

Minimum wages: some key policy issues

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The case for labour market institutions

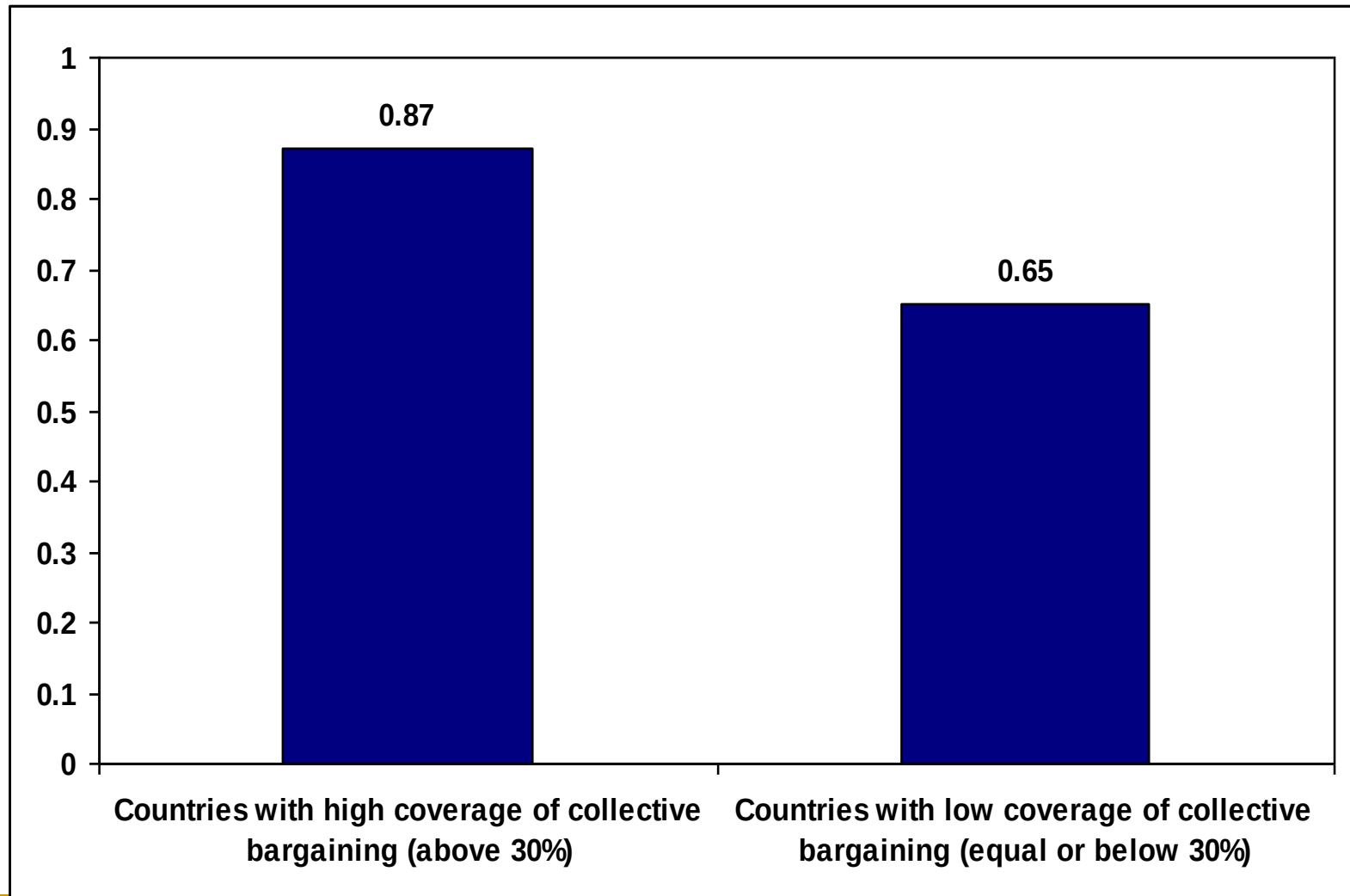
- **Equity-based argument:** the free market often fails to produce outcomes that are socially desirable, morally acceptable or in line with local perceptions of social justice. Hence, regulations are needed to ensure social protection and social justice.

