

The efficiency of the “Employment Equity Act” to curb racial discrimination in the South African labour market: A Microeconomic Analysis

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1. Introduction

South Africa, which was racially divided for many decades, became a democratic country in 1994 with the election of president Mandela as the Head of State. South Africa began its journey for freedom with so many past imperfections to correct, including racial and gender discrimination in the labour market.

In 1998, the Employment Equity Act was implemented as legislation that deals with any form of discrimination in the labour market.

As the public outcry persists on the alleged racial wage, employment and occupational discrimination in the South African labour market (Rospabé (2002), Moll (2000), Erichsen and Wakeford (2001), this paper evaluates the potential of the Employment Equity Act to curb any form of racial discrimination in the labour market as comprehensively as possible.

With regard to the hypothesis that the extent to which labour market participant comply with labour legislation is based on consideration linked to opportunity cost (Maldano 1994), this paper establishes a technique, based on utility and profit maximization, to assess the cost incurred and benefit enjoyed by economic agents who incite or apply discrimination in the labour market. The focus of the study is on personal prejudice that is a form of discrimination caused and incited by either employers, employees or customers (Smith and Ehrenberg 1994).

The paper underlines the fact that a legislation such as the employment equity act cannot succeed in a vacuum, considering conflicting interests of different economic agents participating in or influencing the labour market.

The paper is divided into five sections. Section 2 briefly discusses the theory of discrimination, and section 3 presents the techniques used for assessing the cost incurred and the benefit enjoyed by different discriminating agents, namely employers, employees and customers. Section 4 briefly discusses some contents of the employment equity act and section 5 concludes the paper

2. Theory of discrimination

For many authors, discrimination is easier to define than to discern. This eventually creates a serious problem as far as setting the right policy that combats the problem

(McConnell & Bruce, 1995). One of the contrasting areas of discrimination is the classification of its sources. This is quite fundamental to policy prescription.

This paper uses the classification proposed by Ehrenberg and Smith (1994), which divides the labour market discrimination into three main sources. Each source suggests an associated model of how discrimination is implemented and what its consequences are. Smith and Ehrenberg (1994) attribute the difficulty of a concerted economic theory of discrimination to the fact that a discipline such as economics predicated its analysis on rational behaviour. A phenomenon that may be regarded as irrational tends to pose serious problems for economists. Nevertheless, the three general sources, suggested by the authors, are as follows:

2.1 Personal prejudice, wherein the employer, fellow employees or customers dislike associating with workers of a given race or sex.

2.2 Statistical prejudgement, whereby employers project onto individuals a certain perceived group characteristics; an individual is judged on the basis of the average characteristics of the group.

2.3 Monopoly power. The main idea for monopoly power is that race or gender is collectively used to divide the labour force into *non competing* groups, creating or perpetuating a type of worker caste system. Sloane and Carline (1995) explain the monopoly power as a function of the bargaining power of the employers relative to the workers.

3. Cost-benefit analysis: personal prejudice

We will focus on analyzing personal prejudice as a source of discrimination that identifies employers, employees or customers as sources of discrimination in the labour market. The interest in personal prejudice is justified by the fact that the term “prejudice” suggests a subjective dislike of an individual or group and, therefore, such an irrational attitude and belief is difficult to change even though the productivity of the discriminated workers might improve (Hamermesh & Rees 1996, p.529).

An irrational attitude and belief, such as personal prejudice, may be economically rational or irrational. This is the thesis this paper intends to prove in the first instance, with the aid of cost-benefit analysis, before determining whether legislation needs to be enforced independently or some additional strategies are needed before it is enforced.

3.1 Cost-benefit analysis of employers

The behaviour of the employer is related to that of the firm or producer. The rational producer chooses a production plan so as to maximize profit (Varian, 1999, p.326).

An employer who chooses to discriminate will be economically irrational if such action is not profit maximizing. He can then easily be out of business if he resists the change

required for him to maximize profit. It can easily be understood that if, by discriminating, the employer finds that his behaviour is not profit maximizing (irrational), such an employer will easily abandon a discriminating attitude with or without any compulsion. But if the discriminating attitude is profit maximizing, the firm will find it difficult to comply with legislation, and loopholes might easily be found within the provisions of the law.

