



# Minimum Wages: Institutional aspects

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Patrick Belser  
Senior Economist  
Conditions of Work and Employment  
International Labour office (ILO)  
[belser@ilo.org](mailto:belser@ilo.org)

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# Structure of the presentation

- Short history of minimum wages
- Who sets the minimum wage and how?
- Who is covered
- The definition of wages

# Background: short history of minimum wages

Minimum wages have been enacted as a social protection policy based on the view that in some circumstances free markets fail to produce the desired outcomes in terms of social justice



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# Background: short history of minimum wages

- Minimum wages have developed in New Zealand and Australia at the very end of the 19<sup>th</sup> century, with the New Zealand Industrial Conciliation and Arbitration Act of 1894 and the legislation on wage boards adopted by the Australian state of Victoria in 1896.
- The United Kingdom (U.K.) adopted its first minimum wage legislation in 1909, which initially covered only four industries and was later broadened with the adoption of the Trade Boards Act of 1918 and the Wages Council Act of 1945.
- In these countries, minimum wages started as a substitute for collective bargaining in low-wage industries; they covered relatively few categories of workers, with particularly low levels of pay.

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# Background: short history of minimum wages

- This industry-specific perspective is reflected in ILO Minimum Wage-Fixing Machinery Convention No.26 adopted in 1928.
- The Convention calls for minimum rates of wages for workers employed in trades or part of trades “in which no arrangements exist for the effective regulation of wages by collective agreement or otherwise and wages are exceptionally low” (Art. I) . It covers manufacture and commerce, not agriculture.
- The Convention is among the ILO’s most widely ratified, including by Egypt (1960), Lebanon (1962), and Syrian Arab Republic (1962) . Total ratifications: 104 out of 185 Member States

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# Background: history of minimum wages

After the Second World War Coverage expanded and national minimum wages appeared.

- In France the national minimum wage was introduced in 1950 – a period of great precariousness and rising prices that followed the unpopular “wage controls” of WWII – together with a lower rate for the agricultural sector (SMIG and SMAG)
- In the U.S., coverage of the *Fair Labor Standards Act* of 1938 increased from about 20% of the U.S. workforce initially to nearly 80% in 1970.
- Mexico was a precursor, since it was one of the first countries to introduce a nation-wide system in 1931 already, as the first of many countries in Latin America.

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# Background: history of minimum wages

- The evolution towards minimum wages with national coverage is reflected the adoption of ILO adopted the Minimum Wage Fixing Convention No.131 in 1970.
- Ratifying Member States commit to establish a system of minimum wages which “covers all groups of wage earners” against “unduly low wages”. If some groups are not covered, the Member State should explain the reasons for not covering them.
- Ratification was relatively rapid in the 1970s, including by Egypt (1976), Iraq (1974), Lebanon (1977), Libya (1971), Syria (1972) and Yemen (1976). Total ratifications: 51 out of 181 Member States

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# Background: history of minimum wages

- While minimum wages were generally regarded favourably until the 1970s, the context changed after the oil shock in 1973, the debt crisis in developing countries in the 1980s and the implementation of structural adjustment policies in the 1980s and 1990s.
- This period coincided with the perception of minimum wages as a source of “distortion” in otherwise efficient labour markets which created unemployment.
- The U.K. progressively abolished the Wage Councils in the 1980s and denounced ratification of ILO Convention No.26 in 1985. Other countries did not abolish minimum wage machinery but kept the level frozen or insignificantly low.

