NOTE

A Framework for Minimum Wage Policies*

Principles and applications

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This note is intended to help ILO constituents develop a more effective policy framework for minimum wages by outlining key principles for minimum wages setting and discussing how these principles can be applied, taking into account its specific circumstances. The purpose of this note is to facilitate social dialogue on minimum wages policies, and it should be not be considered as presenting the ILO’s official view on this important subject matter.

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1. Guiding principles for effective minimum wage policies

The principles concerning the key aspects of minimum wage fixing are provided in ILO’s Minimum Wage Fixing Convention No. 131, 1970 and further specific guidance is outlined in its accompanying Recommendation (Minimum Wage Fixing Recommendation No. 135, 1970). Each of these principles is explained below in detail, and relevant paragraphs are quoted (in text boxes) from R 135 for easy reference.

Certainly, it is sometimes challenging to find out the effective ways of implementing these principles in a coherent manner. In fact there are large variations across countries in the system of minimum wages which inevitably reflect country-specific circumstances. However, there appears to be the overall guiding principles which have universal applicability in developing effective minimum wages policies.

1.1 Secure both internal and external coherence in minimum wages policies

In order to be effective, minimum wage policies should be coherent internally. As will be explained below, it is essential to have consistency between purposes, criteria, institutional setup, and implementation (see Figure 1). More specifically, the criteria used for fixing minimum wages should be in line with the goals that minimum wages are intended to achieve. For instance, the system would suffer from incoherence if the lowest-paid workers are the policy target but decisions are mainly based on “median” workers without a proper representation of low-paid workers in the minimum wage fixing body.

Figure 1. Minimum wages policies: Internal and external coherence

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In addition, minimum wage policies should be consistent with other policies, particularly social security policies and collective bargaining. The importance of securing this external coherence appears to be growing for a number of reasons, including: (1) in some cases, minimum wages are set lower than unemployment benefit (and other income transfer), which effectively reduces incentive for work (e.g., Japan); (2) in some other cases, minimum wages have the unintended consequences of discouraging (even replacing) collective wage bargaining (e.g., the Philippines); (3) Minimum wages are often used for determining social benefits and public sector pay, which keeps minimum wages “too low” and make their adjustments “too difficult” (e.g., Vietnam).
1.2 Keep the minimum wage system simple and manageable

In many countries, too much importance is attached to minimum wages and it is sometimes the case that minimum wages provide the only forum in which meaningful social dialogue takes place. While such recognition of minimum wages as “an effective instrument of social protection” (R 135) is certainly a positive development, this often leads to the development of a complex, sophisticated system with a large number of minimum wage rates.

Complexity per se is not a bad thing, but it is important to make sure that the level of complexity should be manageable. For instance, a more complex system requires more sophisticated statistics and analysis, a stronger system of social dialogue and consultation, and an advanced administrative capacity. Other facilitating environments are also essential.

In addition, complexity does not necessarily increase effectiveness, and simplicity does not mean a weak system. In fact, if the *aspired* level of complexity is not manageable, it may risk the proper function of minimum wages, with the paradoxical result that minimum wages cease to be considered seriously. Complexity can also increase difficulties in enforcements. Sometimes, minimum wage fixing bodies struggle with determining which rate of minimum wages should be applied to which types of workers, while workers remain confused over (or unaware of) which rate they are entitled to.

1.3 Extend the coverage to include the most vulnerable groups of workers

The primary goal of minimum wages is to protect vulnerable workers by setting a wage floor. Therefore, whenever possible, efforts should be made to maximize the coverage of minimum wages to include the most vulnerable groups of workers. In recent years, there has been growing interest in how to make “nonstandard” workers (including domestic workers and part-time workers) benefit from minimum wages.

1.4 Ensure that social benefits and public sector pay, whenever possible, are disconnected from the level of minimum wages

As will be discussed below in detail, it is often the case that minimum wages are “overburdened” with a broad range of policy goals, and their effectiveness suffers. Thus, as noted earlier, the goals of minimum wage policies should be specified in ways that make the system simple and manageable. In this regard, attempts to link minimum wages to social benefits and public sector pay need to be discouraged. While it is reasonable that the level of minimum wages is considered as one of the factors which determine social benefits and public sector pay, the use of minimum wages as a sole basis for these benefits or pay should be avoided.

