

Wage Subsidies for Employment

*Supporting Low-Income Youth Transitions
from School to Formal Work in Mexico*



WHAT ARE WAGE SUBSIDIES?

- One type of the broad menu of **Active Labor Market Policies (ALMP)**, also called employment or hiring subsidies
- **Definition:**
A public transfer from the government to **employers** or **workers** aimed at reducing the **cost of labor for firms** and increasing **take-home pay for workers**¹
- **Objectives:**
 1. Expand job opportunities for individuals who **would not be hired if left to the market**
 2. Support **human capital accumulation** (via learning-by-doing) or prevent skill loss among the unemployed
- **A temporary policy tool:**
Designed as a **time-bound intervention** with a fixed duration
- **Track record:**
Mixed findings in early evaluations, but **recent evidence shows more promising results**
Displacement and substitution effects, stigma effects, short-lived impacts, limited cost-effectiveness

MOTIVATION

THE LONG-TERM EFFECTS OF A FIRST JOB

- A young person's **first job**—whether formal or informal—can represent a **critical step toward either economic inclusion or exclusion**.
 - Evidence from transition matrices in Mexico and from the educational and labor trajectories of pilot participants suggests the presence of “**path dependence**.”
- **Wages** in informal jobs tend to remain flat over time, while wages in formal jobs tend to grow by around 25% in the first six months, and up to 35% after one year, due to skill acquisition on the job.
- Youth entering the labor market **tend to prefer informal jobs** because of **short-term** advantages, including:
 - **Higher initial hourly wages** (9–17% higher than formal jobs)
 - Shorter commuting times
 - Greater flexibility

STUDY SETTING AND SAMPLE

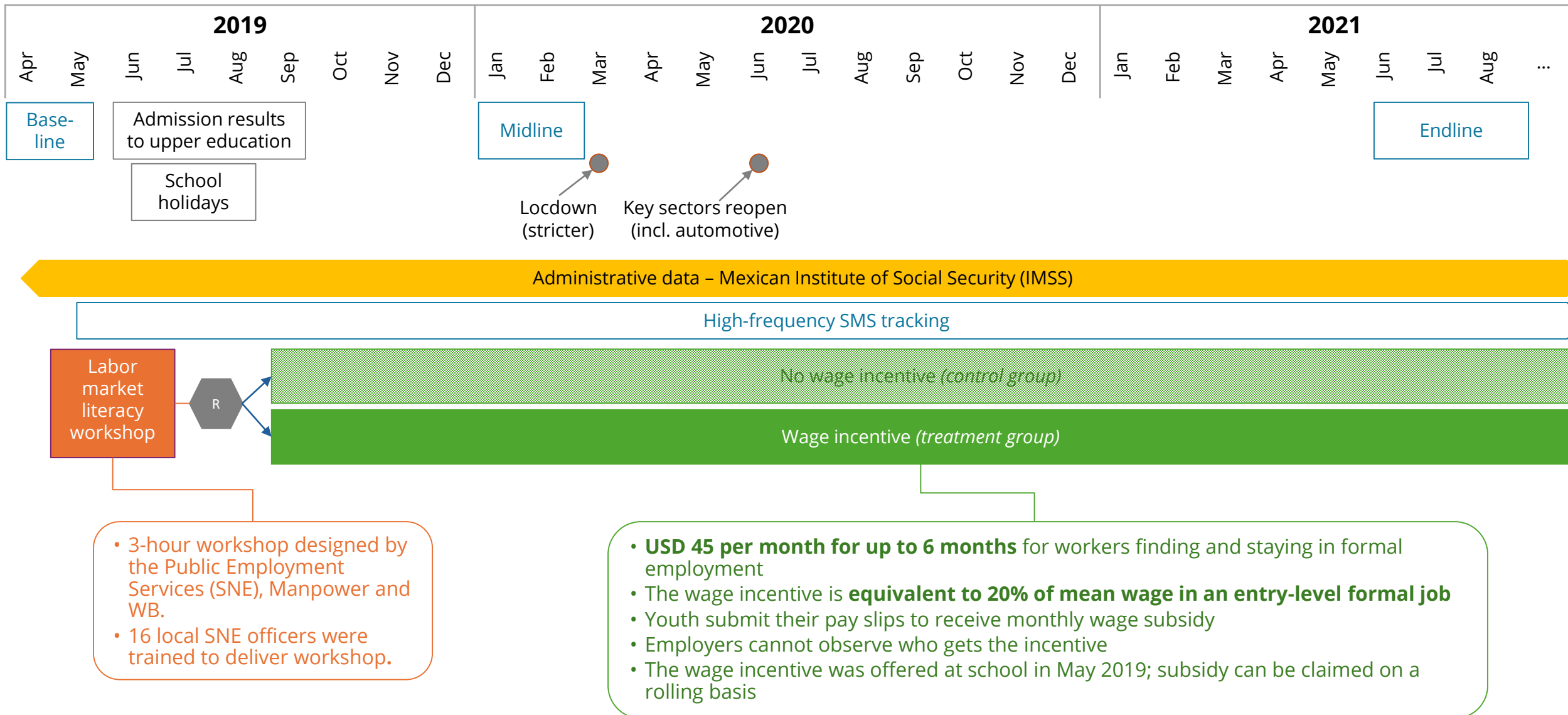
- **Study area:** San Luis Potosi
- **Project:** Multisectoral initiative supporting low-income youth's transition from school to formal work.
- **Sample:** 2,000 low-income youth (incl. former Prospera CCT) graduating from upper-secondary education (vocational, academic and mixed track schools), across 13 schools located within 80 km from the industrial area
- **Baseline characteristics:** age: 17.8, 50% female, 2% married, 18% have formal work experience, 55% plan to work after secondary graduation (unintended consequences?)



