



The Employment Tax Incentive - a reform proposal

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Working Paper Series
Number 310

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Acknowledgements

Funding for an earlier draft of this paper was provided by the Centre for Development and Enterprise.

A previous version of this paper was published on 28 November 2024. Subsequently, we were informed of additional useful references on this topic by Dr. Sean Muller. We are grateful for this contribution and have updated the paper accordingly.

All remaining errors and omissions are the responsibility of the author.

Recommended citation

Donaldson, A.R. (2024). The Employment Tax Incentive – a reform proposal. Cape Town: Southern Africa Labour and Development Research Unit, University of Cape Town. (SALDRU Working Paper Number 310)

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The Employment Tax Incentive – a reform proposal

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Saldru Working Paper 310

University of Cape Town

November 2024

Abstract

South Africa's Youth Employment Incentive is described in this paper and its impact is reviewed. It is argued that in the context of South Africa's deep structural unemployment, neither the empirical evidence nor the underlying theory supports the current narrowly targeted wage subsidy design. Drawing in part on comparison with the US earned income tax credit, recommendations are outlined for reform of the current youth incentive in favour of a broad-based employment subsidy. Illustrative cost estimates for alternative design parameters are set out, together with a concluding note on financing considerations.

Key words: Wage subsidies, employment policy, tax incentives, South Africa

JEL classification: J38, H25

Introduction

The Employment Tax Incentive (ETI) was introduced in 2014 to encourage employers to hire young work-seekers. It followed a recommendation of the 2006-07 International Panel on Growth that a “once-and-for-all” wage subsidy of a fixed amount should be offered to all South Africans to facilitate the school to work transition and to “allow for a subsidized trial period” of work to “encourage employers to experiment with younger workers...”¹ In effect, the International Panel had recommended a flat-rate voucher that first-time work-seekers would offer to potential employers. An experiment along these lines was subsequently conducted by the African Micro-Economic Research Unit at the University of the Witwatersrand.²

The National Treasury took a somewhat different approach and introduced, instead, an earnings-related two-year incentive, implemented through the PAYE tax system. A cautious variation on the International Panel’s recommendation, the ETI also represented a considerably more modest intervention in the labour market than the general wage subsidy then under consideration as part of the comprehensive social security reform process.³ The intention of the social security wage subsidy proposal was to supplement the earnings of *all* low-wage employees, both as a redistributive measure and to assist in their participation in a statutory payroll-financed retirement and social insurance arrangement.

The current ETI arrangements are reviewed below. Its effectiveness as a labour activation intervention is assessed in the context of South Africa’s unemployment and inequality challenges. The evidence suggests that a narrowly targeted youth incentive is an inadequate intervention in the context of high unemployment. On both redistributive and labour market grounds, there should be a reconsideration of the design of the ETI in favour of a broad-based wage incentive. Education and training reforms, and targeted industry support measures, are also key components of the employment policies needed in South Africa’s circumstances.

The current ETI provisions

The ETI operates through employers’ PAYE returns to SARS. Employers can deduct the ETI amount from the total PAYE amount owed to SARS each month. If the ETI exceeds the employees’ tax payable, the excess can be rolled over or reimbursed to the employer. It is in effect a short-term cost-sharing arrangement between government and employers in respect of the wages paid to young employees who earn below a prescribed threshold. It is available to employers other than national, provincial or local government authorities or public entities, subject to a requirement that the incentive does not lead to displacement of employees.

The ETI can be claimed for employees aged 18-29, other than domestic workers or persons “connected”

¹ International Panel on Growth, 2008. Recommendation 9. The underlying analysis is set out in Levinsohn, J, 2008.

² Levinsohn, J, et.al. 2014a; 2014b. The main finding of this study was that individuals who received a temporary employment voucher were about 25 per cent more likely still to be in wage employment than the non-recipient control group a year after the allocation. For a critique of this randomized trial of a wage subsidy and the subsequent policy processes, see Muller, S, 2021.

³ See Section 2.3, National Treasury, 2007a. The ETI introduced in 2014 adopted the design structure of the Treasury’s social security reform proposal, but for a limited two-year period only, rather than the envisaged general subsidy to low-wage employees. See also National Treasury, 2011.

to the employer, for a maximum period of two years.⁴ The wage paid must meet the requirements of applicable collective agreements, sectoral determinations, bargaining council agreements and the national minimum wage. With effect from August 2020, the age restriction (but not the two-year limit) was removed for qualifying companies within designated special economic zones (Coega, Dube Trade Port and the East London, Kaluti-A-Phofong, Saldanha Bay and Richard Bay SEZs).

