François Groepe: South Africa's structural unemployment challenge – the most important issues to be addressed to place South Africa on a sustainable growth path in an effort to reduce unemployment levels

Address by Mr François Groepe, Deputy Governor of the South African Reserve Bank, on the occasion of the release of the 14th UASA South African Employment Report, Johannesburg, 30 April 2015.

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Chairperson, ladies and gentlemen, I am pleased to be part of the proceedings of the day, as we gather here for the release of the 14th UASA Employment Report. This publication has grown in stature over the years and has earned itself a place amongst various high-level publications informing on the state of the South African labour market.

This morning, I shall focus on the most important issues to be addressed to place South Africa on a sustainable growth path in an effort to, amongst others reduce the unemployment levels.

South Africa counts, among its key challenges, its high level of structural unemployment which is exacerbated by the levels of poverty and inequality in the country. These challenges, in turn, give rise to a host of other socio-economic and socio-political challenges.

Earlier policies, such as the Accelerated and Shared Growth Initiative (ASGISA) (2006), as well as the more recent long-term vision for South Africa, as captured in the National Development Plan first released in 2012, highlight the requirement for economic growth in excess of 5 per cent on a sustained basis to meaningfully make inroads towards reducing the high levels of unemployment. Prior to the global financial crisis in 2008/09, some progress had been made in reducing overall levels of unemployment in the country as strong global and local economic growth resulted in higher levels of output leading to increased demand for labour. South Africa, in fact, had experienced one of its longest periods of uninterrupted economic growth – 55 quarters of growth averaging between 3 and 5,6 per cent annually. As the global economic growth recovered after the financial crisis, albeit hesitantly and unevenly, South Africa lagged behind, growing at rates well below its potential, which had been negatively been impacted by strained relations and industrial action, but also by structural deficiencies such as the electricity load shedding.

While South Africa has performed well in managing to largely contain inflation, within the inflation target range, and no doubt assisted in part by the lower international food and oil prices, the country has been less successful in matching levels of growth as experienced in other developing countries. Within the BRICS partnership, South Africa is the smallest economy in terms of its gross domestic product and population size and had both the lowest levels of average growth and employment over the past decade. Of some concern is the fact that South Africa continues to experience levels of inequality that are ranked amongst the most elevated in the world. All these indicators require a renewed focus on both the basic drivers of development, such as education enhancement and interventions that directly address structural barriers to growth and employment.

Broadly speaking, any effective solution should not only focus on stimulating growth in key industries, but those industries that are lagging should actively be engaged through appropriate policies. Such policies should improve the micro-foundations of economic growth, which include education and skills training, industrial and trade policy, labour market policies and competition policy.

Along these lines the National Development Plan (NDP) has as its central focus the elimination of unemployment, poverty and inequality by 2030. Within this Plan, nine main challenges are being highlighted, namely:

- The elevated levels of unemployment;
- The standard of education, which for a large proportion of learners is arguably of an undesirable quality;
- Infrastructure, which is not always optimally located, and which at times is under-maintained and insufficient to foster higher growth rates;
- Spatial patterns which exclude the poor from the benefits of development;
- An economy is that could be described as overly and unsustainably resource intensive;
- A widespread disease burden that is compounded by the challenges faced by the public health system;
- Public services that are uneven and often of in certain circumstances of inadequate quality;
- The corruption levels that is perceived to be wide spread; and
- The perception that exist regarding the divisions within the broader society.

The NDP provides a useful framework by which these issues can be addressed in a systematic and structured manner as government actively pursues its implementation. The challenge remains the alignment of medium-term and short-term planning by government in its efforts to effectively implement the NDP. The adoption by cabinet of the Medium Term Strategic Framework for 2014 to 2019 for each outcome of the NDP is clear evidence of the government's commitment towards the successful implementation of the NDP.

The key pillars of the Medium Term Strategic Framework comprise the following:

- Infrastructure programmes must lead to a crowding in of productive investment as government spending boosts the demand for goods, leading to increased private demand for new output sources, such as factories;
- Growth and employment of the productive sectors of our economy should be supported;
- Red tape and the unintended consequences of regulation should be reduced;
- Skills planning, to address the needs of the economy, should be improved;
- The level of employment in agriculture should be increased;
- Growth and investment should be supported by sustainable fiscal policies;
- Strong partnerships, with business and labour, should be built and workplace conflict should be reduced;
- Public Employment Programmes should be scaled up;
- Economic opportunities for historically excluded and vulnerable groups should be expanded; and
- Investment in research, development and innovation should be supported.

