YOUTH SUBSIDY FOR YOUTH UNEMPLOYMENT

TWO SIDES OF THE SAME COIN ?

It is highly prudent and necessary that the agenda of Youth, their development, their grievances and their aspirations for tomorrow, continues to enjoy prominence in the South African political discourse today.

Not least so because of the fact that the **ANC's youth organisation, founded 68th** years back, have championed and continues to champion the interest of the most challenged young people within South Africa and in the Northern Cape.

We are particular proud of the fact that the People's Struggles has always been led by the vibrancy and energy of the South African youth; more so on the occasion of the **35th commemoration of the assassination of a young man**, whose conviction that *White cannot be Better*, and that *Black is always Bad*, has brought him a suffered death.

We remain confident about our future through the conscious realisation that back **20 years ago, a singular massacre has been inflicted upon 28 youth,** but the spirit of resistance required the death of actually every single 31 million Black South African.

As we celebrate the youth struggles of OR Tambo, Nelson Mandela, Steve Biko and every of the martyrs of the Bisho Massacre, we must stand equally in our conviction 'That the Struggle is Not Over'.

The struggles for both political and economic freedom, has historically been centered firmly in the liberation's credo of People first; Peoples justice first; Peoples education first; Peoples struggles first; Peoples liberation first.

What comes to mind today, as the ANC's flame of freedom, hope and love for its people, burns ever so brightly in the Northern Cape, amongst and within our community, and our people, is the realisation that ***we must continue the fight.*** We are deeply moved and inspire in the further realisation that indeed ***the blood of our struggle heroes, is nourishing the tree of freedom.***

The most pressing problem facing South Africa today is the absence of sustained economic growth and job creation, which are essential to reduce poverty and improve living conditions. The transition to a multi-racial democracy in 1994 posed difficult political, social, and economic challenges, and South Africa's noteworthy achievements in surmounting these challenges have been widely recognized. But the events of last few years demonstrate clearly that the challenge did not end with the transition of power to a new government.

What lies ahead is the daunting task of ensuring that South Africa's rich natural and human resources are employed for the benefit of all, promoting sustainable livelihoods, improving social conditions, and alleviating poverty. Inheriting an economy in disarray and faced with external pressures and questions over credibility, in 1994 the new government was forced to concentrate on macro policy concerns, especially the establishment of a credible and prudent fiscal stance, efforts to reduce inflation, and the needed reunification of the dual exchange rate system.

The policy perseverance exhibited over the last five years has yielded tangible macro stabilization successes and enhanced policy legitimacy. However, the growth-and-employment challenge facing South Africa is a daunting one. Investment rates are low, Foreign Direct Investment (FDI) inflows disappointing, and the unfinished agenda of structural reforms leaves South Africa at a disadvantage within an increasingly competitive global environment. The legacy of apartheid is evident in the pervasive distortions in all factor markets: for labour, as evident in the scale and persistence of unemployment and inadequate investment in human capital; for capital, in the low savings/investment rates and limited FDI.

Given South Africa's success in macro stabilization, the current challenge that we must face relates to the problem areas of growth, jobs, and poverty reduction within a broad economy wide framework.

No one can deny the assertion of the National Development Plan in terms of unemployment. Yes indeed the challenge we face as South Africa is the fact that too few people work. **The key question we need to answer is whether a wage subsidy will address unemployment and all the challenges relating to why we struggle to get more people employed?**

The government has begun to acknowledge the seriousness of the situation, and has proposed a range of interventions to address it. Some of these are of doubtful merit or contradict other government policies or proposals. One initiative, proposed by the National Treasury, is to introduce a wage subsidy for young workers. The logic of this idea is that employers will be encouraged to employ more young and inexperienced workers if the costs of doing so are subsidised.

I suppose they, will be the first to appreciate that because the suggestion on the wage subsidy emanates from National Treasury, it, **the youth wage subsidy, therefore is actually an ANC proposed intervention in the scenario of rampant youth unemployment ?**

Because it is such, allow the African National Congress to explain its content, and equally so, to raise some probable challenges which it may pose.

