**WAGE SUBSIDIES: WHAT WORKS AND FOR WHOM?**

**International, Canadian and Australian evidence**

**MALCOLM COOK**

**ANGUS KNIGHT RESEARCH PAPER SERIES** **October 2023**

**NO. 2023-03**

Malcolm Cook is an economist with extensive experience in labour market policy and analysis. Malcolm was a Lecturer in Economics at the University of New England and Southern Cross University and has authored over a dozen refereed publications on labour statistics, Australian economic history, economic policy, and health economics. After leaving academia Malcolm worked as an employment policy adviser in the Australian Public Service, contributing to the development of Australia’s employment services model, including Job Network, Job Services Australia, jobactive and the Remote Jobs and Communities Program. He now works with Angus Knight researching labour market trends and advising on employment policies.

# **Introduction**

This paper reviews international, Canadian, and Australian evidence on the effectiveness of wage subsidies in helping unemployed job seekers find sustainable employment. The key question asked is “what works and for whom?” There is evidence indicating that wage subsidy programs can be effective, but only if appropriately targeted.

# **What are wage subsidy schemes?**

Wage subsidy programs involve payments to employers to help cover the wages of an employee typically. Wage subsidies provide an incentive to hire disadvantaged unemployed people by reducing the risk of hiring and can recognise lower productivity.

A key issue with wage subsidy programs is that they can have substitution and displacement effects which limit their effectiveness. In particular:

* Employers may hire a job seeker who is receiving a wage subsidy in preference to a job seeker who may be more efficient but not eligible for a wage subsidy.
* Employers may take on a job seeker receiving a wage subsidy and lay-off an existing employee. Typically wage subsidy programs seek to prevent this through guidelines preventing employers from laying-off workers to obtain a wage subsidy for new employees and excluding employers who have recently laid-off workers.

There is general consensus that deadweight costs and displacement effects are around 90 per cent, meaning that for every 100 jobs subsidised 10 additional jobs are created. However, all things being equal, it is likely that deadweight and displacement would be lower in labour markets approaching full employment and/or with chronic skills and labour shortages. Consequently, wage subsidy schemes will probably be more effective for highly disadvantaged job seekers in strongly performing labour markets. These are conditions being experienced in economies such as Australia and Canada right now.

# **What is the evidence?**

## **International evidence**

There is significant evidence that wage subsidies can be effective in generating sustainable employment if tightly targeted. Some key studies and conclusions reached include:

* Kluve’s (2010) review of European labour market programs concluded that “wage subsidies ... can be effective in increasing participants’ employment probability”.
* A review of literature by the OECD (2005, p.183) found “hiring subsidies frequently find a positive impact of participation on employment even when ‘employment’ is defined to arise only after a transition to unsubsidised employment”.
* The Department for Work and Pension’s (2012) evaluation of the UK Future Jobs Fund concluded that the wage subsidy element had positive effects on employment outcomes for the unemployed, resulting in a net benefit in terms of additional income of approximately £4,000 per participant.
* Van Reenan (2001) found that the UK New Deal for Young People led to a significant increase in flows into employment for young males with most of the effect coming from wage subsidies and enhanced job search requirements.
* Denny, et.al. (2000) showed that wage subsidies increase long-term employment rates for youth in Ireland.
* Martin (1998) indicated that it “may be possible to raise the size of net employment gains associated with private sector wage subsidies to 20–30 per cent or more via tight targeting of the measures to particular groups among the unemployed and monitoring of employer behaviour in order to curb abuses” (p.16). However, the more administrative controls are put in place the less likely are employers willing to employ job seekers using wage subsidies.
* Martin and Grubb’s literature review (2001, p.21) point to evidence that the more wage subsidies are targeted at the most highly disadvantaged, the greater is the ‘stigma effect’, discouraging job seekers from taking them up and making employers shy away from such schemes.

## **Canadian evidence**

An analysis of Canadian Targeted Wage Subsidies by O’Brien, et. al, (2005, pgs.11 and 27) indicated:

* Wage subsidies were proven most effective for people at risk of long-term unemployment (e.g., older workers and disadvantaged youth) and members of equity groups (particularly people with disability).
* Targeting wage subsidies for high-risk groups, particularly Indigenous people and disadvantaged youth is most effective when multi-faceted, combining formal and on the job training, strong links to employers, and assessment and job search assistance.
* Wage subsidy durations of between 6-9 months appear most successful. Shorter durations tend to encourage jobs in ‘dead end’, low paying jobs that are not sustained.
* Wage subsidies are more effective when combined with employer and job specific skills training.
* Wage subsidies for people with disability are more effective in increasing employment income and long-term employment when combined with specialised supports.
* Targeted wage subsidies that are well promoted and simple to use have higher take-up rates by employers and are more likely to be successful.

O’Brien et.al, (p.13) also considered in detail the evidence of Canadian wage subsidy effectiveness with respect to four key indicators – employment, earnings, Employment Insurance (EI) use, and Social Assistance (SA) use. The key findings were that for former EI claimants wage subsidies show some positive impacts on employment and earnings and that there is evidence that wage subsidies lead to a reduction in SA payments received. The evidence for current EI beneficiaries was less clear.