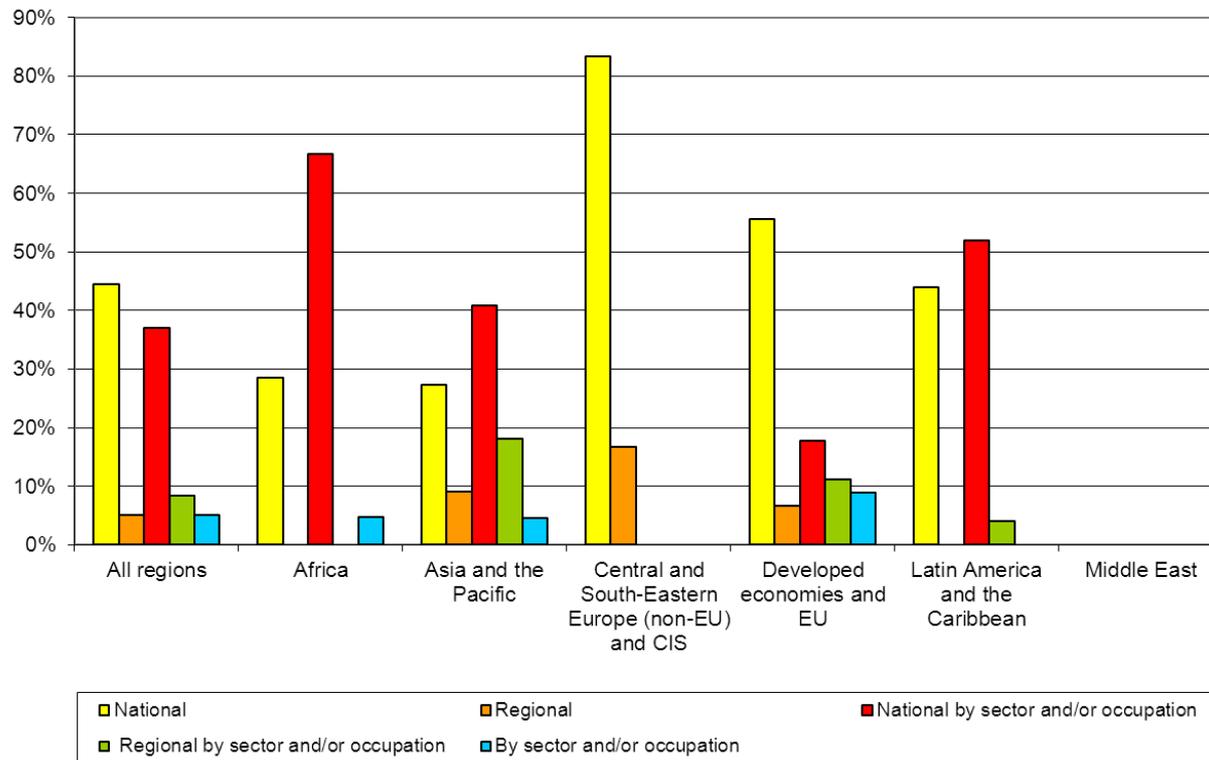
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# The Revival of Minimum Wages

- In the last 2 decades, minimum wage policies have made a comeback. Many countries have recently adopted or reactivated minimum wages. Examples include Brazil, China, South Africa, and the U.K. (which introduced a system of national minimum wage in 1999)
- Recent experiences have changed the perception of minimum wages. In the academic literature many have challenged the assumption that minimum wages necessarily destroy employment. In 2009, after 10 years of monitoring, the UK Low Pay Commission (employers and workers) had not found any significant negative effect on employment. Among policy experts, the minimum wage was named as “the most successful government policy of the last 30 years”.

# Systems of minimum wages in the world

The ILO estimates that by today 90% of member States do have a minimum wage system in place. As result of history, systems vary between sectoral/occupational and national minimum wages



# Systems of minimum wages in the world

Which system is better? There is no general answer

- A regional study in Latin America concluded that the least effective minimum wages institutions are those that are too complex and, therefore, that “it is better to design a simple system that is well understood by all, rather than trying to fully address the heterogeneous needs of the labour force” (Cunningham, 2007, p.4).
- In whatever system, attention should be devoted to keep the level of complexity manageable in light of the country’s institutional capacity, the quality of wage statistics, and the enforcement capacity of labour administrations. When the level of aspired complexity exceeds the capacity of the country, minimum wages cease to be an effective instrument of social protection.

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# Part II

Who sets the minimum wage and how?

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# Who sets the minimum wage and how?

In practice, minimum wages can be set either by:

