

## *What determines wage?*

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The determinants of labor supply and demand are the following:

1. Labor supply: mainly determined by population growth and migration; ie, as population growth and/or migration increases, labor supply increases.
2. Labor demand: mainly determined by the size and growth of the economy; ie, more economic growth, more business activities, more jobs created. Also, the level of skills, educational training, of the workforce.

And there are two types of wages:

1. Market-determined or equilibrium wage: the level of wage where supply meets demand in a given skills level; and
2. Government-mandated minimum wage; very often, this is above the market-determined wage for the unskilled workers.

Why the difference between the two, there are three main schools of thought here:

1. Wage is a function of the cost of living of a family: A family of six would need xxx Pesos or yyy \$ per day or per month; hence, this should be the minimum wage. The minimum wage is the level that even the most unskilled worker must receive.
2. Wage is a function of increases in the price of commodities (inflation rate): The consumer price index (CPI) has moved up from xx to yy points over the last nn years; hence, wages must increase by a proportionate rate, if not higher.
3. Wage is a function of productivity: Whether the worker is single or has 10 children, or inflation rate has increased by 1% or 20% per year on average, if productivity has not increased, wages cannot increase. Otherwise, the company will close shop and workers will be jobless.

The philosophy of government setting minimum wage and the succeeding legislation and tripartite contracts are supposed to protect workers from underpayment and exploitation by their employers. The goal of worker protection is good and laudable, except that the means, minimum wage-setting by government, depresses the dynamism of the labor market.

Setting a government-mandated minimum wage way above the expected productivity of unskilled people, if strictly and rigidly implemented, will result in those unskilled people being hired by no one except the charity-oriented organizations and individuals. If the number of the unskilled people are much plentier than what charity people and organizations can absorb and employ, then the rest of those unskilled people will go hungry. In short, minimum wage and

related laws protect only those who already have jobs, but discriminate the unskilled who are not employed yet.

That minimum wage should be xxx \$ (or Pesos or other currencies) per hour, per day, per month, because that is what a family of five members (couple + 3 children) will need to live decently, regardless of the skills of the worker, will again work against the unskilled. There will be temptation and incentives for employers to hire only unmarried people, or married but have no kids yet (or have only 1 or 2 kids) so that the “needs of family of five” argument will not apply to the workers in negotiating for wage adjustments. And those unskilled workers who have plenty of children will be condemned to perennial joblessness, perpetuating further that family’s poverty.

Indexing wages to inflation rate is also inadvisable. Inflation rate can climb fast for a hundred reasons, like high interest rates due to government over-borrowing to finance the budget deficit; damage to crops or roads from farms to markets due to natural disasters (strong typhoons, hurricanes, floods, earthquake, volcanic eruption) or plain sabotage; hike in transportation cost due to world oil price increases, and so on.

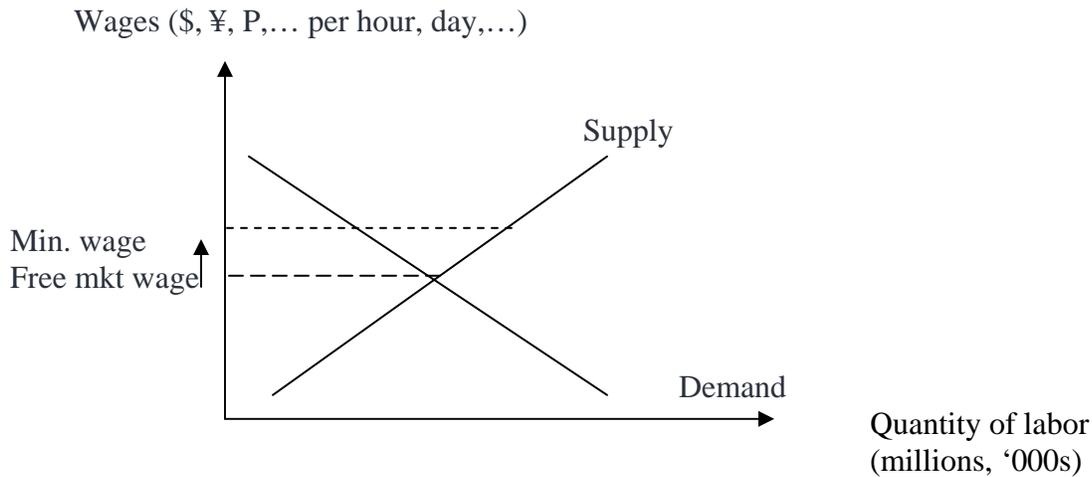
By forcing wages artificially high through government-mandated minimum wage, or by sabotaging certain infrastructures or markets so that inflation rate will rise, and if productivity does not rise by corresponding amount, then certain companies and businesses may be forced to stop additional hiring, or lay off some workers, or just close shop, even temporarily.