For two four-month periods in 2020 and 2021, in the context of Covid-19 lockdown restrictions, an “expanded ETI” was available, in which the two-year restriction and age limits were lifted, and the calculated incentive amounts were raised.⁵

The ETI amount is calculated in relation to an employee’s monthly wage (or on a pro-rata basis if the employee works part-time or for part of a month). With effect from March 2022, an increased ETI benefit was implemented, though the remuneration thresholds were left unchanged. The calculation formulae applicable before and after this change are set out below:

Monthly remuneration:	< R2,000	R2,000 – R4,500	R4,500 – R6,500
ETI Calculation formulae applicable before 1 March 2022			
(Y = monthly remuneration)			
First 12 months	50% of Y	R1,000	R1,000 – (50% of (Y – R4,500))
Second 12 months	25% of Y	R500	R500 – (25% of (Y – R4,500))
ETI Calculation formulae with effect from 1 March 2022			
(Y = monthly remuneration)			
First 12 months	75% of Y	R1,500	R1,500 – (75% of (Y – R4,500))
Second 12 months	37.5% of Y	R750	R750 – (37.5% of (Y – R4,500))

The implication of these formulae is that the ETI amount increases proportionally as the monthly wage rises, up to a level of R2,000 (or equivalent to R2,000 for 160 hours of work if work hours are less than 160 hours a month). If the monthly wage is between R2,000 and R4,500, the ETI amount is fixed. Between a monthly wage of R4,500 and R6,500, the ETI amount is phased down to zero. It is helpful to think of the ETI amount as determined by three thresholds – A: *the monthly earnings level at which the maximum ETI amount is triggered (R2,000)*; B: *the earnings level at which the ETI amount begins to decline (R4,500)*; C: *the earnings level at*

⁴ Initially, an ETI credit was available only for the first two years of an individual’s employment by *any* employer, as would apply in respect of a fixed-amount voucher, but this requirement has been dropped, presumably for administrative practicality reasons.

⁵ The expanded ETI provided for three levels of incentive: a maximum amount of R1,750 calculated at a 87.5% phase-in and phase-out rate, for the first 12 qualifying months of SEZ or age 18-29 employees; a maximum amount of R1,250 calculated at a phase-in and phase-out rate of 62.5% for the second 12 months of SEA or age 18-29 employees; and a maximum amount of R750 monthly at a phase-in and phase-out rate of 37.5% for qualifying employees beyond 24 months and for employees aged 30-65 irrespective of previous employment.

which the ETI falls to zero (R6,500).

The ETI can only be claimed if an employer is compliant with applicable wage determinations and the minimum wage. In general, therefore, it applies only to earnings above the minimum wage (2024: R27.58 an hour, or R4,413 for a 160 hour month). Only within a narrow remuneration band (R4,413 – R4,500 a month) is the maximum ETI amount payable.

The ETI calculation takes into account hours of work, relative to a fulltime 160 hour month. In effect, part-time work attracts a subsidy *proportional* to the subsidy that would be paid for full-time work. This is presumably intended to prevent employers from gaining a cash advantage from job-splitting. But it has the effect of reducing the benefit associated with part-time or shift-based work. Considered together with the minimum wage requirement, this also means that the earnings threshold A and the flat-rate benefit between thresholds A and B are largely irrelevant. The ETI benefit is in practice determined by a proportion of the maximum calculated by reference to hours of work. Apart from the impracticality of ensuring that employers provide accurate information on hours of work, job splitting brings the *benefit* of additional work opportunities, which is what the incentive is intended to achieve. When the ETI was introduced in the 2013 Budget, it was envisaged as “a graduated tax incentive at the entry-level wage falling to zero when earnings reach the personal income tax threshold.”⁶ The PIT threshold for the 2013/14 year was R67,111 (or R5,593 a month). The ETI thresholds introduced in 2014 were consistent with this intent – threshold A was R2,000 a month, threshold B was R4,000 a month and threshold C was R6,000 a month – just above the personal income tax threshold.

Since then, threshold A has remained unchanged, while thresholds B and C have increased by R500. This represents a substantial erosion in the real level of the ETI remuneration thresholds. The 2014 thresholds, fully adjusted for CPI inflation, would be approximately as follows in 2024 prices: A: R3,300; B: R6,600; C: R9,900. (The PIT threshold in 2024/25 is R7,980 a month.) The maximum ETI amount of R1,000 in 2014 has similarly eroded in value, as its equivalent of R1,650 in 2024 prices has only partially been accommodated by the increase in the phase-up rate to 75% with effect from 2022.