1.5 Determine minimum wages based on sound statistics and analysis (evidence-based approach), and if possible, establish a technical body which provides reliable data and analysis for social dialogue and policy decisions

The process of determining minimum wages is inevitably “political”, involving a series of consultations and compromises. However, in order to make minimum wages effective, this “political” process should be based on relevant, reliable statistics and analysis. Without a
common understanding of basic data and situation analysis, negotiations on minimum wages would be more difficult and unnecessarily politicized. To ensure the reliability of data collection and analysis, an independent technical body which assists the minimum-wage fixing body by undertaking this task could be established (for details, see Section 6 on minimum-wage fixing machinery).

2. Determining purposes and target groups

2.1 Policy goals and their implications: the question of coherence

Effective minimum wages policies begin with a clear understanding of the purposes of minimum wages and the successful identification of target groups. This sounds very basic, but surprisingly, it is not difficult to find countries who fail in basics. In fact, the goals attached to minimum wages in practice are unclear, two broad and ambitious. The goals which are commonly found include:

- To protect the most vulnerable workers (lowest paid workers)
- To reduce poverty (working poor)
- To reduce wage/income inequality
- To be used as a basis for wage bargaining

All of these are certainly important policy goals, but it is important to remember that these goals are often difficult to achieve simultaneously due to the potential tensions between them. Indeed, depending on priority goals of minimum wages, target groups will be different and, as a result, the level of minimum wages will vary. Of course, this has great implications for types and combinations of criteria for minimum wage fixing.

To illustrate this, Figure 2 presents a hypothetical wage distribution with three marked vertical lines which represent bottom 20% (W1), 35% (W2), and 50% (median, W3), respectively. As emphasized, the most fundamental goal of minimum wages is to protect the most vulnerable groups of workers, say bottom 20% wage earners. If this is the only goal, decisions on minimum wages will be based on wage situation for these workers, and the focus will be placed on how to increase wages for workers who are earning less than W1. In this case, the impact of minimum wages on employment and other labour market variables may not be large.
However, if there is strong interest in minimum wages as a tool for reducing wage equality, the level of W1 may not be sufficient to make differences (although W1 has some moderate impacts). In this case, the target group for minimum wages needs to be broadened. For instance, workers earning less than W2 would be the policy target. Thus, as soon as the reduction of wage inequality is prioritized, the level of minimum wages tends to increase. In this case, the impact of minimum wages on the labour market in general (if fully enforced) would be larger and the minimum wage fixing body should be more careful in monitoring such impacts.

If minimum wages provide an important benchmark for wage bargaining, the reference wage tends to be even higher, for instance, at W3 (median wages). In this case, the impacts of minimum wages on employment and prices can be significant, and great care needs to be taken in fixing minimum wages. At the same time, this shift in target groups tends to create problems with enforcement. For instance, the level of minimum wages fixed in this way is seen as “too high” for the most vulnerable workers (e.g., earning less than W1) and, as a result, it may not apply to these workers in practice. If this happens, the whole system encounters the paradox that the very groups of workers which need protection most through minimum wages are effectively excluded. In addition, there is the risk that minimum wages reduce incentives for unions and employers to negotiate on wages. In an extreme case (which sometimes happens), this type of minimum wage system could “crowd out” collective bargaining.

2.2 Other policy goals

As the importance of minimum wages is almost universally recognized, other goals are also being added. Two interesting examples are:

- To be used as a basis for determining the level of benefits and public sector pay: When there are not other benchmark figures which command social acceptability, it is not uncommon that minimum wages are used by default as a basis for social benefits and even public sector pay. While this is understandable, the risk is also high. First, such linkage tends to make minimum-wage fixing more difficult, as their impacts are far-reaching. The factors which are not normally considered in fixing minimum wages (such
as fiscal constraints) begin to play an important role, which often put pressures to keep minimum wages at a very low level. This is why many countries have been trying to separate minimum wages from social security system and public sector pay (e.g., Brazil).

