A critical analysis of the impact of the implementation of a national minimum wage in South Africa on Job Creation and Income Inequality

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In its 2014 election manifesto the ruling party identified the introduction of a national minimum wage as one of the key mechanisms to reduce income inequality. In line with the manifesto, the President mentioned in his state of the nation address that the social partners need to deliberate on wage inequality. He then committed government to the investigation into the national minimum wage as an income inequality reduction mechanism. If South Africa does indeed adopt the minimum wage, what will be the impact on job creation? Will the minimum wage implementation make a marked improvement on our inequality as measured by the Gini coefficient, or not? Substantiate your answer by looking at international experience of countries (e.g. Brazil) which have adopted the national minimum wage.

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INTRODUCTION

In recent times, the general concept that a higher level of minimum wages would increase unemployment, as proposed by the neo-classical school of thought, has been losing much credibility with the emergence of empirical evidence that suggests that minimum wages can ironically increase employment and lead to increased economic growth (Bhorat, 2013). The Keynesian-school of thought also contradicts this notion through making the proposition that the higher wages of workers increases employment through consumption- fuelled economic growth on the demand side (Parkin et al, 2010). This essay will argue as to why a national minimum wage can possibly increase unemployment in South Africa and increase income inequality and poverty .This will be done by firstly presenting the arguments of relevant social partners and using Brazil as a reference in arguments. This paper will further argue as to why the relevant social partners are incorrect in using Brazil as an example and how the situation in South Africa differs from that in Brazil.

Defining a National Minimum Wage

A national minimum wage is defined as a mechanism that creates a basic wage floor below which no individual worker's wage can fall, regardless of region or sector (Coleman, 2014). It operates on the basis that those individual workers who earn a wage that is below the minimum wage will be upgraded to a wage that is equal to or higher than the stipulated legal minimum wage. Those workers who already earn a wage above the minimum wage will however not be downgraded (Parkin et al, 2010).

View held by Social Partners

There is much public discourse around the implementation of a national minimum wage in South Africa and the appropriate level at which it should be set, with the main proponents being the leading relevant social partner : COSATU (Congress of South African Trade Unions). COSATU proposes that a national minimum wage be implemented in order to address the high levels of unemployment and high levels of poverty within South Africa (Coleman, 2014). The main argument of COSATU, as well as the leading argument in support of a national minimum wage, is that the minimum wage will not only increase the earnings of workers , but would also lead to job creation through the notion that the higher wages earned by workers will increase aggregate consumption and consequently lead to increased economic growth (Seekings and Nattras, 2015) (Coleman,2014). COSATU makes use of Brazil as a prime example of how successful a national minimum wage can be if it is implemented.

<u>The experience in Brazil</u>

Brazil is typically regarded as the leading success story in terms of the implementation of a national minimum wage, particularly for developing countries (Coleman, 2014). The implementation of the national minimum wage within Brazil led to the creation of about 17 million formal jobs in the period 2002-2011 (Coleman, 2014) and consequently higher levels of earnings for workers. It is also thought to have led to roughly two thirds (2/3) of reduction in income inequality (Darrol, 2014). Brazil has also experienced an annual compound growth in GDP of 3.09% and inflation being within a narrow band of between 3.14% and 6.5% recently (Darrol, 2014) This contradicts the notion that a national minimum wage will lead to increased levels of unemployment and increased levels of poverty as held by the proponents of the neo-classical school of thought(Coleman,2014). The increased incomes of workers typically fuelled domestic demand and consequently increased formal employment in Brazil (Coleman, 2014).

