

Minimum wage setting: Balancing Worker Protection While ensuring Enterprise and Productivity

GSG Learning Event,
May 25th, 2016

Focus Questions

- Are there some principles to follow in the management of the MW policy?
- How do countries manage the level?...are there tools to consider?
- How can we gauge “ex-ante”, what impacts to expect with a level change?
- How to find the right balance between protecting workers and avoiding negative consequences on employment and productivity?



Principles to manage the MW

Principles Underlying the Policy Tool

Objectivity:

Define a methodology to make the process objective and related to the reality of the economy

Certainty:

Expected increases in the minimum wage can be accurately anticipated

Equity:

Workers earn what they contribute to the production process and employers have certainty

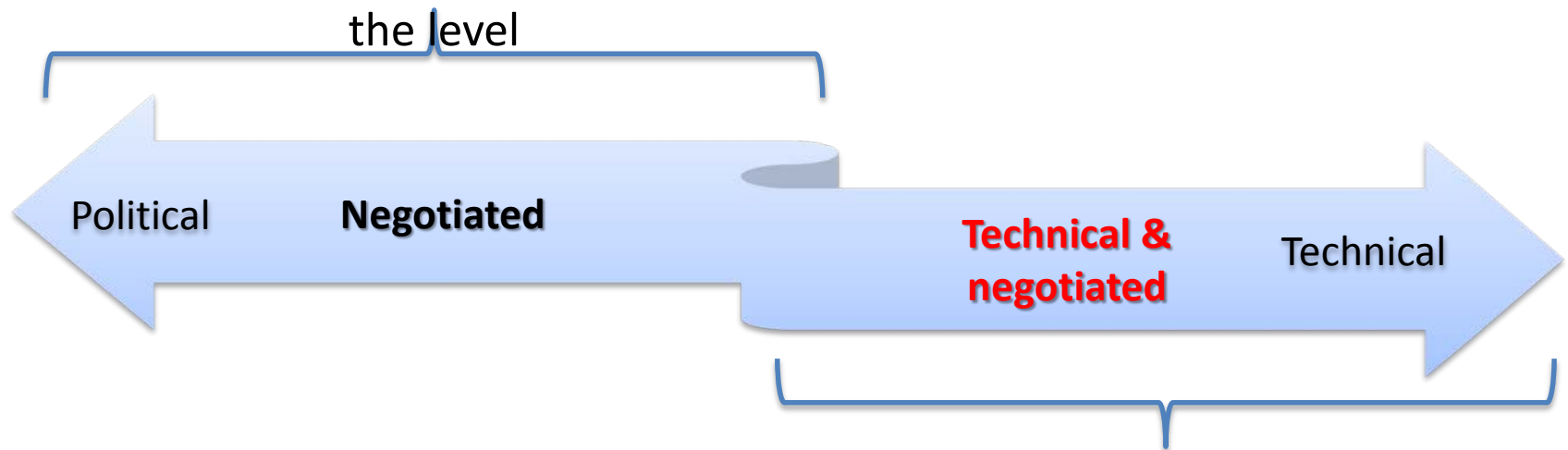
No matter what the objective, (at least) three principles should be followed: Objective, Certain, Equitable.

Why? to keep the level aligned with the reality of the socio-economic context and the government's desire to address labor market inefficiencies



Approaches to set the MW level

Process largely based on negotiation,
stakeholder proposals are used to adjust
the level



Data, evidence, and economic
tools, are used to negotiate or
adjust the level



Examples of approaches and issues

Adjustments use no data or very limited data used:

- Cambodia: Tri-partite stakeholder negotiation
- Laos: Central government assigns the level, with limited consultation

Adjustments with (limited) socio economic criteria used in the negotiation:

- Mexico: Projected GDP growth, inflation.
- Colombia: Inflation and multifactor productivity.
- Chile: Inflation (actual and projected) and labor productivity
- UK: GDP, Inflation, Earnings Growth, Real Wages, Employment and Unemployment and Productivity

