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Last Published: Thu, Aug 17 2017. 05 27 AM IST

# Having a minimum wage law is a mistake

The proposed wage code Bill, which incorporates a universal minimum wage, will lead to higher unemployment and informalization of the economy

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The proposed wage code Bill is the first serious venture in labour law reform by the current government. Photo: Indranil Bhoumik/Mint

The cabinet recently approved the Code on Wages Bill, which proposes to make minimum wages a statutory right for all citizens. The Bill, which was tabled in Parliament in the monsoon session, proposes a monthly minimum wage to be set across India, which will be binding on all the states. Once it is passed, the states cannot set a minimum wage lower than the one set by the Central government.

The proposed Code on Wages will subsume four extant Acts: the Minimum Wages Act of 1948, the Payment of Wages Act of 1936, the Payment of Bonus Act of 1965 and the Equal Remuneration Act of 1976. The Bill is aimed at reducing disparity in minimum wages across geographical regions and sectors.

Enacting labour reforms is always a herculean task and successive governments have shied away from it. Even the great wave of liberalization of 1991 did not include any factor market reforms. The proposed wage code Bill is the first serious venture in labour law reform by the current government. However, the amalgamation of the complex and convoluted labour laws, which is always a step in the right direction, got unfortunately tangled up with a universal minimum wage. This is bound to have negative consequences for employees, businesses and the economy in general.

Though the actual minimum wage is yet to be set by the Central government, there are indications that it will be significantly higher than the current wage rate. This will invariably result in either retrenchment of employees or a significant slowdown in new hiring or both. Economic theory suggests that a price floor, such as a minimum wage, which mandates how low a price can be set, always results in excess supply of that good or service. Several studies conducted across the world corroborate this key insight and show that minimum wages actually lead to higher unemployment in the economy. Seminal work by Nobel Prize winning economist George Stigler concludes that a minimum wage does not satisfy its original intentions—elimination of poverty—and will tend to increase unemployment and reduce family income.

Evidence from a more recent study in a National Bureau of Economic Research paper shows that a minimum wage increase from $11

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The Bill recognizes that a universal minimum wage across India and across different sectors does not work and proposes that the minimum wage set can be augmented based on the skill required, the arduousness of the work assigned to the worker, geographical location of the place of work and other factors which the appropriate government considers necessary. The fixing of the wages and revisions henceforth will be done by setting up "any number of committees and sub-committees" as deemed necessary by the government.

It is appreciable that the Bill recognizes differences in geographical locations and nature of work, but allowing for such variations on a case-by-case basis can lead to lobbying. The recent experience of the Goods and Services Tax Council, where many industries lobbied for lower tax rates, should be indicative of the lobbying possibility for setting lower minimum wages.

Economic theory and evidence also suggest that a price control of any sort will lead to the creation or expansion of the underground or black market. In the labour market, this would mean that companies will prefer to hire contractual labour or keep a majority of their workforce in the informal sector so as to avoid paying the new minimum wage. The Bill does mention that the new national minimum wage is applicable to both the organized as well as the unorganized sector. However, implementation of minimum wages for the unorganized sector has always been problematic and the Bill does not specify any details of how it proposes to fix the implementation gaps. A 2012 paper by Shanthi Nataraj, Francisco Perez-Arce, Sinduja Srinivasan and Krishna B. Kumar, "What is the Impact of Labour Market Regulation on Employment in LICs?", warns us that a 10% increase in the minimum wage would reduce formal employment by 0.8% and increase employment in the informal sectors. Both of these effects go against the stated objectives of the current government and the popular narrative that it is shaping regarding job creation, formalization of the economy, and increasing the ease of doing business.

The fear of automation has not gripped developing economies like India yet, but is looming large in the background. Transport minister Nitin Gadkari's emphatic statement on disallowing driverless cars indicates that it figures in the background of the government's thinking. It is crucial, then, to highlight the possibility of accelerated automation as a result of higher minimum wages. Companies would replace labourers, who are now more expensive, with machines that are more efficient and less expensive in the long run. With regard to the minimum wage increase in Seattle, *Forbes* reported that many retail outlets like Wal-Mart Stores Inc. replaced cashiers with self-checkout machines and restaurant chains like McDonald's Corp. replaced cashiers with apps and ordering kiosks.

Uniquely, in a labour-abundant economy like India, companies are already known for their preference for capital-intensive production. A 2013 paper in the *Indian Growth And Development Review* ("What Explains the High Capital Intensity off Indian Manufacturing?" by Rana Hasan, Devashish Mitra and Asha Sundaram) finds that India uses more capital-intensive techniques of production in manufacturing than countries at similar levels of development and with similar factor endowments, including China and even the US, which is a capital-abundant country. A higher minimum wage will skew the labour-capital ratio further.

The proposed hike in minimum wages is an obvious attempt on the part of the government to be seen as pro-poor and employee-friendly. But if the government really wants to help both the current crop and the future generation of employees, it should solely focus on easing labour laws, facilitating formalization of the economy, and focus on reducing regulatory hurdles for businesses.

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**First Published: Thu, Aug 17 2017. 04 34 AM IST**

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