

**EVALUATION OF THE IMPLICATIONS OF INTRODUCING A
WAGE SUBSIDY SCHEME IN SOUTH AFRICA**

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EXECUTIVE SUMMARY

This report evaluates some implications of introducing a wage subsidy scheme in South Africa. A wage subsidy, as an expression of active labour market policies, is said to help address structural unemployment in South Africa, characterised by the mismatch between skills required for the available jobs and (the lack of) skills possessed by a largely unskilled workforce. However, it could be argued that unemployment in South Africa is also a function of the unavailability of sufficient jobs in the (formal) labour market. Therefore, one of the major challenges facing the introduction of a wage subsidy is whether it could realistically address this latter phenomenon.

While wage subsidies come in different forms (e.g. employer-side, employee-side, general and targeted subsidies), comparative experience indicates that wage subsidies could have unintended adverse effects, could be difficult to sustain, and may lack accountability. Careful design is therefore required. Also, in view of South Africa's unemployment and poverty profiles, a wage subsidy programme should have at its aim the initiation of a *permanent* employment relationship – in order to ensure labour market absorption. Furthermore, the evident skills mismatch characterising structural unemployment in South Africa would require that complementary mechanisms be introduced. Without the availability/provision of appropriate skills training interventions, and possibly job search assistance, wage subsidies are unlikely to achieve their essential aims.

The principal aims of wage subsidies are to increase employment, and to reduce unemployment, poverty and the cost of labour. In the South African context, though, it is suggested by government that a wage subsidy should be structured in such a way as to allow low-income workers to contribute to the envisaged (retirement-based) public social security arrangement. This has been justified on the basis that it would assist in countering the regressive nature of a mandatory social security contribution (tax). However, it is arguable that these regressive elements could also be dealt with by a range or combination of other measures which could achieve the same result.

Careful consideration should be given to mechanisms that have to deal with the wide range of disadvantages which could threaten the impact and success of a wage subsidy programme. However, the challenge is to avoid creating a barrage of cumbersome conditions and administrative checks, while simultaneously ensuring that abuse of the system is minimised. The disadvantages include: (a) the substitution effect of a wage subsidy – a firm may be induced to replace unsubsidised workers with subsidised workers; (b) deadweight loss, i.e. the hiring from the target group that would have occurred also in the absence of the programme; (c) the displacement effect of a wage subsidy, in that a firm with subsidised workers increases output, but displaces output among firms who do not have subsidies workers and, as a result, the subsidy crowds-out employment; (d) stigmatisation of the targeted population in the eyes of employers; (e) a disincentive on the part of the employer to raise wages; and (f) an increase in fiscal costs.

Several crucial choices need to be carefully considered when designing a wage subsidy framework. These choices relate to factors such as duration of the subsidy, the amount of the subsidy, eligibility conditions, and monitoring mechanisms. In essence, it needs to be determined who in particular should be targeted (e.g. first-time labour market entrants) and what specific purpose(s) should be fulfilled by a wage subsidy. One of the problematic issues relates to the fact that restricting the programme to the formal sector would neglect the fact that the bulk of the low-income earners and the atypically employed are involved in the informal economy. Also, the successful implementation of a wage subsidy programme presupposes an effective and efficient administrative and institutional structure.

Proposals aimed at significantly addressing unemployment and welfare dependency, through linking poverty alleviation to economic activity, would require labour market interventions that are not only comprehensive, co-ordinated and integrated, but also effective and tangible. Such an approach would need to go much further than the introduction of particular isolated programmes aimed at job creation.

It is suggested that several constitutional considerations potentially impact on the validity of the envisaged wage subsidy programme. Firstly, issues of equity and the prioritisation of the most vulnerable are raised. It could be argued that the very substantial envisaged financial outlay (R20-30 billion per year) could be used to provide a basic subsistence to a large number of very desperate and, in the social security sense, uncovered people living in deplorable conditions. Secondly, since the Constitution adopts a holistic approach to human livelihood and protection, it is not sufficient to attempt to adopt measures which give effect to the right to access to social security in isolation. This implies a wage subsidy programme should be accompanied by a package approach, whereby the provision of a baseline of services, transfers and resources to those in desperate need is ensured as a matter of priority. The constitutional and developmental imperative for universal basic income support has to be considered within a comprehensive package of measures to address structural poverty.

Thirdly, constitutionally speaking the State would have to indicate that the establishment of a wage subsidy scheme is part of its overall labour market policy framework, not an isolated and uncoordinated policy choice. Finally, the constitutional standard of progressive realisation requires that the State must have in place a policy framework for the realisation of the right of access to social security. In the absence of a social security policy framework providing for incremental provision of social security to the excluded, the Government's plan to introduce the wage subsidy scheme may not pass constitutional muster.

1. GENERAL BACKGROUND

1.1. Introduction

Wage subsidies are a component of *active labour market policies*¹ which *could* play an important role in the prevention and (re)integration endeavours of the South African social security system and most importantly those of the unemployment insurance system. The word ‘could’ is used for the reason that as with any active labour market policy measure, the success of a wage subsidy scheme – if introduced in South Africa – will depend largely on its *design* and *implementation*. This assertion is premised on the view that a poorly designed and implemented active labour market policy measure, is in all probability, an ideal candidate for failure. To facilitate the *review* and the *understanding* of the suitability of a wage subsidy scheme in South Africa (i.e. from a social security perspective), this part of the report will provide an overview of the *labour market trends* which need to be factored in for purposes of the design of a wage subsidy scheme in South Africa. This will be followed by a discussion on the *conceptual framework* as regards the notion of wage subsidies.

1.2. Labour market trends

1.2.1. Nature of unemployment

The unemployment problem currently facing South Africa is largely structural in nature. Structural unemployment can be defined as unemployment that results from a mismatch between skills required for the available jobs and skills possessed by workers seeking work.² Structural unemployment can also occur from a mismatch between the geographical location of available jobs and job seekers.³ As the International Labour Office (ILO) puts it, the seriousness of this type of unemployment from the perspective of individual workers lies not only in its widespread incidence but also particularly in the grave danger that they may remain out of work for a long time.⁴

According to the Statistics South Africa, employment has been on an upward trend since March 2003.⁵ It reports further that in the year to March 2007, the number of employed persons rose from 12 451 000 in March 2005 to 12 648 000 in March 2007.⁶ It is clear that new employment opportunities have been created in South Africa. However, “...low skilled workers who constitute the majority of the South African labour force, struggle to find work opportunities as there is a shift towards demand for high skilled workers. Put differently, the labour force has insufficient skills to take up all the types of employment opportunities created by industry. In addition the types of skills that some of the (skilled)

¹ See, for example, Lee J-K *Evaluation of and Lessons from Wage Subsidy Programmes in OECD Countries* (Directorate of Employment, Labour and Social Affairs (OECD) (2005)) 1- 2.

² Mpedi LG *Redesigning the South African unemployment protection system: A socio-legal inquiry* (Unpublished LLD thesis (UJ) (2006)) 24.

³ Redja GE *Social Insurance and Economic Security* (Englewood Cliffs (1994)) 344.

⁴ International Labour Office *Unemployment Insurance Schemes* (International Labour Office (1955)) 3.

⁵ Statistics South Africa *Labour Force Survey: March 2007* (Statistics South Africa (2007)) iii.

⁶ *Ibid.*

labour force have acquired are not those readily demanded by industry – therefore the economy is challenged by a skills mismatch, further exacerbating the unemployment problem.”⁷ Nevertheless, the nature of unemployment in South Africa is not purely structural. Apart from being structural, unemployment is exacerbated by that fact there are simply not enough jobs available. In other words, even if all unemployed are (re)skilled, not all of them will find jobs. Thus, issues like these need to be factored in as far as the wage subsidy debate is concerned.

1.2.2. Overall unemployment rate and provincial unemployment rates

There are two definitions of unemployment, namely the narrow definition of unemployment and the expanded definition of unemployment. Statistics South Africa explains the meaning of the narrow definition (sometimes referred to as the strict or official definition) of unemployment as involving a condition (being without employment), an attitude (a desire for employment) and an activity (searching for employment).⁸ In accordance with the narrow definition, the unemployed are described as “those people within the economically active population who: (a) did not work during the seven days prior to the interview, (b) want to work and are available to start work within two weeks of the interview, and (c) have taken active steps to look for work or to start some form of self-employment in the four weeks prior to the interview.”⁹ The expanded definition of unemployment excludes the criterion that an unemployed person must have taken active steps to look for work or to start some form of self-employment in the four weeks prior to the interview. Statistics South Africa uses the narrow definition as the official definition of unemployment in South Africa. Accordingly, statistics used in this study are based on the official definition.

The unemployment rate in South Africa, based on the official definition, is 25,5%.¹⁰ Furthermore, the unemployment (based on the official definition) problem in South Africa is not evenly spread between provinces, population groups, gender and age. In March 2007, provinces such as KwaZulu-Natal, Eastern Cape, North West and Limpopo had higher unemployment rates than elsewhere while the Western Cape had the lowest unemployment rate over the same period.¹¹

⁷ National Treasury Wage Subsidy: Draft Discussion Paper (IDTT Working Paper (2007)) 16.

⁸ See Statistics South Africa *Labour Force Survey: March 2007* (Statistics South Africa (2007)) xxii.

⁹ Statistics South Africa *Labour Force Survey: March 2007* (Statistics South Africa (2007)) xxii.

¹⁰ Statistics South Africa *Labour Force Survey: March 2007* (Statistics South Africa (2007)) ii.

¹¹ Official unemployment rate by province, September 2006: Western Cape (17.2%); Eastern Cape (25.5%); Northern Cape (26.5%); Free State (26.4%); KwaZulu-Natal (29.2%); North West (32.0%); Gauteng (22.6%); Mpumalanga (26.3%) and Limpopo (32.4%) (Statistics South Africa *Labour Force Survey: March 2007* (Statistics South Africa (2007)) xv).

UNEMPLOYMENT RATE BY PROVINCE, MARCH 2001 TO MARCH 2007

Province	Mar 2001	Mar 2002	Mar 2003	Mar 2004	Mar 2005	Mar 2006	Mar 2007
Total	26.4	29.7	31.2	27.9	26.5	25.6	25.5
Western Cape	19.0	18.4	19.9	16.8	17.6	15.9	17.2
Eastern Cape	28.4	26.4	29.8	32.6	27.1	22.1	25.5
Northern Cape	23.8	27.7	28.9	22.4	29.4	23.5	26.5
Free State	27.4	31.1	31.2	26.0	30.6	28.3	26.4
KwaZulu-Natal	26.2	35.9	36.3	33.0	31.7	29.9	29.2
North West	27.9	30.3	32.3	30.8	28.8	31.8	32.0
Gauteng	28.2	29.8	30.8	27.7	22.7	23.3	22.6
Mpumalanga	26.3	29.9	30.8	25.7	27.4	27.4	26.3
Limpopo	28.1	35.1	39.4	31.2	32.4	35.6	32.4

Source: Statistics South Africa¹²

These disparities between provinces can be traced back to the old South Africa. Poor performing provinces, such as the Eastern Cape and Limpopo, inherited most parts of the former homelands or Bantustans.¹³ The drawback of this inheritance is that homelands were characterised by deep-rooted social and economic problems which could not just be wished away. These problems include poverty and inequality, unemployment, poorly developed welfare services and infrastructure, authoritarian regimes and prevalence of male migrant labour.¹⁴

1.2.3. Unemployment rate by population group and sex

Unemployment rate by population group and sex (based on the official definition), as shown in a table below, indicates that Africans had the highest unemployment rate in South Africa over the period March 2001 to March 2007 when compared with other population groups. In May 2007, the unemployment rate by population group was as follows: 30,2% among black Africans, 19,8% among coloured people, 13,8% among Indians/Asians and 4,3% among white people.¹⁵

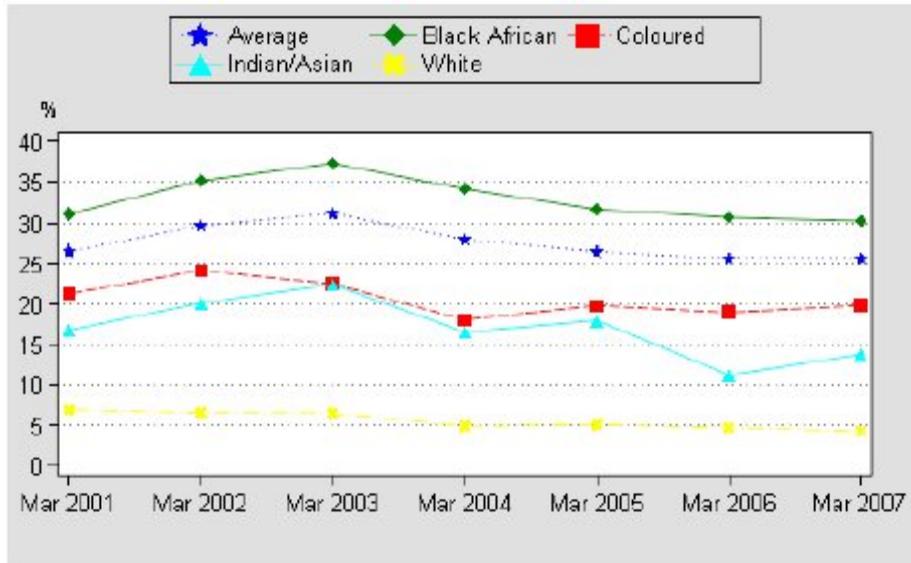
¹² Statistics South Africa *Labour Force Survey: March 2007* (Statistics South Africa (2007)) xv.

¹³ WordIQ (<http://www.wordiq.com/definition/Bantustan.html>) describes Bantustans as follows: "Bantustan or Bantustans is the name that was given to the tribal homelands of South African native black Africans by the white Apartheid rulers of the Republic of South Africa that were designated to become independent states under a grand plan called 'separate development' which would have granted independence to blacks in these newly created tribal states. Bantu means 'people' in the Bantu languages spoken in Southern Africa. There were to be about ten Bantustan-Homelands [Bophuthatswana, Ciskei, Gazankulu, KaNgwane, KwaNdebele, KwaZulu, Lebowa, QwaQwa, and Transkei]. These small, quasi-sovereign nations were established under the 1951 Bantu Authorities Act."

¹⁴ See, for an interesting description of the nature and extent of the socio-economic circumstances which characterised the former homelands, Lahiff *E Land, Water and Local Government in South Africa: A Case of the Mutale River Valley* (IDPM Rural Resources/Rural Livelihoods Working Paper No. 7 (1997)) – accessed at http://idpm.man.ac.uk/publications/wp/rr/rr_wp07.shtml.

