



This policy brief addresses the question of state incentives for ensuring voluntary compliance by businesses with the national minimum wage (NMW). It describes monetary and non-monetary incentives used internationally, outlines the main pros and cons of each type, and provides some policy recommendations with respect to a possible South African incentive scheme.

Summary of Findings:

- A combination of business incentives and strict monitoring and enforcement mechanisms can yield higher levels of compliance with minimum wages.
- Participation in any kind of public procurement and/or government industry specific programmes (such as, for example APDP - Automotive Production and Development Programme or MCEP - Manufacturing Competitiveness Enhancement Programme) should be conditional on national minimum wage compliance. Collective bargaining institutions could assist in certifying compliance.
- Providing access to Industrial Development Corporation (IDC), National Empowerment Fund (NEF) and other development finance institution loans and/or creating opportunities for subsidised loans subject to minimum wage compliance is another cost-effective policy option.
- Providing direct tax incentives might be beneficial if targeted and designed appropriately (for example, Brazil's Simples programme), but may place additional strain on the fiscus.

"Incentives can thus play an important part as one element in a package of measures in order to achieve the successful implementation of a national minimum wage."

The National Minimum Wage Research Initiative is an independent academic research initiative run by CSID in the School of Economic and Business Sciences (SEBS) at the University of the Witwatersrand. It is undertaken in the context of a national dialogue on wage inequality and the potential institution of a national minimum wage (NMW) in South Africa.

The views presented are the views of the National Minimum Wage Research Initiative.

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TYPES OF INCENTIVES

State incentives can be designed to motivate businesses to voluntarily comply with newly implemented legislation. There are a number of benefits to the use of incentives. First, incentives assist in preventing violation of legislation (Newitt 2013). A combination of punitive measures and positive incentives can produce a higher compliance rate with newly implemented legislation than punitive measures alone (Shapiro and Rabinowitz 1997). Second, an incentive system can allow for cost savings to the fiscus: the greater the number of companies that comply voluntarily, the less is the need for costly enforcement, sanctioning and monitoring procedures. (Benassi 2011)¹ (however, it is important to mention that providing incentives can, at times, incur costs). Third, incentives can entice informal businesses to formalise in order to qualify for the incentive. Through this process of formalisation, companies, previously outside, are brought into the tax and regulatory net. Incentives can thus play an important part as one element in a package of measures in order to achieve the successful implementation of a national minimum wage.

With regards to minimum wage legislation the most commonly used encouragement mechanisms/programmes and incentives are the following:



Some countries who have introduced national minimum wage legislation, in particular those who have done so more recently, offer a mix of the above-mentioned incentives. Not every country provides incentives to comply with minimum wage legislation.

A full Working Paper by the National Minimum Wage Research Initiative deals with other issues and strategies relating to monitoring, enforcement and compliance (Murahwa, forthcoming).

INCENTIVES CURRENTLY USED IN SOUTH AFRICA

There are currently no known across-the-board incentives to comply with sectoral determinations or bargaining council agreements. There are, however, certain incentives created in the clothing, leather, and textile industries. The National Bargaining Council for the Clothing Manufacturing Industry (NBCCMI) and the National Textile Bargaining Council (NTBC) issue Certificates of Compliance that are valid for

up to one year for those employers who comply with the bargaining determination. With the certificate, a company can apply to the Industrial Development Company (IDC) for a loan, can receive a discretionary grant from the industry Sector Education and Training Authority (SETA), and can qualify for rebates on import duties when importing inputs for finished products. Additionally, a compliance certificate is a prerequisite for applying to the Department of Trade and Industry for the Production Incentive (PI) and Competitiveness Improvement Programme (CIP). The impact of the certificates of compliance initiative on the clothing and textile industry in South Africa remains largely unstudied. However, anecdotal evidence suggests improvements in compliance since it has been linked with government support.