- Statute (Parliament)
  - Decision of a competent authority
  - Decisions of wage boards or councils
  - Labour courts or tribunals
  - Giving force of law to provisions of collective agreements
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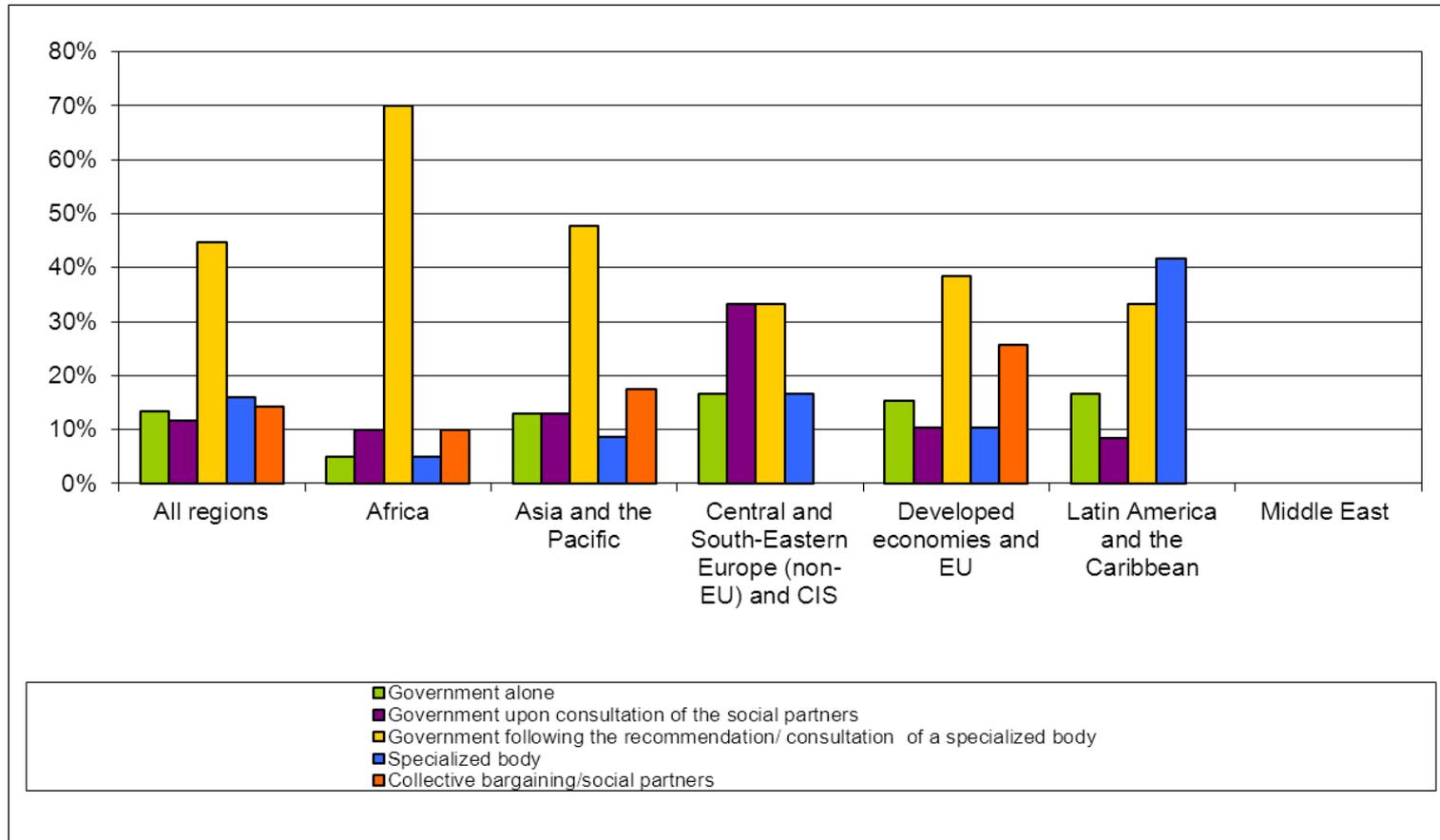
# Who sets the minimum wage and how?

In any case, the *Minimum Wage Fixing Convention*, 1970 (No.131) calls for the provision for the direct participation” in the operation of the minimum wage system of :

- (a) representatives of organisations of employers and workers concerned or, where no such organisations exist, representatives of employers and workers concerned, on a basis of equality;
- (b) persons having recognised competence for representing the general interests of the country and appointed after full consultation with representative organisations of employers and workers concerned, where such organisations exist and such consultation is in accordance with national law or practice.” => importance of objective data and analysis

# Who sets the minimum wage and how?

Social dialogue takes place in most (not all) cases



# Who sets the minimum wage and how?

In most countries, legislation requires that the minimum wage be set in a balanced view, taking into account:

Criteria	% of countries using criteria
<b>(a) Social criteria</b>	
Needs of workers and their families	32
Cost of living / inflation	61
General level of wages	35
Levels of social security benefits	14
<b>(b) Economic factors</b>	
Economic situation and/or development	51
Capacity of enterprises to pay	16
Employment	26
Productivity	26

# Who sets the minimum wage and how?

Effective minimum wages need to be increased from time to time, as the cost of living evolves and labour productivity increases. In some countries this is done at regular intervals in others it is done in an ad hoc, unpredictable way.

