

Category: Undergraduate

The Potential Impact of a National  
Minimum Wage Policy in the South  
African context  
(2016 words)

---

## 1. Introduction

The 2007-2008 global financial crisis has resulted in broad-based critique and re-evaluation of the ideological hegemony of neo-liberalism, and especially its neoclassical conception of self-regulated and efficient markets (Krugman, 2009; Bresser-Pereira, 2010). This has triggered significant debate concerning economic theory and policy (Lawson, 2009:1), and the global political economy has subsequently also experienced a neo-Keynesian shift in macro-economic policy (Blankenburg and Palma, 2009). This neo-Keynesian global shift has thereby acquiesced to a global environment where development agendas can be pursued more successfully. If we shift our focus to South Africa more specifically, this seems to be a welcomed change, since South Africa's political economy has itself seen a more socially characterised, neo-Keynesian shift since the second tenure of Mbeki's presidency (and a consolidation and expansion there-of under Zuma) (Habib, 2013:88-109; Masilela, 2013:36; and Ngepah & Mhlaba, 2013:75). The domestic shift can be attributed to the failure of trickle-down, neoliberal economics in post-1994 South Africa in addressing the country's deep-rooted issues of poverty, inequality and unemployment (Habib, 2013: 108).

Concurrently, I propose that the contemporary challenge to the neoclassical model also alludes to the minimum wage debate. The debate on the effects of the minimum wage as redistributive tool (especially via its impact on employment) seems to greatly characterise the modern day challenge to the neoclassical economic model and its assumptions. Minimum wage research has come to be seen as a test of the applicability of neoclassical price theory to the determination of wages and employment (Leonard, 2000:118). The debate serves as a litmus-test for the domains in which neoclassical price theory can be said to properly apply.

In light of the South African ruling party's identification of a possible national minimum wage mechanism to reduce income inequality in its 2014 election manifesto (ANC, 2014:26), accompanied by the President's hinting there-at in the recent State of The Nation Address (The Presidency, 2015), it seems significantly apt to investigate the potential influence that a minimum wage can have in a South African context. This would, however, first require preliminary investigation into (i) the current state of South Africa's socio-economic climate in terms of economic growth, inequality, poverty and unemployment; and (ii) a contextualisation of the current state of the minimum wage debate. This will allow us to gain insight into how such a minimum wage might operate in a South African context.

## 2. Contextualising the current state of South Africa's growth, inequality, poverty and unemployment

Central to South Africa's political-economic discourse is the agenda of "development". The "developmental state" is seen as central to solving the country's social, economic and institutional

issues (Edigheji, 2010:3). The development discussion in South Africa necessarily entails a discussion on inclusive economic growth and the redistribution of the wealth created. The three key tenets on which this discourse centres around are poverty, inequality and unemployment (Habib, 2013: 73). This developmental focus is exemplified in recent literature discussions (such as that of the National Development Plan (NPC, 2012) and the HSRC's 2012-2013 State of the Nation (Pillay et al., 2013) publication).

Ngepah and Mhlaba (2013:72) indicate that for meaningful and irreversible poverty reduction to occur, two conditions must be met: (i) there must be sufficiently high and sustained economic growth, and (ii) an efficient wealth distribution and reduction of inequality. The South African government therefore plays a central role through the designing and implementation of poverty- and inequality reduction policies. Historical-structuralist explanations, such as those of Habib (2013:73-108) and Seekings and Nattrass (2006), give clear insight on this point by dissecting the dynamic interplay between actors and context and between historical developments and present circumstances. They indicate how the post-1994 general adoption of a neo-liberal economic agenda of deregulation, liberalisation and privatisation has come at the great social cost of exacerbating the apartheid inheritance of poverty, inequality and employment (despite the fiscal gains of increasing finance and stabilising inflation and interest rates). Additionally, this intertwined triad of challenges- poverty, inequality and unemployment- has also been hampering potential economic growth (Bhorat and Kanbur, 2006:1). What results is a mutually exacerbating situation where economic growth is needed to address this triad of issues, but these same issues are what is hampering the potential for economic growth. Furthermore, Kingdom and Knight (as summarised in Chitiga-Mabugu (2013:170)) indicate that high levels of unemployment (and the resulting poverty and inequality) have negative effects on economic welfare and lead to social exclusion, the erosion of human capital, reduced productivity and production, social instability, and crime, among other things. These socio-economic challenges clearly manifest in the current South African socio-economic environment.

