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*A living wage is an income level needed for a household to afford a minimum acceptable living standard, which includes the ability to participate in society, the opportunity for personal and family development, and freedom from severe financial stress. This article discusses the motivation of introducing the living wage, the estimation of a representative level for Kuala Lumpur, and the international experiences and potential impact from adopting a living wage.*

# The Living Wage: Beyond Making Ends Meet

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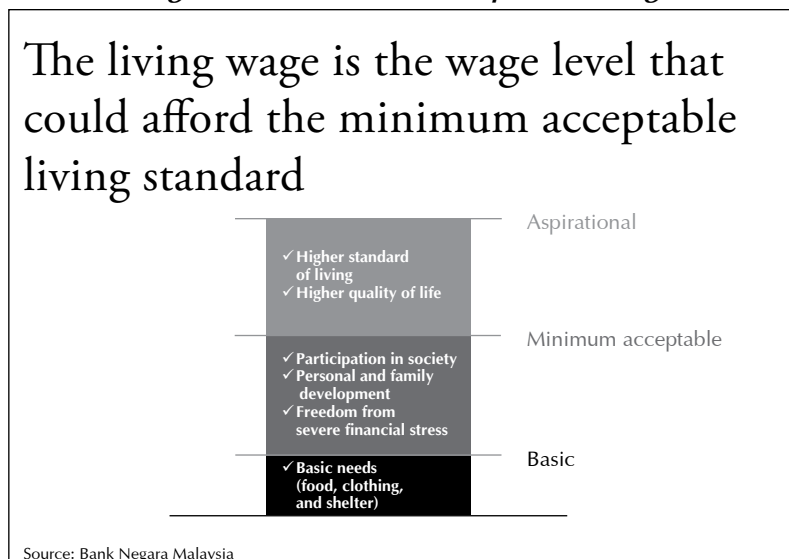
# The Living Wage: Beyond Making Ends Meet

## Introduction

The concept of a ‘minimum acceptable’ standard of living goes beyond being able to afford the necessities, such as food, clothing, and shelter<sup>1</sup>. This standard of living should include the ability to meaningfully participate in society, the opportunity for personal and family development, and freedom from severe financial stress. At the same time, it should reflect needs, not wants. It does not capture the cost of lifestyle, which is the spending to fulfil the desires for an aspirational living standard (Figure 1).

In recent years, many low-wage employees across countries have found it difficult to attain a minimum acceptable living standard. Such development has prompted calls for a living wage – a wage level that could afford such a living standard. This article discusses the motivation of introducing the living wage; the estimation of a representative living wage level for Kuala Lumpur; international experiences in adopting a living wage; and the potential impact on the economy, employers, and employees. While living wage is the standard terminology used in the literature to describe the level of income

*Figure 1: Different Concepts of Living Standard*



<sup>1</sup> The World Bank calculates the global poverty line based on the costs of basic food, clothing, and shelter.

needed for a household to afford a minimum acceptable standard of living, in practice, this standard of living could be achieved through various sources of income besides wages, such as non-wage work benefits and social assistance. For simplicity, this article will use the term 'living wage' to mean income from all sources; i.e. from wages, benefits, and other non-wage incomes.

In 2016, a typical family of two working adults and two children in the United States (US) needed to work nearly four full-time minimum wage jobs to earn a living wage (Glasmeier and Nadeau, 2017). In 2017, more than one-fifth of the employees in the United Kingdom (UK) were still earning below the living wage (IHS Markit, 2017).

In Malaysia, the bottom 40% of households by income experienced a notable increase in average monthly income of 6% per year between 2014 and 2016. Yet, this 6% growth did not amount to much because of the low base. In absolute terms, the monthly income for this group grew from RM2,537 to RM2,848, which is equivalent to a small average increase of about RM150 per year relative to other income groups<sup>2</sup>. After accounting for the increase in the cost of living, households in the bottom 40% experienced a 3.8% growth in real income. For some households, especially the ones with additional dependants, the small increase in income may suffice to keep up with the increase in the price of basic necessities but falls short of achieving a minimum acceptable standard of living<sup>3</sup>.

