

# THE MISUNDERSTOOD MINIMUM WAGE

*A case study of South Africa*

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## **Development Policy Research Unit (DPRU)**

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# SOUTH AFRICA



24.9

Unemployment Rate



65.0

GINI



84.5

Wage and salaried  
workers, total (% of  
total employed)



14659

GDP per person  
employed  
(constant 1990 PPP \$)



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## Introduction

After independence from colonization, many countries within Africa introduced some form of minimum wage legislation. According to the ILO,<sup>1</sup> 37 out of the 55 African countries had a minimum wage policy framework by 2008. However, very few of these countries have tested the economic and labor impacts of such legislation.

Studies conducted in various other developed and developing countries on the impact of minimum wages have produced mixed results and spurred a debate that stretches as far back as 1913.<sup>2</sup> On the one hand, classical economic theory claims that if mandated wages are higher than what the equilibrium of supply and demand for labor would require, the result

will be adverse effects on employment, hours worked, and non-wage benefits.<sup>3</sup> On the other side of the debate is the argument that with an increase in minimum wages comes a reduction in poverty and inequality and increased demand for goods and services, fueling economic growth.<sup>4</sup> Overall, the results produced from these studies on this matter depend on the country context, methodology used, and, in some cases, perceived bias of their authors.<sup>1</sup>

Several studies have measured the effects of minimum wages on employment, wage levels, hours of work and contractual obligations in South Africa. In addition, researchers have examined the institutions mandated to set and

*i* For example, Card and Kruger's (1994) seminal paper *Minimum Wages and Employment: A Case Study of the Fast Food Industry in New Jersey and Pennsylvania* claimed increases in wages did not lead to disemployment effects. However, this paper spurred several response papers from Neumark and Wascher (1995, 2000) which claimed to use the same data set but found disemployment effects. See: D. Neumark and W. Wascher. 1995. *The Effect of New Jersey's Minimum Wage Increase on Fast-Food Employment: A Re-Evaluation Using Payroll Records*. Cambridge: National Bureau of Economic Research, Working Paper 5224; D. Neumark and W. Wascher. 2000. *Minimum Wages and Employment: A Case Study of the Fast-Food Industry in New Jersey and Pennsylvania: Comment*. *American Economic Review*, vol. 90, 5:1362-1396

enforce minimum wages within the country along with levels of compliance with minimum wage legislation. While some sectors such as agriculture appear to be significantly impacted by minimum wage increases, other sectors have witnessed little or no adverse effects. In some of these studies, employers have adapted to minimum wage laws by reducing employees' hours of work rather than laying them off. Importantly, these studies show that, for workers, the benefit of increased wages outweighed the loss in hours worked.

Overall, much is misunderstood about minimum wages within South Africa. Workers' unions within the country lobby for doubling or even tripling the current minimum wages and claim that no adverse effects to employment or the economy

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would result. Some employers' organisations believe that minimum wages should be abolished completely, and that the free market should set wages. These two policy stances represent opposite ends of a spectrum of opinions in South Africa. Yet they share common characteristics: they are unrealistic and would both be detrimental to the economy and social well-being of the country's poor population. This chapter seeks to provide clarity on the topic of minimum wage legislation by contextualizing the debate and detailing sector-specific empirical evidence of minimum wage legislation's impact in South Africa given the country's unique historical, social and economic context. It then outlines policy recommendations based on the core concerns around minimum wages in the country.

# Background: The minimum wage policy framework in South Africa

The major legislative frameworks that govern labor relations in South Africa today are the Labour Relations Act of 1995 and the Basic Conditions of Employment Act of 1997, which outline the country's two major wage-setting systems:

- Collective bargaining through bargaining councils<sup>ii</sup>
- Sectoral Determination (SDs) that are published by the Ministry of Labour and set minimum wages for sectors/areas

The Labour Relations Act (1995) created a voluntary system that promoted centralized bargaining while extending collective bargaining rights to almost all employees. It established private sector bargaining councils as well as public service bargaining councils for civil servants. The Basic Conditions of Employment Act of 1997 sets a minimum floor of rights for all employed individuals in the South African labor market and allows for the Minister of Labour to create SDs that dictate the conditions of employment, including minimum wages, for vulnerable workers in a specific sector.

