



Fostering Employment Through Employment Subsidies

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[Jobs, Labor & Migration Course](#)

What are wage subsidies?

- One type of the broad menu of **Active Labor Market Policy (ALMP)**
- Also called **employment subsidies**
- **Definition:**

any transfer from the government to employers or workers aimed to reduce the cost of labor for employers and increase take-home pay for workers⁽¹⁾

Policy objectives of wage subsidies

- **Objectives:** It is a public policy instrument aimed at
 1. increasing jobs opportunities for those who would not easily find a job if “left to the market”
 2. increasing human capital (through learning-by-doing) or preventing human capital depreciation of workers who otherwise would be unemployment
- **Not a policy to generate permanent employment:** wage subsidies are meant to be transitory policies, of fixed duration of the subsidy
- Not clear it is a policy to reduce informality: go back to informal jobs when subsidy expires
- **Not to confuse with other ALMPs** at the employer’s premises
 - **work-based learning**: is education and training that take place in real workplaces, through some combination of observing, undertaking, and reflecting on productive work.⁽²⁾ It consists at least partly of **learning-by-doing**.
 - **on the job training**: is training in a real work environment, during working hours, while an individual contributes to regular production processes. A wage subsidy does not guarantee training. On-the-job training programs usually have requirements of hours of learning, ratio of mentors to trainees, type of skills to be learnt, etc. and subsidize just the transportation and meal costs during the period of training. Could be difficult to monitor/enforce the conditions for OTJ training are being met.

When to use wage subsidies?

- **Labor demand** side market failures:
 - Stimulate labor demand where it is slow (e.g. economic sector, geographic region)
 - During economic downturns, firms shed “too much” labor due to wage rigidities which leads to skills depreciation of the newly unemployed
- **Labor supply** side market failures:
 - Facilitate access to jobs to disadvantaged groups of jobseekers whose expected productivity is too low relative to the market wage associated with a given vacancy. It can be because of lack of work experience or because they are not able to signal to the employer that they have the necessary skills
 - First labor market entrants/youth
 - Unemployed who are hard to place (long term, low skilled, with disability)
 - Older workers
- **Equilibrium:** Alleviate frictions in identifying, hiring, and firing workers in an environment where firms are unsure of worker types

Advantages and disadvantages

Disadvantages: There can be losses, because

- **Windfall effect**: part of the subsidies go to workers who would have been hired anyways.
- **Substitution effect**: when not all workers have access to the wage subsidy, there can be substitution effects: subsidized workers replace non-subsidized workers: that further reduce employment effects.

For these reasons, under the optics of the static model, wage subsidies are often dismissed as an ineffective or inefficient policy tool for reducing unemployment.

Advantages: However, if workers are able to learn and acquire skills from the work they do (“learning by doing”) the balance of social costs and benefits can be different

Key design parameters (1)

- **Payee:** the employer or the worker
 - The choice of payee depends, then, on factors like the elasticities of labor supply and demand.
 - In developing countries, wage subsidies are almost always paid to the firm, in part for administrative reasons although in a few cases (youth) could be split between employer and worker, or go to the worker (voucher for youth).
 - There could be behavioral responses that have not been studied yet
- **Targeting** (who is eligible):
 - **Individuals:** could be related to the employment status (e.g. unemployed, and length of unemployment), immigration/refugee status, education and skills, age, gender, participation in social programs, vulnerability groups, income.
 - **Firms:** in financial distress or about to shut down, selected industries, firm size, selected regions

Key design parameters (2)

- **Subsidy Amount:** proportional across wage levels, fixed subsidy as a proportion of negotiated wage (i.e. proportional to minimum wage as in UZ)
- **Duration:** usually between 6 to 24 months, depending on the objective of the subsidy
- **Modality of transfer:** payment for social security contribution, tax deduction, direct transfer, voucher
- **Conditionalities** for
 - **employers:** employers are not allowed to dismiss workers during the wage subsidy period (e.g. Macedonia); have to retain the worker once the wage subsidy expires (Albania, difficult to enforce)
 - **workers:** participation in life skills training (e.g. Lebanon and Tunisia)

