PMRC Background Note 3

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PMRC JOB SERIES

Implications of Minimum Wages (SI 45 - 47) On Industry Productivity, Labour and Poverty Reduction: Learning From Evidence

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"There is no valid, research based evidence to support the speculative standpoint that minimum wages cause significant job losses by increasing the costs of employer. Observed research analysis shows that legally mandated raises comprise a small component of employer revenue. Even ripple effects significant enough to triple the cost of minimum wage increase do not pose a large burden on employers."

Overview

The increase in minimum wages for general, shop and domestic workers by Government through the issuance of Statutory Orders SI 45 - 47 of July 2012, has become a sensitive industrial relations and political issue. **Sections of industry, economists and political elites support a reversal of this subsidiary law that protects vulnerable, low wage workers – the working poor - from undue exploitation.**

Two standpoints exist on impacts of minimum wages on industry productivity, labour and poverty reduction. The first **amplifies adverse effects of these wages on economic performance, industry productivity and employers cost structure.** The second, considers them **an opportunity and effective policy instrument, to deliver fair wages and enhance Government's industrial relations policies.**

From the start, the critics' perspective see irreconcilable trade-offs between economic efficiency and equity; economic efficiency is only achievable at the expense of equity. Minimum wages, it is claimed, have bleak consequences on employers and low-wage workers they are meant to serve. They cause small-businesses to close shop and lay off low-skill and low wage workers. Their long-term impact on productivity, jobs and poverty is seen to be worse off than the initial disease - the low wages - they seek to cure.

Little evidence, however, exists to support this stance.

By contrast, the promoters' viewpoint, backed by growing mass of evidence, is that labour market institutions and regulations are vital for a well-functioning and efficient economy. In weak or ineffective labour markets, minimum wages matter.

They:

- Help improve the wages of the low paid workers
- Narrow earnings inequalities and poverty rates
- Enhance industry harmony and productivity
- Foster social equity and justice.

They are, therefore, a hallmark of an effective broad-based wealth, citizens' economic empowerment and anti-poverty strategy that enriches human life rather than just the richness of the economy. They are an effective tool for Government to, at once, achieve efficiency and equity objectives.

This Background Note No. 3 of the job series contributes to the on-going debate on the effects or potential impacts of SI 45-47 on industry productivity, labour and poverty reduction. By drawing on research data and analysis of cross-country experiences with minimum wages, it concludes that the resistance to the minimum wages in Zambia lacks valid, research-based evidence. This lack of evidence is a gap that limits the wider value and credibility of the debate towards supporting meaningful dialogue and effective implementation of the Employment and Labour Market Policy.

Assessment of impact of minimum wage orders on broad-based wealth and job creation needs an observed approach to labour market analysis. This assesses the capacity of industry to absorb the costs and root causes of joblessness, if any. This is the basis for well-thought out, harmonized and sequenced policy and regulatory measures to achieve immediate, short and long-term development objectives.

This is the hallmark strategy to enriching the lives of the majority of Zambians rather just the economic environment in which they live.

The Case for Minimum Wages in Zambia

In July 2012, the Government announced the revised statutory minimum wages by Ministerial orders through issuing:

- Statutory Instrument No.45: Domestic Workers Amendment Order 2012;
- Statutory Instrument No.46: General Amendment Order, 2012; and
- Statutory Instrument No.47: Shop Workers Amendment Order, 2012.

This improved mandated wages and conditions of services for general workers, shop workers, and for the first time, domestic workers.

These orders resulted from amendments and withdrawals of the following statutory orders:

- Statutory Instrument No.57: General Order, 2006;
- Statutory Instrument No.56: Shop Workers Order, 2006;
- Statutory Instrument No.56: Shop Workers Order, 2006;
- The Minimum Wages and Conditions of Employment Act (General) Order 2010;
- The Minimum Wages and Conditions of Employment (Domestic Workers) Order 2011;
- The Minimum Wages and Conditions of Employment (Shop Workers) Order 2011

Governments' reasons for enacting minimum wages and conditions of employment are mainly fourfold:

i. to safeguard the interest of the workers
ii. to protect workers from exploitation or salary working conditions
iii. to Create a legal base on which employers will base their wage rate on
iv. to protect un-unionized workers from abuse.