However, the bargaining council framework, through which some sectoral wages are determined in South Africa, faces some of the same challenges as its predecessor law in terms of its effectiveness and ability to represent and cover a wide spectrum of workers and businesses, enforce compliance, and manage the tradeoff between employer and employee interests.<sup>iii</sup> Currently, there are 47 bargaining councils in South Africa spanning from the clothing industry to civil engineering.

Sectoral Determinations, first introduced in 1999 with the contract cleaning sector, cover a range of sectors including wholesale and retail, domestic workers, farm workers and private security, amongst others.<sup>5</sup> In total, there are currently 124 different wage schedules legislated through SDs that apply across various sectors, areas and occupations. Compared to other BRICS and African countries, this is a high number of minimum wage rates, contributing to the wage system's complexity and making it difficult to enforce (See **Table 1** below).

*ii Bargaining councils can be understood as institutionalized collective bargaining structures established by one or more registered trade unions together with one or more registered employer organizations for a specific area and sector in the economy. They are statutory in the sense that they apply to and are officially recognized by the registrar of labor relations. Participation in a bargaining council is voluntary and the parties negotiate wages, conditions of employment, and social benefit funds. See: S. Godfrey, J. Maree, D. Du Toit, & Theron, J. (2010). Collective Bargaining in South Africa: Past, present, and future? Claremont: Juta & Co, Ltd.*

*iii Benjamin, Borat, & Cheadle (2010) also note rigidities in the labor market are also due to the inefficient judiciary system. While the Commission for Conciliation, Mediation and Arbitration (CCMA) has been proven to efficiently resolve labour disputes, Labour Courts in South Africa have created substantial labor market hysteresis. See: P. Benjamin, H. Borat and H. Cheadle. 2010. The cost of "doing business" and labour regulation: The case of South Africa. International Labour Review, 149: 73–91.*

Table 1

**Minimum Wage Schedules in Select African and Emerging Economies**

Country	Number of Wage Schedules
Brazil	1
Russia	1
Uganda	1
Mali	1
Ghana	1
Malawi	1
Nigeria	2
Botswana	10
Zambia	10
Tanzania	29
China	31
Namibia	32
India	45
Kenya	55
Ethiopia (public sector)	57
South Africa	124

Source: Various Labour Departments of Respective Countries and ILO TRAVAIL Database.

## The impact of sectoral minimum wages in South Africa

The number of empirical studies focused on the impact of minimum wages in South Africa is relatively small compared to the number

conducted in developed countries. Only seven sectors have been studied, and no economy-wide impact studies exist. What the sector-

specific studies show is that minimum wages have had varying effects on employment, hours worked, and wages. These studies also demonstrate a relationship between compliance and enforcement of already established minimum wages and the impact of new minimum wage legislation in South Africa.

In the domestic workers sector, Hertz found that employment decreased and working hours were reduced after the introduction of a sectoral minimum wage for domestic workers over the period 2001 to 2004.<sup>6</sup>

Average wages within the sector, however, did increase as a result of the minimum wage. This is in contrast to more recent work by Dinkelman & Ranchhod<sup>7</sup> and Borat, Kanbur & Mayet,<sup>8</sup> which found no clear evidence of disemployment effects. Borat, Kanbur & Mayet did find that hours worked were reduced, but that increases in the minimum wage outweighed this effect in terms of workers' overall income.<sup>9</sup> In other words, even if their working hours were reduced, workers were still earning more due to the rise in the hourly wage. In addition to the domestic workers sector, Borat, Kanbur & Mayet also examined the

retail, private security, forestry, and taxi sectors. The authors found no disemployment effects in these sectors and showed that real hourly wages

increased for all sectors as a result of the legislation, except for the forestry and taxi sectors.<sup>10</sup>

In agriculture, Borat, Kanbur & Stanwix found significant negative employment effects as a result of the introduction of minimum wages in the sector.<sup>11</sup> Additionally, average wages and the incidence of a written contract increased substantially. Garbers

found that an increase in agricultural minimum wages in 2003 was accompanied by job losses of approximately 16 percent, of which 7.5 percent was directly attributable to higher unskilled labor costs resulting from a higher wage floor.<sup>12</sup> Conradie surveyed 190 wine and table grape farmers in the Western Cape and found that a 10 percent increase in the minimum wage had led to between 3 and 6 percent of workers being let go.<sup>13</sup> Murray & van Walbeek surveyed 103 farmers in Natal and found no large disemployment effects. However, they estimate that workers' hours were reduced by between 22 percent