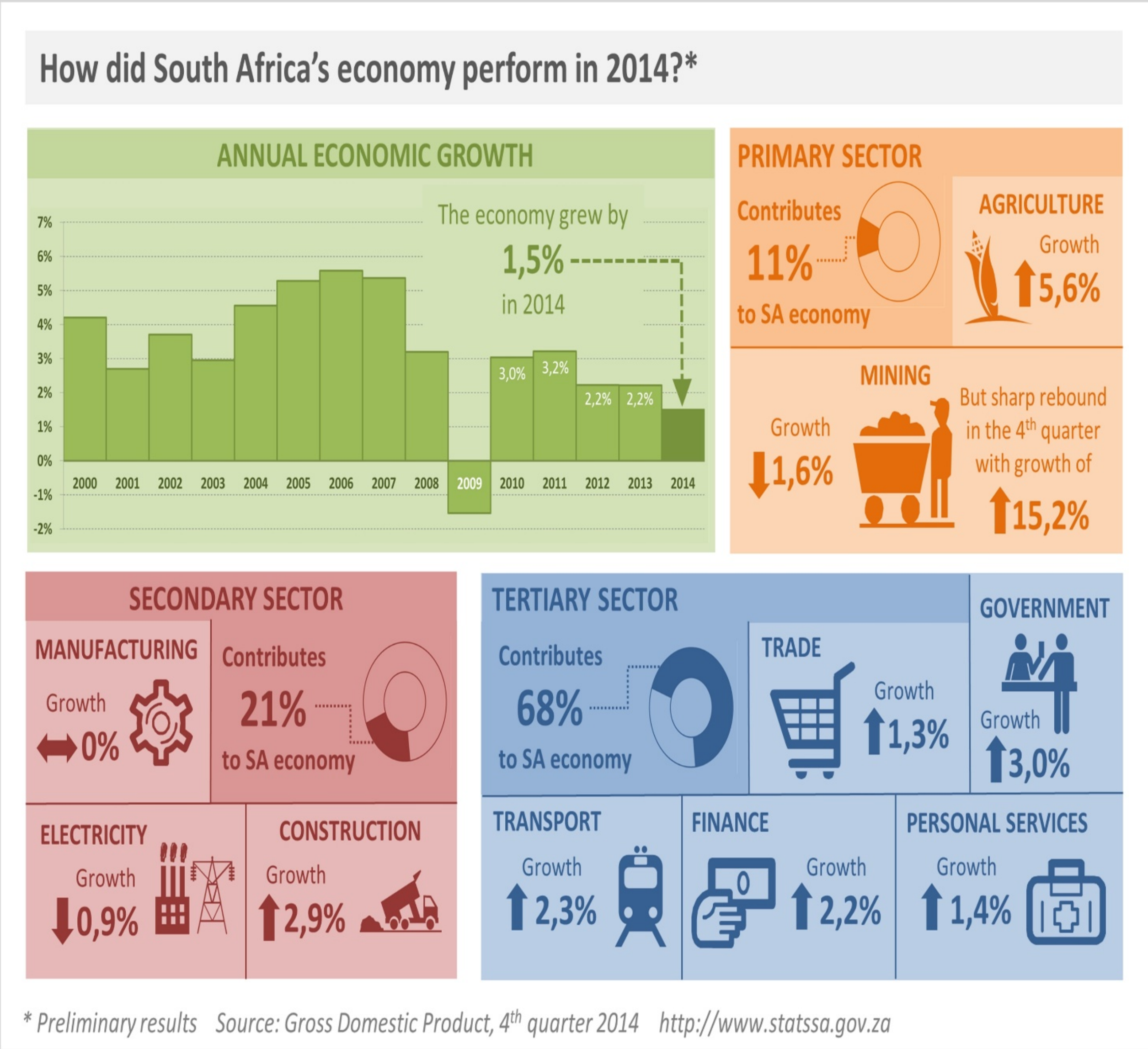
<u>Why a National Minimum Wage will not work in South Africa</u>

COSATU however draws slightly wrong conclusions in using the conditions in Brazil as a prime argument. This is primarily because Brazil has low levels of unemployment in contrast with the high levels of unemployment experienced in South Africa currently(Seekings and Nattras, 2015) .Brazil also has a relatively consistent expansive economy as opposed to South Africa(Nkabinde, 2014). The effect of this low unemployment, especially when considered in the scope of a growing economy with a very inflexible labour market, essentially means that an increase in wages has very little detrimental effects on employment (Seekings and Nattras, 2015). Perhaps another fallacy and misconception with the Brazil scenario is that the national minimum wage in Brazil was only increased after higher levels of productivity and higher levels of demand for labour which had naturally increased the price of labour (Davie, 2014). This made the demand for labour highly price inelastic (Parkin et al, 2010). This essentially meant that the minimum wage implemented at the time had little effect on employment because it was set a level that was lower than what most employers were willing to pay workers (Davie, 2014). The minimum wage level in Brazil was also increased in small increments over a period of 21 years (Davie, 2014).

COSATU also relies on the research of H. Bhorat(2012) in terms of the effects of sectoral minimum wages in South Africa. The research concerned revealed that the introduction of a minimum wage showed no conclusive evidence that the minimum wage had a detrimental effect on employment in terms of five sectors investigated (Retail, Domestic Work, Taxi, Security, Forestry) (Bhorat, 2012). Although there was no detrimental effect on the extensive margin of demand for labour, the research however revealed that there was an effect on the intensive margin, in terms of reduced working hours per week for workers in the Retail and Security Sectors (Bhorat, 2012).Research conducted by Bhorat and Stanwix (2011) previously also showed that the agricultural sector lost close to 220 000 jobs after the implementation of a minimum wage in 2003.

