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Employment Tax Incentive

Exploring the Employment Tax Incentive: why, how and could it work?

Abstract

The Employment Tax Incentive is a Government initiative, part of a multi-pronged strategy to tackle high youth unemployment in South Africa. The employer claims the incentive by reducing the total employee tax (Pay-As-You-Earn/PAYE) amount payable each month to the South African Revenue Service (SARS) by the total employment tax incentive amount for qualifying employees. It is, therefore, a cost-sharing mechanism between the employer and Government, while the employee's wage remains unaffected. Its main objective is to create more employment opportunities for youth while at the same time, improving their skills levels and employability. However, in a context where economic growth is lacking, the magnitude and the design of the incentive (which includes a sunset clause and deterring penalties) make the prospects of using the incentive to create new job opportunities for young people seem unlikely. Yet, we know that if young people are hired, there is a very strong probability that it will improve their employability since people with previous work experience are three times more likely to find a job than those who have none. With more than three million young people currently unemployed, it seems imperative that we create opportunities to experiment with and to improve policy design to create jobs for young people. The Employment Tax Incentive is such an opportunity. In this learning brief we explore the Employment Tax Incentive from various perspectives, also providing useful information for organisations interested in participating.

Note that references (indicated with roman numerals) are provided in a Reference List at the end of this article.

Introduction

The problem of youth unemployment in South Africa is acute - at the extreme end of the growing trend of high unemployment rates for young people worldwide. The 2014 second quarter Labour Force Survey conducted by Statistics South Africa[xiii] reports that the unemployment rate[1] for youth (15 to 34 year olds) is currently around 52% compared to 21% for those between 35 and 64 years. Even if we try to exclude those who should theoretically be in education opportunities at the moment and only consider 25 to 34 year olds, the 40% unemployment rate for this group translates to about 3 116 000 unemployed young people in this age category. If we add the 15 to 24 year olds this number goes up to 5 507 000.

According to National Treasury, this reality means that a large number of young people are not acquiring the skills or experience needed to drive the economy forward, which in turn inhibits the country's economic development and imposes a larger burden on the state to provide social assistance. Unemployment is also associated with social problems such as poverty, crime, violence, a loss of morale, social degradation and political disengagement[viii]. Over the longer term, it also implies a large group of adults who have been unable to save or accumulate wealth through their productive years, being dependent on a smaller group of younger people.

1 *Using the expanded definition of employment which includes everyone who desires employment, irrespective of whether or not they actively tried to obtain a job (i.e. it includes discouraged job seekers).*

Fueling the high youth unemployment rates are both supply and demand side problems. On the demand side, the rate of job creation is too small, given sluggish economic growth. The international recession has prompted a deceleration in the rate of economic growth in South Africa over the last four years, and in 2014 growth has been further inhibited by industrial action in the mining, quarrying and metal industries[xiv]. The country's ability to respond to the gradual global recovery is limited by the lack of diversity in the economy, especially the absence of a strong small manufacturing sector. On the supply side, the root of the problem lies in a weak education system which is providing low quality schooling, in turn leading to poor prospects in terms of tertiary education as well as limited workplace learning capacity. National Treasury points out that employers look for skills and experience and that they regard unskilled, inexperienced jobseekers as a risky investment.

