

## Higher Minimum Wages Causes Unemployment and Steep Inflation? Not Necessarily.

The Malaysian experience seems to suggest that raising the minimum wage has been good for us. The need to implement minimum wages is based on the protection it offers to workers at the lowest income strata. These often tend to be workers from groups often marginalised in society such as youth workers and women. They may not have the bargaining power to demand higher wages without direct government intervention.

For several decades there was a near-consensus among economists that raising minimum wages just like any other floor would substantially reduce employment. Some persist on the potential employment costs argument. However, that view has changed where a majority now view a significant rise to be a good idea.

To understand the shift, it is important to appreciate the natural experiments conducted by Nobel Laureate David Card, who found that increasing minimum wages did not lead to increased unemployment. In fact, it was found to lift many out of poverty and benefit those in the bottom half, including those making more than the minimum wage.

There are those who view the implementation of a higher minimum wage as harming low-wage workers as it is an artificial value imposed by the government rather than determined via market forces. This is because those with lower skills or experience tend to have lower productivity levels. Hence, a higher cost structure would put-off hiring of these workers rather than employing them at lower wages until they become more experienced.

However, my opinion is that the wage policy in Malaysia should be based on the domestic context. In 2013, the minimum wage was first set to be at RM 900 per month for West Malaysia and RM 800 for East Malaysia. The rate has since gone up in stages over the years. About a decade later, it is set to reach RM 1,500 per month effective 1 May 2022.

This seems to be a fair rate given that the International Labour Organisation reported that the average minimum wage around the world for developing and emerging nations to be about 67% of the median wage <sup>3</sup>. At the end of 2019 before the pandemic, according to the **Department of Statistics Malaysia (DOSM)**, the median income in Malaysia was at RM 2,442 where the minimum wage was set at RM 1,200 (about 49%). However, according to data from DOSM, the pandemic has lowered the median income to RM 2,206, a minimum wage of RM 1,500 represents about 68% which is in-line with the global average. Given that the economy is expected to see a strong rebound of more than 5.5% in 2022, the median wage can be expected to surpass 2019 levels by 2024. This would eventually represent a minimum wage representing 60% of the median wage.

Research on the implementation of previous minimum wage levels in Malaysia shows that it tends to increase labour productivity, act as a motivator, and reduce employee turnover <sup>4</sup>. In fact, longer terms studies have shown that it reduces unemployment and increases labour participation rates. Research also documents that the previous increase in 2016 also did not result in any significant reduction in labour demand.

There have been views that increase of minimum wages may lead to inflationary pressures. For example, if a restaurant owner is suddenly forced to pay his workers RM 1,500 instead of RM 1,200, he needs to raise the price of his product to account for this increase in costs.

But in the Malaysian context, it is likely that most employees in urban areas are already being paid close to the proposed rate of RM 1,500. Thus, there might be very little additional price pressure in these areas. It is likely that the new rate would account for the difference in wages and costs in urban versus rural areas, in-line with the current approach.

In addition, inflation tends to be insignificant as a determinant of employment in Malaysia <sup>7</sup> . In fact, research in Malaysia shows that labour markets in Malaysia tend to follow the efficiency-wage theory where the increase of costs (of higher wages) would be recouped through greater productivity as well as increased employee retention <sup>8</sup> . Thus, inflationary pressures are unlikely to be severe, given that increased productivity would then counter the potential increase in price levels. Thus, it seems that the new higher rate may point towards a positive picture overall.

However, given the potential that it may harm SMEs which are unable to offer higher wages, there is a need to explore a mechanism beyond minimum wages going forward. Imposing minimum wage laws puts the role of reducing poverty on the business owner. But a different approach via social welfare programmes for low-wage workers would allow all taxpayers to share the financial burden. Among areas that would be beneficial to B40 households would include part cover for housing costs, healthcare as well as childcare costs.

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