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Principles of Minimum Wage Policy – Economics, Institutions and Recommendations

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PREFACE

This paper is part of the project entitled Minimum Wages in Developed and Developing Countries within the Global Labour University and supported by the International Labour Organization (ILO). The project covers case studies ranging from India, China, Russia, Brazil, Iran, Turkey, to Malaysia, Nigeria, Namibia, South Africa and Cambodia. The research on the case studies was undertaken by the members of this project (mostly alumnae of GLU Master's programs) to whom we feel especially indebted: Anna Bolsheva, Zahra Karimi, Bulend Karadag, Veasna Nuon, Siqi Luo, Arif Ahmad, Rajeswari Raman, Cesar Costa de Araujo, Alfred Angula and Eustace James. Some of the case studies will be selected for publishing in upcoming working papers. We extend our special gratitude to Frank Hoffer and Patrick Belser, both from the ILO, who on numerous occasions contributed so generously with their invaluable comments. We also thank the ILO for their generous financial support of this project.

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1. INTRODUCTION

In the past few decades most OECD countries and the countries in the southern hemisphere have been characterised by changing income distribution based on three factors: a decline in the wage share, increasing wage dispersion and governments tax and expenditures policies which have privileged the rich. On the other side of the coin, the power of trade unions has declined in many countries. As a result, collective bargaining has been weakened and a low-wage sector in almost all OECD countries has developed. It is traditionally argued that the increasing low-wage sector in developed countries is the outcome of globalisation and technological change. Following this argument globalisation shifted labour intensive and low-skilled production to developing countries. In addition, technological progress made unskilled labour abundant. If we consider that many of the low-wage jobs can be found in the non-tradable sector, this assertion is not very convincing. The globalisation and technology argument is even more dubious in developing countries as low-skilled production cannot be shifted to other country groups, and many of the low-wage jobs in these countries are in the non-tradable sector. The swelling low-wage sector is the outcome of specific institutional changes in the labour market, as well as the rise in the informal economy. It is not an outcome of "objective" economic forces.

Minimum wage policy supported by a strong social policy is an efficient mechanism against poverty and income erosion of the poorest households. Minimum wage is one of the instruments which can control wage dispersion and in this way reduce income inequality. It can also help to prevent a general decline in the level of nominal wages and deflationary developments. For almost two decades now Japan has been suffering from deflationary tendencies triggered by falling nominal wages and unit-labour costs (Herr/Kazandziska 2010). There is a certain likelihood that the United States, Europe and other OECD countries will fall into a deflationary trap over the next decade, and a minimum wage policy could help to reduce this danger.

The purpose of this paper is to discuss the principles of minimum wage policy whereby economic dimensions as well as institutional and political questions are taken into account. In the next section of the paper different theoretical views regarding the question of minimum wages are summarised. We concentrate on the neoclassical and Keynesian paradigm. Then institutional and political questions are discussed. Who sets the minimum wage, how is it determined, how frequently is it adjusted, which criteria are taken into account when deciding about the amount of the minimum wage, etc. Moreover, the connection to wage bargaining and the importance of minimum wages for unions are thoroughly examined.

2. THEORETICAL CONSIDERATIONS ABOUT THE ROLE OF STATUTORY MINIMUM WAGES

We start with the mainstream approach on minimum wages, the neoclassical paradigm, and then turn to the Keynesian approach which we use as the basis for our analysis.

Minimum wages in the neoclassical paradigm

Originally, minimum wages did not play a positive role in the neoclassical model (Bazen/Martin 1991; Neumark/Wascher 1992). Under the assumption of homogenous labour, minimum wages are either harmful for employment if they are set above the market equilibrium wage or are ineffective and useless if they fall below the market determined equilibrium wage. When we take heterogeneous labour, the overall conclusion does not change significantly. If there is a unified minimum wage in one economy this will have a negative impact on employment in the low-wage sector as soon as the minimum wage is higher than the market clearance wage for this particular skill group. Unemployment in the low-wage/low-skill sector will increase and, due to substitution effects, employment of skilled workers will increase, although overall employment in the economy will fall.

