

The national minimum wage in South Africa:

Impact on job creation and income inequality

If South Africa does indeed adopt the minimum wage, what will the impact on job creation be? Will the minimum wage implementation make a marked improvement on our inequality as measured by the Gini Coefficient, or not?

Word count: **2 345 words**

(incl. in-text references, excl. Headings, references, figures, tables)

“The goal of the minimum wage is not, of course, to reduce employment, but to redistribute earnings to low-paid workers.”

R. Freeman

1. INTRODUCTION

The national minimum wage debate continues to be a robust one in the different corridors of power in South Africa. This debate is happening against a backdrop of incredible income inequality, high unemployment levels, slow economic growth and thus low job creation. There is a very high sense of unease with regards to how this income gap will be reduced and how adequate job creation can be accomplished. Studies that have been done with the purpose of finding empirical evidence on the distribution of welfare have been seen to use household surveys that have been structured to uncover either expenditure or income data.(Glewwe, 1988:3). The link between income or expenditure and welfare has been proven in the economics discipline time and again (Woolard, I. & Leibbrandt, M., 1999).

This paper will argue that the national minimum wage is the appropriate instrument to be used to correct some of the major shortfalls of the current South African labour market. It will further argue that its implementation will yield a relative reduction in the income equality gap; however, it will not translate into greater job creation. Firstly, a synopsis of the current inequality and unemployment levels in South Africa relative to other developmental states will be given. The national income wage will then be defined in order to assert the relevance of such a policy in the context of the South African job market as it currently stands. To follow will be a discussion of the impact of the national minimum wage on current and future employment; citing relevant examples of the experiences in developmental states with similar economic challenges to South Africa. In conclusion, an analysis of how an efficient national minimum wage can be achieved will be provided; explaining how this achievement will consequently aid in the much needed reduction in poverty and income inequality.

2. SYNOPSIS OF THE STATE OF INEQUALITY AND UNEMPLOYMENT IN SOUTH AFRICA

According to the work done by Kuznets and many other economists, for many decades inequality in developing countries was believed to be inevitable by virtue of them experiencing economic growth (Kuznets, 1955 & 1963). In recent years, observing countries such as those in the Organisation for Economic Cooperation and Development (OECD) has shown that income inequality is not a phenomenon only experienced by developing countries; and that in fact there have been developing countries such as Brazil and most of Latin America that have substantially reduced their levels of inequality (Keeton, 2014).

South Africa as is commonly known, inordinately is one of the most unequal countries in the world, compared to both developing and developed countries. Income inequality among racial groups has somewhat declined over the past 21 years; however, the

income gap has increased among various social groups that make up the population. The black middle class has grown in significant numbers; simultaneously, the income gap within the black community increased tremendously, creating a huge gap between the black middle class and the black working class.

In racial terms, over the past 19 years, the African society has experienced growth by a multiple of over 10 in the number of people earning more than R10 000; the numbers of such earners having increased from 19 000 to 257 000 (Netshitenzhe, 2013). The proportion of the Black African middle class (between R1 440 and R10 000 in income) has increased by about 2.4 times to become the majority in this income bracket; however, the number of white people earning above R10 000, doubled to approximately 888 000 (Netshitenzhe, 2013). Besides the post-apartheid dispensation putting much emphasis on a humanist approach in governing the country, the racial manifestations of income inequality is evidence of how deeply entrenched the social constructs of apartheid colonialism was; and highlights how slow the progress has been in forging a new economic reality for the majority of South Africans (Netshitenzhe, 2013).

It is important to have a holistic understanding of how income inequality manifests itself in a developmental state. The burden of income inequality is borne by the poor and marginalised. Besides income and expenditure itself, the indicators of an unequal society are assets (agents of wealth), access to services and opportunity, and social capital (Netshitenzhe, 2013). The weak financial muscle of the working class in South Africa is characterised by lack with regards to these above mentioned indicators. South Africa has seen a rise in the number of labour disputes since 2008 as a direct result of the huge income disparities among the various social strata. The labour unrest is largely perpetuated by the labour unions that largely represent the black working class. The working class, although they are employed, find it difficult to make ends meet with the rising cost of living in South Africa. People are not guaranteed an escape from poverty by virtue of being employed (Stats SA's Labour Market Dynamics in SA, 2011). Of those employed, the bottom 5% earned approximately R600 per month; half earned between R3 033 and below; however the highest 5% earned R21 666 per month (Stats SA's Labour Market Dynamics in SA, 2011).