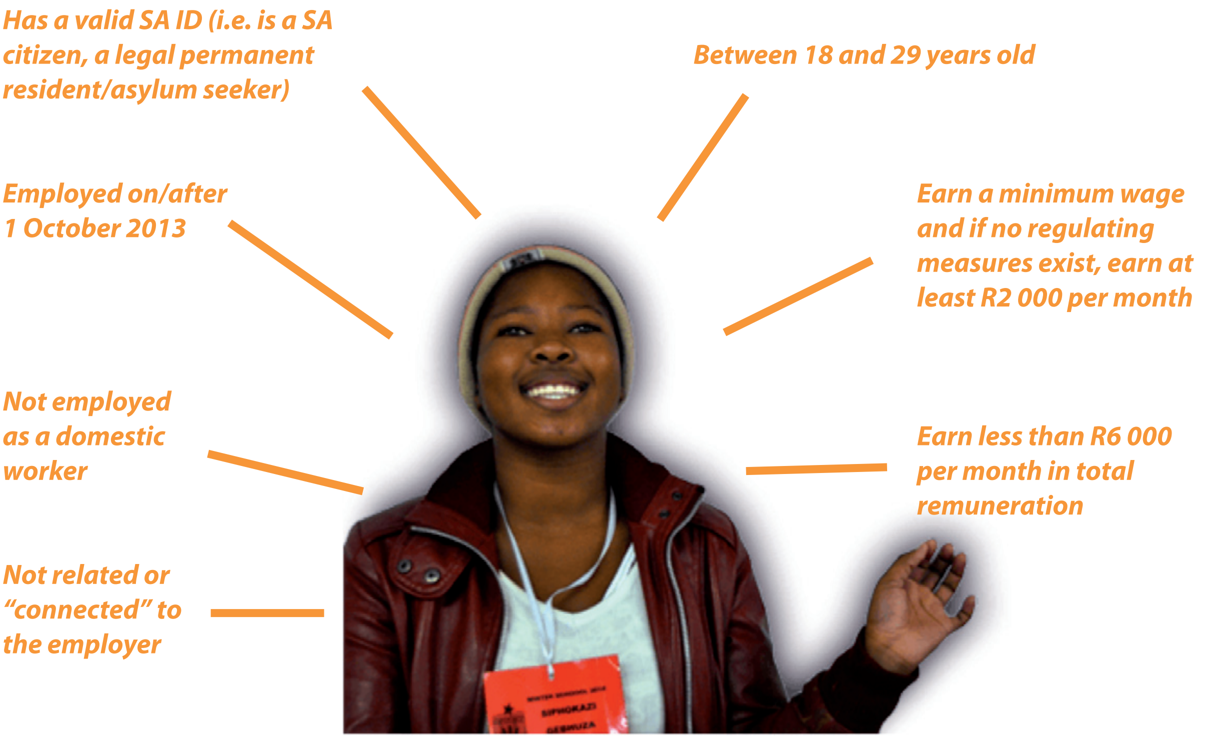
The Employment Tax Incentive (ETI), previously referred to as the Youth Wage Subsidy, is a Government initiative, part of a multi-pronged strategy to tackle youth unemployment in South Africa. During the public consultation phase which started in 2011, the proposed strategy was met with fierce opposition from various fronts and, as a result, the bill only came into effect on 1 January 2014. This learning brief explores the ETI from various perspectives. It aims to understand and share how it works, to understand the technical concerns in terms of the formulation of the bill, but also the larger strategic concerns that are still being raised (for example as part of recent industrial action[2]). It examines what evidence exists to prove the potential of the incentive to achieve its objectives, possible alternatives that are being suggested and provides an informal illustration of the type of thinking and issues that are currently being experienced by organisations and firms which have chosen to claim or not claim the incentive at this point in time.

The purpose of the ETI

The ETI Act aims to reduce the financial cost and risk of hiring inexperienced youth by reducing the employee tax (Pay-As-You-Earn/PAYE), thereby reducing the cost of employment to the employer without affecting the employee's earnings. Theoretically, this saving could make the training of these young employees more affordable, provide more opportunities for young people to gain work experience, and encourage young job seekers

2 *http://www.bdlive.co.za/national/labour/2014/03/17/numsa-vows-that-500000-people-will-oppose-employment-act*

Employees that qualify for the ETI:



to become more active in their search for work. Ultimately, Government hopes that the incentive will lead to the creation of more employment for youth, while at the same time improving the skills levels and employability of youth.

How it works

The ETI came into operation 1 January 2014 and currently has a 31 December 2016 sunset, depending on an ongoing review of the effectiveness of the legislation.

Who qualifies?

Employers: Employers are eligible to claim the ETI if,

- registered for Employees' Tax (PAYE) or eligible to register for PAYE (e.g. the employer can't register just to claim ETI, other registration requirements must be met);
- not in the national, provincial or local sphere of government (including a municipal entity);
- not a public entity listed in Schedule 2 or 3 of the Public Finance Management Act (other than those public entities designated by the Minister of Finance by Notice in the Gazette);
- not disqualified by the Minister of Finance due to the displacement of an employee or by not meeting the conditions as may be prescribed by the Minister by regulation.

Employees: (See diagram on page 2)

The mechanism

The employer claims the incentive by reducing the total PAYE amount per month that is payable to the South African Revenue Service (SARS), by the total ETI amount, calculated monthly. This is done by completing the ETI field on the employer's monthly EMP201 submission to SARS[vii]. Effectively this implies a cost-sharing mechanism between the employer and Government, while the employee's wage remains unaffected.

