**The Employment Tax Incentive in South Africa**

**Input by the Department of Labour to the Standing Committee on Finance (SCoF)**

1. **Introduction**

The Employment Tax Incentive (ETI) was introduced in January 2014 with the intention of stimulating the employment of 18 to 29 year olds in the formal sector by reducing the costs and risks associated with hiring young, less experienced workers. The ETI has been in operation for two years and the National Treasury is recommending that the ETI be extended for a further two years, until 28 February 2019. The Taxation Laws Amendment Bill (B17 of 2016) further proposes that ETI claims by employers not exceed R20 million in respect of any financial year.

The Department of Labour has been represented in the NEDLAC Task Team that reviewed the ETI during August and September 2016 and has been requested to attend the public hearing of the Standing Committee on Finance (SCoF).

The following will focus on the ETI as a policy option for South Africa. Secondly, the context within which it has been introduced will be considered, in particular, the promulgation in January 2015 of amendments to the Labour Relations Act which seek to regulate the use of non-standard forms of employment (labour broking). Finally, the Department will comment on the policy recommendations of the NEDLAC Task Team.

1. **The ETI as a policy option for South Africa**

The ETI is a wage subsidy that can be considered an active labour market policy measure. Active labour market policies are government programmes that intervene in the labour market to help the unemployed find work. Broadly, there are three main categories of ALMP:

* Public employment services that help the unemployed to access employment through various measures such as providing information on vacancies, assisting with job interview skills and writing curriculum vitae;
* Training schemes to help the unemployed increase their vocational skills and hence their employability;
* Employment subsidies that directly create jobs for the unemployed.

ALMP’s are in existence in many countries and have become more widely used during the 1990s, coinciding with economic and social pressures associated with globalisation and, particularly in social democratic countries, such as the Scandinavian countries.

ALMP’s are generally developed as supply side interventions, that is, interventions that target assistance to the unemployed and those seeking to access the labour market. The public employment services and training schemes are generally supply side measures. Demand side interventions are measures that seek to directly stimulate the demand for labour, such as wage subsidies.

South Africa has a history of ALMP’s in the pre-1994 period including subsidies for job seekers. In the post 1994 period, the main active labour market policy measures have been the Expanded Public Works Programme launched in 2004 and the learnership tax incentive which was initiated in 2006. The Public Employment Service of the Department of Labour continues to function and offers assistance to job seekers.

In terms of demand side ALMP measures, it is only the learnership tax incentive that targets training in the private sector and, since 2014, the ETI.

Employment subsidies as a category of ALMP have been controversial in the South African context due to concerns about possible disadvantages and risks associated with these schemes. The literature on employment subsidies typically addresses the following advantages and disadvantages associated with employment subsidies.

Claimed advantages:

1. Subsidies reduce poverty more effectively
2. Assist labour intensive firms in meeting minimum wage guidelines

Claimed disadvantages:

1. Fiscal cost
2. Subsidise inefficient use of labour
3. High administration cost
4. Deadweight losses – jobs would have been created anyhow
5. Substitution effect – existing workers, often older workers, are substituted by the intake of new, subsidised workers.

On the face of it, the claimed disadvantages would seem to outweigh the advantages of employment subsidies. Such an approach would run the risk of not taking account of the objectives of a particular scheme, the labour market context in which it is introduced and the results of experiments or real interventions using an employment subsidy.

There are important reasons for considering an employment or wage subsidy in the South African context. The following are some reasons for doing so:

1. The high levels of unemployment, especially among young persons, constitutes a substantial social and economic cost to South Africa. The largely structural unemployment problem also presents a loss in potential for the economy. As the SALDRU report on wage subsidies argued: “To the extent that a wage subsidy raises employment levels, many of these negative externalities associated with unemployment are mitigated, and any reduction in unemployment, ceteris paribus, will have a positive effect on reducing poverty levels.”[[1]](#footnote-1)
2. Wage subsidies do not address structural issues underlying unemployment, such as educational attainment and skill levels) but they do make targeted workers more attractive to an employer’s demand perspective, they reduce risk associated with hiring and they may preserve jobs in declining enterprises and/or sectors.
3. For young, job seekers, access to employment provides a critical first step ‘in the door’ from which they stand to gain experience and orientation to work. Lack of experience is a significant barrier to employment in many sectors and workplaces. A wage subsidy can improve the chances for some workers to gain access to the labour market.
4. There can be no ‘silver bullet’ that will do away with the problem of unemployment in South Africa and especially youth unemployment. Effective policy aimed at sustainable employment generation will have to combine a set of measures on both the supply and demand sides of the market.[[2]](#footnote-2) Supply side measures are reasonably well developed in South Africa, but the demand side is not strong enough and often fluctuates in the rate of employment growth. Wage subsidies offer the potential to balance the policy options available to arrive at an appropriate mix of interventions that can contribute to a more effective strategy aimed at reducing unemployment.

