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Update on minimum wage developments

Introduction

1. The ILO Declaration on Social Justice for a Fair Globalization (the Social Justice Declaration) states the commitments of member States and the Organization to developing and enhancing "policies in regard to wages and earnings, hours and other conditions of work, designed to ensure a just share of the fruits of progress to all and a minimum living wage to all employed and in need of such protection". The Social Justice Declaration also requires that the Organization assist member States in their efforts and enhance their institutional capacity. This involves a more systematic provision and sharing of knowledge about trends and good practices based on empirical evidence, and the gradual strengthening of ILO technical cooperation in this area.

2. This paper is part of the efforts to give effect to the provisions of the Social Justice Declaration, by sharing information and empirical trends on minimum wages in a large number of countries. It complements a paper submitted to the Committee in November 2004. [1] The information contained in this paper is based on a newly extended minimum wage database which covers more than 100 countries. The database includes statistics on the level of minimum wages in absolute terms as well as relative to both gross domestic product (GDP) per capita and average wages, whenever available. It also includes information on the institutional aspects of minimum wage systems, including the type and degree of involvement of social partners. Data from country-level case studies conducted recently in both developed and developing countries, including a comprehensive review of minimum wage systems in the European Union (EU), have also been used.

3. The first section of this paper examines global trends in minimum wage levels in the period 2001–07 as well as some recent developments during the current economic crisis. The second section discusses the impact of social partners' involvement on minimum wage outcomes. The paper concludes by reiterating the importance of social dialogue for sound minimum wage setting, especially in times of economic downturn.

[1] GB. 291/ESP/5(&Corr.).

(I) Global trends in minimum wages, 2001–07

4. The ILO has defined minimum wages as "the lowest level of remuneration permitted … which in each country has the force of law and which is enforceable under threat of penal or other appropriate sanctions. Minimum wages fixed by collective agreements made binding by public authorities are included in this definition". [2] Based on this broad definition, minimum wages are a nearly universal policy instrument implemented by most countries in all regions, except the Middle East. A great diversity in minimum wage fixing mechanisms exists across countries. This is associated with the level of development of collective bargaining and the role of the State in wage policy. Minimum wage fixing methods range from government statutory decisions to negotiation of minimum wages through bilateral or tripartite agreements. The number of minimum wage rates across countries is equally varied, ranging from one single national statutory minimum wage, as in Brazil and Spain, to over 1,200 minimum wage rates for a range of occupations identified by both the federal and state Governments in India.

5. During the period 2001–07, there have been clear indications of a more vigorous use of minimum wage policies in both developed and developing countries. More than 70 per cent of the countries included in the sample have increased minimum wage levels. On average, minimum wages have increased by 5.7 per cent per year in real terms (i.e. adjusted for inflation). In the average (median) country, the monthly minimum wage expressed in purchasing power parity (PPP) [3] has increased from $178 to $235. This contrasts with earlier periods when the real value of minimum wages tended to increase much more slowly or even to decline. Figure 1 shows that the positive trend in the purchasing power of minimum wage earners was observed in all regions of the world. Another reflection of the renewed importance of minimum wages is the recent increase in the number of member States which have ratified the Minimum Wage Fixing Convention, 1970 (No. 131). [4] Today, a total of 119 member States have ratified either Convention No. 131 or the earlier Minimum Wage-Fixing Machinery Convention, 1928 (No. 26).

6. This renewed importance of minimum wages is related to various economic and social developments. [5] First, the relatively high economic growth during the last decade was in many countries accompanied by an increase in the number of vulnerable workers, particularly those in part-time, temporary or casual employment, and more jobs with low pay. Minimum wages were seen as an effective policy tool for addressing low pay and poverty. Second, widening income inequality in many countries, especially when stemming from some deterioration in wages at the lower end of the scale, has led policy-makers to consider minimum wages as having the potential to limit income inequality. For instance, following the latest EU enlargement, some "older" EU countries have experienced a significant inflow of migrant workers who were often hired at lower wages and different working conditions. This has generated a debate on the need to

[2] ILO: *Minimum wages: Wage-fixing machinery, application and supervision*, Report III (Part 4B) (General Survey), International Labour Conference, 79th Session, Geneva, 1992.