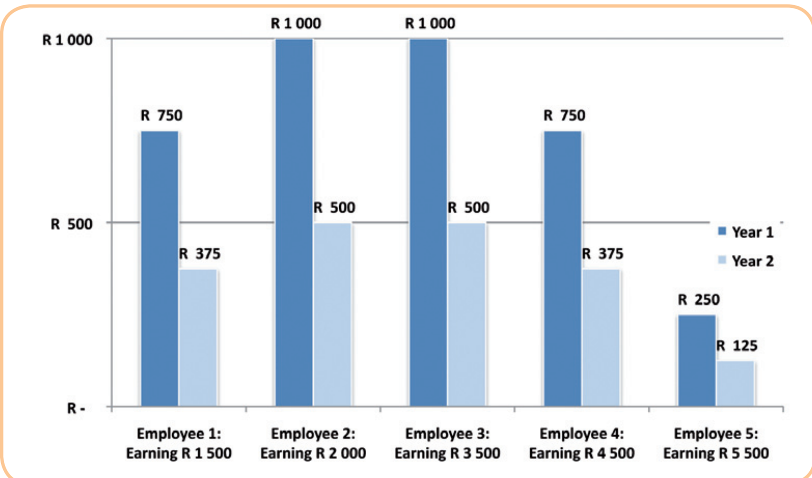
The size of the incentive

The incentive is only available during the first two years of employment, has a cap of R 1 000 per employee (per month) and halves during the second year of employment. The incentive is calculated according to a sliding scale in cases where the remuneration is less than R2 000 or more than R 4 000. Between R 2 000 and R 4 000 the maximum incentive amount is applicable (R1 000 in the first year of employment and R 500 in the second year).

Table 1[*]: Summary of the sliding scale indicating the incentive size under different remuneration scenarios

Year of employment	<R2 000	R2 000-R4 000	R 4 001-R 5 999	=/>R6 000
First year	50% of remuneration	R 1 000	R 1 000 minus 50% of amount exceeding R4 000)	0
Second year	25% of remuneration	R 500	R 500 minus 25% of amount exceeding R4 000)	0

Figure 1: Example of the incentive size for different remuneration size scenarios



* Adapted from a table provided in: Van der Zwan, P. The employment tax incentive – will it work? Accountancy SA, June 2014 Issue

National Treasury and SARS's pamphlet, "How the employment tax incentive works for you"[vii], provides formulas and useful examples of calculations to guide organisations in calculating the incentive amount that they need to deduct from their PAYE. SARS also provides helpful tools, such as online ETI calculators on their website.[3]

The fine print and technical concerns in terms of the formulation of the legislation

The basic guidelines to implement the incentive sound simple enough, but a number of tax experts unpack some of the fine print of the legislation - which should be considered by employers - and raise some concerns regarding the formulation of the legislation that could impact its outcomes:

Number of employees and the size of the incentive:
There are no limits to the number of qualifying employees for which the employer can hire and claim. Although the saving per employee seems quite small, it could be financially advantageous to add more employees at a lower level of remuneration. For example, "a business employing a qualifying employee at R5 800 per month would only be able to claim R100 per month in the first year, whereas a business employing four qualifying staff who each earn R4 000 a month can afford to employ a fifth person for 'free' using the incentive to pay for the fifth employee's salary"[v] (at least in the first year of employment). This inverse relationship between the level of incentive and the level or remuneration, therefore, also serves as an incentive to keep the remuneration of the employee low which, with the rising cost of living, might not be fair towards the employee.

Timing/period of employment: The 1 October 2013 start date clearly implies that the incentive rewards the employer for employing new employees[xvi]. However, because the legislation does not refer to the 'first time' that the employer employs the employee, someone that was employed by the employer before 1 October 2013 (i.e. is not eligible for the incentive), then leaves for a period of time and is then re-employed by this employer after 1 October 2013 would now become eligible. This also means that young people who are participating in multi-year training - divided into half-year blocks of course work followed by practical employment, for example - would qualify for the year 1 level of the incentive each time that they are re-employed for a practical block (even by the same employer). Also, an employee that moves into a different position within the same organisation after 1 October 2013 will also entitle the employer to the incentive (provided the criteria are met in terms of the employee and remuneration level).

According to Professor Pieter Van der Zwan, writing for the Accountancy SA magazine (June 2014)[xvi], this appears to be a contradiction of the purpose and spirit of the Act, which aims to create 'new' employment for youth. The definition of the term employee[4] allows for short-term employment (for example internships) and even those earning wages for only a few days (for example in the case of seasonal farm workers) of employment are included. This provision, along with the time-limited benefit period may discourage the creation of long term sustainable employment if employers choose to conclude shorter-term employment contracts in order to maximize their incentives[xvi].

Penalties: PricewaterhouseCoopers (PwC) warns that "employers will be disqualified from claiming the incentive for a particular month if it has any outstanding tax returns or tax debts at the end of such a month. As the incentive is reduced from the employee's tax liability, employers are at risk that should they not qualify for the incentive for whatever reason, they would have understated and underpaid their employees' tax which would then make them liable for the tax, 10% late payment penalties, possible understatement penalties and interest"[ix]. Further, if an employer claims the incentive for an employee who qualifies and earns less than the minimum wage (or less than R2 000 where a minimum wage is not applicable), a penalty equal to 100% of the incentive is claimed in respect of that employee. This will lead to an under-payment of employee's tax and possible interest and penalties in terms of the Tax Administration Act[xi]. If an employer is believed to have displaced an employee in order to employ an employee who qualifies, a penalty of R30 000 is applicable for each employee displaced.