However, unemployment seems to not only be part of the problem, but also represents an avenue and opportunity through which poverty and inequality can be addressed. Ngepah and Mhlaba (2013:84) indicate that one of the biggest contributors to income inequality is wage income. The root of this wage inequality is identified as the result of a relatively high skilled workforce at the higher end of the income-distribution spectrum, compared to great masses of low- or unskilled labourers towards the bottom (Ngepah and Mhlaba, 2013:84). There also seems to be a mismatch between the demand in the labour market, and the skills and locations of the workers seeking employment (Chitiga-Mabugu, 2013: 172). The labour market is therefore central to addressing inequality and poverty (Bhorat et al., 2001: 205).

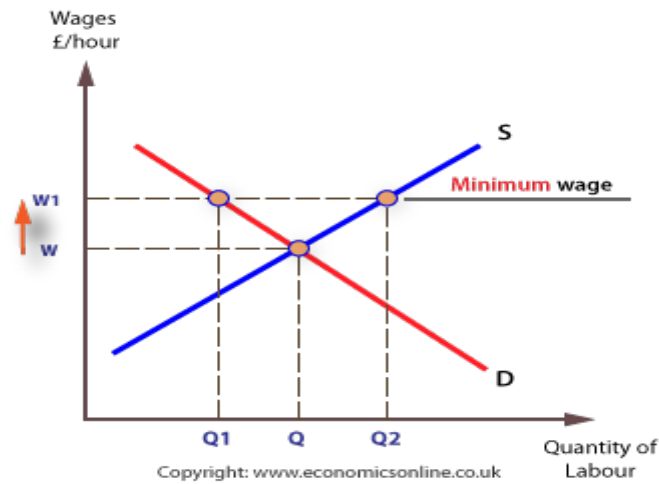
Pro-poor economic growth and government policy, especially in addressing unemployment, is therefore required (Natrass, 2004: 153; Altman, 2004: 180; Chitiga-Mabugu, 2013: 182; Ngepah and Mhlaba, 2013: 85). The pro-poor growth literature, however, has been dominated by discussions on social grants and public work programs (as exemplified in the work of Natrass (2004), Ngepah and Mhlaba (2013), and Altman (2013)). Little attention has been given to the effects that a minimum wage can have in terms of addressing this triad of challenges facing South African society.

### **3. The minimum wage debate**

The literature on minimum wages is enormous. The employment effect of the minimum wage, especially, is one of the most studied topics in all of economics (Schmitt, 2013:1). The debate in minimum wage theory manifests as a contestation between two poles, broadly termed the institutionalists and neo-classical economists (Kaufman, 2010:428).

The neoclassical approach to economics is centred on the presupposed efficient functioning of the market. The neoclassical model indicates that the most important influence on these connections, prices, can be logically explained as results of shifts in supply and/or demand, and that actors in the market, according to these constraints and influences, will always act in an efficient and productive manner (Resnick and Wolf, 2012:37). Labour supposedly also operates in a competitive market based on supply and demand, functioning like the market for any consumer good. At a certain price, the quantity of labour supplied by labourers and the quantity of labour demanded by employers will reach equilibrium. Mandated minimum wages are therefore treated as any other price floor (indicated by  $w_1$  on the graph).

Figure 1: The Neoclassical Minimum Wage Market (Economics Online, n.d.)