I will therefore seek to address two sides of the same coin, thereby providing a *Critical Analysis of the Youth Wage Subsidy*.

Government has proposed that the wages of all workers between the ages of 18 and 29 earning less than R60 000 a year – the current tax threshold – should be subsidised for a period of two years. Registered employers would receive the subsidy via credits on their PAYE accounts. In the first year, the subsidy would comprise 50 per cent of monthly wages up to R2 000 a month, reducing to nothing for wages of R5 000 a month or more. The value of the subsidy would decline by 50 per cent in the second year. Young people who are currently employed would be eligible only for one year and at the lower rate.

Government estimates that the programme would subsidise 423 000 workers. Of these, 245 000 jobs would be created in any case, and the remaining 178 000 would be created in response to the subsidy. The Treasury estimates that some 45 000 workers would drop out of the labour force after having benefited from the programme, so the net result would be 133 000 more people employed by 2015, when the programme would end.

The programme would cost R5 billion over three years. Each job would have cost an average of R37 000, although the actual subsidies would be considerably less.

In November 2010, the **Centre for Development and Enterprise** (CDE) convened a Round Table of senior economic policy-makers, economists, and leaders from business and civil society to examine the key issues surrounding this proposal. It was also attended by two international experts: Professor Paul Romer, a renowned growth economist from Stanford University, and Prof HianTeckHoon of Singapore Management University, a leading labour market economist and expert on wage subsidies.

Questions addressed included: Would a wage subsidy raise employment levels, by how much, and at what cost? Is this an appropriate response to the unemployment crisis? And would it be sustainable? Is a wage subsidy a good idea?

While some issues of policy design were discussed, the main focus of the Round Table was the feasibility, desirability and possible impact of the proposed wage subsidy.

The other critical question we must ask ourselves *is what happens to participants in wage subsidies after the subsidy runs out?* And secondly, *are there longer-term benefits for participants, in the form of higher future employability?*

Will we only replace the older unsubsidised workers with younger workers?

In trying to generate a possible and plausible answer, we must first examine the Sources of Unemployment and the Appropriateness of Wage Subsidies in Addressing Each

Unemployment is a serious concern and should be addressed by policies that *improve the absorption of labour into full-time employment*, preferably in the formal sector. When designing the most appropriate policy response to a particular market failure, it is necessary to understand what contributes to a problem in the first place. **The sources of South Africa's unemployment are certainly multiple and complex.**

Although running the risk of oversimplifying the matter, we group these into four main (but not independent) sources of unemployment; we then assess whether a wage subsidy program is the appropriate response in each instance.

- ***Number One: Weak Economic Growth***

South Africa's economic growth over the past 18 years has not been as susceptible to shocks as during the apartheid period; and yet an average growth of around 2 to 3 percent per year during the 1990s remained low compared with the goals outlined in the Growth Employment and Redistribution (GEAR) programme implemented in 1996 (South Africa, Ministry of Finance 1996). Taking a longer-run comparative perspective, South Africa only experienced a 0.3 percent growth in per capita GDP (purchasing power parity prices) from 1980 to 2008, as compared with 1.15 percent growth in other upper middle-income countries and 2.5 percent in low- and middle-income countries.

Weak economic growth, therefore, certainly explains part of the unemployment outcome. Statistical decompositions of growth, wage, and employment trends reveal another part of the problem - namely, that the output-employment elasticity was insignificantly different from zero for the 1990 - 1998 periods (Fields, Leibbrandt, and Wakeford 2000). Thus, the little growth that did materialize did not translate into higher employment. Since 2001, however, there has been a marked shift in the economy, with a recovery in both economic growth and employment creation relative to the 1990s. Strong employment growth persisted throughout the 2000 - 2005 period, more or less matching the economy's growth rate (Oosthuizen 2005). This growth is indicative of the importance of output growth in stimulating employment demand, especially in more recent years. More important, however, is the fact that more than half of the employment growth was in low-paid informal or self-employment jobs (Casale, Muller, and Posel 2004).