Together with the March 2022 increase in the value of the ETI, the National Treasury indicated in the 2022 *Budget Review* that “improved targeting of the incentive will be considered to support jobs for long-term unemployed work seekers, alongside an expansion of the eligibility criteria for qualifying employees to improve the incentive for small businesses.” These intentions do not appear to have been taken forward.

SARS and National Treasury records indicate that ETI claims amounted to about R4.8 billion in 2019/20, increasing to R7.2 billion and R6.6 billion during the 2020/21 and 2021/22 years in which an expanded benefit was available, and falling back to just under R4.8 billion in 2022/23. The number of individuals for whom claims were submitted, outside of the expanded ETI years, appears to have fallen from a peak of around 700,000 to perhaps 600,000 currently.

Impact and effectiveness of the ETI

Studies of the impact of the ETI have yielded mixed results. Several reviews of the aggregate impact on

⁶ National Treasury, 2013, page 52.

employment of young workers suggest no significant effect.⁷ However, a number of firm-level studies have found positive effects in that employment increases faster at firms that claim the subsidy, which tend to be larger faster-growing firms.⁸ Budlender and Ebrahim, in reviewing the available literature, conclude that the evidence in favour of the ETI as an employment intervention is weak and that in considering its future development “a fuller and more careful and sceptical engagement with the evidence” is warranted.⁹

That the ETI has had little impact on either overall employment of young people or the distribution of income is not a surprise. The erosion in the real value of the ETI thresholds, relative to the minimum wage and to young people’s “reservation wages,”¹⁰ partly explains this outcome and will further limit its impact over the period ahead. But there are several more fundamental reasons.

- From a macroeconomic perspective, the aggregate value of the ETI is small. The effective reduction in the personal income tax burden peaked at less than 1.1% in 2016/17 (apart from the expanded ETI years) and is now less than 0.8%. As a share of GDP, the ETI cost is less than 0.1%.
- As a redistributive measure, the ETI is similarly weak. Calculated as a share of gross reported income *below* the tax threshold, it is less than 1.5%. It amounts to less than a quarter of total wages paid on public employment programmes, and one-fortieth (less than 2.5%) of the total value of social grants paid to households.
- From the perspective of individual firms, the *substitution* of existing employees for ETI-qualifying work-seekers (“displacement”) is prohibited. Though enforcement is probably difficult, this means that active recruitment to take advantage of the ETI is inhibited and is mainly driven by the *income effect* of the incentive. But the income benefit falls away after two years of employment, and in the relevant earnings range above the minimum wage is at best a third of the cost of employment and falls rapidly as the wage rate rises.
- The 75% phase-out rate of the incentive, with effect from March 2022, substantially weakens the income benefit to firms employing new recruits who perform well or exhibit capabilities consistent with earnings above the minimum wage. The cost to the employer of raising the wage of a first-year ETI employee from R4,500 a month to R6,500 is (R1,500 + R2,000) – an implicit marginal tax of over 40%.
- For larger labour-intensive firms, with staff turnover sufficient to target young work-seekers as recruits, the age-limited two-year incentive will be claimable for at most one in ten employees, depending on average age and turnover rates. At the minimum wage, the benefit is around one-third for the first year, and one-sixth of the wage cost for the second year. The effective reduction in the overall wage bill is at best one-fiftieth – and if wages are subject to bargaining council or other determinations above the minimum, then the benefit is less. For small or medium-sized firms, the scope for adjusting the size and composition of the workforce in response to an incentive that attaches to a specific age cohort for a restricted time period is more limited. For any firm preferring continuity of work-force over rapid turnover, the ETI offers no lasting reduction in costs associated with expanding employment.
- The underlying idea behind the ETI is that if firms offer more first-time employment opportunities, younger work-seekers will have better prospects of finding work – and this will stand them in good stead beyond the duration of the incentive. But South Africa’s youth unemployment problem cannot

⁷ Ranchhod, V and Finn, A, 2015. See also Ebrahim, A, et.al., 2017 and Muller, S, 2021.

⁸ For example, Borat, H, et.al., 2020.

⁹ Budlender, J and Ebrahim, A, 2022.

¹⁰ Burger, R, et.al., 2017.

be addressed by a marginal shift in the employment of young people. The 18-29 age cohort is more than a quarter of the total labour force – South Africa’s youth unemployment problem is the sharp end of the *overall* unemployment problem. The overall unemployment problem cannot be solved by intervening only in the *transition* from school to work, it must be addressed on the demand side of the labour market as a whole.

