AN ANALYSIS OF THE USE OF TAX INCENTIVES TO MOTIVATE JOB CREATION

by

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ABSTRACT

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A quarter of the labour force in South Africa is currently unemployed. The majority of the unemployed are between the ages of 18 and 29 years. The causes of these poor employment statistics has been widely debated, however, the cost of unskilled South African labour is a common thread. One of the solutions to improve the statistics is to implement tax incentives to reduce the cost of labour, which would theoretically increase the demand of the labour. Countries such as the United States of America have implemented some form of tax incentive to promote job creation over the years. South Africa has, however, not used this alternative to deal with unemployment. The problem had escalated to such a state that the Government announced in 2011 that it would spend R5 billion on job creation and announced that the funds would be spent through the implementation of a youth wage subsidy.

Current studies on policy choices to promote job creation in South Africa discuss the possible tax incentives which could be implemented. However, these studies have not evaluated the successes of these incentives in other countries and whether it would be possible to apply them to a South African context. The proposed youth wage subsidy has not been analysed in terms of the incentives implemented in other countries to determine whether or not they would be successful in South Africa.

The aim of the study was to determine if there was a gap in the tax legislation with regard to motivating job creation and how this gap could best be filled. This was achieved by firstly, analysing the key causes of unemployment in South Africa, and secondly, determining whether any of the current tax legislation measures deal with those causes. Two tax incentives implemented in the United States of America were analysed for their successes and failures in order to determine what South Africa needs to do if it was to implement any similar incentives. Finally, the National Treasury's discussion paper on its proposed youth wage subsidy was analysed against the findings identified above to determine whether the subsidy is viable in the South African labour market.

Keywords: *unemployment; youth wage subsidy; tax incentives; South Africa; USA*

ABSTRAK
’N ANALISE VAN DIE GEBRUIK VAN BELASTINGAANSPORINGS OM WERKSKEPPING TE BEVORDER

deur

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’n Kwart van die arbeidsmag in Suid-Afrika is tans werkloos met die meeste werkloses tussen die ouderdom van 18 en 29 jaar. Daar word reeds geruime tyd geredeneer oor die oorsaak van die swak arbeidstatistieke, tog is daar ooreenstemming dat die koste van ongeskoolde arbeid in Suid-Afrika ’n bydraende faktor is. Belastingaansporings wat die koste van arbeid verminder en dus teoreties die vraag na arbeid verhoog, kan moontlik die swak arbeidstatistieke verbeter. Lande soos die Verenigde State van Amerika het met verloop van jare sekere belastingaansporings ingestel om werkskepping te bevorder. Suid-Afrika het egter nog nie dié alternatief gebruik om die probleem van werkloosheid aan te pak nie. Die probleem het sulke afmetings aangeneem dat die regering in 2011 bekend gemaak het dat hy R5 biljoen aan werkskepping sal bestee in die vorm van die implementering van ’n jeugloonsubsidie.

Huidige navorsing oor beleidskeuses om werkskepping in Suid-Afrika te bevorder, handel oor die moontlike belastingaansporings wat ingestel kan word. Dié navorsing evalueer egter nie die sukses van hierdie aansporings in ander lande of die moontlikheid van die toepassing daarvan op Suid-Afrikaanse omstandighede nie. Die huidige navorsing ontleed ook nie die voorgestelde jeugloonsubsidie aan die hand van die aansporings wat in ander lande ingestel is om sodoende te bepaal of dit hier sal slaag nie.

Die doel van die navorsing was om te bepaal of daar ’n gaping in die wetgewing oor belasting is ten opsigte van die aanmoediging van werkskepping en hoe sodanige gaping ten beste gevul kan word. Dié navorsing het in sy doel geslaag deur eerstens die sleuteloorsake van werkloosheid in Suid-Afrika te ontleed en tweedens te bepaal of enige van die huidige belastingwetgewingsmaatreëls daardie oorsake aanspreek. Die sukses én mislukking van twee belastingaansporings wat in die Verenigde State van Amerika ingestel is, te ontleed ten einde te bepaal wat Suid-Afrika moet doen indien hy enige soortgelyke aansporings sou implementeer. Ten laaste is die besprekingsdokument oor die voorgestelde jeugloonsubsidie van die Nasionale Tesourie ontleed aan die hand van bogenoemde bevindings om te bepaal of die subsidie in die Suid-Afrikaanse arbeidsmark lewensvatbaar sou wees.

Kernwoorde: *werkloosheid*; *jeugloonsubsidie; belastingaansporings; Suid Afrika; Verenigde State van Amerika*

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CHAPTER 1

INTRODUCTION

1.1 BACKGROUND

The percentage of the labour force who are currently unemployed in South Africa is 25% (Statistics South Africa, 2012:vi). With costs increasing more and more each day coupled with the global economic crisis, businesses find it more and more difficult to create employment opportunities. Employers, especially in small businesses, are also reluctant to hire workers' due to the stringent labour laws imposed in South Africa and the high labour costs these bring. Without the Government's intervention or assistance, this troubling statistic will worsen. The small business sector cannot grow without increasing its work force. If South African business cannot grow, the country will lag behind its African peers in terms of growth.

In 1994, the South African economy generated approximately R800 billion a year. Since that date, the same economy has grown two and a half times in size. However, despite the growth in the economy, South Africa has the same number of people in formal employment as it did in the late 1980s. (Lana, 2011).

The South African Government has stressed that the severe unemployment was one of the major policy concerns and a major focus of Parliament. In his 2010 Budget speech, Pravin Gordhan stated that one in four adults seeking employment was unemployed, and almost half of the young people seeking work were unemployed. (Department of Finance, 2010:3).

The Government has not yet implemented any direct tax incentives to motivate businesses to employ more workers. However, in 2011, Pravin Gordhan (Department of Finance,

2011:16-17) stated that the Government would set aside R9 billion towards innovative public and private sector employment projects and R20 billion towards tax incentives for manufacturing investment, with the focus on job creation. One of the proposals submitted by the National Treasury (2011) to spend the money set aside was the creation of a youth wage subsidy.

1.2 PROBLEM STATEMENT

The high unemployment rate in South Africa has sparked many discussion papers being written on how to solve the unemployment crisis in the country; many have cited tax incentives or tax subsidies as a solution. In a 2001 World Bank discussion paper, the author identified policies to create growth and employment in South Africa and what the causes of unemployment could be (Lewis, 2001). Certain solutions that could be used to alleviate unemployment in South Africa were identified. This report and others have identified general ideas to alleviate the unemployment statistics. However, none of these reports have focused specifically on using a tax incentive to motivate businesses to hire more workers. Current tax incentives focus on isolated causes of unemployment in South Africa; however, none have a direct or targeted approach as a whole. Furthermore, nothing of its kind has been instituted in South Africa and thus past history cannot be relied upon. The successes and failures of implementing a form of job creation tax incentives by other countries would have to be evaluated to determine if they would have any impact on the South African labour market.

1.3 PURPOSE STATEMENT

As stated previously, a significant amount of funds has been set aside to create employment opportunities. The South African Government is intensifying its focus on job creation in the twenty first century thus this study aims to focus on how the Government can use tax incentives as one of its policy options to achieve the objective of job creation.

The purpose of this study is to identify the main factors causing unemployment in South Africa and to identify how current tax incentives alleviate these causes. From these, the

shortcomings can be discussed to identify how one can target unemployment with a tax incentive. Two tax incentives implemented in the USA will be analysed to determine what were the main successes and failures of the incentives and how they can be applied in a South African context. Finally, the purpose of the study is to determine whether the Government has considered the causes of unemployment in South Africa in terms of youth wage subsidy and whether it would be successful after considering the outcome in the USA.

The following research question will be asked throughout the study to ensure that the study resolves the problem identified above: can the proposed youth wage subsidy alleviate the causes of unemployment in South Africa?

1.4 RESEARCH OBJECTIVES

The following specific objectives will guide the study:

- identify the factors of unemployment in South Africa.
- To identify the current tax incentives provided by the Income Tax Act (58/1962) (hereafter referred to as the Act) which have been directly or indirectly used in incentivising businesses to employ more workers'.
- To identify possible tax incentives and/or subsidies implemented in the USA and to analyse the success of such measures to create unemployment through a number of employment opportunities.
- To analyse the proposed youth wage subsidy in terms of the findings above to determine whether the subsidy is plausible in a South African context.

1.5 DELIMITATIONS AND ASSUMPTIONS

1.5.1 Delimitations

The research is limited to only determining how tax incentives can be utilises to motivate job creation in South Africa. The research does not aim to determine a solution to the

problem of the unemployed older than the ages of 29 and the possible substitution effects of those not subject to the youth wage subsidy.

1.5.2 Assumptions

The following assumptions were made throughout the study:

- The successes of tax credits implemented in the United States would have the same impacts in the South African labour market.
- Work experience increases the workers employability. Work experience can aid in alleviating unemployment amongst the unskilled.

1.6 KEY TERMS AND ABBREVIATIONS

The following key terms and abbreviations have been used throughout the study:

Discouraged work-seeker: is “a person who was not employed during the reference period, wanted to work, was available to work/start a business but did not take active steps to find work during the last four weeks, provided that the main reason given for not seeking work was any of the following: no jobs available in the area; unable to find work requiring his/her skills; lost hope of finding any kind of work” (Statistics South Africa, 2012:xxi).

Labour force: consists of “all persons who are employed plus all persons who are unemployed” (Statistics South Africa, 2012:xxi).

Unemployed: “persons are those (aged 15 – 64 years) who:

- Were not employed in the reference week and;
- Actively looked for work or tried to start a business in the four weeks preceding the survey interview and;
- Were available for work, i.e. would have been able to start work or a business in the reference week or;

- Had not actively looked for work in the past four weeks but had a job or business to start at a definite date in the future and were available." (Statistics South Africa, 2012:xxi)

Working-age population: consists of **"**all persons aged 15 – 64 years" (Statistics South Africa, 2012:xxi).

Not economically active: "persons aged 15 – 64 years who are neither employed nor unemployed in the reference week" (Statistics South Africa, 2012:xxi).

Employed: "persons are those aged 15 – 64 years who, during the reference week: did any work for at least one hour; or had a job or business but were not at work (temporarily absent)" (Statistics South Africa, 2012:xxi).

Wage elasticity of labour demand: is "the change in employment for a one percent change in the wage rate" (National Treasury, 2011:51).

Table 1: Abbreviations used the research

Abbreviation	Meaning
CDE	Centre for Development and Enterprise
Cosatu	Congress of South African Trade Unions
DA	Democratic Alliance
DTI	Department of Trade and Industry
GDP	gross domestic product
Nedlac	National Economic Development and Labour Council
NJTC	New Jobs Tax Credit
Numsa	National Union of Metal Workers of South Africa
OECD	Organisation for Economic Co-operation and Development
PAYE	Pay-As-You-Earn system
SETA	Skills Education Training Authorities
SARS	South African Revenue Service
SMMEs	small, medium and micro-enterprises
USA	United States of America

1.7 SUMMARY OF CHAPTERS

The content of this study is set out as follows: Chapter 2 evaluates the causes of unemployment in South Africa through the evaluation of research from various sources; Chapter 3 identifies the current tax incentives implemented in South Africa to determine whether they have any impact on the causes of unemployment as identified in Chapter 2; Chapter 3 identifies the areas where further tax incentives need to be implemented; Chapter 4 analyses the successes and failures of job creation tax incentives implemented in the USA in order to determine whether similar incentives can be implemented in South Africa; Chapter 5 analyses the proposed youth wage subsidy to determine whether it would be successful and if it would theoretically alleviate some of the causes of unemployment identified in Chapter 2;Chapter 6 concludes on the results of the literature review.

CHAPTER 2

SOUTH AFRICAN UNEMPLOYMENT

2.1 INTRODUCTION

There has been much debate and research around the causes of the South African unemployment crisis. An example of such research is research conducted by the Centre for Development and Enterprise (CDE) (2011:7), which collaborated with local and international experts to discuss unemployment and the possible causes in South Africa. According to the CDE's research, the number of South African adults working was between 25 to 30% lower than that of developing nations with similar economies such as China, Brazil and Indonesia. The figure for South Africa as a nation is considered to be 20% lower than the global average for the number of adults working. This is an indication that South Africa performs below par when it comes to tackling unemployment in comparison with countries with similar economies.

The root of the problem needs to be established when developing policies to resolve the causes of unemployment identified in South Africa.