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and 40 percent.<sup>14</sup> Sparrow et al<sup>15</sup> found that an increase in labor costs motivated employers to replace farmworkers with machinery and casual laborers.<sup>iv</sup>

Overall, from the literature examined above, it appears that regular employment in the agricultural sector was most negatively affected by the introduction of minimum wages in 2003 – replaced mainly by mechanization and casual labor. The result of introducing minimum wages in other sectors seems to be mixed but with no major negative impacts. However, where negative effects have been identified, marginalized

populations – such as women, youth and low-skilled workers – seem to be most affected. For example, the impact of the 50 percent increase in agricultural minimum wages in 2013 has not yet been analyzed empirically, but there is some anecdotal evidence to suggest that employment in the Western Cape has been affected, and that employment losses have been concentrated among women.<sup>v</sup>

A minimum wage, however, will only have an impact in the event that it is enforced and therefore compliance plays a key role in determining the outcome of minimum wage policies.

## Compliance and enforcement: A difficult balance

South Africa, like many other developing countries, witnesses high rates of minimum wage non-compliance. Concerns over the economic effects of minimum wage laws – understandably prominent in the context of active labor market policies – have largely overshadowed the discussion of compliance and enforcement. Internationally, the research in this area is nascent and in many cases the data are inadequate to understand enforcement practices and the

various elements that influence compliance. However, papers by Borat et al,<sup>16</sup> Rani et al<sup>17</sup> and Almeida et al<sup>18</sup> provide clear evidence that many workers covered by minimum wage legislation around the world still earn wages below the legal minimum. These studies have found that factors such as levels of unemployment, firm size, informality, intensity of inspection, and the steepness of fines for non-compliance all influence compliance rates.

*iv Farmworkers in this context are full-time, formally employed workers in the sector. Casual laborers are part-time and informally employed – i.e. no contract or working conditions established, typically paid below the legislated minimum wage, v This information comes from interviews with DoL officials and private correspondence with Ruth Hall at PLAAS.*



Table 2

**Maximum Permissible Fines for Violation (Schedule 2 of the BCEA, 1997 as amended 2014)**

No previous violation	R 300 (US\$ 22.74) per employee
No previous violation in respect to the same provision of the Act	R 600 (US\$ 45.50) per employee
A previous violation the same year or two violations in respect to the same provision during the past 3 years	R 900 (US\$ 68.22) per employee
3 previous violations of the same provision within 3 years	R 1200 (US\$ 90.96) per employee
4 previous violations of the same provision within 3 years	R 1500 (US\$ 113.70) per employee

Source: Basic Conditions of Employment Act, 1997

This section presents updated data on the level and depth of non-compliance in South Africa for each of the SDs – meaning the percentage of workers who are underpaid and the degree to which they are underpaid, respectively. It then provides a brief overview of the enforcement procedures in South Africa at present.

Minimum wage regulations in South Africa are currently enforced by labor inspectors who conduct workplace inspections and serve employers with penalties for violations of stipulated employment conditions listed within SDs. Information on the penalties for non-compliance with the minimum wage law reveals that while repeat offenses and

greater levels of underpayment attract larger penalties, overall the fines are small compared to the degree to which employers underpay their workers (see **Table 2**).

*The evidence suggests that compliance levels are generally low across the developing world and that more rigorous enforcement measures are needed to ensure that firms, as well as households, do not underpay their employees.*

What then do levels of compliance look like in South Africa? **Table 3** uses the violation index to report the levels and depth of non-compliance for each covered sector. The index allows us to calculate the overall level of non-compliance, which is simply the percentage of workers who earn below the minimum wage that applies to them. It also allows us to go beyond this to calculate the depth of this non-compliance, which measures how far below the minimum wage these workers earn, on average.