Delivery process

- **Outreach and communication:** for both employers and potential beneficiaries targeted by the program through tailored approaches
- **Eligibility determination:**
 - Employers select eligible candidates
 - Jobseekers (vouchers)
 - Government agency (i.e. PES) determines eligibility
- **Eligibility verification:** government agency, usually PES
- **Payment:** employers do not receive payments ex-ante;
 - Employers are reimbursed for part of the labor/training costs that they have incurred.
 - Automatic subsidy in case of tax deductions and social security contributions;
- **M&E:** need of monitoring to enforce conditions (if any) and evaluate performance
 - Data: PES registry, tax administration data and Social Security systems, survey data, process data
 - Performance evaluation is needed to adjust parameters and ensure effectiveness; through process evaluation, experimental and non-experimental IE methods

Implementation challenges

- **Outreach:** Lack of information about the subsidies, especially among SMEs
- **Low take-up:** especially among employers when the subsidy amount is not large enough to compensate non-wage labor costs; or because of stigma effects
- **Eligibility verification may be costly:** when eligibility criteria (for both firms and workers) are complex and information systems are weak
- **Need strong monitoring and enforcing systems:** to check the conditions are met and benefits outweigh the cost of subsidy.
- **Transparency:** selection of workers and firm should be perceived as fair (within the eligibility conditions);
- **Private sector involvement:** it is important to win employer's trust, for example by involving the chamber of industry and commerce
- **Balance equity and efficiency goals:** give the subsidies to those who would have not found a job otherwise and find workers with whom employers can work/train (make them "happy")
- **Stigma:** when targeted to specific groups may create stigma effects by signaling to employers that productivity is lower among these workers

Effectiveness of Wage subsidies

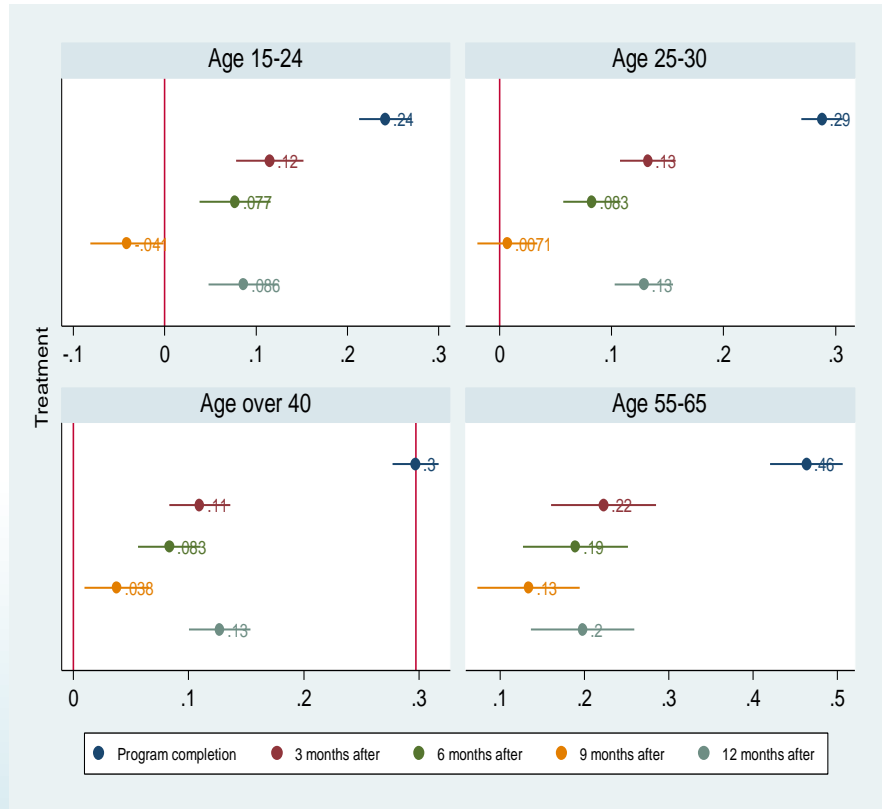
Results from impact evaluations

- Very little evidence from developing countries (mostly OECD and MICs)
- Studies focus on few labor market outcomes: mostly on formal employment, earnings; scant evidence on skills acquisition
- In general, it is difficult to measure substitution effects and dead weight losses. This requires RCTs and empirical strategies to measure general equilibrium effects (e.g. Crepon et al, 2008)
- Evidence from robust IEs indicates mixed results
- But difficult to generalize as programs vary in labor market conditions and design parameters