According to BusinessTech, in 2014, Stats SA reported that out of the 5.1 million unemployed people, 1.5 million people have been seeking employment for more than 5 years. That is up from 974 000 active job seekers in 2008. Black Africans made up 61.0% - 71.0% of the long-term unemployed people who have been looking for a job for more than a year over the period 2008-2014. In the same period, the unemployment rate in the white population group ranged between 4.1% -7.3%, with 7.3% as the 2014 figure. The unemployment figures by race are even more damning. The 2014 figures show that the proportion of Black Africans in the working age population is 79.3% but only 73.0% of those people are employed and an overwhelming 85.7% are unemployed; with those

who are not economically active making up 83.3%. What makes the situation dire is that 87.4% of Black African unemployed people have been actively looking for employment for one year or longer.

3. DEFINITION OF A NATIONAL MINIMUM WAGE AND RELEVANCE IN THE SOUTH AFRICAN LABOUR MARKET

The most appropriate frame of reference to consider when defining the national minimum wage is the 1968 definition of a living wage; stated by the International Labour Organisation (ILO) as the “amount necessary to meet the reasonable needs (or basic needs) of an unskilled labourer with a family of average size”. The question then becomes how one should define the concept of ‘reasonable needs’. Different stakeholders in society define this concept in various ways that are aligned to their interests. In India, a tribunal reached consensus on the fact that there should be distinctions made between subsistence or minimum wages, fair wages and a living wage (Cottle, 2014). Employers and employees define the ability to meet basic needs differently due to their differences in objectives. Employers, naturally having a profit maximising objective, have a modest definition of basic needs. They define basic needs as those that are met through a minimum or subsistence wage such that workers are able to physically nurture themselves and their families at a mediocre standard (Cottle, 2014). The employers’ definition of minimum wage is therefore out of touch with the true realities of their workers.

A living wage is one that would give workers the ability to afford basic needs that encompass; sufficient food, warm clothing for the winter and cool clothing for the summer, good health care, decent education, and recreational activities for their children. The concept of a living wage according to trade unions is held to a higher standard. According to the labour unions, a living wage would enable workers to access goods and services beyond the essentials and their needs would rightfully increase with economic expansion through greater future productivity (Cottle, 2014). Workers find strain in trying to meet these basic needs with their current wages.

In addition to economic reasons for the need for South Africa to implement a national minimum wage, there are vivid moral and political reasons why inequality is unjust. According to the Financial Times’ Martin Wolf, rising inequality is “incompatible with true equality of citizens” which is central to the idea of democracy. A 2012 World Bank report on South Africa found that there is a strong relationship between differences in life opportunities for South African children and the obvious demographical differences based on race, gender, location and household income (Keeton, 2014).

4. IMPACT OF A NATIONAL MINIMUM WAGE ON EMPLOYMENT AND INCOME INEQUALITY

The general consensus that a national minimum wage has a negative impact on employment is subject to serious re-examination. There is very little empirical evidence available to show the impact of minimum wages in developing countries and its effectiveness in meeting its social justice or poverty alleviation role (Alata and Cameron 2003). Labour market conditions in developing countries differ dramatically from those in industrialised countries; “They are typically more segmented, filled with less educated labour, characterized by a high ratio of male-to-female workers, and dominated by small and informal firms. Changes in minimum wages in a developing country can potentially lead to significant heterogeneous effects on a large fraction of the labour force” (Carpio and Nguyen and Wang, 2012).

Theoretically, whether the implementation of a minimum wage will result in greater employment or in job losses is dependent on the level of relative wages relative to workers' marginal product of labour (MPL). If the existing wages are adjusted to be significantly below the MPL, as in the case of a monopolistic firm, workers will benefit from a moderate increase in wages without any job losses; because even with higher wages, the firm still makes exorbitant profits from hiring workers (Rebitzer and Taylor, 1995). However, in a competitive market, where equilibrium wages equal the MPL, a minimum wage increase will result in job losses.

Studies done in the USA and Western Europe have shown that, the minimum wages are expected to increase consumption by elevating wages above the market level that may not be socially acceptable; but they may also lead to job losses and thus decreased consumption (Cunningham, 2007). An exogenously imposed wage structure, implemented in the quest for social justice, may be the appropriate tool to alleviate unfair market wage allocations; but the challenge is the market will still determine labour demand and thus a cost of labour higher than that of the market may result in unemployment.