COSATU is however slightly wrong in primarily basing arguments on the work of Bhorat(2012) in the sense that the relevant sectors investigated by Bhorat at the relevant times enjoyed higher levels of real wages and had increased demand for labour (Seekings & Nattrass, 2015). This essentially meant that a low minimum wage imposed had an insignificant effect on employment as a whole. COSATU also does not take into account the fact that many of the sectors analysed were non-trading sectors which did not face international market competition (Seekings & Nattrass, 2015). This essentially meant that these sectors could pass on most of the increase in the cost of wages to consumers without fear of losing competitiveness. Minimum wages could however make tradeable sectors uncompetitive, with the agricultural sector being a prime example (Seekings & Nattrass, 2015).

FIGURE 1 : ANNUAL ECONOMIC GROWTH OF SOUTH AFRICA

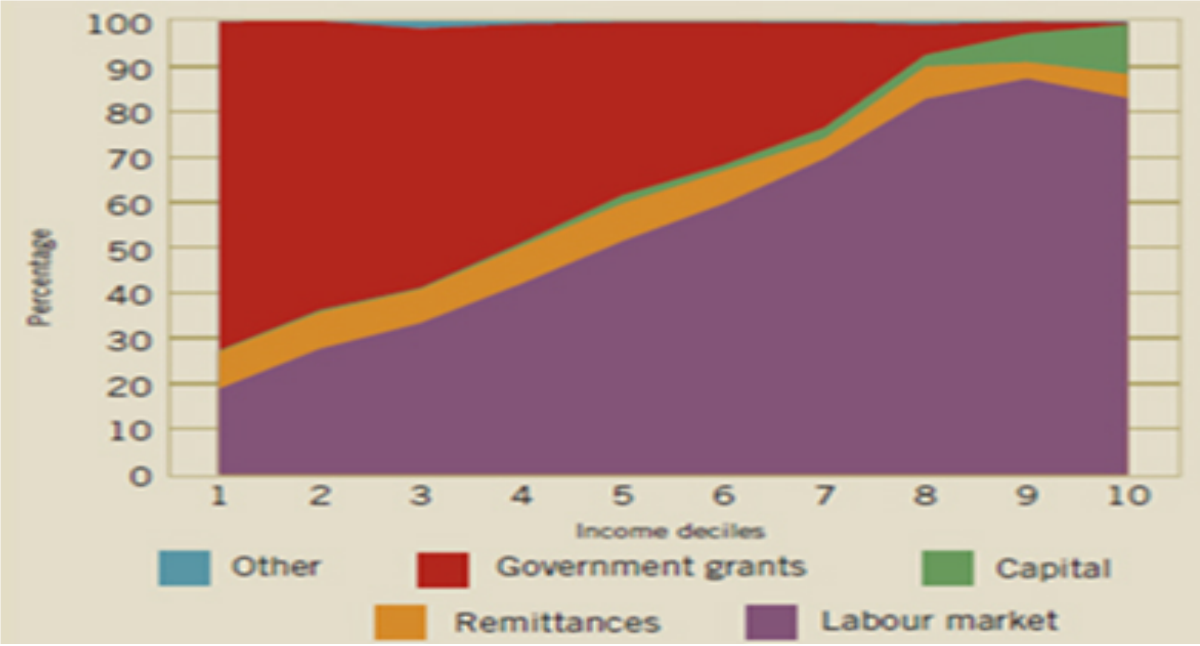


In order for a national minimum wage to be effective and remotely emulate what transpired in Brazil, South Africa requires a high level of economic growth. This would essentially support the notion of consumption-fuelled growth as presented by the proponents of the national minimum wage. South Africa however only showed a 1.5% economic growth rate in 2014 and this has relatively remained at low levels for the past 7 years (2008-2014) as depicted by the graph above.

The implementation of a national minimum wage essentially threatens employment opportunities for low-skilled workers, especially in areas where there is much room for mechanisation (Zwane & Kaplan , 2014).This is particularly relevant in the agricultural sector in South Africa where agricultural employment has declined drastically and continues to decline at a concerning rate (Simbi & Aliber, 2000). There is an increasing use of mechanisation which displaces physical labour in response to increasing factor costs such as labour itself within the agricultural sector (Simbi & Aliber, 2000). The same might become prevalent in sectors such as the clothing sector, manufacturing sector and other sectors where mechanisation might be a possibility.