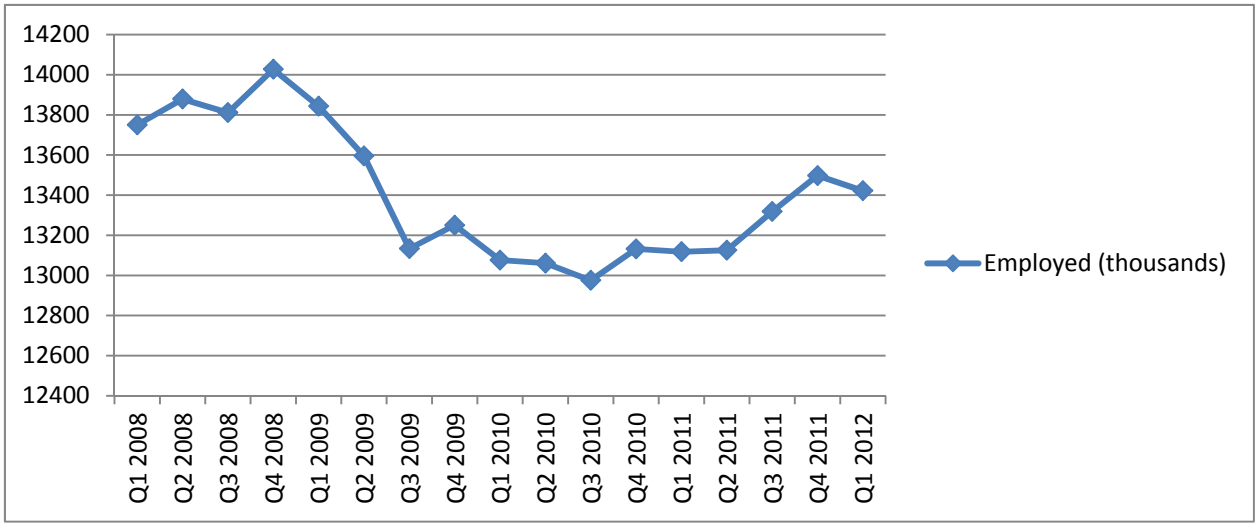
2.2 OVERVIEW OF SOUTH AFRICAN UNEMPLOYMENT

To further understand the scale of unemployment in South Africa, the number of workers who are unemployed needs to be evaluated. The following were the key unemployment indicators as at the third quarter of 2012 (Statistics South Africa, 2012:vi):

- The total working population was 32.3 million. Of the total working population, 14.8 million are not economically active and therefore do not form part of the *labour force*, which amount to 17.4 million workers.
- Of the *labour force*, 13.1 million (75%) are employed and 4.3 million (25 %) are unemployed.

- Currently, the *labour force* definition excludes those who are discouraged workers, however, there are arguments that they should be included in the definition of the labour force and be counted as unemployed (CDE, 2011:9). Therefore, if the discouraged workers were included as part of the labour force, the revised calculation would be 6.5 million or 37% of the labour force currently unemployed.
- The current employment rate is 41% of the labour force.

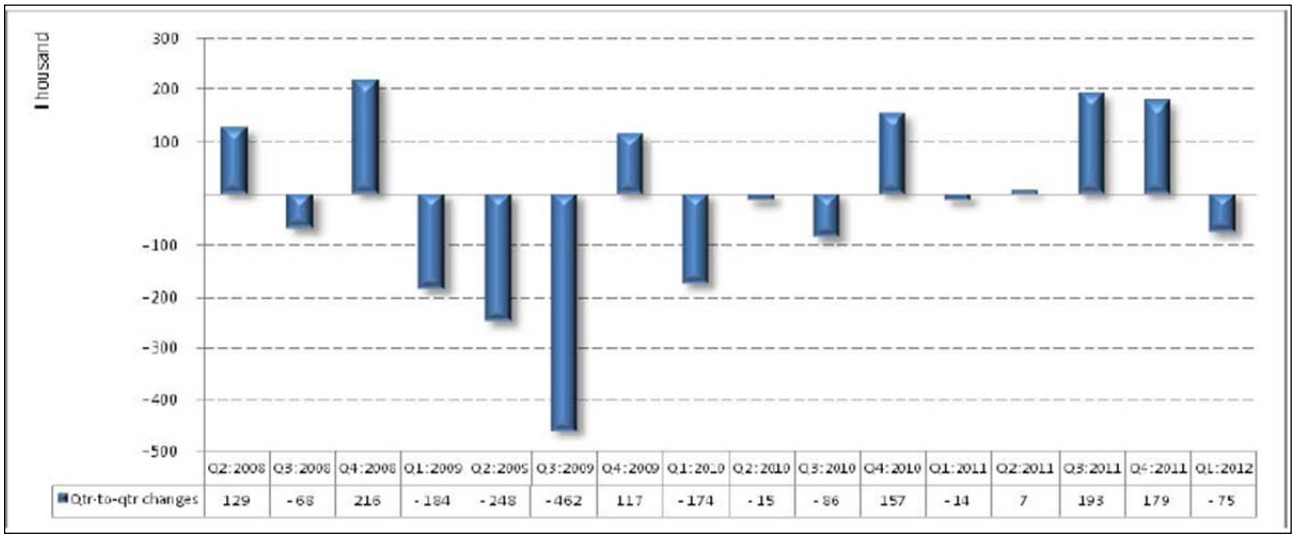
Figure 1: Number of workers employed in South Africa (Q1 2008 – Q1 2012)



Source: Adapted from Statistics South Africa (2012:vi).

To illustrate the scale of unemployment, Figure 1 indicates that the number of workers employed in South Africa has deteriorated since Quarter 4 of 2008. This could have been as a result of the 2008 recession, however, the numbers have not recovered since then. Figure 2 illustrates the quarter on quarter change in the number of workers employed since 2008. The graph highlights the fact that the creation of employment is not consistent quarter to quarter, which causes large fluctuations in the unemployment rate. Should the Government generate a tax incentive, these statistics could become more stable going into the future.

Figure 2: Quarter-to-Quarter change in employment, Quarter 2 2008 to Quarter 1 2012

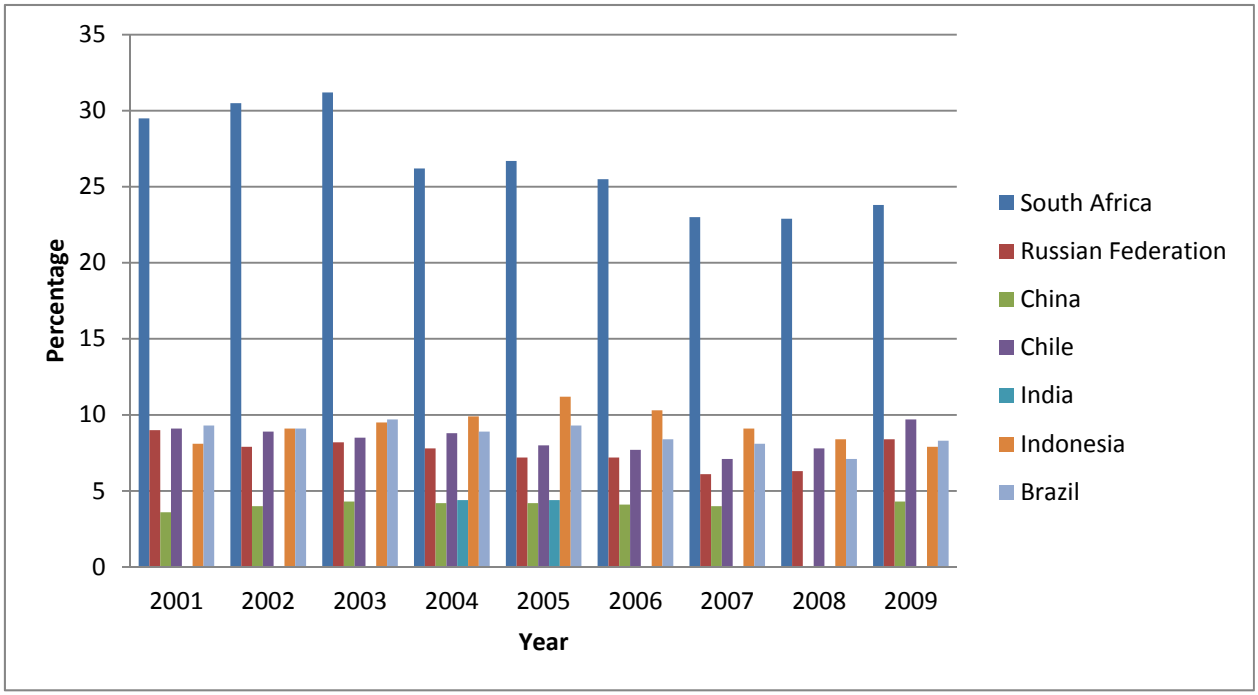


	Q2:2008	Q3:2008	Q4:2008	Q1:2009	Q2:2009	Q3:2009	Q4:2009	Q1:2010	Q2:2010	Q3:2010	Q4:2010	Q1:2011	Q2:2011	Q3:2011	Q4:2011	Q1:2012
Qtr-to-qtr changes	129	-68	216	-184	-248	-462	117	-174	-15	-86	157	-14	7	193	179	-75

Source: Statistics South Africa (2012:vii)

Figure 3 is a comparison of the unemployment rates of South Africa and other developing countries of similar economic growth. The average of the South African unemployment rate was 26.6% during the nine-year period shown in Figure 3. While the average of the other countries combined was 6.4%over the same period, one would expect South Africa's unemployment rate to be within the average of its peers. However, it is four times greater. It is not the size of South Africa's economy which is causing these high unemployment rates, but potentially, the policy decisions of its government.

Figure 3: Comparison of South African unemployment with those of similar developing nations



Source: Adapted from World Bank (2012)

Figure 3 is an indication that it is not the size of South Africa's economy that is generating the high unemployment levels. One would expect that as the South African economy grows, which is expressed as percentage change in the gross domestic product (GDP), the number of workers employed will grow at the same rate.

Between the years 1996 and 2008, the South African GDP grew by 4% (Fox and Gaal:13), however, the number of workers employed decreased by 13% (World Bank, 2012). The above is an indication that there is something inhibiting the employment growth in the country as one would expect that the growth in the economy would have more of an impact on the unemployment rate.

The above graphs provide a broad perspective of unemployment in South Africa. As there is now an understanding of the employment climate of South Africa, the factors causing the high unemployment rates can be investigated at a more defined level.

2.3 AN ANALYSIS OF THE CASUES OF SOUTH AFRICAN UNEMPLOYMENT

After an analysis of a number of sources (Adcorp, 2012; CDE, 2008; CDE, 2011; Finscope, 2010; Lewis, 2001; OECD, 2011), the following are perceived to be the main factors causing unemployment in South Africa:

- the impact of taxation on unemployment;
- the higher than average cost of South African labour;
- The unskilled workforce;
- youth unemployment; and
- the lack of growth in the small business sector.

The following section gives a more detailed analysis of each of the factors mentioned above.

2.3.1 The impact of taxation on unemployment

Taxation on labour determines the cost of the employment for the employer and how much the employee retains ultimately. What is of particular interest to South Africa, is that together with other labour institutions such as unionised bargaining and laws that create minimum wages, taxation will have an impact on unemployment (OECD, 2011:16). Higher costs affect the demand and supply of labour.

Research shows that taxes do not have a direct impact on the unemployment rate. Taxation can, however, be used to alleviate the pressures on unemployment created by trade unions. It is the minimum wage requirements and trade unions which drive up the cost of labour. This ultimately decreases the demand by employers (OECD, 2011:16).

Minimum wages and collective bargaining impact on the semi- and unskilled workers as they tend to be ‘priced out’ of the market. Some OECD countries reduced the amount of payroll tax to be paid or provided a tax credit to employers to incentivise the hire of semi-

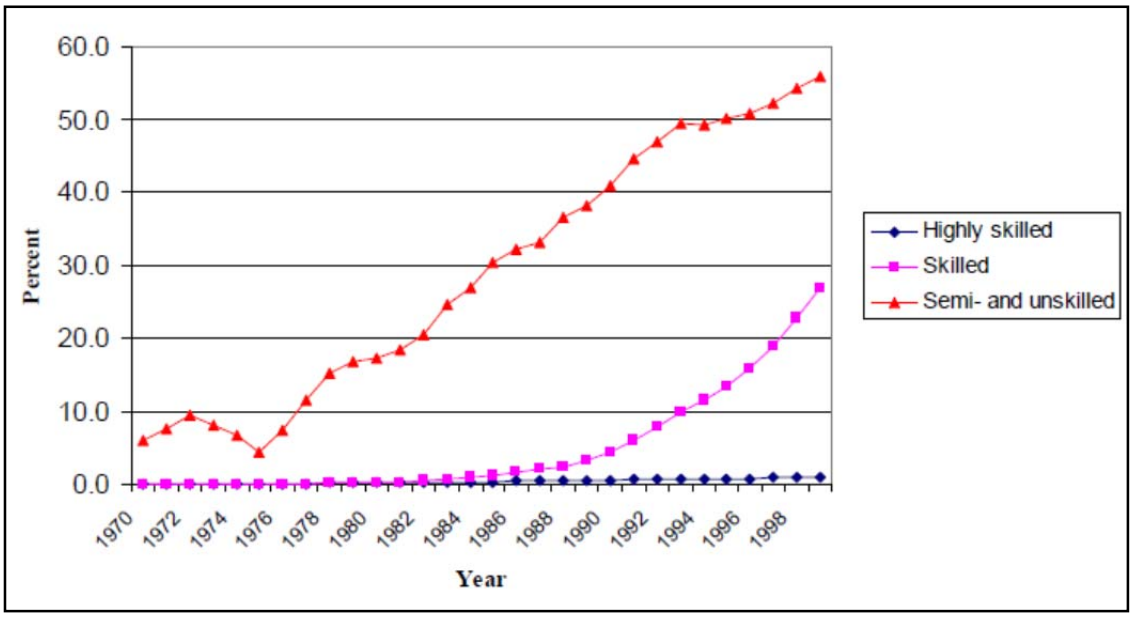
or unskilled workers (OECD, 2011:44). To determine if this is also applicable in South Africa, the following section provides an analysis of South Africa's labour market.