- **Efficiency-based arguments:**

Orthodox economic theory: the free market always equalizes supply and demand and hence leads to an efficient allocation of resources. Regulations create distortions and lower efficiency.

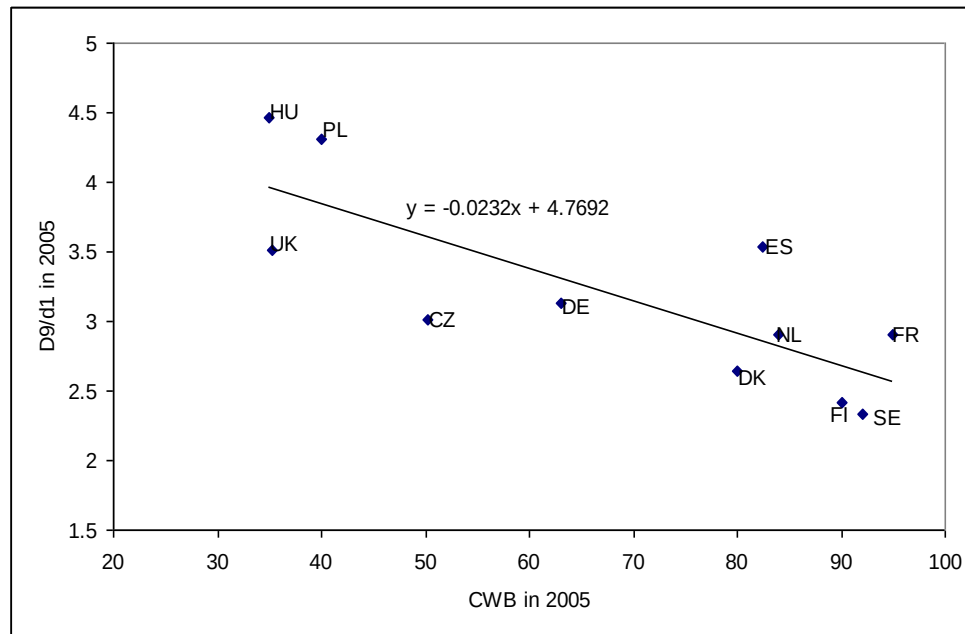
Market failure theory (Stiglitz): The free market is not always efficient because of “market failures” (such as imperfect competition or asymmetric information). Regulations can correct these failures and increase efficiency. For example, without regulation there is a high risk of non-payment of wages or even forced labour, which can be characterized by the use of coercion for the purpose of reducing labour costs.

Wage responsiveness of a 1% increase in GDP per capita growth is higher in countries with higher collective bargaining coverage