While the international experience of employment subsidies has had mixed results, the particular challenges faced by the South African labour market would suggest that a mix of policy options will be required, including demand side measures, to test which interventions may be effective in stimulating employment and labour market access by young persons.

1. **Labour law reform and the ETI**

During 2014 and early 2015, a series of important reforms were effected to labour legislation. These included amendments to the following statutes:

1. The Labour Relations Act (no 66 of 1995)
2. The Basic Conditions of Employment Act (no 75 of 1997)
3. The Employment Equity Act (no 55 of 1998)

During 2014, a new Employment Services Act (no 4 of 2014) was enacted to provide for public employment services and to provide for the establishment of schemes to promote the employment of young work seekers and other vulnerable groups.

A central thread running through the labour law reform was the objective of providing a more effective regulatory framework for regulating non-standard employment (commonly referred to as labour broking). The main amendments in this regard were to section 198 of the Labour Relations Act which are intended to protect three categories of non-standard employees: employees placed by temporary employment services (TESs), employees engaged on fixed term contracts and part-time employees. The amendments extend significant protections to employees earning under the section 6(3) BCEA earnings threshold (currently R205,433.30) who are employed in these categories of work. The majority of these protections are only extended to employees after they have been in employment for six months. This creates an appropriate balance between the need to protect vulnerable employees against the potential for abuse and the need to permit short-term flexibility.

The central policy objective of these amendments is to regulate the activities of firms that provide temporary employment services, to prevent abuse of employees in temporary work and to extend protection to such employees. This policy objective is consistent with the Constitution of the Republic of South Africa and with conventions of the International Labour Organisation (Private Employment Agencies Convention, 181 of 1997).

The main implication for the ETI is thus that the Labour Relations Act (as amended) and other labour legislation applies to employers who may claim the ETI, including labour brokers. ETI claims by labour brokers amount to 9 percent of total claims.

Reform to labour legislation is often associated with short-term reductions in employment as employers adjust to new forms of regulation. The debate over the amendments to the Labour Relations Act and whether to ban labour brokers increased the risks of negative employment impact of the amendments on the labour market.

The Regulatory Impact Assessment (RIA) that was commissioned by the Department and the Presidency in 2010, estimated that approximately 600 000 employees were employed in the temporary employment service industry. While not committing to an actual number, the RIA concluded that “it is a fair assumption that total employment will decline.”[[3]](#footnote-3) The RIA was, of course, conducted in the context of a legislative proposal that section 198 of the LRA be repealed – an attempt at a ban.

 An assessment of the impact on employment of the LRA amendments is in progress, but figures from the Quarterly Labour Force Survey (QLFS) suggest that from the first quarter of 2015 to the first quarter of 2016, employment was higher by 204 000. In other words, the year-on-year change in employment since the amendments to the LRA has been positive. The slight growth in employment over the year applies to both the formal sector and the informal sector.

Employment in agriculture and private households declined over the same period.

It is also worth noting that employment change was positive in the period leading up to the first quarter of 2015, that is, January to March 2015. According to Statistics South Africa, there were employment gains in seven consecutive quarters from the second quarter in 2014 to the fourth quarter in 2015[[4]](#footnote-4).

Employment did, however, decline by 355 000 in the first quarter of 2016, but this is twelve months after the amendments to the LRA.

Looking at conditions of employment from quarter four of 2015 to quarter one of 2016, one sees the following picture:

* a decline in employment of those on limited duration contracts by 191 000;
* an increase in employment of those on contracts of an unspecified nature by 130 000 and;
* an increase in employment of those with contracts of a permanent nature (226 000).