Even within the neoclassical approach there are many flaws, e.g. the necessary assumption about constant returns to scale or the unsolvable complication in the macroeconomic production function when more than one capital good exists and capital cannot be aggregated in physical units. There is also criticism from other paradigms. Especially the Keynesian paradigm stresses that output and employment are determined by goods market demand and not by supply factors like the level of real wages. Related to this criticism is the shortcoming of the neoclassical approach to adequately integrate money in its model.[1]

The simple neoclassical approach was seriously challenged when a whole series of studies did not show negative employment effects from even substantial minimum wage increases; some analyses even found positive employment effects.[2] Interestingly enough, the neoclassical proponents exhumed a very special case analysed by Stigler long ago (1946). Under exceptional circumstances of a monopsony (one buyer of labour in a monopolistic demand position confronted with competitive labour supply, for instance a factory as the only big employer in a city or region) higher minimum wages will increase employment. The argument is that the demand monopolist (the firm) can reduce output and employment and in this way decrease wages. This strategy may increase profits

1 For the theoretical debate in detail see the Herr/Kazandziska/Mahnkopf-Praprotnik (2009) published as a GLU Working Paper.

[2] In the studies conducted by Card/Krüger (1994, 1995, 1998 and 2000); Bell (1995); Benhayoun (1994); Dickens /Draca (2005); Dolado et al. (1996 and 2000); Draca et al. (2006); Lang/Kahn (1998); König/Möller (2007); Machin/Manning (1994) and Stewart (2004) no significant negative effects of increasing minimum wages were found. In fact, under certain circumstances they found positive effects of minimum wage increases on employment.

compared to a situation with higher output and employment and higher wages. If statutory minimum wages are increased the monopolist increases output and employment to maximise its profit which then of course is lower but still positive compared to a situation of lower output and lower wages. Another reason for higher employment as a result of wage increases can be cost-saving on training when the employees of a firm are encouraged to stay longer in the company as their wages are now higher. Unemployment may also be abated when the time for job searching by the unemployed is reduced when wages increase (Hagen 2008). All of these effects may exist and may play a role. However, it is not very likely that they are able to explain the empirical fact that in almost all cases increases in minimum wages have not reduced employment.

Minimum wages in the original Keynesian paradigm

We turn now to an alternative argumentation which is based on the Keynesian paradigm and goes back to the original works of Keynes.[3] Following the original Keynes (1930), increasing labour costs will lead to higher prices. As in an increase in the oil price, with higher labour costs and other intermediate goods, taxes, etc., a so-called mark-up pricing is assumed. This means that in a closed economy a higher level of wage costs leads to a higher price level. Declining wage costs lead to a falling price level. International competition can modify these results but in the medium-term is not able to prevent the impact of nominal wage costs on the price level (Herr 2009).

There are two points which must be emphasised here. Firstly, there is no direct relationship between changes in the wage level and changes in employment, but rather between wage costs and the price level. Secondly, changes in the wage level do not constitute an instrument for changing the functional income distribution between wages and profits. The question then is how to explain the wage sum in per cent of total income and especially why this share has fallen in most countries around the world in recent decades. Imbalances between demand and supply of goods influence functional income distribution over the business cycle. However, they are not able to explain long-term changes in functional income distribution. A shrinking government sector also usually reduces the wage share as in national accounting the government sector is part of GDP but does not make a profit. To explain a falling wage share an increasing oligopoly or monopoly power is the next candidate to explain empirical development. In general, globalisation did not increase oligopoly or monopoly power of firms. Finally, increasing power of financial systems pushes up firm's profit mark-up. We assume this to be the most important factor that explains changes of functional income distribution. The deregulation of a domestic and international financial system, the increase in risk-loving, short-term and speculative oriented segments of the financial system, the change from a stakeholder type of corporate governance to a shareholder type has increased the power of financial

[3] Many of the modern Keynesian interpretations are not based on Keynes but rather are neoclassical approaches stressing some shortcomings of the neoclassical model.

institutions and forced successfully higher profit mark-ups (Dullien/Herr/Kellermann 2011; Herr/Kazandziska 2011).

Following this perspective, changes in functional income distribution in the interest of labour has to be focused on reforming the financial system and corporate governance to enforce lower profit mark-ups. Changes in the nominal wage level are ultimately not efficient enough to change functional income distribution. For some trade unionists these arguments are difficult to digest. However, it is of key importance for union strategy to understand the macroeconomic role of the nominal wage level. Attempts from both the unions and the employer to use the wage level to change wage and profit quotas are dangerous as they lead to inflation and deflation.