This impact will not necessarily manifest in the same manner in developing states such as Mexico, Brazil, and Colombia and Latin America and the Caribbean (LAC) because these countries have bigger informal sectors than formal sectors. The minimum wage is more binding in the informal sector than the formal sector (Cunningham, 2007). With regards to the supply of labour, the minimum wage is regarded a “fair wage” in both sectors. On the demand side, employers in the informal sector will tend to use the minimum wage as a proxy for a “fair wage” in attempt to attract labour and reduce labour turnover. Evidence has been seen to firmly allude to the fact that an increase in minimum wages tends to have a positive effect on wages, and thus reduces poverty and inequality; however it also carries a small negative impact on employment among the workers that the legislation targets. The effect will have the most impact on low-wage workers, low skilled workers and the youth. The extent of the effect depends on the proportion of wage earners affected by a certain minimum wage (Belser, 2012/2013).

5. CONCLUSION: HOW AN EFFICIENT NATIONAL MINIMUM WAGE CAN BE ACHIEVED

In seeing that the national minimum wage will have a positive impact on income and yet will carry negative employment effects; it is important that within the context of a mixed economy, that when the market fails to correct shortcomings with regards to its pricing mechanisms, the government implements certain measures to offset the disemployment effect. A national minimum wage can be efficiently implemented in South Africa. Firstly, the minimum wage should be set so that it does not offset the wage distribution too immensely (Rutkowski, 2003). Secondly, cognisance should be taken of the markets conditions before passing the legislation; ensuring that an increase in the minimum wage is avoided when unemployment is at extremely high levels or is increasing and it is concentrated around low-skilled workers (Rutkowski, 2003). Make an allowance for the high youth unemployment by implementing a youth sub-minimum wage that accounts for approximately 75% of the adult minimum wage (Rutkowski, 2003).

Considering the varying levels of productivity across regions in South Africa, it might be necessary to make adjustments for regional differentiation in the minimum wage. Employers for whom such wages will be too costly, especially Small, Medium and Micro Enterprises (SMME's), should be exempt from regional differentiation with only the national minimum wage applicable to them. The implementation of minimum wages will yield greater productivity because workers will be motivated by the higher income they will be receiving (Rutkowski, 2003). Income equality can be achieved through a national minimum wage policy, however, this policy is not direct enough to the root cause of unemployment to reduce it and yield greater job creation. The volatility of the South African economy will require that regular adjustments are made to allow for price or wage growth as well as labour market changes.

An efficient and equitable national minimum wage is one that is set such that it is at the lowest yet reasonable level, as opposed to the highest level. In the South African context, a national minimum wage will only achieve a reduction in income inequality if it is implemented against a backdrop of other effective policies that will enable an environment for high economic growth. The government needs to be effective and have a sense of urgency in delivering high quality education; good public health care services; greater access to economic opportunities; greater job creation and thus declining unemployment levels which can be aided by growth in the number of successful SMME's; increase in the industrial capabilities of the country and sustainable energy solutions. There is simply no one policy that will be single-handedly successful in reducing the high levels of income inequality that plagues the South African economy. Many other supporting structures will be needed to ensure the success of a national minimum wage policy.

