

# Youth wage subsidy in South Africa

## Cosatu responds to Treasury and DA

The youth wage subsidy (YWS) proposal by the National Treasury that is supported by the Democratic Alliance (DA) does not address the causes of the triple crisis of poverty, unemployment and inequality. Subsidies have also not worked in any country and that is why Cosatu rejects them, writes **Chris Malikane**.

The National Treasury document relies on international studies to justify its proposals on YWS, or even employment subsidies. But careful reading of those studies reveals that they lean towards the Congress of South African Trade Unions (Cosatu) position.

Based on Treasury's own literature which they used to propose this ill-conceived policy, we have shown that there are no real grounds for this policy. The irrelevance and the likely wasteful effects of this proposal have been amply demonstrated in many cases. International literature shows that the wage subsidy idea is extremely costly and wasteful, with huge *deadweight losses*.

The International Labour Organisation (ILO) reports that 'research in various countries has shown that wage subsidies lead to combined deadweight and substitution effects of the order of 70-90% of the number of jobs created'. The estimate by Treasury puts the deadweight loss alone to be 58%, i.e. 58% of the jobs that would have been created without the subsidy will be subsidised (that is, if we believe Treasury's estimates!).

The YWS will have significant *substitution effects*. Firms will have an incentive to let go of existing workers in order to employ subsidised ones. The Treasury document dismisses this concern on the basis of extremely weak arguments. Treasury pretends as if it does not operate in South Africa, where the elementary rights of workers are violated on a daily basis.

For example, the vast majority of workers do not enjoy the minimum wage regulation. But also more pertinent is the fact that only 29% of the workforce is unionised in South Africa, which opens up the rest, 71%, to abuse. In addition, the existence of labour brokers who screen and manage workers for employers also makes it easy to fire existing workers and get good ones on a subsidised basis.

The substitution effects are likely to be widespread, especially with the existence of labour brokers. This substitution will hit the unskilled and semi-skilled parts of the workforce the most. By this criterion, and using the 2011 industry structure tables, we find that at least 3.7 million workers are vulnerable to substitution in the South African economy.

The tables also include a category of mid-level skilled workers, whose skills composition is difficult to find out. However, we can interpret the figure of 3.7 million as a minimum number of workers who are vulnerable to substitution. The Treasury document argues that the subsidy is introduced at the beginning of a recovery, so that substitution effects will be limited.

But this argument is clearly not structural as it does not consider the skills composition of the sectors involved. The second reason why we oppose the YWS is that even if we concede that economic growth will limit substitution, what will happen is that deadweight costs would increase, because with economic growth firms would hire more young workers even if the subsidy is not offered to them.

The third reason why we oppose the YWS is that it *does not guarantee that training and skills development will take place in the workplace*, less so in the sectors where job-creation is likely to be created: wholesale and retail trade, personal services and construction.



African National Congress Youth League march for economic freedom and youth employment.

### LITTLE TRAINING FOR BLACKS

As we have noted from the Commission on Equity and Empowerment (CEE), little training is being provided to black people, less so to the skilled segment of the workforce. The situation is worse for the unskilled workers who are likely to be outsourced, casualised and employed through labour brokers.

What is even worse, Treasury does not want to mandate training: 'the design of any potential employment subsidy may not want to mandate training alongside the subsidy since additional administrative burdens on employers may discourage take-up of the subsidy'.

This is indeed a problem, because Treasury's own literature says that these subsidies depend on training for success. Without mandating training, which is currently very minimal, it is clear that Treasury relies purely on the charity of the private sector, an expectation which runs against the daily experience of the vast majority in the South African workforce.

The fourth reason why we oppose the YWS is that it will lead to the *recycling of young people without training*. In the literature

they say young people will be fired once the subsidy ends. Treasury and the DA dismiss this on the grounds that 'it's lousy business to fire good workers'. But the fact that businesses have moved drastically towards outsourcing, labour broking and casualisation (of good workers) shows that it is good business to have a workforce that is vulnerable and flexible.

The goodness of the worker is subordinate to the power of profit. Indeed there are many good workers that have been retrenched only to be hired under labour brokers, or as casuals. Because Treasury does not mandate that business be held accountable for 'recycling', and seeks to ensure that, during the subsidy period, these young people do not have recourse to labour protection; the proposed YWS will produce huge 'destructive churning'.

The fifth reason why we oppose the YWS is that with major substitution and increased vulnerability of the workforce, there will be downward pressure on wages. *Inequality will worsen* as low wage workers replace those that have managed to capture non-wage benefits in their compensation.

It can be shown that the increase in the mark-up due to the subsidy will raise the profit-share at the expense of the labour share. This therefore will not take us forward with the triple challenges. Indeed jobs have been created, but at the level of poverty wages. In addition *poverty is likely to rise*, because employed workers with relatively higher wages will be replaced by many vulnerable low wage workers.

The sixth reason why we oppose the YWS is that there is an underlying assumption that there is a gap between entry-level wages and productivity among young workers. Treasury and the DA argue that youth wage rates are too high. However, the Treasury document fails to compute this gap between the wage and productivity.

With an average wage of R940 for those that fit the characteristics of at least 60% of the unemployed, it would be interesting to know what is expensive about this average monthly wage. We thus argue that the YWS proposal has no empirical basis in South Africa. The YWS also has no real basis internationally, as demonstrated by the literature that Treasury and the DA use to support the subsidy.

The seventh reason why we oppose the YWS is that Treasury and the DA incorrectly assumes that the wage is the major constraint to job-creation. The emphasis on the empirically unsubstantiated gap of an entry-level or minimum wage, that is above productivity lies at the heart of Treasury and the DA's standpoint. In the first instance, the vast majority of young workers who fit the characteristics of many of the unemployed do not enjoy the statutory minimum wage.