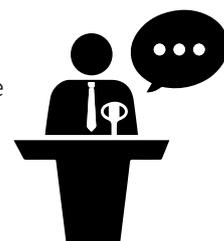
For instance:

- The number of clothing firms with compliance certificates from the NBCCMI have increased since 2010, when the Production Incentive was introduced and linked to compliance;
- The number of home textile firms with compliance certificates from the NTBC have increased substantially since 2010 when the International Trade Administration Commission introduced a rebate on the import duties on fabric used in the manufacture of bed and table linen and linked this rebate to compliance (Vlok, 2015).

THE INTERNATIONAL EXPERIENCE

POSITIVE PUBLIC DISCOURSE

One of the simplest ways to encourage compliance is the creation of a *positive public discourse*. In general this is about generating public awareness of the benefits and necessity of the policy intervention. The positive public discourse runs in two ways - first it motivates companies to comply with the NMW legislation, and secondly it raises awareness amongst workers of their rights. Best performers should be duly recognised by the government and rewarded, and those who do not comply should be presented as "cheaters" and should not be treated favourably (Benassi 2011). Some government departments in the United Kingdom and Denmark, for instance, have a practice of "faming, naming, and shaming" companies in their annual reports (Hampton 2004). The "naming and shaming" part deals with non-compliant businesses, while "faming" recognises companies and organisations that go above and beyond the legislated standards. This type of motivation, however, works best for large corporations, as big companies tend to have high reputational costs.



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¹ There is, however, no research that provides guidance on the optimal balance between punitive measures and positive incentives to ensure maximum compliance with minimum wage laws in the most cost-efficient way.

At the 2015 Employment Equity Awards, the South African Deputy President publicly acknowledged how the cement company PPC took a decision in 2013 to cut the pay of its CEO by R1 million and freeze the pay of its top 60 managers in order to improve the wages of its 1200 lowest earners (Ramaphosa 2015). The Deputy President praised PPC for acting boldly to reduce wage differentials, an example of how "faming" can be executed.

Positive public discourse can also aim to motivate companies to create codes of good conduct that will ensure that employees of those companies, as well as various subcontractors, are not paid below the minimum wage level. Such codes are already in place at certain South African institutions, for example the University of Cape Town (UCT). This practice should be scaled up.

Considerations for a NMW in South Africa:

One of the first incentives to be implemented should be the creation of a positive public discourse and a thorough explanation of the necessity and public benefit of the national minimum wage both to workers and to the business community. According to Benassi (2011) creating an understanding of the importance of a particular policy persuades a number of businesses to comply with new legislation without any additional incentives. Creating awareness also empowers workers to champion their rights.

CERTIFICATES OF COMPLIANCE AND COLLECTIVE BARGAINING AGREEMENTS

Providing various sorts of *certificates of compliance* could be another way of motivating businesses to comply with minimum wage legislation. Usually a company applies to a relevant Commission (often within the Department of Labour), undergoes a full inspection of labour law compliance, and if successful is issued a certificate which is valid for a prescribed period. This certificate of compliance can be tied to access to state loans, tax rebates, public tenders and governmental industry-specific incentives (OECD 2000).

Certificates of compliance and various reputation-related incentives are one of the cheapest types of incentives: the requisite inspection is often relatively easy to conduct, which is an obvious advantage. In addition to their low cost, they can also save the government money in the long term through reduced inspection costs in the future. Certificate of compliance schemes can fail to be useful if the process of getting a certificate becomes lengthy and excessively burdened by red tape. Certificates of compliance have been used in a number of countries for many years and have been recognised as having a positive impact on improving the conditions of workers (Newitt 2013). Newitt cautions that certificate of compliances are unlikely to reach small and medium sized companies. The South African experience, however, shows that this consideration does not hold true across all countries and all sectors. In South Africa, in the clothing and textiles sector around 65% of the companies that participated in the certificate of compliance scheme were small and medium sized enterprises, showing how such certificates can be highly effective (Vlok, 2015).