The prevalent casualisation of labour, amidst abundance natural wealth, arable land and impressive macro-economic performance in Zambia bolsters the case for mandated wage increases.

Table 1: Zambia's GDP Growth Rates: 2001-2012

Year	Percentage Growth Rate (%)
2001	4.9
2002	3.3
2003	5.1
2004	5.4
2005	5.3
2006	6.2
2007	6.2
2008	5.7
2009	6.4
2010	7.1
2011	6.6
Period Average	**5.7**

Source: African Development Bank (2010) Africa Growth Outlook. Tunis, AfDB.

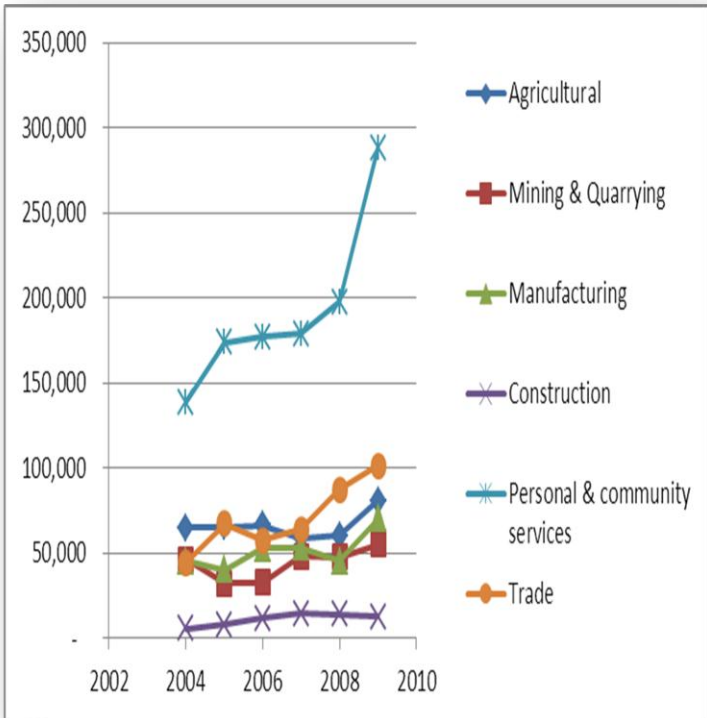
This weakness of the labour market and its inability to protect the low wage workers is noted in numerous strategy documents. These include: the Sixth National Development Plan (SNDP), the Patriotic Front Manifesto 2011-2016, Civil Society Trade Network of Zambia (CSTNZ) and the Catholic Centre for Justice, Development and Peace (CCJDP), now CARITAS Zambia.

In the SNDP Government notes that redistributive policies are an important strategy for reducing poverty. "There is no basic trade-off between long-run aggregate efficiency and overall equity." Government's strategy, therefore. hinges on an approach to poverty reduction that is based on broad-based wealth and job creation. Similarly Part 16 of the PF Manifesto, the Party in Government, notes that conditions of services for the Zambian workers have for years been declining as the economy declined. Generally workers have been undervalued, overworked and underpaid. Statistics on formal sector earnings for Zambia since 1985 support this observation.

Despite a positive employment trend, growth in jobs has been weak while earnings have consistently fallen since 1985. This is despite impressive foreign direct investment flows, real growth rates and low inflation. Services, Trade, Manufacturing and Construction industries have been key drivers for job creation between 2008 and 2009.

In 1 year, 157,078 jobs were created in the following sectors.

