Minimum Wage Laws in Malaysia: An Answer to the Increasing Rate of Unemployment

Kaviyarasu Elangkovan
Department of Economics, Faculty of Economics and Management, Universiti Putra Malaysia

Abstract
This study aims to study the perspective of the minimum wage laws gazette by the government of Malaysia besides explaining their underlying incentive structure. Workers in Malaysia celebrate Labour Day knowing the minimum wage that will be paid to workers in the private sector, which will be RM900 per month for employees in the Peninsula and RM800 for those in Sabah, Sarawak and the Federal Territory of Labuan.

Prime Minister Datuk Seri Najib Tun Abdul Razak when revealing details of the minimum wage on 30 April 2012, said it complements the National Transformation Policy that is meant to drive Malaysia towards becoming a high-income nation. With some exceptions, this will be implemented in six months after the Minimum Wages Order is gazetted. Finally, Malaysia will have a minimum wage policy in place. However, the minimum wage policy is not a guarantee of better things to come. It has to be matched with hard work, innovation and vigilance. Labour productivity has to improve consistently across the board. Employers had, naturally, been lukewarm about Malaysia having a minimum wage policy. But the sooner the employers understand the overall benefits of minimum wages, the better. Malaysia cannot be a develop nation if a significant portion of its workers have salaries that keep their household income below the poverty line. A high-income economy does not rely on low-cost labour to speed up progress. Instead, it is prompted by ideas and value enhancement. This research was done to explore how the government started of the minimum wage law policy and how the market conditions favor these policies. Several data were obtained from the Ministry Of Finance to make an inference whether the policy either helps or hurt the workers. Some of the response from the people was positive while some shows great concern over the minimum wage laws especially on the increase of unemployment rate.

Keywords: Minimum, Wages, Employment, Income, Expenses

Background Of the Study
A minimum wage is defined through lowest hourly, daily or monthly remuneration that employers legally pay to workers. It is the lowest wage at which workers may sell their labor. In the past several years, there were many differences of opinion that exists about the benefits and disadvantages of setting a minimum wage although minimum wage laws are seen effective in many cases. Some of the people support the minimum wage laws as it increases the standard living of workers, reduces poverty, and making the business more efficient. In the other hand,
the minimum wage laws was opposed by some of the peoples claiming that if it is high enough to be effective, why does it increases unemployment, particularly among workers with very low productivity due to inexperience or handicap, thereby harming less skilled workers and possibly excluding some groups from the labor market besides it is less effective and more damaging to businesses than other methods of reducing poverty.

The public policy is allegedly based on the implication of the economic theory proposed by the economist. Unfortunately, the economic analysis of government policy is often abided for the political reasons. Such a great example would definitely be the minimum wage laws gazette by the government of Malaysia. In Malaysia, every politician wanted to decrease the double-digit teenage unemployment by setting the minimum wage laws. But, when economist claims the it may cause a regretful outcome, their voice is not heard by the politicians in Malaysia. It is undoubtful that the politicians will pay their attention to economist’s advice in framing out the economic policies but such advices will not stay too long when it conflicts with the political reality of winning votes.

According to the National Wage Consultative Council (2012), the government has set a minimum wage of RM900/month for Peninsular Malaysia and RM800/month for Sabah, Sarawak and Labuan. This will benefit 3.2m private sector workers (25.8% of total employment) other than those in domestic services. The minimum wage will take effect six months from the date of the Minimum Wages Order is gazetted. Small firms with no more than five workers will be allowed to defer it for a further six months.

Lee Heng Guie (2011) stated the RM900 minimum wage is 49.9% of the national mean wage of RM1,804.43 in 2010. In setting the minimum wage, the government took into account social and economic considerations: cost of living, productivity, competitiveness and employment. In Malaysia, almost 33.8% of about 1.3m private sector workers still earned less than RM700/month in 2009, well below the RM800/month that is considered the poverty line. Wages have been lagging behind productivity growth, rising 2.6% p.a. versus productivity growth of 6.7% p.a. over the past decade. The new wage rate will have a bigger impact in Sabah (RM800 vs. the current average salary of RM577), followed by Sarawak (RM800 vs. an average of RM758). For Peninsular Malaysia, the new rate of RM900 is 20.4% below the current average salary of RM1,131.