Mixed Results from impact evaluations

- Germany: wage subsidies can be useful to counteract negative business cycles in the short term (*Bernhard et al. 2008, Stephan 2010*)
- Macedonia: no employment impacts
- Jordan:
- Bosnia: Opportunity for All: positive employment effects, but heterogeneous → needs redesign (Balavac and Posadas 2018)
- Poland: males with subsidies were less likely to be hired (stigma?)
- Argentina: WS may have provided incentives for job search – still little take up from employers
- Morocco *Idmaj* seems to have been effective in placing beneficiaries in the presence of high labor cost (also improved the quality of jobs)

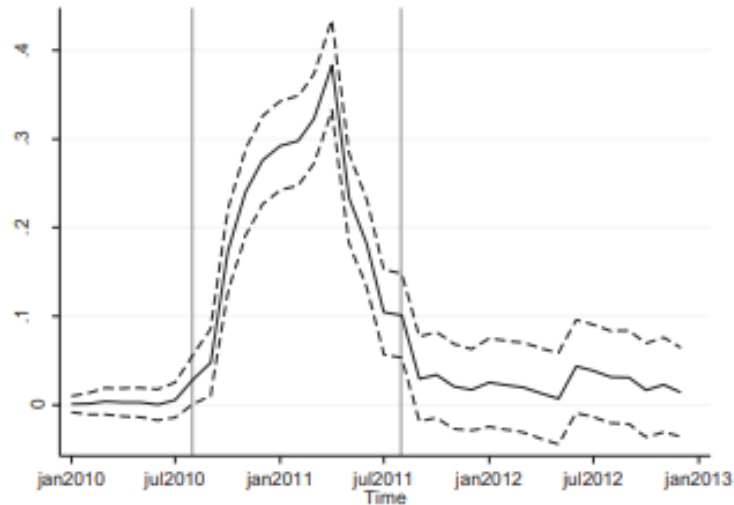
Bosnia and Herzegovina



- Subsidies equivalent to social security contributions
- Various subsidy programs: that vary
 - target groups: unemployed for more than 6 months, vulnerable groups (disability, women, etc.)
 - duration: largest program (Opportunity for all in FBH) for 6 months, youth for 12 months
- Online application until quota is achieved
- Has been in place since 2014: employers discount they will have access to the program
- Non-experimental evaluation (PSM) indicates
 - positive impact on employment: treatment shows 23% higher employment rates 12 months later after subsidy completion relative to control group
 - Increased job tenure, decrease job search times and job turnover
 - Higher impact on older workers, long-term unemployed, women, low skilled

Jordan

FIGURE I.—TREATMENT EFFECT ON EMPLOYMENT, BY MONTH



Design Parameters:

- Graduates assigned to the wage subsidy treatment were given a voucher that they could present to firms while searching for jobs
- Payee: The voucher had the graduate's name on it, was nontransferable,
- Amount: was worth 150 JD (USD \$210) an amount equivalent to the minimum monthly wage,
- Duration: a maximum of six months

IE Results:

- do not appear to have had large impacts on generating sustained employment for young, relatively educated women
- Short-term wage subsidies generated large and significant increases in employment while the subsidies were in effect,
- but most of these jobs disappeared when the subsidies expired