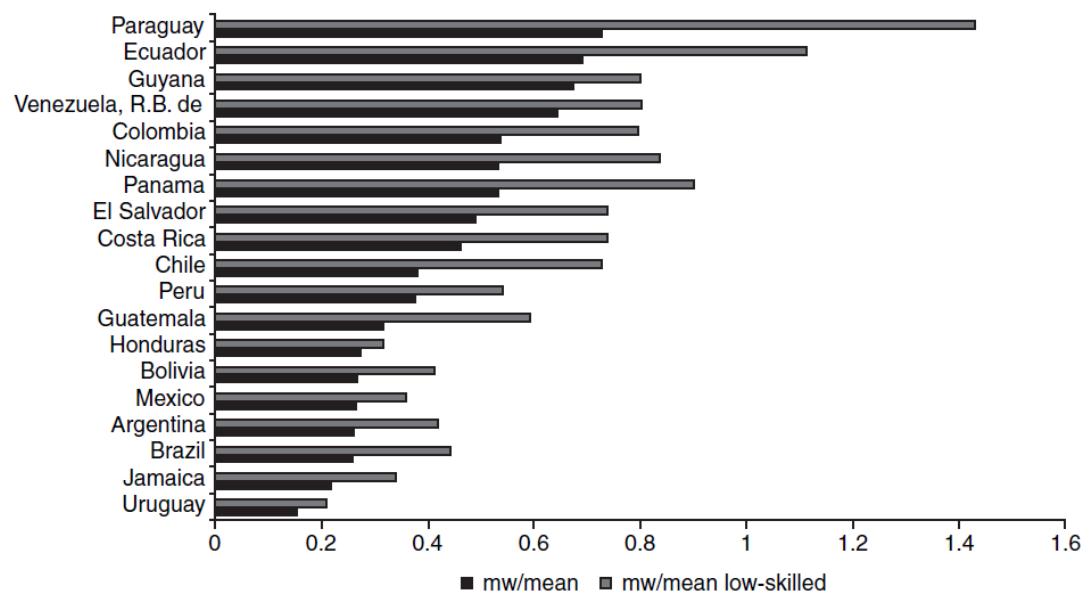
6. TABLES AND FIGURES

MINIMUM WAGES AND SOCIAL POLICY: LESSONS FROM DEVELOPING COUNTRIES**Table 1: Minimum wages in Latin America and the Caribbean (LAC)**

<i>Country</i>	<i>Year</i>	<i>Monthly mw, domestic currency</i>	<i>Mw in PPP- adjusted US\$</i>
Paraguay	2000	680168	\$546
El Salvador	1998	1,083	\$446
Dominican Republic	1997	2,412	\$429
Costa Rica	1999	54,938	\$423
Chile	2001	100,000	\$335
Colombia	1999	236,438	\$293
Guatemala	2000	712	\$289
Honduras	1999	1419	\$221
Brazil	1999	136	\$205
Argentina	2000	200	\$200
Panama	1998	206	\$185
Guyana	1999	19,000	\$181
Peru	1999	345	\$124
Bolivia	1999	330	\$90
Jamaica	1998	800	\$75
Ecuador	1998	762,967	\$75
Venezuela, R.B. de	1998	100,000	\$54
Mexico	1999	888.81	\$50
Uruguay	1998	990	\$45
Nicaragua	2001	1,000	n.a.

Source: Kristensen and Cunningham (2006).

n.a. no data were available.

Figure 1: Minimum wage relative to the Mean or Unskilled Wage

Source: Kristensen and Cunningham (2006).

Table 2: Degree to Which the Minimum Wage is in Wage Employment in LAC and Year of Analysis by Sector