¹⁵ Statistics South Africa *Labour Force Survey: March 2007* (Statistics South Africa (2007)) xv.

UNEMPLOYMENT RATE BY POPULATION GROUP, MARCH 2001 TO MARCH 2007 (PERCENTAGE)



Source: Statistics South Africa¹⁶

In addition, the female unemployment rate in South Africa was, irrespective of the population group, higher than the male unemployment rate over the same period. In May 2007 the unemployment rate among females was 30,8%. This is substantially higher than the male unemployment rate of 21,1%.¹⁷

UNEMPLOYMENT RATE BY SEX AND POPULATION GROUP, MARCH 2001 TO MARCH 2007

Sex and population group	Mar 2001	Mar 2002	Mar 2003	Mar 2004	Mar 2005	Mar 2006	Mar 2007
Male							
Black African	29.4	31.4	32.8	29.4	26.7	25.8	25.0
Coloured	19.9	21.4	20.3	16.2	18.6	18.3	16.9
Indian/ Asian	14.4	17.5	18.2	14.0	15.4	11.8	11.3
White	6.0	5.0	5.6	3.9	4.4	3.6	4.1
Average	24.6	26.1	27.2	23.9	22.4	21.6	21.1
Female							
Black African	33.0	39.5	42.6	39.9	37.6	36.2	36.4
Coloured	22.8	27.2	24.7	20.2	21.2	19.6	22.9
Indian/ Asian	20.5	24.0	28.7	21.0	22.6	10.2	17.9
White	8.2	8.6	7.7	6.3	5.9	6.2	4.6
Average	28.6	33.9	35.9	32.9	31.4	30.3	30.8

Source: Statistics South Africa¹⁸

¹⁶ *Ibid* at xvi.

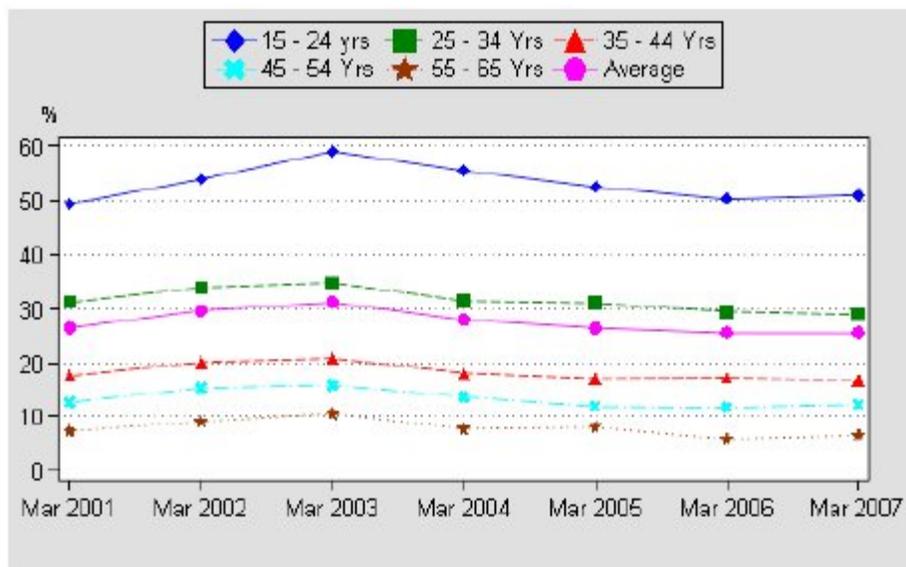
¹⁷ *Ibid* at xvi.

¹⁸ *Ibid*.

1.2.4. Unemployment rate by age

The official unemployment rate by age, as reflected below, reveals that the official unemployment rate is still high among the youth.¹⁹ As shown below, the employment rate among persons aged 15-24 years is higher than those in the 25-34 year age group.²⁰ It has been noted that, with reference to the 2006 Labour Force Survey statistics, the largest number of unemployed individuals is amongst the youth, constituting 73 percent of the unemployed.²¹ Furthermore, the unemployment rate among persons aged 35-44 is higher than among those in the 45-54 age group.

UNEMPLOYMENT RATE BY AGE, MARCH 2001 AND MARCH 2007 (PERCENTAGE)



Source: Statistics South Africa²²

1.2.5. Employment in the formal and informal sector²³

As is apparent from the table below, the formal sector (excluding agriculture) accounts for the largest share of employment in South African economy.²⁴ According to Statistics

¹⁹ The term 'youth', in line with the standard ILO definition, "comprises the age-group between fifteen and twenty-four inclusive." O'Higgins N *The Challenge of Youth Unemployment* (ILO (1997)) 1.

²⁰ Statistics South Africa *Labour Force Survey: March 2007* (Statistics South Africa (2007)) xvii.

²¹ National Treasury Wage Subsidy: Draft Discussion Paper (IDTT Working Paper (2007)) 16.

²² *Ibid.*

²³ Statistics South Africa distinguishes between the 'formal sector' and the 'informal sector' as follows: the 'formal sector' "includes all businesses that are registered in any way" (Statistics South Africa *Labour Force Survey: March 2007* (Statistics South Africa (2007)) xxiv). The 'informal sector', on the other hand, "consists of those businesses that are not registered in any way". Statistics South Africa provides further that: "[These businesses] are generally small in nature, and are seldom run from business premises. Instead they are run from homes, street pavements or other informal arrangements" (Statistics South Africa *Labour Force Survey: March 2007* (Statistics South Africa (2007)) xxiv). In this study, the concept 'informal sector' is used interchangeably with 'informal economy'.

South Africa, in May 2007 employment in the formal sector was 8 423 000 or 66,6% of total employment, whereas informal sector employment was 2 131 000 (16,9%) and domestic work accounted for 936 000 jobs (7,4%).²⁵ Furthermore, formal sector employment continued to rise in the period March 2001 to March 2007.²⁶

EMPLOYMENT IN THE FORMAL AND INFORMAL SECTOR, MARCH 2001 TO MARCH 2007

Sector	Mar 2001	Mar 2002	Mar 2003	Mar 2004	Mar 2005	Mar 2006	Mar 2007
Formal (excluding agric)	6 808	7 097	7 228	7 483	7 750	8 059	8 423
Informal (excluding agric)	2 840	1 824	1 830	1 766	2 071	2 190	2 131
Unspecified sector	208	81	74	37	67	34	83
Domestic workers	843	877	884	847	850	850	936
Agriculture	1 577	1 739	1 288	1 258	1 170	1 318	1 075
Total employment	12 275	11 617	11 304	11 392	11 907	12 451	12 648
Formal (excluding agric)	55.5	61.1	63.9	65.7	65.1	64.7	66.6
Informal (excluding agric)	23.1	15.7	16.2	15.5	17.4	17.6	16.9
Unspecified sector	1.7	0.7	0.7	0.3	0.6	0.3	0.7
Domestic workers	6.9	7.5	7.8	7.4	7.1	6.8	7.4
Agriculture	12.8	15.0	11.4	11.0	9.8	10.6	8.5
Total employment	100.0						

Source: Statistics South Africa²⁷

As regards the employment shares by industry in the formal and informal sectors: (March 2001 to March 2007 (percentage)), the Statistics South Africa reports that:

- The largest group of persons employed in the formal sector work in the community and personal services industry (24,3% in March 2007), whereas in the informal sector the largest group work in wholesale and trade (44,8%).
- In the formal sector, the downturn in the mining industry in recent years is reflected in the falling share of mining in total employment from 8,2% in March 2001 to 5,4% in March 2007.
- The contribution to total employment declined in several industries over the period March 2001 to March 2007 (mining, wholesale and retail trade, transport and private households).
- Over the period March 2001 to March 2007, whereas the percentage of persons employed in wholesale and retail trade in the formal sector rose from 20,3% to 23,5%, in the informal sector the percentage of persons engaged in such activities fell from 57,6 to 44,8%.²⁸

²⁴ *Ibid* ix.

²⁵ *Ibid*.

²⁶ *Ibid*.

²⁷ Statistics South Africa *Labour Force Survey: March 2007* (Statistics South Africa (2007)) ix.

²⁸ *Ibid* xi.

1.2.6. Some observations

The preceding statistics, apart from revealing the immense unemployment challenge faced by South Africa, indicate the areas (at provincial level, in terms of population group, gender and age), that require more emphasis on unemployment eradication endeavours such as the proposed wage subsidies. However, it should be noted that the wage subsidy scheme cannot be romanticised as *the* ultimate solution for the South African unemployment problem. Certain categories of the unemployed may need different interventions other than wage subsidies or such interventions may need to be combined with wage subsidies. The unemployed youth are the case in point. This category of unemployed persons is most likely to require training as well as wage subsidies. Training programmes and wage subsidies aimed at the unemployed youth could be beneficial in addressing the lack of skills as well as the lack of experience problems often experienced by the unemployed youth. This should be viewed from the point of view that:

“While youth unemployment cannot be traced back to a single source, there are, however, several issues which may be pointed out as contributors to rising youth unemployment. A general lack of job opportunities in the labour market tops the list. Secondly, a shortage of relevant and adequate skills (which could be attributed to lack of relevant experience, lack of qualification, inadequate training and irrelevant qualification) delays or prevents the entry of young unemployed persons into the labour market. Thirdly, those who find their way into the world of work often exit the labour market at an early stage in situations of mass layoffs. Limited work experience and redundancy selection criteria such as ‘last in first out’ invariably promote youth unemployment. In addition, [the South African unemployment protection scheme]... neglect young unemployed persons. At the end of the day a majority of the young and unemployed sector of the population is caught in ‘no man’s land’ – that is between school and the labour market.”²⁹

1.3. Conceptual framework

A plethora of different types of active labour market programmes which are designed for a variety of objectives can be found in a sizeable number of countries of the world (e.g. the OECD countries).³⁰ Despite that, these programmes can be classified as follows: wage subsidy schemes in the private sector, direct job creation schemes in the public sector, training programmes, and employment services for job-search assistance. A typical active labour market programme comprise of (some of) the following components: job-search assistance, training for the unemployed, retraining for workers in mass layoffs, training for the youth, training of active workers, wage subsidies, direct job creation (public works) and self-employment assistance.³¹ As shown in a table below, these instruments can be used to address a variety of labour market problems:

²⁹ Mpedi LG *Redesigning the South African Unemployment Protection System: A Socio-Legal Inquiry* (Unpublished LLD Thesis (UJ) (2006)) 30.

³⁰ Lee J-K *Evaluation of and Lessons from Wage Subsidy Programmes in OECD Countries* (Directorate of Employment, Labour and Social Affairs (OECD) (2005)) 1.

³¹ “Active labour market policies” – accessed at <http://idbdocs.iadb.org/wsdocs/getdocument.aspx?docnum=494806>.

OBJECTIVE / PROBLEM	SPECIFIC ALMP INSTRUMENT
Reduce frictional unemployment / moderate cyclical downturns	Labour intermediation services Wage subsidies Self-employment support Training
Reduce structural unemployment / Structural imbalances	Training and retraining Relocation assistance Wage subsidies
Increase demand for labour	Small business technical assistance Job subsidies Temporary job creation
Enhance skills and productivity	Training and retraining
Support disadvantaged or at-risk workers	Employment service Training Wage subsidies

Source: “Active labour market policies”³²

It could be argued that active labour market programmes are premised on the idea that resources should be channeled towards employment promotion and job creation (through, *inter alia*, programmes aimed at job search assistance, job training and wage subsidies). This approach deviates from that of promoting the ‘culture of dependency’ by keeping people on benefits. By their nature, activation policies are generally concerned about the improvement of the jobseeker’s chances of (re)entering the labour market. They, therefore, strive for labour market inclusion through increased labour market participation.³³

With the foregoing in mind, a wage subsidy programme is one of the major forms of active labour market programmes³⁴ in the sense that it is “concerned with the creation or conservation of employment, the improvement of job-related skills, or the improvement of the functioning of the labour market.”³⁵ Different types of wage subsidies, which include the following, are identifiable:

- (a) *General wage subsidy* is paid to all workers, in all sectors.
- (b) *Sectorally-targeted subsidy* is paid for workers in pre-defined “sectors” (such as the manufacturing sector).
- (c) *Size-targeted subsidy* is paid to small-scale firms or/and newly established forms.

³² *Ibid.*

³³ Mpedi LG Redesigning the South African Unemployment Protection System: A Socio-legal Inquiry (Unpublished LLD Thesis (UJ) (2006)) 41-42.

³⁴ Lee J-K *Evaluation of and Lessons from Wage Subsidy Programmes in OECD Countries* (Directorate of Employment, Labour and Social Affairs (OECD) (2005)) 1.

³⁵ Human Resources and Social Development (Canada) “Wage subsidies to encourage the hiring of unemployment insurance claimants – November 1994” – accessed at <http://www.hrsdc.gc.ca>.

- (d) *Group-targeted subsidy* is paid for each worker in pre-defined groups with reference to, for example, race, age, gender, long-term unemployed, etc. This type of subsidy “tend[s] to attract controversy because they are so open to corruption and abuse – employing people only as long as the subsidy is available, for example.”³⁶
- (e) *Marginal employment subsidy* is paid for each extra worker added to employment in a pre-defined period.³⁷

Although wage subsidy schemes can take a variety forms, it should be noted that:

“Wage subsidies can be paid either to employers or to employees. The subsidy itself can be paid as a tax credit or a reduction in social security contribution or as a direct payment. Although wage subsidy programmes have much variance in their designs, their ultimate goal is to increase employment through lowered labour costs or increased labour supply.”³⁸

2. DESIGNING A WAGE SUBSIDY SCHEME

2.1 Circumstances impacting on the design of a scheme

Various economic and labour market factors will impact on the design of a wage subsidy scheme, such as the extent and the nature of unemployment. If one of the primary reasons for high unemployment in South Africa is the relatively low skills levels of a significant portion of the South African labour force and a mismatch of skills possessed by the labour force and skills demanded by industry, a general wage-subsidy aimed at low-skilled workers, unaccompanied by training or reskilling, is not likely to have a significant long-term impact on unemployment.

Sianesi³⁹ also points to the critical link between the active labour market policies adopted in Sweden and the unemployment benefit system and notes that such interaction will intensify when unemployment is high and labour market conditions are unstable. The crux of the issue is that employees’ incentives to work are a function not only of the unemployment rate and their relative wages, but also of their average non-wage income, including unemployment benefits they may receive.⁴⁰ If unemployment benefits are too high, it will have an adverse impact on low-income workers’ incentives to work, and therefore, on the efficacy of any envisioned wage subsidy and how it needs to be designed.

