

Deliberations for the Analysis of Minimum Wage

The discussion about the minimum wage should focus on its initial level (in relation to average salaries) and in an indexation rule that eliminates future discussions about the minimum wage negotiation and the uncertainty associated to it.

Every year by this time, the negotiation process of the minimum wage starts, a situation which puts pressure in the relationship between the Central Única de Trabajadores (CUT)¹ and the Government.

This year, the new Government decided to innovate on this matter by announcing the creation of an Inclusive Technical Commission for the Minimum Wage, which shall be responsible for studying a system that clarifies the benchmarks used for its definition and adjustment.

This initiative is highly justifiable. Considering that the usual discussion during the negotiation period tends to minimize the negative effects of the adjustments in the labor market, it is absolutely necessary that an independent organization devotes itself to evaluate which is the best option in terms of the country's welfare, in general, and the more vulnerable persons, in particular.

The former is especially relevant if we consider that almost nobody ignores the effects of excessive adjustments of minimum wages on the employment creation and on the opportunities of certain population groups. In fact, we all know that a minimum wage increase tends to reduce the demand for work, affecting directly those workers who have lower levels of training and work experience. It is precisely the lowest socioeconomic segment (first quintile) who is most vulnerable when facing more adverse labor market conditions, in terms of its disadvantaged position concerning low employment rate, high unemployment rate and a higher proportion of

¹ General Labor Union

workers that receive a salary equal to or slightly higher than the minimum one.

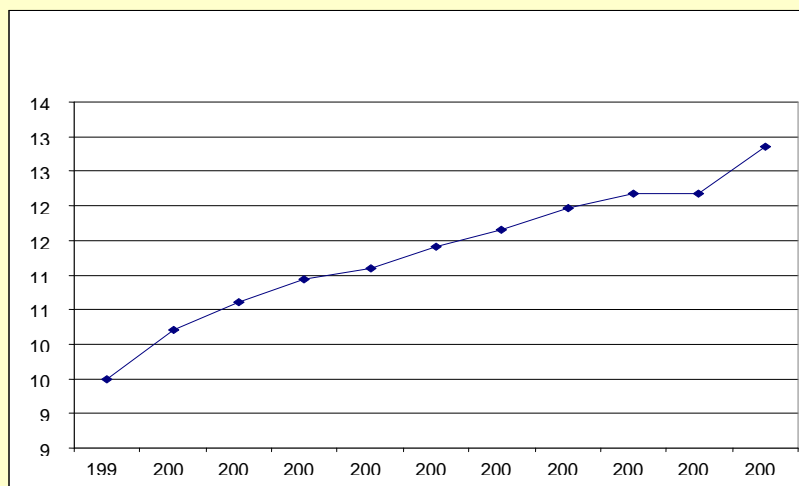
Background

In the last decade (1999-2009), the minimum wages have shown an average annual nominal increase of 6.5%. In the same period, the CPI increased on average 3.5% annually, which reveals that the minimum wages raised significantly in real terms during those 10 years, that is, an average of 3.0% annually.

Chart Nr 1

ACTUAL MINIMUM WAGE

Actual Minimum Wage (Annual average, base 1999 = 100)



Source: Self-preparation based on data from the National Statistical Institute (INE)

In general terms, we could point out that the successive increases of the minimum wage have had an important effect, mostly in specific groups of the society. In particular, with regard to work opportunities, the minimum wage rise has had a direct influence upon the segment which concentrates the highest number of workers with little experience and low qualification levels, mainly young people. As for work demand, small businesses are the most affected in view of the minimum wage increases, not only because they require more labor force, but also because they concentrate the highest number of less trained workers. Therefore, when speaking of minimum wage increases, these groups – young workers with low qualification levels and small businesses – are the most vulnerable ones, a

situation which is rarely taken into account when it comes to negotiate the adjustments.

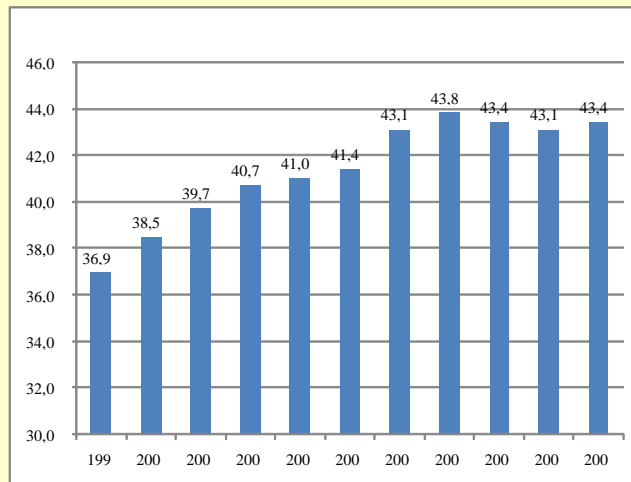
On the other hand, the negotiations to date have achieved a minimum wage increase that has exceeded by far the adjustment of the average salaries of the Chilean economy. In fact, during the period 1999-2009, the average salaries had a mean annual nominal increase of 4.7%, equivalent to an actual increase of 1.2% average for this period.

