

NEWSLETTER

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**ECONOMIC COMMENTARY - By Francois Stofberg****Helping entrepreneurs by doing all the wrong things**

We had an interesting chat this week, myself and Dawie Roodt, about what a “fair-wage” is, and whether entrepreneurs in South Africa are earning an unfairly high return for their efforts. We reached an interesting conclusion.

In pure capitalism, demand and supply dictate what wages should be. In these instances, wages would be set at a rate where the marginal product (output) of an individual is equal to his/her marginal cost (wage/salary). This view however, often sets wages too low as it struggles to account for externalities - the basic needs of an employee, the tough social environment, and wrongs of the past, to name but a few. This view also helps to explain why entrepreneurs earn what they do. Not only do entrepreneurs contribute their output, they also contribute their capital (savings). Entrepreneurs forgo current consumption (not buying the BMW when your young) to save their hard-earned income. They ensure they have a good credit rating (with banks and peers), and most importantly, they are willing to take on the ever-increasing risk of doing business in South Africa - which they are handsomely rewarded for.

The other theoretical wage extreme is pure communism, where everyone earns the same (very low) average wage. To many, this seems appealing in a country where a minority hold assets and masses don't earn enough to be economically active. However, the biggest flaw with this view is that it does not effectively incentivise entrepreneurs and highly skilled individuals to do what they do - create abnormal amounts of wealth by using resources most optimally. “Why would I take the risk to start a business, or study for 8 years to become a medical doctor, I'm just going to earn what everyone else is earning”. In the end, under pure communism, resources aren't allocated effectively or efficiently, surpluses are created in all the wrong industries, and basic needs of individuals can't be met.

History has taught us that neither of these extremes are sufficient in providing a stable social environment, and sustained, strong economic growth. A bit of both is a far better solution, and what we're trying to get at in SA. However, enforcing a minimum wage (or using some other form of social justice through redistribution) is not the way to go. Government interventions like these simply distort the very effective workings of the market. Distortions ultimately lead to a tougher, riskier environment in which we must pay higher returns (incentives) to keep investors (entrepreneurs). In the end, those entrepreneurs who survive earn even greater profits (returns) - fuelling social tensions and propaganda like “white capitalism”.

A far better solution for our government would be to support entrepreneurs with tax cuts, better infrastructure, easier access to capital, and easier ways of doing business, to name a few (talking about SMMEs doesn't help the bottom-line). A stable, less-risky environment like this decreases the returns investors (entrepreneurs) earn, or put differently, it decreases the cost of borrowing their savings (capital). But, this favoured environment that encourages individuals to open businesses, also leads to strong, sustained economic growth and job creation! An environment where the pool of wealth has increased substantially, where the rich (although still very rich) are less rich and the poor are far less poor. Overall, this is a much better approach than simply introducing social tricks like a minimum wage, which does nothing to create more wealth, instead it only increasing the returns of investors (entrepreneurs).