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The impact of youth employment incentives and wage subsidies: results of a trial run

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The Employment Incentive Tax Bill offers tax subsidies to firms to employ new young workers. An evaluation of the impact of a wage subsidy voucher indicates that employment incentives increase the likelihood of young job-seekers being employed; they also increase the time young people remain employed. There is no evidence of older or existing workers being replaced. Such incentives are a relatively cheap and effective way to create employment, but are unlikely to create large numbers of jobs for young people.

Introduction

A wage subsidy for newly-employed young people is now in a bill before Parliament. The idea was first proposed in 2010 and has been controversial since the beginning, being vehemently opposed by some groups, notably COSATU. While the latter cites fears, such as the replacement of older workers by subsidised younger ones, much of the debate about the policy has been very ideological. As a result, sensible discussion of the potential impact of the policy has often become lost. Meanwhile, youth unemployment (broadly defined) continues to hover around 50% – and above 60% for young Africans.

Following several years of inaction, in October 2013 the Minister of Finance submitted the Employment Incentive Tax Bill to Parliament for consideration. This bill casts the scheme in the form of tax incentives (rather than direct wage subsidies) to encourage firms to hire young workers. Its submission provides an opportunity to reflect on lessons from international and South African research on policies of this nature – in particular, a South African empirical trial to test the likely impact in the workplace.

Many existing subsidies discourage the hiring of low-skilled workers in SA

South Africa has many, often hidden, subsidies which discourage the hiring of low-skilled labour by making substitutes for low-skilled labour relatively cheaper. Expenditure on capital (buildings, machinery, high-tech equipment, etc.) is subsidised by allowances for rapid depreciation as well as government-backed lending by institutions such as the Industrial Development Corporation and the Development Bank of South Africa. Electricity is subsidised (via lower prices) for a number of big firms. Research and development also receive beneficial tax treatment and soft funding from government. Amongst the employed, it is the more skilled workers who are generally favoured by government programmes: for example, subsidies are provided for learnerships (which generally require a prior level of skill or education); government also subsidises universities.

Whilst none of these policies is inherently bad, they all make some factors of production (capital, skilled labour, technology) relatively cheaper – and these factors often are substitutes for low-skilled labour. Thus these policies provide incentives to firms to change their input mix towards the subsidised factors of production – and *away* from low- and unskilled labour. The question is: why subsidise the use of these other factors of production rather than low-skilled labour when a key challenge for the South African economy is to create jobs for low-skilled people?[1]

The impact of subsidies on employment: international experience is varied

Active labour-market policies, of which a subsidy to labour is one, are common in both developed and developing countries. This type of subsidy include tax breaks to firms for creating employment, mandated social security contributions paid by government on behalf of firms, or government payments to companies for hiring. They are often temporary, such as the subsidies implemented by a number of countries during the global financial crisis. Many are targeted, such as programmes for marginalised workers or those who have been unemployed for long periods of time. They may also be accompanied by other programmes such as assistance with job search, e.g. a placement service.

Research that uses rigorous impact-evaluation methodologies has shown that the effect of this type of programme on employment is varied. In some cases wage subsidies have worked remarkably well, but only in the short term: in Jordan employment increased by 40

[1] The actual impact on lower-skilled employment depends ultimately on the degree to which the various types of input can be substituted over time, as well as the availability of these inputs in the economy.

percentage points during the subsidy period but then fell again to 'normal' levels once the subsidy lapsed (Groh et al. 2012). In others there have been lasting benefits, such as the Future Jobs Fund (FJF) in the United Kingdom where participants were 27% more likely to be in unsubsidised employment two years after starting their FJF job (Department for Works and Pensions 2012). Another example is that of Turkey, where the number of registered jobs increased, but it was found that many of the subsidised jobs would have been created anyway (Betcherman et al. 2010). The impact of wage subsidies depends very much on labour market conditions in a country and the design of the programme, inter alia.

A South African test of wage subsidies for young people

The importance of context means that it is difficult to predict the effect of a wage subsidy in South Africa. This article reports the results of an impact-evaluation research project (see Levinsohn et al. 2013) to better understand how an intervention, such as a wage subsidy, may affect the way in which young people get into jobs. The project tested the impact of a wage subsidy voucher on the success of a group of young people in gaining employment. A firm which employs such a young person would be given the voucher and could then claim the subsidy (in this case from the project office at Wits University). Thus it would reduce the effective wage cost of the young employee to the firm. While this does not constitute a direct test of the proposed employment incentive format, it comes pretty close.