³⁶ Joffe H “Wage subsidy can be a powerful tool, o kept sharp and used right” Business Day (14 February 2007) – accessed at <http://www.employment-policy.net>.

³⁷ Standing G *et al Restructuring the Labour Market: The South African Challenge* (ILO (1996)) 479.

³⁸ Lee J-K *Evaluation of and Lessons from Wage Subsidy Programmes in OECD Countries* (Directorate of Employment, Labour and Social Affairs (OECD) (2005)) 2.

³⁹ Sianesi B ‘Swedish active labour market programmes in the 1990s: Overall effectiveness and differential performance’ (2001) 8 *Swedish Economic Policy Review* 133 at 164.

⁴⁰ Phelps ES ‘Low-Wage Employment Subsidies versus the Welfare State’ (1994) 84 (2) *The American Economic Review* 54 at 55.

The impact of a wage subsidy on the costs of labour must also be considered in light of the other factors, direct or indirect, that affect the costs of labour.⁴¹ Moolman, for example, states that the (in his view) labour market rigidity in South Africa raises the indirect costs of labour. Therefore, any positive effect a wage subsidy may have on the costs of labour may be dampened or even negated by such indirect costs of labour.⁴²

Ultimately any wage subsidy scheme must be part of an integrative labour market approach and be designed in such a way that its positive effects far outweigh the negative consequences it may have.⁴³ The design of the subsidy must also encourage participation without creating disincentives to work and to be productive, and to report honestly.⁴⁴

2.2 Some comparative experiences

The comparative experiences cited here must be viewed in the context of every country's economic and labour market conditions, the factors that inform the unemployment profile(s) obtaining in these countries, including the extent and nature of unemployment, as well as other labour market factors that may impact on the effectiveness or otherwise of wage subsidy programmes.

2.2.1 Argentina

The wage subsidy scheme in Argentina was operated from 1994 to 1996 and entailed government subsidising the wages of workers registered with the state employment agency. The scheme started out with 1108 persons participating on a monthly basis, but this number had decreased to 49 by the first half of 1996, and it was subsequently discontinued. The Heads of Household Programme was introduced in April 2002, whereby a below minimum wage subsidy was paid to the head of a household, on condition that such person participates in certain work projects.⁴⁵

Argentina's economic landscape⁴⁶ is comparable to that of South Africa, because it faces similarly high unemployment rates, with unemployment tending to affect low-skilled workers more than high-skilled workers. There also seems to be an increase in temporary, unprotected jobs and an increase in inequality within the country.

⁴¹ National Treasury 22.

⁴² *Ibid.*

⁴³ See below on the advantages and disadvantages of wage subsidy schemes.

⁴⁴ Human Resources and Social Development Canada 'Wage Subsidies to Encourage the Hiring of Unemployment Insurance Claimants' (1994) 1.

⁴⁵ http://www-wds.worldbank.org/external/default/main?pagePK=64193027&piPK=64187937&theSitePK=523679&menuPK=64187510&searchMenuPK=64187283&siteName=WDS&entityID=000094946_02110604045865 (23/10/07).

⁴⁶ http://info.worldbank.org/etools/docs/library/111334/Fiszbein_Argentina%20+%20Colombia_12-04.pdf (23/10/07).

In an evaluation that was conducted by the World Bank,⁴⁷ it was found that a substantial number of the beneficiaries of this Programme had been previously inactive. The programme was also well targeted to the poorest households. Although monitoring of the programme was problematic, 65% of respondents said that they worked the requisite hours. It was also established that without the programme, 10% of the beneficiaries would have fallen into extreme poverty.

2.2.2 Chile

Chile has two training-related subsidy schemes. *Chile Joven* is targeted at the youth unemployed and has four sub-programmes: training and work in firms, work training to become self-employed, training for young workers and a form of apprenticeship programme.

The other scheme offers a tax rebate to employers who provide on-the-job training to workers aged 20 years or younger.

Chile Joven was created because unemployment in Chile continued to rise despite economic growth, leading to the conclusion that there was a lack of or mismatch of skills in the economy.⁴⁸ In a cost-benefit-analysis that was conducted, it was calculated beneficiaries generally had to be in the programme for 12 years for it to have a positive Net Present Value. For the youngest beneficiaries, benefits had to be received for 9 years before the programme had positive Net Present Value.⁴⁹

Some of the main questions⁵⁰ that had to be answered included whether these programmes had unintended adverse effects, e.g. did they cause school desertion among individuals that should still have been in formal education? Also, the sustainability of the programmes in economic downturns was questionable.⁵¹

2.2.3 Sweden

Sweden has provided an array of active labour market policies and unemployed persons may potentially choose from programmes that provide direct incentives to work, one option of which is a wage subsidy, and other measures that aim at improving individual productivity and skills, e.g. formal teaching or work experience. The job subsidies in Sweden were originally necessitated by structural adjustments caused by various international and domestic economic calamities in the 1970s. They were principally in the form of specific subsidies to selected firms in distressed sectors and/or regions.⁵²

⁴⁷ *Ibid.*

⁴⁸ Cristian AI 'Job Training Programs: The Cases of Chile Joven and Argentina Proyecto Joven' (2002) *Seminar on Social Protection for the Poor in Asia and Latin America* available at http://www.adb.org/Documents/Events/2002/SocialProtection/aedo_presentation.pdf (23/10/07).

⁴⁹ *Ibid.*

⁵⁰ *Ibid.*

⁵¹ *Ibid.*

⁵² Carlsson B 'Industrial subsidies in Sweden: Macro-economic effects and an international comparison' (1983) 32 *The Journal of Industrial Economics* 1 at 5.

There are, however, various other targeted, general subsidies that are paid:⁵³ Workers who face being retrenched as the result of changing technology are eligible for the Internal Training subsidy over two years. Legal immigrants are eligible for the Hiring Subsidy for Immigrants in all sectors. For youth aged between 17 and 20 years a Pre-vocational Training subsidy is provided of 60% of total salary costs for all sectors and 100% for the public sector who provide on-the-job training and experience. There is a separate wage subsidy programme for the disabled, whereby people with disabilities are eligible for the Employment Subsidy for Disabled Persons.

2.2.4 United States

The United States have adopted various subsidies to increase demand for low-skilled workers and workers from disadvantaged groups. The Clinton Administration tried to effect wage subsidies by means of wage vouchers, which would be given to welfare recipients and who would then approach employers with these vouchers.⁵⁴ This form of targeting, however, created a stigma with employers, who were weary of hiring these welfare recipients.⁵⁵

It has also been found that there is a lack of accountability in many job subsidies that are given to employers.⁵⁶ Companies who receive subsidies would not create jobs at all, some companies have lost jobs after receiving subsidies. Some companies use region-specific subsidies to transfer jobs from one location to another.

2.3 Objectives and philosophy of wage subsidy schemes

National Treasury⁵⁷ lists the principal aim of a wage subsidy as being the reduction of the cost of labour. Governments have utilised wage subsidies to increase labour demand and/or supply or merely to increase the wages of low-income employees. In case of targeted employer-side wage subsidies, the aim is to provide employment opportunities to the targeted worker group by increasing labour demand for disadvantaged groups such as the long-term unemployed, the unemployed youth, low-skilled workers, etc.⁵⁸ They also provide opportunities for these disadvantaged groups to obtain work experience that can be transferable to 'real' jobs in the labour market.⁵⁹

The envisaged wage subsidy is also seen as a means of allowing low-income earners to contribute to the compulsory, contributory retirement scheme that is envisioned.

⁵³ See <http://www.hrsdc.gc.ca/en/cs/sp/hrsd/prc/publications/research/1998-000026/page06.shtml> (23/10/07)

⁵⁴ Whitman D 'Take this job and love it' (1996) 121 (15) *US News and World Report* 45 at 46.

⁵⁵ Katz LF 'Wage Subsidies for the disadvantaged' (1996) *National Bureau of Economic Research Working Paper* 5679 at 5.

⁵⁶ LeRoy G 'No More Cany Store: States and Cities Making Job Subsidies Accountable' (1997) *Good Jobs First Publication, Institute on Taxation and Economic Policy* ii.

⁵⁷ National Treasury 'A Wage Subsidy: Draft Discussion Paper' (July 2007) 34.

⁵⁸ Lee J 'Evaluation of and Lessons from Wage Subsidy Programmes in OECD countries' (2005) 2.

⁵⁹ Lee 10.

In Sweden, employment subsidies represent opportunities to acquire job-specific skills, but also aim at ‘initiating a permanent employment relationship, the engagement being implicitly expected to continue on a regular and indefinite basis after the end of the programme.’⁶⁰ The participant therefore replaces ‘ordinary’ labour.

The philosophy underpinning a wage subsidy scheme will obviously impact on the design of the subsidies to be utilised. An example⁶¹ is the difference between a permanent wage subsidy to low-wage workers on the one hand, and a temporary employment subsidy to hire unemployed workers, on the other hand. The latter subsidy is targeted at the unemployed, while the former subsidy is targeted at low-income workers. However, both subsidies affect people’s incentives to work and therefore impact on both unemployment and working poverty, i.e. poverty amongst those people who do have employment..

2.4 Operation of wage subsidy schemes

In operating a subsidy scheme, choices will have to be made regarding matters such as the duration of the subsidy, its amount, its eligibility conditions and how its operation will be monitored. For any given scheme, the scale, duration and coverage of payments will affect the efficacy of that scheme. A key issue for policymakers is whether it is more effective to spend a given amount on a large number of participants who each receive a small subsidy and/or a subsidy of short duration, or to reduce the number of participants while increasing the amount and/or the duration of the subsidy.⁶²

The IDTT Working Paper of National Treasury envisions that the proposed wage subsidy in South Africa is aimed at employment creation and will be phased out over time, while the social security subsidy that enables low-income earners to contribute to the public retirement scheme is likely to be a permanent feature.⁶³ Of course, the decision at what point and how to phase out the employment creation-oriented wage subsidy has to be sensitive to the need to ensure that, as far as possible, low-income earners have become integrated into the labour market on a longer-term (preferably permanent) basis.

The decision to implement a social security-related wage subsidy has been justified on the basis that –

“Due to its flat rate structure, social security contributions ‘taxes’ tend to be regressive, i.e. the effective burden on income decreases as incomes rise. This effect would be particularly punitive on incomes of employees falling below the tax threshold, as they derive no benefit (indirect subsidy) from the tax system through the deductibility of contributions.”

“Therefore, the social security subsidy would assist in countering the regressive nature of a mandatory social security contribution (tax) by subsidizing a significant portion of the social security contributions for low income workers. Leaving the system without intervention would increase the

⁶⁰ Sianesi 158.

⁶¹ Orszag JM and Snower DJ ‘Designing employment subsidies’ (2003) 10 *Labour Economics* 557 at 558.

⁶² Meager N and Evans C ‘The evaluation of active labour market measures for the long-term unemployed’ (1998) *ILO Employment and Training Papers* 23.

⁶³ National Treasury 35.

cost of low income labour relative to high income labour, which may result in a reduction in both the disposable incomes of low income earners and their total employment.”⁶⁴

Of course, it is debatable whether a wage subsidy would of necessity be needed to redress these regressive elements. One would think that a range or combination of other measures could achieve the same result, such as changes to the system of tax deductibility. It would also appear that the payment of a direct subsidy to enable low-income earners and/or their employers to pay social security contributions is, with some exception, not a measure which is generally applicable in comparative systems in the developing world.⁶⁵

It is unclear whether one subsidy will be expected to fulfill both the employment and the social security function, or if two separate subsidies would be implemented. If only one subsidy is envisaged, how would it be determined which portion of the subsidy is to be phased out over time and how big that portion would be?

2.4.1 Duration

One of the principal benefits of a wage subsidy programme is that the longer people participate, the more their job skills improve and therefore their chances to obtain employment outside the programme increase.⁶⁶

2.4.2 Amount/level of the subsidy

The level of a wage subsidy may be determined with reference to various factors:⁶⁷

(a) Economic conditions

It is possible to set subsidies at higher levels in high unemployment regions than in low unemployment regions. In South Africa that would mean that wage subsidies could be set lower in the Western Cape, where unemployment is relatively speaking not very high, than in Limpopo, where unemployment is very high. This assertion would, however, only apply where non-targeted wage subsidies are at issue. Also, regional or geographical differences in wage subsidies may have to survive a constitutional attack based on the constitutional right and value of equality – the justification will have to be carefully scrutinised, in view of the broader labour market, poverty and related profiles, as well as with reference to whether other less discriminatory means could have been applied.

(b) Duration of unemployment

The best time to intervene with a wage subsidy may be when a person has just become unemployed, as it is clear that the longer a person remains unemployed,

⁶⁴ National Treasury 30.

⁶⁵ See par 5.2.2 below.

⁶⁶ Human Resources and Social Development Canada 7.

⁶⁷ Human Resources and Social Development Canada 6.

the harder it becomes to be integrated into the labour market again. And yet it may still take time for such a person to obtain employment. An important issue is whether the amount of the subsidy should be tied to the length of unemployment.

The Jobstart programme in Australia, for example, offers higher wage subsidies to employers for hiring people who have been unemployed for longer periods.

The danger of using duration of unemployment as a basis for calculating the amount of subsidies lies in that it may offer an incentive to firms to put off hiring a person in order to get a higher subsidy. If a firm waits a few weeks to employ a person, that firm could gain a higher subsidy for months to come.

In the South African context, it is arguable that varying the amount of the subsidy according to the period of unemployment would not be administratively viable. Furthermore, the institutional link between unemployment insurance and the wage subsidy framework is not clear, nor is the institutional framework for monitoring the payment and general efficacy of the said subsidy.

(c) Other employee risk factors

Other risk factors relating to employees may be their level of education, their gender, their ethnicity, etc. However, formulations based on these factors would be cumbersome and increase administrative difficulties. Once again, they may also raise questions of constitutional validity, in particular in the South African context.

(d) Maximum Unemployment Insurance Benefits

It is arguable that subsidy levels should be set so as to be more beneficial than simply collecting the maximum unemployment insurance (UI) benefits. However, a wage subsidy scheme could be designed so that high-risk UI claimants do not have the option of drawing benefits unless they participate in a wage subsidy programme.

It is also possible to place caps or floors on subsidies, depending on whether it is a subsidy to employers or to employees. If the latter, a maximum subsidy per employee would constitute an indirect targeting of the subsidy to low-wage workers, without the potential stigma. However, it must be phased in so as to not cause a downward jump in the subsidy for workers earning just above the cap.

2.4.3 Eligibility conditions

It is useful, at the outset, to distinguish between general subsidies and specific subsidies.⁶⁸ The former are those subsidies that are given under certain standard procedural rules to determine the eligibility of applicants and are then given to all

⁶⁸ at 2.

entrants within that framework. Specific subsidies more often than not involve support for a specific project or product or for the restructuring or re-equipment of a firm. In the South African context, we are likely to deal with general subsidies.