The formal sector output-employment elasticity has therefore remained low. Are wage subsidies appropriate to address the unemployment consequences of weak growth?

The Computable general equilibrium (CGE) (CGE in economic terms refers to a set of economic models that use actual economic data to estimate how an economy might react to changes in policy, technology or other external factors.) simulation of a wage subsidy shows a positive output growth response (1.2 percent in the benchmark scenario). This high possible growth output which the CGE simulation provides for, a largely once-off effect that relates to the absorption of excess (unemployed) labour into formal employment. **A temporary wage subsidy will not thus necessarily induce sustained growth in employment demand.** It is conceivable - and many proponents of wage subsidies make this case - that workers gain experience and skills during their period of subsidized employment. **This experience may enhance their employability**, even at nonsubsidized wage rates. Ultimately, however, a wage subsidy is not the first best policy response to addressing inadequate employment demand associated with slow economic growth. Rather, investment, education, infrastructure, market power, and industry concentration and openness have all been found to be important determinants of South Africa's growth process (Fedderke 2006). Nevertheless, the wage subsidy, by raising the employment intensity of output, may enhance the rate of employment growth, particularly formal employment growth associated with output growth.

- ***Number Two : The Changing Structure of Employment in South Africa***

Although economic growth itself is important, it is also insightful to reflect on the nature of economic growth in South Africa over the past two decades. Throughout the post-apartheid period, output has shifted away from low-skilled, labour-intensive primary and secondary sectors toward skill-intensive services, or tertiary sectors (see Bhorat and Oosthuizen 2004). Rodrik (2008) argued that the weak performance of the export-oriented manufacturing sector, in particular, has deprived South Africa of growth opportunities and job creation at the relatively low end of the skill distribution. The structural shifts in the economy have thus not only lowered the growth rate, but the general shift toward the services sector has been at the disadvantage of less-skilled labour and the overall employment intensity in the economy. This process may have been complemented by skill-biased technological change within sectors that is, at every level of output, the demand for skilled relative to low-skilled labour increased (Rodrik 2008).

Although the net impact on employment depends on the growth effects of this technological change, Edwards (2006) has shown that employment growth between 1994 and 2002 was probably about 4 percent lower per annum than it would have been at a constant labour-output ratio and at observed output levels. The source of unemployment is not the structural change in itself such changes are natural for developing countries; rather, it is that South Africa’s workforce has failed to adjust to the changing labour demand patterns. Semi- and unskilled workers remain in excess supply and do not have the skills necessary to compete for the kinds of vacancies that exist. By nature, structural unemployment is unlikely to correct itself without some form of policy intervention (Banerjee et al. 2007).

In this regard, Go et al. argued that **structural unemployment “cannot be solved by macroeconomic management or temporary swings in aggregate demand”** (2009, 5), as this would only perpetuate the labour market problems associated with South Africa’s current growth path.

Certainly, wage subsidies will, through raising the attractiveness of low-skilled jobseekers relative to others, lead to an increase in overall employment. However, such a policy still does not address the underlying problems of inadequate or irrelevant education, skills, and experience that lie at the heart of the structural unemployment problem. Whether the subsidization of wages will provide enough of an incentive for firms to lower their expectations and employ people without the right skills also remains debatable.

At best, a wage subsidy policy will ensure that people just below the minimum skill threshold are absorbed into the workforce.

The primary, long-term intervention must be in education and training.

