

WHY THE MINIMAL WAGE SHOULDN'T BE ESTABLISHED ON THE MINIMUM CONSUMPTION BASKET?

Gabriela-Mariana Ionescu, PhD. Student⁶

Abstract:

The paper examines from the point of view logical and institutional (i.e. behavioural) the concept of minimal wage regarding its establishing, functioning, and impact. The key focus is the comparison of the economic basis of establishing and adjusting of the minimal wage nominal value: on the one hand, the average nominal productivity of the employees, and, on the other hand, the (average) consumption basket. Theoretical arguments will be brought in favour of the conclusion that the minimal nominal wage must be anchored on the average nominal productivity of the employees, while its establishing on the average consumption basket transforms it into a social aid (like the minimal income). Finally, some institutional and methodological suggestions are provided in order to lead to the best choice of the macroeconomic fundamentals of establishing and periodically adjusting the minimal wage.

Keywords: *minimal wage, consumption basket, income, social aid, productivity*

JEL Classification: *B41, D01, H24*

Preamble

State intervention is legitimate where and only where the private sector is unable to self-test its economic (usually, macroeconomic) variables.⁷ Generally, the criterion to identify the places where the private sector is non-self-testable is the following: positive gap between the "quantity" of negative feed-backs and the "quantity" of positive feed-backs in the place concerned (I shall name that gap as *legitimizing gap of state intervention* – further LGSI). For example, regarding the monopolization phenomenon, it seems that the economic interest of parts involved leads to a negative LGSI, so the state intervention is fully legitimate there, while regarding the level of prices (including wage, which is a price, too), it seems the LGSI is positive, thus the state intervention in establishing prices for the private sector is illegitimate. In the paper will be applied this reasoning in order to examine the way in which the level (and the adjustment, as well) of the minimal wage should be anchored. Basically, there are two ways for such a regulating: a) the average productivity of labour, and the consumption basket (Cavallo, 2020). I will examine both solutions, providing economic arguments to choose between them.

Objectives of the Paper

The paper aims to get three main objectives:

- to examine whether minimal wage establishing and periodically adjusting must or must not be object of state intervention, based on the criterion of the legitimacy (Patty & Penn, 2014) of such an intervention;
- to identify the most appropriate macroeconomic anchor for (especially) periodical adjusting of the minimal wage – either the labour productivity or the consumption basket;
- to verify, with theoretical scientific argue, the hypotheses defended in the paper.

Methodology Used

⁶ *School of Advanced Studies of the Romanian Academy (SCOSAAR), 125, Calea Victoriei, sector 1, RO-010071, Bucharest, Romania, gabrielaionescu13@gmail.com.*

⁷ The idea of legitimate (or non-legitimate) intervention of state into the private sector is held in nuce in the seminal work of Ludwig von Mises, *Human Action. A Treatise on Economics*. More developments of the idea have been done by author elsewhere, and, consequently, this concept will be not more analytically treated here.

The methodology used in the paper consists in two inter-related ways:

- i. a logical examination of the process of minimal wage establishing and periodically adjusting, from the perspective of the most appropriate macroeconomic anchor, so that the economic process properly work;
- ii. an theoretical assessing, from an economic point of view, of the macroeconomic anchors in competition – that is, labour productivity (Woźniak-Jęchorek & Pilc, 2020), and consumption basket, respectively –, so that the economic basic correlations be verified;

Research Organization

In this context, the research is organized in the following steps:

- I. A short reminding of the concept of minimal wage (including the conceptual distinction between minimal wage and minimum wage);
- II. Examining the legitimacy state intervention in the matter of minimal wage, based on concept of LGSi;
- III. Comparative examination of the appropriate anchor for the minimal wage, between labour productivity and consumption basket;
- IV. Final evaluations.