The eligibility criteria for the wage subsidy must not be too difficult to cross-check. For example, Argentina encountered considerable difficulties in the Heads of Household Programme, because it was difficult to check whether someone was in fact unemployed and the head of a household. Similarly, it was difficult to check whether the person actually performed the requisite hours in designated work projects.⁶⁹

2.4.4 Monitoring

There is a definite link between eligibility requirements of a subsidy and the requirements for its effective monitoring. The easier it is to cross-check criteria, the easier it is to monitor compliance with the scheme.

Effective monitoring is required regardless of whether a subsidy is paid to employees or employers. If it is paid to employees, it must be ensured that employees actually perform their required functions. If it is paid to employers, it is necessary to follow up whether employers have in fact employed persons from targeted groups, whether the working conditions and the quality of the jobs provided are adequate and whether workers are actually working for the requisite time periods.

In the South African context, the institutional framework for monitoring the effective implementation of the proposed wage subsidy is unclear. If SARS is to be involved in the administration, would it also take responsibility for monitoring, or would it fall to the Department of Labour? If the latter, would general labour inspectors be utilised or would specific appointees take responsibility for this task? Could the Unemployment Insurance Fund have a role in this regard if methods of targeting include application for or receipt of unemployment insurance benefits?

2.4.5 Other considerations for implementation

In Europe it has been found that there may be legal impediments to the extension of wage or job subsidies. The public sector is not allowed to use such grants and since 1997 the European Union has also prevented their use in the synthetic fibre, automotive, steel, shipyard, fishery and transport industries.⁷⁰

While the rationale for these limitations is not clear, it may be that the deadweight and displacement effects⁷¹ in the given sectors were found to be too high.

⁶⁹ http://info.worldbank.org/etools/docs/library/111334/Fiszbein_Argentina%20+%20Colombia_12-04.pdf (22/10/07).

⁷⁰ Sianesi 166.

⁷¹ See par 4.3 below for a discussion of these issues.

3. THE DESIRABILITY OF INTRODUCING A WAGE SUBSIDY

3.1 Introduction

There are considerable differences in the design of wage subsidies and they differ in accordance with the type adopted. General wage subsidies are paid to all low-wage earners in an economy, regardless of their employment history. Targeted wage subsidies, on the other hand, are tailored to particular groups of the unemployed and typically granted for a limited period.⁷² Wage subsidies are paid either to the employer (employer-side wage subsidy) or to the employee (employee-side subsidy).⁷³

This discussion will, however, focus generally on the desirability of the introduction of a wage subsidy generally, with some reference made to these specific types. The discussion will also look at the pros and cons of introducing a wage subsidy and against this backdrop, analyse the desirability of its introduction, bearing in mind the labour market concerns currently prevalent in South Africa.

3.2 Advantages of a wage subsidy

Low and insecure earnings are some of the characteristics which apply to those in the low-income earning bracket. A transition from such a labour environment to a more secure work environment is extremely difficult if the income from such low-wage and insecure employment does not replace low levels of this income support. This is further aggravated when the available work is low-wage, part-time, or contract employment, and also when work also means incurring major child care costs, as well as loss of health.⁷⁴ The need for transitional support, as well as to create incentives for those who have never been employed to be employed, comes in the form of wage subsidies.

The wage subsidy has an added advantage of increasing employment and decreasing unemployment by changing labour costs (in the case of employer-side wage subsidy) or by increasing labour supply (in case of employee-side wage subsidy).⁷⁵ Wage subsidies may also have the added macro-economic advantage of reducing inflation to the extent

⁷² Jaenichen U & Gesine S “The effectiveness of targeted wage subsidies for hard-to-place workers” accessed at <http://doku.iab.de/discussionpapers/2007/dp1607.pdf>. (17/10/07) See par 1, 3 above for a discussion on the various types of wage subsidies.

⁷³ It can run through the tax system or to be in the form of a reduction in social security contributions or a direct payment and the subsidy can also be general or targeted. See Lee J-K “Evaluation of and lessons from wage subsidy programmes in OECD countries” 10.

⁷⁴ Jackson A “Are wage supplements the answer to the problems of the working poor?” accessed at http://www.policyalternatives.ca/documents/National_Office_Pubs/2006/Wage_Supplements.pdf. Wage subsidies are an active labour market policy that is concerned with the creation or conservation of employment, the improvement of job-related skills, or the improvement of the functioning of the labour market. Wage subsidies differ in kind from the unemployment insurance programme, which is a passive policy providing compensation for those who are unemployed while they search for jobs. (17/10/07). See also Human Resources and Social Development Canada “The rationale for wage subsidies” accessed at <http://www.hrsdc.gc.ca/en/cs/sp/hrsd/prc/publications/research/1998-000026/page05.shtml>. (17/10/07)

⁷⁵ Jae-Kap Lee, Evaluation of and lessons from wage subsidy programmes in OECD countries, 2.

which unemployment decreases or a country's balance of payments improves due to reduced costs of production to domestic firms. An added macro-economic objective is resource allocation as well as increased income equality.⁷⁶

In some instances, wage subsidies for the disadvantaged improve equity to the economy as a result of the disparity between high-skilled and low-skilled workers in the labour market.⁷⁷

A wage subsidy assists in reducing the costs of employment. According to the July 2007 National Treasury document,⁷⁸ the envisaged introduction of a wage subsidy in South Africa will also cushion low-income workers from the likely negative effects on employment of a mandatory social security scheme. With wage subsidies, those at risk of becoming the long-term unemployed⁷⁹ will be able, through the incentive of wage subsidies to employers, to enter into the labour force.

Unlike pure training, which is a means to a job, a wage subsidy has a job as its direct goal, the subsidy is only offered when a targeted person becomes employed. In most jurisdictions, the subsidy usually is directed to the private sector employer, the reasoning being that it is in the private sector that the permanent, productive jobs will ultimately be found.⁸⁰

A wage subsidy, seen comprehensively, in the context of multiple medium-term policy interventions is aimed at employment creation, at enhancing the earnings of the poor, and potentially at financing social security funding arrangements. This has the added benefit of ensuring that the proportion of workers who are considered the 'working poor' is significantly reduced over time.⁸¹ Furthermore, in addition to wage subsidies encouraging labour participation, wage subsidies have the additional advantage of being, when utilised effectively, a tool to reduce poverty. One widely cited model is the U.S Earned Income Tax Credit in the United States, which provides a low annual income supplement to working poor families, i.e. families which have low incomes and also participate in the paid job market.⁸²

Wage subsidies act as a policy intervention to improve both the wages of the working poor,⁸³ and increase employment of low-wage earners by stimulating demand for

⁷⁶ *Ibid.*

⁷⁷ *Ibid.*

⁷⁸ National Treasury 'A Wage Subsidy: Draft Discussion Paper' (July 2007), 45.

⁷⁹ Once people leave the labour force, their human resources are permanently lost to the economy if they do not return. People without work become isolated from society and become increasingly vulnerable to poverty, crime and violence. See also Human Resources and Social Development Canada "The rationale for wage subsidies".

⁸⁰ This is in contrast to public sector employment or job creation programmes, often criticised as make-work projects where people are given work only long enough to re-qualify for unemployment insurance. *Ibid.*

⁸¹ Jaenichen U & Gesine S "The effectiveness of targeted wage subsidies for hard-to-place workers", 46.

⁸² Jackson A "Are wage supplements the answer to the problems of the working poor?" 5.

⁸³ A wage subsidy can ensure an effective minimum income for workers.

labour.⁸⁴ Theoretically, it can be said to be aimed at increasing employment by reducing the direct cost of labour, i.e. wages, while maintaining a reasonable wage income for workers. In this regard, the direct consequence would be an increased labour absorption.⁸⁵

Wage subsidies either lower, or have no effect on, labour cost and thus do not discourage, but may encourage, hiring of workers with limited skills. Furthermore, wage subsidies, by encouraging work, bring their benefits to more poor families. Wage subsidies also are cost-effective since they limit eligibility to those most in need, if properly construed.⁸⁶

Wage subsidies also have the added advantage of stimulating demand for labour. This demand for labour could possibly be stimulated by offering an incentive to employers for example through the use of some tax deduction.⁸⁷ Also, a wage subsidy can ensure an effective minimum income for workers.

Frequently, employment subsidy programmes are targeted at less skilled workers or individuals that have been unemployed for a relatively long period. Due to the fact that employment subsidies increase employment without reducing average wage income, they can form part of a strategy of redistribution as well as job creation.⁸⁸ An employment subsidy is often considered a tool in a broader set of 'active' labour market policies with the goal of boosting labour demand.

Wage subsidies therefore also address another important issue often raised concerning the limitations of lowering wage incomes to create jobs. Wage reductions can provide a disincentive for employees to work productively and can create workplace tensions that reduce productivity. In such a situation, employment subsidies can be used as a strategy for increasing employment through lower labour costs without producing negative consequences for productivity and competitiveness.⁸⁹

The wage subsidy can also, if utilised effectively, have the desired outcome of buying time to accommodate change, so that subsidised employees can gain a niche in the labour market and adapt to changing labour market conditions. Therefore, the long run effect of a wage subsidy, if it is effective, is to improve the productivity, employment prospects and wages of the targeted groups.⁹⁰

⁸⁴ Urbach Jasson, Wage subsidies are a well-meant but ineffective tool for reducing unemployment, 1 accessed at <http://www.itinews.co.za/news.aspx?categoryid=32&subcategoryid=1151&itemid=4e0bd1d7-6950-415e-9a46-d684a5fb2679>. (22/10/07).

⁸⁵ *Ibid.*

⁸⁶ Employment Policies Institute, The case for a targeted living wage subsidy, accessed at http://www.epionline.org/study_detail.cfm?sid=6. (22/10/07)

⁸⁷ Urbach Jasson, Wage subsidies are a well-meant but ineffective tool for reducing unemployment, 1 accessed at <http://www.itinews.co.za/news.aspx?categoryid=32&subcategoryid=1151&itemid=4e0bd1d7-6950-415e-9a46-d684a5fb2679>. (22/10/07).

⁸⁸ Role of the working class and organised labour in advancing the national democratic revolution. Accessed at http://www.anc.org.za/ancdocs/policy/2007/discussion/labour_ndr.pdf. (22/10/07)

⁸⁹ *Ibid.*

⁹⁰ *Ibid.*

3.3 Disadvantages of a wage subsidy

Due regard must be had to the potential unintended consequences, especially negative, of introducing wage subsidies. These unintended consequences include deadweight loss, the substitution effect, and the displacement effect.

A wage subsidy which targets a specific subgroup of workers can be disadvantageous in so far as it may cause the labour force to be split into subsidised and unsubsidised workers, and may induce the firm to replace unsubsidised workers with subsidised workers.⁹¹ However such a substitution effect⁹² depends on the elasticity of the demand, both for subsidised and unsubsidised workers. Furthermore, subsidies for hiring long-term unemployed can lead to inefficient hiring practices and ‘discrimination’ against shorter-term unemployed.⁹³

Another negative consequence of the wage subsidy is the occurrence of deadweight loss, which means the hiring from the target group that would have occurred also in the absence of the programme. If this loss is high within a wage subsidy scheme, the effectiveness of the subsidy instrument to improve the labour market position of the unemployed is limited.⁹⁴ In some instances, deadweight losses have been found to be extremely large. e.g. the Irish Employment Incentive Scheme, which was a marginal targeted employment subsidy, had 91 per cent of new hires which would have taken place anyhow, with 23 percent of the new hires being brought forward.⁹⁵ With regard to employer-based employment subsidies, there is the risk of there being distortionary effects on the investment choices of firms. Also there is latitude for increase in employer’s profits with little or insignificant job creation, resulting in high deadweight losses with significant costs to the fiscus.⁹⁶

The displacement effect is the possible reduction of jobs elsewhere in the economy because of competition in the goods market. This effect occurs when a firm with subsidised workers increases output, but displaces output among firms who do not have

⁹¹ Jae-Kap Lee, Evaluation of and lessons from wage subsidy programmes in OECD countries, 11.

⁹² *Ibid.* The substitution effect is the extent to which jobs created for a certain category of workers simply replace jobs for other categories, because relative wage costs are changed.

⁹³ However it has been argued that substitution may have positive connotations. The substitution of the long-term unemployed for short-term unemployed will have beneficial general equilibrium effects in a labour market characterised by imperfect competition of various sorts. The argument is essentially that the long-term unemployed are ‘outsiders’ in the labour market and by making these ‘outsiders’ into ‘insiders’, the equilibrium rate or unemployment is lowered because effective labour supply is higher. Therefore, although substitution in the short term mitigates the employment generating effects of subsidies; in the long run, it is the mechanism by which the ‘natural rate of unemployment’ is reduced. *Ibid.*, 10.

⁹⁴ Welters Ricardo, Muysken Joan, Recruiting long-term unemployed: lessons from wage subsidies, 4 accessed at http://www.unimaas.nl/media/um-layout/fdewb/opmaak.htm?http://www.fdewb.unimaas.nl/algec/coffee-europe/working_papers.htm. (17/10/07).

⁹⁵ Standing Guy, Sender John and Weeks John, Restructuring the Labour market: The South African challenge, 481 accessed at http://books.google.co.za/books?id=H_bTePwFpDUC&pg=PP1&ots=WzvquqIZcv&dq=Restructuring+the+Labour+market:+The+South+African+challenge&sig=p66zGnP6IFVBYuOfj5leXKPS8nY#PPP1.M1.

⁹⁶ National Treasury ‘A Wage Subsidy: Draft Discussion Paper’ (July 2007), 44.

subsidies workers and, as a result, the subsidy crowds-out employment.⁹⁷ All these aspects must be factored in to the consideration for the policy on a wage subsidy.

Another potential drawback of a targeted wage subsidy is that it may stigmatise the targeted population in the eyes of employers.⁹⁸ This stigma may convey a negative signal to potential employers concerning the productivity and motivation of the disadvantaged workers. e.g. in the United States, an experimental study on stigmatisation found that participants who were given vouchers for direct tax subsidies and for tax credits to be presented to prospective employers were found to be less likely to find employment than those participants who were not given vouchers.⁹⁹ In this regard, a more widely defined target group must be encompassed.¹⁰⁰

Also, employers can deliberately maintain low wage levels in order to qualify for the highest benefit under the subsidy scheme.¹⁰¹ In this regard, the design of the wage subsidy mechanism and effective monitoring would be the tool to counter this negative consequence.¹⁰² Another disadvantage is the so called 'auntie effect'. This is whereby relatives and others likely to be added to payroll are used to increase the subsidy claim. Also, those who have left the jobs in unfortunate circumstances may be retained on payroll for as long as possible to ensure increase in subsidy claim.¹⁰³

In order to counter this negative effect, some subsidies are laden with restrictions to limit potential misuse of the programme. However, the outcome of too many restrictions may cause potential employers to shy away from the programme because they do not want the administrative hassles. Therefore, before adding unnecessary regulations, the programme should be designed to make it in the interest of employers and employees to use the programme as it is intended.