Adjustments use a pre-set approach based on economic indicators:

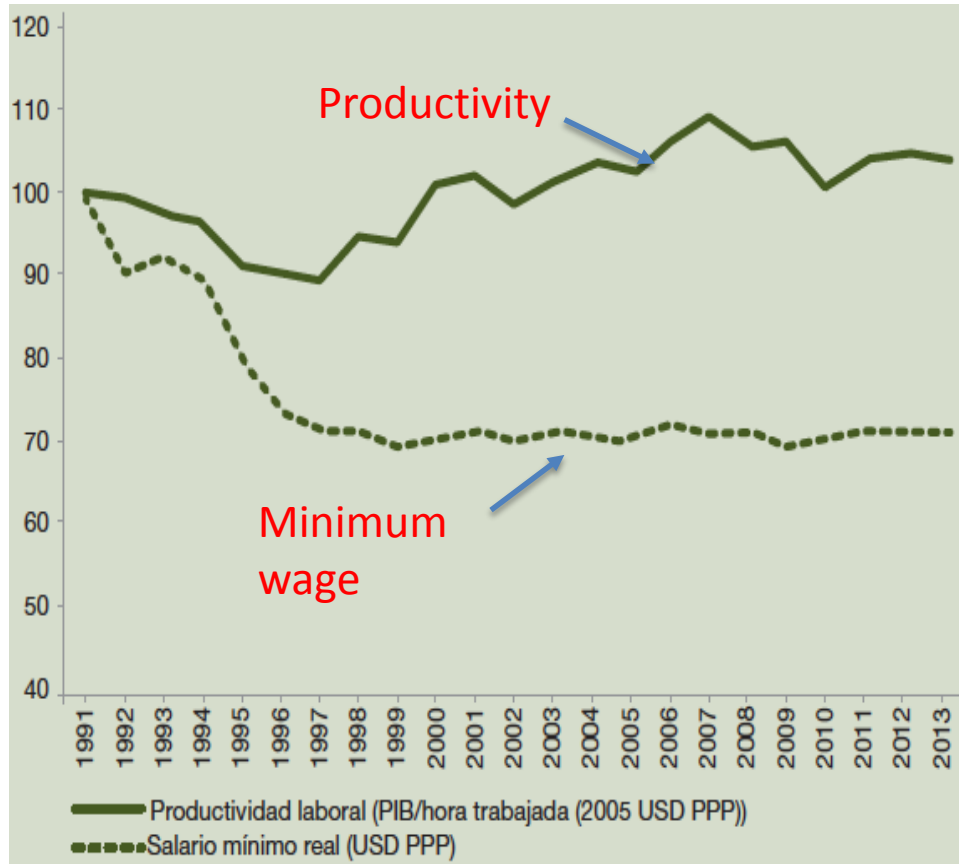
- Brazil: prior year inflation plus GDP growth from two years prior
- Costa Rica: expected inflation plus a fraction of the per-capita GDP growth (4 yr. avg). Fraction of growth considered is between 20-40% and it is determined by the national commission of MW.
- Korea: A multi-variable (socio-economic) formula yields a level (range) used for negotiation.
- Malaysia: A multi-variable (socio-economic) formula yields a level (range) used for negotiation.



