HKUST IEMS
INSTITUTE FOR EMERGING MARKET STUDIES

APRIL • 2015 | No.7

THOUGHT LEADERSHIP BRIEF

Migrant Worker in Dormitory
by the World Bank, CC BY 2.0,
https://flic.kr/p/fAtowj

How Do Minimum Wage Policies Affect Workers in Emerging Markets?

Albert Park and Qing Xia, HKUST Institute for Emerging Market Studies

KEY POINTS

- The policy process for determining minimum wage levels varies greatly across BRICS countries (Brazil, Russia, India, China, and South Africa), leading to differences in objectives, priorities, and outcomes.
- Unlike in advanced countries, lack of compliance with minimum wage regulations is a major challenge in emerging markets, reducing policy impacts and creating an uneven playing field when implementation is uneven across sectors and firms.
- Although minimum wage regulations do increase wages at the bottom of the wage distribution, evidence on the impact of minimum wage regulations on employment and on inequality and poverty is mixed and incomplete. Impacts depend upon compliance. Minimum wage regulations may have increased informality in Russia and Brazil.

Issue

Minimum wage policies are gaining popularity globally and in the major emerging markets, despite unsettled debates over the impacts of minimum wage regulations. In this brief, we summarize what is known about the role of minimum wages in emerging market countries, focusing on the BRICS countries (Brazil, Russia, India, China, and South Africa). We examine how minimum wages are set, how well they are implemented, and their impacts on employment, inequality, and informality, concluding with policy recommendations.

Assessment

How are minimum wages set? Government-set minimum wages exist in all BRICS countries. However, the policy process for determining minimum wages varies greatly. In China and Russia, central governments have led major reforms of minimum wage policy (China in 2004, Russia in 2007) but have decentralized minimum-wage setting authority to regional governments. In Brazil, following military dictatorships, the 1988 Constitution required that a national minimum wage be set to meet the basic needs of all workers and their families. In India, central and state governments appoint tripartite advisory boards composed of government, employer, and worker representatives. In South Africa, minimum wages are negotiated as part of collective bargaining processes in each sector, with unions representing workers' interests.

In some countries, minimum wage levels are different for different types of work. There are 11 sectoral minimum wages in South Africa. India has no less than 1171 different minimum wages depending on location, education, skill level, industry, etc. In both countries, many types of work are not covered at all by minimum wage regulations.

Not surprisingly, these different procedures reflect different objectives, priorities, and implementation challenges, leading to different outcomes. Table 1 summarizes the growth rates in minimum wages and average wages over the period 2003 to 2011 as well as the ratio of minimum wages to mean wages in 2011. Figure 1 plots trends in real minimum wages, real wages, and unemployment rates since 2003 for each BRICS country. In the figure for each country, the mean wage in 2003 is set equal to 100 and all other wages (both minimum

Growth in Minimum Wages and Mean Wages in BRICS Countries 2003-2011

	Brazil	China	India	Russia	South Africa
Real Wage Growth (2003-2011)	25.3	132.5	-8.6	95.4	21.1
Real Minimum Wage Growth (2003-2011)	55.0	103.9	24.4	318.1	16.4
Ratio of Minimum to Average Wage (2011)	33.4	22.7	46.1	19.0	25.8

Unit: %

wages and mean wages in other years) are valued relative to the 2003 mean wage after controlling for inflation.

The varying patterns across countries show how difficult it is to generalize. The two former socialist countries China and Russia have seen the fastest increases in the real minimum wage starting from the lowest bases relative to mean wages. However, these two countries also have seen the fastest growth in real mean wages and by 2011, minimum wages in the two countries as a share of mean wages (22.7% in China, 19.0% in Russia) remain lower than in the other countries (25.8% in South Africa, 33.4% in Brazil, and 46.1% in India). There does not appear to be a positive association between minimum wage levels and the unemployment rate over time. In the three countries where minimum wages grew faster than mean wages, the unemployment rate actually fell over time, while the unemployment rate increased in China and after 2007 in Russia despite minimum wages growing slower than mean wages. By 2011, with the exception of India, minimum wages in emerging markets remained relatively low as a share of mean wages when compared to advanced countries.

Compliance and informality. In contrast with advanced countries, there is ample evidence that lack of enforcement and compliance with minimum wage laws is a major problem in emerging markets (Bhorat and Stanwix, 2013). Among BRICS countries, compliance has been found to be low in India and South Africa particularly, and significantly better in Brazil and the former socialist economies of China and Russia (Bhorat et al, 2012a; Rani et al, 2013; Fang and Lin, 2014). Factors contributing to low levels of enforcement include lack of government capacity, lack of political will to enforce regulations that increase the costs of business, and the difficulty of enforcing regulations in large informal sectors.