- Services 90, 372 (58%)
- Manufacturing 24, 902(16%)
- Agriculture 20,641 jobs (13%)
- Trade 13, 908 jobs (9%)
- Mining and quarrying 7,255 jobs (4%)



CSO raw data 2006-2010, Quarterly Employment and Earnings Enquiry

The Construction industry, which has a significant untapped potential to create low-skill, labour intensive jobs, shedded a total of 1,204 jobs (3%) between 2008/09. Interestingly, the **Trade, Agricultural and Construction sectors, which can easily add to quick creation of jobs have not matched their potential and adequately been exploited by policy-makers**. These sectors provide opportunities for Government to create the much needed decent jobs. This means that **with the right policies that combine efficiency and equity it is feasible for Government to create 1 million jobs easily in order to unlock Zambia's potential towards "resource rich and wealthy people."**

Trends in Industry Productivity and Earnings in Zambia: Lessoning from Evidence

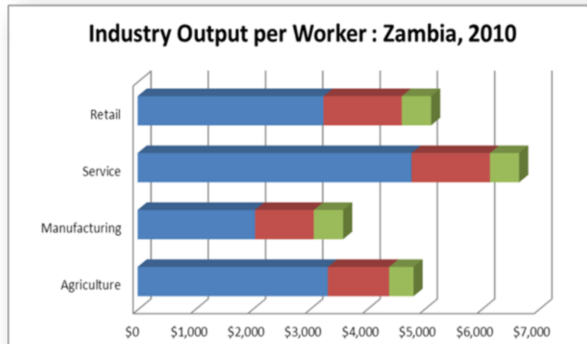
The implementation of SI 45-45 increases the average basic wage of general and shop workers from K724, 250 (US $148) to K1, 209, 964 ($246) per month. With consumer price inflation stable within the single digit band, this is represents a nominal wage increase of K480, 200 ($98). However, the real wage increased can only arrived at when inflation over the years is taken into account.

When the World Bank's income poverty benchmark of $2.00 a day, is applied used to analyse the impact on income poverty of an average worker, this translates to a gross income of K40, 180($8.2) a day.

For a single member household, this level of income is sufficient to provide the very basic necessities of life but not to enrich their lives through investments in assets to drive substantial poverty reduction efforts.

The challenge is that **an average Zambian family consists of 6 members**. For a family of 6 the current wage rate, survives on a gross income/expenditure of K6, 697.00($1.36) per day. **This still leaves the worker and the family within the income poor based on the $2 a day benchmark.** This leads to a scenario where the majority of low-skill and wage worker fall into the category of "working poor category" amidst abundant natural resource and when macro-economic performance and growth outlook remain healthy.

Evidence based on analysis of time-series data between 1985 and 2010, shows the following interesting scenarios that are relevant to the current debate:

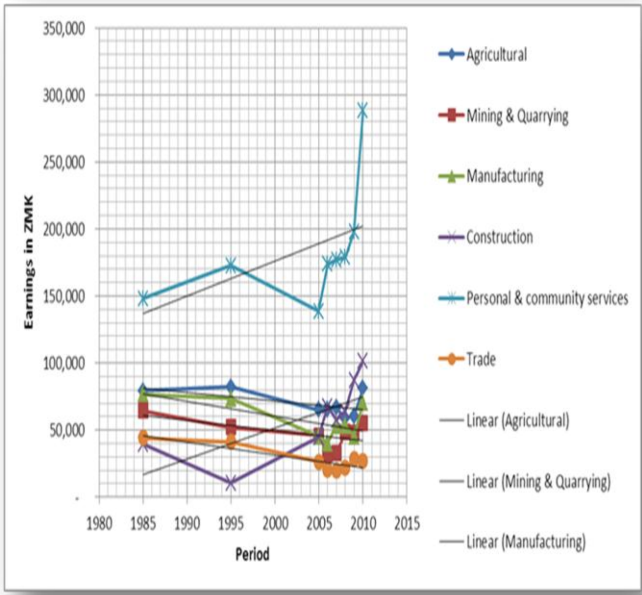


	Agriculture	Manufacturing	Service	Retail
75th Percentile	$3,321	$2,050	$4,783	$3,246
Median	$1,071	$1,025	$1,367	$1,366
25th Percentile	$427	$513	$512	$512

CSO raw data 2006-2010, Quarterly Employment and Earnings Enquiry

- Overall, labour productivity or total output per worker in industry has been rising. Productivity of labour in the manufacturing industry though slightly lower, was comparable to China, India and Kenya in 2004.
- Little variation exists in worker productivity across firms of different sizes.
- Zambian firms of all sizes, especially in manufacturing industry, use more capital per unit of labour than Chinese Indian, Ugandan and Ethiopian firms that have created more broad-based wealth and jobs per unit of capital. This is despite returns on labour in Zambia being higher than returns on capital.
- Most Zambian firms use their capital stock very inefficiently.