- A wage subsidy is an intervention both in the cost of labour and in the earnings of low-wage or vulnerable employees. But a subsidy to *young* low-wage employees that is not available to older workers, more likely to be family breadwinners and with higher living costs than the young, cannot be reconciled with basic distributive justice norms. There are not enough basic work opportunities available to *all work-seekers*, not just to the young.

In sum, the available evidence indicates that the ETI has little impact on South Africa’s unemployment rate, as it does little to reduce the cost of labour for labour-intensive firms or activities, or to shift technology in a labour-intensive direction. If fiscal support is to be provided to employment creation in South Africa’s circumstances, a broader labour market intervention has to be sought. The theoretical case for a broad-based labour subsidy in a context of high structural unemployment is well-understood. It was made in the 1990s by at least one of the international advisors to the South African Labour Market Commission,¹¹ though its Report limply recommended that “a task force ... be convened to consider the pros and cons of employment subsidies.”¹² A subsequent analytic review argued that a wage subsidy programme would raise employment and GDP and reduce poverty and inequality in South Africa, though links to training activities and targeting of industries with employment growth potential were identified as important complementary measures.¹³

If the structure of the economy yields fewer jobs than are required, and if there are good reasons for not allowing wages to fall to market-clearing levels, then consideration must be given to a subsidy or incentive design that impacts broadly on the demand for labour. There are many variations on this in international practice,¹⁴ but far the largest programme of support internationally for low-wage earners is the earned income tax credit (EITC) administered as part of the US federal tax system.

A comparative perspective: the US Earned Income Tax Credit

Like the ETI, the EITC has its theoretical roots in the idea of a “negative tax” on earned income.¹⁵ If vertical equity in the tax structure is given effect by progressively *lowering* earnings in the hands of the employee relative to the wage or salary cost to the employer, above some threshold, the negative tax aims progressively to *increase* income in the employee’s hands at earnings levels below this threshold. This is essentially a redistributive function, though it also impacts on both labour market participation and employment.

Both the ETI, and the basic EITC, are structured to rise with earnings up to some maximum value, and phase down to zero at or around the individual tax threshold. The ETI is phased in to its maximum comparatively

¹¹ Heintz, J and Bowles, S, 1996.

¹² Presidential Commission to Investigate Labour Market Policy, 1996, p. 135.

¹³ Burns, et.al., 2010.

¹⁴ See for example, Bird, N, 2020.

¹⁵ The EITC was introduced as part of the Tax Reduction Act of 1975. It was an adaptation of the negative income tax proposal originally included in Richard Nixon’s 1969 Family Assistance Plan. Since its introduction it has been extended and expanded on several occasions, notably in the Tax Reform Act of 1986. In 1993 it was effectively tripled in value in President Clinton’s tax reforms.

rapidly and is phased out at the same rate. The EITC is phased in slowly and is phased out more slowly than it is phased in.¹⁶ The EITC is administered as a reimbursable credit claimed by and payable to the *individual* (or couple if filing jointly), whereas the ETI is administered as a credit to the employer.

The federal EITC costs about USD72 billion a year, or about 3.3% of individual income tax revenue and 0.3% of GDP. Together with the child tax credit, it is one of the largest and most effective poverty reduction programmes in the US. This impact is achieved in part because the value of the EITC is substantially higher for claimants with dependent children than for individuals with no children.¹⁷ The EITC is therefore broadly similar in its intent and distributional outcomes to the family allowances and tax-benefit systems of many other OECD economies, though not all are administered by the tax authorities. Reforms to these arrangements in recent years have strengthened links between social security benefits and participation in work.¹⁸

In 2023, the maximum EITC benefits ranged from \$600 (a year) for individuals without children to \$3,995 for taxpayers with one child and \$7,430 for three or more children. In effect, the EITC serves as a substantial supplement to earnings both for low-income workers with only *part-time* income from work during the tax year and for earners with family dependents who earn up to about four times the US minimum wage (currently \$7.25 an hour, or about \$14,000 a year).

Although it is primarily a redistributive measure designed to improve income security of families with children, studies of its labour market effects confirm that it increases employment, particularly of single women with children.¹⁹ By increasing both incomes and labour market participation of low-income families, the EITC is widely regarded as the most important fiscal channel through which income inequality and poverty are reduced in the US.