Mexico's labor market:

- Pre-covid unemployment rate: 3.5% (total), 6% (youth 18-32 y.o.)
- Informality rate: 56.5% (total), 60.5% (youth 18-32 y.o.)
- Informality criteria: social security contributions, self-employment, commission work
- Social security contributions from firms are equivalent to 26% of formal wage rate (Levy 2016)

INTERVENTION AND IMPLEMENTATION TIMELINE



MAIN FINDINGS

- **Increase in the formal employment rate** by 4.2 percentage points (14.5%) two years after the offer, among graduates from technical or technological upper-secondary schools.
 - The effect is strongly driven by youth working under a **permanent contract**.
 - Half of the effect comes from a **reduction in informal employment**.
- **No evidence of unintended consequences:**
 - The offer of the temporary wage subsidy has **no effect** on **study decisions** for graduates of general schools, nor among students who indicated at baseline plans to continue studying after finishing upper-secondary education.
- **Greater job stability:**
 - Lower **risk of job exit** (26% lower) among those who start with temporary contracts
 - Longer **duration in formal employment** (1 month or 14.8% longer)
 - Greater accumulated experience has a positive impact in the **daily wages** in formal employment.
- **Strongest gains for those expected to benefit most:**
 - The effects on employment are strongly concentrated among **low- and middle-income youth**, as well as among graduates of **technical and technological upper-secondary schools**, and **youth who planned to work** upon graduating from upper-secondary education.

MECHANISMS

- There are three factors that help explain **young people's preferences regarding employment**, why the formal sector may seem unattractive to them, and why a monetary incentive could help address the problem:
 1. **High reservation wages:**
On average, study participants have a **reservation wage** that is **25% higher** than the initial wage they would earn in a formal job, which discourages entry into formal employment.
 2. **High discount rates:**
Youth discount payments they would receive in one year by at least **75%** compared to payments within a month.
 3. **Underestimation of formal sector wage growth:**
While beliefs about wage growth in the informal sector are relatively accurate, most participants **significantly underestimate wage growth in formal jobs**.

WHAT DID WE LEARN?

- Wage subsidies can work
 - Modest, time-bound incentives helped youth enter and stay in formal jobs.
- Right tool for the right problem / group
 - Effectiveness depends on **local labor market context** (latent demand, barriers).
 - Strongest effects concentrated among **younger youth ready to work** and from lower-income backgrounds, highlights the value of **targeting** and **tailoring**.
- Better data, better insights
 - Combining high-frequency admin data and survey data captured outcomes and behavioral drivers.
 - Track multiple outcomes—because impacts may show up on different margins.
- Behaviorally-informed design and delivery matters
 - Paying youth (not firms) boosted take-up and avoided hiring distortions.
 - Contact times, hours of operation, electronic verification and payment, and streamed processes. help boosted take-up and reduced friction

WHERE ELSE CAN WAGE SUBSIDIES WORK?

- Support worker **retention** during downturns and economic recovery in advanced and middle-income countries
- Stimulate **labor demand** in rural areas or declining industries facing job losses
- Promote **hiring** of women, older workers, persons with disabilities, long-term unemployed
- Test **innovative models** for apprenticeships or work-based learning for first-time workers
- Encourage **participation in formal sector** through short-term incentives to firms or workers
- **Shifting labor** into emerging sectors like care, green jobs, or tech

Thank you!

REFERENCES:

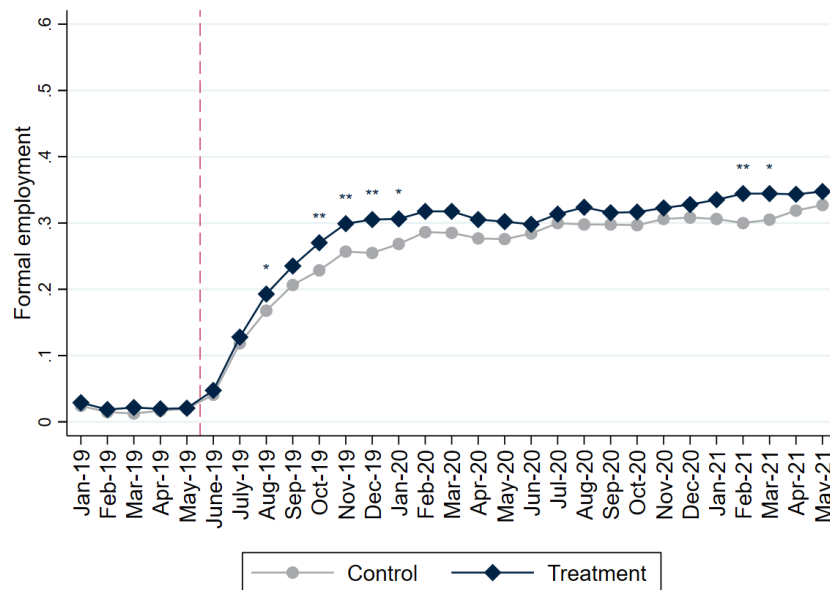
- Abel, Martin, Eliana Carranza, Kimberly Geronimo, Maria Elena Ortega (2025) “Can Temporary Wage Incentives Increase Formal Employment? Experimental Evidence from Mexico.” [WPS10234](#), World Bank.
- Weber, Michael. “Fostering Employment through Wage Subsidies.” World Bank.