Considerations for a NMW in South Africa:

The South African clothing and textile sector is currently running a relatively successful Certificate of Compliance programme, in which the companies compliant with bargaining agreements are eligible for IDC loans, SETA assistance and import duty rebates. Such a practice can be scaled up and applied to compliance with the national minimum wage legislation. The ANC's 2014 Elections Manifesto signals a wider proposed use of such schemes, calling for bargaining councils to "be used as vehicles to promote greater equity in the economy through linking access to state incentives and procurement to adherence to living wage standards, and commitments to promoting wage equity in collective agreements." (ANC 2014). A NMW could help expand this beyond bargaining councils.

It is necessary to consider which bodies should be responsible for issuing a certificate. There may be the need to either create a new consolidated body that specialises in this, under the Department of Labour, or to give such a power to an existing department and/or bargaining councils.

PUBLIC PROCUREMENT



Another means through which to incentivise business compliance is tying minimum wage compliance to *public procurement*. Including various social and labour-related clauses in public procurement contracts can be traced back to the mid-19th century (Schulten et al. 2012). In the twentieth century such practices were popularised. For instance, in 1949, the International Labour Organization (ILO) put forward its Convention No. 94 or "Labour Clauses (Public Contracts) Convention" which entered into force from 1952. The ILO Convention stipulates that government public procurement schemes should include clauses that specify that minimum stipulated wages, hours of work, and various working conditions should either be compliant with established collective agreements/national regulation, or be no less favourable than the general observed conditions in the industry or a specific district (Rani 2013).

Sixty three (63) countries have ratified this convention since its adoption in 1949; South Africa is not among these. Some of the countries that have not ratified the convention have, however, adopted similar principles in terms of public procurement. For instance, Germany and the United Kingdom having not ratified the Convention still follow the general European Union public procurement guidelines and have made provisions in public procurement legislation that all participating companies have to pay no less than the minimum wage.

Businesses that enter into contracts with certain municipalities in the United States have to pay their employees above the applicable minimum wage (Benassi 2011, Luce 2012). Some states in Germany, France, Netherlands, Brazil, Ghana, Cuba, and Costa Rica, among others, have put wage-related clauses into their procurement processes.

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The UK is actively rolling out a campaign for public procurement to be tied to the payment of "living wages" (wages higher than the national minimum). Scotland, the City of London (a district in the Greater London area), Oxford, Glasgow and other cities have ensured that their procurement policies require contractors to pay the living wage to their employees (Schulten et al. 2012).

The advantage of leveraging such public procurement practices is the simplicity of the method, and the relatively low administrative cost of such an intervention. The requirement has the potential to lead to a "compliance multiplier" whereby the main contractor (winner of the tender) is liable for the wage compliance not only in her company but also among various sub-contractors that they hire (this was part of the above-mentioned UCT code of conduct). On the downside, some researchers, specifically Lawton and Pennycook (2013), have expressed concerns that vulnerable and very low paid workers might not be reached through this incentive and that public procurement impacts only a limited number of sectors, not reaching sectors like retail for instance.

Considerations for a NMW in South Africa:

According to the 2015 MTBPS, the public sector in South Africa spends over R500 billion a year procuring goods and services. One of the conditions for participating in public tenders should be that contractors and subcontractors (including those manufacturers supplying intermediaries that win tenders) must fully comply with minimum wage legislation.

Public spending in South Africa is on both large government projects and regular procurement. For the latter, small and medium enterprises receive a relatively high share of tenders. This means that this strategy could be effective for both larger corporates and SMEs.

In sectors where SMEs are currently less likely to participate in public procurement such participation can be encouraged through quotas.

TAX INCENTIVES



Some governments *create tax incentives* to motivate businesses to comply with minimum wage laws. Two of the most successful tax incentives programmes are Brazil's *Simples* programme² and the French tax incentive for employers of domestic services.