In other words, the minimum wage is not a binding constraint. Secondly, there is no empirical basis to create a causal link between the extent of coverage by collective bargaining agreements and youth unemployment. Countries with high union and bargaining coverage do not necessarily exhibit high youth unemployment rates, the issue has more to do with economic structure and the role of the state in the economy.

The ninth reason why we oppose the YWS is that it will simply increase the mark-up of firms without increasing employment. As we have argued above, the reasoning of Treasury on the technical aspects of the YWS is partial and incorrect. Given goods demand, it is clear that a wage cut for employers will simply raise the profit margin without increasing output. No firm will add labour simply because the wage has been cut for it. Additionally, no firm will add labour beyond what is required to meet the demand for its goods at a given price.

#### SUBSIDY AND TRIPLE CRISIS

The tenth reason why we oppose the YWS is that it *does not contribute to addressing the underlying causes of the youth unemployment problem*. In fact the YWS may worsen the triple crisis of poverty, unemployment and inequality. To think that our proposals are 'long-term' is to fail to understand how practical they are.

The basic education system funnels 400,000 young people every year into the labour market. What is required is a national effort to drastically expand the education and training opportunities of these young people. The YWS proposal is like taking out water from a highly leaky boat, using a small leaky bucket.

The Cosatu position uses the National Skills Development Strategy III as a point of departure, by calling for expansion of the further education and training sector to accept a million learners per annum by 2014, compared to the current 400,000 per annum. This will in turn reduce the youth labour force, by extending their stay in the education and training system, so that they acquire basic and high-level cognitive skills (as the Germans and now the Australians are doing).

Then state-owned enterprises, agencies and departments must stand ready to absorb these young people into practical training and provide work experience, especially



Cosatu marchers against the youth wage subsidy.

William Matlala

given the massive infrastructure backlogs and maintenance that has to be done. The private sector can do the same, without being given wage subsidies, but policies must be in place to support industrialisation and agriculture.

The state must have capacity to plan and forecast for the numbers of young people who enter the post-school system and exit it, and ensure that no one falls through the cracks. This is what the German system does; it does not encourage young people to enter the labour market unskilled, it prepares and empowers young people to have solid career paths in the workplace.

### SOCIO-ECONOMIC CONTEXT

Youth unemployment is obviously the dominant form of unemployment in South Africa, and has become a global phenomenon. According to Stats SA, the vast majority of the unemployed, an estimated 72%, are young people between 15 to 34 years of age; 43% of the unemployed are new entrants into the labour market and are therefore young, and 42% are between the ages of 25 and 34.

Given the age profile of the unemployed, it is clear that youth unemployment is not a sectoral problem. Resolving youth unemployment is in fact almost equivalent to resolving unemployment in general. Therefore the line between youth unemployment and unemployment in general is extremely faint.

In terms of profile, 68% of the unemployed have been unemployed for more than a year, 60% of the unemployed have less than secondary education, 33% have completed secondary education but have no tertiary education, and 95% of the unemployed do not have tertiary education. In addition, 60% of the unemployed have either never worked in their lives or have not worked in the past five years. This situation shows that South

Africa may be in an 'inequality trap'. Unemployment tends to disproportionately affect Africans, women, people in rural areas, and those with less than Standard 10 level of education.

In confronting this problem of youth unemployment, it is important to reflect on the current working conditions of young people. The ILO also reports that 30% of the employed young people in South Africa earn \$2 a day, which is roughly R15 a day. The UNDP's Human Development Report (2010) mentions that 44% of South African workers live on less than \$1.25 a day, which is less than R10 a day.

There is further evidence to show that the increased employment of young people over the past 10 years has been accompanied by increasing poverty among workers. The CEE Report says that the fall in poverty nationally has been due to social grants rather than the increase in employment that we have experienced.

It is also important to reflect on the experiences of young workers whose characteristics are the same as those of the majority of the unemployed youth: African, below the age of 34, with less than secondary education. Putting aside the other conditions of work, such as casualisation and labour brokering, their wage is less than R1,250.

According to Stats SA a more detailed analysis of the average wage of young people with these characteristics shows that on average, these young people earn R940 a month. This low wage level that is currently earned by young workers without secondary education shows that the problem of unemployment faced by these young people has nothing to do with wages, as the majority of them earn less than the minimum wage to begin with. In this regard a YWS has no material basis in South Africa.

There is little training that is taking place in the sectors that have been creating employment in the past decade. Over the seven years prior to the crisis, Stats SA reports that approximately 1.9 million jobs were created in the economy. More than half of these jobs were lost as a result of the global economic crisis, especially in 2009. The sectors in which many of these jobs were created are the wholesale and retail trade sector, private services and construction.

The New Growth Path states that the informal sector, agriculture and domestic work contribute a third of all employment, more than two thirds of working people earn less than R1,000 a month and one in five employed African women is a domestic worker. Very little skills development and training is taking place in these sectors.

In fact the CEE Report (2010) observes that for professionally qualified workers, skills development and training remains biased towards whites, who command 61% of the skills among those who are professionally qualified.

Among skilled workers, the CEE Report says: 'it is evident that private sector employers continue to invest more training on whites than on other population groups. If there was willingness on employers to empower blacks, it would have been evident in the training provided. This therefore suggests that employers are not utilising their training strategically to ensure that they empower the under-represented groups to ensure their upward mobility within the workplace'. Unfortunately, the report does not provide information about skills development and training of the unskilled segment of the workforce. <sup>16</sup>

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