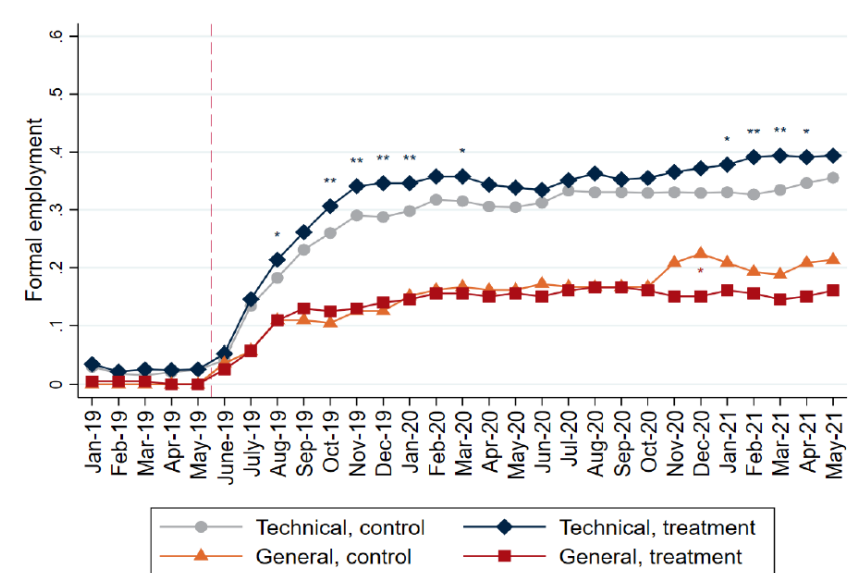
FORMAL EMPLOYMENT

- Large and significant **gains in formal employment** after graduation and maintained for 4 months (5pp / 20%)
- The effects are **larger for those planning to work** (8pp / 25%)

a. Share with formal work by treatment



b. Share with formal work by treatment and school type



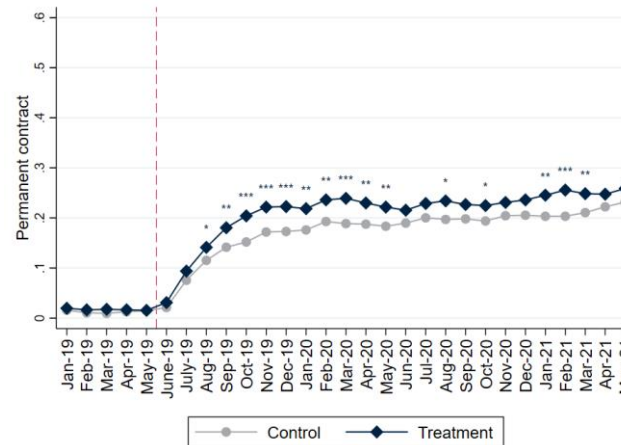
Note: Standard errors are robust. The p-value of the difference in means between treatment and control groups is denoted by *** $p < 0.01$, ** $p < 0.05$, * $p < 0.1$. The dotted line indicates the start of the intervention.

Source: Author's calculations using IMSS data.

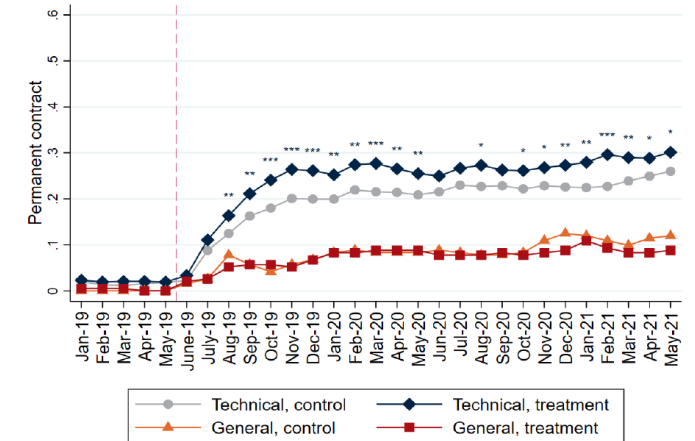
EMPLOYMENT BY TYPE OF CONTRACT

- The increase in overall formal employment is driven by an **increase in employment with permanent contracts**
- Significant effects on jobs with permanent contract for almost all post-treatment periods (5pp / 34%)
- No effect on jobs with temporary contracts

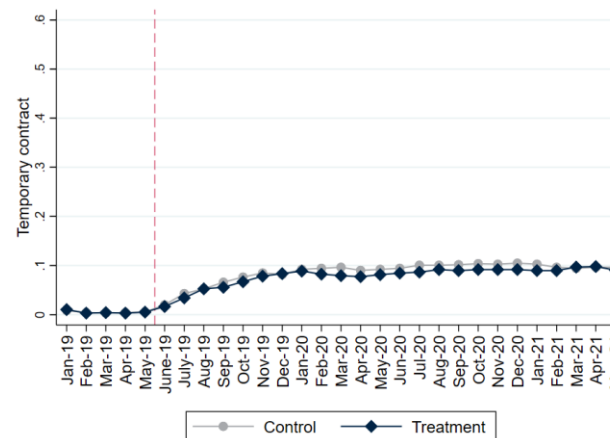
a. Share with permanent contract by treatment



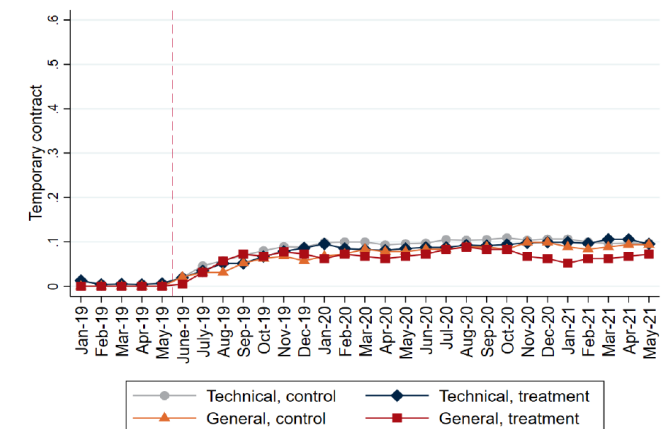
b. Share with permanent contract by treatment and school type