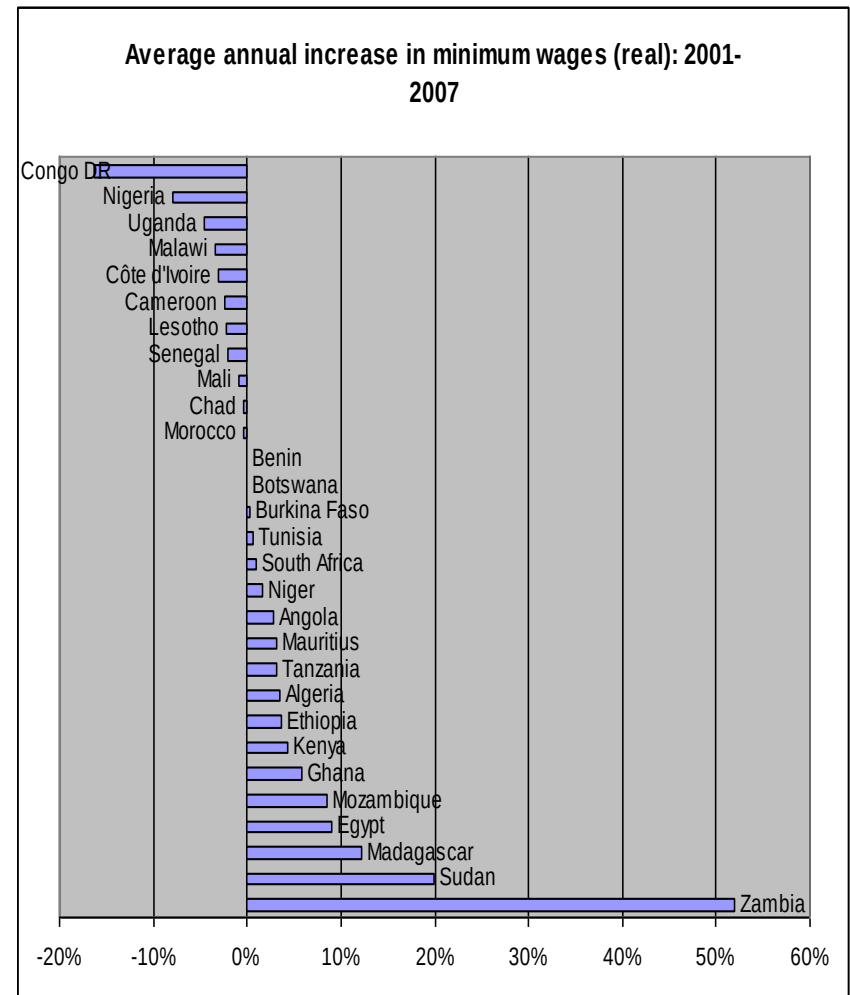
Better collective bargaining can reduce overall wage inequality

**Wage differentials (D9/D1) and collective bargaining rate (2005),
EU countries**



Growth in the real minimum wage

- Globally, over the period 2001-2007, more than **70%** of all the countries included in our sample have increased their minimum wage in real terms. On average, in these countries, the real minimum wage was increased by **5.7%** per year in real terms.
- Real gains for minimum wage earners were substantial in both developed economies (**+3.8%**) and developing countries (**+6.5%**).



Minimum wages :

- Our statistical analysis shows that countries with higher minimum wages (above 40% of average wages) have less inequality in the bottom half of the labour market (D5/D1) and that minimum wages can reduce the gender pay gap, with little or no adverse impact on employment.
- Some challenges: a) Ensure that minimum wages and collective bargaining are complementary, not substitutes; b) How to link wage policies with the broader set of economic and social policies, including in particular income policies or social security

Minimum wages: good practices

- In 1928 the ILO adopted the Minimum Wage-Fixing Machinery Convention No.26, which commits ratifying Member States to fix minimum rates of wages for workers employed in trades where there is no “effective regulation of wages by collective agreement and wages are exceptionally low” (Art. I)
- In 1970, the ILO adopted the Minimum Wage Fixing Convention No.131 which provides more general protection to wage earners against “unduly low wages” and calls for “a system of minimum wages which covers all groups of wage earners whose terms of employment are such that coverage would be appropriate”
- Total ratifications: 119 out of 181 Member States

Minimum wages: good practices

- More than 90% of ILO Member States have minimum wages. This includes the UK since 1999 or Ireland since 2000; important exceptions are Gulf states.
- 60% of countries have simple national minimum wages and 40% have more complex sectoral or occupational minimum wages (57% in Latin America and much of South Asia)



5 key questions :

1. By whom should MW be managed and monitored?
2. How many rates should there be?
3. To whom should MW apply?
4. How can MW best enforced ?
5. What is the right level and how often should MW be adjusted?

1. Managed & monitored by whom and how?

The Government alone? Tripartite committees?

Flexible but less
democratic, risks of
mismanagement

Much better, but what
composition and what
level of decision-making?

