Public submission on 2016 Taxation Laws Amendment Bill (Second Batch): Employment and Learnership Tax Incentives

05 November 2016

Att: Standing Committee on Finance

c/o: Mr Allan Wicomb (Committee Secretary)

Dear Chairperson and Honourable Members,

The purpose of this submission is to briefly address one specific question raised by the above Bill, namely: should Parliament approve the extension of the Employment Tax Incentive when it expires at the end of 2016?

Below I raise a number of serious concerns about the basis for the proposed extension. Given these I caution against rushing in to an unconditional extension of the policy. I instead outline a 'second-best' alternative that does more to identify whether the policy is in fact a success and whether it merits extension.

Unfortunately I am unavailable to make a verbal presentation to the Committee on the 9th of November.

Yours sincerely,

Seán Muller

(in my individual, professional capacity)

UNIVERSITY OF JOHANNESBURG

Dr Seán M. Muller
Senior Lecturer: School of Economics and Econometrics (IDEP MPhil programme)
Faculty of Economics and Financial Sciences
Email: seanm@uj.ac.za
Tel +27 11 559 7456

A History of Inadequate Evidence

In 2013 I made submissions to Treasury and SARS arguing that the original 'youth employment tax incentive' proposal was flawed because the evidence and argument in support of the policy was inadequate. I have attached to the current submission my original submission to Treasury and SARS in 2013, a Mail and Guardian article on the subject from 2014 and my more recent submission to Treasury and SARS on the current proposal.

The core of the original criticism was two-fold:

1. Despite claims to the contrary, there was no evidence to support the position that such an incentive would create new jobs
2. If the incentive was implemented without creating jobs, the result would be to 'transfer' significant public resources (foregone taxes) to firms – increasing inequality.

Three years later, we are none the wiser. Although there is evidence on uptake by firms, there is no evidence showing whether the jobs firms are claiming for are ones created because of the incentive or ones that would have been created anyway. This is acknowledged in the Treasury's Employment Tax Incentive Descriptive Report:

It is not possible to use descriptive data to determine whether these supported jobs are new jobs created, jobs that have been saved from being lost or jobs that would have been created anyway

While there are indeed technical challenges involved, the result is that Members of Parliament have no evidence upon which to base a decision. Worse, in the absence of this evidence, it is unclear whether high uptake is a good thing or a bad thing. Given the magnitude of the amounts involved (now over R4bn/year) and many pressures on the fiscus, this is concerning. It is concerning that the research that might inform such a decision may only be published after the renewal decision is taken. The principle of extending a policy because an assessment has *not* been completed could be easily abused.

A further critical issue is the apparent absence, in the documentation I have seen provided to the committee, of estimates of the foregone revenue under the two difference scenarios over the medium-term expenditure period. I cannot see how the Committee can make a decision in the public interest without such information. Indeed, I would argue that such consideration is *required* of the Committee by 11.3(a) and 11.3(c) of the Money Bills Act. What is the total cost, is that affordable in the current environment, and might there not be better uses for some of those funds?

In the comments sent to Treasury and SARS I caution about the broader precedent that the ETI may set in deciding whether to continue policies in the absence of adequate evidence. One of the critical components of a developmental state is an ability to experiment and learn, necessitating a willingness to acknowledge failure. This is one area where South Africa continually fails, keeping ineffective policies and interventions on 'life support' (with injections from public finances) indefinitely. The approach to the ETI appears to merely continue this pattern.

Way forward

Neither of the Treasury's two proposals – a simple extension, or extension with a cap – addresses the above concerns.

Ideal approach

An ideal approach to the approval process might be as follows:

1. Treasury provides the committee with an estimate of the likely fiscal cost of the incentive over the next three calendar years, with and without the proposed cap.
2. Treasury should provide the Committee with, and publish, all research it has commissioned and referenced. Furthermore, any researcher should be given access to the (suitably anonymised) administrative datasets to conduct independent estimates of the policy's effect.
3. The Parliamentary Budget Office – as per its mandate in 15.2(b) of the Money Bills Act – conducts its own, independent microeconometric assessment of the policy and produces a report for the committee that also synthesises research provided by Treasury. The PBO also assesses the reliability of the total cost estimates.
4. The Committee has public hearings on the above and then decides whether to extend the policy. If the decision is not to extend, there could be consultation with the Standing Committee on Appropriations in order to provide Treasury with a recommendation as to what other initiatives or Budget votes the funds could be redirected to.

Unfortunately, there is now insufficient time for such a process in the current year, and the PBO does not at present have the technical capacity to conduct a credible microeconometric analysis of its own.

Second-best approach

Despite the constraints, it should be clear that an unconditional renewal of the policy would be problematic. A second-best approach, within current constraints, might incorporate the following:

1. Treasury provides the committee with an estimate of the likely fiscal cost of the incentive over the next three calendar years, with and without the proposed cap.
2. The Committee extends the proposal for a further year (until 31 December 2017)
3. A cap is placed on the *total amount* that can accrue in foregone taxes through this incentive. Given the initial projections of R5bn over 3 years, a cap of R4bn seems generous in the current environment of low growth and underperforming revenue.
4. The Committee requires that National Treasury publish all relevant research to date, and give independent researchers access to the relevant dataset, by the end of January 2017.
5. The Committee schedules public hearings for mid-2017 to make a more final decision as to the extension, or termination, of the incentive.
6. The above hearings could include an invitation to experts and members of the public to present on alternative uses for the R4bn/year that relate to supporting unemployed youth.

Brief Notes on Statements Made During 10 October Meeting

The PMG minutes of the SCoF meeting on 10 October 2016 provide further arguments and information relating to evidence on the effect of the ETI that had not previously been placed in the public domain. *My comments are in italics.*

- Treasury asserts that Prof Rankin "worked with NT on the tax data and...found that there is a positive effect on employment at a firm level of between 2.4 and 15.9% growth in youth employment. These positive effects are particularly pronounced for smaller employers". *It would be desirable if such analysis was conducted by an independent expert, who had not been involved in advocating the original intervention, and placed in the public domain so that it can be scrutinised by other experts.*
- Treasury refers to a presentation by Prof Bhorat to NEDLAC in which it is argued that the ETI "compares favourably with other government initiatives on a cost per job basis". *It is unclear how such a comparison was possible given that we do not know how many jobs, if any, were created as a result of the initiative. The low 'cost per job' could simply reflect the fact that few of the jobs were actually created because of the incentive.*
- There is acknowledgement that none of the studies done find an effect at the national level, but Treasury refers to Prof Bhorat as suggesting that "the Quarterly Labour Survey may not be the right tool to use to determine the effect of the ETI". *While it is true that the Quarterly Labour Force Survey has serious limitations, no-one – including Treasury – has yet provided a better approach for identifying a national effect (or non-effect).*
- Treasury states that "All the research presented to NEDLAC would be made available to the Committee once the report is finalised". *One wonders whether such research, with all relevant information, will be provided to SCOF and placed in the public domain in time for an informed decision to be made?*