At a glance, it would appear as if there was a small decline in short-term contract employment which is most likely to be those workers engaged through labour brokers. On the other hand, overall employment increased and there was an increase in permanent employment. Moreover, the increase in permanent employment was greater than the decline in employment of those on limited duration contracts.

It is worth noting that one of the studies conducted on the ETI noted that respondents highlighted that the ETI had enabled them to make the transitions related to the LRA amendments without having to reduce the number of jobs in the company.

1. **Policy Recommendations of the NEDLAC Task Team**

The recommendation by Government is that the employment tax incentive be extended for two years. An option contained in the Taxation Laws Amendment Bill is that claims by employers for all qualifying employees may not exceed R20 million in respect of any year.

The table reproduced below provides a description of ETI claims and the number of ETI supported jobs.

Table 1: Descriptive Statistics of ETI Claims and Jobs[[5]](#footnote-5)

|  |  |  |  |
| --- | --- | --- | --- |
|  | **2013/4** | **2014/5** | **2015/6** |
| **Duration of ETI Incentive** | 2 months | 12 months | 12 months |
| **Total ETI Claimed (Rand millions)** | 61.16 | 2 465 | 3 534 |
| **Claims as a % of Total Fiscal Spending** | 0.04% | 0.2% | 0.3% |
| **Number of Firms Claiming** | 13 399 | 32 368 |  |
| **Number of ETI Supported Jobs** | 134 923 | 686 402 |  |
| **ETI Supported Jobs as % of Total Jobs** | 1.02% | 5.10% |  |
| **Number of Individuals in ETI Supported Jobs** | 134 196 | 645 973 |  |
| **Marginal Job Cost (R)** | 1 090 | 3 578 |  |
| Source: National Treasury 2016; National Treasury Statistical Tables, own calculations. |

The descriptive evidence clearly suggests a positive impact of the ETI on employment of young persons. The number of firms claiming has also increased substantially and the cost per job of the ETI compares favourably with the “Jobs Fund and other industrial policy subsidies.”[[6]](#footnote-6)

The studies presented to the NEDLAC Task Team did not find evidence of wages decreasing for employees in the 18 to 29 age category, nor was there a significant decline in the duration of new, non-ETI supported jobs compared to ETI supported jobs. The econometric studies did point to a limited displacement effect in the lower paid 30 to 35 age group.

An important concern in the Task Team was the limitation on monitoring and evaluation, due to data being available for a limited period (14 months) and difficulty in isolating the ETI effects relative to other factors.

In summary, the recommended extension to the ETI should be viewed in the context of the initial indication of its generally positive impact and the continued high rate of unemployment in the South African labour market, particularly among young persons. The unemployment rate for 15 to 24 year olds was 63.2 per cent in the second quarter of 2016. The weak economic environment at present also provides an important part of the context for the ETI with economic growth forecast at 0.5 per cent in 2016, rising to 1.7 per cent in 2017.

An extension will also allow for ongoing monitoring and evaluation of the ETI to fully test its impact on the labour market.

1. K Pauw & L Edwards*, Investigation into the merits of using wage subsidies as a policy instrument to promote employment in South Africa*. SALDRU, July 2009, page. 97. [↑](#footnote-ref-1)
2. G Edgren, How different is the South African Labour Market? International perspectives and parallels. HSRC, October 2005. [↑](#footnote-ref-2)
3. P Benjamin, DPRU & SBP, Regulatory Impact Assessment of Selected Provisions of the: Labour Relations Amendment Bill, 2010, Basic Conditions of Employment Amendment Bill, 2010, Employment Equity Amendment Bill, 2010, Employment Services Bill, 2010. Prepared for the Department of Labour and the Presidency, September 2010, page. [↑](#footnote-ref-3)
4. Statistics SA, Quaterly Labour Force Survey, Quarter 1: 2016, Statistical release P0211, 9 May 2016. [↑](#footnote-ref-4)
5. H Bhorat & A Thornton, The Employment Tax Incentive in South Africa: A Brief Assessment of the Initial Impact. Development Policy Research Unit, September 2016. [↑](#footnote-ref-5)
6. H Bhorat & A Thornton, page 5. [↑](#footnote-ref-6)