Arguably, the higher wage will have a net positive impact on the economy as any potential small loss of jobs will be more than covered by its multiplier effect as it puts more money in the hands of workers, thereby releasing pent-up consumption, albeit with some inflationary impact. There is strong empirical evidence that countries which implement a minimum wage tend to see a positive wage effect and a small negative employment effect among workers covered by the minimum wage legislation.
Minimum Wages for Peninsular, Sabah, and Sarawak (RM/month)

<table>
<thead>
<tr>
<th>State</th>
<th>Minimum wage</th>
<th>Current average salary</th>
<th>2010 mean wage</th>
<th>2009 poverty line income</th>
</tr>
</thead>
<tbody>
<tr>
<td>Peninsular</td>
<td>900.00</td>
<td>1131.00</td>
<td>1739.16</td>
<td>763.00</td>
</tr>
<tr>
<td>Sabah</td>
<td>800.00</td>
<td>577.00</td>
<td>1565.93</td>
<td>1048.00</td>
</tr>
<tr>
<td>Sarawak</td>
<td>800.00</td>
<td>758.00</td>
<td>1630.48</td>
<td>912.00</td>
</tr>
</tbody>
</table>

Source: Ministry Of Human Resources

Research on Minimum Wage Laws

We focus our attention on this more recent literature, which has become known as the “new minimum wage research.” Because the earlier literature on the employment effects of the minimum wage was carefully and extensively summarized by BGK, it seems unnecessary to repeat that review in this monograph. In contrast, there is no comprehensive review of the extensive literature that has emerged over the past 15 years. We thus begin our review with how the government of Malaysia started the new minimum wage policy. Next, we bring up some issues on how the market conditions favors the government policy. Thus, we review that the advantages of the minimum wage policies gazette by the government. We also identify the economic impact such as the small negative employment rate and investment impact.

Our intent in reviewing this literature is threefold. First, most of the political debate surrounding proposed changes in the minimum wage concerns the potential effects on employment. Although we do not view that focus as entirely appropriate, the fact that the employment question takes on such importance means that the answers should be based on a comprehensive survey of the literature, recognizing that minimum wage effects may differ across different segments of the population and in different economic circumstances and contexts. We therefore attempt to draw general conclusions about the effects of the minimum wage on employment that are relevant to policymakers, pointing out, in particular, in what context and for which workers the minimum wage will have consequences.

Second, we hope that our review will help readers assess alternative models of the labor market. The recent literature has reopened the debate about the appropriate theoretical description of the low age labor market, with some of the empirical research characterized as rejecting the competitive model in favor of other formulations. As we note throughout the monograph, economic theory often fails to make an unambiguous prediction about the employment effects of minimum wages.

Even in the neoclassical model, the effect of the minimum wage on any given set of workers will depend on, among other things, the elasticities of substitution across different types of workers and crosselasticities of demand across different types of goods. However, some empirical
tendencies tend to match up better with one model or the other, and we try to provide a sense of what these tendencies are.

Third, many economists or policymakers perusing the literature may find it quite difficult to draw conclusions from the existing evidence. More than 100 studies have been published on the effects of minimum wages on employment since the 1990s, and the findings from this newer research are summarized differently in different places. In some cases, the new minimum wage research is described as failing to find evidence of disemployment effects.

For example, Bazen (2000) states that “(t)he latest studies of the experience of the USA and the UK in general find no evidence of negative effects on youth employment” (p. 64). Somewhat more cautiously, Flinn (2006) writes that “these recent studies have been particularly useful in indicating that the “textbook” competitive model of the labor market . . . may have serious deficiencies in accounting for minimum wage effects on labor market outcomes . . . ” (pp. 1013–4). In contrast, others summarize the findings as more ambiguous, suggesting that no conclusions can be drawn, and that positive effects may be as likely as negative effects.

Lemos (2004), for example, asserts that “there is no consensus on the direction and size of the effect on employment” (p. 219), while Stewart (2002) notes that some studies find employment effects to be “absent or positive” and that others find “significant negative effects” (p. 585). In contrast, much of our own work tends to find negative employment effects for the lowest-skilled groups.

David Neumark (2001) states that given the differences in the conclusions one might draw depending on what one reads, and the difficulties of wading through the mass of recent studies, we thought it would be useful to present a comprehensive review of the more recent minimum wage literature that provides an accurate accounting of the range of estimates in existing studies, and attempts to understand some of the sources of differences in results across studies, in addition to determining what conclusions can be drawn.