- The productivity of capital stock in Zambia is the least efficient when compared to 8 other countries, namely, Cameroon, China, Cote d'Ivoire, Ghana, India, Kenya, Tanzania and Uganda. Unit costs of labour are fairly similar across size categories.

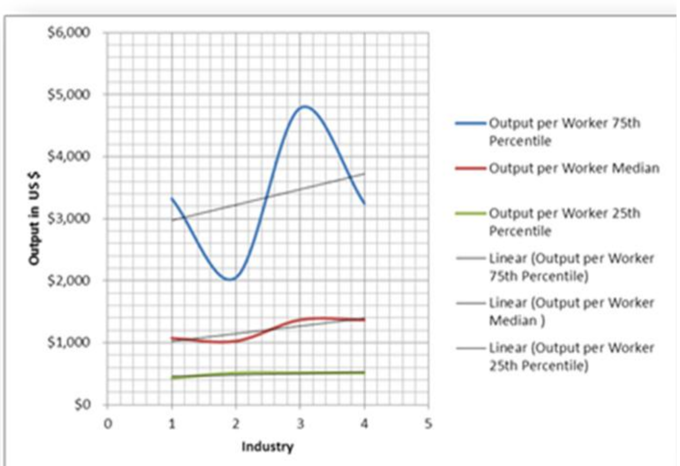


CSO raw data 2006-2010, Quarterly Employment and Earnings Enquiry

- Overall, earnings in the formal sector have consistently fallen (despite years of public sector reforms, economic restructuring and impressive years of real economic growth).

The questions worth exploring as we debate the current minimum wages are, therefore, threefold:

i. Have we just "advanced the richness of the economy at the expense of richness of human life?"
ii. Is there a real trade-off between the national pursuit of efficiency and equity based policy objectives?
iii. Are minimum wages, therefore, a call to socio-economic justice and fairness between industry and labour?



CSO raw data 2006-2010, Quarterly Employment and Earnings Enquiry

Implications on Industry Productivity, Labour and Poverty Reduction: Cross Country Experiences.

The Minimum Wage and Conditions of Employment Act, Chapter 276 of the Laws of Zambia empowers the state through the Minister of Labour to prescribe minimum wages and related conditions of employment. These relate to sectors where collective bargaining in either not effective or not possible.

The analysis of the current labour market shows evident weakness and thus inability to protect low-skill workers with low bargaining power. Current weakness of the labour markers is demonstrated by:

- Multiple and sometimes competing labour unions seeking registration and recognition
- Fragmentation and inability to effectively articulate and champion workers' rights and interests
- Cumbersome collective bargaining process as one employer has to deal with several union representatives
- Refusal by some unions to enter collective bargaining jointly;
- Reluctance by new investors to tolerate and deal with trade unions worsening casualisation;
- Retrenchments, redundancies and non-payment of severance payments.

This picture of the labour market justifies legal protection to the vulnerable in their industrial relations with employers to create a level playing field. This resulting industrial harmony, political and macro-economic stability are a solid foundation for increasing industry productivity, inclusive wealth and job creation.

In Zambia the Zambia Federation of Employers has taken Government to court over the declaration of minimum wages. This has been on account that raising the minimum wage for low-wage workers would have a chain reaction, what economists the call ripple-effects. This means that even wages of non-low-wage workers would demand an increment to maintain their band. Industry will then be obliged to raise the wages of all workers. To do this, employers have two options, either to raise the costs of goods and services to absorb the costs or to shed off low-wage workers. Critics argue that both options are detrimental to economic efficiency and ultimately lead to job loses. In the long-term this job losses pose a serious threat to industry performance, broad-based growth and poverty reduction. In this view, minimum wage increments are difficult enough for employers to absorb. Ultimately, minimum wages laws are a less effective tool for addressing joblessness and poverty. However, such theoretical standpoints lack supported evidence. Analysis of cross-country data on minimum wages shows that despite widespread controversy, industry is not overwhelmed by the costs of a higher minimum wage, including the ripple effects.