Government efforts to increase enforcement of minimum wage laws in Brazil led to greater compliance, more formal employment, and higher wages (Almeida and Carneiro, 2011). However, in South Africa having more labor inspectors did not significantly influence compliance (Bhorat et al, 2012), although compliance was significantly influenced by the minimum wage level. Other research confirms a strong inverse cross-country relationship between compliance and the level of minimum wages relative to mean wages (Rani et al, 2013).

Lack of compliance directly undermines all potential impacts of the minimum wage, both positive and negative, and may partially explain why researchers have found fewer negative impacts on employment in developing countries. However, differences in enforcement across regions, formal versus informal sectors, and different firm types, can lead to distortions in employment incentives leading to higher informal small-firm employment.

Impacts of minimum wage policies. What do we know about the impact of minimum wage policies on employment outcomes and poverty and inequality? As debates on the merits and demerits of minimum wages continue, much of the debate has focused on methodological issues (Card and Krueger, 1995; Neumark and Wascher, 2008). Only recently has there been empirical research on emerging market countries.

The results of recent studies on BRICS countries report mixed findings. In Russia, minimum wages reduced employment among younger workers but not female workers (Murayev and Oshchepkov, 2013). In China, higher minimum wages reduced employment of younger workers, female workers, and less skilled, low-wage workers (Fang and Lin, 2014; Huang, Loungani, and Wang, 2014). In South Africa, minimum wages have reduced employment in the agricultural sector, but

References (1 of 2):

Almeida, R, and L. Ronconi (2012). "The Enforcement of Labor Law in the Developing World: Some Stylized Facts from Labor Inspections, paper presented at the IZA/World Bank Conference on Employment and Development, New Delhi, November 5-7.

Besler, Patrick, and Uma Rani (2010). Extending the Coverage of Minimum Wages in India: Simulations from Household Data, ILO Conditions of Work and Employment Series No. 26.

Bhorat, Haroon, Ravi Kanbur, and N. Mayet (2012a). "Minimum Wage Violation in South Africa", International Labor Review 151(3): 277-287.

Bhorat, Haroon, Ravi Kanbur, and N. Mayet (2012b). "Estimating the Causal Effect of Enforcement on Minimum Wage Compliance: The Case of South Africa", Review of Development Economics 16(4): 608-623.

Bhorat, Haroon, Ravi Kanbur, and N. Mayet. (2013). "The Impact of Sectoral Minimum Wage Laws on Employment, Wages, and Hours of Work in South Africa", IZA Journal of Labor and Development 2(1) January 2013.

Bhorat, Haroon, Ravi Kanbur, and Benjamin Stanwix (forthcoming). "Estimating the Impact of Minimum Wages on Employment, Wages, and Non-wage Benefits: The Case of Agriculture in South Africa", American Journal of Agricultural Economics.

Bhorat, Haroon, and Benjamin Stanwix (2013). Minimum Wage Enforcement in the Developing World, Development Policy Research Unit Policy Brief 13/29.