3.1.1. Profit maximization

A firm's demand for labour is a derived demand, meaning that a firm employs labor for its productivity than for any other reason (Salvatore, 1991, p.420). This leads to the fact that the employment of labour is linked to the profit maximization behaviour of the firm.

With a profit function expressed as:

$$\Pi = TR - TC \quad (1)$$

where Π stands for Profit
 TR stands for Total Revenue and
 TC represents Total Cost.

Expressing TR as a function of price and quantity of a given product, and TC as a function of the cost of capital and labour, we have the following expression:

$$TR = PQ \quad (2)$$

$$TC = wL + rK \quad (3)$$

Where P is the price of the product and Q the quantity produced, w is the price of labor, and r is the price of capital. L and K are the quantity of labour and capital respectively.

The profit function may be rewritten as:

$$\Pi = PQ(K,L) - (wL + rK) \quad (4)$$

Assuming that there is perfect competition, maximizing profit according to input labour, L yields:

$$P \frac{\partial Q}{\partial L} = w \quad (5) \quad \text{where } \frac{\partial Q}{\partial L} \text{ stands for marginal product of labour.}$$

This equation simply states that if a firm chooses to maximize its profit, the wage paid to a supplier of labor must equal the value of his/her marginal product (additional productivity to the firm). Besides that maximizing point, any other point is not optimal for the firm.

If a firm discriminates against a certain group of workers, such workers receive wage amount less than w , which may be expressed as, $w-d$, where d is the discriminating amount. The equation stating the equilibrium condition of the firm employing workers being discriminated against can be written as:

$$P \frac{\partial Q}{\partial L} = w-d \quad (6)$$

As a firm cannot have two static equilibriums, identity (6) is then equivalent to saying that the employer demands greater output from discriminated worker than from non-discriminated workers if they are to be offered the same wage.

3.1.2 Assessment of cost and benefit of a discriminating employer

As equation (5) expresses an equilibrium condition for profit maximization under perfect competition, any other point besides the one found from equation (5) will not maximize the profit of the firm under perfect competition. But it is eventually possible for equation (6) to express a profit maximization condition for a monopsonic firm, where the wage paid to workers, $w-d$, could be below the wage, w , received by workers in a perfect competitive labour market. The difference in the wages, $w-d$ and w , increases if the monopsonist faces a high elasticity of the supply of labour and very low elasticity of the demand of his/her product (Rebmann & Levacic, 1991, p.64).

A monopsonist, therefore, benefits from discriminating wages between workers. Such a low wage paid to discriminated workers reduces the employer's total cost for a given revenue. This also increases its profit, compared with the case where there is no wage discrimination.

With competition in the product and labour markets, discriminating employers will find it difficult to compete with non-discriminating employers for human resources. As workers belonging to discriminating groups will find it wasteful to supply their labor resources for a very low wage, employers who discriminate are, probably, operating at a loss (Rees *et al*, 1996, p.536).

This is to say that if there is competition in the output and input markets, a discriminating employer might lose (incur a high cost). But the dominant market structure is a monopsony, discriminating firms may realize abnormal (high) profits. Discriminating attitude would be profit maximizing.

The following figure depicts graphically what would happen in the labour market.

Figure 1: Supply of labour, demand of labour and reserve wages

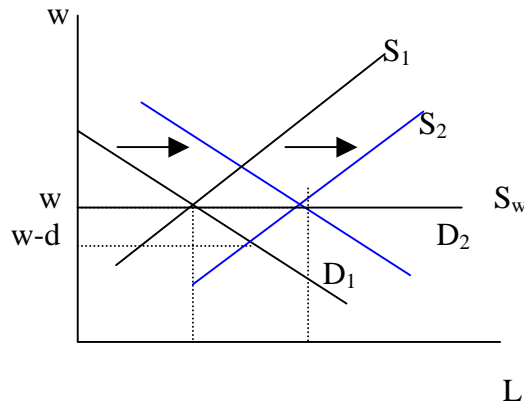


Figure 1 shows the equilibrium in the labour market, where the equilibrium wage is w . S_w represents the supply of labour by the non-discriminated worker while S_1 and S_2 represent the supply of labour by the discriminated worker at time 1 and time 2 respectively.