Key principle: Involve social partners

1. *Managed & monitored by whom and how?*

Example: The UK Low Pay Commission

- Wage councils abolished in 1993, followed by fierce political debate for many years, and adoption of national minimum wage in 1999
- Appointment of a *Low Pay Commission*: an independent commission with mandate to recommend to the Prime Minister the coverage and initial level of national MW + propose increases every year
- Based on social dialogue: 9 members: 3 employers; 3 workers and 3 academics => decisions are taken unanimously
- Monitors every year the impact of minimum wages and recommends appropriate annual up-ratings

1. Managed & monitored by whom and how?

Example: The UK Low Pay Commission

- Holds consultation meetings around the country, with enterprises and low-paid workers
- Uses statistical analysis based on official data sources (establishment surveys and labour force surveys) to monitor effects on different groups of low-paid workers: women, young people, ethnic minorities, people with disabilities, part-time workers, casual and seasonal workers, home-workers.
- Studies the impact on economic indicators (employment, prices) and the competitiveness of specific low-pay industries: retail, contract cleaning, security, social care, hospitality, hairdressing, agriculture, clothing and footwear

1. Managed & monitored by whom and how?

MW effects on employment:

- Conventional wisdom: “a minimum wage will always seriously harm the economy and destroy jobs” (The Economist, June 97)
- The new evidence: “we have not found any significant negative effects. And we have looked long and hard in all places” (The UK Low Pay Commission, March 2008)

1. Managed & monitored by whom and how?

- In practice, MW can be fixed by:
 - ❑ Government without obligation to consult social partners
 - ❑ Government with direct consultation with social partners
 - ❑ Government following recommendation of a specialized body (with tripartite representation)
 - ❑ By a specialized body (e.g., minimum wage commission)
 - ❑ Collective bargaining, without the intervention of the government (e.g., Denmark)

2. How many rates?

One National Rate?

- simple & easy to manage
- BUT : must be low

Several Rates?

- can be tailored to productivity in the sector
- BUT: difficult to manage

Recommendation: Keep it simple enough !

2. *How many rates?*

The Case of India:

- Minimum Wage Act adopted in 1948 is still considered to be one of the most important pieces of labour legislation (John, 1997)
- But the system is complex: “appropriate government” sets minimum wages to employees in some selected “employment schedules” (sectors/occupations). By 2005: 311 different employment schedules and 1’171 different minimum wage rates
- Ghose (1997): the system results in a “plethora of statutory minimum wages which vary across jobs within a state and across states in a same job” and is “indefensible”

2. *How many rates?*

- Often, there are gaps between aspiration and capacity
- More complex system requires strong institutional capacity (organizational to ensure coherence, administrative to ensure compliance, statistical to ensure monitoring)

3. Applicable to whom?

Only formal sector?

- more targeted but not fair and no effects on poorest workers

All wage-earners?

- comprehensive but hard to enforce in casual, rural, informal work (migrants)

Recommendation: have broad coverage and include all vulnerable workers, but de-link it from social benefits !

3. *Applicable to whom? Salaried & casual ?*

- India: What is the size of the target population? **173 million wage earners (57 million salaried + 116 million casual workers)**

	Male	Female	Total
Rural			
Self-Employed	58.1	63.7	60.2
Salaried	9.0	3.7	7.1
Casual Labour	32.9	32.6	32.8
Total	198'605'700	112'859'300	311'462'800
Urban			
Self-Employed	44.8	47.7	45.4
Salaried	40.6	35.6	39.5
Casual Labour	14.6	16.7	15.0
Total	70'025'200	19'201'300	89'301'100
Total			
Self-Employed	54.6	61.2	56.8
Salaried	17.2	8.4	14.3
Casual Labour	28.1	30.3	28.9
Total	268'282'800	132'191'300	400'658'900