As Malaysia moves closer towards becoming a high-income nation, it is timely to aspire for all citizens to attain at least a minimum acceptable living standard. The provision of a living wage can be a step towards that goal. Using the living wage as a benchmark to assess the adequacy of current wages and social assistance, international experiences suggest that it has the potential to inform, challenge, and enhance policies towards the

goal of achieving a minimum acceptable living standard. As such, a significant amount of consideration is needed in calculating a representative living wage level.

### The motivations for a living wage

A range of market imperfections, such as unequal market power and labour immobility, may depress wages in favour of large employers. Support for a living wage was particularly strong during the British Industrial Revolution in the 18th century, in response to the low pay and bad working conditions for manual workers. The more recent calls for a living wage over the past two decades reflect renewed efforts to enable workers to afford a minimum acceptable standard of living, amid a large number of underpaid full-time workers seeking social assistance (International Labour Organization, 2014). An increased concentration of wealth in the hands of those with higher incomes amid robust economic growth, has led to widening inequality in many advanced economies. In these economies, the resultant income inequality was one of the central concerns that motivated the need for a living wage framework.

Modern society recognises that the minimum acceptable living standard is beyond just affording the necessities, but should also provide for social participation and financial security. On social participation, the acceptable minimum includes being able to afford a trip to visit family and friends during festive seasons, and having the ability to occasionally purchase gifts for family members, such as during birthdays or visits. In addition, financial strains should not be a source of persistent stress. Figure 2 summarises some motivations that prompted the advocacy for a living wage in several countries.

Apart from allowing employees to afford a minimum acceptable standard of living, the living wage may also yield positive spillovers to the broader economy. These include reductions in employee turnover rates and improvements in employees' morale and productivity<sup>4</sup>.

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<sup>2</sup> The middle 40% of households by income and top 20% experienced an average increase of RM420 per year and RM892 per year respectively. Source: Report of Household Income and Basic Amenities Survey 2016, Department of Statistics, Malaysia.

<sup>3</sup> For example, the increase in income may not be able to keep up with the increase in expenditure associated with the expansion in family size.

<sup>4</sup> Several studies in the US show that employee turnover rates in firms fell significantly following the implementation of the living wage, resulting in improved productivity (Brenner and Luce, 2005; Reich, Hall and Jacobs, 2005; Fairris, 2005). A study in the US also finds that paying the living wage raised employees' morale and boosted productivity (Brenner and Luce, 2005).

Figure 2: Motivations for a Living Wage in Canada, New Zealand and the United Kingdom

The minimum acceptable living standard should also provide for social participation and financial security



Source: Living Wage Canada; Living Wage New Zealand; and Living Wage Foundation, United Kingdom

### Differences between a living wage, a minimum wage, and an aspirational income

In practice, a living wage differs from a minimum wage in several aspects. First, a living wage is typically not a statutory requirement for the economy unlike a minimum wage<sup>5</sup>. Second, a living wage refers not just to the existence of a minimum level of remuneration, but also to a minimum acceptable standard of living (International Labour Organization (ILO), 2014). Therefore, the living wage rates are usually higher than the minimum wage rate, especially when the latter has been less frequently updated in line with living cost increases. Third, while the determination of a living wage is based primarily on cost of living concerns, the minimum wage may consider additional factors given that it is a legislated requirement, such as its effect on employment and job creation (ILO, 2014).

In terms of affording a certain standard of living, the living wage is meant to sustain the socially acceptable minimum standard of living, beyond the basic necessities such as food, clothing, and shelter. An aspirational income goes beyond that: it could fulfil a desired lifestyle beyond the socially acceptable minimum, including spending on the latest gadgets or travels abroad.