c. Share with temporary contract by treatment



d. Share with temporary contract by treatment and school type

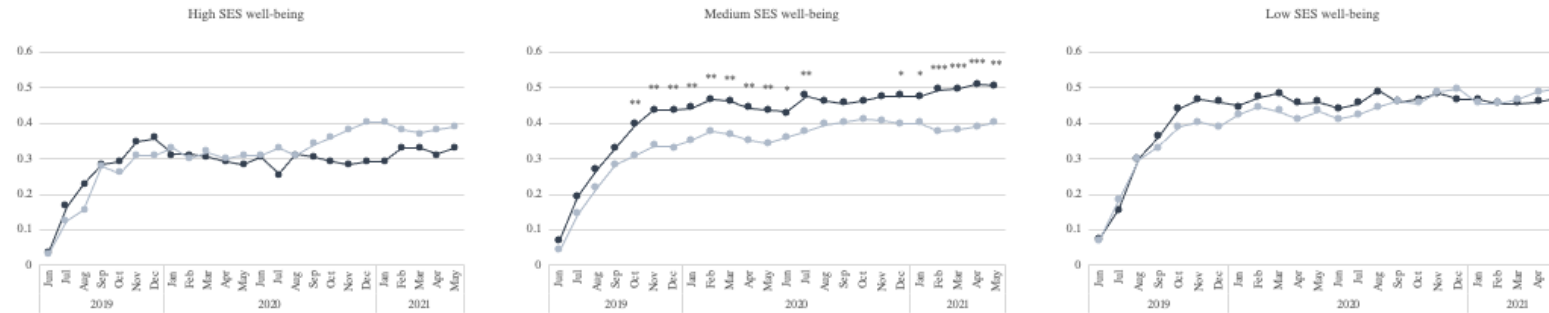


Note: Standard errors are robust. The p-value of the difference in means between treatment and control groups is denoted by *** $p < 0.01$, ** $p < 0.05$, * $p < 0.1$. The dotted line indicates the start of the intervention.
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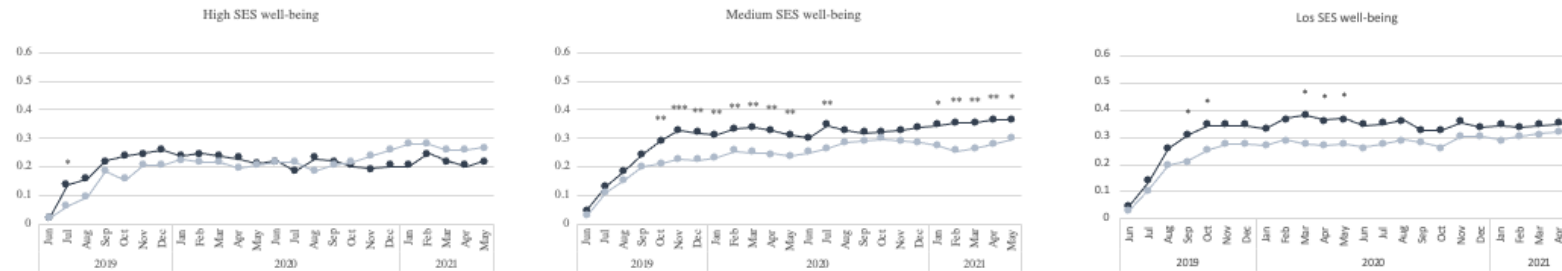
EMPLOYMENT EFFECTS