2.3.2 The higher than average cost of South African labour

South Africa has an 'inflexible' labour market. Improving South Africa's labour flexibility would reduce the unemployment (Lewis, 2001:12). To do this, policy-makers would have to ensure that labour is at the right cost to ensure that a sufficient amount of workers' are hired.

In South Africa, the trade unions have the upper hand and cause a 'large union wage effect', which is not in correlation with productivity (Lewis, 2001:13). Since 2000, the amount paid to workers has risen, however, productivity has declined. The labour costs will depend on how productive the employees are. The higher the labour costs and the lower the productivity, the more likely that the business will be forced to retrench those workers. It is the unproductive workers who do not generate sufficient revenue to fund the ultimate labour costs (CDE, 2011:16). The wage cost of those workers' will play a large role for businesses when determining whether or not they should hire more workers. If one overpays a worker in a job and he/she is not productive enough to earn that wage, it creates an unbalanced situation. This created the inflexible market in South Africa at present.

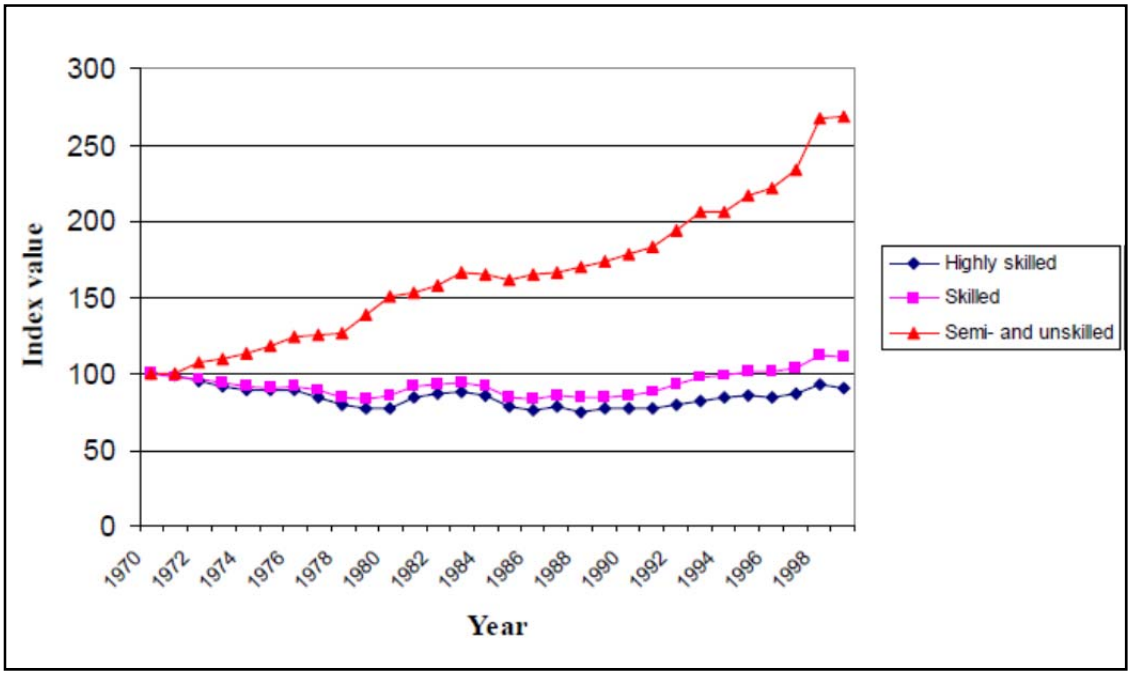
Figure 4: Unemployment rate in South Africa by skill class



Source: Lewis (2001:14)

Figure 4 illustrates that the unemployment rate per skill level has significantly changed over the years. The unemployment rate of the semi- and unskilled workers rose to over 50% by the year 1995, while there has not been as large an impact on the skilled and highly skilled workers. Figure 5 is a comparison of the remuneration change per skill level over the same period. The remuneration of the semi- and unskilled increased by 250% and almost at the same rate as the unemployment rate (Lewis, 2001:13-14).

Figure 5: Change in remuneration by skill class



Source: Lewis (2001:14)

This led some to believe that it is the inflexible labour market driven by stringent and protective labour laws which caused the large inconsistencies in the labour market. These semi- and unskilled workers' are overpaid for a skill level which does not generate an equivalent amount of returns for the employer. Odendaal (2012) states that "the unskilled labour was being overpaid on average over 100% and the semi-skilled labour forces were earning close to 60% more than they should". These skill levels are thus less attractive in the labour market and this has resulted in a higher level of unemployment.

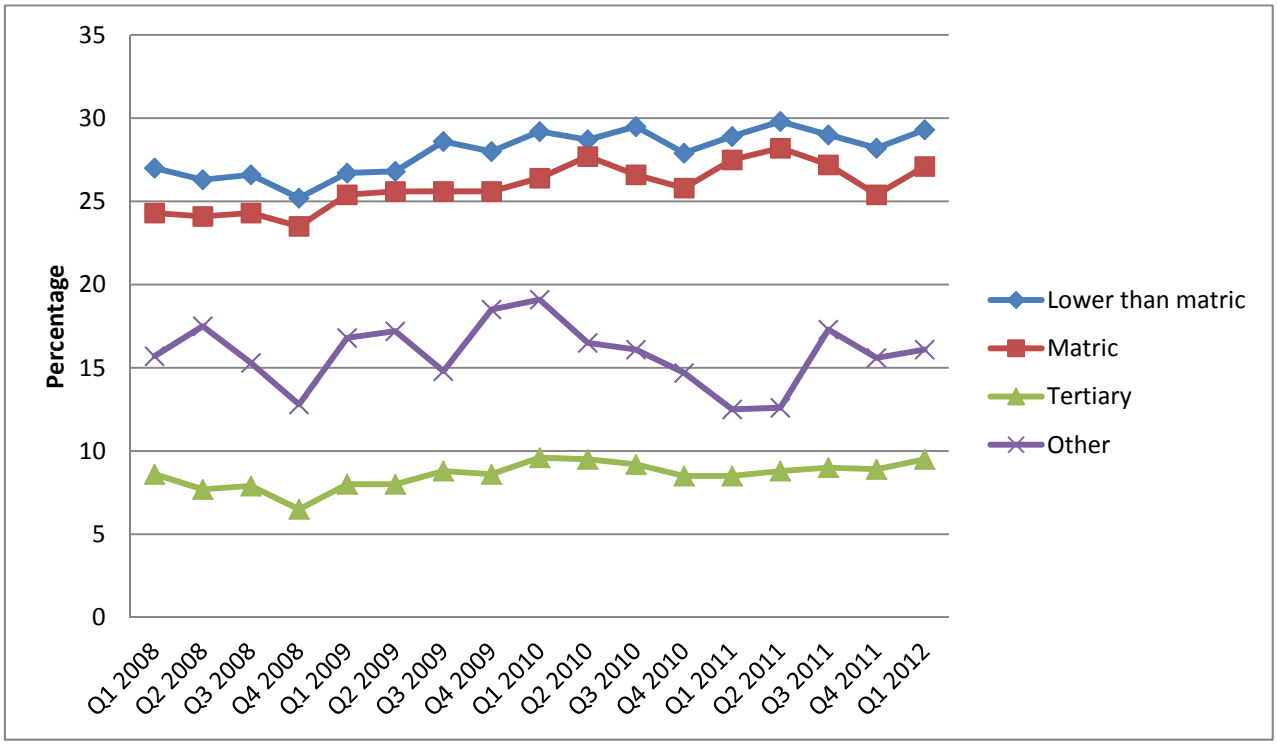
To further illustrate the inflexible labour market in South Africa, the World Economic Competitiveness Report ranked South Africa at the bottom when compared with 59 other nations on whether their labour regulations on the wages, hours or dismissals favour flexibility (Lewis, 2001:15). When Thabo Mbeki was president of South Africa, he stated that the country should change its labour laws in favour of smaller businesses and adapt the labour laws based on "age, geography, industry or enterprise size" (CDE, 2008:21). This, however, was opposed by the trade unions and it did not gain any further traction. If South Africa cannot amend its current labour laws due to the trade unions being stalwartly on the issue, other policy decisions would have to be developed to lower the cost of employment. Based on the above, it is evident that lowering the cost of employment of semi- or unskilled workers' would alleviate the unbalanced situation created in the labour market at present. Further information would need to be analysed to determine the exact target market for a tax incentive as suggested by the OECD. To determine the target market, the make-up of the semi- and unskilled labour market would need to be analysed further.

2.3.3 Unskilled workforce

South African businesses have entered into a "skills-based technological change", which has resulted in higher-skilled workers being in more demand than unskilled workers (CDE, 2008:20). Large and small enterprises stressed that the skills shortage was one of their constraints to expanding their businesses (Lewis, 2001:viii). Current training programmes in South Africa are inadequate in size and are more focused on training the already

employed rather than focusing on developing the skills of the unemployed (Lewis, 2001:viii). This forced an imbalance in the labour market in South Africa whereby most of the unemployed are unskilled, and as stated above, it is these unskilled workers that are too expensive to hire. If more incentives are provided to businesses in employing unskilled labour, this could change (CDE, 2008:20).

Figure 6: Unemployment rate by education level



Source: Adapted from Statistics South Africa (2012:xiv)

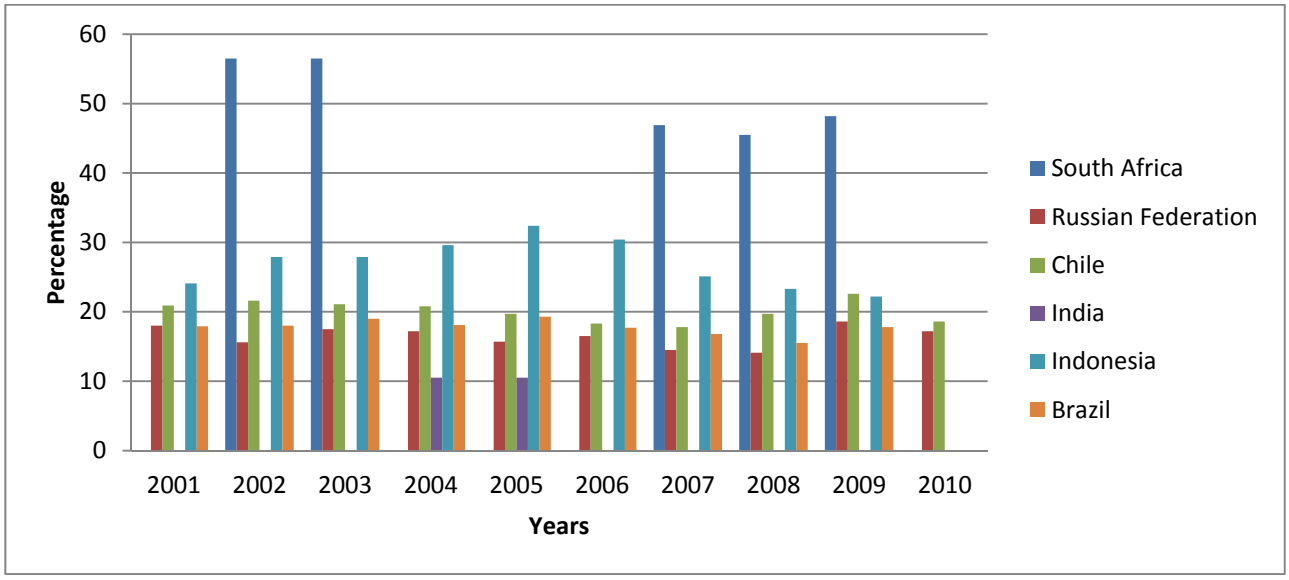
Figure 6 illustrates the amount that the level of education contributes to the unemployment rate. Workers' who have an education level of matric or lower contribute approximately 56% to the unemployment rate. It was found that only 10% of those with a tertiary education are currently unemployed. Therefore, it is the level of education that makes a

worker more attractive to employ. However, some people in this country cannot afford a tertiary education and thus would need to develop a skill through other means.

2.3.4 Youth unemployment

Figure 6 indicates that those with a matric certificate and lower contribute to the unemployment rate, the majority of which are the youth. Thus it can be said that the majority of the unemployed are the youth. In his 2010 budget speech, Pravin Gordhan (Department of Finance, 2010:9) stated the following: "labour market data confirms that employers are reluctant to hire inexperienced work-seekers, while school-leavers lack basic workplace competencies. Furthermore, our bargaining arrangements push up entry level wages, pricing out inexperienced work-seekers." In the same speech, Pravin Gordhan announced that there would be more focus on creating employment for the youth in South Africa.

Figure 7: Comparison of youth unemployment by developing economy (ages 15 to 24)



Source: Adapted from World Bank (2012)

Figure 7 is an illustration of the depth of the unemployment problem faced by the youth in South Africa. Note that for some of the years, data is missing due to the fact that the country had not released that information to the public. The average youth unemployed across the developing nations is 19.75% in the Figure 7. South Africa's youth

unemployment average is 50.72%. It is alarming that the average is much higher when compared with nations with similar economies. This indicates that youth employment is a major problem in South African society and thus policies should be developed to resolve this.