According to minimum wage laws, such a price floor inevitably results in unemployment (the difference between  $Q_2$ , the amount of people willing to work at the higher wage  $w_1$ , and  $Q_1$ , the amount of people that firms are willing to hire at the higher wage  $w_1$ ). At such a minimum wage price the aggregate supply of labour therefore exceeds the aggregate demand for it (McConnell and Brue, 1999:594; Gwartney et al, 2003:97). Consequently, it can be deduced from this model that those adversely affected by the shortage of employment will be those in the low-skill labour market. Although some workers might receive the higher wage, other workers will be laid off, or will work fewer hours. If the quantity of labour refers to employment, then the wage gains of those who keep their jobs must be traded off against the wage losses of those who lose their jobs (Leonard, 2000: 118).

I do not concur with this seemingly universal neoclassical norm prevalent in general analysis, where studies of a minimum wage effects explicitly or implicitly start with the assumption of a competitive labour market and the subsequent dialogue on how demand and supply via self-interest, market competition, and the Invisible Hand leads to an efficient, welfare-maximizing formation of prices and quantities. Like the institutionalist paradigm, I agree with Kaufman's (2010: 432) contention that traditional neoclassical economic price theory assumes away the most important and difficult part of the economic problem- its social and human character. This is especially the case with its core competitive market model that to this day is the principal tool used in analysing the minimum wage (Kaufman, 2010: 432). Institutionalists are therefore critical of the mechanistic, generic assumptions that the neoclassical approach follows so religiously. They advocate that the competitive model and neoclassical price theory in general, although contributing to certain useful insights, also bypass the fundamental determinant of whether a country is rich or poor, and its people satisfied or discontented. Kaufman (2010:432) therefore identifies the institutionalist goal as:

*“devising and strengthening an efficient and just institutional order that promotes material abundance and social advance when individual agents have limited brains and a propensity to selfish, short-sighted, and emotionally driven behaviour, and when conflicts, power plays, and non-cooperative behaviour define the base-line state of nature”.*

#### **4. Empirical evidence**

As characteristic of debates between contesting theoretical perspectives, the empirical results are mixed subject to the theoretical basis of the research. Meta-studies of the results of global empirical studies into the effects of minimum wages (such as those of Doucouliagos and Stanley (2009), Wolfson and Belman (2014) and Herr et al (2009)) have indicated the following: (i) there were no statistically significant negative employment effects found for moderate minimum wage increases; (ii) almost all the empirical studies found that higher minimum wages compress the wage structure and alter the income distribution; (iii) low-paid, low-skilled and especially female labour benefit from minimum wage increases (Herr et al., 2009:7); and (iv) to a certain extent there is also grounds for posing that minimum wage policy increases can also reduce poverty (seen in the studies of (amongst others) Machin and Wilson (2004), Dolado et al. (2000) and Neumark and Wascher (1997)).

#### **5. Concluding by applying the minimum wage as redistributive tool in a South African context**

The discussion of the essay until thus far has highlighted the importance of pro-poor, inclusive economic growth and development in the South African context. Employment, especially, has been highlighted as an important tool to address the triadic challenge of inequality, poverty and unemployment. It was therefore critical that a potential minimum wage would not increase an already high unemployment rate. However, meta-studies of the empirical results of the impact of minimum wages around the globe found no statistically significant impact on employment, whilst other redistributive benefits were found to result (see above).

Hirsch, Kaufman, and Zelenska (2011:1) propose a "channels of adjustment" approach, which investigates the means by which cost increases associated with the minimum wage alter "...the behaviour of firms, with impacts on workers, consumers, owners, and other agents". The institutionalist model indicates several such channels of adjustment, which does not necessarily lead to decreased employment, benefits, training, or working hours for employees; or to higher prices for consumers (and the consequent inflation) such as advocated in the neoclassical competitive model (Schmitt, 2013:12) . From the institutionalist perspective, (i) employers may respond to a minimum-wage increase by applying greater managerial effort towards enhancing productivity; (ii) higher

minimum wages could also increase productivity through "efficiency wage" effects (where employees are more productive at the higher wage-level, either to ensure that they stay employed (Akerlof, 2012), or in reciprocity for the higher wages paid (Hirsch, Kaufman, and Zelenska, 2011:5-7; Hall and Cooper, 2012); (iii) it is possible that a higher minimum wage-level, through increasing the spending capacity of low-wage workers, can stimulate the economy by increasing greater demand for firms' output, at least partly offsetting the rise in wage costs (Hall and Cooper, 2012). Such an institutionalist model therefore seems to anticipate greater total productivity and welfare as the general consequences of a minimum wage.