Macedonia

Figure 6 – Labor-market status of the participants

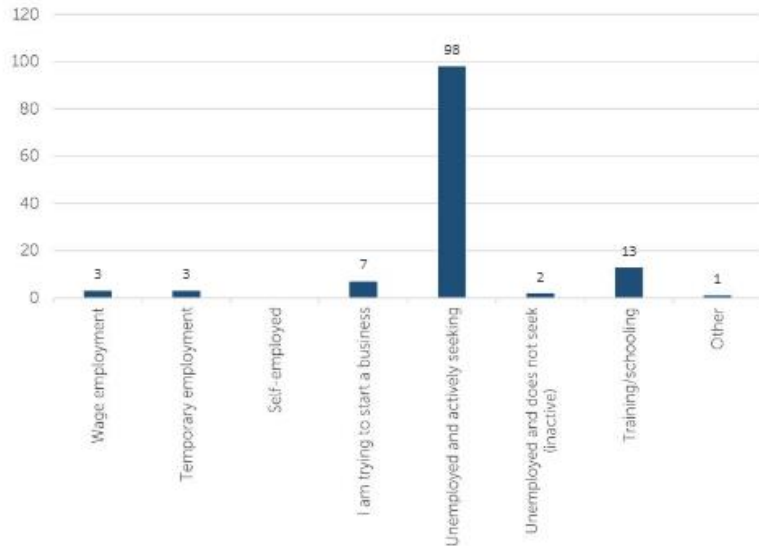
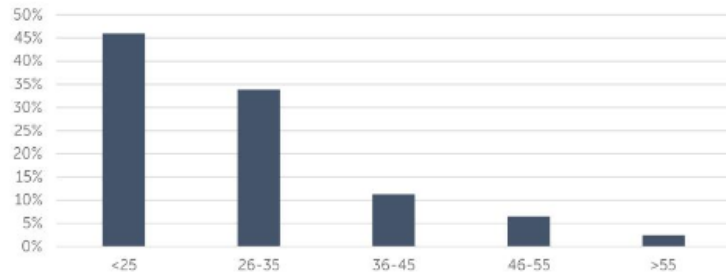


Figure 2 – Age distribution of the sample



Source: Own baseline survey

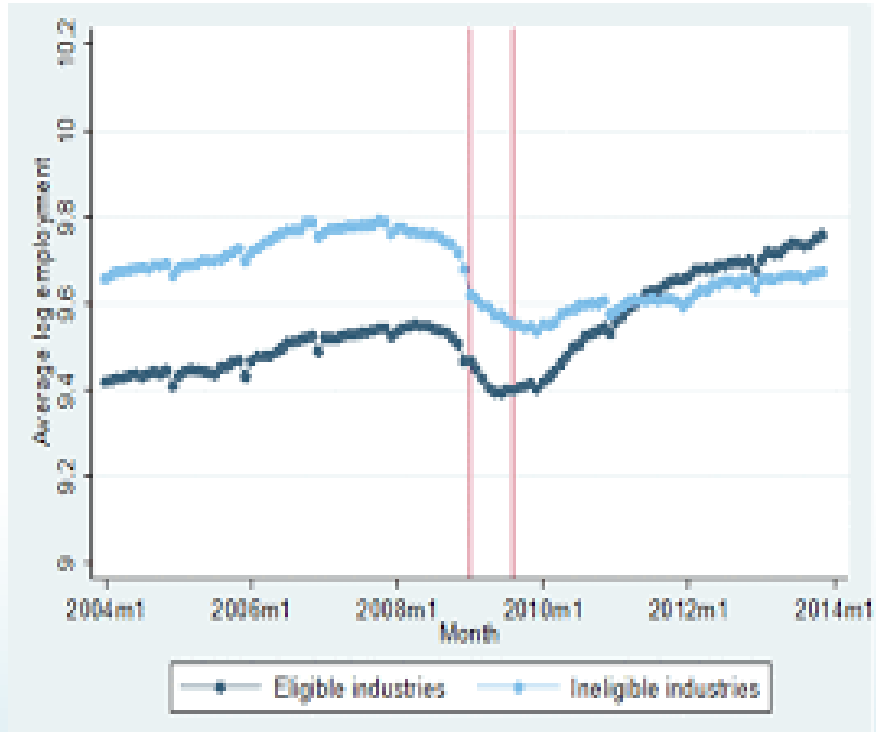
Design parameters:

- Wage subsidies (16,000 MKD per month) covering wage, personal income tax and social contributions.
- Duration: 6 months
- Employer conditionality: keep workers on job for additional 12 months.
- Eligibility: older workers (55-64), young unemployed (up to 27 years of age), redundant workers

Results from IE:

- No significant impacts
- Negative impact on employment after program end. Possible explanations:
 - used by employers to overcome short-term needs for workers
 - stigma effect