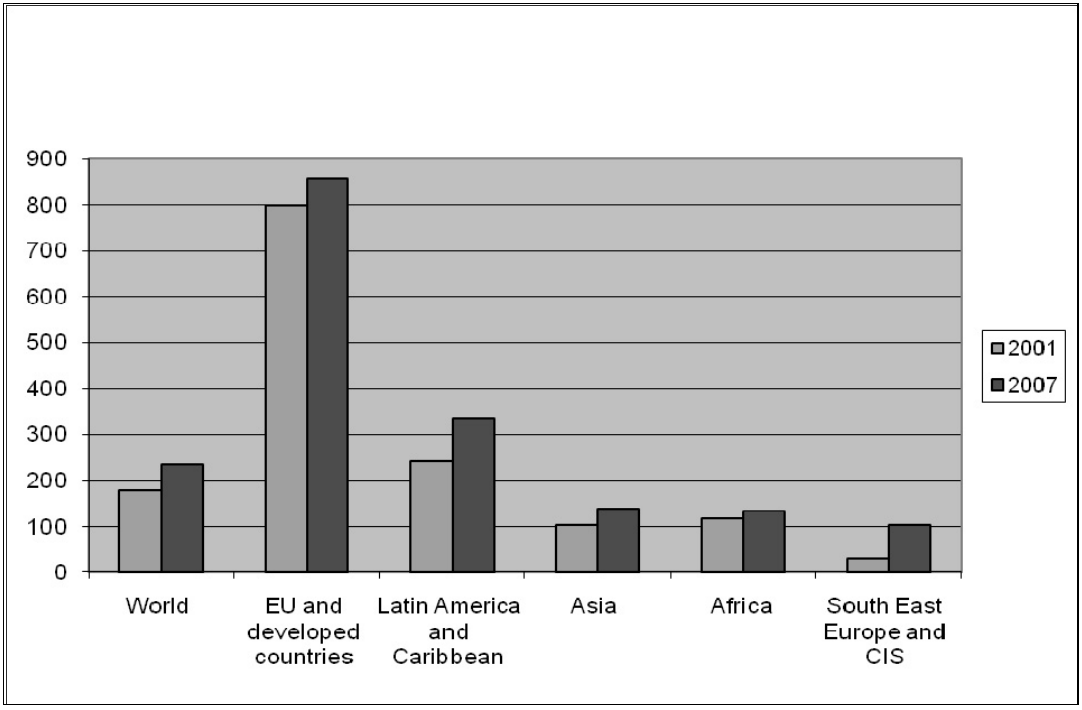
[3] The PPP rate is the number of units of domestic currency that are necessary to obtain a purchasing power that is equivalent to $1 in the United States.

[4] Recent ratifications include Albania (2004); Antigua and Barbuda (2002); Armenia (2005); Central African Republic (2006); Republic of Korea (2001); Kyrgyzstan (2007); Republic of Moldova (2000); Montenegro (2006); Serbia (2000); and Ukraine (2006).

[5] ILO: *Global Wage Report 2008–09*; D. Vaughan-Whitehead (ed.): *The minimum wage revisited in the enlarged EU*, Report prepared for the conference "Minimum wage revisited in the enlarged EU: Issues and challenges", Brussels, 30–31 October 2008, pp. 3–16.

strengthen national minimum wage-setting mechanisms to avoid social dumping. This debate has been paralleled by discussions about the desirability of establishing a minimum wage policy at the EU level. [6] Third, concerns about accelerated inflation (at least until mid-2008) and the erosion of the purchasing power of wages, especially of the lowest paid, also played a role. Timely adjustments of minimum wages reflecting consumer price increases were considered as helping these workers maintain their living standards.

Figure 1. Minimum wages in the median country, by region US$ PPP (2001 and 2007)



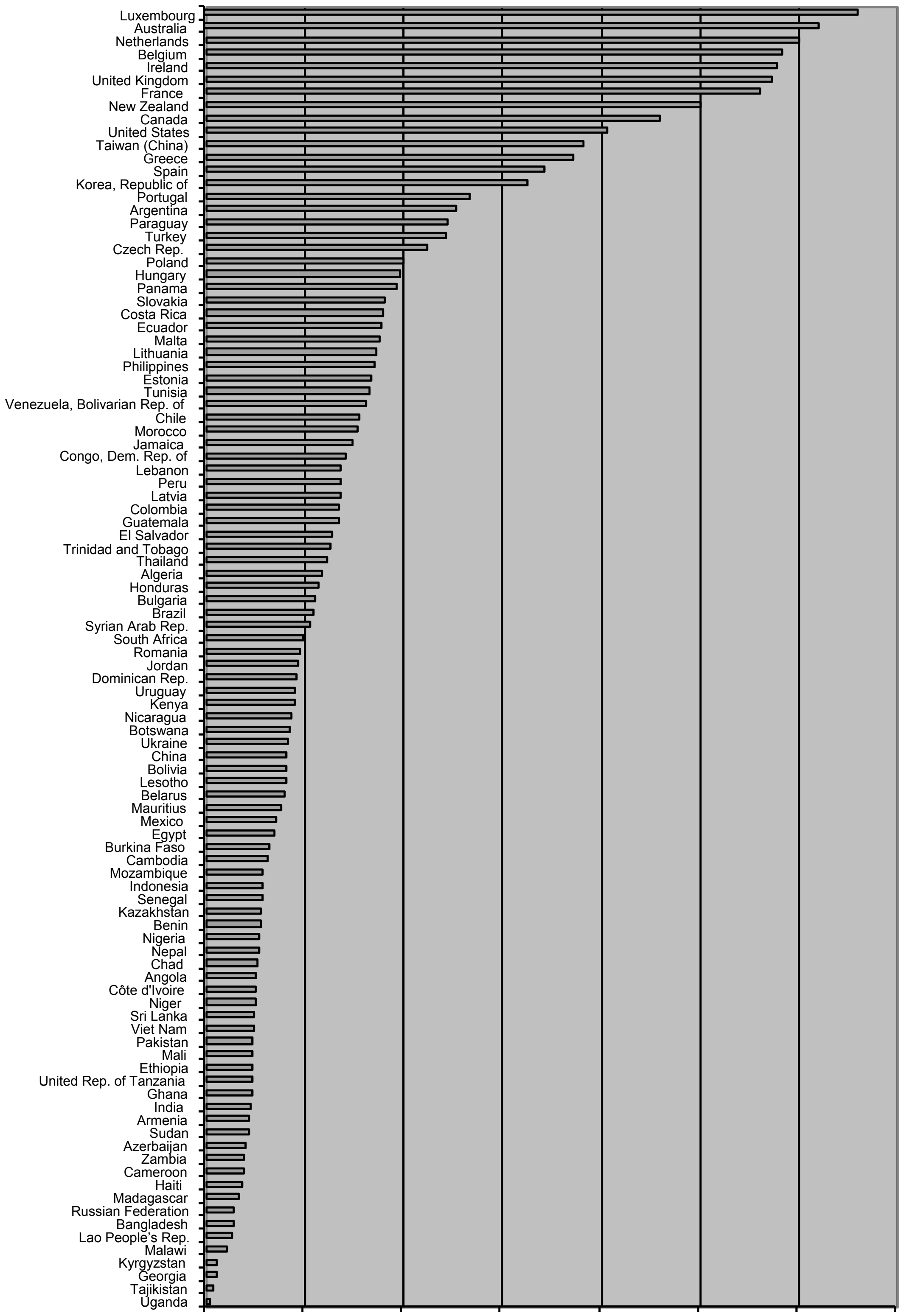
7. In absolute terms, however, minimum wage levels remain rather low (figure 2). In 50 per cent of countries the minimum wage is set at less than $250 PPP per month and 80 per cent have a minimum wage under $500 PPP per month. At the higher end of the scale, in about 10 per cent of countries, the level of monthly minimum wages exceeds $1,000 PPP per month.

8. These differences reflect, to a large extent, cross-country differences in the level of economic development. Another relevant indicator is the level of minimum wages in each country compared to its own level of economic development, as measured by its GDP per capita. [7] Globally, in the world's median country the minimum wage is set at about 48 per cent of GDP per capita. On average, minimum wages are set at higher relative levels in developing countries than in the EU and developed countries. Exceptions are the countries of South-East Europe and the Commonwealth of Independent States (CIS), where minimum wages are still very low, even when compared to their own GDP per capita.

[6] Vaughan-Whitehead (ed.), op. cit.; T. Schulten: "Towards a European minimum wage policy? Fair wages and social Europe", in *European Journal of Industrial Relations*, Vol. 14, No. 4 (2008), pp. 421–439.

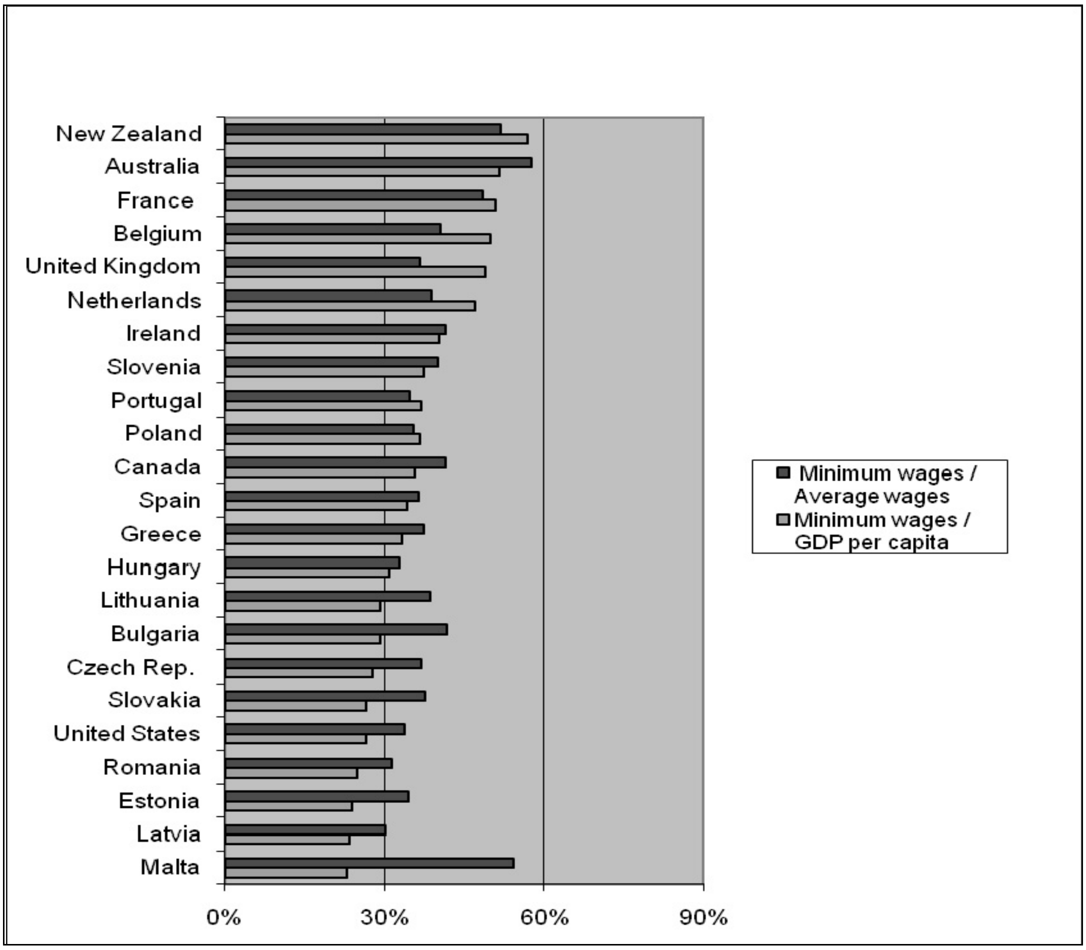
[7] Comparing the minimum wage with average wages gives a better indication of its rank in the wage distribution, but there are a number of problems connected to this indicator, including the lack, or the poor quality, of data on average wages. The advantage of comparing minimum wages with GDP per capita is the availability of the latter for almost all countries. For a discussion on the advantages and disadvantages of different ways of establishing the level of a minimum wage, see C. Saget: "Fixing minimum wage levels in developing countries: Common failures and remedies", in *International Labour Review*, Vol. 147, No. 1 (2008).

Figure 2. The level of minimum wages in 2007 (PPP US$)



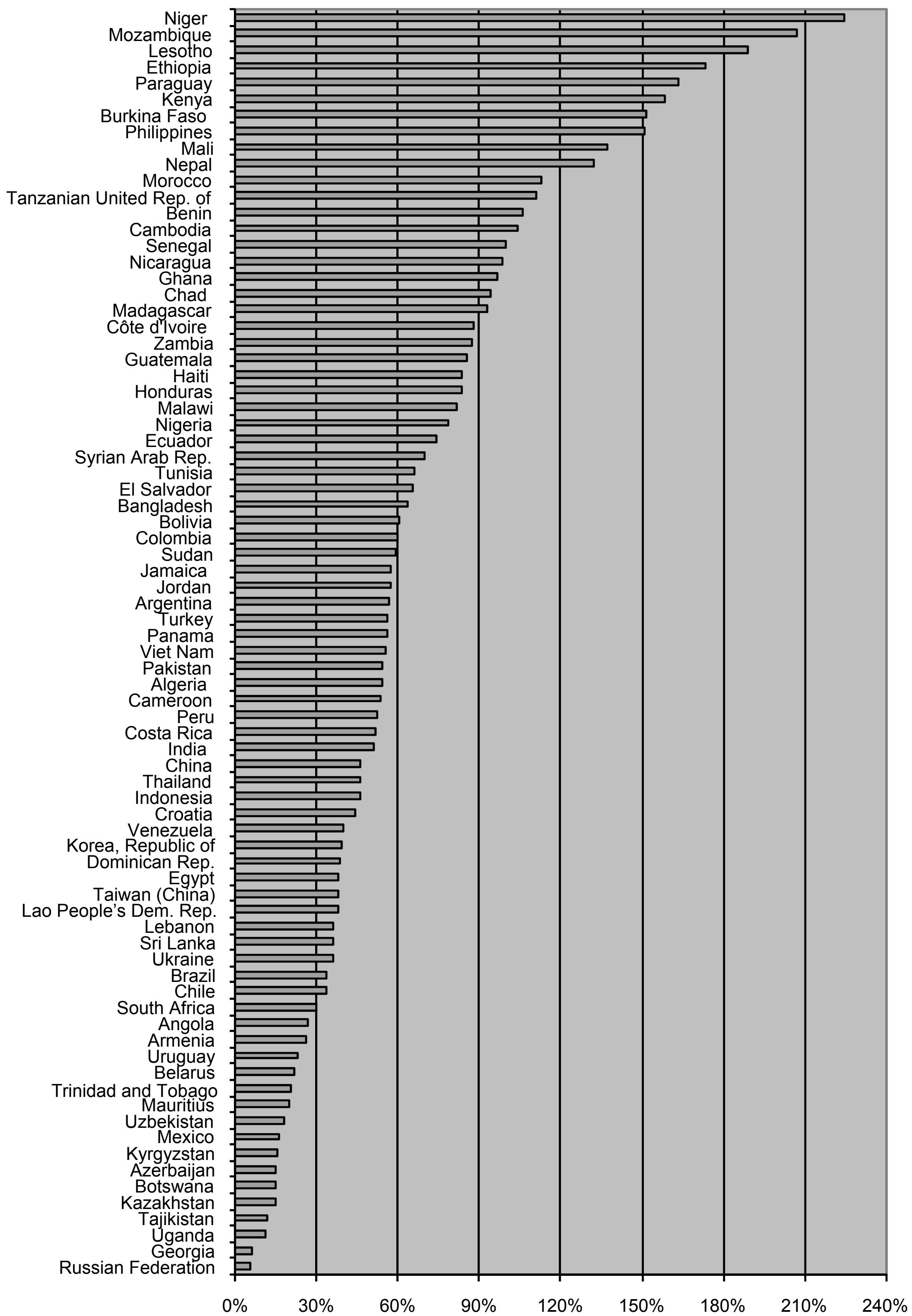
9. The level of minimum wages varies not only across regions but also across countries. Figure 3 shows minimum wages as compared to GDP per capita, and also to average wages, in a number of EU and developed countries. We see that, in a majority of countries, minimum wages are set within a range of 30–60 per cent of GDP per capita. There is much more dispersion in developing and transition countries, sometimes with very extreme values. From figure 4 it can be calculated that 40 per cent of developing and transition countries have minimum wages which either exceed 100 per cent or remain below 30 per cent of GDP per capita. As for the levels of minimum wages relative to average wages, the *Global Wage Report 2008–09* showed that in the surveyed countries there is a high frequency around 0.4.

Figure 3. Level of minimum wages: European Union and developed countries



10. The recent global economic crisis has already begun to affect minimum wage policies in many countries, and will continue to do so in the coming months. Although economic downturns tend to highlight the labour costs aspects of minimum wages and raise concerns about their impact on jobs, they also heighten the importance of minimum wages for protecting the purchasing power of the most vulnerable workers and sustaining overall consumption, which is vital for economic recovery. In light of these considerations, Spain and Brazil for instance have decided to pursue minimum wage adjustments in real terms to achieve longer term goals, despite the crisis. As a response to the financial crisis, the German Government also decided to extend collectively bargained minimum wages to a number of industries, covering a total of 1.7 million workers.

Figure 4. Levels of minimum wages relative to GDP per capita: Developing and transition countries



11. At the same time, a number of countries have decided to freeze minimum wages or consider changes to their current minimum wage systems. The Republic of Korea is examining, among others, the possibility of introducing lower rates for older workers and differentiated regional rates. In addition, some emerging market countries have changed their minimum wage practices following International Monetary Fund (IMF) advice. Countries that have sought financial assistance from the IMF in recent months have been advised to reform social and fiscal policy. This includes freezing minimum wages, fiscal restraint through cuts in public investment, cuts in public sector wages, and strict public sector wage restraint. Such policy packages can restore confidence in national financial markets but they are “pro-cyclical” and tend to amplify the negative impact of the recession on employment and wages. The countries concerned face a distinct possibility of an increase in income inequality, and previous crises show that a return to pre-crisis wage levels can take much longer than restoring economic growth. For instance, wage inequality in some Asian and CIS countries worsened considerably following the Asian financial crisis of 1998 and the hyperinflation period of the 1990s in the CIS countries.

(II) The impact of social partners’ involvement on minimum wage outcomes

12. The costs and benefits of minimum wages depend first and foremost on the level at which they are set and on whether they are paid. The extent and type of involvement of social partners in minimum wage fixing play an important role in this respect.

13. Convention No. 131 leaves the determination of the level of minimum wages that are necessary to protect “wage earners against unduly low wages” to the member States themselves. It nevertheless highlights the potential trade-offs by emphasizing that the two key elements to be taken into consideration are: “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 “economic factors, including the requirements of economic development, levels of productivity and the desirability of attaining and maintaining a high level of employment”.

14. How these elements weigh into the final determination of the minimum wage level varies widely from one country to another, depending on national circumstances and perceptions. In general, however, statistical analysis shows that countries with higher minimum wages are also the countries with reduced wage inequality in the bottom half of the labour market. [8] This finding from cross-country analysis is in line with a relatively large body of country-specific academic research showing that minimum wages can increase the number of workers with access to decent wages and reduce the pay gap between men and women (as a majority of minimum wage earners are typically women). These findings have been well documented in developed countries, but they also hold in developing countries. In Brazil, for example, it has been estimated that a 10 per cent increase in the real minimum wage typically compresses the inequality between the median wage earner and the lowest paid 25 per cent of workers by 1.3 per cent. [9]

15. While it is often assumed that minimum wages will reduce employment, empirical evidence is mixed. Indeed, recent surveys show that the employment effects of minimum

[8] ILO: *Global Wage Report 2008–09*, Geneva, 2008.

[9] S. Lemos: “Minimum wage effects across the private and public sectors in Brazil”, in *Journal of Development Studies*, Vol. 43, No. 4, May 2007.

wages tend to be small or even not negative. [10] This may be due to the relatively small effect of minimum wage increases on total production costs in most enterprises. A recent study in the area of San Francisco (United States) calculated that labour costs in fast food restaurants represent on average about 35 per cent of operating costs, and that fewer than 50 per cent of workers are at the minimum wage. In such conditions, a 25 per cent increase in the minimum wage (from $6.75 to $8.50) raised total operating costs by about 4.5 per cent. [11] Although this may result in lower profits or higher prices or both, the overall impact is likely to remain small. This was also confirmed in a survey of the literature which reported that, despite the use of different methodologies, most studies found that a 10 per cent increase in the United States minimum wage raised overall prices by no more than 0.4 per cent. [12] This is unlikely to trigger inflation or massive unemployment. Research would need to be carried out to assess the impact of minimum wages on the total production cost of enterprises, especially small and medium-sized enterprises (SMEs), in developing and transition economies.