- In Brazil, the minimum wage is increased by the sum of inflation in the previous year plus the GDP growth of 2 years before (if  $>0$ ).
- In France, the minimum wage is automatically increased by the amount of previous year inflation, whenever inflation is in excess of 2%, and no less than half of the average hourly wage growth of blue collar workers.

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# MW fixing is not the end... but is the beginning of another challenging process: Implementation

- Compliance depends on:
  - Probability of labour inspections and level of sanctions
  - Awareness of employers and employees
  - Existence of incentives for low-productivity firms (eg reductions in social contributions)
  
- Key challenges:
  - The informal economy
  - Limited capacity of labour administration (e.g., labour inspection)
  - Limited union coverage
  - Lack of other alternative mechanisms (e.g., civil society organizations)

*Small steps can  
make a big difference*

*Awareness tends to  
lead to better  
compliance*

US (1956)

Lee and McCann (forthcoming)



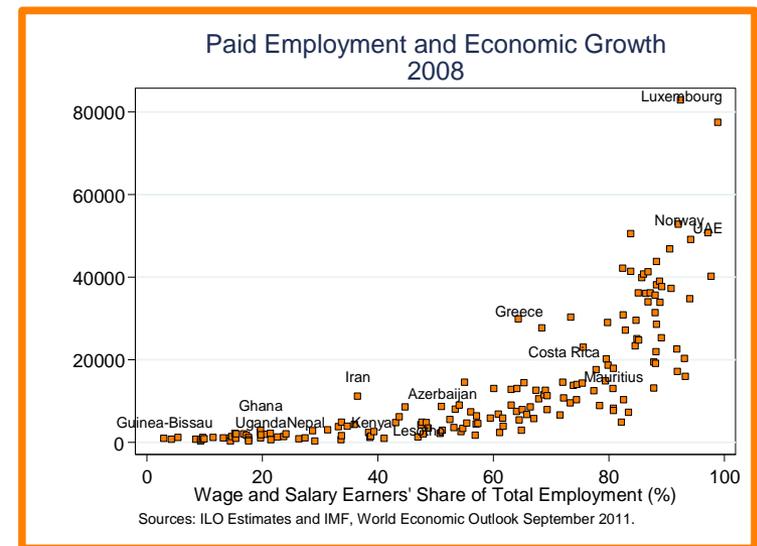
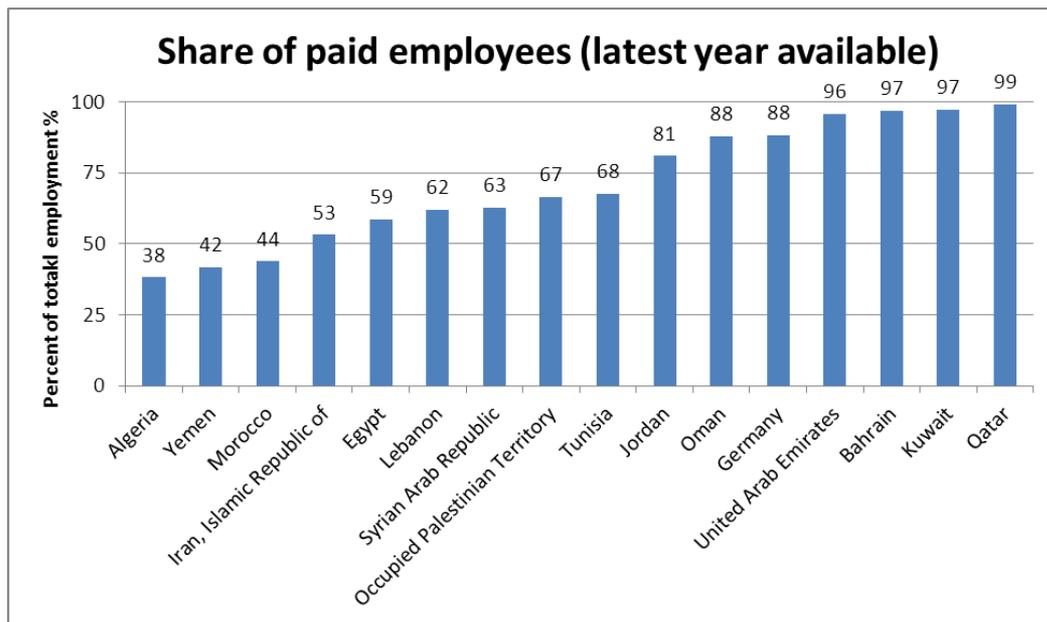
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# Part III