An increase in minimum wages in 1997 in America from $4.75 to $5.15 an hour translated 4 million workers receiving mandated wages.

This action increased the employers' wage bill by $741 million. An additional 11 million workers benefitted from the ripple effect, adding a further $1.3 billion to the wage bill. The overall impact was a quadrupling of the benefiting workers and tripling the employers' wage bill.

In 2004 minimum wage increments in America to $6.15 per hour tripled the number of beneficiary workers from 300,000 to 850,000 and doubled the wage bills associated with its implementation from $155-$410 million. But this only increased the employers wage bill by less than 0.5% of the employers' sales revenue.

In the UK, the introduction of minimum wages in 1999 increased the wages of 10% of the low-wage workers, benefitting a total of 1.5 million. It also narrowed the gender-based income inequalities, thus enhancing equity.

In both cases, there was no significant negative impact on employment. Conclusive research **evidence on the impact** on minimum wages on employment in the US, based on the experience of 12 States below, **casts further doubt on the validity of the association between minimum wage increments and high job losses or unemployment.**

- Many states, **Michigan, Illinois, South Carolina** and **Texas whose minimum wages were set below the Federal level, also had high unemployment rates in December, 2003**
- **Hawaii, Delaware and Vermont,** three **states with higher minimum wage levels, were among the 15 states with unemployment rates below 5%, which was less than the national average.**
- Of th**e 12 states with higher minimum wages, 8 saw a smaller increase in unemployment between 2000 and 2003.**

Several economists conclude, based on work undertaken in several countries that **minimum wages have no negative impact on jobs. In some case positive effects have been observed.** In fact a more positive view on this debate suggests that incentives exist for industry to keep wages above the market rate.

Higher wages, increase worker morale, loyalty, industrial harmony and political stability all of which are hallmarks of higher labour productivity, profitability and business growth.

The homework for industry and policy-makers therefore is to understand that low pay has much less to do with productivity as evidence for Zambia shows. Numerous sociological factors, many of them historical, come into play. Low wage jobs are those historically associated with low-skill, servant classes or women's work. As such they are undervalued, overworked and underpaid.

Guaranteed availability of low wage labour to industry erodes its incentives to increase productivity through investments in skills transfer, training and new technology. This traps firms on the low road productive system, where competitiveness is based on low cost structures and pricing rather than improvements in quality, service, technology and overall innovation.

Minimum wages can also have macro-economic benefits. They can increase government taxes, reduce welfare subsidies and increase aggregate demand as most, if not, low-wage worker spend all their earnings. This expenditure may stimulate growth of productivity as industry aims to increase the supply of goods and services to match increased demand. The result is likely to be increased employment opportunities**.**

Conclusion

For the last two decades, **labour productivity, measured as output per worker has grown significantly.** Overall**, job growth in formal sector has been positive in nearly all sectors**. Yet, worker **earning overall have consistently fallen since 1985.**

Services, Manufacturing and Agricultural sectors have enormous opportunity for supporting broad-based wealth and job creation. But together with the construction sectors, these sectors remain unexploited to support decent jobs and enrich the lives of Zambians. Significant foreign direct investments in mining sector and Government support to the agricultural sector have been weak in creating formal and decent job. **The overall benefit of the robust growth in the last few years has been enriching the economy at the expenses of the people.**

The fragmentation and competition among **multiple trade unions has eroded their effectiveness in representing and championing worker rights and interests.** Cross country analysis shows that there is no trade-off between efficiency and equity in the long –run.

The minimum wage debate should, therefore, be informed by and learn from evidence from within and elsewhere. P**olicy makers should be aware that facts on the ground in nearly all countries demonstrate that benefits overall of such increases outweigh any perceived or actual costs.**

Minimum wages are, therefore, **a call to socio-economic justice and fairness between industry and labour. Its overall implications and benefits on the macro-economic performance of the country, industrial productivity, labour and poverty reduction are likely to be positive.**

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