	45,7
1981	16 774	7 585	45,2
1982	17 324	7 736	44,7
1983	17 889	7 876	44,0
1984	18 467	8 011	43,4
1985	19 060	8 140	42,7
1986	19 648	8 255	42,0
1987	20 233	8 340	41,2
1988	20 822	8 382	40,3
1989	21 423	8 373	39,4
1990	22 044	8 317	39,1
1991	22 667	8 222	36,3
1992	23 295	8 106	34,8
1993	23 931	7 992	33,4
1994	24 574	7 906	32,2
1995	25 225	7 867	31,2
1996	25 865	7 878	30,9
1997	26 479	7 920	29,9
1998	27 064	7 968	29,4
1999	27 630	8 007	29,0
2000	28 156	8 041	28,6
2001	28 628	8 078	28,2
2002	29 036	8 123	28,0
2003	29 388	8 076	27,8
2004	29 653	8 234	27,8
2005	29 892	8 294	27,7

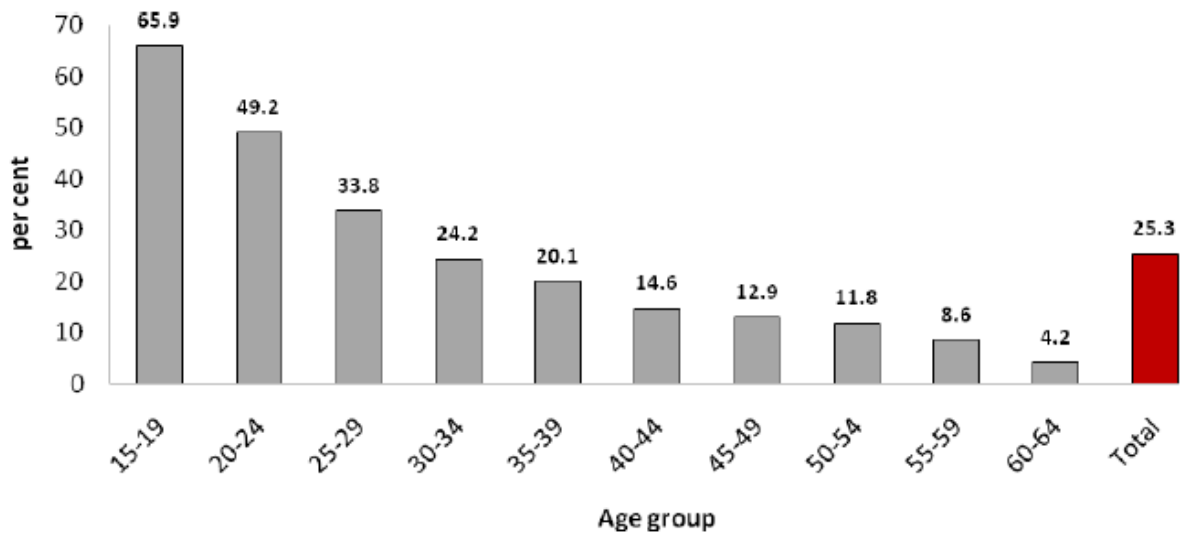
Source: Ligthelm, 2006: 38.

TABLE 2: Comparative unemployment and informal employment rates

	Urban unemployment rate	Employment rate in the informal sector ^d	Ratio of informal sector employment to unemployment
South Africa	29.3	18.9	0.7
Other sub-Saharan Africa	16.0	74.8	4.7
Benin	10.1	92.8	
Burkina Faso	–	77.0	
Chad	–	74.2	
Guinea	12.3	71.9	
Kenya	16.2	71.6	
Mali	9.9	78.6	
Mauritania	31.6	75.3	
Mozambique	–	73.5	
Zambia	–	58.3	
Latin America ^{b,c}	8.1	56.9	7.0
Argentina	18.8	53.3	
Bolivia	3.6	63.6	
Brazil	4.6	57.6	
Colombia	9.0	55.5	
Ecuador	6.9	53.5	
Mexico	6.3	59.4	
Paraguay	5.6	65.5	
Venezuela	10.3	46.9	
Asia ^b	5.3	63.0	11.9
India	–	73.7	
Indonesia	7.2	77.9	
Pakistan	6.1	64.6	
Philippines	7.4	66.9	
Thailand	0.4	51.4	
Iran	–	43.5	

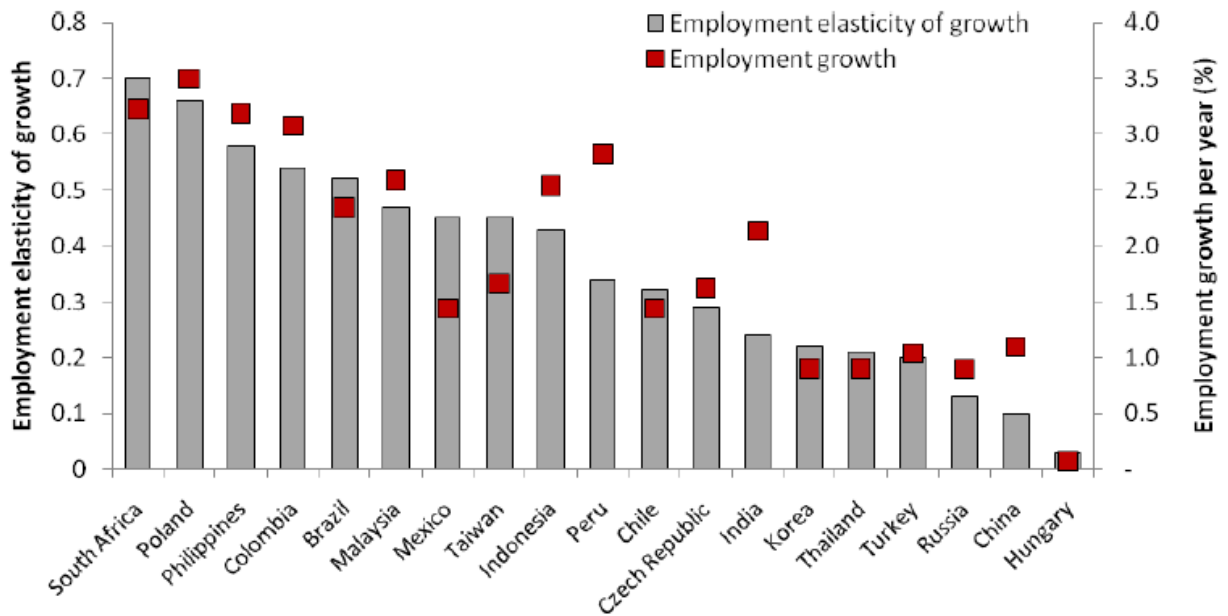
Source: Kingdon & Knight, 2003: 392.

FIGURE 1: Distribution of unemployment by age group



Source: National Treasury, 2011: 13.

FIGURE 2: Employment growth and the employment elasticity of growth, 2004 – 2008



Source: National Treasury, 2011: 18.

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