- To be used as macroeconomic policy tools. Sometimes, minimum wages are used as an instrument for labour market or economic developments (e.g., attracting investment or skilled workers). This is particularly the case when minimum wages are set differently for different regions. However, this approach would potentially prompt “regional politics” concerning minimum wages, which might risk the stability of the whole minimum wage system. These “regional politics” take the form of *either* “overbidding” minimum wages where each region attempts to attract skilled workers by setting their minimum wages higher than other regions (e.g., China) *or* “underbidding” so as to secure labour-cost advantages and/or attract investments (e.g., India where trade unions demand for the statutory national minimum wages). If this happens, the fundamental goal of protecting vulnerable workers would be compromised.

2.3 Summary

Therefore, the first step toward coherent minimum wages policies should be to clarify the purposes of minimum wages. It should be noted that, while other goals can be added to minimum wages, the minimum wages system be anchored at the most fundamental goal of protecting vulnerable workers (see Box 1). The experiences of other countries show that, as the system becomes more complex and sophisticated, its purposes get ambiguous, which creates tensions within the system.

**Box 1. Purpose of Minimum Wage Fixing (ILO Recommendation No. 135)**

Minimum wage fixing should constitute one element in a policy designed to overcome poverty and to ensure the satisfaction of the needs of all workers and their families.

The fundamental purpose of minimum wage fixing should be to give wage earners necessary social protection as regards minimum permissible levels of wages.

### 3. Criteria for fixing minimum wages

3.1 General principles

The level of minimum wages is determined, following the set of criteria. The criteria which are used around the world are various, but they normally fall into two broad categories: “needs of workers” and “economic factors”. Box 2 provides the list of major criteria which are specified in R 135. Criteria from (a) to (e) are related to “needs of workers” which are essential given the purposes of minimum wages. “Economic factors” are also important in that minimum wages should be basically affordable and should not have significant negative impacts on the labour market and the economy in general.
The need for considering these criteria appears to be universally accepted. Real challenges in practice are what criteria will be selected, how they will be reflected, and more specifically, how much weight will be given to each of the selected criteria.

While the final decisions on criteria are both technical and political (and this is why national practice varies considerably), it is critical to ensure that the criteria used are consistent with the intended goals of minimum wages policies. For instance, given that the most basic goal of minimum wages is to maintain the purchasing power of vulnerable, low-paid workers, top priority should be given to consumer prices. The failure to reflect price changes properly in minimum wages simply mean real wage cut for minimum-wage earners.

**Box 2. Criteria for Determining the Level of Minimum Wages (ILO Recommendation No. 135)**

In determining the level of minimum wages, account should be taken of the following criteria, amongst others:

(a) the needs of workers and their families;
(b) the general level of wages in the country;
(c) the cost of living and changes therein;
(d) social security benefits;
(e) the relative living standards of other social groups;
(f) economic factors, including the requirements of economic development, levels of productivity and the desirability of attaining and maintaining a high level of employment.

3.2 Criteria and formula

However, as wage inequality and other goals relating to collective bargaining are added, other criteria such as GDP growth and wage growth become more important. Social security or income-related criteria can also be considered. Therefore, the minimum-wage fixing body is expected to determine how much each of these criteria will be reflected in order to achieve the goals. As expected, a more complex system with multiple policy goals tends to confront a more complex formula for minimum-wage fixing.

For an illustration, a hypothetical formula for minimum-wage fixing is presented below. The basic (but not-always-easy) task for a minimum-wage fixing body is to fully reflect price changes, which means $\alpha=1$. The affordability of such increases can be measured by changes in GDP (real term). By making $\beta$ positive, the fixing body may want minimum wage growth to be constrained during the period of economic contraction or to exceed price changes during the period of economic growth. The question is then how to determine the exact size of $\beta$. Moreover, if minimum wages play a critical role in collective bargaining, the fixing body tends to reflect $\gamma$ more actively (e.g., $\gamma$ is high). In practice, the formula is far more complex than this example, as many other factors (e.g., changes in national poverty line and social benefits) are also considered.
Criteria and formula for minimum-wage fixing: an illustration

\[ MW_t = MW_{t-1} + \alpha \text{(CPI)} + \beta \text{(GDP growth)} + \gamma \text{ (average wage growth)} + \delta \text{ (others)} \]

