Treasury evidence on YWS suspect

The arguments used by the National Treasury in supporting the introduction of a youth wage subsidy (YWS) are not only thin on evidence, but are not relevant to a developing country such as South Africa, write **Niall Reddy** and **Ilan Strauss**.

The YWS is being touted as a vital measure to reduce unemployment in South Africa. The National Treasury is an important advocate for the policy, arguing for its implementation in a 2011 paper titled 'Confronting Youth Unemployment: Policy Options for South Africa'. In this article we review the literature on the international experience with YWS, focusing on the evidence presented by Treasury. At best, the evidence finds mixed results, which are of questionable applicability to the South African context.

Youth unemployment is an international crisis and not peculiar to South Africa. According to a 2012 International Labour Organisation (ILO) report, young people around the world are three times more likely to be unemployed than adults. The ILO estimates the global youth unemployment rate to be 12.7%.

South Africa's youth unemployment is severe. Over half of 15 to 24 year olds, nearly 1.4 million people, are unemployed, although the ratio of 'youth' to 'adult' unemployment is in line with global rates. Youth unemployment reflects the wider unemployment crisis in the country. Nearly four in ten South Africans in the labour force, i.e. over four million people, are unemployed. Of these, 44% have never worked before, and 68% have been searching for work for a year or longer.

According to the Democratic Alliance (DA) and those in favour of the YWS, high wages cause and deepen mass unemployment. Whose wages we might ask? A 2010 Organisation for Economic Co-operation and Development (OECD) study on South Africa shows that since 1997, the richest 20% of the population 'were the only ones to experience any growth in real wages. All other deciles [tenths of the population divided by income] suffered a decrease in real wages.' During this period real wages of the bottom 10% almost halved. The study concludes that, 'ultimately the highest decile enjoyed the highest increase in real wages while the lowest decile suffered the highest decrease, further entrenching wage inequality'.

An unequal distribution of income can have long-lasting negative effects on an economy. As Nobel prize-winning economist Joseph Stiglitz notes, a shift in the distribution of income away from those who spend their incomes (the working class) to those who do not (the richest 20% in South Africa's case) lowers total demand. This is the primary reason why the global 'recovery' remains lackluster. The International Monetary Fund (IMF) have joined the chorus, and now note the centrality of inequality in increasing instability and undermining economic growth.

South Africa's unemployment crisis existed before the Labour Relations Act of 1995, and the introduction of sectoral minimum wages. Large-scale unemployment began in the 1970s and by 1994 was already, broadly defined, 30%. Trying to locate the causes of our unemployment crisis in the post-apartheid period, as the 'high wages' argument does not make sense.

WHAT FOR YWS

The proposed subsidy will provide R5-billion in tax credits to businesses over an initial three-year period. It will cover half the wages of an employee aged 18 to 29 earning below R60,000 a year. Each employment subsidy lasts for a period of two years for new workers.

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DA marches for youth wage subsidy.

The DA asserts that 430,000 new jobs will be created. However, according to Treasury, the source of this figure, only 178,000 of these – still a significant amount – will be new jobs, since the rest would have been hired anyway. Treasury created these figures by multiplying a range of estimates on old data gathered between 2003 and 2008, rather than using empirical evidence or sophisticated modelling. These figures should be treated with much scepticism.

One researcher noted in 2005 that 'the measured net employment effects [of wage subsidies] tend to be considerably lower than what most theoretical models and simulations predict, even under relatively pessimistic assumptions'.

The strongest argument for a YWS is that formal employment, even if temporary, has been found to have a lasting benefit for young job-seekers in South Africa.

Congress of South African Trade Unions (Cosatu)'s opposition is rooted in the expectation that the subsidy, so far proposed, will cause bosses to plot to discharge non-subsidised, i.e. older, workers; that, when it expires in two years, businesses will retrench the previously subsidised youth or induce everyone to take a wage cut; in short, that it is the thin end of the wedge in a general attack on wage levels.

In tacit acknowledgement of the probable substitution effects, Treasury proposes that the subsidy also be offered to existing eligible employed youth for 12 months, in order to ensure these workers are not immediately substituted out.

WHAT EVIDENCE

Almost all advanced economies have some experience with a mix of Active Labour Market Policies (ALMPs). ALMPs typically include a combination of job assistance, training and vocational programmes, and employment subsidies. Despite ALMPs having been implemented in most countries, insufficient quality evaluations exist to draw definite conclusions about their effectiveness. This is particularly the case when it comes to developing countries where robust assessments are rare.

Little consensus exists as to which policies work or the conditions for their success. One obstacle to reaching a consensus is the difficulty in isolating the effects of a targeted wage subsidy from the wider mix of ALMPs with which it is normally combined.

Major economic bodies like the World Bank advise that wage subsidies can have a positive impact if carefully designed and administered. This is necessary in order to avoid high substitution effects and deadweight losses. Deadweight losses will occur in the South African YWS proposal because in the majority of cases, employment subsidies will be paid to companies to employ labour which they would have hired even in the absence of the subsidy.

The importance of policy design is echoed by most major surveys, which find that wage policies designed as part of a comprehensive mix of interventions, including job training, are more effective. This is notably absent from the South African proposal.

On methodological grounds, studies evaluate policy effectiveness using two main methods. The first uses 'experimental' methods which look at how a policy affects a target group of interest relative to (an assumed) identical 'control' group. These studies neglect to assess the effect of the subsidy on employment in the economy as a whole, rather than just the target group.

