Proposal for Jobs Summit- reducing Wage Inequality

2 July 2018

1 Problem statement

As outlined in a policy brief on tackling wage inequality in South Africa:

The data suggest that wage inequality in South Africa has deepened over the last 20 years. In his review of earnings trends in South Africa from 1993-2014, Wittenberg (2016) notes: "when we look at the earning distribution as a whole it turns out that the trends are remarkably clear…the top part of the earnings distribution has moved away from the middle, while the distribution at the bottom has become more compressed." (Wittenberg, 2016, p.1). When discussing inequality, it is therefore important to assess the gap between low or median earners and high earners, rather than using the average wage as a benchmark.

Wage inequality matters, because, as found by Finn (2015), it is the largest determinant of overall income inequality by a significant margin. Wages account for 90.65 percent of total income inequality in South Africa – far in excess of the contribution to inequality from remittances and investment income combined.

In order for appropriate action to be taken regarding wage inequality, it is most important to be armed with appropriate and accurate information regarding pay differentials.

There are challenges raised by companies over requiring pay ratio disclosure. However, each of these can be overcome. One argument is that the calculation is an expensive and time-consuming process. However, many companies have to do this already, and the equity-enhancing benefits for society of such a policy have the potential to outweigh any additional cost to the company in collecting the data. Another concern is that companies are able to manipulate the pay ratio reported by outsourcing the lowest-paid jobs or turning low-paid workers into contractors or part-time workers. This could be overcome by mandating the inclusion of such workers in pay ratio calculations even if they are outsourced in these ways. To be meaningful, clear methodological approaches must be defined, regarding which employees are to be compared and what parts of their pay must be included. All elements of remuneration should be taken into account – not just cash payments.

South Africa already has a legislated mechanism for reporting on pay differentials, in the form of section 27 (s27) of the Employment Equity Act (EEA). The strongest possibility for providing say on pay through labour market regulation is contained in the EEA provision that requires designated employers to report on 'income differentials' within the organisation. This provides a mechanism on which to build.

This proposal suggests a suite of interventions to reduce wage inequality, building on the mechanism provided by S27 of the EEA, including information disclosure, public policies promoting reduction of wage inequality, and introduction of a maximum wage ratio.

2 Jobs impact

The main benefit of the proposal will be on improving the quality of jobs and wage income, and the reduction of extreme levels of wage inequality, as outlined in the TORs for the Jobs Summit, under the stream of Inclusive growth, Redistribution and Transformation.

The proposal could indirectly act as a stimulus to employment creation by placing more income in the hands of low paid workers, thereby raising effective demand across the economy.

3 Theory of change

Interventions are proposed, which include provision of information around wage ratios, the setting of norms and standards, and the introduction of maximum ratios between the top and bottom tier of the workforce.

Various international and domestic precedents exist for these interventions, most of them voluntarist. However the extent of pay disparity in South Africa is amongst the highest in the world, and therefore cannot rely solely on voluntarism, and requires clear regulation. This was the conclusion of the Deputy President's National Minimum Wage Expert Panel in 2016, which supported the call for introduction of legislated maximum pay ratios between the top and bottom 5% of earners.

The basis has been laid for such an intervention by Section 27 of the Employment Equity Act, which requires disclosure of pay ratios, and requires measures to be taken to reduce 'disproportionate income differentials'. However Section 27 has not been enforced. It is proposed that Section 27 is amended and strengthened.

4 Existing initiatives/experience

The limitations of existing voluntarist interventions to reduce wage gaps over the last twenty years in South Africa are considered, which demonstrate the need for effective regulation. Additional international experience is considered of using public policy instruments, such as taxation and procurement to leverage greater wage equity.

According to the Deputy Presidents Expert Panel on the National Minimum Wage "More consideration should be given to Section 27 of the Employment Equity Act (EEA).. (to) regulate the observed ratio between the top 5% and bottom 5% of earners in all companies and institutions. We have seen voluntary cases where companies have taken this step; Pretoria Portland Cement (PPC), for example, instituted pay cuts for senior executives, which reduced the ratio between the salaries of senior management and the lowest paid workers from 1:120 to 1:40 (Klein and Masote, 2014). However, it is clear that a voluntarist approach might not be as desirable, and a regulated system could be considered that creates effective wage ceilings to reduce wage inequality."

5 Constituency participation in implementation

There is enormous potential for all constituencies to participate in implementation. Government would play a key role in introducing the legislation, and supporting relevant research, with the assistance of bodies such as the National Minimum Wage Commission. It would also need to play a role as employer in ensuring measures are taken in the state (including state owned enterprises) to appropriately reconfigure the wage structure.

Employers and unions would need to look at how to manage this transformation of the wage structure, and consider complementary strategies through collective bargaining for instance, to ensure that the reduction of wage inequalities takes place not only between the top and the bottom tiers, but also at other levels of the workforce, and between sectors.

6 Benefits

Group	**Job creation**	**Other benefits**	**Time frame for success**
Workers	Unquantifiable at this stage	Increased income. Greater dignity.	Short to medium term
Employers	Greater effective demand necessitating requisite supply-side response	Increased productivity, reduction of workplace conflict	Short to medium term
Communities		Improvement of living standards.	Short to medium term
Government		As above. Increased revenue.	Short to medium term

7 Cost and potential sources of funding

Group	Anticipated costs	Potential sources of funding to implement the project	Time frame for impact
Employers	This depends on the way wage structures are reconfigured, and whether executives, management and other high paid employees are prepared to restrain their pay.	Reorganisation of the wage and salary structure, including reduction of executive bonuses, share schemes etc. Redistribution of part of the surplus.	Short term

8 Risks

Resistance from employers to introducing, or implementing, such measures. However there are growing voices amongst employer leaders, and in the business media, recognising that the current situation is unsustainable.

9 Risk mitigation

There needs to be a frank discussion, led from the top (ie by the President, with his counterparts in the social partners) on the explosive potential of maintaining the current wage disparities, their economic irrationality, and their indefensibility. Agreement needs to be reached that a key element of a social compact is a decisive intervention to address the unsustainable levels of wage inequality. Government and leading employers, together with trade unions, need to be seen to champion the importance of such an intervention.