A broad-based wage subsidy

As envisaged in the Treasury's 2007 *Social Security and Retirement Reform* paper, a wage subsidy intended to impact on the *demand* for labour is best implemented through the employer's tax return. The proposal was elaborated in some detail in a November 2007 National Treasury paper, which included cost estimates and the results of three modelling estimates of the potential impact on employment, poverty and inequality.²⁰ The paper envisaged a "general wage subsidy" – to "raise employment in two ways: firstly, by offsetting the costs of social security contributions for low wage employees and, secondly, by reducing the overall wage bill for low-income employees."²¹ The analysis indicated that a wage subsidy with a maximum value of R5,000 a year (approximately R12,500 in 2024 prices) and phased out at around the tax threshold would cost between R16 billion and R20 billion a year (R40 – R50 billion in 2024 prices). Approximately 70% of this would be the cost of subsidizing social security contributions (at a payroll tax rate of 15%). The implied reduction in wage costs was therefore about R5 billion, with the benefit mainly going to the agriculture, construction, trade and manufacturing sectors. In this proposed form, the analysis

¹⁶ The EITC phase-out rate for a claimant with one qualifying child is 16%, and for claimants with more than one qualifying child it is 21%.

¹⁷ In 2023, a taxpayer with two qualifying children could claim EITC if earnings were less than \$52,918 for an individual, or \$59,478 if married and filing jointly. The threshold for taxpayers without children was \$17,640 for an individual or \$24,210 for couples filing jointly.

¹⁸ Comparative reviews of countries' tax and benefit systems are published regularly by the OECD. See www.oecd.org/social/benefits-and-wages.

¹⁹ See Greenstein, R and Shapiro, I, 1998; and Schanzenbach, D and Strain, M, 2020.

²⁰ National Treasury, 2017b.

²¹ *Ibid.*, p. 17.

suggested that employment would be raised by 200,000 to 300,000, while also impacting positively on earnings (and retirement security) of the lowest-paid workers.²² In the absence of a payroll tax, or if mandatory social security is introduced at a lower rate, the employment impact would be somewhat larger.

The more important impact of a reform along these lines is in its *long-term* impact on the relative cost of labour-intensive activities and firms. It is through a permanent downward shift in the relative cost of labour at the extensive margin that a sustained shift towards greater labour absorption, and poverty reduction through employment, can be achieved.

It is important to stress, though, that an employment incentive through the tax system will not in itself resolve South Africa's unemployment problem. Complementary improvements in education and training, in local economic development and living conditions and in industrial and trade competitiveness are as important. But equally, it has to be recognized that market-oriented "structural reforms" cannot address the problem without associated fiscal redistributive measures. In the absence of fiscal support for low-wage employment, the degree of downward pressure on wages that would be needed to achieve near-full employment would be both politically and socially unfeasible. Effective labour market activation programmes and employment services targeted at work-seekers are needed, but a basic redistributive measure to support low-wage employees is also a critical enabling condition for both more rapid employment creation and sustainable poverty reduction.

When the Treasury's social security reform proposals were tabled in 2007, sectoral determinations and bargaining council agreements covered much of the formal economy, but there was no minimum wage. In the presence of a national minimum wage, which has already been increased several times in inflation-adjusted terms, it is that much more important that a broad-based fiscal support measure should be implemented to support low-wage industries and activities.

Additional to its employment-enhancing and redistributive benefits, a third consideration comes into play in the presence of enforceable basic labour standards. It is well-documented in comparative development experience that rising real minimum wages, particularly when coupled with mandatory social security participation, lead to "informalization," unevenly applied regulations and an increasing gulf between established high-paying formal businesses and an unregulated informal economy. If this tendency is to be countered, fiscal support for low-wage employment is a helpful element in the policy mix. It is an "incentive compatible" approach to the modernization of labour standards and broadening of social insurance and retirement funding participation.

Reform of the ETI: design considerations

If the ETI is to serve as an effective *demand-side* fiscal incentive, while contributing to poverty reduction and supporting compliance with the national minimum wage, how should its design be adapted?

- *The ETI should be available to employers outside of government for all low-wage employees, subject to compliance with applicable labour standards.* Its extension to domestic and informal workers will not initially be practical but should be contemplated as and when social security and retirement funding arrangements are extended.

²² Ibid., p. 22.