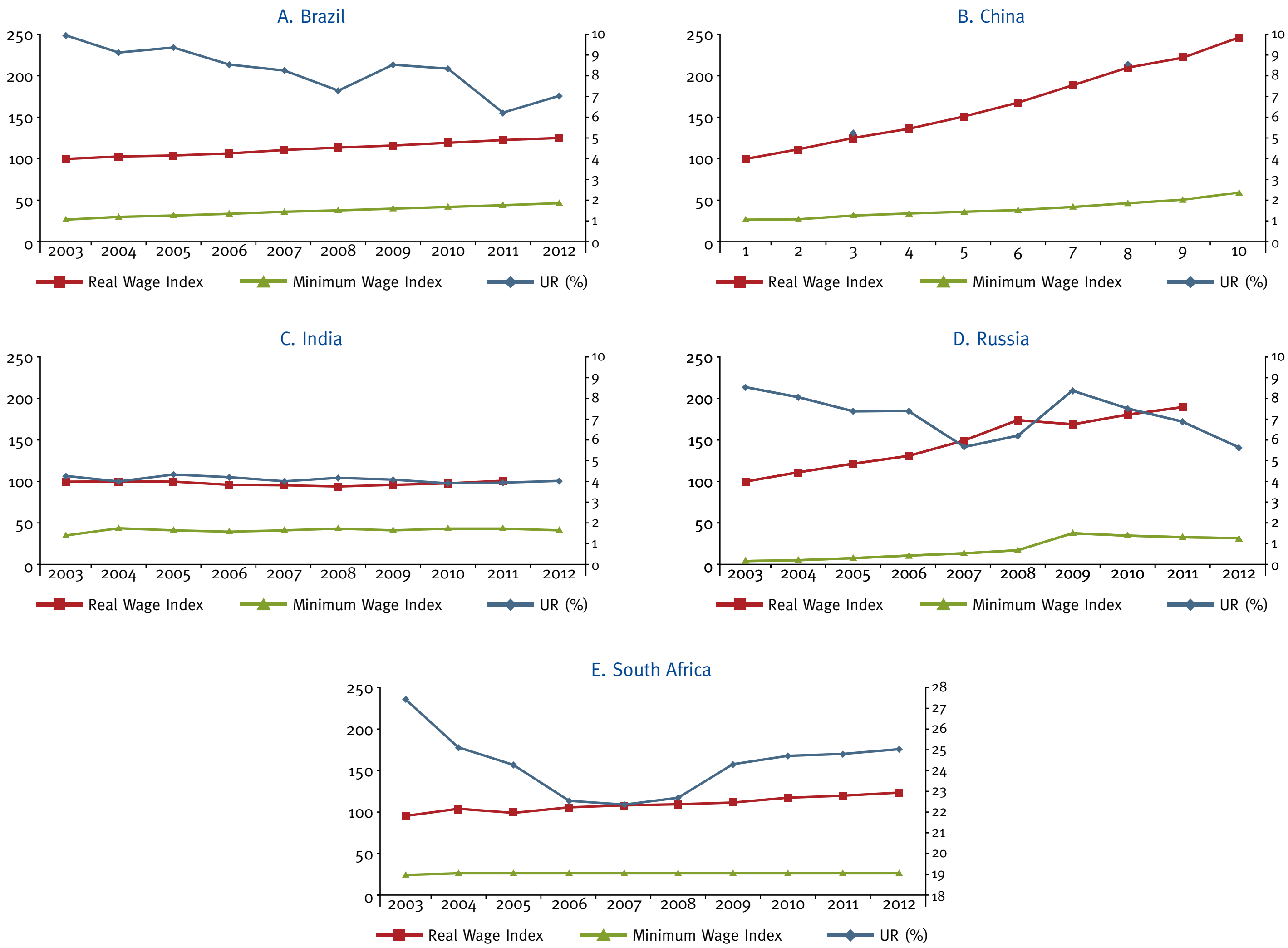
Bolsheva, Anna (2012). Minimum Wage Development in the Russian Federation, Global Labor University Working Paper No. 15.

Carneiro, Francisco Galrao (2001). An Overview of the Effects of the Minimum Wage on the Brazilian Labor Market, working paper, Catholic University of Brazilia.

Fang, Tony, and Carl Lin (2014). Minimum Wages and Employment in China, working paper.

Huang, Yi, Prakash Loungani, and Gewei Wang (2014). Minimum Wages and Firm Employment: Evidence from China, working paper.

Figure 1: Minimum Wages, Real Wages, and Unemployment Rates in BRICS Countries, 2003-2012



Notes on data sources: Mean wages by year are from International Labor Organization. Wages are deflated using national CPI from World Bank Development Indicators. Other data come from Brazil Monthly Employment Survey, IPEA Data (The Institute of Applied Economic Research (IPEA) is a federal public foundation linked to the Strategic Affairs Secretariat of the Presidency), China 2005 and 2010 census data, Labour Bureau of the Government of India, Fang and Lin (2014), Muravyev and Oshchepkov (2013), South Africa Department of Labor, Statistics South Africa.

not in other sectors (Bhorat, Kanbur, and Stanwix, forthcoming; Bhorat, Kanbur and Mayet, 2013). Recent studies find no negative employment effects of the minimum wage in Brazil (Lemos, 2009). Authors of a study of minimum wages in India posit no or little impact on employment (Besler and Rani, 2010). Lack of negative employment impacts may be associated with poor compliance.

Minimum wages are expected to lift wages at the bottom of the wage distribution and thus reduce inequality. The magnitude of these effects depends upon the level of the minimum wage, the extent of coverage and compliance, and employment impacts. Impacts on poverty reduction also depend on whether those affected by minimum wage policies tend to live in poor or nonpoor households. For instance, if teenagers' wages are increased by higher minimum wages, poverty will not be reduced if most teenagers live in richer households (Burkhauser and Sabia 2007).

A few studies of emerging markets have empirically assessed the impact of minimum wages on inequality and poverty. In Brazil, minimum wages have increased the wages of those at the bottom of the wage distribution in the formal sector and those at the higher part of the income distribution in the informal sector (Lemos, 2009), resulting in a more compressed wage distribution. In China, minimum wages have reduced inequality in the bottom half of the wage distribution (Lin and Yun, 2014). A simulation analysis using household data in India finds that with perfect compliance, India's minimum wage policy could reduce the gini coefficient of wage inequality by 5-9 percentage points and reduce the poverty rate of casual wage workers by 5-8 percent (Besler and Rani, 2010). One study on Russia concluded that the minimum wage was too low to have a meaningful impact on poverty reduction (Bolsheva, 2012).