Wage is a function of, is determined by, a worker’s skills and productivity. It is not a function of the number of children that a worker has, nor is it a function of the change in consumer prices (or inflation rate). Because if this were so, then workers can have 4, 8, a dozen children, and pressure the state to pressure the businessmen and employers to increase their pay because their needs to live decently, from food to clothing to medicines, have increased. In a situation of many poor economies like the Philippines where labor supply always exceeds labor demand every year because of fast population growth, the army of the unemployed will keep increasing and poverty incidence will keep expanding.

To further see these points, the following graphs will help. Supply of labor (or tomatoes or hamburgers or other goods and services) is upward-sloping; meaning as wage or price goes higher, more will be supplied. Demand for labor (or staplers or haircut or other goods and services) is downward-sloping; meaning as wage or price goes up, less will be demanded; and as wage or price goes down, more will be demanded.

We start with the market for unskilled labor. The skilled labor always have wages higher than government-mandated minimum wage because skilled laborers can easily walk out if the offered salary is lower than what they think they deserve.

Chart 1. Determining the wage for unskilled labor

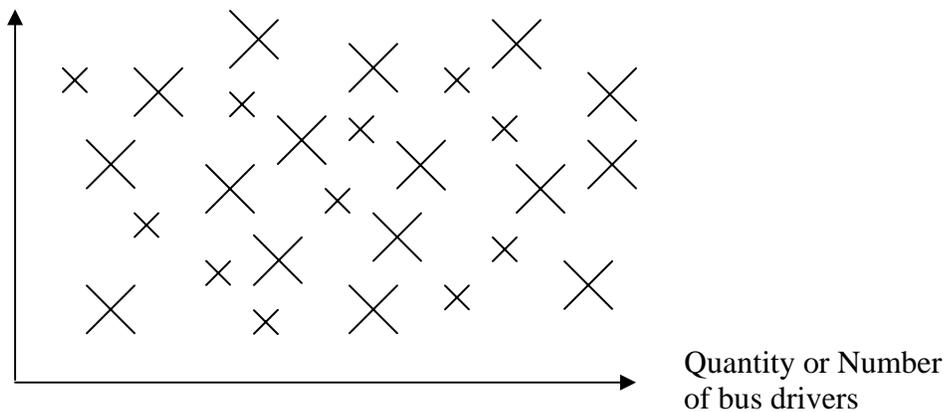


It is possible, and it is happening, that you can have numerous and endless equilibrium wages for numerous type of labor supplied and demanded: for domestic helpers (rich, middle class, poor households), construction workers, agricultural workers, aquaculture workers, hotel and restaurant workers, transpo workers (airlines, shipping lines, bus lines, taxi lines, vans, etc.), scientists, engineers, chemists, lawyers, economists, etc.