Mexico



Design parameters:

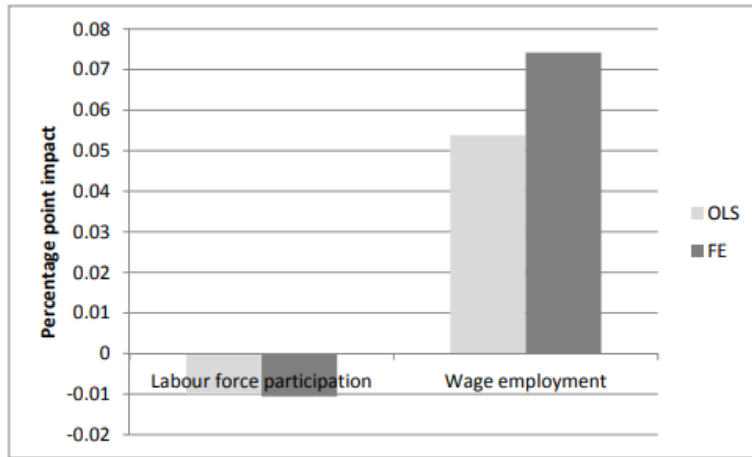
- Program granted firms in certain industries wage subsidies if they decided to keep their workers instead of letting them go during the economic crisis of 2009
- Large subsidy

Results from IE:

- Positive impacts, but not statistically significant, during the program's duration, ranging from 5.7 percent to 13.2 percent
- The impact of the subsidy appears to have continued and grown after the subsidy stopped
 - Industries eligible for the subsidy went back to pre-crisis employment levels two years before those not eligible (2011 vs 2013), with 24 percent higher employment
- No evidence that the results reflect movements from formality to informality, nor of displacement effects in other industries.

South Africa

Figure 4. The impact of the subsidy voucher, in percentage points, on labour force participation and wage employment one year after allocation



Note: These are the coefficient estimates take from the regression results in Table 2

Design Parameters:

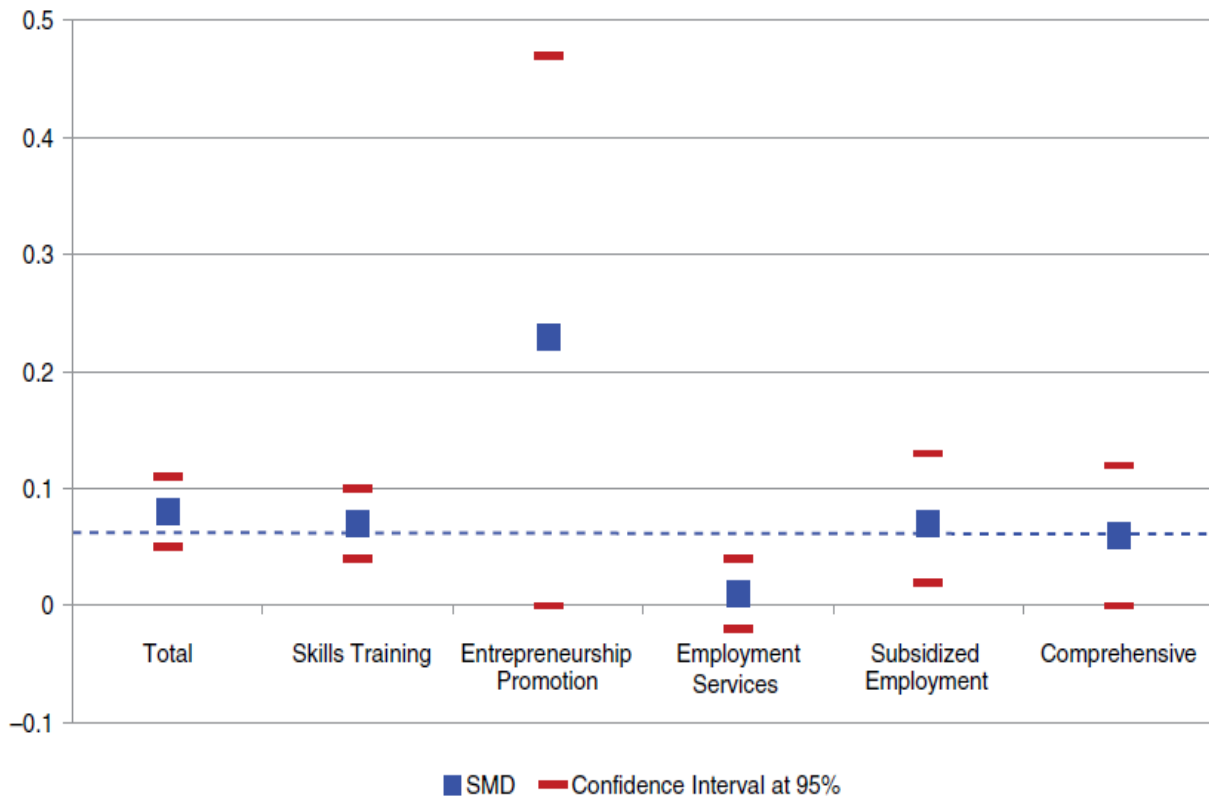
- Voucher for wages (around 40 percent of the actual monthly wages given)
- Duration: 6 months