(MW\(_t\) and MW\(_{t-1}\) are the levels of minimum wages for years \(t\) and \(t-1\) respectively; CPI refers to consumer prices inflation; both GDP and wages are in real term)

As mentioned, the process of selecting and determining criteria and coefficients is not only technically grounded and consistent but also politically sound. Technical soundness and consistence matters in that the final decision should be based on the thorough evaluations of the expected impacts of different sets of criteria and coefficients on wages, employment and other labour market variables. Political soundness also matter greatly, because, at the end of the day, the decisions should be made through consultation/agreements between the government and the social partners.

4. Institutional framework (I): types of minimum wages

4.1 Types of minimum wages

Along with clear/realistic purposes and relevant criteria (and formula), decisions should be made on what types of minimum wages will be introduced. Here again, different possibilities exist, which are recognized in the international standards on minimum wages (see Box 3).

**Box 3. Types of minimum wages (ILO Recommendation 135)**

The system of minimum wages may be applied ... either by fixing a single minimum wage of general application or by fixing a series of minimum wages applying to particular groups of workers.

A system based on a single minimum wage--
- need not be incompatible with the fixing of different rates of minimum wages in different regions or zones with a view to allowing for differences in costs of living;
- should not impair the effects of decisions, past or future, fixing minimum wages higher than the general minimum for particular groups of workers.

Therefore, it is not surprising that national practices vary considerably. They include

- A single minimum wages with a universal coverage
- Multiples rates by region
- Multiple rates by sector
- Multiple rates by occupation
- Other variations according to demographic characteristics (e.g., age)

4.2 Conditions for multiplicity of minimum wages
Here again, the final decisions on types of minimum wages should be consistent with their intended goals. In other words, the decisions should be made in ways of achieving these goals in the most effective way. For instance, when variations in consumer prices are significant, a single-minimum wage system (typically, based on the national average prices) may not be effective in protecting the purchasing power of minimum-wage earners. In this case, regional minimum wages would be considered. Sectoral (and often, occupational) minimum wages tend to have a strong linkage to collective bargaining on wages. If minimum-wage earners concentrate on certain occupations with unique characteristics (e.g., domestic workers), occupation-based minimum wages could be introduced.

Whenever multiple rates are introduced, great care needs to be taken: (1) they should be grounded and justifiable; (2) the scope of application of each rate should be clearly defined in order to avoid confusions in implementation; (3) as emphasized earlier, a more complex system with multiple layers of minimum wages requires stronger technical and institutional capacities. If these conditions are not met, the well-intended system might be not working properly, sometimes ending up generating further confusions and tensions.

5. Institutional framework (II): frequency of adjustments

Another important principle is that minimum wages should be adjusted regularly: otherwise, minimum-wage earners would suffer from increases in consumer prices or would be left out of economic growth (and the resulting change in “basic needs”). As Box 4 shows, the overall guidance would be:

- The frequency of adjustments depends on the scale of changes in living costs and other related economic changes
- Decision should be guided by relevant surveys and statistic
- *Ad hoc* or random adjustments (especially, “political” reasons) should be avoided

Box 4. Adjustment of Minimum Wages (ILO Recommendation No. 135)

Minimum wage rates should be adjusted from time to time to take account of changes in the cost of living and other economic conditions.

To this end a review might be carried out of minimum wage rates in relation to the cost of living and other economic conditions either at regular intervals or whenever such a review is considered appropriate in the light of variations in a cost-of-living index.

In order to assist … [adjustment of minimum wages]..., periodical surveys of national economic conditions, including trends in income per head, in productivity and in employment, unemployment and underemployment, should be made to the extent that national resources permit.

The frequency of such surveys should be determined in the light of national conditions.
6. Institutional framework (III): minimum wage fixing machinery

All of these issues discussed so far need to be addressed through a minimum-wage fixing body. The basic principles of the forms and roles of such body are provided in the relevant ILO standards (see Box 5).