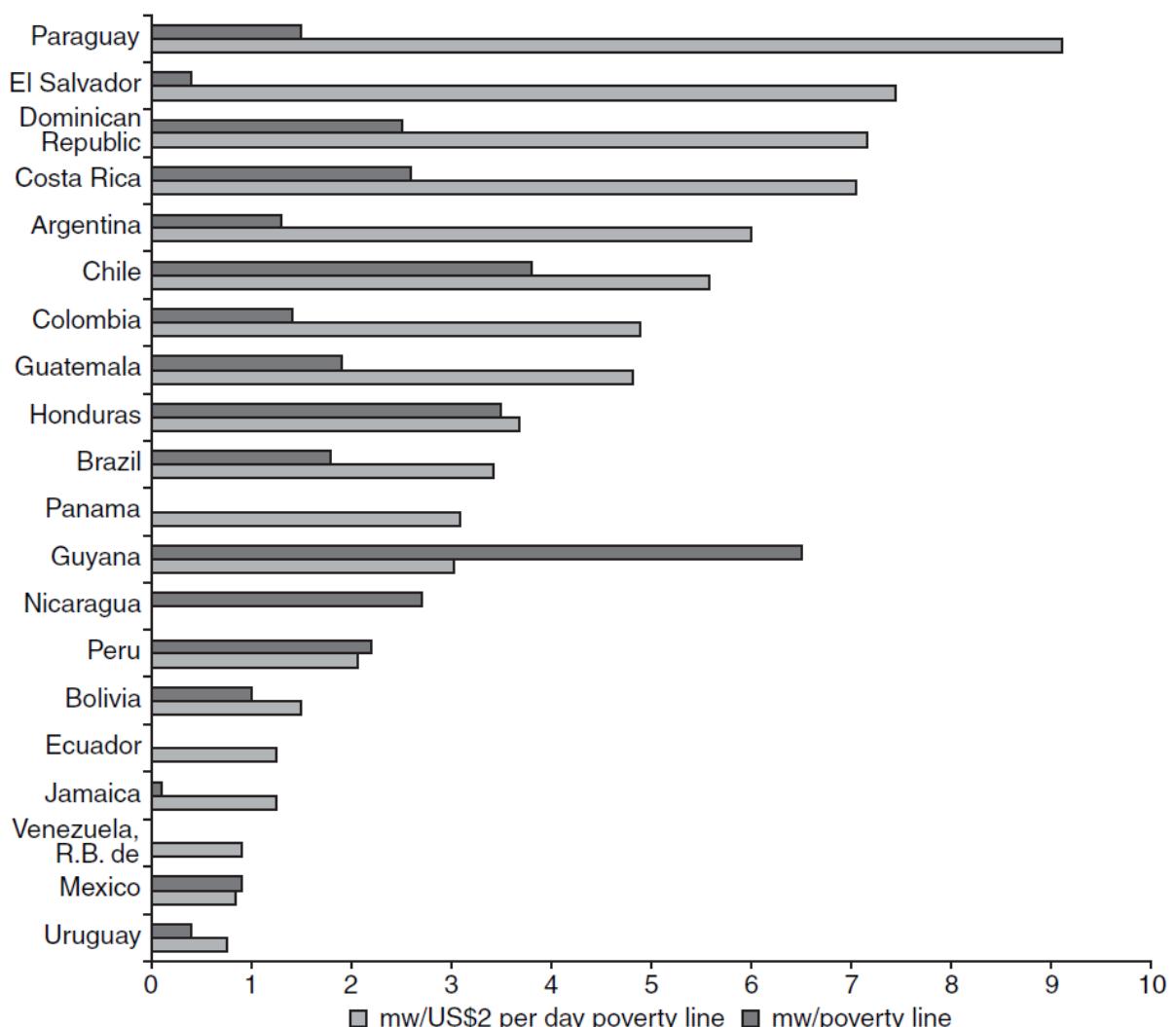
	<i>Mw is somewhat binding (spike at the minimum wage)</i>	<i>Mw is not binding (smooth wage distribution)</i>
Formal wage sector	Brazil (1999)	Argentina (2000)
	Chile (2001)	Bolivia (1999) ^a
	Colombia (1999)	Costa Rica (1999)
	Ecuador (1998)	El Salvador (1998) ^a
	Guyana (1999) ^b	Guatemala (2000) ^a
	Nicaragua (2001)	Honduras (1999) ^a
	Panama (1998)	Jamaica (1998) ^a
	Paraguay (2000)	Mexico (1999)
	Peru (1999)	Uruguay (1998)
	Venezuela, R.B. de (1998)	
Informal wage sector	Brazil (1999)	Argentina (2000)
	Chile (2001)	Bolivia (1999)
	Colombia (1999)	Costa Rica (1999)
	Ecuador (1998)	Dominican Republic (1997) ^a
	El Salvador (1998)	Guatemala (2000)
	Mexico (1999)	Honduras (1999)
	Nicaragua (2001)	Jamaica (1998)
	Panama (1998)	Uruguay (1998) ^a
	Paraguay (2000)	
	Peru (1999)	
	Venezuela, R.B. de (1998)	

Source: Kristensen and Cunningham (2006).

a. The kernel density wage distributions show a spike, but the cdf (right graph) does not show a cliff, suggesting that the minimum wage "impacts" we see in the kernel density may be a statistical artifact.