Development of a Suitable Policy Tool to
Adjust the Minimum Wage Level

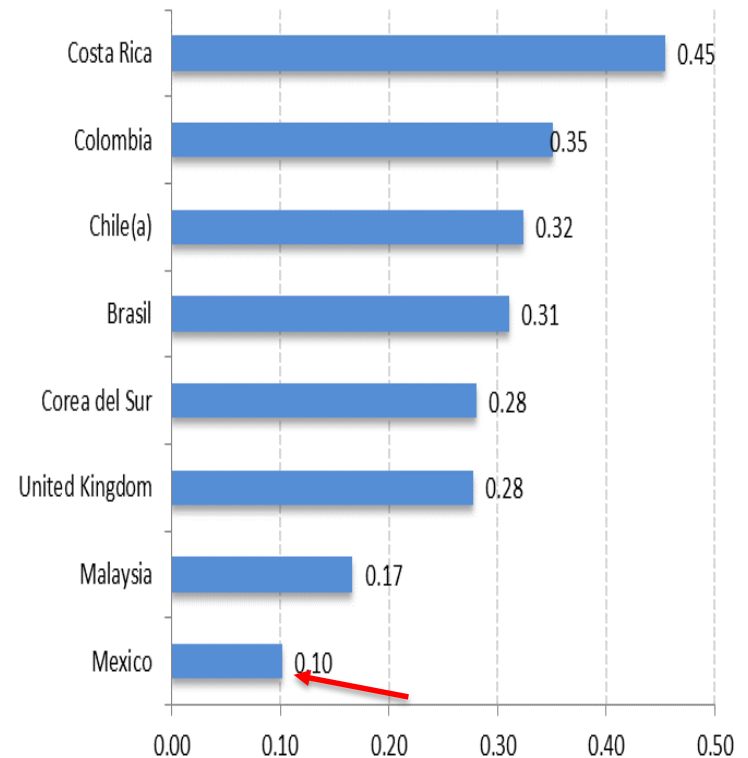


In Mexico, mw was falling behind productivity growth...



Source: ECLAC, 2014

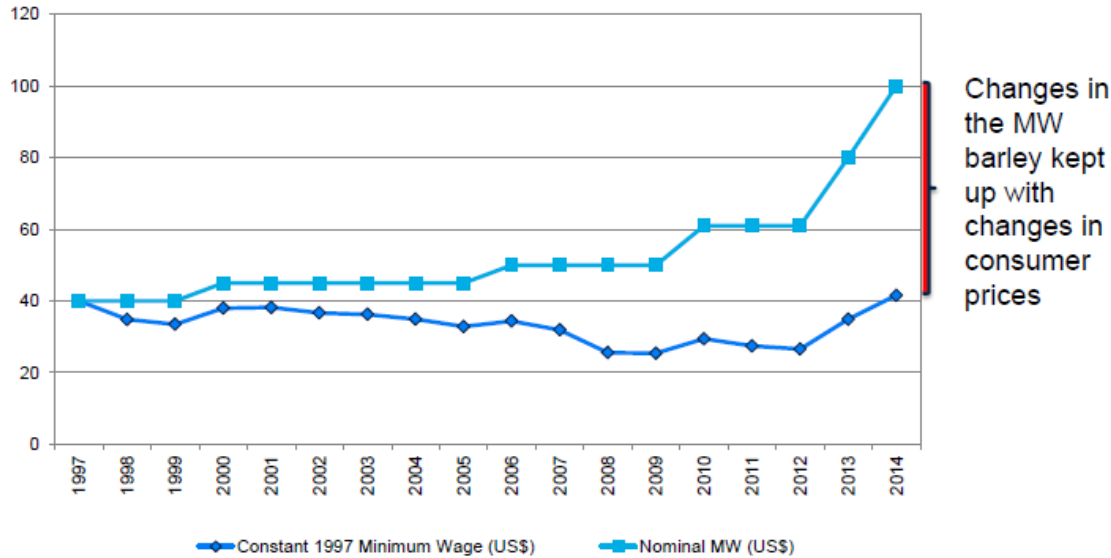
..and the level of MW has been low by international standards, equaling 10% of the GDP per capita