Minimal Wage vs. Minimum Wage

The minimal wage (MW) is that value of the wage in the economy, under which is not allowed to be paid any wage. MW is, thus, mandatorily stipulated into labour contracts (either at individual level or at branch or national one, after the case). So, the MW is an administrative wage, institutionally established, as we shall see below, in a tripartite mechanism. By the contrary, the minimum wage (*mW*) (*European Commission document, 2020*) is the lowest wage actually paid in the economy. The *mW* is, therefore, an economic wage (not an administrative one) which can coincide or not with the MW. Any case, whatever the *mW* would be, we have always the inequality: $mW \geq MW$. Although the differences between *mW* and MW are many and interesting (especially from their impact on the labour market (Bonoli, 2017) functioning) such issues are not among the paper's objective, so they will not be treated further. However, the official legal norms in the matter uses, incorrectly in my opinion, the term minimum wage (Hirsch & Valadez-Martinez, 2017) instead the (correct) term minimal wage. The corresponding terms, defined and assumed by the author, will be used further in this paper.

Legitimizing Gap of State Intervention in the Minimal Wage Matter

In order to examine LGSi in the minimal wage matter, we must see how such a macroeconomic variable functions. Below I provide some considerations:

- Feed-backs are those reactions from the output of a system to its input for the next iteration. Feed-backs can be either positive (the input will be pushed in the same direction in which the output moves, that is, it is a feed-back of auto-catalysing of the statu quo) or negative (the input will be pushed in the opposite direction in which the output moves, that is, it is a feed-back of auto-stabilising of the statu quo).
- When we speak about the self-testability of the private sector (or of a given sub-system of it) we refer to the cases in which the negative feed-backs are stronger (either by their number or intensity) than the positive ones. Thus, the self-testability is provided by a net positive „quantity”⁸ of feed-backs involved in the system's functioning that is by a positive LGSi.

⁸ To be mentioned that a certain impulse quantity is a result of multiplying the medium intensity of that impulse with its extensive dimension (size, duration, number, and so on). A more analytical examination

- Thus, when the LGSi is positive, the state intervention is illegitimate, because the system in case can adjust itself, precisely by the negativity of the LGSi. Instead, if LGSi is negative, this means the positive feed-backs are stronger than the negative ones, so that the private sector cannot adjust itself. In such a case, the state intervention is not only permitted, but also it can be proved as mandatorily.⁹

It must be mentioned that could also exist an un-decidable situation, when the concomitantly impulses came from different points are, principled, mutually off-set. In such a situation, eventually, one of impulses involved gains an infinitesimal ascendant on the other and, thus, it leads the decision in its area of „interest”. In fact, in this case, the minimal wage is assignable to such an un-decidable case. Institutionally, currently, the minimal wage (*MW*) is established by a tripartite procedure (see National Tripartite Council for Social Dialogue – NTCSD), so, it must be found an optimum between the interests of the parties: a) the interest of trade unions – increasing purchasing power of wages; b) the interest of employers – minimizing labour cost growth; c) the interest of the state – ensuring economic equilibrium and sustainability of economic process (Marletto, 2013). The cases of LGSi can be synthesised as in Figure 1.