**Findings Of The Study**

In Malaysia, there are three mechanisms that determine the wages of workers in the private sector 1) the Wages Council Act 1974 (WCA), 2) collective bargaining (CA), and 3) market forces. The WCA and CA fall under the definition of minimum wage. But these minimum wages do not provide a decent standard of living and cover only a small number of workers. The existing CAs do not cover the majority of low-paid workers. As a result, wages in Malaysia are largely determined by market forces. Real wages have been low or stagnating because of price controls, subsidies and the influx of cheap unskilled foreign workers.

The Malaysian Trades Union Congress (MTUC) has been asking for a wage policy for decades. The minimum wage policy was announced by the Prime Minister cum Finance Minister in the Oct 2010 budget speech. On 30 Mar 2010, the New Economic Model (NEM) proposed the formulation of a minimum wage policy to meet the inclusiveness agenda of the NEM. The objective is to rectify the dysfunctional wage-setting mechanism for low-paid workers. In Jul 2011, the National Wages Consultative Council Act 2011 (Act 732) was passed by the Parliament and gazetted on 15 Sep 2011, repealing the WCA 1947 (Act 195).

Various measures showed that Malaysia’s labour market is characterised by 1) a high presence of low-skilled workers (70% of labour force), significantly higher than in Singapore (51%), Taiwan (67%) and South Korea (65%), and 2) over-reliance on low-cost, unskilled foreign workers, which have sustained the profitability of low-value-added business activity, giving businesses no incentive to move up the value chain. It also largely contributed to a dampening effect on wages. The National Employment Returns 2009 study initiated by the Human Resources Ministry revealed that 33.8% (Peninsular Malaysia=27.2%, Sarawak=48.1% and Sabah=63%) of around 1.3m private sector workers in Malaysia still earned less than RM700/month. Wages lag behind productivity growth. A study by the World Bank that shows that wage growth was 2.6% p.a. in the past 10 years compared to productivity growth of 6.7% p.a., suggesting suppression of wages, especially for low-paid workers, and also an inefficient labour market.

There are arguments for and against a minimum wage. The implementation of a minimum wage policy signals the government’s commitment to greater inclusiveness and reduces poverty as the income of at least 30-40% of workers currently puts them below the poverty line. Better wages arguably boost productivity growth, which is positive for employers. Meanwhile, those against the minimum wage argue that it interferes with market forces in wage setting, increases business costs and leads to some inflationary impact as higher costs will be passed to consumers.
Better Wages Boosts Productivity Growth
Services Sub-Sector’s Productivity Growth

In setting the minimum wage, the National Wages Consultative Council (NWCC) took into account social and economic considerations: cost of living, productivity, competitiveness and employment. Other points that it considered include geographic (different states, regions), economic sectors/industries as well as demographic. The extent to which these factors are balanced can be approximated by some rough indicators such as the level of the minimum wage relative to the median or mean wage or the proportion of workers whose wages are affected by the statutory minimum. As stipulated under the National Wages Consultative Act 2011, minimum wage means the basic wage, i.e. the lowest hourly, daily or monthly wage that employers legally pay employees. Part of allowances or fixed payments will be allowed in calculating the minimum wage. The NWCC set a minimum wage of RM900, which is around 49.9% of the national’s mean wage of RM1,804.43 in 2010. In the UK, for example, the
minimum wage corresponds to about half the median wage, lower than 60% of median wages in France but considerably higher than the 32.4% of median wages in the US.

According to Sonia Pereira (2003), there is no universal answer as minimum wage effects depend on a host of country-specific factors such as labour market conditions and variation in worker productivity across regions, industries and occupations. The RM900 minimum wage is a reasonable threshold, being 49.9% of the national mean wage. A minimum wage that is too high or above the market-clearing level would lead to employment reduction and an increase in unemployment. The minimum wage should not be increased when unemployment is high or rising and is concentrated among low-skilled workers. As a rule of thumb, in developing countries, the national minimum wage should be probably less than 40% of the average wage and roughly not more than one-third of the average or mean wage. The proposed increase in minimum wage should take into account inflation, productivity as well as employment growth.

