

Deliberations about the Minimum Wage Increase

Some long-term lessons shall be drawn once the long and complex discussions on minimum wage have ended. Every year, the debate is focused on the idea of including it in social politics. Nevertheless, when you assign this objective to the debate, it generates another type of distortions that might worsen the situation. It seems adequate to promote adjustments to the minimum wage in the population who has a considerable amount of pension funds, thus enhancing the hiring of young people and women and motivating the legitimization of labor relationships.

This year, the discussion on the minimum wage has repeated the weakening and slow logic of previous debates. Once the process has ended – where a reasonable amount of CLP\$193,000 was fixed in spite of the strong pressures from the Opposition and some sectors of the Government's alliance-, it is a matter of concern that every year the most vulnerable population is threatened, precisely the contrary to what the last parliamentary discussions were seeking. These types of policies reduce the capacity to find a job for this group of people and also the possibility of acquiring labor experience.

We believe that the most important objective is to reduce the barriers for the most vulnerable people to obtain a job. In this sense, the increase of minimum wage or other type of hiring costs actually generate the opposite: less protection, less opportunities and increase of unemployment levels, precisely in the population that most needs it.

Chart 1 shows the relationship between the minimum wage and the average salaries for the period 1994-2009. We observe that the gap between both incomes is increasingly less each year. The latter is explained by the minimum wage increase over the salary average in

Chile. The minimum wage has increased 84% from 1994 to 2009, while the salary average has increased 34% during the same period.

Chart 1

EVOLUTION OF THE MINIMUM WAGE AND AVERAGE SALARY
(CLP\$ August 2012)

Year	Real Minimum Wage CLP\$/hr	Real Average Salary CLP\$/hr	Minimum Wage / Average Salary (%)
1994	539	1,547	34.8%
2000	638	1,811	37.7%
2006	870	2,044	42.6%
2009	989	2,072	47.7%

Source: Prepared by LyD based on figures from BNC and INE.

Next we develop three approaches that should be taken into account in the minimum wage discussion. First, it is important not to do social politics with the labor market, particularly with the minimum wage, since it reduces the employment of the most vulnerable population. There are other and more adequate policies to deal with poverty problems which do not discourage employment creation. Additionally, we note an extremely low work force participation in poor people. Finally, we can not forget the fact that employment is an efficient tool to uproot poverty.

1) It is Important not to do Social Politics with the Labor Market

If we compare the minimum wage amount with the families' needs, it may be considered low. A household relying only on this income would be considered poor if composed by three members. According to the CASEN survey, 13.8% of employed people earn between CLP\$100,000 and CLP\$200,000 for full-time work, from which 60.3% are head of household; 35.0% are women and 14.5% are young people.

In general, the heads of household earn this amount; notwithstanding, 50% of these households has at least another member of the family group that also works.

In the literature¹ there is strong evidence that shows that the increase of minimum wage produces unemployment, especially of the most vulnerable population. Estimates² point out that 10% increase in the minimum wage generates 0.5% to 1.0% more unemployment in developing countries. Beyer and Dussaillant³ believe that in Chile the minimum wage increases have produced a negative effect on young people's employment. In their survey, they estimate that 10% increase in this salary generates 2.5% decrease in young people's employment.

According to the CASEN survey, a poor household earns approximately CLP\$31,490 of 2012 money, producing a significantly greater impact than the CLP\$11,000 of the proposed increase.

In this sense, the Family Ethical Income Program (IEF) deals with this challenge. All tools, including psychosocial and labor supports, *Programa Eje*, and different types of allowances, all pursue the same objective, that members of these families obtain a steady job.

In this regard, the IEF Woman Employment Subsidy⁴ (SEM) grants a work bonus of 20% of women's monthly income, and 10% of this compensation is given as a contribution to the employer; the same occurs with the Young People's Employment Subsidy (SEJ). If it is assumed that woman or young earn the minimum wage (CLP\$193,000 proposed), the most vulnerable population would receive CLP\$231,600 approximately.

2) The Challenge is Low Labor Participation

The main problem of poor people is that they do not have a job. According to a Fosis' research in 2010, those participating in the *Programa Puente* in 2010 revealed a higher poverty-stricken level than the one generally shown by CASEN survey statistics. The most impressive fact is that in 79% of these families not a single adult has a regular job or a steady income.