More recently, the Government of Canada introduced the Canada Emergency Wage Subsidy (CEWS) with wage subsidy rates as high as 70 per cent to support businesses during the global COVID-19 Pandemic. Leung and Liu (2022) found that between March and September 2020, 41.6 per cent of all employer businesses used the CEWS at least once and that its use was associated with a 6.9 percentage point lower probability of the business closing down. Leung and Liu estimated that the cumulative employment growth rates between February 2020 and the average of the final three months of 2020 were 5.0 percentage points higher among surviving business that used the CEWS and those that did not. They also showed that businesses (a) at greater risk of closure because of pre-pandemic characteristics (particularly new and smaller businesses), and (b) in the Accommodation and Food Services, and Arts, Entertainment and Recreation industries (impacted most COVID restrictions) benefited more from using the CEWS, compared with all employer businesses.

However, Robson and Smart (2021) contend that as CEWS was poorly targeted, the cost of each person per month of employment saved through the program was about CA$188,000 per job per year.

The Canada Recovery Hiring Program (CRHP) succeeded the CEWS in June 2021, and was in place until May 2022. The CRHP paid a subsidy of up to 50 per cent and targeted non-profits, small cooperatives and Canadian-controlled private corporations. To date, there has been no published evaluation of the effectiveness of the CHRP.

## **Australian evidence**

In Australia a significant body of evidence on the effectiveness of wage subsidies comes from the Working Nation scheme in the early to mid-1990s. A key feature of Working Nation was a Job Compact, where anyone unemployed for 8 months or more would be offered a training place or subsidised employment for 12 months. The main wage subsidy programs were JobStart, JobSkills and New Work Opportunities (NWO). The *Working Nation Evaluation* found that between 22 per cent and 42 per of participants in these programs were in unsubsidised employment 12 months later (refer to Table 1). However, effectiveness, as measured by the net impact,[[1]](#footnote-2) varied significantly – from 5 to 31 per cent.

JobStart was the most effective and it was targeted at private sector employers with the wage subsidy rate increasing for those most disadvantaged as measured by duration of unemployment, education level and age. NWO on the other hand offered project work, often with local government authorities, and was less targeted.

Another finding was that employers tended to only take on workers under a wage subsidy if they had higher skill levels. This points to a major shortcoming of wage subsidy schemes; that employers appear to only be willing to take on unemployed people they regard as relatively ‘job-ready’.

The Working Nation JobStart wage subsidy program is a case in point. It was intended as the major method for improving employment outcomes for the long-term unemployed. However, while 70 per cent of jobs for this group were intended to come from wage subsidies, wage subsidies actually only accounted for 34 per cent of jobs. This is because employers perceived that the long-term unemployed had a range of problems that made them unsuitable employees (DEETYA 1996, pp. 46–47).

*Table 1: Working Nation Wage Subsidy programs.*

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| Program | In unsubsidised employment | Net Impact | Cost per placement | Cost per employment outcome |
| JobStart | 41.1% | 31% | AU$3,700 | AU$9,700 |
| JobSkills | 29.8% | 14% | AU$10,000 | AU$75,700 |
| New Work Opportunities | 21.6% | 5% | AU$12,700 | AU$180,000 |

*Source: (DEETYA) Working Nation: Evaluation of the employment and training elements, 1996*

The *Active Participation Model Evaluation* (2007) also evaluated the impact of wage subsidies. It found that off-benefit outcomes from wage subsidies were nearly 60 per cent 3 months after participation and 65 per cent after 24 months. Regression analysis of the effectiveness of Job Seeker Account spending showed that wage subsidies were the most effective form of financial support expenditure in terms of getting employment outcomes. This is hardly a surprising result as wage subsidies are used for people actually placed into jobs.

The *Evaluation of jobactive Final Report* provides further evidence on the effectiveness of wage subsidies. Participants receiving a wage subsidy under jobactive achieved a 26-week employment outcome rate 16.7 percentage points higher than those who did not. Wage subsidies also increased the likelihood that a participant left income support within 12 months (7.9 percentage points higher for subsidised than unsubsidised job placements). A lower proportion of participants who used wage subsidies returned to income support, compared to participants who did not use a wage subsidy.

### Indigenous wage subsidies

Australian studies of wage assistance/subsidies for Indigenous job seekers show comparable impacts. The *Evaluation Stage 2, Indigenous Employment Policy Report* (2003) found that 12 months after placement 50.3 per cent of wage assistance participants remained employed compared to 39.6% of the control group – giving a net impact of 11 per cent. A 2009 Study by DEEWR (*STEP and Wage Assistance – A net impact study*) found that the off-benefit net impact for wage assistance during 2006-07 was 12 per cent. The 2003 Evaluation Stage 2 report also considered net impact by job seeker characteristics. As shown in Table 2 the net impact is particularly strong in regional and remote locations and in weaker labour markets.