In South Africa, the majority of unemployed workers' is between the ages of 18 and 29, contributing a total of 64.3% to the unemployment rate in 2010 (National Treasury, 2011:14). The following factors were identified as the possible causes for youth unemployment (National Treasury, 2011:14-16):

- The youth lack the skills and work experience required by employers to be employed.
- The minimum wage is a "poor reflection' of the youth's productivity and thus makes them less desirable to be hired by employers.

South Africa's inflexible labour market is a cause for youth unemployment (CDE, 2008:21). South Africa has strict employment protection laws, which increases the cost of dismissal. This resulted in fewer lay-offs and thus a smaller gap for the youth to occupy when they enter the market (CDE, 2008:21). From the information above, one can deduce that the majority of the unemployed in South Africa are the youth, and the cause of the youth unemployment is the fact that they are unskilled (many have only a matric or lower level of education), the cost of labour is high and the youth lack work experience. Therefore to improve the current labour market, policy decisions should be focused on youth employment, with an emphasis on skill development.

2.3.5 The lack of growth in the small business sector

The growth in the small business sector is crucial to the increase in the number of workers employed in South Africa. A survey conducted by Finscope (2010:8) indicates that 67% of small business owners did not employ any workers and operated their businesses themselves, while 32% of small businesses provided between one and 10 employment opportunities. 1% of small businesses provided more than 10 employment opportunities to workers'. In total, small businesses provided six million employment opportunities in South Africa (Finscope, 2010:8). Currently, 68% of the workforce are employed by small

businesses and of that amount, 43% are employed by businesses with five or less employees (Adcorp, 2012:2). Small busineses should be targeted for job creation because they employ the majority of the labour market.

Despite the Government's best efforts in providing initiatives to small businesses, South Africa is below average with regard to the number of adults starting up businesses when compared with other low- to medium-income countries (SBP, 2009:2). The number of entrepreneurs starting a small business declined from 250 000 in 2001 to 58 000 in 2007, which decreased potential job creation opportunities of approximately 2.3 million (Adcorp, 2012:3).

Since 2006, the number of small businesses being opened has declined by 18.2% and over a period of five years, 440 000 small businesses have closed their doors (Adcorp, 2012:2). If those businesses could be re-established, and if the average small business employs 12 workers', the potential job creation growth would be approximately 5.3 million new jobs (Adcorp, 2012:2). If the Government could focus on the expanding of the small business sector, the job growth potential is significant and worth investing in.

Small businesses stated in a survey conducted by the World Bank (Lewis, 2001:28) that the top three conditions they needed for employee expansion were:

- increase in demand;
- fall in real interest rates; and
- increased business visibility.

If policies could be designed around the above areas of concern for small businesses, then a small portion of the unemployment problem could be solved.

2.4 CONCLUSION

The South African labour market is inflexible as a result of the minimum wage and unionised bargaining. There are high costs when dismissing workers', which discourage

employers from hiring for fear of incurring these costs. Another factor which reduces the desirability of hiring is the fact that the majority of the unemployed lack skill and have no work experience, which reduces their 'employability'. There is a disparity between the cost of hiring skilled and semi- or unskilled workers' and the level of their productivity. This is the result of the real wage of the semi- and unskilled workers' increasing over the years. Therefore, the level of unemployment for the semi- or unskilled workers has increased. If the labour laws have discouraged employers from hiring workers, taxation can be used as an incentive to reduce the cost of employment caused by the stringent labour laws.

The unemployed consist mostly of workers between the ages of 18 and 29. It is therefore imperative to focus policy decisions on this group of individuals. These policy decisions should be focused on the reduction of cost for the employment of the youth and increasing the skill set of the youth to make them more hireable. More money should be spent on training these individuals and large incentives should be provided to businesses if they train the youth.

With regard to the businesses which employ the most individuals, small- and medium-sized businesses should be targeted for providing incentives for the creation of employment. However, there are fewer small businesses opening year on year, which inhibits growth. Here, the Government will need to focus on what the small- and medium-sized identify as their constraints to growth as it was shown that if these businesses grow, the number of workers' employed would grow. Tax incentives should therefore focus on what small businesses believe will aid their growth and allow them to employ more people.

CHAPTER 3

CURRENT TAX INCENTIVES WITHIN SOUTH AFRICA

3.1 INTRODUCTION

In terms of the Act there is no direct tax relief given to an employer based on the number of workers his/her business employs. Direct job creation policy decisions should be developed as a means to ensure that the country's economy grows. A developing nation's economy cannot expand if 25% of its population has no income to buy products to stimulate the economy. Indirectly, the Act has, within certain sections, provided tax relief, which either would promote skills development or ease the burden of small businesses. The problem with indirect benefits provided is that the Government cannot be certain that a company will reinvest the money saved from the tax relief in human capital. Also, one cannot be certain that the amount saved from current tax relief is sufficient to warrant the employment of new workers. The business may also not generate sufficient revenue to be able to afford the salaries of new workers. The question that is raised is whether a tax relief based on the number of people one employs is more suited and more effective in the creation of jobs.

Chapter 2 identified the possible causes of unemployment in the country. This chapter aims to explore whether the available tax relief in terms of the Act deals with the possible factors of unemployment and to identify areas where new policies can be created.

From the evaluation of the Act, the following areas could resolve the possible factors of unemployment in South Africa.

Table 2: Current tax relief available

Section within the Act	Causes of unemployment they could possibly resolve
Section 12E: Small Business Corporations Tax	Relief for small business to provide more capital to possibly expand
Section 12H: Learnership tax allowance	Skill development
Section 12I: Additional investment and training in respect of industrial policy projects	Large tax write-offs for project expenditure. Special requirements to prove job creation, skills development and the use of small and medium business enterprises

The available tax relief outlined in Table 2 will be analysed in more detail to determine how much of an impact the relief could have on the factors of unemployment identified in Chapter 2. From the analysis, it can be determined where the tax relief is lacking and further policies can be created.

3.2 SECTION 12E: SMALL CORPORATIONS TAX

3.2.1 Overview of tax relief

The small and medium businesses in developing economies such as South Africa tend to be the driving factor in the economy (Lewis, 2001:25). It is within this sector where there is capacity for businesses to grow and with it the number of workers employed. However, in a World Bank report (Lewis, 2001:25), it was implied that this sector was not growing as it should in South Africa's developing economy.

The results of a survey by the World Bank (Lewis, 2001:31) indicate that it is evident that most new employment is created by small businesses entering the market and not by the expansion of existing businesses. This raises a concern for South Africa as it illustrates that existing businesses do not expand as they should.

The small and medium business sector has the largest capacity to employ more workers. Small and medium businesses were struggling and thus the policy-makers in South Africa saw an opportunity to assist in the pressures faced by small businesses by introducing Section 12E of the Act.

In terms of this section of the Act, the following is the main tax relief provided:

- The accelerated write-off of capital assets. If a small business qualifies for Section 12E, it would be allowed to fully write off an asset used in the process of manufacture in the year it is first brought into use. If an asset was not used in the process of manufacture, the small business would be allowed to deduct the cost of the asset over a three-year period.
- A sliding scale application for tax rate applied to taxable income (Table 3).

Table 3: Small corporation sliding tax scale

Taxable Income	**Rate of tax**
Not exceeding R59 000	0% of taxable income
Exceeding R59 000 but not exceeding R300 000	10% of the taxable income exceeding R59 750
Exceeding R300 000	R24 025 plus 28% of the taxable income exceeding R300 000

Source: SARS (2011b:17)

Before a business can get any of these allowances, it would have to register itself as a small business corporation with SARS. In order for the business to be registered, the company would have to meet the minimum requirements as laid out in Section 12E (4) of the Act.

3.2.2 Evaluation against the tax relief in terms of the causes of unemployment identified

Chapter 2 identified the lack of growth in the small business sector as one of the factors of unemployment: does the tax relief identified above aid in the growth of small businesses?

Table 3 illustrates those small businesses which qualify for Section 12E of the Act and pay tax based on a sliding scale similar to that of an individual. In comparison with the normal company tax rate of 28%, the benefit could be lucrative for small businesses, if they qualify. Assume a small business's taxable income is R1 million. Based on the normal income tax rate of 28%, this company would be paying R280 000 in income tax. Based on the small business tax rates, the same company would be paying R220 025, which is a saving of R59 975 for the tax year. The company can then use these funds to reinvest them in the business to enable it to grow. There is, however, no guarantee that small businesses would reinvest the savings in new employees.

3.3 SECTION 12H: LEARNERSHIP TAX ALLOWANCE

3.3.1 Overview of tax relief

One of the driving forces of the South African unemployment rate is the number of unskilled labour workers in the market and a labour market that is unwilling to employ inexperienced workers at the current price offered (i.e. minimum wages). The market currently does not believe that the wage is an indication of the productivity of unskilled labour and thus it reduced the demand for unskilled labour. This caused the unemployment of the semi- and unskilled workers to soar.

Evidence from research conducted by the World Bank (Lewis, 2001:11) on the South African job market, indicates that semi-skilled and unskilled labour represented half of the labour market, however, they represented the majority of the unemployed. The unemployment rate of the skilled workforce tended to be significantly lower. The skills shortage together with the reduction in the amount spent on training individuals is also an indication of the poor employment performance of South Africa. Surveys showed that in the past, less than 50%of employers trained their employees – if they trained their employees, they were not reluctant to invest in training (Lewis, 2001:33). This resulted in the Government creating an incentive for businesses to hire and provide training through a learnership agreement to encourage more training of employees.

The learnership tax allowance was first introduced in 2002 and was due to expire in 2006, however, it was extended until October 2011, and in 2012, the Minister of Finance extended the allowance by a further five years (South African Institute of Chartered Accountants, 2011). Over the years, the learnership tax allowance has changed. In 2010 amendments to the Act allowed for a more simplified approach to calculating the allowance where it had previously been more complicated and costly to administer (Fasset, 2010).

According to Interpretation Note No. 20 of the Act, "the objective of the learnership allowance is to encourage job creation by reducing the cost of hiring and training employees through learnerships and to encourage human capacity development" (SARS, 2010:1).

In terms of Interpretation Note No. 20 of the Act (SARS, 2011a:3), a *registered learnership agreement* is defined as:

a. a learnership agreement entered into between a learner and an employer before 1 October 2011, which was registered with a SETA, as contemplated in Section 17(3) of the Skills Development Act (97/1998); or

b. a contract of apprenticeship registered in terms of Section 18 of the Manpower Training Act(56/1981), if the minimum period of training required in terms of the Conditions of Apprenticeship prescribed in terms of Section 13(2)(b) of that Act before the apprentice is permitted to undergo a trade test is more than 12 months.

The features of the learnership allowance provided on Fasset's (2010) website are summarised as follows:

- the deduction allowed is R30 000 on commencement and R30 000 on completion of the learnership;
- this increases to R50 000 when the person has a disability;
- if the employer changes, the learnership is still applicable, however, it is reduced proportionately.

3.3.2 Evaluation the tax relief in terms of the causes of unemployment identified

The lack of skills in South Africa is a large contributor to the unemployment rate. This allowance is probably one of the most direct tax incentives to resolve unemployment in terms of the Act. Pravin Gordhan is in the process of analysing the success of the allowance in its intended objective (South African Institute of Chartered Accountants, 2011). There is therefore no concrete evidence of its impact on skill development and the success in creating jobs.

What the learnership allowance created is the reduction in the cost of employing and training workers in the country. The allowance created an incentive for employers to hire workers for a short term and provide them with the necessary training to increase their employability. The learnership tax allowance also provided an incentive to ensure that the employers follow through with the learnership agreement by providing them with another allowance once the agreement is completed. The allowance created an opportunity for an unskilled worker to gain valuable work experience and training to increase his/her employability in the future.

The question is: does this solve the skill development problem? How big an impact did this allowance have? Employers are more willing to employ a worker who was previously employed (CDE, 2011:33). Thus the short-term learnership agreement these workers enter into will provide possible unskilled workers with the necessary work experience to go out into the labour market and find a job with confidence and with previous work experience.

Table 4: Learnership agreements entered into by March 2007

Learners who have registered to date	27 022
Previously employed learners	12 929
Previously unemployed learners	11 876
Learnership agreements cancelled	2 220
Completed learnership agreements	12 022
Currently registered	12 780

Source: Fasset (2007)

Table 4 is information published by Fasset in 2007 (the only information available on the allowance), five years after the implementation of the allowance. Due to the fact that a current evaluation of the allowance is under way, current data is not available. As at March 2007, only 27 022 learners had entered into registered agreements. With 207 000 new entrants into the labour market during the first quarter of 2012, this allowance has only had a minimal impact. Below 50% of the learners who have registered were previously unemployed. Thus the allowance only resolves a small portion skill development problem. For the allowance to be more effective in addressing the factors of unemployment, it would have to target those who had previously been unemployed, as they are the workers' who require the work experience and skills to be more employable.