The CASEN survey 2009 shows that, in average, only 0.82% of the members of poor households have a job, while in non-poor households this figure is significantly greater and reaches 1.47%. On the other hand, poor's labor force participation is 42% and non-poor accounts for 58%.

Chart 2

WORKERS PER CAPITA BY DECILE OF HOUSEHOLDS AUTONOMOUS INCOME

Decile	i	ii	iii	iv	v	vi	vii	viii	ix	x
Workers per capita	0.14	0.24	0.30	0.35	0.40	0.44	0.48	0.51	0.55	0.60

Source: Prepared by LyD based on figures from CASEN Survey 2009.

The low labor force participation of the most vulnerable population remains a challenge. We observe that in lower income households there are fewer members who work. Chart 2 shows that 10% of the poorest population has only a ratio of 0.14 workers by person, whereas 10% of the highest income population has a ratio of 0.60.

3) Employment is the Tool for Poverty Uprooting

As we already mentioned, minimum wage generates more poverty. Work is the tool for poverty uprooting. So, social programs must enhance the capacity of families to find a job and thus improve the welfare of the most vulnerable population.

Though State's allowances may improve vulnerable families' income level, they also produce greater dependence. The answer is to increase labor force participation. As Chart 3 shows, as more people work in a household, the average income increases. In this case, the Chart considers households where one member earns a minimum wage, and shows that where more than 3 of the family members work, the household income is 4 times higher than where only 1 member works.

Chart 3

WORK AVERAGE INCOME PER EMPLOYED PERSON
(CLP\$2012)

	Income per person	Income per household
1 employed person	\$ 74,927	\$192,089
2 employed person	117,712	\$407,565
3 or more	141,831	\$722,568

Source: Prepared by LyD based on figures from CASEN Survey 2009.

A labor force participation exercise mentioned in our Public Issues Nr 1,044 (“Labor Force Participation: A Key to Fight Inequality”) shows how families’ total monthly average earnings per capita by decile of autonomous income would increase if the labor force participation of these families should increase.

Proposal

Considering the importance of the minimum wage for many workers, it can be tempting to include it in social politics. Nevertheless, when you assign this objective to the debate, it generates another type of distortions that might worsen the situation of those you seek to benefit.

If the objective is to improve the quality of life of the most vulnerable ones, there are other programs created for this purpose, which, in the best scenario, the State delivers in a focalized and efficient way to the population that need them most, without discouraging job creation. These benefits include health, housing, education access and allowances.

As we have stated, it seems adequate to promote adjustments to the minimum wage in the population who has a considerable amount of pension funds, thus enhancing the hiring of young people and women (who are the most affected by these increases). Additionally, it would motivate the legitimization of labor relationships and, as a result, the pension fund contribution. In the future it is necessary to find mechanisms that withdraw this variable from the political debate, so as not to impair the recent achievements concerning employment, poverty and extreme poverty uprooting.

In brief...

DISCUSSION ABOUT THE MINIMUM WAGE AND ITS EFFECTS

- Increases in minimum wage generate unemployment in the most vulnerable population.
- Labor force participation of poorest families is low: on average, 0.82% of its members work.
- The Ethical Family Income and the Young People's Employment Subsidy increase the proposed minimum to CLP\$231,600 for women and young people.
- Employment is the best tool to uproot poverty: households where 3 or more family members work, increase their income 4 times more than those where only 1 family member works.

¹ See for instance, Card and Krueger. "Myth and Measurement: The Economics of the Minimum Wage", Princeton University Press, 1995; Hamermesh. "Economics Studies of Labor Demand and Their Application to Public Policy", Journal of Human Resources, 1976; Gramlich. "Impact of Minimum Wages on Other Wages, Employment, and Family Income", Brookling Paper on Economic Activity 1976.

² Lusting and McLeod. "Minimum Wages and Poverty in Developing Countries: Some Empirical Evidence". Brookings Discussion Papers in International Economics No. 125, 1997.

³ Beyer and Dussailant. "*Reajuste del Salario Mnimo: La importancia de Ser Prudentes*". Centro de Estudios Pblicos, 2009.

⁴ This subsidy has a maximum of CLP\$ 34,079 monthly per worker. In a first stage, the benefit is granted to 30% of the most vulnerable women; and gradually, by 2015, it will be reach 40% of this population.