As w is the equilibrium wage, S_w is perfectly elastic as non-discriminated worker wages or reserve wages are always at an equilibrium. If there is a relatively low supply of labour from discriminated workers, there is the possibility of having an equilibrium wage fixed at w , be it from discriminated or non-discriminated workers. At a higher rate of unemployment of the discriminated group, as is the case in South Africa, the supply of labour would move to S_2 . In the presence of the high unemployment of discriminated workers in the economy, the wage paid to discriminated workers is at “ $w-d$ ”, compared to “ w ” earned by non-discriminated workers.

The policy that would set the general wages back at “ w ” is the one that creates competition in the product and labour markets. Such a policy will increase the total demand at D_2 . This shows that if the labour legislation such as the Employment Equity Act operated in a competitive environment, the act would be more successful because competition increases the cost of discrimination practice and compels all employers to abandon wage discrimination

3.2 Cost and benefit analysis from the employee source

One of the sources of racial discrimination in the labour market originates from the unwillingness of fellow employees to associate with employees of different colour.

Whites may have more intense and persistent prejudice against having a black supervisor than against having black subordinates or co-workers (Rees et al 1996).

If the firm trusts whites more than blacks, such a firm will discriminate against blacks not only in certain occupation but sometimes in not employing them. Therefore, the unwillingness of the firm to employ black workers is incited by white employees instead of being a deliberate choice of the firm. The pressure would be reduced if discriminating workers come to the knowledge that such action may decrease their total utility.

3.2.1 Utility function and the satisfaction of the discriminating worker

The discriminating worker, hereafter referred to as a white employee, is seen as an individual willing to satisfy his utility. This utility depends on the wage he earns and the number of black people he works with. If it is true that the utility of discriminating white workers increases with an increase of wages, but decreases with an increase in black workers (as he wishes not to associate with them).

The mathematical model of the discriminating white worker can be represented as :

$U(W, B)$ where

W = nominal wage

B = number of black workers

From the above fact we have:

$\frac{\partial U}{\partial W} = MU_W > 0$, where MU_W is the marginal utility of the nominal wage

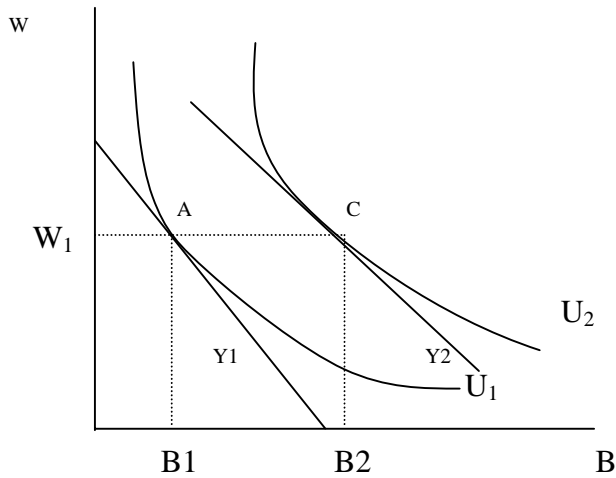
$\frac{\partial U}{\partial B} = MU_B < 0$, where MU_B is the marginal utility obtained when the firm employs an additional black worker.

The marginal rate of substitution of black for wage, which measures the slope of indifference curve is obtained by,

$\frac{dW}{dB} = \frac{MU_W}{MU_B} < 0$, referring to the above conditions of the marginal utility of wage and black worker.

The negative sign of the slope of the utility curve (the Marginal Rate of Substitution) means that the utility function is convex. Such a utility function is represented in Figure 2.

Figure 2: Utility curve of a discriminating employee.



In figure 2, the analysis assumes that the discriminating white worker is at equilibrium at point A (B_1, W_1) with utility function U_1 . If a discriminating worker could abandon its discriminating attitude and accept to associate with more black workers with the same wage, his utility (satisfaction) would increase to U_2 at point C (w_1, B_2). The white workers would in fact be better off at point C than at point A.