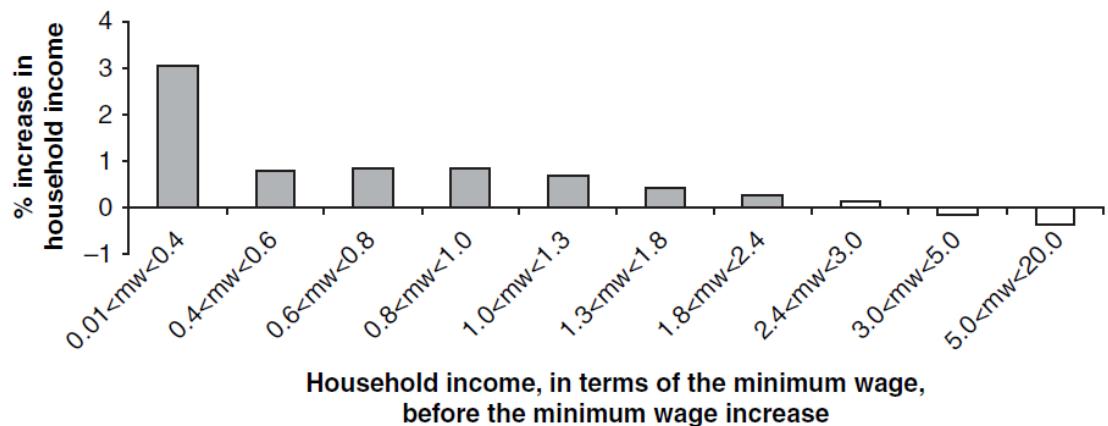
b. Wage workers could not be identified as formal sector or informal sector.

Figure 2: Minimum Wage Relative to the House Hold Per Capita Poverty Lines – US\$2 per Day of the Consumption-Basket Poverty Line



Source: Kristensen and Cunningham (2006).

Figure 3: Impact of a 10% Increase on the Minimum Wage on House Hold Income in Mexico, 1999



Source: Cunningham and Siga (2006).

Note: The shaded bars indicate that an impact was found (t-values are statistically significant at the 5% level); the nonshaded bars indicate that a change was estimated, but we cannot determine whether it is the measured amount or zero (t-values are not significant at the 5% level).

