Southern African Catholic Bishops' Conference
PARLIAMENTARY LIAISON OFFICE

Briefing Paper 316

February 2013

Encouraging employment through incentives: The case of a youth wage subsidy

1. Introduction

Joblessness among South Africa's young people aged between 15 and 34 is chronic and structural. The statistics tell it all: in 2011 almost three quarters (72%) of South Africa's unemployed were younger than 34.

In 2010 President Jacob Zuma proposed a subsidy to firms to employ young people. In the 2011 budget speech Finance Minister Pravin Gordhan announced a youth wage subsidy in Parliament and set aside R5 billion for its implementation. Yet since then, the final implementation of the youth wage subsidy has been delayed and labour, business and government have been trying to thrash out their differences in the National Economic Development and Labour Council (Nedlac).

This paper will examine the youth wage subsidy proposal and how it would be implemented in South Africa. It will also briefly review the criticism levelled against the subsidy.

2. The Nuts and Bolts

During his budget speech in 2011, Minister Gordhan announced a range of measures government would undertake to tackle the high unemployment rate – especially unemployment among the youth. One of these measures was an incentive scheme for firms called the 'youth wage subsidy' ('the subsidy'), which was to be implemented by April 2012. The rationale for a subsidy was to make the hiring of unemployed youth cheaper for businesses which would not ordinarily have hired unemployed youngsters. The subsidy would be administered by the South African Revenue Services (SARS) in a similar way to pay-as-you-earn tax (PAYE). Those businesses which wanted to claim the subsidy must be formally registered with SARS, be registered on the PAYE and Unemployment Insurance Fund (UIF) systems, and have their tax affairs in order.[1]

All South African citizens between the ages of 18 and 29 would qualify if they were unemployed and then hired into a new job. In the first year government would subsidise 50% of the wage if the wage earned was less than R24 000 per annum, decreasing to 20% in the second year. The percentage of the subsidy would decrease progressively, reaching zero at the personal income tax threshold of R60 000. The subsidy would also have been made available to businesses already employing workers aged between 18 and 24. These workers would have been eligible for a subsidy for one year, at 20% of their wage if earning R24 000 or less, and tapering to zero at the personal income tax threshold.[2]

According to the National Treasury[3] estimates, the programme would have subsidised 423 000 workers (at a cost of R5 billion to the fiscus), including 178 000 jobs that would not have been be created without the subsidy. It was further estimated that some 45 000 workers would drop out of the labour force after having benefited from the programme, so the net result would be 133 000 more people employed by 2015, when the programme would end. Furthermore, the National Treasury argued that each of these new jobs would cost approximately R37 000.[4] Other estimates differed (according to Standard Bank, the cost per job would have been R27 900), but there was broad agreement that the subsidy would be far more cost-effective than any other government job creation initiative[5].

The youth wage subsidy was, however, not implemented in 2012 due to opposition from Cosatu, which cited a number of contentious points (see below). The implementation of the subsidy was stymied as the negations between labour, government and business failed to find solutions at the National Economic Development and Labour Council (Nedlac). It seemed that government would not go ahead with the subsidy after the Economic Development Minister, Ebrahim Patel, brokered a youth employment accord at Nedlac which excluded a wage subsidy. However, during his 2013 budget speech, Minister Pravin Gordhan, announced that 'a revised youth employment incentive will be tabled in the House [by July], together with a proposed employment incentive for special economic zones'. According to the Minister, the revised employment incentive has taken cognisance of the contentious points made by labour at Nedlac.

The revised version of the wage subsidy will now be referred to as a 'youth employment tax incentive' and it will retain many of the principles of the original wage subsidy. The final details of the incentive scheme are still not finalised, but it will operate through the tax system (as originally planned), with employers of qualifying employees paying less in payroll tax. The tax deduction would be up to 50% in the first year and 20% of the wage in the second[6]. An employer would be allowed to claim back an amount of up R1000 a month for every salary paid to targeted workers. The new youth employment tax incentive will also allow employers with operations in special economic zones[7] to claim the incentive for new hires of any age.

3. The Case Against a Wage Subsidy

Implementing a wage subsidy is not without associated costs – or negative spin-offs. The first of these is the so-called 'deadweight cost', i.e. firms would have hired the now-subsidised workers anyway. Thus, the full amount of the subsidy is 'wasted' and becomes merely a transfer from government to business.[8] The second cost is associated with substitution – existing workers may be replaced by subsidised workers. Business may also feel more encouraged to employ younger subsidised workers instead of older non-subsidised workers. Thirdly, the subsidy could lead to a situation where businesses with access to cheaper subsidised labour could potentially displace business that do not have access to cheaper labour, thus resulting in job losses and unfair competition. The fourth cost is associated with stigmatisation. It is argued that business may interpret a subsidised worker as having certain characteristics that make them less desirable. It has been shown that where the subsidies have been applied to targeted marginalised groups, such subsidies have been less than successful. Lastly, another potential negative spin-off could arise because the subsidy may distort the way people approach employment opportunities. For example, a subsidised worker may believe that he or she only has a chance of employment if it is subsidised; and youngsters may decide to leave school earlier, believing that a subsidy will ensure them employment.