Based on these arguments we suggest a development of the nominal wage level according to the medium-term productivity changes plus the inflation target of the central bank (or a low inflation rate if there is no explicit inflation target). If the wage level follows this norm and no other inflationary sources exist, the inflation rate is in line with the target of the central bank. This leaves room for expansionary monetary policy, supports growth and employment and prevents deflationary developments. Two clarifications are needed. Firstly, medium-term productivity development can be taken from the industrial sector and should be independent of the business cycle which statistically influences productivity. Secondly, there should be no other strong inflationary sources. If for example the exchange rate collapses and there is a substantial inflationary push it becomes difficult to realise the wage norm. In addition, a nominal depreciation of the currency with the aim of increasing international competitiveness of a country can only be achieved if wages do not increase parallel to the nominal depreciation.

If the worldwide market prices of natural resources or food go up and this leads to an inflationary push with the consequence of falling real wages, a general increase in the nominal wage level will not be able to compensate for this reduction in real wages as higher nominal wages lead to higher inflation. Expressed formally, a strong increase in oil or in rice reflects a change in the structure of prices which is independent of general changes in the price level, even if such changes can trigger inflationary developments. It is unacceptable that prices of natural resources have become driven by speculation as has happened in the recent past.

Apart from the arguments outlined above, there is at least one more argument that supports the idea that, from a macroeconomic perspective, minimum wages should at least increase in line with the wage norm - that means according to the medium-term productivity development and the target inflation rate of the central bank. The rationale for this recommendation is that the minimum wage becomes an important anchor against deflationary developments. This is a very important task that minimum wages should be assigned, especially in periods of economic crisis and weak union power. Any erosion of nominal wages easily translates into a wage-price deflationary spiral which increases among other negative effects the real debt burden of firms and private and public households.

To fulfil this function minimum wages should be high enough to affect the lowest wages. If minimum wages are substantially below the lowest wages actually paid to a relevant group of workers they are meaningless. It is difficult to designate a certain percentage of workers who should be directly affected by minimum wages. But an approximation of five to ten per cent may serve as an orientation. The stronger trade unions are in negotiating sufficiently high wages for the lowest paid, the lower the need for a large share of workers to be affected by statutory minimum wages.

If all wages, including minimum wages, increase according to the wage norm the wage structure will not change. There obviously will be no positive real income effect which would improve the income in the low-wage sector. If on the other hand, minimum wages increase faster than the average wage, then the wage structure will be compressed from below and the low-wage sector will improve its relative real wage position. In most countries this effect is the most significant contribution of minimum wages. So far as distribution depends on wage dispersion, this makes a minimum wage an important and efficient instrument influencing income distribution. Minimum wages are also a successful instrument for combating poverty as they affect the lowest income earners and raise their purchasing power. Of course the poverty of those unaffected by minimum wages, for example the poor unemployed or pensioners, can not be reduced by minimum wages. In many countries statutory minimum wages have an indirect effect as wage developments in the informal sector since they give an orientation of how wages develop. What kind of minimum wage policy is followed and what kind of wages exists at the bottom of the wage structure depend on the power and strategy of the trade unions and government alike. As a general rule, we can expect that the stronger the union movement in a country is, the smaller the wage dispersion will be.

The nominal average wage level may increase faster than the wage norm. In such a constellation increases in minimum wages according to the wage norm would lead to increasing wage dispersion. To avoid this, minimum wages should increase according to the increase in the average wage level to prevent a rise in the low wage sector. A policy to increase minimum wages according to the general wage development may moderately add to the inflationary process, but in this case minimum wages are not the cause of inflation. Keeping the wage structure in place seems to be more important than attempting the fruitless policy of fighting against inflation by not adjusting minimum wages sufficiently.

There is a temptation to demand an automatic indexation of minimum wages according to the above rules. However, annual discretionary adjustments seem to be more suitable. This allows for specific economic developments to be taken into account, supports political mobilisation and stimulates active trade union engagement.