3. Applicable to whom? Domestic workers?

Countries excluding domestic workers from coverage by minimum wage legislation	Countries where minimum wage rates for domestic workers are amongst the lowest minima	Countries in which domestic workers are entitled to the same minimum wage as the general workforce
Saudi Arabia, Egypt, Yemen, Senegal, Pakistan, Republic of South Korea, Japan, Indonesia ² , Malaysia, Cambodia, Peru, India ³ , United States ⁴ , Bangladesh, Sri Lanka, China, Thailand, Jordan, Iran,	Argentina, Chile, Costa Rica, Colombia, Guatemala, Paraguay, The Philippines, Belgium ⁵ , France, Switzerland, Italy, Spain, Nicaragua, Panama, South Africa, Mali, Cote d'Ivoire	Russian Federation, Romania, Croatia, Moldova, Czech Republic, Turkey, Netherlands, Bulgaria, Latvia, Estonia, Ireland, Kazakhstan, France, UK, Portugal, Trinidad and Tobago, Bolivia, Brazil, Tunisia, Zimbabwe ⁶ , Vietnam

4. *Enforced how?*

Labour inspectors?

- have the mandate but not always the capacity

Social partners?

- how to get workers and employers on board?

Recommendation: create incentive systems and use minimum wages in conjunction with other policies

4. *Enforced how?*

A Review of the Literature shows: there is always going to be some non-compliance:

- In the US, the BLS (2009) used the U.S. Current Population Survey and found that about 1.9 million workers – or 2.6% of all hourly-paid workers - were paid below the hourly minimum rate.
- In Brazil, Lemos (2005) used the Monthly Employment Survey (PME) to estimate that in 2000 the proportion of workers earning below the minimum wage was 13.7% in the private sector and 4.6% in the public sector.

4. *Enforced how?*

Key challenges for many developing countries:

- ❑ Poor awareness of current minimum wages among workers and employers
- ❑ The massive presence of informal economy
- ❑ Limited capacity of labour administration (e.g., labour inspection)
- ❑ Limited union coverage
- ❑ Lack of other alternative mechanisms (e.g., civil society organizations)

4. *Enforced how?*

Non-compliance can be reduced by a combination of:

- Improved awareness campaigns and informing workers about their rights
- Strengthening labour administration and labour inspection systems
- Involving trade unions and employers associations in monitoring efforts
- Murgai and Ravallion (2005): MW is only enforceable if the Government acts as the “employer of last resort” and commits to employ the entire excess supply of labour at the stipulated minimum wage rate.

5. What's the right level & how often adjusted?

Too low ?

MW is irrelevant and does not protect workers against “unduly low wages”, poverty and inequality

Too high ?

Risk that workers lose their jobs, inflation accelerates, and collective bargaining is “crowded out”