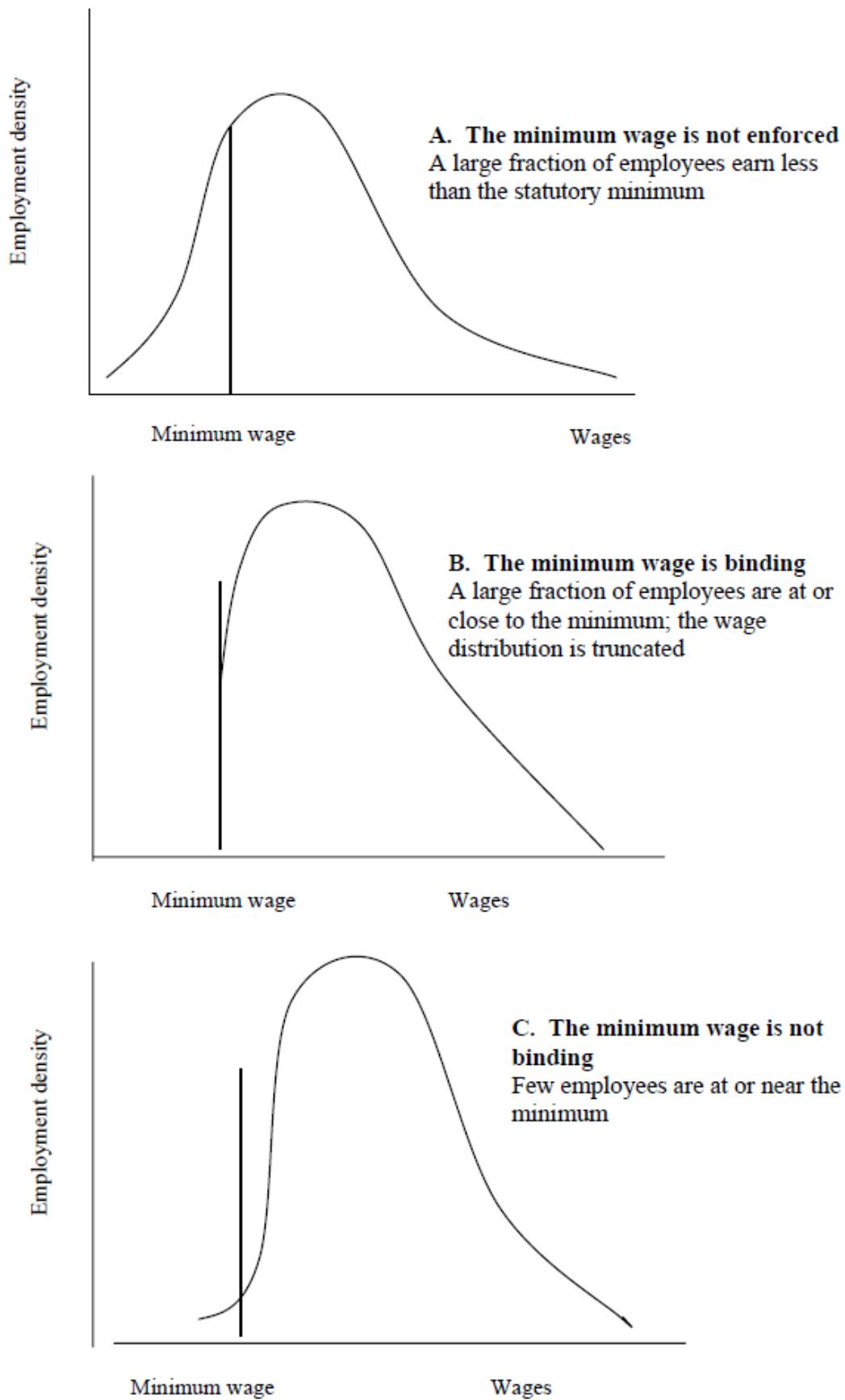
Table 3: Minimum Wage Differentiation

Minimum wage varies by:	Country ¹
Age	Austria, Belgium, Denmark, Finland, France, Germany, Ireland, Italy, Luxembourg, Netherlands, Norway, Portugal, Spain, Sweden, Switzerland, USA
Job tenure	Austria, Belgium, Greece, Ireland, Italy, Norway, Sweden
Region	Austria, Finland, Germany, Ireland
Industry	Austria, Denmark, Finland, Ireland, Italy, Norway, Portugal, Sweden, Switzerland
Occupation	Finland, Greece, Ireland, Sweden

1. OECD countries only.

Source: (Dolado et al. 1996)

Figure 4: The Minimum Wage and the Wage Distribution Source (Rutkowski, 2003)



REFERENCE LIST

1. Alata, V., & Cameron, L. (2003). The Impact of Minimum Wages on Employment in a Low Income County: An Evaluation Using the Difference-in-Differences Approach. *The World Bank*, Working Paper 2985, March.
2. Belser, P. (2012/2013). National Minimum Wages: International Experience. *International Labour Office: Global World Report*.
3. Carpio, X.D., & Guyen, H., & Wang, L.C. (2012). Does the Minimum Wage Affect Employment? : Evidence from the Manufacturing Sector in Indonesia. *The World Bank*, Working Paper 6147, July.
4. Cottle, E. (2014). Bargaining Indicators 2014: Twenty Years – A Labour Perspective. *Labour Research Service*: 2.
5. Cunningham, W. (2007). The Minimum Wages and Social Policy: Lessons from Developing Countries. *The World Bank*, Working Paper 2007003319.
6. Glewwe, P. (1998a). The Distribution of Welfare in Cote d'Ivoire in 1985. *Washington DC: World Bank: Living Standards Measurement Study (LSMS)*, Working Paper No 29.
7. Glewwe, P. (1988b). The Distribution of Welfare in Peru in 1985-1986. *Washington DC: World Bank: Living Standards Measurement Study (LSMS)*, Working Paper 42.
8. Keeton, G. (2014). Inequality in South Africa. *Helen Suzman Foundation*, 74:26-27, November.
9. Kuznets, S. (1955). Economic growth and income inequality. *American Economic Review*, March.

10. Kuznets, S. (1963). Quantitative aspects of the economic growth of nations: VIII Distribution of income by size. *Economic Development and Cultural Change*, January.
11. Netshitenzhe, J. (2013). Why Inequality Matters: South African Trends and Interventions. *Mapungubwe Institute for Strategic Reflection (MISTRA)*: 1-5, November.
12. Rutkowski, J. (2003). The Minimum Wage: Curse or Cure?. *The World Bank*, July 1.
13. Woolard, I., & Leibbrandt, M. (1999). Measuring Poverty in South Africa. *University of Cape Town: Development Policy Research Unit*, Working Paper 99: 33, October.
14. Writer, S. (2015). *BusinessTech: The Shocking Truth about Unemployment in SA*. [Online]. Available: <http://businesstech.co.za/news/general/79035/the-shocking-truth-about-employment-in-sa/>. [11 March 2015]