Employment effects by socio-economic status

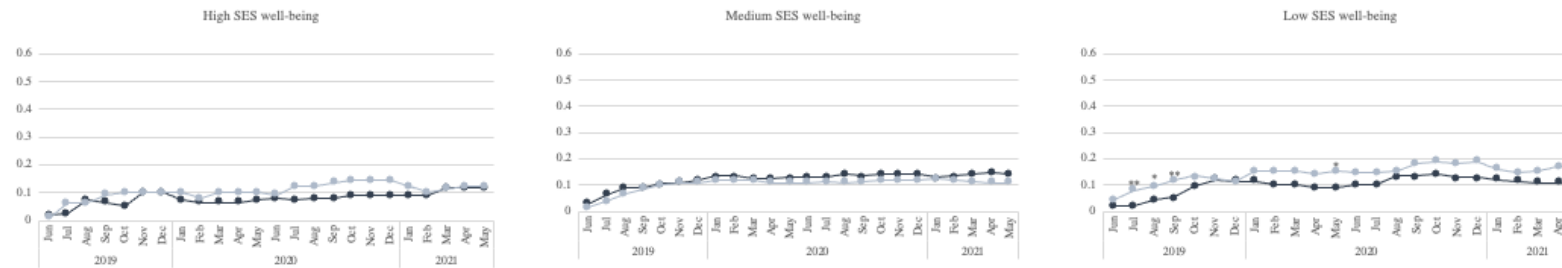
Panel A. Share with formal work



Panel B. Share with permanent contracts



Panel C. Share with temporary contracts

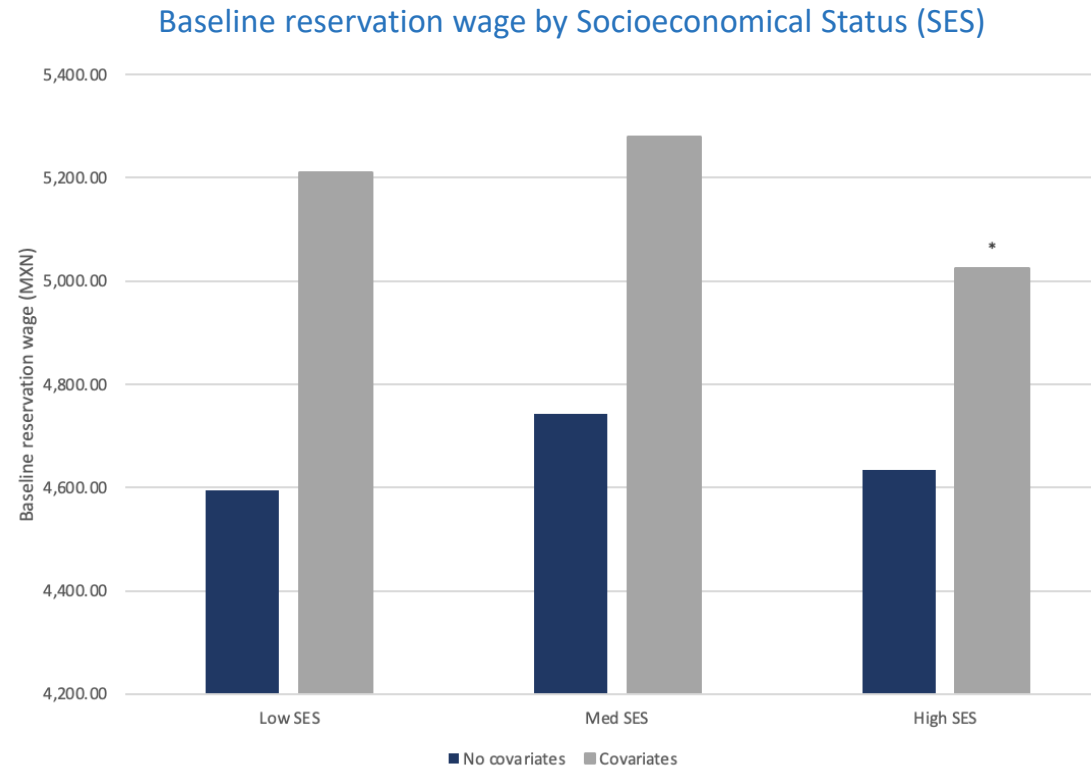


—●— treatment —●— control

Note: Standard errors are robust. The p-value of the difference in means between treatment and control groups is denoted by *** $p < 0.01$, ** $p < 0.05$, * $p < 0.1$. The level of vulnerability is calculated using the SES Index methodology developed by the Mexican Association of Market Intelligence and Opinion Agencies (AMAI). Source: Author's calculations using IMSS data.

RESERVATION WAGE BY SOCIO-ECONOMIC STATUS

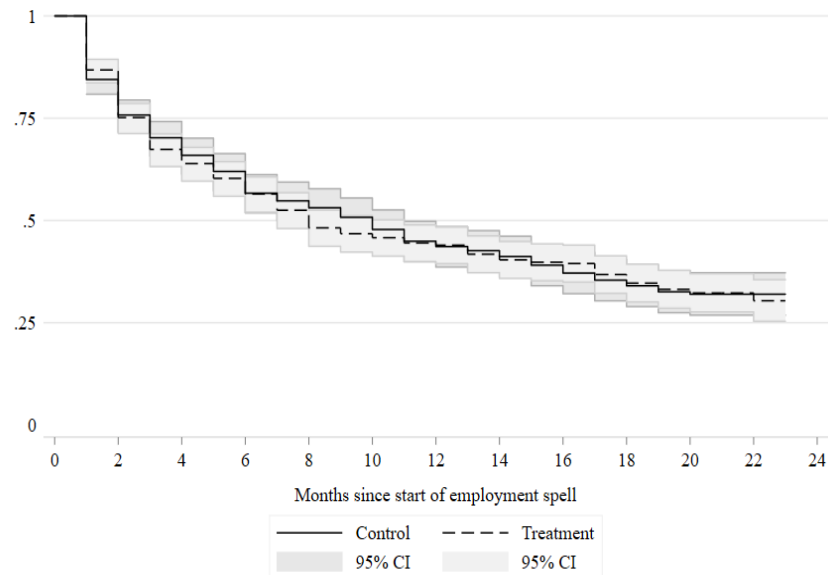
- Youth with higher SES report lower reservation wage at baseline



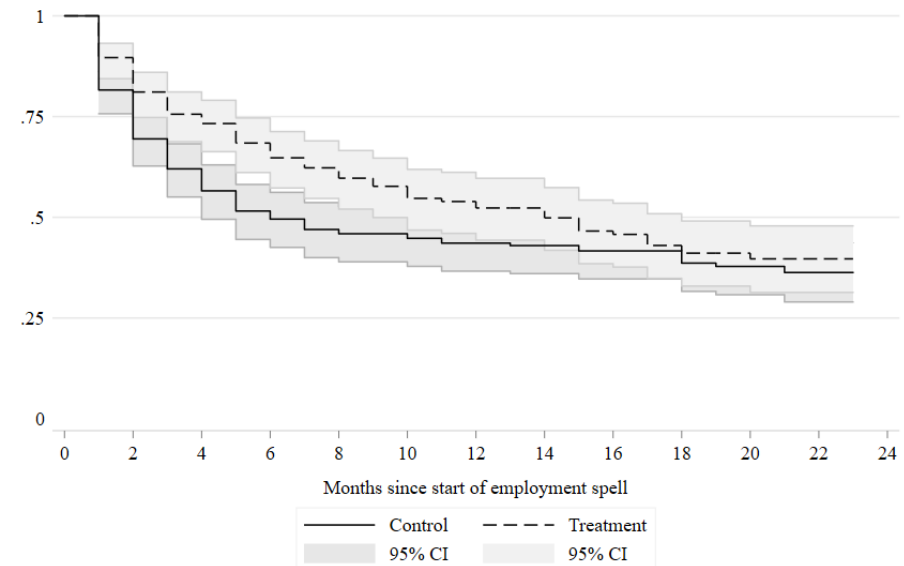
RETENTION

- The wage incentive decreases the risk of recurrent exits from employment by 36% for those on a job with temporary contract
- No effect in survival time at formal employment for youth with permanent contracts