In some developing countries minimum wages do not have the function of changing the wage structure but rather of determining the general development of the wage level. If in the case of an automatic development of wages after minimum wages have been set, let's say when the wages of the unskilled workers increase according to the minimum wage, the wages of skilled workers in the pharmaceutical industry increase four times the minimum wage, those of the semi-skilled workers in the carpenter industry two times, and so on, minimum wages will not change the wage dispersion. This means that as soon as minimum wages rise above the wage norm, inflation will be triggered and the wage structure will remain the same. In the case described here minimum wages to a large extent become a substitute for a coordinated wage bargaining process. So the most important element in a wage round becomes the development of minimum wages. Changing the wage structure must then be negotiated separately. This type of labour market institution for example exists in such countries as Ghana and Vietnam. However, if anything this model of wage determination is an exception in developing countries.

The Keynesian approach gives a clear explanation as to why minimum wage increases do not lead to higher unemployment on a macroeconomic level. Increases in minimum wages which will change the structure or wages will also change the structure of prices (relative prices) of the affected industries. As the output of one industry is the input of other industries, relative prices will change further. The new structure of prices will change the structure of demand, as well as the technology and the structure of production. How employment is affected is theoretically open and extremely difficult to predict empirically. There is also a valid argument that higher minimum wages may lead to a positive employment effect. As households which receive minimum wages tend to have a higher propensity to consume compared to rich households, the level of consumption is also expected to be enhanced which will have a positive impact on aggregate demand, output and employment.

Increases in minimum wages can however have negative employment effects in some industries. In a partial analysis an increase of wages in the security or cleaning industry increases prices and reduces demand and employment. However, those who are still employed in these industries now enjoy a higher income and can consume more. As security services and cleaning are also inputs for other industries, prices in these industries will also change and the chain reaction of changing relative prices will be triggered with an outcome which, as mentioned above, is open on a macroeconomic level. Many of the empirical analyses about the effects of increases of minimum wages on employment remain on the level of a partial analysis, for example the monopsony model which derives positive employment effects. For a comprehensive judgement of the effects of minimum wages a mere partial analysis is not acceptable.

3. INSTITUTIONAL DIMENSIONS OF STATUTORY MINIMUM WAGES

There are many institutional questions concerning a minimum wage policy. These questions are related to many country-specific factors, like the development stage of a country, the national characteristics of the labour market, the type of industrial relations and trade union power, the economic conditions, as well as many other factors. In the following we discuss in detail the key institutional and political questions concerning minimum wage policy.

The level of minimum wages

It is very common to link the size of the minimum wage to the average wage. But in many cases it would be better to compare the minimum wage with the median wage (i.e. the wage received by the worker separating the higher half from the lower half of wage earners). The average wage has for example the disadvantage that it is relatively high if there is a small group of very highly paid employees and relatively low if there is a very big low-wage sector. Yet, in most developing countries the data about the median wage is not readily available, thus it is not unusual to connect the value of the minimum wage to the average mean wage. In some cases the minimum wage is set in relation to the GDP per capita. However, it is important to emphasise that GDP per capita is far from the perfect indicator, particularly in countries where unemployment rates are high (Flanagan 2006).

The International Labour Organization has not defined a specific rate (either in absolute terms or in relation to the average or medium wage) that countries should follow. However, what is being recommended is that the minimum wage be set at a "decent" level. In Convention 131 from 1970 the ILO (1970) writes: "The elements to be taken into consideration in determining the level of minimum wages shall, so far as possible and appropriate in relation to national practice and conditions, include (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; (b) economic factors, including the requirements of economic development, levels of productivity and the desirability of attaining and maintaining a high level of employment."

This term is very vague, yet taking into account that distribution and the wage dispersion as part of it depend on the very specific situation in a country, how high the minimum wage should be has to be treated as a country-specific issue. In many countries the amount of the minimum wage to average wage is set in practice at around 40 per cent (ILO 2009:10). As an orientation minimum wages should be around 40 to 60 per cent of average or better median wages. But in the end the relation of minimum wages to the general wage level involves value judgement which must be politically decided upon in each country.

Looking at minimum wages as a percentage of average wages, they can be as low as 13 per cent in Russia, 20-30 per cent in China or 21 per cent in India. There are two explanations for very low minimum wages relative to average wages. The first is that the minimum wage is so low that it does not affect many workers. If only a very small share of the working population receives the minimum wage, it does not make a mark and is therefore not functional. It is important that sufficient workers are affected by minimum wages. In Russia for example the minimum wage is too low and ineffective. The second interpretation is that wage differences in these countries are very high. In this case wage dispersion is too high to guarantee an acceptable income distribution. China is an example of the latter.

