



A Minimum Wage

"[I]t has come to pass that working men have been surrendered, isolated and helpless, to the hardheartedness of employers and the greed of unchecked competition...To this must be added that the hiring of labour and the conduct of trade are concentrated in the hands of comparatively few; so that a small number of very rich men have been able to lay upon the teeming masses of the labouring poor a yoke little better than that of slavery itself."

[...]

"Just as the symmetry of the human frame is the result of the suitable arrangement of the different parts of the body, so in a State is it ordained by nature that these two classes should dwell in harmony and agreement, so as to maintain the balance of the body politic. Each needs the other: capital cannot do without labour, nor labour without capital."¹

Pope Leo XIII, Rerum Novarum 3, 19.

1. Introduction

South Africa faces alarmingly high levels of inequality, poverty and unemployment in the context of a weak economic outlook. Recently, Parliament hosted a series of hearings and workshops on the possibility of legislating a national minimum wage. A National Economic Development and Labour Council (NEDLAC) task team is currently discussing some form of a minimum wage agreement, and has until July to report back to Deputy President Cyril Ramaphosa. This debate was foreshadowed by the inclusion of a call for an investigation into the topic of a minimum wage in the ANC's 2014 election manifesto, at the behest of the Congress of South African Trade Unions (COSATU).

At this point it seems quite likely that there will be a national minimum wage, but the real question is at what level this wage will be set. On the one hand, some economists, such as Nicoli Nattrass² and Jeremy Seekings warn of job losses and worsening unemployment if the minimum wage is set at too high a level. Given South Africa's serious problems with unemployment these arguments should give us pause. We really cannot afford significant job losses.

On the other hand, not all economists agree³ with this proposition and most trade unions (such as COSATU⁴ and the South African Clothing and Textile Workers Union, SACTWU) insist that a higher minimum wage is needed to allow people to survive, and will in fact stimulate the local economy by fostering demand among the working class. Furthermore, South Africa has extremely high inequality, and current wages are often below the basic amount needed to survive and raise a family. Clearly, this is unsustainable – a point that we should take seriously, given the repeated violent strikes, service delivery protests and, most recently, xenophobic riots.

As things currently stand, South Africa does not have a directly legislated national minimum wage. Rather, minimum wages are determined sectorally, via bargaining councils or through the Employment Conditions Commission. The Commission generates wage determinations for sectors that are not covered by bargaining councils. Such arrangements would not be supplanted by a national minimum wage, but would create a base level below which such determinations could not fall.

This briefing paper will attempt to shed some light

on the terrain of the debate on the national minimum wage. In the process it will discuss some of the economic concepts commonly invoked in debates around minimum wages, as well as some of the arguments for and against a higher national minimum wage. This debate includes issues around the cost of living for the poor and the likely impact of a minimum wage on job creation.

2. Wage Elasticity, Supply and Demand

The neo-classical school of economics tells us that wages and employment are linked via the elasticity of labour demand. Generally, when something is cheaper, people will purchase and use more of it. This supply and demand relationship is affected by a concept called elasticity, which refers to how much the price of something changing will affect the demand for that commodity⁵ on the open market. Elasticity differs from commodity to commodity. Something that is extremely elastic is subject to swings in demand that are very closely linked to the price. For example, if the price of chocolate increased, most people would buy less chocolate, either forgoing it altogether, or choosing equally delectable but cheaper alternatives, such as nougat. There would always be a few diehards who would pay whatever it took, but these would be a minority. Overall, chocolate consumption would fall dramatically.

On the other hand, petrol is relatively inelastic.⁶ When the price of petrol goes up, most people simply have to spend more money. People can avoid leisure driving, and they may have the option of travelling via the train or walking or riding to their destinations, but a great deal of driving is very necessary and simply cannot be avoided. If someone takes a minibus taxi to work, and they have no other way of getting there, then they cannot do anything to reduce their use of the taxi – they simply have to bear whatever the price of petrol (as transmitted through the taxi fare) is, and hope that they can negotiate a higher wage, or find ways to cut back expenses elsewhere.