- *The “grossing up” and “grossing down” provisions of the current ETI arrangement should be dropped in favour of a benefit calculated irrespective of hours worked in a month, or alternatively a de minimus requirement of, say, 40 hours a month.* The proportional adjustment provisions in the current ETI are administratively impractical and have the effect of reducing both the employment impact and the redistributive effect of the ETI benefit.
- *The maximum age of ETI qualifying employees should be set considering the age thresholds applicable to the old-age grant and complementary retirement funding arrangements.* The old-age grant is currently available from age 60. If it is made universal, as is envisaged in some reform proposals, the earnings-related ETI should fall away at this age.
- *A standard ETI benefit should apply to all qualifying employees, irrespective of age and years of service.* A maximum ETI benefit for fulltime work at the level currently applicable to qualifying employees’ second year of R750 a month would be approximately equivalent to 20% of the national minimum wage. A longer-term objective might be to add family or child allowances to the ETI benefit, as part of an integration of the child support grant with the tax-based arrangement. The main advantage of this would be to replace the CSG means test with a more robust earnings-related phase-out.
- *The ETI should be phased down more slowly than the current phase-out rate.* A slow phase-out rate is necessary if distorting effects on wage determination are to be kept in check. A maximum amount of R750 a month reduced to zero over the earnings range between the national minimum wage and the 2024 tax threshold would require a phase-out rate of 21.0%.
- *Recognising that the primary employment impact of a broad-based ETI would be in labour-intensive low-wage sectors or zones, these should also be the target of complementary industrial and development policies and support programmes.* Though sectoral targeting of the subsidy should be avoided, growth opportunities should be sought in agriculture and food processing, light manufacturing, residential construction, restaurants and other service activities, for example – supported through local development planning, training and related supportive policies.

Costs and financing of a broad-based ETI

What would an ETI along these lines cost, and how could it be financed?

A broad-based demand-side employment incentive designed also as a poverty reduction measure would be considerably more expensive than the current youth- and SEZ-focused ETI. Cost estimates are provided below, based on three alternative ETI parameters summarised below and calculated for the distribution of taxable income reported to SARS in 2017/18, raised to 2024 prices.²³ Option 1 is similar in design to the current ETI second-year benefit with a maximum value of R750 a month, except that it is phased out more slowly, down to zero at R8,500 a month, taken as a proxy for remuneration before retirement contribution deductions at the tax threshold. Option 2 adopts the same benefit design parameters as option 1, but without the proportional downward adjustments of benefits for employees working less than 160 hours a month. Option 3 phases up more slowly to a maximum of R1,000 a month (25% of R4,000) and has a single-point peak, before phasing down to zero at R8,500 a month.

²³ Although employees’ income reported to SARS excludes domestic (household) workers and employees of informal or unregistered enterprises, it covers all wage earners of registered businesses (and not just those above the tax threshold). In 2018 a total of 7.1 million individuals reported income greater than zero and below the tax threshold.

Appendix A sets out the modelling assumptions and results in more detail.

These three options differ in their overall cost, and have somewhat different distributional outcomes, proxied by the estimated share of the benefit attributable to employees with taxable incomes less than R55,000 a year.

Option 1			
Monthly remuneration¹ (Y)	< R2,000	R2,000 – R4,500	R4,500 – R8,500
ETI amount	37.5% of Y	R750	R750 – (18.75% of (Y – R4,500))
<i>Proportional downward adjustment if work hours < 160 p month</i>			
Estimated number of claimants	5,0 million		
Average ETI amount	R4,350 pa		
Share attributable to earnings < R55,000 a year	64.4%		
Total ETI cost (Rm 2024/25 prices)	R21,7 billion		
Option 2			
Monthly remuneration¹ (Y)	< R2,000	R2,000 – R4,500	R4,500 – R8,500
ETI amount	37.5% of Y	R750	R750 – (18.75% of (Y – R4,500))
<i>Benefit calculated without reference to work hours p month</i>			
Estimated number of claimants	5,0 million		
Average ETI amount	R5,036 pa		
Share attributable to earnings < R55,000 a year	69.3%		
Total ETI cost (Rm 2024/25 prices)	R25,2 billion		
Option 3			
Monthly remuneration¹ (Y)	< R4,000		R4,000 – R8,500
ETI amount	25% of Y		R1,000 – (22.22% of (Y – R4,000))
<i>Benefit calculated without reference to work hours p month</i>			
Estimated number of claimants	5,0 million		
Average ETI amount	R5,718 pa		
Share attributable to earnings < R55,000 a year	67.9%		
Total ETI cost (Rm 2024/25 prices)	R28,6 billion		

1. Monthly remuneration before retirement contribution deductions.

The estimated total cost at present levels of formal employment of the broadest of these alternatives, option 3, is around R29 billion. This represents just under 4% of projected 2024/25 PIT revenue, and 0.4% of GDP. Over time, the impact of the ETI on formal low-wage employment should be expected to lead to somewhat higher relative costs.