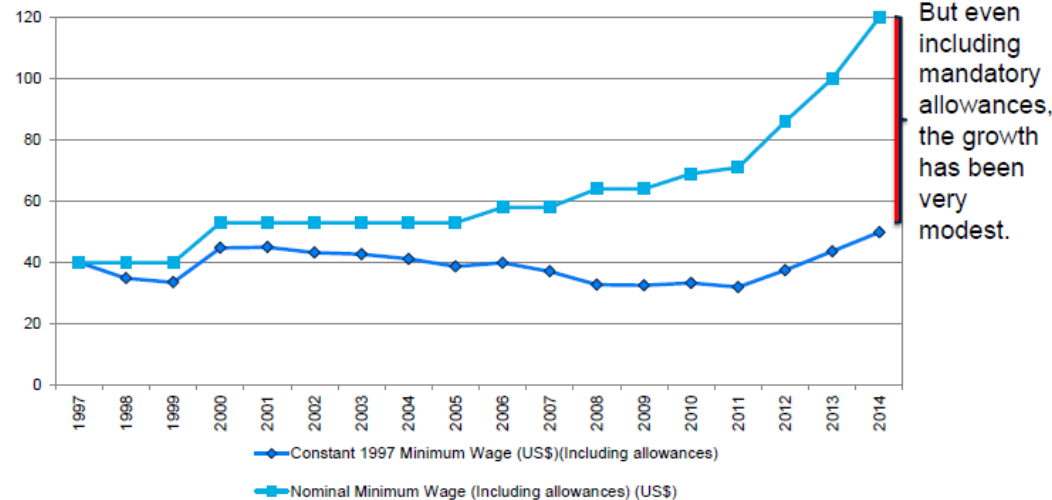
Source: Doing Business, 2014

In Cambodia, minimum wage did not keep pace with the cost of living up to 2012. Real MW started to recover since then

Monthly minimum wage (USD)



Minimum wage (including allowances)



A Proposed Policy Tool to Help Inform Possible Ranges of Minimum Wage Change

Each block represents the interests of each stakeholder in the current negotiation process...



- The proposed policy tool translates the socioeconomic criteria into a set of indicators
- It strikes a balance between the importance of each criteria and data availability.

Criteria	Indicator (examples)
Labor productivity	Value added per worker, Gross output per worker
Informal economy	Informal employment
Level of employment	Ratio of employed to working age population
Cost of living	CPI inflation



A Proposed Policy Tool to Help Inform Possible Ranges of Minimum Wage Change

The Policy Function

$$\Delta \% MW_{t-t-1} = +\beta_1 \% \Delta CPI_{t-t-1} + \beta_2 \% \Delta LPG_{t-t-1} + (-\beta_3) \% \Delta IPIG_{t-t-1} + \dots + (\beta_4) \% \Delta SENC_{t-trend} + \beta_5 \% \Delta EMP_{t-trend} + e$$

↑ Minimum Wage Growth ↑ CPI (General) ↑ Labor Productivity in the Garment Sector ... ↑ Self-Employment Rate plus non-compliance (General and/or in the garment sector) ↑ Employment Rate (General)

Input Price Index in the Garment Sector

- β_1 = This is a coefficient that can be negotiated. This indicator allows for workers to retain their purchasing power in the face of inflation.
- β_2 = 1. Economic principles indicate that this is a key component.
- β_3 = This is a coefficient that can be negotiated. This indicator accounts for input price fluctuations that employers face, largely out of their control.
- β_4 = Estimate using various sources of data (see next slides)
- β_5 = Estimate using various sources of data (see next slides)

Note 1: Coefficients (β_i) calibrate the effect of each indicator on the total increase of the MW

Note 2: IPIG includes prices in energy, transport, customs, textiles and accessories.

A Proposed Policy Tool to Help Inform Possible Ranges of Minimum Wage Change

Method 1

$$SM_i = \left[\text{Promedio} \left(\frac{LP_i}{\text{Promedio de trabajadores por hogar}} + (0.75 * \text{Mediana salarial}) \right) \right] * \left[1 + \left(\frac{P_i}{100} \right) + \left(\frac{IPC_i}{100} \right) - \left(\frac{Des_i}{100} \right) \right]$$

Modelo (1)