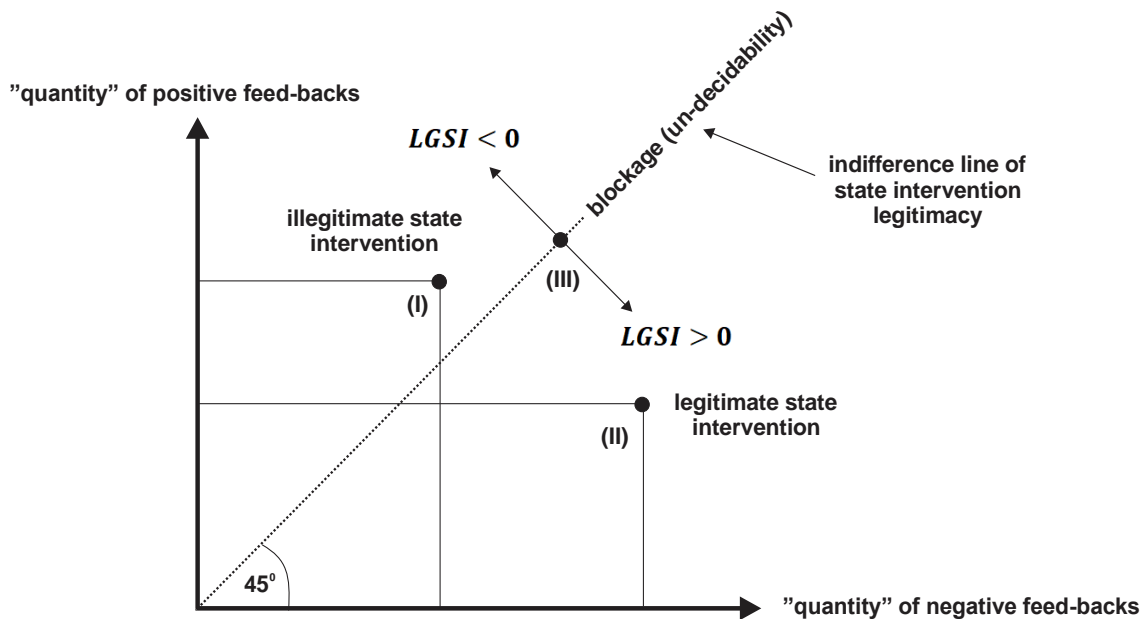


Figure 1 - The three cases to evaluate for establishing of the state intervention legitimacy

Source: Author's work

The question is: in the matter of minimal wage, what is the algebraic sign of LGSi? I shall examine this issue.

- The two parts, namely trade unions and employees seems to be balanced, that is, any essay of trade unions to increase the minimal wage will be off-set by the employers' essay to not increase it,¹⁰ and vice-versa.
- The state itself cannot establish *MW* without an agreement between trade unions and employers' representatives, so a blockage between trade unions and employers become a blockage at the NTCSD level.

could build an indifference curve between intensity and extensiveness, but such developments exceed the paper's objectives.

⁹ From logical point of view, we are in the state „the state must intervene” that is more imperative than „the state can intervene”. In other words, it is passed from the permission to obligation, always keeping the legitimate character of the state intervention.

¹⁰ Of course, if a (no matter how small) un-balance between the two parts occurs, then a decision will be taken by favouring the part which gained the mentioned negotiating advantage.

(c) The issue here is whether the blockage of possibility to establish either the level or adjusting of MW , is or is not real. I affirm that, eventually, the two main parts of bargaining (trade unions, on the one hand, and employers', on the other hand), must somewhat come to an agreement, which the state, with (probably) a supplementary adjustment from its point of view (the sustainability of the economic process on long term) will take it over and will legislate it.

- *Firstly*, it seems the two main parts of bargaining are encouraged (or, likewise, have nowhere to go) to enter a collusion, that is, an understanding which leads to convergence of their common interest, which could compromise the sustainability of the economic process (the state cannot do than a very small adjustment on the agreed values of the two main parts of bargaining).
- *Secondly*, based on the previous result, it seems to arise here a positive feed-back – that is, a replication of the collusional understanding between the two main parts.
- *Thirdly*, it results that in the discussed case, MW should be established by a state intervention without the NTCS framework, so that, the sustainability of the economic process be ensured.
- *Fourthly*, the level of MW , as well as its periodical adjustment should be performed by the state, because we are in an area of legitimate state intervention.

What Should be the Macroeconomic Anchor for MW ?

Above, it has been established that, in the matter of minimal wage (MW), the state intervention is legitimate, according our criterion, i.e. according to LGS, which is negative. But through what macroeconomic anchor would better be bound the level and the adjusting of MW ? In theory and, particularly, in practice there are two such anchors which "compete" for the role of macroeconomic anchor for MW : a) the consumption basket; b) the labour productivity. I will examine the pros and cons arguments for each of them below.

(a) The consumption basket

The consumption basket refers to the monetary amount that is necessary to acquire the goods and services aimed at to satisfy the basic needs of life. This amount is established, by entitled public institutions, based on scientific methods, as well as empirical studies (for example, surveys of different kind). Based on consumption basket (further, CB), MW can be inferred in two main ways: a.1) applying a coefficient of multiplication on CB ; a.2) ensuring only the purchasing power of the previous MW by deflating it with inflation.¹¹

- (a.1) the coefficient of multiplication is aimed at to add to the amount regarding the basic needs of life, other amounts addressing other human (individually or at family level) needs: education, health, culture, and so on. Here some questions arise: 1) the supplementary needs of human beings do not increase linearly with the basic life needs,¹² so a unique coefficient applied to CB could introduce serious constraints regarding the normal development of involved individuals (or their family); 2) in fact, there is a very poor connection between the basic life needs and the needs located above them on Maslow's pyramid, thus this method seems be very vulnerable from the point of view of social justice (Rawls, 1999);
- (a.2) ensuring only the purchasing power of MW , by intermediation of adjusting (directly proportional) the previous level with inflation leads, of course, to a situation of blocking the standard of life. More precise, the standard of life will be at most kept (although, this maintaining operates to the level of standard of life only, but not to its structure, which is very important and significant from the perspective of individual perception).