3.4 SECTION 12I: ADDITIONAL INVESTMENT AND TRAINING IN RESPECT OF INDUSTRIAL POLICY PROJECTS

3.4.1 Overview of tax relief

In 2011, the budget made provision for R20 billion towards tax incentives for manufacturing investment with the focus on job creation. The Department of Trade and Industry (DTI) in response to the needs to incentivise further investment into industrial projects, launched the Section 12I tax allowance for greenfield (new projects) or brownfield (expansion or upgrade of an existing project) project expenditure. The DTI stated that the objective of the Section 12I allowance was the following: to increase the investment into manufacturing assets in order to improve the productivity of the manufacturing sector and to train personnel so that the labour productivity is improved together with the skills of the labour force. (DTI, 2011:34).

The qualification for this allowance would be based on a points system meeting certain criteria (Section 12I (8)(a)-(f) of the Act), namely:

- the utilisation of innovative processes;
- illustrating the use of new technology which is efficient and cleaner technology;
- the provision of business linkages;

- the acquisition of goods and services from small, medium and micro-enterprises (SMMEs);
- the creation of direct employment in South Africa; and
- whether the new project will provide skills development in the republic.

For the purposes of this study, the area of importance with regard to the incentive is that the proposed project has to show that the company will be creating direct employment and that there is evidence of training of employees for the purposes of skills development. Another positive outcome of this allowance is that the project must demonstrate that the company will be acquiring its goods and services from small, medium and micro-enterprises. This initiative will ensure that smaller businesses generate business from this initiative and thus aid in the growth of the smaller businesses in the country.

The qualifying criteria for Section 12I dealing with employment, SMMEs and skill development is explained in the application form (IPP 12I) indicated in Figures 8 and 9.

Figure 8: Point system to qualify as an industrial policy project (qualifying criteria 1 to 5)

POINT SYSTEM TO QUALIFY AS AN INDUSTRIAL POLICY PROJECT		
QUALIFYING CRITERIA: INDUSTRIAL POLICY PROJECT (IPP)	**GREENFIELD PROJECTS (NEW PROJECTS)**	**BROWNFIELD PROJECTS (EXPANSIONS AND UPGRADES)**
Points allocated on the following criteria will determine the status of a project		
1. Innovation	• Will utilise processes of innovation, **and** • Will materially improve production time, reduce production costs, improve product quality or improve product longevity **(Maximum of 1 point)**	• Will utilise processes of innovation, **and** • Will materially improve production time, reduce production costs, improve product quality or improve product longevity **(Maximum of 1 point)**
2. Improved Energy Efficiency: Cleaner Production Technology	The project will utilise viable energy-efficient equipment and processes throughout the additional investment allowance benefit period, innovative for the particular industrial sector, as certified by a measurement and verification agent (not taking into account any period before the month in which the industrial policy project reaches **50%** of its production capacity). **(Maximum of 2 points)**	Eenergy efficiency improvement of at least **12,5 %** **(Maximum of 1 point)** **or** Energy efficiency improvement of at least **15%** **(Maximum of 2 points)**
3. Business Linkages	The project will be engaged in the production of goods, where less than **40%** of the local demand for such goods is produced in the Republic or where these goods were not previously produced in the Republic; **or** The project will contribute to the global competitiveness of an industrial sector by the production of goods where identical or similar goods would not be produced in the Republic without substantial capital investment **(Maximum of 1 point)**	The project will be engaged in the production of goods, where less than **40%** of the local demand for such goods are produced in the Republic or where these goods were not previously produced in the Republic; **or** The project will contribute to the global competitiveness of an industrial sector by the production of goods where identical or similar goods would not be produced in the Republic without substantial capital investment **(Maximum of 1 point)**
4. SMME Procurement	Acquire at least **10%** of its raw materials, intermediate products and services from small, medium and micro enterprises. **(Maximum of 1 point)**	Acquire at least **10%** of its raw materials, intermediate products and services from small, medium and micro enterprises **(Maximum of 1 point)** **or** at least **15%** of its raw materials, intermediate products and services from small, medium and micro enterprises. **(Maximum of 2 points)**
5. Direct Employment creation	Create at least: • **0,67** full-time jobs (but less than 1 full-time job); **(Maximum of 1 point)** **or** • **1** full-time job **(Maximum of 2 points)** for each R1 million of cost of manufacturing	Create at least: • **0,5** full-time jobs (but less than 1 full-time job); **(Maximum of 1 point)** **or** • **1** full-time job **(Maximum of 2 points)** for each R1 million of cost of manufacturing

Source: DTI (2012)

Figure 9: Point system to qualify as an industrial policy project (qualifying criteria 6 to 7)

POINT SYSTEM TO QUALIFY AS AN INDUSTRIAL POLICY PROJECT		
QUALIFYING CRITERIA: INDUSTRIAL POLICY PROJECT (IPP)	**GREENFIELD PROJECTS (NEW PROJECTS)**	**BROWNFIELD PROJECTS (EXPANSIONS AND UPGRADES)**
Points allocated on the following criteria will determine the status of a project		
6. Skills Development (Training of Employees)	The cost of training will be: • more than **2%** of the annual average wage bill, but less than **2,5%**; **(Maximum of 1 point)** **or** • more than **2,5%** of the annual average wage bill **(Maximum of 2 points)**	The cost of training will be: • more than **2%** of the annual average wage bill, but less than **2,5%**; **(Maximum of 1 point)** **or** • more than **2,5%** of the annual average wage bill **(Maximum of 2 points)**
7. Located in an Industrial Development Zone (IDZ)	Located in an IDZ **(Maximum of 1 point)**	**Not Applicable**
Industrial Policy Projects with **Qualifying Status (QS)**	5, 6 or 7 out of 10 points **and** 2 out of 4 ito criteria **5 & 6** above	5, 6 or 7 out of 10 **and** 2 out of 4 ito criteria **5 & 6** above
Industrial Policy Projects with **Preferred Status (PS)**	8, 9 or 10 out of 10 points **and** 2 out of 4 ito criteria **5 & 6** above	8, 9 or 10 out of 10 **and** 2 out of 4 ito criteria **5 & 6** above

Source: DTI (2012)

In addition to the point system requirements, the Minister of Trade and Industry must be satisfied that the cost of all manufacturing assets to be acquired by the company for the purposes of the project will exceed R200 million with respect to greenfield projects (Section 12I (7)(*a*)(i)(*aa*) of the Act) and in the case of brownfield projects, the higher of (A) R30 million; or (B) the lesser of R200 million or 25%of the expenditure incurred to acquire assets previously used in the project (Section 12I (7)(*a*)(i)(*bb*)(A) – (B) of the Act).

These points become important in the application process as they determine how much of an allowance a project qualifies for. The project either qualifies for a 'preferred status' or 'other'. The incentive offers the following (DTI, 2011:34-35):

- R900 million additional investment allowance in the case of any greenfield project with a preferred status;
- R550 million additional investment allowance in the case of any other greenfield project;
- R550 million additional investment allowance in the case of any brownfield project with a preferred status;
- R350 million additional investment allowance in the case of any other Brownfield project;

- An additional training allowance of R36 000 per employee may be deducted from taxable income;
- A maximum total additional training allowance per project, amounting to R20 million, in the case of a qualifying project and R30 million in the case of a preferred project;
- According to the points system, an industrial policy project will achieve 'qualifying status' if it achieves at least five of the total 10 points, and a 'preferred status' if it achieves at least eight of the total 10 points.

3.4.2 Evaluation of the tax relief in terms of the causes of unemployment identified

Figures 8 and 9 respectively indicate the points needed to be earned to qualify for the greenfield or brownfield project as an 'Industrial Policy Project'. Of particular interest the special criteria for the creation of jobs, skill development and acquiring material from SMMEs. The DTI ensured that in accumulating the points mentioned above, the skill development and direct job creation are dealt with and not ignored when participants compile their application. It states that in achieving five out of 10 points, they would have to achieve two out of the four points for the requirements under the skill development and job creation sections respectively. Therefore, one cannot ignore the skill development and job creation categories on the application form, thus forcing applicants to prove that these criteria will be met in the project. Although the tax incentive is not directly aimed at job creation and skills development, through its requirements, the allowance alleviates some of the causes of unemployment.

To illustrate how large an impact the tax allowance can have on job creation, a simple calculation can be done based on the criteria in Figure 8. In terms of the Act, the greenfield project should have an investment of at least R200 million and for the sake of discussion a brownfield project is at least R30 million. The criterion for a greenfield project to obtain the allowance is that the project should create at least 0.67 full-time jobs for each R1 million cost of manufacturing asset (see Point 5 in Figure 8). A brownfield project should create at least 0.5 full-time jobs per R1 million cost of manufacturing assets. Through this, the policy-makers are ensuring that a greenfield project qualifying for this incentive would

generate between 134 to 200 jobs per project. A brownfield project could generate between 15 and 200 jobs based on the cost of acquiring manufacturing assets. If this could be achieved, it would be a large step in the job creation initiative direction in South Africa.

Now that the DTI has ensured that job creation has been dealt with, it requires that the applicant will spend between 2 and 2.5% of the annual average wage bill on training his/her staff. The first reaction would be to think that the Government is further increasing the already high costs of labour. However, Section 12I of the Act provides a further allowance of R36 000 towards training costs per employee, provided that the applicant has proved the company's training programme to the DTI. If a greenfield project employs 200 jobs and trains all 200 employees, the company could obtain a R7.2 million additional tax allowance over and above the R900 million to R550 million investment allowance the section provides for. This reduces the cost of training employees, which was a requirement to qualify for the allowance and resulted in the applicant not being out of pocket. The positive outcome of this is that a newly employed person will be provided with skills to use in the market-place in future.

The one drawback of the use of this tax allowance is that the onus seems to be on the company to prove that they have met the criteria to the DTI. However, all of this information would be readily available through the planning of their project and businesses should plan their projects with this incentive in mind. The initial costs of complying with the criteria and the application form process would seem to be far less than the benefit which the allowance generates.

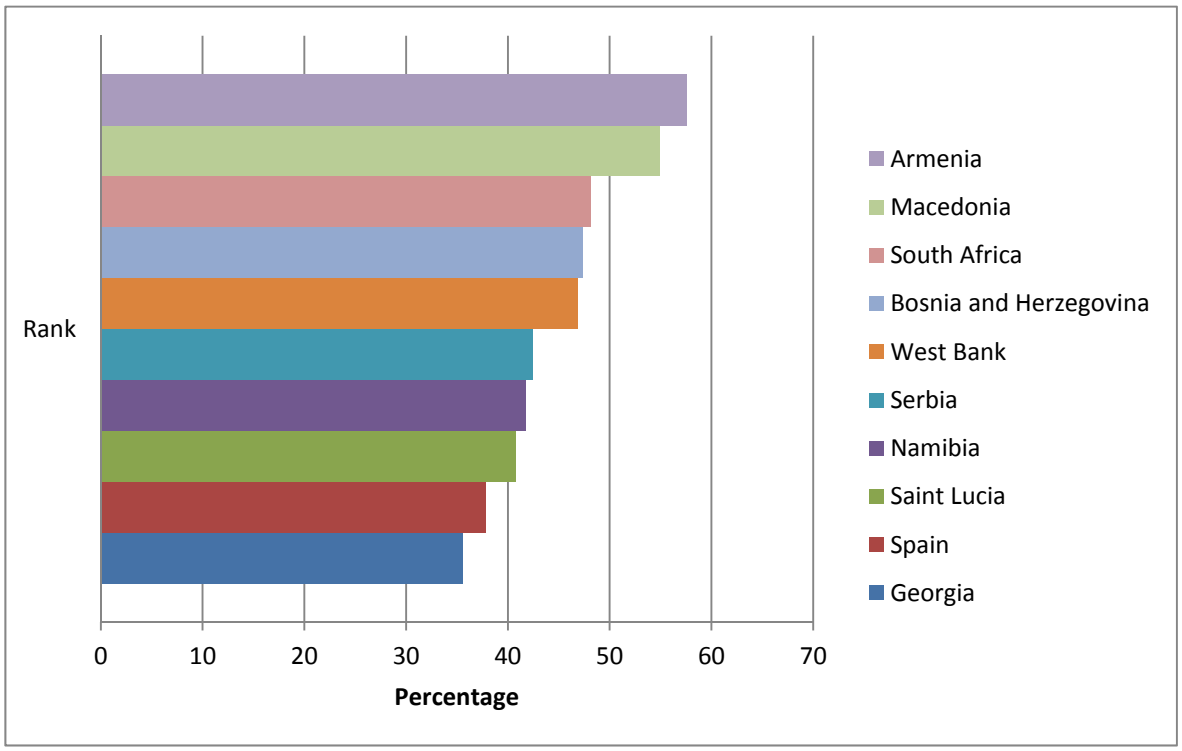
The scale of the take-up of this incentive is currently uncertain. The process to obtain approval to qualify for the allowance is long and onerous. However, with proper planning and documentation, the investment could make a large impact on a company's taxable income. The allowance has a long-term vision in mind, the expansion of projects through capital investment and thus the growth of a company's employment base. This could be the answer to creating sustainable employment for the labour force of South Africa. The allowance, however, is aimed more at businesses that are able to fund large expansion projects. Except for the points allocated to purchasing goods, this allowance is not focused

on promoting SMMEs. Also, the application process is onerous and complicated and may deter companies from applying for the allowance. The question can be asked: could something similar be tailored to SMMEs, in South Africa, possibly on a smaller scale and less complicated?