Recommendation: be cautious and take empirical approach

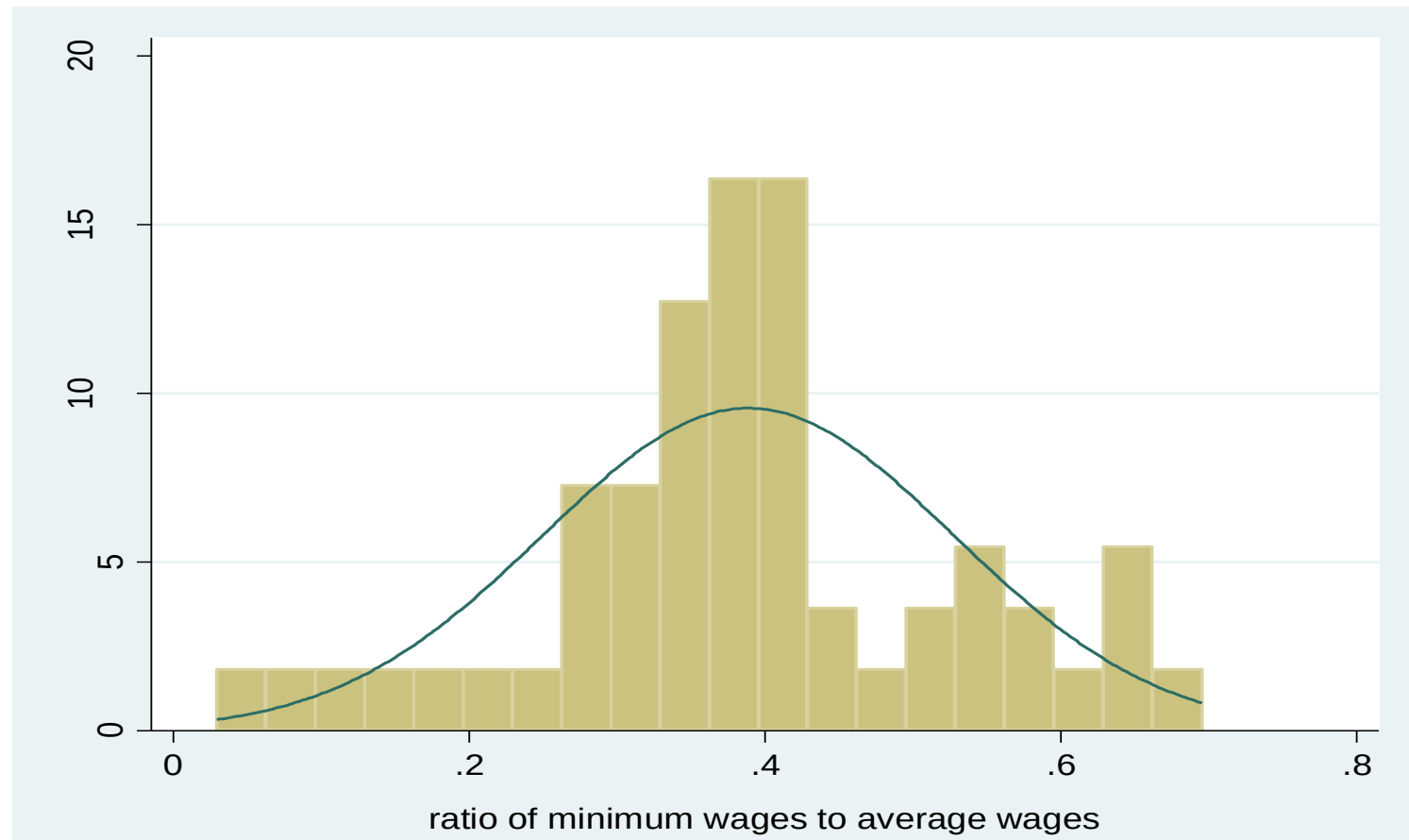
5. What's the right level & how often adjusted?

Good practice: ILO Convention 131 (51 ratifications).

Take into account both:

- a) the needs of workers and their families, taking into account the general level of wages in the country, the cost of living, social security benefits, and the relative living standards of other social groups; and
- b) economic factors, including requirements of economic development, levels of productivity, and the desirability of attaining and maintaining a high level of employment.

5 A – Look at some indicators: globally minimum wages are set at 40% of average wages



5 – Take into account the fraction affected

- INDIA: How many wage-earners are paid less than the proposed national minimum wage? **Answer: 73 million (14.5 million salaried + 58.6 million casual)**

	Male	Female	Total
Salaried Workers			
Rural	27.4	50.1	31.6
Urban	17.9	36	21.3
Total	21.5	41.3	25.3
Casual Workers			
Rural	55.0	45.9	51.9
Urban	38.0	50.7	40.8
Total	52.7	46.3	50.6

5- Simulate impact on inequality & poverty?

In India:

Wage Inequality, by sector

Sector	Actual wage	Adjusting for Minimum wage
Rural	0.48006	0.33221
Urban	0.49501	0.43123
All	0.50566	0.39754

Simulation result: receiving minimum wages, and controlling for other variables, would reduce the probability of being poor by 7 - 10%