Results from IE

- Those who were allocated a wage subsidy voucher were more likely to be in wage employment both one year and two years after allocation.
- The impact of the voucher thus persisted even after it was no longer valid.
- Those in the voucher group were 7.4 percentage points (approximately 25 percent) more likely to be in wage employment one year after allocation and of similar magnitude two years later.
- Relatively few firms actually claimed the voucher.

Meta-analysis

Impacts on employment



- **Modest effects on employment rates:** wage subsidies usually do increase employment for the duration of the subsidy but this impact is not sustained (*Kluve 2014*)
- **Potential distortionary effects in the long term** (*Kluve 2014*),
- ... And deadweight loss (*Betcherman, Daysal, & Pagés 2010*)

World Bank Projects supporting wage subsidies

- Bolivia: Improving Employability (P143995)
- Bosnia and Herzegovina: Employment Support Project (P152347)
- Mexico: Mexico Youth Labor Market Inclusion (P163362)
- Uzbekistan: Strengthening the Social Protection System (166447)

Some interesting features of subsidies in recent WB projects

Bosnia and Herzegovina

Design Parameters:

- Target group: youth, older workers, low skilled, workers w/disabilities; having been unemployed for at least 6 months
- Amount: equivalent to SSC (most of the time).
- Duration: 6 to 12 months
- Eligibility: formal sector job (which can be verify).
- Payee: employer

Context:

- High levels of unemployment, high levels of informality
- Various programs, and design parameters need to be calibrated

Interesting features:

- Project reimburses for re-design of program to increase impact and/or cost effectiveness
- Project supports building the information systems and developing capacity to be able to evaluate the performance of the programs, in order to redesign them

Mexico

Design Parameters:

- Target group: youth who are finishing high school and entering the labor market.
- Amount: a top-up over the entry-level wages for formal employment.
- Duration: 6 months
- Eligibility: first formal sector job (which can be verify).
- Payee: youth (as if it were any other government transfer), so that prospective employers do not know who is receiving it or not

Context:

- High-ability youth can gain higher entry-level wages in the informal rather than in the formal sector. The formal sector pays relatively low entry-level wages as they cannot distinguish who is high/low ability and likely to be a good fit (not to rotate), however wages increase rapidly after the first 6 months (once employers can observe worker productivity). Has implications for the long-run, as a first informal job seems to be a predictor of poverty.

Conclusions

Could work...

Measure (seriously measure)
and adjust

Resources

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- Katalin Bördos, Márton Csillag, Ágota Scharle. *“What works in wage subsidies for young people: A review of issues, theory, policies and evidence”* EMPLOYMENT Working Paper No. 199 (2015)
- James Levinsohn, Neil Rankin, Gareth Roberts And Volker Schöer. *“Wage subsidies and youth employment in South Africa: Evidence from a randomised control trial.”* Stellenbosch Economic Working Papers: 02/14
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- Neumark, David. *“Spurring Job Creation in Response to Severe Recessions: Reconsidering Hiring Credits.”* NBER Working Paper No. 16866. (Issued in March 2011, Revised in August 2012)