### Estimating a representative living wage in Kuala Lumpur

An important process of developing a living wage framework is estimating a wage level that is representative of a minimum acceptable living standard. While a wide range of methods may be used to estimate the living wage, these methods generally follow a standard approach as outlined in the flowchart (Figure 3). The first step is to ascertain whether there are significant variations in prices and living standards across location and household composition, which would make a case for developing different estimates of a living wage. The next step is to derive a representative basket of goods and services. Information is often drawn from a combination

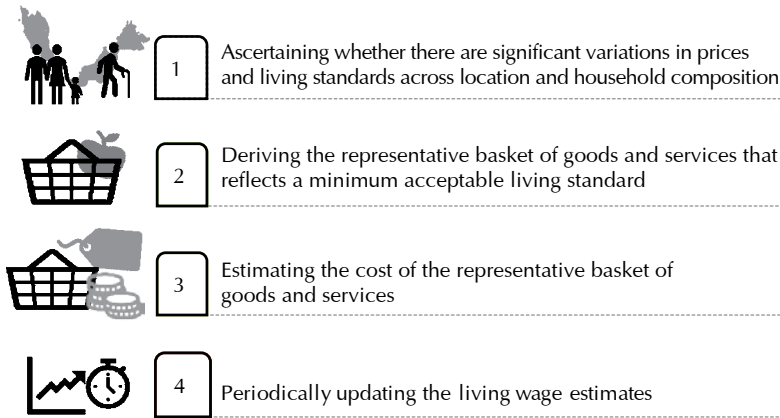
of publicly recognised standards on basic needs, expert opinion, public feedback, and data on household expenditure. Due to the diversity of households' needs, it is imperative to consult households of different profiles, to ascertain what items are deemed as necessities, and to distinguish these from items that are regarded as aspirational. Public consultations are often undertaken through focus group discussions, as was extensively done in the UK for 11 types of households (Bradshaw et al., 2008).

The next step is to compute the total costs for the representative basket given prevailing price levels. Official price statistics are typically used for this purpose. These estimates and the underlying assumptions would be validated through the

<sup>5</sup> The UK government introduced a mandatory National Living Wage, which is a higher minimum wage rate for workers over 25 years old. The rate of the National Living Wage is lower than the estimated Real Living Wage Rate calculated by the UK's Living Wage Foundation.

**Figure 3: A Standard Approach in Calculating a Representative Living Wage**

## The standard approach used to estimate the living wage involves these four steps



Source: Bank Negara Malaysia

focus group discussions. Finally, the living wage estimates are periodically updated to account for inflation. The estimates would also be revisited to consider changes in social norms, given that rising urbanisation could materially influence the composition of households' consumption basket. For instance, in the UK, households have recently indicated the greater difficulty of living near their workplaces due to limited housing options, resulting in an increase in the mileage required to travel to work and for other social activities (Davis, Hill, Hirsch and Padley, 2016).

To derive provisional estimates of a living wage in Kuala Lumpur in 2016, the standard approach is applied using three illustrative household types: single adult, couple without children, and couple with two children. First, a broad representative consumption basket that reflects the average consumption pattern for each type of household in Kuala Lumpur was constructed. Next, the cost of these baskets was estimated using data available from various sources, such as the Department of Statistics Malaysia (DOSM), Ministry of Domestic Trade, Co-operatives and Consumerism (KPDNKK), and the National Property Information Centre (NAPIC). Subsequently,

representatives from the three household types were consulted through focus group discussions to identify the basket of goods and services that best reflect their interpretation of a minimum acceptable living standard. They were also asked to estimate the budget required to obtain the representative basket. The internal estimates were validated against findings from the focus group discussions.

Table 1 presents the living wage estimates in Kuala Lumpur, derived based on the specific assumptions and price levels that prevailed at the point of estimation in 2016. The estimates range between RM2,700 and RM 6,500 per month<sup>6</sup>. The basket of goods and services includes items that reflect the typical purchases of households in Kuala Lumpur, which are validated through the focus group discussions. Assumptions made include the following:

- Food, housing, and transport constitute the largest expenditure shares in the representative basket for these three household types;
- Due to the hectic lifestyle in the city, households are assumed to regularly eat out more often in inexpensive eateries. The frequency of eating out falls as the family size grows due to the higher cost involved;
- Single-adult households are assumed to primarily utilise public transportation, while couples are assumed to own an entry-level locally produced car<sup>7</sup>;
- Allocation is also provided for recreation, such as sport equipment and movies, one inexpensive domestic holiday trip per year, and festive season travel and celebration;
- The estimates also include contributions to the Employees Provident Fund (EPF), income tax payable, and savings that could be used to meet an emergency spending, including an unexpected healthcare bill; and
- A minimum sum is allocated to education and healthcare as these services are provided nearly free-of-charge by the Government.