a. Survival in formal employment spell initiated with a permanent contract



b. Survival in formal employment spell initiated with a temporary contract



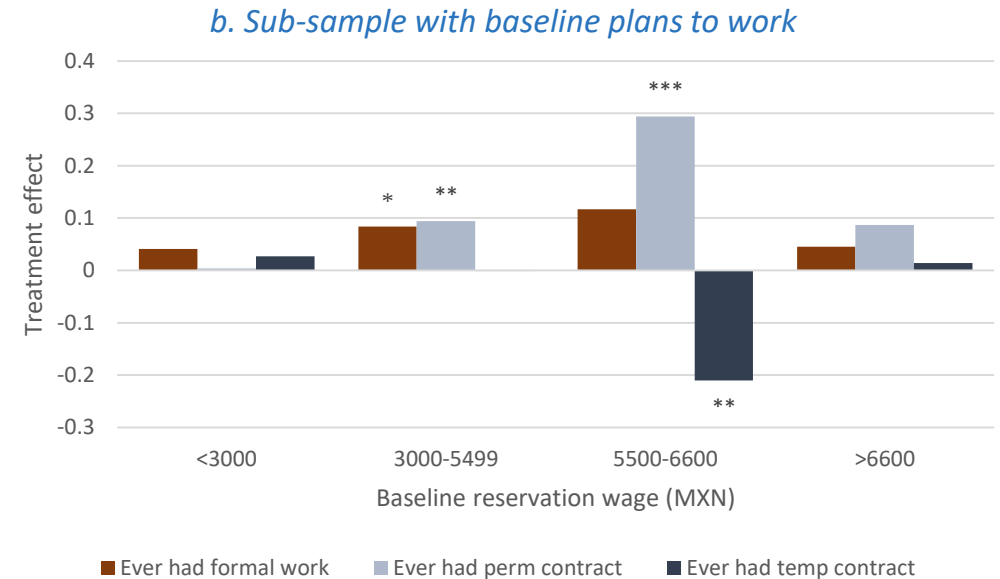
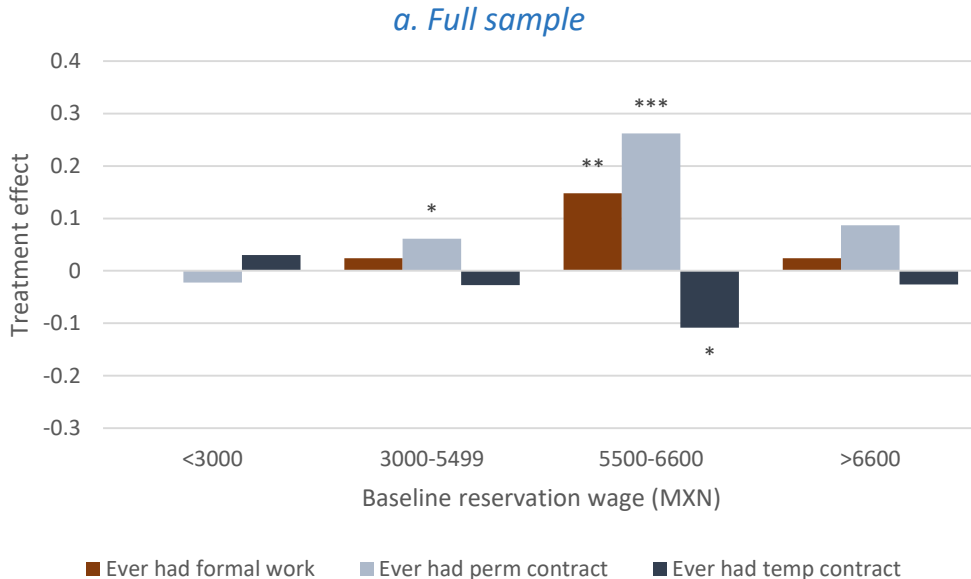
Notes: Kaplan-Meier survival function with recurrent events. Recurrent hazard model allows for individuals to experience multiple exit events. Observations are person-spells. The universe for (a) includes 705 youth who initiated at least one employment spell with a permanent contract during the study period (June 2019-Dec 2020), while the universe for (b) includes 359 youth who initiated at least one employment spell with a temporary contract during the study period. Total youth sample is 1,924.

Source: Author's calculations using IMSS data.

EMPLOYMENT EFFECTS BY RESERVATION WAGE

- At baseline, the average reservation wage is 25% above the average starting wage of formal sector jobs
- For the full sample, the largest treatment effects are found in the third quartile
- The treatment effects are more pronounced among youth with plans to work at baseline
- Largest treatment effect for “compliers”: gain in formal employment and switching from temporary to permanent contracts