However, for such a manifestation of the minimum wage-effects (as described in the institutionalist model), I propose that the minimum wage would also have to meet certain other criteria. First, the minimum-wage would have to operate political-economic environment where there is a concessional agreement between political elites, business (small and large) and labour. In other words, the fears of all parties must be addressed and in this process, compromises are required from and costs need to be borne by all parties involved (this would represent something like the social compact presented by Habib (2013: 136-137) and Masilela (2013:37)). Second, the minimum wage itself must also be high enough to impact on a sufficient number of labourers; it should be adjusted frequently; it should increase at least at the same ratio as the increase in the total revenue earned plus inflation; and it should at least increase in with average wage levels (as to prevent an increase in the wage gap and the resulting income inequality) (Herr et al., 2009:24). Finally, a minimum wage must be used within a larger framework of pro-poor policies that ensure inclusive economic growth that addresses the challenges of unemployment, inequality and poverty.

## 6. Bibliography

- Akerlof, G.A. 1982. Labor contracts as partial gift exchange. *Quarterly Journal of Economics*, 97(4): 543-569.
- Altman, M. 2013. The challenge of employment creation in South Africa. (In Pillay, U., Hagg, G., Nyamnjoh, F. and Jansen, J., eds. *State of the Nation: South Africa 2012-2013: Addressing Inequality and Poverty*. Cape Town: HSRC Press. p. 184-222).
- Altman, M. 2004. The state of employment and unemployment in South Africa. (In Daniel, J., Habib, A. and Southall, R., eds. *State of the Nation: South Africa 2003-2004*. Cape Town: HSRC Press. p. 158-183).
- ANC. 2014. 2014 Election Manifesto: A Better Life for All. <http://www.anc.org.za/docs/manifesto/2014/anc-manifesto.pdf> Date of Access: 28 May 2015.
- Bhorat, H. and Kanbur, R. 2006. Introduction. (In Bhorat, H. and Kanbur, R., eds. *Poverty and policy in the post-Apartheid South Africa*. Cape Town: HSRC Press. p. 1-17).
- Blankenburg, S and Palma, J.S. 2009. Introduction: The Global Financial Crisis. *South African Labour Bulletin*, 16(6): 22-32.
- Bresser-Pereira, L.C. 2010. The global financial crisis, neoclassical economics, and the neoliberal years of capitalism. *Revue de la regulation: Capitalisme, institutions, pouvoirs*, 7(2). <http://regulation.revues.org/7729> Date of Access: 28 May 2015.
- Chitiga-Mabugu, M. 2013. The employment effect of economic growth: Introducing the South African economy. (In Pillay, U., Hagg, G., Nyamnjoh, F. and Jansen, J., eds. *State of the Nation South Africa 2012-2013: Addressing Inequality and Poverty*. Cape Town: HSRC Press. p. 169-184).
- Dolado, J. J., Felgueroso, F. and Jimeno, J.F. 2000. The Role of the Minimum Wage in the Welfare State: An Appraisal. IZA Discussion Paper No. 152.
- Doucoulagos, H. and Stanley, T.D. 2009. Publication Selection Bias in Minimum-Wage Research? A Meta-Regression Analysis. *British Journal of Industrial Relations*, 47(2): 406-428.
- Economics Online. N.d. The Minimum Wage. [http://www.economicsonline.co.uk/Market\\_failures/Minimum\\_wage.html](http://www.economicsonline.co.uk/Market_failures/Minimum_wage.html) Date of Access: 28 May 2015.
- Edigheji, O. 2010. Constructing a democratic developmental state in South Africa: Potentials and challenges. Cape Town: HSRC Press.