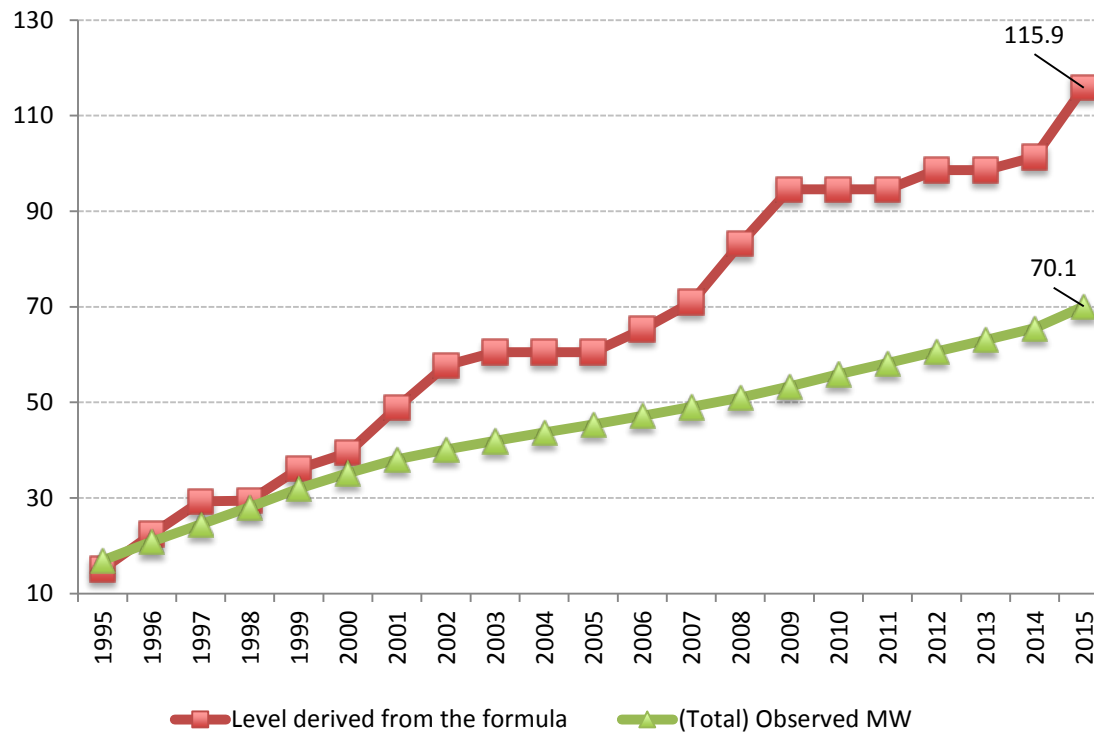
Method 2

$$\Delta \% SM_{t-t-1} = +\beta_1 \% \Delta IPC_{t-t-1} + \beta_2 \% \Delta PT_{t-t-1} - (\beta_4) \% \Delta INF_{t-trend} + (\beta_5) \% \Delta EMP_{t-trend}$$

Metodo(2)

$$\Delta MW_{t+1} = - \left(\frac{1}{Y} \right) (EMP_t - EMP^{Trend}) \text{ (Eq. 3)}$$

In this scenario, the estimated level for Mexico derived from the formula is 65% higher than the legal mw, indicating that the actual mw has not reflected the socioeconomic conditions of the country.