Living wages serve as an alternative for looking at a certain percentage of average or medium wages. In this example wages should allow for a decent life. Living wages are usually defined as a certain basket of goods a worker should be able to buy to have a decent life. Of course it is difficult to define such a basket and it involves a political decision. In poor developing countries the definition of a basket has some advantages as there might be a greater consensus than in developed countries as to what a person needs as a minimum.[4]

When we talk about minimum wages especially defined as a basket of goods a discussion about how many people in one household should be covered by the minimum wage is inevitable. The possibility goes from one person to a whole family with many children including grandparents. There is not one solution to this problem. In developed countries with small families, where more than one person receives a market income, with organised pension systems for the elderly and government support for the children, minimum wages should be sufficient for one person. In developing countries with no established welfare systems and where women are generally not part of the formal workforce the situation is different. In many cases men are the sole breadwinners in the households and all members of households depend on their income. It is in fact not rare to find countries where the minimum wage is planned to cover the needs of a whole family. In Iran, for example, the minimum wage is aimed to be fixed at a level which fulfils the needs of a family of four. In some developing countries a minimum wage for families may not be avoidable, but during the developing process such a system should be overcome. Minimum wages should be used as an instrument first and foremost to control wage dispersion and should not act as a substitute for the social welfare system. Minimum wages in combination with the welfare system and not minimum wages alone can fight against poverty. Income transfers or other instruments focus on households and should be used to reduce poverty and to create a more equal income distribution (Neumark 2008). This is more so, as there are people who are out of the reach of minimum wages, for example the unemployed. Family minimum wages also involve practical problems. If there are not various minimum wage rates for differently

[4] In 2010 in Germany, which has no statutory minimum wages, a basket of goods was taken to define the basis for social security payments – a kind of basic income. Alcoholic beverages as well as cigarettes were completely eliminated from the basket.

sized households there is a danger that the minimum wage will be too big for one person and too little for a family with many children.

Frequency of minimum wage adjustment

Annual adjustment, as for example in the UK, Iran, Brazil or Namibia, seems to be the best solution. The annual adjustment should be institutionalised. In countries without a fixed rhythm of adjustment, as for example in Russia, Nigeria, Cambodia or Malaysia, minimum wages increase in an arbitrary way according to specific economic, social and political conditions in the country (like elections). In an inflationary situation adjustments in only two or even more years will lead to a situation in which the real minimum wage drops substantially and/or the nominal minimum wage loses its contact with the nominal average or median wage. Forced frequent adjustments are also needed to prevent deflationary wage developments, especially when a deflationary wage-price spiral is about to develop. Finally, annual adjustments of statutory minimum wages can add to the mobilisation of union members to lobby and fight for sufficient adjustments of minimum wages.

The number of statutory minimum wages and exemptions

There are also differences between countries in terms of the number of minimum wages set for different regions and/or different occupations, age, qualifications, etc. within the same country. In the UK, Iran, Nigeria or Turkey, for example, there is one national minimum wage. For instance, in India, Cambodia and Malaysia there are multiple minimum wages depending on the regions, occupations, qualifications, etc. An extreme case is India where more than 1200 minimum wages exist. In India the system is especially complicated as in addition to national minimum wages, states can set regional minimum wages following a recommendation from a tripartite body in the regions where wage bargaining has a very low coverage. Minimum wages can also be set through collective bargaining in sectors which are strongly unionised. For example, in the United States there is a national statutory minimum wage, but states and even cities can fix minimum wages above the national level.

Another important aspect to consider is the minimum wage coverage, or who is covered by the minimum wage and if there are any sectors/groups which are exempted from minimum wages. There should be no or only minor exceptions from the minimum wage (as in Russia, Turkey or Malaysia). Big exceptions can be found for example in China where the public sector and the agricultural sector are excluded and in Cambodia where the public sector and the domestic workers sector are excluded. Nigeria is another example where companies with less than 50 employees are allowed to pay lower wages than the minimum wage, which also is the case for part-time employees, seasonal workers and companies where workers are paid on commission or piece-rate basis, which essentially means that the small enterprise sectors do not have to pay minimum wages.