- Gwartney, J. D.; Stroup, R. L.; Sobel, R. S. & Macpherson, D. A. 2003. *Economics: Private and Public Choice*. 10<sup>th</sup> ed. Mason, Ohio: South-Western Cengage Learning.
- Habib, A. 2013. *South Africa's suspended revolution: hopes and prospects*. Johannesburg: Wits University Press.
- Hall, D. and Cooper, D. 2012. How raising the federal minimum wage would help working families and give the economy a boost. Issue Brief No. 341. Washington, DC: Economic Policy Institute. <http://www.epi.org/files/2012/ib341-raising-federal-minimum-wage.pdf> Date of Access: 23 May 2015.
- Herr, H., Kazandziska, M. & Mahnkopf-Praprotnik, S. 2009. The Theoretical Debate about Minimum Wages. [http://www.global-labour-university.org/fileadmin/GLU\\_Working\\_Papers/GLU\\_WP\\_No.6.pdf](http://www.global-labour-university.org/fileadmin/GLU_Working_Papers/GLU_WP_No.6.pdf) Date of access: 26 March 2015
- Hirsch, B.T., Kaufman, B.E. and Zelenska, T. 2011. Minimum Wage Channels of Adjustment. IZA Discussion Paper No. 6132. Germany: Institute for the Study of Labor. [http://www2.gsu.edu/~ecobth/IZA\\_HKZ\\_MinWageCoA\\_dp6132.pdf](http://www2.gsu.edu/~ecobth/IZA_HKZ_MinWageCoA_dp6132.pdf) Date of Access: 23 May 2015.
- Krugman, P. 2009. How Did Economists Get It So Wrong? *New York Times*, 2 September. [http://www.nytimes.com/2009/09/06/magazine/06Economic-t.html?pagewanted=all&\\_r=0](http://www.nytimes.com/2009/09/06/magazine/06Economic-t.html?pagewanted=all&_r=0) Date of Access: 28 May 2015.
- Lawson, T. 2009. The current economic crisis: its nature and the course of academic economics. *Cambridge Journal of Economics*, 33:759-777.
- Leonard, T. 2000. The Very Idea of Applying Economics: The Modern Minimum-Wage Controversy and Its Antecedents. *History of Political Economy*, 32 (supplement): 117–144.
- Machin, S. J. & Wilson, J. 2004. Minimum Wages in a Low-Wage Labour Market: Care Homes in the UK. *The Economic Journal*, 114( 494): 102-109.
- Masilela, T. 2013. A review of the National Development Plan: Introducing politics and the state in South Africa. (In Pillay, U., Hagg, G., Nyamnjoh, F. and Jansen, J., eds. *State of the Nation: South Africa 2012-2013: Addressing Inequality and Poverty*. Cape Town: HSRC Press. p. 35-71).
- McConnell, C. R. & Brue, S. L. 1999. *Economics*. 14<sup>th</sup> ed. New York: Irwin-McGraw Hill.
- Neumark, D. & Wascher, W. 1997. Do Minimum Wages fight Poverty? National Bureau of Economic Research, Working Paper No. 6127.

Ngepah, N. and Mhlaba, S. 2013. The role of South African government policies in economic growth, inequality and poverty. (*In* Pillay, U., Hagg, G., Nyamnjoh, F. and Jansen, J., eds. *State of the Nation: South Africa 2012-2013: Addressing Inequality and Poverty*. Cape Town: HSRC Press. p. 72-97).

Resnick, S.A. & Wolff R.D. 2012. *Contending Economic Theories: Neoclassical, Keynesian, and Marxian*. Boston, Massachusetts: MIT Press.

Seeking, J. and Natrass, N. 2006. *Class, race, and inequality in South Africa*.

South Africa. National Planning Commission. 2012. *National Development Plan*. Pretoria.

South Africa. The Presidency. 2015. *State of The Nation Address 2015*. <http://www.gov.za/president-jacob-zuma-state-nation-address-2015> Date of Access: 23 May 2015. [Speech].

Wolfson, P. and Belman, D. 2014. *What Does the Minimum Wage Do?* Kalamazoo, MI: Upjohn Institute for Employment Research.