Minimum wages in South Africa

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Outline

Two questions:

1) What does the theoretical and empirical evidence say about minimum wages?

2) How does this fit with what the policy aims to do?

Firms choose different inputs and technologies which differ across a number of dimensions, particularly firm size

50 small firms:

1 big firm:

Three things emerge from this (and are backed up by large amounts of empirical research):

- Larger firms pay higher wages
- Smaller firms hire people with lower skills
- Wage share is a higher proportion of costs for smaller firms

How would a (binding) minimum wage affect this?

Levels effect:

- Fewer individuals employed
    - The magnitude of this will depend on the ‘wage elasticity of demand’ (how sensitive employment is to wages)

How would a (binding) minimum wage affect this?

Composition effect:

The impact will differ across individuals, firms and sectors

- Individuals
  - Raises wages of the lowest paid (lowest skilled) by relatively more, i.e. makes them relatively more expensive to hire
- Firms
  - Affects the firms which pay the lowest wages and those with the largest relative wage shares
    - Most labour intensive, generally smallest
- Sector
  - Affects the sectors where (international) competition is the highest and where the cost increases cannot be passed on to consumers
    - Tradable vs non-tradable

Recent South African specific evidence

Bhorat et al (2012, 2014)

- Wages for those who remained employed increased by about 17 percent but employment probability in agriculture fell by 13 percent
- Other sectors less affected
- What is the main difference across these sectors?
  Non-tradable: Retail; Taxis; Security; Domestic workers
  Tradable: Agriculture; Forestry (maybe)

Magruder (2012)

- Centralized bargaining agreements are found to decrease employment in an industry by 8-13 percent, with losses concentrated among small firms

Recent South African specific evidence continued

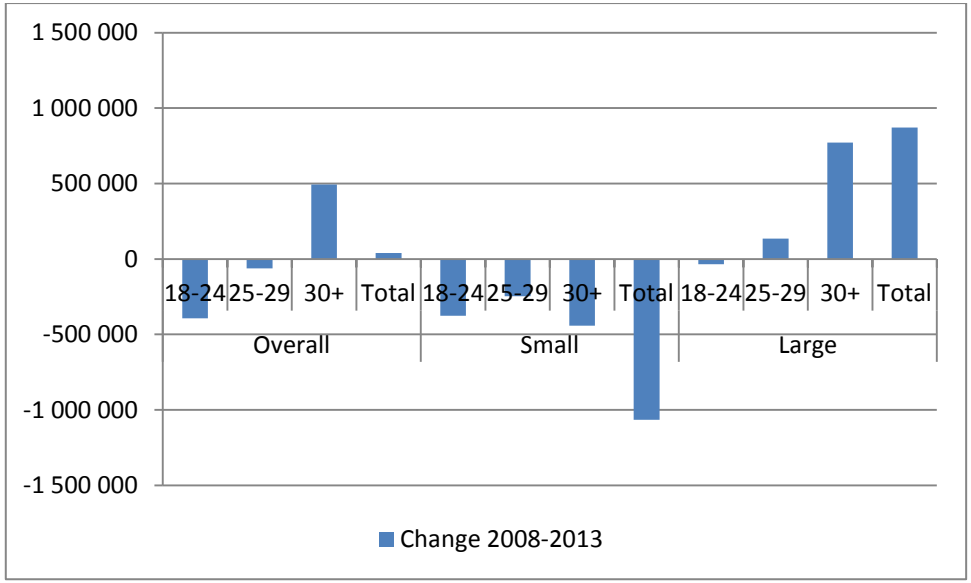
Edwards, Rankin and Stijns (2014)

- Smaller firms in sectors with active Bargaining Councils that face high imports are more likely to exit
- Also labour-intensive firms with higher ratios of unskilled negatively affected
- Possible mechanism: binding Bargaining Council wage agreements mean that small firms which cannot pay the higher wages and cannot upgrade their capital exit

Where have all the lower wage small firm jobs gone?

Kerr et al (2014) – No net new job creation between 2005 and 2011 in firms with fewer than 500 employees (fewer jobs in smaller firms)

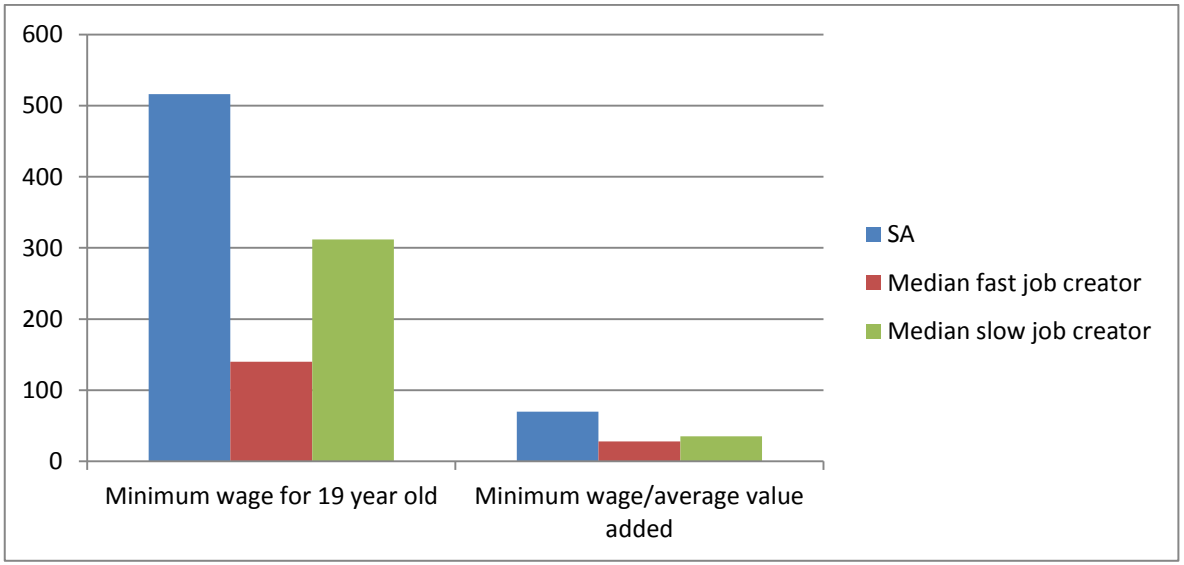
Quarterly Labour Force Survey



How do South African wages compare?