This phenomenon of elasticity also manifests itself in relation to wages and hiring. All other things being equal⁷, if labour is cheaper, businesses are more likely to hire people, provided they will continue to make a profit by doing so. On the other hand, when the cost of labour rises, businesses will look for ways to maintain or increase their output without hiring more people, possibly by using automation or tools that allow fewer people

to do the same amount of work. When building a road, for example, one can hire large numbers of people with shovels, or one can use one bulldozer. Car wheels can be attached by a worker or a robot. Clothes can be moved around a factory floor by people carrying baskets or by an automated overhead rail system.

Such economic observations need to be wreathed in caveats. These broad concepts do not take account of factors such as industrial policy, supply chain efficiencies, tariffs, or a host of intervening issues that affect the competitiveness of various industries or how much people get paid. It would be a mistake to believe in a rigid, mechanistic relationship between the level of the minimum wage and the employment rate.

To be fair, economists such as Professors Nattrass and Seekings who worry about job losses are not deploying such a crude argument – however, they do believe that higher wage levels will affect business decisions, and that the prospect of job losses should be taken seriously when considering how to set minimum wages.

The textile and clothing sector in South Africa has been one of the bellwethers of this broader debate around jobs and wages, and is the specific example that Nattrass and Seekings have focused on. A previously thriving sector, competition from cheap Chinese imports has put serious pressure on this industry and has resulted in numerous factory closures.

According to Professor Nattrass, there are two 'tiers' of clothing manufacturers. The lower tier specialises in cheap, easily made garments such as t-shirts and sleepwear, and pays lower wages while being quite labour intensive. Manual labour is extensively used, for example for putting in rivets in jeans or moving clothes down the factory line.

The second, upper tier makes clothes such as blazers, jackets and sportswear, and is more capital intensive. That is to say, there are fewer workers, but they earn more, are more skilled, and use more tools and equipment. Nattrass' concern is that too high a minimum wage will effectively eliminate the lower tier, which relies on cheap labour to remain competitive with the aforementioned Chinese products.

While this is an example of one industry, the question extends beyond clothing (or agriculture, where similar debates have taken place). Overall,

this can be summed up as an apparent tension between creating decent work (which pays enough for people to survive and support their families) and creating work of any sort, which will allow people to at least do better than just remaining unemployed.

3. Inflation, Food Prices and the True Cost of Living for the Poor

It is important to note that neoclassical economics generally does not take account of morality. For example, in an unregulated market a firm that has a monopoly on a uniquely powerful cancer drug can charge whatever it wants for it, but obviously price-gouging cancer patients is a deeply problematic action. Similarly, when negotiating with desperately poor people it is possible for businesses to offer extremely low wages, especially if the workers have nowhere else to turn to, or are not effectively unionised.

What is economically possible and what is right are often at odds, and marrying the two requires serious thought, and good data about the ultimate impacts of policy decisions. It is important to understand not just what businesses are willing or able to pay, but also how much money people need to survive.

The Pietermaritzburg Agency for Community Social Action (PACSA) has done extensive work on the cost of living for the poor, based on ground level research on issues such as the cost of transport and food. Most notably, they regularly update a monthly food price barometer. This is based on a basket of 32 different types of food, based on the observed purchasing patterns of low-income earners, at shops that they usually frequent.

It is important to understand that PACSA's work has been longitudinal, which means it provides a series of snapshots of the food price over time. This contributes greatly to the value of their work, and allows reliable conclusions to be drawn from their studies.

This has been coupled with other budgetary work on the cost of living and the needs of poor people, in order to develop an accurate understanding of the true cost of living for them. PACSA's work has garnered a significant amount of respect and is often cited in respected publications such as *Business Day* when discussing related topics.

The evidence from PACSA's work overwhelmingly shows that poor people in South Africa do not have the resources they need to sustain themselves. According to their research, "a household earning R4 000 a month would be spending 41% of their income on the food basket." Furthermore, "The 2014 PACSA Food Price Barometer has shown that as economic pressures increase on households and certain foods became unaffordable, households substitute those foods for cheaper products. These cheaper products have now become unaffordable, leaving households with no further choices but hunger... The protests that are mushrooming across the country and the increasingly protracted and violent wage strikes are indicative of the situation in which workers can no longer afford to feed their families on their low wages."⁸ This statement was made in October 2014, and 3 months later the first of the most recent xenophobic attacks took place. It is increasingly being argued that the xenophobic riots, along with other social unrest, are closely linked to poverty and increased financial pressure on the poor.

