# The economics of minimum wages

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THE Rana Plaza tragedy, although devastating and sad as an event, has contributed to one positive result. This has raised sufficient international and national voice to support the need for better employment standards and practices in the organised private sector.

One aspect of this re-examination of what constitutes globally acceptable employment practices is the need for a realistic minimum wage. There is an ongoing heated political and social debate on this subject.

This is welcome but it needs to be tempered with good economics to make sure that the end result is a positive outcome for the labour market, the readymade garments (RMG) sector, and Bangladesh development as a whole.

The importance of looking at the economic aspects of this debate cannot be overemphasised in a labour surplus economy like Bangladesh. For the economy as a whole there is a major employment challenge defined as the need to create good jobs that is characterised by higher productivity and higher incomes.

The most recent Labour Force Survey of 2010 showed that some 88 percent of Bangladesh's 54 million labour force was engaged in economic activities that are informal in nature. Some 45 percent of total employment was in agriculture, where real wages and average labour productivity tend to be the lowest in the economy.

A major development challenge, which also coincides with the most fundamental aspect of the employment challenge, is the need to shift labour from agriculture and other low-productivity, low-income informal activities to formal manufacturing activities.

The growth of the RMG sector has provided Bangladesh a great opportunity to reduce the employment share of agriculture and increase the employment share of formal manufacturing, very much on the basis of the economy's comparative advantage.

Abundant supply of low wage workers, primarily female workers, has been a major factor underlying the growth of the RMG sector. As rising wages (adjusted for productivity) increase the unit cost of RMG (adjusted for quality differential) in competitor countries, such as China, India and Sri Lanka, the international demand has been shifting to lower cost sources including Bangladesh.

AFP

Garment workers shout slogans during a protest asking for wage increase in Dhaka on September 21. Thousands of workers took part in the protest to demand a minimum monthly wage Tk 8,000.

Indeed the labour cost advantage of Bangladesh is the most important reason for sustaining this competitive edge.

This labour cost advantage, however, does not necessarily support the contention of some RMG producers that current wages are appropriate or that the employment conditions cannot be improved because it will increase the cost of production excessively.

International experience shows that most countries have minimum employment standards as a part of the social protection policy that allows for insurance and other allowances to deal with accidents, illness, maternity, child care and employment termination.

Most countries (some 90 percent) also have minimum wage legislation to prevent perceived or actual instances of labour exploitation. These interventions are aimed at improving the welfare of workers thereby contributing to higher productivity through better motivation and commitment.

The issue of minimum employment standards is hardly contentious and the Rana Plaza tragedy and similar other events in the past are ample testimony to the need to fill this legislative and policy gap quickly.

What, however, are contentious amongst economists is the need for and the level of minimum wages. The main issue here is the adverse implication of minimum wages for employment.

Standard economic theory suggests that if wages are set too high in relation to market clearing wages, there will be a reduction in employment. Those who are employed will gain, but those who cannot get a job (or lose job) because of lower demand for labour owing to higher minimum wages will lose. Labour group as a whole may gain or lose depending upon the underlying demand and supply elasticity.

There is a huge body of empirical literature on the subject of minimum wages and employment based on international experience. On balance, the evidence is not conclusive. Studies on both sides of the debate have found evidence in their favour: some studies say employment falls while some conclude that there is no adverse effect on employment.

Those studies that do not find evidence of falling employment explain the result by pointing out that employers have a range of options to adjust to higher minimum wages.

These include adjustment by improving labour productivity through better supervision, by lowering non-wage benefits and training costs, by reducing the number of hours or days of employment, by substituting lower-skilled workers with higher skills, by passing on costs to consumers through higher prices, and by absorbing the extra cost from profits.

As is obvious, not all ways of adjusting to minimum wages is conducive to the interest of the workers and as such a careful research on the level and the impact of minimum wages on the welfare of workers as a whole is important.

In the absence of conclusive evidence from international experience on the impact of minimum wages on employment, how might Bangladesh proceed?

There is no short-cut answer to this question. Considerable research and careful analysis is needed to inform this debate. A few fundamental points will need to be kept in mind in designing this research and making recommendations based on the findings of this research.

First, wages will have to be properly aligned with labour productivity to keep the Bangladesh competitive edge in RMG and other labour-intensive productions.