3.5 YOUTH EMPLOYMENT SUBSIDY

The scale of youth unemployment in South Africa is staggering and policies should be developed to resolve this. Figure 10 indicates that currently, South Africa has the third-highest youth unemployment in the world.

Figure 10: Countries with the highest youth unemployment in the world



Source: IndexMundi (2012)

In his 2010 Budget speech (Department of Finance, 2010:10), Pravin Gordhan announced that the Government would establish policies to assist the youth with skill development and providing access to jobs. The Government would develop a subsidy to reduce the cost employers incur in hiring youth without previous experience (Department of Finance, 2010:11). The proposal was that employers would receive a cash reimbursement through

the payroll system for a period of two years based on the number of workers hired. The estimated benefit of this subsidy was the creation of 500 000 jobs by 2013 (Department of Finance, 2010:11).

This subsidy has not materialised. In his 2011 Budget speech, Gordhan stated that the subsidy was still under consultation (Department of Finance, 2011:33). In the 2012 Budget speech, Gordhan stated that there were concerns with regard to the subsidy; however, he further stated that these could be dealt with in the design of the subsidy (Department of Finance, 2012:31). The process of implementation of the subsidy is being halted by the Congress of South African Trade Unions (Cosatu) and the National Union of Metal Workers of South Africa (Numsa) refusing to agree to the subsidy (Anon, 2012).

3.6 CONCLUSION

This chapter explored the incentives South Africa currently has to deal with unemployment. From current tax legislation, the following can be noted:

- The small business corporation tax does not directly incentivise employment and there is no guarantee that small businesses would use the tax saved to employ more workers.
- The Act should provide more incentives to small business owners with regard to reducing the cost of their financing, as this was one of their biggest concerns limiting their growth.
- The learnership tax allowance is the only direct form of incentive to deal with the concern of skills shortage in South Africa, however, it does not focus on previously unemployed individuals.
- There is currently no formal research on the success of the learnership tax allowance and thus its benefits cannot be determined.
- The Section 12I allowance for greenfield and brownfield projects includes sections which require businesses to train employees and to prove that they will generate more jobs. The process to get the allowance approved is lengthy and onerous and the administrative burden may outweigh the benefit.

All the incentives above lack one important aspect: scale. These are not on a wide enough scale to make a significant impact on the overall statistics. Chapter 4 analyses programmes initiated in the USA in order to evaluate whether such programmes, if implemented, would be successful in a South African context.

CHAPTER 4

ANALYSIS OF TAX CREDITS IMPLEMENTED IN THE UNITED STATES OF AMERICA

4.1 INTRODUCTION

Various papers have suggested that an employment tax credit is the best form of tax incentive which could aid in the reduction of unemployment. An *employment subsidy* is "a general set of labour market interventions that increase employment by lowering labour costs while sustaining the average wage income of employees" (Lewis, 2001:34).. This could be through subsidising a portion of the employer's labour costs or providing tax breaks based on the number of workers hired or jobs created (Lewis, 2001:34). The provision of a subsidy will increase the demand for labour and these subsidies are generally aimed at the less skilled workers.

Burns, Edwards and Pauw (2010:2) explain that there are two types of subsidies, one to encourage unemployed workers to actively seek employment, known as worker-side subsidies, or a firm-side subsidy, which is an incentive for employers to employ more workers. According to Smith (2006:7), the effect on the labour market is identical, regardless of whether the subsidy is provided to the firm or to the worker. On the workers' side, the workers are willing to work regardless of the 'pre-subsidy' wage. Providing a firm-side subsidy increases the demand and employers are willing to hire more workers at any rate.

Smith (2006:7) states that firm-side subsidies have the following disadvantages, which could lead to the subsidy being ineffective. The following problems are cited in the research (Smith, 2006:7-8):

- If the firm-side subsidy is targeted towards a certain group of individuals, it causes a huge administrative burden on the firm. The reason is that the Government will need

to evaluate the eligibility of the individual before it provides the subsidy to the firm. This may be costly and take up too much time.

- Depending whether the subsidy is a targeted subsidy, the firm may have concerns about assessing the eligibility of the worker based on the criteria provided. Research showed that this is a strong deterrent for firms not to act on the subsidy.
- Not sufficient knowledge about the subsidy and the details also resulted in less than desirable action on the subsidy.

Burns *et al.* (2010:3) believe that the firm-side subsidy is more appropriate for South Africa as there is a lack of demand in the labour market. A firm's demand for labour depends on the relative wage, technology used and substitution patterns. Eventually, due to the lower labour costs, the cost of production will decrease and thus the demand for production will increase (National Treasury, 2011:28). The worker-side subsidy would not be effective due to many believing that minimum wages and unionised bargaining reduced the demand for workers in South Africa. If the firm-side subsidy is chosen, the design would have to be formulated in such a way to avoid the problems identified above from recurring.

Employment subsidies have the following characteristics (National Treasury, 2011:28):

- They could be applied to all workers or a specific pre-determined pool of individuals. The problem with this form of subsidy is that it is likely that a business would hire a worker which they would have hired without the subsidy.
- Another form of subsidy which could be used is a marginal (or as some call it, a targeted) employment subsidy. This type of subsidy requires more administration, which could prove to be costly.
- Finally, a form of hiring subsidy could be implemented. The employer will get a subsidy for every worker he/she hires. This, however, could cause employers to fire and rehire individuals just to obtain the subsidy.

The employment subsidy could either be a direct payment by some or another institution or as a tax credit. The latter will be easier to administer as it will form part of an already established system. The subsidy could specifically target a group of individuals (i.e. the youth) or target businesses (i.e. small businesses) (National Treasury, 2011:35)

The USA has a completely different tax system from that of South Africa. A taxpayer in the USA would have to pay taxes to the state in which they belong together with a federal tax which goes to the USA government. This allows for different economic policies to be implemented in each state. Several states in the USA have created some form of tax credit to incentivise job creation.

For the purpose of this research, Georgia's Job Tax Credit was selected to be evaluated for it successes, policy decisions and failures. As this is a state-specific credit, the New Jobs Tax Credit (NJTC) implemented in the USA during 1977 was selected to compare the state versus federal tax credits to determine whether the size of the taxpayer base would impact on the results. These two incentives had very different approaches to providing a tax incentive for the growth in employment.

4.2 ANALYSIS OF POLICY OPTIONS

According to Dagney (2002:263), the question that arises when evaluating tax credits is whether or not these credits had created jobs that would not have been there before the credit. The USA federal government created a policy which was aimed at providing a benefit to only the incremental jobs created, and not the jobs that were already in existence when the credit came in fruition. In order for the administration to determine this incremental employment growth, it created a base rate which would be used to determine the change in the wage bill. This is what the administrators used to determine the amount of tax credit that was earned (United States Department of Labor and Treasury, 1986:30). In the following year, the base amount will be the wages in the previous year, which would be compared with the amount paid in the prior year and thus creating this incremental growth in employment. Due to the complexity of the tax credits, several anti-avoidance measures were put into place.

The NJTC measured the job creation from the increase in a company's wage base. If a company met the minimum wage growth, it received 50%of its wage bill increase in a year as a deduction (United States Department of Labor and Treasury, 1986:2). There were

three requirements in order to receive the NJTC in 1977 to 1998. Firstly, the entity had to be carrying on a trade, secondly, the employer had to increase its previous years' credit base by 2%, and thirdly, the employer's wage bill had to grow by 5% from the previous year (United States Department of Labor and Treasury, 1986: 34). The increase in the credit base was determined by comparing the taxable wages year on year This, in the enactment of the NJTC, was the first $4 200 of wages that a company pays to its workers. A criticism of this base is that it did not take into account the inflationary increases in a wage cost and that this hurt employers who were paying low-waged workers (United States Department of Labor and Treasury, 1986:30-31).

Specific ceilings were placed on these tax credits. These are important with any tax incentive as the entity uses them to measure the cost versus benefit of opting to use the tax credit. The NJTC had the following limitations for which a company had to calculate the dollar value of each of the limits. A company could not exceed the lower of the three limits calculated. The limits imposed were the following (United States Department of Labor and Treasury, 1986:37):

- The new business limit. This limit was to ensure that new businesses who would have a substantial increase in its wage base would not get the maximum credit available. The credit for new businesses was limited to 25% of the wage growth. The wage bill limit. A company had to prove that it had increased its wages by 5% year on year. The shortfall is that companies could easily have maintained this without an increase in the company's employees.
- The small business limit. The maximum credit that a company could claim was $100 000. It would therefore be more beneficial for smaller companies to apply for the credit than larger corporations.

Table 5: Georgia Jobs Tax Credit: Minimum job creation criteria and credit per job created

Tax Year	Tier 1 Counties		Tier 2 Counties		Tier 3 Counties	
1991	Jobs	10	*Not Eligible*		*Not Eligible*	
	Credit	$1,000				
1992	Jobs	10	*Not Eligible*		*Not Eligible*	
	Credit	$1,000				
1993	Jobs	10	Jobs	10	*Not Eligible*	
	Credit	$2,000	Credit	$1,000		
1994	Jobs	10	Jobs	10	*Not Eligible*	
	Credit	$2,500	Credit	$1,000		
1995	Jobs	10	Jobs	25	Jobs	50
	Credit	$1,000	Credit	$1,500	Credit	$500
1996	Jobs	5	Jobs	25	Jobs	50
	Credit	$2,500	Credit	$1,500	Credit	$500
1997	Jobs	5	Jobs	15	Jobs	25
	Credit	$2,500	Credit	$1,500	Credit	$500

Source: Dagney (2002:279)

The Georgia policy had a different approach. The state provided a monetary credit for the number of jobs created per county. Its aim was to identify specific counties which were in need of more development and associated a higher credit per job created within those counties (Dagney, 2002:266). This is a form of targeted subsidy as described above. This is when a government identifies that a specific group/area is in need of a subsidy and it provides a hire value to those groups/areas in order to deter those who are not in need of the subsidy. Table 5 illustrates how different the credit is per county. This form of credit is more specific than the NJTC through the evaluation of the change in employment. As a result, the incentive will enable one to determine which policy was more effective.

Georgia's credit was more specific in nature and less of a 'blanket' approach. The following criteria had to be met for an entity to earn its tax credit (Dagney, 2002:265-266):

- the credit was only allowed for the creation of full-time jobs;
- the minimum number of jobs (see Table 5) created did not have to be maintained;
- a company had to be able to prove before it claimed the credit, that it had an increase in jobs for two complete years;

- If a company maintained its minimum number of jobs as referred to in Table 5, it would be entitled to claim the credit for each year in which it had maintained the minimum.

For Georgia's credit, there was a ceiling of 50% of a company's tax liability, which is the maximum that could be used as a credit. One was also not allowed to claim the credit if one did not have a tax liability. This was to ensure that the state got some revenue from companies and that it did not increase a company's assessed loss. A company could, however, use unused credits in the reduction of tax liabilities in future years if it was limited in the previous tax year (Dagney, 2002:265-266). These were the only limitations of the Georgia tax credit; however, the NJTC had a more complicated set of limitations. It was these limitations that the government used to ensure that a targeted group used the tax credit rather than another group.

According to Dagney (2002:266), the decision that a taxpayer would make to participate in the tax credits was based on the measurement of the costs versus benefit. The benefits are the value of the tax savings, which, as seen above, are capped by certain provisions. Firms would have to determine if the additional cost of employing another worker is worth it for the benefit of the tax savings they receive. The costs associated with the decision to take the credit are the cost of complying with the tax laws to earn the credit. Dagney (2002:266) further states that the costs associated with the credit are the search for employees together with hiring costs. The cost to participate in the tax credit is crucial because if the number of companies that participate is not significant, the purpose of making a difference in the employment statistic would not be achieved.

The credit ceilings listed above are what a company would use in its decision of whether or not this credit is beneficial. A company with a large tax liability would probably not deem that a $100 000 credit would make a massive difference in its tax liability and would rather not go through with the effort of proving that it met all the criteria to receive the NJTC. A company in Georgia might not needed to employ 50 or more workers in 1995 to receive the credit as they might not have had sufficient work for them to be productive in order for the company to receive a return on their wages spent. These are the decisions that an

administrator would need to make to ensure that the participation rate in the tax credit programme is at the level it hopes to achieve.

4.3 EFFECTIVENESS IN CREATING EMPLOYMENT

The credits discussed above were aimed at the creation of jobs. The effectiveness of a tax credit is defined by the number of jobs created. The companies that participated in the programme increased its employment by over 50% as can be seen in Table 6. According to Dagney (2002:271), the increase in non-participating firms between the years 1994 and 1995 was a single company increasing its number of workers by 2 000. Thus it can be seen that the tax incentive did provide an incentive to increase the employment in companies. The average change also increased year on year as the credit provided an incentive to maintain the number of workers on the payroll.

Table 6: Georgia Jobs Tax Credit: Average employment change by year and participation status

	Average Employment Change (1993 to 1995)		
	1993	**1994**	**1995**
Participating companies	54.8	58.7	82.4
Non participating companies	27	35.1	123.4

Source: Dagney (2002:271)

Dagney's (2002:273) analysis indicates that the change in employment was greater in larger companies. These companies are more likely to have the capacity to take on more workers without a significant impact on their bottom line. Dagney's work also indicates that the participating companies grew their employment by 60%more than non-participating companies of a similar size. The author further states that the non-participating companies either were not aware of the credit, or the cost of participating was greater than the credit that they would have received.

