

**11 March 2009**

**Wage subsidies**  
**Draft BUSA Position Paper**

**1. Introduction**

The South African government has embarked on a wide ranging reform of social security arrangements and retirement fund industry. In the broadest sense, the reform process aims to address high poverty levels in South Africa, especially in old age; stimulate employment creation; encourage post-retirement savings; and reduce perceived high administration costs within the retirement fund industry. BUSA supports the view that provision of social security in South Africa is an expression of the country's commitment to national cohesion and thus we are committed to working with government during the reform process.

The reform process is occurring in the context of a country with high levels of unemployment, poverty, and millions of low-income earners – factors that tend to reduce the incentive and ability for individuals contribute towards retirement savings. Additionally, the reform occurs within a small, open economy facing significant competition from other emerging and developed economies. The reform process has to be carefully managed to ensure that it does not reduce South Africa's labour competitiveness by increasing the costs of the average wage bill - as this has negative impact on SA competitiveness as FDI destination.

Against this background of the above, BUSA supports the principle of introduction of wage subsidy as an element of the reform process. It is our assessment that wage subsidies can offset the costs of mandatory contributions to social security and are useful as an active labour market policy instrument. Overtime, the wage subsidy will promote employment creation and savings, as it is designed primarily to affect behaviour through incentives. However, the design and the implementation of wage subsidies must be carefully managed to maximise uptake and ensure optimal returns initial funding. The implementation of the wage subsidy must also be in line with the budget balancing framework and be sustainable in the long run.

**2. Wage subsidies as an active labour market instrument**

Most studies on the South African economy (e.g. OECD report, Harvard group) have highlighted challenges with high unemployment in South Africa. It is reported that unemployment amongst the young people is high, with fewer than 25 percent of those between the ages of 20 and 25 years being employed<sup>1</sup>. High unemployment levels represent underutilised resources which could be directed towards economically productive activities that can contribute towards economic growth.

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<sup>1</sup> Harvard Report, HSRC

BUSA is extremely concerned about high levels of youth unemployment and lack of access to economic opportunities by young people. It is our assessment that under-investment in young people will gradually diminish South Africa's long term competitiveness, as low productivity amongst this group will impact on future productivity of the country. Furthermore, it is also our view that high levels of youth unemployment reduce social cohesion over time, and tend to contribute to prevalent social ills (Levisohn, 2007) and if left unmanaged can undermine democratic gains.

In an attempt to address high unemployment, the Harvard Group has proposed a scheme that makes young South Africans eligible for the wage subsidy when he or she turns 18 years of age. Upon turning 18, each South African receives an account ("Subsidy Account") into which Government has placed a sum of money. This money can only be used to subsidize the wage that the individual receives while working for a registered firm. When the individual secures employment in the formal sector (e.g. for a registered firm), a fraction of the individual's wage (up to a given limit) would be drawn from the individual's Subsidy Account.

Whilst a wage subsidy is useful to encourage entry-level employment, its effectiveness as a job creation instrument can be reduced by rigidities existent labour legislation, which tends to discourage short term employment relationships – a key component of job-school arrangement. Thus it might be more appropriate tie the targeted wage subsidy to revised rules for dismissal for those workers receiving the wage subsidy (ibid). For this reason, it is essential that the targeted wage subsidy entail a probationary period during which some sections of the LRA might be relaxed to afford employers maximum flexibility in their employment process. This can potentially expose greater number of young people to employers.

BUSA supports the proposal towards a targeted wage subsidy for young people to "facilitate the school to work transition and to ensure that the educational skills do not deteriorate through a long period of unemployment"<sup>2</sup>. However, interventions to address unemployment must also consider addressing the existing unemployed individuals – who is most cases are between the ages of 19-35, with limited skills and experience. It is also important that proposals on wage subsidies to stimulate employment are sustainable in the long run.

### **3. Wage Subsidies to offset social security costs**

In the context of the social security and retirement funds reform, wage subsidies are proposed to offset the costs of compulsion on the average wage bill and low income earners. BUSA agrees that "any consideration of compulsory employee contributions to an occupational or individual retirement fund should be mindful of the potential impact on the cost of employment"<sup>3</sup>. BUSA supports the proposal to introduce an explicit wage subsidy and continuing minimum benefits through social assistance, rather than indirect cross-subsidisation. This approach gives greater transparency to social policy, which is important to ensuring trust and builds confidence in the system.

BUSA proposes that the wage subsidy must reflect the realities of employment patterns in South Africa – where the majority of the working population earns less than R2000

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<sup>2</sup> As proposed by Harvard, HSRC,

<sup>3</sup> 2004 Second Discussion paper

per month/R24000 per annum. Thus our proposal is that the existing threshold proposed in the National Treasury paper is reduced significantly to reflect national employment data. It is also our assumption that the mandatory contributions will be implemented on a cascading scale basis with lower percentage contribution by the lowest income earners?

It is important that the administration of the wage subsidy arrangement is efficient to minimise the cost to the economy. In this regard the proposed administration through PAYE/SARS is supported, as the organisation has proven capability in efficient administration and collection of Taxes.

#### **4. Financing the cost of wage subsidies?**

As previously stated BUSA supports the adoption of wage subsidies, both as an active labour market instrument and to offset the cost mandatory social security provisions. Both types of subsidies must be sustainable in the long run – and an authoritative discussion is required on financing arrangements. What is the potential cost of the wage subsidy to the Fiscus? Secondly, how will the wage subsidy be financed by the fiscus?

The National Treasury discussion document estimates that the cost of the wage subsidy to offset compulsion to be between R20-R30 Billion Rand per annum which is an additional 2.5 -3.6% of the current fiscal budget. It is our view that the amount is significant, and an extensive discussion is required on how this amount will be financed. It is also correct to review the impact of this amount on budget balancing in the event of significant decline in government revenues – as in the current global economic crisis.

BUSA is concerned that to offset the cost of the wage subsidy, another indirect tax/levy would be raised from business. The use of the road levy in the current budget framework to raise government revenue is analogous of this possibility. In this regard, we seek greater details on the financing of work subsidies in general. In principle, we are opposed to higher taxes, since higher taxes like higher wage bills tend to diminish the competitiveness of South Africa as an investment destination.

#### **5. Conclusion**

BUSA supports the concept behind the implementation of wage subsidy in South Africa. However, as with the entire social security and retirement reform process, Business requires greater clarity on the details of the wage subsidy. We believe that the structure of the wage subsidy arrangement; the institutional arrangements surrounding its administration will become critical in ensuring maximum outcomes on job creation and increased contribution towards retirement savings. Thus we seek greater consultation from government on the current thinking in this regard.

BUSA is concerned about the possible negative impact of the wage subsidy on budget balancing, and in this regard we require more information of how government expenditure would be reprioritised to accommodate the additional budget requirement?

BUSA is committed to partnering with government to meet the objectives of the social security and retirement fund reform – in our view a partnership between all social partners is the only way to meet the stated objectives of the reform process.