To test the impact of the voucher, the employment experience of a randomly-selected group of young people was compared to that of a similarly-sized group of young people without vouchers (but otherwise with similar characteristics). Thus the research is able to identify the causal effect of having this voucher on a number of labour market outcomes for the 'vouchered' young people relative to those who did not receive the voucher. Approximately 4 000 young people took part. (The experiment was conducted in Gauteng, Kwazulu-Natal and Limpopo.) The value of the voucher was capped at R833 per month or half the monthly wage (whichever was lower) and could be claimed for six months.

To monitor their labour market experiences, the two groups of young people were interviewed annually for four years, starting in 2009 before the vouchers were issued. In 2010, vouchers were allocated to one group. Follow-up interviews determined the effects one year after allocation, whilst the voucher was still valid, as well as two years after allocation, when the voucher had lapsed.

In parallel, groups of firms were interviewed. This involved a sample of the firms which employed the voucher holders, a sample which employed those without vouchers, and a third, random group of firms which employed neither group and was intended to be representative of the broader population of firms.

The wage subsidy increases the odds of employment and the duration of employment

The key finding from the research is that the young people with a wage subsidy voucher were significantly more likely to be in wage employment both one year and two years after having receiving it, compared to those without vouchers. The magnitude of these effects was relatively large – those with vouchers were approximately 25% more likely to be employed one year after having received the voucher than those without vouchers.[2] Moreover, this effect was still present two years later. The positive impact of the voucher thus persisted for quite some time, even after the voucher had lapsed.

Another element was the voucher's influence on the duration of employment. Two years after allocation, those in the group with vouchers had spent more than a month longer in employment than those without the voucher. This suggests that most of those who gained employment were able to remain so and highlights the beneficial longer-term effects of interventions which get young people into jobs earlier.

The research also indicates that some of the criticisms of the wage subsidy are not valid:

- Firms indicated that they were unlikely to use younger, subsidised workers to replace existing workers. The question of whether a firm will replace an existing worker was asked directly of 605 firms: 79% said they would not. Experience and existing relationships between employers and employees are just too valuable to sacrifice (at reasonable levels of subsidy).
- Young people did not leave school or post-school education institutions to look for jobs as a result of the voucher.
- The voucher holders' jobs were not, in general, inferior to those of young people already employed by the firms.

The impact differed between firms of different sizes. It appears that smaller firms were more likely, or more willing, to employ vouchered job applicants than larger firms. This indicates that the national programme may benefit small firms more than larger ones.

[2] The probability of the group without vouchers being in employment in 2011 was 31 percent and the probability of those in the group with vouchers was 7.4 percentage points higher.

Despite a significantly higher proportion of voucher holders becoming employed, only a relatively small number of the employing firms eventually chose to claim the subsidy. This is somewhat puzzling but there seem to be a number of reasons for this behaviour, such as administrative barriers in firms and concerns about the legitimacy of the voucher. A national policy, if implemented, would need to tackle these issues to maximise its effectiveness via reducing actual labour costs.

The number of new jobs created could be relatively small

What can we conclude from this experiment about the likely impact *on job creation* of a youth employment incentive which includes a wage subsidy component?

Clearly this would depend on the scale of the programme and the size of the subsidy. However, if a wage subsidy that is similar in size to the one tested here is introduced, the likely number of new jobs which could be created by the subsidy is likely to be relatively low. Based on the current rates at which unemployed young people get jobs – which are low, given the current sluggish performance of the South African economy – approximately 88 000 new jobs would be created per year for 18-29 year olds. That is not a huge number relative to the total number of unemployed youth.

On the other hand, for a subsidy amount such as that in this experiment (and taking into account the jobs for young people which would be created anyway) the cost per new job is estimated at approximately R25 000. This is considerably less than other government programmes designed to create employment such as the Expanded Public Works Programme (EPWP) and learnerships where rough estimates of the cost per new job are about R100 000. (And of course it is much less than any job created in subsidised industrial projects, where the average cost per job is approximately R300 000 to R400 000.)

Conclusion

Incentives to create employment for young people are unlikely to generate the large numbers of jobs required to substantially reduce youth unemployment rates. But they do seem like a relatively cheap and effective way to create some employment, particularly when compared to other government schemes. They increase young job seekers' likelihood of being employed and increase the length of time young people remain in employment. As such, the introduction of such an incentive is an opportunity to experiment with, to evaluate and to improve policy design to create jobs for young people.

A second conclusion (and a caveat) is that a youth employment programme is likely to change the way in which at least some young people and firms behave in the job market. In any case, we know relatively little about young people's transitions into jobs and their general behaviour in the labour market. For example, some young people are quite discerning about the jobs they accept, particularly if they live in households that can support them. Therefore, such programmes may have unexpected consequences.

In general, many young people do not know what wages they can conceivably earn and the type of job that is open to them. Moreover, many young people have very limited information about available job openings. This could mean that those who are already marginalised are likely to remain so, even if South Africa manages to create large numbers of jobs. There is no easy solution to youth unemployment.

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