The Reasonable Minimum Wage Range

Some 3.2m private sector workers or about 25.8% of total employment will benefit. Many will be from low-to middle-income households. The wage rate will be distributed unevenly, with a
RM100 difference between the Peninsular Malaysia and Sabah, Sarawak as well as the Labuan Federal Territory. The new rates will have a bigger impact in Sabah (RM800 vs. the current average of RM577), followed by Sarawak (RM800 vs. average of RM758). For Peninsular Malaysia, the new rate of RM900 is 20.4% below the current average salary of RM1,131.

Median Monthly Salary And Wages Paid By States In Malaysia

A grace period will be given to employers to restructure their wage schemes once the new minimum wage is implemented. The minimum wage will take effect six months from the date the Minimum Wages Order is gazetted. Most firms with five workers or fewer, so-called small-time employers or micro-enterprises will be allowed to defer it for a further six months. The 12-month grace period does not cover professional outfits such as dental and medical clinics and legal, architecture and consultant firms. SMEs will be given the opportunity to apply to the wage council for an extension before the commencement date. In practice, there are several reasons why the effectiveness of minimum wages may be limited. One obvious factor which can limit the impact of minimum wages is weak enforcement. Other factor is simply the risk of mismanagement – when minimum wages are set at an unrealistically high level, leading to either non-enforcement or displacement of low-paid workers into unemployment or informal employment. In Malaysia, employers which do not comply with the minimum wage policy risk a maximum fine of RM10,000 per worker. For continuous offenders, they will be fined RM1,000 per day and repeat offenders would face a RM20,000 fine or five years’ jail or both.
We do not think that the minimum wage will hurt Malaysia’s competitiveness as some 90% of the countries in the world have minimum wage policies. They include Malaysia’s regional peers such as China, Taiwan, South Korea, Thailand and Indonesia. Furthermore, the minimum wage scheme will only applicable to low-paid workers.

Monthly Minimum Wage By Private Sector

Malaysia’s competitiveness is a function of a conducive investment climate, predictable economic policies, an array of business-friendly incentives as well as the provision of good infrastructure and skilled workers. The impact on the cost of doing business will be manageable as 1) wages constitute 9.2% of the total cost of doing business, and 2) the minimum wage covers lower-income category, which represents about 20% of total manpower in a company. If labour productivity rises faster than wages, capital and stock owners will benefit. Companies may increase the budget for the training of their workers.

Conclusion

There is strong empirical evidence that countries which implement a minimum wage tend to see a positive wage effect and a small negative employment effect among workers covered by the minimum wage legislation if the wage is set above the market equilibrium level. The precise magnitude of the negative effect on employment is a subject of debate and is likely to vary
depending on time, place and the type of job. The NWCC/MOHR studies showed that a minimum wage is expected to reduce the demand for migrants workers by 0.4-6.1% over next four years (2012-15) under monopsony and competitive models if the minimum wage is set at RM900/month and above. Under perfect competition market, the RM900/month minimum wage is expected to increase the country’s unemployment rate by an average 0.4% pt in 2012-14. The impact on investment is very mild with an estimated less than 0.05% decline in total investment rate during 2012-14 when the minimum wage is set at RM900/month.

<table>
<thead>
<tr>
<th>Hypothetical wage level (per month)</th>
<th>Monopsony model (%)</th>
<th>Competitive model (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>RM700</td>
<td>0.0</td>
<td>0.0</td>
</tr>
<tr>
<td>RM800</td>
<td>-0.1</td>
<td>0.0</td>
</tr>
<tr>
<td>RM900</td>
<td>-0.6</td>
<td>-0.4</td>
</tr>
<tr>
<td>RM1000</td>
<td>-0.8</td>
<td>-1.8</td>
</tr>
<tr>
<td>RM1100</td>
<td>-1.0</td>
<td>-1.8</td>
</tr>
<tr>
<td>RM1200</td>
<td>-3.9</td>
<td>-3.9</td>
</tr>
</tbody>
</table>

An appropriate minimum wage level would over time achieve a big push, i.e. move the low-wage, low-consumption and informal labour market to a high-wage, high-consumption and formal labour market. As the adjustment of the minimum wage will be carried out on a staggered basis, the inflationary impact, i.e. the cost pass-through to consumers, is likely to be manageable. If the rise in productivity growth matches the rise in wages, this will result in a lower cost of production and companies may absorb the rise in unit labour cost.

References