- ***Number Three: Unemployment Due to Wage Costs***

A further source of unemployment, particularly among low-skilled workers, relates to wage and nonwage costs of employment rising more rapidly than labour productivity. Several South African econometric analyses support the notion of a trade-off between real wages and employment (Fallon and Lucas 1998; Fedderke and Mariotti 2002; Fields, Leibbrandt, and Wakeford 2000). Although South African wage data spanning long periods are weak, some evidence does indicate that wages of semi- and unskilled workers have risen sharply relative to those of skilled workers (see Lewis 2001). This may explain, in part, the poor employment prospects of low-skilled workers. Fedderke (2006) concurs, attributing large-scale job losses in agriculture and mining two sectors that have traditionally been important employers of low skilled workers to the fact that real wage costs (driven in part by union demands) outstripped improvements in labour productivity. The post-1994 period has also seen increases in nonwage costs of employment due to stricter labour market legislation and regulation, the emergence of a strong trade union movement, and rigidities imposed by bargaining councils (see Bhorat 2008; Fedderke 2006; Nattrass 2000).

The implication is that unemployment in South Africa is not entirely a structural problem; it also relates to relative employment costs of skilled versus low-skilled workers. On the basis of the evidence, Pollin et al. tentatively concluded that reducing unit labour costs “could be a central feature of policies to attack mass unemployment” (2006, 32) in South Africa.

A wage subsidy is one such policy that reduces the cost of labour. Once again, however, **a wage subsidy does not address the root cause of the problem namely, overly high costs of employment caused by rigidities in the market.** To this effect, Levinsohn (2008) proposed that a wage subsidy programme include a probationary period during which a no-questions-asked dismissal policy is in effect.

- ***Number Four: Youth Unemployment***

South African unemployment is highly concentrated among the youth, which is indicative of a general reluctance among firms to employ youth labour market participants. Within the context of structural shifts and skill-biased technical change, the high rate of youth unemployment is closely associated with educational attainment (both the quantity of education and the quality or appropriateness of qualifications are concerns), skills, and work experience among the youth. A supply-side factor is the effectiveness of job search strategies among the youth.

Many youth may have insufficient educational attainment, due either to early exit from the schooling system or to poor quality and coverage of instruction in basic literacy and numeracy. Those who leave school early are hugely disadvantaged, but even those who are better qualified face poor prospects relative to more experienced adults. Several analyses have shown that young people are entering the labour market at an earlier age but with higher education levels than in the past (Branson 2006; Pauw, Oosthuizen, and van der Westhuizen 2008).

In an economy where labour demand is constrained and has shifted toward higher-skilled labour, competition for entry-level jobs is fierce; thus, a matric (the qualification obtained in the final high school year) may simply no longer be enough to guarantee employment. All of this raises the question of whether the youth have appropriate skills or sufficient experience relative to the needs of employers. The **skills-mismatch hypothesis** encompasses issues around the quality and appropriateness of education, as well as the trade-off between general versus job-specific experience or skills (Burns 2008).

Quality of education is a major concern in South Africa. Four out of five school leavers are considered functionally illiterate (i.e., they lack the language skills required to be successful at tertiary institutions) and 60 percent have inadequate mathematics and science skills as they exit high school (Mlatsheni 2005). Kraak argued that this “perceived poor quality of South African schooling (particularly in the former African school system) serves as a major disincentive on the demand-side for employing large numbers of first-time entrants to the labour market" (2005, 31).

Closely related to the quality issue is the appropriateness of courses offered or, indeed, selected by students. Constant evaluation of school curricula and proper career advice to students are crucial. Education is, of course, not the only means through which skills are obtained. Early labour market experience in the form of part-time employment eases the transition from school to work, assists youth with choosing career paths, and instils work ethics considered desirable by employers (Burns 2008).