**Box 5. Minimum Wage Fixing Machinery (ILO Recommendation No. 135)**

The minimum wage fixing machinery … may take a variety of forms, such as the fixing of minimum wages by--
(a) statute;  
(b) decisions of the competent authority, with or without formal provision for taking account of recommendations from other bodies;  
(c) decisions of wages boards or councils;  
(d) industrial or labour courts or tribunals; or  
(e) giving the force of law to provisions of collective agreements.

The consultation … should include, in particular, consultation in regard to the following matters:  
(a) the selection and application of the criteria for determining the level of minimum wages;  
(b) the rate or rates of minimum wages to be fixed;  
(c) the adjustment from time to time of the rate or rates of minimum wages;  
(d) problems encountered in the enforcement of minimum wage legislation;  
(e) the collection of data and the carrying out of studies for the information of minimum wage fixing authorities.

To the extent possible in national circumstances, sufficient resources should be devoted to the collection of statistics and other data needed for analytical studies of the relevant economic factors, particularly those mentioned in [relation to the criteria for determining the level of minimum wages]

7. Institutional framework (IV): implementation and enforcement

7.1 General principle

It is observed in many countries that the focus is placed on fixing the level of minimum wages, while there is no comparable effort to apply them to workers in practice. It goes without saying that ambitious increases in minimum wages would have no meaning for workers, if they are not enforced. Thus, enforcements are as important as fixing minimum wages. Major elements of minimum-wage enforcement are provided in the relevant ILO standards (see Box 6).

**Box 6. Enforcement (ILO Recommendation No. 135)**

Measures to ensure the effective application of all provisions relating to minimum wages … should include the following:  
(a) arrangements for giving publicity to minimum wage provisions in languages or dialects understood by workers who need protection, adapted where necessary to the needs of illiterate persons;  
(b) the employment of a sufficient number of adequately trained inspectors equipped with the powers and facilities necessary to carry out their duties;
(c) adequate penalties for infringement of the provisions relating to minimum wages;
(d) simplification of legal provisions and procedures, and other appropriate means of enabling
workers effectively to exercise their rights under minimum wage provisions, including the right to
recover amounts by which they may have been underpaid;
(e) the association of employers’ and workers’ organisations in efforts to protect workers against
abuses;
(f) adequate protection of workers against victimisation.

7.2  Two types of approaches: sanction versus incentive

A wide range of options are available in developing an effective enforcement system. They
are largely classified into two groups which are complementary to each other:

• Sanction-based: The companies which are found violating the relevant law can be
punished by imposing fine or other measures. The role of labour inspectors is critical in
this regard. To make this approach effective, the level of punishment is high enough to
discourage companies from violating the law. Sometimes, punishment is rather moderate
so that companies prefer being punished to paying minimum wages to workers.

• Incentive-based: Alternatively, companies are encouraged to comply with the law
through proper incentive schemes. For instance, companies in financial difficulties
(which are unlikely to comply) can be offered reduction in social contributions (or other
forms of subsidies or assistance) in return for full compliance.

It is known that sanction-based approach alone may not effective and that it needs to be
combined with incentive approaches.

7.3  Creating basic elements of effective enforcement systems

In developing countries, more challenging issues are related to the lack of basic elements of
enforcement mechanism:

• Poor awareness of current minimum wages among workers and employers is the main
obstacle to their effective enforcement. Improved awareness should always be the first
step to be taken in improving enforcements. Levels of awareness tend to be decreasing,
as the system introduces layers of different minimum wages. Thus, a more complex
system needs much more intensive effort to increase awareness.

• Difficulties can further increase in the massive presence of informal economy. Some
challenging mechanisms through which minimum wages can influence informal
economy should be developed.

• Limited capacity of labour administration (e.g., labour inspection) should be addressed in
order to make the existing policies credible. .

• Other alternative mechanisms such as civil society organizations could be widely utilized
in reducing enforcement gaps (e.g., awareness raising)
ANNEX

DESIGNING COHERENT WAGE POLICIES

(FROM GLOBAL WAGE REPORT 2008/9, pp. 47-53)

Full text is available from: