

## Minimum wage policies to boost inclusive growth

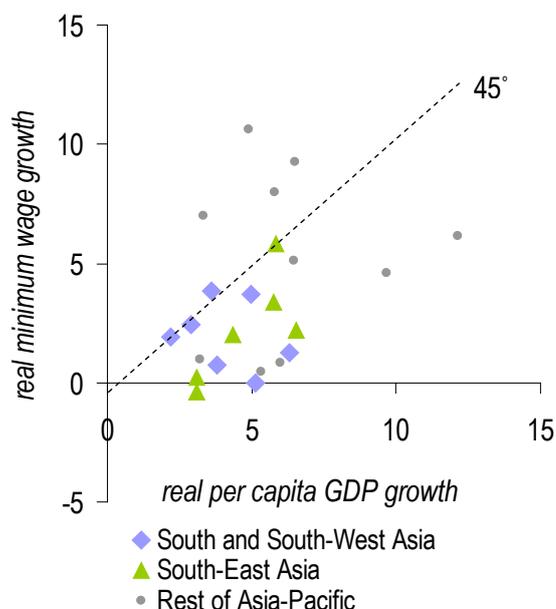
ESCAP analysis indicates that a minimum wage policy, if designed carefully along with supportive adjustment measures, boosts workers' income and improves long-term job prospects without adversely affecting businesses. For example, recent minimum wage hikes in Thailand are projected to increase employment growth by up to 0.6 of a percentage point by 2015, while real GDP growth is expected to increase by 0.7 of a percentage point above the level foreseen if no minimum wage increases were implemented.

Wage growth in Asia and the Pacific has generally remained weak over the past few years despite relatively robust economic performance. According to the International Labour Organization (ILO) *Global Wage Report 2012/13*, real wages in Asia grew, on annual average by 5.2% in the years 2008-2011 compared to its average annual GDP growth of 6.8% over the same period. Slower wage growth contributes, not only to rising inequality, but also constrains domestic effective demand, further deterring economic growth, especially at a time when external demand is weak and faltering.

The trends of real wages growth in the regions become even more worrisome if China is excluded from this calculation. Without China the real average wages contracted by 0.3% per annum in the region. Moreover, minimum wages have fallen into neglect in some countries and they are often insufficient to meet workers' basic daily necessities, including health care. With adjustments in minimum wages lagging behind rising GDP per capita, economic growth has not translated into higher wages, especially in relatively richer countries in South-East Asia and South and South-West Asia (see figure A). Apart from these general observations, the level of minimum wage rates can be seen to vary considerably across countries, driven by differences in domestic economic environments and prevailing labour market institutions. Many countries in the region, including Bangladesh, Bhutan, India, Kyrgyzstan, Myanmar, Sri Lanka, Tajikistan and Uzbekistan, have minimum wage rates set well below \$100 per month (see figure B).

Minimum wage is defined by the ILO as "the lowest level of remuneration permitted which

Figure A. Minimum wage growth and per capita growth in selected developing Asia-Pacific economies, 2002-2011

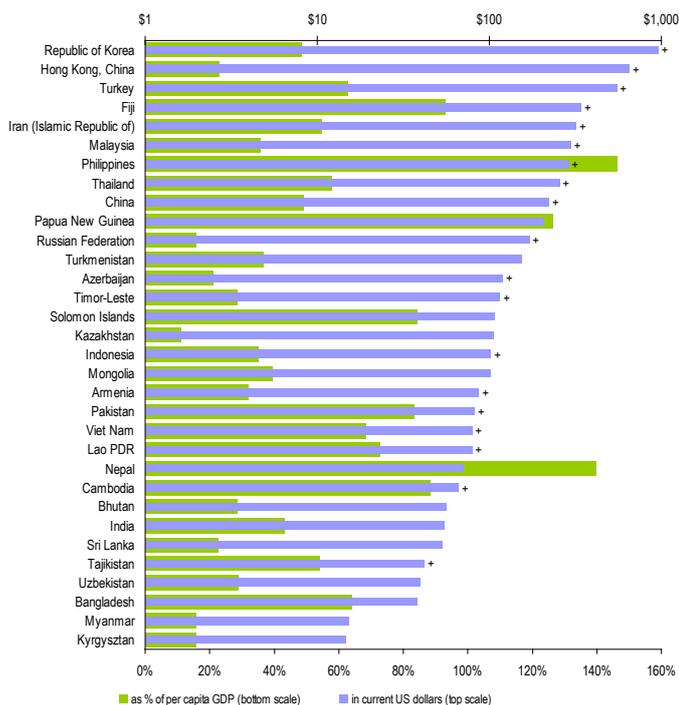


Sources: ESCAP, based on various national sources and data from International Labour Organization, Global Wage Database and United Nations Statistics Division.

