SAEFA
SA ENGINEERS AND FOUNDERS ASSOCIATION

10 February 2025

The Double-Edged Sword: Frequent Minimum Wage Increases in Developing Economies

On 4 February 2025, Employment and Labour Minister Nomakhosazana Meth announced that the National Minimum Wage (NMW) will increase from R27.58 to R28.79 per hour, with effect from 01 March 2025.

In support of the increase, Minister Meth stated that “We are committed to the implementation of social protection initiatives and wage increases, such as the introduction and implementation of the National Minimum Wage, as this ensures that workers receive their dues and are not exploited for the services they render. Every employer may not pay wages that are below the minimum wage."

In the pursuit of economic justice and improved living standards, developing economies like South Africa often turn to frequent increases in the national minimum wage. While these measures may appear well-intentioned, they can inadvertently become a double-edged sword, potentially exacerbating the very economic problems they aim to solve.

The Small Business Dilemma

Small and medium-sized enterprises (SMEs) form the backbone of many developing economies, including South Africa. These businesses often operate on razor-thin profit margins, making them particularly vulnerable to sudden increases in labour costs. As wage bills swell, SMEs may hesitate to take on new employees, opting instead to stretch their existing workforce or invest in automation where possible.

In more severe cases, businesses may be forced to reduce their workforce to remain financially viable, contributing directly to unemployment rates. In an economy with the highest official unemployment rate in the world, this is potentially disastrous. Furthermore, other businesses, unable to afford formal employment at higher wages, may shift towards informal employment arrangements, *reducing* job security and benefits for workers.

Inflationary Pressures

Frequent minimum wage increases can set off a chain reaction throughout the economy. As businesses attempt to maintain profitability in the face of higher labour costs, they often pass these expenses on to consumers through increased prices. This is referred to as cost push inflation.

SAEFA
Administrator charlene@saefa.co.za (018) 771 3210 082 856 7793
Executive Director gordon@saefa.co.za (011) 678 0021 083 412 1437
Registered Employer Organisation LR2/6/3/55
59 Austin Road, Northcliff, Johannesburg, 2195

Higher prices can lead to demands for further wage increases, creating a self-reinforcing cycle of inflation and, paradoxically, while nominal wages increase, the real purchasing power of workers may stagnate or even decline if inflation outpaces wage growth.

<u>The Employment Conundrum</u>
The relationship between minimum wage increases and employment levels is complex. Higher wages may lead employers to demand higher productivity from fewer workers, potentially reducing overall employment opportunities. Employers may also prioritize hiring more skilled workers who can justify higher wages, potentially leaving less skilled workers unemployed. Frequent wage increases may accelerate the adoption of automation technologies, particularly in industries with low-skilled labour.

<u>Economic Growth and Investment</u>
Sadly, the broader economic implications of frequent minimum wage hikes are far-reaching. Higher labour costs may deter foreign investment, as companies seek more cost-effective locations for their operations. In a globalized economy, significantly higher wages without corresponding productivity increases can harm a country's international competitiveness, and frequent wage adjustments can create uncertainty, potentially leading to suboptimal resource allocation as businesses focus on short-term cost management rather than long-term growth strategies.

<u>Conclusion</u>
The challenge of setting appropriate minimum wages in developing economies like South Africa is not one to be underestimated. While the goal of improving workers' lives is noble, the potential unintended consequences of frequent, significant wage increases cannot be ignored. A more holistic approach that considers the complex interplay between wages, employment, inflation, and economic growth is essential. Frequent hiking of minimum wages in an already strained economy with little or no regard to the consequences is taking us backwards, not forwards.

Gordon Angus
SAEFA Executive Director