Even in a single occupation or type of work, say bus driver, at any given time, there are dozens, if not hundreds, of market-determined (or equilibrium) wages for bus drivers among many bus lines in a particular country. And within the same bus company, there are varying rates or wages among drivers: the most experienced, most courteous, and most careful drivers, get higher pay than the less experienced, less courteous, and less careful ones. Thus, you will have a situation like this for the different bus companies:

Chart 2: Different combinations of supply-demand for each driver category

Wages for bus drivers (\$, P,... per hour, per day,...)  
at any given month or year



One alternative that should be made more available, more achievable, for many workers and ordinary employees, is to become start-up entrepreneurs, to become employers themselves someday, at least for themselves and their 1 or 2 employee/s. Yes, people should not aspire to become "employee forever". Unless their company or organization keeps expanding so that they are assured of continued career mobility until they retire, workers should dream of becoming "their own boss" someday. This will put them on the same situation as their former employers, and this will temper them from making unreasonable demands that are beyond the capacity of employers to be granted. Conversely, if employers know that their current hard-working employees will leave them soon to put up their own start-up enterprises, they will be forced to give good pay and benefits to encourage said self-driven employees to stay in their companies.

## **Rigid labor laws and "employee forever"**

Rigid labor laws, or laws that overly protect workers against possible "capitalist exploitation" is rooted in socialist thinking and philosophy. Since workers own no means of production but only their labor and talent, then they should be protected by the state. Among the known rigid labor laws applied in many countries, in highly welfarist western European countries especially, are (a) high minimum wages (even the most unskilled workers should receive this salary); (b) security of tenure, protection from dismissal and lay-off (even if the employee is displaying laziness and declining productivity, or even if the company is losing money); (c) long mandatory leaves with pay (vacation leave, maternity leave, generous sick leave, etc.); (d) expensive separation pay and retirement benefits; and (e) very high taxes, both personal and corporate income taxes, partly to pay for generous unemployment allowances for the jobless. In short, a policy of "expensive to hire and retire, difficult to fire".

One clear and explicit result of rigid labor laws of a country is high unemployment and high underemployment. Many people, the socialist-leaning groups especially, do not consider this as result of rigid labor laws, but as additional reason to make the laws more rigid and more "pro-labor". That is, since unemployment is already high, the more that the government should protect workers from being laid off.

But taking the other side of the issue, one big reason why unemployment is high is because many employers would rather (a) put up their plants and offices in other countries where labor laws are more liberal; or (b) hire temporary and contractual workers or job trainees than hire regular, full-time employees considering the high wages, high separation pay, and difficulty of firing or laying workers off.

Another impact of "expensive to hire, difficult to fire" policy is that many employees are encouraged to become "employee forever" and entrepreneurial spirit is discouraged among them. If the laws are stacked against being a businessman and entrepreneur, and in favor of employees, why be an employer? Why not aspire to become an employee forever and enjoy the benefits of "pro-labor" leaves-with-pay, and generous separation and retirement benefits?

The current labor and student unrest in France is a classic example of the inherent problem and contradictions of rigid labor laws and encouraging "employee forever" mentality. With a 10%

average unemployment rate for the past 3 decades, and unemployment rate among younger people at 20-25%, many French businessmen and entrepreneurs have gotten bolder in asking for a more liberal labor laws, a move that the currently employed and protected workers, and the young people aspiring to enter the protected labor market, oppose. The entrepreneurs want leeway and power to fire younger workers who have been employed for 2 years or less without justifying themselves to the government courts for doing so; the students and labor unions oppose the law and want full protection and security of tenure for young workers (again, even if the employees are displaying laziness and flat or declining productivity, or even if the company is not earning enough). Latest news as of this writing is that the student and labor union march in Paris and other parts of France has turned violent, with many shops ransacked and looted, many cars burned or destroyed, and many demonstrators and policemen injured.

When faced with situations like this, better ask ourselves questions like which is better:

- (i) a high-paying, fully-protected job but is hardly available, or a "low-paying", unprotected job but is easily available?
- (ii) hard to be fired but difficult to be hired, or easy to be fired but also easy to be hired? And
- (iii) government-protected and over-taxed employee forever, or self-protected and low-taxed entrepreneur someday?

The labor laws that workers demand to protect themselves from "capitalist exploitation" will be the same laws that will prevent them and their children from being easily hired someday, or to become self-reliant entrepreneurs and businessmen and women someday.