There are important caveats to these estimates. The estimates are provisional and subject to further revision as the underlying assumptions and cost estimates are refined. The representative

<sup>6</sup> Households with more than two people are assumed to share some expenses, such as utilities. Thus, the living wage estimates for larger households are not multiplicative of the estimate for single-adult households.

<sup>7</sup> An entry-level car is typically small and designed for low-cost operation. An example would be Perodua Axia.

Table 1: Provisional Living Wage Estimates in Kuala Lumpur for 2016

In Kuala Lumpur, the provisional estimates of a living wage range between RM2,700 and RM6,500 per month

	 Single adult	 Couple, without child	 Couple, with two children
Estimates of a living wage in Kuala Lumpur (RM/month)	2,700	4,500	6,500
Key assumptions on the representative basket of goods and services	<ul style="list-style-type: none"> <li>• Rents a room</li> <li>• Eats out more often, cooks occasionally</li> <li>• Drives less, uses more public transport</li> </ul>	<ul style="list-style-type: none"> <li>• Rents a one-bedroom apartment</li> <li>• Eats out half of the time</li> <li>• Owns two vehicles (a motorcycle and a car)</li> </ul>	<ul style="list-style-type: none"> <li>• Rents a three-bedroom apartment</li> <li>• Cooks most of the time, eats out during weekends</li> <li>• Owns two vehicles</li> <li>• Pays for private extra classes and childcare</li> </ul>

Note: The estimates above are provisional and subject to further revision as the underlying assumptions and cost estimates are refined. Single-adult households include adults who live alone and those who live together with non-related members of a household.

Source: Bank Negara Malaysia estimates using data from Household Expenditure Surveys 2014 and 2016, Department of Statistics, Malaysia, Ministry of Domestic Trade, Co-operatives and Consumerism, and the National Property Information Centre

baskets of goods and services constructed in this article are based on the findings from focus group discussions conducted in Kuala Lumpur in 2016 by Bank Negara Malaysia. It is likely that these estimates would be considerably different in other parts of Malaysia due to variations in consumption patterns and prices, which have to be further validated through additional focus group discussions with households that reside in these areas. For instance, urban households have relatively greater access to public transportation to meet their minimum transportation needs, while rural households may need to own a private vehicle. In terms of cost variations by location, one that stands out is housing costs (either owner-occupied costs or rental) are likely to be cheaper in rural areas and the less urbanised states. The estimates of a living wage in Kuala Lumpur are also likely to evolve over time due to inflation and lifestyle changes, and would only remain relevant if the representative baskets are updated periodically.

The living wage estimates in Kuala Lumpur for the three illustrative household types are below the median income in Kuala Lumpur

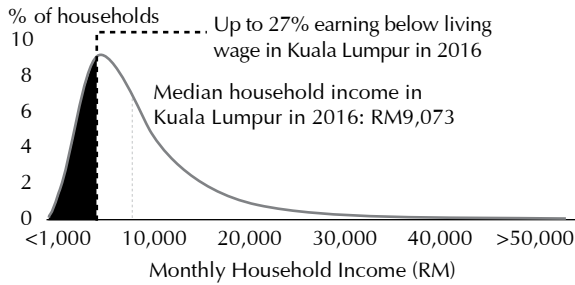
of RM9,073<sup>8</sup>. As shown in Figure 4, up to 27% of households in Kuala Lumpur were earning below the living wage. In terms of household type, a larger share of single-adult households and couples with two children were earning below the estimated living wage in 2016, compared to couples without children. The finding for single-adult households is consistent with the fact that graduates with a first degree or diploma earn on average, starting salaries of RM2,207 and RM1,346 per month respectively<sup>9</sup>. Among households earning below the living wage, close to 70% consisted of just one employed household member. Those earning below the living wage were mostly secondary school graduates with low- to mid-skilled jobs, while those earning above the living wage were mostly tertiary graduates with high-skilled jobs (Figure 5). Indeed, the median monthly salaries in 2016 for managers and professionals in Malaysia – RM5,500 and RM4,450 respectively – are well above the living wage estimates for a single-adult household (Figure 6). These findings underscore the importance of creating a high-skilled workforce in Malaysia that is equipped with the necessary competencies for higher-paying jobs.