Although participating firms created between 24 to 28% more jobs (1 870 and 2 196 jobs), 72 to 77% of those jobs would have been created in the absence of the credit. Thus the state of Georgia spent approximately $3.8 million in providing a credit which did not

achieve that purpose (Dagney, 2002:277). Even though some of the jobs would not have been created if it were not for the credit, it still motivated employers to find positions for some workers.

Tables 7 and 8 indicate the employment growth in companies based on the different thresholds set by the NJTC, being the 2%increase in the credit base and the 5%increase in the wage bill.

Table 7: Percentage change in the credit base

	Less than 0%	0.0 - 1.9%	2.0 - 9.9%	10% or more	Total %
Pecentage of companies	33.5	27.1	10.7	28.7	100
Percentage of employment	27.1	8.6	26.2	38.1	100

Source: United States Department of Labor and Treasury (1986:35)

Table 8: Percentage change in the wage bill

	Less than 0%	0.0 - 4.9%	5.0 - 9.9%	10% or more	Total %
Pecentage of companies	31.4	23.8	7.1	37.7	100
Percentage of employment	22.4	12.1	16.5	49	100

Source: United States Department of Labor and Treasury (1986:35)

The firms that grew its credit base by the required 2% contributed to 64% of the total employment (of the firms that were aware of the credit). Companies that met the two requirements amounted to a third of companies and provided 52% of the total 1977 employment.

The NJTC reduced the average labour costs of small companies when compared with the larger-sized companies (United States Department of Labor and Treasury, 1986:45). The report suggests that the largest incentive was for medium-sized companies. Smaller companies had less chances of being aware and able to qualify for the credit (US Department of Labor and Treasury, 1986:61).

Notwithstanding the above, Hungerford and Gravelle (2010:12) summarised the analysis by various authors on the NJTC. Those companies that were aware of the credit grew their employment base 3% faster than the companies that were not aware of the credit. However, only a third of the companies were aware of the credit. Another author analysed in this report stated that a company's consumer demand determined the level of employment and not the amount of credit that it would receive. Firms were reluctant to take on the credit due to its complexity. Only 2.4% of the companies in the survey conducted had conscientiously hired workers to receive the tax credit.

The United States Department of Labor and Treasury (1986:61) estimated that the reduction in the wage cost of a new job was 26% in 1977 and 20%in 1978. They stated that it was probably the complexity of the programme which limited participation.

4.4 CONCLUSION

Hungerford and Gravelle (2010:13) conclude that a tax credit may not increase the employment levels as it was designed to do. This is due to the following:

- complexity of the provisions and cost of compliance;
- companies may not be aware of the credit when they make hiring decisions; The people involved in the hiring decisions are not aware of tax benefits; and
- demand is the determining factor in a company's hiring decisions.

In terms of the above analysis, the main criticism of the NJTC is that it was too complex, which could have increased compliance costs and have resulted in some companies opting not to participate. Also, only a third of the companies were aware of or utilised the credit. The Georgia programme yielded positive benefits. Positive employment growth was seen in the years in which the credit was available. The study also indicates that compliance costs were a large factor in the costs versus benefits which an employer would determine before participating in the tax programme.

Although the tax credits did not influence a significant amount of the employment decisions, because evidence above suggests that the majority of the workers would have been employed, it did aid in reducing the wage costs of the employer.

CHAPTER 5

ANALYSIS OF PROPOSED YOUTH WAGE SUBSIDY IN SOUTH AFRICA

5.1 INTRODUCTION

In a response to South Africa's youth unemployment crisis, the National Treasury drew up a proposal to present to Parliament together with the budget speech. Pravin Gordhan stated in his 2011 budget speech that the Government would set aside R5 billion towards youth unemployment (Department of Finance, 2011:17). The proposed policy as drafted by the National Treasury was then submitted to the National Economic Development and Labour Council (Nedlac) for negotiation with affected parties (Parker, 2012). During this stage the policy received wide criticism, which halted the implementation.

Cosatu was the main challenger of the policy with the Democratic Alliance (DA) stating that it was in full support of it (Du Plessis, 2012). The opposing views of the policy will be discussed in this chapter together with the design of the policy. The proposed policy will also be compared with the successes and failures as seen in the USA.

5.2 THE YOUTH WAGE SUBSIDY

The discussion paper by the National Treasury (2011:16) indicates that in order to provide a proper environment for job creation, there has to be a relationship between the amount paid and the productivity of the worker. There was a disparity between what South Africa pays its unskilled workers (especially its youth) and the productivity of these workers. For that reason, among others, it was stated that a wage subsidy would be implemented in South Africa.

The policy aims to deal with the following causes of unemployment among the youth. Firstly, as explained above, with the high costs of firing in South Africa; it would "compensate" the employer for taking a risk in employing a youth. When one hires a youth, his/her level of productivity is unknown as there is no historical evidence to support the

employment. This is echoed in Burns *et al.* (2010:19) in discussing the inability of the youth to illustrate their productivity to their employers. It is the unwillingness of employers (as Burns *et al.* state, the 'risk-adverse employers') to allow them to do so. That being said, the subsidy could provide some compensation for these risks being assumed. Secondly, the amount that an employer saves from the subsidy could be invested in training and skills development and this would improve the "employability" of the youth. Even if the employer did not continue employing the worker after the subsidy, that individual would stand in good stead in the labour market. With work experience, there will be job opportunities for unskilled workers and the chance of obtaining a higher wage, according to the CDE (2011:33). And finally, this would improve the confidence of the youth so that they would feel they are more employable (National Treasury, 2011:33). As the youth gain more work experience, the gap between their real wage and their productivity will reduce (National Treasury, 2011:34).

In the design of any tax policy, the simplicity of its application will aid in compliance and will provide more motivation for businesses to participate in the subsidy. Smulders and Stiglingh (2008:335) state that among others, there is a large cost to small businesses in the time spent understanding the rules of the tax legislation as well as the cost of maintaining the necessary records to comply with the same rules. Dagney (2002:267) splits compliance costs into two categories. The first of which is start-up costs, namely gathering information about the tax credit itself and implementing processes to ensure that there is sufficient documentation gathered to present to the regulatory authority. The second is annual costs. This is the cost of completing the relevant tax forms and gathering the necessary information to complete these forms. Other costs that could determine the participation in the subsidy are the hiring costs associated with searching for a suitable candidate (Dagney, 2002:267). The hiring costs are the costs of interviewing and training the individual. For the subsidy to become successful, the benefit of the subsidy must outweigh the additional business costs associated with it. The "guiding principle" for the subsidy was its simplicity to ensure that "limited costs were borne by the employer" (National Treasury, 2011:39). The simplicity will be evaluated through the design of the policy.

5.2.1 Design of the policy

The subsidy is aimed at the low-income youth by determining the eligibility by comparing wages paid with the income tax threshold. Only those earning below the minimum threshold will be eligible to claim the subsidy (National Treasury, 2011:40). The subsidy is available to unemployed workers from the ages of 18 to 29 and for workers already employed aged between 18 and 24. If an employer already has a youth employed in the age bracket explained above, the employer would be entitled to a subsidy of 20% of the wages if a worker's salary is less than R24 000 per year. If that worker earns more than R24 000, the maximum subsidy that can be claimed is R12 000. (National Treasury, 2011:48). The allowance decreases as the salary increases (see Table 9). According to the National Treasury discussion paper, the maximum value of the subsidy is approximately half of what the average youth in the formal sector earns (National Treasury, 2011:48).

If an employer hires a new worker aged between 18 and 29, and that worker earns less than R24 000 a year, the subsidy value would be 50% of the salary. If the worker earns R24 000, the maximum subsidy that can be earned is R12 000 (National Treasury, 2011:48). As with workers already employed, the allowance decreases as the salary increases. This is best described in Table 9.

Table 9: Value of subsidy disaggregated into salary paid

Salary	Value of the subsidy	
	New workers	Existing workers
0 - 23999	50%	20%
24000 - 25999	11 370	4550
26000 - 27999	10 740	4300
28000 - 29999	10 110	4050
30000 - 31999	9 480	3800
32000 - 33999	8 850	3550
34000 - 35999	8 220	3300
36000 - 37999	7 590	3050
38000 - 39999	6 960	2800
40000 - 41999	6 330	2550
42000 - 43999	5 700	2300
44000 - 45999	5 070	2050
46000 - 47999	4 440	1800
48000 - 49999	3 810	1550
50000 - 51999	3 180	1300
52000 - 53999	2 550	1050
54000 - 55999	1 920	800
56000 - 57999	1 290	550
58000 - 59999	660	300
60000 -	0	0

Source: National Treasury (2011:49)

The design of the subsidy is to compensate the employer for the gap between the costs of employing an unskilled youth versus the productivity the worker provides with no experience. The sliding scale in Table 9 gradually reduces the subsidy received as a youth gains more experience (i.e. from 50% to 20%). It is the belief that as the youth gains more experience, the gap has been narrowed and the compensation received will be less (National Treasury, 2011:49).

Salient features of the youth wage subsidy (National Treasury, 2011:43) are the following:

- The subsidy is aimed at workers between the ages of 18 and 24 years for existing workers and between 18 and 29 for those who have never been employed. For those workers who already have existing employment, the subsidy would run for one year. For those never employed, the subsidy would run for two years with the worker being classified as an existing worker in the second year. The employer would therefore receive a smaller subsidy in the second year.

- The duration of the subsidy is a period of two years, which the National Treasury (2011:40) believes is sufficient time to reduce the gap between wages and productivity. This is a similar time to that of the NJTC.
- The policy will be administered by the pay as you earn (PAYE) system or the annual tax return process, depending on the choice opted by the employer. These are systems well known by the employer, which will limit the time it will take to learn the new system.
- Only employers registered on the PAYE system will be entitled to the credit. However, if wages are paid to workers' at less than the PAYE threshold, the subsidy would work as a cash pay-out rather than through the tax system. This could be challenging to control and would be an administration burden to the Government. Also, it would be more challenging to the employer to receive their subsidy.
- The subsidy would apply to the workers total remuneration. The document states that fringe benefits and contributions will be included, however, it does not specify if it is remuneration defined in Schedule 4 of the Act.
- The subsidy would be tax exempt in the hands of the employer.
- The employer, in terms of Section 23(n) of the Act, would not be allowed to deduct the amount of wages including the subsidy. That is the employer would have to reduce the deduction by the amount of the subsidy received.

The employer has a choice between the following two alternatives when claiming the subsidy (National Treasury, 2011:43):

- pay PAYE net of the subsidy received; or
- pay PAYE as normal and be allowed a tax credit or rebate for the subsidy.

5.2.2 Evaluation of the design of the policy

The key areas for policy-makers to keep in mind is the cost of compliance (which is linked to the complexity of the tax legislation), the benefits of the tax incentive and whether the

costs (other than the cost of compliance) needed to qualify for the policy are less than the benefit received.

Table 10: Tax savings if company employed a new worker at a salary of R24 000 a year

	Tax liability (R)	
	With the subsidy	**Without the subsidy**
Gross income	100,000	100,000
Grant received - exempt in employer's hands	-	-
Salary deduction (net of subsidy to be received)	-12,000	-24,000
Taxable income	**88,000**	**76,000**
Tax liability (28%)	24,640	21,280
Tax credit	-12,000	-
Net tax liability	**12,640**	**21,280**
Effective saving	**8,640**	

Table 10 sets out an example of how much tax a company could save if it qualified for the youth wage subsidy. Assuming a company incurred the cost of R24 000 a year to employ a previously unemployed youth worker and the company had a gross income of R100 000 for the tax year; if the youth wage subsidy was not in place, the company would be paying R21 280 in income tax. Adversely, if the subsidy could be claimed, the company would only be liable for R12 640 in income taxes using the subsidy values set out in Table 9. The subsidy claimed in the example above reduced the employer's effective cost of youth labour by 36%. For argumentative purposes, Table 11 is the same example, with the salary being greater than the R24 000 salary where the credit is the highest.

Table 11: Tax savings if company employed a new worker at a salary of R46 000 a year

	Tax liability (R)	
	With the subsidy	**Without the subsidy**
Gross income	100,000	100,000
Grant received - exempt in employer's hands	-	-
Salary deduction (net of subsidy to be received)	-41,560	-46,000
Taxable income	**58,440**	**54,000**
Tax liability (28%)	16,363	15,120
Credit	-4,440	-
Net tax liability	**11,923**	**15,120**
Effective saving	**3,197**	

Using the same facts as above, but increasing the salary to R46 000 annually, the benefit received reduces as the salary increases. If an employer were to employ a youth and pay R46 000 in remuneration annually, using Table 9, the tax credit the company would qualify for is R4 440. The benefit reduces when the salary increases as the tax saving above is only R3 197 or a reduction in the cost of youth labour by approximately 7%. When compared with the tax saving of R8640 or the 36%reduction in the cost of labour (see Table 11), the benefit at this salary level is marginal. It is evident that the aim of the subsidy is to motivate the employers to hire “lower-skilled, lower wage” workers (National Treasury, 2011:48). This is because the National Treasury wishes to target the majority of the unemployed youth, which they deem to be earning within the R24 000 a year range.