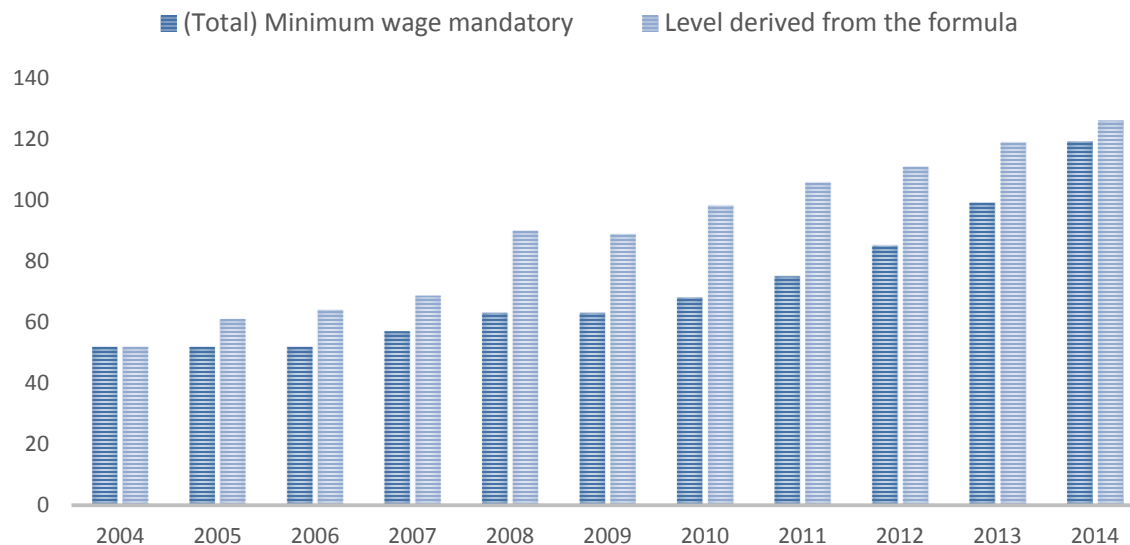


Note: Mexican pesos. Daily rate

In Cambodia, the mandatory mw has been below the estimated level in most years.

Indicators	INDICATORS ARE OBTAINED USING REAL DATA UPTO 2010. FROM 2011 AND FORWARD, ONLY PROJECTIONS ARE USED FOR IPIG AND LP											
(15 - 64 years old)	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013/P	2014/P	2015/P
Annual changes												
CPI (Consumer Price Index) ^(a)	5.26	8.41	4.20	13.95	12.52	5.32	3.14	4.91	2.54	4.60	3.50	3.50
IPIG (Input Price Index in the Garment Sector) ^(b)	3.41	3.41	-13.44	1.70	1.70	18.93	7.70	3.34	3.34	3.34	3.34	3.34
SENC (Self-Employment Rate plus non-compliance) ^(c)	-0.02	-0.02	-0.02	-0.02	-0.04	0.05	0.04	-0.01	-0.03	-0.01	-0.01	-0.01
EMP (Employment rate to working age population) ^(d)	0.01	0.01	0.01	0.00	-0.03	0.00	0.02	0.03	-0.02	0.00	0.00	0.00
LP (Labor Productivity) ^(e)	-4.80	8.70	0.50	-6.90	18.50	-6.00	7.40	2.50	2.50	2.50	2.50	2.50
Total increase												

For age group 15 -64	Based on actual data										Based on projections	
Year (Base Year is 2004)	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015
Level derived from the formula	52	61	64	69	90	89	98	106	111	119	126	134
Basic Minimum	45	45	45	50	50	50	61	61	61	80	100	
Mandatory allowances	7	7	7	7	13	13	7	14	24	19	19	
(Total) Minimum wage mandatory	52	52	52	57	63	63	68	75	85	99	119	
Difference in the estimated level and the actual level	0.00	9	12	12	27	26	30	31	26	20	7	



Using the MW policy tool

- Policy tool is informative to build alternative scenarios of minimum wage trajectories
 - Scenarios will vary depending on coefficients assigned to each indicator
- Exercises can be built forward and backwards, allowing to answer different questions. Some examples:
 - Considering past productivity developments, costs of living, etc., is the current MW level adequate?
 - How would the minimum wage level change if productivity increases next year by 10%?



Other tools to complement the assessment of the policy

- *A recursive computable general equilibrium (CGE) model* that allows to forecast outcomes or alternative MW levels and adjustment paths.
- *Regular impact evaluations* to measure the effect of the policy on key social and economic outcomes (employment, informal employment, human capital and firm productivity).



Thank you

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