3.2.2 Interpretation of discriminating worker's satisfaction

If a discriminating employee decide not to discriminate, he is likely to draw more satisfaction than if he discriminate against his fellow employees. This is justified by the fact that an additional black person employed by the firm means less unemployment among black people and a lower crime rate, especially in the South African social environment where crime rate is related to unemployment among black people. The higher the crime rate is associated with a low real income (Y_1) earned by discriminating workers who are forced to spend part of their nominal income on security-related expenses. In Figure 2, the real income in an environment consisting of discriminating workers is at Y_1 while the real income of a non-discriminating worker would be at Y_2 , which is associated with higher satisfaction.

The other reason related to fiscal policy, would be that by not racially discriminating, an employee receives more satisfaction from the fact that if the firm employs an additional black worker, the South African government will not only increase its income tax receipts but will also reduce unemployment compensation. Such a move creates a sound fiscal environment leading to a decrease in the budget deficit. Such a low budget deficit may lead to a decrease in interest rates. In such an environment, the wages, W_1 , received by

non-discriminating workers has more value than the same wage he received if they were discriminating against other workers.

3.3 Cost and benefit analysis, customer source

Customer or consumer discrimination is a possible source of discrimination that results from prejudice by the consumer against buying a product or services produced or offered by the seller from a certain ethnic groups, sex or race (Filer *et al*, 1996, 545). This feature is likely to be particularly strong where professional services are offered (Carline *et al* 1985, p.105). A white patient may feel awkward about consulting a black medical doctor. This results in discrimination in the labour market where an employer will find it important only to employ white doctors to maintain or extend the market share of a discriminating community of consumers. In a country of historically separated communities such as South Africa, customer discrimination is quite common.

3.3.1 Price discrimination and firm behaviour

This subsection attempts to find out whether a firm enjoys more benefit than the cost incurred if incited by its customers to practise discrimination in the labour market. In so doing we assume that in order for discriminating customers to avoid mixing with people they dislike, they are prepared to offer the firm a higher price for its product or service. In this way discriminating customers would expect the firm to respond to their needs by practising discrimination in the labour market. In case the firm succumbs to the temptation of racially discriminating workers, it may decide to separate the market between discriminating and discriminated customers and charge different prices between the two markets to keep them separate. Such behaviour where a firm charges each customer the price that he/she would be willing to pay is called price discrimination.

A firm that succeeds in retaining a higher price for a discriminating community and a lower or normal price for a non-discriminating community will also succeed in separating the two communities. Such an action will bring satisfaction to the discriminating consumer because they will find it irrational to purchase the same product in an expensive market given their purchasing power. Meanwhile discriminating workers would enjoy having their own market in exchange for paying a premium on the normal price of the product offered by the firm.

Because discriminating workers do not want to mix at all with people of certain groups, the firm that consents to discriminating the price in different markets also has to accept discriminating against the people it employs. Such an occupational discrimination occurs in the workplace for example, in the case of discriminating customers in a restaurant who do not like to be served by people they dislike or a white investor who does not trust a black asset manager to manage his/her assets.

3.3.2 Price discrimination and profit maximizing firms

An attempt will be made to find out if it is beneficial for a firm to discriminate against people of a certain race, gender or ethnic group if it is incited to do so by customers who, in return, offer, to the firm a premium on the normal price of the product.

It is a common belief among economists that price discrimination, mostly practised by monopolists, increases the total revenue and profit of the firm by transferring some of the gain from the consumers to the firm's profits (Frank, 2000, p.416). It is therefore beneficial for the firms to practise price discrimination if given the opportunity, but the only difficulty they would face is the information regarding the elasticity of the demand curve in each market.

A firm practising price discrimination sets a higher price in the market with a lower price elasticity demand and a lower price in the market with a higher price elasticity demand. Firms maximize their profit at the level of production where the marginal revenue of the last unit sold in each market has to be the same (Salvatore, 1991, p.317). Referring to these conditions, one concludes that the firm that practises discrimination once incited by discriminating customers in exchange of a premium on the normal price will benefit from such an action. As the firm sells the products at a lower price in a non-discriminating competitive market that has a higher price elasticity of demand, it sells the same product at a higher price in a discriminating market that has a lower price elasticity of demand. The lower price elasticity of demand of the discriminating consumers is justified by their willingness always to consume a specific product or service even though the price increases.

As we have conditions such as:

$\eta_2 > \eta_1$, where η_1 and η_2 are the price elasticity demands in the discriminating and non-discriminating market, respectively.

$P_1 > P_2$, where P_1 and P_2 are the price of the product and services in the discriminating and non-discriminating markets respectively.

To operate in the two markets simultaneously, the following condition applies:

$MR_1 = P_1(1 - \frac{1}{\eta_1}) = MR_2 = P_2(1 - \frac{1}{\eta_2})$. This states the profit maximization conditions

in case there is price discrimination, Where MR_1 and MR_2 are marginal revenue in discriminating and non-discriminating markets respectively (Varian, 1999, p.444).

If a firm does not grasp the opportunity given to it by the discriminating customer, it will then lose the opportunity to increase its profit. This translates into the firm realizing less profit than if it had to accept to discriminate in exchange for the higher price offered. This shows that it is economically rational for a firm to apply discrimination in the labour market when incited by discriminating customers to do so.

As it is economically rational to discriminate if incited by its customers, a firm would find it difficult to conform to the legislation if the government does not introduce an additional policy to accompany the Employment Equity Act. Therefore, we believe that a policy that would enhance the purchasing power of the discriminating communities would be appropriate to curb discrimination in the labour market. Thank to the policy of black empowerment, which we believe constitutes the right supplement to the act.

4. Employment Equity Act 55 of 1998 and sources of discrimination

This section analyzes the extent of The Employment Equity Act, within its provisions, to deal with the different sources of discrimination discussed in this paper.

The provisions of the Employment Equity Act 55 of 1998 under “disclosure of information” and “income differential”¹ enforce the application of the act among employers in a way that they are requested to provide information to the Employment Conditions Commission on the remuneration and benefits received in each occupational category and the level of that employer’s workforce. Also, under the provision of “monitoring”², an employee representative is entitled to bring an alleged contravention of the act by another employee to the attention of the authorities. This prevents any employee from inciting racial discrimination in the labour market.

There is no clear-cut provision in the act that deals with discrimination incited by customers or consumers. The reason for this may be that it is beyond the power of the legislator to enforce a legislation that goes against the free choice of the consumers. Such a silence from the legislator on the matter will continue to be a threat for perpetuating a cycle of discrimination in the South African labor market unless the accompanying policy of black empowerment and a policy related to the creation of a competitive product market are implemented successfully.

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1. Employment Equity Act 55 of 1998, disclosure of information
 2. Employment Equity Act 55 of 1998, income differential

5. Conclusion

The aim of this paper was to demonstrate that racial discrimination in the labour market, though an irrational attitude, may be economically rational. We prove that there are instances where a discriminating agent maximizes profit by applying racial discrimination. For this reason legislation such as the Employment Equity Act, which intends to curb racial discrimination in the labour market needs not only to be enforced but must also be supplemented by an additional policy so as to make it economically irrational for the discriminating agents to persist in discrimination in the labour market.

The paper demonstrated that an employer (firm) involved in a monopsonic market draws more benefit in discriminating against a certain racial group by paying different wages to each group. For the act to be efficient in curbing racial discrimination in these conditions, the government needs to supplement a policy that encourages competition not only in the output market but also in the input market. This is a way of minimizing the cost of legislation and inciting the firm to conform to it.

If racial discrimination is economically irrational for the economic agent, strict enforcement of the legislation may be enough to curb racial discrimination in the labour market because the cost of the legislation is already minimized. The monitoring provision, for example, as an enforcement, could be effective in preventing any racial discrimination that could be initiated from a fellow employee.

We appreciate the government effort to gear the economy towards a market economy by introducing 'Black Empowerment' policy. Unless such policies create competitive markets and enhance the purchasing power of discriminated communities, the Employment Equity Act will continue to be a piece of legislation without any impact in the labour market, incapable of preventing racial discrimination.

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