16. Of course, sudden or sharp increases in minimum wages can affect employment negatively. In Hungary, for instance, the Government took the unilateral decision to double the minimum wage in 2000–01, entailing a leap of the real minimum wage of 64 per cent. This in turn led to substantial lay-offs and bankruptcies, especially among SMEs. Such effects typically happen when governments decide minimum wage revisions unilaterally, after little, if any, consultation with the social partners. In such circumstances, minimum wage outcomes tend to be erratic and extreme, with important and sometimes sudden downward or upward adjustments, depending on the policy goals pursued by the government through the minimum wage policy.

17. On the contrary, evidence suggests that, when the social partners are involved, the minimum wage adjustments tend to be more balanced and predictable. In the United Kingdom, for instance, minimum wages increased by 25 per cent in real terms between 2000 and 2007, without noticeable adverse impact on employment. [13] The United Kingdom Low Pay Commission, which provides recommendations to the Government on minimum wage adjustments, is an interesting example of the advantages of involving the social partners, and academics in the same consultative forum. Another example is Uruguay, where the Government reactivated the wage councils in 2005, allowing greater involvement by the social partners in wage and minimum wage determination at sectoral level, without any disruption of employment. Such examples show that the involvement of social partners in minimum wage fixing is essential for sound minimum wage policies.

18. The involvement of social partners can take different forms and be direct or indirect. It is direct when workers' and employers' representatives fix minimum wages, whether at the national level or sectoral/occupational level. This can be as a result either of bilateral negotiations, as in Greece and Belgium, or of tripartite agreements, as in South Africa and Argentina. It is indirect, when the ultimate decision about the minimum wage level lies with the government which may consult the social partners – either though bilateral or

[10] See, for example, F. Eyraud and C. Saget: "The revival of minimum wages", in J. Berg and D. Kucera (eds): *In Defence of Labour Market Institutions*, 2008; ILO and Palgrave, or S. Lemos: *A survey of the effects of minimum wages in Latin America*, University of Leicester, Economics Working Paper No. 07/04, 2007.

[11] S. Dube, S. Naidu and M. Reich: "The economic effects of a citywide minimum wage", in *Industrial and Labour Relations Review*, Vol. 60, issue 4, 2007.

[12] S. Lemos: *The effect of the minimum wage on prices*, IZA Discussion Paper No. 1072, 2004.

[13] D. Grimshaw: "Developing a progressive minimum wage in a liberal market economy", in D. Vaughan-Whitehead (ed.), op. cit., pp. 479–480.

tripartite bodies, as in Botswana, Czech Republic and Paraguay, or through separate consultations, as in France and Morocco – without being bound to follow their advice. In some cases, governments are not required by the law to consult the social partners before fixing the minimum wage, but sometimes they do so anyway, as in Brazil and Spain. Indirect involvement is the most prevalent form in which social partners take part in minimum wage setting.

19. In countries were trade unions are weaker, the involvement of social partners in minimum wage setting has the additional benefit of acting as an important catalyst for the development of collective bargaining and the reinforcement of social dialogue. For instance, in Cambodia, the involvement of social partners in minimum wage fixing through the Labour Advisory Committee was an important step towards establishing social dialogue and laying the ground for a change in attitude toward collective bargaining. In 2008, the Tanzanian Government, further to the tensions stemming from a sudden and significant increase in both the number and level of minimum wage rates, commissioned an impact assessment study. One of the main recommendations of the study was the need for the Government to provide training to all parties concerned in order to improve the quality of social dialogue. Another example is South Africa where, since 2002, minimum wages are set for certain sectors by the Government following recommendations of a tripartite commission, thus broadening the coverage of the minimum wage policy. This has led to increasing levels of minimum wages for many of the most vulnerable workers, including domestic and farm workers.