There is also the issue of the administrative burden, on the firm/employer benefiting from subsidies. In the event that specific types of individuals are targeted, eligibility with the

⁹⁷ Jae-Kap Lee, Evaluation of and lessons from wage subsidy programmes in OECD countries, 8.

⁹⁸ "Research in developed countries has sometimes found the counter-intuitive result that the targeted group had employment declines, not increases, and the 'flawed goods' story is the usual explanation." James Levinsohn, Policies to address unemployment in South Africa, Draft document, July 10 2007.

⁹⁹ Jae-Kap Lee, Evaluation of and lessons from wage subsidy programmes in OECD countries, 20 – 21.

¹⁰⁰ *Ibid.*

¹⁰¹ Regard must be given to these institutional factors that will likely raise or lower the wages of low-income earners over time, because if average wages "creep" above the subsidy threshold, then the result may be a relative decline in the welfare of low-income earners, even while wages are increasing. *Ibid.* Misuse can take many forms: collusion between employer and employee whereby a shadow job is created, the employee does no work, and the two split the subsidy; an employer firing one employee and hiring a subsidised worker; collusion whereby an employer lays off an employee with the understanding that the employee can return to work after obtaining a subsidy; an employer offering lower than market wages to increase the value of the subsidy. Human Resources and Social Development, Canada on the rationale for wage subsidies.

¹⁰² National Treasury 'A Wage Subsidy: Draft Discussion Paper' (July 2007), 30.

¹⁰³ This is known as the 'dead souls effect'. Standing Guy, Sender John and Weeks John, Restructuring the Labour market: The South African challenge, 480 accessed at http://books.google.co.za/books?id=H_bTePwFpDUC&pg=PP1&ots=WzvquqIzcv&dq=Restructuring+the+Labour+market:+The+South+African+challenge&sig=p66zGnP6IFVBYuOfj5leXKPS8nY#PPP1,M1.

government criteria, in most instances by sending information about the job seeker to the local labour offices, is done by the firm/employer and the process could prove to be time-consuming and costly. These issues must be factored into the policy for the wage subsidy and provision made for a more efficient and less time-consuming means to hire the job seeker, without creating a barrage of administrative checks – while simultaneously ensuring that abuse of the system is minimised.¹⁰⁴ On the other hand, it must be borne in mind that the administrative costs of worker-side subsidies are generally borne by the government, so there is no cost in this regard to the firms/employers.¹⁰⁵

A further disadvantage of the wage subsidy is the fiscal cost involved as it appears to increase public expenditure and ‘deficit’. Furthermore, wage subsidies can be said to subsidise inefficient use of labour in that it tends to encourage managers to undervalue labour because the costs are not fully borne by firms.¹⁰⁶ There is also an equity consideration to wage subsidies as well, because they transfer incomes from low-risk groups to high-risk groups.¹⁰⁷

Targeted wage subsidies, that is those targeted at particular sectors, have the undesirable effect of having limited economy-wide effects in terms of employment creation because of its limited application. Furthermore, the particular targeting of a specific sector may lead to inequity between sectors, with possible distortions of investment decisions.¹⁰⁸

The targeted wage subsidy would only be effective with firms in the formal sector, as informal employers are unlikely to register with the authorities who would administer the wage subsidy.¹⁰⁹ This creates a drawback as the bulk of low-income earners and atypically employed may be said to be employed in the informal sector. It must be borne in mind that the recent tax amnesty for firms is reported to have induced some 300,000 firms to come forward. The policy considerations of a wage subsidy on this margin must be considered, making entry into the formal sector a relatively attractive option.¹¹⁰

3.4 Feasibility of a wage subsidy in the South African labour market

It is important to bear in mind the object of the introduction of the wage subsidy, which is to deal with high levels of unemployment. However, the labour market conditions prevailing in South Africa must be taken into account. The following issues have been identified to, *inter alia*, underscore and reflect the labour market, *viz*:

¹⁰⁴ Smith C, International experience with worker-side and employer-side wage and employment subsidies, and job search assistance programmes: implications for South Africa, 7.

¹⁰⁵ *Ibid.*

¹⁰⁶ Standing Guy, Sender John and Weeks John, Restructuring the Labour market: The South African challenge, 480 accessed at http://books.google.co.za/books?id=H_bTePwFpDUC&pg=PP1&ots=WzvquqIzc&dq=Restructuring+the+Labour+market:+The+South+African+challenge&sig=p66zGnP6IFVBYuOfj5leXKPS8nY#PPP1.M1.

¹⁰⁷ *Ibid.*

¹⁰⁸ *Ibid.*, 28.

¹⁰⁹ *Ibid.*

¹¹⁰ *Ibid.*

- The largest number of the unemployed individuals is amongst the youth, between 25-34 years, which is 1.77million and between 15-24 years of age at 1.4 million, which makes up 73 percent of the unemployed.¹¹¹
- South Africa has, on the supply side, seen a steady increase in labour participation rates, particularly of low-skilled workers, with no concomitant increase in the labour absorption rate. On the demand side, on the other hand, capital deepening, increases in real wages particularly amongst semi-to-unskilled labour, technological advancements and labour market regulatory rigidities have contributed to the increases in unemployment levels.¹¹²
- Consequently, South Africa suffers from a skills mismatch between the types of skills of the labour force, particularly unemployed graduates and the skills demanded by industry.¹¹³
- It has also been found that unemployed individuals with incomplete schooling heavily outweigh those individuals who have completed school, while the unemployment rate amongst individuals with some form of tertiary qualification is relatively low. These factors all point to the fact that it is those who have inadequate educational qualifications that constitute the bulk of the unemployed.¹¹⁴
- The South African economy has become much more sophisticated and services based, requiring educated skilled labour and thus the economy is not in a position to absorb a labour force with low or no skills in great quantities.¹¹⁵
- It is important to note that the formal sector accounts for the largest proportion of employment in the South African economy.¹¹⁶

In order to be effective, wage subsidies, introduced to address unemployment, must take into cognisance these underlying factors in the labour market that create such unemployment problems in the first place. These factors will, *inter alia*, influence not only the scheme to be adopted, but also influence whether the introduction of a wage subsidy is a viable solution to the unemployment problems faced in the country.

As the highest bracket of unemployment occurs with those with incomplete schooling, the wage subsidy is considered to be the tool needed to ‘give them the push’ needed to enter the job market. Also, the wage subsidy can assist in cushioning these low-income

¹¹¹ National Treasury ‘A Wage Subsidy: Draft Discussion Paper’ (July 2007), 19.

¹¹² *Ibid.*, 8.

¹¹³ *Ibid.*

¹¹⁴ *Ibid.*, 10.

¹¹⁵ *Ibid.*, 16.

¹¹⁶ *Ibid.* This is with the exception of the agricultural sector. According to StatisticsSA (2006), in March 2006 employment in the non-agricultural formal sector was about 8.1 million or 64.7 per cent of the total employment.

workers from the likely effects on employment of a mandatory social security scheme, which is envisaged as the social security scheme to be introduced into South Africa in the near future. The wage subsidy is also considered to be an effective tool in increasing the employment of low wage workers,¹¹⁷

However, it must be stressed, in light of the cons highlighted that the wage subsidy policy must be approached with extreme caution. In order to avoid the dead weight effect as well as substitution, an effective and efficient administrative and institutional structure is one of the key factors for its successful implementation in South Africa. Also it cannot be stressed enough that the wage subsidy must be introduced in conjunction with some skills training for the individuals so as to address the problem of unemployment in the long term. This is especially true as the labour market in South Africa is geared towards skilled and technological-based workers.

The unemployment problem in South Africa, as evidenced by the highlighted characteristics of its labour market, shows that it is structural in nature. The question therefore arises as to whether the introduction of the wage subsidy effectively addresses this problem. The wage subsidy by its nature targets those employed as low-income earners, however this fails to address the skills mismatch as well as the need for sophisticated and technologically-based skills in the higher income sectors of employment. All these issues underscore the need for an approach that utilises the wage subsidy in conjunction with other training and educational programmes.

Furthermore, whereas a considerable number of individuals who are employed work in the formal sector, the bulk of the low-income earners and the atypically employed are involved in the informal economy. The wage subsidy, by its nature, presupposes employment in the formal economy, albeit for a lower wage, however it does not embrace those low-wage workers in the non-formal workforce. In light of the fact that this sector constitutes the largest figures of low-wage and insecure earnings workers in South Africa, the question of the ineffectiveness of the policy of wage subsidy with regard to this category of workers arises.

In this regard, there must also be provision for other forms of income support for other categories of workers. There is need for transitional income support for those leaving the unemployed field who cannot find full-time or permanent jobs. Furthermore, there must be some kind of income supplementation programme for the self-employed, given that many solo self-employed workers are working full-time hours for inadequate incomes, but are not generally covered by minimum wage and other employment standards, or by unemployment insurance.¹¹⁸ In the United States, for example, wage subsidy programmes

¹¹⁷ If utilised effectively, it is envisaged as being able to address the problem of unemployment in the country, which is prevalent amongst those with no or lower educational qualifications who would effectively fall within the low-income bracket. Role of the working class and organised labour in advancing the national democratic revolution. Accessed at http://www.anc.org.za/ancdocs/policy/2007/discussion/labour_ndr.pdf. (22/10/07)

¹¹⁸ Jackson A Are wage supplements the answer to the problems of the working poor?, 11.

that had a mixed strategy approach in so far as it provides job search assistance, training and wage subsidy appeared to be a successful approach.¹¹⁹

3.5 Some observations and conclusions

Firms would not hire some of the high-risk unemployed without the wage subsidy. Yet, if firms are to operate efficiently, wage subsidies cannot be used simply to bypass market signals. Otherwise the subsidised workers will be at the same disadvantage as soon as the subsidy ends. In order to be effective, wage subsidies must address the underlying factors in the labour market that created employment problems in the first place – the mismatch, perceived or real, between the skills of the long-term unemployed and the available jobs.¹²⁰

This can be achieved through work experience gained while on the subsidised job that allows workers to build on their skills. It can be achieved through more efficient labour markets – "stirring the pot" of the unemployed so that high-risk people enter or return to jobs more quickly.¹²¹ There is an asymmetrical relationship between wages and labour demand in that, employment declines faster in response to an increase in real wages, whilst it increases at a relatively low rate in response to reductions in wage costs.¹²² It could then be argued that the wage subsidy would address only wage-cost induced unemployment and not influence structural unemployment. However, since South Africa's unemployment problem is structural in nature,¹²³ rather than wage-cost induced, the introduction of wage subsidies solely as a means to counter wage-cost induced unemployment will prove to have a limited impact. The effectiveness of the wage subsidy must then be considered in the context of alternative policies and/or a combination of complementary policies.¹²⁴

Furthermore, and as stated earlier, wage subsidies must not be seen as an end in itself, but rather as a means to dealing with the high levels of unemployment. In this regard, wage subsidies must be used in conjunction with other measures. A possible solution would be the combination of wage subsidies with training programmes, with major emphasis being placed on training. It must also be borne in mind that as highly targeted programmes may create stigmas of the targeted groups, and therefore undermine their unemployment

¹¹⁹ *Ibid.*

¹²⁰ Human Resources and Social Development, Canada on the rationale for wage subsidies.

¹²¹ *Ibid.*

¹²² National Treasury 'A Wage Subsidy: Draft Discussion Paper' (July 2007), 33.

¹²³ National Labour & Economic Development Institute, Poverty and unemployment in South Africa. Accessed at <http://www.naledi.org.za/docs/Poverty%20and%20unemployment%20in%20South%20Africa%20Feb%202006.pdf>.

¹²⁴ I.e. structural unemployment arising from technological advances in production techniques and structural changes in the economy which result in increased demand for skilled and highly skilled labour, should be dealt with through policy interventions such as investment in education and skills development. Policies combining both wage subsidies with job development, training and job search assistance efforts are successful in improving the employment and earnings of specific targeted disadvantaged groups. *Ibid.*, 34 - 35.

opportunities, target groups need to be designated to those who have significant difficulties in the labour market.¹²⁵

In summary, it must be borne that wage subsidies can play useful supporting roles in assisting the working poor, but it should not be seen as the centerpiece of a new social architecture.¹²⁶

4. ALTERNATIVES TO THE WAGE SUBSIDY: THE POSITION OF THE DEPARTMENT OF SOCIAL DEVELOPMENT

4.1 Poverty alleviation and economic activity

The Department of Social Development proposes a more holistic approach that links social grants beneficiaries and the unemployed to poverty alleviation and economic activity.¹²⁷ It identifies the key constituent parts of this policy intervention as building the gateway or off-ramp; generating employment opportunities and a process model for diversion. It identifies the gateway to economic activities as having the following features:

- Encompass encouraging sustainable employment, reduce poverty and enable individuals.
- Policies and a policy context that support overcoming the individual's barriers to work and the programmes should focus on the individual and be concerned with human capital development.
- The expected outcomes and evaluation should be geared towards reducing the welfare caseload premised on an increase in government expenditure to encourage stable employment, with skills and career development prospects as the key outcomes.¹²⁸

The Department of Social Development leans towards employment creation as a means of addressing unemployment. It proposes that consideration must be given to implementing a range of policies that include active labour market measures, skills development programmes, special employment and labour intensive development programmes and labour intensive government services.¹²⁹

Amongst the strategies identified by the Department to deal with unemployment is additional support, or incentives in cash or in-kind with responsibilities or obligations to achieve a set of outcomes; consideration given to getting younger graduates and those with matric into government employment through half jobs (apprenticeships);¹³⁰

¹²⁵ Jae-Kap Lee, Evaluation of and lessons from wage subsidy programmes in OECD countries, 24.

¹²⁶ *Ibid.*

¹²⁷ Department of Social Development *Linking social grants beneficiaries to poverty alleviation and economic activity* (Discussion document) November 2006, 7.