The second method used is econometric, i.e. statistical analysis for economics. This looks at correlations between variables while controlling for other factors. However, this provides no counterfactual, i.e. would employment still have gone up *even if* the subsidy wasn't implemented?

Notable is that hardly any evaluations examine the effect of wage subsidies on employment in the economy as a whole. Of the studies cited in the Treasury's 2011 policy document, only two offer estimates for economy-wide job effects, and both of these look at general employment subsidies, rather than youth subsidies. The first paper on Turkey in 2009, finds the primary effect of wage subsidies was to bring pre-existing informal jobs under formal coverage, rather than to create new jobs. The second paper on the US, is from 1978 and of limited relevance to South Africa's case.

The Treasury's marshalling of the evidence lacks the scrupulousness needed to justify the use of R5-billion of public finances.

Firstly, Treasury's evidence is overwhelmingly based on advanced economies whose findings are of questionable relevance to the South African context. Seven out of the 13 case studies cited are from rich countries. A further two are from middle-income countries (Argentina and Turkey); three are from 'transition' countries (Slovakia, Czech Republic and Poland); and only one, Colombia, has strong similarities with the South African context. Moreover, the labour market issues which some ALMPs are designed to address in developed countries – such as overcoming high reservation wages – simply do not exist in developing economies.

A number of cross-country reviews of ALMPs with a focus on developing countries go unmentioned in Treasury's document. Noticeable is that the conclusions of these reviews are less favorable than the Treasury's. For example, a 2004 research found that: 'The clear majority of subsidy programmes 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.'

Another study done in 2006, examined over 23 subsidy

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DA supporters pleading for peace during the march.

programmes of various designs from across Europe and North and South America. The study focuses specifically on the applicability of ALMPs for South Africa and concludes that: 'the accumulation of available evidence is discouraging... the employment effects from firm-side subsidies that do exist are small. This is not a new conclusion, as similar reviews by other researchers concluded that employer-side subsidies are cost inefficient because they subsidise hiring that would have occurred anyhow – and if the subsidy is targeted towards workers of specific characteristics, it may simply induce substitution by the employer from untargeted to targeted workers.'

When developed country evaluations are found to be instructive for the South African case, their effectiveness when implemented is far from guaranteed. A 1999 study found that after reviewing ALMPs in 100 countries 'it is unlikely that these programmes will be more successful in developing countries given the scarcity of administrative capacity to implement these programmes and the paucity of monitoring and evaluation experience to study their effectiveness'.

Secondly, many of the case studies that Treasury cites are unable to provide evidence directly in favour of a *youth* wage subsidy. This is because they look at policies which target categories other than 'youth'. The Argentinean subsidy programme cited by Treasury targets 'poor households and low-income workers'; the Colombian programme targets 'disadvantaged workers, working mothers, the disabled and ex-combatants'; the Polish, Turkish and more recent US case studies all target the entire labour force rather than a specific target group; and the German, Danish and Belgian studies all examine programmes which target long-term unemployed individuals. Other studies, not cited by Treasury, review evaluations of 97 ALMPs from 1995 to 2007, and find that 'programmes for youths are less likely to yield positive impacts than untargeted programmes.'

Thirdly, Treasury is selective in the sources it draws upon. For example, the studies cited on Poland and Germany, which findings are in favour of a wage subsidy, are squarely contradicted by more recent research. The study they cite on the Czech Republic in fact looks at wage subsidies in *Estonia* and does not report the results Treasury claims.

In addition, studies cited by Treasury on Argentina, US, Colombia and Turkey report mixed results and are ambivalent as to the effectiveness of wage subsidies. Others, on Slovakia and Sweden, conclude firmly against their usage.

Lastly, Treasury provides very little evidence to counter the well-substantiated concerns that high substitution costs and deadweight losses will undermine the effectiveness of the YWS. Its only defence is that high growth will reduce these effects and that substitution of current labour for subsidised labour makes 'bad business sense', given that some level of training is usually invested in current employees. The rapid diffusion of labour broking and other precarious forms of employment post-apartheid give ample reason to believe that substitution effects will be considerable.

REDUCING UNEMPLOYMENT IN SA

As chief economist of Stanlib, Kevin Lings, notes, 'South Africa's high unemployment requires a far more complete and bolder solution' than a single-minded focus on wages.

As an alternative, Cosatu proposes extending the duration that youth spend receiving education and training. This will delay the time at which youth enter the labour market, thereby reducing the total number of job seekers at any given point in time. The Cosatu proposal will be implemented through an expansion of the Further Education and Training (FET) sector to 1 million learners a year, from 400,000 at present. This is an important proposal and faces the not insignificant challenge of having to galvanise the government bureaucracy towards this end. Most importantly, its long-term effect on employment remains uncertain, especially if literacy and numeracy levels are not substantially improved.

Strong employment growth requires wide-ranging investment, by both government and the private sector, to foster linkages out of low-value added sectors, and develop a healthy, educated and productive labour force.

A range of inducements and controls can be used by government to persuade private capital towards these ends. But without globally agreed and enforced provisions, many of the 'incentives' used by countries to attract capital to invest domestically, rather than engage in speculation or investment elsewhere, will continue to pit nations against one another, in a counterproductive competition for capital's surpluses.

It is possible to use the resources proposed for the wage subsidy, and more, to achieve similar ends, without threatening existing jobs, and in a way that expands the economy as a whole. The DA's insistence on pursuing a YWS, even in the face of the mixed evidence surveyed here, shows its importance as a means to attack organised labour. LB

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