Notes: The horizontal axis shows compound annual growth of real GDP per capita over 2002-2011 for selected developing Asia-Pacific economies. The vertical axis presents real minimum wage growth compounded over the same period.

in each country has the force of law and which is enforceable under threat of panel of other appropriate sanctions. Minimum wages fixed by collective agreements made binding by public authorities are included in this definition" (ILO, 1992). Also, the number of minimum wage rates set within the same country is often quite different. Some countries have only one national minimum wage rate, whereas others

Figure B. Monthly minimum wage rates in selected developing Asia-Pacific economies



Sources: ESCAP, based on various national sources and data from International Labour Organization, Global Wage Database and United Nations Statistics Division.

Notes: Figures shown are monthly minimum wage rates in place as of 1 January 2013 both in current United States dollars (top scale) and as % of per capita GDP (bottom scale). In countries where multiple minimum wage rates are set at the sectoral level, the rate for manufacturing or unskilled workers is applied. In cases where a national statutory minimum wage is not mandated, the minimum wage in place in the capital or major city is used. The (+) signs indicate that the minimum wage rates have been raised since the beginning of 2012.

have multiple minimum wage rates by districts, occupations, age, and qualification. India, for instance, has more than 1,200 different rates.

Recently, governments in the Asia-Pacific region have used minimum wages as a policy tool to protect vulnerable workers and to stimulate domestic aggregate demand. The implementation of minimum wages is also increasingly considered as an important component of industrial policy for promoting industrial restructuring towards higher value-added activities and diversification to maintain international competitiveness by creating enabling environment for employees to receive lifelong learning, knowledge-based skills up-gradation, vocational and retraining opportunities.<sup>1</sup> In other words, the basis for dynamic competitive advantage is productivity growth, not race to the bottom of labour standards and payment conditions.

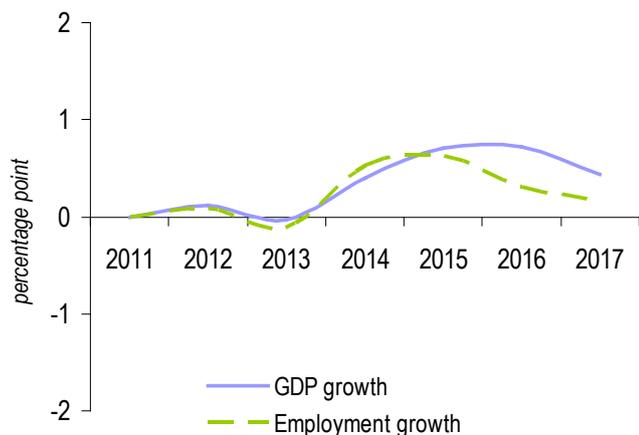
Since the beginning of 2012, minimum wages have been raised or have been introduced for the first time in more than 20 economies across the region. Malaysia was the most recent economy to establish a comprehensive national minimum wage in January 2013, set at 900 Malaysian ringgit (RM) (\$290) a month for Peninsular Malaysia and RM800 for Sabah and Sarawak. Likewise, the new daily minimum wage of 300 Thai baht (THB) (\$10) per day set in Thailand came into effect across the country in January 2013. This large increase of 40% or more, depending on the province, came after more than a decade during which minimum wages hardly kept up with inflation, and fell far short of productivity growth.

A common criticism of minimum wage adjustments is that they interfere with market forces in wage setting and raise labour costs, resulting in layoffs of workers – especially in small and medium sized enterprises (SMEs). This may be a valid consideration if minimum wages were increased abruptly without appropriate measures for adjustment in labour-intensive sectors. However, fears that minimum wages *per se* lead to employment losses appear to lack empirical verification. Instead, a growing number of studies indicate that the relationship between the minimum wage and employment is not necessarily negative.

For instance, a recent World Bank study on Indonesia found that minimum wage increases succeeded in boosting wages in the manufacturing sector, but had not led to employment losses for production workers and had only had a minuscule impact on non-production workers (for details, see Del Carpio, Nguyen and Wang, 2012). Most recently, Borat, Kanbur and Mayet (2013) investigated the impact of minimum wage laws in South Africa and found that there was no significant impact of the laws at the extensive margin (i.e., participation of workers in the labour market), and, in three of the five sectors which they studied, increases in real hourly wages were sufficient to outweigh intensive margin (i.e., number of hours supplied by those working) adjustments, so that workers in these sectors experienced an improvement in real income as a result of the enactment of minimum wage law.

<sup>1</sup> Chowdhury (2008) argued that Singapore and Malaysia used a tripartite wage-fixing mechanism for orderly wage increases in order not to jeopardize macro-economic stability and international competitiveness and thereby accelerated the industrial restructuring process.

Figure C. Estimated impact of minimum wage hikes in Thailand



Sources: ESCAP, based on the Oxford Economic Global Model.  
 Notes: Figures shown are estimated impacts of minimum wage hikes in Thailand in terms of percentage point change of real GDP and employment growth over 2012-2017. Baseline cases are ESCAP projections when minimum wages did not rise in 2012 or 2013.