Second, minimum wages must not be set at a level that is substantially higher than market wages. This begs the question what is the market wage rate in Bangladesh? The answer to this question can be found from a good analysis of wages data from the latest Labour Force Survey. Research done by this author shows that labour markets in agriculture, non-agriculture informal sector and formal manufacturing work reasonably flexibly, and wages respond to productivity improvements.

Wages economy-wide are increasing in response to productivity improvements. This empirical result is of fundamental importance and can guide the process of minimum wage setting. Real wages and average labour productivity are the lowest in agriculture and set a floor on real wages economy-wide in an opportunity cost sense.

Adjusting for differences in number of days worked, transaction costs of migration and productivity differential in manufacturing resulting from better education and training, it is possible to estimate minimum average real wages in manufacturing that will be consistent with the development challenge of inducing labour transfer from agriculture to manufacturing.

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# Samsung dazzles phablet followers with more girth, size

REUTERS, Seoul

SAMSUNG Electronics Co Ltd is seeking to dazzle followers of the phablet with bigger screens, and even possibly with a curved one, in its attempt to fence off a segment of smartphones once mocked for their girth and size.

Phablets, a cross between a phone and a tablet, have been on a roll since late 2011 as tech-savvy consumers, particularly in Asia, devote more time browsing data-heavy Web pages and downloading media content. Even Samsung's flagship Galaxy S4 smartphone, released in April this year, has a 5-inch screen that puts it squarely in the phablet category for some analysts.

On Wednesday, Samsung kicked off global sales of its latest Galaxy Note 3 smartphone in Seoul. The phablet, which boasts a 5.7-inch screen and costs $990 in South Korea without a carrier contract, will be available in 140 nations by October.

Analysts say the medium-term outlook for phablets is good, but price points and the lure of their smaller, more portable cousins will keep a lid on consumer enthusiasm.

Canalys expects smartphones with 5.1-6 inch screens to make up 6 percent of the market in 2013. The Singapore-based research firm is estimating overall global shipments of 993 million smartphones this year.

"We're certainly seeing a shift for large-screen phones, but the vast majority of volumes are sub-5-inch - over 90 percent," said Rachel Lashford, an analyst at Canalys. "We would need to see devices at lower price points and from a much wider range of vendors, including Apple, to go beyond these forecasts."

The growing popularity of phablets has galvanised Western names into action.

Google's Motorola unit recently launched a 5-inch Droid Ultra, and even Apple Inc, which has stuck to a 3.5-inch form factor for its iPhone since 2007 debut, is also exploring


AFP

Models pose for photographers with Samsung Electronics's latest smartphone Galaxy Note 3 and smartwatch Galaxy Gear (C) during its launch event at the company's headquarters in Seoul yesterday.

offering iPhones with larger screens, four people with knowledge of the matter said previously. Nokia had originally planned to launch a large-screen phablet in late September.

"Samsung has been the leader in this trend, helped by its ability to create and drive the segment through significant advertising and marketing," Lashford said.

Driving the phablet's shift to the mainstream is a confluence of trends. Users prefer larger screens because they are consuming more visual content on mobile devices than before, and using them less for voice calls - the phablet's weak spot.

"When we first introduced the Note in 2011, a lot of people made a mockery of it and some even said it was doomed to fail," Lee Young-hee, executive vice president of mobile marketing at Samsung, recently told reporters.

"But we noticed that people were carrying more than three devices on average such as phones, music players and gaming machines, and we thought people may want just one device that can do it all."

Samsung says phablets are largely popular in markets such as China, South Korea, Europe and Southeast Asia. To increase the appeal of its phablet devices, the company has introduced accessories such as the Galaxy Gear smartwatch.

The device allows users to make calls, displays messages, records videos and snaps photos, all while the user's phone stays in the pocket or handbag.

Samsung is now planning to introduce a smartphone with a curved display next month, potentially another variant of the Note 3.

The Note has since grown in stature every year since its first-generation 5.3-inch screen. The Note 3's screen is nearly two-thirds bigger than Apple's 3.5-inch iPhone, and manufacturers are increasingly adopting immense screens dangerously close to tablet territory.

Huawei's HWT.UL Ascend Mate has an even bigger 6.1-inch screen, and Sony's Xperia Z Ultra boasts a 6.4-inch screen, making it only less than an inch smaller than Amazon's Kindle Fire tablet. Samsung's Galaxy Mega has a 6.3-inch screen.