Wage incentive treatment effect on employment outcomes by reservation wage range



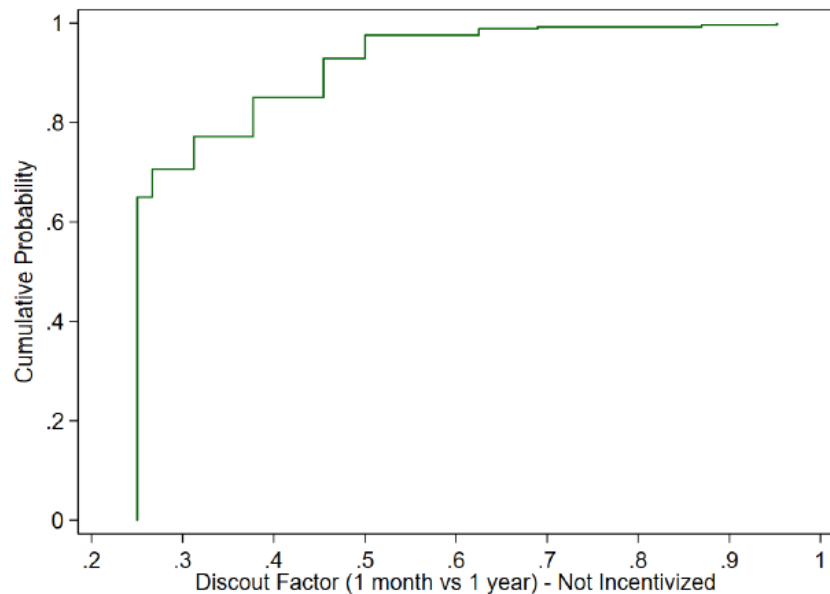
Notes: Standard errors are robust, *** $p < 0.01$, ** $p < 0.05$, * $p < 0.1$. Monthly reservation wages. Cumulative treatment effects over June 2019-May 2021.

Source: Authors calculations using IMSS data

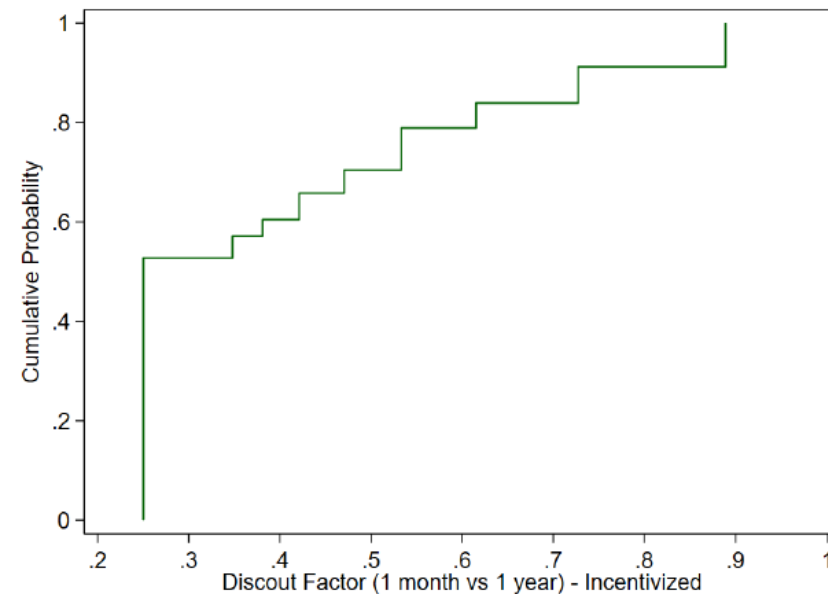
DISCOUNT RATES OF FUTURE PAYOUTS

- A majority of youth discount payouts in one year by at least 75% compared to payouts in one month
→ 65% of youth in non-incentivized and 52% in incentivized elicitation
- Therefore, jobs with lower starting wages but future wage growth are relatively less attractive

a. Discount factor (Not incentivized)



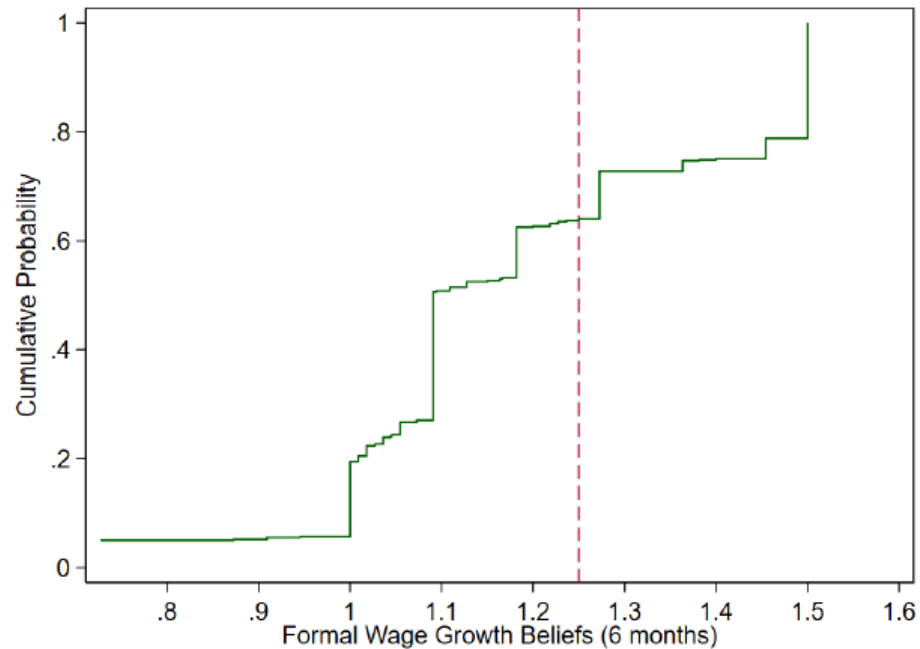
b. Discount factor (Incentivized)