So, it seems the CB anchor has serious deficiencies from the perspective of both economic justification and social justice reasons. Moreover, this anchor seems to be of social aid nature, because is not connected at all to the economic product of the society (for example, GDP), that is,

¹¹ Either CPI or HICP (not CORE 1 or CORE 2 or CORE 2 adjusted).

¹² In fact, here act Engel's "laws", which stipulate that the basic needs (associated with the staple goods and services) increase decreasingly and, ultimately, are capped towards an asymptote), while other needs (associated with the so-called luxury goods and services) increase increasingly.

it is not grounded on the society possibilities to provide a given (or desirable) standard of life or, more than that, a given (or desirable) quality of life. Although there is a "natural" ground for the human being needs, eventually, those needs must be covered by the society resources, so the "natural" features of the basic needs are, to a great extent, adjusted with the actual society state.

(b) The labour productivity

The labour productivity anchor refers to the monetary amount which is due to employee (or to any person which work for another based on a contract) according to the monetary value of the marginal labour productivity. This dependence is inferred under the condition of maximizing the profit of employer (Nota bene: the wage is included to the cost with labour force). Establishing the level (or the degree of periodical adjustment) of *MW* based on labour productivity (our proposal is to take into consideration the average labour productivity of employees at national level) has certain trumps as following:

- *Firstly*, since the labour productivity (World Bank, 2020) is, probably, the most important "channel" to obtain GDP, it results that the directly proportionality of varying *MW* with the labour productivity is sustainable.
- *Secondly*, since the labour productivity is considered in its nominal monetary value, it results the impact of inflation on decreasing the purchasing power of *MW* is totally off-set, by this anchoring.
- *Thirdly*, it is avoid the approximation implied by the calculus of *CB*, implicitly accepting the society economic possibility is a function of its labour productivity. Thus, again, we obtain the sustainability of varying *MW* when it is driven by the labour productivity.

Of course, the analytical methodology which should be applied when the *MW* increasing will be correlated with labour productivity increasing is a problem per se, but the paper is not concerned here with such a question,¹³ because it is not an objective of the study. One of the most significant feature of labour productivity as macroeconomic anchor for *MW* periodical adjustment consists in its autonomy from the political factor. Indeed, establishing the labour productivity with such a role, *MW* will be automatically adjusted, on an objective and sustainable economic basis. In fact, such a choice for the anchor simply introduces in the economic process and mechanism an automatic device regarding the *MW* adjustment.

Thus, in my opinion the best, useful and justified macroeconomic anchor for *MW* periodical adjustment is the average labour productivity of employees at national level.

Other Comments

As said before, the minimum wage (Clemens, 2019) at the national economy level must be feasible - that is, it must be firstly produced to be then paid. Anchoring the minimum wage (and the salary policy, as it is now intended in Romanian Parliament) on the minimum consumption basket for a decent living,¹⁴ means to mix the economic principles with the social ones. From the perspective of social justice, of course, like author of this paper, I agree with the other scientists who have an opinion in this matter, but, eventually, the social justice principles (Jordan, 2005) must be covered by the society's economic possibility (even in the long term).

Obviously, the value (and structure as well) of the minimum consumption basket for a decent living must be established from based on family structure, sociological, and psychological considerations, as well as taking into consideration historical, cultural, and regional factors which define, ultimately, what means a decent living. This consumption basket (as mandatorily expenditures – both monetary and non-monetary, including the self-consumption) must be ensured by a set of public policies which combines the economic public policies with the social ones (Sperling, 2020), central public policies with the local ones. In my opinion, this issue is very

¹³ Author published elsewhere a complete methodology in this matter.