Samsung's domestic rival LG Electronics Inc is planning to launch its 5.2-inch Vu 3 on Friday.

# India's Tata Motors to shut Spanish bus unit over losses

AFP, New Delhi

INDIA'S giant Tata Motors announced Tuesday it is closing its Spanish bus and coach manufacturing factory next month due to "huge losses" in a shrinking European market.

The shutdown of the Tata Hispano Motors Carrocera plant in Zaragoza, after it racked up accumulated losses of more than 60 million euros ($81 million) in the past five years, will mean the loss of 287 jobs.

Tata Motors, which owns Britain-based luxury marque Jaguar Land Rover, blamed the closure of the nearly 75-year-old firm on "economic and business factors".

"Despite strong investments, there has not been a positive result to reverse the challenging business situation and losses for the plant," Tata Motors said in a statement.

Tata Motors, part of India's steel-to-tea Tata conglomerate, said the plant's sales had been falling "primarily due to the worst-ever decline in the bus market" following the 2008 global financial crisis.

Furthermore, "all market evaluations do not predict any positive change in the near future... making the plant production unviable".

Tata Motors, India's largest vehicle-making company and one of the world's biggest bus and truck manufacturers, bought a 21-percent stake in Hispano Carrocera in 2005.

It lifted its holding to 100 percent in late 2009 and renamed the Spanish company Tata Hispano Motors Carrocera.

When Tata Motors first took a stake in the Spanish firm, Hispano Carrocera was one of Europe's leading bus and coach makers and had been making chassis for a variety of international brands since 1939.

# Top banks have $155b capital shortfall, most in Europe


REUTERS

A pedestrian walks past the Canary Wharf offices of JP Morgan in London.

REUTERS, London

THE world's biggest banks would need to boost their capital by 115 billion euros ($155 billion) to comply with tougher rules and more than 60 percent of that shortfall is in Europe, where lenders have been slower to strengthen.

The capital shortfall fell by 83 billion euros during the second half of last year as banks retained more of their profits and raised capital, although the pace of improvement was not as quick in Europe as elsewhere.

The Basel Committee of global regulators said on Wednesday the shortfall at top international banks was based on a target to hold a minimum core capital level of 7 percent, plus capital surcharges required for the biggest banks. Its finding was based on their balance sheets at the end of last year.

Some 70 billion euros of the shortfall was at banks in the European Union, representing 61 percent of the global deficit. The shortfall at EU banks was cut by 29 billion euros in the second half of last year, according to a European Banking Authority (EBA) estimate.

Markets and regulators have been putting pressure on banks to move early to comply with the global Basel III accord being phased in, to dispel any doubts about their ability to thrive and encourage investors to buy their bonds and shares.

Basel roughly triples how much capital banks must hold compared with before the financial crisis, when many undercapitalised lenders had to be rescued by taxpayers.

It requires banks to have a core capital buffer equivalent to at least 7 percent of their assets on a risk-weighted basis by January 2019.

The Basel Committee said the group of 101 global banks in its sample made after-tax profits prior to distributions of 419 billion euros last year.

Under tougher rules which are coming in, banks must also have separate buffers of cash and government debt, known as a liquidity coverage ratio, to survive market shocks of up to a month unaided.

The rules apply to all banks, but there a capital surcharges for the big global banks deemed systemically important, such as HSBC, JP Morgan, Citigroup and Deutsche Bank.

The EBA said the top 42 EU banks already held more liquidity than they are required to by 2019. In Britain, top banks are being encouraged to tap some of their excess liquidity to lend out and aid economic recovery.

There was, however, a liquidity shortfall of 225 billion euros among the remaining 128 smaller, more domestically-focused banks in a bigger sample of lenders studied by the EBA.

A third element of Basel is a leverage ratio requiring banks to hold capital equivalent to at least 3 percent of their total non risk-weighted assets.

It is meant to serve as a simple backstop in case banks have incorrectly added up their risk weightings to calculate core buffers. Regulators in Britain have been pushing hard for UK banks to meet this target as soon as they can.

The EBA said the average leverage ratio for 40 large banks it surveyed was 2.9 percent, and 17 of them had not reached the 3 percent minimum level. The capital shortfall of those banks that did not meet the leverage target was 107 billion euros, the watchdog said.