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COMMENT

on the

NATIONAL MINIMUM WAGE

to the

National Minimum Wage (NMW) Commission, 2021

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Studies by serious researchers on the effects of minimum wage policies, even when those researchers are personally and institutionally sympathetic to such policies, invariably conclude that the imposition of an effective minimum wage depresses employment levels below their natural level. The term, "effective minimum wage" does not imply policy success in achieving its stated goals but rather that the minimum wage is effective only in constraining workers and employers from trading at wage levels at which they would otherwise mutually agree. In simple terms, an effective minimum wage renders most of the affected workers unemployable.

Given the general agreement among researchers that minimum wage restrictions depress employment and add to involuntary unemployment, the only remaining quibble is over the magnitude and distribution of this policy inflicted burden. To proceed with the imposition, or increase, of a minimum wage rate, it is necessary for policymakers to convince themselves that there is some generalized net benefit despite the negative impact on employment levels.

It is argued that income inequality is socially undesirable and that an active policy is needed to reduce, if not eliminate it. But the minimum wage, by separating large numbers of workers from employment in the formal economy, serves to increase inequality in both incomes and living standards.

It might be argued that those workers who remain employed would do so at heightened wage levels and would yield sufficient tax revenue from which to compensate the unemployed for their loss. But this has never been demonstrated. It is true that the removal of lower-productivity workers from the labour force would face employers with a restricted labour supply that would compel them to make operational adjustments to enable them to retain a small number of the marginal workers at a slightly higher wage than they were previously paid. It is also true that higher-skilled workers, by gaining the extra work, would benefit at the expense of the now unemployed lower-productivity workers. But the overall productivity of the population has now been reduced and the minimum wage has, at best, served only to redistribute incomes with no net increase. The real net effect is negative on both current total income levels and future income growth rates.

Of all the possible government policies that could serve to reduce poverty, raising the minimum wage is not one of them. To counter the impact of the negative wealth and income effects of the minimum wage, improvements in other governmental policies would be necessary. Such policy improvements could include those that reduce the cost of doing business: reductions in regulatory burdens, reductions in marginal tax rates, and the simplification of the tax code. Improvement in police services and judicial integrity would help to reduce the costs of business and personal security. Even a reduction in the inflation rate would improve the functioning of the price system and reduce the need for cost-of-living adjustments for all wages, including the minimum wage.

If a policy goal is to promote fair and effective competition in the labour market, the imposition of an effective minimum wage does the opposite. In South Africa and elsewhere in the world, there is a long history of minimum wage laws and other price controls being used to limit competition within the labour market and between companies. Higher income workers who are not directly affected by the minimum wage, but are politically organized and represented by trade unions, can reduce competition from lower paid workers by raising the minimum wage sufficiently to price the competitors out of the market. Similarly, established companies might support a minimum wage to increase the labour costs of smaller, more entrepreneurial firms that are potential business competitors.

When the minimum wage pushes many workers into the informal sector and renders less competitive those marginal workers who retain their jobs, it cannot be argued that the minimum wage promotes fair labour practices. Its general effect is to redistribute wage income from the lowest-paid workers to higher-paid workers, with a net loss from the social perspective. All of this begs the question: Why do minimum wage laws exist?

The imposition of a minimum wage, and any changes, is necessarily a political act and is exercised through governmental authority. The benefits and burdens of the minimum wage are both private and political in their impact. But ultimately only the political costs are relevant to those politicians who take the decisions on setting the minimum wage rate. The burdens are born disproportionately by those who are less politically organized, less educated, and less productive. Those bearing the net burden of the minimum wage are the same people we hear politicians claiming to help.

In that sense, a minimum wage is a luxury good. Invariably, most of those who benefit from minimum wage laws are among the social elites, not those with the lowest income levels. In another sense, the minimum wage is a luxury good in that it is affordable only in countries where per capita income levels are higher. But not even in those countries with higher per capita incomes do politicians dare to push the minimum wage far enough above the market wage to make the unemployment effects obvious and thereby attract political damage. In the lower income countries, with less scope for income redistribution, the net burden is far worse.

Given the stated goals of the minimum wage policy, there is no economic condition for which a minimum wage would be an indicated remedy. An upward adjustment in the wage is certainly not indicated. South Africa's economic growth has been weak over the past several years and the real GDP has not yet returned to pre-lockdown levels. Unemployment levels have been extremely high over many years, with a third of the labour force persistently out of work. Unemployment rates are much higher for the young and for those with lower education levels. These are the people most harmed by an effective minimum wage. With youth unemployment levels now over 60 percent, most young people are unable to get the experience to gain the skills and productive habits that would enable them to earn higher wages.

The minimum wage is one of the factors working against these younger and less-educated members of society. It has rendered them less able to find employment and to get started in their working careers. An increase in the minimum wage would make this worse. A decrease would be better, but even an increase that is less than the inflation rate would help gradually to bring these unemployed people into a productive and stable role in community life.

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