Returning now to the NDP, as part of a broader development agenda, business investment is being identified as a cornerstone to create 11-million jobs and eliminate poverty in South Africa by 2030. It sets a target of reducing the unemployment rate from its current level of 25 per cent to 14 per cent in 2020 and to 6 per cent in 2030 and to increase the labour force participation rate from 54 per cent to 65 per cent. Per capita income is also envisaged to increase from around R50 000 to around R120 000 per year.

The NDP suggests that some labour regulations be relaxed in an effort to encourage business enterprises to employ more easily, as well as lower entry-level wages to facilitate a higher uptake of young people in the jobs market. Some of the proposals in this Plan will no doubt fall within the area of public discourse on possible contestation and will require continued intense negotiations among all social partners in an effort to reach broad consensus in order to secure its implementation.

The Plan takes a pragmatic and broad-based approach to the challenges that South Africa faces in eradicating unemployment. The role that the Plan sees for government's intervention is permeated with a willingness to work with the private sector, as the plan leans towards less regulation of the economy. The Plan envisages small and expanding companies creating around 90 per cent of the new employment opportunities in the economy in the next 20 years. This will place South Africa in step with global employment trends. Small firms would benefit from bold proposals to drastically reduce so-called "red tape" and improve employment and practices and procedures.

The NDP strives towards an economy that will be more enabling for business entry and expansion, with a focus on credit and market access. Cognisance is taken of the fact that any inclusive growth strategy that does not harness the creativity, innovation and competitiveness of the private sector is unlikely to succeed. Regulatory reform and support being advocated by the Plan has the intention to boost mass entrepreneurship.

The topic of strained labour relations is also addressed, indicating that it is inconceivable, that the economy will evolve into a more labour-intensive structure if tensions between employers and labour persist. Ways need to be found to reduce the probability of the occurrence of lengthy strikes, such as those experienced during last year. These tensions need to be dealt with in a transparent and honest manner and not only by amending labour legislation, in order to be conducive of enhanced labour absorbing growth. As the social partners, re-establish trust among themselves, it will go some way towards the process of reinforcing their social pact.

Central to the propositions made in the NDP related to the jobs market, is the statement that over a 20-year horizon wage growth needs to be linked to productivity growth as it is not feasible to sustain a labour absorbing path, unless both are growing in tandem.

In an effort to enhance the labour absorption rate of the economy, the Plan has already led to a reduction in the initial cost of employing young labour-market entrants, through the implementation of the Employment Tax Incentive, Act no 26 of 2013 which came into effect on 1 January 2014. This initiative compliments government's measures to create jobs for young workers and those in special economic zones through offering tax incentives to employers to encourage the employment of these workers. This initiative, according to the Minister of Finance, had led to 200 000 young people being employed, which is significantly in excess of government's initial expectation of 70 000 within six months of implementation.

Furthermore, newly introduced changes to labour legislation, in general, hold the promise of improving the functioning of the labour market, as it better addresses discrimination, and advances the approach of equal pay for work of equal value. These changes will not only benefit young people, but will result in a more equitable labour relations environment in general.

Over and above the focus on the jobs market, the NDP also advances some frank recommendations in areas such as education, health and the public sector, as part of the creation of a nurturing and enabling environment for business to prosper. A set of integrated actions is being proposed to address the issue of inefficiency and other challenges related to public service delivery. To improve educational outcomes, the Plan directly confronts issues, such as teacher performance, appointment procedures and accountability. The challenges in public health management are also addressed and in building a capable state, detailed recommendations are made on professionalising the public service. Some areas of Government, where improvements have occurred, such as the South African Revenue

Service through an improvement in operational procedures, management and delivery systems should be emulated by other organs of state.

An initiative worth mentioning in terms of already improved processes in the public sector is the introduction of an e-portal on 1 April 2015 that will reshape the South African government supply chain processes, particularly as it relates to government tenders. It is envisaged that the public will eventually be able to see all tenders, bidders and their prices quoted, as well as minutes of bid committee meetings. Over and above the e-portal, a national database of all approved and compliant suppliers and an "online shop", where government departments will place orders of less than R500 000, will be established. Initiatives such as these are laudable and will contribute towards increased efficiencies in service delivery which is essential for improved growth prospects.

The focus within the NDP on the eradication of corruption from the system is most welcome, in taking cognisance of the fact that for state officials to act in a corrupt fashion, requires a willing counter party from the private sector is necessary. The introduction of the government's new tender process, as already mentioned, will go a long way in exposing and limiting possible corruption within the system.