In the present context of fiscal consolidation, it is hard to argue for additional spending (or higher tax expenditures), or for a five- or six-fold increase in the costs of a current programme. But South Africa's rising unemployment burden has to be addressed as a critical policy priority. A broad-based ETI is an economically rational response to this challenge partly because it serves both a redistributive income support function while also contributing to the cost competitiveness and growth potential of labour-intensive sectors and large numbers of firms. To the extent that it contributes to absorption of otherwise unemployed resources, the ETI will support growth from both the demand and supply sides and will partially fund itself through the resulting revenue gains. But in its initial phases, an expanded ETI will need to be accommodated through tax measures or complementary spending reductions. Consideration might also be given to a phased introduction, perhaps targeted at employment-intensive sectors or special development zones.

A two-percentage point increase in the UIF contribution (one percent each by employers and employees) would be sufficient to finance an ETI of R25-R30 billion, taking into account that the UIF currently runs a surplus on its statutory obligations. Repeal of the skills development act and diversion of its payroll-based tax to the ETI would release R25 billion in largely ineffective sectoral training and related activities, though some of this might need to go to compensating TVET college funding. A one-percent increase in the VAT rate would yield around R40 billion. A one-percent increase in the base rate of the PIT (from 18% to 19%) would yield around R30 billion. Over time, progress in employment creation would reduce the need for the social relief of distress grant, which currently costs R34 billion a year.

Implementing a broad-based ETI even on more limited terms than outlined above, would represent a sizeable shift towards a more redistributive and employment-oriented fiscal structure in South Africa, operating through greater cost-competitiveness of very large numbers of labour-intensive enterprises. It would be a substantial contribution to more inclusive growth, implemented through tax administration capabilities that are in large already in place. It is an *incentive-compatible* tax-benefit reform, in that it encourages registration and formal participation of small enterprises who employ low-wage or irregular employees. The administrative feasibility of this approach, by comparison with more discretionary and institutionally demanding spending measures, is perhaps its strongest argument.

A broad-based wage subsidy is not a *sufficient* response to South Africa's extreme unemployment conditions. Improvements in basic education are critical, and improved access to vocational education and training might usefully be linked to a re-designed employment incentive and to appropriate industry-targeting measures. But the administrative capabilities to implement a broad-based employment incentive have now been built and should surely be put to work.

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Annexure A

Cost estimates and the distribution of ETI benefits for alternative broad-based design options are set out below.

The underlying data is drawn from the NT-SARS Personal Income Tax Panel for the 2018 tax year, with income estimates adjusted up to 2014 prices.²⁴ The underlying assumption is that the current *real* distribution of income by age group for individuals below a taxable income level of approximately R100,000 (2024 prices) is similar to the 2018 distribution. Aggregate SARS data for the intervening years indicates that the overall numbers of taxpayers in these real income bands has increased only marginally (by about 0.4% between 2018 and 2023). The age distribution has probably shifted upwards, but this will not significantly affect our results.

Age-Taxable Income Groups (age 15-64, below tax threshold) - 2017/18						
	Taxable Income Groups (2017 R p annum)					
	1 - 20,000	20 - 30,000	30 - 40,000	40 - 50,000	50 - 60,000	60 - 70,000
	Taxable Income Groups (2024 R p annum)					
Age groups	1 - 28,000	28 - 42,000	42 - 56,000	56 - 70,000	70 - 84,000	84 - 98,000
15-19	97,644	13,025	8,999	5,485	3,362	2,380
20-24	546,758	142,944	127,722	102,178	65,684	47,123
25-29	498,017	174,608	191,194	185,280	134,135	104,587
30-34	346,974	131,346	157,481	164,636	129,507	108,686
35-39	241,311	93,489	115,643	122,649	102,128	89,469
40-44	163,725	67,424	85,719	91,468	76,778	70,901
45-49	130,392	52,799	68,223	70,716	58,897	53,542
50-54	91,024	37,655	49,617	49,920	41,227	37,411
55-59	86,509	31,687	38,728	37,065	31,270	27,996
60-64	78,107	25,199	26,038	24,159	21,596	19,503
Age 15-64	2,280,461	770,176	869,364	853,556	664,584	561,598

Source: NT-SARS Personal Income Tax Panel.

Not all income-earners are employees. The ETI excludes those below age 18, pensioners and others whose income comes from other sources. The current ETI cannot be claimed if employers are not compliant with the applicable labour standards or minimum wages. We assume that 60% of those aged 15-19, 85% of those age 20-59 and 50% of those aged 60-64 would be ETI claimants. We take as the earnings base for calculation of ETI, income before retirement fund deductions.²⁵ This yields the numbers of claimants, average incomes and aggregate incomes set out below.