<sup>8</sup> Source: Report of Household Income and Basic Amenities Survey 2016, Department of Statistics, Malaysia.

<sup>9</sup> Source: Ministry of Higher Education and Bank Negara Malaysia estimates.

Figure 4: Income Distribution of Households in Kuala Lumpur

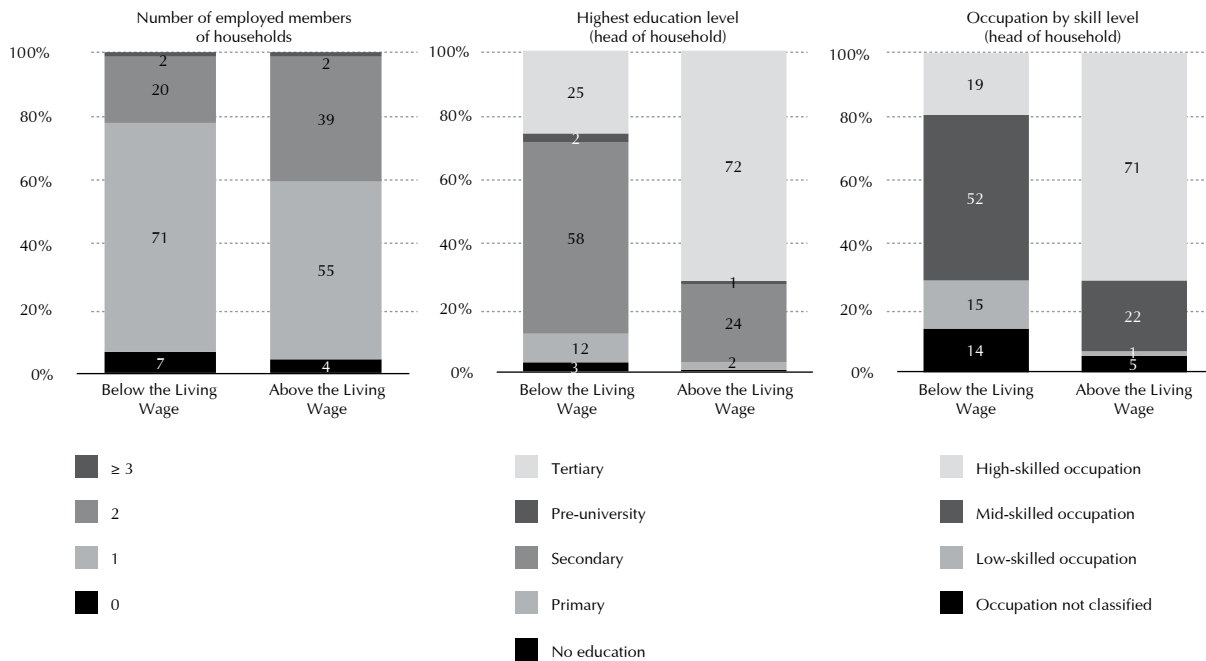
Up to 27% of households in Kuala Lumpur were earning below the living wage



Source: Bank Negara Malaysia estimates using Household Income and Expenditure Survey 2016, Department of Statistics, Malaysia

Figure 5: Profile of Households in Kuala Lumpur Earning Below and Above the Living Wage

Households earning below the living wage were mostly secondary school graduates with low-to mid-skilled jobs