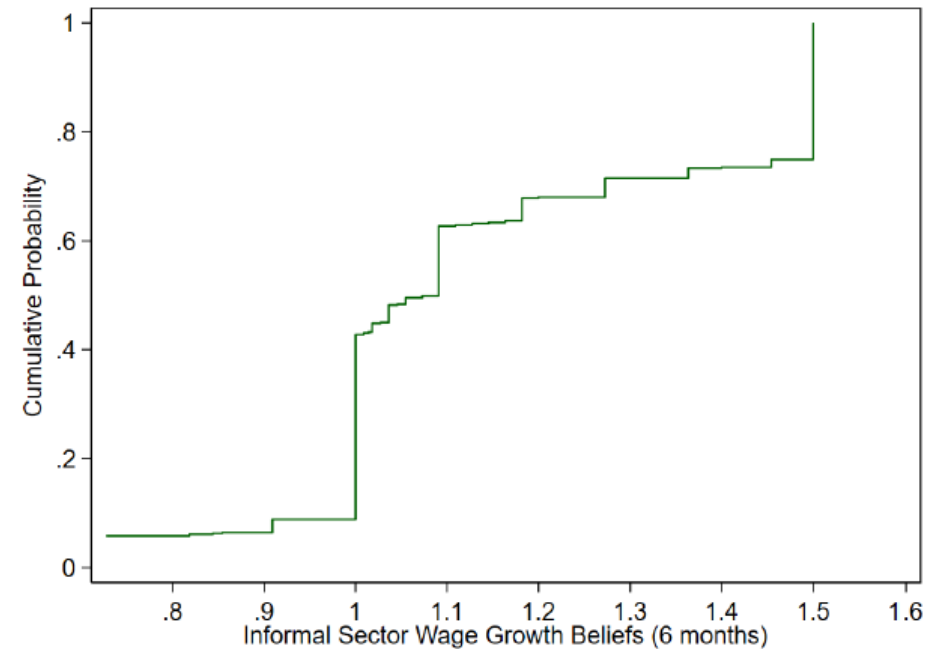
WAGE GROWTH BELIEFS

- The majority of participants substantially underestimate wage growth in formal jobs
 - 20% believe that there is no wage growth, and the median belief wage growth is less than 10%
- Beliefs about informal sector wage growth are more accurate

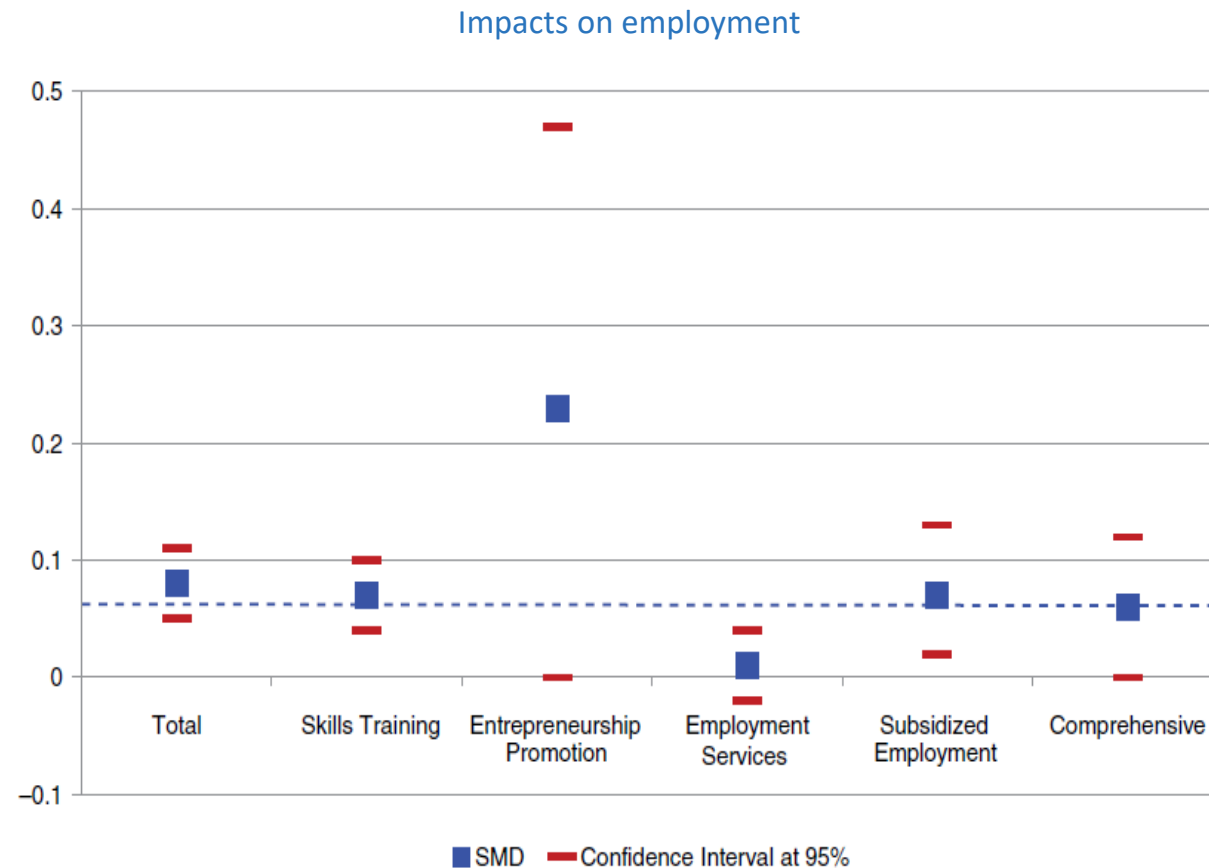
a. Beliefs on formal wage growth



b. Beliefs on informal wage growth



META-ANALYSIS



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*)

KEY DESIGN PARAMETERS

- **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 frequently 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; discouraged out-of-labor force), education and skills level, age, gender, participation in social programs, vulnerable groups, immigration/refugee status, income.
 - **Firms:** in financial distress or about to shut down, selected industries, firm size, selected regions

KEY DESIGN PARAMETERS (cont.)

- **Subsidy Amount:** proportional across wage levels, fixed subsidy as a proportion of negotiated wage (the minimum wage)
- **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 related 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