In countries with small regional productivity differences there should be one unified nationwide statutory minimum wage without any relevant exemptions. However, there should be the possibility of allowing for higher minimum wage rates in regions, counties or even cities. This follows the idea that the minimum wage fixing mechanism should be kept as simple and comprehensive as possible. Only under this condition can minimum wages fulfil their function of compressing a market-driven wage structure from below and contribute to a relatively equal income distribution. In countries where productivity differences between regions are great (for example in India or in the European Monetary Union) differentiated minimum wage rates per regions should be allowed. Setting only one minimum wage for the whole country would imply that the minimum wage in many regions would be too low as the national minimum wage must take into account the situation in the least developed region. Nevertheless, setting different minimum wages for different occupations, sectors, ages or qualifications within one region is not recommendable. The greater the variety of minimum wages the more the characteristic of a minimum wage as a lower boundary of wages is lost. The costs of adjusting, monitoring and enforcing also increase. For these reasons, we think that a national statutory minimum wage should be set which can and should then be made higher in regions with higher productivity and other political and social preferences. Further differentiations of the wage structure for example according to occupations should be left to the wage bargaining process.

In cases where there are big differences in regional productivities the central state can also set a regional structure of minimum wages. For example, in a region where the productivity is beyond the level of the region with the lowest productivity a minimum wage 1.5 or 2 times the lowest minimum wage can be set. In this case general changes of the national minimum wage would keep the structure of national minimum wages unchanged and the structure would only be changed in a discretionary way according the relative performance of the regions. In such a model regions or even cities can still decide whether to have higher minimum wages.

The way of setting minimum wages

In some countries statutory minimum wages are set by the government without formalised consultations with unions or employer's associations and no formal consultation body exists. For example, this is the case in Brazil, where only lately the government started informal consultations with the unions. In many countries statutory minimum wages are set by the government, albeit after the government has had formal consultations with a tripartite body comprising of representatives of trade unions and employer's organisations. The role of the social partners varies in each case. In most countries the government consults with the unions and employers' associations about the amount and other aspects relating to the minimum wage. But when it comes to the final decision, it is the government that makes it autonomously. Examples are Russia, China, Nigeria or Iran. A different model exists when the government decides on minimum wages following and usually adopting an explicit recommendation from a tripartite body with equal seats for unions, employers' associations and government. For example, India, Malaysia and Cambodia fit this model. The tripartite body discusses minimum wage development and recommends how minimum wages should be changed. The government also has the last say in this case. But it has to react to the official recommendation of the tripartite body and has to present arguments in case it objects to the recommendations. The power relations within the tripartite body can differ. One possibility is that the government only mediates in the debate between employers' associations and unions. However, in most cases employers' associations build a coalition with the government and decide about the minimum wages against the demands of unions. The role of the tripartite body in Turkey is even stronger. Here this institution sets minimum wages directly without the possibility of government rejection. This is an interesting case. However, it should be mentioned that in this body employers' associations and government usually vote jointly against unions.

The UK also fits in the category of countries with tripartite institutions. A recommendation is made to the Low Pay Commission consisting of members coming from the unions, employers' associations and academics. Politically it is difficult, but possible, to reject the proposal by the Low Pay Commission. A tripartite body which includes independent members of academia instead of the government is more recommendable than having the government as the third party. The Low Wage Commission writes an annual wage report. In this way a lot of important information and research about wage dispersion and minimum wages is delivered to the public. We favour the UK case as one with a functional minimum wage determination mechanism.

Most countries in the world use tripartite bodies for consultations or recommendations in the sphere of minimum wage adjustment. Finding an efficient mechanism like the one in the UK is an important part of minimum wage policy. However, as mentioned above, tripartite institutions do not work autonomously; they are dependent on power relations within these bodies and in the society as a whole. Minimum wages also always reflect the power of unions in any given society.

Traditionally, in a small number of countries with strong trade union movements, as in the Scandinavian countries or in Germany, statutory minimum wages did not exist as unions where strong enough to prevent the development of a big low-wage sector. Here minimum wages are agreed upon as past of the wage bargaining process. When unions become weaker and/or are not able to cover all economic sectors and no minimum wage exists, a low-wage sector will expand quickly. This was the case in Germany where the unions lost their power to cover all industries and even all companies in the industries in which they were still relatively strong. Another example is Namibia where the minimum wage is fixed through collective bargaining for only three sectors. There is a strong argument that all countries in the world should use statutory minimum wages as an instrument to prevent wages falling to very low levels in some companies and industries in comparison to average or medium wages. It is still a function of trade unions to negotiate higher wages in collecting bargaining.