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Brazil introduced the *Simples* in order to promote the formalisation of small businesses. According to the programme, small companies were entitled to make a single consolidated tax payment rather than numerous contributions to different funds. They were only eligible for participation in this programme upon compliance with labour legislation and minimum wages laws. By 2012 over 9 million small enterprises had been formalised in Brazil and were paying at least the minimum wages and the rate of formal employment increased by almost 14% (ILO 2014b). *Simples* also led to a tax relief for small companies whose owners claimed that their effective tax rate was 20% to 50% lower since they entered *Super Simples* (ILO 2014b). At the same time many businesses who were previously not paying taxes, or observing labour standards, were brought into the tax and regulatory net. This scheme therefore has the tripple advantage of benefiting affected workers, assisting small business, and achieving added revenue for the state. Brazil's treasury has benefitted from an additional R\$ 267 million in contributions from the 9 million businesses that joined the *Super Simples* system of taxation (ILO 2014c).

Another successful example took place in France. France provides tax incentives for employers of domestic and temporary workers who formalise their contracts with these employees and comply with minimum wage legislation. Under the incentive, the employer has to register with the URSSAF (Agency for the Collection of Social Security and Family Allowance Contributions) and then use specially provided bank cheques to pay domestic helpers and other temporary assistants. At the end of a tax year, the employer can claim rebates from the state of up to 50% of wages paid (to a maximum of €1,830) (Gudibande and Jacob 2015). Such a system provides incentives for employers to hire domestic helpers officially and pay them salaries at or above the minimum wage. According to the available research, by 2010, over 66% of domestic workers working for individuals were employed legally (ILO 2013). The state costs of running the incentive amounted, in 2012, to €6.3bn (ILO 2013). At the same time, direct benefits to the state from the incentive amounted to €5.1bn in social insurance contributions, VAT, direct taxation and lower unemployment payouts. An additional €3.875bn was gained as indirect benefits (the study identified the reduction in the costs of supporting dependents and minding children as the biggest benefits), bringing the net gain from running this incentive to €2.6bn a year.

In 2014, in Malaysia, small and medium enterprises and associations could benefit from tax deductions for the first year of the implementation of a national minimum wage. The deducted amount was based on the difference between the cost of previously paid wages and the newly implemented national minimum wage (Asia Pacific Tax Notes 2014). There was no mention of extending these tax deductions to 2015 and later years.

The Thai government reviewed various tax options prior to establishing a national minimum wage in 2013 but decided against providing tax deductions to offset the impact of minimum wages despite the pleas of the SME sector to provide targeted tax relief and loan assistance to small and medium sized enterprises. Instead the government developed a comprehensive tax package to support businesses (Alexander et al. 2013).

Some countries, like the United States, have decided not to grant businesses any additional tax support as an incentive to achieve compliance.

The motivation for not using any broad-based tax incentives, stated during negotiations in 2007 on increasing the national minimum wage, was that:

- Tax cuts/rebates should be temporary in nature, otherwise the cost of tax cuts for the government could be very high and unjustified;
- If tax assistance legislation was not-targeted, that is, if it was not assisting only businesses that have proven their inability to comply with minimum wages, it might create unfair advantages and distort market competition (US Government 2007).

The US Government, therefore, determined that there was no need for nationwide tax cuts in this regard, as there was only a limited number of businesses who might not be able to pay the new minimum wage. Tax incentives, and large tax cuts such as in the Thai case, can be both unwarranted – simply subsidising businesses – and harmful to the fiscus.

The French, Malaysian and Brazil examples show that, tax incentives, if properly designed and targeted, can be successful and have the potential to improve national minimum wage compliance. It is worth noting that the economic logic behind these incentives is different to the usual argument for tax cuts – that this will by default spur investment. Here, the point is to help firms pay higher wages, which can translate into greater spending and economic growth, as well as ensuring a fair wage for workers and a reduction of poverty and inequality. Tax incentives – unlike previously discussed certificates of compliance, name and shame lists and public procurement regulations – can be targeted to those who need them most, and in the context of South Africa these are SMEs and employers of very low-wage earners.