Employers faced with high labour costs and labour market rigidities may become more selective in their hiring decisions by placing greater weight on prior experience. It is for this reason that young jobseekers are disadvantaged: Three-quarters of the unemployed youth surveyed in the LFS 2007 (Stats SA 2008) reported that they had never worked before, compared with less than half of unemployed adults. Once again, there is a racial dimension to this factor. Lam, Leibbrandt, and Mlatsheni (2007) documented large differences in the school-to-work histories across race groups in South Africa's Western Cape Province. By age 20, only 20 to 30 percent of Africans had ever done any paid work, compared with close to 90 percent of whites. Anderson, Case, and Lam (2001) found similar low work rates among African youth in the rest of South Africa. The implication is that to the extent that employers might be willing to hire youth, white youth will be at a significant advantage due to a higher incidence of prior job experience.

Limited work experience may also reflect ineffective job search strategies of the youth. Burns (2008) argued that material job search costs in South Africa are high, due to the large geographical distances between areas where employment opportunities mostly exist and areas where people reside. In particular, the youth are vulnerable given their lack of mobility and limited resources. Many youth rely on word-of-mouth from friends and family to learn about job opportunities. Successful job search through such social networks requires good-quality networks, which places those youth living in isolated areas or in communities with limited attachment to the formal employment sector at a relative disadvantage.

The health status of jobseekers and their family members is a further important consideration. For instance, **the high prevalence of HIV/AIDS among the youth may contribute to unemployment,** since poor health impedes active job search. Some people may also be unable to take up employment because they need to care for sick or elderly family members (Burns 2008).

Once again we should ask ourselves whether a youth-targeted wage subsidy is the appropriate policy tool to address youth unemployment. In well-functioning labour markets, educational qualifications signal youth labour market participants' productive capacity, especially where participants have limited work experience. When these signals are weak, the price of labour would normally adjust, such that firms would still provide individuals with an opportunity to reveal their productive capacity. The problem in South Africa is that these processes do not seem to be working for young people. The market failure, therefore, lies in the fact that individuals are unable to properly signal their productive capacity to firms and are unlikely to be given opportunities to do so by risk-averse employers. Employers thus look for signals elsewhere, placing particular emphasis on past work experience and networks, leaving many youth at a disadvantage.

A highly regulated labour market contributes to employment costs and the risks associated with hiring youth labour market participants. **Wage subsidies may be effective in allowing young people to access the labour market for the first time, because the subsidies compensate firms for the risk associated with being unable to identify the productive capacity of prospective employees. However, a wage subsidy alone may not be adequate.** For example, firms may continue to be unwilling to employ new labour market entrants, even with the subsidy, if the costs associated with retrenchment are high. A relaxation of the labour legislation enabling firms to readily lay off workers may thus be required to enhance the subsidy's effectiveness, and the question one must ask is, is this what we want?

Because a wage subsidy, still does not address the most important source of youth unemployment, namely, that of inadequate or inappropriate educational qualifications? There is a need to evaluate academic qualifications in South Africa and to align them to the needs of the market. Proper career advice will enable young people to choose relevant courses; if young people do not meet the entry requirements for courses with good career prospects, educational institutions should provide bridging courses. The signalling problem can also be addressed through standardization of examinations. Externally administered tests, such as the Standard Aptitude Test (SAT) or the Graduate Record Examination (GRE) in the United States could be adopted in South Africa.

Effective job search, in turn, is best facilitated through the provision of job search assistance or job placement services. This assistance could be combined with **a job search subsidy** (not to be confused with a worker-side wage subsidy) that would reduce the material job search costs. Such job search subsidies have been shown to be very effective elsewhere (see Smith 2006), though there must be proper coordination between employers and the agencies that provide such assistance.

Clearly, this area requires further investigation in South Africa, where much of the focus in the area of active labour market policy intervention has been around wage subsidies and structured workplace training initiatives, such as Learnerships.

Considering all of the above, the ANC we are of the firm view that urgent and extra-ordinary measures are required to address youth unemployment. There are far too many young people who are out of work, and these numbers are growing daily. Urgent action is needed to get more young people into the work place.