Minimum wages (2008 US$) and minimum wages/average value added.

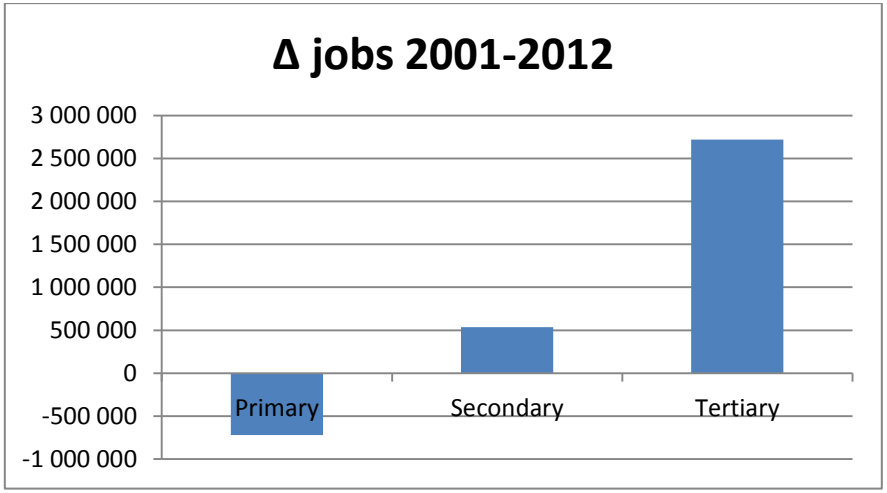
South Africa compared to its peers which have created jobs either rapidly or slowly.



Source: Zhan (2011)

What could explain what we are seeing?

- Increased concentration of jobs in bigger firms which are not constrained by wage floors (and in Bargaining Councils may actually set higher wages to drive out competition from smaller firms)
- Smaller firms which survive choose capital-intensive high skilled production technology (larger firms already generally choose these)
- Shift in jobs away from tradable sectors to non-tradable (tertiary/service) sectors as a response to restrictions and trade competition



Source: Bhorat, 2014

Domestic consumption vs international competitiveness

What characterises periods of exceptional growth?

Growth Commission Report – 13 countries which have sustained growth episodes

"**Is a turn outward the only route to growth?** Some economies have instead **looked inward**, competing with imports in the home market, rather than competing for foreign custom in the world market. These strategies have **occasionally succeeded in spurring investment**, increasing the size and efficiency of domestic producers. They also avoid the risks and dislocations of opening up to foreign competition too abruptly. Nevertheless, **growth strategies that rely exclusively on domestic demand eventually reach their limits**. The **home market** is usually **too small to sustain growth for long**, and it **does not give an economy the same freedom to specialize** in whatever it is best at producing."

How does this fit with a national minimum wage policy?

Calmfors and Driffill (1988) suggest that the ‘worst’ system is bargaining at the sector level

Certainly in sectors like manufacturing the Bargaining Council system, particularly the extension to non-parties, destroys firms and jobs

A change here may actually lead to higher employment but this will depend on the level of the wage and the institutional process in determining it

Is a national minimum wage the correct policy for the desired outcomes?

Poverty, inequality and unemployment

Poverty?

- Social transfers – requires tax revenue
- Jobs – unlikely to be created as a first round effect
- Intra-household transfers – those who remain employed have higher incomes and share this with other household members

Is a national minimum wage the correct policy for the desired outcomes?

Unemployment?

- Jobs – not first round effect
- Probability of job loss and lower likelihood of employment are likely to fall on lower-skilled, smaller firms, youth, tradable sectors. These are precisely the types of jobs we need to be creating for the unemployed to fill

Is a national minimum wage the correct policy for the desired outcomes?

Inequality?

- Depends on what aspect of inequality we are concerned with
- Between those with jobs and those without
  - No
  - Employment already concentrated
  - Those with formal jobs are already relatively high up the income distribution (see for example Seekings, 2014)
- Within wage earners
  - Constraint at the bottom-end is demand
  - Constraint at the top-end is supply
- Do we care about wages or income?
  - Other policies are better at increasing incomes without the same negative effects
    - For example an earned income tax credit similar to that in the US[1]
    - Social transfers

[1] See for example http://www.npr.org/blogs/money/2013/04/12/177063399/episode-451-why-some-people-love-tax-day and http://www.npr.org/blogs/money/2013/03/15/174358638/a-surprisingly-uncontroversial-program-that-gives-money-to-poor-people for a non-technical explanation.

Key issues to think about:

- What is the correct level?
  - Does this differ across certain dimensions?
    - Firm size
    - Youth
    - Sectors

- How does it link productivity and wages?

- How does this affect existing structures?

- Who decides?
  - Are players also the referee?
  - How do you include the excluded like the unemployed and smaller firms?
  - Certainty?