Considerations for a NMW in South Africa:

The formalisation of employment and small business is an important task in South Africa. According to the QLFS, over 2.7 million workers, or 17% of total employed, are working in the informal sector. If an incentive, tied to the successful implementation of a NMW, along the lines of the Brazilian model, could assist in spurring formalisation this should be investigated.

While South Africa does not currently have excessively high tax rates, the effective tax rates for small businesses are higher than for large corporations, so there may be merit in looking at possible interventions in this context. However, across-the-board tax reductions appear neither necessary nor sustainable. In addition, certain targeted tax assistance programmes, most notably the Employment Tax Incentive (the “youth wage subsidy”) has, to date, had zero positive impact despite its significant cost (Ranchhod and Finn 2014, 2015). Therefore any tax incentives need to be carefully thought through.

GOVERNMENT FINANCIAL ASSISTANCE



Another form of incentive is providing *government grants, loans and subsidies to companies* on the basis of minimum wage compliance. In Virginia, US, for example, companies that are located in the Virginia Enterprise Zone and pay their employees at least 1.75 times the current minimum wage could in 2014/15 qualify for a grant of up \$500 per year per position. Those who are paying twice the minimum wage qualify for up to \$800 dollars per year per position for the next five years, starting from 2014/15, provided they are compliant with the legislation and continue paying twice the minimum wage (Virginia Guide to Incentives 2014). Various other US States have similar grant incentive programmes.

Brazil is another example of a country that uses monetary incentives to promote compliance with the national minimum wage. The Brazilian Development Bank (BNDES) offers loans at heavily subsidised rates (the rates were 6.5% versus the market 14.25% in 2015) to companies who comply with minimum wage and labour legislation, environmental legislation, and pay taxes and social contributions among other requirements (Borges 2014; Reuters 2015; WSJ 2015). In addition to this, according to Brazil’s Department of Labour legislation, if an employer has a record of minimum wage non-compliance (established and documented upon inspection by labour inspectors), that employer is blacklisted and denied any access to any *public or private credits and loans*. The employer stays on that blacklist during the next two years and is heavily monitored during that time. Provided the employer changes its behaviour, complies with the minimum wage during the two year period, and pays all the relevant fines and debts, the employer can then be removed from the blacklist (Benassi 2011).

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Thailand has a policy similar to that of Brazil of providing access to state loans at a lower interest rate conditional on labour legislation and minimum wage compliance. Japan and the US have incentives that provided *access to loans from export/import banks* and related agencies based on legislative compliance (OECD 2001). In this latter incentive, both countries aimed at improving compliance with environmental guidelines rather than the minimum wage but such a policy could also be used to motivate businesses to comply with minimum wages.

² Originally a state-level programme, *Simples (Sistema Integrado de Pagamento de Impostos e Contribuições das Microempresas e Empresas de Pequeno Porte* – The Integrated System for the Payment of Taxes and Contributions for Small and Medium Enterprises) was set up in 1996. In 2006/7 it became a national programme until the name of *Simples Nacional* or *Super Simples*.

Generally, the benefit of using grant (and tax) incentives is the opportunity to create a targeted incentive that will result in improved minimum wage compliance. Such incentives are also intuitively very appealing, as they seem to reduce business operating costs and provide a very clear financial benefit of adhering to the legislation. However, these incentives incur costs. They will require increasing the amount of labour inspectors and/or administrative capacity to monitor compliance and the blacklisted non-compliant companies. Moreover, the provision of grants, loans, or tax cuts could require additional spending from government budgets.

However, these funds could also come from development banks and other development finance institutions and may, in the medium and long term, spur productive economic activity and increase the tax intake.

Further, if they are linked to a programme of formalisation of enterprises, they have the benefit of bringing more companies and workers into the regulatory net.