The NDP recognises the need for increased fixed investment in the economy and has set a target of raising the level of gross fixed capital formation from around 20 per cent of GDP currently, to as high as 30 per cent by 2030. Inarguably, well-planned and appropriate infrastructural development is conducive to higher levels of economic growth and job creation. The NDP clearly distinguishes between investment that generates immediate financial returns, such as in airports and power stations and those projects where financial returns are far less measurable, such as in schools and hospitals. The role of business in increasing the overall level of fixed investment in the country will most appropriately lie in the area of fixed investment where financial returns are more evident, through public private partnerships. International experience has shown that private sector participation in infrastructure provision is most successful in the transport and energy sectors. The participation of the private sector contributes to effective cost containment through the profit motive, improves efficiency and leads to more sustainable jobs through more ambitious skills transfer initiatives.

An area, in which the private sector can excel, given appropriate incentives, is that of research and development which could act as a driver of competitiveness and job creation. A number of large R&D projects have already shown feasibility and have the ability to develop into new industries, creating substantial opportunities for increased employment, foreign revenue income, beneficiation and competitiveness.

Many infrastructure investment projects can act as an attractive asset class for private investors, due to the predictable nature of returns, thereby providing a low risk investment profile. Infrastructure investment projects may provide a means whereby a consistent real return over inflation can be attained through a low volatility investment vehicle. Private sector funding is, however, subject to policy certainty so that private investors can be assured that they will be able to realise a return on their investments.

The NDP proposes that Regulatory Impact Assessments be done on all new regulations, and that an expert panel be appointed to prepare a comprehensive regulatory review for small- and medium-sized firms in an effort to assess whether special conditions are required for such entities. To this end, a new unit is being created in the Presidency to carry out thorough impact assessments of both new and existing legislation and regulations within a Social Economic Impact Assessment System that will ensure alignment with the NDP and reduce the risk of unintended consequences.

The continued drive towards the establishment of a viable renewable energy sector in South Africa should be supported and is an example of an area in which small businesses could rapidly gain traction, as countries become more inclined to embrace a Green Growth development approach, as we enter the so-called Solar Age.

The proper implementation of the NDP will be conducive to an increased level of entrepreneurship in the economy, as the ease of doing business improves. The obvious outcome of such a process will be the creation of more sustainable jobs. Small businesses generally have the capacity to attract those who are low to moderately skilled and are, therefore, best placed to recruit from among the significant pool of unemployed workers.

The NDP is already facilitating the bringing together of various stakeholders in the economy within an environment of common purpose. The NDP thus constitutes a powerful and integrated development agenda for the state and the whole of South Africa, and for the Plan to succeed it should continuously be translated into action plans, with clear milestone along the way, within realistic time frames.

To yield relatively swift results, in terms of improved growth, the following two focus areas deserve mentioning. The first is a better integration of the South African economy with that of Africa. This will indeed be beneficial through boosting interregional trade, investment and capital flows, and allow the domestic economy to tap into the more vibrant growth rates being experienced in the rest of sub-Saharan Africa. It is estimated that an effective integration with the sub-continent could add as much as 1,5 per cent to South Africa's growth rate. Furthermore, South Africa should capitalise on its comparative advantages, related to physical, financial and telecommunication infrastructure to attract international firms with the aspiration to gain a foothold in Africa.

A study, recently conducted by the World Bank, identified three areas of opportunity to improve this country's export competitiveness, namely, boosting local competition by opening South African markets to domestic and foreign entry; promoting deeper regional integration in goods and services within Africa; and alleviating infrastructure bottlenecks.

This brings us to the second factor which would meaningfully enhance South Africa's growth potential, namely the forceful implementation of the R1 trillion infrastructure expenditure programme of government. Through multiplier effects, and in terms of job creation, especially with regard to the promotion of low-skilled jobs, economic growth can be materially enhanced. Several studies have shown that investment in economic infrastructure has the potential to act as one of the most effective policies in terms of promoting economic growth. Employment is created during the construction phase of such infrastructure projects, as well as during the operational life thereof.

Moreover, the key driver of private sector investment is public sector investment as it inspires both business and consumer confidence. A combination of these two driving forces has the potential to easily boost South Africa's growth to rates well in excess of current levels, putting this country on a higher road to economic prosperity, thus hopefully reducing unemployment levels, poverty levels and the degree of inequality. I further believe that it will positively contribute to further restore the dignity of our fellow South Africans.

South Africans at times can tend to be fairly pessimistic. The challenges we face are immense, but not dissimilar in scale and extent to those faced not only by developing economies but also developed economies. I however choose to be optimistic and do believe that we have many factors that do count in our favour and am convinced that with the right policy choices we can go a long way towards successfully addressing the triple challenges of structural unemployment, poverty and inequality.

I thank you.