*Table 2: Employment Net Impact of Indigenous Wage Assistance by Characteristics*

|  |  |  |  |
| --- | --- | --- | --- |
| Characteristic  | Net Impact | Characteristic | Net Impact |
| Gender |  | **Duration of une** |  |
| Male | 11.6% | < 12 months | 12.2% |
| Female | 10.2% | 12 months > | 9.4% |
| Age |  | **Labour Market Conditions**  |  |
| 15-24 years | 12.0% | Strong | 7.3% |
| 25 and over | 9.8% | Weak | 9.4% |
| Education |  | **Location** |  |
| < Year 10 | 10.7% | Major cities | 6.3% |
| Year 10 | 10.4% | Inner Regional | 14.3% |
| Year 12 > | 12.6% | Outer Regional & Remote | 19.8% |

*Source: DEWR (2003) Indigenous Employment Policy, Evaluation Stage 2*.

# **Conclusions**

What do we make of all of this?

The evidence is that wage subsidies can be effective for particular cohorts of unemployed people if appropriately targeted. Table 3 provides a summary of who wage subsidies are most effective for and those for who they appear less effective based on the above analysis. Note, that this does not mean that wage subsidies should not be used as a strategy, where it may be less effective – for example, to help very highly disadvantaged job seekers. What the table presents is a breakdown by relative effectiveness.

*Table 3: Who wage subsidies work most and who less for*

|  |  |
| --- | --- |
| Wage Subsidies appear to be most successful for: | Wage subsidies appear to be relatively less successful for: |
| General population* Youth (especially males)
* Long term unemployed
* When subsidy is 30% or more of wage
 | **General population*** Very highly disadvantaged job seekers (due to stigma effects)
* When administrative requirements for employers are onerous
 |
| Indigenous* Youth
* Males
* Those with Year 12 or more education and those with less than Year 12
* Less than 12 months unemployed
* Job seekers in weak labour markets
* Job seekers in regional and remote labour markets.
 | **Indigenous*** Older Indigenous job seekers
* Those unemployed for more than 12 months
* Job seekers in urban areas
 |

# **References**

Borland, J. (2014). “Dealing with unemployment: What should be the role of labour market programs?” Evidence Base, issue 4, 2014.

Department of Education, Employment and Workplace Relations (2007). *Active Participation Model Evaluation: July 2003-June 2006*.

Department of Employment, Education, Training and Youth Affairs (1996). *Working Nation: Evaluation of the employment, education and training elements*.

Department of Employment and Workplace Relations (2003) *Indigenous Employment Policy, Evaluation Stage Two: Effectiveness Report.*

Department of Employment and Workplace Relations (2022) *The evaluation of jobactive - final report.*

Department of Employment and Workplace Relations (2009) *STEP and Wage Assistance – A net impact study*.

Heckman, J., Lolonde, R.J., and Smith J.A. (1999) “The economics and econometrics of active labour market programs” in Ashenfelter, O and Card. D. (eds) *Handbook of Labour Markey Economic*s, vol3a, North Holland, Amsterdam.

Kluve, J (.2010). “The effectiveness of European active labor market programs” *Labour Economics*, Volume 17, Issue 6, December 2010, Pages 904-918

Kluve, J. and Schmidt, C. (2002). “Can training and employment subsidies combat European unemployment?” *Economic Policy*, 35, 410–448.

Leung, D. and Liu, H. (2022). *The Canada Emergency Wage Subsidy program and business survival and growth during the COVID-19 pandemic in Canada*. Statistics Canada <https://www150.statcan.gc.ca/n1/pub/36-28-0001/2022002/article/00006-eng.htm>.

Martin, J., and Grubb, D. (2001). *What works for whom: a review of OECD countries’ experiences with active labour market policies*, IFAU, Office of Labour Market Policy, Working Paper 2001:14.

Martin, J.P. (1998). *What Works among Active Labour Market Policy: Evidence from OECD Countries’ experience*, Paper presented to the Reserve Bank of Australia 1998 Annual Conference.

O’Brien, C., Tommy, D., and Thomas, B. (2005). *Wage Subsidies in Canada, Paper for Korean Ministry of Labour and Korea Institute*, Seoul, South Korea.

Organisation for Economic Cooperation and Development (2005). *OECD Employment Outlook*, Chapter 4: Labour Market Programmes and Activation Strategies: Evaluating the Impacts.

Robson, J., and Smart, M (2022). Canada’s new wage subsidies: Better targeted, or just better hidden? *Finances of the Nation*. <https://financesofthenation.ca/2021/11/04/canadas-new-wage-subsidies-better-targeted-or-just-better-hidden/>.

United Kingdom Department of Work and Pensions 2012*. Impacts and Costs and Benefits of the Future Jobs Fund*, London.

Van Reenan, J (2000) *No More Skivvy Schemes: Active Labour Market Policy and the British New Deal for the Young Unemployed in Context*. University College London.

1. Net impact studies measure the proportion of a program’s participants in employment compared to that of a control group who were not assisted. These programs control for factors such as age, gender, previous program assistance, duration of unemployment and education. [↑](#footnote-ref-2)