Table 3

**Level and Depth of Minimum Wage Violation by Sector, 2013**

Worker Category	Percentage of Workers Earning Below the Minimum Wage	Average Degree to Which Workers are Earning Subminimum Wages
Agriculture	0.65	0.26
Forestry	0.75	0.33
Domestic Workers	0.40	0.14
Private Security	0.65	0.28
Wholesale and Retail	0.47	0.24
Taxi	0.38	0.18
Hospitality	0.37	0.16
Contract Cleaners	0.56	0.24
<b>Average</b>	<b>0.53</b>	<b>0.23</b>

Source: Labour Market Dynamics Survey, 2013. Statistics South Africa, own calculations

The numbers are striking, but it must be noted that a high degree of wage dispersion among minimum wages in a sector can cause overestimation. Because there are multiple minimum wages within a sector, the calculation presented here is based on the average wage rate for the sector. Survey data shows the actual number of workers earning below that average sectoral wage rate. In a sector like Wholesale and Retail or Private Security – where there are several and disparate fixed minimum wages, and the higher wage grades pull up the average minimum wage – the percentage of workers earning below their stipulated wage may be overestimated.

On average, 53 percent of workers covered by an SD report earning wages below the legislated minimum, and among those earning subminimum wages the average distance from the minimum wage is 23 percent (i.e. if a stipulated minimum wage is R 100 (US\$ 7.58) per hour, a worker is earning R 77 (US\$ 5.84) per hour, on average). This average, though, masks large intra-sectoral differences in compliance rates. The highest rates of non-compliance are found in the forestry sector where approximately 75 percent of workers earn below the minimum wage, while in the hospitality sector this figure falls to 37 percent. The depth of non-compliance also differs

significantly by sector and is smallest among domestic workers and highest among workers in private security.

Concerning government policy on enforcement, it is evident that if minimum wages are not effectively enforced, the intended policy benefits will largely be restricted to a small proportion of low-paid workers in the public sector. The evidence suggests that compliance levels are generally low across the developing world and that more rigorous enforcement measures are needed to ensure that firms, as well as households, do not underpay their employees.<sup>19</sup>

South Africa is not unique in this regard. Two fundamental issues face policymakers on minimum wage: First, the level at which minimum wage should be set, and second, the degree to which it is enforced. Setting the minimum wage should balance potential wage gains against the

risks of adverse effects on employment, while also taking account of the extent to which wage laws can be enforced. Evidence shows that minimum wages in developing countries tend to be set fairly high relative to the median wage, and that they are often set above the median wage for unskilled labor. Andalón and Pagés,<sup>20</sup> for example, find that minimum wages in Kenya are set high relative to the median wage (above 70 per cent of the median wage in salaried employment) and thus non-compliance levels in the country are also high. South Africa's experience is similar.

***While a number of African countries implemented minimum wage legislation many decades ago, the impact of minimum wages on key labor market variables is not well understood, in part as a result of non-compliance.***

The observation that higher relative minimum wages are generally correlated with higher levels of non-compliance, together with the fact that these two variables constantly interact with each other, should be factored into decision-making around a minimum wage policy.

## Recommendations for policymakers

South African research on minimum wages presents a number of key findings that are useful for policymakers in developing countries.

- The large number of wage schedules in South Africa has made it one of the most complex wage systems in Africa. Simplification of these schedules by having fewer minimum wages should be considered so that managing them is less resource-intensive and enforcement is easier.
- Specific consideration should be given to the agricultural sector when assessing wage adjustments within the country. Evidence shows that this sector is most vulnerable to adverse effects from wage increases.
- The level of the minimum wage plays a significant role in determining employment effects. Despite negligible effects found in some sectors from small minimum wage increases, substantial increases in minimum wages will likely have large negative impacts, as shown in South Africa's agricultural sector.
- Compliance and enforcement are critical for minimum wages to have an impact on

poverty and inequality. However, the fact is that institutional capacity to enforce minimum wage legislation is low, and increases in minimum wages actually increase the rate of noncompliance. Minimum wage policies, therefore, must be complemented with stronger social protections.

While a number of African countries implemented minimum wage legislation many decades ago, the impact of minimum wages on key labor market variables is not well understood, in part as a result of non-compliance. If anything, the research presented here suggests that the impact of minimum wage legislation cannot be easily predicted and will differ depending on a range of factors, which could include the level of the minimum wage relative to average wages, the size of the minimum wage increase, the sector under consideration, the timing of the wage changes, the level of worker productivity, the enforcement regime, and the extent of compliance. This calls for empirical research in the region to guide policymakers such that legislation plays a key role in lowering levels of poverty and inequality.

## Endnotes

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