This incremental rate in the respective adjustments has meant that the gap between the average salaries and the minimum wages has reduced over time, therefore leaving less space to remunerate the less qualified workers. Actually, the relationship between minimum wage and average salary has increased gradually in the last decade, reaching 4.4% in 2009.

Chart Nr 2

MINIMUM WAGE / AVERAGE SALARY RELATIONSHIP

Minimum wage/average salary relationship



Source: Self-preparation based on data from the National Statistical Institute (INE)

The sustained increases of the minimum wage beyond those of the economy's average salaries have caused an increase of the first ones in relation to the average salaries. In spite of this, the discussion about the level of minimum wage has not been included in the debate, because it is always negotiated in connection with its indexation only.

So far, the negotiation processes for the minimum wage adjustments have tried to incorporate some economic criteria, such as the projected inflation

or the productivity growth. Nevertheless, the predominant criterion has been that of “equity contribution” rather than efficiency concepts. On the other hand, this adjustment should be consistent with the country’s salary situation, so as to avoid damaging those that it seeks to protect, which are the most vulnerable ones in their work condition.

A proposal

The discussion about the minimum wage has basically two edges: the determination of the level of minimum wage and the definition of an indexation process of the same.

With regard to the level of minimum wage, it would be interesting to evaluate if there are economic arguments that justify the existing proportion. This would allow establishing a basis for future adjustments. At first sight, it seems that the relationship between minimum wage and average salary has increased too much and does not reflect a true productivity gain by the former in relation to the rest of the economy’s workers. Therefore, concerning the initial level of the minimum wage, it is advisable to evaluate, on the basis of technical criteria, if the current proportion should be maintained or not.

Once the level of minimum wage has been fixed, we propose to use the relationship between minimum wage and average salary as a reference base, in order to search an annual indexation system that avoids the recurrent pressures suffered during the process. A proposal which seems interesting is the creation of an adjustment rule based on a fixed factor and a variable factor, this latter depending on the prevailing economic conditions.

In short, what we suggest is to establish a “fixed” factor in the minimum wage adjustment which is directly related to the adjustment of the economy’s average salaries. Its beneficial effect is that, besides being a simple and easy-to-apply rule, it guarantees workers and employers that the annual adjustment of the minimum wage is done according to efficiency criteria. In fact, the average salaries are consistent with the Market conditions, which guarantee that its variation includes indexation criteria according to inflation and productivity. This adjustment, by itself, would perpetuate the relationship minimum wage/average salary in a level considered adequate. We propose to use moving averages for the average salaries’ variations, so as to eliminate the effects of the economic cycle, which are sought to be captured in the indexation variable factor.

Additionally, the “variable” factor of the minimum wage adjustment would be designed to adapt the labor condition of these workers who are the most vulnerable ones in the labor market. In doing so, it would contribute to a

higher adjustment of the minimum wage in periods where the economy enters a dynamic cycle, and a minor one in times of less activity, thus avoiding the dismissal of a greater number of workers.

We specifically propose that the indexation variable factor should be related to the economic cycle in a simple way: the gap existing between potential and effective growth of the GDP. Thus, if there is a positive economic cycle, where the economy grows beyond its potential capacity, the minimum wage would benefit from a temporarily higher increase, while in the recessive cycles, the minimum wage adjustment would be temporarily and slightly lower, so as to adjust itself better to the worsened conditions of the economy.

The successive increases of the minimum wage have had an important effect. In terms of work opportunities, it has directly influenced the segments which concentrate the highest number of workers with little experience and low qualification levels, mainly young people. As for work demand, small businesses are the most affected in view of the minimum wage increases, not only because they require more labor force, but also because they concentrate the highest number of less trained workers.

The assessment of this adjustment does not offer major difficulties, because the gap between the trend and effective GDP is identified yearly by the Consulting Committee of Trends in GDP. Therefore, it would only be required to establish a factor which allows incorporating this information to the minimum wage adjustment, thus adapting the salary conditions to the country's economic circumstances.

In brief, if this proposal is accepted, the immediate discussion should focus on the initial level of minimum wages (in relation to average salaries) and in an indexation rule that eliminates future discussions about the minimum wage negotiation and the uncertainty associated to it. The purpose of this proposal is simply to contribute to this debate.

It would also be important to make headway – whatever is the indexation mechanism finally adopted – in an institutional framework that does not limit to the annual assessment of the minimum wage, but that also monitors and evaluates the impact of the minimum wage on the economy and the labor market. This institutional framework could establish some necessary changes over time, aimed at improving the system, either through more extensive research, which eventually leads to modify the categories subject to differential minimum wages, and/or changes in the current age ranges. Additionally, this organism could play a regulatory role on the ground that higher salary costs – such as imposing raises in minimum wages – usually implies the search for mechanisms to sidestep such obligation.

Finally, it is necessary to insist on the fact that the only way to favor the more vulnerable workers is by guaranteeing their access to work. This condition is not achieved by imposing prices (such as the minimum salary assessment), but rather by creating employment opportunities for workers. This, of course, should be done along the lines of increasing the labor market flexibility, which would allow advancing towards a system where the minimum wage is established per hour worked. This, in turn, would allow that more people have access to the labor market in conditions that are favorable both to the workers and the employers.