Poorer countries tend to have larger informal sectors. Among BRICS countries, the informal employment share is lowest in formerly socialist China and Russia, and highest in India where over 90% work in the informal sector. If compliance is lower in the informal sector, then in a dualistic labor market higher minimum wages could push workers from the formal to informal sector and reduce wages in the informal sector. There is some evidence that this occurred in Russia and Brazil (Murayev and Oshchepkov, 2013; Carneiro, 2001). However, there is no evidence of a negative effect on informal wages. In fact, in Brazil, higher minimum wages increased wages in the informal sector (Lemos, 2007). This "lighthouse effect" can be due to minimum wages playing a benchmark role for wage-setting in the economy, or to a high degree of integration between the formal and informal sectors.

Recommendations

Setting minimum wage levels. If minimum wages are set too low, they will fail to ensure a living wage for workers and their families. If they are set too high, they may reduce employment or lead to widespread non-compliance. The challenge, then, is to set minimum wages at a level which balances these concerns using a procedure that is depoliticized, informed by current labor market conditions, and engages all key stakeholders.

Creating a level playing field. Incomplete coverage of workers, multiple lines for different occupations or sectors, and unequal enforcement of regulations distorts employment incentives and reduces the efficiency of labor and capital allocation. It is thus advisable to reduce complexity of the minimum wage system by setting minimum wages that cover all workers and which are uniform by region and equally enforced.

Improving compliance. Low levels of compliance are a major challenge in less developed countries. Governments can improve enforcement: significantly increasing penalties for non-compliance, increasing the frequency of inspections, undertaking public awareness campaigns, naming and shaming violators, and seting up minimum wage-setting processes that involve stakeholders and so ensure that minimum wages are set at realistic levels.

Poverty targeting. The potential for minimum wage policies to reduce poverty will depend on the household characteristics of low-wage workers, which requires systematic evaluation. Poverty targeting through minimum wages often will be highly imperfect, requiring alternative or supplementary schemes to achieve poverty reduction objectives.

Bio:

Albert Park is the Director of HKUST IEMS, Chair Professor of the HKUST Division of Social Science, and Professor of the HKUST Department of Economics. He is a development and labor economist who is an expert on China's economic development. His research has been featured by the Economist, New York Times, Wall Street Journal, BBC, CNN, and NPR. He currently serves on the editorial boards of the Journal of Comparative Economics, Oxford Economic Papers, and Chinese Economic Review.

Qing Xia is currently an Investor Relations Officer at the China Merchants New Energy Group, and previously assisted with academic research projects at the HKUST IEMS. She earned her B.A. in Economics and Hispanic Language and Literature from Peking University, and later earned an MPhil. degree in Social Science from HKUST. Her research interest is in development economics, with specific focus on labor markets, higher education, and healthcare in Mainland China.

References (2 of 2):

Lemos, Sara (2007). "The Effects of the Minimum Wage in the Private and Public Sectors in Brazil", Journal of Development Studies, 43(4):700-720.

Lemos, Sara. (2009), "Minimum Wage Effects in a Developing Country", Labour Economics 16(2): 224-237.

Lin, Carl, and Myeong-Su Yun (2014). Minimum Wages and Income Inequality in Urban China. Paper presented at the Conference on Reforming Minimum Wage and Labour Regulations Policy in Developing and Transition Economies.

Muravyev, Alexander, and Aleksey Oshchepkov (2013). Minimum Wages, Unemployment and Informality: Evidence from Panel Data on Russian Regions, Institute for the Study of Labor (IZA) Discussion Paper No. 7878.

Piore, M., and A Schrank (2008). "Toward Managed Flexibility: The Revival of Labor Inspection in the Latin World", International Labour Review 147(1): 1-23.

Rani, Uma, Patrick Belser, Martin Oelz, and Setareh Ranjbar (2013). Minimum Wage Coverage and Compliance in Developing Countries, International Labour Review 152 (3–4): 381-410.

Ronconi, L. (2010). "Enforcement and Compliance with Labor Regulations in Argentina", Industrial and Labor Relations Review 64(4): 719-736.

HKUST IEMS
INSTITUTE FOR EMERGING MARKET STUDIES

T: (852) 3469 2215

E: iems@ust.hk

W: http://iems.ust.hk

A: Lo Ka Chung Building,
The Hong Kong University of Science and Technology,
Clear Water Bay, Kowloon

Read all issues of HKUST IEMS Thought Leadership Briefs at

iems.ust.hk/tlb

With support from

EY Building a better working world