There are, however, some strong counter-arguments to these objections. For instance, if the subsidy is administered through the tax system, it should be easy for the authorities to identify companies who are dismissing older workers in order to take advantage of the subsidy. It is questionable to what extent there would be unfair competition, as firms competing against each other would presumably have more or less similar labour requirements, and would thus benefit equally from the scheme.

As for the stigma, and the idea that young people may be induced to leave school early, a proper education and awareness campaign ought to address these concerns.

4. International and Local Examples

Wage subsidies are not new – a number of countries have implemented some form of a subsidy. According to the National Treasury, countries such as Singapore, Chile, Australia, Turkey and Argentina have had some success with implementing wage subsidies to stem the tide of unemployment. Singapore, for example, implemented a Job Credit scheme in 2009. The scheme paid up to 12% of a worker's wage. Unemployment statistics during the period of the scheme improved slightly, which potentially meant that the scheme was working.[9] Similarly, a targeted wage subsidy introduced in 2009 in Chile had some success. The subsidy was paid to low wage workers under 25 whose families were among the poorest 40% in the country. The subsidy covered 20% of the wage, with a third of the subsidy paid directly to the employer and the other two thirds to the employee.

While these examples have been cited as positive case studies (by the Treasury and other proponents of a youth wage subsidy), those against such a subsidy have used the very same countries to point out that the subsidies did not in fact impact significantly on the unemployment rate. For example, Cosatu, in its response to the Treasury's document, argued that the Argentinean example was not a full-scale programme but a rather limited experiment conducted in two major towns.

Locally, the Western Cape provincial government piloted a version of a wage subsidy in 2009, called the Work and Skills Programme. The programme is aimed at providing unemployed youth, aged 18 to 35, who have a Matric or equivalent qualification, with a six-month work experience. The provincial government provides a stipend of R1 200 over a period of six months, and the employer is encouraged to top up the stipend. During her State of the Province address, Premier Helen Zille claimed that the programme has since its inception created 2 810 job opportunities, with 60% of participants offered permanent jobs once they have completed the programme[10].

The scope of this paper is too limited to examine all of the arguments cited by the Treasury and other supporters of the subsidy, and the counter arguments cited by Cosatu and others. Suffice it say that South Africa will not be the first country to implement such a subsidy – wage subsidies are often employed (together with other initiatives) to address chronic unemployment – and if the scheme proves unworkable here then it can simply be halted, with little harm done. On the other hand, to reject the idea in principle without giving it a chance to prove itself would be a great pity.

5. Conclusion

Any scheme, under any name, which seems likely to make a dent in the youth unemployment figures must be welcomed. Both the proponents and the opponents of a youth wage subsidy have made good points, and it is now the task of government to make its decision work. A long way is still ahead and it will only be fair to judge what impact the incentive scheme has had on unemployment after it has been in place for a year or two.

Kenny Pasensie
Researcher

[1] Labour Market Navigator (2012): *Waiting for a youth wage subsidy*. http://prophet.co.za/Documents/Labour_Market_Navigator_2012Q2.pdf
[2] *ibid*
[3] National Treasury (2011): *Confronting youth unemployment: Policy options for South Africa.* National Treasury Discussion Paper
[4] Centre for Enterprise Development (2011): *Jobs for young people: Is the Wage Subsidy a good idea?* http://www.cde.org.za
[5] Nomvuyo Guma (2011): *Youth Wage Subsidy programme – what can we expect?* Standard Bank Economic Strategy. South Africa: Viewpoint. 12 April 2011.
[6] Carol Paton & Natasha Marrian (2013): *Youth wage subsidy, with incentives, gets green light*. Business Day Online, 28 February 2013. www.bdlive.co.za
[7] Special Economic Zones or SEZs were introduced by the Department of Trade and Industry in 2012 through its draft Policy & Bill on Special Economic Zones. The policy would allow provinces and municipalities to encourage investment and job creations by offering tax breaks and other incentives.
[8] *ibid*
[9] Labour Market Navigator
[10] Bekezela Phakati (2013): *Zille says successful Western Cape work and skills programme will continue*. Business Day Online, 22 February 2013. www.bdlive.co.za