The change in the cost of labour above could have an impact on the labour demand if one takes into account the *wage elasticity* of labour. The wage elasticity of the labour demand will determine how much of an impact the difference in the cost of labour will have on the labour demand. South Africa’s national average for wage elasticity is typically in the region of -0.5 to -0.7 (Development Policy Research Unit, 2008:10). The example used to explain wage elasticity is that a 10% increase in the wage will result in a reduction of employment levels of between 5 to 7%. Fedderke (in National Treasury, 2011:51) states that the wage

elasticity of unskilled workers is between -2 and -2.23, which is an indication that unskilled labour is highly sensitive to wage changes. Thus the benefit of targeting the unskilled youth is that the change in their cost of labour will theoretically have a significant impact on the demand of the unskilled youth. To illustrate the concept of *wage elasticity*, the percentage change of employment was determined using the maximum cost of labour savings from the subsidy as calculated in Table 10.

Table 12: Wage elasticity of labour assuming a 36%decrease in labour costs

	National Average		Unskilled workers	
	Minimum	Maximum	Minimum	Maximum
Wage Elasticity	-0.5	-0.7	-2	-2.23
% Change in employment	18%	25%	72%	80%

Table 12 indicates that the minimum impact of the wage changes (assuming the national average elasticity of -0.5) is an 18%increase in the youth unemployment rate. If the unskilled workers' elasticity was applied, the minimum would increase to 72%. The subsidy is expected to increase the number of jobs by 423 000 throughout its duration (National Treasury, 2011:40). Of this amount, 178 000 would have been created without the subsidy.

The above job creation numbers cannot be achieved without increasing the participation rate. This was identified as one of the problems of the NJTC. The benefit of the subsidy would be largely dependent on the employer which opts to utilise it. How much tax benefit is the employer looking for to make a difference to the company's tax liability? To employ an inexperienced worker in one's business will increase the amount spent on training costs in the business. Training of the workers would likely be a fixed cost to an employer and thus if the number of workers' employed increased, the underlying cost of training would not. Thus, if more workers are employed, the benefit of the subsidy will increase (i.e. the greater the number of youth employed, the more the subsidy absorbs that fixed cost and then a gain or benefit is made in the employer's hands). The other cost identified is the search costs (Dagney, 2002:266). The Government would have to aid businesses in finding suitable unemployed youths through job assistance programmes. This will limit the

amount spent by businesses searching for youths to fill their employment roles and make the employment of youth more desirable and less costly. The above facts would aid in increasing the participation rate of businesses.

The wage subsidy proposed follows a similar pattern to that of the Georgia Tax Credit in that it is a credit targeted at a specific group of individuals. The Georgia Tax Credit aimed at poor counties and the youth wage subsidy aims at unskilled, low income youth. The Georgia Tax Credit was simple and accessible, which increased its success rate. In comparison, the NJTC was overtly complex, which resulted in its low participation rate limiting its impact. The youth wage subsidy has a similar simplified approach to that of the Georgia Tax Credit. If one employs a previously unemployed youth (within a defined age range), one qualifies for the credit based on the salary earned by that new worker. If the participation rate was higher in the Georgia Tax Credit, then it is expected that the proposed subsidy would have a similar impact as the National Treasury is following a similar approach.

Notwithstanding the simplicity of the design that motivates participation, it is also the ceiling imposed by policy-makers which is a determining factor in the participation rate. The Georgia Tax Credit had such a ceiling whereby a minimum number of jobs had to be created before the credit could be claimed. The credit also had a limitation whereby a company could not claim more than 50%of its tax liability in one year (i.e. if a company's tax liability is R30 000, only R15 000 of the tax credit could be claimed in this tax year with the balance being carried forward). Even with these limitations imposed, the tax credit was successful. The youth wage subsidy has no such limitations. The absence of these limitations should increase the participation rate for the proposed subsidy. The administration burden created by the Georgia Tax Credit to prove the number of workers employed will be eliminated and the employer can use the full tax credit in any given year, which makes the youth wage subsidy more lucrative. It will mean that any job created will result in tax benefit as no ceilings are imposed limiting its impact. The removal of these ceilings creates more incentive for workers to employ youth in their businesses.

A similar incentive seen in South Africa is the learnership allowance. Even though the learnership allowance was lucrative for businesses, the participation rate was low (see Table 4). This could be due to the stringent requirements in order to qualify for the allowance (have a registered learnership through SETA), which refined the target market to a few who qualified. The proposed subsidy does not have such limitations and thus it would be expected that the participation rate would be higher as it is more open to the broader public.

Another benefit that companies would have under the proposed subsidy is that the employer has the option to claim the subsidy through the PAYE system or through a tax credit on the company's yearly return. This places the power of choice into the taxpayer's hands, which increases the motivation to participate. The subsidy is also designed in such a way that the company will reduce the amount owed to SARS instead of physically applying for the subsidy, which provides more motivation to businesses as the benefits will be more immediate. This will aid in the cash flow of a business.

5.2.3 Perceived pitfalls of the youth wage subsidy

One of the aims of creating a targeted policy is to ensure that jobs are created because of the subsidy and not paid to those unemployed who would have been hired without the subsidy. The National Treasury (2011:40) estimated that approximately 42% of the jobs would have been created in the absence of the subsidy. In the case of the Georgia Jobs Tax Credit, it was estimated that between 72 and 77% of the jobs would have been created in the absence of the credit. This did not impair the success of the tax credit implemented in Georgia. However, this will be difficult to analyse in pre-implementation of the credit in a South African context.

Cosatu's (Anon, 2012) main opposition to the wage subsidy is that it causes a substitution effect. By subsidising the youth, Cosatu fears that older workers will be replaced with young workers to ensure the subsidy is obtained. In their report addressed to the National Treasury and the Democratic Alliance (Cosatu, 2012), Cosatu stated that the older

workers not belonging to a union are vulnerable and open to substitution. To combat the possible side effects of the subsidy, the design of the subsidy could state that an employer must maintain, after receiving the subsidy, its average employment numbers of before the subsidy and through audits by either SARS or the Department of Labour, the abuse of the subsidy could be investigated.

Another pitfall identified is the displacement effect created when a company increases its output due to the increase in subsidised workers, which displaces the output of those businesses that opt not to employ subsidised workers (National Treasury, 2011:29). However, this could be used to further incentivise businesses to employ more subsidised workers as it would give them an edge over their competitors.

The youth wage subsidy would not guarantee that the unskilled youth will obtain the skills needed to be able to be more employable in future, however, it would show that they are employable and the two years' experience gained by the subsidy would increase their employability. This is also one of the reasons why Cosatu (Anon, 2012) do not believe the subsidy would work. However, there is no evidence to suggest that this is the case. Little information is available as to how long a worker could be unemployed after the subsidy is over. It would be in the employer's best interest to ensure that the workers employed get the necessary training.

5.2.4 Analysis of subsidy in terms of causes of unemployment in South Africa

The following causes of unemployment in South Africa were identified:

- South Africa has an inflexible labour market;
- current tax incentives in South Africa are either onerous and have high administrative burdens or they lack scale and have an insignificant impact;
- there is a lack of skill, which determines the hiring decisions of employers;
- unemployment among youth (between the ages of 18 and 29) is high;
- most of the unemployed in South Africa are between the ages of 18 and 29;

- policy decisions should be aimed at small- and medium-sized businesses because they have been identified as the largest area for growth and employment.

From the above, it can be seen that the youth wage subsidy deals with these causes of unemployment to some degree. It is aimed at the area of South Africa's highest unemployment, namely the youth between the ages of 18 and 29 years. The subsidy motivates employers to hire workers without the necessary skill by compensating employers for the differential between the cost of the unskilled labour and the workers' productivity. The subsidy is not specifically targeted at SMMEs, however, one would assume that it would be lucrative for these businesses to participate as the administration costs would be minimal (as part of their normal PAYE or income tax return process) and the design of the policy has been simplified. It would seem that the design of the subsidy has dealt with some of the causes of unemployment in South Africa.

The design of the subsidy should, however, ensure that the rights of other workers not eligible to the subsidy are protected. Policy-makers need to ensure that the employment level of the older workers before the implementation is maintained after the implementation.

5.3 CONCLUSION

It is difficult to determine how many businesses in the South African market would opt to participate in this initiative. However, if the benefit is lucrative and the costs of compliance are low, businesses will participate. Theoretically, the subsidy could work. However, the substitution effects would have to be avoided to limit the losses of employment.

The design of the policy is simple and in terms of the experience in the USA, there is evidence to suggest that this would increase the participation rate. It is unavoidable that employment created would have been created in the absence of the subsidy; however, the objective of creating jobs would have been achieved.

CHAPTER 6

CONCLUSION

6.1 INTRODUCTION

The research analysed possible tax incentives that could be implemented to alleviate the poor unemployment statistics currently shown in South Africa. This chapter provides a summary of how the research objectives were met throughout the study and how the research objectives guided the conclusion.

6.2 ACHIEVING THE RESEARCH OBJECTIVES

In the introduction to this study, the following research objectives were identified to guide the study:

- to identify the factors of unemployment in South Africa;
- to identify the current tax incentives provided by the Income Tax Act (58/1962),which have been directly or indirectly used in incentivising businesses to employ more workers;
- to identify possible tax incentives and/or subsidies implemented in the USA and to analyse the success of such measures to create employment through a number of employment opportunities created;
- to analyse the proposed youth wage subsidy in terms of the findings above to determine whether the subsidy is plausible in a South African context.

The research indicates that most of the unemployed were unskilled workers between the ages of 15 and 29. One of the main factors that led to their unemployment is the fact that these workers did not have the necessary skills to increase their employability. Also, the minimum wage for these unskilled workers is deemed not to correlate with their

productivity. This created an “inflexible” labour market and resulted in the reduction in the demand for their labour.

From the analysis of current tax incentives in South Africa, it is clear that there is no direct tax incentive focused at incentivising employers to hire unskilled youth labour, which represents the bulk of the unemployed. Direct tax incentives are aimed at increasing the skill set of the employed (through the learnership allowance), however, this allowance is not on a large enough scale to make an impact on the underlying unemployment statistic. There is also no evidence to suggest that these individuals, after their learnership, are able to find employment after obtaining a particular skill set. From the analysis of current tax incentives in the South African legislation, it is clear that there is a need for a more focused and direct incentive for employers to employ more unskilled youth. From the analysis, it was determined that a youth wage subsidy would be the most appropriate as a direct tax incentive for employers.

The success and failures of similar subsidies implemented in the USA were analysed to determine the best way to design the youth wage subsidy by learning from the results in the USA. Through this analysis, it is clear that one would have to be careful with the design of the “credit ceilings” in these policies as they have a sensitive influence on the participation rate. If the participation rate in South Africa is low, then the youth wage subsidy would not have the desired impact on the unemployment statistics. Also, the simplicity of the policy is crucial as this also impacts on the compliance costs of a business together with the participation rate. The more costly and complex the credit, the lower the participation rate. The one unavoidable consequence of the subsidies in the USA is that the government subsidised jobs that would have been created in the absence of the subsidy.

In terms of the discussion paper by the National Treasury (2011), the design of the proposed youth wage subsidy was analysed against the successes and failures identified in the USA and whether or not the subsidy deals with the main factors causing unemployment in South Africa. The design of the policy is not overly complex and the

subsidy can be claimed through the PAYE system, which eases the administrative burden. Overall, the subsidy addresses these factors as it is aimed at the unskilled youth (by targeting the lower-waged workers) and it reduces the cost of unskilled labour, which influences their demand. However, the main concern is that newly employed youth would replace workers who do not meet the qualifications of the subsidy. This pitfall would have to be taken into account to ensure the subsidy is successful.

6.3 CONCLUSION

In conclusion, the proposed youth wage subsidy influences the majority of the unemployed in South Africa. It reduces the cost of the labour, which is crucial in a South African environment as it would make the country more competitive globally. It also increases the demand for unskilled labour, which is currently lacking. The research determined that experience is one of the influences a worker's employability and thus the youth wage subsidy would provide workers with such experience (even if it is for a limited period). The design avoids many of the flaws identified in the USA such as it being overly complex and a large administrative burden to taxpayers. This has thus ensured that, in theory, the participation rate would be higher than the subsidies analysed in the USA.

In theory, the youth wage subsidy would influence the labour market by increasing the number of unskilled youth employed (through reducing the cost of labour). However, this largely depends on the number of businesses willing to participate in the subsidy, which did not form part of this study.

6.4 RECOMMENDATIONS

Based on the evidence above, the recommendation is that the youth wage subsidy should be implemented in South Africa. The reason is that there is no other policy or tax incentive currently on a large enough scale. If policy-makers can ensure that the subsidy is properly advertised and remains simplified and does not cause large administrative burdens for the taxpayer, it could be effective. It is also recommended that the workers are not replaced by the youth as it would defeat the purpose of creating employment.

6.5 FUTURE RESEARCH

In order to conclude whether the youth wage subsidy would be successful in South Africa, a survey needs to be conducted to determine if it were implemented, how many businesses (with specific focus on small businesses) would participate in the subsidy. Participation by employers is a key element to its success. It would be valuable to understand why businesses do not hire more unskilled youth workers. By understanding their constraints, the subsidy could be specifically tailored to ensure employers hire for the right reasons and that employers' benefit from the subsidy.

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