¹²⁸ *Ibid.*

¹²⁹ *Ibid.*

¹³⁰ In half jobs, the benefits of income and training opportunities are shared, and the policy can be implemented in the private sector, *Ibid.*, 8.

consideration should be given to more significantly expanding labour intensive government services which target low-income groups such as nursing and community-based care workers, teachers and police officers.¹³¹

The Department stresses the need for multi-actor responsibility with government, religious leaders, the NGO sector, labour, business and all other stakeholders to collaborate on linking beneficiaries to economic activities.¹³²

With regard to linking those on social assistance to employment opportunities, the Department proposes the development of more detailed profiles of each beneficiary in terms of education, skills profile and previous employment experience. It proposes that the architecture of the database should be centralised, providing a distributed platform for provinces and local offices to manage individuals on a case management approach basis with a view to link them to opportunities.¹³³ Furthermore, it is proposed that based on the profiles of beneficiaries, community profiles, emerging trends in the labour market and collaboration with civil society, programmes should be designed to migrate beneficiaries to education, training, skills development and employment.¹³⁴

4.2 Institutional framework

The Department of Social Development proposes a framework based on the principle that the social security system will only function effectively with a holistically conceptualised institutional model with the basis on the core elements of value chain; the governance framework and the regulatory framework.¹³⁵

The Department¹³⁶ proposes a fundamental overhaul of the social security institutional arrangements as a necessary prerequisite towards the establishment of certain new social security functions and benefits. The central rationale for this approach is that the social security system should be considered holistically in respect of the value chain, governance and regulatory considerations.¹³⁷ The effect of this would be that significant institutional restructuring will need to be undertaken.

With regard to the value chain, the Department proposes that the following four functions should be centralised into separately accountable institutions: all functions related to the direct interface with the public, including enrolment and communication; the maintenance of a central social security registry containing personal information required by all social security organisations; the collection of social security contributions, including those contributions in respect of people below the tax threshold, consolidated

¹³¹ *Ibid.*

¹³² *Ibid.*, 7.

¹³³ *Ibid.*, 10.

¹³⁴ *Ibid.*

¹³⁵ *Ibid.*, 23.

¹³⁶ Department of Social Development *Concept design options for institutional framework* (Discussion document) September 2007, iv.

¹³⁷ *Ibid.*

into the South African Revenue Services; and the investment of social security assets that should be pooled, subject to an appropriate governance arrangement.¹³⁸

With regard to public interface, it was noted that currently each part of the social security system has its own dedicated arrangement for interfacing with the public,¹³⁹ despite the fact that they have roughly similar public interface requirements. In order to overcome this systematic shortcoming, it is proposed that consideration be given to consolidate the social security public interface function into a dedicated institution which acts as a support to the purpose-designed social security organisations and related government departments with a service function.¹⁴⁰

Envisaged framework

The Department proposes that, in order to maximize the economies of scale associated with the interface between the public and the social security system, a single entity¹⁴¹ should be established which focuses exclusively on this function. This single entity will provide this function on an agency basis for all social security institutions.¹⁴²

The effect of the proposal, if put into play, would be that all public interface functions currently resident in other parts of the social security system would need to be consolidated into the proposed single entity.¹⁴³ Furthermore, this entity would, *inter alia*, make social security benefit payments where beneficiaries are reliant on direct cash or cheque payments; however its role would be limited to that of merely an agent acting on behalf of a relevant part of the social security system.¹⁴⁴

A feature of the collection of social security contributions in South Africa is the varying means of collection. Some social institutions collect their own revenue, i.e the UIF, which collects contributions from people/employers in respect of people earning below the tax threshold, while in other instances, SARS performs the function of collection. It is proposed that SARS become the dedicated social security collection agent on behalf of all social security arrangements.¹⁴⁵

4.3 Some observations and conclusions

The proposals of the Department of Social Development on linking poverty alleviation to economic activity attempt to adopt a holistic approach to dealing with the issue of

¹³⁸ *Ibid.*

¹³⁹ For example, the Road Accident Fund (RAF), Workman's Compensation (COID), Unemployment Insurance (UIF) and the South African Social Security Agency (SASSA).

¹⁴⁰ *Ibid.*, 4.

¹⁴¹ Referred to in the document as the Social Security Interface or "SSI".

¹⁴² Department of Social Development discussion document, September 2007, 4.

¹⁴³ It is then envisaged that all social security institutions or relevant government departments could then redesign their business model to develop "wholesale" relationships with the SSI rather than the "retail" relationship with the general public. *Ibid.*

¹⁴⁴ *Ibid.*, 5.

¹⁴⁵ *Ibid.*, 11.

unemployment in the country. It seeks to place emphasis on skills development, creating linkages to “pull out” beneficiaries of social assistance from welfare to envisaged employment as well as seeks out labour intensive programmes that target young university graduates as well as other unemployed people. This more or less holistic approach is one which is essentially also highlighted in this report. However, it needs to be pointed out that an integrated approach aimed at significantly addressing unemployment and welfare dependency would require labour market interventions that are not only comprehensive, co-ordinated and integrated, but also effective and tangible. Such an approach would need to go much further than the introduction of particular isolated programmes aimed at job creation. Also, care should be taken that the proposed programme framework does not fall foul of the criticism levelled at the expanded public works programme.¹⁴⁶

Furthermore, the Department proposes a comprehensive institutional framework for the provision of social security. It suggests the integration of certain specific social security functions currently executed by the different social security institutions within the framework of a single entity to be created. These institutional proposals provide possibilities for co-ordination and integration which will be canvassed in the final report to be submitted to the UIF (on the institutional context).

There is, however, no mention in the Department's proposals of the introduction of a wage subsidy as a means to address unemployment; emphasis is rather placed on skills development and employment placement, all these overseen by the various stakeholders as participants and not government alone.

As reiterated earlier on, whereas wage subsidies are a means to deal with the high levels of unemployment, it must not be seen as an end in itself. In this regard, wage subsidies must be used in conjunction with other measures, such as the employment and training programmes proposed by the Department of Social Development.

5. SOCIAL SECURITY (WAGE SUBSIDIES) IN COMPARATIVE SYSTEMS

5.1 Introduction

Wage subsidies are aimed at improving the wages of the working poor and to increase employment of low-wage earners. Subsidies increase employment by reducing the direct cost of labour (in the form of wages) while maintaining a reasonable wage income for workers. The “tax wedge” further contributes to the rising direct costs of labour.¹⁴⁷ The tax wedge is the difference between workers' take home pay and the costs of employing them (including social security contributions and tax).¹⁴⁸ However, the National Treasury has stated that:¹⁴⁹

¹⁴⁶ See par 7.2.2 of the report submitted to the UIF entitled "Strengthening and improving the current unemployment insurance system".

¹⁴⁷ National Treasury Wage Subsidy: Draft Discussion Paper (IDTT Working Paper (2007)) 12.

¹⁴⁸ National Treasury Wage Subsidy: Draft Discussion Paper (IDTT Working Paper (2007)) 24.

¹⁴⁹ National Treasury Wage Subsidy: Draft Discussion Paper (IDTT Working Paper (2007)) 22.

“It is not only the direct costs of labour that influences the demand for labour, but also the indirect costs. The increased labour market rigidity in SA raises the indirect cost of labour. The non-wage cost of employment also includes the additional time and money which is spent in attending to labour relations and regulations. Therefore to the extent that an intervention like the wage subsidy might reduce the direct costs of labour and hence stimulate employment creation, the impact on unemployment might be dampened by significant indirect costs of labour. Therefore it is important that attention also be given to the perceived or real indirect costs of employment.”

The envisaged mandatory social security system would increase the cost of low-income labour relative to high-income labour, which may result in a reduction in both the disposable incomes of low-income earners and their total employment.¹⁵⁰ A wage subsidy given to employees is a mechanism for poverty alleviation as it essentially increases the consumption wages of the working poor by increasing the net returns to employment. Wage subsidies are primarily aimed at increasing the purchasing power of the targeted group. The social security subsidy component of the proposed wage subsidy is intended to protect the income levels of the working poor during retirement or the income of their dependants in the event of death.

5.2 Wage subsidies (including a social security component)

Wage subsidies (including a social security component) have been employed in many developed and developing countries, particularly in European countries where social security contributions are high relative to average earnings. These programmes take a variety of forms.

5.2.1 Developed countries

The US has implemented a variety of wage subsidy schemes. These include the New Jobs Tax Credit (NJTC) from 1977-1979; the Targeted Jobs Tax Credit (TJTC) from 1979 until 1996; and the Work Opportunity Tax Credit (WOTC) between 1996 and 1997.¹⁵¹ The New Jobs Tax Credit aimed to increase the demand for low-skilled workers by offering an additional subsidy for low-skilled workers; while the TJTC provided tax credits to employers for the hiring of economically disadvantaged groups. The Earned Income Tax Credit programme, which covers 20-million low-income earners, is a tax credit for low-income families to offset a portion of worker contributions to the social security payroll tax.¹⁵²

In the United Kingdom a wage subsidy programme, called the Working Families Tax Credit (WFTC), was introduced from 1999 to 2003.¹⁵³ The programme was designed to

¹⁵⁰ *Ibid*, 30.

¹⁵¹ *Ibid*.

¹⁵² Joffe H “Wage subsidy can be a powerful tool, if kept sharp and used right” [Business Day](#) (14 February 2007).

¹⁵³ Replaced in 2003, together with other then existing tax credit schemes, by the Child Tax Credit and Working Tax Credit: see http://www.jobcentrepplus.gov.uk/jcp/Partners/Allowancesandbenefits/Dev_010208.xml.html accessed on 17 November 2007.

provide support for low-wage families with children who were working. A family with children needed to have one adult working 16 hours or more per week to qualify for FC. Each family was potentially eligible to a maximum amount, depending on the number of children in the household and a small addition if they worked full-time. This maximum amount was payable if the family's net income (after income tax and National Insurance Contributions) was lower than the threshold (£90 per week). Net income in excess of the threshold reduced entitlement to the subsidy.¹⁵⁴ The British government spent about £5 billion per year (1.5 per cent of government budget, 0.6 per cent of GDP) on the subsidy.

Finland also grants wage subsidies to passenger shipping companies, in the form of cuts in taxation and social security contributions on seafarers' wages. Owners of and companies operating passenger ships are subsidised to the tune of FIM 240 million (approx. €40 million) by decreasing their taxes and social security contributions.¹⁵⁵

In the Netherlands, the SPAK subsidy programme introduced in 1996 operated in the form of a reduction in employers' social security contributions for low-wage earners.¹⁵⁶

Some OECD countries have wage subsidy schemes targeted at older workers.¹⁵⁷ In Austria, employers' unemployment insurance contributions are halved if they employ workers aged between 50-55 years. No contributions are paid for persons aged over 55. In Belgium, employers hiring long-term unemployed people aged 45 and above are partially exempted from paying their social security contributions for 5 years. In addition, since the newly-hired long-term unemployed are entitled to an employment subsidy under the *Activa Programme*, employers may reduce their wages by up to €500 per month.

Under the Danish Service Jobs Scheme, municipalities employing individuals who are more than 48 years old and have been unemployed for at least 18 months are paid an indefinite wage subsidy of DKR 100 000 per year. In France, companies employing an unemployed person aged 50 and above can take advantage of the "*Contrat Initiative Emploi*" (Contract to promote employment) scheme. This consists of a total reduction in employers' social security contributions at the level of the minimum wage (about 40% of gross minimum wages). The subsidy is paid for 24 months in case a permanent contract is offered, and indefinitely where a person aged 50-64 and is disabled or has been unemployed or on social assistance for more than a year.

5.2.2 Developing countries

Argentina has experimented with various work subsidy programmes, such as the Private Employment Programme (PEP) and the *Programa se Empleo Privadopara* (PyME);

¹⁵⁴ Dilnot A & McCrae T "The Family Credit System and the Working Families Tax Credit in the United Kingdom" *OECD Economic Studies No. 31, 2000/II*, 71-72.

¹⁵⁵ "Government grants new wage subsidies for shipping" accessed at <http://www.eurofound.europa.eu/eiro/2001/06/inbrief/fi0106188n.htm>

¹⁵⁶ National Treasury Wage Subsidy: Draft Discussion Paper (IDTT Working Paper (2007)) 30.

¹⁵⁷ See generally OECD *Aging and employment policies: Korea 2004*, 110.

Promoted Temporary Employment Contracts and training-related subsidies.¹⁵⁸ In the PEP programme, persons with or without previous training were eligible; and had to be hired for at least 4 months. The State subsidised part of the wages of the workers registered with the state employment service.¹⁵⁹ In the PyME programme, the state offered the minimum wages of up to 6 months and covered the cost of liability insurance policy for employment injuries and diseases. Promoted Temporary Employment Contracts is aimed at stimulating employment creation in the private sector. These employees are partially and totally exempt from social security contributions. They are also exempted from payroll taxes except those with health care schemes and the national employment fund.

Two employment training-related subsidy programmes exist in Chile. The *Joven* programme is targeted at unemployed persons aged 15-24 years old who are out of the schooling system. It has four sub-programmes: training and work experience in firms, work training to become self employed, training for young workers and a kind of apprenticeship programme. The apprenticeship programme (*Aprendices*), offers a tax rebate to firms that train persons aged 20 years old or less on-the-job.

Some SADC countries also have wage subsidies.¹⁶⁰ Botswana provides fixed grants per job created; wage subsidies for unskilled/low-skill workers pegged at the lowest grade: where 80%, 60%, 40%, 20% of wages are covered for years 1&2, 3, 4, 5 respectively; 50% of training costs for 5 years; and an employer can claim a deduction of 200% of the cost of training his or her employees, if the training is approved by the Commissioner. In addition, Namibia offers training cost deduction at 125% tax deductible; direct production wages deduction at 125% tax deductible. Export Processing Zones qualify for a 75% wage subsidy and 75% of the direct cost of on-the-job and institutional training.

5.3 Other policy options

It is clear that a wage subsidy scheme in South Africa, in whatever form, has enormous fiscal implications. The issue, therefore, is not whether there will be costs involved, but as to who will bear these costs. Literature on comparative experiences seems to suggest that the costs are either borne by the state, or transferred to other (well-off or high-income) members of a social insurance scheme. Examples exist in South Africa – such as with the UIF – whereby solidarity principles have been built into the scheme to enable high-income earners to subsidise the coverage of low-wage workers. In light of the level of unemployment, poverty and destitution currently prevalent in South Africa and the huge demands on the national budget, an alternative to the state spending R20-30 billion is very compelling.

As mentioned earlier, the wage subsidy would entail significant capital outlays by government. If the social security portion of the subsidy is to be a permanent feature, as suggested by the National Treasury, it means that the aforementioned outlay will persist indefinitely.

¹⁵⁸ National Treasury Wage Subsidy: Draft Discussion Paper (IDTT Working Paper (2007)) 48.

¹⁵⁹ National Treasury Wage Subsidy: Draft Discussion Paper (IDTT Working Paper (2007)) 47.