20. Ultimately, the impact and usefulness of a minimum wage policy depends on whether minimum wages are paid. This, in turn, depends on the effectiveness of the enforcement mechanism. Penalties for violators, adequate compensation for workers whose rights have been breached, and suitable resourcing of the enforcement authority, are all crucial factors. But the active involvement of social partners in both the design and operation of minimum wage enforcement regimes is essential to enhance their impact. Recently, in the United Kingdom, in the face of growing problems of underpayment of minimum wages, the Government organized consultative meetings with interested parties to discuss the suitability and implications of suggested changes to the minimum wage enforcement regime. Both workers' and employers' organizations put forward a number of constructive proposals. In the United States, the US Government Accounting Office (GAO) recommended to the Department of Labor to involve employers' and workers' organizations in planning their enforcement activities [14] so as to counter the decline in the number of actions to enforce the Fair Labor Standards Act between 1997 and 2007. Minimum wage enforcement is typically more problematic in SMEs; this sometimes reflects an inability of these enterprises to pay, but often mirrors employers' lack of knowledge of either the minimum wage level or of their obligation to comply with the minimum wage law. Well-tailored, awareness-raising campaigns, in cooperation with employers' and workers' organizations, can help address this situation.

21. In order to fully ascertain the impact of minimum wage policies and better inform subsequent policy decisions, it is essential to know the number and the profile of the workers who earn a minimum wage, as well as the sectors, occupations and type of enterprises in which they are found. While this type of information is more readily available for industrialized countries, it is rare to find it in developing and transition countries. This is another research area which warrants attention from the ILO.

[14] GAO: "Fair Labor Standards Act: Better use of available resources and consistent reporting could improve compliance", Testimony before the Committee on Education and Labor, House of Representatives, GAO-08-962T, July 2008; and GAO: "Department of Labor: Case studies from ongoing work show examples in which wage and hour division did not adequately pursue labor violations", Testimony before the Committee on Education and Labor, House of Representatives, GAO-08-973T, July 2008.

Conclusions

22. Minimum wage policies can protect the purchasing power of the most vulnerable workers and reduce the incidence of low pay. During the 2001–07 period, real minimum wages increased significantly in most countries reviewed – often in response to increases in income inequality and/or in the number of working poor – thus improving the purchasing power of the least paid workers. In the majority of countries, minimum wages were set within a range of 30–60 per cent of GDP per capita. In the case of industrialized countries for which average wage data is available, minimum wages, when fixed at above 40 per cent of average wages, contributed to narrowing wage inequality in the bottom half of the labour market.

23. The upward trend in minimum wages across the world occurred in a period of relatively sustained economic growth in most countries. In the current economic situation, minimum wage adjustments may be more difficult: in some cases, tensions over minimum wages between the government and the social partners have already intensified. In Ireland, for instance, there have been debates over the adjustments in minimum wages for work on Sunday, while, in Indonesia, workers have protested against the issuance of a joint ministerial decree in October 2008 calling on provincial governments not to set new minimum wages for 2009. Yet, minimum wages remain an important tool to maintain the consumption of those at the bottom of the wage scale and can thus contribute to a quicker economic recovery. Previous crises show that recovery to pre-crisis wage levels can take much longer than restoring economic growth. Minimum wage policies should, therefore, not be compromised in a hasty manner without the consequences being fully considered. Minimum wage policy decisions are to be based on the careful monitoring of variations in wage earnings and other sources of income of the most vulnerable groups of workers. This should provide the basis for decisions about how to maintain their purchasing power, through a combination of minimum wages and other income support policies and/or tax reductions.

24. Effective policy responses require strong social dialogue and close monitoring of the impact of the crisis on the most vulnerable workers. The methods and processes whereby minimum wages are set are as important as the minimum wage levels. While no universal system of minimum wage fixing exists, as national institutional arrangements reflect the level of collective bargaining development and the role of the State in wage policy, evidence shows that the involvement of social partners matters. Minimum wages are more likely to be adjusted more regularly and more in line with productivity levels, economic performance and enterprises' capacity to pay, while preserving workers' purchasing power.

25. Under certain conditions social dialogue is also conducive to a better articulation between a statutory minimum wage policy and wage bargaining, especially in countries where trade unions are weak and collective bargaining coverage is low or is yet to function as a mechanism to set wages. An indispensable condition is that social partners have equal access to all relevant information and data and have the means and capacity to comprehend fully the implications of the different issues involved such as setting minimum wages at different levels for low-paid workers, inequality in the lower half of the wage distribution, productivity, inflation, employment and wage bargaining.

Geneva, 5 February 2009.

Submitted for debate and guidance.