3 http://www.sars.gov.za/TaxTypes/PAYE/Pages/The-Employment-Tax-Incentive-ETI-Calculations-Explained.aspx

4 A natural person who works directly for another person and who receives, or is entitled to receive, remuneration from another person as defined in the 4th schedule of the Income Tax Act.

Net refund/Incentive rollover: If employees are not in the PAYE bracket[5] but all qualify for the tax incentive (this might for example be a scenario with certain farming work) the employer must still be registered for PAYE tax. The PAYE would be zero, but the benefit owed to the employer must be treated as an excess[i].

In a situation where employers are entitled to a greater incentive amount than the employees' tax withheld (excess) (e.g. in cases where a large number of low-income-earning employees are employed or when employees are not in the PAYE bracket), the excess is rolled forward and paid out to them during the month that the half-yearly PAYE is reconciled. The incentive can also roll over in cases where the employer was unable to claim in a particular month for any reason. The rollover is capped at R6 000 for each qualifying employee[6].

A practical example of how the rollover works: If an employer is entitled to a benefit of R1 000 and his total PAYE bill is R500, he will receive only R500 as a portion of his benefit. He would thus be left with R500 owed to him. This excess can be rolled over until the next month and can finally be claimed at the end of six months, when he would be entitled to the unpaid portion of the benefit (R3 000 in this example)[i].

Verification: Employers should be able to produce IDs for the employees that the incentive is claimed for, if required to.

What is the administrative burden?

According to tax experts, the administration required is not onerous[xvi]. PwC describes the following as additional administrative tasks that the organisation will have to take-on in order to claim the incentive[ix]:

- ensuring that the sliding scale formulae have been correctly applied for the first and second years and to the correct monthly remuneration;
- ensuring that the employee is a qualifying employee in respect of age and status (to do this the employees' personal details need to be retained); and
- ensuring that the employer is not prevented from claiming the incentive and not at risk of disqualification and penalties.

SARS and National Treasury[vii] provide practical steps to determine the value of the incentive for a particular month:

- identify all qualifying employees for that month;
- determine the applicable employment period for each qualifying employee (1st 12 months/2nd 12 months);
- determine each employee's monthly remuneration;
- calculate the amount of the incentive per qualifying employee (by applying the provided formulas); aggregate the result.

Does the incentive have the potential to achieve its objectives?

International Evidence

Examining international evidence to gauge the potential of youth wage subsidies/incentives to improve the employment prospects of young people proves to be less helpful than would be expected, as is illustrated by the discussion following:

In 2011 National Treasury prepared a discussion paper exploring the policy options for the proposed youth wage subsidy and in the process, provided a detailed motivation and theory of change to justify the implementation of the subsidy[vii]. This paper also provides an extensive review of international experience in terms of the implementation of youth wage subsidies (pages 23-24; 31-32) and cited fairly positive evidence in terms of impact. For example, it mentions that in Australia it has been estimated that the youth subsidy improved employment prospects by at least 20 per cent up to 26 months after the subsidy expired. It also refers to a 2007 World Bank report stating that wage subsidies have been particularly successful in improving short-term employment outcomes in transition economies, while having mixed outcomes in industrialised countries".

A submission by a local NGO working for quality and equality in South African education, Equal

5 In 2014 if you are earning R5 891 and below per month you are not eligible for PAYE: http://www.sars.gov.za/AllDocs/Documents/PAYE%20tables/2015%20paye%20 tables/2015%20Monthly%20Deduction%20Tables.pdf

6 http://www.sars.gov.za/TaxTypes/PAYE/Pages/The-Employment-Tax-Incentive-ETI-Calculations-Explained.aspx

Formulas to calculate the incentive per employee[vii]

Monthly remuneration	Year 1	Year 2
R0 - R2 000	50% of Monthly Remuneration	25% of Monthly Remuneration
R2 001 - R4 000	R1 000	R500
R4 001 - <R6 000	Formula: R1 000 minus (0.5 x (Monthly Remuneration minus R4 000))	Formula: R500 minus (0.25 x (Monthly Remuneration minus R4 000))

Education, however lists various problems with the review provided in the National Treasury report. For example:[iii]

- that "the evidence is 'micro' in focus, i.e. it looks at whether the subsidy was successful in getting the target group employed relative to other groups, not if the policy had an overall positive effect on employment or the economy";
- that "studies referenced by National Treasury often refer to examples of 'active labour market policies', or policies which involved more than just a wage subsidy";
- that many of the examples National Treasury draws from are over a decade old and their value is therefore diminished due to significant changes in the dynamics of labour markets;
- that National Treasury's body of evidence is predominantly derived from moderately or strongly advanced economies and omits discussion of most of the available international literature focused on the implications for developing nations.
- that the National Treasury document incorrectly summarises the conclusions of the examples that it draws upon and that it does not meet the standards for academic rigour.