As PACSA has astutely noted, this pressure on the poor comes from a variety of sources. It is not just the rapid increase in the cost of food that has put so much pressure on their budgets, but a host of sources, including the increased cost of electricity. Any hope for relief resulting from lower petrol prices has been dampened by recent tariff increases announced in the latest national Budget. Writing for the *Mail and Guardian*, Chantelle Benjamin notes that "In general, those in favour of the government's proposals to implement a minimum wage put forward a figure of R4 500."⁹ COSATU (alongside others) has argued that people require approximately R4 500 per month to survive, and that a minimum wage should be set at between R4 800 and R6 000 per month¹⁰. This, in their account, will both address poverty and inequality, as well as actually assist the economy, through a phenomenon known as wage-led growth.

4. Wage-led Growth

Henry Ford, the American industrialist, famously paid his workers well enough that they could afford to buy the cars that they made. The argument for wage-led growth seeks to take this idea and manifest it broadly. If workers are paid well they can afford to buy more products, which stimulates demand and in turn leads to a virtuous

cycle of increased production, job creation and economic growth.

This argument has been put forward by supporters of an increased minimum wage, such as COSATU's Neil Coleman. Drawing on experiences from Brazil, the UK and the US, Mr Coleman has argued that increasing the minimum wage can both alleviate poverty and assist in economic growth by increasing the purchasing power of the working class, resulting in a faster growing economy.¹¹

This prospect needs to be considered seriously. If COSATU is correct, putting more resources in the hands of the poor via an increased minimum wage would be both in accordance with Catholic social thought, and economically sound. Their specific demands sound high, but the thrust of their argument is worth engaging with.

Professor Nattrass argues, however, that Mr Coleman's examples (Brazil and the US) are both economies in which inequality is high, but unemployment is relatively low. In other words, addressing unemployment is not a priority in these economies, and consequently there is more space to increase minimum wages, without having to worry about unemployment increasing.

Professor Nattrass also argues that Brazil has reached the limits of its wage-led growth. Furthermore, she notes that the increased spending will not always necessarily reinvigorate the economy and that a portion of this spending will likely go towards imports (e.g., of Chinese products), thus deepening our trade deficit without improving the economy.

5. Beyond the Minimum Wage

One of the fundamental problems is that the poor need more income, but transferring this wealth to them via increased wages could lead to fewer jobs. Professor Nattrass has suggested that we should seek alternative means of transferring wealth to the poor that will not increase unemployment, such as greatly increasing taxes on the wealthiest sectors of the society and using the increased revenue to fund a basic income grant. This, she argues, would have the effect of avoiding job destruction.

In their paper on the topic, economists Gilad Isaacs and Ben Fine have argued that minimum wages are merely a (relatively small) part of the totality

of factors that determine employment.¹² Industrial policy, tariff policies and so on are all important, and Isaacs and Fine urge sensitivity to these factors, accusing Professor Nattrass of 'fixating' on minimum wages. While they are correct about the need for a 'big picture', this claim is perhaps a little unfair. Professor Nattrass is certainly not uninterested in the plight of the poor, nor is she ignoring all other issues. Indeed, advocates on both sides of the issue have been willing to look further than the debate. For example, some advocates of a higher minimum wage (such as Mervyn Abrahams, the director of PACSA) have also recognized the potential problem of job losses, and have suggested that smaller businesses need to be assisted to deal with this.

When considering this debate, the foremost question must be how to best help the poor and address inequality. The complication is how this can be effected without potentially backfiring, due to the amoral nature of market economics.

6. Conclusion

Whether the minimum wage is implemented, and at whatever level it appears, it is obviously nothing like a complete solution to South Africa's economic woes. An entire array of issues, including electricity constraints, productivity, education and industrial policy need serious attention. Indeed, the labour writer Terry Bell argues that the minimum wage is at best an extremely small piece of the puzzle in dealing with South Africa's problems, if not an outright distraction.¹³

However, wading into such debates at this point in time is not feasible. The current proposed policy is to institute a minimum wage. Government has not proposed, and is not seriously considering, a more progressive tax system in order to fund a Basic Income Grant. General progress in implementing the National Development Plan has been disappointing. These are all issues that urgently need be discussed, but it would be a mistake to use these as 'silver bullet' notions in order to avoid any discussion of the level at which the minimum wage should be set.