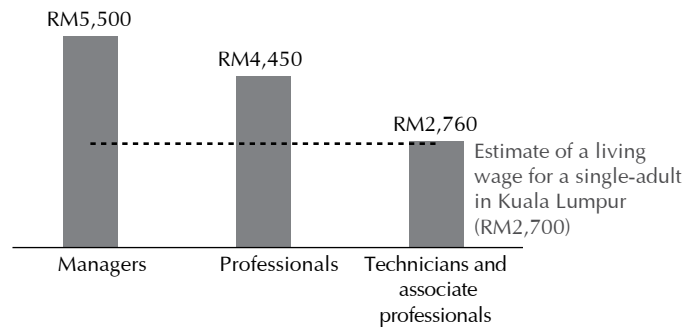
Note: Occupations are categorised by skill level according to the Malaysia Standard Classification of Occupations 2013 (MASCO 2013). High-skilled occupations include managers, professionals, and technicians and associate professionals; mid-skilled occupations include clerical support workers, service and sales workers, skilled agricultural, forestry, livestock and fishery workers, craft and related trades workers, and plant and machine-operators and assemblers; and low-skilled occupations include elementary occupations.

Source: Bank Negara Malaysia estimates using Household Income and Expenditure Survey 2016, Department of Statistics, Malaysia



**Figure 6: Median Monthly Salaries and Wages in 2016 for High-Skilled Occupations in Malaysia**

The median monthly salaries for high-skilled occupations are higher than the living wage estimate for a single-adult household in Kuala Lumpur



Source: Salaries & Wages Survey Report Malaysia 2016, Department of Statistics, Malaysia

## International experiences in operationalising a living wage

Contemporary living wage movements are often spearheaded by civil society organisations, consisting of unions, community- and faith-based groups, academics, and employers (Heery, Hann and Nash, 2017). They are also often the ones undertaking the estimation of the living wage rate. Formal institutions may also oversee the estimation, as in the case of Europe, where the European Commission funded a project to develop estimates of reference budgets that are necessary to reach an acceptable standard of living<sup>10</sup>.

In Canada, New Zealand, and the UK, civil society organisations play an active role in advocating public and large private employers to voluntarily pay living wages in return for accreditation, which could be in the form of a plaque, the Living Wage trademark, or a listing of the company's name on the Living Wage website. In the US, the living wage was initiated by the public sector, with ordinances being passed in more than 140 cities and counties, aimed at

employees of private businesses that have service contracts with the local governments. Thus, the living wage does not cover low-income workers who are not under the jurisdiction of living wage ordinances. However, the enforcement of living wage ordinances in the US has arguably been weak (Luce, 2004)<sup>11</sup>. In some cities, the ordinances were eventually repealed (Holzer, 2008)<sup>12</sup>. Like the US, several local governments in South Korea have also established the living wage ordinance for its employees and workers of organisations that are funded by the local governments. While there have been efforts to estimate a living wage especially in the cities, the push for a living wage for private sector employees in Asia has not been as prevalent as in Canada, New Zealand, and the UK<sup>13</sup>.

## Macroeconomic and distributional impact of a living wage

Unlike a minimum wage, the living wage is not widely implemented and has mainly been confined to a few advanced economies. Empirical studies based on US cities<sup>14</sup> found that paying a

<sup>10</sup>Further information is available on the European Reference Budgets Network (<http://www.referencebudgets.eu/>).

<sup>11</sup>State and federal laws do not require employers to routinely provide details to the government on hours worked and pay.

<sup>12</sup>For instance, the living wage ordinance in Omaha, Nebraska was rescinded in August 2001 after the election of a new council majority who were committed to repealing the law (Luce, 2004).

<sup>13</sup>Amid the rise in international trade, ethical initiatives in importing countries have led to the promotion of living wage for garment workers in exporting countries in Asia (Hirsch and Valadez, 2017).

<sup>14</sup>Unsuccessful living wage laws in some cities in the US also provide a control group or counterfactual for estimating the effects of living wage laws.

living wage brings benefits for both employees and employers<sup>15</sup>. The impact on employment also appears to be more modest than the theoretical predictions of a binding wage floor<sup>16</sup>.

Nevertheless, it is worth cautioning against broad-brush applications based on the conclusions from these studies. Macroeconomic effects are likely to vary across countries due to differences in labour market characteristics and the prevailing economic environment. Paying a living wage, for example, would be easier during an economic boom, when employers are less compelled to minimise labour costs.