¹⁴ This is the new denomination of the former consumption monthly basket.

important in a free and democratic society. But this determination should not be linked to the minimal wage and the salary public policy. Such a causal connection would have at least the following negative effects (some of them being of adverse¹⁵ nature):

- it will transform the wage (or, generally, the salary) into a social aid, at least regarding the difference between the wage deserved according to the marginal labour productivity and the wage paid according to the consumption basket;
- the problem is, of course, that the social aid is paid, in turn, also through the economic substance (that is, PIB) which is, in fact, the result of labour productivity;
- anchoring the minimal wage to the consumption basket could, with a great probability, to discouraging of the able-bodied family's members from searching a job, which necessarily creates a vicious circle on the labour market, by introducing some elements of economic non-sustainability on medium and, especially, on long term;¹⁶
- based on the previous mentioned, there is a great probability to generate, at the national economy level, a state of moral hazard, which is not compatible at all with a free market economy and with a democratic society.

A synoptical view of the two anchors for the minimal wage (consumption basket of a decent living, and average labour productivity at national level) is provided by Figure 2 (MW means minimal wage; CB means consumption basket; LP means labour productivity).

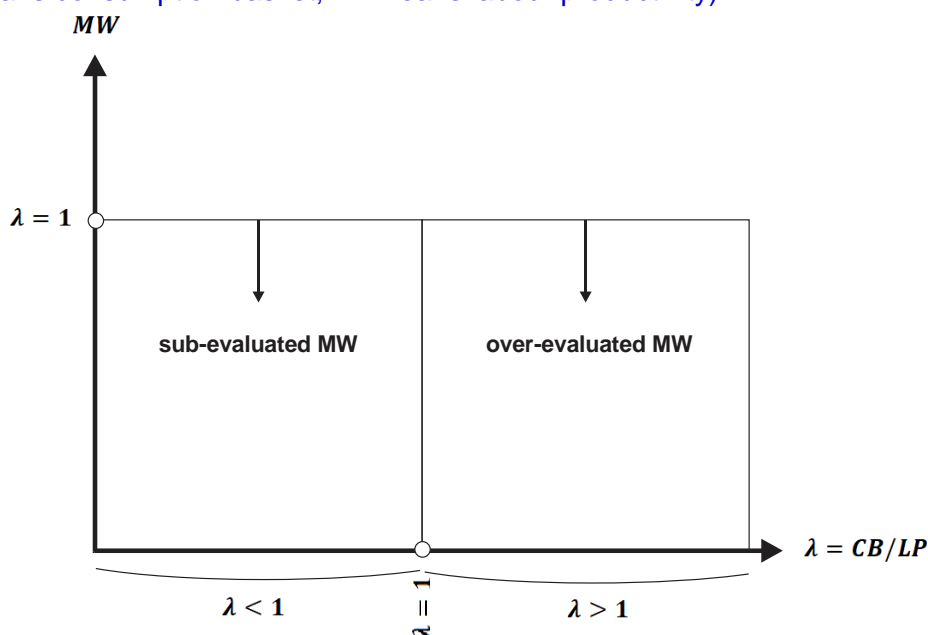


Figure 2 - Anchoring of the minimal wage to the two anchors

Source: author's work

A question that cannot be avoid (according to Figure 1 and to discussion around it) is whether anchoring the minimal wage (either as level or only as dynamics) to consumption basket (also either as level or only as dynamics) is a state intervention in its legitimate area in a free market economy and democratic society (Lipset, 1959). I put into discussion the following ideas:

- on the one hand, the consumption basket is a non-self-testable economic (or social) variable. This means that external resources must be provided to individuals (or families, after the case) in order to ensure the minimum consumption according to a decent living standard. Consequently, the state intervention is, in such area of societal life, mandatory and legitimate;

¹⁵ Adverse effects mean those effects which are undesirable although, in some extent, they are predictable (as are those mentioned here).

¹⁶ In fact, from conceptual point of view, we have to do here with a sort of "inequality between needs and possibilities". Methodologically, such an inequality could be treated similarly with the economic inequality which generates the society polarization from economic point of view.