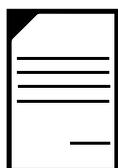
In designing such incentives caution should be taken as sometimes monetary motivations may have perverse effects: for instance providing direct monetary incentives to small businesses at times might motivate businesses to either stay small and not grow (in order to maximize gains on incentives) or can motivate businesses to undertake illegal practices in order to hide the real turnover/staff numbers (in order to capitalize on incentives) (Lawton & Pennycook 2013).

Considerations for a NMW in South Africa:

Research by the National Credit Regulator (NCR 2011) identified that businesses in South Africa (and small and medium sized enterprises in particular) are having significant difficulties in accessing financing and credit: 41.8% of SMEs are completely financially excluded from any financing opportunities. The Industrial Development Corporation (IDC) has introduced a programme of extending loans at subsidised interest rates for SMEs and no longer requires collateral for a loan. In South Africa development finance institutions, such as the IDC and the National Empowerment Fund (NEF) can play an active and positive role in providing affordable development finance tied to national minimum wage compliance.

In addition, ensuring that all DTI Incentive Schemes – such as the Automotive Production and Development Programme (APDP) and Manufacturing Competitiveness Programme (MCEP) – various government competitiveness and business support programmes, and all state and SOE procurement, should have a NMW-compliance clause as part of the requirements to participate in the programme.

POLICY CONSIDERATIONS



Incentives can be a very useful mechanism to achieve high levels of national minimum wage compliance. When it comes to minimum wage legislation, the most widely used incentives include certificate of compliance programmes, public procurement labour and social clauses, access to grants and loans from banks or credit agencies, and various tax incentives.

International practice shows, however, that in order to be successful, incentives should not be the only means through which to ensure the enforcement of minimum wages (Benassi 2011). As such, incentives have to be coupled with sufficient monitoring and enforcement (see Murahwa forthcoming) to achieve nationwide NMW compliance.

In order for positive incentives to assist with the successful implementation of the NMW the OECD argues that they should be targeted towards the entities that are least likely to comply or will have the most difficulty in complying (OECD 2000). The OECD (2000) proposes to:

1. Identify the main difficulties in complying with the new legislation;
2. Develop and/or adjust incentives for various businesses;
3. Do a cost-benefit analysis calculating the potential effect of the subsidy and the cost of the incentive to the government budget;
4. Monitor the outcomes of incentives regularly and adjust incentives when needed.

Taking the OECD framework into account, and applying it to the South African situation, it might be useful to consider a mix of various incentives and approaches.

Namely:

- Legally tying access to SETA, IDC and other loans, grants, subsidies, Department of Trade and Industry schemes and other government programmes to NMW compliance;
- Issuing certificates of compliance, valid for a certain period, as a compliment to other monitoring mechanisms;
- Creating a name and shame list with tangible negative consequences associated with being on a shame list (for instance, a ban on public tender participation for several years, or a ban on accessing loans);
- Inserting clauses that specify compliance with the NMW as part of public tender participation; the German design, where both the main contractors and all sub-contractors must pay the NMW, is optimal;
- Tax incentives can be the most targeted but also most difficult to design policies. In particular tax relief applicable to SMEs only, or various tax rebates for SMEs may assist NMW compliance. South Africa might also look at the highly successful *Simples* programme in Brazil that assisted formalisation and NMW compliance. However, given that tax incentives could put strain on the fiscus, it is important to provide them for a limited time and phase them out over time.

It is worth mentioning that some of the discussed incentives are highly cost-effective and do not entail significant government contributions but have significant positive impacts on NMW compliance. Given the low cost of some incentives (namely certificates of compliance, blacklisting, public procurement clauses on compliance, and limiting access to loans and government schemes to compliant companies), there is no reason to focus on only one incentive type and use it. Instead, one can create a mix of numerous incentives, targeting specific areas and assisting with NMW compliance in certain sectors. It will be important to develop the necessary institutional capacity to support these incentives although many can be accommodated within existing legislation and government programmes.

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