## Coverage of minimum wages

# Who is covered by minimum wages?

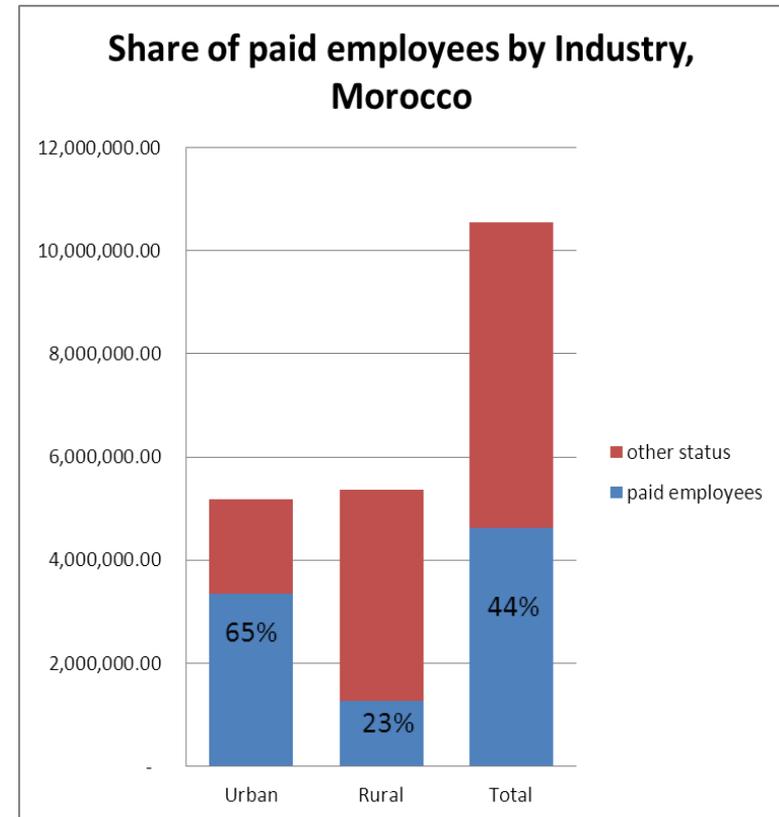
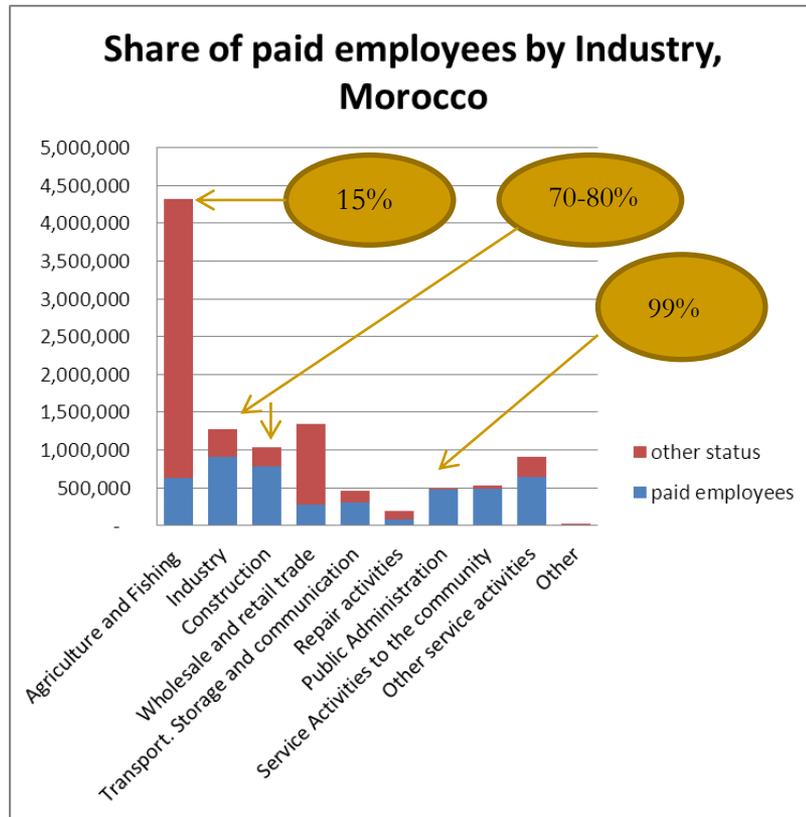
Minimum wages is only one of the tools of social protection because, by definition, only wage-earners can be covered. The proportion of wage-earners varies across countries, depending on economic development.