Equal Education goes further, citing a 2004 World Bank document reporting on 159 youth wage subsidy studies, by concluding that "the clear majority of subsidy programs do not appear to have net positive impacts on the longer-term employability or earnings of participants. This is particularly the case for developing and transition countries where the limited evaluation evidence is uniformly negative." They further cite various authors who discuss discouraging evidence showing that the employment effects from subsidies that exist are small and that the intervention is cost inefficient because it subsidises hiring that would have occurred anyhow.

Equal Education also provides detail on recent (2014) Financial Times reports on the "failed" wage subsidy policy in the United Kingdom: "In a survey of 200 employers by the Recruitment and Employment Confederation, none said it had used a wage incentive of £2,275 on offer employing a young person who had been out of work for several months. At the current rate, it looks as though it will come nowhere near meeting its own assumptions about the scheme's demand".

The following cautious, if not particularly helpful, comment made in a 2014 report by the International Initiative for Impact Evaluation (3ie) seems appropriate in considering international experience: "Evidence from other countries suggests that the success of a wage subsidy can be context specific and depends on the nature of the intervention and the structure of the labour market amongst other things"[vi].

A South African experiment

That said, the randomised control trial conducted by 3ie and funded by Global Development Network (GDN), National Treasury and Department of Labour, the European Union and the World Bank was equally criticised by Equal Education in terms of its strength to estimate the potential of a youth wage subsidy in South Africa. The following discussion draws heavily on a shortened paper summarising the findings of the 3ie report prepared by Neil Rankin from the Stellenbosch University[x].

"The study was designed to investigate whether providing a wage subsidy voucher to young people, which firms who employed them could claim, resulted in higher employment within the South African context". It documented the employment experience of a randomly-selected group of young people with vouchers that could be claimed from Wits University by employers, compared to that of a similarly-sized group of young people without vouchers, but with similar characteristics. Approximately 4 000 young people took part in the experiment which 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 (i.e. a total of R5 000 per subsidised individual). 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 of the two groups".

According to Rankin, the key finding from the research was 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. Those with vouchers were approximately 25% more likely to be employed one year after having received the voucher than those without vouchers and this effect was still present two years later". Rankin thus concludes that the positive impact of the voucher persisted for quite some time, even after the voucher had lapsed. That conclusion is, however, a bit puzzling given that the study also found that only a relatively small number of the employing firms claimed the subsidy (citing administrative barriers and concerns about the legitimacy of the voucher as some of the reasons for not claiming). Another interesting finding was that smaller firms were more likely, or more willing, to employ vouchered job applicants than larger firms.

Equal Education points out that the study does not constitute a direct test of the proposed employment incentive format and also that the finding regarding the limited claiming behavior by employers creates doubt as to whether the voucher had a positive effect on employers or on the work seekers. For example, work seekers with vouchers might have been more confident and increased their efforts to find work knowing that they have the voucher, improving their chances of employment. This point is acknowledged and well explored in the 3ie study which found little evidence of changes in search behaviour or intensity, but some evidence that those in the control group were more likely to turn down job offers (various theories are proposed to explain this trend[vi], but nothing that clearly illustrates why this should necessarily be the case, see pages 22-24). Still, this finding does call to question the ability of such an incentive to motivate employers to create new work opportunities for youth. Equal Education makes the point that the experiment cannot illustrate whether total employment has increased (i.e. that new employment was created for young people) as a result of the incentive.

This is indeed the case, and in fact, the study did not set out to test this. Instead, it attempted to answer the question: Are those with a wage subsidy more likely to be in employment as a result of the allocation of the voucher? Nonetheless, Rankin and the 3ie authors estimate that the number of new jobs that would be created by a youth wage subsidy would be relatively small. According to Rankin, based on the current low rates at which unemployed young people in South Africa get jobs and the poor performance of the South African economy – approximately 88 000 new jobs would be created per year for 18-29 year olds at a cost per new job of approximately R25 000 (with a subsidy amount such as that in this experiment - R5000 per subsidised individual- and taking into account the jobs for young people which would be created anyway). Rankin states that 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 for subsidised industrial projects, where the average cost per job is approximately R300 000 to R400 000. In terms of objectives, in 2011 National Treasury expected to spend around R5 billion to create 133,000 sustainable new jobs over three years through the incentive at R37,000 per new job[vii]. Over three years this is less than the 264 000 jobs projected by Rankin and 3ie and which they state is a small number relative to the total number of unemployed youth (5 507 000 according to Statistics South Africa's 2014 second quarter Labour Force Survey Report[xiii]) .