These findings show that the theoretical wage-employment trade-off is not always readily observed in practice, and that the medium-term labour market consequences of minimum wage policy are far more varied and unpredictable than most theory would suggest. They are also in line with findings from developed economies that all point at the negligible negative employment effects of minimum wages.

Moreover, minimum wages have many benefits apart from boosting workers' income. Increased incomes for workers boost consumption demand, while increased labour costs trigger new economic activities with higher value-added content. Minimum wages thus improve the competitiveness of an economy by raising knowledge-based skill contents of workers in preparation for increased international labour competition. Such wage policies also contribute to reduction of income inequality by redistributing income towards low wage workers as well as lower labour market inequality. This, in turn, improves workers' morale and reduces the risk of industrial unrest, which ultimately increases productivity and reduces worker turnover, resulting in a lower cost of production and allowing firms to absorb the rise in unit labour cost.

The multi-year simulation exercise of ESCAP, based on the actual data for Thailand, models the impact of minimum wage increases on employment and real GDP growth for the period 2012-2017. In Thailand, the previous province-level minimum wages have been successively replaced by a single minimum wage of THB300 per day for the entire nation in 2012 and 2013 – corresponding to nominal increases of 40% or more, depending on the province. According to the Government official figures, the labour supply grew by 1.4% in 2012, 0.5% faster than growth of the working-age population.

Arguably, higher wages attract more people to enter the labour force, especially drawing workers from the informal economy, and helping to overcome the labour shortage in the country. Assuming that 5 million workers were paid less than THB300 per day before the wage increase,<sup>2</sup> the scenario analysis indicates that employment growth would accelerate by up to 0.6 of a percentage point by 2015, while real GDP growth would increase by 0.7 of a percentage point above the level without the minimum wage increase (see figure C).

More importantly, the initial adjustment costs, the reason for which minimum wage laws are often criticized, are likely to be insignificant. The net negative impacts on employment and GDP growth are estimated at just under 0.1 of a percentage point in 2013, implying that an increase in labour costs resulting from minimum wage increases would be offset by, or, in most cases, dominated by positive employment impacts due to a boost in domestic consumer demand.

The results of this macroeconomic simulation illustrate that recent minimum wage hikes in Thailand are unlikely to trigger significant unemployment. In fact, unemployment has fallen marginally in Thailand since the new minimum wage was first introduced in six provinces in April 2012, ahead of nation-wide implementation in 2013. Additionally, any price effect of the new minimum wage is likely to be short-lived and relatively small in size.

Nevertheless, it should be emphasized that minimum wage policies need to be designed

<sup>2</sup> This assumption is in line with the number estimated by the National Economic and Social Development Board, a Thai government agency.

to minimize any potential adverse impact. For instance, a periodic adjustment should be considered to take into account unexpected economic shocks such as changes in labour market conditions and productivity growth. If the adjustment of minimum wages is carried out on a staggered basis, the cost pass-through to consumers is likely to be manageable and the near-term fear of inflationary pressures can be minimized.

In China, minimum wage laws are regularly reviewed and revised at least once every two years to ensure that changes are not too drastic and do not have a significant short-term impact on overall economic growth. The introduction of macroeconomic and labour market policy support measures should be considered to smoothen the adjustment phase for businesses, especially for the vulnerable sections of the society. For example, in Thailand, upon the announcement of the minimum wage hike in 2012, the government introduced several targeted macro-labour market policy support measures such as providing tax allowances and reducing employers' social security contributions in order to steer the business sentiments and uncertain market reactions.

In sum, a minimum wage policy, if carefully designed and implemented with supportive adjustment policies by governments, could be a powerful macroeconomic and labour market policy instrument to increase incomes for workers, boost domestic effective demand and help narrow the income/earning gap. Moreover, it forces firms to improve production efficiency and hence contributes to economy-wide productivity growth and increases firms' competitiveness.

While some fear that higher minimum wages could have some short-term negative impacts on employment, inflation or GDP growth, these impacts have been found to be negligible in most cases – and need to be weighed against the long-term economic

benefits and their positive social impacts. Nevertheless, it is important for countries which have introduced minimum wage legislation to simultaneously undertake active labour market programmes in tandem with policy measures to create enabling environment for private sector business, especially for SMEs, and subsequently provide space to tide over short-term economy-wide fear of adjustment difficulties.

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The MPDD Policy Briefs aims at generating a forward-looking discussion among policymakers, researchers and other stakeholders to help forge political will and build a regional consensus on the needed policy actions and pressing reforms. Policy Briefs are issued without formal editing. This issue has been prepared by Mr. Sudip Ranjan Basu and Mr. Yusuke Tateno of the Macroeconomic Policy and Development Division, ESCAP. It is based on the *Economic and Social Survey of Asia and the Pacific 2013: Forward-Looking Macroeconomic Policies for Inclusive and Sustainable Development*. For further information on the policy brief, please contact Mr. Anis Chowdhury, Director, Macroeconomic Policy and Development Division, ESCAP (escap-mpdd@un.org)