Further dialogues on the need for a discussion about youth employment that embraces the private sector, public sector, youth organizations and trade unions, would be welcomed. These discussions should aim to rapidly achieve consensus in the form of a **compact or accord on youth employment.**

The youth subsidy will advance as its singular purpose private companies to maximise their profits, that radical intervention by the state in the country's economy was the only way to change the situation of unemployed young people. If the youth wage subsidy was implemented, the government would be subsidising companies to pay the wages of young people they employ.

Private companies would claim the subsidy instead of paying for labour out of their own coffers. “What the youth wage subsidy will do is to give private companies billions to spend to pay young employees instead of paying out of their own pockets.

The attempt to return South Africa to reliance on cheap labour is wrong-headed and ignores the vital lessons of the past. Strong employment growth will require wide-ranging investment and a healthy, educated and productive labour force. The youth wage subsidy does nothing to address these fundamental and urgent tasks.

A job - centred approach to growth

Employment is vital for South Africa’s social, economic and political development. It is the key mechanism for addressing mass poverty. In addition, many other benefits flow from higher levels of employment. Many of the skills needed to improve a worker’s employability – punctuality, discipline, the ability to work with others, and so on – are most easily acquired on the job.

This is especially important in South Africa. Millions of people are the products of South Africa’s dysfunctional education system and have had few opportunities to acquire skills. For many, the workplace is the institution in which they are most likely to be able to acquire skills. Jobs also generate a sense of accomplishment, dignity and participation.

While welfare grants can provide a modest income, they cannot offer any of these other benefits, making employment growth vital to creating a more inclusive society.

As the National Treasury has stated, the proportion of working age adults with jobs may be the best measure of social inclusion in a modern society – far better in many respects than the Gini coefficient. On this measure, Brazil, where close to 70 per cent of adults have jobs, is a far more inclusive society than South Africa, where barely 40 percent of adults have jobs even though levels of income inequality are similar.

If South Africa is to be more inclusive, far more people must find jobs, but what kind of jobs?

South Africa's labour laws mean that any job that is fully compliant with the law is also, from an employer's point of view, a reasonably expensive job. This is especially true when compared with the costs of employment in other developing countries. Minimum wages in South Africa's clothing industry are two or three times higher than those for similar jobs in Swaziland and Lesotho, let alone India, Vietnam, Bangladesh and Pakistan. To justify this, levels of productivity have to be high, resulting in employers' offering fewer jobs but for more skilled workers.

In recent decades the South African economy has generated fewer and fewer new jobs for every unit of economic growth. While some of this reflects increased productivity, much of the decline in job creation can be attributed to rising wages and increased labour market regulations, which have made employers more reluctant to hire workers, particularly those who are young and unskilled. **Employers, who might be willing to incur the costs of employing highly productive workers with significant skills, are much more reluctant to do so for workers whose lack of skills and experience mean they will be less productive.** This is a key reason why so many young, inexperienced workers are unable to find work.

While South Africa has sought to ensure that jobs are well paid and well protected, dynamic emerging economies in Asia have sought to expand the absolute number of jobs as rapidly as possible. Many of these jobs do not pay high wages or offer very good conditions of employment, but they do pay better than almost any alternative form of employment for unskilled people. Critically, they exist in very large numbers. Experience in Asia and elsewhere shows that once high levels of employment have been reached, productivity gains and progress up the industrial value chain lead to a rapid rise in workers' incomes and quality of life. It also leads to much higher rates of growth for the economy as a whole.

This is the process that has lifted hundreds of millions of people out of poverty over the past 40 years. And, apart from the discovery of previously untapped natural resources, it is the only process that has ever improved the quality of life of large numbers of people in poor countries both rapidly and sustainably.

The story of Singapore's rapid development is instructive. There, economic growth has generated a rapid change in its areas of comparative advantage. In the 1960s, shortly after independence, when unemployment was high, the country concentrated on attracting manufacturing firms, particularly in the garment and textile sectors. This was low-skilled work, but it lifted the incomes of the poor. In the 1970s, Singapore began to produce simple electronics, after which it began making hard-drives and semi-conductors. Since then, it has moved further up the value chain, with the country now having a comparative advantage in bio-medical research and development. Thus, over the decades, the country has steadily moved up the ladder of comparative advantage, with very positive implications for average wages as well as economic growth.

In response to the need to create jobs for young, unskilled workers, the Treasury has proposed the introduction of a wage subsidy for young workers at the bottom of the pay scale. Such a subsidy would narrow the gap between the costs employers incur when employing these workers and those workers' likely levels of productivity. The Treasury argues that this would induce firms to employ more young people.

The risks of implementing a youth employment subsidy

There is a strong case for instituting wage subsidies in South Africa. Promoting employment would generate far more inclusivity than increasing welfare payments. At an appropriate level, these subsidies could also stimulate significant employment creation. **There is good evidence from countries as diverse as the United States, Belgium and Singapore that wage subsidies do encourage employment and help to reduce poverty.**

Nonetheless, there were a number of concerns about the introduction of a wage subsidy. These includes ***Cost and sustainability*** *(*The number of jobs created by a wage subsidy depends on how many workers it induces firms to employ. This depends on the size of the subsidy, but larger subsidies raise issues of affordability and sustainability.); ***Waste*** (Wage subsidies can be more efficient than other forms of public policy, but they can also generate wasteful spending when jobs that would have existed in any event are also subsidised);• ***Employer response*** *(* Many employers may feel that it would be too risky to take on potentially unsuitable (albeit subsidised) workers unless the process of dismissing them was made considerably less onerous); ***Opportunity costs*** *(* The funds devoted to a wage subsidy might be better used for other government initiatives); ***Sustainable jobs*** *(* The Treasury's proposal assumes that, after two years of subsidised employment, a young worker will be productive enough for employers to keep him without the subsidy. Whether this will happen is impossible to know); and ***Creating new distortions*** *(* A wage subsidy could result in the growth of businesses who's only rationale is to absorb public money through subsidies. Employers might also replace unsubsidised workers with subsidised ones).

Two of the most significant concerns were that a wage subsidy would do nothing to address the current regulatory regime, which plays a key role in raising the costs of employment, especially of unskilled and inexperienced workers; and that the Treasury's proposal was too small to impact significantly on South Africa's unemployment crisis or on the politics of reforming the labour market.

In some respects, the Treasury's proposal represents a significant break from existing government policy. **For the first time, an intervention is being proposed that takes seriously the negative impact of high employment costs on people's chances of finding work.** It suggests that some policy-makers have recognised that high and rising employment costs are a key reason for South Africa's unemployment crisis. This injects a dose of realism into the debate about the choices facing the country. However, this does not necessarily mean that a wage subsidy is the best way to create jobs.

Is a wage subsidy desirable in principle?

Employment incentives are common across the world, with OECD countries spending an average of about 0,15 per cent of GDP on programmes of this sort. In South Africa, this would amount to R15 billion over three years, or three times more than the costs of the programme that has actually been proposed.

There are many reasons why governments subsidise wages, and the relevant literature suggests that these programmes are quite effective in relieving poverty or increasing employment levels. In South Africa, however, questions need to be asked about the desirability of introducing wage subsidies when it is existing labour market regulation that has ensured that labour costs have risen quickly over the past few decades.

In these circumstances, a wage subsidy – which transfers some of the costs of employment from employers to taxpayers – may not be the most appropriate way to close the gap between employment costs and productivity. Instead, it may be more appropriate to address directly the reasons for high and rising labour costs.

In general terms, the outlook for labour market reform that would reduce labour costs is poor. As recently as December 2010, the government proposed amendments to the Basic Conditions of Employment, Labour Relations and Employment Equity Acts, and proposed a new law – the

Employment Services Bill – aimed at governing labour brokers. There is widespread agreement that these proposals would have increased the cost of employment and resulted in more unemployment.

As a result, the 'social partners' represented in NEDLAC – national government, organised business and organised labour – agreed in April 2011 that the four bills should be re-drafted.

A process of consultation is currently under way regarding these bills. It is not yet clear what will emerge from this. The fact that these bills were drafted at all, however, suggests that key government institutions want to increase labour market regulation rather than decrease it. It is especially telling that government proposed these measures even after its own regulatory impact assessment concluded that the changes would reduce employment. It seems unlikely, therefore, that reforms will emerge from this process that will significantly reduce the direct and indirect costs of hiring young, unskilled work-seekers.

There is no indication that the proposed wage subsidy is part of an incremental strategy to reform the labour market. If the wage subsidy is an isolated initiative, is it worth implementing anyway?

An alternative would be to engage directly in the process of reforming the labour market in order to reduce the costs of employment – in general, or for this group of workers. . As it stands, the Treasury's proposals – assuming its projections are accurate – would have only a modest impact on the crisis of unemployment.

One reason for framing the issue in these terms is the sense that 133 000 new jobs are simply too few to make a meaningful difference to the employment prospects of the jobless. Equally important, this number may also be insufficient to shift the debate about labour market policy. In practice, a much larger programme could help change the terms of the debate and start convincing those who would like to increase regulation of the labour market that creating more jobs actually requires lowering the costs of employment.

There is merit in the Treasury's proposal, but South Africa could do better. **First prize would be to address directly the high costs of employment, especially of young, unskilled and inexperienced workers.** While this would be politically difficult, the benefits could be significant.

Even if political circumstances effectively rule out more fundamental labour market reform, serious questions remain about the current Treasury proposal. Chief among these is why it is so modest. If the Treasury is confident about its projections, why it is not pushing for a more ambitious programme? Is it concerned that it would cost too much? Is it seeking to avoid a more serious political battle?

That said, there is also an argument that the modesty of the proposal is a virtue. The success and affordability of a wage subsidy is not guaranteed. If there is some chance of failure, the relative modesty of the proposal insulates it from incurring significant costs. Whether or not the proposed wage subsidy succeeds, questions need to be asked about what government will do next. If the programme does succeed, will more resources be devoted to subsidising employment, or will a new debate about addressing the costs of employment be instigated? And if the proposal fails to increase employment, what lessons will government (and others) draw from this experience? Will efforts to tackle the costs of employment be expanded and enhanced, or will there be a retreat from any reform at all?

These are vital questions because, even if it achieves its stated goals, the Treasury's proposal will make no more than a modest dent in South Africa's massive challenge of unemployment. Addressing unemployment is South Africa's most pressing national priority. As the Treasury itself recognises, a relatively small wage subsidy programme would not have a very significant impact.

Despite its obvious dangers, the crisis indicates that the world is at a crossroads. In these conditions, the imperative of taking decisive charge of national destiny is even more important. Our responsibility to act in unity, duty bound to protect the livelihoods of the poor and enhance the welfare of our people with care and forethought, is greater than ever.

The ANC will continue to strive for macro-economic balances that support sustainable growth and development. This applies to such indicators as the budget deficit, inflation and interest rates. In other words these balances shall not be treated as things-in-themselves, but as requirements that ensure higher rates of growth, labour-absorption and poverty-reduction

The changes we seek will not emerge spontaneously from the 'invisible hand' of the market. People acting collectively in the spirit of human solidarity must shape the patterns of economic development. In this process the state must play a central and strategic role, by directly investing in underdeveloped areas and directing private sector investment.

This places the democratic developmental state, capable of intervening effectively to transform economic relations, at the centre of our economic agenda. Transformative state intervention in the economy can and must take many different forms.

As we said in our introduction, ***we will continue the fight.*** We remain deeply moved and inspire in the further realisation that indeed ***the blood of our struggle heroes, is nourishing the tree of freedom.***

Alvin Botes

ANC Northern Cape Deputy Secretary and MEC for Social Development

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