Source: ILO, KILM

# Who is covered by minimum wages?

The proportion of wage-earners varies by industry, region, and sex



Source: Royaume du Maroc, "Activité, Emploi et Chômage, 2010"

# Who is covered by minimum wages?

<b>Paid Employees in Total Employment by sex</b>	<b>Male (2011)</b>	<b>Female (2011)</b>	<b>Total 2011</b>
World	48.4	48.0	48.3
Developed Economies & European Union	83.6	89.7	86.4
Central & South-Eastern Europe (non-EU) & CIS	76.3	78.8	77.4
East Asia	51.9	45.7	49.1
South-East Asia & the Pacific	38.5	33.3	36.3
South Asia	23.0	15.4	21.0
Latin America & the Caribbean	62.5	64.9	63.5
Middle East	68.0	57.3	66.2
North Africa	55.1	42.1	52.2
Sub-Saharan Africa	28.3	14.5	21.9

<b>Labour Force Participation Rate in 2011 (ILO estimate)</b>	<b>Total</b>	<b>Male</b>	<b>Female</b>
World	64.1	77.1	51.1
Developed Economies & European Union	60.3	67.9	53.1
Central & South-Eastern Europe (non-EU) & CIS	59.4	70.3	49.8
East Asia	73.3	79.6	66.7
South-East Asia & the Pacific	70.1	81.8	58.7
South Asia	57.1	81.3	31.8
Latin America & the Caribbean	66.3	79.7	53.5
Middle East	47.8	74.0	18.4
North Africa	47.8	74.1	24.2
Sub-Saharan Africa	70.3	76.2	64.5

## MENA:

Out of 75 million paid employees, 63 million are males and only 12 million are females. This is due to:

- 1) lower share of wage work
- 2) lower participation

Source: ILO, KILM

# Who is covered by minimum wages?

Wage employees are a diverse group with good jobs and bad jobs, including workers in precarious employment, casual workers, short-term workers, seasonal workers and workers whose contract of employment can be terminated at short notice. Are they covered by the law?

Salaried employee



Casual employee



Domestic worker



Employee of small coffee shop with less than 5 workers)



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# Who is covered by minimum wages?

- Note that minimum wage is often used as a *basis* for calculating social benefits, especially when there is no other socially acceptable benchmark. This can have wide budgetary implications for the State and makes minimum wage adjustment more complex
- A note of caution: the role of minimum wages is to provide social protection to low-paid wage-earners, not to set wages for all wage-earners or to substitute for collective bargaining ...

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# Part III

## The definition of minimum wages

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# Definition of minimum wages

- ILO legal experts have defined the minimum wage as: “the lowest level of remuneration permitted”, “the wage which in each country has the force of law and which is enforceable under threat of penal or other appropriate sanctions” and “the minimum sum payable to a worker for work performed or services rendered, within a given period (...) which may not be reduced either by individual or collective agreement (and) which is guaranteed by law”.
- Can be hourly or monthly, or both. In principle, a worker should be entitled to the minimum wage for each hour of actual working time, averaged over the workers’ normal pay reference period up to a maximum of one month. For example, at the end of the month all workers – including homeworkers or those with piece rates – should receive the minimum, whatever the piece rate or output achieved.

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# Definition of minimum wages

What components of pay count towards the minimum?

- In general compliance is determined by adding base salary plus incentive payments such as commissions, centralised tips, or bonuses (tips paid directly by the customer to the worker should be excluded).
- Minimum wages refer to gross earnings before taxes, social security contributions and other statutory deductions
- Allowances and premiums for non-standard work hours or overtime should be excluded. In other words, workers should not be forced to work overtime to obtain the minimum wage.

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# Definition of minimum wages

What about payment in kind?

- The ILO Protection of Wages Convention, 1949 (No.95) recognizes that various allowances in kind may be customary or desirable in particular industries or occupations, and considers that such a method of payment is permissible when it is authorized at the national level.
- However, the payment of wages in-kind may only be additional to cash payment, and therefore partial. The Convention also lays down a payment wages in the form of liquor or drugs are prohibited. Other conditions are that in-kind allowances are for the personal benefit of the worker and that the value attributed to the allowances is fair and reasonable.