Links between minimum wages and social security payments

In a number of countries there is a link between minimum wage and certain social security payments. Brazil is an example of such a country as pension payments and unemployment benefits are directly linked to and calculated on the basis of minimum wages. Russia, Nigeria and Iran follow similar institutionalisations. Of course, this means that when minimum wages increase transfer payments increase too, which is on the one hand beneficial for the pensioners or the unemployed as their income is kept in line with the incomes of the lowest-paid workers. But on the other hand, increasing minimum wages implies a bigger burden for the government's budget. Hence, it is understandable why in these countries the governments behave very reluctantly when a minimum wage increase is in question. It is no surprise that in countries like Russia, Nigeria or Iran the role of tripartite bodies is very limited or do not exist while government more or less dictates minimum wage development. Increasing minimum wages normally doesn't cost anything for governments; especially as there are no expected negative employment effects and only very small price level effects. However, as soon as minimum wages are linked to social security benefits such a "free lunch" is no longer possible for a government. For this reason, minimum wages should be handled as a separate policy and de-linked from social security payments. This gives more leeway to governments for a more aggressive minimum wage policy.

Minimum wages in the informal economy

According to the International Labour Conference Resolution on decent work and the informal economy in 2002 the informal sector is (not very precisely) defined as "all economic activities by workers and economic units that are – in law or in practice – not covered or insufficiently covered by formal arrangements" (ILO 2002). Thus they either operate outside the reach of the law, or they operate within the law but the law does not apply to them or cannot be enforced. The informal economy has grown rapidly in developed, but especially developing countries. In extreme cases the informal economy covers around 90 per cent of the total work force or even more, for example in Ghana or India (ILO 2008:39).

Minimum wage law applies to the formal economy and by definition does not cover the informal economy. At first glance the conclusion could be drawn that the above debate has no relevance for the informal economy and hence, is an irrelevant issue for the biggest part of the economy in many countries. However, research has shown that minimum wage development in many countries has a certain influence on wage development in the informal economy.[5] In Brazil it was discovered that in 1996 fifteen per cent of the workers in the informal economy received a wage equal to the minimum wage (Saget 2006). There seems to be a

[5] Cf. Kristensen/Cunningham (2006); Maloney/Nuñez (2001) and Lemos (2003).

signalling effect from statutory minimum wages to wages paid in the informal economy.

Another way to influence minimum wages in the informal economy is to create a so-called "reservation wage". A reservation wage can be a government guaranteed wage for public work or also cash payment which sets the minimum for the market wage. One such approach is India where in rural areas every household can apply for a 100-day unskilled job provided through the public employment program NREGA (enacted in 2005) and be paid the minimum wage. As there is an alternative for becoming employed nobody would work for a wage below the reservation wage. The aim is to reduce the unemployment in the remote, rural regions and to reduce informal employment. It is hoped that transfer payments and/or government given job guarantees paid at minimum wages give employees an option and in this way enforce employers in the private sector to pay at least the minimum wage to make jobs attractive (Lal/Miller 2010:16). These policies fix the so-called reservation wage under which no labour would be supplied. With cash payments in Brazil a similar strategy is followed. However, more research is needed to understand the wage determination in the informal economy in different countries and the role that minimum and reservation wages can play.

Minimum wages and collective bargaining

Statutory minimum wages are not a substitute for wage bargaining. The main purpose of minimum wages is to set a floor for wages in the whole economy. Unions can and whenever possible should increase the wages of the lowest paid above the minimum wage. This means that in countries where there is a significant coverage of workers by collective agreements and there exists a strong union movement, statutory minimum wages are of secondary importance. But even in these countries statutory minimum wages can give an orientation of how the low-wage sector should develop. They can add to the coherence of the wage bargaining process. The luxurious situation as in some Scandinavian countries where strong unions in all parts of the economy make a statutory minimum wage dispensable is unfortunately not the standard case. In many countries trade union movements are generally weak and/or do not cover all industries sufficiently. In all of these cases statutory minimum wages are highly desirable and urgently needed to control wage dispersion.