Rankin concludes with another cautious statement regarding the potential of the incentive scheme to achieve its intended objectives: "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". If administered in the format tested in the experiment, the incentives increase young job seekers' likelihood of being employed and increase the length of time young people remain in employment. The findings of the study are not too clear in this regard, but it seems like the initial lever for these trends might be 'work seeker' effects and not 'employer effects', which given that the ultimate design of the ETI being implemented now is largely reliant on employer behavior, might lead to different outcomes than those documented in the 3ie research. Rankin thus sees the introduction of such an incentive not necessarily as a big solution, but as "an opportunity to experiment with, to evaluate and to improve policy design to create jobs for young people".

What are the concerns?

Many organisations and public entities do not, however, take kindly to the mild 'why not experiment' stance proposed by Rankin. The proposed incentive received, and still receives, a lot of opposition from some civil society organisations like Equal Education, trade and labour unions like COSATU and NUMSA, among others.

A major concern especially for the trade and labour unions is the displacement of older workers. The fear is that 'new' jobs created by a wage subsidy are created by retrenching existing workers to take advantage of the subsidy. To address this issue, National Treasury initially proposed that employers found to have 'unfairly dismissed' an employee in order to hire a 'qualifying employee' will pay a penalty of 150% the value of the total incentive that they have received over the previous 12 month period and be excluded from future participation in the incentive. However, when the incentive came into effect in 2014, the bill stated that a penalty of R30 000 is applicable for each employee displaced and that an employer may be disqualified by the Minister of Finance after taking into account the number of employees that have been displaced and the effect that the disqualification may directly or indirectly have on the employees of the employer. Objecting organisations are not convinced that the measures included in the final bill are an adequate deterrent to prevent the displacement of older workers. In interviews with over 605 South African firms, 79% of them however said they would not consider replacing older workers with younger qualifying employees because existing relationships between employers and employees are too valuable to sacrifice[vi].

However, these measures won't prevent organisations from filling vacant positions that might have been filled by older people with younger people (because it is cheaper to do so) and in that way simply 'shifting' unemployment to another demographic grouping. According to Equal Education, if experienced workers are being replaced by younger workers, so that businesses can qualify for the two-year subsidy rather than creating genuinely new jobs, the result of the subsidy will be to put downward pressure on all wages[iii]. The theory is that those experienced workers who do keep their jobs will be seen as overpaid relative to their younger, subsidised colleagues, and their jobs might be threatened.

As has been already mentioned, another important concern is that the subsidy would lead to short-term temporary employment and young people would be replaced once their subsidy lapsed. The 3ie research team believes that its study has shown that this is an unlikely scenario since employees with vouchers were more likely to be in longer term employment than the control group. However, tax experts warn that the technical details of the bill allows for precisely this situation (for example, even those earning wages for only a few days qualifies).

Is the tendency to provide short term employment/ work experience such a big worry however, especially since analysis of South Africa's labour market shows that people with previous work experience are three times more likely to find a job than those who have none[viii]? In this regard Equal Education points out: "correlation does not prove causation. Whilst there is a high correlation between previous work experience and strong future job prospects, there may be an equally high correlation between strong job prospects and having better education, or living closer to an urban centre. The factor causing the person to be more employable is, therefore, not necessarily the work experience per se but the underlying factors which saw the person gain work experience in the first place". This perspective, though with some validity, may be overly cynical given that job adverts generally call for previous work experience in areas relevant to the job being advertised.

Some lesser concerns include issues like young people leaving school or post-school education institutions to look for jobs as a result of the incentive; or that jobs linked to the incentive might be generally inferior to those of young people already employed by organisations. However, the most important concern reflects frustration with what is seen as a short term, inferior way to address a surface level problem, while it is felt that the substantial financial investment made to roll out the incentive (R5 billion) could have been better spent boosting ongoing efforts to address the actual roots of the problem. The absence of complementary training and mentoring requirements in order to qualify employers to claim the incentive is perceived as a particular point of weakness.

What alternatives are being suggested?

It is useful to consider whether the R5 billion could have been allocated more efficiently to meet the same objective. We should however note that just because there are other existing alternatives that could be viewed as more cost-effective, it does not necessarily mean that the country should not try out innovations with potentially greater returns in the long-run.

Equal Education provides a list of suggestions of how the R5 billion could have been spent, such as:

- improving FET colleges and school infrastructure;
- establishing structured internship and training programs which large business should be required to participate in;
- creating a national youth service scheme that employed young people as assistants in Early Childhood Development (ECD) centres, assistant sports coaches in schools, or as youth-librarians etc.