If nothing else changes, but the minimum wage is increased significantly, then marginal businesses will quite likely be forced to close their doors. At the same time, allowing businesses to enrich themselves by exploiting the poor is deeply unjust.

As with so many South African issues, this one is likely to remain deeply divisive, whatever the legislated outcome of the debate.

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¹ Pope Leo XIII (1891) *Rerum Novarum – Encyclical of Pope Leo XIII on Capital and Labour*

² Professor Natrass presented many of her arguments at a Round Table discussion held by the Catholic Parliamentary Liaison Office in April of 2015. For an explanation of Natrass and Seeking's position, see Natrass and Seeking, (2015) *What is at issue in the minimum wage debate?* Econ 3x3, 20 January 2015. < <http://www.econ3x3.org/article/what-issue-minimum-wage-debate>>. A copy of Professor Natrass' presentation from the Round Table is available on the CPLO's website, at <http://www.cplo.org.za/wp-content/uploads/2015/04/National-Minimum-Wage-15-April-2015.pdf>.

³ See Isaacs and Fine's work for a nuanced, well thought out challenge to Natrass and Seeking's position. Isaac and Fine (2005) *The National Minimum Wage Debate: looking beyond a narrow focus on labour markets*, Available at <<http://www.econ3x3.org/article/national-minimum-wage-debate-looking-beyond-narrow-focus-labour-markets>>. Historically, one of the most famous papers challenging the theory of minimum wage increases leading to job losses is Card and Krueger (1992), which showed a minimum wage increase in New Jersey not leading to job losses, by comparison with next-door Pennsylvania, which did not increase the minimum wage. Of course, Nicoli Natrass challenges the idea of drawing parallels from the US experience. Card and Krueger (1992) *Minimum Wages and Unemployment: A Case Study of the Fast Food Industry in New Jersey and Pennsylvania* < <http://www.nber.org/papers/w4509.pdf>>

⁴ Neil Coleman has written two pieces laying out COSATU's position. See *Many benefits to decent pay – and no, it does not kill jobs* available at <<http://www.bdlive.co.za/opinion/2014/08/22/many-benefits-to-decent-pay--and-no-it-does-not-kill-jobs>> and *Myths and so-called facts about the national minimum wage* available at <<http://www.dailymaverick.co.za/opinionista/2014-11-10-myths-and-so-called-facts-about-the-national-minimum-wage/#.VUHv0yGqqko>>

⁵ I use the word commodity advisedly, since this is the way labour is treated in this school of thought.

⁶ It varies significantly from location to location and changes over the short and long term, but one study found that a 10% increase in the cost of petrol decreases consumption by about 2.5%. For an accessible summary of this issue, see Moffat, Mike *What's the price elasticity of demand for gasoline?* Available at: <http://economics.about.com/od/priceelasticityofdemand/a/gasoline_elast.htm>.

For a more technical paper on this topic, see. Graham, Daniel J and Glaister, Stephen. 2002. *The Demand for Automobile Fuel – A Survey of Elasticities*. Journal of Transport Economics and Policy, Volume 36, Part 1, January 2002, pp.1±26. Available at: <<http://www.ingentaconnect.com/content/lse/jtep/2002/00000036/00000001/art00001>>

⁷ It is important to remember that quite often all other things are not, in fact, equal, and many other factors can impact on hiring decisions. At this point we are still discussing theory, however.

⁸ From their press release, available at:

<http://www.pacsa.org.za/images/docs/Media%20Statement%202014%20PACSA%20Food%20Basket_Final.pdf>.

See PACSA's website for all years of the food barometer, as well as an in depth explanation of their methodology.

<http://www.pacsa.org.za/research/research-reports/food-price-barometer#!2012_PACSA_Food_Price_Barometer_small>

⁹ Benjamin, Chantelle. *Minimum Wage, Maximum Debate*. Mail and Guardian, 12 September 2014. <<http://mg.co.za/article/2014-09-11-minimum-wage-maximum-debate/>>

¹⁰ <http://www.cosatu.org.za/docs/pr/2014/pr0204.html>

¹¹ See endnote 3 for Mr Coleman's arguments.

¹² See endnote 2 for this reference.

¹³ Mr Bell also spoke at the Round Table with Professor Natrass and Mervyn Abrahams.