¹⁶⁰ National Treasury Wage Subsidy: Draft Discussion Paper (IDTT Working Paper (2007)) 58-59

A viable alternative may be to structure the social security contributions of the envisaged social security scheme in such a way that higher-income individuals subsidize the lower-income workers that are the proposed beneficiaries of a wage subsidy. Such a course of action would be based on the principle of solidarity, a concept which is generally accepted in social security discourse.

The International Labour Organisation has stated the following regarding solidarity:¹⁶¹

“It is not possible to have social security, worthy of the name, without a consciousness of national solidarity and perhaps – tomorrow – international solidarity. The effort of developing social security must therefore be accompanied by continuing efforts to promote this crucial sense of shared responsibility.”

An example of where solidarity principles have been implemented is found in the UIF’s graduated scale of benefits. The scale differentiates between higher-income contributors and lower-income contributors, with the former in effect subsidizing the latter.¹⁶² The main purpose is to strengthen the financial base of the UIF and to allow lower-income earners to benefit.¹⁶³

There are also sound constitutional arguments for adopting a course of action along the lines of what is proposed here. Firstly, given the extent of extreme poverty in South Africa and the high unemployment rate, it may be argued that it is not reasonable for government to spend billions of Rands to enable low-income workers in the formal sector to participate in the envisaged compulsory public fund, while the plight of the most vulnerable groups is not affected by such measures.¹⁶⁴ Secondly, the principle of *ubuntu botho* has received constitutional recognition in South Africa¹⁶⁵ and can be construed as a South African expression of social solidarity.¹⁶⁶

Given the huge income inequalities and disparities in the social security system as a whole, it is imperative that South Africa incorporates social solidarity into its social security measures.¹⁶⁷ Redistributive policies are not foreign phenomena in South Africa,

¹⁶¹ International Labour Organisation *Into the Twenty-First Century: The Development of Social Security* (1984) 115.

¹⁶² ET Van Kerken and MP Olivier ‘Unemployment insurance’ in MP Olivier, N Smit and ER Kalula (eds) *Social Security: A Legal Analysis* 415 at 429.

¹⁶³ *Ibid.*

¹⁶⁴ See PAR 6 below for the constitutional guidelines relating to the plight of the most vulnerable.

¹⁶⁵ Postamble to the interim Constitution; *Dikoko v Mokhatla* 2006 (6) SA 235 (CC) para [68]; *Port Elizabeth Municipality v Various Occupiers* 2005 (1) SA 217 (CC) para [37]; *Bhe v Magistrate, Khayelitsha (Commission for Gender Equality as Amicus Curiae)*; *Shibi v Sithole*; *South African Human Rights Commission v President of the Republic of South Africa* 2005 (1) SA 580 (CC) para [163]; *S v Makwanyane* at para [225] per Langa J, para [263] per Mahomed J, para [308] per Mokgoro J; *Crossley and Others v National Commissioner of South African Police Service and Others* [2004] 3 All SA 436 (T) paras [18]-[20]

¹⁶⁶ Olivier 39.

¹⁶⁷ MP Olivier ‘The concept of social security’ in MP Olivier, N Smit and ER Kalula (eds) *Social Security: A Legal Analysis* 23 at 38.

nor in a social security context.¹⁶⁸ A wage subsidy can of course also be viewed as a redistributive measure, but it is arguable that effecting that redistribution through the tax system instead of on the basis of solidarity within the social security system itself is unnecessarily long-winded.

6. CONSTITUTIONAL IMPLICATIONS

6.1. Introduction

As stated earlier, a wage subsidy scheme is one of several labour market policies that could be implemented. Labour market policies have the effect of creating jobs, thereby reducing unemployment. Wage subsidies boost the demand and supply of low-skilled labour, while partially or completely subsidising the social security contributions of low-income earners. This may help to significantly reduce poverty and unemployment in South Africa. Therefore, a wage subsidy scheme, as a labour market policy has an impact on the realisation of the right to have access to social security. The 2007 Budget Review states, in relation to a wage subsidy scheme, that “a key consideration in the South African context is the need to broaden social security while encouraging job creation”. Therefore, the introduction of a wage subsidy also brings the opportunity to protect the incomes of the working poor through the phasing in of a social security scheme funding arrangement.¹⁶⁹

In his 2007 State of the Nation Address,¹⁷⁰ the President proposed that a basic saving and social protection system must be put in place that will cater for the needs of low-income employees. This includes a mandatory earnings-related social security scheme with improved unemployment insurance, disability and death benefits which will target the income needs of dependants; and a standard retirement savings arrangement. In addition, to offset the cost of social security tax for low-income workers and to lower the cost of creating employment, a further proposal of introducing a wage subsidy for those whose earnings fall below the income tax threshold will be introduced.

Wage subsidies are aimed at expanding employment by reducing the cost of labour to the employer. According to the position adopted in the July 2007 National Treasury working paper, it will ensure access of low-wage employees to the envisaged national social security scheme by subsidising the cost of their participation, while maintaining a reasonable wage income for them. Many direct and indirect positive effects of a wage subsidy have been identified. Firstly, it leads to higher labour absorption by firms. Secondly, an accumulation effect occurs when lower labour costs raise expected profits and lead to increased capital investment. Employment is also induced indirectly. It has been held that:

“Since more workers are employed, household income increases, which in turn leads to an increase in consumption. At the same time, firms are able to lower prices, thus increasing the real spending

¹⁶⁸ Olivier 41-42.

¹⁶⁹ National Treasury *A Wage Subsidy Draft Discussion Paper* July 2007, 4.

¹⁷⁰ Accessed at <http://www.info.gov.za/speeches/2007/07020911001001.htm>.

power of households. Firms increase their output to satisfy higher consumption demand, and hence demand more labour indirectly. Employment subsidies therefore have various positive downstream effects, which render them useful to address a number of issues directly and indirectly, including poverty alleviation, income redistribution, and the stimulation of private investment and aggregate demand”.¹⁷¹

The envisaged mandatory national social security fund would be large in terms of the number of contributors. Standardisation of contributions and benefits and consolidated information systems will provide some scope for economies of scale and low operating costs per member. Cost-efficient administration will contribute in turn to the value and security of benefits for contributors. Furthermore, the social security reform is about attacking poverty, by reducing income vulnerability. According to the July 2007 National Treasury Draft Discussion Paper, the wage subsidy makes the social security reform affordable for low-wage workers, and it will also reduce the costs of job creation.¹⁷²

The wage subsidy proposal indicates that it will cost about R20 – 30 billion per annum. This raises the issue of the constitutionality of implementing a wage subsidy for low-income earners in light of the fact that millions of other people are unemployed, and without access to any social security coverage. It could be argued that this amount could be used to provide a basic subsistence to a large number of very desperate and, in the social security sense, uncovered people living in deplorable conditions, in addition to the portion of the social welfare budget set aside to for social benefits for the elderly, poor, disabled and children. In the opinion of the Minister of Finance, the social security system gives fiscal expression to a nation’s sense of solidarity, provides an important vehicle for both savings and financing income security, promotes social stability and mitigates several categories of individual and household risk.¹⁷³ Proponents of a more universal social security system (or the extension of the targeted system currently in place) could point out that employing the funds destined for the wage subsidy towards the extension of social assistance benefits to the millions vulnerable people in this country is one of the best ways of expressing this nation’s sense of solidarity.

It is agreed that an understanding of the context within which the labour market and labour market policy function is informed by, inter alia, the Constitution, and South Africa’s historical, political, and socio economic reality, is important.¹⁷⁴ The question that arises is whether a wage subsidy scheme, as is currently envisaged in South Africa, passes a constitutional test. This can be answered by examining the nature of the state’s obligations, the requirements for realisation of the right to have access to social security and the role and impact of fundamental values and other rights on the state’s obligations. This requires an evaluation of the reasonableness of implementing a wage subsidy to low-wage workers in the face of widespread poverty in South Africa.

¹⁷¹ Pauw K “Evaluating the general equilibrium effects of a wage subsidy scheme for South Africa” University of Cape Town 2002.

¹⁷² *Ibid.*

¹⁷³ Manuel TA “Longer-term Fiscal policy issues in South Africa” Bureau for Economic Research 60th Anniversary Conference, Somerset West, 18 November 2004, 7.

¹⁷⁴ ANC “Role of the working class and organised labour in advancing the national democratic revolution” accessed at http://www.anc.org.za/ancdocs/policy/2007/discussion/labour_nldr.html.

6.2 The state's obligation to realise the right of access to social security

The Constitution accords 'everyone' the right to have access to social security, including, if they are unable to support themselves and their dependants, appropriate social assistance.¹⁷⁵ It further compels the State to adopt reasonable legislative and other measures, within its available resources, to achieve the progressive realisation of the right of access to social assistance.¹⁷⁶ Section 7(2) obliges the state to respect, protect, promote and fulfil the rights in the Bill of Rights. The Constitution therefore introduces a constitutional imperative whereby the state is compelled to ensure the progressive realisation of this right. It could, therefore, rightly be concluded that;

"This constitutes a clear and unambiguous undertaking by the drafters of the Constitution to develop a comprehensive social security system, based on, *inter alia*, two important paradigms: the right of access to social security for everyone, and financial viability. In this regard, the Constitution imposes an obligation on the state to ensure universal access to social security."¹⁷⁷

The White Paper for Social Welfare of 1997¹⁷⁸ reaffirmed Government's commitment to establish a comprehensive social security. It stated that:

"The general long-term objective is to have an integrated and comprehensive social security system supported by the collective potential of existing social and development programmes. This would be supported by a well-informed public, which is economically self-reliant, in a country which has active labour market policies aiming at work for all, while accepting that all will not necessarily have formal employment. Where these broad goals cannot be met, social assistance should be a reliable and accessible provider of last resort. A comprehensive and integrated social security policy is needed to give effect to the Constitutional right to social security."

This right to access to social security is reinforced by other fundamental rights, such as the right to have access to health care services,¹⁷⁹ to sufficient food and water,¹⁸⁰ to adequate housing,¹⁸¹ and the right to education,¹⁸² as well as the right of children to basic nutrition, shelter, basic health care services and social services.¹⁸³ Together these rights can be said to ensure, from a constitutional and human rights perspective, adequate social protection. There are also other fundamental rights, which play a role in the context of South African social security, such as the right to equality,¹⁸⁴ the right to privacy,¹⁸⁵ the

¹⁷⁵ S 27(1)(c).

¹⁷⁶ S 27(2).

¹⁷⁷ Olivier MP *et al* "Constitutional Issues" in Olivier MP *et al* *Social Security: A Legal Analysis* LexisNexis Butterworths: Durban 2003, 58.

¹⁷⁸ General Notice 1108 in *Government Gazette* 18166 of 1997-08-08, par 45.

¹⁷⁹ S 27(1)(a)), and the right to equality (s 9).

¹⁸⁰ S 27(1)(b).

¹⁸¹ S 26(1).

¹⁸² S 29(1).

¹⁸³ S 28(1)(c).

¹⁸⁴ S 9.

¹⁸⁵ S 14.

right to property¹⁸⁶ and the right to just administrative action.¹⁸⁷ The State is obliged to respect, protect, promote and fulfill all of these fundamental rights.¹⁸⁸

6.2.1. Reasonableness of wage subsidies as a labour market policy

The Constitution requires the State to take reasonable legislative and other measures. In *Grootboom* the Constitutional Court stated that the state will fulfil its obligations if the measures adopted are reasonable, both in their conception and implementation.¹⁸⁹ A court considering reasonableness will not enquire whether other more desirable or favourable measures could have been adopted, or whether public money could have been better spent. The question would be whether the measures that have been adopted are reasonable. In *Minister of Health and Others v Treatment Action Campaign and Others*, the court stated that a purposive reading of section 27 implies that the right should not be construed as entitling everyone to demand that a minimum core be provided to them. All that is possible, and all that can be expected of the state, is that it acts reasonably to provide access on a progressive basis.¹⁹⁰

The state is required to formulate, fund, implement and constantly review comprehensive and co-ordinated programmes and policies. Mere legislative measures are not enough as the state has to act such as to achieve the intended result. Legislative measures will invariably be supported by appropriate and well-directed policies and programmes. Such programmes and policies must be reasonable in their conception and implementation. They must give effect to, and promote all related constitutional rights and values, such as human dignity, equality, freedom and social justice and must eliminate the large areas of severe deprivation that afflict our society.¹⁹¹ Provided the measures adopted by the State are reasonable, a social security programme which institutionalises social security provision will generally be upheld.¹⁹²

In the *Grootboom* case, the Constitutional Court outlined the requirements relating to the reasonableness of the state's measures. It held that:

"Reasonableness must also be understood in the context of the Bill of Rights as a whole. A society must seek to ensure that the basic necessities of life are provided to all if it is to be a society based on human dignity, freedom and equality. To be reasonable, measures cannot leave out of account the degree and extent of the denial of the right they endeavour to realise. Those whose needs are the most urgent and whose ability to enjoy all rights therefore is most in peril, must not be ignored by the measures aimed at achieving realisation of the right. It may not be sufficient to meet the test of reasonableness to show that the measures are capable of achieving a statistical advance in the realisation of the right. Furthermore, the Constitution requires that everyone must be treated with

¹⁸⁶ S 25.

¹⁸⁷ S 33.

¹⁸⁸ See ss 7(2) and 27(2) of the Constitution.

¹⁸⁹ Par 63.

¹⁹⁰ Par 35.

¹⁹¹ *Minister of Health & others v Treatment Action Campaign & others* (2002) 10 BCLR 1033 (CC); (2002) 5 SA 713 (CC) par 36.