According to an article on Finweek.com[iv], the Centre for Development and Education (CDE) advocated a four-pronged approach to economic policy to create jobs in 2010. This approach would see Government providing tax breaks and exemptions from laws on hiring and firing first-time employees between the ages of 18 and 24. The CDE also proposed the creation of special economic zones to generate employment for youth in particular, and recommended the creation of vocational education programmes linked to apprenticeships. Finally, it proposed the creation of employment schemes in the poorest provinces to provide useful employment at a subsistence wage.

Statistics make a strong case for the long-term strengthening of South Africa's education system and structures as an investment with proven effectiveness. The Labour Market Dynamics 2013 report (by Statistics South Africa)[xii] found that people with matric and higher qualifications were significantly more likely to find employment than those without these qualifications. Unemployment among people without matric – at 30.2% – is almost three times higher than among those with a tertiary qualification. In 2013, a study by Stellenbosch University found that graduate unemployment is less than 6% in South Africa, comparing well with rates in developed countries[xiii].

What are employers saying about the ETI?

To get a sense of whether organisations are implementing the incentive and how they are experiencing processes to do so, we informally talked to a small number of organisations about the incentive and their engagement with it. It is very important to note that this was an informal exploration, the purpose of which was originally to document and share some of the advice that implementing organisations can offer those that are not as yet implementing. Formal research on the effectiveness of the incentive thus far is currently being conducted by National Treasury and should be released within the next few months.

We started by asking one of our implementing partners, DreamWorker[7], an NGO specialising in connecting low-skilled unemployed people to short/long term job opportunities. Because they have connected almost 14 000 unemployed people to more than 720 000 days of work since 2008 through their large employer network, we were interested to establish if they have seen an

7 *http://dreamworker.org.za/*

increased demand for the services of young people among the employers that they work with (since the incentive came into effect). After scrutinizing their database, they could unfortunately report no such trend. None of the DreamWorker offices have any indication from employers that they are utilising the subsidy. In turn, they asked a number of the employers that they work with if they are implementing the incentive and mostly the response was negative. For example the Lewis Group reported the following:

> *"From January 2014, we created parameters in our payroll, to process a report each month that calculates the incentive that we could claim from our PAYE that we pay to SARS each month. To date, we have not claimed, due to the penalties that may arise due to the non-compliance rules that exist. We cannot reduce our PAYE payment if other Returns have not been submitted, e.g. VAT, Company Tax, Import/Export Returns. Our Finance Department receives our Payroll Report each month and it is their decision whether to claim or not, to date we have not claimed".*

A notable exception, the Mr Price Jumpstart Project (which works with Mr Price in creating work opportunities) gave a very positive report of their experience implementing the incentive:

> *"We have been applying this in our own companies (about 10 people qualify) and Mr Price has been applying it to their employees. It is very easy to administer, as it only requires you to enter one figure when doing monthly PAYE returns. The calculation is not that complicated. It is quite beneficial to environments with high turnover rates like retail and hospitality (even though its intention is not to benefit replacement hires for high turnover)".*

We asked the Mr Price Jumpstart Project respondent whether any new positions have been created for young people as a result of the incentive:

> *"Our situation is a bit unique. We recently employed 10 interns across 3 related companies, all at R2000 each. These interns are all from an FET college as part of their mandatory 18 month work experience to complete their qualification. The FET college is able to arrange funding to pay them stipends, but this would only likely come through early next year. Therefore, we decided to pay them ourselves until the funding came through. We might not have taken them all on if it weren't for the subsidy - at the very least we would have taken less on.*
>
> *In the case of Mr Price, I doubt they are changing their employment habits because of the wage incentive. It is actually quite a risk for a large employer to take on more people BECAUSE of the wage incentive, as the incentive is supposed to be a temporary measure. It is a risk for a business to inflate their staff numbers and then for this incentive to stop at some point. The business would then possibly be bloated, and less efficient than it would desire to be in terms of employment numbers. It's quite difficult for large businesses to reduce staff numbers through retrenchments. Therefore, I think the large businesses will take advantage of the tax breaks, but not necessarily hire more people.*
>
> *However, I think small businesses would be much more likely to take on more people because of the wage incentive, as the risk is lower if the incentive falls away. It is easier to retrench if necessary. In our case, the interns are able to assist us with improving the quality of our work (e.g. by doing more follow-up work) and to free up other staff members to focus on higher level responsibilities. At the end of their internship with us, we would either need to employ some of them or have new interns to take their place".*

Supporting the view expressed by the Mr Price Jumpstart Project, in an article in the Entrepreneur Magazine[ii], David Warneke, head of Income Tax at auditing firm BDO South Africa, expresses the opinion that the incentive won't lead to much youth employment purely because the incentive of R1000 (generally) is not large enough to motivate corporates to participate in the short term, especially given that there is a sunset clause in the long term.