- on the other hand, the wage (as free economic variable, that is, as market variable) is self-testable – employer and employee, either at individual level or at trade unions level – establish, by their own criteria, the level of wage, usually based on the marginal labour productivity. Being self-testable, the wage establishing by the state is a i-legitimate intervention;
- however, the minimal wage is an economic variable which is not of a free market nature. Its level is rather anchored to the social justice principles, so it could be, in fact, non-self-testable as such by market free functioning. It seems, thus, the state intervention in establishing the level (including the criterion of establishing such a level or the periodical change of it) of minimal wage at the national economy level is legitimate;
- nonetheless, although both the consumption basket and the minimal wage are placed in the area of legitimate state intervention, remains an element of non-miscibility of them: while the consumption basket is of social nature, the minimal wage is of an economic nature;
- taking into account such a non-miscibility, we come, again, to the conclusion that the minimal wage (as legitimate result of state intervention) should be anchored to the labour productivity, not to the consumption basket.

Results and Conclusion

In the first part of the paper we have defined the concepts we used in formulating the arguments in this paper. In further I have affirmed that the state intervention is legitimate in the case where the private sector is unable to self-test its economic variables. As we have shown in this paper the criterion to identify that places where the private sector is non-self-testable, it refers to the positive gap between the "quantity" of negative feed-backs and the "quantity" of positive feed-backs in the place concerned, and it is called the *legitimizing gap of state intervention* (LGSi).

It was identified the three cases to evaluate for establishing of the state intervention legitimacy. The two anchors which "compete" for the role of macroeconomic anchor for *MW*, the consumption basket and the labour productivity has been examined with the pros and cons arguments for each of them.

It was formulated the reasons of anchoring the minimal wage on the minimum consumption basket for a decent living, and we conclude that means to mix the economic principles with the social ones because the consumption basket is of social nature and the minimal wage is of an economic nature.

In the paper, it was clearly formulated opinions about the legitimate state intervention in the field of anchoring the minimal wage in the consumption basket, in a free market and a democratic society.

Future Directions

The minimum wage (Dube, 2019) has an important role to play in the current period, of the coronavirus pandemic, a period of slowdown in economic growth. Establishing adequate minimal wages, in accordance with principle 6 of the European Pillar of Social Rights, is very important both for the immediate period, and for the perspective of the next period, of sustainable recovery of world economies. Future research directions will continue to consider studying the legitimacy of state intervention in the issue of the minimal wage.

Bibliography

- Bonoli, G. (2017). Labour Market and Social Protection Reforms in International Perspective: Parallel or Converging Tracks? Routledge.
- Cavallo, A. (2020). Inflation with Covid Consumption Baskets (No. w27352). National Bureau of Economic Research.
- Clemens, J. (2019, May 14). Making Sense of the Minimum Wage: A Roadmap for Navigating Recent Research.

- Dube, A. (2019). Impacts of minimum wages: Review of the international evidence (pp. 72) [Independent Report]. GOV.UK.
- Hirsch, D., & Valadez-Martinez, L. (2017). *The Living Wage*. Agenda Publishing.
- Jordan, B. (2005). Social Theory and Social Policy: Choice, Order and Human Well-being. *European Journal of Social Theory*, 8(2), pp. 149–170.
- Lipset, S. M. (1959). Some Social Requisites of Democracy: Economic Development and Political Legitimacy. *American Political Science Review*, 53(1), pp. 69–105. Cambridge Core.
- Marletto, G. (2013). *Creating a Sustainable Economy: An Institutional and Evolutionary Approach to Environmental Policy*. Routledge.
- Patty, J. W., & Penn, E. M. (2014). Social choice and legitimacy possibilities impossibility | Political economy. Cambridge University Press.
- Rawls, J. (1999). *A THEORY OF JUSTICE* (1999th ed.). The Belknap Press of Harvard University Press.
- Second phase consultation of Social Partners under 154 TFEU on a possible action addressing the challenges related to fair minimum wages. (2020).
- Sperling, G. (2020). *Economic Dignity*. Penguin Press.
- World Bank. (2020). *Global Economic Prospects*. World Bank.
- Woźniak-Jęchorek, B., & Pilc, M. (2020). *Labour Market Institutions and Productivity: Labour Utilisation in Central and Eastern Europe*. Routledge & CRC Press.