Especially in some developing countries minimum wage negotiations in tripartite bodies have become a substitute for wage bargaining. In these cases minimum wage development becomes the anchor for the determination of almost all wages in the economy which is why the process of setting the minimum wages plays a very significant role in the labour market. The wage round starts with the determination of the minimum wage; the other wages are then adjusted accordingly without usually changing the wage structure. In Viet Nam for instance there is a minimum wage multiplier through which the wages of all workers in all sectors of the economy are automatically arranged. When this type of linkage between minimum wages and wages in the economy exists, statutory minimum wages crowd out independent and additional collective bargaining. In our judgement this model of wage bargaining is not ideal. It reflects that unions are unable to organise collective bargaining in firms or at the industry level. This can result from a fundamental weakness of unions, and/or unions are not allowed to bargain wages as in some former planned economies.

4. SUMMARY

On a macroeconomic level the main result is: Increases in minimum wages do not have big systematic employment effects, positive or negative. Inflationary pressures from minimum wages are usually small and tolerable. One very positive effect of minimum wages is that they change the wage structure in such a way that a more equal income distribution is reached. Minimum wage policy thus contributes to poverty reduction. To illustrate this: 12.5 per cent of the employees in Brazil receive the minimum wage and it has been found that the aggressive policy in Brazil during the past 8 years has had a strong effect on the compression of the wage structure (Lemos 2007). In some cases we can observe that minimum wages have even had a positive employment effect. The argument is based on the fact that low-wage earners have a higher propensity to consume than richer households and thus higher minimum wages increase aggregate demand and output. Furthermore, taking into consideration that women have a large share in the low-wage sector increasing minimum wages also has a positive gender equality effect.

In this paper, on the basis of the theoretical model and case studies we have used, broad principles of minimum wage policy covering a large range of dimensions have evolved. Table 1 summarises our results. We do not claim to have found the philosopher's stone. This paper is meant as a contribution to the ongoing debate about minimum wage policy from a union perspective.

Table 1: Summary about statutory minimum wage policies

Rules for quantitative changes of minimum wages	- At least according to the wage norm (medium-term productivity in the industrial sector plus target inflation rate of the central bank) - If the wage level increases faster than the wage norm minimum wages should increase according to the wage level - To compress the wage structure from below, minimum wages should increase faster than the wage level - No automatic indexation of minimum wage adjustments/ discretionary adjustment process of statutory minimum wages
Level of minimum wages	- Minimum wages must affect a sufficient number of the lowest wage earners to be effective - Minimum wages should be between 40 and 60 per cent of average or median wage (this is the case in most countries) - A basket of goods can be defined as a living wage and this can become the minimum wage - The minimum wages should as far as possible allow a single worker to live a decent life; in developing countries minimum wage may cover the living expenses of a whole family. However, along with the process of development minimum wages and welfare payments to individuals should supersede those to families.
Frequency of minimum wage adjustment	- Annual adjustments; in a situation of very high inflation a more frequent adjustment is needed - Discretionary adjustments
Number of minimum wages	- A national statutory minimum wage is recommended. - In the case of high productivity differences a structure of minimum wages set by the national government is recommended - States or even cities should have the right to fix higher minimum wages - There should be no minimum wages for certain professions or industries; this should be reserved for wage bargaining
Adjustment mechanism of minimum wages	- There should be at least one tripartite body that recommends minimum wage adjustments - Instead of governments' representatives in the tripartite body, independent experts can be appointed; the model of the Low Pay Commission in the UK is a positive example

Link between minimum wages and social security payments	- Minimum wages and social security payments should be de-linked - As soon as such a link exists because of budgetary reasons governments are very reluctant to increase minimum wages - The more minimum wages and social security payments are de-linked, the higher the likelihood that governments will increase the power of tripartite bodies to determine minimum wages
Role of minimum wages for the informal sector	- Empirical analyses show that statutory minimum wages influence wages in the informal economy - There seems to be a signalling effect from the formal to the informal economy.
Minimum wages and collective bargaining	- Minimum wage policy should not substitute collective bargaining - Minimum wages should set the platform for wages, unions can and should then negotiate higher minimum wages in certain industries whenever possible

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