It is worth noting that the effectiveness of any minimum wage is also dependent on the compliance of employers with the minimum wage regulations. Bhorat (2011) presented findings in terms of compliance of employers of sectoral minimum wages and found that in four of the five sectors analysed, approximately 40-60% of workers were not paid the appropriate minimum wage, with employers in the domestic sector having approximately 75% non-compliance with the sectoral minimum wage. This may further have diluted and negated the negative impacts that a minimum wage might have had on employment as investigated by Bhorat (2012). If these findings are extrapolated to a national minimum wage, it might see non-compliance increasing to an even higher level as there will be a much broader scope for the minimum wage than a mere sectoral setting.

FIGURE 2: INCOME COMPONENTS BY DECILE, 2008 (14)



Background: Income Inequality in South Africa

South Africa generally has a high level of income inequality. Income inequality is generally measured in terms of a Gini co-efficient, which is generally derived from the Lorenz Curve (Parkin *et al*, 2010:420-422). South Africa's Gini co-efficient is currently 0.7, which is one of the highest in the world (CAI, 2012). One of the core drivers of the Gini co-efficient, and income inequality in general, is the inability of an economy to generate employment opportunities (CAI, 2012). In fact, income derived from the labour market is the leading constituent of total income of the population as depicted by the diagram above. Many of the people in the lower income decile spectrum as depicted in the diagram are essentially non-white unemployed individuals (CAI, 2012). Many of these individuals are unskilled, inexperienced and relatively uneducated (CAI, 2012).

Income Inequality in Brazil

One cannot refer to the effects of a minimum wage without regarding the effects on income inequality. A leading success story in this regard is once again Brazil (Coleman, 2014). It is generally argued by proponents of the minimum wage that an increase in minimum wages essentially leads to a decrease in income inequality as what transpired in Brazil (Coleman, 2014). It should however be noted categorically that it is however widely accepted that the success of Brazil in reducing income inequality is mainly attributed to the success of Brazil's conditional cash transfer programme known as Bolsa Familia (Gindling, 2014). The conditional cash transfer programme instituted in Brazil is in fact regarded to have been more effective in reducing income inequality and poverty than higher minimum wages when comparisons under similar conditions are drawn (Gindling, 2014) .It is therefore quite unreasonable to say that the reduction in income inequality in Brazil is a direct result of the increase in minimum wages solely when it can arguably be said that Brazil's conditional cash transfer programme was a supporting factor.

Formal and Informal sector

Another factor to consider is the fact that minimum wage laws only apply to the formal sector (Gindling, 2014). South Africa has an informal labour sector (non-agricultural) of approximately 18.3 % (Stats SA, 2015). It should be noted that the lowest earning workers, where income inequality is most prevalent, are essentially employed in the informal sector in general (Gindling, 2014). If workers are to be dismissed because of unaffordability in the formal sector where minimum wage laws are imposed on employers, then it may happen in theory that these workers enter the informal labour sector which could essentially increase competition in this sector and in theory drive down wages in general within the informal sector (Gindling, 2014) .There has however not been conclusive evidence to support this view.

In terms of Brazil, job losses were mainly concentrated at the lower end of the wage and skills distribution. If a comparison between South Africa and Brazil is to be drawn then it does not present a great image for South Africa(Gindling, 2014), because of the fact that income inequality is most prevalent in the lower income decile spectrum of workers in South Africa(CAI, 2102).It should also be stated categorically that much of the success of any minimum wage is dependent on whether there are supporting social safety net programmes that are tied to the minimum wage by supplementing incomes when a worker is dismissed(Gindling, 2014). South Africa as it stands however is already running a high budget deficit and it is highly unlikely that such supporting social safety net programmes will be implemented successfully.

A national minimum wage affects firms that can least afford to pay higher wages the most. This is essentially smaller firms in the market. In South Africa, where the establishment and development of Small to Medium sized Enterprises (SMEs) is encouraged and supported (MSME, 2014), it seems rather counter-intuitive that a national minimum wage be implemented. One of the major driving forces behind South Africa's GDP and labour market is essentially SMEs (National Development Plan). The implementation of a national minimum wage could therefore perhaps discourage emerging SMEs to enter the market and even lead to some exiting the market, with these being unable to afford the relatively higher wages. This could therefore further increase unemployment to higher levels.

Conclusion

Although many recent studies have emerged that indicate that the traditionally known trade-off between wages and employment does not always hold, it should be noted that the context in which an analysis of such is made is extremely of paramount importance. Each country should be analysed individually to determine the viability of a national minimum wage. In the case of South Africa, a mere national minimum wage will not bear great results. It is the view of this essay that the economic conditions of South Africa does not make it suitable for the implementation of a national minimum wage. The key manner in which issues such as unemployment, poverty and income inequality can be addressed is through increased government intervention through public investment and sound industrial policies.

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