¹⁹² See Olivier MP *et al Social Security: A Legal Analysis* LexisNexis Butterworths, Durban 2003, 93.

care and concern. If the measures, though statistically successful, fail to respond to the needs of those most desperate, they may not pass the test."¹⁹³

This implies that the wage subsidy scheme as a labour market policy will need to meet requirements set out by the Constitutional Court. The reasonableness of the wage subsidy scheme will, therefore, be evaluated against the following criteria:

- the social, economic and historical context of the system the wage subsidy scheme aims to address;
- whether the scheme is balanced, flexible and open to review, and makes appropriate provision for attention to the deficiencies in the system and to short-, medium- and long-term needs;
- whether it is inclusive and does not exclude a significant segment of society such as the millions of unemployed and informally-employed;
- whether it ensures that basic human needs are met and takes into account the degree and extent of unemployment, poverty and destitution in South Africa; and,
- whether it ensures that a larger number of people and a wider range of people benefit as time progresses.¹⁹⁴

The Constitution focuses on vulnerable groups and requires that provision be made for the most vulnerable and desperate in society. The poor are particularly vulnerable and their needs require special attention.¹⁹⁵ This will be the case where excluded or affected persons and communities have historically been marginalised and/or excluded or appear to be particularly vulnerable. In such instances, a statistical advance may not be enough and the needs that are the most urgent must be addressed.¹⁹⁶ Frequently, employment subsidy programs are targeted at less skilled workers or individuals that have been unemployed for a relatively long duration. It is clear that because wage subsidies increase employment without reducing average wage income, they can form part of a strategy of redistribution as well as job creation.¹⁹⁷ Moreover, with a history of such pronounced inequalities as South Africa's, a focus on issues of redistribution remains important. Wage subsidies provide a possible tool for pursuing job creation and redistribution simultaneously.¹⁹⁸

The Constitution requires a comprehensive and integrated approach. The Constitutional Court has affirmed that all the rights contained in the Bill of Rights are interrelated and mutually supporting.¹⁹⁹ It is, therefore, not sufficient to attempt to adopt measures which give effect to the right to access to social security in isolation. This implies that in its attempt at improving the social security system through a wage subsidy, the State must ensure that all related constitutional values and rights, such as human dignity, freedom

¹⁹³ *Grootboom* par 44.

¹⁹⁴ *Grootboom* pars 42-45. See also *Transforming the Present – Protecting the Future*, 51.

¹⁹⁵ *Grootboom* par 37.

¹⁹⁶ *Grootboom* par 35.

¹⁹⁷ Lewis JD "Policies to Promote Growth and Employment in South Africa" The World Bank, July 2001, 34.

¹⁹⁸ *Ibid*, 35.

¹⁹⁹ *Grootboom* par 53.

and equality, be given effect to; and that access is granted to resources which are necessary for the realisation of the right to access to social security and other related rights. This could and should be effected through a package approach, whereby the provision of a baseline of services, transfers and resources to those in desperate need is ensured as a matter of priority. The constitutional and developmental imperative for universal basic income support has to be considered within a comprehensive package of measures to address structural poverty.²⁰⁰ It should be clear that in the light of the extreme inequalities in South African society, a major social security policy option of this nature is also a mechanism for income redistribution thus promoting greater social stability and reconciliation."²⁰¹ The State should indicate that the establishment of a wage subsidy scheme is part of its overall labour market policy framework, not an isolated and uncoordinated policy choice.

6.2.2. A wage subsidy scheme as part of progressive realisation of social security

The Constitution requires that reasonable measures must be adopted, within the available resources, to progressively achieve the right to have access to social security. In *Grootboom*, the Court stated that the term “progressive realisation” shows that it was contemplated that the right could not be realised immediately. But the goal of the Constitution is that the basic needs of all in our society be effectively met and the requirement of progressive realisation means that the state must take steps to achieve this goal. It means that accessibility should be progressively facilitated: legal, administrative, operational and financial hurdles should be examined and, where possible, lowered over time; and that rights must be made more accessible not only to a larger number of people but to a wider range of people as time progresses.²⁰²

Progressive realisation requires that the State must have in place a policy framework for the realisation of the right of access to social security. The policy, if there is one, must be designed so that the State’s obligations can be met.²⁰³ The term ‘reasonable’ relates to the content of the policy, the way the policy was implemented, the choice about who the policy was targeted to cater for and the allocation of resources to that policy.²⁰⁴ In the absence of a social security policy framework providing for incremental provision of social security to the excluded, the Government’s plan to introduce the wage subsidy scheme may not pass constitutional muster.

6.2.3. Resource constraints as a constitutional defence

A defining aspect of the state’s obligation is that the Constitution does not require the state to do more than its available resources permit. This means that both the content of the obligation in relation to the rate at which it is achieved as well as the reasonableness

²⁰⁰ Olivier MP *et al Social Security: A Legal Analysis* LexisNexis Butterworths, Durban 2003, 93.

²⁰¹ Liebenberg S “The Right to Social Assistance: the Implications of *Grootboom* for Policy Reform in South Africa” (2001) *South African Journal of Human Rights*.

²⁰² *Grootboom* par 45. See also *Treatment Action Campaign* par 125.

²⁰³ *Grootboom* par 40.

²⁰⁴ Iles K “Limiting socio-economic rights: beyond the internal limitations clauses” accessed at <http://www.law.wits.ac.za/sajhr/2004/iles.pdf>

of the measures employed to achieve the result are governed by the availability of resources.²⁰⁵ There is no unqualified obligation on the state to meet the existing needs of the citizens. The right to have access to social security is qualified by the availability of resources. The Constitutional Court in *Soobramoney v Minister of Health (KwaZulu-Natal)*²⁰⁶ spelt out the implications of this limitation. It stated that:

"What is apparent from these provisions is that the obligations imposed on the state by sections 26 and 27 in regard to access to housing, health care, food, water and social security are dependent upon the resources available for such purposes, and that the corresponding rights themselves are limited by reason of the lack of resources. Given this lack of resources and the significant demands on them that have already been referred to, an unqualified obligation to meet these needs would not presently be capable of being fulfilled. This is the context within which section 27(3) must be construed."²⁰⁷

The Constitutional Court emphasised that the state has to manage its limited resources in order to address all these claims. There will be times when this requires it to adopt a holistic approach to the larger needs of society rather than to focus on the specific needs of particular individuals within society.²⁰⁸ Resource constraints could, therefore, be a relevant factor in assessing the state's ability to do more for those excluded, due to the fiscal and macro-economic implications of such an endeavour. The availability of resources is thus a factor in determining whether the State has taken reasonable measures. Resource constraints could be a basis for the State justifying its rate of progress in achieving the full realisation of social security rights. Resource constraints were also recognised in the *Grootboom* case, although it was held that the state must make provision for the extremely vulnerable.²⁰⁹ This also implies that those in desperate need should be provided with some form of immediate relief and should not have to wait for medium or long-term measures designed to ensure the progressive realisation of their rights. Various other constitutional principles will be considered. These include the need for policy-based programme and legislative implementation; allocation of responsibilities and empowering implementing and delivery institutions; the requirement of sufficient budgetary support; the inadmissibility of retrogressive measures

6.3. The role of other (non-state) actors

Some analysts advocate a dynamic dimension to the "availability of resources" qualification, arguing that the state should make substantial resources available now for programmes that will facilitate sustainable economic and social development, thereby increasing the availability of resources for the realisation of socio-economic rights.²¹⁰ The wage subsidy, with its stated aim of enabling low-wage workers access to the social insurance system could qualify this dimension. In this way, the State will be making available resources available now to enable poor and vulnerable workers to realise their right of access to social security through social insurance contributions. This will reduce

²⁰⁵ *Grootboom* par 46.

²⁰⁶ 1997 (12) *BCLR* 1696 (CC).

²⁰⁷ *Soobramoney* par 11.

²⁰⁸ *Soobramoney* par 31.

²⁰⁹ *Grootboom* par 44.

²¹⁰ Sandra Liebenberg, "The Right to Social Assistance: the Implications of *Grootboom* for Policy Reform in South Africa" (2001) *South African Journal of Human Rights* vol 17 part 2.

the social security burden of the state, and make available more resources towards social assistance in the future.

The *Grootboom* case emphasised that the Constitution does not require the state to be the sole provider of socio-economic rights. The state's duty differs according to whether persons have the ability to realise their rights or not. In relation to the right to have access to adequate housing, the Court held in the *Grootboom* case that a right of access to adequate housing also suggests that it is not only the state who is responsible for the provision of houses, but that other agents within our society, including individuals themselves, must be enabled by legislative and other measures to provide housing. The state must create the conditions for access to adequate housing for people at all economic levels of our society. State policy dealing with housing must therefore take account of different economic levels in our society.²¹¹

For those with the ability, the state's duty is not that of direct provider, but only of unlocking the system and providing a legislative framework to facilitate access to social security benefits. Issues of development and social welfare are raised in respect of those who cannot afford to provide for themselves, and state policy needs to address both of these groups.²¹²

7. CONCLUSIONS AND FINDINGS

- 7.1. The proposal to introduce a wage subsidy in South Africa is said to help address structural unemployment in South Africa, characterised by the mismatch between skills required for the available jobs and (the lack of) skills possessed by a largely unskilled workforce. However, it is suggested that unemployment in South Africa is also a function of the unavailability of sufficient jobs in the (formal) labour market. Therefore, one of the major challenges facing the introduction of a wage subsidy is whether it could realistically address this latter phenomenon.
- 7.2. It is imperative to factor in the impact of country-specific economic and labour market factors, when considering the introduction of a wage subsidy. Unemployment in South Africa is not only structural in nature, but displays substantial geographical, population groups, gender and age differentials. One of the most notable factors relates to the massive unemployment of the youth and would-be younger labour market entrants between 15 and 34 years – this group constitutes 73 percent of the unemployed.
- 7.3. Wage subsidies, as an expression of active labour market policies, come in different forms. There are, among others, employer-side and employee-side, and general and targeted subsidies. Each of these forms has its particular advantage and disadvantage.

²¹¹ *Grootboom* par 35.

²¹² *Grootboom* par 36.

- 7.4. Several lessons are to be gleaned from comparative examples, amongst which that wage subsidies could have unintended adverse effects (see below), could be difficult to sustain, and may lack accountability. Careful design is therefore required.
- 7.5. The principal aims of wage subsidies are to increase employment, and to reduce the cost of labour. In the South African context, though, it is suggested by government that a wage subsidy should be structured in such a way as to allow low-income workers to contribute to the envisaged (retirement-based) public social security arrangement.
- 7.6. The introduction of a wage subsidy, in particular in view of South Africa's unemployment and poverty profiles, would make little sense if it is not designed in such a way that it encourages the initiation of a *permanent* employment relationship – in order to ensure labour market absorption.
- 7.7. In addition, the evident skills mismatch characterising structural unemployment in South Africa would require that complementary mechanisms be introduced. Without the availability/provision of appropriate skills training interventions, and possibly job search assistance, wage subsidies are unlikely to achieve their essential aims.
- 7.8. Several crucial choices need to be carefully considered when designing a wage subsidy framework. These choices relate to factors such as duration of the subsidy, the amount of the subsidy, eligibility conditions, and monitoring mechanisms. In essence, it needs to be determined who in particular should be targeted (e.g. first-time labour market entrants) and what specific purpose(s) should be fulfilled by a wage subsidy.
- 7.9. In South Africa, the decision to implement a social security-related wage subsidy has been justified on the basis that it would assist in countering the regressive nature of a mandatory social security contribution (tax). Of course, it is debatable whether a wage subsidy would of necessity be needed to redress these regressive elements. One would think that a range or combination of other measures could achieve the same result, such as changes to the system of tax deductibility. It would also appear that the payment of a direct subsidy to enable low-income earners and/or their employers to pay social security contributions is, with some exception, not a measure which is generally applicable in comparative systems in the developing world.
- 7.10. Several advantages are said to flow from wage subsidies, including increasing employment and decreasing unemployment, increased labour market absorption and poverty reduction.
- 7.11. However, it is evident that a wide range of disadvantages could threaten the impact and success of a wage subsidy programme. These disadvantages include:

- The substitution effect of a wage subsidy – a wage subsidy which targets a specific subgroup of workers can be disadvantageous in so far as it may cause the labour force to be split into subsidised and unsubsidised workers, and may induce the firm to replace unsubsidised workers with subsidised workers;
- The occurrence of deadweight loss, which means the hiring from the target group that would have occurred also in the absence of the programme;
- The displacement effect of a wage subsidy – this effect occurs when a firm with subsidised workers increases output, but displaces output among firms who do not have subsidies workers and, as a result, the subsidy crowds-out employment;
- Stigmatisation of the targeted population in the eyes of employers;
- A disincentive on the part of the employer to raise wages; and
- An increase in fiscal costs.

7.12. These disadvantages are usually dealt with on the basis of the creation of relatively stringent conditions and administrative requirements, which could make wage subsidies unattractive. The challenge therefore is to avoid creating a barrage of administrative checks, while simultaneously ensuring that abuse of the system is minimised.

7.13. It is suggested that factors such as the following would have a crucial impact on the feasibility of a wage subsidy programme in South Africa:

- Whether the programme is sensitive to the labour market and unemployment context prevailing in the country;
- The presence of an effective and efficient administrative and institutional structure;
- Appropriate links with and incorporation of other core interventions, in particular skills training;
- The clear and careful designation of the target group(s);
- Whether the programme is restricted to the formal sector, neglecting the fact that the bulk of the low-income earners and the atypically employed are involved in the informal economy; and
- Whether the programme sufficiently takes into account that there is an asymmetrical relationship between wages and labour demand in that, employment declines faster in response to an increase in real wages, whilst it increases at a relatively low rate in response to reductions in wage costs. It could be argued that the wage subsidy would address only wage-cost induced unemployment and not influence structural unemployment. However, since South Africa's unemployment problem is structural in nature, rather than wage-cost induced, the introduction of wage subsidies solely as a means to counter wage-cost induced unemployment will prove to have a limited impact.

7.14. Proposals aimed at significantly addressing unemployment and welfare dependency, through linking poverty alleviation to economic activity, would require

labour market interventions that are not only comprehensive, co-ordinated and integrated but also effective and tangible. Such an approach would need to go much further than the introduction of particular isolated programmes aimed at job creation.

7.15. Several constitutional considerations potentially impact on the validity of the envisaged wage subsidy programme, including:

- As a matter of equity and giving priority to the most vulnerable, it could be argued that the very substantial envisaged financial outlay (R20-30 billion per year) could be used to provide a basic subsistence to a large number of very desperate and, in the social security sense, uncovered people living in deplorable conditions, in addition to the portion of the social welfare budget set aside to for social benefits for the elderly, poor, disabled and children.
- It is not sufficient to attempt to adopt measures which give effect to the right to access to social security in isolation. This implies that in its attempt at improving the social security system through a wage subsidy, the State must ensure that all related constitutional values and rights, such as human dignity, freedom and equality, be given effect to; and that access is granted to resources which are necessary for the realisation of the right to access to social security and other related rights. This could and should be effected through a package approach, whereby the provision of a baseline of services, transfers and resources to those in desperate need is ensured as a matter of priority. The constitutional and developmental imperative for universal basic income support has to be considered within a comprehensive package of measures to address structural poverty.
- The State would have to indicate that the establishment of a wage subsidy scheme is part of its overall labour market policy framework, not an isolated and uncoordinated policy choice.
- The constitutional standard of progressive realisation requires that the State must have in place a policy framework for the realisation of the right of access to social security. In the absence of a social security policy framework providing for incremental provision of social security to the excluded, the Government's plan to introduce the wage subsidy scheme may not pass constitutional muster.