Social enterprise Fetola[8], designing and

8 www.fetola.co.za

implementing high-impact enterprise development programmes, are using the incentive to subsidise their small internship programme (with four qualifying employees their PAYE is reduced with R4000 each month). They have not created new employment for young people (they would have implemented their internship programme anyway), but do mention that it motivated them to offer the interns slightly higher salaries. They report that the administrative process is extremely simple and they have experienced no problems in this regard. The Fetola representative said information on how to claim was easy to come by and understand by doing a small amount of internet research.

Not all organisations are that informed or proactive however, the large youth development focussed NGO, loveLife, which mostly employ younger people, informed us that they don't believe they qualify for the incentive since they are a tax exempt NGO (this understanding is incorrect). A Western Cape Wimpy franchise holder told us that despite attending recent franchisee meetings, he was not aware that the franchisor is sharing specific information on the incentive or encouraging franchisees to implement it.

We also found a few online platforms representing small businesses where employers initially reacted quite positively to the news of the incentive in January, for example[9]:

> *"We are interested as it will help our industry a lot (hair salon). My wife trains up her staff and it takes them a year to move up the ladder from the lowest job in the industry (shampoo girl) to that of a junior stylist. The youth subsidy would work well for us because after a year, the person has either been promoted to a position where they start making money for the business or they move on to go work for themselves".*

We prompted the conversation thread by asking if the incentive had turned out to be as useful as the businesses initially hoped it would. One of the responses pointed to the fact that the incentive excludes higher skilled/graduate employees and their employers from benefiting:

> *"The minimum wage in our industry (under the MEIBC) is R 33.67/H that equates to R 5836 per month, and I don't have any staff on this grading scale; all my staff earn above R6 K per month so none would qualify. To benefit from this one would need to pay well below Minimum Wage, and there is now a financial incentive for the employer not to increase the wages of those he is receiving a subsidy on, if by paying more than R 4 000 per month they start to lose the subsidy".*

Conclusion

All in all, it does seem as though Equal Education is fair in making the point that the ETI is being implemented with little evidence that it could achieve its objective of creating more employment opportunities for youth. Even though it would do so at lower cost to the State than other job-creating programmes, new employment opportunities are firstly dependent on economic growth. In a context where this growth is lacking, the magnitude and the design of the incentive - together with a sunset clause and deterring penalties - make the prospects of new job opportunities being created for young people because of the incentive seem less likely. The second objective of improving skills and employability of young people is firstly dependent on the availability of employment opportunities; however, once young people are hired, the achievement of this objective seems more probable, even if employment is only for a short period of time. The probability of this could have been further enhanced if the incentive design included requirements for training/mentoring/coaching, especially in the case of short term employment opportunities.

The 3ie youth subsidy experiment, conducted on behalf of National Treasury and others, reported very positive and desirable outcomes - even during an economic recession and even when the incentive was mostly not claimed by participating firms. However, in the experiment the incentive design was more supply side driven (i.e. the work seeker was the holder and supplier of the voucher). The design of the ETI implies that uptake is almost entirely driven by employers, and even though another objective of the incentive is to encourage young job seekers to be more active in

9 *Comments made on a conversation thread at: http://www.thehubsa.co.za/forum/topic/134777-youth-wage-subsidy/page-2*

their search for work, there is almost no evidence on the internet of the incentive being promoted among young people. When the subsidy was originally being discussed in 2011 and earlier, one of the suggestions to implement it was that young people would be issued a 'card' loaded with their incentive (and other resources that could aid their search for employment and employability). Even though the PAYE design seems to be quite elegant in its simplicity to implement, given the 3ie results, a more complicated system involving the work seeker in the administration of the incentive seems like an alternative design with some potential.

Finally, is the R5 billion well spent on this incentive or would it have been better used to boost long term efforts to improve the education system? National Treasury, and others, make very valid arguments in this regard – yes, in the long term the best solution is to improve the quality of education, but at the moment there are more than three million young people that have already been failed by this system and second chance opportunities are very few. These young people have the same right as future generations who might benefit from an improved education system, to aspire to reach their potential, to hope for a good living and to provide for their families. And, as National Treasury points out, "employment is not only about earning an income – it also promotes dignity, independence, achievement and innovation". It is, therefore, indeed important that we create opportunities to experiment with, to evaluate and to improve policy design to create jobs for the young people that are unemployed now, as is suggested by Rankin. Hopefully the National Treasury research results due to be released soon, will provide greater evidence of whether the incentive is achieving its objectives, and allow opportunity to revise it to address areas of weakness.

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