In addition, a living wage could only be effective if it is set at a realistic and sustainable level. It is imperative to carefully derive living wage estimates that balance between ensuring employees can afford a minimum living standard, and the capability of employers to pay wages that commensurate with employees' productivity. Setting a living wage rate that is too high could lead to the risk of employers passing on the additional wage cost to consumers through higher prices of goods and services. Wage pressure on employers could also intensify if high-wage workers insist on maintaining the same wage differential with low-wage workers as before. The benefits of the living wage may be offset if the wage pressure eventually translates to an even faster increase in inflation and cost of living.

Furthermore, the living wage could inadvertently harm the intended beneficiaries in the near term<sup>17</sup>. For instance, employers could respond to the living wage by employing more high-skilled workers at the expense of low-skilled ones, who could be the group of people earning below the living wage, before they could upskill themselves (Hirsch and Valadez, 2017). An environment of strong growth, however, could sustain labour demand and reduce the possibility of labour retrenchment of low-skilled workers.

## The need for corresponding productivity improvements

The possibility of adverse outcomes from the implementation of the living wage underscores the importance of a corresponding increase in productivity and movement towards a high-skilled workforce. Productivity improvements and higher value-added output make paying a living wage more affordable for employers, thereby enabling them to sustain the living wage in the long run. A high-productivity, high value-added economy will promote a supportive environment that could mitigate the risks of retrenchment and labour substitution.

The Malaysian economy faces the challenge of modest productivity growth relative to its peers. Based on data from the International Labour Organization, between 2011 and 2017, Malaysia's growth of GDP per person employed – a measure of labour productivity – is only 1.7%, less than half of the average labour productivity growth in upper-middle income economies (3.8%)<sup>18</sup>. Persistently weak productivity growth risks lower wage growth, which could ultimately hamper the ability of households to afford at least a minimum acceptable living standard.

The move towards productivity-led wage growth relies on wide-ranging support from all parts of the economy. Governments can foster a conducive environment for employers to improve productivity by ensuring the availability of good institutional support, minimal regulation on productive investment activities, and the affordability of training and higher-level education. Employers can train existing employees and provide incentives for them to upgrade their skills. Higher morale and lower turnover rates that come with the living wage could, in turn, set off a virtuous cycle of higher wages, and higher productivity. Employees need to also recognise the importance of self-improvement to achieve a higher wage level that can sustain a minimum acceptable living standard, and take the initiative to upskill.

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<sup>15</sup>See Brenner and Luce (2005), Reich et al. (2003), and Sokol et al. (2006).

<sup>16</sup>See Brenner and Luce (2005), Lester (2011) and London Economics (2009). Theory predicts that a wage floor that exceeds the market wage level will lead to retrenchments. This prediction, however, assumes that all workers are the same and have a fixed productivity, and that employers could only respond by reducing the number of workers. Additionally, the prediction also relies on the assumption that the existing wage level is at the equilibrium. However, if the prevailing wage level is below the equilibrium due to, for instance, labour market imperfections, mandating a higher wage level could lead to more employment.

<sup>17</sup>See for example, Neumark and Adams (2003).

<sup>18</sup>For international comparison, the GDP component of this measure is the GDP that is converted to 2011 constant international dollars using purchasing power parity rates. This estimate of average labour productivity growth in 2011-2017 is close to the average based on the labour productivity data published by the Department of Statistics, Malaysia (2.3%).

## Conclusion

As Malaysia develops into a progressive high-income nation, all segments of society should reap the benefits and not be dislocated in the process. It is thus important that Malaysia overcomes the challenge of modest productivity growth, and strives towards creating high-productivity, high-paying jobs that could afford a minimum acceptable living standard. The living wage can be a tool to potentially inform, challenge, and enhance policies towards that end.

If successfully adopted, the living wage can bring benefits to both employees and employers, with limited negative consequences on the economy. This relies on a few pre-requisites. The living wage estimates have to be representative and reasonable enough to guide employers towards paying fair wages to employees. The living wage also has to be accompanied by greater productivity, and this requires collective effort from employers, employees, civil societies, and the public sector.

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