Although full compliance with the national minimum wage (NMW) and other labour standards cannot be taken for granted, it is reasonable to assume that a large proportion of those reporting earnings levels below the NMW are employed in irregular or part-time positions or are employed for less than a full twelve-month year. We make the simplifying assumptions for purposes of this analysis that ETI claimants reporting incomes below the minimum wage – equivalent to R52,954 a year for full-time work of 160

²⁴ Donaldson, A, 2023a. See also Donaldson, A, 2023b.

²⁵ The taxable income threshold in 2024/25 for individuals aged below 65 is R95,750. Taking into account deductible retirement fund contributions, we take income before deductions of R102,000, or R8,500 a month, as the upper threshold for the ETI aligned with the tax threshold.

hours a month – comprise two equally sized groups: employees working part-time for the full year at the hourly minimum wage rate, and employees working full-time at the minimum wage for part of the year only.

Estimated numbers of ETI claimants, average income and total income							
Taxable Income Groups (2017 R p annum)							
	1 - 28,000	28 - 42,000	42 - 56,000	56 - 70,000	70 - 84,000	84 - 98,000	Total
Estimated number of ETI claimants							
	1,886,643	642,574	727,596	715,696	556,497	469,937	4,998,944
Average Income before deductions							
R pa	12,064	35,620	50,542	65,157	80,479	95,776	43,779
Total Income before deductions							
R m pa	22,761	22,889	36,774	46,632	44,786	45,009	218,851

For option 1, we assume that the “grossing up” and “grossing down” provisions of the current ETI are applied, so that annual earnings below the minimum wage qualifies for an ETI benefit limited to a proportion of the maximum given by the ratio of income to the annual minimum wage. For options 2 and 3, we assume that part-time earnings qualify for the ETI at the monthly earnings formula rate (ie, no proportional adjustment), whereas full-time earnings for part of the year would qualify for the ETI at the NMW ETI rate.

These assumptions generate the estimates of ETI benefits and costs set out below.

Estimated impact and cost of broad-based ETI options¹

Option 1	Phase-in	Threshold A	Maximum	Threshold B	Phase-out	Threshold C	
	37.5%	24,000	9,000	54,000	18.8%	102,000	
Income Group	1 - 28,000	28 - 42,000	42 - 56,000	56 - 70,000	70 - 84,000	84 - 98,000	Total
Av ETI benefit	2,050	6,054	8,590	6,908	4,035	1,167	4,350
% of Income	17.0%	17.0%	17.0%	10.6%	5.0%	1.2%	9.9%
Total cost (Rm)	3,868.4	3,890.1	6,250.2	4,944.1	2,245.5	548.5	21,746.9
Share of benefit	17.8%	17.9%	28.7%	22.7%	10.3%	2.5%	100.0%
Option 2	Phase-in	Threshold A	Maximum	Threshold B	Phase-out	Threshold C	
	37.5%	24,000	9,000	54,000	18.8%	102,000	
Income Group	1 - 28,000	28 - 42,000	42 - 56,000	56 - 70,000	70 - 84,000	84 - 98,000	Total
Av ETI benefit	3,287	7,527	8,795	6,908	4,035	1,167	5,036
% of Income	27.2%	21.1%	17.4%	10.6%	5.0%	1.2%	11.5%
Total cost (Rm)	6,201.9	4,836.7	6,399.3	4,944.1	2,245.5	548.5	25,175.9
Share of benefit	24.6%	19.2%	25.4%	19.6%	8.9%	2.2%	100.0%
Option 3	Phase-in	Threshold A	Maximum	Threshold B	Phase-out	Threshold C	
	25.0%	48,000	12,000	48,000	22.2%	102,000	
Income Group	1 - 28,000	28 - 42,000	42 - 56,000	56 - 70,000	70 - 84,000	84 - 98,000	Total
Av ETI benefit	2,875	8,489	11,727	8,187	4,782	1,383	5,718
% of Income	23.8%	23.8%	23.2%	12.6%	5.9%	1.4%	13.1%
Total cost (Rm)	5,424.0	5,454.5	8,532.4	5,859.7	2,661.4	650.0	28,582.0
Share of benefit	19.0%	19.1%	29.9%	20.5%	9.3%	2.3%	100.0%

1. ETI benefit increases at the phase-in rate up to threshold A; the maximum amount is payable up to threshold B; the benefit is phased down to zero at threshold C.



Founded in 1975, the Southern Africa Labour and Development Research Unit (SALDRU) is a research-based social responsiveness initiative housed in the School of Economics at the University of Cape Town.

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Our mission is to challenge inequalities through policy relevant academic research.



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